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Alaska's FY 2011 Budget**

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**Abstract**

This report treats factors explaining Alaska's FY 2011 budget process and outcomes. It discusses the Alaska economy in 2009 and 2010 and some major issues affecting Alaska's political system during this period (e.g., the natural gas pipeline and outer continental shelf (OCS) drilling). It introduces the governor's budget requests, legislative responses, and the final operating, supplemental and capital budgets.

**Keywords:** Alaska state budget, state fiscal policy, state taxes, state legislatures, oil revenues, Sarah Palin

# What Recession? Alaska's FY 2011 Budget

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## Introduction

This report treats factors explaining Alaska's FY 2011 budget process and outcomes. It discusses the Alaska economy in 2009 and 2010 and some major issues affecting Alaska's political system during this period (e.g., the natural gas pipeline and outer continental shelf (OCS) drilling). It introduces the governor's budget requests, legislative responses, and the final operating, supplemental, and capital budgets.

Overall the report is quite positive, as Alaska has experienced few of the recession problems of the other states. In FY 2010, the state had \$13 billion in the bank, excluding the Permanent Fund (PF), making it the "envy of most other states" (*Fairbanks Daily News-Miner [FDNM]*, January 20, 2010). In fact, the state ended the previous fiscal year (FY 2009) with a \$2.2 billion surplus and expected to end fiscal year 2010 with at least \$500 million in general fund reserves.

The state's FY 2011 operating budget is about 5.6 percent larger than that of FY 2010 (if FY10 supplementals are included, the figure drops to two percent). The supplemental budget included a payback to the CBR and forward funding of K-12 education. The capital budget of \$2.7 billion (including \$600 million in FY10 supplemental funds) was larger than any in the last two decades, but on an inflation-adjusted basis, smaller than those of the oil rich early 1980s.

Some leaders asked how the state could continue to afford large budgets when oil production was steadily declining and prospects for gas production/sales were uncertain. Yet high oil prices and cash reserves made most leaders reluctant to call for greater fiscal discipline when Alaska's fiscal boat appeared stable.

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## **The Alaska Economy in 2009 and 2010**

The primary pivot to the Alaska economy is oil/gas development and production. Taxes on oil and gas (royalties, severance taxes, and oil industry business and corporate income taxes) produce 89 percent of the general purpose, unrestricted revenue of the state. The petroleum industry supports directly and indirectly nearly one-third of the jobs in Alaska. As we note below, other industries play quite important roles by providing jobs and investment; they include fisheries, mining, logging, and tourism, in addition to retail/wholesale jobs. Governments, including federal military and civilian employment, state government and the university, and local government (including K-12 teachers) generate another third of Alaska jobs. However, collectively these sectors bring little wealth to the state treasury, and for this reason we focus first upon oil prices and production.

### **Oil Prices**

Unlike the radical price swings of FY 2009, when oil prices fell from \$147/barrel to \$43/barrel in less than one year, oil prices were less volatile in FY 2010. In mid-March 2010, the price of oil per barrel was slightly above \$70. In the fall revenue forecast, the state Department of Revenue estimated that the average price of oil throughout the year would be \$67/barrel (producing \$5 billion in revenue for the state) and increase slightly into the next fiscal year (*Anchorage Daily News [ADN]*, December 11, 2009; and Alaska Department of Revenue, Fall 2009 Revenue Sources Book). The spring revenue forecast placed oil wellhead prices at \$73.75 for FY 2011 (Department of Revenue, Spring 2010 Forecast).

### **Oil Production Prospects and Problems**

The Alaska Legislature raised taxation rates on the oil industry in 2006, and revised tax rates upward the following year. The tax take climbed as oil prices increased, and this explains the flood of tax dollars into state coffers since 2006. Although the state also increased tax credits for oil and gas exploration activity, the oil companies complained that high taxation rates made the cost of new exploration uncomfortably high. In the author's judgment, they have started an "investment strike" through a statewide media campaign displaying closure of oil industry-dependent businesses and slowed exploration activity.

Oil production in Alaska reached its peak in 1988, at two million barrels/day; by FY 2010 production had dropped to 662,000 barrels/day. The revenue department's forecast for FY 2011 is a 5.4 percent decline, to 630,000 barrels/day (Department of Revenue, December 10, 2009, April 9, 2010). Two-thirds of oil production comes from the Prudhoe Bay and Kuparuk fields, the largest (and oldest) on the North

Slope. Newer fields have covered part of the gap, but in this reporting period, the majors (ConocoPhillips, British Petroleum [BP], ExxonMobil) did little drilling for new oil. Indeed, ConocoPhillips planned no onshore drilling for the first time in 45 years, complaining that the state's taxation regime discouraged this (FDNM, December 6, 2009). Governor Parnell objected, declaring that the company had not met the permit deadline for continued exploration. In any case, oil exploration activity definitely is sluggish. (For one perspective on the impact the state's oil tax regime had in discouraging new investment, see the Alaska Economic Report, AER, 8/3/10.)

A problem related to reduced oil exploration is the aging oil transportation infrastructure. Alyeska, the consortium operating and managing the Trans-Alaska Pipeline System (TAPS) on behalf of the owner-companies, is in the process of reconfiguring the pipeline (for example, closing some pump stations) to accommodate production declines, a multiyear process (FDNM, January 6, 2010). The consortium's plan to shift workers to nonunion contractors and to reduce positions overall occasioned strife with labor (but likely also increased support for revision of oil tax legislation) (FDNM, December 3, 2009; January 6, 2010). BP, which operates the Prudhoe Bay facility on behalf of the other owners, announced yet another oil spill caused by a pipeline rupture attributed to an ice buildup (Alaska Daily News, ADN, December 10, 23, 2009).

The Deepwater Horizon explosion and oil spill in the Gulf of Mexico in late April 2010 cost lease owner/operator BP billions and influenced its Alaska assets. BP did not immediately adjust its 2010 exploration and development spending plan in Alaska (FDNM, 5/14/10), but it entertained offers for its properties globally. Alaskans thought Prudhoe Bay, still the state's largest producing well, was on the chopping block. However, the \$7 billion asset sale in late July did not include any Alaska oil field (FDNM, 7/21/10, *New York Times* [NYT], June 23, 2010 and July 11, 2010). As noted below, increased federal scrutiny of OCS drilling caused BP to delay plans for drilling the Liberty field off the North Slope coast (Alaska Economic Report [AER], 7/13/2010).

We note below the activity of the petroleum industry regarding exploration and development of natural gas. ExxonMobil drilled the initial section of its first production well at Pt. Thompson in late 2009. It had been sued by the state for failure to develop gas resources it had leased in the area, and this production well was the evidence it needed to convince a Superior Court judge of its contract compliance. It also has initiated a \$1.3 billion natural gas cycling project (ADN, September 15, 2009). And oil companies said they were now more interested than previously in Alaska's large heavy oil deposits (most lie in the West Sak fields of the North Slope).

### **Other Natural Resource Production: Mining, Fisheries**

Probably the brightest spot in the state for non-oil/gas resource development was mining. Gold production in 2008 was the largest since 1916, and Alaska produced one-tenth of U.S. production, some 800,000 ounces, in 2009. Most of the gold came from two large mines—Fort Knox near Fairbanks and Pogo Mine near Delta. Gold futures rose to an unprecedented high of \$1,114.60/ounce in late 2009 (FDNM, November 10, 11, 2009). Two additional areas promised large expansions of mining—a new gold find near Livengood (70 miles north of Fairbanks), a huge deposit but of low grade, and the Pebble Mine near Bristol Bay. This mine's estimated deposits continue to grow and now stand at: 80 billion pounds of copper, 100 million ounces of gold, and 5.6 billion pounds of molybdenum (ADN, February 2, 2010).

However, development at Pebble challenges commercial and subsistence salmon fisheries in Bristol Bay. Our FY 2010 report noted the proposition battle between mining and environmental advocates in 2008, a struggle that continues (McBeath, 2010; FDNM, March 19, 2010). State permits for mining were reinstated, but a suit launched by Bristol Bay fishermen and environmentalists won in superior court where the judge found that the permits violated the state constitution (ADN, 4/21/10; FDNM, 7/14/10).

The 2009 fishing season was one of the best in recent years, but the state's ocean fisheries may encounter increased restrictions. U.S. Commerce Secretary Gary Locke approved the Arctic Fishery Management Plan, which prohibits an expansion of commercial fisheries until more data are accumulated on potential climate change effects; further, increased acidity detected in the oceans will affect Alaska fisheries (ADN, August 23, 24, 2009). While production in both mining and fishing was healthy in 2009, reduced demand from foreign and domestic markets registered in a decline of exports (one-fifteenth of the state's economic product). Coal exports rose 43 percent (ADN, March 5, 2010).

