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**Alaska: Arctic Groundhog Day**

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**Abstract**

Since the early 1980s, Alaska has relied on oil taxes for almost all of its state government revenue. Like many resource-based economies, including many of the Western states, the result is a boom and bust economy. With production declining and the price of Alaska's North Slope crude around \$75 per barrel, the state is in a bust cycle, with a large state government deficit. Although Alaska is experiencing a somewhat improved revenue outlook compared to 2017, the state's executive and legislative branches continue to wrestle with unpopular political choices; do we implement a state income tax, tap the state's Permanent Fund sovereign wealth fund (and thereby reduce or eliminate Alaska's annual Permanent Fund Dividend payment to Alaskan residents), or some combination of those two approaches? In Spring 2018, the Alaska State Legislature—supported by Independent Governor Bill Walker—chose the first of these options, tapping Alaska's Permanent Fund to fund state government operations for the first time. The result is a dramatically improved fiscal position for 2019, and although the state remains in deficit, chances of a balanced budget are much improved. Use of the Permanent Fund has not been popular, however; a number of incumbents who supported the use Permanent Fund earnings were defeated in November 2018 by opponents who campaigned on the issue. At the moment, Alaska's fiscal future remains in doubt.

## **Introduction**

Alaska has historically relied on oil taxes for more than 85% of the state's tax revenue, and Alaskan oil production has been falling since the 1980s. Although production from Alaska's North Slope oil fields is today around 25% of peak oil production in 1988, high oil prices from 2006 to 2014 cushioned Alaskan state government from the need to choose between higher taxes and cuts to services in the face of this production decline. In 2014, however, oil prices collapsed, dropping from about \$110 per barrel to a low of about \$20 per barrel in summer 2015. Since then Alaska's government spending has declined around 40%, and even with these large spending cuts, the state has been spending heavily in deficit. These large deficits (around 65% of the state's budget) have been funded by relying on the state's substantial reserve accounts. The last of Alaska's easily accessible reserves, however, will soon be gone, requiring some new source of revenue, or massive cuts to services. Like the 2015, 2016, and 2017 state legislative sessions, the biggest question Alaska's state legislature faced in 2018 was how to reduce or eliminate this deficit; do we rely on savings, reducing or eliminating Alaska's popular Permanent Fund Dividend (PFD)? Or do we implement an income tax or another broadly-based tax?

Despite slow progress, and to the surprise of many observers (including the authors), the Alaska State Legislature agreed, in Spring 2018, to use revenue from Alaska's Permanent Fund to fund state government operations in Fiscal Year (FY) 2018-2019. This was a significant step towards fiscal sustainability for Alaska and a difficult political choice for many incumbent politicians, especially Alaska's Governor, Bill Walker, and leaders in the State House of Representatives.

Although Alaska's fiscal position is much improved as a result of these difficult political choices, the use of Permanent Fund earnings to fund state government—and the resulting reduction in the size of Alaska's popular Permanent Fund Dividend—was politically unpopular. As a result, a number of incumbents were defeated in November 2018, including Governor Bill Walker and leaders of a Democrat-led House coalition who advocated for the use of Permanent Fund earnings to balance the budget.

At the moment, Alaska's fiscal future remains in doubt, with the Governor's office and both chambers of the legislature controlled by Republicans who have promised to return to the use of the state's historical formula for funding the Permanent Fund Dividend, leaving no room for state government funding. If Republicans succeed in returning the state to the pre-2018 budgetary equilibrium, the state will return to the large deficits of the 2014-2018 period, with continued large cuts to public services.

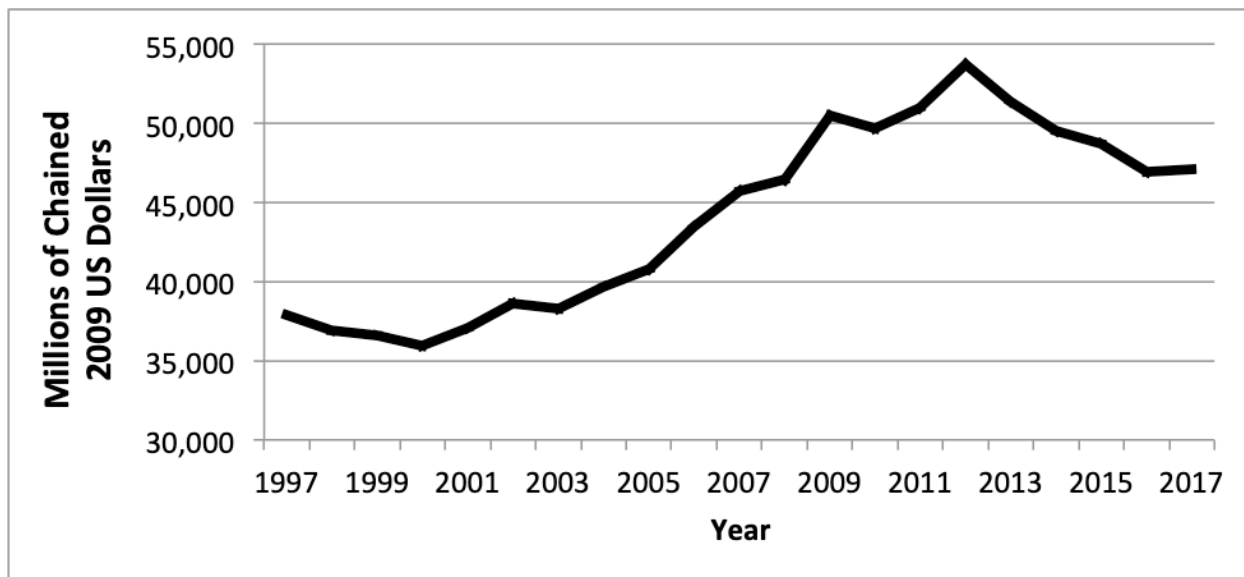
## **Alaska's Economy in Fiscal Year 2017**

