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

Commonwealth North
Fiscal Policy Study Group
Anchorage, Alaska
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Institute of Social and Economic Research
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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

• Primary reliance on earnings is an unusual, if not unique, fiscal structure and thus a challenge to implement successfully

• Current proposals have different concepts of SUSTAINABILITY and force us to consider which target is most appropriate

• The amount we can sustainably spend depends on future petroleum revenues and the investment rate of return—-we cannot avoid deciding what assumptions are most appropriate

• We have just begun the task of crafting a workable plan for use of Permanent Fund earnings and it won’t be easy
Fiscal Challenge: Cautious View

Based on DOR Fall 2015 Revenues
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
- School Tax
- Health Care Provider Tax
- Increase the....
- Fish Tax
- Mining Tax
- Tourism Tax
- Gas Tax
- Alcohol Tax
- Tobacco 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 $)

$10

$5

$0

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 $)**

- **$0**
- **$5**
- **$10**

- 2017
- 2021
- 2025
- 2029
- 2033
- 2037
- 2041

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Understanding Alaska:
Special Economic Studies
Double the Oil Production Tax

**UNRESTRICTED GENERAL FUND (Bill $)**

-$10$

-$5$

-$0$

2017  2021  2025  2029  2033  2037  2041
Don’t Use PF Earnings: Negative Economic Effects

• Budget cuts
• Taxes on households
• Petroleum investment
• Business community vote of no confidence
Meanwhile: Permanent Fund

PERMANENT FUND (Billion $)
Start of Fiscal Year

PERMANENT FUND: TOTAL EARNINGS (Billion $)

PERSONAL INDICATORS (Real Thousand $ Per Person)
Fiscal Challenge: Fill the Gap

UNRESTRICTED GENERAL FUND (Bill $)

$10

$5

$0

2017 2021 2025 2029 2033 2037 2041
Cuts + PF Earnings Draw

UNRESTRICTED GENERAL FUND (Bill $)

2017 2021 2025 2029 2033 2037 2041

$10

$5

$0
Add a Tax?

UNRESTRICTED GENERAL FUND (Bill $)

|$10

|$5

|$0

2017 2021 2025 2029 2033 2037 2041
Or a Gas Line?
The Permanent Fund

PERMANENT FUND (Billion $)
Start of Fiscal Year

$150
$100
$50
$0
2017 2021 2025 2029 2033 2037 2041

PERMANENT FUND: TOTAL EARNINGS (Billion $)

$9
$8
$7
$6
$5
$4
$3
$2
$1
$0
2017 2021 2025 2029 2033 2037 2041

PERSONAL INDICATORS (Real Thousand $ Per Person)

$8
$6
$4
$2
$0
2017 2021 2025 2029 2033 2037 2041

UGF SPEND PERSONAL TAXES PFD
Tradeoff

Available for the General Fund

PF DIVIDEND (2015$)

<table>
<thead>
<tr>
<th>Year</th>
<th>NO</th>
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<tbody>
<tr>
<td>2017</td>
<td></td>
<td></td>
</tr>
<tr>
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<td>2025</td>
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<tr>
<td>2041</td>
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PERMANENT FUND EARNINGS (Billion $)

<table>
<thead>
<tr>
<th>Year</th>
<th>2017</th>
<th>2021</th>
<th>2025</th>
<th>2029</th>
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Use Permanent Fund Earnings: Short Term Effects

- No solution without this tool
- Biggest single tool in solution
- No Negative Economic Impact from Taxes
- Negative Economic Impact from Cuts alone less damaging to Economy
- Centerpiece of a workable GAME PLAN
- Positive Economic Impact from Confidence Boost
- Relatively easy to implement
- And........
Buy Time to Prepare for the Inevitable and Prolonged Tug of War

No Income Tax!

No Sales Tax!

No Dividend Cuts!

No More Budget Cuts!
Implementation: Alaska Fiscal Structure

Diagram showing the flow of funds between different funds and revenues.

- **Non-Royalty Petroleum Revenues**
- **Petroleum Royalties**
- **Permanent Fund Statutory Income**
- **Non-Petroleum Revenues**
- **C BR**
- **Unrestricted General Fund**
- **Unrestricted General Fund Spending**
- **Per Capita Dividend**
- **Permanent Fund Corpus**
- **Inflation Proofing**

Flow arrows indicate the movement of funds and revenues, with specific percentages and connections indicated.
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

- **CREMO PLAN (Constitutional Endowment)**
  - Similar to POMV except ALL petroleum revenue deposited into PF

- **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
  - Draw % of PF value or $3.2 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
Fiscal Structure: 2 Policy Switches

PERMANENT FUND CORPUS

25% ROYALTIES

OIL REVENUES

Share to PF

EARNINGS RESERVE

Draw Type

SPENDING
- GENERAL FUND
- PF DIVIDEND
## Compare Spending Level: DOR Assumptions

<table>
<thead>
<tr>
<th>PLAN</th>
<th>% of PF</th>
<th>Draw Type</th>
<th>FY 2017 SPEND FROM ASSETS: ugf+dividend</th>
<th>DRAW NOTES</th>
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<tbody>
<tr>
<td>POMV</td>
<td>NONE</td>
<td>%</td>
<td>$4</td>
<td>$2.7</td>
</tr>
<tr>
<td>SB114</td>
<td>NONE</td>
<td>%</td>
<td>$4</td>
<td>$2.7</td>
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<tr>
<td>GOV-SWF</td>
<td>SOME</td>
<td>Amt</td>
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<td>ALL</td>
<td>Amt</td>
<td>$3.4</td>
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Sustainability Target

A spending level based on current financial assets and the projected future petroleum revenue stream which, if adopted now, could be maintained consistently long into the future--adjusted for inflation and population growth.
Complication: 2 Assets in Portfolio

- Cash in the Bank
- Revenues from Future Petroleum Production

- Coordination Needed during Transition to Complete Rentier Fiscal Structure
- Value of Financial Asset Must Increase at Rate to Offset Decrease in Value of Petroleum
Quasi-Sustainability of Gov Plan

Value of Portfolio Falls Tomorrow

Due to Overspending Today

STATE ASSET PORTFOLIO: PER CAPITA

SPENDING FROM ASSETS: PER CAPITA
2 Critical Assumptions

Future Petroleum Revenues

Fiscal Structure: 2 Policy Levers

Return on the PF
Effect of Different Assumptions

**FY17 SPENDING: DOR Assumptions**

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<tr>
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<th>GOV</th>
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<th>CREMO</th>
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<tbody>
<tr>
<td>Billion $</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>DRAW</td>
<td>3.5</td>
<td>3.0</td>
<td>1.5</td>
</tr>
<tr>
<td>OIL REV</td>
<td>0.5</td>
<td>0.5</td>
<td>0.0</td>
</tr>
<tr>
<td>Sustainable Target</td>
<td>5.0</td>
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**FY17 SPENDING: Higher Oil Revenues**

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**FY17 SPENDING: Higher Fund Return**

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Some Criteria for Choice

• SUSTAINABLE
• STABILITY OF REVENUE STREAM
• IMPOSE DISCIPLINE ON SPENDING
• 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—TUG OF WAR**
  - More Budget Cuts
  - Dividend Reduction
  - Sales Tax
  - Income Tax