

Fiscal Policy

Summary

The Fiscal Policy Committee recognizes the fiscal challenges facing the Walker-Mallott Administration. Low oil prices, declining oil production, and dependence on oil revenues combine to create a significant deficit in the current fiscal year and for several years to come.

The committee's work followed the Transition Conference plenary presentations on Alaska's fiscal situation from Brad Keithley (independent budget consultant), Jonathan King (Northern Economics), Amanda Ryder (Legislative Finance Division), and Gregg Erickson (Erickson and Associates). It is clear that current spending levels are unsustainable, but that too-rapid spending reductions will have a deleterious impact on the state's economy, and on state services.

The Fiscal Policy Committee's issues and recommendations include short-term actions that can be taken in the first six months of the new administration, together with longer-term measures that will address the imbalance between Alaska's revenues and expenditures.

In the very near-term, the committee recommends suspension and a cost/benefit review of six mega-projects, including those designed to pay for themselves, with the goal of recapturing some existing appropriations and avoiding additional capital appropriations. At the same time, the committee recommends a modest (\$50 million) reduction to the current fiscal year (FY15) budget, together with a significant (\$500 million) reduction to the coming year (FY16) budget.

The administration should work with the legislature to identify expenditure targets for the next four years, with the goal of achieving a balanced revenue and expense budget by FY20. This will require development of new budget strategies that include criteria for capital spending, consideration of all state assets in making budget decisions, and review of all formula program spending.

The committee does not make any immediate recommendation on changes to oil and gas taxation, but does recommend the current tax regime be examined to ensure it is working as anticipated. The committee recommends the administration and legislature work to better communicate Alaska's fiscal situation to the general public, and to begin analyses of alternative revenue sources.

We recognize that the challenges Alaska's fiscal structure are long-standing and cannot be addressed overnight. Alaska's fiscal policy solutions will require sustained cooperative effort between the administration, the legislature, and the public.

Priority Issues and Recommendations for Alaska Fiscal Policy:

Transition Team Committees were asked to identify the top five priority issues in their topic areas by identifying the biggest challenges they believe the State of Alaska needs to work on. Out of many ideas that were brought forward, the top six were voted on and solidified by the fiscal policy committee:

1. Revisit mega projects and eliminate (suspend spending until a more rigorous cost-benefit review)
2. Alaska needs a capital budget strategy
3. Alaska needs a short term budget strategy to deal with imbalance of revenues and expenditures
4. Ensure the oil tax is performing as anticipated
5. Focus on alternative revenues, including assets, in budget solutions
6. Deal with costs, both short term and long term, particularly formula programs

Other Issues Considered

- We need a time horizon to plan around
- We need a strategy based on an objective outlook and a time horizon to plan around
- We need an objective “outlook” (oil prices, reserves, revenue, etc.)
- Alaska needs a sustainable budget using multi-year, long look approach to realistic revenue projections
- The administration should conduct proper due diligence on lowest-cost delivery of North Slope resources
- Alaska needs to change the fiscal policy conversation
- Address the “Alaska Disconnect” - consistency, tax, reverse incentives, globalization
- Advance the large gas pipeline as core priority
- Look at budget growth - framing, expectations, infrastructure, population, economy

For each of the priority issues committees were tasked with identifying what success or resolution of the priority issues would look like and what actions would lead to success or resolution. The committees also discussed what barriers to achieving the success elements would be and what actions might make progress to help resolve them. Below are the recommendations for achieving success or resolution for each of the six priority issues identified by the Fiscal Policy Committee:

Priority Issue #1 Revisit mega projects and eliminate

Success Elements Considered to be Agreeable to Most Alaskans

- Decisive action occurs early
- Saving significant money in first year, from mega projects and programs, reducing the deficit from both
 - a) eliminating ongoing appropriation needs and
 - b) freeing up prior unspent appropriations

Possible Actions to Success on Agreed Success Elements

- Suspend the following megaprojects for a more rigorous fiscal cost/benefit review, considering our fiscal climate
 - Knik Arm Crossing
 - Juneau access road
 - ASAP Bullet Line
 - Sustina Dam
 - Ambler access road
 - Alaska Aerospace Corporation
- Eliminate any General Fund subsidies to industry support programs that are supposed to be self-sustaining
- (Long-term) Moratorium on funding road or other excess projects for the access community or communities are not in support (e.g., Ambler Access affected communities, McCarthy)

