OFFICE OF GOVERNOR MIKE DUNLEAVY

FY2023 Budget Overview and 10-Year Plan

Office of Management and Budget

December 15, 2021

Statutory Requirement

AS 37.07.020(b) requires the Governor to publish a 10-year fiscal outlook that balances sources and uses of funds while providing for essential State services and protecting the economic stability of the state. The 10-year plan reflects the Governor's vision of Alaska's fiscal future given the information available today. This plan incorporates official financial forecasts for revenue and expenditures where possible and makes informed assumptions where published data are not otherwise available.

Fiscal Year 2023 Budget Package

Governor Dunleavy is proposing a budget for fiscal year 2023 that reinvests in Alaskans and paves the way for a prosperous economic rebound. This budget puts Alaskans first by providing for a fair Permanent Fund Dividend that ensures the people benefit from the state's natural resource wealth. It also continues the Governor's commitment to invest in the priorities important to Alaskans, like public safety, education, and jobs. This budget demonstrates the Governor's vision for fiscal reform through efficiencies and modernizations that ensure Alaskans receive the services they want with a smaller government footprint.

Alaska's fiscal position has recovered from the economic fallout of the pandemic and related recession. Oil revenue has rebounded after a precipitous decline, and other revenue generated from local and visitor spending is beginning to return to pre-pandemic levels. Revenue for the current fiscal year is nearly $1.5 billion more than what was anticipated this time last year, and revenue for the upcoming budget year is projected to be even higher. With the stabilization of oil markets and the resumption of normal economic activity, including tourism, the economic hardship faced by everyday Alaskans is in the rearview. In fiscal year 2023, State revenues will sufficiently fund statutory expenditure obligations and no draw from savings reserves are required to balance the budget.

This budget puts Alaska on track to rebuild and thrive in fiscal year 2023 and the years thereafter.

Investing in Public Safety

The Governor has been steadfast in his commitment to a safer Alaska. This budget continues to prioritize public safety through investments that support law enforcement, accelerate the State's lagging trial process, and recognize that urban and rural Alaskans alike have a right to live in safe communities. The Governor's budget includes public safety investments such as:

- ✓ $7.3 million for Governor Dunleavy's People First Initiative, a holistic multi-agency approach to combating domestic violence, sexual assault, human trafficking, homelessness, and Missing and Murdered Indigenous Persons
- ✓ $5.1 million to support the Village Public Safety Officer program which includes funding for 10 new VPSO positions, a 5% raise for VPSOs, new equipment and a tribal liaison position to ensure maximum collaboration between State Troopers and VPSOs

- ✓ 15 new Troopers plus associated administrative support positions to ensure law enforcement officer time is spent on public safety rather than paperwork
- ✓ More than $25 million in the operating budget and $35 million in the capital budget in support of other public safety programs, including:
    - Body worn camera initiative for commissioned law enforcement to improve officer safety and communication and aid in evidence collection and court proceedings

    Rural fire training and education program that sends fire training specialists across the State to provide hands-on life-saving training as well as hiring a new Bethel-based Deputy Fire Marshall

Protect Alaska's Independence

Self-governance, self-reliance, and independence are core Alaskan values, and this budget defends those values even as federal overreach threatens access to our lands, waters, and resources. Alaska has a proud history of sustainably developing its natural resources for the benefit of all its people through economic opportunity, jobs, and even the permanent fund dividend. In order to protect and promote state self-determination, priority budget items include:

- ✓ $5.7 million for assumption of State primacy over resource development permitting currently controlled by the federal EPA
- ✓ $4 million for legal services related to defense of Alaska's rights established at statehood to develop and protect the state's natural resources, manage its fish and wildlife resources, and protect state sovereignty
- ✓ Support for the Alaska State Defense Force to increase community emergency capacity and resiliency
- ✓ Expansion of Alaska's statewide timber resource capacity through support for timely and accessible timber sales on State lands
- ✓ More than $8 million for scientific research on critical fish and wildlife species to protect the State's ability to manage its own natural resources

In recognition that food security is critical for self-sufficiency, this budget also includes funding for agriculture and mariculture development, including $5.0 million for mariculture infrastructure in Southeast Alaska, a $25 million mariculture grant program, and the reinstatement of State support for the Future Farmers of America program.

