

A Framework for Analyzing Fiscal Plans

House Finance Committee

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David Teal, Director, Legislative Finance Division

Answering a few questions can help you get a basic fiscal plan/bill. But there are also options to consider if you want a more comprehensive plan. Advice:

- Options do not make or break a plan—most options can be added/deleted from any basic plan.
- Options are important, but avoid getting bogged down in discussion of options until you agree on the basics.

1) Do you want to use earnings of the Permanent Fund to help balance Alaska's budget?

Considerations:

1. Alaska is facing a sixth consecutive year of budget deficits, and deficits are forecast into the foreseeable future if we continue business as usual.
2. Deficits can be filled by a combination of cuts, taxes, use of investment earnings and use of reserves.
3. Reserves are declining rapidly and neither cuts nor taxes appear to be capable of filling deficits. As a practical matter, no tool other than earnings is capable of filling more than about 1/3 of the annual deficit.
4. Use of earnings is not only the most powerful tool we have, using earnings would have far less economic impact than cuts or taxes.

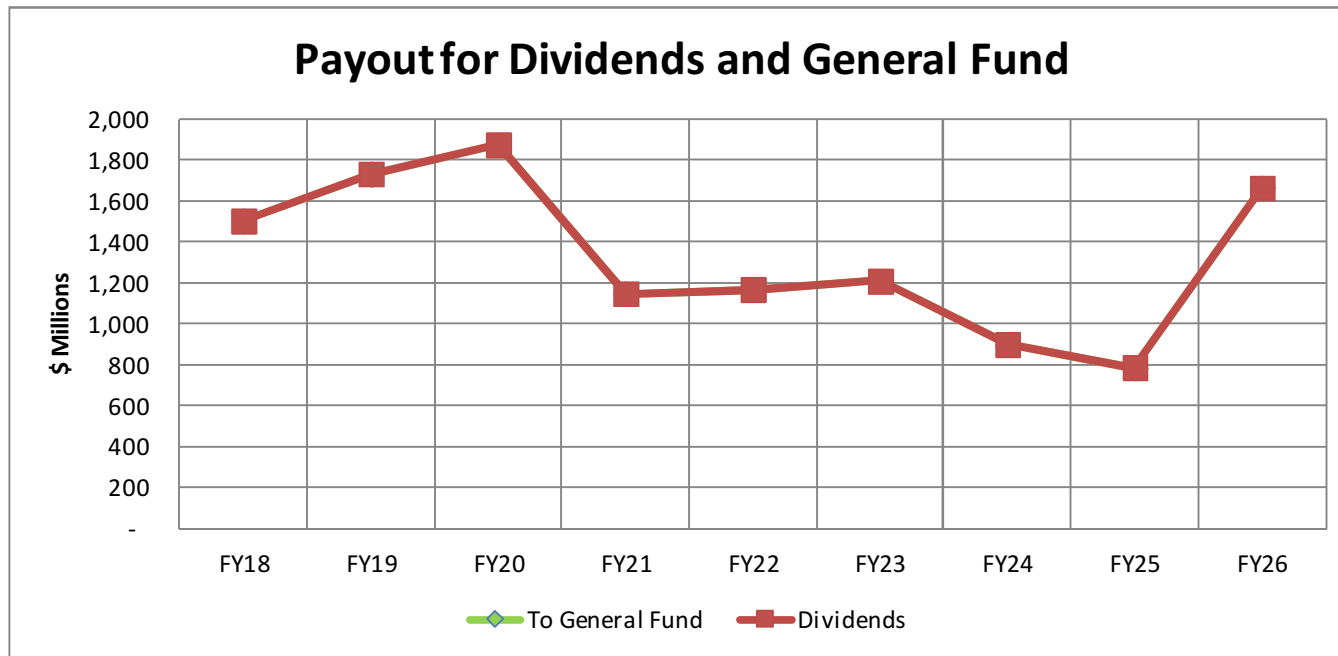
2) Do you want transfers to the general fund to be based on earnings directly or on a POMV (percent of market value of the Permanent Fund) payout?

