

**SENATE AND HOUSE
JOINT JOURNAL SUPPLEMENT**

March 5, 2003

Wednesday

No. 5

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Fiscal Budget and Investment Plan

by

The Honorable Frank Murkowski

Governor

State of Alaska

Before a Joint Session

of the

Twenty-third Alaska State Legislature

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March 5, 2003

Juneau, Alaska

The following was submitted for publication:

Introduction

Thank you for making this time available for me to speak to you about our proposed Budget and Investment Plan for Alaska.

Where We Are Going

At its core, our plan embodies this administration's primary mission - namely, to build a robust, growing economy with good-paying job opportunities, so that our young people may choose to stay in Alaska.

Our mission is also to generate sufficient state revenue to fund quality education, public safety, transportation and provide health care and other services to those in need. I found encouragement for our efforts to boost Alaska's economy when I met with President Bush last week in Washington, D.C. and later with bond analysts in New York City.

It is clear we must use our natural resource wealth to increase our revenues to pay for the services Alaskans need and expect. Like so many other states, Alaskans have to tighten our belt and work hard together over the next several years to get there. The goal is to achieve a balance in which revenues from economic development, especially oil and gas, equal or exceed the costs of state and local government services provided to Alaskans.

We won't achieve this balance overnight. It will take time for us to see increased oil and gas development and other economic activity resulting from the streamlined permitting, investment in community and industrial roads, and the many other initiatives that we've launched since taking office.

Where We Are Now

The bright tomorrow for Alaska is sure to come. The question is, what do we do until new jobs and revenues kick in? Answer: The same thing we would do with our family budget: Reduce spending.

And let me give the Legislature credit, here. You have recognized this and acted on it for the last seven years. There were good reasons for the budget cuts you made – and others you tried to make.

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As this first chart shows, over the last decade past Administrations added 173 new programs and 2,125 new full-time state employees. The FY04 budget we propose will reduce 21 programs and about 200 employees. In all, state government has been spending more than \$7 billion dollars a year: in Permanent Fund dividends and investments, in federal government grant money, and in state taxes, fees and other revenues. (Chart #1, Addendum)

Unfortunately, we've also been spending our savings - the Constitutional Budget Reserve. The next chart shows that of the \$7 billion dollars deposited into the Constitutional Budget Reserve since it was established by a 1990 vote of the people, we have just \$1.9 billion left. (Chart #2, Addendum)

Someone likened our situation to having a brown bear move in under your back porch to hibernate. We've been ignoring it while winter is here - but with spring just around the corner, we need to act soon. We can't continue to grow government.

What the Administration Is Doing

Last year as we traveled across the state, we heard the message over and over again that Alaskans wanted government to be more efficient and effective. I made the commitment that my Administration would do that. And in the three months that this Administration has been in office, I believe we're well on our way to making good on that promise.

First, we started the process of reorganizing departments to attain increased efficiency and better align functions. We're continuing this departmental review and anticipate more savings during FY 04.

Second, we cut the supplemental budget for FY 03, which we inherited from the previous Administration. By working with the departments we were able to cut \$77 million dollars.

Our third step was to reduce spending to operate government. This process began with Administrative Order 202, which I signed within two hours of taking office on December 2nd. It directed departments to review the economies and efficiencies of resources allocated to them. Our OMB team worked closely with each department to define

core functions and identify which programs might be combined or eliminated in order to lower spending and “right-size” government.

Fourth, we began an examination of the fees charged for state services, with the intent of increasing them where appropriate. I am a firm believer in user fees - Those who receive a benefit from government should pay government for the service.

Limiting Draw from the CBR

One of the first questions I had for OMB Director Cheryl Frasca last December was how much would we spend in general fund dollars if we were simply to continue services and programs at the level approved by the Legislature for FY 2003.

She said that just to stay even with FY 03 would require an increase of \$220 million dollars to cover formula-driven entitlements and other requirements. She also estimated that if we intended to spend at that level, it would require us to withdraw \$900 million dollars from the Constitutional Budget Reserve in FY 04. Such a large draw from our CBR savings is unsustainable, and therefore unacceptable.

No income tax, raid on PF

Now in case there is any doubt, I am not proposing a personal income tax or taking people’s Permanent Fund dividends to pay for increasing the size of government. I never have and never will.

