Alaska faces huge short-term and long-term budget problems, and the Permanent Fund is at the center of both

Author: James Brooks | Anchorage Daily News | December 20, 2021

Note: You can read the article on the ADN site here. Board member Cliff Groh is quoted as part of this article.

Shortly before his death in 2005, Jay Hammond concisely expressed his vision for the Alaska Permanent Fund.

“I wanted to transform oil wells pumping oil for a finite period into money wells pumping money for infinity,” the former Alaska governor wrote.

For the first time since the Permanent Fund was created in 1976, the state of Alaska is seriously considering a step away from that vision. Gov. Mike Dunleavy has proposed spending billions from the fund to pay for a $5,000 stimulus in 2021. Such a stimulus is badly needed, economists say: Unemployment is high, thousands of Alaskans aren’t caught up on their rent and many residents don’t have enough to eat.

That stimulus would have a long-term cost. The Permanent Fund’s investment earnings now account for over 70% of state revenue. Spending more from the fund means less money to invest and bigger deficits in the future. In turn, that would mean more tax increases and cuts to services.

The debate between short-term needs and long-term needs is expected to consume the opening months of next year’s legislative session because Dunleavy is requesting action by

March.

To short-circuit that argument, some state experts are suggesting a third way: Short-term spending now, but an agreement on future tax increases to reduce deficits in the long run.

In 2018, lawmakers passed a bill that created an annual transfer from the Permanent Fund to the state treasury, and that money has kept the state afloat even as oil tax revenue has crashed.

In the fiscal year that starts July 1, oil will provide 19% of the state's revenue, the lowest figure since 1960, according to state projections and historical figures kept by the nonpartisan Legislative Finance Division. The annual transfer from the Permanent Fund will account for 71% of the money the state spends on schools, roads, health care and other services.

Because the Permanent Fund is now so important to state revenue, lawmakers have taken extraordinary efforts to follow the 2018 law, even if it means cutting the Permanent Fund dividend in the process. (This year, state tax revenue has dropped so much that Alaska will likely have a small deficit even with no dividend.)

Many lawmakers have kept $100 billion as a target in their minds.

If the Alaska Permanent Fund reaches $100 billion, an average of $5 billion per year would flow from the fund to the treasury under the 2018 law, enough to pay for services and a small dividend.

If the fund keeps growing, the transfer would grow as well, keeping pace with inflation and services needed as the state's population grows. The state could keep running without a sales tax, an income tax or higher taxes on oil companies.

The problem is getting to $100 billion.

On Nov. 30, the fund stood at $73 billion, and the Permanent Fund’s tentative forecasts indicate it will not reach $80 billion until 2030. Less than two weeks after the fund hit $73 billion, Dunleavy suggested his $6.2 billion spending plan.

The fund has enough money to pay for the plan — its value has risen significantly this year — but the governor’s proposal is about double the spending limit approved by lawmakers in 2018 and would drop the fund’s value.

“What the governor is proposing is that we take nearly 10% of the fund in one fell swoop, which I think will result in a significant loss to the overall value of the Permanent Fund, and that extreme whack at the fund, it will most certainly affect the future,” said state Sen. Natasha von Imhof, R-Anchorage.

The fund has earned an average of 6.44% annually over the past five years. Spending an extra $3 billion this year would cost the state over $1.9 billion in missed earnings over the next 10 years.

“How do you get to $100 billion if you take 10% of it in one fell swoop?” von Imhof said.

“As a realistic matter, it might make it impossible to get there,” said Rep. Zack Fields, D-Anchorage.

Since 1976, the fund has been capitalized by oil revenue, mostly from Prudhoe Bay, and Fields said Alaskans shouldn’t expect another Prudhoe Bay.

“I mean, you don’t want to plan on wishful thinking. I hope that happens, that would be great. But, you know, you don’t want your whole future to be contingent on that,” he said.

Others say the crisis happening now is more important than what might happen in the future.

Short-term needs

“Providing cash to people right now is probably one of the most efficient and effective ways to help reduce hardship,” said LaDonna Pavetti, vice president for family income support policy at the Washington, D.C.-based Center on Budget and Policy Priorities.

This week, the center analyzed U.S. Census Bureau data collected in the last week of November and the first week of December. It found that more than a third of Alaska adults are having problems paying for their normal household expenses. Almost 1 in 5 aren’t caught up on their rent. And more than 1 in 10 say their household doesn’t have enough to eat.

