

HJR

48

FISCAL NOTE

STATE OF ALASKA
1994 LEGISLATIVE SESSION

BILL NO. HJR 48

Revision Date: _____
 Title: 'Proposing amendments to the Constitution of the St. of AK relating to revenues from natural resources, the Alaska permanent fund, the appropriation limit and the budget reserve fund; and providing for an effective date for the amendments.'
 Sponsor: House Finance Committee
 Requestor: House Judiciary

Dept. Affected: Department of Revenue
 BRU: APFC
 Component: APFC
COMPONENT SERIAL NO. 109

Expenditures/Revenues:

(Thousands of Dollars)

OPERATING	FY95	FY96	FY97	FY98	FY99	FY00
PERSONAL SERVICES	-0-	70.0	208.0	271.5	271.5	271.5
TRAVEL	-0-	22.5	30.5	30.5	30.5	30.5
CONTRACTUAL	-0-	505.5	1645.5	2849.6	4053.8	5257.9
SUPPLIES	-0-	-0-	-0-	-0-	-0-	-0-
EQUIPMENT	-0-	6.0	12.0	6.0	-0-	-0-
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	-0-	1704.0	1896.0	3157.6	4355.8	5559.9

CAPITAL	-0-	-0-	-0-	-0-	-0-	-0-
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REVENUE FUND SOURCE:	-0-	1704.0	1896.0	3157.6	4355.8	5559.9
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FUNDING:

(Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1006 GF/MHTIA						
Other (Corporation Receipts)	-0-	1704.0	1896.0	3157.6	4355.8	5559.9
TOTAL	-0-	1704.0	1896.0	3157.6	4355.8	5559.9

POSITIONS:

FULL-TIME	-0-	1	2	1	-0-	-0-
PART-TIME	-0-	-0-	-0-	-0-	-0-	-0-
TEMPORARY	-0-	-0-	-0-	-0-	-0-	-0-

Estimate of current year (FY94) Impact: \$ -0-

ANALYSIS: (Attach a separate page if necessary)

(See Attached.)

Prepared by: William H. Scott, Executive Director
 Division: Alaska Permanent Fund Corporation
 Approved by: Darrel J. Rexwinkel, Commissioner
 Commissioner: _____
 Agency: Department of Revenue

Phone: 465-2047
 Date: January 31, 1994
 Date: 1/31/94

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Fiscal Analysis: HJR No. 48

Proposing amendments to the Constitution of the State of Alaska relating to revenues from natural resources, the Alaska permanent fund, the appropriation limit and the budget reserve fund; and providing for an effective date for the amendments.

The Alaska Permanent Fund Corporation's operations are program-driven and program-financed. Operating cost levels are proportional to the actual and anticipated growth of the Fund and reflects the Corporation's ability to generate income. As funds under management increase, Fund custody and investment management fees increase; and the need for additional accounting and investment staff with associated support costs are also needed as portfolios grow.

Personal Services - Salary & Benefits for 4 new positions:

- FY 96: Data Processing Analyst/Programmer \$70.0
- FY 97: Investment Officer \$100.0; Accounting Clerk \$38.0
- FY 98: Portfolio Accountant \$63.5

Travel - Transportation, Per Diem, Honorarium:

- (a) 7th Trustee added to Board: Board meeting travel \$16.9; asset allocation/investment management related travel \$5.6
- (b) Investment officer travel: Board meeting and investment management travel \$8.0

Contractual Services:

- (a) Equity management fees: This increment is due to increased funds under management.
- (b) Custody fees: This increase is due to the increase in the amount of assets requiring safekeeping.
- (c) Financial network fees: Cost for additional financial data, networks, and associated terminals for new Investment Officer.

	<u>Equity Mgmt</u>	<u>Custody Mgmt</u>	<u>Financial Data</u>
FY 96	1,423.4	182.1	0.0
FY 97	1,423.4	182.1	40.0
FY 98	2,491.0	318.6	40.0
FY 99	3,558.6	455.2	40.0
FY 00	4,626.2	591.7	40.0

Equipment - one-time associated costs of new positions: workstation furniture (desk, credenza, chair, telephone, file, computer)

- (a) FY 96: Analyst Programmer \$6.0
- (b) FY 97: Investment Officer \$6.0; Accounting Clerk \$6.0
- (c) FY 98: Portfolio Accountant \$6.0

DRAFT

LETTER OF INTENT

After reviewing HJR 48 (Restructuring the Permanent Fund) the subcommittee decided that before the legislature embarks on a new method of budget funding many policy issues must first be addressed. The decision was made after carefully evaluating the premises of HJR 48, in addition to information provided from individuals knowledgeable in evaluating financial proposals.

This Letter of Intent contains 1) A Basic Outline of HJR 48, 2) Policy Questions That Must Be Asked and 3) A Proposal For Further Action by the Legislature.

1) A Basic Outline of HJR 48 "The Cremo Plan"

The purpose of the plan is to stabilize state resource revenues at a sustainable level, to increase the size of the Permanent Fund, and to minimize the negative consequences of the fiscal gap. The plan requires this session's legislature to propose - and the voters in the fall election to approve - an amendment to the State Constitution to provide that beginning July 1, 1995 and henceforth, all natural resource revenues be deposited in the Permanent Fund along with the assets of the state's two budget reserve accounts and the Railbelt Energy Fund. All future income earned by the Fund would be retained in the Fund, but there would be an annual withdrawal from the Fund based on its average market value over the past 12 quarters. The first year, the withdrawal would equal 20 percent, but then would be reduced geometrically each year until the permanent withdrawal rate of 6 percent is reached in the year 2006.

2) Policy Questions That Must Be Asked

There are major policy and technical questions which must be thoroughly researched and answered before we are in a position to present any plan to the voters. Those issues include:

1. Revenue Allocation - If only resource revenues are used to determine the budget amount available, and our entitlement programs continue to grow, won't most of the available revenues eventually go into the entitlements and less into resource development, thereby reducing the revenue source which funds the cycle? Additionally, what about the negative impact to natural resource development by encouraging high severance and other taxes in order to generate enough income to support the growing needs of an expanding population?

2. Effect on Bonds - How will a budgetary funding mechanism such as this affect the State's current bond rate? If adopted, could it impair the State's credit and, thereby impair the ability of the State, state agencies and local governments to fund capital improvements through bonds?