Barriers to Further Success

- Nobody wants to lose their project
- Legislative opposition
- Local impact of megaproject
- Adequate information to make decision
- Constitutional and statutory limitations
- Maintenance backlog
- Funding position of state
- Lobbying efforts

Actions to Address Barriers

- Gather data quickly
- Make priority for December 2014 decision
- Public support for fiscal responsibility to counter special interest
- Compared needs on deferred maintenance list to mega-project fiscal needs
- Use revenue bond and public corporations to finance projects with revenue stream, either based on higher oil prices or new revenues
- Outreach with information to Alaskans
- Administration/legislative cooperative planning

- Gather data on projects appropriated with unspent balances
- Learn from past mistakes

Priority Issue #2. Alaska needs a capital budget strategy

Success Elements Considered to be Agreeable to Most Alaskans

- A program that produces a sustainable and prioritized list of projects evaluated on objective criteria

Possible Actions to Success on Agreed Success Elements

- Review status of all current year appropriations
 - Can the purpose still be accomplished with those resources?
 - Can funds be re-appropriated or saved?
 - Can the project be completed as funded or will it need more?
 - Is state money leveraged or matched?
- Stop partial funding of capital projects
- Conduct rigorous macro cost benefit analysis on capital projects
- (Long-term) Seek agreement between administration and Legislature of new objective program evaluation criteria
- Identify cost drivers (things that drive up costs on capital projects) and seek ways to change (with legislative action if necessary)
- (Long-term) Overall debt needs to be predetermined (i.e. % of general fund to maintain AAA rating, etc.)
- (Long-term) Make CAPSIS information available to public
- (Long-term) Conduct rigorous macro cost benefit analysis on capital projects

Barriers to Further Success

- Determining objective criteria
- Available funding
- Legislative District vs. Statewide needs
- Local buy-in (cost share – capital, operating costs)
- Local jealousies/parochial interests
- How to prioritize existing projects
- Special interest groups
- Operation/maintenance cost plan

Actions to Address Barriers

- Metrics need to be defined
 - Job created, cost, etc.
 - Revenues likely to be generated
- Revenue bond/public corporations should be used when possible
- Outreach on process and results
 - Established budget target within means

- Legislative change on the approach and process for capital budgets
- Clear articulation by administration of rationale for inclusion of capital budget
- Established culture of frugality and capital budget plan
- Conduct lifecycle cost analysis

Priority Issue #3. Alaska needs a short term budget strategy to deal with imbalance of revenue and expenditures

Success Elements Considered to be Agreeable to Most Alaskans

- A reduction of \$50 - \$100M (1.2%) from the current year (FY15) operating budget with increased public awareness of the crisis
- Selectively/strategically reduce capital expenses from FY15
- Define budget reduction
 - Target and timelines (step down schedule)
 - Charge the Legislature to create a task force
- Implement budget neutrality requirement
 - New/growing programs require offset
- Target Year-over-year FY16 budget decrease \$500M (to achieve a \$2.5B budget reserve withdrawal)

Possible Actions to Success on Agreed Success Elements

- By February 1, 2015, identify and order line items for sequestration in FY15 operating budget and capital budget
- Analyze and amend FY16 budget proposal to reduce expenditures by \$500 million year-over-year by February 14, 2015
- Meet with Legislative leaders to obtain commitment to expenditure cuts by December 31, 2014
- Develop a budget reduction schedule (broad stroke) with the Legislature by April 15, 2015
- Frame the fiscal challenge and initial solutions in the State of the State address
- Propose budget neutrality rules to the Legislature
- (Long-term) Continue the process laid out above
- (Long-term) Show a long-term plan that gets us through 10 years, using revenues and reserves, and show how next year's plan fits in with that plan

Barriers to Further Success

- Fiscal structure of budget
- "Pink slips at holiday time"
- Tight timelines
- Legislative solutions are needed
- Political gridlock
- Efficiency (5% across the board) vs. effectiveness
- Limited and political capital

- Unintended consequences
- Effect on state economy
- Financial border shifts to other entities
- Equity
- Effective communication
- Lack of impetus to change
- “Not my problem” “not my program, line item...”

