

# A Few Observations on Alaska's Fiscal Choices

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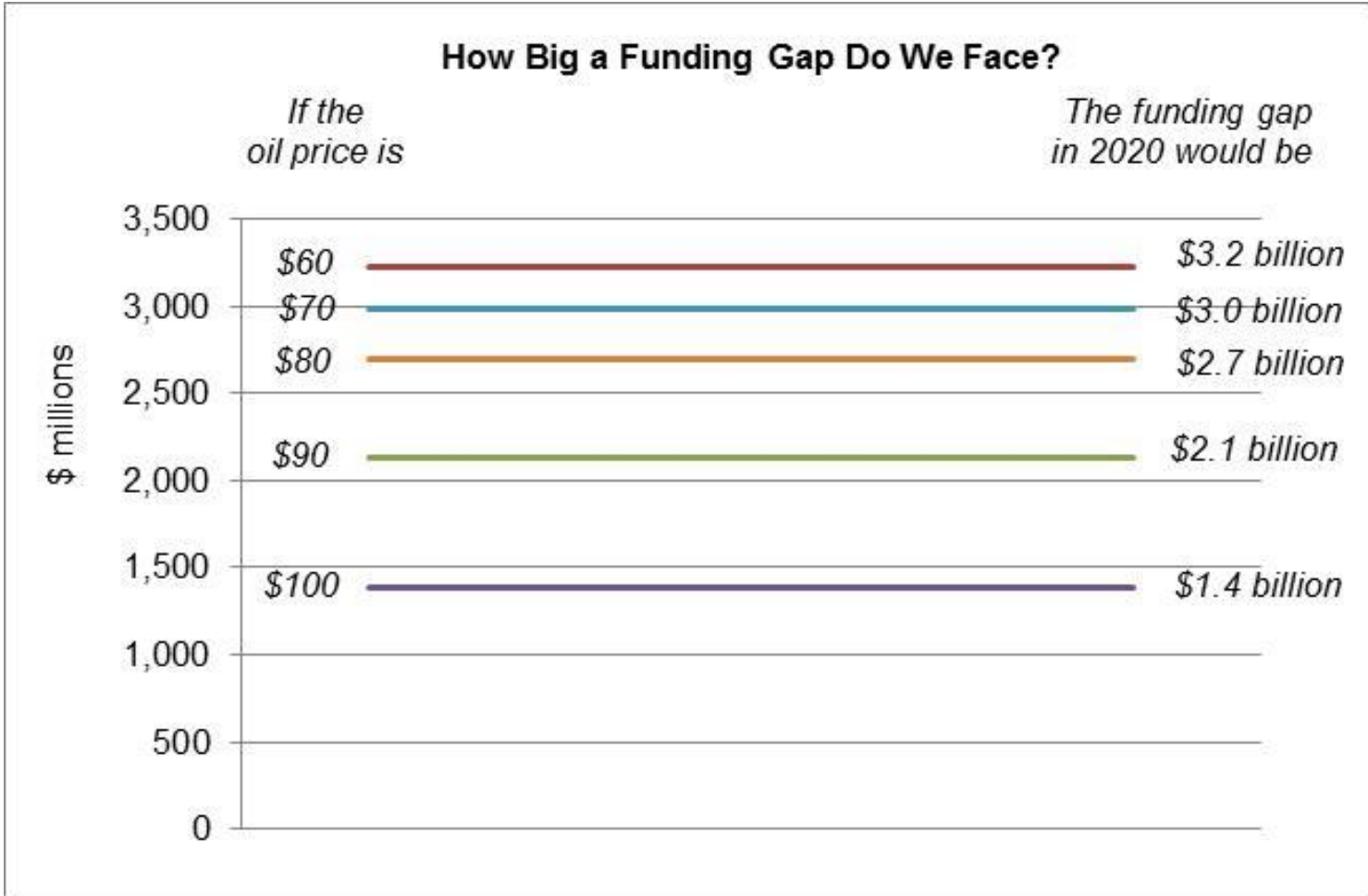
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If we continue to spend at the FY16 level of \$5.2 billion and use only our current revenue sources, we face a large **funding gap** between our spending and our revenues—which we will have to pay for from our savings reserves.

The lower the price of oil, the bigger the funding gap and the sooner we will drain our reserves.



We face two fundamental choices:

WHEN WILL WE FILL THE FUNDING GAP?

HOW WILL WE FILL THE FUNDING GAP?

