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Planning Amid Abundance: Alaska's FY 2013 Budget Process

Abstract: This report describes the fiscal policy process relating to the development of Alaska's FY 2012–2013 budget. Alaska entered FY 2013 with a substantial surplus and with hefty financial reserves. The report explains the origin of these conditions, which distance Alaska from most of the other western states; it also provides information on the threats to Alaska's fiscal stability represented in its extreme dependence on depleting oil reserves and on federal government support.

Keywords: Alaska; budget; FY 2012–2013; governor; legislature; West.

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1 Introduction

This paper describes the fiscal policy process explaining the Alaska FY 2013 budget plan. It covers the period from the most recent Alaska report (McBeath and Corbin 2011) in late August, 2011 to December 2012. The report begins with a discussion of the Alaska economy from the third quarter of 2011 through most of 2012 and briefly treats the redistricting process after the 2010 census, which set the parameters for the 2012 state elections.

Next, we discuss state issues with a federal connection tracked in the Alaska reports over the last dozen years. The core of the paper is analysis of the FY 2013 budget process, including the governor's requested budget (operating, supplemental and capital), and legislative responses. A special section examines the main fiscal issue of the 27th Alaska Legislature: Governor Parnell's proposed reform of the state oil taxation regime, followed by a report on the 2012 special session.

The last section of the report presents the final state budget, with analysis of revenues, the capital, supplemental and operating budgets for FY 2013, and reserve funds.

Alaska entered FY 2013 with a substantial surplus (variously estimated from $2 to $3.7 billion) and with hefty financial reserves. The report explains the origin of these conditions, which distance Alaska from most of the other western states;

it also provides information on the threats to Alaska’s fiscal stability represented in its extreme dependence on depleting oil reserves and federal government support.

2 The Alaska Economy in 2011 and 2012

Alaska’s economy has three pivots: the oil and gas industry, the Alaska Permanent Fund (PF), and everything else (including disproportionately large federal receipts in the last two decades). The oil industry through severance taxes, royalties, and corporate income and other business taxes supplies 92% of the general fund (GF) revenue of the state. Since 1980 the state has not had an income tax; it never has had a state sales tax; earnings of the PF contribute little to state government revenues.

Yet economic conditions have been good in Alaska during the national economic downturn. The October 2012 rate of unemployment was 7.1%, as compared to a national rate of 7.9%. Job growth was good in nearly all categories except some construction trades and the public sector. Because of its seasonal economy and limited job opportunities in most rural areas, the Alaska unemployment rate typically is higher by several points than the national average, but in the last 3 years it has been below the national rate (Alaska Economic Trends February 2012). State taxation of hydrocarbons explains the difference, and because tax revenues depend on both the highly volatile price of oil and the amount of production, we consider these first before discussing other natural resource circumstances and the state’s return on investments.

2.1 Oil Prices

Nine years ago, at the start of the Murkowski administration, oil prices were in the $20/barrel range, and the state suffered. The treasured longevity bonus for seniors was one of many casualties of low oil prices. Then global supply of oil declined as US wars in Iraq and Afghanistan and also later general Middle East war scares disturbed the market; on the demand side, China and to a lesser extent India and other emerging market economies aggressively sought oil resources globally. Together, these forces brought a 5-fold increase in the price of oil. During the review period, prices did not fall below $100/barrel until May 2012 (*Anchorage Daily* News [ADN], 5/5/12). The state’s Department of Revenue (DOR) estimated that the price of oil for FY 2012 would be $109.33/barrel and for FY 2013, slightly higher, at $109.47/barrel (DOR, Revenue Sources Book [RSB], Fall 2011). These are healthy prices for an oil-dependent state, and explain Alaska's budget surpluses now.

2.2 Oil/Gas Production Prospects and Problems

However, production from the state's legacy fields of Prudhoe Bay and Kuparuk has continued to decline. From the peak North Slope oil production of 2.1 million barrels/day in 1988, by 2011 production had declined to 603 million barrels/day. DOR projections for 2012 and 2013 are 0.580 million barrels/day (a decline of 4% from 2011) and 0.563 million barrels/day (a decline of 3% from 2012 (DOR, spring 2012 Forecast, 4/15/12). Although new oil is replacing some of the depleted Prudhoe Bay and Kuparuk production, it has not been located and brought online sufficiently quickly to ease fears of a near-term oil industry collapse in Alaska.

There was some good news on the oil and gas front in 2011 and 2012. A US Geological Services report (the first of its kind) indicated that North Slope shale formations could contain two billion barrels of oil and 80 billion cubic feet of natural gas. If so, this would be among the largest shale deposits in the US. The agency opined that using today's hydraulic fracturing technology, the oil and gas could be tapped (*Fairbanks Daily News-Miner* [FDNM], 2/25/12).

The largest gas field in the North Slope is at Point Thompson, which has been in litigation because the state believed ExxonMobil (the largest holder of gas leases in the state) had no intention to develop the gas. In April 2012, the state dropped its suit (FDNM, 4/411/12) and shortly thereafter approved the Final EIS for development (ADN, 7/30/12) and issued a permit to the company (FDNM, 10/27/12).

Later we discuss Alaska's Outer-Continental Shelf (OCS) deposits, but the potential oil recovery in this vast region is huge. Shell announced in late 2011 that its Burger Prospect in the Chukchi Sea had the potential to become a multi-million barrel field and a basin opener for the region. A pipeline would connect this OCS development to National Petroleum Reserve-Alaska (NPR-A), regarded as the most likely on-shore oil development region (Alaska Economic Report [AER], 9/10/11).

Our previous reports on Alaska natural gas mentioned declining production in Cook Inlet. This situation changed in 2011 as independents discovered several new fields. Escopeta discovered a field containing 3.5 trillion cubic feet (ADN, 11/7/11, AER, 11/8/11). Buccaneer discovered a half-trillion cubic foot resource (ADN, 3/11/12). Then a subsidiary of Cook Inlet Regional Inc. made a large gas find on the Kenai Peninsula (AER, 11/20/11).

Oil industry employment on the North Slope reached a record high for recent years. The McDowell Group reported that the industry had 4000 direct oil field jobs in 2011; industry support and oil field services created another 7700 jobs; and indirect employment effects created 26,000 jobs – a total of 44,800 jobs and an annual payroll of $2.65 billion (AER, 10/31/11; 2/4/12). However, oil and gas production activity slowed by 13%, while operating costs rose (AER, 2/20/12). This decline in activity was a fact often repeated in the industry's argument for tax reductions.

