

Elements of a Credible Alaska Fiscal Plan

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It's past time for Alaska to face up to our critical fiscal challenge. We have been spending far more than our revenues and rapidly draining our savings. We face fundamental choices about our spending and revenues.

I've spent the last three years trying to help Alaskans understand our fiscal challenge and the choices we face. The Alaska Dispatch News asked me to share what I think we should do.

We need a credible fiscal plan for how we will close the gap between our spending and revenues that resolves uncertainty about Alaska's fiscal future. We need a plan that will work, based on realistic economic and political assumptions about how much money we will spend for government and dividends, receive from current and new revenue sources, and add to or draw from our savings over at least the next five years. We need a plan that not only works financially, but gets Alaska to a future we and our children want.

Without a credible fiscal plan, we're flying blind. We risk draining our savings and crashing both government spending and dividends. We risk further downgrades to our credit rating and higher borrowing costs. We leave state and local governments unable to plan. We sap the morale of public workers. Most importantly, we leave Alaska residents and businesses uncertain about whether Alaska is a place they want to live and invest in.

It's time to move beyond the excuse that we can't act because it would harm Alaska's economy. Not facing up to our fiscal challenge will harm our economy. We don't necessarily have to fully close the deficit this year. But we have to get to a credible plan for how and when we *will* close it.

Of course any fiscal plan should and will change over time as circumstances change. Planning for the future doesn't mean locking in what you'll do in the future. It means thinking enough about what you want for tomorrow that you can make responsible choices today.

Here are some of the most important elements of a credible fiscal plan.

Credible assumptions about future government spending

A credible fiscal plan has to be based on serious discussion of the right balance between the government services we need and want, what they cost, and what we are willing and able to pay for them — for all the major parts of state spending. We have to recognize that some spending *can't* be cut, such as our debt service obligations. Some spending brings Alaska far more in matching federal funding than it costs. Some spending we need to *increase*. That includes the capital budget —unless we want to let our past investments in roads and buildings crumble and don't aspire to any future growth.

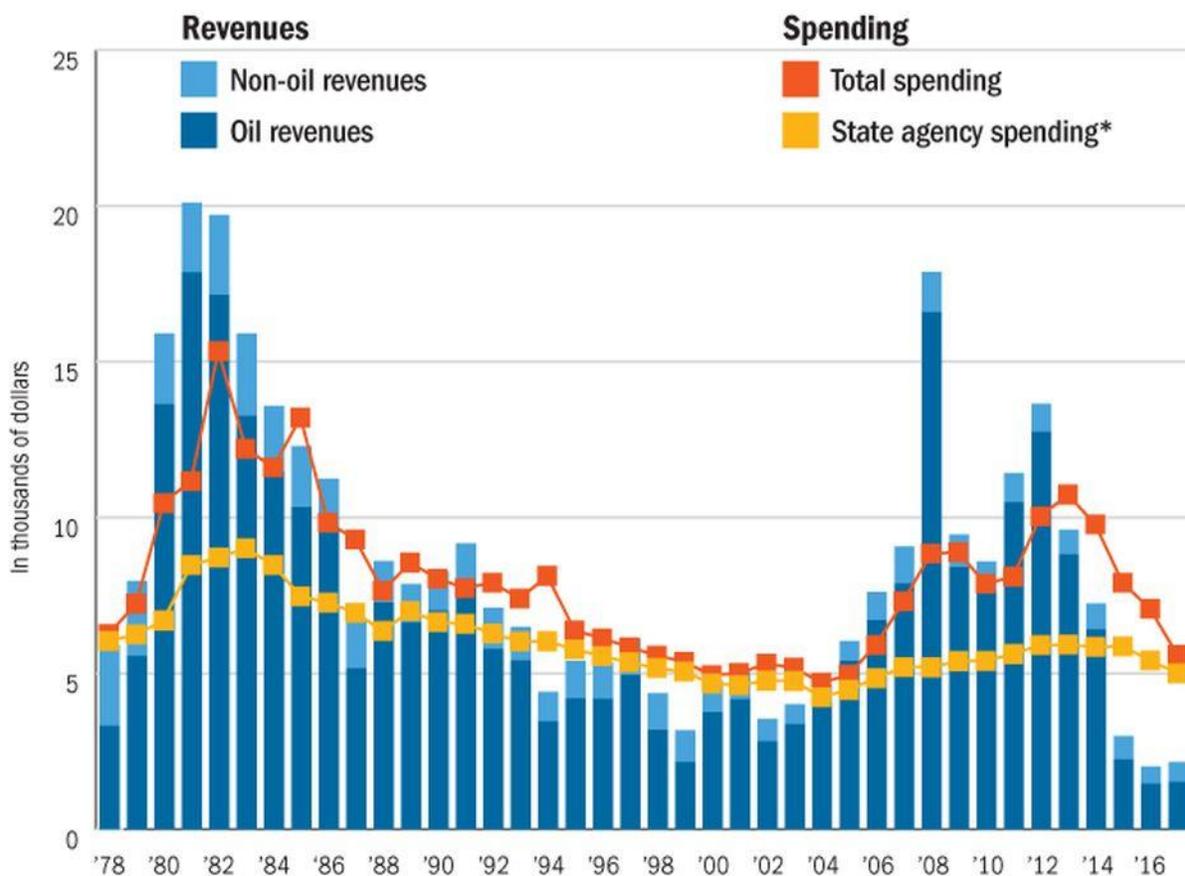
We can't find the right balance just by calculating how much we would need to cut to avoid taxes. Future cuts are neither credible nor responsible unless they are based on serious conversations about whether they are possible and whether Alaskans want them.

