

HB 311: Sustainable Budget Reporting

House Finance Committee
April 13, 2016

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Agenda

- Background
- Objective
- Implementation

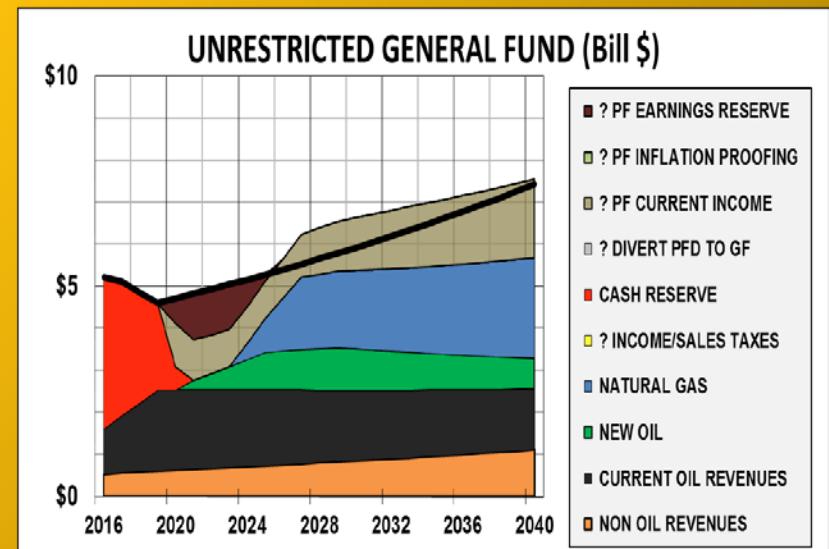
Background

- HB 136 (28th Legislature)
- Hearings on HB 136:
 - Apr. 5, 2013 (full Committee)
 - Jan. 9, 2014 (Fiscal Policy Subcommittee)
- HB 311 is the same bill
 - In preparation for the 2013 testimony Dr. Goldsmith and I prepared a work draft that improved some provisions
 - We have included that work draft here as part of this testimony

Objectives

- Requires the Administration to calculate and submit each year as part of the December budget process a long term sustainable budget number

“A spending level based on current financial assets and the projected future petroleum revenue stream which, if adopted now, could be maintained consistently long into the future, adjusted for inflation and population growth”