2.3 Other Natural Resources

With the exception of forest products and later King salmon, Alaska's other natural resource sectors performed well in 2011. The fisheries and seafood industry found the international market less soft than the domestic. Although the 2011 salmon harvest was no larger than that of the previous year, higher prices brought in more profits (ADN, 10/10/11). Tourism operators reported modest increases for 2011, with an appreciable increase in international traffic (ADN, 9/4/11).

Mineral industries reported larger gains than Alaska's renewable resources in 2011–2012. The high price of gold brought a new surge of interest in hard rock mining. Gold peaked at $1907/ounce in September 2011; from 2003 through 2011 the average price was $1572/ounce (FDNM, 7/15/12). The most recent peak of mineral production was $3.4 billion in 2007. The production value in 2010 was $3.1 billion (FDNM, 11/10/11), and it seemed likely to reach the 2007 level in 2011 or 2012, as new finds at developed mines such as Pogo in the Interior extended project life (FDNM, 4/14/12).

During the report period, controversy continued to surround the plans to open the Pebble Mine, which in the opinion of environmentalists and fishermen would threaten the Bristol Bay salmon fisheries in southwest Alaska. Opponents of mine development challenged the state's decision to issue exploration permits (FDNM, 9/28/11); they criticized the 27,000 page environmental study issued by Pebble Limited Partnership (FDNM, 2/27/12); and they placed an initiative on the Lake & Peninsula Borough's local election to ban mining that would destroy or degrade salmon habitat. In the campaign, mine opponents attracted national attention with the assistance of Robert Redford, a national chefs association, and Tiffany's (which vowed it would not sell gold from the project), and the initiative passed with a vote of 280-246 (ADN, 10/18/11, 10/19/11). An EPA report said the mine could harm fish habitat (FDNM, 5/14/12); and the controversy seemed certain to continue (ADN, 11/10/12; AER, 5/25/12; 7/15/12).

Alaska has 70 of the rare-earth elements (REEs), which increasingly figure in national and international trade and investment debates. In late September 2011, public and private sectors joined in a state summit on REEs, with a focus on "critical and strategic minerals" (FDNM, 9/30/11). The seminar met for the second time in September 2012.

Most newly discovered mines in Alaska are distant from transportation routes, and thus mineral development is linked to "roads (or rails) to resources" and infrastructure construction. Governor Parnell proposed a 36-mile road to the interior village Tanana for access to gold and other minerals (FDNM, 12/8/11; 7/16/12). A second road proposal was to connect the Dalton Highway (heading north from Fairbanks to Prudhoe Bay) to Umiat, a site where the Navy discovered oil in the early 1940s (*Alaska Legislative Digest* [ALD], 2/20/12). A third transportation proposal would connect the state's road system to the Ambler Mining District in the western Brooks Range. This 220 mile road would likely cost $430 million (AER, 9/26/11, 10/7/11). The Ambler site could also be reached by an extension of the Alaska Railroad, at slightly higher cost. All proposals to build roads to resources have encountered opposition from community residents who fear "outsiders" will exploit their fish and game resources. (FDNM, 8/3/12; also *Alaska Legislative Digest* [ALD], 4/19/12).

2.4 Returns on Investments

The state's largest single asset remains the PF, which lost $10 billion of its value in the recession. Since 2009, the PF has regained all of this loss; its unaudited market value on November 28, 2012 was $42.6 billion. Although the legislature has approved minor government expenditures from the earnings reserve of the PF, its major role for Alaskans and state economic development is providing earnings to fund Permanent Fund Dividends. In late September, 2011 Governor Parnell happily announced that the 2011 dividend – given to each eligible Alaskan – would be $1174. This amount was $107 less than the 2010 dividend, as the amount is based on a 5-year rolling average of PF earnings. The PF dividend in 2012 was only $878, one of the smallest payouts in program history (ADN, 9/09/12).

3 State Population and Redistricting

The essential demographics of the Alaska population – size, characterization by age, race, ethnicity, gender, education, income – did not change much from previous reports (McBeath 2010; McBeath and Corbin 2011). However population changes identified in the 2010 census were reflected in the state's redistricting process. Alaska's process now is conducted by a five-member Redistricting Board, which has a strong Republican bias. The preliminary report of the board proposed major changes, most noticeable in the Interior and western Alaska rural regions. The plan was approved by the federal Justice Department (a requirement of the Voting Rights Act of 1965; FDNM, 10/12/12).

Two citizens and the Fairbanks North Star Borough filed suit in state court alleging that the plan violated the state constitution, which requires that election districts be compact and contain areas with similar socio-economic characteristics. They objected to two house districts which divided the city of Fairbanks; to one house district that joined a suburban Fairbanks area with small, distant coastal village populations on the Bering Sea; and to a fourth house district stretching from the Interior to the Aleutians. Plaintiffs believed the plan was a political gerrymander, as it placed two incumbent Democratic senators in the same senate district, and two incumbent House members, one Democrat and the other a Republican, in the same district.

By the end of 2011, Superior Court Judge Michael McConahy had agreed to hear the case. The affected senators told the judge that the board had engaged in political gerrymandering (FDNM, 1/10/12). A voting rights expert invited to defend the board said the plan, while flawed, did meet requirements of the Voting Rights Act (to insure that the number of districts in which Native, or Native-supported candidates, would be competitive had not been diminished; FDNM, 1/11/12). Based on the testimony Judge McConahy invalidated all four of the proposed House districts (1, 2, 37 and 38), and required the board to redraw them (FDNM, 2/4/11). Both sides then appealed to the Alaska Supreme Court. In mid-March, this court both agreed and disagreed with the superior court. It ordered that the plan to pair two Fairbanks House districts resulting in pitting two incumbent Democratic senators against one another was incomplete. It violated *Hickel v. Southeast Conference*, an earlier Supreme Court decision requiring the redistricting board to first draw a plan meeting state constitutional requirements, and then to determine if the plan met terms of the Voting Rights Act. However, in a third decision the high court declined to mandate a redrawing of the other two House districts (ADN, 3/15/12; 5/23/12).

