Why Not Use the Cash Reserves First?

The state legislature based the fiscal 1994 budget on an anticipated oil price of $18 per barrel. But in recent months the price of oil has been at its lowest since the 1986 price crash, pulling oil prices $5 per barrel below the earlier projection. That big difference between projected and actual oil prices—together with a larger projected fiscal gap—have occurred in several recent years.

What Has Happened?

Combining cash reserves with earnings from the Permanent Fund, Alaska could find itself with a huge hole in the budget, programs and services it can’t pay for, and disruption in the economy, which relies heavily on government spending. That’s the Hard Landing scenario.

In this publication, all the dollar amounts for future years are inflated to show the likely effects of increasing prices, assuming 4 percent annual inflation. This method is different from the one we have used in earlier Fiscal Policy Papers, where we removed the effects of inflation and put all the figures in constant dollars—that is, in today’s purchasing power. Many readers told us that it easier to understand possible future changes in revenues and spending if we include the effects of inflation.

Inflated Versus Constant Dollars

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What Has Happened?

Oil Prices Flat...

![Oil Prices Flat Graph](#)

Since falling sharply in 1986, oil prices have fluctuated between $10 and $20 per barrel, except for a brief period during the 1991 Iraq war. Recently prices have hovered near the lower end of that range.

Oil Production Down...

![Oil Production Down Graph](#)

Oil production has declined from a peak of over 2 million barrels per day in 1988. The increase at the start of fiscal 1994 is temporary, reflecting production from the Point Mckinley field and enhanced recovery at Prudhoe Bay.

Revenues Down, Spending Up...

![Revenues Down, Spending Up Graph](#)

While oil revenues have fluctuated, non-oil revenues have remained flat. Spending has increased with population and inflation, and general fund deficits—evidence of a fiscal gap—have occurred in several recent years.

Reserves Close the Gap

![Reserves Close the Gap Graph](#)

Growing cash reserves easily closed the fiscal gap for several years. But the estimated $1.4 billion needed to close the gap in 1994 will take a third of the remaining reserves.

Fiscal Year

<table>
<thead>
<tr>
<th>Status Quo</th>
<th>General Fund Spending*</th>
<th>General Fund Revenues*</th>
<th>General Fund Revenues*</th>
<th>Filling the Fiscal Gap</th>
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<tr>
<td>1998</td>
<td>2.205 T</td>
<td>441 T</td>
<td>1.811 T</td>
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<td>1989</td>
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<td>431 T</td>
<td>1.958 T</td>
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<td>1.970 T</td>
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<td>508 T</td>
<td>2.567 T</td>
<td>(675) T</td>
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<tr>
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<td>1.999 T</td>
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<tr>
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<td>423 T</td>
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<td>5,326 T</td>
<td>595 T</td>
<td>400 T</td>
<td>4,331 T</td>
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**Historical and Projection:** Department of Revenue fall 1993 low case non-oil revenues including general fund interest, plus author estimate of program receipts. The Fall 1993 low case projection is similar to the recently released Spring 1994 mid case projection.

**Historical:** Calculated from author from Alaska Department of Revenue, Revenue Sources Book. Includes revenues from current production. Projection: 1994 by author, subsequently DOR Fall 1993 low case which assumes average Lower 48 oil prices as follows: $15 in 1995, increasing to $17.80 in 2000, and $20 in 2015. This projection is similar to the recently released Spring 1994 mid case projection.

**Assumes combined cash reserves of $2 billion at start of FY 1995 in General Fund, Constitutional Budget Reserve, and Earnings Reserve of Permanent Fund. No additions in later years except earnings on balances.

**Budget reductions, new taxes, Permanent Fund earnings, and revenues from economic development that more than pays its own way.**
Where Are We Heading?

An Expanding Fiscal Gap...

Closed With Cash Reserves...

Leads To A Hard Landing, Sooner...

...Or A Harder Landing Later

What's the Alternative?

Hold the Line on Spending...

Re-introduce Income Taxes

Maximize Growth of Permanent Fund...

And Make A Safe Landing

Even with a drop in spending in fiscal 1995, a $500 million fiscal gap will remain. Depending on oil prices, the gap could range between $500 million and $1.5 billion annually between now and the end of the decade.

Cash reserves in hand can close the fiscal gap through 1997 if oil prices rebound. New cash settlements (shown above), higher oil prices, or additions to the Permanent Fund Earnings Reserve would extend the life of the cash reserves.

Relying on cash reserves could precipitate a Hard Landing as early as 1998, if oil prices rise only moderately and if no new settlements augment the cash reserves.

Higher oil prices, new settlements, and growing balances in the Permanent Fund Earnings Reserve can postpone the Hard Landing, but at the risk of making it worse.

If the state does not increase the budget with inflation, spending is effectively cut over time, because a dollar won't buy as much tomorrow. Spending includes both general spending and dividends; if the state keeps paying dividends, it will have to cut more general spending.

Collecting revenues from sources other than oil would make the cash reserves last longer—and make individual Alaskans more aware of the price tag on public services. A personal income tax, for instance, could add $250 to $300 million to annual revenues today.

If Alaska annually reinvested in the Permanent Fund an amount equal to what is now paid in dividends (whether dividends were eliminated or the money came from some other source), it could sharply increase earnings available to contribute to the Safe Landing.

A Safe Landing is possible through a combination of constrained spending, cash reserves (including potential new settlements), new non-oil revenues, Permanent Fund earnings, and revenues from development that more than pays its own way.