

**SB**

**128**


**(FILE 2)**

<TARGET><BILL>SB 128</BILL><SUBJECT>SB 128 (FILE  
2)</SUBJECT><COMM>SFIN29</COMM></TARGET>

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David Teal, Director, Legislative Finance Division

March 23, 2016



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**1**

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**SENATE BILL NO. 128**

IN THE LEGISLATURE OF THE STATE OF ALASKA

TWENTY-NINTH LEGISLATURE - SECOND SESSION

BY THE SENATE RULES COMMITTEE BY REQUEST OF THE GOVERNOR

Introduced: 1/19/16

Referred: State Affairs, Finance

**A BILL**

**FOR AN ACT ENTITLED**

1 "An Act relating to the Alaska permanent fund; relating to appropriations to the  
2 dividend fund; relating to income of the Alaska permanent fund; relating to the  
3 earnings reserve account; relating to the Alaska permanent fund dividend; making  
4 conforming amendments; and providing for an effective date."

5 **BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:**

6 \* **Section 1.** AS 37.13.010(a) is amended to read:

7 (a) Under art. IX, sec. 15, of the state constitution, there is established as a  
8 separate fund the Alaska permanent fund. The Alaska permanent fund consists of

9 (1) 25 percent of all mineral lease bonuses, rentals, royalties, royalty  
10 sale proceeds, net profit shares under AS 38.05.180(f) and (g), and federal mineral  
11 revenue sharing payments received by the state [FROM MINERAL LEASES ISSUED  
12 ON OR BEFORE DECEMBER 1, 1979, AND 25 PERCENT OF ALL BONUSES  
13 RECEIVED BY THE STATE FROM MINERAL LEASES ISSUED ON OR  
14 BEFORE FEBRUARY 15, 1980];

1                   (2) unless required to maintain the target balance of the earnings  
 2 reserve account under AS 37.13.145, an additional 24.5 [50] percent of all mineral  
 3 lease bonuses, rentals, royalties, royalty sale proceeds, net profit shares under  
 4 AS 38.05.180(f) and (g), and federal mineral revenue sharing payments received by  
 5 the state;

6                   (3) except as otherwise provided under art. IX, sec. 17,  
 7 Constitution of the State of Alaska and unless required to maintain the target  
 8 balance of the earnings reserve account under AS 37.13.145, 100 percent of oil  
 9 and gas production taxes collected by the Department of Revenue under  
 10 AS 43.55.011 - 43.55.180 may be appropriated to the Alaska permanent fund  
 11 [FROM MINERAL LEASES ISSUED AFTER DECEMBER 1, 1979, AND 50  
 12 PERCENT OF ALL BONUSES RECEIVED BY THE STATE FROM MINERAL  
 13 LEASES ISSUED AFTER FEBRUARY 15, 1980]; and

14                   (4) [(3)] any other money appropriated to or otherwise allocated by  
 15 law or former law to the Alaska permanent fund.

16 \* **Sec. 2.** AS 37.13.010 is amended by adding a new subsection to read:

17                   (d) In this section "target balance" is calculated under AS 37.13.145(I).

18 \* **Sec. 3.** AS 37.13.140 is amended to read:

19                   **Sec. 37.13.140. Income.** Net income of the fund includes income of the  
 20 earnings reserve account established under AS 37.13.145. Net income of the fund shall  
 21 be computed annually as of the last day of the fiscal year in accordance with generally  
 22 accepted accounting principles, excluding any unrealized gains or losses. [INCOME  
 23 AVAILABLE FOR DISTRIBUTION EQUALS 21 PERCENT OF THE NET  
 24 INCOME OF THE FUND FOR THE LAST FIVE FISCAL YEARS, INCLUDING  
 25 THE FISCAL YEAR JUST ENDED, BUT MAY NOT EXCEED NET INCOME OF  
 26 THE FUND FOR THE FISCAL YEAR JUST ENDED PLUS THE BALANCE IN  
 27 THE EARNINGS RESERVE ACCOUNT DESCRIBED IN AS 37.13.145.]

28 \* **Sec. 4.** AS 37.13.145(b) is amended to read:

29                   (b) At the beginning [END] of each fiscal year, and subject to  
 30 appropriation, the corporation shall transfer from the earnings reserve account to the  
 31 dividend fund established under AS 43.23.045, an amount equal to 50 percent of all

1        mineral lease bonuses, rentals, royalties, royalty sale proceeds, net profit shares  
 2        under AS 38.05.180(f) and (g), and federal mineral revenue sharing payments  
 3        received by the state during the prior fiscal year [THE INCOME AVAILABLE  
 4        FOR DISTRIBUTION UNDER AS 37.13.140].

5        \* **Sec. 5.** AS 37.13.145(c) is amended to read:

6                (c) If, following the transfer under (b) of this section, the balance of the  
 7        earnings reserve account exceeds the target balance, [AFTER] the corporation,  
 8        subject to appropriation, shall transfer from the earnings reserve account to the  
 9        principal of the fund an amount equal to the difference between the balance of the  
 10       earnings reserve account and the target balance [SUFFICIENT TO OFFSET THE  
 11       EFFECT OF INFLATION ON THE PRINCIPAL OF THE FUND DURING THAT  
 12       FISCAL YEAR]. However, none of the amount transferred shall be applied to  
 13       increase the value of that portion of the principal attributed to the settlement of State v.  
 14       Amerada Hess, et al., 1JU-77-847 Civ. (Superior Court, First Judicial District) on  
 15       July 1, 2004. [THE CORPORATION SHALL CALCULATE THE AMOUNT TO  
 16       TRANSFER TO THE PRINCIPAL UNDER THIS SUBSECTION BY

17                        (1) COMPUTING THE AVERAGE OF THE MONTHLY UNITED  
 18       STATES CONSUMER PRICE INDEX FOR ALL URBAN CONSUMERS FOR  
 19       EACH OF THE TWO PREVIOUS CALENDAR YEARS;

20                        (2) COMPUTING THE PERCENTAGE CHANGE BETWEEN THE  
 21       FIRST AND SECOND CALENDAR YEAR AVERAGE; AND

22                        (3) APPLYING THAT RATE TO THE VALUE OF THE  
 23       PRINCIPAL OF THE FUND ON THE LAST DAY OF THE FISCAL YEAR JUST  
 24       ENDED, INCLUDING THAT PORTION OF THE PRINCIPAL ATTRIBUTED TO  
 25       THE SETTLEMENT OF STATE V. AMERADA HESS, ET AL., 1JU-77-847 CIV.  
 26       (SUPERIOR COURT, FIRST JUDICIAL DISTRICT).]

27        \* **Sec. 6.** AS 37.13.145 is amended by adding new subsections to read:

28                (e) Except as otherwise provided under art. IX, sec. 17, Constitution of the  
 29       State of Alaska, if, following the transfer in (b) of this section, the balance of the  
 30       earnings reserve account is less than the target balance, up to 100 percent of the  
 31       money collected by the Department of Revenue, within the fiscal year, under the oil

1 and gas production tax, AS 43.55.011 - 43.55.180, may be appropriated to the earnings  
2 reserve account. Any portion of these funds not required to bring the earnings reserve  
3 account balance to the target balance may be appropriated to the principal of the fund.

4 (f) If, following the transfer under (b) of this section, the balance of the  
5 earnings reserve account is less than the target balance, up to 24.5 percent of all  
6 mineral lease bonuses, rentals, royalties, royalty sale proceeds, net profit shares under  
7 AS 38.05.180(f) and (g), and federal mineral revenue sharing payments received by  
8 the state may be appropriated to the earnings reserve account. Any portion of these  
9 funds not required to bring the earnings reserve account balance to the target balance  
10 may be transferred to the principal of the fund.

11 (g) In addition to the funds appropriated under (f) of this section, 50 percent of  
12 all mineral lease bonuses, rentals, royalties, royalty sale proceeds, net profit shares  
13 under AS 38.05.180(f) and (g), and federal mineral resource sharing payments  
14 received by the state may be appropriated to the earnings reserve account.

15 (h) Each fiscal year and subject to appropriation, the corporation shall transfer  
16 from the earnings reserve account to the general fund the sustainable draw amount  
17 under (i) of this section.

18 (i) The sustainable draw amount may not exceed \$3,300,000,000 for a fiscal  
19 year. Except that, beginning in fiscal year 2020, the sustainable draw amount may be  
20 adjusted for inflation. The commissioner of revenue shall calculate the inflation rate  
21 by computing the

22 (1) average of the monthly United States Consumer Price Index for all  
23 urban consumers for each of the two previous calendar years; and

24 (2) percentage change between the first and second calendar year  
25 average.

26 (j) The commissioner of revenue may recommend that the sustainable draw  
27 under (i) of this section be adjusted based on a sufficiency of assets review conducted  
28 in calendar year 2017, in calendar year 2020, and every four years thereafter. The  
29 commissioner of revenue shall consult with the board in conducting the review. The  
30 commissioner shall issue a report evaluating the sufficiency of assets in the earning  
31 reserve account and anticipated revenue to meet the draw for the following four years

1 and whether it is more likely than not that the real value of the permanent fund assets  
 2 will be less in 20 years than at the beginning of fiscal year 2017. To calculate the  
 3 sufficiency of assets, the report shall use

4 (1) as adopted by the board, a 10-year forecast of net income of the  
 5 fund including income of the earnings reserve account, as defined in AS 37.13.140,  
 6 and a 10-year forecast of total income of the fund including the earnings reserve  
 7 account that includes unrealized gains or losses;

8 (2) a forecast of natural resource revenues by the Department of  
 9 Revenue;

10 (3) the balance of the earnings reserve of the Alaska permanent fund,  
 11 including unrealized gains and losses;

12 (4) the balance of the principal of the Alaska permanent fund,  
 13 including unrealized gains and losses;

14 (5) historical and forecasted inflation; and

15 (6) any additional factors the commissioner of revenue determines are  
 16 relevant.

17 (k) The commissioner of revenue shall submit the sufficiency of assets report  
 18 to the president of the senate and the speaker of the house of representatives. The  
 19 report, supporting modeling and calculations and data input, including the information  
 20 relied on by the board for the return forecasts, shall be made available to the public.  
 21 The supporting modeling shall be provided in its native file format, except that any  
 22 confidential tax information may be provided in aggregate form.

23 (l) In this section,

24 (1) "sustainable draw amount" means an amount of money to be  
 25 appropriated in a fiscal year from the earnings reserve account to the general fund;

26 (2) "target balance" is equal to four times the prior year's sustainable  
 27 draw from the earnings reserve account.

28 \* **Sec. 7.** AS 37.13.300(c) is amended to read:

29 (c) Net income from the mental health trust fund may not be included in the  
 30 computation of net income [AVAILABLE FOR DISTRIBUTION] under  
 31 AS 37.13.140.

1 \* **Sec. 8.** AS 43.55.080 is amended to read:

2           **Sec. 43.55.080. Collection and deposit of revenue.** (a) Except as otherwise  
3 provided under art. IX, sec. 17, Constitution of the State of Alaska, the money  
4 collected by the department [SHALL DEPOSIT IN THE GENERAL FUND THE  
5 MONEY COLLECTED BY IT] under AS 43.55.011 - 43.55.180 may be  
6 appropriated to the permanent fund under AS 37.13.010 and 37.13.145.

7 \* **Sec. 9.** The uncoded law of the State of Alaska is amended by adding a new section to  
8 read:

9           2016 PERMANENT FUND DIVIDEND. Notwithstanding any other provision in this  
10 Act or other applicable law, the permanent fund dividend for each eligible individual for  
11 calendar year 2016 shall be \$1,000.

12 \* **Sec. 10.** This Act takes effect July 1, 2016.

**2**

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# Fiscal Note

State of Alaska  
2016 Legislative Session

Bill Version: SB 128  
Fiscal Note Number: \_\_\_\_\_  
( ) Publish Date: \_\_\_\_\_

Identifier: SB128-DOC-PHC-03-23-16  
Title: PERM. FUND:DEPOSITS;DIVIDEND;EARNINGS  
Sponsor: RLS BY REQUEST OF THE GOVERNOR  
Requester: (S) Finance

Department: Department of Corrections  
Appropriation: Health and Rehabilitation Services  
Allocation: Physical Health Care  
OMB Component Number: 2952

**Expenditures/Revenues**

Note: Amounts do not include inflation unless otherwise noted below. (Thousands of Dollars)

	FY2017 Appropriation Requested	Included in Governor's FY2017 Request	Out-Year Cost Estimates					
			FY 2017	FY 2018	FY 2019	FY 2020	FY 2021	FY 2022
<b>OPERATING EXPENDITURES</b>								
Personal Services		8,117.4	8,117.4	8,117.4	8,117.4	8,117.4	8,117.4	8,117.4
Travel								
Services		12,119.5	12,119.5	12,119.5	12,119.5	12,119.5	12,119.5	12,119.5
Commodities								
Capital Outlay								
Grants & Benefits								
Miscellaneous								
<b>Total Operating</b>	<b>0.0</b>	<b>20,236.9</b>	<b>20,236.9</b>	<b>20,236.9</b>	<b>20,236.9</b>	<b>20,236.9</b>	<b>20,236.9</b>	<b>20,236.9</b>

**Fund Source (Operating Only)**

1004 Gen Fund			11,200.3	15,766.1	15,954.1	15,348.2	14,585.5
1171 PFD Crim		20,236.9	9,036.6	4,470.8	4,282.8	4,888.7	5,651.4
<b>Total</b>	<b>0.0</b>	<b>20,236.9</b>	<b>20,236.9</b>	<b>20,236.9</b>	<b>20,236.9</b>	<b>20,236.9</b>	<b>20,236.9</b>

**Positions**

Full-time							
Part-time							
Temporary							

**Change in Revenues**

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**Estimated SUPPLEMENTAL (FY2016) cost:** 0.0 *(separate supplemental appropriation required)*  
*(discuss reasons and fund source(s) in analysis section)*

**Estimated CAPITAL (FY2017) cost:** 0.0 *(separate capital appropriation required)*  
*(discuss reasons and fund source(s) in analysis section)*

**ASSOCIATED REGULATIONS**

Does the bill direct, or will the bill result in, regulation changes adopted by your agency?  
If yes, by what date are the regulations to be adopted, amended or repealed?

**Why this fiscal note differs from previous version:**

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Prepared By: <u>April Wilkerson</u>	Phone: <u>(907)465-3460</u>
Division: <u>Administrative Services - Department of Corrections</u>	Date: <u>03/23/2016 05:00 PM</u>
Approved By: <u>Dean Williams</u>	Date: <u>03/23/16</u>
Agency: <u>Department of Corrections</u>	

FISCAL NOTE ANALYSIS

STATE OF ALASKA  
2016 LEGISLATIVE SESSION

BILL NO. SB 128

**Analysis**

Passage of this legislation will change the way permanent fund dividends are calculated having an impact on the amount of Permanent Fund Dividend criminal funds allocated to the Department of Corrections Physical Health Care component.

The Department of Corrections Physical Health Care component receives permanent fund dividend criminal funds which are based on a fluctuating annual PFD amount and the number of persons deemed ineligible during the appropriate year. The amount of PFD Criminal Funds appropriated to corrections for FY2017 was \$20,236,900.00 based on the CY2015 annual PFD amount of \$2,072.00 and an estimated 10,448 individuals deemed ineligible under AS 43.23.005(d).

Based on the Office of Management and Budget projections and using the same number of individuals identified as ineligible, this legislation would adjust the amount of PFD Criminal Funds available for allocation to the department requiring fund source changes as follows:

FY2018 reduce PFD Criminal Funds (\$11,200.3) increasing General Funds \$11,200.3

FY2019 reduce PFD Criminal Funds (\$4,565.8) increasing General Funds \$4,565.8 for a continued change of (\$15,766.1) PFD Criminal Funds / \$15,766.1 General Funds

FY2020 reduce PFD Criminal Funds (\$188.1) increasing General Funds \$188.1 for a continued change of (\$15,954.1) PFD Criminal Funds / \$15,954.1 General Funds

FY2020 increase PFD Criminal Funds \$606.0 reducing General Funds (\$606.0) for a continued change of (\$15,348.2) PFD Criminal Funds / \$15,348.2 General Funds

FY2022 increase PFD Criminal Funds \$762.7 reducing General Funds (\$762.7) for a continued change of (\$14,585.5) PFD Criminal Funds / \$14,585.5 General Funds

# Fiscal Note

State of Alaska  
2016 Legislative Session

Bill Version: SB 114  
Fiscal Note Number: \_\_\_\_\_  
( ) Publish Date: \_\_\_\_\_

Identifier: SSSB114-DOC-PHC-03-23-16  
Title: PERM FUND: EARNINGS, DEPOSITS,  
ACCOUNTS  
Sponsor: MCGUIRE  
Requester: (S) FINANCE

Department: Department of Corrections  
Appropriation: Health and Rehabilitation Services  
Allocation: Physical Health Care  
OMB Component Number: 2952

### Expenditures/Revenues

Note: Amounts do not include inflation unless otherwise noted below. (Thousands of Dollars)

	FY2017 Appropriation Requested	Included in Governor's FY2017 Request	Out-Year Cost Estimates				
	FY 2017	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021	FY 2022
<b>OPERATING EXPENDITURES</b>							
Personal Services		8,117.4	8,117.4	8,117.4	8,117.4	8,117.4	8,117.4
Travel							
Services		12,119.5	12,119.5	12,119.5	12,119.5	12,119.5	12,119.5
Commodities							
Capital Outlay							
Grants & Benefits							
Miscellaneous							
<b>Total Operating</b>	<b>0.0</b>	<b>20,236.9</b>	<b>20,236.9</b>	<b>20,236.9</b>	<b>20,236.9</b>	<b>20,236.9</b>	<b>20,236.9</b>

### Fund Source (Operating Only)

1004 Gen Fund			11,200.3	11,200.3	11,200.3	11,200.3	11,200.3
1171 PFD Crim		20,236.9	9,036.6	9,036.6	9,036.6	9,036.6	9,036.6
<b>Total</b>	<b>0.0</b>	<b>20,236.9</b>	<b>20,236.9</b>	<b>20,236.9</b>	<b>20,236.9</b>	<b>20,236.9</b>	<b>20,236.9</b>

### Positions

Full-time							
Part-time							
Temporary							

<b>Change in Revenues</b>							
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**Estimated SUPPLEMENTAL (FY2016) cost:** 0.0 *(separate supplemental appropriation required)*  
*(discuss reasons and fund source(s) in analysis section)*

**Estimated CAPITAL (FY2017) cost:** 0.0 *(separate capital appropriation required)*  
*(discuss reasons and fund source(s) in analysis section)*

### ASSOCIATED REGULATIONS

Does the bill direct, or will the bill result in, regulation changes adopted by your agency?  
If yes, by what date are the regulations to be adopted, amended or repealed?

**Why this fiscal note differs from previous version:**

Prepared By: April Wilkerson  
Division: Administrative Services - Department of Corrections  
Approved By: Dean Williams  
Agency: Department of Corrections

Phone: (907)465-3460  
Date: 03/23/2016 05:00 PM  
Date: 03/23/16

FISCAL NOTE ANALYSIS

STATE OF ALASKA  
2016 LEGISLATIVE SESSION

BILL NO. SSSB 114

**Analysis**

Passage of this legislation will change the way permanent fund dividends are calculated and establish an annual dividend of \$1,000.00 per eligible individual. This change will impact the amount of Permanent Fund Dividend criminal funds allocated to the Department of Corrections Physical Health Care component.

The Department of Corrections Physical Health Care component receives permanent fund dividend criminal funds which are based on a fluctuating annual PFD amount and the number of persons deemed ineligible during the appropriate year. The amount of PFD Criminal Funds appropriated to corrections for FY2017 was \$20,236,900.00 based on the CY2015 annual PFD amount of \$2,072.00 and an estimated 10,448 individuals which were denied.

If the same number of individuals were denied in CY2016 and the amount of the PFD was established at \$1,000.00 the amount of FY2017 PFD Criminal Funds would be reduced to approximately \$9,036,644.00 requiring a fund change to general funds of approximately \$11,200,256.00 in FY2018 and would potentially fluctuate in the out years based on the total number of persons deemed ineligible.

# Fiscal Note

State of Alaska  
2016 Legislative Session

Bill Version: SB 128  
Fiscal Note Number: \_\_\_\_\_  
( ) Publish Date: \_\_\_\_\_

Identifier: SB128-Fund Cap-Dup-CVCF-03-22-16  
Title: PERM. FUND:DEPOSITS;DIVIDEND;EARNINGS  
Sponsor: RLS BY REQUEST OF THE GOVERNOR  
Requester: Governor

Department: Fund Capitalization  
Appropriation: Caps Spent as Duplicated Funds  
Allocation: Crime Victim Compensation Fund  
OMB Component Number: 2936

## Expenditures/Revenues

Note: Amounts do not include inflation unless otherwise noted below. (Thousands of Dollars)

	FY2017 Appropriation Requested	Included in Governor's FY2017 Request	Out-Year Cost Estimates					
			FY 2017	FY 2018	FY 2019	FY 2020	FY 2021	FY 2022
<b>OPERATING EXPENDITURES</b>								
Personal Services								
Travel								
Services								
Commodities								
Capital Outlay								
Grants & Benefits								
Miscellaneous								
<b>Total Operating</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>

## Fund Source (Operating Only)

None								
<b>Total</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>

## Positions

Full-time								
Part-time								
Temporary								

<b>Change in Revenues</b>								
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Estimated SUPPLEMENTAL (FY2016) cost: 0.0 (separate supplemental appropriation required)  
(discuss reasons and fund source(s) in analysis section)

Estimated CAPITAL (FY2017) cost: 0.0 (separate capital appropriation required)  
(discuss reasons and fund source(s) in analysis section)

## ASSOCIATED REGULATIONS

Does the bill direct, or will the bill result in, regulation changes adopted by your agency? Not known  
If yes, by what date are the regulations to be adopted, amended or repealed?

## Why this fiscal note differs from previous version:

Updated from indeterminate to zero.

Prepared By: Kate Hudson  
Division: Violent Crimes Compensation Board  
Approved By: Sheldon Fisher, Commissioner  
Agency: Department of Administration  
Phone: (907)465-5525  
Date: 03/22/2016 03:00 PM  
Date: 03/22/16

FISCAL NOTE ANALYSIS

STATE OF ALASKA  
2016 LEGISLATIVE SESSION

BILL NO. SB 128

**Analysis**

There will be zero financial impact of this bill on the Crime Victim Compensation Fund because it is assumed that any reductions in the permanent fund dividend will be absorbed by the Department of Corrections.

# Fiscal Note

State of Alaska  
2016 Legislative Session

Bill Version:	SB 128
Fiscal Note Number:	1
(S) Publish Date:	1/19/2016

Identifier: DOR-PFD-1-15-16  
 Title: PERM. FUND:DEPOSITS;DIVIDEND;EARNINGS  
 Sponsor: RLS BY REQUEST OF THE GOVERNOR  
 Requester: Governor

Department: Department of Revenue  
 Appropriation: Taxation and Treasury  
 Allocation: Permanent Fund Dividend Division  
 OMB Component Number: 981

**Expenditures/Revenues**

Note: Amounts do not include inflation unless otherwise noted below. (Thousands of Dollars)

	FY2017 Appropriation Requested	Included in Governor's FY2017 Request	Out-Year Cost Estimates					
			FY 2017	FY 2018	FY 2019	FY 2020	FY 2021	FY 2022
<b>OPERATING EXPENDITURES</b>								
Personal Services								
Travel								
Services								
Commodities								
Capital Outlay								
Grants & Benefits								
Miscellaneous								
<b>Total Operating</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>

**Fund Source (Operating Only)**

None								
<b>Total</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>

**Positions**

Full-time								
Part-time								
Temporary								

<b>Change in Revenues</b>								
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**Estimated SUPPLEMENTAL (FY2016) cost:** 0.0 *(separate supplemental appropriation required)*  
*(discuss reasons and fund source(s) in analysis section)*

**Estimated CAPITAL (FY2017) cost:** 0.0 *(separate capital appropriation required)*  
*(discuss reasons and fund source(s) in analysis section)*

**ASSOCIATED REGULATIONS**

Does the bill direct, or will the bill result in, regulation changes adopted by your agency? No  
 If yes, by what date are the regulations to be adopted, amended or repealed?

**Why this fiscal note differs from previous version:**

Not applicable, initial version.
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Prepared By:	Sara Race, Director	Phone:	(907)465-4785
Division:	Permanent Fund Dividend	Date:	01/14/2016 04:00 PM
Approved By:	Jerry Burnett, Deputy Commissioner	Date:	01/14/16
Agency:	Department of Revenue		

## FISCAL NOTE ANALYSIS

STATE OF ALASKA  
2016 LEGISLATIVE SESSION

## Analysis

**Bill Analysis**

The Permanent Fund Dividend distribution amount has been calculated using the formula defined in Alaska statute since 1986. Annually, in mid-September, the appropriated funds available, total estimated number of eligible applicants, total reductions due to reserves for prior year liabilities and obligations to other appropriations are variables that are entered into the set formula.

Establishing a fixed \$1000.00 dividend for 2016 with a new calculation used thereafter, is a significant alteration to this annual process. However, it will have a minimal impact on program operations. The primary changes in this legislation will have the greatest impact on the 2016 dividend.

With the 2016 dividend application period beginning January 1, 2016, the Charitable Contribution pledge threshold has been implemented and set at \$2300.00. The set amount will be used throughout the duration of the filing period with the anticipation that a true up will occur with all 638 of the participating organizations upon this legislation passing.

For the 2016 dividend, we estimate to receive 670,000 to 673,000 applications, of which we estimate between 640,000 and 647,000 applicants will be eligible for payment. Therefore, roughly \$647,000,000 will need to be available for the 2016 dividend at \$1000.00. In addition to that, a \$900,000 reserve for prior year liabilities, along with appropriated amounts associated with the hold-harmless provision for Public Assistance \$17,724,700, Physical Health Care \$20,236,900, and the Violent Crimes Compensation Board \$1,411,400, and the Division's Administrative costs \$8,361,200. For an approximate total of \$695,634,200.00, given the division's carry forward fund balance is similar to prior years, \$11,500,000.00.

In future years, this impact will decrease as the new calculated amount will be known prior to the current year dividend application being created, tested, and implemented. Overall, the calculation and operational methods to determine an estimated number of eligible applicants, amount available for appropriation, and reserves for prior year liabilities would not change. The amount available for annual transfer would be the only alteration to the process, which is one of the modifications presented in this bill. The annual amount would be equal to 50 percent of the resource royalties received by the state, instead of a five year average from the earning reserve account. Annual dividend payouts will continue to occur the first Thursday in October and the third Thursday of every month thereafter.

# Fiscal Note

State of Alaska  
2016 Legislative Session

Bill Version:	SB 128
Fiscal Note Number:	2
(S) Publish Date:	1/19/2016

Identifier: DOR-APFC-1-15-16  
 Title: PERM. FUND:DEPOSITS;DIVIDEND;EARNINGS  
 Sponsor: RLS BY REQUEST OF THE GOVERNOR  
 Requester: Governor

Department: Department of Revenue  
 Appropriation: Alaska Permanent Fund Corporation  
 Allocation: APFC Operations  
 OMB Component Number: 109

**Expenditures/Revenues**

Note: Amounts do not include inflation unless otherwise noted below. (Thousands of Dollars)

	FY2017 Appropriation Requested	Included in Governor's FY2017 Request	Out-Year Cost Estimates					
			FY 2017	FY 2018	FY 2019	FY 2020	FY 2021	FY 2022
<b>OPERATING EXPENDITURES</b>								
Personal Services								
Travel								
Services								
Commodities								
Capital Outlay								
Grants & Benefits								
Miscellaneous								
<b>Total Operating</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>

**Fund Source (Operating Only)**

None								
<b>Total</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>

**Positions**

Full-time								
Part-time								
Temporary								

<b>Change in Revenues</b>								
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**Estimated SUPPLEMENTAL (FY2016) cost:** 0.0 *(separate supplemental appropriation required)*  
*(discuss reasons and fund source(s) in analysis section)*

**Estimated CAPITAL (FY2017) cost:** 0.0 *(separate capital appropriation required)*  
*(discuss reasons and fund source(s) in analysis section)*

**ASSOCIATED REGULATIONS**

Does the bill direct, or will the bill result in, regulation changes adopted by your agency? No  
 If yes, by what date are the regulations to be adopted, amended or repealed?

**Why this fiscal note differs from previous version:**

Not applicable, initial version.
----------------------------------

Prepared By:	Laura Achee	Phone:	(907)796-1522
Division:	Alaska Permanent Fund Corporation	Date:	01/15/2016 12:00 AM
Approved By:	Angela Rodell	Date:	01/15/16
Agency:	Alaska Permanent Fund Corporation		

## FISCAL NOTE ANALYSIS

STATE OF ALASKA  
2016 LEGISLATIVE SESSION

## Analysis

This bill would allow for up to 99.5 percent of the mineral royalty deposits received by the State of Alaska to be deposited into the principal and earnings reserve of the Permanent Fund. The annual allocation of deposits between the principal and the earnings reserve of the 74.5 percent of royalties not allocated by the Constitution would be determined by the balance of the earnings reserve. Similar provisions are provided to deposit all of the unrestricted petroleum tax revenue received by the State into the Permanent Fund principal and earnings. Using the Fall 2015 Revenue Sources Book, AFPC anticipates this would add about \$900 million to the assets under management each year. The cost of managing these funds can be absorbed within the APFC's current budget request for FY17.

In addition, the bill would mandate a \$3.3 billion annual draw from the Permanent Fund earnings reserve and would provide for a transfer of an amount equal to 50 percent of the mineral royalties collected by the State to the Permanent Fund Dividend Fund. Managing toward these fixed liabilities may change the asset allocation of the Permanent Fund, however at this time it is difficult to forecast if it would impact the asset allocation to a degree that would require additional investment staff, accounting staff or related resources.

# Fiscal Note

State of Alaska  
2016 Legislative Session

Bill Version:	SB 128
Fiscal Note Number:	3
(S) Publish Date:	3/16/2016

Identifier: SB128-DOA-VCCB-02-03-16  
 Title: PERM. FUND:DEPOSITS;DIVIDEND;EARNINGS  
 Sponsor: RLS BY REQUEST OF THE GOVERNOR  
 Requester: Governor

Department: Department of Administration  
 Appropriation: Violent Crimes Compensation Board  
 Allocation: Violent Crimes Compensation Board  
 OMB Component Number: 2694

## Expenditures/Revenues

Note: Amounts do not include inflation unless otherwise noted below. (Thousands of Dollars)

	FY2017 Appropriation Requested	Included in Governor's FY2017 Request	Out-Year Cost Estimates				
			FY 2018	FY 2019	FY 2020	FY 2021	FY 2022
<b>OPERATING EXPENDITURES</b>	<b>FY 2017</b>	<b>FY 2017</b>					
Personal Services	***		***	***	***	***	***
Travel							
Services							
Commodities							
Capital Outlay							
Grants & Benefits							
Miscellaneous							
<b>Total Operating</b>	<b>***</b>	<b>0.0</b>	<b>***</b>	<b>***</b>	<b>***</b>	<b>***</b>	<b>***</b>

## Fund Source (Operating Only)

None							
<b>Total</b>	<b>***</b>	<b>0.0</b>	<b>***</b>	<b>***</b>	<b>***</b>	<b>***</b>	<b>***</b>

## Positions

Full-time							
Part-time							
Temporary							

<b>Change in Revenues</b>							
---------------------------	--	--	--	--	--	--	--

Estimated SUPPLEMENTAL (FY2016) cost: 0.0 (separate supplemental appropriation required)  
 (discuss reasons and fund source(s) in analysis section)

Estimated CAPITAL (FY2017) cost: 0.0 (separate capital appropriation required)  
 (discuss reasons and fund source(s) in analysis section)

## ASSOCIATED REGULATIONS

Does the bill direct, or will the bill result in, regulation changes adopted by your agency? Not known  
 If yes, by what date are the regulations to be adopted, amended or repealed?

## Why this fiscal note differs from previous version:

Not applicable. Initial version.

Prepared By:	Kate Hudson	Phone:	(907)465-5525
Division:	Violent Crimes Compensation Board	Date:	02/03/2016 05:00 PM
Approved By:	Sheldon Fisher, Commissioner	Date:	02/03/16
Agency:	Department of Administration		

## FISCAL NOTE ANALYSIS

STATE OF ALASKA  
2016 LEGISLATIVE SESSION

**Analysis**

The financial impact of this bill on the Violent Crimes Compensation Board is indeterminate but potentially will significantly reduce available funding. The bill will change the way in which the permanent fund dividend is calculated, and it is more likely than not that the amount of the dividend will decrease as a result. Accordingly, the bill is likely to have the effect of significantly reducing the current source of state funding for the Violent Crimes Compensation Board (appropriation from the PFD fund) without any indication of how that funding would be replaced.

This appropriation is not the only source of funding for the Violent Crimes Compensation Board. The Board also receives an annual federal grant. However, this is a formula grant, predicated on the prior year's certified state expenditures. Therefore, if less state money is available to spend on grants to victims of crime, so federal funding would decrease the following year, hence zero revenue in FY16 onwards.

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STATE CAPITOL  
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[Governor@Alaska.Gov](mailto:Governor@Alaska.Gov)

Governor Bill Walker  
STATE OF ALASKA

January 15, 2016

The Honorable Kevin Meyer  
President of the Senate  
Alaska State Legislature  
State Capitol, Room 111  
Juneau, AK 99801-1182

Dear President Meyer:

Under the authority of Article III, Section 18 of the Alaska Constitution, I am transmitting a bill relating to the Alaska permanent fund and the funding structure for state government.

This bill would establish a new financial model to enable sustainable and stable funding of state services and the protection of the permanent fund. To accomplish these goals, additional resource revenues would be directed to the permanent fund and the earnings reserve account. This would enable greater permanent fund earnings to be generated and remove the damaging volatility from the general fund. In turn, a sustainable and stable annual draw from the earnings reserve account to the general fund would support state government. Additionally, the bill would change the manner in which permanent fund dividends are calculated from the current practice of calculating the dividend based on investment returns to a process in which the dividend is calculated based on the state's receipt of natural resource royalties. Further, the bill would establish a process to assure sustainability of state revenues in which the Commissioner of Revenue, in consultation with the Alaska Permanent Fund Corporation, would periodically review state financial resources in order to recommend whether adjustments should be made to the sustainable draw from the earnings reserve account to the general fund. Additionally, the bill provides for inflationary adjustments to the sustainable draw beginning in fiscal year 2020. As a result of these changes, the permanent fund earnings reserve account would generate predictable and stable revenues for state government. The permanent fund dividend would continue, but would reflect the state's success in natural resource development rather than investment performance.

In detail, the bill proposes to amend AS 37.13.010, the Alaska permanent fund, to require that 49.5 percent, rather than the current approximately 30 percent, of resource royalties would be deposited into the permanent fund principal. This would be subject to the condition that the earnings reserve account had reached a target balance necessary to provide for a sustainable annual draw of \$3,300,000,000 billion dollars from that account to the general fund. If the target had not been reached, 24.5 percent of the resource royalties would go to the earnings reserve account (0.5 percent of mineral lease royalties would continue to go to the school fund). Additionally, the bill provides that up to 100 percent of oil and gas production taxes may be appropriated to the permanent fund

or the earnings reserve account. The bill would amend AS 37.13.145(b) to provide that the annual transfer from the earnings reserve account to the dividend fund for the payment of dividends would be the amount necessary to equal 50 percent of the resource royalties received by the state. In order to support this dividend payment, the bill provides that the Legislature may appropriate 50 percent of the resource royalties received by the state to the earnings reserve account. Based on these changes, income of the permanent fund would no longer be used to calculate the amount available for payment of dividends, but instead the dividend would be calculated based on resource royalties received by the state.

To further stabilize the income stream available for state budgets, the bill would amend AS 37.13.145 in order to eliminate an annual inflation transfer from the permanent fund earnings reserve account to the principal. Instead of this transfer, the bill provides for a transfer from the earnings reserve account to the permanent fund principal that will occur if the earnings reserve account contains more money than needed for a four-year sustainable draw from that account to the general fund. If the earnings reserve account has not reached this target balance, the bill provides that 100 percent of oil and gas production taxes and up to 24.5 percent of resource royalties may be appropriated to the earnings reserve account.

The bill further amends AS 37.13.145 to establish a process for review by the Commissioner of Revenue to determine whether the sustainable draw sum should be adjusted based on an assessment of state financial resources. This review would result in a report being submitted to the President of the Senate and the Speaker of the House of Representatives. To ensure transparency, the bill would require that the information and analysis supporting the report be made available to the public, including the Legislature. Additionally, the bill provides for inflation adjustment to the sustainable draw beginning in fiscal year 2020. The bill would establish a dividend amount of \$1,000 for each eligible individual for calendar year 2016.

The bill is an integral component of the New Sustainable Alaska Plan to provide a balanced and sustainable budget for Alaska's long-term fiscal stability.

I urge your prompt and favorable action on this measure.

Sincerely,



Bill Walker  
Governor

Enclosure

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# ALASKA PERMANENT FUND PROTECTION ACT

## SECTIONAL ANALYSIS SB 128

### FOR THE SENATE FINANCE COMMITTEE

#### Section 1 - Revenues to the Corpus

Section 1 amends AS 37.13.010(a) to increase the petroleum revenues directed to the corpus of the permanent fund, subject to a redirection mechanism that ensures the earnings reserve account is not degraded.

- Production Taxes: 100% of production taxes are directed to the corpus
  - Currently, these funds go to the general fund
  - Requires an appropriation
- Mineral Royalties: 49.5% of all mineral royalties are directed to the corpus
  - Constitutionally mandated 25% (no change)
  - An additional 24.5% (an increase from 5%)
- Redirection Mechanism: if needed to maintain the target balance (*see* Sections 2 and 6), some petroleum revenue may be redirected to the earnings reserve account
- Removes distinction between old and new leases

#### Section 2 - Target Balance of the Earnings Reserve Account

Section 2 adds subsection (d) to AS 37.13.010, which cross-references AS 37.13.145(l) (*see* Section 6), setting the target balance at equal to four times the prior year's sustainable draw.

#### Section 3 – Conforming Amendment

Section 3 is a conforming amendment to AS 37.13.140 that removes the calculation of “income available for distribution” because (1) the term relates to the current dividend formula, which would change (*see* Section 4), and (2) other revenues, including production taxes and royalties, may also be available in the earnings reserve account.

#### **Section 4 – Transfers from the Earnings Reserve Account to the Dividend Fund**

Section 4 amends AS 37.13.145(b) to change the calculation of the annual dividend.

- Changes the amount transferred from earnings reserve account to the dividend fund to 50% of the prior year royalties instead of approximately 50% of realized investment earnings
- Changes timing of the transfer from the end of the fiscal year to the beginning

#### **Section 5 – Transfers from the Earnings Reserve Account to the Corpus**

Section 5 amends AS 37.13.145(c) to change the timing and amount of transfers from the earnings reserve account to the corpus.

- Changes amount transferred to the corpus from the amount necessary to inflation proof the corpus to funds in earnings reserve account exceeding the “target balance”
- Changes timing of the transfer from every year to when excess funds are available
- Flexible inflation proofing and a presumption of savings
  - Over time, these transfers inflation proof the corpus
  - Transferred funds may exceed the amount needed for inflation proofing
  - The flexibility in timing improves the durability of the earnings reserve account and protects the corpus

#### **Section 6 – Revenues to the Earnings Reserve Account and the Sustainable Draw to the General Fund**

Section 6 adds subsections (e) to (l) to AS 37.13.145 to direct some petroleum revenues to the earnings reserve account and establish the endowment transfer to the general fund.

- **Redirection Mechanism:** Subsections (e) and (f) mirror the redirection provisions in Section 1. Specifically, if needed to maintain the target balance, up to 100% of production taxes and 24.5% of royalties that are otherwise deposited in the corpus may be redirected to the earnings reserve account.
  - Durability of the earnings reserve account: making these petroleum revenues available to the earnings reserve account helps ensure it is not depleted if there are several consecutive years of low petroleum revenue and low investment income

- Protects the corpus: depleting the earnings reserve account would put the corpus at risk as the state searches for additional funds to pay for government
  - Savings: establishes a presumption of saving excess revenue in the corpus when possible
- **Dividend Royalties:** Subsection (g) provides that funds for the dividend (50% of royalties) gather in the earnings reserve account until they are transferred to the dividend fund under Section 4.
  - Retains the connection between the dividend and the permanent fund.
  - Helps with cash flow, particularly in first few years.
  - Establishes the cash flow pathways in the first year and minimizes departures from the permanent framework.
- **Sustainable Draw:** Subsections (h) and (i) provide for the annual endowment transfer from the earnings reserve account to the general fund.
  - \$3.3 billion fixed-draw
    - Maximum amount
    - Adjusted for inflation beginning in FY 2020
    - Flexible transfer timing allows the Treasury and the Alaska Permanent Fund Corporation to work out a practical and efficient system based on cash flow needs and investment practices
  - Appropriation
    - Framework relies on legislature partnering with the executive
    - The Alaska legislature has a long history of following a rule-based policy for the earnings reserve account
- **Periodic Review:** Subsections (j) and (k) provide for a periodic sufficiency of assets review and adjustments to the draw amount.
  - The Commissioner of Revenue, in consultation with the Alaska Permanent Fund Corporation, conducts a review of the state's financial assets and forecasts and may recommend adjusting the draw amount
  - Scheduled: 2017, 2020, then every 4 years
  - Formulaic: the periodic review uses the same approach and variables used to calculate the initial draw
  - Protects the permanent fund: the periodic review ensures that, in light of experience, Alaska remains on a sustainable fiscal course

- Collaborative: the review is provided to the legislature
- Transparent: all supporting material – data, modeling, etc. – must be made available to the public in its native file format (except for confidential taxpayer information which may be provided in aggregated form)
- Subsection (l) defines “sustainable draw amount” and “target balance.”

#### **Section 7 – Conforming Amendment**

Section 7 is a conforming amendment to AS 37.13.300(c) isolating income of the mental health trust fund from net income available for transfer to the general fund.

#### **Section 8 – Conforming Amendment**

Section 8 is a conforming amendment to AS 43.55.080 directing production taxes to the permanent fund.

#### **Section 9 – \$1,000 Dividends in 2016**

Section 9 amends uncodified law to specify that 2016 dividend checks will be \$1,000 per person. This provision eases the transition to the new dividend formula.

#### **Section 10 – July 1, 2016 effective date**

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# ALASKA PERMANENT FUND PROTECTION ACT

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Randall Hoffbeck, *Commissioner of Revenue*

Craig W. Richards, *Attorney General*



Senate Finance Committee  
March 21, 2016

# OVERVIEW

- Defining the Problem
- Fiscal Policy for Oil Economies
- Analysis of Options
  - APFPA Summary
  - Defining “Sustainable”
  - How to Handle the Draw
  - How to Handle the Volatility
  - How to Handle the Dividend
- APFPA Sectional Analysis





The Fiscal Challenge

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# DEFINING THE PROBLEM

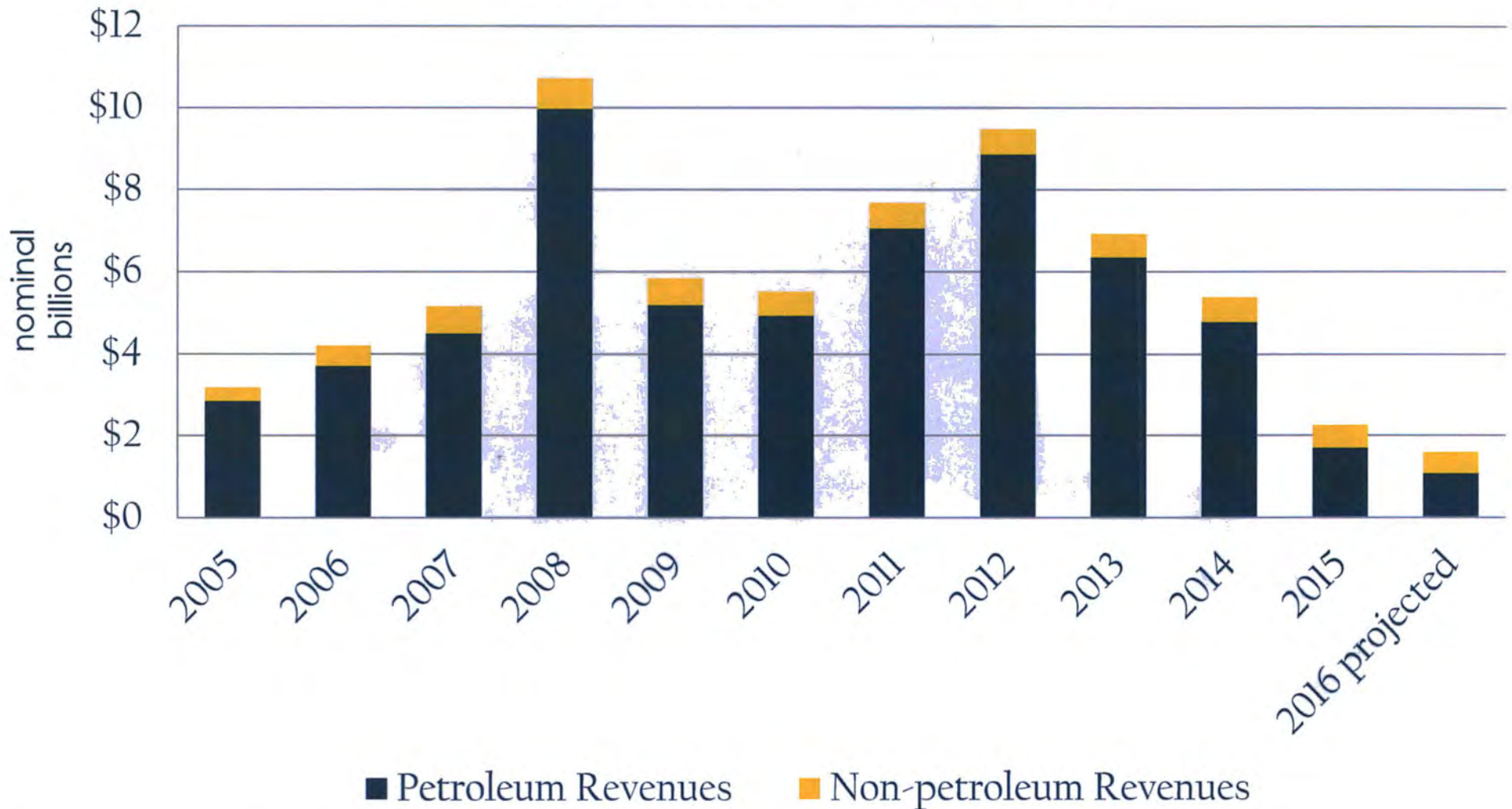
# DEFINING THE PROBLEM

- Short-Term:
  - Drop in oil prices has resulted in large budget gaps
  
- Medium-Term:
  - State savings will be spent in about 4 years
  - Uncorrected, state budget hole will damage Alaska's economy
  - Dividend payments are unsustainable under the status quo
  
- Long-Term:
  - State's undiversified budget is highly dependent on petroleum revenues
  - There has been a declining trend in North Slope petroleum production
  - Cyclicity in petroleum prices creates an unstable state budget and economy

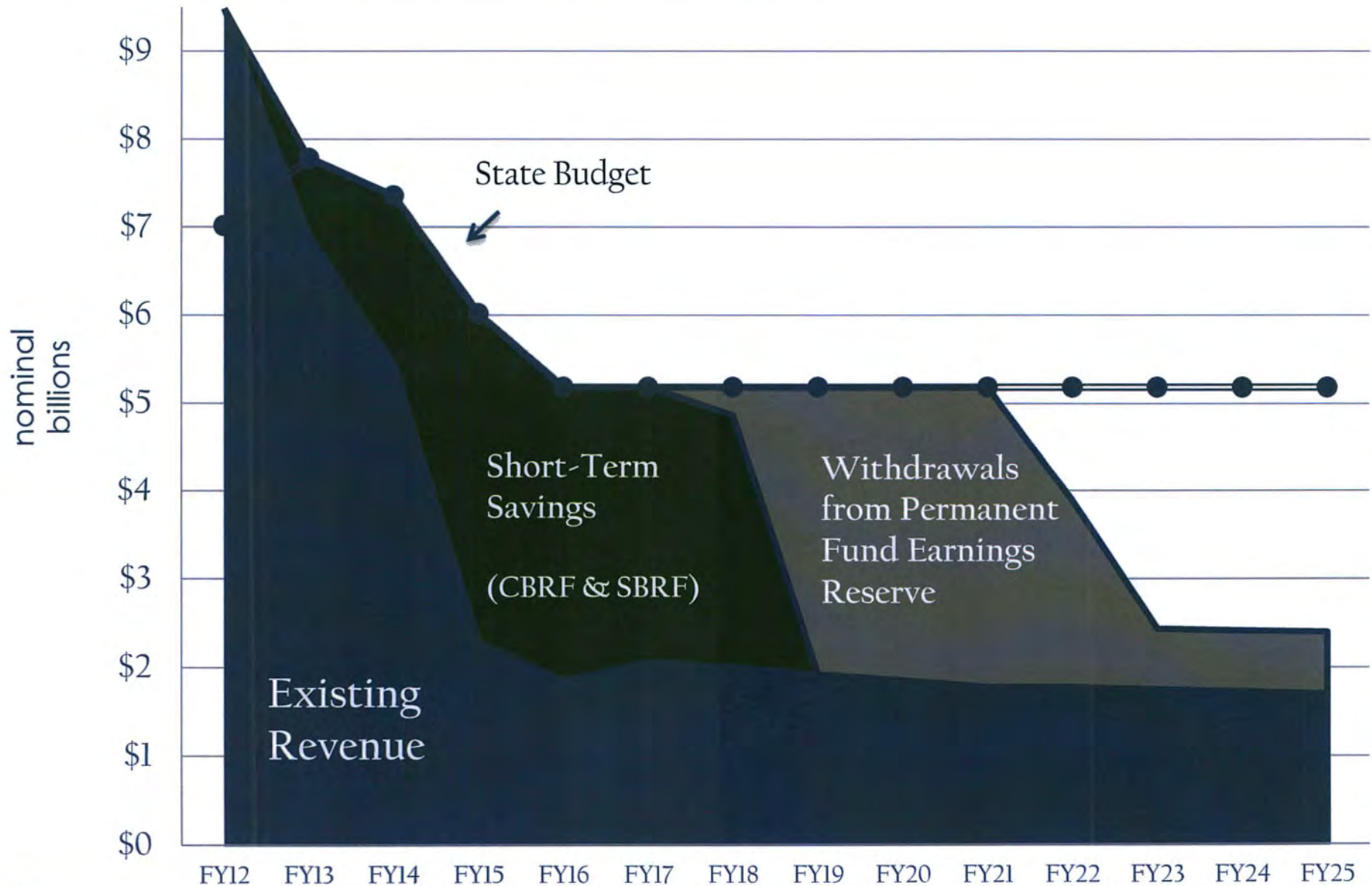


# SHORT-TERM PROBLEM

Alaska's Unrestricted General Fund Revenue

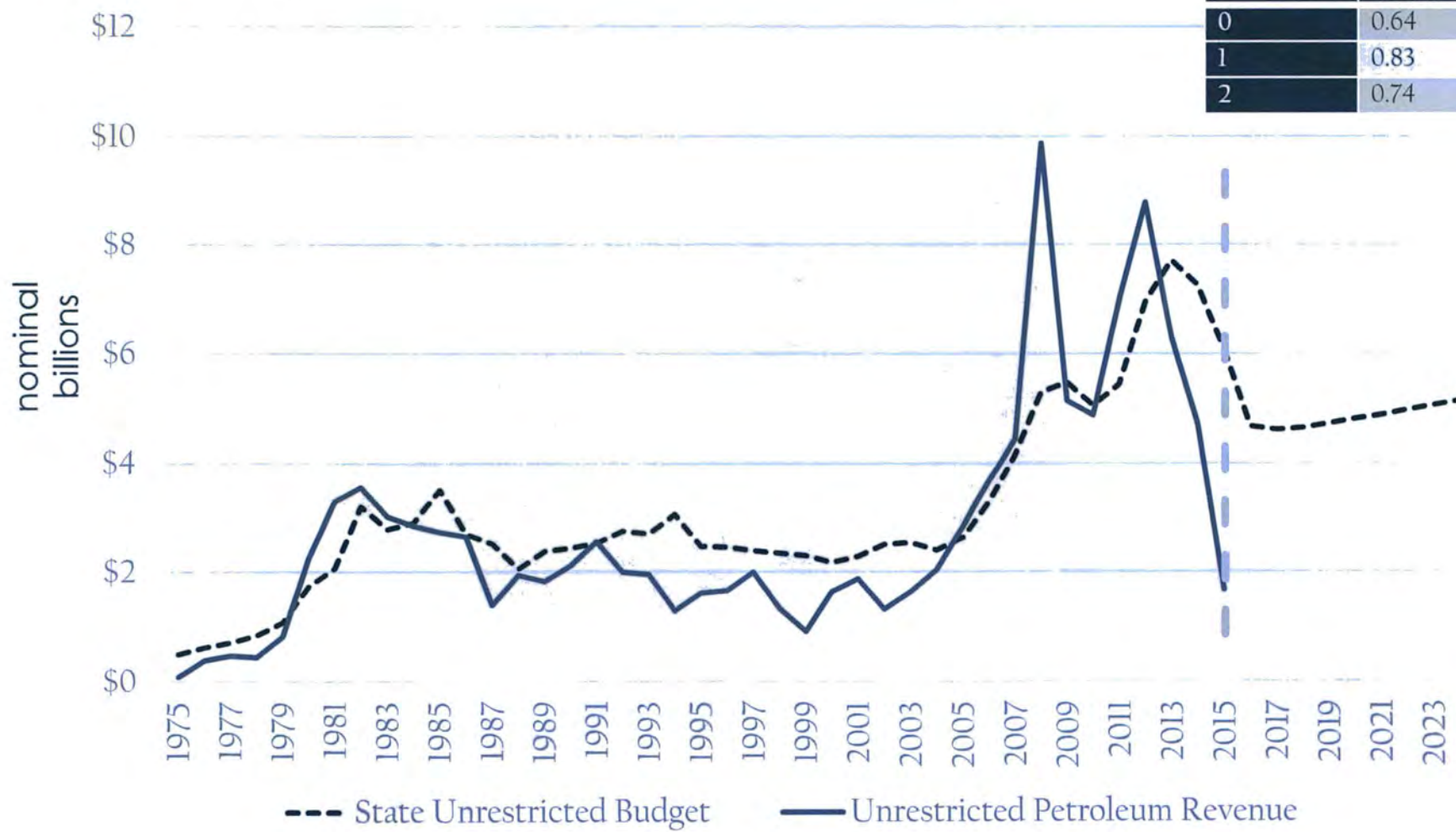


# MEDIUM-TERM PROBLEM



# LONG-TERM PROBLEM

Year Lag	R-Square Value
0	0.64
1	0.83
2	0.74



# WHY THE PERMANENT FUND?

- Other pieces of the plan provide millions, the Fund can *sustainably* contribute billions
- Placing petroleum revenues in the Permanent Fund is the cleanest way to address oil price volatility
- There is no solution without Permanent Fund earnings and adjusting the dividend



# WHY THE PERMANENT FUND?

“Of all the fiscal options for closing the deficit, only saving less of Permanent Fund earnings . . . would have no short-run economic impacts.”

Economic Impacts of Alaska Fiscal Options: Draft Report  
Gunnar Knapp, Mouhcine Guettabi, and Matthew Berman  
Institute of Social and Economic Research (March 2016).



# DELAY WILL . . .

- Reduce the sustainable draw
- Risks a downgrade of Alaska's credit rating
- Damage the economy



# LOWER SUSTAINABLE DRAW

- Every year of inaction, we spend around **\$2 billion** more than called for in the New Sustainable Alaska Plan
  - That money could be invested and produce income indefinitely
  - But, once it's spent, it's gone
- Overspending reduces the sustainable draw every year, *forever*
- Reduction must be made up in future cuts or taxes

Reduced Sustainable Draw (millions\$)				
Excess Spending	Years of Delay			
	1	2	3	4
\$500	\$75	\$150	\$200	\$250
\$1,000	\$100	\$250	\$300	\$400
\$1,500	\$125	\$275	\$350	\$450
\$2,000	\$150	\$325	\$400	\$500



# COST OF A DOWNGRADE

“The state sold \$135 million of general obligation bonds yesterday [03/09/16], its first sale in almost a year. Tax-exempt securities maturing in August of 2035 sold at a top yield of 2.9 percent, about 0.35 percentage point higher than the benchmark securities due in 20 years. That gap is four times wider than what the state paid when it last sold debt in March of 2015.”


*Bloomberg News*



# DAMAGE TO ALASKA'S ECONOMY

- Lower sustainable draw from financial assets requires
  - More taxes
  - Less government spending (services and jobs)
- Degraded confidence and less private sector investment
- Direct impacts on Alaskans
  - Job Market
  - Home Values





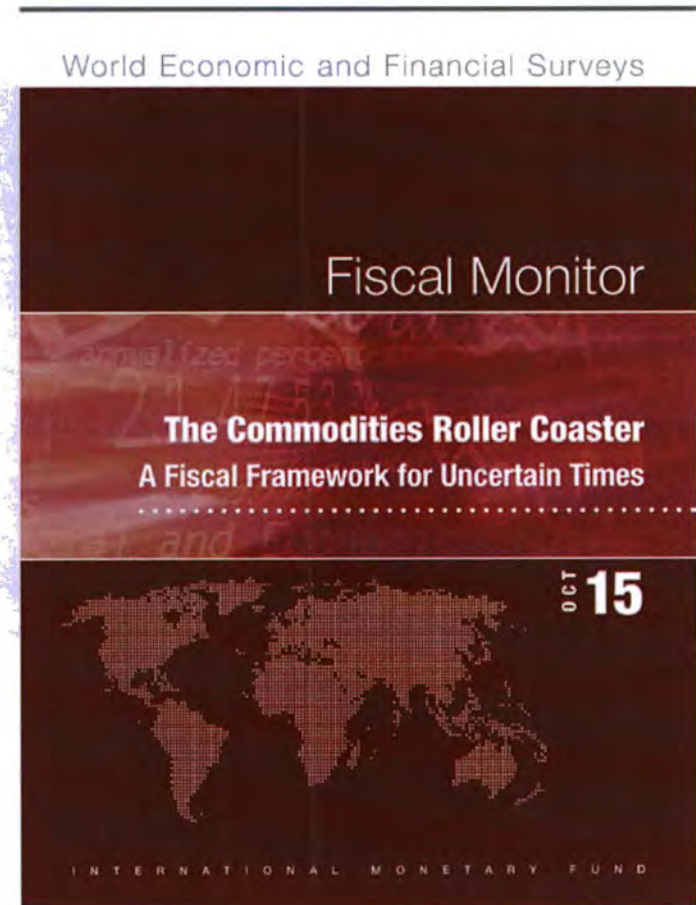
Solving the Long-Term Challenge

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# FISCAL POLICY FOR OIL ECONOMIES

# GOVERNMENT SPENDING & THE ECONOMY

- *The Commodities Roller Coaster* – the International Monetary Fund studied 85 economies over 3 decades
- Government spending in commodity-based economies tends to move up and down with commodity revenue
- Pro-cyclical government spending stunts economic growth
- Stabilizing fiscal policy has the inverse effect, increasing GDP growth by 0.3% annually



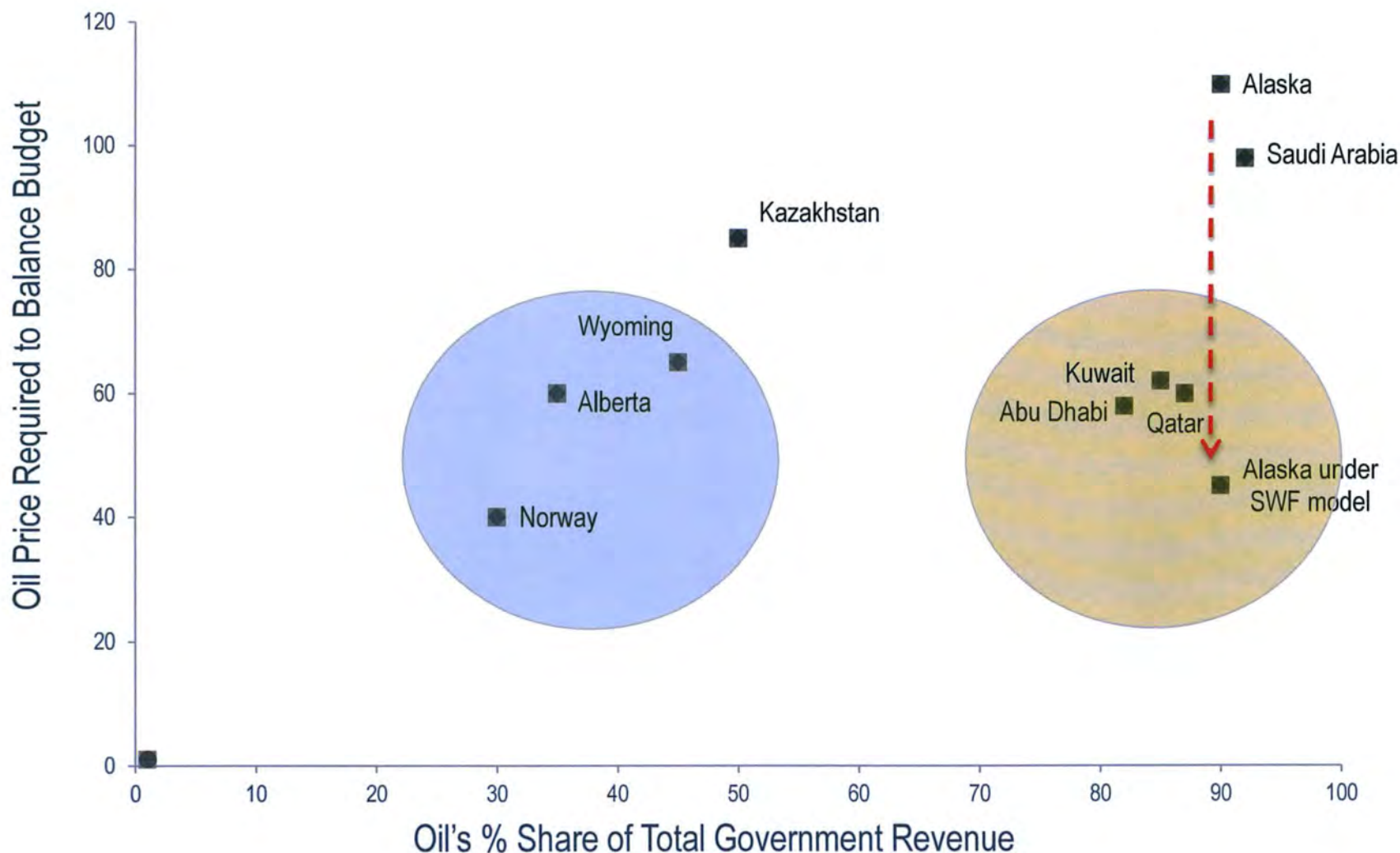
# BREAK-EVEN OIL PRICE

- A widely used rule-of-thumb measure of the oil price required to balance the government budget in any given year
- Options for petroleum states to bring down break-even oil prices are generally
  - Diversify revenues through other types of taxation
  - Use sovereign wealth assets
- Alaska: \$109

Country	Break-Even Oil Price (2015)
Norway	\$40
Kuwait	\$54
Abu Dhabi	\$55
Russia	\$105
Saudi Arabia	\$106
Nigeria	\$122
Iran	\$131
Algeria	\$131
Venezuela	\$160



# OIL: BREAK-EVEN PRICE & SHARE OF REVENUE





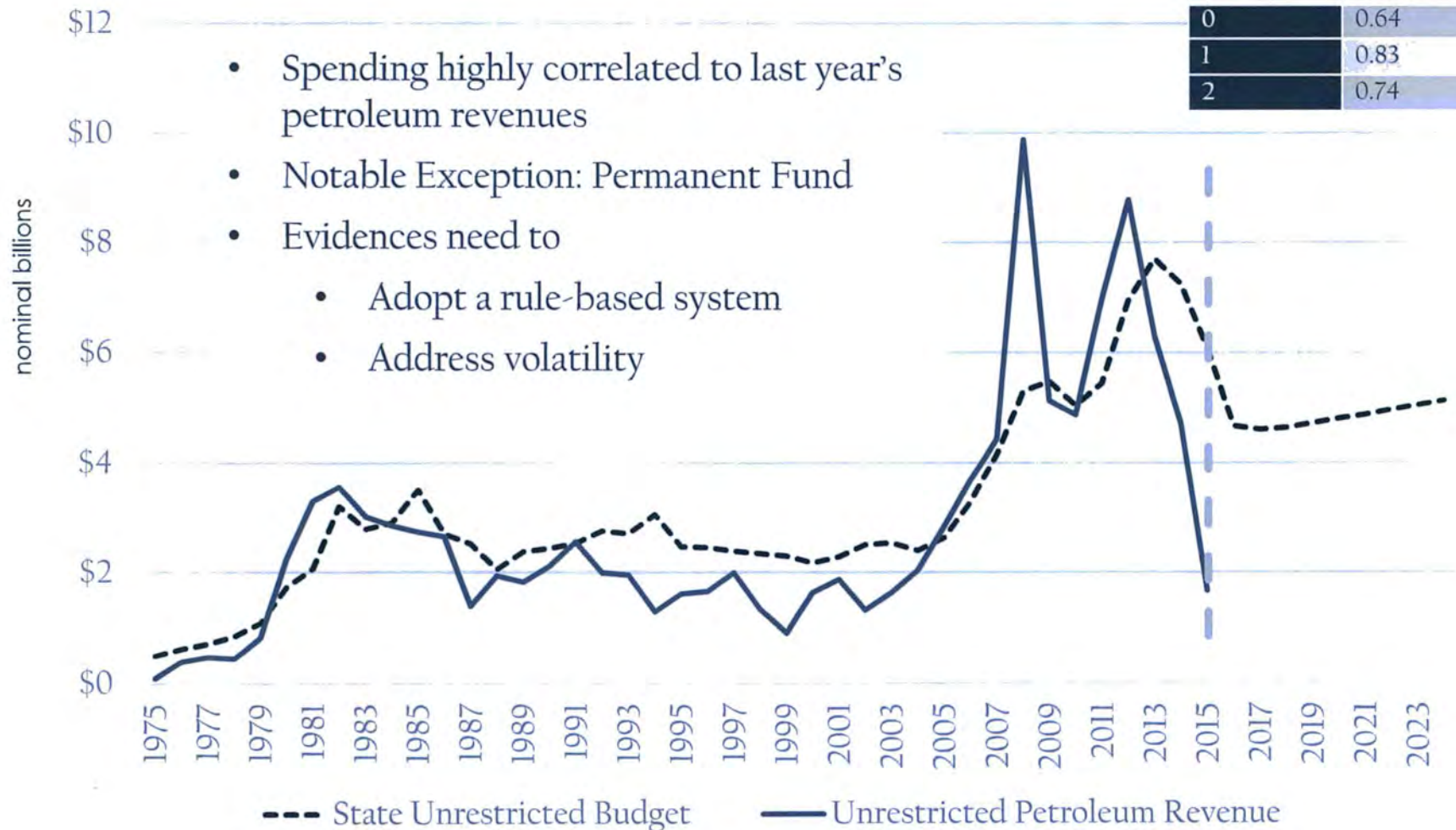
Fiscal Policy for Alaska

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# ANALYSIS OF OPTIONS

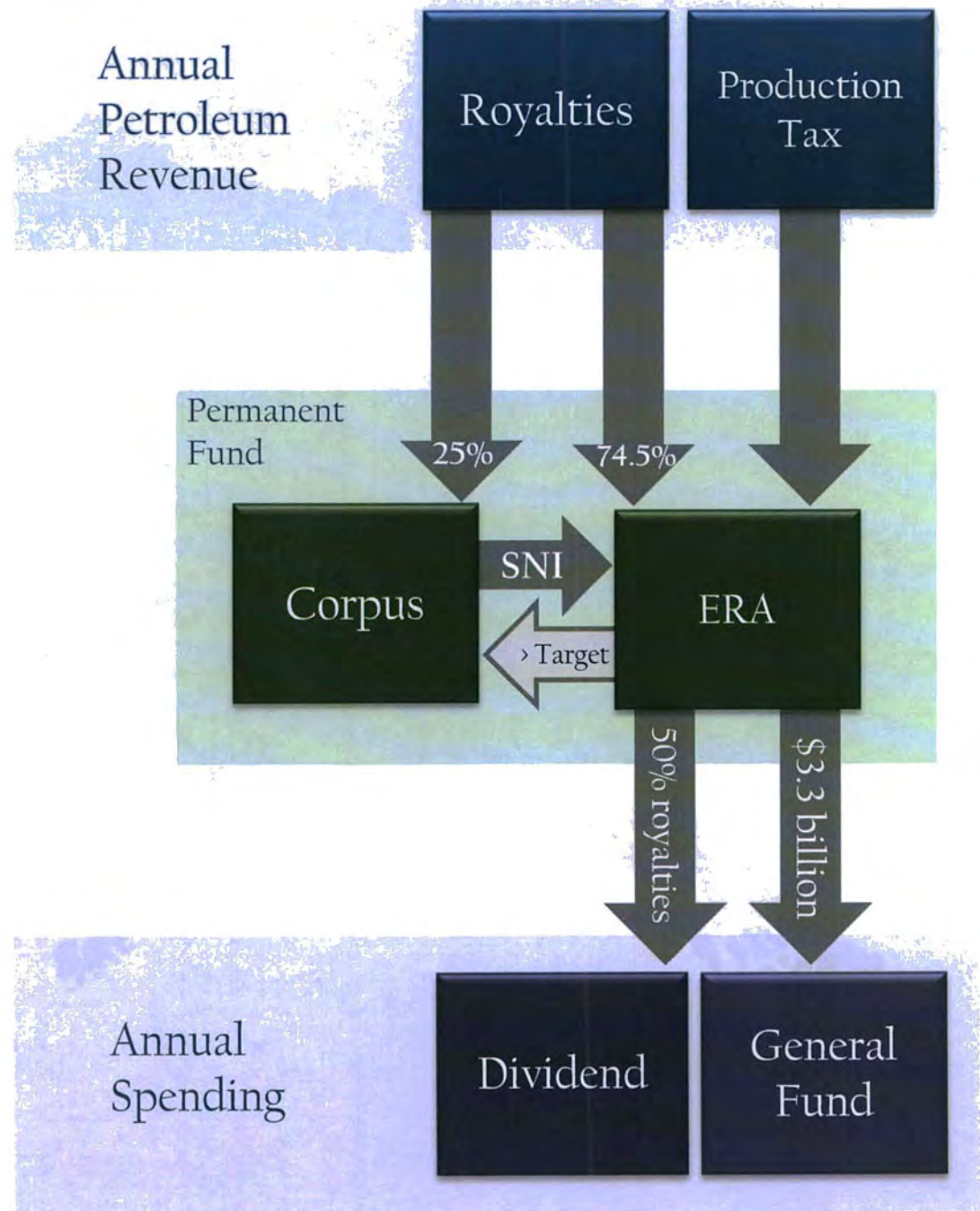
# RULE-BASED FRAMEWORK

Year Lag	R-Square Value
0	0.64
1	0.83
2	0.74



# APFPA

1. Volatile petroleum revenues to the Permanent Fund
2. \$3.3 billion draw to the General Fund
3. Dividends  
50% royalties



# DEFINING “SUSTAINABLE”

- Protect the Corpus
- Earnings Reserve Durability
- Inflation Proofing
  - Maintain the real value of the Permanent Fund
  - Transfers to the Corpus



# HOW TO HANDLE THE DRAW

There are tradeoffs between different types of draw formulas

- Status quo framework
  - Sustainable draw  $\approx$  \$2.4 billion
  - Funds to the general fund = \$2.4 billion – dividend (\$1.4 billion in FY16)
- APFPA framework
  - Sustainable draw = \$3.3 billion or 6% POMV
  - Separate cash flow allocated to the dividend

POMV	Fixed
<ul style="list-style-type: none"><li>• Draw self-adjusts<ul style="list-style-type: none"><li>Lower chance of depletion</li><li>Less fund growth potential</li></ul></li><li>• Year-to-year budget volatility*</li></ul>	<ul style="list-style-type: none"><li>• Draw does not self-adjust<ul style="list-style-type: none"><li>Greater chance of depletion</li><li>Greater fund growth potential</li></ul></li><li>• Stable Budget</li></ul>

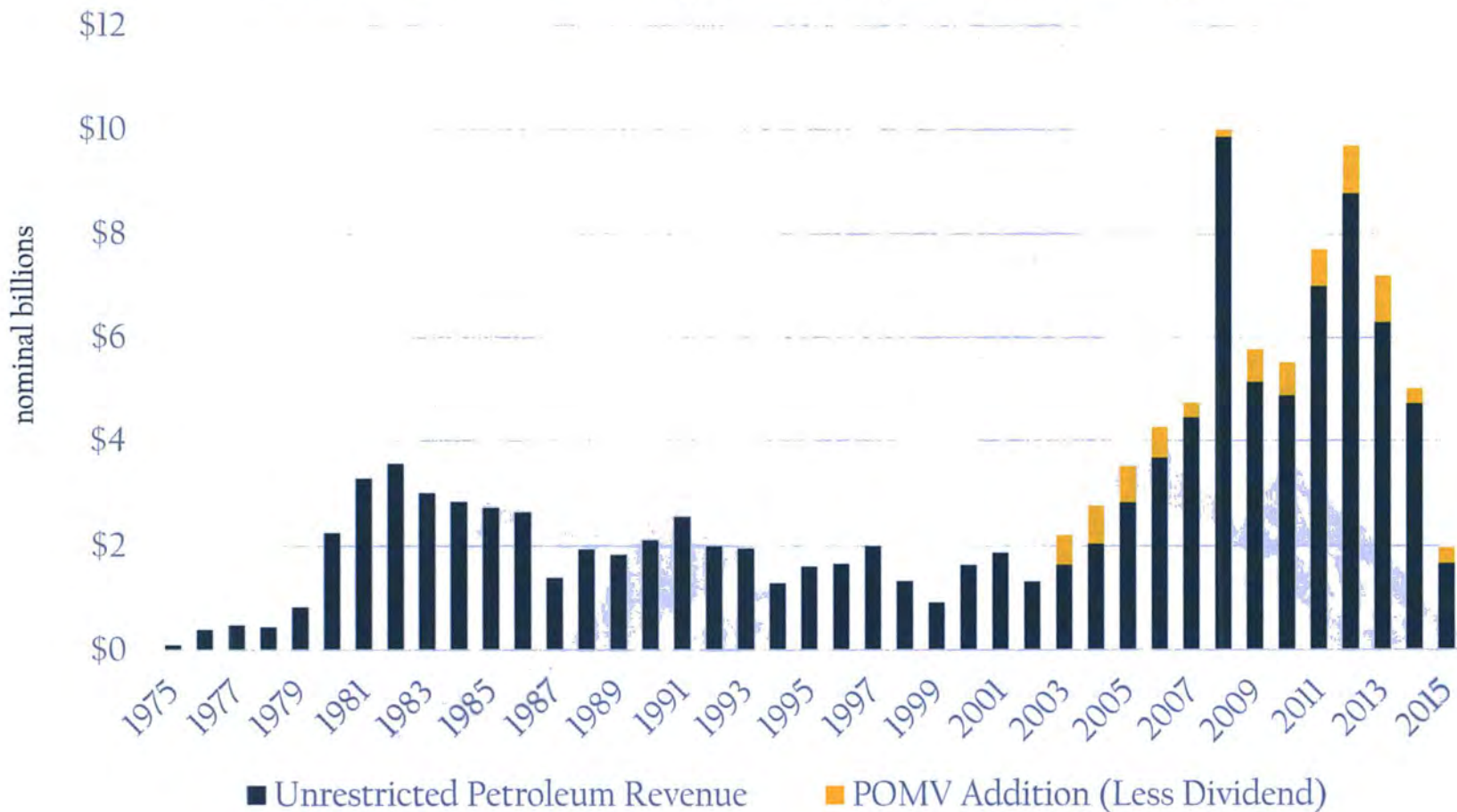
\*Volatility may be reduced, but not eliminated, with use of smoothing rule such as 5- year averaging



# HOW TO HANDLE THE DRAW

A simple endowment draw adds revenue, but does not address volatility

Alaska Tax Revenue with Hypothetical POMV Payouts Starting in 2003



# HOW TO HANDLE VOLATILITY

## STATUTORY NET INCOME (SNI) VOLATILITY

- Option 1:
  - SNI placed in earnings reserve
  - Formulaic draw (e.g., fixed draw or POMV)
  
- Option 2: constitutional amendment allowing pure POMV

## PETROLEUM REVENUE VOLATILITY

- Option 1:
  - Royalties and production taxes placed in earnings reserve
  - Formulaic draw (e.g., fixed draw or POMV)
  
- Option 2:
  - Revenue limit
  - Reduce POMV draw as petroleum revenues in general fund go up
  
- Option 3:
  - Spending or appropriation limit not linked to earnings
  - Difficult to have a dependable rule



# CALCULATING THE DRAW

- Probabilistic v. Deterministic Analysis
- Evening out the volatility allows us to draw more in a low oil price environment, but requires saving when prices are high
- APFPA can sustain a higher draw because it incorporates and stabilizes *both* investment earnings and petroleum revenues



# CALCULATING THE DRAW

## *Annuity Payment to the General Fund*

Starting Balance = \$55 billion (\$45B in corpus; \$7B in earnings reserve account; \$3B from CBR)

+ Inflows =

Investment income  
100% production taxes  
100% royalties

- Outflows =

Expenses  
Dividend  
Draw (inflation increase delayed until 2020)

= End-of-Year Balance

... **\$3.3 billion** annuity from financial and petroleum wealth  
(2040 Balance = 2016 Balance + Inflation)



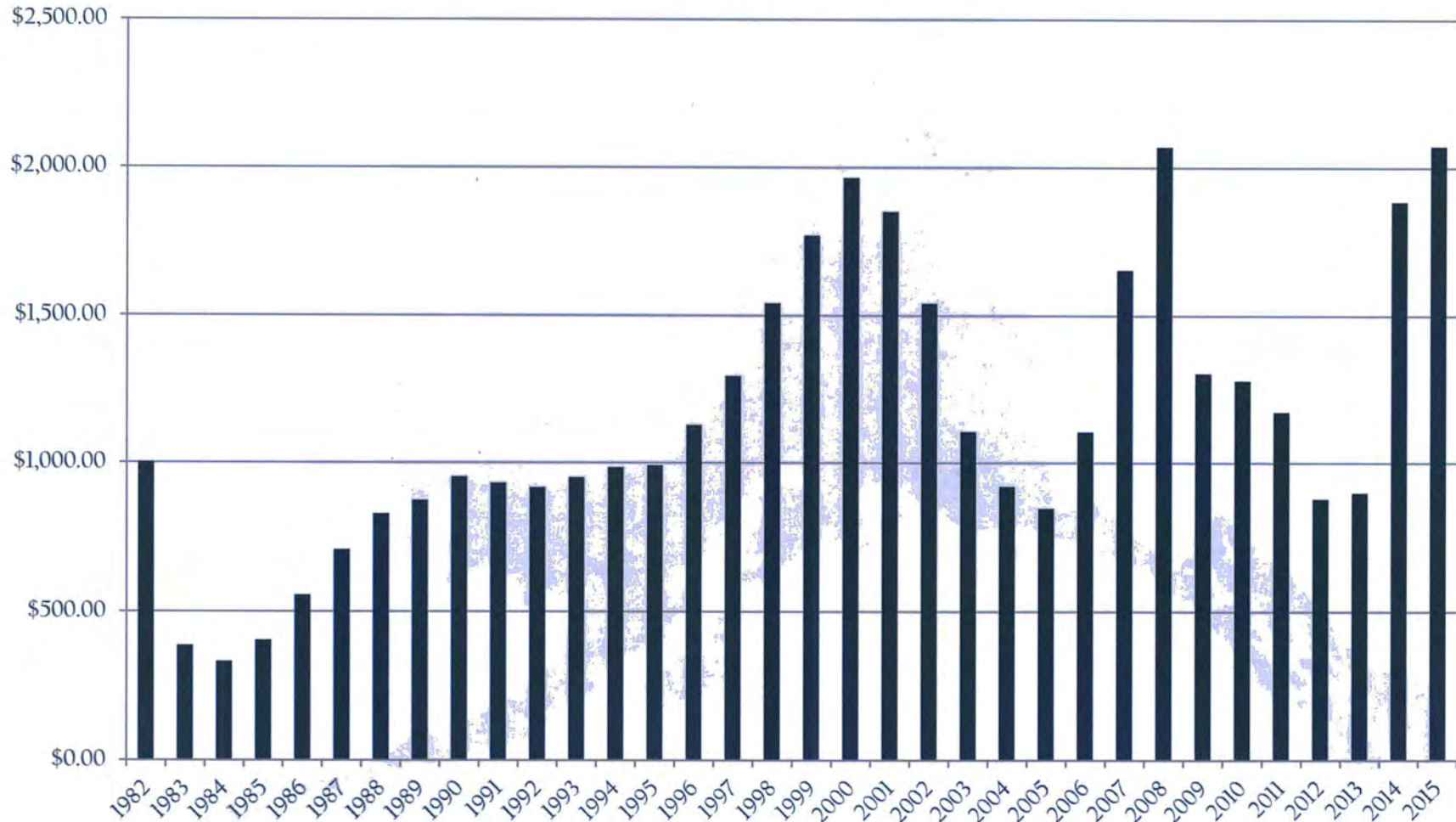
# EARNINGS RESERVE DURABILITY

- Robust Earning Reserve Cash Inflows
  - \$3B transfer from the CBR
  - Statutory Net Income
  - Petroleum revenue
- Long-Lead Adjustment Opportunities
  - 4:1 coverage ratio
  - Periodic review
  - Robust modeling
  - Sufficient time to react



# HOW TO HANDLE THE DIVIDEND

## Historic Dividends



# HOW TO HANDLE THE DIVIDEND

- Earnings Dividend (current formula): half of statutory net income (SNI)
- Royalties Dividend: connects Alaskans to the economy
- POMV Dividend: based on Fund market value, not SNI
- CBR Dividend: based on CBR balance; rewards Alaskans for Legislature maximizing stabilization account
- \$1,000 Flat: ~ \$650 million, reduces the sustainable draw
- Mixed Formula: combination of different ideas



# HOW TO HANDLE THE DIVIDEND

- Dividend formula should connect Alaskans to the economy and the fund
- Certain draw and dividend combinations do not work well
  - POMV draw & earnings dividend
  - Volatile dividend formula (*i.e.* royalty dividend) and floor
- Dividend formula tied to the balance of stabilization funds (*i.e.*, CBR) runs risk of politicizing rule-based dividend payout formula





Alaska Permanent Fund Protection Act

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# THE BILL

# ALASKA PERMANENT FUND PROTECTION ACT

- Section 1: Revenue to the Corpus
- Section 2: Defines “target balance”
- Section 3: Conforming Amendment
- Section 4: ERA transfer to Dividend Fund
- Section 5: ERA transfer to Corpus
- Section 6: Revenue to the ERA, Draw, and Periodic Review
- Section 7: Conforming Amendment
- Section 8: Conforming Amendment
- Section 9: \$1,000/person dividend in 2016
- Section 10: Effective July 1, 2016



# RULE-BASED FISCAL POLICY

- **Savings Rule**
  - Permanent Fund SNI to earnings reserve
  - 25% of mineral royalties to corpus
  - 24.5% of royalties and 100% production taxes to earnings reserve
- **Growth Rule**
  - Assets grow with inflation
  - Opportunities for additional growth assigned to the corpus and dividend
- **Protection Rule**
  - Constitutional protection of the corpus
  - Transfers funds in excess of earnings reserve target balance to the corpus
  - Earnings reserve durability tested
- **Spending Rule**
  - Draw: fixed \$3.3 billion with periodic review
  - Dividend: 50% of annual mineral royalties to Alaskans
- **Volatility Rule**
  - Permanent Fund: SNI, 49.5% royalties 100% production tax volatility in the Permanent Fund
  - Dividend: 50% royalty volatility in dividend
  - General Fund: No SNI, royalty or production tax volatility in general fund



# ALASKA PERMANENT FUND PROTECTION ACT

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1. Volatile petroleum revenue to the Permanent Fund
2. Stable endowment draw to the General Fund
3. Continued dividend for Alaskans



6

# **Managing natural resource funds: global trends and practices**

**Malan Rietveld**

Fellow, Center for International Development  
Kennedy School of Government, Harvard University

Director, Kalytix Partners

Juneau, Alaska  
January 2016

# The growth of new SWFs

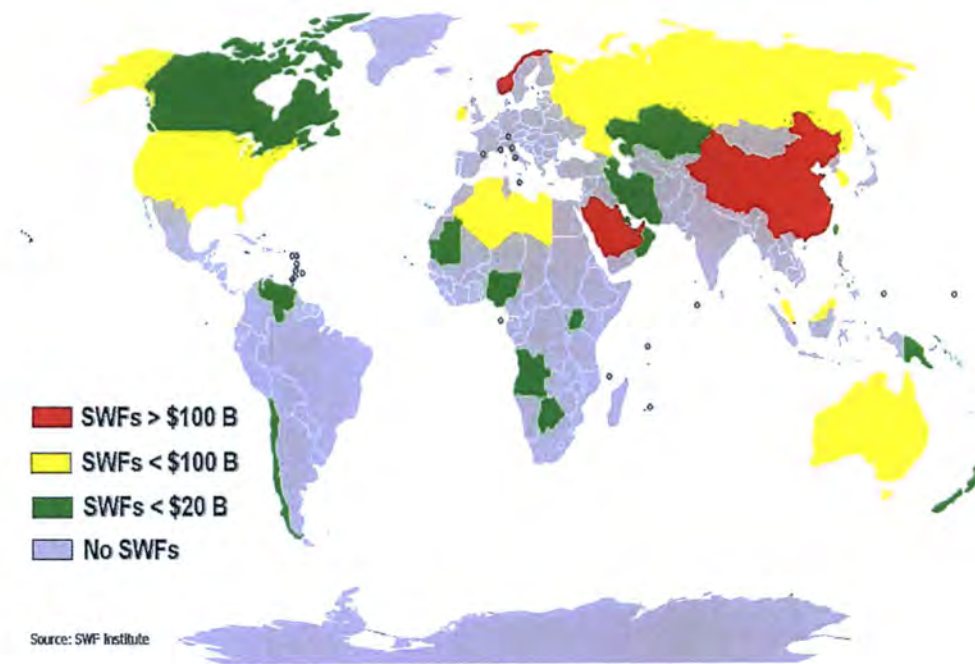
A number of very established, large funds (the “top 8”)

- Proliferation of new funds since 2000 (resource boom)

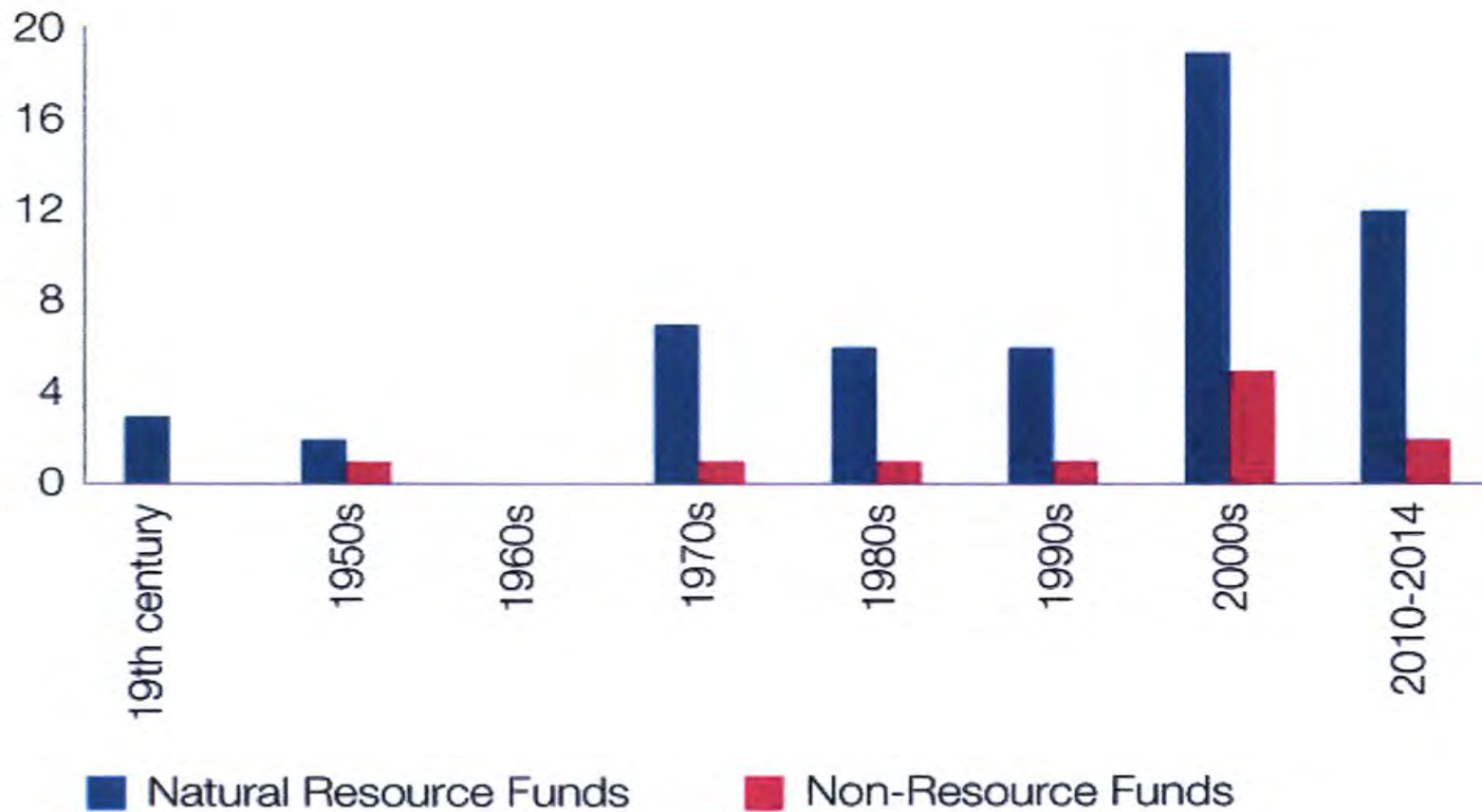
The sovereign investor universe

- Stabilization funds
- Savings funds
- Investment income funds
  - North American permanent fund model (since 1850s)

“Sovereign” includes a number of sub-national governments



# The growth of new SWFs



# Major global trends: the context

Its all about the fiscal framework

- Rules and mechanisms for funding and withdrawals
- Every single SWF in the world is going through this

We moved from SWFs 1.0 to SWFs 2.0 over the past decade

- Now moving on to SWFs 3.0

## SWFs 1.0

- Early adopters in resource-dependent jurisdictions
- Various waves of adoption in resource-dependent jurisdictions
- Very simple investment models
- Focus on saving (often a political compromise)

# Major global trends: the context

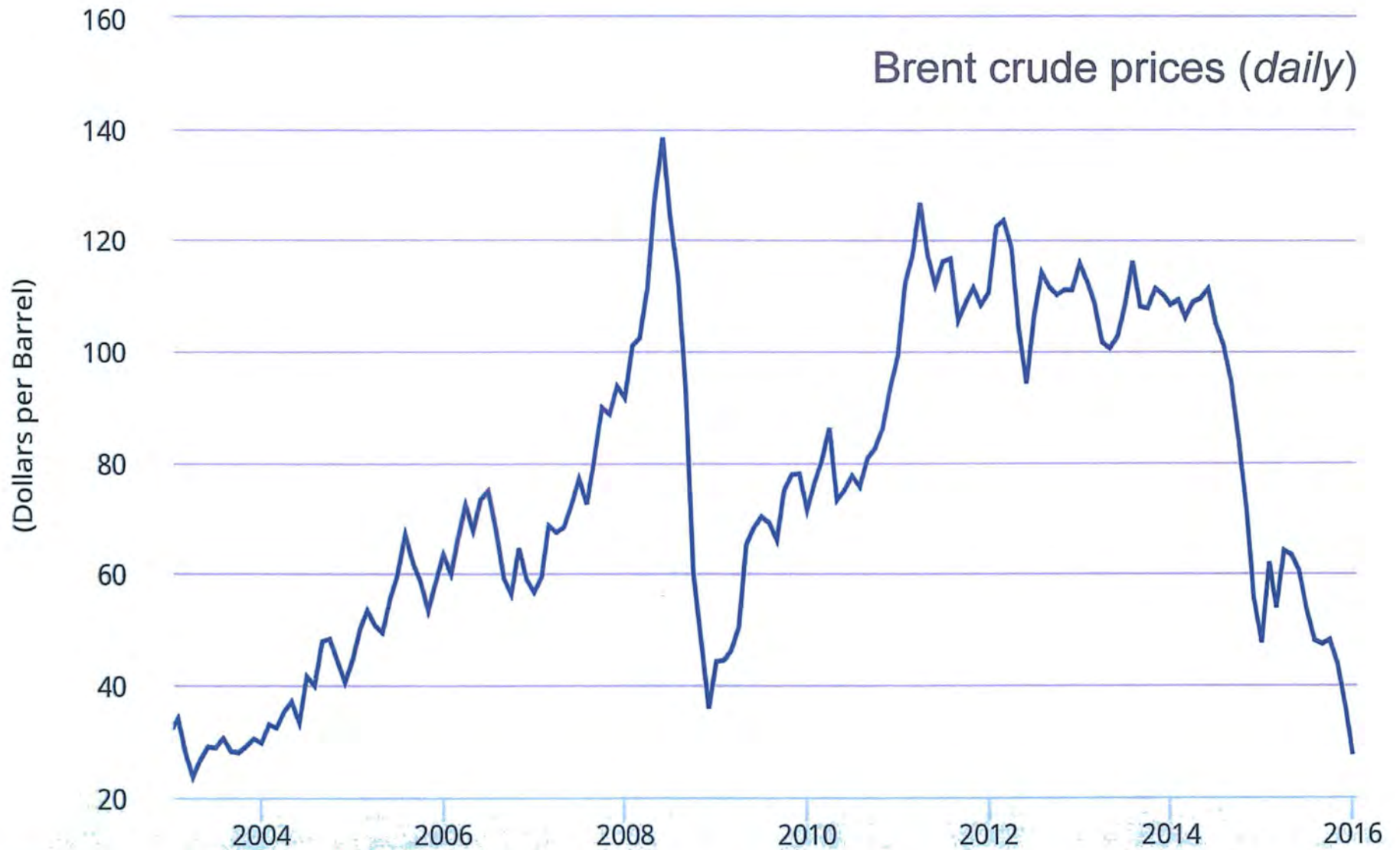
## SWFs 2.0

- Growth (in number, size and prominence from 1998-2014)
- Buoyed by rising commodity revenues (and in Asia, trade surpluses)
- Healthy financial returns

## SWF model goes mainstream

- Broad consensus on benefits of SWFs
- Creation of the International Forum of Sovereign Wealth Funds
- Reduced political pressure
- Much more analysis and research

# And then...this happened



# SWFs 3.0: Adjusting to new fiscal realities

SWFs 3.0 era underlines the importance of “cyclically robust” savings and spending mechanisms

- Old rules of thumbs are one-sided, work fine when running surpluses
- Norway, Abu Dhabi and Chile are rare exceptions

Focus for resource-based SWFs is now on:

- Avoiding depletion of assets (unless constitutionally protected)
- Decoupling saving/spending from commodity cycle

An ebbing tide reveals who has been swimming naked

- Not all SWFs are all they're cracked up to be

# SWFs 3.0: Adjusting to new fiscal realities

Are the rules appropriate for both boom and bust times?

