

**SENATE AND HOUSE  
JOINT JOURNAL SUPPLEMENT**

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**January 20, 1999**

**Wednesday**

**No. 1**

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**State of the State  
and  
State of the Budget  
Address**

**by**

**The Honorable Tony Knowles**

**Governor**

**State of Alaska**

**Before a Joint Session**

**of the**

**First Session of the**

**Twenty-First Alaska State Legislature**

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**January 20, 1999**

**Juneau, Alaska**



**Governor Tony Knowles  
1999 State of State Address  
Jan. 20, 1999**

Lt. Governor Fran Ulmer, Senate President Drue Pearce, House Speaker Brian Porter, members of the 21<sup>st</sup> Alaska Legislature, my cabinet, my wife Susan, two of my children - Luke and Sara - and fellow Alaskans. Good evening.

Tonight marks my fifth appearance before you in this forum, and the first in my second term as your governor. To Alaskans across our state, thank you for giving me the honor to serve you another four years. To those in these chambers, I note we share the unique privilege of serving as Alaska's last elected leaders of the 20<sup>th</sup> century - and the first of the 21<sup>st</sup>. So I offer my congratulations on your election, and pledge my bipartisan cooperation to build a better Alaska.

1999 is an important year to all Alaskans, as we celebrate 40 years of statehood. We honor those who generously assumed the responsibility and contributed their service in building a modern state that's the envy of the nation.

No one better exemplifies the Statehood era than the team of Bill and Neva Egan. Beginning together in Valdez - he a merchant, she a teacher - the Egans successfully led the Statehood battle to the highest levels of our nation's capital. Then as Alaska's first governor and first lady, they helped build the foundation for the Alaska we love today. Neva still blesses us with her inspiration, her good humor and occasionally, her beautiful singing voice. We're honored tonight to be joined by Alaska's first, first lady, so please help me recognize Neva Egan.

The best way we can show our gratitude to Neva Egan and the many other architects of statehood, is to fulfill our responsibility: to build a better Alaska based on the values we share with the pioneers who preceded us. A strong belief in work; a love of independence; a reverence for our cultural diversity; a cherished sense of family,

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village, community and state. Keeping these values alive for future generations requires us to make further progress on the three priorities we all embrace: good jobs and a growing economy; better schools; and safe, healthy children.

Yet, continued progress for Alaska families is jeopardized by a single factor beyond our control - the dramatic drop in the world price of oil, which largely fuels our economy and funds vital public services. This has created an increase in our budget gap to \$1 billion.

Today, the state of our state is the state of our budget. That's why I'm breaking with tradition and combining the two speeches normally made by Alaska's governor the opening week of the legislative session.

As elected leaders, our biggest immediate challenge is dealing with the lowest oil prices since North Slope production began a generation ago.

The consequences of failing to act quickly and responsibly, in the small window open to us this session, are severe. Without action, we will deplete our savings account, place heavy burdens on local taxpayers, abandon our commitment to secondary and university education excellence, threaten public safety, transportation and economic development. We don't want to suffer a repeat of the deep recession Alaska's economy experienced a decade ago. There's no greater threat to Alaskan jobs and families than ignoring our responsibility to resolve today's \$1 billion budget gap.

So tonight I'll outline a comprehensive, yet admittedly politically risky proposal, to keep Alaska's economy healthy for many years to come.

Before detailing that proposal, I want to report on the state of our state and this year's budget.

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On our top priority - good jobs and a healthy growing economy - Alaska is doing well, despite low oil prices. Thanks to the innovative skills of Alaskans and a pro-business environment, the number of Alaskans working is at an all-time high. More than 273,000 Alaskans earned a record \$9 billion in 1998. In just the past four years, 14,000 new jobs have been created and last year's unemployment rate set an all-time record low.

We're making astonishing progress in moving Alaskans from welfare to work. With our new welfare reform law and investments in child care and worker training, fewer Alaskans are on welfare today than in the past eight years - 33 percent below the 1994 peak. This will save Alaskans \$37 million in welfare payments next year alone.

Thanks to our open and ready for business partnership and entrepreneurial risk-taking by a growing number of companies, Alaska's North Slope and Cook Inlet are prime targets for oil development. Despite low oil prices, our industry remains committed to its investments in Alaska's new and existing oil and gas fields. Because we've insisted on Alaska hire, this development is being accomplished in Alaska, by a growing number of skilled Alaskan workers.

