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ALASKA'S FISCAL FUTURE
(Talk to Unitarian Church 12-15-13)

This paper will discuss past fiscal policy efforts and our current "this month" state fiscal situation.

We have had a long history of efforts to enact a sustainable fiscal policy. The most recent was in 2010 – sponsored by Representative Austerman and Senator Fairclough. Ultimately, legislative leaders said "no" to a renewed statewide public policy effort.

Commonwealth North issued a report on state fiscal policy in 2007 and again this year.

There have been many prior efforts involving wide public engagement. The last major one was in 2004.

At least twice the proposals coming out of public meetings for fiscal sustainability involving use of the Permanent Fund income have passed one house of the legislature. There are three hurdles in Alaska for any such proposal. They are each house of the legislature and the governor.

The Commonwealth North group met many times with legislators and candidates over six months and produced a plan in February 2013. The Commonwealth North plan was based on Scott Goldsmith's study, Wealth Management for the Owner State.

As that study demonstrates, increasingly it appears that savings are the answer to fiscal sustainability.

Scott presented the question as how much can we spend each year from our petroleum endowment or nest egg and maintain its future value.

He said that we must look at petroleum revenues as an endowment or nest egg. It is at an estimated $149 billion now consisting of $65 billion in current savings and $87 billion in future oil revenue – which means that we can afford to spend about $5.5 billion annually now. This annual draw he calls our maximum sustainable yield.[1]

So, what were our findings and where are we now?

1. Alaska Needs a Sustainable Fiscal Plan.

A critical component of a sustainable fiscal plan is a savings account or an endowment of today's nearly $13 million in surplus revenues. Invested for growth while revenues remain high, earnings in future years can be used to supplement declining oil revenues.

In the last 12 months, the Permanent Fund earned 13%. Approximately one-fifth of annual Permanent Fund earnings is spent for dividends.

The predictable benefits of a sustainable fiscal plan include avoiding future statewide taxes, providing for intergenerational equity, and stabilizing our economic future.

There is a climate of public distrust of government. It might be mitigated by a management review to see if services can be delivered more cost effectively. We could look at other states to see what they did to weather their budget crises. An improved

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[1] How is it figured? Oil revenues and financial earnings equal $11.8 billion. 4% of $149 billion equals $6 billion. $5.8 billion goes back into nest egg. Pay the $1 billion dividend out of it. ($4.8 billion) Add $0.5 billion non-oil revenues and equals the $5.5 maximum sustainable yield. He said that this expenditure puts us on a path to exhausting cash reserves by 2023. Maximum Sustainable Yield: A Fiscal Road Map for Alaska, Scott Goldsmith, August 2013, 29 pp, ID: 1557, http://www.iser.uaa.alaska.edu/publications.php.

budget process using performance measures and displaying budget expenses programmatically would help. An improved accounting and reporting system for state finances is a "must have." Currently, we must wait almost six months after the end of the state fiscal year (July 1) to get a report on the state's finance. By law, the report is due October 15, it is always late. In fact, we should have prompt quarterly reports during the year given the volatility of our revenues.

2. Strengthen the Permanent Fund.

We should calculate our Permanent Fund annual payout like endowment funds do and strengthen management of this very important asset. The Board consists of six members, two cabinet, four private. It should be enlarged and private sector Board members should be chosen exclusively on merit, as we chose judges.

3. It is Everyone's Job.

There is strong support for a new statewide process to develop a long-range fiscally responsible plan.

The statewide process must be carefully planned with all constituencies – the Governor, both legislative houses, and the public – involved in its design.

Other places in the world, unlikely places, have devised major governmental changes through public process. These include European-wide conferences on pensions, deliberative polling in Chinese cities, and conferences in Canada and elsewhere. In British Columbia – in six months – a large number of citizens meeting together devised a new provincial voting plan.

We can, as a state, achieve a responsible long-term fiscal plan, for which our children and grandchildren will thank us.

4. What else do we need?

In December 2013, the state informed us of dramatic downward changes in state oil revenues. The sharp drop in unrestricted revenues from $6.7 billion in 2013 to $4.9 billion in 2014 in the State Department of Revenue estimates is attributed to a drop in oil prices. But oil price estimates have dropped only $4.00 from the spring revenue forecast from $109.61 to $105.60, less than 4%. The revenue estimate dropped 18%. What's up? North Slope oil production dropped 8.2% in FY 2013. Lower production increases per barrel transport costs which will be $10 in FY 2014 and $14 per barrel next year. In the spring, $8.87 was the 2004 estimate. No one anticipated huge increases in capex deductions in computing the tax. Additionally, ending ACES caused a $300 million reduction to close out capital credit liabilities. Most importantly, page 12 of the Fall Revenue Forecast states:

> "Compared to the spring 2013 revenue forecast, lease expenditure increased $500 million for FY 2014 and nearly $1 billion for FY 2015. Over the next decade the department includes about $10 billion in additional investment on the North Slope, above and beyond what was expected in spring."

Oil revenue estimates are $4.5 billion for the FY 2015 budget. On December 15, 2013, the governor proposed a general fund budget for FY 2015 of $5.6 billion, $1.3 billion below the current year's budget of $6.9 million. This is a budget drop of approximately 20% from the current year.

These wildly swinging oil estimates and budget figures argue for a new way of revenue estimating. The state needs to commission an independent study immediately of how we can improve our revenue estimating game. The result of the study might be creation of an independent, non-partisan agency staffed with experts without political ties to give the best estimates or range of estimates with full public disclosure.

In his Budget address on December 15, the governor proposed a ten year fiscal plan. Unlike Scott Goldsmith's plan, he would not spend Permanent Fund earnings above the dividend. His plan holds the annual budget at $5.6 billion every year for ten years. This amounts to a 3 1/2% decline each year.

The governor also proposes a transfer of $3 billion from the general fund to reduce the state's pension funds unfunded liability. Last year he suggested freezing spending for ten years at $6.5 billion, which would put the CBR and SBR at $24.7 billion in 2023. This year his ten-year freeze at $5.6 billion puts us at $15 billion in the two funds in 2023. Although the pension fund transfer will obviate the need for the very substantial annual transfers and has merit, it is a fiscal change, together with sharply reduced revenue estimates, of a magnitude which demands better accounting reporting and revenue estimating and wide public debate and public inclusion in a statewide process to determine the state's fiscal future.