Accessing Permanent Fund Earnings to Reduce the Fiscal Gap

by
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Presented to
Alaska Senate State Affairs Committee

Anchorage, Alaska
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Outline for Today

- The Gap
- Bogus Solutions
- 3 Real Tools in the Kit
- The Biggest Tool—Use Asset Earnings
- Compare Proposals to Use Earnings
- Assumptions
- Criteria for Choice
- Fragile Economy
Fiscal Gap: New Reality?

2015 based on $50 oil

General Fund Unrestricted Revenue: Fall 2015 Forecast


Fiscal Year

Million $:

- $1,000
- $2,000
- $3,000
- $4,000
- $5,000
- $6,000

Fall 2015  Fall 2014  Fall 2013  GF SPENDING

Oil and the Alaska Economy
Fiscal Gap: Bogus Solutions

- Higher Oil Price
- Hold Our Breath
- Gas Line
- Nickel and Dime Solutions
- Zombie Solutions
- Silver Bullets?
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!
Use Permanent Fund Earnings: Why Start Here & Why Start Now

• Biggest single tool in solution
• No solution without this tool
• Centerpiece of a workable GAME PLAN
• No negative economic impact
• 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!
Proposals for Use of Earnings

MECHANISMS

◆ STABILITY—SB128 ALASKA PERMANENT FUND PROTECTION ACT
  - Dump SB21 revenues and royalties into PF
  - Draw $3.3 Billion from PF Earnings Reserve for UGF (inflation adjusted amount that sustains PF value)
  - Pay PF Dividend from 50% of Royalties

◆ IMMEDIATE PLUG—SB114
  - Draw 5% of PF value from PF Earnings Reserve for UGF
  - Pay PF Dividend from 50% of Royalties

TARGET

SUSTAINABILITY—“Goldsmith Plan”
  - Dump all Petroleum Revenues into Permanent Fund
  - Draw amount from PF Earnings and Earnings Reserve that can be Sustained and allow PF to continue to grow
  - Divide draw between UGF and PF Dividend
All Proposals: 2 Policy Switches
Control Spending from Endowment

PERMANENT FUND CORPUS

OIL REVENUES

25% ROYALTIES

Share to PF

EARNINGS RESERVE

SPENDING
- GENERAL FUND
- PF DIVIDEND
All Proposals: Common Objectives

Reduce Deficit Today

TRADEOFF

Sustain Assets for Tomorrow
Tradeoff SB128

PF Draw (2017) -- a fixed amount that maintains future value of PF

Spend starts high, declines, and total asset value falls

<table>
<thead>
<tr>
<th>TOTAL</th>
<th>$4.25</th>
</tr>
</thead>
<tbody>
<tr>
<td>PF</td>
<td>$ 3.3</td>
</tr>
<tr>
<td>Pet Rev</td>
<td>$ .83</td>
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</table>

SPENDING FROM ASSETS: PER CAPITA

STATE ASSET PORTFOLIO: PER CAPITA

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Dept of Revenue  Petroleum Revenue Forecast
**Tradeoff SB114**

**PF Draw (2017) -- a fixed percentage of PF value**

Spend starts high, declines slowly, and total asset value falls slowly

<table>
<thead>
<tr>
<th></th>
<th>TOTAL</th>
<th>$4.07</th>
</tr>
</thead>
<tbody>
<tr>
<td>PF</td>
<td>$2.8</td>
<td></td>
</tr>
<tr>
<td>Pet Rev</td>
<td>$1.27</td>
<td></td>
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</tbody>
</table>

**Graphs:**
- Draw from Assets: Real per Capita
- State Asset Portfolio: Per Capita

Dept of Revenue  Petroleum Revenue Forecast
Tradeoff Sustainable Spending

**PF Draw (2017) -- a fixed amount that maintains future value of PF + unproduced petroleum**

<table>
<thead>
<tr>
<th>TOTAL</th>
<th>$3.55</th>
</tr>
</thead>
<tbody>
<tr>
<td>PF</td>
<td>$ 3.55</td>
</tr>
<tr>
<td>Pet Rev</td>
<td>$  -</td>
</tr>
</tbody>
</table>

Spend starts lower, draw and asset value both stay constant
Which Draw Mechanism Produces the Best Sustainability Tradeoff?

• Do we care about the future?

• What do we think the future will look like as petroleum production continues to fall?

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.
Dealing with Volatility & Risk: Future Petroleum Revenues?

<table>
<thead>
<tr>
<th></th>
<th>TOTAL</th>
<th>PFD</th>
<th>SS-UGF</th>
<th>Pet Rev</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Early 2014</td>
<td>$5.4</td>
<td>$1.4</td>
<td>$4.5</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>DOR price and production, + gasoline, new production</td>
</tr>
<tr>
<td>2</td>
<td>Early 2015</td>
<td>$4.52</td>
<td>$1.4</td>
<td>$3.66</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>DOR price and production, + gasoline, new production</td>
</tr>
<tr>
<td>3</td>
<td>Early 2015 (3yr ma)</td>
<td>$4.39</td>
<td>$1.4</td>
<td>$3.53</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>DOR price and production, + gasoline, new production</td>
</tr>
<tr>
<td>4</td>
<td>Early 2015</td>
<td>$3.72</td>
<td>$1.4</td>
<td>$2.85</td>
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<td></td>
<td></td>
<td></td>
<td>DOR price and production, + new production</td>
</tr>
<tr>
<td>5</td>
<td>Early 2015</td>
<td>$3.55</td>
<td>$1.4</td>
<td>$2.68</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>DOR price and production</td>
</tr>
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</table>
## Approximating a Draw Mechanism: Total Spend from 3 Proposals

<table>
<thead>
<tr>
<th></th>
<th>2017 TOTAL SPEND</th>
<th>Tradeoff</th>
<th>Future Petroleum Revenues</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>SB128</strong></td>
<td>$4.25</td>
<td>Favor today</td>
<td>Conservative</td>
</tr>
<tr>
<td><strong>SB114</strong></td>
<td>$4.07</td>
<td>Favor today</td>
<td>Conservative</td>
</tr>
<tr>
<td><strong>SS</strong></td>
<td>$3.55</td>
<td>Balanced</td>
<td>Conservative</td>
</tr>
<tr>
<td><strong>SS (3yr ma)</strong></td>
<td>$4.39</td>
<td>Balanced</td>
<td>More optimistic</td>
</tr>
</tbody>
</table>
Criteria for Choice for Draw Mechanism

• SUSTAINABLE
• IMPLEMENTABLE
• FAIR
• DISCIPLINED
• FLEXIBLE
• MINIMIZES UNINTENDED CONSEQUENCES
Fragile Economy

Job Growth in Alaska and the Nation

Oil and the Alaska Economy
Strategy Moving Forward?

- **THIS YEAR (at a minimum)**
  - Budget Cuts
  - Structured Use of PF Earnings
  - Business and Use Taxes

- **NEXT YEAR**
  - 4 Sided Battle
    - More budget cuts
    - Income tax
    - Sales tax
    - Dividend reduction
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