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Resource Review

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The plan

Doing nothing puts dividend program, Permanent Fund principal in peril

"After paying annual dividends to residents and inflation-proofing the Permanent Fund, should a portion of Permanent Fund investment earnings be used to help balance the state budget?"

This is the question Alaskans will answer in voting booths this fall as Governor Tony Knowles and the Alaska Legislature seek the public's judgment regarding a stable and sustainable long-term budget plan. If voters approve the advisory question, the Legislature and the Governor will set into motion the Balanced Budget Plan.

The plan will restructure the Permanent Fund into an endowment that will generate a healthy, growing dividend, protect and inflation-proof the fund's principal, and produce a sustainable revenue stream to help fund essential state services.

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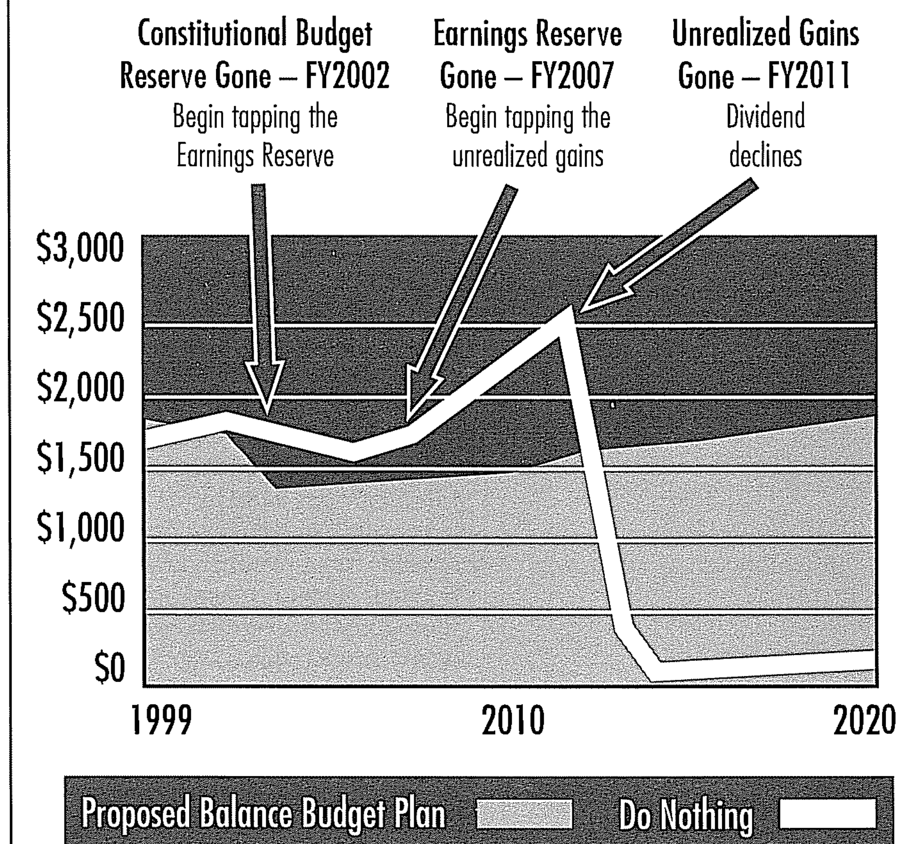
Dividends disappear if Alaskans decide to do nothing



Alaska will exhaust its rainy day account, the Constitutional Budget Reserve, in two more years. When that happens, the state will start cashing in the Permanent Fund's paper profits -- a move that will temporally send the dividend sky high as the dividend is based on realized earnings. Once the state exhausts the paper profits, it will rapidly draw down the Fund's Earnings Reserve Account, leaving no money to pay dividends or inflation-proof the Fund's principal.

Message from the Executive Director
by Ken Freeman

Vote "yes" to protect the economy and balance the budget

The September advisory vote asks Alaskans if they support using Permanent Fund earnings to pay dividends and support essential state services. A "yes" vote sets the stage for the Balanced Budget Plan that creates a new, sustainable revenue stream for essential state services, ensures a healthy dividend program and inflation-proof's the Fund. The plan also includes continuing budget cuts, additional revenue enhancement and creates a Citizens Budget Task Force to find additional reductions and revenues.