Actions to Address Barriers

- Reorganize state budgeting to stimulate thinking
- Invest enough time on communications and outreach
- Create political covers, e.g. Task Forces
- Prioritize actions on span of control
- Set and maintain deadlines
- Reach out for Legislative support and commitment
- Consult with responsible parties (those doing the jobs now)
- Articulate a vision that demonstrates the fairness of the “social contract”
- Reduce spending through attrition
- Encourage entrepreneurial activity on local level
- Make local investments to relieve problems for state cuts

Priority Issue #4¹. Ensure the oil tax is performing as anticipated

Success Elements Considered to be Agreeable to Most Alaskans

- Maximize produced Alaska wellhead value over time discounting for inflation
 - Sufficient to induce investments in new production
 - Increase rig count
 - New field production increase
- Alaska jobs increased
 - Healthy balance with operations/maintenance vs. future production related jobs
 - New entrants to market
 - Facilitate lower energy costs for Alaska residents and businesses
- Economic multiplier impact

Possible Actions to Success on Agreed Success Elements

- Proper due diligence on lowest-cost of exporting North Slope gas

¹ There was a three-way tie for the fourth priority issue, so the Fiscal Policy Committee addressed each of the three items, yielding six top priorities. Priorities 4, 5 and 6 are equally supported by the committee

- Public awareness regarding legitimate state options
- Make or work with federal and state governments on regulations on in-state refineries and other value added companies
- Evaluate best short-term solutions to decrease energy costs for Alaskan
- (Long-term) Track performance of SB21 and modify as necessary to magnify North Slope production ensure minimum tax level
- (Long-term) Formally measure over time how to get multiplier impacts of North Slope development
- (Long-term) Be sensitive to industry needs to maintain/expand ops in Alaska in way that serves Alaska interests

Barriers to Further Success

- Tendency to not to do due diligence
- Special interest forgiving approach
- Lack of critical data (audited)
- Pressure to “do something”
 - Lack of patience
- Alaska jobs - boots on ground
 - Shipping labor to emerging developments
 - Judicial history
 - Workforce development and training
 - Industry inertia (no pressure to change)
 - Global employment culture in Oil and Gas
 - Lack of economic incentive to grow Alaskan based companies
- Realizing economic multiplier impact
- Lack of shared interest between owner, producer, contractor(s)

Actions to Address Barriers

- Education of the public and elective officers
- Governor encourages consensus processes
- Prioritize these audits over others
- Competitive expert auditor pay
- A dedicated Cabinet/administrative focus
- Use tax policy to encourage actions
- Encourage new entrants
- Recruit oil and gas retirees to service
- Develop institutional expertise on energy within state
- Develop a think tank (look at Norway)
- Consider novel contracting structures
- Examine the impact of leasing model (e.g. monopoly rights, lease terms, performance)

Priority Issue #5. Focus on alternative revenues, including assets, in budget solutions

Success Elements Considered to be Agreeable to Most Alaskans

- Reducing the deficit at a rate that avoids the point of panic (soft landing); there will be public acceptance of reductions at a level that avoids or minimizes recession
- Developing other revenue streams; including new industry with the tools other than tax abatement, which will require regulatory buy-in
- A public that understands how the Permanent Fund works, manifested at the level of the Legislature
- Tax rate on non-oil industry that will allow them to thrive while contributing
- Alaska Municipal League understanding and supporting policies
- Alaskans have skin in the game
 - At what level are Alaskans paying taxes?
- Old (unspent) capital budget dollars are on the table for appropriation
- Elected leadership and administrations (state and local) share the issues with public

Possible Actions to Success on Agreed Success Elements

- Task someone in the Governor's office or the Office of Management and Budget with leading public communication and education around additional revenue sources (taxes on non-petroleum, broad-based personal tax; use of permanent fund in ways other than current, such as earnings reserve, percent of market value [POMV], etc.)
- Assess potential re-appropriations
- (Long-term) Assess the tax structure in nonpetroleum industries
- (Long-term) Continue permit streamlining
- (Long-term) Examine possible broad-based personal taxes
 - Assess, discuss, possibly implement on residents and non-residents
- (Long-term) Deposit state earnings currently going to ACIF (Alaska Capital Income Fund) into the General Fund
- (Long-term) Consolidate administrative functions (leases) and more cost effective manners
- (Long-term) Look at ways to monetize non-cash and natural resource assets

Barriers to Further Success

- Public understanding of the complex subject of the fiscal issue (individual, municipalities, stakeholders)
 - Diversity of messages from different interests
 - Language barrier
 - Ends do not equal means
 - Bureaucratic status
 - Legacy of spending mentality
 - Financial side pays for social side
 - Political voice is not willing to speak candidly