The Redistricting Board drew "the amended proclamation plan" complying with the court's order, and submitted it to the federal Department of Justice (ADN, 5/4/12; FDNM, 5/11/12; ALD, 5/23/12, 6/11/12). The interim plan was used in the 2012 primary and general elections; it is uncertain whether it will be used for the rest of the elections of this decade, because it has not survived all legal challenges.

The board's consistent objective was to create a Republican majority in the Senate (and thereby destroy the Bipartisan Working Group) and to increase the number of Republicans in the House. It did this through straightforward "cracking and packing"–collecting Democratic votes into a smaller number of districts while spreading Republican votes more widely. For example, in the general election, the plan paired two incumbent Republican senators against two incumbent Democrats, with the former in more congenial precincts. This gave Republicans the majority in the Senate. In the House, the plan paired two incumbent Republicans against two incumbent Democrats. As we shall see, the plan produced the outcomes its framers intended – a Republican-controlled legislature.

4 State Issues with a Federal Connection

We treat four issues that have some bearing on fiscal policy in Alaska: the Arctic National Wildlife Refuge (ANWR), OCS drilling, the natural gas pipeline, and federal government downsizing in Alaska. We also make a brief reference to the congressional delegation.

4.1 Arctic National Wildlife Refuge (ANWR)

As the best candidate for the next giant on-shore oil field in the US, ANWR invariably enters energy policy discussions. The last half of 2011 was a particularly opportune time because of deficit and debt concerns, and Representative Doc Hastings, chair of the House Natural Resource Committee, suggested that the congressional deficit committee open drilling in ANWR to reduce the deficit (ADN, 9/8/11). When that did not materialize, Hasting and Alaska's sole congressman Don Young (ranking member of the resources committee) introduced the Alaska Energy for American Jobs Act, another vehicle to open ANWR for oil exploration (FDNM, 11/12/11). An half dozen Alaska legislators joined the lobbying campaign, and the US House did pass a drilling-friendly energy package, which lifted the ban on drilling in a small section of ANWR, by a vote of 237 to 187 (ADN, 2/17/12). Predictably, the US Senate failed to support this action, voting against it 57 to 41. Senator Lisa Murkowski lamented that ANWR would not be opened soon, but she said it "will be drilled" when the Senate is under Republican control and the administration sympathetic (FDNM, 3/15/11).

4.2 OCS Drilling

Royal Dutch Shell claims to have invested $5 billion in efforts to drill for oil in five leased near-shore areas of the Chukchi and Beaufort Seas. Drilling advocates complain that the EPA has unnecessarily delayed issuing permits (particularly air quality permits), but the agency faces multiple pressures, including strong objection to the permits by organizations representing Alaska Native villages and environmentalists (FDNM, 10/25/11). Drilling opponents challenged the Interior Department's allowing Shell to drill exploratory wells too, but the department and the Bureau of Ocean Energy Management formally authorized the drilling with explicit time stipulations (ADN, 12/17/11). Under pressure from the oil industry and resource states like Alaska, the Obama administration upheld its decision to sell 500 new leases to drill for oil in arctic waters, and to expand oil drilling in Alaska from 2012 to 2017 (FDNM, 10/4/11; 11/4/11).

In the 2012 season, Shell began drilling "top holes" in the Chukchi Sea (drilling down to hydrocarbon-producing zones requires presence of a spill response barge, delayed this year; *New York Times* [NYT], 5/23/12; AER, 9/3/12). Shadowed by Greenpeace, Shell ended the short season in October, remaining optimistic about the prospects for offshore drilling (FDNM, 11/1/12). (For the national interest represented in this issue, see Broder and Krauss, "New and frozen frontier awaits offshore oil drilling," *New York Times*, 5/23/12.)

4.3 Natural Gas

Much discussion but little action has occurred on moving Alaska's huge natural gas deposits to market, especially because the abundance of shale gas in the lower-48 states has lowered prices. Governor Parnell changed his strategy on exporting gas to other areas late in 2011. He asked the state's largest gas owners (ExxonMobil, BP, and ConocoPhillips) to agree to his proposal on liquefied natural gas (LNG). He met with the Alaska CEOs in early January, 2012 and set an end-of-March deadline for "alignment" of the companies' position on LNG exports with the state's (FDNM, 10/28/11; ADN, 1/5/12, 1/6/12; AER, 1/9/12; ALD, 1/22/11). He announced that the producers were in agreement with the state on development and eventual sales of Point Thompson gas, although it remained unclear whether a large LNG project would be feasible and profitable (ALD, 4/2/12).

A major hurdle for a large diameter gas line is public skepticism. A Dittman poll in March 2012 indicated that 74% of the sample either was not too confident or not at all confident that the administration's AGIA plan would work – bringing a natural gas pipeline for Alaska. Respondents blamed these factors for the failure to build a gas line: flaws in the AGIA process (17%); failure of leadership to "do what it takes to get the project started"(48%); change in market conditions (22%). Some 13% were unsure (Dittman Research, 3/2012).

Discussion continued throughout the year on construction of a bullet line from the North Slope, either to Valdez, to Southcentral, or just to the Interior. New discoveries of gas in Cook Inlet prompted leaders to include moving gas from the Inlet to the Interior. There is no question that an in-state gas line would cut local energy costs, some experts say by as much as 80% (FDNM, 12/7/11). But the market for gas – the population of the Interior is little over 100,000 and rural villages where heating costs are the highest have fewer than 20,000 people – is small. Toward the end of the review period, discussion had focused on trucking natural gas from the North Slope to Fairbanks for distribution there (FDNM, 11/18/12).

4.4 Federal Government Downsizing

The federal government is the largest government employer in Alaska. The combined total of military and civilian employees exceeds 40,000, and the state in most recent years has been the top recipient of federal funds among all states. Changes in two agencies made news in Alaska in 2011–2012. First the US Postal Service sought to close 33 expensive rural post offices. Hollers from 27 off-road communities led to proposed cuts of only 6 stations on the road system (FDNM, 9/10/11). For the last 3 years, the USPS has sought to eliminate or sharply reduce the "bypass" mail service it provides to remote rural communities, and this attempt continues.