The tourism industry was most affected by declining U.S. personal income growth. Estimates of declines ranged around 15 percent for 2009 (FDNM, 5/3/10). In response to this condition, Japan Airlines cut one-half of its winter flights to Fairbanks (FDNM, December 13, 2009). The state tourism industry alleged that the cruise ship tax approved in a 2008 initiative had depressed this business. Cruise ship owners sued the state, claiming the tax was an unconstitutional infringement on interstate travel, leading the governor to negotiate with the companies and ask for legislation reducing the tax from \$46.00 to \$34.50/person, which the legislature supplied (AER, 3/31/10; ADN, 4/15/2010). Finally, logging remains a depressed industry.

## Returns on Investment

The Alaska Permanent Fund (PF) is the second major point of the state's economy; it influences economic growth primarily through the distribution of earnings to residents in the form of annual Permanent Fund Dividends (PFDs). In late September 2009, the state issued PFDs of \$1,305 to each eligible resident, a reduction of \$700 from the previous year's amount. A larger number of people applied for the PFD in 2009, outpacing population growth and presenting a puzzle to dividend administrators. Was the size of the dividend increasing applications? Did a recent increase in military population spur applications (ADN, September 24, 28, 2009)? The size of the PFD is based on a five-year rolling average of PF performance, divided by the number of eligible applicants; thus each additional qualified applicant has a slight impact on the PFD amount. The size of the 2010 PFD is expected to mirror that of 2009 (FDNM, 8/1/10).

The PF itself recovered some value during 2009 and 2010. Recall that from a high of \$40.4 billion in October 2007, the fund's value dropped to \$30 billion the following September; by the close of FY 09, its value reached \$33 billion and by mid-July 2010 it had climbed to \$35 billion (Alaska Permanent Fund Corporation, March 2010, July 21, 2010).

The state's second largest fund, the Constitutional Budget Reserve (CBR) also had increased in value to \$8.6 billion in FY2010 (the subaccount value had rebounded to \$4.5 billion). This was welcome news to legislators who had excoriated Department of Revenue officials' management in the previous year because of large losses in the CBR subaccount (FDNM, January 26, 2010). Approximately \$15 billion in reserves are available for the state to draw on in FY 2011 (AER, 6/15/2010).

## Alaska Demographics

In 2009, the Alaska population stood at 698,473. It was the fourth most sparsely populated state, but growing at the rate of 11.4 percent in the first decade of the century. In most respects, demographic characteristics resembled those of previous years in terms of residence (two-thirds urban), race/ethnicity (see Table 1), gender and age.

Alaska's rural-urban divide, among the most important long-standing demographic issues because it overlaps the Native/non-Native dichotomy, continued to attract interest and discussion. The McDowell group, a leading consultant on state issues, reported that rural costs had increased more in the previous three years than earlier; they rose by 10, 14, and 23 percent in 2007, 2008, and 2009. In late 2009 they were 50 percent higher than living costs in the state's largest city, Anchorage

**Table 1. Alaska's Race/Ethnic Distribution**

White, non-Hispanic	65.7 %
Alaska Native	15.3 %
Hispanic/Latino	6.1 %
Asian	4.5 %
Black	4.3 %
2+ races, other	4.1 %
<b>Total</b>	<b>100.0 %</b>

*Source:* Adapted from UScensus.gov/states/02000.html (retrieved 7/14/2010).

(ADN, November 6, 2009). Fuel cost increases were a significant part of the overall cost increases.

### **Recession and the Alaska Economy**

As noted in last year's report, Alaska continued to be less adversely influenced by the global and national economic crises than other states. The February 2010 unemployment rate was 8.5 percent, one full percentage point lower than the national rate, and by early July it had dropped to 7.9 percent, 1.6 percent below the national rate (ADN, 7/13/2010). In fact, 2009 was the first year since 1982 that Alaska had an annual unemployment rate below the nation's (Alaska Department of Labor and Workforce Development, March 24, 2010).

While bankruptcies rose nationwide, Alaska had the lowest rate of growth in this area, some 12 percent, and it scored 51st of the 50 states and District of Columbia (FDNM, January 5, 2010). The state still has not experienced a housing foreclosure crisis. One half as many Alaskans had subprime, adjustable rate mortgages as elsewhere in the U.S. (only two percent of the total); and it has a larger ratio of government-backed, low-risk mortgages (ADN, January 23, 2010).

In a previous section we discussed losses in the tourism business because of the national recession. The construction industry fared less well too. Although civil construction work in 2009-2010 held at 2008 levels, structural building dropped sharply, explained by two factors. First, structural work has a higher labor component and wages have not declined much. Second, out-of-state contractors have been more aggressive in competing for Alaska contracts.

The 2009 construction season dropped in value about 10 percent. Military construction continued apace and picked up a part of the slack in this industry (FDNM, November 18, 2009). Nevertheless, one of several motivations behind the state's



large capital budget for FY 2011 was to improve income for contractors and construction workers. Table 2 presents information on Alaska's workforce in 2010:

As mentioned repeatedly in these reports, Alaska's main product is oil/gas, but oilfield workers and company employees are a small part of the workforce. The "goods-producing" occupations employ 46,800 workers, just 14 percent of total nonfarm wage and salary positions. Most Alaskans produce services, the largest of which is government. In 2010, the military was the state's largest employer, using 23,000 workers, followed by state government, employing 18,139 workers and slightly more than 7,000 University of Alaska employees (including adjuncts and other part-time employees). Private employers pale in comparison. The largest is Providence Health & Services (4,000) supplying personnel for Anchorage's largest hospital, and Walmart, with slightly more than 3,000 employees. (See FDNM, August 4, 2009 and *Alaska Economic Trends*, January 2010 and July 2010).

### **Major Current Issues**

We discuss five issues influencing the budget process. We treat the Alaska National Wildlife Refuge (ANWR), the proposed natural gas pipeline to mid-America and the in-state line, outer-continental shelf (OCS) oil/gas development, wolf control, and say a few words about the Alaska congressional delegation.

#### **ANWR**

Located in the northeastern area of Alaska, bordering Canada, ANWR became a wildlife refuge under the Alaska National Interest Lands Conservation Act (ANILCA) of 1980. Surveys of the small 1002 (c) section of the refuge indicate it may contain as many as 13 billion barrels of oil, making it a suitable replacement for Prudhoe Bay. However, the land is federal public domain and only Congress can permit oil/gas exploration and development. In the last two decades the Alaska congressional delegation annually sought to open ANWR without success, because the refuge is the poster symbol of the American environmental movement.

Even Republican control of the Congress and White House (as for most of the period from 2001 to 2006) did not lead to opening ANWR. The Obama election in 2008 and strengthened Democratic control of Congress seemed to make ANWR a dead issue. Prospects for opening ANWR worsened in 2010 as Democratic legislators filed legislation to place the refuge off limits for oil and gas exploration (FDNM, 5/11/2010). Surprisingly, field hearings in Alaska in May 2010 attracted more opponents of drilling than supporters (ADN, 5/14/2010; FDNM, 5/18/2010). Still, a majority of Alaskans want the refuge opened for resource development, and regard federal resistance as yet another instance of discrimination against the state.

**Table 2. Alaska’s Workforce in 2010\***

Mining and logging (includes 12,200 oil/gas workers)	17,200
Construction	17,000
Manufacturing (includes 6,600 in seafood processing)	12,600
Trade, transportation and utilities	64,400
Information	6,400
Financial activities	14,000
Professional and business services	24,500
Educational (private) and health services	40,100
Leisure and hospitality	33,000
Other services	11,100
Government	
federal (excluding military),	18,200
state (including U. of Alaska)	25,300
local (including K-12 teachers)	42,000
	85,500
Total	329,300

\*Excludes self-employed, fishermen, agricultural workers and private household workers.

Source: Alaska Department of Labor and Workforce Development, *Alaska Economic Trends*, July 2010, 18.

### **Natural Gas Pipeline, Alaska North Slope to Mid-West**

For the previous two years, Alaska has had two natural gas pipeline plans. Under the Alaska Gasline Inducement Act (AGIA), championed by former Governor Palin, the state contracted with TransCanada to build a 2,000+ mile line from the Alaska North Slope to the Mid-West. The legislature committed to spending \$500 million on pre-construction costs, and TransCanada, since late 2008, has had a state license. However TransCanada owns no natural gas, and thus in mid-2009 welcomed ExxonMobil, with the largest gas holdings of the three majors, as a partner (but Exxon has not made any commitments to ship its gas through a line, if developed). The second- and third-largest gas owners, BP and ConocoPhillips, in early 2009 formed a consortium called Denali Ltd to build a pipeline, but Denali lacks state authorization.

