

Reducing the Deficit: Investing Alaska's Vast Cash Reserves



Senate Bill 114

Senator McGuire

Senate Finance Committee

3-22-16



Is there Fiscal Problem?

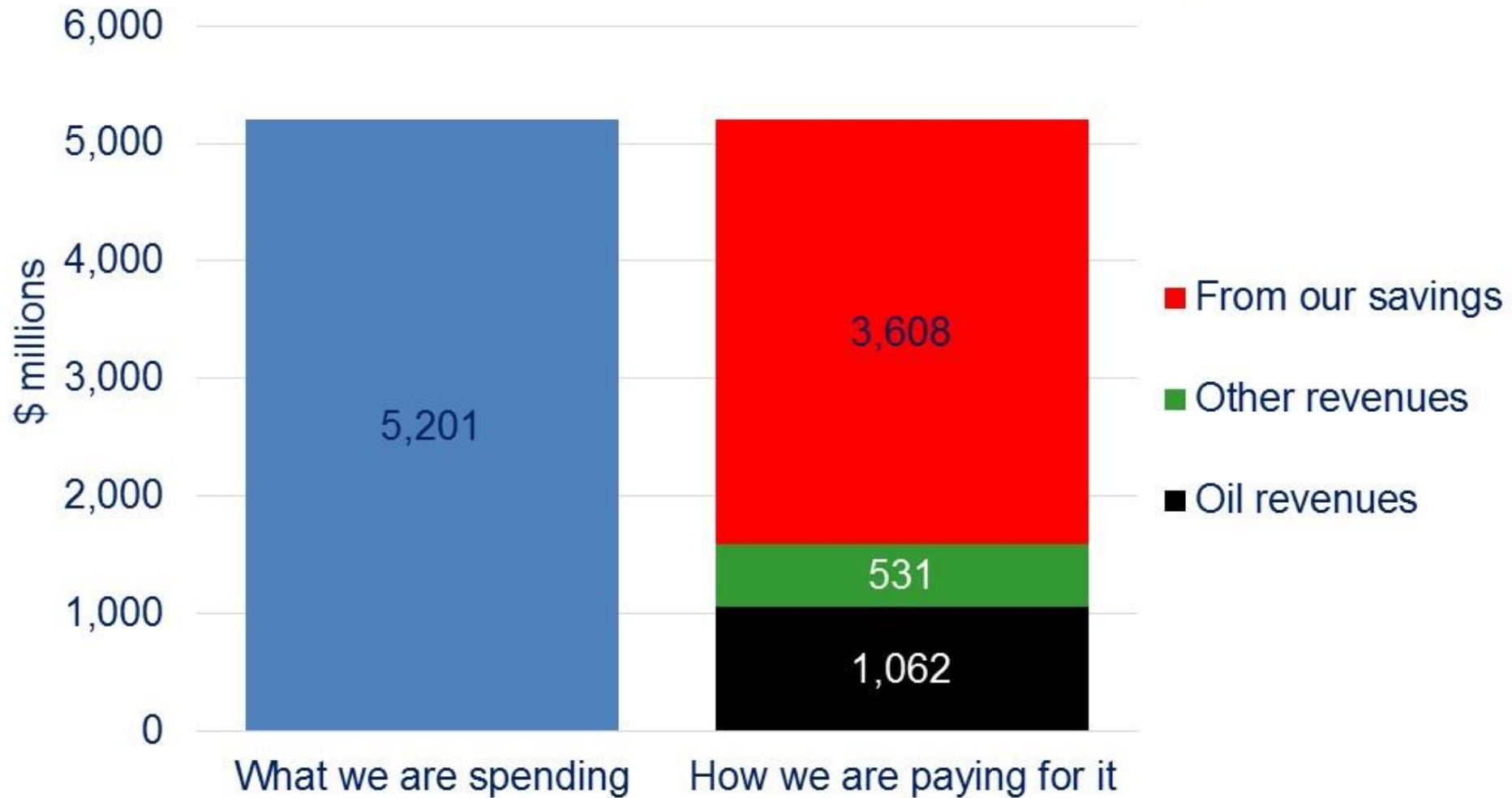
We have a \$3.5 to \$4Billion Deficit

- 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

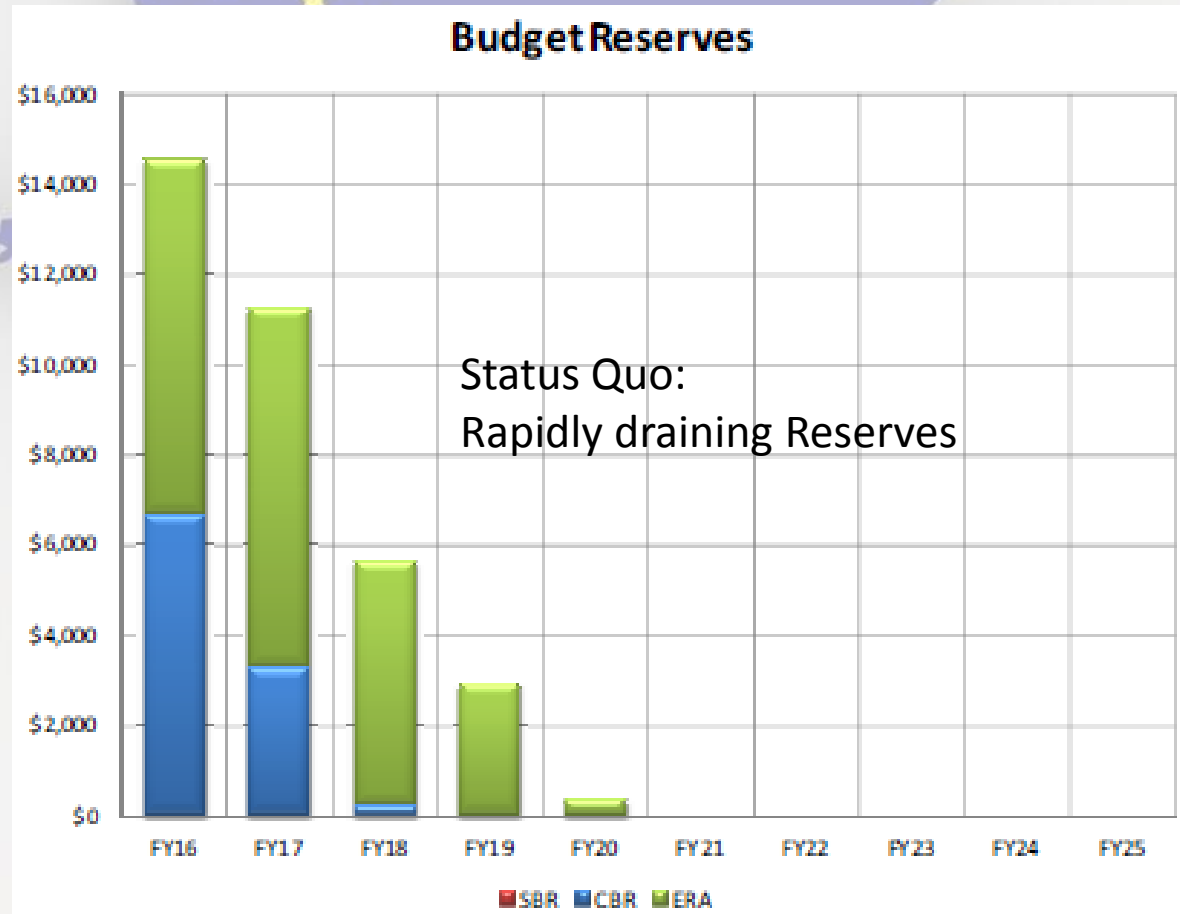
- We cannot wait and hope for high oil prices
- The price of inaction now could be disastrous for the state's future

