

State of Alaska

Fiscal Overview

Budget Gap Analysis and Fund Source Balances

Senate Finance Committee
October 31, 2017

Office of Management and Budget
Pat Pitney, Director

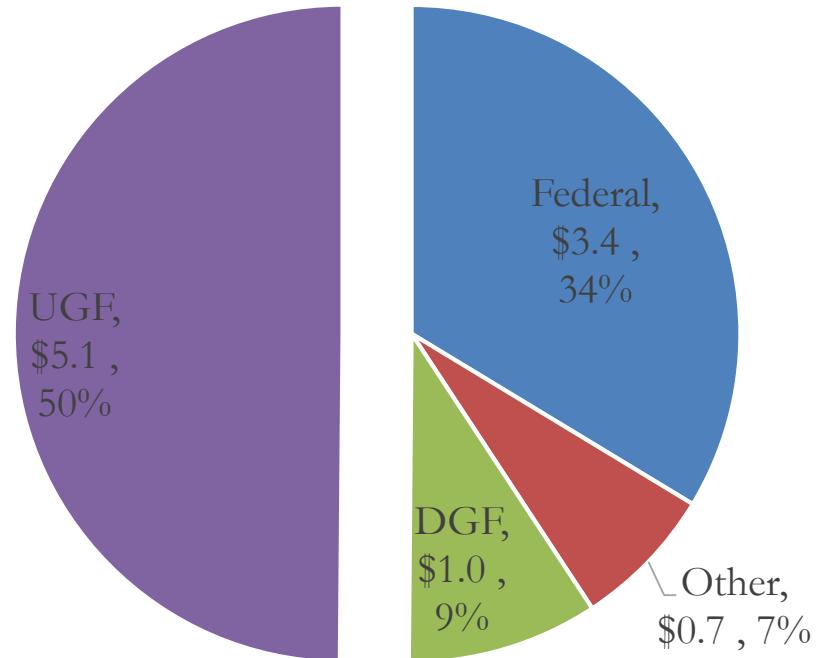
Spending: State Budget Overview

The total state budget is \$10.2 billion, and comprises:

- Federally funded programs
- Service generated revenue
- State funded programs and services

Only 50% of the budget impacts the deficit, the unrestricted general fund (UGF) portion.

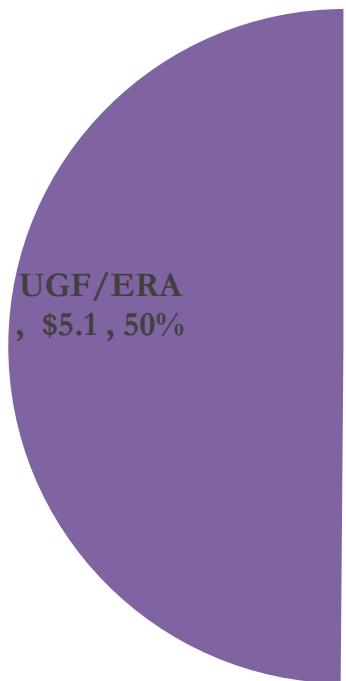
FY2018 Budget by Source
(\$billions)



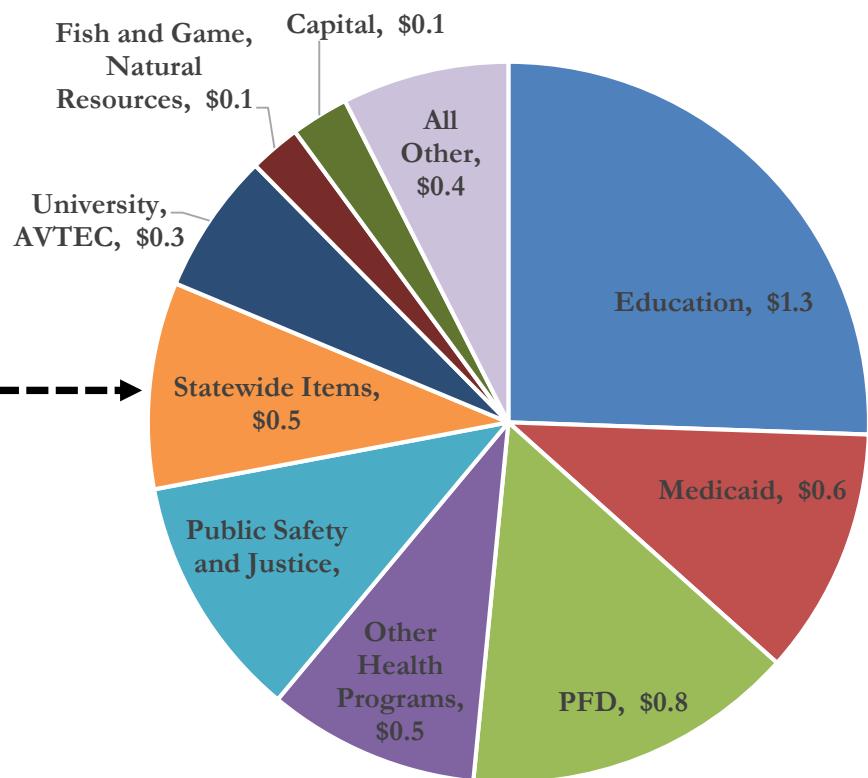
Spending: State Budget Overview

State funding is spent on....

FY2018 Budget by Source
(\$billions)



\$5.1 billion UGF Budget



Spending: State Budget Overview

More than 50% of the state-funded share of the budget is sent as direct payments to communities, providers, oil companies, and individuals.

