Alaska's Permanent Fund and Its Impact on the State Budget:

Implications for North Dakota

North Dakota Legacy Fund Earnings Committee

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David Teal, Director, Legislative Finance Division, Alaska

The Purpose of the Permanent Fund

1. "The Permanent Fund began, chiefly, with a 'negative' goal, to place part of the one-time oil wealth beyond the reach of day-to-day spending." Elmer Rasmuson, first chairman of the Permanent Fund Board of Trustees
2. Governor Jay Hammond wanted to make an intergenerational transfer and he hoped to achieve it by converting finite natural resource wealth into perpetual (or permanent) financial wealth that would generate revenue for the benefit of future Alaskans long after the oil was gone.

Comparing Alaska’s Permanent Fund to North Dakota’s Legacy Fund

What money goes into the funds?

Both Alaska and North Dakota constitutionally protect a portion of oil and gas revenue.

Comparing Alaska's Permanent Fund to North Dakota's Legacy Fund

How is the fund protected from appropriation?

1. Alaska has a ***permanent*** fund—the principal of the fund cannot be appropriated.

Article IX, sec. 15, Constitution of the State of Alaska

At least twenty-five percent of all mineral lease rentals, royalties, royalty sale proceeds, federal mineral revenue sharing payments and bonuses received by the State shall be placed in a permanent fund, **the principal of which shall be used only for those income-producing investments** specifically designated by law as eligible for permanent fund investments. All income from the permanent fund shall be deposited in the general fund unless otherwise provided by law. (Effective February 21, 1977)

2. North Dakota has a ***legacy*** fund—principal can be appropriated with a supermajority vote.

Is your goal to provide legacy infrastructure or legacy financial strength?

Considerations:

1. The more money that is deposited into the fund and the less money that is spent, the larger the financial legacy.
2. Roughly 30% of the principal of the Permanent Fund is attributable to constitutionally mandated deposits.
3. You may choose to
   a) never appropriate principal,
   b) make additional deposits to offset the impact of inflation,
   c) make non-mandatory deposits to prevent money from being spent for unsustainable operating or capital purposes, and/or
   d) not spend earnings on “normal” government operations.
4. If you do all four, you would be following in Alaska’s footsteps.

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How can the fund be invested?

1. Investment options aren’t a critical difference.
2. Investors balance risk and return. In the early years, Alaska could invest only in high grade bonds. Rules have loosened over the years and we have very few restrictions any more. I expect that the board will come to you if they need more investment flexibility.

Comparing Alaska’s Permanent Fund to North Dakota’s Legacy Fund

What is the purpose of the fund?