Alaska's Fiscal Situation This Year (FY16)

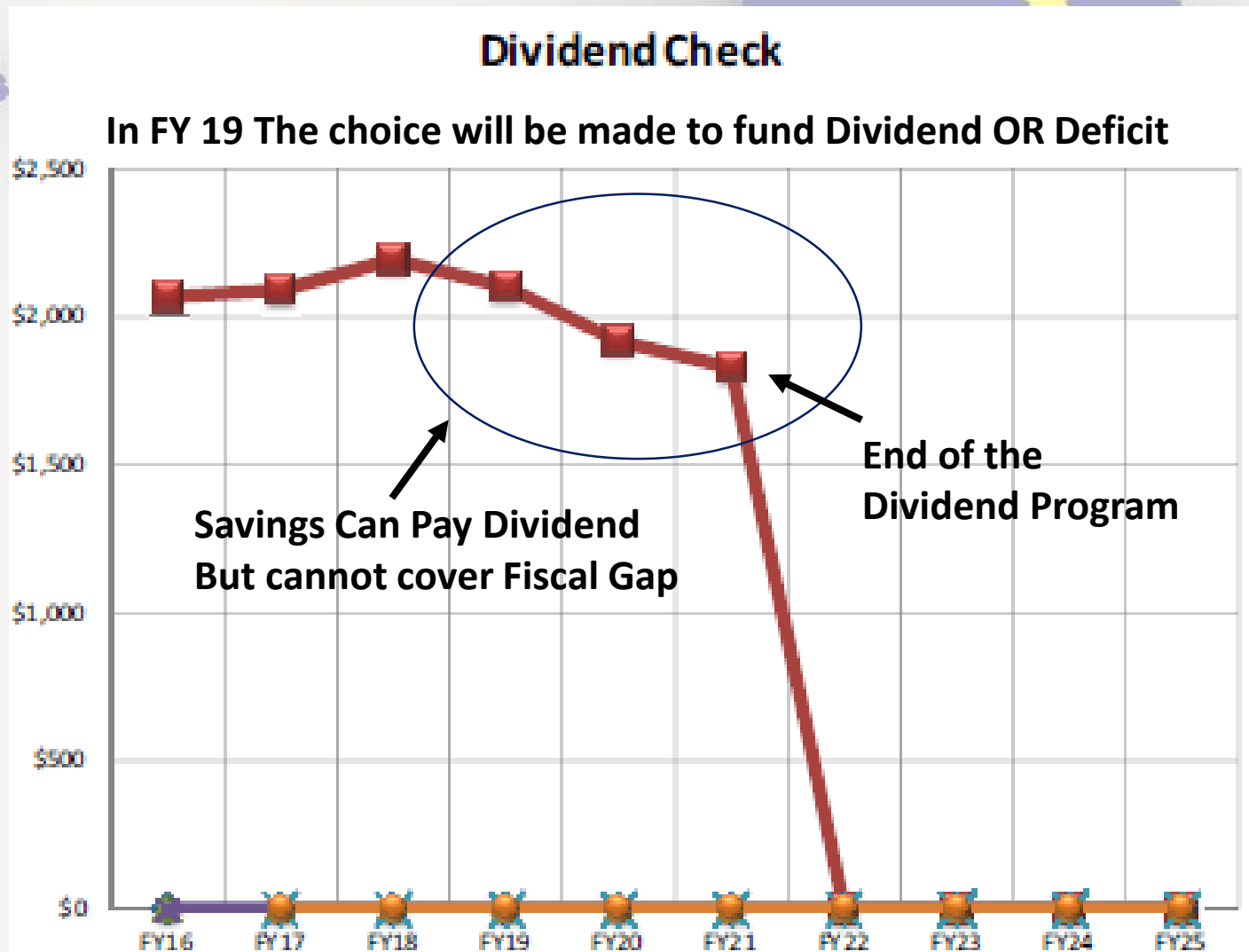


The Cost of Doing Nothing/ Status Quo

- 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



A Path Forward

We need a plan to address the problem

In crafting SB114 I had these principles in mind:

The solution needed to:

- 1) Retain a dividend
 - a) Without making the dividend dependent on the size of state spending
- 2) Reduce the volatility in the state budget
- 3) To clearly expose the size and cost of government
 - so that downward pressure would ensure that Alaskans could begin an honest assessment of needs vs. wants
- 4) Be enduring to allow maximum use of our wealth over generations so that benefits and burdens are shared
- 5) Be Simple and Easy to implement

The Five Stages of Grief

- Denial
- Anger
- Bargaining
- Depression
- Acceptance

Other Options?

