Executive Summary

Bridging the Revenue Gap from Today to First Gas

Looking ahead at the next 10 years, Alaska must move to diversify its revenue base. The main emphasis of the 10-year plan is to facilitate Alaska's transition from a predominantly oil revenue base to an oil and natural gas revenue base. Construction of a pipeline to monetize Alaska's natural gas resources is a key element in providing for the future fiscal and economic stability of the state. Revenue generated from a natural gas pipeline will help diversify Alaska's revenue sources and provide a substantial source of new revenue to offset declining oil revenue. In addition, the gas pipeline will provide economic opportunity through the provision of a stable, clean source of energy to fuel Alaskan businesses and homes for years to come.

Based on the Alaska Department of Revenue's Fall 2009 forecast and the assumed expenditure projections, Alaska can use spending discipline combined with prudent use of the state's reserve accounts to sustain itself through fiscal year 2020. This plan would achieve the goal of transitioning the state from FY2011 to first gas, which is currently estimated to occur in the 2018 to 2020 time period. Under these assumptions, the balance of the state's primary reserve account, the Constitutional Budget Reserve, would grow well above $10 billion during the next ten years. By the end of the period, an anticipated fall in oil production will increase pressure to draw on reserves; however the onset of gas revenue would position the state to continue building its reserve accounts. The 10-year forecast shows that unanticipated budget shortfalls during the 10-year period could be filled primarily through the use of reserve funds; however, other fiscal tools including spending reductions would likely be used in addition to, or in lieu of, reserve funds.

The plan assumes modest spending growth of 3.0% annually beginning in FY2012, and anticipates no major change to the revenue structure in place as of the beginning of FY2010. This growth rate assumption will be challenging to meet, and implies that the delivery of state services will become more efficient over the 10-year period. Inflation is assumed at 2.75% and population growth will be slightly above 1.0% annually. That implies that state spending on a per capita basis will decline over the next ten years in real terms.

While overall spending is projected at an average annual growth rate of 3.0%, it is anticipated that portions of the budget will grow faster, and that will require other areas to grow at a slower rate or decline to meet the projected rate of growth. One particularly challenging example of this issue in the operations portion of the budget is the state's projected Medicaid spending. In FY2010 the state's portion of the federal Medicaid program was $395 million. Over the next 10 years that figure is projected to increase at an annual rate of over 7.0% and by FY2020 is projected to require a $922 million contribution from the state's general fund.

Among the other challenges that must be considered in the planning horizon are: financing investment expenses associated with the gas line project; the unfunded liability to the public employee and teachers retirement systems, dealing with the high cost of energy for Alaskans; shoring up aging transportation and other state-owned infrastructure; handling the effects of growing elderly and prison populations; and tackling the adverse affects of climate change. All of these issues must be considered while continuing to provide an acceptable level of government services to Alaskans.

Oil Prices and the Plan

In view of history, the possibility of oil prices falling below the Fall 2009 forecast must be considered. In that scenario, current projections for spending and use of the state's reserve accounts must be reevaluated. More conservative spending plans would be necessary and the ability of the state's available reserve accounts to facilitate a transition from today to a gas pipeline becomes more challenging.

The Plan's Imperative

The overarching objectives of the 10-year fiscal plan are guided by the statutory language that requires the Executive branch to produce a 10-year plan on an annual basis. Alaska Statute 37.07.020 (b) (2): says that the fiscal plan

> ***"must balance sources and uses of funds held while providing for essential state services and protecting economic stability of the state."***

Essentially, there are three requirements that the Executive's plan must meet:

- Balance the budget between sources and uses of finds,
- Provide for essential state services, and
- Protect Alaska's economic stability.

The Plan's Guiding Principles and Supporting Strategies

The 10-year plan meets the statutory objectives through the application of several foundational principles. The principles outlined below provide the guidance for spending and savings strategies represented in the plan.

Principle: Responsibly Develop Alaska's Natural Resources

The State of Alaska's future prosperity hinges on the responsible development of its abundant natural resources. In 1959, when Alaska became a state, 99.8 percent of the land was owned by the federal government. The Alaska Statehood Act gave the State the right to select and acquire approximately 104 million of the nearly 365 million acres of federal lands in Alaska. It was envisioned that the management of this land base and the associated resources would provide the State with a viable economic foundation. That stable economic base would then enable the State to provide governmental services to the people of Alaska, and reduce the likelihood that Alaska would be a drain on the federal treasury.

