

HB

304

FISCAL NOTE

STATE OF ALASKA
2002 LEGISLATIVE SESSION

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 Bill Version: HB 304
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Revision Date/Time (Note if correction): _____ Dept. Affected: Revenue
 Title Permanent Fund Income BRU Permanent Fund Corp.
 Component Permanent Fund Corp.
 Sponsor Representative Whitaker
 Requester House State Affairs Component No. 109

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Liens & Claims						
Miscellaneous						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0

CAPITAL EXPENDITURES	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008

CHANGE IN REVENUES ()	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008

FUND SOURCE (Thousands of Dollars)

FUND SOURCE	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008
1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type--Do not abbreviate)						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY2002) cost: 0.0
 Check this box (X) if funding for this bill is included in the Governor's FY 2003 budget proposal:

POSITIONS

POSITIONS	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008
Full-time						
Part-time						
Temporary						

ANALYSIS: (Attach a separate page if necessary)

The proposed legislation would not increase the cost of operations for the Alaska Permanent Fund Corporation.

Prepared by: Robert D. Storer, Executive Director Phone (907)465-2047
 Division: Alaska Permanent Fund Corporation Date/Time 2/22/02 2:58 PM
 Approved by: Larry Persily, Deputy Commission Date 02/22/2002
 Agency: Department of Revenue

HB 304
Permanent Fund Income

Section 1 – Adds a subsection to AS 37.13.145 that (e) directs the permanent fund corporation to calculate the realized income of the earnings reserve and (f) transfer to the general fund either; an amount that is equal to the realized earnings or \$7,000,000.00 (plus an indexing for inflation and population change), whichever is less.

Section 2 – Amends the uncodified law by (a) designating the amount transferred to the general fund for FY 02 and 03 as the lesser of the realized earnings or \$2,000,000 and (b) designates \$2,000,000.00 as the benchmark amount by which subsequent years shall be calculated.

Section 3 – Sets the effective date of this legislation as June 30, 2002.



Alaska Permanent Fund Corporation

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MEMORANDUM

DATE: November 21, 2001

TO: Lori Backes,
Finance Aide to Representative Jim Whitakers

FROM: Jim Kelly
Director of Communications

SUBJECT: APFC analysis of your proposal

You have asked the APFC to analyze the impact of appropriating \$200 million per year of Fund income, after dividends and inflation-proofing, beginning in 2002 and then increasing that payment annually by (a) the rate of inflation, or (b) the rate of inflation plus the rate of population growth.

As the chart at the end of this memo indicates, the APFC estimates the average annual rate of inflation for the next ten years at 3.25 percent and population growth at 1.1 percent. With those assumptions, the \$200 million annual appropriation grows to \$267 million in the first case and \$294 million in the second.

In terms of the proposal's impact on the Fund, there are three essential points to make.

1. Taking volatility of investment returns into consideration, the APFC projects that over the next ten years the Fund will most likely produce between \$175 - 300 million per year available for appropriation for legislative purposes in addition to the transfers required for dividends and inflation-proofing per existing statutory formulas.
2. Expenditure of that \$175 - 300 million would not place inflation-proofing in jeopardy; the Fund would still be able to retain sufficient income over

time to provide long-term protection of the total Fund's purchasing power.

3. Any appropriations out of the Fund, in addition to dividends per existing statutes, would cause dividends to decline relative to the status quo.

Volatility. Before discussing the specific impacts of the proposal, it is important to understand how the APFC addresses volatility. In recent years, the APFC has moved away from providing forecasts which focus on individual numbers and instead has preferred to talk in terms of ranges of likely outcomes.

This shift recognizes that it is not only impossible to produce reliably accurate single point-in-time numbers for future years, it is misleading to indicate that any of us can assess the impacts of future events such as financial market performance with "laser-guided precision."

With that cautionary note, there are two fundamental principles - one relating to investment policy and one to spending policy - with which one can assess the soundness of any proposed change to the current use of Fund income.

