Reducing the Deficit: Investing Alaska's Vast Cash Reserves

CS for SS Senate Bill 114

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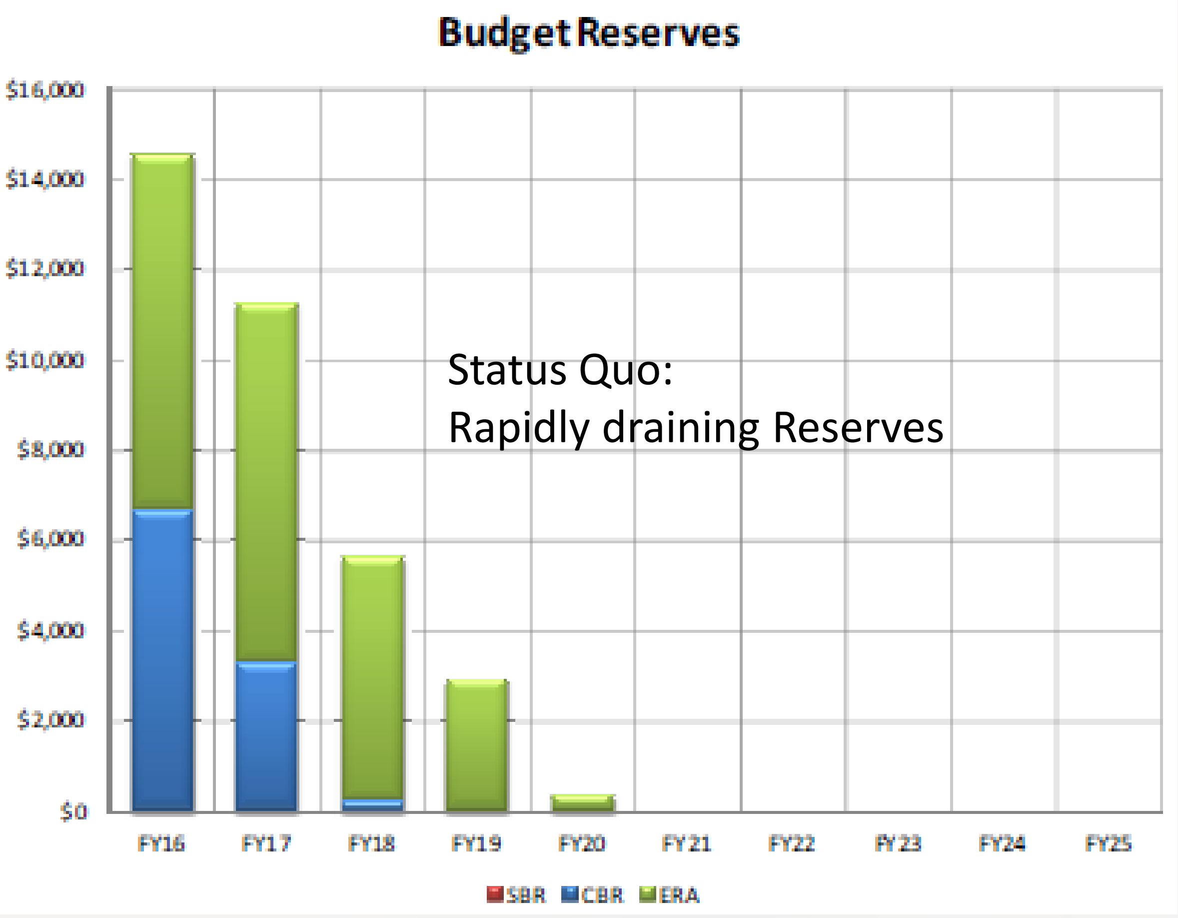
Senate State Affairs