To date, the strategy of building Alaska's economy on natural resources has been effective. The State takes in significant revenues from companies that lease State-owned lands for extraction of oil, natural gas and coal, gold, zinc and other minerals and shares with the federal government revenues from oil, natural gas and other assets extracted from federal lands leased by private companies. Currently, nearly 90% of the State's unrestricted General Fund revenue is generated from petroleum production activities. For the foreseeable future, the health of Alaska's fiscal system will be linked to the wealth generated from the monetization of Alaska's natural resource base.

Strategy: Facilitate Gas Line Development- The Administration's highest priority is the development of the State's natural resources. The State's long-term planning is based in part on efforts to develop natural gas resources before oil resources are depleted. Currently, natural gas produced in conjunction with oil production on the North Slope is stranded from the market, and development of this critical resource has been limited because a means to transport recovered natural gas to markets outside Alaska has not been available. To spur commercialization of Alaska natural gas, the Administration proposed and the Legislature enacted the Alaska Gasline Inducement Act ("AGIA") in 2007; and in August 2008, authorized the State to award an AGIA license to TransCanada Alaska, a wholly-owned subsidiary of the TransCanada Corporation ("TransCanada"). Along with the license, the state committed to a cost-sharing agreement with TransCanada that provided a $500 million state commitment to assist in underwriting a portion of the pre-development costs of the project. In addition to the TransCanada project, two of the three major North Slope producers, ConocoPhillips and BP, are pursuing their own gas pipeline project, called Denali. While the State's economic past and present is tied to oil, the state's future is dependent upon the development of its abundant natural gas resources. During the next several years the Administration will be actively pursuing a project to monetize Alaska's gas.

Strategy: Facilitate Other Oil & Gas Development- In addition to the promotion of activities to spur bringing Alaska's natural gas to market, the State implemented a taxation structure called Alaska's Clear and Equitable Share (ACES) that is intended to encourage additional exploration and development of Alaska's oil resources. While increasing the rate of taxation, the ACES system authorizes a company to reduce its tax liability to the extent that it invests in equipment, projects or other items that are deemed to be capital expenditures. Additionally, a limited credit is granted to companies that qualify as small producers. Also, under certain conditions the state will assist in underwriting a portion of qualifying oil and gas development investment expenditures by providing nonproducing companies with cash rebates. These are intended to spur additional investment in Alaska's oil patch that will result in increased oil production in the future.

The State is also financing and promoting pre-development activities associated with production of natural gas that would be targeted for in-state markets.

Strategy: Facilitate Other Natural Resource Development-While oil and gas resources are the largest potential revenue sources for the state, other resource development efforts can also help diversify the state's revenue base. While they currently play smaller roles than oil and gas in terms of generating revenue to the state, mineral mining activity, fisheries and tourism also are critical contributing industries to the State's revenue stream and economic diversity.

Principle: Restrain Spending

In contrast to revenue, the part of the fiscal equation that Alaska's policy makers can have the greatest impact on is the size of the State budget. Given current expectations of future revenue and reserve availability, the base spending scenario in the 10-year plan contemplates growth over the period averaging 3.0% annually. The projected spending rate is not intended to indicate a commitment to spend at that level, and will be adjusted as circumstances dictate.

Strategy: Implement Results Based Budgeting- The Administration implemented results-based budgeting with the intention of restraining government spending. The Administration has directed agencies to focus on agency missions, core services and results expected for the current spending level. This is intended to assure Alaskans that state government dollars are being spent wisely. Within that framework, spending areas that will be a priority are those that are constitutionally mandated: education, public safety and transportation. By implementing this approach the Administration has committed to promoting more efficient ways of providing and delivering government services.

Strategy: Evaluate Long term Costs of Investment Initiatives In addition to assessing current spending for effectiveness, the Administration is committed to evaluating the long-term financial implications of proposed savings and investment initiatives. Taking a long-term view is intended to provide a framework for budget and policy decisions that promote the economic growth and fiscal stability necessary for Alaskans to prosper beyond the current budget cycle.

In order to restrain growth, the Administration will have to implement multiple strategies. Substantial reductions in state spending would require reductions in important public services and less investment in Alaska natural resource development and infrastructure. Anticipated growth in areas such as Medicaid, K-12 education and retirement system costs also make it challenging to reduce total state spending over time.