Considerations:

1. Governments (and economies) are not very good at handling volatile amounts of money available for appropriation.
2. Earnings are volatile and can be negative. Even a five year moving average of earnings—like we have for PFDs—is volatile.
3. The balance of a fund is far more stable than the stream of investment earnings on the same fund, so POMV offers a far more stable revenue stream than earnings can provide.
4. Adopting POMV changes the existing method of calculating dividends.

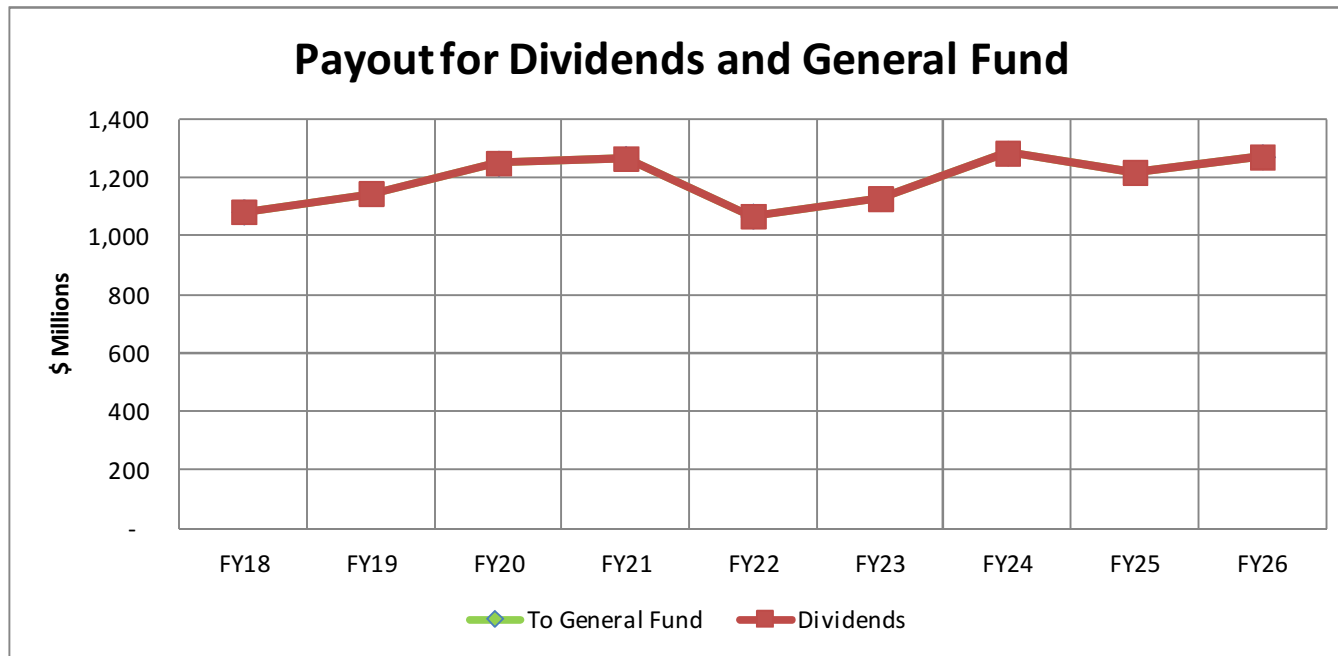
Payout to the General Fund under a Plan Sending 50% of Realized Earnings to the General Fund

(Assuming Earnings Repeat the Most Recent 9 Years)



Payout to the General Fund under a Plan Sending a Percent of Market Value to the General Fund