3 Proposals have been introduced to the Legislature

- **SB128 - Annuity Model**
- **SB114 – 5% POMV**
- **HB224 – 4.5% POMV**

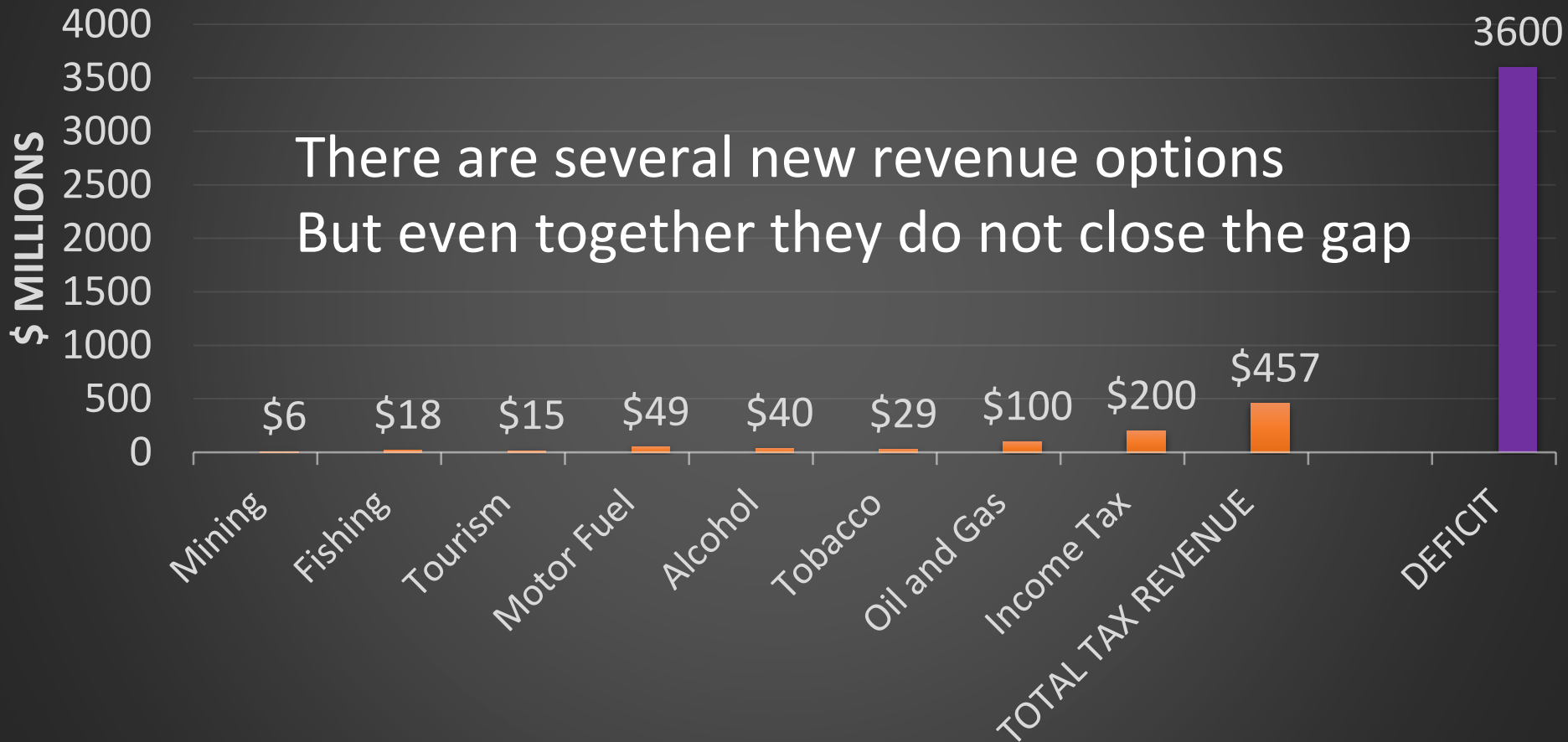
All Use the Permanent Fund Earnings

What else could we do?

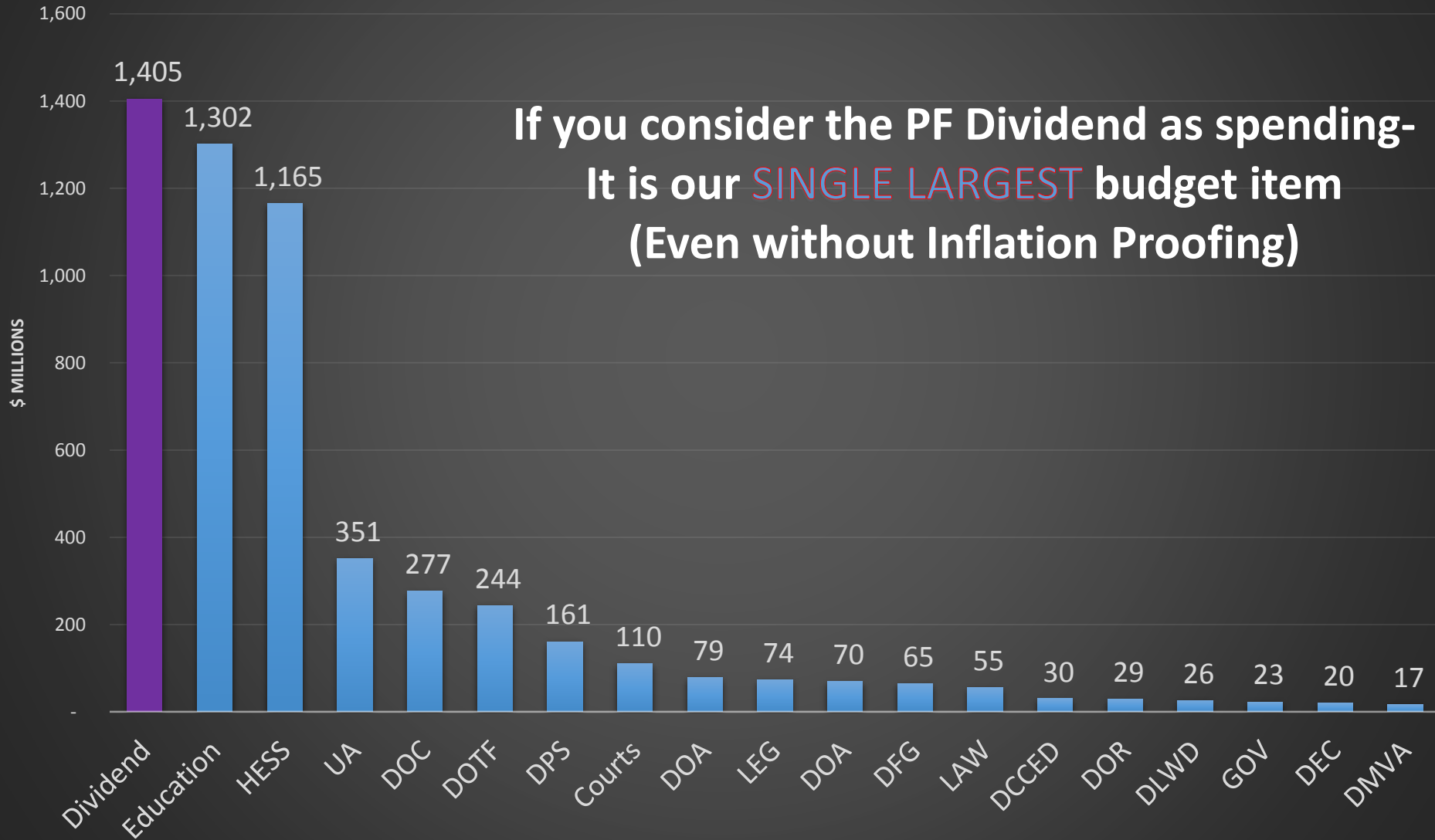
- **Constitutional Amendment to access the Corpus of the Permanent Fund?**
 - **Requires vote on next General Election**
- **New Taxes?**

