

# An Introduction to Alaska Fiscal Facts and Choices

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Over the past year I have been traveling around the state, talking with many organizations about the fiscal challenge Alaska is facing. My goal is to help Alaskans understand the basic facts of Alaska's revenues, spending, and saving, as well as the choices we face.

I have been regularly updating this presentation as new data become available and to address new questions I hear. This is the most recent version. As I develop updated versions, I will post them on ISER's website at: [www.iser.uaa.alaska.edu](http://www.iser.uaa.alaska.edu)

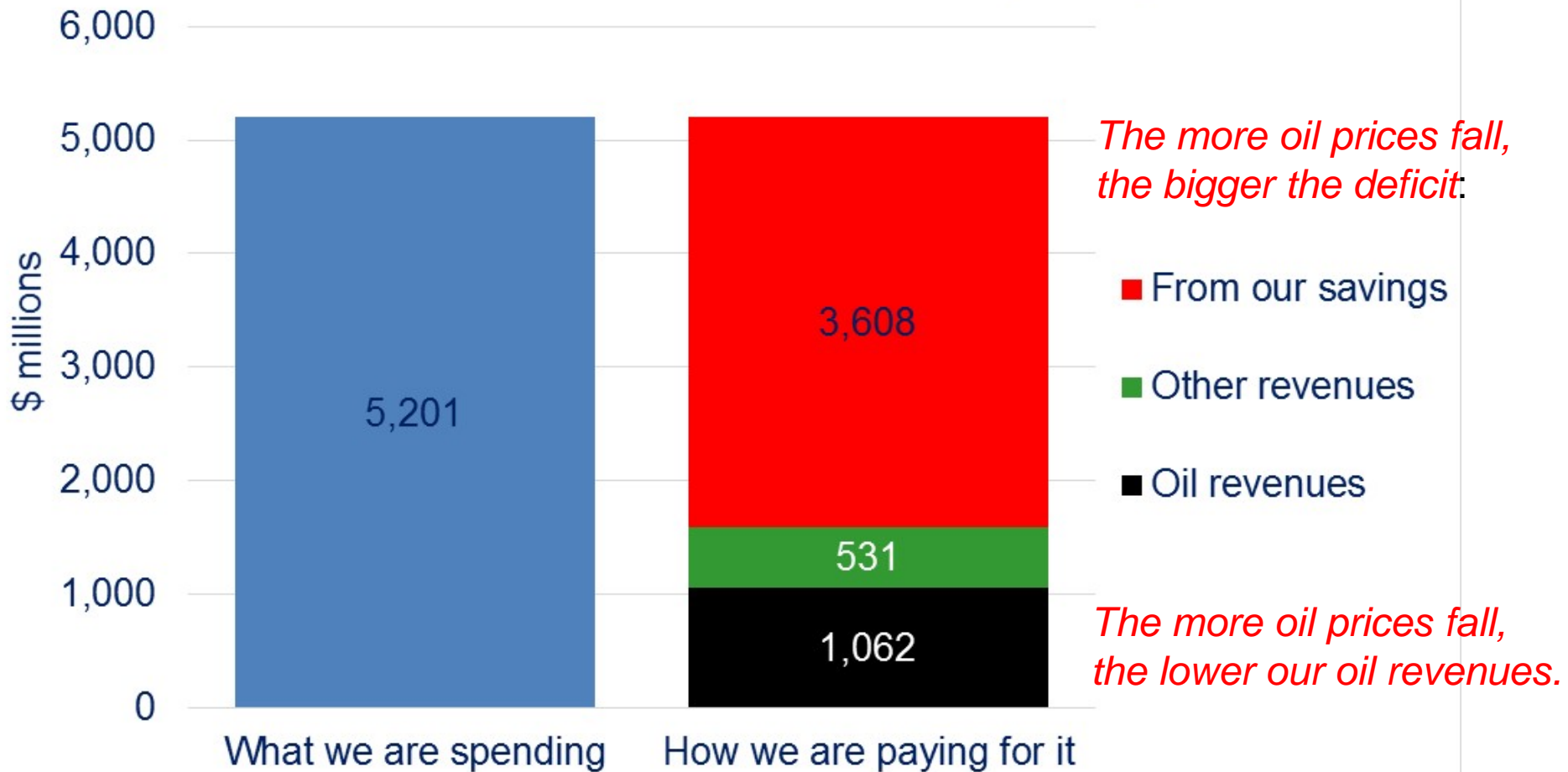
I welcome questions, comments and suggestions at the e-mail address shown above.



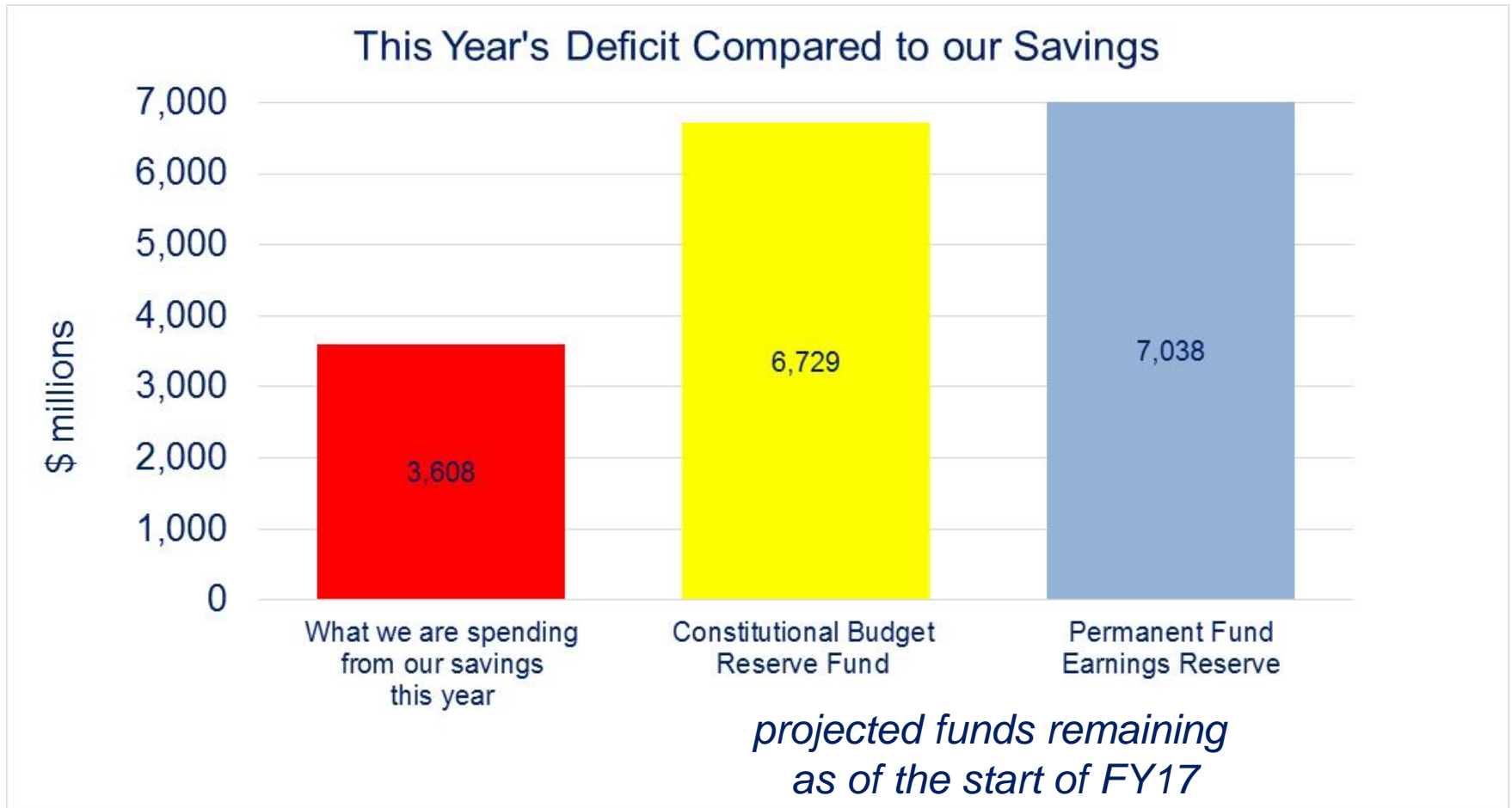
UAA Institute of Social  
and Economic Research  
UNIVERSITY of ALASKA ANCHORAGE

Alaska faces an extremely serious fiscal challenge.  
We are spending three times as much as our revenues.  
We are paying for the deficit by drawing down our savings.

### Alaska's Fiscal Situation This Year (FY16)



We can't continue to run huge deficits like this year's.  
We don't have enough savings.



In the next few years,  
we will have to close the funding gap  
between our spending and our revenues.

We will have to make big changes  
in what we spend or how we pay for it—or both.

Our choices will significantly affect all Alaskans  
and Alaska's future.

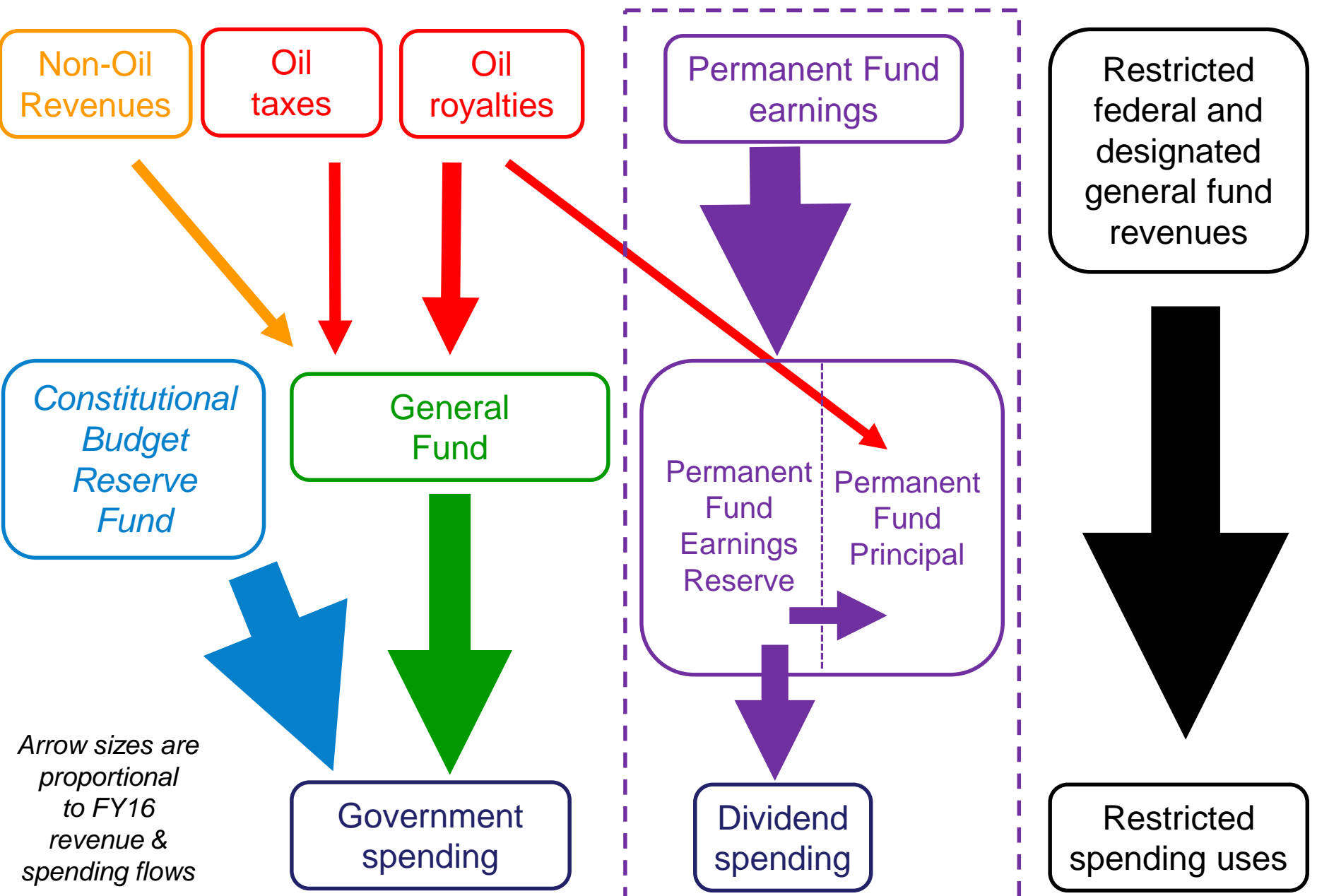
## Alaska's fiscal challenge: a perfect storm

- Very important
- Very complex
- High uncertainty about our options
- Very little time to address it
- About fundamental political issues