3-15-16

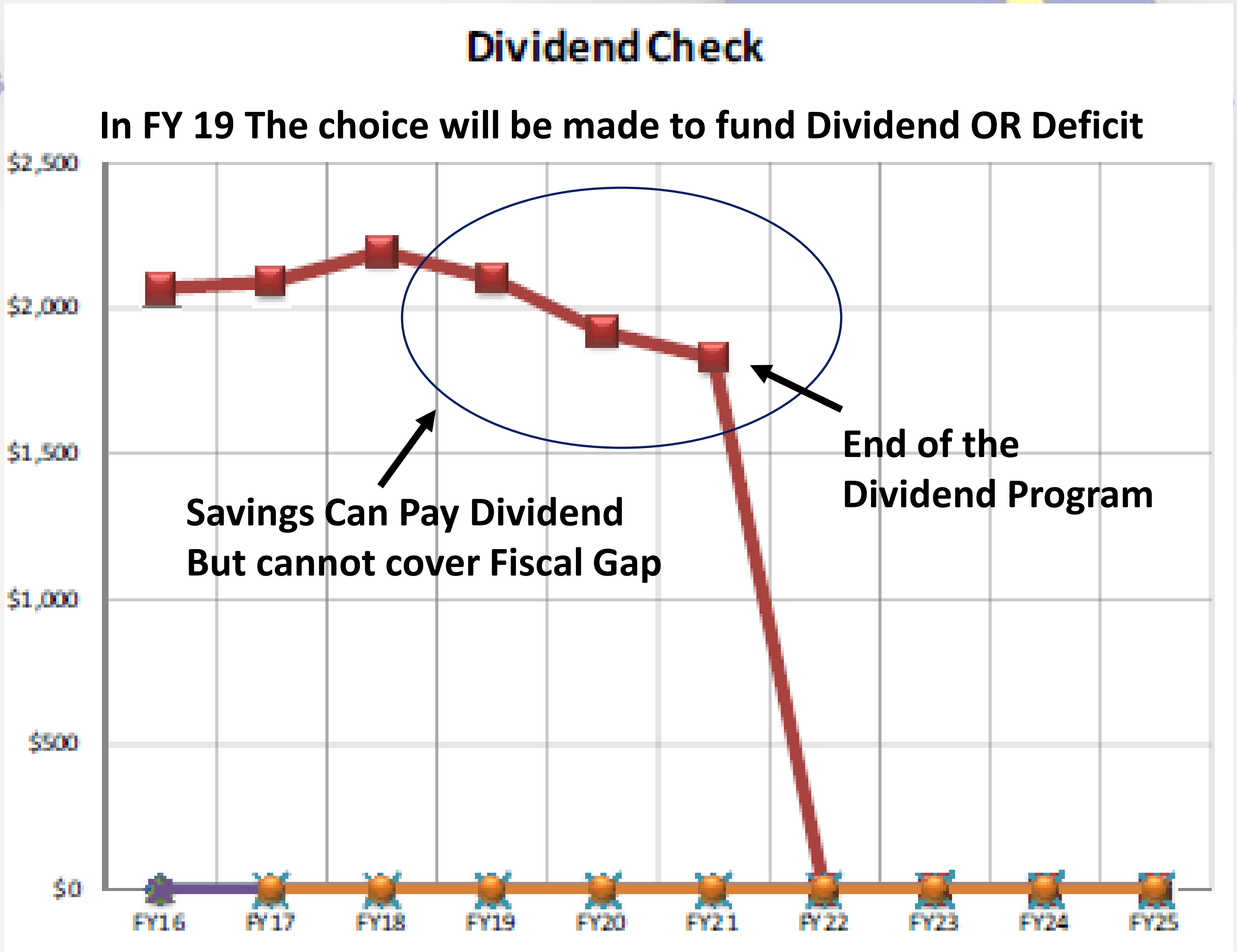
The Cost of Doing Nothing/ Status Quo

- **The longer we wait to act**
  - **The lower are our reserves**
  - **The higher the risk of Failure**

