

Alaska's Fiscal Challenge and critical questions it raises for the Permanent Fund

Gunnar Knapp
Professor Emeritus of Economics
Institute of Social and Economic Research
University of Alaska Anchorage
Gunnar.Knapp@gmail.com

Prepared for
Institute of the North
Future of the Alaska Permanent Fund Webinar

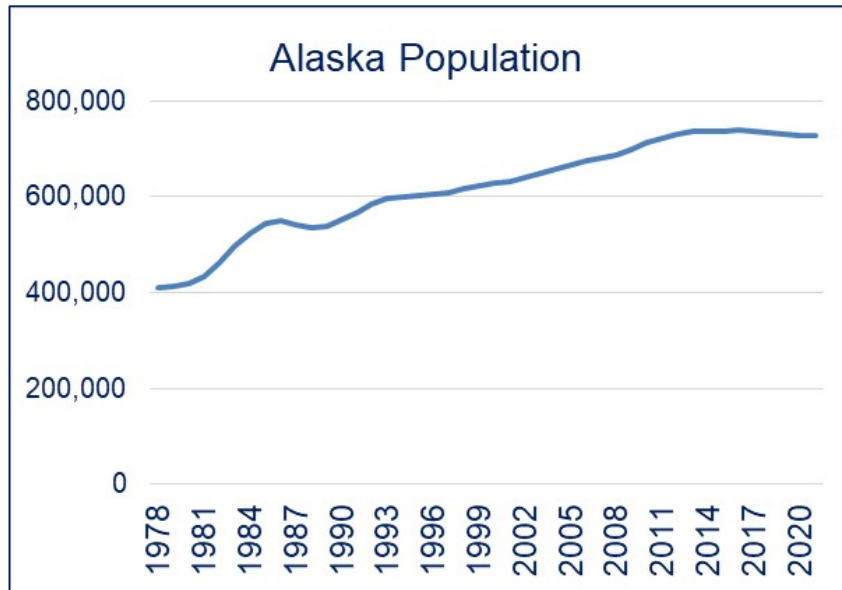
November 9, 2020

How Alaska's finances have changed since:

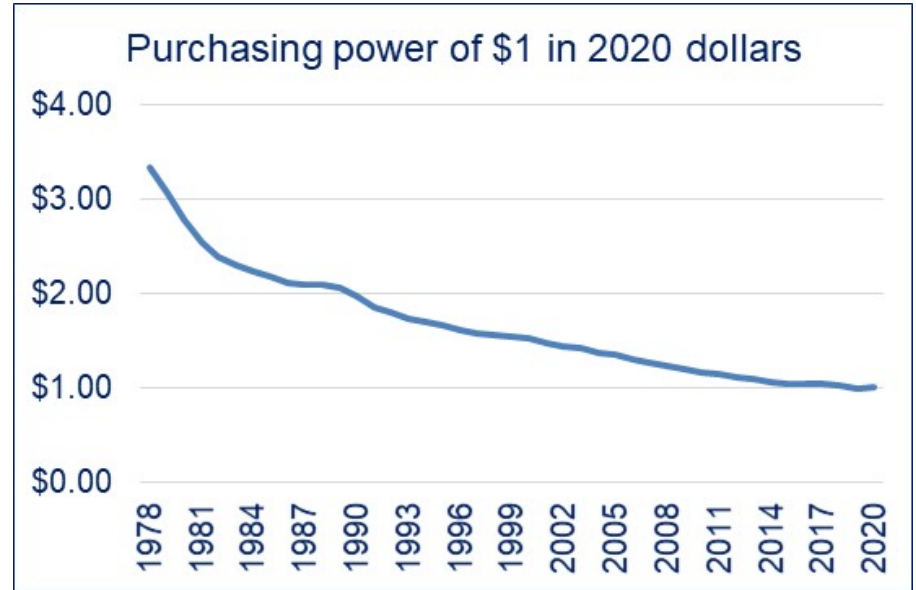
- North Slope oil production began in 1978
- the Permanent Fund Dividend Program began in 1982



Alaska's population
grew by 74% since 1980



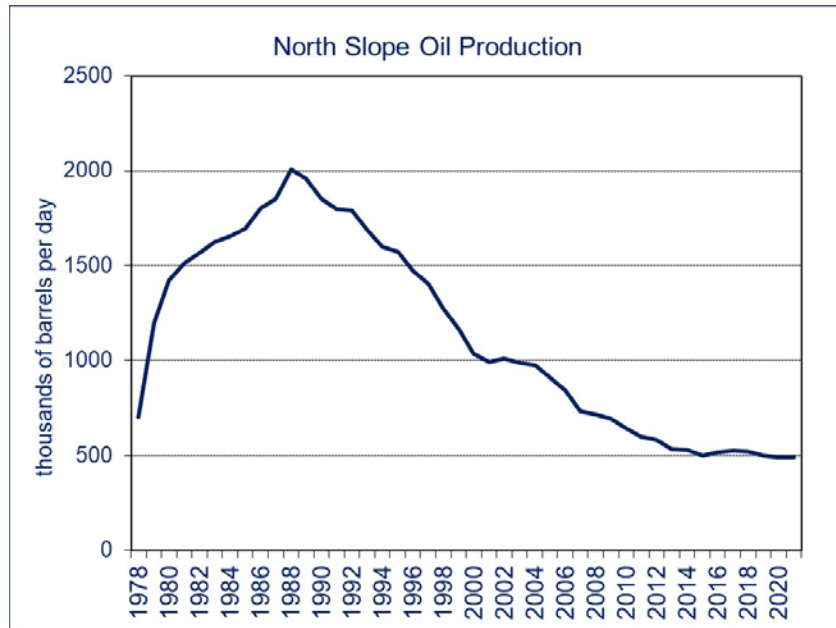
The value of a dollar has
fallen by 64% since 1980



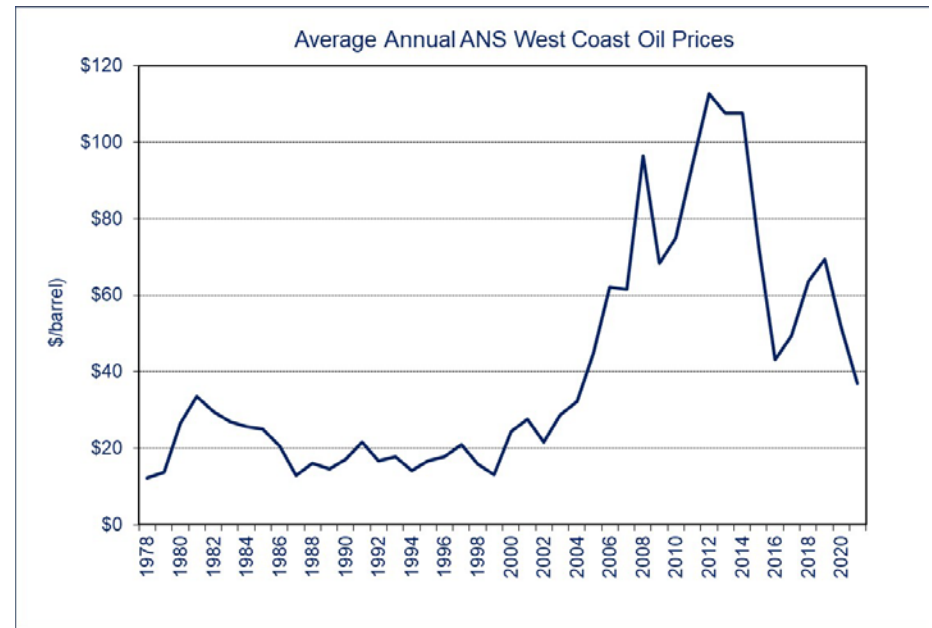
All data in the next set of historical graphs are converted to
inflation-adjusted dollars per Alaskan

Two key drivers of changes in Alaska oil value and revenues:

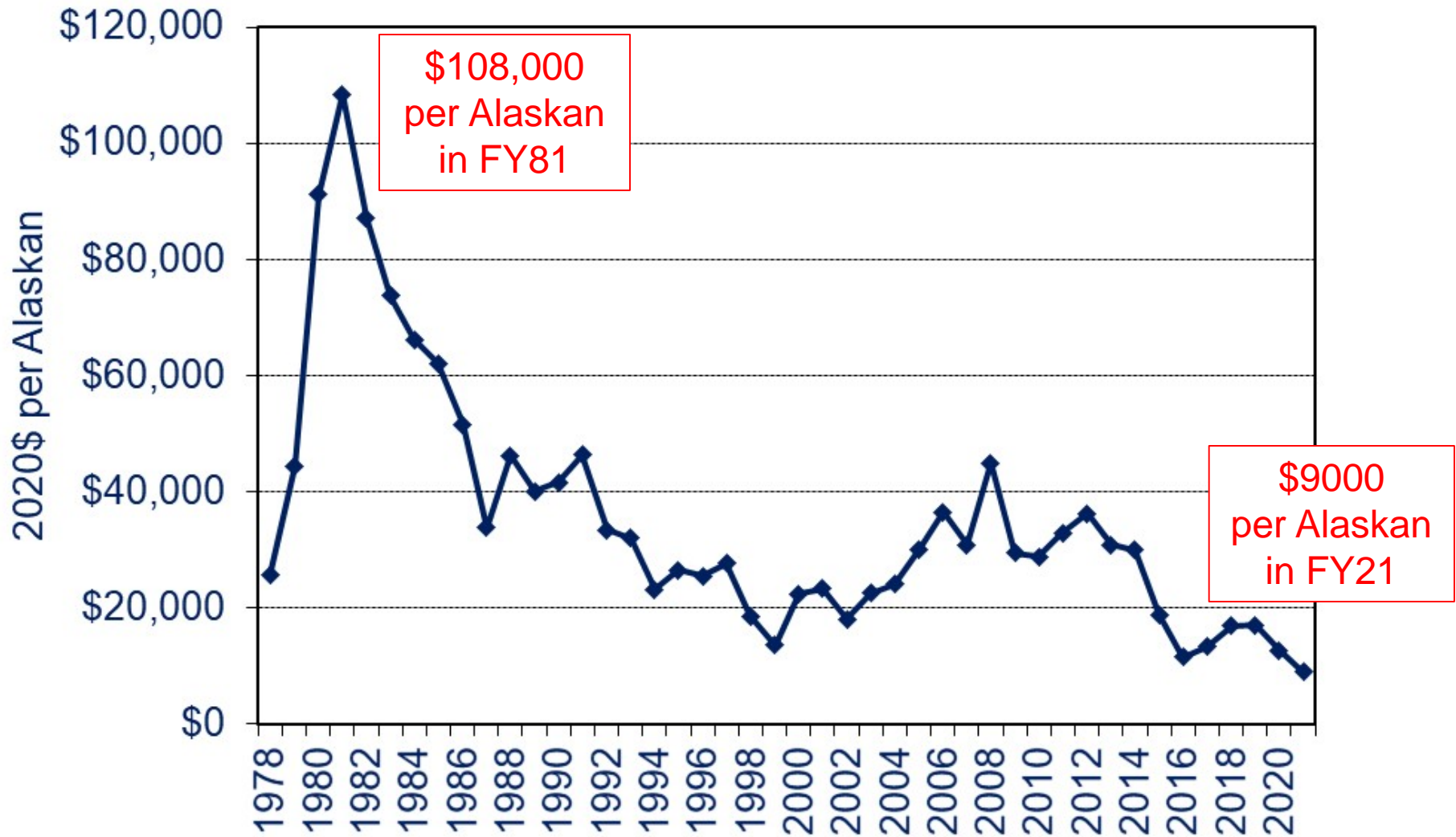
Oil production grew rapidly after 1978 but has fallen by 75% since 1988



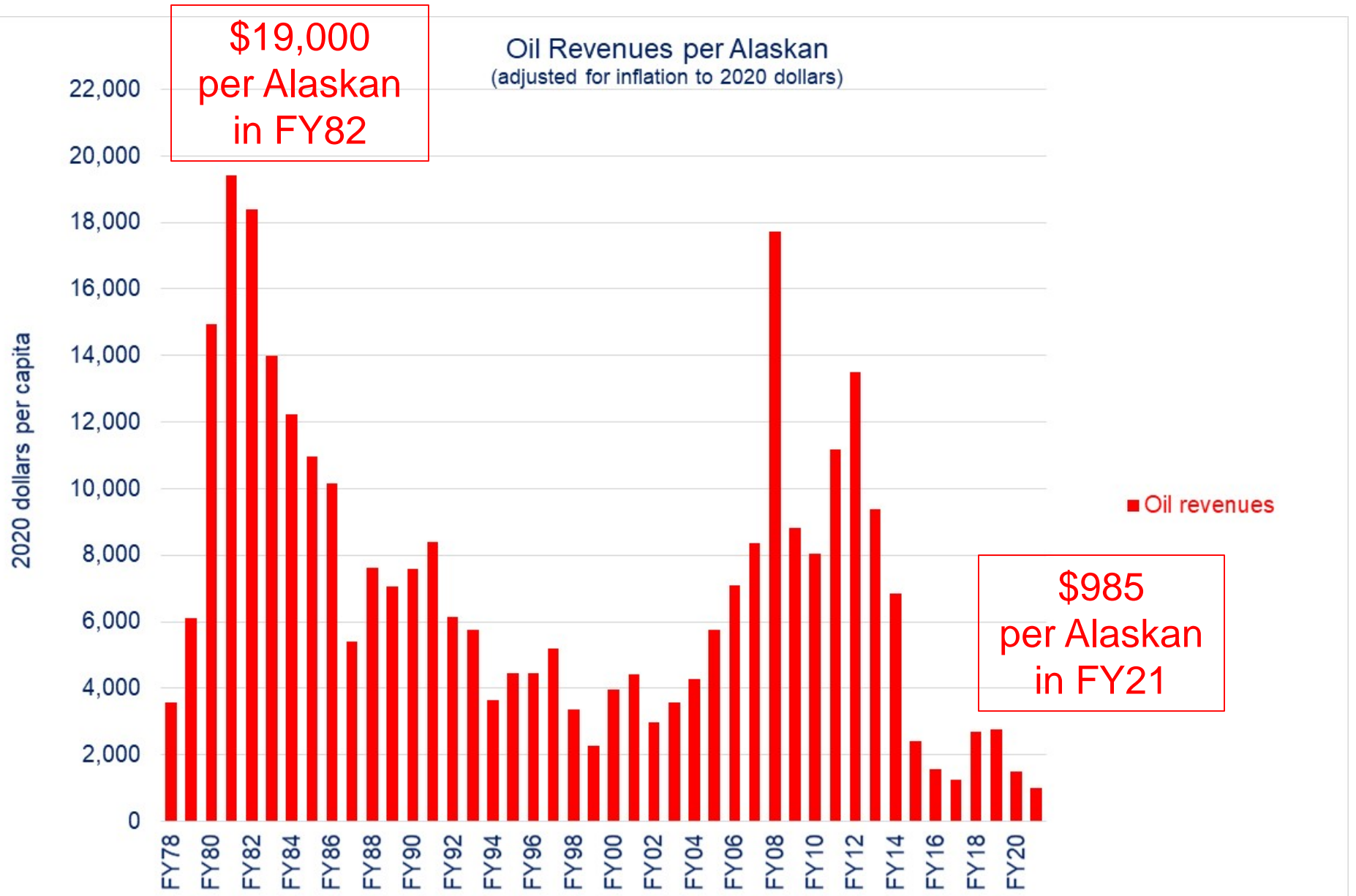
Oil prices have fluctuated dramatically



Value of Oil Production *per Alaskan*
(adjusted for inflation)



Oil Revenues per Alaskan . . .



Total Revenues per Alaskan . . .

\$21,000
per Alaskan
in FY82

Total Revenues per Alaskan
(adjusted for inflation to 2020 dollars)

2020 dollars per capita

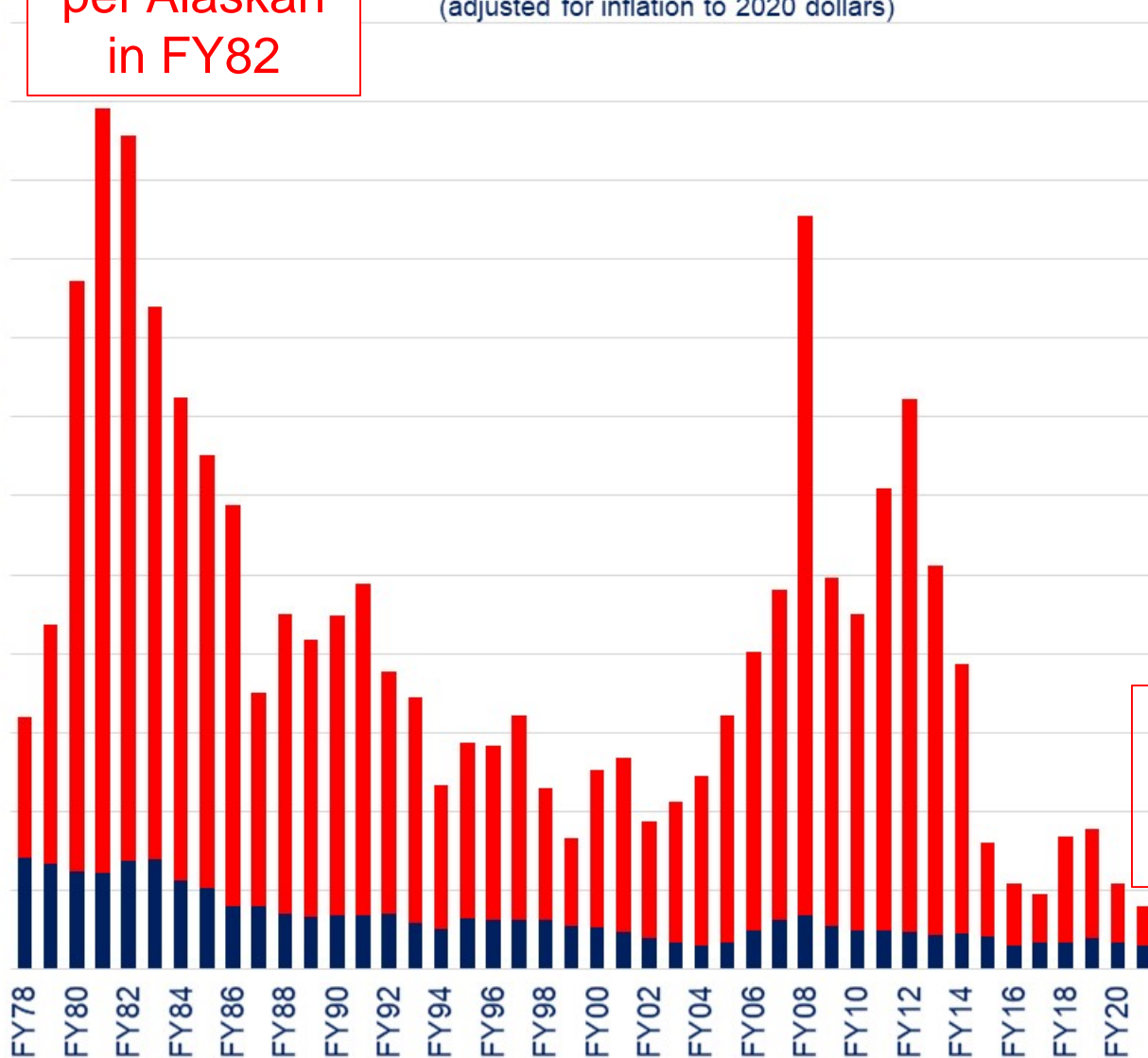
24,000
22,000
20,000
18,000
16,000
14,000
12,000
10,000
8,000
6,000
4,000
2,000
0