- Short term mentality
- Elected leaders share issues with public
 - Different needs among different political bodies
 - Election cycles
 - Ability to track and retain talent
 - Conflicting needs across geographies
 - Understanding of revenue streams is siloed
- Unspent capital on table for re-appropriation rather than rolling into General Fund
 - Political interests/lobbyist
 - Needs of district
 - At agency level, lack of transparency about unspent funds
 - Compromise/(political) capital budgeting
 - Economic interests
 - Industries that feed off budget
 - Confident project management
- Tax structures on non-oil resources
 - Lowest hanging fruit (mining?) has strong constituency
 - Needs of local government taxation
 - More bang for buck on oil fiddling
 - Expectation of no/low taxes developed over 1-2 generations
- Alaskans with skin in the game (broad-based tax)
 - Alaskans
 - Transient population
 - Entitlement mentality
 - Perception of Alaska as “get rich place”
 - Public understanding of situation
 - Unbalanced understanding of relative contribution of taxes already paid
 - Resistance of industry to pay for socio-economic impacts

Actions to Address Barriers

- Governor and Administration talk about the fiscal issues
- Regional roundtables
- Formal state interest publications
- Governor provides political cover/frame conversation, etc.
- Revenue sharing
- Cabinet coordination
- Put pressure on legislature
- Line-item vetoes
- Sunset for appropriations
- Encourage opening up CAPSIS (in legislative branch) to public
- Governor demands from agencies
- Get good people to lead
- Benefit/cost analysis for projects
- Tax rate analysis
- Better data

- Communicate with local government
- Education/public outreach
- “Department of Skin in Game”

Priority Issue #6. Deal with costs - short term and long term, particularly formula programs

Success Elements Considered to be Agreeable to Most Alaskans

- FY 15 budget control plan - a reduction from current FY 15 budget
- FY 16 - FY20 expense and revenue profile with multi-year progress on operating deficit
- FY 16 operating budget is constrained budget within profile
- Growth in formula programs is constrained
 - Comparison of project and actual formula performance
- Formulas encourage rational restructuring of efficient services, including revisions to formulas
- Short-term capital budgets focus on energy conservation and deferred maintenance projects that demonstrate operating savings, with demonstrated Return on Investment
- Budgets recognize opportunity cost of underperforming assets
 - Analysis of assets’ Return on Investment
- Public understanding of budget growth and last decade
 - Fiscal policy outreach program

Possible Actions to Success on Agreed Success Elements

- Fiscal policy conferences / workshops / forums around the state
- FY16 capital budget includes energy continuation projects for districts, state, municipalities, and university - that generate operating savings
- Analyze return on investment on state corporate assets and funds
- Establishing communicate FY16 budget priorities for FY16 and beyond. Use those priorities to established operating targets by department/function.
- Develop multi-year revenue and scenario - target budget actions to meet revenues
- (Long-term) Analyze opportunities to restructure delivery of state services, including
 - Education
 - Medicaid
 - Agency operations
 - Staffing
 - Outsourcing
- (Long-term) Establish a task force on formula programs and prepare legislation to revise formula program allocations
- (Long-term) FY17-20 Budgets developed to achieve FY20 Recurring revenue = FY20 recurring expense = sustainability operating budget
- (Long-term) Review and refine formula program results to ensure restraint/limit did occur (without using one time funding/reserve)

- (Long-term) Use vacancy and retirement management program to reduce/limit state personnel expenditures

Barriers to Further Success

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- Reach out for legislative support and commitment
- Consultation with responsible parties (those doing the jobs now)
- Articulate a vision that demonstrates fairness “social contract”
- Reduce through attrition
- Entrepreneurial activity on local level
- Make local investments to relieve problems for state cuts

Other Recommendations

- Stronger collaboration with Denali Commission and other partners
- Seek federal OCS revenue-sharing
- Reduced \$ spent fighting federal government
- Divest state lands interest for \$
- Consider which programs to protect the budget process (municipalities)
- Considered differential impact of budget reductions on different communities (especially rural)
- Empower public employees to make decisions, reducing outside contracts
- Get more areas of state to organize local government
- Rational needs basis in budget cutting
- Local hire incentives

Possible Next Steps

- Are we being too timid?
 - Reevaluate role of state services; downsizing budgets
- Overarching goal - maximize wealth from resources to take Alaska the rest of the way
- Possible continuing role of the committee to provide context and assist progress
- Working group on task necessary to focus on results now
- Need methodology/approach to ensure buying from state employees/departments
- Visibility in how fiscal recommendations fit in with other 16 groups
- Need process/team for follow through long term recommendations
- Positive steps on outreach and community consensus (e.g., Mallott oration skills)
- Use of social media
- Team participants individually take the role of info dissemination
- Pictures of all charts to members with interest