

HB

136

<TARGET><BILL>HB 136</BILL><SUBJECT>HB
136</SUBJECT><COMM>HFIN28</COMM></TARGET>

Fiscal Note

State of Alaska
2014 Legislative Session

Bill Version: HB 136
Fiscal Note Number: _____
() Publish Date: _____

Identifier: HB136-GOV-OMB-01-21-2014
Title: SUSTAINABLE BUDGET REPORTING
Sponsor: MILLETT
Requester: House Finance

Department: Office of the Governor
Appropriation: Office of Management and Budget
Allocation: Office of Management and Budget
OMB Component Number: 2144

Expenditures/Revenues

Note: Amounts do not include inflation unless otherwise noted below. (Thousands of Dollars)

	FY2015	Included in	Out-Year Cost Estimates				
	Appropriation Requested	Governor's FY2015 Request	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020
OPERATING EXPENDITURES	FY 2015	FY 2015					
Personal Services							
Travel							
Services							
Commodities							
Capital Outlay							
Grants & Benefits							
Miscellaneous							
Total Operating	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Fund Source (Operating Only)

None							
Total	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Positions

Full-time							
Part-time							
Temporary							

Change in Revenues							
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Estimated SUPPLEMENTAL (FY2014) cost: 0.0

Estimated CAPITAL (FY2015) cost: 0.0

ASSOCIATED REGULATIONS

Does the bill direct, or will the bill result in, regulation changes adopted by your agency? No
If yes, by what date are the regulations to be adopted, amended or repealed?

Why this fiscal note differs from previous version:

Updated for 2014 Legislative Session. No other changes.

Bill assigned
to subcommittee
for interim
work on 4/5/13

Prepared By: <u>John Boucher, Senior Economist</u>	Phone: <u>(907)465-4677</u>
Division: <u>Office of Management and Budget</u>	Date: <u>10/07/2013 03:00 PM</u>
Approved By: <u>Karen Rehfeld, Director</u>	Date: <u>10/08/13</u>
Agency: <u>Office of Management and Budget</u>	

FISCAL NOTE ANALYSIS

STATE OF ALASKA
2014 LEGISLATIVE SESSION

BILL NO. HB 136

Analysis

HB 136 adds a new section to the Executive Budget Act that requires the Office of Management and Budget, for informational purposes, to produce "the projected amount available for spending for the succeeding 10 fiscal years;" excluding money from the following sources:

- the projected principal of the Alaska Permanent Fund;
- the projected principal of the constitutional budget reserve fund;
- the projected principal of the statutory budget reserve fund; and
- the net present value of the state's projected oil reserves.

For purposes of this fiscal note it is assumed that appropriate agencies such as the Alaska Permanent Fund Corporation, the Department of Revenue and Department of Natural Resources will be able to provide all of the required information to produce this projection without additional resources, including the calculation of the net present value of the state's projected oil reserves.

The Office of Management and Budget anticipates no fiscal impact as a result of passage of this legislation. As further information becomes available regarding the implementation of this legislation, it is possible that the fiscal note would need to be revised to reflect costs that are not identified at this time.

Fiscal Note

State of Alaska
2013 Legislative Session

Bill Version: HB 136
Fiscal Note Number: _____
() Publish Date: _____

Identifier: HB136-OOG-OMB-03-29-13
Title: SUSTAINABLE BUDGET REPORTING
Sponsor: MILLETT
Requester: House Finance

Department: Office of the Governor
Appropriation: Office of Management and Budget
Allocation: Office of Management and Budget
OMB Component Number: 2144

Expenditures/Revenues

Note: Amounts do not include inflation unless otherwise noted below. (Thousands of Dollars)

	FY2014 Appropriation Requested	Included in Governor's FY2014 Request	Out-Year Cost Estimates				
			FY 2015	FY 2016	FY 2017	FY 2018	FY 2019
OPERATING EXPENDITURES	FY 2014	FY 2014					
Personal Services							
Travel							
Services							
Commodities							
Capital Outlay							
Grants & Benefits							
Miscellaneous							
Total Operating	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Fund Source (Operating Only)

None							
Total	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Positions

Full-time							
Part-time							
Temporary							

Change in Revenues							
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Estimated SUPPLEMENTAL (FY2013) cost: 0.0

Estimated CAPITAL (FY2014) cost: 0.0

ASSOCIATED REGULATIONS

Does the bill direct, or will the bill result in, regulation changes adopted by your agency? No.
If yes, by what date are the regulations to be adopted, amended or repealed?

Why this fiscal note differs from previous version:

Initial version.

Prepared By: <u>John Boucher, Senior Economist</u>	Phone: <u>(907)465-4677</u>
Division: <u>Office of Management and Budget</u>	Date: <u>03/29/2013 04:00 PM</u>
Approved By: <u>Karen Rehfeld, Director</u>	Date: <u>03/29/13</u>
<u>Office of Management and Budget</u>	

FISCAL NOTE ANALYSIS

STATE OF ALASKA
2013 LEGISLATIVE SESSION

BILL NO. HB136

Analysis

HB 136 adds a new section to the Executive Budget Act that requires the Office of Management and Budget, for informational purposes, to produce "the projected amount available for spending for the succeeding 10 fiscal years;" excluding money from the following sources:
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the net present value of the state's projected oil reserves.

For purposes of this fiscal note it is assumed that appropriate agencies such as the Alaska Permanent Fund Corporation, the Department of Revenue and Department of Natural Resources will be able to provide all of the required information to produce this projection without additional resources, including the calculation of the net present value of the state's projected oil reserves.

The Office of Management and Budget anticipates no fiscal impact as a result of passage of this legislation. As further information becomes available regarding the implementation of this legislation, it is possible that the fiscal note would need to be revised to reflect costs that are not identified at this time.

28-LS0353\N
Bailey
4/5/13

CS FOR HOUSE BILL NO. 136()

IN THE LEGISLATURE OF THE STATE OF ALASKA

TWENTY-EIGHTH LEGISLATURE - FIRST SESSION

BY

Offered:
Referred:

*not adopted
as of 4/5/13*

Sponsor(s): REPRESENTATIVE MILLETT

A BILL

FOR AN ACT ENTITLED

1 **"An Act requiring the governor's fiscal plan to include certain information."**

2 **BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:**

3 *** Section 1.** AS 37.07.020(b) is amended to read:

4 (b) In addition to the budget and bills submitted under (a) of this section, the
5 governor shall submit a capital improvements program covering the succeeding six
6 fiscal years. The governor shall also submit a fiscal plan with estimates of significant
7 sources and uses of funds for the succeeding 10 fiscal years. The fiscal plan

8 (1) must include sufficient details to identify

9 (A) significant sources of funds;

10 (B) significant uses of funds, including lump sum projections

11 of

12 (i) operating expenditures;

13 (ii) capital expenditures;

14 (iii) debt service expenditures;

15 (iv) fund capitalizations;

- 1 (v) appropriations of income of the Alaska permanent
2 fund (art. IX, sec. 15, Constitution of the State of Alaska), if any;
- 3 (2) must balance sources and uses of funds held while providing for
4 essential state services and protecting the economic stability of the state;
- 5 (3) must include projected balances of significant funds held in
6 separate accounts, including the budget reserve fund (art. IX, sec. 17, Constitution of
7 the State of Alaska), the public education fund (AS 14.17.300), and the Alaska capital
8 income fund (AS 37.05.565);
- 9 (4) must set out significant assumptions used in the projections with
10 sufficient detail to enable the legislature to rely on the fiscal plan in understanding,
11 evaluating, and resolving issues of state budgeting, including information that supports
12 major areas of operating increases, such as population demographics that affect the
13 need for particular government services;
- 14 **(5) must set out, for informational purposes, the amount projected**
15 **to be available for spending from the general fund for the following fiscal year,**
16 **which shall be the sum of**
- 17 **(A) four percent of**
- 18 **(i) the projected principal of the Alaska permanent**
19 **fund (art. IX, sec. 15, Constitution of the State of Alaska);**
- 20 **(ii) the projected principal of the budget reserve**
21 **fund (art. IX, sec. 17, Constitution of the State of Alaska);**
- 22 **(iii) the projected principal of the statutory budget**
23 **reserve fund (AS 37.05.540); and**
- 24 **(iv) the net present value, calculated using a 5**
25 **percent discount rate, of the state's projected oil reserves, including**
26 **projected revenue from royalty payments and production,**
27 **property, and income taxes;**
- 28 **(B) plus the projected amount of non-oil revenue included**
29 **in the projected general fund minus the projected amount to be**
30 **distributed as permanent fund dividends under AS 37.13.140 - 37.13.145**
31 **and AS 43.23.045 - 43.13.055;**

1
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3
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(6) in addition to the information required to be set out under (5) of this subsection, must set out, for informational purposes, the amount projected to be available for spending for the nine fiscal years following the year for which projections are calculated under (5) of this subsection, which, for each of the nine years, shall be the projected amount calculated under (5) of this subsection increased annually by the rate of inflation used by the office of management and budget to calculate its fiscal plan, plus one percent.