3. Emergency Relief - The amendment makes perhaps 90 percent or more of the recurring unrestricted revenue of the state "not appropriable." The amendment then prescribes a set percentage for expenditure each year. There is no allowance of amounts necessary to meet unforeseen disaster emergencies. The State needs to have a rainy day fund for atrocities such as earthquakes and other natural disasters.

4. Assumptions - The plan is based on the Department of Revenue's fall 1993 mid-case revenue projections, and assumes an annual total rate of return for the Permanent Fund of 10 percent and an annual inflation rate of 4 percent. The Alaska Permanent Fund Corporation's projections are based on the low-case revenue projections, and assume a long-term average rate of return for the Permanent Fund of 9 percent and a long-term average rate of inflation of 6 percent. Long term market

history does not support conservative investments returning 2 1/2 times the inflation rate. The "Cremo" plan assumes some combination of state spending cuts and revenue increases. Given the plan's assumptions, a 12 percent annual increase in conventional revenues and a \$30 million cut in annual state spending would eliminate the fiscal gap. This is a tremendous statement when no one has the ability to predict future deposits into the fund up to the year 2006.

5. Appointments to the Board of Directors - The directors of the corporation should not be subject to confirmation. Under the present approach used in the constitution, only department heads and the heads of quasi-judicial boards are subject to confirmation. The corporation would be the trustee of the source of most of the expendable money of the state. There could be an inherent conflict of interest if the legislature shares the power to make appointments to the board.

6. The Transition Period - The plan provides for a higher but gradually reduced withdrawal rate during a 10-year transition period in order to minimize the negative consequences of the fiscal gap. The proposed constitutional amendment states that the withdrawal rate shall decrease geometrically throughout the transition period, but does not provide specific details. This ambiguity should be cleared up. We lack sufficient information to know whether the percentages proposed beginning in fiscal year 1996 and thereafter will have the effect of depleting the corpus, or leave it unprotected from the effects of inflation.

3) A Proposal For Further Action By the Legislature

Before the legislature and the citizens of this state will approve this plan, they need to be convinced that it is clearly an improvement over the status quo. While there are some positive and intriguing aspects of HJR 48 there are also a number of undesirable outcomes which might occur should actual conditions in the future vary significantly from the assumptions upon which the plan is based. Indeed, the consequences for Alaska of this plan are too serious to rush a study. The subcommittee believes that it would be beneficial to the state and its citizens to establish a long-range plan that organizes the state's approach to handling its finances. It is for these reasons and the aforementioned concerns that the subcommittee proposes the establishment of a blue ribbon task force comprised from all branches of government, as well as technical experts in the field, that would thoroughly investigate the concept contained in HJR 48 and other feasible long-term financial plans. Unfortunately, there is not time enough during the current legislature to complete the study and think the task force should meet during the interim. We feel that further action, at this time, on this issue falls under the purview of the Finance Committee.

STATE OF ALASKA

DEPARTMENT OF LAW

OFFICE OF THE ATTORNEY GENERAL

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February 1, 1994

Honorable Brian Porter
Chairman
House Judiciary Committee
State Capitol, Rm. 122
Juneau, AK 99801-1182

Re: HJR 48

Dear Representative Porter:

I was asked to review the provisions of HJR 48 (amending the Alaska Permanent Fund) and be available for testimony. Unfortunately, I will be out of town on February 2 and will not be able to attend the committee meeting in person. I offer the following comments for your consideration:

1) page 1, line 9: the amendment makes perhaps 90 percent or more of the recurring unrestricted revenue of the state "not appropriable." The amendment then prescribes a set percentage for expenditure each year. There is no allowance of amounts necessary to meet unforeseen disaster emergencies.

2) page 2, line 9: investment standards for the permanent fund principal would be set by law. This could permit investment standards that may not be consistent with those used by a hypothetical prudent investor.

3) page 2, lines 10 - 13: measuring the rate of withdrawal against the average market value of assets requires the corporation to set an extremely aggressive investment strategy.

4) page 2, line 7: the term "long term capital appreciation" appears to require an investment strategy that will not include the type of return necessary to provide a rate of return exceeding a 6 percent actual rate.

5) page 2, line 19: the directors of the corporation should not be subject to confirmation. Under the present approach used in the constitution, only department heads and the heads of quasi-judicial boards are subject to confirmation. The corporation would be the trustee of the source of most of the expendable money

AG's ANALYSIS

Hon. Brian Porter, Chair
House Judiciary Committee

February 1, 1994
Page 2

of the state. There could be an inherent conflict of interest if the legislature shares the power to make appointments to the board.

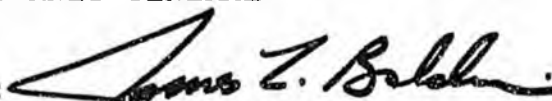
6) page 2, line 32: I don't know what is intended when the applicable percentage is decreased "geometrically." This ambiguity should be cleared up. I lack sufficient information to advise you whether the percentages proposed beginning in fiscal year 1996 and thereafter will have the effect of depleting the corpus, or leave it unprotected from the effects of inflation.

I hope these comments are of use to the committee when considering this joint resolution. If I can be of further help, please do not hesitate to contact me.

Sincerely,

BRUCE M. BOTELHO
ATTORNEY GENERAL

By:



James L. Baldwin
Assistant Attorney General

JLB:tg

cc: Raga Elim
Legislative Liaison
Office of the Governor

Deborah Behr
Assistant Attorney General
Legislation & Regulations Section

Traditional vs. Cremo Budgeting

Column 1	Column 2	Column 3	Column 4	Column 5	Column 6	Column 7	Column 8	Column 9	Column 10	
Non-dedicated Petroleum & Interest Revenues	Non-petroleum Revenues	Net GF Unrestricted Revenues (Columns 1 + 2)	PPC Dividend	Traditional Budget (Columns 3 + 4)	Crema Budget (Columns 7 + 8)	Crema Withdrawal	Non-petroleum Revenues	Traditional PF Balance	Crema PF Balance	
			584.0					13,777.0	14,952.00	FY95
FY95										
FY96	1,875.0	280.9	614.0	2,769.9	2,924.9	2,644.0	280.9	14,601.0	15,688.29	FY96
FY97	2,031.0	289.3	652.0	2,972.3	2,814.0	2,524.7	289.3	15,486.0	16,801.53	FY97
FY98	2,127.0	298.0	681.0	3,106.0	2,687.5	2,389.5	298.0	16,432.0	16,280.88	FY98
FY99	2,064.9	306.9	753.0	3,124.8	2,567.9	2,261.0	306.9	17,751.0	19,989.23	FY99
FY00	1,902.5	316.1	816.0	3,034.6	2,472.0	2,155.9	316.1	19,130.0	21,769.31	FY00
FY01	1,751.0	325.6	883.0	2,959.6	2,402.5	2,076.9	325.6	20,575.0	23,614.07	FY01
FY02	1,632.8	335.4	955.0	2,923.2	2,341.4	2,006.1	335.4	22,096.0	25,563.20	FY02
FY03	1,524.3	345.4	1,031.0	2,900.8	2,279.5	1,934.0	345.4	23,696.0	27,624.22	FY03
FY04	1,406.7	355.8	1,098.0	2,860.5	2,214.8	1,859.0	355.8	25,380.0	29,810.57	FY04
FY05	1,280.8	366.5	1,167.0	2,814.3	2,149.5	1,783.0	366.5	27,150.0	32,122.61	FY05
FY06	1,131.6	377.5	1,238.0	2,747.1	2,084.7	1,707.3	377.5	29,008.0	34,543.99	FY06
FY07	1,000.0	388.8	1,312.0	2,700.8	2,229.8	1,841.1	368.8	30,960.0	36,883.49	FY07
FY08	893.1	400.4	1,389.0	2,682.5	2,380.9	1,980.5	400.4	32,930.0	39,156.55	FY08
FY09	812.7	412.5	1,468.0	2,593.2	2,534.0	2,121.6	412.5	34,743.0	41,384.60	FY09
FY10	749.1	424.8	1,551.0	2,725.0	2,685.6	2,260.8	424.8	36,632.0	43,584.22	FY10

Traditional assumes mid-case Fall '93 DoR Revenue Forecast and Permanent Fund Corporation Fall '93 Forecast

Crema assumes same DoR Revenue Forecasts, PFC earnings assumptions,

10 year transition, and PFC assumptions on Earnings Reserve balance

Traditional vs. Cremo Budgeting
Notes and Assumptions for Spreadsheet

Page 1

Column 1

These figures are taken from the Department of Revenue Fall 1993 Revenue Sources Book (hereafter DoR Forecast), pages 40 and 41. In particular, the non-dedicated petroleum and interest revenues are determined by subtracting Non-petroleum, Non-interest Revenues on page 40, column 10, from Total Net G.F. Unrestricted Revenues on page 41, column 20.

Column 2

These figures are taken from DoR Forecast, page 40, column 10.

Column 3

These figures are determined by adding non-dedicated petroleum and interest revenues to non-petroleum revenues (columns 1 and 2), and are also found in DoR's Forecast, page 41, column 20.

Column 4

The dividend amounts are taken from the Alaska Permanent Fund Corporation financial projections as of October 31, 1993 (hereafter PFC projections). Rate of return assumptions call for a nominal return of 8.37% from FY96 - 98, and 9.00% from FY99 - 2010. All numbers in the worksheet are nominal, therefore inflation projections need not be considered.

Column 5

Combining columns 3 and 4 produces the amount available to the Legislature for appropriation under our traditional system. Dividends must be appropriated from this amount.

Column 6

Combining columns 7 and 8 produces the amount available to the Legislature for appropriation under the Cremo plan. Dividends must be appropriated from this amount.

Traditional vs. Cremo Budgeting
Notes and Assumptions for Spreadsheet

Column 7

These figures are determined by taking a percentage of the 12 quarter average balance of the Permanent Fund. The Cremo plan assumes a transition period beginning in FY96 and ending in FY06 when a permanent 6% withdrawal rate is achieved. Percentages during the transition are determined by a geometric progression. They are as follows:

FY96 20%	FY97 17.73%
FY98 15.72%	FY99 13.94%
FY00 12.36%	FY01 10.95%
FY02 9.71%	FY03 8.61%
FY04 7.63%	FY05 6.77%
FY06 6.00%	

After FY06, a 6% withdrawal rate is continued.

The withdrawal amount, relative to the Cremo plan's Permanent Fund year-end balance, is a lower withdrawal percentage. For example, the withdrawal amount in FY96 is actually 16.9% of the year-end balance of the Permanent Fund.

The Cremo plan assumes the identical rate of return assumptions for the Permanent Fund as contained in the PFC projections (i.e. 8.37% from FY96 - 98 and 9.0% from FY99 - 2010).

Column 8

These figures are identical to figures in column 2.

Column 9

Figures in this column are from PFC projections.

Column 10

To achieve financial parity with the traditional model, \$1.175 billion was added to the Permanent Fund in the Cremo plan, distributing this amount evenly through the 12 quarters prior to FY96. This number was taken from the PFC projections as the Earnings Reserve balance available at the end of FY95.

Data: Dept. of Revenue (projections: fall, 1993, mid case)

* Permanent Fund Corp. (projections: October 31, 1993, mid case)

Transitional withdrawal: 20% in initial year to permanent % in 2006 10
 Permanent withdrawal: 6.00%
 Total return FY95 - 98: 8.37%
 Total return FY98 - 2010 9.00%
 Reserves: 1,175

Proposed State Financial System
 (millions of dollars)

