

HB

303

<TARGET><BILL>HB 303</BILL><SUBJECT>HB
303</SUBJECT><COMM>HFIN29</COMM></TARGET>

Fiscal Note

State of Alaska
2016 Legislative Session

Bill Version: HB 303
Fiscal Note Number: _____
() Publish Date: _____

Identifier: HB303-DOC-PHC-03-23-16
Title: PERM FUND: EARNINGS, DEPOSITS,
ACCOUNTS
Sponsor: MILLETT
Requester: (H) FINANCE

Department: Department of Corrections
Appropriation: Health and Rehabilitation Services
Allocation: Physical Health Care
OMB Component Number: 2952

Expenditures/Revenues

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

	FY2017 Appropriation Requested	Included in Governor's FY2017 Request	Out-Year Cost Estimates				
			FY 2018	FY 2019	FY 2020	FY 2021	FY 2022
OPERATING EXPENDITURES	FY 2017	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021	FY 2022
Personal Services		8,117.4	8,117.4	8,117.4	8,117.4	8,117.4	8,117.4
Travel							
Services		12,119.5	12,119.5	12,119.5	12,119.5	12,119.5	12,119.5
Commodities							
Capital Outlay							
Grants & Benefits							
Miscellaneous							
Total Operating	0.0	20,236.9	20,236.9	20,236.9	20,236.9	20,236.9	20,236.9

Fund Source (Operating Only)

1004 Gen Fund			11,200.3	11,200.3	11,200.3	11,127.2	10,510.7
1171 PFD Crim		20,236.9	9,036.6	9,036.6	9,036.6	9,109.7	9,726.2
Total	0.0	20,236.9	20,236.9	20,236.9	20,236.9	20,236.9	20,236.9

Positions

Full-time							
Part-time							
Temporary							

Change in Revenues

--	--	--	--	--	--	--	--

Estimated SUPPLEMENTAL (FY2016) cost: 0.0 *(separate supplemental appropriation required)*
(discuss reasons and fund source(s) in analysis section)

Estimated CAPITAL (FY2017) cost: 0.0 *(separate capital appropriation required)*
(discuss reasons and fund source(s) in analysis section)

ASSOCIATED REGULATIONS

Does the bill direct, or will the bill result in, regulation changes adopted by your agency?
If yes, by what date are the regulations to be adopted, amended or repealed?

Why this fiscal note differs from previous version:

Prepared By:	April Wilkerson	Phone:	(907)465-3460
Division:	Administrative Services - Department of Corrections	Date:	03/23/2016 05:00 PM
Approved By:	Dean Williams	Date:	03/23/16
Agency:	Department of Corrections		

FISCAL NOTE ANALYSIS

STATE OF ALASKA
2016 LEGISLATIVE SESSION

BILL NO. HB 303

Analysis

Passage of this legislation will change the way permanent fund dividends are calculated having an impact on the amount of Permanent Fund Dividend criminal funds allocated to the Department of Corrections Physical Health Care component.

The Department of Corrections Physical Health Care component receives permanent fund dividend criminal funds which are based on a fluctuating annual PFD amount and the number of persons deemed ineligible during the appropriate year. The amount of PFD Criminal Funds appropriated to corrections for FY2017 was \$20,236,900.00 based on the CY2015 annual PFD amount of \$2,072.00 and an estimated 10,448 individuals deemed ineligible under AS 43.23.005(d).

Based on the Office of Management and Budget projections and using the same number of individuals identified as ineligible, this legislation would adjust the amount of PFD Criminal Funds available for allocation to the department requiring fund source changes as follows:

FY2018 reduce PFD Criminal Funds (\$11,200.3) / increase General Funds \$11,200.3

FY2019 continue PFD Criminal Fund reduction of (\$11,200.3) / continue increased General Funds of \$11,200.3

FY2020 continue PFD Criminal Fund reduction of (\$11,200.3) / continue increased General Funds of \$11,200.3

FY2021 increase PFD Criminal Funds \$73.1 for a continued change of (\$11,127.2) PFD Criminal Funds / and reduce General Funds by (\$73.1) for a continued General Fund adjustment of \$11,127.2

FY2022 increase PFD Criminal Funds \$616.4 for a continued change of (\$10,510.7) / and reduce General Funds by (\$616.4) for a continued change of \$10,510.7 General Funds

Reducing the Deficit: Investing Alaska's Vast Cash Reserves

House Bill 303

House Finance Committee

2/16/16

The Permanent Fund and the Dividend



November 1976- Voter Approved Constitutional Amendment Creating the Permanent Fund

2/21/1977- 9th Legislature

Created Permanent Fund thru CS to SS to HJR 39

-to convert a part of the depleting petroleum asset into a permanent and sustainable financial asset- (Goldsmith, 2002)

Zobel v. Williams (Argued: 10/7/1981, Decided: 6/14/1982) US Supreme Court

HELD: The Alaska Dividend distribution plan violates the guarantees of the Equal Protection Clause of the 14th Amendment

1982 The first Permanent Fund Dividend

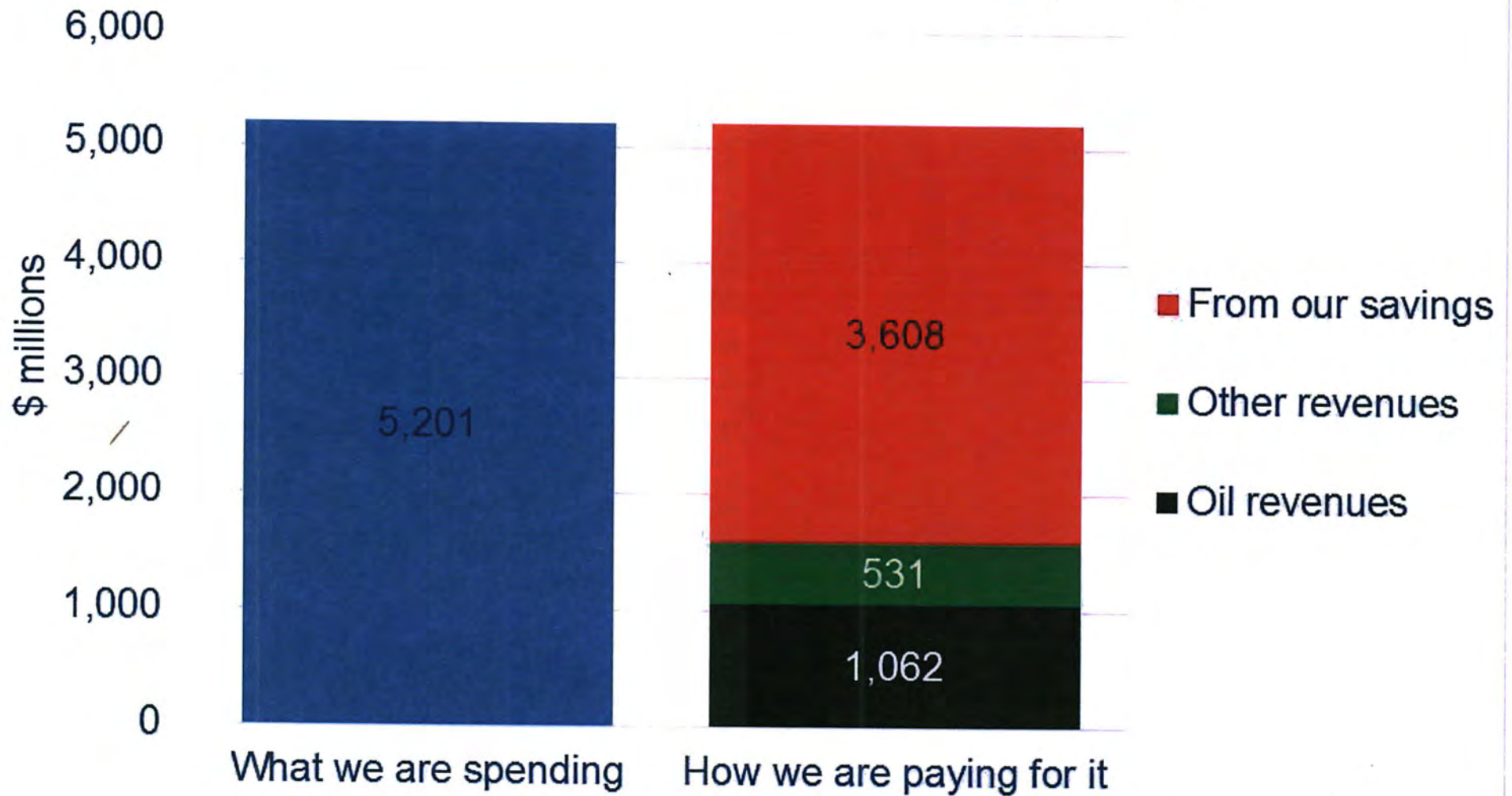
Created by a statutory overlay on the constitution (signed into law 4/16/1980)

Is there a Problem?

A \$3.5-4 Billion Deficit

- The legislature has enacted heavy spending cuts over the last 2 years
- The state has several savings accounts, but
Revenue models show that if oil prices do not rebound, those savings will be gone in about 2 years
- We cannot wait and hope for high oil prices
- The price of inaction now could be disastrous for the state's future

Alaska's Fiscal Situation This Year (FY16)



The Five Stages of Grief

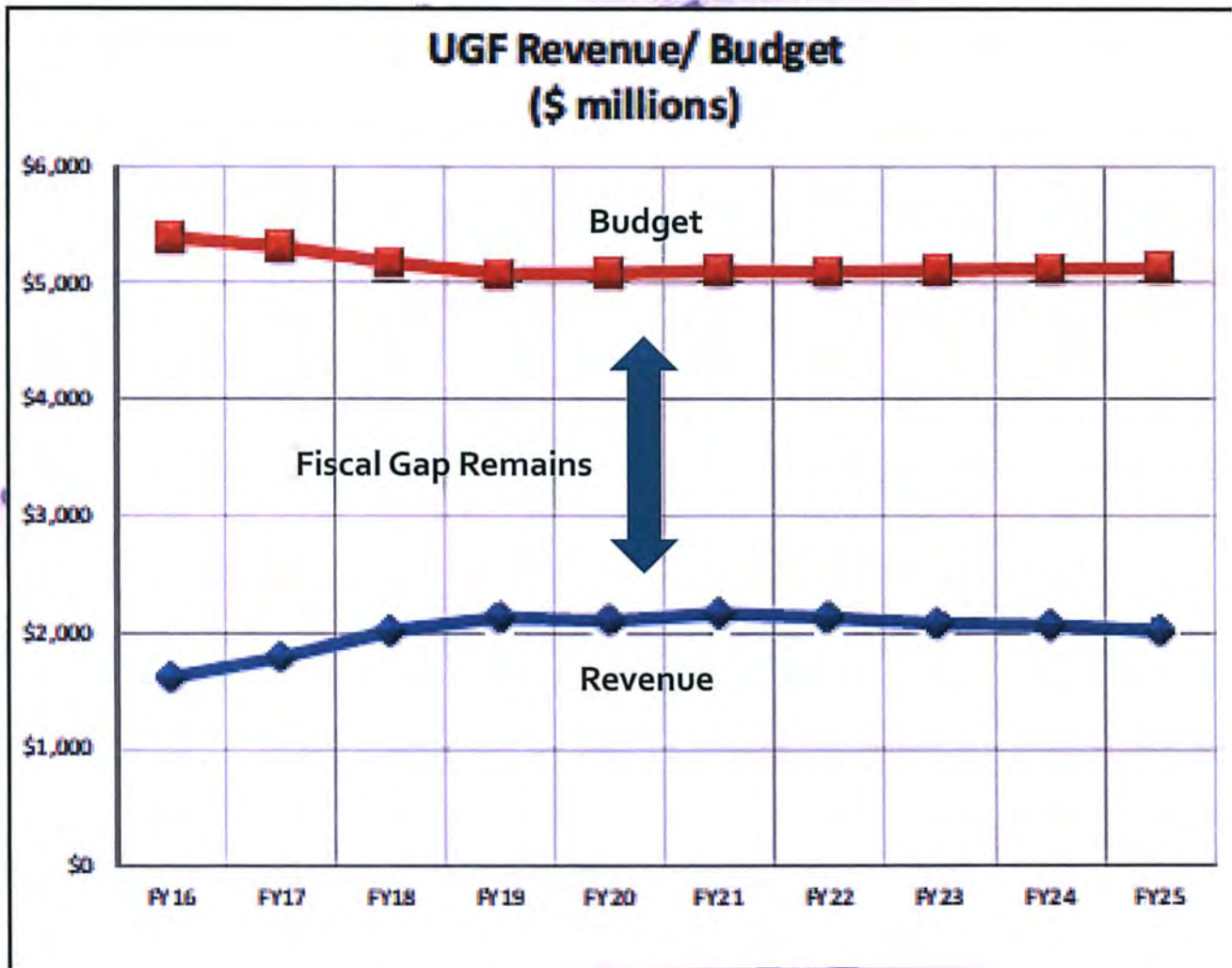
- Denial
- Anger
- Bargaining
- Depression
- Acceptance





What is the cost of doing nothing?