The US Air Force initiated a second proposal to move the squadron of F-16 fighter planes from Eielson Air Force Base (25 miles south of Fairbanks) to the Joint Base Elmendorf-Richardson in the Anchorage area, and to retire four elderly C-130 cargo planes. Lt. General Hoag of the Air Force said Eielson would retain the National Guard refueling unit and continue to play a critical role in the Red Flag training exercises (FDNM, 2/11/12). The Fairbanks community feared this was the first step in another attempt to close Eielson and quickly began mobilizing itself to resist this change. Eielson hosts more than 5000 military and civilian employees of the Defense Department; its contribution to the borough's economy is estimated to be around 10% (FDNM, 2/4/12).

The Air Force justified the proposal by the need of the Defense Department to reduce expenditures by $487 billion in 10 years, to do its part in reduction of national deficits and debt. However, the amount saved by moving most of Eielson's functions south would be just $32 million over 5 years, said locals (FDNM, 2/19/11). Critics were skeptical that even this much would be saved, and they pointed to a new Government Accountability Office report on the 2005 base closures (including the downsizing of Eielson) that showed sharply lower savings (ADN, 3/9/12). In response to the howls of the congressional delegation, AF generals visited Alaska and agreed to present firmer numbers on potential savings (FDNM, 3/13/12). Both the state and most affected local government (in Fairbanks) hired consultants to prepare yet another campaign to "save Eielson."

By the end of the review period, opponents of the proposed move had upped the ante. Senator Begich placed a hold on an Air Force officer's promotion until he "got answers" to his F-16 questions. Senator Murkowski extracted a promise from Defense Secretary Panetta that Eielson would not close (ADN, 4/21/12; FDNM, 5/16/12, 6/14/12). The delegation sought to link blocking the transfer of F-16s to essential budget actions (FDNM, 8/1/12). Yet without an advocate for Eielson with the status of former Senator Ted Stevens, the Alaska political establishment faced great difficulty in making its case when national economic circumstances were far poorer than Alaska's.

4.5 Congressional Delegation

On issues considered vital to Alaska, such as retaining federal installations and dollars and easing federal restrictions, the delegation of two Republicans (Murkowski, Young) and one Democrat (Begich) worked together well. On social issues – for example whether the state should or should not seek a waiver to opt out of NCLB, or whether abortion expenses should be covered under insurance programs of Catholic institutions – they divided along partisan lines (FDNM, 9/24/11; ADN, 11/11/11; 6/29/12).

5 The FY 2013 Budget Process

In 2012 Alaska had a conservative Republican governor, Sean Parnell, a Republican majority in control of the state House, but (until the general election) a Bipartisan Working Group (including 10 Democrats and 6 Republicans of the 20-member body) ran the Senate.

Well before introducing his request budget for FY13, Governor Parnell said he wanted a "reasonable" operating budget and a "healthy" capital budget (FDNM, 10/31/11). At this time, Alaska was one of only a handful of states with budget surpluses, as it had taken in $1.9 billion more in FY11 than expected, and estimates then were that the FY12 surplus would be nearly as great (ADN, 11/6/11). Initially, revenue estimates for FY 2013, even based on somewhat higher oil prices predicted for this year, were some $700 million lower than the current year – largely because of production declines (ALD, 12/18/11).

However, by the time of the spring 2012 forecast, DOR said it expected $942 million more GF revenues in FY 2012 and an additional $222 million more in FYI 2013. Indeed, the department predicted that GF revenue in the coming decade (FY 12-FY 21) would be $82 billion as a result of higher oil prices. It also anticipated slightly higher oil production (AER, 4/12/12).

5.1 Executive Budget Request: Operating

The Alaska Constitution requires the governor to submit his/her budget request on December 15, thereby giving the legislature slightly more than a month to consider it before its January session begins. Governor Parnell proposed a $12.1 billion operating and capital budget for FY13, some $800 million less in total spending than FY12 (thus more than offsetting the anticipated decline in revenues for FY 2013). He mentioned the $3.7 billion expected budget surplus, remarking "with that lower starting point on dollars and positions, we can have a public conversation with the Legislature about needs versus wants ... about efficiencies and about more effective use of the public's dollars." (FDNM, 12/16/11). Parnell estimated that the growth in the operating budget would be about 3.5%.

The governor proposed flat funding for K-12 education, but an $8 million increase for his performance scholarship program for high school graduates attending the University of Alaska. Explaining the governor's disinclination to increase the Basic Student Allowance (BSA), OMB Director Karen Reyfield said since 2007, state funding of K-12 education had increased by $182.8 million or 20%; however, the number of students in the public school system had not changed much (in the neighborhood of 129,000–130,000) and the state needed a new approach (ADN, 26/11).

In his State of the State address, Governor Parnell said: "Amid this sea of uncertainty, Alaska has emerged as a rock of stability. But while we are well positioned, Alaska is not immune from an ailing global economy." He urged the legislature to pass "meaningful tax reform" to refill the Trans-Alaska Pipeline System (TAPS) and boost throughput to 1 million barrels per day. Also, he urged legislators to support construction of a large-diameter LNG gas pipeline through Alaska to tidewater. Parnell mentioned developing other resources (fish, timber, rare-earth elements), sought aid for small businesses, championed investment in education (higher, not K-12) and safety, and vowed to fight against domestic violence and sexual assault (FDNM, 1/19/12; ALD 12/18/11). We return to the operating budget after introducing the governor's supplemental and capital budget requests.

5.2 Supplemental Budget

In early February, Governor Parnell released his supplemental request. This request totaled $97 million including $78.5 million from the state's general fund; the request was about $28.5 million larger than what he had requested the previous year. Nearly half of the general fund request was for legal judgments, a good portion of which ($18 million) would fund the settlement reached in *Moore v. State* (to resolve in several years contestation over the adequacy of the K-12 education system for disadvantaged rural youth). Additional supplemental funds would pay for fire suppression activity, disaster relief, Department of Law litigation, adult public assistance, low-income home energy assistance, replacement of federal funds no longer available for traffic enforcement and a half dozen smaller projects (ABR, 2/2/12).

5.3 Capital Budget

The governor's initial capital budget proposal was $1.4 billion, which was 34% lower than his FY12 request. Too, he proposed a $350 million bond package for road and port improvements statewide. As in recent years, this is the last budget the legislature enacted; quickly legislators in the House and Senate added more than $1 billion to the request. Unlike recent years, the two branches did not spar over the size of the budget.

