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

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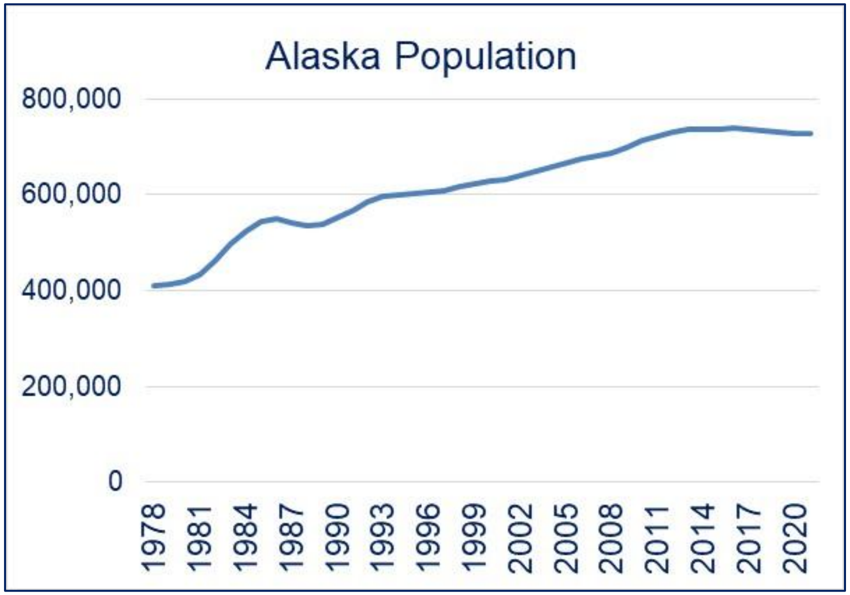
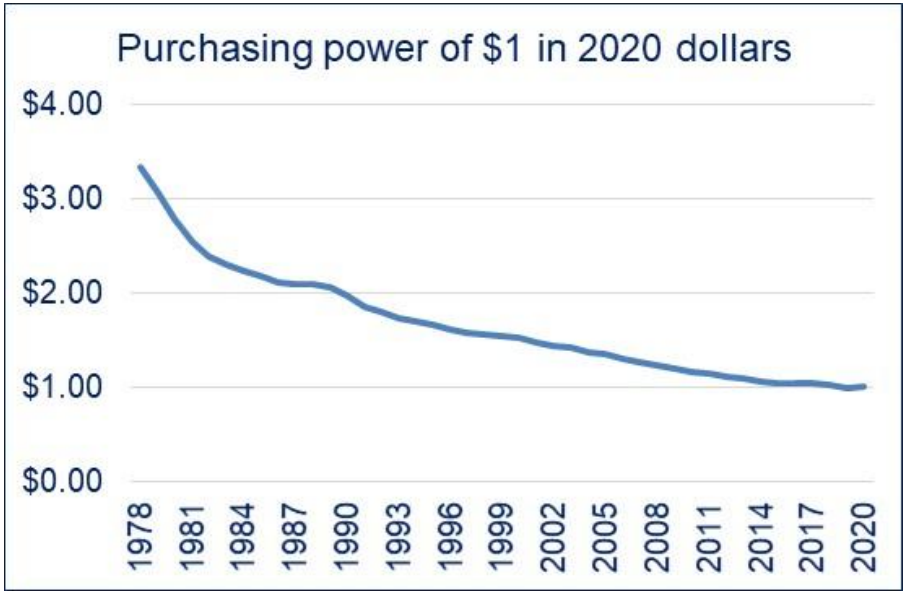
How Alaska's finances have changed since:

- 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

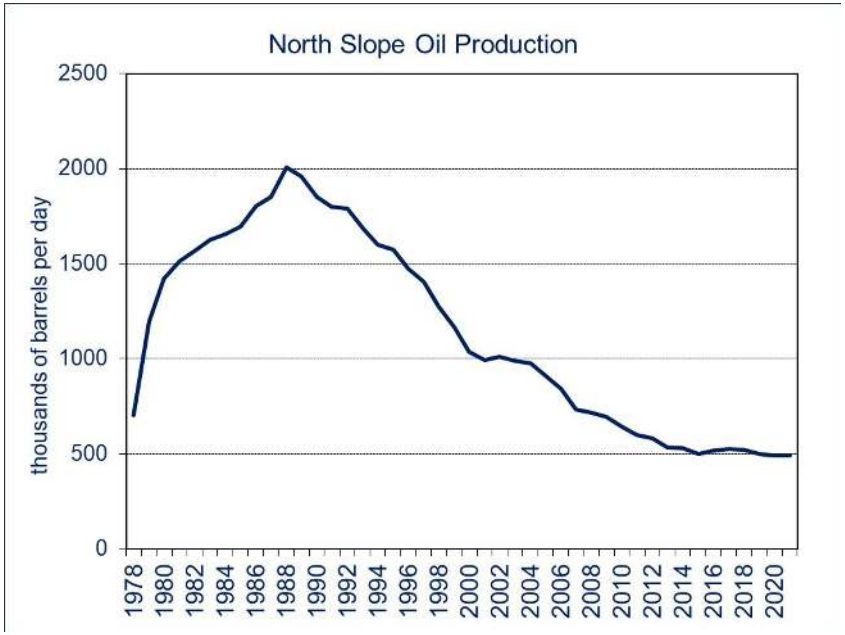


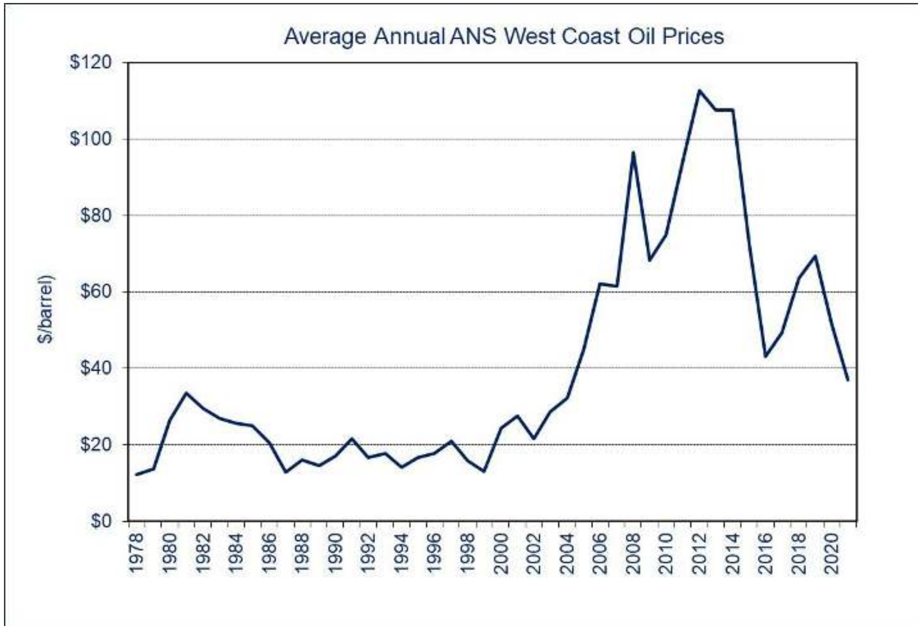
All data in the next set of historical graphs are converted to *inflation-adjusted dollars per Alaskan*