In this, the 10<sup>th</sup> year since the Exxon Valdez oil spill, the state, industry and concerned Alaskans are taking responsibility to assure development of the world's safest oil transportation system. In just two weeks, the first of five of the most technologically advanced tractor tugs will be christened in Bill and Neva Egan's hometown of Valdez. These tugs join an oil transportation system from the Beaufort Sea to Prince William Sound that has the most oil spill prevention and response equipment and personnel anywhere in the world. We remain vigilant because we know the price of complacency.

Our North Slope is also home to one of the nation's best new oil prospects - the Indiana-sized National Petroleum Reserve. The federal government has scheduled leasing there as early as April. Exploration

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Exploration in the NPRA will show the nation we Alaskans do development right - by hiring Alaskans, using Alaska businesses and protecting our water, air, wildlife and habitat.

Thanks in part to legislation we passed together last session, Alaska's vast North Slope natural gas resources are under serious evaluation by an international partnership led by Arco. This team has pledged up to \$100 million to try to make the long-awaited Alaska natural gas project commercially viable.

With the worth of our mining industry at nearly \$1.2 billion, Alaska is enjoying a world-class mining boom. Our mining industry's value has tripled in the past 10 years, accounting for about 3,800 direct Alaska jobs, from Red Dog near Kotzebue to the Interior's Fort Knox to Greens Creek in Southeast.

This past year also saw Alaska's tourism industry join the billion-dollar club. The record 1.4 million visitors to our state helped make tourism Alaska's second largest private sector employer.

Our fishing industry suffered downturns in many regions last year, but none harder hit than Bristol Bay and the Yukon and Kuskokwim Rivers. Many Alaskans deserve thanks for coming together quickly to deal with this crisis, as we work to better understand our ocean and freshwater fisheries to prevent a future crisis. Alaska's fishing industry is moving forward on quality, value-added processing and marketing. We will succeed on the competitive world market as we stand with Alaska's fishing families.

Timber, another major natural resource industry, is restructuring following troubled times. We have held nearly 100 state timber sales for value-added manufacturing and for the first time, Alaska Railroad ties are being manufactured by an Alaskan-owned and operated sawmill in Southeast.

Alaskans are at the cutting edge of other rapidly growing industries - transportation, telecommunications, finance and health care.

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Along with favorable economic trends, Alaska's savings accounts are more flush than ever. Thanks to a booming stock market and additional deposits by the Legislature and my administration, the market value of our Permanent Fund totals \$25 billion, generating record high dividends. Our other major savings account - the Constitutional Budget Reserve - totals \$3 billion, providing a cushion against the changing price of oil. Three other state assets - Alaska's Housing Finance Corporation, Industrial Development and Export Authority and Science and Technology Foundation - all will continue to pay dividends, if we protect and grow their assets.

In addition to creating a pro-business environment, one of the most important steps to grow the economy is to improve and expand Alaska's transportation. In the last four years, we have made significant progress. We are revamping our antiquated 40-year-old National Highway System - including the Seward, Glenn, Parks, Dalton and Alcan highways - to new 21<sup>st</sup> century standards of safety, efficiency and access.

We launched a 10-year, \$350 million overhaul of Anchorage International Airport and the transportation links which serve it. Next summer, with the new Whittier road, we'll open the new gateway to one of Alaska's most spectacular playgrounds in Prince William Sound. We've invested \$300 million into 261 rural airports, and brought on line our first new ferry in 21 years. And we've opened up Alaska with 64 new trails and recreation projects.

I propose we continue this progress with a new generation of transportation systems. Together, this would comprise Alaska's largest construction and jobs-producing project since the pipeline a generation ago. All this is possible because national changes in the way America funds transportation mean Alaska could receive twice the amount of federal money we normally get - up to \$3 billion. Over the next five years, we could invest more than \$600 million a year to bring our highways, roads, airports, ports, harbors, railroad and trails, up to new high standards. Like all opportunities, this one comes with strings - the very reasonable requirement of state matching dollars.