Smarter countries are not resting on the laurels

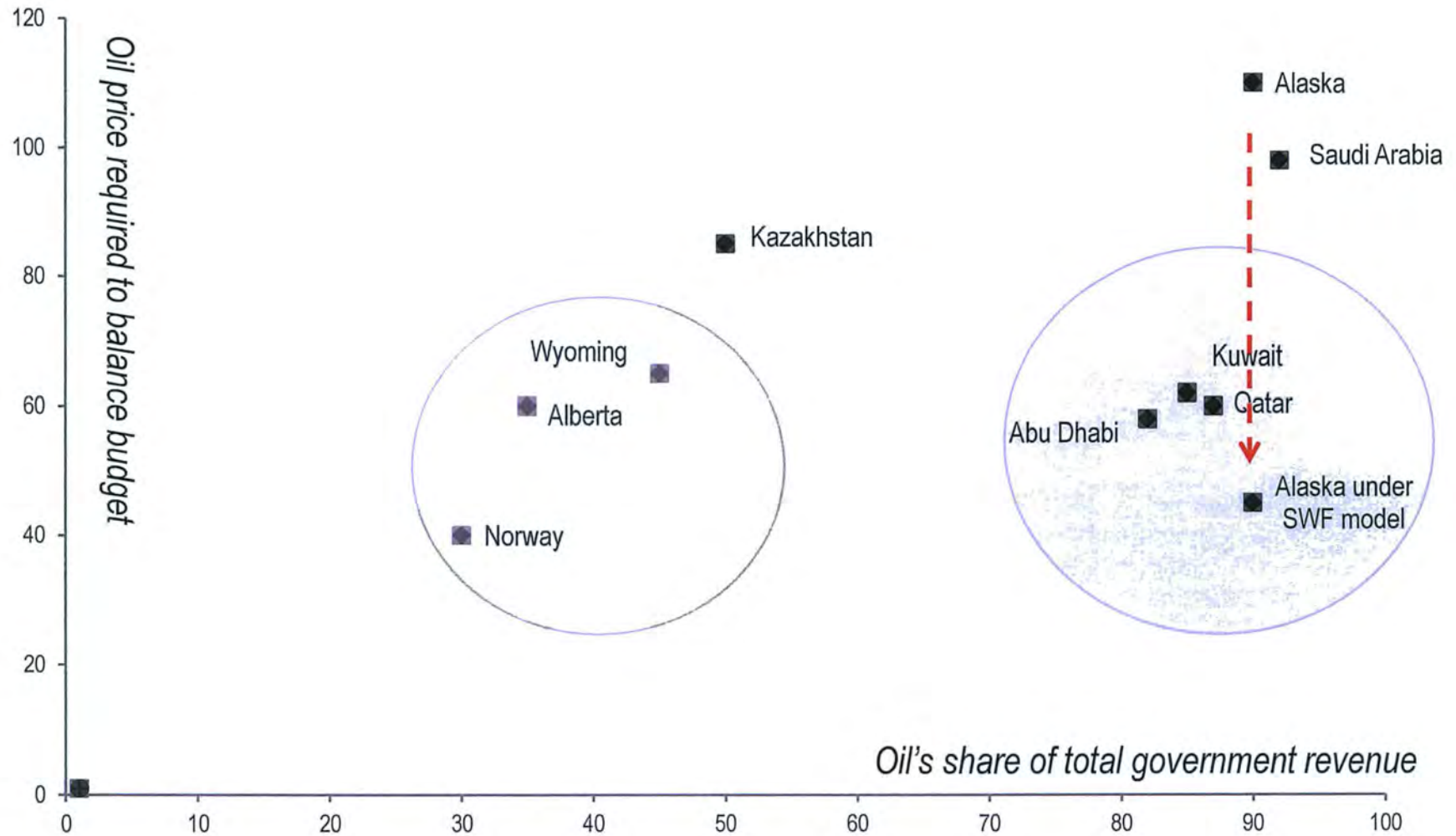
- Group A: never saved enough (Venezuela, Nigeria)
- Group B: depleting now (Russia, Saudi Arabia)
- Group C: reforming saving and spending rules (Abu Dhabi, Kuwait, Norway, *potentially* Saudi Arabia)

Despite all the pressure, “voting with feet” for SWFs

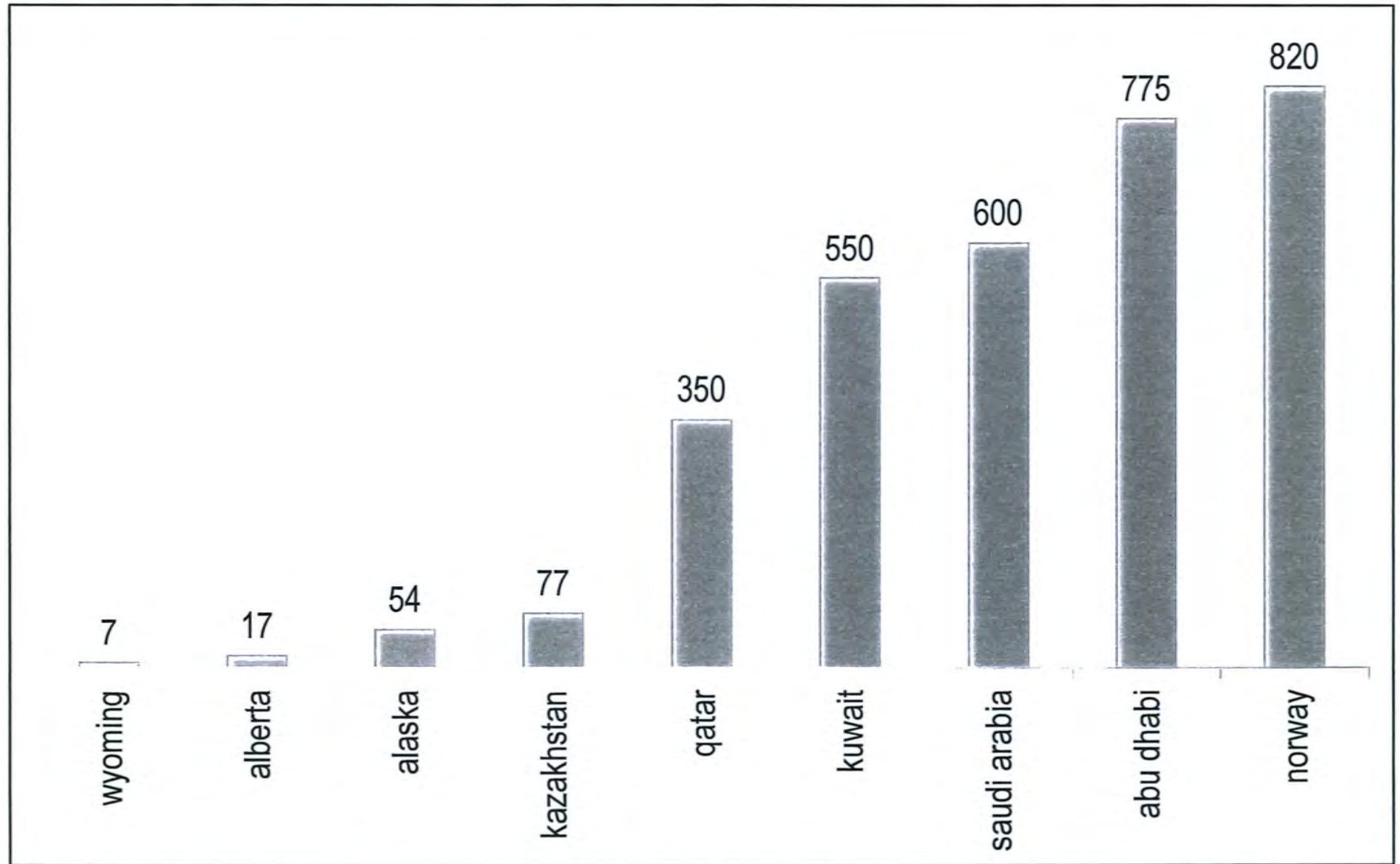


The Alaska situation:  
an outside perspective

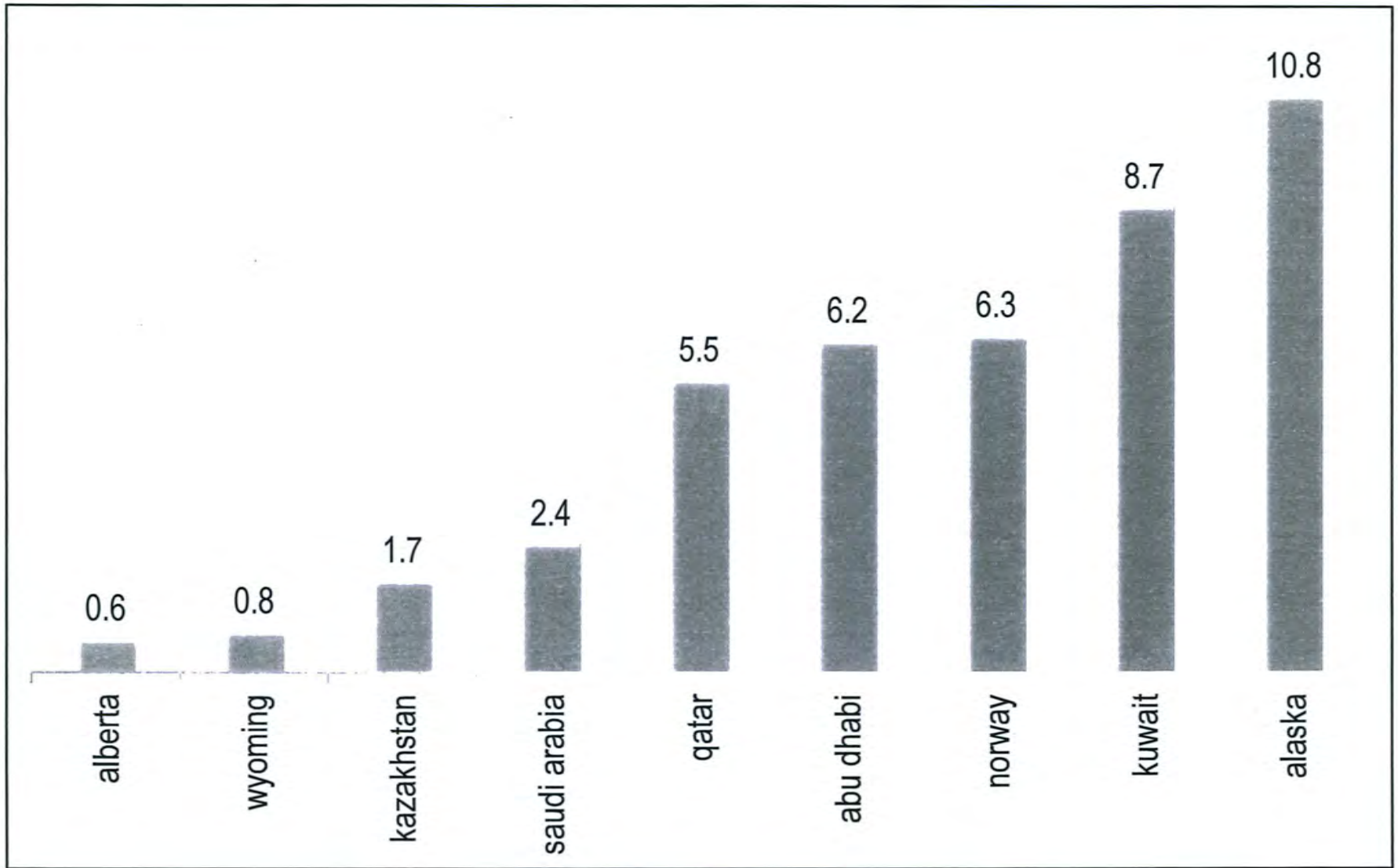
# Oil's % of revenue & fiscal break-even price



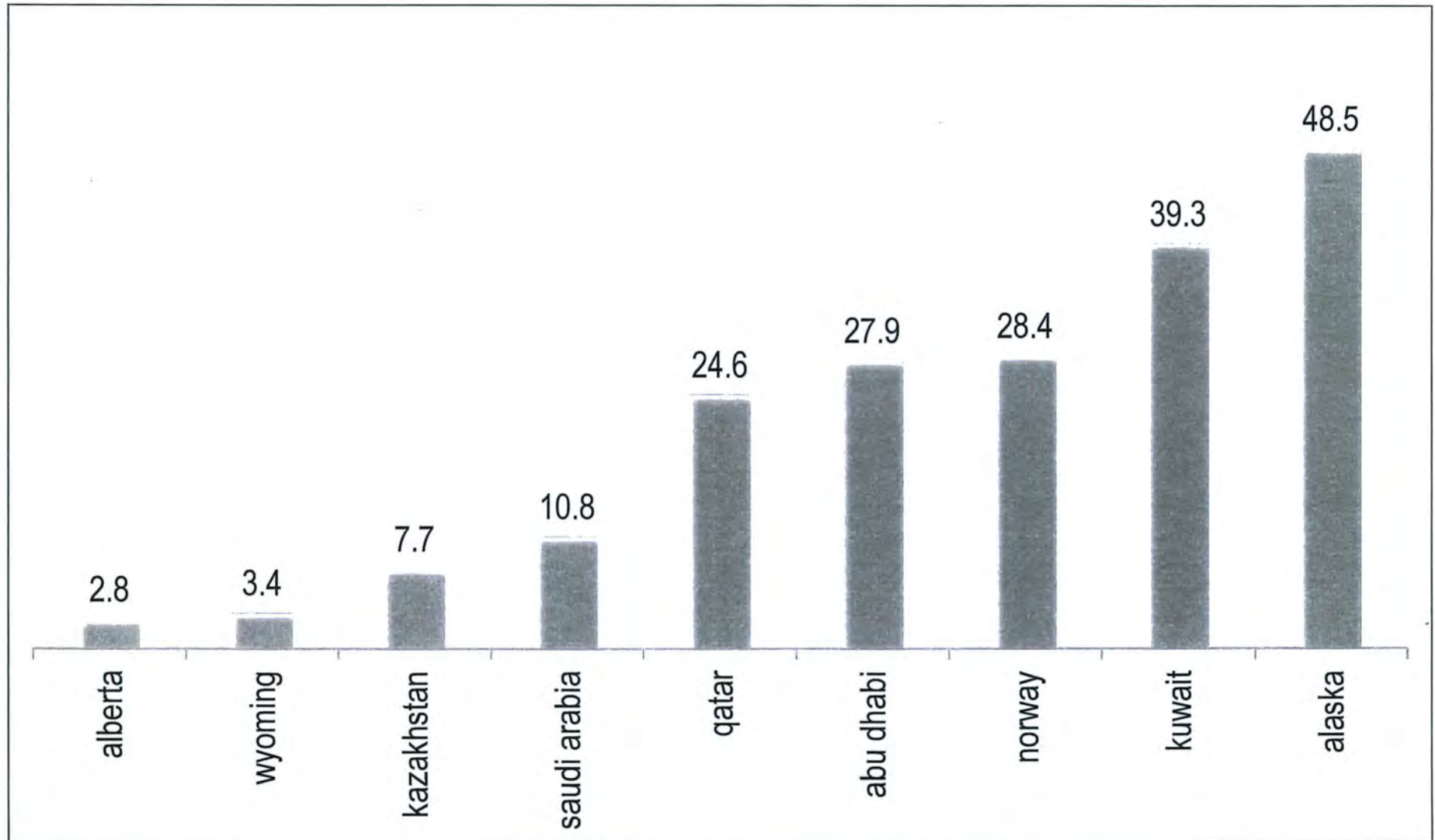
# SWF assets under management



# Size of assets relative to budget



# Notional sustainable draw as a % of budget



Note: sustainable draw assumed to be 4.5% per annum

# Alaskan strengths and weaknesses

	Like	Dislike
Size of savings	✓✓✓	
Size of accessible buffers		XX
Fiscal dependence on oil		XXX
Existence of saving rule	✓	
Appropriateness of fiscal rule		XX
Prospects for raising non-oil revenue (long term)	?	
Prospects for raising non-oil revenue (near term)		?
Long-term viability and profile (production)		XX
Fund governance structure and independence	✓✓✓	
Fund investment style (relative to mandate)	✓✓	
Support for fund staffing needs		XX



## The sustainable SWF model: key aspects

# What are resource-based SWFs really about?

The most disadvantageous lottery in the world  
**Adam Smith**

## Saving

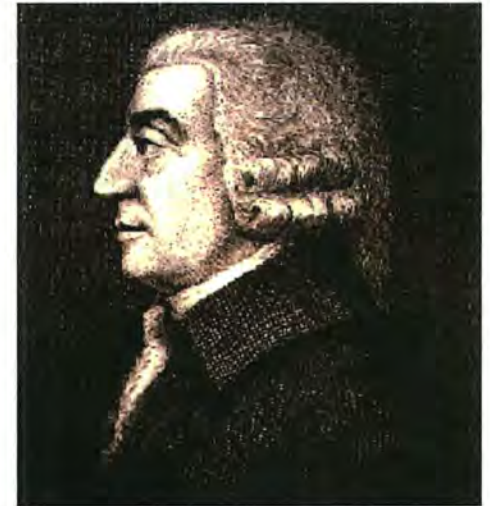
- Transforming a depleting asset & income stream
- Unmanageably large windfall

## Macroeconomic and fiscal stabilization

- Decoupling spending from commodity cycle
- Volatility moves from the budget to the funds

## Preventing waste and bad investments

- Boom-bust cycle, with “absorptive capacity” constraints
- White elephants



# Oil to equities

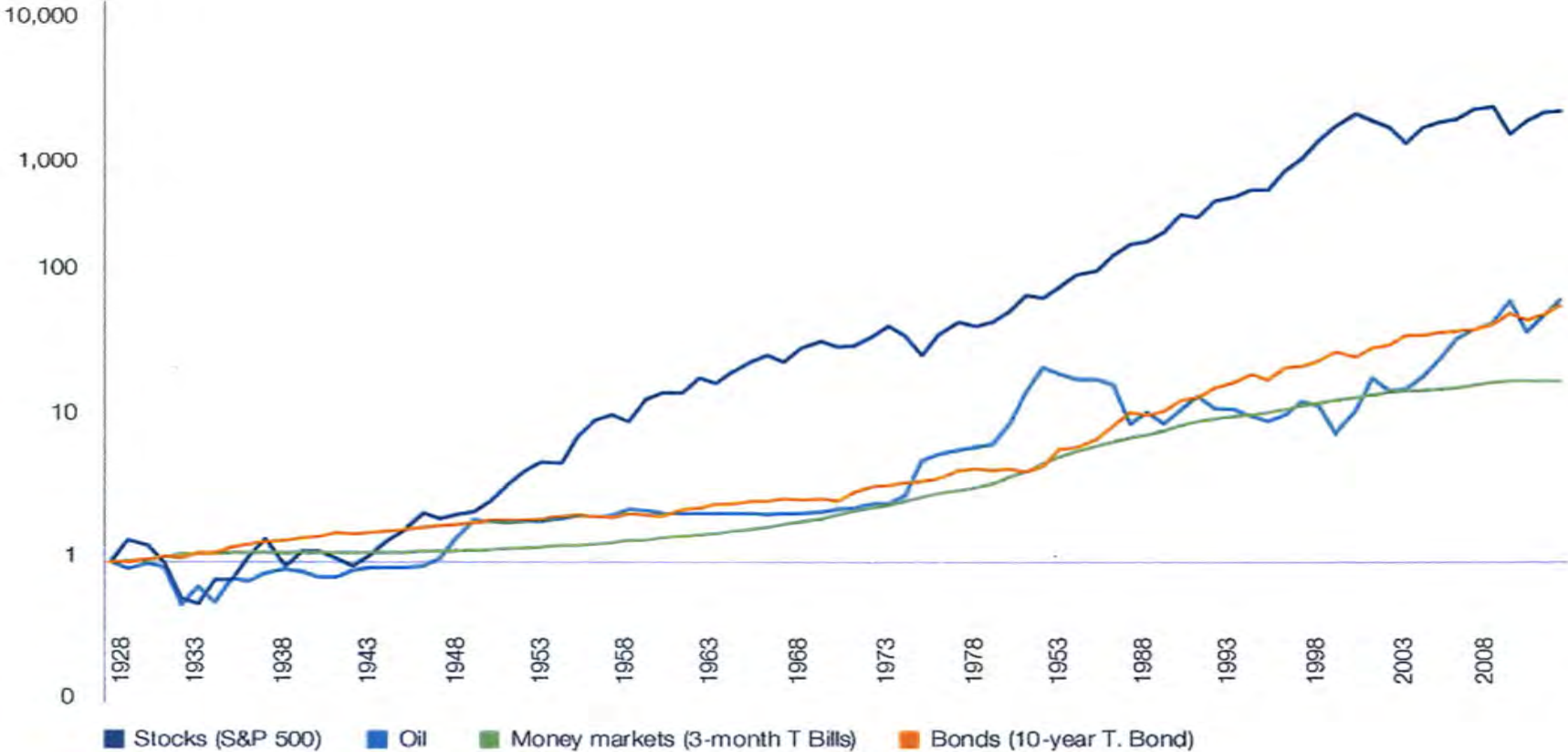
Financial assets have had much better risk-adjusted returns than oil, historically

- Oil: the risk of stocks, with the return of bonds
- Even more compelling when you think of total wealth into a portfolio

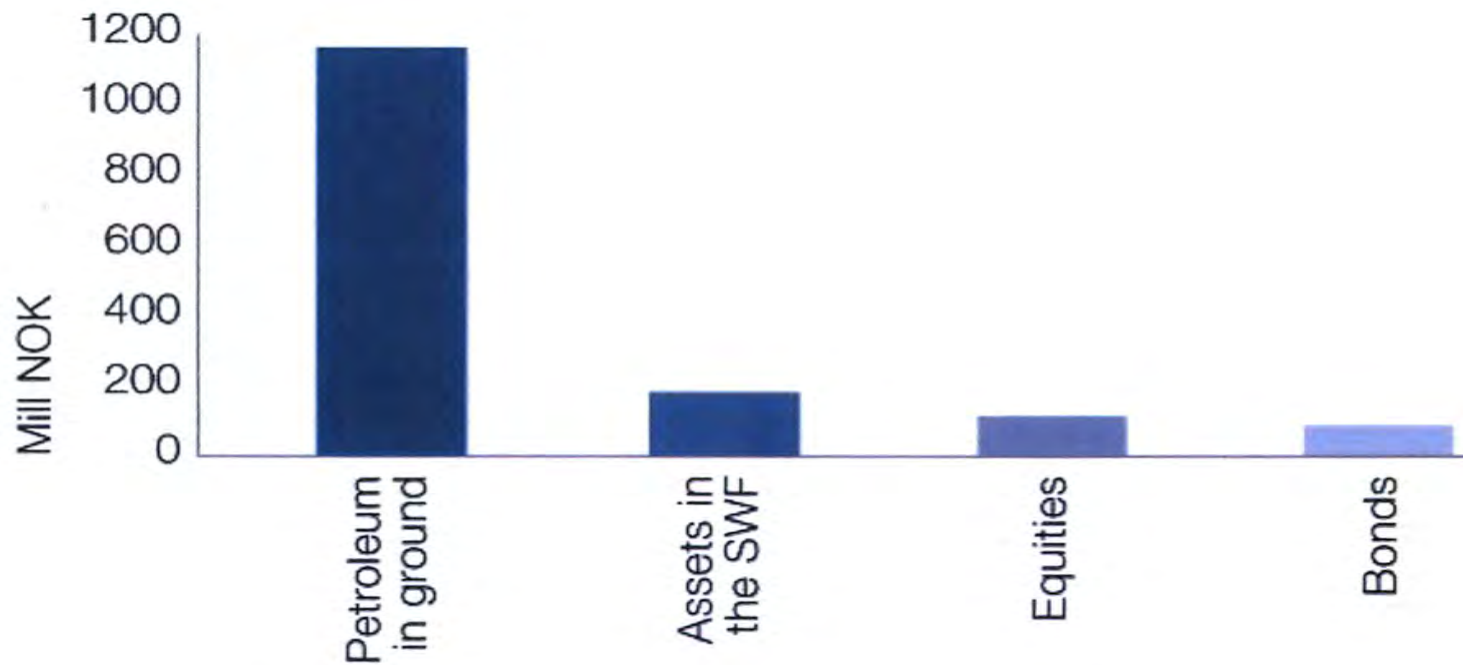
Transforming resource wealth into financial capital has (historically) been rewarded

- Despite having a \$900bn SWF, Norway still holds more wealth in subsoil assets
- That is perceived as a massive national risk

# Oil to equities: what would you rather hold?



# Oil to equities: what would you rather hold?



# Key elements of a rule-based SWF model

Saving rule: how much to transfer to SWF, and when?

- Transfer to the SWF in general
- And potentially between stabilization fund (liquid, safe assets) and savings/income fund (illiquid, risk assets)

Spending rule: how much to transfer from SWF, and when?

- Depends to fund's purpose: stabilization, savings and income
- Short-term stabilization, long-term "endowment" income and/or locked-up savings for the future

# Why have a rule?

Like all rules, the idea is to constrain discretion

- Particularly in boom-bust oil-rich states, memories tend to be short
- Human ability to forecast oil prices (and revenues) are extremely limited

Fiscal rule is “symmetric” and “counter-cyclical”

- Real, not partial, decoupling
- Constraining spending growth in boom times
- Allowing sustainable, rule-based draws from SWFs in leaner times

Expectation management and credibility of medium- to long-term fiscal policy

- Ratings agencies
- Businesses and investors
- Public



## The changing nature of fiscal rules

# Existing approaches to rules

## Rule-of-thumb measures

- Fixed percentage (for example, 20% of revenues)
- Deviation from moving average (revenue or price)
- Reference-price (above and/below \$75)

## Rule-of-thumb measures better than nothing, but...

- Specific problems: procyclicality, setting “right” reference price?
- General problem: these are “accumulation rules”, but not integrated with budget
- Offer inadequate counter-cyclical decoupling

# A fiscal rule for resource-based SWFs

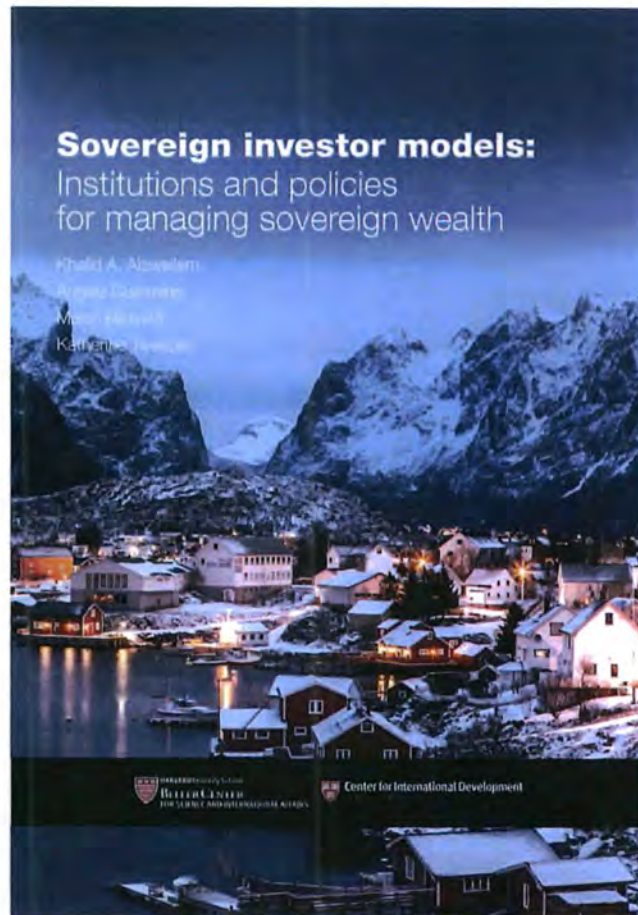
Based on Harvard Prof. Ricardo Hausmann's work for resource-rich governments

- Rule expresses critical policy choices around the use of volatile and finite resource revenues
- Finding a balance between spending, stabilization and saving

Model is flexible to different contexts and country needs

- Different revenue scenarios, assumptions and shocks
- Different assumed SWF returns and volatilities
- Spending rates
- Dynamics: spending now versus the future

# Harvard research



## Fiscal rules for resource-based SWFs

- Rule of thumb measures: suboptimal (ie. Alaska)
- Better to have an integrated, dynamic and rule-based framework

## Model

- Rule-based framework for savings, spending and stabilisation

## Governance and implementation

- Rules for resource-based SWFs
- The role and structure of the board
- Institutional positioning: arm's length independence, the central bank model, etc.

# Intuitive overview

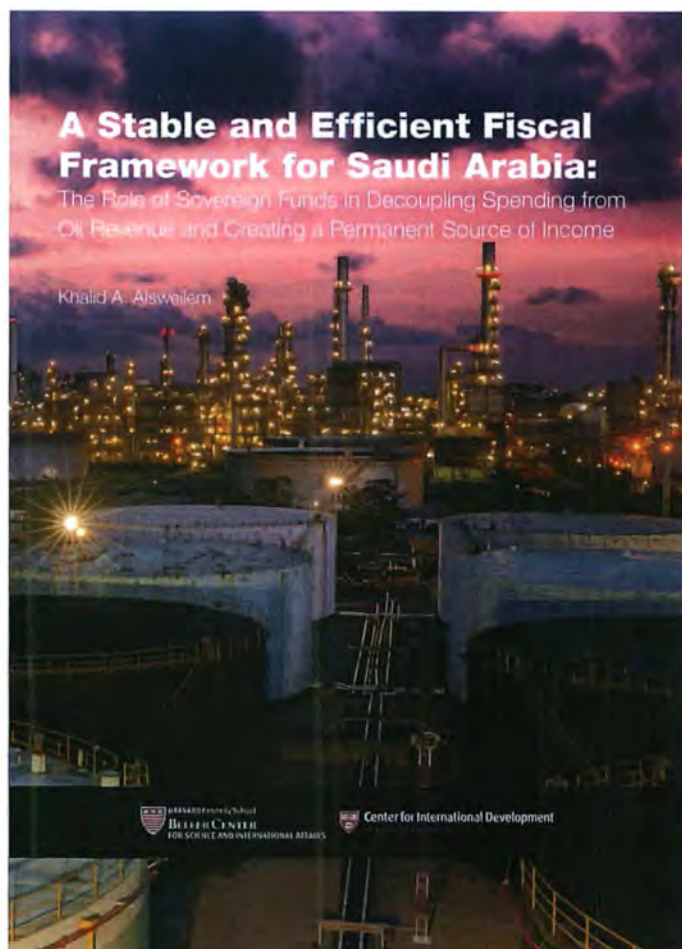
Several conceptual departures from rule-of-thumb approach

1. Resource revenues flow first to the fund, then via a rule-based spending policy, to the budget;
2. The fund – rather than the budget – bears the “burden of adjustment” to positive or negative oil-revenue shocks;
3. Spending is decoupled from annual oil-revenue volatility
4. Rule ensures that spending only adjusts partially and with a lag, via a change in the level of the fund:
  - NOTE: this holds for positive and negative oil price shocks



## The Saudi Report: a more detailed look

# Saudi Arabian report



## The basic economics (starting point)

- World's largest oil producer
- Decades of (cheap) oil reserves
- \$850bn in reserves

## What on earth could go wrong?

- Oil dependence: high and rising
- Volatility in revenue and capital spending
- Reserves at risk: rising breakeven
- Uncertain long-term oil-revenue trends
- Rising long-term spending pressure

## Assets accumulated is *ad hoc*

- Spending and saving decisions not anchored by a rule-based framework

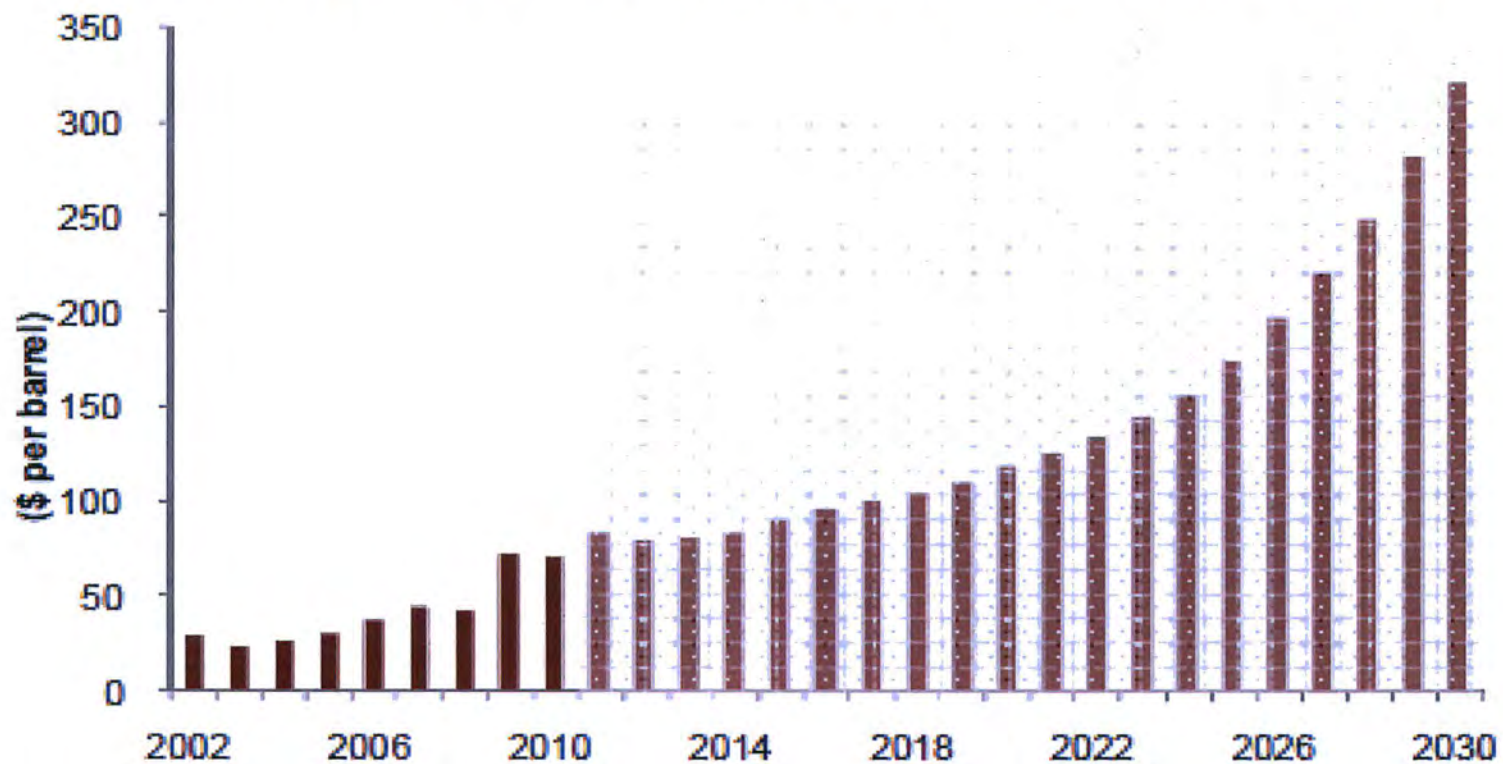
# Saudi Arabia's problems: lessons for Alaska?

<b>COUNTRY</b>	<b>ESTIMATED OIL PRICE REQUIRED TO BALANCE 2015 BUDGET</b>
Norway	\$40
Kuwait	\$54
Abu Dhabi	\$55
Russia	\$105
Saudi Arabia	\$106
Nigeria	\$122
Iran	\$131
Algeria	\$131
Venezuela	\$160

Sources: International Monetary Fund (2014b), except for Nigeria, Russia and Venezuela (Deutsche Bank, 2014) and Norway (Fitch Ratings, 2014).

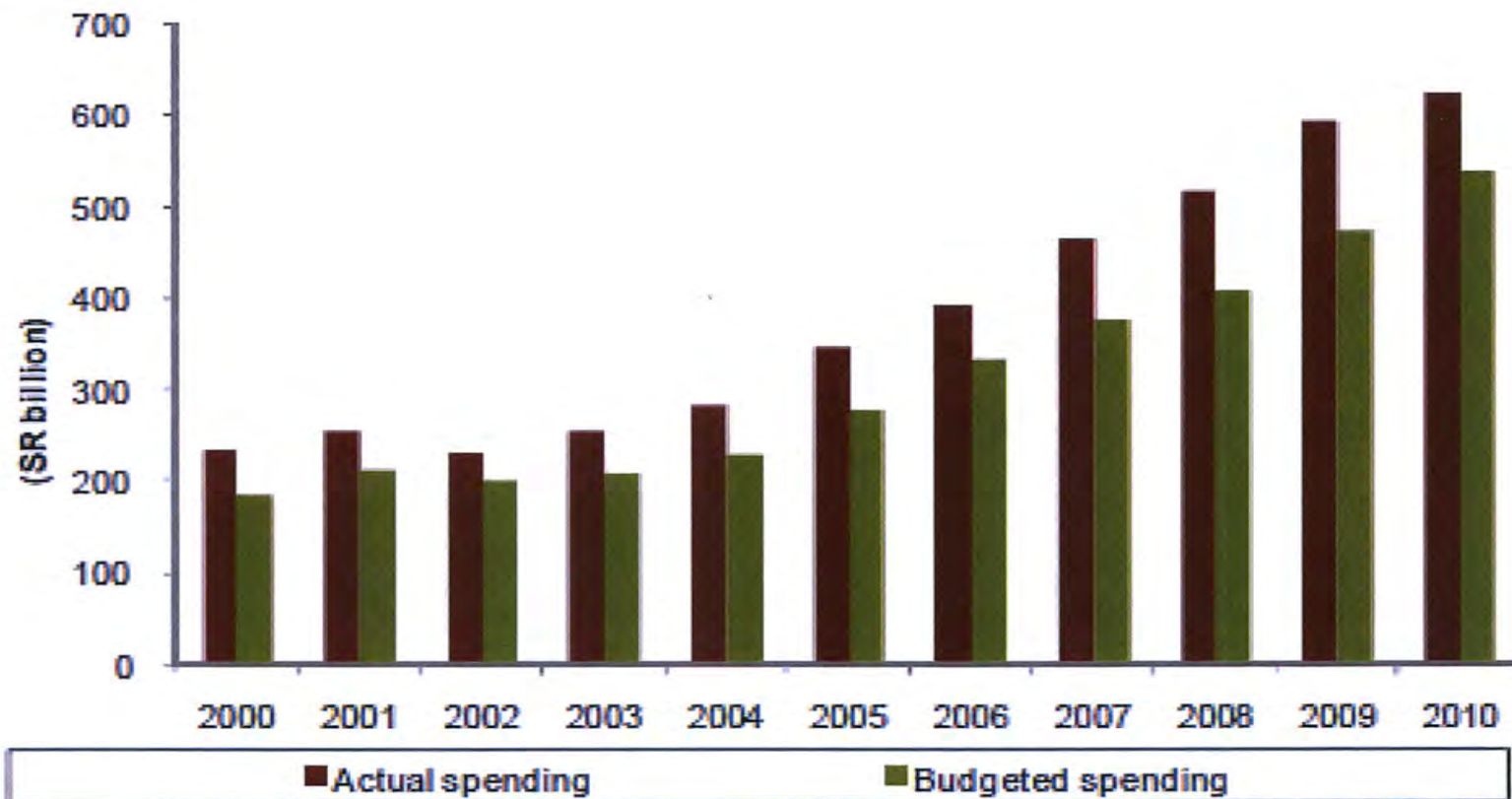
# Saudi Arabia's problems: lessons for Alaska?

**Projected breakeven oil price**  
(Saudi export crude; forecasts in shaded area)



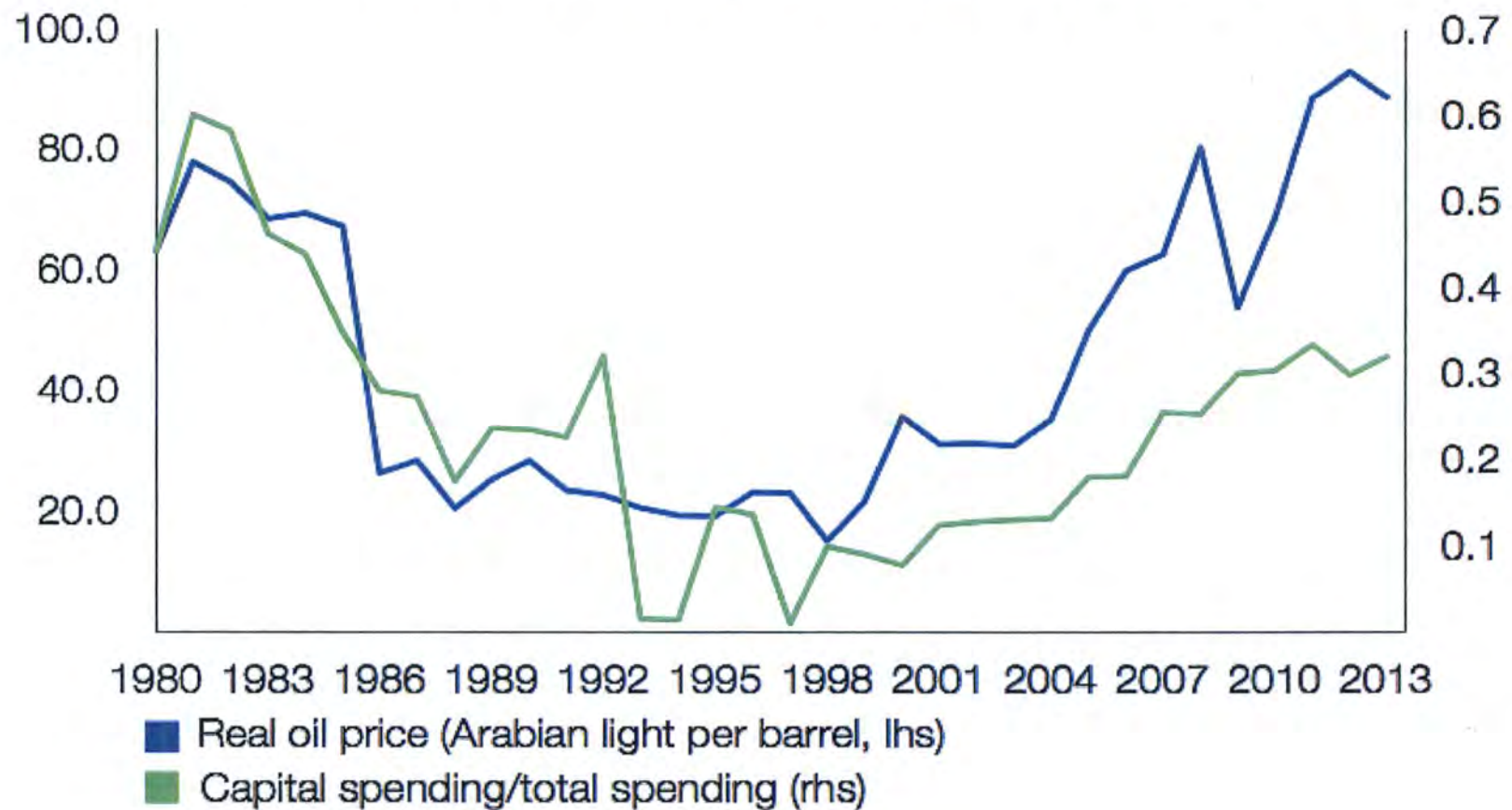
# Saudi Arabia's problems: lessons for Alaska?

## Budgeted and actual government spending



# Saudi Arabia's problems: lessons for Alaska?

## Oil-driven cyclicality in capital spending



# Policy recommendations: Saudi Arabia

## Establishment of savings and spending rule

- Under the jurisdiction of the Supreme Economic Council
- Modelled impact of specific fiscal rules on Saudi government finances
- Key message: don't delay further...delays are costly (have already been)

## Proposed the formalisation of two sovereign funds

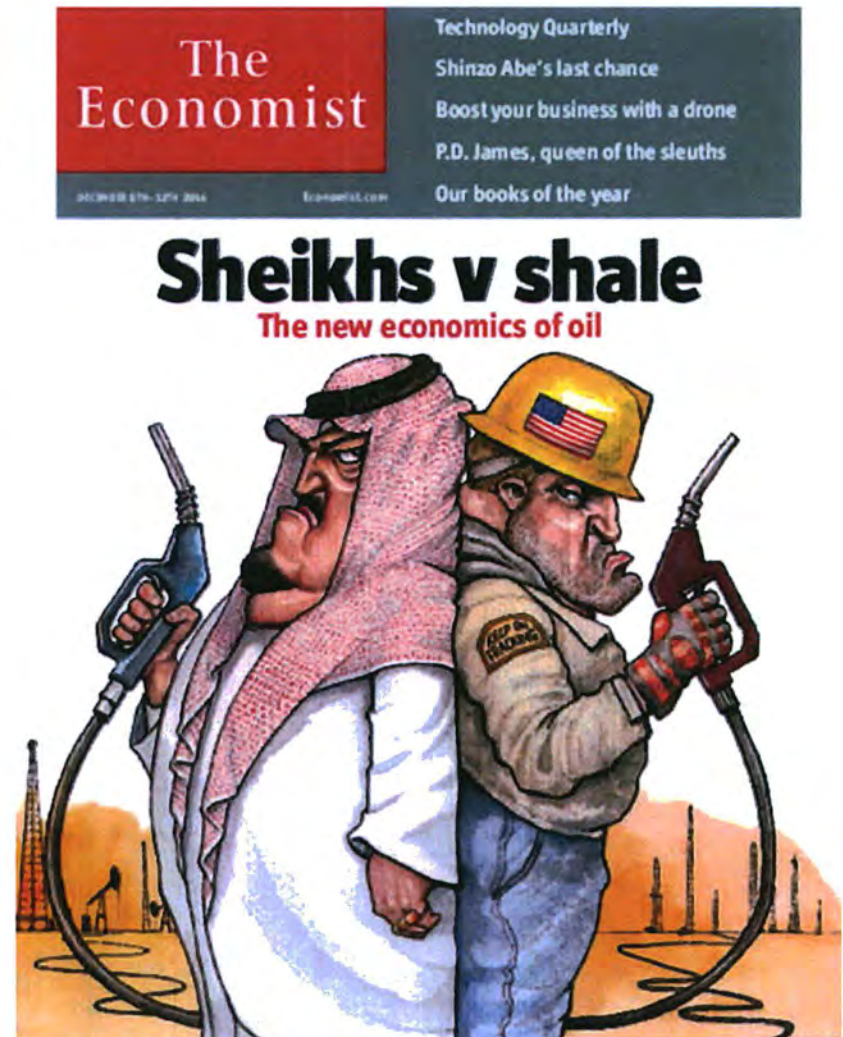
- Stabilisation Fund: with \$250bn in initial capital
- Saudi Future Generations Fund: with \$500bn in initial capital

## Suggested governance arrangements for both funds

- Stabilisation to remain with SAMA (central bank), reporting to MoF
- Future Generations Fund to be managed by new entity, with:
- Governing Council: Supreme Economic Council
- Board of Directors: independent, fixed-term appointments
- Management authority: led by Senior Executive

# Implications for Saudi energy policy

- Royal family and key ministers convinced US shale is a flash in the pan
- Always been much more concerned about Iran and Iraq production increases



# Implications for Saudi energy policy

Willing to engage in all-out price war to regain market share, no matter the fiscal cost

- Deeply scarred by past episodes of uncoordinated OPEC policy
- Have enough gas in the tank to handle a 2- to 3-year oil slump

Burn through reserves, cut capital spending and raise debt

- Rather than cut production and be the swing producer of old
- Already gone through \$150bn in previously-accumulated reserves
  - Most recently: sale of parts of Saudi Aramco

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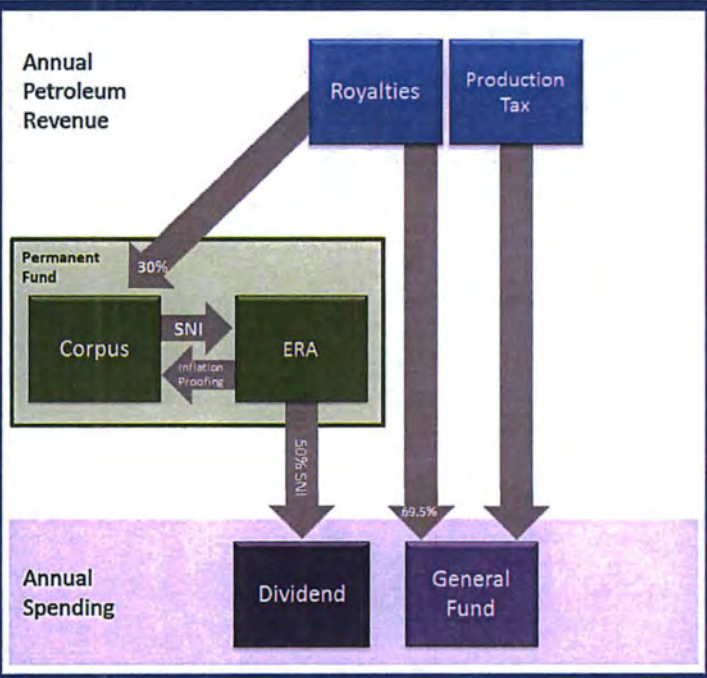
prepared by: DOK

	Status Quo	SB 114	CS SB114 (with dividend amendment)	APFPA (SB128)
<b>Savings Rule</b>				
Royalties	30% to corpus Remainder to UGF	25% to corpus Remainder to UGF	25% to corpus Remainder to UGF	25% to corpus Remainder to ERA
Production Taxes	To UGF	To UGF	To UGF	To ERA
PF Investment Income	To ERA	To ERA	To ERA	To ERA
<b>Protection Rule</b>				
Corpus	Constitutionally Protected	Constitutionally Protected	Constitutionally Protected	Constitutionally Protected
Inflation Proofing Transfer to Corpus	Inflation proofing is calculated and transferred to the corpus annually	Inflation proofing transfer repealed	Funds in the ERA over 4 times the POMV draw are transferred to the corpus	Funds in the ERA over 4 times the fixed draw are transferred to the corpus
ERA Durability	No rule	No rule	The dividend formula is reviewed periodically. However, the durability of the ERA is uncertain because dividends are not accounted for in the "4 times draw" rule.	The draw is the subject of a review and adjustment process every 4 years. Incoming revenue is put in the ERA until it reaches 4 times the draw to ensure the account is not depleted in low revenue years
<b>Growth Rule</b>				
By inflation	Yes. Maintain value of corpus	Yes, but uncertain because of dividend floor	No, because of dividend	Yes. Maintain value of \$55 billion
Over inflation	By an amount equal to 30% of royalties	No growth over inflation anticipated	No growth over inflation anticipated	From revenues resulting from unaccounted for resource development projects
<b>Spending Rule</b>				
Royalties (those not deposited in corpus)	Spending not limited (UGF)	Spending not limited (dividend)	15% (dividend) Spending of remainder not limited (UGF)	50% (dividend)
Production Tax	Spending not limited (UGF)	Spending not limited (UGF)	Spending not limited (UGF)	\$3.3 billion (UGF)
Permanent Fund	½ realized earnings spent (dividend)	5% of fund's value spent (UGF) + unknown amount for the dividend floor	Amount equal to 4.5% of fund's value, less petroleum revenue over \$1B spent (UGF) + unknown amount for the dividend	
<b>Volatility Rule</b>				
UGF Spending	Production tax and royalty volatility	Production tax and investment volatility	Production tax, royalty, and investment volatility; But, smoothing between \$1B and \$3.5B of petroleum revenue by reducing POMV	STABLE

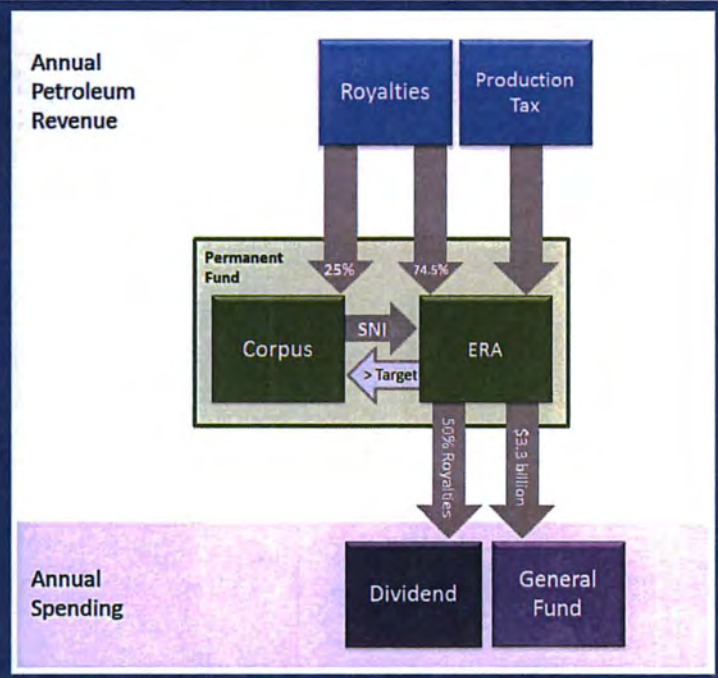
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prepared by DUK

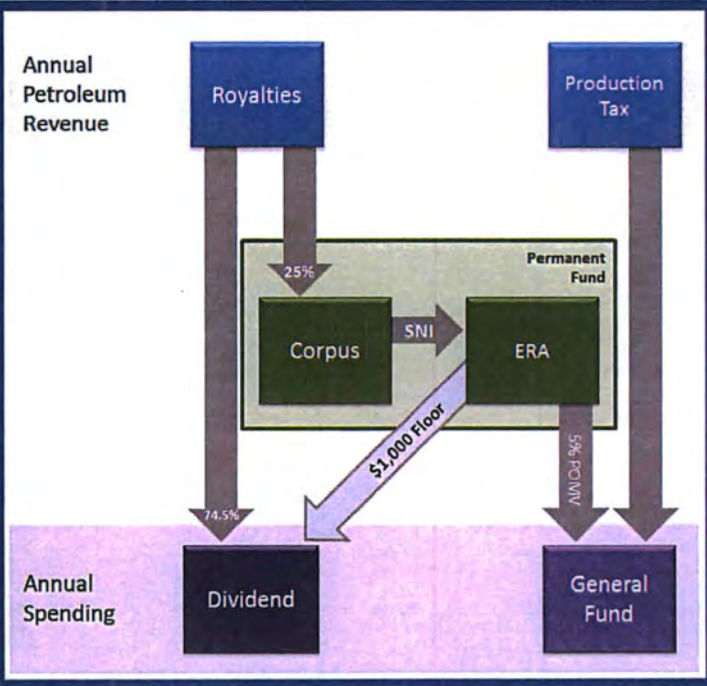
### Status Quo



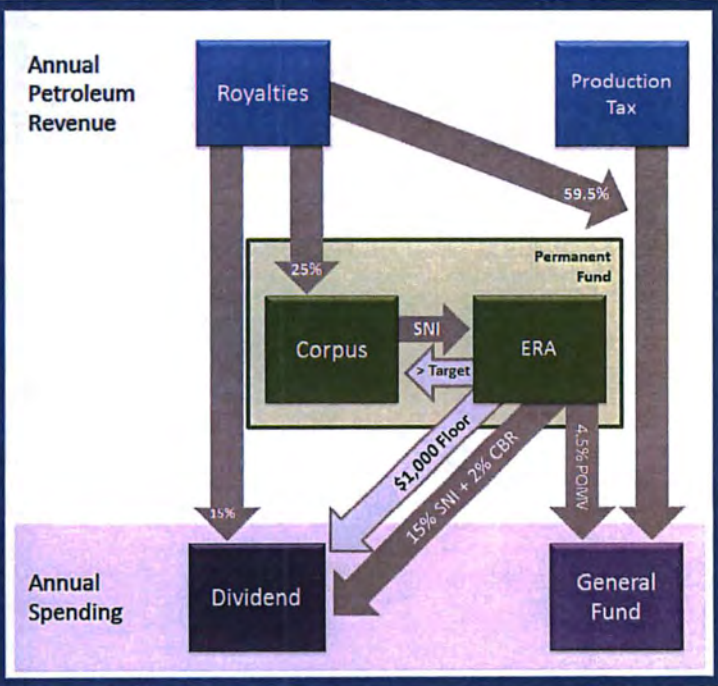
### APFPA (SB 128)



### SS SB 114



### Work Draft CSSS SB 114 (STA) & Am. V.I.



9



THE STATE  
of ALASKA

GOVERNOR BILL WALKER

Department of Law

CIVIL DIVISION

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January 25, 2016

Honorable Representative Mark Neuman  
Co-Chair of the House Finance Committee  
Alaska State House of Representatives  
Alaska State Capitol, Room 505  
Juneau, Alaska 99801

Honorable Representative Steve Thompson  
Co-Chair of the House Finance Committee  
Alaska State House of Representatives  
Alaska State Capitol, Room 515  
Juneau, Alaska 99801

Re: Issue raised relating to the CBR sweep (HB 245)

Dear Co-Chairs and Members of the House Finance Committee:

We understand an issue has been raised as to whether the permanent fund earnings reserve account ("ERA") must be "swept" into the Constitutional Budget Reserve ("CBR") (art. IX, sec. 17(d) of the Alaska Constitution) in order to repay the CBR for prior appropriations from the budget reserve fund under the new framework set forth in the proposed Alaska Permanent Fund Protection Act ("APFPA"). For the reasons set forth below, it is our opinion that the ERA would not be subject to the CBR sweep.

**I. Constitutional Budget Reserve**

The CBR was established by constitutional amendment in 1990 at article IX, section 17 of the Alaska Constitution. There are four subsections to this constitutional provision:

(a) There is established as a separate fund in the State treasury the budget reserve fund. Except for money deposited into the permanent fund under section 15 of this article, all money received by the State after July 1, 1990, as a result of the termination, through settlement or otherwise, of an administrative proceeding or of litigation in a State or federal court involving mineral lease bonuses, rentals, royalties, royalty sale proceeds, federal mineral revenue sharing payments or bonuses, or involving taxes

imposed on mineral income, production, or property, shall be deposited in the budget reserve fund. Money in the budget reserve fund shall be invested so as to yield competitive market rates to the fund. Income of the fund shall be retained in the fund. Section 7 of this article does not apply to deposits made to the fund under this subsection. Money may be appropriated from the fund only as authorized under (b) or (c) of this section.

(b) If the amount available for appropriation for a fiscal year is less than the amount appropriated for the previous fiscal year, an appropriation may be made from the budget reserve fund. However, the amount appropriated from the fund under this subsection may not exceed the amount necessary, when added to other funds available for appropriation, to provide for total appropriations equal to the amount of appropriations made in the previous calendar year for the previous fiscal year.

(c) An appropriation from the budget reserve fund may be made for any public purpose upon affirmative vote of three-fourths of the members of each house of the legislature.

(d) If an appropriation is made from the budget reserve fund, until the amount appropriated is repaid, the amount of money in the general fund available for appropriation at the end of each succeeding fiscal year shall be deposited in the budget reserve fund. The legislature shall implement this subsection by law.

## **II. The Permanent Fund Earnings Reserve Account**

The earnings reserve account is "established as a separate account in the fund." AS 37.13.145(a). The "fund" is defined in statute as "the Alaska permanent fund established under art. IX, sec. 15 of the Constitution of Alaska." AS 37.13.900(3).

## **III. *Hickel v. Cowper*, 874 P.2d 922 (Alaska 1994)**

Under art. IX, sec. 17(b), an appropriation can be made from the CBR by a majority vote when the "amount available for appropriation" for the upcoming fiscal year is less than the amount "appropriated for the previous fiscal year." The Alaska Supreme Court in *Hickel v. Cowper*, 874 P.2d 922 (Alaska 1994) addressed the definition of monies "available for appropriation" under art. IX, sec. 17(b). The Court held as follows:

"amount available for appropriation" within the meaning of article IX, section 17 of the Alaska Constitution includes all monies over which the legislature has retained the power to appropriate and which require further

appropriation before expenditure. In addition, all amounts actually appropriated, whether or not they would have been considered available prior to appropriation, are available within the meaning of section 17. Illiquid assets, such as land and unexploited natural resources, are not available so long as they remain illiquid. For these reasons, trust receipts are available for appropriation, as are funds like the Railbelt energy fund and the educational facilities maintenance and construction fund, which are not available for expenditure without additional appropriations. In contrast, the oil and hazardous substance release response fund is not counted as available because the entire balance of the fund may be expended at any time without further legislative action. ....*Finally, the permanent fund earnings reserve account must be counted as available for appropriation, because appropriations may be made from it and it is not subject to expenditure without legislative action.*

*Id.* at 935 (emphasis added). Significantly, the Court in *Hickel* acknowledged a distinction between the amount available for appropriation under subsection (b), which would include the ERA, and the "payback" provision in subsection (d) which was limited to funds in the general fund and thus would not include the earnings reserve account. The Court stated as follows:

*the payback provision in section 17(d) is limited to only those funds which are 'available for appropriation' and 'in the general fund.' Thus, available amounts outside the general fund, such as the earnings reserve account, need not be deposited in the budget reserve.*

*Id.* at 936, n. 32 (emphasis added).

#### **IV. The impact on the earnings reserve account resulting from the proposed Alaska Permanent Fund Protection Act and the fiscal year 2017 operating budget**

The proposed APFPA seeks to establish a stable budget framework by adopting a set of rules that would result in a sustainable yearly draw of money from the ERA to the general fund to support state operating expenses. The APFPA also provides for additional revenues in the form of royalties and oil and gas production taxes to be appropriated to the Alaska permanent fund and to the ERA in order to ensure that a sustainable yearly draw can be made from the ERA to the general fund. Additionally, the bill changes the calculation of money to be withdrawn from the ERA to pay permanent fund dividends so that the amount withdrawn is based on an amount equal to fifty percent of the resource royalties received by the state. The proposed fiscal year 2017 operating budget seeks appropriations along the model established under the APFPA. Specifically, the operating

budget bill seeks an appropriation of \$3.3 billion dollars from the ERA to the general fund. It also seeks to appropriate 24.5 percent of resource royalties to the ERA, along with an additional 50 percent of resource royalties to the ERA in order to provide for dividend payments from the ERA. The proposed fiscal year 2017 operating budget also seeks to appropriate one hundred percent of oil and gas production tax revenue to the ERA next fiscal year.

## V. Analysis and Conclusion

The issue is whether the ERA would be subject to a sweep to the CBR under art. IX, sec. 17(d). As set forth above, in *Hickel v. Cowper* the Alaska Supreme Court acknowledged a distinction between the definition of monies available for appropriation under art. IX, sec. 17(b) and monies subject to sweep under the payback provision in art. IX, sec. 17(d). As discussed above, the Court noted that amounts outside the general fund were not subject to the sweep and it specifically identified the ERA as an account outside the general fund that would not need to be deposited into the CBR under the sweep provision. *Id.* at 936, n. 32.

Although the question would appear to be settled based on the plain language in the constitution and the Court's decision in *Hickel*, it appears the Division of Legislative Finance is assessing whether the ERA should be considered subject to the CBR sweep under the framework proposed in the Alaska Permanent Fund Protection Act. This consideration appears to be based on the following: the account would no longer be comprised only of income from the permanent fund, and the account would be used to pay state government operating expenses rather than being a fund restricted to the payment of dividends. Although both of these statements are true, this information does not transform the ERA into a fund within the general fund. The proposed legislation does not seek to change the existing statutory provisions<sup>1</sup> that clearly identify the ERA as a fund in the permanent fund. This is important because the sweep provision in art. IX, section 17(d) expressly limits the funds subject to the sweep to those monies that are "in the general fund." As the Court in *Hickel* noted when it was interpreting Section 17: "Our analysis of a constitutional provision begins with, and remains grounded in, the words of the provision itself. We are not vested with the authority to add missing terms or hypothesize differently worded provisions in order to reach a particular result." *Id.* at 927-928. Moreover, although the ERA under the proposed legislation will be used to pay for general government operating expenses through an appropriation to the general fund, the ERA has always been available to pay for government operating expenses even if it has not been traditionally used for that purpose. In fact, the Court in *Hickel* held that the ERA was available for appropriation by the legislature.

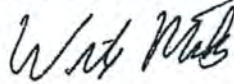
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<sup>1</sup> AS 37.13.145(a); AS 37.13.900(3).

Consequently, based on the constitutional language in section 17(d), the existing statute establishing the earnings reserve account in the permanent fund, the Court's analysis in *Hickel*, and the other reasons set forth above, it is our opinion that the earnings reserve account "need not be deposited in the budget reserve" under the CBR sweep provision. *Id.* at 936, n. 32.

Sincerely,

CRAIG W. RICHARDS  
ATTORNEY GENERAL



By:

William E. Milks  
Senior Assistant Attorney General

WEM/ajh

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**Cases and Attorney General Opinions (Formal and Informal)**  
**Regarding the Permanent Fund and the Constitutional Budget Reserve**

Created by Department of Law

February 3, 2016


The following are the cases and opinions provided to the Senate State Affairs Committee on the topics of the permanent fund and the constitutional budget reserve. Please note these are only representative of the opinions and were selected for relating most closely to the concerns that have been raised relating to the Alaska Permanent Fund Protection Act. More opinions can be provided if further information is needed.

**CBR**

1. ***Hickel v. Halford*, 872 P.2d 171 (Alaska 1994)** [addresses the definition of “administrative proceeding”]
2. ***Hickel v. Cowper*, 874 P.2d 922 (Alaska 1994)** [seminal case on interpretation of the Constitutional Budget Reserve (CBR) and holding that the earnings reserve account is available for appropriation for purposes of determining what vote is needed to spend from the CBR but the ERA is not included in the pay-back provisions of the CBR]
3. **May 18, 1995, Inf. Op. Att’y Gen., File Nos. 663-95-0475; 663-95-0474** [addressing definition of “administrative proceeding”]

**Permanent Fund**

4. **August 31, 1977, Inf. Op. Att’y Gen., File No. J-66-106-78** [addresses an extra appropriation to the permanent fund]
5. **September 16, 1977, Inf. Op. Att’y Gen., File No. J-66-107-78** [addresses inflation]
6. **March 10, 1983, Inf. Op. Att’y Gen., File No. 366-484-83** [addresses appropriation of income from and deposits into the permanent fund]
7. **February 6, 1984, Inf. Op. Att’y Gen., File No. 366-405-84** [addresses the appropriation of money from the permanent fund income to replace public assistance payments to individuals lost because of the receipt of permanent fund dividends]
8. **February 12, 1987, Inf. Op. Att’y Gen., File No. 663-87-0356** [addresses an extra appropriation made to the principal of the permanent fund]

 KeyCite Yellow Flag - Negative Treatment  
Opinion Amended on Rehearing April 18, 1994  
872 P.2d 171

Supreme Court of Alaska.

Walter J. HICKEL, Governor of the State of Alaska, Darrel J. Rexwinkel, Commissioner of the Alaska Department of Revenue, and the State of Alaska, Appellants and Cross-Appellees,

v.

Rick HALFORD, President of the Alaska State Senate, Drue Pearce, Steve Frank, Bert Sharp, Mike Miller, Randy Phillips, Tim Kelly, Loren Leman, George Jacko, Steve Rieger, and Robin Taylor, comprising the Senate Majority of the Eighteenth Alaska Legislative Session, Appellees and Cross-Appellees,

and

Steve Cowper, Appellee and Cross-Appellant.

Nos. S-6124, S-6134.

April 4, 1994.

As Amended on Limited Grant of Rehearing April 18, 1994.

Proceedings were commenced to resolve disputes about the state budget reserve fund containing money received by state from termination, through settlement or otherwise, of administrative proceeding or litigation involving mineral lease bonuses, rentals, royalties, or taxes imposed on mineral income, production, or property. The Superior Court, Third Judicial District, Anchorage, John Reese, J., ordered the state to restore funds that had been deposited in the general fund, rather than in the budget reserve fund. Appeal and cross appeal were taken, and expedited review was granted. The Supreme Court, Matthews, J., held that: (1) assessment issued by Department of Revenue (DOR) satisfies all essential elements of an "administrative proceeding" under the state constitutional provision creating the state budget reserve fund; (2) an audit letter was not sufficient to initiate an administrative proceeding; and (3) the decision could be given retroactive effect.

Affirmed and remanded.

West Headnotes (7)

<sup>[1]</sup> **States**

↔ Special Funds

"Administrative proceeding," as used in state constitutional provision creating state budget reserve fund to contain money received by state from termination, through settlement or otherwise, of administrative proceeding or litigation involving mineral lease bonuses, rentals, royalties, or taxes imposed on mineral income, production, or property, involves adjudication-like proceeding to resolve existing dispute. Const. Art. 9, § 17(a); AS 44.62.360, 44.62.370.

2 Cases that cite this headnote

<sup>[2]</sup> **States**

↔ Special Funds

"Administrative proceeding," as used in state constitutional provision creating state budget reserve fund to contain money received by state from termination, through settlement or otherwise, of administrative proceeding or litigation involving mineral lease bonuses, rentals, royalties, or taxes imposed on mineral income, production, or property, requires sufficient written notice through document that serves function of complaint to specify nature of dispute and relief requested. Const. Art. 9, § 17(a); U.S.C.A. Const.Amends. 5, 14; AS 44.62.360, 44.62.370.

1 Cases that cite this headnote

<sup>[3]</sup> **States**

↔ Special Funds

"Administrative proceeding," as used in state constitutional provision creating state budget reserve fund to contain money received by state from termination, through settlement or otherwise, of administrative proceeding or

Gen., and Bruce M. Botelho, Atty. Gen., Juneau, for appellants and cross-appellees Hickel, et al.

G. Kent Edwards, Hartig, Rhodes, Norman, Mahoney & Edwards, Anchorage, for appellees and cross-appellees Halford, et al.

Douglas Pope, Wagstaff, Pope & Katcher, Anchorage, for appellee and cross-appellant Cowper.  
Before MOORE, C.J., RABINOWITZ, MATTHEWS and COMPTON, JJ., and BRYNER, J., Pro Tem.'

### OPINION

MATTHEWS, Justice.

This case requires us to interpret article IX, section 17 of the Alaska Constitution, which establishes the budget reserve fund.<sup>1</sup> \*173 The voters adopted article IX, section 17 in the 1990 general election. It was placed on the ballot after being passed by a legislative resolution approved by a two-thirds vote of each house of the 1990 legislature.

Section 17 requires deposit into the budget reserve fund of all money received by the State after July 1, 1990, "as a result of the termination, through settlement or otherwise, of an administrative proceeding or of litigation ... involving mineral lease bonuses, rentals, royalties ... or involving taxes imposed on mineral income, production, or property..." § 17(a). Appropriations from the fund require a super legislative majority, *i.e.*, three-fourths of each house. § 17(c). However, if the amount available for appropriation for a given fiscal year is less than the amount appropriated for the previous fiscal year, an appropriation from the budget reserve fund can be made by a majority vote of each house of the legislature. Such an appropriation is limited to the difference between the amount available for appropriation for the fiscal year and the amount appropriated "in the previous calendar year for the previous fiscal year." § 17(b).

The primary issue in this case is the meaning of the term "administrative proceeding" as used in article IX, section 17(a) with respect to mineral taxes. The dispute can only be understood in the context of the applicable statutory and administrative procedures for collection of such taxes.

For all taxes, the tax collection process begins with the filing of the return by the taxpayer. Oil and gas production returns must be filed monthly. AS 43.55.020-.030. Income tax returns must be filed

annually. AS 43.20.030. Payments of taxes due must accompany the tax returns. *See* AS 43.20.030; AS 43.55.020. The oil and gas audit division generally audits all taxpayers for all tax periods, with a single audit covering from one to three years, or twelve to thirty-six tax periods. The income and excise audit division also generally audits every oil and gas return filed under AS 43.20. When an audit is complete, the taxpayer is notified of any deficiency by a notice of assessment and demand for payment (hereinafter referred to as the assessment). This is provided for in AS 43.05.245. Assessments must be issued within three years after a return is filed or collection is barred. AS 43.05.260(a).

When a taxpayer receives an assessment, the taxpayer is presented with a number of choices. It may pay the taxes in accordance with the assessment; it may appeal the assessment within sixty days by filing a request for appeal under AS 43.05.240 and 15 AAC 05.010; or it may do nothing. If the taxpayer does nothing, the Department of Revenue (DOR), after the sixty-day period for appeal has expired, may proceed to levy on the taxpayer's property until the tax is collected. AS 43.05.270.

When a taxpayer files a request for appeal with DOR, it may request either an "informal conference" or a "formal hearing." AS 43.05.240(a)(b). If a taxpayer requests an informal conference and the conference does not resolve the dispute to the taxpayer's satisfaction, the taxpayer may request a formal hearing within thirty days after the decision resulting from the informal conference. AS 43.05.240(b)(2). If a taxpayer fails to request a formal hearing within thirty days after the decision of the informal conference, the informal conference decision becomes the final decision of DOR and it may be enforced as such. Informal conference decisions may not be appealed to the courts. AS 43.05.240(d); 15 AAC 05.020(c), .040. Where a formal hearing is requested, either following an informal conference or directly upon filing a request for appeal, the taxpayer is given a formal adjudicatory hearing. 15 AAC 05.030. If the taxpayer is dissatisfied with the result of the formal hearing, the taxpayer may appeal \*174 to the superior court within thirty days after the decision. AS 43.05.240(d).

At any point in this process DOR and the taxpayer may agree on the taxes owed, or the taxpayer may decide to pay the amount claimed by the State either as a result of the assessment, the informal conference decision, or the decision following a formal hearing. DOR has taken the position that funds received after a request for formal hearing must be deposited in the budget reserve fund while funds received before a request for formal hearing are paid into the State general fund. DOR, in other words,

particularly after calling the matter to the attention of the parties and affording them the opportunity to brief the issue.”), *reh'g granted*, 670 P.2d 707 (Alaska 1983). For this reason we have ordered supplemental briefing.

Supplemental briefs were submitted by the parties and additional oral argument was held. Both Gov. Cowper and the Senate Majority argue that an assessment begins an administrative proceeding and that a ruling to this effect should not be given only prospective effect. Gov. Cowper argues in addition to the questions ordered briefed that an audit letter which identifies the tax returns to be audited and the information and documents \*176 to be produced at the audit, rather than a subsequently occurring notice of assessment, is the beginning of an administrative proceeding. In addition, Gov. Cowper argues specifically with respect to a settlement with BP which included some years for which no assessment had been issued as well as some years for which an assessment and a notice of appeal had been issued, that, as to the pre-assessment years, the funds received should be included within the budget reserve fund because the funds were received “as a result of the termination ... of an administrative proceeding,” even though the particular years in question were not formally part of the administrative proceeding. The State agrees that these questions should be addressed.

The Senate Majority also seeks the resolution of an additional issue. The Senate Majority notes that in our order of January 27, 1994, we indicated that one of the attributes of an administrative proceeding included setting in motion “mechanisms prescribed by statute or regulation under which the dispute would ultimately be resolved.” It points out that with respect to royalty disputes as distinct from tax disputes, the State has indicated that the Department of Natural Resources does not have statutory or regulatory procedures by which such disputes are conducted. The State agrees that further guidance on this issue is warranted. Neither party, however, describes the dispute resolution mechanism pertaining to royalties.

We address first the basis for our conclusion that administrative proceedings possess the attributes we identified in the order of January 27th. Next, we conclude that in view of these attributes an administrative proceeding concerning back taxes begins when an assessment is issued. An audit letter does not mark the beginning of an administrative proceeding. We also conclude that our ruling that an administrative proceeding begins with an assessment should not be given solely prospective effect. With respect to the issues characterized by the BP settlement and the questions

concerning the procedures used in resolving royalty disputes, we express no opinion as the record before us is insufficient both in terms of underlying facts and development of legal issues for expression of any view. Finally, we hold that on the record before us, the superior court did not abuse its discretion by subjecting the accounting to a protective order, in light of the confidentiality requirements of AS 43.05.230. On remand, however, the superior court remains free to consider whether a more narrow protective order may adequately protect these concerns.

**1. Attributes of an Administrative Proceeding.**

<sup>[1]</sup> As noted, we set out the following as attributes of an administrative proceeding in our order of January 27, 1994:

1. A dispute must exist.
2. A document reflecting the fact of the dispute which serves a function similar to that of a complaint in a civil action, or an accusation or statement of issues under the Administrative Procedure Act, AS 44.62.360, 370, must be served by one party on the other party.
3. The document must set in motion mechanisms prescribed by statute or regulation under which the dispute will ultimately be resolved.

Although there is no single authority which concisely defines an administrative proceeding, examination of case law and Alaska statutes involving adjudicatory administrative proceedings demonstrates that these attributes are common to such proceedings.<sup>6</sup> The context in which the term administrative proceeding is used in section 17, the common meaning of the words, and evidence of legislative and voter intent and purpose also support the recognition of these attributes.

We have previously set forth the appropriate approach to interpreting constitutional language. “Constitutional provisions should be given a reasonable and practical interpretation in accordance with common sense. The court should look to the plain meaning and purpose of the provision and the intent of the framers.” \*177 *Arco Alaska, Inc. v. State*, 824 P.2d 708, 710 (Alaska 1992) (citation omitted); *see also Kochutin v. State*, 739 P.2d 170, 171 (Alaska 1987). “Adherence to the common understanding of words is especially important in construing provisions of the Alaska Constitution, because the court must ‘look to the meaning that the voters would have placed on its provisions.’ ” *Division of Elections v. Johnstone*, 669 P.2d 537, 539 (Alaska 1983) (quoting

Administrative Procedures Act (APA), AS 44.62.330-.630, clearly anticipate the existence of a dispute before action is taken. For example, an accusation under AS 44.62.360 must set out "the acts or omissions with which the respondent is charged, so that the respondent is able to prepare a defense." AS 44.62.360(1). Both the use of the word "charged" and the recognition of the need for a defense indicate the necessary existence of an underlying controversy or dispute. A statement of issues, as provided for in AS 44.62.370, anticipates that the respondent "must show compliance [with a statute or regulation] by producing proof at the hearing," and must specify "particular matters that have come to the attention of the initiating party and that would authorize a denial of the agency action sought." AS 44.62.370(a)(1)(2). The necessity of one party carrying a burden of production and the possibility that a request for a right or privilege may be denied also indicate the existence of an underlying dispute.<sup>15</sup>

Because a dispute exists in all adjudicatory proceedings, and because the language of section 17 and the voter pamphlet indicate that "administrative proceeding" meant a proceeding involving a dispute, the first essential attribute of an administrative proceeding is that a dispute must exist.

<sup>12]</sup> The second essential attribute of an administrative proceeding is that a document reflecting the fact of the dispute, which serves a function similar to that of a complaint in a civil action, or an accusation or statement of issues under the APA, must be served by one party on the other party.<sup>16</sup> This element is required in order to ensure that the procedures we recognize as administrative proceedings meet minimal due process requirements.<sup>17</sup> Although we are not directly concerned in this litigation with the due process rights of the participants in administrative proceedings, minimal due process requirements do define necessary requirements of all adjudicatory proceedings. Without providing at least notice and the \*180 opportunity to participate to those who might be affected, no administrative action can either resolve the dispute to the satisfaction of all of the parties or be considered final despite later objections. See *Wickersham*, 680 P.2d at 1144; *Kerr*, 779 P.2d at 342. Because we conclude that an "administrative proceeding" must be an action capable of finally resolving the issue in dispute, either by the express consent of all of the parties or by reaching a determination which could be accorded finality consistent with due process, we hold that sufficient written notice, specifying the nature of the dispute and the relief requested, is essential to an administrative proceeding.<sup>18</sup>

<sup>13]</sup> Our conclusion that an administrative proceeding must be an action which is capable of being accorded finality consistent with the requirements of due process is supported by the language of section 17. The phrase "as a result of the termination, through settlement or otherwise, of an administrative proceeding" clearly implies that an administrative proceeding may terminate with or without the express consent of all of the parties. A party must be aware of the dispute and the existence of the proceedings in order to terminate them by settlement. More importantly, in order for an administrative action to terminate without the consent of all the parties in a manner which may result in the collection of money by the State, individuals affected must have notice and an opportunity to object. Otherwise, no finality will be accorded the administrative agency's decision in any subsequent action.<sup>19</sup>

The third essential attribute of an administrative proceeding—that the document which one party serves on the other must set in motion mechanisms prescribed by statute or regulation under which the dispute will ultimately be resolved—derives from the ordinary meaning of the word proceeding and the nature of adjudication.

*Webster's Third New International Dictionary* 1807 (1969) defines "proceeding" as "a particular step or series of steps adopted for doing or accomplishing something."<sup>20</sup> Our reference to "mechanisms ... under which the dispute will ultimately be resolved" closely parallels the dictionary definition and follows from it.<sup>21</sup>

The two requirements which our "essential attribute" adds to this dictionary definition—that the document served on the other party set these mechanisms in motion and that the mechanisms be prescribed by statute or regulation—follow from the nature of adjudication and from our recognition that a administrative proceeding under section 17 must be capable of being accorded finality.

Adjudicatory proceedings begin with the issuance by one party to the other of a document which serves both as the initiation of the dispute resolution process and as notice \*181 that the process has been initiated.<sup>22</sup> For example, the APA expressly states that filing an accusation or a statement of issues initiates a hearing. AS 44.62.360, .370. Similarly, the civil rules provide that a civil action is commenced by filing a complaint with the court, and that a copy of the complaint must be served on the opposing party. Alaska Rules of Civil Procedure 3, 4. Therefore, it may be said that these documents have legal significance beyond merely providing notice. They also start in motion the coercive force of the law with the ultimate objective

proceeding and provides mechanisms for resolving the dispute irrespective of the opposing party's response. An assessment has this effect. On receipt of an assessment, the taxpayer may 1) pay the assessment; 2) appeal the assessment; or 3) do nothing. If the taxpayer pays, the dispute is resolved. This is similar to a defendant admitting liability in a civil suit. If the taxpayer appeals, the mechanisms provided for by AS 43.05.240 are set in motion to attempt to resolve the dispute. Finally, if the taxpayer does nothing, AS 43.05.270 provides that the State may levy against the taxpayer. Once the sixty-day period for appealing the assessment has expired, however, the taxpayer may no longer challenge the substantive basis of the assessment.<sup>26</sup> The statutory scheme by which an assessment is converted into a debt to the State if no appeal is filed is itself a mechanism for resolving the dispute.

\*183 As an assessment possesses each of the essential attributes which we have identified, it marks the beginning of an administrative proceeding in the tax collection process for purposes of Article IX, section 17 of the Alaska Constitution.<sup>27</sup>

### 3. An audit letter does not mark the commencement of an administrative proceeding.

<sup>151</sup> An audit letter does not satisfy the essential elements of an administrative proceeding. Mere notice of an intention to investigate neither indicates the existence of a dispute nor sets in motion mechanisms for the resolution of a dispute.

No dispute exists when the audit letter is sent. On the contrary, the need for an audit indicates that more information is required before the State can agree or disagree with the taxpayer's return. For this reason, an audit is more properly described as an investigation than an administrative proceeding. See *Mallas v. United States*, 993 F.2d 1111, 1122-24 (4th Cir.1993) (holding that an I.R.S. audit is an investigation and not an "administrative proceeding").

In addition, an audit letter does not set in motion any mechanisms for resolving a dispute, even if a dispute did exist at the time. As an investigative procedure, an audit helps the State to determine what its position is. Nothing in the audit procedure itself can be characterized as an attempt to resolve a dispute.<sup>28</sup>

### 4. Whether our ruling that an administrative proceeding is triggered by an assessment should be given only

#### *prospective effect.*

<sup>161</sup> This court set forth the conditions necessary for nonretroactive treatment in *Plumley v. Hale*, 594 P.2d 497, 503 (Alaska 1979):

- 1) the holding is one of first impression, or overrules prior law, and was not foreshadowed in earlier decisions;
- 2) there has been justifiable reliance on an alternative interpretation of the law;
- 3) undue hardship would result from retroactive application;<sup>29</sup> and
- 4) the purpose and intended effect of the holding is best accomplished by prospective application.

We apply these factors both to our initial decision that an informal conference is an administrative proceeding and to our decision today that the notice of assessment marks the beginning of an administrative proceeding in the tax collection process. Although the question of retroactive application arose separately in the course of the proceedings in this case with respect to these two decisions, the analysis is essentially the same.

The first factor is a threshold requirement. *Commercial Fisheries Entry Comm'n v. Byayuk*, 684 P.2d 114, 117 (Alaska 1984). It is satisfied. In *Johnstone*, 669 P.2d at 544, this court held that this requirement was met where "[n]o prior Alaska case has attempted to construe the meaning of the word" and prior nonjudicial opinions "indicated the \*184 presence of real uncertainty." This court has also stated that "if the question answered by the new rule was 'subject to rational disagreement' the threshold showing is met and the court will weigh the remaining criteria." *Truesdell v. Halliburton Co.*, 754 P.2d 236, 239 (Alaska 1988) (quoting *Vienna v. Scott Wetzel Services, Inc.*, 740 P.2d 447, 450 (Alaska 1987)). Although we reject the State's interpretation of "administrative proceeding," we cannot say that it was irrational. Moreover, at the time the State adopted its position, no Alaska case indicated the proper result. We therefore consider the remaining factors.

The second factor—justifiable reliance on an alternative explanation—supports nonretroactive application, but carries relatively little weight. The State has demonstrated that the intended recipients of fiscal year 1994 appropriations have relied on the appropriations. While retroactive application might cause reevaluation of these appropriations, it will not, however, require any specific appropriation to be rescinded. In addition, this reliance is two steps removed from the issue in this case—the proper

section 17(d), which requires that all money appropriated from the budget reserve fund must be repaid out of money remaining in the general fund at the end of a fiscal year. Alaska Const. art. IX, § 17(d).

On consideration of all of these factors, we conclude that nonretroactive application of our decision construing the term “administrative proceeding” and holding that the notice of assessment marks the beginning of an administrative proceeding in the tax collection process would be highly inappropriate. The potential hardships of retroactive application and the State’s reliance on a more narrow interpretation than we adopt do not outweigh the importance of giving effect to the constitution as adopted by the people.

**5. The superior court did not abuse its discretion by subjecting the accounting of informal conference settlement receipts to a protective order.**

<sup>17</sup> Alaska Statute 43.05.230 provides that “[i]t is unlawful for a current or former officer, employee, or agent of the state to divulge the amount of income or particulars set out or disclosed in a report or return made under [Title 43]” except under limited circumstances. AS 43.05.230(a). At the time of the superior court’s final order, the parties disputed whether the information which would be contained in the accounting, particularly the dates and amounts of individual settlements, would effectively reveal both the identity of individual taxpayers

and “particulars” \*186 of their returns. Rather than resolve this dispute on the scant information before it and risk accidentally revealing confidential information, or delay entry of final judgment until the issue could be more fully litigated and thus thwart the strong public interest in a speedy resolution of the underlying dispute over a collateral matter, the superior court granted the protective order and explicitly stated that it was subject to further order of the court. On the record before us, we are unwilling to say that the superior court abused its discretion. On remand, however, the superior court is free to revise this protective order in the light of a more fully developed record.<sup>34</sup>

For the reasons set forth in this opinion, we hold that an administrative proceeding begins, for tax purposes, with the issuance of an assessment to the taxpayer. We express no opinion on the issues characterized by the BP settlement, or on the questions concerning the procedures used in resolving royalty disputes. We remand to the superior court for further proceedings in accordance with this opinion.

**All Citations**

872 P.2d 171

**Footnotes**

\* Sitting by assignment made pursuant to article IV, section 16 of the Alaska Constitution.

<sup>1</sup> Article IX, section 17 provides as follows:

**Budget Reserve Fund.** (a) There is established as a separate fund in the State treasury the budget reserve fund. Except for money deposited into the permanent fund under Section 15 of this article, all money received by the State after July 1, 1990, as a result of the termination, through settlement or otherwise, of an administrative proceeding or of litigation in a State or federal court involving mineral lease bonuses, rentals, royalties, royalty sale proceeds, federal mineral revenue sharing payments or bonuses, or involving taxes imposed on mineral income, production, or property, shall be deposited in the budget reserve fund. Money in the budget reserve fund shall be invested so as to yield competitive market rates to the fund. Income of the fund shall be retained in the fund. Section 7 of this article does not apply to deposits made to the fund under this subsection. Money may be appropriated from the fund only as authorized under (b) or (c) of this section.

(b) If the amount available for appropriation for a fiscal year is less than the amount appropriated for the previous fiscal year, an appropriation may be made from the budget reserve fund. However, the amount appropriated from the fund under this subsection may not exceed the amount necessary, when added to other funds available for appropriation, to provide for total appropriations equal to the amount of appropriations made in the previous calendar year for the previous fiscal year.

(c) An appropriation from the budget reserve fund may be made for any public purpose upon affirmative vote of three-fourths of the members of each house of the legislature.

(d) If an appropriation is made from the budget reserve fund, until the amount appropriated is repaid, the amount of money in the general fund available for appropriation at the end of each succeeding fiscal year shall be deposited in the budget reserve fund. The legislature shall implement this subsection by law.

those described by the Administrative Procedures Act, AS 44.62.330-.630, (APA) to be controlling. Although we look to the APA for help in determining the essential attributes of adjudicatory procedures, the APA also provides procedural protections which serve other functions and are not essential to the concept of adjudication, or individualized decision-making.

- 11 "Dispute" is defined as "a conflict or controversy; a conflict of claims or rights; an assertion of a right, claim, or demand on one side, met by contrary claims or allegations on the other. The subject of litigation; the matter for which a suit is brought and upon which issue is joined, and in relation to which jurors are called and witnesses examined." *Black's Law Dictionary* 472 (6th ed. 1990).
- 12 This pamphlet is an authoritative source of the voters' common understanding of section 17. See, e.g., *State v. Lewis*, 559 P.2d at 637-38 (relying on widely distributed report explaining constitutional provisions to Alaska voters as the most "cogent expression of the intent ... of those voting for ratification of the Constitution").
- 13 The ballot measure refers to money received from "mineral revenue lawsuits or administrative actions." The neutral description of the amendment prepared by the Legislative Affairs Agency uses the term "administrative proceeding." The statement in support of the amendment also refers to "[r]evenues from mineral or oil and gas legal settlements and administrative proceedings."
- 14 See, e.g., AS 10.13.870 (providing for appeal from "administrative proceedings"; implying that proceeding itself adjudicated rights); AS 14.480.190 (providing for imposition of civil fine in "administrative proceeding"); AS 25.35.120 (referring to parties to an administrative proceeding); AS 34.08.320 (granting association of owners in common interest community the power to "institute, defend, or intervene in litigation or administrative proceedings"). We decline to undertake an extensive analysis of each of the several statutory references to "administrative proceedings" because the use of the term in the statutes is never so specific as to impose a peculiar meaning.
- 15 We emphasize that a dispute may exist for our purposes even where the non-initiating party immediately agrees with the initiating party's assertions and where the non-initiating party would have been disposed to agree prior to initiation of the proceeding. It is the placing of an issue in controversy, under circumstances that require a response and eventual resolution of the issue, and not the exact means by which a resolution is reached, that indicate the presence of a dispute.
- 16 The primary function of each of these documents is to provide specific written notice to the other party that rights or obligations between the parties are being contested and that particular relief is being sought. For example, under the APA both an accusation and a statement of issues must be in writing, specify the statute or regulation at issue, include reference to any particular conduct which would justify denial of the right at issue, and be served on the opposing party. AS 44.62.360, .370. Similarly, a civil complaint must contain a statement of the claim showing entitlement to relief and a demand for judgment, and be served on the opposing party. Alaska Rules of Civil Procedure 4, 8. We note that each of these documents also serves to set in motion mechanisms for the resolution of the dispute. We address this function as the third essential attribute of an administrative proceeding.
- 17 See *Wickersham v. State, Commercial Fisheries Entry Comm'n*, 680 P.2d 1135, 1144 (Alaska 1984) ("An elementary and fundamental requirement of due process in any proceeding which is to be accorded finality is notice reasonably calculated, under all the circumstances, to apprise interested parties of the pendency of the action.") (quoting *Mullane v. Central Hanover Bank and Trust Co.*, 339 U.S. 306, 314, 70 S.Ct. 652, 657, 94 L.Ed. 865 (1950)); see also *Kerr v. Kerr*, 779 P.2d 341, 342 (Alaska 1989) ("Notice reasonably calculated to afford the parties an opportunity to present objections to a proceeding, and affording them a reasonable time to do so, is a fundamental requirement of due process.").
- 18 Our conclusion that minimal due process must be afforded in order for an administrative action to be an administrative proceeding under section 17 does not require either a formal hearing or a right of immediate judicial appeal. Both of these additional conditions relate to whether and to what extent the administrative decision will be subject to judicial review, assuming that the private party is not satisfied with the decision. Our concern, however, is not with the means by which further objections may be pursued, but rather with whether, if no objection is made, the decision will be treated as final.
- 19 See, e.g., *Black's Law Dictionary*, at 42 ("Adjudicatory hearing" is a "proceeding before an administrative agency in which the rights and duties of particular persons are adjudicated after notice and opportunity to be heard.").
- 20 In another context, we have stated: "'Proceedings' has been generally described as 'all the steps or measures adopted in the prosecution or defense of an action.' ... the phrase 'other action or further action or proceeding' as used

until well into the current litigation.

33 The Alaska Permanent Fund was established under article IX, section 15 of the Alaska Constitution.

34 We also reject Gov. Cowper's argument that the accounting ordered by the superior court should include the income actually earned on funds which should have been deposited in the budget reserve but were not. Article IX, section 17 establishes the correct measure of income owed to the fund on monies incorrectly withheld from the fund: "Money in the budget reserve fund shall be invested so as to yield competitive market rates to the fund." § 17(a). The State proposed calculating the interest due on the amount in controversy based on the actual return received by the fund for the relative time periods. The superior court ordered the State to provide Gov. Cowper and the Senate Majority with these computations. Unless the plaintiffs can show reason why this is not an accurate means of calculating the interest owed, no further information is necessary. Our ruling on this point should not be read as suggesting that the income actually earned is not public information available to any member of the public even in the absence of litigation. Such information is, however, not relevant to the remedy in this case.

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874 P.2d 922  
Supreme Court of Alaska.

Walter J. HICKEL, Governor of the State of  
Alaska, Darrel J. Rexwinkel, Commissioner  
of the Department of Revenue for the  
State of Alaska, and the State of Alaska,  
Petitioners and Cross-Respondents,

v.

Steve COWPER, Respondent and Cross-Petitioner.

Nos. S-6294, S-6304.

|

May 27, 1994.

Action was brought challenging as unconstitutional statute defining terms contained within section of the Alaska Constitution establishing budget reserve fund. The Superior Court, Third Judicial District, John Reese, J., declared statute unconstitutional, and the state petitioned for emergency review. Petitioner cross-petitioned on same issue. After granting petitions, the Supreme Court, Matthews, J., held that statute was unconstitutional because it did not provide accurate definition of constitutional terms.

Affirmed.

**Attorneys and Law Firms**

\*923 James L. Baldwin, Stephen C. Slotnick, Juneau, Jenifer A. Kohout, Anchorage, Asst. Attys. Gen., and Bruce M. Botelho, Atty. Gen., Juneau, for petitioners and cross-respondents.

Douglas Pope, Thomas A. Ballantine, Wagstaff, Pope & Katcher, Anchorage, for respondent and cross-petitioner.

Before MOORE, C.J., RABINOWITZ, MATTHEWS and COMPTON, JJ., and BRYNER, J. Pro Tem. \*

MATTHEWS, Justice.

**OPINION**

In *Hickel v. Halford*, 872 P.2d 171 (1994) (*Halford*), we addressed the meaning of the term "administrative proceeding" as used in article IX, section 17 of the Alaska

Constitution.<sup>1</sup> This is one of the terms which describes state revenues which must be deposited into the budget reserve fund. We are now required to interpret several other key terms of section 17, including "amount available for appropriation" and "amount appropriated for the previous fiscal year." § 17(b). These terms govern the legislature's ability to withdraw from the budget reserve fund by a simple majority vote.

This case arises out of a legislative attempt to define these terms. While final decision in *Halford* was pending, the Alaska Legislature passed and Governor Hickel signed Senate Committee Substitute for Committee Substitute for House Bill 58 (FIN) (the Act). Chapter 5, SLA 1994. Section 1 of the Act amends AS 37.10 by adding new sections AS 37.10.410 and .420. Alaska Statute 37.10.410 defines what money is received as a result of the termination of an administrative proceeding under article IX, section 17(a) of the Alaska Constitution. Alaska Statute 37.10.420 defines several other key phrases and concepts used in section 17, including "amount available for appropriation," "amount appropriated for the previous fiscal year," and "amount of appropriations made in the previous calendar year for the previous fiscal year." Alaska Statute 37.10.420 also establishes the means by which appropriations from the budget reserve fund are \*924 repaid.<sup>2</sup> Section 2 of the Act states that the provisions of section 1 "are declaratory of existing law and represent the intent of the legislature when the Sixteenth Alaska State Legislature passed [the resolution proposing the constitutional amendment creating section 17]." Ch. 5 SLA 1994.

Following passage of the Act, the current respondent and cross-petitioner, former Governor Steve Cowper, applied to this court for a limited remand in the pending *Halford* case so that he could challenge the constitutionality of the Act.<sup>3</sup> Petitioners and cross-respondents, Governor Walter J. Hickel, Commissioner of Revenue Darrel J. Rexwinkel, and the State of Alaska (hereafter referred to as the State), applied to this court for original jurisdiction to consider the constitutionality of the Act. We granted a limited remand to the superior court so that Gov. Cowper could move to amend his complaint in order to challenge the constitutionality of the Act.<sup>4</sup>

On remand, the consolidated cases were severed and Gov. Cowper was allowed to amend his complaint to allege that the Act was unconstitutional. He then moved for partial summary judgment on this question. The State also moved for a partial summary judgment declaring the Act constitutional.

to the program receipts excluded under AS 37.05.146, this definition excludes the funds listed in AS 37.05.146, several other funds which have been established by the legislature,<sup>10</sup> and the surplus assets of public corporations.<sup>11</sup> Gov. Cowper argues that the “amount available for appropriation” includes the total amount accessible by the legislature, including all of the funds and assets referred to above. Under this argument, funds are available for appropriation so long as a simple majority can make the funds available.

We reject both interpretations. The text of section 17 cannot support the State's narrow interpretation. However, Gov. Cowper's position would require a complete restructuring of the established financial system of the state government. We are unwilling to add “missing terms” to the Constitution or to interpret existing constitutional language more broadly than intended by the framers or the voters. Instead, we consider it appropriate, as well as consistent with both the language of the amendment and the intent of the framers, to focus on the legal status of the various funds implicated in relationship to the legislative power of appropriation. The “amount available for appropriation” must include all funds over which the legislature has retained the power to appropriate and which are not available to pay expenditures without further legislative appropriation. It must also include all amounts which the legislature actually appropriates for the fiscal year, whether or not they could have been considered available prior to the appropriation.

Our analysis of a constitutional provision begins with, and remains grounded in, the words of the provision itself. We are not vested with the authority to add missing terms or hypothesize differently worded provisions \*928 in order to reach a particular result.<sup>12</sup> Our task is to identify the meaning that the people probably placed on the term. *Halford*, 872 P.2d at 176. The dictionary definitions of the controlling words “amount” and “available” provide a helpful starting point. *Webster's Third New International Dictionary* defines “amount” as “a: the total number or quantity ...; b: the sum of individuals ...; c: the quantity at hand or under consideration.” *Id.* at 72. Relevant definitions of “available” are “3: such as may be availed of: capable of use for the accomplishment of a purpose: immediately utilizable ...; 4: that is accessible or may be obtained ...: at disposal esp. for sale or utilization.” *Id.* at 150.

From similar dictionary definitions, Gov. Cowper paraphrases “amount available for appropriation” as meaning “the total funds accessible by the legislature for

appropriation.” He further interprets this paraphrase as meaning that all funds which the legislature can make available to itself by a majority vote, whatever their current use or designation, are “available for appropriation.”<sup>13</sup> At the outer limits, this construction would require that all net assets held by the State, however liquid, be considered available in determining whether the amount available was less than the amount appropriated for the previous year.<sup>14</sup> Such an expansive reading of the constitutional language would render section 17(b) superfluous for all practical purposes.<sup>15</sup> It would also involve the adoption of a radically different approach to government financing. Neither result is consistent with the purpose of the amendment, the intent of the framers, or extrinsic indications of the voters' probable understanding of section 17's terms.

Section 17(b) allows a simple legislative majority to use the constitutional budget reserve fund in order to make up the difference between the “amount available for appropriation” for a given fiscal year and the “amount appropriated for the previous fiscal year.” If net state assets are included in the total amount available, then they would have to be actually expended before the budget reserve fund could be reached by a simple majority to keep spending at a constant level. Even if we consider only net assets which exist in a cash form—such as the balances contained in \*929 any one of the State's several revolving loan funds<sup>16</sup>—the existing state programs dependent on these funds would have to be curtailed if these funds were expended on another purpose. These funds are maintained, however, because in the judgment of the legislature they serve worthwhile purposes. Therefore, one of the uses the legislature presumably would want to make of the newly available money would be to reestablish these funds. Yet, to the extent that any of these funds were started and funded before the previous year, there would not be an equivalent appropriation in the previous year to balance out the appropriation required in the present year. Gov. Cowper's interpretation of section 17(b)'s majority access formula would, in effect, require reductions in the level of government service until no liquid funds remained before a simple majority could reach the budget reserve.

One of the purposes of the budget reserve amendment, however, was to provide a “stabilizing mechanism” in the budgetary process.<sup>17</sup> The formula in section 17(b), which compares funds currently available to the amount appropriated for the previous fiscal year, and allows simple majority appropriation from the budget reserve fund to the

state appropriations at a constant level. Although all funds might be available by some means, counting funds already validly appropriated to a specific purpose as still "available" would disrupt existing state programs and would constitute an inflexible constitutional intrusion on the legislature's authority to evaluate the wisdom of particular appropriations. Although such a constitutional intrusion is conceivable, we are unwilling to read it into a provision with quite a different purpose.

It is far more reasonable to interpret "amount available for appropriation" in light of the relative consequences of and circumstances attendant in making appropriations from different sources. In this light, monies which already have been validly committed by the legislature to some purpose should not \*931 be counted as available.<sup>20</sup> In addition, illiquid assets owned by the state are not available so long as they remain illiquid. Given the "stabilizing" purpose of the amendment, it would make little sense to interpret section 17 as requiring the costly and time-consuming process of liquefying state assets before allowing majority access to the constitutional budget reserve fund. See *supra* note 14. The "amount available for appropriation" would include, however, all monies from which the legislature can make an appropriation and which require a legislative appropriation before they can be expended, as well as any amount which would not otherwise be counted as "available" but from which the legislature does in fact appropriate. This interpretation is consistent with the stabilizing purpose of section 17 and with the extrinsic evidence of the voter's understanding of the amendment. Most importantly, it is consistent with the text of section 17(b), as it is based on a reasonable and practical interpretation of the words of that section, in accordance with common sense.<sup>21</sup>

This definition necessarily includes all amounts which are in fact appropriated for a fiscal year, including "trust receipts."<sup>22</sup> There is nothing in the text or history of section 17 which would justify classifying money actually appropriated as *unavailable* for appropriation.<sup>23</sup>

The State argues that "[s]ound policy" requires that these trust receipts be excluded because they "are not available for discretionary appropriation by the legislature." Even if we were to agree that policy considerations favored a system which compared only amounts available for discretionary appropriation to the previous year's appropriations from such

amounts, we could not impose that policy choice on a differently worded constitutional provision.

Moreover, it is not clear that excluding these receipts would constitute a better policy. The appropriations made from these receipts represent a significant portion of state spending. The purposes to which these funds are restricted include many core state government functions, including education, \*932 health, social services, public safety, and transportation. See State of Alaska, Dep't of Revenue, *Revenue Sources Book* (Fall 1993) at 54 (listing historical grants-in-aid by category). Because these funds are an integral part of the State's annual spending, changes in the amounts received would certainly affect other budget decisions. Policy considerations therefore appear to favor including trust receipts in the amount available, so that, for example, declines in federal funding might result in increased access to the budget reserve fund. The budget reserve amendment does anticipate that all budget decisions be made in relation to one another. We need not choose between these alternative policies, however. Regardless of which policy argument is in fact more compelling, the text of section 17(b) clearly requires that all funds which are in fact appropriated be counted as "available for appropriation."

The key question in applying our interpretation of the term "amount available for appropriation" to particular funds<sup>24</sup> is what constitutes a valid appropriation such that the funds involved are no longer available. "Appropriation" is defined as

something that has been appropriated; *specif.*: a sum of money set aside or allotted by official or formal action for a specific use (as from public revenue by a legislative body that stipulates the amount, manner, and purpose of items of expenditure).

*Webster's Third New Int'l Dictionary* 106 (1969). *Black's Law Dictionary* defines "appropriation" as

[t]he act of appropriating or setting apart; prescribing the destination of a thing; designating the use or application of a fund

....

In governmental accounting, an expenditure authorized for a specified amount, purpose, and time.

....

these funds cannot support any expenditure, the money in these funds remains "available for appropriation" until further appropriations are made.<sup>27</sup>

A similar analysis applies to the permanent fund earnings reserve account (earnings reserve account), AS 37.13.145. This fund is established as a separate account within the permanent fund under the authority of the last sentence of Article IX, § 15 of the Alaska Constitution: "All income from the permanent fund shall be deposited in the general fund unless otherwise provided by law." AS 37.13.145(a) provides otherwise: "The earnings reserve account is established as a separate account in the fund. Income from the fund shall be deposited by the corporation into the account as soon as it is received." Therefore, money in the earnings reserve account never passes through the general fund, and is never appropriated as such by the legislature.

A percentage of the money in the reserve account is automatically transferred to the dividend fund at the end of each fiscal year. AS 37.13.145(b). After that transfer has been made, an additional amount is transferred from the earnings reserve account to the principal of the permanent fund in order to "offset the effect of inflation on principal of the fund." AS 37.13.145(c). No regular provision is made for amounts in the earnings reserve account in excess of that necessary to fund dividends and inflation proof the permanent fund principal. Absent an appropriation, this excess accumulates from year to year. The unencumbered balance of this account was \$1.087 billion as of February 28, 1994.

The balance remaining in the earnings reserve account each year after the dividend and inflation-proofing transfers have been made is liquid, has never been appropriated by the legislature, and is not subject to expenditure without further legislative action. There are no statutory or constitutional prohibitions against direct appropriations from this account.<sup>28</sup> The earnings reserve account is therefore available for appropriation.<sup>29</sup>

\*935 [3] Alaska Statute 37.10.420 fails to include several funds-including trust receipts, "restricted" accounts within the general fund which require further legislative appropriation before they can be expended, and the permanent fund earnings reserve account-in the "amount available for appropriation" which are in fact available within the meaning of article IX, section 17 of the Alaska Constitution. It therefore does not provide an accurate definition of the constitutional term. Therefore, although we differ from the

superior court in our analysis of the "amount available for appropriation," we affirm the superior court's decision declaring AS 37.10.420(a)(1) unconstitutional.

In summary, the "amount available for appropriation" within the meaning of article IX, section 17 of the Alaska Constitution includes all monies over which the legislature has retained the power to appropriate and which require further appropriation before expenditure. In addition, all amounts actually appropriated, whether or not they would have been considered available prior to appropriation, are available within the meaning of section 17. Illiquid assets, such as land and unexploited natural resources, are not available so long as they remain illiquid. For these reasons, trust receipts are available for appropriation, as are funds like the Railbelt energy fund and the educational facilities maintenance and construction fund, which are not available for expenditure without additional appropriations. In contrast, the oil and hazardous substance release response fund is not counted as available because the entire balance of the fund may be expended at any time without further legislative action. The availability of funds not specifically discussed in this opinion must be determined in accordance with this opinion. Finally, the permanent fund earnings reserve account must be counted as available for appropriation, because appropriations may be made from it and it is not subject to expenditure without legislative action.

