

# Reducing the Deficit: Investing Alaska's Vast Cash Reserves



## **Senate Bill 114**

Senator Lesil McGuire

Senate State Affairs

2/23/16

# A Path Forward



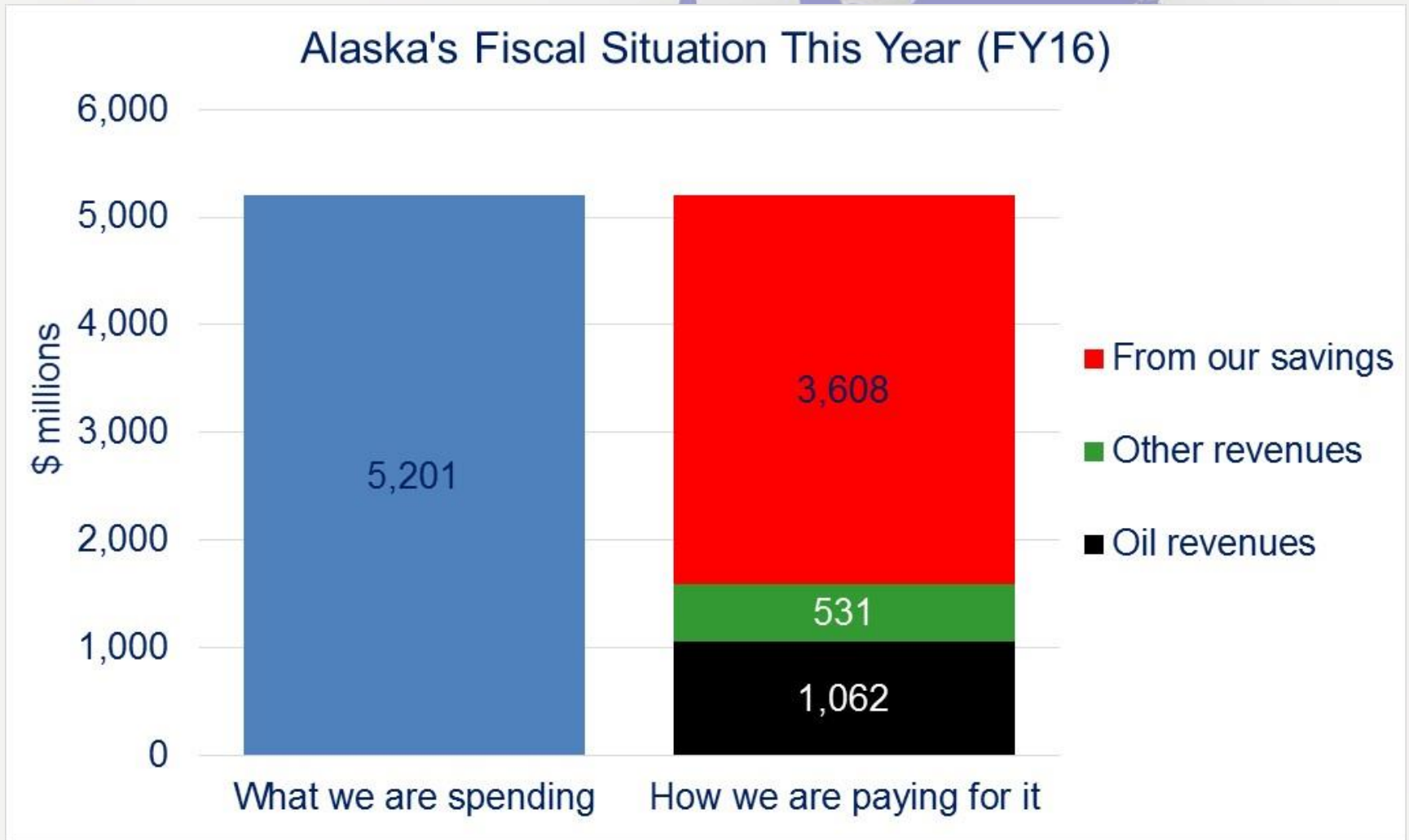
We need a plan to address the problem

In crafting SB114 I had these principles in mind:

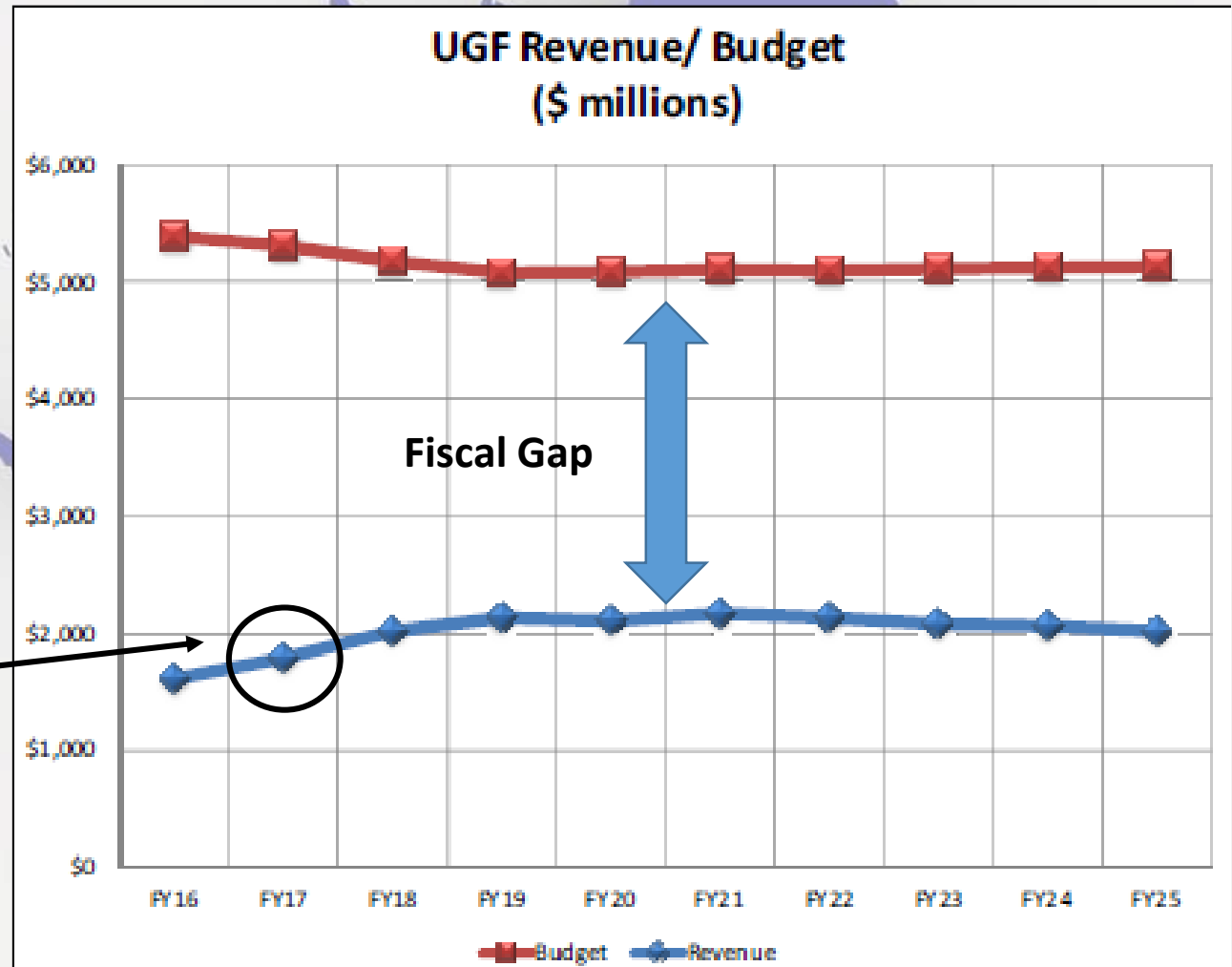
The solution needed to:

- 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

# Defining the Problem



# Defining the Problem



UGF for FY17 (status Quo)

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

Total \$1.8 B

# 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?***

# Other Options?

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

# Other Options?

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

## UGF for FY17 (status Quo)

Royalties	\$800M
Production Taxes	\$200M
Other Taxes	\$800M
<b>Total</b>	<b>\$1,800 M</b>

