

CORRECTED

2

Berrier

A M E N D M E N T

Offered in the HOUSE

By Adams

TO: CSHJR 39(Fin)

Page 1, line 10, through page 3, line 21, delete all material and insert:

"* Section 1. Article IX, sec. 16, Constitution of the State of Alaska, is repealed and readopted to read:

SECTION 16. APPROPRIATION LIMITATIONS. Except for appropriations for Alaska permanent fund dividends, appropriations of the proceeds of revenue or general obligation bonds and appropriations required to pay the principal and interest on general obligation bonds, appropriations of money from a nonstate source in trust for a specific purpose, including revenue of a public enterprise or public corporation of the state that issues revenue bonds, appropriations from the treasury during a fiscal year may not exceed the lesser of the amount appropriated in the fiscal year preceding the fiscal year that this section takes effect adjusted for the cumulative inflation and population growth or decline as defined by law or 95 percent of the unrestricted revenue of the state for the previous calendar year. An appropriation in excess of this limit may not be made unless a state of emergency is declared by the governor as provided by law. The governor shall cause any unexpended or unappropriated balance to be invested so as to yield competitive market rates to the treasury.

* Sec. 2. Article IX, Constitution of the State of Alaska, is amended by adding a new section to read:

SECTION 17. APPROPRIATION RESERVE FUND. An appropriation reserve fund is established. Appropriations may not be made from the appropriation reserve fund except for the purpose of repelling invasion, suppressing insurrection, defending the state in war, meeting natural disasters, or appropriations required to pay the principal and interest on general obligation bonds. On June 30 of the fiscal year in which the balance of the appropriation reserve fund exceeds 1.5 times the appropriations of unrestricted revenue in the preceding fiscal year, the balance of the appropriation reserve fund shall lapse into the treasury. The balance of the appropriation reserve fund shall be invested at competitive national market rates. All earnings of the fund shall become part of the principal of the fund.

* Sec. 3. Article XV, Constitution of the State of Alaska, is amended by adding a new section to read:

SECTION 29. APPROPRIATION RESERVE FUND. Beginning July 1, 1985, and continuing until June 30 of the fiscal year in which the balance of the appropriation reserve fund exceeds 1.5 times the appropriations of unrestricted revenue in the preceding fiscal year, an amount equal to 8.8 percent of the unrestricted revenue for each month shall be transferred from the treasury to the appropriation reserve fund on the first day of the succeeding month. No less than 25 percent of that portion of the unrestricted revenue of the state that has not been appropriated as allowed by this section shall be transferred from the general fund on the first day of each fiscal year during the period defined in this section.

* Sec. 4. Section 1 of this amendment takes effect on July 1 of the

fiscal year following the fiscal year in which the balance in the appropriation reserve fund established in sec. 2 of this amendment exceeds 1.5 times the appropriations of unrestricted revenue in the preceding fiscal year.

* Sec. 5. The amendments proposed by this resolution shall be placed before the voters of the state at the next general election in conformity with art. XIII, sec. 1, Constitution of the State of Alaska, and the election laws of the state."

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10 ~~year during the period defined in this section. During the period in~~
11 ~~which this section is in effect the provisions of Section 16 of~~
12 ~~Article IX of this Constitution are superseded.~~

13 * Sec. ~~3.4~~ Section 1 of this amendment takes effect on July 1 of the
14 fiscal year following the fiscal year in which the balance in the appropri-
15 ation reserve fund established in sec. 2 of this amendment exceeds 1.5
16 times the appropriations of unrestricted revenue in the preceding fiscal
17 year.

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20 with art. XIII, sec. 1, Constitution of the State of Alaska, and the elec-
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Offered: 3/13/84
Referred: Rules

Original sponsors: Hayes, Abood,
Barnes, et al

1 IN THE HOUSE

BY THE FINANCE COMMITTEE

2

CS FOR HOUSE JOINT RESOLUTION NO. 39 (Finance)

3

IN THE LEGISLATURE OF THE STATE OF ALASKA

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THIRTEENTH LEGISLATURE - SECOND SESSION

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AMENDMENT BY ADAMS TO CSHJR 39 (Fin) accomplishes the following:

1. On line 13, page 1, corrects language to make appropriations for Permanent Fund Dividends exempt from the Cash-Based spending limit, because those funds come from Permanent Fund earnings, not from the General Fund.
2. New language on line 15 exempts from the limit funds which are other than a normal expenditure from the General Fund. The amendment merely expands the language to be certain all legitimate exemptions are identified.
3. New language in line 17 corrects the time sequence, so that the correct base year is identified.
4. On page 2, line 12 in the CS, July 31 is changed to July 1 to include the first month of the fiscal year.
5. The temporary spending limit, which would have replaced the one presently in Article IX of the Constitution, has been removed. From that section of the CS, the clause which deposits 25% annually of unappropriated General Fund revenues into the reserve is moved up into Section 3 of the amended bill.