5.4 Legislative Responses

The legislature began the second session of the 27th Alaska Legislature considering how much of the surplus to save, whether funds should be placed in the PF, and whether the bodies should cap spending (*Juneau Empire* [JE], 1/17/12). In response to the governor's State of the State address, Senator Paskvan of the Senate's Bipartisan Working Group emphasized that senators were moving forward on oil taxation issues: "We know more facts than we did a year ago, and I think we have a better foundation to act upon" (JE, 1/19/12). Representative Beth Kertula, leader of the Democratic minority in the House, wanted a "fair share" for all Alaskans and more emphasis on education: "There really isn't any better investment than investing in Alaskans … We should give every Alaskan that wants to learn the best opportunity possible" (JE, 1/19/12).

David Teal, Director of the Legislative Finance Division (the legislature's budget office and watchdog) gave an address to legislators reported widely across Alaska. Teal commented that since 2005, the Alaska budget had grown at a rate of 7.8% annually, and this was not sustainable. The proposed budget had a 3.2% increase for operating expenses, which would keep the state's reserves safe until 2025. He recommended that the legislature deal with the unfunded pension liability of the state (estimated to be $11 billion in 2012) during the session. He pointed out that the decline in oil production meant only higher oil prices would avoid a deficit. The FY 2012 budget could be balanced on $94/barrel; however, the FY 2013 budget, of relatively the same amount, would require oil to be priced at $100/barrel in order to be in balance (because of the decline in oil production). In passing, Teal remarked that about half of the $800 million the governor claimed to have reduced in his request was composed of savings (largely unfilled positions) already made. Overall, he said the 2012 session was critical to the fiscal health of the state, and urged legislators to save more to delay the onset of deficits later (FDNM, 1/23/12; ABR, 1/25/12).

On March 15, the House passed a $9.5 billion state operating budget on a 31–5 vote. The size of this budget was $500 million larger than the FY 2012 operating budget. The House bill restored funds for pre-kindergarten programs and teacher mentoring program (the latter was a part of the Moore settlement). In floor debate, house members debated but voted down a transfer of $2 billion from the general fund to the Permanent Fund; most opponents feared that the PF would be too hard a lock to crack open when the state confronted deficits (FDNM, 3/16/12).

6 Revision of Alaska's Clear and Equitable Share (ACES)

In the first session of the 27th legislature, Governor Parnell introduced his proposed revision to ACES, believing it essential to lower taxes on the industry in order to encourage companies to invest in exploration and production. The legislative vehicle, HB110, sharply cut the "progressivity" feature of ACES. It capped the production tax at 50% (compared to the ACES rate of 75%), and established a tiered or bracketed system, starting at 25% for new field sites. It also proposed reduced penalties for late tax filings and additional tax credits. The House adopted HB110 on a narrow, partisan vote.

The Senate demurred, thinking oil companies would benefit greatly at the expense of the state (estimates of the costs over 5 years ranged from $3 to 6 billion; by the time of the general election, Democrats alleged the "giveaway" would be $2 billion a year), with no evidence that oil companies would invest even a commensurate amount in Alaska petroleum development. Too, the Senate leadership allowed that the state lacked sufficient information about the effects, costs and benefits of ACES to engage in a major revision. In fact, co-chair of Senate Finance Stedman said "Making that decision in haste could be very detrimental to the state's treasury or detrimental to the industry if we get it wrong ... . In the 90-day session, to deal with an extremely complex subject matter like that ... is extremely optimistic on the time line" (ABR, 2/2/11).

From the end of the first session to nearly two-thirds of the way through the 2012 session, the Senate collected information. It grilled relevant commissioners on ACES' efficacy (all were loyal to the governor), but relied on expertise it solicited. Most influential were the Van Meurs Group, PFC Energy and Rogers Oil and Gas Consulting. The Senate purchased for use of legislators the costly "World Rating of Oil and Gas Terms" by Van Meurs. Consultants' initial responses (late September 2011) were that ACES "is not specifically oriented toward developing the two possible new resources that could change Alaska government revenues: heavy oil and natural gas" (FDNM, 9/21/11), and "the state's incentives for oil investment are excessive" (FDNM, 10/9/11). Table 1 presents the most recent estimates of state tax credits to oil companies.

The Van Meurs report criticized the state's oil taxation regime for its "serious shortcomings" and poor incentives for new investment (ADN, 10/23/11).

Table 1: State Tax Credits to Oil Companies (in billions).

Fiscal Year	Credits redeemed in cash	Credits used to reduce oil tax payments	Total
2007 and before	$0.1	$0.6	$0.7
2008	0.1	0.4	0.5
2009	0.3	0.3	0.6
2010	0.4	0.4	0.8
2011	0.5	0.4	0.9
2012	0.1	0.4	0.5
Total	**$1.5**	**$2.5**	**$4.0**

Source: Adapted from Alaska Department of Revenue (FY 12 is an estimate); ABR, 2/2/12.
Note: Throughout debate on ACES, critics of the governor's proposals alleged that tax credits had not significantly increased oil industry investment.

Finally, in February 2012 the Senate Resources Committee, which did the lion's share of work on oil taxation issues, invited consultants to public hearings. Dr. Pedro Van Meurs, probably the most respected consultant of the Senate, said Parnell's bill "does not even come close" to produce one million barrels for the pipeline. He thought the state needed to make $7.5 billion in additional investments, to define competitive but fixed fiscal terms for oil and gas, and to distinguish its awards and credits for new light crude from heavy oil, natural gas and shale oil. Fiscal stability was paramount for major projects (difficult to achieve under the Alaska Constitution). While the government take in Alaska was "slightly high," he implied that oil companies could afford it. They were in an "harvest mode," drawing cash from Alaska for investments elsewhere (FDNM, 2/14/12; also ALD, 2/28/12). Van Meurs also alerted legislators that if oil prices dropped, ACES rates at low prices would cause losses. Further, oil and gas taxes needed to be decoupled (ADN, 2/15/12).