The plan is not perfect and certain specifics are still forthcoming, but it does serve as a crucial step to balance the state budget and bring long-term stability to Alaska's economy.

This September Alaskans have a choice between a sustainable dividend and a balanced budget or a big gamble where the odds are stacked against us.

Alaska's fiscal gap is real and it's not going away. Oil revenues, which use to account for 85 percent of all state revenues, now totals 70 percent and are declining daily. Oil production from the North Slope is half of what it was ten years ago and will continue to fall. This time Alaska will not be saved by rising oil prices because there is not enough oil production to produce the revenues needed to fund vital state services.

The state could raise oil taxes, but such action could accelerate the production decline. Instead the state needs to encourage industry to continue an aggressive investment policy to bring smaller, more expensive fields into production. Alaska, however, has one of the highest oil tax structures in the world. If we increase taxes, Alaska would risk sending future capital to more friendly oil provinces abroad.

We could cut the budget more, even though state spending has been reduced $235 million since 1996 and the General Fund portion of the budget is now $1,700 less per capita than it was in 1979, the year before oil revenues started to flow into the state treasury. Alaska, however, cannot whack $1 billion off the state budget without causing major disturbances and throwing the state into a recession. Many changes and improvements have occurred all over Alaska. Going back to pre-oil spending levels is not a realistic option.

We could revert to a state income tax or statewide sales tax, but neither would close the gap.

The problem is not going away. Alaska now has huge deficits and declining oil production which translates into falling revenues.

Fortunately, Alaskans prepared well for this day. There's the Constitutional Budget Reserve. Unfortunately, this account will be used up soon if we don't do something now.

We established the Permanent Fund to save a portion of our oil wealth for this and future generations. The fund has two parts – the principal, which cannot be tapped without a vote of the people, and the earnings reserve account, which is annually available to appropriation by the Legislature. September's vote applies to the earnings reserve.

The Balanced Budget Plan preserves, protects and grows the principal of the Permanent Fund. It sustains a healthy dividend. Yet a "no" vote supporting the status quo jeopardizes the dividend program. The budget deficit could grow so severe that the state may eventually be forced to tap all the Fund's earnings to pay for general government services. Several years of poor financial markets and escalating inflation could also bring down the dividend.

A "yes" vote this fall would change the dynamics. Voters have the opportunity to turn the Fund from an annual savings account into a long-term revenue generator, just like a pension fund.

The plan is a step in the right direction, one which we need to take to help secure a stable future for Alaska.

Resource Review is the official periodic publication of the Resource Development Council (RDC), Alaska's largest privately funded nonprofit economic development organization working to develop Alaska's natural resources in an orderly manner and to create a broad-based, diversified economy while protecting and enhancing the environment.

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IN MOTION

YES VOTE

• Preserves the dividend
• Protects and grows the Permanent Fund
• Closes the fiscal gap

A "YES" vote would set into motion the Balanced Budget Plan which will:

• Ensure Alaskans continue to receive healthy dividends
$1,700+ this year
$1,700+ next year
$1,300+ in 2001
Growing dividends thereafter

• Protect and grow the Permanent Fund principal (the part that's truly permanent and cannot be touched without a Constitutional Amendment)

• Inflation-proof the Fund's principal

• Use investment earnings of the Permanent Fund -- none of the principal -- to provide a steady, predictable flow of revenues to pay for essential state services.

• Continue state General Fund budget reductions and commit to long-term budget discipline and efficiencies.

• Institute new revenue sources

• Defer imposition of a personal income tax

NO VOTE

• Dividend eventually disappears, new taxes imminent
• Permanent Fund Earnings Reserve depleted
• Permanent Fund principal loses its value
• Drastic cuts in state services and programs

A "NO" vote would do nothing to address Alaska's mounting budget deficit. Despite three years of successive budget reductions totaling $235 million, Alaska still faces a deficit exceeding $1 billion. It's a deficit that will grow next year, and the years that follow. By voting "NO" and doing nothing:

• The Permanent Fund will suffer and our dividends could disappear in almost ten years.

