ALASKA COMMON GROUND

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.[i] 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.[ii] 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."

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[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.