NEW SUSTAINABLE
ALASKA
PLAN
Pulling Together to Build Our Future

HB 245 / SB 128 (Alaska Permanent Fund Protection Act)
March 20, 2016

The Cost of Delay

Waiting until next year to enact legislation correcting Alaska's fiscal imbalance will:

1. Forever reduce the amount that can be sustainably drawn from our financial assets;
2. Compromise the sustainability of any endowment plan;
3. Risk a downgrade of the state's credit rating; and
4. Damage Alaska's economy.

Some of these impacts can be quantified now; the magnitude of others is uncertain. They are all significant. More importantly, by providing a comprehensive solution to our fiscal challenge this year, these costs can be avoided.

The centerpiece of the New Sustainable Alaska Plan, the Alaska Permanent Fund Protection Act (APFPA) establishes a new fiscal framework to address the bulk of this year's budget gap. This new framework redirects volatile petroleum revenues to the permanent fund and then provides a sustainable and consistent $3.3 billion endowment draw from the permanent fund as the primary funding source for unrestricted general fund expenditures. More than helping to resolve this year's fiscal challenge, the APFPA provides the foundation for a sustainable and balanced fiscal future. The biggest threat to Alaska having a balanced and sustainable future is delay. Delay compromises our ability to execute this, or any other, plan to correct the fiscal imbalance.

1. Delay permanently reduces the amount of the sustainable draw, a reduction that must be offset by additional cuts or higher taxes.

Years of Delay	Draw Reduction
1	$150 million
2	$325 million
3	$400 million
4	$500 million

Without fiscal reform this year, we will continue to spend from our savings to fill the fiscal gap. But, drawing more than a sustainable amount from our savings in the near-term reduces the amount that the fund can sustainably produce going forward. The shortfall resulting from a lower sustainable draw will have to be addressed through additional cuts or additional new revenues.

A one year delay reduces the how much our savings can generate by $150 million – annually. Compensating for that loss would require measures equivalent to doubling the proposed mining, fishing, tobacco, alcohol, and motor fuel tax increases. Four years of delay would require measures equivalent to more than doubling the proposed income tax or eliminating the dividend program.

2. Delay will compromise the sustainability of any endowment plan as the risk of depleting the limited funds available for appropriation increases.

The availability of funds to maintain a steady level of spending through years of low revenue is essential to any plan for an endowment draw from the Permanent Fund. Endowment draws are calculated on the value of the entire endowment base. But, in the case of the Permanent Fund, spending from the corpus is constitutionally prohibited. Consequently, there is a risk that over several years of low annual revenues a draw that is "sustainable" with respect to the value of the entire fund could deplete the funds available for spending.

To mitigate this risk, the APFPA proposes maintaining a target balance of four times the sustainable draw in the earnings reserve account (ERA), including a transfer of $3 billion from the Constitutional Budget Reserve (CBR) in FY17.[1] But, under current levels of spending and expected revenues,[2] the CBR will likely be depleted by the end of FY19 and the ERA will follow by the end of FY22.[3] Delay and status quo spending (exceeding sustainable levels by $2 billion) compromise the availability of the $3 billion from the CBR and increases the risk of depleting the ERA –leaving the state with few options other than spending from the Permanent Fund corpus.

3. Delay risks a downgrade of the state's credit rating.

Both Standard and Poor's and Moody's credit rating agencies have downgraded Alaska's credit rating and cautioned that further downgrades may follow if lawmakers fail to address the structural imbalance between state spending and revenues this year. The nation's third major rating agency, Fitch Ratings issued a clear caution that failure to address the state's fiscal imbalance will result in a credit downgrade. The consequences of a downgrade are real.

While a downgrade would not wholly undermine the good reasons for bonding, it would increase the cost. If interest rates rise, direct cost impacts will be amplified even more.

But, those increased direct costs are minor compared to the broader significance of the credit ratings for the state's economy. The ratings provide a market-based metric for the state's economic health and investor confidence. As our rating falls, as a result of a failure to address the state's revenue imbalance, it will impact consumer and investor confidence as discussed below

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[1] The remaining CBR balance is allocated to other purposes under the New Sustainable Alaska Plan (NSAP).

[2] Current levels of spending include: UGF expenditures of $5.2 billion per year, status quo annual inflation proofing of the Permanent Fund corpus, and dividends distributed under the current formula. Annual revenues include: petroleum revenues as set out in the APFPA model and around $800 million of other stable UGF revenues.

[3] Perhaps more worrisome, there is a substantial chance of depleting Alaska's savings even sooner. Even if the Alaska Permanent Fund Corporation (APFC) achieves the average long-term statutory return of 6.01% over the next few years (the assumption used for the expected case), there is a 17% probability that the CBR may be depleted by FY18 and a 21% probability that the ERA may be depleted by FY21.

4. Delay will damage Alaska's economy.

Failing to articulate a pathway for the sustainable use of our financial assets and a plan to stabilize the state budget will degrade investor and consumer confidence, increasing the chance of a statewide economic downturn. A measureable contraction in Alaska's economy would mean a shrinking job market, outmigration, and reduced home values. The longer it takes for the state to correct our current fiscal imbalance, the more investor confidence will erode and the greater the damage to the broader state economy.