Fiscal Year	Deposit	Year Begin	2nd Qtr Begin	3rd Qtr Begin	4th Qtr Begin	Year End	Avg Prior Bal	Wdrl %	Withdrawal
1993 *		11,800.92	12,044.85	12,280.79	12,532.73	12,776.67			
1994 *		12,874.58	13,100.52	13,326.46	13,552.40	13,778.33			
1995 *		13,876.25	14,145.19	14,414.13	14,683.06	14,952.00			
1996	2,117.12	14,952.00	15,130.39	15,312.52	15,498.46	15,688.29	13,219.99	20.00	2,644.00
1997	2,295.33	15,688.29	15,958.02	16,233.39	16,514.52	16,801.53	14,238.83	17.73	2,524.74
1998	2,416.40	16,801.53	17,159.96	17,525.89	17,899.48	18,280.88	15,200.52	15.72	2,389.53
1999	2,354.71	18,280.88	18,687.34	19,102.30	19,525.94	19,989.23	16,222.87	13.94	2,260.97
2000	2,175.06	19,989.23	20,412.40	20,844.42	21,285.48	21,769.31	17,448.13	12.36	2,155.89
2001	2,008.86	21,769.31	22,207.46	22,654.78	23,111.46	23,614.07	18,959.57	10.95	2,076.92
2002	1,883.00	23,614.07	24,076.78	24,549.18	25,031.46	25,563.20	20,655.92	9.71	2,006.08
2003	1,754.37	25,563.20	26,052.25	26,551.54	27,061.27	27,624.22	22,462.17	8.61	1,934.04
2004	1,626.18	27,624.22	28,142.82	28,672.28	29,212.81	29,810.57	24,353.56	7.63	1,859.04
2005	1,486.83	29,810.57	30,358.77	30,918.43	31,489.80	32,122.61	26,345.99	6.77	1,783.01
2006	1,321.81	32,122.61	32,696.39	33,282.18	33,880.22	34,543.99	28,454.83	6.00	1,707.29
2007	1,175.92	34,543.99	35,097.06	35,661.70	36,238.16	36,883.49	30,684.26	6.00	1,841.06
2008	1,057.16	36,883.49	37,419.61	37,966.95	38,525.74	39,156.55	33,008.32	6.00	1,980.50
2009	965.92	39,156.55	39,680.93	40,216.29	40,762.86	41,384.60	35,359.84	6.00	2,121.59
2010	892.22	41,384.60	41,901.28	42,428.77	42,967.29	43,584.22	37,679.44	6.00	2,260.77

—Cremo plan worksheet - uses DoR Fall '93
 Forecasts, and PFC Fall '93 Forecasts



Alaska Permanent Fund Corporation

FINANCIAL PROJECTIONS (In millions)

as of October 31, 1993

GROWTH OF FUND PRINCIPAL

FY	FY Begin Balance	Appropriations	Dedicated State Revenues*	Inflation-Proofing	FY End Balance	Inflation-Proofing Shortfall
78	0		54		54	
79	54		84		139	
80	139		344		483	
81	483	900	385		1,769	
82	1,769	800	400		2,969	
83	2,969	400	421	231	4,021	
84	4,021	300	366	151	4,838	
85	4,838	300	388	235	5,741	
86	5,741		323	216	6,281	
87	6,281	1,264 **	170	148	7,864	
88	7,864		418	305	8,585	
89	8,585		228	360	9,173	
90	9,173		267	454	9,894	
91	9,894		435	558	10,888	
92	10,888		338	477	11,703	
93	11,703	5 ***	315	362	12,385	
94	12,385	5	228	377	12,995	
95	12,995	5	247	530	13,777	
96	13,777	5	257	562	14,601	
97	14,601	5	284	596	15,486	
98	15,486	6	308	632	16,432	
99	16,432	4	310	1,095	17,751	
0	17,751	4	292	1,083	19,130	
1	19,130	4	278	1,165	20,575	
2	20,575	4	266	1,251	22,098	
3	22,098	5	255	1,341	23,696	
4	23,696	5	243	1,437	25,380	
5	25,380	5	228	1,537	27,150	
6	27,150	5	211	1,642	29,008	
7	29,008	5	195	1,752	30,990	
8	30,960	5	181	1,784	32,930	85
9	32,930	5	169	1,638	34,743	349
10	34,743	6	158	1,725	36,632	369

Cumulative Totals Projected
or FY 1994 - 2010:

3,949 20,055 803

USE OF FUND INCOME

Net Income	Distributions			Reserves		FY End Balance	FY
	Dividends	Inflation-Proofing	General Fund	Add (Delete)	FY End Balance		
2			1				78
8			7				79
32	12		12				80
150	28		28	59	59		81
368	71		71	185	244		82
471	108	231	110	110	354		83
630	175	151		203	537		84
658	217	235		208	763		85
1,021	303	216		501	1,264 **		86
1,069	391	148		529	529		87
789	424	303		62	591		88
868	480	360	4	44	635		89
916	487	454	4	(30)	605		90
1,030	489	559	4	(24)	581		91
1,036	488	477	5	64	645		92
1,226	632	362	5	320	865		93
1,028	550	377	5	90	1,055		94
1,238	584	530		120	1,175		95
1,518	614	562		137	1,312		96
1,403	632	596		149	1,452		97
1,494	681	532		176	1,638		98
1,718	753	1,005		(44)	1,594		99
1,837	816	1,083		(66)	1,528		0
1,960	883	1,165		(82)	1,436		1
2,087	955	1,251		(123)	1,313		2
2,218	1,031	1,341		(159)	1,154		3
2,254	1,088	1,437		(186)	968		4
2,494	1,167	1,537		(214)	754		5
2,640	1,238	1,642		(245)	508		6
2,791	1,312	1,752		(279)	230		7
2,848	1,388	1,784		(230)			8
3,112	1,468	1,638					9
3,282	1,551	1,725					10
35,920	16,741	20,055	5				

REALIZED RATE OF RETURN ASSUMPTIONS:

	Nominal	Inflation	Real
Y 94:	7.47%	2.99%	4.48%
Y 95 - 98: ****	8.37%	4.00%	4.37%
Y 99 - 2010:	9.00%	6.00%	3.00%

* Department of Revenue Fall Mid-Case Revenue Forecast.

