

# Reducing the Deficit: Investing Alaska's Vast Cash Reserves



## **Senate Bill 114**

Senator Lesil McGuire

Southeast Conference

3-16-16

# The Permanent Fund and the Dividend



November 1976- Voter Approved Constitutional Amendment Creating the Permanent Fund

2/11/1977- 9<sup>th</sup> 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)*

Dividend Established in 1980- Statutory Overlay to Constitution

*-base \$50 Dividend to each adult citizen for every year lived in Alaska since 1959*

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

HELD: The Alaska Dividend distribution Plan violated the guarantees of the Equal Protection Clause of the 14<sup>th</sup> Amendment

1982- First Dividend Issued to All Alaska Residents



# Is there Fiscal Problem?

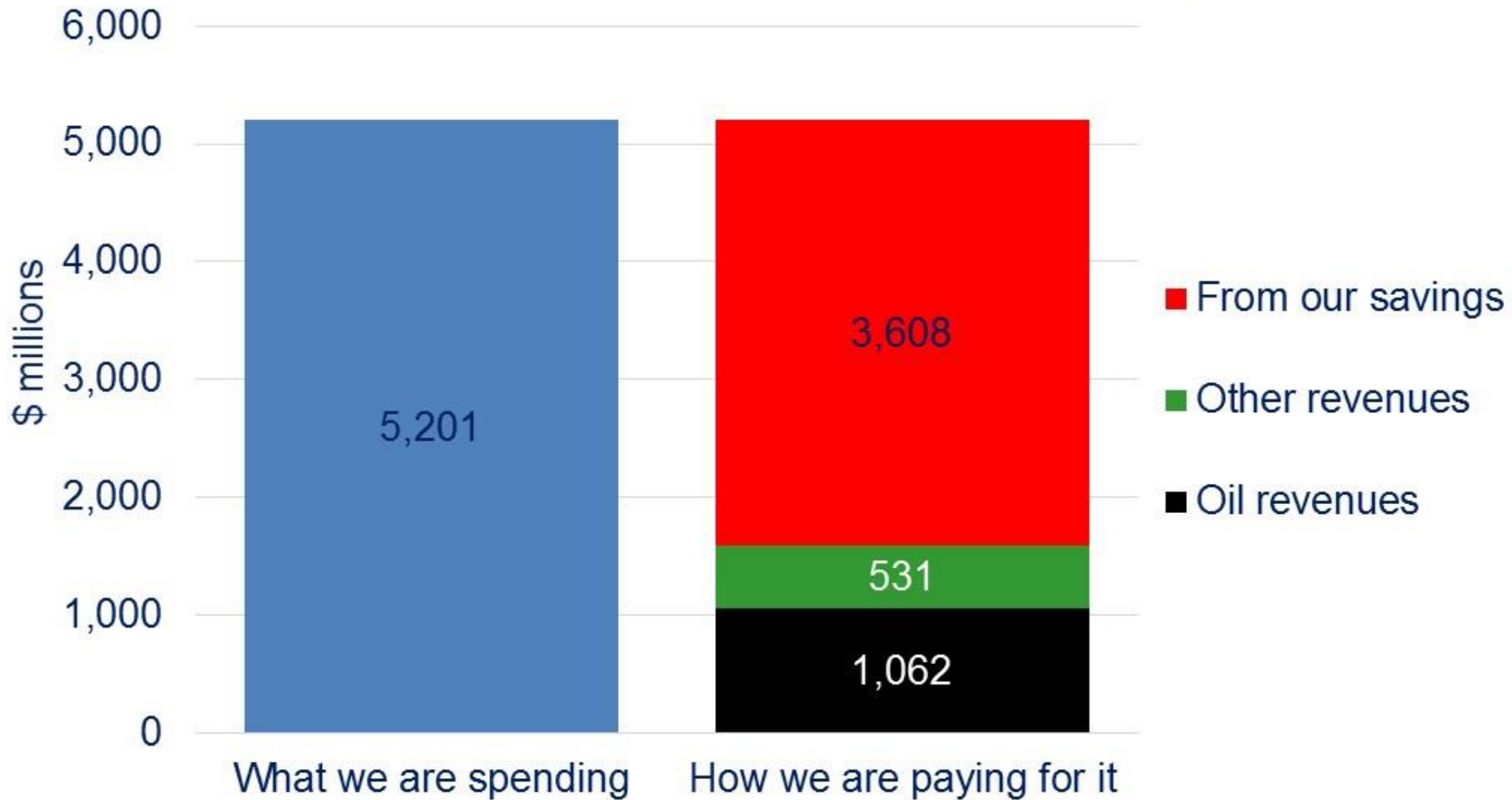
## We have a \$3.5 to \$4Billion Deficit

- The legislature has enacted heavy spending cuts over the last 2 years
- The state has several savings accounts, but