Although lower oil prices seem to have had only moderate impacts on unemployment in Alaska, the state has been in a recession since 2014 (Guettabi, 2017). For an illustration, see Figure 1, showing declining Alaskan GDP over the last several years. In 2017, economists suggested that this recession will end with a permanently smaller Alaska economy, and no recovery to pre-2014 levels (Wohlforth, 2017), and those predictions appear to be coming true (Wohlforth, 2018). Even so, impacts of the recession on Alaskan citizens have taken several years to appear, and there are some bright spots in the Alaskan economy, including tourism, which is growing, and fisheries, which are stable.

## Oil

After the Trans-Alaska Pipeline System (TAPS) began moving oil from the Alaska North Slope in 1977, oil revenues quickly became the most important source of revenue for the State of Alaska, often around 90% of the state's tax revenues. Because of the state's reliance on oil for its tax revenues, Alaska's budget expands when oil prices and oil production are high, and when production and prices are low, the state government's revenues and expenditures contract.

**Figure 1: Alaska's GDP**



Note: Since 2012, and increasingly since 2014, Alaska's economy has been in decline, driven by lower oil prices and production.<sup>1</sup>

Alaska has experienced two notable contractions since oil became an important driver of the state's economy. The first of these (and by far the most dramatic) was in the late 1980s, and the second was in the 1990s, both resulting from global increases in oil supplies and consequent price declines. Between 1985 and 1988, low prices for crude oil led to dramatic declines in state government revenues, widespread layoffs and a nearly \$10,000 decline in median family income<sup>2</sup>. In the late 1990s, a similar drop in the price of oil led to a much softer landing for Alaska's economy, as low oil prices were buffered by relatively high and stable state government spending. In effect, the state used its savings to keep low oil prices from impacting the state's economy.

After a dramatic decline in global oil prices in 2014, the price of Alaska's North Slope crude bottomed out at around \$20 per barrel in early 2016, rising fitfully since then (see Figure 2). However, current prices (around \$72/bbl) are well below their 2008 peak of \$126/bbl.

More important (and, for Alaskans, more worrying) has been a long-term production decline on Alaska's North Slope; Alaska North Slope crude production peaked in 1988 and has been in decline ever since, and currently is about 25% of that historical production peak. Oil producers, including ConocoPhillips,

<sup>1</sup> Real total gross domestic product for Alaska. Federal Reserve Bank of St. Louis. <https://fred.stlouisfed.org/> Retrieved November 12, 2018.

<sup>2</sup> Federal Reserve Economic Data. <https://research.stlouisfed.org/fred2>. Retrieved April 1, 2016.

Repsol, and Caelus Energy have made large discoveries in the last two years. These finds may eventually generate meaningful increases in taxable North Slope oil production (Associated Press, 2017; Harball, 2017a; 2017b). However, oil production will remain far below the 1988 peak (see Figure 3).

**Figure 2: Alaska North Slope Crude Oil First Purchase Price per Barrel**



Note: Between 2002 and 2014, rising and high oil prices masked Alaska’s oil production decline. However, since 2014, dramatic declines in Alaska North Slope crude (and global oil prices) have cut deeply into Alaska’s tax revenues. Although global oil prices have recovered somewhat since their low in 2015, these price increases have been insufficient to balance Alaska’s budget.<sup>3</sup>

Therefore, despite recent increases in oil prices and small increases in production, the state continues to run a substantial deficit—around 60% of the state’s FY 2018 budget was deficit spending (about \$2.3 billion of a \$4.5 billion budget) (Kitchenman, 2018a). Alaska’s ability to rely solely on revenue from oil seems unlikely, going forward, leading to Alaska’s continuing fiscal dilemma--how do we balance our budget?

## Employment

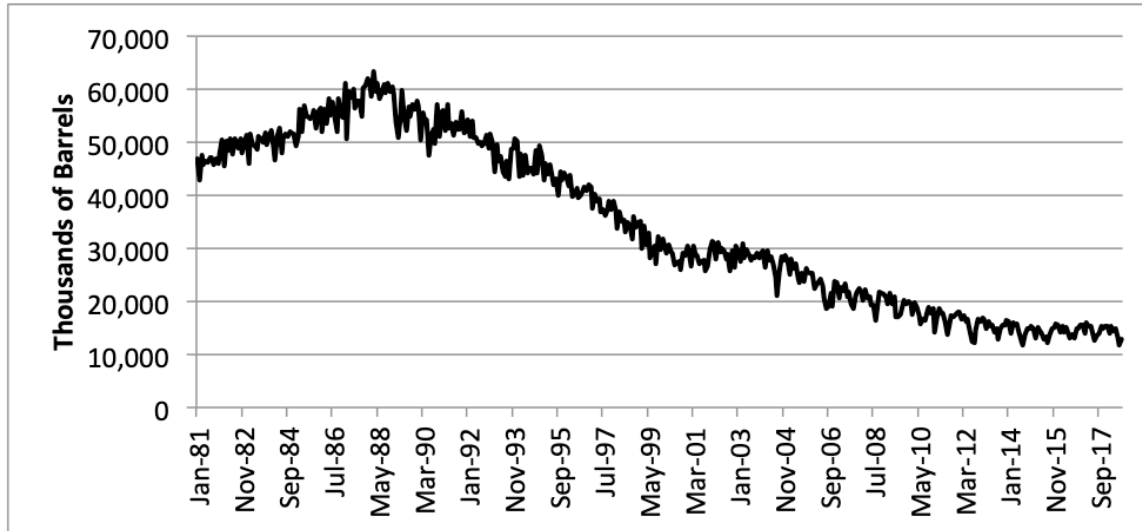
Despite declining GDP, impacts on unemployment and underemployment have been modest; Alaska’s seasonally-adjusted unemployment rose less than one percent between summer 2015 and summer 2018 and is now declining (see Figure 4). In effect, the state has been able to buffer the impacts of oil price and production declines by relying on its substantial savings. Though Alaskan unemployment is higher than the national average, Alaska’s relatively high unemployment figures seem to be associated with high structural unemployment, especially poor employment prospects in often-impoverished rural Alaska. Other measures of economic well being are mixed. However, Alaska seems to have weathered the economic storm of low oil prices relatively well so far, despite dire predictions.