In the remainder of 2009 and to early August, 2010, both ventures claimed to have made progress. The Denali group started work on construction of the largest gas treatment plant in the world, employing 95 workers by the end of 2009 (FDNM, November 19, 2009). TransCanada focused directly on the 90-day “open season,”

beginning May 1, 2010, when project companies courted gas producers, attempting to secure commitments for shipping contracts. Such commitments are essential to attract the interest of investors. TransCanada lowered its shipping rates for the proposed line, and offered significant discounts (FDNM, February 2, 2010).

Meanwhile, cost estimates soared, with an anticipated range from \$35 to \$41 billion, depending on the route (ADN, January 2, 2010; FDNM, 4/8/10). Of equal importance, both economic and political difficulties began to plague project planning. Natural gas prices remained depressed because of abundant supplies globally; within the United States, shale gas production increased, and this reduced demand for Alaska gas (ADN, March 9, 2010).

Federal agencies were prepared to help the pipeline proposal through the permitting process (FDNM, November 18, 2009), and the federal pipeline coordinator, Larry Persily, said the "time was right" to launch construction of the pipeline (ADN, 5/5/10). However, AGIA critics hoped to stall and ultimately derail the proposal. They alleged that the accounting methods were flawed, especially those favoring a third-party builder (TransCanada); they also wanted an analysis of AGIA, focusing on the penalty clause prohibiting competing state-assisted pipelines, which critics contended could hinder development of an in-state line (see among others, ADN, 10/26/09; FDNM, 11/9/2009, 3/25/10).

As we note below, the state's former leaders joined the criticism of the state's AGIA position. Most of the critics of AGIA either favored the earlier process launched in the Murkowski administration, objected to former Governor Palin's apparent attacks on the oil/gas industry, or sought to weaken the political position of Governor Parnell, who continued state support of AGIA after Palin left office. Indeed, the first credible Republican to file against Parnell for the 2010 gubernatorial primary was former Republican representative (Anchorage) and house majority leader Ralph Samuels, who was the only member of the house to vote against AGIA. Much of his primary campaign focused on problems with AGIA and lack of market demands for gas from a large-diameter gas line (FDNM, 5/7/10).

A large-diameter gas line headed south would do little to address high energy costs in Alaska, and this has spurred interest in a small-diameter, in-state line, discussed next. The "big construction project" mentality keeps the natural gas pipeline plan alive because it would create thousands of short-term construction jobs. Taxation revenue from a large diameter gas line would help the state treasury, but to a far lesser extent than TAPS oil.

After legislators voted to split oil and gas taxation, to increase the future take from gas (a bill vetoed by the governor, discussed below), state energy consultant Dan Dickinson gave them cautionary advice. He said the state's heavy reliance on natural gas revenues would scare off investors (FDNM, 6/10/10). Clearly, gas producers and investors are concerned about lack of certainty in Alaska's taxation

regime on natural gas. Although TransCanada received multiple bids from “major industry players and others” by the end of the open season (FDNM, 7/31/10), negotiations will not be completed until late 2010/early 2011 (FDNM, 7/21/10), by which time the state’s political climate on natural gas issues may have been clarified by the 2010 general election.

### **The Bullet Line**

In-state use of Alaska’s natural gas became an issue in 2007 when legislators called on then-governor Palin to develop a state plan, as Cook Inlet supplies of gas began to run low. The vice presidential campaign interrupted the governor’s planning, and legislators indicated some impatience over lack of progress. The legislature granted the governor \$7 of the \$9 million she sought for analysis and planning at the end of the first session of the 26th legislature in 2009.

Controversy continued under the Parnell administration. Harry Noah, the coordinator of the administration’s study, resigned shortly after Parnell took office. The foremost critic of AGIA and of the slow pace of administration efforts (Jay Ramras, R, Fairbanks) suggested that Noah was forced out (FDNM, November 23, December 12, 2009). The new governor reiterated his strong commitment to the project and immediately appointed a former state geologist, Bob Swenson, to replace Noah.

Then, in a feisty salvo, former U.S. Senator Ted Stevens said AGIA had failed and demanded substantial state participation in the bullet line project (ADN, March 14, 2010). In testimony to the legislature, former governors Bill Sheffield and Frank Murkowski echoed Stevens’ criticism (FDNM, March 19, 2010). The Alaska Railroad, with the authority to issue revenue bonds, moved closer to taking a lead in gas line development, while legislators developed two different vehicles to start the project in late 2010 (ADN, February 26, 2010; FDNM, March 16, 2010).

By the end of March, the house passed unanimously (38-0) legislation to require a development plan for an in-state line to be completed by July 1, 2011, specifying how the line would be designed, financed, built and “made operational” by December 2015 (ALD, March 29, 2010). The Parnell administration opposed this set of empty strictures initially, and legislators toned down the requirements somewhat. Shortly before the end of the legislative session, the governor signed a bill costing \$16 million that would create a Joint In-State Gas Line Development Team. This would bring together the Alaska Natural Gas Development Authority (ANGDA) and state agencies such as the Department of Transportation and Public Facilities (DOTPF) with a mandate to plan a small-diameter line from the North Slope to Fairbanks and Anchorage. The target date for the start of operation was 2016 (FDNM, 4/27/10; also see Alaska Legislative Digest [ALD], 4/12/10).

Questions remain about the bullet line: whether it complies with AGIA requirements, whether it will reconcile conflicts across regions and organizations (ANG-DA, the Alaska Gas Port Authority, state agencies), and whether it is economically feasible. The most recent estimate for the cost of a small-diameter line is \$7 to \$8 billion, if gas usage were double the current amount (ADN, 7/2/10). It is unlikely that private investors would defray this amount, and most proponents seek a substantial state investment in the line. Given the volatility in natural gas prices and markets, and the prospect of declining state revenue after 2014, it is questionable if the state's investment would be prudent (see AER, 7/8/10, 7/20/10).

### **Outer-Continental Shelf (OCS) Drilling**

Unlike development of the state's natural gas bounty, development of oil and gas resources in the Alaska OCS is largely determined by federal action. Shell Oil returned to Alaska in 2005 to develop leases it owned in the Beaufort Sea. This OCS area is a habitat for polar bears, and the 2008 decision by Interior Secretary Kempthorne to list this species as endangered under the Endangered Species Act (ESA) won praise from environmentalists and blame from industry and the state (which sued Interior over this issue).

When Shell proceeded to conduct seismic tests, environmental groups sued in the 9th Circuit to order drilling stopped. The court ordered a review, whereupon Shell cancelled its 2009 drilling program. Under protest from the company and the state, the 9th Circuit vacated its previous decision; then reversed itself, ending the Alaska OCS drilling plan because the Bush administration had not studied potential environmental impacts.

In August 2009 the 9th Circuit reversed itself again, ruling that the Bush Administration had been correct in not requiring a new environmental review before authorizing the 2007 Beaufort Sea oil lease sale (FDNM, August 29, 2009). Thereupon the Minerals Management Service (MMS) of the Department of the Interior approved, with conditions, Shell's plan to drill exploratory wells in two Beaufort Sea leases (ADN, October 20, 2009). Two months later, MMS approved Shell's plan to drill three exploratory wells in the Chukchi Sea (FDNM, December 15, 2009). Immediately thereafter, environmental organizations objected. The Alaska Eskimo Whaling Commission joined by 10 environmental NGOs asked the 9th Circuit to block drilling plans (FDNM, December 6, 2009). Shell asked the appeals court to rule quickly on this challenge, because it had already invested \$3.5 billion in the project (ADN, 5/7/10). At this writing, the 9th Circuit has not yet ruled.

The drama in OCS matters occurred with the 2010 Gulf oil spill. Shortly before the spill, the Obama Administration announced its plan design on OCS drilling. The plan would leave Bristol Bay as a sanctuary, but would make 130 million acres of

the Chukchi and Beaufort seas eligible for drilling after extensive studies (FDNM, 3/31/10). Soon after the Deepwater Horizon explosion and massive spill, Interior Secretary Salazar halted all new offshore drilling permits (ADN, 5/7/10). He also delayed action on new permit applications until 2011 (while cancelling 2011 lease sales in Bristol Bay and the Chukchi and Beaufort seas (FDNM, 5/27/10). The governor and congressional delegation blasted these actions, but Native and environmental groups supported them (FDNM, 5/28/10). As mentioned, BP's Liberty project was delayed until 2011 too. Overall, the Gulf oil spill had expected effects on exploration drilling and development prospects of the Alaska OCS.