In the 2011 session, Governor Parnell and oil industry advocates pointed out three adverse investment factors brought about by ACES: loss of industry jobs to areas such as North Dakota because of lower taxes; a sharp decline in production because state taxes discouraged investment; and the probable need to close TAPS soon because low rates of production would make its operation infeasible (ABR, 2/9/12). Contrasting narratives emerged as the debate continued into 2012. Both private consultants (the McDowell Group) and the state labor department verified historically high rates of employment for the oil/gas workforce. The argument that declines in oil production endangered TAPS did not sway a superior court judge, who found that even the oil companies attested to the fact that TAPS could operate for decades with a far lower throughput than at present; and the Senate Resources Committee heard an abundance of evidence undermining oil industry claims of potential losses from ACES.

By mid-March, the Senate's legislative vehicle, SB 192, had moved from resources to the finance committee. Its chief differences from HB 110 included:

- A far smaller cut to the "progressivity" feature of ACES – reduction of the petroleum tax from 75 to 60%
- It decoupled oil and gas taxation (the same measure had been vetoed by Governor Parnell in 2010)
- It increased credits for new oil brought into production
- In addition to greater access to production information from oil companies, it established a new "centralized" petroleum information management system (ABR, 3/15/12).

Predictably, Governor Parnell, legislative and industry supporters, said the Senate bill did not address the decline in production (ADN, 3/1/12). The governor asked senators what commitments they would have secured from producers under their plan (FDNM, 3/6/12). They responded that there was no evidence that industry's promises to increase investment were guarantees.

Opinion polling on ACES toward the session's end revealed a divided public. Some 14% wanted to repeal it, 28% to keep it as it was, and 48%, the plurality, sought to modify it (13 percent were unsure). When asked whether they preferred the governor's approach or that of the state Senate, 43% favored the governor, 49% (of a sample of 1000) favored the Senate and 8% were unsure. Most respondents felt strongly (52%) or very strongly (41%) about their viewpoints (Dittman, March 2010).

Further legislative testimony and interest group activity did not change minds. Executives of Alaska's three largest multinational oil corporations said that additional investment was essential to avoid production declines (ADN, 3/22/12). Their critics said the industry provided no proof that increased investments would lead to new production (FDNM, 3/25/12). A rally of 200 oil industry workers and supporters in Fairbanks clamored for lowering state oil taxes. Yet Senate President Gary Stevens said Parnell's plan was an "historic gamble" that would "give billions in revenues" to the oil industry (ADN, 4/1/12).

It was not until a few days before the end of the 90-day session that the Senate Finance Committee released the oil tax plan, leaving the House insufficient time to consider it (FDNM, 4/2/12). The Senate plan focused its revisions on the progressivity portion. The two houses adjourned having passed the operating, supplemental and capital budgets, but without having addressed the governor's major legislative priority.

7 Special Session

The governor then called the legislature into special session to resolve three issues: 1) the oil production tax controversy, 2) an in-state natural gas line, and 3) sex trafficking in Alaska (ADN, 4/10/12; ABR, 4/12/12). The Senate proposal was on the floor, and the governor introduced a blended oil tax reform bill, borrowing from both House and Senate proposals (ADN, 4/19/12; ALD, 4/26/12). The Senate's consultants were skeptical about this plan, and Senate leaders passed the buck to the House (FDNM, 4/25/12). The governor then pulled his proposal from the legislature, blaming the Senate for its failure to pass legislation to reverse Alaska's oil production decline (JE, 4/26/12). The Senate adjourned, followed 2 days later by the House. The only measure passed by both houses was increased scrutiny of sex trafficking in Alaska (ADN, 4/27/12; FDNM, 5/1/12).

8 Final State Budget

We discuss supplemental, operating and capital budgets after first considering Alaska's revenue stream.

8.1 Revenues

Alaska's FY 2013 total authorized (unduplicated) spending, including operating capital, supplemental and Permanent Fund dividends is $13,595.1 billion. Table 2 indicates all sources of revenue for state government, comparing estimated revenues for FY 2012 with those estimated for FY 2013.

The 2011 report listed revenues of $11.8 billion for FY 2012, and the amount listed above is nearly $2.6 billion greater. This is because the figure we used then was an estimate, and the data (particularly oil prices) changed. Also, our 2011 figure did not include supplementals, which now are included.

Overall, state revenues are projected to decline through FY 2013, with the difference from the previous year projected to be nearly 9% lower. Total general funds are expected to decline by $1.45 billion, the decline associated primarily with the projected reduction in oil production from legacy fields (Prudhoe Bay and Kuparuk). While other state funds are expected to remain stable, federal funds flowing into Alaska are expected to decline more than $300 million.

8.2 Capital Budget

The size of the capital budget is nearly identical to that for FY 2012: $2.8 billion. This is approximately the amount the governor asked for, and during the 2012

Table 2: Revenue Sources, FY 2012–2013 Budgets (millions).

Revenue source (excludes Permanent Fund earnings)	FY 2012	FY 2013
Unrestricted General Funds (based on oil forecasts of the Department of Revenue	9923.5	8440.1
Designated General Funds	806.9	836.7
Total General Funds	10,730.4	9276.8
Other State Funds	510.3	508.9
Federal Receipts	3135.1	2825.9
All Funds	**14,375.8**	**12,611.6**[a]

Source: State of Alaska Fiscal Summary – FY 12 and FY 13, 7/26/12.

[a]Excludes PF earnings.

session the branches (and legislative houses) did not spar over the size (ALD, 4/19/12; ABR, 4/12/12; ABR, 4/15/12; AER, 4/25/12). Because capital appropriations extend over many years, it is difficult to gauge what is authorized and expended in any given year. As Legislative Finance Director David Teal noted in 2011: the funds are reserved when appropriated but are not tracked until money is spent (personal communication, 8/25/11). In FY 2012, federal funds comprised about 40% of the total capital spending; in FY 13, federal receipts dropped $282 million and were replaced with undesignated general funds.

8.3 Supplemental Budget

The final, official amount for the FY 12 supplemental was $198.6 million, which included both agency and statewide operating totals of $116.9 million and capital spending of $115.2 million. This amount was larger than the FY 11 supplemental. Supplemental budgets are designed to accommodate unanticipated needs during the year in which the legislature is adopting a budget for the next fiscal year. The state had such needs, for example increased expenditures on Medicaid.