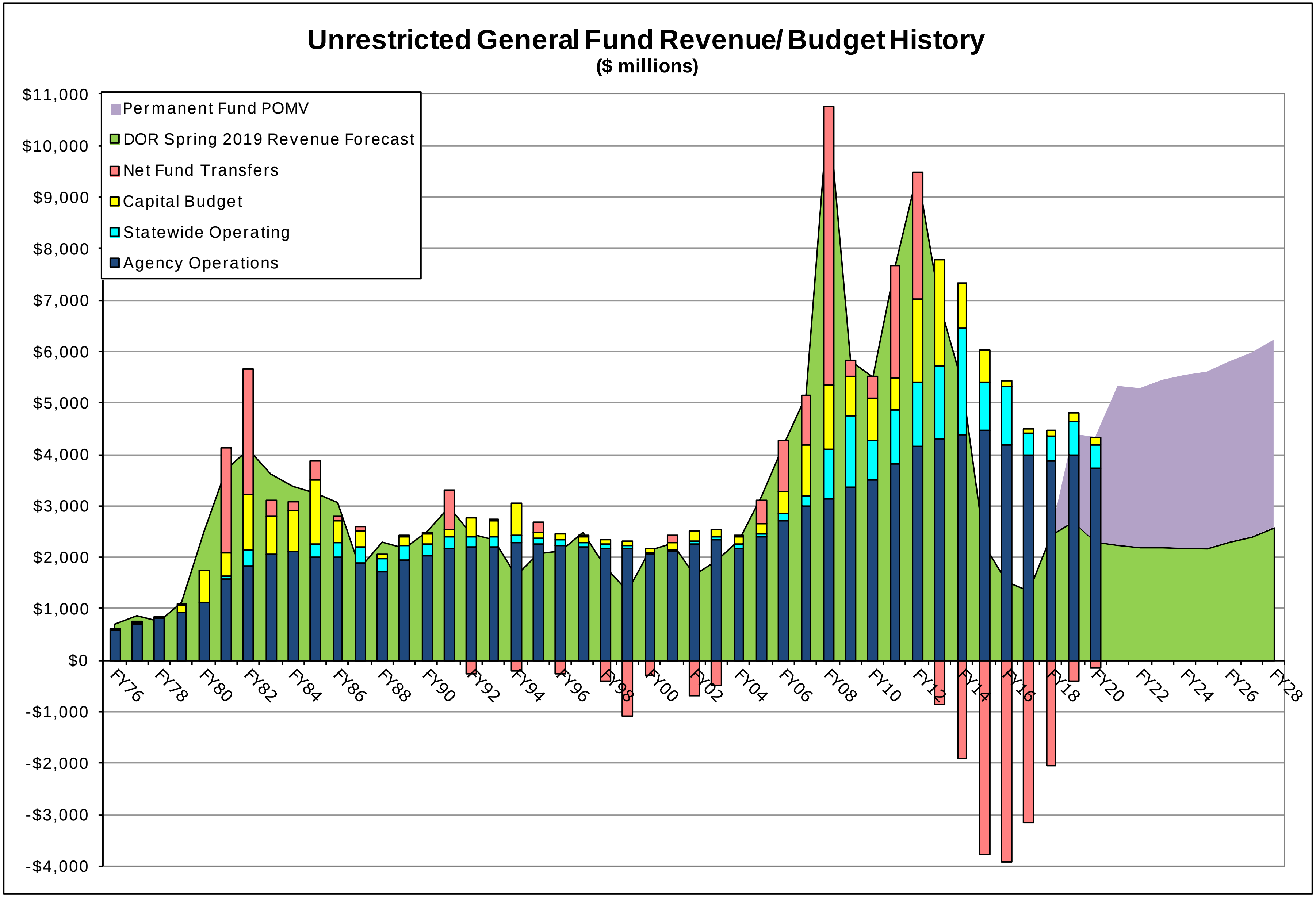
1. “Purpose” does not refer to why a portion of nonrenewable resource revenue should be set aside for future generations. To all but the greedy, establishing a legacy is fair and reasonable. You have taken that step.
2. The debate is about earnings: when, how much, and for what purposes should they be used?

Spending Legacy Fund Earnings

1. You are now at a point that earnings are available and spending decisions will be made—by default if not by design.
2. Question: Why would you spend earnings on operating items before your oil production curve turns downward?

How did the Permanent Fund affect Alaska's budget?

1. Alaska transferred Permanent Fund earnings to the general fund and spent them for a few years, just as outlined in the Constitution.
2. Then we eliminated the individual income tax in 1980. (Not attributable directly to earnings of the Permanent Fund—The non-legacy portion of revenue was so large that some people saw no need to tax.)
   - Big mistake
     a) The legacy just took a big shift from post-oil generations to the oil-producing generation. Could have set more aside.
     b) We became more reliant on oil—a volatile revenue source.
     c) Repeal of the income tax was Governor Hammond's "greatest regret."


Unrestricted General Fund Revenue/ Budget History
($ millions)
Permanent Fund POMV
DOR Spring 2019 Revenue Forecast
Net Fund Transfers
Capital Budget
Statewide Operating
Agency Operations
$11,000
$10,000
$9,000
$8,000
$7,000
$6,000
$5,000
$4,000
$3,000
$2,000
$1,000
$0
-$1,000
-$2,000
-$3,000
-$4,000
FY76
FY78
FY80
FY82
FY84
FY86
FY88
FY90
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FY94
FY96
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FY00
FY02
FY04
FY06
FY08
FY10
FY12
FY14
FY16
FY18
FY20
FY22
FY24
FY26
FY28

How did the Permanent Fund affect Alaska's budget?

