OFFICE OF GOVERNOR MIKE DUNLEAVY

FY2022 Budget Overview and 10-Year Plan

Office of Management and Budget

December 11, 2020

Statutory Requirement

AS 37.07.020(b) requires that the Governor submit a 10-year fiscal plan that balances sources and uses of funds while providing for essential state services and protecting the economic stability of the state.

Fiscal Year 2022 Budget Package

The Dunleavy Administration is proposing a budget for fiscal year 2022 that stabilizes and strengthens Alaska's economy in the aftermath of an unprecedented and devastating global pandemic that has affected every aspect of the way Alaskans live, work, and play. Protecting Alaskans' health and safety has been a top priority amidst this turmoil. Looking ahead, it is imperative that Alaskans get back to work and normalcy. A key element of this proposal is an infrastructure package that will make critical investments in transportation corridors and public infrastructure and lay the foundation for future economic growth while creating much-needed jobs. These shovel-ready projects will be financed by a state general obligation bond which must be approved by a vote of the people – ensuring the public is an equal shareholder and beneficiary in the state's economic recovery.

The pandemic and resulting economic fallout significantly worsened Alaska's fiscal position. Oil revenue declined precipitously as the price of Alaska North Slope crude tumbled and other tax revenue generated from local and visitor spending failed to materialize during what was projected to be the busiest tourism summer on record. Revenue for the current fiscal year is more than $700 million less than what was anticipated this time last year, and projected revenue for the upcoming budget year is not projected to fully recover from the slump. While Alaska's fiscal challenges are significant, the economic hardship faced by everyday Alaskans is even more severe. In the coming fiscal year, state revenues will not sufficiently fund statutory expenditure obligations; requiring a draw from available reserves to balance the budget. Now is not the time pull money from Alaskans' pocketbooks to fund government while adequate reserves still exist.

At the onset of the pandemic, the President and Congress worked to pass a series of COVID-19 relief bills that directed more than $5.8 billion in federal stimulus to Alaska. These funds helped buoy Alaskans through the early months of the pandemic, but with winter here and months before a vaccine is widely available, struggling Alaskans need further assistance. The unprecedented nature of this pandemic and subsequent recession necessitate an unprecedented response, which is why this budget contains a fast-track supplemental payment of the remainder of the 2020 permanent fund dividend: an additional $1,900 for every qualifying Alaskan. Not only will this payment satisfy the statutory requirement for a formula-based permanent fund dividend, it provides a much needed shot in the arm to Alaska families and businesses. Alaskans need this money now, more than ever, and with speedy action by the administration and the legislature, Alaskans could receive a supplemental dividend check as early as March, 2021.

This budget puts Alaska on track to stabilize, rebuild and thrive in fiscal year 2022 and the years thereafter.

Alaska's Fiscal Challenge

After the completion of the trans-Alaska pipeline system (TAPS) in 1977, oil production became so singularly valuable in Alaska that the bulk of state government revenue was captured through royalty payments and taxes levied on the oil industry. This was no accident – at the time of statehood, Alaska's small, remote population and limited commercial economy meant that the state would struggle for generations to pay for things like schools and roads by taxing residents. When the U.S. government handed Alaska the keys to self-governance, the new state was granted over 100 million acres of land – nearly the acreage of California – as well as permanent subsurface rights to minerals below that land.

Alaska's economy is foundationally dependent on natural resources and has always been susceptible to the boom-and-bust economic cycles associated with commodities markets. The Statutory Budget Reserve (SBR) and the Constitutional Budget Reserve (CBR) were established as savings accounts to help the state weather these inevitable revenue downturns. Over three decades, the SBR and CBR have bridged the gap between available revenue and government expenditures and have served as an important buffer against commodity price volatility. Sustained significant deficit spending over the past seven years has all but evaporated these accounts, and by the end of the next fiscal year, the CBR is projected to have a balance barely large enough to cover the state's cash-flow needs during the year – essentially providing sufficient cash to bridge short-term timing gaps for revenue and expenditures to and from the state treasury.

This fundamental instability in Alaska's fiscal system requires bold solutions. Stability has long been the watchword of industry and economic development experts who say the biggest obstacle to further development and growth in Alaska is government unpredictability. The suite of constitutional amendments proposed in this budget package guarantee a solid fiscal foundation that is not subject to the whims of politics and special interests. The permanent fund – in its entirety – will be protected for all future generations of Alaskans, and a predictable source of revenue generated by the fund will be available to pay for both essential government services and a permanent fund dividend. A fair split of the earnings of Alaskans' communal wealth between the people and the government that serves them will put an end to the perennial fight about the dividend and secure a balance into the future. The power of government rests with the people, and like any element of the state's great constitution, these policies can be changed by a vote of the people if the time is right.