## What addressing Alaska's fiscal challenge demands of us

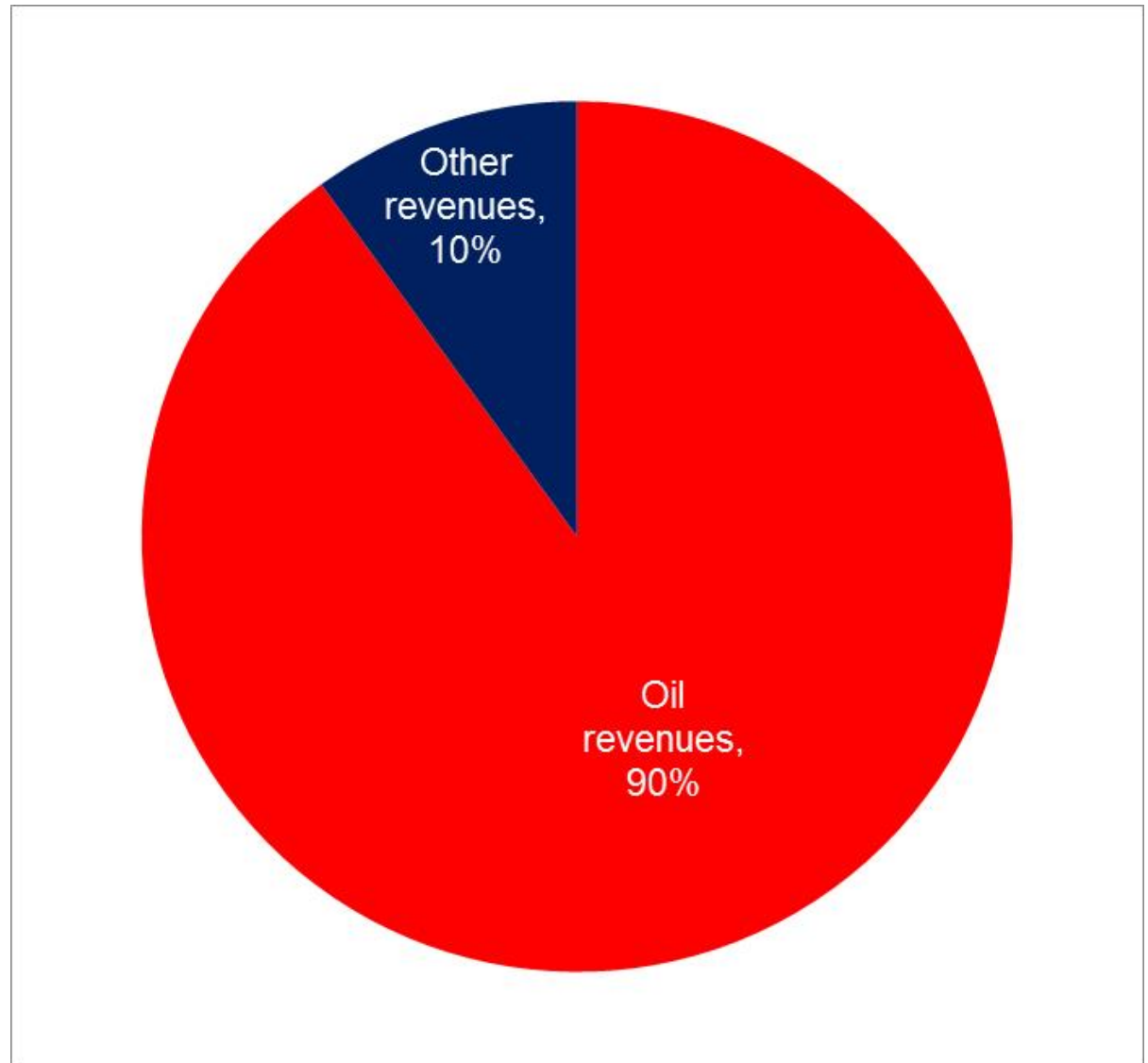
- Of all Alaskans
  - Become informed about our fiscal reality
  - Recognize that there are no easy solutions
- Of advocates
  - Reality-based proposals for how to solve the problem
  - Opposing others' proposals is not enough
- Of our elected leaders:
  - Educating Alaskans
  - Hard work
  - Cooperation
  - Hard choices

# Major state revenue sources and spending flows



# Alaska has been extremely dependent on oil revenues to fund state government.

From 2005 to 2014,  
oil revenues  
averaged 90% of  
Alaska's  
"unrestricted general  
fund revenues"





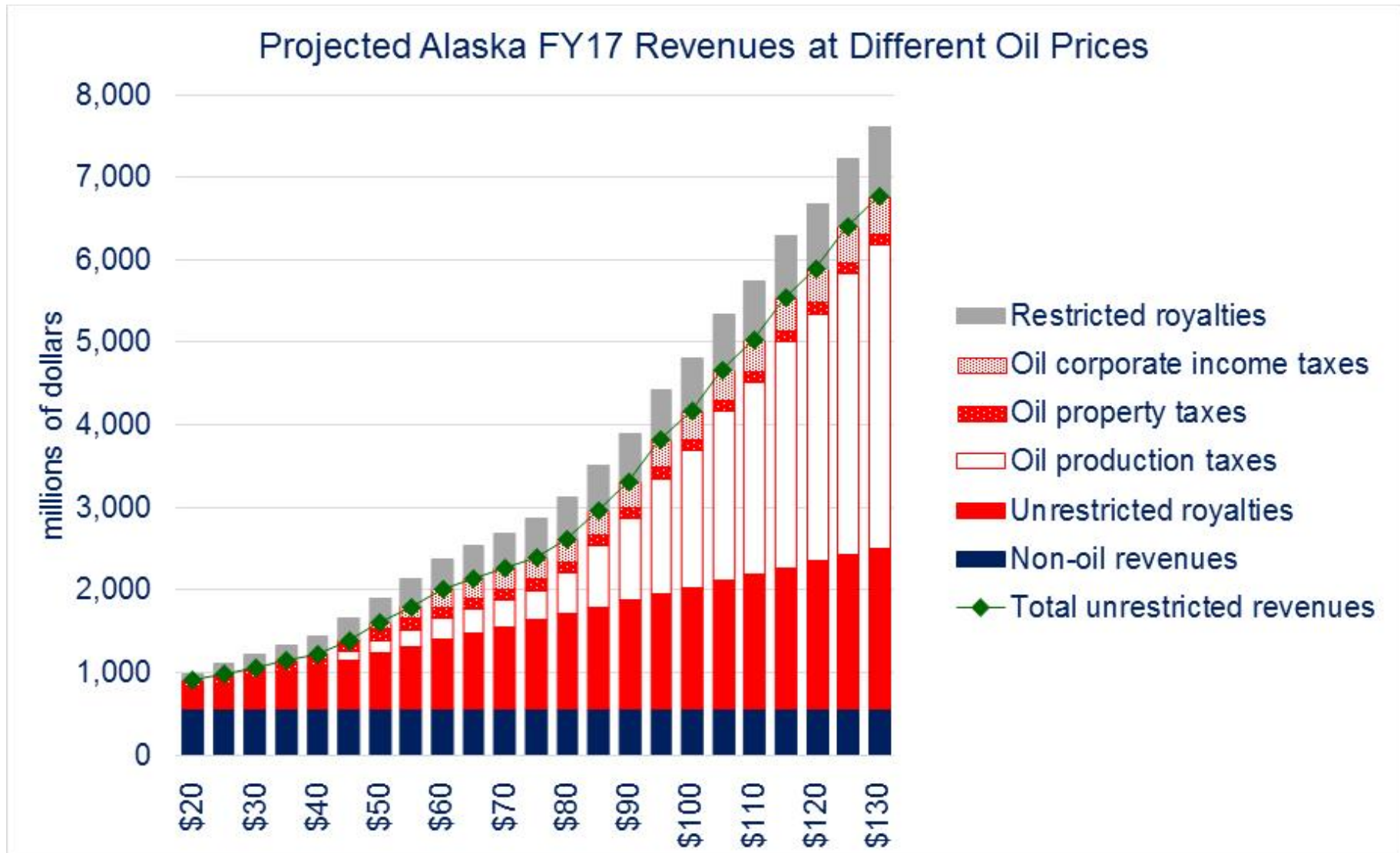
Oil prices have fallen drastically over the past year and a half.

### Daily ANS West Coast Oil Price



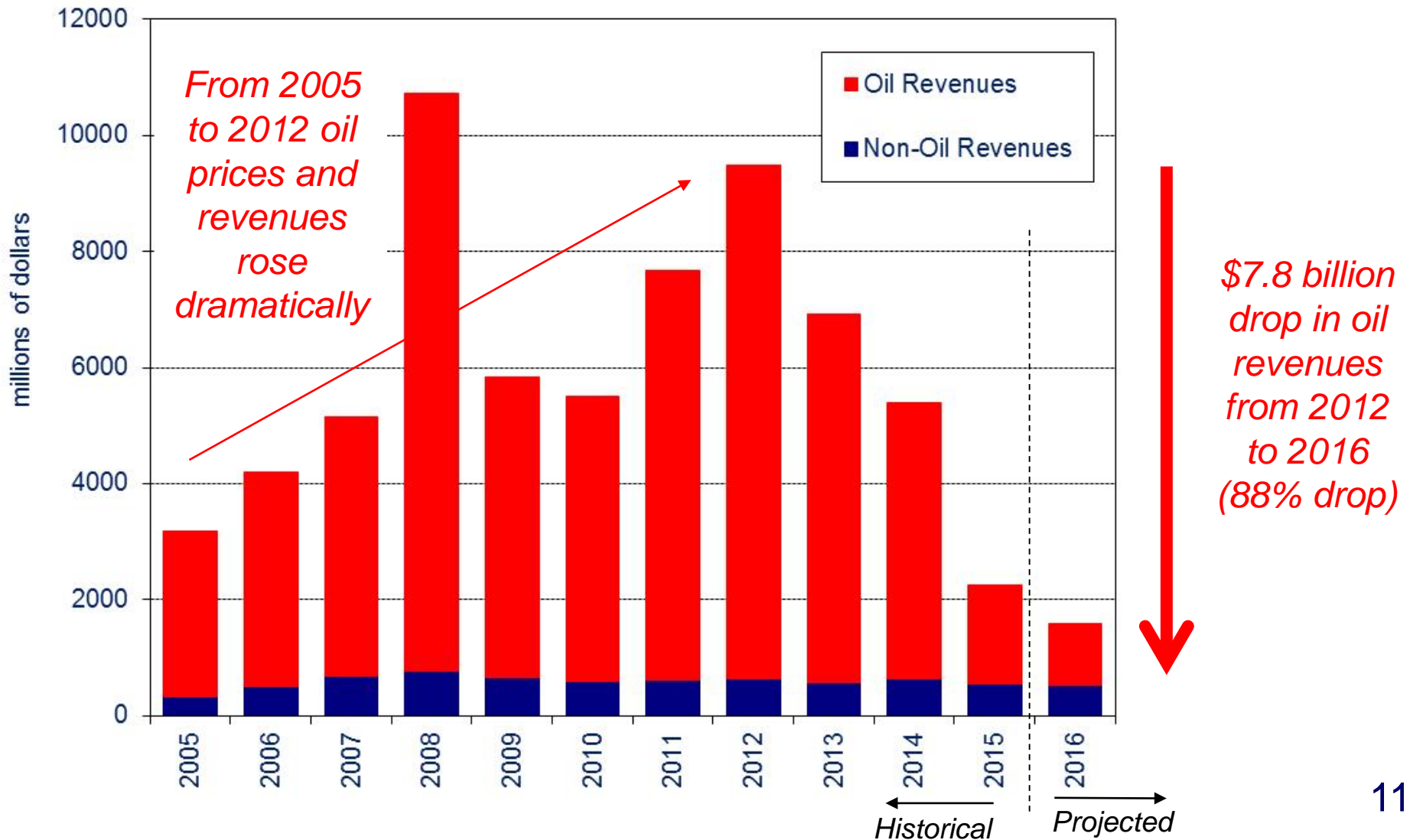
The price was \$32/barrel on January 28

Our state revenues are extremely sensitive to oil prices  
—particularly production taxes, which are based on profits.



Since 2012, our oil revenues have fallen drastically because of lower prices, lower production and higher costs and credits.

Alaska Unrestricted General Fund Revenues



In just four years,  
most of the money we had been  
using to pay for state government  
evaporated.

It's gone.

That's why we have a big problem.

