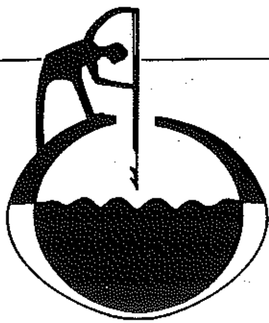

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FISCAL POLICY NOTE

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COMPARING FISCAL POLICY PROPOSALS

by Scott Goldsmith

The Alaska Department of Revenue recently forecast that higher oil prices will mean much higher petroleum revenues for the state government in the early 1990s—several hundred million dollars more per year than previously anticipated. Does that mean Alaskans can forget about the fiscal gap ISER has been predicting in its *Fiscal Policy Paper* series?

Unfortunately, no. The higher than anticipated oil prices we're seeing now are certainly good news for Alaska, but history shows that the only certainty about oil prices is their uncertainty. Setting spending levels based on forecasted oil prices has created trouble for the state in the past.

But *if* oil prices are at about $19 a barrel (the Alaska Department of Revenue's spring 1990 mid-case projection in 1990 dollars); *if* the state picks up $200 million a year in settlement money; and *if* the state holds annual spending at around $2.5 billion (the estimated level for the coming fiscal year in 1990 dollars), the start of the budget shortfall could be postponed until 1993.

Those are big "ifs". More optimistic revenue forecasts create pressure for more spending; estimated spending for the coming year is already about $100 million higher than spending this year. Already oil prices have slid considerably from their highs earlier this year. And the underlying problem remains the same: Alaska is producing less oil with each passing year and therefore collecting less petroleum revenue as time goes on.

Even if the state is lucky and the budget stays in balance for a few more years, Alaskans still need to plan now to avoid a serious budget crisis. Legislators and others have proposed a number of alternatives using existing revenues as partial or total solutions to the fiscal gap.

This fiscal note examines eight of those proposals to assess what effects each would have over the next 20 years on (1) state spending (per capita General Fund spending); (2) the Permanent Fund dividend; and (3) state savings (the balances of the Permanent Fund, the General Fund, and any other funds created under specific proposals). The alternatives we assess range from continuing current policies to freezing the budget to changing the allocation of Permanent Fund earnings.

None of these alternatives includes adding new sources of revenues; they just propose different allocations of *existing* funds. In Fiscal Policy Paper #3 we examined potential *new* sources of state revenues, and found that additional taxes could add $500 million to annual state income now and possible new development could add another $300 million to annual state income after the turn of the century. This fiscal note just shows the effects of various proposals using existing revenues.

Each alternative and its effects in 2000 and 2010 are briefly described on pages 2 and 3. This summary is based on work detailed in Fiscal Policy Working Paper #1. We use the Department of Revenue's Spring 1990 mid-case revenue projections as the starting point for our analysis. Other important assumptions are described in the box on page 4.

It's important to recognize that the future always holds pleasant and unpleasant surprises—for instance, higher or lower oil revenues than we've assumed. The results of changing major assumptions are described in detail in Fiscal Policy Working Paper #1 and are summarized in the conclusions on page 4. All figures are in 1990 dollars—an adjustment that allows us to assess the real changes over time, minus the effects of inflation.

This fiscal note is an offshoot of ISER's *Fiscal Policy Papers*, a series examining Alaska's looming budget crisis as petroleum revenues decline. Scott Goldsmith, the author, is professor of economics with ISER and has 14 years of experience examining state spending. Fiscal Policy Working Paper #1, the basis for this summary, is available from ISER. The work was funded by a grant from ARCO Alaska.

ALTERNATIVE FISCAL PROPOSALS

(All Figures in 1990 Dollars)

Chart values are given as 1990 / 2000 / 2010.

	Make No Change	Eliminate Inflation -Proofing	Permanent Budget Cap	Establish Education Endowment
	Continue spending general revenues as they come in and using Permanent Fund earnings to pay dividends, inflation-proof the principal of the fund, and maintain an earnings reserve.	Pay dividends with half the Permanent Fund earnings but deposit the rest in the General Fund for spending; eliminate inflation-proofing and the earnings reserve.	Hold General Fund spending to $2.3 billion annually, with no adjustment for inflation; deposit any revenues above the cap in the General Fund for use in years when revenues fall short.	Pay dividends with half the Permanent Fund earnings, transfer 40 percent of earnings to an Education Endowment Fund, and use remaining 10 percent for inflation-proofing. Beginning in 2001, transfer earnings of the Endowment Fund to General Fund for spending.
State Government Spending Per Person (In Dollars)	4622 / 2400 / 694	4622 / 2979 / 1068	4622 / 2333 / 1152	4622 / 2400 / 1262
	Spending in 2000 half of current level and by 2010 15 percent.	Spending in 2000 two-thirds of current level and by 2010 less than one-quarter.	Spending in 2000 half of current level and by 2010 one-quarter.	Spending in 2000 half of current level and by 2010 just over one-quarter.
Size of Individual Permanent Fund Dividend (In Dollars)	880 / 777 / 750	880 / 581 / 388	880 / 777 / 750	880 / 618 / 442
	Dividend 12 percent smaller in 2000 and 15 percent smaller by 2010.	Dividend 33 percent smaller by 2000 and 56 percent smaller by 2010.	Dividend 12 percent smaller by 2000 and 15 percent smaller by 2010.	Dividend 30 percent smaller in 2000 and 50 percent smaller by 2010.
Fund Balances (Includes Permanent, General, and Reserve Funds) (In Billions of Dollars)	10.4 / 12.9 / 14.2	10.4 / 8.6 / 6.6	10.4 / 15.7 / 14.2	10.4 / 13.6 / 12.7
	Funds 24 percent bigger in 2000 and 37 percent bigger by 2010.	Funds 17 percent smaller by 2000 and 37 percent smaller by 2010.	Funds 50 percent bigger in 2000 but drop to 37 percent bigger by 2010.	Funds 31 percent bigger in 2000 but drop to 22 percent bigger by 2010.

