The Fiscal Impact of Capital Spending in Alaska

According to a new report published by the University’s Institute of Social and Economic Research, a continuation of current state spending patterns will result in elimination of the general fund capital budget in eight years. The capital facilities purchased during this period will subsequently deteriorate as operation and maintenance expenditures for the capital stock are reduced because of declining revenues.

The report, prepared for the Office of the Governor, deals with the fiscal effects of state capital spending. It examines the level of the public capital stock and the relationship between capital projects and the fiscal demands for operations and maintenance those projects place on state financial resources. It further describes the growth and composition of the state capital stock as well as demands on the capital and operating budgets of three alternative strategies for future state expenditure.

Value and Nature of Alaska Capital Stock

The report estimates the value of the state’s gross fixed capital stock in 1982 at approximately $5.8 billion. Of this amount, highways comprised 52 percent; buildings, 16 percent; equipment, 12 percent; improvements, such as airports, 10 percent; and construction in progress, 10 percent. The state holds a considerably larger amount of wealth (which has not been analyzed in this study) in the form of land and other natural resources like petroleum royalties, as well as in financial assets like the Permanent Fund. In addition, the state finances a large share of local governments’ capital stock which is also not included in this estimate of the state’s capital stock.

Cost of Maintaining and Operating Capital Stock

In fiscal year 1982, more than 10 percent of the state budget was allocated to sustaining the state’s capital stock, and additional funds were transferred to local governments to sustain the locally owned stock. Researchers identified operations and maintenance expenditures totaling $159 million—4 percent of the budget. Finance costs, including both interest and principal on bonded debt, totaled $102 million—2.5 percent of the budget. Replacement costs for worn-out buildings, one portion of the stock, were estimated at $45 million—1 percent of the budget. Replacement of other deteriorated portions of the capital stock as well as unidentified additional operations and maintenance costs were estimated to be an additional 2.5 of the budget. However, even this level (and distribution) of spending is still insufficient to maintain the stock, based upon capital stock condition surveys. These surveys indicate a need to spend an additional $253 million to bring buildings up to current code.

Three Scenarios

Researchers used this information on the size of the capital stock and the cost of maintaining it to estimate future financial commitments associated with different state capital expenditure programs. From this they developed three scenarios to show how different state expenditure patterns would produce different levels of capital stock and different budgetary demands for operations and maintenance expenditures.

1. Continuation of Current Capital Expenditure Practices

If current spending patterns continue (with one-third of appropriations going to the capital budget as long as possible), and if recent revenue projections prove accurate, revenues from the general fund would allow at most only eight more capital budgets before the combination of growing operating budgets and falling revenues completely eliminates the general fund portion of the capital budget. These capital budgets would increase the capital stock by $6 billion (in 1982 dollars). Falling revenues would prevent the maintenance of this level of capital stock in later years. Depreciation would begin to erode the value of the capital stock beginning in the mid-1990s, since nongeneral fund sources for capital spending (federal funds and general obligation bonds) would be
insufficient to replace wornout stock. A policy of disinvestment of fixed assets would become necessary in the 1990s, and no money would be available for new capital facilities. Money for maintenance and replacement of the capital stock would be allocated to the most important facilities while the less important would be allowed to deteriorate. By the year 2010, the capital stock would be no larger than it is today. Between now and then operations and maintenance costs resulting from the capital stock expansion would place a growing demand on the operating budgets of both state and local governments. Operations and maintenance costs would eventually consume one-third of the state operating budget, an approximate threefold, increase.

2. Balanced Contraction of Capital and Operating Appropriations

The second scenario involves an anticipation of declining petroleum revenues through a planned reduction of the capital budget to 25 percent of appropriations. In addition, when revenues begin to decline, the personal income tax would be reimposed. The Permanent Fund dividend distribution would be eliminated, with the proceeds, in addition to all other Permanent Fund earnings, transferred to the general fund. These additional resources would reduce but not eliminate a growing gap between the spending limit and revenues and would allow an extension of the period during which capital accumulation could take place, into the late 1990s. As a consequence, a somewhat larger capital stock level could be attained (but not sustained) at the cost of higher downstream expenditures for operations and maintenance of the larger stock. This again would reduce revenues available for other demands on the operating budget.

Thus, this alternative would only temporarily produce a higher level of capital and operating expenditures—expenditures which would not, in the long run, be sustainable.

Maintaining Capital Stock at Existing Level

The third scenario examines the implications of maintaining the capital stock at its existing level. This would require a much lower level of capital appropriations than is currently occurring (approximately equivalent to the level of funding available from nongeneral fund sources—federal transfers, and general obligation bonds). In spite of a constant capital stock level, the demand for funds for operations and maintenance of state capital would increase in relative importance in this case as total general fund revenues declined in the coming years.

In summary, Alaska's current revenue projections impose serious constraints on the state's ability to expend, operate, and maintain its capital stock. This study develops the preliminary data required to trace the consequences of alternative capital spending practices. The analyses illustrate the desirability of making current capital spending decisions in the context of their future consequences.