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Recognizing the budget gap, I urge your prompt action on a proposal before you to raise the \$26 million a year required to match the new federal funds. It asks the users of Alaska's highways to contribute about a 9-cent a gallon increase in Alaska's fuel tax. Alaska's fuel tax - the nation's lowest - hasn't changed since 1961. Yet even with a 9-cent increase, 45 states still will have higher gas taxes than Alaska. There are few smarter investments in Alaska's economic good health than rebuilding our transportation system.

As the clock ticks down on the 20<sup>th</sup> century, we face a deadline to guarantee Alaska management of our fish and game resources. The rural subsistence priority is morally right, historically smart and benefits every Alaskan. Thanks to the support of the Alaska Federation of Natives, business leaders, commercial and sport fishing groups, community and state leaders and our congressional delegation, we almost reached a resolution last year.

Three times in 1998, the will of the majority of Alaskans - and the majority of the Legislature - was thwarted by the refusal of a small minority to allow Alaskans the opportunity to vote on subsistence.

Any solution must ensure state - not federal management - of our fish and wildlife resources, and it must protect the fundamental role of subsistence in the cultures and economy of rural Alaska.

We Alaskans must take the responsibility to solve this uniquely Alaskan problem in Alaska this session. The future of rural Alaska, home to many of our first people, deserves the attention of all Alaskans. That's why I appointed a statewide Commission on Rural Governance, which later this year will offer recommendations on ways to bring all Alaskans together.

To strengthen the bonds of our unity and sharpen the understanding of our common goals, I have called for Alaskans to convene in a Convention on Alaska's future, as we face a new millennium. I look forward to our participation in this statewide discussion.

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Any discussion of the next millennium is incomplete without mentioning the Y2K computer problem, which presents a costly challenge to a wide variety of public and private sector operations. We are requesting less than \$20 million for Y2K, far less than many envisioned and substantially less than other states. If the Legislature acts in a timely way on our funding request, we will be on track to protect the 89 mission-critical systems affecting life, health, safety and economic well being.

As we work to keep our economy healthy, there's no more important job than continuing to improve Alaska's schools. A solid education is the ticket to a lifetime of success. Working together last year, we agreed to put 27 million more dollars into schools this year and next, and mandated new high standards and testing for students and accountability for schools.

Every Alaskan family has a stake in fulfilling the promises we made last year to improve our schools. Keeping Alaska competitive in the 21<sup>st</sup> century requires both good public schools and a strong University of Alaska. Regrettably, state support for the university has been inadequate.

Last year, we began turning the corner, with invigorating university leadership and renewed public support. I propose we continue this progress with a new university endowment for excellence. Our congressional delegation has looked to the federal government to fulfill its land grant obligations to the University of Alaska. But this has stalemated and caused disputes among Alaskans. So, I am urging our congressional delegation to pass legislation to help meet the federal government's land grant obligations by earmarking a portion of the federal revenues from development in the National Petroleum Reserve-Alaska for this university endowment.

For every young Alaskan to realize their full God-given potential, we must continue our investment in Alaska's children. I commend the Legislature for implementing, in part, the "Smart Start" program last year - a historic new investment in better protecting

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Alaska's children. It includes new troopers and child protection workers, better health care for the children of working Alaska families, improved foster care and adoption, quality child care and strengthening families at risk.

In keeping with my principle of no new programs without a source to fund them, we worked with our congressional delegation to change the federal Medicaid formula, providing Alaska an additional \$32 million for these Smart Start investments. By investing now in zero tolerance for the abuse and neglect of Alaska's children, we will save millions later in the avoided cost of new juvenile detention facilities, jails and welfare payments.

We must continue the down payment we made last year in providing adequate resources for foster care, permanent adoptions, day care, additional child protection workers, children's health and anti-tobacco programs. I propose they be funded with the \$22 million a year for the next 25 years from Alaska's share of the national tobacco settlement. The well-being of Alaska's children should not fluctuate with the price of oil.

We must continue to remain vigilant in combating crime. Thanks in part to investments in crime prevention, new technologies and new laws, Alaska's violent crime rate dropped 15 percent between 1995 and '97. We must fulfill our commitment to fighting crime with troopers, Village Public Safety Officers, youth detention centers and the additional prisons we approved last year.

For the coming year, our general fund budget totals \$2.3 billion. It was developed based on four goals.

First, it keeps Alaska's economy healthy and growing.

Second, it continues the initiatives we passed together last year for quality schools and better protecting Alaska's children.