We’ve all heard solutions proposed for the budget gap: virtually all relate to new taxes. Our approach is to identify and fund priorities, and eliminate spending for non-priorities. That’s what we are proposing. Using the criteria for results-based budgeting, which we call our “Missions and Measures” review, OMB and the departments systematically identified core state programs that work well and those that don’t. My intention is to discontinue or reduce programs that are not relevant to the core services or do not operate efficiently.

I met with my Cabinet in mid-February to work out reductions with each commissioner. The OMB director and her staff followed up to implement the decisions and identify additional spending cuts. Based on our results-based process, we identified \$189 million dollars in reductions. As I mentioned earlier, this will require the elimination of 21 state programs.

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We intend to make additional reductions in the FY 05 budget after we have had a full year's opportunity to review programs more thoroughly and determine other ways to deliver services more efficiently. Perhaps the best way to present our budget for 2004 is with this graphic comparison It shows General Fund expenditures for last year's and the coming year's operating budgets. (Chart #3, Addendum)

2003

- The FY 03 General Fund budget proposed by the prior Administration totaled \$2.318 billion.
- The FY 03 GF budget approved by the Legislature was \$2.222 billion.

2004

- The FY 04 prior Administration's Agency Budget Proposal was \$2.595 billion.
- The FY04 Budget Proposal that I'm submitting totals \$2.169 billion, which includes that \$220 million increase in entitlements that our OMB director identified in December.

You know, it might sound harsh to some people to hear me talk about lowering the number of state "jobs" or eliminating so many state "programs," as if these were merely statistics - not people.

We appreciate and value the important contribution of hard-working State employees.

I am also very much aware that the budget cuts we recommend to you will impact people, families and communities. There are no easy choices to make. It is a painful process to identify cuts in government spending, knowing that they will affect quality of life for individual Alaskans. Some are losing their jobs, some being asked to absorb loss or reduction of benefits, others to pay higher user fees. Obviously, it is much easier and more popular to announce increases in spending than cuts. We've done our best to make sure the process being followed is equitable, and that the cuts are as fair.

Our belt tightening started with government operations. The department-by-department administrative reductions total about \$13 million, and as I've mentioned, a personnel reduction of some 200 state positions.

Among the other programs that we propose to cut many have merit but are either of lower priority, overlap other programs, or have outlived their original intent.

One of the higher profile ones is the Longevity Bonus program, which we propose to end. This program provides many seniors monthly payments of up to \$250. It was established in 1972 as a way to say "thank you" to pioneer Alaskans who brought us into statehood.

The first year, it cost the state \$2.5 million dollars and served less than 5,000 Alaskans. In 1984, the Alaska Supreme Court opened the program to all seniors in Alaska who were 65 or older at the time and could establish residency. By 1993, the cost to the state was up to \$67 million dollars a year, and had 22,741 recipients. Today, 18,000 Alaskans are on this program at a cost of \$47 million dollars. Elimination of this program will allow state funds to be redirected to primary services of education, public safety and safe transportation systems - services that benefit seniors as well as other Alaskans. We will not abandon our seniors. We have sufficient safety nets through other programs that I intend to maintain. We will protect people in need. (adult public assistance)

Another example of a program that has outlived its usefulness is the State (Alyeska) Correspondence school. In today's newspaper you may have read the details of this change. When this program started, it was the only one providing the service in Alaska. Today, there are at least a dozen school districts operating correspondence programs. By eliminating the program in Juneau we eliminated duplication which allows the program to be run regionally particularly in rural areas of the State.

We also recommend a reduction of 25% in state funds distributed to municipalities. "Sharing" means sharing the bad times with the good. Just as our belt tightening will reduce programs and ask individuals to be more self reliant, it also calls on municipalities to rely more on their own financial resources.

And finally, we believe it's time to completely revisit the Alaska Science and Technology Foundation, transferring its endowment to the General Fund and its wind-down to AIDEA. This was a program set up by Governor Cowper in 1988 when the State had greater resources. ASTF has failed to live up to the promise of delivering usable science and technology to benefit Alaska business and industry in a cost efficient way. It has been estimated that each new business created has cost the State as much as \$300,000 and some jobs have cost the state \$52,000. We just can't afford this program, and I know you have recognized this in the past.

Many other programs identified to either be terminated or reduced are covered in the budget submittal I am making tonight.