** Earnings reserve appropriated to Fund principal by the Legislature July 1, 1987.

*** Transferred to principal from earnings reserve account per AS 37.13.145(d).

**** Based on capital market assumptions adopted by the Trustees in April 1993.

MID-CASE PROJECTION

Table 23

Mid Scenario Detailed Revenue Projections
(Millions on Dollars)

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
FY	SEVERANCE TAX	PROPERTY TAX	OIL&GAS INC TAX	GROSS ROYALTIES	MINERAL RENTS	BONUS SALES	INCOME FROM PRIOR YEARS	TOTAL PETROLEUM REVENUES	NON-PETR NON-INTR REVENUES	GEN FUND INTEREST REVENUES	TOTAL REVS W/ PERM FND DEDICATION
1981	1170.20	143.00	860.10	1501.60	7.90	14.10	0.00	3696.90	186.10	227.80	4110.80
1982	1581.70	142.70	668.90	1553.20	26.40	10.30	0.00	3983.20	209.00	324.70	4516.90
1983	1493.70	152.60	236.00	1447.40	54.20	73.10	0.00	3457.00	228.60	375.80	4061.40
1984	1393.10	131.00	265.10	1409.00	21.90	16.70	0.00	3236.80	245.80	282.70	3765.30
1985	1389.40	128.40	168.60	1390.30	23.70	23.60	0.00	3124.00	283.00	233.50	3640.50
1986	1107.90	113.50	133.90	1098.20	44.50	70.10	460.70	3028.80	222.40	195.20	3446.40
1987	648.50	102.50	120.40	591.60	29.10	1.00	85.20	1578.30	243.00	161.90	1983.20
1988	818.70	96.20	158.00	953.50	24.20	11.30	329.00	2390.90	223.60	132.60	2747.10
1989	698.80	89.70	166.00	818.70	18.00	23.00	259.70	2073.90	245.10	100.70	2419.70
1990	1001.60	89.80	117.20	1004.43	21.00	0.00	156.80	2390.83	271.33	117.90	2780.06
1991	1284.80	85.00	185.10	1292.83	21.30	38.30	398.59	3305.92	291.04	125.00	3721.96
1992	1053.20	69.00	165.50	1021.32	17.10	5.25	447.61	2693.44	353.40	101.80	3148.64
1993	1017.60	66.90	834.70	982.62	20.30	76.60	75.82	3074.54	325.58	70.90	3471.02
1994	942.80	63.20	189.90	851.20	21.85	1.10	9.40	2079.45	275.69	36.30	2391.44
1995	921.70	60.20	139.00	926.40	20.76	0.00	9.40	2077.46	280.11	27.20	2384.77
1996	924.90	56.70	139.00	967.40	19.72	0.00	9.40	2117.12	280.86	27.20	2425.18
1997	1011.70	53.10	127.00	1071.40	18.73	0.00	13.40	2295.33	289.29	32.20	2616.82
1998	1052.10	49.90	119.00	1164.20	17.80	0.00	13.40	2416.40	297.96	34.55	2748.91
1999	994.80	46.00	111.00	1172.60	16.91	0.00	13.40	2354.71	306.90	36.15	2697.76
2000	888.20	42.80	109.00	1105.60	16.06	0.00	13.40	2175.06	316.11	35.33	2526.50
2001	793.20	39.80	105.00	1042.20	15.26	0.00	13.40	2008.86	325.59	33.02	2367.47
2002	726.50	36.80	99.00	1006.20	14.50	0.00	0.00	1883.00	335.36	30.91	2249.26
2003	649.10	34.10	94.00	963.40	13.77	0.00	0.00	1754.37	345.42	29.50	2129.30
2004	574.20	31.50	89.00	918.40	13.08	0.00	0.00	1626.18	355.79	27.88	2009.85
2005	498.60	29.60	84.00	862.20	12.43	0.00	0.00	1486.83	366.46	26.29	1879.57
2006	406.60	27.70	79.00	796.70	11.81	0.00	0.00	1321.81	377.45	24.57	1723.83
2007	326.90	26.10	76.00	735.70	11.22	0.00	0.00	1175.92	388.78	22.50	1587.19
2008	265.60	24.70	71.00	685.20	10.66	0.00	0.00	1057.16	400.44	20.71	1478.31
2009	226.20	23.30	67.00	639.30	10.12	0.00	0.00	965.92	412.45	19.29	1397.67
2010	200.90	21.80	62.00	597.90	9.62	0.00	0.00	892.22	424.83	18.28	1335.32

(13)	(14)	(15)	(16)	(17)	(18)	(19)	(20)	(21)
	TOTAL REVS W/ PERM FND	PUB SCII	NPR-A	OTHER	PERM FUND	CONSTITUTIONAL BUDGET RESERVE	NET GEN FUND UNRESTRD REVENUES	
EY	DEDICATION	FUND	FUND	FUNDS	DEDICATN	FUND	NOM \$	REAL 1992\$
1981	4110.80	7.50	0.00	74.30	385.10	0.00	3718.20	
1982	4516.90	8.00	0.00	0.00	400.50	0.00	4108.40	
1983	4061.40	9.40	0.00	0.00	421.00	0.00	3631.00	
1984	3765.30	9.00	0.00	0.00	366.20	0.00	3390.10	
1985	3640.50	7.10	5.40	0.00	368.00	0.00	3260.00	
1986	3446.40	6.50	41.00	0.00	323.40	0.00	3075.50	
1987	1983.20	3.30	9.90	0.00	170.60	0.00	1799.40	
1988	2747.10	6.60	1.00	15.80	417.90	0.00	2305.80	
1989	2419.70	4.30	0.80	0.00	228.40	0.00	2186.20	
1990	2780.06	5.13	0.60	0.00	267.10	0.00	2507.23	
1991	3721.96	8.83	0.37	0.00	435.00	291.20	2986.56	
1992	3148.64	15.04	0.13	0.00	337.80	333.07	2462.60	2462.60
1993	3471.02	6.80	0.19	0.00	315.30	67.13	3081.60	2991.84
1994	2391.44	4.37	0.40	0.00	228.07	0.00	2158.60	2032.71
1995	2384.77	4.74	0.30	7.00	246.83	0.00	2125.90	1941.73
1996	2425.18	4.94	0.10	7.00	257.24	0.00	2155.90	1895.76
1997	2616.82	5.45	0.00	7.00	284.09	0.00	2320.28	1964.35
1998	2748.91	5.91	0.00	10.00	308.03	0.00	2424.97	1976.56
1999	2697.76	5.95	0.00	10.00	309.99	0.00	2371.82	1861.27
2000	2526.50	5.61	0.00	10.00	292.31	0.00	2218.58	1676.20
2001	2367.47	5.29	0.00	10.00	275.57	0.00	2076.61	1509.86
2002	2249.26	5.10	0.00	10.00	265.99	0.00	1968.17	1377.14
2003	2129.30	4.89	0.00	0.00	254.65	0.00	1869.76	1259.02
2004	2009.85	4.66	0.00	0.00	242.74	0.00	1762.45	1142.08
2005	1879.57	4.37	0.00	0.00	227.93	0.00	1647.27	1027.25
2006	1723.83	4.04	0.00	0.00	210.70	0.00	1509.09	905.65
2007	1587.19	3.73	0.00	0.00	194.65	0.00	1388.81	802.08
2008	1478.31	3.48	0.00	0.00	181.34	0.00	1293.49	718.90
2009	1397.67	3.25	0.00	0.00	169.24	0.00	1225.18	655.30
2010	1335.32	3.04	0.00	0.00	158.32	0.00	1173.96	604.26