Restoring Trust in the Permanent Fund Dividend

Governor Dunleavy's Constitutional plan for the PFD guarantees a fair and permanent split between Alaskans and government. The Governor's 50-50 plan ensures that the first call on the annual Permanent Fund draw is the payment of a fair and reliable dividend to the people of Alaska and provides for a growing dividend that won't be subject to the political influence.

This budget includes a full 50-50 PFD for the 2022 dividend payment, estimated to be $2,564 for each eligible Alaskan, as well as a supplemental dividend payment to true-up this year's short-funded PFD. When the legislature passes the fast-track supplemental PFD, Alaskans can expect to receive a completion to their 2021 dividend of more than $1,200 each as soon as March.

Protecting State Savings

After the completion of the Trans-Alaska Pipeline System (TAPS) in 1977, oil production became the primary source of State revenue 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 ownership of subsurface rights to minerals below that land. This wealth enabled the creation of the Alaska Permanent Fund, enshrined in the Constitution by Alaska voters in 1976, which preserved a portion of the state’s finite resource wealth to the benefit of future generations.

The suite of constitutional amendments proposed by the Governor further protects the Permanent Fund by extending constitutional protections to the fund’s income, which can currently be spent by a simple majority vote of the legislature. Once the Governor’s resolution is passed by the Legislature and approved by the voters, the Permanent Fund – in its entirety – will be protected for all future generations of Alaskans. A fair split of the earnings of Alaskans’ communal wealth will put an end to the perennial political dispute over the dividend and secure a balance into the future.

In addition to protecting the Permanent Fund, this budget bolsters the State’s rainy day budget reserve account. 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 ten years has all but evaporated these accounts, but because of the hard work done by this Administration to reduce spending and reinforce these critical accounts, by the end of the next fiscal year the CBR is projected to have a balance healthy enough to bridge short-term revenue shortfalls for the foreseeable future.

Revenue Outlook

The Alaska Department of Revenue, in conjunction with the Department of Natural Resources, produces official forecasts of all State revenue sources. The Fall Forecast is used for the development of the budget for the coming year. It is important to note that a level of uncertainty is inherent when making predictions on the stock market, oil prices, or future tourism activity.

Total unrestricted revenue from traditional sources is forecast to be $2.66 billion in the current fiscal year and $2.58 billion in fiscal year 2023. Petroleum revenue is projected to amount to $2.08 billion in fiscal year 2023, based on a price forecast of $71 per barrel and a production forecast of 500,200 barrels per day.

An important source of State revenue is the structured 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, created the statutory framework to draw of up to five percent of the average value of the previous five years of the Permanent Fund. The statutory Permanent Fund draw for fiscal year 2023 is $3.36 billion.

The Department of Revenue anticipates total unrestricted general fund revenue will be $5.73 billion for the current fiscal year and $5.94 billion in fiscal year 2023. The department's long-term revenue forecast assumes stable oil prices in the mid- to high-$60s per barrel and 6.2 percent annual Permanent Fund returns.

The OMB 10-year plan supplements the Department of Revenue official forecast by including federal COVID-19 relief funds designed to replace unrestricted general fund revenue. The 10-year plan includes $250 million and $375.4 million in unrestricted federal revenue replacement for fiscal years 2022 and 2023, respectively.

Operating Budget Outlook

The fiscal year 2023 budget represents the Dunleavy administration's fourth year of shrinking the footprint of state government. Unrestricted general fund spending on the operating budget will be reduced by $326.4 million since fiscal year 2019, or seven 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.

The operating budget authorizes State agencies across all branches of government to make expenditures to support day-to-day functions for a fiscal year, which runs from July 1st through June 30th. The operating budget is frequently reported in two major categories: agency operations, which includes the cost of operating each executive branch department, the University of Alaska, the Legislature, and the Judiciary; and statewide operations, which includes the budget for non-department specific expenditures like retirement system payments, State debt obligations and transfers between State funds.

