

**HOUSE AND SENATE
JOINT JOURNAL SUPPLEMENT**

January 11, 1996

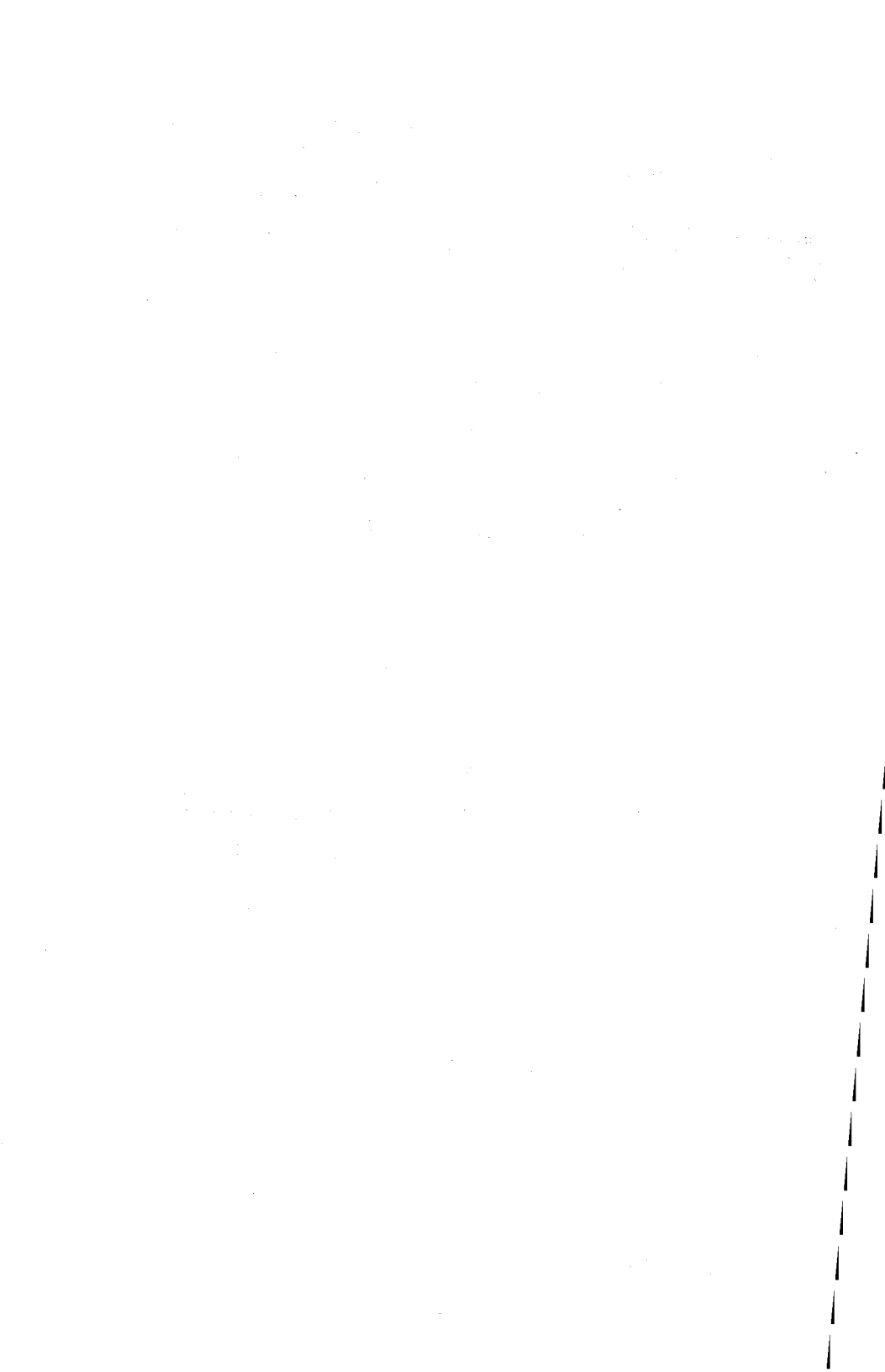
Thursday

No. 14

**STATE OF THE BUDGET ADDRESS
BY
THE HONORABLE TONY KNOWLES
GOVERNOR OF ALASKA
STATE OF ALASKA
BEFORE A JOINT SESSION
OF THE
SECOND SESSION OF THE
NINETEENTH ALASKA STATE LEGISLATURE**