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STATE OF ALASKA 1984 LEGISLATIVE SESSION
FISCAL NOTE

Revision Date: _____

REQUEST

Bill/Resolution No.: CS HJR 39 (FIN)
Title: Cash Based Budgetting

FISCAL DETAIL

Agency Affected: _____
Program Category Affected: _____

Sponsor: Hayes
Requestor: House Finance
Date of Request: 3/12/84

BRU, Program or Subprogram(s) Affected: _____

EXPENDITURES/REVENUES: (Thousands of Dollars)

	FY 84	FY 85	FY 86	FY 87	FY 88	FY 89
OPERATING						
100 PERSONAL SERVICES						
200 TRAVEL						
300 CONTRACTUAL						
400 SUPPLIES						
500 EQUIPMENT						
600 LAND & STRUCTURES						
700 GRANTS, CLAIMS						
800 MISCELLANEOUS						
TOTAL OPERATING	0	0	0	0	0	0
CAPITAL						
REVENUE						

FUNDING: (Thousands of Dollars)

GENERAL FUND						
FEDERAL FUNDS						
OTHER						
TOTAL						

POSITIONS:

FULL-TIME						
PART-TIME						
TEMPORARY						

SOURCE OF FUNDS TO OFFSET FISCAL IMPACT OF BILL:

ANALYSIS: Attach a separate page for analysis

This resolution requires an annual transfer from revenues to CBB if voters approve.

Prepared By: Rep. Al Adams, Chair *AVA* Phone: 465-3706
Division: House Finance Committee Date: 3/12/84

Approved by Commissioner: _____ Date: _____
Agency: _____

Distribution (by Agency preparing fiscal note):

- Legislative Finance
- Legislative Sponsor
- Requestor
- Office of Management and Budget
- Impacted Agency(ies)

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THE GENERAL FUND AS A REVENUE SOURCE FOR CASH-BASED BUDGETING
 Based on a 30th Percentile Revenue Projection
 (millions of dollars)

Fiscal Year	DOR Revenue Forecast	Revenue Under CBB	Potential Expenditure Level	General Fund Earnings	General Fund BalanceCash-Based Budgeting Reserve Fund....		
						Contributions	Earnings	Balance
1981	3,769		3,769	201	2,010			
1982	4,174		4,174	254	2,540			
1983	3,624		3,624	266	2,660			
1984	3,233		3,233	300	3,000			
1985	3,219		3,219	250	2,500			
1986	3,365	3,069	3,069	259	2,590	296.1	14	310
1987	3,729	3,401	3,401	288	2,880	328.2	48	686
1988	3,711	3,384	3,384	288	2,880	326.6	87	1,100
1989	4,068	3,710	3,710	318	3,180	358.0	132	1,590
1990	3,880	3,539	3,539	301	3,010	341.4	183	2,114
1991	3,582	3,267	3,267	275	2,750	315.2	236	2,665
1992	3,536	3,225	3,225	270	2,700	311.2	294	3,270
1993	3,405	3,105	3,105	258	2,580	299.6	357	3,927
1994	3,290	3,000	3,000	247	2,470	289.5	425	4,641
1995	3,195	3,644	3,348	685	7,297			
1996	3,033	3,483	3,467	672	7,174			
1997	3,092	3,540	3,564	673	7,180			
1998	3,159	3,617	3,512	687	7,325			
1999	3,213	3,680	3,578	698	7,447			
2000	3,245	3,718	3,648	705	7,527			
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)

col.