## Won't oil prices go back up and save us?

- It happened in the early 2000s when we faced a similar fiscal challenge. It *could* happen again.
- But it probably won't.
- Even at current very low oil prices:
  - There is a glut of oil on world markets
  - Growth in world oil demand is slowing

SUNDAY, JANUARY 31, 2016

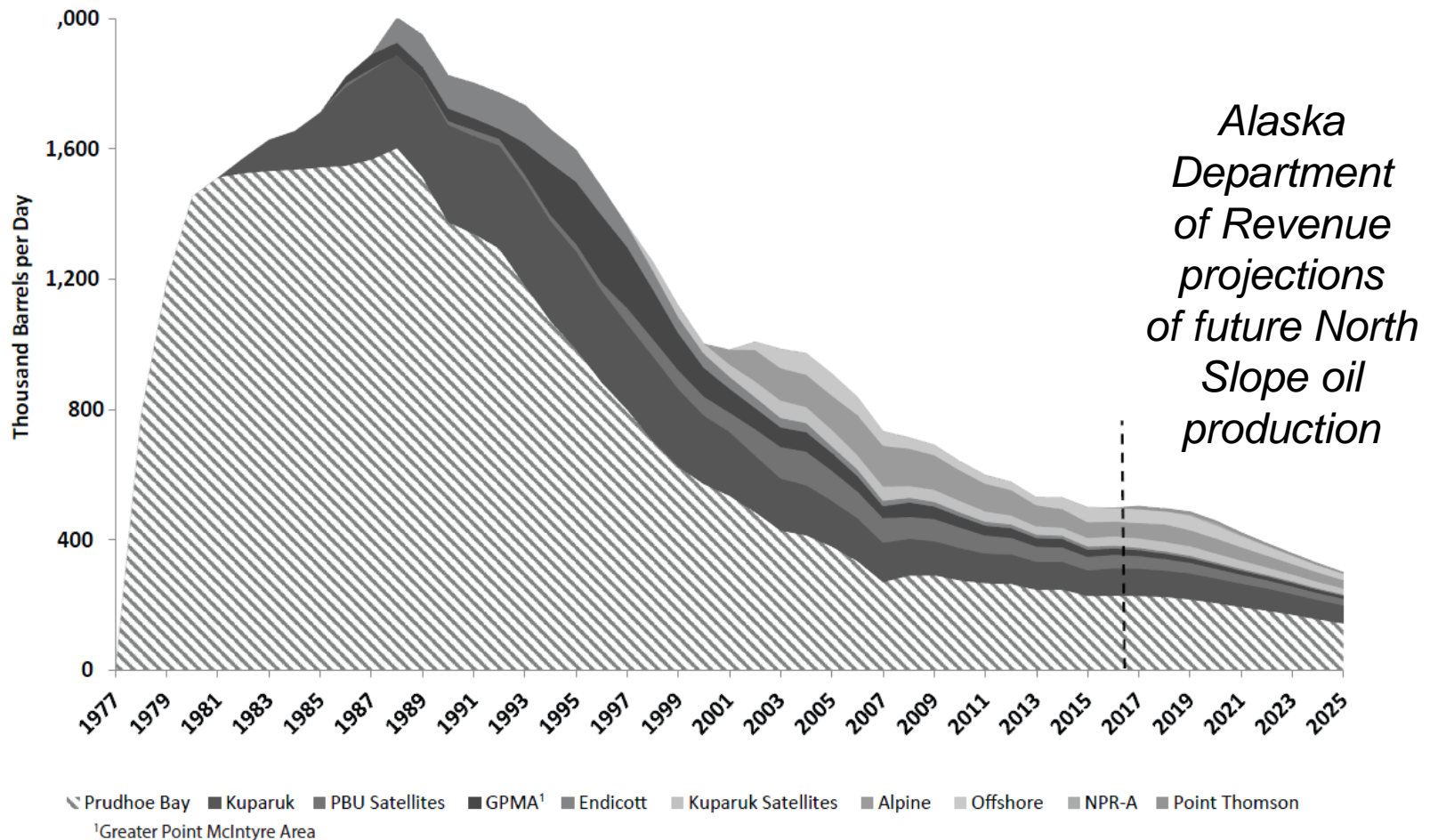
**OPEC oil production rose to record  
in January, survey shows**

Hoping that oil prices rise is not a realistic  
or responsible solution to our fiscal challenge.

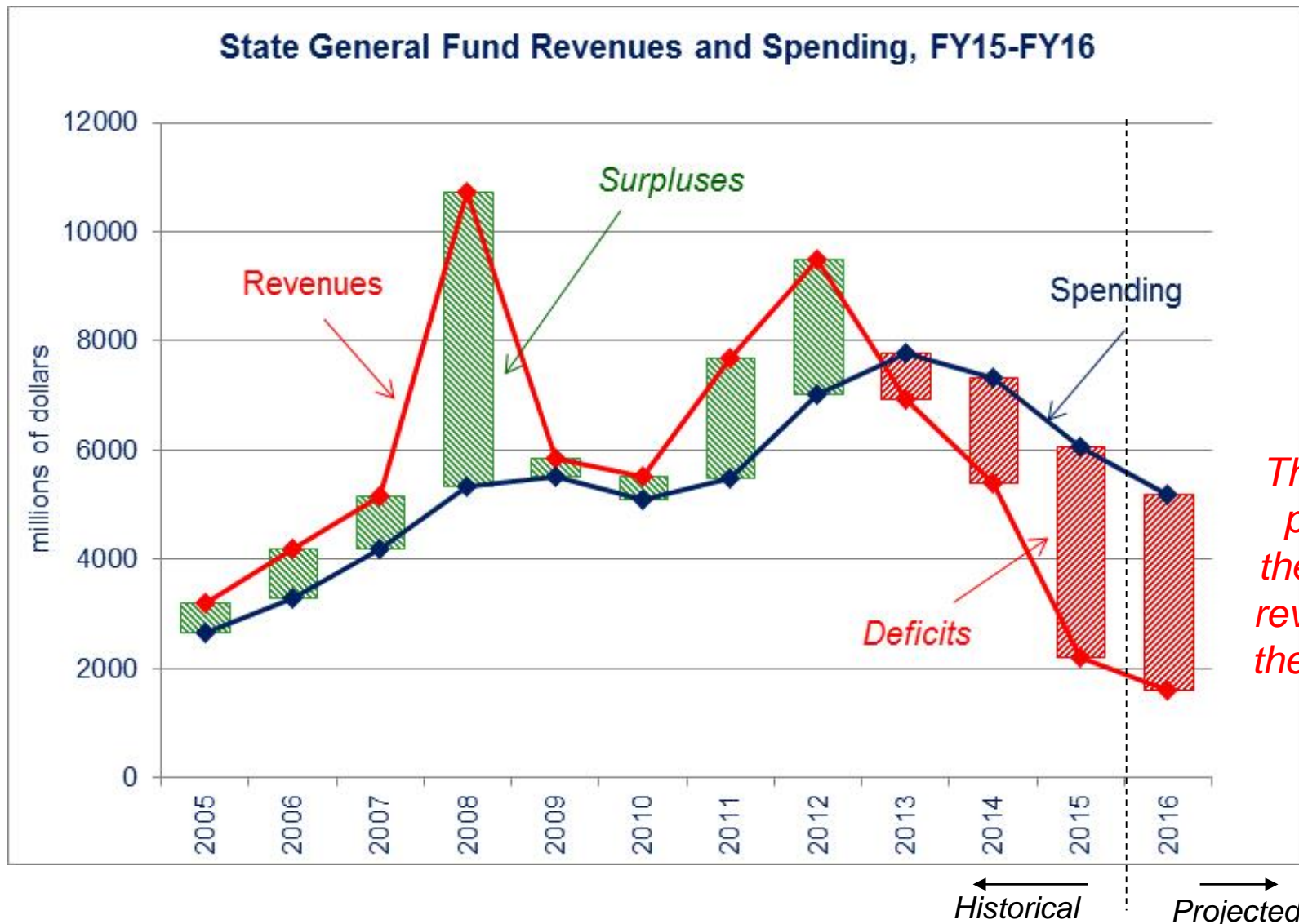
Even if oil prices rise, our future oil revenues will decline as oil production falls.

## Alaska North Slope Production

By production area, 1977-2025

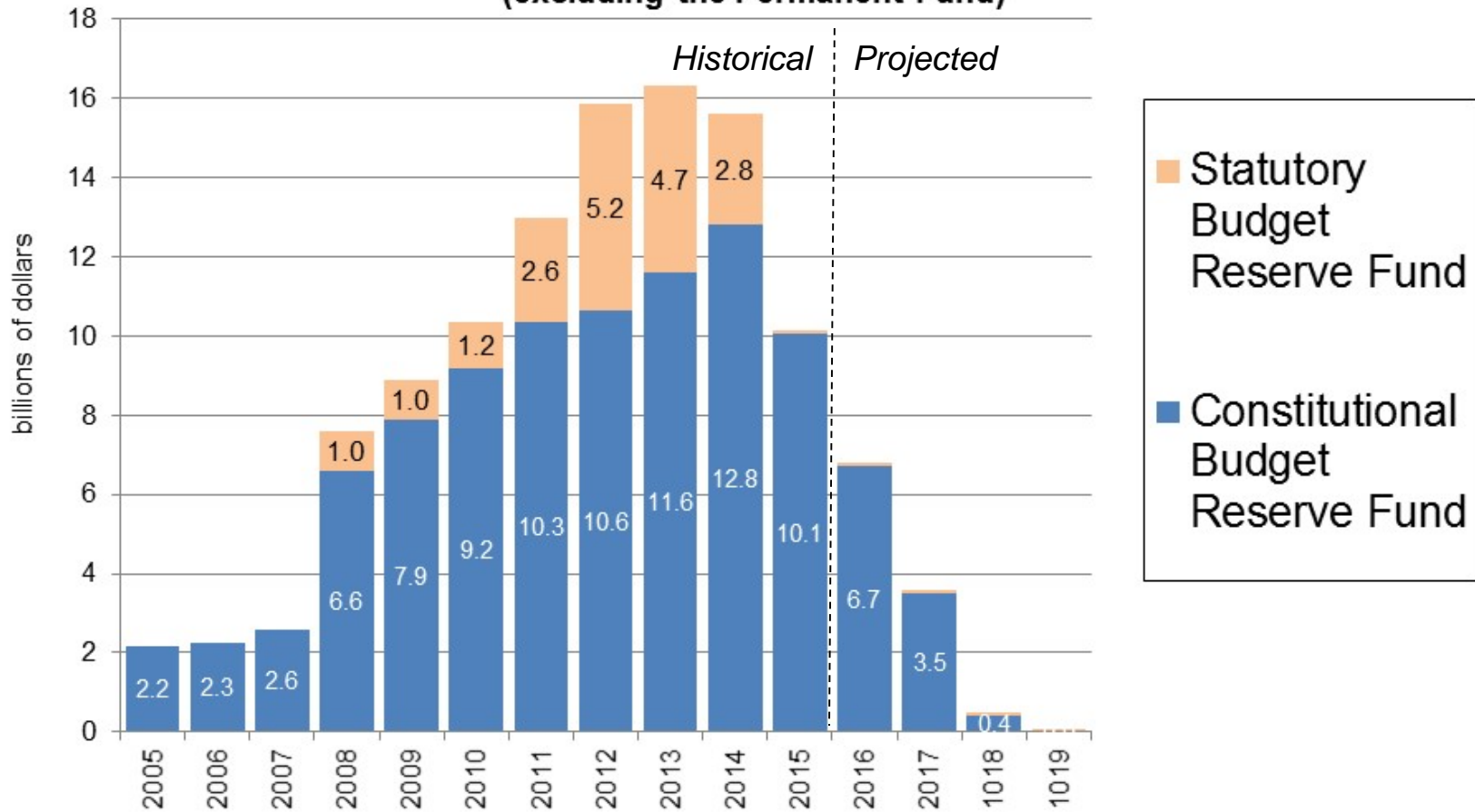


From 2005 to 2012, even though spending was rising, we ran big General Fund **surpluses**. Since 2013 we have been running big General Fund **deficits**.



We used the surpluses prior to 2012 to build up our savings reserve.  
 Since 2013 we have been rapidly drawing down our reserves.  
 Continued deficits of this year's level could drain our reserves in 2 years.