January 11, 1996

Juneau, Alaska



1996 State of Budget Address
By Alaska Governor Tony Knowles
January 11, 1996

President Drue Pearce, Speaker Gail Phillips, members of the 19th Alaska Legislature, Lt. Gov. Fran Ulmer, members of my cabinet, my wife Susan and fellow Alaskans.

Two evenings ago, I described a journey for Alaska's Family as we embark on a five-year expedition toward the 21st century. Getting us there safe and sound requires that we are properly equipped, that we possess the basic gear I describe as the common vision of Alaskans - jobs, better schools, safe, healthy communities and budget discipline.

Tonight I focus on the final necessity for our journey - budget discipline. Without it, we're not going anywhere.

Our greatest challenge this legislative session is to navigate Alaska's economy toward a safe landing as we go from one that's Prudhoe Bay-based to an economy that's diversified and more secure. The good news is, we can make it.

So let's start this journey - I urge the Legislature to commit to a responsible course of action to balance Alaska's budget in no more than six years. That's what budget discipline means - an end to the dangerous practice of draining cash reserves to make the budget balance.

Let each of us be judged on our ability to balance the budget, while holding steady the ladder of opportunity for Alaska families.

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Can we agree to help the private sector create jobs, so fewer Alaskans require state assistance? Can we agree to improve our schools, so our children are prepared for the competitive global economy? Can we agree to improve our schools so that maybe - just maybe - we don't have to build so many prisons in the future?

Can we agree to properly manage our fish, wildlife and wildlands, so future generations enjoy their benefits? Can we agree to protect our homes and neighborhoods, so Alaskans are safe in our communities?

Can we agree that turning our backs on these essential services is unacceptable? This is what I mean by a safe landing for Alaska's families and I believe we can agree.

The magnitude of the problem we collectively face is enormous - a budget shortfall which this year alone is nearly half a billion dollars. Without responsible action by responsible people in this room, the jobs, homes and businesses of Alaskan families are at risk. So is Alaska's long-term financial security.

Balancing Alaska's budget requires a plan - a commitment to use all the tools available to us. There are those who will offer simplistic, bumper sticker solutions. Their claims may be memorable, but they don't measure up. Serious problems demand serious solutions.

Last year, virtually all of us here agreed we needed a plan when we created the Long-Range Financial Planning Commission. Senate President Pearce and House Speaker Phillips jointly sponsored the resolution that established the commission, and I commend you both for your leadership.

The commission - 10 members appointed by the Legislature and five by me - spent all summer developing a long-term financial plan. This bipartisan group of 15 Alaskans worked long and hard and deserve our thanks.

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Speaker Phillips has suggested - and I think it's a great idea - that the Legislature devote the initial weeks of this session to hearings on this plan. I urge a result of these hearings be a firm legislative commitment to balance Alaska's budget in no more than six years. Alaskans deserve no less.

The financial commission realized there are no easy answers when it devised its plan. That's why it recommended using a combination of all the tools in Alaska's toolbox - budget cuts, user fees, taxes and the earnings of the Permanent Fund, while growing and protecting the Fund's principal.

While not perfect, the plan is a solid start. Its most commendable feature is that it works - the numbers add up, it balances Alaska's budget.

Tonight, I want to share with you the task the commission faced. And we're going to try something a little different for a budget address - while you in the chamber have hand-outs on your desks, we'll be showing the illustrations to those watching on television.