Of course, with no state income or sales tax, employment (and, in fact, the overall strength of Alaska’s economy) has little positive impact on the state’s budget. Instead, somewhat perversely, low

<sup>3</sup> US Energy Information Administration. <https://www.eia.gov/> Retrieved November 12, 2018.

unemployment and a strong economy tends to lead to population growth which places additional strain on the state’s resources and makes it more difficult for the state to balance its budget.

**Figure 3: Alaska North Slope Monthly Oil Production**



Note: Alaskan oil production has been in decline since the late 1980s, although fluctuations in prices have often masked the fiscal effects of this decline<sup>4</sup>.

## Fisheries

In general, Alaska’s commercial and sport-fishing industries are very healthy. Although commercial fisheries landings were down somewhat in 2016 (the most recent year for which data is available), they were strong by historical standards, coming in only lower compared to a string of very profitable years for Alaska’s fishing industry. In 2016, commercial fisheries brought in about \$1.5 billion in revenues in 2016, as compared to around \$1.76 billion in 2015.<sup>5</sup> However, fishing contributes little to state government revenues—Alaska generates around 6% of its revenue from taxes on fisheries,<sup>6</sup> although some municipalities are substantially supported through taxes and fees on commercial fishing. In addition, fishing licenses and other fees related to sport fishing provide some support for state government conservation efforts and fish and game regulation enforcement.

## Timber

As recently as the 1990s, timber harvest was a mainstay of Alaska’s economy, although large-scale forestry was largely limited to the Southeast panhandle. Several factors—including declining prices for lumber and paper due to increased global supplies, stricter Forest Service regulation, aging infrastructure and the too-rapid harvest of old-growth timber in the ‘60s, ‘70s and ‘80s—led to the rapid decline of Southeast Alaska’s forestry industry (Beier, 2011; Beier, Lovcraft, & Chapin, 2009). Today, timber is no longer a significant employer in any part of the state, and does not contribute in a meaningful way to

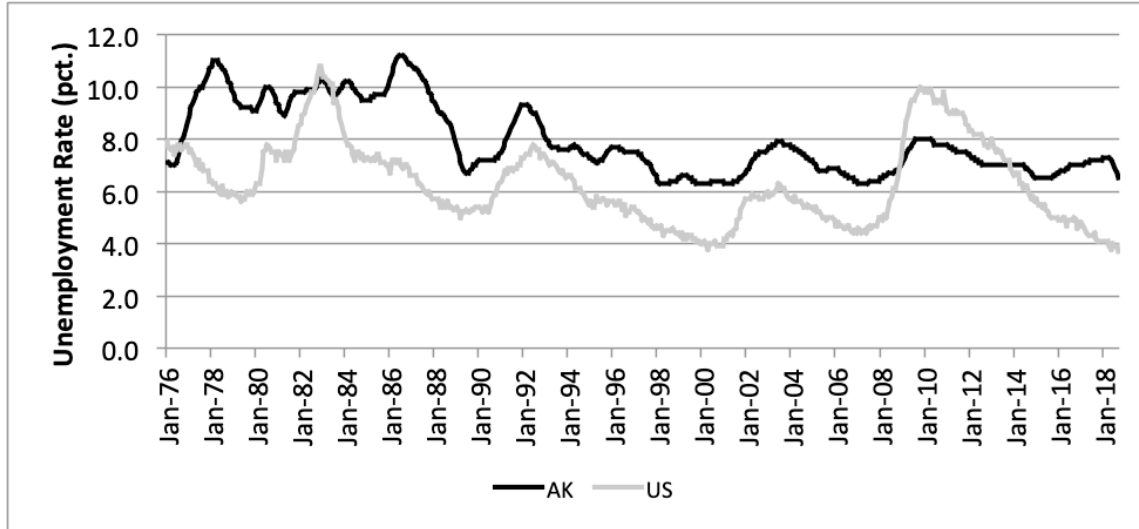
<sup>4</sup> US Energy Information Administration. <https://www.eia.gov/> Retrieved November 12, 2018.

<sup>5</sup> National Marine Fisheries Service Commercial Landings data. <https://www.st.nmfs.noaa.gov>. Retrieved April 8, 2017

<sup>6</sup> Here, “fisheries” is defined broadly, to include most taxes on the seafood industry and commercial and sport fishery taxes and fees. Data from <http://www.tax.alaska.gov/programs/programs/reports/>. Retrieved April 8, 2017.

state revenues. Although the US Forest Service has recently begun to discuss a gradual increase in timber harvest on federal lands in Southeast Alaska—a so-called “transition to second growth harvest”—forest harvest will not contribute significantly to State revenues for the foreseeable future (Kheiry, 2016).