ALASKA STATE LEGISLATURE
HOUSE FINANCE COMMITTEE

State Capitol, Room 519

Rep. Alan Austerman, Co-Chair

Rep. Bill Stoltze, Co-Chair

Friday, April 5, 2013

1:30 PM

Agenda:

HB 136-SUSTAINABLE BUDGET REPORTING

Rep Millett - Vasilios Gialopsos - aide

NEW FN Gov zero

In person:

Dr. Scott Goldsmith, Institute of Social and Economic Research, University
of Alaska Anchorage

Bradford Keithley, Attorney, Perkins Coie L.L.P.

HB 31-CONSTITUTIONAL HISTORY CURRICULUM

Rep. Keller - Jim Pound - aide

SB 21-OIL AND GAS PRODUCTION TAX

sg → Dr. Goldsmith

xbk → Mr. Keithley

IMPLEMENTING A STATE FISCAL PLAN:

Step 1.

Tracking Maximum Sustainable Yield

Alaska State Legislature
House Finance Committee

Juneau, Alaska

April 5, 2013

Scott Goldsmith

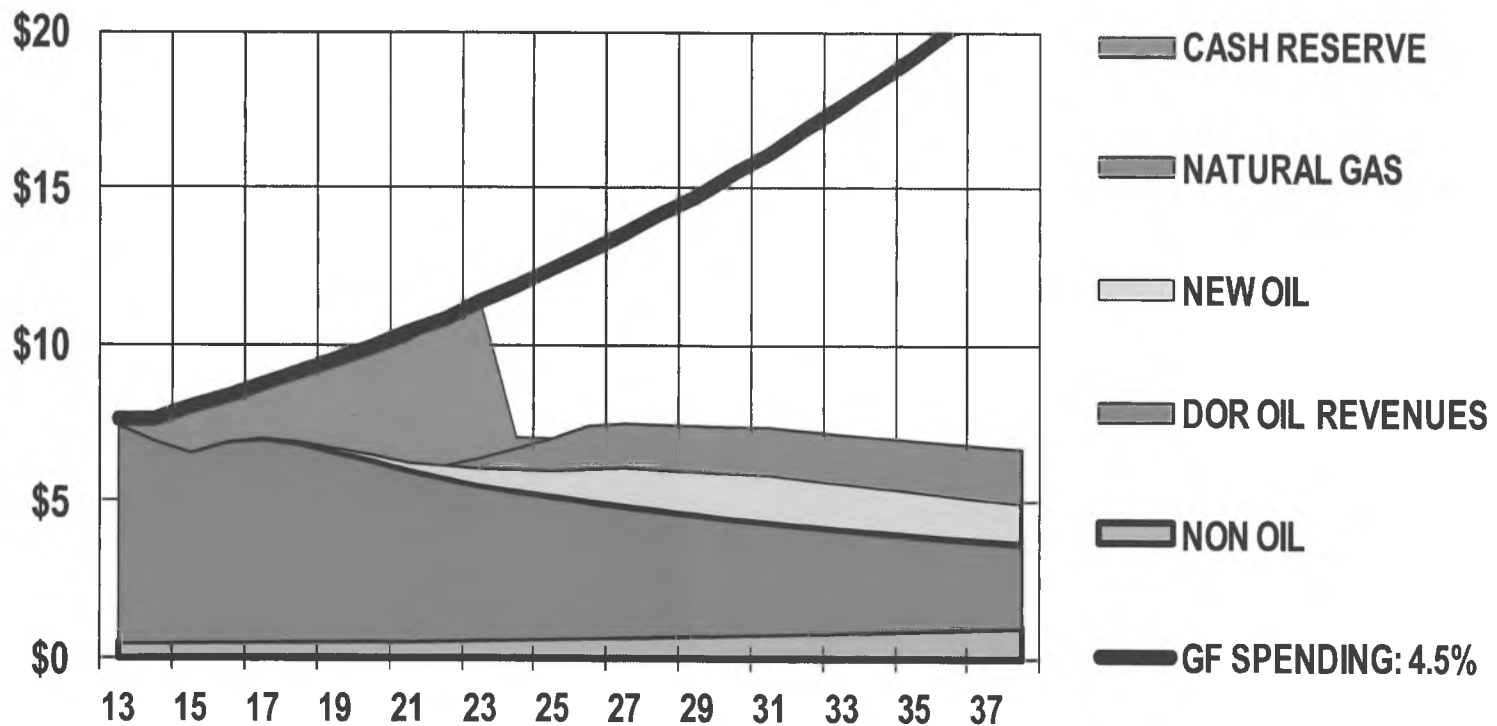
Institute of Social and Economic Research
University of Alaska Anchorage

Bradford G. Keithley

Perkins Coie LLP

The Problem: Unsustainable Spending Growth

LOOKING BEYOND THE 10-YEAR HORIZON



The Solution:

RECOGNIZE AND MANAGE OUR PETROLEUM WEALTH LIKE A DEPLETABLE ASSET

1. How much is it worth?
2. How much of it can we spend without depleting it?
3. How can we invest it for maximum return?

Petroleum Wealth of the "Owner State"



