



Let's Talk Alaska – Doing Democracy

Alaska's Fiscal Gap: Challenges, Opportunities, & Choices

Challenge

On Thursday, January 8, 2015 Governor Walker informed the people of Alaska we are in a “fiscal crunch.” He explained, “With oil worth only about half what it was when our current State budget was developed, a \$3.5 billion gap has formed between the amount being spent and the amount of oil revenue the State receives.”¹ “[T]his year, for the first time in state history, we are making less than zero from a tax meant to compensate Alaska for the taking of its oil resources.” ... “Next year, the problem is expected to worsen, with the state netting negative \$400 million on what has traditionally been our biggest source of unrestricted revenue.”¹

A more recent analysis by Dr. Gunnar Knapp, Professor of Economics and Director of the UAA Institute of Social and Economic Research dated April 8, 2015 reports the deficit at \$3.9 billion which is 63% of budgeted spending.²

So, what is a fiscal crunch? The New Oxford American Dictionary defines crunch as “a crucial point or situation, typically one at which a decision with important consequences must be made.”³ To call Alaska’s situation “a crucial point” is a partial truth that ignores the systemic instability of our economy based on one revenue source – oil. Alaska’s crucial point is a symptom of a deeper, longer-term problem that is as much constitutional and democratic as it is fiscal.

It is a constitutional problem because the choices we will make about taxing and spending will change our government. How we make those choices will determine how, or if, government serves “the good of the people as a whole.”⁴

It is a democratic problem because we are a representative democracy and it is our responsibility as citizens to inform our elected representatives of our interests and expectations. We must be able to articulate our expectations not as a multitude of competing petitions of self interest, but as a public voice advocating for the public good. If we cannot come to a consensus about what is good for the people as a whole, we fail our democratic responsibilities, and we have no power.

Finally, it is a fiscal problem because our fiscal choices define the good we would do for our fellow Alaskans. They are choices that define the moral basis of our society.

What Are the Fiscal Facts?

The following excerpts from Professor Knapp's "Fiscal Facts and Choices"² makes the following points:

- Alaska is extremely dependent on oil revenues to fund state government. From 2005 to 2014, oil revenues averaged 90% of unrestricted general fund revenues.
- Over the past three years oil prices and our oil revenues have fallen drastically with a \$7.2 billion decline from 2012 to 2015 – a 61% drop.
- This year's projected deficit of \$3.9 billion is 63% of budgeted spending.
- We did use surpluses from prior years to build up savings in two reserve funds to pay for possible deficits: the statutory budget reserve and the constitutional budget reserve.
- At current spending levels the projected deficits would drain those reserves in about four years.
- Our problem isn't just low oil prices. Production is also falling and our population is increasing. Our fundamental long-term problem is that falling revenues cannot keep paying for a growing population's needs for state government services.
- It would be very hard to close projected deficits just by cutting spending as most of the budget is agency operations.
- Increasing revenues from raising oil prices in the future is uncertain and unlikely to be sufficient to cover deficits.
- Increasing revenues from taxes on residents would not by themselves be sufficient to cover deficits.
- We have been running big General Fund deficits and we have been running big Permanent Fund surpluses.
- If we used Permanent Fund earnings, we could balance our budget with much less drastic spending cuts or new revenues—and keep paying dividends.

Opportunity

Our State Constitution was written in 1955. Today, 60 years later, a younger generation of Alaskans are faced with fiscal challenges that raise many of the same key questions faced by the framers of our constitution. What kind of government do we want? What kind of government can we afford? As previously stated, changes in taxing and spending will change our government. This is both a challenge and an opportunity – an opportunity to create a government that is better fitted to our needs today and the needs of future generations. More accurately, our opportunity is also a constitutionally required obligation. Section 2 of Article 1 of our State Constitution ends with the injunction “all persons have corresponding

obligations to the people and to the State.”⁴ How our fiscal choices embody the “corresponding obligations” we have to our neighbors and the state will be a moral choice. We can make fiscal choices with moral consequences, or we can make moral choices with fiscal consequences.

This discussion guide focuses on three interrelated parts of the fiscal formula: spending, taxation, and use of permanent fund earnings. Which of the parts or what combination of the three will achieve the optimal outcome? You decide.

Choices

One: Reduce State Spending

Argument: Some believe our government spending exceeds our needs. Government needs to be reduced to a size that provides only essential services. They argue that we can solve our deficit by cutting programs and reducing spending.

Some Facts:

- The Operational budget funds government agencies.
- Government agencies provide services to Alaskans.
- “Adjusted for inflation, agency operations spending per Alaskan has not grown dramatically since 2005, and is much lower than it was in the 1980s.”²
- Budgeted spending in the current year is \$8,200 per Alaskan.²
- It would be very hard to close projected deficits just by cutting spending. For example, 59% of the FY 15 agency operations budget is for education and health – two constitutionally directed services.²

Some cutting may be possible without eliminating essential services, but it would be very hard to close the deficit just by cutting spending.

Two: Increase Income

Argument: Some argue that we need to “diversify” our income by asking Alaskans to share the costs of their government. Both state-wide sales and income taxes have been proposed. Some also believe we should increase taxes on the oil industry or eliminate oil industry tax credits.

Some Facts:

- Our Constitution requires that we maximize the value of our natural resources for the benefit of the people. But, Governor Walker recently reported that “[T]his year, for the first time in state history, we are making less than zero from a tax meant to compensate Alaska for the taking of its oil resources.”¹

- Alaskans paid a Territorial and State income tax from 1949 to 1980 at rates ranging from 10 to 16 percent. Personal income taxes were repealed in 1980 after oil revenues became the main source of income to the state.⁵
- Republican Representative Paul Seaton of Homer has introduced HB 182 to enact a state income tax that would generate an estimated \$500 million at a rate of 15% of Federal Taxes. Nonresidents share of this would be \$70 million.⁶
- Republican Senator Click Bishop has recommended Alaskans consider a flat education tax, increased motor fuel tax, a state wide sales tax, and an income tax.⁷
- “Senator Bill Wielechowski (D-Anchorage) and Representative Les Gara (D-Anchorage) have sponsored legislation to protect Alaska in times of depressed oil prices by adjusting the current production tax floor from 4% to 12.5%.”⁸ The legislation also includes a reduction to some per barrel tax credits.

Three: Use Permanent Fund Earnings

Argument: Some Alaskans believe it is time to use the earnings of the Permanent Fund to pay for some government operations. They argue that this was the original intent of the fund and we can use earnings without eliminating dividends.

Some Facts:

- In 1976 Alaskans voted for a constitutional amendment that authorized the creation of the Alaska Permanent Fund.⁹
- The amendment restricted use of the fund’s principle to income producing investments.⁹
- It also stipulated that *earnings* of the permanent fund “shall be deposited in the general fund unless otherwise provided by law.”⁹ thus making them available to pay for basic government services.
- Our legislature makes the decisions as to how these spendable earnings will be allocated. They are presently used to:
 1. preserve the value of the fund by reinvesting a portion of earnings equivalent to annual inflation rates,
 2. pay dividends, and
 3. increase the value of the fund by investing surpluses in excess of dividends and inflation proofing back into the fund.

It is this last category of earnings (item 3 above) that is available to pay for basic government services. For example, in F/Y 2014 statutory net income to the fund was \$3.5 billion of which \$1.2 billion was allocated to dividends, \$546 million to inflation proofing, and \$1.75 billion to reinvestment.¹⁰ It is this last amount that could be available to pay for government services without impacting the payment of permanent fund dividends.

Sources

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