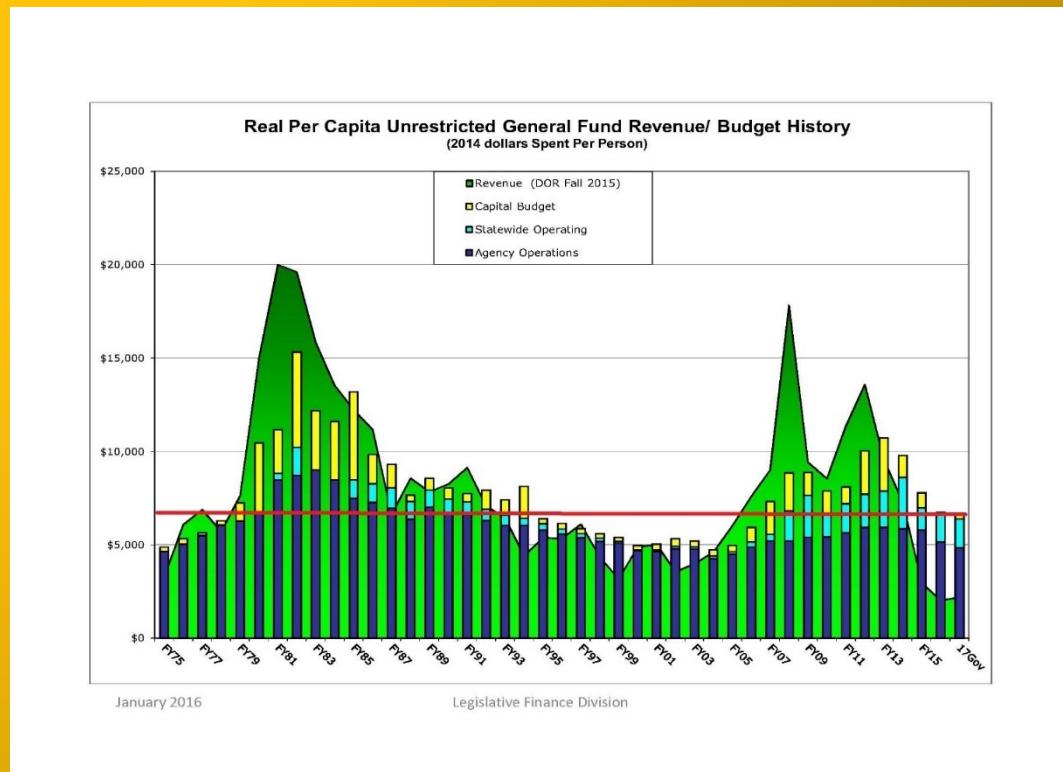
Objectives

- Goal is to provide a number that “looks through” the ups and downs of the commodity cycle and identifies a stable, long term (i.e., “sustainable”) budget number
- **Not** a spending cap, although it could be used for that (as I and others have advocated)
- **Not** a fiscal plan, although it could be used for that as well (as I and others have advocated)
- ***But in the form of HB 311 a guide*** to the spending levels that help ride through the ups and downs of commodity cycles

Origin of the model

- A response to wide swings in spending levels (and economy) based on revenue levels

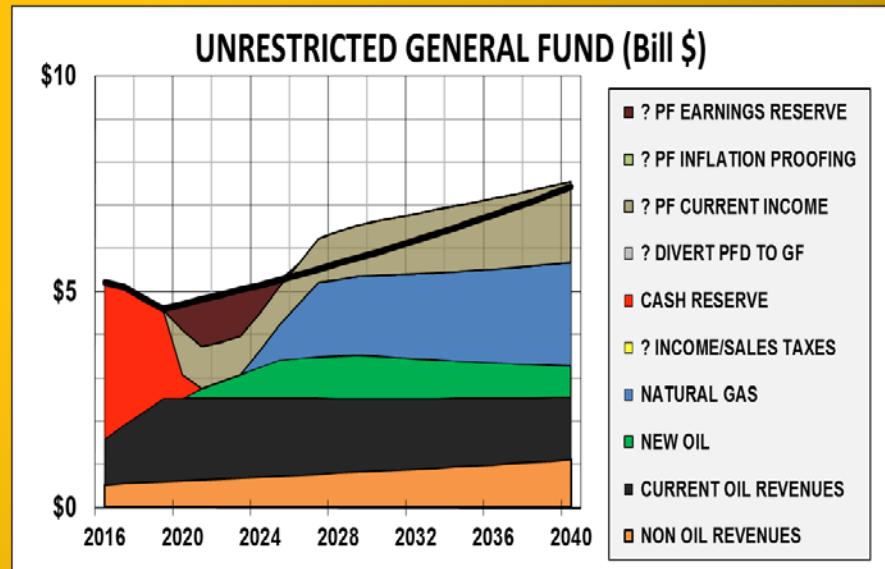
“How much do we need to save during a high revenue period in order to be prepared to offset the effect during a low revenue period”



Creates focus on long-term outlook

If you assume future is always like the present:

- *At high prices, too optimistic and current spending overshoots the mark*
- ***But pessimism is an equal problem – at low prices, too pessimistic and policy makers pull tax/PFD levers that unnecessarily penalize the current economy***



*HB 311 creates a tool to help focus fiscal policy on the **long-term outlook** to look through high and low cycles, which is critical in a commodity based economy*

IMPLEMENTING A STATE FISCAL PLAN

An Example of Tracking Maximum Sustainable Yield with HB 311

March 22, 2016

Scott Goldsmith
Institute of Social and Economic Research
University of Alaska Anchorage

RECOGNIZE AND MANAGE OUR PETROLEUM WEALTH (ENDOWMENT) LIKE A DEPLETABLE ASSET

1. How much is it worth?
2. How can we invest it for maximum return?
3. How much of it can we spend annually without depleting it?

Petroleum Wealth of the “Owner State”