TOTAL

\$149 Billion

In the Bank

\$60 Billion



In the Ground*

\$89 Billion

Known Conventional Oil

\$67 Billion

Other Oil and Gas

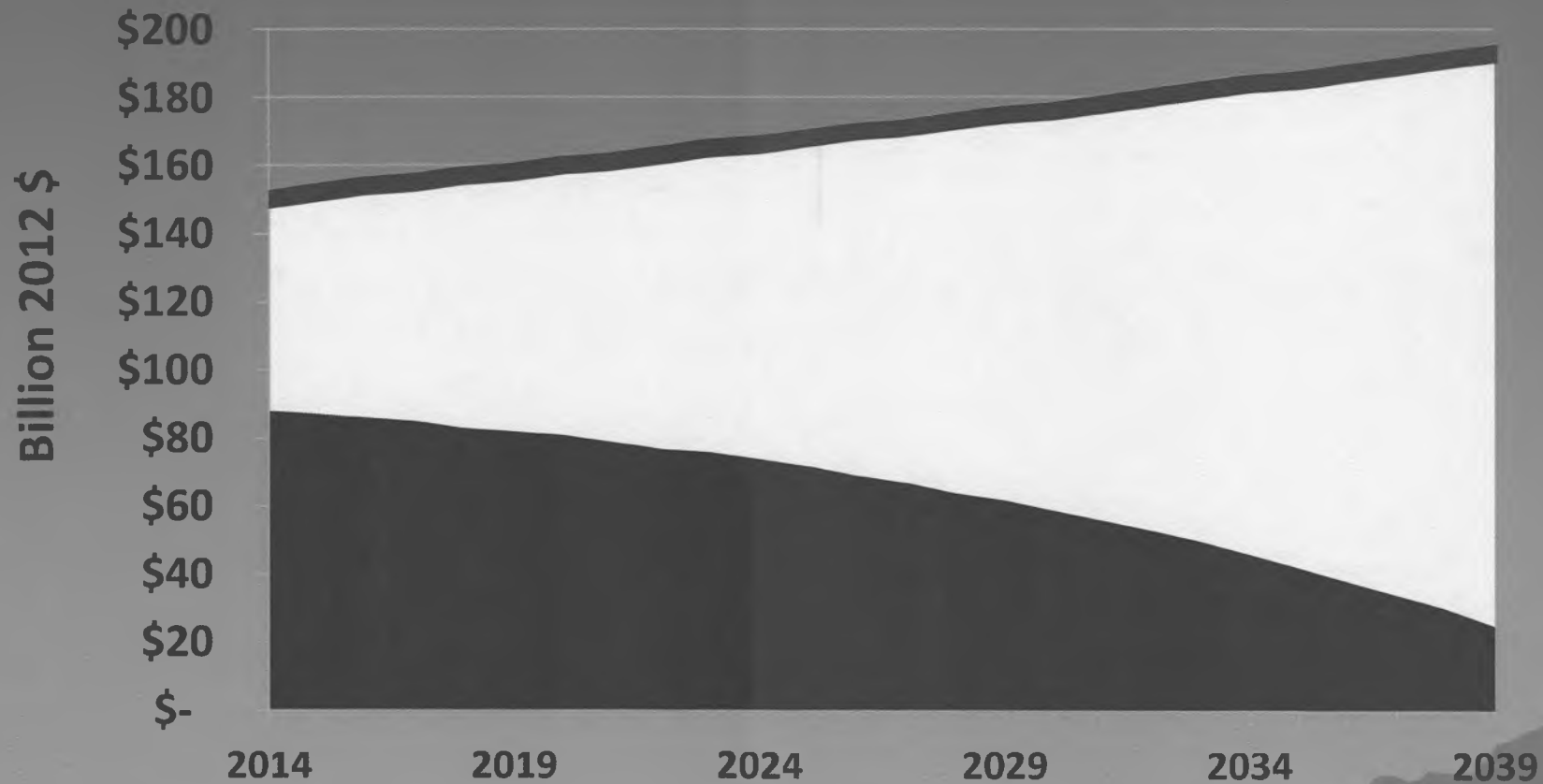
\$22 Billion

* Estimated Net Present Value of Future Petroleum Revenues

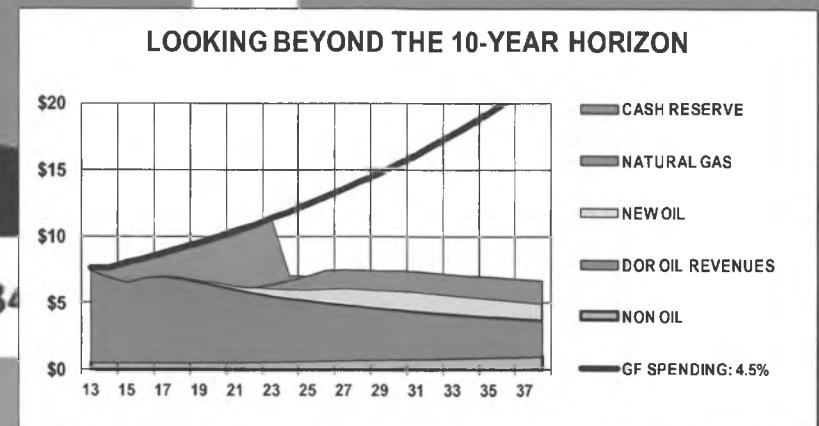
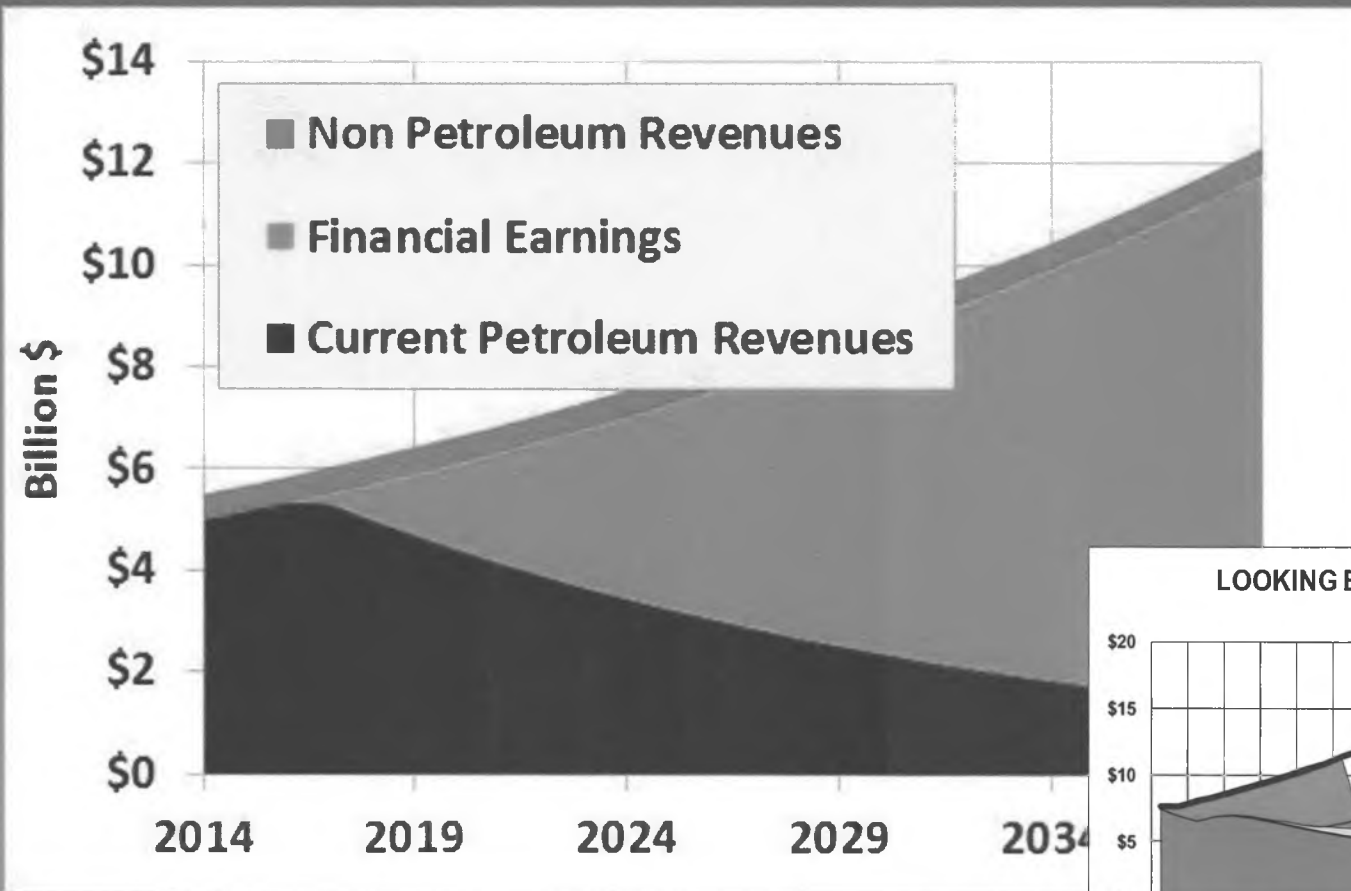
How Much Can We Spend Today: GF Maximum Sustainable Yield

NEST EGG	\$149 Billion
Multiply: MSY Draw Rate	4% (5%-1%)
Equals: MSY Draw	\$6 Billion =(\$149*4%)
Minus: PF Dividend	\$ 1 Billion
Plus: Non-Petroleum GF Revenues	\$.5 Billion
General Fund Maximum Sustainable Yield (FY2014)	\$ 5.5 Billion =(\$6 -\$1+\$0.5)

Maximum Sustainable Yield: Nest Egg Growth



Maximum Sustainable Yield: General Fund Growth



Maximum Sustainable Yield: Implementation

- Manage financial assets for maximum long term return
- Establish monitoring system to track Nest Egg value, set MSY target, and track progress towards sustainability
- Gradually transition to GF Maximum Sustainable Yield level
- Proactively participate in management of petroleum in the ground for maximum return

Track Nest Egg and GF MSY

Permanent Fund Balance

+ CBR Balance

+ SBR Balance

= **Financial Assets**

+ Value of Petroleum in Ground

= **NEST EGG**

Multiply by 4%

= **MSY**

+ Non-Petroleum GF Revenues

- Permanent Fund Dividend

= **GENERAL FUND MAXIMUM SUSTAINABLE YIELD**

4/5/13



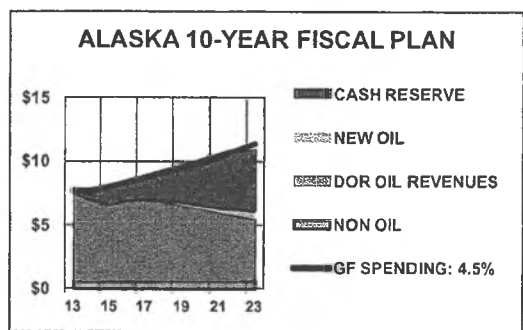
Institute of Social and Economic Research
University of Alaska Anchorage

Maximum Sustainable Yield: FY 2014 Update by Scott Goldsmith Web Note No. 14 • January 2013

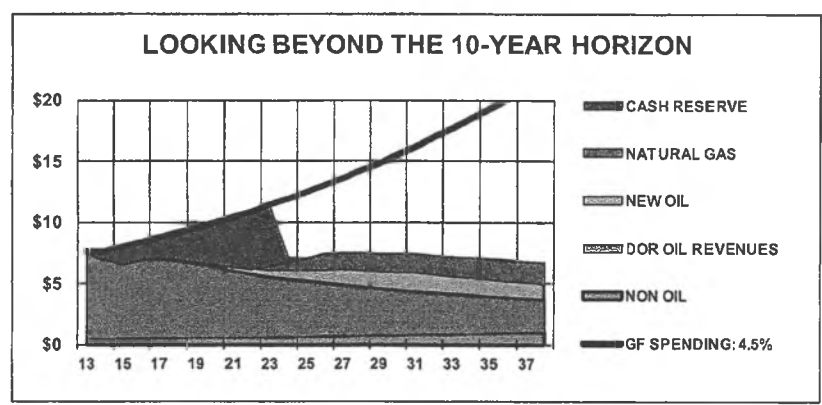
In fiscal year 2014, Alaska's state government can afford to spend about \$5.5 billion. That's an estimate of the level of Unrestricted General Fund spending the state can sustain over the long run, based on the current petroleum nest egg of about \$149 billion—a combination of state financial assets (the Permanent Fund and cash reserves) and the value of petroleum still in the ground.

