

**SENATE-HOUSE JOINT SUPPLEMENT**

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**1/16/86**

**THURSDAY**

**No. 15**

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**ANNUAL BUDGET MESSAGE**

**BY**

**THE HONORABLE BILL SHEFFIELD**

**GOVERNOR**

**OF THE STATE OF ALASKA**

**BEFORE A JOINT SESSION**

**OF THE SECOND SESSION OF THE**

**FOURTEENTH ALASKA STATE LEGISLATURE**

**JANUARY 16, 1986**

**JUNEAU, ALASKA**

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Speaker Grussendorf, President Bennett, ladies and gentlemen of the House and Senate:

When examining a budget as long and detailed as this one, the eye naturally heads for the bottom line. What does it all add up to?

Simply this: Government is getting smaller, not bigger.

For the first time since Alaska entered the golden age of North Slope oil wealth, we're streamlining government, not expanding it.

But while government is getting smaller, our state is getting bigger.

Alaska remains the fastest-growing state in the Union. Since 1980, we've grown nearly 30 percent! That means almost a third of Alaska's people arrived here in this decade - in the last five years.

That 30 percent growth translates into more than 130 thousand people. And therein lies an amazing accomplishment.

Even as our population has increased dramatically, we've kept our expenses down - and continued to provide excellent service to the people of this state. At the same time, we continued to save money in the Permanent Fund.

All of which proves this important point: Government is running right.

We can keep government running right with the budget I've proposed for the coming year. In fiscal 1987, I'll ask you to approve these major items from the general fund:

- \* An operating budget of 1-point-9 billion dollars;
- \* 299 million dollars for public construction projects statewide.
- \* 63 million dollars for loans, primarily to help finance higher education for Alaska students;
- \* 155 million dollars to pay our general obligation debts;
- \* Another 106 million dollars to help local communities repay their debts for school construction;
- \* 14-point-5 million dollars in pay raises for state employees covered by labor contracts, raises we negotiated in good faith two years ago;
- \* 50 million dollars for the Bradley Lake hydroelectric project on the Kenai Peninsula, and 19 million dollars to equalize rural power costs.

In addition, yesterday I introduced legislation that would solve a problem created by a court decision last summer.

My bill would re-deposit 200 million dollars in the Power Development Fund for Railbelt energy projects, restore funding for Bradley, and meet the requirements of this year's power cost equalization program.

Now, let's take a closer look at the operating budget. Overall, I've called for a reduction of 1.3 percent in our agency operating expenses.

That may not sound like much - but it comes to about 30 million dollars. And, when you consider the hidden costs of inflation, the real reduction in the operating budget is closer to five or six percent.

Through careful cutting, I came up with a net reduction of 136 positions from the state payroll. I cut back significantly on state travel. And the commissioners also worked hard to trim expenses and streamline operations within their departments.

The reductions, however, will not reduce the effectiveness of state government.

For example, included in that operating budget is more than 850 million dollars in pass-through programs to individuals and local governments:

- \* 137 million dollars in municipal assistance and revenue sharing, money that helps hold down local property taxes and pay for local services;

- \* 536 million dollars in operating aid to schools, which pays most of the bills for education in communities large and small, from Selawik to Anchorage.

- \* And a wide variety of grant programs that provide health care, fight alcohol and drug abuse, or combat domestic violence.

That money, which shows up under the state's operating expenses, is really money that winds up in local communities. It's 850 million dollars managed and spent by Alaskans - in their own communities - on local needs.

Also included in that operating budget are increases for key departments and key programs - even as we reduced overall operating expenses.

We cut programs, where possible, and added funds, where necessary. We rejected the idea of across-the-board cuts, because it fails to account for the realities of government.

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In a state where the population has grown 30 percent in the past five years, some departments needed more resources, no matter what the revenue figures said.

Some of the important additions were relatively small -- the extra 900 thousand dollars to help us promote tourism, for instance.

Our aggressive advertising campaigns have paid off so far, with record years - every year - for the visitor industry. In an expanding and competitive market, we can't afford to quit promoting Alaska.

On a much larger scale, we can't cut back on the essential state services that help us maintain our quality of life in Alaska.

As a result, four key departments received increases:

- \* Health and Social Services;
- \* Public Safety.
- \* Corrections;
- \* and Environmental Conservation;

The expanding needs of a growing state simply can't be ignored.

For example, in fiscal year 1987, the state will open 11 new or expanded facilities. Those are projects we needed - projects the House and Senate approved in previous years.

