

ALASKA PERMANENT FUND PROTECTION ACT

Randall Hoffbeck, *Commissioner of Revenue*

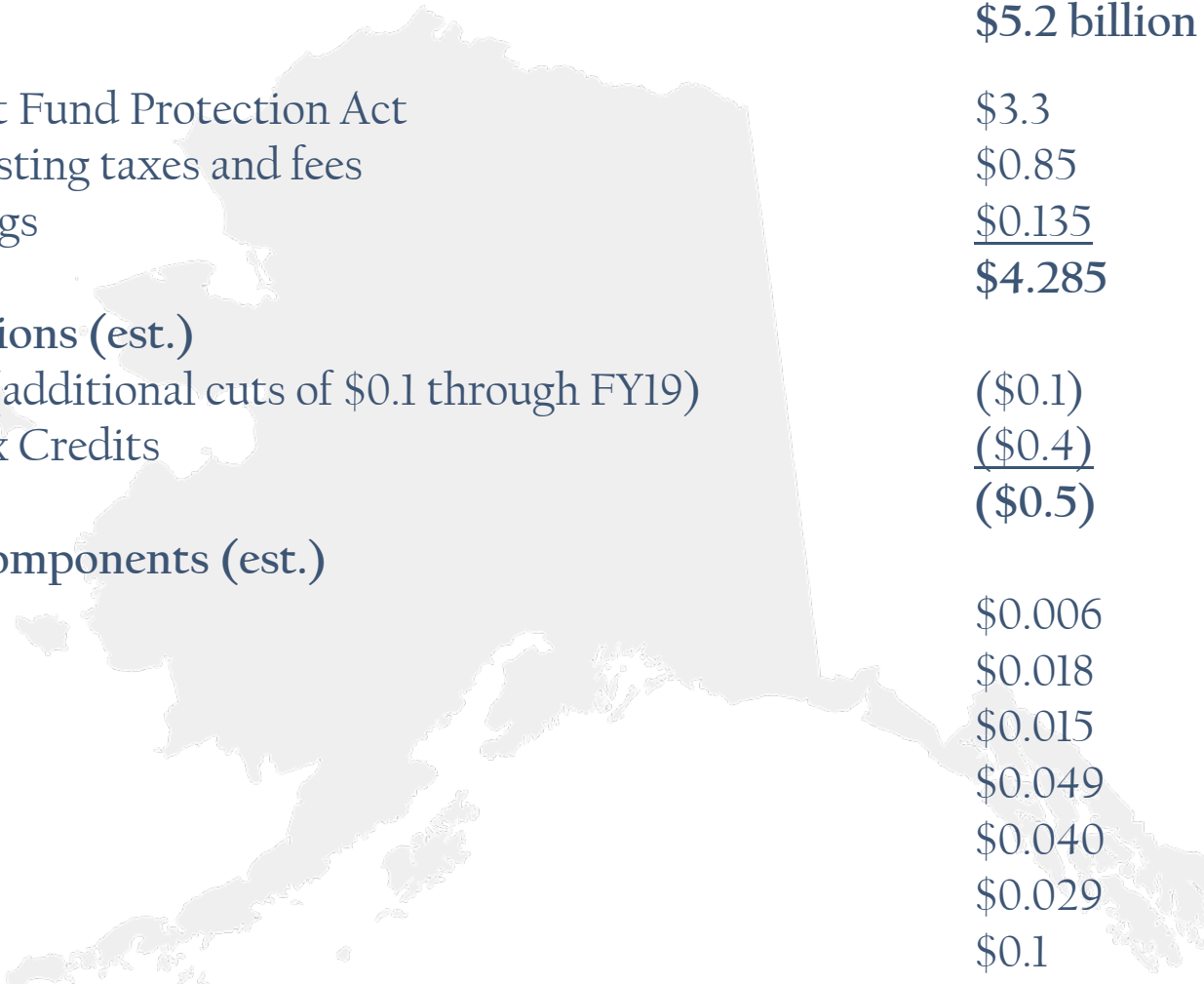
Craig W. Richards, *Attorney General*





INTRODUCTION

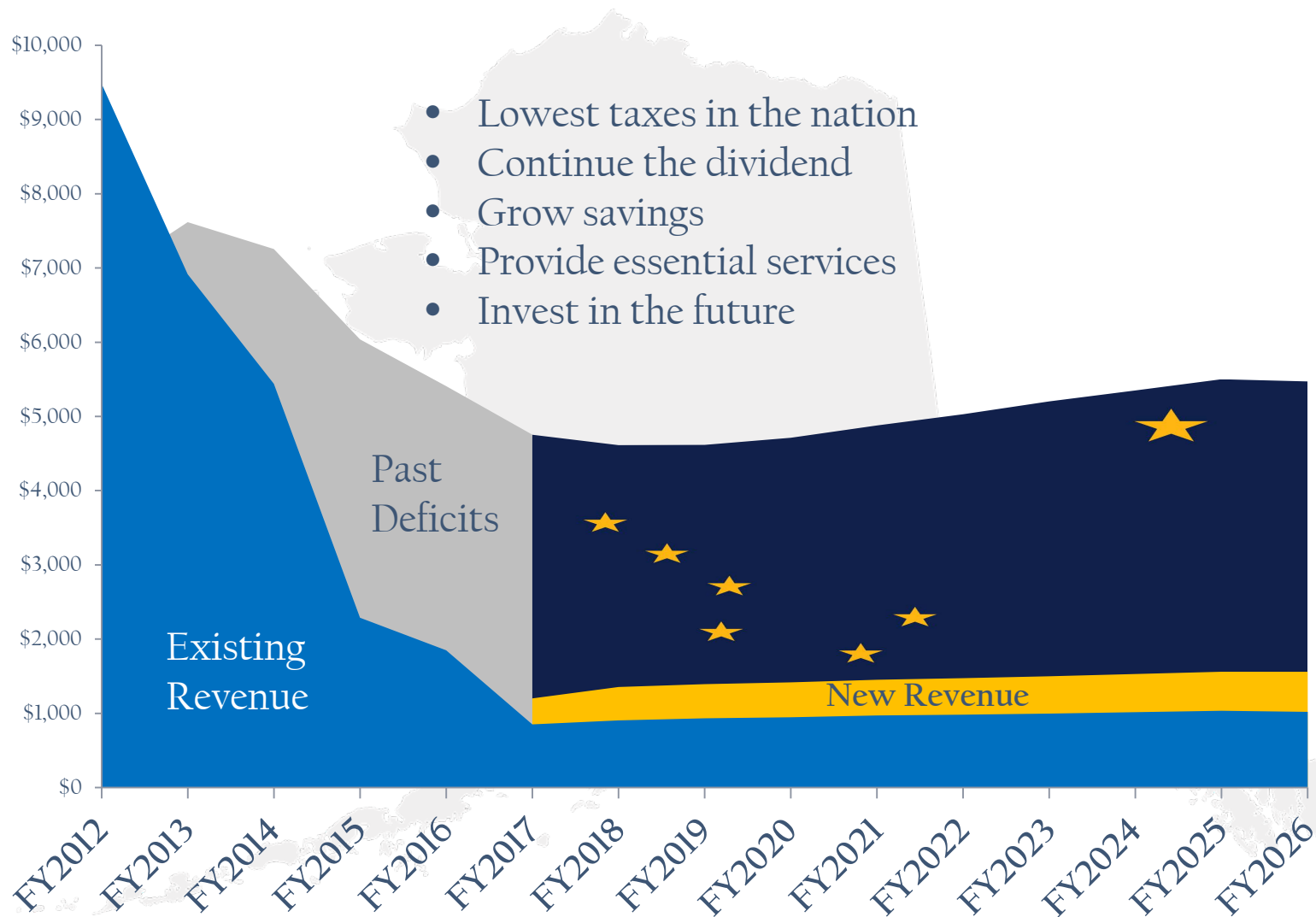
THE NEW SUSTAINABLE ALASKA PLAN



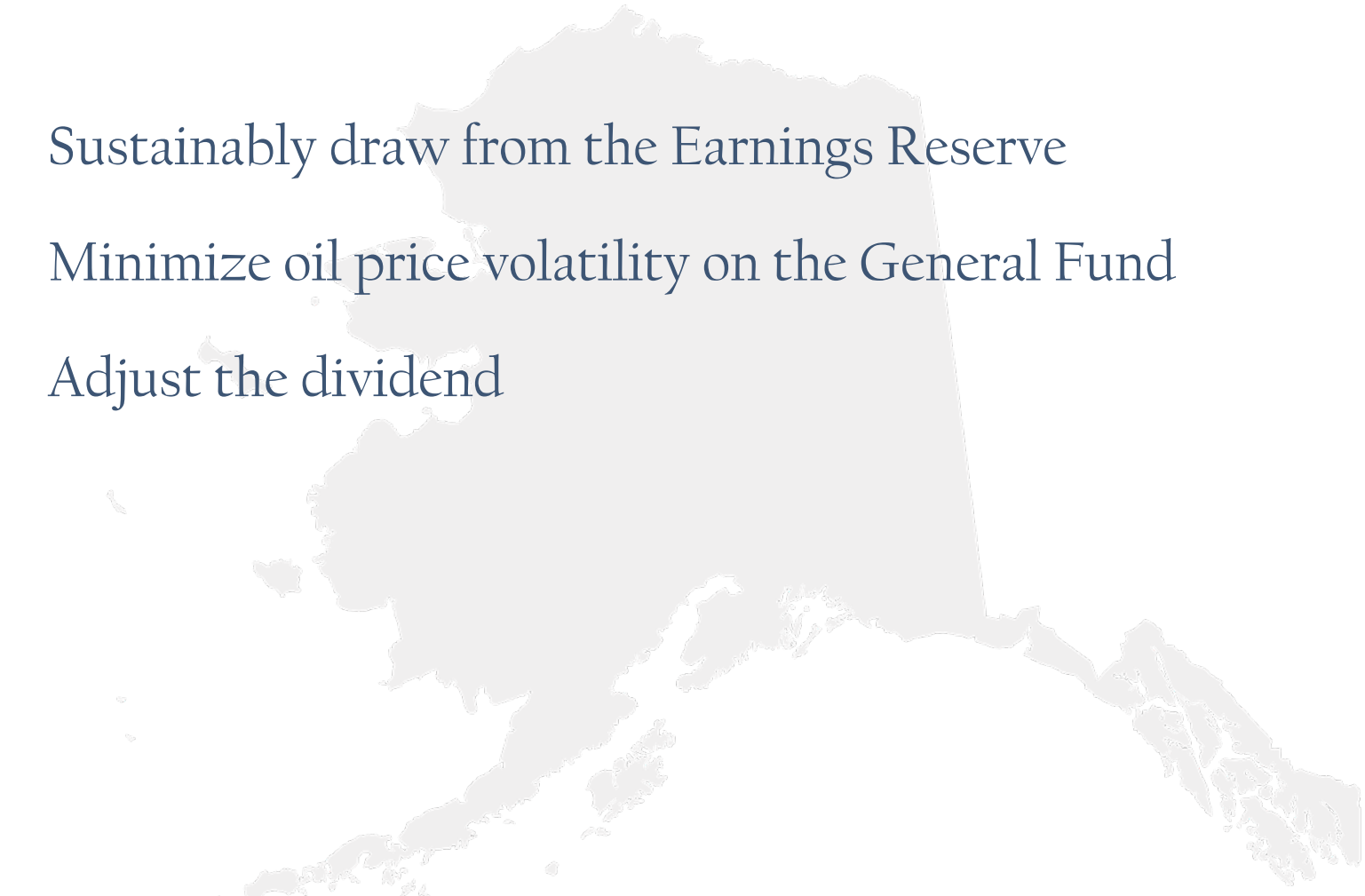
FY16 Budget	\$5.2 billion
Alaska Permanent Fund Protection Act	\$3.3
Revenue from existing taxes and fees	\$0.85
Earnings on savings	<u>\$0.135</u>
	\$4.285
Spending reductions (est.)	
Net cuts in FY17 (additional cuts of \$0.1 through FY19)	(\$0.1)
Reform O&G Tax Credits	<u>(\$0.4)</u>
	(\$0.5)
New Revenue Components (est.)	
Mining	\$0.006
Fishing	\$0.018
Tourism	\$0.015
Motor Fuel	\$0.049
Alcohol	\$0.040
Tobacco	\$0.029
Oil and Gas	\$0.1
Individual Alaskans (Income Tax)	<u>\$0.2</u>
	\$0.457