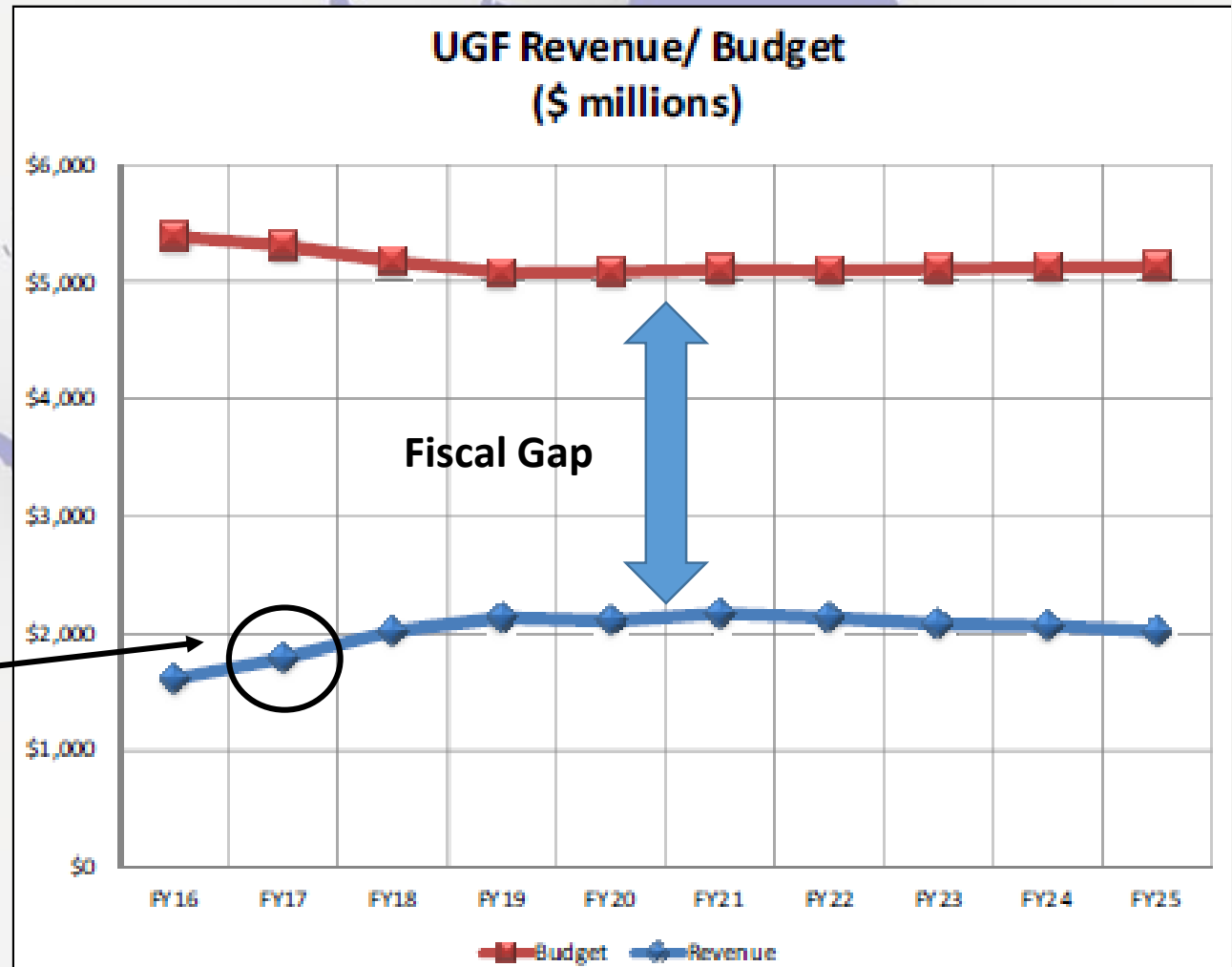
**Revenue models show that if oil prices do not rebound, those savings will be gone in about 2 years**

- 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)



