THE STATE
of ALASKA
GOVERNOR BILL WALKER

Department of Revenue
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February 15, 2016

The Honorable Mark Neuman and the Honorable Steve Thompson
Alaska State Representatives
Co-chairs, House Finance Committee
State Capitol Rooms 505 and 515
Juneau, AK 99801

Dear Co-Chairs Neuman and Thompson:

The purpose of this letter is to provide you with responses to the questions asked of the Department of Revenue during our presentation to the House Finance Committee on January 22, 2016. Please see questions in italics and our responses immediately below the questions.

1. *What assumptions are behind the sovereign wealth fund model, and what assumptions were considered that didn't work?*

Here are some of the major assumptions behind the sovereign wealth fund model:

- Starting fund size: $52 billion
    - Principal: $40 billion
    - Unrealized earnings: $5.5 billion
    - Earnings reserve: $6.5 billion
- Transfer from CBRF to earnings reserve: $3 billion
- Starting payout amount: $3.3 billion
- Total investment returns:
    - Long-run geometric mean: 6.90%
    - Standard deviation: 13.90%
    - Arithmetic mean: 7.87%
- Statutory return:
    - 10th percentile: 3.70%
    - Median: 6.01%
    - 90th percentile: 8.14%
    - Distribution: PERT
- Oil prices distributed according to DOR 2015 fall forecast.

There are not other models with different sets of assumptions; however, DOR is happy to list some of the scenarios that would cause the earnings reserve to be depleted according to the model. The earnings reserve could be depleted if investment returns, oil prices, and/or oil production are much lower than expected over an extended period of time (rather than simply the low years within the normal variance we expect). The earnings reserve could also be depleted if the state budget is not kept low enough to be funded by the $3.3 billion annual transfer from the sovereign wealth fund.

Of course, these scenarios (low oil revenue, low investment returns, and high spending) would also result in depletion of the earnings reserve under the status quo. Extreme scenarios, such many years of persistent low oil prices and more than two years of negative investment returns, reflect a global economic environment in crisis that no amount of risk-averse behavior can mitigate.

2. *Please provide a chart of projected Permanent Fund corpus balances through 2040.*

Please see the attached charts. One shows projected Permanent Fund corpus balances under the status quo; the other shows projected balances under the Alaska Permanent Fund Protection Act.

3. *What would it cost to implement the governor's proposed income tax?*

According to the fiscal note, the operating cost of the income tax would start out at $1.5 million in FY 2017, rising to $4.3 million in FY 2018, $7.2 million in FY 2019 (the first fiscal year of full staffing), and $8.4 billion by FY 2022, since salaries of the new staff would gradually rise due to step increases.

4. *Commerce took a huge hit. Have we lost opportunity because we've cut too much? For example, we're hosting the International Arctic Council for the next several years, are we taking advantage of that opportunity?*