• The State will be forced to draw down the Permanent Fund's earnings, eventually leaving no money to pay dividends or inflation-proof the Fund's principal. Without inflation proofing, the Permanent Fund's principal will lose its value.

• There would be a greater likelihood of a personal income tax, sooner than later, as well as new taxes on Alaska's resource industries and all business, putting the state at a competitive disadvantage to new capital investments.

• Drastic budget cuts from municipal revenue sharing to vital state services and programs are likely.

• Alaska is making a choice to gamble on its future economic stability and prosperity

Why budget cuts alone won't close the gap

• Alaska cannot whack $1 billion off the state budget without throwing the state into a recession. We cannot cut our way to a sustained balanced budget. The following are sample scenarios of the magnitude of cuts that would be required to close the fiscal gap.

• Stop paying K-12 education, the Medicaid match, general funds appropriated by the Department of Transportation and Public Facilities and all general fund appropriated to the University of Alaska.

• Eliminate all general funds from every state agency except the Department of Health and Social Services and the Department of Education.

• Eliminate all general funds in the Department of Health and Social Services and the Department of Education.

• Institute a head tax of $1,799 for every person in Alaska, including children or eliminate the Permanent Fund dividend.

* Many changes and improvements have occurred in Alaska over the past 20 years. Going back to pre-oil spending levels is not a realistic option.

***Oil prices could double and Alaska would still not have enough money to provide essential government services to its residents.*

The plan

New direction offers stability, balanced budget and growing dividend

(Continued from page 1)

This change is endorsed by many former Permanent Fund trustees, staff and consultants.

Two central features of the plan are combining of reserve accounts and restructuring distributions from the Permanent Fund.

Under the plan, the Earnings Reserve Account and the Constitutional Budget Reserve will be combined and renamed the Alaska Income Account. The AIA will then be invested with the Permanent Fund principal and all earnings will go into the AIA. The AIA will generate income to ensure inflation-proofing, payment of dividends and funding of essential government services.

Under the new method, dividends will be based on a five-year market value of the total fund. Each year, an amount equal to 5.88 percent of the total market value will become available, half for payment of dividends and half for essential services.

Over the long term, the plan inflation-proofs the principal of the Permanent Fund in two ways. First, all earnings in excess of 5.88 percent of the market value stay in the fund. Second, whenever the liquid portion of the fund (the AIA) equals more than 40 percent of the total fund, the excess will be deposited into the principal.

Fund managers favor this approach because historically it provides better protection for the principal, ensures growth and produces a reliable income stream. This approach is similar to that used by foundations, endowments and pension funds all over the world.

Under the new plan, dividends will be lower in the short term, but will grow over the long haul.

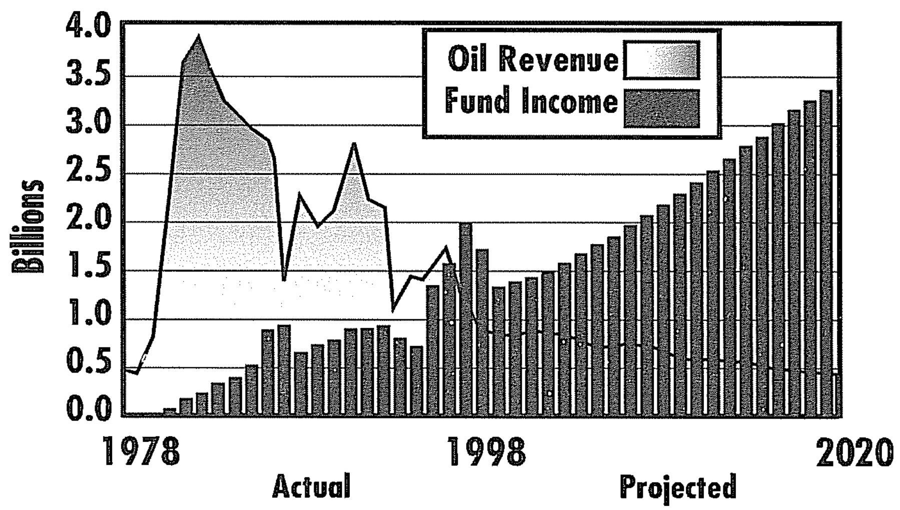
Each year's Permanent Fund Dividend is currently based on a rolling five-year average of the fund's realized earnings. For several years, the trustees of the Permanent Fund have recommended the system be changed to a calculation based on the fund's market value because this methodology protects the principal better and generates dividends that are less volatile, more reliable and more predictable.