# Defining the Problem



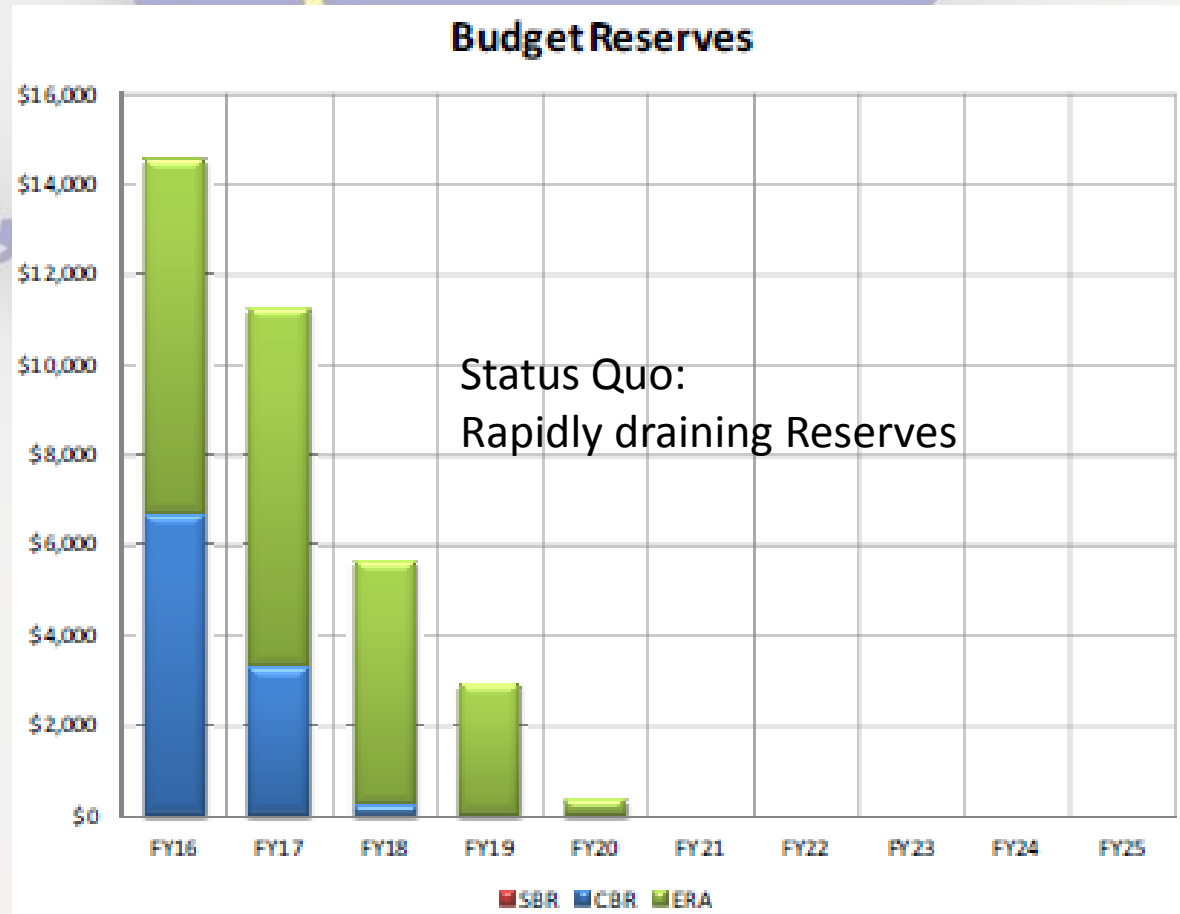
UGF for FY17 (status Quo)

