Alaska’s Fiscal Future: Goal, Problem, and Options

THE GOAL

We want Alaska to be a place where all people have an opportunity to thrive, our children will choose to live, existing businesses will flourish, new enterprises are started, poverty is reduced, and the environment is protected. To achieve this, we need quality services provided by the State of Alaska, including decent education, transportation, public safety, justice, and more.

THE PROBLEM

In the spring of 2021, amidst the severe economic downturn caused by the global COVID-19 pandemic, the Alaska Legislature will face the biggest budget crisis in the state’s history.

Reserves Depleted—Although the State of Alaska’s spending has fallen by 43 percent in the past eight years, years of deficit spending have drained reserves used to cover budget shortfalls. The State of Alaska depleted its remaining emergency reserve—the Constitutional Budget Reserve (CBR)—to such a low level that the Alaska Legislative Finance Division has predicted it is unlikely that the CBR will have sufficient cash to cover appropriations beyond Fiscal Year 2021, the current fiscal year.

Unsustainable Deficits—Even with the traditional budget kept flat and without paying a Permanent Fund Dividend (PFD), next spring’s Legislature faces a budget deficit of about $270 million for the fiscal year starting July 1, 2021. This figure is likely to increase due to lower revenues and higher expenditures caused by the pandemic. If PFDs were paid based on the original formula adopted in the 1980s, the State would have a budget deficit of over $2 billion each year forward. With or without a PFD, balancing the State's budget will require either a new source of revenue or budget cuts far surpassing those that were initially proposed last year by the Governor.

POSSIBLE SOLUTIONS

The size of the State of Alaska's budget deficit and the lack of reserves means that some combination of the following will be needed.

1. ***Continued spending from the Permanent Fund Earnings Reserve Account (Earnings Reserve).*** The Earnings Reserve is the portion of the Permanent Fund that receives earnings from the Fund. For the last three fiscal years the Earnings Reserve has been used to pay for the State of Alaska's outlays—including the PFD—and is providing more than 70 percent of the revenues for the budget this year. The PFD has been the State's largest program except for K-12 education. State budget experts agree that continued spending from the Earnings Reserve within the limits of current state law is sustainable. However, overdrawing from the Earnings Reserve beyond the limit set out in current law would significantly reduce the State's ability to use the Earnings Reserve to help balance the budget and pay Dividends in the future.
2. ***Raising oil taxes.*** Oil was the primary source of state government revenue from the mid-1970s until the past few years, but the peak of Alaska's oil production has passed while the price of oil has dropped well below previous highs. The oil tax initiative by itself, if approved, would not raise enough money to cover the current level of government services, but it would help. Regardless of the initiative, the Legislature could also address changes to oil taxes.

3. ***Instituting broad-based taxes such as an income or sales tax***. Alaska is the only state in the country that has no form of broad-based tax. An income or sales tax adopted in 2021 would not generate revenue until 2022 at the earliest.
    a. ***A state income tax*** financed much of the State's budget before the arrival of revenues from the North Slope. For most of that time, the state's income tax was based on a percentage of the federal income tax. If the same system were reinstated, those who pay no federal tax would pay no state tax, and those who do pay federal taxes would pay state taxes on a sliding scale. Those who earn money in Alaska but live elsewhere would also pay taxes on Alaska-earned income. In 2017 the House of Representatives passed an income tax proposal that was estimated to yield $700 million per year when fully implemented, but the proposal failed to pass the Senate.
    b. ***A statewide sales tax*** could be structured to raise as much as an income tax. To many this seems preferable to an income tax because individuals control their spending. But sales taxes hit those with the least income the hardest. In incorporated areas that currently have a sales tax, a statewide tax would impose a second layer of taxation of sales.
4. ***Drastically cutting spending on services provided by the State of Alaska***. As stated in the problem summary above, even a zero-PFD budget that keeps spending on traditional services flat leaves a deficit of about $270 million for the next fiscal year alone. With savings in the reserves gone and revenues expected to grow slowly, the deficits are expected to get larger over time. Closing that deficit by relying on budget reductions would have significant negative impacts on schools, the University of Alaska, public safety, highways, ferries,

the courts, health care, social services, and more. Alaska would become a less attractive place to live and do business, and people would leave, severely hurting the state economy.