**Continue with Strategic Cuts to the budget
But we cannot cut our way out of this**

Potential New Revenue From Sustainable Alaska Plan



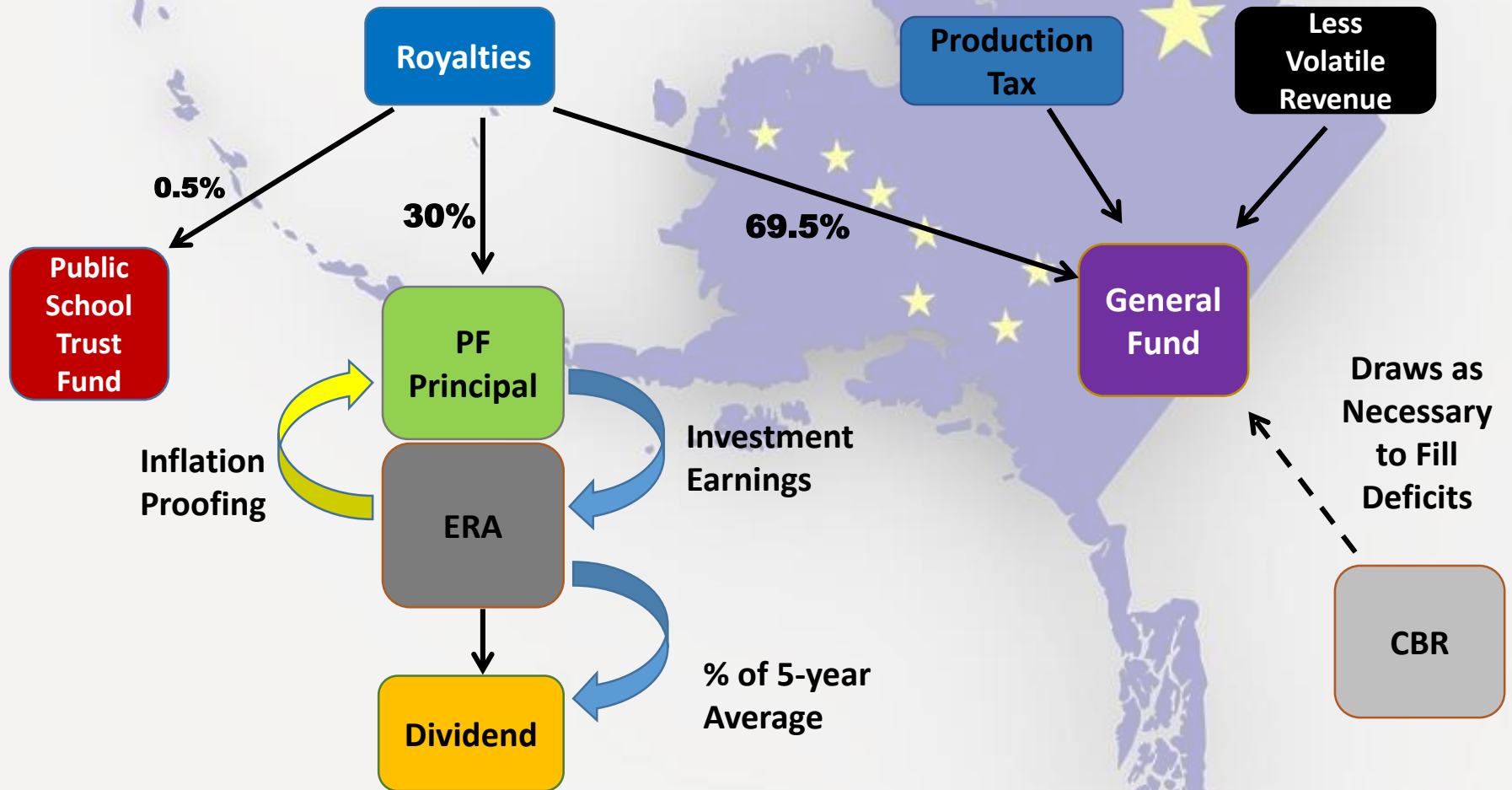
FY16 Agency Share of Total Agency Operations and the Appropriation for Permanent Fund Dividends (UGF Only)