Payments are for items such as:

- Medicaid payments to providers (on behalf of enrollees)
- K-12 Schools
- Retirement payments (on behalf of communities and schools)
- School debt reimbursement
- Senior benefits
- Public assistance
- Foster care
- Oil and gas tax credits
- Permanent fund dividends

Less than 50% of state funded budget is spent on government services like troopers, road maintenance, ferries, airports, prisons, the legislature, Pioneer Homes, the courts, the governor's office, fish and game, etc.

Spending: State Budget Overview

Unrestricted General Fund Spending Trend

| | FY2015 | FY2018 | FY2015-2018 | |
|---------------------------------|-------------------|-------------------|---------------------|-------------|
| Education & University | \$ 1,722.1 | \$ 1,584.6 | \$ (137.5) | -8% |
| Health & Safety Departments | \$ 936.6 | \$ 849.2 | \$ (87.3) | -9% |
| Medicaid & Other Health Formula | \$ 865.4 | \$ 699.8 | \$ (165.6) | -19% |
| Other Executive Departments | \$ 786.7 | \$ 446.4 | \$ (340.4) | -43% |
| Debt, Retirement, Credits, etc. | \$ 982.7 | \$ 471.6 | \$ (511.1) | -52% |
| Legislature & Courts | \$ 189.5 | \$ 168.4 | \$ (21.1) | -11% |
| Total Operating Budget | \$ 5,482.9 | \$ 4,220.1 | \$ (1,262.8) | -23% |
| Capital | \$ 594.9 | \$ 132.0 | \$ (462.9) | -78% |
| Total Budget | \$ 6,077.8 | \$ 4,352.1 | \$ (1,725.7) | -28% |

Spending: State Budget Overview

Unrestricted and Designated Spending Trend

| | FY2015 | FY2018 | FY2015-2018 |
|---------------------------------|-------------------|-------------------|--------------------------|
| Education & University | \$ 2,019.8 | \$ 1,928.0 | \$ (91.8) -5% |
| Health & Safety Departments | \$ 1,024.1 | \$ 941.3 | \$ (82.8) -8% |
| Medicaid & Other Health Formula | \$ 870.2 | \$ 706.4 | \$ (163.8) -19% |
| Other Executive Departments | \$ 1,068.4 | \$ 825.4 | \$ (243.0) -23% |
| Debt, Retirement, Credits, etc. | \$ 1,002.1 | \$ 609.4 | \$ (392.7) -39% |
| Legislature & Courts | \$ 190.1 | \$ 169.6 | \$ (20.5) -11% |
| Total Operating Budget | \$ 6,174.7 | \$ 5,180.1 | \$ (994.6) -16% |
| Capital | \$ 759.4 | \$ 160.2 | \$ (599.2) -79% |
| Total Budget | \$ 6,934.1 | \$ 5,340.3 | \$ (1,593.8) -23% |

Budget Gap: State Budget Overview

Known Increases FY2018 to FY2018

| | OMB | LFD | Difference | |
|--------------------------------|-----------------|-----------------|-------------------|---|
| Medicaid | \$ 75.9 | \$ 32.0 | \$ (43.9) | OMB assumes FY19 enrollment and utilization growth, LFD assumes flat |
| AMHS | \$ 44.0 | \$ 40.0 | \$ (4.0) | OMB - Additional \$4.0 million brings DGF level with expected fare revenues |
| Fire Suppression | \$ - | \$ 15.0 | \$ 15.0 | OMB excludes, difficult to forecast |
| Salary and Benefits | \$ - | \$ 15.0 | \$ 15.0 | OMB excludes, negotiations still pending |
| Inmate Health Care | \$ 10.0 | \$ 10.0 | \$ - | |
| Mt. Edgcumbe | \$ - | \$ 4.7 | \$ 4.7 | Fund Change - may or may not be restored |
| Debt Service | \$ (4.0) | \$ (4.0) | \$ - | |
| Community Assistance | \$ (8.0) | \$ (8.0) | \$ - | |
| Oil and Gas Tax Credits | \$ 118.0 | \$ 118.0 | \$ - | |
| Public Education Fund | \$ 17.0 | \$ 17.0 | \$ - | |
| State Assistance to Retirement | \$ 107.9 | \$ 107.9 | \$ - | |
| Subtotal | \$ 360.8 | \$ 347.6 | \$ (13.2) | |
| Capital Budget | \$ 93.0 | \$ - | \$ (93.0) | Dependent upon level of DGF and Reappropriations used |
| Fiscal Notes, Sunsets, OTIs | \$ (65.5) | \$ - | \$ 65.5 | LFD Excludes |
| Total Budget Change | \$ 388.3 | \$ 347.6 | \$ (40.7) | |

Budget Gap: State Budget Overview

| Base Scenario Calculation (\$millions) | | | | |
|--|---------------------|---------------------|---------------------|--|
| Fiscal Year | 2019 | 2020 | 2021 | |
| Budget maintaining flat service levels | \$ 4,749.5 | \$ 4,900.1 | \$ 4,980.3 | |
| Revenue | \$ 2,019.0 | \$ 2,070.0 | \$ 2,165.0 | |
| Deficit | \$ (2,730.5) | \$ (2,830.1) | \$ (2,815.3) | |
| | | | | |
| Senate Permanent Fund plan | \$ 2,092.1 | \$ 2,250.5 | \$ 2,257.5 | |
| Gap | \$ (638.3) | \$ (579.6) | \$ (557.9) | |
| | | | | |
| House Permanent Fund plan | \$ 1,866.9 | \$ 2,009.3 | \$ 2,016.4 | |
| Gap | \$ (863.5) | \$ (820.8) | \$ (798.9) | |