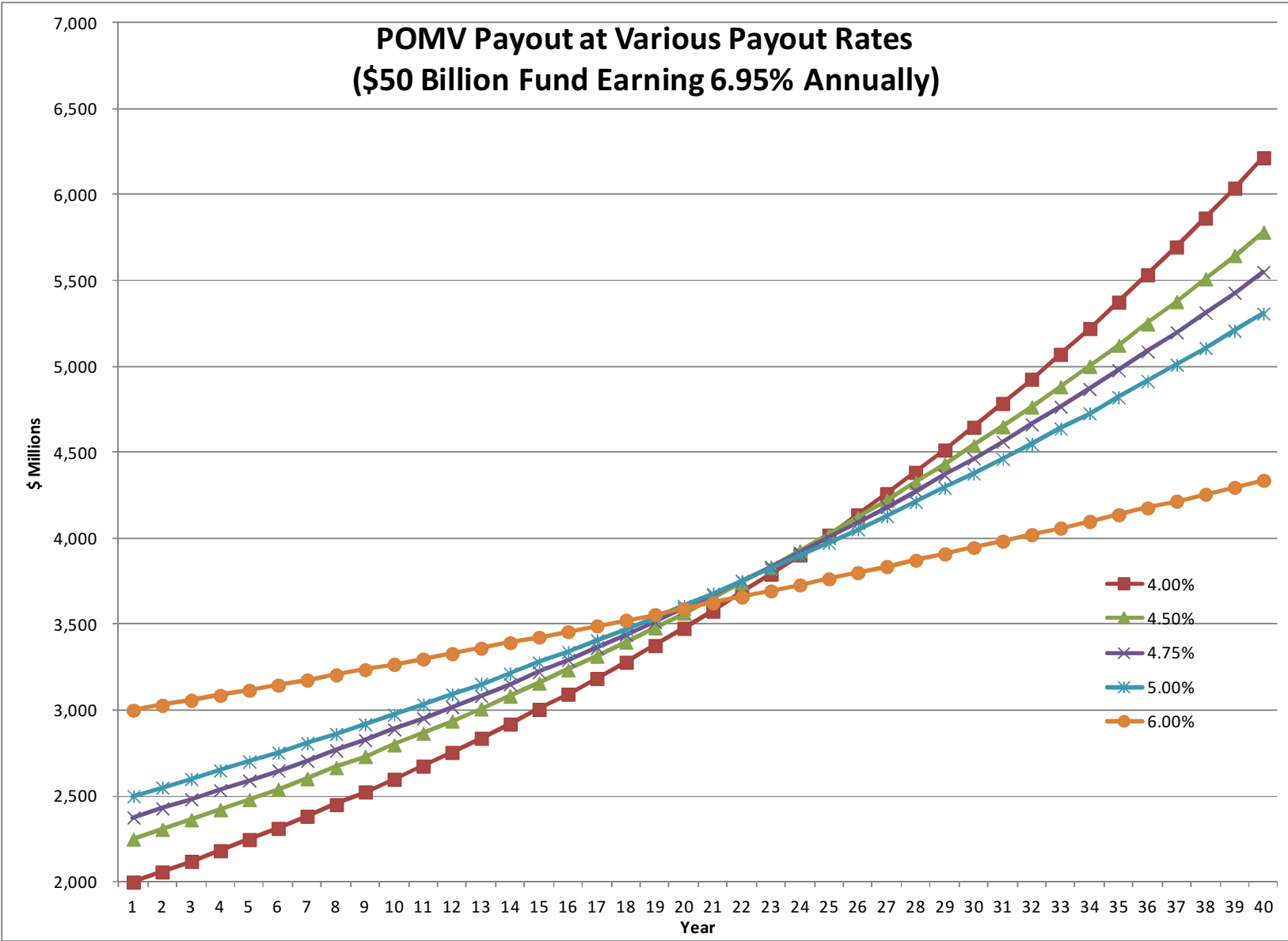
(Assuming Earnings Repeat the Most Recent 9 Years)



3) Assuming POMV is selected, what is an appropriate payout rate?

Considerations:

1. A lower payout rate provides a lower payout in early years, but a higher payout in the future.
2. A nominal rate of 4.75% (4.5% effective rate) offers a good balance between high payout and safe payout.
3. The payout rate does not need to be constant.