## Potential New Revenue from Sustainable Alaska Plan

**Total** **\$457M**

**Total= \$2,257M**

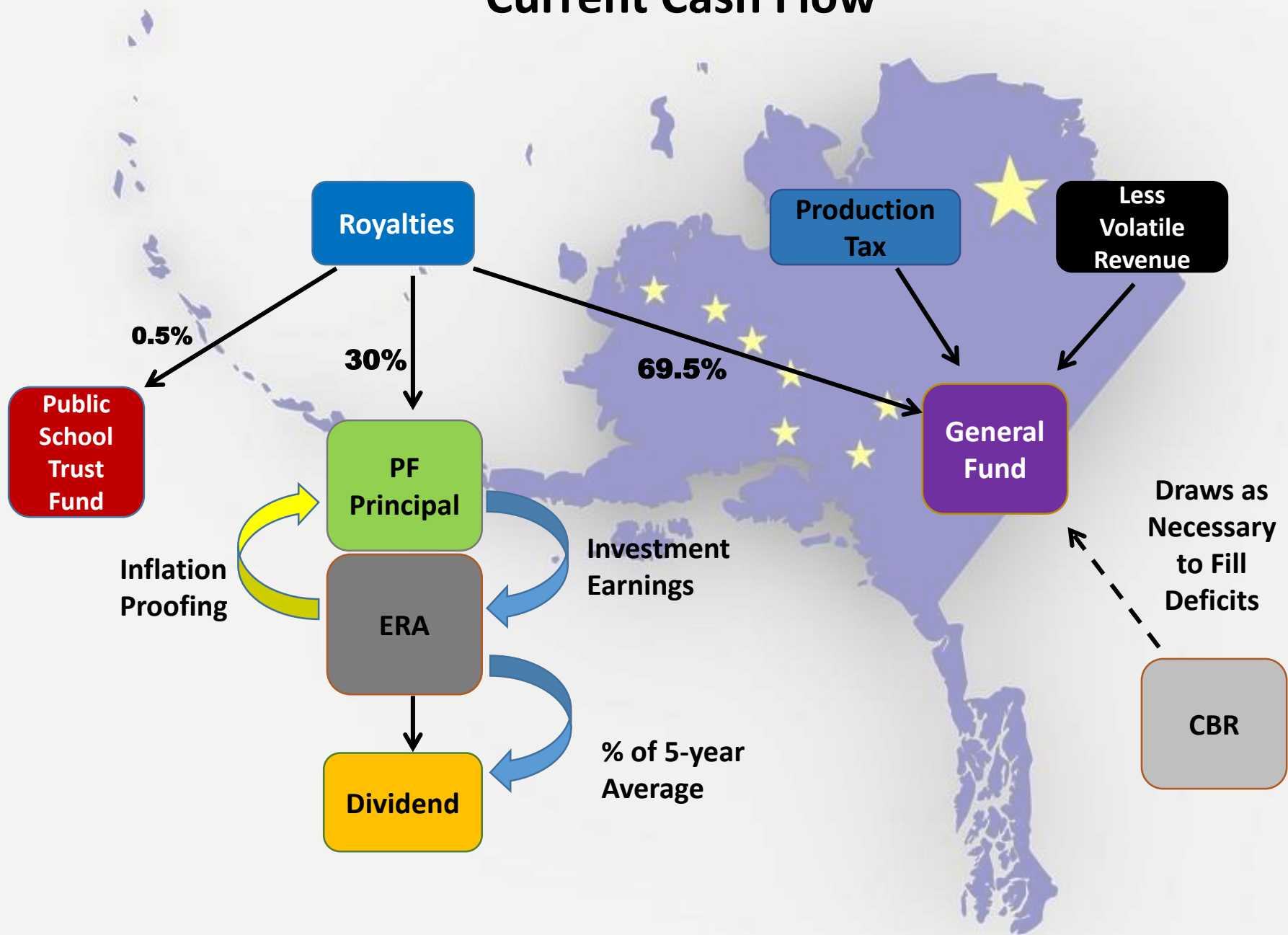
**\$3,000M in Cuts**

# Other Options?

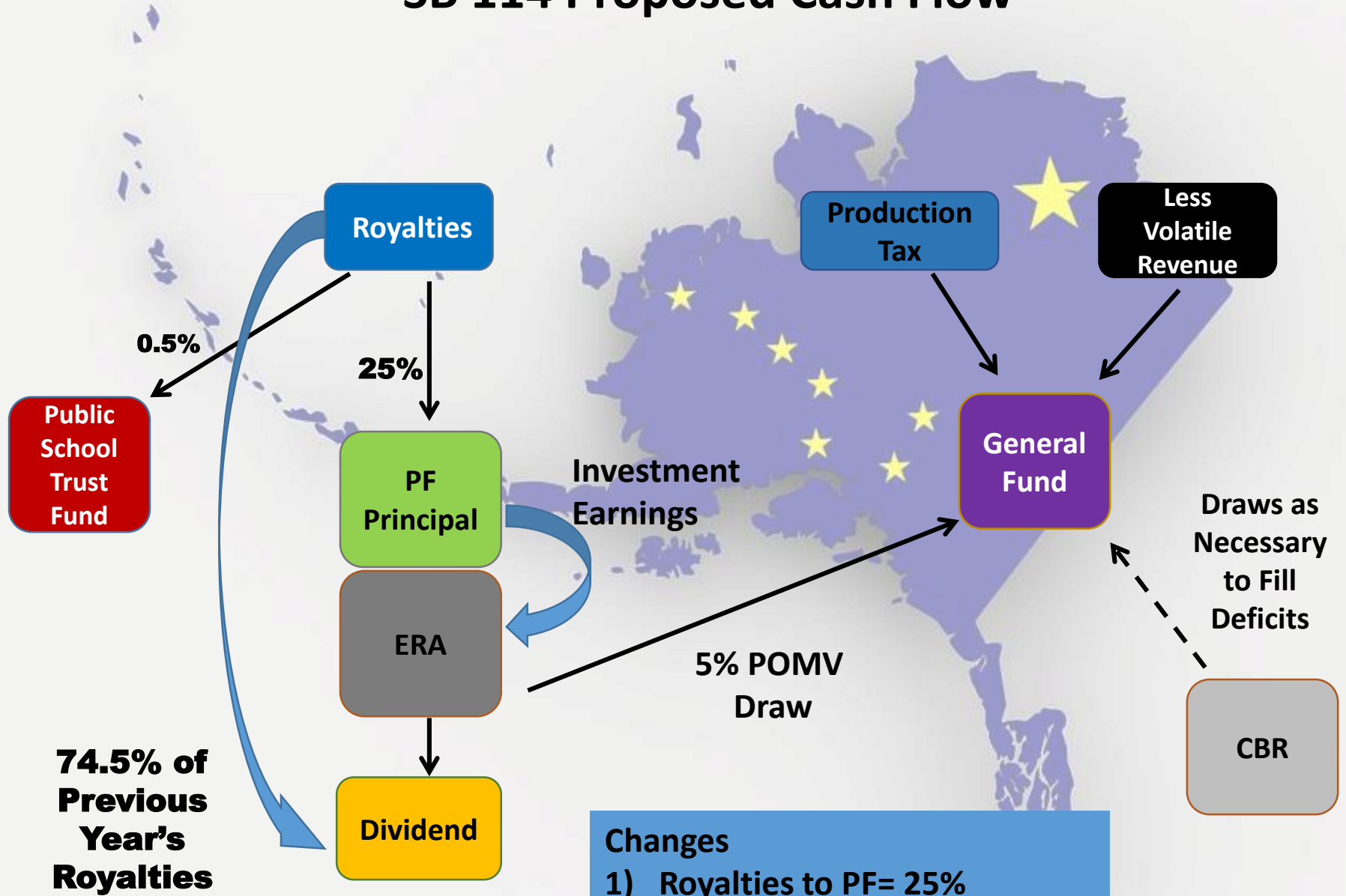
- **All 3 Proposals have been vetted in the Callan Report to the APFC Board**
  - **Which analyzed the impact of the proposals to the Permanent Fund**
- **All 3 proposals:**
  - **Callan does not recommend needing major asset reallocations for the PF**
    - **Though it is something for the APFC to look at**
    - **The Fund should remain viable**