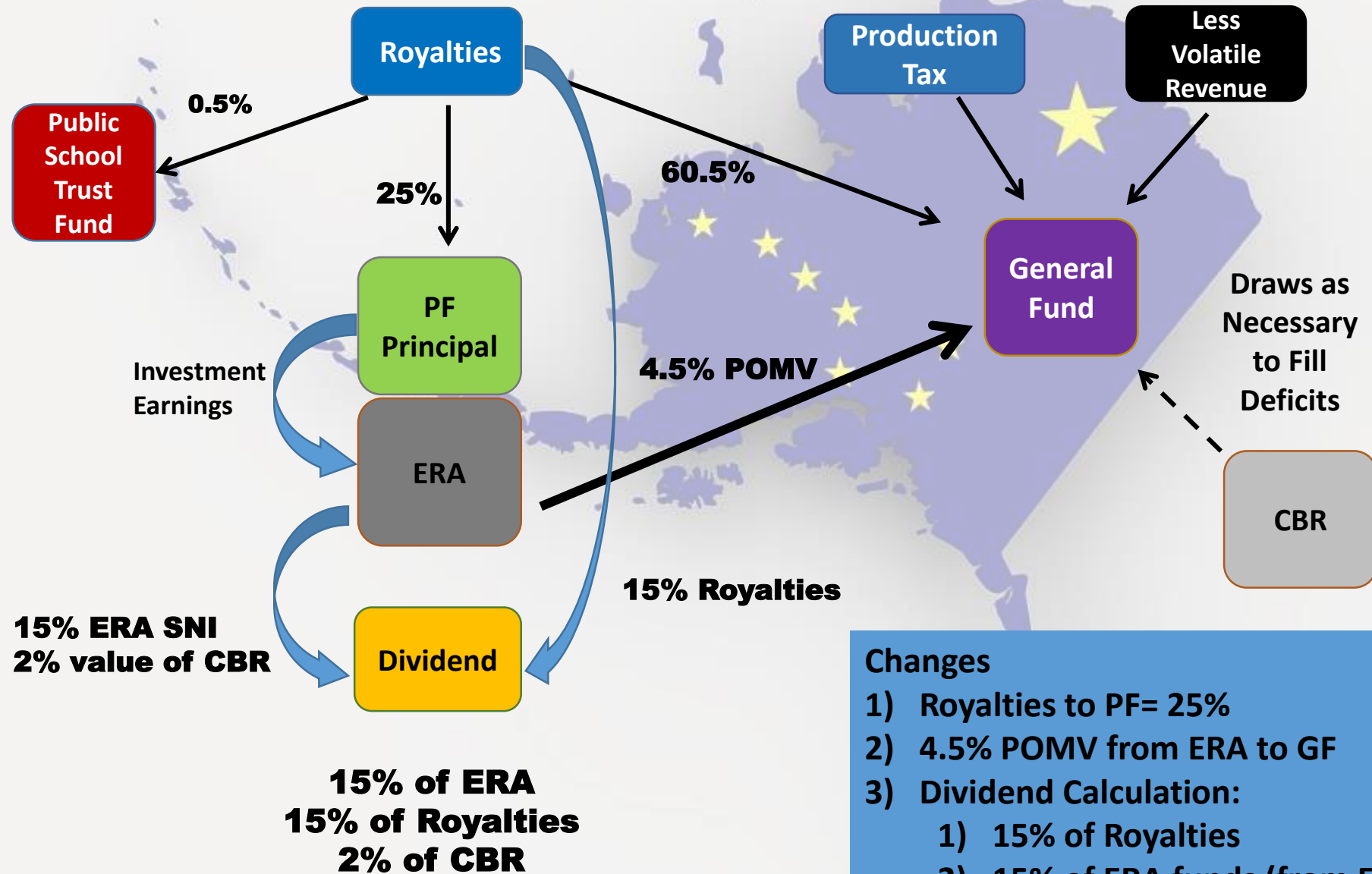
A map of the state of Alaska is shown in a light blue color. Overlaid on the map are eight yellow stars. One star is located in the northeast corner of the state. A diagonal line of seven stars runs from the central interior towards the southwest coast. The text "Structure of SB 114" is centered over the map.

Structure of SB 114

Current Cash Flow



Proposed SB 114 Cash Flow



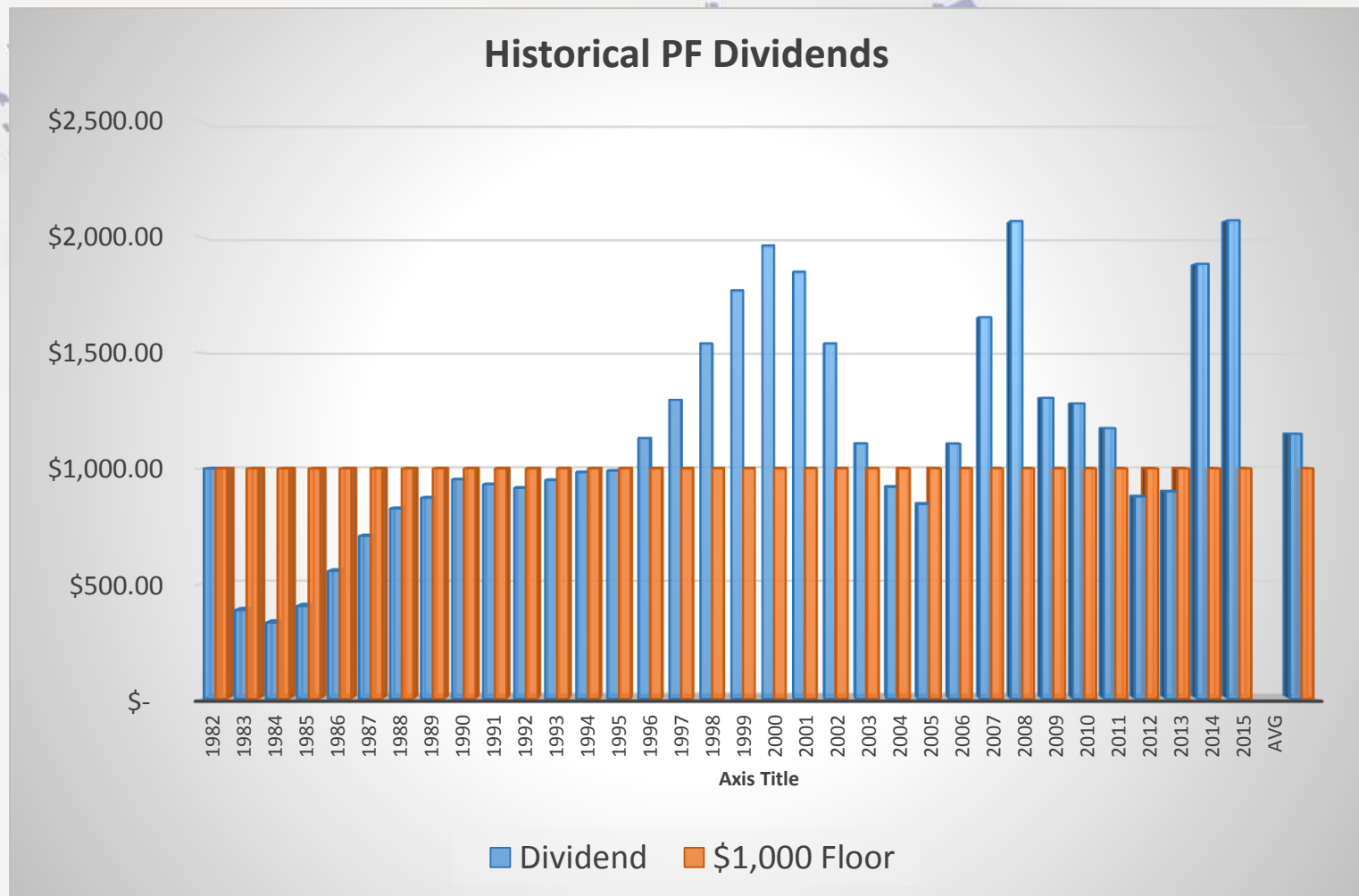
Changes

- 1) Royalties to PF= 25%
- 2) 4.5% POMV from ERA to GF
- 3) Dividend Calculation:
 - 1) 15% of Royalties
 - 2) 15% of ERA funds (from ERA)
 - 3) 2% of CBR (from ERA)