4) How much should go to dividends?

Considerations:

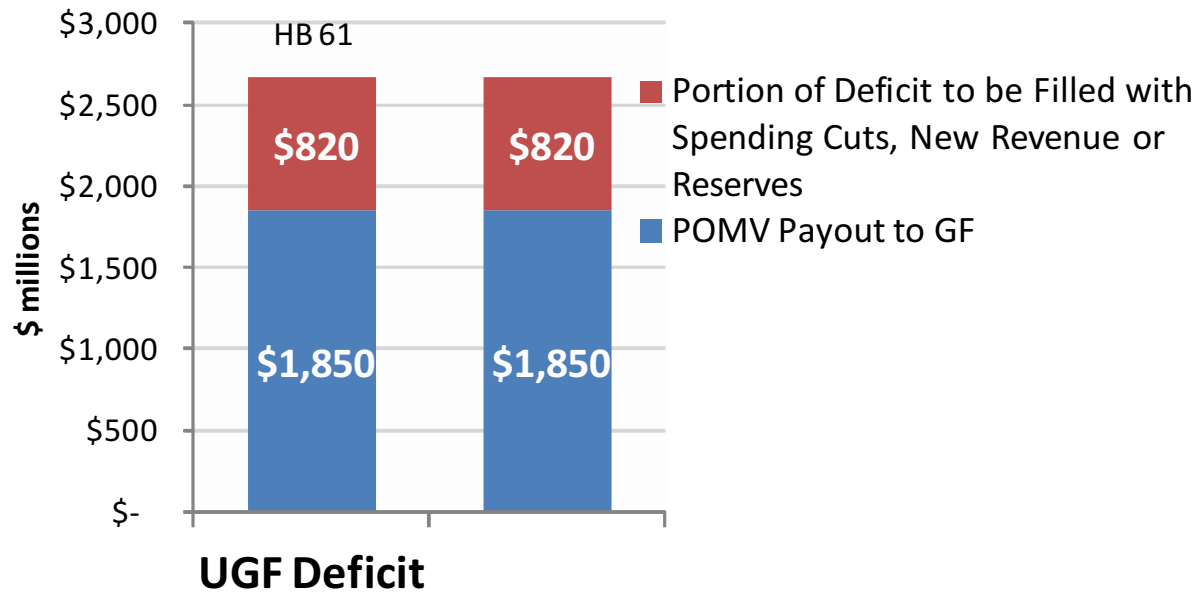
1. This is not just a political choice—higher dividends translate directly to the need for some combination of
 - a. additional revenue,
 - b. additional budget reductions, or
 - c. larger draws from reserves.
2. It doesn't matter whether dividends go through the general fund or directly from the ERA to the dividend fund—dividends compete with other programs as soon as you decide to transfer money from the ERA to the general fund.

Desired Permanent Fund Dividend

\$ 1,000 per Alaskan



\$ millions			
5-Year Market Value	\$	48,100	
Payout Rate		5.25%	
Total Payout	\$	2,525	
less Dividends	\$	(675)	26.7%
Payout to GF	\$	1,850	



