What Does a Right Sized Government Look Like?

At first glance, Alaska's budget, on a per person basis, appears significantly larger than any other state. Alaska spends $13,762.86 per resident ($10.1 billion FY2018 Governor's Budget/737,732 residents) which is more than double the US average of $6,826.53. The conventional explanation of this disparity is that once oil revenues began flowing to the state in the early 1980s, spending increased rapidly as new programs were added and services were expanded – after all, it is much easier to establish a new program than it is to sunset when revenues decline. While some programs were added in the early years of oil production such as the Permanent Fund Dividend, the Power Cost Equalization program and construction of several state office buildings and schools, Alaska's per capita spending has always been between two and three times the average of other states even before oil revenues began. The purpose of this paper is to explain some of the reasons for the high per capita spending in Alaska.

Rank	**State**	**Per Capita (All Funds)**	**Federal Per Capita**
50	Florida	$ 3,940.88	$ 1,252.73
49	Nevada	$ 4,060.09	$ 1,403.26
48	Missouri	$ 4,061.57	$ 1,266.11
47	Illinois	$ 4,345.90	$ 1,305.07
-	**US Average**	**$ 6,826.53**	**$ 2,022.24**
5	Hawaii	$ 9,745.97	$ 1,805.49
4	North Dakota	$ 10,891.41	$ 2,405.74
3	Delaware	$ 10,944.68	$ 2,299.03
2	Wyoming	$ 13,508.45	$ 2,239.14
1	Alaska	$ 13,762.86	$ 4,666.06

The Appropriation Limit and Increasing Budgets

In 1982, an amendment to the Constitution providing an appropriation limit was approved in order to prevent future growth of the budget. There were concerns (still lingering today) that added oil revenues would lead to a rapid increase in government spending. But what actually happened in the 35 years since FY1982 is that the budget has grown at a slower pace than inflation and population.

If the FY1982 (when the limit was enacted) budget of $3.2 billion would have only increased by inflation and population growth, today's budget would be $12.9 billion, or 26% **above** the FY2018 Governor's Budget.

Alaska's Unique Budget Process Skews Results Upwards

Much of the gap between Alaska's budget and its peers can be explained by the budget process itself. In most states, federal receipts are either not subject to appropriation by the legislature or are appropriated in lump sum. As a result, Alaska departments must budget more federal receipts than they reasonably expect to receive. For example, the Department of Transportation and Public Facilities requests $1.1 billion in federal receipts even though they can only actualize $800.0 million. This is in order to minimize the administrative work necessary to reallocate funding to projects that are moving forward. This empty authority is often referred to as an "unrealizable" fund source. There are no real dollars behind these unrealizable funding sources, but they are reported in budget figures, nonetheless.

Greater Proportion of Federal Receipts

In addition to the unrealizable fund sources, Alaska also receives a greater share of federal dollars than many peer states. A partial list of programs with a large proportion of federal support can be found below:

- Large populations of Alaska Natives increase the Federal share of Medicaid Payments
- Federal reimbursement percentage of transportation projects is based on a sliding scale with the amount of federal land in the state being a major factor; Alaska has the highest rate of federal support for transportation projects
- Payment in Lieu of Taxes reimburses states for lost property taxes (pass through to communities) due to federal land which is tax exempt
- Alaska Impact Grants are federal dollars directed towards communities impacted by oil exploration activities in the National Petroleum Reserve-Alaska

Comparing State Budgets

Excluding federal receipts from these figures brings Alaska's per capita budget closer to that of peer states, but it is still an outlier (see the below table). For the purposes of this paper, per capita budgets will exclude federal receipts.

The remaining state sourced funds are classified in three ways: UGF, DGF, and Other. Unrestricted General Funds (UGF) may be used for any purpose without restriction. Designated General Funds (DGF) are special funds that have a preferred purpose codified in law. Many DGF funds were filled with UGF funds in past years and are now operated as endowments to fund specific programs. The endowment-style funds account for about one-sixth of DGF fund sources while the remainder represents earned revenue such as ferry fees. Other state funds are restricted in their use because they are a gift or bequest for a specific purpose or because the federal government compels that the funds are used for a specific purpose.