The size of that nest egg fluctuates, depending on the state's forecast of petroleum revenues, earnings on investments, and other factors. This Web Note presents the latest in a series of estimates of the maximum amount the state can spend and still stay on a sustainable budget path.

Right now, the state is on a path it can't sustain. Growing spending and falling revenues are creating a widening fiscal gap. In its 10-year fiscal plan, the state Office of Management and Budget (OMB) projects that spending the cash reserves might fill this gap until 2023, as the adjacent figure shows¹. But what happens after 2023?

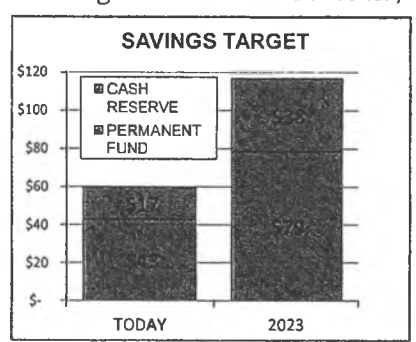


Reasonable assumptions about potential new revenue sources suggest we do not have enough cash in reserves to avoid a severe fiscal crunch soon after 2023, and with that fiscal crisis will come an economic crash. The figure on the right shows the growing General Fund fiscal gap—even assuming new revenues from natural gas production and more oil production—if spending increases at a rate of 4.5% annually.



What can the state do to avoid a major fiscal and economic crisis? The answer is to save more and restrict the rate of spending growth. All revenues above the sustainable spending level of \$5.5 billion—including Permanent Fund income, except the share that funds the dividend—would be channeled into savings.

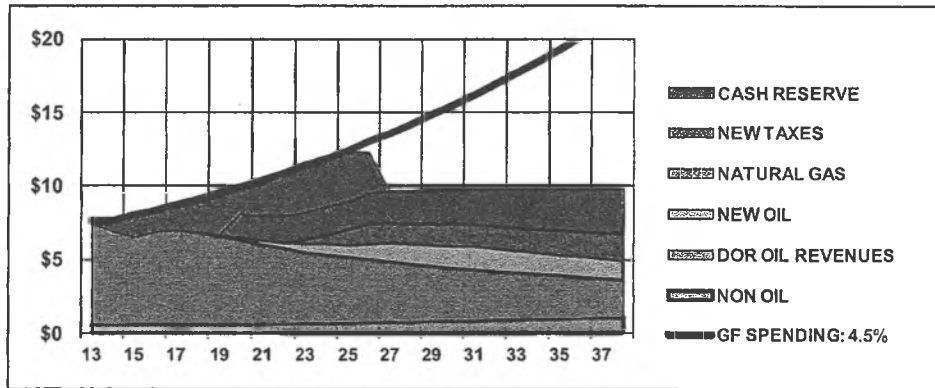
If Alaska had \$117 billion in cash reserves and the Permanent Fund by 2023, the state would be on the path to sustainable spending far into the future. But as the adjacent figure shows, that's twice what the state has in financial assets today. So the state needs to sharply step up its savings rate, starting now.



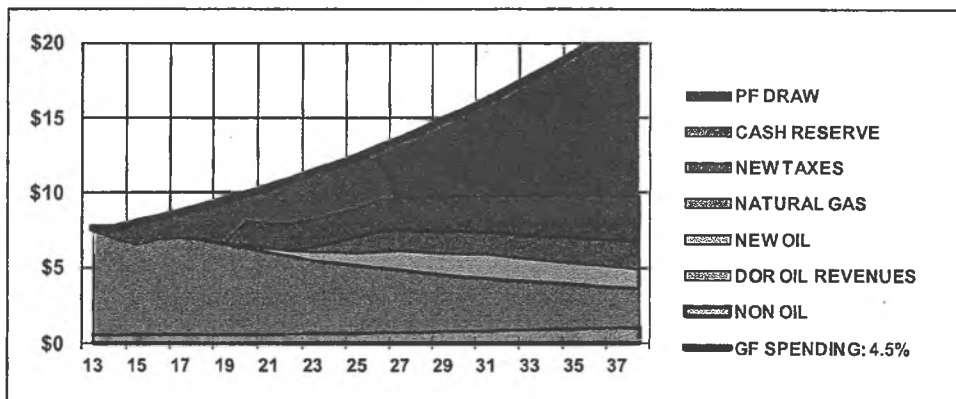
This research is part of ISER's *Investing for Alaska's Future* research initiative, funded by a grant from Northrim Bank.



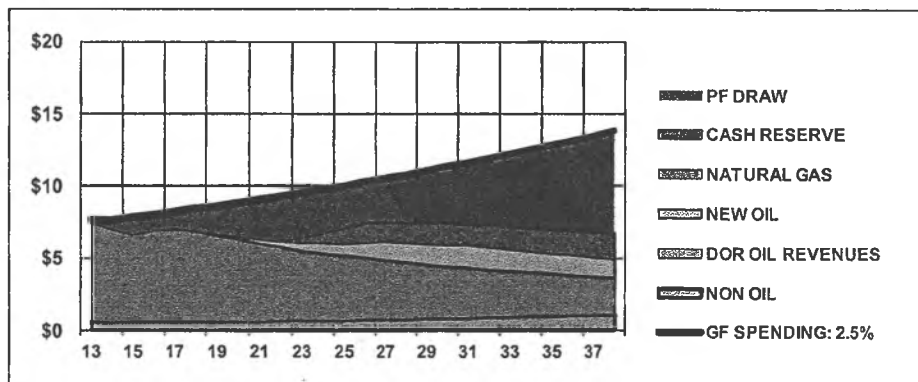
The graphs below show additional evidence of why the state needs to save more and restrict spending. New broad-based income and sales taxes (purple) would postpone but not eliminate the fiscal crunch.



Even using the entire Permanent Fund would not avoid the crunch, with the fund (brown) running out soon after 2038.



Alternatively, holding growth of the budget to the rate of inflation would reduce the size of the crunch when it arrived, but postpone it for only 5 years.ⁱⁱ



What is Maximum Sustainable Yield (MSY)?

Maximum sustainable yield is the amount the state can spend each year from its petroleum endowment, or nest egg, and still sustain the value of that nest egg for future generations. The nest egg is a combination of the state’s financial assets and the estimated value of petroleum still in the ground. The amount the state can safely spend each year depends on the size of the nest egg, the return it can achieve through prudent management of that nest egg, and the time over which it will need the nest egg to sustain public spending.

The table below shows that if the petroleum nest egg has a value of \$149 billion, if it can be managed to generate a 5% return (net of inflation), and if it is to increase over time to account for population growth, the maximum sustainable yield would be \$5.95 billion.

MAXIMUM SUSTAINABLE YIELD CALCULATION FOR FY 2014

TOTAL NEST EGG (Billion)	\$148.7
Financial Assets	\$60
Petroleum in the Ground	\$88.7
Rate of Earnings (net of inflation)	5%
Draw Rate (Earnings net population growth)	4%
MSY FY2014 (Billion)	\$5.95

Currently, spending from the petroleum nest egg goes to the General Fund and the Permanent Fund dividend. Constrained to no more than the maximum sustainable yield of \$5.95 billion, the split would be \$4.99 billion to the General Fund and \$.96 billion to the dividend (based on the current formula for determining dividends). Including the \$.540 billion of non-petroleum revenues in the General Fund, the maximum sustainable yield for the General Fund would be \$5.53 billion.

