The Most Important Things to Understand About Alaska’s Fiscal Situation

Gunnar Knapp
Director and Professor of Economics
Institute of Social and Economic Research
University of Alaska Anchorage
Gunnar.Knapp@uaa.alaska.edu

January 2015

The presentation will be posted on ISER’s website at:
www.iser.uaa.alaska.edu
The fall in oil prices has led to growing concern among Alaskans about the state’s fiscal situation.

This presentation summarizes some of the most important things to understand about our fiscal situation.

This is a short introduction to a complicated topic. 
I’ve focused on the “big picture.”
I’ve used some simplified terms, and I’ve left out many important details.

At the end of the presentation I’ve listed the sources for the data shown in the presentation.
1. Alaska is extremely dependent on oil revenues to fund state government.
From 2005 to 2014, oil revenues averaged 90% of Alaska’s unrestricted general fund revenues.
2. After rising dramatically for many years, over the past three years oil prices and oil revenues have fallen drastically.
Average annual prices since 2005.

Projected

Historical  Projected

Daily prices since 2011.

FY15
As oil prices have fallen, oil revenues have fallen drastically.

$6.8 billion drop in oil revenues from 2012 to 2015 (77% drop)
3. Spending has also fallen since 2013—but not as fast as revenues.

We have gone from large surpluses to large deficits.
We ran big **surpluses** from 2005 to 2012. Since 2013 we have been running big **deficits**.
This year’s projected deficit is huge.

FY15 unrestricted general fund spending

- $5.9 billion
- $3.4 billion (57% of spending)
- $2.6 billion

Projected deficit

- $8,000 per Alaskan
- $4,500 per Alaskan
- $3,500 per Alaskan
4. At current spending and projected revenues, we would continue to run large deficits.
Even though revenues are projected to rise beginning in 2017, at current spending deficits would remain very large.
5. When we were running surpluses we built up big savings which are now paying for deficits.

At current spending and projected revenues, projected deficits would drain our savings in about seven years.
We used the surpluses between 2005 and 2012 to build up our savings in two reserve funds.

**Constitutional Budget Reserve Fund and Statutory Budget Reserve Fund Start-of-Year Balances**

- **FY15**: $3 billion special contribution towards retirement obligations
- **Available to pay for deficits**
At the start of FY15, we had $12.2 billion in savings available to pay for deficits.
At this year’s spending level and projected future revenues, we would drain our savings in 7 years.
End-of-year savings

Projections if we continue spending at current levels

Budget, revenues & deficits

Legislative Finance Division estimates, January 19, 2015
6. Future oil prices are highly uncertain. They might be significantly lower than the Department of Revenue assumed for their revenue projections.
The revenue projections assume oil prices will rebound after 2016.
Most “experts” think:

- Prices fell because world oil production exceeded demand
- Falling prices will reduce production
- When production equals demand prices will stop falling
- Prices will rise again as demand grows

*BUT*

- So far production hasn’t fallen much
- Slowing economic growth is reducing demand
- Future price growth may be limited by rebounding production
What will actually happen to oil prices is highly uncertain. We can’t assume that the Department of Revenue projections will be correct.
7. How long our savings might last depends critically on oil prices.

If oil prices are lower than projected, we could drain our savings much sooner.
Legislative Finance Division estimates, January 19, 2015

Projections if oil prices average $60/barrel

Budget, revenues & deficits

End-of-year savings
Projected month in which savings would run out under different constant oil price assumptions

Source: Department of Revenue Fall Revenue Sources Book, page 61
8. We can’t run deficits without savings to pay for them.

   Unless oil prices rise dramatically within a few years we will have to make big changes to our spending or revenues.
9. Unless oil prices rise dramatically, we face two big choices:

**How to adjust?**

- Spend less?
- Find new revenues?
- Both?

**When to adjust?**

- Now?
- Gradually?
- When our savings run out?
10. It is not obvious how to cut spending enough to make up for the deficits we face.
Most of the state budget is in agency operations.

FY15 budget = $5.8 billion

- **Capital budget**: $0.6 billion
  - Roads, buildings, etc.
- **Statewide operations**: $0.7 billion
  - Debt service, retirement fund payments, etc.
- **Agency operations**: $4.5 billion
  - State government departments

Operating budget ($5.2 billion)
We have reduced the capital and agency operations budgets—but the agency operations budget has kept growing.

Source: Legislative Finance Division
Education and Early Development & Health and Social Services account for 59% of the FY15 agency operations budget.

