ALASKA PERMANENT FUND PROTECTION ACT

House Finance Committee

CSSB 128(FIN)

June 13, 2016

Frequently Asked Questions

Q: What does the Alaska Permanent Fund Protection Act (APFPA) do?

The APFPA establishes a rule-based framework for the sustainable use of permanent fund earnings to support public services. APFPA adopts rules establishing a sustainable percent-of-market-value (POMV) draw of 5.25% from the earnings reserve account (ERA) to the general fund; a new inflation-proofing mechanism; a new dividend formula; and a draw limit to reduce budget volatility.

Q: Why is it called the “Permanent Fund Protection Act”?

The act is meant to ensure that as we begin to use permanent fund earnings for government expenditures, we take only what is sustainable and protect the fund – and dividends – for future Alaskans. Without rules requiring sustainable use of earnings, the value of the permanent fund could be degraded or the ERA might be depleted leaving less for the future.

Q: How will the dividend be calculated and what can individuals expect to receive?

Instead of being calculated solely on permanent fund earnings, the dividend would be determined based on the value of the permanent fund (20% of the POMV draw) and our mineral royalties (20% of royalties deposited into the general fund). Projections show that this will result in a dividend of around $1,000 into the future. To transition the dividend would initially be set at $1,000 for the first three years.

Q: What will the dividend be if no action is taken to address the state's fiscal challenge?

Under current projections, the constitutional budget reserve will be drained within two years, at which point lawmakers would need to tap the ERA – the source of dividends. It’s anticipated that there will be no money left to pay a dividend within four years.

Q: Why is the plan needed?

In the last two years, state revenue fell by more than three-quarters. Over those two years we reduced spending by more than $1 billion, but we still have a $4 billion deficit. We're projected to run out of savings in less than two years, and exhaust the ERA in less than two years later. Alaska must transition to a stable, sustainable fiscal structure in order to continue providing essential public services and avoid a significant recession.

Q: Does the APFPA use the principal or corpus of the Permanent Fund?

No, the act does not spend any money from the principal. Because the plan does not use the principal it does not require a constitutional amendment.

Q: If the entire plan is subject to appropriation by the legislature, why is the APFPA necessary?

The legislature has shown great discipline in following long-term financial plans set out in statute. The Permanent Fund has grown all these years and is now ready to help supply some of the money for the budget because of the legislature's adherence to statutory rules: (1) inflation proofing the fund annually and (2) using the ERA only for dividends. Also, statutory rules ensure a transparent and public process if future legislators choose a different approach.

Q: Why is a draw limit necessary?

The purpose of the draw limit is to get State spending and budgeting off the oil price rollercoaster. By saving more money in high revenue years (e.g., high oil price or high production), there is more money available in the low revenue years. A draw limit also avoids unsustainably increasing the budget in high revenue years, ensuring more stable and predictable budgets in the long-term. This provides a better economic environment not only for government but for private sector investment.

Q: Doesn't the draw limit need to increase with inflation in order to account for inflationary growth over time?

First, as the fund grows the amount drawn from the earnings of the permanent fund under the POMV formula increases too (5.25% of $70 billion is more than 5.25% of $52 billion). The draw limit does not affect the calculation of the maximum amount to be drawn. Second, the general fund will receive only about $500 to $600 million in production taxes and royalties this year; there is room for $700 million in budget growth between now and when the draw limit would even be triggered. Third, the draw limit only addresses production taxes and royalties. It says nothing about other revenues (including new revenues) or savings.

Q: Why do we need a plan this year, can't we just use our savings for now?

Continuing to draw down our savings without a plan and at an unsustainable rate will leave us with fewer choices next year. Setting a system in place now will help avoid depleting our savings. Inaction also risks another downgrade of the state's credit rating – increasing costs to the state. Third, uncertainty about the state's future causes private businesses and investors to lose confidence in the state and chills economic growth.

Q: Shouldn't we wait to address the permanent fund until we have more budget cuts, more reform to oil and gas tax credits, or new revenues?

More budget cuts, new taxes, and further tax credit reform might contribute hundreds of millions on the pathway to fiscal balance. But, the permanent fund is the only tool that can sustainably provide billions. APFPA is the one piece of the fiscal plan that we must have – the other pieces of the plan combined would not come close to addressing the gap without it.