Alaskans have become accustomed to an ever-growing dividend, but the current system in no way guarantees a bigger check every year. Declines in the stock market and years of high inflation can put the dividend on a roller-coaster. According to a computer model built for the Permanent Fund Trustees, there will likely be years in which the dividend drops to zero because of market conditions and inflation.

Under the status quo, dividends are expected to peak at $1,856 in 2001 and begin dropping after that point. Unless significant new sources of revenue are found, the dividend could disappear by 2013 as fund earnings are used to pay for essential services.

The Balanced Budget Plan provides stable and predictable dividends; at least $1,700 in 1999 and 2000, and approximately $1,340 in 2001. After 2001, the dividends would grow gradually but steadily.

Permanent Fund is Alaska's largest revenue source



Annual earnings from the Alaska Permanent Fund exceeded state oil revenues for the first time in fiscal 1998, and the gap between the two is expected to rapidly widen over the next 20 years.

Fact Sheet

Alaska Permanent Fund

• The Permanent Fund was created by amendment to the Alaska Constitution in 1976.

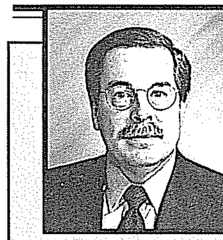
• The original intent and purpose of the fund was to save a portion of Alaska's revenues from its petroleum resources, invest that revenue, and use the earnings to help provide essential public services in the future when petroleum revenues decline.

• In 1998 earnings from Permanent Fund investments exceeded oil revenues. The gap between oil revenue and Permanent Fund earnings will continue to accelerate.

• The principal can never be touched unless and until voters vote to do so by constitutional amendment.

• The Legislature has the authority to appropriate all earnings from Permanent Fund investments at any time.

• The fund is currently valued at $25.8 billion. The total includes the fund principal ($18.6 billion) and earnings ($7.2 billion). One third of the principal came from dedicated oil revenues with the remainder by legislative action in the form of inflation-proofing and special appropriations.



Thoughts from the President
by Jim Branch

MIX module is largest ever built in Alaska

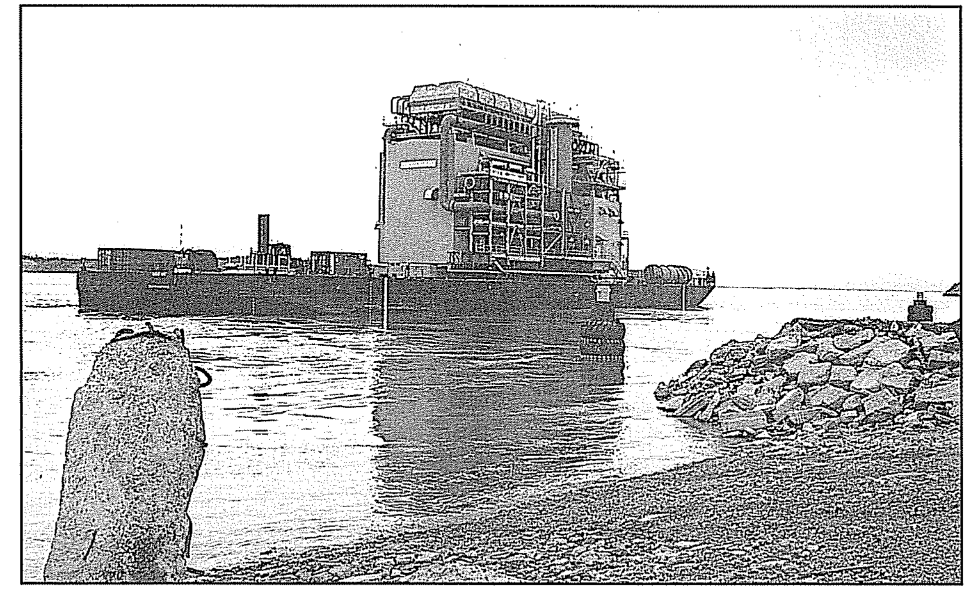
Product of new industry

It may have been a cloudy, cool day, but it was an afternoon that warmed many of our hearts when Representative Ramona Barnes christened a colossal 2,700-ton compressor module in Anchorage July 19, marking the product of a new industry for Alaska.