Right-Sizing State Government

The fiscal year 2022 budget represents the Dunleavy administration's third consecutive year of shrinking state government. Unrestricted general fund spending on the operating budget will be reduced by $389.0 million since fiscal year 2019, more than eight percent, when this budget proposal is enacted. These reductions have been hard-won, particularly given that the state's most aggressive cost drivers are based on statutory formulas that dictate spending. Increasingly, budget reductions must be based on policy decisions and statutory changes broader than the budget process itself.

In recent budget cycles, multi-billion dollar gaps have been closed by using a combination of savings draws and permanent fund dividend reductions. Government cuts, while significant, have not been sufficient to balance the budget. The ten-year fiscal plan outlined here clearly shows that budget reductions alone cannot eliminate the fiscal gap. While the Dunleavy administration vigilantly continues to seek savings and identify and eliminate government waste, operating budget reductions cannot be policy makers' only fiscal tool without significant reforms to the way services are delivered to Alaskans.

The proposed fiscal year 2022 unrestricted general fund operating budget totals $4.29 billion.

Capital Budget

The capital budget has also been used as a tool to reduce overall spending, but the recent sustained period of anemic capital spending has led to the degradation of Alaska's infrastructure and the shedding of construction jobs. This budget proposes a two-pronged approach to capital investment: the first is the traditional capital budget, which includes critical capital projects that were left behind in the haste of the 2020 legislative session and annual federal highway and aviation match, as well as a general obligation bond package that will feature up to $350 million in investment in capital development.

A key funding element for the traditional capital budget will come from the proceeds of bond sales by the Alaska Housing Finance Corporation (AHFC). As a public corporation separate from the state of Alaska, AHFC has the ability to issue bonds to finance capital projects. The corporation will finance the debt using a portion of the annual return paid to the state. The bonds will cover $101 million in annually-recurring state general funds that generates just under $1 billion of federal match for surface and air transportation and the village safe water program.

The GO bond-financed infrastructure proposal will focus on critical investment in three main areas: bolstering transportation safety, deferred maintenance on public facilities, and access to resources.

Revenue Outlook

The Alaska Department of Revenue, in conjunction with the Department of Natural Resources, produces a forecast of all state revenue sources twice each year. The Fall Forecast is used for the development of the budget for the coming year. This year's revenue forecast comes during a continued period of uncertainty regarding COVID-19, and it is important to note that certainty is particularly impossible when making predictions on the stock market, oil prices, or future tourism activity.

Total unrestricted revenue is forecast to be $4.33 billion in the current fiscal year and $4.27 billion in fiscal year 2022. Petroleum revenue is projected to amount to $808.9 million in fiscal year 2022, based on a price forecast of $48 per barrel and a production forecast of 447,000 barrels per day.

Another important source for discretionary state spending is the structured savings draw from the permanent fund earnings reserve account, frequently referred to as a percent of market value (POMV) draw. Senate Bill 26, passed in 2018, allowed the draw of up to five percent of average value of the previous five years of the permanent fund.

The statutory draw limit outlined by SB26 attempts to protect the permanent fund, but without a constitutional draw limit, the earnings reserve portion of the fund remains available for appropriation. The resolution proposed as part of this budget proposal will collapse the earnings reserve into the protected principal and constitutionally limit appropriations from the fund to no greater than five percent of the average value of the previous five years. This final step in moving to a modern endowment-style of fund use assures stability for generations to come.

Budget Outlook

The $4.31 billion unrestricted general fund operating and capital budgets proposed for fiscal year 2022 represent a seven percent reduction from the current year. Because of the use of one-time fund sources, like the bonding option for capital projects, it is unreasonable to assume such sizable reductions are possible every year – especially when faced with mounting upward budget pressures like negotiated salary cost-of-living adjustments and health care cost inflation.

The ten-year fiscal plan assumes the agency operating budget is reduced $450m over the next three fiscal years and limited to 1.5 percent inflation after fiscal year 2024. These reductions and low growth target will be the fruit of long-term policy initiatives to control cost drivers and restructure spending formulas.

The first element of formula spending reform is to modernize the permanent fund dividend statutory calculation. The current calculation, conceived in the early 1980s, is based on out-of-date accounting and fund management principles. It is also subject to considerable volatility – statutory dividend checks can jump from $900 one year to $1,900 the next. This volatility is tough for families, who rely on these annual payments to fill their fuel tanks and buy new clothes for the school year.