Royalties \$800M  
Production Taxes \$200M  
Other Taxes \$800M

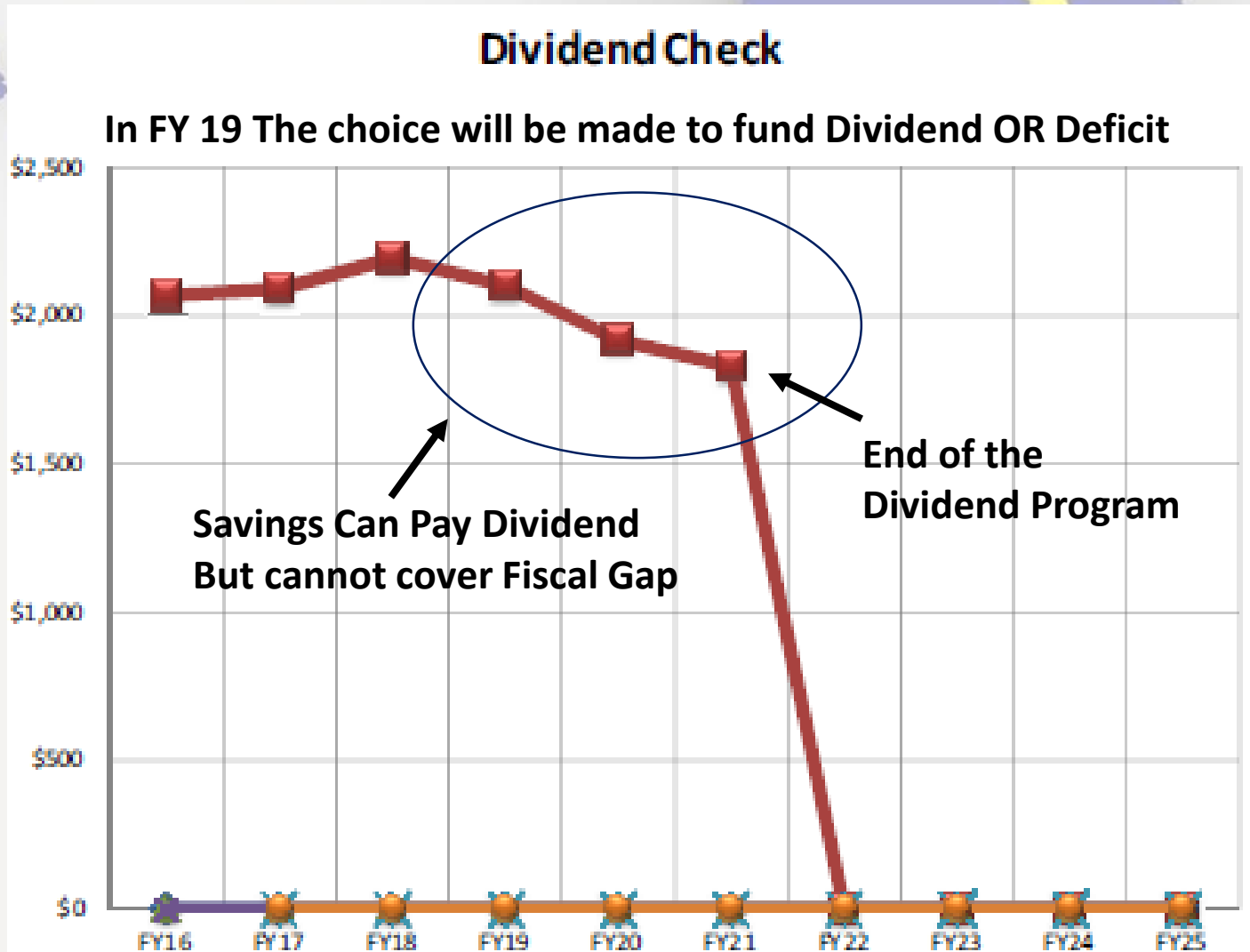
Total \$1.8 B

# The Cost of Doing Nothing/ Status Quo

- The longer we wait to act
  - The lower are our reserves
  - The higher the risk of Failure
- A lower reserve balance
  - Simply takes away choices we have to fill the deficit



# The Cost of Doing Nothing/ Status Quo



# Options without using the Earrings Reserve?

Reduce spending and Size and Cost of Government to match current Revenues  
And  
Raise New Revenue?

## UGF for FY17 (status Quo)

Royalties	\$800M
Production Taxes	\$200M
Other Taxes	\$800M
<b>Total</b>	<b>\$1,800 M</b>

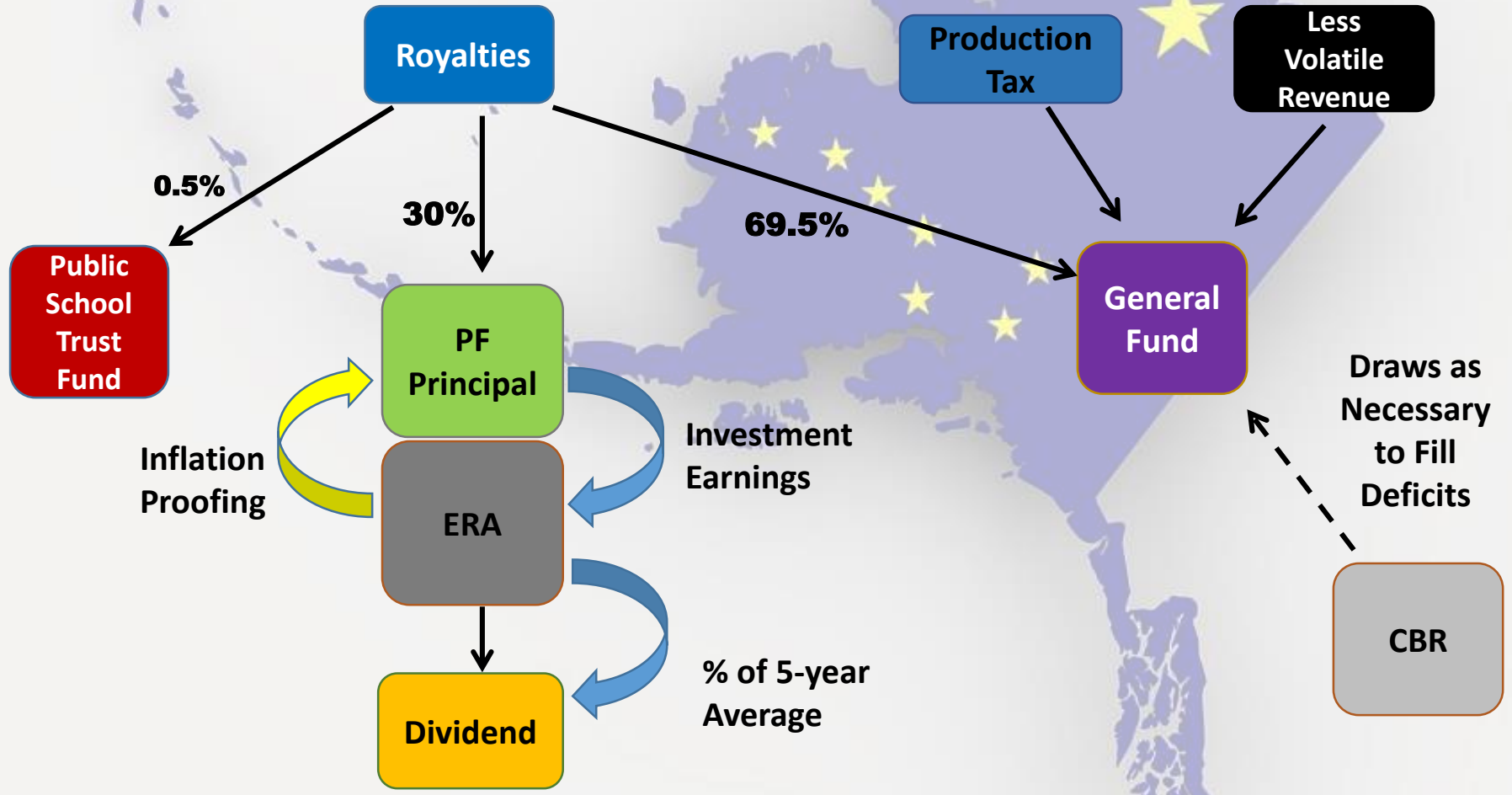
## Potential New Revenue from Sustainable Alaska Plan