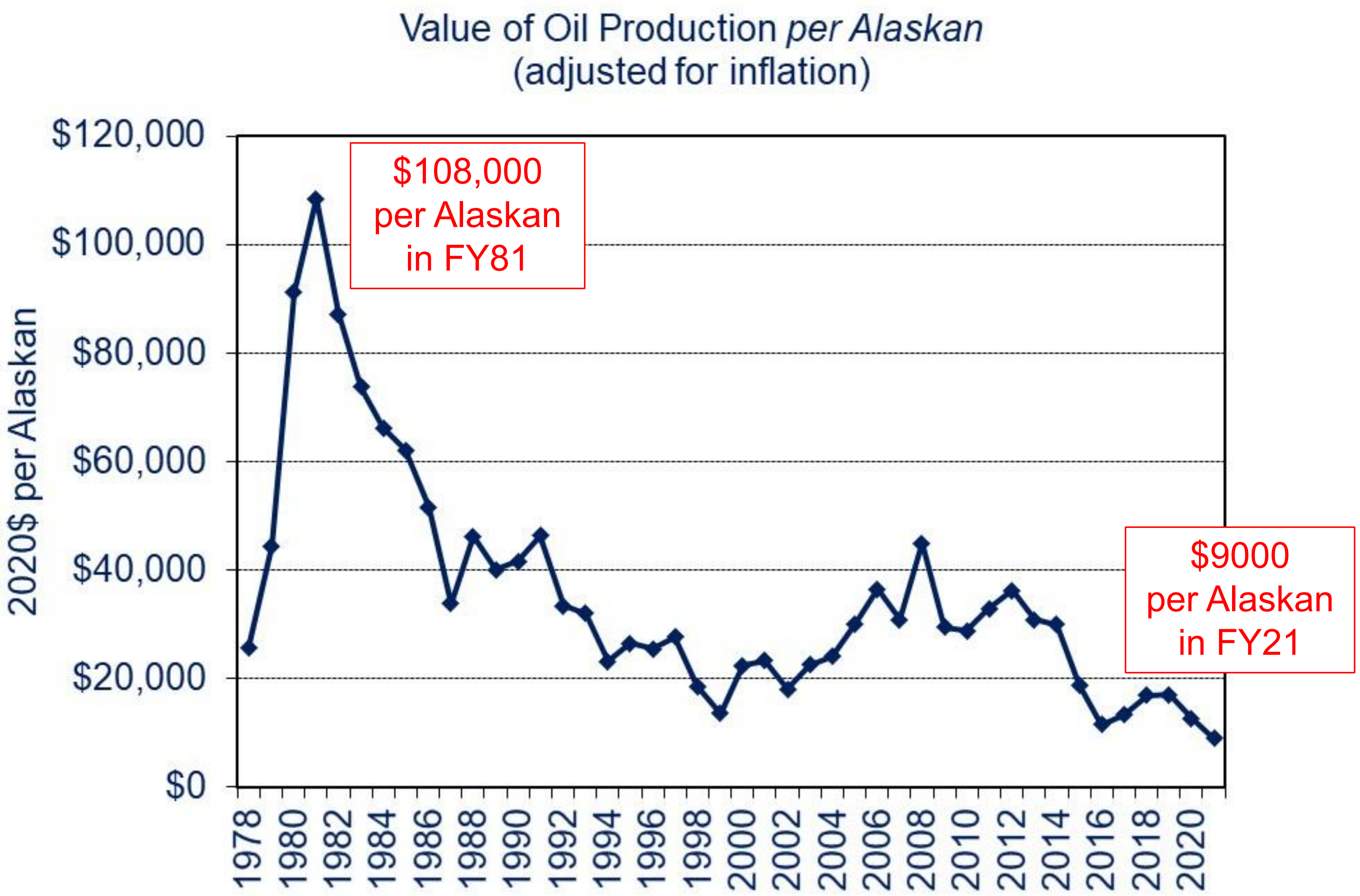
Two key drivers of changes in Alaska oil value and revenues:

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

Oil prices have fluctuated dramatically

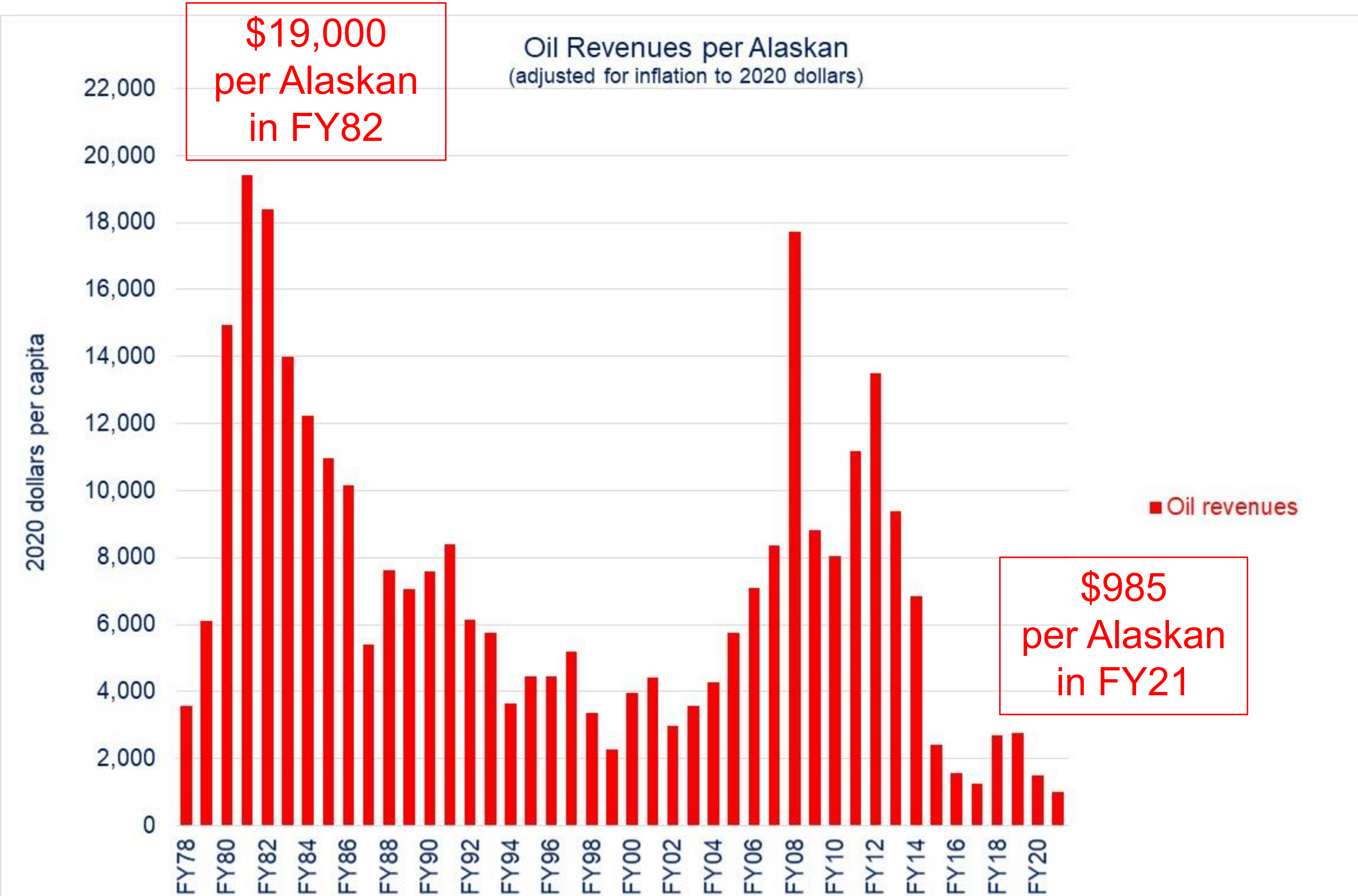




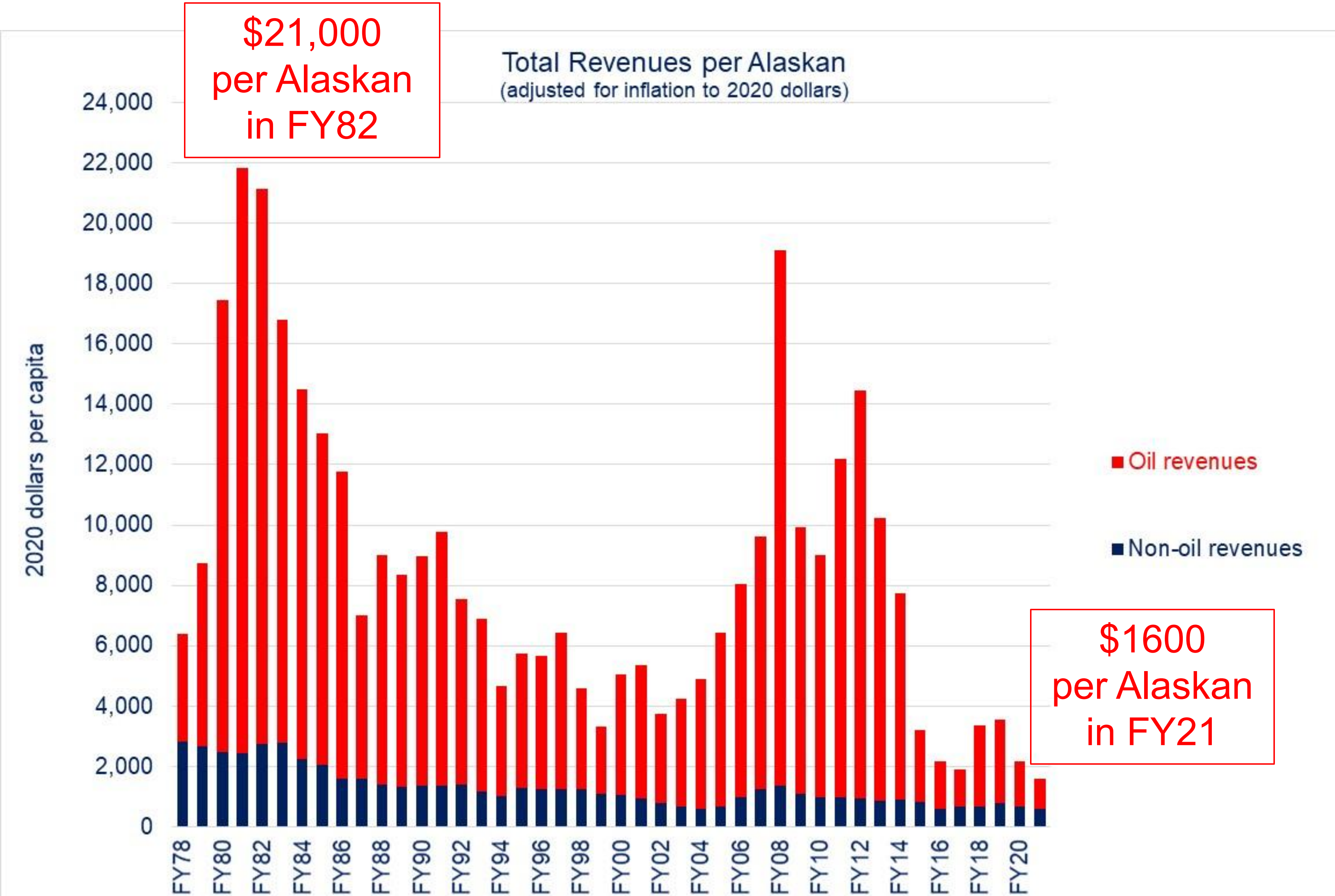


Value of Oil Production per Alaskan
(adjusted for inflation)
2020$ per Alaskan
$120,000
$100,000
$80,000
$60,000
$40,000
$20,000
$0
$108,000 per Alaskan in FY81
$9000 per Alaskan in FY21
1978
1980
1982
1984
1986
1988
1990
1992
1994
1996
1998
2000
2002
2004
2006
2008
2010
2012
2014
2016
2018
2020

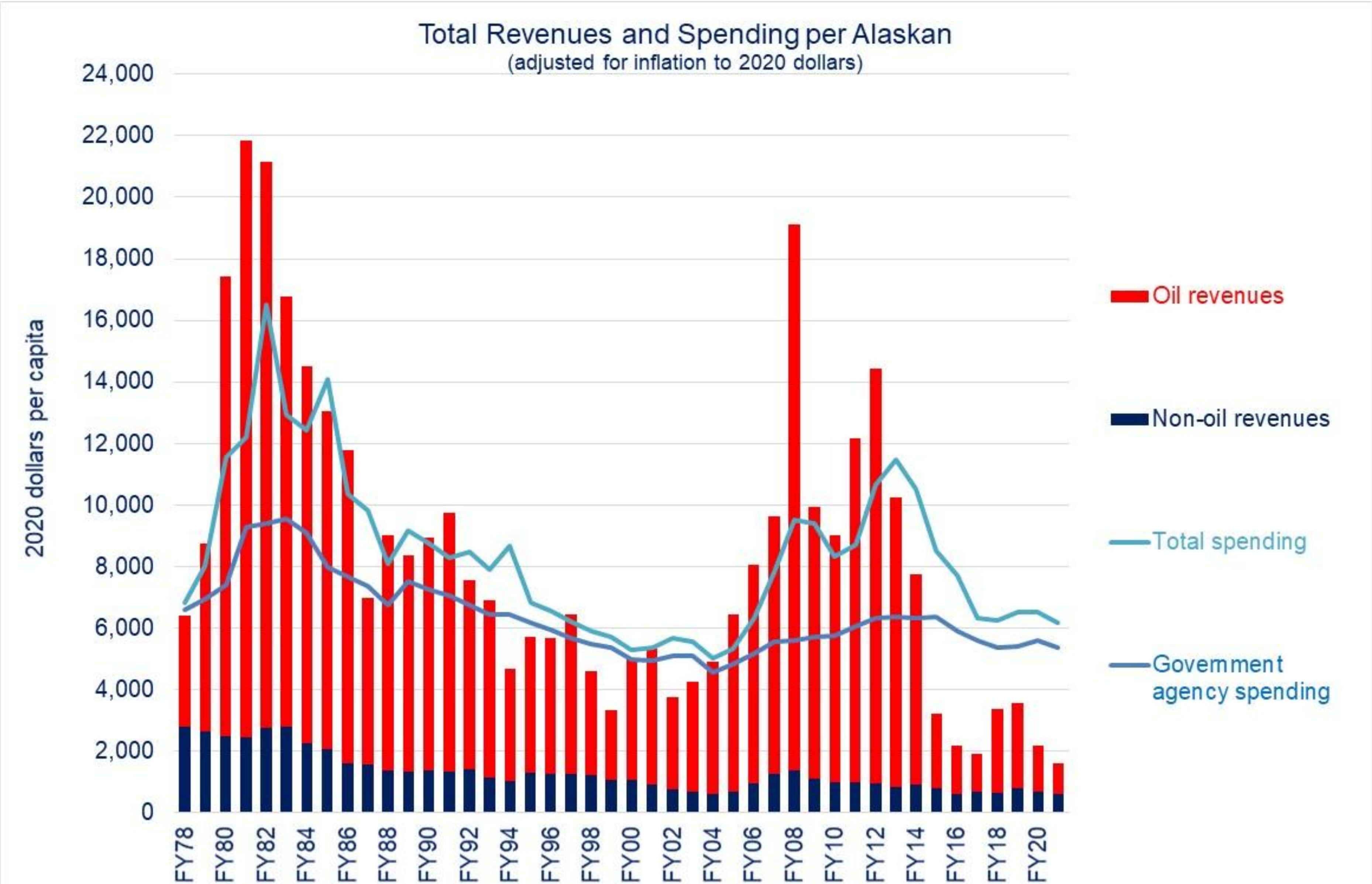
Oil Revenues per Alaskan . . .



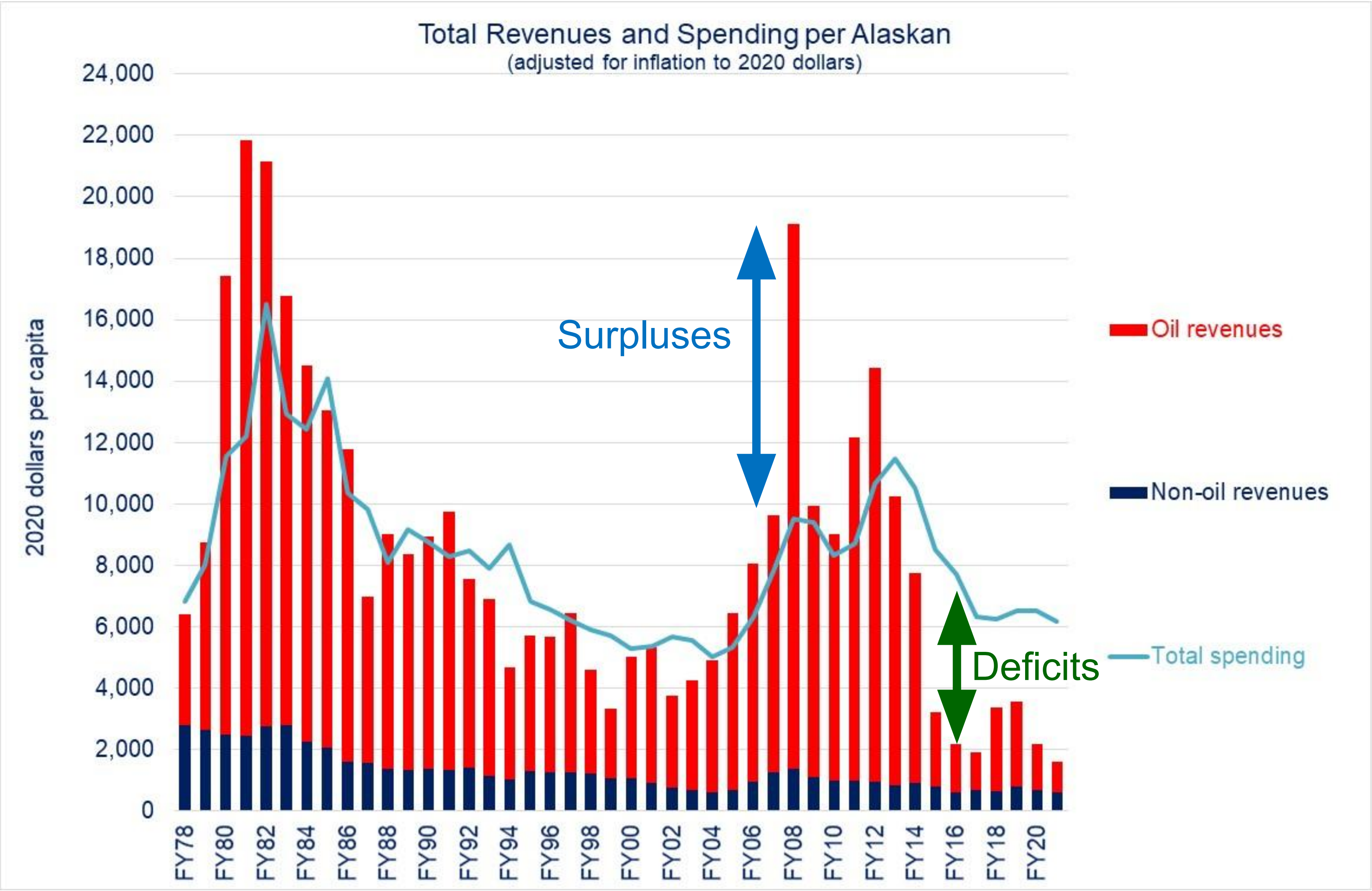
Total Revenues per Alaskan . . .