- Time greatly reduces - but does not eliminate - the volatility in annual returns. That is why from an investment policy perspective, asset allocation, diversification, disciplined rebalancing and long-term time horizon are all key elements of a successful investment program. **The proposal does not have an adverse effect on the Board's investment strategy.**
- From a spending policy perspective, the best way to moderate the impact of volatility is averaging. So, for example in the case of the Alaska Permanent Fund, which - with its 53 percent target allocation to equities - has a one-in-four chance of a negative total Fund return in any given year, averaging returns over five years reduces the likelihood of a negative return to one-in-twenty. This moderation of the impact of volatility provides a valuable cushion to ensure stability of distributions. **Although the proposal does not include an averaging provision, we know from other analyses that this level of additional payout fits within the range of long-term average real income which the Fund can be expected to produce on a sustainable basis - five percent of the Fund's average five-year market value in perpetuity.**

Impacts of this proposal on the dividend. The actual effect of this proposal, which would pay out between \$200 - 300 million annually to the General Fund

over the next ten years, will depend on two factors. The first is certain – the increased payouts relative to the status quo mean the Fund will produce relatively less income each year in the future; the second is uncertain – the impact of volatility in the financial markets.

Taking only the first factor into consideration, it is likely that the proposal would have very little impact – less than \$20 per check – for the first 4-5 years, growing to an annual difference of approximately \$150 in ten years.

Now, let's consider the impact of the second factor, volatility. Under the status quo – depending on market conditions between now and then – per capita dividends in 2011 are most likely to fall within the range of \$1,600 to \$3,300. Under your proposal, the most likely range is \$1,500 to \$3,000.

So, the impact of your proposal on per capita dividends ten years out – compared to the status quo – is in the range of \$100 - \$300 per year. Note the much larger impact of volatility, which could cause the actual dividend in 2011 to vary, depending on market conditions between now and then, by as much as \$1,700 in the status quo case.

If you have any further questions, please let me know.

**Estimated annual payout of \$200 million of Fund income
adjusted for inflation growth or inflation plus population
(in millions)**

	\$200 million + inflation (3.25%)	\$200 million + inflation (3.25%) + population (1.1%)
2002	200	200
2003	207	209
2004	213	218
2005	220	227
2006	227	237
2007	235	248
2008	242	259
2009	250	270
2010	258	282
2011	267	294

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324 Willoughby
Juneau, AK 99801

February 25, 2002

The Hon. Ethan Berkowitz; Alaska House of Representatives
State of Alaska
Juneau, AK 998

re: Dickens & Numbers

han B.

Thanks for the opportunity to talk to State Affairs today-- here are a few comments on Alaska's budget and growth percentages.

Dickens One of Charles Dickens' characters, Micawber, succinctly expresses the facts of budget life (paraphrased below):
"Income twenty pounds, expenditures 19 pounds, 11 shillings, 19 pence; result, happiness. Income twenty pounds, expenditures 20 pounds, 0 shillings, 1 penny; result, DESPAIR."

Irrelevant Percentages It really doesn't matter what percentage Alaska's income or expenditures increased by, whether this percentage is above or below some hypothesized ideal. All that matters is that current income be a bit MORE than current spending.

7% Seven percent, compounded for THIRTY years, results in a multiplier close to that 10.34 multiplier derived from actual population increases times inflation (consumer price index increases; using CPI gives a HIGHER number than producer price increases).

Only THREE, Not 4, doubles But using 1960 as a starting point, when actually the \$150 million was the 1969 budget figure for Alaska, is incorrect. This 9-year difference is significant because 1969-2002 would be about THREE 'doubles' at 7% {using the 'Rule of 72'} but 1960-2002 would be FOUR.

Three doubles would be: \$300, \$600, \$1,200 millions (\$1.2 billion). See accompanying "Claims & Facts", which shows a 10.34 ACTUAL multiplier: i.e., 1969 budget = \$1.551 billion in 2003.

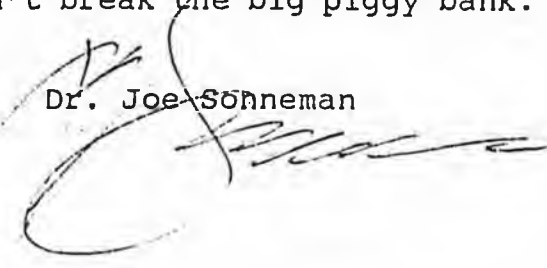
As I told the Committee, this is of historical interest only, because the essential point is that current spending be kept below current income, regardless of historical trendlines.

