

RUNNING OUT OF GAS

Alaska's oil riches are slowing down and forcing legislators to make tough choices.

Editor's note: This is one in a series of in-depth state fiscal profiles as legislatures grapple with the recession, deep budget shortfalls and painful decisions on how to cut spending and increase revenue.

BY SEAN COCKERHAM

Welcome to Alaska. And now forget everything you've ever learned about how state finances work.

Up here, it's all about oil. The state was so flush with cash just six months ago that it mailed a \$3,269 check to every man, woman and child who had lived in Alaska for more than a year. And it's been sending out those sorts of checks for years. But now that oil prices have plummeted, state officials are looking at big budget deficits—just like nearly every state in the nation.

“Unless the price of a barrel of oil dramatically increases soon, we're looking at a potential revenue shortfall in excess of a billion dollars this year,” says Governor Sarah Palin.

Palin, though, has battled with the Legislature over accepting the federal economic stimulus money being offered to Alaska. Last year's Republican nominee for vice president said the federal dollars would go for services people would expect to continue after the stimulus money runs out, when the state won't have enough to pick up the tab.

She balked at accepting nearly a third of the federal stimulus dollars, calling it

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an “unsustainable, debt-ridden package of funds,” but now plans to take almost all of it. Her initial resistance to stimulus money in areas including education, energy efficiency grants, and meals for seniors proved controversial. Alaska has a long love affair with federal money, receiving more of it per capita than any other state. Legislators want every penny, with many saying the worry about what happens when the stimulus funds run out is overblown.

“Are you afraid that if we start feeding those seniors more they are going to expect to keep being fed more on a continuing basis?” Representative Mike Hawker asked Palin's budget chief.

State officials agree that the end of stratospheric oil prices spells trouble. In response, legislators slashed their spending on hometown construction projects for this year. But neither the governor nor legislative leaders are calling for significant cuts to state programs, or talking about making unpopular revenue choices like imposing taxes.



REPRESENTATIVE
MIKE HAWKER
ALASKA



REPRESENTATIVE
MIKE DOOGAN
ALASKA

They've chosen to rely on savings accounts that swelled last year when oil prices were high. That will work for awhile, but Palin and legislators concede a day of reckoning is coming—and soon.

“I'd say it's a very responsible budget, but it's not sustainable,” says Hawker, the main architect of the operating budget that passed the House in March. “Oil production is in severe decline, and even high prices aren't going to bail us out with the declining production volumes.”

Gregg Erickson, an economist in Juneau who has closely watched the Legislature for more than three decades, says Alaska will soon enter a new era.

“We're going to have oil for years and years and years, but it's clearly not going to be able to support our needs,” Erickson says. “It's quite painful when you make these transitions, and it's not at all clear how it's going to play out.”

OIL IN DECLINE

Alaska remains in an enviable position compared to other states. Alaskans pay no state sales tax or state income tax, and receive annual dividend checks from an oil wealth savings account called the Permanent Fund, which is politically off limits for general state spending. Almost 90 percent of the unrestricted revenue to Alaska state government comes from oil through taxes and royalties.

North Slope oil production in Alaska, however, has declined by 64 percent since 1988, from a peak of 2.01 million barrels a day to what's expected to be an average of 689,000 barrels a day through FY 2009, which ends June 30. That decline is projected to continue over the next decade as oil reserves are depleted. High oil prices have masked the production decline in recent years, halting talk of a pending budget crisis during most of Palin's term as governor. Now, though, the price of Alaska North Slope crude oil, which peaked at \$144

a barrel last July, has dropped by about two-thirds since.

The state has about \$6 billion in the Constitutional Budget Reserve it has long used as a cushion for the swings in oil prices. Under current oil price projections and levels of spending, the legislative finance division forecasts lawmakers could face a \$2 billion deficit when they come back to session next year to write a new budget. Budget analysts say that similar deficits could be expected in each subsequent year, quickly emptying the reserve. “Unless you believe that oil [prices] are going way up again,” said David Teal, director of Alaska’s legislative finance division.

Representative Mike Doogan argues legislators should be at least discussing how Alaska could live with a smaller state budget than it has now. “But there is not a lot of heart for doing any budget cutting this year,” he says.