GENERAL FUND MAXIMUM SUSTAINABLE YIELD SPENDING FOR FY2014

1	MSY FY2014 (Billion) (2+3)	\$5.95
2	PFD	\$.96
3	GF	\$4.99
4	Non petroleum revenues	\$.54
5	GENERAL FUND MSY FY2014 (Billion) (3+4)	\$5.53

The difference between the actual General Fund appropriation and the maximum sustainable yield is the “fiscal burden” passed to a future generation of Alaskans. It is the amount future generations will pay to cover current spending above the sustainable level. The “nest egg deficit” is amount the nest egg falls short of being able to support a sustainable spending path.

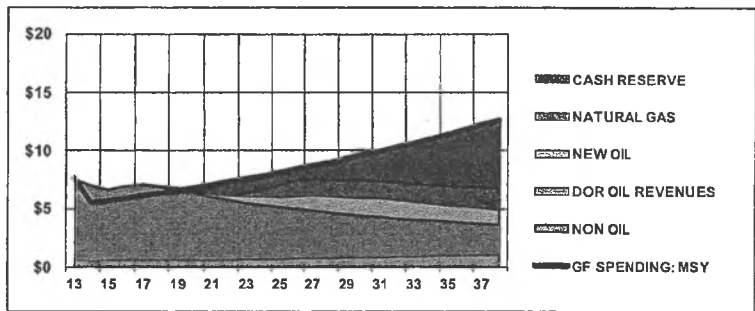
For example, as shown below, if FY 2014 General Fund spending were to be \$7 billion, the fiscal burden on future generations would be \$1.5 billion. Furthermore, it would take an additional \$37.5 billion in the petroleum nest egg for that level of spending to be sustainable.

FISCAL BURDEN AND NEST EGG DEFICIT AT DIFFERENT GF SPENDING LEVELS

FY2014 GF Spending (Billion)	\$6	\$6.5	\$7.0	\$7.5	\$8.0
Fiscal Burden (Billion)	\$0.5	\$1.0	\$1.5	\$2.0	\$2.5
Nest Egg Deficit (Billion)	\$12.5	\$25	\$37.5	\$50	\$62.5
Fiscal Burden and Nest Egg Deficit assume future budget growth constrained to be the combined rate of inflation and population increase.					

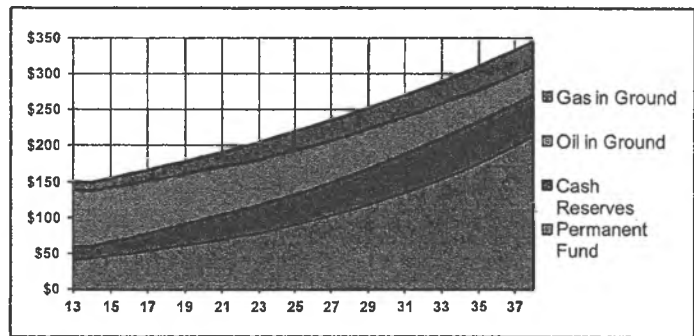
In contrast to business-as-usual, there is no fiscal cliff associated with the maximum sustainable yield strategy. Enhanced financial resources, combined with new revenues from long-term petroleum developments, would be sufficient to cover General Fund spending growing with population.

MAXIMUM SUSTAINABLE YIELD: GENERAL FUND SPENDING (BILLION \$)



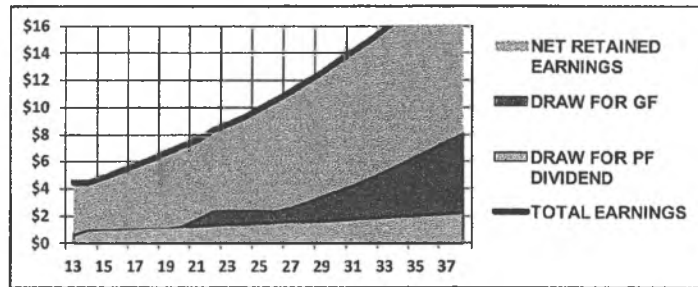
The petroleum nest egg would also increase at the combined rate of inflation and population. Over time, the declining value of oil and gas in the ground would be replaced by the growing value of financial assets.

MAXIMUM SUSTAINABLE YIELD: COMPOSITION OF THE NEST EGG (BILLION \$)



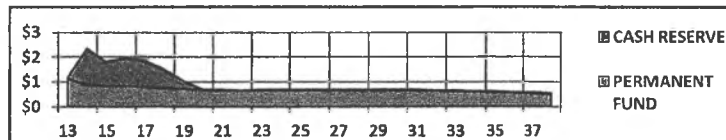
On this sustainable path the combined earnings of all the financial assets (solid black line) would initially all be reinvested, except the amount set aside to pay the Permanent Fund dividend, which would increase with inflation and population (orange)ⁱⁱⁱ. The financial assets would gradually become the most important source of revenues for the General Fund (red)^{iv}. Retained earnings (light blue) would offset inflation and population growth.

MAXIMUM SUSTAINABLE YIELD: USE OF FINANCIAL EARNINGS (BILLION \$)



Financial account deposits would transform depleting petroleum revenues into a sustainable asset.

MAXIMUM SUSTAINABLE YIELD: DEPOSITS IN FINANCIAL ACCOUNTS (BILLION \$)



What's In the Nest Egg?

The nest egg consists of financial assets accumulated from past saving of petroleum revenues as well as the current value of the estimated revenues from future petroleum production.

The current value of financial assets is easily estimated at about \$60 billion, mostly in the Permanent Fund, and in cash reserves—the Constitutional Budget Reserve and the Statutory Budget Reserve.

The value of revenues from future production is \$88.7 billion. We determine this value by estimating future taxes and royalties for 50 years, assuming the current fiscal structure and energy prices as well as reasonable estimates of economically recoverable reserves, both known and unknown. We convert these revenue flows to their net present value at a discount rate equal to the rate of return on financial investments. (This method is similar to monetizing the flow of revenues that assets can produce by calculating their net present value.)

The value of revenues from future production is broken into three categories—oil in known fields, unconventional and new oil, and natural gas.

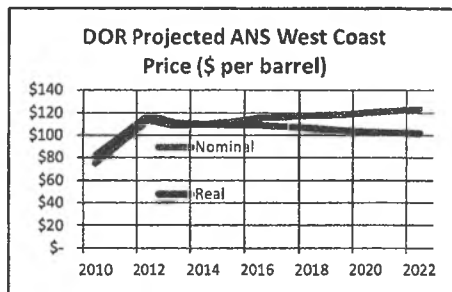
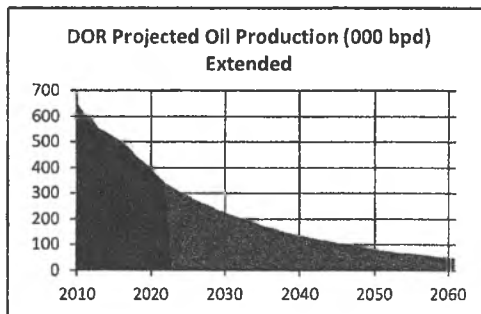
The values for these categories are modest for three reasons. Future production is likely to be more costly than current production on state lands, and production on federal lands generates no royalties directly for the state and is exempt from some state taxes. Therefore, the revenue “take” per barrel will

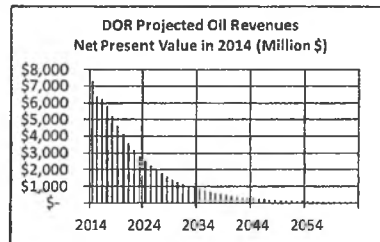
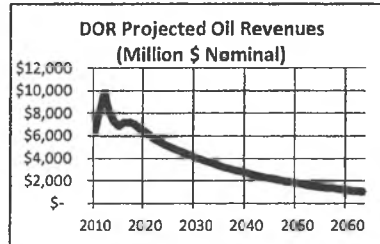
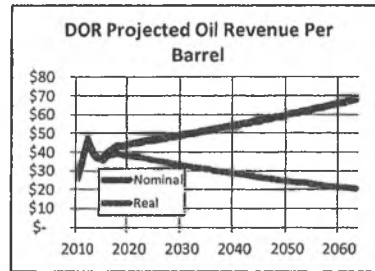
be lower than that on current production. Finally, the discounting of revenues that will not be received for many years reduces their value today.