Panama Canal Revelance? Whatever was spent on the Panama Canal (1895-1915?), even if of the same nominal dollar amount as Alaska's 1969 budget [UNTRUE], is irrelevant to Alaska's present situation. ["Nominal dollars" of course are radically different in real value when separated in time by perhaps 70 years, yes?].

Please keep the PFD program and Permanent Fund UNTOUCHED and UNCHANGED. Build up--and TAX--value-added manufacturing, winding down the CBR and balance State spending with State income. Yes, it can be done, probably in any of many different ways. Please do NOT involve the PFD or Permanent Fund: don't break the big piggy bank.

Sincerely & cordially,

Dr. Joe Sonneman



HOUSE STATE AFFAIRS
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CLAIMS AND FACTS RE: PANAMA CANAL, ALASKA POPULATION, PRICE INDEX

by Joe Sonneman

CLAIM

FACT & SOURCE

The Panama Canal cost \$150 million.

One encyclopedia lists the cost of construction at \$380 million. Another encyclopedia does not list the construction cost, but notes that the U.S. paid Panama \$10 million to start, plus \$250,000 per year (starting in 1913), with the annual payment increased in 1936 to \$400,000 and increased again in 1955 to about \$1.9 million. {Panama always called this a "rental payment," not a purchase; hence, the return of the canal under Pres. Carter in 1978-79.}

The combination of Alaska population and inflation from 1969 [NOT 1960] to present is a compounded 7% {so it is OK to use the Rule of 72 in comparing 1969 and present Alaskan budgets}

[All numbers from the Statistical Abstract of the United States, 2001 and 1981 editions].

POPULATION of Alaska
1970: 303,000 2000: 627,000

INFLATION (national Consumer Price Index)
1982-83 = 100:
1969 = 2.726 2000 = .581

ANALYSIS: Not quite clear what kind of 'combination' is meant, additive or multiplicative, so let's take the bigger number by multiplying the differences.

$$\text{Population increase} = \frac{627,000}{303,000} = 2.069 \quad (1970 - 2000)$$

ROUNDING: let's round this up to 2.2 (1969 -2003)

$$\text{Price Index increase} = 2.726 / .581 = 4.6919 \quad \{\text{round to } 4.7\}$$

MULTIPLYING the 2.2 population increase x 4.7 price increase yields a result of 10.34, taking both population and inflation into maximum account ['maximum', because these were multiplied, not just added].

APPLYING the 10.34 multiplier to the 1969 Alaska budget total of \$150 million yields an equivalent year 2003 budget of about \$1.551 billion.

CONCLUSION: Alaska is spending far more in 2002 & 2003 than it did in 1969, even when corrections are made both for population increases and for inflation. That extra spending may be good in part--no one says the 1969 level was ideal--but the higher present level may be bad if spending continues to run ahead of income, especially if income actually declines as predicted by Dept. of Revenue (which does not have a good track record on predicting).

BACK UP MATERIALS SENT TO REP. BERKOWITZ

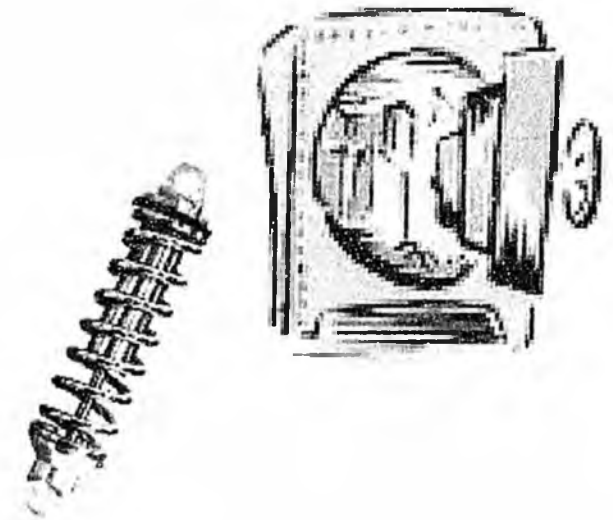
Understanding Alaska's Finances

**General
Fund**



CBR

**Permanent
Fund**



ERA

General Fund



Revenues from:

- **Oil Royalty, Severance Tax, Property Tax**
- **Corporate Income Tax**
- **Fees and other sources**



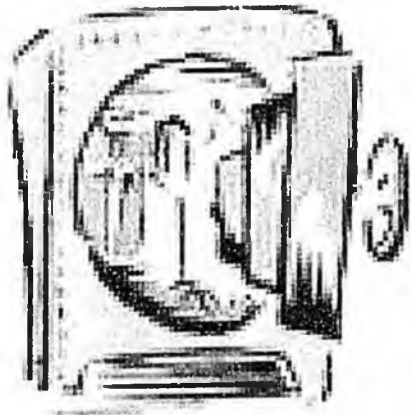
The CBR

\$2.4 Billion

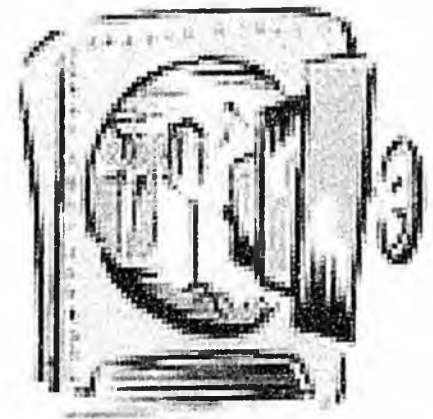
- **Used as a shock absorber for the budget in times of deficit.**

- **Draw in FY 2002 \$865 Million**

The Permanent Fund Corpus



\$21 Billion



- The Fund Principal is protected.

What comes out of the Principal?

NOTHING



The ERA

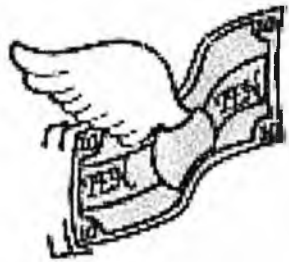
\$2.8 Billion

- **The ERA acts as the shock absorber for the Permanent Fund.**
- **Debits and Credits to the Permanent Fund are realized by the ERA. (Earnings, Losses, Dividends)**
- **If the Permanent Fund Corpus realizes a loss, the ERA absorbs the loss.**

**How are these funds
affected by an ongoing
budget deficit?**

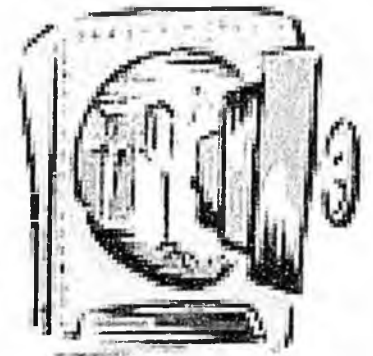
The Funds are Related

**General
Fund**



FY2004

**Permanent
Fund**



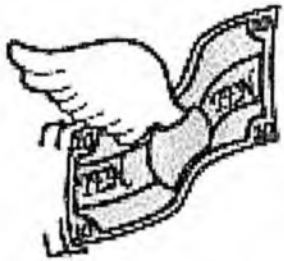
ERA

Conclusion:

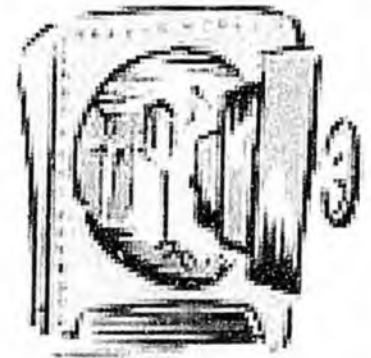
- **The ERA is not sustainable functioning as a shock absorber for both General Fund and the Permanent Fund**
- **If the ERA functions as a shock absorber for both funds, it will most probably, effectively be drained by the end of the decade.**
- **And the dividend program will end.**

And then there were two...

**General
Fund**



**Permanent
Fund**



If nothing is done, by the end of the decade:

- The dividend program is gone**
- Government spending will be significantly reduced**
- And our economy will shrink**