How Did Alaska Get to this Place, and What Are the Options Now?

Fiscal update by Cliff Groh, ACG Board Member, September 30, 2019

After an exhausting and apparently endless seven-month fight over budget cuts and the size of the Permanent Fund Dividend, the State of Alaska is set up for continuing struggles over the same issues in the coming years. You might be tired of it all, but this set of fiscal conflicts is primed to keep going.

Alaska politics is tumultuous (Mike Dunleavy is the sixth person to be elected Governor in the last six elections, as Governing magazine has noted). Alaska politics is also unusual (try explaining it to people outside the state). One reason for the tumult and the uniqueness is existential. The issues of what the State of Alaska should do and how to pay for what it does raise questions like “What kind of Alaska can we have?” and “What kind of Alaska do we want?”

Let’s set the stage with familiar yet critical facts. Alaska oil production has fallen by more than 75 percent in the last three decades, going from over 2 million barrels per day in the late 1980s to less than 500,000 a day now. Meanwhile, oil prices have not stayed high

enough to
compensate for the fact that the State of Alaska now has so much less oil from
which to collect royalties and taxes. World oil prices, in fact, bounce around
a lot and in 2019 have been substantially below what they were in the summer of
2014 (even though the Middle East is roiled by war).

The combination of the big decline in Alaska oil production
and unpredictable world oil prices well under historical highs creates a big
problem for our state. From the early 1980s to 2018, the State of Alaska's
fiscal system was based on having a whole bunch of new oil money coming in, and
that system stopped working about five years ago.

The fiscal system changed in 2018 with the adoption of
legislation—Senate Bill 26—that provides for the use of substantial amounts of
Permanent Fund earnings to pay for conventional public services. Even with that
injection of Permanent Fund earnings into the regular budget, however, the
massive drop in oil revenues in the absence of unrealistically high stock
market returns or an apparently unsustainable long-term run-up in oil prices
means that the State of Alaska still lacks sufficient revenues to pay for the
level of public services a majority of Alaskans seem to want—including a
Permanent Fund Dividend paid pursuant to the formula set out in Alaska

statutes—without instituting a broad-based tax and/or raising oil taxes. That last sentence runs 86 words, but that's what it takes to sum up our fiscal circumstances. (The State of Alaska could always finance itself for a while by going through all its spendable savings, but that is of course a short-term strategy at best.)

It All Seems So Different Now from Last Fall

You have probably observed how this account of Alaska's current fiscal situation is at odds with how the Governor's race went last year. Former State Sen. Mike Dunleavy ran and won on a platform of super-sized Permanent Fund Dividends (remember the Dunleavy Dividend of $6,700 promised to arrive in October of 2019?); no personal taxes; and relatively small and painless budget cuts.

The Dunleavy campaign's platform regarding the budget is crucial and poorly remembered. Independent journalist Dermot Cole and Alaska Public Media's Nathaniel Herz have labored to set out what candidate Mike Dunleavy actually said on the trail in 2018. Candidate Mike Dunleavy promised to increase spending on K-12 education and not cut funding for the University of Alaska, Power Cost Equalization (PCE), and the Pioneer

Homes—among other agencies. He also specifically promised not to “lop off and chop off big aspects” of the ferry system (officially called the “Alaska Marine Highway System”) and said that there was “no plan to hack, cut, or destroy” that ferry system.

Instead of making cuts to these popular programs, candidate Dunleavy said in 2018 that he would save $200 million by cutting 2,000 funded but unfilled positions, save another $100 million with a voluntary school district health insurance consolidation plan, and save another $150 million by making Medicaid more efficient. Dunleavy told the Fairbanks Daily News-Miner in August of 2018 that “I do not have a specific program I would like to reduce or eliminate.” When he did identify specific budget cuts he wanted to make, candidate Dunleavy said that he would axe a $4.5 million study of fast rail between Palmer and Anchorage and not fund “climatologists.”