## WHEN WILL WE FILL THE FUNDING GAP?

*The longer we delay:*

The less the immediate pain  
The less unnecessary pain if oil prices unexpectedly recover

*but*

The sooner we risk **draining our reserves**  
The bigger the risk of facing **drastic immediate adjustments**  
The greater the risk to our **credit rating**  
The greater the risk to **investor confidence**  
The lower our future **investment earnings** from savings  
The less savings we leave for **future generations**

## HOW WILL WE FILL THE FUNDING GAP?

Our only significant and practical options are some combination of:

Spending cuts

New revenues

Use Permanent Fund earnings

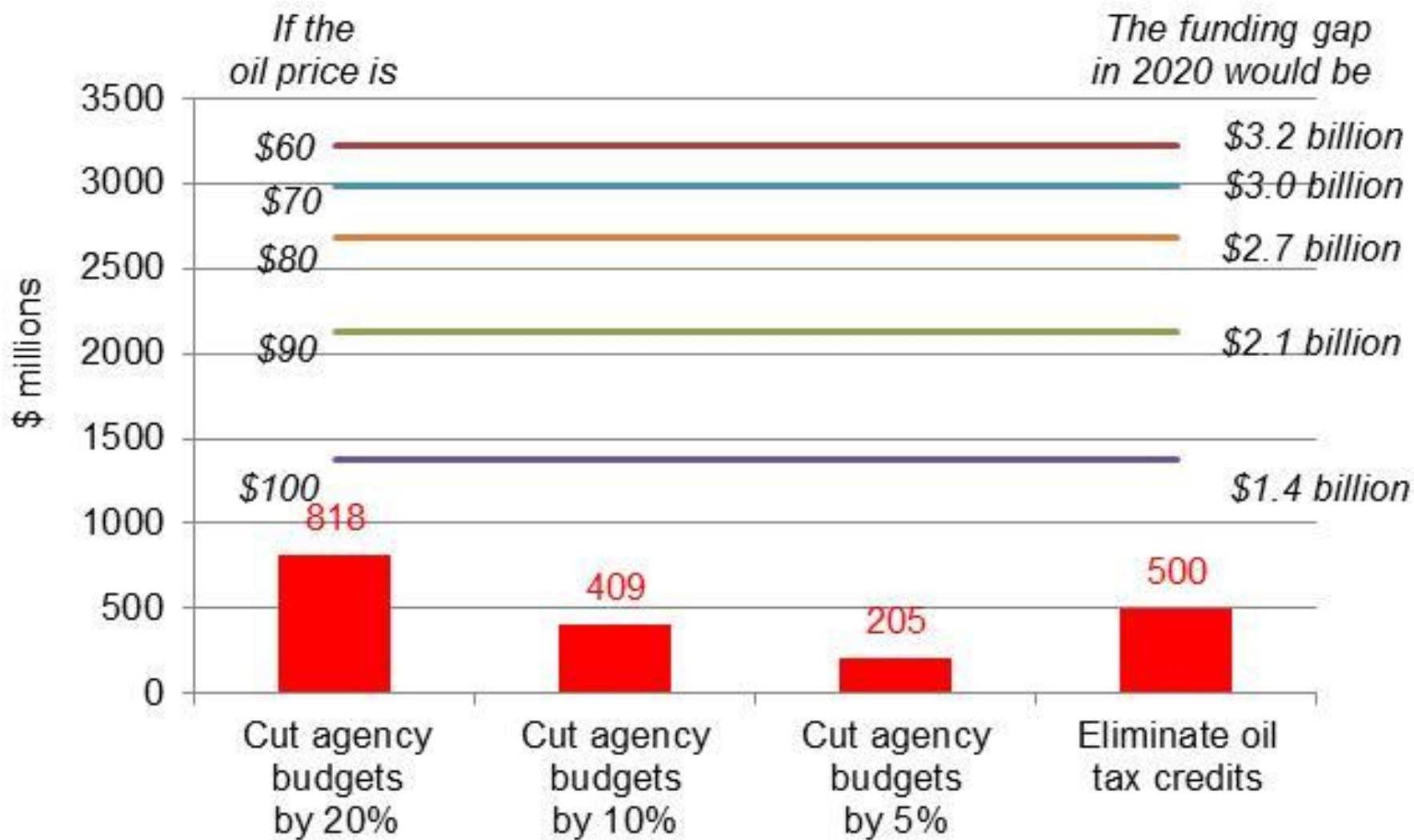
None of these options are easy or popular.