Known issues: Base scenario ~\$600-800 million/year

Assumptions:

- Department of Revenue oil price and production forecast: Fall 2017
- Agency cost increases are maintained at or below inflation
- No federal cost shifts
- K-12 school increases maintained at inflation only – no student growth

Budget Gap: State Budget Overview

A number of items could increase the gap:

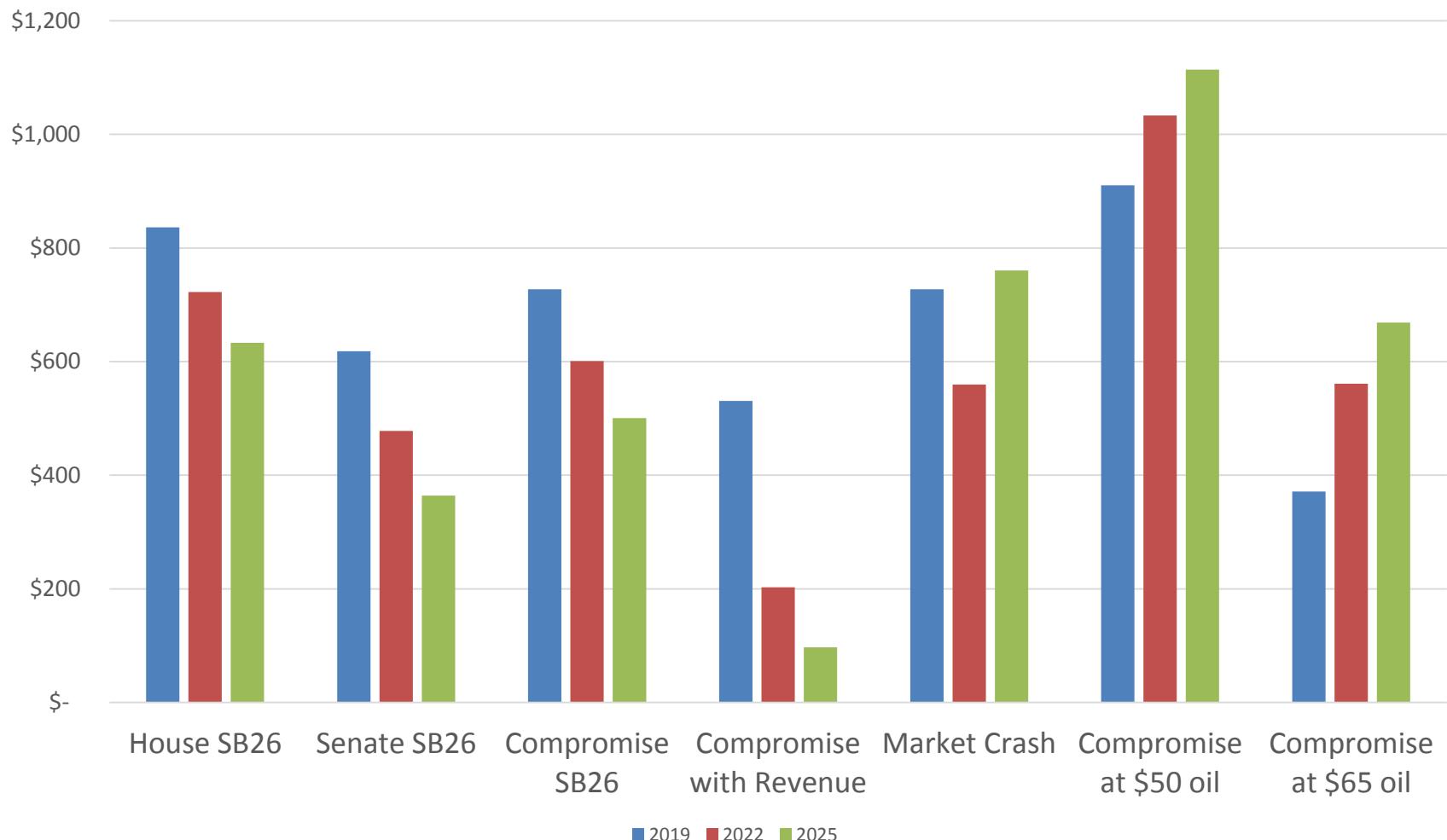
- Compromise dividend ~\$80.0-\$100.0 million (cost)
- Federal level health care changes ~\$100.0+ million (cost)
- Supplemental budget ~100.0+ million (cost)
- Health care cost containment efforts (necessary to meet forecast)
- Criminal justice initiatives (cost)
- Major disaster spending (cost)
- Market correction affecting permanent fund earnings
- Overdrawing the fund today, increases the gap in the future:
 - Assuming \$500.0 million/year in excess draw:
 - Over 5 years: this will cost \$153 million in annual revenue forever.
 - Over 10 years: this will cost \$368.5 million in annual revenue forever.