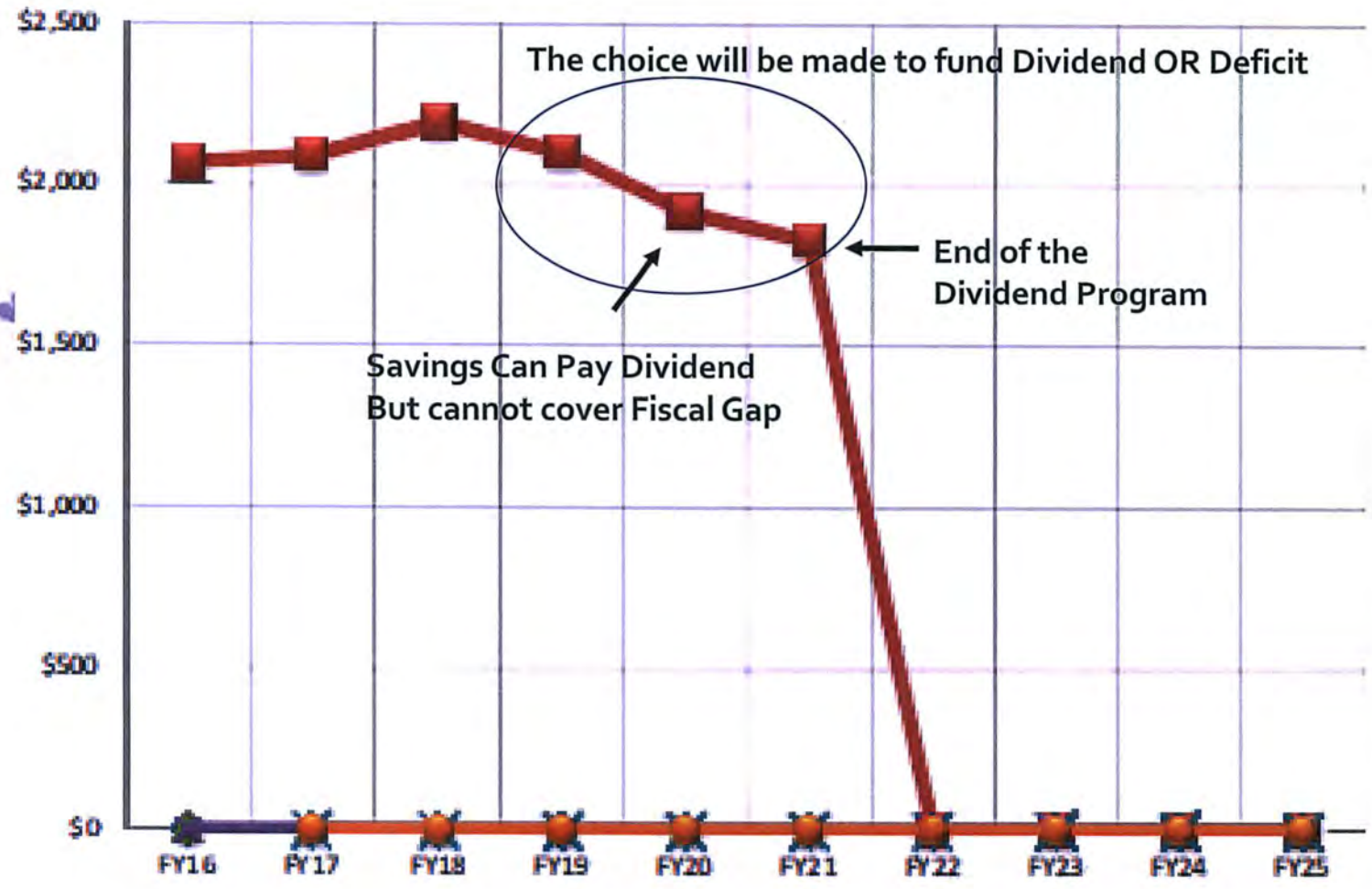
Status Quo



Status Quo



Dividend Check



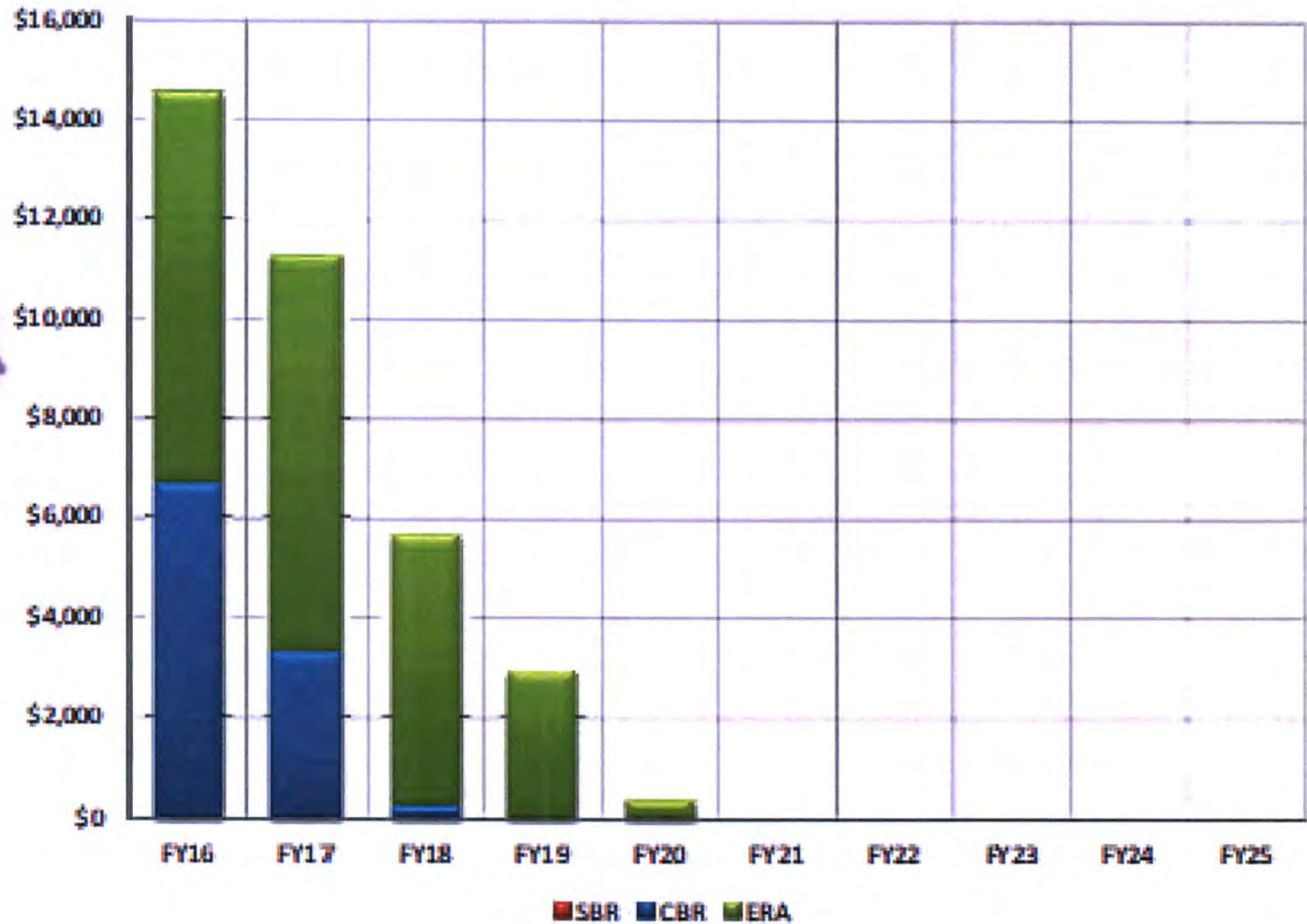
Status Quo

When the CBR is gone
The ERA will be required

When the ERA is gone....

What do we draw from then?

Budget Reserves



A Path Forward

We need a plan to address the problem

"If I had one hour to solve a problem, I would spend 55 minutes thinking about the problem and 5 minutes thinking about the solution."

- Albert Einstein

In crafting this plan I had these principles in mind:

The solution needed to:

- 1) Retain a dividend
- 2) Reduce the volatility in the state budget
- 3) To clearly expose the size and cost of government
 - so that downward pressure would ensure that Alaskans could begin an honest assessment of needs vs. wants
- 4) Be enduring to allow maximum use of our wealth over generations so that benefits and burdens are shared
- 5) Be Simple and Easy to implement

What HB303 IS NOT

It is NOT

- **A Raid on the Permanent Fund**
 - **The Permanent Fund cannot be touched without a constitutional amendment**
 - **HB 303 would only draw funds from the Earnings Reserve Account**
- **A way for Government to increase the Budget**
- **A Dividend Killer**

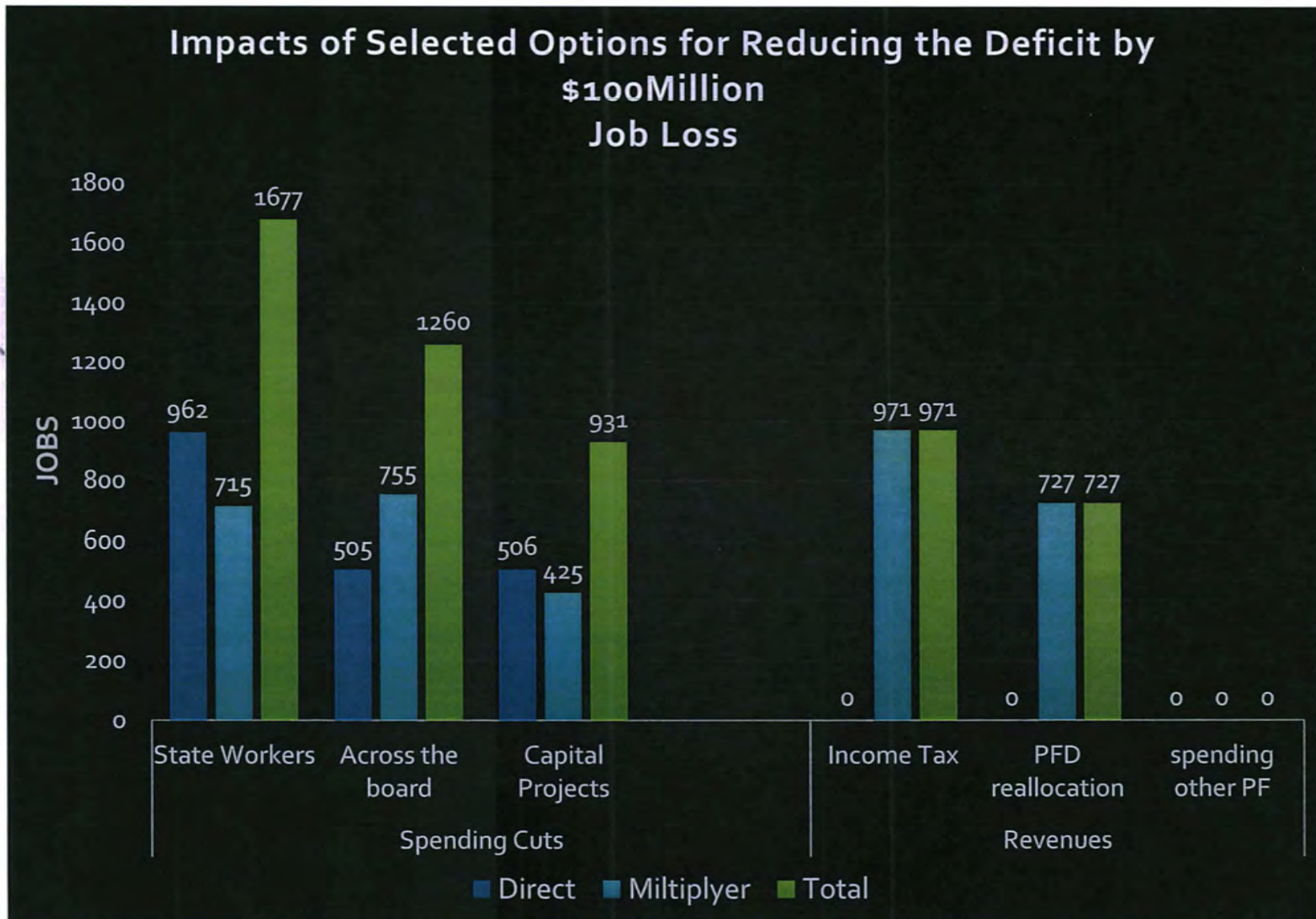
What HB303 IS

It IS

- A way to connect Alaskans directly to their share of the Natural Resources
- A way to protect your dividend into the future
 - Without a structural change, the dividend will go away in a few short years
- A way to ensure that services you enjoy continue to be provided
 - Police (public Safety)
 - Firefighters
 - Roads
 - Education
 - Health and Human Services
 - The Marine Highway
 - Parks and Recreation
 - Fish and Game management



Source:
 Mouhcine Guettabi
 And Gunnar Knapp
*Alaska Business
 Monthly 2016*



HB303 Spending Limitations? Volatility in Commodity Prices

- Without Oil Tax Revenue flowing through the ERA
 - Available General Funds will continue to swing with commodity price
 - Some volatility will remain

Unless limitations are put in place

There are many options



HB303 Spending Limitations? Volatility in Commodity Prices

- The Legislature *could* consider some of the following to reduce volatility:
 - Language that says “FY(x) appropriation cannot exceed 110% or 120% of previous years draw” – can pick a number.
 - POMV could be a range of % depending on returns, oil tax revenue, cash flow needs, capital project outlays, etc...
 - i.e.—POMV could equal 2%-8% to fill the budget deficit, “whichever is less”
 - Can create an overall spending cap

A \$3.5-4 Billion Deficit- volatility in Commodity Prices'

We have seen this before

For decades

Oil Price x Volume = State Budget

This has been Volatile and Unstable

We have been saved in the past by rebounding oil prices

What is different today is:

We no longer have the volume

(oil would need to be over \$108bbl to balance the budget)

Einstein said "We cannot solve our problems with the same level of thinking that created them."

A \$3.5-4 Billion Deficit

Some things we Must ask ourselves:

(oil would need to be over \$108bbl to balance the budget)

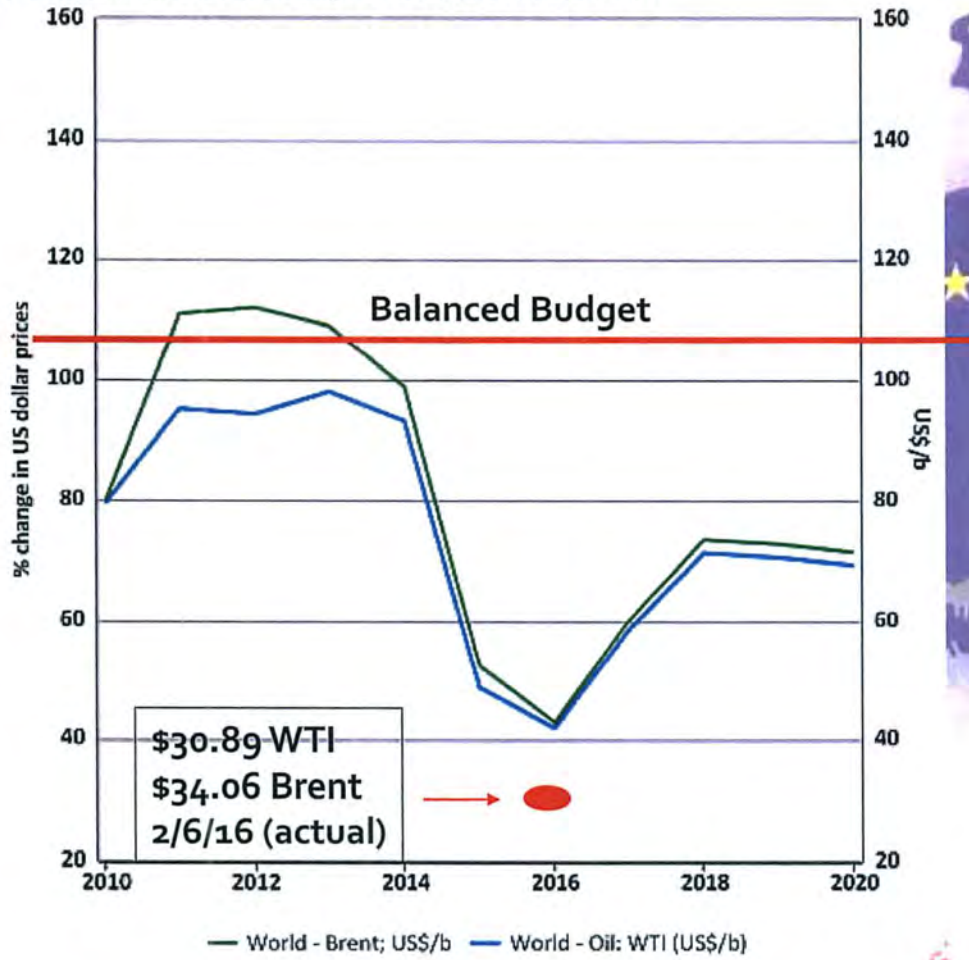
Will Oil Prices Rebound?

How high?