## *Options for closing the funding gap:*

### **Spending cuts . . .**

- Capital budget cuts
  - Very little is left to cut
- Statewide operations cuts
  - We can't cut debt service
  - Cutting retirement contributions would be very difficult
  - We could cut oil tax credits—but that could affect future production
- Agency operations cuts
  - Most cuts would have to come from agency operations
  - Significant cuts would require cutting the largest agencies:
    - Education & Early Development
    - Health and Social Services

## How Much Could Spending Cuts Fill the Funding Gap?



## *Options for closing the funding gap:*

### **New revenues . . .**

There are many potential options.

Each option raises questions:

- How much money would it generate?
- How long would it take and what would it cost to implement?
- Who would pay how much of the taxes?
- How would it affect the economy?
- What risks does it pose?

Any revenue option would take time to implement.

Any revenue option needs careful study and debate.

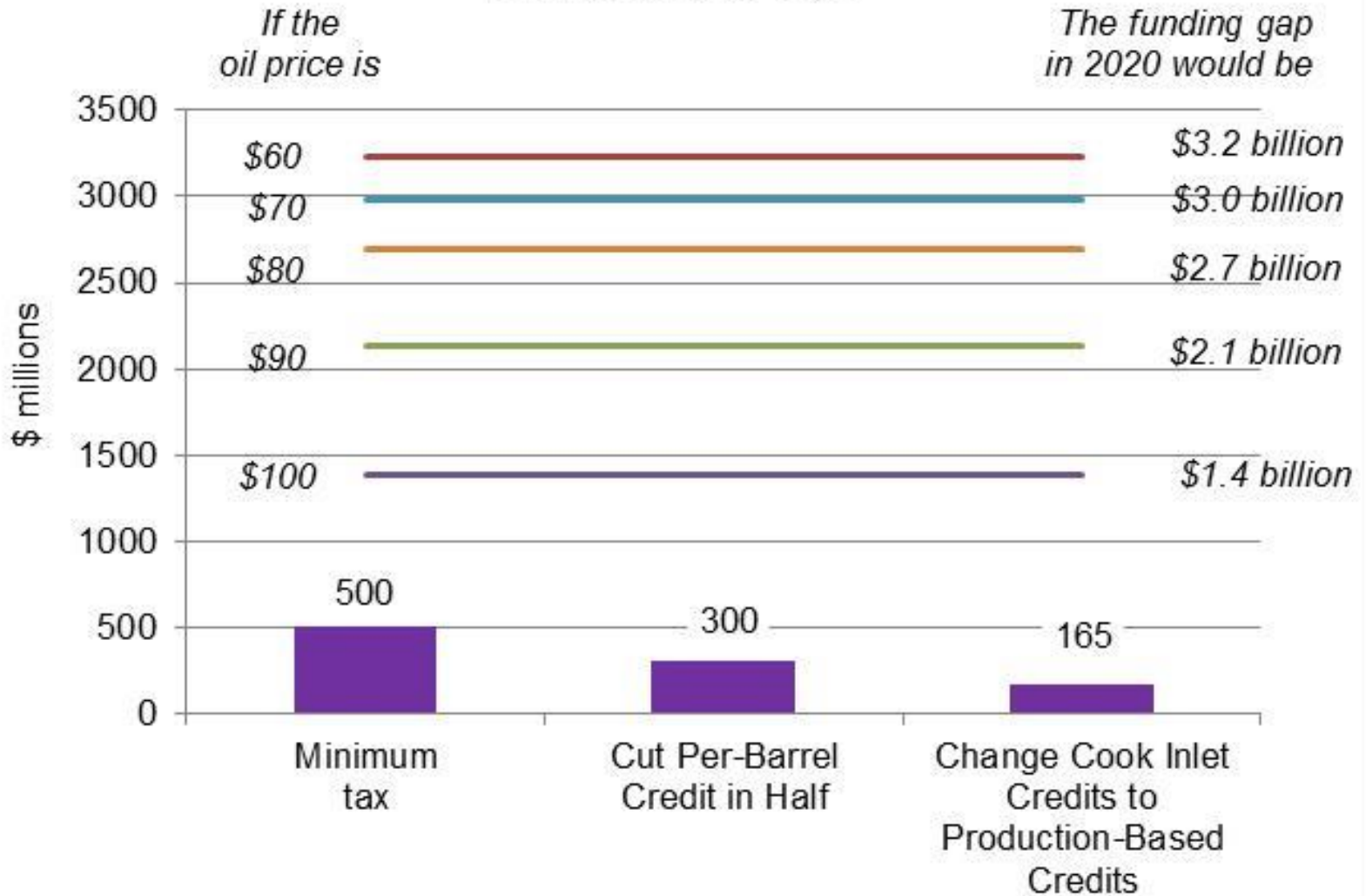
For any new revenue option, the devil is in the details!!!!