While traditionally UGF has been the focal point of the state budget because it affects the deficit, looking at all state sourced funds (UGF, DGF and Other) gives a good basis of comparison to other states. For example, many other states classify their motor fuels tax as Other due to common restrictions associated with the funding source (many states mandate that they are to be used only for highway maintenance). By capturing all three types of state funding for each state, a thorough analysis can be performed on the reasons for Alaska's higher than average per capita spending.

Per Capita Spending (State Dollars - UGF, DGF, Other)		
Rank	**State**	**Per Capita (GF/Other)**
50	Nevada	2,656.83
49	Florida	2,688.14
48	New Hampshire	2,730.60
47	Missouri	2,795.46
46	Indiana	2,873.79
-	**US Average**	**4,804.29**
5	Hawaii	7,940.48
4	North Dakota	8,485.67
3	Delaware	8,645.66
2	Alaska	9,096.80
1	Wyoming	11,269.31

Permanent Fund Dividend

Alaska is the only state that pays a cash dividend to residents. These figures include the FY2017 dividend of $1,022. Many Alaskans do not consider this payment as a "cost of government" because it comes from the designated earnings of the Permanent Fund rather than the general fund. In reality it is calculated as part of total government spending and is the second largest line item in the budget behind education payments of $1.2 billion.

County Level Programs

By necessity, Alaska cannot outsource many responsibilities to municipalities. In the Lower 48, many functions are administered by county governments, largely funded by sales, property, income, and employment taxes at the local level. With the exception of a few urban areas, Alaska municipalities do not have the population or industry base to implement these types of taxes. As a result, the state has had to take on additional responsibilities to provide these necessary services.

The reason for this is embedded into the history of statehood. Many states were opposed to Alaska statehood because it would mean less federal support for everyone else. At the time, the Alaska economic base was rooted in resource development, largely in mining and fishing. As long as the state retained resource ownership of the newly discovered oil reserves, Alaska could support itself on royalties as those resources were developed. At the time, several young western states had squandered their land grants for short-term gains. In the Alaska Statehood Compact, Congress mandated that the mineral resources in Alaska were to always be owned by Alaska. To ensure that happened, the Compact contained a reversionary clause which stated that if Alaska sold the resources in the ground, the land in question would revert back to the federal government. Therefore, Alaska must retain its resource rights; this principle is enshrined in the Constitution

(Article VIII of the constitution. By retaining ownership of resource rights, the state acknowledged it would be the exclusive recipient of potential revenue generating tools, e.g. future royalties. As a result, the responsibility for many government functions lies with the state rather than the cities and boroughs. Some of those services are listed below with Alaska's spending on the service shown parenthetically.

- **Management of 242 Airports** – Alaska is the largest operator of airports in the world. If the state does not maintain airports throughout rural Alaska, these communities would be isolated. Many political subdivisions in the Lower 48 operate county airports as profit centers. ($30.0 million - UGF)
- **Child Support Collections** – Collection and distribution of child support is a county responsibility in most states. ($7.9 million - UGF)
- **Measurement Standards** – Most counties are charged with ensuring that grocery scales and gas pumps are tallying accurately. ($1.1 million UGF/DGF/Other)
- **Local match for transportation projects** - This requirement is commonplace in the Lower 48 and could generate $15.0 million/year, but would prioritize projects in wealthy communities over poorer ones. Only a handful of Alaska communities have the funds available to serve as match. ($15.0 million - UGF)
- **Medical Examiner/Coroner** – This is a common county function (or a city function in large urban areas). ($3.1 million - UGF)
- **Alaska has no Local or Federal Jails** – In the Lower 48, counties and municipalities are responsible for 34.5 percent of prison costs. This represents $106.4 million of the Department of Corrections' budget. ($106.4 million – UGF)
- **Prisoner Transportation** – Most county sheriff offices handle prisoner transportation and it rarely includes airplanes. ($2.8 million - UGF)
- **Ferries** – In New York and many other jurisdictions, ferry service is provided by political subdivisions. While Washington ferries are operated by the state, they serve a different demographic (short runs, commuters, tourists) rather than a long haul/community access/public service. ($140.9 million UGF/DGF)
- **Public Safety** - Most Lower 48 counties have police powers and have county sheriffs versus Alaska's system of state police and village public safety officers. (Cost Indeterminate – UGF)
- **Tax Collections –** The state collects tobacco, alcohol and other taxes on behalf of communities and passes the proceeds to localities. ($1.2 million - UGF)
- **Juvenile Justice –** In the Lower 48 this is often a county function. ($57.5 million – Largely UGF)
- **Court System** -- In the Lower 48 many counties have local district courts while in Alaska there are only state courts.($15.0 million - UGF)