Budget Gap: State Budget Overview

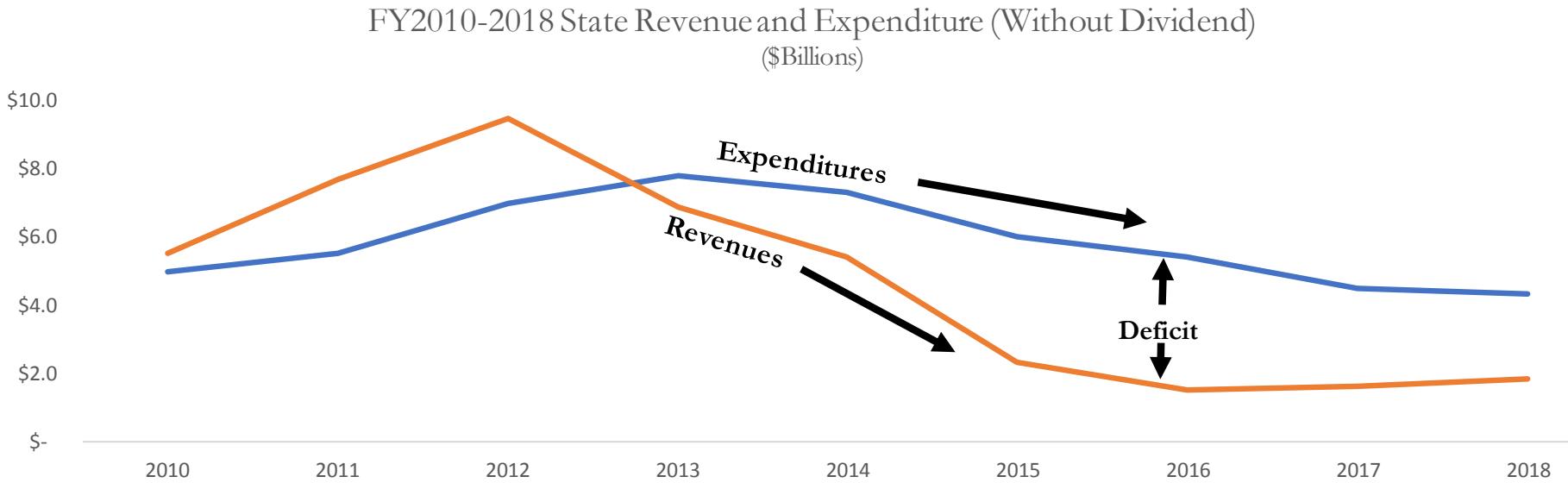
| Scenario | Budget Gap Under Various Assumptions | | | | | | Compromise | Compromise |
|--------------------------|--------------------------------------|------------|------------|----------------|----------------|----------------|----------------|----------------|
| | Senate SB26 | House SB26 | Compromise | | SB26 | SB26 | SB26 | SB26 |
| | | | SB26 | (\$65/bbl Oil) | (\$65/bbl Oil) | (\$50/bbl Oil) | (\$50/bbl Oil) | (\$50/bbl Oil) |
| 2019 Baseline Revenue | \$ 2,019.0 | \$ 2,019.0 | \$ 2,019.0 | \$ 2,019.0 | \$ 2,375.0 | \$ 2,375.0 | \$ 1,836.0 | \$ 1,836.0 |
| 2019 Permanent Fund Earn | \$ 2,112.4 | \$ 1,894.0 | \$ 2,003.2 | \$ 2,003.2 | \$ 2,003.2 | \$ 2,003.2 | \$ 2,003.2 | \$ 2,003.2 |
| 2019 Budget | \$ 4,749.5 | \$ 4,749.5 | \$ 4,749.5 | \$ 4,749.5 | \$ 4,749.5 | \$ 4,749.5 | \$ 4,749.5 | \$ 4,749.5 |
| Budget Gap | \$ (618.1) | \$ (836.4) | \$ (727.2) | \$ (371.3) | \$ (371.3) | \$ (910.3) | \$ (910.3) | \$ (910.3) |

- Wide range of gap depending on assumptions
- To preserve the CBR and avoid overdrawing the Permanent Fund, \$600 million is a prudent target for other revenue measures
- A market crash could widen these gaps by \$200.0 million or more over time.