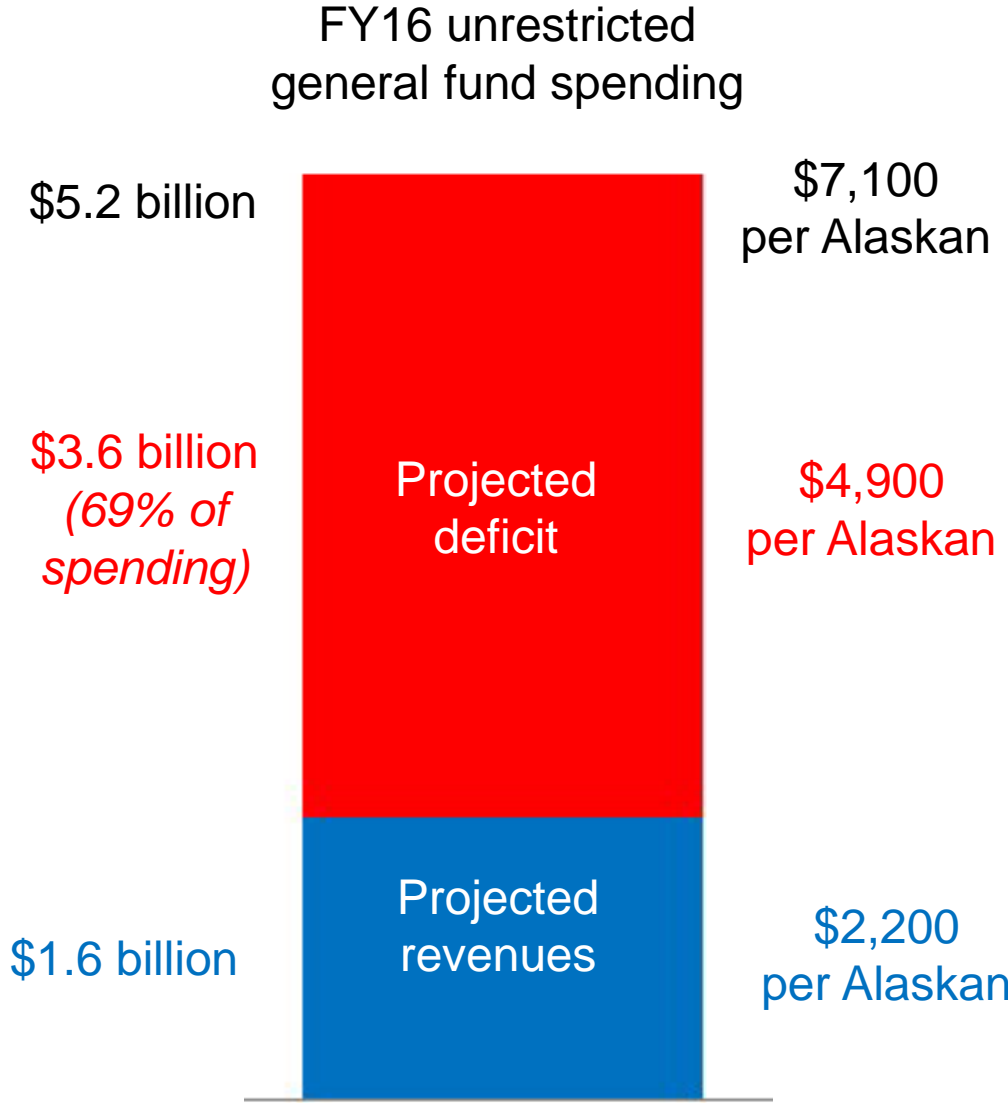
**Historical and Projected End-of-Year Balances of State Reserve Funds  
 (excluding the Permanent Fund)**



Source for end-of-year fund balances through 2015 is Legislative Finance Division. Projections beginning 2016 assume drawdown of CBRF by future deficits resulting from general fund spending of \$5.2 billion and DOR Fall 2015 revenue projections.

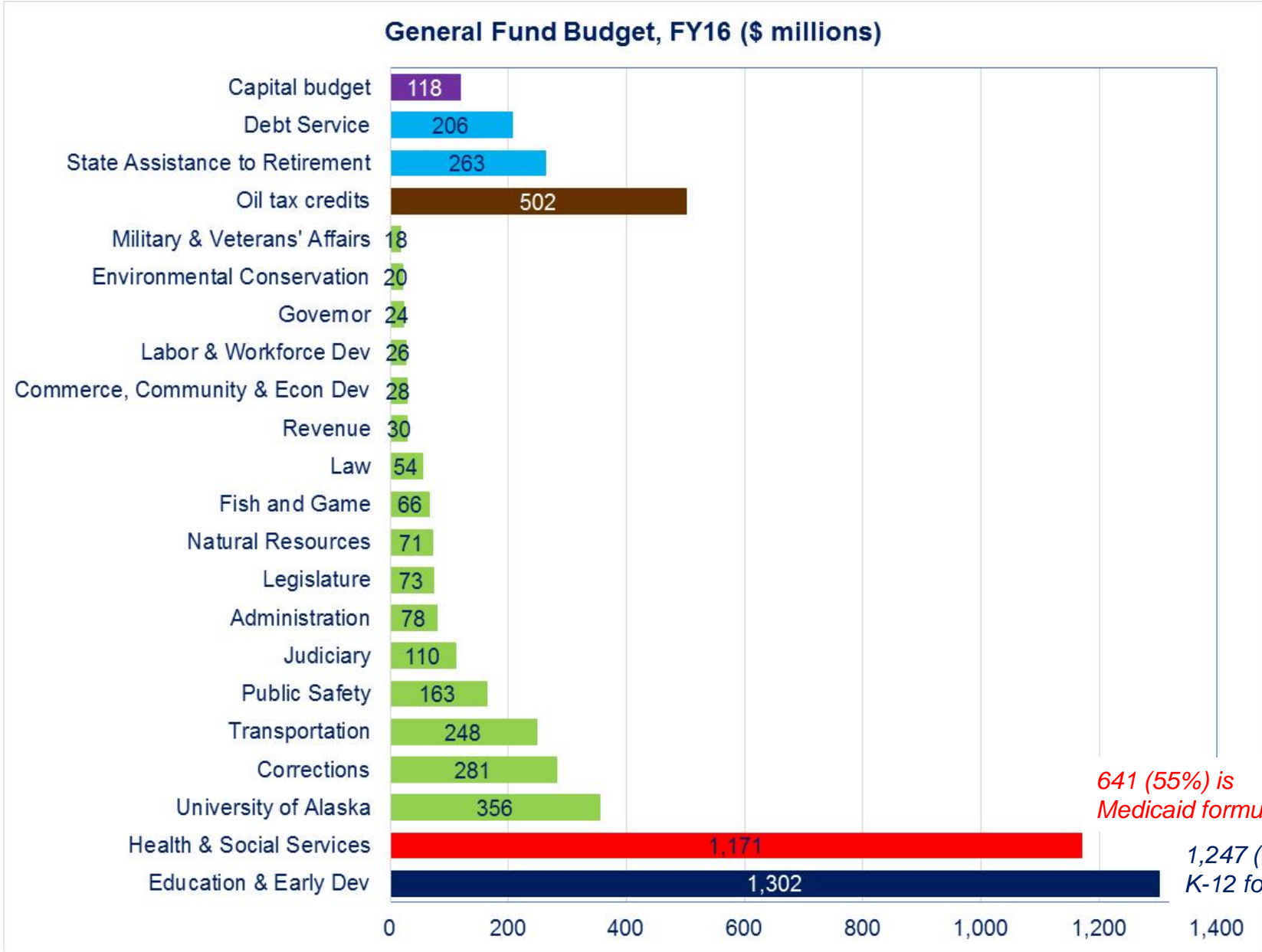


# This year's (FY16) projected deficit is huge.



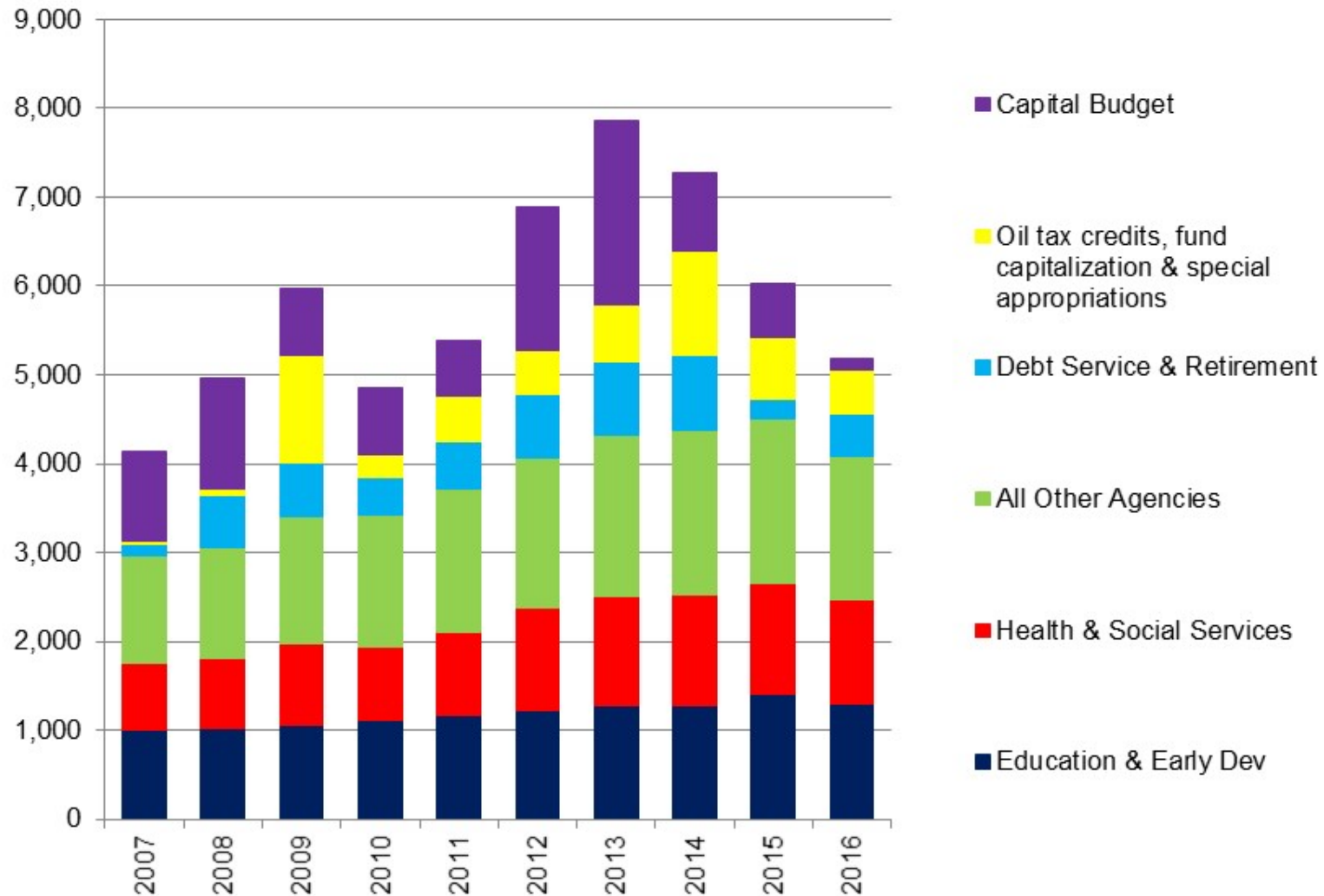
*"Per Alaskan" figures are based on 2014 Alaska population estimate of 735,601.*

# How we are spending \$5.2 billion in FY16



## Trends in General Fund spending, FY07-FY16

**General Fund Budgets, FY07-FY16**  
(\$ millions)



# How the Permanent Fund works . . .

25% of oil royalties  
(0.3 billion)

Realized earnings  
(\$2.4 billion)

**Principal**  
(\$45.3 billion)

**Inflation  
Proofing**  
(\$0.9 billion)

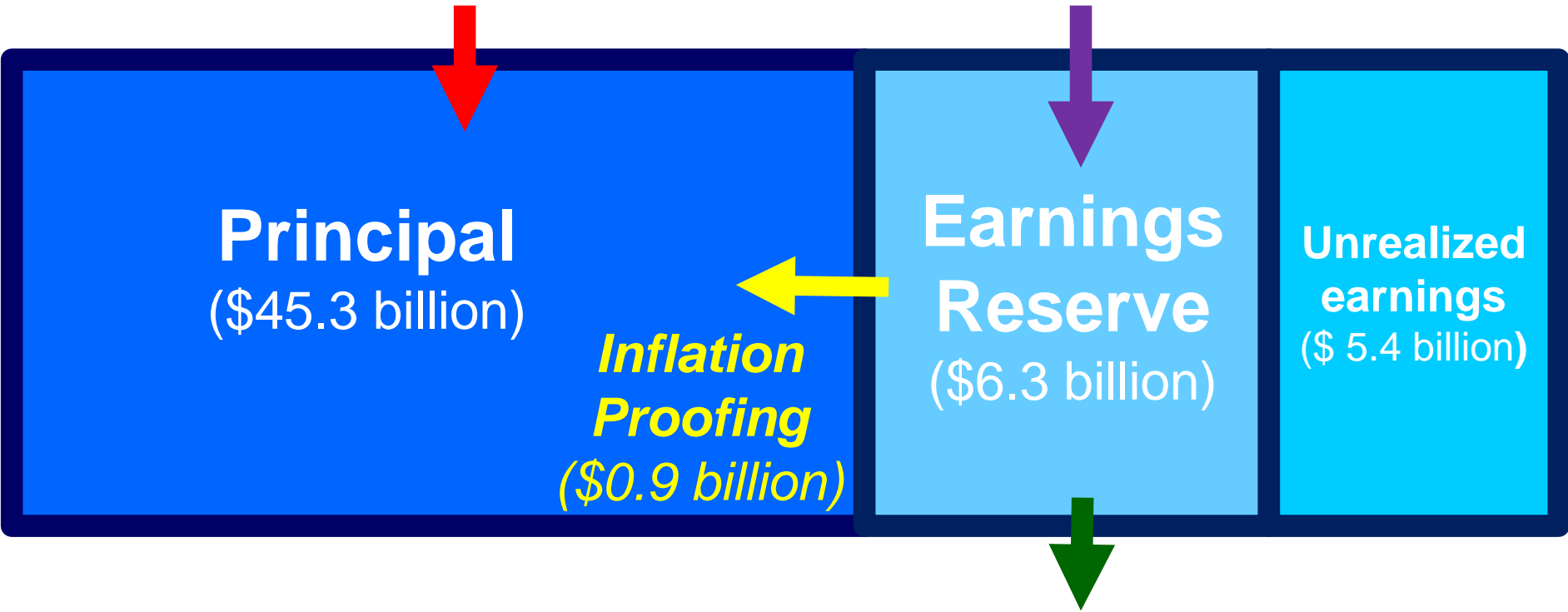
**Earnings  
Reserve**  
(\$6.3 billion)

