Assessment of Potential FY20 Fiscal Impacts of Actions Taken During the 2018 Legislative Session

Legislative Finance Division Informational Paper 19-1, August 2018

The following discussion highlights situations that may affect spending and deficits in FY20 (and beyond). Some topics connect actions taken during the 2018 legislative session with the fiscal impact of those actions. Other outcomes hinge on actions likely to occur during the 2019 legislative session. There is no intent to criticize actions; the intent is to make legislators aware that the FY20 budget process is likely to be complicated and that net spending reductions from FY19 may be difficult to achieve.

Potential spending impacts are summarized in the table below, with explanation/detail following. The numbers are not predictions; spending levels are ultimately determined by the legislature. The list is not exhaustive; it is intended only to provide warning that the FY20 budget could consume over $200 million UGF (excluding up to $900 million for dividends) more than the FY19 budget to provide the same level of service.

Item	Category/ Brief Description	Impact ($ thousands)
1	**Use of Funds that Will Not Be Available in FY20**	**77,547.0**
	Alaska Comprehensive Health Insurance Fund (1248)	32,600.0
	Reappropriation of General Funds Appropriated for Past Capital Projects	26,000.0
	Alaska Capital Income Fund (1197)	14,000.0
	Commercial Charter Fisheries Revolving Loan Fund (1223)	4,147.0
	Municipal Capital Project Matching Grant Fund (1087)	400.0
	Fish and Game Criminal Fines and Penalties (1134)	400.0
2	**Short-funded Programs**	**50,416.1**
	Department of Health and Social Services/ Medicaid Services	50,000.0
	Department of Law/ Eight New Positions in the Criminal Division	290.8
	Department of Public Safety/ Two New Positions in the Alaska Bureau of Investigation	125.3
3	**Funds that are Spending at Unsustainable Levels**	**2,400.0**
	Alcohol and Other Drug Abuse Treatment & Prevention Fund (1180)	1,200.0
	Tobacco Use Education and Cessation Fund (1168)	800.0
	Workers Safety and Compensation Administration Account (1157)	400.0
4	**Future Commitments**	**67,500.0**
	Retirement Contributions	38,000.0
	Capitalization of the Curriculum Improvement and Best Practices Fund	19,500.0
	K-12 Funding	10,000.0
	Subtotal	***197,863.1***
5	**Permanent Fund Dividends at the Statutory Level**	**900,000.0**
	Total	**1,097,863**

1) Use of Funds that Will Not Be Available in FY20

Alaska Comprehensive Health Insurance Fund—ACHI fund (1248)
$32.6 million

For fiscal years FY16 through FY19, insurance premium tax receipts totaling approximately $179.4 million flowed directly into the Alaska Comprehensive Health Insurance (ACHI) fund. No additional ACHI appropriations are anticipated through FY23, and the diversion of insurance premium tax receipts from the general fund was repealed effective FY20. The repeal will increase FY20 unrestricted general fund revenue (and decrease the potential deficit) by about $60 million.

The positive revenue situation will be partially offset because ACHI money was used in place of UGF during the 2018 legislative session.

Of the $179.4 that flowed into the ACHI fund, the legislature appropriated:

- $55 million to the Health Care Reinsurance Program for calendar year 2017 (FY17-FY18) and
- $55 million to the Health Care Reinsurance Program for calendar years 2018 through 2022 (FY18-FY23).

These appropriations left $69.4 million of ACHI funds available for other purposes. In FY18, Premera contributed $25 million to the Alaska Comprehensive Health Insurance Agency (ACHIA) for the health care reinsurance program. This contribution reduced the State's required contribution for the calendar year 2017 reinsurance program and increased the available fund balance to $94.4 million.

The 2018 legislature appropriated $87 million from this "one-time" source as follows:

1. $30 million FY18 deposit to the Community Assistance Fund for a $30 million distribution in FY19.
2. $9 million FY18 appropriation to the Department of Health & Social Services for Substance Use Disorder Services (Capital).
3. $7 million to support Hospital-Based Mental Health Care by matching federal Disproportionate Share Hospital (DSH) funding (multi-year FY19-FY20).
4. $1 million for one-time Health Studies in the Department of Administration in FY19.
5. $18 million for FY19 School Debt Reimbursement.
6. $2 million FY19 deposit into the Disaster Relief Fund to increase the fund balance.
7. $20 million FY19 deposit into the Major Maintenance Grant Fund (Capital).