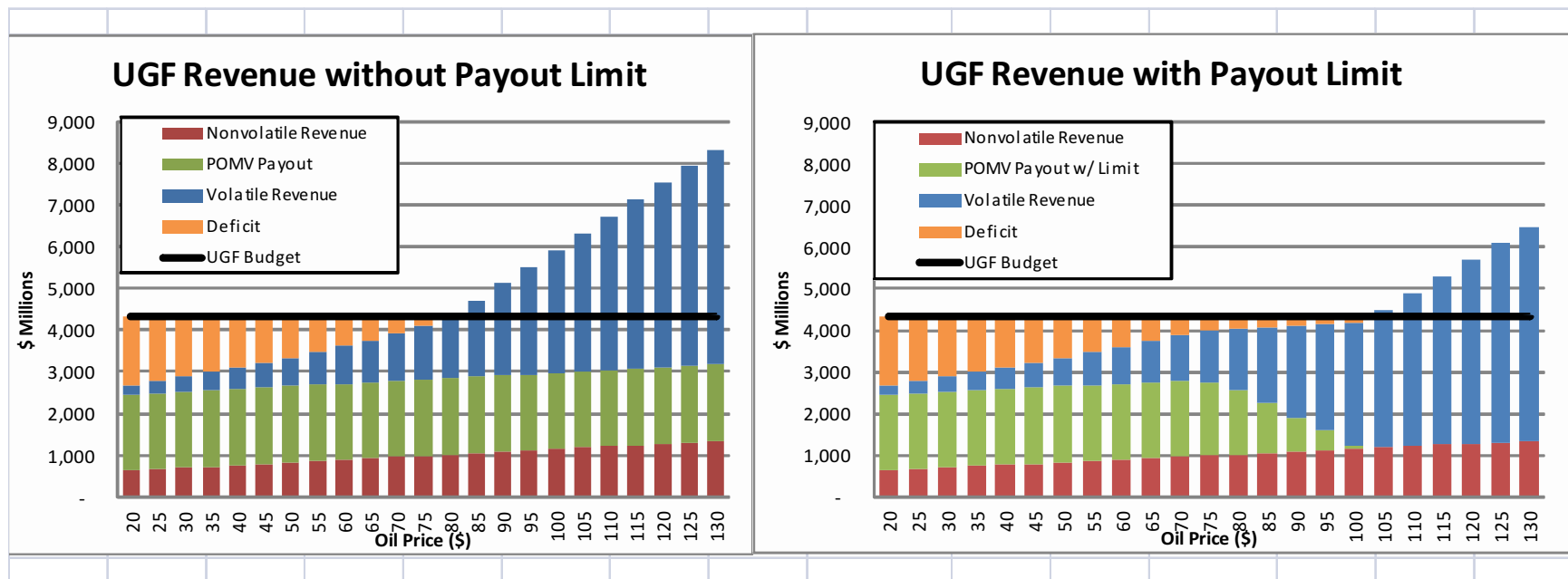
After Deciding on the Basics, Decide on Options

1. Revenue limit
2. Spending limit
3. Surplus buckets
4. Inflation Proofing
5. Extra 25% royalties
6. Royalties to dividends
7. What about the remaining deficit?

Revenue limit

1. Reduces the POMV payout once oil revenue reaches a trigger level
2. Revenue may be limited even when a deficit exists, depending on the trigger level
3. Depending on your perspective, a revenue limit is
 - a) A clever way to encourage taxes that are not subject to the limit or
 - b) A way to encourage spending reductions
4. The limit doesn't have to be flat
5. The limit doesn't have to be a fixed amount over time
6. The graph is not a time series
7. What happens over time?