#### B. "Amount appropriated for the previous fiscal year"

[4] The meaning of the term "amount appropriated for the previous fiscal year" in article IX, section 17(b) of the Alaska Constitution follows logically from the definitions of the word "appropriation" listed above. The "amount appropriated for the previous fiscal year" means all amounts set aside for the previous fiscal year by the legislature "for a specific purpose or object in such a manner that is executable, mandatory, and reasonably definite with no further legislative action." *Fairbanks Convention and Visitors Bureau*, 818 P.2d at 1157. In short, the "amount appropriated" includes every dollar appropriated by the legislature, whatever its source.<sup>30</sup> Because our definition of the amount available for appropriation includes all amounts actually appropriated, it is unnecessary to exclude artificially any amount actually appropriated from the "amount appropriated" in order to achieve symmetry in the comparison. The State correctly argues that this symmetry is necessary in order to insure that the comparison required by section 17(b) fairly measures the need for access to the budget reserve fund. Contrary to the

**Budget Reserve Fund.** (a) There is established as a separate fund in the State treasury the budget reserve fund. Except for money deposited into the permanent fund under Section 15 of this article, all money received by the State after July 1, 1990, as a result of the termination, through settlement or otherwise, of an administrative proceeding or of litigation in a State or federal court involving mineral lease bonuses, rentals, royalties, royalty sale proceeds, federal mineral revenue sharing payments or bonuses, or involving taxes imposed on mineral income, production, or property, shall be deposited in the budget reserve fund. Money in the budget reserve fund shall be invested so as to yield competitive market rates to the fund. Income of the fund shall be retained in the fund. Section 7 of this article does not apply to deposits made to the fund under this subsection. Money may be appropriated from the fund only as authorized under (b) or (c) of this section.

(b) If the amount available for appropriation for a fiscal year is less than the amount appropriated for the previous fiscal year, an appropriation may be made from the budget reserve fund. However, the amount appropriated from the fund under this subsection may not exceed the amount necessary, when added to other funds available for appropriation, to provide for total appropriations equal to the amount of appropriations made in the previous calendar year for the previous fiscal year.

(c) An appropriation from the budget reserve fund may be made for any public purpose upon affirmative vote of three-fourths of the members of each house of the legislature.

(d) If an appropriation is made from the budget reserve fund, until the amount appropriated is repaid, the amount of money in the general fund available for appropriation at the end of each succeeding fiscal year shall be deposited in the budget reserve fund. The legislature shall implement this subsection by law.

2 AS 37.10.420 provides:

(a) For purposes of applying art. IX, sec. 17(b), Constitution of the State of Alaska,

(1) "the amount available for appropriation" or "funds available for appropriation" means

(A) the unrestricted revenue accruing to the general fund during the fiscal year;

(B) general fund program receipts as defined in AS 37.05.146;

(C) the unreserved, undesignated general fund balance carried forward from the preceding fiscal year that is not subject to the repayment obligation imposed by art. IX, sec. 17(d), Constitution of the State of Alaska; and

(D) the balance in the statutory budget reserve fund established in AS 37.05.540;

(2) "the amount appropriated for the previous fiscal year" means the amount appropriated from the

(A) constitutional budget reserve fund under the authority granted in art. IX, sec. 17, Constitution of the State of Alaska; and

(B) same revenue sources used to calculate the money available for appropriation for the current fiscal year; and

(3) "the amount of appropriations made in the previous calendar year for the previous fiscal year" means appropriations made from sources identified in (2) of this subsection for a fiscal year that were enacted during the calendar year that ends on December 31 of that same fiscal year.

(b) If the amount appropriated from the budget reserve fund has not been repaid under art. IX, sec. 17(d), Constitution of the State of Alaska, the Department of Administration shall transfer to the budget reserve fund the amount of money comprising the unreserved, undesignated general fund balance to be carried forward as of June 30 of the fiscal year, or as much of it as is necessary to complete the repayment. The transfer shall be made on or before December 16 of the following fiscal year.

(c) In this section, "unrestricted revenue accruing to the general fund" or "unreserved, undesignated general fund balance carried forward" is money not restricted by law to a specific use that accrues to the general fund according to accepted principles of governmental or fund accounting adopted for the state accounting system established under AS 37.05.150 in effect on July 1, 1990.

(d) An appropriation under art. IX, sec. 17(b), Constitution of the State of Alaska, requires an affirmative vote of the majority of the members of each house of the legislature. An appropriation under art. IX, sec. 17(c) requires an affirmative vote of three-fourths of the members of each house of the legislature.

3 See *Halford*, 872 P.2d at 174-76, for a full statement of the earlier proceedings in this case.

4 This court does not possess original jurisdiction over the case. AS 22.05.010. In addition, no Alaska court could normally adjudicate an action by the State seeking to have a statute declared constitutional, in the absence of the willing participation of a truly adverse party. See *Greater Anchorage Area Borough v. City of Anchorage*, 504 P.2d 1027, 1036 (Alaska 1972) ("Parties seeking a judicial determination of a hypothetical, advisory or moot question will be denied relief.").

5 The superior court found AS 37.10.410 unconstitutional based on an inconsistency between the statute and this court's interpretation of the term "administrative proceeding" in *Halford*. The State does not challenge this portion of the court's decision in this petition.

(E) funds managed by the Alaska Housing Finance Corporation (AS 18.56.020), the Alaska Railroad Corporation (AS 42.40.010), the Municipal Bond Bank Authority (AS 44.85.020), the Alaska Aerospace Development Corporation (AS 14.40.821), or the Alaska Industrial Development and Export Authority (AS 44.88.020);

(F) fish and game fund (AS 16.05.100);

(G) school fund (AS 43.50.140);

(H) training and building fund (AS 23.20.130);

(I) retirement funds (AS 14.25, AS 22.25, AS 26.05.222, AS 39.35, and former AS 39.37);

(J) permanent fund (art. IX, sec. 15, Alaska Constitution);

(K) public school fund (AS 37.14.110);

(L) second injury fund (AS 23.30.040);

(M) fishermen's fund (AS 23.35.060);

(N) FICA administration fund (AS 39.30.050);

(O) receipts of the employee benefits program established under AS 39.30.150-39.30.180;

(P) receipts of the deferred compensation program established under AS 39.45;

(Q) clean air protection fund (AS 46.14.260);

(R) receipts of the group insurance programs established under AS 39.30.090.

(5) receipts of or from the trust established by AS 37.14.400-37.14.450, except reimbursements described in AS 37.14.410.

10 These additional funds include the Railbelt energy fund, AS 37.05.520, the Alaska marine highway system vessel replacement fund, AS 37.05.550, the educational facilities maintenance and construction fund, AS 37.05.560, the oil and hazardous substance release response fund, AS 46.08.010, the power cost equalization and rural electric capitalization fund, AS 42.45.100, the power project fund, AS 42.45.010, the Alaska science and technology endowment, AS 37.17.020, and the permanent fund earnings reserve account, AS 37.13.145.

11 In 1985, the Department of Law issued an informal opinion, written by Assistant Attorney General James L. Baldwin, which concluded that "unrestricted money in the [Alaska Housing Finance Corporation] revolving fund is probably *available for appropriation*." 1985 Informal Op. Att'y Gen. 307 at 309 (emphasis added). The Opinion recommended that the statute governing the Alaska Housing Finance Corporation (AHFC) be amended to specifically authorize interim transfers of unrestricted surplus assets of AHFC to the general fund and to provide that the board of directors annually determine the amount of surplus available for transfer. *Id.* at 310-11.

The statutes governing the AHFC and the Alaska Industrial Development and Export Authority (AIDEA) now require each organization to annually determine whether it has assets in excess of the amount required to fulfill its purposes. See AS 18.56.089(b)(1); AS 44.88.205(b)(1). Each organization must present this determination to the legislature by January 10 of each year. AS 18.56.089(b)(2); AS 44.88.205(b)(2); See Ch. 12 SLA 1991.

12 On this basis alone, we must reject the State's plea to convert the term "amount available for appropriation," as used in section 17(b), to either "amount available for appropriation from the [unrestricted] general fund" or "revenues available for appropriation." If the definition of "amount available for appropriation" in AS 37.10.420 is to withstand constitutional scrutiny, it must be because it is in conformity with the text of section 17(b), and not because section 17(b) is missing words which would make it conform to AS 37.10.420.

13 The State argues that the "common understanding" of the phrase "available for appropriation" is more limited. It states that the term should have the same meaning in the Constitution that it has in the budget process, meaning only "revenue sources customarily considered by the legislature." The State asserts that only unrestricted revenues are so considered. To be distinguished are "restricted revenues," the use of which is restricted in some way, usually by the source of the funds, predominantly the federal government.

The State never asserts or shows evidence, however, that the term "available for appropriation" is actually used in any particular way in the budget process. Rather, it argues that the term "should be interpreted with reference to revenue sources customarily considered by the legislature when it considers the state budget." It is also not clear that the legislative definition of "amount available for appropriation" includes all monies "customarily considered by the legislature." Although it probably does include all *revenues* customarily considered, it may not include all amounts so considered.

14 Gov. Cowper does limit his argument to cash funds, presumably because of the relative ease with which cash funds can be converted to different purposes, as compared to illiquid assets. This is a reasonable limitation. Although we have held, in a different context, that property other than money may be "appropriated," see *McAlpine v. University of Alaska*, 762 P.2d 81, 87-89 (Alaska 1988), it does not follow that it is necessarily "available for appropriation" within the meaning of section 17(b).

- 24 In this regard, the State argues that the question of whether funds outside the unrestricted general fund are "available for appropriation" is "not justiciable in a court of law." To the extent the State argues that this court cannot decide the meaning of the term "available for appropriation" or the legal status of different funds under this definition, its position is without merit. The meaning of the constitution and its application to particular facts are questions squarely within the jurisdiction and inherent power of the judiciary. "[T]he judicial branch of government has the constitutionally mandated duty to ensure compliance with the provisions of the Alaska Constitution, including compliance by the legislature." *Malone v. Meekins*, 650 P.2d 351, 356 (Alaska 1982). The State's error is in assuming that the "power of appropriation necessarily includes the power to determine what amounts are available to finance appropriations enacted." *Compare Abood v. Gorsuch*, 703 P.2d 1158, 1161-62 (Alaska 1985) ("What quorum is necessary for the confirmation votes is a question of Alaska constitutional law. It is therefore a question to which the nonjusticiability doctrine does not apply."). Although the court cannot say what particular funds should be used for appropriations, or set the amount of appropriations, it can and must determine the status of particular funds when such a determination is necessary for constitutional interpretation or enforcement.
- The State is correct, however, insofar as it asserts that decisions to appropriate certain funds and withdraw other appropriations are political questions. All this means, however, is that the court cannot second guess the wisdom of individual appropriation or non-appropriation decisions. This limitation supports a definition of "available for appropriation" which does not require amounts validly appropriated to specific purposes to be counted. As these amounts have already been appropriated, counting them as available is functionally equivalent to questioning the wisdom of the original appropriation.
- 25 AS 46.08.040 lists eight other purposes for which the commissioner of environmental conservation may use money from the fund. See AS 46.08.040(a)(2)-(7) and (d)(1)-(2). Except as provided for in AS 46.08.040(d)(1), however, expenditures for these purposes are limited to amounts available from appropriations made specifically for the purposes listed. AS 46.08.040(c). AS 46.08.040(d)(1) provides that the commissioner of environmental conservation shall, upon request of the Alaska Legislative Council, "use money from the fund to reimburse the Alaska Legislative Council for expenditures that it makes for the operation of the Citizens' Oversight Council on Oil and Other Hazardous Substances."
- 26 The lists of specific purposes in each statute for which these second appropriations "may" be made are not sufficient to make the assignment of money to these funds "appropriations." Further appropriations are necessary before expenditures can be made. In addition, we have previously recognized that statutory statements that the legislature "may" appropriate money from funds within the general fund for specific purposes "impose no legal restraint on the appropriations power of the legislature." *Sonneman v. Hickel*, 836 P.2d 936, 939-40 (Alaska 1992).
- 27 In a hybrid situation, where expenditures can be made from part but not all of a fund, the fund is not available for appropriations to the extent that it is subject to expenditure without further legislative approval. We express no opinion on the possible status of funds which technically are subject to full expenditure, but which are funded well beyond any reasonably expectable need, as there is no evidence in the record before us that any such fund exists.
- We also make no attempt to name and classify as "available" or "unavailable" every fund within the treasury of the State of Alaska. We leave it, in the first instance, to executive and legislative branch officials more familiar with all of the funds involved to apply the general definition we adopt today.
- 28 In a May 1990 memorandum describing the budget reserve amendment, budget officer Mary Halloran states that the amount available for appropriation includes "all revenue sources, such as permanent fund earnings, federal funds and other restricted funds."
- In addition, the language of section 17, and specifically the difference in language between sections 17(b) and (d), suggests that at least some funds outside the general fund may be available for appropriation. Compare § 17(b) ("the amount available for appropriation for a fiscal year") with § 17(d) ("the amount of money in the general fund available for appropriation").
- 29 In oral argument before the superior court, the State argued that the earnings reserve account should not be considered available because, under current projections of the Alaska Permanent Fund Corporation, the entire balance will be used for dividend payments and inflation proofing by the year 2010. This argument rests on reasoning similar to that which prompted us to conclude that the oil and hazardous substance release response fund was not available for appropriation: the entire account may be expended without further legislative action. Unlike the release response fund, which may be needed for expenditure at any time, the earnings reserve account balance will not be used for many years to come. In the meantime, there are no restrictions on its use. Something more than a possibility of future use is necessary before a fund is considered no longer available for appropriation.

1995 Alaska Op. Atty. Gen. (Inf.) 111 (Alaska A.G.), 1995 WL 867852

Office of the Attorney General

State of Alaska

File Nos. 663-95-0475; 663-95-0474

May 18, 1995

**Subject: Application of the definition of "administrative proceeding" in the budget reserve fund provision of the Alaska Constitution to settlements of tax appeals involving unaudited years and royalty settlements prior to litigation**

\*1 The Honorable Wilson Condon  
Commissioner  
Dep't of Revenue

The Honorable John Shively  
Commissioner  
Dep't of Natural Resources

We have been asked two questions concerning allocation of certain mineral revenues between the general fund and the constitutional budget reserve fund. Both questions concern whether the state received these revenues as a result of the termination of an administrative proceeding. The administrative proceeding determination is important because revenue received in settlement of an administrative proceeding must be deposited in the budget reserve fund; revenue received in settlement of a dispute before an administrative proceeding begins is deposited in the general fund.<sup>1</sup>

The Department of Revenue (DOR) asks about settlement of tax disputes. The Alaska Supreme Court has held that an administrative proceeding begins when DOR issues an assessment. In some cases, however, tax disputes are settled issue-by-issue. Sometimes the parties reach agreement on issues in tax years for which no assessment has been issued. DOR asks whether money received for settlement of issues in years for which no assessment has been issued should be deposited in the budget reserve fund.

We conclude that the entire amount of a lump-sum settlement agreed to during an administrative proceeding is the result of the termination of the administrative proceeding, regardless of whether some of the money is received in settlement of unassessed years. Thus, the entire amount of a lump-sum settlement should be deposited in the budget reserve fund. Money subsequently received, however, in payment for issues in unassessed years for which liability was not fixed by the settlement of the administrative proceeding, would not be received as a result of the termination of the administrative proceeding and should be deposited in the general fund.

The Department of Natural Resources (DNR) asks about settlement of royalty disputes. Royalty disputes are creatures of contract, and, unlike tax disputes, no statute mandates use of a statutory dispute resolution procedure. Accordingly, DNR asks whether a settlement of a royalty dispute before litigation ensues can be the result of an administrative proceeding.

We conclude that royalty settlements occurring before litigation can be the result of an administrative proceeding, and thus subject to deposit in the budget reserve fund. An administrative proceeding does not begin, however, until one of the parties notifies the other that it is invoking a binding administrative dispute resolution procedure. Any settlement occurring before such notice would not be the result of an administrative proceeding.

## INTRODUCTION

The parties agreed that settlements of royalty disputes sometimes occurred before litigation, but few facts were placed in the record concerning these settlements. Instead, the question was put before the court as a matter of law. The state argued that royalty payments were creatures of contract and thus, settlement of royalty disputes, in the absence of an administration adjudication, were the result of consensual contract negotiations. The Senate Majority and former Governor Cowper argued that because these settlements occurred in an administrative agency they were necessarily the result of administrative proceedings.

In contrast, the question concerning tax settlements of unassessed years was very fact specific. This question was called the "BP question," because the BP settlement raised the issue. The record before the supreme court showed that in February 1993, the state negotiated an agreement with BP settling certain disputes under the Alaska Net Income Tax, AS 43.20. BP agreed to pay the state 630 million dollars on June 30, 1993.

Most of the BP settlement was received to settle BP's income tax liability for tax years 1982-86. The Department of Revenue had completed the audit of BP's returns for these tax years, and had issued an assessment for underpayment of tax. BP filed a notice of appeal and requested an informal conference to resolve the dispute.

At issue in the informal conference were, among other disputes, four "big" issues that both the taxpayer and the state knew would also arise in the next audit cycle, 1987-90. At the time of the negotiation, state auditors were conducting an audit of BP for 1987-90, but no assessment had been issued. In the informal conference, the negotiators agreed that if they could reach resolution of the "big four" issues for 1982-86, they should also reach agreement on the issues for 1987-1990, and avoid having to negotiate those issues again in the next audit/appeal cycle. The parties did in fact reach agreement on those four issues. The closing agreement negotiated between the parties specified that the lump-sum settlement of \$630 million constituted a final determination of BP's income tax liability for tax years 1982-86 and of its liability for the "big four" issues for 1987-90.<sup>3</sup>

\*4 The BP settlement was deposited in the general fund, pursuant to the April 1992 opinion. In interpreting the agreement establishing the administrative settlement subaccount, department officials concluded that not all of the BP settlement was received as a result of an informal conference. In their view, there was no informal conference for tax years 1987-90 because no request for appeal had been filed for those years. Accordingly, the Department segregated the amount received from BP that it calculated was attributable to the issues settled in the unassessed years, 1987-90. Only that amount received for the closed years, 1982-86, was deposited in the administrative settlements account. The remaining amount was commingled in the general fund.

In arguing the BP issue before the supreme court, the state suggested that when a settlement extends forward into future years, money received in settlement for the future years was the result of an application of an agreed methodology, and not the result of the administrative proceeding. Accordingly, we argued, the BP settlement was properly allocated between assessed and unassessed years. During oral argument, one supreme court justice, Judge Bryner, sitting pro tem, took issue with the state's approach. Although he agreed that independent payments received in the future might not be subject to deposit in the budget reserve fund, Judge Bryner suggested that the state's approach ignored the word "result" in **Article IX, Section 17** of the Alaska Constitution. He expressed the view that the issue was not whether an appeal existed for unassessed years but whether the settlement for those years was the result of the proceeding, and that this inquiry would depend on the facts of each case.

The supreme court issued a published decision on April 4, 1994. The court rejected the state's argument that an administrative appeal begins with the notice of appeal, and held that an administrative proceeding begins with the assessment. Moreover, the court declined to discuss the "BP issue" or the royalty issues. *Hickel v. Halford*, 872 P.2d 171, 183 (Alaska 1994).

In explaining its decision, the supreme court identified the three essential attributes of an "administrative proceeding":

1. A dispute must exist.
2. A document reflecting the fact of the dispute which serves a function similar to that of a complaint in a civil action, or an accusation or statement of issues under the Administrative Procedure Act, AS 44.62.360, 370, must be served by one party on the other party.

\*6 We do not think a court would agree with this interpretation of *Hickel v. Halford*. *Hickel v. Halford* merely held that an assessment begins an administrative proceeding. 872 P.2d at 181. The court did not hold that the administrative proceeding was limited to those issues raised in the assessment. Indeed, by recognizing that the BP question remained unresolved, the court implicitly acknowledged that the question of the scope of the proceeding was different from the question of the initiation of the proceeding. *Id.* at 186. In short, nothing in *Hickel v. Halford* dictates that the BP settlement should be allocated between the general fund and the budget reserve fund.

The second possible argument in favor of an allocation was raised by the state in oral argument. We argued that settlement of issues for years not covered by the request for appeal could be viewed as equivalent to applying a methodology after a judgment. Under this argument, the portion of the BP settlement that applied to unassessed years was not the result of the termination of an administrative proceeding, but was the result of applying an interpretation of law to future factual situations.

In other contexts, this argument would be persuasive. For example, in the settlement of the ANS royalty litigation, the parties resolved the issue of valuation of royalty oil, and agreed to a formula for future valuation. Only the payments received for the settlement of the years at issue in the ANS litigation, however, were deposited in the budget reserve fund. Future royalty payments calculated under the settlement formula will be deposited in the general fund unless those payments themselves become the subject of an administrative proceeding or litigation.

In the BP case, however, this argument is not persuasive. We expect the courts will follow Judge Bryner's reasoning that the facts of each case should be examined to determine if a payment was a result of the proceeding or was independent of the proceeding. The BP settlement was a lump-sum settlement received at the termination of the proceeding. No formula or method was derived in that settlement that will be applied to future tax years. Instead, the parties determined BP's final liability for both the assessed years and for certain issues from unassessed years, and one closing agreement governed the entire settlement. Money received in settlement of the unassessed issues was commingled with money received in settlement for other issues in the proceeding. Under these facts, the BP settlement is distinguishable from the ANS settlement.

Moreover, *Hickel v. Halford* held that the hallmark of an administrative proceeding is finality. 872 P.2d at 181-82. Here, BP's liability for the settled issues is final. The money received from BP for these issues is not subject to further appeal. In contrast, application of a settlement or judgment to future liability could be the subject of an appeal, even though the methodology or point of law decided in the settlement or judgment would not be at issue. It follows that all money received in the lump-sum settlement from BP was received as a result of termination of an administrative proceeding, and should be deposited in the budget reserve fund.

\*7 Thus, we advise that the money received in the 1993 BP settlement that had been allocated to the general fund should be transferred to the budget reserve fund, with the interest it would have earned had it been in the budget reserve fund. Any other lump-sum settlements agreed to as a result of the termination of an administrative proceeding that fixed liability for unassessed years should also be deposited in the budget reserve fund. Revenues received for unassessed years that were affected by a settlement of an administrative proceeding, but for which the tax liability had not been finally determined at the proceeding, however, are not subject to deposit in the budget reserve fund.

II. Contractual disputes concerning royalty payments are administrative proceedings if one party properly notifies the other that a binding proceeding has begun.

Commissioner Shively has requested advice on when settlements of disputes concerning mineral revenues under oil and gas leases and royalty sale contracts are settlements of "administrative proceedings" subject to deposit in the budget reserve fund. In royalty disputes, unlike tax disputes, the rights of the parties are usually governed by contract. Two types of contracts are at issue. First, DNR administers contracts for sale of royalty oil to third parties. Many of these contracts contain dispute resolution clauses that require a purchaser to seek adjudication of a dispute before the commissioner of DNR. Second, DNR administers

not require DNR to pursue administrative remedies if it wishes to challenge a purchaser's contractual payment. Nor do the royalty sales contracts provide for a specific document that begins an administrative proceeding. DNR's administrative appeal procedure, however, is "available to a person adversely affected by a decision of the department." 11 AAC 02.010(a). Thus, the document that begins the administrative proceeding is the "decision" specified by the regulation.

Under the regulations, "decision" means "a written determination by the department specifying the details of the action taken." 11 AAC 02.080(3). This decision can include a decision of the director of a division, which may be appealed to the commissioner, or even the decision of an employee, which may be appealed to the division director. A royalty sales dispute often arises following an audit of a purchaser's payments. Usually, an employee or the director of the division of oil and gas would write a demand letter to the purchaser. As explained below, if the demand letter provides notice that it is a final decision, and that the purchaser must appeal the decision to a higher authority or lose all legal recourse, then it begins the administrative proceeding.

Hickel v. Halford stated that the document that triggers an administrative proceeding must bind the recipient against its will unless the recipient appeals the decision. Notice is a crucial element in a binding decision. "Adjudicatory proceedings begin with the issuance by one party to the other of a document which serves both as the initiation of the dispute resolution process and as notice that the process has been initiated." Id. at 180-81.

Notice of the right to appeal a decision must be included in the decision. "Unless the document which the first party serves on the opposing party creates a legal obligation on the opposing party to either respond or accept a determination made in the party's absence, then the opposing party is free to ignore the document." Id. at 181. In Manning v. Alaska Railroad Corp., the court held that "[f]or Appellate Rule 602(a)(2) to apply, an agency must clearly indicate that its decision is a final order and that the claimant has thirty days to appeal." 853 P.2d 1120, 1124 (Alaska 1993).

Thus, not all communications from DNR officials to a purchaser would necessarily begin an administrative proceeding. For example, DNR could send a notice of deficiency and demand for payment without initiating an administrative proceeding, if DNR does not inform the purchaser that it was initiating a proceeding and that the purchaser had thirty days to respond: An adjudication does not begin, however, until both functions have been served. Notice without the initiation of the proceedings is only notice of intent to initiate, requiring further notice. Similarly, until the second party is notified of the initiation of the proceeding, the proceeding cannot be effective as an adjudication.

\*10 Hickel v. Halford, 872 P.2d 181 n.22.<sup>6</sup>

The same criteria apply when a purchaser purports to invoke the dispute resolution clause contained in many of the royalty sales contracts. If the purchaser has the right to invoke the clause and provides sufficient notice that it is invoking the clause, DNR would be obligated to respond within a reasonable time. This legal obligation to respond means that an administrative proceeding has begun. Id. at 181.

In sum, any money received in settlement of a dispute arising under a royalty sale contract after either party clearly invokes administrative dispute resolution procedures in a manner that binds the other party, must be deposited in the budget reserve fund. This is true even if the money is received as a result of amicable settlement negotiations prior to the convening of a hearing.

As we understand the facts, this opinion will not require transfer of any money from the general fund to the budget reserve fund. Most of the royalty sales disputes settled since July 1, 1990, were being litigated in court and the money was deposited in the budget reserve fund. In one dispute settled before litigation began, DNR sent a demand letter to the purchaser, but did not notify the purchaser of its right to appeal or purport to invoke the dispute resolution clause. Accordingly, in that case, no administrative proceeding was begun and the money received in settlement was properly deposited in the general fund.

appealed to superior court, arguing, among other things, that it was not given sufficient opportunity to present its case. Although the only process specified in the contract provided that the Commissioner would issue a decision after the purchaser presented its views in writing, the court held that due process principles applied and that Tesoro's right to argue its position fully was impaired. Yet, even in this case, the problem was defective notice--had DNR notified Tesoro that the dispute resolution clause had been invoked, Tesoro could have voiced its arguments more fully.

- 7 Settlements under mineral leases other than oil and gas leases may also be subject to deposit in the budget reserve fund. We have not researched these leases, but the principles of this opinion apply when determining whether mineral revenue was received as a result of the termination of an administrative proceeding.

1995 Alaska Op. Atty. Gen. (Inf.) 111 (Alaska A.G.), 1995 WL 867852

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\*2 Or the legislature could appropriate to the **fund** and specify that the monies appropriated are not to be considered a part of the **fund's** "principal" in the sense of the constitution, i.e., as monies available solely for investment, but rather are to be considered as a temporary addition to the **fund** which is to be used for investment but which shall be accounted for separately and may be withdrawn. Again, the problem is that the courts would likely rule that such legislation is so inconsistent with the provisions of section 15 that it is void. Either there is a **permanent fund** or there is not.

We are dealing here with a peculiar—perhaps unique—quasi-trust. Unlike most trusts, the principal may not be reached whatever, either now or in the future. No one has a future right to the principal. Instead, the principal is to be invested in perpetuity to produce income. Only the income from investments may be reached. Absent still another constitutional amendment, we see no way around this result. A **permanent fund** was intended, and a **permanent fund** appears to have been achieved.

Accordingly, we doubt very much that any money appropriated to the **permanent fund** may subsequently—without a constitutional amendment—be withdrawn.

Sincerely yours,

Avrum M. Gross  
Attorney General  
Rodger W. Pegues  
Assistant Attorney General

1977 WL 21975 (Alaska A.G.)

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\*2 Of course, the Alaska Supreme Court could rule that no trust or quasi-trust exists and the law of trusts does not, therefore, govern the **fund's** administration. That would remove the administration of the **fund** from the operation of the prudent-man rule. There would then be no duty to limit investments to those which are prudent. That would pretty much give the legislature the power to authorize the expenditure of the **fund's** principal on any income-producing investment even though it would not be a prudent, *i.e.*, an investment which a trustee could not properly make. This result would allow the **fund** principal to be frittered away and thereby frustrate the basic purpose of the constitutional amendment. Principally for that reason, we believe the Alaska Supreme Court will impose trust concepts to avoid that result and to give the amendment its full effect.

There can be no question that a trustee must take into consideration the trend of prices and the cost of living, the prospect of inflation or deflation. RESTATEMENT (SECOND) OF TRUSTS 2d § 227, Comment e (1959). To do otherwise would hardly be the conduct of a man of prudence. Accordingly, the **fund** managers will have to take inflation (or deflation) into account in making and changing investments, if—as we believe—the **fund** constitutes a trust.

It does not follow, however, that the legislature has a duty to provide specific guidelines on the matter. If the court rules that there is a trust, the prudent-man rule applies. If it rules otherwise, the rule does not apply. Unless the legislature itself resolves the question by making the **fund** a trust, the matter is entirely up to the court. Whichever way it rules, the court would not, and could not, order the legislature to adopt any particular guidelines. It would merely order the **fund** managers to follow the prudent-man rule.

Nor does the legislature have any duty to increase the amount of the **fund** principal because of inflation. The constitutional amendment, which sets forth the principal terms of the trust, makes it mandatory to deposit 25 percent of the designated mineral revenues in the **fund**. That is the trust property which must be administered, we believe, under the prudent-man rule. While the legislature qua legislature clearly has the power to increase that amount, nothing in trust law places a duty on it to do so. It could also provide for all or a portion of the income from the principal to be deposited in the **fund**, *i.e.*, added to the principal. But under the terms of the trust, *i.e.*, the constitutional amendment, it has no duty to do so.

We hope that this answers your question. We remind you that we are making an educated guess as to the trust or quasi-trust nature of the **permanent fund**. We believe it is a trust or quasi-trust and that trust law applies. We are constrained to add that we could be wrong. The legislature may wish to treat the **fund** as a trust. That would resolve the issue. It should feel free, however, to experiment and treat it otherwise insofar as it determines the public interest warrants doing so, and let the court resolve the issue.

Sincerely yours,

\*3 Avrum M. Gross.  
Attorney General  
By: Rodger W. Pegues  
Assistant Attorney General

#### Footnotes

- a1 While the **permanent fund** is essentially a conservative device, the constitutional amendment was not overly conservative. It did not apply to taxes on minerals at all and it still leaves 75 percent of other mineral revenues available for expenditure.

1977 WL 21820 (Alaska A.G.)

the ballot materials, election pamphlet, or publicity surrounding the amendment. See 1980 Op. Att'y Gen. No. 3 (March 19) at 7-9 (copy attached).

\*2 For this reason, I favor a narrower interpretation of the last sentence of article IX, section 15. One possible reading would be that the legislature intended that the income could be used without appropriation either for reinvestment or for distributing dividends to Alaskans, as explicitly mentioned in the joint chairman's report, and the attached Attorney General opinion. However, it is difficult to discern from the language of article IX, section 15 why the income could be dedicated for these but not for other important public purposes. Another possible interpretation is that an appropriation is required for any use of the income, including reinvestment as principal of the **permanent fund**. However, this interpretation would render the phrase 'unless otherwise provided by law' meaningless, since the income would then be treated as automatically becoming part of the general **fund** despite any attempted dedication by law. Article IX, section 15 clearly contemplates that the legislature may by law provide for some use of the **fund** other than deposit in the general **fund**.

The interpretation of article IX, section 15 which I find to be most reasonable and compatible with the constitutional prohibition against dedications is that the legislature may provide by law for the income to remain in the **permanent fund** (either through reinvestment as principal or retention in an undistributed income account) without appropriation, but may not transfer income to another **fund** or authorize it to be spent without an appropriation. This view is consistent with the legislation enacted last session providing for reinvestment of an amount sufficient to offset inflation, and retention of the balance in an undistributed income account where it remains available for appropriation. AS 37.13.145, a amended by ch. 81, SLA 1982. Legislation which will soon be introduced at the Governor's request will propose amendments to AS 37.13 which are consistent with this view.

I share your concern that our state government avoid the problems associated with statutory dedications of revenue. I also appreciate that the legal and constitutional provisions regarding governmental finance and their past and present administrative interpretations are sufficiently complex to require careful study and thorough discussion by all involved. A copy of a recent lengthy opinion regarding the meaning and application of the dedicated **fund** prohibition is attached for your information. 1982 Op. Att'y Gen. No. 13 (Nov. 30). Please let me know if I can be of further assistance.

Very truly yours,

Norman C. Gorsuch  
Attorney General

1983 WL 42491 (Alaska A.G.)

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2003 WL 25875053 (Alaska A.G.)

Office of the Attorney General

State of Alaska

AG File No. 663-03-0153

June 18, 2003

**Re: Questions Concerning the Accounting for Principal and Income of the Alaska Permanent Fund**

\*1 Eric Wohlforth

Chair

Board of Trustees

Alaska Permanent Fund Corporation

P.O. Box 110410

Juneau, Alaska 99811-0410

Dear Mr. Wohlforth:

This letter responds to a request from the Alaska Permanent Fund Corporation (the corporation) for an opinion interpreting the provisions of article IX, section 15, of the Alaska Constitution and implementing statutes. Particularly, the APFC trustees ask if their current policies correctly determine net income available for appropriation and the limitations, if any, properly placed upon the expenditure of income from the earnings reserve account.

#### Introduction

At the end of each fiscal year, AS 37.13.145(b) directs the corporation to transfer to the dividend fund established under AS 43.23.045 an amount that is equal to 50 percent of the "income available for distribution" under AS 37.13.140. In addition, AS 37.13.145(c) directs the corporation to transfer to the principal of the Alaska permanent fund an amount "sufficient to offset the effect of inflation" on the principal ("inflation-proofing"). These transfers are to be made from the permanent fund's earnings reserve account established by AS 37.13.145(a). Separate appropriations authorizing those transfers for the current fiscal year (ending June 30, 2003) were approved by the legislature in the FY 2003 operating budget (sec. 10, ch. 94, SLA 2002).

Although the necessary appropriations for the transfer of money to pay permanent fund dividends and inflation-proofing in 2003 are enacted, possible declines in the financial markets can cause some uncertainty whether there will be a balance available for expenditure from the earnings reserve account to cover the amounts appropriated. The question arises for two related reasons. First, there is an apparent inconsistency between the provisions of AS 37.13.140 and AS 37.13.145, both adopted in the 1980's, and the accounting requirements of GASB 31,<sup>1</sup> which became effective in 1998, regarding how to determine the size of the earnings reserve account from which money may be transferred. Second, although the constitutional provision that created the permanent fund<sup>2</sup> has always been viewed as providing "protection" for the principal, the nature and extent of that protection are unclear. Accordingly, the corporation requested an opinion from this office to assist in determining how much is available for expenditure from the earnings reserve account to finance the 2003 appropriations for dividends and inflation-proofing.<sup>3</sup>

#### Questions presented:

Is the corporation's current policy that only realized income of the permanent fund is available for expenditure under AS 37.13.145 correct? If not, how should the amount available for expenditure from the permanent fund under AS 37.13.145 be determined?

I hear public support for the **fund** from three sectors, ... from those who favor a savings account approach, those who want it used to provide assistance in community development and those who want it to provide economic diversity in the state. ... [A] major goal [is] the strengthening of the state's economic base by investing in renewable resources and by policies which would reduce seasonality of employment.<sup>10</sup>

The voters were told that “the income from the **fund** will be available for general appropriation by the legislature but the principal of the **fund** may not be touched.”<sup>11</sup> The **permanent fund** was described as “a lasting savings account.”<sup>12</sup> The object is to prevent future legislatures from doing what previous legislatures did with the \$900 million bonanza received by the state from the sale of Prudhoe Bay leases in 1969. That gigantic sum ran through the legislators' fingers like water, to the alarm of many who had pleaded at the time that the \$900 million be invested, the principal preserved and the state spend only that money derived from interest.<sup>13</sup>

There is fairly strong evidence that the voters were aware that the legislature would have a role in providing the details for administration of the **permanent fund**. Whether the **fund** was to be a savings account or a development bank was not resolved by the legislature until four years after adoption of the amendment.

## 2. Post Adoption

### A. Legal Opinions

After the amendment took effect, the attorney general was asked to interpret its meaning for various purposes. Set out below are opinions discussing aspects of the **permanent fund** that are relevant to our consideration of the corporation's accounting practices.

In August of 1977, the attorney general answered whether money appropriated to **permanent fund** principal in excess of the amount required by the constitution is irretrievable. The attorney general confirmed that once money was deposited in principal by any means, it could not be removed without further amendment of the constitution.<sup>14</sup> The attorney general advised that the constitution's restriction on the use of **fund** principal is an implied restriction against the withdrawal of appropriated principal.<sup>15</sup> The attorney general speculated that the legislature probably could not condition appropriations to principal on the ability to withdraw at a future date or to specify that such amounts would not be considered principal. The attorney general observed that the **permanent fund** was a “peculiar — perhaps unique — quasi-trust.”

\*4 In September of 1977, the attorney general again interpreted the amendment to determine whether the legislature was required to enact legislation which takes inflation into consideration in the management and investment of **fund** principal.<sup>16</sup> In this opinion, the attorney general restated the conclusion that the **permanent fund** was a trust or quasi-trust. This was based on a prediction that “the Alaska Supreme Court will follow a previously exhibited tendency to impose trust-like duties on the state's management of its patrimony” and the amendment “is extremely similar to the classic spendthrift trust both in its roots and causes and in its establishment ....”

The attorney general also concluded that the legislature acts as a trustee which must prudently exercise any duty in relation to administration of the **permanent fund**. In this regard, the legislature was advised that its power was not plenary but limited by the constitution and implied trust concepts. This office advised that there was no legal requirement that inflation be taken into account in statutes enacted to implement the **permanent fund**. The legislature was advised that the foregoing interpretation cannot be considered settled until the supreme court rules on the matter. However, the legislature was advised that it could resolve the question of status by making or treating the **permanent fund** as a trust.

ch. 18, SLA 1980. For the entire period 1977 - 1982 during which the **fund** was limited to fixed income investments, appreciation in value ("gain") was credited to principal, interest was credited to income.<sup>21</sup> However, if losses exceeded gains, interest was to be transferred to principal in an effort to cover some of the loss. Former AS 37.13.130 (repealed 1982); former 15 AAC 137.060 (repealed 7/12/92).

\*6 In 1982 after the **fund** was authorized to invest in equities, income was defined to include realized gain representing appreciation in value. Under then-applicable generally accepted accounting principles ("GAAP"), only realized gains (and losses) of the **fund** were recorded as income in the earnings reserve account established under AS 37.13.145. This former GAAP approach was consistent with the statutory requirement of AS 37.13.140 (in effect since 1982) for determining **fund** "net income" (from which the amount of the annual dividend transfer is then computed), which specifically excluded unrealized gains and losses from the determination.<sup>22</sup>

This consistency in treatment ended with the implementation of GASB 31 in 1997. Under GASB 31, the corporation is required to record as revenue in its financial statements the **permanent fund's** readily marketable investments at current fair value. The corporation has interpreted this change in GAAP as requiring all unrealized market appreciation and depreciation (unrealized gains and losses) to be included in determining income for accounting purposes, potentially resulting in large differences between GAAP net income and "net income" under AS 37.13.140. As a result, the corporation now has two different ways to report income. The first method is to report realized income, as called for by the definition of "net income" under AS 37.13.140, to determine how much is available for distribution. The other method is to apply the GAAP definition and include both realized and unrealized gains and losses to determine net income for financial reporting purposes. Depending on the situation, the corporation applies both approaches in its financial statements. The inherent conflict between these two approaches is at the heart of the request for this opinion.

In late 2001, the audit committee of the corporation considered an issue paper prepared by APFC staff which discussed the policy for determining the amount available for expenditure to pay the dividend and inflation-proofing transfers provided for under AS 37.13.145. The issue paper did not resolve the matter, but recommended the trustees seek a legal opinion from the Department of Law. While the subject was briefly discussed by the trustees, they did not pursue an opinion from the Department of Law at that time. In the absence of an attorney general's opinion, the corporation has applied a conservative "invasion test" under which realized income may not be spent if doing so causes the total value of the **permanent fund** and the earnings reserve account to fall below the historic dollar amount ("notational principal") contributed to principal from all sources. Although this limitation is not specifically addressed in the statutes, it was presumably applied in order to "protect" past contributions to principal from diminishment and has been subsumed in the corporation's accounting practices.

\*7 Notwithstanding this conservative "invasion test," there have been instances in the past when distributed earnings were more than offset by unrealized losses. These distributions to the state general **fund** occurred in fiscal years 1978 and 1979 and would have amounted to an expenditure of principal under the corporation's "invasion test." This is apparently why, beginning in 2001, the corporation and corporate counsel recommended obtaining a legal review of corporate accounting policy by this office.

For fiscal year 2002, there was enough realized income accumulated in the earnings reserve account and in excess of "notational principal" to fully pay the 2002 dividend and inflation-proofing distributions without having to apply the limitation regarding invasion of principal. However, given the current investment allocation of the **fund**, a sustained downward trend in financial markets could result in the total market value of the **permanent fund** at the end of a fiscal year totaling less than the sum of the amount attributed to "notational principal," plus the amount of realized income in the earnings reserve account. If total market value of the **permanent fund** is less than the sum of those two figures, then current corporation accounting practices would limit the amount available for expenditure under AS 37.13.145 to the amount (if any) by which the total market value of the **permanent fund** on the last day of that fiscal year, including the earnings reserve, exceeds "notational principal" (the sum of all dedications and appropriations to the principal of the **fund** over time).

appropriation without any diminishment for gain or loss on investments. However, in doing so it appears that the corporation failed to consider the potential effect on the constitutional requirement that income be made available for appropriation.

\*9 The pre-adoption history of the **permanent fund** amendment provides no evidence that a particular definition of income would be preferred over another. As explained above, the amendment was promoted by some as a savings account that would serve as a form of development bank to help diversify an economy that was too dependent on non-renewable resource revenues. There was also a clearly stated purpose to dedicate oil revenue and prevent expenditure of the dedicated amounts. The amendment expressly provided that income is to be deposited in the general **fund** or other legislatively authorized purpose. After the amendment was adopted, the legislature abandoned the development bank approach in favor of an investment **fund** managed by a public corporation authorized to make conservative fixed income investments.<sup>26</sup>

At the time the **permanent fund** amendment was adopted in 1976, trust law traditionally allocated gain and loss on equity securities to principal rather than income.

The proceeds of the sale of trust property are ordinarily to be treated as trust principal, even though they include profit in excess of cost price or inventory value. Losses on such sales fall on trust principal. The rule should govern sales of corporate stock where there is a gain in value due to undistributed earnings.

*Bogert on Trusts*, sec. 120 (6th ed. 1987). As recently as 1984, the legislature chose to adopt traditional allocation rules for common trusts.<sup>27</sup>

There has been a movement among the trustees of endowment trusts to change traditional allocation rules to permit investment in equity securities. This approach would authorize a trustee to consider capital gain as part of the total return, enabling distributions to beneficiaries without being restricted by whether the returns are accounting income or value appreciation. A uniform act was proposed in 1972 to permit trustees to allocate both realized and unrealized capital appreciation to income for distribution purposes.<sup>28</sup> The uniform act is the law in 46 states and the District of Columbia. The UMIFA contains an impairment rule very similar to the "invasion test" contemplated by the corporation. Realized and unrealized gains are offset to determine if the historic dollar amount of contributions to principal will be impaired by a planned distribution. Sec. 2 UMIFA. However, the uniform act is not the law in Alaska. Aside from the difference between the **permanent fund** and an endowment trust, the uniform act differs from existing law by permitting distributions based on unrealized appreciation. State law charts a different course for the **permanent fund** by not allowing such a distribution. For that reason, it is not appropriate to apply the impairment rule of the uniform act. When the legislature expanded authority for investments to include equity securities, it added a definition of income. AS 37.13.140 provides in pertinent part:

\*10 Net income of the **fund** shall be computed annually as of the last day of the fiscal year in accordance with generally accepted accounting principles, excluding any unrealized gains or losses.

(Emphasis added.) This hybrid definition of income is intended to "to allow the maximum use of disposable income." AS 37.13.020(3). By making clear that "gain" is to be an element of income, the definition of income was expanded to include capital appreciation, but it plainly prevented any distribution of unrealized gain. Section 140 does not explain the accounting treatment for unrealized gains and losses other than to provide that this form of appreciation or loss is to be excluded from the determination of income.

The limitation of income to that which is realized appears to be consistent with the text of both the constitution and statute. The constitution provides the income "shall be deposited in the general **fund**." Alaska Const., art. IX, sec. 15. The statute provides: "[I]ncome from the **permanent fund** shall be deposited by the corporation into the [earnings reserve] account as soon as it is received." AS 37.13.145(a). When interpreting these words, a court will attempt to discover the plain meaning and purpose of the provision.

Finally, we anticipate some will claim that our reading of the constitution and statutes serves to permit a silent invasion of principal when the **permanent fund** is carrying a large unrealized loss on its books. Realized income does not lose its character as income even if it were offset by unrealized capital losses. There simply is no basis in the history of the amendment or the enabling statutes for a liberal interpretation that would expand the scope of the dedicated **fund** by foreclosing expenditure of traditional accounting or statutorily defined income. To do so would do violence to the plain meaning of the constitution and section 140 which require that income be determined by realized gains and losses and be available for expenditure.

The constitutionally required dedication of principal is more than satisfied by the prudent investing practices of the corporation in statutorily approved investments and the generous inflation-proofing and contributions to principal appropriated by the legislature. We decline to read into either the constitution or the statutes a broader exception to the general prohibition on dedicated **funds** than can be justified by the plain meaning of article IX, section 15 of the Alaska Constitution and relevant implementing statutory provisions and the history leading to the adoption or enactment of these provisions.

Sincerely,

\*12 Gregg D. Renkes  
Attorney General

#### Footnotes

- 1 "GASB 31" is shorthand for Statement No. 31 of the Governmental Accounting Standards Board, Accounting and Financial Reporting for Certain Investments and for External Investment Pools.
- 2 Section 15, article IX of the Alaska Constitution provides:  
Section 15. Alaska **Permanent Fund**. At least twenty-five per cent of all mineral lease rentals, royalties, royalty sale proceeds, federal mineral revenue sharing payments and bonuses received by the State shall be placed in a **permanent fund**, the principal of which shall be used only for those income-producing investments specifically designated by law as eligible for **permanent fund** investments. All income from the **permanent fund** shall be deposited in the general **fund** unless otherwise provided by law.
- 3 Since it is clear under both AS 37.13.145 and the appropriations for **permanent fund** dividends and inflation-proofing that **funding** of the PFD appropriation has priority and must be fully paid before any amount is transferred for inflation-proofing, you did not request our advice on whether or how those two transfers should be prioritized or allocated.
- 4 The ballot summary read as follows:  
This proposal would amend Article IX, Section 7 (Dedicated **Funds**) and add a new section to Article IX, Section 15 (Alaska **Permanent Fund**) of the Alaska Constitution. It would establish a constitutional **permanent fund** into which at least 25 percent of all mineral lease rentals, royalties, royalty sale proceeds, federal mineral revenue sharing payment and bonuses received by the State would be paid. The principal of the **fund** would be used only for income producing investments permitted by law. The income from the **fund** would be deposited in the State's General **Fund** and be available for appropriation for the State unless law provided otherwise. 1976 Ballot Proposition No. 2.
- 5 The resolution was introduced in January, 1976 as a sponsor substitute for the initial version of HJR 39, introduced by the governor the previous June, which had only proposed amending the dedicated **funds** provision of article IX, section 7 of the Alaska Constitution to permit the dedication of the proceeds of mineral lease bonuses. The sponsor substitute proposed adding a new section 15 to article IX to create a **permanent fund** by dedicating 10 percent of nonrenewable resource revenue. The resolution substituted by the governor also expressly provided that the legislature could make additional contributions to the **fund**. 1976 House J. at 39-40.
- 6 Joint Chairmen's Report on CS SSHJR 39, 1976 House J. at 684.
- 7 1976 House and Senate J. Supp. (fiscal note comments dated January 12, 1976).
- 8 Anchorage Daily News editorial, October 26, 1976 ("a percentage of the **fund** would go for direct use by Alaskans - for loans to businessmen, fishermen and builders.") The **permanent fund** was described as a "tool whereby Alaska can take some of today's mineral wealth and prepare for the future by investing in the development of human and material resources that will remain productive for many generations ...." *Quoting* Revenue Commissioner Sterling Gallagher.
- 9 Anchorage Times, October 24, 1976 ("Lawmakers Would Shape **Permanent Fund**").
- 10 Anchorage Times, October 14, 1976 ("Panel Mulls **Permanent Fund**").
- 11 Anchorage Times, October 27, 1976 ("Governor's Point of View").
- 12 Anchorage Daily News, October 24, 1976 (editorial, "Its **Permanent**").
- 13 Anchorage Times, October 24, 1976 (editorial, "No Easy Choice").

(amounts in millions)

Year	Amount	Source
FY 81-85	\$2,700	Surplus Oil Revenues
FY87	1,264	Earnings Reserve Account
FY96	1,842	Earnings Reserve Account
FY97	803	Earnings Reserve Account
FY00	250	Earnings Reserve Account

In FY 03 the legislature appropriated an additional amount to principal which could not be determined as of the date of this opinion.  
2003 WL 25875053 (Alaska A.G.)

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3. Nothing in law prohibits an appropriation from the earnings reserve account, even if doing so would reduce the total value of the **permanent fund** to less than the amounts deposited or appropriated to the principal.

4. Nothing in law prohibits the payment of **permanent fund** dividends this year. A valid appropriation for 2009 **permanent fund** dividends has been enacted into law, **funds** are currently available for this appropriation in the earnings reserve account, and therefore these dividends can be paid.

\*2 5. The earnings reserve account is a government investment account established by AS 37.13.145(a) which will naturally have unrealized gains and losses on its investments. While AS 37.13.145 does not expressly address how to account for the unrealized gains and losses on the investments of the earnings reserve account, AS 37.13.170 requires the Corporation to include in its annual report "an appraisal at market value" of the investments of the **fund**. We think AS 37.13.170 reasonably contemplates that the Corporation should report on the market value of the investments of the principal as well as the market value of the investments of the earnings reserve account. Thus, the unrealized gains and losses attributable to the earnings reserve account should be accounted for in the earnings reserve account.

The questions you have asked are prompted by two developments.

First, as discussed in our 2003 Opinion, in 1997 the Governmental Accounting Standards Board adopted a new standard for reporting income. This new accounting standard, GASB Statement No. 31 ("GASB 31"), required that investment income include changes in the fair value of investments of government entities. GASB 31 defines fair value to mean "the amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale." For publicly traded securities, fair value is the same as market value. Thus, GASB 31 raised the question as to whether the net income of the **permanent fund** calculated under AS 37.13.140 should include the unrealized gains and losses that accrue on investments. We observed in our 2003 Opinion that this accounting change had been anticipated when the legislature repealed and reenacted AS 37.13.140 in 1982, and that the legislature intended to exclude unrealized gains and losses from the calculation of statutory net income. 2003 Opinion at 14 n.22, 23-26.

Second, because of unrealized investment losses incurred during FY 2009, the fair value of the principal of the **permanent fund** has been "underwater," in other words, the fair value has declined below the original dollar value of the amounts deposited to or appropriated to principal. As a consequence, some observers have suggested that 2009 **permanent fund** dividends should not be paid.

As discussed more fully in this opinion, neither accounting changes nor investment losses can change a fundamental fact about the **permanent fund**: the earnings reserve account is subject to the constitutional prohibition against dedicated **funds**. Therefore, if there are **funds** in the earnings reserve account, and those **funds** have been appropriately deposited in that account, they can be appropriated for any public purpose, including the payment of **permanent fund** dividends. Accordingly, we re-affirm our conclusions from the 2003 Opinion.

Because the answers to these questions turn in large part upon the extent to which the constitutional prohibition against dedicated **funds** applies to the **permanent fund**, we begin with a background discussion of that prohibition. Next, we show how the legislature may always appropriate **funds** from the earnings reserve account by analyzing the following issues: (a) how the constitutional prohibition against dedicated **funds** applies to the **permanent fund**; (b) whether the framers and voters expressed an intent to not permit the expenditure of income when the value of the **permanent fund** is underwater; and (c) whether the modern law of endowments permits the expenditure of income when the value of an endowment **fund** is underwater. Finally, we consider the issue of the appropriate accounting treatment of the unrealized gains and losses on the investments of the earnings reserve account.

## **I. Background: The Constitutional Prohibition Against The Dedication Of Funds**

As noted above, the answers to your questions turn in large part upon the extent to which the constitutional prohibition against dedicated **funds** applies to the **permanent fund**. In particular, as discussed below, the corpus of the earnings reserve account is subject to the prohibition, and therefore always subject to appropriation.

#### A. How the Constitutional Prohibition Against Dedicated **Funds** Applies to the **Permanent Fund**

Created by amendment to the Alaska Constitution in 1976, the **permanent fund** is a state **fund** into which certain mineral proceeds are placed for purposes of investment. Alaska Const, art. IX, § 15.<sup>9</sup> Like many trust or endowment **funds**, the accounting framework of the **permanent fund** is a variation on the “principal and income” model.

The accounting framework of the **permanent fund** has a number of unique elements, some of which are established by constitution (the mineral revenue earmark, restricted principal, and alternative income use authorization), and others by statute (earnings reserve account, **permanent fund** income dedication, **permanent fund** dividend transfer, and inflation-proofing transfer). We analyze here how the constitutional prohibition against dedicated **funds** applies to the accounting elements of the **permanent fund**.

##### 1. The Constitutional Framework of the **Permanent Fund**

Article IX, § 15 of the Alaska Constitution establishes three elements of the accounting framework of the **permanent fund**: the mineral revenue earmark, the restricted principal, and the alternative income use authorization. The first two of these elements must be established in the Alaska Constitution, otherwise they would be void, and in the case of the alternative income use authorization—probably void if used to dedicate income, under the constitutional prohibition against dedicated **funds**.<sup>10</sup>

###### i. Mineral Revenue Earmark

\*5 The first accounting element of the **permanent fund** is the mineral revenue earmark. “At least twenty-five per cent of all mineral lease rentals, royalties, royalty sale proceeds, federal mineral revenue sharing payments and bonuses received by the State shall be placed in a **permanent fund** ....” Alaska Const, art. IX, § 15. As seen above, revenue earmarks are impermissible under the constitutional prohibition against dedicated **funds**. *Alex*, 646 P.2d at 207-210. Thus, establishing the mineral revenue earmark in the Alaska Constitution is necessary in order to ensure its validity.

###### ii. Restricted Principal

The next accounting element of the **permanent fund** is the restricted principal. The proceeds from the mineral revenue earmark are placed in the **permanent fund**, “the principal of which shall be used only for those income-producing investments specifically designated by law as eligible for **permanent fund** investments.” Alaska Const, art. IX, § 15. Because the principal may only be used for income-producing investments, it is not subject to legislative appropriation.<sup>11</sup> As discussed above, placing **funds** in a separate state account is permissible, but only if the legislature retains its power of appropriation. *Sonneman*, 836 P.2d at 939-40. Thus, to restrict an account from appropriation, as this clause does, the restriction must be set forth in the constitution.

###### iii. Alternative Income Use Authorization

The final accounting element in the constitution is the authorization for an alternative use of **permanent fund** income: “All income from the **permanent fund** shall be deposited in the general **fund** *unless otherwise provided by law*.” Alaska Const, art. IX, § 15 (emphasis added). As noted above, the Alaska Supreme Court has expressed doubts as to whether the prohibition against dedicated **funds** would permit the retention of income in a statutory **fund**. *SEACC*, 202 P.3d at 1175. Accordingly, to the extent that this language is intended to authorize a statutory dedication of **permanent fund** income, its placement in the constitution is probably required in order for the dedication to survive scrutiny under the prohibition against dedicated **funds**.

**funds** to the **permanent fund** dividend **fund** should be made by appropriation). We have based our reluctance on the view that the voters were not advised in 1976 that the “unless otherwise provided by law” language could be used to create a “tremendous exception” to the prohibition against dedicated **funds**. *Id.* at 2. In any event, to the extent that this alternative income use language is intended to authorize a statutory dedication of **permanent fund** income, its placement in the constitution is probably required in order for the dedication to survive scrutiny under the prohibition against dedicated **funds**.

## 2. The Statutory Framework of the **Permanent Fund**

\*7 The legislature has fleshed out the constitutional framework of the **permanent fund** by adding a number of statutory elements: the earnings reserve account, **permanent fund** income dedication, **permanent fund** dividend transfer, and inflation-proofing transfer. The extent to which the constitutional prohibition against dedicated **funds** applies to these elements varies.

### i. The Earnings Reserve Account

The earnings reserve account is established by AS 37.13.145(a) as a separate account in the **permanent fund**. Income from the **permanent fund** must be deposited into the earnings reserve account “as soon as it is received.” AS 37.13.145(a).

Nothing in law restricts the earnings reserve account from appropriation. In *Hickel v. Cowper*, 874 P.2d 922 (Alaska 1994), the Alaska Supreme Court held: “There are no statutory or constitutional prohibitions against direct appropriations from [the earnings reserve] account. The earnings reserve account is therefore available for appropriation.” *Id.* at 934. Thus, the prohibition against dedicated **funds** applies to the balance in the earnings reserve account. Under *Hickel* and *Sonneman*, all **funds** in the earnings reserve account are subject to appropriation by the legislature. This office has held this view for at least 25 years. *See* 1984 Inf. Op. Art’y Gen. (366-405-84; Feb. 6) (“nothing in law prevents the unallocated part of the **permanent fund** income from being appropriated by the legislature”).

### ii. The **Permanent Fund** Income Dedication

By statute, “[i]ncome from the **fund** shall be deposited” into the earnings reserve account “as soon as it is received.” AS 37.13.145(a). The income deposited into the earnings reserve account comes from two sources: (1) investments of the principal, and (2) investments of the earnings reserve account.

Since the balance in the earnings reserve account is subject to appropriation, the automatic deposit of income to the earnings reserve account is arguably not a dedication, since such income remains subject to the appropriation power of the legislature. *See* 1982 Op. Att’y Gen. No. 13 at 20 (Nov. 30). But we remain mindful that the objective of the prohibition against dedicated **funds** is to maintain legislative budgeting flexibility and control. As a practical matter, any deposit of **funds** into the earnings reserve account arguably decreases the legislature’s flexibility and control over such **funds** because of the public and political pressure to use such **funds** only for **permanent fund** dividends or inflation-proofing. Accordingly, a court may conclude that in this context the deposit of investment income into the earnings reserve account is for all practical purposes a dedication.

The dedication, however, is authorized by the Alaska Constitution: “[a]ll income from the **permanent fund** shall be deposited in the general **fund** unless otherwise provided by law.” Alaska Const, art. IX, § 15; Alaska Const, art. IX, § 7 (allowing dedications “as provided in section 15”). Alaska Statute 37.13.145(a) implements this provision by requiring **permanent fund** investment income to be automatically deposited in the earnings reserve account.

\*8 The AS 37.13.145(a) dedication of income from investments of the **permanent fund's** principal and earnings reserve account to the earnings reserve account has been in place since 1982.<sup>14</sup> In our opinion, the doubts recently expressed by the Alaska Supreme Court in *SEACC* regarding the statutory dedication of income from an investment **fund** are addressed by the constitutional language permitting the legislature to otherwise provide for the income from the **permanent fund**. We understand

the amounts in the earnings reserve account are constitutionally subject to appropriation regardless of whether the fair value balance of the principal is underwater. Unless otherwise required by the Alaska Constitution, legislative goals or statutes must give way to the constitutional prohibition against dedicated **funds**.

Accordingly, we must examine whether there is any constitutional requirement that the principal retain income and stop further deposits into the earnings reserve account until such time as the fair value of the principal is restored to a level above original dollar value. There is no such requirement in the plain text of the Alaska Constitution. As discussed above, the text of article IX, § 15 is limited to establishing the revenue earmark, the restricted principal and the alternative income use authorization. The text of the constitution sets out no limitations or restrictions on the expenditure of income, nor does it require retention of income when the value of principal is underwater.

Thus, we turn to intent.

The framers' intent for the **permanent fund** is sometimes invoked in the ongoing public discussion regarding the extent to which the Alaska Constitution prohibits the payment of **permanent fund** dividends when the fair value of the **fund** is underwater. The intent of the framers is considered by the courts in determining the meaning of the Alaska Constitution. *Hickel*, 874 P.2d at 926. Additionally, the Court will consider the extrinsic evidence of the voter's understanding of a constitutional amendment's provisions. *Id.* at 929.<sup>17</sup> Accordingly, we review the framers' intent as well as the extrinsic evidence of the voter's understanding regarding the **permanent fund** amendment to the Alaska Constitution.<sup>18</sup>

\*10 As set forth below, following review of the entire record of HJR 39, as well as the public record from 1976, we find no evidence that the framers or the voters expressed an intent for article IX, § 15 of the Alaska Constitution to require retention of income as principal when the fair value of principal is underwater. We start with the framers' intent.

### 1. Framers' Intent

From January to May 1976, the legislature debated Governor Hammond's proposal for a constitutional **permanent fund** and made a number of significant changes. During the course of these deliberations, a representative from the Hammond Administration (Department of Revenue Commissioner Sterling Gallagher), and the primary legislative proponents of HJR 39 (Representative Hugh Mai one and Representative Clark Gruening) described the intent and vision of the **permanent fund** proposal.

During the hearings, Representative Malone and Representative Gruening articulated a three-part vision for the **permanent fund**. The first objective was to save a portion of the state's non-renewable mineral income for the future. The second objective was to preserve the legislature's flexibility with respect to how the principal of the **permanent fund** was to be invested, and how the income was to be used. The third objective was to use the **permanent fund** to diversify the Alaska economy.

The first objective—savings—was accomplished simply by restricting the use of principal to income-producing investments. As discussed above, this meant that the principal could not be appropriated. Representative Gruening testified: “none of that principal could be used under the ... governor's concept for operating expenses.” Hearing on HJR 39 Before the House Judiciary Comm., 9<sup>th</sup> Legislature (Mar. 15, 1976) (tape in State Archives Box 18287).

The second objective—flexibility—was accomplished by not specifying the types of investments (beyond “income-producing”) or how the income was to be used. The flexibility objective was reiterated multiple times.<sup>19</sup>

The third objective—diversification of Alaska's economy—was repeatedly emphasized by Representatives Malone and Gruening both during the legislative hearings and in their comments in the media. *See* Appendix A (collected statements). Representative Malone in particular envisioned that the **fund** would be used to make business loans to all Alaskans. *Id.*<sup>20</sup> Of

\*12 Review of the public materials from the June — November 1976 time period demonstrates that the three-part vision articulated by the framers (savings, flexibility and economic development) was effectively communicated to the voters prior to the November election. *See* Appendix B.

As noted above, in older cases the Alaska Supreme Court has expressed concerns about the difficulties inherent in discerning voter intent. *Starr v. Haglund*, 374 P.2d at 319, 321. In the case of the **permanent fund**, however, discerning voter intent is made easier by the fact that a number of surveys were conducted immediately following the 1976 election. These surveys reflect that the voters understood and agreed with the vision articulated by the framers.

In early 1977, Governor Hammond commissioned a statewide policy issue survey. Some of the questions pertained to the use of the **permanent fund**. The survey found that “[w]ith the exception of a few percent who would either save the money outright [5%], or reduce present taxation with it [5.3%], the public is thinking about ways of investing the money wisely in Alaska, and almost always the idea sounds a lot like most of the capital improvement concepts emerging from the government itself.” Rowan Group, Citizen Feedback No. 2—A Survey of Alaskan Citizens on the Major Policy Questions of the Day 11 (July 1977). The survey also found that 72 percent of the participants agreed with the following statement: “The **permanent fund** should be managed to assist Alaska directly through low-interest loans for such things as community development, fisheries enhancement, and so on.” *Id.* at 12. The survey found no consensus on the use of **permanent fund** earnings, and concluded that “[t]he public has not yet made up its mind about what the **permanent fund** is; only that it should exist. The purposes of the **fund**, the purposes of the earnings, and the relationship of the size of the **fund** to the size of the operating budget, are unsettled points.” *Id.* at 15 (emphasis in original).

The Alaska Public Forum conducted statewide policy issue surveys in 1977 and 1978. These surveys also included questions about the **permanent fund**. The results were similar to the Rowan Group survey. In 1977, the survey showed that 36 percent of participants wanted to use the **permanent fund** for loans for renewable resources, and 26 percent wanted to “save it.” The Alaska Public Forum, Year End Report 10 (1977). In 1978, the survey showed that 79 percent wanted to use the **permanent fund** to promote renewable resource industries. The Alaska Public Forum, Year End Report 36 (1978). “The support for these industries was so strong that 68 percent of Forum respondents this year were willing to sacrifice a substantial return on **Permanent Fund** investments in order to promote renewable resource industries, which are considered a risky investment.” *Id.* at 37.

### 3. Summary

\*13 There is no question that the record from 1976 demonstrates that the intention of the framers and the voters was to save a portion of mineral revenue for the future. Moreover, the framers repeatedly expressed their desire that the **permanent fund** would be invested in diversifying the Alaska economy. But of the three-part vision set forth above, the dominant objective appears to be preservation of legislative flexibility. Under the flexibility objective, the framers and the voters expressed the intent that the legislature would decide how to invest the principal of the **permanent fund** and how to use the income.<sup>21</sup>

The record from 1976 reflects a considerable spectrum of views as to how the **permanent fund** would be invested and how the income would be spent. One proposal was to pledge **permanent fund** income to secure state bonds. Hearing on HJR 39 Before the House Finance Comm., 9<sup>th</sup> Legislature (Feb. 21, 1976) (tape in State Archives Box 18460). Such a pledge would be required to be paid from income even if the value of the principal were to decline. Another proposal was to invest the principal in huge infrastructure assets the value of which depreciate over time — such as hydroelectric dams. Yet at the same time, the framers envisioned that the income from such investments would continue to be available for expenditure by the legislature. Hearing on HJR 39 Before the Senate Resources Comm., 9<sup>th</sup> Legislature (May 15, 1976) (tape in State Archives Box 18290). In yet another proposal, the **permanent fund** would be invested in potentially risky in-state economic development investments —but there is no suggestion that the income from the **permanent fund** could not be spent if such investments were to lose value. Debate on HJR 39 on the House Floor, 9<sup>th</sup> Legislature (Mar. 25, 1976) (tape in State Archives Box 18385).

The Uniform Law Commission partially adopted the Cary and Bright view when it drafted UMIFA in 1972. The Uniform Law Commission distinguished, however, between appreciation (*i. e.*, realized and unrealized capital gains) and income (interest, dividends and rents). At that point in time, the law was in flux as to whether capital appreciation should be credited to principal, as opposed to income. The Uniform Law Commission adopted a hybrid approach. Under UMIFA, income as defined can always be spent, regardless of the value of principal. Appreciation, however, could only be spent when the fair value of the endowment exceeded the historic dollar value (*i. e.*, original dollar value), unless otherwise specified by the rules governing the endowment. *UMIFA*, § 2, 7 A U.L.A. 19-20 (2006).

\*15 UMIFA commentators have repeatedly recognized an endowment's power to spend income, as defined by UMIFA, when the endowment is underwater. For instance, in the view of the New York Department of Law:

[T]he assets [of an endowment **fund**] must be invested, and the income — traditionally, interest, dividends, rents and royalties — is available for expenditure, even if the value of the principal drops below historic dollar value, whether because of specific investment losses or general decline in market values.<sup>29</sup>

Under New York law, however, appreciation cannot be appropriated when **fund** value is below historic dollar value, unless such appreciation was appropriated prior to the decline in value:

If the board properly appropriates net appreciation, the corporation may expend such appreciation even if at the time of expenditure endowment **fund** value drops below historic dollar value. However, like appropriation, such expenditure must be prudent under [New York UMIFA].

New York Dep't, Advice for Not-for-Profit Corporations on the Appropriation of Endowment **Fund** Appreciation (undated).

One commentator, however, has observed that appreciation can be spent from an underwater endowment **fund** if the donor has permitted it:

[A] charity may *always* spend the **fund's** income — that is interest, dividends, and other classic forms of income such as rents and royalties — if three conditions are met: (a) if the gift instrument does not prohibit spending income when the **fund** is underwater, (b) if the **fund** is underwater due to asset depreciation rather than appropriations that dipped into historic dollar value, and (c) if the expenditure of the income meets the standard of prudence .... Capital gains in an underwater endowment **fund** are not considered income for this purpose, unless, again, the donor has stipulated otherwise.

John Sayre, *United States: Underwater Endowments: Understanding Your Options*, Patterson Belknap Webb & Tyler Client Advice Publication (Mar. 29, 2009) (emphasis in original).

In 2006, the Uniform Law Commission recommended that UMIFA be replaced with the Uniform Prudent Management of Institutional **Funds** Act (UPMIFA). The reason for the revision was the Commission's recognition that the prudence standards that governed the investment of institutional **funds** had evolved to govern all aspects of **fund** management, including expenditure of **fund** income. *UPMIFA*, Prefatory Note, 7A Pt. Ill U.L.A. 4 (2008).

One of the most significant changes advanced by UPMIFA was the elimination of the rule prohibiting expenditure of appreciation when **fund** value is less than historic dollar value. The Commission was concerned about the impact of this historic dollar value rule on investment strategy:

\*17 By their very nature, unrealized gains and losses represent economic value that is attributable to the investments from which they are generated. For example, if the earnings reserve account is invested in 100 shares of Company X, and those shares appreciate in value from \$100 to \$200, that increase in value belongs to the earnings reserve account. Moreover, we think the legislature has the right to appropriate that value as it sees fit, including appropriating it to principal. Conversely, if those shares decrease in value from \$100 to \$50, an appropriation by the legislature of the balance of the earnings reserve account, unadjusted for unrealized loss attributable to the earnings reserve account, would arguably result in an impermissible appropriation of principal.

The legislative history indicates that the legislature intended for the earnings reserve account to retain the earnings produced by the investments of the earnings reserve account. This was explicitly stated in the law from 1982 to 1992: “[i]ncome from the investment of the earnings reserve account shall be treated as an addition to that account.” See Sec. 2, ch. 28, SLA 1986; sec. 9; ch 81, SLA 1982 (former AS 37.13.145). This language was repealed in 1992, but the legislative history for the 1992 changes reflects an intention to conform the statute to the accounting practices in place since 1982.<sup>33</sup> The Alaska **Permanent Fund** Corporation historically retained the earnings reserve account income in the earnings reserve account:

#### How the Alaska **Permanent Fund** Works

TABULAR OR GRAPHIC MATERIAL SET FORTH AT THIS POINT IS NOT DISPLAYABLE

Alaska **Permanent Fund** Corporation, 1987 Annual Report at 10. Accordingly, we believe that the unrealized gains and losses attributable to the investments of the earnings reserve account should be booked in the earnings reserve account.<sup>34</sup>

#### IV. Conclusion

In summary, our answers to your questions are as follows.

##### A. First Question

Question. Is the corporation's policy that only the realized income of the **permanent fund** is available for expenditure from the **permanent fund** under AS 37.13.145 correct? If not, how should this amount be determined?

Answer. Under AS 37.13.140 only realized net income from the investments of the principal is considered income for purposes of depositing **funds** into the earnings reserve account in AS 37.13.145. As discussed above, income consists of interest, dividends, royalties, rents, and net realized capital gain.

Once deposited, such income must be re-invested. AS 37.13.145(a). In our view, the entire balance of the earnings reserve account, including the unrealized gains on the investments of the earnings reserve account, is subject to appropriation. If the legislature were to appropriate the entire balance of this account, the unrealized gains or losses would be recognized in the process of appropriation.

##### B. Second Question

Question. Is the corporation's practice that both realized and unrealized income of the **permanent fund** should be taken into account in determining the amount that is available for appropriation, i.e., distribution under AS 37.13.140, correct? If not, how should the amount available for distribution from the **permanent fund** be determined? Should unrealized income of the **Fund** be excluded in determining the amount that is available for distribution?

Sincerely,

\*19 Richard A. Svobodny  
Acting Attorney General  
By: Michael A. Barnhill  
Senior Assistant Attorney General

## APPENDIX A

### Framers' Statements Regarding Use of the **Permanent Fund** for Economic Development

#### I. Excerpts from Legislative Deliberations on HJR 39, 1976

\*20 "I think the idea is to as much as possible so far as the Alaska economy can provide good and reasonable investments within the state that's where we would want to invest the money at least finally if not initially and that that's something that's sort of the case where you can have your cake and eat it too. You can put the money out in sound investment programs some of which could be loan programs that benefit the people of the state in the form of capital and the same time derive an income from it and when those loans are returned new loans will be made. So it's the situation where the wealth stays basically in the state; stays at work in the state and continues to provide both direct and indirect benefits to the people." Hearing on HJR 39 Before the House Judiciary Comm., 9<sup>th</sup> Legislature (Mar. 15, 1976) (Representative Malone statement) (tape in State Archives Box 18287).

"The very purpose for which we're asking that this become part of our constitution that is to start building a reserve **fund** to build a more viable economic base for the state." Debate on HJR 39 on House Floor, 9<sup>th</sup> Legislature (Mar. 25, 1976) (Representative Gruening statement) (tape in State Archives Box 18385).

"A **permanent fund** at the 25 percent level would result in an accrual of capital investment available for investment within Alaska in homes and in businesses for the good of the people in the state of approximately \$2.8 billion by 1985. It's an alternative approach to using state money rather than filtering it through the state bureaucracy. It's an approach that provides direct tangible benefits to the people of the state." Debate on HJR 39 on House Floor, 9<sup>th</sup> Legislature (Mar. 25, 1976) (Representative Malone statement) (tape in State Archives Box 18385).

"Sometimes you can do as much or more good for people by making some capital available to them as individuals, groups and corporate organizations, both public and private, as you can by having the state perform those types of services .... The purposes of this **fund** are much broader than any narrow dedication of taxes. It's a **fund** that would be available for the diversification of the economy of the state and be available to the citizens of the state as individuals and groups. It would lend some economic stability, I believe, once the **fund** is established." Hearing on HJR 39 Before the Senate Resources Comm., 9<sup>th</sup> Legislature (May 15, 1976) (Representative Malone statement) (tape in State Archives Box 18290).

"[Unless there is a significant attitude change by a future legislature], we're pretty well assured that the [implementing] legislation will be written and the laws enacted to provide for maximum possible investment within the state." Hearing on HJR 39 Before the Senate Resources Comm., 9<sup>th</sup> Legislature (May 15, 1976) (Representative Malone statement) (tape in State Archives Box 18290).

"The [Hammond] administration has that same commitment." Hearing on HJR 39 Before the Senate Resources Comm., 9<sup>th</sup> Legislature (May 15, 1976) (Commissioner Sterling Gallagher statement referring to Representative Malone's statement regarding maximum possible investment within the state) (tape in State Archives Box 18290).

\*21 "I think this is the primary purpose of the **permanent fund** and that is to retain capital in Alaska .... I think the **permanent fund** can provide for more capital leverage for the state. ... I think the **permanent fund** of course can provide I think greater control or greater development by Alaska capital in the areas than say even outside capital would not develop in. An example

The **permanent fund** will be a "lasting savings account from some of the oil revenues." *Editorial, It's Permanent*, Anchorage Daily News, Oct. 24, 1976, at 4.

"The object is to prevent future legislatures from doing what previous legislatures did with the \$900 million bonanza received by the state from the sale of Prudhoe Bay leases in 1969. That gigantic sum ran through the legislators' fingers like water, to the alarm of many who had pleaded at the time that the \$900 million be invested, the principal preserved and the state spend only that money derived from interest." *Editorial, No Easy Choice*, Anchorage Times, Oct. 24, 1976, at A-4.

"[Those promoting the **permanent fund**, including Gov. Jay Hammond] also view it as a savings account, to keep some of the state's income from oil and gas out of the general **fund** so it can't be spent." Susan Andrews, *Lawmakers Would Shape Permanent Fund*, Anchorage Times, Oct. 24, 1976, at A-3.

"The income from the **Permanent Fund** will be available for general appropriation by the legislature, but the principal of the **fund** may not be touched. It could only be removed from the **fund** by another constitutional amendment." Gov. Jay Hammond, *The Governor's Point of View*, Anchorage Times, Oct. 27, 1976, at 6.

"The principal of the **fund** would be used only for income-producing investments permitted by law." Legislative Affairs Agency, *Summary of Proposition*, 1976 Official Election Pamphlet, at 56.

"Just as a wise and prudent family sets aside money in a savings account for the future, so should Alaska's state government set aside a rainy day **fund** to benefit this and future generations of Alaskans." Alaska State Chamber of Commerce, *Statement in Favor of Proposition No. 2*, 1976 Official Election Pamphlet, at 57.

## II. Flexible Use

\*23 "Exactly how the **permanent fund** is set up would be the job of future legislatures. Our elected representatives, by law, would prescribe how the money is to be invested. That may demand a different application of the **fund** from one year to the next, but flexibility to meet changing demands is guaranteed by current legislation. Likewise, future legislators would be able to decide what to do with the considerable earnings of the **fund**." *Editorial, 2 Plans, 1 Fund*, Anchorage Daily News, April 21, 1976, at 6.

"[T]he legislature would supervise [the **permanent fund**] as a 'board of directors' and designate investments for which it could be used." *Demos Hear Gruening, Sassari*, Anchorage Daily News, July 16, 1976, at 6 (quoting Representative Gruening).

"Nobody knows exactly how the **fund** will be used; that decision will be made by legislative action in the future. Although the **fund** is protected against certain kinds of usage, its precise organization and management have been left flexible by designers .... [t]he flexibility of allowing future legislatures to decide on precise uses will prevent the 'locked up' circumstance .... There have been many proposals for possible **fund** uses. They range from paying direct dividends to Alaskans to using the money to underwrite such vast projects as hydroelectric dams." *Permanent Fund Raises Use Issue*, Anchorage Daily News, Oct. 22, 1976, at 2.

"[Representative] Malone said the **fund** could go for all three of those uses [economic development, savings, and community development]. The legislature would decide what per cent of the **fund** would go to each use." Susan Andrews, *Lawmakers Would Shape Permanent Fund*, Anchorage Times, Oct. 24, 1976, at A-3.

"Consultants have told the state's Investment Advisory Committee that the "income-producing requirement" [for investments of the principal] of the **fund** gives the state broad latitude." Susan Andrews, *Lawmakers Would Shape Permanent Fund*, Anchorage Times, Oct. 24, 1976, at A-3.

“Others see the **fund** as a source of loans for community development, such as home mortgages, small business loans, for power development, ports, utilities, roads ....” Susan Andrews, *Lawmakers Would Shape Permanent Fund*, Anchorage Times, Oct. 24, 1976, at A-3.

“The **Permanent Fund** won't be simply a giant bank savings account—it will be a pool of cash available for business investments either in Alaska or outside the state. If these investments are approved wisely by the state, we'll not only have continued earnings from our one-time oil resources but we'll also have a new spur to the economy of our state through loan programs which could extend from the largest businessman to the smallest homeowner.” *Editorial, Some Serious Propositions*, Fairbanks Daily News-Miner, Oct. 29, 1976, at A-4.

\*25 “Projects invested in with sources from the ‘**Permanent Fund**’ could help broaden Alaska's narrow based economy and bring more stability to our State.” Alaska State Chamber of Commerce, *Statement in Favor of Proposition No. 2*, 1976 Official Election Pamphlet, at 57.

“Because of the constitutional requirement that the **permanent fund** be used only for income-producing projects, it is likely the **fund** will be designed to provide loans to Alaskan individuals or businesses.” Paul Nussbaum, *The Issues in 77*, Anchorage Daily News, Nov. 11, 1976, at 1.

## Footnotes

- 1 We have also opined that a dedication additionally requires that the legislature relinquish any further control over the **funds**. 1982 Op. Att'y Gen. No. 13 at 20 (Nov. 30).
- 2 Article IX, section 15 of the Alaska Constitution pertains to the **permanent fund**.
- 3 Georgia is the only other state with a constitutional prohibition against dedicated **funds**. *Myers v. Alaska Hous. Fin. Corp.*, 68 P.3d 386, 389 (Alaska 2003).
- 4 *Alex*, 646P.2d at 210.
- 5 *Myers*, 68 P.3d at 390-91.
- 6 *SEACC*, 202 P.3d at 1167-70.
- 7 We note that the Court in *SEACC* observed that “the reach of the dedicated **funds** clause might be extended to statutes that, while not directly violating the clause by dedicating revenues, in some other way undercut the policies underlying the clause.” *SEACC*, 202 P.3d at 1170. We do not know what kinds of statutes the Court has in mind, but we are aware of the extensive practice of **fund** and account designations that give certain recipients a “‘talking point,’ that is, a possible advantage over other agencies, when seeking the **funds** from the legislature.” *Id.* at 1174.
- 8 This office has recognized certain implied exceptions to the broad interpretation of “proceeds of state tax or license,” including pension contributions, bond proceeds, sinking **fund** receipts, and revolving **fund** receipts because the Alaska Constitutional Convention clearly intended to exempt these types of revenues from the scope of the prohibition against dedicated **funds**. 1982 Op. Att'y Gen. No. 13 at 10-11 (Nov. 30). We continue to believe that the Court would recognize these implied exceptions.
- 9 The legislature has also made a number of special appropriations to principal from the general **fund** or earnings reserve account over the history of the **permanent fund**.
- 10 The constitutional framework of the **permanent fund** was graphically depicted prior to the vote of the people in 1976 as follows:  
  
TABULAR OR GRAPHIC MATERIAL SET FORTH AT THIS POINT IS NOT DISPLAYABLE  
Anchorage Times, October 24, 1976, A-3. This depiction, however, does not show the alternative income use authorization.
- 11 The legislative history of HJR 39, the constitutional resolution establishing the **permanent fund**, establishes that the framers intended this language to restrict the principal from appropriation. The principal “could not be used to **fund** the general operating expenditures or capital improvements of the State.” Letter from Gov. Hammond to Speaker Bradner (Jan. 15, 1976), *reprinted in 1976 House J.* 39-40.
- 12 Tape in State Archives Box 18460. Because the condition of the tapes referred to in this opinion have significantly deteriorated, the State Archives has made digitized copies of them. The disks are identified by archive box number and date.
- 13 Staff Jim Rhodes later described this element of the **permanent fund**: “Perhaps the most important break with the past may have been the language dispersing the earnings of the **fund** to the general **fund** ‘unless otherwise provided by law.’ This opened numerous

I recall writing an article in which I enumerated various worthy things the **Permanent Fund** could do. Principal among these was the opportunity to use **Permanent Fund** money to diversify the economy and to replace absentee ownership of certain industries, particularly renewable resource industries, with Alaskan ownership. Now that I'm older and wiser, or at least older, I see the **Permanent Fund** cannot reasonably be expected to accomplish all our goals at once. One reason for a modification in my view is that the **fund** didn't turn out to be as big a pot of gold as anticipated. Another fact was the realization that many of the "development banking" investments would be at risk levels generally incompatible with the concept of a savings trust.

Hearing Before House Special **Permanent Fund** Comm., 11<sup>th</sup> Legislature, (Mar. 30, 1979) (written testimony of Clark Gruening at 10-11).

- 24 In past opinions, we have questioned whether the **permanent fund** is subject to trust law. Our view has generally been that the **permanent fund** is not a true "trust" but that courts might apply trust principles. *See* 1977 Inf. Op. Att'y Gen. at 2 (J-66-106-78; Aug. 31); 1977 Inf. Op. Att'y Gen. at 1-5 (J-66-106-78; Sept. 16); 2003 Op. Att'y Gen. at 9-10, 18-19 (June 18). In addition to applying trust principles, we think the courts may also at least consider the law of endowments.
- 25 The Ford Foundation also commissioned a blue ribbon panel to review this work. The blue ribbon panel was comprised of many leading lawyers of the day including Lewis F. Powell, Jr., Eli Whitney Debevoise, and Alan Stroock. William Cary and Craig Bright, *The Law and the Lore of Endowment Funds* at vii (1969). For a discussion of Cary & Bright, see Susan N. Gary, *Charities, Endowments, and Donor Intent: The Uniform Prudent Management of Institutional Funds Act*, 41 Ga. L. Rev. 1277, 1284-88 (Summer 2007).
- 26 *UMIFA*, Prefatory Note, 7A U.L.A. 3 (2006).
- 27 A bill for the adoption of UPMIFA was introduced this year. S. B. 13 4, 26<sup>th</sup> Legislature (2009).
- 28 For instance, the Alaska Supreme Court routinely considers the American Law Institute's Restatements of the law of various subjects.
- 29 New York Dep't of Law, Advice for Not-for-Profit Corporations on the Appropriation of Endowment **Fund** Appreciation (undated); *see also*, Pietrina Scaraglino, Restricted Gifts, Practicing Law Inst. No. 8571 at 144 (2006) ("Importantly, income on an endowment can always be expended [under New York law], regardless of whether a **fund** falls below its historic dollar value. Of course, consistent with the applicable gift instrument, a nonprofit board may determine that it is prudent not to expend income when a **fund** is below its historic dollar value; however, there is no statutory prohibition against the appropriation and expenditure of income").
- 30 A subjective prudent spending rule in the **permanent fund** context could be difficult to administer. To the extent that the legislature or the people wish to consider a UPMIFA-like law to govern the **permanent fund**, it may be worth considering an objective spending limitation, such as a maximum expenditure ceiling, rather than a subjective rule of prudence.
- 31 The "income" to be deposited in the earnings reserve account is the net income of the **permanent fund**, computed according to generally accepted accounting principles, excluding any unrealized gains or losses. AS 37.13.140. Thus, the definition of income includes traditional components of income, such as interest, dividends, royalties and rents, and also includes net realized appreciation, that is, net realized capital gains and losses.
- 32 It follows that the Corporation should state the value of principal at original dollar value (as it currently does) with an entry adjusting that value to reflect the unrealized gains and losses of the investments of the principal. Thus, only the unrealized gains and losses attributable to principal should be accounted for in the principal. The term "principal" simply means the amount deposited to principal. Because investment value changes over time, there are two ways to describe principal: original dollar value and current fair value.
- 33 The legislative history states that the purpose of rewriting this statute was to "clarify original legislative intent and Corporation practice regarding the annual disposition of **Fund** income." Memo from David Rose to Sen. Pat Pourchot at 2 (Feb. 1, 1991), S.B. 39 Bill File, 17<sup>th</sup> Legislature (1991)
- 34 The APFC may wish to consider the use of unitized pooling, where a common pooling account holds and invests the assets of multiple participating government accounts and each government account owns units in the common pooling account. Unitized pooling is commonly used by endowments. Unrealized gains and losses are accurately tracked because the unit values reflect the net asset values of the investments of the underlying unitized pooling account.

2009 WL 1719849 (Alaska A.G.)

**11**

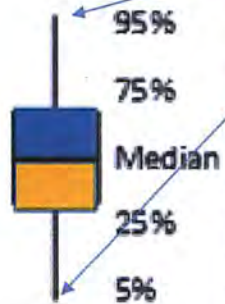
# Dividend Forecast

Comparing the dividends anticipated under the status quo, the Alaska Permanent Fund Protection Act (SB 128), and SB114

February 23, 2016

Department of Revenue, Economic Research Group

# How to read box plots



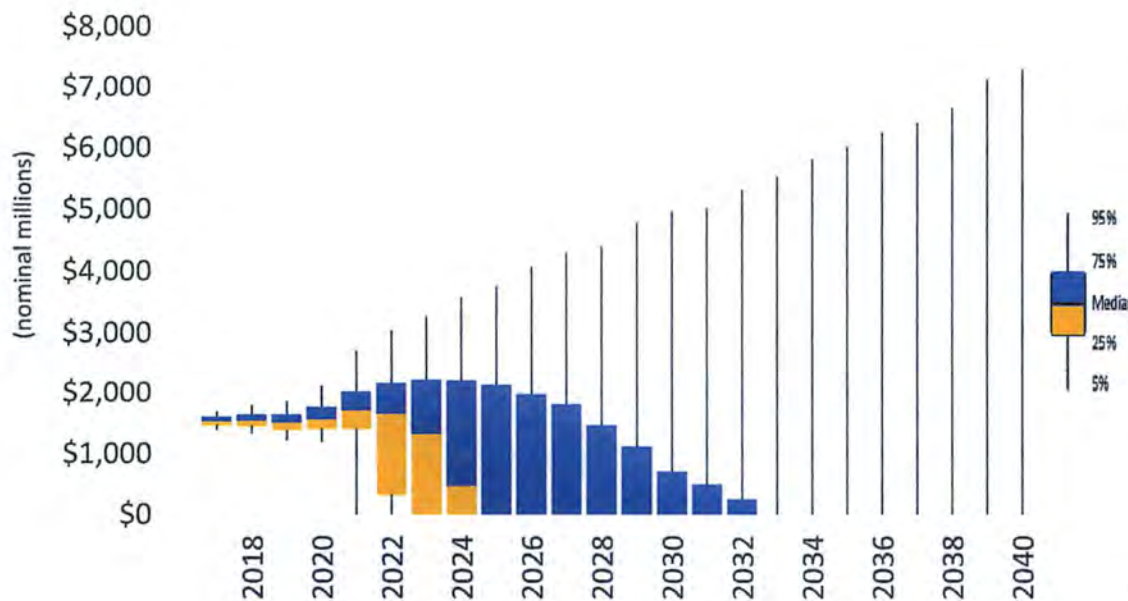
- We are 90% confident that the true value will be between the top and bottom of “whiskers” (the thin lines coming out of the box)
  - There is a 5% chance that the true value will be above the top
  - There is a 5% chance that the true value will be below the bottom
- We are 50% confident that the true value will be in the shaded area
- The line between the blue and yellow areas is the median
  - There is a 50% chance that the true value will be above the median
  - There is a 50% chance that the true value will be below the median

# Scenarios

	Status Quo	APFPA	SB 114
Deposits	<ul style="list-style-type: none"> <li>• <b>Mineral Royalties</b> <ul style="list-style-type: none"> <li>• 30% deposited in the Permanent Fund corpus</li> <li>• 69.5% deposited in the General Fund</li> </ul> </li> <li>• <b>Production Taxes:</b> 100% deposited in the General Fund</li> <li>• <b>Realized Investment Income:</b> deposited in the ERA</li> </ul>	<ul style="list-style-type: none"> <li>• <b>Mineral Royalties</b> <ul style="list-style-type: none"> <li>• 25% deposited in the Permanent Fund corpus</li> <li>• 74.5% deposited in the ERA</li> </ul> </li> <li>• <b>Production Taxes:</b> 100% deposited in the ERA</li> <li>• <b>Realized Investment Income:</b> deposited in the ERA</li> </ul>	<ul style="list-style-type: none"> <li>• <b>Mineral Royalties</b> <ul style="list-style-type: none"> <li>• 25% deposited in the Permanent Fund corpus</li> <li>• 74.5% deposited in the dividend fund</li> </ul> </li> <li>• <b>Production Taxes:</b> 100% deposited in the General Fund</li> <li>• <b>Realized Investment Income:</b> deposited in the ERA</li> </ul>
Withdrawals	<ul style="list-style-type: none"> <li>• <b>Dividend:</b> approximately half of 21% of the last 5 years of realized earnings drawn from the ERA</li> <li>• <b>UGF:</b> deficit filled with draw from ERA after CBR is exhausted</li> </ul>	<ul style="list-style-type: none"> <li>• <b>Dividend:</b> 50% of prior year mineral royalties from the ERA</li> <li>• <b>UGF:</b> \$3.3 billion (adjusted for inflation starting in 2020) draw from the ERA to the General Fund</li> </ul>	<ul style="list-style-type: none"> <li>• <b>Dividend:</b> <ul style="list-style-type: none"> <li>• 74.5% of prior year royalties allocated to the dividend</li> <li>• Supplemental funds for the \$1,000 dividend floor drawn from the ERA</li> </ul> </li> <li>• <b>UGF:</b> 5% POMV draw from the ERA to the General Fund</li> </ul>

# Status Quo: projected dividend appropriation

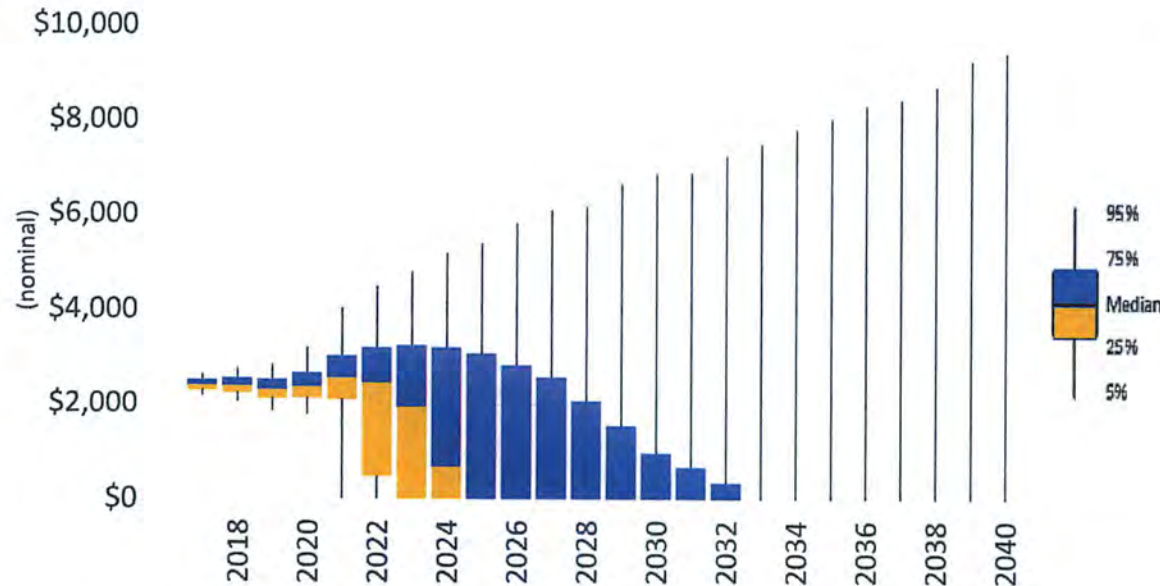
Limited by funds available after using earnings reserve to cover deficit once CBR depleted



- Under the status quo, we can anticipate appropriating between \$1.5 and \$1.7 billion each year for the dividend.
- However, the ongoing deficit would require drawing from the CBR and ERA for UGF expenditures as well. We expect to begin drawing from the ERA for UGF expenditures around FY19.
- Assuming we continue to pay dividends after FY19 when the ERA is the only source of funds to close the deficit, the ERA would likely be depleted by the end of FY22. Once savings are spent, only annual realized earnings are available for both the dividend and UGF expenditures.
- The expected result of the status quo is an inability to fund the dividend after 2024. But, this moment could arrive sooner; there is a chance that there will not be funds available for the dividend as soon as 2021.

# Status Quo: projected dividends per person

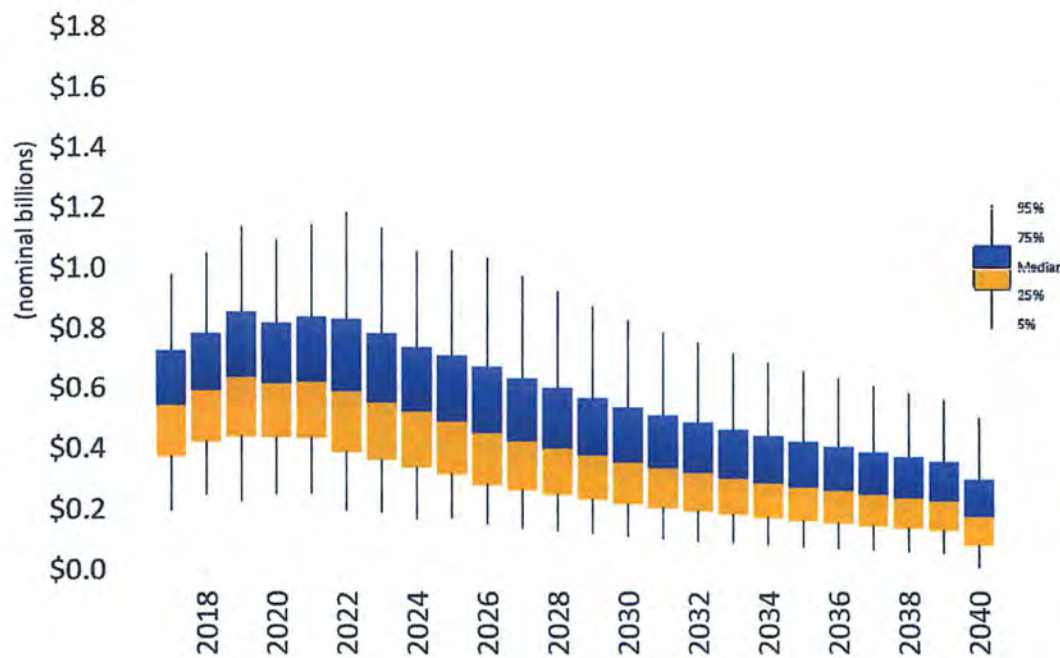
Limited by funds available after using earnings reserve to cover deficit once CBR depleted



- Under the status quo, we can expect dividends to exceed \$2,000 through 2022 or 2023.
- It is uncertain whether we would continue to pay dividends once the ERA is the only savings available for UGF expenditures (expected in FY19).
- But, the savings in the ERA will likely be depleted by FY22. Once savings are spent, only annual realized earnings are available for both the dividend and UGF expenditures. As a consequence, dividends will decline sharply beginning in 2023.
- There likely will not be adequate funds for the dividend after 2024.

# APFPA: projected dividend appropriation

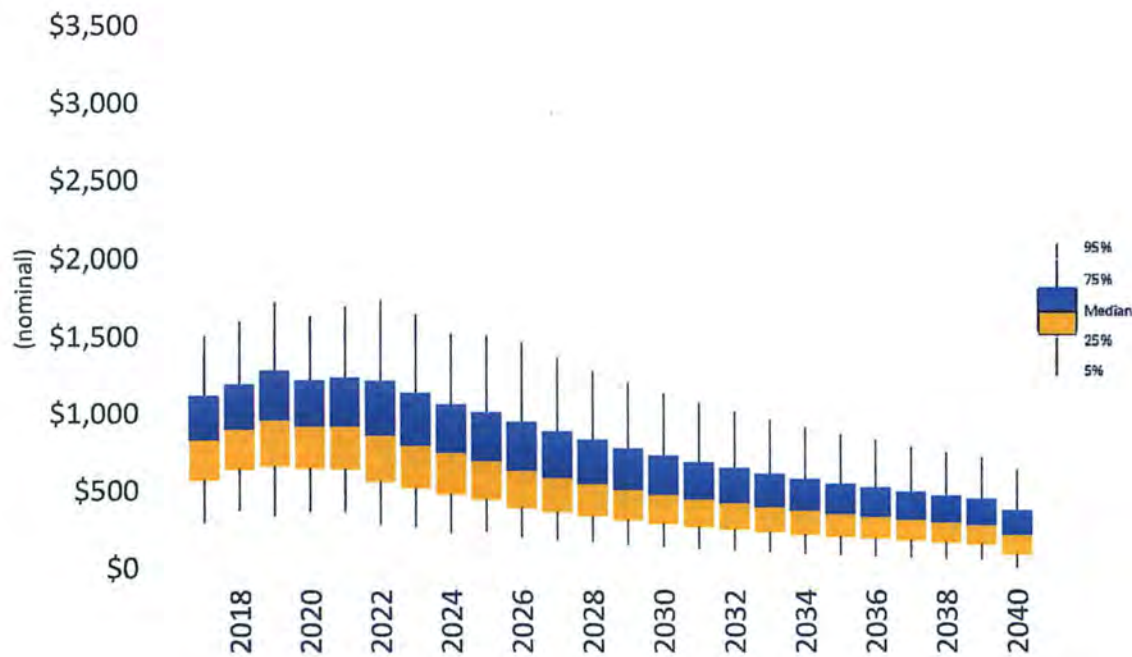
50% of royalties received in the prior fiscal year



- The APFPA proposes to allocate 50% of mineral royalties to the dividend program.
- This dividend formula means appropriating around \$0.6 to \$0.7 billion for dividends in the next several years. While this is less than the formula under the status quo, the revenue stream allocated to dividends is separate from UGF needs and continues far into the future.
- Dividends increase or decrease with the success or failure of resource development in Alaska.
- The trend in this graph reflects the trend in the Department of Revenue's conservative production forecast.
- There is great potential for additional development beyond what is reflected in the official forecast.

# APFPA: projected dividends per person

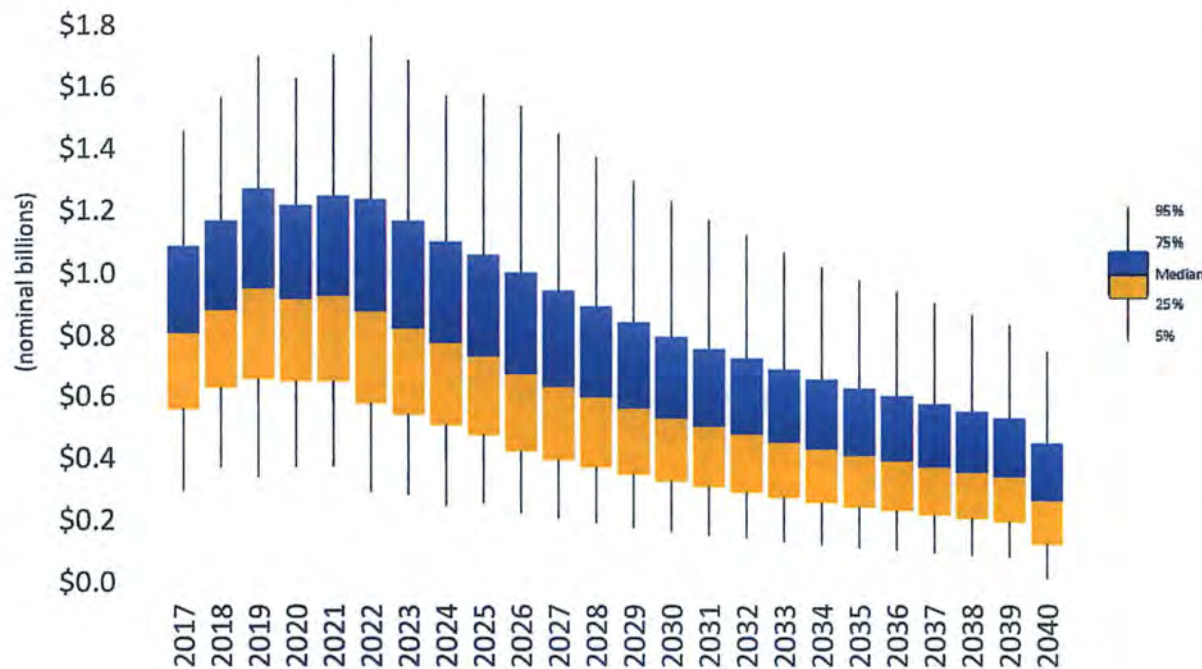
50% of royalties received in the prior fiscal year



- The APFPA proposes to allocate 50% of mineral royalties to the dividend program.
- \$1,000 dividend guaranteed for 2016
- Thereafter, we can expect dividends around \$1,000 for the next decade. While this is less than the formula under the status quo, the dividend survives into the future.
- Dividends increase or decrease with the success or failure of resource development in Alaska. As long as resources continue to be produced from Alaska, the dividend also continues.
- The trend in this graph reflects the trend in the Department of Revenue's conservative production forecast.
- There is great potential for additional development beyond what is reflected in the official forecast.