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Third, recognizing the budget gap, it initiates no new program without a source to fund them. That's why we have identified funding sources to continue progress in transportation and Smart Start.

Fourth, it continues reducing costs and delivering public services more cost-effectively. For example, my year 2000 budget continues to reduce general fund spending - by \$13.5 million - while absorbing \$27 million more for public schools and the university, \$15 million more in prisons and public safety and millions in inflation costs.

In addition, I am directing state departments to develop recommendations for reducing spending, to be achieved through budget cuts, increased efficiencies, consolidations and better use of technology.

Last year, the Legislature agreed to major improvements in education and children's programs, yet funded them for only part of a year. That's why the additional \$5 million in children's health, the \$16 million in education and more than a million for troopers and child protection workers, among others, may appear as increases. In fact, this is not an expansion, but just full year funding for commitments made to Alaskans last year. Just as any family or business faced with a sudden drop in income reduces their expenses, so should government.

Over the past four years, we've done precisely that. We've worked together to provide vital public services, agreed to new initiatives in education and child protection while reducing spending. The results of this bipartisan cooperation are good for Alaskans. We have a growing economy, better schools, healthier and safer children, and we've cut the budget.

In fact, since Budget Year 1995, state spending has been cut nearly a quarter of a billion dollars. As Illustration 1 shows, state general fund spending per Alaskan in today's dollars is nearly \$1700 less than in 1979.

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According to the National Governors' Association, Alaska is the only state in the nation to have cut its budget over the past four years. At the same time, all other states - including 35 with Republican governors - increased their budgets a combined 22 percent. That makes Alaska number one in budget cuts. We've done this even though Alaska has one of the nation's fastest growing populations of children and seniors, both of whom require the most expensive public services.

With clearly defined goals, a strong economy and substantial, growing savings accounts, Alaskans are deservedly optimistic about the future. Unequaled opportunity continues to define the Great Land. But with that opportunity comes responsibility, as we meet the challenges ahead. Simply put, we face a gap now of nearly \$1 billion between the money coming in to the treasury and what's needed to provide Alaska families and communities with needed services and benefits.

You can see the size of this gap on Illustration 2 - what is paid for public services compared to the amount of our revenues. Unattended, this budget gap threatens our jobs, businesses and families.

The fact is we have the wealth and resources to fix the problem of stabilizing our fiscal future. The question is: do we have the wisdom and will to make the savings and investment necessary to achieve a sustainable balanced budget? Or will we continue to borrow from the future?

For the last 20 years, Alaska has enjoyed unique prosperity, fueled primarily by our bountiful supply of oil and its generally high price. Wisely assuming this would not last forever, Alaskans years ago prepared for the transition from a budget based on a single source to one that is more diversified.

Indeed, many wise and responsible steps have been taken. For instance, Alaska's General Obligation Bond indebtedness was designed to stop next year because that's when early predictions

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estimated the end of the Prudhoe Bay field. Alaskans established the Permanent Fund to transfer one time non-renewable resource revenues into a permanent source of earnings and benefits for future Alaskans. The Constitutional Budget Reserve was established in 1990 to protect the budget and economy against oil price fluctuations.

Alaskans, although knowing the day of reckoning would come, have been able to avoid the difficult decisions of revenue restructuring for a decade, thanks to two factors. One, good fortune in the form of high oil prices. And two, the success of good policy decisions to partner with industry and create a favorable business climate. Coupled with additional industry investments and new technology, this has boosted Alaska's oil production far beyond early predictions.

Now, with falling prices and production, we can no longer postpone the difficult decisions. As you can see in Illustration 3, today's oil prices - the lowest since North Slope oil production began - give us no choice. If low oil prices continue as projected, Alaska's \$3 billion Constitutional Budget Reserve will run dry in four years. And although my budget proposal for the coming year includes additional reductions and cost-efficiencies, Alaska simply can't cut its way to a balanced budget.

In fact, if we lay off every single state-funded worker, we would still have a \$300 million gap. And on top of that, if we wiped out state aid to communities and stopped building roads, schools and safe water systems, we'd still have a \$100 million budget gap. Likewise, no other single fix, including higher oil prices, can fill the gap.

Today, we Alaskans face no less a challenge than the framers of our state constitution two generations ago. Failure to act would be irresponsible. We should not - we cannot - bankrupt our children's future.