THE NEW SUSTAINABLE ALASKA PLAN



ALASKA PERMANENT FUND PROTECTION ACT

- 
1. Sustainably draw from the Earnings Reserve
 2. Minimize oil price volatility on the General Fund
 3. Adjust the dividend





The Fiscal Challenge

DEFINING THE PROBLEM

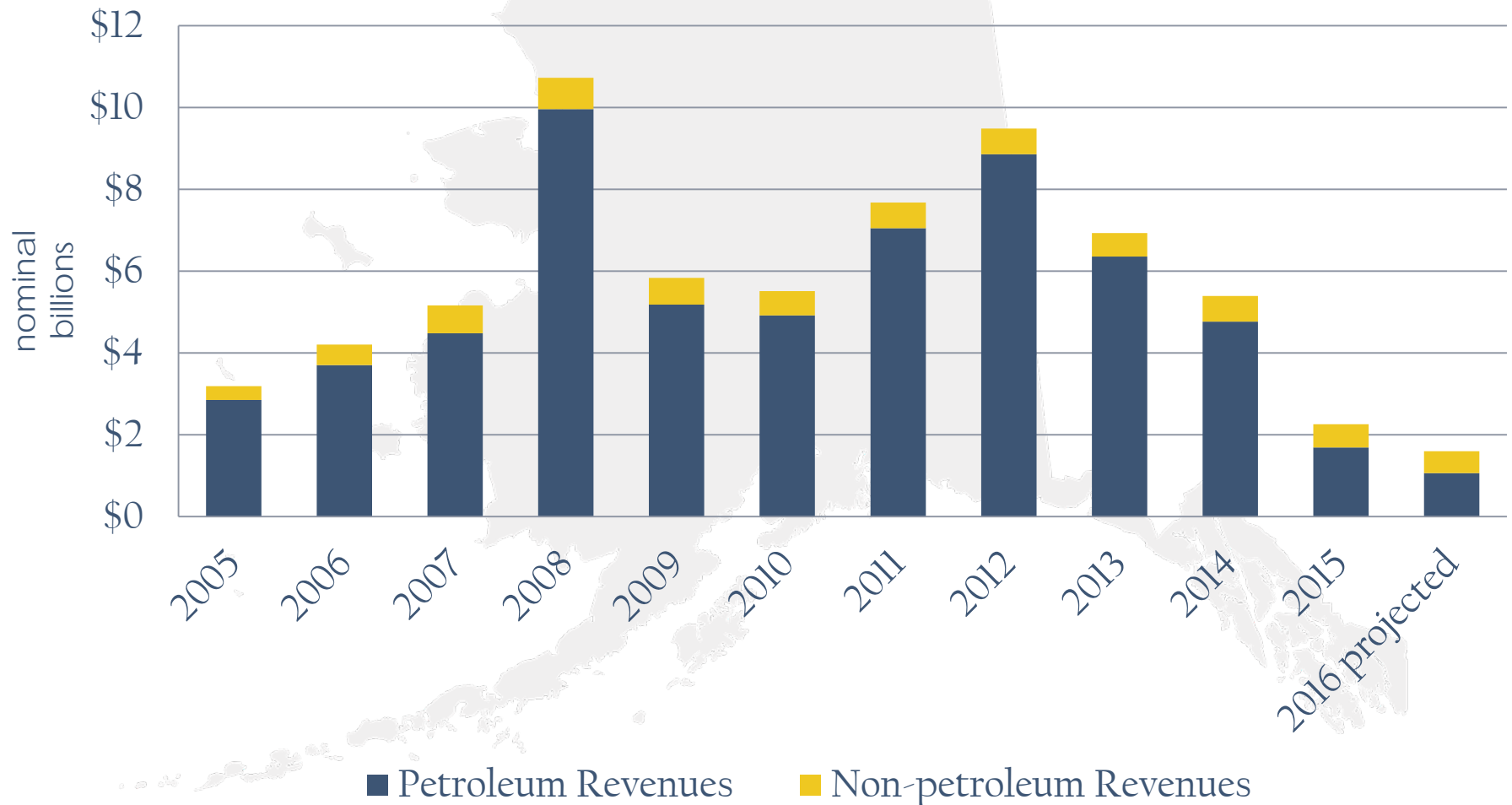
DEFINING THE PROBLEM

- Short-Term:
 - Drop in oil prices has resulted in large budget gaps
- Medium-Term:
 - State savings will be spent in about 4 years
 - Uncorrected, state budget hole will damage Alaska's economy
 - Dividend payments are unsustainable under the status quo
- Long-Term:
 - State's undiversified budget is highly dependent on petroleum revenues
 - There has been a declining trend in North Slope petroleum production
 - Cyclicity in petroleum prices creates an unstable state budget and economy