This discussion and associated 10-year budget projection focus on the expenditure of unrestricted general fund revenues or appropriations from undesignated reserves. While this represents just under half of the entire State budget, the unrestricted general fund portion of the budget is thought to be the most discretionary, and more importantly, is the portion of the budget subject to the fiscal instabilities discussed earlier. A budget surplus or deficit, one of the most important indicators of fiscal health, is measured by a comparison of unrestricted general fund revenue against unrestricted general fund expenditures. Expenditures of other revenue types (e.g., federal grants, licensing fees, constitutionally dedicated fund sources, etc.) are generally level to revenue.

Agency Operations

There are several ways to analyze in detail the budget for agency operations, including by Department, by expenditure line item, or revenue detail, but for the purposes of the 10-year plan fiscal projections a broader analysis of major cost drivers is more appropriate.

Agency budgets for all 16 executive branch Departments, the University of Alaska, the Legislature, and the Judiciary can be categorized into formula and non-formula spending. Formula spending is typically less discretionary due to state or federal statute and is driven by public demand via enrollment or population. While non-formula spending is not determined by a statutory calculation or formula based on participation, it is often no more discretionary and may still be linked to statutory or even constitutional requirements.

Non-Formula Cost Assumptions

An example of a non-formula program is the commercial fisheries management program within the Department of Fish and Game. Expenditures for the program are not driven by a statutory formula, measure of catch volume, or participation in fisheries; rather, it is driven by a constitutional and statutory obligation to manage natural resources for the maximum sustained benefit of all Alaskans.

One method for projecting future expenditure changes in non-formula State spending is to use a projection of a common inflation metric, like the Consumer Price Index (CPI), which is a measure of the cost of goods purchased by the normal consumer published by the federal Bureau of Labor Statistics. An analysis of historical trends, however, does not indicate a strong correlation between CPI and State government spending and find that expenditure trends are more closely aligned with the availability of revenues and the policies of incumbent administrations. Given the Governor's commitment to fiscal prudence, and projections indicating adequate but constrained future revenues, OMB uses a 1.5 percent inflation rate for non-formula programs.

Formula Cost Assumptions

Formula programs make up more than half of the agency operating budget. There are two formula programs that dwarf other budget line items: the payment of State aid for K-12 education and the Medicaid program. These two programs alone make up just less than half of the budget for agency operations, and efforts to contain per-capita cost growth require significant stakeholder engagement and statutory reform.

K-12 Foundation Formula

State assistance to K-12 education is based on a statutory formula that takes into consideration student counts, geographic cost differentials, student demographics, and the method of education delivery. In fiscal year 2023, student demographics are projected to continue to shift from in-classroom education to correspondence. The rise in home-based learning, combined with a small decrease in overall student count, resulted in a 1.7 percent reduction in the State assistance payment for fiscal year 2023. The Alaska Department of Labor and Workforce Development projects a mostly flat student-age population over the next decade, which indicates a flat student count, however, to accommodate a potential return to in-classroom learning and other demographic changes, a 1.5 percent annual adjustment to K-12 State assistance payments through the 10-year period has been applied.

Medicaid

Medicaid is the State's medical assistance program that pays for health care services for low income and disabled Alaskans based on both state and federal statutory eligibility, coverage, and payment structures. It is a shared cost between the state and federal governments that varies by enrollment, covered services, and federal policy changes outside the State's control. These factors make projecting the State's share of the Medicaid budget challenging, and OMB works with staff at the Department of Health and Social Services to monitor and project spending and utilization for the State's Medicaid program. The 10-year plan uses a 1.0 percent inflation factor for the State's share of the Medicaid program based on the assumption that cost controls and health care payment reforms will keep Medicaid cost growth roughly in line with projected population growth over the period while allowing for modest provider rate increases.

Non-Agency Spending

Often referred to as 'statewide items', non-agency spending reflects expenditures like debt or payments for public employee retirement funds that aren't direct services to the Alaskan but are still obligations of the State. Projected expenditures in these items commonly come from publicly verifiable expert sources.