## Examples of **new revenue** options and some of the issues they raise

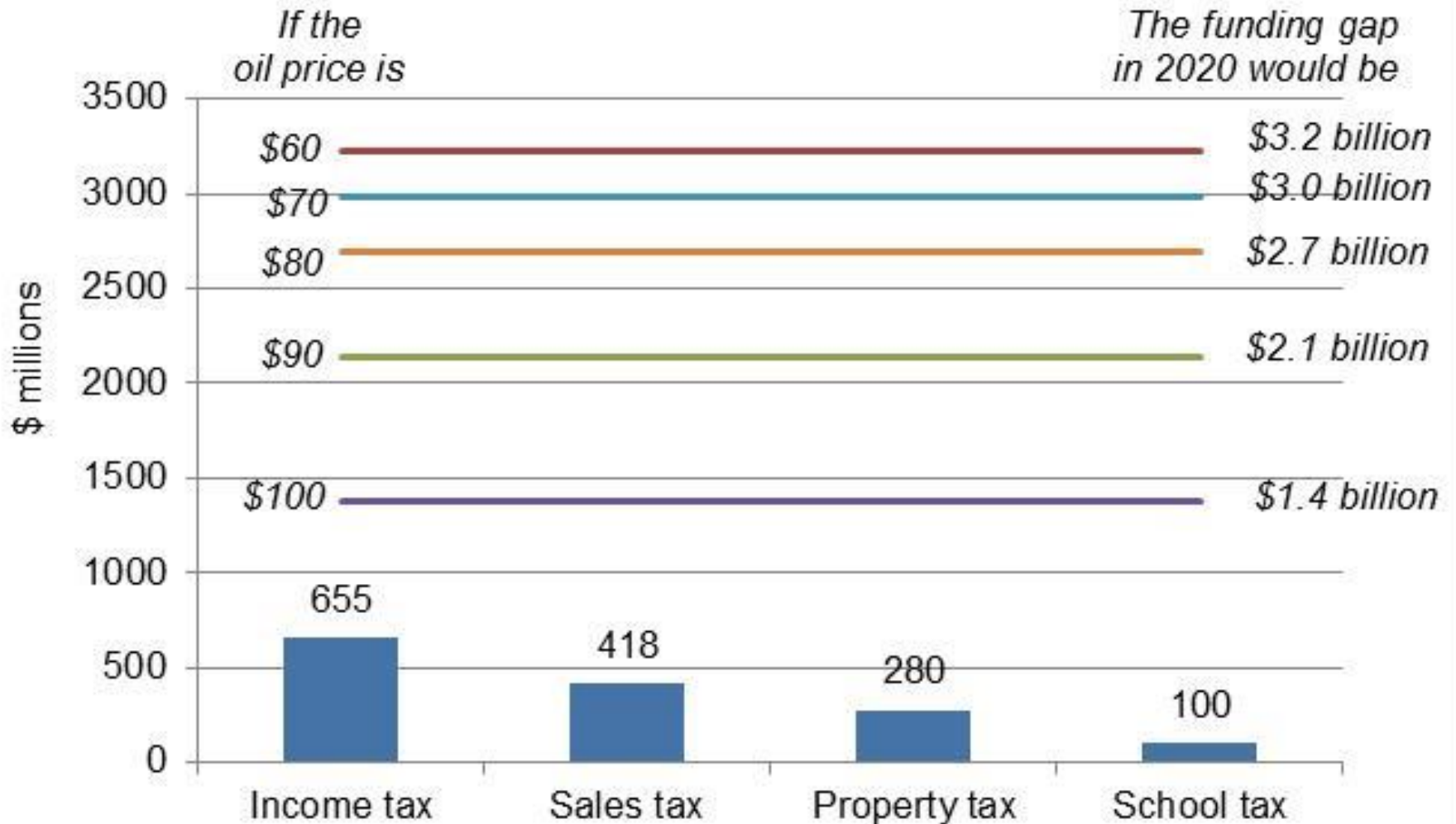
Option	Some of the Issues
Increase oil revenues	Issues which arose in last year's oil tax debate
Income taxes	Who bears the burden? Effects on the economy? Potential to tax non-resident workers?
Sales taxes	Who bears the burden? Effects on the economy? Effects on local government revenues? Potential to tax tourists?
Increase other resource revenues (mining, seafood, tourism, etc.)	Ability of these industries to pay
Economic diversification	What new industries? Ability of these industries to pay
Increase return on state funds	What are the risks?
LNG project	Still a long time away and many uncertainties