Following the Election, Gov. Dunleavy Dramatically Changes His Positions on the Budget and the Dividend

Mike Dunleavy was elected Governor on November 6, 2018, receiving 51 percent of the vote. The next month, the new Governor’s budget only included funding for a $3,000 Dividend in 2019, while the administration said that additional funding to pay a larger 2019 Dividend would come in legislation outside the budget. By January of 2019, the administration had abandoned the plan to send a Dividend of $6,700 to all Alaskans in October of 2019. Instead, Gov. Dunleavy proposed to pay bigger Dividends in future years to compensate Alaskans for the amounts the Legislature and former Gov. Bill Walker had cut Dividends in 2016, 2017, and 2018 compared to what the payments would have been under the formula for Dividends adopted in the 1980s that is still on the books. Eventually, Gov. Dunleavy's demand for the 2019 Dividend turned out to be that $3,000 that would be paid pursuant to that formula adopted in the 1980s.

The Dunleavy switch on the funding for conventional public services came in February of 2019, and it was big.

The Governor proposed on Feb. 13 the following budget reductions compared to the previous year (the figures in this paragraph represent cuts in Unrestricted General Funds according to the Alaska Legislative Finance Division):

- K-12 education—25 percent cut
- Medicaid—38 percent cut

- University of Alaska—41 percent cut
- Department of Transportation and Public Facilities (DOTPF)—32 percent cut

The Governor also proposed to:

- Shift $420 million in petroleum property tax revenues from local governments to the State of Alaska
- Eliminate the endowment for Power Cost Equalization (PCE)
- Substantially increase the fees charged to Pioneer Home residents
- Zero out funding for public radio and TV
- Cut funding for the ferry system (which is part of DOTPF) by at least 65 percent—requiring that the ferries at least be tied up for the winter—while exploring privatization

Along with claiming that the public knew that he would propose big budget cuts when he was elected, the Governor's defense of his switch on the budget cuts was that oil prices were lower in December of 2018 than they were briefly in October of 2018.

Note that despite various statements and suggestions to the contrary, Gov. Dunleavy did not propose in February of 2019 a budget that aligns expenditures with current revenues. The Alaska Legislative Finance Division broke out the Governor's budget proposal as $650 million in reductions in agency operations, $520 million in cost-shifting from the

State government (primarily or entirely to local governments), and $352 million in use of reserves.

The Public Protests and the Legislature Reacts

Gov. Dunleavy's proposed budget cuts galvanized public opposition. Testimony at legislative hearings ran overwhelmingly against the proposed cuts, both generally and in their specifics. Letters, e-mail messages, and telephone calls to legislators' offices also apparently leaned against the proposed cuts.

Polling results regarding the Governor's budget proposal, however, showed that Alaskans were more evenly divided than the public testimony suggested. A poll conducted in late March and early April of 2019 showed that 28 percent strongly supported Gov. Dunleavy's budget proposal and 21 percent mildly supported it while 32 percent strongly opposed it and 14 percent mildly opposed it. Another public opinion survey taken in late May and early June of 2019 provided similar numbers. That poll showed that 25 percent strongly supported the Governor's budget proposal and 22 percent somewhat supported it, while 37 percent strongly opposed it and 10 percent somewhat opposed it.

The Legislature rejected most of Gov. Dunleavy's proposed budget cuts and re-allocations. The operating budget the Legislature passed in

June at the end of the first special session was $190 million lower than from the previous year, with most of the cuts coming from Medicaid ($87 million) and the ferry system ($40 million). (Once again, these figures represent Unrestricted General Fund (UGF) spending as reported by the non-partisan Alaska Legislative Finance Division.) In an under-reported move, the Legislature also voted to make a special transfer of $9.4 billion from the Permanent Fund Earnings Reserve to the Permanent Fund principal—which under the Alaska Constitution cannot be spent without a vote of the people—with the announced intent of satisfying inflation-proofing over the next eight fiscal years.

The Legislature was unable to pass a capital budget and could not decide on the level of the Permanent Fund Dividend before the end of the first special session came in mid-June.

The Governor Brings the Veto Pen the First Time, and the Legislature Adds Back Most of the Vetoed Funding in a Second Special Session

Governor Dunleavy responded on June 28 by vetoing more than $400 million from the budget, adopting much of the approach he had unveiled in the budget cuts he had proposed in February (which—as noted earlier—was

contrary to the specific statements he made during his gubernatorial campaign).
Prominent among the vetoes announced were $130 million from the University of
Alaska (a cut in line with the Governor's budget proposal in February) and $77
million from Medicaid (on top of the Legislature's cut). Among the rest of the
182 line-item vetoes were $49 million for school debt bond reimbursement and
Senior Benefit payments totaling $21 million, resulting in a planned
elimination of the latter program. (These figures were those announced by the
Dunleavy administration's Office of Budget and Management.)