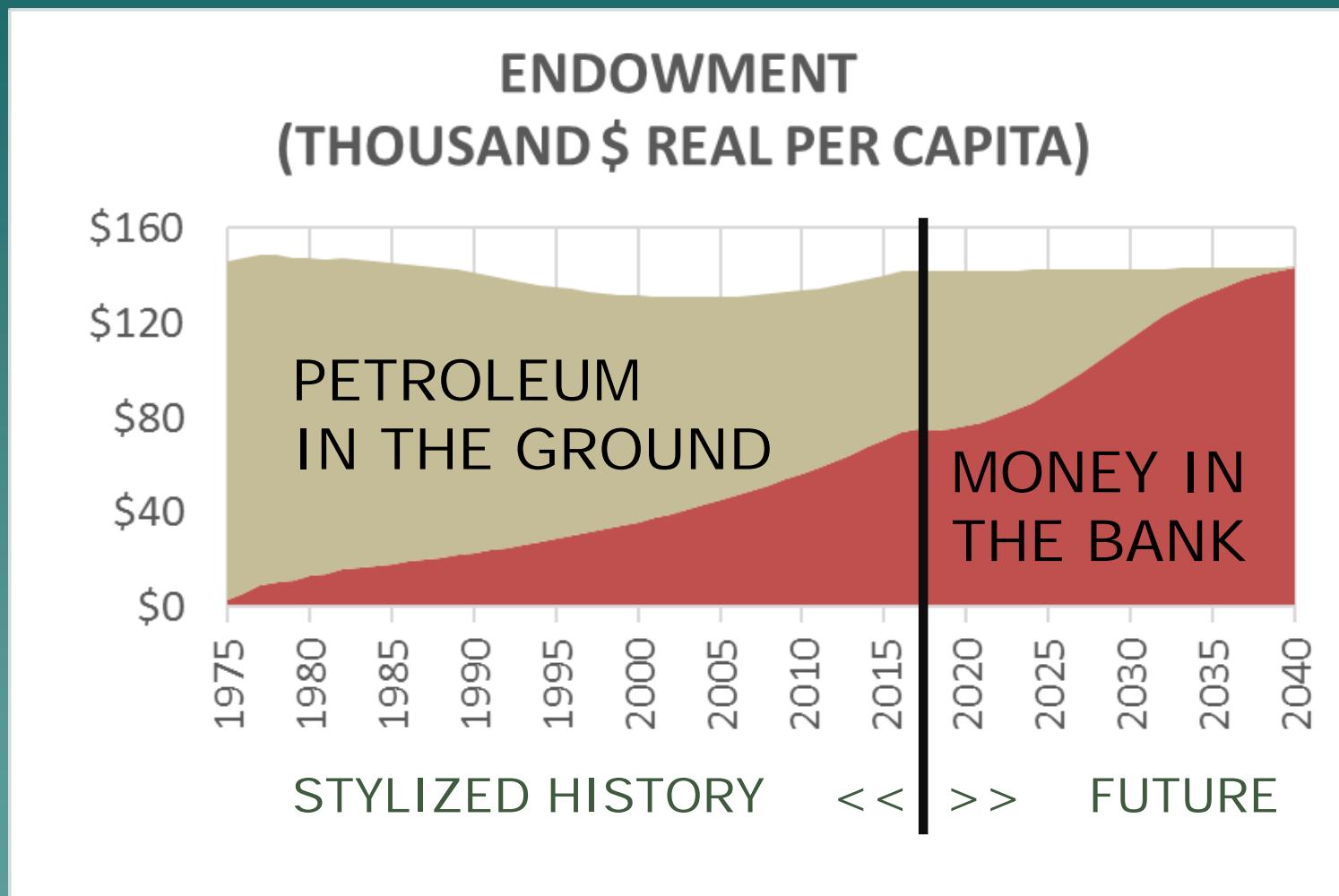
TOTAL (FY 2017)	\$125 Billion
In the Bank	\$64 Billion
In the Ground*	\$61 Billion
Known Conventional Oil	\$37 Billion
Other Oil and Gas	\$24 Billion

* Estimated Net Present Value of Future Petroleum Revenue—3 Yr Moving Average

How Much Can We Spend Today: GF Maximum Sustainable Yield

NEST EGG	\$125 Billion
Multiply: MSY Take Rate	4.2% (5%-.8%)
Equals: MSY Take	\$5.2 Billion =(\$125*4.2%)
Minus: PF Dividend	\$ 1.3 Billion
Plus: Non-Petroleum GF Revenues	\$.5 Billion
General Fund Maximum Sustainable Yield (FY2017)	\$ 4.4 Billion =(\$5.2 -\$1.3+\$5)

What Should We Sustain?



Maximum Sustainable Yield: Implementation

- Manage financial assets for maximum long term return
- Proactively participate in management of petroleum in the ground for maximum return
- Establish monitoring system to track Nest Egg value, set MSY target, and track progress towards sustainability
- Gradually transition to GF Maximum Sustainable Yield level

Other perspectives



COMMONWEALTH
NORTH

LONG TERM ECONOMIC SUSTAINABILITY
FOR THE STATE OF ALASKA

A COMMONWEALTH NORTH FISCAL POLICY STUDY

Co-Chairs Eric Wohlforth and Cheryl Frasca

February 2013

Edited by Jim Egan and Joshua Wilson

“The State is spending money at an unsustainable rate. If this is not checked, extreme measures such as diverting all Permanent Fund Dividends and and/or instituting state taxes could become necessary to sustain spending on State programs

The State has an urgent need to develop the practice of creating successive long-term strategic plans with annual budgets based on maximum sustainable yield of the State’s primary assets.”

- Commonwealth North (Feb. 2013)

HB 311

*A tool to help keep Alaska fiscal policy
focused on the long term ...*