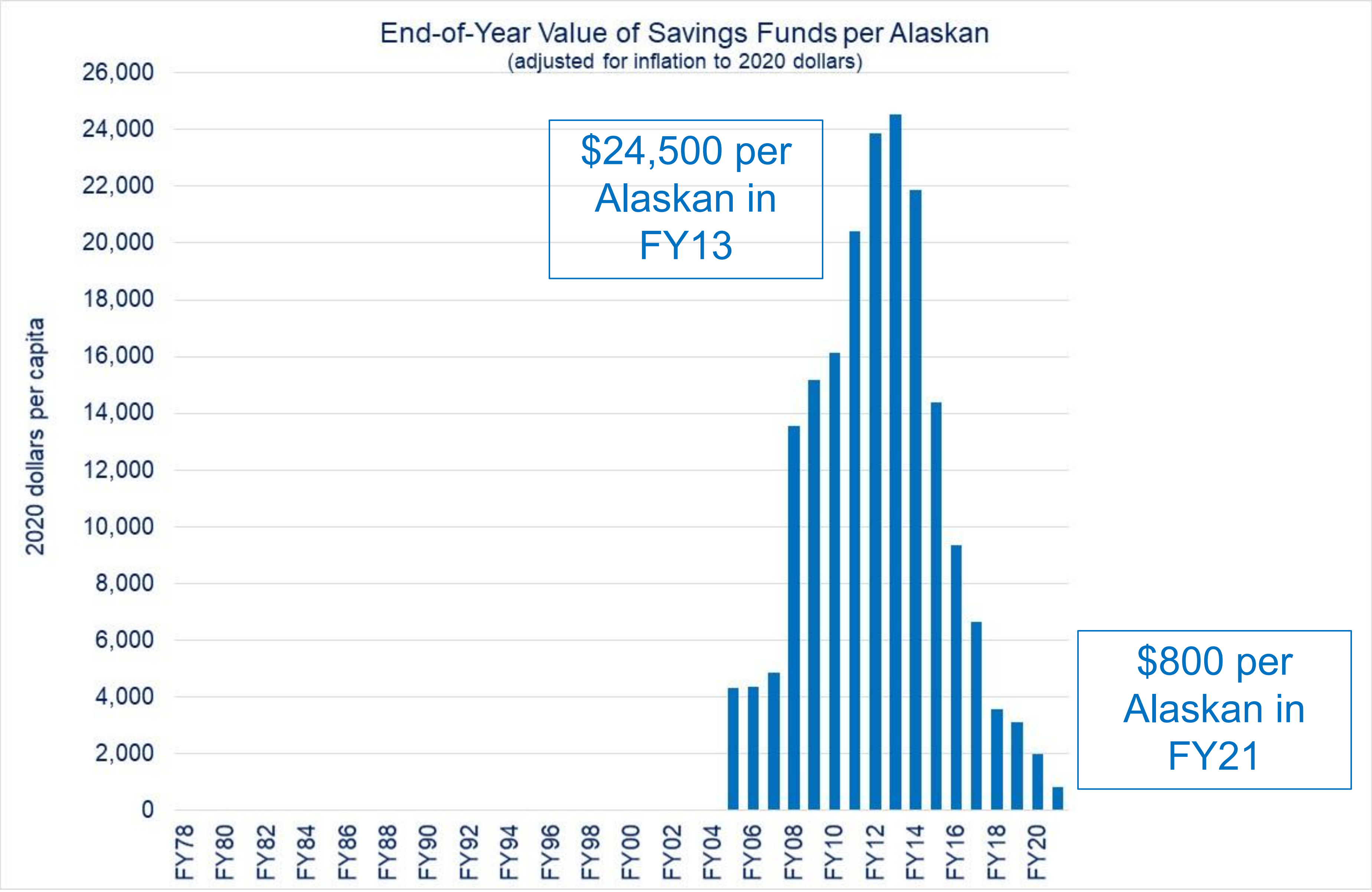
Total Revenues and Spending per Alaskan



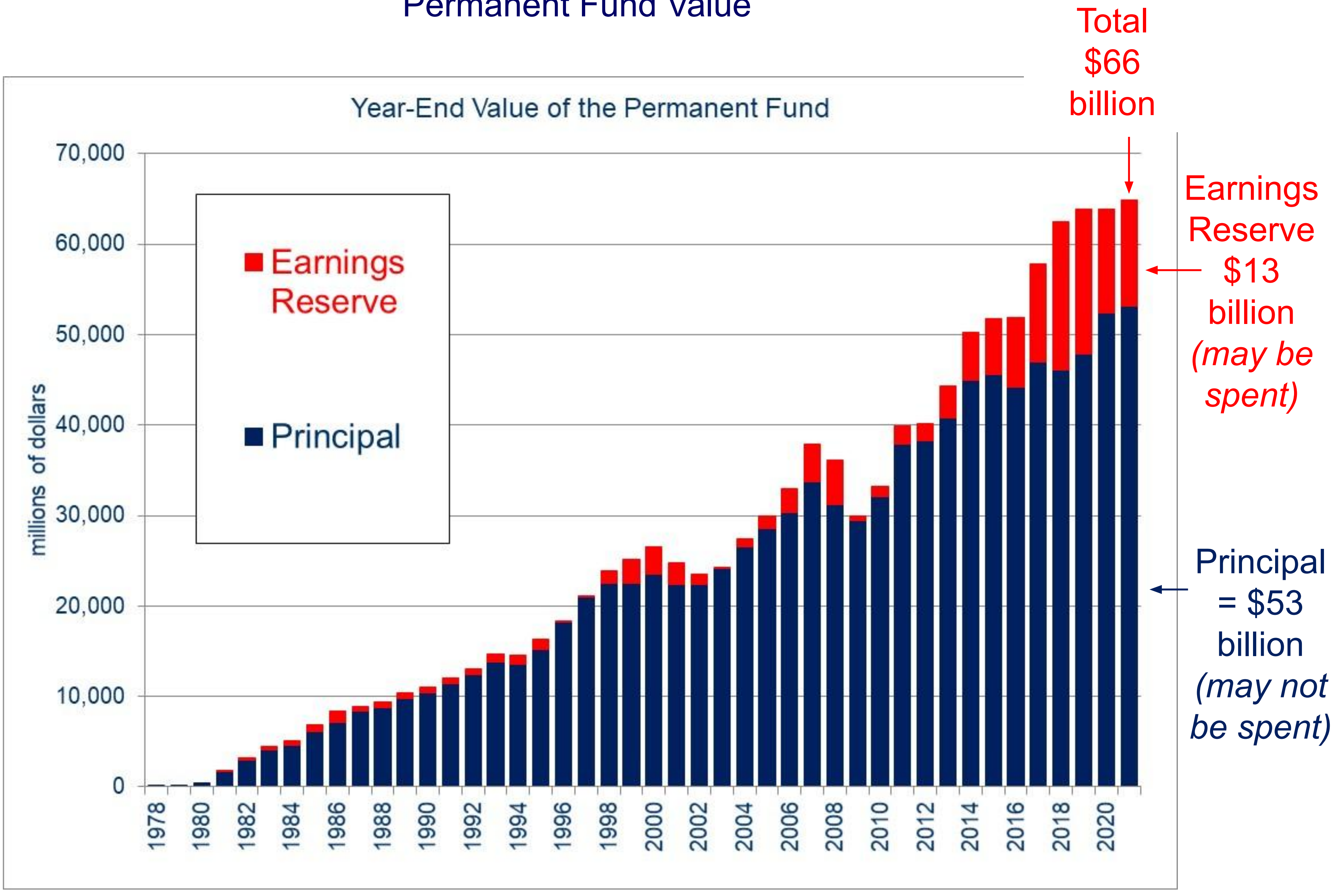
Surpluses and deficits . . .