This partial list totals $296.0 million, or $516.31 per Alaskan.

Unique Alaska Programs

The state has implemented a number of programs that other states do not have. Some of these programs were implemented to fill gaps left by the private sector (such as Pioneer Homes) while others were implemented in times of high oil prices to assist struggling municipalities. Many of these programs have been reduced in recent years following oil price declines.

- **Retirement On-behalf Payments** – Payments made on behalf of communities for municipal and school district retirement plans. ($215.9 million UGF/DGF)
- **School Construction** – The state pays a portion of municipal debt associated with building schools ($91.5 million – Largely UGF)
- **Power Cost Equalization** – Subsidized utility rates in areas of the state with high energy costs. This program runs from a DGF fund source, but was originally made possible through a UGF deposit to create the endowment. ($38.5 million - DGF)
- **WWAMI** – This is a collaborative medical school among universities in five northwestern states, Washington, Wyoming, Alaska, Montana, and Idaho and the University of Washington School of Medicine. ($3.0 million - DGF)
- **Rural Trooper Housing** – Housing scarcity is not as great of a problem in more populous states. ($4.0 million -UGF)
- **Cold Climate Housing Research Center** – Another uniquely Alaska program, necessary given the state's climate. ($1.0 million - UGF)
- **Performance Scholarships** – Some states have scholarship programs, others do not ($11.5 million - DGF)
- **Online with Libraries** - Internet connectivity is more common and less expensive in the Lower 48. ($0.6 million - DGF)
- **Mt. Edgecumbe Boarding School** – Few other states run their own boarding schools. Those that do charge much higher tuition or exempt them from the budget process. ($10.8 million – UGF/Other)
- **Pioneer Homes** – Alaska is the only state that operates nursing homes. ($61.5 million - UGF/DGF)
- **Senior Benefits Program** – This program supplements the income of low income seniors. ($20.0 million - UGF)
- **Permanent Fund Hold Harmless** – Because the PFD is paid to every eligible resident, those on public assistance would be taken off the rolls due to this income spike every October. This provision allows Alaskans to keep their benefits and is funded through the designated earnings of the Permanent Fund. ($18 million - DGF)
- **Alaska Aerospace Corporation** – No other state operates a rocket launch facility. While this funding comes from the receipts of the self-contained corporation, it still counts as a state-spend in the budget process. ($8.1 million - Other)

- **Village Public Safety Officers** – This program takes the place of local law enforcement in some areas. ($13.8 million - UGF)
- **Community Assistance Fund** – Payouts are made to communities in order to assist with the cost of operating local communities. ($30.0 million -UGF)
- **Alaska Housing Finance Corporation (AHFC)** - Many remote areas of the state do not have access to traditional mortgage services. As a result, AHFC was established to provide affordable loans to Alaskans. Similar to the Aerospace Corporation, these self-contained receipts count as a state-spend in the budget even though they operate free from UGF. ($32.0 million - Other)
- **International Airports** – Alaska operates International Airports as a state entity rather than a port authority. This means it is subject to budget process and counts as state-spend. Most states do not appropriate funding for their self-sustaining airports. ($181.8 million - Other)
- **Permanent Fund Management Fees** – These fees to investment managers to grow Alaska's wealth are paid through the restricted balance of the Permanent Fund, but they count as a state-spend. Most states either do not appropriate investment fees or do not have the wealth to create this spend. ($148.2 million - Other)

This partial list totals $889.2 million, or $1,205.32 per Alaskan.