- 2 Department of Revenue January, 1984 revenue projection.
- 3 Revenues after effects of cash-based budgeting program. During the CBB reserve contribution period, revenues (column 3) are equal to DOR projections minus annual CBB contributions. Starting with the first cash-based budgeting year, revenues (column 3) are equal to DOR projections plus additional earnings which accrue to the general fund as a result of transferring the CBB reserve fund balance to the general fund.
- 4 Expenditure levels are presently limited to projected revenues (ignoring the Constitutional appropriation limit). Beginning with the first cash-based budgeting year, expenditures will be limited to the revenues collected in the previous calendar year.
- 5 General fund earnings are DOR projections up to the start of cash-based budgeting, at which point the general fund earnings will be augmented due to the increased earnings capacity of the general fund from that point on into the future.
- 6 Beginning with the first cash-based budgeting year, the general fund balance is substantially increased by the transfer of the CBB reserve fund.
- 8 Reserve fund earnings are calculated at a 10 percent annual interest rate compounded monthly.
- 9 The earnings rate of the CBB reserve fund is compounded monthly using a 10% annual interest rate.

This projection is based on a general fund unrestricted revenue contribution of 8.8 percent.

Prepared by House Research Agency - March 12, 1984

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Sent to all L.I.O.s for testifiers

AMENDED DRAFTING

HOUSE JOINT RESOLUTION 39

In early February of 1984 the Research Agency of the Alaska House of Representatives published an 80-page study titled "Cash-Based Budgeting, A Response to Revenue Uncertainty." It is the culmination of more than a year of thorough and exhaustive study by that Agency into one of the most vexing problems of any state or local government. At present, all state governments and virtually all municipalities prepare annual or biennial budgets based on anticipated income. In the case of the State of Alaska, a few weeks before the beginning of each fiscal year the Legislature completes and the Governor subsequently signs a budget based on revenues expected to begin coming into the state treasury on July 1.

Under this system the possibility always exists -- perhaps most particularly in Alaska -- of failure to fund needed projects or services because of a low revenue forecast when money actually would have been available. More serious, however, is the possibility of the Legislature and Administration authorizing funding for projects and programs for which money is later not available. Then projects must be discontinued, programs curtailed, operations interrupted and hopes and expectations dashed.

Cash-Based Budgeting is a fiscal system which eliminates the possibility of either of those events, and makes planning a more rational, certain and efficient process. By creation of an appropriation reserve fund, built up over a period of years, the Administration and the Legislature would know, going into a budget cycle precisely how much money was "in the bank" and available for appropriation. Municipalities, which rely heavily upon state funding through revenue sharing, municipal assistance and grant programs; school districts, dependent upon School Foundation funding and construction bond retirement programs; hospital districts, which rely upon state funding for operations and expansion in part, all would have a clearer idea, when preparing budgets for submission to their assemblies and boards and to the Legislature, of how much money was available.

In addition, the reserve would create a new earnings source for the State. As the legislation is presently written, an average 18 months' normal expenditures would be held in reserve. The six months additional is necessitated by the fact that the Legislature operates on a calendar year and the treasury on fiscal. This would

mean an additional annual income of approximately \$400 million, given present revenue and earnings projections, which would become part of the regular budgeting reserve. The amount of money held in the reserve could be invested in relatively long-term, stable securities, much as the Permanent Fund is at present, because as the reserve is drawn down with each day's expenditures -- paying the state's daily bills -- the day's income would be added to the account, maintaining an approximately stable earnings base of about \$4.5 billion. The effect would be a "pay-as-you-go" system, with cash certainty and added income accrual as well.

As HJR 39 is presently written and being considered by the House Finance Committee, 8.8% of General Fund income would be reserved, with deposits made on a monthly basis. When the reserve reached an amount equal to 1 1/2 times the previous year's appropriations, Cash-Based Budgeting would go into effect; that is, all budgeting would be done from the reserve fund, and all income would go into the reserve.

The Legislation imposes limitations upon expenditure so that the reserve would continue to grow and increase its earning power. Appropriations in any given year would be limited to 95% of the amount in the reserve, or an amount equal to the previous year's budget plus or minus population and inflation adjustments, whichever was less. This factor would function as a strict control on the growth of government, in addition to incrementally increasing the earning power of the reserve. There is an additional incidental check on government growth, which is the extraction of the 8.8% of General Fund income during the reserving period.

The legislation is written as a constitutional amendment for the reason that the reserve fund must be constitutionally protected. Since one legislature may not legally bind a successor body without the approval of the voters, the security of the fund would never be complete nor the system guaranteed to function as designed without constitutional protection. For this reason, the proposal must go to a general election ballot. That means that if HJR 39 is not passed this year, it would be another two years before it could be attempted again, and Fiscal Year 1988 before deposits to the reserve fund could begin. Given present income projections, 1984 would appear to be the last best opportunity to institute such a system Alaska might ever have.