The Community Assistance formula (offering a $30 million annual distribution to communities) is not expected to require general funds in FY20. "Surplus" FY18 earnings of the Power Cost Equalization endowment fund are expected to cover the annual deposit required to fund Community Assistance grants that will be distributed in FY21.

Items 2, 3 and 4 are either one-time items or were funded through FY20 or beyond. That leaves items 5, 6 and 7 as potential FY20 UGF increases required to maintain the FY19 level of service. Those items total $40 million. The remaining fund balance (estimated to be $7.4 million) reduces the potential FY20 UGF increase to $32.6 million.

Note that spending an additional $32.6 million of UGF in FY20 (to replace non-recurring ACHI funds) will be seen as a negative action by those who focus on the level of spending, while those with a broader perspective will count the $60 million increase in UGF revenue as a net $27.4 million improvement in Alaska's fiscal condition.

Reappropriation of General Funds Appropriated for Past Capital Projects
$26 million

With UGF revenue far below the peak years of the earlier 2000s, past capital appropriations have been scoured in a search for unused money that can be reappropriated for projects in current-year capital budgets. Because original appropriations were counted as spending in the year the money was appropriated, capital reappropriations are excluded from the roll-up of expenditures (in order to avoid double counting).

With each passing year, the search for available money becomes more difficult. In FY19, a total of $52 million UGF from past projects was reappropriated for projects that would have otherwise required FY19 UGF appropriations. The potential results of a FY20 search for money available for reappropriation are unknown, but maintaining the FY19 level of capital spending with fewer reappropriations is likely to require an increase in UGF spending. Legislative Finance estimates that the search for reappropriations during the 2019 session will find about half the $52 reappropriated in FY19.

Alaska Capital Income Fund—ACIF (1197)
$14 million

The Capital Income Fund is comprised of earnings on a $425 million "fenced off" portion of the permanent fund that is not available for payment of dividends. Appropriation of these funds during the 2018 legislative session included prior-year balances that will not be available in FY20. Maintaining the FY19 level of expenditures in FY20 means that the $14 million must be replaced with other funds, presumably UGF.

Alaska Housing Capital Corporation Receipts—AHCC (1213)
$0.0

This item is mentioned only because appropriation of these funds during the 2018 legislative session used prior-year balances that will not be available in FY20. However, the AHCC account is classified as UGF so that replacing the AHCC code with normal UGF will not affect total UGF spending.

Commercial Charter Fisheries Revolving Loan Fund—CharterRLF (1223)
$4,147.0

The Department of Commerce, Community and Economic Development estimated the Commercial Charter Fisheries Revolving Loan Fund balance to be $5,046.9 at the end of FY17. The legislature appropriated $4,147.0 in FY19, leaving approximately $900.0 in the fund. The remaining balance is more than sufficient to continue operating the loan program.

$2,147.0 of charter loan funds was appropriated in the operating budget for various Commercial Fisheries, Sport Fisheries and Wildlife Management programs. The use of this non-recurring fund source included:

1. $997.0 to expand commercial fisheries management projects on a long-term basis.
2. $150.0 in Sport Fisheries for costs associated with logging charter-fish catch and for a vessel registration program.
3. $1,000.0 in Wildlife Conservation to provide the State match for increased federal Pittman-Robertson funds without increasing the use of general funds or Fish & Game funds. Continued high levels of federal funding will require continued high levels of State match if the goal is to use all available federal funds. Efforts are underway to replace charter loan funds with private and/or local money. To the extent those efforts are successful, general funds may not be needed to replace charter loan funds while avoiding depletion of the Fish & Game Fund.

In addition, $2 million of charter loan funds was appropriated for Wildlife Management, Research and Hunting Access capital projects. While capital projects are generally considered to be non-recurring, use of this fund source addressed the recurring need for more State matching funds to avoid the potential lapse of federal Pittman-Robertson funds. Continued high levels of federal funding will require continued high levels of State match if the goal is to use all available federal funds.