Higher Wages

It's a common misconception that state workers earn significantly more than their private sector counterparts. In fact, a recent ISER study found no consistent evidence of this and that on average state employees earn eight percent less than those in the private sector. (http://www.iser.uaa.alaska.edu/Publications/2016_07-OverpaidOrUnderpaidReport.pdf)

In actuality, all wages (private and public) are higher in Alaska than in the Lower 48 to compensate for the higher cost of living in Alaska. This factor drives the state's employee compensation upward when compared to other states but not when compared to Alaska's own private sector.

The average weekly wage of state employees in Alaska is $1,173, 14th highest in the nation. Average state employee wages varied from as low as $816 in Missouri to as high as $1,488 in California with a US average of $1,085. The $88 monthly difference between the US average wage and Alaska's is largely explained by higher cost of living in Alaska. A dollar is worth 6.63 percent less in Alaska (Bureau of Economic Analysis, Regional Price Parities) therefore state employee wages are 7.5 percent more than in the Lower 48 to help compensate. This additional cost to the state is $76.0 million, or $105.00 per Alaskan.

Health Insurance Costs

According to the Pew Trusts, Alaska leads the nation in health care costs. In the Lower 48 the average state employee premium paid by the employer is $502/month for an individual and $1,004/month for an employee with dependents. Compare this to the AlaskaCare rate of

$1,555/month or even the more modest General Government Unit cost of $1,389/month. The amount of Alaska's health care costs over the rest of the nation is $109.7 million, or $148 per Alaskan.

It is important to note that the state's employee health plans do not offer far greater benefits when compared to those of the private sector. Health care is more costly in Alaska for all employers, public and private. The Anchorage School District pays $1,580 per member per month while large private employers average premiums above $1,600 per employee per month and it is not uncommon for small business plans to reach $2,500 per member per month.

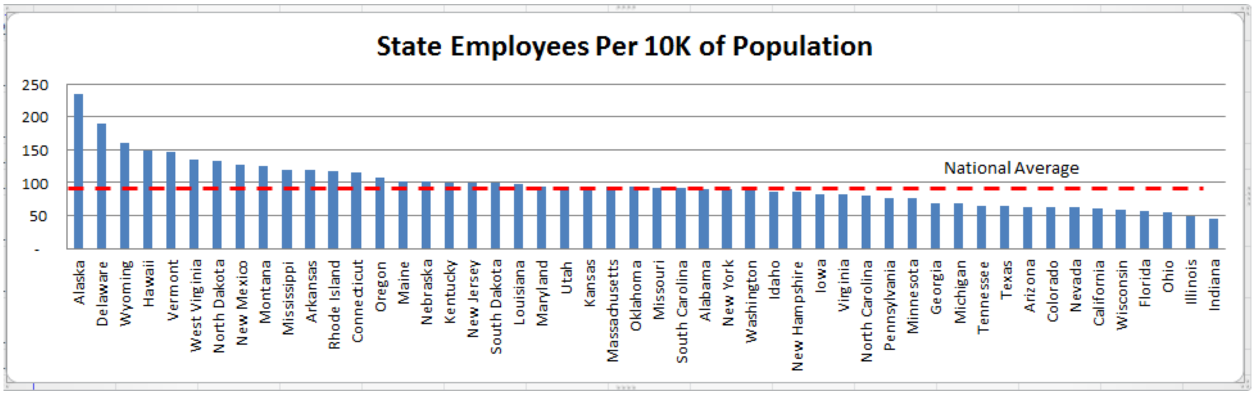
Benefits

While historically, state employees were compensated for lower wages through better benefits and more job security, the benefits afforded to state employees today are becoming less robust. Up until 2006, the state offered a defined benefit retirement plan that pays the retiree a percentage of their final salary (based on their three highest salary years) for the remainder of their life with no required employee match. Newer state employees, however, receive a defined contribution retirement plan comparable to that of the private sector – the employee contributes at least eight percent of his or her salary and the employer contributes five percent. In fact, most of the state's current retirement costs are attributed to the unfunded pension liability associated with the now-closed defined benefit system. This is just one of several past obligations that the state is compelled to fund as a result of decisions made under past administrations.