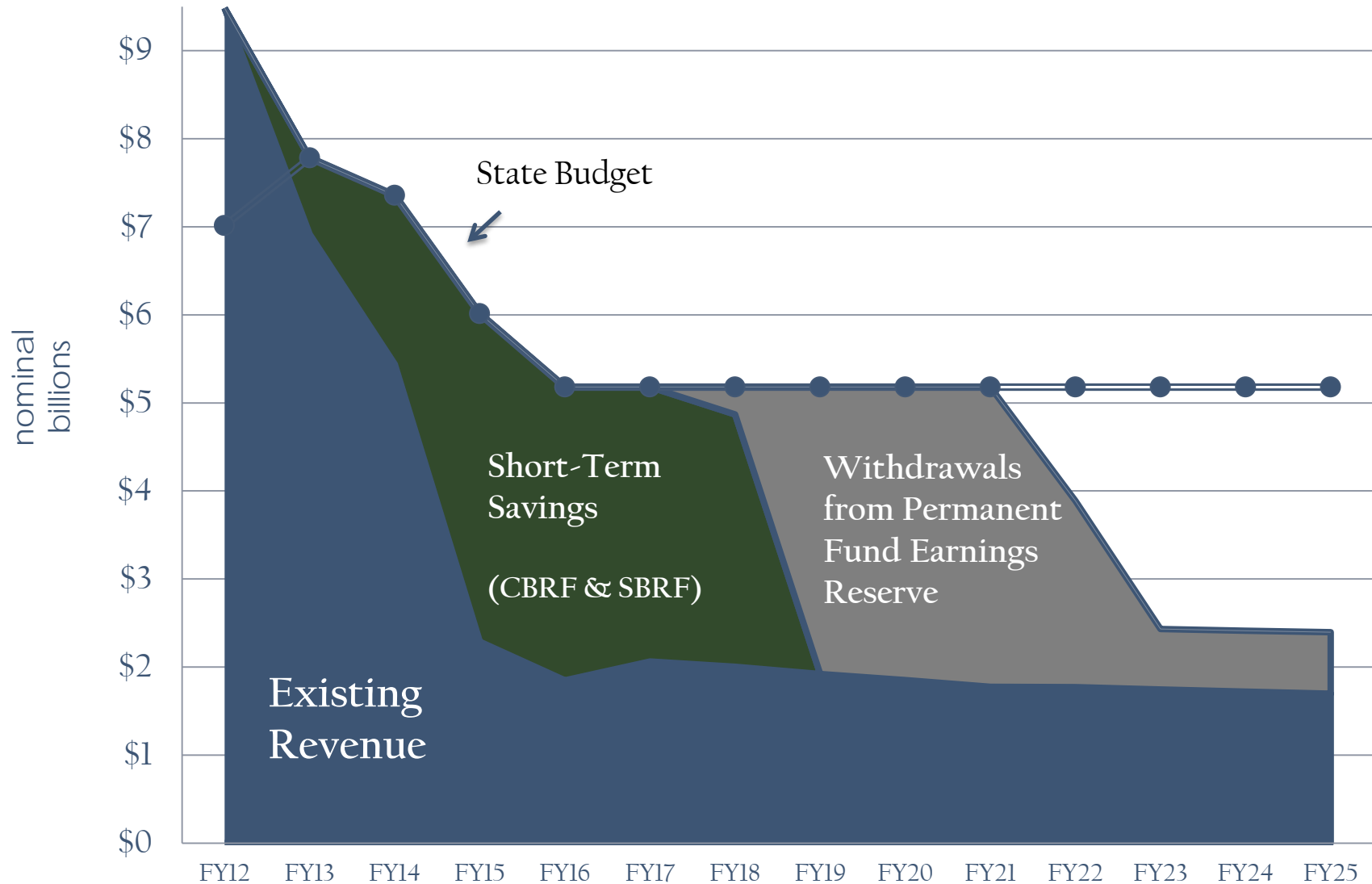


SHORT-TERM PROBLEM

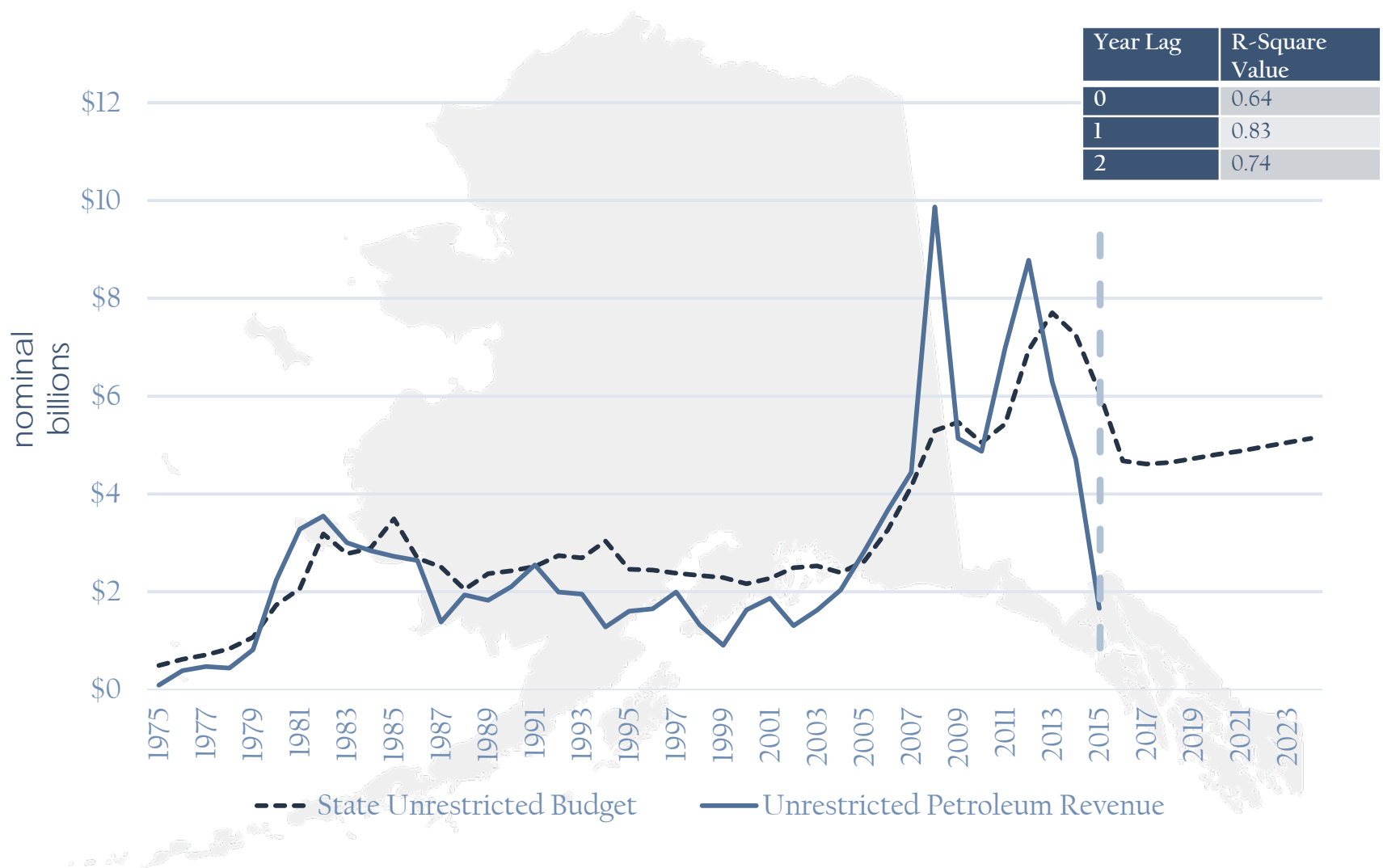
Alaska's Unrestricted General Fund Revenue