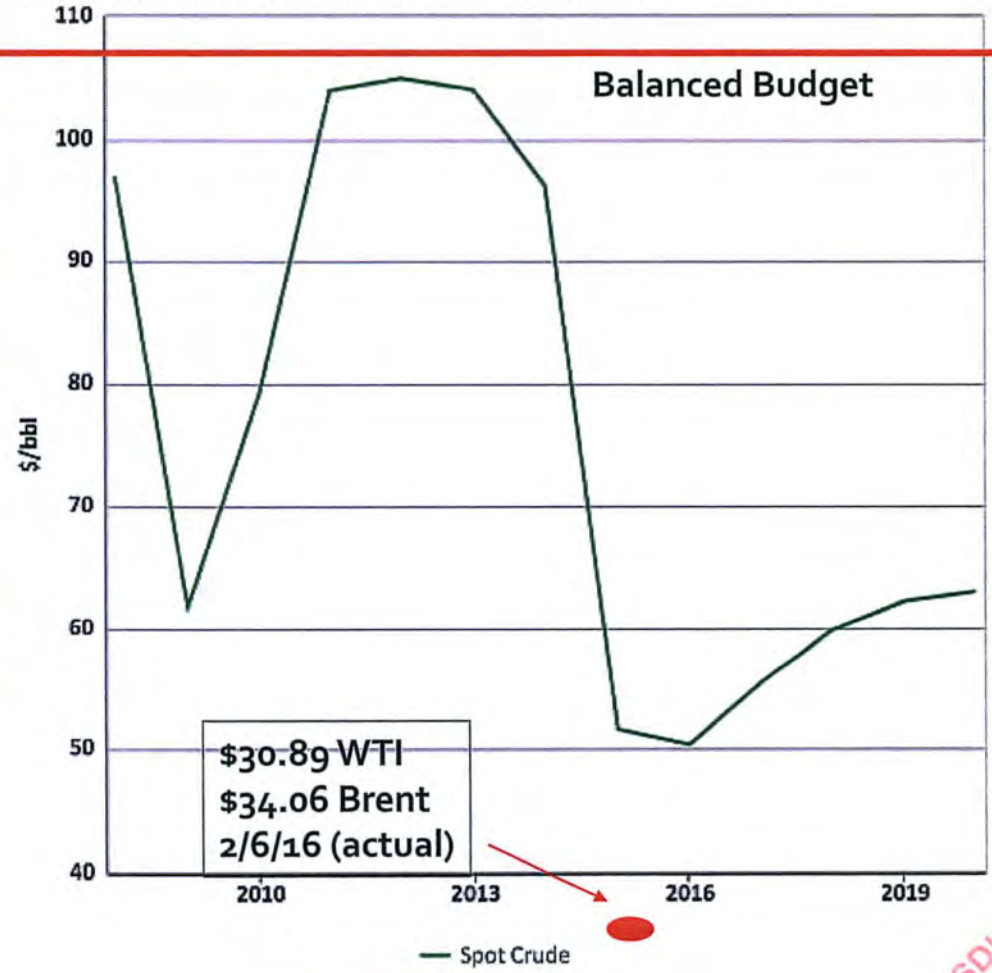
When?

Einstein said "We cannot solve our problems with the same level of thinking that created them."

EIU Economic and Commodity Forecast, December 2015

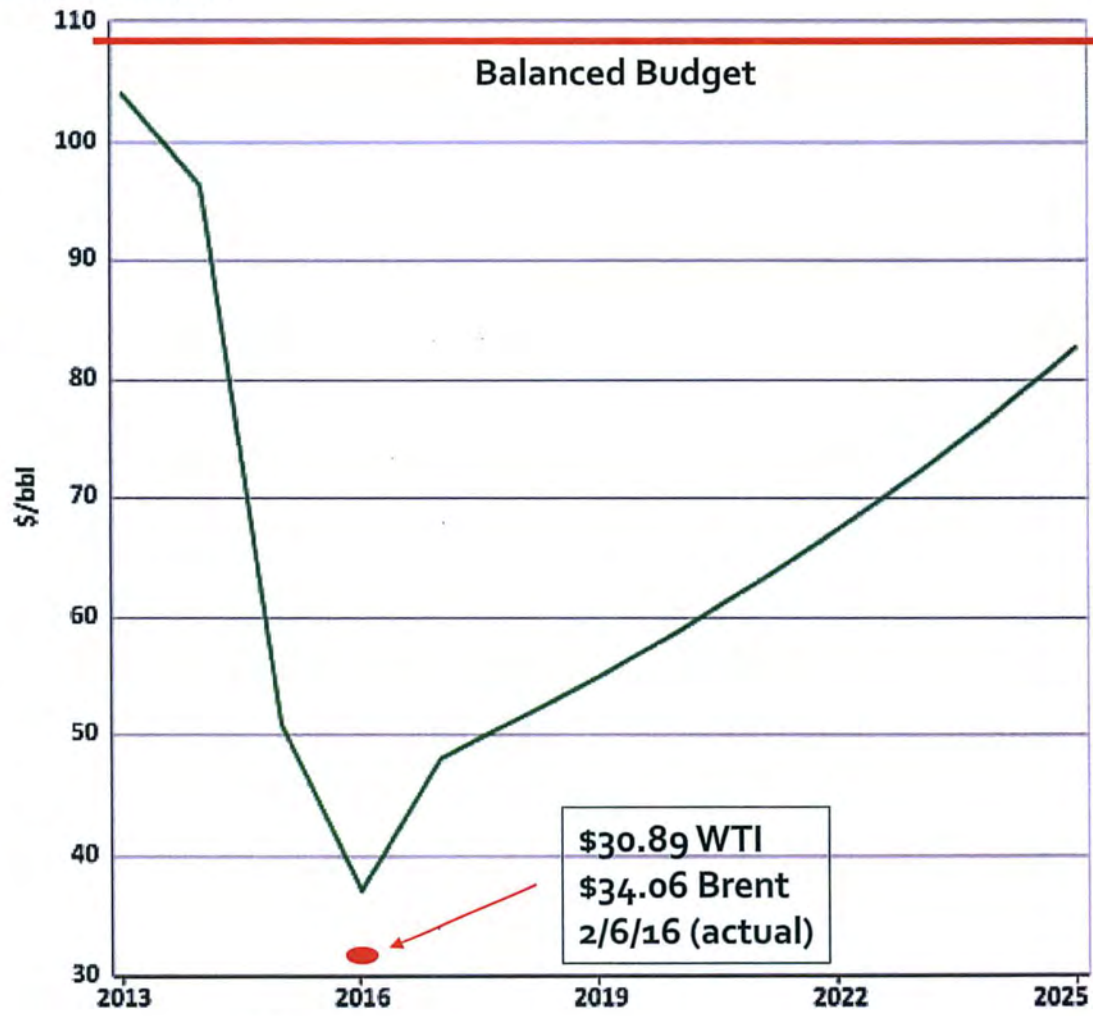


Medium Term Commodity Price Baseline - U.S. Dollars



SDK

Nominal US Dollars



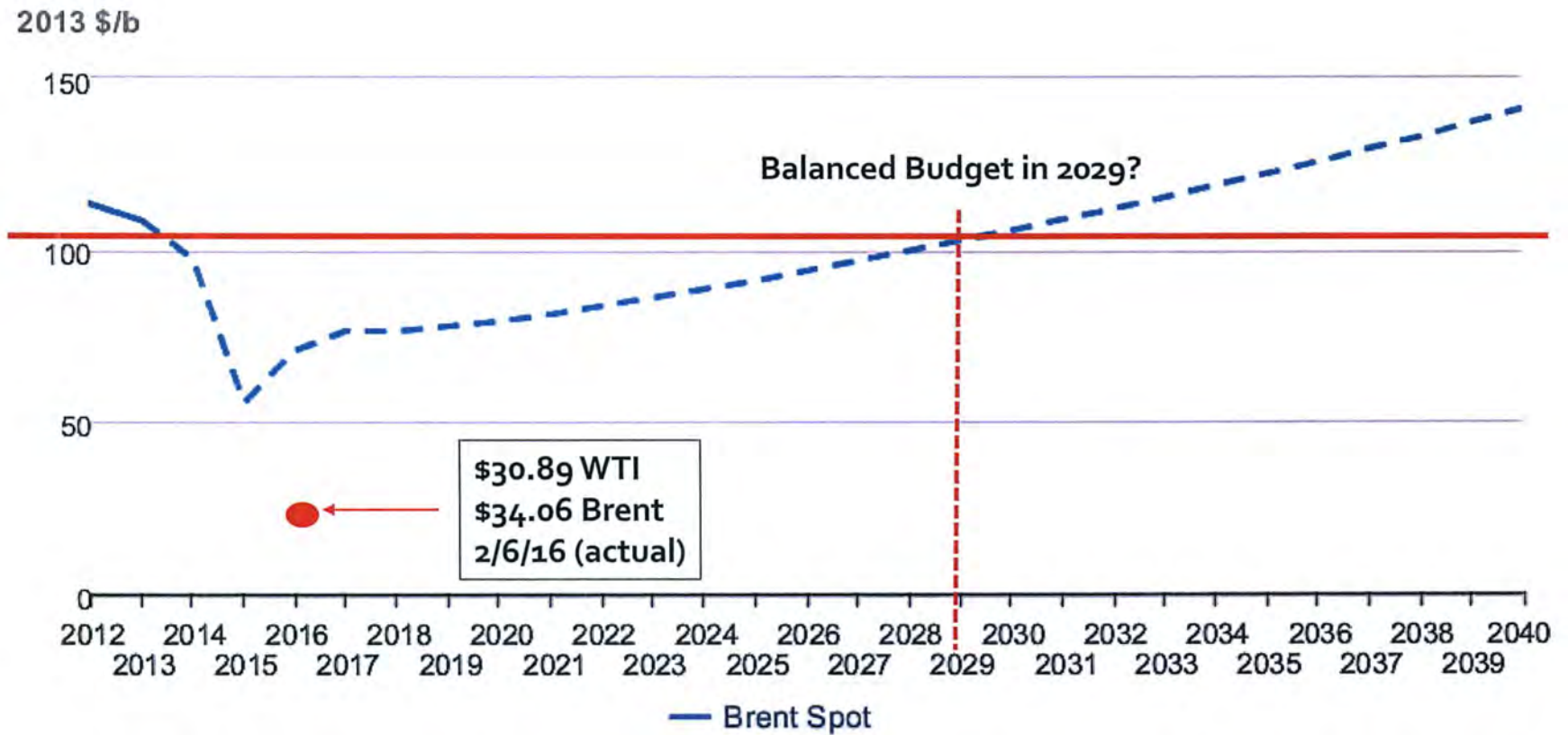
World Bank

— Crude oil, avg, spot

SDK

Real Petroleum Prices: Crude Oil

Case: Reference case



A \$3.5-4 Billion Deficit



- Oil Price Projections have been inaccurate
- Is the International Oil Market fundamentally different now?
 - Perhaps
- *Should we bet on oil prices to save us in the future?*
 - A better question:
Should we bet our future on oil prices?

A \$3.5-4 Billion Deficit

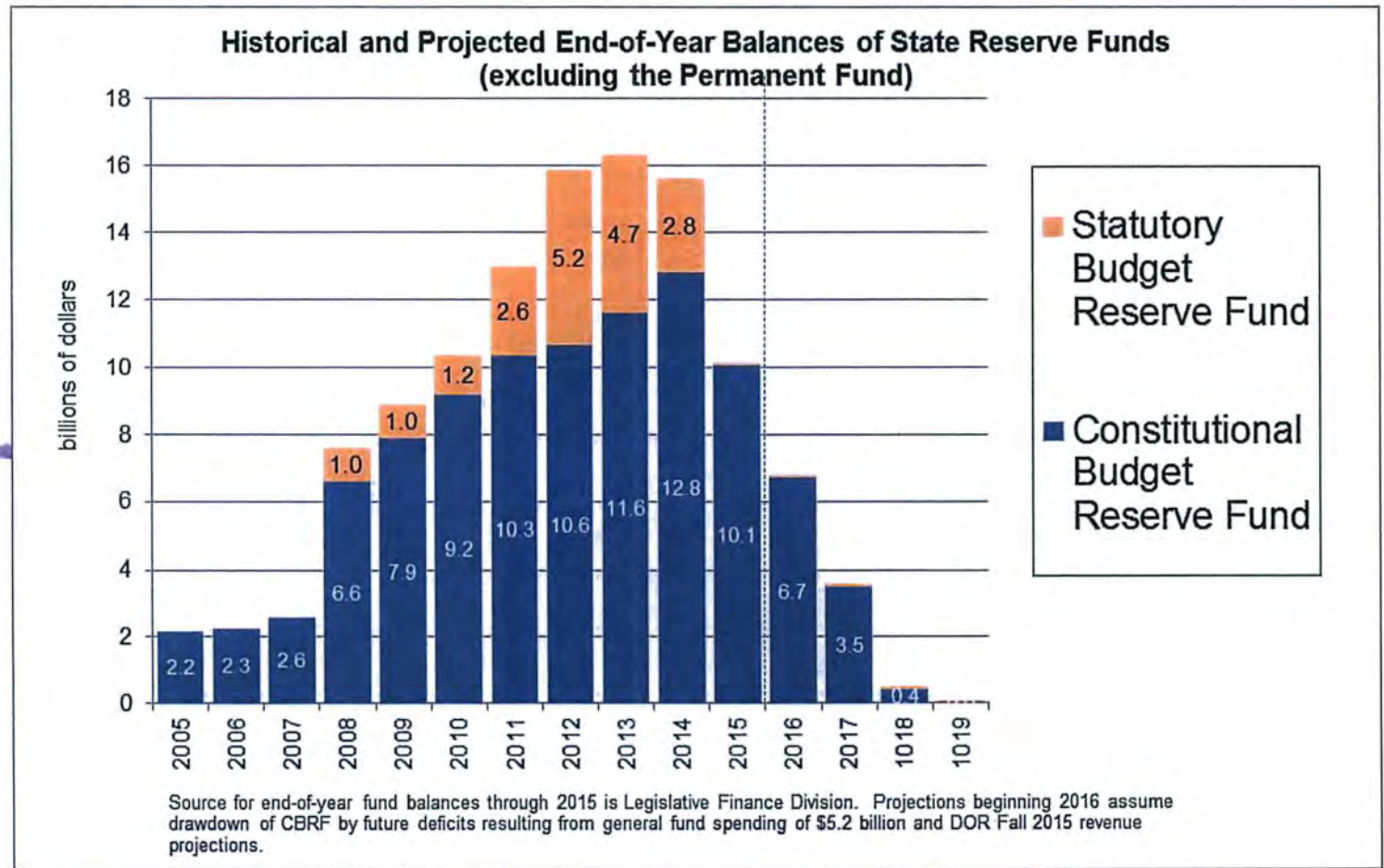


- What has been done with savings at high oil prices?
- Snapshot of the Present
- Looking forward