FY78 FY80 FY82 FY84 FY86 FY88 FY90 FY92 FY94 FY96 FY98 FY00 FY02 FY04 FY06 FY08 FY10 FY12 FY14 FY16 FY18 FY20

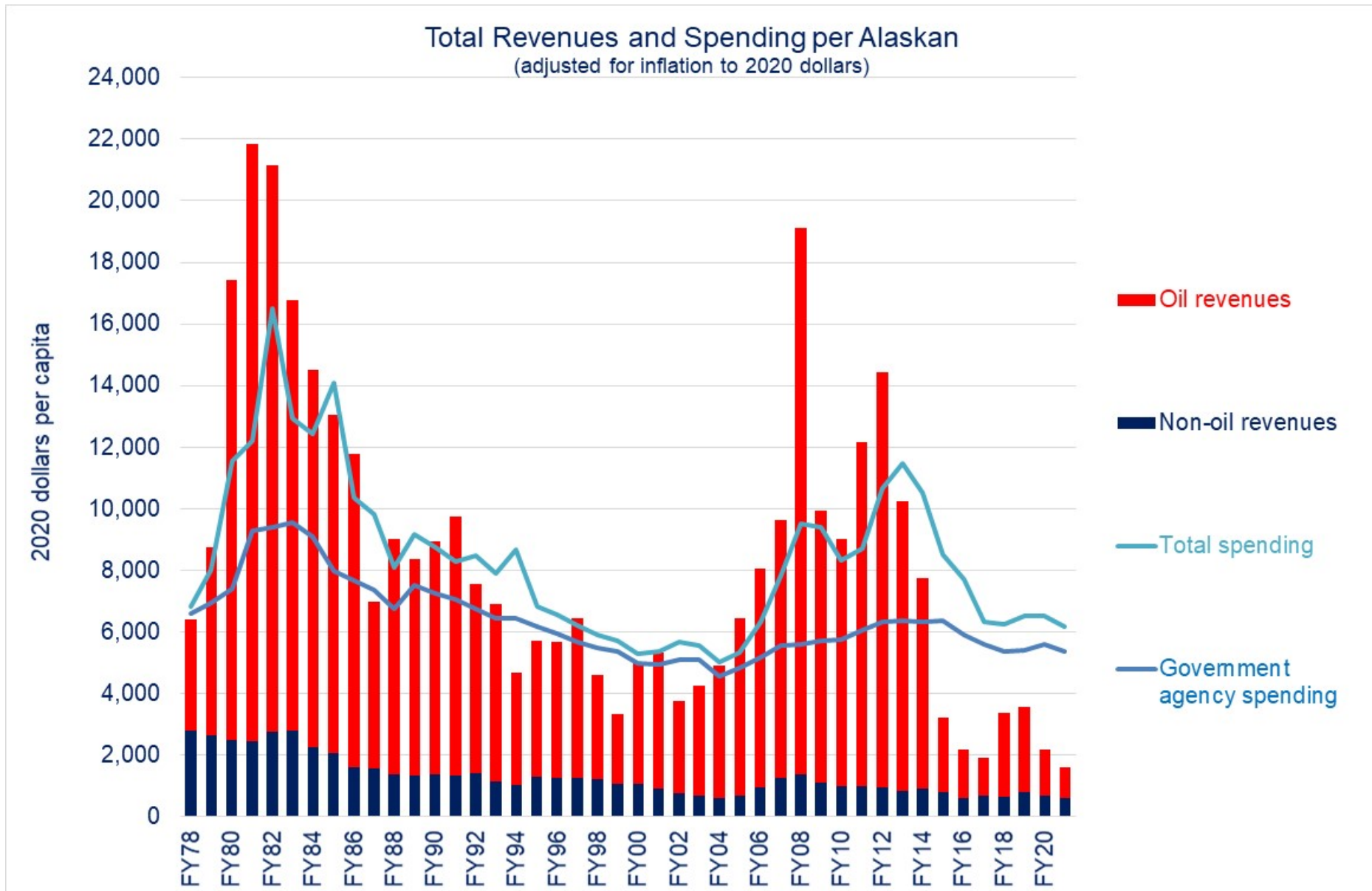
Oil revenues

Non-oil revenues

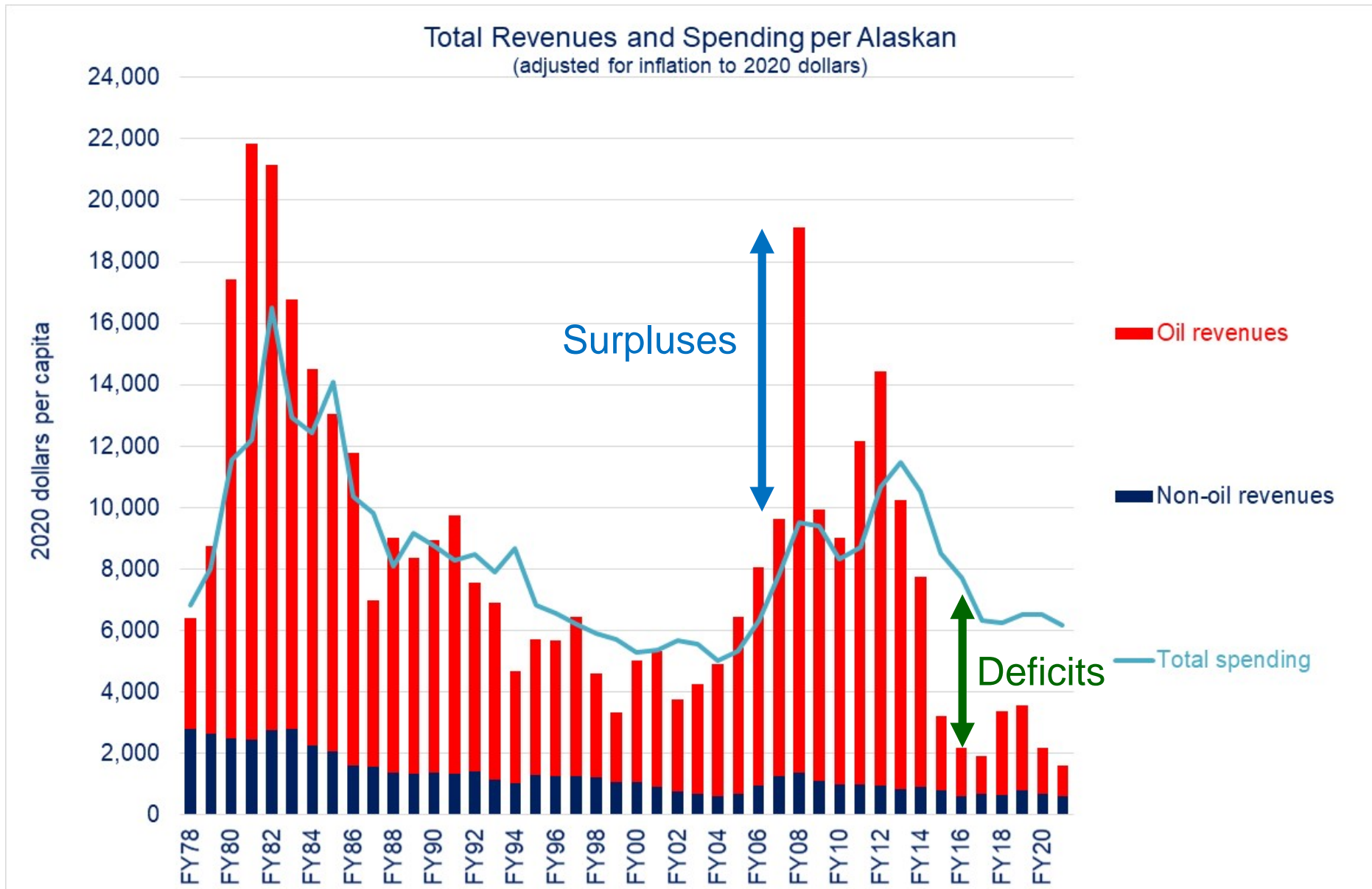
\$1600
per Alaskan
in FY21



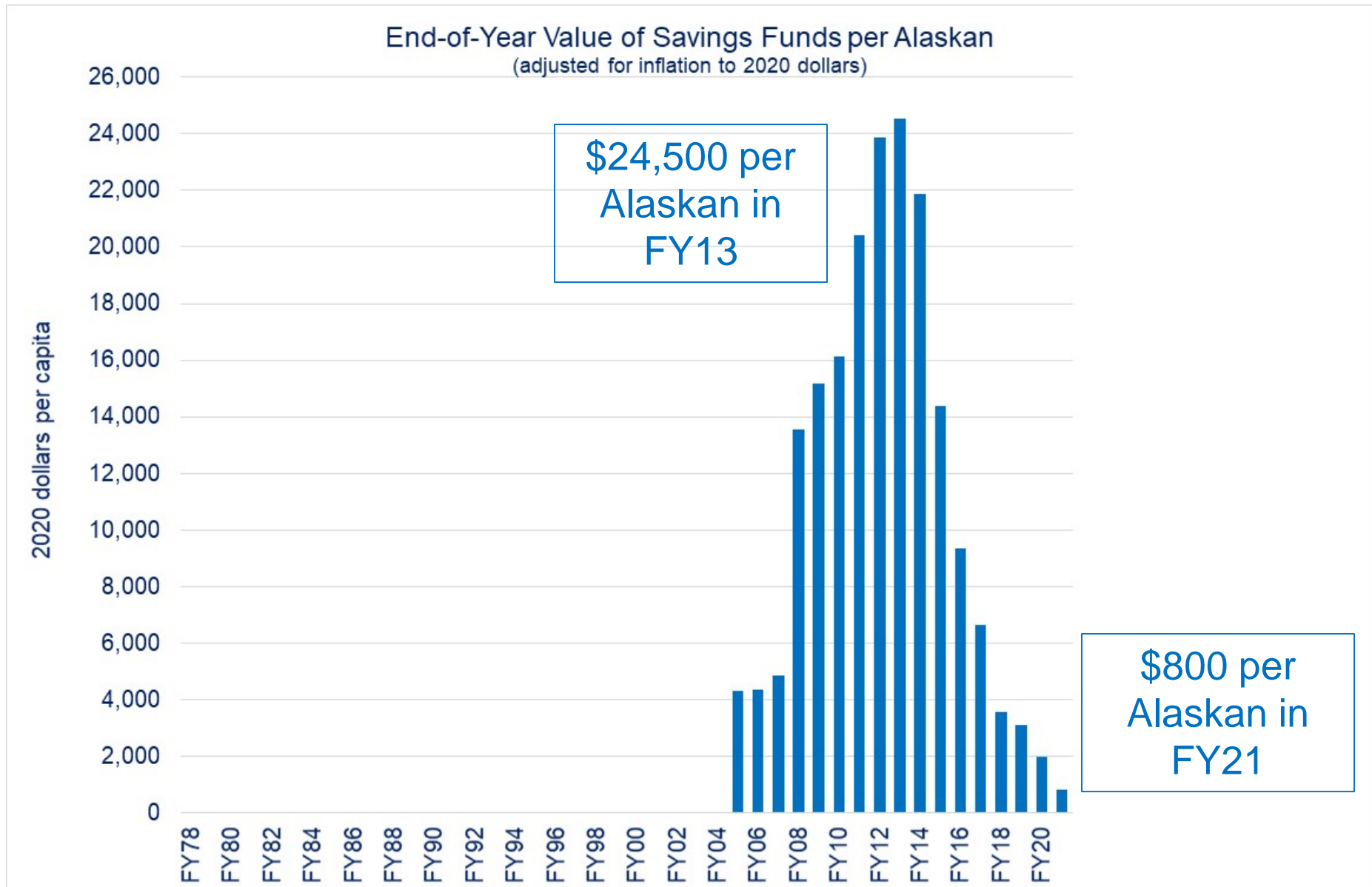
Total Revenues and Spending per Alaskan



Surpluses and deficits . . .