The $80 million module, the largest ever built in Alaska, was fabricated at North Star Terminal in Anchorage over the past 14 months. After the christening ceremony, the module was then shipped on a barge to Prudhoe Bay where it will boost production at North America's largest oil field by 20,000 barrels a day by the end of the year. Over the remaining life of the field, the module is expected to squeeze an extra 50 million barrels of oil from Prudhoe, the equivalent of finding another small North Slope oil field.

The oil industry refers to the structure as the MIX module. It is the centerpiece of a $160 million investment by Arco, BP and Exxon to create up to 25 percent more "miscible injectant," a solvent injected into the reservoir to allow more oil to flow to the surface. The process washes residual oil off the reservoir rocks and into production wells. The mammoth module will be installed adjacent to the Central Gas Facility at Prudhoe.

More than 200 Alaskans worked on the project, 120 in Anchorage with the remainder in Fairbanks and Prudhoe. This venture is one of two proving that world-class construction projects can be assembled in our own backyard. A similar project employing large modules for the new Alpine field were built by Natchiq in Nikiski and also set sail to the Slope in July.



The 9-story, 2,700-ton compressor module for the North Slope MIX project departs the North Star Terminal in Anchorage by barge. (Photo by Randy Lissey)

By working together creatively, we will have future opportunities to celebrate similar successes, not only in the oil and gas industry, but Alaska's other resource industries.

Construction of oil field modules in Alaska is not new. The industry has built small ones in Anchorage that were hauled to the Slope on trucks, but the MIX and Alpine modules were so large they had to be barged north. In the past, modules of this size were built in the Lower 48 or abroad.

I have enjoyed watching the 9-story MIX module become part of Anchorage's skyline as I fished Ship Creek, our world-class salmon stream just a few hundred yards from the construction site. It truly symbolizes the new opportunity that has been made available to the oil industry and the citizens of Alaska. It also is an excellent example of both the challenges and opportunities that still remain on the North Slope, even in our mature fields like Prudhoe Bay. Arco, BP and Exxon and their other North Slope partners, using collective expertise, will continue to work together to make today's challenges into opportunities.

Arco Alaska, who managed the MIX project for the Prudhoe Bay unit owners, and VECO Construction, who built the module, as well as the many suppliers and subcontractors who worked on the module, should be proud of their accomplishment.

By working together creatively, we will have future opportunities to celebrate similar successes, not only in the oil and gas industry, but Alaska's other resource industries.

Recommendation on listing beluga whales sent to Washington

Final determination expected in one year

The National Marine Fisheries Service (NMFS) in Alaska has sent a recommendation to its headquarters in Washington, D.C., on whether to list the Cook Inlet beluga whale population for special protection as a "depleted" or "endangered" species under the Marine Mammal Protection Act or the Endangered Species Act. A final recommendation is expected from Washington this month and will be subject to public comment before a final determination is made.

Federal biologists claim the beluga population in Cook Inlet has declined by half in the past four years. Native hunting is believed to be the primary cause behind the decline. Currently Native hunters have voluntarily halted hunting and are working with federal biologists on a co-management agreement to regulate future harvests.

Trustees for Alaska, along with six other environmental groups, have filed a petition with NMFS for an emergency finding that Cook Inlet beluga whales are "endangered." The petition named hunting as the primary source, but also identified commercial fishing, sport fishing, port activity, municipal water discharges, noise from military and civilian aircraft, oil and gas, tourism and shipping as having impacts on the beluga population.

However, numerous studies over the past decade have consistently found no evidence of environmental degradation in Cook Inlet from industrial and community development activities. Last month NMFS released the results of a new study which revealed Cook Inlet beluga whales are cleaner than those of the Chukchi and Beaufort Seas. The findings of that study largely ruled out exposure to pollutants as a factor in the decline of the Cook Inlet beluga, NMFS said.