MEDIUM-TERM PROBLEM



LONG-TERM PROBLEM





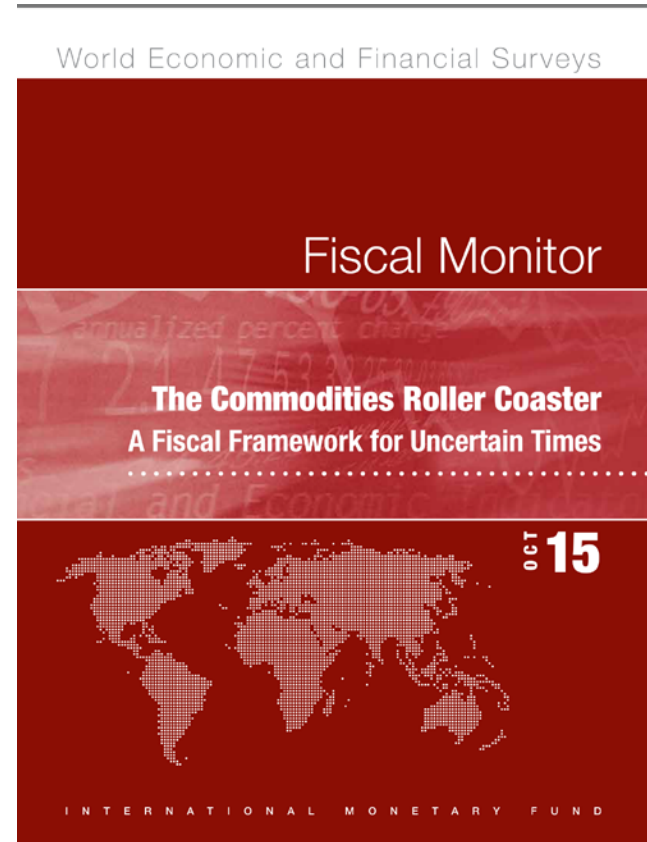
Solving the Long-Term Challenge

FISCAL POLICY FOR OIL ECONOMIES

THE COMMODITIES ROLLER COASTER

For better or worse, state spending impacts the broader economy

- Study of 85 economies over 3 decades
- Government spending in commodity-based economies tends to move up and down with commodity revenue
- Pro-cyclical government spending stunts economic growth
- Stabilizing fiscal policy has the inverse effect, increasing GDP growth by 0.3% annually



BREAK-EVEN OIL PRICE

- A widely used rule-of-thumb measure of the oil price required to balance the government budget in any given year
- Options for petroleum states to bring down break-even oil prices are generally
 - Diversify revenues through other types of taxation
 - Use sovereign wealth assets
- Alaska: \$109

Country	Break-Even Oil Price (2015)
Norway	\$40
Kuwait	\$54
Abu Dhabi	\$55
Russia	\$105
Saudi Arabia	\$106
Nigeria	\$122
Iran	\$131
Algeria	\$131
Venezuela	\$160



ALASKA: IN THE MIDDLE

Alaska lacks

- Revenue diversity
- Fiscal rules to address pro-cyclical spending

But, like Norway, Kuwait, and Abu Dhabi, Alaska has

- A large sovereign wealth fund
- Proven experience with rule-based fiscal policy
- An independent investment authority

Alaska has a cash flow problem, not a wealth problem.