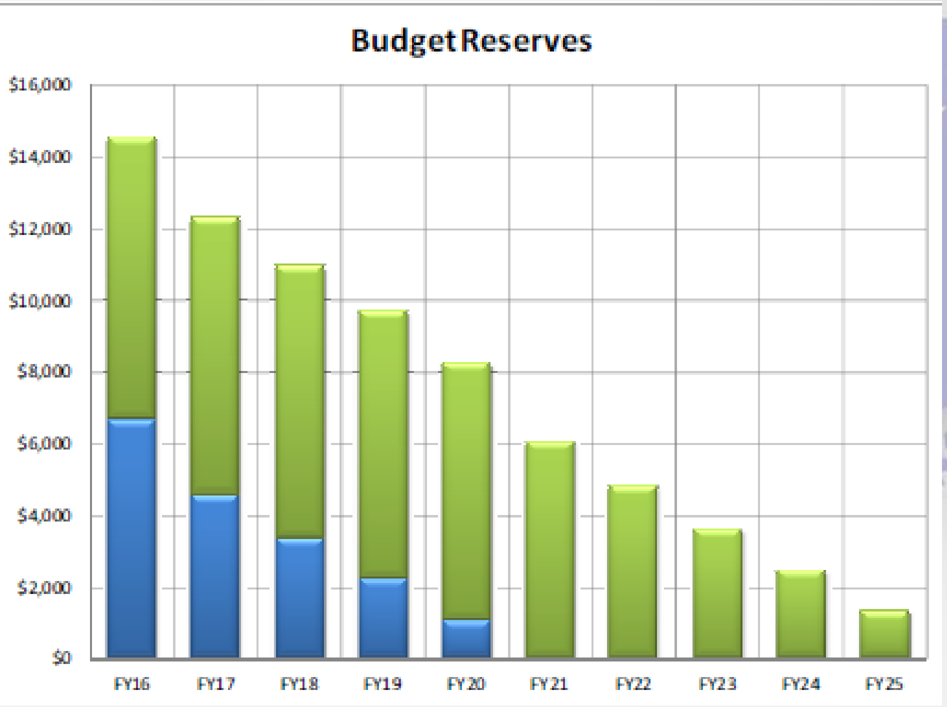
- **A lower reserve balance**
  - **Simply takes away choices we have to fill the deficit**