Budget Gap: State Budget Overview

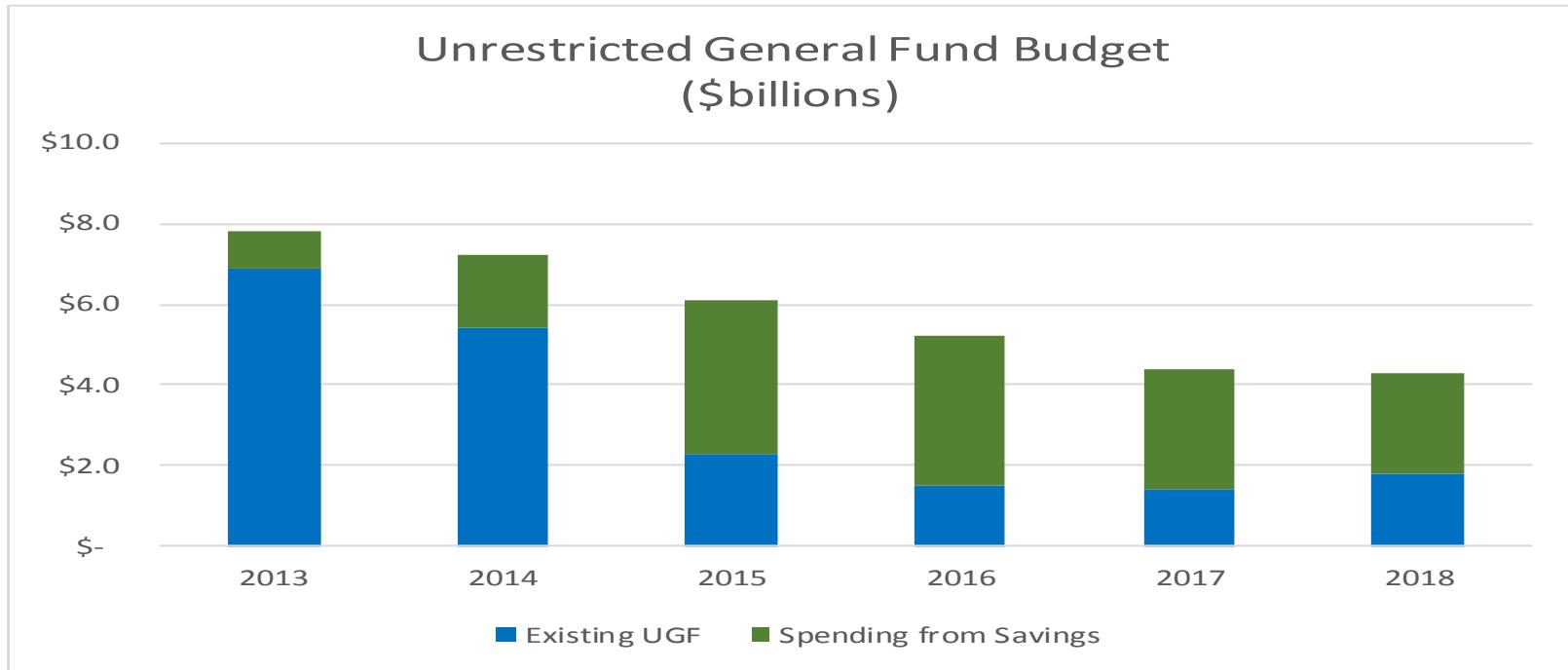


Savings: State Budget Overview



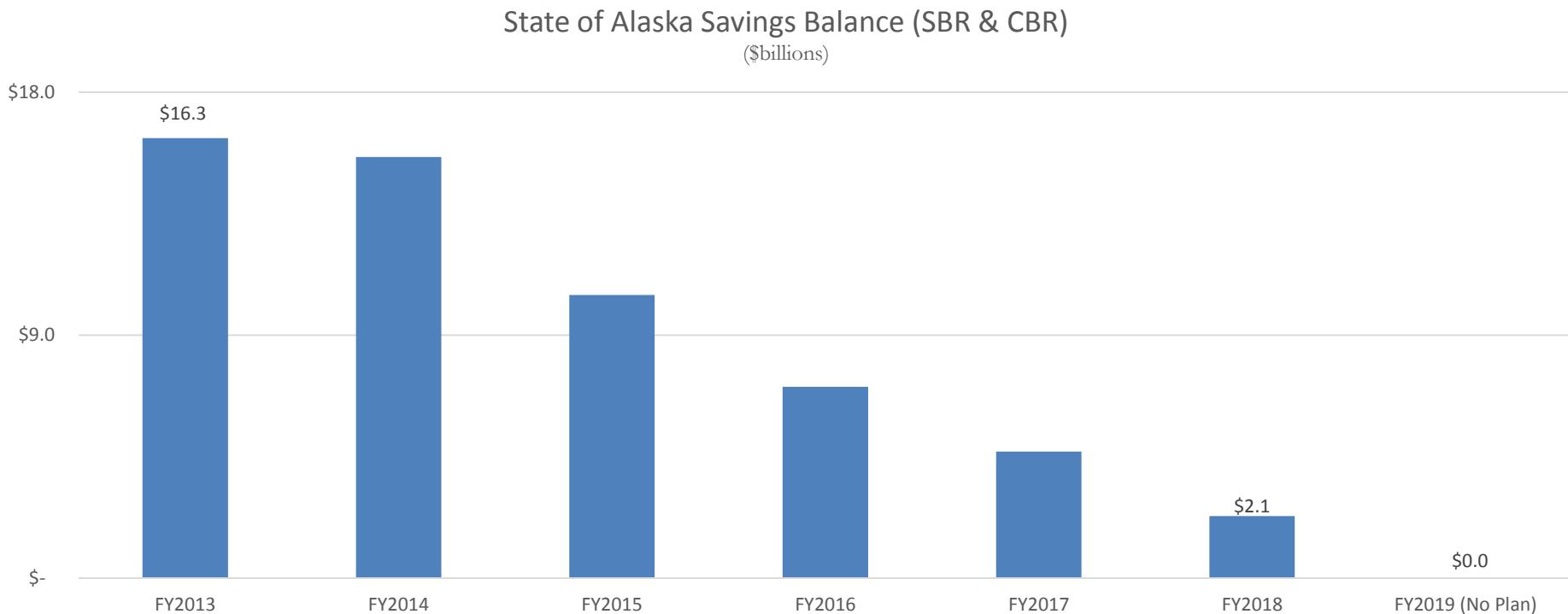
Substantial budget reductions have been made (44 percent since FY2013), but revenues have declined by almost 80 percent during that time.