# SB 114: projected dividend appropriation

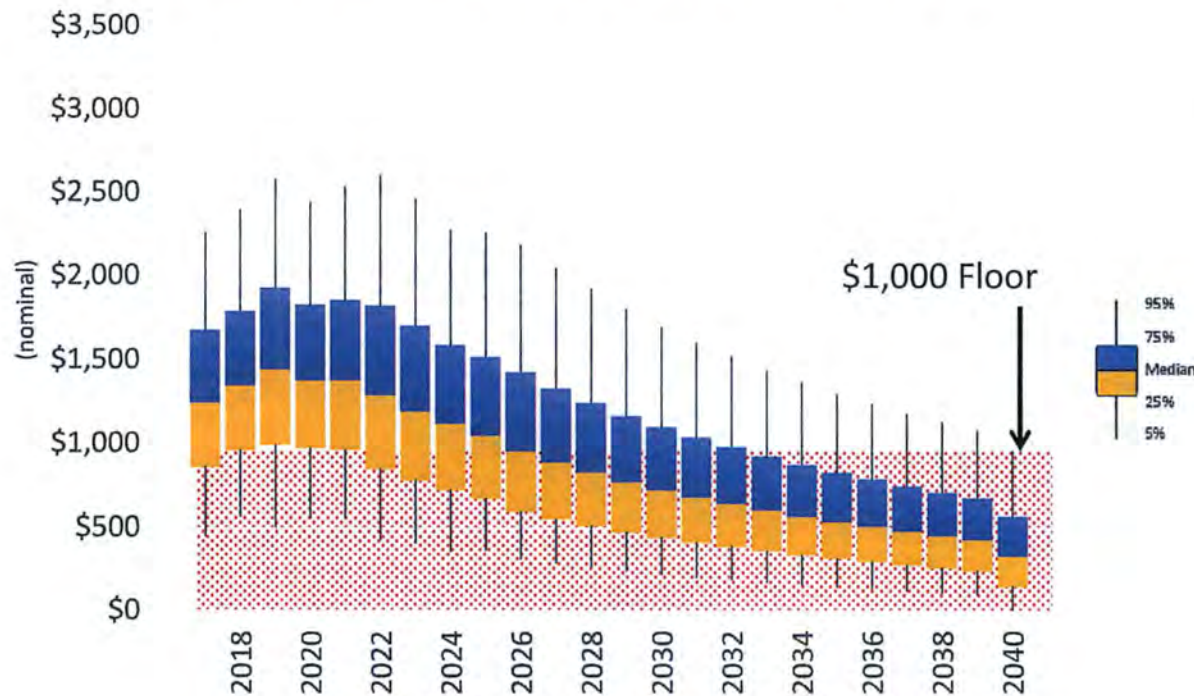
74.5% of royalties received in the prior fiscal year



- SB 114 proposes to allocate 74.5% of mineral royalties to the dividend program.
- This formula means appropriating around \$1 billion for the dividend. While this is less than the formula under the status quo, the dividend can be paid for a longer period.
- As with the APFPA formula, dividends increase or decrease with the success or failure of resource development in Alaska.
- As shown in slide 13, this is not the total amount appropriated for dividends under SB 114. Additional funds must be taken from the ERA to maintain the \$1,000 floor.
- The trend in this graph reflects the trend in the Department of Revenue's conservative production forecast.
- There is great potential for additional development beyond what is reflected in the official forecast.

# SB 114: projected dividends per person

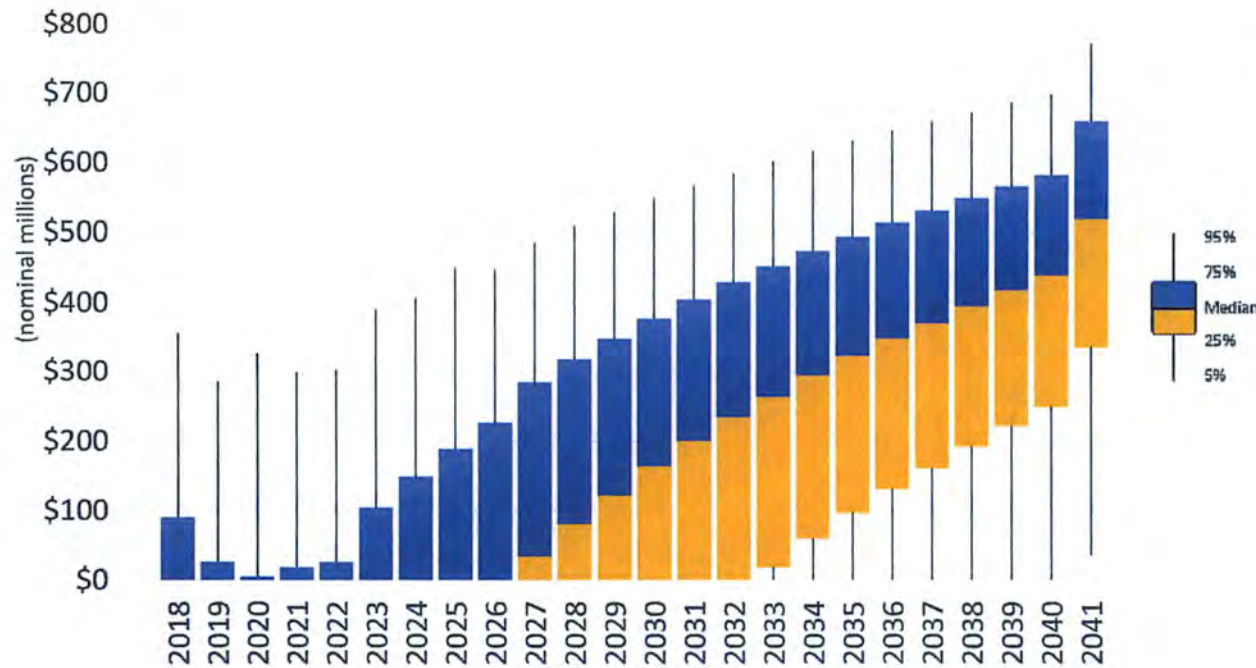
74.5% of royalties received in the prior fiscal year



- SB 114 proposes to allocate 74.5% of mineral royalties to the dividend program.
- This formula results in dividends that are 50% higher than proposed in the APFPA, but following the same production forecast trend.
- SB 114 also has a dividend floor of \$1,000 per person.
- To maintain the floor, we expect additional funds will be needed from the ERA to supplement the royalties by 2026. That said, there is better than a 1 in 4 chance that supplemental funds may be needed as soon as 2018.
- The trend in this graph reflects the trend in the Department of Revenue’s conservative production forecast.
- There is great potential for additional development beyond what is reflected in the official forecast.

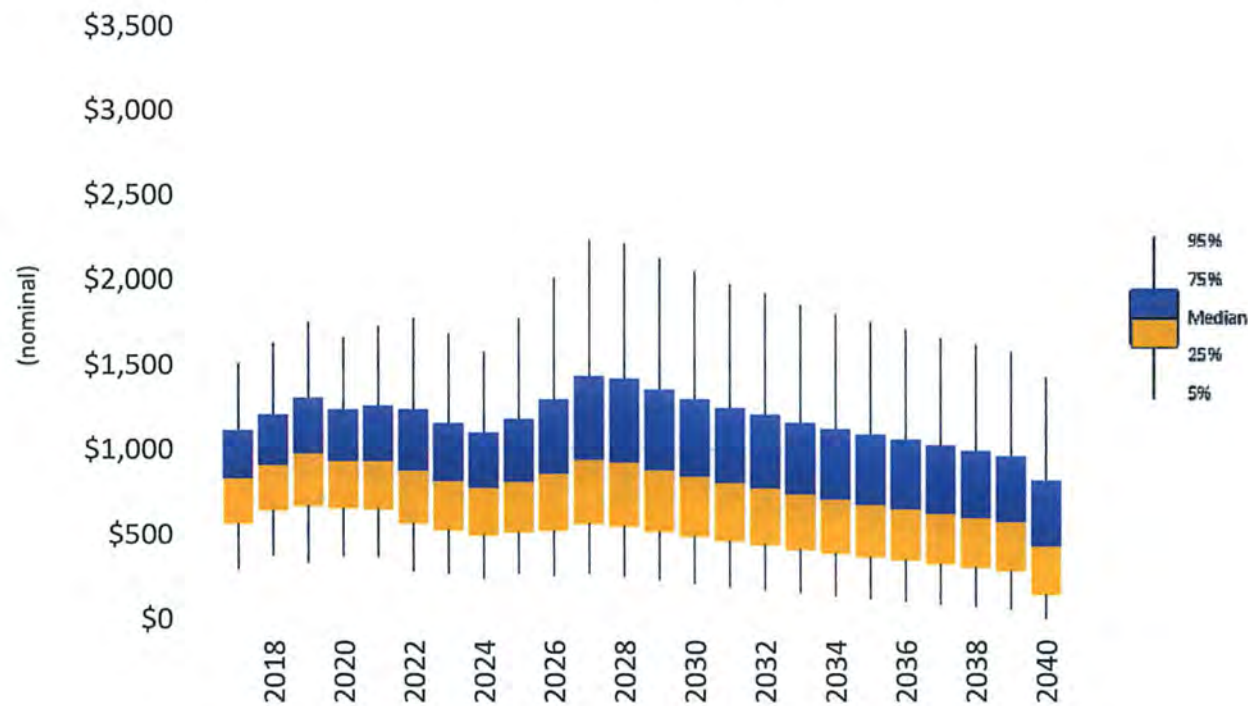
# SB 114: dividend floor

Supplemental funds need to maintain the \$1,000 dividend floor from the ERA



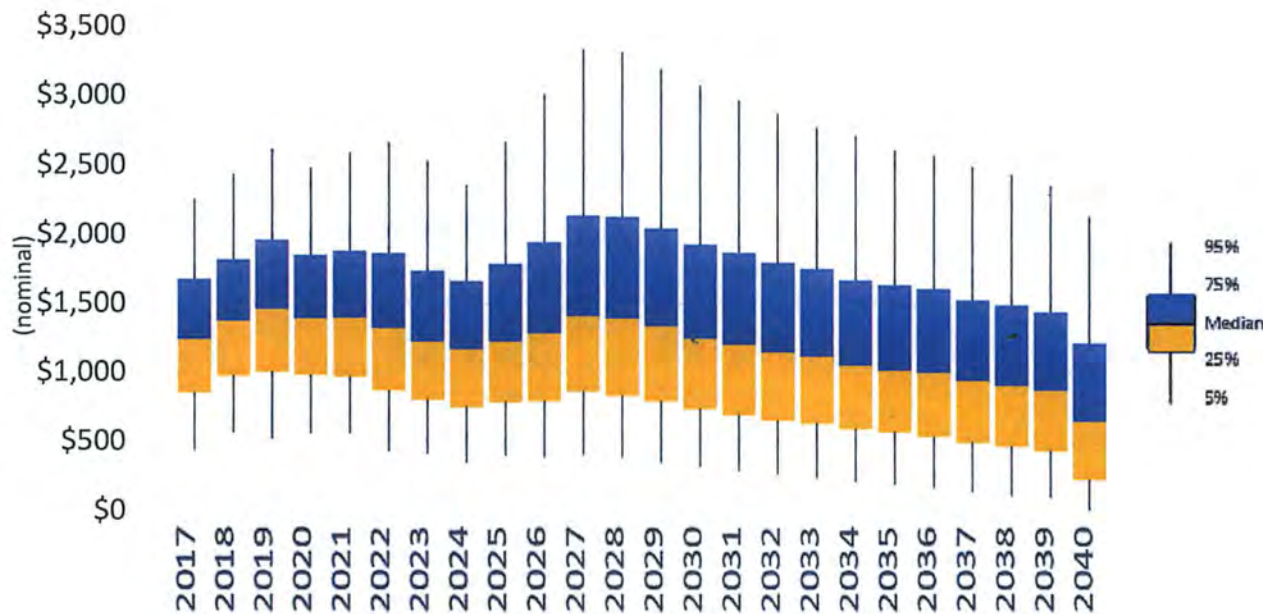
- SB 114 provides a floor of \$1,000 per person on the dividend.
- Royalties may not be enough to provide a \$1,000 dividend as production declines or under low oil prices.
- SB 114 draws from the ERA to cover the shortfall and maintain the \$1,000 floor. These supplemental draws are in addition to the 5% POMV draw. This graph shows the projected draws needed to maintain the floor.
- To maintain the floor, we expect additional funds will be needed from the ERA to supplement the royalties by 2024. That said, there is better than a 1 in 4 chance that supplemental funds may be needed as soon as 2018.

# APFPA: projected dividends per person with a gas line



- A dividend formula based on mineral royalties increases with new projects and production not reflected in the official production forecast.
- By example, this chart shows the impact of additional royalties resulting from the construction of a gas line.

# SB 114: projected dividends per person with a gas line



- A dividend formula based on mineral royalties increases with new projects and production not reflected in the official production forecast.
- By example, this chart shows the impact of additional royalties resulting from the construction of a gas line.

# Potential Increases North Slope Production

Increases in production will increase the dividend beyond the current forecast: values for 50% royalty dividend

Peak Rate Increment (barrels/day)	Rate-Comparable Pools, Peak Basis	Potential Size (millions of barrels recoverable)	Likelihood of Individual New Pools Placed on Production*	Impact on per person dividend per pool at peak year
10K	Tabasco, Meltwater, O3 Kuparuk Pools	20-50	Highly Likely (up to 10 or more pools?)	\$20-\$30
50K	10% less than Milne Kuparuk Pool, 20% less than Lisburne Pool	150-250	Highly Likely (several pools?)	\$100-\$150
100K	25% higher than Northstar Ivishak Pool, 33% less than Endicott Pool	300-500	Likely (a few pools?)	\$220-\$280
500K	40% higher than Kuparuk Pool	3,000-6,000	Very Unlikely (one at the most?)	\$1000-\$1500
1,000K	~3x maximum Kuparuk Pool rate 55% lower than Prudhoe Pool	7,000-10,000	Extremely Unlikely	\$2250-\$2750

\* Qualitative estimates. Assumes development of certain discoveries, considers assessed undiscovered resource, likelihood and extent of exploration access to ANWR, OCS, and NPRA, and assumes at least three decade timeframe (TAPS remains mechanically and commercially viable through 2045 or longer). Does not attempt to capture unconventional (heavy oil, shale oil) not currently economically exploited on the North Slope.

# Method, Inputs, and Assumptions

- Forecast produced from the Alaska Permanent Fund Protection Act model, *available at* <http://gov.alaska.gov/Walker/priorities/new-sustainable-alaska-plan.html>
- **Permanent Fund Starting Value:** \$52 billion
  - Realized portion of corpus: \$40 billion
  - Realized portion of earnings reserve account: \$6.5 billion
  - Unrealized earnings held by the fund: \$5.5 billion
- **Constitutional Budget Reserve Starting Value:** \$7 billion
- **Investment Return:** Callan Associate's 10-year forecast
  - Total return: 6.9% geometric, 13.90% standard deviation
  - Statutory return: P10 = 3.70%, P50 = 6.01%, P90 = 8.14%
- **Petroleum Revenues**
  - **Oil price:** mean outcomes from probabilistic analysis of ANS oil prices using a PERT distribution from the fall price forecasting session. *See* Fall 2015 RSB (pages 33 and 104); *also see* note on slide 4 of this document
  - **Production:** Fall 2015 RSB (page 39)

# Method, Inputs, and Assumptions

- Dividend Recipients: Department of Labor population forecast with dividend participation rate from historic data
- Dividend Program Costs: Department of Revenue estimate of \$8 million, increasing with inflation. The forecast does not include any other transfers from the dividend fund
- Status Quo Draws for UGF: FY16 budget net of unrestricted General Fund revenues. The calculation likely underestimates the UGF draw as it does not account for anticipated growth in formula programs or large projects.

<b>2017</b>	<b>2018</b>	<b>2019</b>	<b>2020</b>	<b>2021</b>	<b>2022</b>	<b>2023</b>	<b>2024</b>	<b>2025</b>	<b>2026</b>	<b>2027</b>
\$3,150	\$3,124	\$2,951	\$3,061	\$3,112	\$3,241	\$3,390	\$3,517	\$3,640	\$3,812	\$3,963

- When earnings reserve account funds are limited priority is given first to the UGF transfer, then to the dividend transfer, and finally to the inflation proofing transfer to the Permanent Fund corpus
- Unless otherwise stated, all dollar amounts are in nominal terms.
- Unless otherwise stated, years are the calendar year in which the dividend is paid.

# Method, Inputs, and Assumptions

- Though the model uses the same underlying data, the petroleum revenues vary slightly from those reported in the Fall 2015 RSB for the reasons stated in this excerpt from page 43 of the RSB
- For the gas line scenarios, natural gas was converted to barrels of oil equivalent (BOE)

At times, the department's forecast numbers may appear different for different analyses even if they come from the same data source. This can happen for many reasons and does not necessarily discount other analyses, nor should it be considered an "error."

One example is in petroleum revenue forecasting, where results can differ depending on whether the department uses confidential company-specific data versus statewide aggregated summary data.

Another example where differences can occur is when the department provides deterministic and

probabilistic results of oil revenue calculations. The *Revenue Sources Book* relies more heavily on deterministic (single-value) inputs and results. A probabilistic analysis of oil revenues brings the possibility of higher prices in the petroleum tax calculation, and because the tax calculation is progressive at higher prices, results can be higher than a deterministic analysis utilizing the same basic price data.

Therefore, even though all the department's models start with the same set of data, the results can differ depending on assumptions about central tendency and the distribution of potential results.

**Projected AKLNG BOE Royalty Barrels**

<b>Fiscal Year</b>	<b>2018</b>	<b>2019</b>	<b>2020</b>	<b>2021</b>	<b>2022</b>	<b>2023</b>	<b>2024</b>	<b>2025</b>
<b>Millions bbl/day</b>	0.008	0.008	0.008	0.008	0.008	0.008	0.014	0.055
<b>Fiscal Year</b>	<b>2026</b>	<b>2027</b>	<b>2028</b>	<b>2029</b>	<b>2030</b>	<b>2031</b>	<b>2032</b>	<b>2033</b>
<b>Millions bbl/day</b>	0.109	0.171	0.182	0.179	0.176	0.173	0.171	0.168
<b>Fiscal Year</b>	<b>2034</b>	<b>2035</b>	<b>2036</b>	<b>2037</b>	<b>2038</b>	<b>2039</b>	<b>2040</b>	
<b>Millions bbl/day</b>	0.166	0.164	0.162	0.160	0.158	0.156	0.155	

**12**



# THE ALASKA PERMANENT FUND PROTECTION ACT

*For a Strong Alaskan Economy and an Enduring Permanent Fund*

The centerpiece of the New Sustainable Alaska Plan, the Alaska Permanent Fund Protection Act (APFPA) establishes a new fiscal framework to address the bulk of this year's budget gap. This new framework replaces volatile petroleum revenues with a sustainable and consistent \$3.3 billion endowment draw from the Permanent Fund's earnings reserve account (ERA) as the primary funding source for unrestricted General Fund expenditures. The APFPA also reforms the formula for calculating dividends to connect Alaskans with the state's economic health.

The main components of this new fiscal framework include:

- (1) Depositing volatile petroleum royalty and production tax revenue into the Permanent Fund;
- (2) Transferring a stable \$3.3 billion endowment draw from the ERA to the General Fund for annual spending; and
- (3) Distributing 50% of royalties in a dividend to Alaskans.

By directing the highly variable flow of petroleum revenue into a larger pool of assets and correctly calibrating annual withdrawals from that pool, the APFPA harnesses the state's financial wealth to provide long-term stability to the state budget while preserving the dividend program and the value of the Permanent Fund.

More than helping to resolve this year's fiscal challenge, the APFPA ends four decades of boom-and-bust budgeting and the damaging impact those cycles have on the broader state economy. Backed by rigorous financial modeling, this is the change that will correct the structural imbalance in our fiscal framework, regain the confidence of the credit rating agencies, and set Alaska on a course to greater economic prosperity.

## Incoming Revenue Placement

The APFPA fiscal structure distributes annual revenue between the fund and dividends:

Mineral Royalties: 50% to the dividend; 49.5% to the Permanent Fund<sup>1</sup>

Production Taxes: 100% to the Permanent Fund

Investment Income: 100% to the Permanent Fund

Within the Permanent Fund, the incoming revenue is allocated between the corpus and the ERA according to two rules. First, the constitution requires that 25% of royalties go to the corpus. Second, the remaining revenue is allocated to maintain the ERA at a target balance of four times the prior year's draw. Investment income is the first revenue to maintain the ERA balance. All additional revenue – royalties, taxes, and investment income – beyond the amount required to maintain the target balance goes to the corpus where it is constitutionally protected.

## Calibrating the Endowment Draw

To be sustainable over the long-term, the draw must be calibrated to ensure that it does not degrade the value of the financial assets and to allow opportunity for growth in the fund. Reasoned assumptions, paired with the best available data, underlie the probabilistic financial model used to determine the amount that may be sustainably withdrawn on an annual basis.

The probabilistic modeling of oil price and investment income is crucial. Unlike a deterministic calculation, which uses singular inputs for each variable and calculates a single anticipated future outcome, the probabilistic model uses a range of inputs and produces a range of potential future outcomes. Given the annual variability in both investment returns and petroleum revenues, the probabilistic model provides essential insight about the down-side risk and the up-side potential.

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<sup>1</sup> AS 37.14.150 directs one-half of one percent of mineral royalties to the Public School Trust Fund.

The significant modeling constraints, assumptions, and data inputs include:

- Sustainability Metrics: (1) maintain the real value of starting assets and (2) ensure the durability of the ERA to avoid pressure to spend from the corpus
- Starting Fund Value: \$55 billion (APFC forecast for end of FY16 and a \$3 billion transfer from the Constitutional Budget Reserve)
- Oil Price: modeled probabilistic using DOR Fall 2015 forecasting session data
- Oil Production: DOR Fall 2015 Revenue Sources Book (deterministic modeling)<sup>2</sup>
- Investment Returns: 6.90% total return, 6.01% statutory return (Callan Associates)
- Inflation: 2.25% (Callan Associates)

Using these assumptions, if the draw is not adjusted for inflation until 2020, the system can sustainably produce an annual draw of \$3.3 billion.

Understanding that it is impossible to know future outcomes with certainty, the APFPA institutes a periodic review to ensure the draw remains sustainable and may be adjusted if necessary. Specifically, the APFPA requires that in 2017, 2020, and every four years thereafter the Commissioner of Revenue will issue a Sufficiency of Assets Report that includes:

1. An evaluation of the sufficiency of the ERA balance, given anticipated revenues;
2. An evaluation of the long-term sustainability of the draw amount; and
3. A determination that the draw amount (a) may be continued or (b) is unsustainable and recommend a reduced draw or another adjustment strategy.

To ensure the legislature and the public may review and critique the recommended draw, to ensure transparency, the APFPA requires publication of the underlying data and calculations in their native file format.

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<sup>2</sup> The model does not include production beyond the projects reflected in the official revenue forecast. Projects excluded from the analysis include many potential large projects, such as AKLNG. Generally, future projects would improve the durability of the system and increase the growth of both the Permanent Fund and dividends. The production forecast is one source of conservatism in the model.

## Royalty Dividend

Under the current fiscal framework, the state does not have adequate financial resources to fund a dividend over a sustained period of low petroleum revenue without also imposing a heavy tax burden on Alaskans. The existing dividend distributes investment income from the ERA. But, the state is on course to begin funding the budget from the ERA in FY2018. Without a change, Alaskans will soon face a depleted ERA, no dividend payouts, and the prospect of spending down the corpus of the Permanent Fund.

The APFPA funds the dividend from 50% of resource royalties – the state's ownership share of natural resources. Based on the royalty forecast in the APFPA model, this formula produces dividends listed in Table 1. The forecast below does not include new resource development; so, dividends will increase beyond this forecast as new projects produce new royalty revenues.

Table 1: 50% Royalty Dividend Forecast<sup>3</sup>

	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
Un-risked	\$850	\$932	\$1017	\$1014	\$1057	\$1038	\$999	\$949	\$928	\$877
Risked	\$850	\$923	\$977	\$939	\$951	\$908	\$849	\$787	\$755	\$700

While changing the dividend formula is necessary for a sustainable fiscal framework, in the current oil price environment, the forecast does mark a substantial step down from the last dividend checks. To smooth the transition, the APFPA supplements the 2016 dividend so the checks total \$1000 per person.

The royalty dividend equitably distributes Alaska's resource wealth across generations. This formula also allocates a specific and independent revenue stream to dividends to ensure the program continues even as the state makes the necessary changes to correct the current fiscal imbalance and provide a stable economic environment for positive private-sector growth in the state.

<sup>3</sup> This forecast includes adjustments for population growth and program costs. The RSB publishes risked values – values that are discounted to account for the uncertainty of future events.

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# ALASKA PERMANENT FUND PROTECTION ACT

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Randall Hoffbeck, *Commissioner of Revenue*

Craig W. Richards, *Attorney General*

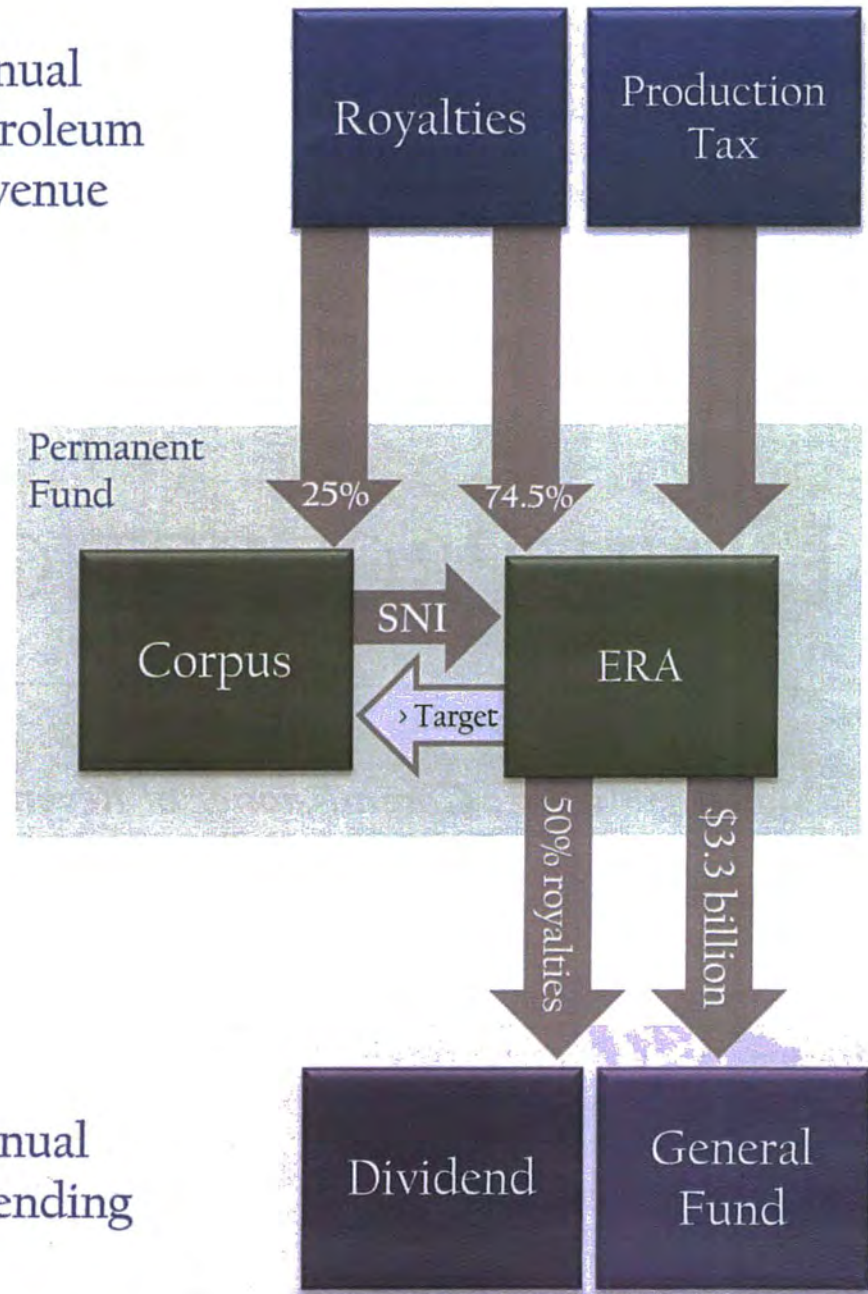


Senate State Affairs Committee  
March 15, 2016

# APFPA

1. Volatile petroleum revenues to the Permanent Fund
2. \$3.3 billion draw to the General Fund
3. Dividends  
50% royalties

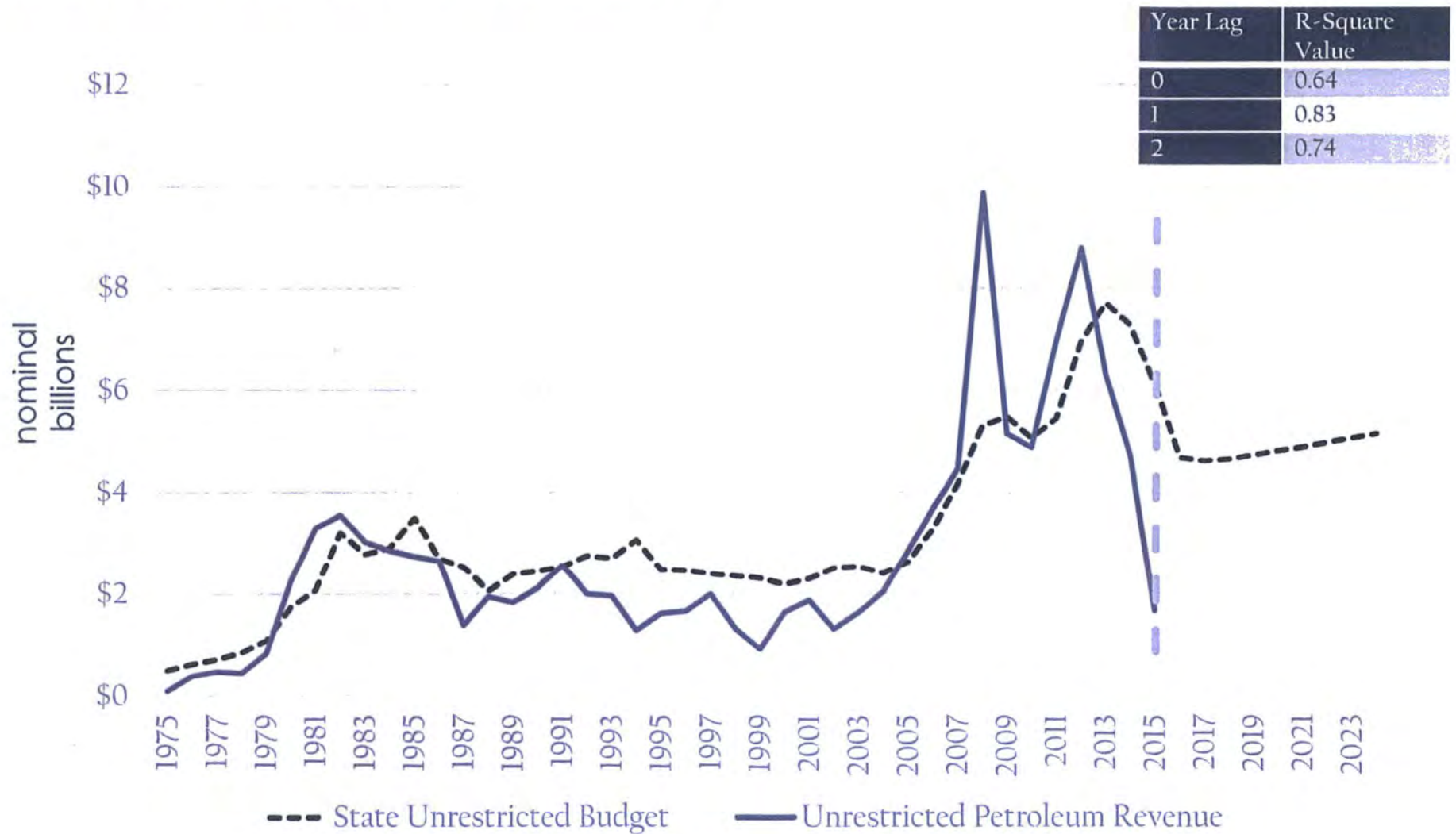
Annual  
Petroleum  
Revenue



Annual  
Spending

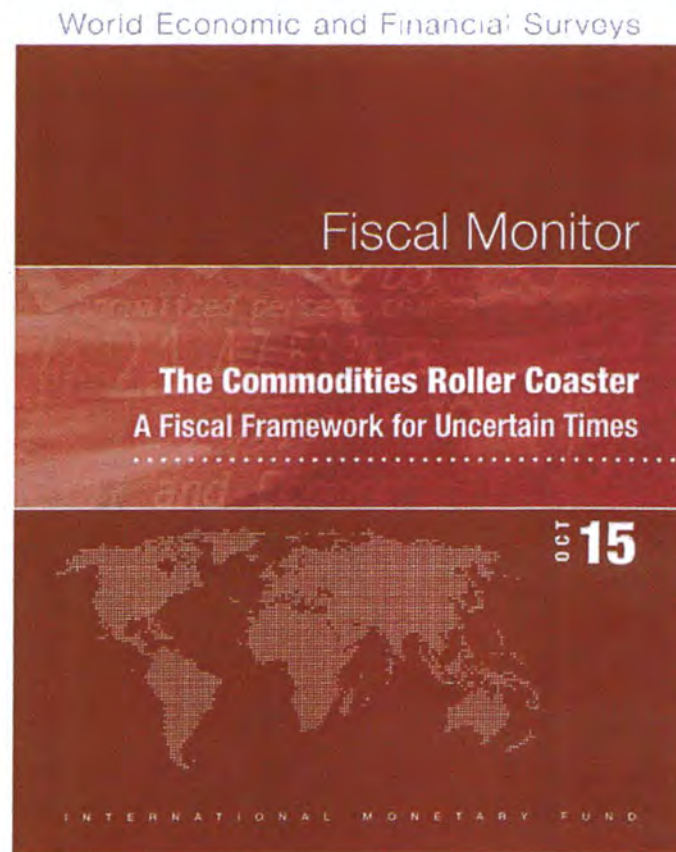


# LONG-TERM PROBLEM



# FISCAL POLICY FOR OIL ECONOMIES

- Government spending in commodity-based economies tends to move up and down with commodity revenue
- Pro-cyclical government spending stunts economic growth
- Stabilizing fiscal policy has the inverse effect, increasing GDP growth by 0.3% annually



# HOW TO HANDLE THE DRAW

## Defining “sustainable”

- Protect the Corpus
- Earnings Reserve Durability
- Inflation Proofing
  - Maintain the real value of the Permanent Fund
  - Transfers to the Corpus



# HOW TO HANDLE THE DRAW

	Sovereign Wealth Model - Volatility in the Fund -	Endowment Model - Volatility in the Budget -
Fixed-Draw	<ul style="list-style-type: none"> <li>• Budget Stable</li> <li>• Fund Growth Presumed savings Oil price volatility Investment volatility</li> </ul>	<ul style="list-style-type: none"> <li>• Budget Volatile Oil price volatility</li> <li>• Fund Stable Less investment volatility</li> </ul>
POMV-Draw*	<ul style="list-style-type: none"> <li>• Budget Volatile Investment volatility</li> <li>• Fund Growth Reduced Spending more (% of high revenue) Oil price volatility Less investment volatility</li> </ul>	<ul style="list-style-type: none"> <li>• Budget Very Volatile Oil price volatility Investments volatility</li> <li>• Fund Stable</li> </ul>

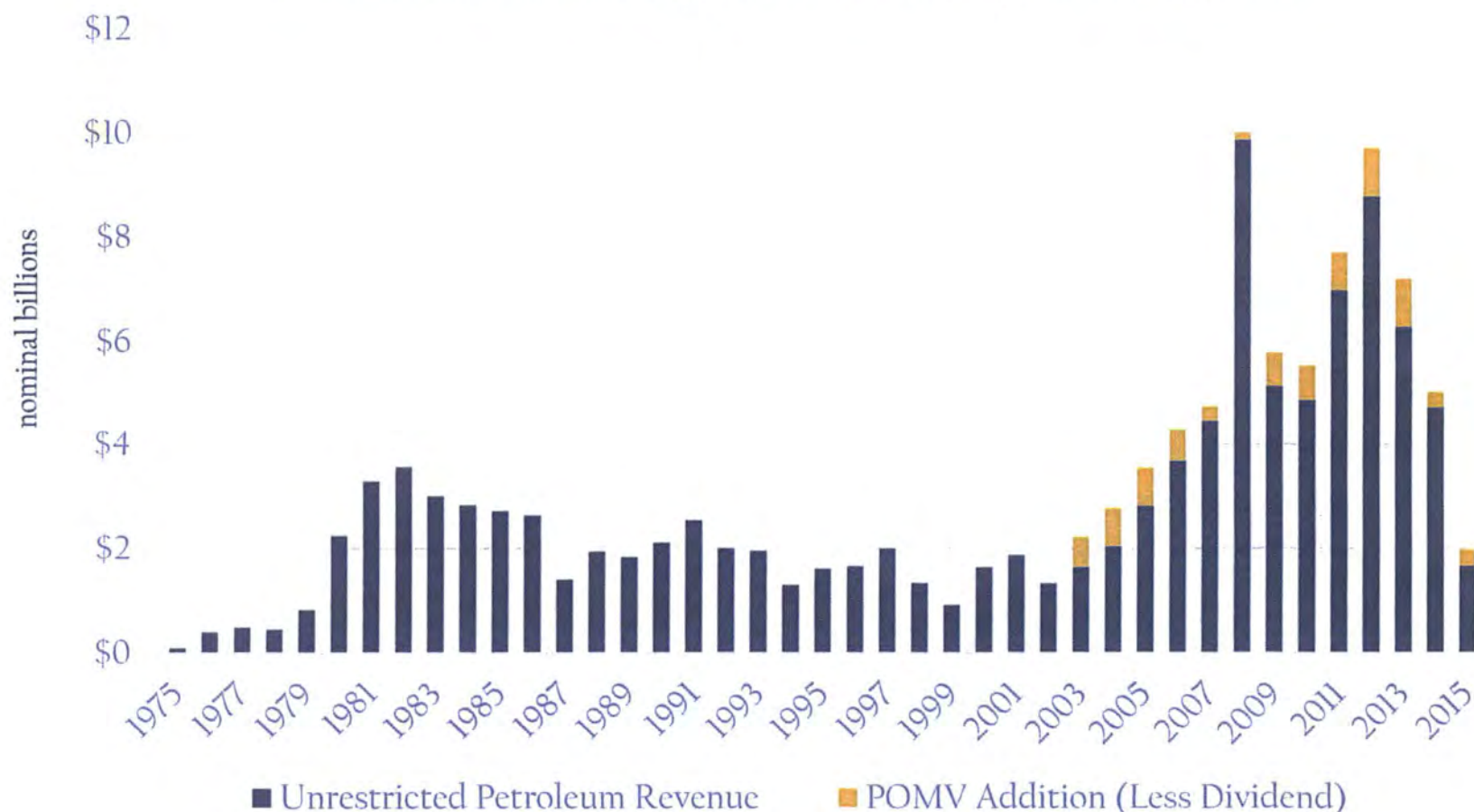
\*Volatility may be reduced, but not eliminated, with use of smoothing rule such as 5- year averaging.



# HOW TO HANDLE THE DRAW

A simple endowment draw adds revenue, but does not address volatility

Alaska Tax Revenue with Hypothetical POMV Payouts Starting in 2003



# HOW TO HANDLE THE DIVIDEND

Earnings Dividend(current formula): half of statutory net income (SNI)

Royalties Dividend: connects Alaskans to the economy

POMV Dividend: based on Fund market value, not SNI

CBR Dividend: based on CBR balance; rewards Alaskans for Legislature maximizing stabilization account

\$1,000 Flat: ~ \$650 million, reduces the sustainable draw

Mixed Formula: combination of different idea

Warning: certain combinations do not work well

POMV Draw & Earnings Dividend

Royalty Dividend & Floor



**14**

NEW SUSTAINABLE  
**ALASKA**  
 PLAN  
*Pulling Together to Build Our Future*



HB 245 / SB 128 (Alaska Permanent Fund Protection Act)  
 March 20, 2016

## The Cost of Delay

Waiting until next year to enact legislation correcting Alaska’s fiscal imbalance will:

1. Forever reduce the amount that can be sustainably drawn from our financial assets;
2. Compromise the sustainability of any endowment plan;
3. Risk a downgrade of the state’s credit rating; and
4. Damage Alaska’s economy.

Some of these impacts can be quantified now; the magnitude of others is uncertain. They are all significant. More importantly, by providing a comprehensive solution to our fiscal challenge this year, these costs can be avoided.

The centerpiece of the New Sustainable Alaska Plan, the Alaska Permanent Fund Protection Act (APFPA) establishes a new fiscal framework to address the bulk of this year’s budget gap. This new framework redirects volatile petroleum revenues to the permanent fund and then provides a sustainable and consistent \$3.3 billion endowment draw from the permanent fund as the primary funding source for unrestricted general fund expenditures. More than helping to resolve this year’s fiscal challenge, the APFPA provides the foundation for a sustainable and balanced fiscal future. The biggest threat to Alaska having a balanced and sustainable future is delay. Delay compromises our ability to execute this, or any other, plan to correct the fiscal imbalance.

1. Delay permanently reduces the amount of the sustainable draw, a reduction that must be offset by additional cuts or higher taxes.

Years of Delay	Draw Reduction
1	\$150 million
2	\$325 million
3	\$400 million
4	\$500 million

Without fiscal reform this year, we will continue to spend from our savings to fill the fiscal gap. But, drawing more than a sustainable amount from our savings in the near-term reduces the amount that the fund can sustainably produce going forward. The shortfall resulting from a lower sustainable draw will have to be addressed through additional cuts or additional new revenues.

A one year delay reduces the how much our savings can generate by \$150 million – annually. Compensating for that loss would require measures equivalent to doubling the proposed mining, fishing, tobacco, alcohol, and motor fuel tax increases. Four years of delay would require measures equivalent to more than doubling the proposed income tax or eliminating the dividend program.

2. Delay will compromise the sustainability of any endowment plan as the risk of depleting the limited funds available for appropriation increases.

The availability of funds to maintain a steady level of spending through years of low revenue is essential to any plan for an endowment draw from the Permanent Fund. Endowment draws are calculated on the value of the entire endowment base. But, in the case of the Permanent Fund, spending from the corpus is constitutionally prohibited. Consequently, there is a risk that over several years of low annual revenues a draw that is “sustainable” with respect to the value of the entire fund could deplete the funds available for spending.

To mitigate this risk, the APFPA proposes maintaining a target balance of four times the sustainable draw in the earnings reserve account (ERA), including a transfer of \$3 billion from the Constitutional Budget Reserve (CBR) in FY17.<sup>1</sup> But, under current levels of spending and expected revenues,<sup>2</sup> the CBR will likely be depleted by the end of FY19 and the ERA will follow by the end of FY22.<sup>3</sup> Delay and status quo spending (exceeding sustainable levels by \$2 billion) compromise the availability of the \$3 billion from the CBR and increases the risk of depleting the ERA –leaving the state with few options other than spending from the Permanent Fund corpus.

3. Delay risks a downgrade of the state’s credit rating.

Both Standard and Poor’s and Moody’s credit rating agencies have downgraded Alaska’s credit rating and cautioned that further downgrades may follow if lawmakers fail to address the structural imbalance between state spending and revenues this year. The nation’s third major rating agency, Fitch Ratings issued a clear caution that failure to address the state’s fiscal imbalance will result in a credit downgrade. The consequences of a downgrade are real.

While a downgrade would not wholly undermine the good reasons for bonding, it would increase the cost. If interest rates rise, direct cost impacts will be amplified even more.

But, those increased direct costs are minor compared to the broader significance of the credit ratings for the state’s economy. The ratings provide a market-based metric for the state’s economic health and investor confidence. As our rating falls, as a result of a failure to address the state’s revenue imbalance, it will impact consumer and investor confidence as discussed below

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<sup>1</sup> The remaining CBR balance is allocated to other purposes under the New Sustainable Alaska Plan (NSAP).

<sup>2</sup> Current levels of spending include: UGF expenditures of \$5.2 billion per year, status quo annual inflation proofing of the Permanent Fund corpus, and dividends distributed under the current formula. Annual revenues include: petroleum revenues as set out in the APFPA model and around \$800 million of other stable UGF revenues.

<sup>3</sup> Perhaps more worrisome, there is a substantial chance of depleting Alaska’s savings even sooner. Even if the Alaska Permanent Fund Corporation (APFC) achieves the average long-term statutory return of 6.01% over the next few years (the assumption used for the expected case), there is a 17% probability that the CBR may be depleted by FY18 and a 21% probability that the ERA may be depleted by FY21.

4. Delay will damage Alaska's economy.

Failing to articulate a pathway for the sustainable use of our financial assets and a plan to stabilize the state budget will degrade investor and consumer confidence, increasing the chance of a statewide economic downturn. A measureable contraction in Alaska's economy would mean a shrinking job market, outmigration, and reduced home values. The longer it takes for the state to correct our current fiscal imbalance, the more investor confidence will erode and the greater the damage to the broader state economy.

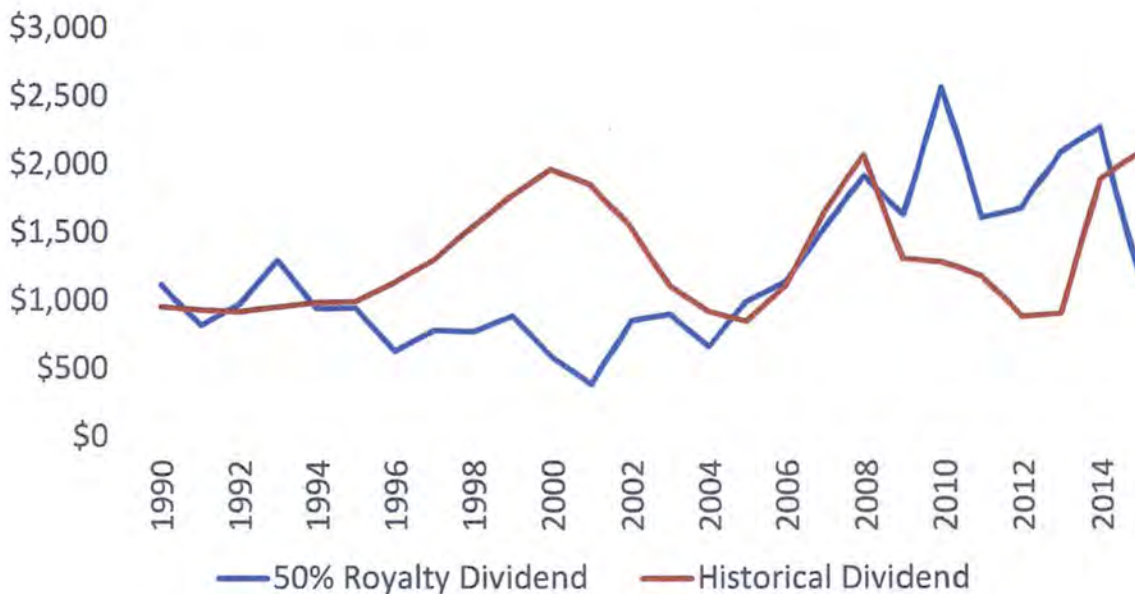
**15**

HB 245 (Alaska Permanent Fund Protection Act)  
February 17, 2016

## Dividend Comparison

Created by Department of Revenue, Economic Research Group

The accompanying chart reflects a comparison of the historic dividends and a hypothetical dividend reflecting the formula proposed in the Alaska Permanent Fund Protection Act (APFPA), beginning in 1990. The historic dividends distributed approximately 50% of the Permanent Fund's realized earnings. The APFPA proposes a dividend formula that distributes 50% of mineral royalties.



The comparison shows:

1. Year-to-year the two formulas would have produced different dividend amounts.
2. Both formulas reflect the significant volatility of the respective underlying revenue sources – investment income and mineral royalties.
3. Overall, the formulas would have distributed approximately the same amount to dividend recipients:
  - a. Since 1990, under the current formula (which distributes approximately half of 21% of the last 5 years of the realized earnings) the Permanent Fund has distributed \$19.9 billion to dividend recipients.
  - b. If, over the same period, the Permanent Fund had calculated dividends based on 50% of mineral royalties the dividend would have distributed \$19.2 billion.

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# Mineral Royalty and Investment Earnings Dividend Formulas

Economic Research Group, Department of Revenue  
Friday, March 11, 2016

## Scenarios:

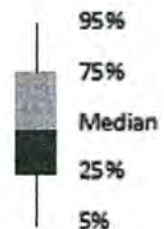
In every scenario, the draw for general fund held constant at \$3.1 billion until 2020, after which it increases at the rate of inflation. The percent of investment earnings or fund value allocated to the dividend is based on the amount necessary for the 2017 dividend to equal \$1,000 per person when added to 25% of 2016 royalties. That percentage is then applied to calculate dividend going forward.

- Scenario 1     **5-Year Average POMV:** 25% of prior year royalties plus a percent of the average market value of the fund for the last 5 years.
- Scenario 2     **Annual POMV:** 25% of prior year royalties plus a percent of the market value of the fund that year.
- Scenario 3     **5-Year Average of Statutory Net Income:** 25% of prior year royalties plus a percent of the average annual statutory net income for the last five years.
- Scenario 4     **Annual Statutory Net Income:** 25% of prior year royalties plus a percent of the prior year statutory net income.

This report provides the probabilistic outcomes for the amount of dividends and the fund balance based on inputs and assumptions noted in the appendix of this report. Two caveats should be noted. First, the outcomes do not reflect the adjustments to the draw in periodic review, as contemplated by the Alaska Permanent Fund Protection Act. This mechanism greatly reduces the downside risk. Second, the actual downside risk is substantially reduced from what these scenarios suggest because the constitution prohibits spending the corpus of the fund.

## Reading Box Plots:

- We are 90% confident that the true value will be between the top and bottom of “whiskers” (the thin lines coming out of the box)
  - There is a 5% chance that the true value will be above the top
  - There is a 5% chance that the true value will be below the bottom
- We are 50% confident that the true value will be in the shaded area
- The line between the blue and yellow areas is the median
  - There is a 50% chance that the true value will be above the median
  - There is a 50% chance that the true value will be below the median

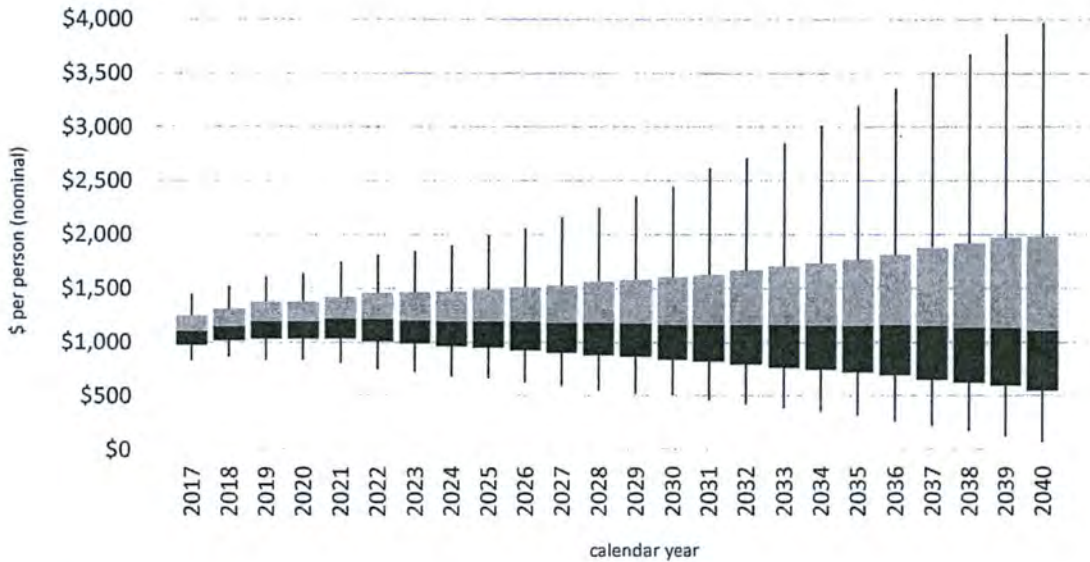


## Amount of Dividend Checks (per recipient)

### Scenario 1: 5-Year Average POMV and 25% of Royalties

2040 median value: \$1114

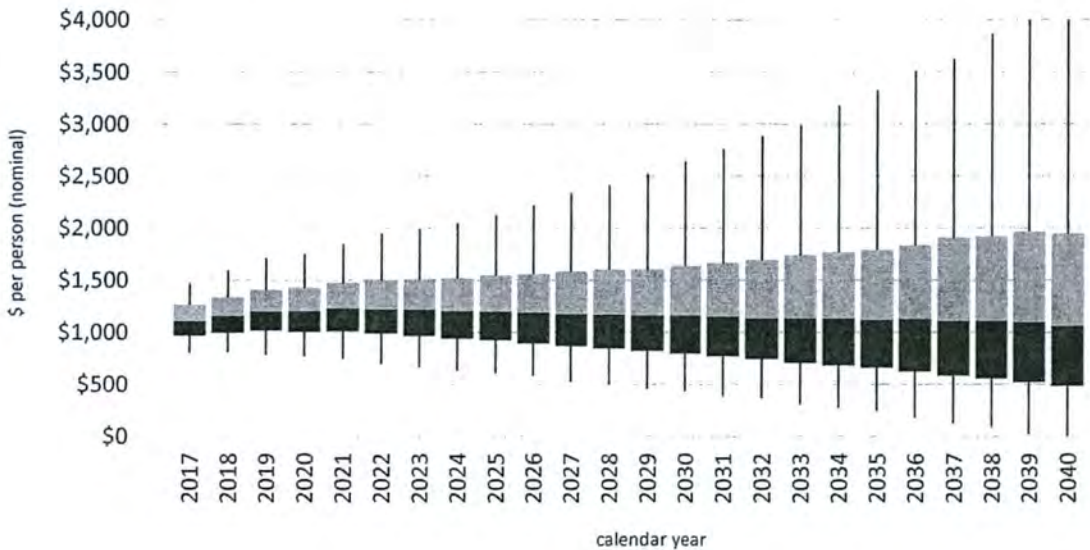
Percent of Market Value (5-year average): 0.81%



### Scenario 2: Annual POMV and 25% of Royalties

2040 median value: \$1063

Percent of Market Value (1 year): 0.78%

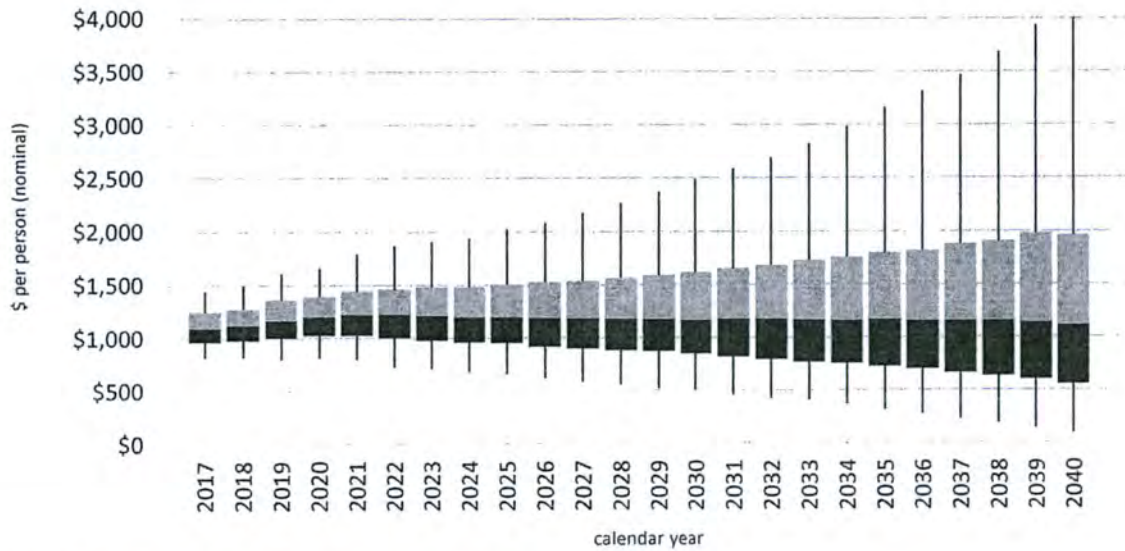


## Amount of Dividend Checks (per recipient)

### Scenario 3: 5-Year Average of Statutory Net Income and 25% of Royalties

2040 median value: \$1113

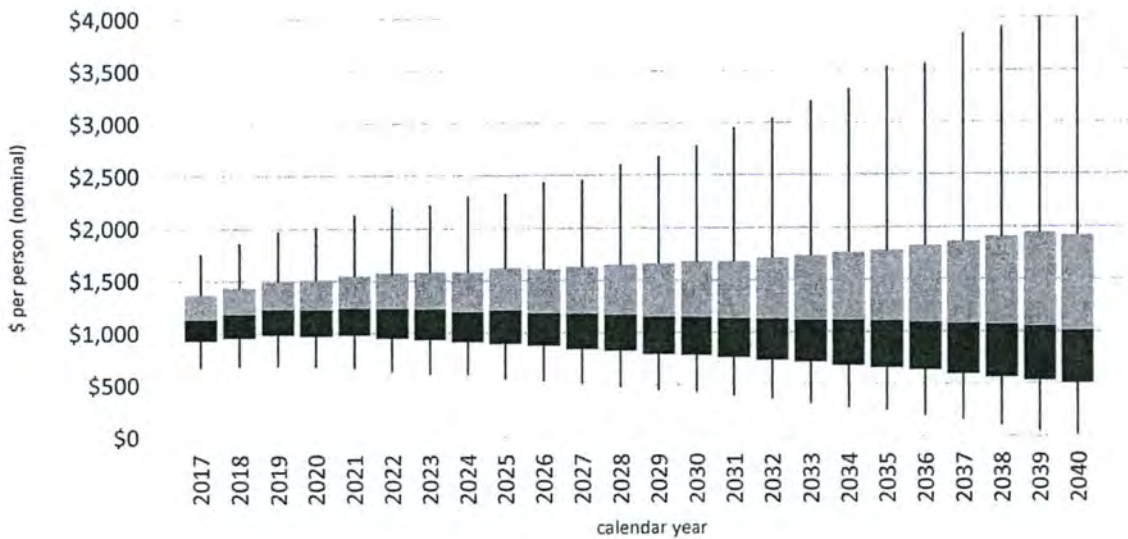
Percent of Statutory Net Income (5-year average): 14.5%



### Scenario 4: Annual Statutory Net Income and 25% of Royalties

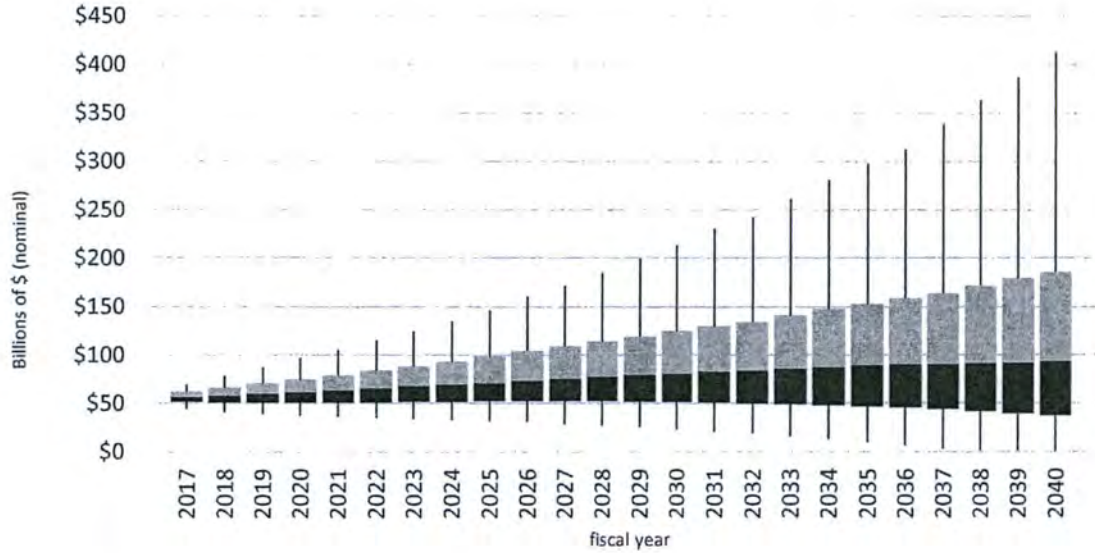
2040 median value: \$1012

Percent of Statutory Net Income (1 year): 13.5%

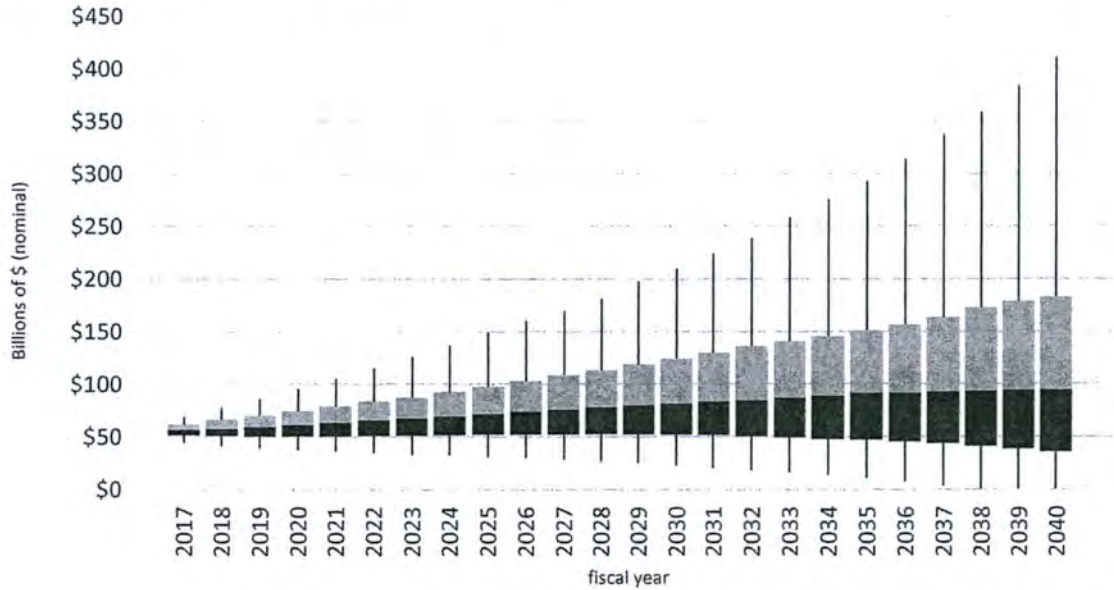


## Permanent Fund Value

**Scenario 1: 5-Year Average POMV and 25% of Royalties**  
 2040 median value: \$93,914 (\$55,057 real)



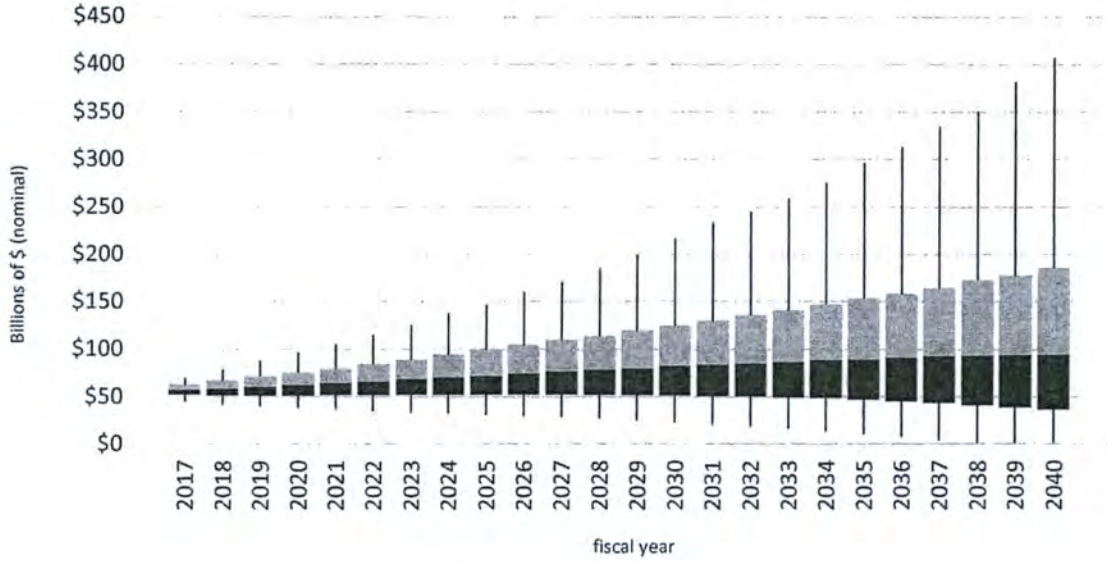
**Scenario 2: Annual POMV and 25% of Royalties**  
 2040 median value: \$94,264 (\$55,262 real)



## Permanent Fund Value

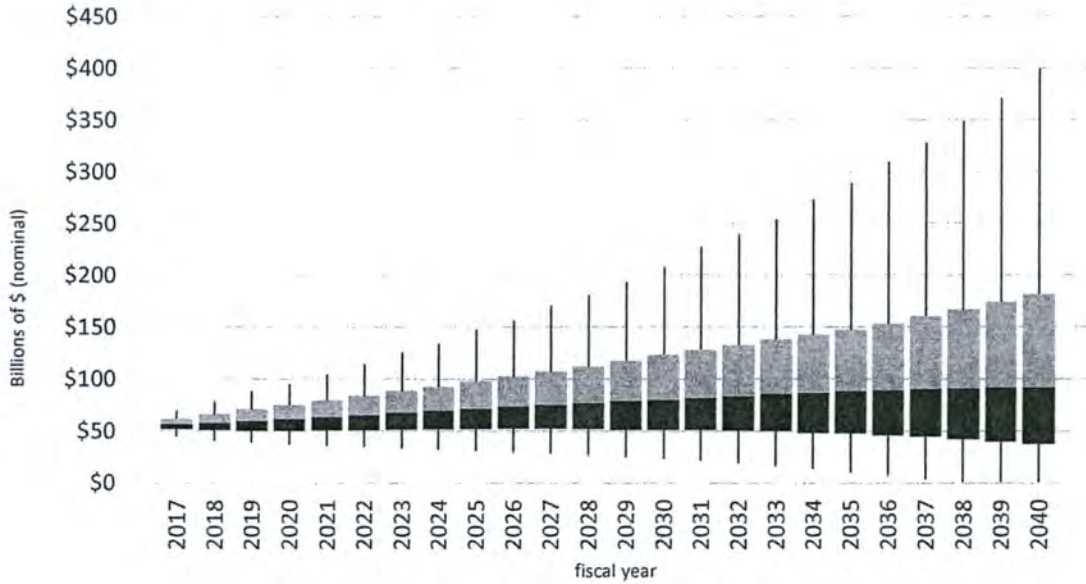
### Scenario 3: 5-Year Average of Statutory Net Income and 25% of Royalties

2040 median value: \$95,306 (\$55,873 real)



### Scenario 4: Annual Statutory Net Income and 25% of Royalties

2040 median value: \$92,131 (\$54,012 real)



## Appendix: Methods, Inputs, and Assumptions

- Forecast produced from the Alaska Permanent Fund Protection Act model, *available at* <http://gov.alaska.gov/Walker/priorities/new-sustainable-alaska-plan.html>
- **Permanent Fund Starting Value:** \$55 billion (\$52 billion + \$3 billion from CBR)
- **Investment Return:** Callan Associate's 10-year forecast
  - Total return: 6.9% geometric, 13.90% standard deviation
  - Statutory net income: P10 = 3.70%, P50 = 6.01%, P90 = 8.14%
  - Inflation rate: 2.25%
  - Earnings allocated to dividend are withdrawn from the earnings reserve at the end of the fiscal year
- **Petroleum Revenues:**
  - **Oil price:** mean outcomes from probabilistic analysis of ANS oil prices using a PERT distribution from the fall price forecasting session. *See* Fall 2015 RSB (pages 33 and 104)
  - **Production:** Fall 2015 RSB (page 39)
  - **Total 2016 Royalties:** approximately \$850 million assumed
- **Deposits:** Production taxes and 74.5% of royalties deposited into the permanent fund.
- **Dividend Recipients:** Department of Labor population forecast with dividend participation rate from historic data
- **Dividend Program Costs:** Department of Revenue estimate of \$8 million, increasing with inflation. The forecast does not include any other transfers from the dividend fund.

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**Doniece Gott**

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**From:** Bill Ward <bward@hughes.net>  
**Sent:** Tuesday, March 22, 2016 8:50 PM  
**To:** Senate Finance Committee  
**Subject:** SB 128, SB 114

This is submitted as testimony on the hearings for SB 128 and SB 114.

I am **in favor** of the legislation to restructure the earnings of the Permanent Fund which would allow it's use for the necessary obligations of state government.

**I support** the capping of the dividend paid to Alaska residents to be limited to \$1000 or even \$500 provided the extra money available to the state is used to benefit all the residents by means of basic services and infrastructure development.

**I do not support** it if the money is used primarily to maintain the bloated bureaucracy of the state.

Submitted by:

Bill D Ward  
Box 1087  
Delta Junction, AK  
907-895-5415

**Doniece Gott**

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**From:** Joyanne Bloom <joyanneb@gmail.com>  
**Date:** Wednesday, March 23, 2016 8:57 AM  
**To:** Senate Finance Committee  
**Subject:** SB128 Yes!

The rainy day has come in a downpour! Founders of the Permanent Fund were wise to set this money aside. I don't need a \$2000 bonus check. I'll settle for \$1000 or even \$500. I support SB128 so the Fund can be used as it was designed.

Respectfully yours,  
Joyanne Bloom

--  
Joyanne Bloom  
883 Basin Road  
Juneau, Alaska 99801

(907) 723-3604

**Doniece Gott**

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**From:** Martin Schuster <mdschuster@alaska.edu>  
**Sent:** Wednesday, March 23, 2016 8:29 AM  
**To:** Senate Finance Committee  
**Subject:** Walker's fiscal plan

To the Senate Finance Committee of the State of Alaska,

I would like to encourage the Committee to consider a diversified approach to closing our budget gap. While I can see the temptation in using our State's savings to close the gap until our revenue returns to average levels I believe that now is the time to change the way that we see our State's revenues. An income tax that is a fraction of the federal income tax is not something to be afraid of. A hike in our amazingly low gasoline tax is not something to be afraid of. Cutting the oil tax credits that cost our State hundreds of millions of dollars annually is not something to be afraid of. I believe that the people of Alaska realize that we can't indefinitely survive on oil revenue, though we've done so for a long time. As governor Walker has said, the time to change our paradigm is during this legislative session, when economic hardship makes it clear that there is a better way.

I humbly encourage the finance committee to consider all the options, and to have faith in your constituents that we will understand the difficult decisions you must make this legislative session,

Sincerely,

Martin Schuster

## Doniece Gott

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**From:** Betsy Brennan and Mike Wade <betsmike@nome.net>  
**Sent:** Wednesday, March 23, 2016 8:06 AM  
**To:** Senate Finance Committee  
**Subject:** SB128 and SB114 public testimony

March 23, 2016

Dear Senators,

I would like this entered into the public record for the two Senate Bills regarding Permanent Fund legislation you are hearing testimony on today.

My name is Elisabeth Brennan and I live in Nome with my husband and two children. I have been a resident of Nome since 1988. I would like to express my frustration about the slow pace the legislature has taken in getting to the budget revenue part of the budget crisis equation. Frankly, the budget deficit did not suddenly appear overnight. The State knew this situation was upon us long ago. Both SB 128 and SB 114 have good merits. Personally, I believe SB 128 is the best option. Here is my humble advice: Pick one and go with it. I am willing to pay more taxes and have less PFD (or none!) to keep the state services we need for healthy communities.

Public polling shows Alaskans want three things: A balanced plan to restructure the PFD; Strategic budget cuts and; Trying out new taxes. This makes logical sense. So why is there so much delay? Relying on cuts alone will spell disaster for our State.

I have read news article and heard quotes from legislators saying we need to cut more before looking at revenue measures, or that the cuts that have already happened have not been felt because no one is complaining enough. Senator Kelly was quoted as saying he knows government is too big because "we cut a whole bunch of fat off of it and nothing happened." I wonder where he may be looking to see this "nothing" happening? Who may he be talking with that feels no repercussions from budget cuts that have occurred in the last several years?

In the area I live in, we have some of the highest rates of domestic violence and sexual assault in the ENTIRE NATION. Yet, we have had an unfilled State Trooper position for the last 5 months. Perhaps it may not be filled to help save the State of Alaska money. This does not seem right. Public Safety is important to communities, and the response time increases when you lose 1/7<sup>th</sup> of your public safety force in a large chunk of Western Alaska.

I attended a FY 17 budget meeting last night for Nome Public Schools. I care about the future of all children in my community (Two of them are my own). The School District in Nome will be cutting their budget by almost \$1,000,000.00 from the FY 16 budget. The District has already operating on a very lean budget. There is no fat

to trim, but class sizes will increase and Pre K funding is gone. Staff work to the best of their abilities with less, and supplies are being cut. Hard choices were made and our JROTC program will be cut for next year. The District is going into its fund balance to help balance the budget and make ends meet as they have for several years. Yet, some legislators think nothing is happening because of cuts?

We have an amazing University of Alaska System that looks to be gutted by some legislators. This is extremely scary and short sighted in my opinion. I hope my children will stay within Alaska for higher education. I see great hope for the youth of our State with such a fine institution. Can the University be better managed? Of course, and the powers that be are working on that change. But the proposed cuts I have read about will devastate a top notch education institution.

Please put in the hard work now in this legislative session. Do not prolong the situation and leave this important work of resolving the fiscal state for the future. Get serious about looking into revenue and work on a plan to fix the deficit that does not do irreparable damage to Alaska.

Thank you for listening and thank you for your service.

Elisabeth Brennan

PO Box 1623

Nome, AK 99762

**Doniece Gott**

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**From:** Charlotte Fox <cafox@gci.net>  
**Sent:** Wednesday, March 23, 2016 7:21 AM  
**To:** Senate Finance Committee  
**Subject:** 2017 budget

Dear Finance Committee:

Please take steps to ensure a healthier future for our state by determining a revenue method for sustainability. While I prefer Governor Walker's combination of revenue methods, and combination of Permanent Fund earnings coupled with income tax would suit us.

What is not acceptable is not taking action NOW on this critical issue. We can't cut our way to prosperity.

Charlotte Fox  
10230 Carlson Road  
Anchorage, AK 99507  
907-903-0450

## Doniece Gott

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**From:** Bill Ward <ward-farms@hughes.net>  
**Sent:** Wednesday, March 23, 2016 5:56 AM  
**To:** Senate Finance Committee  
**Subject:** Testimony SB114 & SB128

I would like to provide testimony on SB114 and SB128.

I support these pieces of legislation which will reduce the dividend payout each year to the residents of Alaska and allow the State of Alaska to use part of the earnings for basic needs.

I remember that the fund was initially established as a "rainy day fund" and if needed it could be used in the future. The reduced income from oil revenues at this time justifies the need for these monies by the state.

Since these earnings are considered property of all the residents of Alaska, it is important to me that the utilize these fund to pay for basic services and development projects that will benefit all Alaskans.

I do not want these monies to be used just to keep funding a bureaucracy that is to big. Our large government came from excess oil wealth and now must be reduced to live within our means.

Submitted by:

Marcia E. Ward  
1225 Ward Farm Rd  
Delta Jct., AK  
907-895-5415

## Doniece Gott

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**From:** Bruce Jaffa <bruce@jaffaconstruction.com>  
**Sent:** Tuesday, March 22, 2016 9:55 PM  
**To:** Senate Finance Committee  
**Cc:** Sen. Peter Micciche; 'Ben Jaffa'; 'Carole Jaffa'; 'Jake Jaffa'  
**Subject:** SB 128 & SB114

Senators Micciche, McGuire , et al.

Although my work assignment is heavily in Fairbanks, I will try to attend the Seward meeting.

I have considered the deference between the Governor's Bill SB 128 and the Finance Committee Bill SB 114. Obviously both plans have merit. The method used to use the PF for benefit in the current crisis can be debated endlessly depending on the individual views of participants. Suffice to say some change in the distribution of the PFD is needed. Thankfully we have this opportunity. The debate of what is meant by a "rainy day account" was postponed until now. Whichever method is used, the citizens, legislators and voters of this State MUST decide philosophically if we wish to support the needs and obligations of Statehood. I believe the use of the PF or rather PFD should be a small bridge to help us cross the funding gap.

We have had a free ride for a long time based on the extraction of a finite resource. Participation can be explained as simply as "put your money where your mouth is". The complete cancellation of statewide taxes in the 1980's was ill conceived. Today we have become a population with our hand out expecting the government to meet our requests with no pain. That pain is meeting our responsibility. Any plan to solve Alaska current shortfalls should include the reinstatement of a graduated income tax. This tax will be collected from all wage earners regardless of their place of residence. Further, immediately reinstate the "School Tax" that was assessed to all workers. This tax had been dedicated but could just as easily be collected to the GF. This is a small amount in the overall scheme of things, but some of us still think it is important to collect pennies, after all each penny puts us that much closer to our goal.

I have had discussions with my Moose Pass neighbors and in other parts of the State. I believe that most Alaskans realize the time for personal income taxes is now or right around the corner. As the Governor's description of delays has merit, please find the resolve to address these remedies in the current term. I believe that the need for a special session would suggest timidity. The plans have been on the table for long enough to fully consider already.

Respectfully,

**Bruce Jaffa**

Quality Control Manager

7-224-8002 Seward

907-479-5241 Fairbanks

907-240-0362 Mobile

Bruce@jaffaconstruction.com

## Doniece Gott

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**From:** MICHAEL WISNEWSKI <alaskamike38@hotmail.com>  
**Sent:** Tuesday, March 22, 2016 7:16 PM  
**To:** Senate Finance Committee  
**Subject:** Yes to APFPA

To the Finance Committee,

My wife and I both support Senate Bill 128, the bill to use part of the permanent fund to fund the government of AK. We have collected the dividend every year since its inception, and at the very beginning, I felt that it was a marvelous far sighted thing to set up for the state. Even back then, I thought that someday, the state will need to use it for the budget. That time has arrived.

Combine it with taxes, perhaps an income tax and/or a small sales tax (not too big as local areas need sales taxes too). Cut spending as much as you reasonably can.

We have to have a good plan. I think we have enough wise heads in the legislature to do it and to do it now. The Perm. Fund has been the goose that laid golden eggs. The goose will be dead if we don't start using some of the eggs to support the government. We can do it without killing the goose if we are smart and set it up wisely.

Lastly, Alaska has been very good to us. I feel we owe the state some help.

Sincerely,  
Mike and Marcy Wisnewski  
201 W. Mattle Rd.  
Ketchikan, AK  
99901  
907-247 2376

Sent from Windows Mail

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March 23, 2016

Honorable Co-Chairs Senators Kelly and MacKinnon and Senate Finance  
Committee Members,

Thank you for the opportunity to testify on SB114 and SB128, the Permanent Fund Dividend bills. The PFD was set up to be given to the people by the state, Governor Hammond. The companies that take our oil were and are required to pay us for taking that oil and Governor Hammond wisely set up a fund to give back to the people of this great state. There are many people in the state that depend on their dividends to pay their taxes and many of their bills. My family is not the only family that depends on our dividends. If you take this money away from us it will be financially crippling.

Don't take the Permanent Fund Dividend from the people. If you need to use some of the money, take some of the interest of the PFD every other year. Do not take it every year or it will delete our fund and there will be none left for the people which is what it was set up for. By taking the interest every other year, this allows the fund to build up on the off year. I think this would be in the best interest of the dividend holders because it was built for Alaskans.

I would not be against a state income tax like we had before but I am against a fisheries tax or any other tax. We are being taxed a lot at the city level and if you put more taxes on us a lot of cities in the state will go bankrupted. Also, I think it is very disrespectful to our Senior Citizens to say that they should move out of the state because the state pays too much for them. I heard a Representative say this on the radio the other day and was taken aback by the statement. Our State would not be what it is today if it were not for the Senior Citizens. They are the ones who built this great state and nation and they deserve everything we can give them.

I would like to thank Governor Hammond for creating the Permanent Fund Dividend for the people of Alaska. God bless him for that from my family.

Darrel Gross

PO Box 754

Wrangell, Alaska 99929

**Doniece Gott**

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**From:** Christel <christel@gci.net>  
**Sent:** Wednesday, March 23, 2016 9:15 AM  
**To:** Senate Finance Committee  
**Subject:** Restructuring of PFD

Let my testimony be very clear.

**DO NOT RESTSTRUCTURE, REDUCE OR DO ANYTHING ELSE WITH ALASKAN'S PFD UNTIL**

- 1) **YOU GET OUT OF THE LIO**
- 2) **YOUR REDUCE YOUR PER DIEM TO THE STATE AMOUNT WHICH EVERYONE ELSE RECEIVES**
- 3) **GET RID OF THE OIL TAX CREDIT GIVE AWAY**
- 4) **TAKE OUT FUNDING FOR HUGE NONSENSICAL PROJECTS (I.E. KABATA, SUSITNA WATANA ETC.)**

**Doniece Gott**

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**From:** steve cothran <cothransteve@hotmail.com>  
**Sent:** Wednesday, March 23, 2016 9:10 AM  
**To:** Senate Finance Committee  
**Subject:** State Budget

Instead of looking at short term measures of tapping into the Permanent Fund Earnings to meet budget shortfalls (a regressive policy that hits the poorest Alaskans the hardest), I encourage the legislature to find more long term sustainable solutions through new revenue sources. Many Alaskans are concerned that new taxes will become permanent and only lead to wasteful spending once oil prices rise again. Why not peg the rate of new taxes inversely to the price of oil?

Steve Cothran

## Doniece Gott

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**From:** Chuck Wheeler <charle10wheeler@gmail.com>  
**Sent:** Wednesday, March 23, 2016 8:37 AM  
**To:** Senate Finance Committee  
**Subject:** SB 128 - Gov. Walker

Do not Support SB 128 submitted to the ASL by Gov. Walker.

To state the PF dividend would be \$1000 or more, pending the "moving target" of the State of Alaska deficit spending, is not based on a long term "run", 2021 and on. PF dividend would drop below 900 ..!  
Drawing on the ERA to fund Govt. Opns with A STATEWIDE SALES tax is unacceptable. Also unrestrictive funds are " unfair and unjust" to the remote rural communities in Northern Alaska who rely on AIR TRANSPORTATION for the very Basic NEEDS to exist. With a population of 1/7 , approximately 14% of the TOTAL STATE POPULATION, the revenues derived do NOT reflect expenditures in Remote rural communities because of POLITICAL power in the URBAN regions. Furthermore, natural resource revenues are derived from lands and areas within rural Alaska and imparts to communities' is real and damaging to the Subsistence lifestyle which is NOT recognized by the State of Alaska, Department of Labor and Workplace. Nor is the State of Alaska in compliance with federal law.

Revenues from natural resources, specifically Oil Production and Royalties' to fund govt. Operations do not fairly and justly benefit REMOTE Rural communities, on the contrary , are reduced incrementally for the past 3 decades. For these reasons I find No support for SB 128.

Emory C. Wheeler

## Doniece Gott

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**From:** Joseph Hummel <jhummel73@gmail.com>  
**Sent:** Wednesday, March 23, 2016 7:13 AM  
**To:** Senate Finance Committee  
**Subject:** pfd restructure...No!

To the Senate Finance Committee:

I firmly oppose any restructuring of the PFD.

Please put this to the people for a vote. They will overwhelmingly reject it, I believe. However, if they approve, at least their voice will have been heard, and the government will have the consent of the people to take action on this powderkeg issue!

To legislatively act on this will be EXTREMELY unpopular!

The PFD is a lifeline for many people here in Alaska. Oftentimes it is the only thing which keeps people in this state.

What about the children saving for college?

Please don't take away our "dividend dance" !

Sincerely,  
Joe Hummel  
Fairbanks, AK

## Doniece Gott

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**From:** AL THOMAS <skiner1@yahoo.com>  
**Sent:** Tuesday, March 22, 2016 10:22 PM  
**To:** Senate Finance Committee  
**Subject:** permit fund

i am told that the state government wants their cake and mine too. If the state would take away any part of the pfd's it would be devastating to a lot of folks as that we look forward to that to buy firewood,repair the house or car,or medical bills,and stock up on foods for the freezer for the winter I live a small budget and if I can so can they *I oppose any changes to the pfd*

## Doniece Gott

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**From:** joyce porte <joybaker6@hotmail.com>  
**Sent:** Tuesday, March 22, 2016 9:47 PM  
**To:** Senate Finance Committee  
**Subject:** Permanent fund vs. Taxes

As a long-time Alaska resident (since just before Statehood), I have observed my fellow Alaskans in their daily financial dealings and feel very strongly that an income tax, similar to Alaska's original income tax, is the best way to solve the problems we have as a commonwealth state. Here is my reasoning.

The typical working family of four often depends on the dividend to be able to stretch the comfort one of living with higher prices in housing, food, travel etc., and sometimes as a way to save for childrens' college funds.

This typical family of four will probably pay a Federal Income tax of \$8,000. If a State income was set up to pay 10% of that amount to the State, \$800, that would be a far cry from losing the 4 permanent dividends each year.

The more wealthy would pay much more in State income tax, but the taxes are spread much more equitably between the rich and the needs.

The same goes for a State sales tax – those close to the poverty level will hurt more than the wealthier.

In conclusion, the cost to the individual to alleviate the crisis should be fairly and equitably divided. Of course, it's the wealthier segment of our society that will get to decide on this, and they would opt for losing the individual permanent fund rather than levying taxes because they would have more to lose.

Joyce Porte

41455 Crested Crane Street

Homer, AK 99603

907-235-6511

**Doniece Gott**

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**From:** Wade & Amy <wadeamy@yahoo.com>  
**Sent:** Tuesday, March 22, 2016 9:29 PM  
**To:** Senate Finance Committee  
**Subject:** Permanent Fund and Taxes

I will only support use of the Permanent Fund if more is done to cut the state government than has been currently proposed by the legislature. After much more has been cut, than I would support a balanced approach using the PFD, sales and income taxes.

Wade Ellis- Anchorage

## Doniece Gott

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**From:** MaryBeth Printz <printz.mb@gmail.com>  
**Sent:** Tuesday, March 22, 2016 8:42 PM  
**To:** Senate Finance Committee  
**Subject:** Budget suggestions

Dear Senate Finance Committee:

Please consider the following budget suggestions and act upon them for the good of the citizens of Alaska.

· 1. Size of Government. It is too large and controls too many aspects of our lives. I would ask that you explore every means possible to reduce the size of government before considering the usage of the PFD. Please investigate if one person can do the job of two in every department. Reduce the number of departments to what is absolutely necessary to run the state. Pare down the number of employees to the bare minimum and increase efficiency by offering incentives. The elimination of aides, travel expenses, reimbursement for dining out, etc., need to be considered as well. Moving the capital to Anchorage would also save a lot of money because Alaska is the only state with 'two' capitals, which is pointless and costly.

· 2. Spending. Fund what supports the good of the population not what is politically motivated. If the project does not benefit the entire population in an area, then it should be *permanently* discarded. There are too many projects like bridges and roads to nowhere that do not make any fiscal sense. When economic evaluations show that a project (i.e., Knik River Bridge) will never pay for itself and the burden for its support falls on taxpayers, eliminate it forever.

· 3. Sales/Income Taxes.

o If a sales or income tax is going to be instituted, do not give people PDF money and then take it back as a tax because it makes no fiscal sense. It is the same principle as Daylight Savings Time. And taxes only go up.

o If there is an income tax, it should be a flat tax, say 10% of a person's income, *including investment income and out-of-state residents*. That way, it would be fair for low-income individuals. It would be simple and would not require a multitude of state employees to oversee.

o Capping the Dividend. Only after significant housecleaning is done, should using the PDF be considered. This is a last resort when budgets in all other areas have been stripped to the bone, it should be at the lowest proposed rate.

· 4. Medical care.

o Support our elderly. Most seniors live on limited incomes and need assistance with all forms of medical care. Let's take care of our old folks, our family members, and not discard them!

o Copy Canada's health care system. It works.

· 5. Education. Funding for education needs to be closely examined.

o Close UAF. The three funded programs there can be moved to UAA, Anchorage.

- o Technology in schools is antiquated and needs to be updated to keep pace with the rest of the world.
- o Now that No Child Left Behind is no longer a federal mandate, get rid of the plethora of tests. There is too much money (millions of dollars) spent on (over) testing our children. The number of days in a school year spent testing is 30 days or more (in the ASD), which is a significant loss of educational time. Testing is not learning. Years ago, students had one test a year, the Iowa achievement test. Teachers did not have to spend days of educational time in a lab prepping students for a pre-test or a post-test and missing more educational days for the actual test.
- o Return to one achievement test a year in the spring as a measurement of annual progress. That test would take no more than one day of educational time. There would be no prep because teachers instruct what is in the curriculum and that is what would be tested.
- o Funds could be spent to better prepare future teachers in our state universities.
- o Teacher assessment. Using the AMP/MAP/STAMP, etc. test scores to assess teachers is an unfair practice because students who didn't care spent minutes on a test that took others several days or more for serious students to complete. The scores from the apathetic students impact the teacher's evaluation. Principals should assess teachers, not standardized test scores.
- o Educational Choices. There are enough educational choices available to students. Several schools are losing population and those neighborhood schools might close. If there are too many options, how will any school be strong to support itself or a neighborhood? I do not support vouchers because they will undermine our current educational system.
- o Too much money is spent on over-staffed administrations. Only a small amount of the funds for education actually go to teachers who work with children everyday. Funds should be directed to benefit those teachers and their students.
- o Listen to teachers. We do our job every day and know what is needed and what is not necessary better than anyone else.

· 6. Early Teacher Retirement. Please pass the early retirement initiative. I am a veteran teacher (this is my 16<sup>th</sup> year) and highly educated. I would certainly take advantage of early retirement. This would save the state money because there are many teachers with a lot of education and experience who are near retirement eligibility. Younger, less experienced teachers are more economical! We would be buying the years.

· 7. Daylight Savings Time. Please get rid of this archaic ritual. It does nothing for the population but creates sleepy people in the spring. It is pointless, especially in Alaska.

· 8. Alaska LNG project. The state should go-it-alone and not rely upon oil companies who can leave the state at any time. However it needs to be managed by someone knowledgeable in business who will run it properly.

Thank you for your time and consideration of my suggestions.

Sincerely,

 MaryBeth Printz

Anchorage, AK 99517

## Doniece Gott

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**From:** Kathy Matta <itmattas@icloud.com>  
**Sent:** Tuesday, March 22, 2016 5:57 PM  
**To:** Senate Finance Committee  
**Subject:** Permanent Fund

Dear Sirs,

As a resident of Soldotna I do not want to see the permanent Fund used for any other purpose such as paying off debts because of wasteful spending. Its not the peoples fault that this debt has come about. Its the governments fault for all the grants and whatever else. We the people are not responsible for this mess and we the people should not have to continue to pick up what these politicians have done to the State of Alaska.