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So tonight I propose a plan to balance our budget - today and well into the next century. Alaska's Balanced Budget Plan borrows the best elements of proposals developed in recent years by Alaska business groups like Commonwealth North, and state leaders, like Gov. Jay Hammond, and former Permanent Fund Executive Director Dave Rose, and legislators, including many in this room.

It is based on three principles that I believe most Alaskans agree are essential to any acceptable long-term budget plan:

- One, it balances the budget on a sustainable basis.
- Two, it protects and grows our savings accounts - the Permanent Fund and the Constitutional Budget Reserve.
- Three, it requires that any changes to the Permanent Fund and dividends occur only with a vote of Alaskans.

The plan accomplishes four goals:

First, it balances the budget within 18 months - our Fiscal Year 2001.

Second, it creates a sustainable balanced budget that lasts as far into the future as one can reasonably predict.

Third, it protects and grows the state's savings accounts, the Permanent Fund and the Budget Reserve.

As Illustration 4 shows, under this plan, the combined value of our two major savings accounts - the Permanent Fund and Constitutional Budget Reserve - would total \$31.2 billion.

Fourth, this plan maintains a sizeable Permanent Fund dividend that provides for future growth.

To accomplish this, two actions are necessary.

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First, we would make a one-time appropriation of \$4 billion from unrealized stock market gains of the Permanent Fund to the Budget Reserve. This transfer would be made only upon approval of a majority of Alaskans voting in a special election early this year.

Second, we need another \$350 million per year to balance the budget. I believe the fairest way to raise this is through an Alaska Credit Income Tax.

Let me discuss these two steps which constitute the core of the proposal.

First, the transfer of surplus Permanent Fund earnings. Today, much of the Permanent Fund's enormous stock market profits in recent years exist only on paper. As you can see in Illustration 5, the market value of Alaska's Permanent Fund has soared nearly 50 percent in just the past four years, from \$17 billion in 1995 to \$25 billion today. Yet, this growth will exist in the bank only when the trustees and fund managers sell the stock.

Just as other investors have taken their profits from the booming stock market, so can Alaska. I propose we capture the gains from our stock investments and transfer \$4 billion to the Constitutional Budget Reserve. With that amount, we would increase the earnings of our Budget Reserve by about \$550 million a year on sustainable basis.

As you can see in Illustration 6, a \$4 billion transfer would put the Budget Reserve on a sustainable footing. It then does what Alaskan voters intended when we created the Permanent Fund in 1976 - help Alaskans meet their needs when oil revenues began running out.

The effects of this transfer on dividends would be two-fold. First, as you can see on Illustration 7, the income from the stock sale would increase the 1999 dividend to approximately \$2,100 per person.

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In the year 2000, it would be about \$1,300 and continue growing as the Permanent Fund and its earnings increased. Averaged over a five-year period, the dividend would be about \$1,550 per person with continued future growth, as shown in Illustration 8.

Although not required by law or the constitution, I have always insisted that any changes to the Permanent Fund must be approved by Alaska's voters. So I request the Legislature authorize an advisory vote on this one-time transfer in a special statewide election early this year.

Even with the sustainable earnings from a larger Budget Reserve, Alaska would continue to face a deficit of about \$350 million. So the second part of this plan addresses the need to raise those additional revenues. There are limited options that are both fair and efficient.

States raise most of their revenues from sources that grow with population and state economy, either through an income tax, a sales tax or a combination of both. Alaska is the only state with neither.

I believe the fairest, most progressive way to raise the \$350 million of additional revenue we need, is an Alaska Credit Income Tax. Some of it will come from non-Alaskans who work in our state but pay nothing for the benefits they receive.

According to Alaska's Labor Department, 10 percent of Alaska's wages, or about \$800 million, is earned by non-residents. We can structure the income tax so an average Alaskan family of four making up to \$60,000 a year - the median Alaska income - would pay nothing. It would credit residents for federal taxes we pay on our Permanent Fund dividend and recognize other costs of living in Alaska.

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I do not favor additional business taxes because Alaska's resource-based industries are already suffering from low world prices for timber, fish, oil and other minerals. The Asian economic downturn has slowed our exports. This is not the time to shake the confidence of business investment, employment and operations in Alaska.