**Figure 4: Unemployment in Alaska**



Note: Alaska was relatively unaffected by the 2008 economic crisis, and although relatively high structural unemployment in Alaska has led to long term unemployment rates higher than those of the United States as a whole, Alaska’s unemployment rate has only recently been affected by low prices for Alaskan oil. Seasonally adjusted monthly unemployment rate (Alaska) and seasonally adjusted monthly civilian unemployment rate (US).<sup>7</sup>

**Tourism**

The tourism industry remains an important part of the Alaskan economy, although it contributes little to state government revenues. The last year for which records are available, 2017, was the busiest year in Alaska history for tourism, with around 1.92 million visitors between May and September, up from 1.86 million visitors in 2016 (McDowell Group, 2017). Cruise ship visits for the 2017 season were the highest on record, just breaking the previous record, set in 2008 (McDowell Group, 2018). These increases in cruise ship visitors translate directly into revenue for the state because of a state head tax of around \$32 per person on commercial passenger ships with more than 250 berths, and around 33% on income from gambling aboard passenger vessels. Municipalities, however, are allowed to siphon off the great majority of head tax revenues, and consequently, the State of Alaska only generated about \$2.5 million from head taxes in 2017 (Alaska Department of Revenue, 2018a). Other revenues are typically larger, with tourism bringing in revenue through the Alaska Railroad Corporation, the Alaska Marine Highway System, vehicle rental taxes, and other taxes (McDowell Group, 2016). Even so, total state revenues from tourism are not a significant proportion of Alaska’s state government budget.

**Mining**

Mining also generates revenue for the State of Alaska; Alaska has a “mining license tax,” which is, in effect, a progressive tax on mining firms which increases from zero to seven percent depending on each

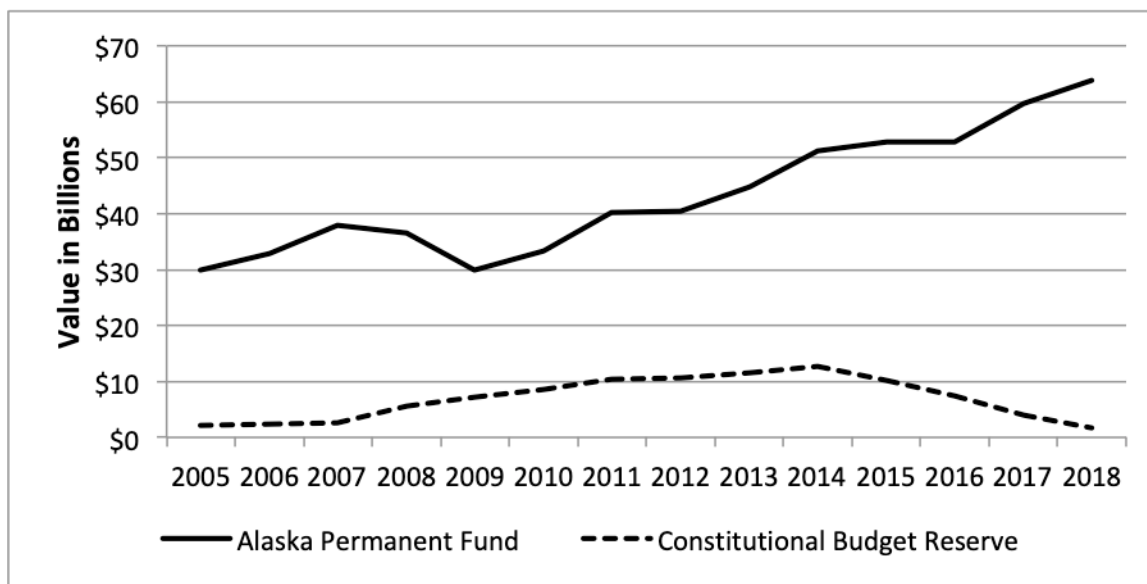
<sup>7</sup> Federal Reserve Economic Data. <https://research.stlouisfed.org/fred2>. Retrieved March 20, 2017.

individual firm’s net income (Alaska Department of Revenue, 2010). The mining license tax falls primarily on a number of large hard-rock and open pit mines in Alaska, including copper, zinc, silver, and gold mines. Relative to oil revenues, mining tax revenues are quite small, though revenues were up in FY 2017, to \$41.5 million, from \$11.1 million in FY 2016 (Alaska Department of Revenue, 2018b).

## Alaska’s Reserve Funds

Although Alaska is not unique among the states in its ownership of sovereign wealth funds, Alaska’s investment funds are uniquely large. The most well known of Alaska’s several investment funds, the Alaska Permanent Fund, is currently valued at roughly \$63.9 billion. The second-largest of Alaska’s funds, the Constitutional Budget Reserve is also substantial—currently about \$1.7 billion dollars—though spending has depleted the fund’s balance, from around \$12 billion in 2013 (see Figure 5).