**NET PRESENT VALUE: FUTURE PETROLEUM REVENUES,
50-YEAR TIME HORIZON (BILLION \$)**

TOTAL	\$88.7
OIL IN KNOWN FIELDS	\$67.1
2014-2022	\$43.1
2023-2063	\$24.0
UNCONVENTIONAL AND NEW OIL	\$9.9
Conventional from New Fields in Central North Slope	\$4.8
Shale Oil	\$1.7
Viscous and Heavy Oil	\$1.7
OCS	\$1.7
ANWR	0
NPRA	0
NATURAL GAS	\$11.7

Oil in Known Fields is estimated through 2022 from the annual forecast of the Alaska Department of Revenue. This is almost entirely conventional oil on state lands, but also includes small amounts of production on federal lands (OCS and NPRA) and private lands, as well as some unconventional oil (viscous oil). After 2022, we project production to decline at 5% annually and revenue per barrel to increase at 1%—about half the rate of inflation (2.5%). Based on these assumptions, the 50-year cumulative revenues would be \$168 billion (net present value of \$67.1 billion), generated from production of 3.5 billion barrels of oil.



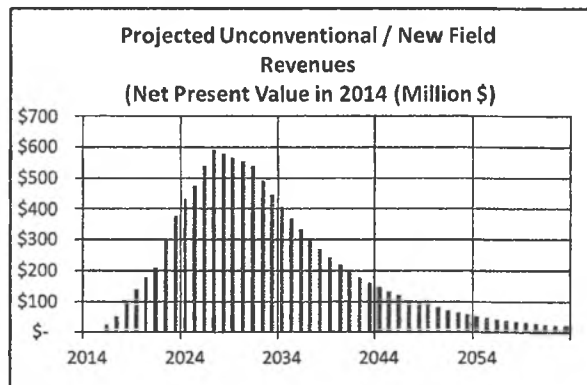
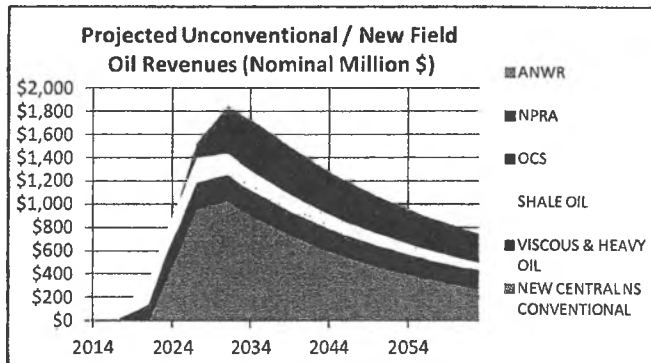
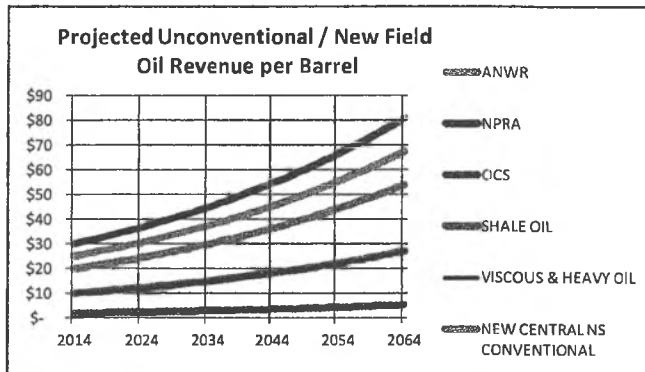
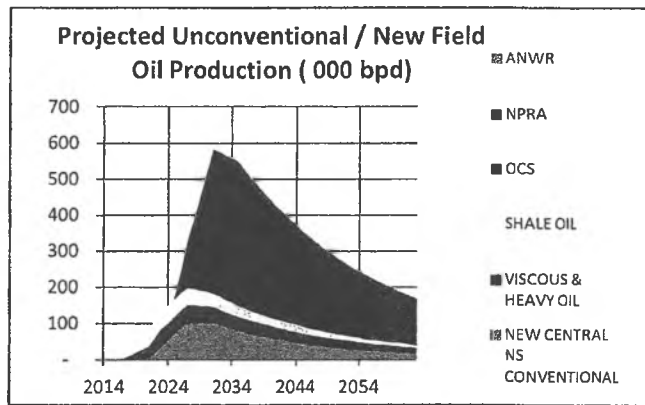


Unconventional and New Oil is divided into six categories, with revenues in each based on production and per barrel revenue—or “take”—assumptions summarized below.

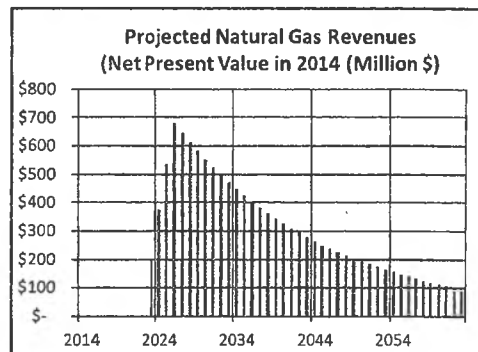
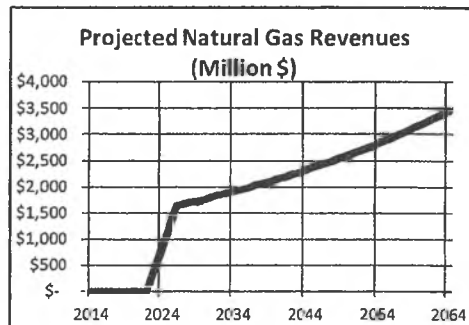
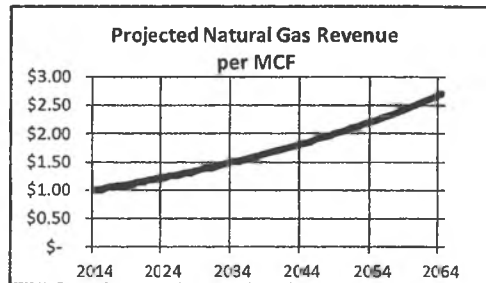
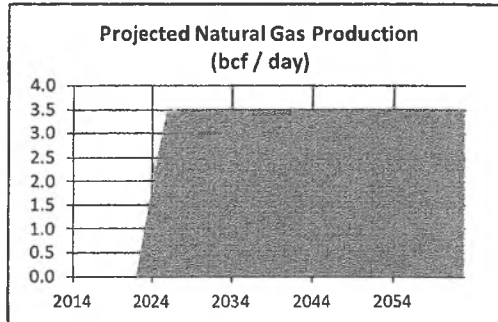
	OCS	Viscous & Heavy Oil	ANWR	NPRA	Shale Oil	New Central NS Conventional
START OF PRODUCTION	2026	2018	2200	2200	2016	2022
PEAK PRODUCTION IN BPD (000)	400	50	500	0	50	100
ANNUAL DECLINE RATE	4.0%	3.0%	5.0%	5.0%	5.0%	6.0%
REVENUE PER BARREL IN 2013	\$ 2	\$ 10	\$ 25	\$ 30	\$ 10	\$ 20
REVENUE PER BARREL GROWTH RATE (Nominal)	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%

Estimated revenues assume no production from ANWR. OCS revenues exclude royalties and production taxes. And although there is no production separately indicated for NPRA, there is NPRA production, as well as a small amount of viscous oil production, built into the DOR forecast. These assumptions produce an estimate of \$52 billion in revenues over the next 50 years (net present value of \$9.9 billion), based on production—both on and offshore—of 5.2 billion barrels of oil.

	OCS	Viscous & Heavy Oil	ANWR	NPRA	Shale Oil	New Central NS Conventional	TOTAL
REVENUES FOR 50 YEARS (Billion \$)	\$ 12.4	\$ 8.7	\$	\$	\$ 6.5	\$ 24.8	\$ 52.3
PRODUCTION FOR 50 YEARS (Billion Barrels)	0.48	0.53			0.43	0.77	5.21



Natural Gas is assumed to be monetized through a pipeline to tidewater, exporting 3.5 bcf per day starting in 2023. Because of the high cost of getting the gas to market, the netback value on the North Slope—which is the basis for taxes and royalties—is small. So the “take” at start-up is about \$1.25 per mcf. The net present value of that gas production over the 50-year period is estimated at \$11.7 billion.



Tracking Maximum Sustainable Yield (MSY)

The estimated size of the nest egg has fluctuated over time, but it has stayed in a range between \$126 and \$160 billion. Consequently, the General Fund MSY has varied between \$5 billion and \$6.4 billion. Part of the reason for the upward revision in the size of the nest egg during FY 2012, from \$126 billion to \$155 billion, was the strong recovery in value of the Permanent Fund after the financial crash. This investment performance is not likely to be duplicated in future years.

