List of Things Alaska Could Do Legally to Address the Fiscal Challenge

By Cliff Groh

The deep slump in oil prices since the summer of 2014 has exposed and exacerbated underlying structural problems in the State of Alaska's fiscal system. These problems include:

(1) The dominant role of oil in the state budget—taxes and royalties from oil production account for more than 85 percent of the State of Alaska's Unrestricted General Fund revenues (the Unrestricted General Fund is what most people mean when they say "the state budget");
(2) The long-run decline in oil production that has left the Trans Alaska Pipeline System (TAPS) carrying less than a quarter of the oil it was carrying in the late 1980s;
(3) Increasing costs of producing that oil on the North Slope; and
(4) Partly because of (2) and (3) above, the unlikelihood of oil prices rebounding enough to bail Alaska out of this dilemma.

With revenues sharply down, matters are complicated by the desires many Alaskans have for more state spending in various areas.

Add it up, and you have an ugly picture. The budget this year (Fiscal Year 2015—or FY2015—which runs July 1, 2014-June 30, 2015) balances at oil prices of about $117 per barrel. Oil prices are below $50 per barrel as of this writing, and the Alaska Department of Revenue has reduced its oil price forecast to $65 for the rest of FY2015 and $66 for FY2016. With an approximately $6 billion state budget and revenues looking likely to be approximately $2.5 billion this year, the budget deficit at current oil prices and production would be close to $3.5 billion in FY2015. This means that the State of Alaska would have a budget deficit of more than 50 percent in the current fiscal year.

What follows is an attempt at a comprehensive catalogue of the steps the State of Alaska could take to address the fiscal challenge. This is an exercise in description, not prescription. <u>No</u> endorsement of any course of action is

intended, and there is no discussion here of the many pros and cons of these approaches, whether philosophical, practical, or otherwise. Some of these items are obviously far less politically or practically possible than others.

Note also that although the list below includes dollar estimates for amounts possibly gained or saved regarding some of the items listed, not all of the fiscal impacts are easily predictable.

The items below can be grouped into four categories, with a more detailed list following:

1. **Change spending**
2. **Collect more revenues**
3. **Use our savings accounts and/or money generated by or in the Permanent Fund**
4. **Get someone else to pay**

I. Change spending

- **A. Reduce the budget as compared to the previous year's spending (Notable facts about the budget include: 1. The State of Alaska's budget is widely understood to be No. 1 in per capita spending among the states; 2. Roughly two-thirds of the budget is composed of three items—K-12 education, Medicaid, and retirement assistance; 3. The capital budget is only about 10 percent of the budget; 4. cuts could either be either targeted or across-the-board)**

- **B. Re-allocate unspent and/or lapsed appropriations in the General Fund**

- **C. Impose another constitutional amendment limiting spending (Alaska has had a constitutional spending limit since 1982)**

    1. **Limit spending as a percentage of revenues somehow defined**
    2. **Limit spending as a percentage of savings somehow defined**

II. Collect more revenues

A. Adopt broad-based tax paid by individuals (Alaska is the only state in the union without either a general statewide sales tax or any form of a state income tax paid by individuals. Alaska had a state individual income tax until it was repealed in 1980; Alaska has never had a statewide sales or property tax paid by individuals. Note that a deficit of $3.5 billion works out to more than $4,500 per Alaskan, including children. According to Prof. Scott Goldsmith of the University of Alaska Anchorage's Institute of Social and Economic Research, U.S. Department of Commerce figures show that combined state sales and income tax per capita averaged $1,812 for the U.S. as a whole in 2010.)

1. **State income tax (A 2010 legislative report estimated that an individual income tax in Alaska taxing 2.8 percent of adjusted gross income on a flat-tax basis would generate $500 million annually. This estimate was based on 2006 IRS data for Alaska residents and thus does not count income that could be collected from non-residents working in Alaska.)**
2. **Statewide sales tax (That same 2010 report estimated that a state sales tax of three percent without exemptions would bring in $450 million a year.)**
3. **Statewide property tax**
4. **Others**

B. Expand and/or increase selective sales and/or excise taxes

1. **Alcohol**
2. **Tobacco**
3. **Fuel**
4. **Marijuana**
5. **Others**

C. Adopt other taxes, such as head tax or estate tax

D. Increase fees

E. Increase petroleum taxes

F. Impose and/or increase taxes on other industries

1. **Fisheries**
2. **Mining**
3. **Tourism**
4. **Others**

G. Increase the intensity of auditing of tax and/or royalties returns filed by petroleum producers

H. Increase the rate of return on the state's savings

I. Promote economic development that allows the collection of additional revenues under existing taxes

1. **Increase petroleum production**
2. **Arrange for gasline/LNG export project to go into service**
3. **Others**