**Figure 5: Alaska’s Reserve Funds**



Note: While budgets have drawn on and continue to reduce the size of Alaska’s easily accessible Constitutional Budget Reserve fund, the Alaska Permanent Fund continues to experience healthy long-term growth.<sup>8</sup>

## The Alaska Permanent Fund

For the last several years, earnings from Alaska’s investments, including the Permanent Fund and Constitutional Budget Reserve, have been greater than earnings from taxes on oil. However, earnings from the Permanent Fund have not typically been used to fund government operations, and instead are primarily reinvested in the fund and are used to pay out Alaska’s famous (or infamous) Permanent Fund Dividend. In 2018, Alaska’s Permanent Fund Dividend (PFD) was \$1600 dollars, which means that almost every Alaska resident received a \$1600 payment in early October (Ballard, 2018). The total value of the permanent fund increased in 2018, from around \$60 billion in Spring 2017.

As the size of the permanent fund has grown and Alaska’s oil revenues have declined, commentators and politicians have proposed using the earnings of the permanent fund to close Alaska’s fiscal gap (McGuire,

<sup>8</sup> Alaska Permanent Fund Corporation and Alaska Department of Revenue. <http://www.apfc.org/> and <http://treasury.dor.alaska.gov/Investments>. Retrieved March 12, 2016.



2016; Walker & Mallott, 2016). Such an approach is attractive to many legislators, because politicians can shrink or eliminate Alaska’s deficit, at least for several years, by using permanent fund earnings without implementing broadly based taxes. Although the principal of the fund is protected in Alaska’s Constitution, there is no restriction on the legislature’s ability to use fund earnings. However, 35 years after it was created, the permanent fund dividend is very popular, and is viewed as an entitlement by many Alaskans. Arguably, this is consistent with the goals of the dividend program—some have argued that the dividend was primarily a tool to create a constituency which would fight to protect the permanent fund (Hammond, 2012). Certainly, the permanent fund dividend has been fabulously successful in protecting the permanent fund. Although the fund is under-researched, there is also some evidence that it has a stimulatory effect on Alaska’s economy and is an important factor in reducing economic inequality in Alaska, which is currently the lowest of any state (Goldsmith, 2012). Recent work also strongly suggests that the PFD has significantly reduced poverty in Alaska (Berman & Reamey, 2016). Consequently, many state politicians fear the political and macroeconomic consequences of reducing or eliminating the dividend by spending fund earnings.

Nevertheless, in 2018, legislators in both parties and in both the State House and Senate have successfully proposed using revenues from the Alaska Permanent Fund to fund government. These plans—the most significant change in Alaska’s budgeting process in nearly 40 years—as discussed below, under “Policy Issues.”

### **The Constitutional Budget Reserve**

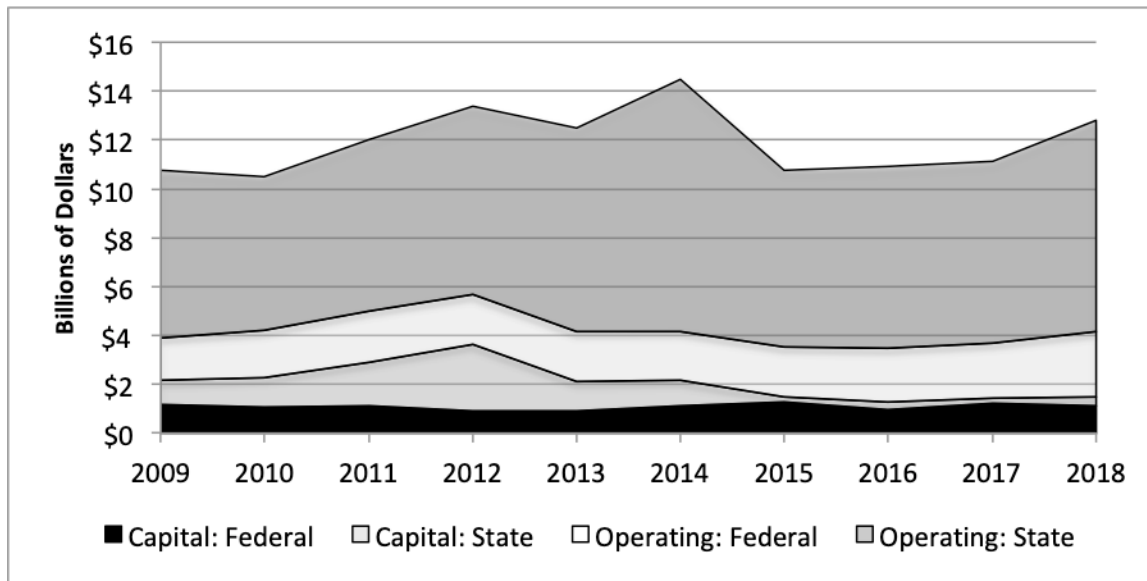
The second largest of Alaska’s funds is the Constitutional Budget Reserve (CBR), which was a receptacle for surplus revenues from multi-state lawsuits against US tobacco firms and Alaska’s lawsuit against Exxon-Mobil in the wake of the Exxon Valdez oil spill. The fund was created in 1990, and was depleted in the late 1990s, when oil prices declined and the state ran large deficits. However, when oil prices rose again in the mid-2000s, the state legislature replenished the CBR. Alaska has used CBR funds to balance its budget in the last several years. In 2014, the value of the fund peaked, at around \$12.8 billion. Today, the fund is worth approximately \$1.7 billion, down from \$3.8 billion last year. If Alaska’s deficits are not reduced through some combination of budget cuts and new revenues, the remainder of the CBR will gone this coming fiscal year.

Under the Alaska State Constitution, the CBR can only be spent with the approval of three quarters of each legislative chamber. This has given legislative minorities greater leverage over the budget than they would otherwise hold; for the last several years, legislative minorities have been able to effectively bargain with majorities in order to promote their own budgetary priorities. This year, it is possible that legislative majorities will choose to use earnings from the Alaska Permanent Fund rather than the Constitutional Budget reserve to balance the budget. This would require only a legislative majority in both houses.