Calculation Year	Nest Egg			General Fund		Fiscal Burden	Source
	Total	Financial Assets	Petroleum in the Ground	MSY	Actual Spend		
FY2012	\$126	\$45	\$81	\$5.0	\$7.0	\$2.0	Feb 2011, WebNote 7 & May 2011, WebNote 8
FY2012	\$155	\$55	\$100	\$6.2	\$7.0	\$.8	March 2012, WebNote 10
FY2013	\$160	\$60	\$100	\$6.4	\$7.6	\$1.2	August 2012, WebNote 13
FY2014	\$149	\$60	\$89	\$5.5	?	?	Jan. 2013, WebNote 14

In both FY 2012 and FY 2013, actual spending exceeded the MSY, creating a fiscal burden for future generations. The nest egg estimate for FY 2014 is \$11 billion lower than last year’s estimate, mostly because the Alaska Department of Revenue’s forecast of petroleum revenues between FY 2014 and FY 2022 is \$8 billion lower than it was last year. The value of financial assets is the same in FY 2014 as in FY 2013, partly because of the \$1.2 billion fiscal burden passed forward from the previous year. The General Fund MSY has also fallen because the expected Permanent Fund dividend amount has increased.

Sensitivity of Estimates

Opinions will differ about the value of the petroleum nest egg, based on different assumptions about future energy prices, production, and government policies. Different assumptions about return on investment and the growth rate of spending also will influence the size of the MSY.

A partial set of possible scenarios generates a range of nest egg values from \$145 to \$195 billion—shown in the higher and lower scenario tables below—although the value could fall outside that range. Combining different assumptions about return on investment and rate of growth of the budget results in a General Fund MSY that ranges between \$2.5 billion and \$7.4 billion. Although that range is quite wide, the actual General Fund budget of \$7.6 billion in FY 2013 would have been non-sustainable under any of these scenarios.

HIGHER SCENARIOS	NEST EGG	GF MSY FY2014
ANWR @ 500 Thousand Barrels per Day	\$175	\$7.0
ANWR + OCS @ 500 Thousand Barrels per Day with Shared Royalties	\$182	\$6.8
Double Estimate of Post 2022 Revenues	\$195	\$7.4

LOWER SCENARIOS	NEST EGG	GF MSY FY2014
Lower Investment Return (4%)	\$160	\$4.4
Lower Investment Return (4%) + No Gas Revenue	\$145.2	\$3.9
Lower Investment Return (4%) + No Gas Revenue + General Fund Growth 1% Real Per Capita (4%)	\$145.2	\$2.5

Other Forms of Petroleum Wealth

The state has put \$45 billion of the \$170 billion of petroleum revenues collected through FY 2012 into financial assets that today have a value of \$60 billion.

The state has spent much of the rest to enhance the well-being of Alaskans through investments in physical capital like roads, harbors, and utility systems, and in human capital through spending on health care, education, and other services. Estimates of the value of those investments are not available, but they certainly enhance the size of the petroleum nest egg.

And although the value of those investments has not been quantified, the MSY fiscal strategy does not ignore them: the sustainable flow of earnings from the financial nest egg provides the state with the funding to continue to invest in the well-being of both present and future generations of Alaskans.

The strategy also provides a framework for deciding when an investment in physical or human capital would provide more benefit than a financial investment. That would be the case when it could be demonstrated that the flow of benefits from such an investment would exceed the flow of benefits that would come from spending the income from the financial investment.

PETROLEUM WEALTH MANAGEMENT WORKSHEET				
		FY 2013	FY 2014	Change
PETROLEUM WEALTH		Billion \$	Billion \$	Billion \$
1	Financial Assets (2+3+4+5)	\$ 60.00	\$ 60.00	\$ -
2	Permanent Fund Balance	\$ 42.00	\$ 43.00	\$ 1.0 a
3	+ Constitutional Budget Reserve	\$ 16.00	\$ 11.00	\$ (5.0) b
4	+ Statutory Budget Reserve	\$ 2.00	\$ 5.00	\$ 3.0 c
5	+ Other	\$ -	\$ 1.00	\$ 1.0
6	Petroleum in Ground (7+10+17)-Net Present Value discounted @ 5.0%	\$ 100.68	\$ 88.69	\$ (12.0)
7	Conventional North Slope-State Lands	\$ 80.54	\$ 67.11	\$ (13.4) d
8	DOR projection (thru 2022)	\$ 50.89	\$ 43.11	\$ (7.8)
9	DOR extended	\$ 29.65	\$ 24.00	\$ (5.6)
10	+ Other Oil	\$ 6.75	\$ 9.85	\$ 3.1
11	Conventional	\$ 2.14	\$ 4.75	\$ 2.6 e
12	Viscous/Heavy Oil	\$ 1.56	\$ 1.72	\$ 0.2
13	Shale Oil	\$ 1.57	\$ 1.72	\$ 0.1
14	OCS	\$ 1.49	\$ 1.67	\$ 0.2
15	ANWR	\$ -	\$ -	\$ -
16	NPRA	\$ -	\$ -	\$ -
17	+ Gas	\$ 13	\$ 12	\$ (1.7) f
18	= TOTAL PETROLEUM WEALTH (1+6)	\$ 160.7	\$ 148.7	\$ (12.0)
SUSTAINABLE DRAW RATE				
		Annual Rate	Annual Rate	
19	Real Rate of Return Net of Inflation	5.0%	5.0%	
20	+ Projected Population Growth Adjustment	1.0%	1.0%	
21	- Projected Real Per Capita Budget Growth Adjustment	0.0%	0.0%	
22	= SUSTAINABLE DRAW RATE (19-20-21)	4.0%	4.0%	
MAXIMUM SUSTAINABLE YIELD (MSY)				
		Billion \$	Billion \$	
23	= MAXIMUM SUSTAINABLE YIELD (18 x 22)	\$ 6.43	\$ 5.95	\$ (0.5)
GENERAL FUND MSY SPENDING CAP				
		Billion \$	Billion \$	
24	Maximum Sustainable Yield (1-23)	\$ 6.43	\$ 5.95	\$ (0.5)
25	Permanent Fund Dividend Distribution	\$ 0.57	\$ 0.96	\$ 0.4 g
26	= General Fund Petroleum Spending Cap (24-25)	\$ 5.86	\$ 4.99	\$ (0.9)
27	- General Fund Earnings Spending (from Petroleum Wealth)	\$ 0.18	\$ 0.07	\$ (0.1) h
28	= GENERAL FUND CURRENT PETROLEUM REVENUE SPENDING CAP	\$ 5.68	\$ 4.92	\$ (0.8)
29	+ General Fund Non-Petroleum Revenues (excluding GF earnings)	\$ 0.56	\$ 0.54	\$ (0.0) i
30	= GENERAL FUND MSY SPENDING CAP (27+28+29)	\$ 6.42	\$ 5.53	\$ (0.9)

Source: Institute of Social and Economic Research, University of Alaska Anchorage

Assumptions: No new taxes
Growth of General Fund spending and Permanent Fund Dividend account constrained to the combined rate of population increase and inflation

All financial assets earn maximum rate of return

Notes: Financial Assets valued at start of fiscal year.
Fifty years of revenues from petroleum in the ground discounted to start of fiscal year.

a. Growth from new revenues and earnings

b. FY2013 GF spending higher and revenues lower than anticipated, resulting in lower surplus