Municipal Capital Project Matching Grant Fund—Muni Match (1087)
$400.0

The balance of this small, one-time account was appropriated to operate the Mt. Edgecumbe pool in FY18 and FY19. Although a portion of pool operating costs is expected to be covered by user fees, the State will likely need to cover the majority of costs.

Fish & Game Criminal Fines and Penalties—F&G CFP (1134)
$400.0

The Fish & Game Criminal Fines and Penalties fund is no longer active—receipts have gone to the general fund for several years—but the fund had a small available balance that was used to avoid over-appropriation of Commercial Fisheries Entry Commission Receipts in

FY19. Oddly, the account retains about $14.0. The account could be cleaned up in FY20 by appropriating the balance to the general fund or for a specific purpose.

2) Short-funded Programs

Medicaid Services
$50 million Medicaid Shortage in FY19 and FY20 ($100 million total)

Medicaid entered FY18 with a clean budget, meaning essentially no FY17 claims were left unpaid to be rolled forward into FY18.

The Governor's FY18 Medicaid Services UGF budget request was $580 million, which was $45 million less than projected costs. The legislature further reduced the Governor's request by $16 million, leaving the program $61 million short of meeting potential FY18 costs. The Department of Health and Social Services said they would take steps to reduce UGF spending by $30 million.

The Department's updated projections of FY18 costs generated a $93 million supplemental funding request for FY18. The legislature appropriated $73 million. In addition to the $20 million shortfall, failure to receive certification of the Medicaid Management Information System (MMIS) resulted in $15 million less than expected in federal reimbursement of UGF costs. Combined with an additional $2.8 million for various other items, funding was $37.8 million short of the amount required to fully pay providers in FY18.

Throughout the 2018 session, the Department's FY18 cost projections were on target (with the caveat that some legislators may not have understood the implications/importance of MMIS certification). Short-funding resulted in payment delays to some large service providers beginning in early June. Smaller providers continued to be paid and a few providers that contacted the Department with cash-flow concerns were promptly issued payments. The Department met the federal requirement that 90% of claims be paid within 30 days of receipt. On the first day that FY19 money was available to spend, all successfully adjudicated claims (that is, claims requiring no additional review or correction by the provider) that had been filed in FY18 had been paid.

The legislature short-funded the Governor's FY19 request by $30 million UGF. In addition, using FY19 money to pay $37.8 million in suspended FY18 claims means that FY19 began with a projected shortage of $67.8 million.

The legislature budgeted FY19 savings of $20 million due to increased Tribal Medicaid claiming and provided a staffing increase to facilitate this claiming. Legislative Finance expects the impact to be about half of the $20 million budgeted, with some additional reductions associated with certification of the MMIS and some additional costs associated with Medicaid Expansion (which levels off at 90% federal match on January 1, 2020).

The combined impact is a potential $50 million shortfall for FY19, along with a $50 million increase in the FY20 budget (assuming no program growth). If the legislature does not fund FY19 costs in FY19, those costs will be rolled forward into FY20. Including costs rolled forward into FY20 and assuming no program growth, the program would be underfunded by $100 million in FY20.

Funding the anticipated $50 million FY19 shortfall in the supplemental process would consume half of the $100 million CBR supplemental headroom provided for FY19 in the operating budget.

If a sufficient number of payments are delayed beyond 30 days in either FY19 or FY20, the State will violate federal "timely payment" requirements and face potential loss of federal matching funds for the quarter in which the violation occurred. Federal funding is nearly $400 million per quarter.

Law/Criminal Division
$290.8 UGF needed in FY20

Although all eight positions related to the Governor's Public Safety Action Plan (PSAP) were approved, the legislature funded only 75% of these positions in an effort to account for delays in recruitment. To fully fund the positions in FY20, another $290.8 UGF is needed. The preferred method of accounting for delayed hiring is to fully fund new positions and remove unnecessary funding during the supplemental process.