While there has been no indication the belugas are impacted by any human activities other than hunting, a listing under either the Endangered Species Act or the Marine Mammal Protection Act could impact all activity in Cook Inlet.

"NMFS believes it needs a listing status in order to regulate the beluga, but in doing so, it would force all users of Cook Inlet who are not part of the problem to become the solution by potentially restricting every activity that occurs in Cook Inlet," said Ken Freeman, RDC's Executive Director. "These restrictions could be severe and very costly to each user."

The solution to this issue lies in a number of critical, but difficult steps, Freeman said.

First, a co-management agreement between NMFS and the Cook Inlet Marine Mammal Council needs to be established to set parameters so a sustainable hunt can occur.

Second, additional information is needed. "We do have a considerable amount of data about the belugas, but we need to learn more," said Freeman.

The RDC executive director explained that more DNA studies need to take place, in particular to see if the belugas in Cook Inlet are following their dinner to Bristol Bay where there are higher concentrations of fish and a growing population of belugas. He also noted population surveys need to take place at other times of the year other than just June, which according to the Cook Inlet Marine Mammal Council should demonstrate increased numbers of belugas in conjunction with increased numbers of fish during other summer months.

Another option is additional special legislation granting NMFS greater authority to manage the resource. This legislation would go beyond a congressional moratorium that bans hunting for one year until a co-management agreement can be reached.

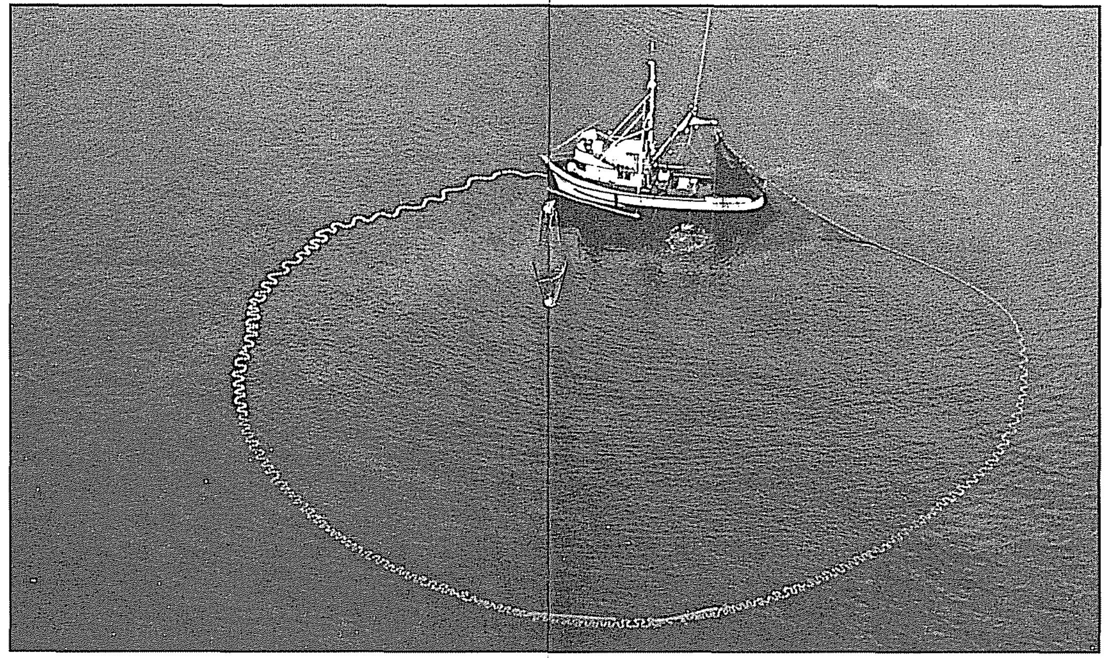
The beluga issue came to a boil in November 1998 when NMFS opened a 60-day "status review" of Cook Inlet belugas. Published data showed the whale count at 800 in Cook Inlet with a drop in sightings. There was no cause for alarm at that time, except for the high number of harvested whales over the past year. The estimated harvest of 72 whales in 1998 was considered five times more than the sustainable harvest target of 14.