We've already cut billions of dollars in spending over the past few years. It's getting harder for the Legislature to make further cuts, because fewer Alaskans support further specific cuts. Cuts that aren't politically possible aren't a credible solution.

Many Alaskans argue that state government is bloated and that we need to cut hundreds of millions of dollars more in spending—without saying *what* they would cut. Unspecified cuts are neither credible nor a responsible part of a fiscal plan. I'm losing patience with those who argue for spending cuts which they can't identify and we can't discuss.

Alaska unrestricted general fund revenues and spending per person

Since 1978, Alaska's unrestricted general fund revenues, which pay for most of government, have overwhelmingly come from oil and have fluctuated widely. For the last three years, revenues per Alaskan have fallen to the lowest levels of the past 40 years, leaving spending far above revenues despite major cuts.



*Operating budgets of state agencies. Excludes capital spending, debt service, & oil tax credits.

Source: Legislative Finance Division

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Clear thinking about dividends

Alaska's fiscal challenge poses difficult choices for us about dividends. In recent years, dividends have been the second largest component of state spending, after education. A credible fiscal plan has to be based on clear thinking about why we pay dividends, what they cost, who will be harmed if we cut them, and how they help protect the Permanent Fund.

Some argue that dividends are Alaskans' return on our saved oil wealth. The money is ours — not a gift government can cut when it needs money. Others argue that Permanent Fund earnings are the government's money, to be used however most benefits Alaskans, and always intended to help pay for public services when oil revenue declined.

I respect both perspectives. But if dividends are the people's money and can't be cut, then Alaskans will need to accept bigger spending cuts or pay more in taxes to address our fiscal challenge. If dividends are government spending we can no longer afford, we must recognize that cutting dividends would have a far greater impact on poor Alaskans than rich Alaskans. Cutting dividends takes as much from the poorest child as from the richest millionaire. It actually takes more from the poorest child, because part of the richest millionaire's dividend goes to federal income taxes. And unlike taxes, which non-resident workers or visitors would help to pay, cutting dividends takes money only from Alaskans.

The public's understanding that dividends are linked to the value of the Permanent Fund has been a powerful barrier to "raiding" the fund for unwise spending. Without dividends, would we have grown the Permanent Fund to more than \$50 billion, able to earn critically needed investment revenues for Alaska? We should beware risking that link. As we begin to use Permanent Fund earnings for more than dividends, we should make sure that Alaskans still demand wise stewardship of the Fund. We've seen how easy it has been to deplete our other savings funds.

Prudent assumptions about future oil and investment revenues

Alaska's fiscal future depends critically on highly volatile and highly uncertain future oil and investment revenues. But we rarely discuss what *range* of revenues we might face in the future, or the implications of lower or higher than projected revenues. We base our fiscal discussions on the most recent Department of Revenue projections of future oil revenues and the most recent Permanent Fund Corporation projections of future investment returns—even though those projections almost never come even close to reality a few years out.

A credible plan needs to work whether oil revenue and investment returns meet projections or not. Partly that means basing our plans on prudent assumptions about future oil and investment revenues. Just as importantly, it means being able to adjust if revenues come in lower or higher than we planned for.

Future oil and investment revenues will always be uncertain. We need to plan for uncertainty. That mattered less when we had high savings balances to draw on if needed. It matters much more now with our savings depleted. And it's one of the reasons why we need to diversify our revenue sources.

Ways to increase and diversify our revenue

Given the government services Alaskans need and want, the drastic drop in our oil revenues, and the uncertainty of our future oil and investment revenues, a credible fiscal plan has to include ways to increase and diversify our revenues. Those could include an income tax, a sales tax, or other kinds of taxes or tax increases.