### **Budgetary Changes**

Between 2012 and 2015, the State of Alaska reduced its nominal budget by around 25% (see Figure 6). Since then, the total size of the budget has expanded incrementally. This year’s budget includes the first significant increases in several years. This significant increase in the overall size of Alaska’s budget, however, masks both significant increases and decreases in agency budgets.

**Figure 6: Alaska Budget by Revenue Source**



Note: While Alaska’s capital and operating budgets have changed over time, with significant changes between 2014 and 2018, federal receipts have been steady.<sup>9</sup>

### Operating Budget

Under the house budget, several agencies would experience significant changes in Fiscal Year 2019 (see Figure 7), including Corrections; the Governor’s Office; Natural Resources; Labor and Workforce Development; and Commerce, Community and Economic Development. These budgetary changes, however, are all dwarfed by a significant increase in the budget of the Department of Health and Social Services, which is slated to receive a roughly 20% increment, an order of magnitude greater than other agency changes, at nearly \$550 million.

Interestingly, many of these agency changes are related to Alaska’s changing health care system. The large budget increase for the Department of Health and Social Services is almost entirely a result of increases in the cost of Affordable Care Act Medicaid expansion in Alaska<sup>10</sup>. The budgetary increase to the Department of Corrections--around \$21.6 million--is largely slated to fund increases in Alaska’s prison population, but around half of the budgetary increase is allocated to prison health care services. The legislature’s \$97 million cut to the Department of Commerce, Community and Economic Development is also related to changing health care expenses. Ninety million dollars of this reduction is due to a reduction in the size of the “Alaska Reinsurance Program,” a state-funded high risk health insurance pool operating on Alaska’s Affordable Care Act individual health insurance marketplace. Here, state appropriations are being reduced because of higher-than-anticipated federal contributions.

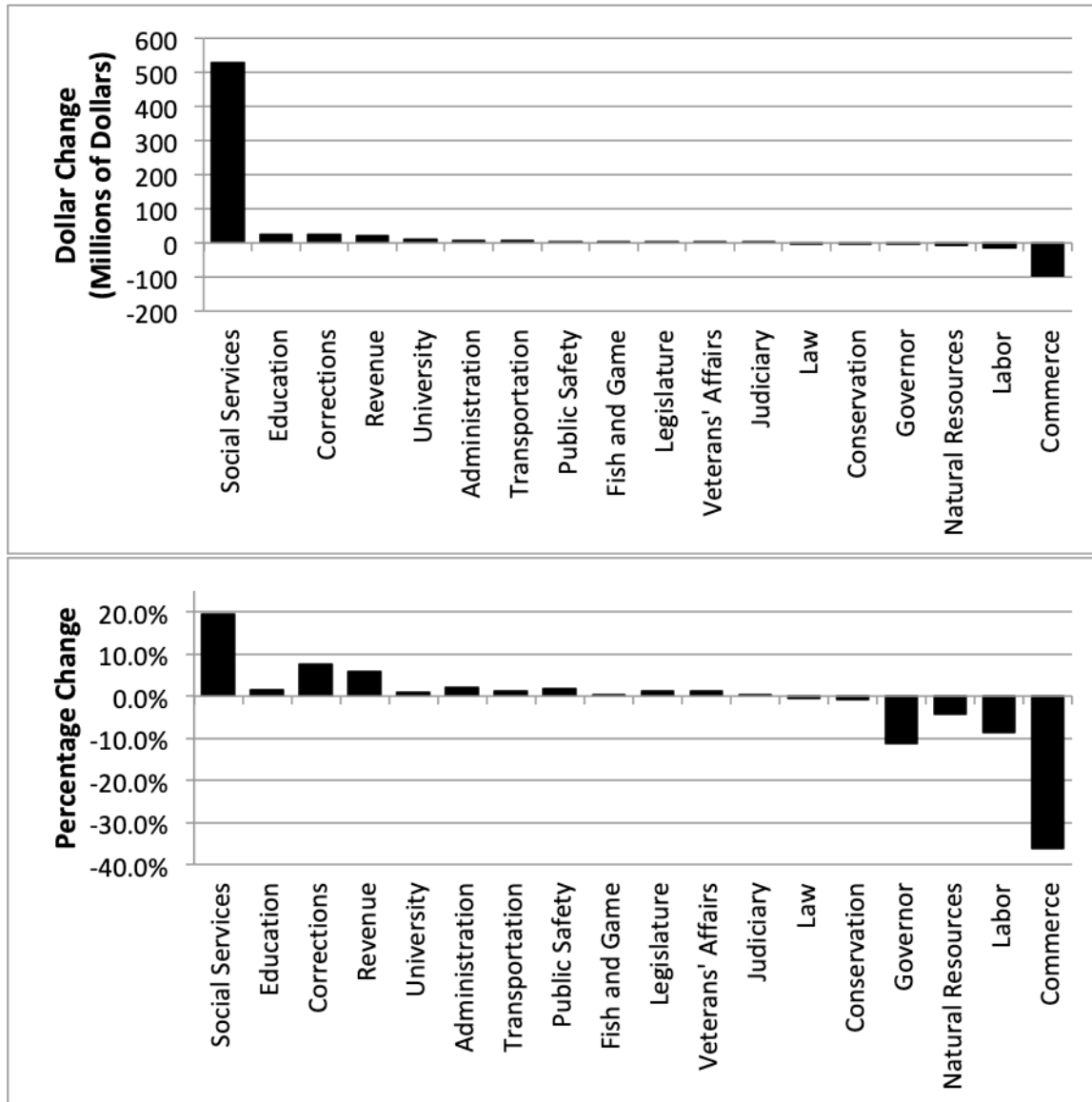
Several other budgetary changes are important. Cuts to the Department of Labor (around \$14.9 million) are the result of reductions to workforce training and unemployment insurance, the latter of which is mostly a reduction in federal funding to the state. \$5.5 million of the large cut to the Department of

<sup>9</sup> <http://www.legfin.akleg.gov/BudgetReports>. Retrieved March 29, 2017.