Alaska had 23,500 fewer jobs in November 2020 than it did in November 2019, according to figures published this week by Alaska Department of Labor and Workforce Development.

“If there was ever a good time to give people a chunk of money, it’s today,” said Ed King, an economist who formerly worked for the state Office of Management and Budget but now operates a private firm.

Announcing his proposed budget on Dec. 11, Dunleavy said, “Alaskans and the private sector need assistance now. Businesses that have been devastated, and Alaskans that are suffering, will benefit from immediate action by the legislature placing money into the people’s hands by March.”

The governor’s proposal calls for a $1,900 payment — costing about $1.2 billion — in the spring. A second payment, expected to be above $3,000, would come after the state’s new fiscal year starts July 1. It would cost about $2 billion, according to Permanent Fund Corp. estimates.

“I think it’s necessary, perhaps even prudent, to tap some portion of the Permanent Fund to stabilize economic activity,” said economist Mouhcine Guettabi of the Institute of Social and Economic Research at the University of Alaska Anchorage.

Pavetti suggested that a payment targeted at the poorest Alaskans might be more cost-effective. Dunleavy has proposed a payout through Alaska’s Permanent Fund dividend.

That would help him fulfill a 2018 campaign pledge to support the old formula the state used for the annual Permanent Fund dividend. The state hasn’t followed that formula since 2016, but it still remains law. The governor has proposed changing the law to a smaller payout, if Alaskans approve the change in an advisory vote.

“I believe the governor’s FY22 budget approach strikes a reasonable balance between immediate needs of our neighbors who have been struggling for much of this year and the longer-term concerns of stabilizing Alaska’s economy and protecting and growing the Permanent Fund for the future,” said Rep. Cathy Tilton, R-Wasilla. “Obviously, I would much prefer if we didn’t have to strike that balance and make those choices.”

Rep. Cathy Tilton, R-Wasilla, in the state Capitol in Juneau, March 2020. (James Brooks / ADN)

The problem is that even with the governor-endorsed formula change, the state still projects deficits — more than a billion dollars each year through 2025, and diminishing to just under $700 million by 2030.

Long before then, the Permanent Fund will be out of spendable money.

Economists suggest a middle way

Earlier this year, Anchorage attorney Cliff Groh, one of the authors of Alaska's 1982 Permanent Fund dividend law, wrote a lengthy strategy that could provide a path to balancing the state's short-term and long-term needs.

In brief, Groh's strategy involves an overdraw from the Permanent Fund this year but also passing a tax that would take effect in 2022. Revenue from the tax would offset the investment losses from the overdraw and make Dunleavy's proposed new dividend formula practical.

Economists have separately endorsed similar ideas.

"In an ideal world, we would be 'overdrawn' in the fund but at the same time setting the course for either future taxes or some sort of revenue that's going to balance the budget," Guettabi said. "That doesn't seem to be the case – we have one part of the equation but I'm not sure we have the other one quite yet."

Groh prefers an income tax over a sales tax, and the Alaska Department of Revenue has previously said that it would take time to set up an income tax.

"What the Department of Revenue says is that it takes about 18 months, and that's a fact," Groh said.

The time needed to set up a tax would reduce its impact: Alaska would have time to rebound from the pandemic-caused recession before the new tax begins.

"That's kind of what I hope comes out of this whole conversation: We don't just solve a (short-term) problem, we also address the long-term, and we start working towards a solution," King said, not referring specifically to the Groh plan. "So if you know it's going to take at least a year to start generating revenue, you need to start having those revenue conversations a year before you need them, which is now."

Dunleavy's 10-year fiscal outlook acknowledges the possibility. Starting July 1, 2023, it lists more than $1 billion in undefined "other revenue sources."

"Over the next two years Alaska's economy will rebound from the pandemic-induced recession and as soon as fiscal year 2023 may be healthy enough to bear additional revenue measures," the outlook states.

Any new taxes, changes to the Permanent Fund dividend formula or overdraws from the Permanent Fund must first be approved by the Alaska Legislature.

Neither the House nor Senate have selected leaders so far. The legislative session begins Jan. 18.

About this Author

James Brooks

Juneau-based James Brooks covers state government, the Alaska Legislature and general assignments for the Daily News. He previously reported and edited for the Juneau Empire, Kodiak Daily Mirror and Fairbanks Daily News-Miner.