Savings: State Budget Overview



- The gap between revenue and spending has been funded primarily from the Constitutional Budget Reserve (CBR) -- Alaska's rainy day fund
- By the end of FY2018, we will have drawn over \$14.0 billion from savings
- The constitution requires that any borrowing from the CBR fund be repaid
- CBR spend and non-repayment provisions require a three-quarter vote

Savings: State Budget Overview



- Alaska has the most volatile revenue of any state
- Any plan that leaves a fiscal gap depletes the state's reserves
- Maintaining sufficient savings is prudent to hedge against low oil prices, stock market volatility or other unforeseen events

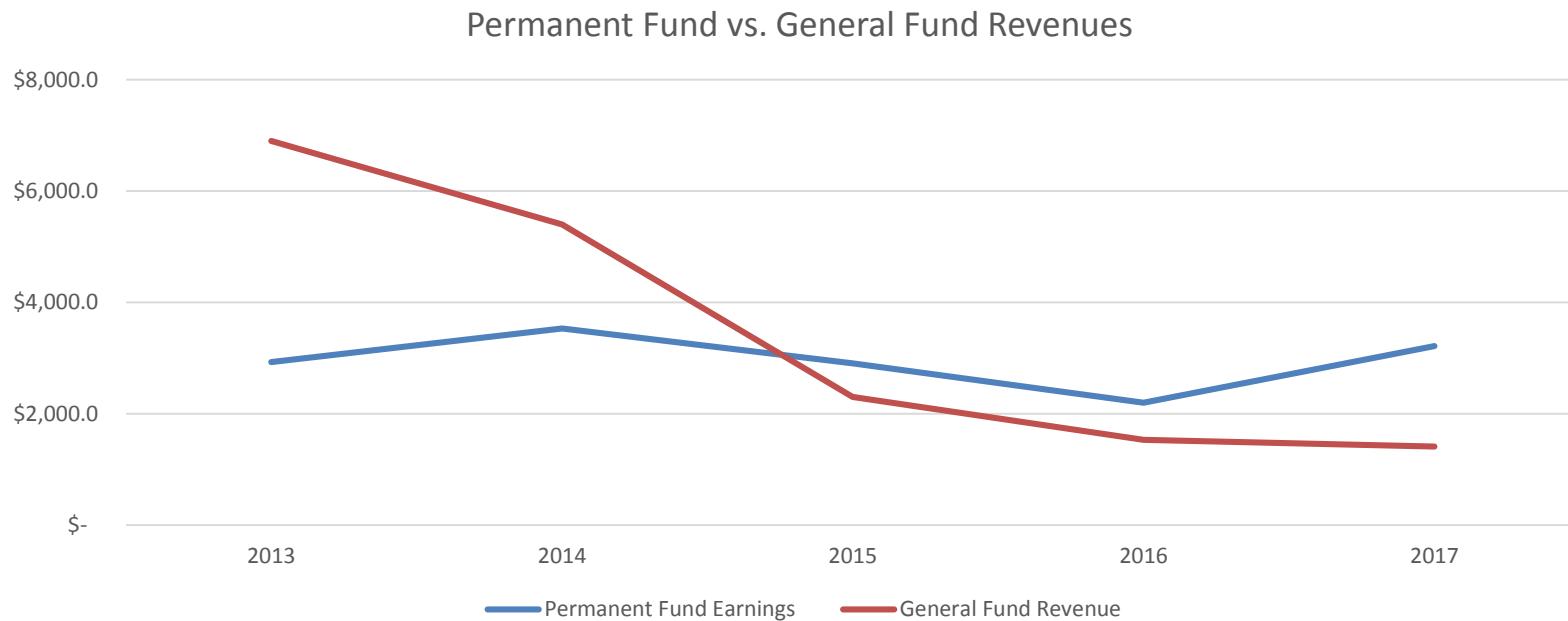
Savings: State Budget Overview

Other Fund Balances

| Selected Fund Balances (\$millions) | | |
|--|--|--------------|
| Fund | Projected FY2018 Year End Balance | |
| Power Cost Equalization* | \$ | 1,024 |
| Alaska Higher Education Fund* | \$ | 339 |
| AHCC Account | \$ | 22 |
| Capital Income Fund | \$ | 26 |
| Community Assistance Fund | \$ | 60 |
| Vessel Replacement | \$ | 22 |
| Various Smaller Funds | \$ | 12 |
| <i>Public School Trust Fund</i> | \$ | 623 |
| Total | \$ | 2,170 |