Oil revenues have fallen drastically, not just because oil prices collapsed but also because our oil production has fallen to one-fourth of what it used to be and may continue to fall. We can no longer rely on oil revenues to pay for most of Alaska state government, like they did for almost forty years. While we can hope for higher prices and production, it's not prudent to assume that oil revenues will rebound to anywhere near what they used to be.

Fortunately, investment revenues from the Permanent Fund can make up for a lot of the decline in oil revenues. But they can't cover all of it. And future investment revenues are as uncertain and potentially volatile as our future oil revenues. Anyone who has ever invested in the stock market knows that investments sometimes crash.

Some people argue that we can and should adjust to the drastic fall in oil revenues without imposing any new taxes on Alaska residents or businesses. I don't think we can or should.

Without new revenues, we will continue to be overwhelmingly dependent on highly unstable oil revenues and highly unstable Permanent Fund earnings to pay for government services we need and want. I don't want the quality of my kids' schools to be driven or limited by the price of oil or what the stock market did last year. If the price of oil is high and I don't have to pay for good schools, that's great. If the price of oil is low and I need to pay for good schools, I'm willing.

Reasonable people can disagree about how and how much we should tax ourselves. But it's irresponsible to refuse to talk about taxes.

We need to move beyond the rhetoric that all taxes are bad for the private economy and bad for Alaska. Of course excessive taxation can harm an economy. But that doesn't mean that the only acceptable level of taxes is zero. In every other state, people pay either state income taxes, state sales taxes or both. And unlike Alaska's, almost every other state's economy is *growing*.

People in other states don't enjoy paying taxes any more than we would. But they pay taxes for government services they want and need. No other state thinks they can have — or deserve — state government services without helping to pay for them. And every other state gets non-resident workers or visitors to help pay for government.

We need to move beyond the rhetoric that every government job supported by taxes destroys a private job. Government jobs provide services that are essential to our private economy. What kind of private economy would we have without schools or roads or courts? Who would want to live or invest here? The real issue is finding the right balance of private and government jobs for a healthy economy.

Some argue that taxes would take the pressure off legislators to cut government — and over time any tax will grow into higher taxes and more government. That's a concern — but there

are other ways to limit the size of government. Is keeping government too small the only way to keep it from getting too big?

Some argue that Alaskans won't accept taxes until we cut spending more. Maybe that's backwards. Maybe Alaskans won't cut spending until we pay taxes. When you pay taxes, you really pay attention to what government spends. If we had been paying taxes, would we have spent so much in the past?

As an economist, I worry about the "Alaska disconnect." Without broad-based taxes, most growth (except for a few resource industries) doesn't pay for itself: it adds costs but doesn't add revenue. When businesses and citizens don't help pay for the services they use, you're setting yourself up for trouble.

Our savings goals

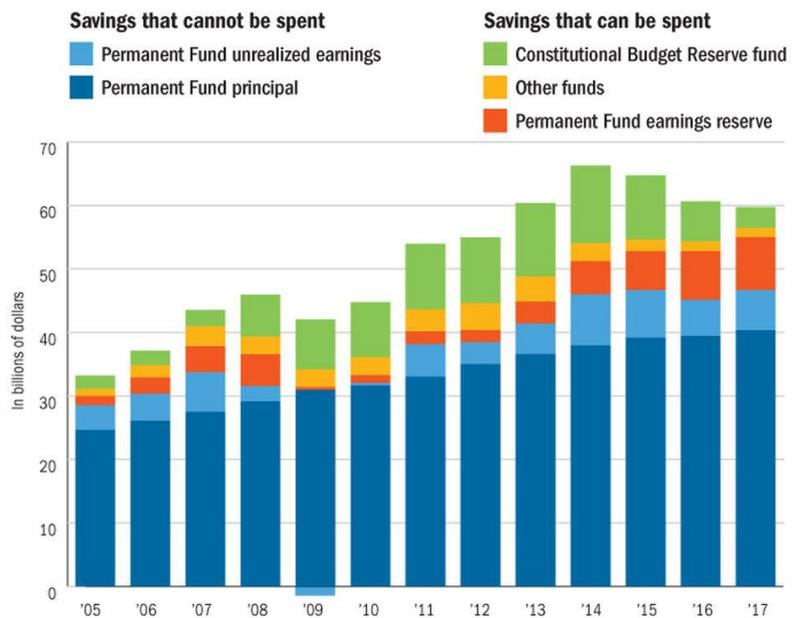
A credible fiscal plan requires clear thinking about how much we plan to draw from or add to the Constitutional Budget Reserve, the Permanent Fund and other funds. Will we have enough cash to pay our bills if we face an emergency such as a major natural disaster, or even a big stock market crash?