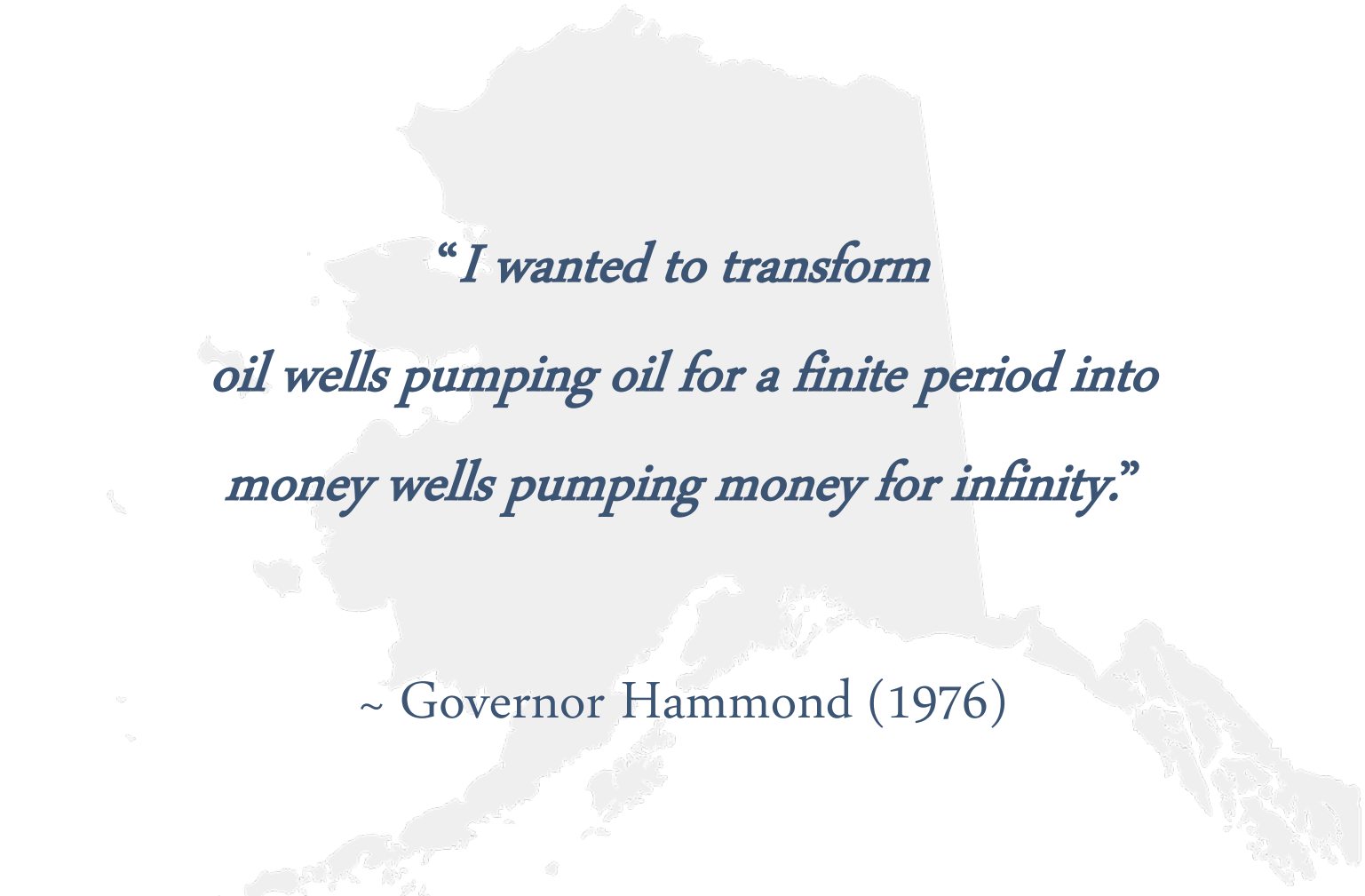




Fiscal Policy for Alaska

ANALYSIS OF OPTIONS

THE PERMANENT FUND

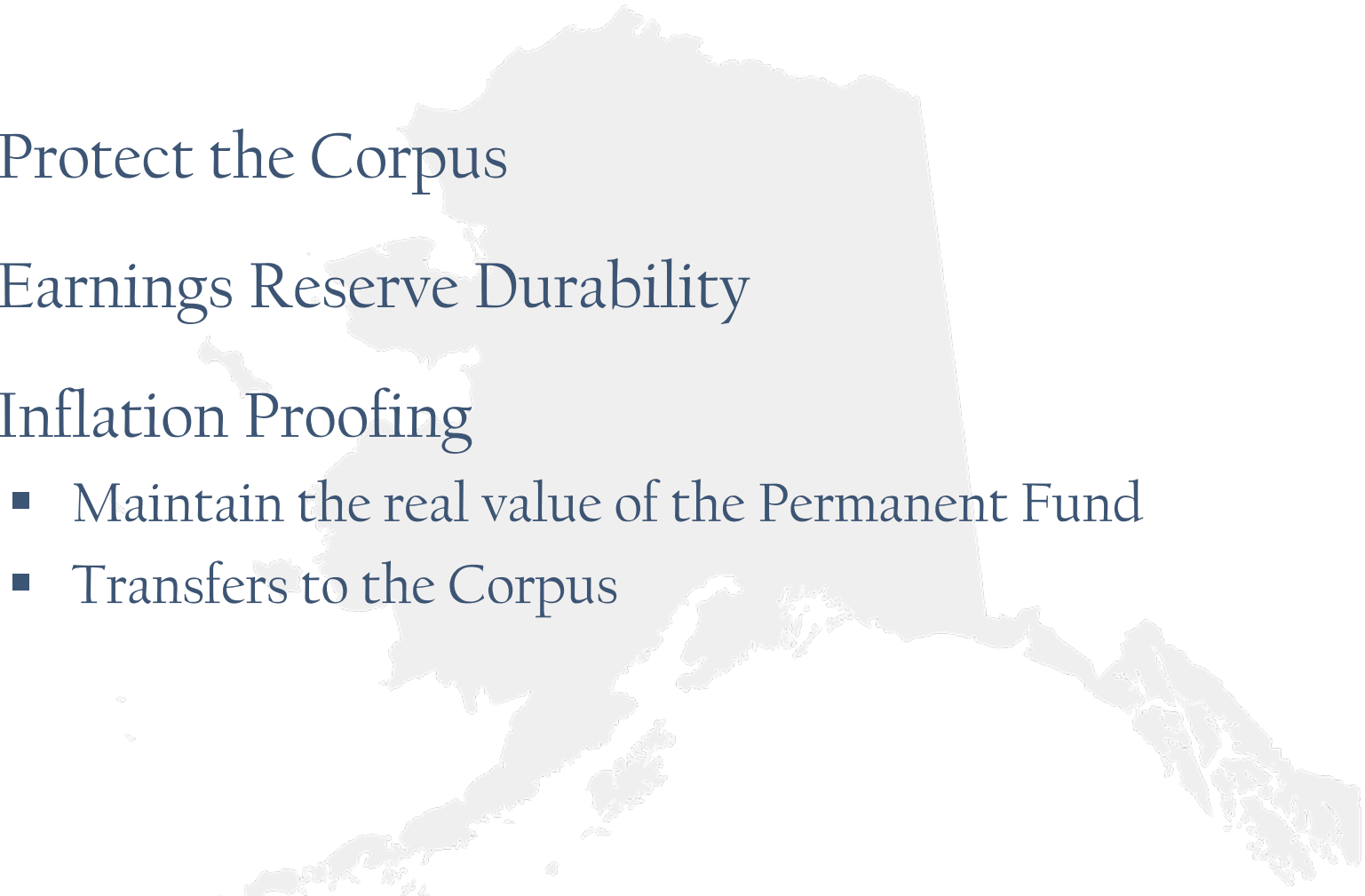


*“I wanted to transform
oil wells pumping oil for a finite period into
money wells pumping money for infinity.”*

~ Governor Hammond (1976)



DEFINING “SUSTAINABLE”

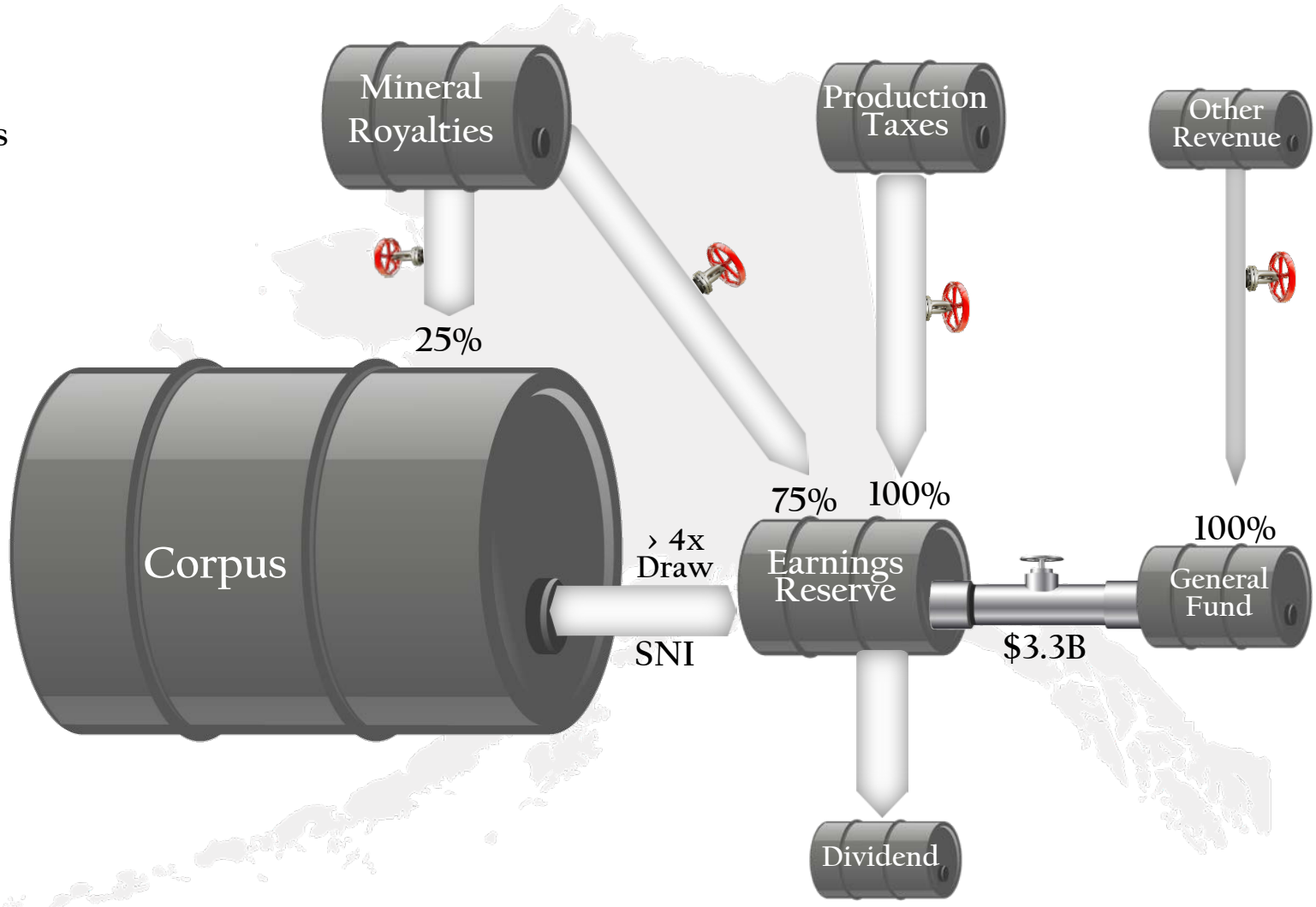
- 
- Protect the Corpus
 - Earnings Reserve Durability
 - Inflation Proofing
 - Maintain the real value of the Permanent Fund
 - Transfers to the Corpus



APFPA CASH FLOWS

Annual
Revenues

Funds



HOW TO HANDLE THE DRAW

Status quo sustainable draw = \$2.4 billion

Funds to the general fund = \$2.4 billion – dividend payout (\$1.4 billion in FY16)

POMV:

- Draw self-adjusts
 - Lower chance of depletion
 - Less fund growth potential
 - No periodic review
- Year-to-year budget volatility
- Rule incorporating petroleum revenue is complex
- Must be on net value of assets

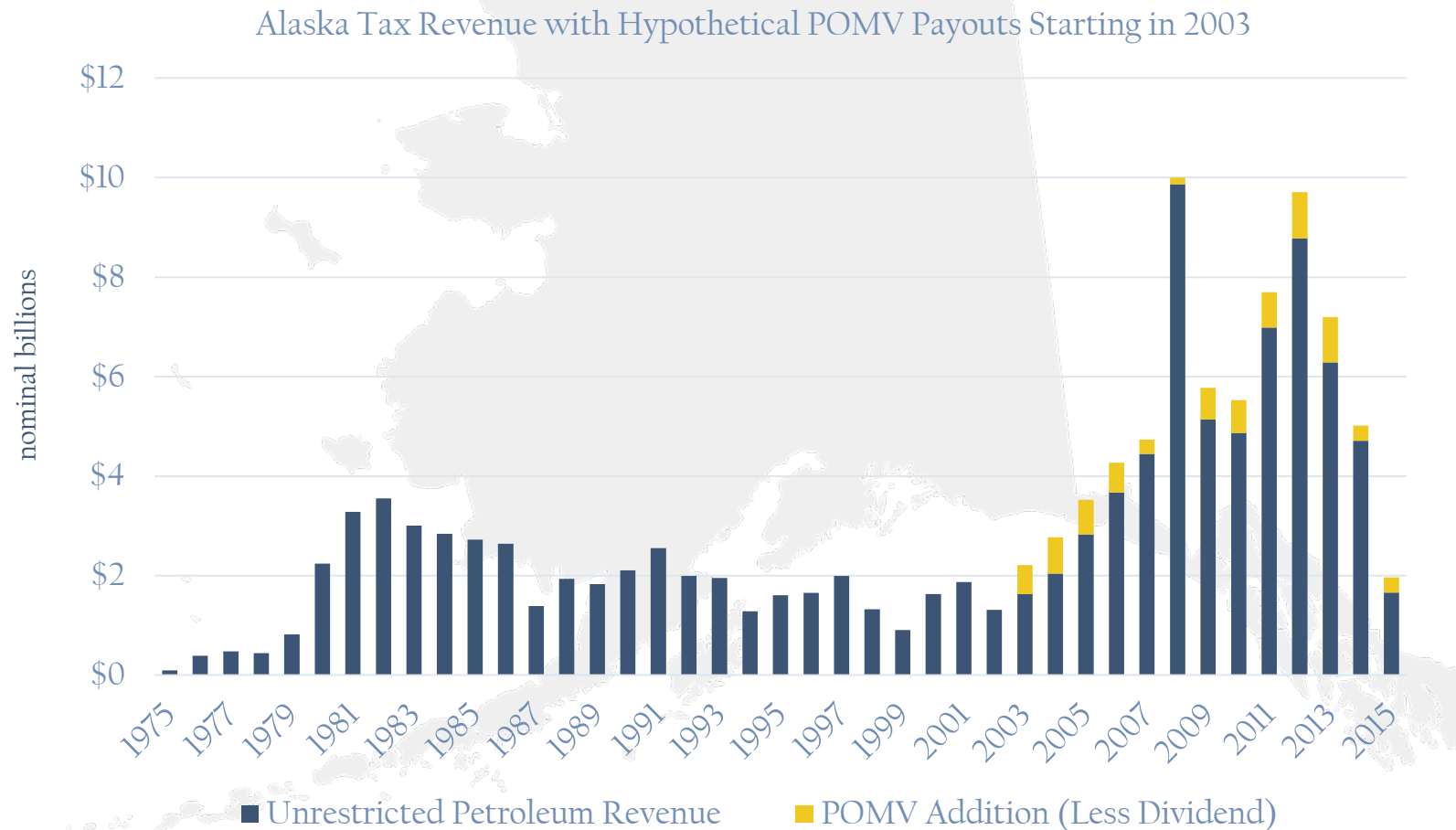
FIXED:

- Draw does not self-adjust
 - Greater chance of depletion
 - Greater fund growth potential
 - Requires periodic review
- Stability for the budget
- Incorporating petroleum revenue not complex



HOW TO HANDLE THE DRAW

A simple POMV endowment draw adds revenue, but does not address volatility



CALCULATING THE DRAW

The Financial Model

- Probabilistic: provides range of potential outcomes
- Starting Assets = \$55B
 - \$45B in Corpus
 - \$7B in Earnings Reserve
 - \$3B from CBR
- Inflation = 2.25%
- Investment Returns
 - Total Return = 6.90%
 - Statutory Net Income = 6.01%



CALCULATING THE DRAW

The Petroleum Model

- Oil price
 - Mean value from probabilistic distribution (2017 = \$56.23)
 - Inputs – a range of prices for each year – from revenue forecasting session
 - Same underlying data used for the Revenue Sources Book, but the RSB uses only a single price (the median) from the forecasting session
- Production volumes and costs
 - Same forecast as Revenue Sources Book (Fall 2015)
 - Conservative
- Shortcut Model
 - Input the above oil price, production volume, and costs
 - Deterministic calculation of annual production tax and royalty revenues



CALCULATING THE DRAW

Annuity-Like Fixed Payment to the General Fund

Starting Balance = \$55 billion

+ Inflows =

Investment income from financial model
100% production taxes from petroleum model
100% royalties from petroleum model

- Outflows =

Expenses
Dividend
Draw (inflation increase delayed until 2020)

= End-of-Year Balance

... **\$3.3 billion** annuity from financial and petroleum wealth
(2040 Balance = 2016 Balance + Inflation)

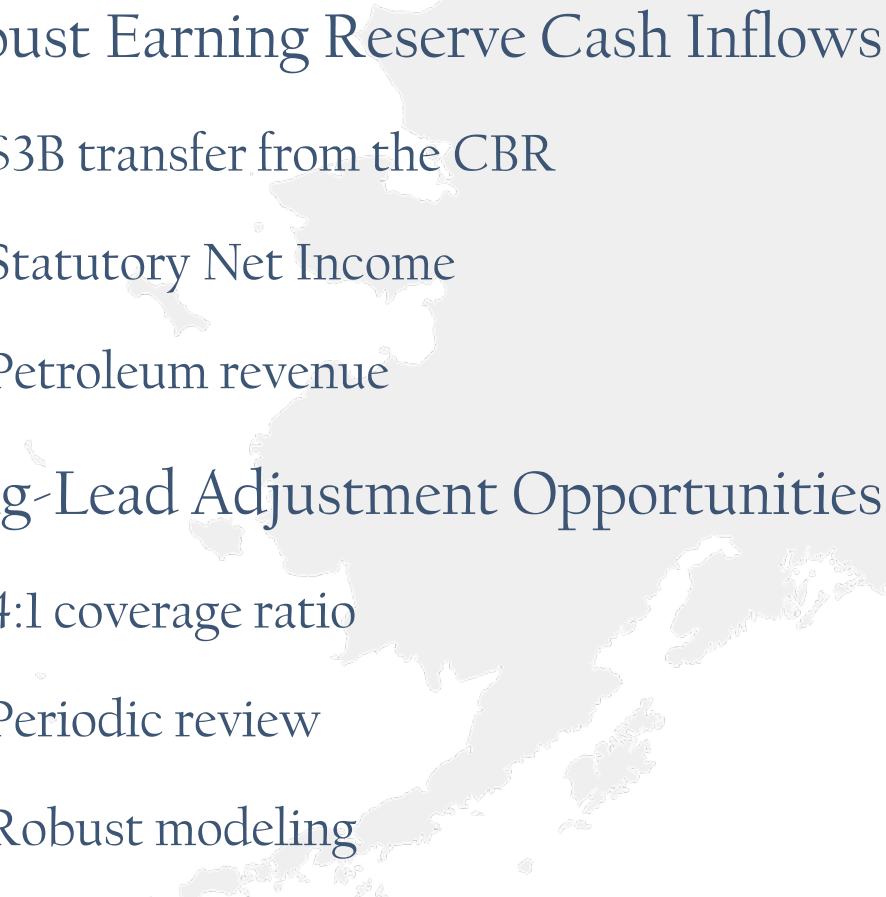


EARNINGS RESERVE DURABILITY

- Target balance: 4 times the prior year draw
 - If Earnings Reserve at target balance:
 - 100% of production taxes and 50% of royalties deposited in Corpus
 - 50% of royalties deposited in Earnings Reserve
 - If Earnings Reserve under target balance:
 - Up to 100% of taxes & 75% of royalties deposited in Earnings Reserve
 - Minimum of 25% of royalties deposited in Corpus
 - If Earnings Reserve over target balance:
 - Excess transferred to the Corpus
- **\$3 billion transfer from the CBR for a starting balance of \$11.6 billion (including anticipated FY16 income)**



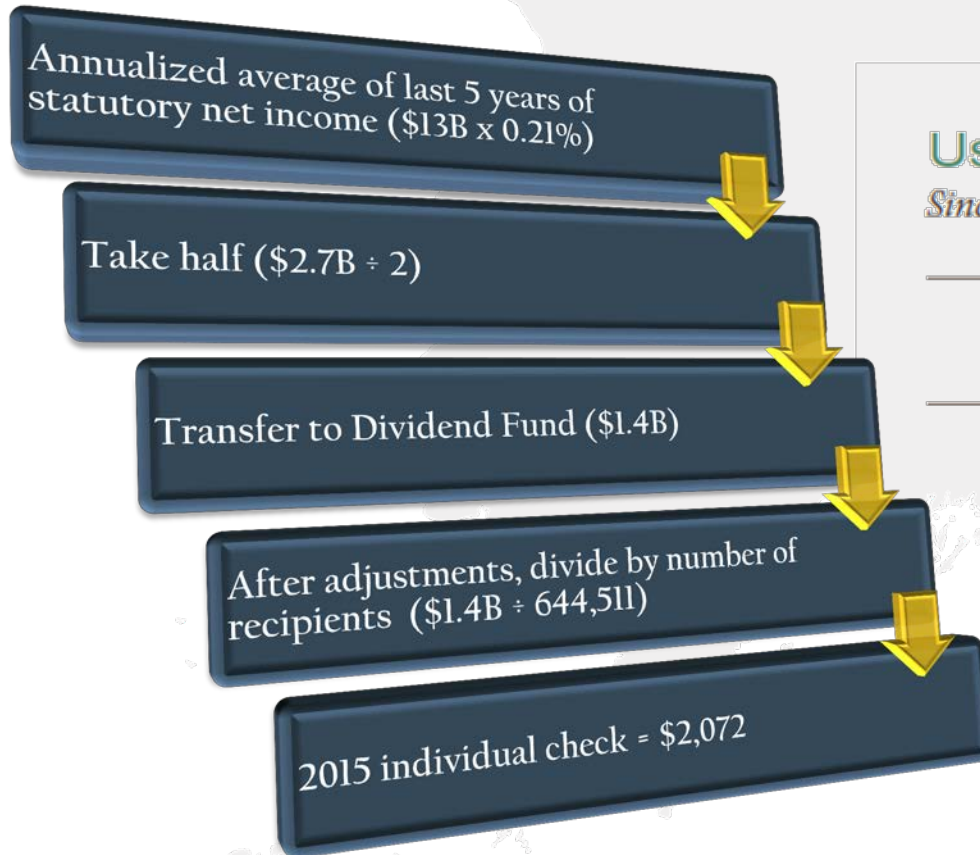
EARNINGS RESERVE DURABILITY

- 
- Robust Earning Reserve Cash Inflows
 - \$3B transfer from the CBR
 - Statutory Net Income
 - Petroleum revenue
 - Long-Lead Adjustment Opportunities
 - 4:1 coverage ratio
 - Periodic review
 - Robust modeling
 - Sufficient time to react