Principle: Save for Future Generations of Alaskans

Along with resource development, the savings element of the plan meets a basic challenge facing Alaska, turning the non-recurring revenue stream produced from Alaska's resources in to a long term recurring revenue source that can help maintain Alaska's economic stability beyond the life of the resource. The primary vehicle for this effort is Alaska's Permanent Fund, and a primary objective of the plan is to continue growing the Permanent Fund. In addition to growing the Permanent Fund, when an opportunity presents itself, the plan contemplates depositing unspent unrestricted revenue in reserve accounts such as the Constitutional Budget Reserve. Continual building of Alaska's reserve accounts provides the State a means to stabilize a revenue stream that is subject to the dramatic swings of oil prices or production interruptions. The availability of reserves underpin the state government's ability to provide the services that are mandated without having to draw upon other means of revenue generation such as broad-based taxes or use of the Permanent Fund.

Strategy: Preserve and Grow The Permanent Fund - The primary vehicle for this effort is Alaska's Permanent Fund, which receives ongoing deposits of mineral royalty revenue as well as annual appropriations to inflation proof the fund. Currently, the main contribution of Alaska's Permanent Fund to the state's residents is the annual Permanent Fund dividend payment. In 2009, the dividend amounted to $875 million distributed to about 624,000 dividend eligible citizens. This distribution was nearly the equivalent of a 13th month of private sector wage and salary payroll to the state's economy.

Strategy: Build Reserves When Possible, Use Them Judiciously When Necessary - Beyond continuing to grow the Permanent Fund, the plan contemplates that in times of surplus unrestricted general fund revenue that a portion of that revenue be used to build reserve accounts. To date, the primary reserve account drawn upon to fund ongoing operations of state government has been the Constitutional Budget Reserve fund (CBRF). Since its inception more than $5.2 billion has been borrowed from that fund to pay for state funded services. Recent general fund revenue surpluses have allowed the CBRF to be replenished so that as of June 30, 2009 the entire borrowed balance had been repaid by the general fund. The available balance has grown to approximately $8.2 billion as of December 2009. Additionally, $1.0 billion has been placed in another savings account called the Statutory Budget Reserve.

Strategy: Forward Fund When Appropriate - Another method the plan contemplates to provide fiscal stability is forward funding programs. Examples where the state has built or plans to build reserves to fund programs in future years include:

- Public Education Fund: More than $1 billion was set aside to fund the State's projected contribution to funding K-12 education one year in advance. This fund helped stabilize the funding stream for Alaska's K-12 education sector, and during the initial FY2010 budget cycle this set aside was critical in balancing the budget. The Administration has proposed to replenish the fund with a portion of the projected FY2010 surplus, and repeat this proposal in FY2011.

- Community Revenue Sharing Fund- $180 million is set aside in an attempt to stabilize annual funding to local communities for provision of local government services.
- Alaska Housing Capital Corporation Fund: More than $300 million was set aside to fund future capital projects, the Administration is proposing in FY2011 to use some of these funds for gas line expenditures.
- Governor’s Performance Scholarship: As part of the FY2011 budget, the Administration has proposed setting aside a portion of the projected FY2011 surplus to fund merit scholarships to in-state universities or job-training programs for students who complete a rigorous academic course of study and earn higher grades.

Strategy: Focus Investment The plan prioritizes spending according to the Administration’s investment priorities of:

- Education
- Transportation infrastructure
- Public Safety, health and welfare
- Economic and Resource development

Fall 2009 Revenue Forecast, FY2011 Governor's budget

with 3% annual budget growth beginning in FY2012

Oil Price & Production	**FY10**	**FY11**	**FY12**	**FY13**	**FY14**	**FY15**	**FY16**	**FY17**	**FY18**	**FY19**	**FY20**
Fall 2009 Forecast ANS West Coast ($/bbl)	$66.93	$76.35	$83.93	$86.24	$88.61	$91.05	$93.55	$96.13	$98.77	$101.49	$104.28
Fall 2009 Forecast production (mbbl./day)	0.659	0.623	0.617	0.624	0.635	0.623	0.604	0.588	0.561	0.524	0.489
Revenue vs Spending ($ Millions)											
General Fund Unrestricted Revenue	$4,777.9	$5,236.6	$5,573.3	$5,931.6	$6,340.2	$6,399.8	$6,170.7	$6,120.1	$6,069.5	$6,002.7	$5,904.9
General Fund Expenses	$4,415.2	$4,742.6	$4,884.9	$5,031.4	$5,182.4	$5,337.8	$5,498.0	$5,662.9	$5,832.8	$6,007.8	$6,188.0
Budget Surplus/Shortfall	$384.8	$94.0	$688.4	$900.2	$1,157.8	$1,062.0	$672.7	$457.2	$236.7	$5.1	$283.1
Reserve Balances											
CBRF Total	$9,070	$9,750	$11,082	$12,704	$14,674	$16,649	$18,330	$19,884	$21,301	$22,561	$23,903
Statutory Budget Reserve Balance	$1,000	$1,000	$1,000	$1,000	$1,000	$1,000	$1,000	$1,000	$1,000	$995	$712
Total Reserve Balances	$10,070	$10,750	$12,082	$13,704	$15,674	$17,649	$19,330	$20,884	$22,301	$23,556	$24,615