Debt

The State debt projection includes the Department of Revenue's payment schedules based on current outstanding debt. OMB has also included an adjustment for additional debt service for the proposed issuance of general obligation bonds that starts in fiscal year 2024. The Department of Education and Early Development publishes the statutory payment schedule for state assistance for municipal debt for school construction, which is assumed to be paid at the 50 percent level in fiscal years 2024 and beyond. Overall debt payments are projected to taper as historical debt service obligations are fully paid, even with debt service on the proposed $310 million general obligation bond package.

Retirement

Projected payments to the retirement system made by the State on behalf of other public employers to finance the retirement system's unfunded liability are produced by an actuarial firm hired by the Alaska Retirement Management (ARM) Board. The retirement projections in the 10-year plan assume that the ARM Board will continue the practice of recommending full funding for the retirement system without overfunding components of the trust, which risks increasing liabilities in the long term. The ARM Board's October recommendation to avoid overfunding the system resulting in more than $179 million savings for fiscal year 2023 and beyond.

Fund Capitalizations & Transfers

The largest item in the fund capitalization category is the statutory payment for oil and gas tax credits owed by the State, which are projected to be fully paid off in fiscal year 2026. An $18 million annual deposit to the rural school construction fund and a $5 million annual deposit to the Disaster Relief Fund are also included in fiscal years 2024 and beyond. Unrestricted general fund transfers are anticipated to be minimal in the out years.

Capital Investments

This budget proposes a two-pronged approach to capital investment: the first is the traditional capital budget, which includes $248 million in unrestricted general fund dollars and $1.4 billion in federal dollars, as well as a general obligation bond package for $310 million which must be approved by a vote of the people – ensuring the public is an equal shareholder and beneficiary in the state's economic future.

The GO bond-financed infrastructure proposal will bolster Alaska's intermodal transportation system and invest in community resiliency and development while keeping Alaska's construction workforce in-state.

Analysis of the recently passed federal Infrastructure Investment and Jobs Act (PL117-58) is underway, but initial estimates suggest that Alaska will receive nearly $5 billion in federal investment over the next five years. The bill provides funding for roads, bridges, ferries, ports, water and wastewater infrastructure, power and energy projects, environmental remediation, public lands, and broadband. The federal infrastructure funds coming directly to the State will require legislative appropriation and the administration expects those discussions to be initiated during the 2022 legislative session as additional federal guidance is made available. The infrastructure bill increased overall funding levels for several existing federal programs that will require increased State match, so the 10-year plan includes a $200 million unrestricted general fund capital appropriation each year through fiscal year 2027, after which it returns to the baseline capital assumption.

Ten Year Fiscal Outlook & Discussion

Fiscal Year 2023 Ten Year Outlook

(Amounts in millions)