In proposing an Alaska Balanced Budget Plan as I do tonight, I encourage questions, scrutiny and criticism. We must engage Alaskans in a broad discussion about the future of our state. There is no one correct plan, nor is there any single solution that will be acceptable to every Alaskan.

Indeed, there will be many other proposals. But any acceptable proposal must meet the goals I believe most Alaskans agree are essential:

- It must balance the budget on a sustainable basis;
- Protect and grow our savings accounts;
- Provide a substantial and growing dividend;
- And in a fair and balanced way, raise the additional revenues we need for vital public services from both Alaskans and non-Alaskans.

Making the decisions to arrive at the plan I outline tonight was not easy. In fact, I - along with every other elected official in this room - could probably escape any political pain during our current terms by doing nothing. Yet each of us knows in our hearts that would be irresponsible. We must act, and we must act this year. Even inaction is a choice - but it's the wrong choice. Failure to act today means liquidating Alaskans' assets tomorrow.

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Forty years of Statehood have taught us the task before us isn't easy, but it never has been for Alaskans. Our challenge is to muster the same courage and foresight that inspired Alaskans of an earlier era. To fulfill our responsibility to generations of Alaskans - today and tomorrow. To share in the bounty provided each of us by the Great Land. As we take stock of Alaska at the beginning of a new century, Alaskans have ample reason for optimism about the unprecedented opportunities before us.

We Alaskans are the right people in the right place at the right time. We can and must accept the responsibility to make the right choice.

Thank you.