The State's Revenues and the Economy

Premises

- a substantial part of the state's revenues will continue to be derived from natural resources ¹
- revenues from natural resources fluctuate ²
- Alaska's economy will continue to be dependent on state spending

Existing system

- the state spends the natural resource revenues ³

Problem caused by existing system

- when natural resource revenues are plentiful, state spending creates a great demand in the private sector for goods and services
- if the revenues then decrease substantially, spending is cut and the demand evaporates
- the consequences of economic busts are well-known

Theory

- for a stable economy, the state must spend at a sustainable level
- but it can't do that, because of the fluctuation of natural resource revenues
- therefore, the state should not spend the natural resource revenues
- it should try to convert them into revenues that don't fluctuate, so that it can spend at a sustainable level

Proposed system

- natural resource revenues are not appropriable and are deposited into the Alaska Permanent Fund
- the fund is invested, and earnings are reinvested
- a fixed percentage of the fund (at its average market value over a period) is withdrawn annually for appropriation⁴
- the withdrawal feature is designed to provide revenues that continually increase (and thus are not fluctuating)⁵

Advantage of Proposed System

- state spending no longer causes economic busts

¹ In Alaska the chief source of wealth is natural resources. The state owns and can tax them or otherwise is entitled to the revenues from them.

² Because they are governed by discovery, production and world price.

³ Except about 10% of them, which goes into the Alaska Permanent Fund.

⁴ The fixed percentage is 6% which is the real annual rate of total return on investment if the nominal rate is 10% and the rate of inflation is 4%.

⁵ If the actual rate of return or the actual rate of inflation differs adversely from the assumed rate, the amount withdrawn can decrease, depending on the extent of the difference and the amount of natural resource revenues deposited.

Some other advantages of proposed system

- since state spending is not only at a sustainable level but at the maximum sustainable level, the economy is supported to the greatest extent possible
- budgeting becomes feasible, because income for the subject year is known
- the state's assets (formerly, land and natural resources) are diversified to include securities
- public works projects are no longer crammed into periods of high revenues, with inadequate planning and incomplete accounting
- the state's credit is reestablished
- long-range planning becomes feasible

Conversion to proposed system

- requires (1) the transfer of reserves to the fund, (2) temporarily, the same reduced spending and increased conventional revenues that the coming fiscal gap would require under the existing system and (3) a higher but gradually reduced withdrawal percentage factor during a transitional period

Obstacles to change

- the legislature's reluctance to allow the people to vote on a constitutional amendment that would revoke its authority to spend natural resource revenues
- the misconception that the proposed system eliminates dividends
- a fear that the fund will be depleted if there is less investment return or more inflation than anticipated or, during transition, there is a greater decrease in oil revenues than forecasted
- a fear that if great wealth results,
 - the bureaucracy will expand
 - the state will lose its incentive to develop natural resources
 - Alaskans will become dependent, disinterested in government, lethargic and immoral