In Graph 1, you can see that for this year, Alaska has a budget gap - a shortfall between what we collect and what we spend - totaling \$429 million. Absent action to fill the hole, our budget gap will widen into a giant crevasse of about \$850 million in just three years and to a billion dollars by the year 2000. The cumulative total of this projected deficit in those five years is nearly \$4 billion.

Why is this? As graph 2 shows, it's largely because Alaska depends on one source - the oil industry - for most of our revenues. Those revenues are shrinking as North Slope oil production declines.

For years, Alaskans have debated taking steps to avoid a budget gap. But we've either lacked the political will or have been spared the hard choices, like when the Persian Gulf war filled our treasury with revenues from skyrocketing oil prices.

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Now, we must act. We should not deceive ourselves or Alaskans into thinking this will be easy. Cutting the budget is a vital first step, but that alone won't get us there. For example, even cutting the entire state payroll would not save enough money to fill the budget gap.

The commission also recognized that doing it through cuts alone would send Alaska's economy into a tailspin. Graph 3 reminds us of the oil price depression of 1986, when 22,000 Alaskans lost their jobs, property values dropped more than \$7 billion and bankruptcies reached almost 100 a month. No Alaskan wants to relive that disaster.

Many commission members were surprised there has been progress in recent years to reduce state spending, as you can see in Graph 4. In 1979, the state spent about \$4,000 for each person in Alaska. That amount peaked at nearly \$6,000 per person in 1983, but has declined since.

In today's dollars, per person spending in Alaska is \$250 less than it was 17 years ago. From another perspective, when adjusted for inflation, the state operating budget has been cut 25 percent since 1991.

The commission addressed a question raised by many Alaskans - why Alaska spends more on public services and benefits than other states. It discovered Alaska pays a greater share of services funded elsewhere by local governments, such as corrections, transportation and education.

We do some things done by no other state, like the \$565 million we mail Alaskans in Permanent Fund dividends and the \$72 million for senior citizens Longevity Bonus payments - programs important to Alaskans.

To match what Alaska spends with what it takes in, the commission pointed to several tools. All members agreed that no single tool could complete the job by itself.

As we work together this session to consider the commission's plan and perhaps devise a new one, we must remember a budget is more than just a column of numbers. It represents the values of those who construct it.

As I noted in my speech Tuesday evening, I believe any long-term budget plan must provide a safe landing for Alaskan families and be based on five principles. These are shown on Illustration 5:

- * One, we must close the budget gap and balance our budget.
- * Two, we must continue to cut the budget.
- * Three, we must protect and enlarge the Permanent Fund.
- * Four, any plan to raise taxes and fees to pay for essential services must be fair.
- * Five, there will be no tinkering with the Permanent Fund without a vote of the people.

Several commission recommendations are controversial, so I want to tell you where I stand. As the country song wails: "If you don't stand for something, you'll fall for anything."

The commission recommended doubling the amount of Prudhoe Bay royalty deposits into the Permanent Fund principal and using earnings from the inflation-proofed and enlarged Fund to close the budget gap. Then, they recommended that if necessary, an income tax would be proposed if revenues are needed to balance the budget. I disagree with this approach.

The values I would use in developing future-year budgets are as follows.

First, continue cutting the budget while providing essential services and protecting the health of the economy.

Second, raise revenues through fees and taxes, including those on the thousands of out-of-state workers.

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Third, before ever considering a change to Permanent Fund earnings, I would look to an income tax because it is more fair and includes people who get a free ride by making their money here but live Outside.

It will probably surprise no one that I appreciate the opinion of one of the fathers of Alaska's Permanent Fund, former Governor Jay Hammond, who said in his newspaper column last month: "Fortunately, there remain some in public office with enough common sense to recognize nonsense when they see it. Governor Knowles, for example, has said that while he endorses much of the Planning Commission's proposal, he believes dividends should not be cut prior to imposition of an income tax, and before he will permit such a cut to occur, he will demand a public vote on the matter."