The Legislature did a GREAT job saving during high oil Prices

But

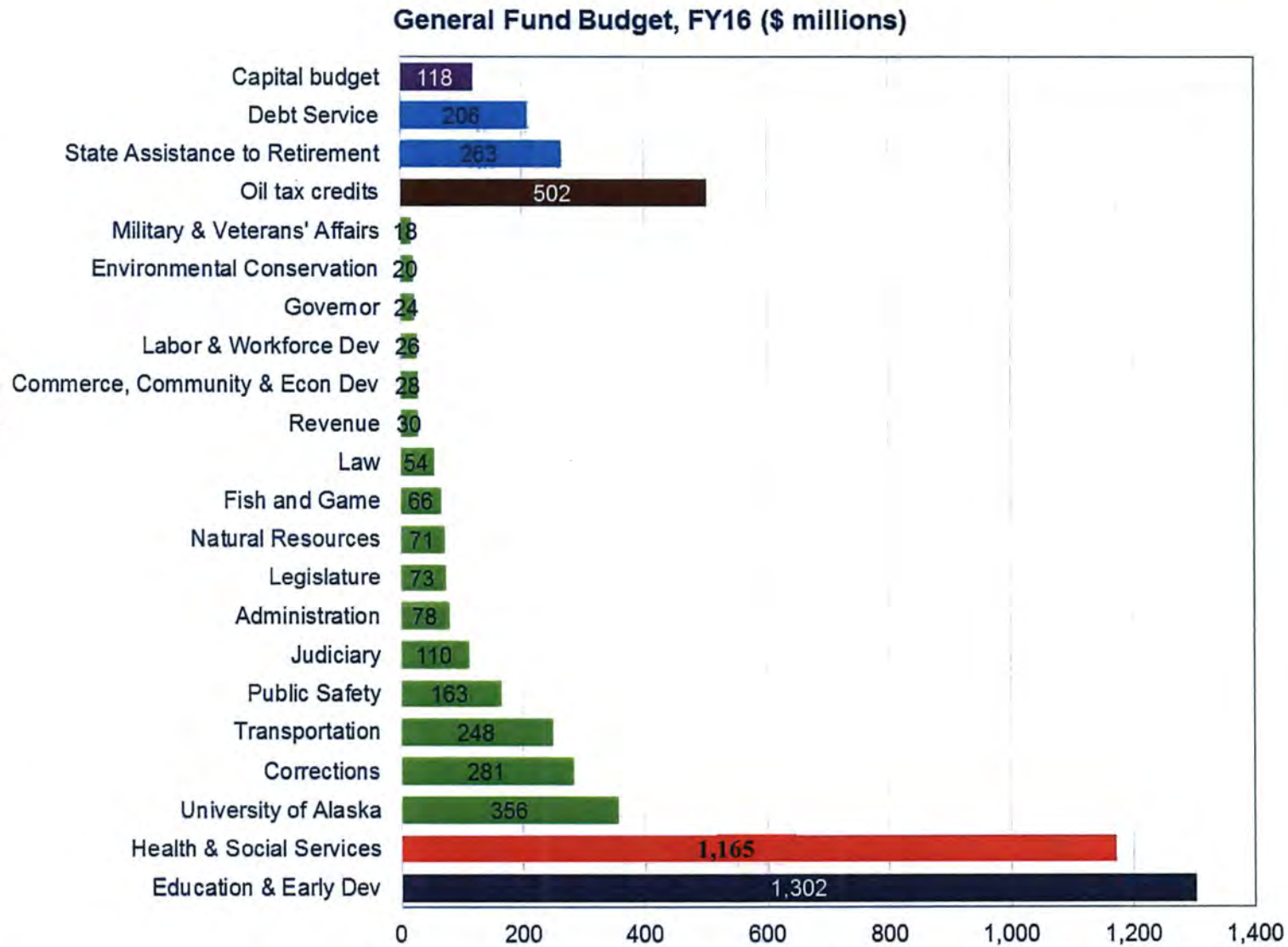
Savings have Been depleted



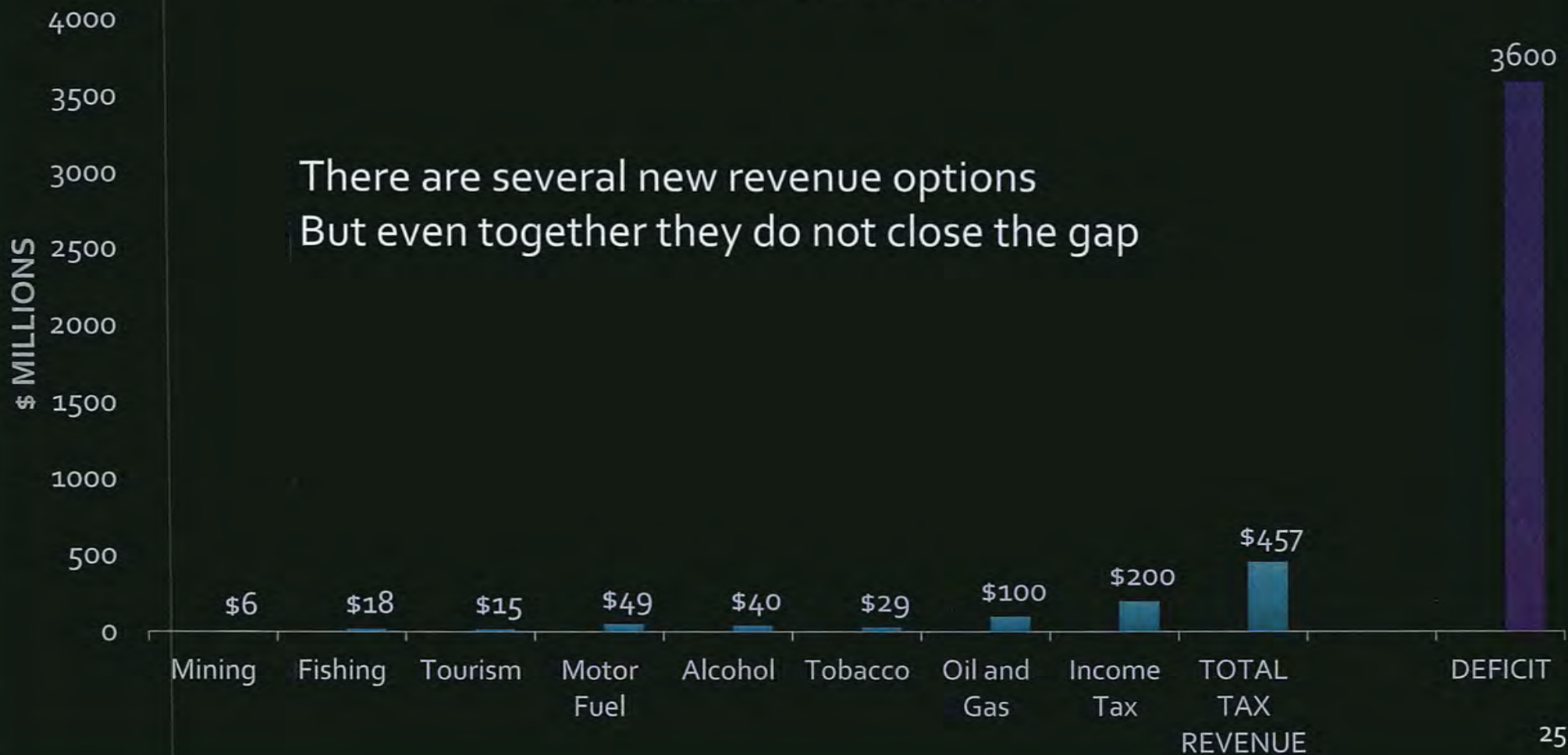
- 2008-09: Record high oil prices under ACES
- 2013: Low price and low volume- began draw down of SBR
- 2018: We cannot pay our bills with savings

- How we are spending \$5.2 billion in FY16

- There are still cuts we can make
- But the low-hanging fruit may be gone
- These outlays do not capture program receipts or federal matches
 - Which would be vulnerable with deep cuts



Potential New Revenue From Sustainable Alaska Plan

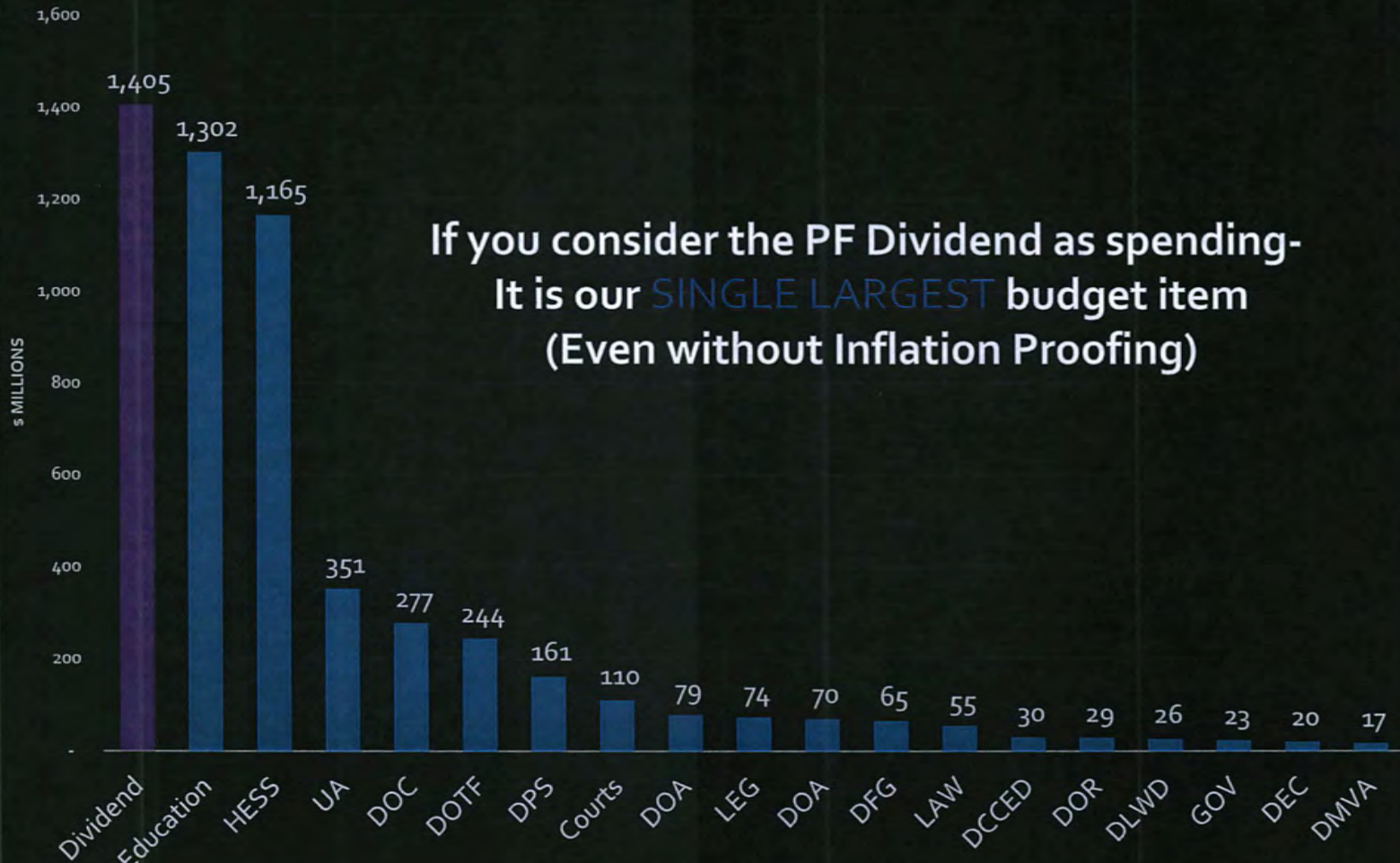




**We cannot close the gap with cuts or new broad-based revenue
ALONE**

**A sound fiscal solution will necessarily involve using the Permanent
Fund**

FY16 Agency Share of Total Agency Operations and the Appropriation for Permanent Fund Dividends (UGF Only)



SB 128 (APFPA) vs HB 303

Key Elements

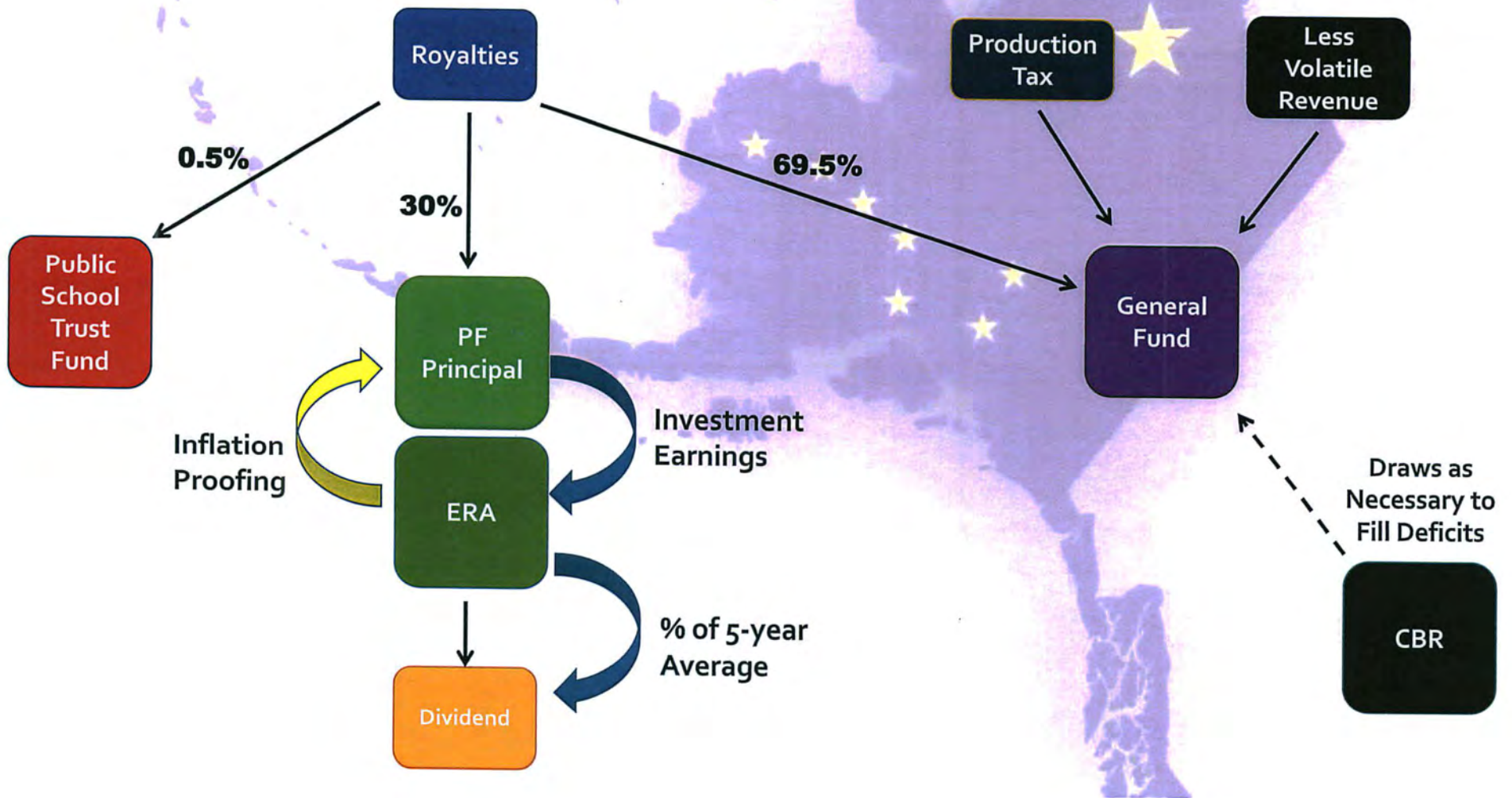
- **Royalties go to Dividend under both plans**
 - **PFPA = 50% of Royalties (~\$1,000 dividend and falling)**
 - **HB303= 74.5% of Royalties (nearly 50% Higher Dividend)**
 - **\$1,000 minimum**
- **PFPA plan moves CBR and Oil tax revenue into Earnings Reserve Account**
 - **There are possible legal issues regarding the CBR sweep**
- **PFPA plan is NOT a POMV**
 - **Targets a set number (\$3.3B) for withdrawal and spending**
 - **This is telling the legislature you have "x" amount to spend every year**
 - **Does not adjust to market returns and actual earning of the ERA**
- **HB303 does not change oil tax revenue (still straight to GF)**
- **AFPA is designed as an annuity- looks 25years into the future: Foresight**
- **POMV is based on actual values- Looks 5 years into the past: Hindsight**