**Unrealized  
earnings**  
(\$ 5.4 billion)

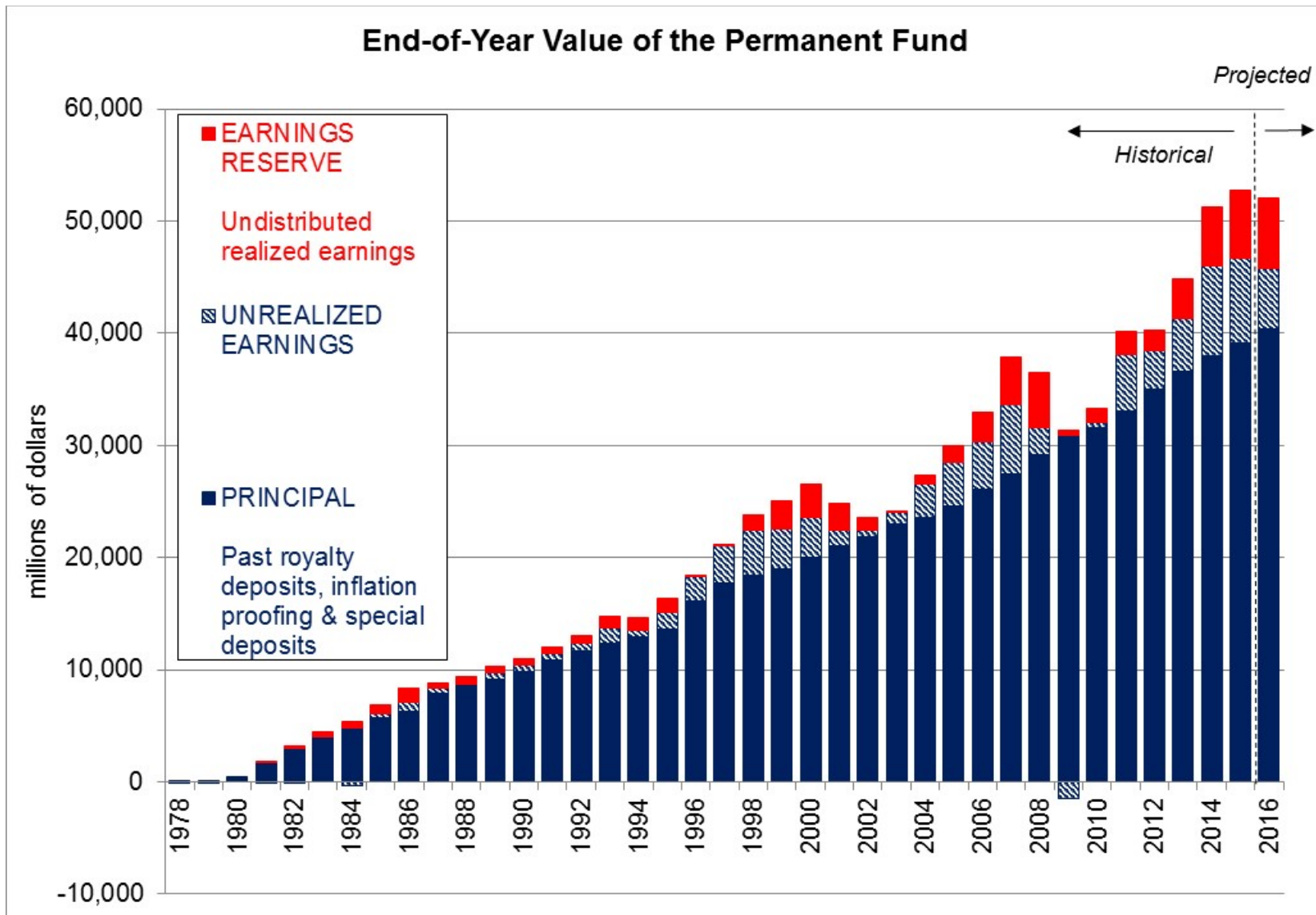
**Dividends**  
(\$1.4 billion)

*half of realized earnings  
over the past 5 years*

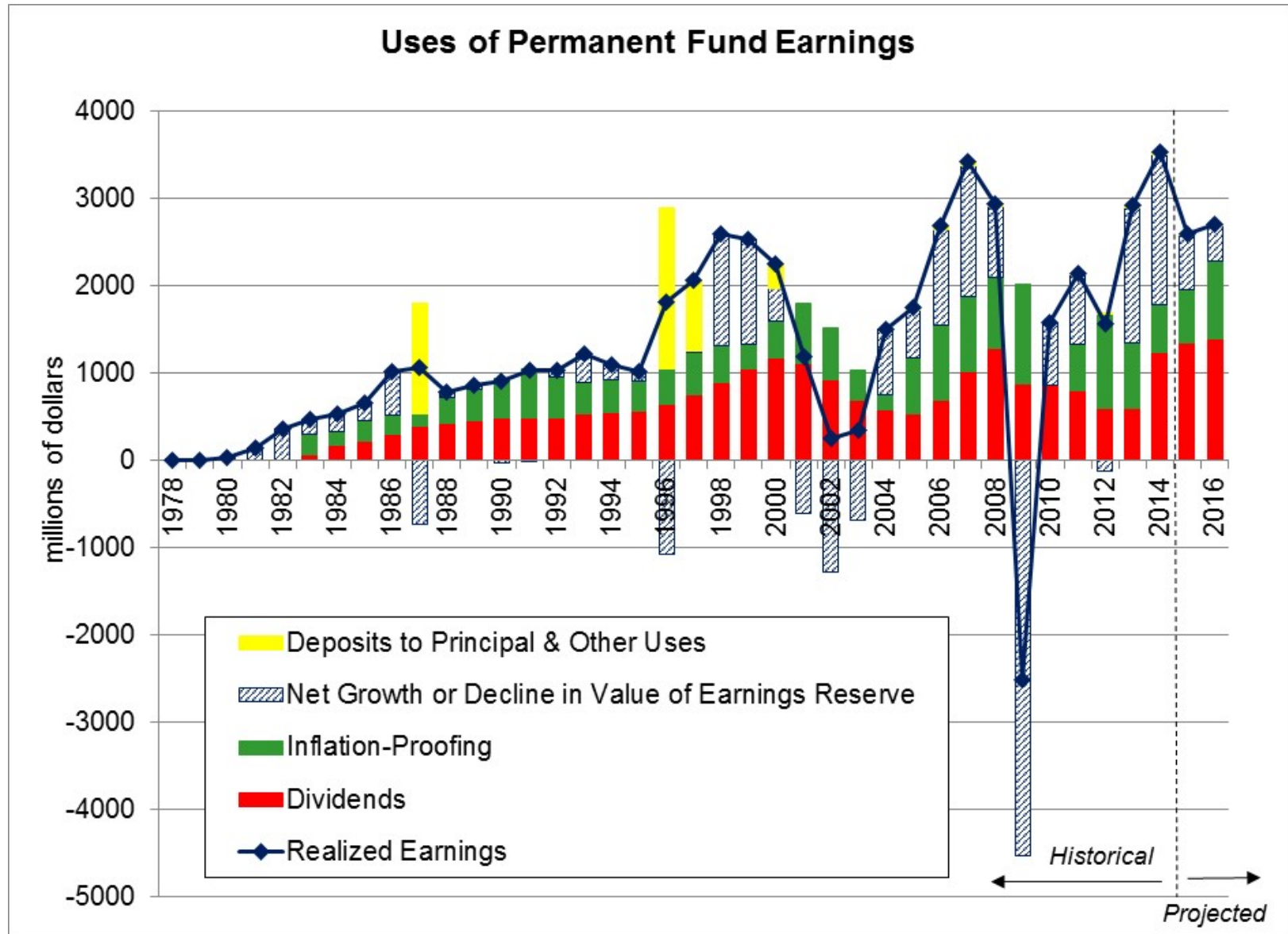
*Dollar values  
are FY16 flows  
and estimated  
end-of-year  
values*



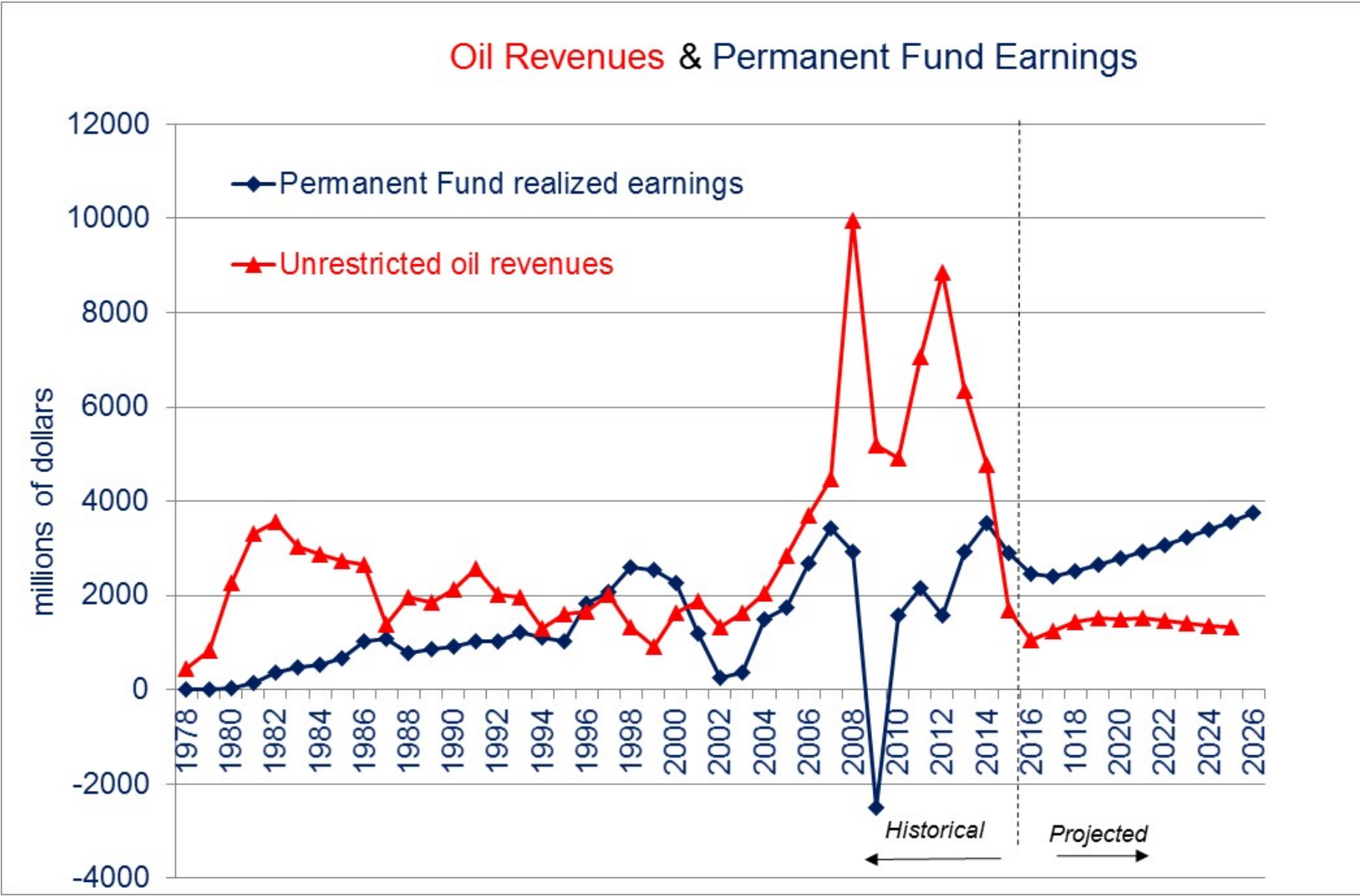
The Permanent Fund is worth about \$52 billion.  
 We can only spend the realized earnings we have saved  
 in the **earnings reserve** (about \$7 billion).