Regarding oil exploration on approved leases, the state faced different challenges. The most feasible basis of protest by NGOs concerned exploration activity in critical habitat of polar bears. The federal government designated 200,000 square miles off the Alaska coast as critical habitat, and this threatened OCS oil and gas drilling (FDNM, October 23, 2009). Following the Palin policy, Governor Parnell sued the federal government to overturn the ESA listing of polar bears (ADN, November 16, 2009). Although a federal court did dismiss the appeal launched by the Center for Biodiversity to strengthen regulations on polar bears in OCS exploration (ADN, December 5, 2009), the listing seems likely to remain in effect. The Parnell administration proposed a \$1 million public relations campaign to oppose the listing, and Alaska lawmakers, both state and federal, fumed over the ESA (FDNM, March 12, 2010).

### **Wolf Control**

The state's predator control policy continues to provoke opposition from national animal rights organizations and some members of the Congress, while it remains popular with Alaskans who prefer eating moose and caribou to preserving wolves and bears in the wild. Protests from outside Alaska continued during the study period. California Democrats Diane Feinstein and George Miller proposed federal legislation to allow aerial shooting of wolves only if a biological emergency were declared (FDNM, August 11, 2009). Defenders of Wildlife and PETA continued protests to Alaska's wolf control policies, and the former group even sought an audience with the governor.

State wildlife officials enforced the policy during 2009-2010, claiming the policy (both aerial killing of wolves and bear baiting) had increased the population of caribou and moose (ADN, August 15, 2009). However, winter weather disrupted policy implementation: lack of snow made it difficult to spot wolves until mid-March, and the state did not come close to its target.

The state and federal governments resolved issues over wolf kills, agreeing to an April 30th termination of the program (FDNM, 3/22/10, 3/31/10). However, con-

troverly continued in other regions. The National Park Service closed three hunting and trapping regions in the Interior, and the state fish and game department objected to this intrusion on state management of bears and wolves (ADN, 4/16/10). In view of decline in the caribou population on Unimak Island, the state sued USFWS and the interior secretary, seeking a court order to kill wolves and preserve caribou in the Alaska Maritime National Wildlife Refuge (FDNM, 5/29/10).

All these issues reflect ongoing problems in the dual federal-state management of fish and game in Alaska. Since the enactment of ANILCA in 1980, the state has declined to amend its constitution to bring it into conformance with federal land-use provisions for refuges and parks. The two systems differ regarding Native use for subsistence and natural resource conservation and use, guaranteeing conflict as resource use intensifies.

### **Congressional Delegation**

The 2009 session of Congress was Senator Mark Begich's first, and he waited until August to deliver his maiden speech. He introduced seven bills, all concerning arctic development, to an indifferent senate (FDNM, August 4, 2009). Begich is the first Democrat in the Alaska delegation since 1980. He differed with the state's senior senator, Lisa Murkowski, on health care reform, proposed EPA action to regulate carbon dioxide emissions, and the economic stimulus package that Murkowski said had failed in Alaska [FDNM, February 19, 2010]. The senate delegation also divided on the financial reform legislation. Congressman Young, now the state's most senior member of Congress, claimed leadership in soliciting earmarks for Alaska in the federal budget (FDNM, March 12, 2010). For the first time, Young was connected to the evanescent VECO corruption case. Allegedly, Young had received \$200,000 in gifts from VECO over 13 years (ADN, October 24, 2009). The Department of Justice declined to pursue this investigation (FDNM, 8/5/10), removing most of the ethical cloud as Young ran for his 20th term in the House of Representatives.

Although Congressman Young faced only token opposition in the Republican primary, Lisa Murkowski had a credible opponent in her second re-election campaign. Fairbanks attorney Joe Miller filed against her, claiming he was a true conservative and constitutionalist and she was a Republican-in-name-only (RINO). Miller is a West Point and Yale Law graduate, and won a medal during the Iraq campaign. He had run an aggressive campaign for the state legislature in 2006, nearly defeating a Democratic incumbent. What made him credible in 2010 was an endorsement from Sarah Palin and from the Tea Party Express. The latter group promised to spend \$1 million to help him win the primary (about \$500,000 became available one week before the August 24 primary). Murkowski seemed likely to

win the primary with at least 60 percent of the vote, as she had moved right in her party and up the senate leadership ladder (with \$2.1 million in campaign funds before the primary). However, in one of the nation's major upsets, Miller defeated Murkowski with a margin of 2,000 votes (FDNM, 8/25/10).

## **The FY 2011 Budget Process**

### **Preliminaries**

At the start of the fiscal year in July 2009, Alaska faced an unusual situation. The elected governor, Sarah Palin, planned her resignation from office at the end of the month, and the simultaneous swearing-in of Lt. Governor Sean Parnell as governor. Soon after this transfer of power, the Alaska Legislature met in a special session to consider three measures: two proposed override votes on financial legislation vetoed by Palin during the regular session, and the third was the confirmation of Lt. General Craig Campbell, Commissioner of Military & Veterans Affairs, whom Palin had selected to become lieutenant governor upon Sean Parnell's elevation.

The legislature after the 2008 elections still had a conservative cast. Twenty-two Republicans controlled the 40-member house and with 4 rural Democrats had a working majority. The 20-member senate, evenly divided between the parties as in the previous year, was led by the Bipartisan Working Group, with 10 Ds and 6 Rs, leaving 4 Rs in the minority.

Meeting in joint session, the special session confirmed Campbell on a 55-4 vote (the minority complained he was little known). Then, in a 45-14 vote, the session overrode Palin's veto of \$28.56 million in energy-related expenditures in Alaska's portion of the federal stimulus program (discussed in last year's report). Legislators failed to obtain the 45 votes needed (the vote was 40-19) to override Palin's veto of six south-central and southeast Alaska capital projects (ADN, August 11, 2009).

As the new incumbent governor, Parnell needed to establish some policy distance from Palin. Within two months of his inauguration, he unveiled a "Performance Scholarship" proposal to open college opportunities for Alaska youth while inducing more rigor into the state high school curriculum. Under the plan, graduating seniors would receive a full tuition scholarship to the University of Alaska if they had an "A" average in a "rigorous" curriculum (defined as 4 years of English and math and 3 years of science and social studies). For those receiving a "B" average, 75 percent of tuition would be paid; "C" students would receive 50 percent scholarships. Funding for the scholarships would come from earnings on \$400 million invested in the CBR, "walled off" to protect it. The plan was modeled on the scholarship plan established in Louisiana and 22 other states (ADN, October 8, 2009).



## **Executive Budget Request: Operating**

Under the Alaska Constitution, the governor files a budget request on December 15, one month before the legislature convenes. By that date, Governor Parnell had announced a largely status quo budget for FY 2011. In excess of \$10 billion, it would be the largest state budget in the United States on a per capita basis. The operating budget request approached \$8 billion (including \$4.3 billion in “expanded” general funds, other and federal funds) and the capital proposal was \$1.6 billion. Including PF distributions in PFDs, the total rose to spending of \$10.5 billion (*Alaska Legislative Digest [ALD]*, December 21, 2009, 2). Agency increases on average were 3.2 percent, above the inflation rate (the Anchorage CPI in 2009 was 2.2 percent). However, overall general fund (GF) spending was projected to rise at a higher rate due to required funding increases for schools, Medicaid and state pensions (FDNM, December 15, 2009; *Alaska Budget Report [ABR]*, January 21, 2010, 3).

The Department of Revenue's December price forecasts stated surpluses of \$1.45 billion in FY 2010 and \$330 million in FY 2011, excluding interfund transfers. If, however, oil prices remained at the December year-to-date average of \$73.42/barrel, the FY 2010 surplus would grow to \$2.2 billion. Co-chair of senate finance, Lyman Hoffman, noted: “We have reserves in excess of \$10 billion at the end of the last fiscal year. On the darker side, we have the least amount of oil flowing through the oil line than we've ever had” (ABR, January 21, 2010, 2).

The requested budget included funding for post-secondary scholarships for high-achieving students, \$6.5 million for work related to development of the in-state natural gas pipeline and a nearly \$4.4 million increment to cover expenses projected for the 2010 state elections. In his State of the State address, at the start of the legislative session, Governor Parnell said little about the FY 2011 budget. His message was vintage fed-bashing; he remarked that federal actions on protection of endangered species, land access, and health care “often seem at war with Alaska interests” (ADN, January 21, 2010).

## **Supplemental Budget Request**

In early February, Governor Parnell proposed the state's fourth largest supplemental budget request—to spend an additional \$1.8 billion in operating and capital funds during FY 2010. The lion's share of the total figure was \$1.2 billion to be allocated to the public education fund, which would forward fund state assistance to school districts, and send \$402 million to the CBR, eliminating part of the GF's long-standing debt to Alaska's primary savings account (ABR, February 4, 2010, 1). Additional legislation would boost the operating budget by \$113 million for

anticipated Medicaid cost increases and expenses for fire suppression and disaster relief. A supplemental capital appropriation of \$129 million would start Governor Parnell's proposed five-year \$500 million deferred maintenance program, described below (ABR, February 4, 2010, 2; FDNM, February 2, 2010).