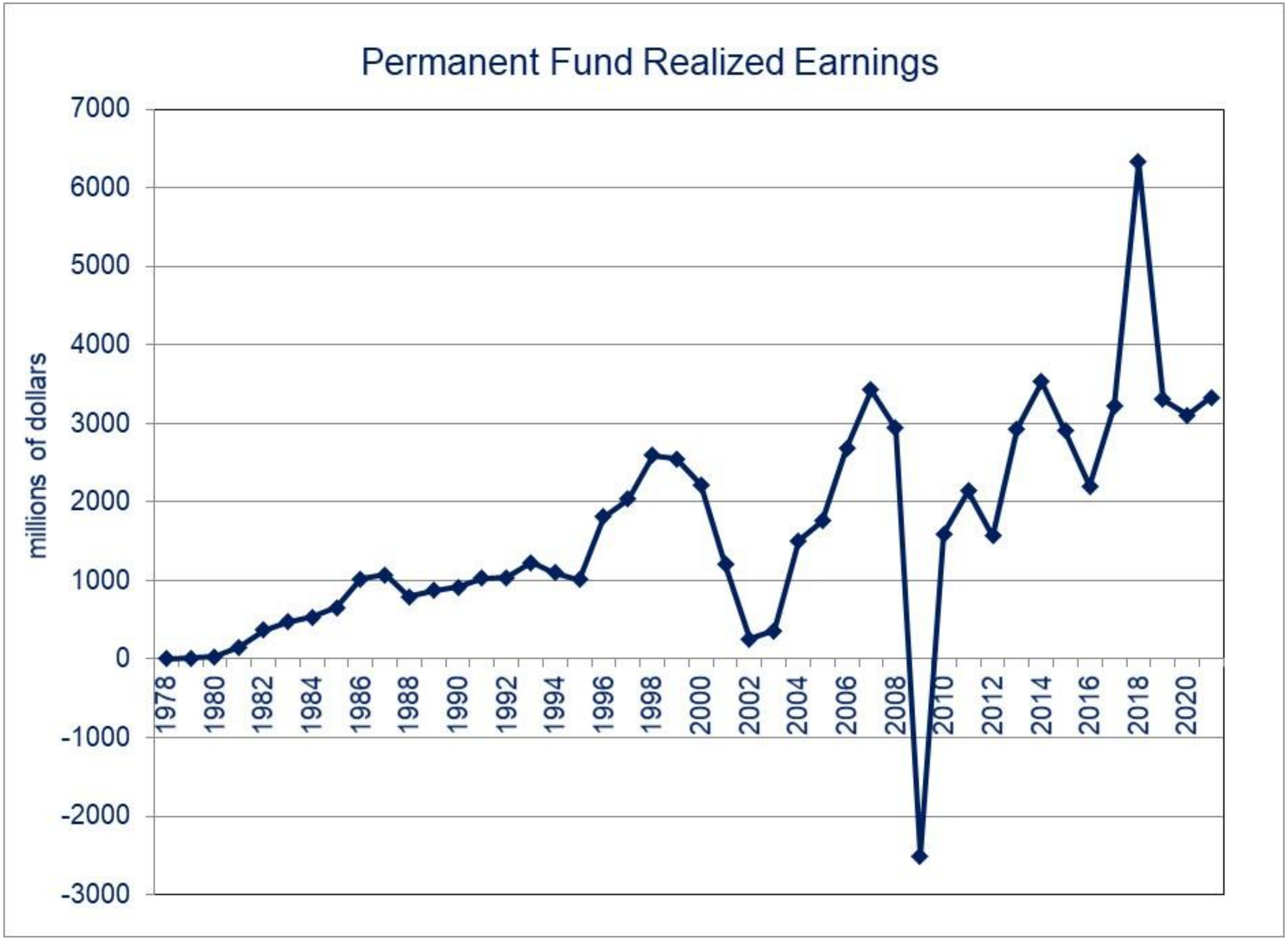
End-of-Year Value of Savings Funds per Alaskan



Permanent Fund Value



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

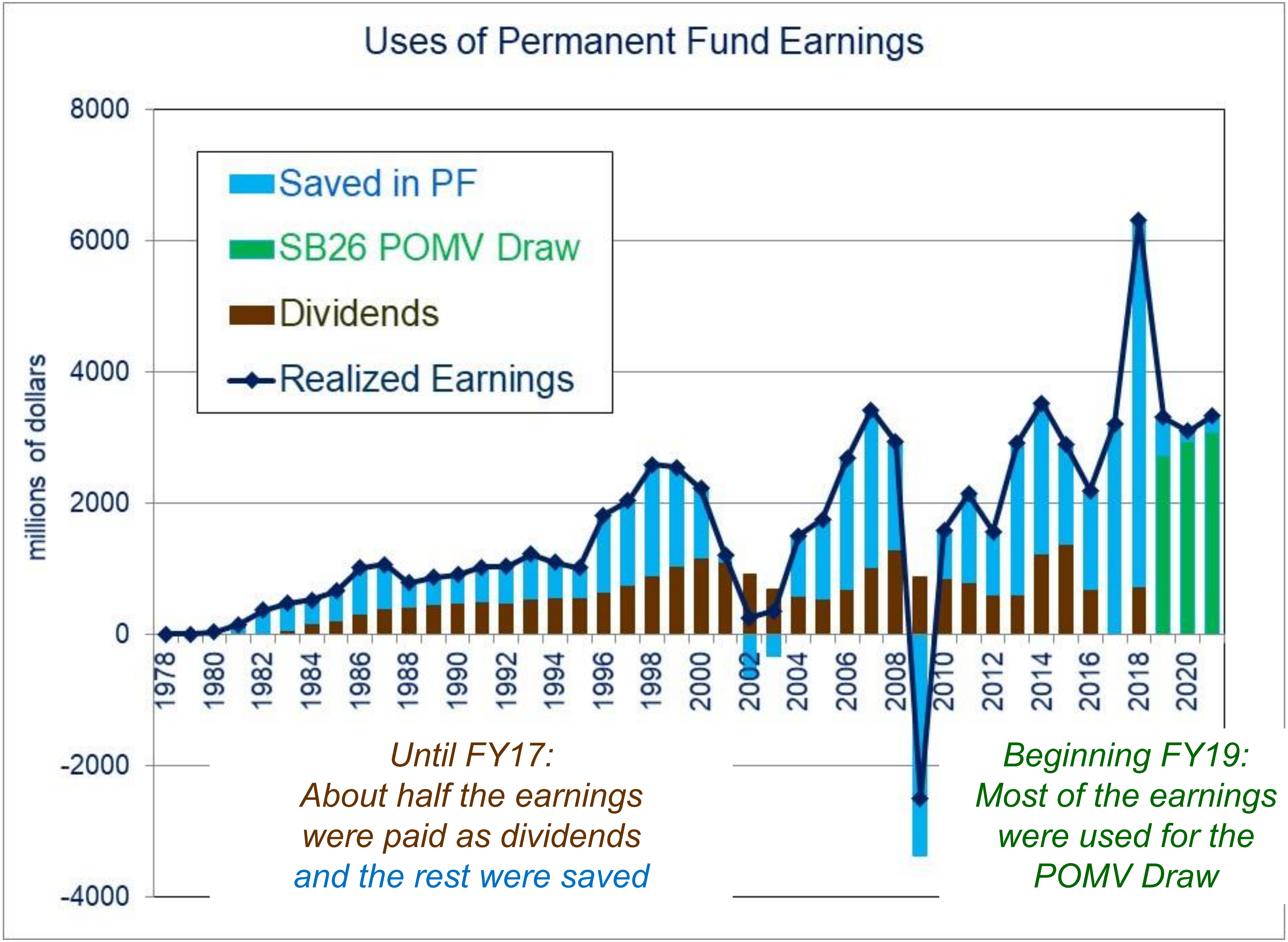
Revenue source	Uses before FY19
Oil revenues	Government
Non-oil revenues	
PF earnings	Dividends

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.