HOLD THE LINE

The Legislature in April passed an operating budget that spends about \$10 billion—including \$1.8 billion in federal funds and nearly \$2 billion for Alaska Permanent Fund dividends and inflation-proofing the fund.

“I’d have to characterize this budget basically as a hold-the-line, status quo budget,” says Representative Harry Crawford.

Senator Bert Stedman, co-chair of the Senate Finance Committee, said it’s no time to cut. “We can’t overreact and slash and burn the operating account or we’ll push the state into a recession,” he says.

That’s Palin’s position as well.

“We were trying very hard to minimize the impact on public services,” says Karen Rehfeld, the governor’s budget director. Massive reductions or layoffs could cause serious economic problems in the state, she says.

Legislators will spend less this year in the capital budget for construction and infrastructure projects. That’s a decision made easier by the governor’s choice to accept the federal stimulus money that would go to such

projects, while hesitating to take it for other state services.

Palin has not yet offered a solution to close the state’s billion-dollar gap, but the Department of Commerce, Community and Economic Development is working to put together a “Legacy Plan.”

Alaska needs to create a long-term plan that will allow the state to sustain the services it has today, Palin says. Otherwise, she says, “We’re going to have to start cutting services. That’s what’s being discussed and worked on.”

LINES AT BEST BUY

A hugely contentious issue is whether to turn to the Alaska Permanent Fund for state services. The Permanent Fund is unique to Alaska, and a factor that can make people in other states feel less sympathetic to the state’s fiscal woes.

The \$27 billion fund automatically receives 25 percent or 50 percent of royalties from state oil leases—depending on the lease. Every Alaska resident who has lived in the state for more than a year qualifies for an annual dividend check from the fund. That dividend is expected to be more than \$1,500 for each qualifying resident this year.

Last year’s dividend started at \$2,069. The state was so flush with surplus money from high oil prices at the time, however, that the Legislature, at the governor’s prodding, used more than \$700 million in general funds to add an additional \$1,200 “resource rebate” on top of that. That resulted in the state sending checks for \$3,269 to the 610,768 residents who qualified. The state’s estimated population is just under 680,000 people.

There were long lines at the stores in Anchorage the day last September when the money went out, with people wheeling big screen televisions out of Best Buy. But that giddiness has faded now that Alaskans are paying their federal income taxes on the money.

The Permanent Fund isn’t what it used

to be. It is invested in global markets, and the economic downturn has hit it hard. The fund’s value dropped by more than 33 percent since the fall of 2007. Since the amount of the dividend is based on an average of the fund’s profits over the previous five years, its top manager told state legislators that the dividends could drop to just \$68 by 2013.

Some legislators have proposed amending the state constitution so dividends are no longer paid only out of the fund’s profits. The change would allow lawmakers each year to spend up to 5 percent of the fund’s entire market value. The money could be used for dividend checks as well as for state services.

“There’s a concern that we come up with something that stabilizes the dividend stream because it’s a big economic stimulus every fall for the state,” says Stedman, who sponsored the proposed change to the Permanent Fund.

He sees it as a way to ensure Alaskans keep getting annual dividends in the \$1,200 range. But lawmakers have long discussed the change as a method to create a stream of Permanent Fund income to help pay for state government.

Messing with the Permanent Fund is about the most dangerous thing an Alaska politician can do, and previous proposals that could free fund money for state services have met fierce public backlash. Stedman’s plan would require a statewide vote.

Although the fund principal is protected by the state constitution, legislators already have the power to tap its earnings and help fill the state budget’s hole with a simple majority vote. That would be hugely controversial, and the earnings reserve is quickly disappearing because of the heavy market losses.

Now that Palin is a national political figure and a possible presidential candidate in 2012, she’ll be closely watched nationwide to see how she deals with the state’s budget issues. She doesn’t appear ready to turn to the Permanent Fund to help make up the big difference between state spending and revenue—at least not yet.

“We support the constitutional protection of the Permanent Fund principal,” says her spokesman, Bill McAllister, “and oppose proposals that open the Permanent Fund in order to grow government spending.”



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