## How Much Could Changes to Oil & Gas Taxes Fill the Funding Gap?



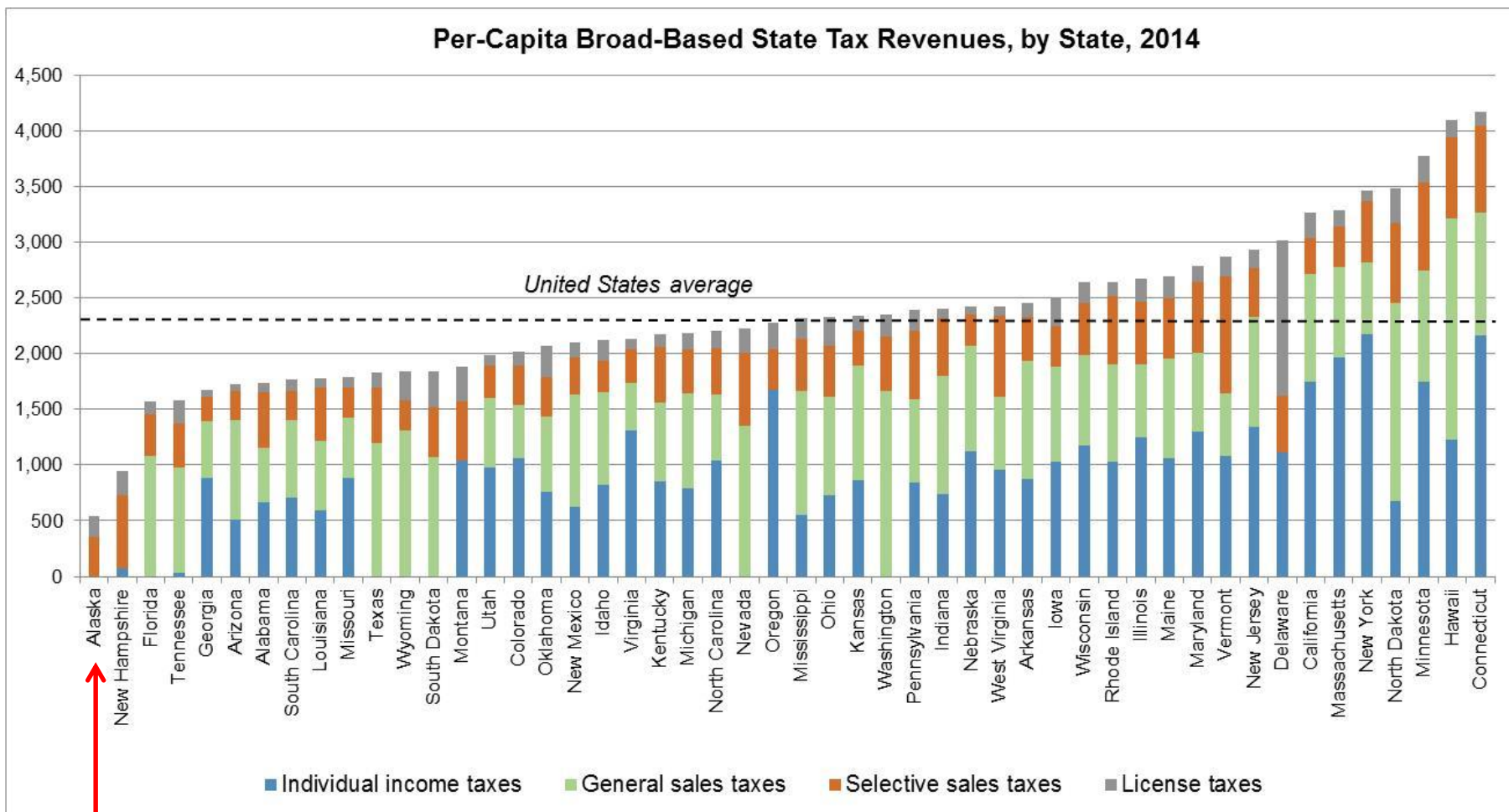
Source: Alaska Department of Revenue estimates