# 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

# SB 114 Dividend and GF Scenarios

## Scenario 1

### Oct 2016 Dividend at Status Quo

Dividend= \$2,000  
POMV (net increase)= \$1,269.3 Million

- This Cuts the Deficit by 1/3

## Scenario 2

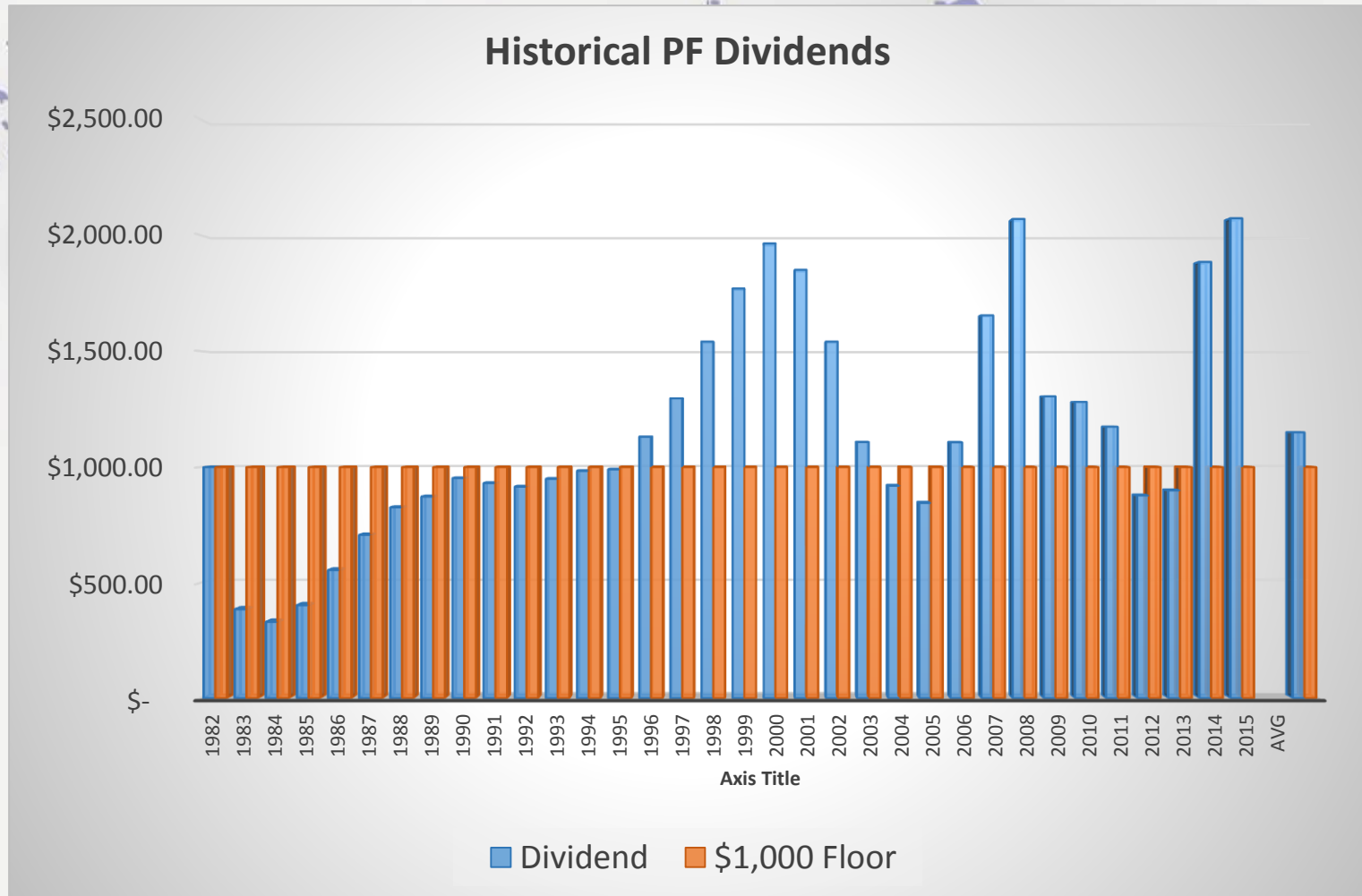
### 2016 Royalties Swap Occurs

Dividend= \$1,023  
POMV (net increase)= \$1958.4 Million

- This Cuts the Deficit in HALF

**Difference: \$700 Million**

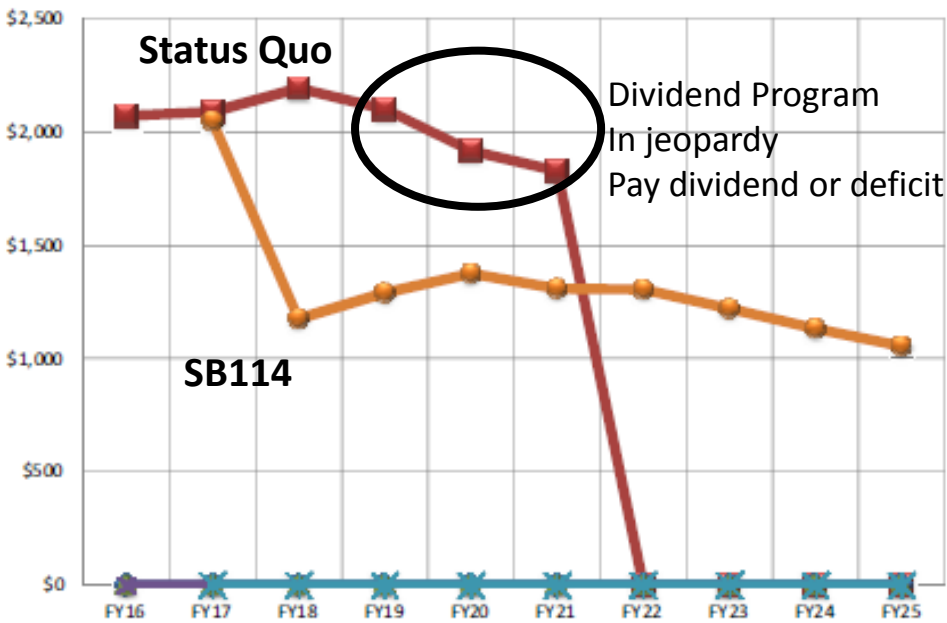
# SB 114 Dividend



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

# SB 114 Dividend

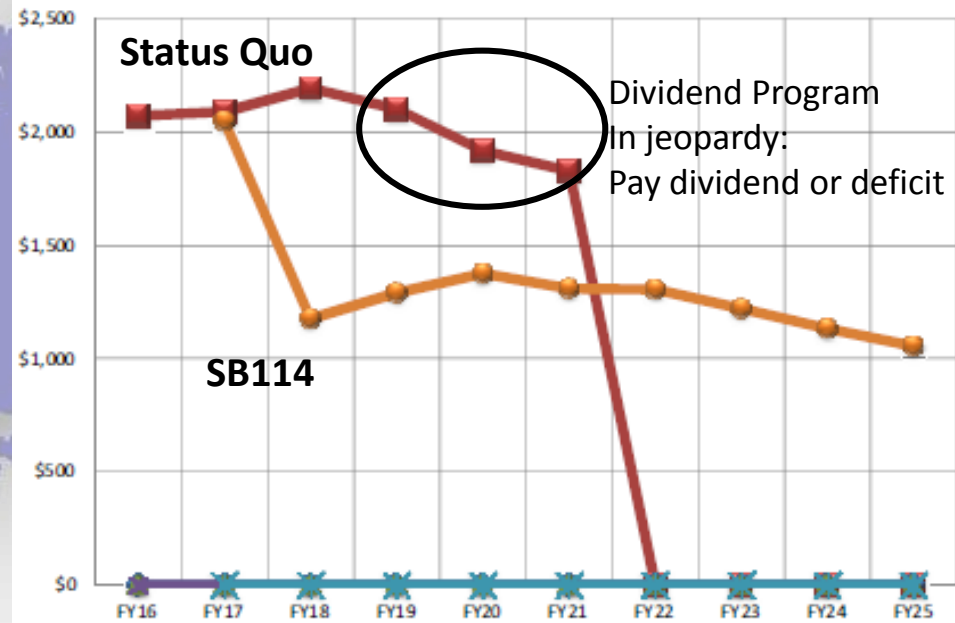
Dividend Check



Scenario 1

Dividend held harmless

Dividend Check



Scenario 2

Swap occurs in 2016

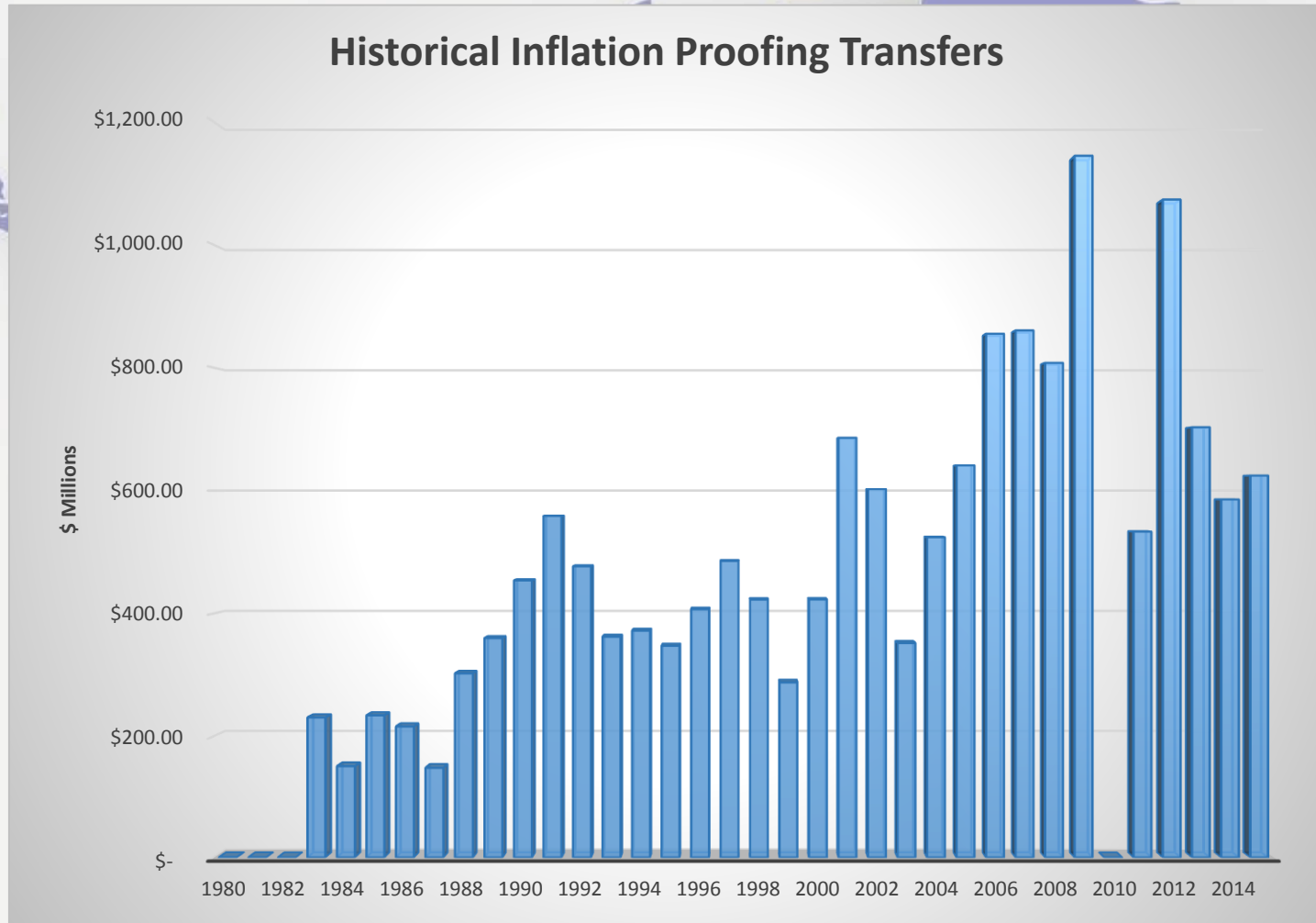
**SB114 Guarantees a minimum dividend of \$1,000**

# Addressing Volatility in POMV

- **POMV is a variable payout**
  - **Volatility arises due to Oil Production Taxes going directly to General Fund**
- **Solution:**
  - **“payout may not exceed x% of prior year appropriations”**
    - **after production taxes, royalties not used for dividends, and other revenue**
  - **“x%” could be “110%” or “120%”= can pick a number**



# Addressing Inflation Proofing



**Total= \$16,235.5 Million**

# Addressing Inflation Proofing

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

POMV Dra = 5%

Remaining in the Earnings Reserve Account = **1.9%**

**POLICY CALL**

Is this sufficient for Inflation Proofing?

Is it considered inflation Proofing when not transferred to Corpus of PF?