But the issue isn't just whether we'll run out of cash. It's also how much we should be leaving for future Alaskans. We've been drawing down our total savings—the Permanent Fund and other funds combined. Is it OK to keep drawing them down? Or should we be trying to maintain their current level? Or grow them? The answer critically affects how much we can responsibly spend. Without knowing our savings goals, it's hard to have an informed discussion about the rest of our fiscal choices.

Our saving over past decades grew the Permanent Fund to more than \$50 billion, and its investment earnings now promise to be a very important source of funding as oil revenues decline. But by using more of those earnings we'll slow the fund's growth. We can't know how much of the Permanent Fund's earnings we can prudently use unless we know how much we want it to grow — or how much we're willing to deplete it.

Alaska's total savings are declining — particularly savings we can spend

We have paid for huge deficits the past three years by drawing money from our Constitutional Budget Reserve Fund savings account and other accounts. Those funds are mostly gone. We could spend money from the Permanent Fund earnings reserve, but that's all we have left to spend.



Source: Legislative Finance Division, Alaska Permanent Fund Corporation

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Local government obligations and finances

A credible fiscal plan has to work for not only state government but also for local governments. State and local government spending and revenues are inextricably connected. Our state government pays for many of the services local governments pay for in other states. We could cut state spending by making local governments more responsible for providing local services, cutting revenue sharing, and cutting the share of state support for education, school bond debt service, and unfunded retirement obligations. But those would all drive up local government costs and local taxes. A state sales tax could cause big problems for communities which rely on sales taxes to fund local government.

How do we get there from here?

Reasonable people can disagree about the right balance of revenues, spending and savings for Alaska's future. I have my own opinions about the right balance—but they're not what I'm advocating for here. I don't expect the Legislature to get to the balance I want. None of us should. To address our fiscal challenge, we'll all need to compromise. That's how democracy works.

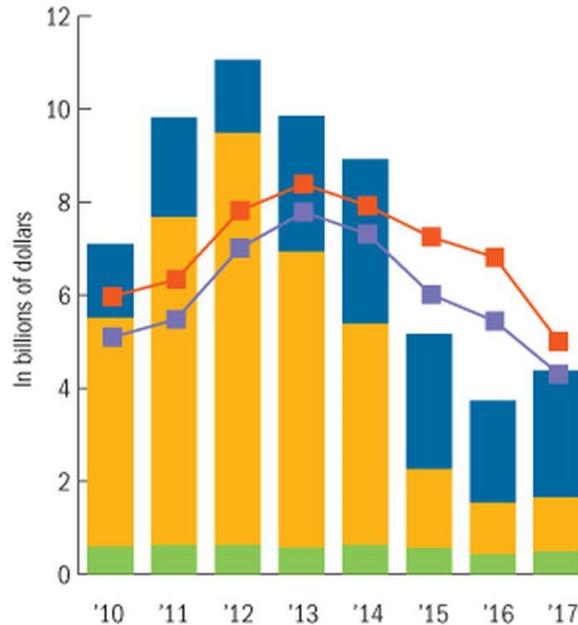
Time is running out. Like many Alaskans, I'm frustrated that once again the Legislature hasn't yet found a way to compromise on a credible fiscal plan for Alaska. I'm discouraged that we haven't had a more open, thoughtful and informed discussion about the choices we face — about how we can fairly share the burden of the adjustments we face, about how they will affect our future economy and society—and about what kind of future we want for Alaska. I'm discouraged that instead of debating these critical issues we are debating who we should blame if the government shuts down. I'm worried that we no longer have time this year for thoughtful public input and discussion of potential compromises.

How do we get to a compromise? A starting point is to recognize that the issue is not what we don't want. It's what combination of difficult options, given the reality of our fiscal situation, is best for Alaska.

We should be increasingly impatient with people who talk only about what they *don't* want and promise to protect you from it — whether it be cuts to government spending, cuts to dividends or new taxes. We should respect and thank legislators with the skills and courage to not only advocate for what they and their constituents want, but also to move the discussion forward and get us to a compromise on the difficult choices we face.

Alaska revenues* and spending**

Part of our fiscal challenge is that we are spending far more for government (spending excluding dividends) than the oil and non-oil revenues which have paid for government in the past. Using Permanent Fund earnings to help pay for government can help to fix that problem. But a more fundamental challenge is that our spending, including dividends, is higher than our revenues, including Permanent Fund earnings. Only cutting government, cutting dividends, and/or increasing revenues can fix that.



*Includes Unrestricted General Fund revenues and Permanent Fund realized earnings

**Includes Unrestricted General Fund spending and Permanent Fund Dividends.

Source: Legislative Finance Division, Alaska Permanent Fund Corporation

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