(All Figures in 1990 Dollars)

	Distribute Permanent Fund Earnings 40/30/30	Cap Dividend At Current Level	Create Perpetual Fund	Cap Spending and Create Reserve
	Allocate 40 percent of Permanent Fund earnings for dividends, 30 percent for inflation-proofing, and 30 percent for spending through the General Fund.	Hold per capita dividends at 1990 level, with no adjustment for inflation. Use the rest of Permanent Fund earnings first for inflation-proofing and then for General Fund spending.	Deposit all petroleum revenues in the Permanent Fund, to be renamed the Perpetual Fund; withdraw a percentage of the fund to pay for general government operations and dividends each year. In the first year the withdrawal is 31.5 percent but by 2001 declines to a fixed 9 percent annually.	Impose a budget cap at $2.3 billion (with no inflation adjustment) for 5 years, depositing excess in a Budget Reserve Account. Permanently freeze per capita dividends at the 1990 level; continue inflation-proofing with a portion of Permanent Fund earnings and deposit remainder in Budget Reserve account.
State Government Spending Per Person (In Dollars)	4622 / 3021 / 1051	4622 / 2662 / 1089	4622 / 2078 / 1799	4622 / 2662 / 1476
	Spending in 2000 two-thirds of current level and by 2010 less than one-quarter.	Spending in 2000 about 60 percent of current level and by 2010 one-quarter.	Spending in 2000 45 percent of current level and dropping to 40 percent by 2010.	Spending in 2000 60 percent of current level and by 2010 32 percent.
Size of Individual Permanent Fund Dividend (In Dollars)	880 / 566 / 465	880 / 539 / 347	880 / 477 / 413	880 / 539 / 347
	Dividend 36 percent smaller by 2000 and 47 percent smaller by 2010.	Dividend 40 percent smaller in 2000 and 60 percent smaller by 2010.	Dividend 46 percent smaller in 2000 and 53 percent smaller by 2010.	Dividend 40 percent smaller in 2000 and 60 percent smaller by 2010.
Fund Balances (Includes Permanent, General, and Reserve Funds) (In Billions of Dollars)	10.4 / 11.1 / 10.6	10.4 / 12.7 / 13.9	10.4 / 15.4 / 16.5	10.4 / 15.4 / 15.0
	Funds grow 7 percent by 2000 but decline to 1990 level by 2010.	Funds grow 22 percent by 2000 and 34 percent by 2010.	Funds 48 percent bigger by 2000 and 60 percent bigger by 2010.	Funds 48 percent bigger in 2000 but drop to 44 percent bigger by 2010.

Legend: 1990 (black), 2000 (shaded), 2010 (white)

CONCLUSIONS

- The state could maintain the current level of spending until 1993 if the assumptions hold, and spending could even increase in the near term if petroleum revenues exceed current projections.
- In the long run per capita general fund spending would be forced down sharply under all proposals, even if petroleum revenues were twice as high as the Department of Revenue is currently projecting.
- Real per capita spending under most proposals (and assuming no new revenues) would be about half the current level by 2000 and one-quarter by 2010.
- Allocating some of the Permanent Fund earnings to the General Fund would prop up per capita spending in the 1990s—but such a move would shrink the Permanent Fund and by 2010 spending would be at about the same level that it would have been otherwise.
- The Permanent Fund dividend would decline by 2010 under all proposals, but the drops vary from 15 percent if the fund principal is inflation-proofed to 60 percent if it is not.
- State savings (fund balances) would grow considerably by 2000—about 50 percent—under proposals that cap spending at the current level and include methods for saving excess revenues. Those balances would later be drawn down.
- The Permanent Fund would grow slowly—about 1.3 percent annually over the next 20 years—if the state maintains current policy.
- Permanent Fund dividend distributions would exceed total General Fund spending in less than 20 years, if the state maintains current policy.
- Policies that use the entire earnings of the Permanent Fund will shrink fund balances over time, even if petroleum revenues are twice as high as the Department of Revenue is now projecting.
- All proposals involve tradeoffs between current and future spending—some would result in higher spending in the near term and some higher spending in the long term.
- Most proposals provide little or incomplete protection against instability caused by large year-to-year fluctuations in revenues.
- The more comprehensive policies would provide a cushion against revenue fluctuations, protect fund balances from unanticipated inflation, provide a smoother transition to lower spending, and channel any unexpected revenues into fund balances.

ECONOMIC ASSUMPTIONS

REVENUES: Revenues from existing sources projected by Alaska Department of Revenue, Spring 1990 Mid-Case Projections; no revenues from new sources

SETTLEMENT OF PETROLEUM DISPUTES: State receives $2 billion (in 1990 dollars), about one-quarter of which goes into the Permanent Fund, from 1991 to 2000

RETURN ON FUNDS: Permanent Fund earns 4 percent annually and the General Fund 3 percent, net of inflation

INFLATION RATE: 5 percent annually **POPULATION GROWTH:** 1.5 percent annually

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