The Overall Effect

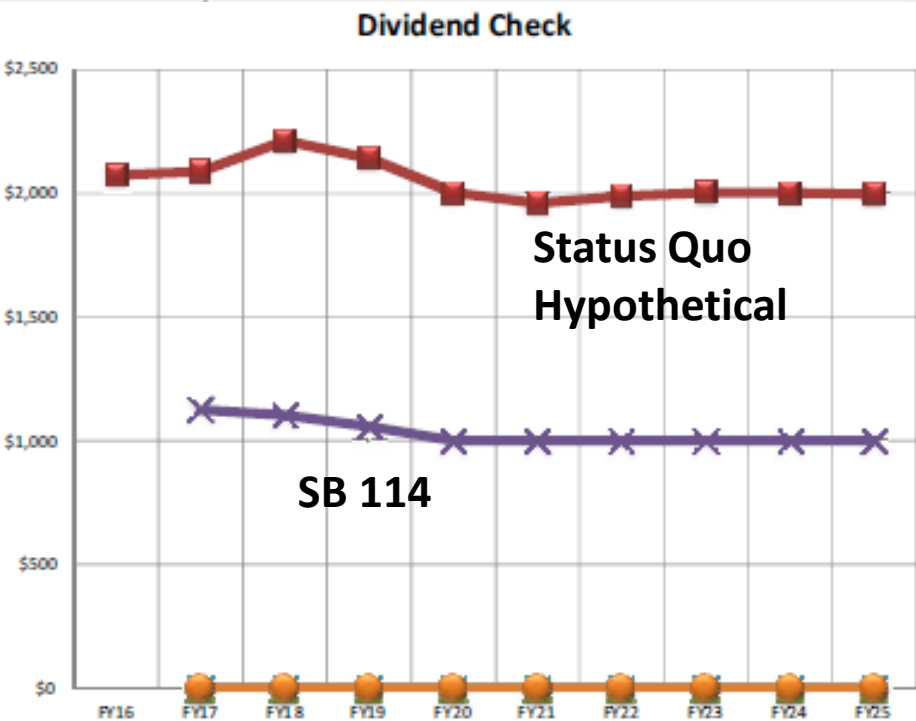
- **Reduces the Deficit by \$2 Billion**
- Reduces volatility in budget
- Grows the Permanent Fund
 - Maintains buying power of the corpus of the fund
- Preserves the Dividend
 - With a minimum of \$1,000
- Reduces the CBR draw to cover deficit
- Helps maintain good state credit rating
- Maintains downward pressure on state Spending