3. Alaska began paying dividends to citizens in 1982.
   a) Not only did this shift benefits from the future to the present, it created an entitlement mentality that is proving extremely difficult to change: some Alaskans believe they should not pay taxes and that dividends are the way we get our fair share of the mineral rights that the state stole from us upon statehood.
   b) Dividends prompted the following changes
      1. inflation proofing (good idea—accounts for 1/3 of the fund's value).
      2. an earnings reserve account (a necessary evil to address volatility of earnings).
      3. a halt to spending earnings for public services that persisted until FY19. The impact of this policy tradition significantly increased the size of the legacy

Why did Alaska pay dividends?

1. **Build a political constituency to protect the Permanent Fund's principal against raids by special interests.** May have been important.
2. **People make the best spending choices.** In theory, the State cuts assistance to communities, communities claw back the dividends according to local choice. This was a failed experiment.
3. **People have a right to a share of the oil wealth.** Why cash instead of services?
4. **Deliver benefits more equitably than alternative uses of the surplus oil money.** But that means that any reduction to dividends is regressive.
5. **Fortify the safety net for low-income Alaskans.** Flawed concept.

How did the Permanent Fund affect Alaska's budget?

3. Alaska began paying dividends to citizens in 1982. Alaska has the only sovereign wealth fund in the world that distributes money to citizens.
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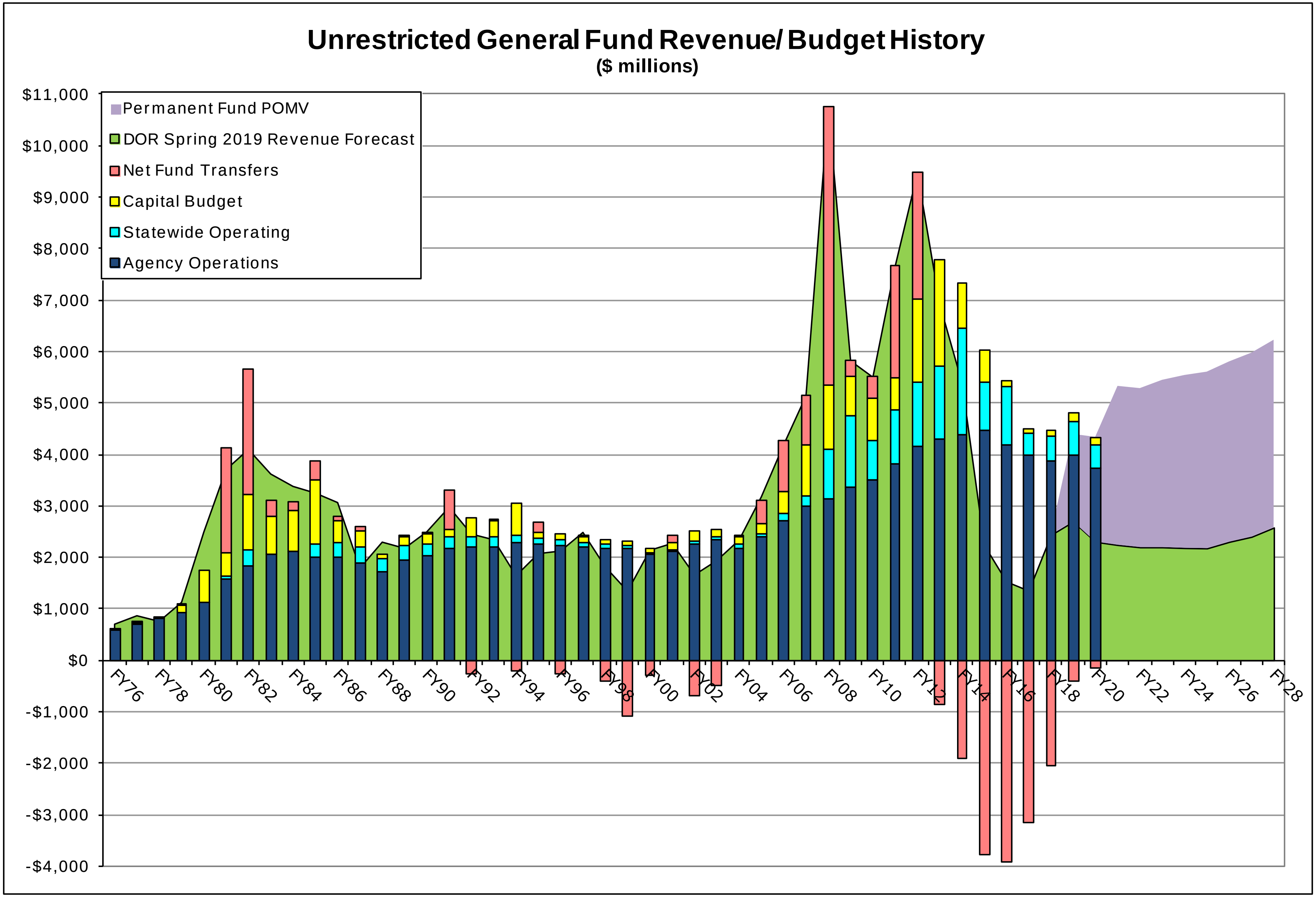
How did Permanent Fund <u>earnings</u> affect Alaska's budget process?