III. Use our savings accounts

A. Spend easily spendable savings—the Statutory Budget Reserve and Constitutional Budget Reserve contain together more than $10 billion as of January of 2015, and the Legislature could spend all of that money in the budget

B. Spend funds or accounts outside the General Fund, the Statutory Budget Reserve, the Constitutional Budget Reserve, or the Permanent Fund

C. Use Permanent Fund earnings in the budget in significant amounts (The Permanent Fund holds as of this writing more than $51 billion in assets. Of that more than $51 billion, the Permanent Fund Corporation's most recent balance sheet (November 30, 2014) posted on its website shows $38.2 billion in the constitutionally

protected principal (also known as the "corpus contributions and appropriations") and another amount of more than $5.9 billion "not in spendable form—unrealized appreciation on invested assets." More than $1.19 billion of Permanent Fund earnings are being distributed in Permanent Fund Dividends this year, and more than $660 million is reserved for inflation-proofing this year. Another sum of more than $5.55 billion is "assigned for future appropriations," with $4.55 billion of that amount in realized earnings and the rest in unrealized appreciation on invested assets. The Permanent Fund's principal is constitutionally protected and could only be spent by a vote of the people, while the earnings are as a legal matter available for legislative appropriation. The earnings of the Permanent Fund have traditionally been used almost entirely for the payment of Permanent Fund Dividends and inflation-proofing the Permanent Fund itself, with a fraction being used in the budget for functions related to the payment of Dividends.)

1. **Reduce share of earnings going for Permanent Fund Dividends**
2. **Reduce share of earnings going for inflation-proofing**
3. **Adopt a version of a Percent of Market Value (POMV) approach through a constitutional amendment that would both change how the Permanent Fund is protected against inflation and also change the allocation of Permanent Fund earnings in a way that would allow spending of significant amounts of Permanent Fund income in the budget**

D. Amend the constitution to allow spending of Permanent Fund principal in the budget

IV. Get someone else to pay

A. Shift responsibilities from the State to local governments

B. Shift responsibilities from the State to the federal government
C. Borrow more money, perhaps through collateralization or from the Permanent Fund itself
D. Securitization, perhaps by selling shares in the revenues from a gasline/LNG export project

There are variations on these basic steps. Some of the most frequently discussed variations are:

1. **Pump up the Permanent Fund's principal to facilitate a slide into explicit rentier status, where the State of Alaska would finance its operations entirely or almost entirely through the use of Permanent Fund income (the word "Norway" has become shorthand in Alaska for this approach, apparently from a misunderstanding of Norway's fiscal system)**
2. **Keep the Permanent Fund Dividend while bringing back the individual income tax**
3. **Guarantee some level of Permanent Fund Dividends in the constitution as a trade for using some Permanent Fund income in the regular budget**
4. **"Cash out" part or all of the Permanent Fund principal in lump-sum payments to all Alaskans as a trade for using Permanent Fund income in the regular budget**
5. **Cap the Permanent Fund Dividend to reduce the amount of money distributed each year so that the money not paid out can be used in the regular budget; such capping could occur either as a percentage of Permanent Fund income or as a hard dollar cap on either the size of the Permanent Fund Dividend or the amount of Permanent Fund income going annually to the Permanent Fund Dividend**

The long-term decline in Alaska oil production—now compounded by the recent sharp drop in oil prices—poses tough questions for Alaska. Those questions are made tougher by the effects that the journey down the Prudhoe Bay Curve will have on the economy as well as the government, given that the oil industry accounts—directly or indirectly—for approximately one-half of all the jobs in the state. Alaskans need to think deeply and carefully about the implications of the various steps we could take to address these questions.

Cliff Groh is a lifelong Alaskan and a lawyer and writer. Groh authored a chapter for the 2012 book *Exporting the Alaska Model: Adapting the Permanent Fund Dividend for Reform around the World* (Palgrave Macmillan, 2012), and some of the material in this essay overlaps with that chapter. That chapter was one of four chapters Groh authored or co-authored for that book or for the 2012 book *Alaska's Permanent Fund Dividend: Examining its Suitability as a Model* (Palgrave Macmillan 2012). Groh was involved in the creation of the per capita Permanent Fund Dividend Alaska has today while serving as an assistant to the Alaska Legislature in 1982. Groh was also Special Assistant to the Alaska Commissioner of Revenue in 1987-1990 and a delegate to the Conference of Alaskans in 2004. A board member of Alaska Common Ground for almost two decades, Groh became that organization's chair in May of 2014.