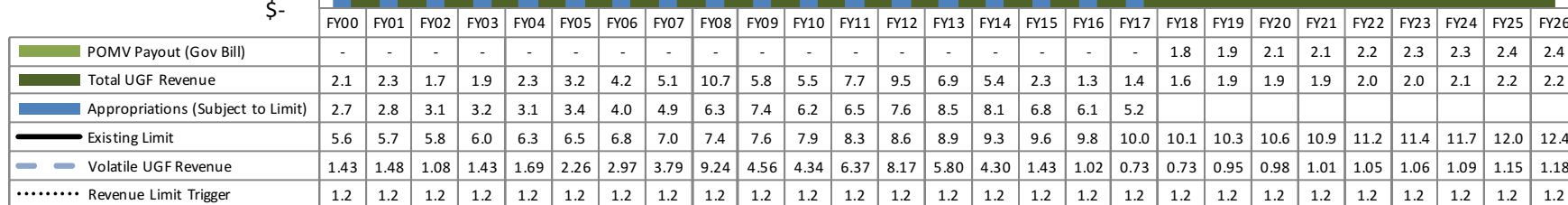
How A Revenue Limit Works



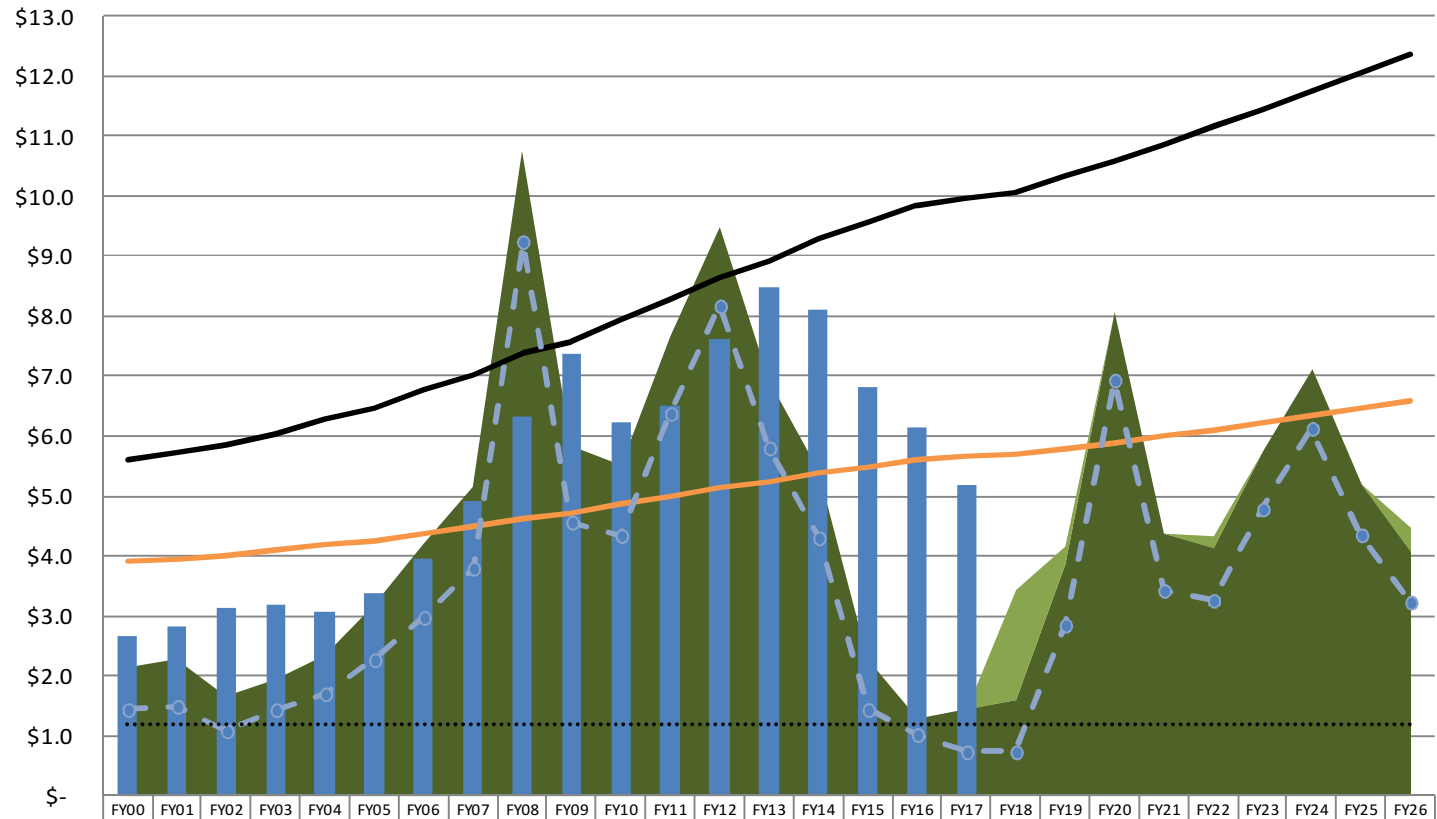
Spending Limit

1. Some envision a spending limit as something that exerts annual pressure to restrain expenditures
2. It could do that, but exerting constant pressure is the purpose of the revenue limit
3. A spending limit can kick in after the revenue limit has done all it can do
4. A spending limit takes the peaks off the revenue stream; it prevents the spending of windfall revenue
5. Complications: fund groups, cumulative vs. annual, tax credits and other large expenditures, legal issues
6. Advice: leave this topic to a separate bill—it is too complex and requires a Constitutional amendment to be fully effective