And when we open new buildings, we have to staff them and take care of them. New facilities accounted for 6-point-6 million dollars and 88 new full- or part-time positions.

Those new buildings included new mental health facilities in Fairbanks, and welcome additions or improvements to the University of Alaska statewide system.

But largest among the increases were those needed for youth and adult correctional and treatment facilities -- youth centers in Fairbanks and Bethel, and new jails in Nome and Palmer.

Unfortunately, we need those new jails. Since August of 1981, the number of prisoners has doubled. We've kept pace with that growth by doubling the number of prison beds.

It's taken a major commitment of state funds. And although I prefer to spend our resources on law-abiding Alaskans, we can't dodge the problem of an exploding prison population.

As our population grows, so does crime. And as we get tough on crime, we put more people in jail. But we can't lock the problem up and forget about it. Crime may not pay, but it sure is expensive.

So, new facilities account for most of the proposed increase for Corrections, and some of the increase for Health and Social Services.

However, other human needs got special attention as well, which is why Health and Social Services received an extra 7 million dollars for FY87.

Just one item - an increased caseload for Aid to Families with Dependent Children - that one program needs an extra 3.4 million dollars in the next fiscal year.

As our state grows, so must our commitment to public health and human services. For example, in the last two and a half years alone, AFDC caseloads have risen 30 percent. Child protection caseloads are up 32 percent, with 9,000 children who need help each year.

In Public Safety, the most important item I targeted was 1.4 million dollars to accomplish one important task - namely, to put more troopers on the force.

The Alaska State Troopers are among our most dedicated public servants, and this commitment of additional state funds will help them do an even better job of protecting the people.

Next, to protect the quality of our land, air and water, I'm asking you to approve additional funds for the Department of Environmental Conservation.

As the pressures of population and industry grow in Alaska, so must our commitment to protect and enhance the quality of life in our great land.

The additional funds allotted for DEC will allow us to better monitor industrial activity on the North Slope, in Kenai and Valdez, so local residents can live in confidence.

Our environment must remain clean and safe, even as we grow and prosper.

The increase will also clean up streams in Anchorage and Southcentral Alaska, improve water quality in one of our oldest industries, placer mining, and provide proper maintenance for water and sewer systems in rural Alaska.

A greater commitment to environmental conservation will allow us to better manage and clean up hazardous wastes, so all Alaskans can be sure there are no environmental time-bombs created by improper disposal.

I'm confident the House and Senate understand the need for an increased commitment to the human needs I just mentioned -- care for women and children, more troopers on the street, essential new facilities, and better protection for the environment.

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Now, let's take a closer look at the capital budget, because human needs such as transportation, sanitation - and in part, education - are also met with concrete and steel.

To that end, I've proposed a modest increase in public construction spending for FY87 - 299 million dollars in state funds. Federal money and other funds bring the total to 656 million dollars to help build Alaska.

It's a solid spending plan, one that reflects the wishes of each community in Alaska. We know that, because for the third straight year, the people of the cities and villages sat down together and drew up their priority lists, often with the help of their local legislators.

It's an effective and democratic system, one that provides individual citizens with a powerful say in what gets built next door. It is an active exercise of local control.

Requests ranged from hundreds of millions of dollars in our largest communities, to a few thousand dollars in our smallest.

In Anchorage, home to half our population, I believe we should spend 175 million dollars in state and federal funds. That includes 16 million dollars for the Eklutna water project and 133 million dollars for roads in the metropolitan area.

That road money will augment an already ambitious program. In the coming year alone, that 133 million dollars, coupled with contracts already on the street - and those to be let between now and May - will put Anchorage in the midst of a 300-million-dollar road program.

In Fairbanks, our second-largest city, I've asked for 77 million dollars in roads and other projects, including more than 8 million dollars for the University of Alaska.

Other line items reflect similar basic needs, from the honeybucket lagoon in Nuiqsut to a sewer line in Petersburg.

The capital budget also includes economic development efforts, from hatchery equipment, to a million dollars for logging roads at small timber sales in Southcentral and the Interior.

And overall, the capital budget calls for 30 million dollars in school construction, and 50 million dollars in water and sewer projects.

So you see, I've got a good budget for you to act on. On the operating side, we've addressed our most pressing human needs, even as we scale back the costs of government. And in capital spending, we've addressed basic needs all over the state.

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Now, let me turn to what's not in the budget. And then, I'd like to outline two major plans for planning better budgets in the future.