\$ 8,218 fall 2011 revenue forecast for FY2013

\$ 7,512 fall 2012 revenue forecast for FY2013

\$ 7,042 OMB forecast for FY2013 GF spending

\$ 7,600 final appropriations for FY2013 spending

c. Re-assignment of some surplus to SBR from CBR

d. FY2013 revenues spent and DOR forecast lower

e. Lower DOR projection leaves more for future production

f. Size of pipeline reduced from 4.5 bcf to 3.5 bcf per day

g. Larger because of PFD formula mechanics

h. Reduction in GF earnings

i. No change in non-petroleum GF revenues

	BASE CASE	LOW CASES			HIGH CASES		DOUBLE POST 2022 REVENUES
	FY 2014	LOW INVESTMENT RETURN	LOW INVESTMENT RETURN + NO GAS REVENUES	LOW INVESTMENT RETURN + NO GAS REVENUES + GF RPC GROW 1%	ANWR @ 500K BPD	ANWR @ 500K BPD + OCS @ 500K BPD WITH SHARED ROYALTIES	
PETROLEUM WEALTH							
	Billion \$	Billion \$	Billion \$	Billion \$	Billion \$	Billion \$	Billion \$
1 Financial Assets (2+3+4+5)	\$ 60.00	\$ 60.00	\$ 60.00	\$ 60.00	\$ 60.00	\$ 60.00	\$ 60.00
2 Permanent Fund Balance	\$ 43.00	\$ 43.00	\$ 43.00	\$ 43.00	\$ 43.00	\$ 43.00	\$ 43.00
3 + Constitutional Budget Reserve	\$ 11.00	\$ 11.00	\$ 11.00	\$ 11.00	\$ 11.00	\$ 11.00	\$ 11.00
4 + Statutory Budget Reserve	\$ 5.00	\$ 5.00	\$ 5.00	\$ 5.00	\$ 5.00	\$ 5.00	\$ 5.00
5 + Other	\$ 1.00	\$ 1.00	\$ 1.00	\$ 1.00	\$ 1.00	\$ 1.00	\$ 1.00
6 Petroleum in Ground (7+10+17)- Net Present Value discounted @ 5.0%	\$ 88.69	\$ 100.03	\$ 85.24	\$ 85.24	\$ 115.03	\$ 121.70	\$ 134.55
7 Conventional North Slope-State Lands	\$ 67.11	\$ 73.37	\$ 73.37	\$ 73.37	\$ 67.11	\$ 67.11	\$ 91.39
8 DOR projection	\$ 43.11	\$ 44.91	\$ 44.91	\$ 44.91	\$ 43.11	\$ 43.11	\$ 43.11
9 DOR extended	\$ 24.00	\$ 28.46	\$ 28.46	\$ 28.46	\$ 24.00	\$ 24.00	\$ 48.28
10 + Other Oil	\$ 9.85	\$ 11.87	\$ 11.87	\$ 11.87	\$ 16.19	\$ 42.87	\$ 19.71
11 Conventional	\$ 4.75	\$ 5.74	\$ 5.74	\$ 5.74	\$ 4.75	\$ 4.75	\$ 9.50
12 Viscous/Heavy Oil	\$ 1.72	\$ 2.04	\$ 2.04	\$ 2.04	\$ 1.72	\$ 1.72	\$ 3.43
13 Shale Oil	\$ 1.72	\$ 1.98	\$ 1.98	\$ 1.98	\$ 1.72	\$ 1.72	\$ 3.43
14 OCS	\$ 1.67	\$ 2.11	\$ 2.11	\$ 2.11	\$ 1.67	\$ 8.35	\$ 3.34
15 ANWR	\$ -	\$ -	\$ -	\$ -	\$ 26.34	\$ 26.34	\$ -
16 NPRA	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
17 + Gas	\$ 12	\$ 15	\$ 0	\$ 0	\$ 12	\$ 12	\$ 23
18 = TOTAL PETROLEUM WEALTH (1+6)	\$ 148.7	\$ 160.0	\$ 145.2	\$ 145.2	\$ 175.0	\$ 181.7	\$ 194.5
SUSTAINABLE DRAW RATE							
	Annual Rate	Annual Rate	Annual Rate	Annual Rate	Annual Rate	Annual Rate	Annual Rate
19 Real Rate of Return Net of Inflation	5.0%	4.0%	4.0%	4.0%	5.0%	5.0%	5.0%
20 - Projected Population Growth Adjustment	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%
21 + Projected Real Per Capita Budget Growth Adjustment	0.0%	0.0%	0.0%	1.0%	0.0%	0.0%	0.0%
22 = SUSTAINABLE DRAW RATE (19-20-21)	4.0%	3.0%	3.0%	2.0%	4.0%	4.0%	4.0%
MAXIMUM SUSTAINABLE YIELD (MSY)							
	Billion \$	Billion \$	Billion \$	Billion \$	Billion \$	Billion \$	Billion \$
23 = MAXIMUM SUSTAINABLE YIELD (18 x 22)	\$ 5.95	\$ 4.80	\$ 4.36	\$ 2.90	\$ 7.00	\$ 7.27	\$ 7.78
GENERAL FUND MSY SPENDING CAP							
	Billion \$	Billion \$	Billion \$	Billion \$	Billion \$	Billion \$	Billion \$
24 Maximum Sustainable Yield (x23)	\$ 5.95	\$ 4.80	\$ 4.36	\$ 2.90	\$ 7.00	\$ 7.27	\$ 7.78
25 - Permanent Fund Dividend Distribution	\$ 0.96	\$ 0.96	\$ 0.96	\$ 0.96	\$ 0.96	\$ 0.96	\$ 0.96
26 + General Fund Petroleum Spending Cap (24-25)	\$ 4.99	\$ 3.84	\$ 3.40	\$ 1.94	\$ 6.04	\$ 6.31	\$ 6.82
27 - General Fund Savings Spending (from Petroleum Wealth)	\$ 0.07	\$ 0.07	\$ 0.07	\$ 0.07	\$ 0.07	\$ 0.07	\$ 0.07
28 + GENERAL FUND CURRENT PETROLEUM REVENUE SPENDING CAP	\$ 4.92	\$ 3.77	\$ 3.33	\$ 1.88	\$ 5.97	\$ 6.24	\$ 6.75
29 + General Fund Non-Petroleum Revenues (excluding GF earnings)	\$ 0.54	\$ 0.54	\$ 0.54	\$ 0.54	\$ 0.54	\$ 0.54	\$ 0.54
30 = GENERAL FUND MSY SPENDING CAP (27+28+29)	\$ 5.52	\$ 4.38	\$ 3.93	\$ 2.48	\$ 6.58	\$ 6.84	\$ 7.36

ⁱ The OMB plan includes four illustrative projections, all assuming the FY 2014 General Fund appropriation will be \$6.5 billion—\$1.1 billion below FY 2013. Three are clearly not sustainable. This graph assumes FY 2014 General Fund spending will be the same as last year and that revenues will equal the Alaska Department of Revenue projection published in December 2012.

ⁱⁱ This case would be sustainable with the inclusion of income and sales taxes.

ⁱⁱⁱ This assumes all financial assets would be invested to generate an average over time of 5% (net of inflation).

^{iv} Earnings to fund General Fund appropriations would come from any combination of cash reserves and the Permanent Fund.

Alaska Legislature

Representative Charisse Millett

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HOUSE BILL 136 SPONSOR STATEMENT

This year the State of Alaska will go into deficit spending. Despite the warnings, session after session has produced a steady increase in the Operating and Capital budgets. This is not a condemnation of funding for programs, or school, or necessary infrastructure. It is rather a recognition that our state government has not been able to tame its appetite for obligations that outgrow our revenue capabilities. Record high oil prices can no longer mask the arithmetic truth: we are spending the principles of our savings accounts. Senator Pete Kelly said it best "we are literally spending our children's money."

House Bill 136 is a step in the right direction. What the bill proposes is to require the Governor to submit certain crucial information before each legislative session. This information is specifically is how much the legislature, and the governor, can spend without dipping into the principles of the Statutory Budget Reserve, the Constitutional Budget Reserve or the Permanent Fund. The bill also calculates the net present value of oil in the ground that has not been harvested. House Bill 136 provides information rather than a mandate. But Alaskans deserve to know that, if the proposed budgets go over that "red line" and spend part of the principle of our savings accounts, there had better be a good reason for it.

This piece of legislation is inspired by the work of Dr. Scott Goldsmith at the Institute of Social and Economic Research (I.S.E.R.) at the University of Alaska, Anchorage. We must think forward to a time when Alaska will not have the luxury of valuable but finite resources to sustain ourselves. Please join me in supporting House Bill 136

Prepared by Vasilios Gialopsos

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MEMORANDUM

February 27, 2013

SUBJECT: Sectional summary, information in governor's 10-year fiscal plan;
(HB 136; Work Order No. 28-LS0353\U)

TO: Representative Charisse Millett
Attn: Vasilios Gialopsos

FROM: Dennis C. Bailey *DCB*
Legislative Counsel

You have requested a sectional summary of the above-described bill.

As a preliminary matter, note that a sectional summary of a bill should not be considered an authoritative interpretation of the bill and the bill itself is the best statement of its contents.

Section 1. Requires the governor's annual 10-year fiscal plan to include the projected amount available for spending for the succeeding 10 years, not including money from the principal of the Permanent Fund, the principal of the Constitutional Budget Reserve Fund, the Statutory Budget Reserve Fund, or the net present value of the state's projected oil reserves.

If I may be of further assistance, please advise.

DCB:ljw
13-122.ljw