HB 303

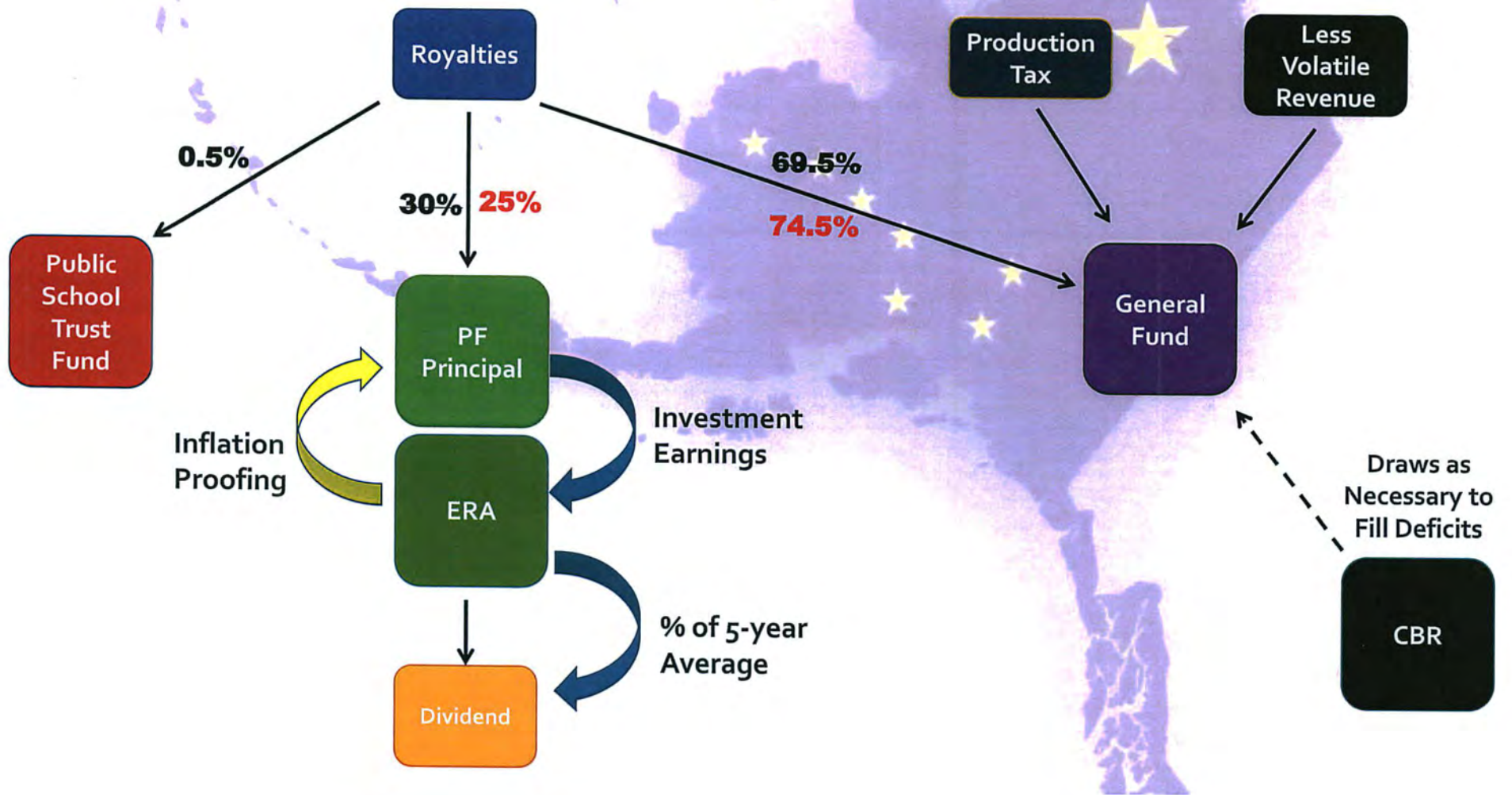
Key Elements

The Plumbing 4 basic Changes

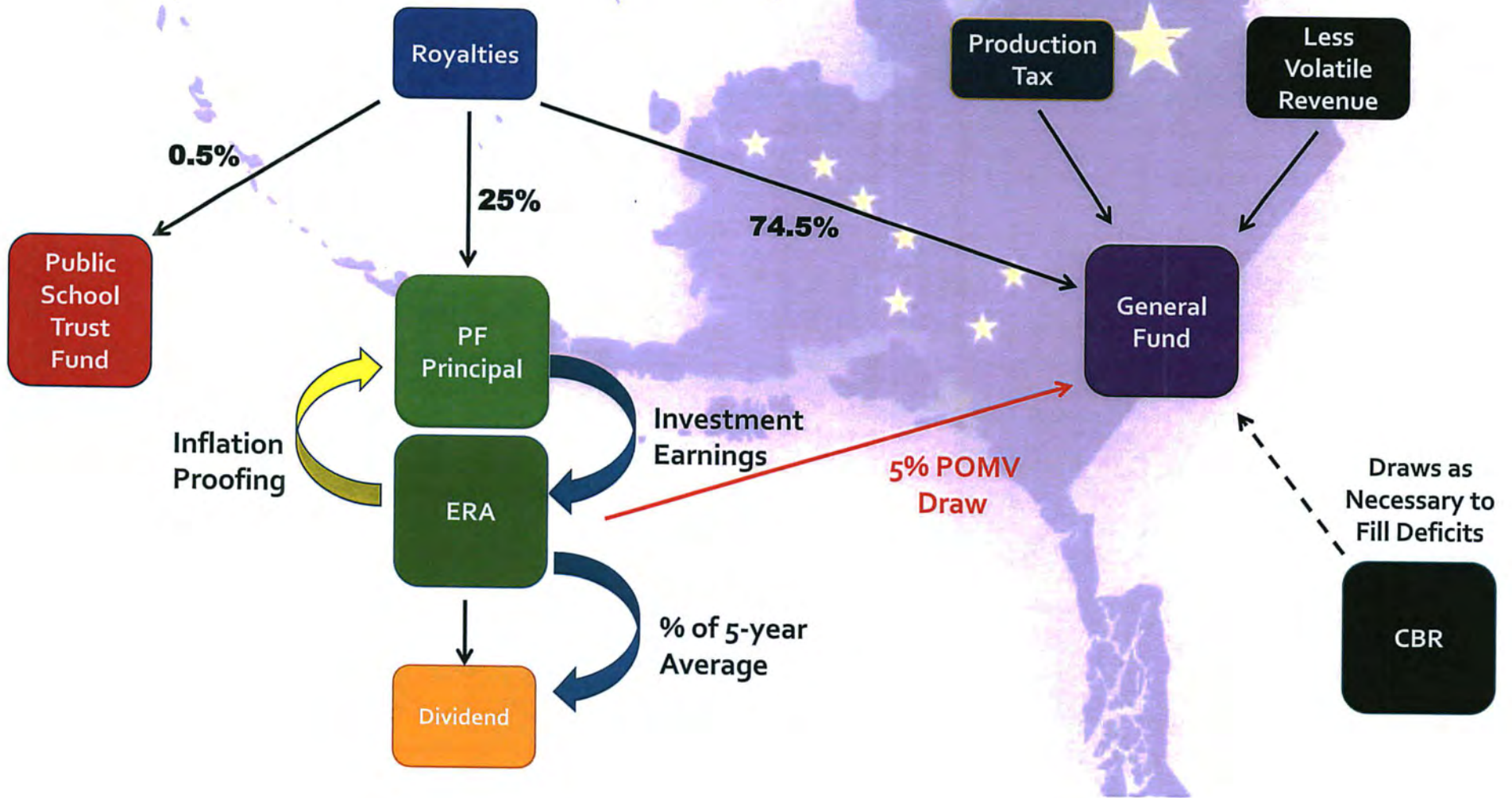
Current Cash Flow



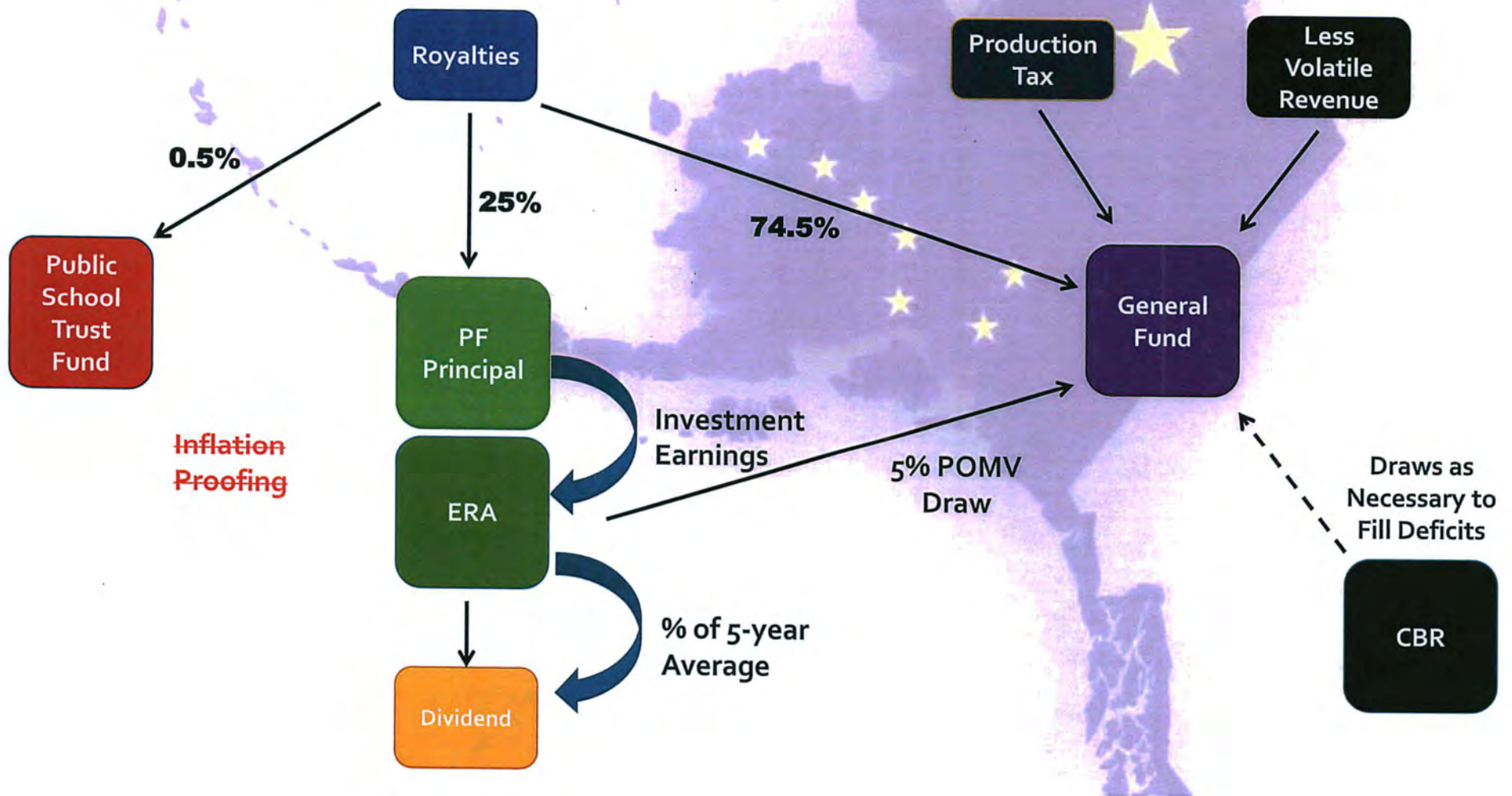
HB 303 Change 1. Royalty Percentage



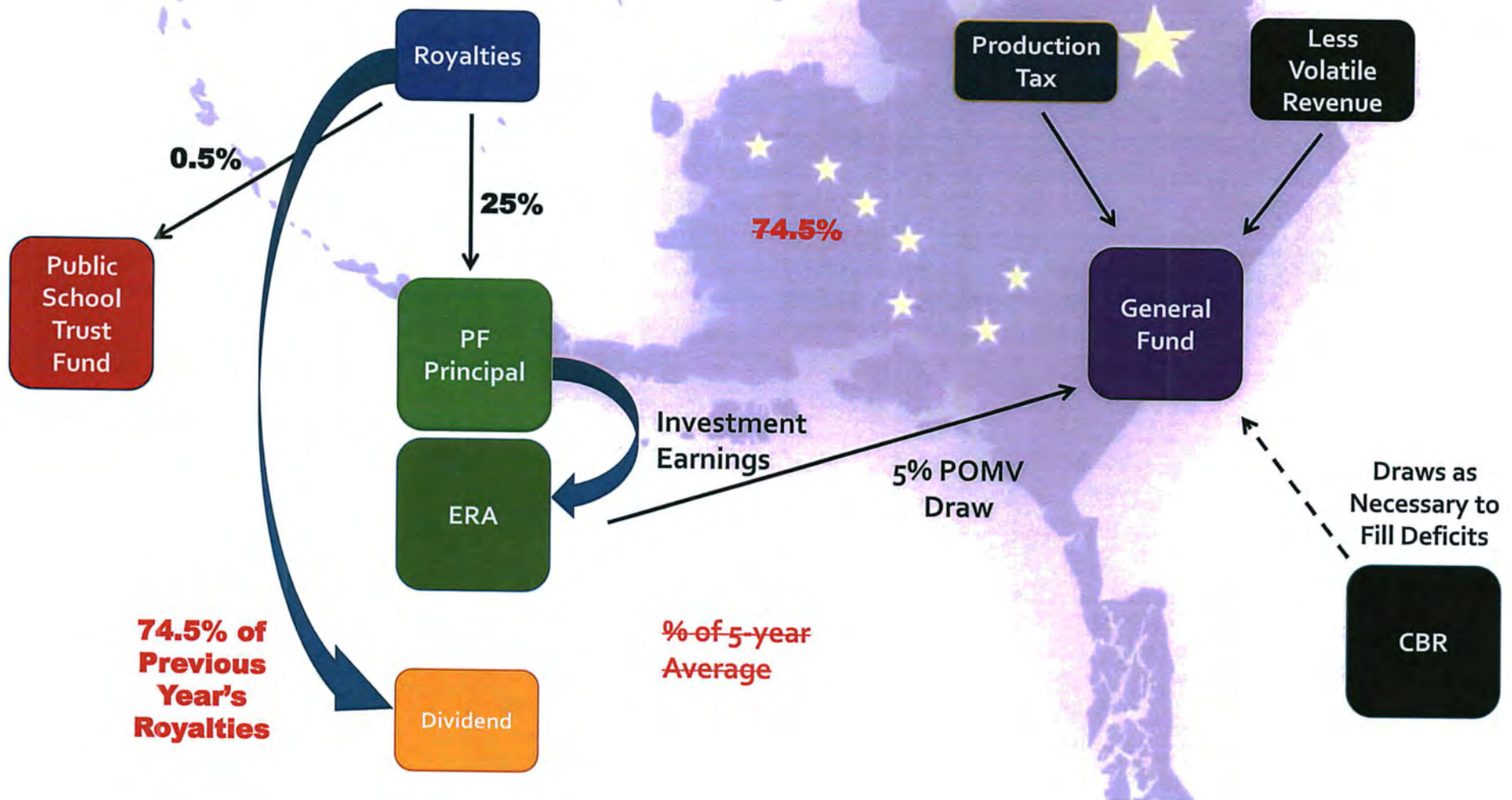
HB 303 Change 2. Add POMV Payout



HB 303 Change 3. Remove Inflation Proofing



HB 303 Change 4. Dividend Source and Calculation



HB 303: The SWAP- Rents and Royalties



- Currently,
 - 30% of all Royalties and Rents from
 - Oil, Gas and Federal Mining revenue
 - Deposited into the Permanent Fund corpus
 - 0.5% to School Trust Fund
 - 69.5% deposited to General Fund

HB 303: Rents and Royalties to Dividend



- 74.5% of all R&R would be deposited into the Dividend Fund
- No Permanent Fund Earnings would be used for Dividend
- SB 114: puts a floor (guarantee) of \$1,000 Dividends