First, what you won't find in the state budget:

On the one hand, you won't find two items we may have to add later. We don't yet know the fiscal impacts of the review and reclassification of state jobs. This review, designed to bring more equity into the pay scales of state employees, will be ready in February.

Neither do we know the possible impacts of the mental health lands decision handed down recently by the state Supreme Court. Several state departments are reviewing the situation right now.

But on the other hand, my spending plan leaves a large surplus

In the next year, we expect more than 50 million dollars from the federal government to square up accounts in the so-called 8(g) dispute.

We also expect to receive 300 million dollars - or more, depending on the circumstances - from the owners of the trans-Alaska pipeline to settle a lawsuit over pipeline tariffs.

And just yesterday, the Atlantic Richfield Company paid us more than 240 million dollars to settle back severance taxes they owe to the state.

Together, all those settlements -- TAPS, 8(g), and the ARCO back taxes - total well over half a billion dollars. They took a lot of hard negotiating to settle, and that money was a long time in coming.

For that reason, we shouldn't be in any hurry to spend it. It would be easy to spend it all this year, but I believe this is a time for planning carefully, not spending wildly.

We should use today's windfalls to ease tomorrow's revenue declines. I have a proposal to do just that, and I'll describe that idea in a minute.

But here's some straight talk: As far as I'm concerned, that money must be saved, one way or another.

You'll also note that I haven't planned to spend every dollar our December revenue projections tell us we'll receive. And most important, I haven't touched a penny of the undistributed income of the Permanent Fund.

Alaska is lucky. Unlike a lot of states, we have a wealth of resources, a healthy savings account, and a state full of potential.

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We have a young, skilled, well-educated workforce. We levy no income tax on our citizens, and have no statewide sales tax. We've got a growing economy, and a growing sense of community as our young state matures.

Furthermore, we have the opportunity to plan ahead, and use today's wealth to lay the groundwork for tomorrow's prosperity. It's an opportunity a lot of states wish they had. It's an opportunity we cannot afford to miss.

Here's why:

For one thing, Prudhoe Bay isn't a bottomless well. After three years of making that point time and time again, I'm sure just about every Alaskan is now aware of that fact.

In addition, Alaska's relationship with the federal government is changing. We're no longer in a transition phase between territorial status and statehood, and Washington is less likely to consider us a special case for a number of funding programs.

Moreover, the Reagan administration is changing the relationship between the federal government and all the states.

Social service programs have taken some of the biggest cuts at the federal level, and many of those cuts hurt women, children and the poor. We can't turn our backs on them.

My sense of responsibility has compelled this administration to step in -- in many areas where the federal government is stepping out.

In addition, the Gramm-Rudman-Hollings amendment, just passed by Congress, promises sharp reductions in federal aid to the states. Federal grants would be reduced next year by an average of 10 percent - with western states feeling the most pain.

Social programs aren't the only areas of the budget threatened by the Gramm-Rudman meat-axe. According to recent estimates, Alaska could lose as much as 33 million dollars in federal highway construction money in 1987.

For these and other reasons, I've taken a conservative approach to financial planning for the past three years -- control the cost of government, protect the Permanent Fund, and enhance the private sector.

Now, it's time to add two new initiatives to that plan.

They're vital to economic good health in Alaska now -- and in the 1990s. With the measures I propose, Alaskans have a chance to act on a plan for the future, rather than react to a problem down the line.

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First, I will submit for your consideration a plan to better manage Alaska's debt.

It's important to make sure we have tight control on how much money we borrow, so we make sure we can pay it back. That's just plain common sense.

Last year, voters in individual communities approved about 410 million dollars in new debt, mainly through bond sales. And Alaskans could be voting on another 100 million dollars of debt in this year.

Many of those are school construction bonds. And right now, the state pays up to 80 percent of the cost if a school district sells bonds to build a school.

The state's share came to just over 100 million dollars last year. Once communities start to sell new bonds, our obligation will surely go up.

However, the number I have in the budget right now -- 106 million dollars -- is the upper limit we will pay out. . . until we approve and implement a comprehensive plan to manage the state's debt.

Once we've put that plan in place, we will prove to the financial markets that the young state of Alaska is mature enough to manage our money and control our debt load.

And that, in turn, will preserve our good standing in the financial world, and allow us to borrow the money we need to build Alaska.

I ask the full cooperation of the House and Senate on this matter. It will help us help our school districts build the new schools we need.

It makes sense that the state should have some control over that important cost-sharing program.

My plan would limit the annual growth of state school debt, without unreasonably limiting the construction of the schools we need around the state.