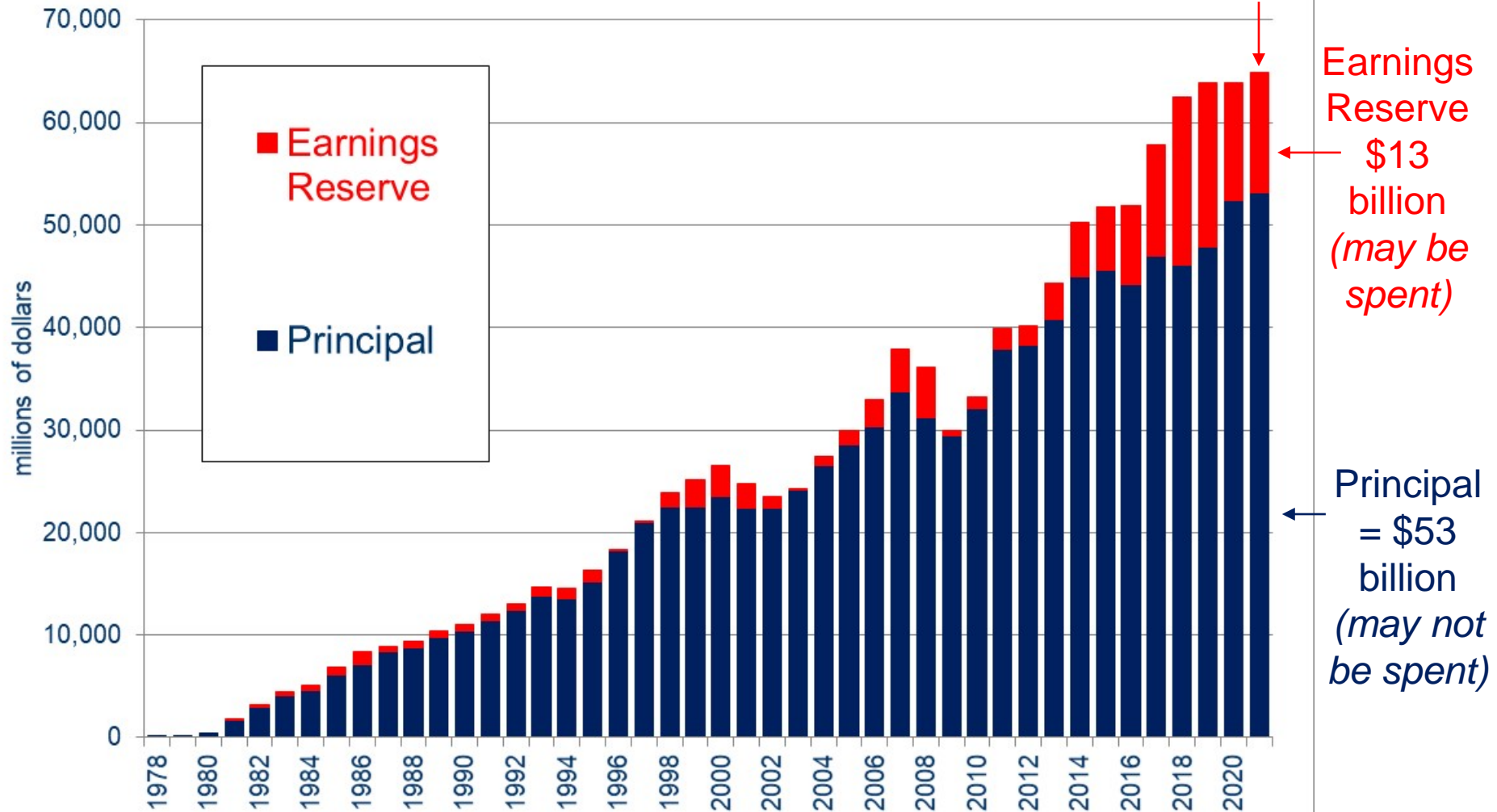


End-of-Year Value of Savings Funds per Alaskan

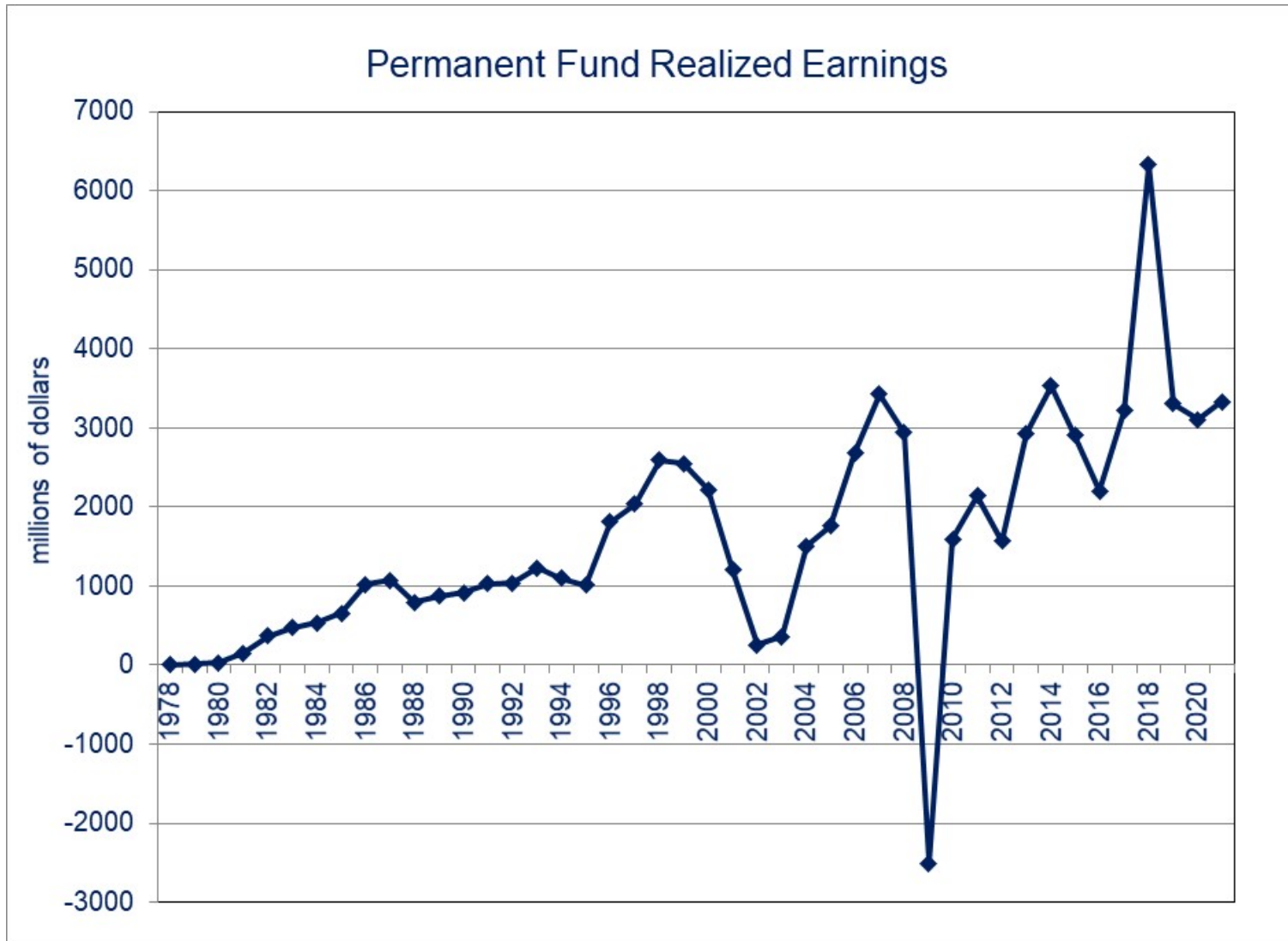


Permanent Fund Value

Year-End Value of the Permanent Fund



Permanent Fund earnings have grown as the fund has grown.



The earnings go into an “Earnings Reserve” which may be spent.

Alaska finances before FY19:

Oil and non-oil revenues paid for government
PF earnings paid for dividends

Revenue source	Uses before FY19
Oil revenues	Government
Non-oil revenues	
PF earnings	Dividends

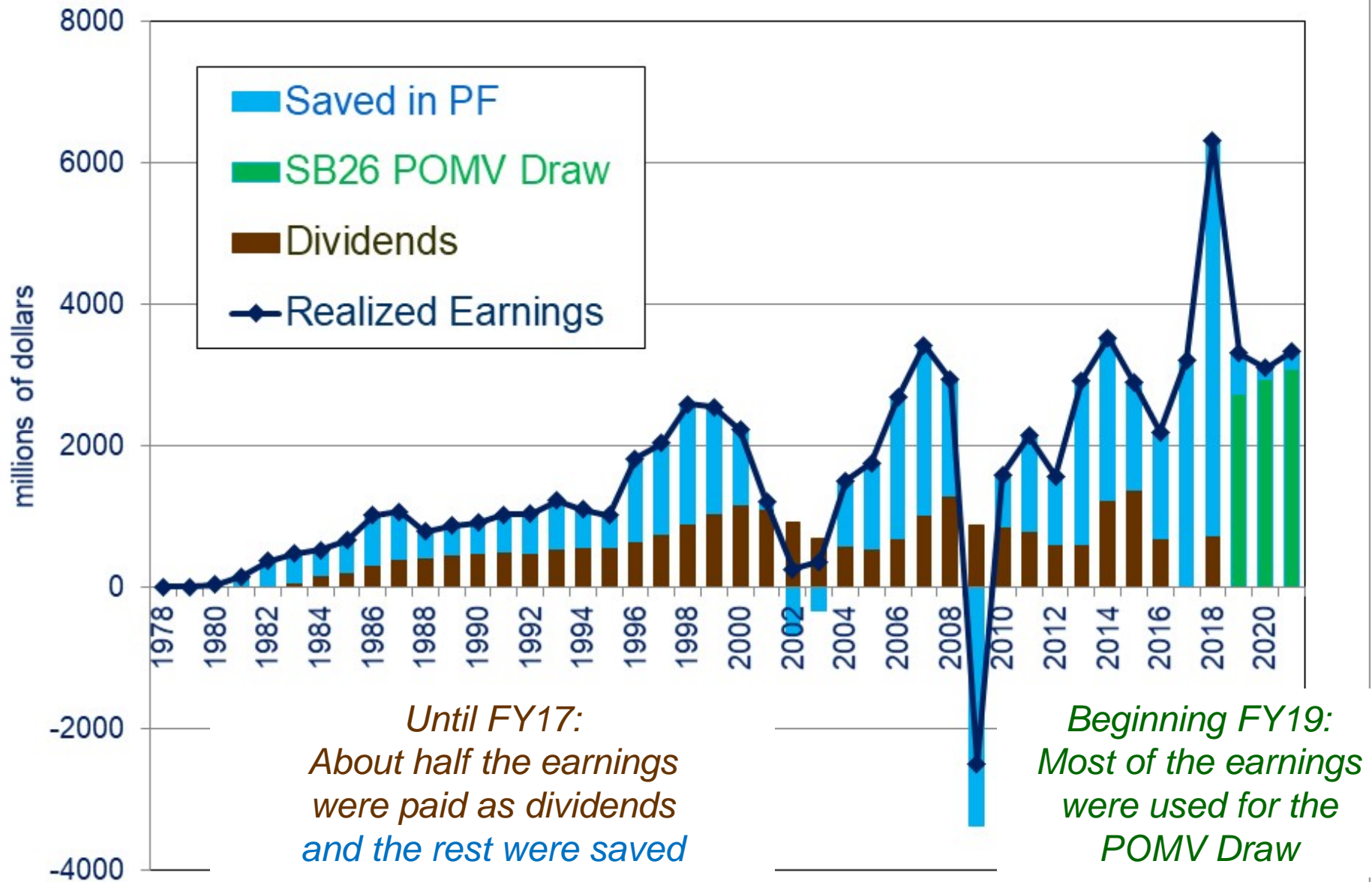
Dividend formula:
Dividends =
1/2 of average earnings
Over past 5 years

In 2018 the legislature passed a bill (SB26)
which significantly changed how PF earnings are used.

Under SB26, there is an annual
“Percent of Market Value” (POMV) distribution from PF earnings
which the legislature may spend for government or dividends.

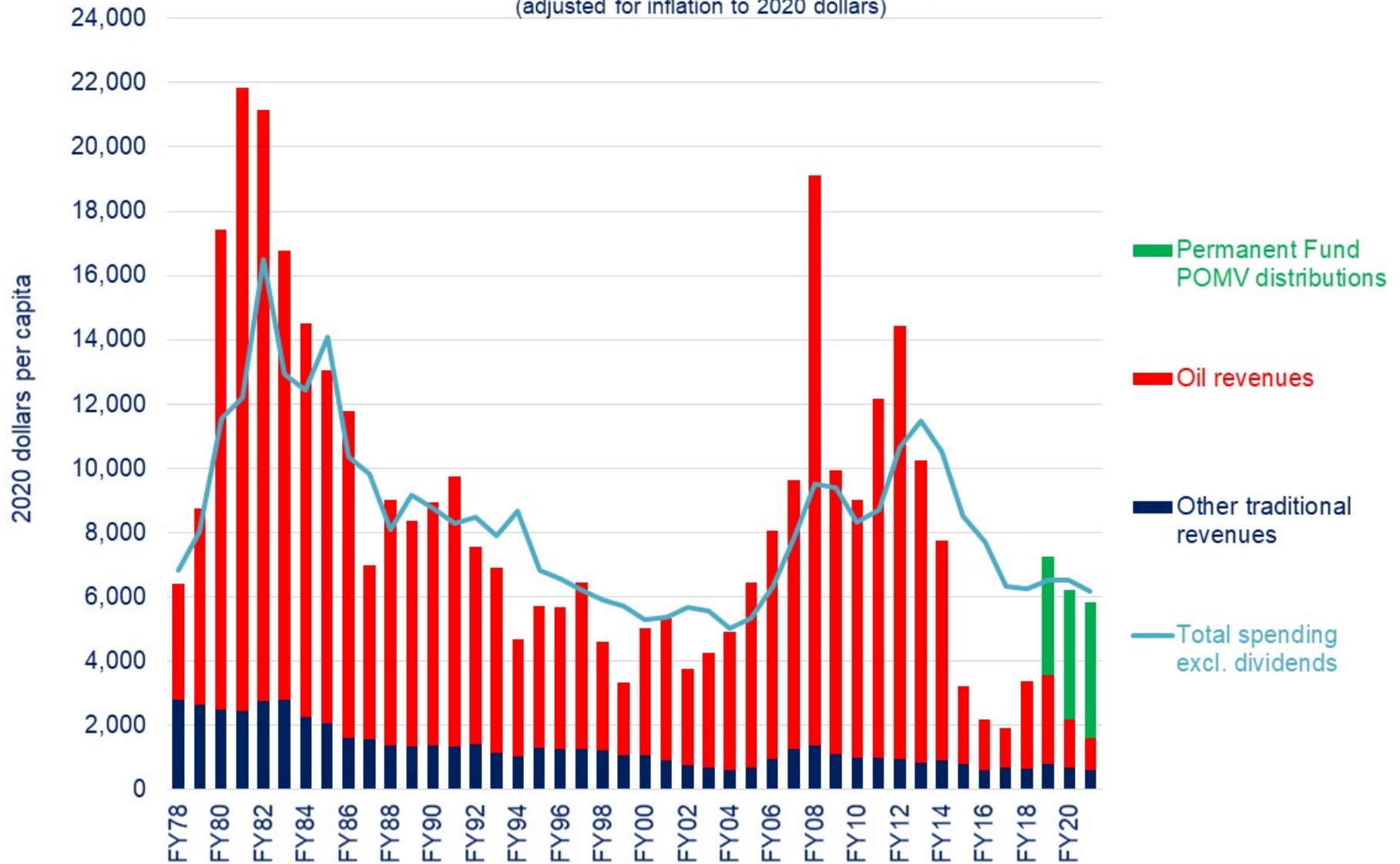
Revenue source	Uses before FY19	Uses beginning FY19
Oil revenues	Government	Government & Dividends
Other traditional revenues		
PF earnings	Dividends	Total PF POMV draw = About 5% of average value over the past 5 years