# Addressing Inflation Proofing

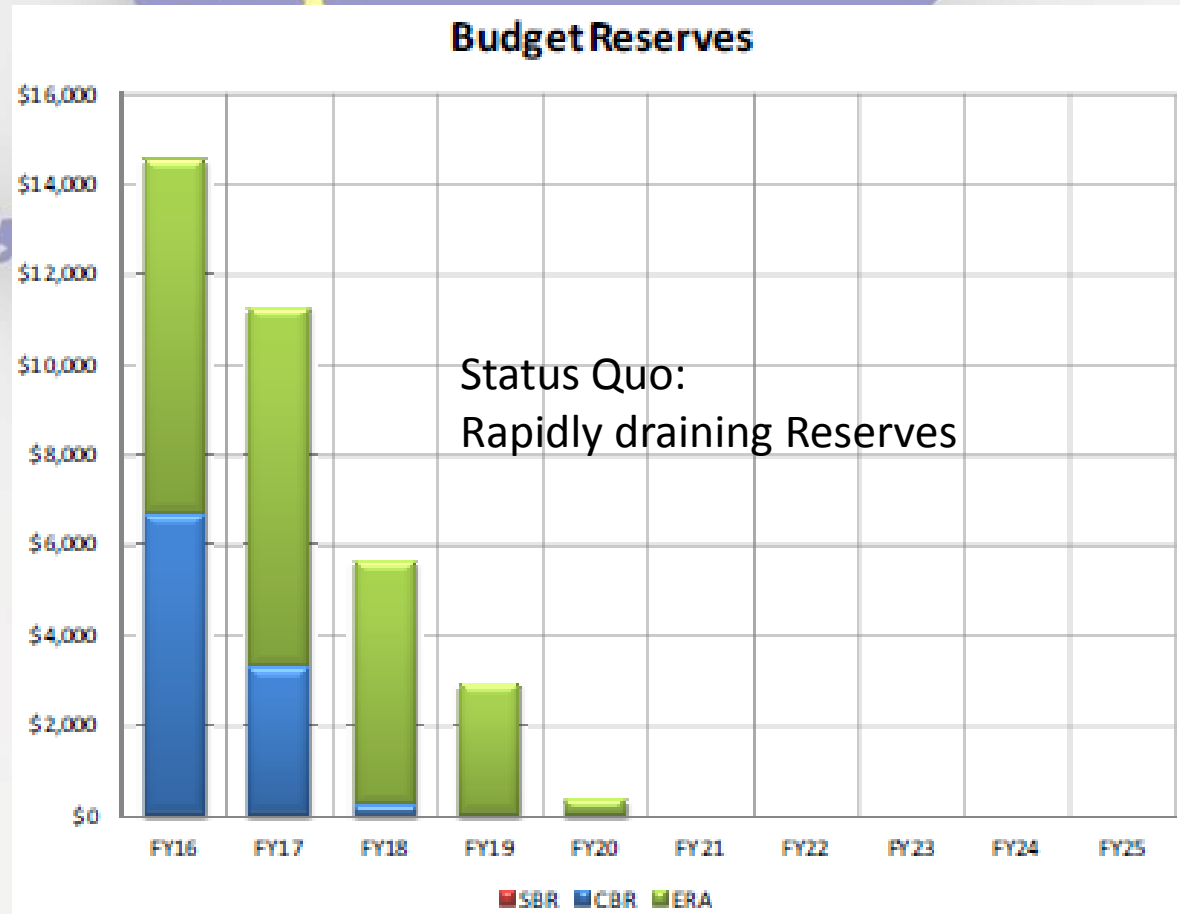
## POLICY CALL

Could easily be addressed:

**“When total value of the Earnings Reserve Account exceeds the target amount of four (4) times the current year’s transfer, the excess *shall* be transferred to the principle of the fund for inflation proofing.”**

# The Cost of Doing Nothing/ Status Quo

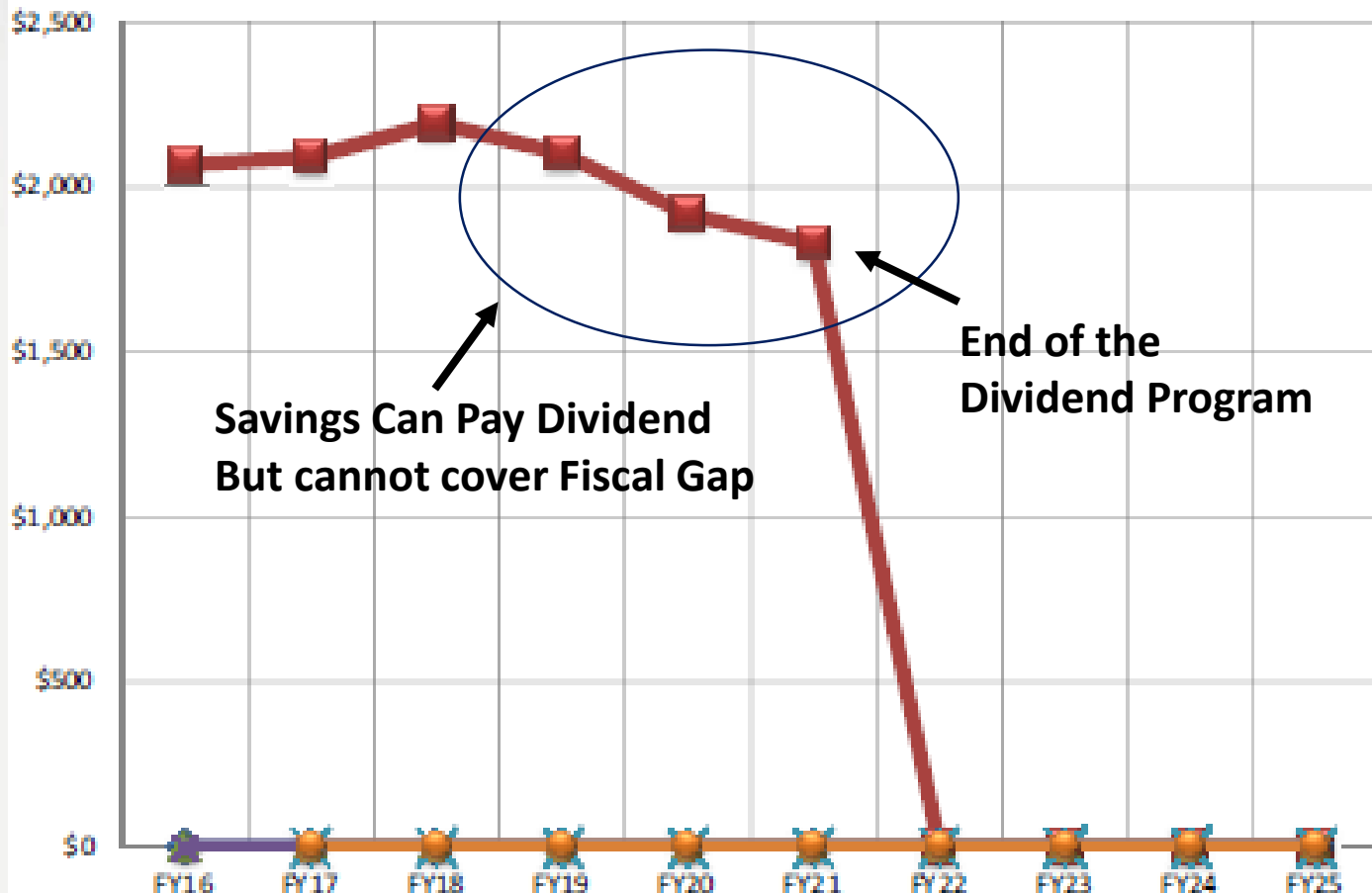
- The longer we wait to act
  - The lower are our reserves
  - The higher the risk of Failure
- A lower reserve balance
  - Simply takes away choices we have to fill the deficit