HOW TO HANDLE THE DIVIDEND

The current formula distributes 50% of realized gains



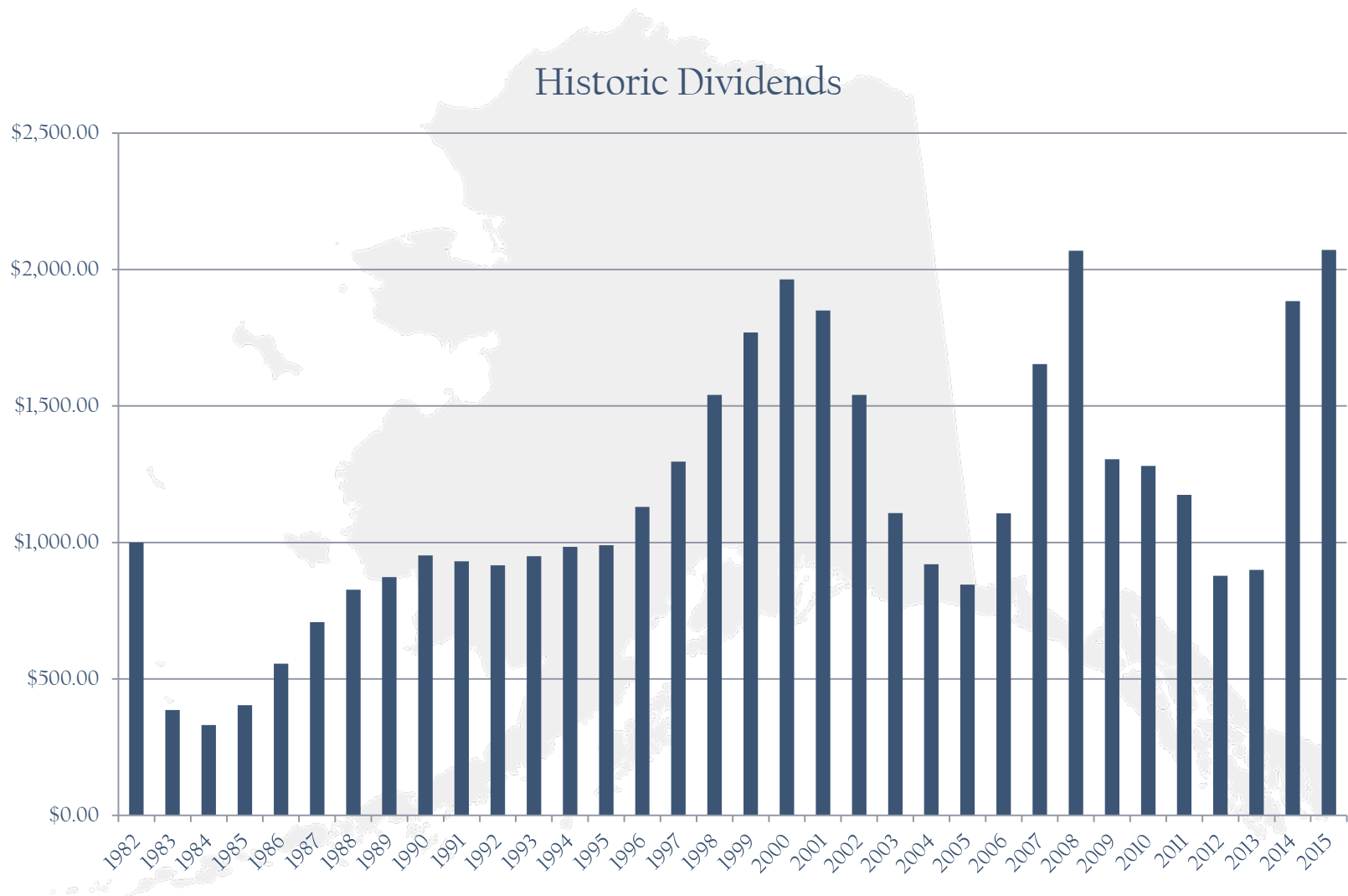
Use of Fund Income *Since inception (in billions)*



46%	Paid out to Current Generations	23.5
54%	Saved for Future Generations	27.7



HOW TO HANDLE THE DIVIDEND



HOW TO HANDLE THE DIVIDEND

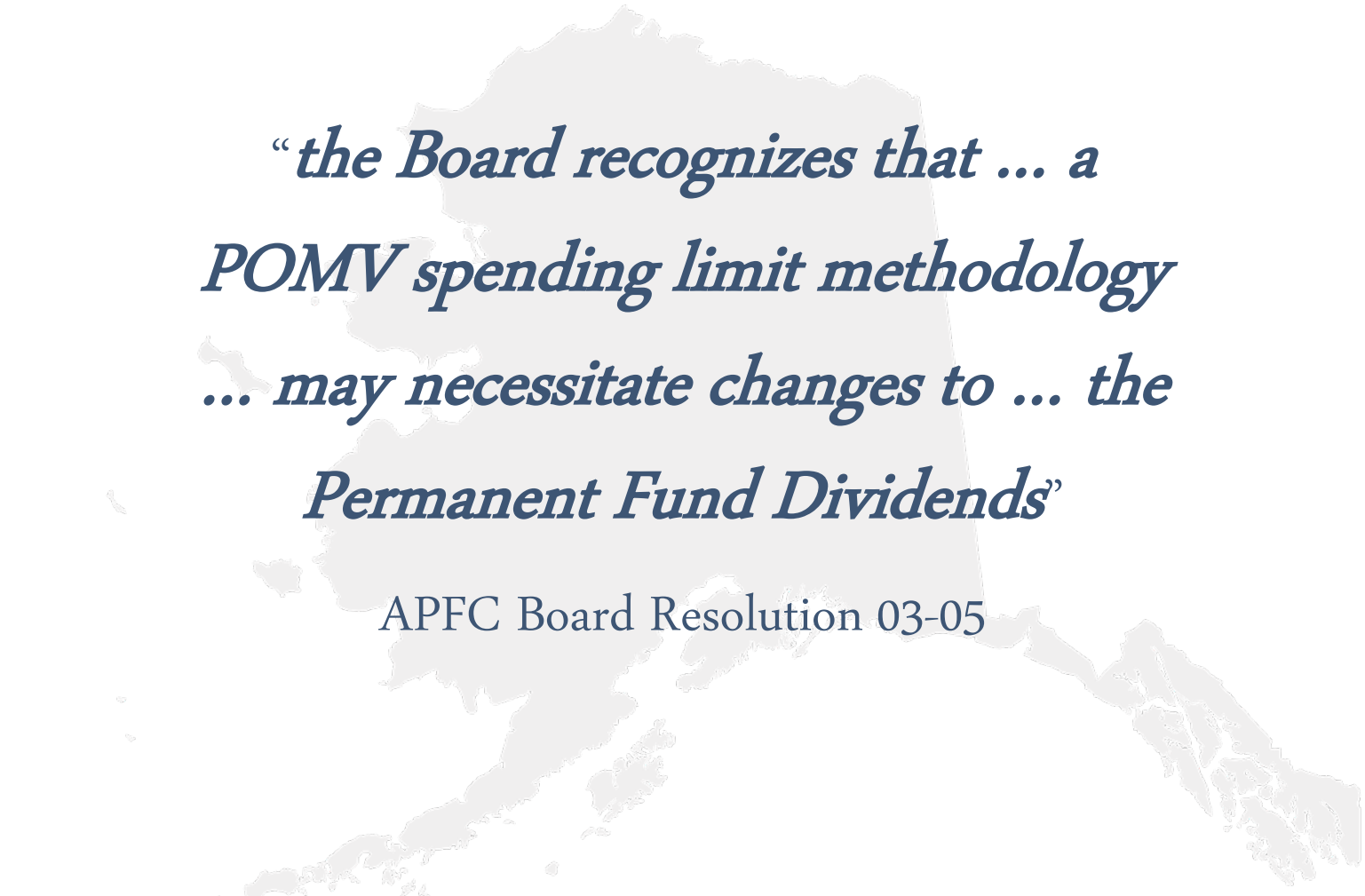
\$1,000 Flat Dividend

- Costs about \$650 million per year
- Compared to 50% royalty dividend, reduces the sustainable draw by about \$200 million per year

Royalty Dividend

- 50% of Alaska's ownership share of oil revenue
- Reflects our success as a state and connects Alaskans to the economy
- Increases or decreases according to what we can afford