<sup>10</sup> In fact, in 2017 the executive branch called for higher expenditures on Medicaid, anticipating greater costs than legislative estimates, but were rebuffed by the Legislature, which claimed the Governor’s estimates of FY 18 health care costs were inflated.

Commerce and Community Development is a reduction in payments to rural residents through the Power Cost Equalization program, which seeks to reduce the high cost of energy in rural Alaska. Other cuts, including cuts to the Governor’s Office and the Department of Natural Resources are largely reductions to administrative salaries and costs.

**Figure 7: Changes to Departmental Budgets in 2018-2019**



Note: The 2018 budget for Fiscal Year 2019 includes several significant budgetary changes at the agency level, including large increases to the Department of Corrections, and substantial cuts to the Departments of Natural Resources, Labor and Workforce Development, and Commerce, Community and Economic Development. These changes are all dwarfed, however, by increases to the Department of Health and Social Services by over \$500 million, a nearly 20% increase to agency’s budget. The Governor’s office is also slated for a significant decrement, but the total size of the Governor’s budget is insignificant compared to larger agencies. State of Alaska Legislative Finance Division.<sup>11</sup>

<sup>11</sup> <http://www.legfin.akleg.gov/BudgetReports>. Retrieved November 17, 2018.

## **Capital Budget**

After several years of budget reductions, Alaska's capital budget has dwindled away to almost nothing. The current year's capital budget totals around \$1.7 billion, a roughly \$3 billion reduction from the most recent peak in capital spending, in 2012 (though a small increase over FY 2018). Further, almost all of this year's capital project spending is funded by the federal government—the Governor's capital budget proposal included only \$590 million in state revenue spending (though even this tiny expenditure is a dramatic increase over last year's \$147 million in state capital spending).

Because the capital budget is so small, it includes few notable items, though the most significant dollar amounts are slated for road construction and upgrades, deferred maintenance costs, and airport upgrades in both urban and rural Alaska.

## **“Fast Track” Supplemental**

Each year, Alaska's state legislature passes a supplemental budget to cover unanticipated shortfalls in the then-current fiscal year. Typically, supplemental budgets are quite small and relatively uncontroversial. In 2018, however, the FY 2018 supplemental budget is procedurally unusual and somewhat larger than usual, and is therefore deserving of mention here.

At the beginning of the 2018 legislative session, the co-chairs of Finance Committees in the Alaska State House agreed on a set of supplemental budgetary priorities for inclusion in a supplemental budget, ostensibly with the intent of shepherding the 2018 supplemental budget through the committee process more quickly than normal, leading observers to refer to the supplemental as the “Fast Track Supplemental.” This approach is interesting because the Alaska State House is largely controlled by Democrats, and the Alaska State Senate is largely controlled by Republicans (and is significantly more conservative). In fact, Senate and House agreement on the contents of the “fast track” supplemental did little to expedite the bill's passage through the committee process, though it was successfully transmitted to the Governor for signature in mid-March (Mauer, 2018).

The bill contains three items of note. First, it increases Alaska's ACA-expanded Medicaid operation by \$45 million so that the program remains solvent to the end of the fiscal year. Second, the bill increases funding for the Alaska Marine Highway System (AMHS) by \$24 million. AMHS is Alaska's coastal ferry system which serves mostly-rural communities in Southeast Alaska, Cook Inlet and Prince William Sound, and the Alaska Peninsula and Aleutian Chain. Finally, the bill expands funding for Alaska's prison system by around \$18 million, in order to address an increase in the state's prison population, largely related to the opiate crisis (Alaska Senate Majority, 2018).

## **Policy Issues**

In addition to a generally challenging fiscal situation, Alaska faces a number of policy questions with clear fiscal implications. The biggest issue at hand in 2018 was how to generate new revenues. As in the past, the legislature has two choices. First, they might implement new taxes. Second (and most likely) they might draw on some of the earnings of the Alaska Permanent Fund, which is projected to generate around \$2.3 billion in earnings in FY 2018.

## **New Revenues**

For decades, the Alaska Permanent Fund has been viewed as the third rail of Alaska's politics; Alaska's legislators viewed any attempt to touch the fund as immediate political suicide, because expenditures from the permanent fund would inevitably lead to reductions in the value of Alaskans' Permanent Fund Dividend checks. In the current budgetary environment, however, after several years of cutting, numerous failed attempts to generate reliable revenues, endless special sessions, the nearly complete depletion of Alaska's most accessible reserve funds, and the halving of the dividend (by line-item veto) in 2016, it appears that a decision to close (or at least narrow) Alaska's deficit is inevitable, and politicians seem more willing to draw on some of the earnings of Alaska's permanent fund than to implement new taxes (though there have been ongoing discussions about the creation of a state income tax).