This budget proposal includes a statutory change to the permanent fund dividend calculation from the current formula of 50 percent of the five-year average statutory net income to 50 percent of the POMV draw, which is based on the five-year average of the permanent fund as a whole. In the short term, this change will reduce the PFD check for Alaskans compared to the current year's statutory calculation, however, it will pay consistently higher dividends than the existing statute has provided over the last 30 years and will be an increase from recent ad hoc dividends. This 50-50 split will provide stability and longevity for the dividend program, especially when accompanied by a constitutional amendment that limits draws from the permanent fund and guarantees a formula-based dividend that requires a vote of the people to modify. This change is essential to protect both the dividend and the permanent fund itself.

A second key element of this budget package that assures long-term budget sustainability is a revision to the constitutional spending limit. Alaska voters already approved a constitutional spending limit in 1982, but the formula governing the limit turned out to be too generous – today's budget could nearly double and still be within to the current cap. The Dunleavy administration is proposing a revision to the spending limit formula that will limit qualifying appropriations to no more than average of the prior three years adjusted for the greater of population or inflation growth.

Ten Year Fiscal Outlook & Discussion

Alaska’s fiscal outlook is promising conditioned on the implementation of policy initiatives outlined in this budget proposal. Reliance on savings draws to balance the budget will be minimized and eliminated within three years based on current projections. Over the next two years Alaska’s economy will rebound from the pandemic-induced recession and as soon as fiscal year 2023 may be healthy enough to bear additional revenue measures.

Fiscal Year 2022 Ten Year Outlook										
(Amounts in millions)										
Unrestricted Revenues	**FY2022**	**FY2023**	**FY2024**	**FY2025**	**FY2026**	**FY2027**	**FY2028**	**FY2029**	**FY2030**	**FY2031**
Traditional UGF Revenue	1,202.6	1,432.5	1,572.7	1,634.7	1,650.1	1,661.7	1,707.3	1,778.6	1,812.0	1,887.9
Permanent Fund POMV GF Draw	3,069.3	1,596.9	1,620.5	1,624.3	1,627.0	1,641.3	1,662.8	1,695.3	1,729.9	1,766.4
Other Revenue Sources		1,233.2	967.0	951.4	990.6	1,026.6	1,023.8	980.2	969.4	910.9
Total Revenue	**4,271.9**	**4,262.6**	**4,160.2**	**4,210.4**	**4,267.7**	**4,329.5**	**4,393.9**	**4,454.1**	**4,511.3**	**4,565.2**
Unrestricted General Fund Expenditures	**FY2022**	**FY2023**	**FY2024**	**FY2025**	**FY2026**	**FY2027**	**FY2028**	**FY2029**	**FY2030**	**FY2031**
Agency Operations	3,813.2	3,712.7	3,612.7	3,666.9	3,721.9	3,777.7	3,834.4	3,891.9	3,950.3	4,009.5
Statewide Items	483.1	466.3	462.1	456.1	456.4	460.4	466.2	466.7	463.5	456.1
Operating Budget	**4,296.3**	**4,179.0**	**4,074.8**	**4,123.0**	**4,178.3**	**4,238.2**	**4,300.5**	**4,358.7**	**4,413.8**	**4,465.6**
Capital Budget	**58.5**	**126.9**	**128.8**	**130.7**	**132.7**	**134.7**	**136.7**	**138.7**	**140.8**	**142.9**
Proposed Legislation	**(43.3)**	**(43.3)**	**(43.3)**	**(43.3)**	**(43.3)**	**(43.3)**	**(43.3)**	**(43.3)**	**(43.3)**	**(43.3)**
Total General Fund Appropriations	**4,311.4**	**4,262.6**	**4,160.2**	**4,210.4**	**4,267.7**	**4,329.5**	**4,393.9**	**4,454.1**	**4,511.3**	**4,565.2**
Budget change from previous year	(294.6)	(48.8)	(102.3)	50.2	57.3	61.8	64.4	60.2	57.2	53.9
Surplus/(Deficit)	**(39.5)**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Savings draw from Constitutional Budget Reserve	**39.5**									
Permanent Fund Dividend Transfer	**FY2022**	**FY2023**	**FY2024**	**FY2025**	**FY2026**	**FY2027**	**FY2028**	**FY2029**	**FY2030**	**FY2031**
PFD Fund Sources										
Permanent Fund POMV for PFD (50%)		1,596.9	1,620.5	1,624.3	1,627.0	1,641.3	1,662.8	1,695.3	1,729.9	1,766.4
Permanent Fund Earnings Reserves	2,023.9									
PFD Appropriation	**2,023.9**	**1,596.7**	**1,620.0**	**1,623.4**	**1,625.5**	**1,638.7**	**1,659.3**	**1,690.7**	**1,724.1**	**1,759.6**
Per capita PFD	$3,057	$2,378	$2,410	$2,402	$2,392	$2,399	$2,417	$2,451	$2,487	$2,526