HB 303: PF Reserve Earnings Account and the General Fund

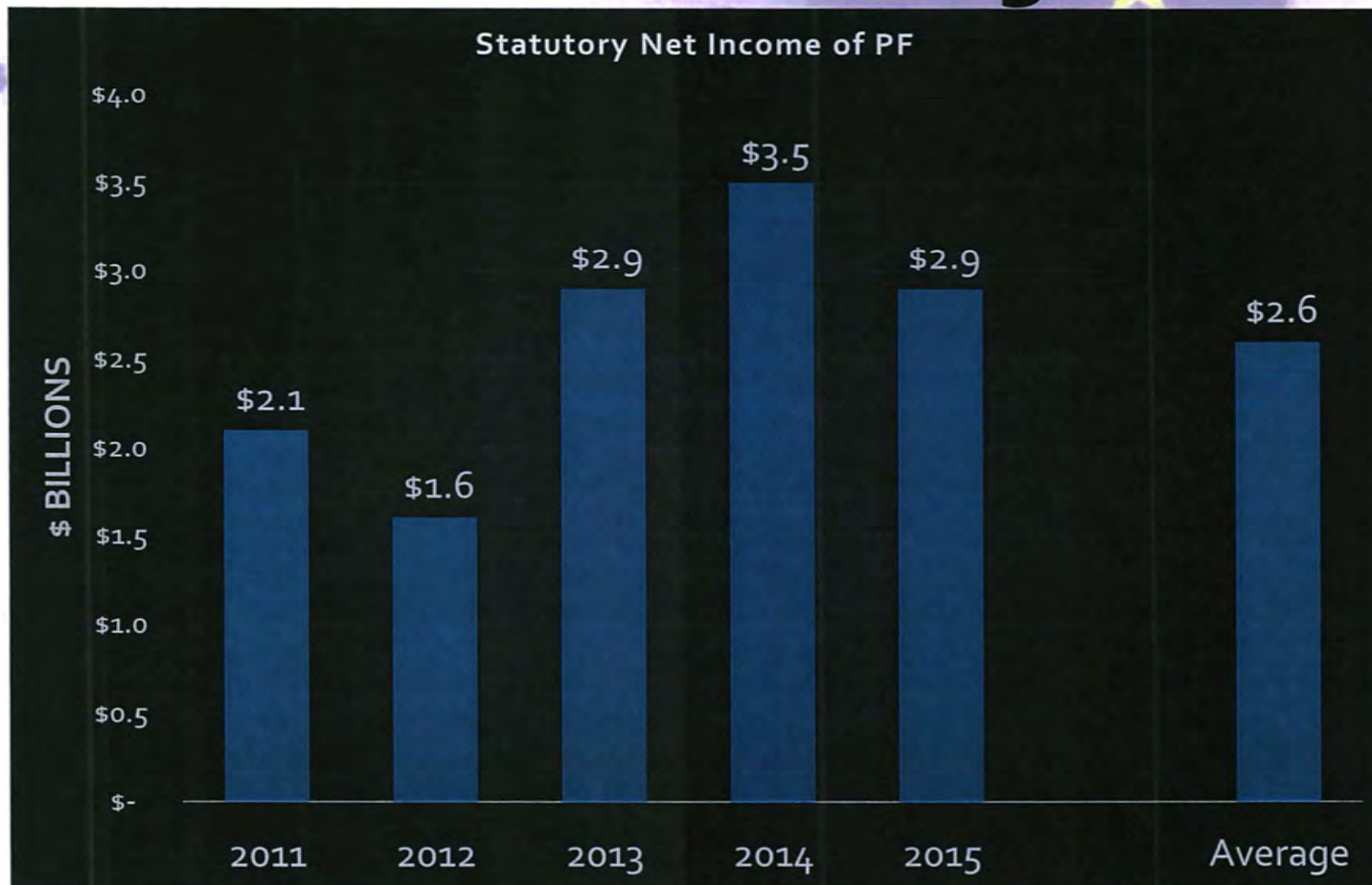
- The exchange for R&R to Dividend Fund:
 - 5% of the total value of the Permanent Fund (Corpus + ERA)
Withdrawn from ERA
Deposited into General Fund
- This is often called a Percent of Market Value (POMV) concept
- Returns on PF investments average more than 5%
 - Thus you inflation proof the PF plus the 25% R&R deposit
The PF continues to grow

HB 303: PF Reserve Earnings Account and the General Fund Inflation Proofing?

Callan's Est. Return on Permanent Fund Investments = 6.9%
POMV Draw = 5%
To the Earnings Reserve Account = 1.9%

To the Corpus of the Permanent Fund = 25% of Royalties
Total Royalties \$961M * 25% = \$240M

HB 303: PF Reserve Earnings Account and Inflation Proofing?



HB 303: The Dividend

Two Scenarios

Currently the bill holds the Oct 2016 Dividend harmless (status Quo)

This effects the amount of the POMV draw to the general fund

HB 303: The Dividend

Scenario 1

- Oct 2016 Dividend is Held Harmless (Status Quo)
- Dividend= More than \$2,000 (total payout \$1,405 Billion)
- POMV= \$1,269.3 Billion net increase to General Fund

- This cuts the Deficit by 1/3

HB 303: The Dividend

Scenario 2

- Oct 2016 The Royalties Swap Occurs

- Dividend= \$1,023.74 (total payout \$715.9 Billion)
- POMV= \$1,958.4 Billion net increase to General Fund
- This Cuts the Deficit in half

HB 303 Dividend and GF Scenarios

Scenario 1

- Oct 2016 Dividend at Status Quo

- Dividend= \$2,000
- POMV= \$1,269.3 Billion

- This Cuts the Deficit by 1/3

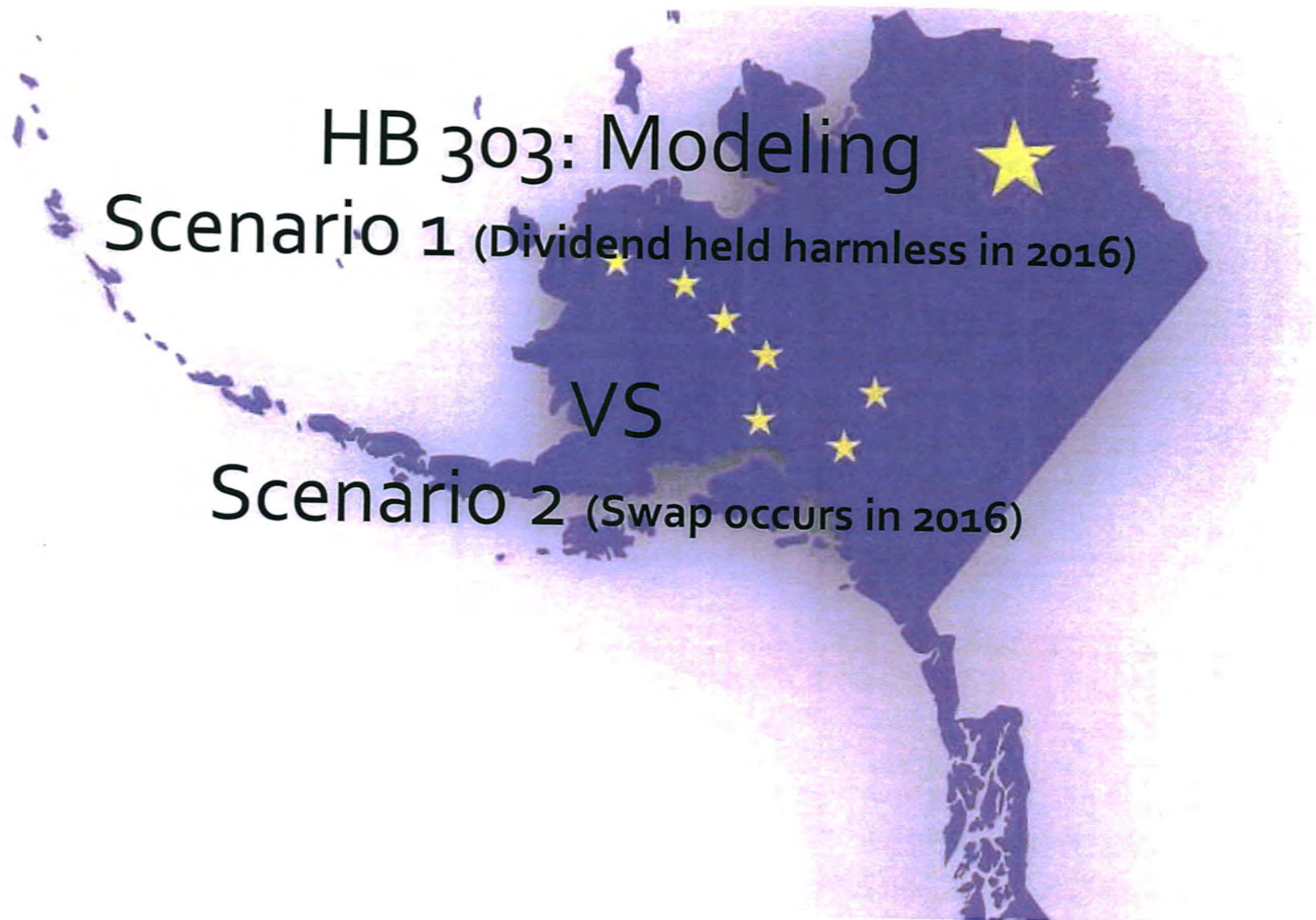
Scenario 2

- 2016 The Royalties Swap Occurs

- Dividend= \$1,023.74
- POMV= \$1,958.4 Billion

- This Cuts the Deficit in half

Difference: \$700Million



HB 303: Modeling

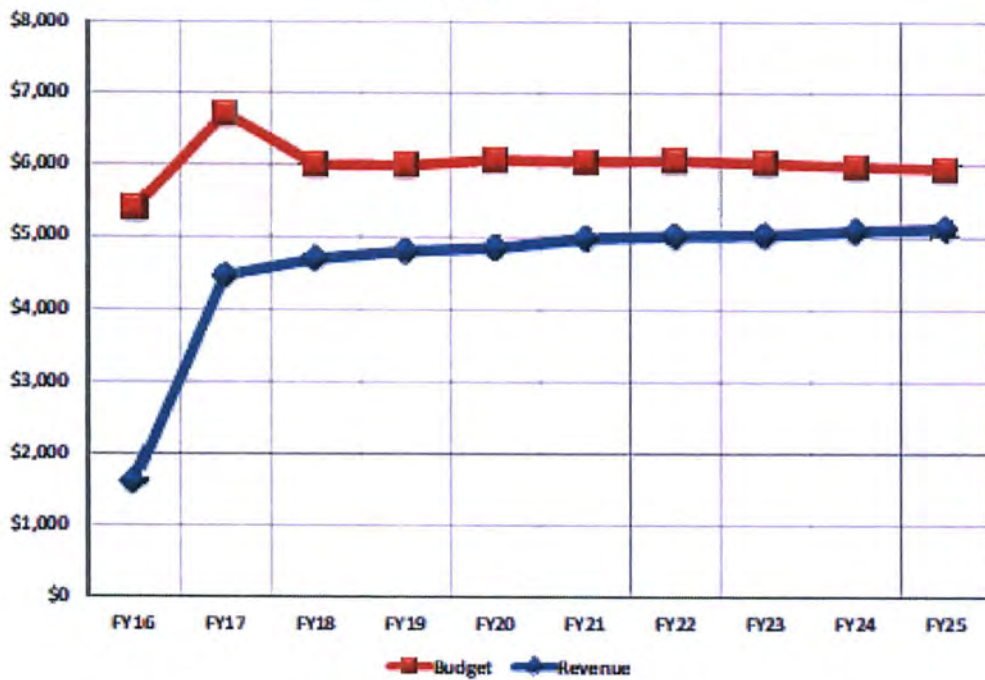
Scenario 1 (Dividend held harmless in 2016)

VS

Scenario 2 (Swap occurs in 2016)

