Reducing the Deficit: Investing Alaska’s Vast Cash Reserves

Senate Bill 114
Senator Lesil McGuire
Southeast Conference
3-16-16
The Permanent Fund and the Dividend

November 1976- Voter Approved Constitutional Amendment Creating the Permanent Fund

2/11/1977- 9th Legislature
Created Permanent Fund thru CS to SS to HJR 39

to convert a part of the depleting petroleum asset into a permanent and sustainable financial asset- (Goldsmith, 2002)

Dividend Established in 1980- Statutory Overlay to Constitution
-base $50 Dividend to each adult citizen for every year lived in Alaska since 1959

HELD: The Alaska Dividend distribution Plan violated the guarantees of the Equal Protection Clause of the 14th Amendment

1982- First Dividend Issued to All Alaska Residents
Is there Fiscal Problem?
We have a $3.5 to $4 Billion Deficit

• The legislature has enacted heavy spending cuts over the last 2 years
• The state has several savings accounts, but

Revenue models show that if oil prices do not rebound, those savings will be gone in about 2 years

• We cannot wait and hope for high oil prices
• The price of inaction now could be disastrous for the state’s future
Defining the Problem

UGF for FY17 (status Quo)

Royalties $800M
Production Taxes $200M
Other Taxes $800M

Total $1.8 B

Fiscal Gap
The Cost of Doing Nothing/Status Quo

- The longer we wait to act
  - The lower are our reserves
  - The higher the risk of Failure
- A lower reserve balance
  - Simply takes away choices we have to fill the deficit

Status Quo: Rapidly draining Reserves
The Cost of Doing Nothing/Status Quo

In FY 19 The choice will be made to fund Dividend OR Deficit

End of the Dividend Program

Savings Can Pay Dividend But cannot cover Fiscal Gap
Options without using the Earrings Reserve?

Reduce spending and Size and Cost of Government to match current Revenues And Raise New Revenue?

UGF for FY17 (status Quo)

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Royalties</td>
<td>$800M</td>
</tr>
<tr>
<td>Production Taxes</td>
<td>$200M</td>
</tr>
<tr>
<td>Other Taxes</td>
<td>$800M</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$1,800M</strong></td>
</tr>
</tbody>
</table>

Potential New Revenue from Sustainable Alaska Plan

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total= $2.257 Billion</td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$3 Billion in Cuts</strong></td>
</tr>
<tr>
<td>$457M</td>
<td></td>
</tr>
</tbody>
</table>
Current Cash Flow

- **Public School Trust Fund**: 0.5%
- **Royalties**: 30%
- **Production Tax**: 69.5%
- **Less Volatile Revenue**
- **General Fund**
  - **Draws as Necessary to Fill Deficits**
  - **Inflation Proofing**
  - **ERA**
    - % of 5-year Average
  - **Dividend**

**Notes**:
- **Investment Earnings**
Proposed SB 114 Cash Flow

Public School Trust Fund

Royalties

Production Tax

Less Volatile Revenue

General Fund

Draws as Necessary to Fill Deficits

Investment Earnings

Royalties to PF = 25%

4.5% POMV from ERA to GF

Dividend Calculation:
1) 15% of Royalties
2) 15% of ERA funds (from ERA)
3) 2% of CBR (from ERA)
The Overall Effect

- **Reduces the Deficit by $2.25 Billion**
  - Reduces volatility in budgeting
  - Maintains downward pressure on state Spending
  - Preserves the Dividend
    - With a minimum of $1,000
  - Reduces the CBR draw to cover deficit
  - Helps maintain good state credit rating
The Size of the Dividend

SB 114 Has a minimum $1,000 Dividend

Status Quo Hypothetical

Status Quo Realistic

Status Quo Dividend Program WILL END
The Reserves SB 114 vs. Status Quo

SB114

Status Quo
The Reserves SB 114/ Status Quo
POMV and Inflation Proofing

Callan’s Est. Return on Permanent Fund Investments = 6.9%

POMV Draw = 4.5%

To the Earnings Reserve Account = 2.4%

To the Corpus of the Permanent Fund = 25% of Royalties

Total Royalties $961M * 25% = $240M

The Bill also allows inflation proofing to the Principle if the ERA is 4 times the size of the POMV Draw
Review oversight

Each year on or before January 30
The commissioner of revenue may consult with the Permanent Fund board and recommend
• Adjustments to the percentages of money appropriated to the dividend

Each year on or before January 30
The commissioner of revenue Shall provide a legislative report that:
• Evaluates the sufficiency of the assets in the ERA
• Evaluates the amount projected to be distributed to the General Fund
Revenue Limitations From POMV Draw

- For Oil revenue over $1B there is a corresponding reduction of the POMV draw
- This improves the sustainability of payouts from the ERA
- Reduces the risk of increasing spending in high years of petroleum revenue
- Reduces the volatility in the budgeting process for UGF expenditures

<table>
<thead>
<tr>
<th>Production Taxes (PT)</th>
<th>POMV Draw (4.5%)</th>
<th>PT and POMV Draw</th>
</tr>
</thead>
<tbody>
<tr>
<td>$0.5</td>
<td>$2.25</td>
<td>$2.75</td>
</tr>
<tr>
<td>$1.0</td>
<td>$2.25</td>
<td>$3.25</td>
</tr>
<tr>
<td>$2.0</td>
<td>$1.25</td>
<td>$3.25</td>
</tr>
<tr>
<td>$3.0</td>
<td>$0.25</td>
<td>$3.25</td>
</tr>
<tr>
<td>$3.5</td>
<td>$0.00</td>
<td>$3.50</td>
</tr>
<tr>
<td>$4.0</td>
<td>$0.00</td>
<td>$4.00</td>
</tr>
<tr>
<td>$5.0</td>
<td>$0.00</td>
<td>$5.00</td>
</tr>
</tbody>
</table>
Conclusion/Summary

- **SB 114 is NOT**
  - A raid on the Permanent Fund
    - SB114 would only draw from the Earnings Reserve Account
  - A way for Government to increase spending
  - A dividend Killer

- **SB 114 IS**
  - A way to share the risks and rewards of the states fiscal health
  - A way to protect the dividend into the future
  - A way to ensure that services we enjoy continue to be provided
    - Police
    - Firefighters
    - Roads
    - Education
    - Health and Social Services
    - The Marine Highway
    - Parks and Recreation
    - Fish and Game Management
Questions?