However, in recent years, the state has also had unexpended budget authority, and used this to make supplemental transfers. Legislators made two small transfers – to the vessel replacement fund of the Alaska Marine Highway System ($50 million) and to the Public Education Fund ($76.7 million). Then, near the end of the session, legislators allocated $1.75 billion to the Statutory Budget Reserve Fund. This amount, like most other reserve funds, can be spent for any purpose agreed to by a majority of legislators in each house.

8.4 Operating Budget

Alaska's FY 2013 operating budget totals $9.7 billion, which is 4.3% larger than the FY 2012 budget at $9.3 billion.

Normally, Alaska governors make few if any vetoes in the operating budget, and Governor Parnell did not veto funding for any substantive policy area. However, he did veto $50 million in pension authority for the state court system and several smaller amounts from the operating budget. The overall budget reductions were just over $66 million.

Table 3 displays the FY 2013 operating budget as compared to the FY 2012 final budget and changes in appropriations.

The budgets of ten agencies changed by 5% or more. The Department of Commerce, Community and Economic Development's budget was reduced by 14.3%.

Table 3: Operating Budgets FY 12/13 and Changes (millions).

Agency	FY 2012	FY 2013	Change in percent
Administration	314.7	326.8	3.8
Commerce, Community and Econ. Dev.	223.2	191.8	−14.1
Corrections	289.8	323.2	11.5
Education and Early Development	1561.3	1553.8	−0.5
Environmental Conservation	80.4	83.6	4.0
Fish and Game	199.1	211.8	6.4
Governor	45.2	33.7	−25.4
Health and Social Services	2478.1	2654.7	7.1
Labor and Workforce Development	197.0	195.6	−0.7
Law	107.7	95.1	−11.7
Military and Veterans Affairs	85.1	63.7	−25.2
Natural Resources	159.8	165.9	3.9
Public Safety	200.4	201.3	0.4
Revenue	310.7	330.9	6.5
Transportation	617.2	621.5	0.7
University of Alaska	896.1	925.8	3.3
Alaska Court System	105.4	110.8	5.1
Legislature	69.7	74.0	6.1
Branch-wide Unallocated Approp.	13.0	36.0	176.9
Sub-total, agencies	7953.9	8200.1	3.1
Statewide Items			
Debt service	337.2	310.4	−8.0
Fund capitalization	530.9	621.6	17.1
Direct appropriation to retirement	479.5	613.9	28.0
Special appropriations	40.7	0.0	−100.0
Sub-total statewide	1388.3	1545.8	11.3
Statewide Total	9342.2	9745.9	4.3

Source: 2012 Legislature-Operating Budget, Agency Summary-Conf Comm Structure, Legislative Finance Division, July 28, 2012. The author has adapted this table and compared the FY 12 final budget to the total FY 13 operating budget. Information on significant increases/decreases in agency budgets is drawn from Legislative Finance's conference committee books, by agency.

The main change is a reduction in the anticipated FY 13 National Forest Receipts program. Originally, this federal program was scheduled to sunset in FY 08, but it was extended to FY 12 as part of federal stimulus legislation. A secondary part of the reduction is attributable to the need to offset losses in the state endowment for the Power Cost Equalization Fund.

The Department of Corrections budget increased by 11.5%. A significant part of the change is associated with operating costs of the state's new Goose Creek correctional center. A second increase will expand the substance abuse treatment program; a third increment funds increased costs of inmates' physical and mental care. The Department of Fish and Game's (ADFG) budget increased 6.4%. While most of the increments to the ADFG budget increased numbers of agency personnel, one-time equipment, special projects/surveys or additional program receipts authorization requested by the agency, about one-third of the increments were legislative additions, such as fisheries enhancement projects in different regions of the state.

The operating budget has two categories to accommodate cost increases that are system-wide – the "branch-wide unallocated appropriation" and the governor's budget. The branch-wide appropriation increased by 177%, explained by increases for agency fuel costs for heating and electricity. The allocation for the governor's office fell by 25%. The governor had asked for $3.6 million as a one-time request to pay costs associated with the 2012 state elections (in which all but one of Alaska's 60 legislators were required to run). The legislature funded the request but did not add it to the base budget, and thus it appears as a budget reduction for FY 2013.

The increase of 7.1% for the Department of Health and Social Services is accounted for by the growing population of Medicaid recipients and higher utilization rates of medical services (including some medical inflation). Second, additional funding paid costs of a 4% increased (increased enrollment) in adult public assistance (ABR, 7/15/12).

The Department of Law's budget declined by 11.7%. Expected expenditures for litigation concerning the state's "fast" ferry as well as funding for oil and gas (and also gas pipeline) outside counsel was provided instead through FY 12 supplemental funding, thereby reducing the need for FY 13 funding. The Department of Military and Veterans Affairs took an only apparent 25.2% cut to its budget, as the legislature cancelled authorization of federal receipts for the Alaska Aerospace Corporation, which had not been used.

Personnel increases accounted for part of the 6.5% increase to the Department of Revenue's budget. However, the major increment was supplied by the legislature, which added $3.5 million to pay for expenses related to sale and issuance of general obligation bonds for transportation projects. Relatively slight increases adding up to 5.1% of the court system's budget put into effect the fifth and final year of funding for the "no dark courtrooms" project to improve courtroom effectiveness and streamline proceedings. Also, increments paid for employees' geographic differentials and increased operating expenses. Finally, a 6.1% increase to the legislature's budget is accounted for by personnel and operating expense increases for the Legislative Council, expenses for the new Arctic Policy Commission, and increases in the legislative per diem rate.

The second session of the 27th legislature lacked drama regarding the funding of agencies, with the exception of opposition of liberal legislators to the disinclination of the Parnell Administration to increase formula funding for K-12 education. Some additional funds were added to ensure that school districts (and each legislator represents at least one) benefitted from the climate of high state revenues. There was no function of state government that "lost" during this year of continued abundance in Alaska. Table 4 presents agency totals alone for all sources of funding.

Not with standing federal fiscal distress and the expiration of most stimulus funding, the federal share of the operating budget is roughly the same as in the previous year. Three agencies are the primary beneficiaries of federal funding. In terms of absolute federal dollars, the Department of Health and Social Services has the largest take, some $1.25 billion (more than half of the agency's budget). Two other departments also are significantly dependent on federal funding: The Department of Military and Veterans Affairs receives more than one-third of its budget from the federal government; and the Department of Labor and Workforce

Table 4: Agency Summary – FY 2013 Operating Budget, All Sources (millions).

