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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.

(Continued to page 6)

Dividends disappear if Alaskans decide to do nothing

<table>
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<th>Year</th>
<th>Constitutional Budget Reserve Gone – FY2002</th>
<th>Earnings Reserve Gone – FY2007</th>
<th>Unrealized Gains Gone – FY2011</th>
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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 temporarily 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.

(Continued to page 6)
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 introducing the Balanced Budget Plan that creates a new, sustainable revenue stream for continuing budget cuts, additional essential state services, ensures a balanced budget, and brings long-term stability.

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.

Executive Committee Officers
President - Jim Shinnich
Vice President - Robert Stiles
Secretary - Ute Gross
Treasurer - Stan Foo
Past President - Allen Bingham

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.

Executive Committee Officers
President - Jim Shinnich
Vice President - Charles Johnson
Secretary - Ute Gross
Treasurer - Stan Foo
Past President - Allen Bingham

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.

Why budget cuts alone won’t close the gap

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

- Ensure Alaskans continue to receive healthy dividends.
- Protect and grow the Permanent Fund principal.
- Close the fiscal gap.

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. With out 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.

Alaska cannot whisk $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.

- 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.**

August 1999 / RESOURCE REVIEW / Page 7
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 re-structuring 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 general state use.

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 fund stream. The current system is 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 $1,866 in 2000 and begin dropping after that point. Unless significant new sources of revenue are found, the dividend could disappear by 2015 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.

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 prices 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.

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 when petroleum prices decline.

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 Natchi in Iniskilin and also set sail to the Slope in July.

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.

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 industry 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.

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.

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.
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 Griffin of Chugach Electric Association. "It's another small snail darter issue that 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 Crowston of Anchorage Water and Wastewater Utility.

If the belugas are listed, Crowston 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.

Crowston 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 Woronzof and the federal Department of Commerce is expected to announce listing the beluga as an endangered species this month. The belugas in Cook Inlet are the same population as in the delta area, and the RDC executive director explained that public comment could be taken on the beluga issue.

"Beluga hunting until a marine mammal is listed for protection," Brady said. "That puts the resource managers in a terrible position, and it puts the hunters in a terrible position," Crowston 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 and should regulate right now. They believe they can't, and have not been."