The legislature is allowed to use the earnings for any purpose.  
 We have been using most but not all of the money  
 for **dividends** and **inflation proofing**



The Permanent Fund is earning more than our oil revenues.



## Alaska's fundamental fiscal tradeoffs . . .

*Over any period of time*

<b>What we can spend</b>
<b>= Our income</b>
<b>- What we add to our savings</b>



# Alaska's fundamental fiscal tradeoffs . . .

*Over any period of time*

<b>What we can spend</b>	<b>Government spending</b> <b>Dividend spending</b>
<b>= Our income</b>	Oil income Permanent Fund earnings Other current revenues New tax revenues
<b>- What we add to our savings</b>	Royalty deposits to the PF principal Inflation proofing deposits to the PF principal Net growth in the PF earnings reserve & CBRF

# Alaska's fundamental fiscal tradeoffs . . .

*Over any period of time*

<p><b>What we can spend</b></p>	<p><b>Government spending</b> <b>Dividend spending</b></p>
<p>= Our income</p>	<div data-bbox="562 568 1224 762" style="border: 2px solid red; background-color: #f0f0f0; padding: 5px;"> <p>Oil income Permanent Fund earnings Other current revenues</p> </div> <p>New tax revenues</p> <p style="text-align: right;"><i>Beyond our control</i></p>
<p>- What we add to our savings</p>	<div data-bbox="562 905 1437 968" style="border: 2px solid blue; background-color: #e0e0ff; padding: 5px;"> <p>Royalty deposits to the PF principal</p> </div> <p><i>Mandated</i></p> <p>Inflation proofing deposits to the PF principal Net growth in the PF earnings reserve &amp; CBRF</p>

Alaska's fundamental fiscal tradeoffs are between:

- Government spending
- Dividend spending
- New tax revenues
- Inflation proofing deposits to the PF principal
- Net growth in the PF earnings reserve & CBRF

Our choices are not between any two of these.  
Our choices are between all five.

# HOW WILL WE FILL THE FUNDING GAP?

Our only significant and practical options are some combination of:

Cutting government spending

Cutting dividend spending

(and using the money to help fund government)

Adding new taxes

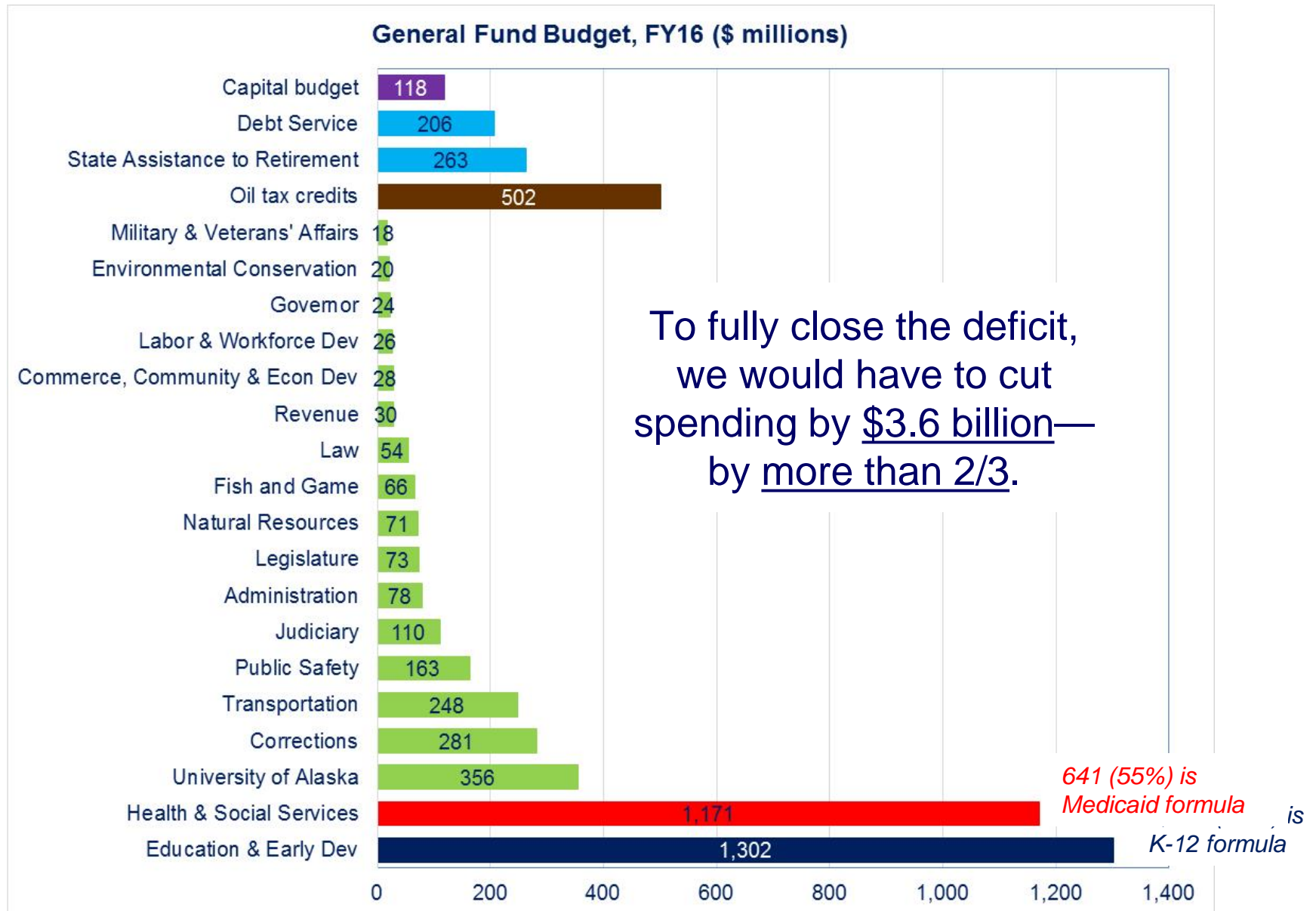
Saving less

(and using the money to help fund government)

There are no easy choices.

The funding gap is so large that we will probably need to use *all* of these options.

The challenge with **cutting government spending** is figuring out what to cut that isn't mandated, essential, "penny-wise but pound-foolish," or too popular to cut.



SATURDAY, JANUARY 30, 2016

Many Alaskans argue we need to “cut spending first”

But . . .

- Cutting spending *right* takes time
  - to debate the state’s priorities
  - to figure out better ways of delivering services
  - to find efficiencies
- It’s politically hard
- It will get harder

COMMENTARY  
**Business will back disciplined, sustainable state budget**  
Curtis Thayer

*Cutting spending right will take time.*

Formula-based programs must be brought in line with state revenue. Spending outside the state’s constitutional mandates is no longer a luxury Alaska’s budget can afford. State services must be prioritized. Efficiencies must be pursued in delivering those services. And services that aren’t a function of government must be eliminated.

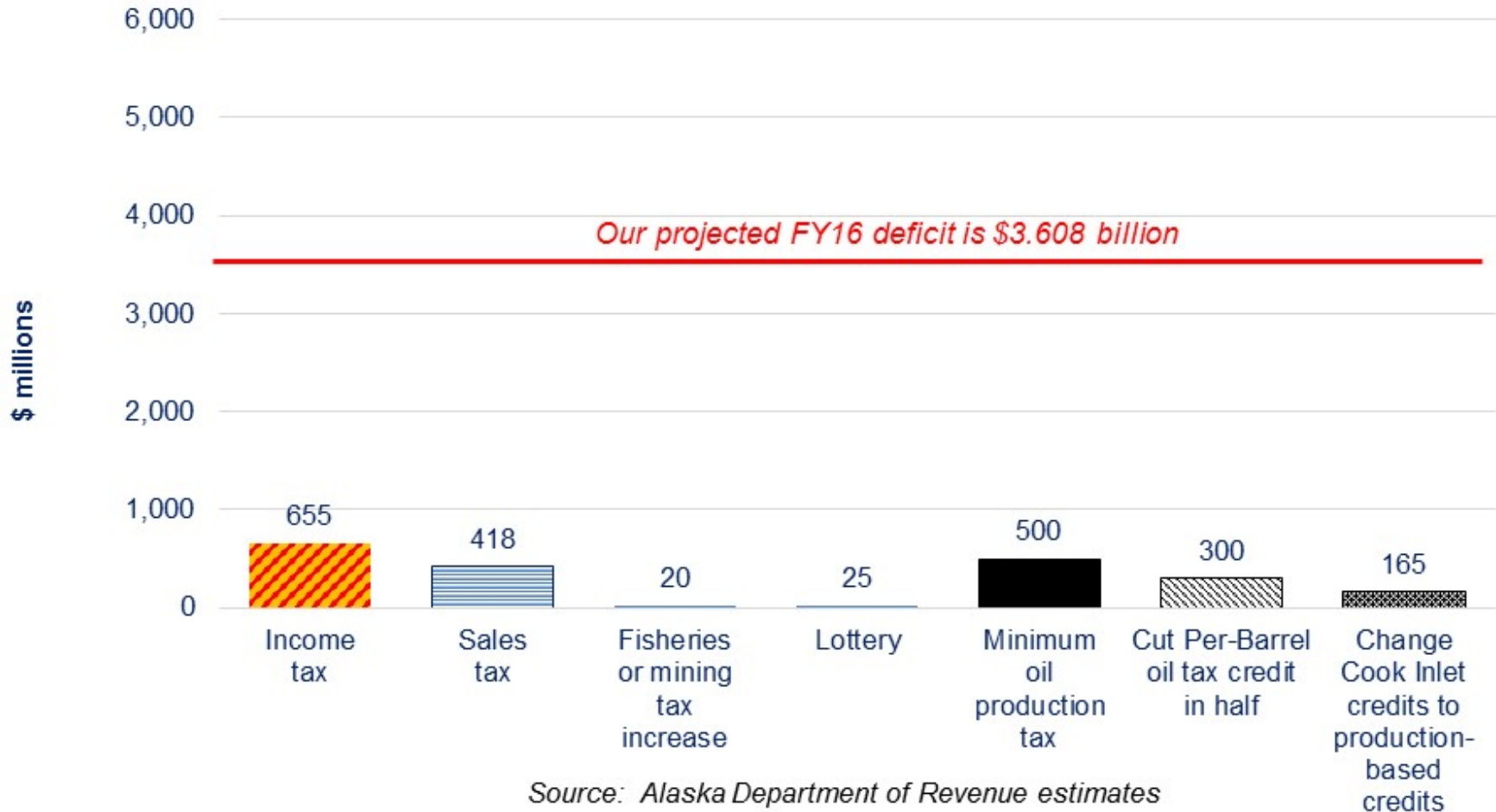
*Getting new taxes right will also take time.*

If revenues are still insufficient after these steps, the last option should be new taxes.