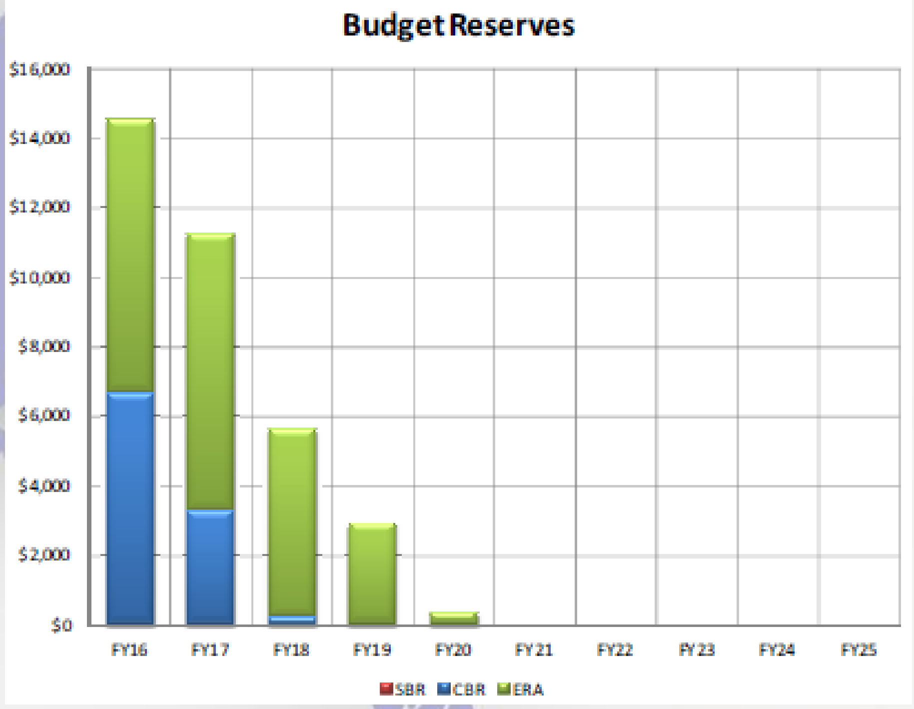


The Cost of Doing Nothing/ Status Quo



The Cost of Doing Nothing/ Status Quo

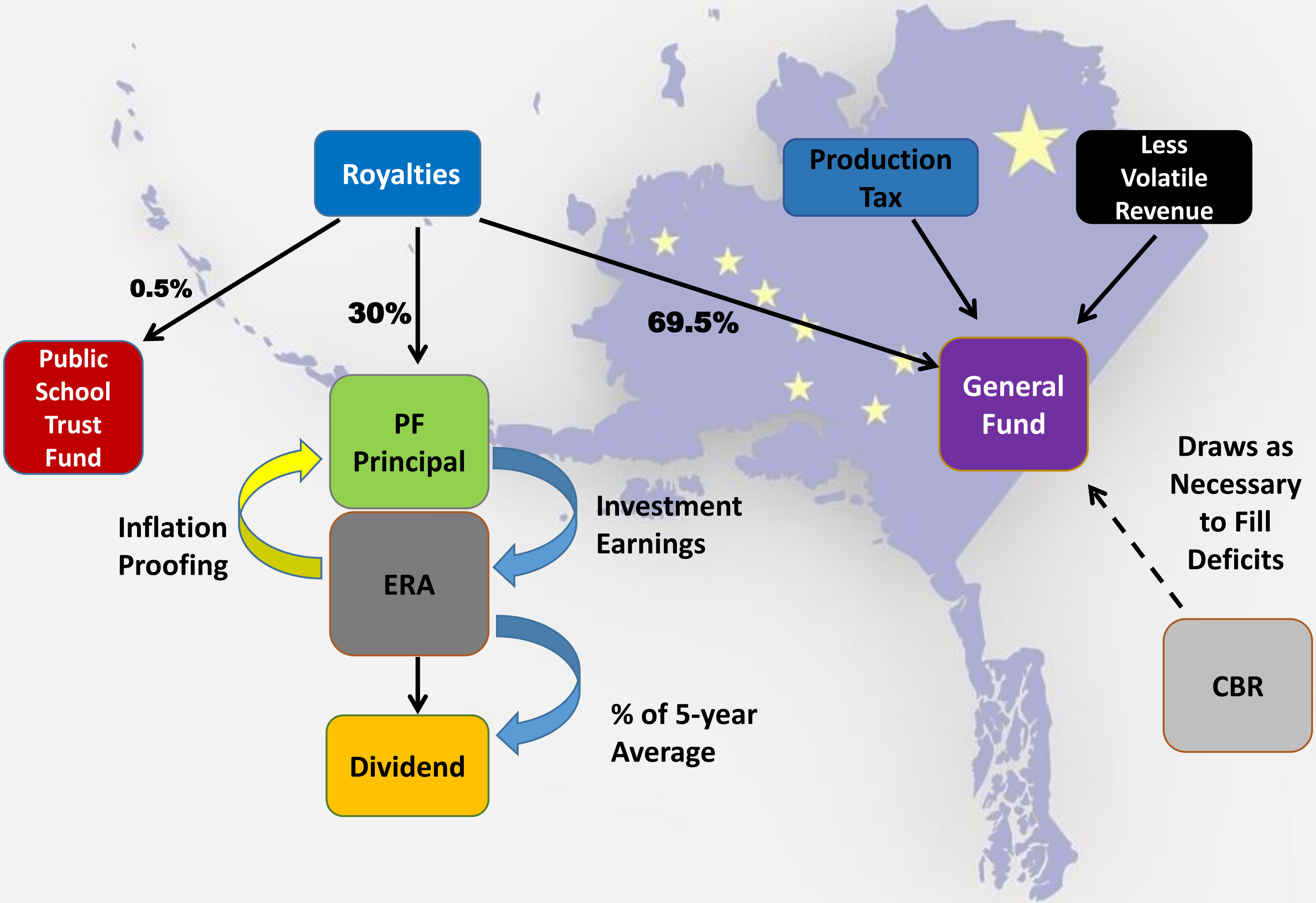




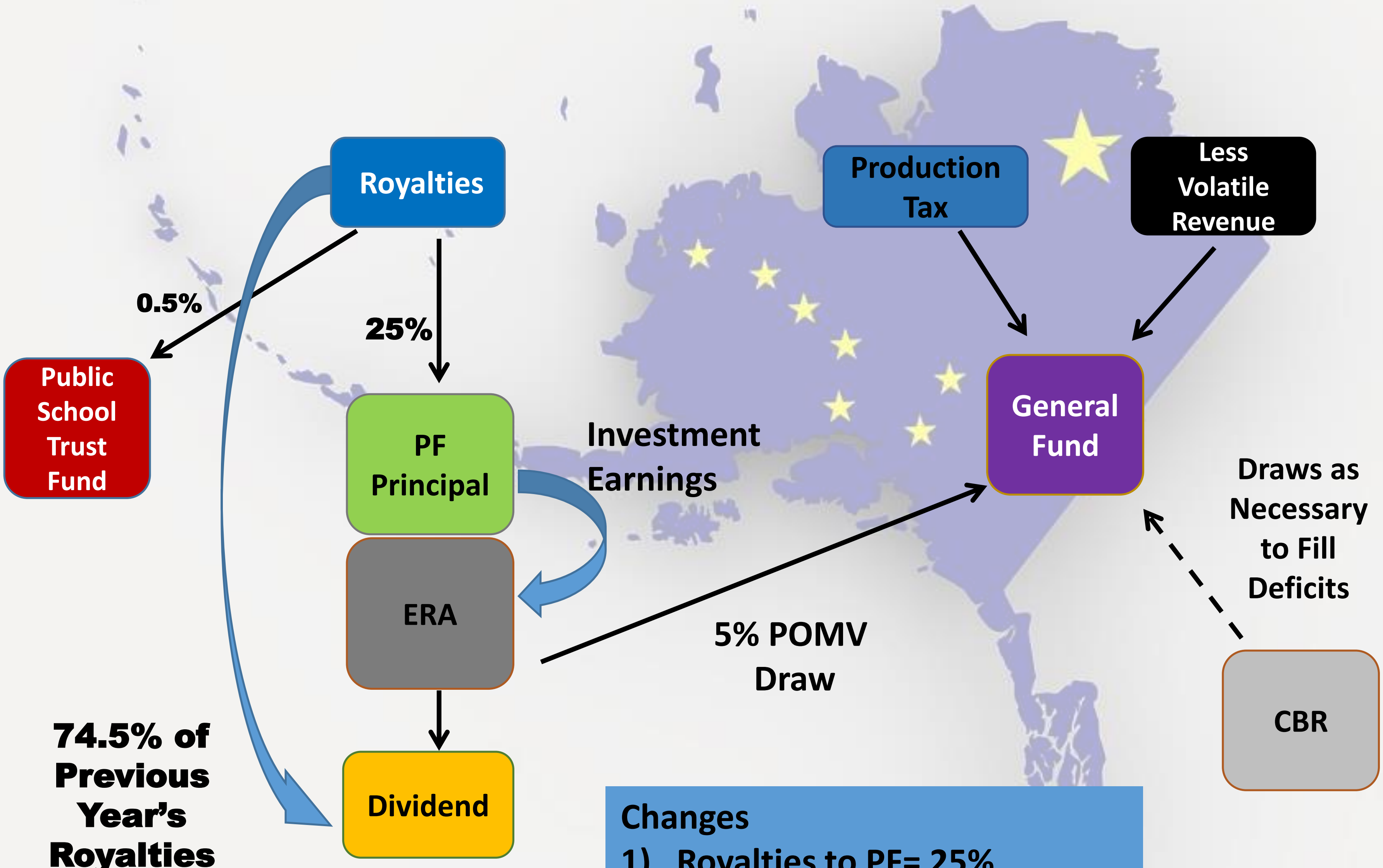
SB114
Scenario 1

Status Quo

Current Cash Flow



SB 114 Proposed Cash Flow



Changes
1) Royalties to PF= 25%
2) Dividend= 74.5% of Royalties
3) 5% POMV from ERA to GF

4 issues identified in SS for SB 114

1) 5% vs. 4.5% POMV
2) Inflation Proofing
3) Lack of review oversite
4) Spending Limitations

POMV Payout 5% vs. 4.5%

Section 3. Page 2, Line 26

Both are standard POMV amounts

5% - greater stress on the balance of the ERA

Advantage= Greater payout in the next few years

Disadvantage= 1) Less available cash in tight years
2) Slower growth of the PF

4.5%- Greater stress on the balance of the CBR

Advantage= 1) Slower draw down of ERA- greater rate of PF growth
2) IF PF grows sufficiently, the total payout can be higher sooner than under a 5% mechanism

Disadvantage= Smaller payout in next few years

Addressing 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

Addressing Inflation Proofing

In the CS for consideration inflation proofing is addressed in Section 5. Page 3, Lines 13-23