Revenue: State Budget Overview

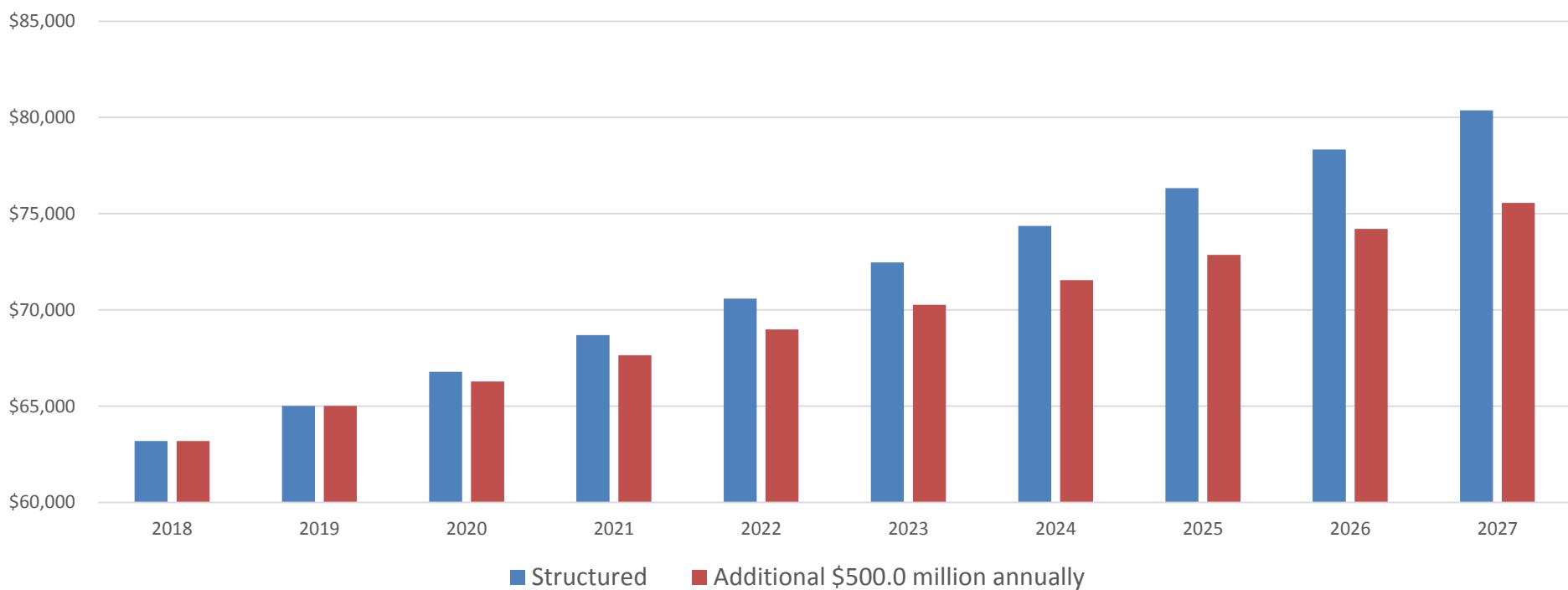
Alaska Permanent Fund Earnings



- During this time of low oil revenues, the Permanent Fund continues to generate \$2-3 billion in annual revenue
- The state has not been utilizing Permanent Fund earnings revenue (except for dividends)
- It is time to consider using this revenue stream

Revenue: State Budget Overview

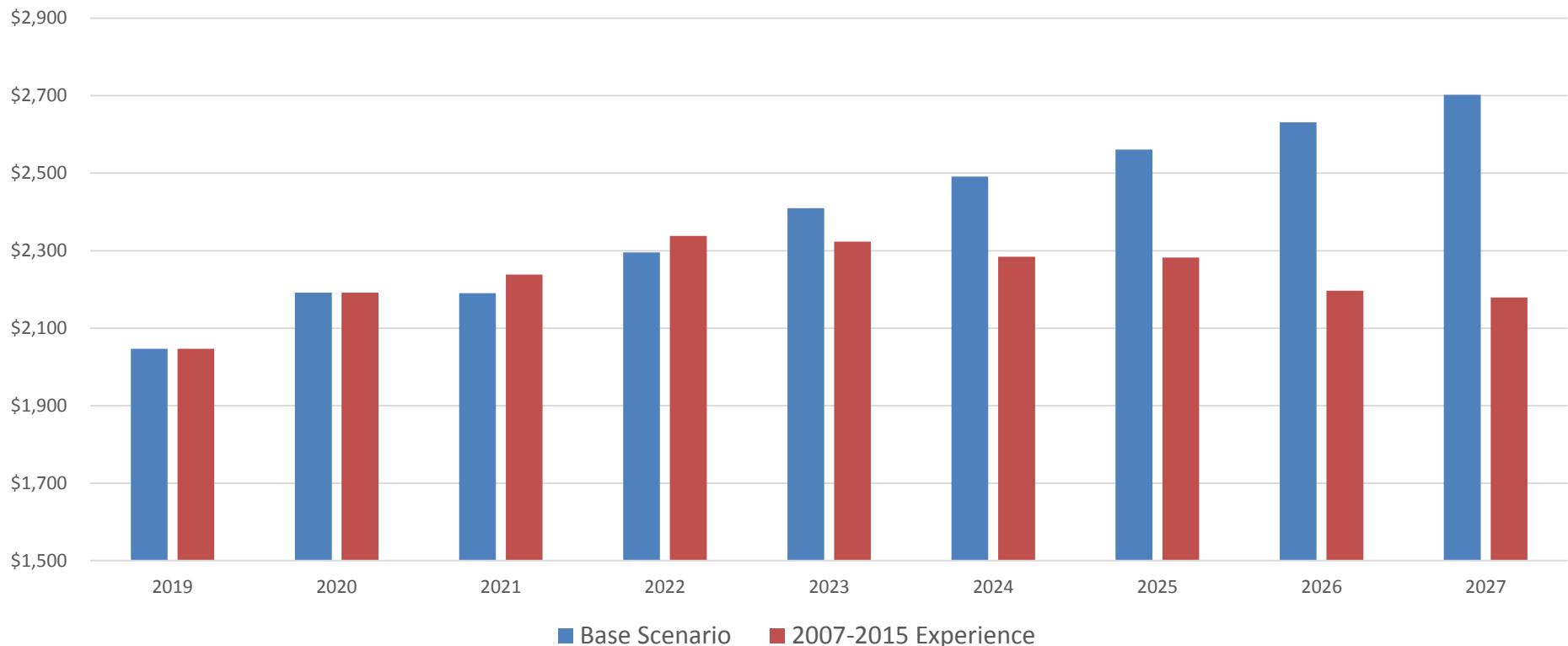
Permanent Fund Earnings Over Draw Impact



- Maintaining the CBR balance at \$2 billion minimum level is crucial but leaves little flexibility.
- An additional \$500.0 million annually taken from the ERA above the structured draw reduces the Permanent Fund balance by \$5 billion compared to a structured draw with additional revenues
- That \$5 billion left in the PF generates \$250.0 million annually - reducing future tax.

Revenue: State Budget Overview

Market Correction Impact



Should Permanent Fund earnings fall short of expectations, the amount available to draw annually declines. For example, using FY07 to FY15 actual returns, the FY2027 draw declines by nearly \$600 million (split between dividend and government).