**Total** \$457M

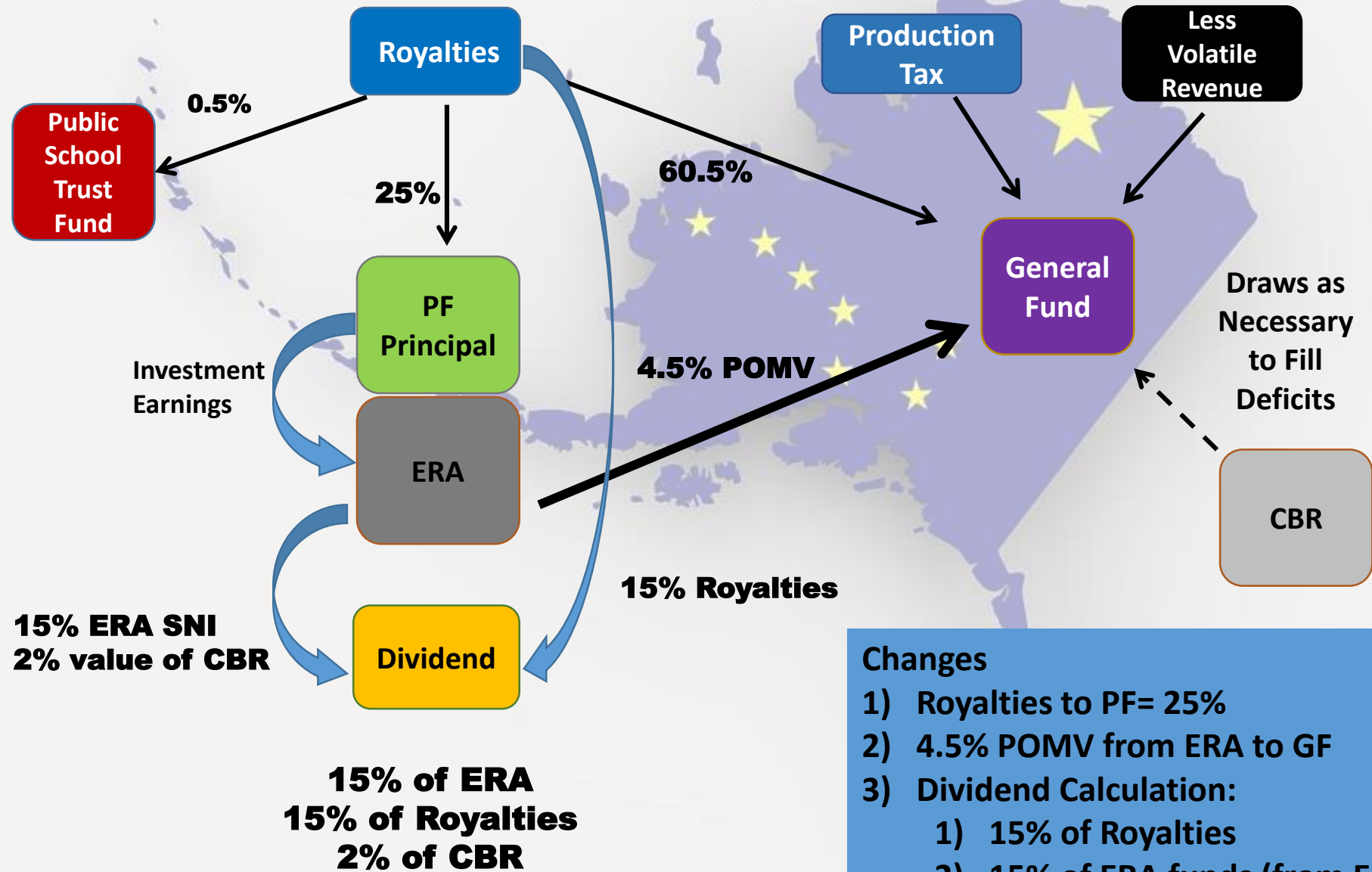
**Total= \$2.257Billion**

**\$3 Billion in Cuts**

# Current Cash Flow



# Proposed SB 114 Cash Flow



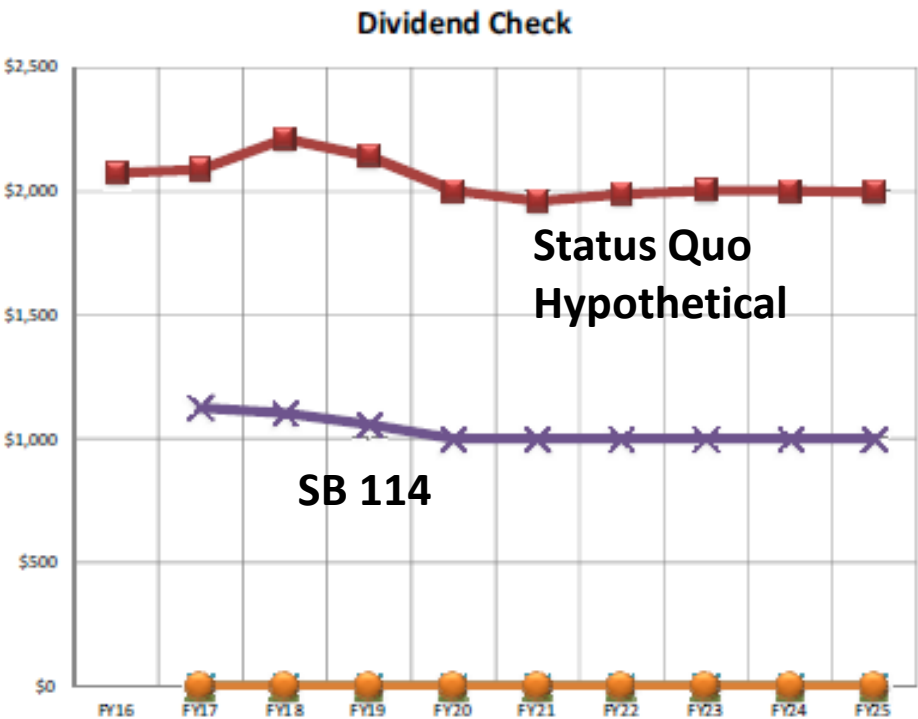
- Changes**
- 1) Royalties to PF= 25%
  - 2) 4.5% POMV from ERA to GF
  - 3) Dividend Calculation:
    - 1) 15% of Royalties
    - 2) 15% of ERA funds (from ERA)