Agency	UGF[a]	DGF[a]	Other	Federal	All Funds
Administration	84.5	24.0	213.3	5.0	326.8
Commerce, Community and Econ. Dev.	55.3	76.9	37.5	22.1	191.8
Corrections	283.4	21.6	15.0	3.3	323.2
Education and Early Development	1273.9	21.0	25.2	233.8	1553.8
Environmental Conservation	21.2	26.9	11.3	24.2	83.6
Fish and Game	78.3	9.5	61.7	62.4	211.8
Governor	33.0	0.1	0.5	0.2	33.7
Health and Social Services	1249.6	74.1	101.9	1229.1	2654.7
Labor and Workforce Development	34.2	33.9	26.5	101.0	195.6
Law	62.9	2.7	27.5	2.0	95.1
Military and Veterans Affairs	21.9	0.03	16.6	25.2	63.7
Natural Resources	79.1	25.9	38.4	22.6	165.9
Public Safety	164.6	5.9	19.8	11.0	201.3
Revenue	31.6	9.6	214.8	74.9	330.9
Transportation	281.8	69.1	266.8	3.8	621.5
University of Alaska	358.3	333.3	86.3	147.9	925.8
Alaska Court System	106.7	0.5	1.9	1.7	110.8
Legislature	73.5	0.07	0.4	0.0	74.0
Branch-wide unallocated appropriations	36.0	0.0	0.0	0.0	36.0
Total	**4329.6**	**734.9**	**1165.5**	**1970.1**	**8200.1**

Source: 2012 Legislature-Operating Budget; Agency Summary with Funding-Conf Comm Structure, Legislative Finance Division, December 4, 2012 (adapted by author).
[a]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.

Development receives more than half of its budget authority from the US. These ratios are not greatly different from those of previous years.

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 FY 13, they will comprise 68% of the budget of the Department of Revenue, 16% of the University of Alaska budget, 69% of the Department of Administration's funding, and 30% of the Department of Fish and Game budget.

8.5 Reserve Funds and the Budget

As in previous years, Alaska's enacted budget is a plan, with revenues from oil (and thus dependency on production rate and oil prices) setting budget parameters. If expected revenues do not materialize, there will be automatic draws from reserves. Our last table presents information on Alaska's savings accounts, because they provide an essential cushion to the state given the volatility of its revenue stream.

In our 2011 report, we noted that reserves for FY 11 and FY 12 were $18 and $19 billion respectively. This year's projected reserves are significantly larger, at $21 and nearly $24 billion (see Table 5 below). A large part of this increase can be attributed to actions of recent legislatures. Legislators in 2012 added $1.75 billion to the statutory budget reserve, thereby increasing the FY 12 amount by 87%. The Permanent Fund earning reserve account is used to fund PFDs, and this will cost the state nearly $600 million in FY 13. However, the remainder of the reserves provides a comfortable cushion for the state in continued troubled fiscal times nationally and internationally.

9 Conclusion

Much of the FY 13 budget process was normal and routine. As typically occurs, legislators cherry picked areas in which they sought more, or less funding than found in the governor's request. In 2012, legislators focused on education and social services, which the conservative governor had proposed relatively less support for. A formula increase to schools funding was an issue that separated the governor from the Senate, and was not resolved at the end of the session. However, schools did reasonably well, as the surplus climate allowed the legislature to add funding to assist districts address shortfalls in the formula as it applied to their districts.

Table 5: Approximate Balances of Savings Accounts, FY 12 and FY 13 (in millions).

Nature of Savings	FY 12	FY 13
Undesignated Savings	19,378.3	21,199.8
Permanent Fund Earnings Reserve Account	2676.1	3542.1
Constitutional Budget Reserve Fund (cash)	10,399.5	10,958.2
Statutory Budget Reserve Fund	5273.0	6011.5
Alaska Housing Capital Corporation Fund	1029.8	688.0
Designated Savings	2280.4	2704.7
Alaska Capital Income Fund	63.3	85.3
Alaska Higher Education Investment Fund	0.0	400.0
Public Education Fund	1235.0	1196.2
Revenue Sharing Fund	180.0	180.0
Railbelt Energy Fund	(0.0)	(0.0)
Power Cost Equalization Endowment	802.1	843.2
Total Reserves (excluding Permanent Fund Principal)	**21,658.8**	**23,904.5**
Years of Reserves (Reserves/UGF Appropriations)	2.38	3.01

Source: State of Alaska Fiscal Summary – FY 12 and FY 13 (Part 2), Legislative Finance Division, July 28, 2012 (adapted by author).

A second unresolved issue was the re-establishment of the ACMP with contrasting legislative vehicles in the House and Senate, competing with a qualified initiative ready for the ballot in the 2012 elections when the legislature did not adopt a similar bill in the special session. Opponents of the reestablishment had a funding advantage of 4:1, and the initiative was defeated, leaving Alaska, with the longest coast line of any American state, without a coastal zone management plan compliant with the federal statute.

The chief controversy in 2012 as in the previous year was the state's petroleum taxation regime. Governor Parnell proposed the reduction in taxation to spur oil production, in the hope of extending Alaska's highly productive relationship with the oil/gas industry. Parnell's strategy took into account his popularity with Alaskans. In late February 2012 Hellenthall and Associates found him to be the most popular Alaska leader, scoring 75% positive ratings as compared to 71.7% for Lisa Murkowski and 58.1% for Mark Begich (AER, 2/20/12).

The governor's plan ran into opposition from the Bipartisan Working Group of the Senate. The confrontation extended beyond partisanship and ideology, however, as there was no immediately correct answer to the Goldilocks question of how high the state's "take" of oil industry profits should be. The oil tax issue was not resolved in the second session of the 27th Alaska Legislature, leaving the issue to voters in the newly configured districts of the 2010 redistricting process.

The strong Republican bias in redistricting after the 2010 census gave Governor Parnell, and Alaska Republicans, the opportunity to win back the Senate from the Bipartisan Working Group. This is what transpired in the 2012 Alaska elections: Voters elected a Republican Senate and House, leaving analysts to wonder whether Alaska's abundant revenues since the 2007 revision of petroleum production taxes would continue under unified Republican political control.

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