### **Capital Budget Request**

The greatest projected growth in GF spending was in the capital budget, with the state portion nearly 100 percent larger than in FY 2010 (until 2010 supplements raised the floor). The governor's budget request included \$549 million in state general funds, \$257 million in other funds, and \$839 million in federal dollars.

The major piece in the governor's proposal was a new \$500 million, five-year capital spending plan for maintenance of roads, buildings and facilities, to address the estimated \$1.8 billion maintenance backlog for the state's 2,300 buildings and the marine highway system (FDNM, November 13, 2009). Other projects included:

- \$150 million to the Alaska Gasline Inducement Act reimbursement fund (part of the state's promised \$500 million to TransCanada, to pay for development and permitting expenses on the Alaska natural gas pipeline project);
- \$109 million for a new UAF biological sciences classroom/laboratory facility;
- \$76 million for a new state crime laboratory;
- \$21 million for Anchorage high school renovation; and
- \$10 million for the Alaska Housing Finance Corporation's homeless assistance program (ABR, January 21, 2010, 4).

### **Legislative Responses**

Two different proposals of Governor Parnell attracted legislative interest and discussion. The performance scholarship proposal was based on merit, and this prompted several legislative counterproposals for basing at least part of this assistance on economic need (ADN, January 23, 2010; FDNM, February 8, 2010). Second, legislators, smarting after the relatively small infusion of capital dollars in the FY 2010 budget, sought increased discretionary capital funds for their districts (as opposed to the governor's designated capital spending in just a few districts). They also criticized the administration's lack of preparation on the deferred maintenance plan (FDNM, February 23, 2010).

In general, the administration had done its budget homework, and the spending plan addressed well current state needs. Notwithstanding significant surplus revenues, the administration did not propose, nor did legislators, any "field of dreams" projects (with the exception of the in-state bullet line). Thus, there were few acrimonious exchanges of legislators and administrators as operating, supplemental and capital budget requests moved through the committee process. In early March,

the house passed the state's operating budget of \$8.2 billion on a 34-6 vote. All dissidents were Democrats, and even they did not ask for drawn-out discussion/debate on amendments before the final vote was called (ADN, March 12, 2010). The operating budget as adopted by the house and senate closely resembled the governor's request, but did not include funding for the scholarship program. Only the capital budget, as discussed below, varied significantly.

### **Oil & Gas Taxation Issues**

The oil industry in Alaska has reduced exploration for oil and has been reluctant to accede to the state's request that producers sign onto the state's plan (under AGIA) to develop and transport natural gas to American markets. The industry started what the author interpreted as an "investment strike," by portraying the industry as overtaxed, to the extent it could not efficiently allocate resources to increase exploration activity.

Governor Parnell's proposal to increase tax credits for industry, by making changes to ACES (Alaska's Clear and Equitable Share) (ADN, January 15, 2010; also FDNM, November 15, 2010) was sensitive to this threat. This was in response to a letter to Parnell by 15 members of the house (all Republicans), asking that he order an in-depth, public review of the 2007 petroleum production tax. (For background, see McBeath et al., 2008.) Democrats opposed a review, but the governor complied (FDNM, December 11, 2009). This action did not satisfy critics within his party, leading a new Anchorage Republican house member, Craig Johnson, to propose that oil tax increases be eased when oil prices spiked in order to increase the state's competitiveness (FDNM, February 16, 2010). This proposal was still born.

The legislature hired several consultants (as it had done prior to adopting ACES), asking them to ascertain whether the progressivity of the oil tax structure impeded exploration and production. First reports from consultants indicated that Alaska's taxes were moderate, and that the state's tax structure compared well to those of foreign locations (ADN, February 23, 2010).

However, oil industry executives paraded to Juneau and rebuffed the analyses of legislative consultants. They asserted that little drilling of new wells would proceed if the legislature did not cut production taxes (FDNM, February 24, 2010). This discussion continued through the remainder of the legislative session without resolution. The debate over oil taxation rests on perceptual as well as factual grounds. The Alaskan legislature is nearly evenly divided by the parties, and there is no consensus on a state oil taxation regime (in the absence of a major scandal and a populist governor).

Mid-way through the legislative session, the focus of debate turned to taxation of natural gas. The state's petroleum production tax is assessed on both oil and natural gas. This is because oil and gas are extracted from the ground as a mixture, and it is difficult to separate the commodities for tax purposes—as it is to correctly apportion production costs. The ACES system focused on taxation of oil, and emphasized increased taxation as oil prices rose. It paid little attention to the value of natural gas, because most of the state's natural gas (and all North Slope gas), has not yet entered the market.

Natural gas is less valuable than oil when considered on an energy equivalency basis, so combining oil and gas effectively reduces the tax on oil. The larger the price differential is between oil and gas, the greater the subsidy on oil (ABR, March 4, 2010, 1). A legislative consultant reported that in FY 2008, when oil prices peaked at nearly \$150/barrel, if a gas pipeline had been in operation, the state would have lost nearly \$2 billion in oil and gas revenue (FDNM, March 9, 2010).

Legislators were aware that AGIA committed the state's partner, TransCanada, to an "open season" beginning May 1, 2010. Under AGIA, producers who agreed to move their gas through the proposed pipeline would be granted a 10-year freeze of taxes on their gas, based on the tax regime in effect at that time. In early March, co-chair of senate finance Bert Stedman (Sitka Republican) proposed to "surgically" separate oil from gas in the combined production tax, which in his view would eliminate the risk that the lower value of gas would reduce state revenues significantly (ABR, March 4, 2010, 1).

Some Democratic legislators were suspicious of Stedman because he had been a firm ally of former Governor Murkowski in the much criticized and opaque plan of 2006 to forge a state-industry alliance to develop Alaska's natural gas resources (ABR, March 4, 2010, 2). Others questioned whether oil and gas production costs could be separated, referring to Stedman's statement in 2006 that "It would be an accounting nightmare to try to separate those two issues" (Alaska Special Sessions Report, ABR, August 11, 2006). Still others thought insufficient time remained in the session to sort out the complex issues of costs, pricing and allocation. Even Stedman, an accountant by profession, recognized this difficulty as he prepared substitutes for his own legislative proposals, late in the session. The revenue commissioner reflected the views of many when he urged caution in making any changes to state taxation on natural gas (FDNM, March 13, 2010; also see ABR, March 25, 2010, 12).

The legislature did vote to separate state taxes on oil and gas later in the 90-day session, and Governor Parnell quickly vetoed this act. He said a change in the structure of the taxation regime now "could be a destabilizing influence and adversely affect the two upcoming open seasons for Alaska natural gas shipping commitments" (ABR, 4/30/10; FDNM, 4/30/10). At the time Revenue Commissioner

Galvin noted that a \$2 billion loss (if oil and gas taxes remained unified) would be possible only under three conditions: (1) Alaska realized a major gas line, (2) oil and gas prices remained far apart “defying fundamental economic principle,” and (3) the next five legislatures left current taxes alone (ALD, 5/1/10).

### **Final State Budget**

At the very end of the legislative session, lawmakers approved operating and capital budgets, which we discuss after considering Alaska's revenue stream.

#### **Revenues**

Alaska's FY 2011 total, all-source, operating budget is \$7.6 billion, which is 5.6 percent greater than the budget of the previous year. The total authorized spending, including capital, supplemental and Permanent Fund dividends, is \$11.03 billion. Table 3 indicates all sources of revenue for state government, comparing estimated revenues for FY 2011 with those of FY 2010:

The revenue decline of 5.7 percent from FY10 to FY11 is an estimate, influenced by two large uncertainties. The first, reflected in the decline of unrestricted general funds, is the price of oil and production rate. The Department of Revenue's forecast for FY10 was production at the rate of 0.650 million barrels/day at \$75.32/barrel; for FY11 the department forecast production at 0.619 million barrels/day at a higher oil price, \$77.65/barrel.

The second uncertainty is the amount of federal dollars transferred to Alaska. These are anticipated to decline by \$235.8 million, at the expiration of most allocations from the American Recovery and Reinvestment Act (stimulus funding). However, federal support, as indicated in operating budget tables below, remains a very large part of Alaska budgets (See NYT, 8/18/10).

As we note in a section below, Alaska's cash reserves increased from FY 2010 to FY 2011, and the existence of surpluses from FY 2010 made it unnecessary for the legislature to dip into the Constitutional Budget Reserve to fund FY 2011 operations.