Uses of Permanent Fund Earnings

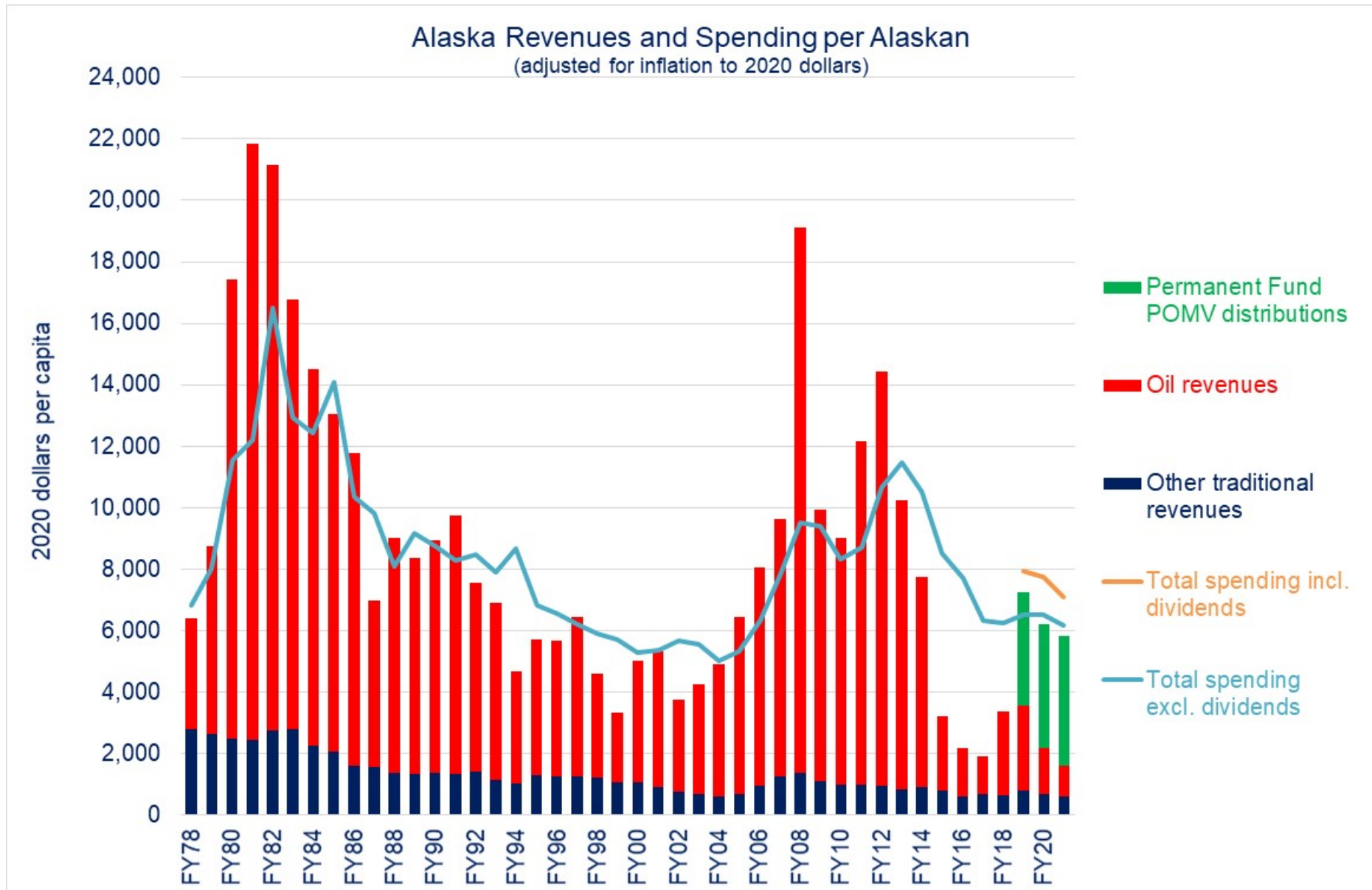


The **POMV distribution from PF earnings** greatly expanded funds available to pay for government spending!

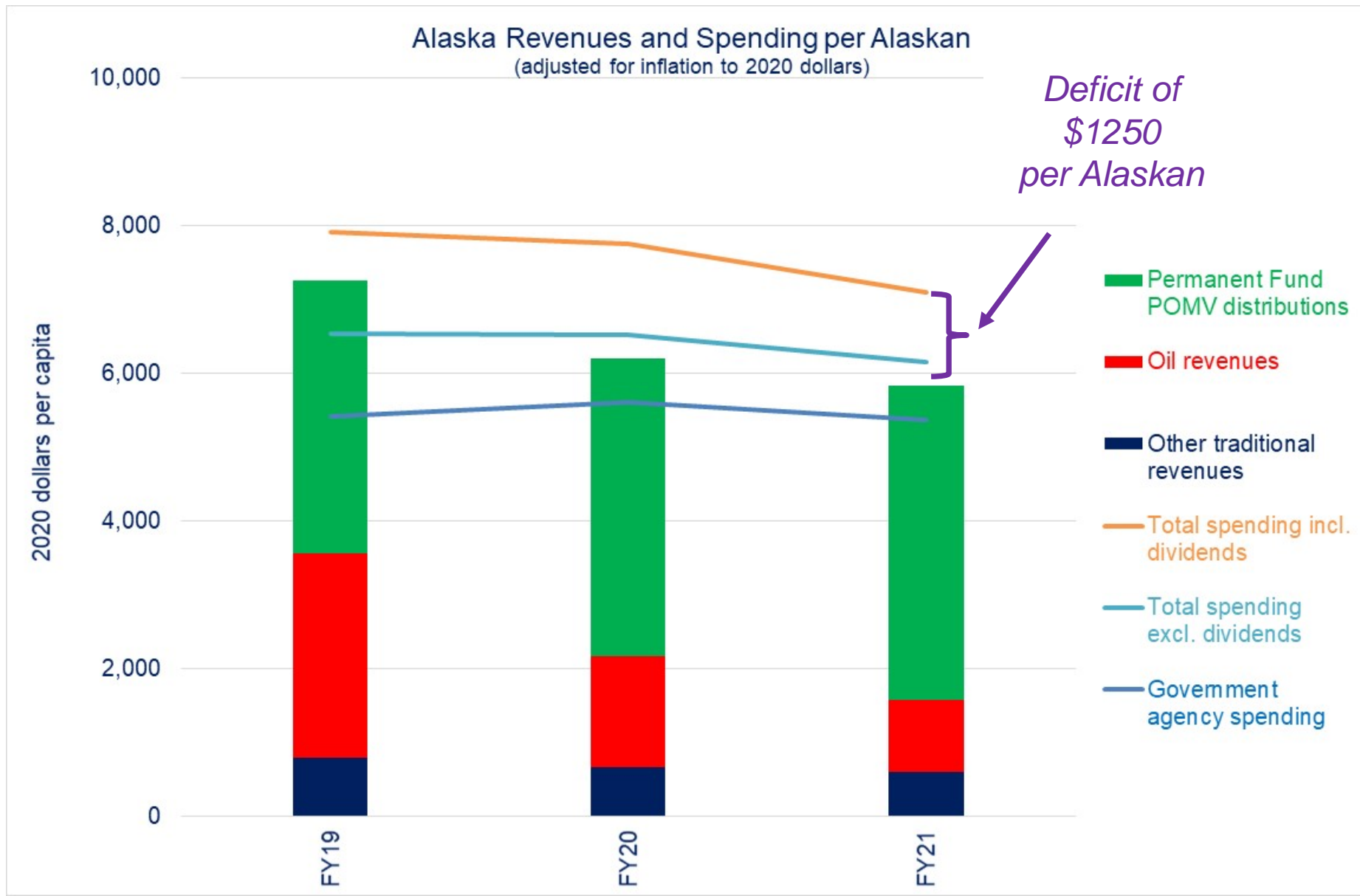
Alaska Revenues and Spending per Alaskan
(adjusted for inflation to 2020 dollars)