ALASKA STATE LEGISLATURE
HOUSE OF REPRESENTATIVES
RESEARCH AGENCY

Pouch Y, State Capitol
Juneau, Alaska 99811
(907) 465-3991

MEMORANDUM

January 9, 1984

TO: Neil Phelps-Munson

FROM: Alexander Hoke

Alexander Hoke

REGARDING: Accelerated Start-up of Cash-Based Budgeting

I would like to bring to your attention two alternatives for accelerating the initiation date (start-up) of Cash-Based Budgeting. These options were not included in our outline for legislation.

Other than by simply increasing the percentage contributions to the CBB reserve fund each year, the following mechanisms could shorten the contribution period by one year each:

Early CBB Contribution. The point at which the CBB reserve fund would be sufficient to begin Cash-Based Budgeting could be made to occur one year earlier if an initial contribution were made as a "grubstake" to the reserve fund. If an appropriation to the CBB reserve fund of between \$250 and \$300 million (comparable to the annual percentage contribution) were made at the start of the contribution period, this amount and its interest earnings would effectively reduce the need for further contributions by \$600 million when Cash-Based Budgeting begins some seven to nine years later. Our preliminary calculations show that this early contribution could potentially cause the automatic CBB initiation to occur one year earlier than it otherwise would. Presumably, the "grubstake" appropriation would be made during this session and would be contingent on voter approval of the Cash-Based Budgeting constitutional amendment during the next general election.

Advanced Cash-Based Budgeting. According to the provisions in our CBB legislation outline, Cash-Based Budgeting would begin once the reserve fund equalled or exceeded the prior 18-months' revenues. This means that at the start of the fiscal year when this condition exists, probably between July 1, 1993 and July 1, 1995, the administration will begin to prepare the budget for the following fiscal year based on the

principles of Cash-Based Budgeting. By the time that the legislature approves this budget and it becomes effective, one year would have elapsed from the point at which the CBB reserve fund was large enough to fund Cash-Based Budgeting. In other words, there will be a one-year delay between the time that the CBB reserve fund is large enough and the point at which the first Cash-Based Budget becomes effective. During the elapsed year, additional investment earnings will accrue to the reserve fund, causing it to grow further beyond what is minimally required to start Cash-Based Budgeting.

The advanced Cash-Based Budgeting alternative would require that the Administration and the legislature project the growth of the CBB reserve fund each year and forecast the point at which reserve funds would be sufficient to start Cash-Based Budgeting. For example, if by July of 1993, the reserve fund contained about 90 percent of the funds needed to start Cash-Based Budgeting, and it became evident to the administration that the monthly percentage contributions would cause the fund to exceed the amount necessary for CBB startup by the end of the current fiscal year, then the next budget would be designed as a Cash-Based Budget assuming that CBB would start the following July 1. Likewise, the legislature would prepare a budget which anticipates that Cash-Based Budgeting will be effective at the start of the coming fiscal year. Consequently, the first Cash-Based Budget would become effective on the first July 1 for which the CBB reserve is sufficiently large to begin Cash-Based Budgeting, not one year later.

Of course, there exists the possibility that the administration and/or the legislature will inaccurately predict the size of the CBB reserve fund. The consequences of this error would be that the budget would be designed within the constraints of Cash-Based Budgeting: that total appropriations would be limited to the lesser of 95 percent of the prior calendar year's revenues or the total previous fiscal year appropriations adjusted for inflation and population changes.

With an annual growth rate of about \$600 to \$700 million towards the end of the contribution period, the CBB reserve fund will likely fall short of or exceed the required amount by several hundred million dollars making prediction of Cash-Based Budgeting start-up a simple matter. However, there would remain a chance that a prediction of whether or not Cash-Based Budgeting will become effective may result in a hair-

splitting decision for the legislature and even more so for the administration because of the greater uncertainty of their forecast. This may mean that the budget would have to be designed within the constraints of Cash-Based Budgeting even though this may not be required should the total CBB reserve fall short of having the funds needed to initiate Cash-Based Budgeting by the start of the fiscal year.

If you have any questions about these alternatives, please call me.