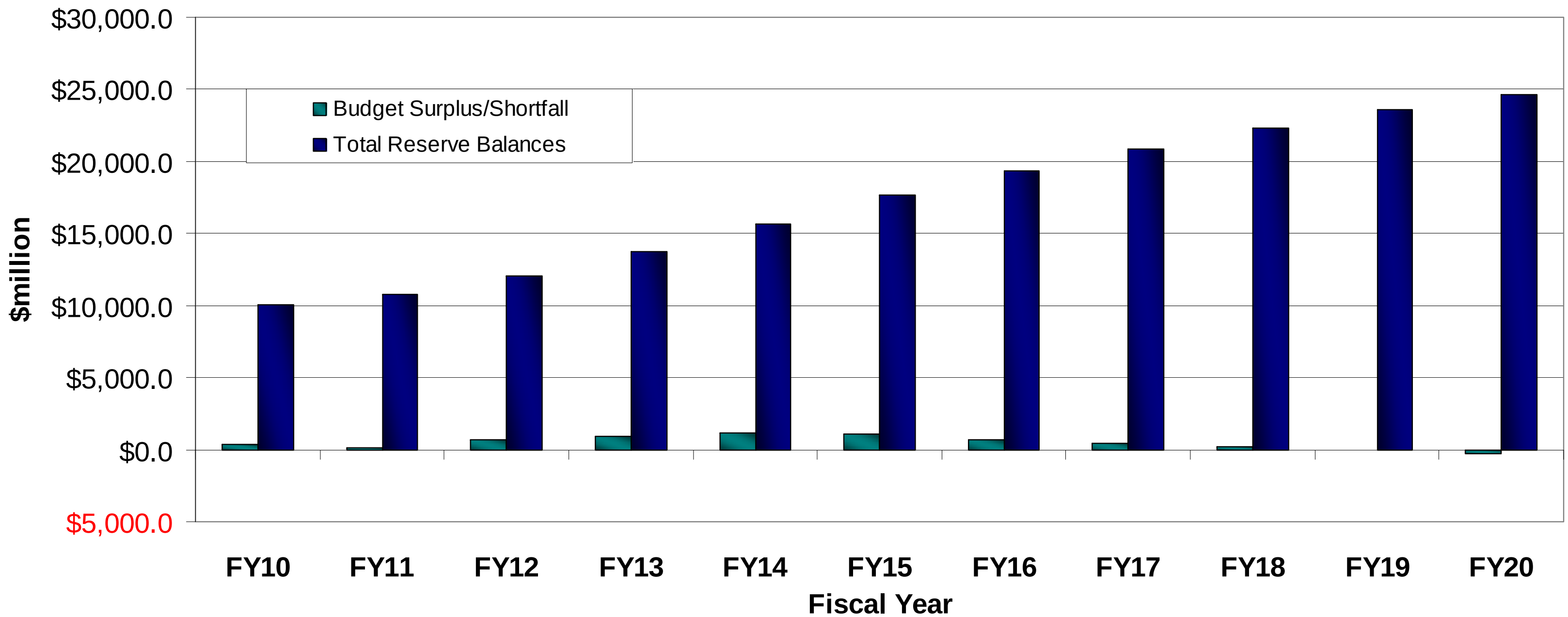
FY2010 surplus/shortfall calculation adds $22.1 reappropriations and carry over to total available revenue.
FY2011 surplus calculation subtracts $400 million from surplus for Governor's Performance Scholarship Fund and $13.1 deposit to Public Education Fund for FY2012.
CBR balance assumes that all available surplus is deposited to CBR main fund.

Appropriations projections in the plan do not represent a commitment by the Administration to propose spending at a particular level in FY2011 or any future year.

The 10 year forecast shows that unanticipated budget shortfalls during the 10-year period could be filled primarily through the use of reserve funds; however, other fiscal tools including spending reductions would likely be used in addition to, or in lieu of, reserve funds.

The plan will be revisited as conditions warrant.

Budget Surplus/Shortfall and Total Reserve Balance Through FY2020



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