The Governor also vetoed $5.4 billion of that special appropriation from the Permanent Fund Earnings Reserve to the Permanent Fund's
principal.

The Legislature's initial responses to these vetoes were hampered by both a temporary factor and a structural issue. The short-run factor was the Governor called the second special session to be held at Wasilla Middle School, while most legislators gathered more than 500 miles away in the State Capitol in Juneau. The structural issue was that Alaska's Constitution was intentionally designed to make the Governor one of the nation's most powerful. A constitutional provision that it takes a ¾ vote of the Legislature to override a veto of an appropriation is a critical element of what makes Alaska's Governor so powerful. This requirement to line up 45 votes (as opposed to 31 or 40) out of the 60 members of the Legislature in order to override a line-item veto of an appropriation is a giant weapon for the Governor who can make that veto. (Alaska is the only state with a requirement as high as ¾ of legislators to override a governor's veto of an appropriation, according to the [National Conference of State Legislatures](#).)

Hampered by both impediments, the Legislature failed to override the budget vetoes. When all the legislators eventually gathered in Juneau later in July, the Legislature instead passed a new bill that restored all but about $20 million of the more than $400 million in operating budget vetoes that the Governor vetoed June 28. (The conflict over funding for K-12 education was put off, as the Legislature and the Governor agreed to put the issue on hold while the issue of constitutionality for forward funding for education was resolved in the courts.) The Legislature also approved a capital budget at the end of July, resolving a complicated funding question called the "reverse sweep."

The debate over the Dividend ate up much of the second special session in July, much as it consumed the Legislature all year. The Legislature passed a bill providing for a $1,600 Dividend rather than the $3,000 Dividend based on the formula adopted in the 1980s that the Governor had sought for months. The votes on the new budget bill—including the different Dividend figure—were aided by the fact that Gov. Dunleavy's approach helped unite in opposition to him a number of Republicans and Democrats who before his election were not allies.

The Legislature then adjourned in early August and awaited the Governor's next move.

The Rise of the Recall and the Return of Ben Stevens to Power Seem to Change the Governor's Mindset on How Much to Cut How Fast

Two other events occurred at the end of July that may have been related but definitely affected the Governor's relationship with the Legislature. A recall effort was announced against the Governor with two Republicans—one a coal baron—and a Democrat as the three co-chairs. Two of the five specific allegations in the recall specifically related to the Governor's budget vetoes, and signatures came much faster than expected (organizers submitted just over 49,000 signatures collected in just over a month).

The other notable announcement on July 31 was the replacement of Tuckerman Babcock as Chief of Staff with former State Senate President Ben Stevens. Some observers saw Babcock as an ideologue who may have overestimated the appeal of a $3,000 Dividend in his advice to the Governor, while the experience of Stevens in the legislative leadership may temper his counsel. Legislators reported that Gov. Dunleavy moderated in his negotiations following the naming of Stevens as Chief of Staff. (Given that in 2007 the U.S. Department of Justice got two men to plead guilty to bribing Ben Stevens (even though he was never charged—much less convicted—of any crime), some observers are surprised that he has been put in charge of a public official's image rehabilitation.)

Another step in changing the Governor's image came in the announcement Sept. 16 that Donna Arduin was out as the Governor's Director of Office of Management and Budget. Arduin had been a lightning rod for criticism of the administration's budget-cutting approach, and insiders expect that the threat of recall will lead Ben Stevens to continue to work hard to make Gov. Dunleavy appear more empathetic.

While the Governor was pondering a second round of vetoes in August, he announced an agreement apparently aimed at lowering the temperature on University funding, the target of his biggest operating budget veto in dollar terms. Gov. Dunleavy signed on August 13 a document approved by the University of Alaska's Regents in which the Governor stated his intent to replace a $135 million budget cut in one year for the

University with a $25 million cut in State of Alaska funding for the current fiscal year and another $45 million cut over the following two years. Skeptics noted that the Legislature—not the University of Alaska's Regents—retains the constitutional power to make appropriations for the University (subject of course to the Governor's veto and the Legislature's power to override such a veto).