5. ***Diversify and expand the state's economy.*** This is a long-term proposition. Economic growth and diversification require an educated and trained workforce, and for that a strong University of Alaska is particularly important. The lack of a broad-based source of tax revenue cripples Alaska's ability to provide the additional schools, transportation, public safety, and other services from the State that are required by population increases that accompany new development. New resource development (including mining) does not generate anywhere near the amount of revenue as oil, which has a very different set of economic factors.
6. ***Obtaining more federal grant funding***. Federal grants related to COVID-19 relief would likely be one-time funding and thus a short-term fix for Alaska's fiscal crisis. Depending on the amount and allowed uses of federal COVID-19 relief funding, this could provide a partial fix short term. Federal grants are for specific purposes and probably would not cover most of Alaska's operating costs. Most federal grants require a matching share from the state.
7. ***Borrowing from the federal government, banks, or other lenders.*** Borrowing is traditionally used for capital improvements such as transportation facilities, school buildings, and other structural development or repair. Alaska has a backlog of capital projects and often such spending stimulates a lagging economy. Borrowing for operating expenses, however, is merely making future generations pay for services we receive today and adds to the State's long-term debt. Without measures that improve the State's credit rating, any borrowing would be costly.
8. ***Using money from the Permanent Fund principal***. The

Permanent Fund was meant to turn Alaska’s depletable short-term oil wealth into a legacy for future generations. Spending from the Permanent Fund principal defeats that purpose. The principal of the Permanent Fund cannot be spent without an amendment to the Alaska Constitution, which would require a majority of Alaskans voting “Yes.”

[i] In this paragraph and the rest of this paper “the budget” refers to the Unrestricted General Fund (UGF). Revenue projections come from the Alaska Department of Revenue and spending projections come from the Alaska Legislative Finance Division. Unless otherwise stated, the spending projections assume the laws on the books (including paying Dividends under the statutory formula developed in the 1980s) as well as spending limited to inflation

[ii] The Permanent Fund includes the constitutionally protected principal or corpus (that cannot be spent without a vote of Alaskans) and the Earnings Reserve. The Earnings Reserve receives revenue from the whole Permanent Fund, including the Earnings Reserve. The amount that can be spent each year is established by law as a percent of market value (POMV) of the whole Permanent Fund. Annual revenue from the POMV is projected to grow. This growth hinges on the Legislature staying within the spending limits of the amounts allowed under the law establishing the POMV system. In FY 2020, the POMV draw from the Earnings Reserve was $2.9 billion. In FY 2021, $3.09 billion is available.

Not Your Ordinary Fiscal Crisis

[Janet McCabe : Opinion Piece Anchorage Daily News : March 22, 2020]

In the shadow of the COVID-19 pandemic and a consequent worldwide recession, Alaska legislators have self-isolated in Juneau, communicating with the public remotely. This is an abnormal and worrisome time. We want them to complete the essential work of the session and be able to go home.

But they should not quit until they agree on an affordable amount for the Permanent Fund dividend and give the dividend a dependable and stable future so it will grow as the Permanent Fund does.

Using the 40-year-old statutory formula to calculate the amount of the dividend, the Legislative Finance Division has projected that the state's budget deficit for the upcoming fiscal year will exceed $1.5 billion. Many of us have trouble visualizing a number that large. As a current example, take the governor's proposal to raise $100 million from a state lottery. It would take 15 lotteries in a single year to raise $1.5 billion and close the fiscal gap.

Without action this session, $1.5 billion will be drained from the Constitutional Budget Reserve (CBR). That's the state's emergency rescue account, separate from the Permanent Fund. Budget analysts say the CBR should always be at least $2 billion. But unless legislators cure the fiscal crisis this session, the CBR will be reduced to $500,000, one quarter of the needed amount.

What if COVID-19 does strike with a vengeance, or climate change increases food insecurity in villages, or next summer. the forest fires we saw last year become overwhelming? Life is far too uncertain for the state to drain its emergency rescue account.

Recently, in recognition of the urgency of the fiscal crisis, the Trustees of the Alaska Permanent Fund Corporation, normally an apolitical group, added their voices to a growing chorus (Resolution 20-01). On March 5, Craig Richards, chairman of the Trustees, announced that payments from the Permanent Fund earnings are endangered. He recommended “that the State put in place a structure that minimizes that risk before a series of bad market events result in payment shortfalls.”

That warning was on March 5. Since then, the stock market has tumbled and a worldwide recession is looming.

The root of the problem as set forth by the Trustees is the conflict between (1) the statute that set the amount of the dividend 40 years ago, and (2) the percent-of-market-value statute adopted in 2018 to provide the state with sustainable annual revenue from the Permanent Fund Earnings Reserve Account. If the market falls repeatedly, Permanent Fund earnings would be reduced to the point where “we couldn’t fund the government and we couldn’t fund people’s dividends.”

The Trustees’ warning came with some useful advice, offering the legislature realistic solutions. The first of which was: “Transform by constitutional or statutory amendment, the Alaska Permanent Fund and the (Permanent Fund) Earnings Reserve Account into a single fund and limit the annual draw to the fund’s long term real return.”

House Joint Resolution No. 31 would do just that, using a constitutional amendment to combine the two parts of the Permanent Fund. Annual payments to the general fund follow the system adopted by the legislature in 2018 by passing SB 26. That bill established a percent of market value (POMV) system putting annual draws from the Permanent Fund on a sustainable system like that used by many institutions to manage large endowments.