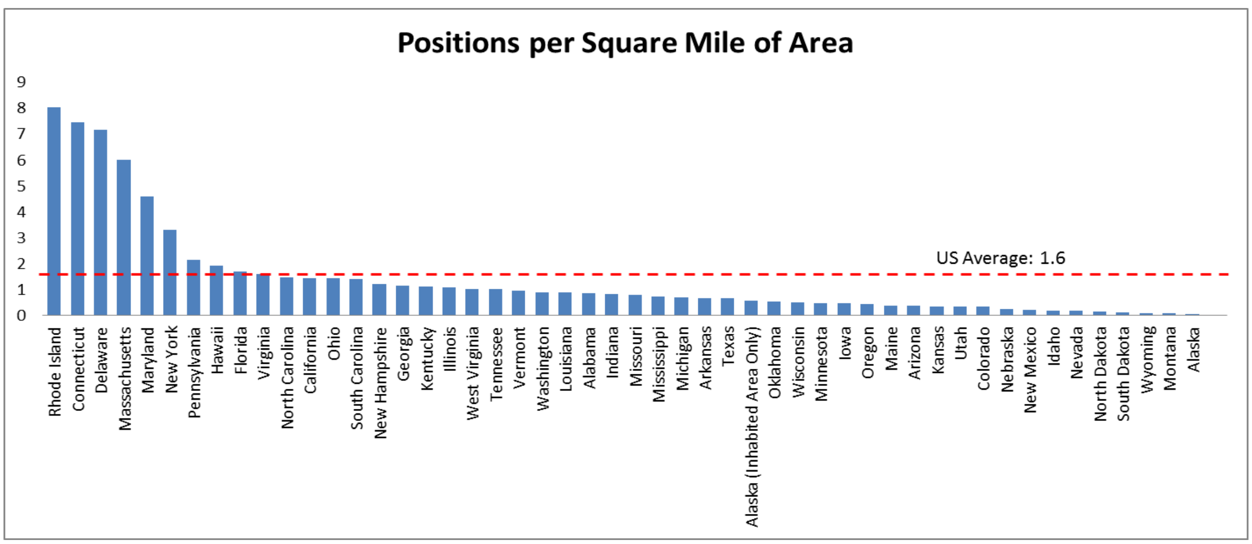
As referenced above, state health insurance benefits have experienced a similar decline. In recent years, insurance provided through the state has required increasing employee contributions and rising deductibles.

Number of State Employees

The number of state employees per 10,000 residents is significantly higher than other states (234 compared to the nation average of 97). While Alaska is a clear outlier, this is lower than the 382 employees in 1967 and 250 in 1987. Alaska is a large and sparsely populated state without county governments to absorb many required services. Delivering these services over large (especially rural) areas requires certain staffing levels regardless of population. Additionally, the lack of road connections limits the ability of one rural office to easily serve a larger area. The large geographic area combined with the low population drives staffing requirements upwards. Public assistance administrators, construction workers and others are needed in all areas throughout the state.



The chart below illustrates a different lens on state employment. Alaska has 0.03 state employees per square mile, the lowest in the nation. While much of the state is sparsely populated and does not need intensive state services, the state does carry a greater burden due to geographic challenges. Even if only the inhabited areas, about 5.6 percent of the state are included, Alaska's state employees per square mile are 0.55, well below the national average of 1.6. While not a perfect proxy, this illustrates that staffing levels are to a great extent a function of geography.



Oil and Gas Tax Credits

Alaska's oil and gas tax program is unique. The system is referred to as a "net tax." Most systems include provisions for credits as a reduction of revenue; however, our tax system pays credits to producers in cash, which is reflected in the budget as an expense rather than in the form of decreased revenue. ($74.0 million or $100.31 per Alaskan)

Fishing as a Major Industry

Alaska's seafood industry comprises a major proportion of the state economy. The cost to regulate fishing activity as well as the seafood marketing efforts in Alaska total $153.1 million ($207.52 per Alaskan). While peer states with large fishing and hunting industries spend far less on a per capita basis (about $42.49 per capita) this is due to the fact that this cost is spread over a larger population. If Alaska's per capita spend were brought down to the average of these peer states, it would render regulation ineffective. Therefore absorbing the necessary amount over a much smaller population affects the per capita amount by $165.04 per Alaskan ($121.8 million).

