FY2018 Budget Overview

Introduction

Last year, faced with a $4 billion state budget deficit, Governor Walker proposed a comprehensive solution to the state’s fiscal crisis which was described by David Teal, Legislative Finance Director as, “… the gravest fiscal crisis in state history.” The Governor’s fiscal plan included three parts: 1) state government cuts, 2) sustainable use of the Permanent Fund Earnings Reserve to preserve the dividend near $1,000 while providing revenue for essential state services, and 3) several broad based tax measures.

Last year resulted in additional deep funding cuts, but no agreement on restructuring the Permanent Fund Earnings Reserve, or other revenue measures. To preserve the state’s remaining savings and the Permanent Fund Earnings Reserve, the Governor vetoed a portion of funding for state agencies, oil and gas tax credits above the statutory formula amount, some school funding to communities, part of the Permanent Fund dividend, and halted many large capital projects. The vetoes exceeded $1 billion. After all of these actions, the state’s deficit is still $3 billion. To put $3 billion in perspective, we are draining our savings by $8.2 million a day, or $342,000 per hour.

Alaska has the ability to address this fiscal deficit and avoid economic meltdown if action is taken now. In the FY2018 budget proposal, the Governor is staying the course with a three part fiscal plan, modified in some areas to better conform to proposals the legislature finds acceptable. The budget includes additional government reductions, restructuring the Permanent Fund Earnings Reserve in a manner similar to that passed by the Senate last session, and re-introducing a motor fuels tax. The FY2018 budget proposal leaves a gap of $892 million to be closed this session in cooperation with the legislature.

The Governor is ready to work with the legislature to address acceptable broad-based tax measures such as an income or sales tax and changes to corporate tax rates.

The Governor also recognizes the K-12 education formula and healthcare costs as the two largest cost drivers of the state budget. Long-term cost containment requires a spotlight on these issues. The complexity and the sheer number of stakeholders require an open and in-depth dialog to achieve lasting change while maintaining the quality education and healthcare Alaskans deserve. The administration has been actively working to hold costs down and is prepared to lead work groups comprised of legislators and stakeholders with a goal of identifying and proposing systemic changes for the second session of the 30th Legislature.
Highlights of the FY2018 Governor's Budget

The FY2018 Governor's unrestricted general fund budget total is $4.3 billion, the unrestricted operating budget is $4.2 billion, and the unrestricted capital budget is $115 million. The size of the unrestricted general fund budget is the primary driver of the state's deficit. However, use of designated general funds can offset some unrestricted general fund costs. When considering both unrestricted and designated general funds the total is $5,367 million. Designated general funds include earned fees (business license fees, marine highway revenue from fares, university tuition, etc.), use of earnings from designated funds (power cost equalization, higher education funds, etc.), and annual revenue from taxes designated for specific purposes (alcohol, tobacco, marijuana, insurance, etc.). The total budget including unrestricted and designated general funds, federal, and other funds totals $10,241 million which includes a Permanent Fund dividend of $1,000 per person (Budget Comparison FY2015, FY2017, FY2018).

The FY2018 proposed capital budget of $115 million unrestricted general fund is very minimal, covering federal match for transportation, rural and municipal water and sewer programs, housing, and the minimum deferred maintenance. Agency level re-appropriations will be directed to urgent maintenance needs. Additionally, due to the decision to halt the Juneau access road, a re-appropriation was included to preserve the funding for Juneau and Lynn Canal transportation and infrastructure needs. Last year’s capital budget was very small as well, just $96 million. Before last year, FY2000 was the last time the unrestricted capital budget was this low. (FY2005 was an exception when there were general obligation bonds to cover capital projects.)

1) Government reductions

Since the beginning of Governor Walker’s term in FY2015, unrestricted state operating and capital spending has been reduced by $1.7 billion, 16.6% for agency operating costs including education and health formula programs and a 28.7% reduction when including capital, oil and gas tax credits, retirement and debt service.

In his FY2018 budget, Governor Walker continues to cut government. This budget reduces government agencies by $123 million in unrestricted general funds and a net $73 million cut when accounting for reclassification of the motor fuels tax. Nearly half of the reduction -- $30 million -- was provided by the legislature’s action on Medicaid and criminal justice. Statutory changes are important to reducing the cost of government. Nearly every program the state provides is legislated.

The remaining cuts are from additional executive branch agency personnel cost reductions resulting from reorganizations, consolidations, hiring restrictions, healthcare premium increases, mandatory furloughs, proposed state employee pay freezes, as well as lease reductions and travel restrictions.

There are 2,500 fewer state employees this year compared to two years ago. State employment today is lower than it was in 2002 (comparing month to month to avoid seasonal changes). The
FY2018 budget eliminates 795 positions; this is in addition to the 690 and 774 eliminated in the last two budgets.

The FY2018 budget proposes a freeze on remaining steps and merit increases for exempt and partially exempt state employees. The proposed legislation includes executive agencies, legislature, judiciary, university, and state corporations.