Growth has occurred in all agencies’ budgets.

Source: Legislative Finance Division
K-12 and Medicaid Programs account for 45% of the FY15 Agency Operations budget.

Major Components of Agency Operations Budget, FY06 and FY15 ($ millions):

- **Medicaid (15%)**
  - Grew by 149%
  - 26% of total growth

- **K-12 programs (30%)**
  - Grew by 57%
  - 31% of total growth

- **All other programs (55%)**
  - Grew by 72%
  - 43% of total growth

Source: Legislative Finance Division
Debt service obligations can’t be cut.

Source: Legislative Finance Division
State assistance to retirement would be difficult to cut.

In FY15 we are making a special contribution of $3 billion from our savings, but payments will resume at about $260 million in FY16.
From a long-term perspective, the growth in spending since 2005 looks dramatic, expressed in total dollars.
Adjusted for inflation, the growth in spending *per Alaskan* since 2005 seems less dramatic, particularly for agency operations.

Source: Legislative Finance Division
11. Many Alaskans think the Permanent Fund should be “off the table” in how we respond to our fiscal situation.

But:

The Permanent Fund accounts for a growing share of state savings and revenues.

Permanent Fund dividends account for a growing share of state spending.
This Permanent Fund is worth more than $50 billion. We can only spend the “realized earnings” in the “earnings reserve.”
Each year the **statutory net income** of the Permanent Fund gets added to the earnings reserve.
Each year we draw from the earnings reserve to pay for dividends and inflation proofing.
Permanent Fund statutory net income is highly variable but it has been growing as the Fund grows. This year it is more than our oil revenues.

Alaska Unrestricted General Fund Revenues and Permanent Fund Statutory Net Income

- Oil Revenues
- Permanent Fund Statutory Net Income

(millions of dollars)


Historical Projected
Dividends are significant compared with other state spending.
Overview of Data Sources for this Presentation
Data for historical and projected state revenues in this presentation are from Fall Revenue Sources Books prepared by the Alaska Department of Revenue’s Tax Division. These clearly-written reports provide detailed information about the many different sources of state revenue. They are available at:


Most of the revenue data are from the Fall 2014 Revenue Sources Book. Some data are from earlier revenue sources books.
Most of the state spending data in this presentation were provided by the Legislative Finance Division. Very detailed information about state budgets is provided on the Division’s website:

http://www.legfin.state.ak.us/

The Division regularly prepares two-page fiscal summarizes of major budget categories by fund type. These are very useful as a summary of budgets by major fund type. They are posted at:

http://www.legfin.state.ak.us/FisSum/DisplayReports.php

Most of the spending data in this presentation are for fiscal year final budgets. Data for the FY14 and FY15 budgets are from the state of Alaska fiscal summary published August 29, 2014, which is shown on the next two slides.

Much more detailed budget information is provided in the annual Summary of Appropriations documents, which are posted at:

http://www.legfin.state.ak.us/Summary/DisplayReports.php
The Legislative Finance Division puts out two-page Fiscal Summaries which summarize major items in the state’s budget and how they are funded.

State of Alaska Fiscal Summary—FY14 and FY15 (Part 1)
## Legislative Finance Division Fiscal Summary (page 2)

<table>
<thead>
<tr>
<th>State of Alaska Fiscal Summary—FY14 and FY15 (Part 1)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Unrestricted General Funds</strong></td>
</tr>
<tr>
<td>FY14 BUDGET</td>
</tr>
<tr>
<td>47 Transfers (7)</td>
</tr>
<tr>
<td>48 Current Fiscal Year Transfers</td>
</tr>
<tr>
<td>49 Loans</td>
</tr>
<tr>
<td>50 Designated Reserves</td>
</tr>
<tr>
<td>51 Undesignated Reserves</td>
</tr>
<tr>
<td>52 Oil &amp; Hazardous Substance Fund</td>
</tr>
<tr>
<td>53 RSAA School Fund</td>
</tr>
<tr>
<td>54 AMHS Fund</td>
</tr>
<tr>
<td>55 Renewable Energy Fund</td>
</tr>
<tr>
<td>56 Other Funds</td>
</tr>
<tr>
<td>57 Supplemental Transfers</td>
</tr>
<tr>
<td>58 Undesignated Reserves (Alaska Housing Capital Corp)</td>
</tr>
<tr>
<td>59 AMHS Fund</td>
</tr>
<tr>
<td>60 AMHS Vessel Replacement Fund</td>
</tr>
<tr>
<td>61 Permanent Fund Transfers</td>
</tr>
<tr>
<td><strong>Total Authorizations (unallocated)</strong></td>
</tr>
<tr>
<td><strong>Total Authorizations (unallocated)</strong></td>
</tr>
<tr>
<td><strong>Total Authorizations (unallocated)</strong></td>
</tr>
</tbody>
</table>