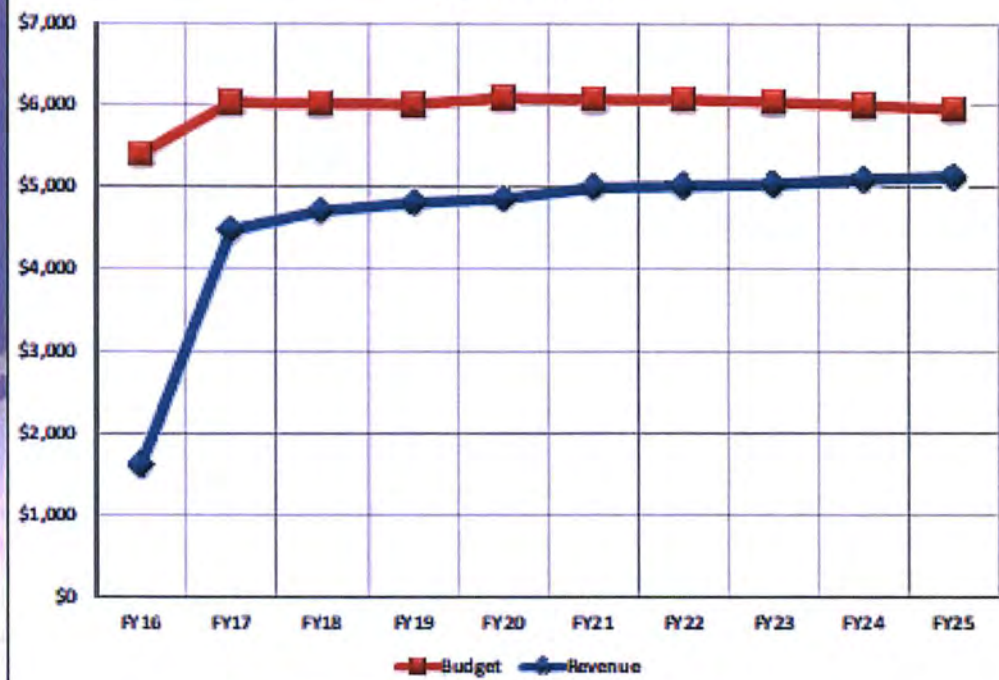
HB 303: Modeling

**UGF Revenue/ Budget
(\$ millions)**



Scenario 1
Dividend held harmless

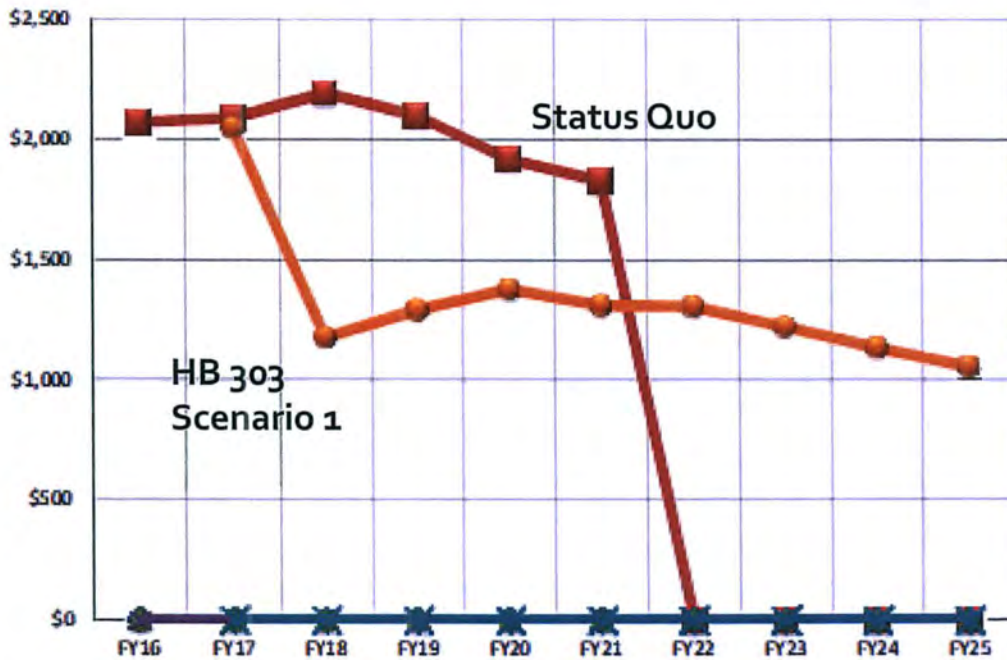
**UGF Revenue/ Budget
(\$ millions)**



Scenario 2
Swap occurs in 2016

HB 303: Modeling

Dividend Check



Scenario 1
Dividend held harmless

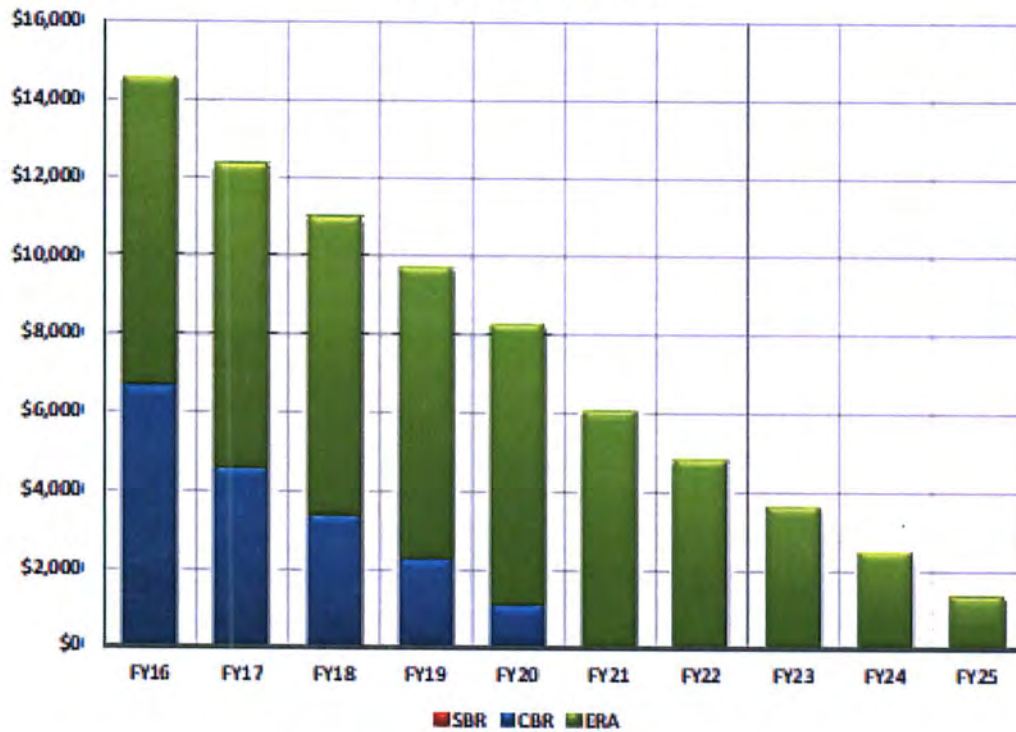
Dividend Check



Scenario 2
Swap occurs in 2016

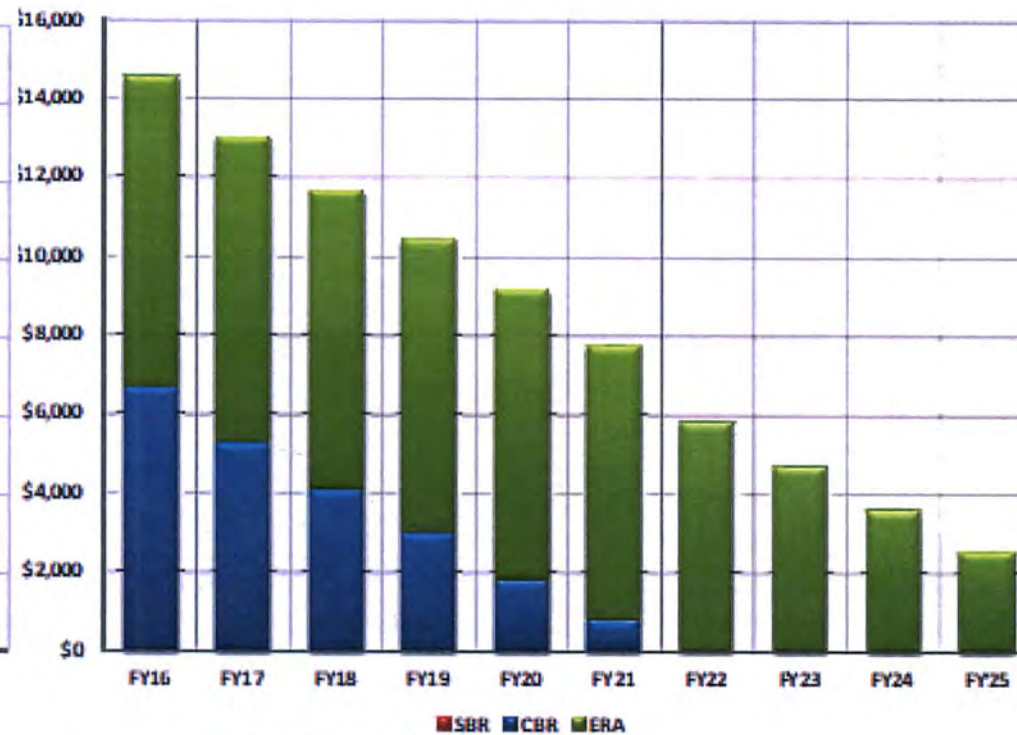
HB 303: Modeling

Budget Reserves



Scenario 1
Dividend held harmless

Budget Reserves



Scenario 2
Swap occurs in 2016

A map of Alaska is shown in a light purple color. Several yellow stars are placed on the map: one in the upper right, one in the center, and a cluster of five in the lower right. The text is overlaid on the map.

HB 303: Modeling
Scenario 1

Vs

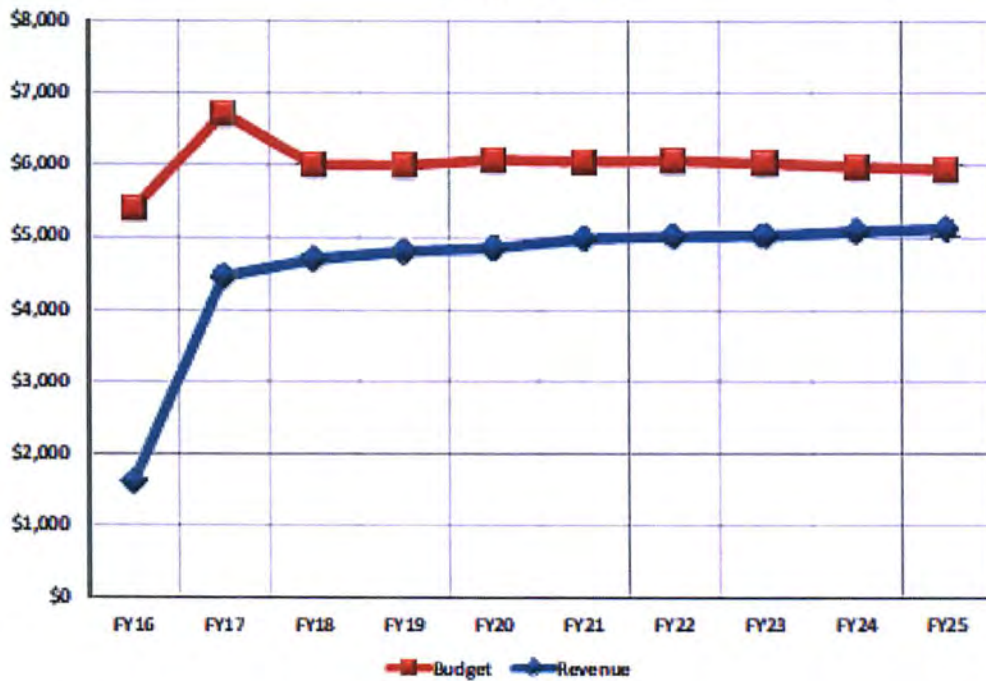
Status Quo

(Dividend held harmless in 2016)

SB 114: Modeling Scenario 1

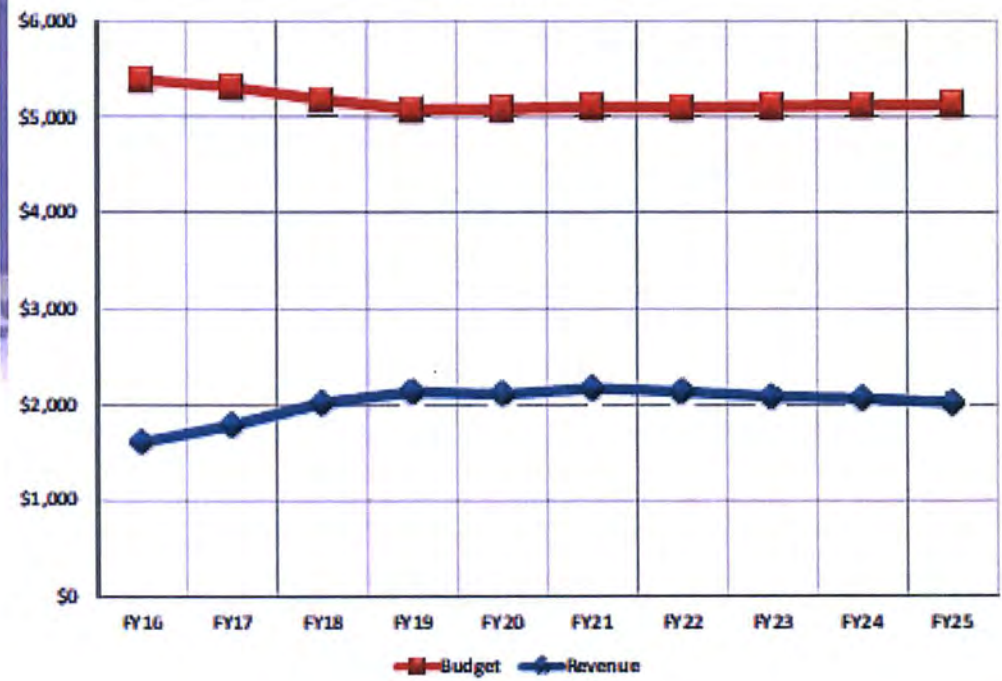


UGF Revenue/ Budget (\$ millions)



HB 303

UGF Revenue/ Budget (\$ millions)