"Forecast Oil Price Scenario"
(\$billions)



Budget History/ Revenue Projections with POMV, Revenue Limit, and Revised Spending Limit
"Higher Oil Price Scenario"
(\$billions)

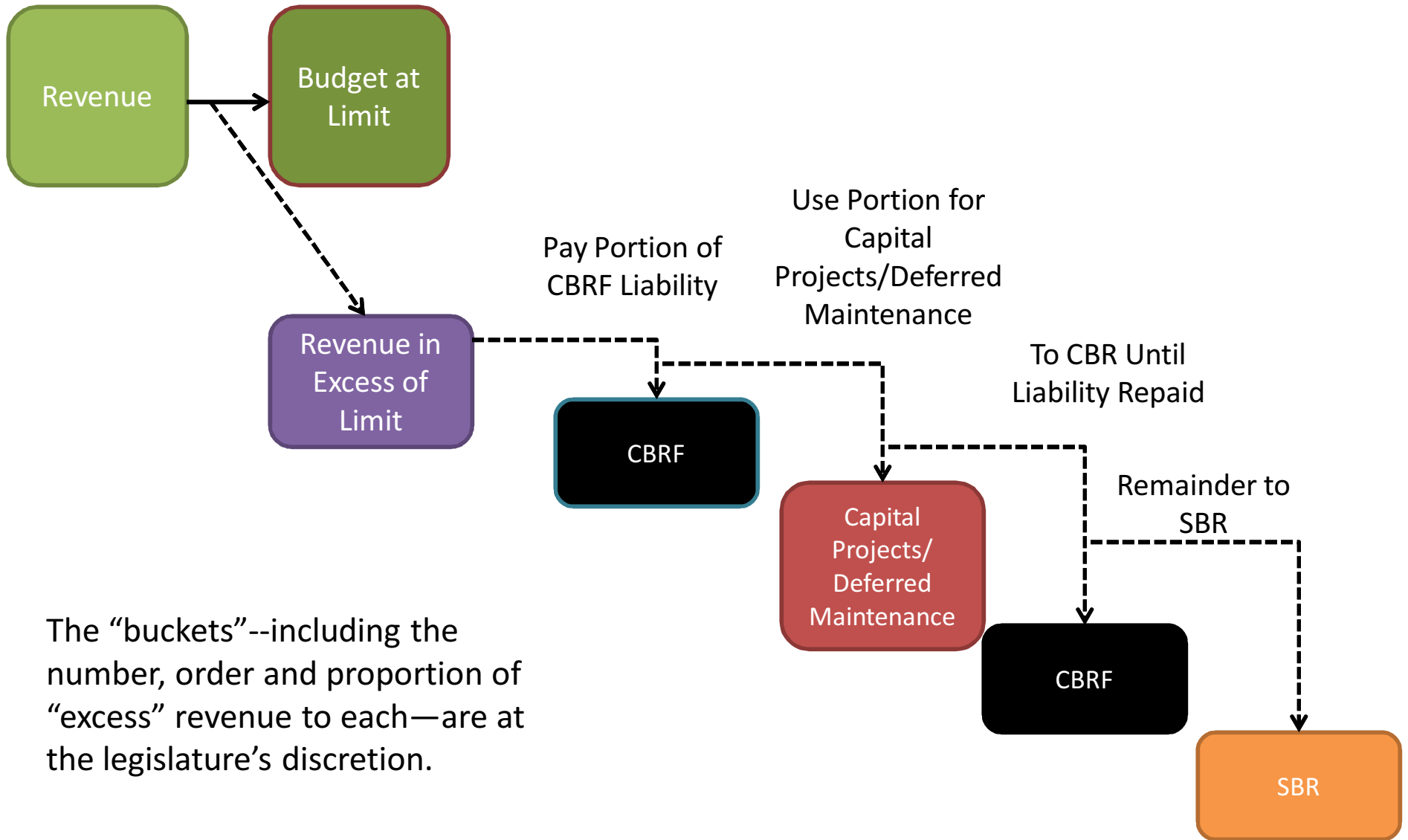


<div></div> POMV Payout (Gov Bill)																			1.8	0.3	-	-	0.2	-	-	-	0.4
<div></div> Total UGF Revenue	2.1	2.3	1.7	1.9	2.3	3.2	4.2	5.1	10.7	5.8	5.5	7.7	9.5	6.9	5.4	2.3	1.3	1.4	1.6	3.9	8.1	4.4	4.1	5.8	7.1	5.2	4.1
<div></div> Appropriations (Subject to Limit)	2.7	2.8	3.1	3.2	3.1	3.4	4.0	4.9	6.3	7.4	6.2	6.5	7.6	8.5	8.1	6.8	6.1	5.2									
<div></div> Existing Limit	5.6	5.7	5.8	6.0	6.3	6.5	6.8	7.0	7.4	7.6	7.9	8.3	8.6	8.9	9.3	9.6	9.8	10.0	10.1	10.3	10.6	10.9	11.2	11.4	11.7	12.0	12.4
<div></div> Modified Limit	3.9	4.0	4.0	4.1	4.2	4.3	4.4	4.5	4.6	4.7	4.9	5.0	5.1	5.2	5.4	5.5	5.6	5.6	5.7	5.8	5.9	6.0	6.1	6.2	6.3	6.4	6.6
<div></div> Volatile UGF Revenue	1.4	1.5	1.1	1.4	1.7	2.3	3.0	3.8	9.2	4.6	4.3	6.4	8.2	5.8	4.3	1.4	1.0	0.7	0.7	2.8	6.9	3.4	3.3	4.8	6.1	4.3	3.2
<div></div> Revenue Limit Trigger	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2

Surplus Buckets

If you insist on including a spending limit, it might be preferable to outline how surplus revenue is to be used rather than simply putting a cap on spending

Planned Use of Excess Revenues



The “buckets”--including the number, order and proportion of “excess” revenue to each—are at the legislature’s discretion.

Inflation Proofing

1. From a purely financial perspective, there is little reason to move money from the ERA to principal
2. The current method—annual deposits to principal based on inflation—endangers the payout (and dividends) by potentially eroding the balance of the ERA
3. The “4 times” approach in HB 61 is designed to work in conjunction with a revenue limit—it transfers money to principal only when the ERA balance appears sufficient to make payouts for the next few years
4. Inflation proofing is usually seen as a trade-off between the present and the future—inflation proofing takes money off the table now but increases future cash flows to the general fund, but inflation proofing may not be necessary
5. The value of the Permanent Fund increases due to dedicated deposits of oil royalties, which is a form of inflation proofing

Extra 25% of Royalties

1. HB 61 proposes a reduction in dedicated deposits to the Permanent Fund
2. More than \$50 million annually would be redirected to the general fund
3. The provision increases general fund revenue in the near future, but reduces the POMV payout in the long-run

Royalties to Dividends

- HB 61 proposes a dividend kicker of 20% of royalty revenue
- Linking dividends to current oil revenue was intended make dividends more responsive to oil prices
- Including royalties makes the dividend more volatile, but volatility is less important to dividends than it is to general fund revenue
- There are other ways to adjust the dividend amount
- Higher dividends means less money for government operations

What about the remaining deficit?

1. POMV alone is unlikely to fill the deficit in the near future, and may not fill deficits in the longer run
2. A broad-based tax could be part of a fully developed plan, or could be taken up as a separate topic