STATE OF ALASKA 1984 LEGISLATIVE SESSION
FISCAL NOTE

Revision Date 2/15/84

REQUEST
 Bill/Resolution No: CS HJR 39
 Title: Proposing amendments creating an Appropriation Reserve Fund.
 Sponsor: Hayes
 Requestor: A. State Affairs
 Date of Request: 02/14/84

FISCAL DETAIL
 Agency Affected: Revenue
 Program Category Affected: _____
 BRU, Program of Subprogram(s) Affected: _____

EXPENDITURES/REVENUES: (Thousands of Dollars)

	FY 84	FY 85	FY 86	FY 87	FY 88	FY 89
OPERATING						
100 PERSONAL SERVICES	-	-	-	-	-	-
200 TRAVEL	-	-	-	-	-	-
300 CONTRACTUAL	-	-	-	-	-	-
400 SUPPLIES	-	-	-	-	-	-
500 EQUIPMENT	-	-	-	-	-	-
600 LANDS & STRUCTURES	-	-	-	-	-	-
700 GRANTS, CLAIMS	-	-	-	-	-	-
800 MISCELLANEOUS	-	-	-	-	-	-
TOTAL OPERATING	-	-	-	-	-	-
CAPITAL	-	-	-	-	-	-
REVENUE	-	-	-	-	-	-

FUNDING: (Millions of Dollars)

GENERAL FUND	-	-	(296.1)	(328.2)	(326.6)	(358.0)
FEDERAL FUNDS	-	-	-	-	-	-
OTHER: Approp. Reserve	-	-	310.0	376.2	413.6	490.0
TOTAL	-	-	-	-	-	-

POSITIONS:

FULL-TIME	-	-	-	-	-	-
PART-TIME	-	-	-	-	-	-
TEMPORARY	-	-	-	-	-	-

SOURCE OF FUNDS TO OFFSET FISCAL IMPACT OF BILL:

ANALYSIS: Attach a separate page for analysis.

Prepared By: David R. Tonkovich ^{DT}
 Division: Research Section

Phone: 465-2173
 Date: 02/15/84

Approved by Commissioner: *Paul Hertz*
 Agency: Revenue

Date: 2/16/84

Distribution (by Agency preparing fiscal note):

- Legislative Finance
- Legislative Sponsor
- Requestor
- Office of Management and Budget
- Impacted Agency(ies)

Analysis for CS HJR 39

1. Methodology: The Department of Revenue has cooperated with the House Research Agency in their study of cash based budgeting. Revenue numbers used by House Research are based on projections prepared by the Department in January 1984. The Department did not prepare a separate and possibly redundant projection of the fiscal effects of cash based budgeting. Rather, our analysis is based on figures prepared by the House Research Agency. The particular run evaluated is based on 30 percent case revenue projections and a contribution of 8.8 percent of unrestricted revenues each month beginning in fiscal year 1986.

2. General Observation on Bill Language: The Department feels that the bill is extremely difficult to interpret in its present form. The major source of confusion is that in several references to "year" it is unclear whether the bill means fiscal year or calendar year. This makes it very hard to think through the implications of the various bill provisions.

3. Comments on House Research Agency Figures: [See Attached Printout]

a. The Department feels that the 30 percent revenue case provides an appropriate benchmark for evaluating the impacts of cash based budgeting. Compared to the mean case there is a higher probability that revenues projected in the 30 percent case will actually be realized. The conservative outlook is justified given the long time span considered and the uncertainty in the numbers presented in the analysis.

b. Calculations of contributions, earnings, and balances of the Appropriation Reserve Fund seem reasonable. Two potential problems should be noted. First, there are complications in forecasting long-term interest rates, given the uncertain impacts of massive federal deficits. Second, any of the analyses which are presented in nominal dollars need to be interpreted carefully. For instance, if a 6 percent inflation rate is assumed, the reserve fund balance of \$4.641 billion in FY 94 is equivalent to \$2.747 billion of purchasing power in FY 85.

c. In FY 95 the balance of the Appropriation Reserve Fund is transferred to the general fund. The attached analysis adds this balance to an estimated balance in the general fund. A problem of interpretation arises in that the critical starting point of budget deliberations is the balance available for appropriation. Because a substantial portion of the general fund balance at any point in time may be in illiquid assets or be reserved for some purpose (e.g. money appropriated but not yet spent), the entire balance is not available for appropriation. On the other hand, the balance transferred from the Appropriation Reserve Fund would be available for appropriation within the limits prescribed by the bill's expenditure limitation provisions. This difference needs to be kept in mind in examining the combined balance.

4. Additional Assumptions for Fiscal Note:

a. The fiscal note treats contributions to the Appropriation Reserve Fund as a reduction in general fund revenues. The amounts shown for the Appropriations Reserve Fund include this contribution plus interest earnings.

b. If contributions were not made to the Appropriation Reserve Fund, that portion of unrestricted revenues would go to the general fund. The analysis assumes that all of this money would be spent and that any interest earned would be relatively small.