Additionally, state employees covered by AlaskaCare will share the burden of rising healthcare costs starting with a significant employee premium increase during FY2018. State employee health insurance premiums are anticipated to range from $1,200 to $5,400 annually depending on plan and coverage selection. This is in line with other self-funded plans in Alaska and throughout the country.

Future union contracts will be negotiated recognizing these pay freezes and healthcare premium increases. Union contracts negotiated to date include mandated furloughs, and no cost of living increases and contributions for healthcare by all employees.

The Governor recognizes the negative impact this will have on lower paid state employees, but it is necessary for the State to make changes that are equal in measure to the challenge. To demonstrate that change in government must be wide spread and significant, Governor Walker is reducing his own salary by one-third.

The increase in employee health premiums avoided $8 million of state cost increases and the pay freeze, when all entities are included, will provide $9-$12 million in savings, a portion in FY2018 and the remaining amount in FY2019.

Reorganizations, consolidations and outsourcing initiatives are underway. Three major efforts are in the initial phase: shared services for common administrative functions, information technology consolidation, and the Department of Transportation’s design outsourcing. Over the next two years, the Department of Transportation will downsize existing staff and privatize the majority of its design department, maintaining only a small core for project management and oversight. Outsourcing design has the added advantage of bolstering the private sector economy while maximizing the number of projects completed with the available transportation funding. There are 76 position reductions associated with outsourcing design and up to 300 more to follow in future budgets. Shared services provides FY2018 savings of $600,000 and $1.2 million by FY2019.

Unfortunately, the cuts to executive agencies just barely offset the state funded increases for grants to communities, organizations, and individuals. These payments are based largely on existing legislative statutes. The statutory formula for oil and gas tax credits increased from $30 million to $74 million. Based on the statute, the state is current on its oil tax credit payments. Additional oil tax credit reform and new revenue sources to balance the budget are required before payments above the statutorily required level would be practical.
School debt reimbursement and related rural school funding was restored to the statutory level, adding $40 million. The K-12 education formula base student allocation did not increase, but enrollment and funding source changes result in a $6 million increase to unrestricted general funds.

The Medicaid amount in this budget is set at the FY2017 level for now. Reform efforts instituted by SB74 are currently underway and additional time is needed to fully understand the impact on the Medicaid budget and provide a more precise FY2018 estimate. Regardless of the final estimate, due largely to Medicaid expansion, it will remain $50 million to $80 million below the FY2015 level.

2) Restructuring the use of Permanent Fund Earnings Reserve to preserve the dividend near $1,000 while providing revenue for essential state services

The Governor’s FY2018 budget includes the budget related provisions of the Permanent Fund restructure approved by the Senate last session. The calculated sustainable draw from Permanent Fund earnings totals $2,507 million. The Permanent Fund Dividend is set at $1,000 per person in 2017, at an estimated cost of $695 million.

The budget being submitted includes a similar sustainable Permanent Fund earnings draw for FY2017 as a supplemental appropriation. Had the House passed the Permanent Fund restructure there would have been a similar revenue impact in FY2017. Together these two actions restore the balance of the Constitutional Budget Reserve to a level that provides the State the safety net it requires. If the FY2018 budget and proposed Permanent Fund legislation is passed as proposed, the CBR balance at the end of FY2018 will be $5.5 billion. (Alaska Permanent Fund Protection Act).

3) Introduce broad-based tax measures

The motor fuels tax is the only tax bill included in the budget proposal. The budget includes a $40 million increase based on accompanying legislation that increases motor fuels tax from eight to 16 cents in FY2018 to 24 cents in FY2019. Jet fuel tax is increased from three cents to six cents; aviation gasoline is increased from four cents to nine cents. Marine fuel increases from five cents to 10 cents per gallon. The legislation also designates the revenue to transportation and offsets the transportation unrestricted general fund budget for highway maintenance, rural airports, marine highway and the municipal harbor program (Motor Fuels Tax).

Alaska has the lowest motor fuel tax in the nation. Except for the 0.9 cent increase for oil spill response passed in 2015. The last highway tax rate increase was in 1970; marine rate in 1977; aviation and jet fuel in 1994. Assuming the average Alaskan drives the typical 14,000 miles per year with an average fuel consumption rate of 25 miles per gallon, the cost increase for each Alaskan will be $44.80 per year.
Conclusion

The FY2018 budget as presented maintains key services such as education and support to local communities. It maximizes federal funding opportunities to support Alaskans and Alaska’s economy. The budget reduces the draw on the Constitutional Budget Reserve by $2 billion, from $2.9 billion to $892 million, and restores the Constitutional Budget Reserve balance to $5.4 billion, a prudent balance. It is the Governor’s goal to eliminate the draw on savings this year through a collaborative effort. The administration and legislature can find acceptable broad-based tax measures that will fill the gap and put Alaska on track to a sustainable, yet cost constrained budget. This budget and the Governor’s ten-year plan provide the path for the State of Alaska’s long term, sustainable budget (10-Year Plan).