## How Much Could Statewide Taxes Fill the Funding Gap?



Source: Alaska Department of Revenue estimates

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



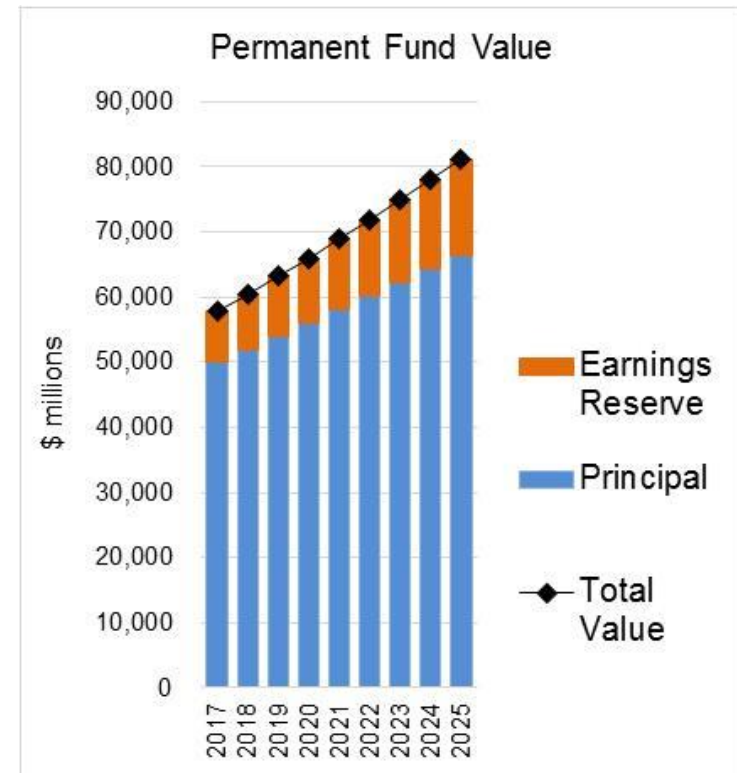
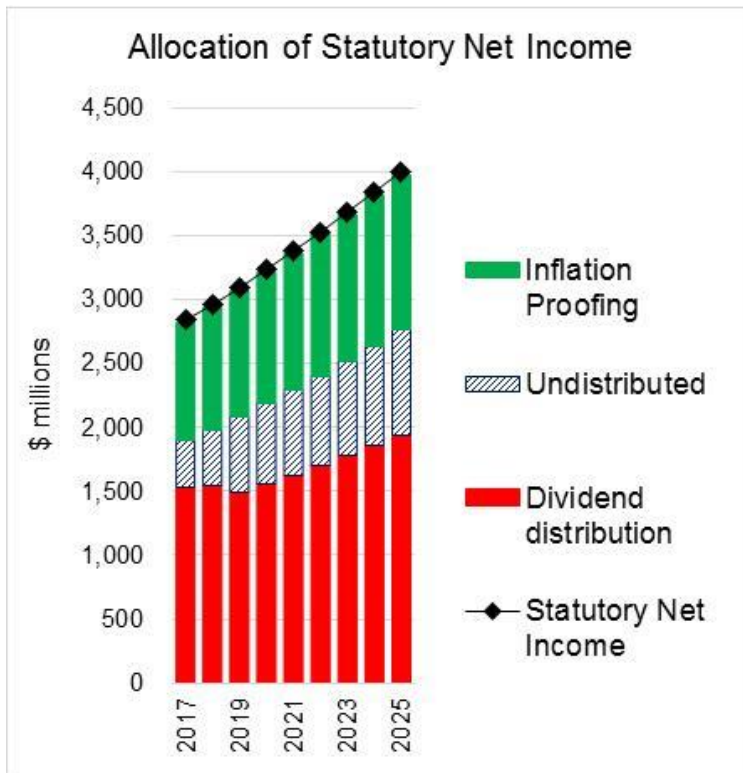
Alaska

## Options for closing the funding gap:

### Use Permanent Fund earnings . . .

- Earnings, dividends and the fund value are all projected to grow
- We haven't been spending all the earnings. We could:
  - Use some earnings and still keep or grow dividends
  - Use more earnings by capping or reducing dividends