THE GENERAL FUND AS A REVENUE SOURCE FOR CASH-BASED BUDGETING
 Based on a 30th Percentile Revenue Projection
 (millions of dollars)

Fiscal Year	DOR	Revenue	Potential	General	GeneralCash-Based Budgeting Reserve Fund....		
	Revenue Forecast	Under CDB	Expenditure Level	Fund Earnings	Fund Balance	Contributions	Earnings	Balance
1981	3,769		3,769	201	2,010			
1982	4,174		4,174	254	2,540			
1983	3,624		3,624	266	2,660			
1984	3,233		3,233	300	3,000			
1985	3,219		3,219	250	2,500			
1986	3,365	3,069	3,069	259	2,590	296.1	14	310
1987	3,729	3,401	3,401	288	2,880	328.2	48	686
1988	3,711	3,384	3,384	288	2,880	326.6	87	1,100
1989	4,068	3,710	3,710	318	3,180	358.0	132	1,590
1990	3,880	3,539	3,539	301	3,010	341.4	183	2,114
1991	3,582	3,267	3,267	275	2,750	315.2	236	2,665
1992	3,536	3,225	3,225	270	2,700	311.2	294	3,270
1993	3,405	3,105	3,105	258	2,580	299.6	357	3,927
1994	3,290	3,000	3,000	247	2,470	289.5	425	4,641
1995	3,195	3,644	3,348	685	7,297			
1996	3,033	3,483	3,467	672	7,174			
1997	3,092	3,540	3,564	673	7,180			
1998	3,159	3,617	3,512	687	7,325			
1999	3,213	3,680	3,578	698	7,447			
2000	3,245	3,718	3,648	705	7,527			
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)

col.

- 2 Department of Revenue January, 1984 revenue projection.
- 3 Revenues after effects of cash-based budgeting program. During the CBB reserve contribution period, revenues (column 3) are equal to DOR projections minus annual CBB contributions. Starting with the first cash-based budgeting year, revenues (column 3) are equal to DOR projections plus additional earnings which accrue to the general fund as a result of transferring the CBB reserve fund balance to the general fund.
- 4 Expenditure levels are presently limited to projected revenues (ignoring the Constitutional appropriation limit). Beginning with the first cash-based budgeting year, expenditures will be limited to the revenues collected in the previous calendar year.
- 5 General fund earnings are DOR projections up to the start of cash-based budgeting, at which point the general fund earnings will be augmented due to the increased earnings capacity of the general fund from that point on into the future.
- 6 Beginning with the first cash-based budgeting year, the general fund balance is substantially increased by the transfer of the CBB reserve fund.
- 8 Reserve fund earnings are calculated at a 10 percent annual interest rate compounded monthly.
- 9 The earnings rate of the CBB reserve fund is compounded monthly using a 10% annual interest rate.

This projection is based on a general fund unrestricted revenue contribution of 8.8 percent.

Prepared by: House Research Agency

CS HJR 39 Sectional Analysis
Prepared by House Research Agency

Chronological Sequence of Provisions

- 1) An appropriation reserve fund is created upon voter approval in the next general election.
- 2) Contributions to the reserve fund (as provided in Section 3 of this resolution) begin July 31, 1985 and continue through June 30 of the year in which the reserve balance exceeds 1.5 times the preceding year appropriations of unrestricted revenues.
- 3) General fund appropriations are limited (as provided in Section 4 of this resolution) during the period of time in which contributions are made to the reserve fund.
- 4) When sufficient funds to begin cash-based budgeting have been collected, the reserve fund balance is transferred into the treasury.
- 5) Once cash-based budgeting begins, a new spending limit (as defined in Section 1 of this resolution) is imposed.

Section 1.

This section replaces the existing State Constitutional spending limit provisions. According to Article 9, Section 16 of the Alaska Constitution, the present appropriation limit is equal to \$2.5 billion adjusted for federal indices of change in population and inflation since July 1, 1981, except for appropriations for permanent fund dividends, revenue bond proceeds, debt service on general obligation bonds, and non-State trust funds. Article 9 Section 16 further provides that within the appropriation limit, "at least one-third shall be reserved for capital projects and loan appropriations." Appropriations for capital projects above the appropriation limit are permitted if approved by the governor or passed by a three-fourths legislative veto override and if approved by the Alaska voters.