The Governor announced on August 19 his vetoes on the budget bill passed in July. The action attracting the most attention was his decision to not veto as insufficient the appropriation that would produce a Permanent Fund Dividend in 2019 of about $1,600. Gov. Dunleavy vowed to fight for a second check of $1,400 to bring the total Dividend payments to $3,000 for this year. To get that total of $3,000, he said in a video announcement that he expected to call a third special legislative session this fall to seek an additional appropriation from the Permanent Fund Earnings Reserve to pay for the second check this year.

That same day as the announcement of the non-veto of Dividend funding that generated the $1,600 payment, Gov. Dunleavy unveiled the vetoes on the bill the Legislature passed in July adding back funding after his first round of vetoes. Highlighting the vetoes in Round 2 were

$48 million from Medicaid services (including funding for adult preventative dental Medicaid services in an intended elimination of the program); $49 million from school bond debt reimbursement; and $2.7 million for public radio and TV. The Governor vetoed $5 million the Legislature added back in funding for the Alaska Marine System; with the Legislature having cut $43 million in funding during the 2019 session, some coastal communities off the road system such as Cordova will go as much as seven months this winter without ferry service.

Simultaneously, the Governor let stand some of the add-backs made by the Legislature in July. Prominent in the restorations (that is, the July appropriations not vetoed) were $21 million for the Senior Benefits program and $3.9 million for the Alaska State Council on the Arts.

Where Do the Numbers Stand Now?

Following the vetoes announced in mid-August on the add-back bill (House Bill 2001), the Alaska Legislative Finance Division reported that the budget without Dividends was $4.3 billion in Unrestricted General Funds, which is $486 million lower than last year—a 10 percent reduction. Add in the approximately $1.14 billion to pay for a Permanent Fund

Dividend of $1,606 this year, and you get to $5.4 billion and a roughly balanced budget for Fiscal Year 2020, the year that runs July 1, 2019-June 30, 2020. Add in another $1,400 to pay for a second Dividend check this year—and absent new revenues—the State of Alaska would be in a deficit of close to $1 billion this year.

What's Coming Up? (Hint: More Proposed Big Budget Cuts from the Governor)

As noted above, Gov. Dunleavy has stated that he expects to call for this fall a special session—the third special session this year—to focus solely on paying the second check of $1,400 to make the $3,000 total Dividend this year that he has promised. Some legislators have said that this third special session should also address another appropriation bill that would reverse some of the vetoes made in the second round. Another potential topic at that potential special session this fall is a new formula for distribution of Permanent Fund Dividends that would be sustainable in light of the new realities the State of Alaska confronts. Some lawmakers kick around the idea of a grand bargain that would resolve these questions simultaneously.

Whatever happens this fall, Alaskans need to know that Gov.

Dunleavy is by all indications committed to additional funding cuts in his budget proposal for the next fiscal year which by law must be unveiled no later than December 15. When a legislator pointed out at a public gathering this summer that Gov. Dunleavy had never proposed a budget that in fact aligned expenditures with current revenues, Commissioner of Revenue Bruce Tangeman responded that he was confident that the Governor would do so in that proposal to be submitted for the upcoming fiscal year. This statement strongly implies that the Governor's next round of proposed budget cuts will total $500 million or more.

K-12 education is the most likely big target for that next blitz of the Governor's proposed budget cuts. Recall that the Governor proposed a 25 percent budget cut—approximately $300 million—to K-12 funding back in February, and that fight only got sidetracked this year because of the Governor's agreement with the Legislature to put the issue on hold while the courts resolved the question of the constitutionality of forward-funding.

Math and history both dictate that the Governor—who spent nearly two decades as a teacher, principal, and school district superintendent in the Bush—reach for the hatchet on K-12 education. Gov. Dunleavy has said repeatedly that he is determined to align expenditures with current revenues, and K-12 education is the biggest non-Dividend spending item in the budget. (And with the Dividend still legally at $1,606, K-12 is the largest expenditure; it’s the $3,000 Dividend that would make that outlay the biggest of all expenditures.)