1. They didn't (until FY19). Earnings are not shown on the graph.
2. Effectively, we pretended earnings did not exist. Earnings were not counted as revenue and were not spent on anything but dividends and those were not counted as state expenditures.
3. Then came the crash. Oil revenue covered only about one third of expenditures. Reserves dwindled.
4. POMV was resurrected. We fought about it for several years and finally went with 5.25%/5.00% payout to the GF, which adds $3b annually to revenue.
5. You may think this greatly eased the budget process.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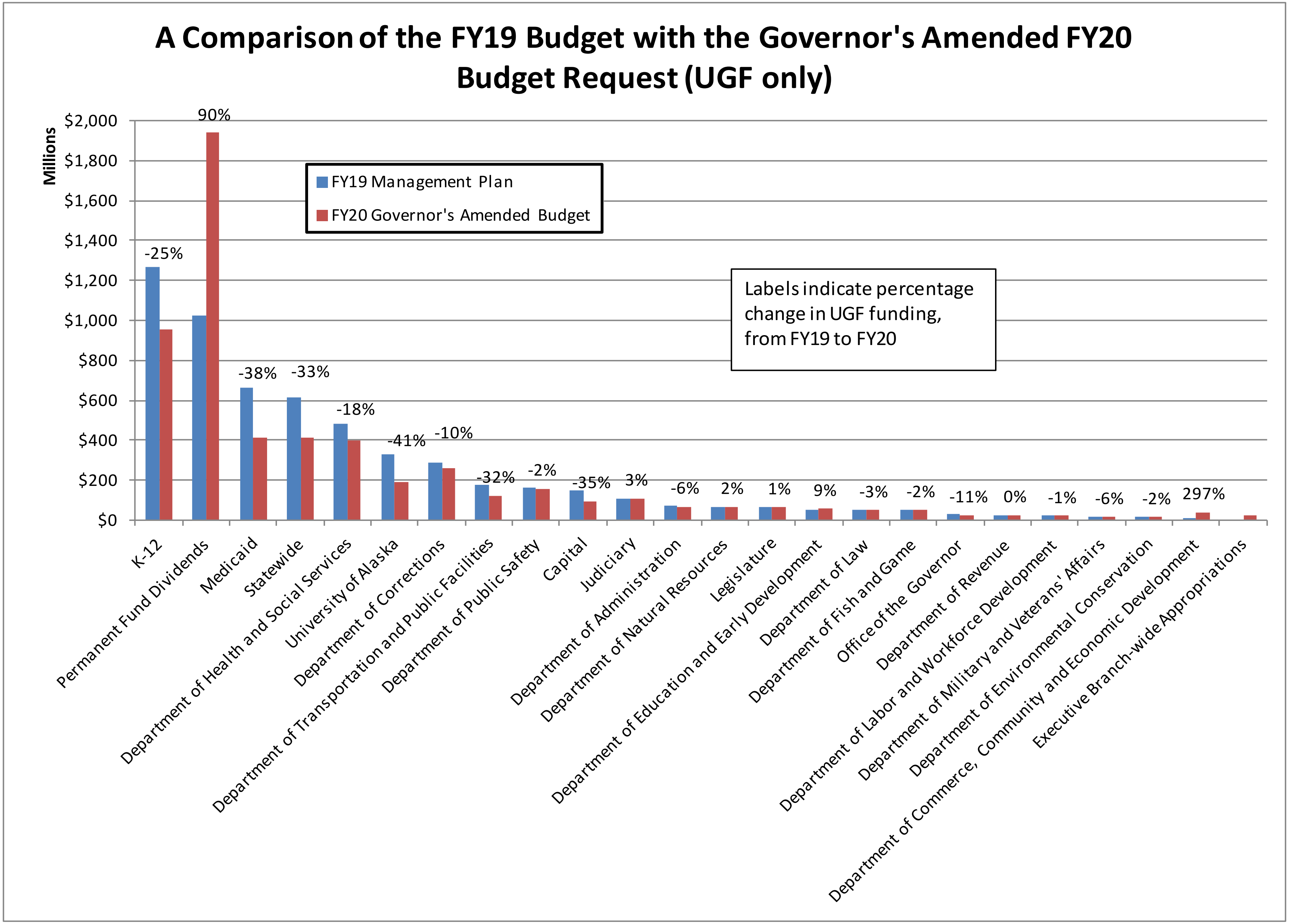
How did Permanent Fund ***earnings*** affect Alaska's budget?