Two months following the close of the comment period, NMFS held a meeting in which RDC and other organizations learned for the first time that in November the federal agency changed the formula by which it determines how to count "unseen" whales. The formula revision cut in half the population estimates for the past six years, dropping the 800 count to 400. The 1998 count, which had not yet been released, fell to 300.

On the basis of this new information, Trustees immediately petitioned NMFS for an emergency listing. Meanwhile, NMFS refused requests by RDC and others to reopen the status review so that public comment could be taken on the formula revision and other changes that have occurred since November.

While the consequences of a depleted listing are not as severe as one under the Endangered Species Act, environmental forces could still use a depleted finding under the Marine Mammal Protection Act as a tool to obstruct human activity in Cook Inlet.

Under either a depleted, threatened or endangered listing, all users of Cook Inlet could be impacted, especially through third party lawsuits. Within one month of filing the petition for an endangered listing, Cook Inlet Keeper filed a motion this spring for a stay on 70 tracts of the Cook Inlet lease sale held in April. Then later in the spring, Trustees asked the Corps of Engineers to halt the dredging of shipping channels near Anchorage.



Commercial and sport fishing, community development, recreation, tourism, shipping and the oil gas industry have all successfully worked and grown together in Cook Inlet. Studies indicate development has not had a detrimental impact on Cook Inlet or the beluga whales.

Beluga listing has steep price tag

The widespread economic implications of listing the Cook Inlet beluga whale as an endangered or depleted species were outlined at a July Anchorage Chamber of Commerce luncheon forum featuring business leaders from throughout the community.

"If you aren't concerned now, you should be," said Joe Griffith of Chugach Electric Association. "It's another snail darter issue which strikes at the very heart of the transportation system that supports not only our businesses, but every aspect of the economy statewide."

Speakers warned that general commerce in the Cook Inlet basin and beyond could be severely impacted if the beluga is listed for special protection. From higher shipping costs to multi-fold increases in utility rates, Alaskans could end up paying big dollars directly and indirectly. Participating in the panel presentation were Ken Freeman of RDC, Judy Brady of the Alaska Oil and Gas Association, Representative Gail Phillips, Roger Graves of the Port of Anchorage, Phil Cutler of the Alaska Sportfishing Association and Brian Crewdson of Anchorage Water and Wastewater Utility.

If the belugas are listed, Crewdson warned that the Municipality of Anchorage could be forced to build a $500 million-plus secondary treatment plant, including a tertiary treatment process and an advanced metals removal for wastewater it discharges into Cook Inlet. Anchorage residents would have to pick up the tab for these additional expenditures, as well as annual operating costs that are estimated at more than $15 million.

Crewdson noted the Municipality of Anchorage is currently in the process of renewing a wastewater discharge permit and site-specific criteria for its treatment plant at Point Waronzof. The permit is sitting on the desk of federal regulators as part of the consultations on listing the belugas.

The Municipality does extensive monitoring of Cook Inlet waters on an annual basis as a condition for retaining its discharge waiver. Those monitoring efforts and other water quality studies have consistently shown no impacts to Cook Inlet from community or industrial development activities. Moreover, the monitoring has confirmed that city discharges have not exceeded state water quality standards and studies have largely ruled out exposure to pollutants as a factor in the recent decline in the Cook Inlet beluga population.

"More than ninety-nine percent of the metals detected in Knik Arm come from natural runoff and less than one percent is the result of human-influenced point or non-point sources," Crewdson pointed out. Both Cook Inlet and Knik Arm have extremely high suspended solids and particulate metals, originating from glaciers and rivers.

Under the Endangered Species Act, economic impacts from proposed regulations and other remedies to enhance protection of a species cannot be considered when making a decision to list, noted Judy Brady, Executive Director of the Alaska Oil and Gas Association.

Brady said the goal of everyone involved in the issue is the sustainability of the Cook Inlet beluga population.

"The problem is hunting, but NMFS insists it cannot regulate subsistence hunting until a marine mammal is listed for protection," Brady said. "That puts the rest of us in a terrible position, and it puts the hunters in a terrible position," she said. "Many of us believe they can indeed regulate right now. They believe they can't, and have not been."