USER FEES

As far as new revenues are concerned, I'm against broad-based taxes that would inhibit the growth of our economy. At a time when we want to increase economic activity, it is not prudent to discourage investment in Alaska by enacting large corporate tax increases. Nor is it practical to initiate a state income tax which would simply take money out of the pockets of hard working Alaskans and deposit them in the bottomless pockets of government.

At the same time, those who benefit from State services should contribute a fair share for those services. Visitors to our state and people who work in Alaska but don't live here, ought to be paying their share for the services they receive.

1. The budget I propose anticipates \$35 million annual revenue from one of two targeted choices that would address this situation.

One could be revival of the old school tax that Alaska used to levy on everyone's first paycheck of the year, including those of out of state workers.

Another possibility is a seasonal statewide sales tax, which could be in effect, say from May through September. It would allow us to collect a tax from non-Alaskans.

I will work with the Legislature to determine which choice would best accomplish our objectives.

2. The budget also anticipates \$38 million in new revenue from a 12-cent increase in the state motor fuel tax, bringing it up to the average of the other states. I look at this more as a user fee to support maintenance and operation of our state highway system. We first set this rate of 8 cents a gallon in 1961 when highway O&M was about \$6.2 million dollars. Forty years later, the rate is still only 8 cents, but the cost of maintaining our highway system has risen to \$55 million. Alaskans must be assured that their highways are safely maintained, the snow is cleared and potholes filled.

3. Another new source of revenue being proposed is a “wildlife conservation pass,” that would be charged of all tourists, shipboard passengers, train users, outdoor recreation participants, etc. This fee will generate an estimated \$8 million dollars annually, and will be collected by vendors who participate in wildlife viewing and other outdoor services. Alaska residents will be exempt.

4. We will also increase the State Business License Fee from \$25 per year to \$200 per year. This fee has not been raised since 1949. It will help business pay for the services provided by the State. It will raise \$6.9 million dollars.

5. We propose to increase the fee on gaming to 5% on the gross revenue from pull-tab operations. In 2001 total receipts for these operations exceeded \$273 million a year, from which charities receive less than 10 %, or \$23 million and the state collects just over \$2 million. Under our proposal charities would be held harmless in the fee increase being proposed. This will raise \$11.5 million for the state in the first year.

This isn't the first time Alaskans have been called upon to sacrifice and shoulder a challenge together. We've done it in times of war, in times of natural disaster and in times of economic crises - much tougher than the one we face today. Our faith-based community, charitable organizations, neighbors, friends and family - as well as appropriate Federal programs will contribute. The months ahead will be a time for all of us to be compassionate and work together to ensure the changes do not unduly harm anyone.

Alaska Gramm Rudman

As you review and refine this budget proposal and make changes, please limit the draw on savings to the minimum necessary. If you increase general fund spending for a program, I request you reduce general fund spending elsewhere to offset that increase. (Perhaps, we should look at this as our Alaska version of the Gramm-Rudman balanced budget approach.)

Saving the Permanent Fund

There has been much public concern recently about the decrease in the value of Alaska's Permanent Fund. In June of 1998 the Fund was at about \$28 Billion. Now it's \$22.6 billion.

The drop in the Stock Market and corresponding drop in the earnings of the Permanent Fund have Alaskans wondering what's going to happen to their dividend checks. This is an appropriate time to re-evaluate the formula we use to determine inflation proofing and what's available for the dividend. As the Associated Press reported the other day, there is the potential the dividend could drop to \$470 or even zero this year the way the market's been going. For the long-term viability of the Permanent Fund and the dividend program, I call upon the Permanent Fund Board of Trustees and others to make recommendations that would protect the long-term value of the Fund and dividends for Alaskans. I will discuss these recommendations with the Legislature to determine whether action is warranted.

Let me reiterate a pledge I made to Alaskans last fall - no change will be made to the Dividend Program without a vote of the people. If action is needed to save the Dividend Program I want to lay it on the table before the Legislature adjourns so that Alaskans will have a chance to evaluate and debate proposed changes before any contemplated vote in November 2004.