    - 3) 2% of CBR (from ERA)

# The Overall Effect

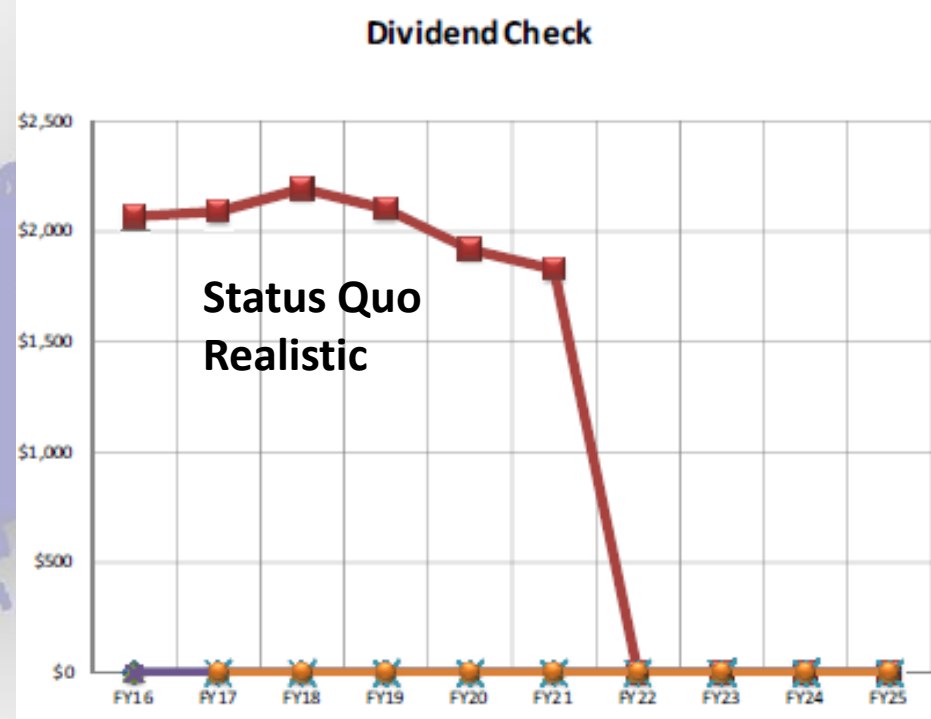


- **Reduces the Deficit by \$2.25 Billion**
  - Reduces volatility in budgeting
- Maintains downward pressure on state Spending
- Preserves the Dividend
  - With a minimum of \$1,000
- Reduces the CBR draw to cover deficit
- Helps maintain good state credit rating