Public Safety/Alaska Bureau of Investigation
$125.3 UGF needed in FY20

Two new State Trooper/Investigator positions were added to provide assistance on domestic violence and sexual assault investigations and enforcement. Although the legislature approved the two positions requested by the Governor, the legislature funded only 75% of these positions in an effort to account for delays in recruitment. To fully fund the positions in FY20, another $125.3 UGF is needed.

3) Funds that are Spending at Unsustainable Levels

Alcohol and Other Drug Abuse Treatment and Prevention Fund—AD T&P (1180)
$1.2 million

During the past several fiscal years, appropriations from the Alcohol and Other Drug Treatment and Prevention Fund have exceeded revenue to the fund. The excess appropriations have been covered by a carryforward balance. At current revenue and appropriation levels, the carryforward balance will be exhausted in FY21.

Funding the $24.6 million included in the FY19 Governor's request for alcohol programs would have consumed $3.9 million more than the $20.7 million of anticipated FY19 revenues and would have exhausted the fund's carry forward balance in FY20. The legislature appropriated $1.5 million of Recidivism Reduction Funds (DGF code 1246) to replace Alcohol funds in order to delay exhaustion of the carryforward balance until FY21 and explore other funding options such as:

1. replacing a portion of ADT&P funding with another fund source;
2. reducing funding in ADT&P funding in DHSS, DOR, or the Judiciary; and/or
3. increasing the alcohol tax.

Balancing revenue and expenditures by FY22 while maintaining the FY19 level of service could require a UGF increase of about $1.2 million in each of the next three years.

Tobacco Use Education and Cessation Fund—Tob Ed/Ces (1168)
$800.0

The Tobacco Use Education and Cessation Fund primarily supports the Tobacco Prevention and Control program in the Department of Health and Social Services (DHSS, $9.1 million in FY19) and the Department of Law (DOL, $102.9 in FY19). Through FY15, the fund received annual deposits of approximately $9 million (composed roughly of one-third cigarette taxes and two-thirds tobacco master settlement agreement deposits).

Increasing spending (and declining cigarette tax revenue) eroded the available fund balance (from $16 million in FY10 to $9.6 million in FY17). In response, the legislature initiated reductions to appropriations in FY14 ($746.4), and continued with a $400.0 reduction in FY15 and $375.0 in FY17 and FY19. Continuation of this trend would have balanced revenue and expenditures by FY25.

In FY18, Master Settlement Agreement (MSA) formula changes resulted in a permanent reduction of approximately $2 million in annual cash flow from the MSA. Balancing revenue and expenditures by FY22 while maintaining the FY19 level of service would require a UGF increase of about $800.0 in each of the next three years.

Workers Safety & Compensation Administration Account—Wrkrs Safe (1157)
$400.0

The Workers' Safety and Compensation Administration Account (WSCAA) was developed as a way to establish a more stable fund source for workers' safety and workers' compensation programs that had been historically funded by general funds. Since FY09, employer fees diverted from the general fund to WSCCA have been fairly stable (at about $7 million annually), but appropriations from the fund have grown from about $7 million annually to over $9 million annually.

The imbalance of revenue and spending has drained the fund balance over the years, to the point that a carryforward balance of more than $11 million in FY09 has fallen to just over $1 million. HB79 increased the portion of workers compensation insurance premiums that are deposited into the WSCAA from 1.82% to 2.5% and decreases deposits to the general fund from 0.88% to 0.20%. Based on 2017 premiums, this means $1.8 million that would have gone to the general fund will begin going to the WSCAA and will be reclassified as DGF revenue. The action will not increase UGF spending—in fact, it avoids what would likely have been an increase in UGF spending. However, the action reduces UGF revenue and so will increase the deficit. This fund is one of many that divert UGF revenue and provides an example emphasizing the reason to focus on the size of deficits rather than on levels of spending.

Although HB79 will avoid a negative fund balance in FY20, cash flow is expected to remain negative by about $400.0 annually and result in fund exhaustion in the mid FY20s. Addressing this situation could require increased UGF funding of about $400.0 annually.

4) Future Commitments

Retirement Contributions
$38 million

Per the latest available valuation (June 2017), FY20 state contributions on behalf of PERS and TRS employers are expected to be $159 million and $142 million, respectively. That $301 million total is $38 million more than the $263 million that was appropriated for retirement assistance in FY19.