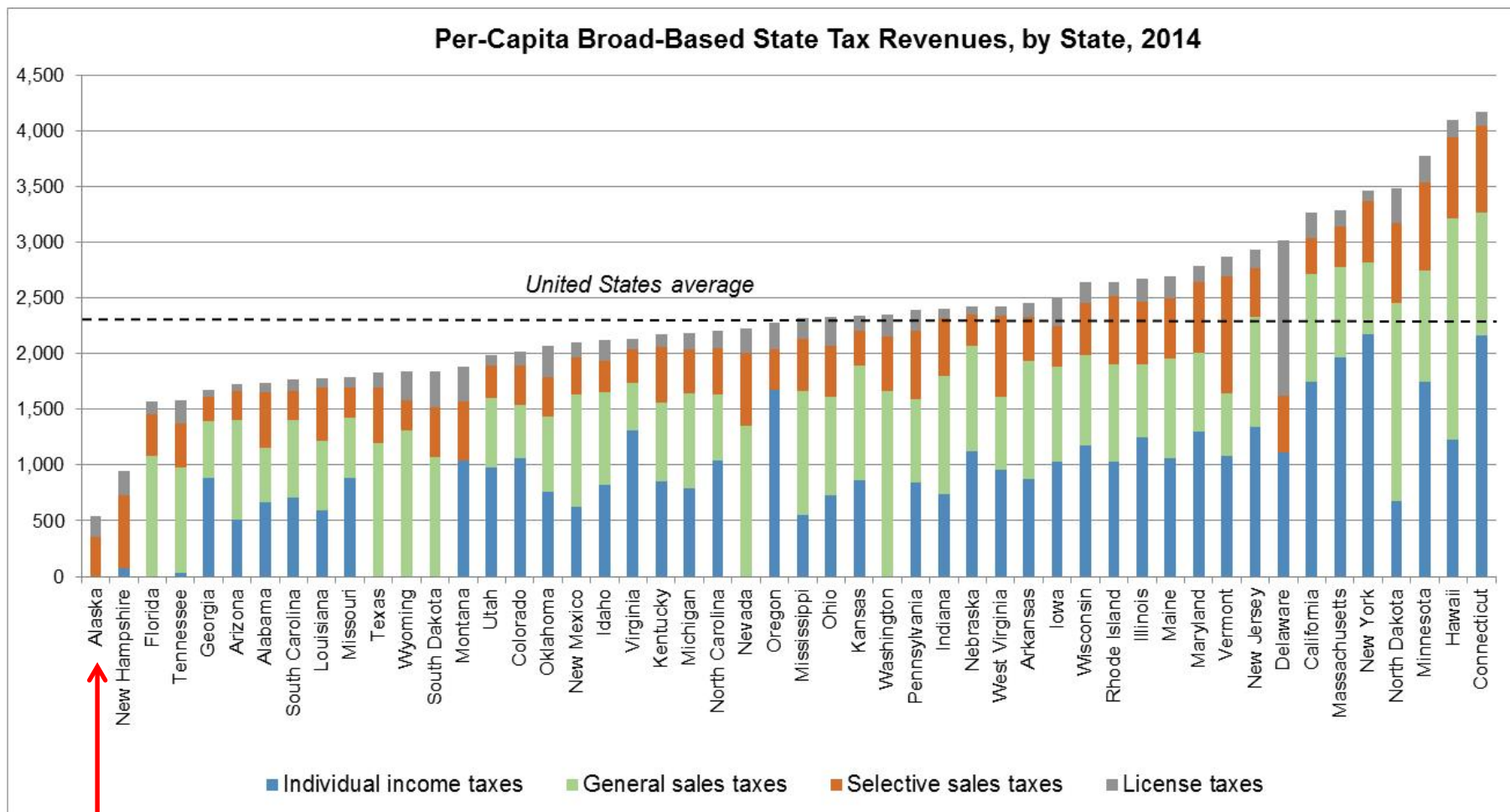
## Adding new taxes . . .

We have many options—but even all together they wouldn't close the deficit

### Some Potential New State Revenues



# Alaskans pay much lower broad-based state taxes than residents of any other state.



Alaska

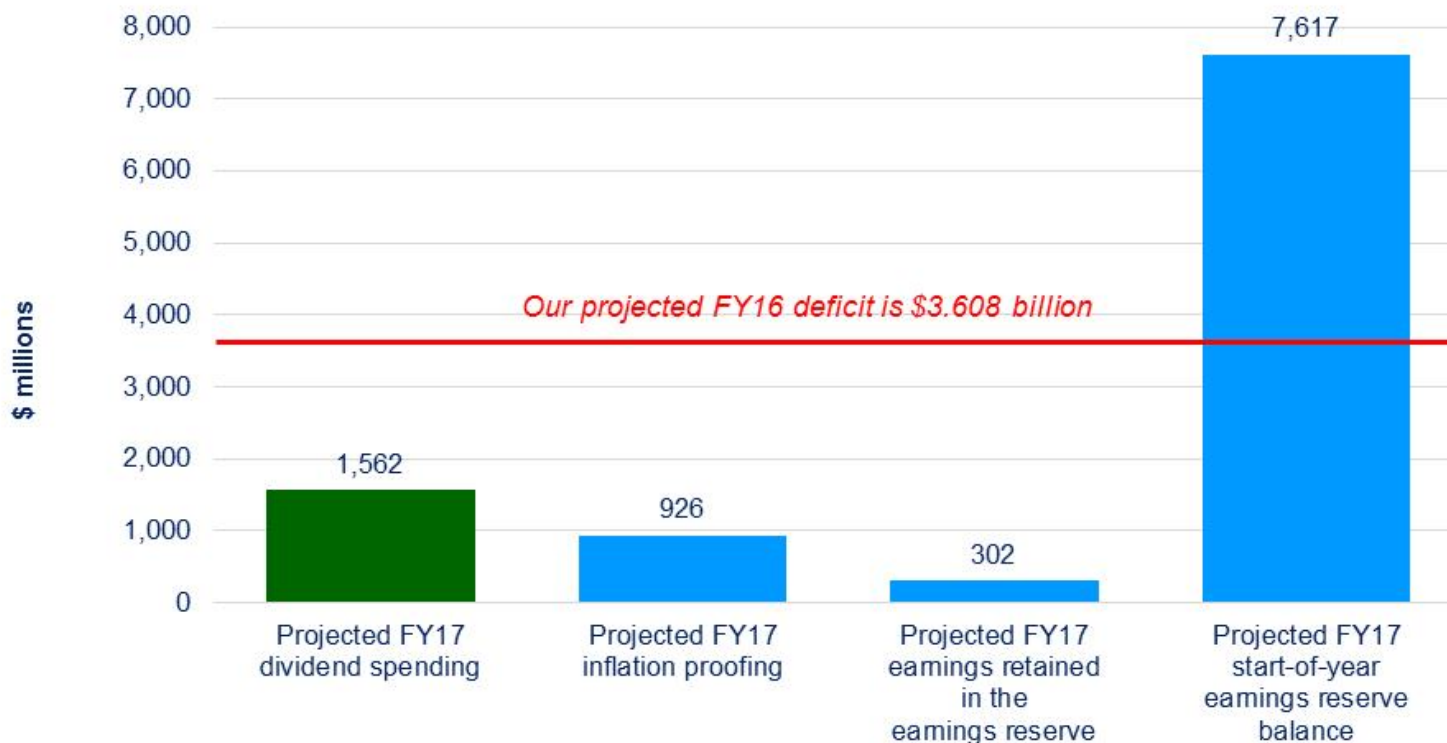


We could use Permanent Fund earnings to reduce the deficit in two ways:

**Cutting dividend spending**  
(and using the money to help fund government)

**Saving less by reducing inflation proofing  
or other additions to the earnings reserve**  
(and using the money to help fund government)

### Potential Sources of Permanent Fund Earnings

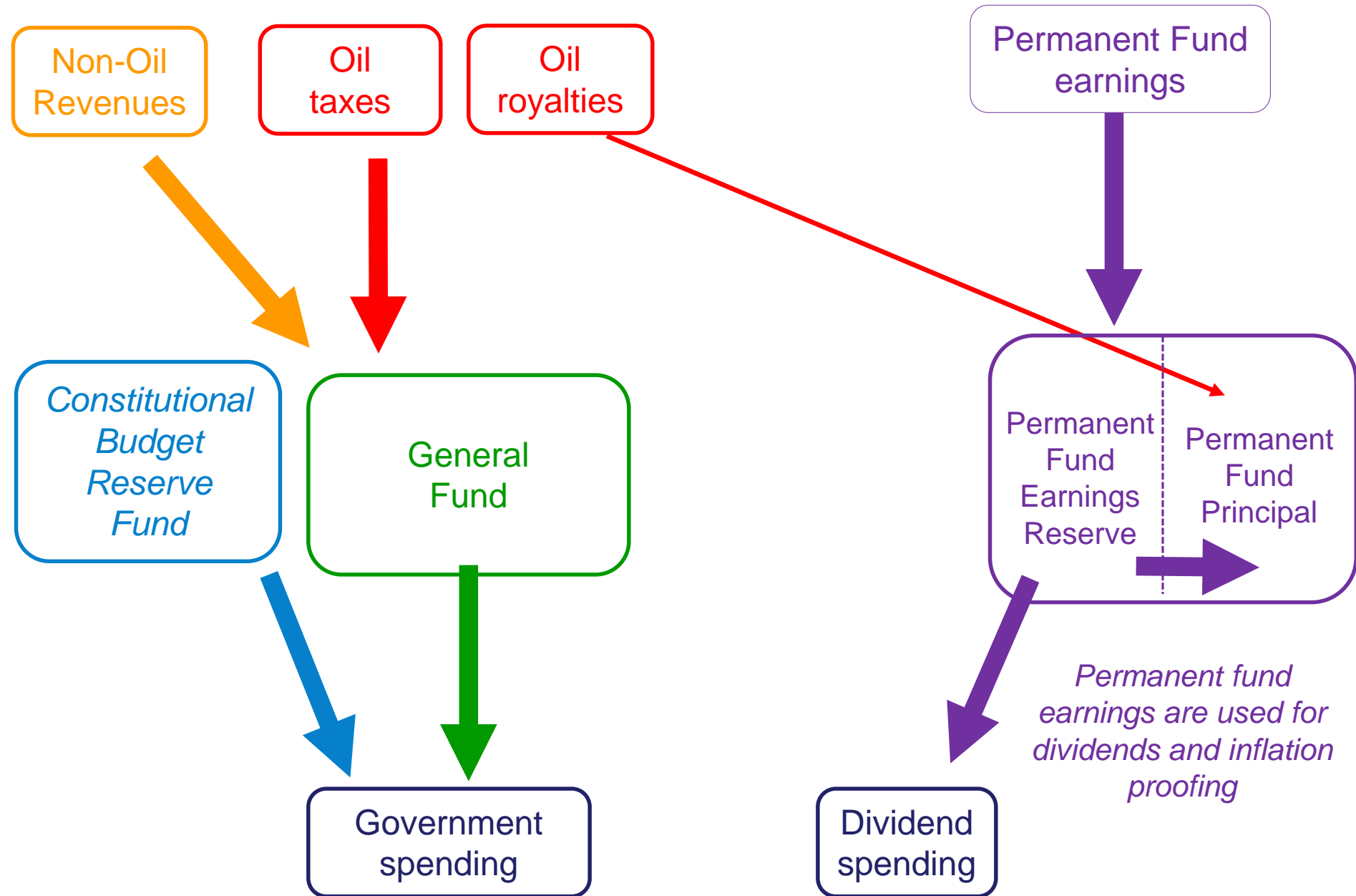


Source: Alaska Permanent Fund Corporation projections as of 9/30/15

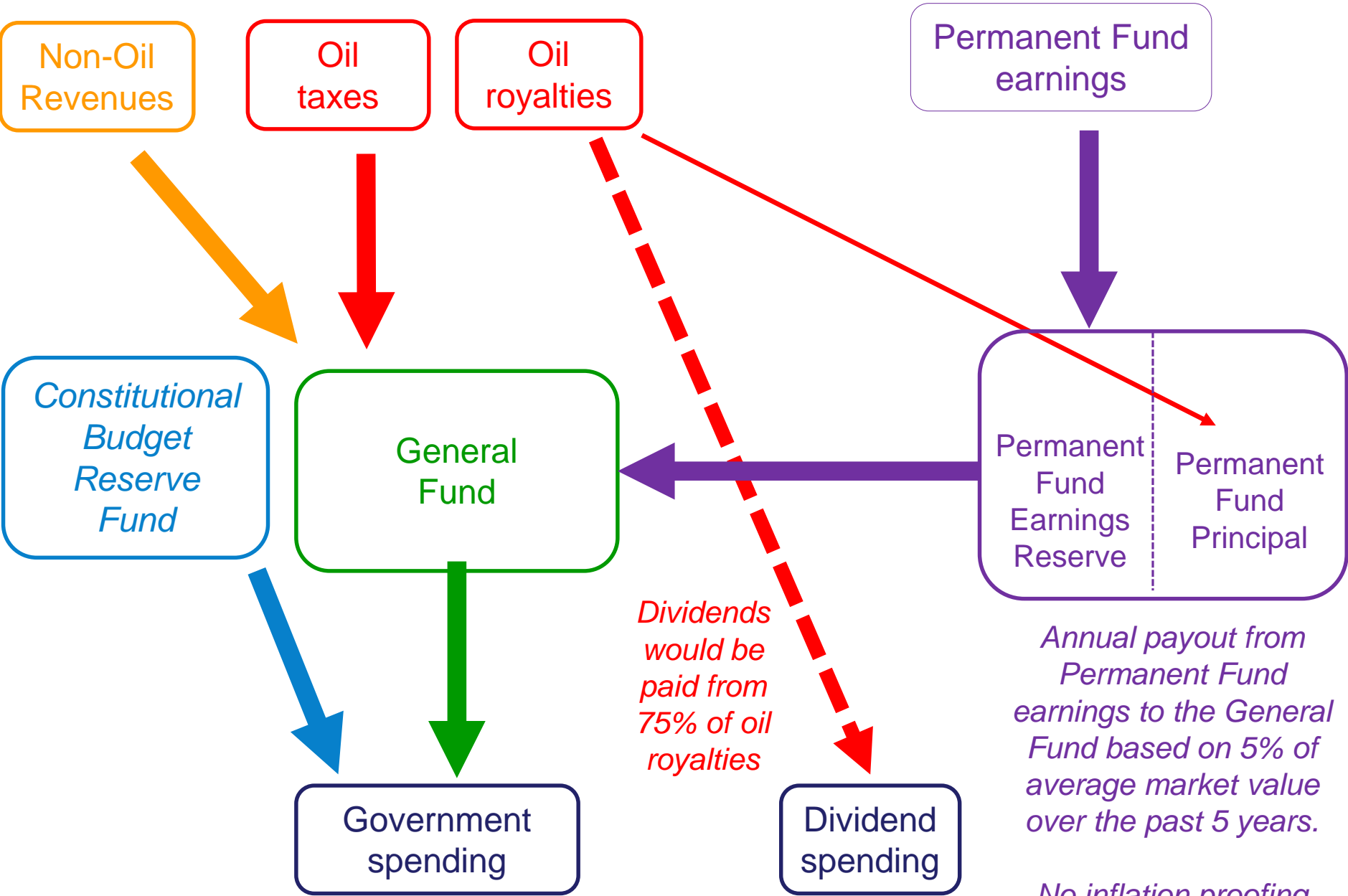
There are two proposals for “re-plumbing” Alaska’s finances and using Permanent Fund earnings to address the fiscal challenge