**Fiscal Year Summary**

<table>
<thead>
<tr>
<th>Agency Operations</th>
<th>7,319.2</th>
<th>2,977.3</th>
<th>10,036.5</th>
<th>587.6</th>
<th>2,977.1</th>
<th>13,352.5</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Operating</td>
<td>6,438.6</td>
<td>243.6</td>
<td>6,682.2</td>
<td>406.5</td>
<td>2,284.1</td>
<td>9,765.7</td>
</tr>
<tr>
<td>Total Operating</td>
<td>5,234.6</td>
<td>977.5</td>
<td>6,212.1</td>
<td>352.4</td>
<td>2,284.1</td>
<td>8,596.5</td>
</tr>
<tr>
<td>Statewide Operations</td>
<td>886.4</td>
<td>220.8</td>
<td>1,107.2</td>
<td>406.5</td>
<td>2,304.1</td>
<td>4,410.5</td>
</tr>
<tr>
<td>Unduplicated Appropriations of Permanent Fund</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Transfers (non-additions)</td>
<td>264.5</td>
<td>14.3</td>
<td>229.2</td>
<td>1.9</td>
<td>-</td>
<td>(249.9)</td>
</tr>
</tbody>
</table>

Notes:

(1) Although Permanent Fund earnings may be appropriated for any purpose, the legislature traditionally excludes them from the definition of available resources. Appropriations of Permanent Fund earnings are reported in lines 64-67 of the summary. Permanent Fund earnings and balance information is reported in part 2 of the Fiscal Summary.
(2) The Department of Revenue's Spring 2014 oil forecast for FY14 is 802.5 mbl at $105.61 per barrel; the FY15 forecast is 809.0 mbl at $101.91 per barrel.
(3) Carryforward in money that was appropriated in a prior year that is needed available for spending in a later year via multiple appropriations or reappropriations. Carryforward into FY15 will be unknown until the close of FY14.
(4) Designated general funds include 1) program receipts that are restricted to the program that generates the receipts and 2) revenue that is statutorily designated for a specific purpose.
(5) Duplicated authorizations are in the budget twice, such as when funds flow in and out of a holding account or one agency pays another for services provided. Duplicated authorizations can only include the expenditure of bond proceeds when debt service on bonds (which includes repayment of principal) will be reflected in the operating budget.
(6) Including duplicated fund sources in the amount of capital spending provides a valuable measure of "money on the street" because it includes projects funded with bond proceeds and other duplicated fund sources.
(7) The "Transfers" refer to appropriations that move money from one fund to another within the Treasury. Although transfers are not true expenditures, they reduce the amount of money available for other purposes so must be included in the calculation of the surplus/deficit. For reserve accounts, a positive number indicates a deposit and a negative number indicates a withdrawal. When money is withdrawn and spent, the expenditure is included in the operating or capital budget, as appropriate.
(8) The "other transfers" necessary for balance to budget is anticipated to be $17 billion in FY14 and $4 billion in FY15.
(9) Amounts shown on line 89 can be considered duplicated appropriations—they are included in the operating or capital budgets above. The Designated General Fund column includes amounts associated with the dividend program. Amounts in the Other column reflect gross earnings of the Permanent Fund spent for purposes other than operation of the capital budget.
Approximate start-of-year and end-of-year balances of reserves in state funds can be found near the front of the Summary of Appropriations documents in part 2 of the Fiscal Summary.

Most of the historical budget data in the presentation for years prior to FY14 was provided to me by the Legislative Finance Division as Excel spreadsheets by special request.

In mid-January 2015, the Legislative Finance Division prepared a report entitled The Fiscal Year 2016 Budget: Legislative Fiscal Analyst’s Overview of the Governor’s Request. The 8-page introduction to this report provides a very useful summary of the state’s budget situation as of January 2015.

http://www.legfin.state.ak.us/Overview/Overview2016.pdf
Detailed current and historical data about the Permanent Fund can be found in the monthly and annual reports posted on the Alaska Permanent Fund Corporation website at:

http://www.apfc.org/home/Content/publications/reportArchive.cfm