In addition to another wave of budget cuts that will be fought over in the legislative session starting in January, the Governor seems likely to continue to push for his three proposed constitutional amendments, each of which would have a major impact on Alaska’s fiscal system. One amendment would substantially tighten the existing spending limit. A second would require all new taxes or tax increases to be approved by both the Legislature and a vote of the people. The third would guarantee in the Alaska Constitution the annual payment of Permanent Fund Dividends pursuant to the distribution formula that has been on the statute books since the 1980s.

What Are the Constraints on What Can Happen?

In the short run, fear of the recall might slow down some of Gov. Dunleavy’s efforts to cut the budget and reshape the fiscal system. Regardless of what happens with the recall, Alaskans need to ponder some hard facts about saviors, desires, and goals.

Let’s start with saviors. Alaskans have long imagined or speculated that various rescuers are coming over the hill to save our state from making difficult fiscal choices. Those potential saviors have been at various times ANWR; the gasline/LNG/various other efforts to commercialize/monetize natural gas on Alaska’s North Slope; offshore oil development; the Pebble Mine; taxation of non-residents only; and small and relatively budget cuts. Unfortunately, these rescuers have not arrived, and they seem unlikely ever to get here due to a number of factors, including economic and technological changes and (in the case of taxing non-residents only) the U.S. and Alaska Constitutions. Alaska is transforming, and the announced departures of BP from Alaska and the flagship Nordstrom department store from downtown Anchorage both represent aspects of that transformation. No outside force or magic trick is going to save us, folks, and we must save ourselves.

In saving ourselves, we need to distinguish between desires and options. Many Alaskans want the State of Alaska’s fiscal system to run as much as possible as it did between the early 1980s and the mid-2010s. The four pillars of those three and a half decades were:

- Large amounts of new oil money generated by taxes and royalties regarding oil development
- Relatively high state spending per capita compared to the national average
- No use of Permanent Fund income/earnings in significant amounts beyond the payment of Permanent Fund Dividends or to protect the Permanent Fund’s principal from the effects of inflation (this latter effort is known as “inflation-proofing”)
- No general statewide taxes on individuals or significant general statewide taxes on Alaska-based corporations

Three out of four of these pillars have fallen. Large amounts of new oil money stopped arrived in the mid-2010s; the annual budget has fallen substantially since the mid-2010s and after adjusting for inflation and population is now below what is was before this fiscal system was created in the early 1980s; and starting in 2018 the State of Alaska has come to rely heavily on Permanent Fund earnings to finance the budget. Despite the falling budget and use of a lot of Permanent Fund earnings/income to pay for conventional public services, the State of Alaska still has a deficit—and will continue to do so for any future seeable now—without either raising additional revenues and/or not following the statutory Permanent Fund Dividend formula.
(To get an idea of revenue options discussed now, the income tax that the Alaska House passed in 2017 would have generated about $700

million per year,
and supporters of the recently proposed oil tax initiative assert that it would
raise approximately $1 billion annually.)

On top of all that, the State of Alaska also faces pressures to increase the budget that has recently been going down each year. One
pressure is an aging population, as people over 70 tend to need more medical
care and other services than people between, say, 20 and 40 years of age. A
second pressure is the capital budget; spending for infrastructure has fallen
substantially in the last four years, and most experts see it as too low now. A
third upward force on the budget is the State of Alaska's officially adopted
plan to pay off the unfunded liabilities for the Public Employees' Retirement
System (PERS) and the Teachers' Retirement System (TRS). Regarding that last
factor, the State is paying off the unfunded liabilities on a 25-year plan that
ends in 2039; those payments are one of the half-dozen biggest spending items
in the budget, and they increase each year until the final payment in 2039.

Given current realities, Alaskans appear to want mutually contradictory outcomes. A lot of Alaskans seem to want big budget cuts in
theory and in general, but rebel loudly when those cuts are made specific and
real and rule out the additional taxes and/or reduction of

Permanent Fund
Dividends necessary to finance the actual budget they seem to want. Alaskans
need to figure out what desires are unrealistic and investigate the genuine
options for our state.

**The choices among options should be guided by an explicit
discussion of goals. Once again: What kind of Alaska can we have? What kind of
Alaska do we want?**

Cliff Groh speaks only for himself in this article.