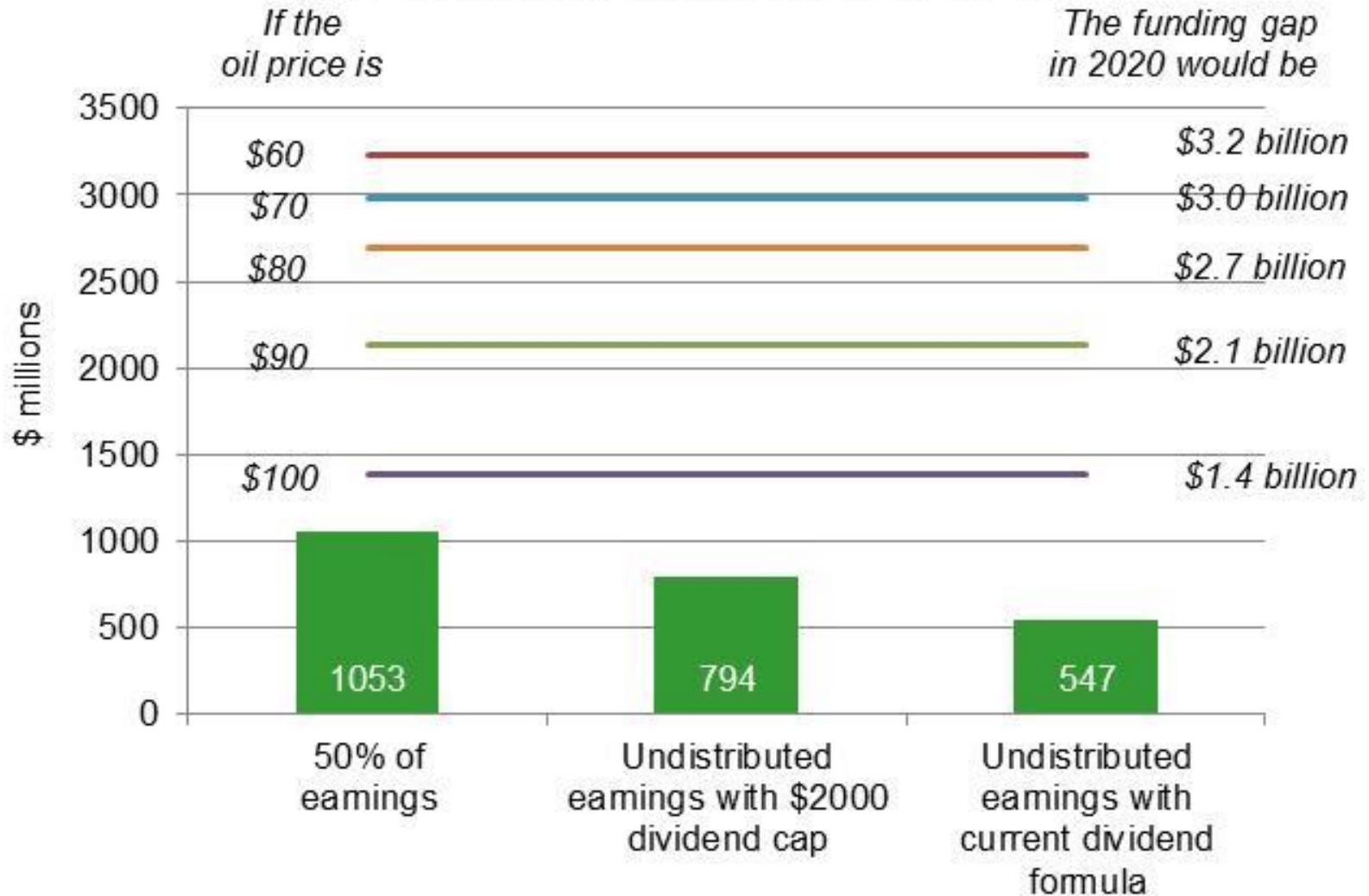
### Alaska Permanent Fund Corporation Projections, 2017-2025