#### **Capital Budget**

The capital budget occupied lawmakers in the final weeks of the session. Two issues dominated discussion. First, minority Democrats criticized the size of the budget and the large number of discretionary funds, added at the sole discretion of the two house members and senator representing any one of the state's 20 senate districts, without review of others. Much of this funding was in the form of small

**Table 3. Revenue Sources, FY 2010-2011 Budgets (millions)  
Revenue source (excludes Permanent Fund Earnings) FY 2010 FY 2011**

Unrestricted General Funds based on oil forecasts of the:		
Department of Revenue	5,739.0	5,352.7
Designated General Funds	756.5	769.5
Total General Funds	6,495.5	6,122.2
Other State Funds	507.6	527.7
Federal Receipts	3,181.3	2,945.5
<b>All Funds</b>	<b>10,184.3</b>	<b>9,595.4*</b>

\*Excludes PF earnings

Source: State of Alaska Fiscal Summary—FY10 and FY11, Alaska Legislative Finance, 8/5/10.

grants for PTAs, senior centers, sports groups and other nonprofits. The second was regional rivalry between the Interior and South-central.

The University of Alaska (UA) Regents adopted as its sole capital project a \$109 million biological sciences building at the University of Alaska Fairbanks (UAF). The co-chair of House Finance, Bill Stolze from Eagle River (near Anchorage), objected to the “neglect” of higher education facilities in Anchorage and Mat-Su (in fact, most new UA facilities have been built in South-central). He proposed adding a new \$60 million sports facility at UAA. This issue ultimately was resolved by pulling the bioscience facility from the capital spending plan and placing it, along with the sports facility and rural school construction projects, in a \$370 million bond package for voter approval in the 2010 general election.

The legislature approved a \$3.087 billion state capital budget as it adjourned a few minutes after midnight on April 19 (the 91st day of the legislative session). The budget would be paid for with \$1.489 billion of state general funds, \$556.6 million in other state funds, and \$1.029 billion in federal funds. The \$3.1 billion amount includes:

- \$133.8 million in FY10 supplemental capital spending
- \$118.42 million in deferred maintenance projects
- \$1.026 billion in Department of Transportation projects (including \$537 million for surface transportation and \$268 million for airports)
- \$54.4 million for UA projects
- \$466.3 million in grants to municipalities
- \$136 million in discretionary projects
- \$49.5 million in projects funded with cruise ship passenger taxes

- \$397.2 million in proposed general obligation bonds
- \$5 million in North Slope Borough community projects (AER, 4/30/10)

As promised, Governor Parnell vetoed about \$300 million or 10 percent of this budget. He said the final budget was larger than he had proposed; instead, he focused on “smart, targeted” investment in public infrastructure while expanding on savings approved by the legislature earlier (FDNM, 6/4/10). The governor met with 54 of the 60 legislators before making his cuts, and pledged fairness. The gubernatorial vetoes and budget reductions hit funding for municipalities particularly severely (ALD, 6/9/10).

### **Supplemental Budget**

We addressed the supplemental budget above. Passed early in the legislative session, it repaid approximately \$400 million previously borrowed from the CBR, and made a \$1.2 billion appropriation as forward funding of K-12 education.

### **Operating Budget**

The state's FY2011 operating budget totals \$7.6 billion, larger by 5.6 percent than the FY 2010 final budget of \$7.4 billion. (If duplicated expenses were included, the total would be \$8.2 billion). The FY11 budget (unduplicated funding) includes \$4.5 billion in unrestricted general funds, \$706.1 million in designated general funds, \$440 million in other funds, and \$1.913 billion in federal funds. As in previous years, the governor made few vetoes in the operating budget. The most controversial concerned an expansion of the children's health program. It would have increased the recipient family's qualifying income level from 175 percent to 200 percent of the federal poverty line (as done in 44 states). The governor's veto eliminated the expansion of this program to 1,277 children and 58 mothers. Although Parnell previously had supported the bill, when he discovered it could pay for abortions he vetoed it, presumably to fortify his credentials with religious conservatives before the primary election (ALD, 6/9/10).

Table 4 displays the FY 2011 operating budget as compared to the FY 10 final budget (FY10 includes supplemental items and FY11 does not), and changes in appropriations.

The budgets of nine agencies changed by 5 percent or more. The Department of Commerce, Community and Economic Development spending plan increased by 5.6 percent. In addition to salary increases, the legislature added funds for marketing Alaska seafood products and for work on climate change and endangered species issues. The 5.4 increase to the Department of Fish & Game's budget covers salary increases as well as coordination of ESA listings, stock assessments and

**Table 4. GF Operating Budgets FY 10/11 and Changes (millions)**

<b>Agency</b>	<b>FY 2010</b>	<b>FY 2011</b>	<b>Change in %</b>
Administration	138.3	135.1	-2.3
Commerce, Community & Econ. Dev.	178.6	188.6	+5.6
Corrections	253.9	244.5	-3.7
Education & Early Development	1,435.8	1,417.1	-1.3
Environmental Conservation	68.5	71.6	+4.6
Fish and Game	163.2	172.0	+5.4
Governor	57.9	30.6	-47.2
Health & Social Services	2,110.4	2,185.4	+3.6
Labor & Workforce Development	170.1	167.5	-1.5
Law	63.9	65.9	+3.0
Military & Veterans Affairs	34.5	36.6	+6.3
Natural Resources	168.2	135.5	-19.4
Public Safety	164.4	164.1	-0.2
Revenue	243.6	302.4	+24.1
Transportation	381.8	393.9	+3.2
University of Alaska	757.1	775.9	+2.5
Alaska Court System	89.9	98.2	+9.1
Legislature	55.8	69.3	+24.1
Branch-wide unallocated appropriation	18.	27.	+50.0
<b>Subtotal, agencies</b>	<b>6,553.9</b>	<b>6,681.3</b>	<b>+1.9</b>
<b>Statewide Items</b>			
Debt service	228.2	263.1	+15.3
Fund capitalization	261.9	256.5	-2.1
Direct appropriation to retirement	284.7	357.6	-100.0
<b>Subtotal statewide</b>	<b>863.9</b>	<b>877.2</b>	<b>+1.5</b>
<b>Statewide Total</b>	<b>7,417.9</b>	<b>7,558.5</b>	<b>+1.9*</b>

\*The 5.6 percent increase from FY10 to FY11 in the state’s fiscal summary is based on management plan data, which include multi-year appropriations. This table is based on a comparison of the FY10 final budget (which includes the FY10 Management Plan, supplemental appropriations, and RPLs [revised program-legislative]) with the FY11 budget, and thus the rate of increase is smaller.

Source: Alaska Legislative Finance Division, 2010 Legislature—Operating Budget (all funds, unduplicated), 8/13/10.



monitoring for Southeast regional fisheries and other allocations to commercial fisheries.

The large reduction to the governor's office budget is explained by transfers to departments of natural gas pipeline work temporarily lodged there. The 63 percent increase to Military & Veterans Affairs includes appropriations to maintain Air Guard facilities and salary adjustments. The decline of 19.4 percent in Department of Natural Resource Funding is an artifact of a large supplemental in the previous fiscal year for fire suppression expenses.

The 24 percent increase in the Department of Revenue appropriation reflects increases in management fees for the CBR as its assets have increased, for bond issuance costs and planning expenses for the in-state natural gas pipeline, among others. The Alaska Court System budget increased by 9.1 percent to cover costs associated with improvement of court operations statewide, and to align the salary structure for nonjudicial employees. Finally, the 24.1 percent increase to the legislature's budget will pay for increased salaries and benefits of legislators, an increase in appropriations for the Legislative Council, and fund legislative studies such as those on large mine development and electrical power procurement practices.

Table 5 presents agency totals alone for all sources of funding.

The federal share of the operating budget is slightly smaller than in the previous year, primarily because of the expiration of stimulus funding and reductions in Medicaid funding. The agency receiving the largest amount of federal funding continues to be the Department of Health & Social Services. For FY 2011, this department will receive a majority of its funding from federal pass through dollars (constituting 52 percent of its budget). Two other departments are more dependent on federal government transfers. The Department of Military & Veterans Affairs will receive 67 percent of its budget from the federal government; and the Department of Labor & Workforce Development will receive 61 percent of its funding from the federal government.

Program receipts, such as user, license and permit fees, as well as university tuition, are large parts of the budgets of several state agencies. For FY11, they comprise 54 percent of the budget of the Department of Revenue, 39 percent of the University of Alaska budget, 23 percent of the Department of Administration's funding, and 21 percent of the Department of Fish & Game budget.