CBR DRAW

There are probably some people thinking right now: "If the governor's not going to use an income tax or raid the Permanent Fund, then he must intend to clean out the Constitutional Budget Reserve - the state's savings account!" I think you've seen those "Dooms Day" predictions that we would have to deplete the CBR by more than a billion dollars. Well, they're wrong. By following the plan I have laid

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out tonight, this budget proposal would only require a withdrawal of \$393 million. (Chart #4, Addendum)

Conclusion

Mr. President, Mr. Speaker - as the Legislature reviews the Budget package there will be many questions about the specifics of this fiscal plan. I did not go into the details of each cut and adjustment tonight because they are in the Budget I just handed to you. I also know that your process will go into the details. My purpose has been to give Alaskans a description of this Administration's fiscal plan and how each piece fits together.

We share the responsibility to get our state's fiscal house in order and find a way to live within our means. I believe this budget and investment plan will allow us to meet these responsibilities, and I ask for your support.

I welcome the broader public dialogue that certainly lies in the days ahead. And most of all, I welcome the opportunity for us to work together to restore our state to long-term fiscal stability and economic security.

God speed us on our way and God bless Alaska.

Please report corrections to the Senate Secretary's office.

Chart #1

FY 1993 VS. FY 2004

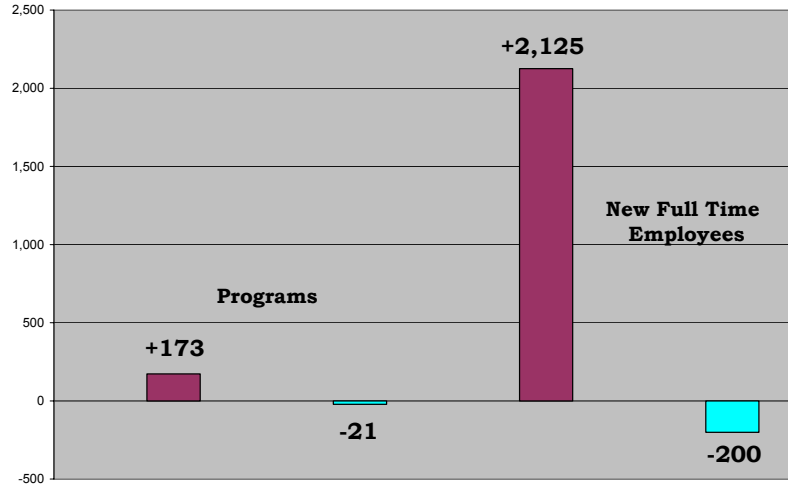


Chart # 2

Operating Budget - General Funds

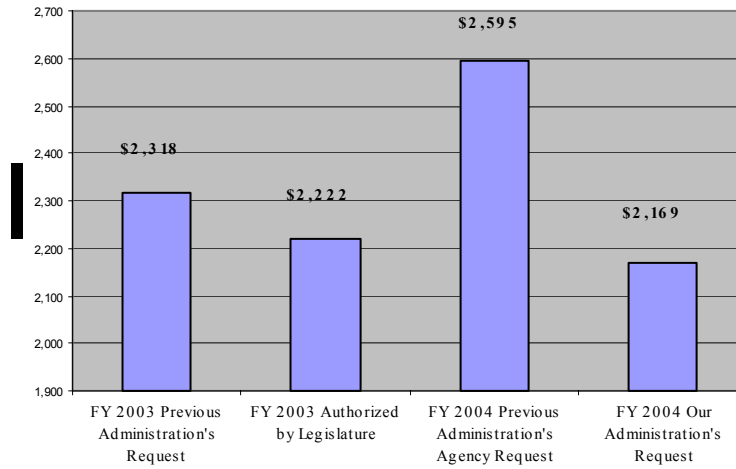


Chart #3

Constitutional Budget Reserve
\$7 Billion Total Deposits

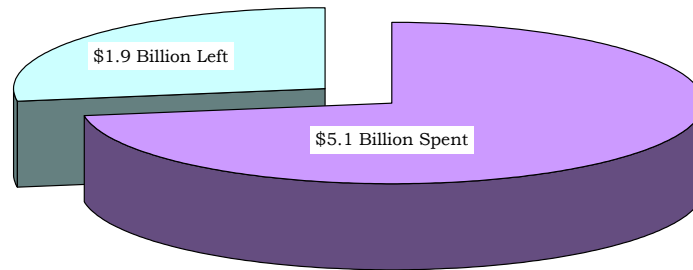


Chart #4

CBR Projected Draw