Kathy Matta  
32940 Robert Ave  
Soldotna AK  
99669

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# **A Comparison of Plans to Re-Plumb Alaska's Cash Flow**

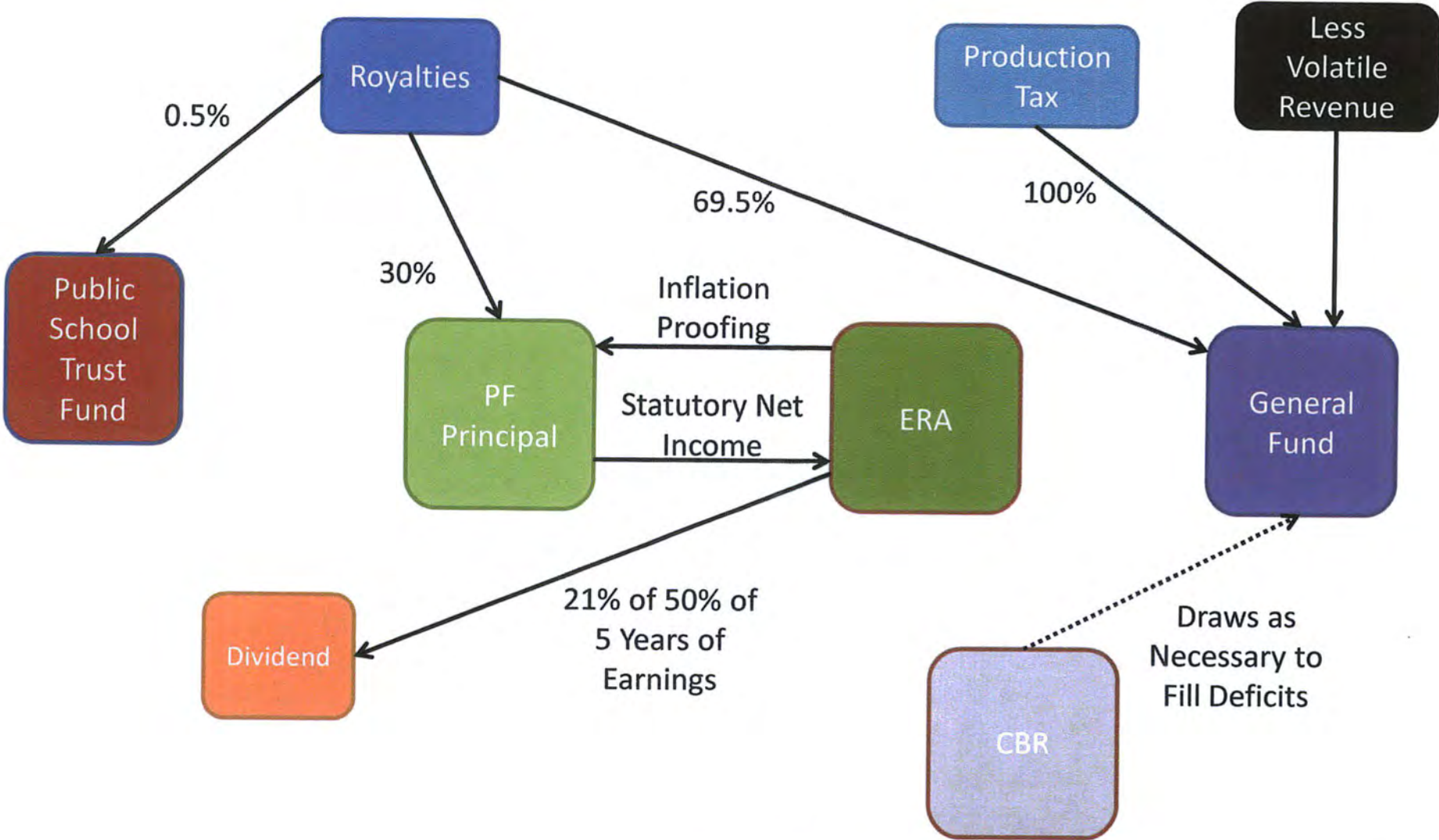
- Cash Flow Diagrams
- Models

Senate Finance Committee—March 23, 2016

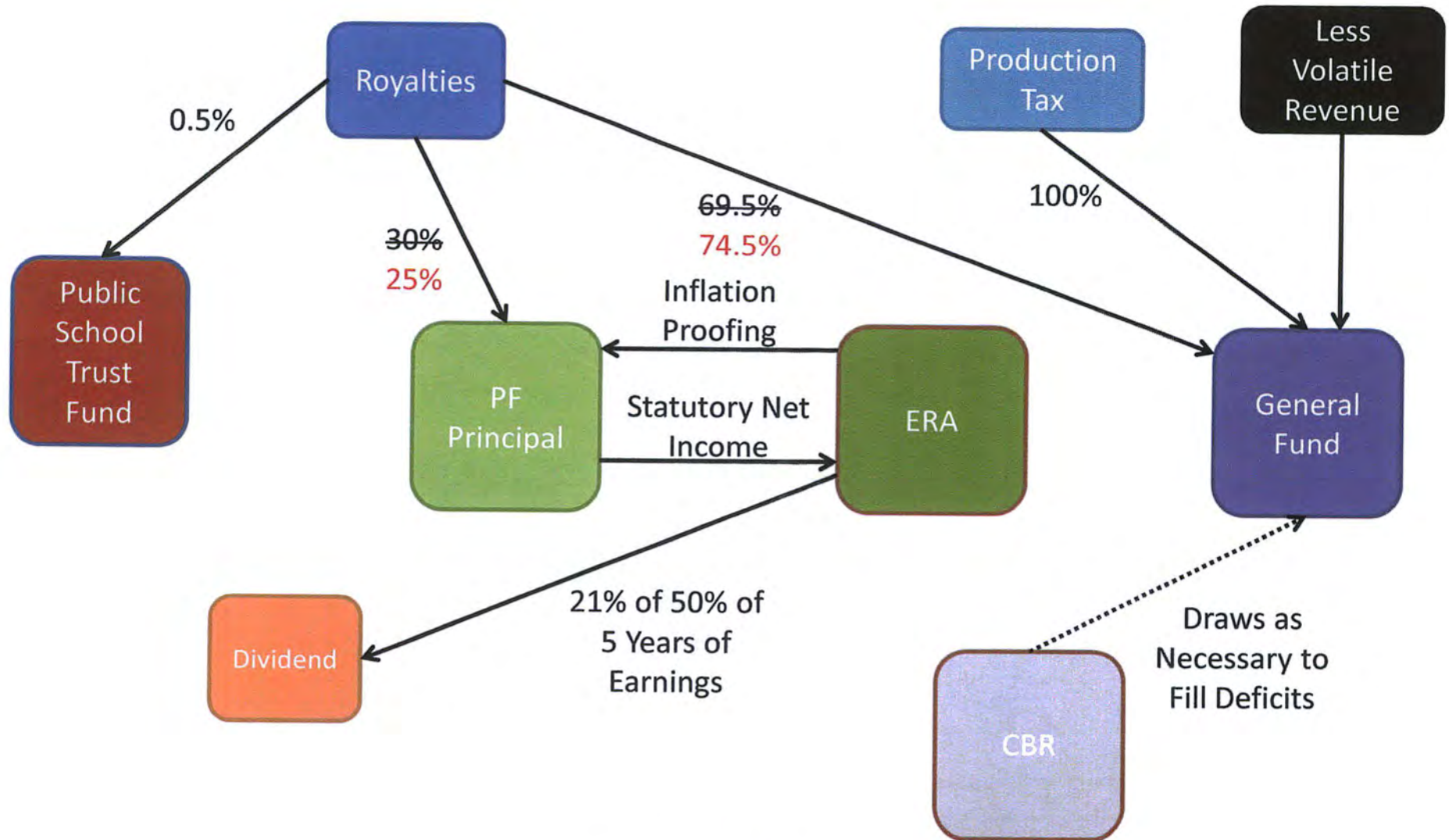
David Teal, Director

Legislative Finance Division

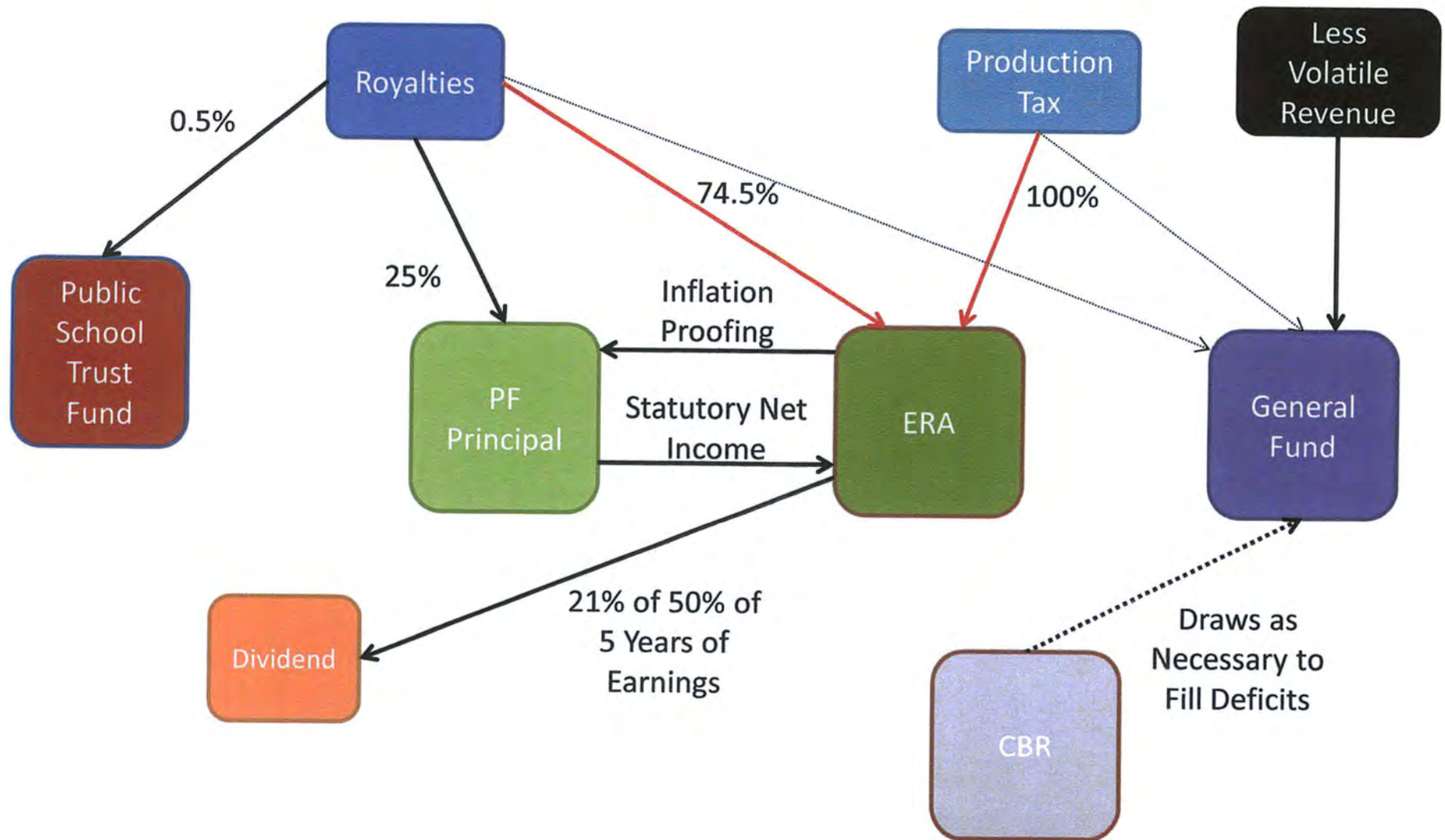
# Current Cash Flow



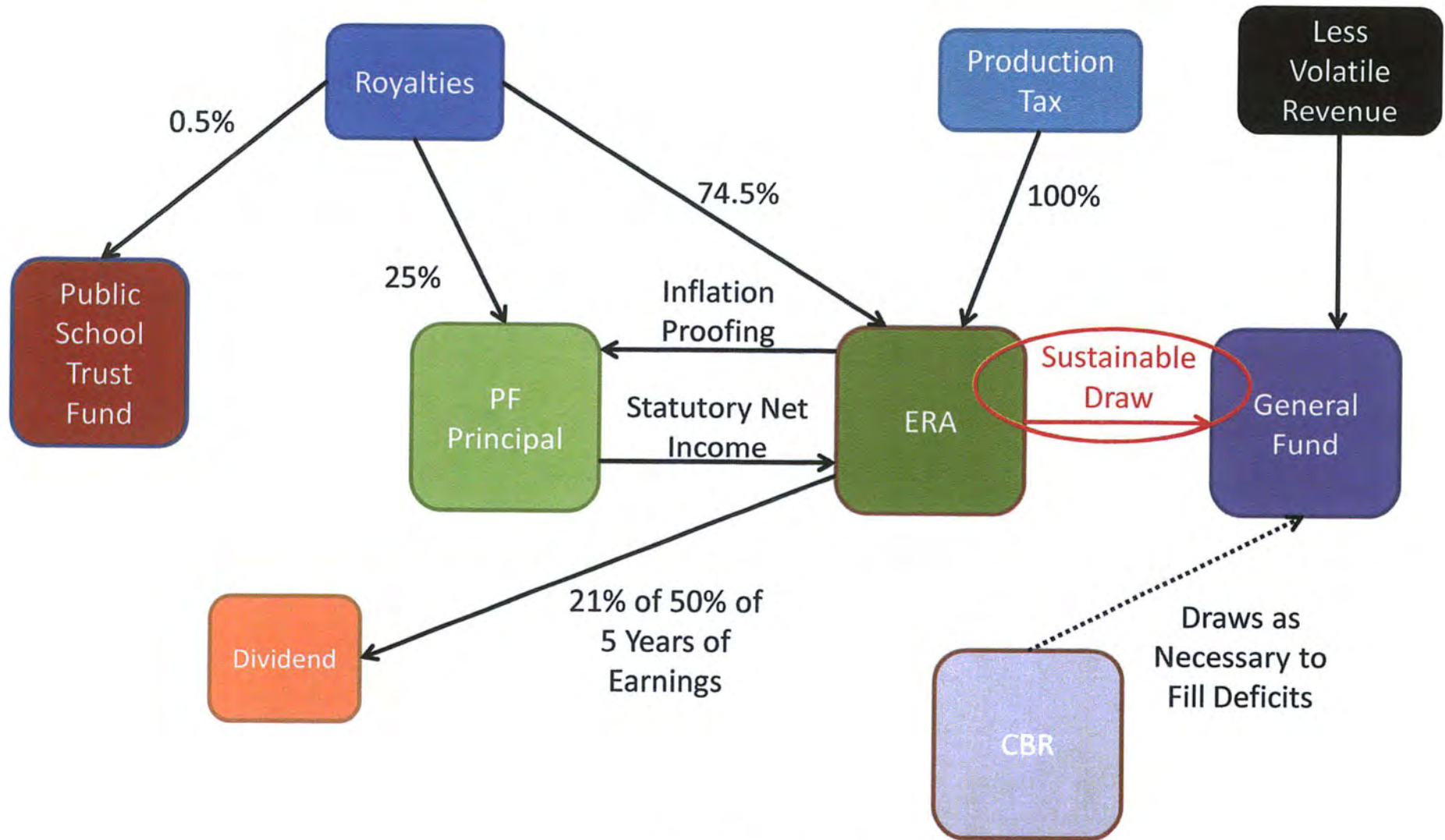
# 1. Change Royalty Percentage (PFPA)



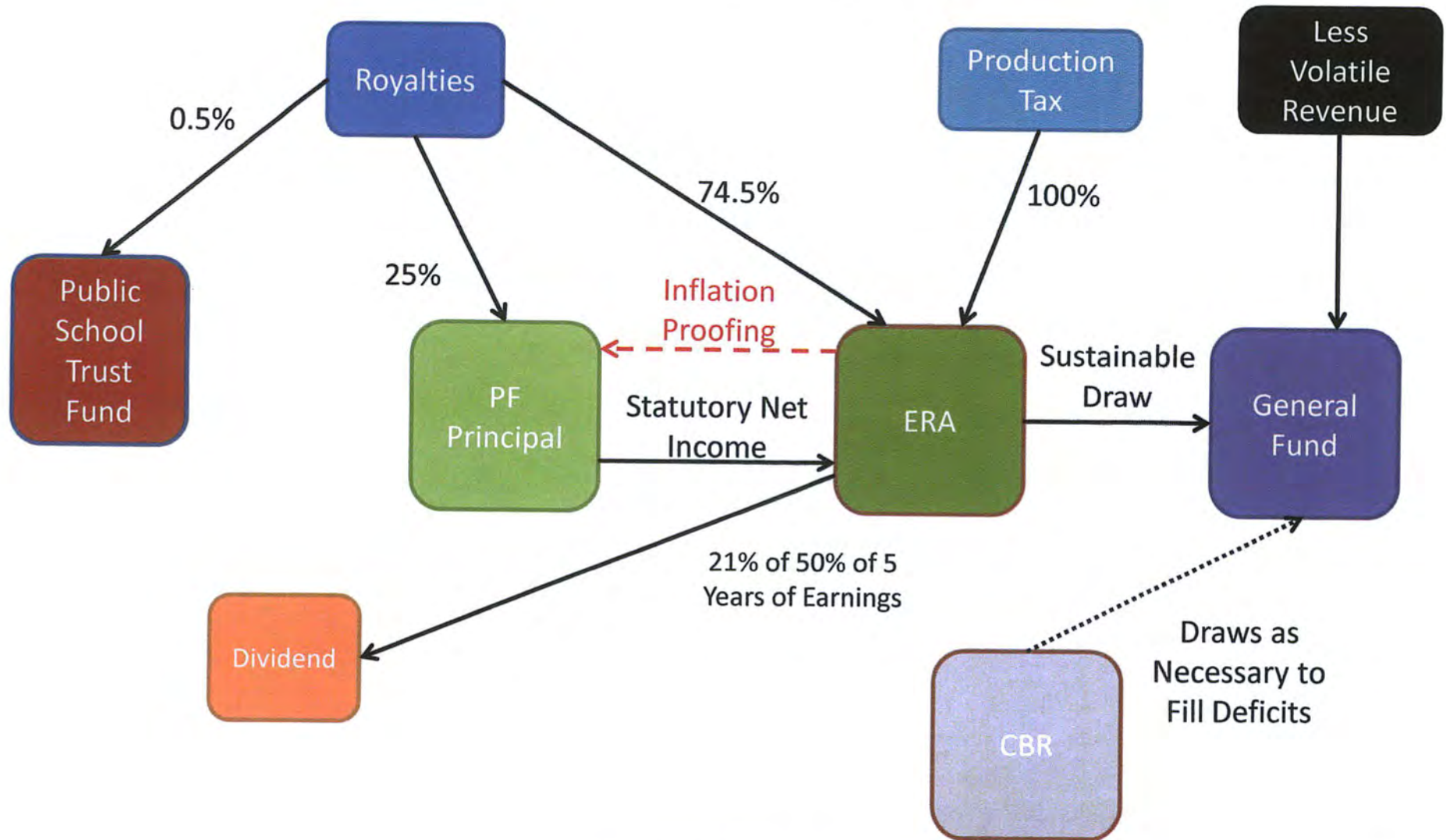
## 2. Re-Route Taxes and Royalties to ERA (PFPA)



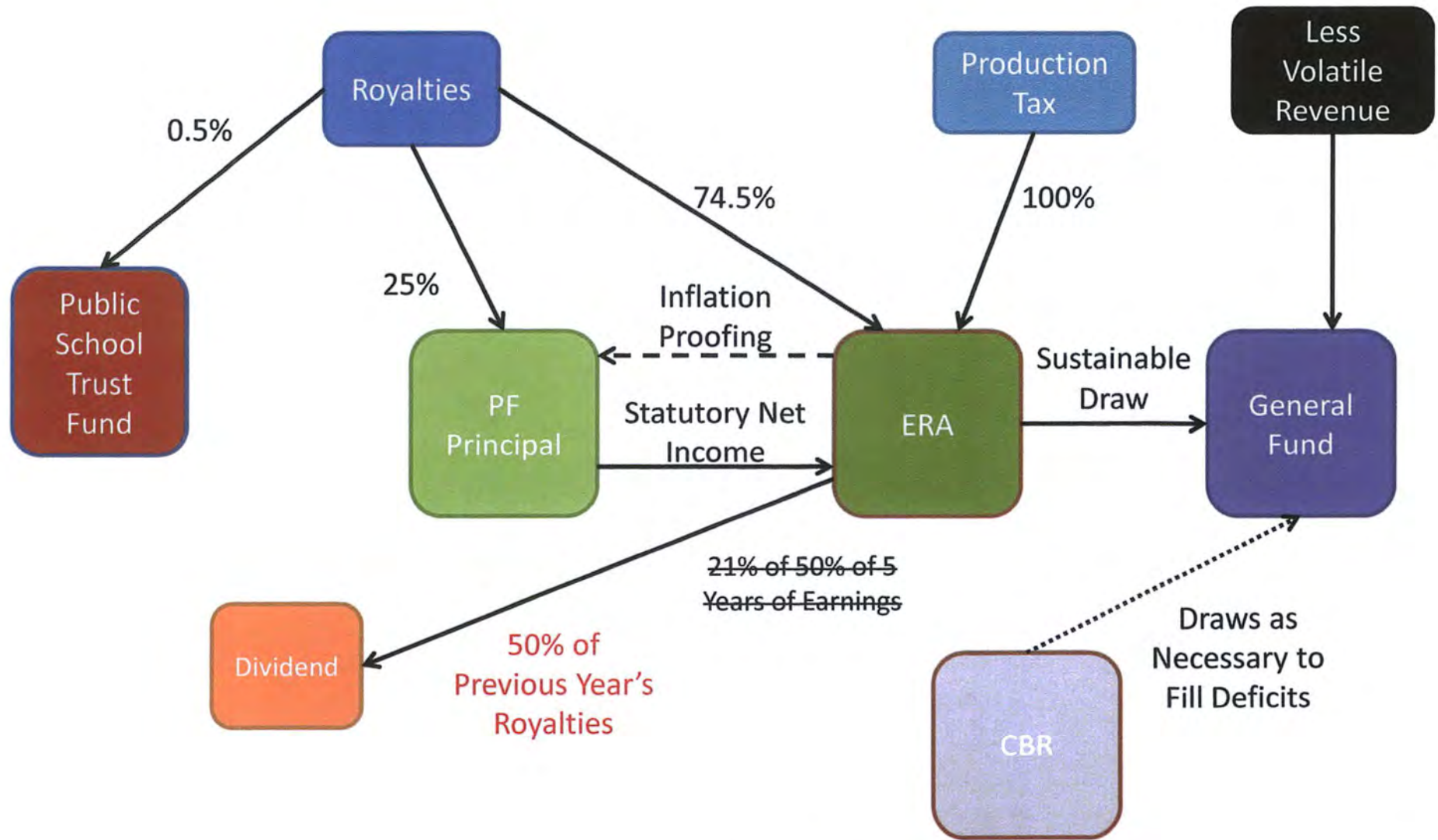
### 3. Add Sustainable Draw from ERA (PFPA)



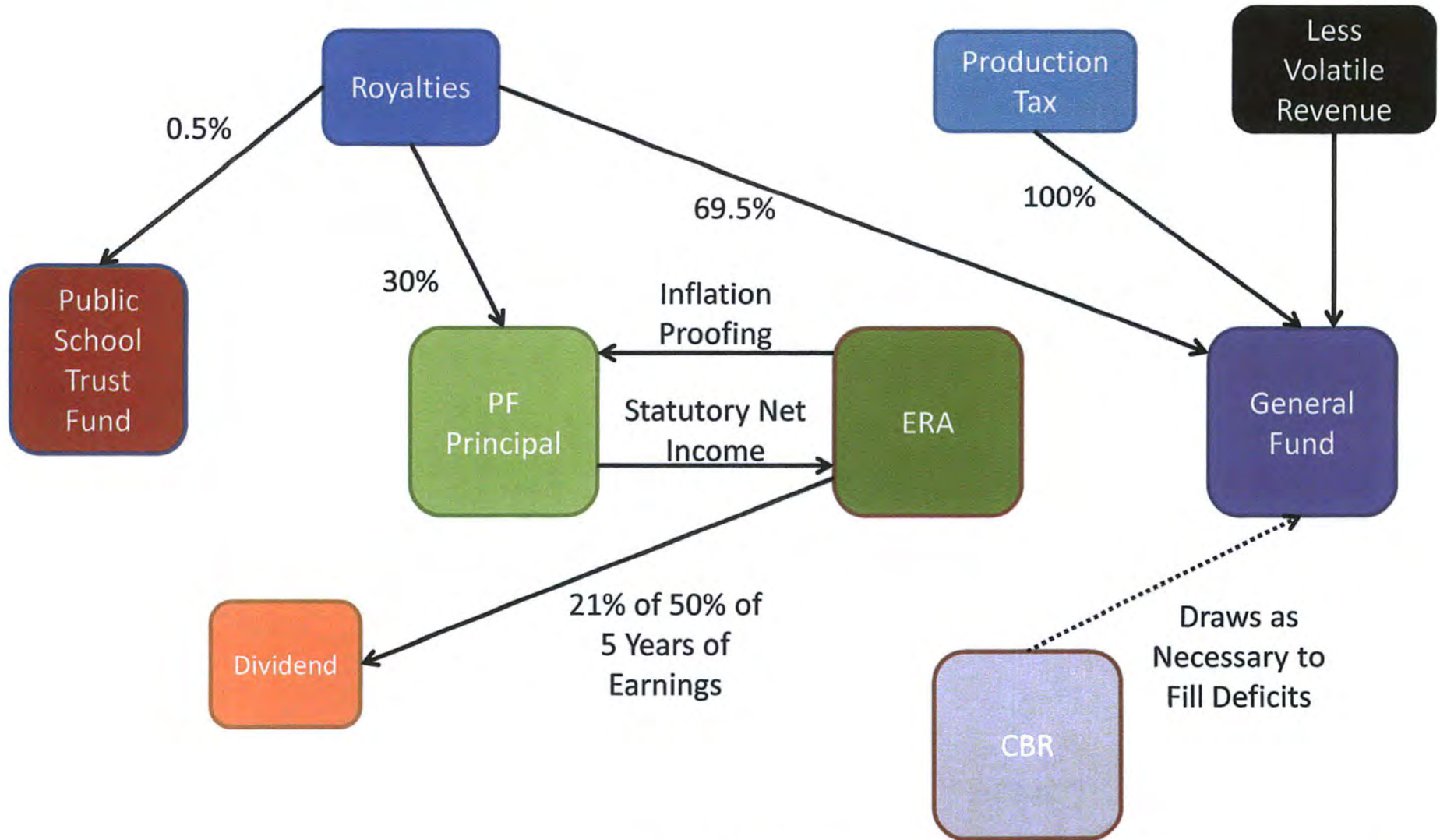
## 4. Change Inflation Proofing to an “Overflow” Mechanism (PFPA)



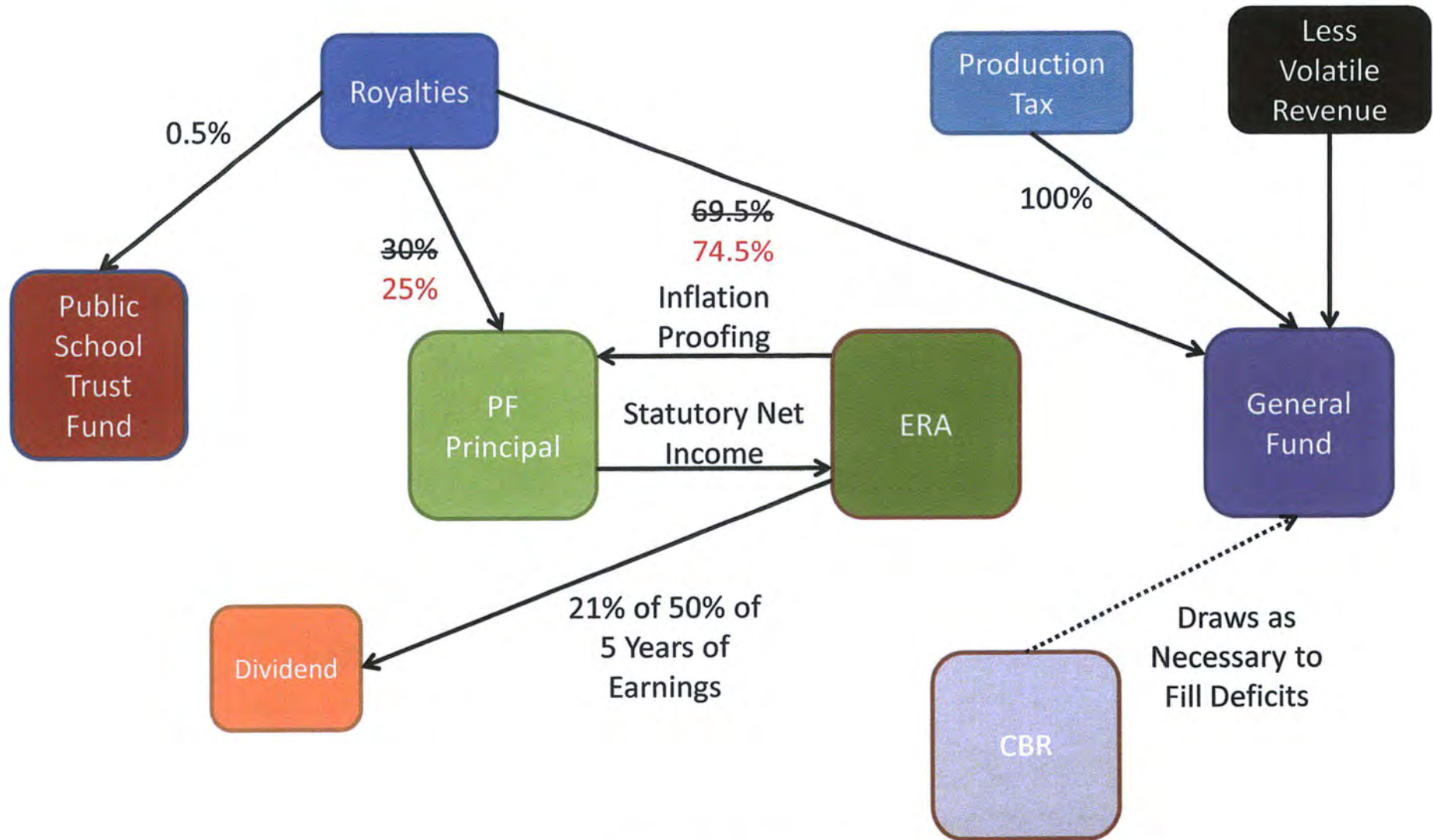
# 5. Change Dividend Source and Calculation (PFPA)



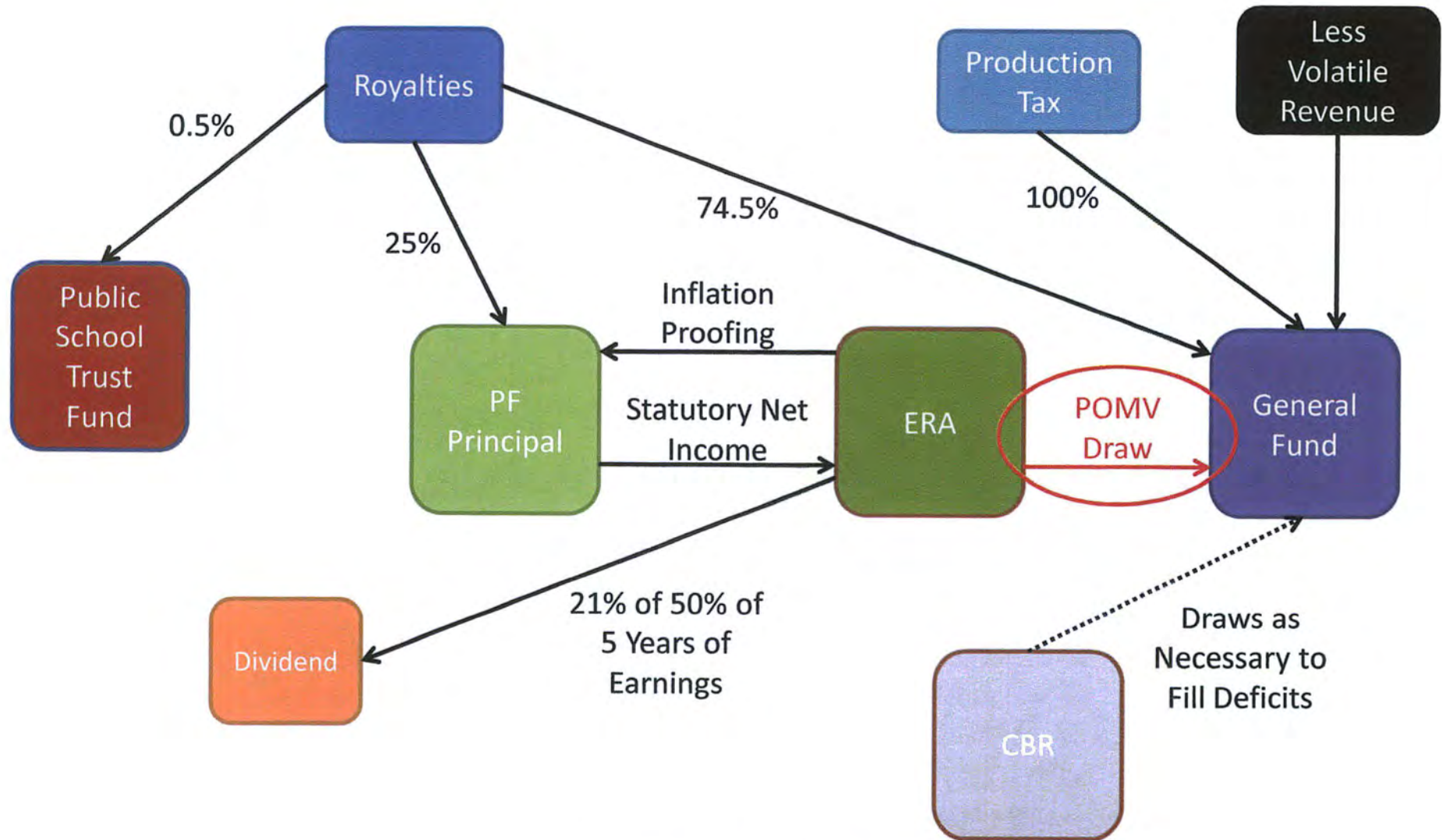
# Current Cash Flow



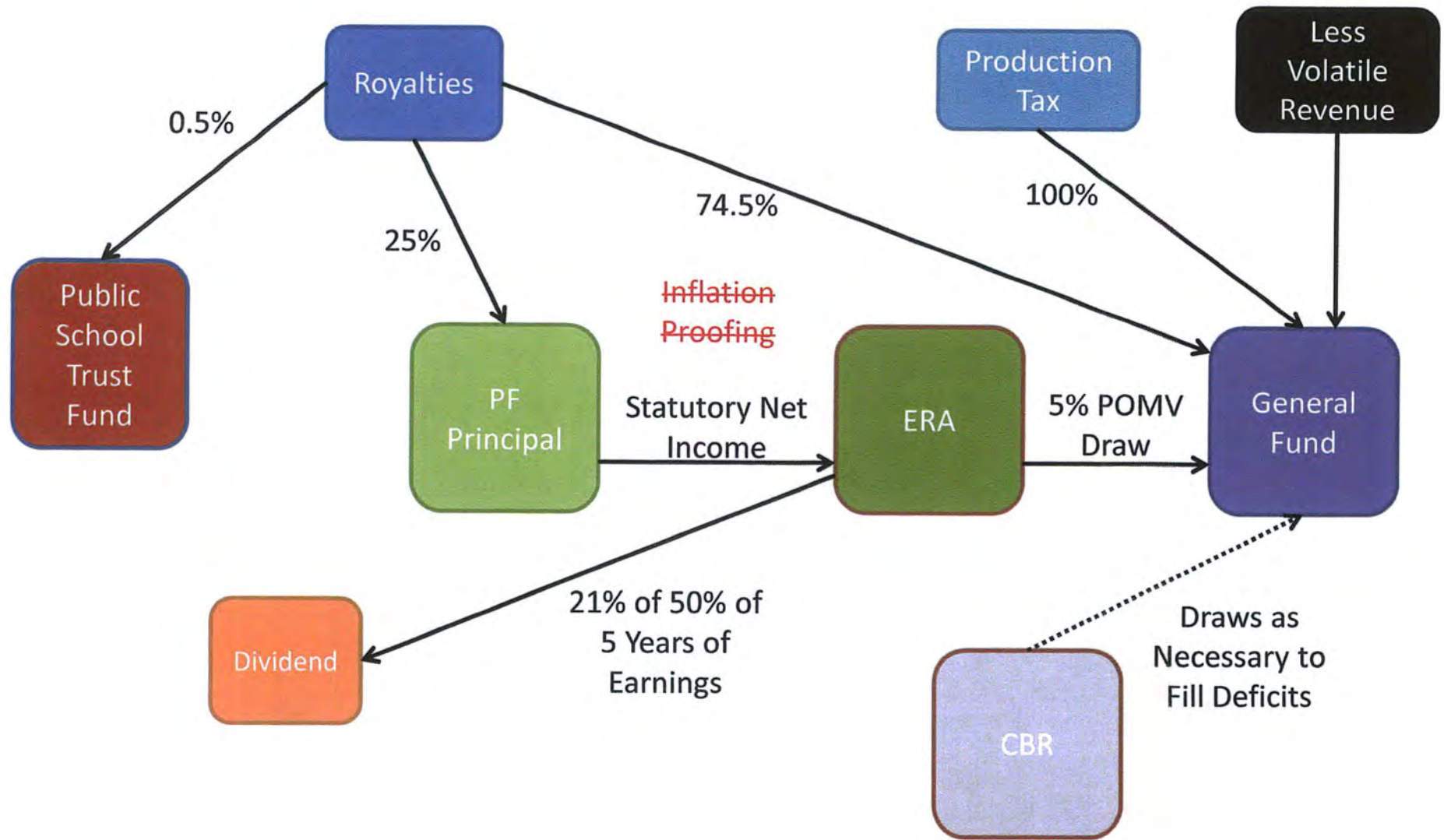
# 1. Change Royalty Percentage (SB114 / HB303)



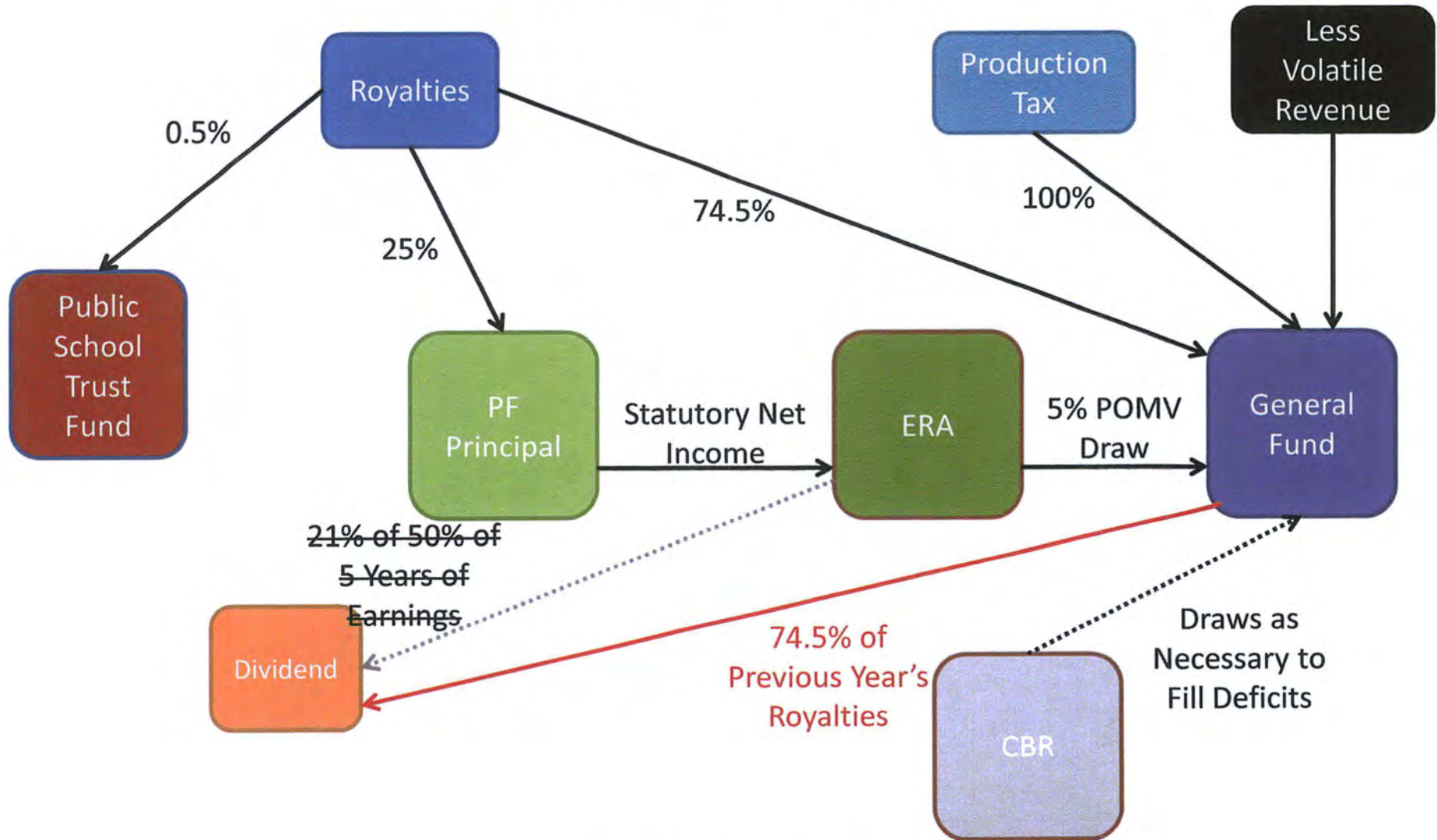
## 2. Add POMV Payout (SB114 / HB303)



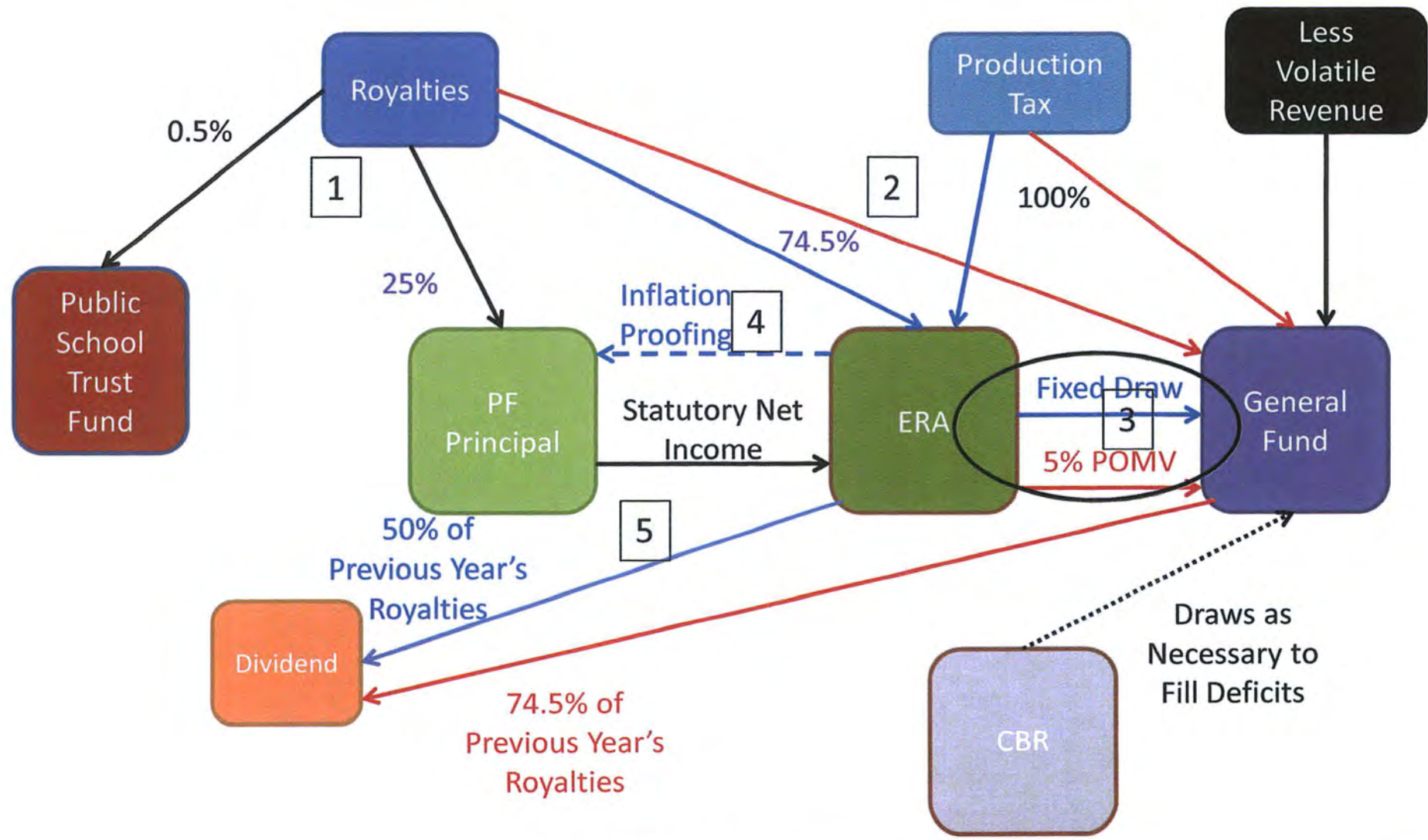
### 3. Remove Inflation Proofing (SB114 / HB303)



## 4. Change Dividend Source and Calculation (SB114 / HB303)



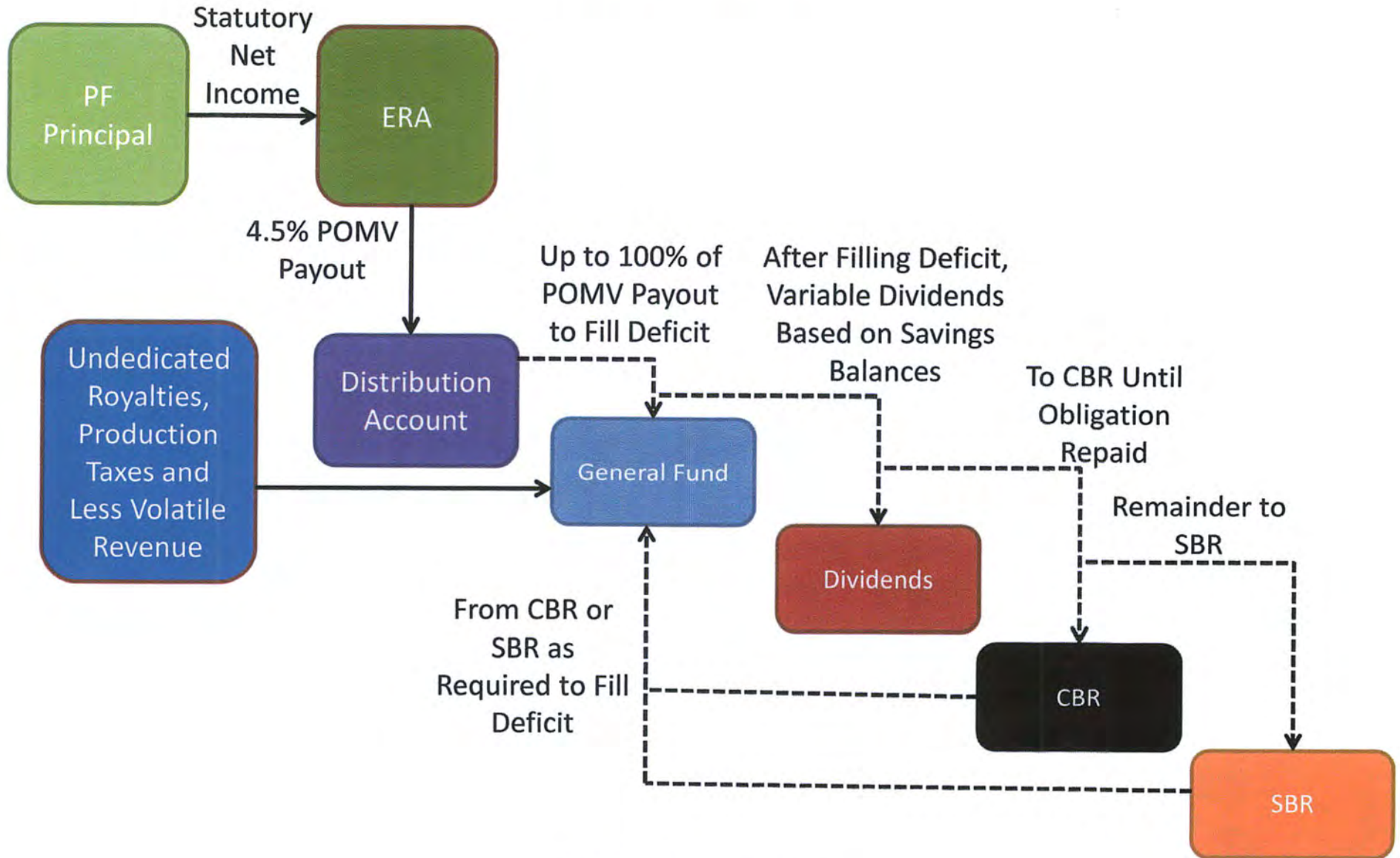
# PFPA vs. SB114 / HB303



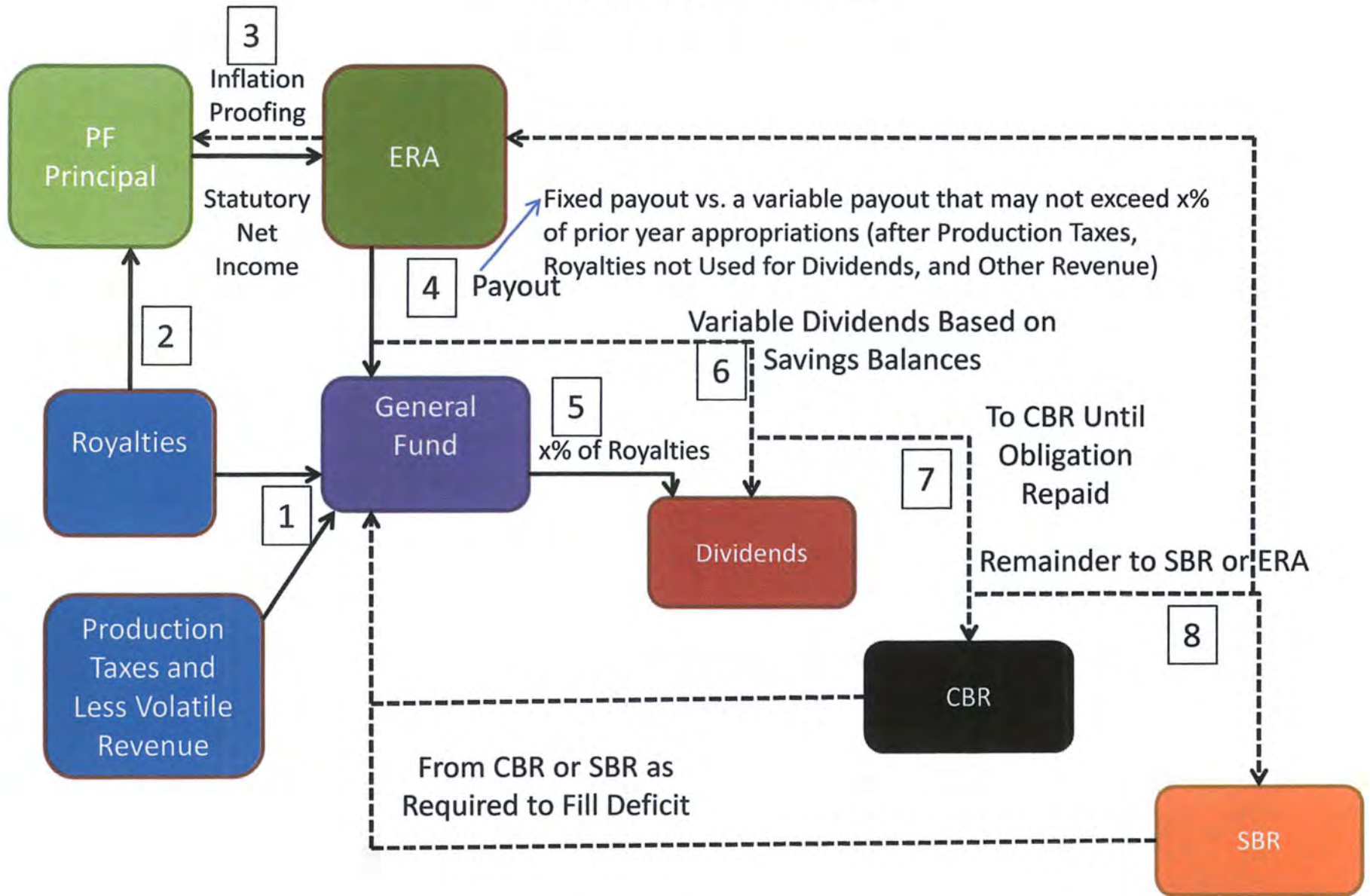
# PFPA vs. POMV: Which is Better?

1. A fixed draw is highly dependent on actually attaining the projected rates of return and projected oil revenue.
2. Those projections look forward 20 years--hence the need for review of sustainability of the draw.
3. We are not very good at projecting rates of return, and even worse at projecting oil revenue.
4. POMV looks backwards 5 years and the payout is based on actual events rather than on projections.
5. Ask yourself this question: Is your hindsight better than your foresight?
6. Lest that question appears to be one-sided, note that POMV fails the stability test—if royalties and production tax revenue jump \$4b and fill the deficit without the need for a payout, the payout still occurs and there would be a tendency, or at least a possibility, of spending the windfall.
7. Is there a hybrid that offers the comfort of hindsight offered by POMV and the stability of PFPA?

# HB 224 Cash Flow



# Decision Points



# Decision Points

1. Do you direct volatile revenue to the GF or the ERA? Trade-off: fixed draw vs. “good enough” stability. This choice is made once you decide on #4.
2. Reduce dedication to 25%? Do you save while harvesting? Not a critical decision—it affects 10s of millions vs. 100s of millions under decision #3.
3. Inflation Proofing--Do you want greater protection of the PF if it increases the risk of failing to have the cash needed for a payout? Once money is in the PF, it can never be spent, while money in the ERA can be spent any time.
4. The payout is your first critical decision. Trade-off: do you favor a forward-looking, manual adjusting fixed draw that promises greater stability, or a backward-looking, self-adjusting draw that offers less stability? Spending restraint under high oil prices is a key element of PFPA. But POMV’s weakness in that area can be overcome by limiting the payout to prior year appropriations (plus some room for growth, if desired). The POMV payout can be turned into a spending limit.  
If you chose a variable draw, what payout rate will you choose? Trade-off: a lower rate means less money now, but it increases growth of the ERA and other reserves so could mean larger payouts in the future. 4.5% of \$70b is greater than 5% of \$60b.

But a lower payout rate means larger deficits in the short-term—do you want to reduce spending or increase taxes to fill the gap, or do you have sufficient reserves to fill deficits? The longer you wait to act, the lower your reserves and the higher the risk of failure.

5. Second critical choice is the amount and source of dividends. This applies to #5 and #6. Recall that IP can never be spent, but it spins off spendable earnings in the future. Once money is spent on dividends, it can never be recovered. **Trade-off:** higher dividends mean lower reserves and greater risk of unfillable deficits (or higher taxes or reduced spending on things other than dividends). This trade-off exists regardless of the source of dividends. **Another trade-off: dividends and the economy.**
6. The source of money for dividends may not be a critical choice in terms of maintaining healthy reserves, but it is a decision you will need to debate. Dividends now reflect the health of financial markets rather than the fiscal health of the state. Basing dividends on royalties (PFPA and SB114) would bring in short-term fiscal health, while basing dividends on reserve balances (HB224) would bring in long-term fiscal health. Why not do all three? That would provide a stable, guaranteed dividend with a kicker.
7. And 8. Deciding what to do with money that remains after the deficit is filled and dividends are paid is hardly worth talking about. You can set up rules or leave that decision to future legislatures.

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# Observations on Alaska's Economy and Economic Implications of Alaska's Fiscal Choices

Gunnar Knapp  
Director and Professor of Economics  
Institute of Social and Economic Research  
University of Alaska Anchorage  
[Gunnar.Knapp@uaa.alaska.edu](mailto:Gunnar.Knapp@uaa.alaska.edu)

Prepared for presentation to  
Alaska Senate Finance Committee  
March 30, 2016



UAA Institute of Social  
and Economic Research  
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## Outline

- Overview of Alaska's economy
- Short-run economic impacts of Alaska fiscal options
- Economic implications of how fast we reduce the deficit

I am not advocating for or against any bills or proposals

# Overview of Alaska's Economy

Thanks to the Alaska Department of Labor and Workforce Development economists who do an excellent job tracking Alaska's economy.

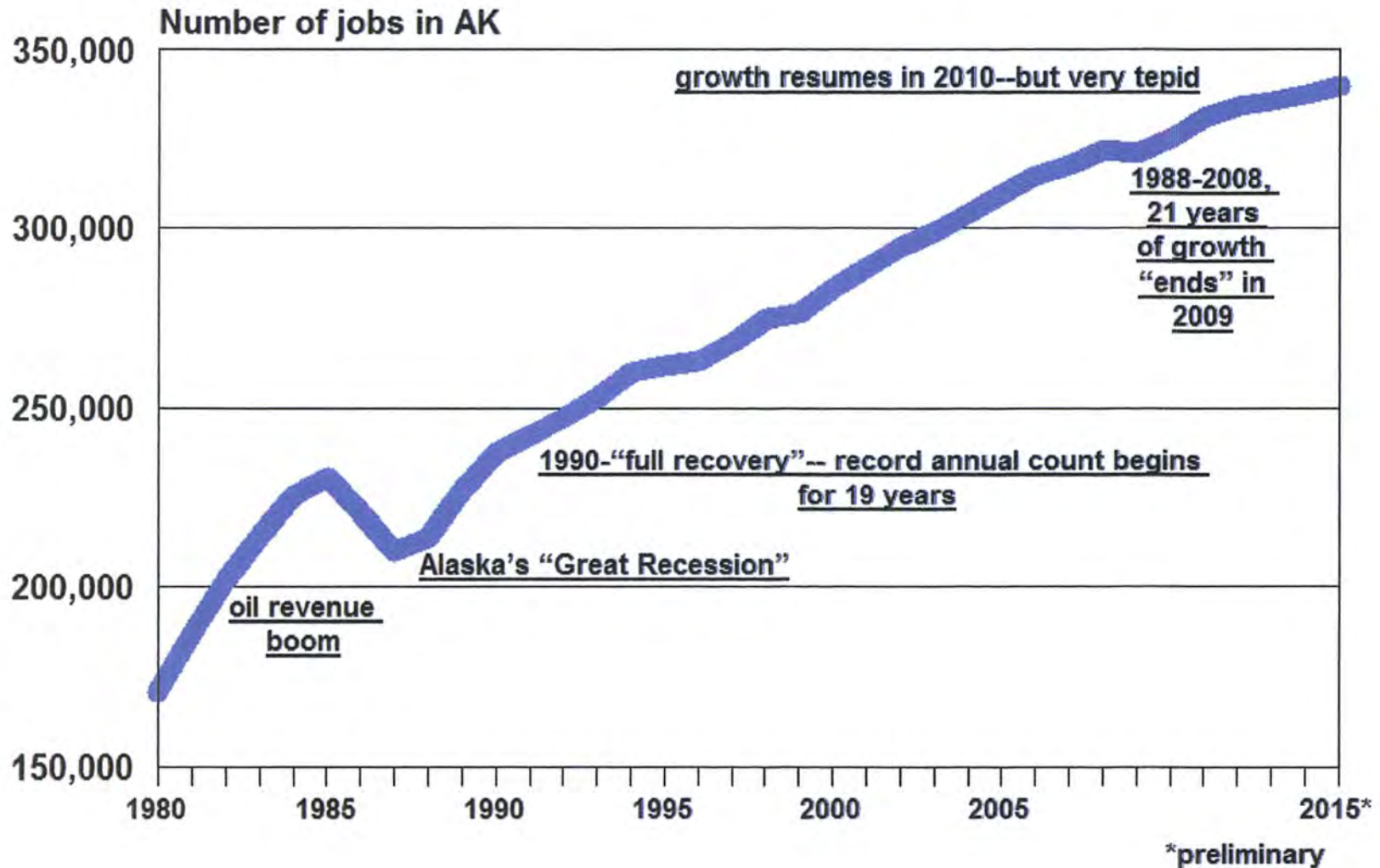


They provided me with most of the data and charts about the economy that I'm using in this presentation.

## Summary of main points about Alaska's economy

- There is significant concern about:
  - Are we facing a recession?
  - Could what we do to reduce the deficit aggravate the recession?
  - Could we be facing a repeat of the 1980s recession?
- Despite these concerns:
  - The best available evidence is that Alaska's overall economy is not yet in a recession
  - There are important positive indicators in the economy
- Several sectors of Alaska's economy are declining:
  - Oil industry
  - Construction
  - State government
- We probably are facing a recession
- But it is unlikely that it will be as severe or damaging as the 1980s recession

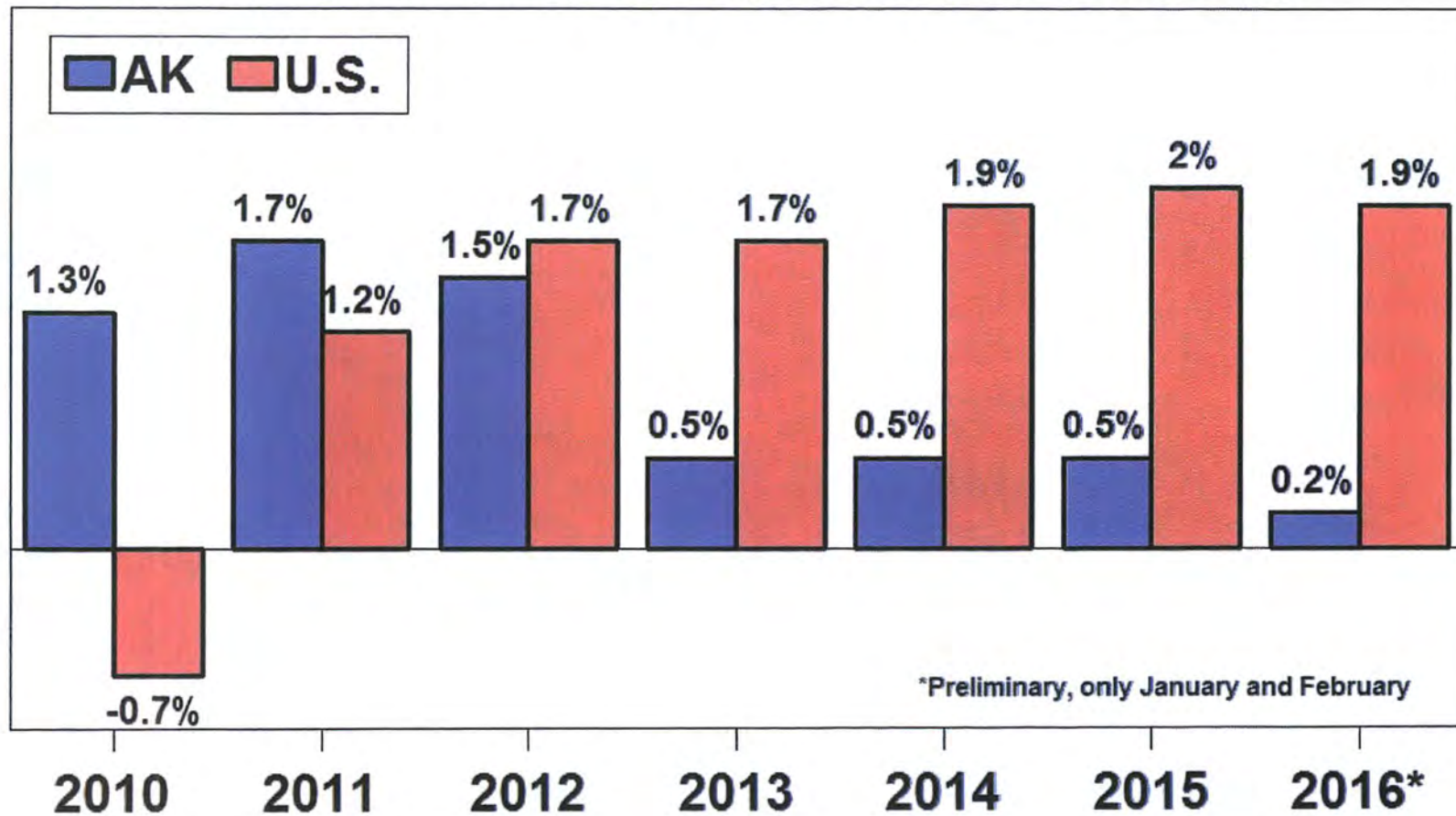
Alaska has had twenty-five years of almost continuous but slowing economic growth.



Source: Alaska Department of Labor and Workforce Development, Research and Analysis Section.

The best available evidence is that the total Alaska economy—as measured by the number of jobs—is still growing, but at a very slow rate.

Percent employment change from previous year-AK and U.S.



Source: Alaska Department of Labor and Workforce Development, Research and Analysis Section.

The most recent job estimates show total employment higher than a year ago.

### Total Wage and Salary Jobs, Over-the-year Percent Change

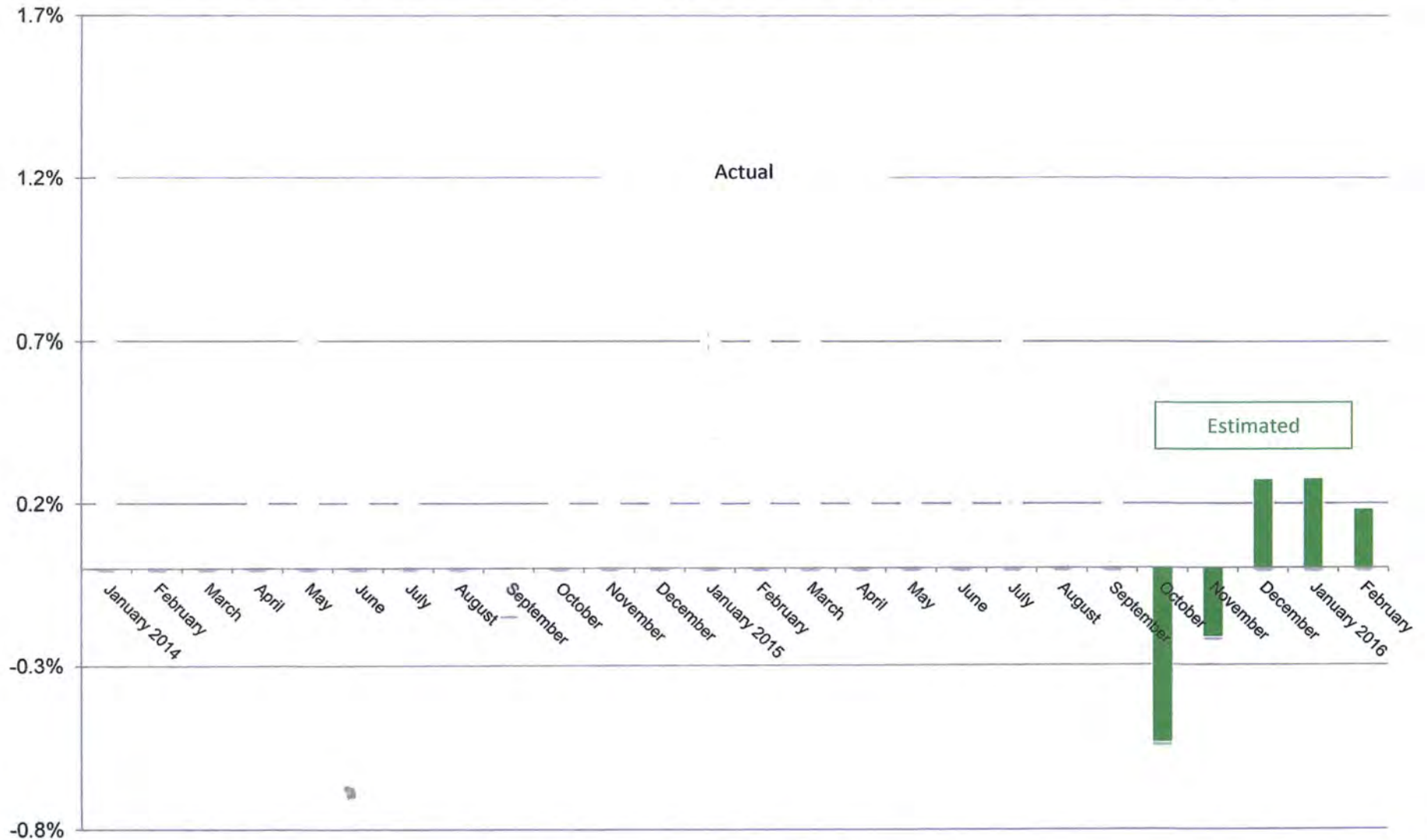


Chart provided by Alaska Department of Labor and Workforce Development, Research and Analysis Section.

Alaska personal income continued to grow in 2015.

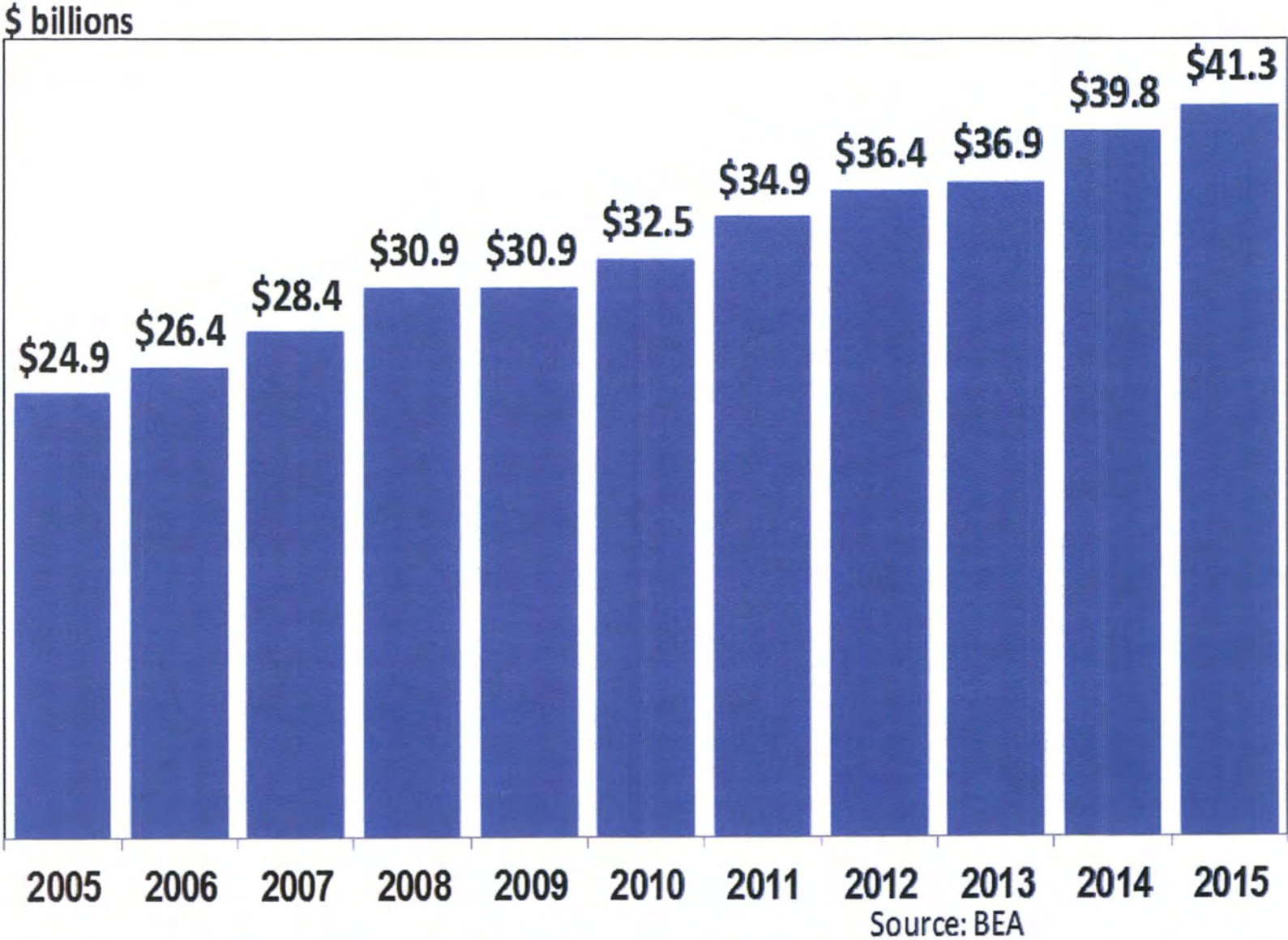
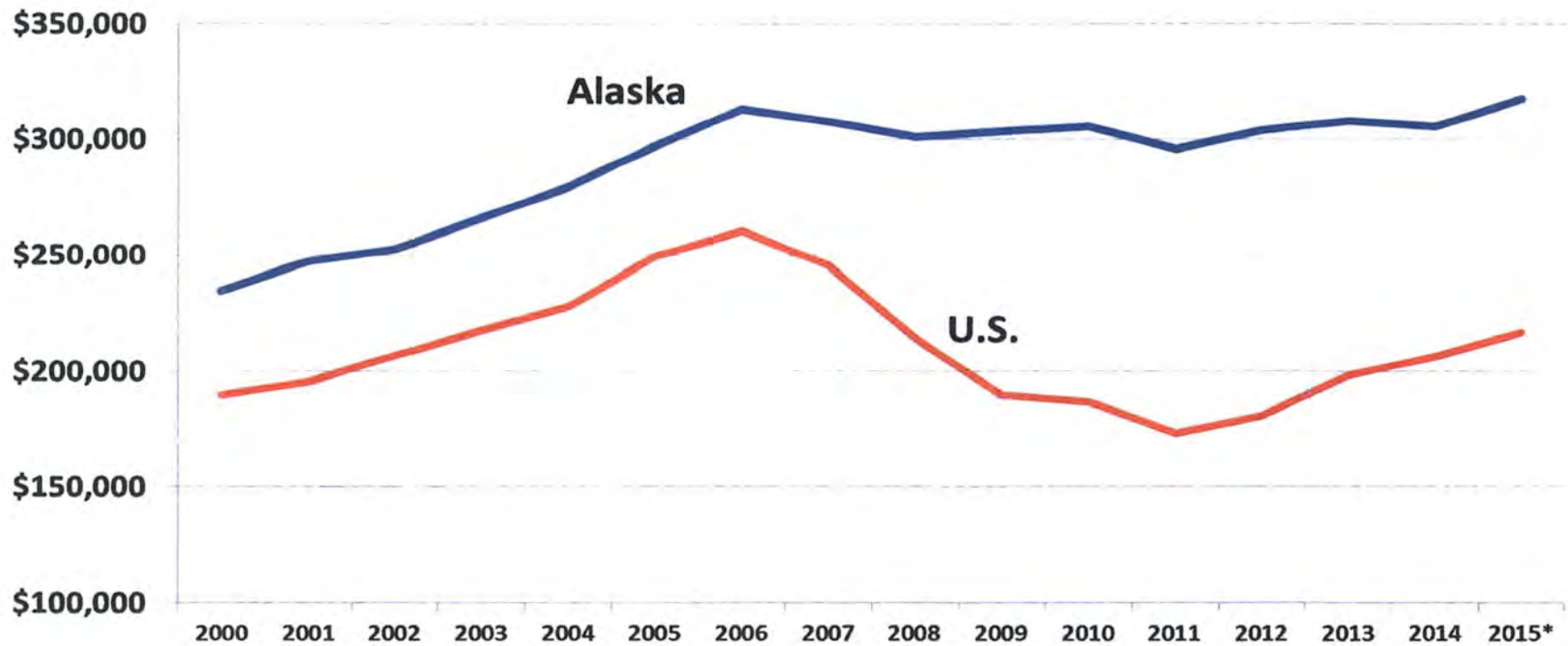


Chart provided by Alaska Department of Labor and Workforce Development, Research and Analysis Section.

Alaska's housing market is not showing signs of significant weakness.

### Average Single-Family Sales Prices in 2015 Dollars Alaska and U.S

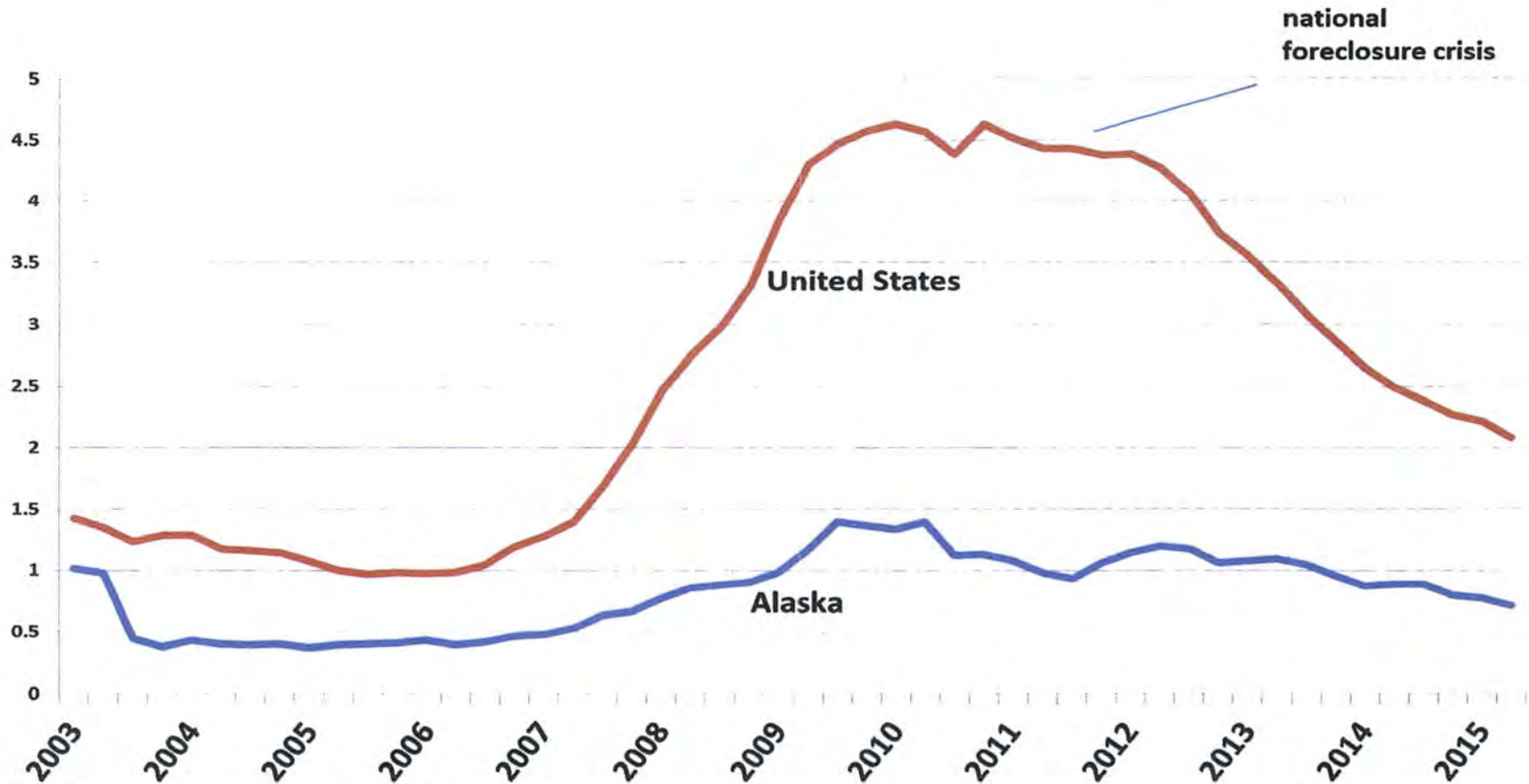


\* 1st half 2015

Source: Alaska Department of Labor and Workforce Development, Research and Analysis Section, Quarterly Survey of Mortgage Lending Activity; National Association of Realtors

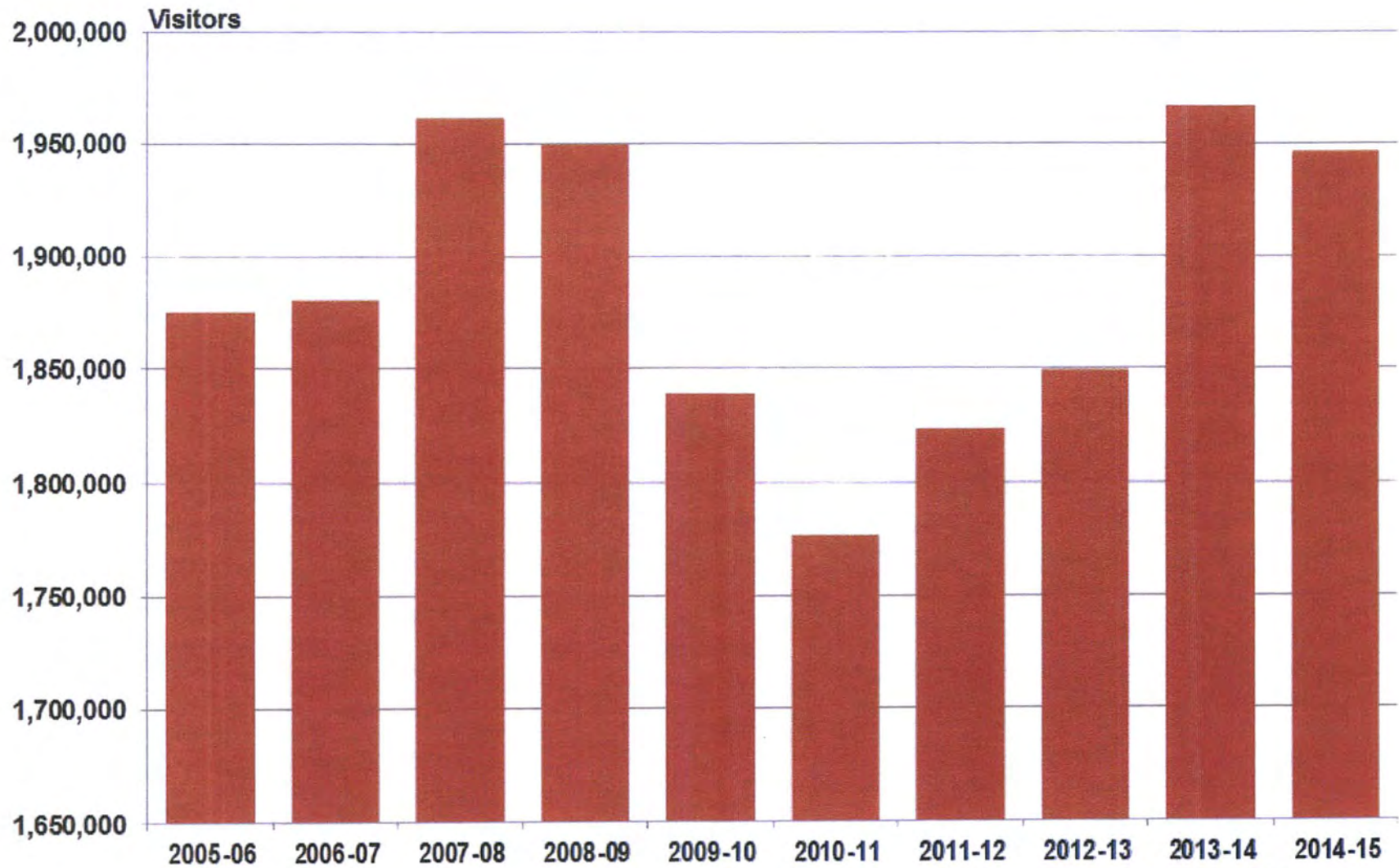
Alaska's housing market is not showing signs of significant weakness.

## Foreclosure Rate, Alaska and the U.S.



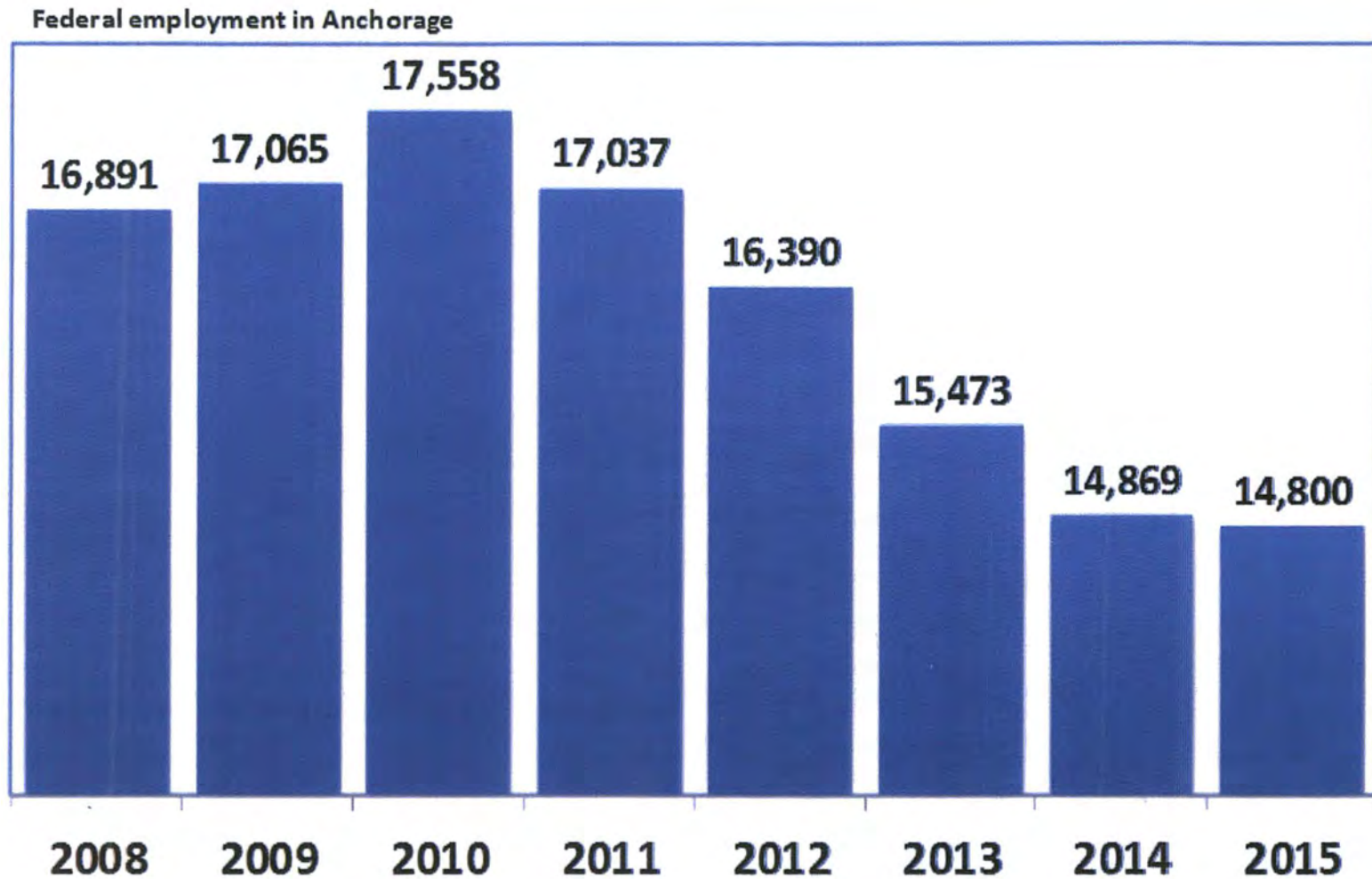
Source: Alaska Department of Labor and Workforce Development, Research and Analysis Section; Mortgage Brokers Association

## Alaska's visitor industry is doing well.



Source: Mcdowell Group

Federal job losses have been a significant drag on Alaska's economy in recent years—but these job losses appear to be easing.



Source: Alaska Department of Labor and Workforce Development, Research and Analysis Section.

But job losses are occurring in selected economic sectors . . .

### Oil and Gas Jobs, Over-the-year Percent Change

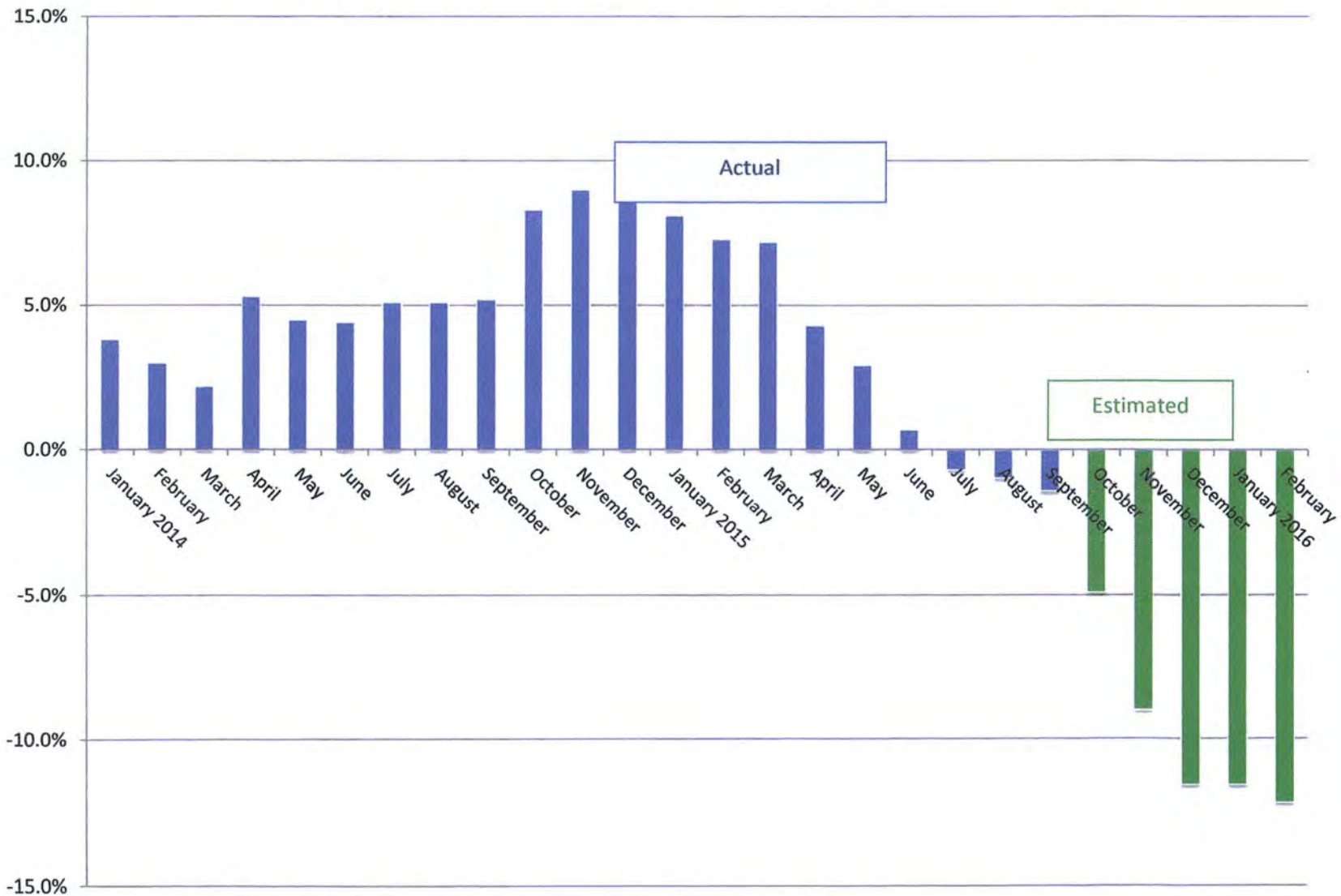
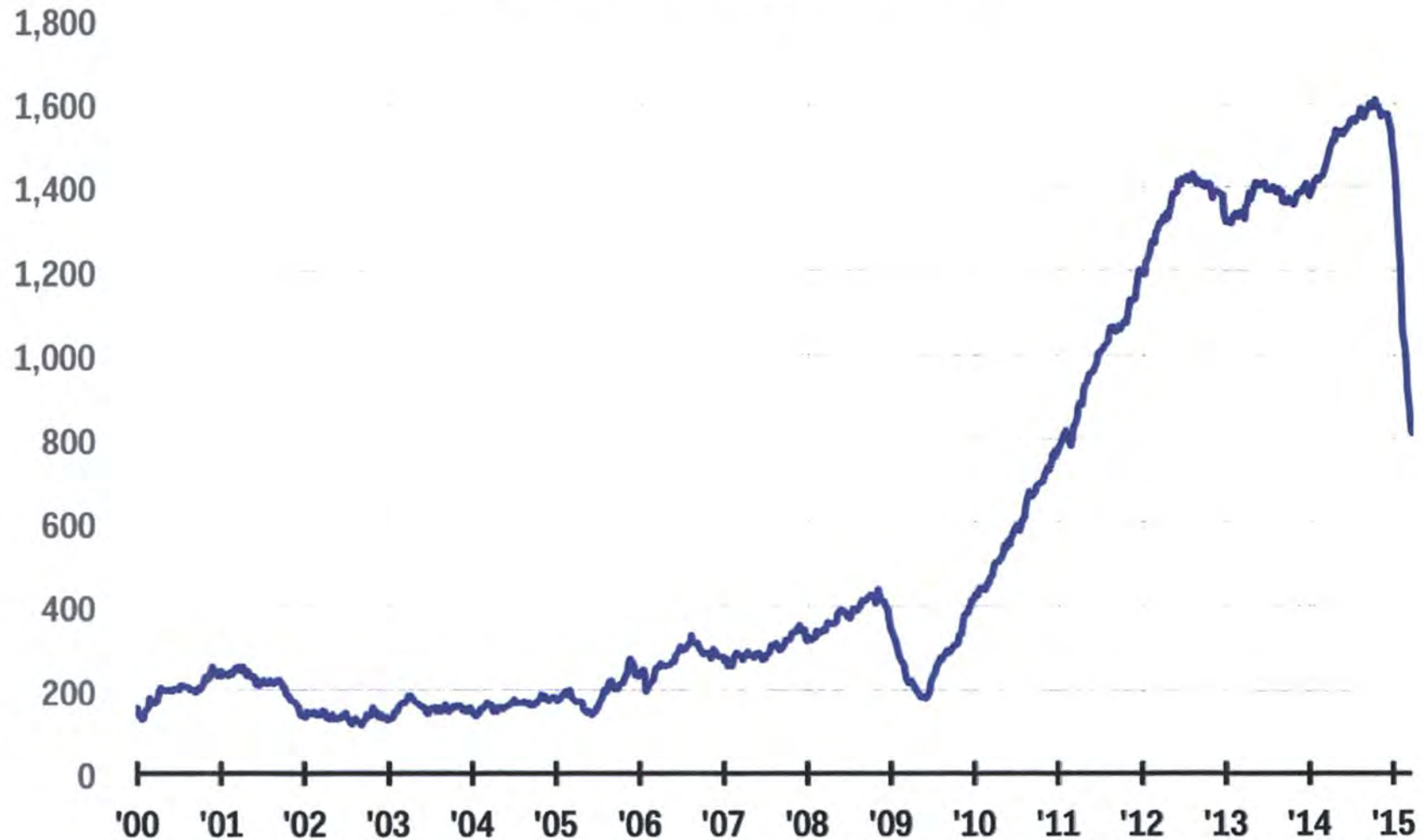
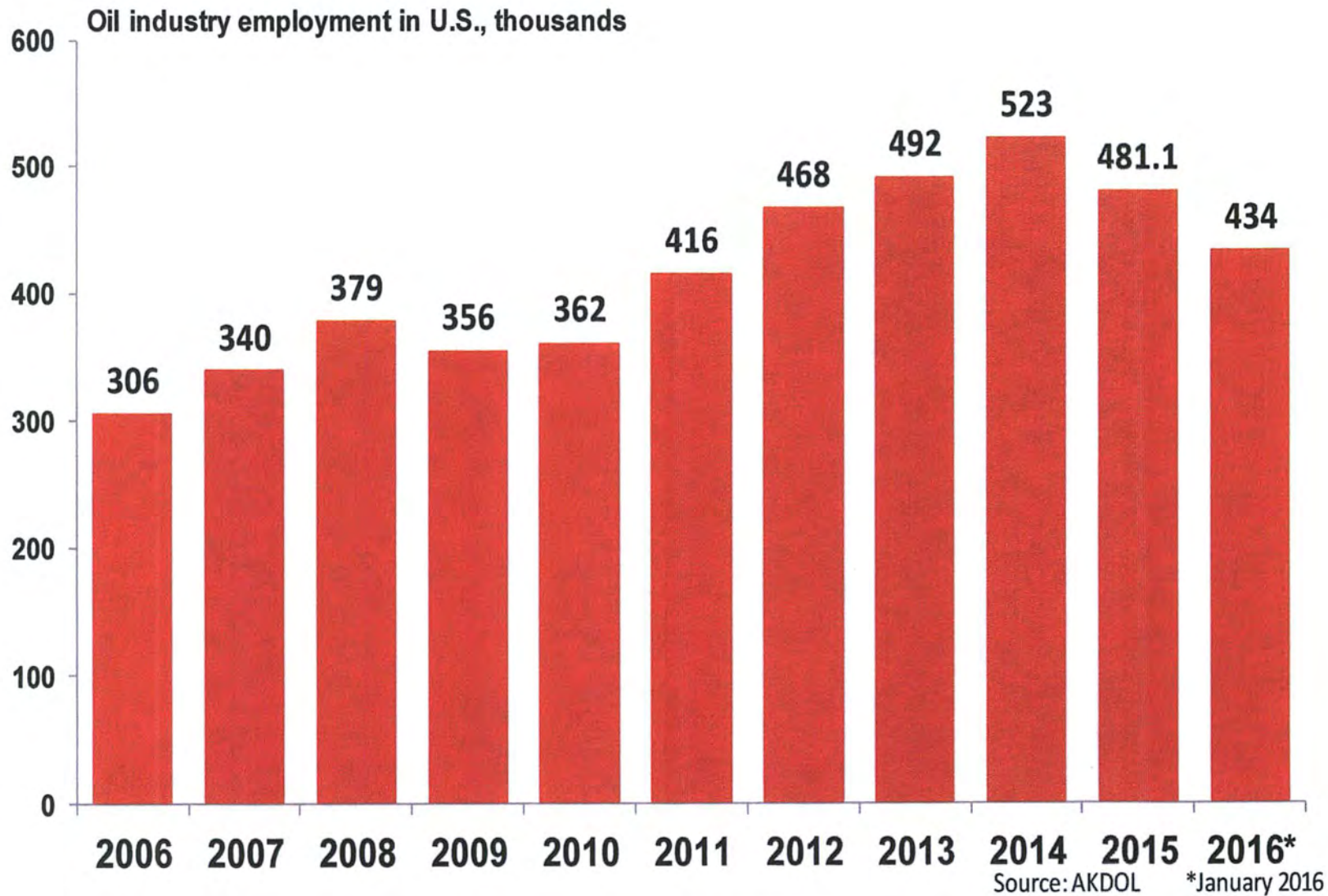


Chart provided by Alaska Department of Labor and Workforce Development, Research and Analysis Section.

# US Oil Rig Count



# National Oil Industry Employment



# Job losses in selected economic sectors . . .

## Construction Jobs, Over-the-year Percent Change

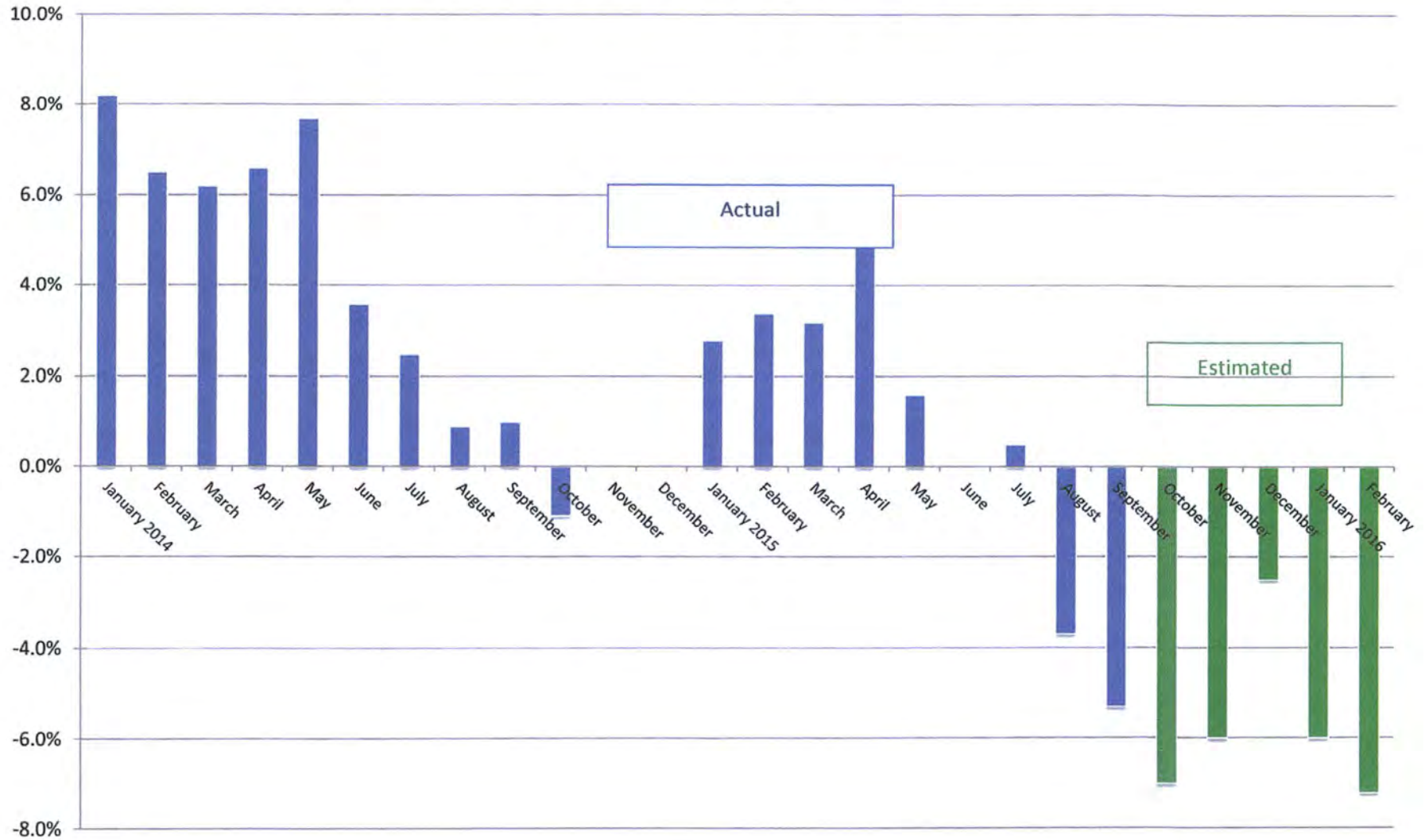
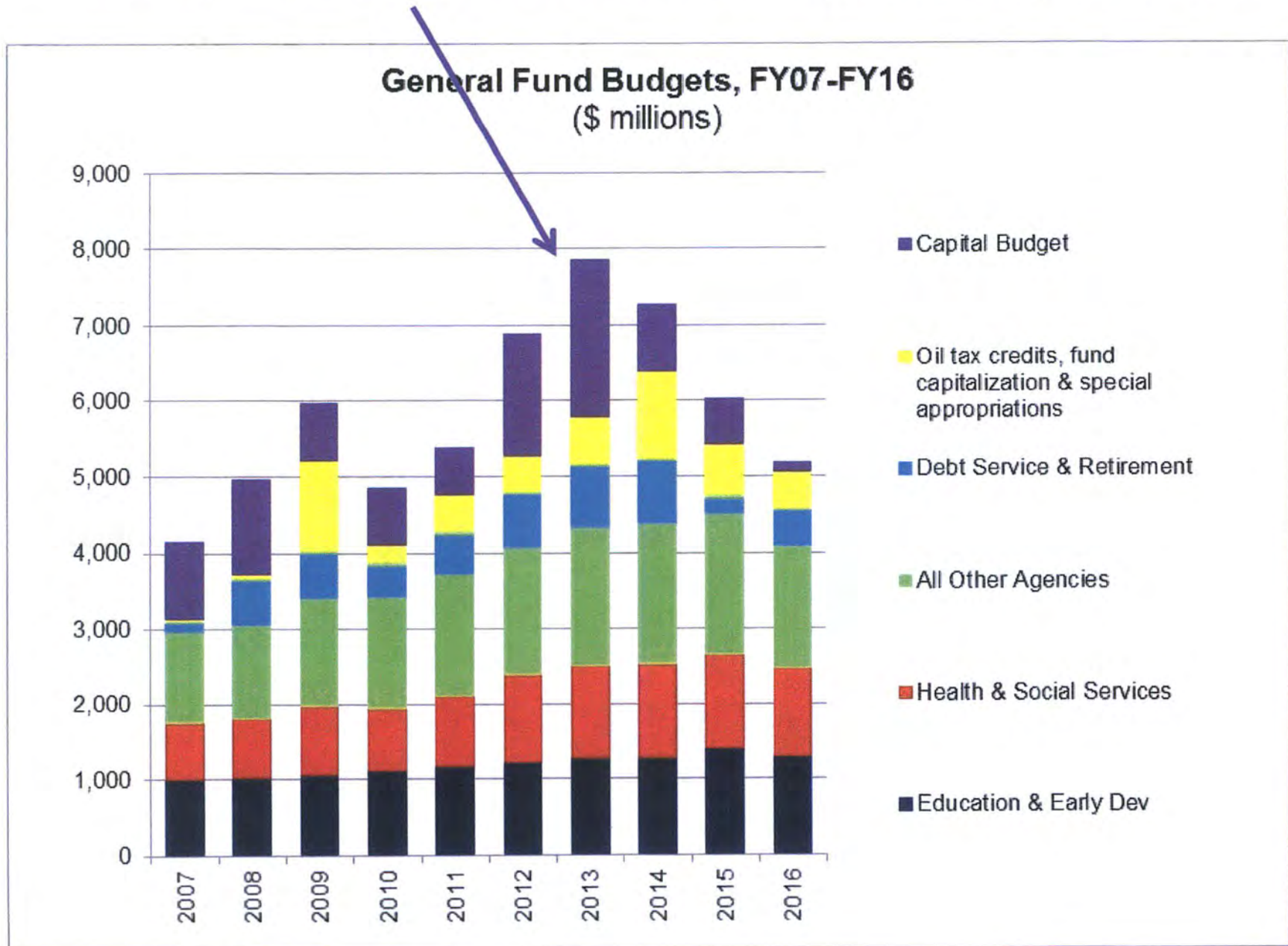
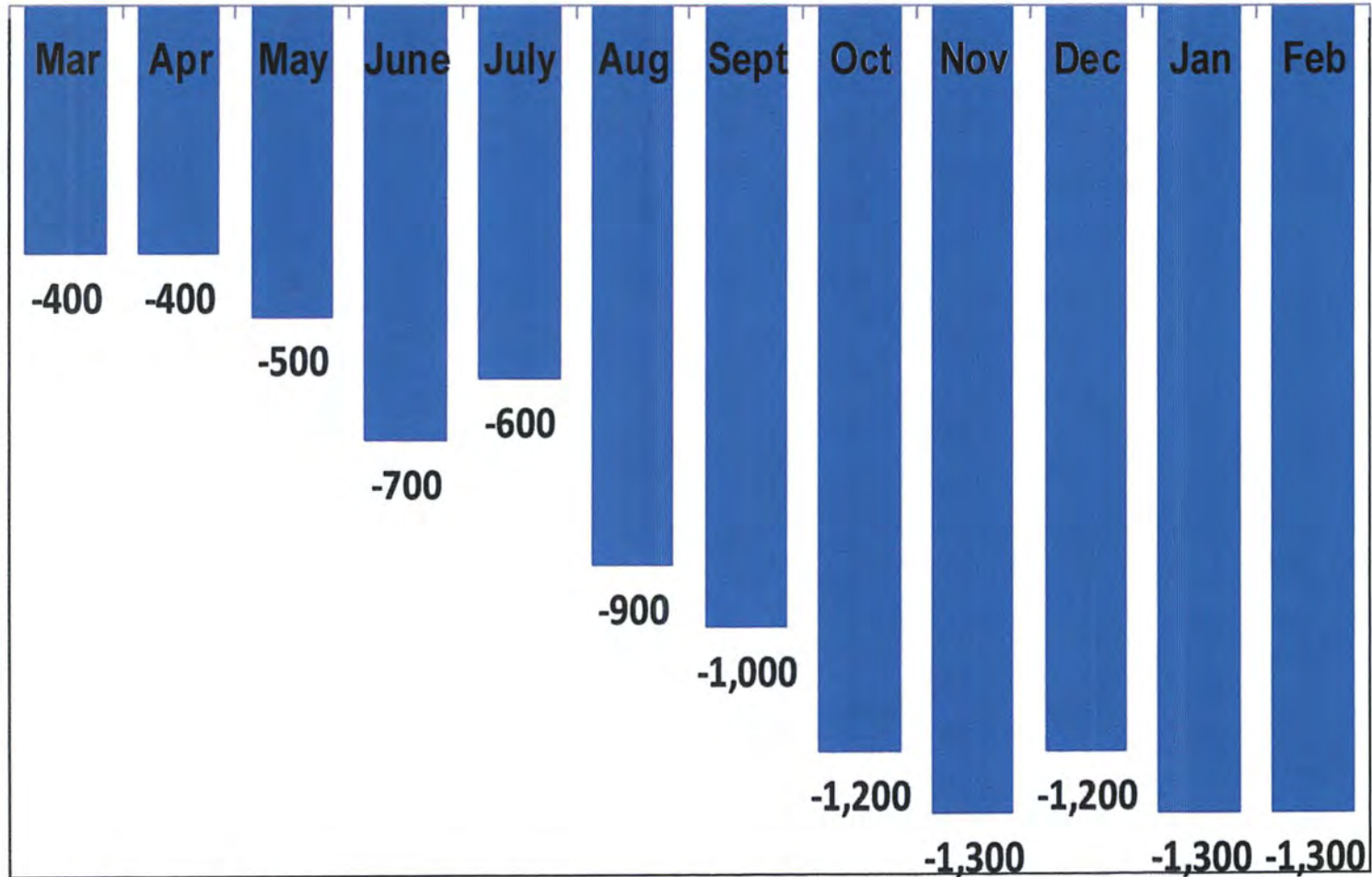


Chart provided by Alaska Department of Labor and Workforce Development, Research and Analysis Section.

The capital budget has been cut very sharply over the past four years.