### **Reserve Funds and the Budget**

As in previous years, Alaska's enacted budget invariably is a plan, with revenues from oil (and thus dependency on production rate and oil prices) determining final budget outcomes. Our analysis is incomplete without providing information

**Table 5. Agency Summary—FY 2011 Operating Budget, all sources (millions)**

<b>Agency</b>	<b>UGF*</b>	<b>DGF*</b>	<b>Other</b>	<b>Fed.</b>	<b>All Funds</b>
Administration	76.6	24.9	30.6	3.9	135.1
Commerce, Community & Ec Dev.	42.1	73.5	7.4	65.6	188.7
Corrections	222.9	17.9	.7	3.0	244.5
Education & Early Development	1,173.3	12.3	13.7	217.9	1,417.1
Environmental Conservation	18.8	25.6	4.7	22.6	71.6
Fish and Game	66.3	8.2	36.5	62.1	172.1
Governor	30.3	0.1	0.1	0.1	30.6
Health & Social Services	957.0	68.2	27.2	1,132.9	2,185.4
Labor & Workforce Development	29.3	34.4	.9	102.9	167.5
Law	59.3	2.4	2.1	2.1	65.9
Military & Veterans Affairs	12.1	.1	.4	24.0	36.6
Natural Resources	69.7	24.9	21.1	19.8	135.5
Public Safety	136.5	15.0	3	12.3	164.1
Revenue	51.9	9.1	163.6	77.7	302.4
Transportation	251.7	62.6	75.7	3.9	393.9
University of Alaska	335.9	305.5	1.7	132.8	775.9
Alaska Court System	94.8	.5	1.2	1.7	98.2
Legislature	68.5	.8	0.0	0.0	69.3
Branchwide unallocated appropriations	27.0	0.0	0.0	0.0	27.0
<b>Total</b>	<b>3,722.9</b>	<b>684.9</b>	<b>387.8</b>	<b>1,885.7</b>	<b>6,681.3<sup>#</sup></b>

\* UGF=unrestricted general funds; DGF=designated general funds, including program receipts that are restricted to the program that generates the receipts and revenue that is statutorily designated for a specific purpose

# The total excludes statewide items such as debt service, fund capitalization and direct appropriations to retirement systems.

Source: Alaska Legislative Finance Division, 2010 Legislature—Operating Budget, 8/10/10.

(The Legislative Finance Division changed nomenclature regarding some fund categories in 2009-10. These changes are explained in the division’s Budget Clarification Project, the first report of which is found in the appendix.)

on the reserves providing the cushion for the state in volatile oil markets. Table 6 presents information on Alaska’s savings accounts.

### **Fiscal Sustainability**

We have summarized issues most directly concerning the state’s current fiscal policy but have thus far said little about Alaska’s fiscal sustainability. The Depart-

**Table 6. Approximate Balances of Alaska's Savings Accounts (millions)**

<b>Nature of Savings</b>	<b>FY10</b>	<b>FY11</b>
<b>Undesignated Savings</b>	11,501.7	13,277.1
Permanent Fund Earnings Reserve Account	1,210.0	1,139.0
Constitutional Budget Reserve Fund (cash)	8,663.9	10,215.5
Statutory Budget Reserve Fund	1,205.5	1,462.3
Alaska Housing Capital Corporation Fund	379.1	409.0
Alaska Capital Income Fund	43.2	51.2
<b>Designated Savings</b>	1,722.5	1,737.2
Public Education Fund	1,162.1	1,183.1
Revenue Sharing Fund	180.0	180.0
Railbelt Energy Fund	66.9	66.9
Power Cost Equalization Endowment	306.5	307.2
<b>Reserves (excluding Permanent Fund Principal*)</b>	<b>13,224.2</b>	<b>15,014.3</b>
Years of Reserves (Reserves/UGF Appropriations)	2.07	2.21

\*The principal of the Alaska Permanent Fund—about \$35.2 billion in late August 2010—cannot be spent without amending the state constitution.

*Source:* Alaska Legislative Finance Division, State of Alaska Fiscal Summary, 8/5/10.

ment of Revenue's fall revenue forecast set a meaningful floor, when it opined, in December 2009, that the CBR stood at \$8.3 billion and no significant withdrawals from it would be necessary to balance the state's budget. Further, the department remarked: "(G)iven the current revenue forecast and up to 10 % in budget growth from FY 2010, the CBRF would not be depleted before 2020. If oil prices were to fall below our forecasted level and stay at that low level, we expect the CBRF to be depleted as early as July 2014, if the budget increases at a rate of 10 % per year. If oil prices were to decline to an annual average of \$50 per barrel, and the budget increases at 3 % per year, the CBRF could be depleted by July 2017.

In the context of states struggling to maintain basic services amid a situation of high unemployment and sharply reduced general fund revenues, these are very optimistic projections. Nevertheless, some legislators did focus on sustainability issues in the 26th Alaska Legislature. A series of committees examined energy sustainability. More to the point, a house committee began addressing the state's long-term financial future (FDNM, January 21, 2010; ADN, February 5, 2010). And the predictable Mike Kelly (R, Fairbanks) proposed a constitutional amendment to cap state spending (FDNM, March 20, 2010). In 1982, under prodding from Governor Jay Hammond, the legislature proposed and voters approved a spending cap,

now part of the Alaska Constitution (see McBeath, 1997, 176-7). It has never been implemented.

### **Conclusion**

The overall political and economic conditions for Alaska budget planning in 2009-10 were quite auspicious. Oil prices averaged \$70/barrel during this period, which was good news for a state whose unrestricted GF revenue is 89 percent dependent on oil royalties, production and corporate taxes. Alaskans pay neither state sales nor income taxes and in 2009 received Permanent Fund Dividends of \$1,305 each. The state unemployment rate of 7.9 percent was below the national rate (usually it exceeds it by 1-3 percent). Reserves for FY10 and FY11 are estimated to be \$13 and \$15 billion. No other American state enjoys conditions like these.

At the state level, little contention interrupted budget planning. After Sarah Palin's departure from office to pursue a higher calling, new Governor Sean Parnell (affectionately called the "oatmeal" governor) returned the state to normal politics. Although a red state, the legislature has been relatively evenly balanced between the parties: Republicans have a working majority in the house; a bipartisan working group dominated by Democrats runs the senate. The major political issues (except gas pipeline development)—opening ANWR for oil/gas development, OCS oil/gas development (including ESA strictures protecting polar bears and Beluga whales), even state predator control policies to increase caribou and moose populations—pitted Alaska's interests in natural resource exploitation against federal government controls. Such issues allowed most Alaskans (and their political representatives) to glibly bash the federal government while on a per capita basis, Alaska receives more federal support than any other state.

In this context, producing a fiscal plan for FY 2011 was easy. Legislators accepted nearly all of the governor's requests for funding state operations in FY 2011, adding several millions of their own projects, in a budget that was 5.6 percent larger than the final FY 2010 budget. In an historically large supplemental budget, the two branches agreed to forward fund K-12 education (\$1.2 billion) and repay \$402 million to the CBR, demonstrating some ability to save. Only the capital budget was controversial. Most legislators thought the governor's proposal was too slim, while still smarting from former Governor Palin's vetoes of pet projects in 2008 and 2009. They adopted a rather large \$3.1 billion capital budget, but Governor Parnell objected to the bottom line. In a process that was more cooperative than his predecessor's, Parnell cut capital project funding by 10 percent after consulting with most legislators. Municipal projects were the primary casualties.

Next year's report will provide updates on the current large issues in Alaska budget planning—construction of a large diameter gas pipeline from the North

Slope to the Mid-West and planning for a small diameter, in-state gas pipeline to reduce energy costs in the Alaska Railbelt. Results of the open seasons held by the competing pipeline construction firms will determine whether gas producers see it in their interest to make commitments to ship product to market. Such commitments are essential to construct a pipeline of 2,000 miles at the cost of between \$35 and \$41 billion. The consensus expressed in the Alaska Gas Inducement Act (AGIA) is eroding, and the 2010 general election—as well as economic conditions—should clarify what the state interest is. Reducing Alaska energy costs is a priority of most political leaders, but the decision to pledge state dollars to construction of a \$7-8 billion bullet line is linked to the questions concerning the large diameter line.

Compared to other western states, Alaska is faring well during the prolonged recession, and the short-term fiscal prospects (at current high oil prices) are excellent. During this study period, several leaders raised questions about the state's long-term fiscal sustainability. Much of the concern came across as political rhetoric, yet—after a gap of a half dozen years—legislative committees again are exploring alternate revenue futures. Alaska remains a natural resource exporting state, heavily affected by changes in global market demands, and will need a long period, or a major economic crisis, to force attention to the role that the second pivot of the Alaska economy—the Permanent Fund—is to play in financing public services.