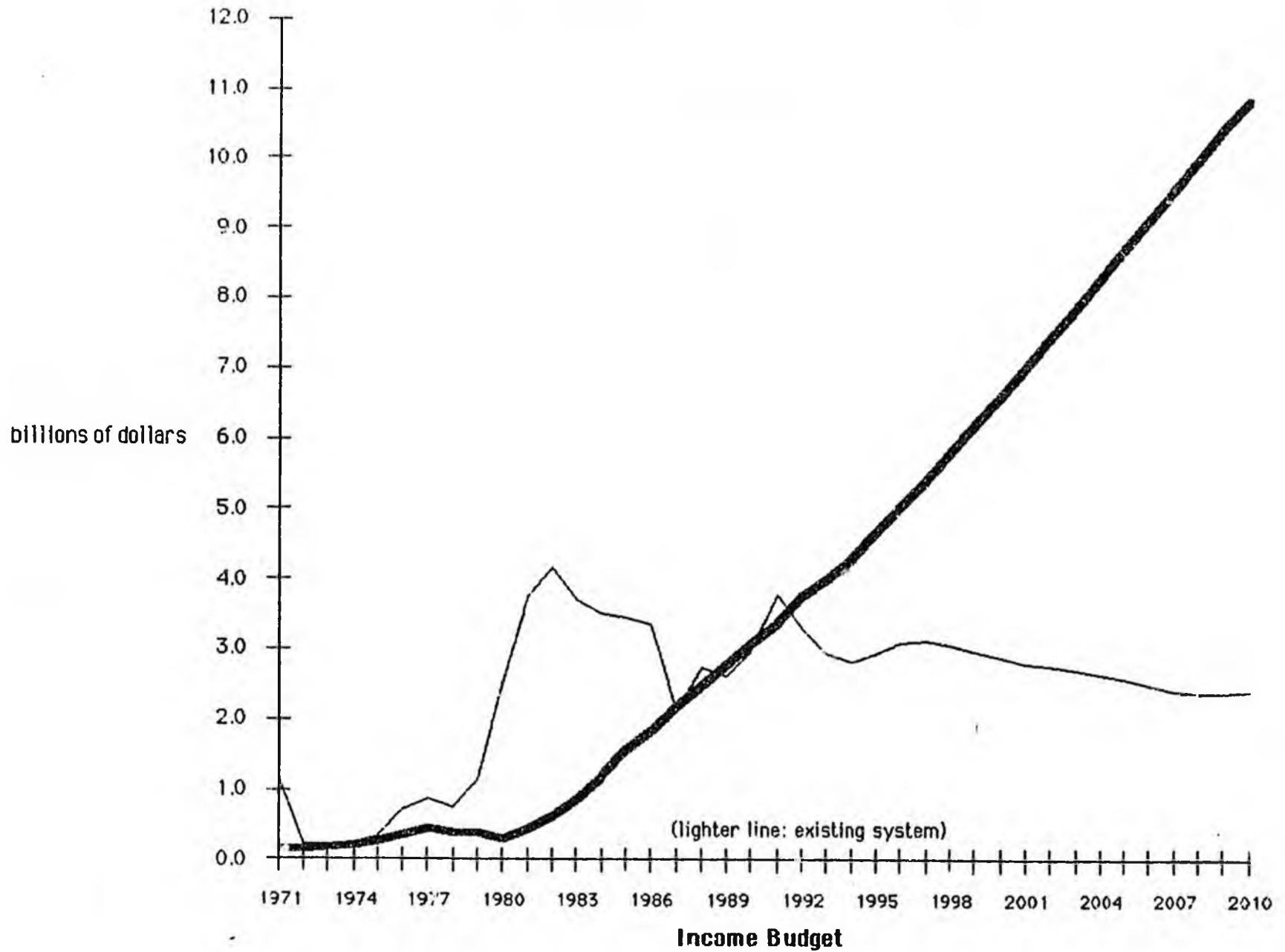
Schedule

- spring, 1994 - legislature passes resolution proposing constitutional amendment
- fall, 1994 - people vote in favor of proposed constitutional amendment
- July 1, 1995 - conversion to new system begins

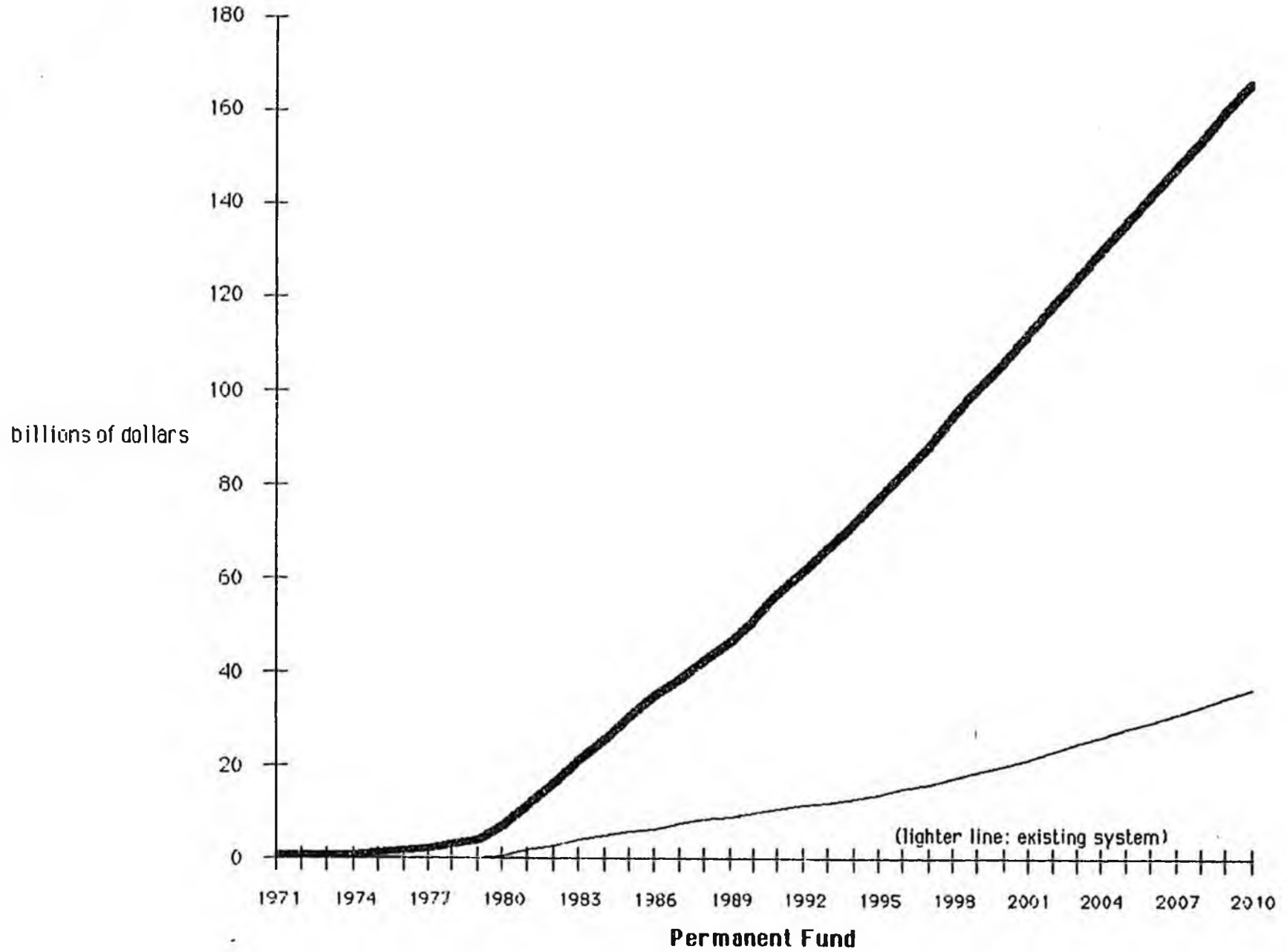
10/14/95

spring, 1993, mid case

Proposed State Financial System - Retrospective



Proposed State Financial System - Retrospective





Alaska Permanent Fund Corporation

P.O. Box 25500 Juneau, Alaska 99802-5500

(907) 465-2047

MEMORANDUM

DATE: January 18, 1994

TO: Board of Trustees

FROM: Jim Kelly *JK*
Research & Liaison Officer

SUBJECT: **20 Questions (and Answers) on the Cremo Plan**

1) What is the plan's purpose?

To stabilize state resource revenues at a sustainable level, to increase the size of the Permanent Fund, and to minimize the negative consequences of the fiscal gap.

1) How does the plan work?

The plan requires this session's legislature to propose – and the voters in the fall election to approve – an amendment to the State Constitution to provide that beginning July 1, 1995 and henceforth, all natural resource revenues be deposited in the Permanent Fund along with the assets of the state's two budget reserve accounts and the Railbelt Energy Fund. All future income earned by the Fund would be retained in the Fund, but there would be an annual withdrawal from the Fund based on its average market value over the past 12 quarters. The first year, the withdrawal would equal 20 percent, but then would be reduced geometrically each year until the permanent withdrawal rate of 6 percent is reached in the year 2006.

