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April 28, 2016

Honorable Representative Steve Thompson
Alaska State House of Representatives
State Capitol, Room 515
Juneau, AK 99801

Honorable Representative Mark Neuman
Alaska State House of Representatives
State Capitol, Room 505
Juneau, AK 99801

Re: Questions from April 20 presentation on permanent fund legislation and fiscal plan

Dear Representative Thompson and Representative Neuman:

Thank you for bringing the administration and legislators together last week to discuss the committee substitute (CS) for the Alaska Permanent Fund Protection Act (APFPA). We greatly appreciate the engagement by members of the House and Senate on this important issue and your leadership and efforts to advance the conversation. Brief responses to the questions asked during and shortly after the presentation are set out below. The attached materials contain additional information on each point.

1. Representative Vazquez: What are the modeling results for future production, dividends after the third year, and expected permanent fund earnings?

   Attachment 1 provides modeling of anticipated dividends, permanent fund value, and variable unrestricted general fund (UGF) revenues, including any contribution from the earnings reserve account (ERA), under the various versions of HB 245.

   In summary, the revenue limit is critical for maintaining the value of the permanent fund with a draw set at 5.25% of the market value of the fund. Without the revenue limit or additional deposits into the fund, a draw at this level will likely degrade the value of the permanent fund over time. The modeling also illustrates how, by saving all peak revenues, the initial APFPA proposal would smooth UGF revenues over a broader range of oil prices than the CS, with the effect of allowing higher withdrawals in low revenue years.

For example, for FY2017, the CS would add $1.92 billion from the ERA to other UGF revenues for a total UGF budget of $3.0 billion before a draw from the constitutional budget reserve (CBR) or new revenues. By contrast, adding $3.1 billion from the ERA, the initial APFPA proposal would provide a starting point around $3.8 billion in UGF revenue, $700 million more than the current CS.

2. Senator Micciche: If the CS had been enacted in 2005, what would the permanent fund balance, dividends, and UGF revenues have looked like through 2015?

   The comparison in attachment 2 illustrates that both the CS and the initial APFPA proposal likely would have better protected the permanent fund and better prepared the state to handle highly variable UGF revenues than the current framework. As noted above, the original APFPA framework has the advantage of smoothing variability in UGF revenues over a broader range of oil prices than the CS, thereby allowing higher draws from the permanent fund in low revenue years.

3. Representative Gara and Representative Kawasaki: Given the anticipated decline in production volumes, what does the chart illustrating the impact of the revenue limit at different oil prices (slide 19 of the April 20 presentation) look like in later years?

   The chart included in the April 20 presentation illustrated the impact of the revenue limit in FY2020. Attachment 3 provides the same charts for FY2017, FY2022, and FY2027. These charts reflect a revenue limit set at $1 billion (increasing with inflation).[1] Both the oil price at which the revenue limit threshold is reached and the oil price at which the POMV draw is fully offset increase over time: in FY2017 the limit would be triggered at $65 per barrel oil, but by FY2027 it is not triggered until $105 per barrel. This occurs for three main reasons: (1) oil production is projected to decline, (2) the threshold in the current CS increases with inflation, and (3) the POMV draw grows as the permanent fund grows.

4. Representative Hughes: What are the consequences of delaying implementation of the plan until next year?

   A number of significant consequences follow from delaying implementation and closing the entire fiscal gap with permanent fund earnings this year. These

[1] The current CS uses a $1.2 billion (inflation-adjusted) threshold for the revenue limit, not the $1.0 billion (inflation-adjusted) that the Department of Revenue has modeled in response to questions. The administration prefers a $1.0 billion threshold that does not increase with inflation because oil price is not indexed to inflation and because the permanent fund would be better protected.

consequences include degrading the culture of following a rule-based system when using the permanent fund earnings and an increased risk of depleting the ERA in the near-term. If the gap is closed with an ad hoc withdrawal from the ERA, the account would only be left with $1.9 billion. If near-term market returns remain low (or turn negative), the ERA would be depleted next year. Attachment 4 provides more detailed analysis of this potential and other consequences.

5. Senator Micciche: What would the CBR balance have been from 2005 to 2015 if it had earned the same rate of investment return as the permanent fund?

   The analysis in attachment 5 estimates that the CBR balance may have been about $1.9 billion larger than it is today, but this assumes that the statutory restriction on how the CBR can be invested would not have applied.

6. Representative Hughes: What would a targeted, progressive sales tax look like?

   The information we currently have is that the State would bring in approximately $140 million annually for each 1% in sales taxes collected, with food excluded from the tax. Although the administration has not undertaken a recent analysis of the cost of administering a sales tax, an analysis was conducted for sales tax legislation in 2004 (CSSB 366(FIN)). Attachment 6 is the fiscal note for that bill. Based on a preliminary review of the information, if the fiscal note were updated and included items like travel costs for audits, the cost of administering a sales tax would likely be a little higher than for an income tax.

7. Senator MacKinnon: How much do lower income households receive in government services compared to the amount that the state would collect in an income tax paid by higher income households?

   We are not able to obtain data that can easily compare what households receive in government services versus what would be paid in an income tax, but attachment 7 contains information from the Division of Public Assistance on the various programs and average amounts distributed as well as the Department of Revenue estimate of individual and household income tax liability under the current proposal.

   As an example, the average monthly benefit under the Alaska Temporary Assistance Program is $612 per month, or $7,344 per year.[2] A household with one child is eligible for this benefit if the household has a net income of not more than $16,944. A household with two children is eligible if it has a net income of not more than $19,080. The estimated income tax for a married couple filing jointly

[2] Note that this particular program has a 60-month limit, so these are not indefinite payments.

with two children under HB 250 would range from $15 (at $50,000 in income) to $3,894 (at $300,000 in income).

Thank you again for bringing the administration and legislators together for what we hope was a constructive exchange. If we can answer any additional questions, please feel free to contact us.

Sincerely,

Randall Hoffbeck
Commissioner of Revenue

Craig Richards
Attorney General

Attachments

Cc: Alaska Legislature