*“the Board recognizes that ... a
POMV spending limit methodology
... may necessitate changes to ... the
Permanent Fund Dividends”*

APFC Board Resolution 03-05



PERIODIC REVIEW

- Flexibility to adjust the draw downward
- Schedule: 2017, 2020, then every 4 years
- Consistent methodology
 - Variables
 - Sustainability metric
- Report, supporting data, and analysis publically available

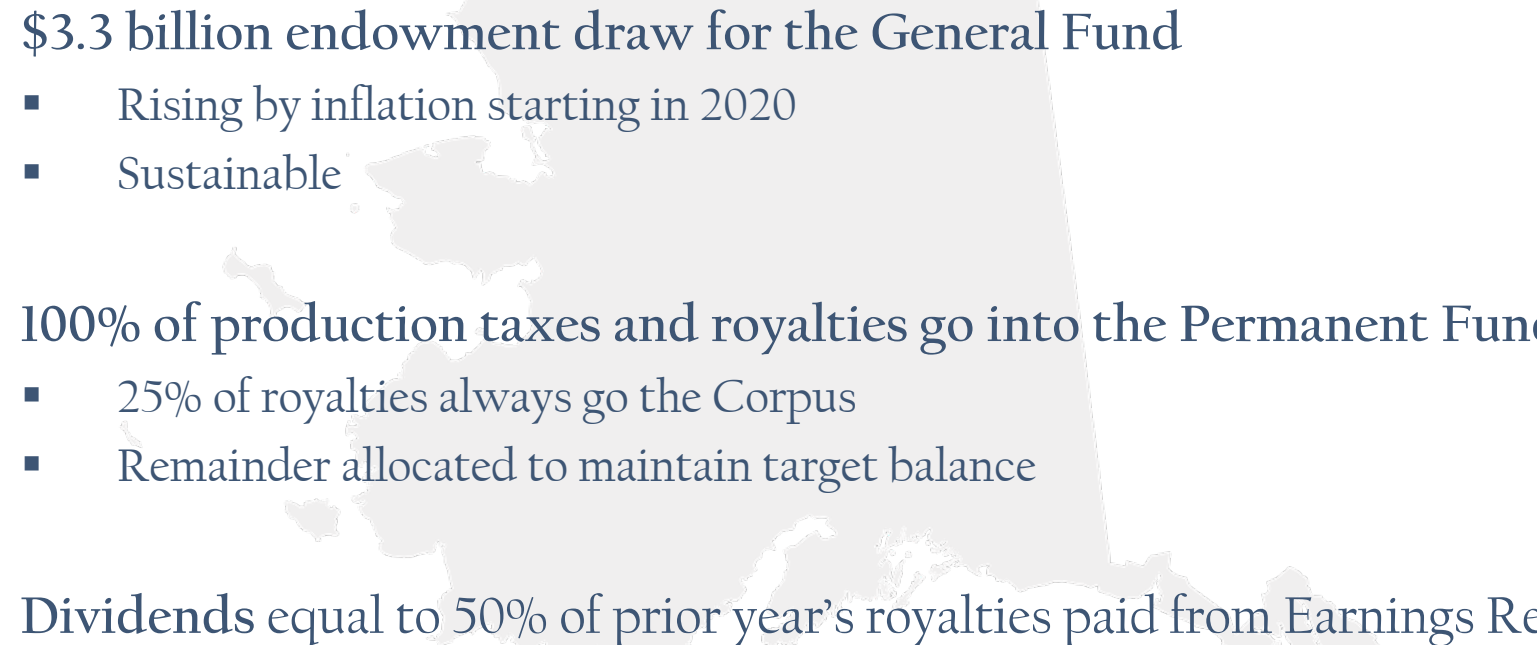




Alaska Permanent Fund Protection Act

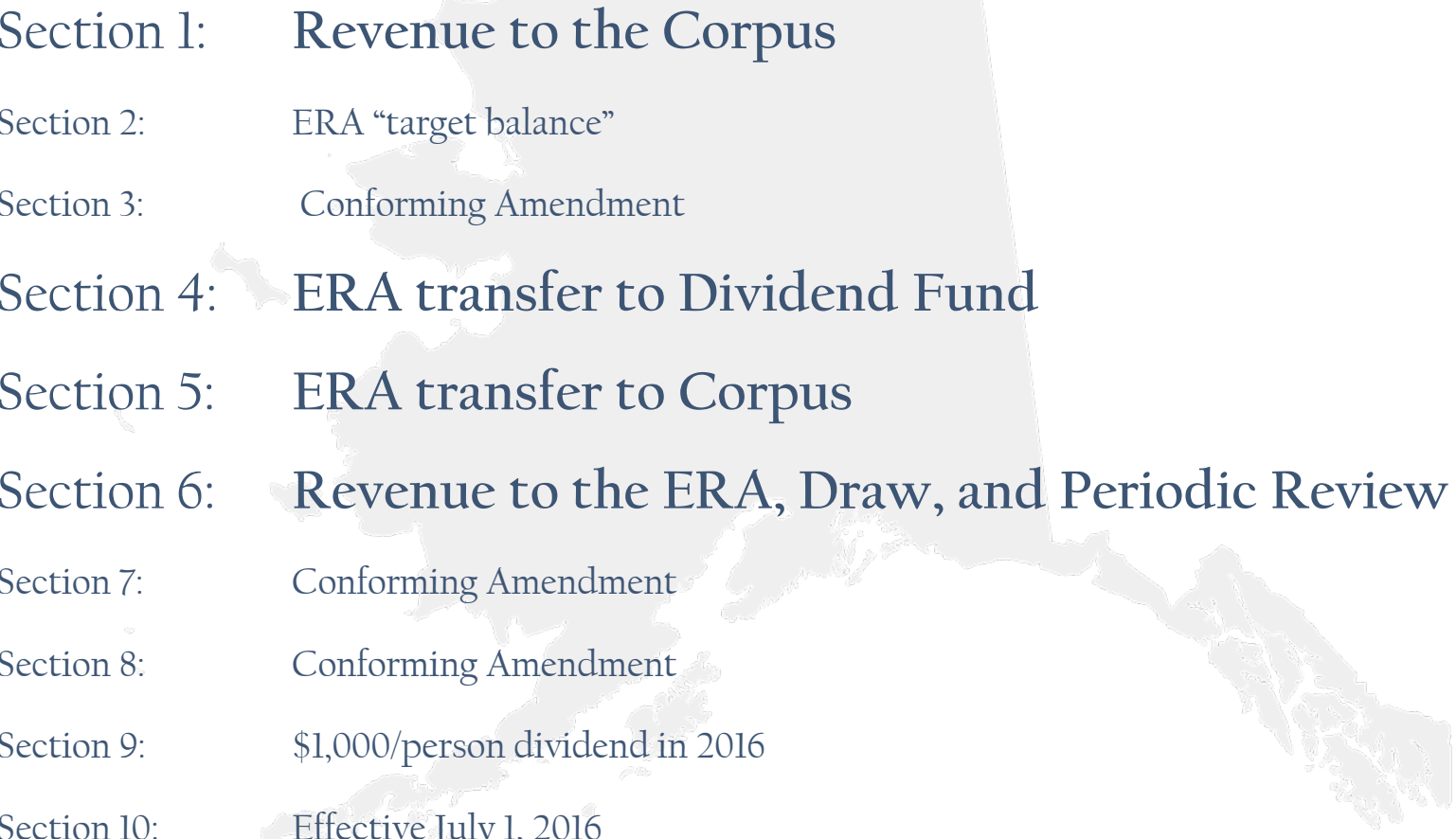
THE BILL

OVERVIEW

- 
1. \$3.3 billion endowment draw for the General Fund
 - Rising by inflation starting in 2020
 - Sustainable
 2. 100% of production taxes and royalties go into the Permanent Fund
 - 25% of royalties always go the Corpus
 - Remainder allocated to maintain target balance
 3. Dividends equal to 50% of prior year's royalties paid from Earnings Reserve



ALASKA PERMANENT FUND PROTECTION ACT

- 
- Section 1: **Revenue to the Corpus**
 - Section 2: ERA “target balance”
 - Section 3: Conforming Amendment
 - Section 4: **ERA transfer to Dividend Fund**
 - Section 5: **ERA transfer to Corpus**
 - Section 6: **Revenue to the ERA, Draw, and Periodic Review**
 - Section 7: Conforming Amendment
 - Section 8: Conforming Amendment
 - Section 9: \$1,000/person dividend in 2016
 - Section 10: Effective July 1, 2016



ALASKA PERMANENT FUND PROTECTION ACT

- 
1. Protect the corpus
 2. Protect the dividend
 3. Grow the fund
 4. Stabilize the budget
 5. Stabilize the economy