## **Appendices**

### **Budget Clarification Project Progress Report 1 December 3, 2009**

As part of a continuous process, Legislative Finance has been planning for and working on major improvements to the presentation of Alaska's budget for nearly a year. Because implementation of changes proposed for the FY11 budget is a complicated process, Legislative Finance intends to provide weekly progress reports to the Finance Co-Chairs and to OMB until roll-out is complete.

#### **Background**

The budget clarification project has three distinct parts, all of which are critical to presenting Alaska's budget in a simpler, clearer, more accurate and more meaningful way. The parts are:

1. Reappropriations,
2. Fund transfers and duplicated appropriations, and
3. Fund code recategorization.

#### **Reappropriations**

Unless problems arise, reappropriations will not be discussed in future progress reports. OMB does not intend to do anything contrary to the reappropriation guidelines dated October 2009. The guidelines can be summarized as follows:

1. Agencies will terminate capital projects administratively; there will be no reappropriations to new executive branch projects.<sup>1</sup> The legislature will then review all of the governor's capital requests on equal footing. Money associated with terminated projects will show as revenue in the year of project termination.
2. Legislative capital reappropriations will continue as in the past. Reappropriations can be included or excluded from election district reports, depending on the purpose of the report.
3. Operating carry forward reappropriations will appear in the operating bill so subcommittees can include them in their review of the FY11 operating budget.
4. Reappropriations affecting FY10 will appear in the supplemental bill.
5. All reappropriations will include estimates of amounts to be reappropriated and will be entered into the budget database.

*Fiscal Summary Impact:* None. Reappropriations are, and will remain, net zero transactions. This part of the project will improve information available to the public, but it does not affect the amount, fund classification, timing or agency assignment of an appropriation.

## **Budget Clarification Project Report 2 of 5 1/18/2010 Fund Transfers and Duplicated Appropriations**

Unless problems arise, fund transfers and duplicated appropriations will not be discussed in future progress reports. Legislative Finance and OMB have reached agreement on budget structure and classification of duplicated codes. OMB intends to use the new structure and codes in budget bills submitted for FY11. OMB also intends to simplify appropriation language in the bills to reflect the new structure. An explanation of changes follows:

Traditionally, capitalization (for example, appropriating general funds to the Railbelt Energy Fund) shows in the fund capitalization line of the fiscal summary. In order to avoid double counting, appropriations *from* a capitalized fund are classified as duplicated expenditures and are netted out of the fiscal summary. This treatment affects:

1. Classification—appropriations from a capitalized fund are always classified as “other funds” rather than matching the source of the original funding (because general and federal funds cannot be classified as duplicated). This may result in less scrutiny of appropriations from various funds.

2. Location—appropriations show on the fund capitalization line of the fiscal summary rather than in the agency that money is actually spent. For example, general funds moving through the Oil and Hazardous Waste Fund to the Department of Environmental Conservation do not appear in the fiscal summary as agency expenditures; they show as a fund capitalization. This treatment understates the amount of general funds used in agency operating budgets, which is the part of the budget that many people mean when they say “the budget.”

3. Timing—appropriations to a fund are counted in the year the fund capitalization is made, while money in the fund may not be spent until years later. Beginning with FY11, appropriations will be counted when money leaves the treasury rather than when it is transferred from one fund to another. Fund transfers will be recorded as transactions and included in reports, but will be excluded from the roll- up of totals. The new treatment of transfers and duplicated funds will:

1. Retain the original classification of funds, and show where and when money is actually spent as well as when it is deposited into a savings account or other fund.

2. Simplify and clarify budget bills by allowing direct appropriations for items like debt service.

3. Eliminate most duplicated fund codes.

*Fiscal Summary Impact:* The new approach provides a clearer, more accurate and more meaningful presentation of the budget. In the long-run, unduplicated appropriations will be no more, and no less, than under the current presentation. However, there are some transitional issues in the short-run. Because money will be counted as it flows *out* of funds, while historically money was counted on its way *into* funds, historical data must be revised (to incorporate the new treatment of transfers and duplicated fund codes) in order to avoid double counting. That task may take significant effort. Fortunately, the budget process does not involve significant historical review, so efforts to “fix history” can be deferred until interim.<sup>2</sup>

For FY10, the new approach—counting money as it leaves the treasury—will give the appearance of about \$33 million of additional general fund spending. This will occur because appropriations from the Railbelt Energy Fund and Capital Income Fund were formerly classified as duplicated “other” expenditures (because money was counted as it flowed into those funds in years past) and will now be counted as FY10 general fund expenditures. These expenditures will not increase the fiscal gap because the expenditures will be offset by transfers from capitalized funds to the general fund.

### **Fund Code Recategorization**

The Governor’s budget bills will *not* incorporate the new fund code categories. This does not indicate a lack of support for the proposed changes—OMB has been working jointly with Legislative Finance on this project for months—but rather a combination of technical and political issues. Those issues are:

1. OMB staff effort was focused on preparing FY11 budgets; resources available for fund recategorization were insufficient to ensure a smooth transition by December 15.

2. The power of appropriation is vested in the legislature. That power includes categorization of appropriations. OMB release of a budget in which fund sources were recategorized could be viewed as infringing on a legislative prerogative.

In summary, future progress reports will address the resolution of issues/problems associated with implementing the fund recategorization portion of the budget clarification project.

As with reappropriations and transfers/duplicated codes, the purpose of fund recategorization is to provide budget information in a more meaningful way. Of the three parts of the project, this portion is the most complex and has the largest impact on presentation of the budget.

Traditionally, appropriations have been tallied in three groups: general funds, federal funds and other funds. For years, some budget-watchers expressed concern



about the proliferation of “other funds.” The primary reason for concern seems to be the contradiction between statements and action—despite continued statements recognizing that “other funds” are truly state funds, the media and the legislature focus on general funds to the extent that appropriations of “other funds” are often referred to as “off budget.”

Of course, the “off-budget” label is a mischaracterization—other funds *are* included in the budget. But focusing on technicalities misses the salient points:

1. appropriations of other funds get less scrutiny than appropriations of general funds, despite the fact that many “other funds” are so indistinguishable from general funds that they have been referred to by names such as “spends like GF,” “funny money” and “flexible funds” and

2. over use of “other funds” makes it more difficult to understand the budget and, perhaps more to the point, to make the best possible budget decisions.

As we worked with the Finance Committee Co-Chairs and OMB toward presenting the budget in a more meaningful way, it became obvious that traditional fund code categories—general, federal and other—were incapable of distinguishing degrees of discretion within the “other funds” category. The “other funds” category includes not only dedicated funds, trust funds, bonds and corporate receipts—that is, funds over which the legislature has limited discretion—but also numerous fund sources with an identified use—or, more accurately, a suggested use (given constitutional prohibition of dedicated revenue)—that does not limit the legislature’s ability to appropriate the funds for another purpose.

Once degree of discretion was identified as the key to improving presentation of the budget, the obvious solution was to create a fourth fund category. Adding a new category for designated general funds (the existing general fund category is for *unrestricted* general funds) will signal the legislature that fund sources with designated, or suggested, uses are not outside the purview of the legislature.

Legislative Finance reviewed all fund codes, placing each in one of the four fund categories. Most, but not all, movement from one category to another was from “other” to designated general funds. Work is not complete; there may be some reassignment of codes and there will be additional work required in budget subcommittees. Any changes will be discussed in future progress reports.

*Fiscal Summary Impact:* In simple terms, recategorization will move about \$750 million from “other funds” to general funds.<sup>3</sup> Although recategorization provides an opportunity for people to make statements about budget growth, such statements would be a demonstration of ignorance.

One of the tasks associated with this project will be to educate people regarding the fact that recategorization—in fact, the entire budget clarification project—does not affect the level of spending, it just rolls up spending in a different way. The

intent is that the new presentation results in better spending decisions and better understanding of the budget.

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## Notes

<sup>1</sup> The Administration does not currently expect to terminate any capital projects or reappropriate any FY10 operating money to FY11. OMB says that 1) capital projects were scrubbed for potential reappropriation last year and 2) agencies have been told to request new operating money for FY11 rather than carry money forward from FY10.

<sup>2</sup> Unfortunately, the effort to produce and analyze 10-year agency operating plans becomes complicated when historical, present and future appropriations are inconsistently presented. The complications need not delay consideration of the plans during the FY11 budget cycle, but it does mean that plans may require rebenchmarking in FY12.

<sup>3</sup> In addition, the Permanent Fund Earnings Reserve Account is classified as general funds. Dividends and inflation proofing will now show in one of the general fund categories. That change will have little apparent impact because Permanent Fund appropriations will continue to be shown in a separate portion of the fiscal summary.