I'll also ask you to approve construction standards for schools built with state money. That way, we make sure state dollars are spent equitably from district to district. And ultimately, it means we can build more schools.

In addition to the school debt controls, I propose measures to control the construction of new state buildings.

I'll ask you to approve an innovative change recommended by a citizens' task force concerning the Alaska State Housing Authority. This will give us flexibility to finance new public buildings, along with better control over the debt we incur for that purpose.

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I will also ask you to consider legislation that addresses the debt obligations of local governments.

All these measures -- controlling school costs, overseeing local debt, and changes in the way we finance public buildings -- will strengthen the state's financial position as we approach the 1990s.

As I mentioned in my State of the State address on Tuesday, Alaska's per capita debt is the highest in the nation. Your individual share comes to nearly 7,000 dollars. That's many times the national average.

We can manage that debt, but it takes planning.

My second major initiative will bring a measure of stability to state spending. It will protect our budgets from the unpredictable swings in world oil prices.

And that, in turn, protects cities, school districts, and individuals who depend on a steady flow of state dollars.

I will ask the Legislature to approve a constitutional amendment creating a budget reserve fund -- a buffer zone, if you will.

It's a spending plan, a savings plan, and a spending limit. Furthermore, it's a buffer protecting the Permanent Fund. The buffer account will serve these main functions:

- \* When revenues take a sharp dip, we can avoid shocks to essential services by drawing a limited amount from the account.

- \* When revenues peak sharply, most of the extra money would go into savings, either to replenish the buffer account or augment the Permanent Fund.

- \* And, perhaps most important, the amendment would set an effective limit on state spending in any given year.

The voters put a spending limit in the constitution in 1982, but it has never worked. For example, based on inflation and population, our "limit" on spending next year is . . . 4-point-6 billion dollars.

I predict we'll make it -- because our revenues will be about two billion dollars under the cap.

As you can see, the formula we have now just doesn't work. The new amendment and its companion legislation set a real limit.

The buffer account will even out the peaks and valleys in state spending, providing predictability to municipalities and school districts, and protecting the economy from sudden shocks.

Under our projections, the reserve will be effective only if there's at least 500 million dollars to start. And if we watch our spending this session, we'll have the money to accomplish that.

First, there's 280 million dollars in the Rainy Day Account, which would become obsolete once we created the budget reserve fund.

Then, there's the more than half a billion dollars I mentioned a few minutes ago -- 300 million dollars from the TAPS case, 243 million dollars in the ARCO tax settlement, and more than 50 million dollars in 8(g) money from the federal government.

From those and other sources, we could capitalize our budget reserve fund at more than 900 million dollars, and build a solid financial foundation for Alaska.

Moreover, by creating the budget reserve fund, Alaskans are creating a buffer -- between impulsive spenders, and the Permanent Fund.

In regards to the Permanent Fund, let me say this:

Last year, I asked for -- and received from the House of Representatives -- approval to make a special deposit of 500 million dollars to the Permanent Fund.

That authorization, contained in House Bill 71, is now pending in the Senate, along with another saving measure. That measure, House bill 28, would deposit 400 million dollars of the Undistributed Income Account into the principal of the fund.

This year, members of the Senate have sponsored legislation to put all the undistributed income into the body of the Permanent Fund.

Regardless of which vehicle you choose, I know the people of Alaska would applaud a major step by the 14th Alaska Legislature to enhance the Permanent Fund. I urge you to select one - or all - of those measures . . . and go for it.

The Permanent Fund is our Permanent foundation. And we can make that foundation even stronger by acting on the major points I've outlined for you today.

They are:

\* A conservative operating budget, that meets our human needs even as we scale back the size of government.

\* A solid capital budget, filled with the basics -- roads, schools, water and sewer.

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\* A comprehensive plan to control our debt, and maintain the financial integrity of Alaska's cities, boroughs, and school districts.

\* A reserve fund that brings stability to the budget process, and predictability for municipalities and school districts.

\* A truly effective spending limit.

\* And a buffer protecting the Permanent Fund.

But that's not really the bottom line here today.

Ladies and gentlemen of the House and Senate, we have a great opportunity this year. We can set a precedent that future Alaska governments will envy.

We can set a precedent for working together, trusting each other, and bringing to the people the most responsive, honest and cost-effective government of this decade.

More than ever, we've got listen to each other. More than ever, we've got to cooperate. And more than ever, we've got to put politics aside when decisions are on the line.

The people of Alaska deserve nothing less. That's really the bottom line.

Thank you and good afternoon.