**ALTERNATIVE FISCAL FUTURES**

For 20 years, taxes and royalties the state government collects from North Slope oil production have paid for most general government operations. But the state's oil income is much smaller than it used to be, the victim of declining oil production and lower oil prices. Various plans for dealing with the resulting $1 billion deficit in the state government's General Fund have been proposed. Each plan involves a complicated set of fiscal details, but all plans can be boiled down to some combination of three sets of variables—how much we spend, how much we save, and how much new revenue we need. We compare six combinations of these variables on a level playing field, using common assumptions about future oil revenues and other important variables (see the box on the last page). The specific variables we measure are spending per Alaskan, state financial assets, and new revenue requirements.

**Spending Per Alaskan—Per Capita General Fund Spending and Permanent Fund Dividends:**

The $2.3 billion General Fund (GF) pays for a large share of basic services, including schools, courts, prisons, police protection, highway maintenance, and more. General Fund spending per person peaked in 1982 and has since declined to the real (adjusted for inflation) 1976 level. Dividends are cash payments the state makes to Alaskans every year from earnings of the Permanent Fund. Those annual dividends have grown steadily since the early 1980s. (The first dividend, in 1982, was a special legislative appropriation not based on earnings.) Together, state General Fund expenditures and dividends are an indication of state spending to improve the general welfare of Alaskans. The best measures of such spending over time take into account both population growth and inflation. The graphs below do that, showing all numbers in 1999 dollars.

**Case 1: Business As Usual**

- **State General Fund Expenditures:** Grow with inflation and half the rate of population growth.
- **Permanent Fund Dividend:** Retain formula that calculates dividends based on half of Permanent Fund earnings.
- **Use of Financial Assets:** Cash out Constitutional Budget Reserve to cover General Fund deficit as long as possible. Continue to use Permanent Fund earnings to pay the dividend, to inflation-proof the fund, and to hold in reserve in the Earnings Reserve.

**Case 2: Just Cut The Budget**

- **State General Fund Expenditures:** Grow with inflation and half the rate of population growth as long as possible, then cut to match annual revenues.
- **Permanent Fund Dividend:** Retain formula that calculates dividends based on half of Permanent Fund earnings.
- **Use of Financial Assets:** Cash out Constitutional Budget Reserve to cover General Fund deficit as long as possible. Continue to use Permanent Fund earnings to pay the dividend, to inflation-proof the fund, and to hold in reserve in the Earnings Reserve.

**New Revenue Requirements:** Each alternative includes choices about spending and saving. The spending choice affects the well-being of Alaskans today. The savings choice affects the future well-being of Alaskans, because it adds to the financial legacy we pass on to the coming generations. The new revenue requirement is the amount of new money we'll have to find under each alternative, to meet those spending and saving targets.

**State Financial Assets:** This includes the state's largest financial accounts—Permanent Fund (including unrealized gains), Earnings Reserve (ER), and Constitutional Budget Reserve (CBR). The adjacent graph shows how Alaska has built these assets since 1975. Together they have a current value of $27 billion. If invested prudently, for a 5% real (after inflation) rate of return, this balance can generate annual earnings of about $1.3 billion and maintain its purchasing power. Earnings are now the largest source of state revenue and are becoming more dominant as oil revenues fall. Financial earnings dwarf all other actual or potential sources of revenue to pay for basic public services. Therefore, a large financial balance is an important indicator of fiscal strength.
**Case 3: Tax and Cut Equally**

- State General Fund Expenditures and Income Tax: General Fund cut $350 million (about 15 percent) in 2000 to match $350 million in annual revenues from a new state personal income tax. After that, annual expenditures grow with inflation and half the rate of population growth.

- Permanent Fund Dividend: Retain formula that calculates dividend based on half of Permanent Fund earnings.

- Use of Financial Assets: Cash out CBR to cover General Fund deficit as long as possible. Continue to use Permanent Fund earnings to pay the dividend, inflation-proof the fund, and hold in reserve in the Earnings Reserve.

**Case 4: Cash Out Permanent Fund**

- State General Fund Expenditures: Grow with inflation and half the rate of population growth.

- Permanent Fund Dividend: Retain formula that calculates dividends based on half of Permanent Fund earnings.

- Use of Financial Assets: Cash out Constitutional Budget Reserve, Earnings Reserve, and the Permanent Fund principal to cover General Fund deficit as long as possible. Continue to use Permanent Fund earnings to pay the dividend, inflation-proof the fund, and hold in reserve in the Earnings Reserve.

**Case 5: Maintain Assets by Varying Dividend**

- State General Fund Expenditures: Grow with inflation and half the rate of population growth.

- Permanent Fund Dividend: Revise the formula, so the size of the dividend varies to keep the purchasing power of financial assets constant.

- Use of Financial Assets: Use earnings of the Permanent Fund, as well as the principal and earnings of the Earnings Reserve and Constitutional Budget Reserve, to maintain the real value of financial assets. Earnings above this amount are first allocated to the General Fund. The residual is allocated to pay Permanent Fund dividends.

**Case 6: Terminate Dividend and Use Permanent Fund Earnings**

- State General Fund Expenditures: Grow with inflation and half the rate of population growth.

- Permanent Fund Dividend: Terminate.

- Use of Financial Assets: Reinvest the earnings of the Permanent Fund as long as the General Fund deficit can be filled by cashing out the Constitutional Budget Reserve and Earnings Reserve. Then use Permanent Fund earnings, including inflation-proofing as necessary, to cover the General Fund deficit. When Permanent Fund earnings are insufficient, find new revenues.

**Phases out Dividend, Requires Moderate New Revenues, and Maintains Permanent Fund**

- State General Fund Expenditures: Grow with inflation and half the rate of population growth.

- Permanent Fund Dividend: De-cline half a percent annually as population grows.

- Use of Financial Assets: Cash out CBR to cover General Fund deficit as long as possible. Continue to use Permanent Fund earnings to pay the dividend, inflation-proof the fund, and hold in reserve in the Earnings Reserve.

**Closes the Budget Gap, but Erodes Value of Permanent Fund after 2015**

- State General Fund Expenditures: Grow with inflation and half the rate of population growth.

- Permanent Fund Dividend: De-cline half a percent annually as population grows.

- Use of Financial Assets: Cash out CBR to cover General Fund deficit as long as possible. Continue to use Permanent Fund earnings to pay the dividend, inflation-proof the fund, and hold in reserve in the Earnings Reserve.