# The Size of the Dividend



**SB 114**  
Has a minimum  
\$1,000 Dividend



**Status Quo**  
Dividend Program WILL END

# The Reserves SB 114 vs. Status Quo

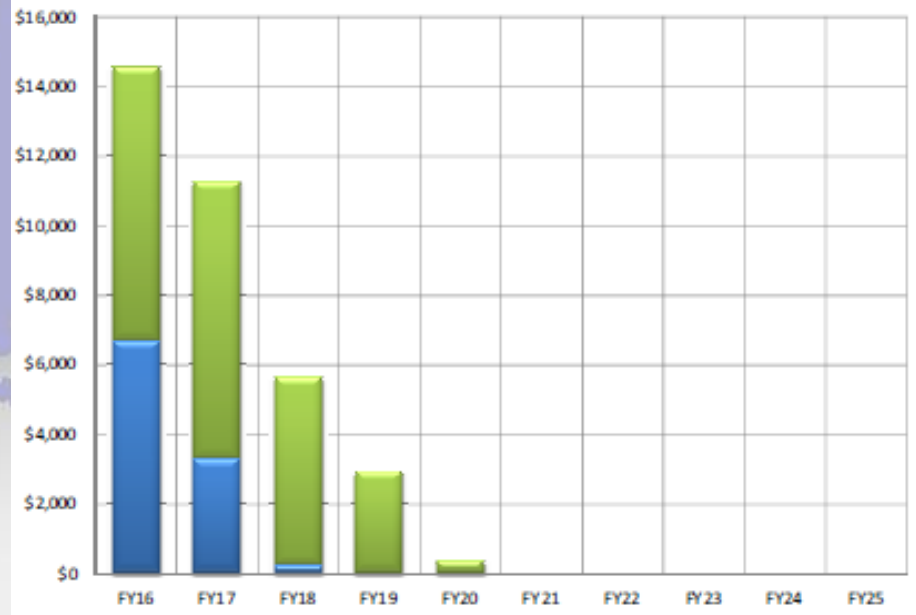
Budget Reserves



CBR
  ERA

**SB114**

Budget Reserves

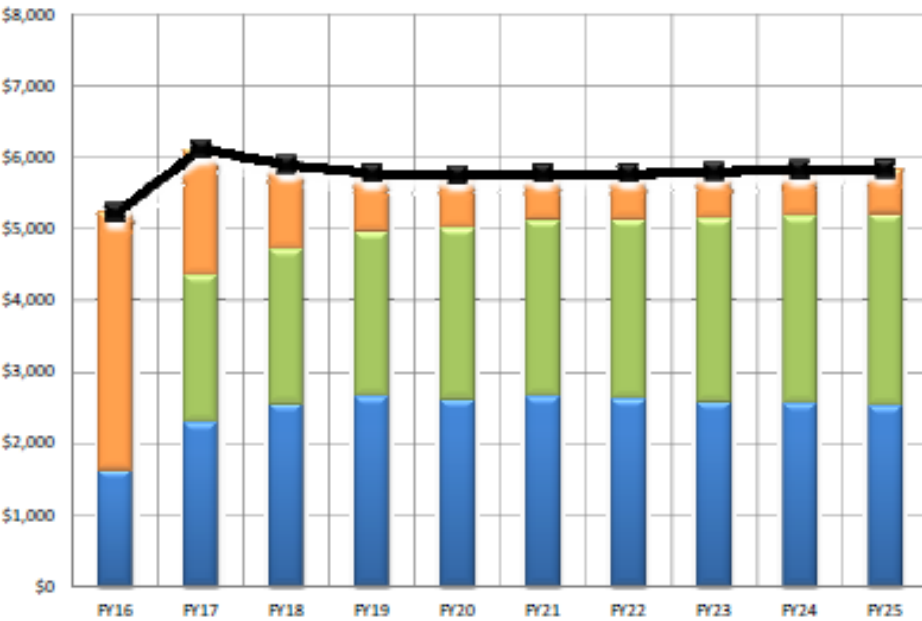


CBR
  ERA

**Status Quo**

# The Reserves SB 114/ Status Quo

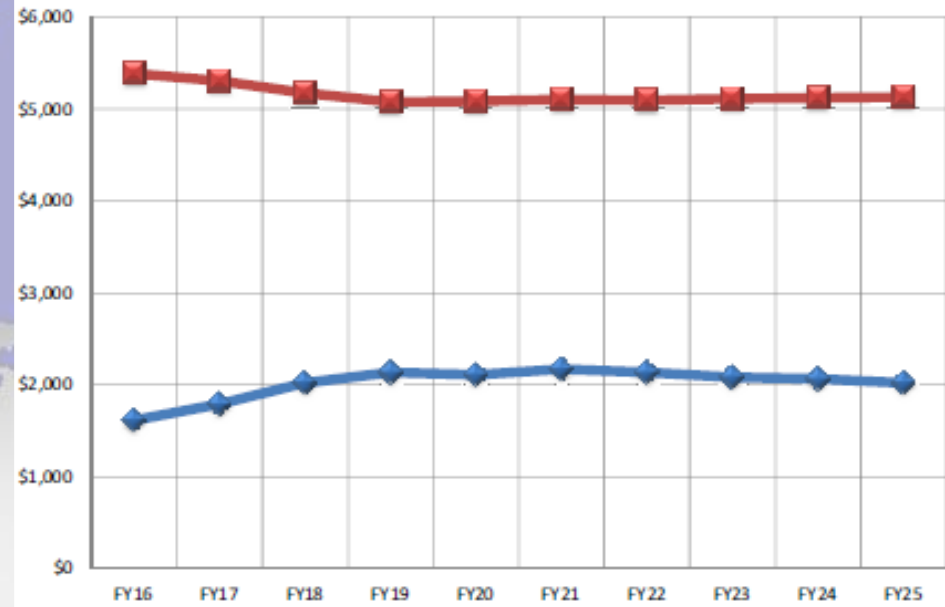
UGF Revenue/ Budget (\$ millions)