SB 114 Dividend

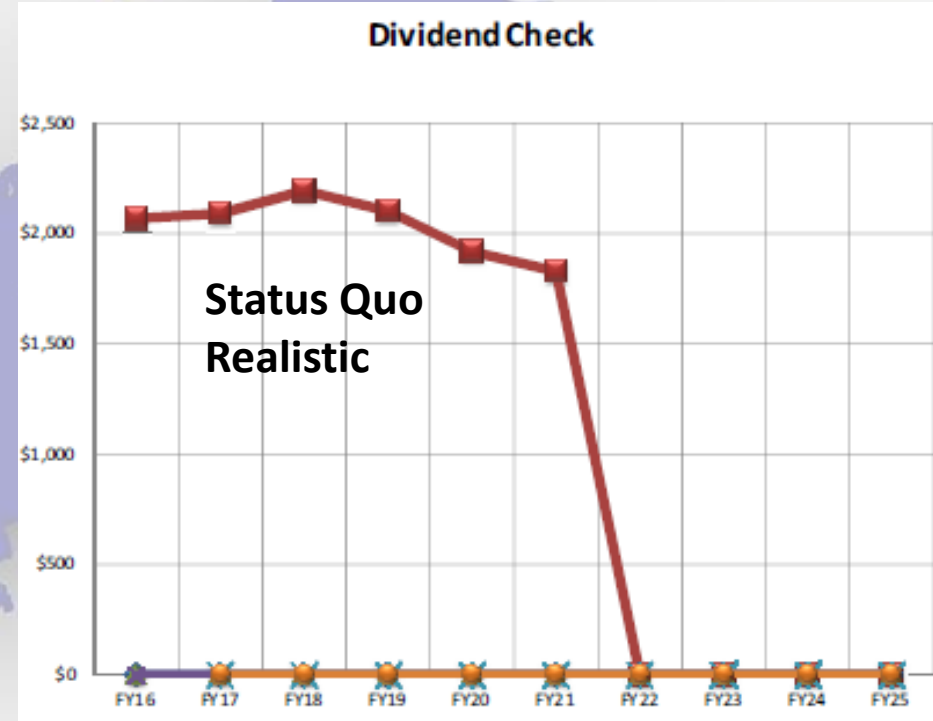


34 Dividends have been paid
18 Have been \$1,000 or less
16 Have been greater than \$1,000

The Size of the Dividend

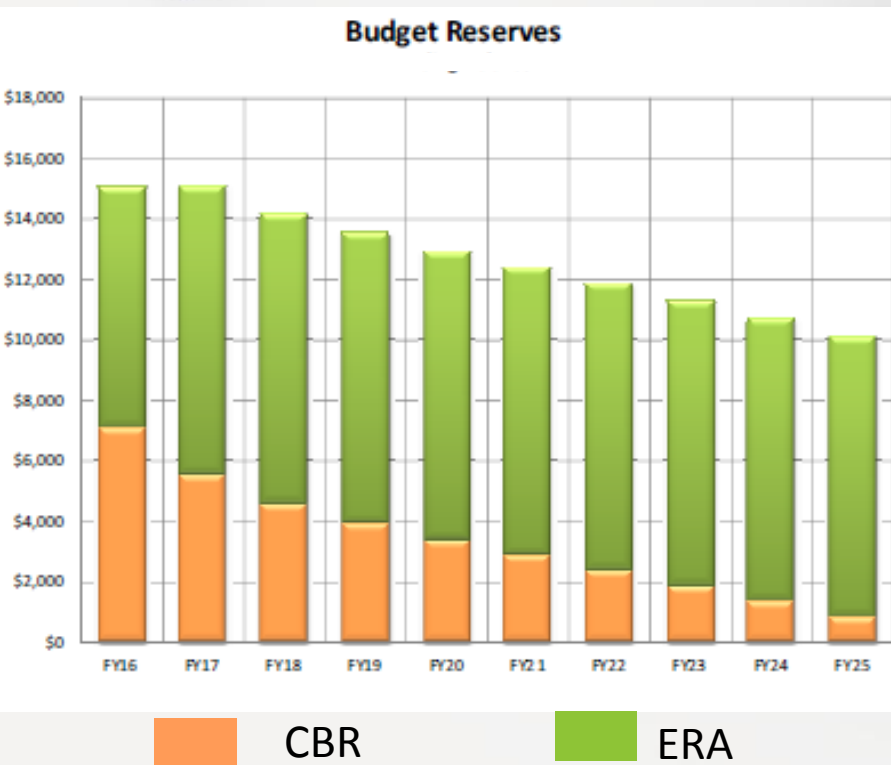


SB 114
Has a minimum
\$1,000 Dividend

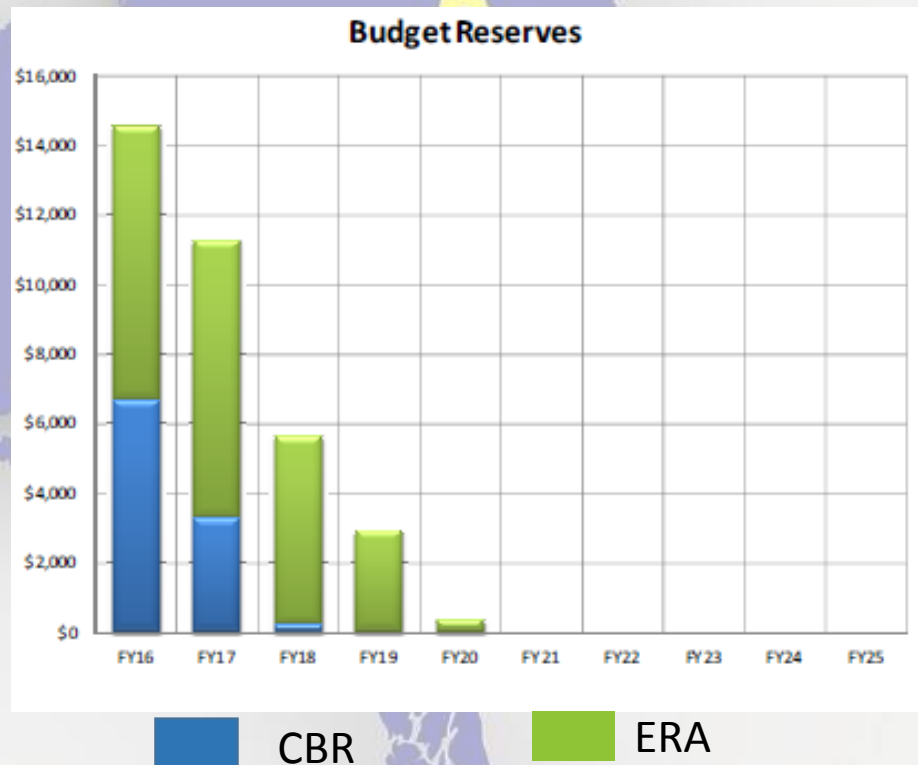


Status Quo
Dividend Program WILL END

The Reserves SB 114 vs. Status Quo

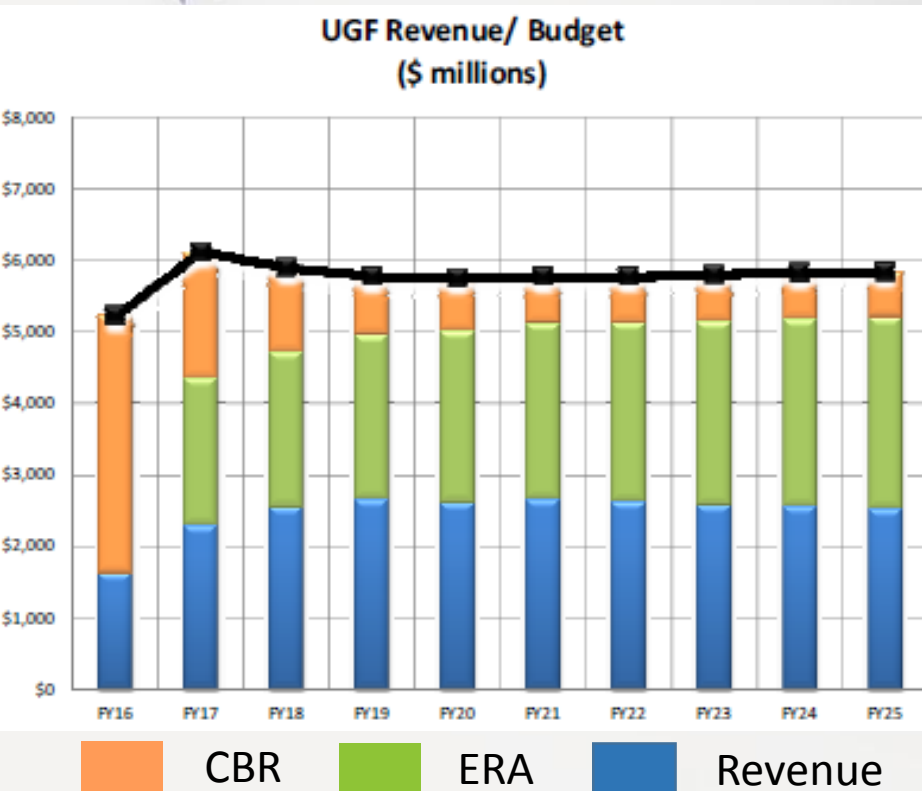


SB114

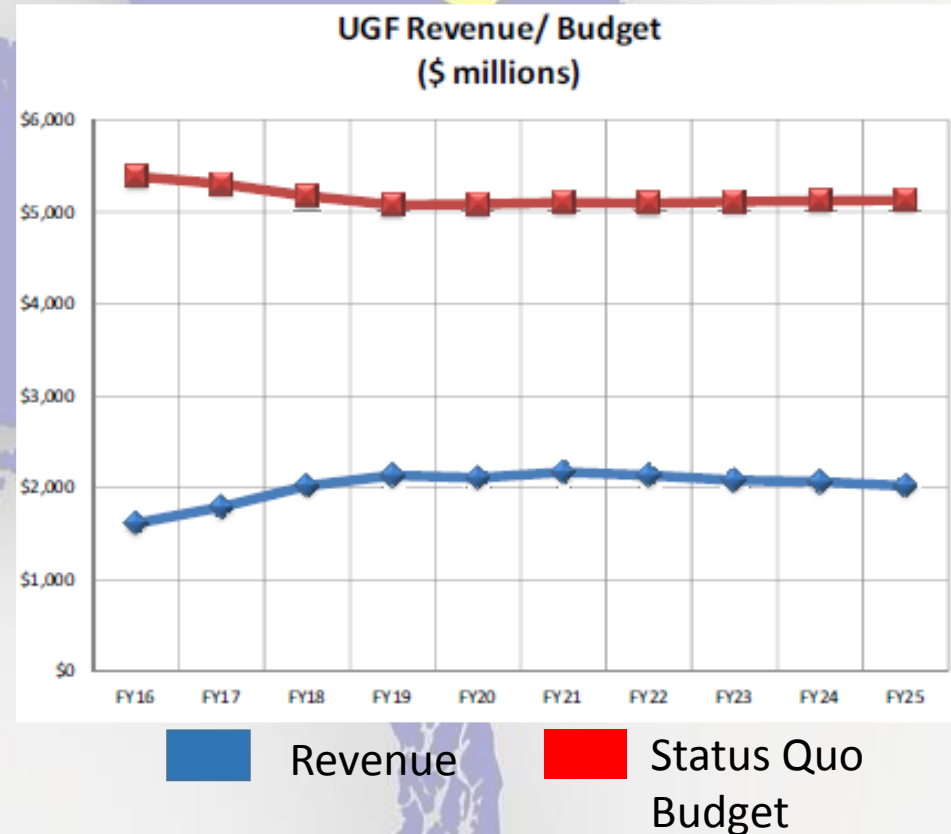


Status Quo

The Reserves SB 114/ Status Quo



SB114



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 \$690M * 25% = **\$172M**

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

Review oversight



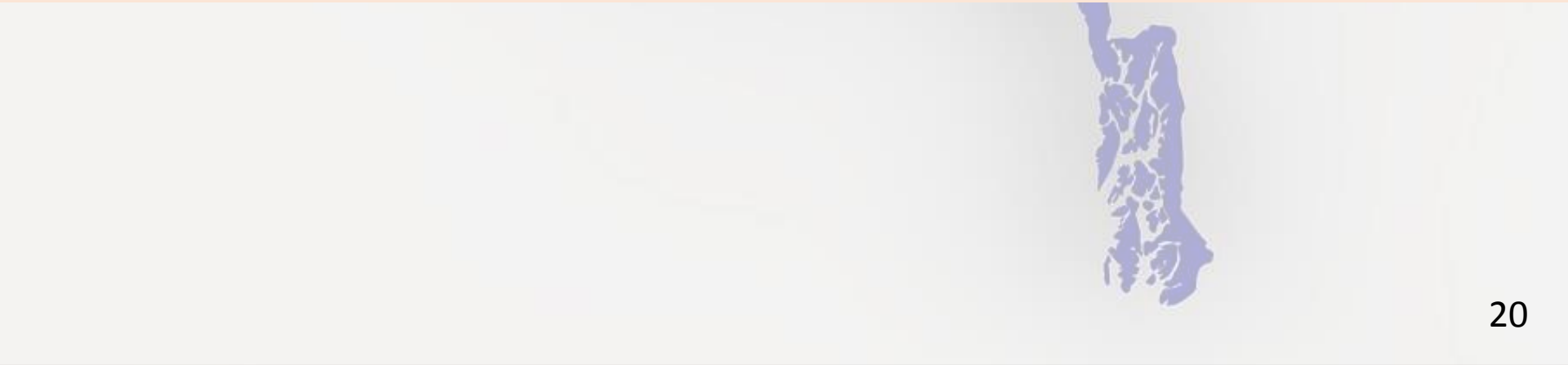
Each year on or before January 30

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

\$ 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

What SB 114 *IS* and *IS NOT*

- 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

MAJOR POLICY CALLS



- POMV vs. Sovereign Wealth Model
- Revenue Limitation
- % of POMV Draw
- Dividend Calculation
- CBR Investment

MAJOR POLICY CALLS

POMV vs. Sovereign Wealth Model

- **POMV is a 5 year look back (hindsight)**
- **SWM is a 25 year look forward (foresight)**

Which is better?

MAJOR POLICY CALLS

Revenue Limitation

Dramatically reduces volatility in the budget

However

Current language does not limit revenue when Oil Revenue exceeds \$3.5Billion

Should it?

MAJOR POLICY CALLS

% of the POMV

The Percentage of POMV draw is sustainable around 5%- total draw from ERA

Questions we must ask ourselves:

- *Will* this percentage include a portion for the Dividend?
 - The current bill excludes the 15% SNI of the ERA and the 2% from CBR from the 4.5% POMV Draw