Concluding that POMV has eased the budget process couldn't be further from the truth—disagreements about how the payout should be used (particularly for dividends)

1. caused multiple extended sessions and special sessions and
2. entirely changed the world we live in.

   Dividends are part of the budget and there is a dollar for dollar trade-off between dividends and government services.


A Comparison of the FY19 Budget with the Governor's Amended FY20 Budget Request (UGF only)
Millions
$2,000
$1,800
$1,600
$1,400
$1,200
$1,000
$800
$600
$400
$200
$0
FY19 Management Plan
FY20 Governor's Amended Budget
Labels indicate percentage change in UGF funding, from FY19 to FY20
-25%
90%
-38%
-33%
-18%
-41%
-10%
-32%
-2%
-35%
3%
-6%
2%
1%
9%
-3%
-2%
-11%
0%
-1%
-6%
-2%
297%
K-12
Permanent Fund Dividends
Medicaid
Statewide
Department of Health and Social Services
University of Alaska
Department of Corrections
Department of Transportation and Public Facilities
Department of Public Safety
Capital
Judiciary
Department of Administration
Department of Natural Resources
Legislature
Department of Education and Early Development
Department of Law
Department of Fish and Game
Office of the Governor
Department of Revenue
Department of Labor and Workforce Development
Department of Military and Veterans' Affairs
Department of Environmental Conservation
Department of Commerce, Community and Economic Development
Executive Branch-wide Appropriations

Considerations on Spending Legacy Fund Earnings

1. The 30% set-aside of oil revenue that you (and your predecessors) didn’t spend is the legacy. The fund is a financial asset that you created to generate future revenue. The other 70% of oil revenue provides current benefits.
2. Future revenue is not designated for legacy projects; earnings are simply general fund revenue that is intended to replace declining oil revenue.
3. Nothing prevents current earnings from adding to the legacy fund or being used for legacy projects or programs.
4. Use of current earnings for purposes other than increasing the size of the legacy fund will reduce future earnings.
5. If earnings go to the general fund, the revenue stream should be stripped of as much volatility as possible.
6. Why spend annual earnings before oil production begins to decline? Doing so shifts benefits from the future to the present.

What can North Dakota learn from Alaska's experience?

Focus on the intent: build a true legacy fund—one that transfers wealth from the "producing generation" to "post production" generations.

1. **Do not eliminate "normal" revenue sources.** Ensure that reducing taxes is based on the 70% revenue stream to the general fund, not grabbing a share of the 30% revenue stream to the legacy fund.
2. **Avoid using earnings for government services before oil revenue begins to decline.**
3. **When you begin to use earnings, implement a variable POMV payout system.** It will give you a sustainable revenue stream that can protect the real value of the fund and offers tremendous advantages in budget planning.
4. **Keep the payout simple.** Alaska wasted three years on overly complex mechanisms—a simple system with the payout rate rising as production declines has many advantages—including a larger legacy.
5. **Avoid paying dividends to individuals.** Individual dividends will create an entitlement mentality that will haunt you in the future. Community dividends are less insidious, but are less progressive.
6. **North Dakota government can retire if you do this right.** If Alaska had not paid dividends, the fund balance would be sufficient to generate a sustainable payout that covers all general fund expenditures.