■ CBR   
 ■ ERA   
 ■ Revenue

**SB114**

UGF Revenue/ Budget (\$ millions)



■ Revenue   
 ■ Status Quo Budget

**Status Quo**

# POMV and Inflation Proofing

Callan's Est. Return on Permanent Fund Investments = 6.9%

POMV Draw = 4.5%

To the Earnings Reserve Account = 2.4%



To the Corpus of the Permanent Fund = 25% of Royalties

Total Royalties \$961M \* 25% = **\$240M**

The Bill also allows inflation proofing to the Principle if the ERA is 4 times the size of the POMV Draw

# Review oversight



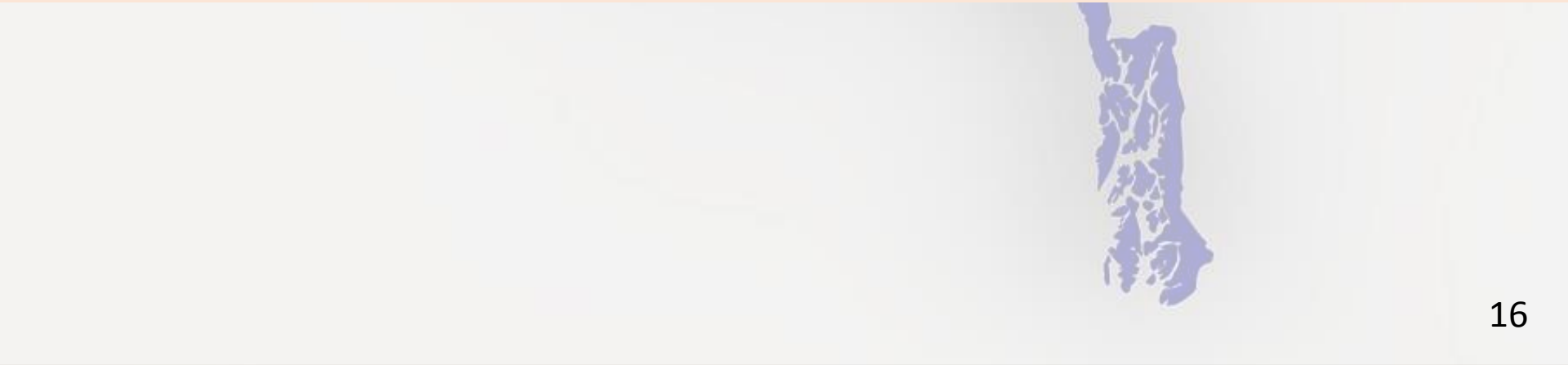
**Each year on or before January 30**

**The commissioner of revenue may consult with the Permanent Fund board and recommend**

- **Adjustments to the percentages of money appropriated to the dividend**

**Each year on or before January 30**

**The commissioner of revenue Shall provide a legislative report that:**

- **Evaluates the sufficiency of the assets in the ERA**
  - **Evaluates the amount projected to be distributed to the General Fund**
- 

# Revenue Limitations From POMV Draw

\$ Billions		
Production Taxes (PT)	POMV Draw (4.5%)	PT and POMV Draw
\$0.5	\$2.25	\$2.75
\$1.0	\$2.25	\$3.25
\$2.0	\$1.25	\$3.25
\$3.0	\$0.25	\$3.25
\$3.5	\$0.00	\$3.50
\$4.0	\$0.00	\$4.00
\$5.0	\$0.00	\$5.00

- For Oil revenue over \$1B there is a corresponding reduction of the POMV draw
- This improves the sustainability of payouts from the ERA
- Reduces the risk of increasing spending in high years of petroleum revenue
- Reduces the volatility in the budgeting process for UGF expenditures

# Conclusion/Summary



- SB 114 *is NOT*
  - A raid on the Permanent Fund
    - SB114 would only draw from the Earnings Reserve Account
  - A way for Government to increase spending
  - A dividend Killer
- SB 114 *IS*
  - A way to share the risks and rewards of the states fiscal health
  - A way to protect the dividend into the future
  - A way to ensure that services we enjoy continue to be provided
    - Police
    - Firefighters
    - Roads
    - Education
    - Health and Social Services
    - The Marine Highway
    - Parks and Recreation
    - Fish and Game Management

# Questions?