The Alaska Permanent Fund Corporation—the public corporation which manages Alaska's sovereign wealth, including the Alaska Permanent Fund—has long advocated that eventual draws on the earnings of the Permanent Fund be made using a Percent of Market Value approach (colloquially known as a “POMV draw,” “POMV,” or “Percent of Market Value Draw”). Under this approach, the maximum allowable draw would be some percentage of the average market value of the fund over the previous several years. The idea of this approach is prevent the state government from drawing more than the average earnings of the fund, after accounting for inflation, thus preventing the fund from shrinking through excessive expenditures of fund earnings (Rodell, 2018).

Along these lines, the Republican-controlled Senate Finance Committee proposed legislation which would draw 5.25% of the market value of the Permanent Fund, averaged over the previous five years, and would reduce Permanent Fund dividends to around \$1000 for three years. The legislation allowed for larger dividends in future years, if the size of the Permanent Fund continues to grow and population growth is not too rapid (Senate Finance Committee, 2017).

The Senate Finance committee has also proposed a statutory spending cap of \$4.1 billion from Alaska's Undesignated General Fund (the bulk of the state's own revenues). This figure seems unrealistic, as no adjustment is made for inflation, and the 2018 budget as passed by the State House calls for roughly \$5.3 billion in Undesignated General Fund spending. In addition, the measure would be statutory, and therefore, future budgets (which are also statutory) would override the spending limit (“Alaska Senate passes spending cap criticized as toothless,” 2018).

The House majority backed a similar proposal, though at a somewhat lower POMV (4.75%), which they believe will improve the resilience of the Permanent Fund. The House majority has not supported a spending cap. The Republican minority in the House has argued that a 4.75% POMV draw would be insufficient to cover state needs and would therefore make the implementation of an income tax, which they oppose, more likely (Kitchenman, 2018a).

In early May, the legislature arranged a compromise through the conference committee process. The compromise bill permits a 5.25% POMV draw for three years, then 5% annually after that. This draw will generate around \$2.7 billion in FY 2018-2019, leaving the state with a much smaller deficit (around \$500 million, compared to several billion dollars in previous years) (Brehmer, 2018).

Going forward, this legislation puts Alaska in a much improved fiscal position, reducing its deficit to a manageable size, lengthening the life of the Constitutional Budget Reserve, and pushing off the date when Alaska needs to adopt some form of broadly-based tax, such as a property, sales, or income tax. Indeed, it

is even possible that broadly-based taxes will be unnecessary for the foreseeable future if oil prices rise significantly.

For lovers of Alaska fiscal-political drama, however, all is not lost. In November 2018, Alaska elected a Republican populist Governor, Mike Dunleavy, who campaigned almost exclusively on returning the Permanent Fund Dividend to its former funding formula (which would have generated a roughly \$2800 dividend in 2018). Dunleavy, who also vocally opposes taxes, has not presented a coherent vision of Alaska's future fiscal policy, or an alternative to the POMV draw model. Nevertheless, budgetary issues are likely to again take center stage in Spring 2019.

### **Permanent Fund Dividend**

In addition to the measures proposed by the Senate Finance Committee (discussed above, under "New Revenues") the legislature considered measures which would protect the Alaska Permanent Fund Dividend in the state constitution. Although the principal of the fund itself is protected under the state constitution and cannot be appropriated without constitutional amendment, permanent fund investment earnings, which fuel the Permanent Fund Dividend program, are not constitutionally protected. The dividend could be eliminated or reduced if the Legislature chooses to appropriate some significant portion of the fund's earnings. Therefore, to protect the dividend, the House majority has proposed a constitutional amendment which would enshrine the dividend in the state constitution. Any constitutional amendment would require a 2/3 majority of both houses however, and the Senate opposed such a plan (Brooks, 2018).

### **Groundhog Day Again?**

After several years of often-vehement debate about the appropriate policy approach to fix Alaska's large deficit, the state seems to have arrived at a solution, or at least a partial one. Although Alaska has relied on easily-accessible reserves to balance its budget for the last several years, those reserves will be nearly gone before the end of FY 2019. Consequently, Alaska faced the need to endure draconian cuts, impose new taxes, or draw funds from the earnings of the Alaska Permanent Fund to get through the year. Cuts large enough to balance the budget for FY 2019 would have been deeply harmful to the state's economy and would be unpopular, and the Republican-dominated State senate was unwilling to acquiesce to new taxes, though the Democrat-dominated House favored an income tax. Viewed as the least bad option, a "Percent of Market Value" draw on the Alaska Permanent Fund became the policy on which both chambers of the Alaska Legislature could agree.

Adopting a policy of regularly and systematically drawing revenue from the Alaska Permanent Fund's earnings puts Alaska in largely uncharted territory. First, it significantly reduces Alaska's historical dependence on natural resources such as oil. Second, it places the state in the unique position of being largely funded by sovereign investments.

For good or for ill, though, this unique situation might not last long. In November 2018, Alaska elected a Governor who campaigned primarily on rolling back the fiscal reform enacted by the 2018 legislative session and returning the Alaska Permanent Fund to its pre-2018 funding formula. This policy would necessarily imply the quick end of the state's use of sovereign earnings to fund state government operations. However, Governor-elect Mike Dunleavy has not presented a policy alternative (he opposes new taxes and campaigned on the unlikely promise of balancing the budget through cuts alone). Further,

in 2018, most legislators in both the Senate and House favored some use of Permanent Fund earnings to fund state government. The future remains unclear.

At a minimum, in 2019, we can safely predict continued battles over revenue and appropriations, taxes, and the use of Alaska's Permanent Fund.

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