

# Balanced Budget Plan - An Explanation

The Legislature has approved and sent to voters a proposal for a Balanced Budget Plan for Alaska. In a special election to be held on September 14, voters will be asked whether the plan should be enacted into law.

The proposal, which was approved by a bipartisan vote in both the House and the Senate and endorsed by Governor Knowles, calls for using a portion of the earnings of the Permanent Fund for essential state services while preserving the Permanent Fund dividend at a level that can be sustained and will grow with the market value of the fund over the coming years.

## How does the Balanced Budget Plan work and why do we need it now?

First, some background: Alaskan voters created the Permanent Fund in 1976, with the expressed purpose of saving some of the value of the nonrenewable oil resource for a time when those resources ran out. In 1976, that day of reckoning was expected to be sometime in the late 1980s, when Prudhoe Bay was predicted to be depleted. Technological advances extended the life of the massive Prudhoe Bay oilfield by many years, but now historically low oil prices have combined with dropping production to create a budget deficit of more than \$1 billion. Despite declining oil revenues, we still have the ability to reorganize our assets to ensure a bright and sustainable future for today's Alaskans and for our children and grandchildren.

Various proposals have been put on the table to fill this billion dollar gap, including a new income tax, a statewide sales tax, and drastic reductions in state spending. While the proposed income tax and a five percent sales tax could each raise about \$300 million, it's still far short of filling the gap. And what will happen to the vital services Alaskans want the state to provide if the budget is cut by \$500 million or more?

Legislators have filled the gap in the budget since 1992 by borrowing more than \$3.4 billion from savings accounts. But we cannot continue to draw down these accounts as a short-term fix. We have, right now, a window of opportunity to make the changes needed to fix the fiscal gap, because we still have enough money in our savings accounts to make a solution work.

## How will the Balanced Budget Plan resolve this problem?

The core mechanism of the plan is one that has been successfully used for centuries, and is the same system that provides long term sustainable income and safety for the assets of most of the world's corporate and university endowments. The Balanced Budget Plan combines the assets of the Constitutional Budget Reserve into the Earnings Reserve account of the Permanent Fund and renames the account the Alaska Income Account.

The Permanent Fund will consist of the Alaska Income Account and the constitutionally protected principal, or "corpus" of the Permanent Fund. Petroleum royalties will continue to be deposited to the principal of the Permanent Fund and the principal will continue to be inflation-protected.

Historical data shows that over long periods of time the assets of the fund will earn in excess of 8 percent annually. The plan provides long-term inflation-proofing by utilizing all returns above 5.88 percent for inflation-proofing. The remaining 5.88 percent of the market value of the assets allows the plan to provide a healthy level of benefits to future generations of Alaskans.

In addition, because the useable income of the plan is a percent of the market value of the assets of the fund, Alaska's assets will be less susceptible to the volatility of the marketplace. This includes the dividend which is preserved under the plan. Of the 5.88 percent payout, 50 percent is allocated to dividend payments.

It is important to keep in mind that under the present system, the dividend is tied directly to how well Permanent Fund investments perform. By virtue of the incredible bull market, income has been very high. A few years of a bear market would be immediately reflected in lower dividends, especially when considering required inflation proofing and a growing population.

In 1982, the legislature created the Permanent Fund Dividend, so that individual Alaskans could benefit directly from their savings account. This has been a very popular decision, and has been a great boost to the economy statewide. Dividends have averaged \$869 per capita since the inception of the dividend program. Under the Balanced Budget Plan, the dividend is guaranteed to be not less than \$1700 for 1999 and 2000. It is anticipated that it will be approximately \$1340 in 2001 and that it will then gradually increase over time.

The Balanced Budget Plan does not require an income tax. It does propose reductions to the state budget this year and next, and prioritizes funding for essential services, such as state troopers, education, and transportation needs. The plan also holds down state spending by directing that, when the balance of the Alaska Income Account exceeds 40 percent of the combined total of the Permanent Fund principle and the Alaska Income Account, the excess will be deposited directly into the principal of the Permanent Fund.

The plan calls for creation of a Citizens' Balanced Budget Task Force to present options to further reduce state spending and to identify future revenue sources.

Since 1976, Alaskans have been wisely saving a substantial portion of our nonrenewable resource income. Since 1981, the legislature has also protected more than \$6 billion in excess general fund income and Permanent Fund earnings by depositing those dollars into the principal of the Permanent Fund. This is in addition to \$5.5 billion added through inflation-proofing. ***In fact, fully two-thirds of the money deposited into the Permanent Fund, beyond that required by the 1976 constitutional amendment, is there because of actions taken by the legislature.***

In summary, the Balanced Budget Plan holds the promise of a bright future for Alaska by:

- Preserving and protecting the Permanent Fund;
- Providing a long-range balanced budget;
- Providing accountability and public input;
- Not requiring an income tax.

In short, the Balanced Budget Plan protects the Permanent Fund and ensures that essential government services and the dividend will be provided for the future generations of Alaska.