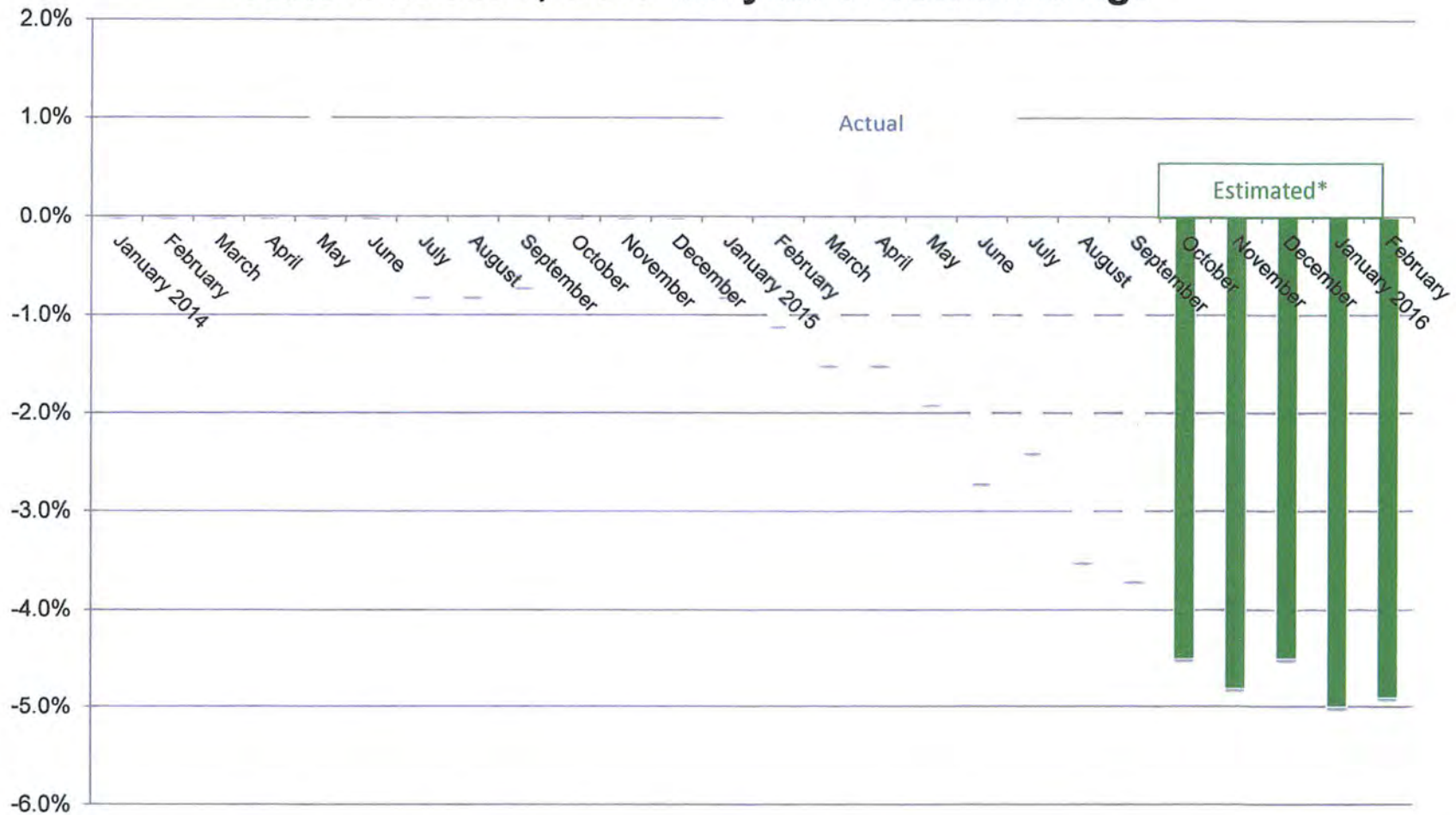
# State Government Job Losses Growing 2015-2016



\*Total State Government Employment was 25,200 . February 2016

# Job losses in selected economic sectors . . .

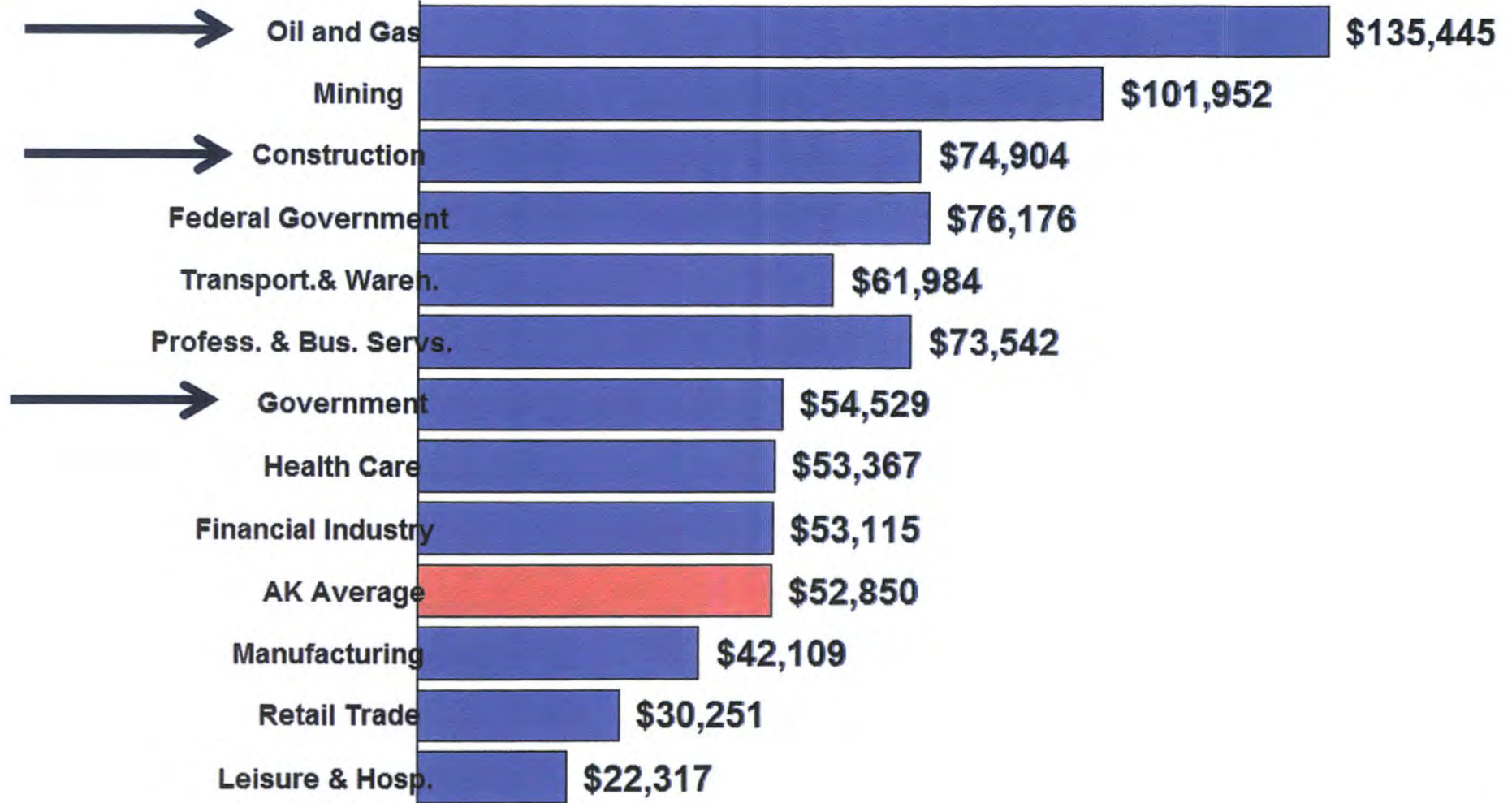
## State Gvt. Jobs, Over-the-year Percent Change



\* State government estimates are more reliable than other estimates because the job numbers come directly from state payroll data.

# We are losing jobs in high-wage sectors of the economy

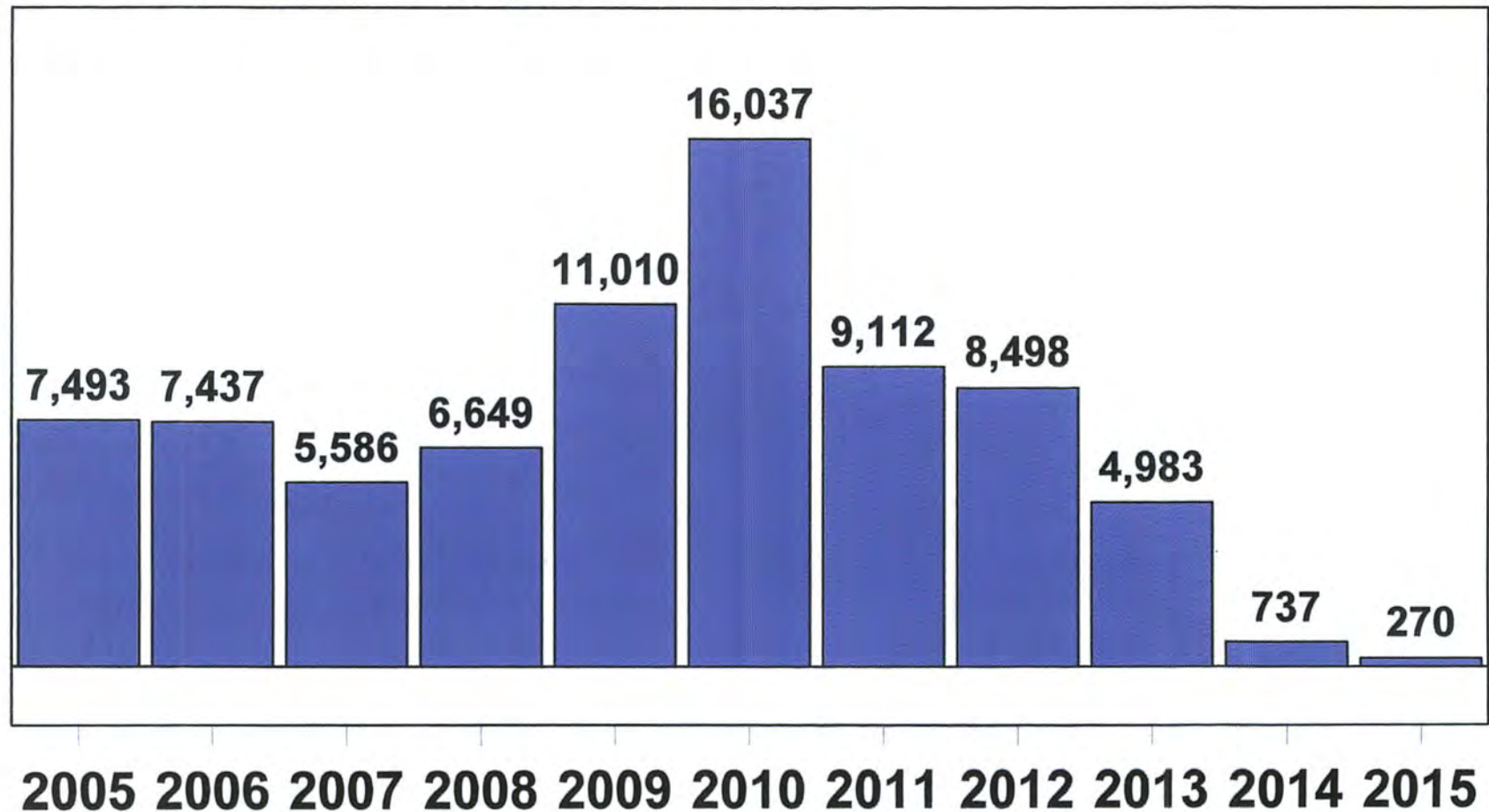
Alaska's 2014 average annual earnings



# Alaska's Population Gains Grew With National Recession--But Now Slowing

Alaska's total 2015 population count was 737,624

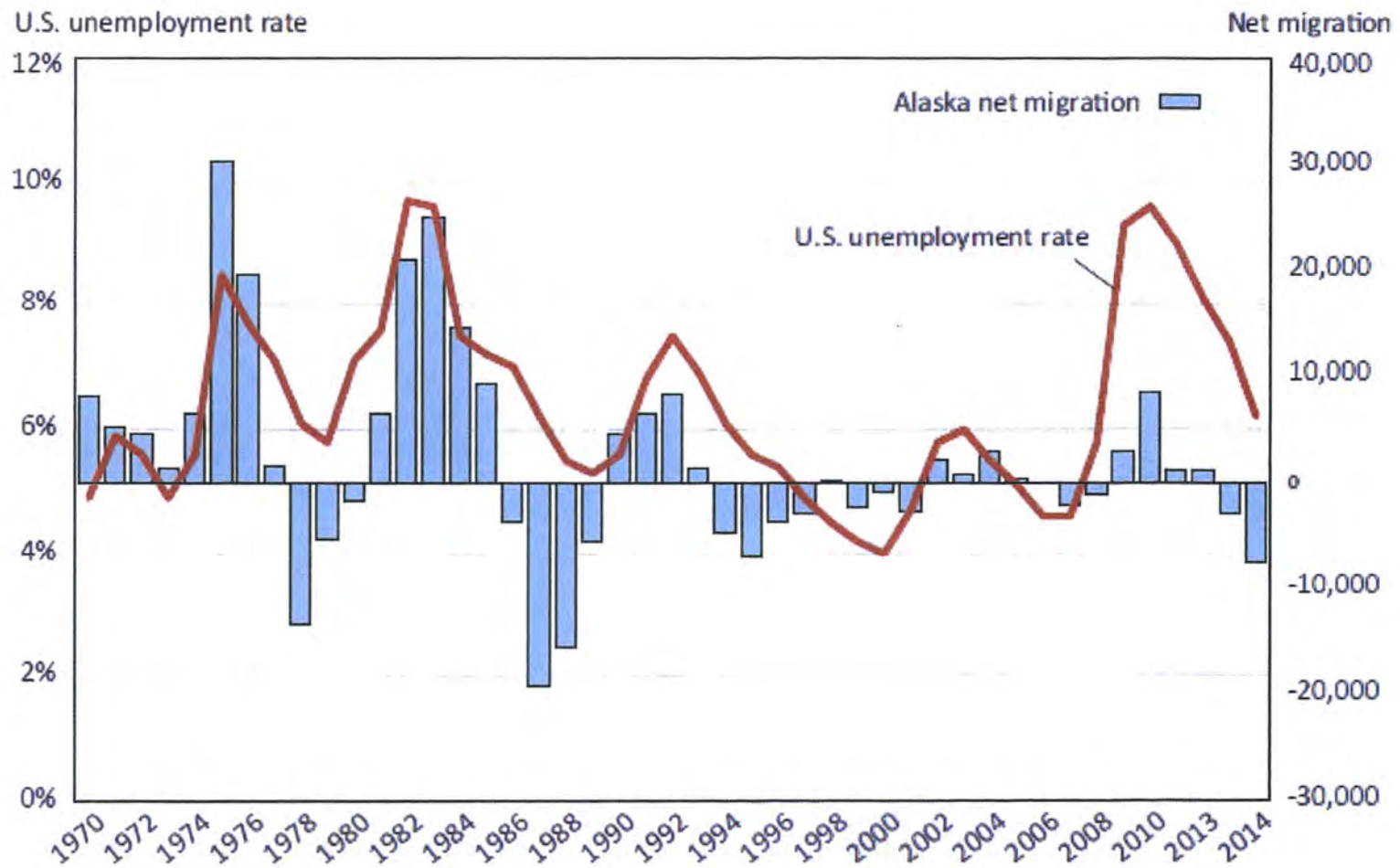
Total annual population gains Alaska



# 1

## Alaska Migration, U.S. Jobless Rate Track Together

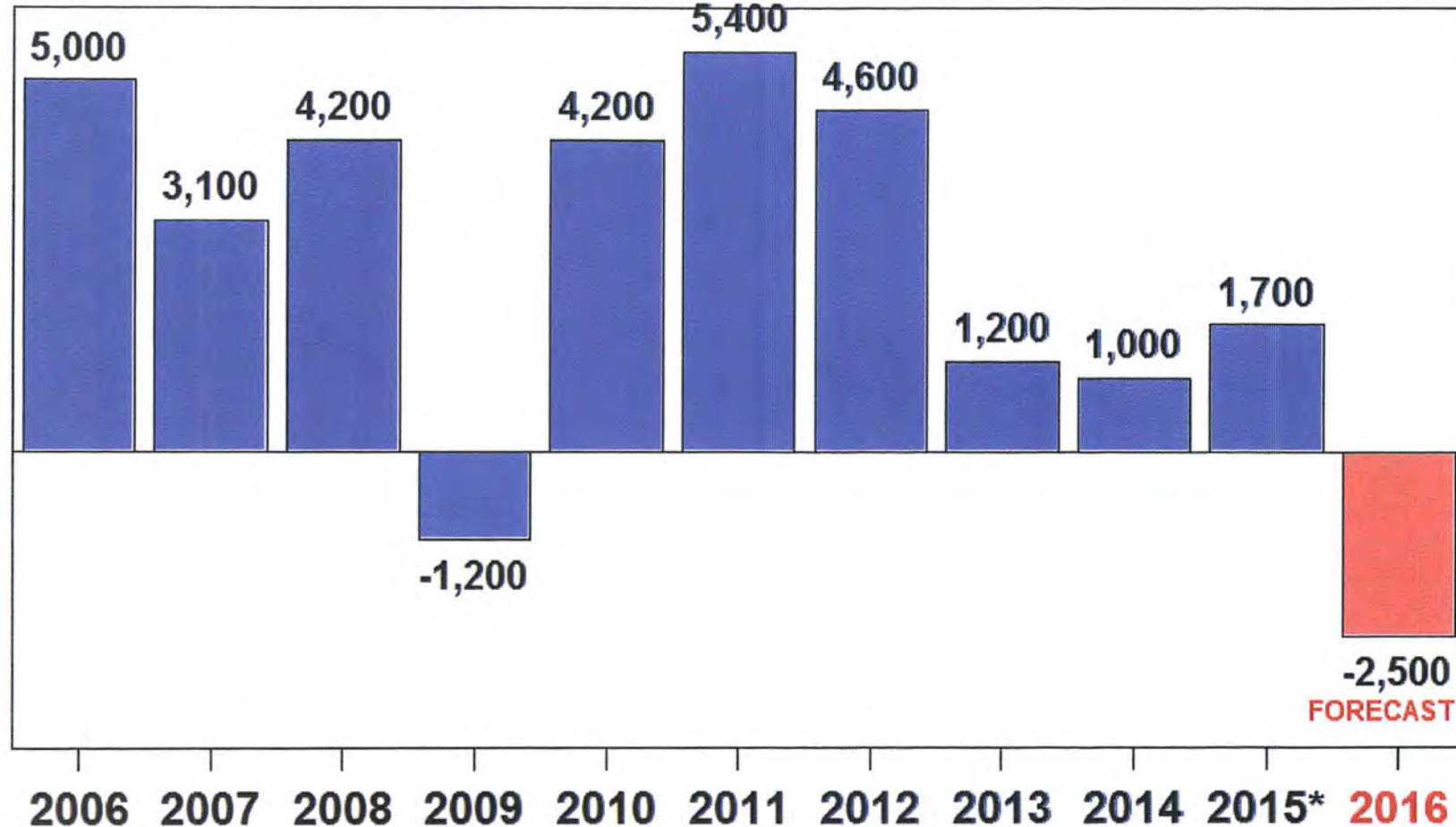
1970 to 2014



Source: Alaska Department of Labor and Workforce Development, Research and Analysis Section

Alaska Department of Labor and Workforce Development  
economic projections for 2016 . . .

**Annual employment growth in AK**

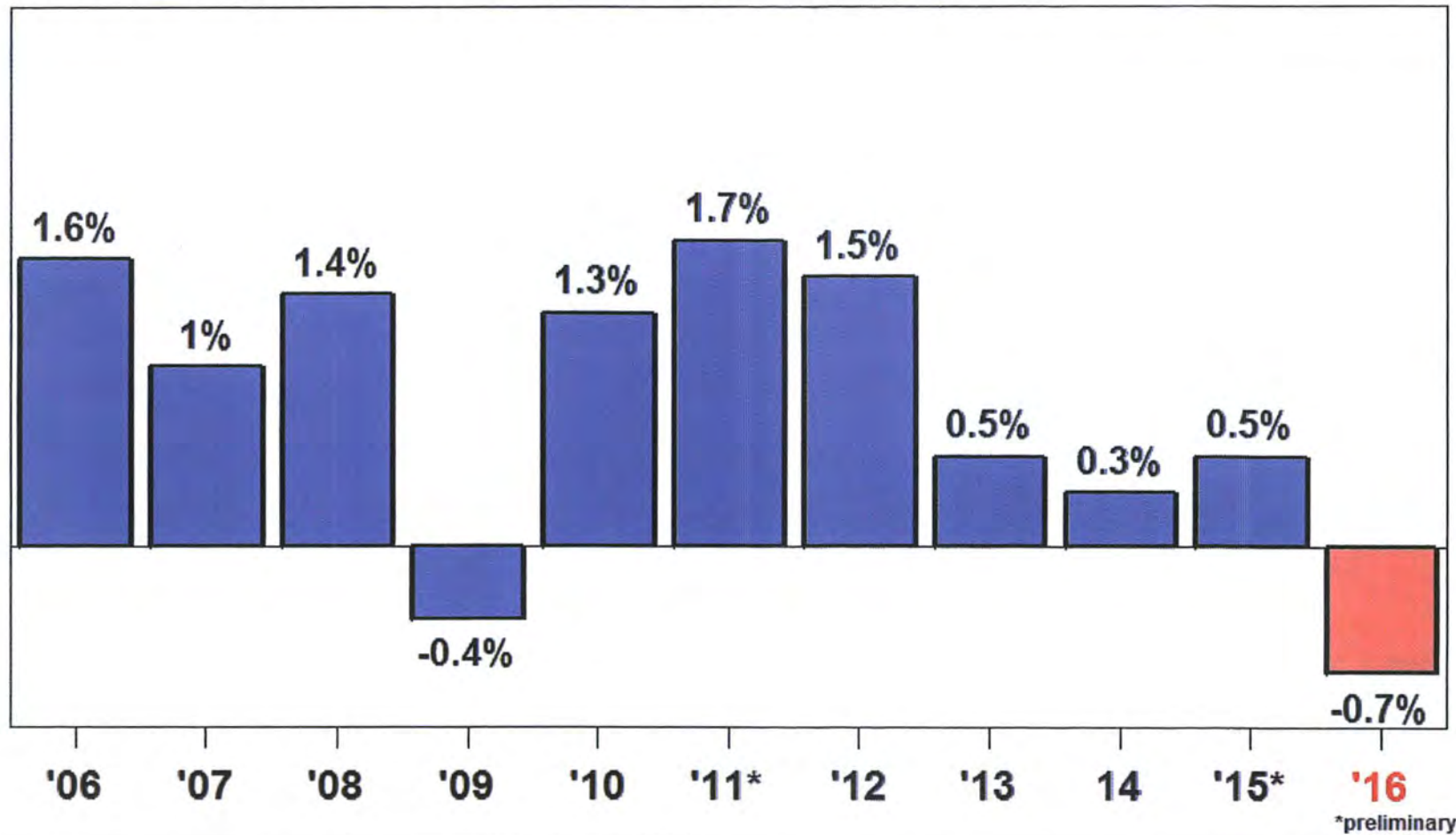


Source: Alaska Department of Labor and Workforce Development, Research and Analysis Section

\*preliminary

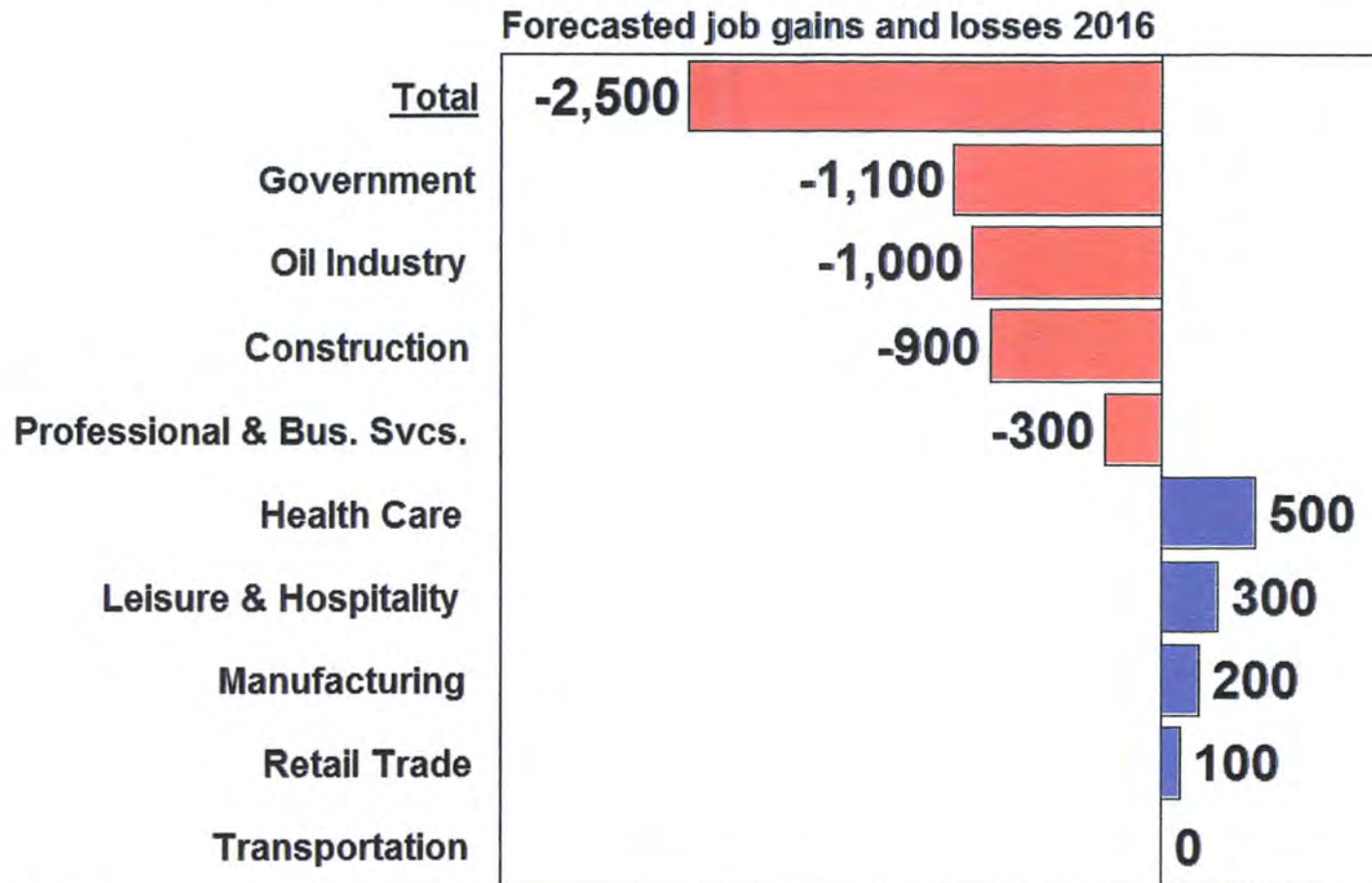
Alaska Department of Labor and Workforce Development  
economic projections for 2016 . . .

percent employment change from previous year-AK



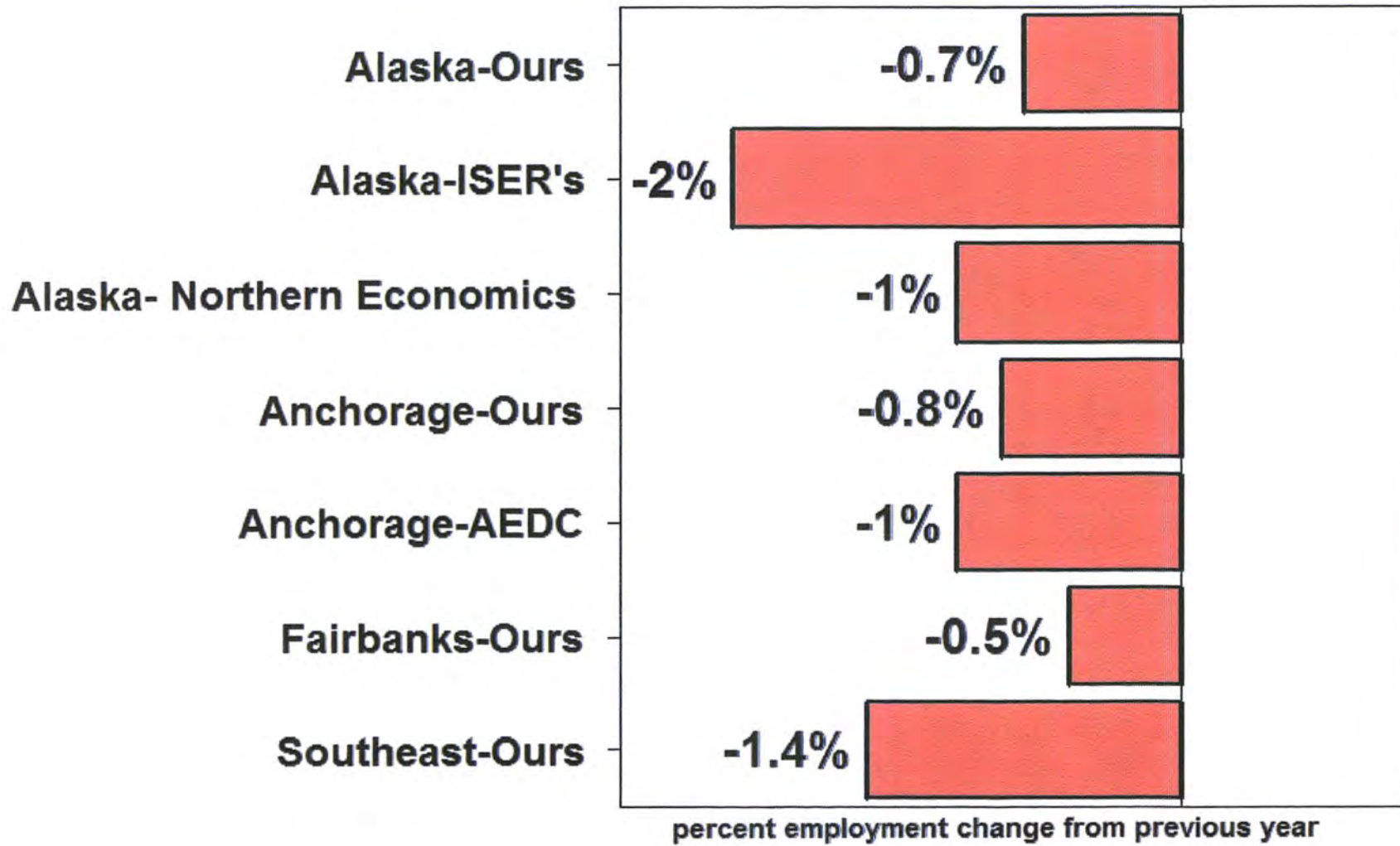
Alaska Department of Labor and Workforce Development  
economic projections for 2016 . . .

## Where Jobs Are Forecast To Come From And Disappear From In 2016



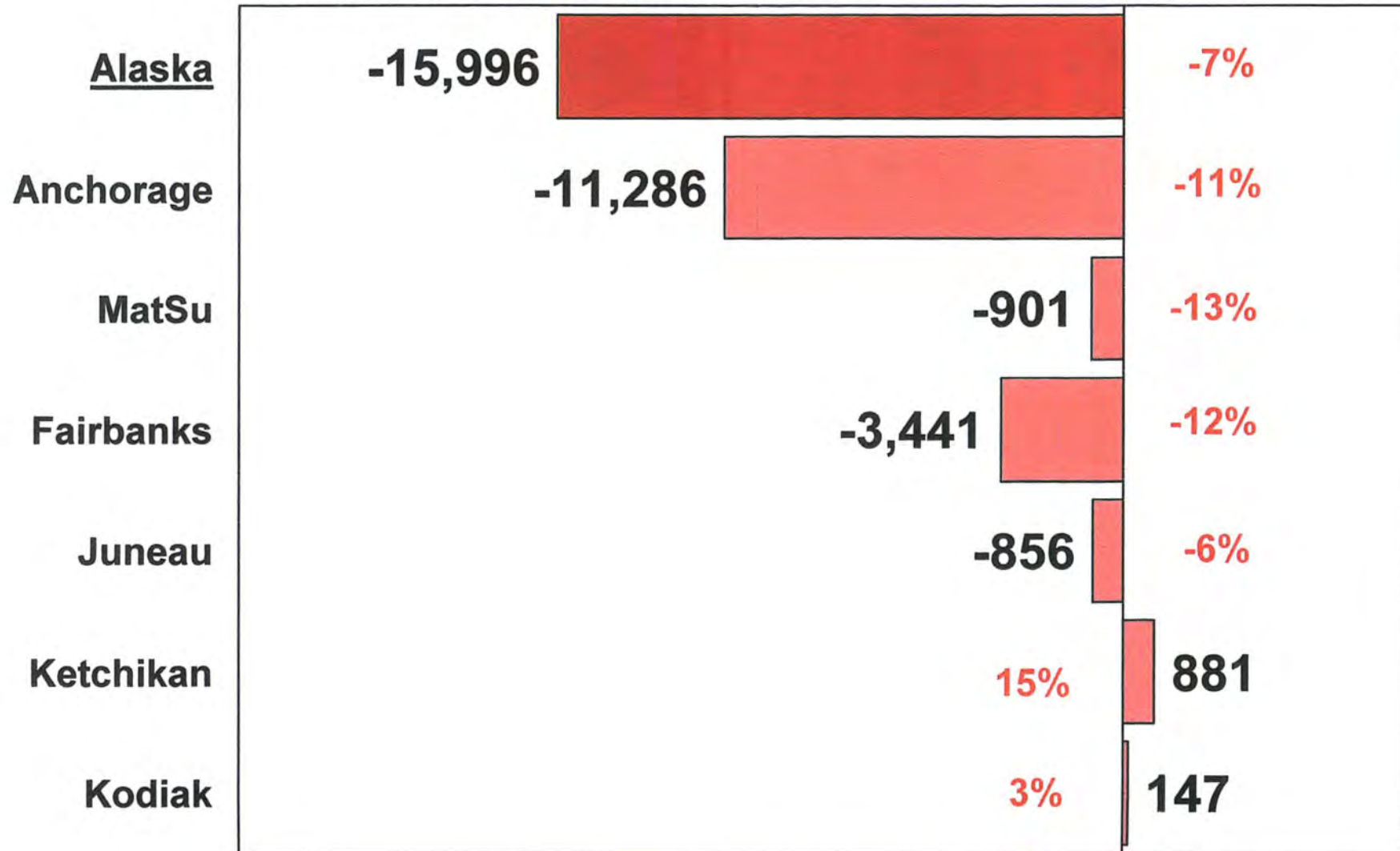
Source: Alaska Department of Labor and Workforce Development, Research and Analysis Section

Alaska Department of Labor and Workforce Development  
comparison of their economic projections for 2016 (“ours”)  
with other projections . . .



# The Extent Of Job Losses During Alaska's "Great Recession" Of The 1980s

Jobs lost and gained between 1985-1988



## The 1980s and now: What's different?

- Economy (as measured by jobs) is about 50% larger
- Older population bringing in much more retirement income
- Alaska Native Corporations bringing significant income to Alaska
- Much larger Permanent Fund dividend a stabilizing factor in the economy
- Visitor industry has grown dramatically
- Bank lending has been more conservative: people are less overextended in their borrowing
- Housing markets are much tighter and stronger
- We have not been experiencing a construction boom

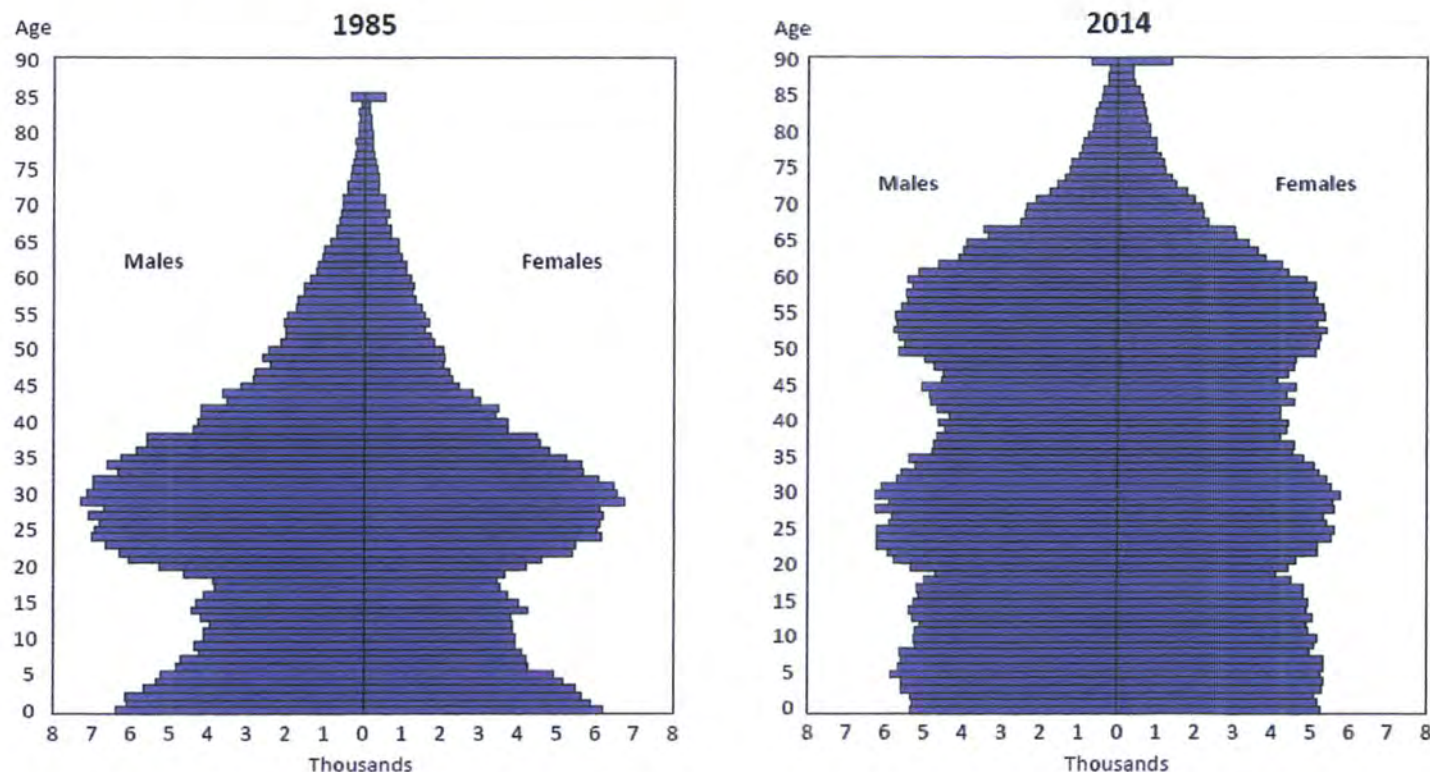
Alaska housing markets are much stronger now  
than they were in the 1980s.

Anchorage residential building permits issued in 1983	9082
Total Anchorage residential building permits issued, 2006-2015	6,808

As Alaska's population has aged, retirement income represents a significantly larger share of Alaska income, and a stabilizing component of the economy.

# 4 The Population Has Gotten Older

ALASKA'S AGE STRUCTURE, 1985 AND 2014



Source: Alaska Department of Labor and Workforce Development, Research and Analysis Section

# ISER's study of Short-Run Economic Impacts of Alaska Fiscal Options

## What we studied, for selected fiscal options . . .

- Revenue impacts of taxes and dividend cuts
  - What share would non-residents pay?
  - What share would be offset by lower federal taxes?
  - What would be the relative impacts on different income groups?
- Short run economic impacts of spending cuts, taxes and dividend cuts. Per hundred million of deficit reduction:
  - What would be the impacts on Alaskans' incomes?
  - What would be the impacts on Alaska jobs?
- Total economic impacts of reducing the deficit
  - What would the total short-run impacts on income and jobs of reducing the deficit by different amounts?
- Regional economic impacts
  - How would the impacts of different options vary between regions?

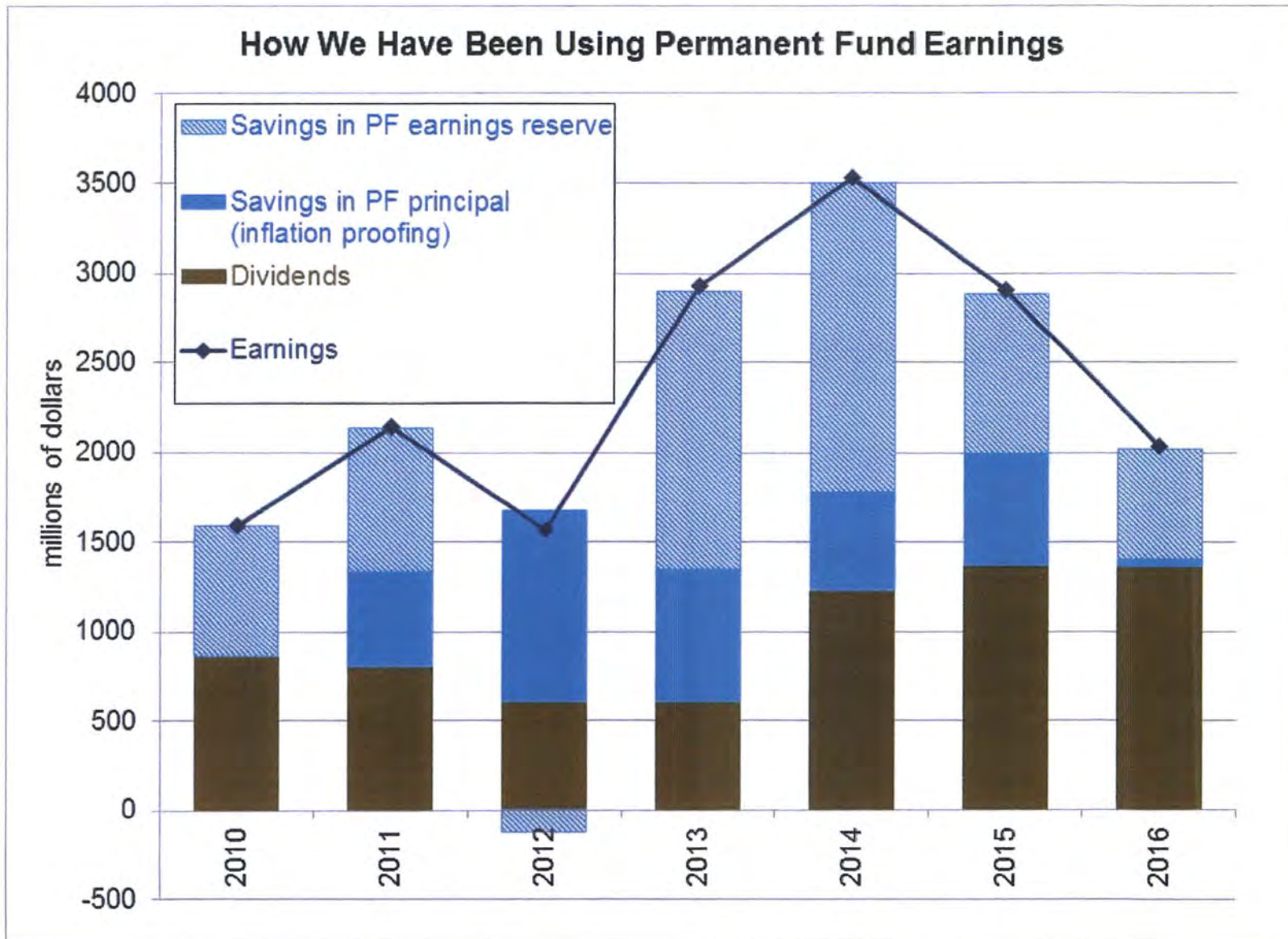
We only studied short-run direct economic impacts of fiscal options. There are many other important potential impacts which we *didn't* study.

- A few examples of impacts we *didn't* study:
  - Economic impacts of reductions in government services
  - Impacts on investment
  - Impacts on infrastructure development & resource industries
  - Impacts on labor markets & population
- Our fiscal choices will significantly affect Alaska's future
- We should think about not only their short-term economic impacts but also their longer-term economic and social impacts.

Of all the options for reducing the deficit, only **saving less** (and using the money to fund government) would have no short-run economic impacts on the Alaska economy.

- Options for **saving less** include:
  - Reducing inflation-proofing transfers to PF principal
  - Adding less to the PF earnings reserve
- **Saving less** would not:
  - take *any* money out of the economy
  - have *any* short-run impacts on jobs or income
- But it would reduce:
  - our future investment earnings
  - how much savings we leave for future Alaskans

From 2010 to 2015, we saved an average of \$1.4 billion annually of Permanent Fund realized earnings

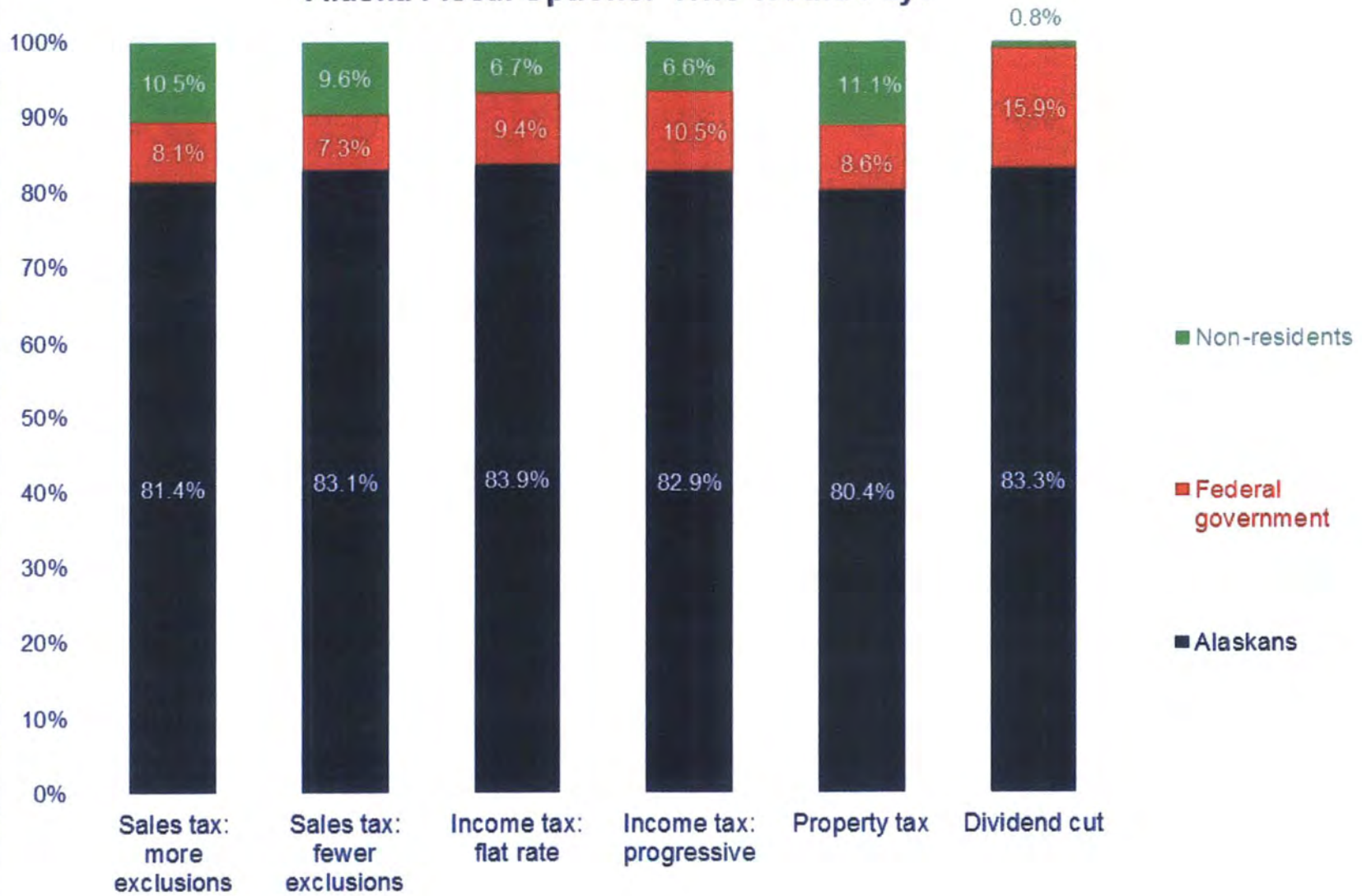


All of the other options for reducing the deficit, including spending cuts, taxes, and dividend cuts, would have significant short-run economic impacts.

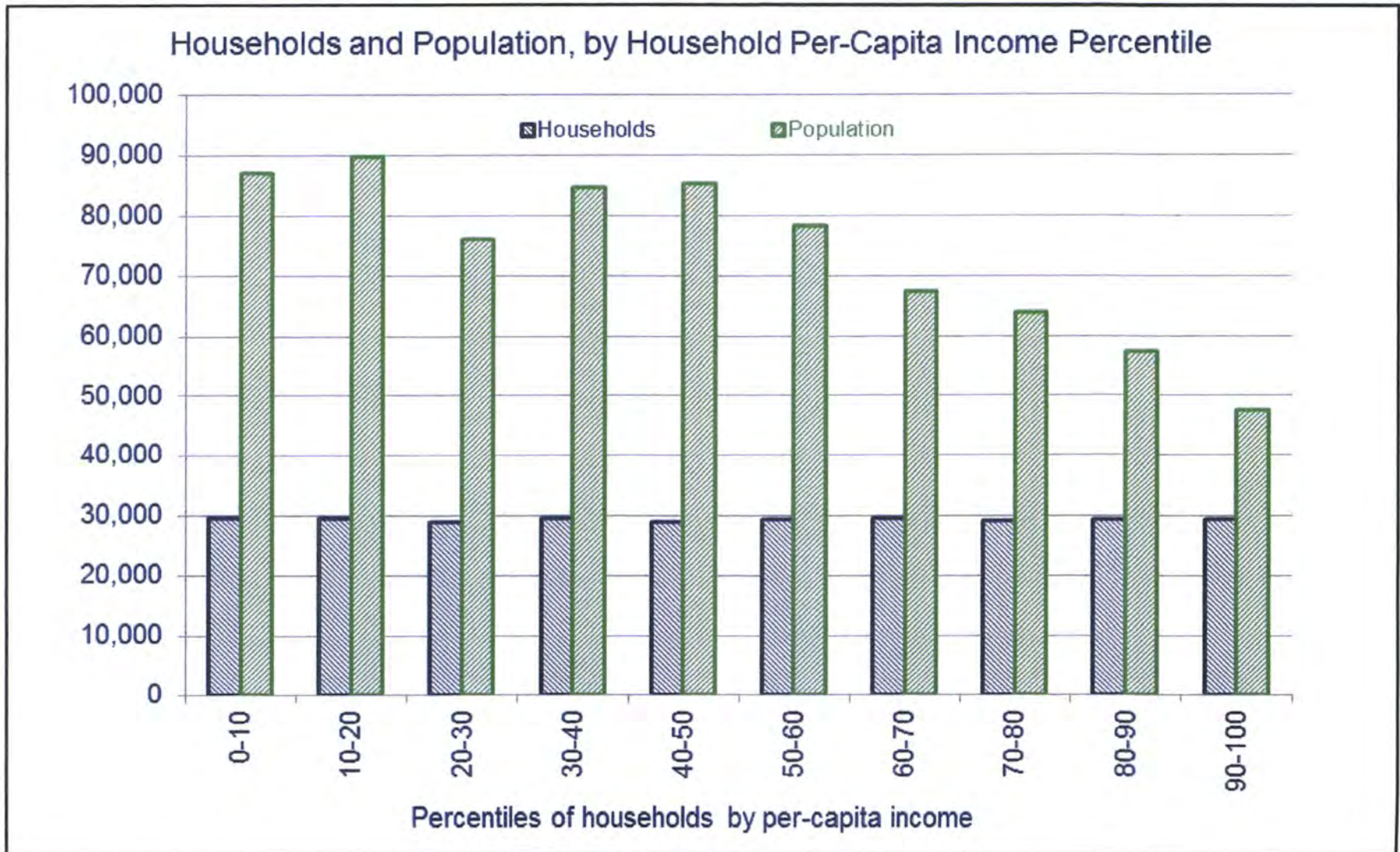
They would *all* take significant amounts of money out of the economy.

But they would do so in different ways, with different impacts on different Alaskans and different relative impacts on public and private income & jobs.

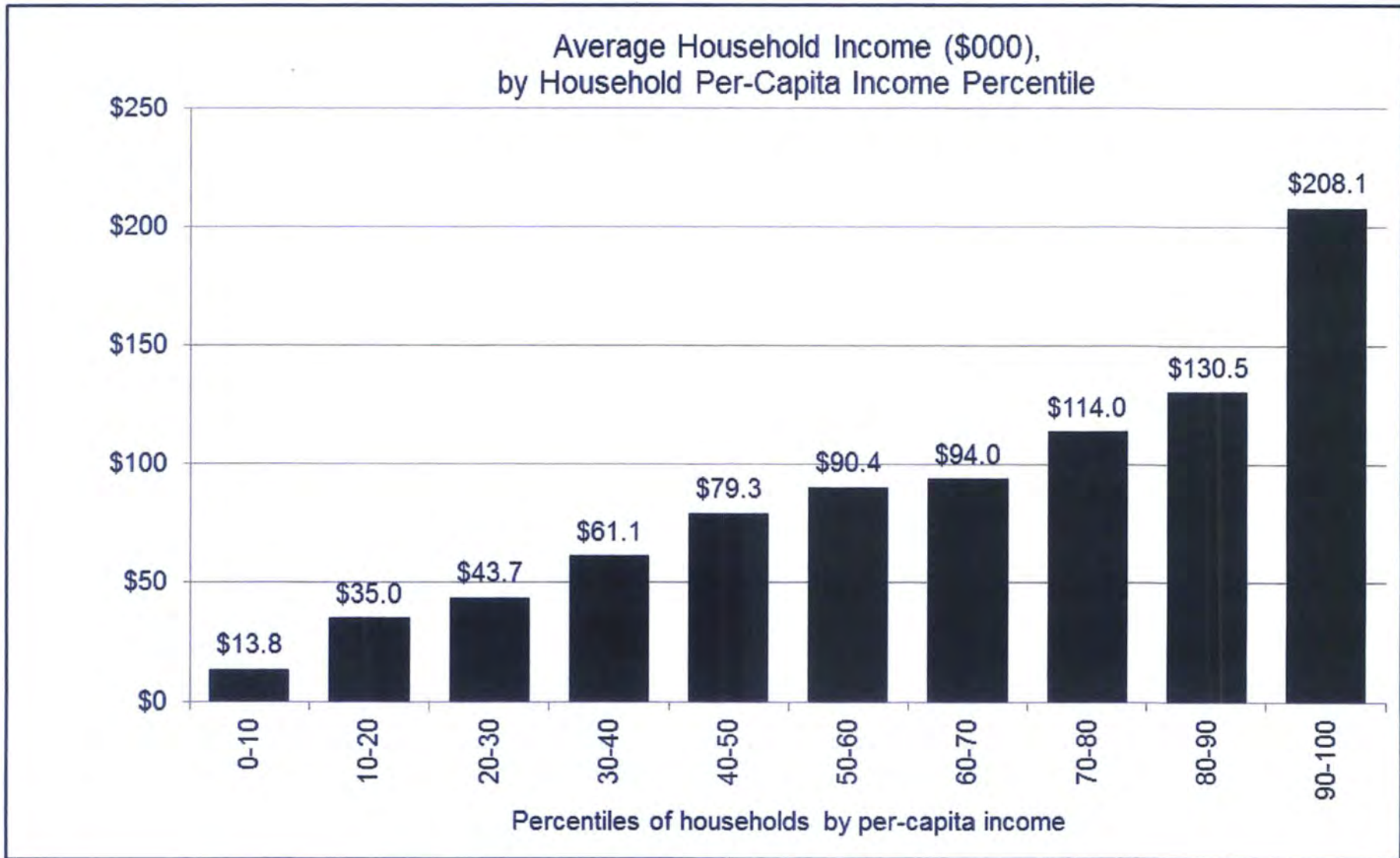
### Alaska Fiscal Options: Who Would Pay?



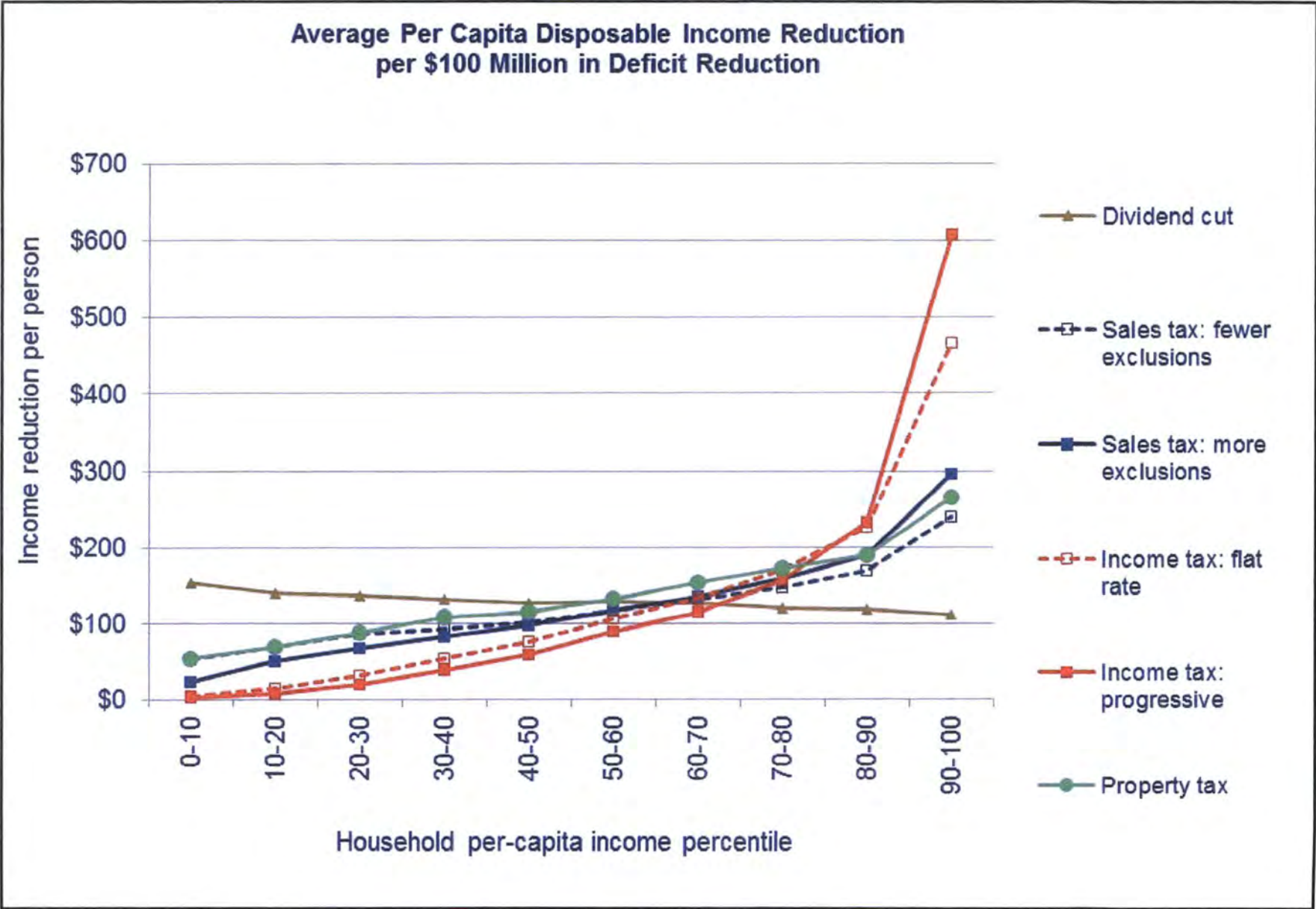
We estimated effects of taxes and dividend cuts for 10 groups of Alaska households, grouped by their per-capita cash income in 2013, from the lowest 10% to the highest 10%



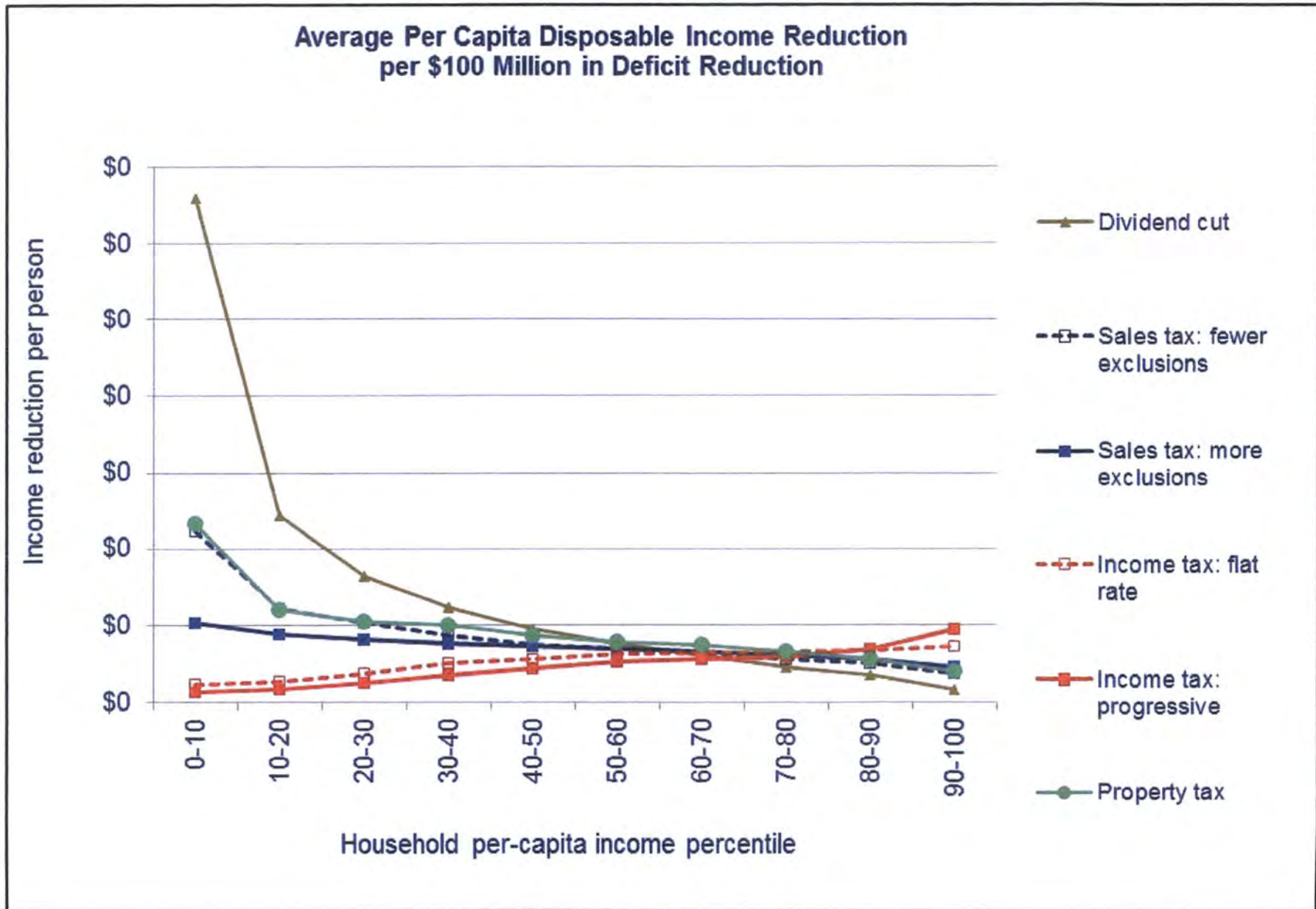
The three lowest-income groups had average household incomes of less than \$45,000. The highest-income group had an average household income of more than \$200,000.



# How options affect different groups: income reduction per person



## How options affect different groups: percentage income reduction per person



Short-run economic impacts of *spending cuts* depend on what is cut

What is cut affects the extent to which the cuts directly affect jobs and income of government and contractor workers and the resulting multiplier effects on the economy.

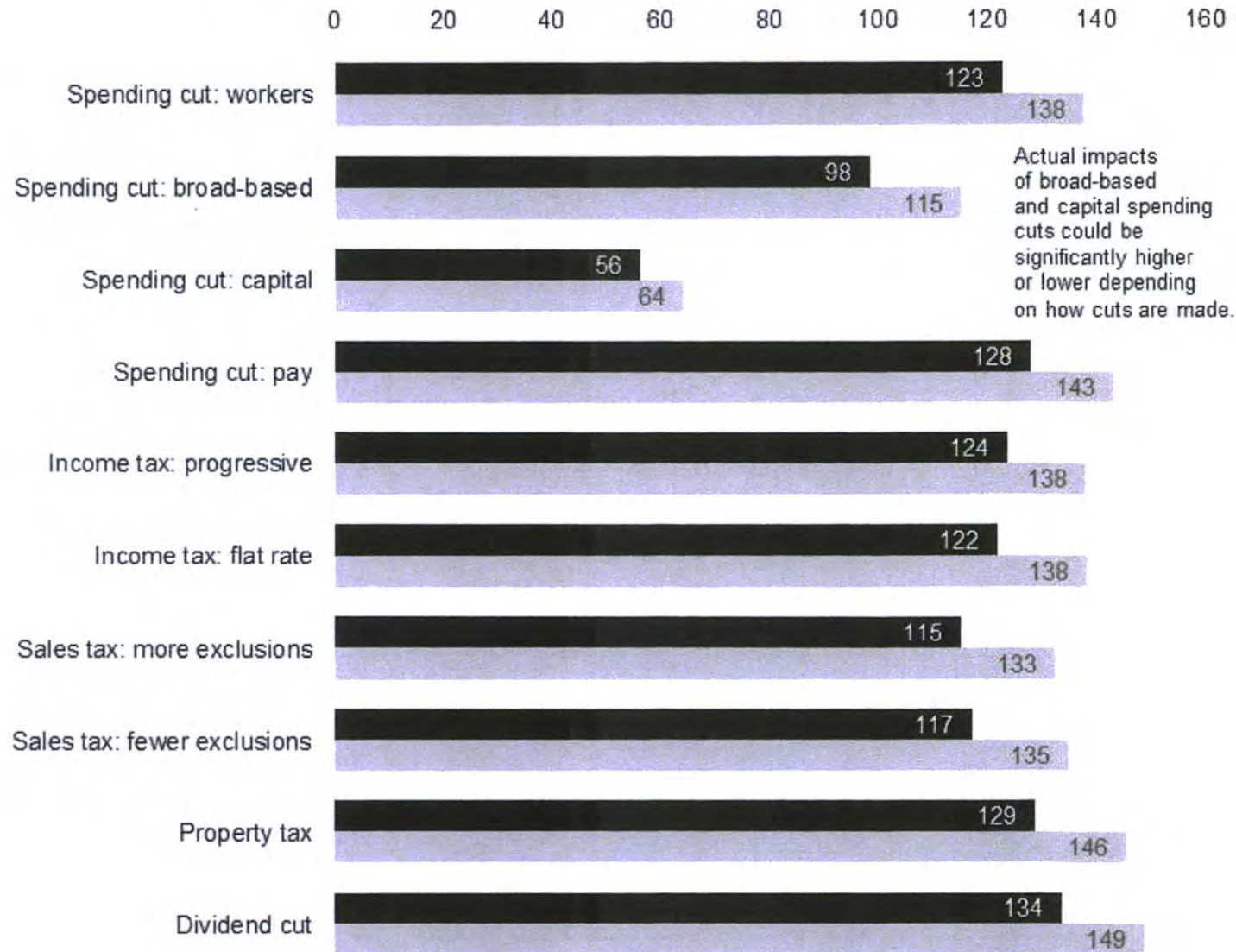
What is cut also affects the extent to which the cuts have other short-run impacts on the economy, such as:

- Transportation (Marine Highway service, road plowing, etc.)
- Resource management (fish catches, mine permitting)

*You can't generalize about economic impacts of *spending cuts*.  
Our estimates illustrate a range of potential impacts.*

# Income impacts

Estimated Income Impacts per \$100 Million of Deficit Reduction (\$ millions)



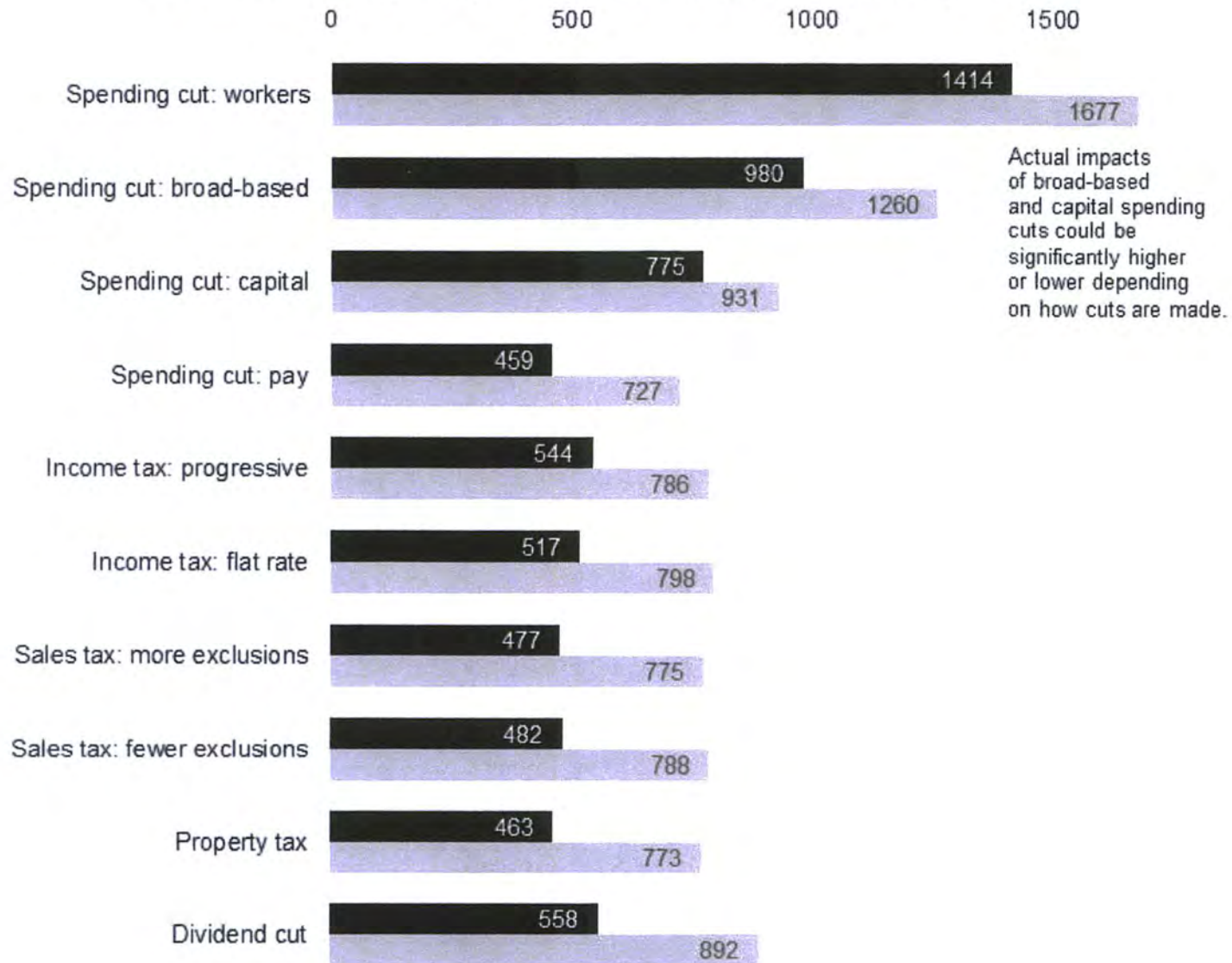
Actual impacts of broad-based and capital spending cuts could be significantly higher or lower depending on how cuts are made.

■ Low  
■ High

Low and high estimates are based on different assumptions about how households and markets would react to changes in disposable income.

# Job impacts

**Estimated Job Impacts per \$100 Million of Deficit Reduction (FTE jobs)**



Actual impacts of broad-based and capital spending cuts could be significantly higher or lower depending on how cuts are made.

■ Low  
■ High

Low and high estimates are based on different assumptions about how households and markets would react to changes in disposable income.

**Summary of Fiscal Options & Estimated Impacts per \$100 Million of Deficit Reduction**

Fiscal Option	Direct economic impacts	Who would be most affected	Short-run income impacts (\$ millions)	Short-run job impacts (FTE jobs)
Spending cut: workers	Reduce gov't jobs & pay	Gov't workers	122 - 138	1414 - 1677
Spending cut: broad-based	Reduce gov't jobs & pay Reduce other gov't purchases	Gov't workers Gov't contractors & workers	98 - 115	980 - 1260
Spending cut: capital	Reduce gov't capital spending	Construct. ind. & workers	56 - 64	775 - 931
Spending cut: pay	Reduce gov't employee pay	Gov't workers	127 - 143	459 - 727
Income tax: progressive	Reduce Alaskans disposable income	Higher income Alaskans	124 - 138	544 - 786
Income tax: flat rate			122 - 138	517 - 798
Sales tax: more exclusions		Medium & lower income Alaskans	116 - 133	477 - 775
Sales tax: fewer exclusions			117 - 134	482 - 788
Property tax			114 - 132	463 - 773
Dividend cut	Reduce Alaskans' income	Lower income Alaskans	130 - 149	558 - 892
Saving less	No short-term impacts	Future Alaskans		

Note: The numbers shown for income and job impacts represent low and high estimates of impacts based on different assumptions about how households and markets would react to changes in disposable income.

The Permanent Fund “re-plumbing” proposals would reduce the deficit through a combination of cutting dividends and saving less.

Summary of Fiscal Options & Estimated Impacts per \$100 Million of Deficit Reduction

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Saving less	No short-term impacts	Future Alaskans		

Note: The numbers shown for income and job impacts represent low and high estimates of impacts based on different assumptions about how households and markets would react to changes in disposable income.

**Examples of Ranges of Estimated Economic Impacts Per \$100 Million of Deficit Reduction  
Resulting from Selected Potential Combinations of Fiscal Options**

Examples of potential combinations of options	Option	Two options						Three options				Four options
	Spending cut: workers											
Spending cut: broad-based	50%	50%		50%				33%	33%	33%		25%
Spending cut: capital												
Spending cut: pay												
Income tax: progressive	50%		50%			50%		33%		33%	33%	25%
Income tax: flat rate												
Sales tax: more exclusions												
Sales tax: fewer exclusions												
Property tax												
Dividend cut		50%	50%		50%			33%	33%		33%	25%
Saving less				50%	50%	50%			33%	33%	33%	25%

Range of estimated impacts	<b>Total income impact (millions of \$ of income)</b>											
	Low scenario	111	114	127	49	65	62	117	76	74	85	88
	High scenario	127	132	143	58	74	69	134	88	84	96	101
	<b>Total jobs impact (FTE jobs in Alaska)</b>											
	Low scenario	762	769	551	490	279	272	694	513	508	367	521
	High scenario	1023	1076	839	630	446	393	980	717	682	560	735

# Estimated income and job impacts of reducing the deficit by different amounts using different options

**Estimated Impacts of Reducing the Deficit by Selected Total Amounts Using Different Potential Combinations of Fiscal Options**

		Two options						Three options				Four options
Combinations of fiscal options	Spending cut: broad-based	50%	50%		50%			33%	33%	33%		25%
	Income tax: progressive	50%		50%			50%	33%		33%	33%	25%
	Dividend cut		50%	50%	0%	50%		33%	33%		33%	25%
	Saving less				50%	50%	50%		33%	33%	33%	25%
Estimated impacts of reducing deficit by \$100 million	Income: Low scenario	111	114	127	49	65	62	117	76	74	85	88
	Income: High scenario	127	132	143	58	74	69	134	88	84	96	101
	Jobs: Low scenario	762	769	551	490	279	272	694	513	508	367	521
	Jobs: High scenario	1,023	1,076	839	630	446	393	980	717	682	560	735
Estimated impacts of reducing deficit by \$500 million	Income: Low scenario	554	570	635	244	326	310	586	380	369	424	440
	Income: High scenario	633	660	717	288	372	345	670	440	422	478	503
	Jobs: Low scenario	3,812	3,845	2,754	2,451	1,394	1,361	3,470	2,563	2,541	1,836	2,603
	Jobs: High scenario	5,116	5,380	4,196	3,150	2,230	1,966	4,898	3,587	3,411	2,798	3,673
Estimated impacts of reducing deficit by \$1.0 billion	Income: Low scenario	1,108	1,139	1,271	488	651	620	1,173	759	739	847	879
	Income: High scenario	1,265	1,320	1,434	576	745	690	1,340	880	844	956	1,005
	Jobs: Low scenario	7,623	7,690	5,509	4,902	2,788	2,721	6,940	5,126	5,082	3,673	5,205
	Jobs: High scenario	10,232	10,761	8,393	6,300	4,461	3,932	9,795	7,174	6,821	5,595	7,346
Estimated impacts of reducing deficit by \$1.5 billion	Income: Low scenario	1,662	1,709	1,906	732	977	930	1,759	1,139	1,108	1,271	1,319
	Income: High scenario	1,898	1,981	2,152	864	1,117	1,035	2,010	1,320	1,265	1,434	1,508
	Jobs: Low scenario	11,435	11,534	8,263	7,353	4,182	4,082	10,411	7,690	7,623	5,509	7,808
	Jobs: High scenario	15,348	16,141	12,589	9,450	6,691	5,898	14,693	10,761	10,232	8,393	11,019
Estimated impacts of reducing deficit by \$2.0 billion	Income: Low scenario	2,216	2,278	2,542	976	1,302	1,240	2,345	1,519	1,477	1,695	1,759
	Income: High scenario	2,531	2,641	2,869	1,152	1,489	1,379	2,680	1,761	1,687	1,913	2,010
	Jobs: Low scenario	15,246	15,379	11,018	9,804	5,575	5,442	13,881	10,253	10,164	7,345	10,411
	Jobs: High scenario	20,464	21,521	16,785	12,600	8,921	7,864	19,590	14,348	13,643	11,190	14,693
Estimated impacts of reducing deficit by \$2.5 billion	Income: Low scenario							2,932	1,898	1,846	2,118	2,199
	Income: High scenario							3,350	2,201	2,109	2,391	2,513
	Jobs: Low scenario							17,351	12,816	12,705	9,181	13,013
	Jobs: High scenario							24,488	17,934	17,053	13,988	18,366
Estimated impacts of reducing deficit by \$3.0 billion	Income: Low scenario							3,518	2,278	2,216	2,542	2,638
	Income: High scenario							4,020	2,641	2,531	2,869	3,015
	Jobs: Low scenario							20,821	15,379	15,246	11,018	15,616
	Jobs: High scenario							29,385	21,521	20,464	16,785	22,039

Note: Units for income impacts are millions of dollars. Units for job impacts are FTE jobs. Table omits combination of options and total deficit reduction which would require reductions of more than \$1 billion from any single option. Table calculated by extrapolating from the estimated impacts of reducing the deficit by \$100 million shown in Table III-7.

## How big is Alaska's economy?

### Selected Estimates of Alaska Income and Employment, 2014

Income (\$ millions)	Personal income	39,793
	Earnings by place of work	30,059
	Wages and salaries	20,683
Employment (jobs)	Total full-time and part-time employment	465,130
	Wage and salary jobs	367,291
	Other jobs	97,839

Source: Bureau of Economic Analysis, SA30 Economic Profile (updated September 30, 2015), [www.bea.gov](http://www.bea.gov).

## Estimated percentage income impacts of reducing the deficit by different amounts using different options

**Estimated Income Impacts of Reducing the Deficit by Selected Total Amounts Using Different Potential Combinations of Fiscal Options, Expressed as a Share of Estimated Total Alaska Personal Income in 2014 (\$39.8 billion)**

		Two options						Three options				Four options
Combinations of fiscal options	Spending cut: broad-based	50%	50%		50%			33%	33%	33%		25%
	Income tax: progressive	50%		50%			50%	33%		33%	33%	25%
	Dividend cut		50%	50%		50%		33%	33%		33%	25%
	Saving less				50%	50%	50%		33%	33%	33%	25%
\$100 million	Income: Low scenario	0.3%	0.3%	0.3%	0.1%	0.2%	0.2%	0.3%	0.2%	0.2%	0.2%	0.2%
	Income: High scenario	0.3%	0.3%	0.4%	0.1%	0.2%	0.2%	0.3%	0.2%	0.2%	0.2%	0.3%
\$500 million	Income: Low scenario	1.4%	1.4%	1.6%	0.6%	0.8%	0.8%	1.5%	1.0%	0.9%	1.1%	1.1%
	Income: High scenario	1.6%	1.7%	1.8%	0.7%	0.9%	0.9%	1.7%	1.1%	1.1%	1.2%	1.3%
\$1.0 billion	Income: Low scenario	2.8%	2.9%	3.2%	1.2%	1.6%	1.6%	2.9%	1.9%	1.9%	2.1%	2.2%
	Income: High scenario	3.2%	3.3%	3.6%	1.4%	1.9%	1.7%	3.4%	2.2%	2.1%	2.4%	2.5%
\$1.5 billion	Income: Low scenario	4.2%	4.3%	4.8%	1.8%	2.5%	2.3%	4.4%	2.9%	2.8%	3.2%	3.3%
	Income: High scenario	4.8%	5.0%	5.4%	2.2%	2.8%	2.6%	5.1%	3.3%	3.2%	3.6%	3.8%
\$2.0 billion	Income: Low scenario	5.6%	5.7%	6.4%	2.5%	3.3%	3.1%	5.9%	3.8%	3.7%	4.3%	4.4%
	Income: High scenario	6.4%	6.6%	7.2%	2.9%	3.7%	3.5%	6.7%	4.4%	4.2%	4.8%	5.1%
\$2.5 billion	Income: Low scenario							7.4%	4.8%	4.6%	5.3%	5.5%
	Income: High scenario							8.4%	5.5%	5.3%	6.0%	6.3%
\$3.0 billion	Income: Low scenario							8.8%	5.7%	5.6%	6.4%	6.6%
	Income: High scenario							10.1%	6.6%	6.4%	7.2%	7.6%

Note: Table omits combination of options and total deficit reduction which would require reductions of more than \$1 billion from any single option.

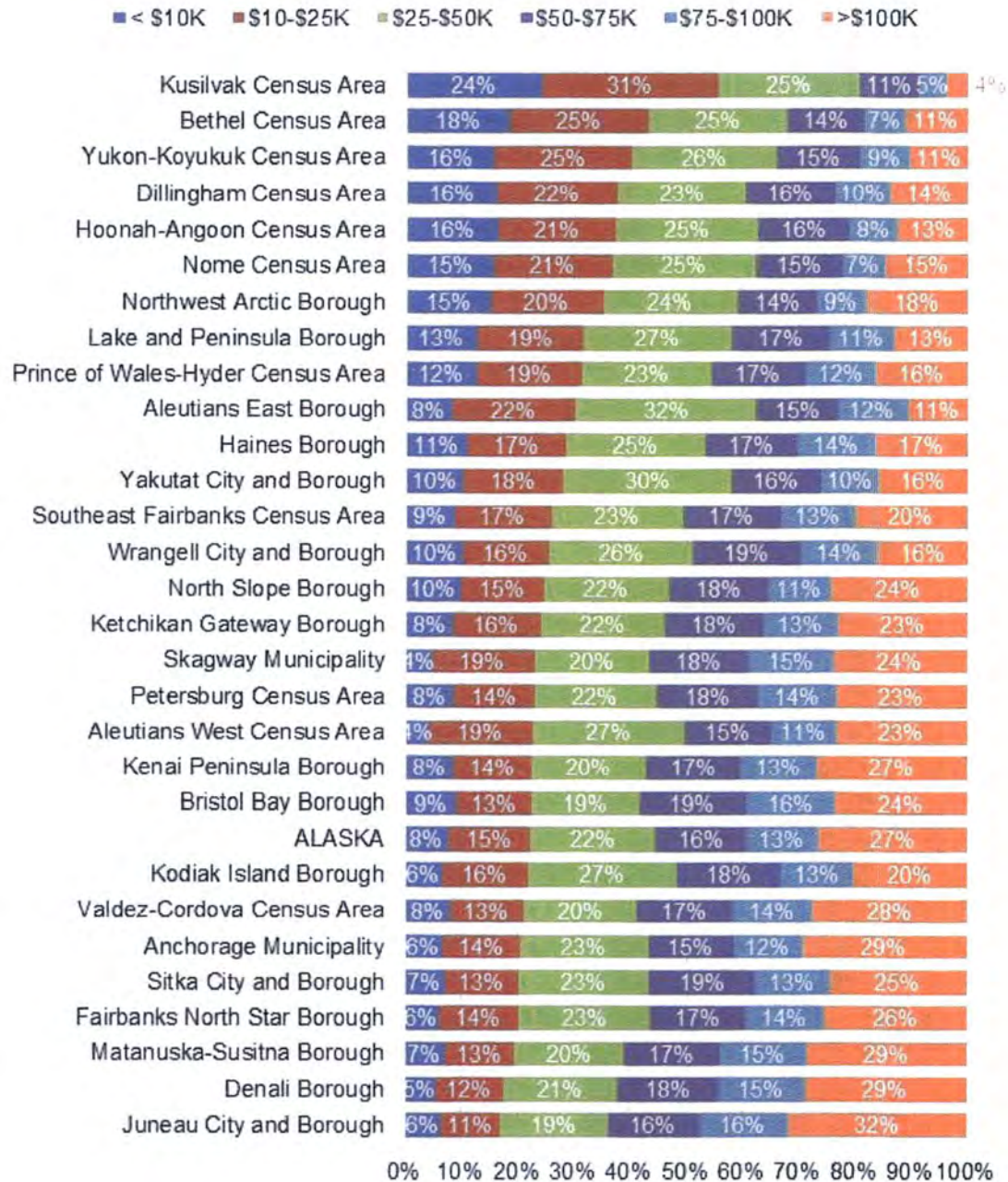
## Estimated percentage job impacts of reducing the deficit by different amounts using different options

**Estimated Job Impacts of Reducing the Deficit by Selected Total Amounts Using Different Combinations of Fiscal Options, Expressed as a Share of Estimated Total Alaska Full-Time and Part-Time Employment in 2014 (465,000 jobs)**

		Two options					Three options				Four options	
Combinations of fiscal options	Spending cut: broad-based	50%	50%		50%			33%	33%	33%		25%
	Income tax: progressive	50%		50%			50%	33%	0%	33%	33%	25%
	Dividend cut		50%	50%		50%		33%	33%		33%	25%
	Saving less				50%	50%	50%		33%	33%	33%	25%
\$100 million	Jobs: Low scenario	0.2%	0.2%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%
	Jobs: High scenario	0.2%	0.2%	0.2%	0.1%	0.1%	0.1%	0.2%	0.2%	0.1%	0.1%	0.2%
\$500 million	Jobs: Low scenario	0.8%	0.8%	0.6%	0.5%	0.3%	0.3%	0.7%	0.6%	0.5%	0.4%	0.6%
	Jobs: High scenario	1.1%	1.2%	0.9%	0.7%	0.5%	0.4%	1.1%	0.8%	0.7%	0.6%	0.8%
\$1.0 billion	Jobs: Low scenario	1.6%	1.7%	1.2%	1.1%	0.6%	0.6%	1.5%	1.1%	1.1%	0.8%	1.1%
	Jobs: High scenario	2.2%	2.3%	1.8%	1.4%	1.0%	0.8%	2.1%	1.5%	1.5%	1.2%	1.6%
\$1.5 billion	Jobs: Low scenario	2.5%	2.5%	1.8%	1.6%	0.9%	0.9%	2.2%	1.7%	1.6%	1.2%	1.7%
	Jobs: High scenario	3.3%	3.5%	2.7%	2.0%	1.4%	1.3%	3.2%	2.3%	2.2%	1.8%	2.4%
\$2.0 billion	Jobs: Low scenario	3.3%	3.3%	2.4%	2.1%	1.2%	1.2%	3.0%	2.2%	2.2%	1.6%	2.2%
	Jobs: High scenario	4.4%	4.6%	3.6%	2.7%	1.9%	1.7%	4.2%	3.1%	2.9%	2.4%	3.2%
\$2.5 billion	Jobs: Low scenario							3.7%	2.8%	2.7%	2.0%	2.8%
	Jobs: High scenario							5.3%	3.9%	3.7%	3.0%	3.9%
\$3.0 billion	Jobs: Low scenario							4.5%	3.3%	3.3%	2.4%	3.4%
	Jobs: High scenario							6.3%	4.6%	4.4%	3.6%	4.7%

Note: Table omits combination of options and total deficit reduction which would require reductions of more than \$1 billion from any single option.

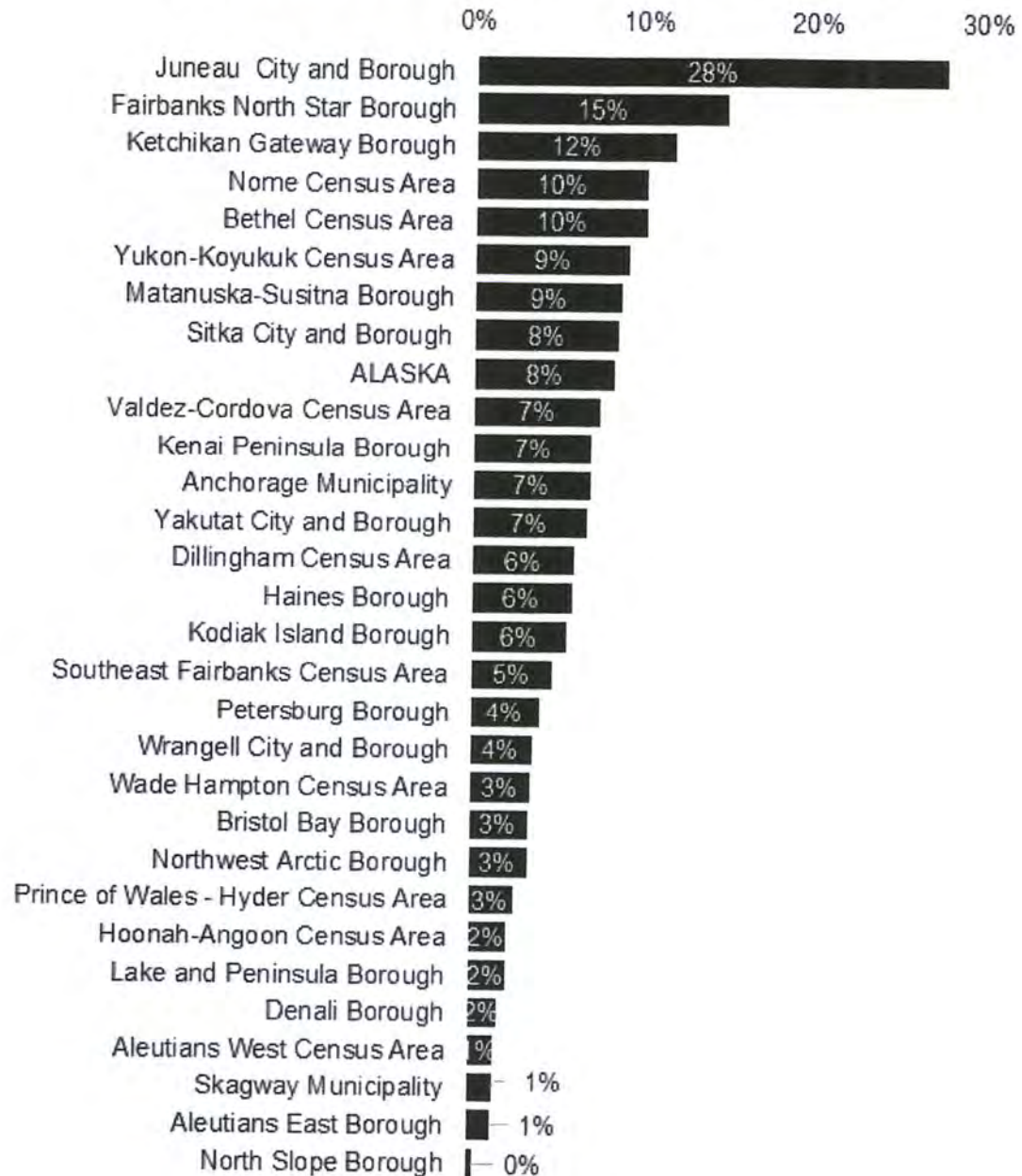
Share of Total 2013 Federal Income Tax Exemptions,  
by Adjusted Gross Income Group and Alaska Census Area



Income distribution varies for different regions of Alaska

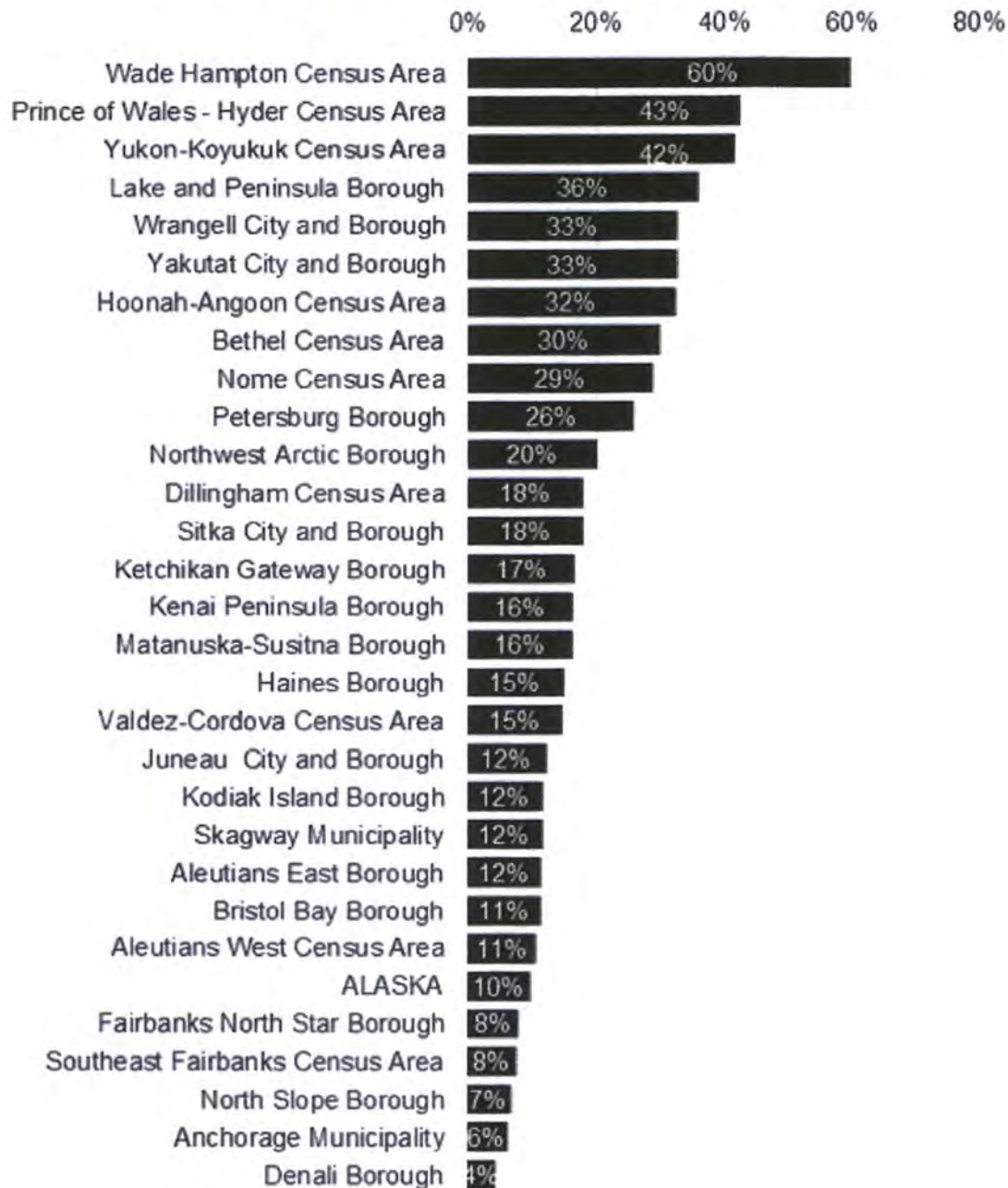
Regional economic impacts of state spending cuts would depend on how important state government jobs and income are in the regional economy. Some regions are much more dependent than others.

Share of State Government Jobs in Wage & Salary Earnings



Regional economic impacts of cuts to revenue sharing, K-12 education, and other ways that state spending helps fund local government would depend on how important local government jobs are in the regional economy. Some regions are much more dependent than others.

Share of Local Government Jobs in Wage & Salary Earnings



# Economic implications of how fast we reduce the deficit

We have lost billions of dollars of oil revenues.

We will experience significant economic impacts of adjusting to lower oil revenues.

- Impacts of spending cuts we've already made:
  - Impacts of capital budget cuts on construction industry
  - Delayed because capital projects take several years
  - Actual capital spending will decline as money from past large capital budgets runs out
- Impacts of future adjustments we will have to make
  - Spending cuts
  - Taxes
  - Dividend cuts
- It's not a question of whether we will face these impacts.
  - It's only a question of when.

Alaskans are justifiably concerned about the impacts of deficit reduction on an already weakened economy

- We are already experiencing the impacts of:
  - Oil industry job losses
  - Past state capital budget reductions
  - State government job losses
  - Mining industry downturn
  - Low salmon prices
  
- These impacts would be increased by large:
  - Spending cuts
  - New taxes
  - Dividend cuts

We can reduce the direct short-run economic impacts of reducing the deficit by continuing to draw down our savings.

**BUT**

Continued large deficits and draws from our savings would also have significant negative economic impacts.

*Negative economic impacts of continued large deficits . . .*

Certain downgrading of Alaska's credit rating  
and increases in our future borrowing costs



## **S&P downgrades Alaska's debt rating**

**Dated:** January 5, 2016 - 1:04pm

Standard & Poor's also said it expects Alaska's credit rating to continue its fall if the Alaska Legislature does not "enact significant fiscal reforms to reduce the state's fiscal imbalance" during the upcoming 2016 session.

**Alaska** Dispatch News

Tuesday, March 1, 2016

*Moody's docks state's credit rating;  
Fitch issues stern warning*

*Negative economic impacts of continued large deficits . . .*

Loss of future investment income

<b>Deficit and resulting drawdown in investment assets</b>	<b>Permanent annual loss of future investment earnings @ 5% rate of return</b>
\$1 billion	\$50 million
\$2 billion	\$100 million
\$3 billion	\$150 million
\$4 billion	\$200 million

*Negative economic impacts of continued large deficits . . .*

Potential future insufficiency of cash in Permanent Fund earnings reserve to cover otherwise sustainable payouts of Permanent Fund investment earnings in low-earnings years.

*Negative economic impacts of continued large deficits . . .*

Lack of time for new taxes to begin to bring  
in revenues before we really need the money.

*Negative economic impacts of continued large deficits . . .*

Continued and growing

# UNCERTAINTY

about

Alaska's fiscal and economic future

among

Alaskans

Alaska businesses

Resource industries

Public and private employees

## Economic implications of uncertainty

Alaska businesses postpone investment  
Alaskans postpone spending and investment  
Young Alaskans leave  
The best employees leave  
Resource industries invest elsewhere

People focus on the negative impacts of what is coming  
rather than on moving forward

We face a tradeoff between the  
short-run negative economic impacts of reducing the deficit  
and the  
significant short-run and longer-run economic impacts  
of not reducing the deficit.

How can we minimize the economic impacts of adjusting to permanently lower oil revenues?

- Probably not by fully closing the deficit this year.
- Certainly not by running another huge deficit this year.

We will have a smoother economic transition to the reality of lower oil revenues if we

- Significantly reduce the deficit this year
- Make real choices about how we will reduce the rest
  - Even if we implement them over several years
- Reduce uncertainty and build confidence about our economic future

If the fall in our oil revenues was temporary  
then it would make sense to run deficits  
to help support the economy.

But the fall in our oil revenues is not temporary.

We can't indefinitely support the economy by running deficits.

Not paying for what we spend this year  
means that our children will pay  
for what we spend this year.

# Observations on Alaska's Economy and Economic Implications of Alaska's Fiscal Choices

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Prepared for presentation to  
Alaska Senate Finance Committee  
March 30, 2016



**UAA** Institute of Social  
and Economic Research  
UNIVERSITY of ALASKA ANCHORAGE

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**NEW**

## Outline

- Overview of Alaska's economy
- Short-run economic impacts of Alaska fiscal options
- Economic implications of how fast we reduce the deficit

I am not advocating for or against any bills or proposals

# Overview of Alaska's Economy

Thanks to the Alaska Department of Labor and Workforce Development economists who do an excellent job tracking Alaska's economy.