- Senate Bill 114
- Governor’s proposal (Permanent Fund Protection Act)

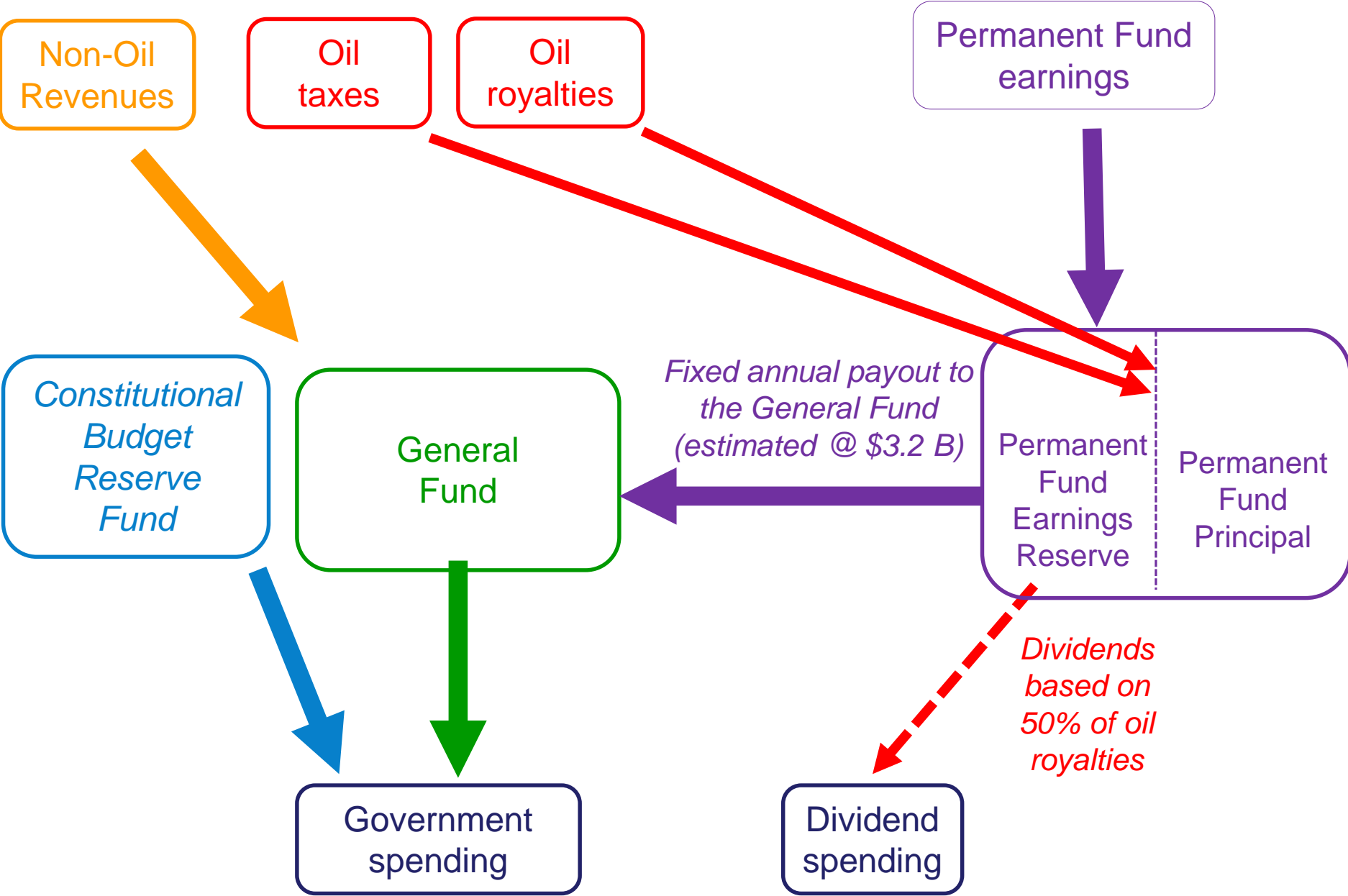
# Alaska's fiscal "plumbing": status quo



# SB 114 proposal: "Swap" funding for dividends and government



Governor's proposal: All oil revenues would go to the Permanent Fund, which would make a fixed annual payout to fund government. Dividend payouts would be based on royalties.



“Re-plumbing” our fiscal system wouldn’t change how much money we have or the fiscal choices we face.

“Re-plumbing” *could*:

- Provide sustainable approaches for using Permanent Fund earnings to help fund state government
- Reduce and change the formula for dividends:
  - Formulas based on royalties rather than Permanent Fund earnings
- Reduce net savings in the Permanent Fund
- Provide more stability and predictability for government funding
  - But only if the legislature follows the formulas

## WHEN WILL WE FILL THE FUNDING GAP?

*The more gradually we adjust,  
the smaller the immediate economic impacts.*

*But the longer we delay:*

The bigger the future economic impacts.  
The greater the risk of **forced drastic adjustments**.

The greater the risk to **investor confidence**  
The greater the risk to our **credit rating**

The lower our future **investment earnings**  
The less savings we leave for **future generations**

# S&P downgrades Alaska's debt rating

**Posted:** January 5, 2016 - 1:01pm

Standard & Poor's also said it expects Alaska's credit rating to continue its fall if the Alaska Legislature does not "enact significant fiscal reforms to reduce the state's fiscal imbalance" during the upcoming 2016 session.



Our fiscal options aren't so bad compared with most other states.

- Most other states:
  - Don't have any oil revenues
  - Don't have any Permanent Fund earnings
- That's why most other states:
  - Spend much less for government
  - Have income taxes and/or sales taxes
  - Don't pay dividends
  - Don't accumulate wealth in Permanent Funds
- Our basic fiscal options are to become more like other states:
  - Spend less for government
  - Tax ourselves more
  - Pay smaller dividends
  - Save less in the Permanent Fund

How can we minimize the economic impacts of  
how we close the deficit? . . .

Our only significant and practical options are some combination of:

Cutting government spending

Cutting dividend spending  
(and using the money to help fund government)

Adding new taxes

Saving less  
(and using the money to help fund government)

Of all our options, only **saving less** would have no short-run economic impacts.

- Reducing how much we save in the Permanent Fund would not:
  - take any money out of the economy
  - have any short-run impacts on jobs or income
- But:
  - Saving less would reduce future Permanent Fund earnings
  - We can't close the deficit solely by saving less.

All other options—**cutting government spending, cutting dividends, and adding new taxes**—would have short-run economic impacts.

They would *all* take significant amounts of money out of the economy.  
They would *all* have significant multiplier effects.

The short-run economic impacts of **cutting government spending** depend critically on what is cut

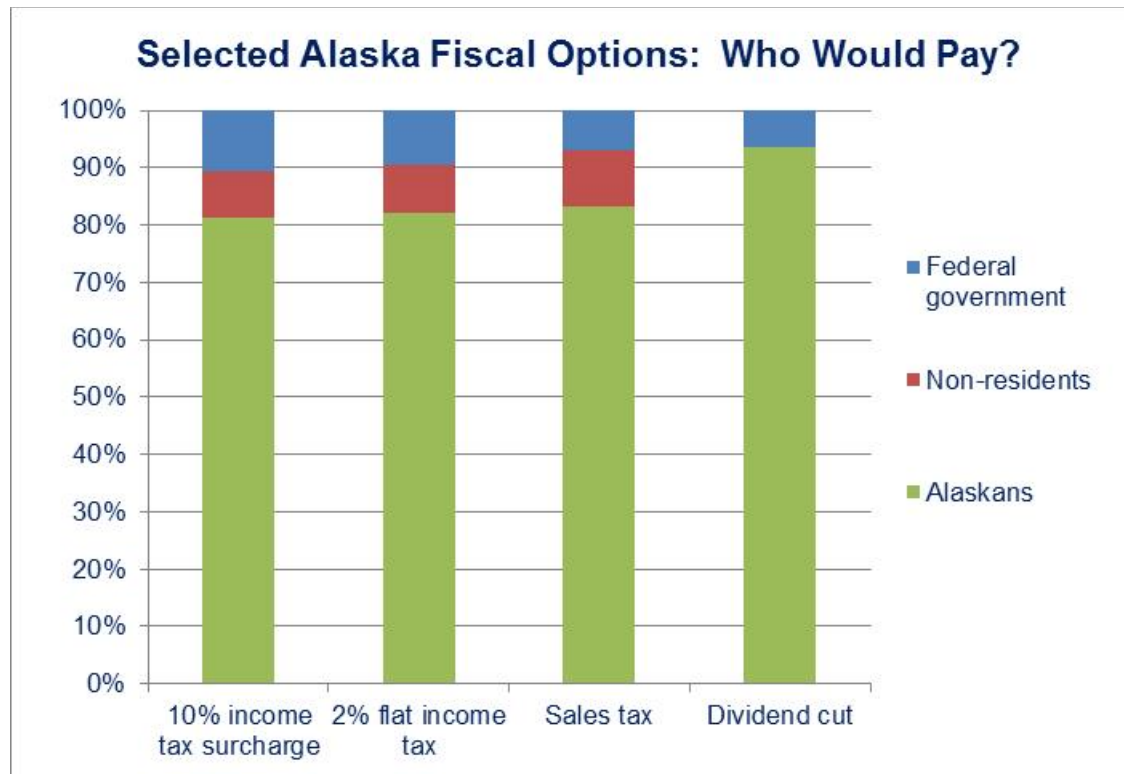
- You can't generalize about the economic impacts of cuts.
- Some cuts would have large impacts
  - cutting government workers
  - In government-dependent regions
- Some cuts would have small impacts
  - cutting purchases from outside Alaska.
- The impacts of **cutting government spending** also depend on the economic impacts of resulting reductions in state services
  - Infrastructure development and maintenance
  - Resource management
  - Effects of government service levels on quality of life and labor markets

## Our fiscal options vary significantly in who would be most affected

- Saving less would most affect future generations of Alaskans
- Cutting government spending would most affect:
  - government and contractor workers
  - regions with high government employment
  - Alaskans who depend on the government services that are cut.
- Cutting dividends would most affect poorer Alaskans and larger families
- Income taxes would most affect wealthier Alaskans

# The federal government and non-residents can help us reduce the deficit.

- Lower federal taxes would help to offset the impacts of taxes and dividends
  - dividend cuts would reduce taxable income
  - income and sales taxes would be deductible
  - Wealthier people who pay higher tax rates would benefit most
- Non-resident workers and visitors would help pay income & sales taxes



## How can we minimize the economic impacts of how we close the deficit? . . .

- There is no way to close our \$3.5 billion deficit without significant economic impacts on Alaska's economy.
- Fully closing the deficit this year would have a very large impact on an already-weak economy.
- But delaying significant progress would also have large impacts:
  - Business uncertainty and lower investment
  - Alaska's credit rating
- We will have a smoother transition if we make significant progress this year (including planning for future reductions) than if we:
  - Fully close the deficit this year, or
  - Don't make a significant start this year

Short-term economic impacts matter—  
but they should probably not drive our fiscal choices.

- Our fiscal choices will affect:
  - The costs of living and doing business in Alaska
  - What kinds of government services we have
  - What kinds of people choose to live and work in Alaska
  - Our future economic development
  - Who pays for government
  - Our income distribution
- We should think about these kinds of longer-run impacts as we think about our fiscal choices.
- We should think about what about kind of state we want Alaska to be