General Fund Spending Per Alaskan  
In Today's Dollars

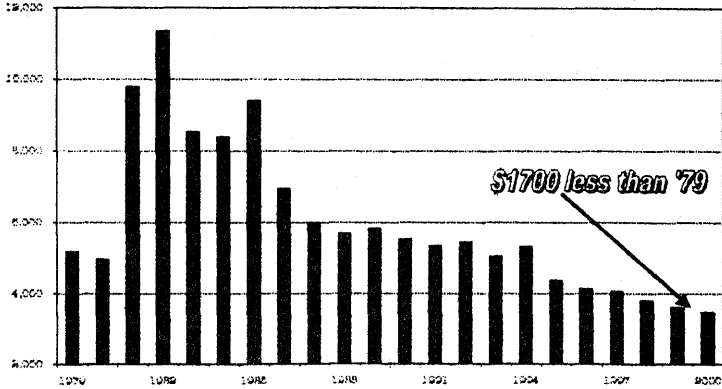


Chart 1

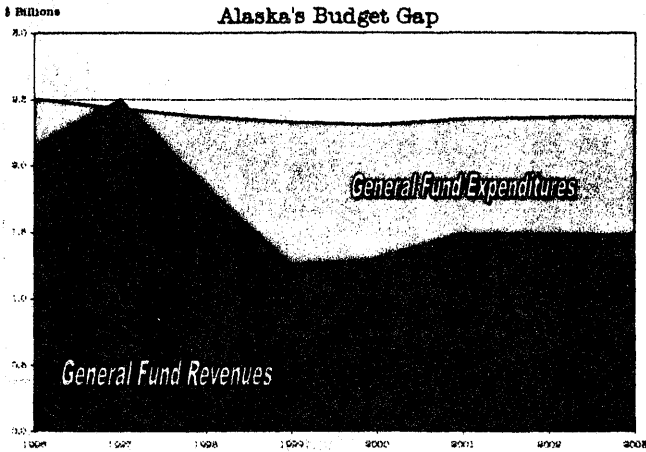


Chart 2

Oil Price Decline

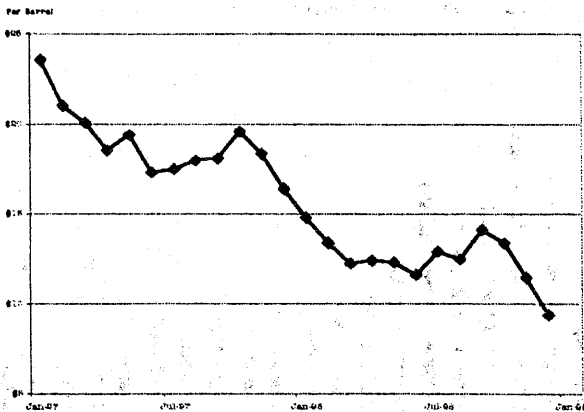


Chart 3

Savings Accounts Under  
Alaska's Balanced Budget Plan

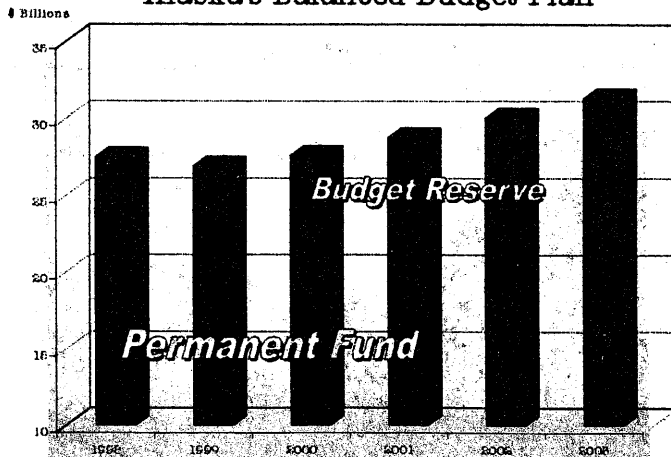


Chart 4

Permanent Fund Market Value

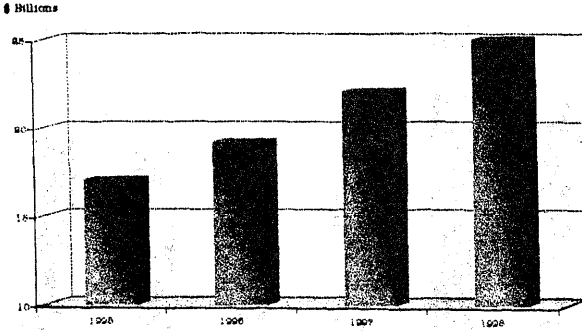


Chart 5

Constitutional Budget Reserve

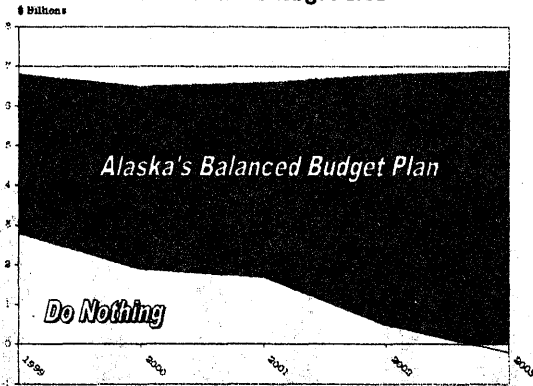


Chart 6

Permanent Fund Dividends With  
Alaska's Balanced Budget Plan

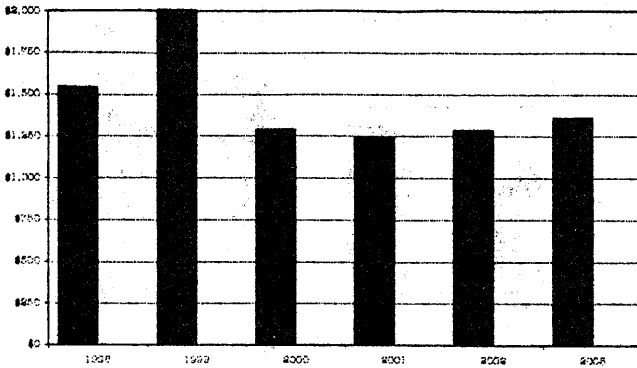


Chart 7

Average Out the Dividend Growth

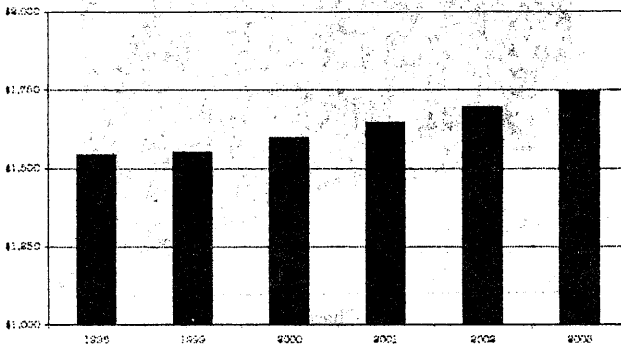


Chart 8