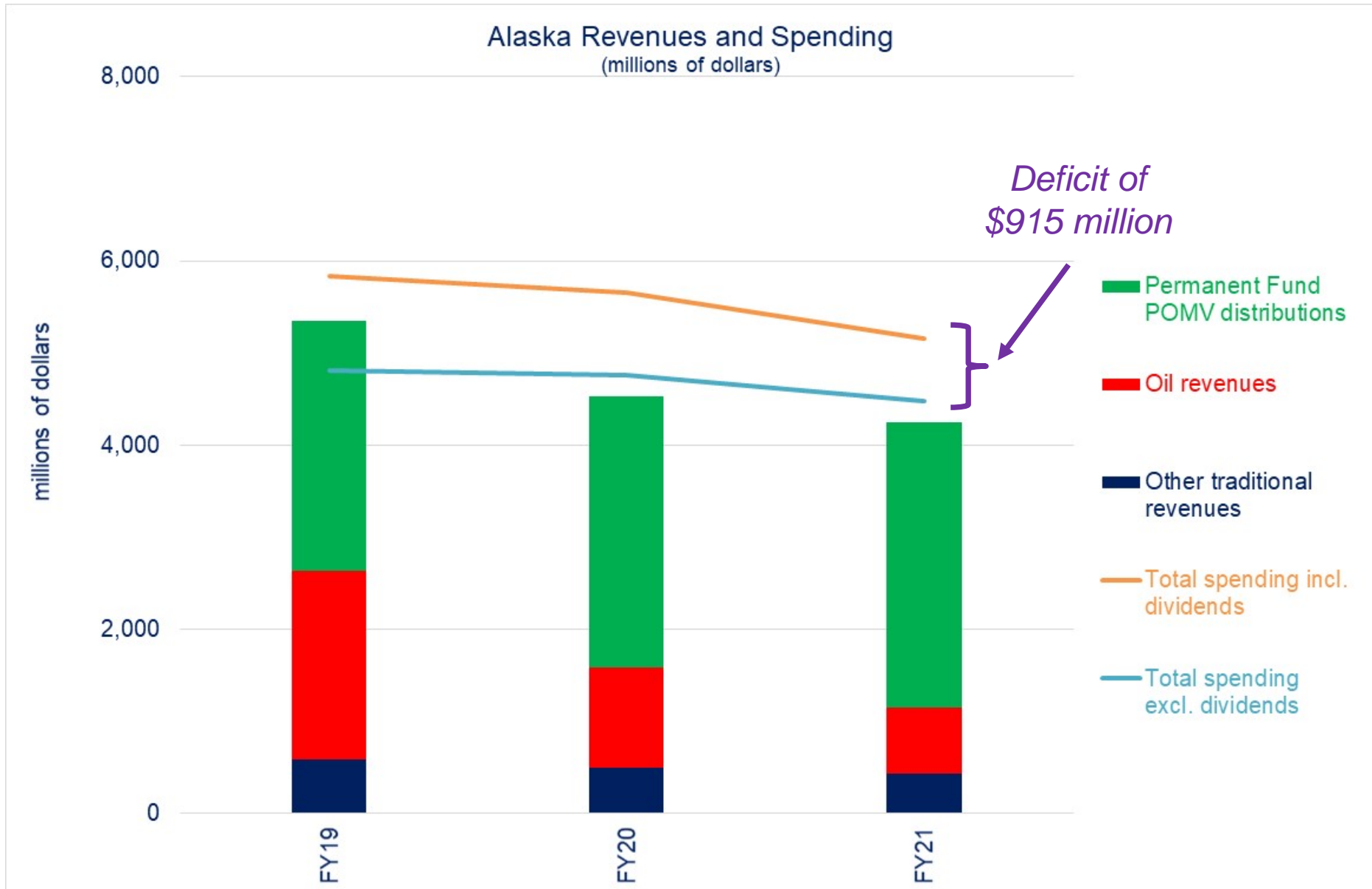
But the POMV distribution from PF earnings also has to pay for dividends.



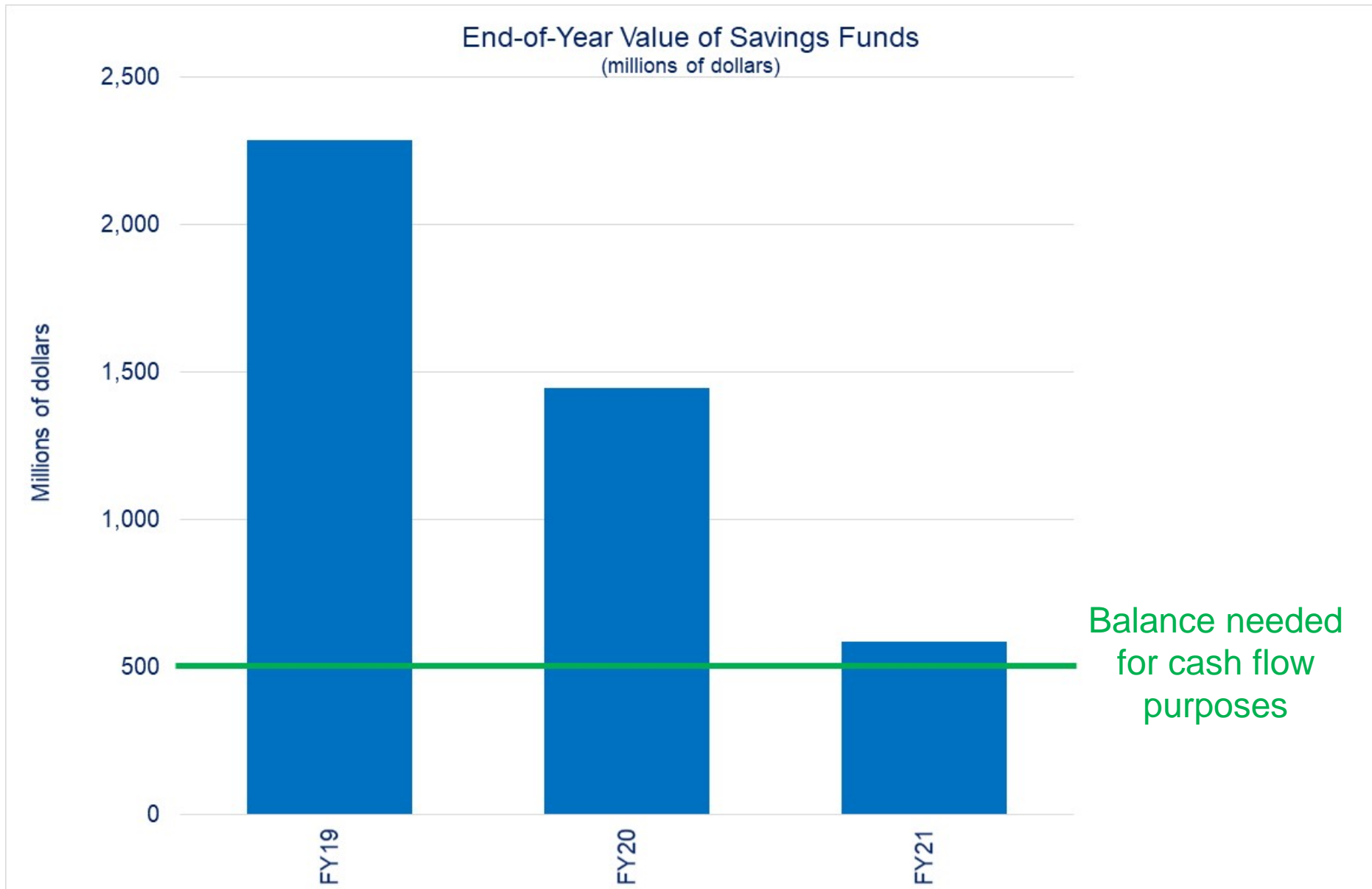
We still have a deficit of \$1250 per Alaskan in FY21.



We have a deficit of \$915 million in FY21.



This year we will fully deplete our cash savings.



Alaska's FY21 budget (millions of \$)

Projected Revenues **4,244**

Oil	717
Other traditional	436
Permanent Fund POMV	3,092

Spending **5,160**

Dividends	680
Government	4,480

Deficit **-915**

We are
spending
\$900 million
more than
our revenues

End-of-Year

CBR Balance **587**

Needed for cash flow	500
Available for future draws	87

We are
draining the
last of our
savings

Alaska's Fiscal Challenge

With no more savings, we can no longer run deficits.

Beginning next year, we will have to eliminate this year's \$900 million deficit through some combination of three difficult options:

- Government spending cuts
- Dividend cuts
- New revenues
 - Taxing industries
 - Taxing Alaskans

. . . unless we draw an unsustainable amount from the Permanent Fund.