Senate Bill 26 was just in time. Oil revenues dropped to $2 billion in 2018, but the POMV draw from the Permanent Fund (Earnings Reserve account) provided $2.9 billion, reversing a long decline in total state revenue.

Now, in implementing the Trustees’ proposal, the Legislature should pick up a piece of unfinished business from 2018. In developing SB 26, the 30th Legislature had intended to include language establishing a percentage for the dividend so it would be a stable ongoing amount of the POMV draw. But they had bogged down because, at that time, a few legislators still supported the traditional formula.

Now that the state is facing an immediate fiscal crisis specifically caused by a supersized dividend that would drain our emergency rescue account; now that the Trustees of the Alaska Permanent Fund Corporation have warned the legislature about effects of a “series of bad market events”; now that the size of the traditional dividend threatens the future of the dividend itself – now is surely the time to give the dividend a stable and affordable place in Alaska’s fiscal future. The dividend should grow as the Permanent Fund grows. This can be done by statutorily resetting the amount of the dividend, so it is a percentage the annual POMV payment.

Last December at Commonwealth North’s traditional pre-session luncheon, House Speaker Bryce Edgmon and Senate President Cathy Giessel both emphasized their wish to “communicate, collaborate and compromise.” Giessel quoted from President John F. Kennedy’s first inaugural address. Even more memorably, she quoted former U.S. Sen. Ted Stevens: “To hell with politics. Let’s do what’s right for Alaska.”

***Janet McCabe** is a member of Alaska Common Ground and Commonwealth North. She has a master’s degree in urban planning from Harvard’s Kennedy School of Government, and has been following Alaska’s fiscal future since she and her husband came to Alaska in 1964.*

Read the piece in the ADN here.

What Kind of Alaska do we

want?

A packed crowd gathered at the 49th State Brewing Company on December 10, 2019 for Alaska Common Ground's fiscal forum entitled **What kind of Alaska do we want? How do we get there?** The discussion featured Senator Natasha von Imhof, Co-chair of the Senate Finance Committee; Anchorage Mayor Ethan Berkowitz; CIRI Government Relations Vice President, Greg Razo; Institute of Social and Economic Research economist, Mouhcine Guettabi; and Atwood Chair at the UAA Department of Journalism, Larry Persily. Thea Agnew Bemben of Agnew::Beck moderated. The goal of the event was to increase public knowledge and understanding of the realities of Alaska's financial situation, and of potential measures to achieve a positive fiscal future.

Senator von Imhof launched the forum with a well-illustrated dose of reality (see her presentation slides here). "We are at a crossroads!" she said. Alaska cannot stay solvent if the state continues to pay dividends at, or even close to, the current statutory amount. She wants the legislature to find middle ground for all spending and establish a spending cap. Though she believes there are still government inefficiencies to be corrected, she noted that "It takes time and focus and energy to find more efficiencies…large cuts have to be walked back."

She and other panelists highlighted the fact that Alaska’s primary source of revenue for government spending is now through management of the Permanent Fund as an endowment under Senate Bill 26. State revenue from this source now exceeds revenue from petroleum production, and, based on current projections, will continue to do so. The statute established 5.5% as the percentage of the market value available from the Permanent Fund this year. Next year it will be 5%. Other endowment systems were studied, and percentages were carefully gaged and set to protect the principle of the fund.

Greg Razo noted that Alaska’s public spending must recognize the food insecurity in villages where part of the economy is subsistence hunting, fishing, and gathering. Climate change is threatening this ancient and traditional part of Alaska’s economy.

Mayor Berkowitz described how once generous state assistance to Anchorage has been reduced over the years to a pittance. Now the state does not even clear sidewalks on state roads within the municipality. He sees great potential to build the earnings of the Permanent Fund by investing more money in it. The Mayor advocated dividing the growing “percent of market value” earnings three ways to establish an ongoing percent for municipalities, for state services, and for dividends.

Mouhcine Guettabi and Larry Persily took the lead in emphasizing the economic value of quality of life and the fact that attracting people and economic development to Alaska depends greatly on having good state educational systems, transportation, and other public services. Persily concluded by telling people to look at the math, face reality, and find the revenues to build the secure and prosperous state that we want. All speakers noted that establishing ongoing fiscal predictability and stability would be an economic stimulant. The need for new revenue sources, such as taxes, was mentioned frequently in describing a positive fiscal future for our state.

The event was audio recorded by Alaska Public Media, livestreamed on Facebook, and video recorded by Jenson Hall Creative. You can watch the video here. Co-chairs of the planning committee for this forum were Janet McCabe and Cliff Groh. Cliff Groh has written a series of articles for the Anchorage Press on Alaska's fiscal issues. You can read one here. If you want to read them all, search for Cliff Groh at anchoragepress.com.