- 4.5% POMV + 15% SNI + 2% CBR is probably closer to 5.2% total draw
- Is this Sustainable?

MAJOR POLICY CALLS

Dividend Calculation

- **Current bill holds the 2016 Dividend harmless (status quo)**
 - **This will cost the state \$750M vs. implanting a new calculation this year**
- **Current bill guarantee's a \$1,000 Dividend minimum**
 - **This protects Alaskans on the low side, but the state pays out**
 - **This must be drawn from savings and will not be paid back when dividends increase**

MAJOR POLICY CALLS

Dividend Calculation

Consideration

- The current bill draws a 4.5% POMV from the ERA
 - Then bases the dividend, in part, on 15% of a 5yr avg. SNI
 - These two things are counter to each other POMV vs. SNI payouts

This introduces Volatility to the POMV over time

- Could consider a Flat dividend amount, or
 - Better, a formula that
 - Uses a % of Royalties and
 - And % of the POMV

This could spread the risk and reward between residents and the state

MAJOR POLICY CALLS

CBR Investment

Consideration

- **AS 37.10.430**
 - (a) DOR may transfer management of the fund to the APFC
 - (c) The subaccount in the CBR can be invested for higher returns IF
 - The Commissioner of Revenue does not expect them to be needed for the next 5 years.
- A sustainable POMV draw reduces the drain on the CBR
- Some of it could be invested long for a higher yield

Annual CBR- Main Performance

-DOR/Treasury

FY	Return %
2015	0.84%
2014	1.35%
2013	1.45%
2012	3.22%
2011	2.64%

SB 114: Alaska's Glide Path

Right now we have options

The Cost of inaction is to reduce the effectiveness of
those options

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