Owner State/Resource Management

The state of Alaska spends $50.2 million, or $68.10 per Alaskan regulating the oil and gas industry. Compare this to the spending on resource departments in other oil-dependent peer states of $25.73 per resident. Alaska's per capita spending is higher for a reason; a lower population with a greater dependence on the oil and gas industry. Absorbing this required amount over a much smaller population affects the per capita amount by $42.37 per Alaskan ($31.3 million).

Education Budget

Many of the factors above are reflected in this item (health insurance costs, wages, and general level of costs in Alaska). In fact, health insurance costs for school districts comprise nearly a quarter of the cost of the state education formula. State support to school districts averages $5,968.75 per pupil (http://www.governing.com/gov-data/education-data/state-education-spending-per-pupil-data.html) In Alaska, the per pupil budget is $9,593 ($1.25 billion/130,295 average daily enrollment). Bringing this down to the national average would yield $472.3 million or $623.31 per Alaskan. Doing so, however, would not fully compensate school districts for the cost of staff, including benefits and health care, as well as other cost of living factors. Most school districts in the Lower 48 have the population and industry base to tax and so they need less state support.

Nationally an average of 51 percent of non-federal education funding comes from the state while 49 percent comes from localities (funded through local sales/property/employment taxes) (http://www.cbpp.org/research/state-budget-and-tax/most-states-have-cut-school-funding-and-some-continue-cutting). In Alaska, the state provides 76 percent of the non-federal K-12 funding – a clear outlier due to the limited (or non-existent) taxing capacity of local governments in Alaska.

University Land Grant

The University of Alaska never received its full land grant. Much of the land the University received is either inaccessible or otherwise unable to be monetized. At the turn of the 20th century, Congress promised 350,000 acres of land to the Alaska Agricultural College and School of Mines, now known as the University of Alaska. The idea was to allow the university to develop the land and use income earned from it to help offset operating costs. As a result of it being land-poor, the state general fund subsidy is significantly higher than that of peer states.

Additionally, the presence of state-funded universities in most states is largely a function of population, but in Alaska the low population density necessitates a university presence throughout rural Alaska due to the lack of internet connectivity and other infrastructure in order to build an educated workforce.

Fuel and Commodity Costs

Fuel costs are, on average, 20-30 percent higher in Alaska than in the Lower 48. In FY2016 the state spent over $50.0 million in fuel. This represents $10.0 million or $13.20 per Alaskan. Not only is the cost of fuel higher in Alaska, but the cold climate necessitates the use of more fuel than in the Lower 48.

Conclusion

The majority of the state's per capita budget can be explained by the above items. The table below illustrates that only $347.54 per Alaskan of the total spend above the US average was not quantified by this analysis. Most of that is reflected in transportation costs, deficiencies in land grant assets for the university, and the general cost of doing business in Alaska that was not captured above. The colder climate drives heating costs upward and the size of the state increases costs to operate in rural Alaska. Travel budgets are, by necessity, larger than in peer states because the majority of the state is only accessible through expensive air-travel rather than by road. These are valid reasons for Alaska to have a higher per capita budget. Rather than characterizing the per capita budget as excessive it is important to drill down to see that valuable programs and special circumstances comprise the difference.

Special Alaska Circumstances

Permanent Fund Dividend	$1,022.00
County Programs	$516.31
Unique Alaska Programs	$1,205.32
Higher Wages	$105.00
Higher Health Insurance	$148.00
Oil & Gas Tax Credits	$100.00
Education	$623.31
Fisheries	$165.04
Resource Management	$42.37
Fuel	$13.20
	$3,940.86 per person

National Comparison:

Alaska per capita spend	$9,096.80
Less special circumstances	($3,940.86)
Adjusted Comparison	$5,155.94 per person*
	* Within 7.2% of the US average ($4,808.40)

After considering inflation, population growth, and the special circumstances noted above, the size and cost of Alaska's state government is not disproportionate to other states, nor has it changed significantly since before oil began to flow. This analysis should be duly considered when evaluating the "right sized" government for Alaska.