


Long-term fiscal plan will require compromises

ALASKA MUNICIPAL LEAGUE SUMMER LEGISLATIVE CONFERENCE

Aug. 4, 2021 - by Larry Persily, former deputy commissioner, Department of Revenue



History lesson first: What happened to oil

- It's not just price and production — tax structure counts, too
- Important to understand the history amid public confusion
- A majority of Alaskans believe oil is state's No. 1 revenue source
- June poll: Southcentral residents by more than 2-to-1 margin believe state receives more revenue from oil than investments
- Misinformation makes it hard to convince public of the problem, the need for new revenues, and why the dividend is in jeopardy

State deficits not a new problem

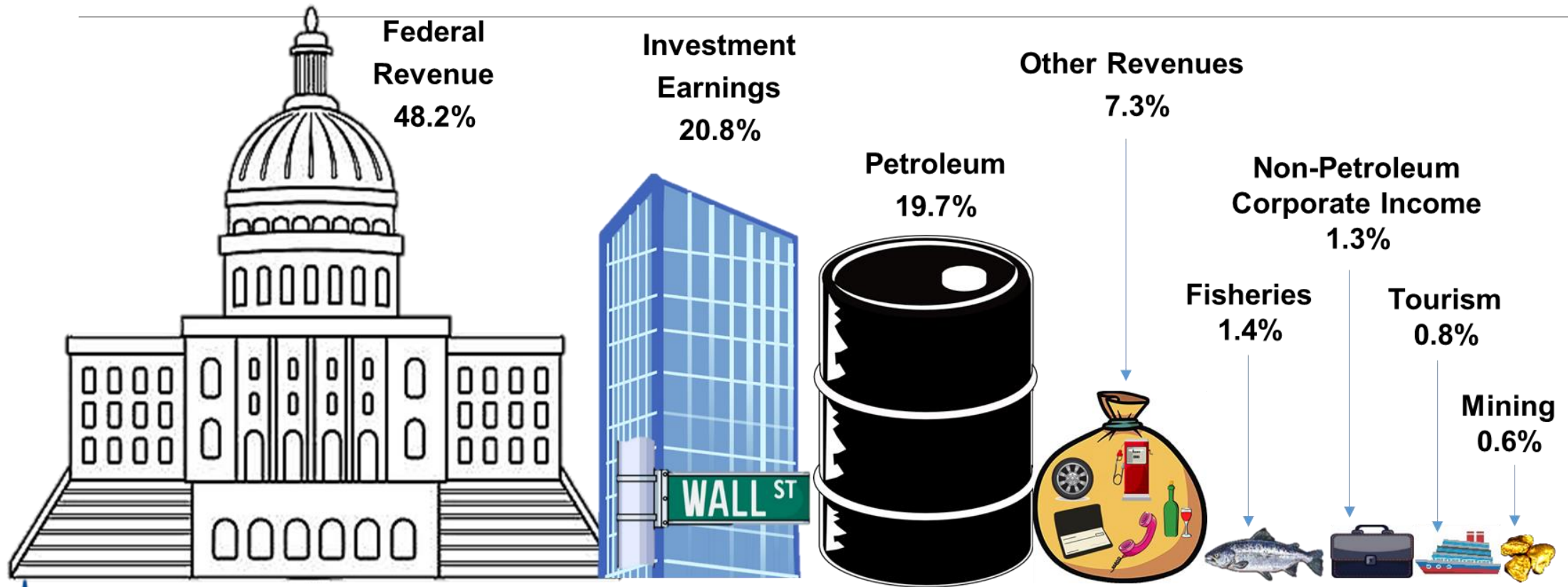
- Voters established Constitutional Budget Reserve Fund in 1990; and Alaska relied on its “rainy day account” most years since
- At deepest deficit in the 1990s, CBRF covered 40% of state budget
- With sharp decline in oil revenues and a drained CBRF, Alaska turned to Permanent Fund earnings in Fiscal Year 2019
- PFD has been downsized to an affordable amount since 2016
- Run out of good options — everything left is politically unpopular

Budget cuts have been real

- Agency operation GF budgets cut almost 15% FY15-18; \$661 million
- Not much change in total state spending the past few years
- Winners and losers: Corrections and Public Safety budgets are up, while Natural Resources and University of Alaska are down
- Retirement fund payments are up, while debt service is down
- Meanwhile, the annual capital budget is at its low point and deferred maintenance backlog estimated at \$2 billion

Relative contributions to total state revenue FY 2020

Total State Revenue: \$8.7 Billion



Disclaimer: Numbers may not add to 100% due to rounding. Examples may not be to scale.

What can (should) the Legislature do

- Agree on the facts and educate the public
- Compromises will be required on new revenues, including income or sales tax and changes to oil production tax structure
- Craft an affordable dividend and decide whether it belongs in state statute or fully enshrined in the Alaska Constitution
- Resolve ongoing battles to protect Power Cost Equalization, school debt reimbursement, community assistance, services
- Oh yes, and overcome the politics of impending 2022 election year

Regional, economic divisions at the core

“To find a common ground means people have to give up something.” People’s perspectives are different, increasingly influenced by which state services they use, their household size, how much they may depend on the PFD, how much they might pay in taxes — if the state were to adopt any new taxes.