The budget I propose to the Legislature for the coming year reflects many of the first-year recommendations of the commission. At the same time, it adheres to the five balanced budget principles I outlined earlier. My budget proposal for the coming year includes these elements:

It reduces the budget gap by \$40 million, including \$35 million in cuts, and eliminates the equivalent of about 160 full-time and 100 part-time positions.

It provides for essential public services - education, transportation, public safety, economic development.

In a fair way, it asks the Alaskans who benefit from certain state services to begin paying something for them.

It raises additional state revenues by increasing select taxes - on alcohol, tobacco and gasoline.

Finally, and perhaps most importantly, it enlarges and protects the Permanent Fund.

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Let me take these steps in order. First, budget cuts. More than \$20 million in cuts comes directly from state agencies. No department is untouched, my office included.

\$7 million is saved through retirement incentives and other streamlining measures. Taking a page from the private-sector, I urge the Legislature to pass the retirement program I introduced last year, which reduces the number and cost of public employees.

We negotiated new, cheaper contracts with more than 90 percent of the state work force. Compared to previously negotiated contracts, they save \$34 million over the next four years. Our negotiations were tough, but state employees deserve credit for sharing the responsibility in helping government make ends meet. The Legislature should fund these contracts.

We're saving more than \$2 million by streamlining the way state government does business. We consolidated three divisions into one to make our economic development efforts more efficient and saved 25 percent by downsizing the Division of Energy.

New speed-regulator devices on highway sander trucks will save \$350,000 by reducing sand and salt use, and also cut down dust pollution.

Anyone with a family or business knows prices are going up, so by requiring state departments to absorb \$75 million worth of inflationary increases, we're doing more with less.

We're also using the best and latest technology to make government more efficient and customer-friendly. Thousands of computer users across the world can now browse ferry and railroad schedules, get their business licenses, send us E-mail messages and even find a biography of their favorite legislator.

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Number two in our budget plan provides for essential public services. My budget gives us the tools to provide a healthy start for Alaska's children and it fully funds the educational Foundation Formula.

It fosters economic development through the creation of jobs and job training. It permits us to manage our natural resources wisely through sound science and public involvement.

When it comes to the basics, next year's capital budget is again dedicated to about \$110 million in barebones funding for Alaska's basic needs - transportation, water and sewer, schools and deferred maintenance at the university and other public facilities.

Third in our budget plan is asking Alaskans who benefit from certain state services to pay more for them. Our budget reduces our dependence on oil revenues by \$8 million by having service users shoulder more of the costs.

For example, at Pioneers' Homes it costs the state up to six thousand, four hundred dollars a month for each resident, while the average monthly payment to live there is only \$700. We asked senior citizens who could afford it to help pay more to maintain services.

They and their families said yes, so rates will gradually rise to a level closer to the cost of care. We'll save about \$2 million in state support, but will be able to continue services and no one will be turned away for lack of money.

The commission thought municipalities should take on some services which are now paid for by the state. While we are fully funding the education of students, we're asking local communities to pick up a small share of the cost of getting them to school.

Overall, the reduction in state aid to communities is only 1.2 percent.

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Number four of the budget plan is raising additional revenues. This budget incorporates the financial commission's recommendations for three tax increases. One is the wholesale equivalent of 10 cents a drink more on alcoholic beverages, which raises about \$19 million a year.

The budget includes a \$1 tax increase on cigarettes and smokeless tobacco. Studies show price increases are the main deterrent to children using cigarettes. Although it's projected to generate \$42 million, frankly, I hope this proposal doesn't raise a single dollar.

This budget also calls for an increase in Alaska's gasoline tax, now the lowest in the nation. It would move from the 8-cent-a-gallon rate set in 1961 to the national median of 22 cents, raising \$39 million a year.

Alaskans deserve a safe and reliable public transportation system. So I urge the Legislature to consider a constitutional dedication of the revenues from a gasoline tax to maintaining our roads and other public transportation facilities. I know many in this room have been at the forefront of this initiative in the past and I look forward to working with you on it.