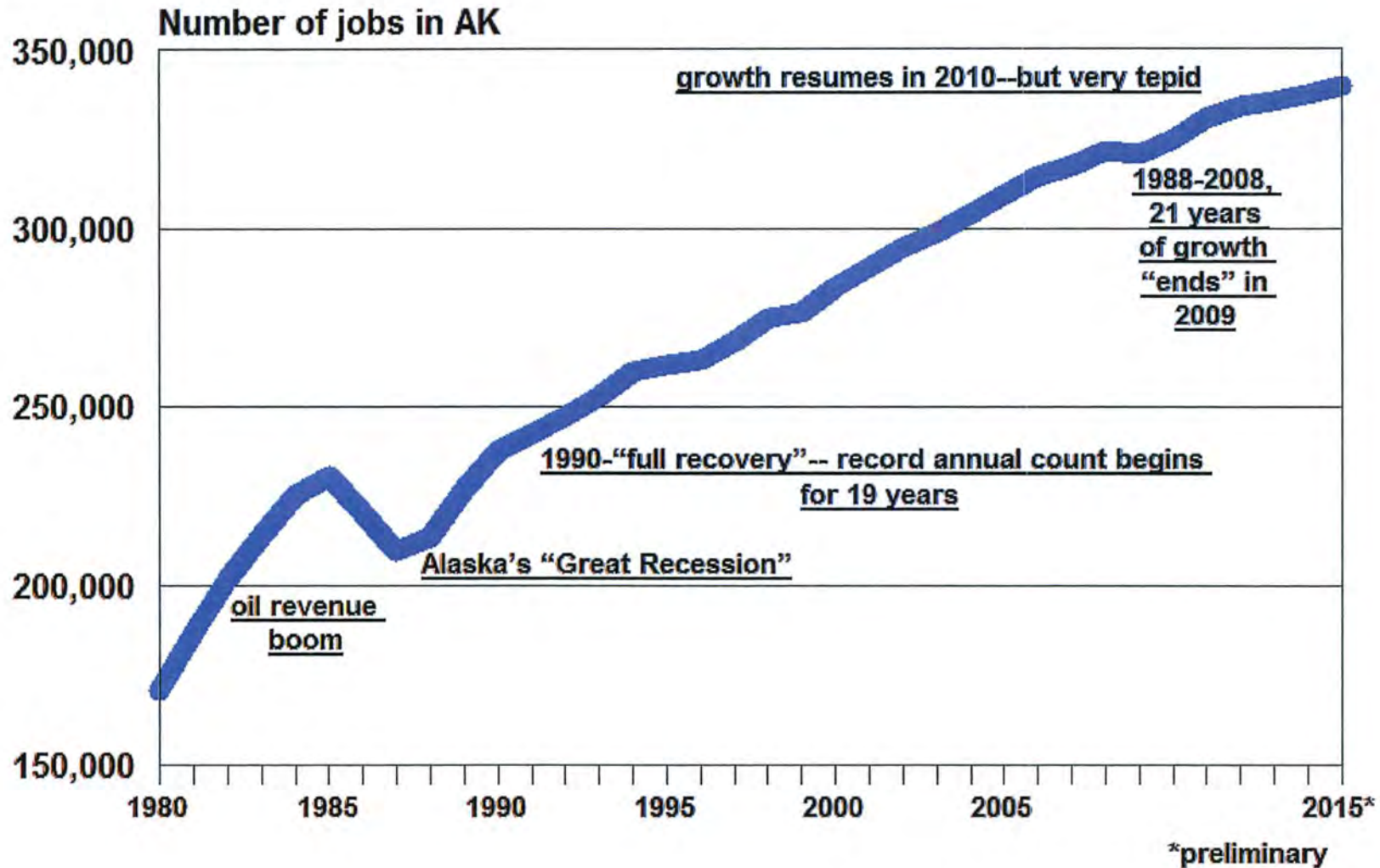


They provided me with most of the data and charts about the economy that I'm using in this presentation.

## Summary of main points about Alaska's economy

- There is significant concern about:
  - Are we facing a recession?
  - Could what we do to reduce the deficit aggravate the recession?
  - Could we be facing a repeat of the 1980s recession?
- Despite these concerns:
  - The best available evidence is that Alaska's overall economy is not yet in a recession
  - There are important positive indicators in the economy
- Several sectors of Alaska's economy are declining:
  - Oil industry
  - Construction
  - State government
- We probably are facing a recession
- But it is unlikely that it will be as severe or damaging as the 1980s recession

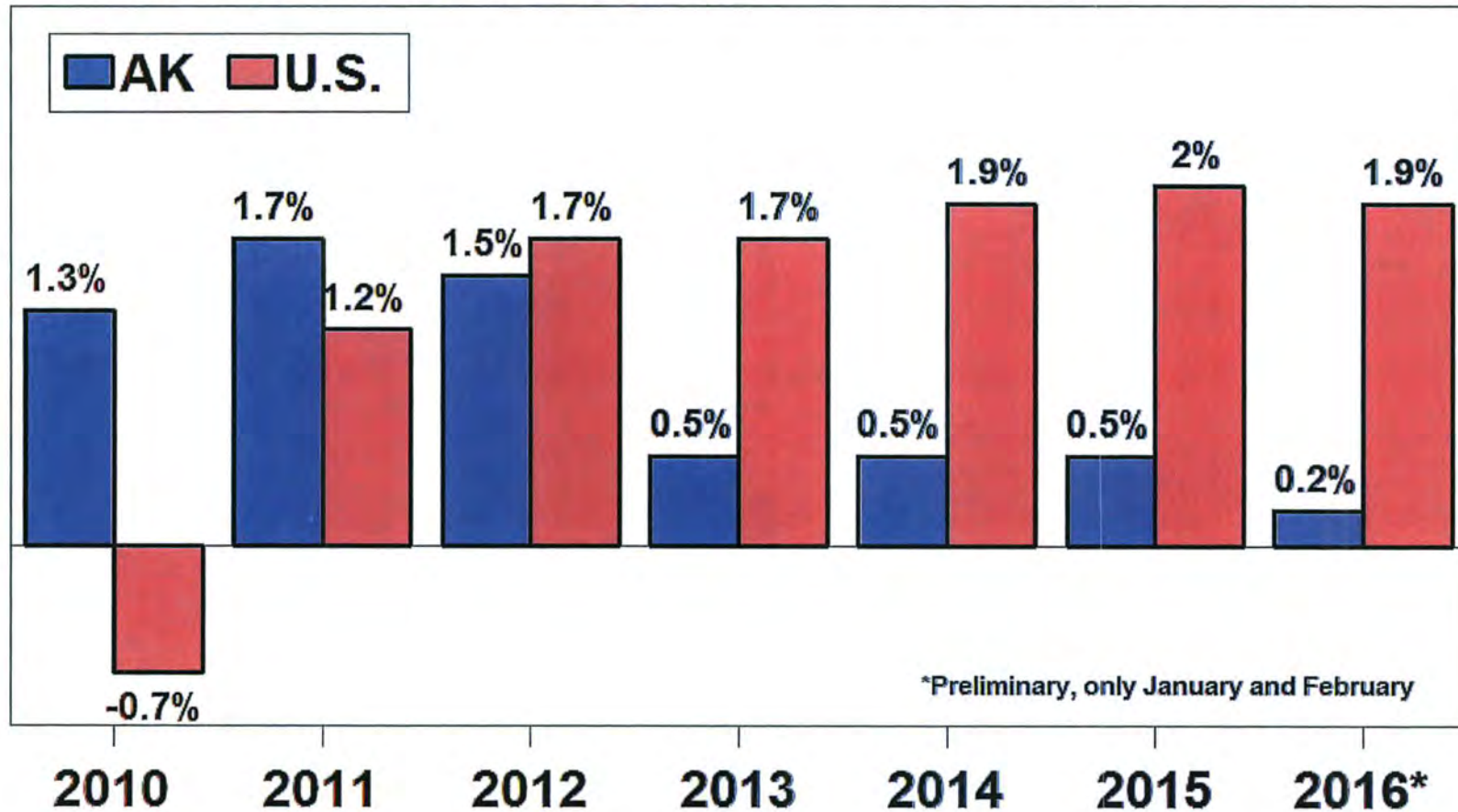
Alaska has had twenty-five years of almost continuous but slowing economic growth.



Source: Alaska Department of Labor and Workforce Development, Research and Analysis Section.

The best available evidence is that the total Alaska economy—as measured by the number of jobs—is still growing, but at a very slow rate.

**Percent employment change from previous year-AK and U.S.**



Source: Alaska Department of Labor and Workforce Development, Research and Analysis Section.

The most recent job estimates show total employment higher than a year ago.

### Total Wage and Salary Jobs, Over-the-year Percent Change

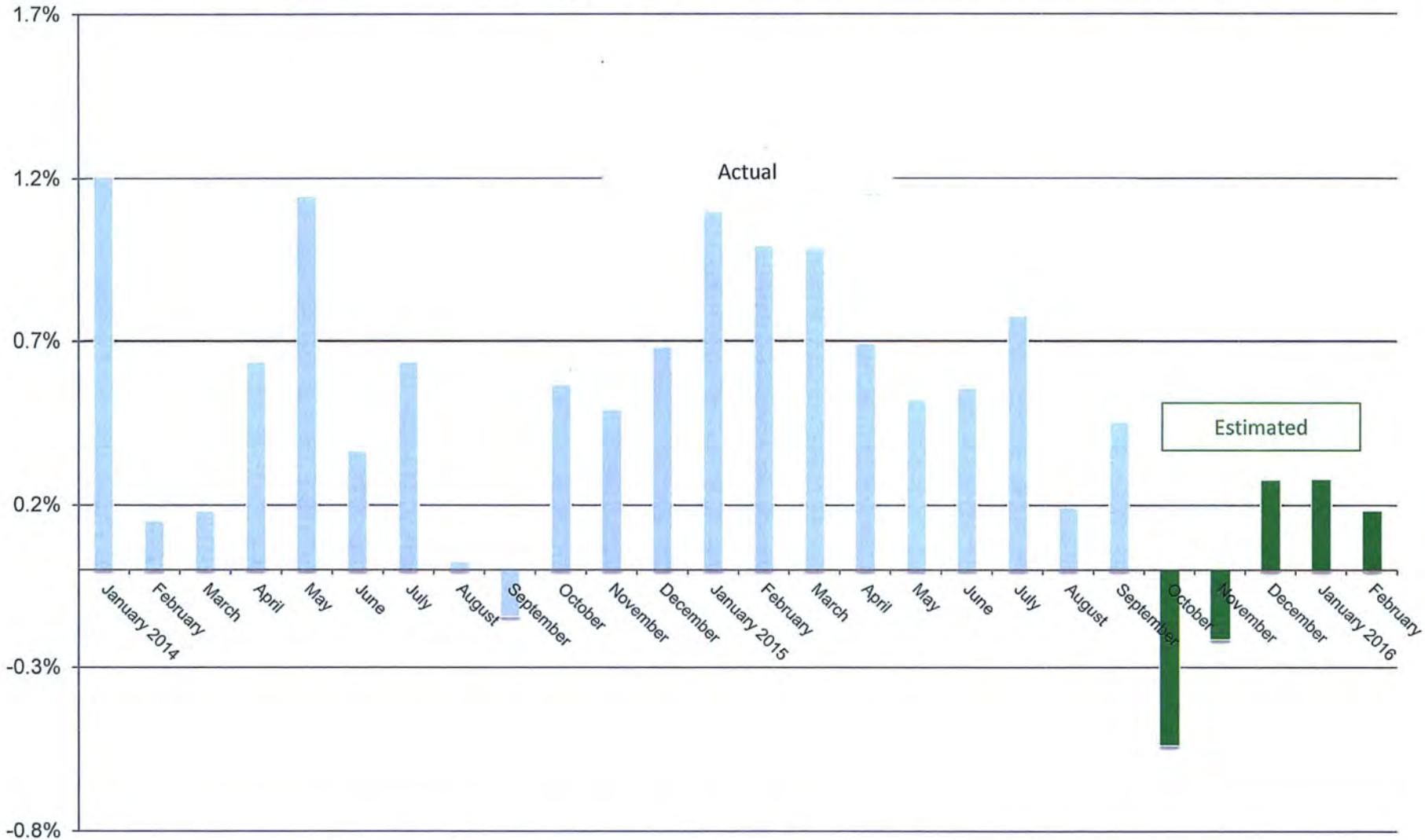


Chart provided by Alaska Department of Labor and Workforce Development, Research and Analysis Section.

Alaska personal income continued to grow in 2015.

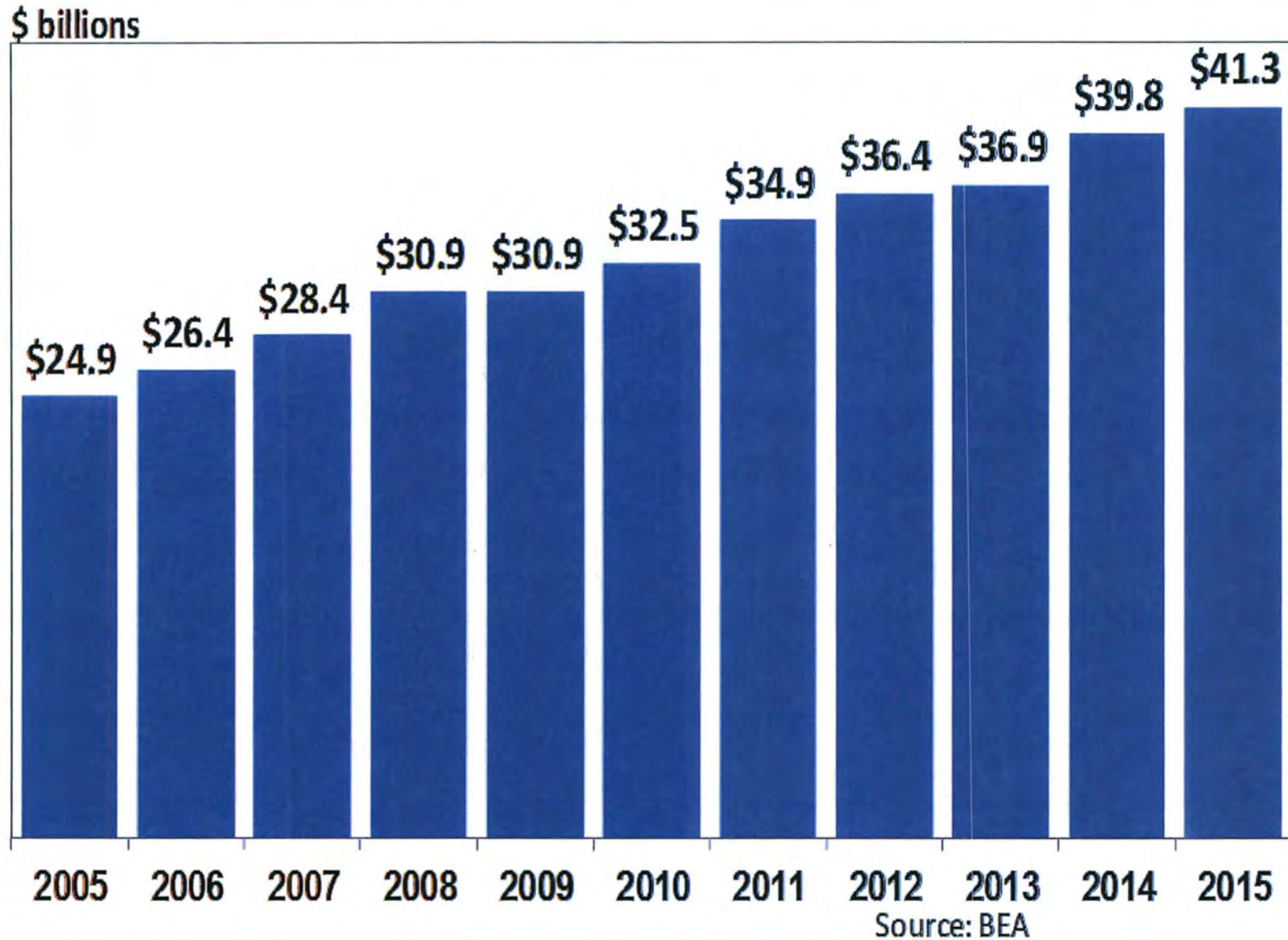
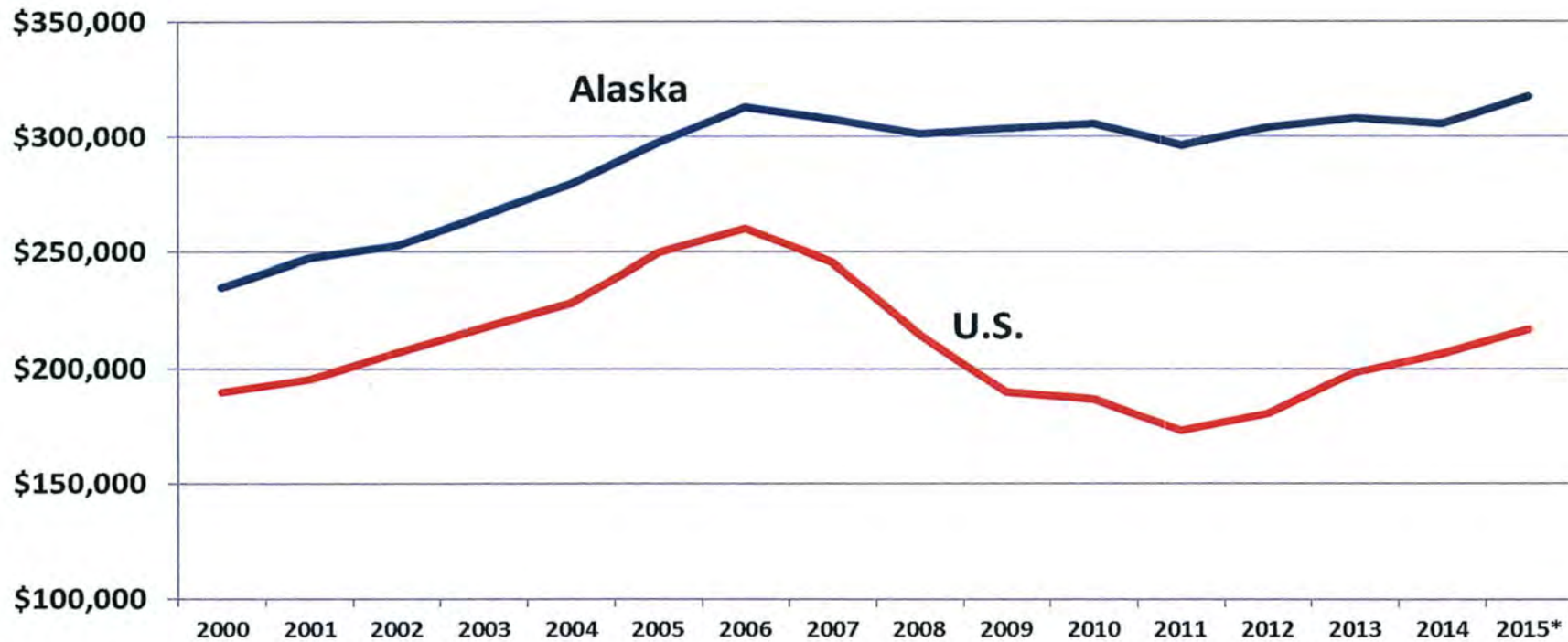


Chart provided by Alaska Department of Labor and Workforce Development, Research and Analysis Section.

Alaska's housing market is not showing signs of significant weakness.

### Average Single-Family Sales Prices in 2015 Dollars Alaska and U.S

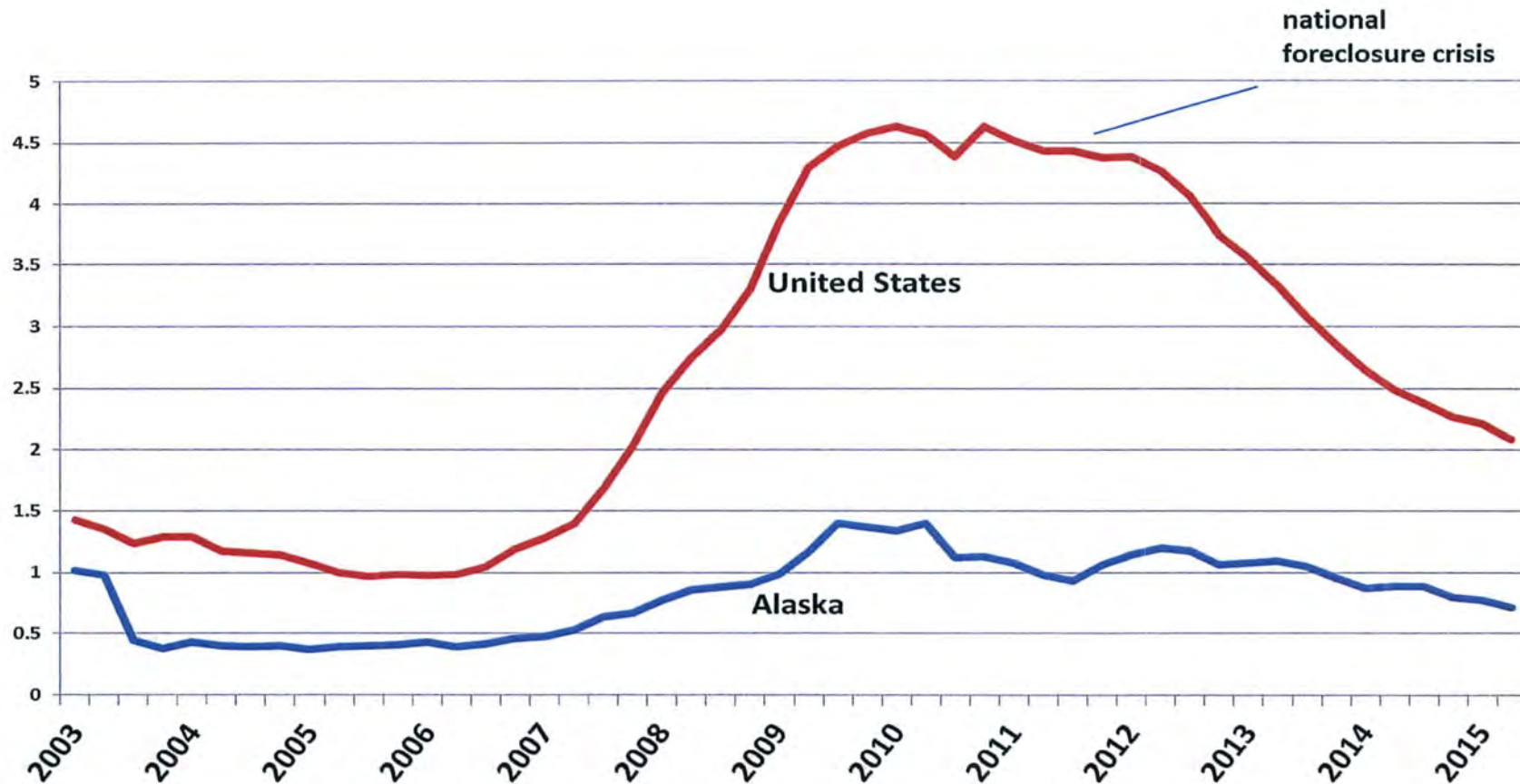


\* 1st half 2015

Source: Alaska Department of Labor and Workforce Development, Research and Analysis Section, Quarterly Survey of Mortgage Lending Activity; National Association of Realtors

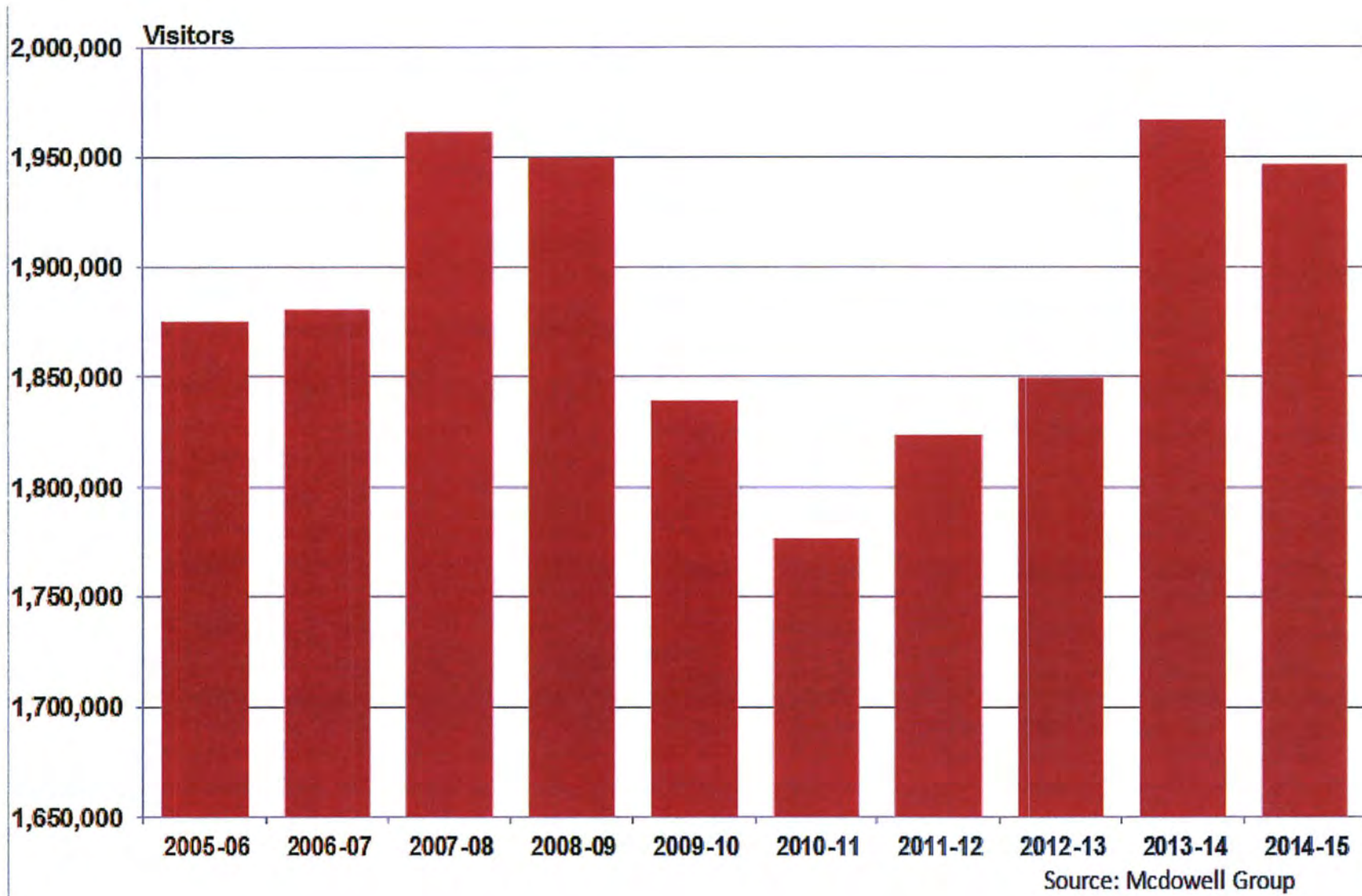
Alaska's housing market is not showing signs of significant weakness.

## Foreclosure Rate, Alaska and the U.S.

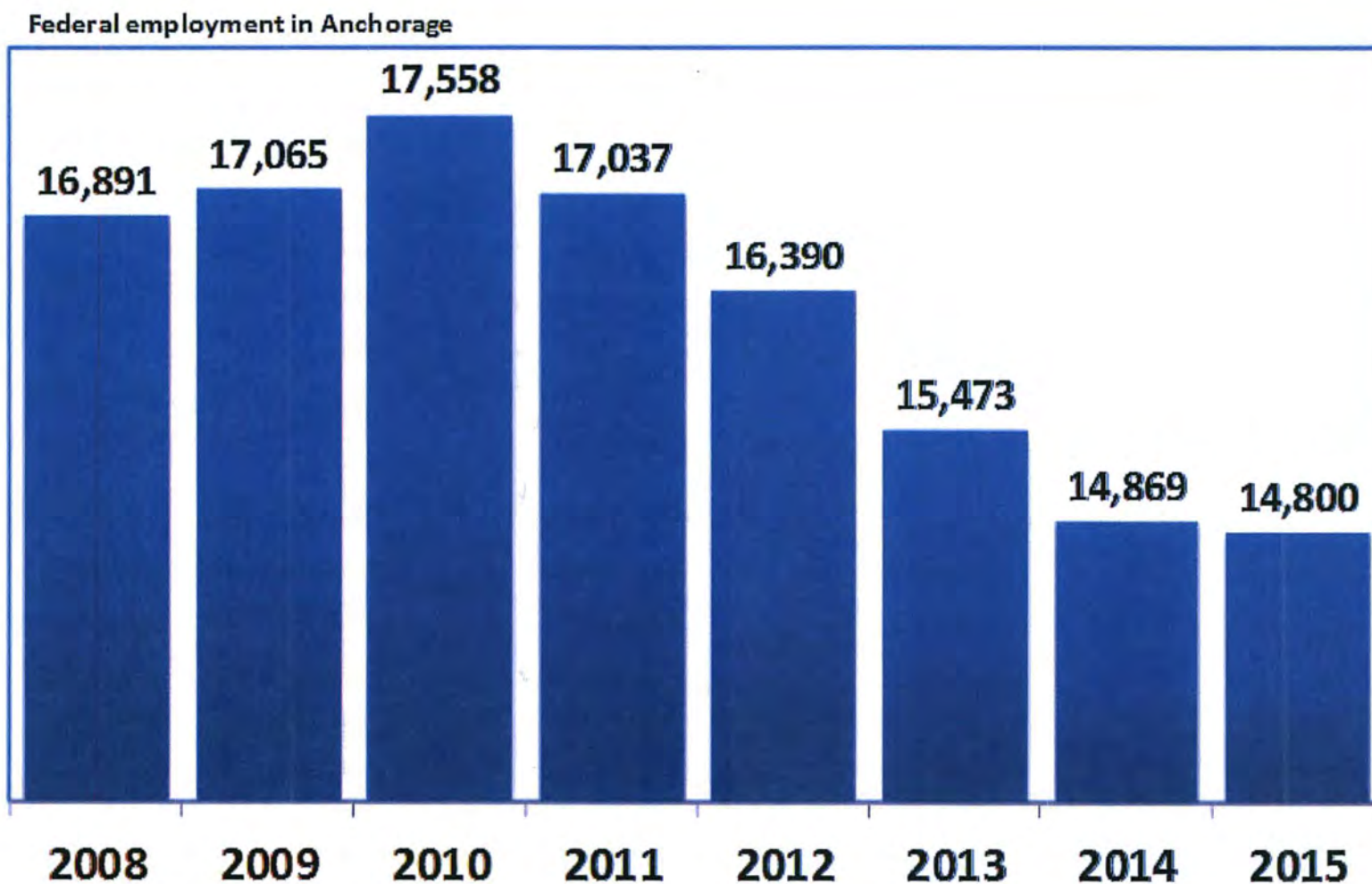


Source: Alaska Department of Labor and Workforce Development, Research and Analysis Section; Mortgage Brokers Association

## Alaska's visitor industry is doing well.



Federal job losses have been a significant drag on Alaska's economy in recent years—but these job losses appear to be easing.



Source: Alaska Department of Labor and Workforce Development, Research and Analysis Section.

But job losses are occurring in selected economic sectors . . .

### Oil and Gas Jobs, Over-the-year Percent Change

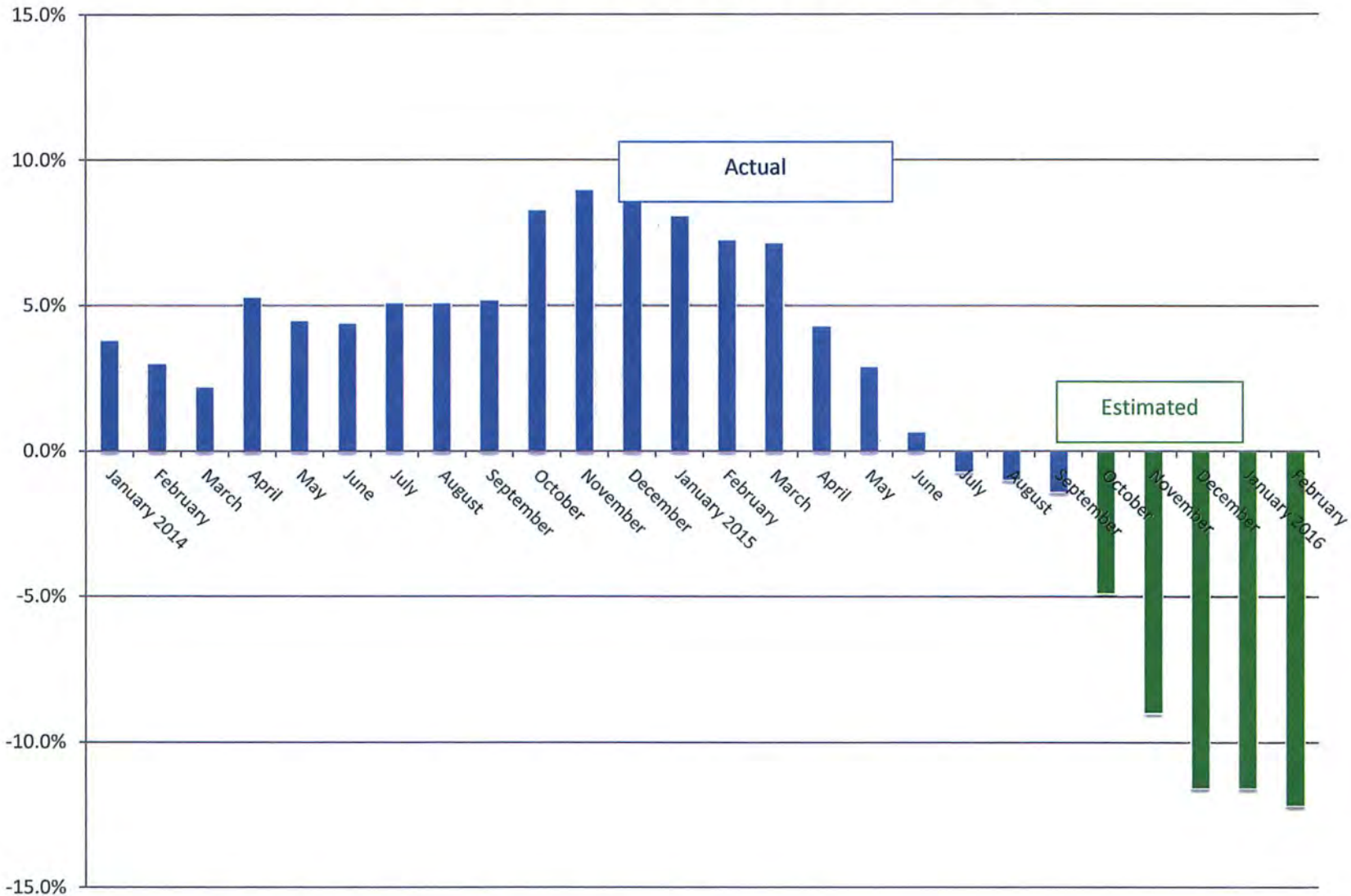
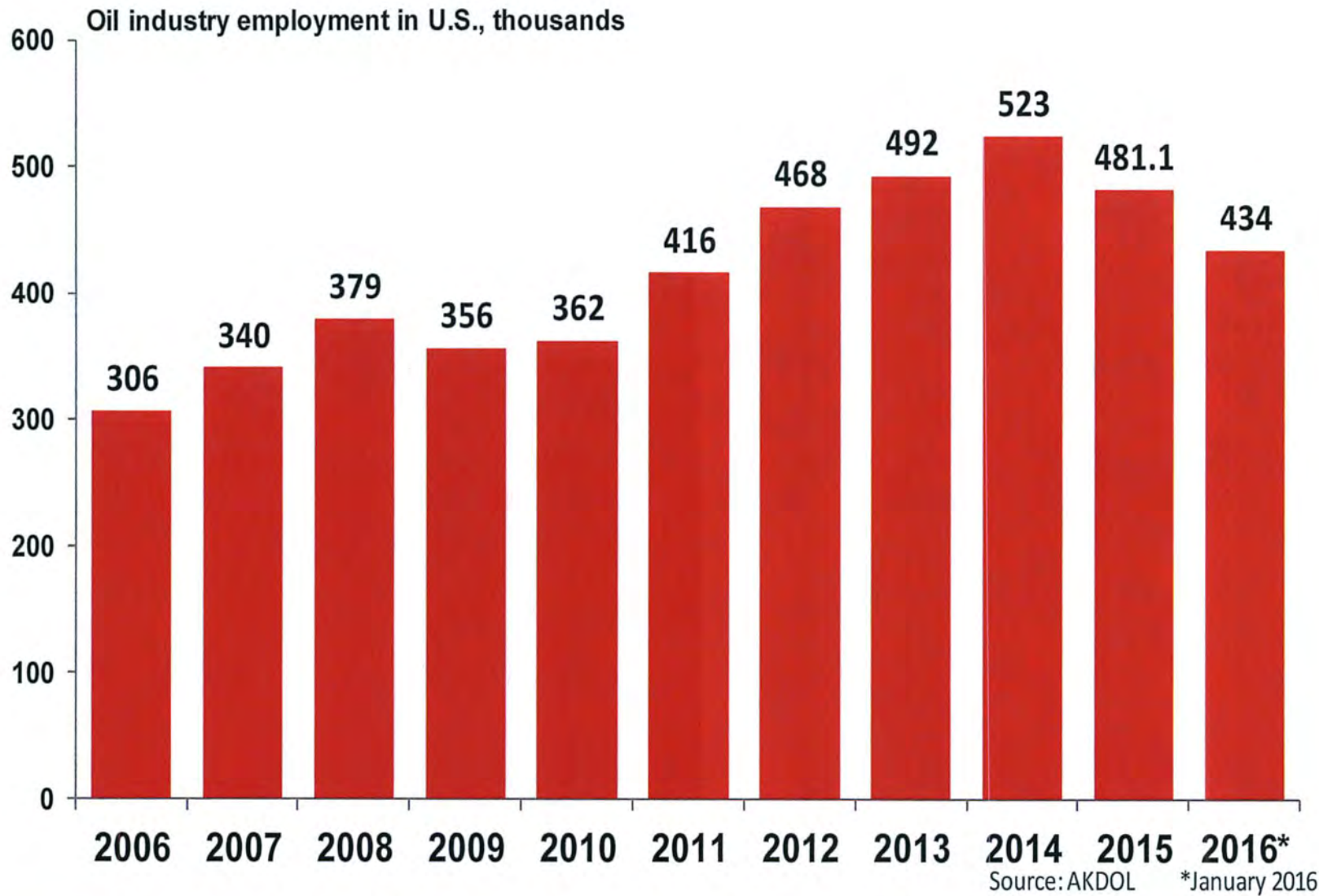


Chart provided by Alaska Department of Labor and Workforce Development, Research and Analysis Section.

# US Oil Rig Count



# National Oil Industry Employment



# Job losses in selected economic sectors . . .

## Construction Jobs, Over-the-year Percent Change

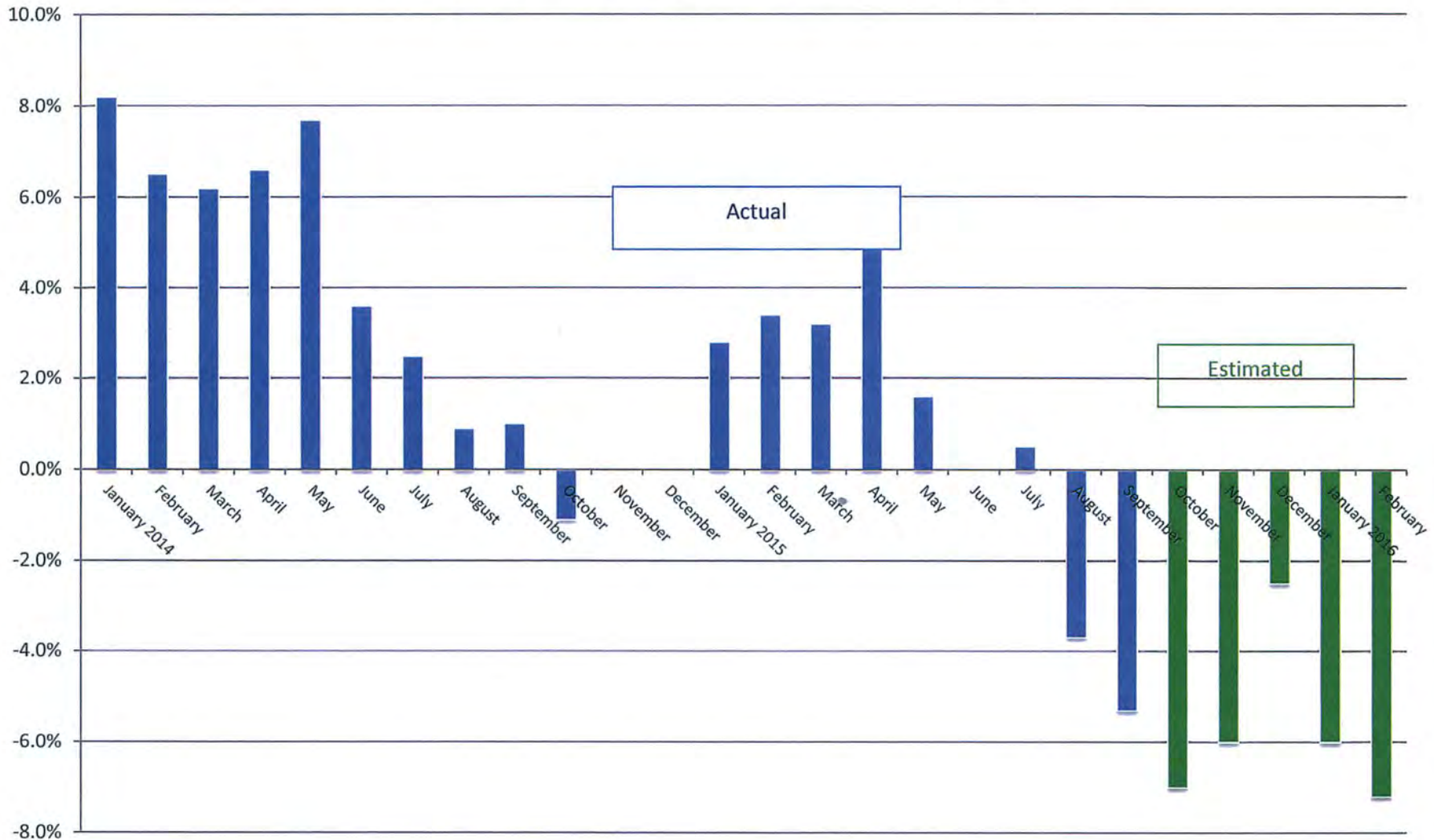
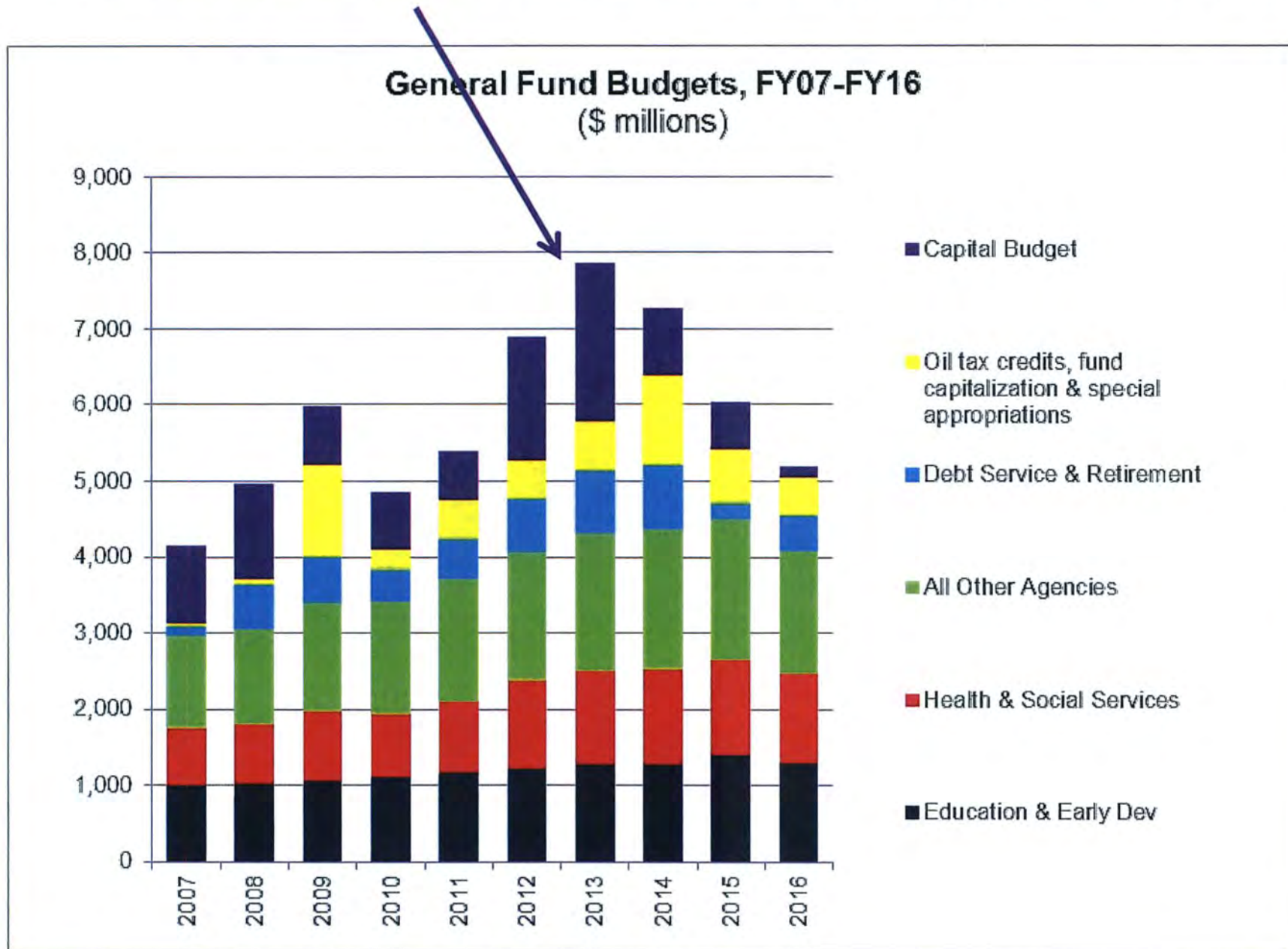
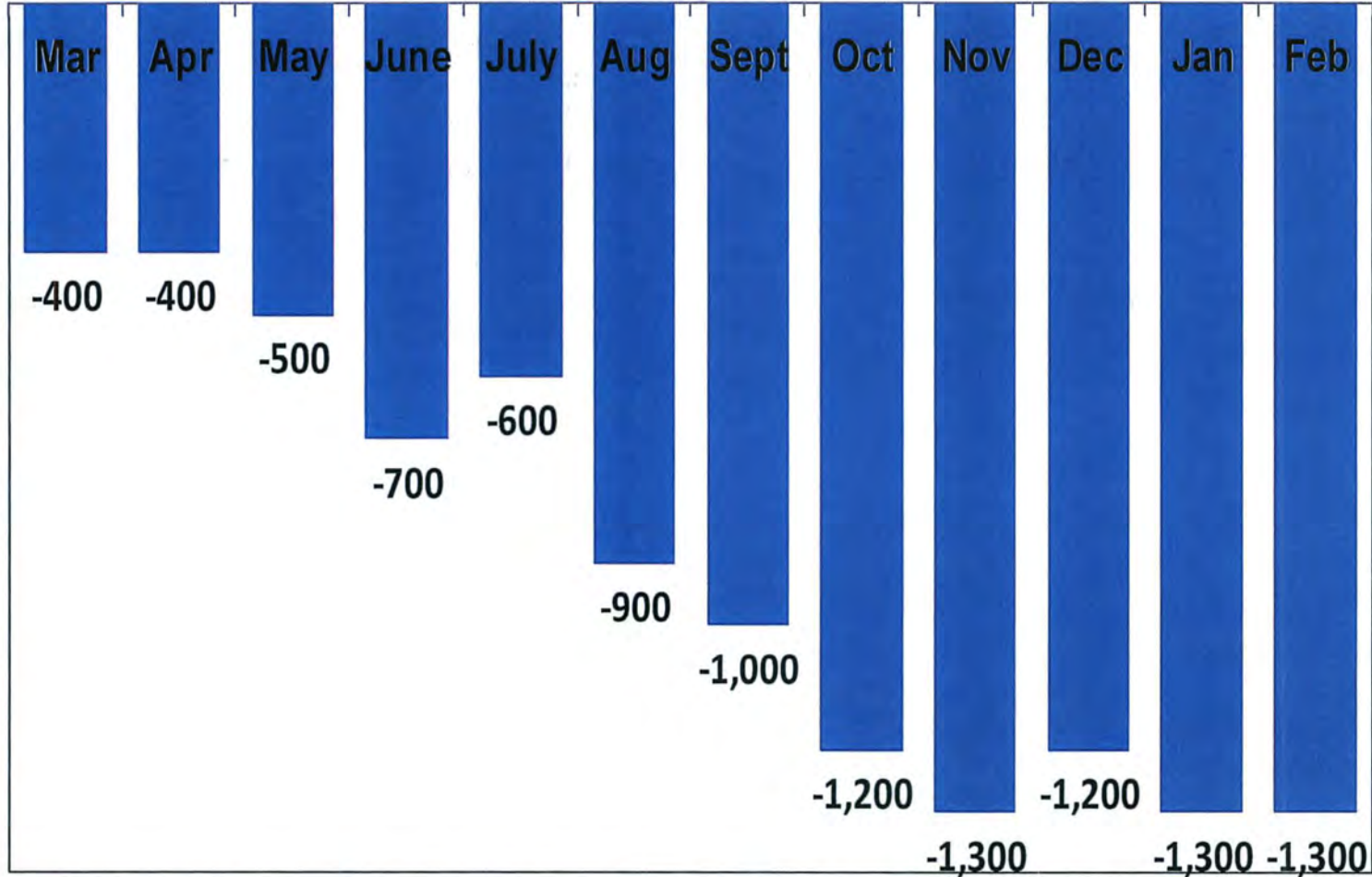


Chart provided by Alaska Department of Labor and Workforce Development, Research and Analysis Section.

The capital budget has been cut very sharply over the past four years.



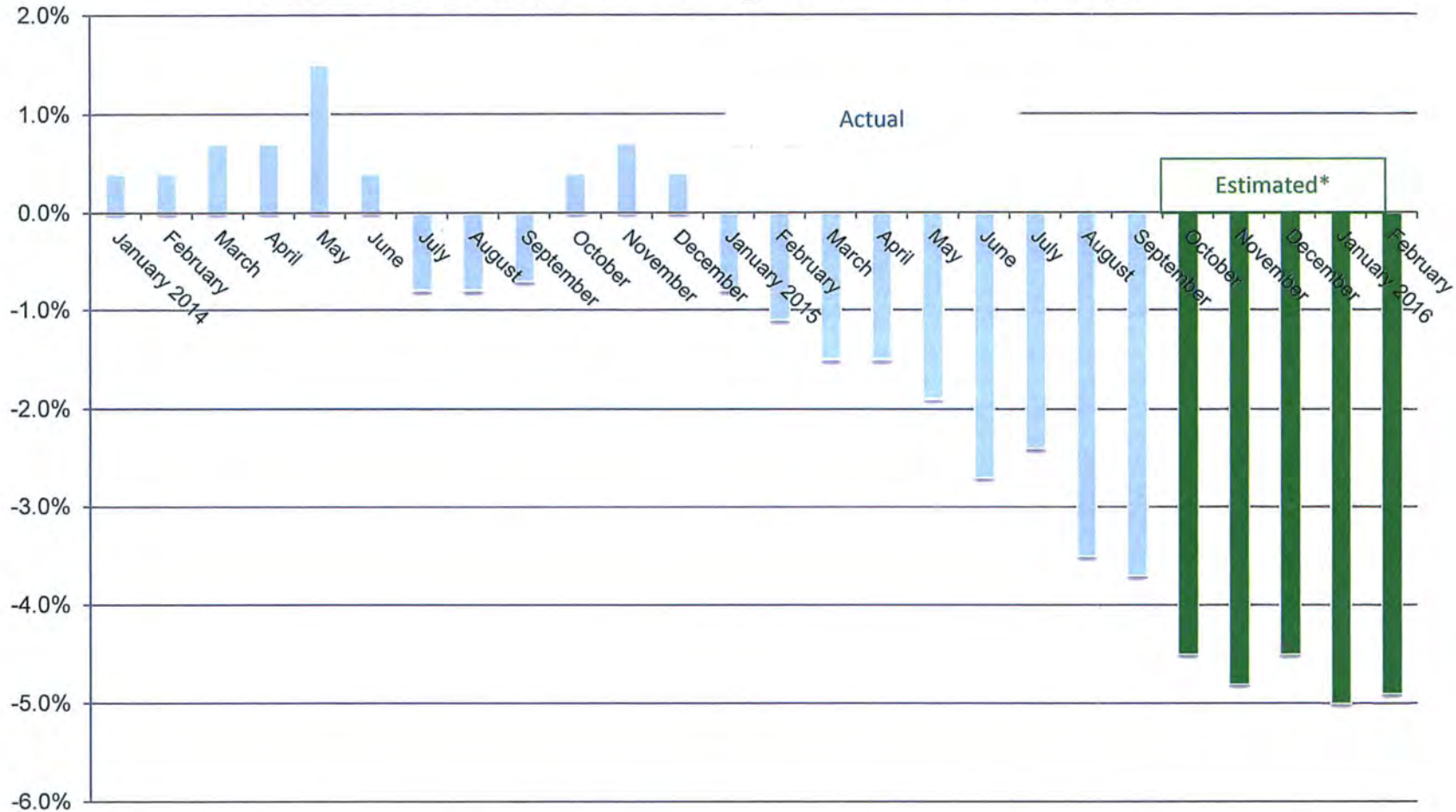
# State Government Job Losses Growing 2015-2016



\*Total State Government Employment was 25.200 . February 2016

# Job losses in selected economic sectors . . .

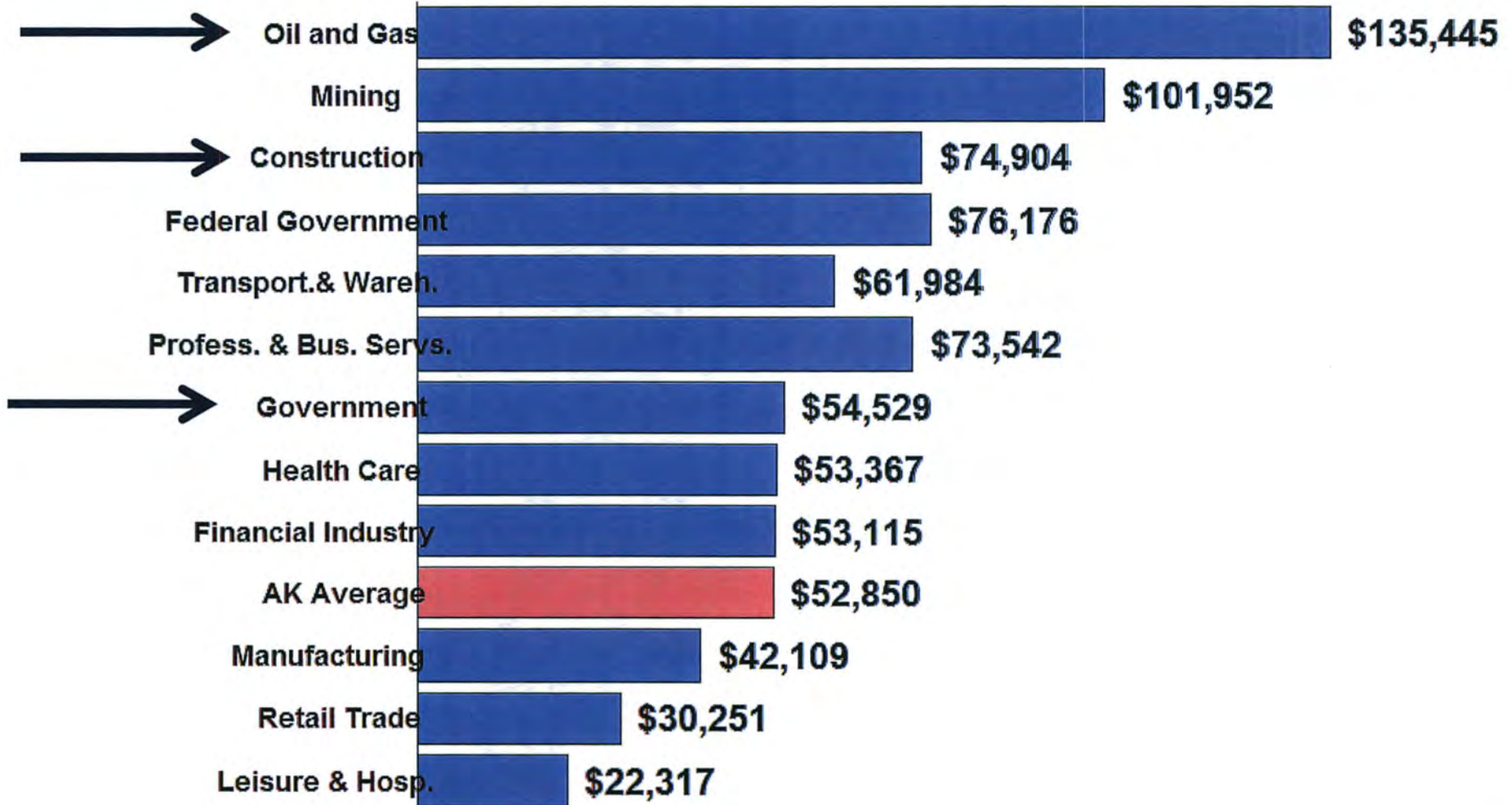
## State Gvt. Jobs, Over-the-year Percent Change



\* State government estimates are more reliable than other estimates because the job numbers come directly from state payroll data.

We are losing jobs in high-wage sectors of the economy

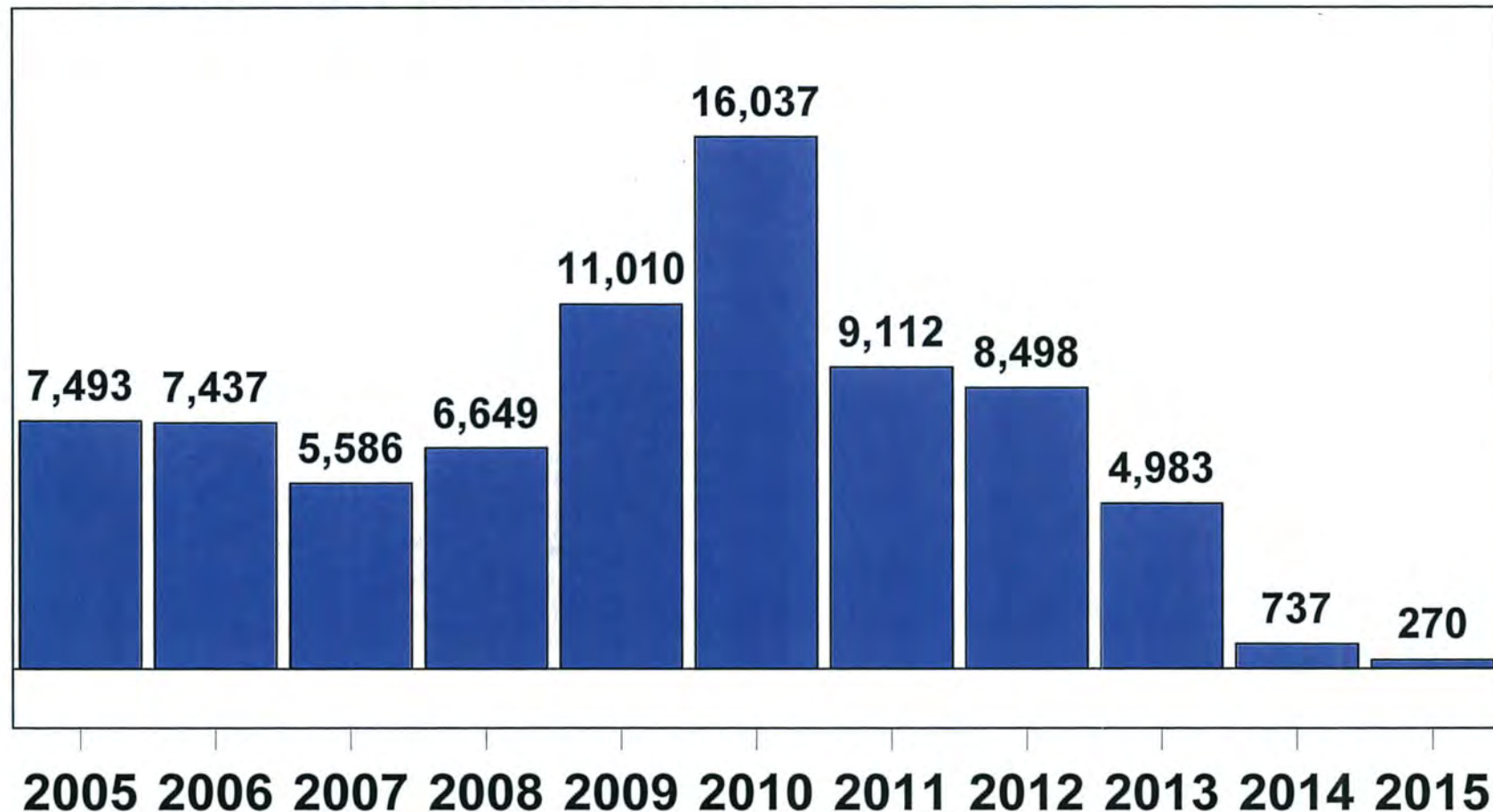
**Alaska's 2014 average annual earnings**



# Alaska's Population Gains Grew With National Recession--But Now Slowing

Alaska's total 2015 population count was 737,624

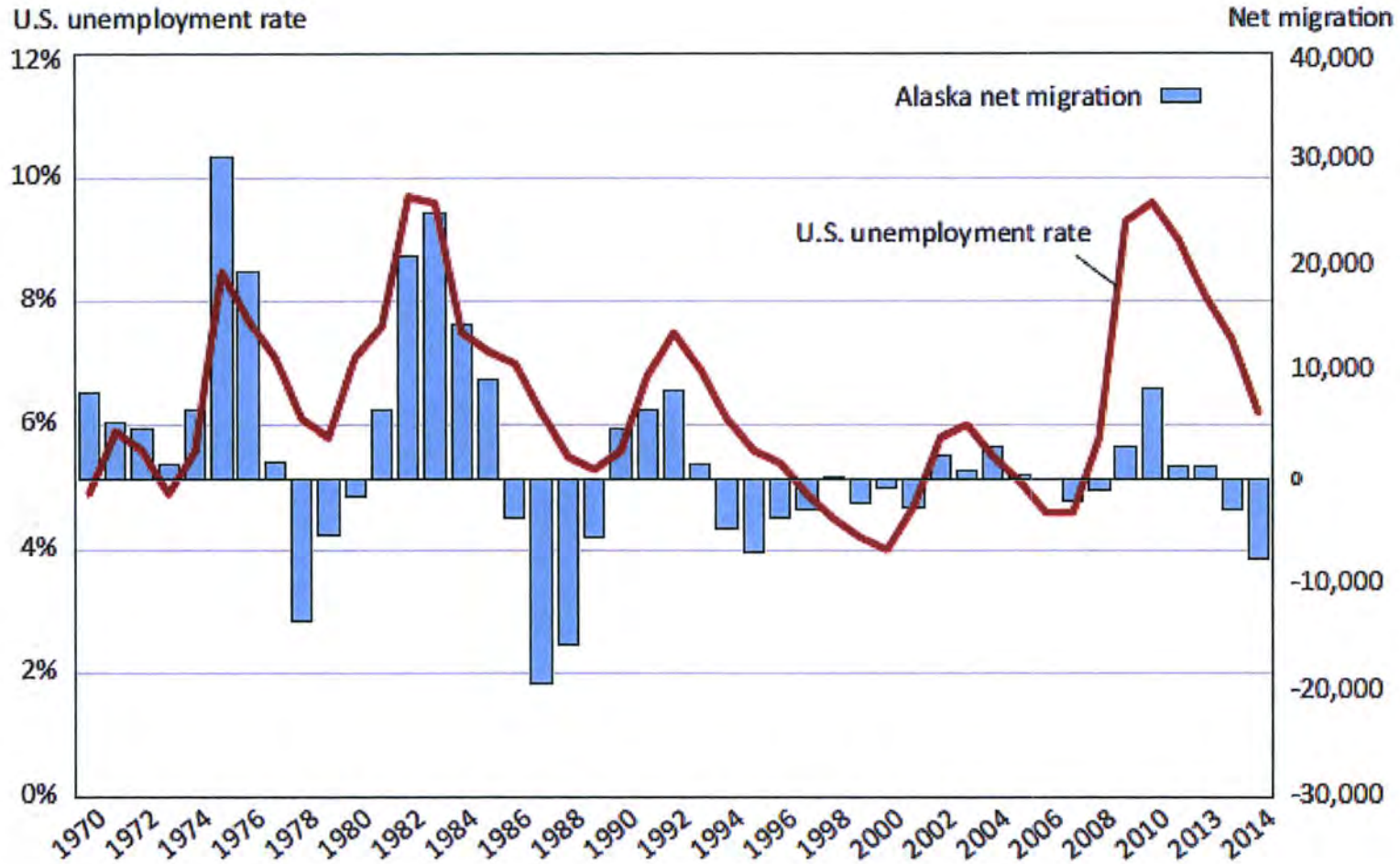
Total annual population gains Alaska



# 1

## Alaska Migration, U.S. Jobless Rate Track Together

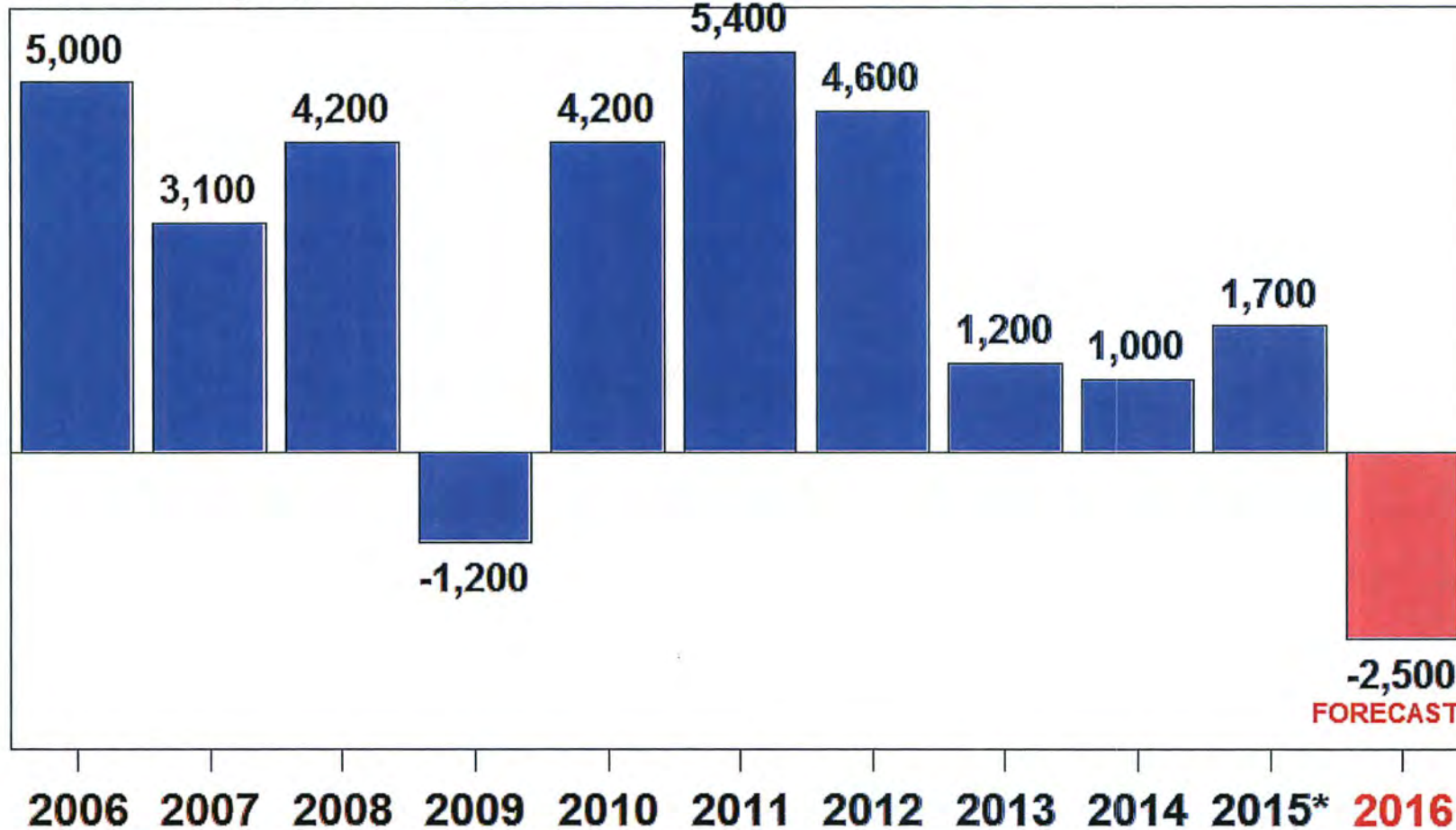
1970 TO 2014



Source: Alaska Department of Labor and Workforce Development, Research and Analysis Section

Alaska Department of Labor and Workforce Development  
economic projections for 2016 . . .

**Annual employment growth in AK**

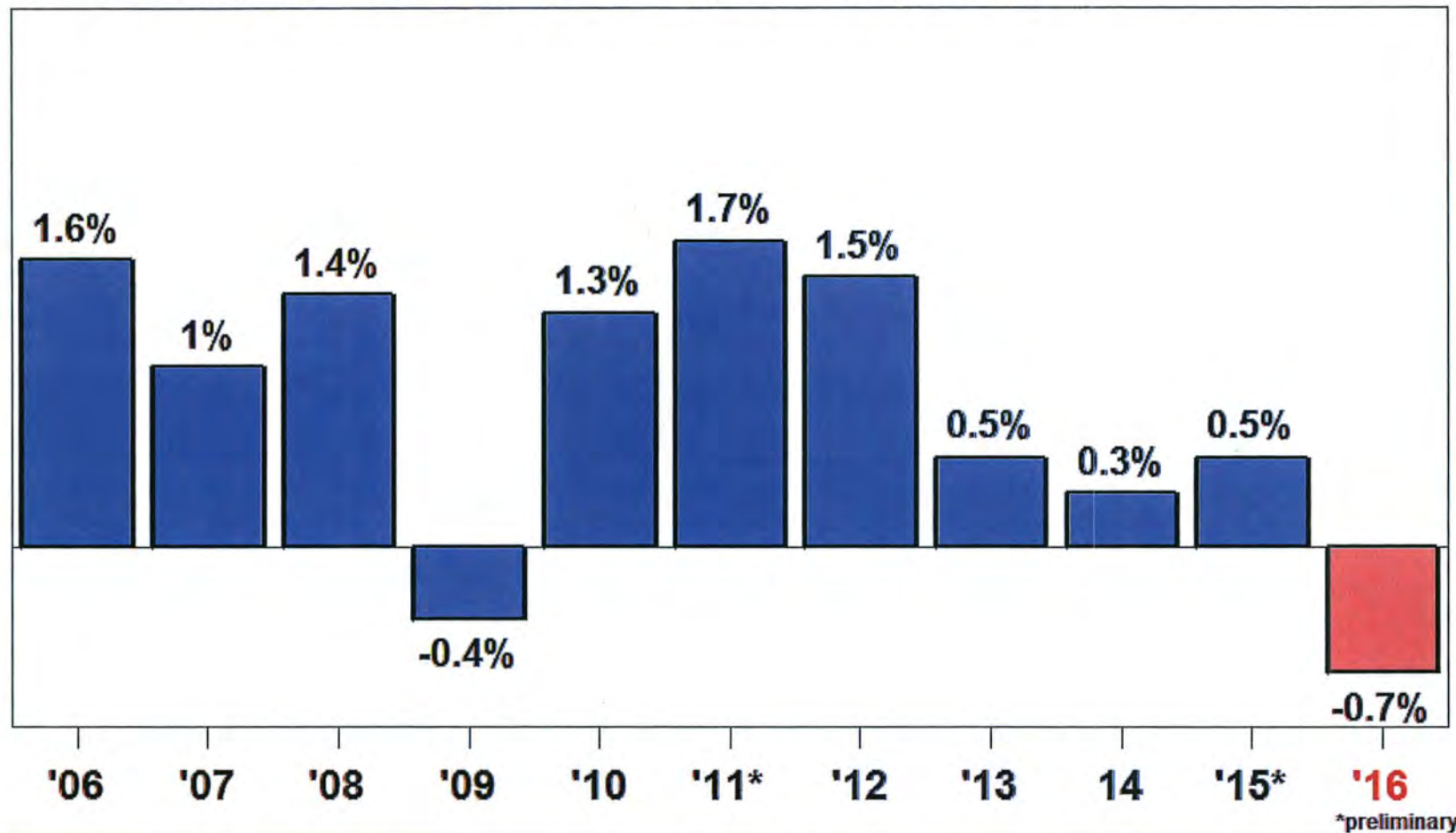


Source: Alaska Department of Labor and Workforce Development, Research and Analysis Section

\*preliminary

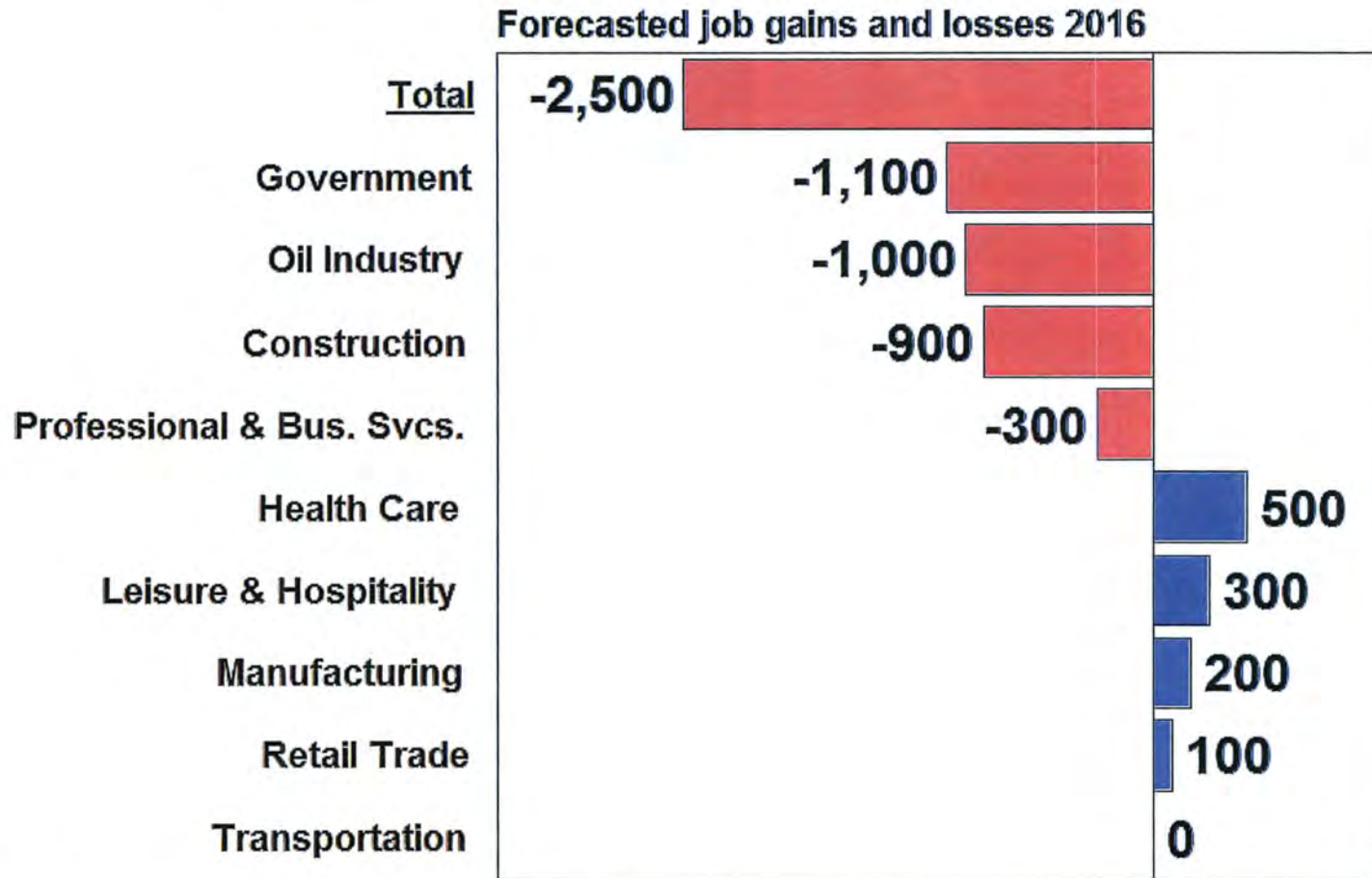
Alaska Department of Labor and Workforce Development  
economic projections for 2016 . . .

percent employment change from previous year-AK



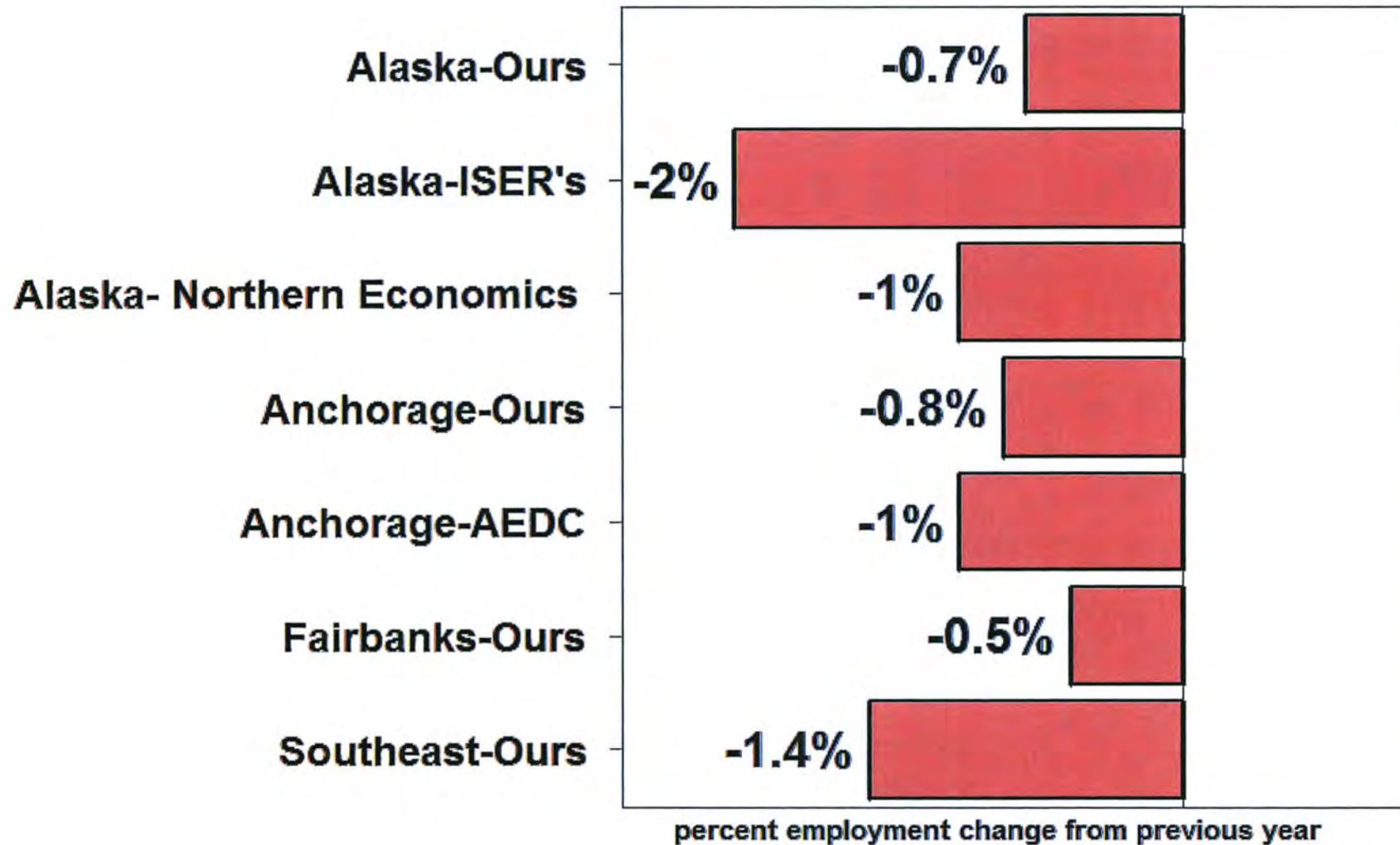
Alaska Department of Labor and Workforce Development  
economic projections for 2016 . . .

## Where Jobs Are Forecast To Come From And Disappear From In 2016



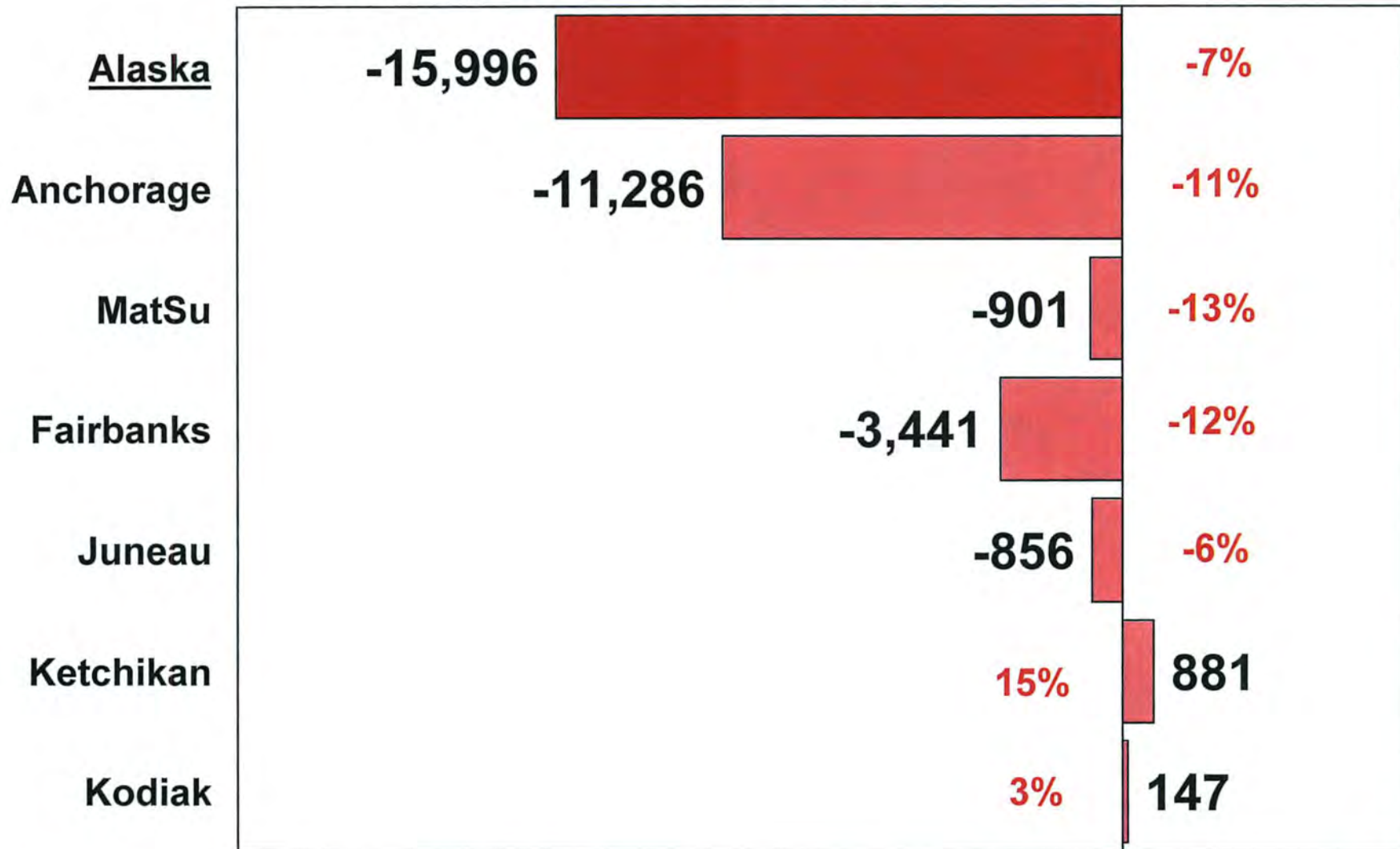
Source: Alaska Department of Labor and Workforce Development, Research and Analysis Section

Alaska Department of Labor and Workforce Development  
comparison of their economic projections for 2016 (“ours”)  
with other projections . . .



# The Extent Of Job Losses During Alaska's "Great Recession" Of The 1980s

Jobs lost and gained between 1985-1988



The 1980s and now:  
What's different?

- Economy (as measured by jobs) is about 50% larger
- Older population bringing in much more retirement income
- Alaska Native Corporations bringing significant income to Alaska
- Much larger Permanent Fund dividend a stabilizing factor in the economy
- Visitor industry has grown dramatically
- Bank lending has been more conservative: people are less overextended in their borrowing
- Housing markets are much tighter and stronger
- We have not been experiencing a construction boom

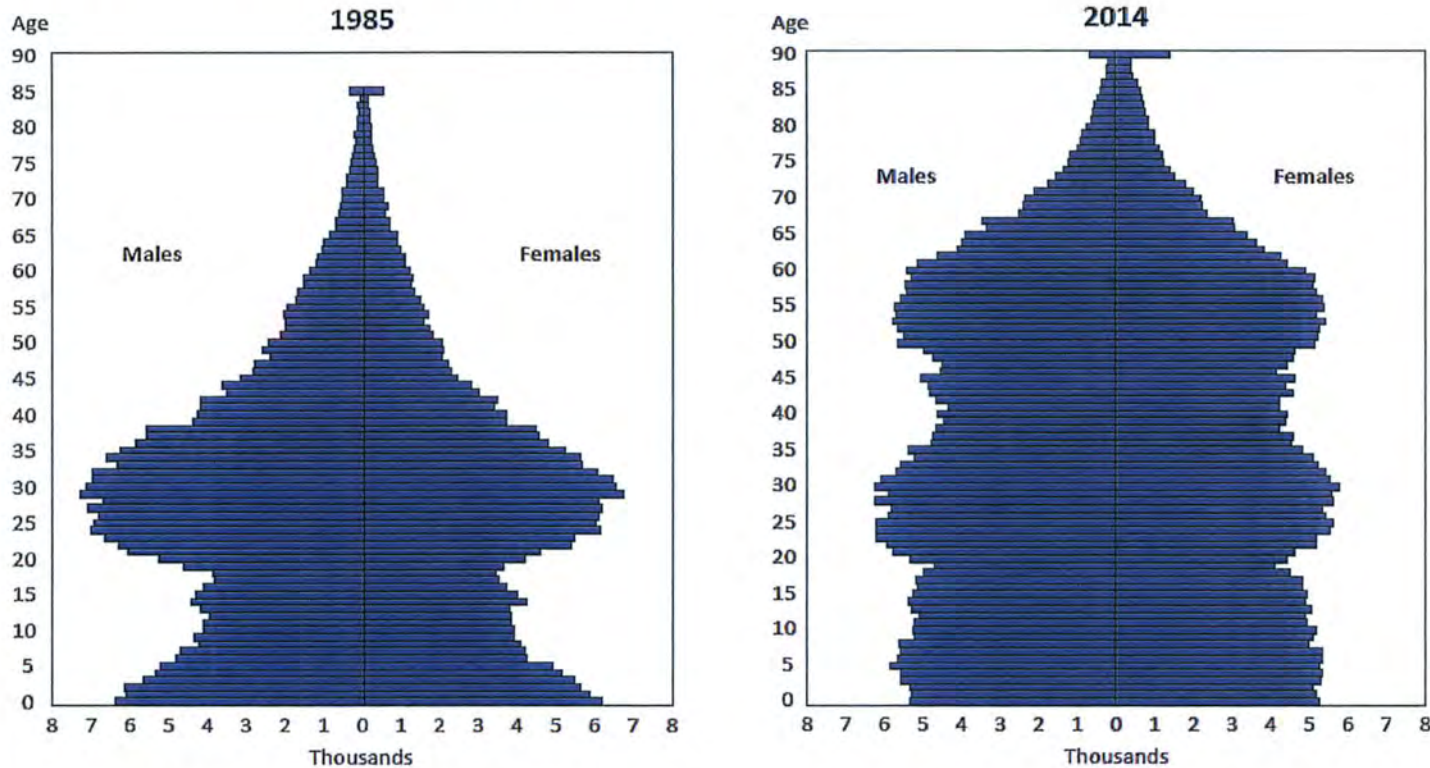
Alaska housing markets are much stronger now than they were in the 1980s.

Anchorage residential building permits issued in 1983	9082
Total Anchorage residential building permits issued, 2006-2015	6,808

As Alaska's population has aged, retirement income represents a significantly larger share of Alaska income, and a stabilizing component of the economy.

# 4 The Population Has Gotten Older

ALASKA'S AGE STRUCTURE, 1985 AND 2014



Source: Alaska Department of Labor and Workforce Development, Research and Analysis Section

# ISER's study of Short-Run Economic Impacts of Alaska Fiscal Options

The study is posted on  
ISER's website at  
[www.iser.uaa.alaska.edu](http://www.iser.uaa.alaska.edu)



## What we studied, for selected fiscal options . . .

- Revenue impacts of taxes and dividend cuts
  - What share would non-residents pay?
  - What share would be offset by lower federal taxes?
  - What would be the relative impacts on different income groups?
- Short run economic impacts of spending cuts, taxes and dividend cuts. Per hundred million of deficit reduction:
  - What would be the impacts on Alaskans' incomes?
  - What would be the impacts on Alaska jobs?
- Total economic impacts of reducing the deficit
  - What would the total short-run impacts on income and jobs of reducing the deficit by different amounts?
- Regional economic impacts
  - How would the impacts of different options vary between regions?

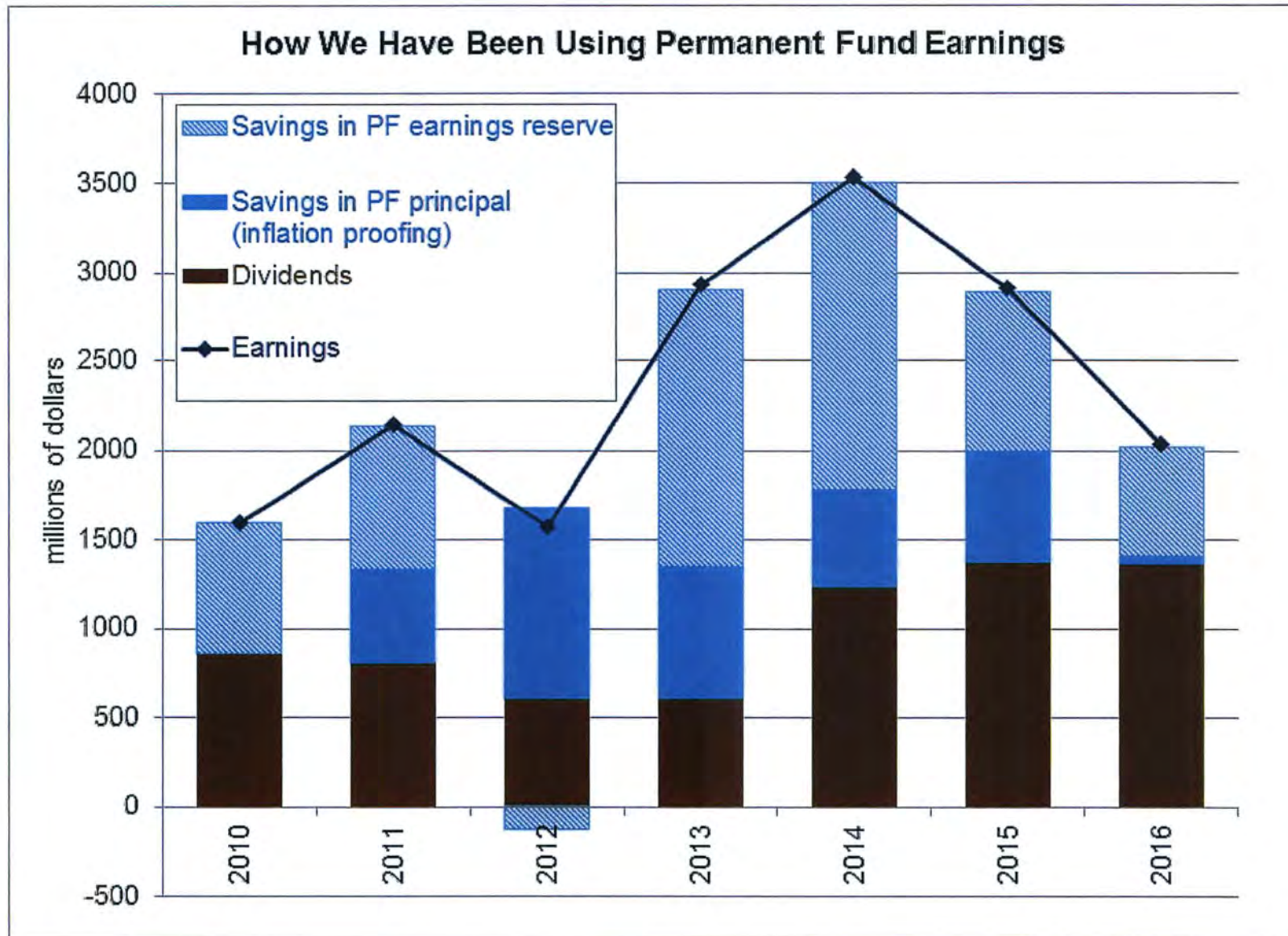
We only studied short-run direct economic impacts of fiscal options. There are many other important potential impacts which we *didn't* study.

- A few examples of impacts we *didn't* study:
  - Economic impacts of reductions in government services
  - Impacts on investment
  - Impacts on infrastructure development & resource industries
  - Impacts on labor markets & population
- Our fiscal choices will significantly affect Alaska's future
- We should think about not only their short-term economic impacts but also their longer-term economic and social impacts.

Of all the options for reducing the deficit, only **saving less** (and using the money to fund government) would have no short-run economic impacts on the Alaska economy.

- Options for **saving less** include:
  - Reducing inflation-proofing transfers to PF principal
  - Adding less to the PF earnings reserve
- **Saving less** would not:
  - take *any* money out of the economy
  - have *any* short-run impacts on jobs or income
- But it would reduce:
  - our future investment earnings
  - how much savings we leave for future Alaskans

From 2010 to 2015, we saved an average of \$1.4 billion annually of Permanent Fund realized earnings

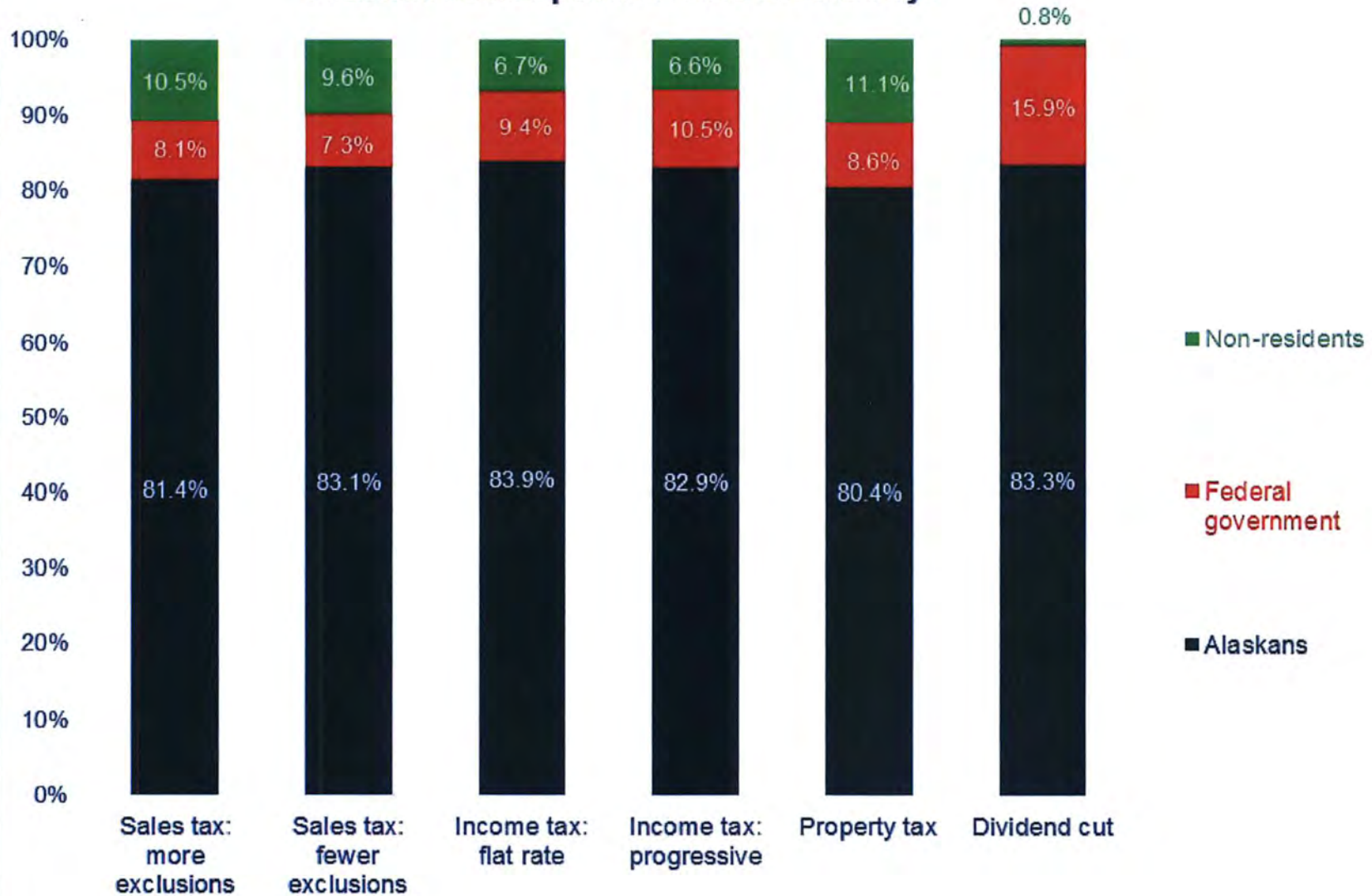


All of the other options for reducing the deficit, including spending cuts, taxes, and dividend cuts, would have significant short-run economic impacts.

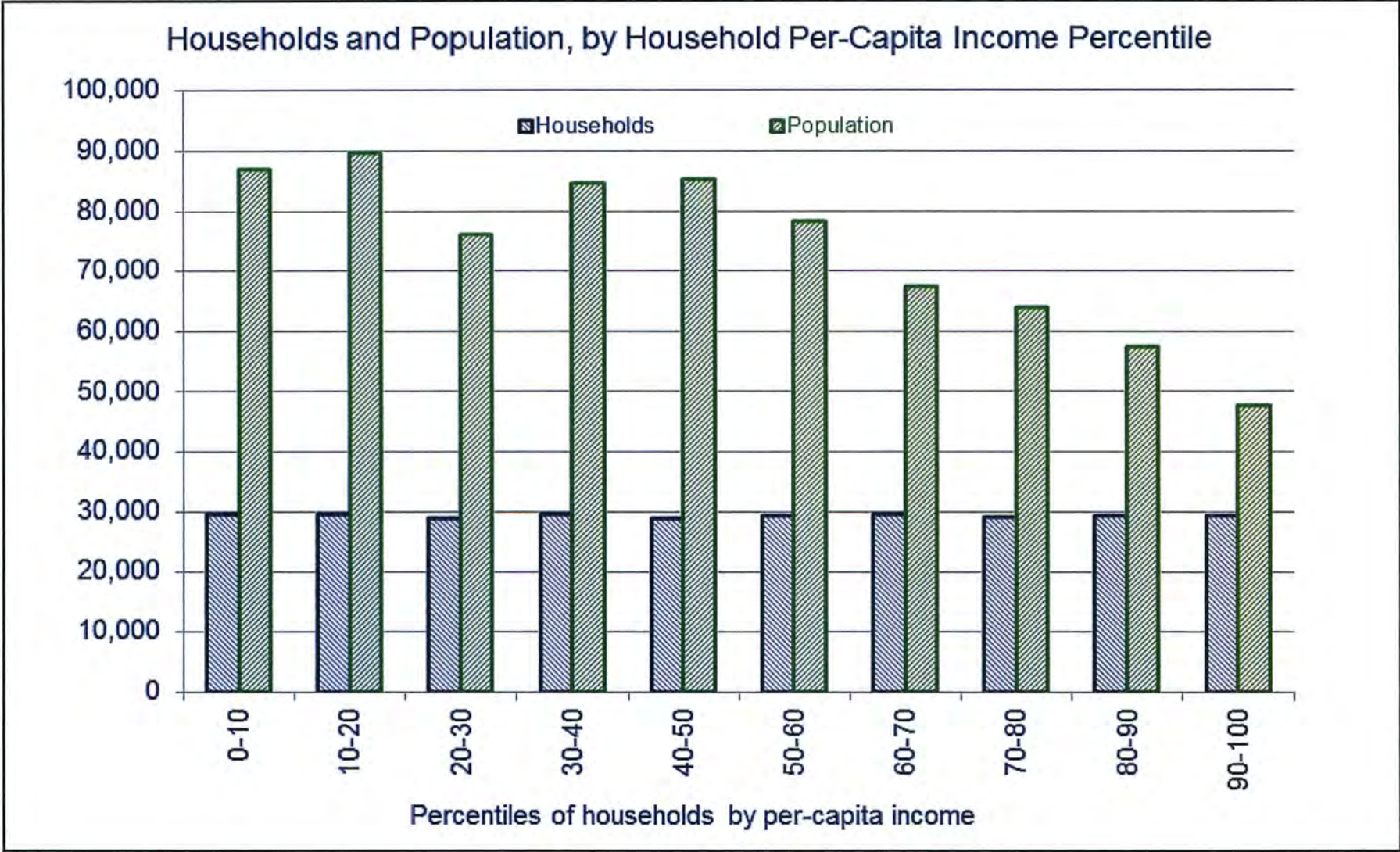
They would *all* take significant amounts of money out of the economy.

But they would do so in different ways, with different impacts on different Alaskans and different relative impacts on public and private income & jobs.