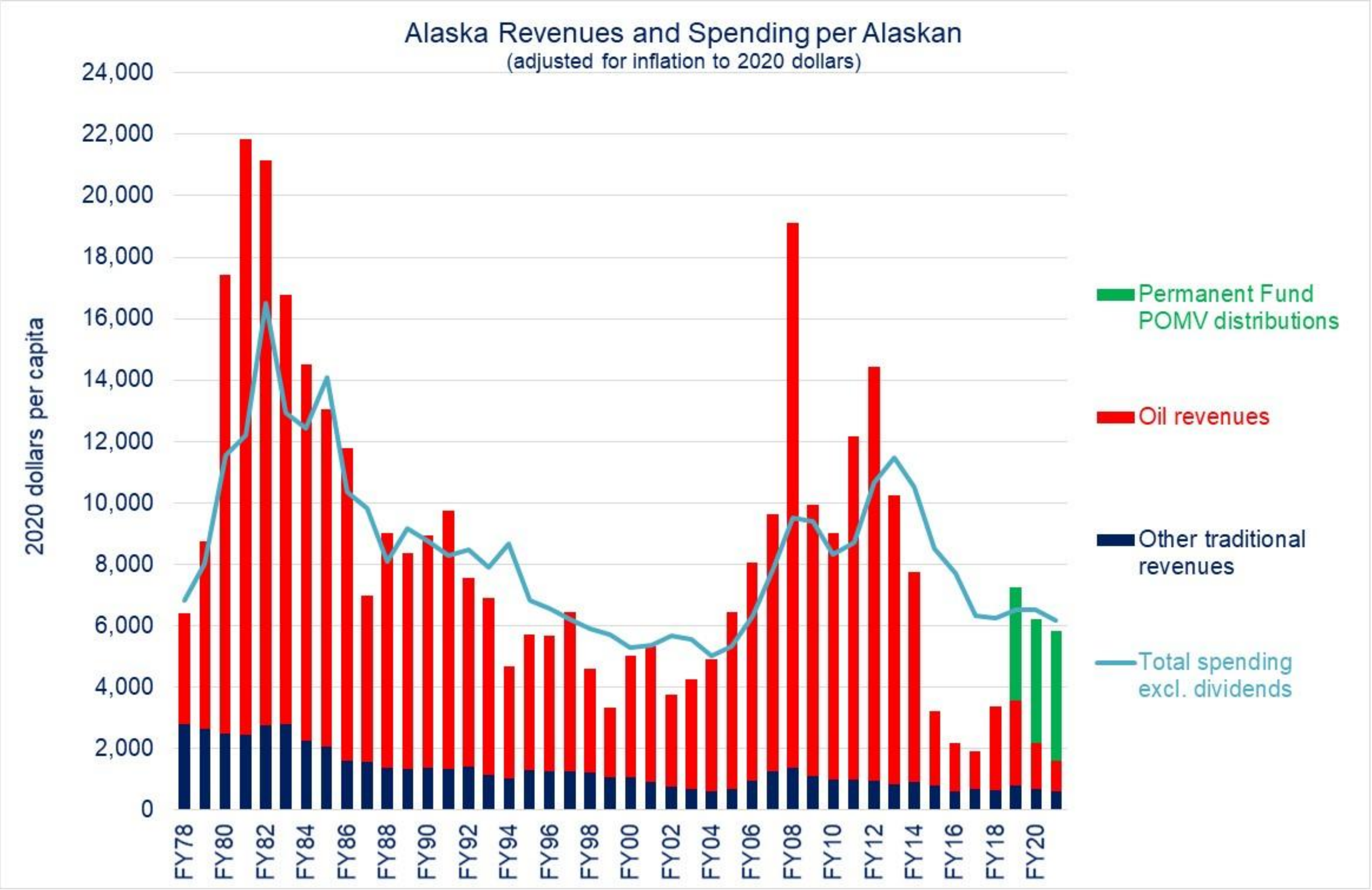
Under SB26, there is an annual "Percent of Market Value" (POMV) distribution from PF earnings which the legislature may spend <u>for government or dividends</u>.

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

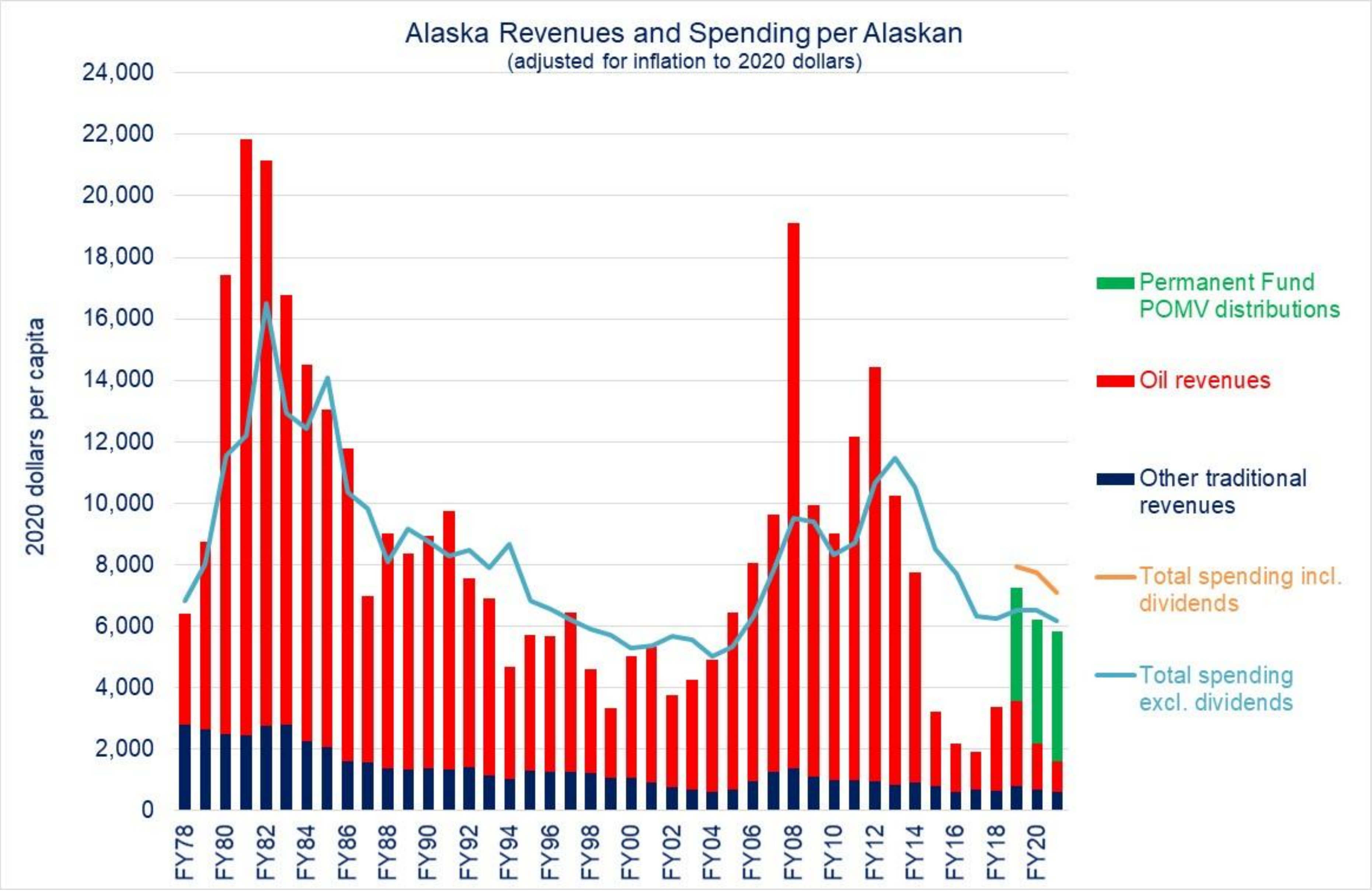


Uses of Permanent Fund Earnings
Saved in PF
SB26 POMV Draw
Dividends
Realized Earnings
millions of dollars
8000
6000
4000
2000
0
-2000
-4000
1978
1980
1982
1984
1986
1988
1990
1992
1994
1996
1998
2000
2002
2004
2006
2008
2010
2012
2014
2016
2018
2020
Until FY17:
About half the earnings
were paid as dividends
and the rest were saved
Beginning FY19:
Most of the earnings
were used for the
POMV Draw

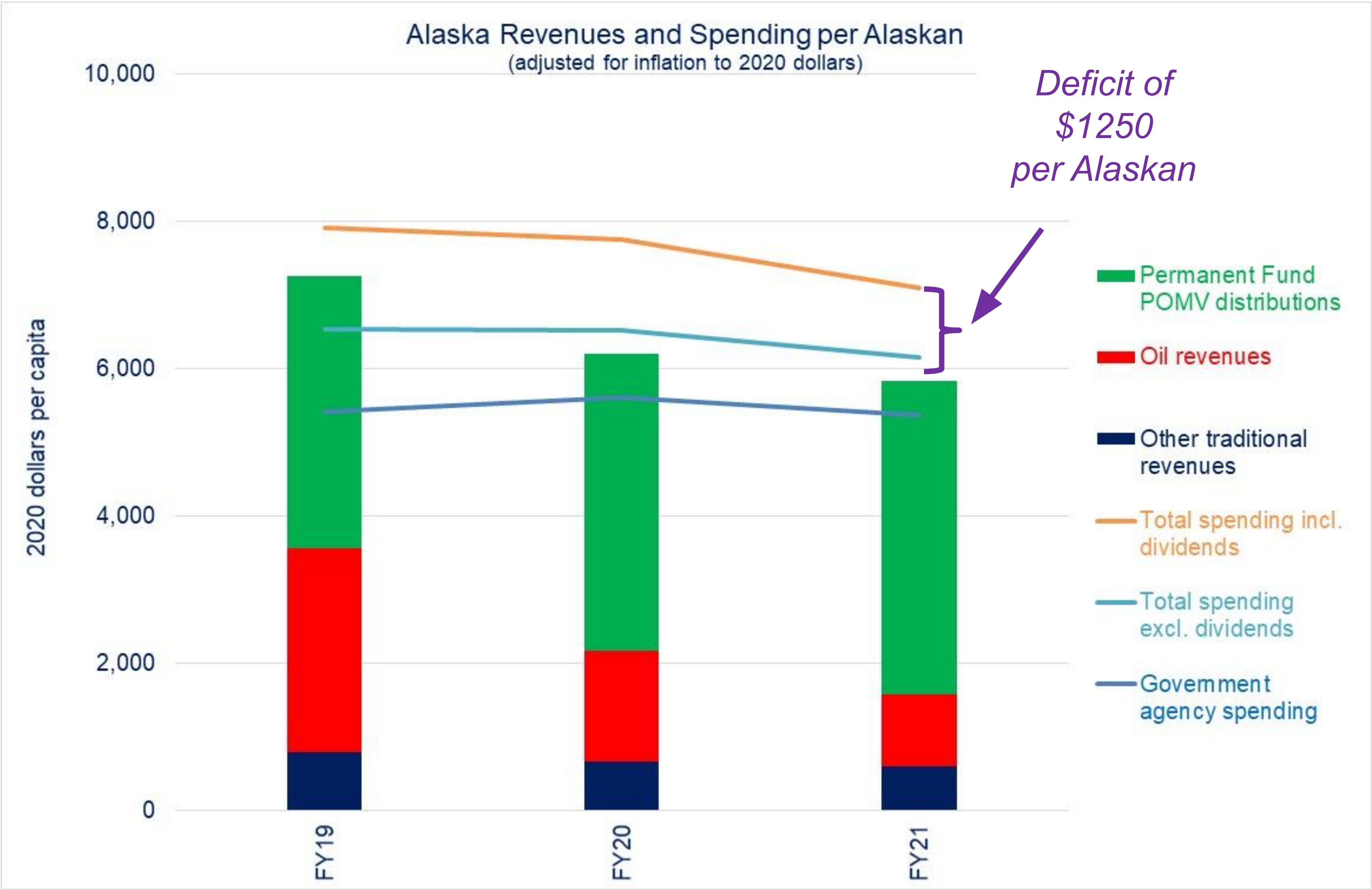
The POMV distribution from PF earnings greatly expanded funds available to pay for government spending!