The fifth, final and most important element of our budget plan is enlarging and protecting the Permanent Fund.

That's why I propose depositing surplus earnings of \$1 billion, \$200 million to the principal of the Fund, on top of the \$500 million deposited in June. This \$1.2 billion will be the second largest deposit ever.

Alaskans have a special relationship with the Permanent Fund. It's our long-term savings account, our share of a common public asset. Every year we realize benefits from it.

If we protect it and grow it, as I propose and is illustrated in Graph 6, the Fund will help our children and grandchildren realize the benefits of living in the Alaska we now enjoy.

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All Alaskans should be thankful we have the opportunity to make this deposit and I commend the legislators in this chamber for their part. I know some have questioned why the entire legislative deposit was not made last year.

Simply put, it was being done without a plan. I believed then and now, we needed to give the Long-Range Financial Planning Commission an opportunity to review Alaska's overall budget situation.

The commission has now recommended a deposit to the Permanent Fund principal as part of an overall budget plan. I applaud the legislators tonight who supported that responsible course of action to balance the budget - for not taking the easy way out.

In that vein, I'd like to recognize the people in this room for standing up for their principles earlier this evening - for putting policy above politics.

I've talked about what this budget does, but there's also something this budget does not do. It doesn't remove the safety net from Alaska's most needy.

Far too often the quiet voices of those in need get overwhelmed by the shouts of those in powerful places. Compassion is not something to be bargained for, like some chit in a political poker game. It is something we protect and maintain.

That brings up two important places where we are controlling fast-growing areas of the budget to save dollars - welfare reform and Medicaid.

While Washington remains gridlocked, we've stepped up to the plate on welfare reform. The number of Alaskans on public assistance dropped by more than 500 in 1995, saving \$6 million in welfare payments. To ensure more families move from welfare to work, we're putting those savings into child care and job

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training. By reinvesting those savings now, we'll save tens of millions more in the future.

As for Medicaid - which provides basic medical care to the elderly poor, disabled and to low-income mothers and children - Alaska has unique needs that are being ignored in Washington. Under Congress' proposal, Alaska is at least \$250 million short of what we need over the next seven years.

We're working closely with our congressional delegation to fix this and hope they'll be successful in protecting the 69,000 vulnerable Alaskans who count on Medicaid for their health care.

As we embark on our journey into the next century, let us all remember Alaska is a land of great challenge, great success and even greater potential. The tremendous progress we've made in the 37 years since Statehood has been hard-fought. Yet, it is the product of unity and courage, not partisan squabbling and political expediency.

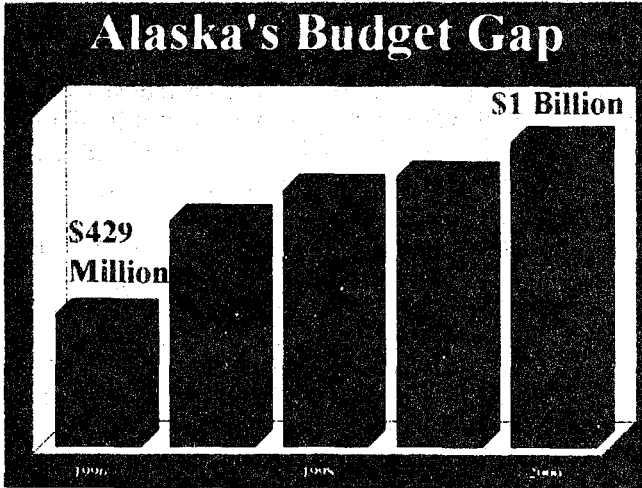
This year, as you see in the final graph, we face an equally daunting challenge - eliminating the budget gap in no more than six years. If we take responsibility for our future and quit living off reserves, we can ease the state to a safe landing.