3) Will the plan stabilize state resource-derived revenues at a sustainable level?

Yes. However, that level would be insufficient, for at least the next 15 years, to fund the entire costs of state government. Matching projected state revenues with projected state spending would still require reductions in the state budget and increases in other non-resource-derived state revenues.

4) Will the plan increase the size of the Permanent Fund?

Yes, given the assumptions upon which the plan is based.

5) What are the assumptions?

The plan is based on the Department of Revenue's fall 1993 mid-case revenue projections, and assumes an annual total rate of return for the Permanent Fund of 10 percent and an annual inflation rate of 4 percent. The Alaska Permanent Fund Corporation's projections are based on the low-case revenue projections, and assume a long-term average rate of return for the Permanent Fund of 9 percent and a long-term average rate of inflation of 6 percent.

6) What happens if the more conservative estimates prove to be true?

If the Corporation's estimates prove accurate, the Fund would still grow larger than under the status quo, but the money provided each year to the treasury from the Permanent Fund would be significantly less than the plan projects.

7) Why is there a transition period before implementation of the permanent withdrawal rate?

The plan provides for a higher but gradually reduced withdrawal rate during a 10-year transition period in order to minimize the negative consequences of the fiscal gap. The economy depends to a significant extent on state spending and too sharp a reduction would directly and indirectly eliminate many jobs and sink the state into a serious recession.

8) What is the rationale for the 6 percent withdrawal rate?

Given the plan's assumptions, a 6 percent withdrawal rate provides the maximum amount of money to the state treasury while still protecting the Fund against inflation. Arguments can be made that the number should be higher or lower: the higher the rate of withdrawal, the more money is made available for state spending; the lower the number, the greater the protection to the Fund from inflation. From the Fund's perspective, it would be more prudent to base the annual withdrawals on the real growth of the Fund, not on an arbitrary number.

9) Does the plan provide the Permanent Fund with protection against inflation?

Only if the annual amount withdrawn by the treasury plus the amount "withdrawn" by inflation is less than the total earnings of the Fund for that year plus the new deposits. Using conservative estimates of all four variables – a 4 percent withdrawal rate, new deposits according to the DOR low-case revenue forecast, a 9 percent earnings rate, and a 6 percent rate of inflation – the Fund experiences a net inflation-proofing surplus in the first 15 years of the plan.

10) What has been the historic rate of inflation, and what does the Corporation project for the future?

Since 1926, inflation has averaged just over 3 percent. Since the Fund started in 1977, inflation has averaged just under 6 percent. The Corporation projects a 4 percent average rate of inflation for the next four years, and a 6 percent average rate of inflation over the long-term.

11) What have been the Fund's historic rate of return, and what does the Corporation project for the future?

Since the Permanent Fund started in 1977, the realized rate of return has averaged 11 percent. The Fund's total return for the past 9 and 3/4 years has been just over 12 percent. The Corporation projects a 8.37 percent rate of return for the next four years, and a 9 percent rate of return over the long term.

12) Does the plan provide for the payment of full dividends?

Technically, the plan would increase dividends because the current statutory dividend formula is based on the Fund's annual income, which would increase. However, using that current statutory dividend formula, the plan would produce significantly less resource revenue for state spending than would be produced under the status quo.

13) What if the dividends were capped at \$1,000 per capita?

Then, dividends would be reduced from the status quo, but the revenues made available for state spending would be increased.

14) How does the plan address the fiscal gap?

As mentioned above, the plan assumes some combination of state spending cuts and revenue increases. Given the plan's assumptions, a 12% annual increase in conventional revenues and a \$30 million cut in annual state spending would eliminate the fiscal gap.

15) Are the Cremona Plan's assumptions realistic?

The assumptions may be realistic, but they are not conservative.

16) What other effects would adoption of this proposal have on the Permanent Fund?

The plan would certainly create a need for more staffing and a higher operating budget for the Permanent Fund Corporation. Additionally, and more importantly, the plan might also affect public perceptions. It might blur the distinction between the Permanent Fund as a savings account and the General Fund as the state's spending account, and it might destroy the link which exists currently between the citizens and their savings account. Finally, if state government comes to rely on the Permanent Fund as its primary source of operating revenues, pressure would likely build on the Board of Trustees to take more risks with the investment policy in order to attempt to earn greater rates of return.

17) Does the plan have advantages over the current situation?

As the Commission on the Future of the Permanent Fund said about it in 1990, "A successful transition to this concept would remove substantial elements of doubt and uncertainty regarding future state revenues and the health of Alaska's economy."

18) Does it have disadvantages over the current system?

The plan forces the legislature to make a number of difficult decisions over the next several years. Based on the Corporation's estimates, it is likely that taxes would have to go up, state spending would have to go down, the dividend formula would have to be adjusted downward, and inflation-proofing would have to be curtailed.

19) What is the bottom line? Is this a good plan or not?

The plan is based on sound principles and could work, but there are significant risks involved. If the Fund's growth is significantly hindered, particularly in the early years, either by lower-than-expected oil deposits or deposits of other state reserves, low earnings or high inflation, this plan will not necessarily be an improvement over other alternatives.

20) What obstacles have to be overcome?

Before the legislature and the citizens of this state will approve this plan, they need to be convinced that it is clearly an improvement over the status quo. Unfortunately, there are a number of undesirable outcomes which might occur should actual conditions in the future vary significantly from the assumptions upon which the plan is based. Against these uncertainties, one thing is known for sure: the Permanent Fund as currently structured is not broken.

**Alaska Permanent Fund Corporation**

P.O. Box 25500 Juneau, Alaska 99802-5500

(907) 465-2047

MEMORANDUM

DATE: January 19, 1994

TO: Board of Trustees

FROM: Jim Kelly
Research & Liaison Officer

SUBJECT: 20 Questions (and Answers) on the Cremo Plan

1) What is the plan's purpose?

To stabilize state resource revenues at a sustainable level, to increase the size of the Permanent Fund, and to minimize the negative consequences of the fiscal gap.

2) How does the plan work?

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