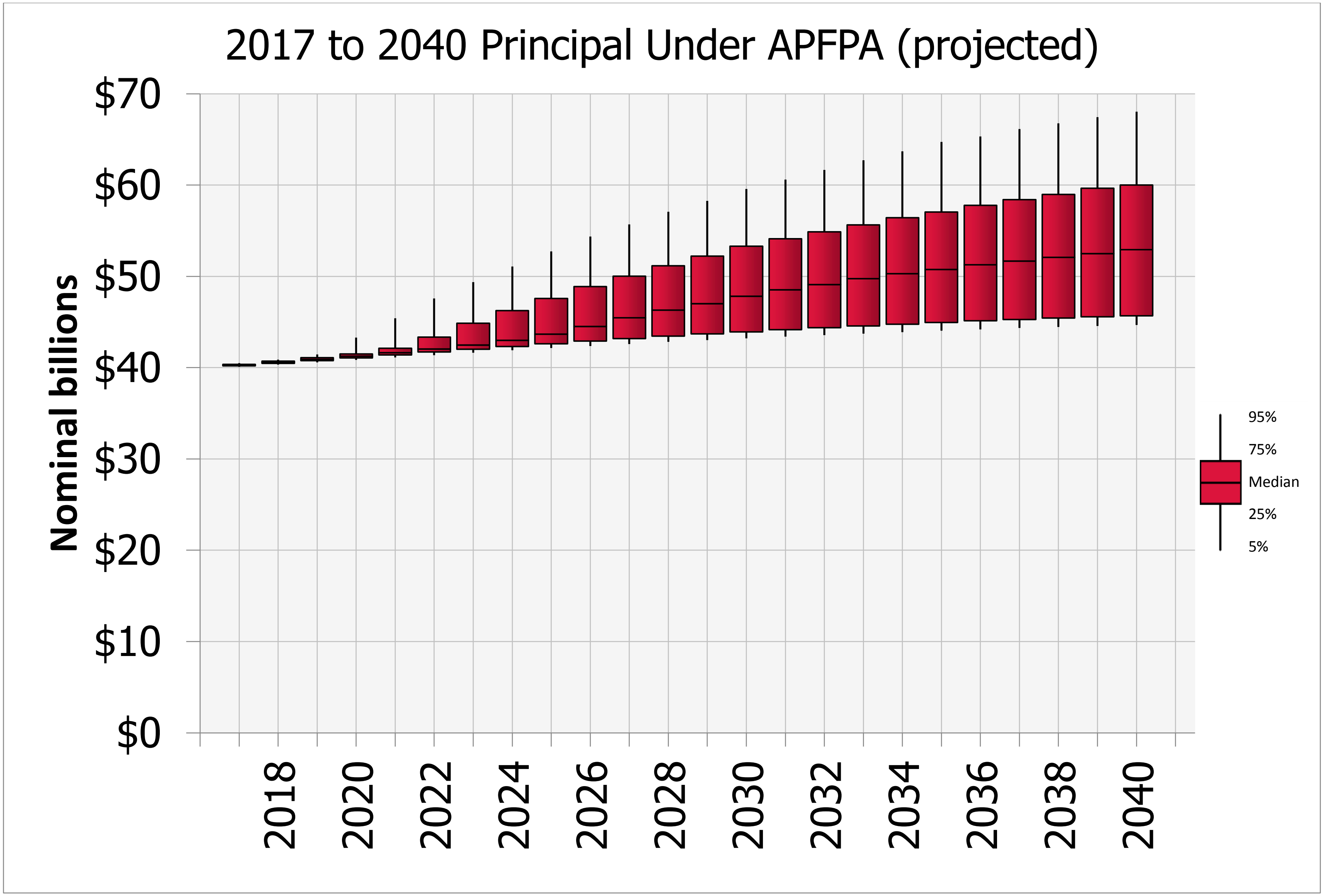
The Governor's proposed budget was developed with a goal of maintaining government services to the maximum extent possible while reducing unrestricted general fund spending. Specifically regarding the Department of Commerce, Community, and Economic Development, the FY 2017 proposal is for a reduction in unrestricted General Funds of $8.6 million. Some of these cuts will impact programs that benefit Alaska businesses and residents. For specific impacts of the proposed budget reductions, we defer to DCCED which will be able to address these questions during the subcommittee process.

I hope you find this information to be useful. Please do not hesitate to contact me if you have further questions.