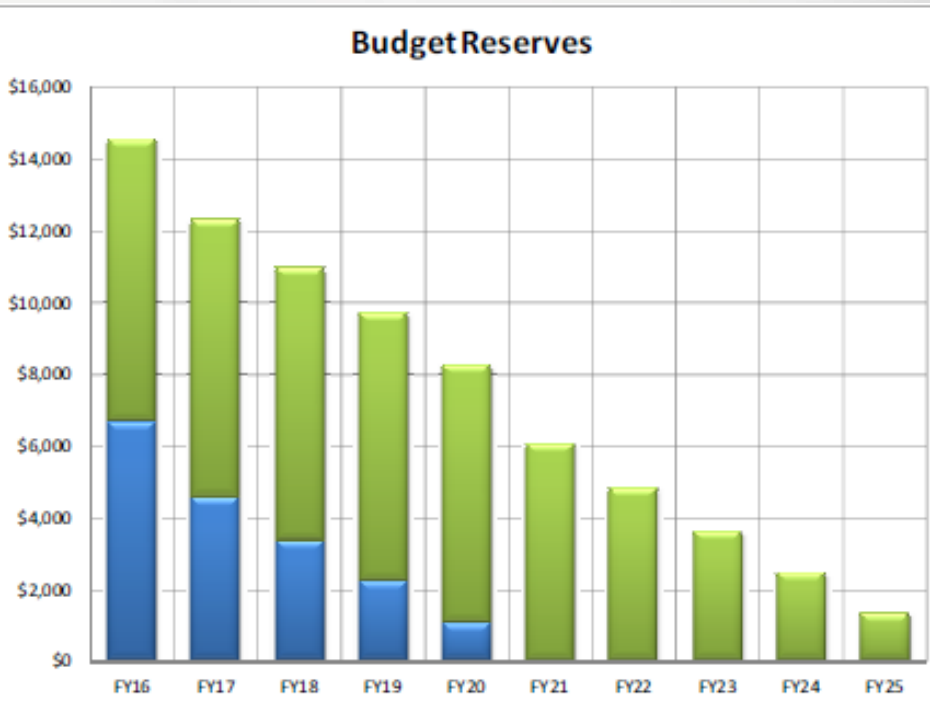
# The Cost of Doing Nothing/ Status Quo

## Dividend Check

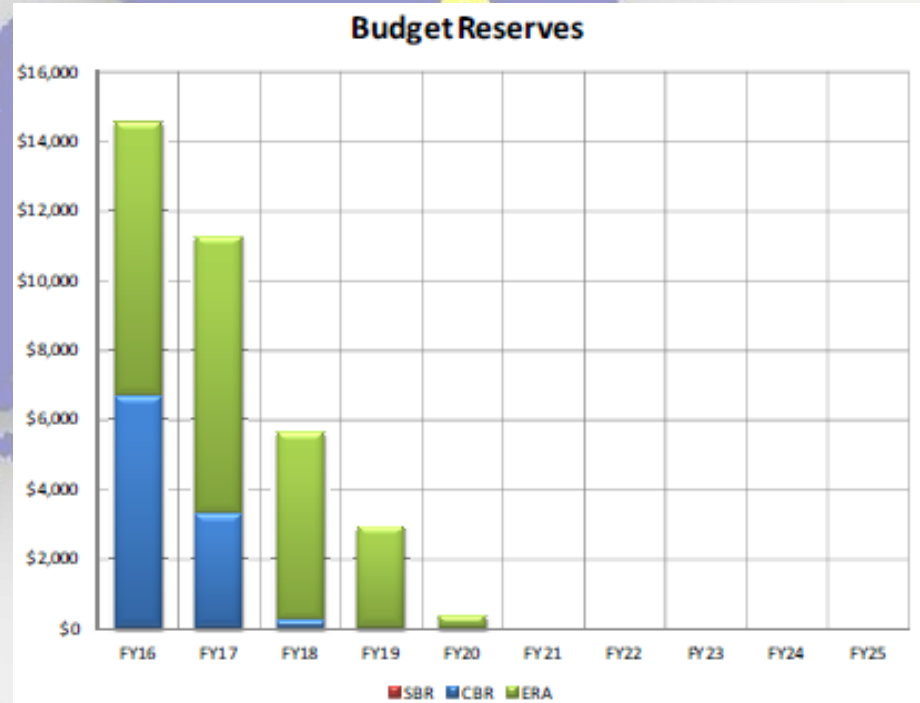
In FY 19 The choice will be made to fund Dividend OR Deficit



# The Cost of Doing Nothing/ Status Quo



**SB114  
Scenario 1**



**Status Quo**

# SB 114: The Net Effects



- Adds up to \$2Billion to the General Fund
- Guarantees an annual \$1,000 Dividend (the only proposal to do so)
- Reduces Volatility in the Budget
- Grows the Permanent Fund
- Maintains buying power in the corpus of the Fund
- Maintains downward pressure on state spending

# SB 114: Alaska's Glide Path



**Right now we have options  
The Cost of inaction is to loose those options**