Capitalization of the Curriculum Improvement and Best Practices Fund
$19.5 million

SB104 created the Curriculum Improvement and Best Practices Fund. A FY19 fiscal note capitalizing the fund was repealed and replaced with a $19.5 million appropriation (in the capital budget) effective in FY20. This funding will be used to provide grants to school districts for a curriculum pilot project. Absent future legislative action, there will be a one-time $19.5 million increase in spending in FY20 compared to FY19.

K-12 funding
$10 million

The capital budget included a FY19 appropriation of $20 million to be allocated to school districts in the same proportions that occur under the statutory funding formula. As with other special appropriations, this appropriation is not part of the FY20 base budget. Normally, the situation would create a $20 million "hole" in the FY20 budget requiring an appropriation during the 2019 legislative session in order to maintain the FY19 level of funding.

However, a separate appropriation bill for funding K-12 education—HB 287—not only fully funded both the FY19 and FY20 foundation and pupil transportation formula amounts, it appropriates $30 million to supplement FY20 formula allocations. The appropriations for FY20 have an effective date in FY20 and will take effect unless additional action is taken by the legislature to reverse them.

In effect, the $20 million hole in the FY20 budget was filled by the $30 million that has already been appropriated for FY20. Absent future legislative action, there will be a $10 million increase in total K-12 spending in FY20 compared to FY19.

5) Appropriations that are Inconsistent with Statute

Royalty deposits to the general fund
$77 million reduction of UGF revenue if statutes are followed

Chapter 9, Section 15 of the Alaska Constitution states that "at least 25% of all mineral lease rentals, royalties… shall be placed in the permanent fund." AS 37.13.010 establishes that the permanent fund consists of 25% of all mineral lease rental proceeds…. from mineral leases issued on or before 12/1/1979 (subsection (a)(1)) and 50% of all mineral lease rental proceeds… from mineral leases issued after 12/1/1979" (subsection (a)(2)).

Historically, both the mandated deposits (subsection (a)(1)) and the optional deposits (subsection (a)(2)) have been appropriated to the permanent fund in the operating budget. Beginning in FY18, the optional amounts associated with subsection (a)(2) were not appropriated to the permanent fund, so became general fund revenue. The amounts are estimated to be $55 million in FY18 and $78.5 million in FY19.

If FY20 appropriations to the permanent fund are consistent with statute, $77 million will go to the permanent fund instead of to the general fund, thereby increasing the FY20 deficit (or reducing the FY20 surplus) by that amount.

Permanent Fund Dividends
$900 Million Increase in Spending if Dividends are at the Statutory Level

With the passage of SB26, AS 37.13.140 now provides for a percent of market value (POMV) payout from the Permanent Fund's Earnings Reserve Account (ERA) to the general fund. The FY19 operating budget appropriated $2.7 billion from the ERA to the general fund. Of that amount, $1 billion was further appropriated from the general fund to the dividend fund. The appropriation for dividends was a negotiated amount that is inconsistent with statute.

The lack of clarity/consistency in SB26 is almost certain to be the primary issue of the 2019 legislative session. Following statute would increase dividends (and reduce the amount available for government services) by about $900 million. Using the latest available official projections of revenue and expenditures, paying statutory dividends generates deficits between $1.4 billion and $1.8 billion each year from FY20 through FY27.

The fiscal model breaks down under these circumstances because the constitutional and statutory budget reserves would be exhausted by FY21 and the statutory limit on appropriations from the ERA would preclude filling deficits with appropriations from that source—there would be no way to fill deficits without increasing revenue or reducing expenditures.

Modifying the dividend formula to 50% of the POMV payout (instead of the existing formula paying 50% of available earnings) would reduce individual dividends by about $1,000 annually (to about $2,500) and generate annual deficits between $800 million and $1.1 billion. The fiscal situation would improve, but the deficits would remain unfilled without tax increases or expenditure reductions.

In order to balance the budget without tax increases or expenditure reductions, annual dividends would have to be limited to about 25% of the POMV payout, or roughly $1,200 per person.