Revenue: State Budget Overview

Market Correction Impact

Ten Year Forecasts: Average Return and Market Correction

- Scenario 1. Compromise Version SB26 combined with various other actions - 6.95% annual returns
- Scenario 2. Compromise Version SB26 combined with various other actions – FY07-FY15 market returns

*see two-page spreadsheet

Revenue: State Budget Overview

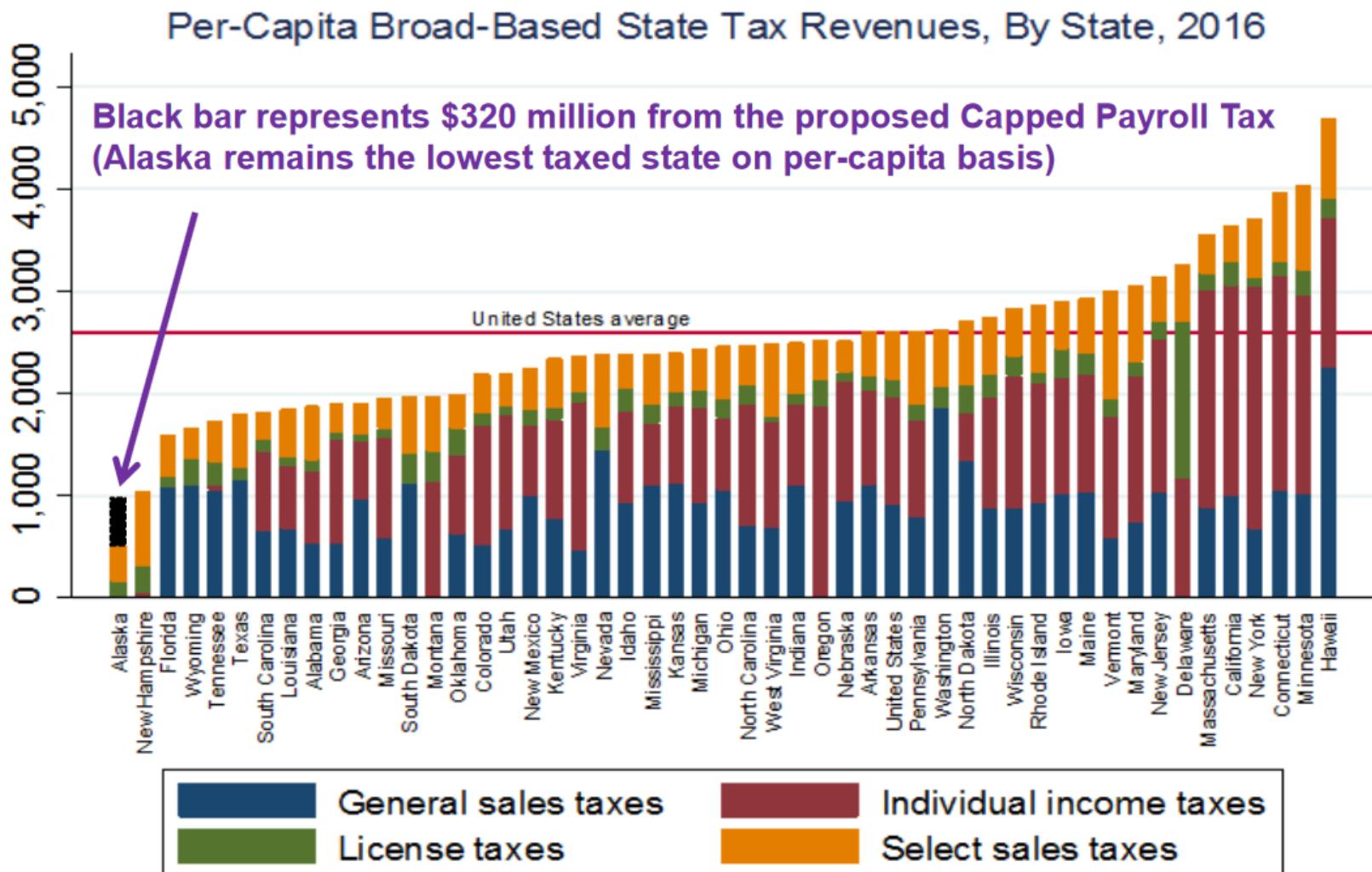
Tax Proposal

| Total Wages and Self-Employment Income | Tax Obligation | Permanent Fund Dividend | Net Tax Payment |
|--|----------------|-------------------------|-----------------|
| \$25,000 | \$375 | \$1,100 | (\$725) |
| \$50,000 | \$750 | \$1,100 | (\$350) |
| \$75,000 | \$1,125 | \$1,100 | \$25 |
| \$100,000 | \$1,500 | \$1,100 | \$400 |
| \$150,000 | \$2,200 | \$1,100 | \$1,100 |
| \$200,000 | \$2,200 | \$1,100 | \$1,100 |

- 1.5% tax on wages and self-employment income
 - Does not tax investments, retirement income, rental income, etc.
- Tax is capped at \$2,200 or twice the PFD, whichever is greater
 - Cap begins at \$147,000/year
- Targeted to generate \$320.0 million
- Without a cap, it would only generate \$10.0 million more
- Including the PFD, most Alaskans will still receive a net payment from the state
- Out-of-state residents will pay the highest rate because they do not receive PFDs

Revenue: State Budget Overview

Tax Proposal



For more information on the budget



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