Permanent Fund Dividend	**FY2022**	**FY2023**	**FY2024**	**FY2025**	**FY2026**	**FY2027**	**FY2028**	**FY2029**	**FY2030**	**FY2031**	**FY2032**
50-50 Permanent Fund Dividend Transfer	1,534.7	1,680.3	1,800.0	1,904.0	2,009.5	2,128.5	2,172.5	2,214.5	2,254.0	2,291.5	2,328.5
Per capita PFD *(dollars)*	$2,330	$2,564	$2,712	$2,855	$3,000	$3,164	$3,212	$3,258	$3,300	$3,338	$3,375
Unrestricted General Fund Expenditures	**FY2022**	**FY2023**	**FY2024**	**FY2025**	**FY2026**	**FY2027**	**FY2028**	**FY2029**	**FY2030**	**FY2031**	**FY2032**
Agency Operations	3,927.9	3,933.6	3,932.1	3,987.8	4,043.3	4,100.6	4,157.8	4,217.7	4,277.6	4,339.3	4,401.8
Agency Formula	2,042.6	2,078.4	2,078.1	2,106.0	2,133.3	2,161.9	2,190.0	2,219.5	2,248.4	2,278.6	2,309.3
K-12 Formula	1,233.7	1,215.1	1,215.1	1,233.3	1,251.8	1,270.6	1,289.7	1,309.0	1,328.6	1,348.6	1,368.8
Medicaid	610.6	656.0	656.0	662.6	669.2	675.9	682.6	689.5	696.4	703.3	710.4
Other Formula	198.3	207.2	207.0	210.1	212.3	215.5	217.7	221.0	223.4	226.7	230.2
Agency Non-Formula	1,885.2	1,855.3	1,854.0	1,881.8	1,910.0	1,938.7	1,967.8	1,998.3	2,029.2	2,060.6	2,092.5
Statewide Items	462.6	517.8	453.2	412.2	242.0	217.9	222.5	221.9	224.5	217.9	222.4
Debt	96.7	156.2	133.1	123.2	118.0	116.4	114.6	107.6	103.4	90.5	88.7
Retirement	246.2	129.6	111.6	93.5	72.5	79.0	85.4	91.8	98.6	104.9	111.2
Fund Capitalizations & Transfers	119.7	232.0	208.5	195.5	51.5	22.5	22.5	22.5	22.5	22.5	22.5
Operating Budget	**4,390.5**	**4,451.4**	**4,385.3**	**4,400.0**	**4,285.3**	**4,318.6**	**4,380.2**	**4,439.6**	**4,502.1**	**4,557.2**	**4,624.2**
Capital Budget	**335.9**	**154.7**	**154.7**	**154.7**	**154.7**	**154.7**	**154.7**	**154.7**	**154.7**	**154.7**	**154.7**
Total General Fund Appropriations	**4,726.4**	**4,606.1**	**4,540.0**	**4,554.7**	**4,440.1**	**4,473.3**	**4,535.0**	**4,594.3**	**4,656.8**	**4,711.9**	**4,779.0**
Unrestricted Revenues	**FY2022**	**FY2023**	**FY2024**	**FY2025**	**FY2026**	**FY2027**	**FY2028**	**FY2029**	**FY2030**	**FY2031**	**FY2032**
Traditional UGF Revenue	2,662.5	2,577.2	2,464.5	2,429.9	2,340.0	2,314.2	2,340.8	2,297.1	2,402.8	2,549.7	2,549.7
POMV Draw for Government	1,534.7	1,680.3	1,800.0	1,904.0	2,009.5	2,128.5	2,172.5	2,214.5	2,254.0	2,291.5	2,328.5
Revenue Adjustments	672.7	375.4									
Total Revenue	**4,869.7**	**4,632.9**	**4,264.5**	**4,333.9**	**4,349.5**	**4,442.7**	**4,513.3**	**4,511.6**	**4,656.8**	**4,841.2**	**4,878.2**
Pre-Draw Surplus/(Deficit)	143.3	26.7	(275.5)	(220.8)	(90.6)	(30.6)	(21.7)	(82.7)	0.0	129.3	99.2
Savings Draw			275.5	220.8	90.6	30.6	21.7	82.7			
Final Surplus/(Deficit)	**143.3**	**26.7**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**129.3**	**99.2**
Reserve Balances	**FY2022**	**FY2023**	**FY2024**	**FY2025**	**FY2026**	**FY2027**	**FY2028**	**FY2029**	**FY2030**	**FY2031**	**FY2032**
Constitutional Budget Reserve											
CBR/SBR Beginning Balance	1,175.7	1,350.6	1,438.4	1,215.4	1,042.7	995.3	1,005.7	1,024.3	982.3	1,022.2	1,192.4
Earnings & Deposits	31.6	61.1	52.5	48.1	43.2	41.1	40.2	40.7	39.9	40.9	44.8
Surplus/(Draws)	143.3	26.7	(275.5)	(220.8)	(90.6)	(30.6)	(21.7)	(82.7)	0.0	129.3	99.2
CBR End Balance	**1,350.6**	**1,438.4**	**1,215.4**	**1,042.7**	**995.3**	**1,005.7**	**1,024.3**	**982.3**	**1,022.2**	**1,192.4**	**1,336.4**