Section 1 of CS HJR 39 proposes to substitute for the current appropriation limit one of the following limitations, whichever is less:

- 1) the appropriations for the year that this constitutional limit becomes effective (see Section 5 for effective date), adjusted each year for changes in population and inflation; or
- 2) "95 percent of the unrestricted revenue of the State in the previous calendar year." (In a period of declining revenues, this would likely be the effective limit on State appropriations).

Section 2.

An appropriation reserve fund is created in this section and is protected from appropriation except in a state of emergency or for meeting the general obligation bonded debt of the State. During a period of (roughly 7 to 9) years, contributions to the reserve fund will be made from unrestricted revenues as described in section 3 below. The reserve fund will be transferred into the treasury once the balance exceeds 1.5 times the preceding fiscal year appropriations of unrestricted revenue. This automatic termination of contributions to the reserve fund insures that cash-based budgeting will begin with the equivalent of 18 month's of State appropriations in the reserve.

This section further provides that the appropriation reserve balance is to be invested at competitive market rates and that all earnings from these investments will be retained by the reserve fund during the years when contributions are being made to the fund.

Section 3.

This section provides that 8.8 percent of unrestricted revenues received each month will be transferred into the appropriation reserve fund from July 31, 1985 until the reserve fund exceeds 1.5 times the appropriations of the preceding year. In other words, until the appropriation reserve fund contains a balance sufficient to begin cash-based budgeting, monthly contributions equal to 8.8 percent of the previous month's unrestricted revenues are deposited into the reserve fund.

Contributions under this section are to be calculated after deducting the amount of contributions defined in Section 4 of this resolution. Section 4 contributions to the reserve fund are equal to 25 percent of any remaining (unappropriated) revenues at the end of each fiscal year. Contributions under this section are equal to 8.8 percent of unrestricted revenues minus the amount of contributions under the 25 percent mechanism.

Section 4.

This section provides for an interim appropriation limit to be effective during the period when contributions are being made to the appropriations reserve fund. Except for appropriations to the permanent fund or for bonded debt service, spending is limited under this section to the fiscal year appropriations on the effective date of this section adjusted annually for changes in population and inflation. Appropriations above this limit may be made only in a state of emergency.

A supplementary source of contributions to the reserve fund is provided in this section. These contributions equal 25 percent of any unappropriated revenues remaining at the end of each fiscal year during the contribution period. For example, unappropriated revenues would remain in the event that actual revenues received during the year exceed expectations, and more importantly, exceed total appropriations for the year.

Section 5.

This section establishes an effective date for the appropriation limitation defined in Section 1 of this resolution. The effective date is July 1 of the year in which the appropriation reserve fund balance exceeds 1.5 times the preceding fiscal year appropriations.*

Section 6.

This section provides that the Constitutional amendments proposed in this resolution shall be placed before the voters in the next general election.

*According to the language in this section, the appropriation limits defined in Section 1 of this resolution will become effective the year before the balance of the reserve fund is transferred to the treasury. In other words, the budgetary procedures of cash-based budgeting will become effective before the money to implement cash-based budgeting has been transferred to the treasury. This appears to be an unintended discrepancy.

CS HJR 39 Appropriation Limitation Comparison to Existing Law

The appropriation limitation in Section 1 of CS HJR 39 differs from the existing appropriation limit (Article IX Section 16 of the Alaska Constitution) in the following ways:

Appropriation Limit

The existing Constitutional limit equals \$2.5 billion adjusted annually for changes in population and inflation. Section 1 of CS HJR 39 provides that appropriations are limited by one of two limits, whichever is less:

- 1) the appropriations for the year that this constitutional limit becomes effective, adjusted each year for changes in population and inflation; or
- 2) "95 percent of the unrestricted revenue of the State in the previous calendar year."

Base of Appropriation Limit

The existing Constitutional limit identifies a base amount of \$2.5 billion. By comparison, the first limit of Section 1 of CS HJR 39 identifies a base equal to "the amount appropriated in the fiscal year this section takes effect ..." Section 5 of CS HJR 39 defines the effective date of this section as the year following the fiscal year in which the balance of the appropriation reserve fund exceeds 1.5 times the appropriation of unrestricted revenue in the preceding fiscal year. This effective date can be thought of as the fiscal year in which cash-based budgeting begins (approximately FY 95).

Population and Inflation Adjustment Indices

The existing Constitutional limit specifies that the base appropriation limit is to be adjusted by federal indices of change in inflation and population. CS HJR 39 states that the base limit is to be adjusted by changes in population and inflation as defined by law.