## Two key questions in any use of Permanent Fund earnings

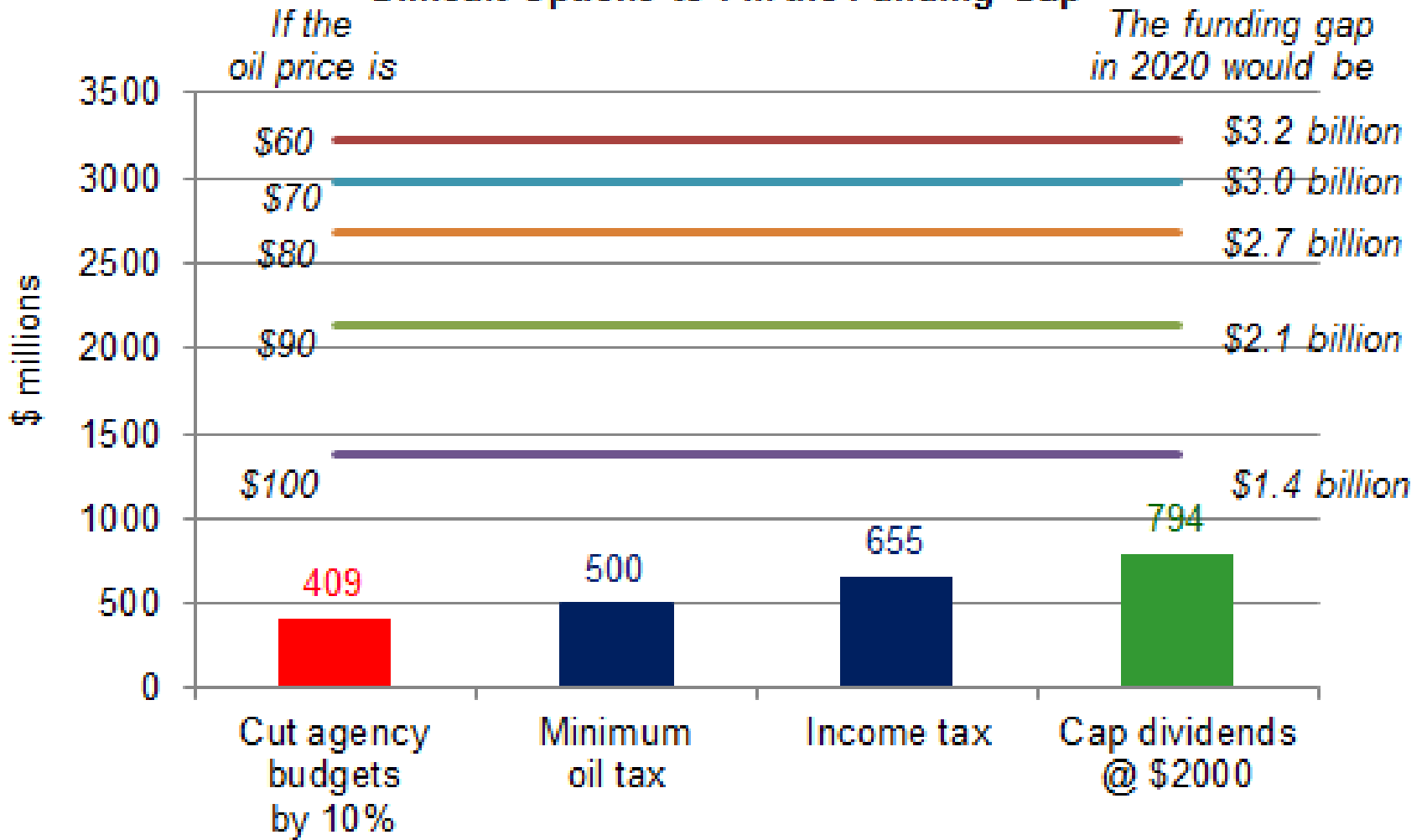
	How much should we distribute from earnings?	How much should go to dividends and how much to government?
What we do now	Distribute half of average statutory net income over the previous five years	100% goes to dividends
Some examples of what we could do	<p>Keep the same formula</p> <p>Distribute a higher share of statutory net income</p> <p>Distribute a fixed percent of market value</p>	<p>Cap the dividends</p> <p>Use the rest for government</p> <p>Keep dividends the same</p> <p>Use the increase in distributions for government</p>

## How Much Could Permanent Fund Earnings (After Inflation Proofing) Fill the Funding Gap?



Source: Gunnar Knapp estimates based on APFC earnings projections

## At Low Oil Prices, It Could Take a Mix of Difficult Options to Fill the Funding Gap





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 less for government
  - Have income taxes and/or sales taxes
  - Don't pay dividends
- Our basic fiscal options are to become more like other states:
  - Spend less for government
  - Tax ourselves more
  - Pay smaller dividends