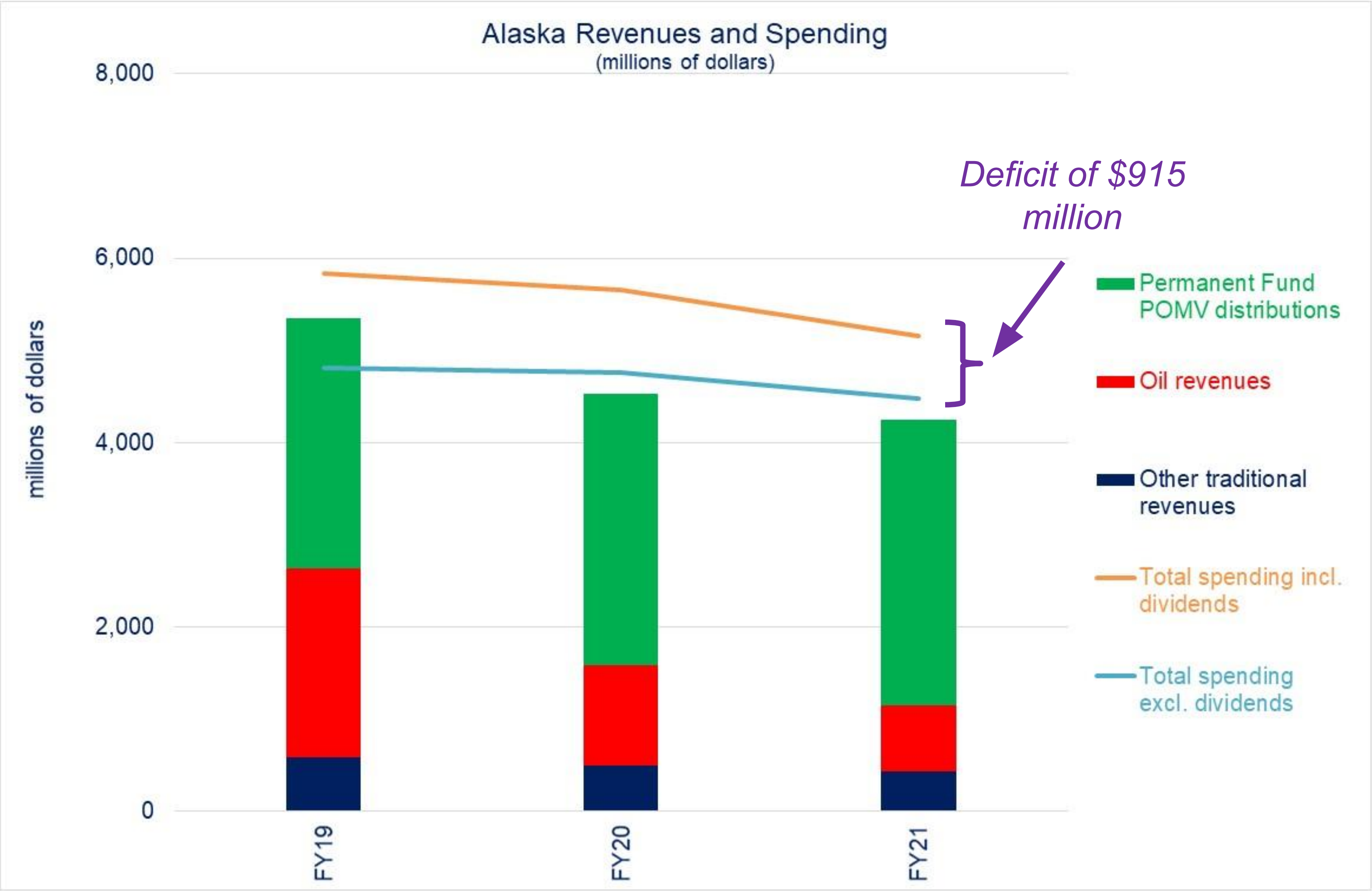
But the POMV distribution from PF earnings also has to pay for dividends.



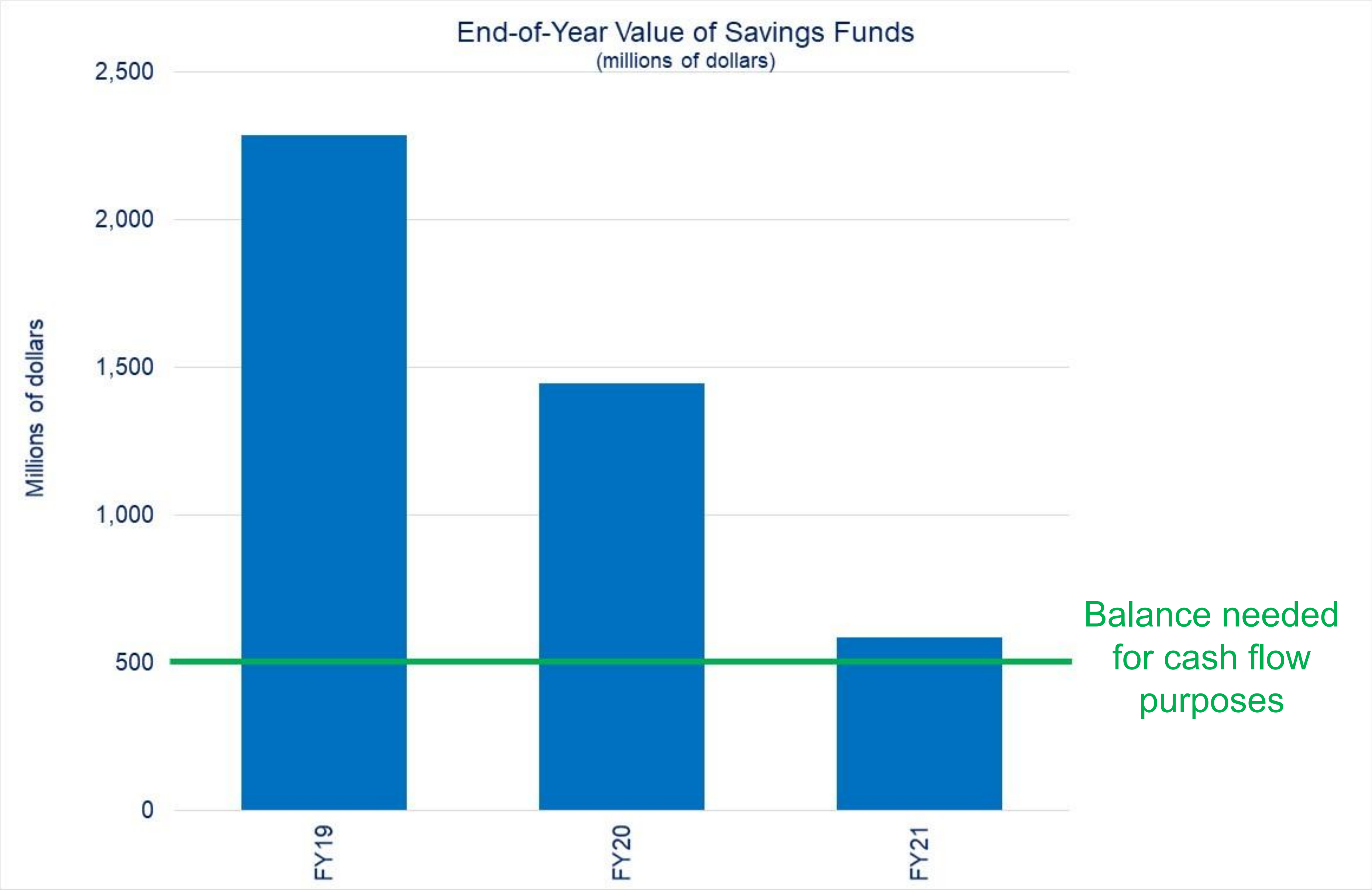
We still have a deficit of $1250 per Alaskan in FY21.