Large government spending cuts will be very difficult.

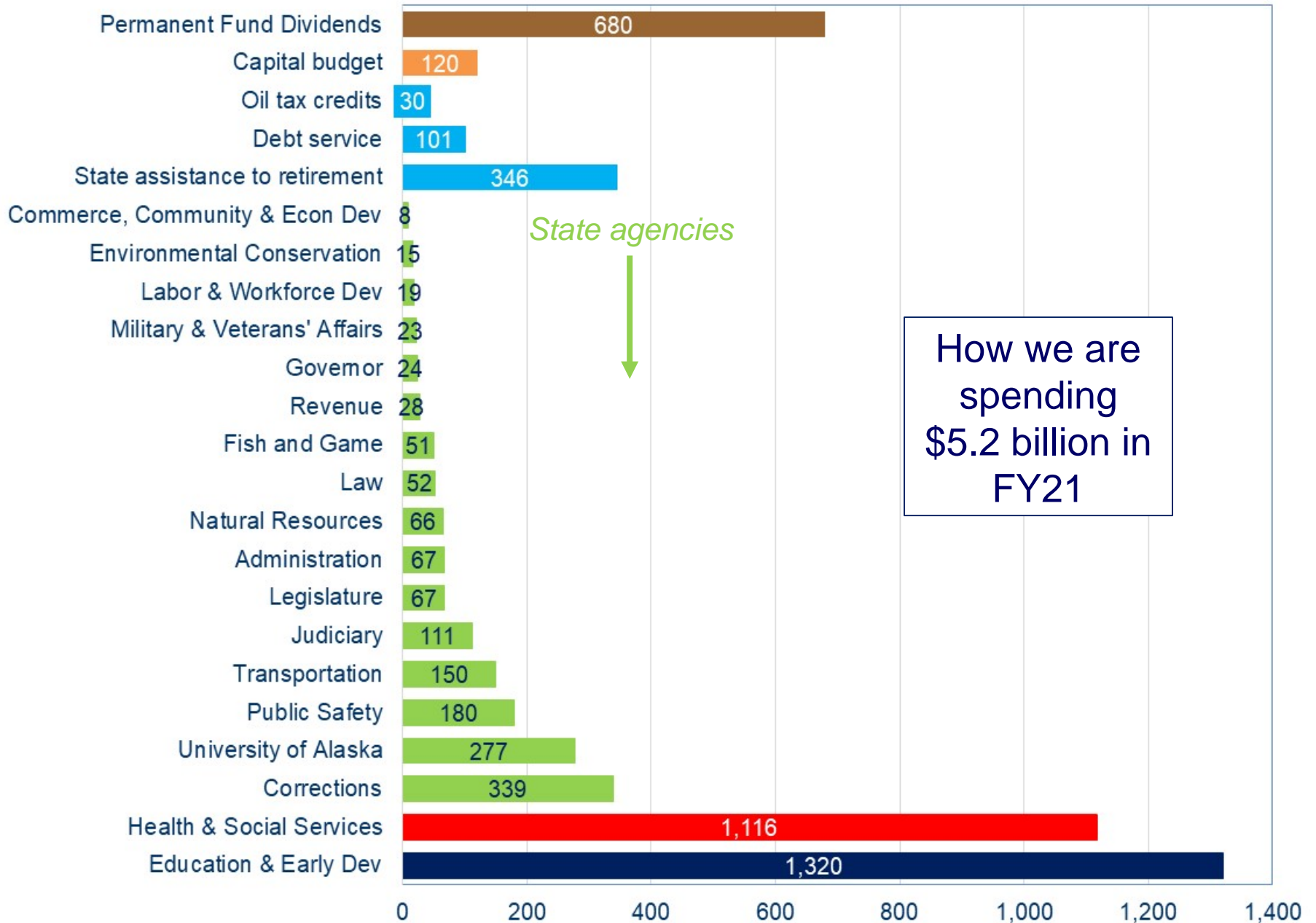
- The easy cuts have already been made
- Some kinds of spending can't be cut
- We will need or want to increase some kinds of spending
- There is strong public resistance to further cuts

Large dividend cuts will be very difficult.

Many Alaskans believe that:

- Dividends are the people's money—not a gift from government
- Cutting dividends to pay for government spending is not an option

Unrestricted General Fund Budget, FY21 (\$ millions)

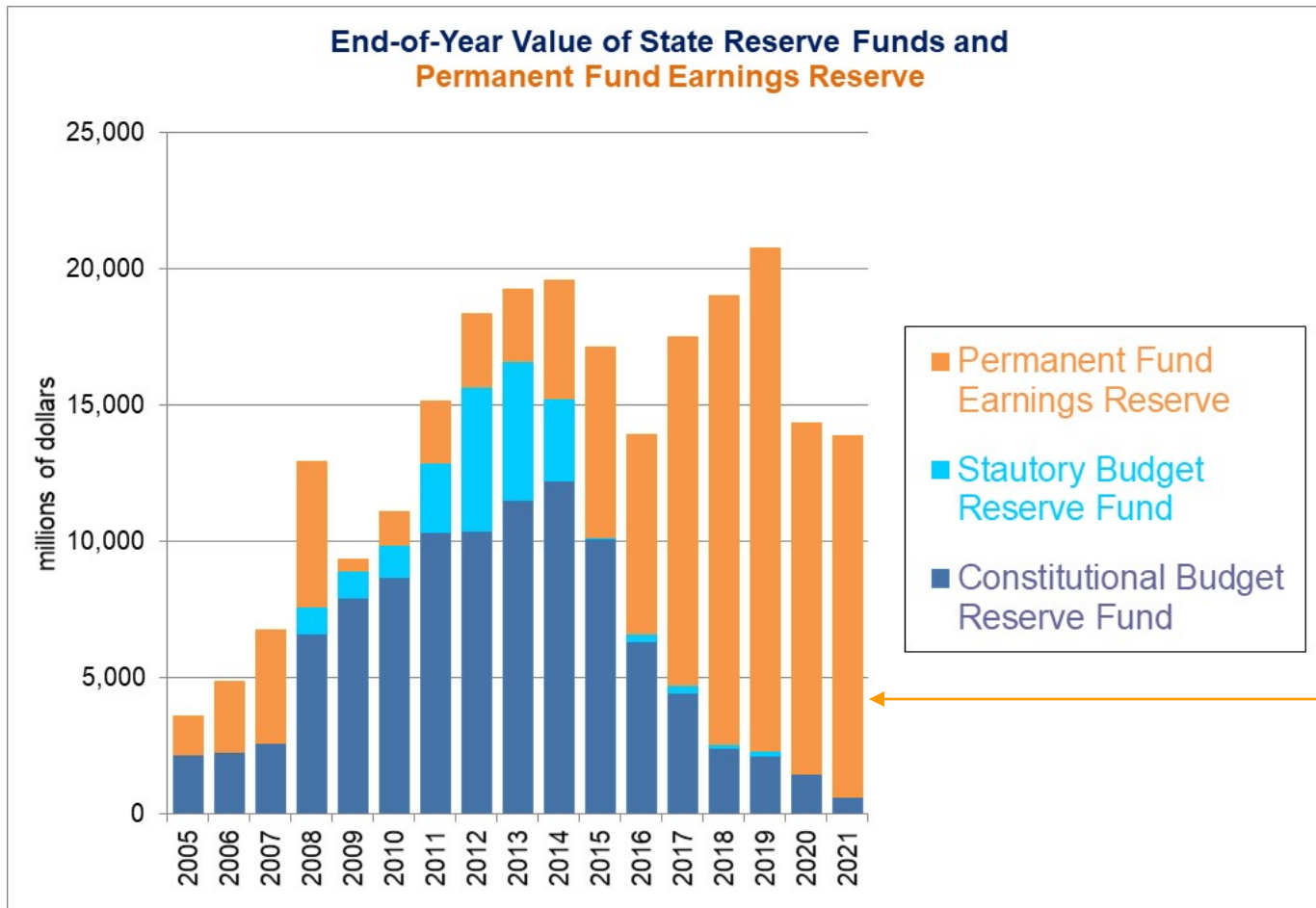


Increasing revenues will be difficult.

- Taxing industries
 - Industries argue
 - they already pay too much
 - increasing taxes will harm development
- Taxing Alaskans
 - Many Alaskans don't want to pay taxes
 - when they think spending should be cut
 - when they think taxes would pay for dividends
 - To fill this year's deficit of \$915 million, we would have to pay taxes averaging \$1,250 per person.

We can hope that oil revenues will rise and save us—
but they probably won't.

Even though we've drained our cash savings,
We haven't run out of money which the legislature *could* spend.
We could draw more than a sustainable 5% from the PF earnings reserve . . .



Next year's
5.5% PF draw
will be about
\$3.1 billion.

The Permanent
Fund Earnings
Reserve will
have about \$13
billion.

Drawing more than the sustainable 5%
from the PF earnings reserve would:

- Reduce the PF value and future earnings
- Risk depleting the earnings reserve so that funds wouldn't be available even for a 5% draw
- Only put off the hard choices a few more years

.

BUT

*But our historic inability to spend within our means
suggests that we might do it anyway.*

Alaska's fiscal challenge confronts us with big choices about the future of the Permanent Fund.

- How much will we draw from the fund's earnings?
- What is the future of Permanent Fund dividends?