— *Senate Finance Committee member Natasha von Imhof*

“The most concerning issue is the resurfacing of the urban versus rural divide.” Those differing perspectives helps determine what residents think is important, what should be included in the state budget, and what can be cut.

— *Senate Finance Committee Co-Chair Bert Stedman*

Fights over each fiscal piece

- PFD needs constitutional protection vs. why should it be elevated to the same high status as education funding and public health
- Little argument over POMV, but many want to overdraw to pay a larger dividend and to buy time for new revenues
- Legislators starting to coalesce around state sales tax, but they can't figure out how to avoid collateral damage from stacked tax to municipal revenues and local economies
- Growing number of legislators say oil needs to write checks, too

Lawmakers back in session Aug. 16

- Without action, there will be no dividend this fall
- Without compromise, there will be no PCE payments this year
- Without a breakthrough, the entire mess will roll into election year
- An eight-member, House-Senate / majority-minority working group has been meeting, taking testimony, trying to reach consensus
- Surprisingly, public testimony at hearings has been light — are people tired of the fight, or is summer a distraction?

Veto overrides unlikely

- Legislators will have five days after they convene to take up vetoes
- Veto override requires 3/4 majority of combined House/Senate
- That means 16 legislators out of 60 can block any overrides
- An exceedingly high hurdle for override supporters to overcome
- Override advocates will have to decide to pick and choose or go for all
- The 5-day deadline will make it hard for much political trading to gain override votes as part of a deal on a long-term fiscal plan

Same supermajority for CBRF 'sweep'

- It requires the same 3/4 majority vote to override the 'sweep' that pulled PCE fund and college scholarship money into CBRF
- Unlike the budget veto override, the 5-day deadline does not apply
- Allows time for political trading of 3/4 vote for larger dividends, or placing constitutional amendments before voters in 2022
- Something else to look for in political dealmaking: Paying a PFD will require appropriation bill; lawmakers could add to the bill

Fiscal pieces on the trading table

- Dividend: New formula, and statute vs. constitution decision
- Amend constitution to make Permanent Fund a true endowment
- Put PCE Fund in the constitution, but would it ensure appropriation
- Constitutional spending limit a fight over baseline and escalators
- New taxes: Income vs. state sales tax; more money from oil taxes
- Governor appears to have dropped request for constitutional amendment to ban any new taxes without public approval

Numbers show need for new revenues

- Fiscal Year 2022 general fund revenue numbers:
 - ❑ \$3.069 billion annual 5% draw on Permanent Fund earnings
 - ❑ \$1.3 billion oil revenues at \$60 oil (\$1.6 billion at \$70 oil)
 - ❑ Less than \$360 million from all other non-oil taxes and fees
 - ❑ It's enough for operating budget and minimal capital budget
 - ❑ It leaves just a smidgie for Permanent Fund dividends this year

Governor's fiscal math

- Proposes constitutional amendments to share Permanent Fund annual withdrawal 50/50 between dividends and budget
- Pull \$3 billion out of Permanent Fund earnings reserve to buy two more years to find (maybe) a balanced fiscal plan
- Without new revenues and/or deep cuts to services, governor's plan creates budget deficit averaging almost \$1 billion a year to FY30
- Administration has asked to present legislative working group with "revenue measures" — no specifics have been provided

Time is short for Alaska, as is money

- Permanent Fund Corp. June 30, 2021, balance sheet shows \$13.9 billion uncommitted and available in earnings reserve
- That accounts for this year's POMV draw of \$3.069 billion and the \$4 billion transfer from earnings reserve to the principal
- Governor proposes taking an additional \$3 billion to buy more time
- Risk is that a terrible investment year could reduce Fund's reserves, possibly jeopardizing the ability to cover the annual POMV draw

Difficult but possible trade-offs

- Municipalities could support a workable sales tax in exchange for school debt reimbursement, community assistance, services
- Spending cap detractors worry it would prevent the state from responding to future needs; will want to see sufficient 'openings'
- Most everyone supports POMV in the constitution, but the PFD?
- Return of so-called 'school head tax' could be an option that looks like an income tax but is less politically offensive than income tax

Federal pandemic relief saves Alaska

- State will receive \$1.4 billion under American Rescue Plan Act; \$1 billion for general spending, \$112 million for capital projects, \$200 million for housing assistance programs, and more
- More than \$230 million in aid to municipalities and communities
- Schools will receive \$360 million; more than double previous aid
- Additional funding to tribal organizations in hundreds of millions
- Fewer limits than CARES Act; just don't use the money to cut taxes

Don't mistake federal money for a fix

- One-time federal aid may help fill budget and save PFD, it does nothing to improve long-term state general fund revenues
- Economic activity without a tax is worse than a loss leader at a grocery store — at least store profits from increased foot traffic
- Federal COVID aid is like Visqueen over the window in the winter; it is far short of a permanent solution to keep the house warm
- Broad-based tax would provide more consistency for state budget; more stability for construction, maintenance, public services

Sorry for being such a pessimist

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