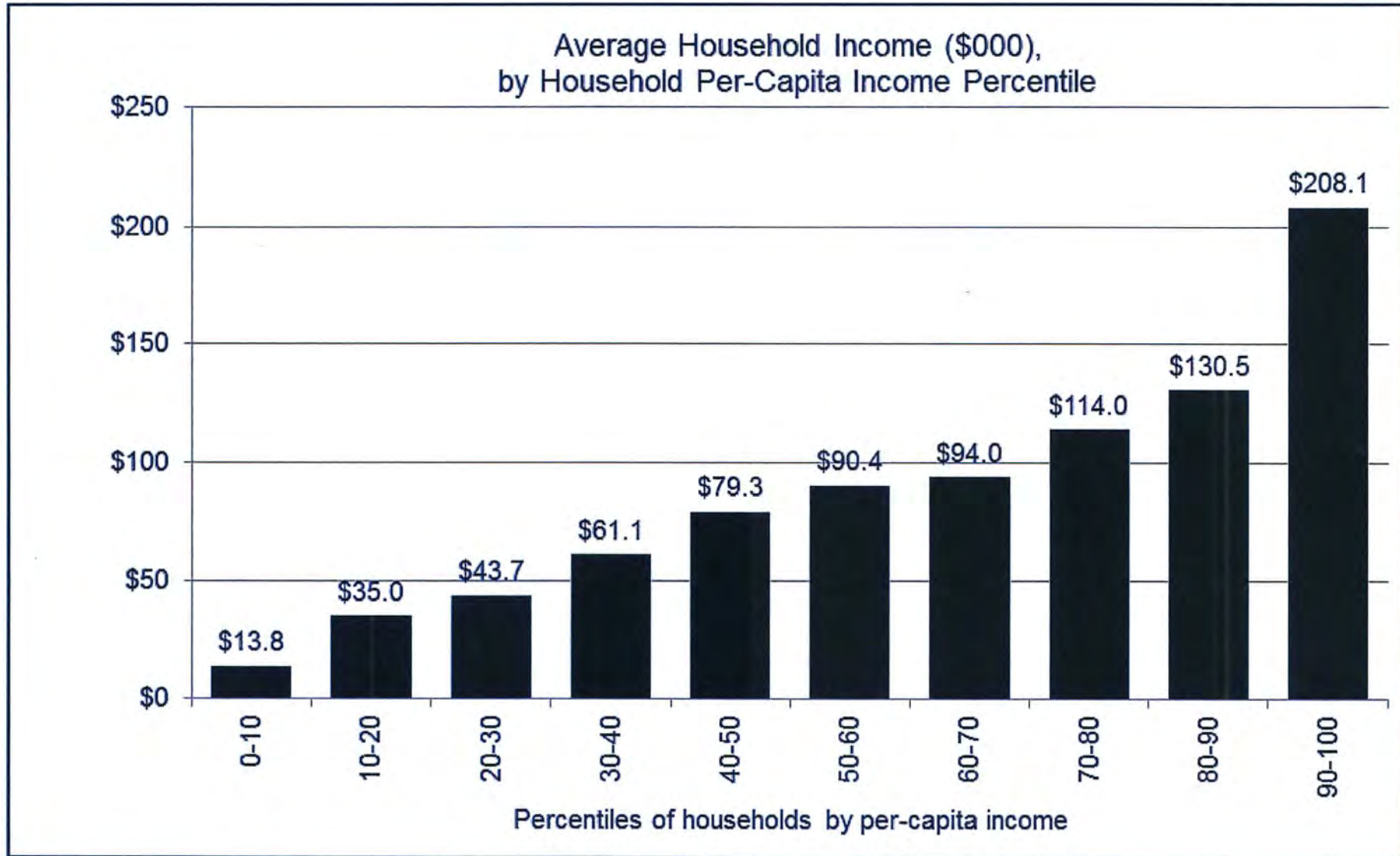
### Alaska Fiscal Options: Who Would Pay?



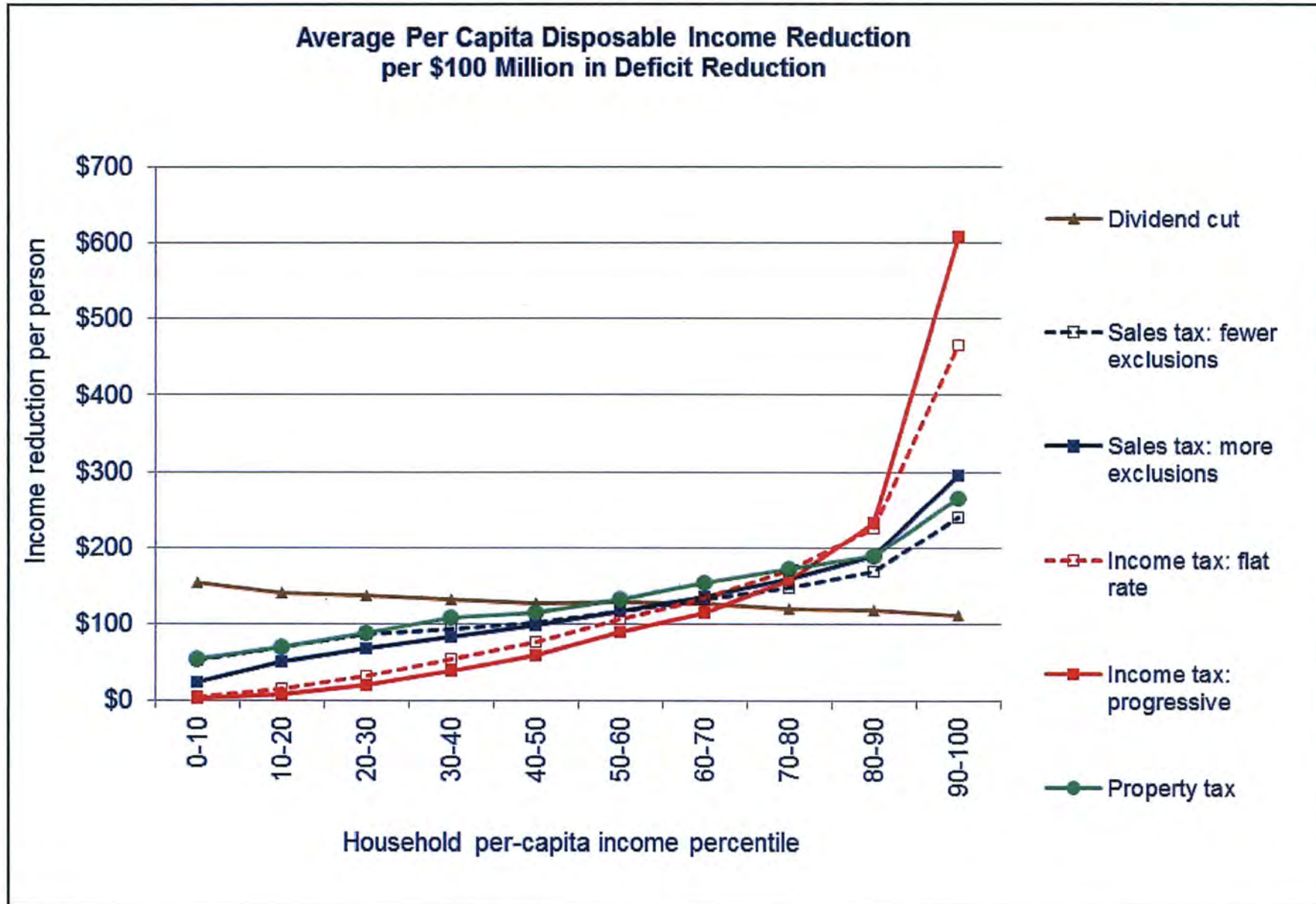
We estimated effects of taxes and dividend cuts for 10 groups of Alaska households, grouped by their per-capita cash income in 2013, from the lowest 10% to the highest 10%



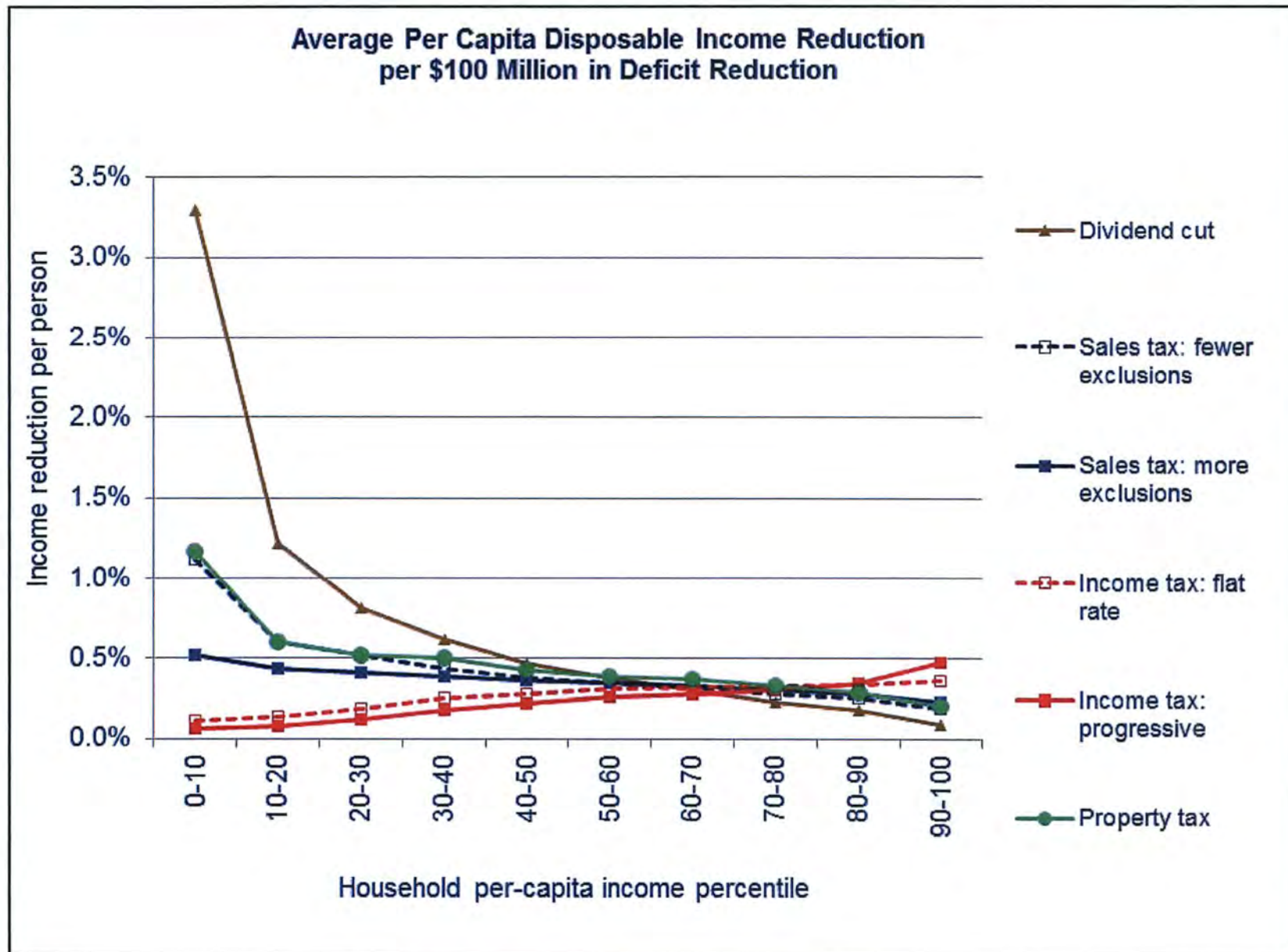
The three lowest-income groups had average household incomes of less than \$45,000. The highest-income group had an average household income of more than \$200,000.



## How options affect different groups: income reduction per person



## How options affect different groups: percentage income reduction per person



Short-run economic impacts of **spending cuts** depend on what is cut

What is cut affects the extent to which the cuts directly affect jobs and income of government and contractor workers and the resulting multiplier effects on the economy.

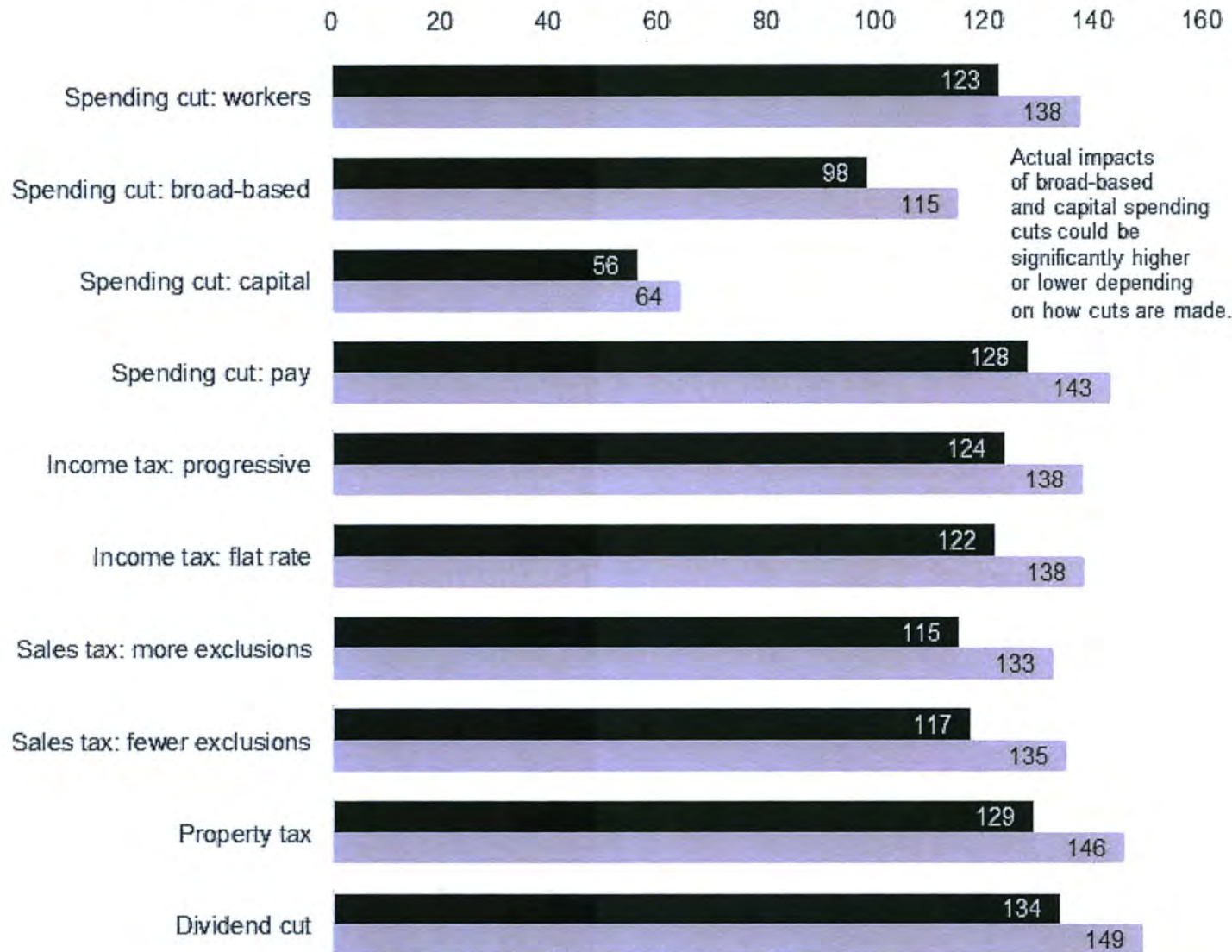
What is cut also affects the extent to which the cuts have other short-run impacts on the economy, such as:

- Transportation (Marine Highway service, road plowing, etc.)
- Resource management (fish catches, mine permitting)

*You can't generalize about economic impacts of spending cuts.  
Our estimates illustrate a range of potential impacts.*

# Income impacts

Estimated Income Impacts per \$100 Million of Deficit Reduction (\$ millions)



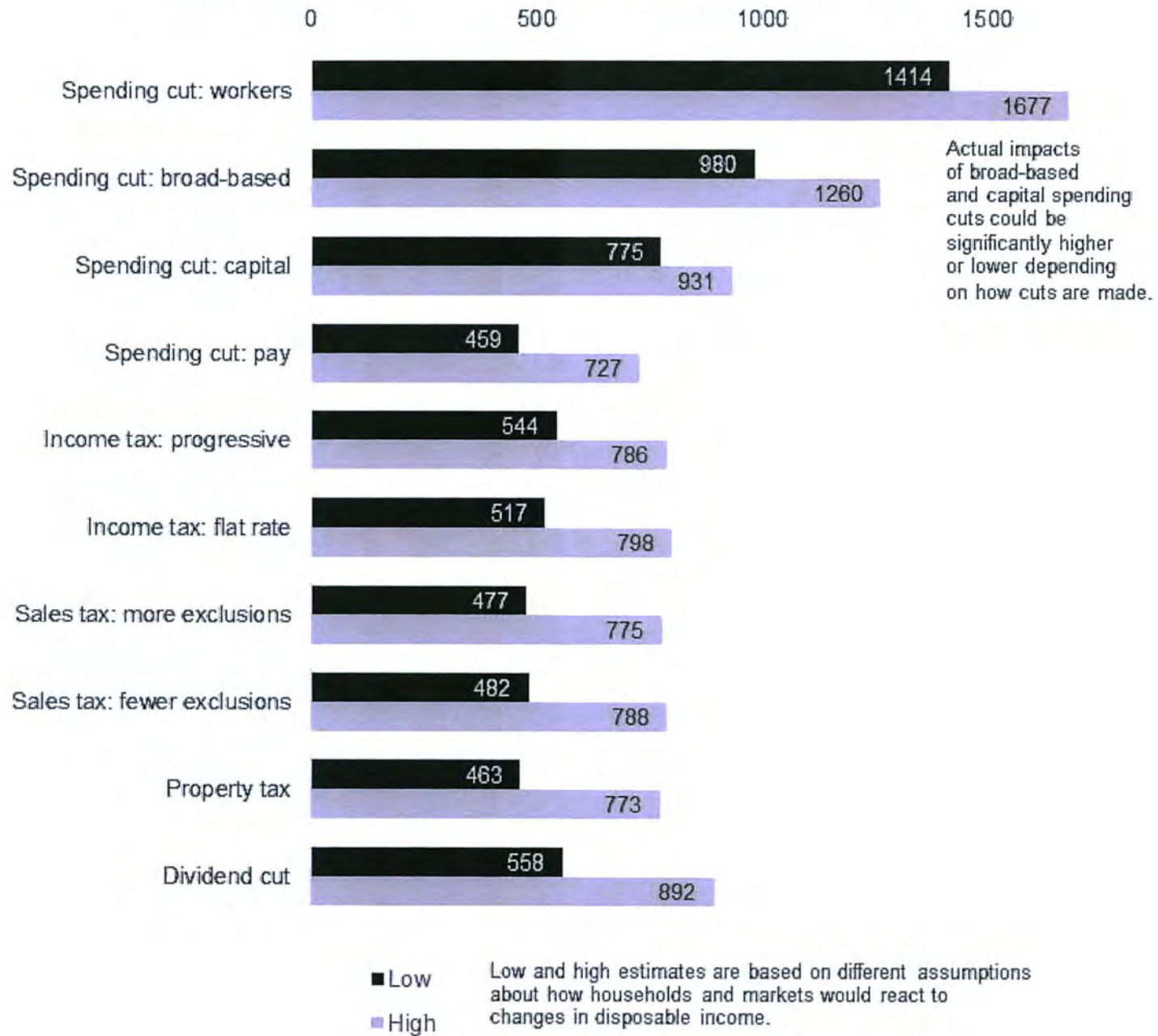
Actual impacts of broad-based and capital spending cuts could be significantly higher or lower depending on how cuts are made.

- Low
- High

Low and high estimates are based on different assumptions about how households and markets would react to changes in disposable income.

# Job impacts

Estimated Job Impacts per \$100 Million of Deficit Reduction (FTE jobs)



**Summary of Fiscal Options & Estimated Impacts per \$100 Million of Deficit Reduction**

Fiscal Option	Direct economic impacts	Who would be most affected	Short-run income impacts (\$ millions)	Short-run job impacts (FTE jobs)
Spending cut: workers	Reduce gov't jobs & pay	Gov't workers	122 - 138	1414 - 1677
Spending cut: broad-based	Reduce gov't jobs & pay Reduce other gov't purchases	Gov't workers Gov't contractors & workers	98 - 115	980 - 1260
Spending cut: capital	Reduce gov't capital spending	Construct. ind. & workers	56 - 64	775 - 931
Spending cut: pay	Reduce gov't employee pay	Gov't workers	127 - 143	459 - 727
Income tax: progressive	Reduce Alaskans disposable income	Higher income Alaskans	124 - 138	544 - 786
Income tax: flat rate			122 - 138	517 - 798
Sales tax: more exclusions		Medium & lower income Alaskans	116 - 133	477 - 775
Sales tax: fewer exclusions			117 - 134	482 - 788
Property tax			114 - 132	463 - 773
Dividend cut	Reduce Alaskans' income	Lower income Alaskans	130 - 149	558 - 892
Saving less	No short-term impacts	Future Alaskans		

Note: The numbers shown for income and job impacts represent low and high estimates of impacts based on different assumptions about how households and markets would react to changes in disposable income.

The Permanent Fund “re-plumbing” proposals would reduce the deficit through a combination of **cutting dividends** and **saving less**.

**Summary of Fiscal Options & Estimated Impacts per \$100 Million of Deficit Reduction**

Fiscal Option	Direct economic impacts	Who would be most affected	Short-run income impacts (\$ millions)	Short-run job impacts (FTE jobs)
Spending cut: workers	Reduce gov't jobs & pay	Gov't workers	122 - 138	1414 - 1677
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Saving less	No short-term impacts	Future Alaskans		

Note: The numbers shown for income and job impacts represent low and high estimates of impacts based on different assumptions about how households and markets would react to changes in disposable income.

**Examples of Ranges of Estimated Economic Impacts Per \$100 Million of Deficit Reduction  
Resulting from Selected Potential Combinations of Fiscal Options**

Examples of potential combinations of options	Option	Two options						Three options				Four options
	Spending cut: workers											
Spending cut: broad-based	50%	50%		50%			33%	33%	33%			25%
Spending cut: capital												
Spending cut: pay												
Income tax: progressive	50%		50%			50%	33%		33%	33%		25%
Income tax: flat rate												
Sales tax: more exclusions												
Sales tax: fewer exclusions												
Property tax												
Dividend cut		50%	50%		50%		33%	33%		33%		25%
Saving less				50%	50%	50%		33%	33%	33%		25%

Range of estimated impacts	<b>Total income impact (millions of \$ of income)</b>											
	Low scenario	111	114	127	49	65	62	117	76	74	85	88
	High scenario	127	132	143	58	74	69	134	88	84	96	101
	<b>Total jobs impact (FTE jobs in Alaska)</b>											
	Low scenario	762	769	551	490	279	272	694	513	508	367	521
High scenario	1023	1076	839	630	446	393	980	717	682	560	735	

# Estimated income and job impacts of reducing the deficit by different amounts using different options

**Estimated Impacts of Reducing the Deficit by Selected Total Amounts Using Different Potential Combinations of Fiscal Options**

		Two options						Three options				Four options
Combinations of fiscal options	Spending cut: broad-based	50%	50%		50%			33%	33%	33%		25%
	Income tax: progressive	50%		50%			50%	33%		33%	33%	25%
	Dividend cut		50%	50%	0%	50%		33%	33%		33%	25%
	Saving less				50%	50%	50%		33%	33%	33%	25%
Estimated impacts of reducing deficit by \$100 million	Income: Low scenario	111	114	127	49	65	62	117	76	74	85	88
	Income: High scenario	127	132	143	58	74	69	134	88	84	96	101
	Jobs: Low scenario	762	769	551	490	279	272	694	513	508	367	521
	Jobs: High scenario	1,023	1,076	839	630	446	393	980	717	682	560	735
Estimated impacts of reducing deficit by \$500 million	Income: Low scenario	554	570	635	244	326	310	586	380	369	424	440
	Income: High scenario	633	660	717	288	372	345	670	440	422	478	503
	Jobs: Low scenario	3,812	3,845	2,754	2,451	1,394	1,361	3,470	2,563	2,541	1,836	2,603
	Jobs: High scenario	5,116	5,380	4,196	3,150	2,230	1,966	4,898	3,587	3,411	2,798	3,673
Estimated impacts of reducing deficit by \$1.0 billion	Income: Low scenario	1,108	1,139	1,271	488	651	620	1,173	759	739	847	879
	Income: High scenario	1,265	1,320	1,434	576	745	690	1,340	880	844	956	1,005
	Jobs: Low scenario	7,623	7,690	5,509	4,902	2,788	2,721	6,940	5,126	5,082	3,673	5,205
	Jobs: High scenario	10,232	10,761	8,393	6,300	4,461	3,932	9,795	7,174	6,821	5,595	7,346
Estimated impacts of reducing deficit by \$1.5 billion	Income: Low scenario	1,662	1,709	1,906	732	977	930	1,759	1,139	1,108	1,271	1,319
	Income: High scenario	1,898	1,981	2,152	864	1,117	1,035	2,010	1,320	1,265	1,434	1,508
	Jobs: Low scenario	11,435	11,534	8,263	7,353	4,182	4,082	10,411	7,690	7,623	5,509	7,808
	Jobs: High scenario	15,348	16,141	12,589	9,450	6,691	5,898	14,693	10,761	10,232	8,393	11,019
Estimated impacts of reducing deficit by \$2.0 billion	Income: Low scenario	2,216	2,278	2,542	976	1,302	1,240	2,345	1,519	1,477	1,695	1,759
	Income: High scenario	2,531	2,641	2,869	1,152	1,489	1,379	2,680	1,761	1,687	1,913	2,010
	Jobs: Low scenario	15,246	15,379	11,018	9,804	5,575	5,442	13,881	10,253	10,164	7,345	10,411
	Jobs: High scenario	20,464	21,521	16,785	12,600	8,921	7,864	19,590	14,348	13,643	11,190	14,693
Estimated impacts of reducing deficit by \$2.5 billion	Income: Low scenario							2,932	1,898	1,846	2,118	2,199
	Income: High scenario							3,350	2,201	2,109	2,391	2,513
	Jobs: Low scenario							17,351	12,816	12,705	9,181	13,013
	Jobs: High scenario							24,488	17,934	17,053	13,988	18,366
Estimated impacts of reducing deficit by \$3.0 billion	Income: Low scenario							3,518	2,278	2,216	2,542	2,638
	Income: High scenario							4,020	2,641	2,531	2,869	3,015
	Jobs: Low scenario							20,821	15,379	15,246	11,018	15,616
	Jobs: High scenario							29,385	21,521	20,464	16,785	22,039

Note: Units for income impacts are millions of dollars. Units for job impacts are FTE jobs. Table omits combination of options and total deficit reduction which would require reductions of more than \$1 billion from any single option. Table calculated by extrapolating from the estimated impacts of reducing the deficit by \$100 million shown in Table III-7.

How big is Alaska's economy?

### Selected Estimates of Alaska Income and Employment, 2014

Income (\$ millions)	Personal income	39,793
	Earnings by place of work	30,059
	Wages and salaries	20,683
Employment (jobs)	Total full-time and part-time employment	465,130
	Wage and salary jobs	367,291
	Other jobs	97,839

Source: Bureau of Economic Analysis, SA30 Economic Profile (updated September 30, 2015), [www.bea.gov](http://www.bea.gov).

## Estimated percentage income impacts of reducing the deficit by different amounts using different options

**Estimated Income Impacts of Reducing the Deficit by Selected Total Amounts Using Different Potential Combinations of Fiscal Options, Expressed as a Share of Estimated Total Alaska Personal Income in 2014 (\$39.8 billion)**

		Two options						Three options				Four options
Combinations of fiscal options	Spending cut: broad-based	50%	50%		50%			33%	33%	33%		25%
	Income tax: progressive	50%		50%			50%	33%		33%	33%	25%
	Dividend cut		50%	50%		50%		33%	33%		33%	25%
	Saving less				50%	50%	50%		33%	33%	33%	25%
\$100 million	Income: Low scenario	0.3%	0.3%	0.3%	0.1%	0.2%	0.2%	0.3%	0.2%	0.2%	0.2%	0.2%
	Income: High scenario	0.3%	0.3%	0.4%	0.1%	0.2%	0.2%	0.3%	0.2%	0.2%	0.2%	0.3%
\$500 million	Income: Low scenario	1.4%	1.4%	1.6%	0.6%	0.8%	0.8%	1.5%	1.0%	0.9%	1.1%	1.1%
	Income: High scenario	1.6%	1.7%	1.8%	0.7%	0.9%	0.9%	1.7%	1.1%	1.1%	1.2%	1.3%
\$1.0 billion	Income: Low scenario	2.8%	2.9%	3.2%	1.2%	1.6%	1.6%	2.9%	1.9%	1.9%	2.1%	2.2%
	Income: High scenario	3.2%	3.3%	3.6%	1.4%	1.9%	1.7%	3.4%	2.2%	2.1%	2.4%	2.5%
\$1.5 billion	Income: Low scenario	4.2%	4.3%	4.8%	1.8%	2.5%	2.3%	4.4%	2.9%	2.8%	3.2%	3.3%
	Income: High scenario	4.8%	5.0%	5.4%	2.2%	2.8%	2.6%	5.1%	3.3%	3.2%	3.6%	3.8%
\$2.0 billion	Income: Low scenario	5.6%	5.7%	6.4%	2.5%	3.3%	3.1%	5.9%	3.8%	3.7%	4.3%	4.4%
	Income: High scenario	6.4%	6.6%	7.2%	2.9%	3.7%	3.5%	6.7%	4.4%	4.2%	4.8%	5.1%
\$2.5 billion	Income: Low scenario							7.4%	4.8%	4.6%	5.3%	5.5%
	Income: High scenario							8.4%	5.5%	5.3%	6.0%	6.3%
\$3.0 billion	Income: Low scenario							8.8%	5.7%	5.6%	6.4%	6.6%
	Income: High scenario							10.1%	6.6%	6.4%	7.2%	7.6%

Note: Table omits combination of options and total deficit reduction which would require reductions of more than \$1 billion from any single option.

## Estimated percentage job impacts of reducing the deficit by different amounts using different options

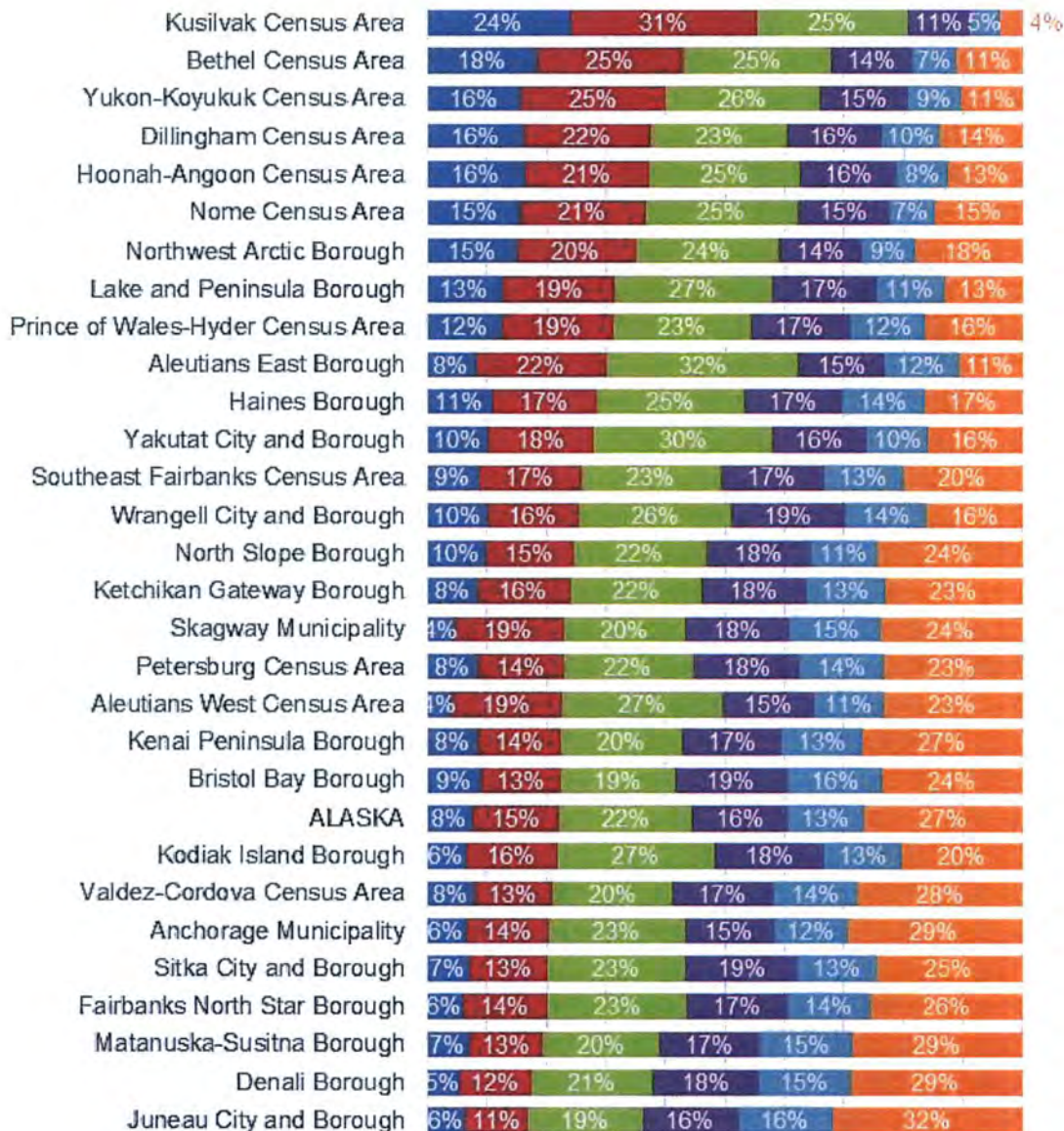
**Estimated Job Impacts of Reducing the Deficit by Selected Total Amounts Using Different Combinations of Fiscal Options, Expressed as a Share of Estimated Total Alaska Full-Time and Part-Time Employment in 2014 (465,000 jobs)**

		Two options						Three options				Four options
Combinations of fiscal options	Spending cut: broad-based	50%	50%		50%			33%	33%	33%		25%
	Income tax: progressive	50%		50%			50%	33%	0%	33%	33%	25%
	Dividend cut		50%	50%		50%		33%	33%		33%	25%
	Saving less				50%	50%	50%		33%	33%	33%	25%
\$100 million	Jobs: Low scenario	0.2%	0.2%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%
	Jobs: High scenario	0.2%	0.2%	0.2%	0.1%	0.1%	0.1%	0.2%	0.2%	0.1%	0.1%	0.2%
\$500 million	Jobs: Low scenario	0.8%	0.8%	0.6%	0.5%	0.3%	0.3%	0.7%	0.6%	0.5%	0.4%	0.6%
	Jobs: High scenario	1.1%	1.2%	0.9%	0.7%	0.5%	0.4%	1.1%	0.8%	0.7%	0.6%	0.8%
\$1.0 billion	Jobs: Low scenario	1.6%	1.7%	1.2%	1.1%	0.6%	0.6%	1.5%	1.1%	1.1%	0.8%	1.1%
	Jobs: High scenario	2.2%	2.3%	1.8%	1.4%	1.0%	0.8%	2.1%	1.5%	1.5%	1.2%	1.6%
\$1.5 billion	Jobs: Low scenario	2.5%	2.5%	1.8%	1.6%	0.9%	0.9%	2.2%	1.7%	1.6%	1.2%	1.7%
	Jobs: High scenario	3.3%	3.5%	2.7%	2.0%	1.4%	1.3%	3.2%	2.3%	2.2%	1.8%	2.4%
\$2.0 billion	Jobs: Low scenario	3.3%	3.3%	2.4%	2.1%	1.2%	1.2%	3.0%	2.2%	2.2%	1.6%	2.2%
	Jobs: High scenario	4.4%	4.6%	3.6%	2.7%	1.9%	1.7%	4.2%	3.1%	2.9%	2.4%	3.2%
\$2.5 billion	Jobs: Low scenario							3.7%	2.8%	2.7%	2.0%	2.8%
	Jobs: High scenario							5.3%	3.9%	3.7%	3.0%	3.9%
\$3.0 billion	Jobs: Low scenario							4.5%	3.3%	3.3%	2.4%	3.4%
	Jobs: High scenario							6.3%	4.6%	4.4%	3.6%	4.7%

Note: Table omits combination of options and total deficit reduction which would require reductions of more than \$1 billion from any single option.

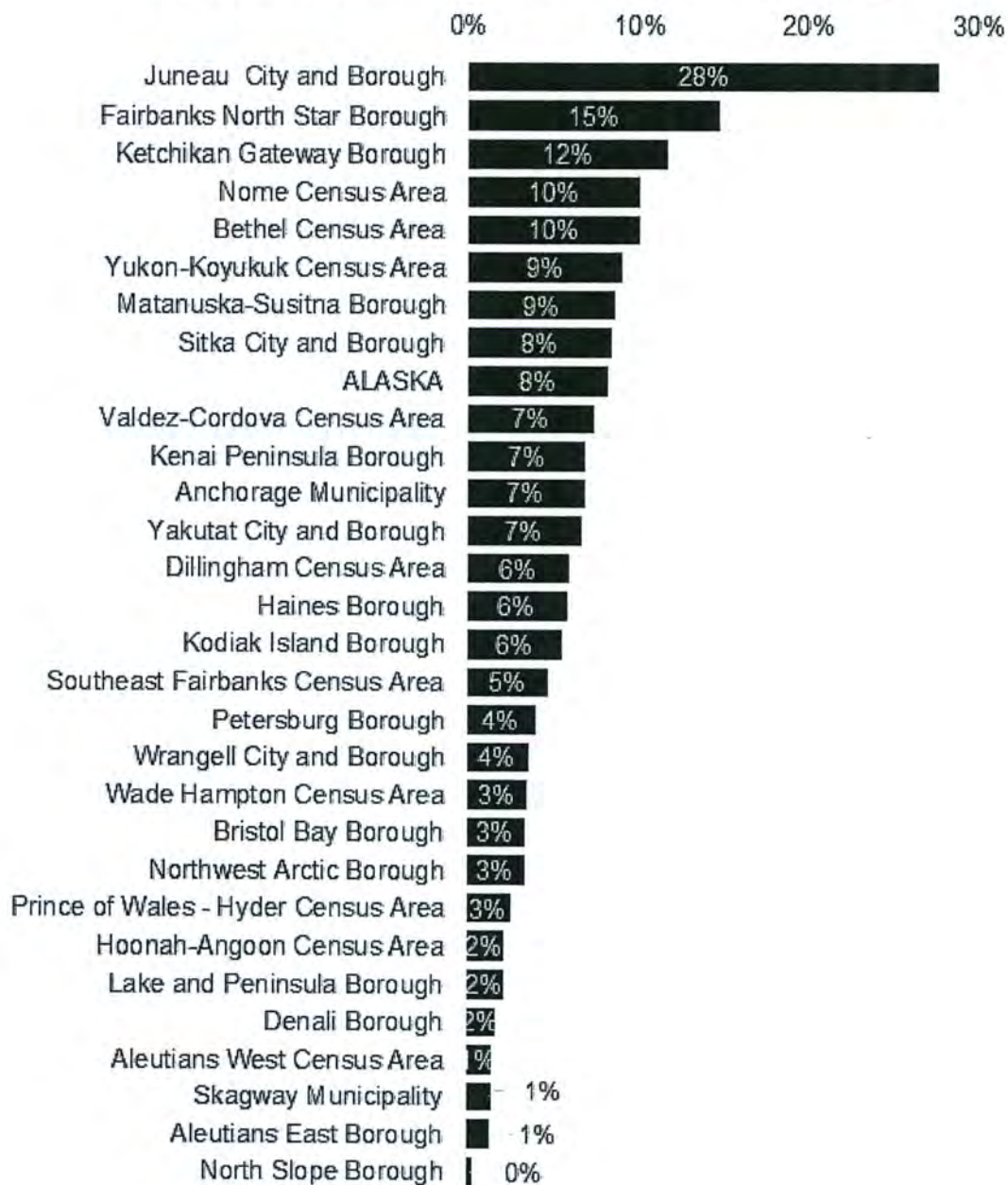
Share of Total 2013 Federal Income Tax Exemptions,  
by Adjusted Gross Income Group and Alaska Census Area

■ < \$10K ■ \$10-\$25K ■ \$25-\$50K ■ \$50-\$75K ■ \$75-\$100K ■ >\$100K



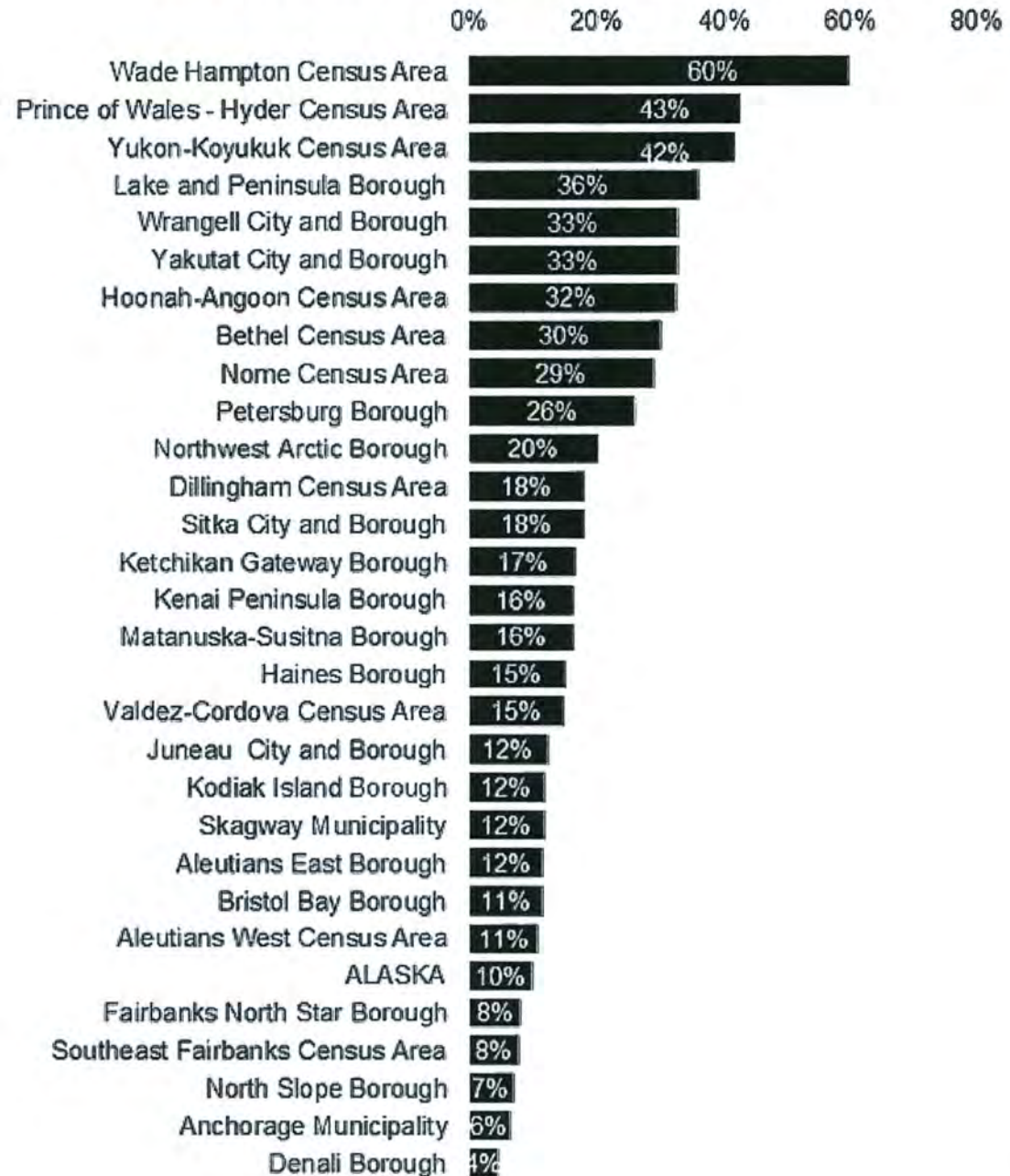
Income distribution  
varies for different  
regions of Alaska

### Share of State Government Jobs in Wage & Salary Earnings



Regional economic impacts of state spending cuts would depend on how important state government jobs and income are in the regional economy. Some regions are much more dependent than others.

### Share of Local Government Jobs in Wage & Salary Earnings



Regional economic impacts of cuts to revenue sharing, K-12 education, and other ways that state spending helps fund local government would depend on how important local government jobs are in the regional economy. Some regions are much more dependent than others.

# Economic implications of how fast we reduce the deficit

We have lost billions of dollars of oil revenues.

We will experience significant economic impacts of adjusting to lower oil revenues.

- Impacts of spending cuts we've already made:
  - Impacts of capital budget cuts on construction industry
  - Delayed because capital projects take several years
  - Actual capital spending will decline as money from past large capital budgets runs out
  
- Impacts of future adjustments we will have to make
  - Spending cuts
  - Taxes
  - Dividend cuts
  
- It's not a question of whether we will face these impacts.
  - It's only a question of when.

Alaskans are justifiably concerned about the impacts of deficit reduction on an already weakened economy

- We are already experiencing the impacts of:
  - Oil industry job losses
  - Past state capital budget reductions
  - State government job losses
  - Mining industry downturn
  - Low salmon prices
- These impacts would be increased by large:
  - Spending cuts
  - New taxes
  - Dividend cuts

We can reduce the direct short-run economic impacts of reducing the deficit by continuing to draw down our savings.

**BUT**

Continued large deficits and draws from our savings would also have significant negative economic impacts.

*Negative economic impacts of continued large deficits . . .*

Certain downgrading of Alaska's credit rating  
and increases in our future borrowing costs



## **S&P downgrades Alaska's debt rating**

**Dated:** January 5, 2016 - 1:04pm

Standard & Poor's also said it expects Alaska's credit rating to continue its fall if the Alaska Legislature does not "enact significant fiscal reforms to reduce the state's fiscal imbalance" during the upcoming 2016 session.

**Alaska** Dispatch News

Tuesday, March 1, 2016

***Moody's docks state's credit rating;  
Fitch issues stern warning***

*Negative economic impacts of continued large deficits . . .*

Loss of future investment income

<b>Deficit and resulting drawdown in investment assets</b>	<b>Permanent annual loss of future investment earnings @ 5% rate of return</b>
\$1 billion	\$50 million
\$2 billion	\$100 million
\$3 billion	\$150 million
\$4 billion	\$200 million

*Negative economic impacts of continued large deficits . . .*

Potential future insufficiency of cash in Permanent Fund earnings reserve to cover otherwise sustainable payouts of Permanent Fund investment earnings in low-earnings years.

*Negative economic impacts of continued large deficits . . .*

Lack of time for new taxes to begin to bring  
in revenues before we really need the money.

*Negative economic impacts of continued large deficits . . .*

Continued and growing

# UNCERTAINTY

about

Alaska's fiscal and economic future

among

Alaskans

Alaska businesses

Resource industries

Public and private employees

## Economic implications of uncertainty

Alaska businesses postpone investment  
Alaskans postpone spending and investment  
Young Alaskans leave  
The best employees leave  
Resource industries invest elsewhere

People focus on the negative impacts of what is coming  
rather than on moving forward

We face a tradeoff between the  
short-run negative economic impacts of reducing the deficit  
and the  
significant short-run and longer-run economic impacts  
of not reducing the deficit.

How can we minimize the economic impacts of adjusting to permanently lower oil revenues?

- Probably not by fully closing the deficit this year.
- Certainly not by running another huge deficit this year.

We will have a smoother economic transition to the reality of lower oil revenues if we

- Significantly reduce the deficit this year
- Make real choices about how we will reduce the rest
  - Even if we implement them over several years
- Reduce uncertainty and build confidence about our economic future

If the fall in our oil revenues was temporary  
then it would make sense to run deficits  
to help support the economy.

But the fall in our oil revenues is not temporary.

We can't indefinitely support the economy by running deficits.

Not paying for what we spend this year  
means that our children will pay  
for what we spend this year.

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# Transfers to principal

as of June 30, 2015

Deposit type	Total
Mineral royalties	\$15.9 billion
Transfers from General Fund	\$2.7 billion
Lawsuit settlement proceeds	\$169 million
Inflation proofing transfer	\$16.2 billion
Transfers from Earnings Reserve	\$4.2 billion



# The Alaska Constitution

## Article IX, Section 15 Alaska Permanent Fund

### Section 15. Alaska Permanent Fund

At least twenty-five percent of all mineral lease rentals, royalties, royalty sale proceeds, federal mineral revenue sharing payments and bonuses received by the State shall be placed in a permanent fund, the principal of which shall be used only for those income-producing investments specifically designated by law as eligible for permanent fund investments. All income from the permanent fund shall be deposited in the general fund unless otherwise provided by law [Effective February 21, 1977].



# Statutory findings

## Section 37.13.020. Findings.

The people of the state, by constitutional amendment, have required the placement of at least 25 percent of all mineral lease rentals, royalties, royalty sale proceeds, and federal mineral revenue sharing payments and bonuses received by the state into a permanent fund. The legislature finds with respect to the fund that

- (1) the fund should provide a means of conserving a portion of the state's revenue from mineral resources to benefit all generations of Alaskans;
- (2) the fund's goal should be to maintain safety of principal while maximizing total return;
- (3) the fund should be used as a savings device managed to allow the maximum use of disposable income from the fund for purposes designated by law.



# Investment Authority

## AS 37.13.120 “Prudent Investor Rule”

- Exercise judgment and care of similar institutional investors,
- while considering preservation of the purchasing power of the fund over time, and
- while maximizing the expected total return from both income and the appreciation of capital.



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**22**



**Alaska Permanent Fund Corporation**

P. O. Box 115500 Juneau, AK 99801  
Tel: (907) 796-1500 Fax: (907) 586-2057

February 24, 2016

Senator Anna MacKinnon  
Alaska State Capitol Room 516

Dear Senator MacKinnon,

On February 19<sup>th</sup> at a special meeting of the Corporation's Board of Trustees, Greg Allen from Callan Associates presented the results of his modeling of the three plans under consideration by the Legislature for use of the Permanent Fund for government operations. Following that presentation, I received a formal request from you to have Callan model the results of SB128 without the deposit of \$3 billion into the earnings reserve of the Permanent Fund from the Constitutional Budget Reserve.

My request to Callan was to remove the \$3 billion deposit and determine the maximum draw that would be possible while maintaining the current market value of the fund in real dollars.

The results of Callan's analysis is attached, as well as the underlying assumptions; however, the short answer is that under these parameters, the maximum draw would be \$2.95 billion through FY19, with optional inflation adjustments thereafter.

Please let me know if we can be of further assistance.

Sincerely,

Angela Rodell  
Executive Director

Principal	Status Quo	SB128/HB245	SB128 no CBR	SB114/HB303	HB224
<b>Deposits</b>	30% royalties	25% royalties	25% royalties	25% royalties	30% royalties
<b>Additional appropriations to Principal</b>	Change in inflation rate applied to principal balance at end of year	ER balance in excess target (target = 4 X distribution)	ER balance in excess target (target = 4 X distribution)		

Earnings Reserve	Status Quo	SB128/HB245	SB128 no CBR	SB114/HB303	HB224
<b>Income</b>	Statutory Net Income	Statutory Net Income	Statutory Net Income	Statutory Net Income	Statutory Net Income
<b>Deposits</b>		\$3b from CBR in FY17, 74.5% royalties, 100% production taxes	74.5% royalties, 100% production taxes		
<b>FY 2016 Dividend Distribution</b>	Status Quo	Amount necessary to pay \$1,000 dividend	Amount necessary to pay \$1,000 dividend	Paid from distribution to government fund	Status Quo
<b>Distributions</b>	Half of 21% of five-year total statutory net income	\$3.3b through FY19, optional inflation adjustment thereafter, plus 50% of royalties	\$2.95b through FY19, optional inflation adjustment thereafter, plus 50% of royalties	5% of lagged five-year average market value	4.5% of lagged five-year average market value
<b>Limitation on Total Distribution</b>	Earnings Reserve Balance	Earnings Reserve Balance	Earnings Reserve Balance	Earnings Reserve Balance	Earnings Reserve Balance
<b>Timing of Draw</b>	End of July	Throughout year	Throughout year	Throughout year	Throughout year (simplifying assumption)

Annual Net Flow	Status Quo	SB128/HB245	SB128 no CBR	SB114/HB303	HB224
2016	(\$1,085,421)	(\$1,085,421)	(\$1,085,421)	(\$1,085,421)	(\$1,085,421)
2017	(\$993,470)	\$320,311	(\$2,330,831)	(\$2,021,250)	(\$3,057,753)
2018	(\$987,701)	(\$2,365,878)	(\$2,017,020)	(\$2,101,211)	(\$1,788,596)
2019	(\$881,338)	(\$2,312,113)	(\$1,963,255)	(\$2,174,939)	(\$1,840,157)
2020	(\$785,906)	(\$2,479,395)	(\$2,122,688)	(\$2,250,502)	(\$1,906,316)
2021	(\$769,829)	(\$2,497,228)	(\$2,132,494)	(\$2,260,987)	(\$1,912,331)
2022	(\$942,269)	(\$2,657,545)	(\$2,284,605)	(\$2,288,950)	(\$1,942,918)
2023	(\$1,129,630)	(\$2,799,275)	(\$2,417,944)	(\$2,352,541)	(\$2,021,346)
2024	(\$1,311,849)	(\$2,897,989)	(\$2,508,078)	(\$2,440,300)	(\$2,119,682)
2025	(\$1,494,989)	(\$3,003,193)	(\$2,604,509)	(\$2,533,627)	(\$2,223,884)
<b>5-Year Total</b>	(\$4,733,836)	(\$7,922,497)	(\$9,519,215)	(\$9,633,323)	(\$9,678,244)
<b>10-Year Total</b>	(\$10,382,402)	(\$21,777,727)	(\$21,466,845)	(\$21,509,728)	(\$19,898,405)

Annual In-Flow	Status Quo	SB128/HB245	SB128 no CBR	SB114/HB303	HB224
2016	\$287,681	\$287,681	\$287,681	\$287,681	\$287,681
2017	\$326,878	\$4,271,962	\$1,271,962	\$272,399	\$326,878
2018	\$362,445	\$1,478,919	\$1,478,919	\$302,037	\$362,445
2019	\$390,649	\$1,591,961	\$1,591,961	\$325,541	\$390,649
2020	\$376,986	\$1,545,936	\$1,545,936	\$314,155	\$376,986
2021	\$380,751	\$1,581,253	\$1,581,253	\$317,292	\$380,751
2022	\$361,130	\$1,504,839	\$1,504,839	\$300,942	\$361,130
2023	\$338,612	\$1,409,783	\$1,409,783	\$282,176	\$338,612
2024	\$320,244	\$1,354,701	\$1,354,701	\$266,870	\$320,244
2025	\$301,859	\$1,301,872	\$1,301,872	\$251,549	\$301,859
<b>5-Year Total</b>	\$1,744,639	\$9,176,458	\$6,176,458	\$1,501,812	\$1,744,639
<b>10-Year Total</b>	\$3,447,235	\$16,328,906	\$13,328,906	\$2,920,643	\$3,447,235

Annual Out-Flow	Status Quo	SB128/HB245	SB128 no CBR	SB114/HB303	HB224
2016	(\$1,373,102)	(\$1,373,102)	(\$1,373,102)	(\$1,373,102)	(\$1,373,102)
2017	(\$1,320,348)	(\$3,951,651)	(\$3,602,793)	(\$2,293,649)	(\$3,384,632)
2018	(\$1,350,146)	(\$3,844,797)	(\$3,495,939)	(\$2,403,248)	(\$2,151,040)
2019	(\$1,271,987)	(\$3,904,074)	(\$3,555,216)	(\$2,500,479)	(\$2,230,806)
2020	(\$1,162,892)	(\$4,025,331)	(\$3,668,624)	(\$2,564,657)	(\$2,283,303)
2021	(\$1,150,580)	(\$4,078,481)	(\$3,713,748)	(\$2,578,279)	(\$2,293,082)
2022	(\$1,303,399)	(\$4,162,384)	(\$3,789,444)	(\$2,589,892)	(\$2,304,049)
2023	(\$1,468,242)	(\$4,209,059)	(\$3,827,728)	(\$2,634,717)	(\$2,359,957)
2024	(\$1,632,093)	(\$4,252,689)	(\$3,862,778)	(\$2,707,171)	(\$2,439,926)
2025	(\$1,796,848)	(\$4,305,064)	(\$3,906,380)	(\$2,785,176)	(\$2,525,743)
<b>5-Year Total</b>	(\$6,478,475)	(\$17,098,956)	(\$15,695,673)	(\$11,135,135)	(\$11,422,883)
<b>10-Year Total</b>	(\$13,829,637)	(\$38,106,633)	(\$34,795,751)	(\$24,430,371)	(\$23,345,640)

Ending Market Value	Status Quo	SB128/HB245	SB128 no CBR	SB114/HB303	HB224
2016	\$49,779,818	\$50,448,515	\$50,448,515	\$51,100,166	\$49,779,818
2017	\$52,058,624	\$50,936,833	\$48,526,348	\$50,056,176	\$49,196,952
2018	\$54,681,107	\$52,085,079	\$49,852,812	\$51,271,142	\$50,686,290
2019	\$57,685,700	\$53,450,183	\$51,405,136	\$52,575,910	\$52,300,295
2020	\$60,951,504	\$54,789,750	\$52,958,520	\$53,985,825	\$54,043,067
2021	\$64,344,989	\$56,223,415	\$54,627,234	\$55,582,687	\$55,991,880
2022	\$67,835,357	\$57,670,650	\$56,333,097	\$57,301,502	\$58,081,360
2023	\$71,421,810	\$59,108,139	\$58,055,176	\$59,071,674	\$60,221,525
2024	\$75,109,444	\$60,562,150	\$59,822,184	\$60,874,040	\$62,413,976
2025	\$78,899,520	\$62,029,731	\$61,633,699	\$62,724,663	\$64,671,927

Real Ending Market Value <sup>1</sup>	Status Quo	SB128/HB245	SB128 no CBR	SB114/HB303	HB224
2016	\$48,684,419	\$49,338,401	\$49,338,401	\$49,975,712	\$48,684,419
2017	\$49,792,743	\$48,719,778	\$46,414,211	\$47,877,452	\$47,054,671
2018	\$51,150,202	\$48,721,806	\$46,633,683	\$47,960,427	\$47,413,340
2019	\$52,773,379	\$48,898,545	\$47,027,647	\$48,098,722	\$47,846,577
2020	\$54,534,061	\$49,021,064	\$47,382,640	\$48,301,783	\$48,352,997
2021	\$56,303,427	\$49,196,853	\$47,800,156	\$48,636,200	\$48,994,254
2022	\$58,051,427	\$49,352,781	\$48,208,144	\$49,036,875	\$49,704,254
2023	\$59,775,651	\$49,469,868	\$48,588,603	\$49,439,349	\$50,401,704
2024	\$61,478,703	\$49,571,428	\$48,965,751	\$49,826,717	\$51,087,188
2025	\$63,159,865	\$49,655,428	\$49,338,401	\$50,211,728	\$51,770,533

1. Market value adjusted to 6/30/2015 dollars using cumulative inflation.

Earnings Reserve Balance	Status Quo	SB128/HB245	SB128 no CBR	SB114/HB303	HB224
2016	\$6,959,529	\$7,675,889	\$7,675,889	\$8,372,689	\$6,959,529
2017	\$6,718,111	\$9,448,636	\$6,827,056	\$7,809,255	\$6,732,509
2018	\$6,864,085	\$9,249,035	\$6,798,347	\$7,778,167	\$6,881,606
2019	\$7,436,381	\$9,354,922	\$7,084,618	\$7,923,350	\$7,236,833
2020	\$8,333,884	\$9,631,001	\$7,563,990	\$8,271,251	\$7,823,533
2021	\$9,382,703	\$10,097,375	\$8,254,153	\$8,860,503	\$8,675,478
2022	\$10,590,569	\$10,697,490	\$9,101,251	\$9,679,641	\$9,782,573
2023	\$11,955,181	\$11,396,084	\$10,072,049	\$10,680,627	\$11,085,358
2024	\$13,469,537	\$12,201,325	\$11,177,085	\$11,824,863	\$12,552,057
2025	\$15,127,032	\$13,100,946	\$12,406,617	\$13,099,813	\$14,170,559

Additions to Reserved Principal	Status Quo	SB128/HB245	SB128 no CBR	SB114/HB303	HB224
2016	\$334,679	\$334,679	\$334,679	\$334,679	\$334,679
2017	\$1,215,619	\$272,399	\$272,399	\$272,399	\$326,878
2018	\$1,278,538	\$302,037	\$302,037	\$302,037	\$362,445
2019	\$1,335,509	\$325,541	\$325,541	\$325,541	\$390,649
2020	\$1,351,895	\$314,155	\$314,155	\$314,155	\$376,986
2021	\$1,386,078	\$317,292	\$317,292	\$317,292	\$380,751
2022	\$1,397,643	\$300,942	\$300,942	\$300,942	\$361,130
2023	\$1,406,572	\$282,176	\$282,176	\$282,176	\$338,612
2024	\$1,419,852	\$266,870	\$266,870	\$266,870	\$320,244
2025	\$1,433,414	\$251,549	\$251,549	\$251,549	\$301,859
<b>5-Year Total</b>	\$5,516,240	\$1,548,810		\$1,548,810	\$1,791,637
<b>10-Year Total</b>	\$12,559,799	\$2,967,641		\$2,967,641	\$3,494,233

Statutory Net Income	Status Quo	SB128/HB245	SB128 no CBR	SB114/HB303	HB224
2016	\$1,640,654	\$1,640,654	\$1,640,654	\$1,640,654	\$1,640,654
2017	\$1,851,846	\$1,814,501	\$1,919,375	\$1,905,251	\$1,958,885
2018	\$2,183,460	\$2,322,078	\$2,194,550	\$2,218,210	\$2,150,197
2019	\$2,491,876	\$2,602,864	\$2,465,926	\$2,502,428	\$2,433,983
2020	\$2,790,066	\$2,882,919	\$2,740,254	\$2,762,412	\$2,699,221
2021	\$3,096,080	\$3,119,814	\$2,975,318	\$2,993,061	\$2,939,617
2022	\$3,421,778	\$3,356,539	\$3,213,937	\$3,209,829	\$3,170,560
2023	\$3,743,941	\$3,570,726	\$3,433,352	\$3,418,426	\$3,398,000
2024	\$4,060,974	\$3,761,140	\$3,632,103	\$3,619,057	\$3,619,035
2025	\$4,374,378	\$3,938,838	\$3,821,099	\$3,810,449	\$3,832,926
<b>5-Year Total</b>	\$10,957,903	\$11,263,018	\$10,960,760	\$11,028,955	\$10,882,941
<b>10-Year Total</b>	\$29,655,054	\$29,010,075	\$28,036,569	\$28,079,779	\$27,843,079

Net Additions to Earnings Reserve	Status Quo	SB128/HB245	SB128 no CBR	SB114/HB303	HB224
2016	\$273,308	\$942,006	\$942,006	\$1,593,656	\$273,308
2017	(\$387,041)	\$1,969,267	(\$577,001)	(\$388,397)	(\$105,399)
2018	(\$4,620)	(\$405,114)	(\$183,784)	(\$185,039)	(\$843)
2019	\$384,124	(\$81,797)	\$130,123	\$1,949	\$203,177
2020	\$664,577	\$112,140	\$326,182	\$197,755	\$415,918
2021	\$787,354	\$299,020	\$519,257	\$414,782	\$646,535
2022	\$917,023	\$430,753	\$661,090	\$619,937	\$866,512
2023	\$1,043,888	\$526,805	\$770,762	\$783,709	\$1,038,043
2024	\$1,164,518	\$626,894	\$887,768	\$911,887	\$1,179,109
2025	\$1,279,622	\$714,738	\$995,683	\$1,025,273	\$1,307,183
<b>5-Year Total</b>	\$930,349	\$2,536,501	\$637,526	\$1,219,924	\$786,162
<b>10-Year Total</b>	\$6,122,754	\$5,134,710	\$4,472,086	\$4,975,511	\$5,823,543

Additions to Earnings Reserve	Status Quo	SB128/HB245	SB128 no CBR	SB114/HB303	HB224
2016	\$1,640,654	\$1,640,654	\$1,640,654	\$1,640,654	\$1,640,654
2017	\$1,851,846	\$5,814,065	\$2,918,938	\$1,905,251	\$1,958,885
2018	\$2,183,460	\$3,498,960	\$3,371,432	\$2,218,210	\$2,150,197
2019	\$2,491,876	\$3,869,284	\$3,732,346	\$2,502,428	\$2,433,983
2020	\$2,790,066	\$4,114,700	\$3,972,035	\$2,762,412	\$2,699,221
2021	\$3,096,080	\$4,383,775	\$4,239,279	\$2,993,061	\$2,939,617
2022	\$3,421,778	\$4,560,436	\$4,417,833	\$3,209,829	\$3,170,560
2023	\$3,743,941	\$4,698,333	\$4,560,959	\$3,418,426	\$3,398,000
2024	\$4,060,974	\$4,848,970	\$4,719,934	\$3,619,057	\$3,619,035
2025	\$4,374,378	\$4,989,160	\$4,871,422	\$3,810,449	\$3,832,926
<b>5-Year Total</b>	\$10,957,903	\$18,937,664	\$15,635,406	\$11,028,955	\$10,882,941
<b>10-Year Total</b>	\$29,655,054	\$42,418,339	\$38,444,832	\$28,079,779	\$27,843,079

Subtractions from Earnings Reserve	Status Quo	SB128/HB245	SB128 no CBR	SB114/HB303	HB224
2016	(\$1,367,346)	(\$698,649)	(\$698,649)	(\$46,998)	(\$1,367,346)
2017	(\$2,238,887)	(\$3,844,797)	(\$3,495,939)	(\$2,293,649)	(\$2,064,284)
2018	(\$2,188,080)	(\$3,904,074)	(\$3,555,216)	(\$2,403,248)	(\$2,151,040)
2019	(\$2,107,752)	(\$3,951,081)	(\$3,602,223)	(\$2,500,479)	(\$2,230,806)
2020	(\$2,125,489)	(\$4,002,561)	(\$3,645,853)	(\$2,564,657)	(\$2,283,303)
2021	(\$2,308,726)	(\$4,084,755)	(\$3,720,021)	(\$2,578,279)	(\$2,293,082)
2022	(\$2,504,755)	(\$4,129,683)	(\$3,756,743)	(\$2,589,892)	(\$2,304,049)
2023	(\$2,700,053)	(\$4,171,528)	(\$3,790,197)	(\$2,634,717)	(\$2,359,957)
2024	(\$2,896,456)	(\$4,222,077)	(\$3,832,166)	(\$2,707,171)	(\$2,439,926)
2025	(\$3,094,756)	(\$4,274,423)	(\$3,875,739)	(\$2,785,176)	(\$2,525,743)
5-Year Total	(\$10,027,554)	(\$16,401,162)	(\$14,997,880)	(\$9,809,031)	(\$10,096,779)
10-Year Total	(\$23,532,300)	(\$37,283,628)	(\$33,972,746)	(\$23,104,267)	(\$22,019,536)

Real Ending Market Value	Status Quo	SB128/HB245	SB128 no CBR	SB114/HB303	HB224
5th Percentile	\$106,683,281	\$110,017,638	\$107,761,821	\$100,950,717	\$103,068,088
25th Percentile	\$77,514,675	\$69,962,189	\$69,125,227	\$67,325,268	\$68,935,153
Median	\$61,660,630	\$50,850,570	\$51,049,070	\$51,381,837	\$52,934,652
75th Percentile	\$47,916,210	\$37,771,110	\$37,820,604	\$38,617,291	\$39,758,086
95th Percentile	\$35,168,091	\$28,165,335	\$28,108,328	\$28,500,577	\$29,374,679

Cumulative 10-Year Distributions	Status Quo	SB128/HB245	SB128 no CBR	SB114/HB303	HB224
5th Percentile	\$29,105,713	\$39,113,299	\$35,526,872	\$30,452,479	\$28,938,068
25th Percentile	\$19,753,057	\$37,355,976	\$33,927,393	\$25,811,075	\$24,542,904
Median	\$14,487,974	\$35,943,879	\$32,636,437	\$23,103,842	\$22,087,194
75th Percentile	\$9,762,045	\$33,756,625	\$30,167,729	\$19,815,913	\$19,068,897
95th Percentile	\$4,431,591	\$22,541,113	\$19,496,618	\$9,798,988	\$9,665,374

Probability of Hitting an  
ER Limit

Percent Probability

Status Quo

25%

SB128/HB245

30%

SB128 no CBR

35%

SB114/HB303

25%

HB224

25%

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# Ensuring a sound fiscal future

Presentation by McKinsey & Co.

Prepared for Senate Finance – SB 128  
April 4, 2016

**The Alaska Department of Revenue has sought an objective assessment of the financial model it built to evaluate an annual draw from the Earnings Reserve of the Permanent Fund, as outlined in the Alaska Permanent Fund Protection Act. The fact-based assessment of the financial model included in this document was conducted by McKinsey & Company, Inc. with support from expert Martin Baily.**

## Context for this effort



**The APFPA proposal would re-route oil revenues to the APFC to help stabilize State spending**

- The Alaska Permanent Fund Protection Act (APFPA) calls for directing a steady annual amount to the General Fund to mitigate the impact of oil price volatility on year-to-year budgeting. Specifically, the proposal recommends that:
  - 50% of oil royalty revenues and 100% of production tax revenues flow to the Alaska Permanent Fund Corporation (APFC) for investment
  - A fixed annual draw of \$3.3B (adjusted for inflation beginning in 2020) from the APFC to the General Fund to fund State expenditures; the amount would be methodically revisited every 4 years to ensure continued Fund sustainability
  - Dividend payments be paid out of the remaining 50% of oil royalties



**The APFPA seeks to improve budget stability**

- Given a rising budget deficit and declining oil production revenues, the APFPA seeks to:
  - Protect and grow the State's sovereign wealth to maximize long-term returns, acknowledging the rising importance of investment income in funding its budget
  - Delink public spending from volatile commodity prices and stabilize the budget by establishing a disciplined, formulaic approach to drawing from the State's wealth



**State modeling proposes that a \$3.3B draw should be sustainable**

- The Department of Revenue (DOR) has undertaken an extensive exercise to assess in a financial model what amount of annual draw will be sustainable (i.e., what draw amount can the State expect with greater than 50% confidence to maintain the starting asset's real value over time without depleting the Earnings Reserve)
- Given the Earnings Reserve's current size and the \$3B proposed transfer from the Constitutional Budget Reserve, the State can plan with 100% confidence to draw \$3.3B annually for at least 4 years (at which point the draw amount will be reviewed)
- The cumulative confidence level of being able to draw \$3.3B annually falls to 95% over 10 years and to 69% through 2040. Revisiting the draw on a 4-year cadence will lend additional confidence (e.g., this safeguard has not been factored in to modeling)



**The State sought an independent review of this model's rigor**

- The State sought an independent evaluation of (i) the soundness of the model's methodology and (ii) critical assumptions underlying the model (most notably those related to expected oil revenues and investment returns)

## Overview of conclusions



### **The DOR model is sound in its methodology**

- The model tests whether a \$3.3B annual draw will be sustainable
- The DOR used probabilistic analysis, including Monte Carlo simulations, to estimate confidence levels for (i) future oil prices and (ii) investment returns, as well as deterministic analysis to establish a base case scenario for oil production
- The approach taken is reasonable and the model's logic is generally robust in testing the likely impact of a \$3.3B draw, based on a review of the model's structure, logic, conceptual soundness, and process for future updates



### **The assumptions that underlie the model are reasonable**

- Key assumptions on future crude oil selling price, oil production, and investment returns (total and statutory) were obtained from credible, objective sources
- These assumptions are all within the range of reasonableness
  - Assumptions on oil production and price are reasonable and, taken together, somewhat more conservative than most
  - Investment returns assumptions are reasonable, though were considered optimistic for the near-term by some members of the APFC investment staff and were higher than those projected by APFC's strategic partners (third-party asset managers)



### **Certain institutional investor best practices could help improve this plan's long-term sustainability**

- The State of Alaska could further strengthen the long-term viability of the APFC and the sustainability of its contributions to the General Fund by leveraging best practice learnings from other SWFs and investors, e.g.:
  - Clear savings-and-spending rules and capital planning
  - Regular communication between investor and sponsor
  - Formal and informal investment education opportunities for government officials and board members
  - Board governance processes with appropriate composition, appointment expertise and roles
  - Well-designed strategy tied to Fund obligations and long-term investing

# Contents

- Scope of the review
- Summary of the APFPA proposal
- Review of DOR model

## The scope of this assessment



### Overview

The Department of Revenue is seeking an objective assessment of its financial model which analyzes a \$3.3B fixed annual draw from the Earnings Reserve of the Permanent Fund to finance General Fund spending

### In scope

- ✓ Detailed review and vetting of the DOR financial model's **methodology** and construction, including appropriateness of use of Monte Carlo analysis
- ✓ Assessment of the reasonableness of key baseline **assumptions** (oil price, oil production, investment returns) affecting the sustainable draw
- ✓ Perspective on **best practices** of other SWFs which inform consideration of the proposed model

### Not in scope

- ✗ Holistic evaluation of the proposed budget or budget deficit
- ✗ Perspectives relating to current or future tax regimes (e.g., Petroleum Value model)
- ✗ Assessment of the Permanent Fund's mandate or its investment management processes
- ✗ Macroeconomic study of future market fundamentals
- ✗ Recommendations for alternative funding models

## SWFs benefit from establishing a clear set of disciplined saving and spending rules to invest for the long-term

Establishes a clear set of disciplined saving and spending rules as well as a predefined capital plan



- Singapore's SWF, GIC, has developed a **proprietary internal model** projecting 20-year sub-asset class level returns
- Government of Singapore is **allowed to spend 50% of the annualized 20-year expected returns** giving Government flexibility on a year-by-year basis on how much to draw, but capping outflows at a low enough level to grow the corpus



- The National Fund of Kazakhstan had previously suffered from discretionary draws from the corpus. Under 2010 reforms **annual draw is fixed at \$8 billion** for use both to reduce budget deficits and for economic development. Government can adjust the annual draw by 15% (as it did in 2013)
- If the balance of the National Fund **falls below 20% of Kazakh GDP** in a given fiscal year the Government must reduce the annual draw until the balance has returned to 20% of GDP



- Norway has a bipartisan balanced budget consensus which **limits government non-oil deficits to 4 percentage points**. This prevents the government from drawing down the corpus of Norway's Government Pension Fund Global unless Norges Bank Investment Management beats the long-run expected investment returns of 4%
- Temporary increases in withdrawals are allowed under only limited circumstances, but **requires a specific parliamentary resolution**

## The DOR model was built to establish and test the sustainability of a fixed annual draw from the Earnings Reserve

### What are the major inflows into the Fund?



- Production tax revenues
- Royalty revenues
- Investment returns

### What are the most important drivers of future inflows?



- Oil production
- Oil price
- Investment returns (total and statutory)

### What is the projected spendable output based on cash flow projections?



- Sustainable draw amount must ensure:
  - >50% confidence that real value of starting assets is preserved over time
  - Earnings Reserve durability (confidence that the annual draw can be taken from ER)

# The DOR conducted advanced probabilistic (“Monte Carlo”) modeling to better understand the Fund’s ability to sustain the draw

## High-level description of the DOR modeling process

### Step 1

Understand the critical revenue drivers of the model – in terms of restricted and unrestricted revenue sources

Total oil revenue to Alaska State FY2007-15



### Step 2

Build a probabilistic model of expected oil price and investment returns fluctuations

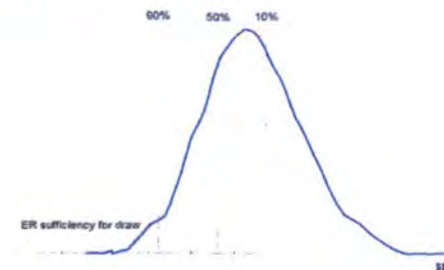
Monte Carlo scenario simulation modeling



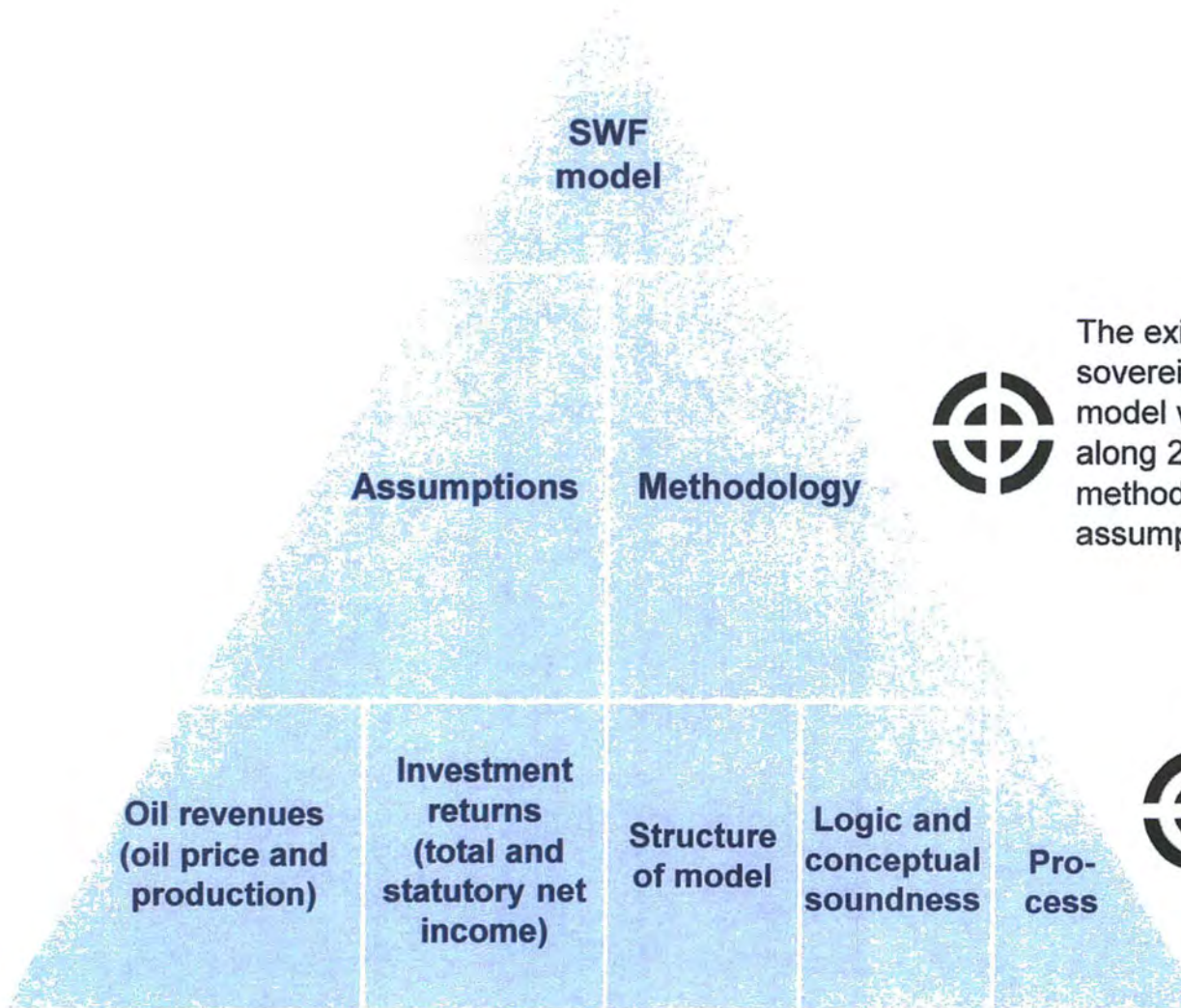
### Step 3

Understand impact on revenue flows into the Fund and Earnings Reserve available for the annual draw

Earnings Reserve balance distribution



# Over 4 weeks, a detailed review of the most critical elements of the DOR's modeling methodology and assumptions was conducted



The existing DOR sovereign wealth fund model was reviewed along 2 dimensions: methodology and assumptions



Key elements of the model were prioritized and pressure-tested using industry experts, third-party projections and proprietary modelling assessment framework

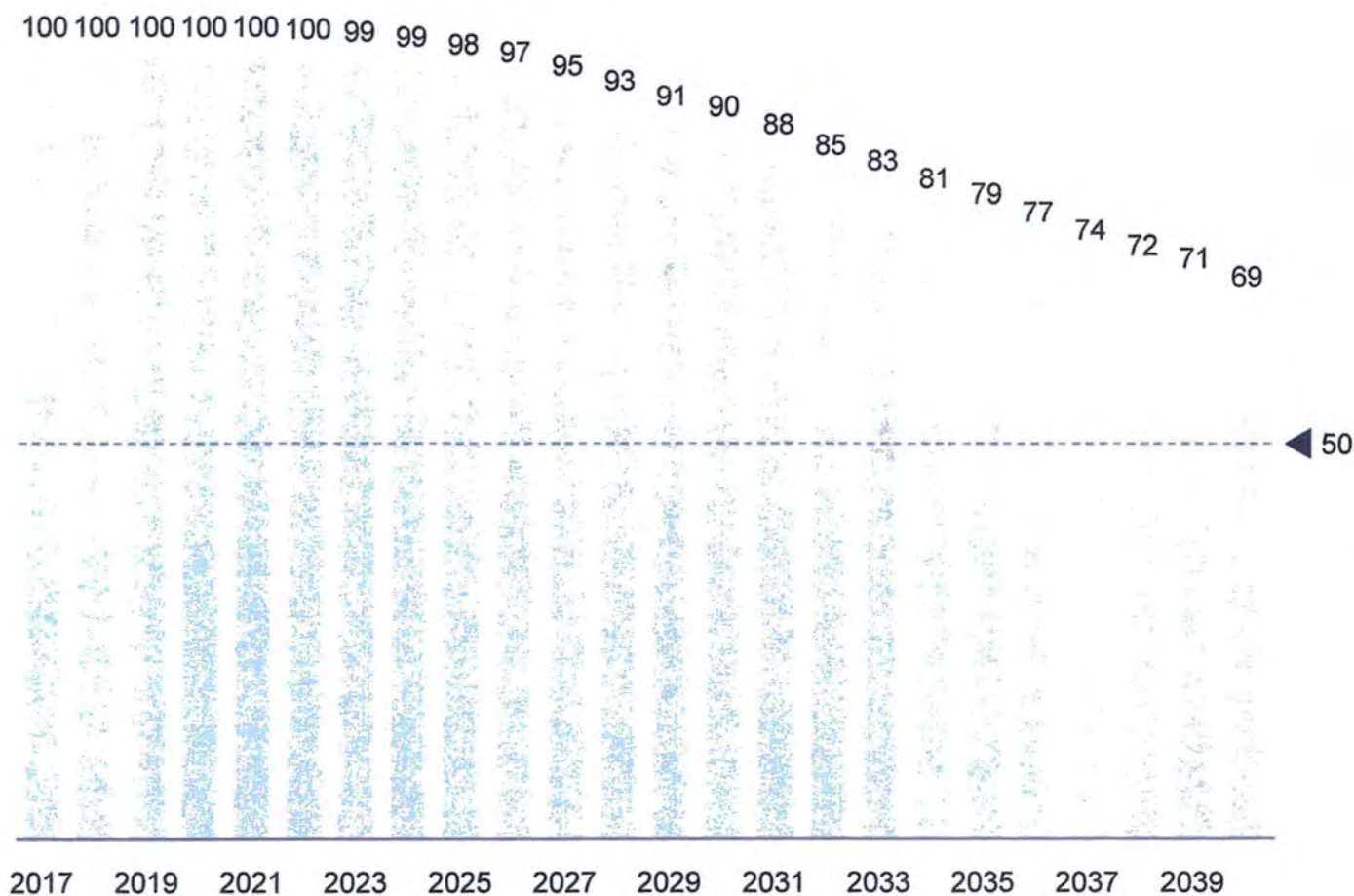
# Contents

- Scope of the review
- **Summary of the APFPA proposal**
- Review of DOR model

# The DOR model implies a 69% cumulative confidence that a \$3.3B annual draw can be made from the Earnings Reserve each year through 2040

## Cumulative confidence of making an annual \$3.3B draw from Earnings Reserve

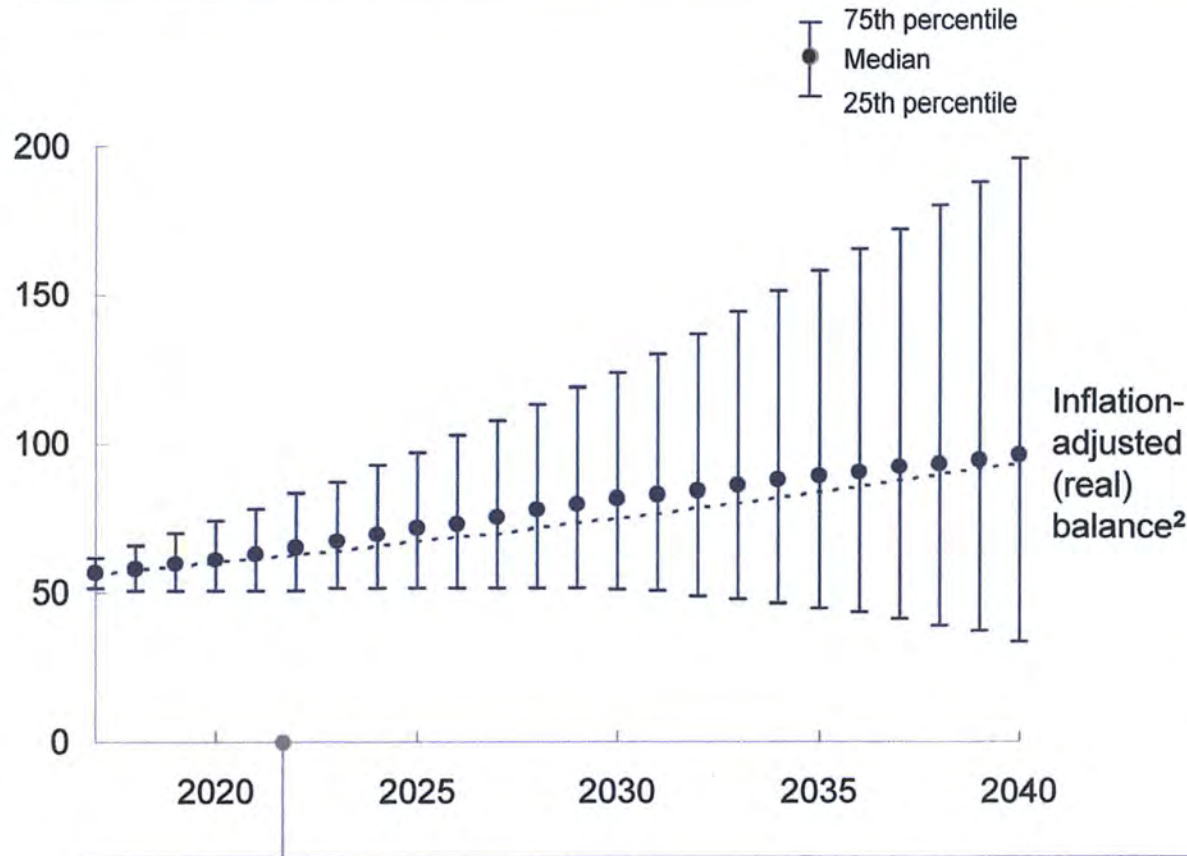
% likelihood



- Earnings Reserve acts as a buffer to short-term investment return and oil revenue volatility
- \$10B starting balance means near 100% confidence of being able to draw \$3.3B per year for first four years even with negative investment returns
- APFC has only had negative total investment returns four times in the past 30 years
- Effects of cumulative volatility and declining oil production reduce confidence over time – but even in 2040 cumulative confidence that a \$3.3B annual draw can be made from Earnings Reserve is 69% (confidence would be even higher if adjusted for periodic review)

# The DOR model predicts that the Permanent Fund will be \$96B in 2040 with an interquartile range of \$34B and \$196B

Expected total balance of Permanent Fund<sup>1</sup> in given year  
\$ billion (est. 2017 values)



- Permanent Fund balance will grow or shrink in any given year because of volatility in investment returns and oil revenues
- DOR goal is to maintain the real value of starting assets by seeing the median balance grow with inflation of 2.25%
- Modelled output meets this threshold, predicting median balances rising to ~\$96B in 2040 (nominal value)
- Given expected volatility, 2040 ending balance is predicted to be between \$34B and \$196B with a 50% confidence level (the threshold set by DOR)

*Over time, the ability to revisit the draw on a 4-year cadence will lend additional confidence in the ability to preserve the Fund's balance (e.g., this additional safeguard has not been factored in to modeling)*

<sup>1</sup> Includes Earnings Reserve <sup>2</sup>. Draw amount is adjusted for inflation beginning in 2020

# Contents

- Scope of the review
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# Review of the DOR model indicates that the assumptions and methodology underlying Fund projections are sound

## Conclusions from the review

- **The DOR modeling assumptions and methodology are reasonable**
  - Key assumptions on future oil price, oil production, and investment returns (total and statutory) were obtained from objective sources and are within the range of reasonableness
  - The methodological approach taken, including use of Monte Carlo simulations, is reasonable, and the model logic is generally robust in testing the likely impact of a \$3.3B draw
- **Future iterations of the model could benefit from the following changes:**
  - Build functionality to account for second-order relationships (e.g., year-on-year correlation between variables<sup>1</sup> and the impact on production of reaching certain breakeven prices for crude<sup>2</sup>)
  - Establish consistent process and ownership for model construction and sources
  - Assumptions may be periodically revisited based on changes to Fund strategy and investment management, or changes to the tax regime affecting Fund inflows

1. Analysis of historic year-on-year correlations of oil prices and investment returns from 1985-2015 returned statistically insignificant relationships (e.g., adding this complexity would have minimal impact on the model outcome)

2. The relationship between production levels and the theoretical break-even price of crude is unlikely to have material impact on the model outcome because the marginal price varies considerably across producers and production does not tend to vary with short-term oil price volatility

## The review considered the modeling methodology and assumptions behind critical drivers of inflows to the Fund

Driver	Explanation of DOR approach	How approach was assessed
Crude selling price	<ul style="list-style-type: none"> <li>DOR has employed a Monte Carlo analysis using ERG crude oil price projections to determine the likelihood of price evolution in the future based on a survey of expert forecasts<sup>1</sup></li> </ul>	<ul style="list-style-type: none"> <li>Comparison of projections with multiple third-party objective sources (e.g., Woodmac, Rystad)</li> </ul>
Production volume	<ul style="list-style-type: none"> <li>DOR has employed a deterministic analysis using ERG oil production projections – this approach takes a fairly conservative approach (e.g., approach reflects the uncertainty of future production projects)</li> </ul>	<ul style="list-style-type: none"> <li>Comparison of projections with multiple third-party sources</li> </ul>
Total return rate	<ul style="list-style-type: none"> <li>DOR has relied on Monte Carlo analysis based on projections from Callan Associates (the third-party financial consultant that the Permanent Fund has used for 20+ years) to estimate the likelihood of future Fund performance based on current Fund strategy</li> </ul>	<ul style="list-style-type: none"> <li>Comparison of projections with historic performance and third-party projections</li> </ul>
Statutory net income rate		<ul style="list-style-type: none"> <li>Interviews with Permanent Fund investors to understand view of projections and potential for change to future fund performance</li> </ul>

<sup>1</sup> DOR Probabilistic Model oil revenue inputs based on probabilistic PERT analysis of oil price (use of estimates for P10, P50 and P90 estimated values as per DOR sampling methodology and proprietary company specific data); may differ slightly from publically published DOR RSB estimates.

## Two types of analysis are used in the DOR model: “probabilistic” and “deterministic” analysis

### Type of analysis methodology

#### Deterministic

#### Explanation

- **Describes the outcome of some scenario given appropriate inputs** (in this case, based on the average or median value and the degree to which that value varies over time)

#### When is it best used?

- **When projections are based on an assumed trend given variance from that trend within certain standard deviation** (e.g., use of a conservative baseline case for oil production)

#### Probabilistic “Monte Carlo”

- **Monte Carlo analysis is a modeling technique that runs multiple trials and gives a distribution of potential outcomes.** Running a Monte Carlo model creates a probability distribution that **indicates the likelihood that an outcome will occur**

- **When attempting to project highly volatile and less predictable drivers** where the impact of “randomness” is important to understanding risk (e.g., oil price, investment returns)

# Model methodology is robust, with some potential opportunities for future improvement

- Requires review
- Requires no substantial review

Element of methodology assessment	Assessment	Explanation	Potential steps to improve model
Structure	●	<ul style="list-style-type: none"> <li>▪ No major mechanical errors found</li> </ul>	<ul style="list-style-type: none"> <li>▪ None</li> </ul>
	◐	<ul style="list-style-type: none"> <li>▪ Petroleum Model model sub-optimally structured</li> <li>▪ Oil production projections are not linked to price projections</li> </ul>	<ul style="list-style-type: none"> <li>▪ Consider full audit of Petroleum Model (particularly in light of tax / royalty regime)</li> <li>▪ Wire model to account for price/production relationship in future model iterations</li> </ul>
	◑	<ul style="list-style-type: none"> <li>▪ Sources consistently used with exception of some oil price inputs (e.g., median used in Petroleum Model vs. probabilistic price used in SWF model)</li> </ul>	<ul style="list-style-type: none"> <li>▪ Validate Petroleum Model for consistency in oil pricing (e.g., using probabilistic model vs. median)</li> </ul>
Logic and conceptual soundness	◐	<ul style="list-style-type: none"> <li>▪ Underlying data sources are objective (e.g., Callan)</li> <li>▪ Does not account for impact of unrealized returns on Earnings Reserve balance)</li> </ul>	<ul style="list-style-type: none"> <li>▪ Consider impact unrealized returns that are apportioned to Earnings Reserve on the funds available for spend</li> </ul>
	●	<ul style="list-style-type: none"> <li>▪ Current use of Monte Carlo methods is defensible given behavior of oil price and investment returns</li> </ul>	<ul style="list-style-type: none"> <li>▪ None</li> </ul>
	◑	<ul style="list-style-type: none"> <li>▪ Pert distribution of oil price (i.e., 3 points) is sufficient but highly sensitive to accuracy of underlying inputs to the distribution (P10, P50, P90)</li> <li>▪ Does not account for year-on-year correlations in oil prices (e.g., "gamblers dilemma")</li> </ul>	<ul style="list-style-type: none"> <li>▪ Consider exploring more sophisticated probabilistic methodology (e.g., revisit accuracy of Delphi-style method used in PERT distribution)</li> <li>▪ Account for year-on-year correlations in probabilistic analysis</li> </ul>
Process	◐	<ul style="list-style-type: none"> <li>▪ Informal construction process (partly driven by ongoing iterative policy process)</li> <li>▪ Governance procedures to ensure systematic auditing/updating not yet developed</li> </ul>	<ul style="list-style-type: none"> <li>▪ For future sustainable draw re-visitations, create set of rules / guidelines for timeline / triggers of update and develop design principles to guide construction</li> </ul>
	◐	<ul style="list-style-type: none"> <li>▪ Unclear future ownership (partly driven by unclear end use of model)</li> </ul>	<ul style="list-style-type: none"> <li>▪ For future sustainable draw re-visitations, articulate clear owner(s) with auditing / updating rights</li> </ul>

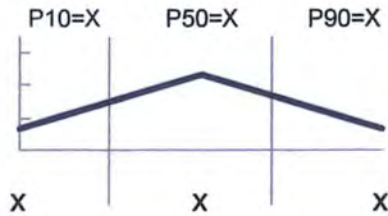
# Each of the modeling methodology used by the DOR model to project critical fund inflow drivers is technically sound

## Fund inflow driver projections

## Description of DOR model methodology

## Rationale for methodology

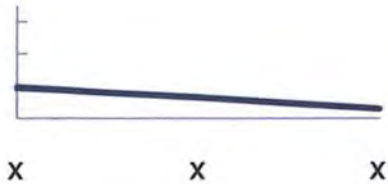
Crude selling price



Use of **probabilistic** analysis (PERT distribution) based on P10=\$31/bbl, P50=\$56/bbl, P90=\$87/bbl

- Probabilistic analysis accounts for volatility
- Distribution method leverages preexisting DOR/ERG crude oil price projections

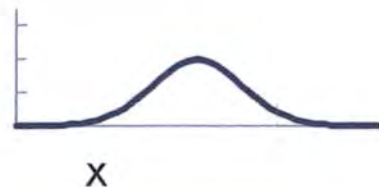
Production volume



Use of **deterministic** analysis based on conservative base case (e.g., assuming no new project-driven increase in production)

- Not much volatility in the projections and hence no need for probabilistic analysis

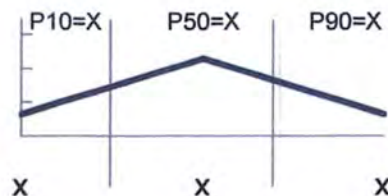
Total return rate



Use of **probabilistic** analysis (normal distribution) based on 6.9% mean rate of return and 13.9% standard deviation

- Objective and transparent methodology
- Distribution method based on mean reversion methodology used by Callan

Statutory net income rate



Use of **probabilistic** analysis (PERT distribution) based on based on P10=3.7%, P50=6.01%, P90=8.14%

- Probabilistic analysis accounts for volatility
- Distribution based on data available from Callan statutory model (P10/50/90 distribution)

## Based on the recommendations that came out of the model review, a series of actions were executed

### Improvement identified

- Build Earnings Reserve sufficiency test into the master model (versus using separate models to test Fund balance and ER sufficiency)
- Adapt fully objective, repeatable source for investment returns (versus prior use of blended projected and historic returns rates)
- Update standard deviation of returns assumption to match Fund returns projections
- Use most technically correct formulas and @Risk functions (e.g., calculation for geometric mean, @Risk and risk target function cross check)

### Changes made to model

- Expanded model to include ER sufficiency analysis
- Changed source from a 50% historic/50% projected return to a 10 year deterministic projection from 3<sup>rd</sup> party (Callan)
- Changed standard deviation from use of Power Cost Equalization Fund deviation to deviation matched to returns source (Callan)
- Executed tactical improvements (e.g., updated the formula to calculate geometric mean, revised at risk function to calculate cumulative confidence)

## Assumptions appear generally reasonable; returns projections are perhaps aggressive in the near term

- Requires no substantial review
- Need for review

	Assumption	Source <sup>2</sup>	Assessment of viability	Explanation
<b>Crude oil price</b>	<ul style="list-style-type: none"> <li>10<sup>th</sup> percentile @ \$31/bbl</li> <li>Median @ \$56/bbl</li> <li>90<sup>th</sup> percentile @ \$87/bbl</li> </ul>	<ul style="list-style-type: none"> <li>Annual expert conference held by DOR/ERG<sup>1</sup></li> </ul>		<ul style="list-style-type: none"> <li>Roughly in-line with third-party estimates, albeit conservative</li> <li>Objective use of DOR/ERG projections</li> </ul>
<b>Crude production</b>	<ul style="list-style-type: none"> <li>Declining from 500k bbl/day in 2017 to 112k in 2040</li> </ul>	<ul style="list-style-type: none"> <li>Survey of O&amp;G companies (with likelihood adjustments)</li> </ul>		<ul style="list-style-type: none"> <li>In line with or below third-party estimates in short term; below 3<sup>rd</sup> parties in long-term due to AK LNG exclusion</li> <li>Objective use of DOR/ERG projections</li> </ul>
<b>Total returns</b>	<ul style="list-style-type: none"> <li>Mean 6.9%</li> <li>Standard deviation 13.9%</li> </ul>	<ul style="list-style-type: none"> <li>Callan deterministic model (Dec 2015)</li> </ul>		<ul style="list-style-type: none"> <li>In line with other available projections (e.g., 6.4% historic returns, 7.45% alternative probabilistic projection)</li> </ul>
<b>Statutory net returns</b>	<ul style="list-style-type: none"> <li>10<sup>th</sup> percentile at 3.7%</li> <li>Median @ 6.01%</li> <li>90<sup>th</sup> percentile @ 8.14%</li> </ul>	<ul style="list-style-type: none"> <li>Callan probabilistic model (Dec 2015)</li> </ul>		<ul style="list-style-type: none"> <li>Only viable estimate available (e.g., no other multi-year projections available)</li> </ul>

<sup>1</sup> Conference conducts Delphi-style methodology to arrive at PERT distribution

<sup>2</sup> DOR Probabilistic Model oil revenue inputs based on probabilistic PERT analysis of oil price (use of estimates for P10, P50 and P90 estimated values as per DOR sampling methodology and proprietary company specific data); may differ slightly from publically published DOR RSB estimates.

## Future iterations of the model could account more rigorously for future trends and second-order relationships

### Potential model update

#### Future shifts in fund target or mandate

#### Description

- SWF proposal requires Permanent Fund to **manage toward fixed stream of liabilities** (i.e. like a pension fund)
- Likely to entails **shift in strategy and potentially returns projections**

#### Observations on impact

- Investment earnings are **single largest driver of success of SWF** (vs. O&G taxes and royalties)
- Even small % changes in earnings therefore imply significant changes to fund value and sustainability

#### Future shifts in fund allocation strategies

- Permanent Fund will **likely change investment strategies** in due course
- SWF proposal considers possibility of **bringing more investment in-house**

- Changes in investment strategy for a given asset class will alter **risk/return distributions**
- Investing in-house will **reduce fees**

#### Liquidity constraints

- **Clearer liability stream** will allow for more appropriate level of liquidity
- **Liability driven investing** may introduce greater leverage to portfolio

- Reduced levels of liquidity and/or higher leverage may **exacerbate risk on extremes of market return distribution**

#### New tax proposals

- Current proposal would amend the tax credit system and **directly impact O&G revenues going to the State**

- O&G revenues are a **relatively small percent of revenue** in SWF model
- Short-term impact, however, could be significant to ensure stability of fund