Status Quo

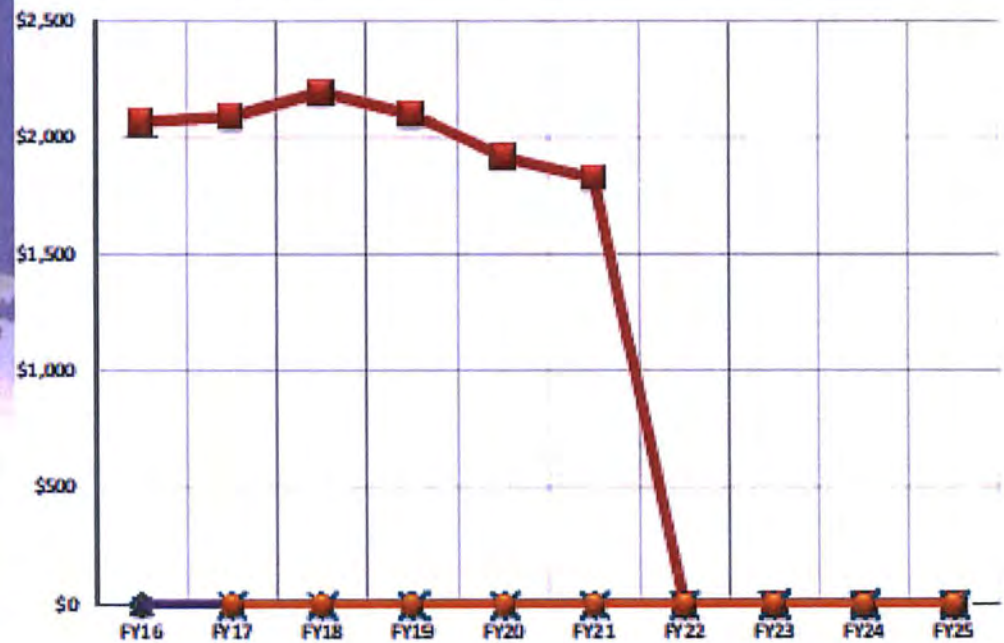
SB 114: Modeling Scenario 1

Dividend Check



HB 303

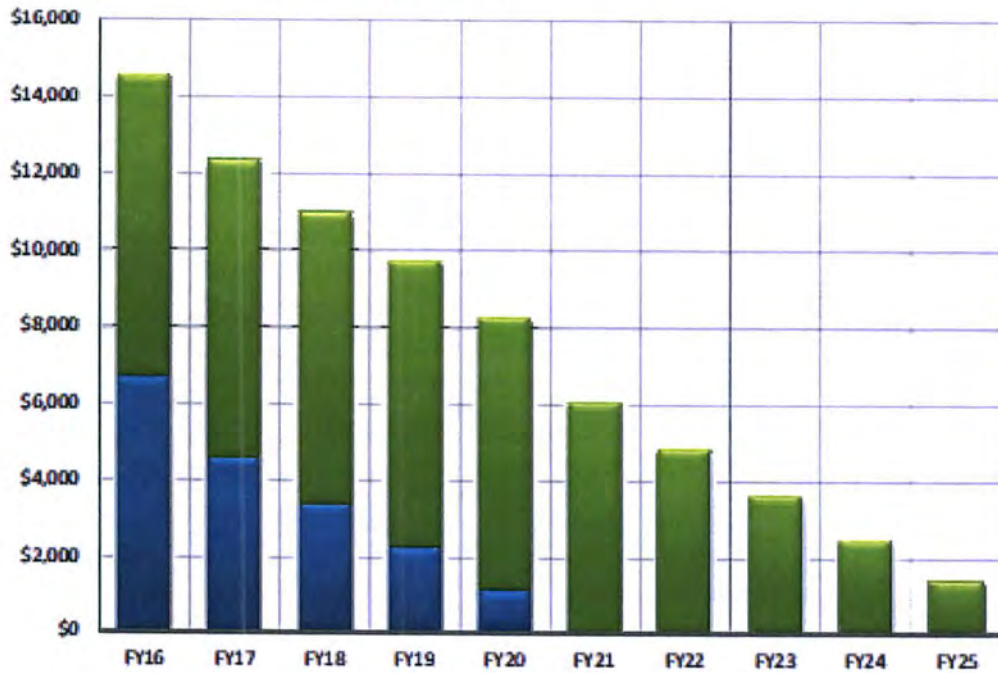
Dividend Check



Status Quo

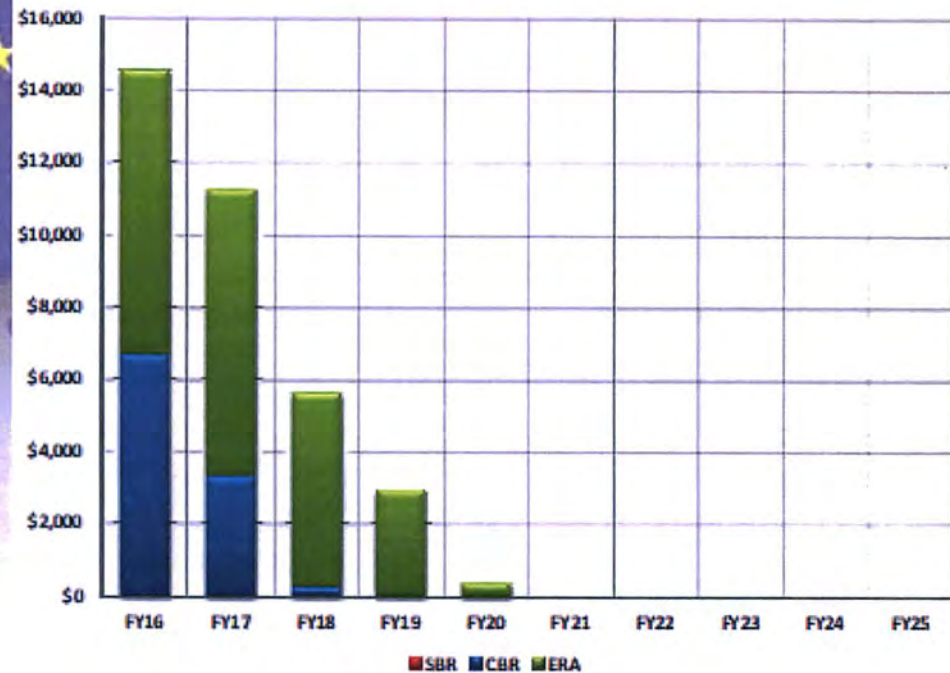
SB 114: Modeling Scenario 1

Budget Reserves



HB 303

Budget Reserves



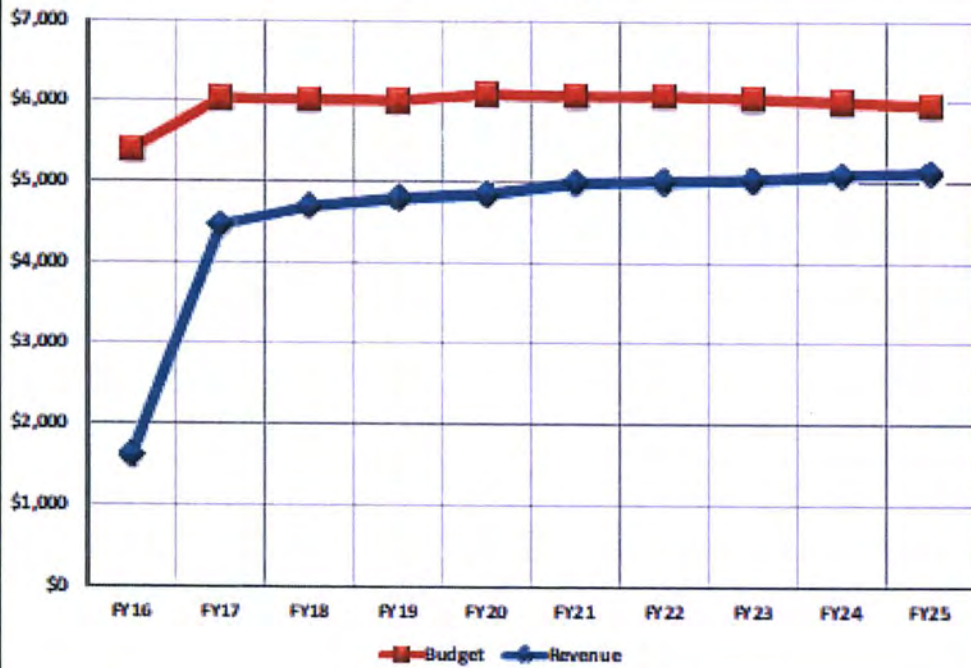
Status Quo

A map of the United States is shown with a purple glow around it. Several yellow stars are placed on the map, with one prominent star in the Northeast region. The text is overlaid on the map.

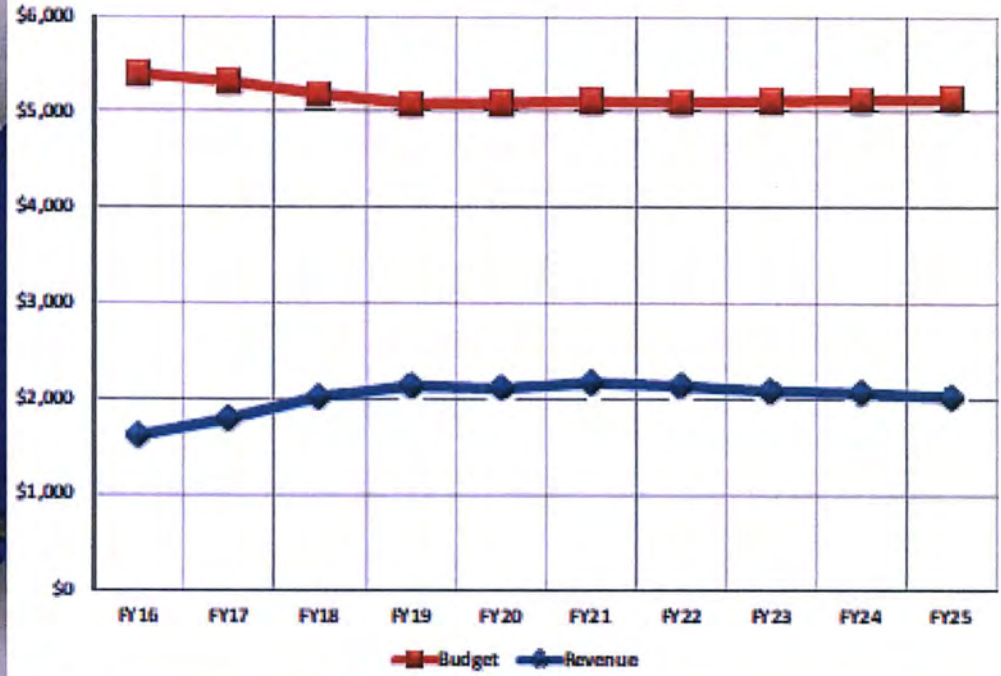
HB 303: Modeling
Scenario 2
VS
Status Quo

Dividend Swap in 2016

UGF Revenue/ Budget
(\$ millions)



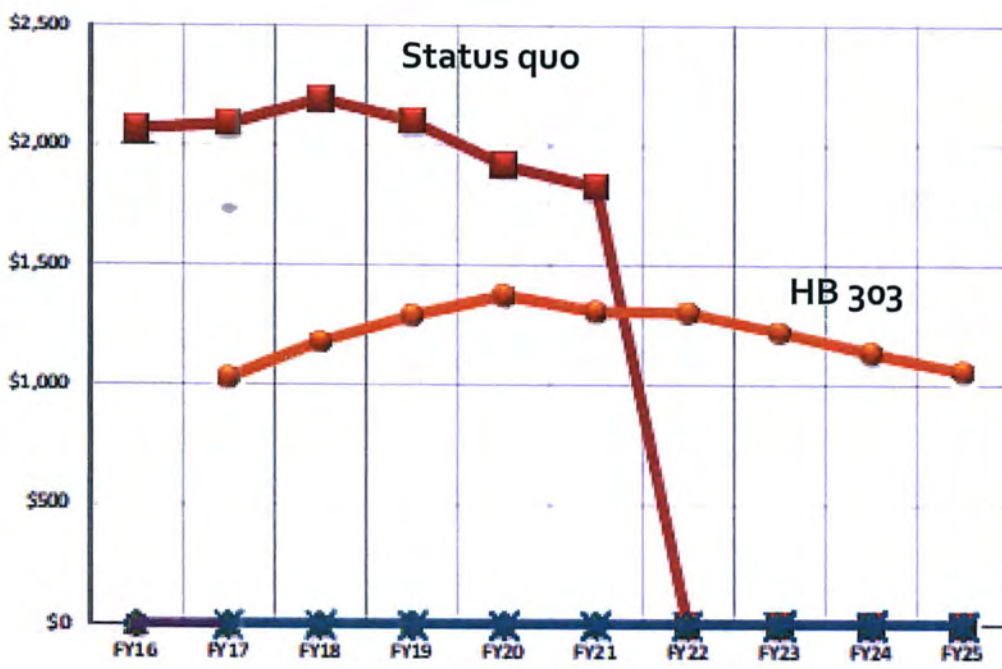
UGF Revenue/ Budget
(\$ millions)



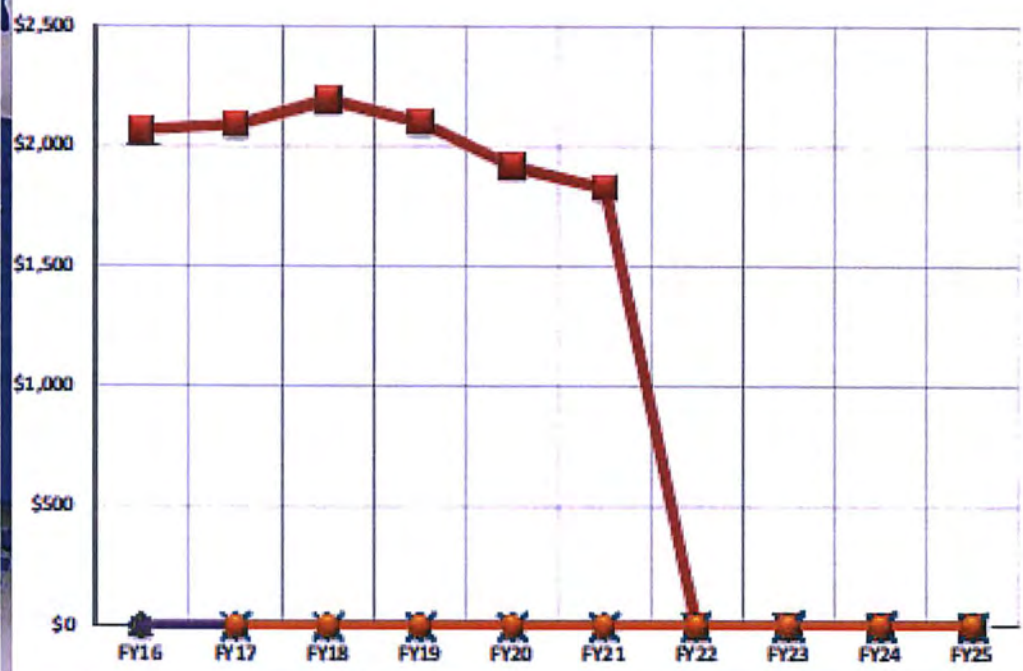
HB 303

Status Quo

Dividend Check



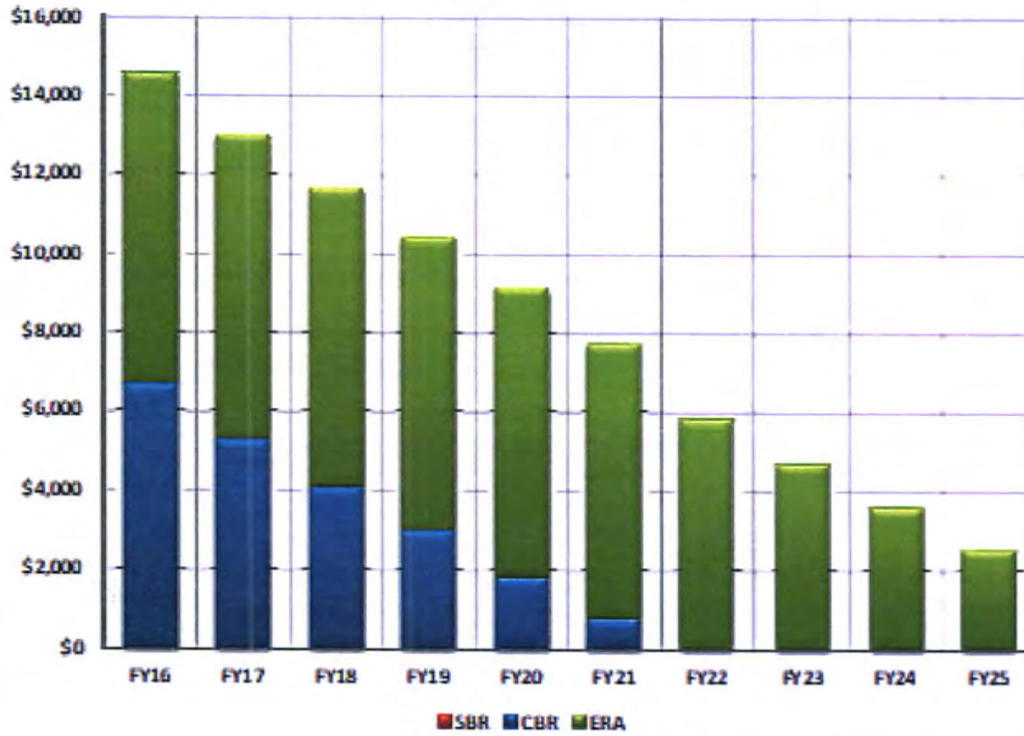
Dividend Check



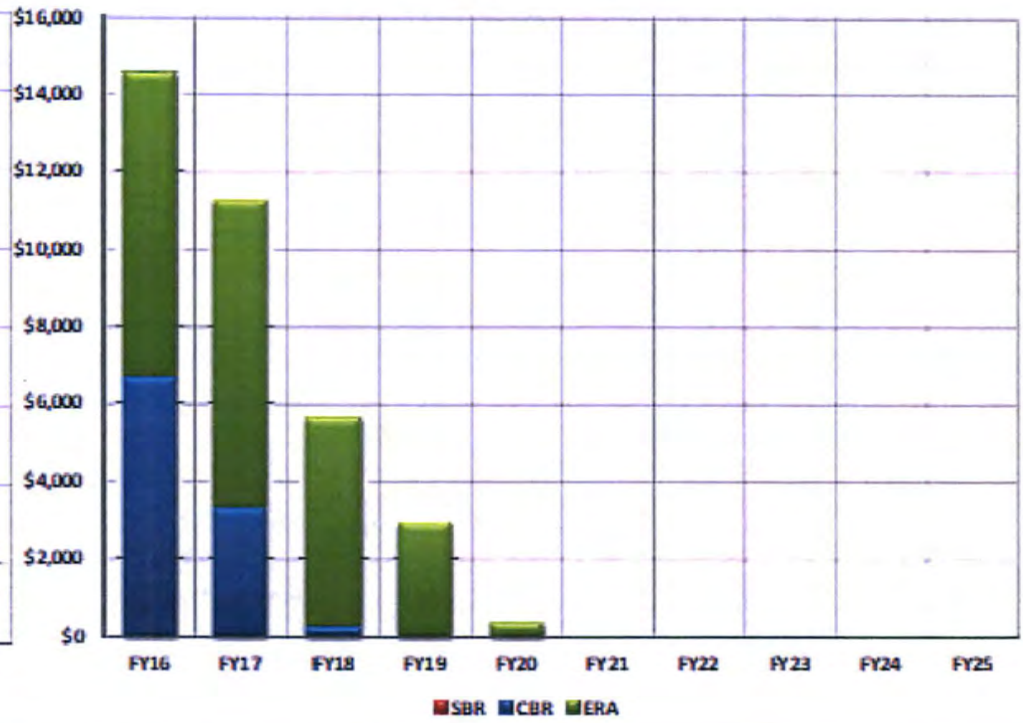
HB 303

Status Quo

Budget Reserves



Budget Reserves



HB 303

Status Quo



HB 303: The overall effect

A stylized graphic of the state of Alaska in a dark purple color, set against a lighter purple and white background. Several yellow stars are scattered across the map, with one prominent star in the upper right corner.

- Ties the Dividend directly to Oil & Gas and Mineral production
 - Currently structured to pay a dividend with a floor of \$1,000
 - Protects the Dividend for future generations
- Reduces the CBR draw to cover deficit
 - This will extend the life of the CBR several years
- Gives the legislature “Glide Path” (breathing room) to consider
 - Additional budget cuts
 - New sources of revenue
- Reduces the deficit between $\frac{1}{3}$ and $\frac{1}{2}$ depending on final formula (scenario 1 vs scenario 2)

HB 303: The overall effect



- Maintains downward pressure on the operating budget- by not closing the gap
- Provides for constitutional and statutory underpinnings of the PF
- Reduces the volatility in the budget process
 - Stability
- A POMV is a proven model and considered “Best Practice” by many fund managers

HB 303: Final Thoughts

- Alaska has always been a “Boom and Bust” state (now due to commodity volatility)
 - BUT, we don’t have to be
- We are in Chapter 38 of ALASKA
 - How do we want the next chapters to read?



HB 303: Our Glide Path