If we don't, if we continue business as usual, the landing won't be safe at all. We'll sputter and stall, then crash the economy right into a mountainside. Our children will be stuck picking up the pieces of our recklessness.

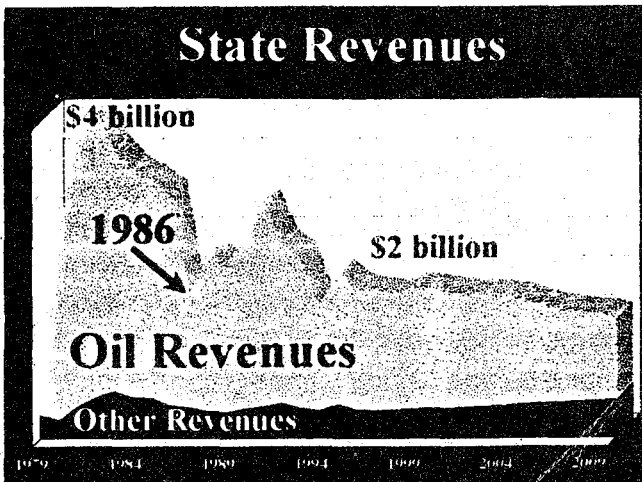
We all know anyone can engineer a crash landing. It's the safe landings that take the collective skill and hard work of everyone on board.

The plan I've outlined here tonight is a flight plan for that safe landing. For jobs. For better schools. For safe, healthy communities. For budget discipline. For Alaska's family.

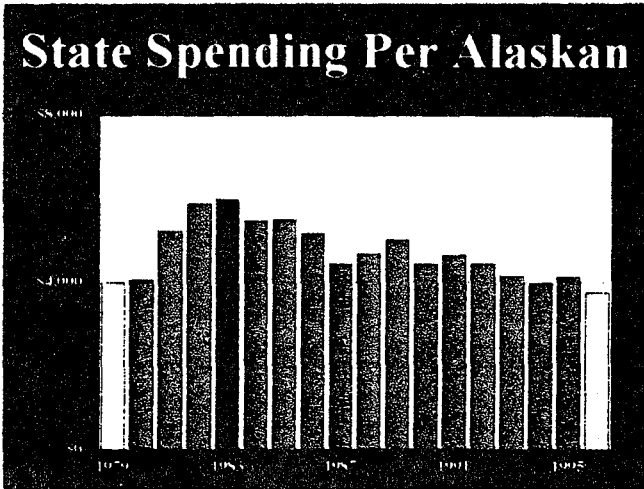
Thank you.



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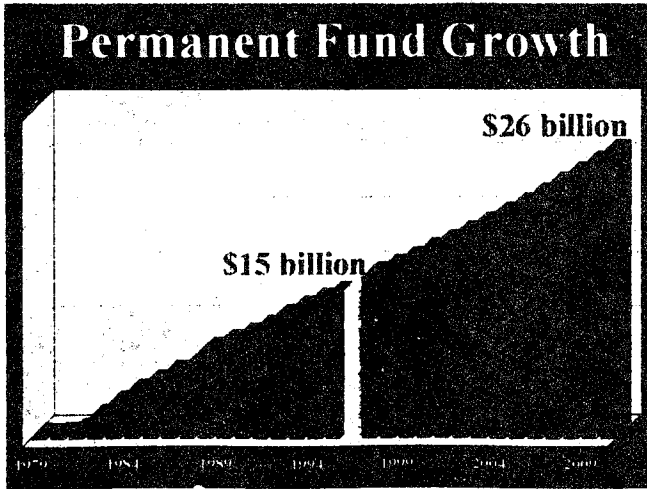


#4

Safe Landing for Alaska

- 1 Close the budget gap
- 2 Cut the budget
- 3 Protect and enlarge Permanent Fund
- 4 Fair taxes and fees for essential services
- 5 No changes in Permanent Fund without a vote of the people

#5



#6



FINAL