Unlocking our Petroleum Wealth Potential: A Game Plan for Meeting Alaska's Fiscal Challenge

State of Alaska
House Special Committee on Economic Development, Tourism, and Arctic Policy
Anchorage, Alaska
December 9, 2015

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Take Away

- There is no solution to our Fiscal Challenge without use of the earnings of the Permanent Fund.

- We can use the earnings without compromising either the Permanent Fund or the Permanent Fund dividend.

- Use of the earnings is challenging since no other state, and probably no other nation, has had a fiscal structure relying primarily on the earnings of its accumulated wealth.

- We have several proposals for implementing the use of earnings to help us start thinking about the best solution.

- Crafting a successful solution (game plan) will require everyone working together.
Fiscal Challenge: Cautious View
Time is Running Out

CONSTITUTIONAL BUDGET RESERVE (Billion $)

Start of Fiscal Year

<table>
<thead>
<tr>
<th>Year</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
<th>2021</th>
</tr>
</thead>
<tbody>
<tr>
<td>Value</td>
<td>$6</td>
<td>$5</td>
<td>$3</td>
<td>$0</td>
<td>$0</td>
</tr>
</tbody>
</table>
Fiscal Gap: Zombie Solutions

- Natural Resource Development
- Value Added Processing
- Economic Diversification
- Infrastructure Investments in Power and Transportation
- Footloose Industry
- Renewable Energy
Fiscal Gap:
Nickel and Dime Solutions

- Lottery
- Marijuana Tax
- Increase the....
  - Gas Tax
  - Fish Tax
  - Mining Tax
  - Tourism Tax
  - Alcohol Tax
  - Tobacco Tax
  - School Tax
- Health Care Provider Tax
Fiscal Gap: Silver Bullet Blank Solutions

- Squeeze Petroleum
  - Increase Production Tax Minimum
  - Eliminate GVR (lower tax rate on new oil)
  - Increase Production Tax Rate / Progressivity
  - Gas Reserves Tax

- Optimize Financial Asset Portfolio
  - Pension Obligation Bonds
  - Adjust Debt to Equity Ratio
  - Leverage Assets
Fiscal Gap: 3 REAL Tools

- MORE BUDGET CUTS
- INCOME TAX/SALES TAX/PFD REDUCTION
- EARNINGS FROM STATE ASSETS

PICK ANY 3 FROM THE LIST ABOVE!
Why Not Do Nothing?
Fiscal Challenge: Fill the Gap

UNRESTRICTED GENERAL FUND (Bill $)

- $0
- $5
- $10

Year:
- 2017
- 2021
- 2025
- 2029
- 2033
- 2037
- 2041
Cut the Budget

UNRESTRICTED GENERAL FUND (Bill $)

$10
$5
$0

2017 2021 2025 2029 2033 2037 2041
Add Income or Sales Tax

UNRESTRICTED GENERAL FUND (Bill $)

- $10
- $5
- $0

2017 2021 2025 2029 2033 2037 2041

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Understanding Alaska:
Special Economic Studies
Double the Oil Production Tax
Add Gas Line Revenues

UNRESTRICTED GENERAL FUND (Bill $)

2017 2021 2025 2029 2033 2037 2041

$0 $5 $10
Don’t Use PF Earnings: Negative Economic Effects

• Budget cuts
• Taxes on households
• Petroleum investment
• Business community confidence
Meanwhile: Permanent Fund

**PERMANENT FUND ( Billion $ )**
Start of Fiscal Year

<table>
<thead>
<tr>
<th>Year</th>
<th>Principal</th>
<th>Earnings Reserve</th>
</tr>
</thead>
<tbody>
<tr>
<td>2017</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2021</td>
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<td>2037</td>
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<tr>
<td>2041</td>
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</tbody>
</table>

**PERMANENT FUND: TOTAL EARNINGS ( Billion $ )**

- **ACTUAL**
- **Trend**

**PERSONAL INDICATORS**
(Real Thousand $ Per Person)

<table>
<thead>
<tr>
<th>Year</th>
<th>UGF Spend</th>
<th>Personal Taxes</th>
<th>PFD</th>
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<tbody>
<tr>
<td>2017</td>
<td></td>
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</tbody>
</table>
Add a Gas Line?

UNRESTRICTED GENERAL FUND (Bill $)

- $10
- $5
- $0

2017 2021 2025 2029 2033 2037 2041
Or a Tax?

UNRESTRICTED GENERAL FUND (Bill $)

$10

$5

$0

2017  2021  2025  2029  2033  2037  2041
The Permanent Fund

**PERMANENT FUND ( Billion $ )**
Start of Fiscal Year

**PERMANENT FUND: TOTAL EARNINGS ( Billion $ )**

**PERSONAL INDICATORS**
(Real Thousand $ Per Person)
Tradeoff

**PF DIVIDEND (2015$)**

- **NO**
- **YES**

**PERMANENT FUND EARNINGS (Billion $)**
Use Permanent Fund Earnings--Economic Impact

NO DRAW FROM POCKETS OF ALASKANS TODAY

SIGNAL OF CONFIDENCE FOR INVESTORS
Postpone Inevitable Tug of War

No Income Tax!
No Sales Tax!
No Dividend Cuts!
No Budget Cuts!
Implementation: Alaska Fiscal Structure

- Permanent Fund Corpus
- unrestricted general fund spending
- unrestricted general fund
- petroleum royalties
- non-royalty petroleum revenues
- non-petroleum revenues
- statutory income
- inflation proofing
- CBR
- ER
- PF dividend
Proposals for Use of Earnings

ACCESS TOTAL EARNINGS OF PF--POMV (Constitutional Endowment)
- Fold Earnings Reserve into PF Corpus
- Draw 4.5% - 5% of PF value from PF Corpus
- Divide draw between UGF and PF Dividend

IMMEDIATE PLUG--SB114 (Statutory POMV)
- Draw 5% of PF value from PF Earnings Reserve for UGF
- Pay PF Dividend from 75% of Royalties (with a floor)

STABILIZE REVENUE STREAM—GOVERNOR WALKER PROPOSAL (Statutory Sovereign Wealth Fund)
- Dump SB21 revenues and additional 25% of Royalties into PF Corpus
- Transfer $3 Billion from CBR to ER
- Draw % of PF value or $3.1 Billion from PF Earnings Reserve for UGF (inflation adjusted amount that sustains PF value)
- Pay PF Dividend from 50% of Royalties

SUSTAINABILITY--SUSTAINABLE SPENDING (Statutory)
- Draw amount from PF Earnings and Earnings Reserve) that, together with current Petroleum Revenues, equals the Sustainable level
- Divide draw between UGF and PF Dividend
Sustainability

A spending level based on current and projected future revenue streams which, if adopted now, could be maintained consistently long into the future--adjusted for inflation and population growth.
Some Criteria for Choice

- STABILITY OF REVENUES
- DISCIPLINE SPENDING
- SUSTAINABLE
- FAIR TO ALL ALASKANS
- UNDERSTANDABLE
- IMPLEMENTABLE
- FLEXIBLE
- PROTECT ASSETS
- MINIMIZES UNINTENDED CONSEQUENCES
Strategy Moving Forward

- **THIS YEAR**
  - Budget Cuts
  - Structured Use of PF Earnings

- **NEXT YEAR**
  - Budget Cuts continued
  - Tug of War
    - Income Tax
    - Sales Tax
    - Dividend Reduction
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