Inflation proofing amount is calculated by the following:

“multiplying the amount available for distribution for the previous fiscal year under AS 37.13.140(b) by four and subtracting the product of that calculation from the balance of the earnings reserve account on June 30 of the pervious fiscal year.”

i.e.—

If the value of the Earnings Reserve Account is more than 4 times the maximum draw allowed (4.5%), the excess can be transferred into the principle of the Permanent Fund.

This transfer is subject to legislative approval

Review oversite

Section 7. Page 4, Line 23-31

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

Section 3. Pages 2, Line 29 thru Page 3, Line 2

Section 3
Creates a limitation on how much can be drawn from the ERA in the event that oil production taxes are sufficient to balance the budget

"The amount available for distribution may not be less than zero and equals 4.5% of the average market value of the fund, including the ERA, for the five fiscal years immediately preceding the fiscal year just ended, reduced by an amount equal to the production taxes over $1Billion received in the fiscal year just ended."

- **This improves the sustainability of payouts from the ERA**
- **Reduces the risk of increasing spending in high years of petroleum revenue**
- **This reduces the volatility in the budgeting process for UGF expenditures**

Revenue Limitations

Section 3. Page 2, Lines 29 thru Page 3, Line 2

- For Oil revenue over $1B there is a corresponding reduction of the POMV draw

$ Billions		
Production Taxes (PT)	POMV Draw (4.5%)	PT and POMV Draw
$0.5	$2.25	$2.75
$1.0	$2.25	$3.25
$2.0	$1.25	$3.25
$3.0	$0.25	$3.25
$3.5	$0.00	$3.50
$4.0	$0.00	$4.00
$5.0	$0.00	$5.00

Conclusion/Summary

These change reflect comments and concerns voiced by

Colleagues

Neighbors

The Public

- **A 4.5% POMV is more sustainable and puts less pressure on the ERA**
- **Though a POMV is often viewed as self inflation proofing-**
  - **It is important to have a specific mechanism layered on top of that to ensure stability to the Permanent Fund corpus**
- **A review is a simple way to ensure that the mechanisms we put into place are working correctly, and that there is room for adjustments as needed**
- **The Revenue Limitation provision helps prevent rapid growth and possible contraction of state spending following high oil prices.**

Questions?