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**
End-of-Year CBR Balance	**587**
Needed for cash flow	500
Available for future draws	87

We are spending $900 million more than our revenues

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.

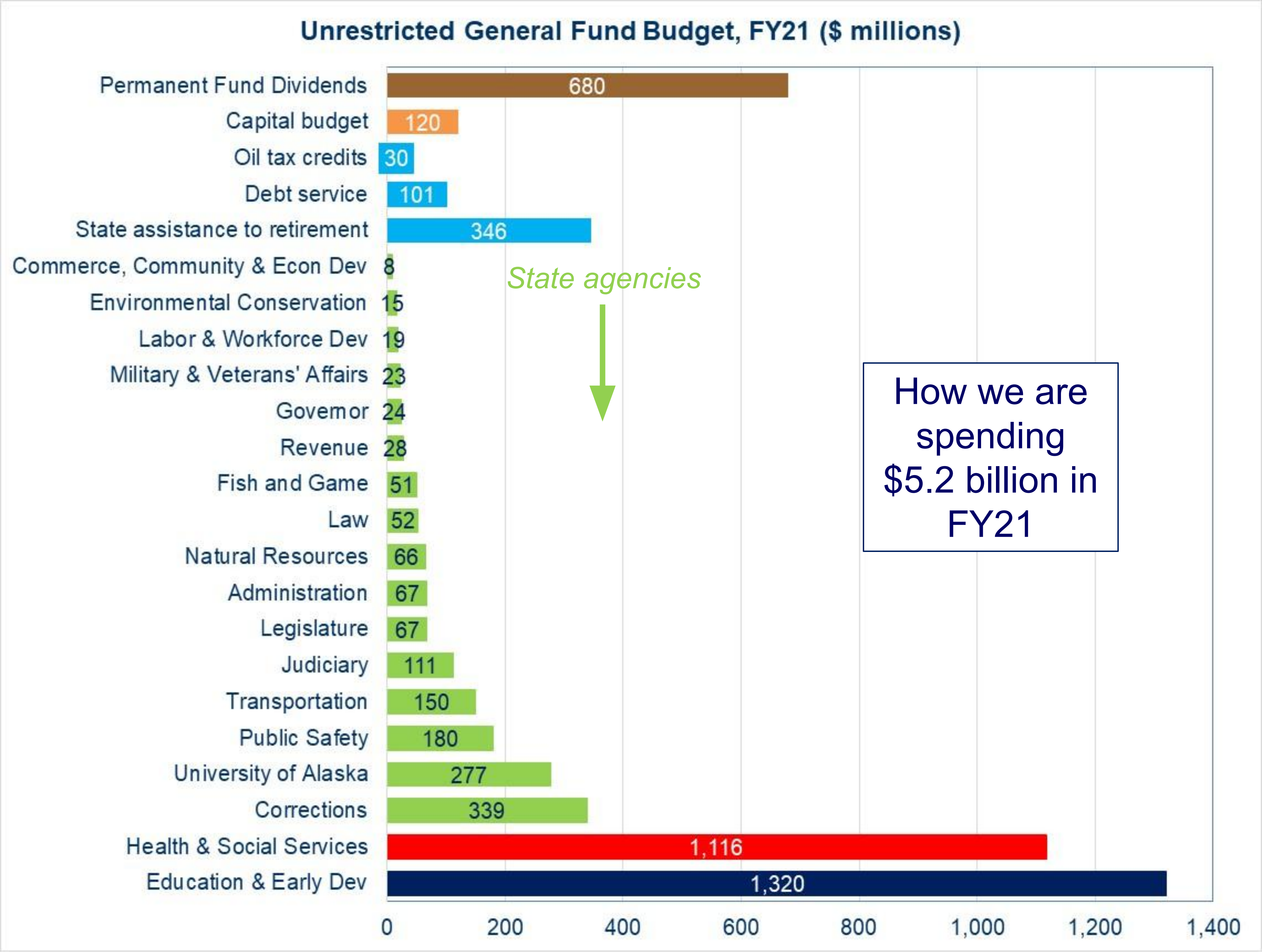
Large government spending cuts will be very difficult.

- 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)
Permanent Fund Dividends 680
Capital budget 120
Oil tax credits 30
Debt service 101
State assistance to retirement 346
Commerce, Community & Econ Dev 8
Environmental Conservation 15
Labor & Workforce Dev 19
Military & Veterans' Affairs 23
Governor 24
Revenue 28
Fish and Game 51
Law 52
Natural Resources 66
Administration 67
Legislature 67
Judiciary 111
Transportation 150
Public Safety 180
University of Alaska 277
Corrections 339
Health & Social Services 1,116
Education & Early Dev 1,320
0 200 400 600 800 1,000 1,200 1,400
State agencies
How we are spending $5.2 billion in FY21

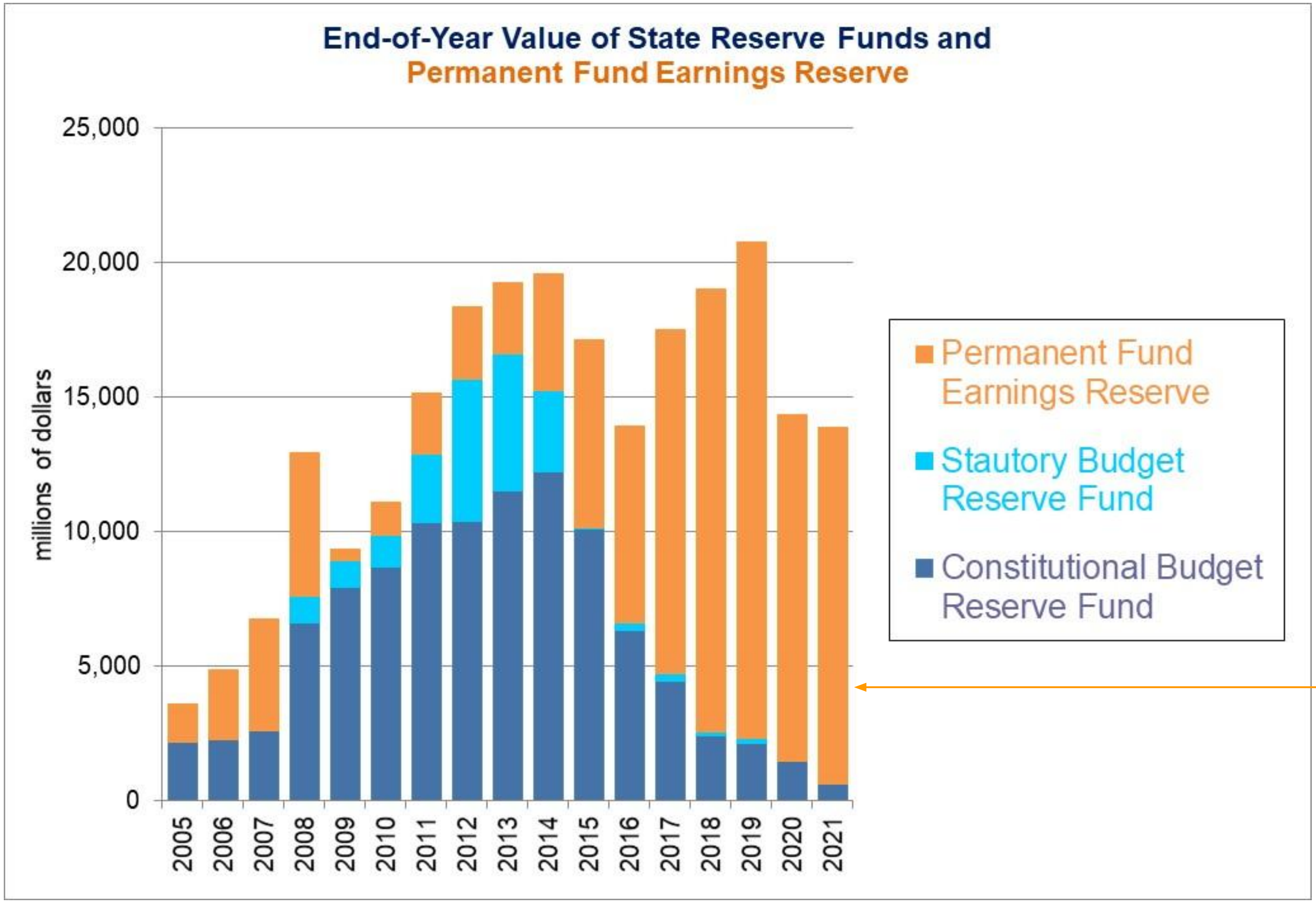
Increasing revenues will be difficult.

- 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?