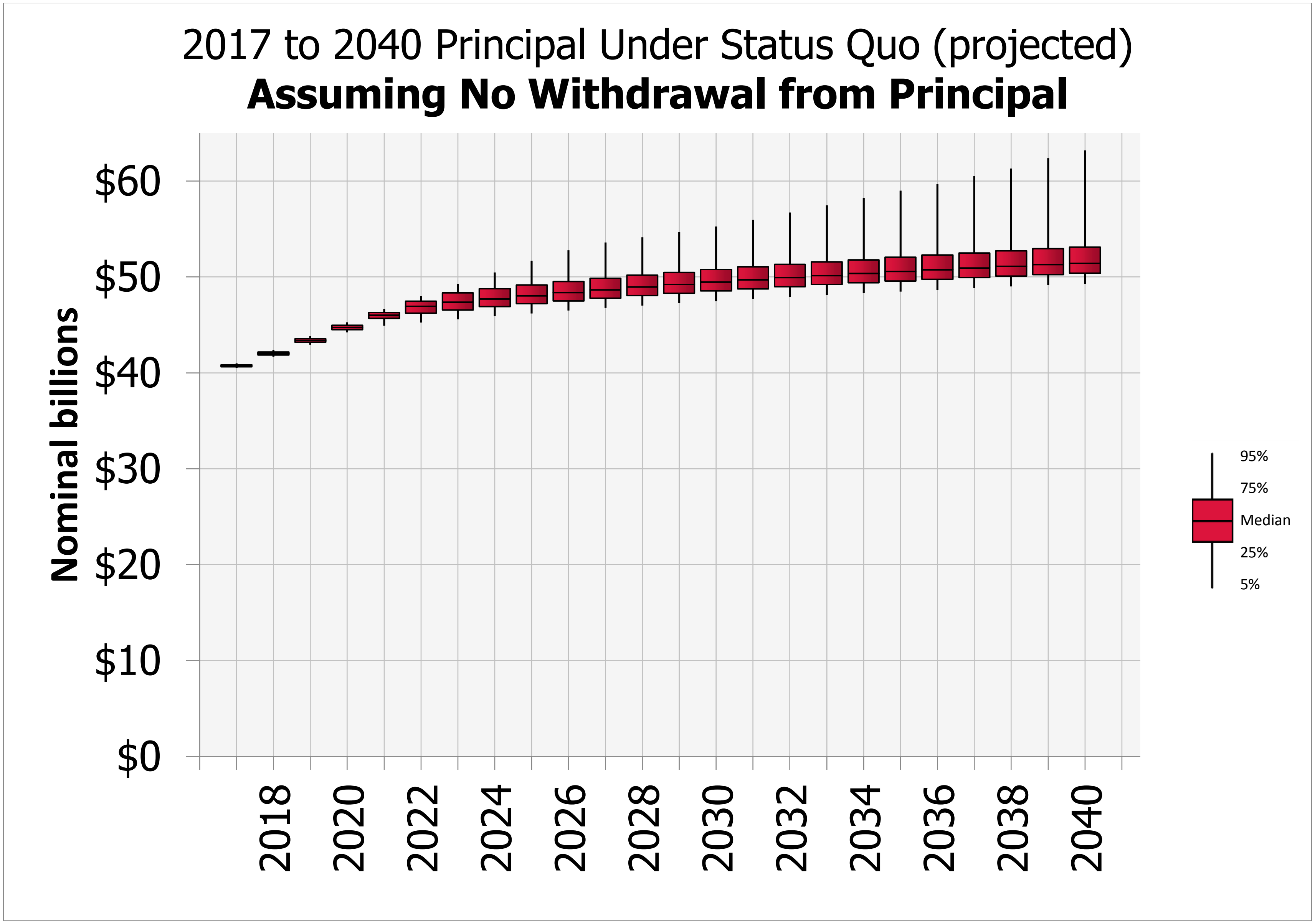
Sincerely,

Randall Hoffbeck
Commissioner

Attachments: 2017 to 2040 PF principal under APFPA and status quo



2017 to 2040 Principal Under APFPA (projected)
$70
$60
$50
$40
$30
$20
$10
$0
Nominal billions
2018
2020
2022
2024
2026
2028
2030
2032
2034
2036
2038
2040
95%
75%
Median
25%
5%


2017 to 2040 Principal Under Status Quo (projected)
Assuming No Withdrawal from Principal
Nominal billions
$60
$50
$40
$30
$20
$10
$0
2018
2020
2022
2024
2026
2028
2030
2032
2034
2036
2038
2040
95%
75%
Median
25%
5%