One Third Capital Budget Reservation

The existing Constitutional expenditure limit states that within the limit of appropriations, "at least one-third shall be reserved for capital projects and loan appropriations." CS HJR 39 makes no such provisions.

State of Disaster/Emergency

The existing Constitutional limit allows appropriations in excess of the limit "to meet a state of disaster declared by the governor as prescribed by law." CS HJR 39 similarly permits appropriations in excess of the limit when "a state of emergency is declared by the governor as provided by law."

Other Exceptions for Appropriations Beyond the Limit

The existing Constitutional limit excludes from the limit: appropriations for Alaska permanent fund dividends. CS HJR 39 provides that Alaska permanent fund appropriations are excluded from the limit.

The existing Constitutional limit excludes from the limit: appropriations of revenue bond proceeds and appropriations to pay the principal and interest on general obligation bonds. CS HJR 39 excludes from the limit "appropriations of the proceeds of revenue or general obligation bonds and appropriations required to pay the principal and interest on general obligation bonds."

*approved
Johansen
"or other source"
Troy*

The existing Constitutional limit excludes from the limit: "appropriations of money received from a non-State source in trust for a specific purpose, including revenues of a public enterprise or public corporation of the State that issues revenue bonds...". CS HJR 39 makes no such provisions.

Appropriations During/For a Fiscal Year

The existing Constitutional limit applies to appropriations "made for a fiscal year". CS HJR 39 limits appropriations from the treasury "during a fiscal year".

*4/19/72
Appropriation
cleaner picture*

Interim Appropriation Limit

Section 4 of CS HJR 39 contains provisions for an interim appropriation limit to be effective during the period when contributions are being made to the reserve fund. The provisions in this section differ from the appropriation limitation provisions of Section 1 in that Section 1 provides for a second limit based on "95 percent of the unrestricted revenue of the state for the previous calendar year." The interim limit does not impose this additional limitation.

CS HJR 39 Sectional Analysis
(Finance Committee Substitute)
Prepared by House Research Agency

Chronological Sequence of Provisions

- 1) An appropriation reserve fund is created upon voter approval in the next general election.
- 2) Contributions to the reserve fund (as provided in Section 3 of this resolution) begin July 31, 1985 and continue through June 30 of the year in which the reserve balance exceeds 1.5 times the preceding year appropriations of unrestricted revenues.
- 3) General fund appropriations are limited (as provided in Section 4 of this resolution) during the period of time in which contributions are made to the reserve fund.
- 4) When sufficient funds to begin cash-based budgeting have been collected, the reserve fund balance is transferred into the treasury.
- 5) Once cash-based budgeting begins, a new spending limit (as defined in Section 1 of this resolution) is imposed.

Section 1.

This section replaces the existing State Constitutional spending limit provisions. According to Article 9, Section 16 of the Alaska Constitution, the present appropriation limit is equal to \$2.5 billion adjusted for federal indices of change in population and inflation since July 1, 1981, except for appropriations for permanent fund dividends, revenue bond proceeds, debt service on general obligation bonds, and non-State trust funds. Article 9 Section 16 further provides that within the appropriation limit, "at least one-third shall be reserved for capital projects and loan appropriations." Appropriations for capital projects above the appropriation limit are permitted if approved by the governor or passed by a three-fourths legislative veto override and if approved by the Alaska voters.

A) SHORT.

Section 1 of CS HJR 39 proposes to substitute for the current appropriation limit one of the following limitations, whichever is less:

- 1) the appropriations for the year that this constitutional limit becomes effective (see Section 5 for effective date), adjusted each year for changes in population and inflation; or
- 2) "95 percent of the unrestricted revenue of the State in the previous calendar year." (In a period of declining revenues, this would likely be the effective limit on State appropriations).

These limitation provisions become effective once cash-based budgeting begins (see Section 5 for the effective date). Appropriations which fall within the limits of this section exclude appropriations "to the permanent fund, appropriations of the proceeds of revenue or general obligations bonds and appropriations required to pay the principal and interest on general obligation bonds..."

Section 2.

An appropriation reserve fund is created in this section and is protected from appropriation except in a state of emergency or for meeting the general obligation bonded debt of the State. During a period of (roughly 7 to 9) years, contributions to the reserve fund will be made from unrestricted revenues as described in section 3 below. The reserve fund will be transferred into the treasury once the balance exceeds 1.5 times the preceding fiscal year appropriations of unrestricted revenue. This automatic termination of contributions to the reserve fund insures that cash-based budgeting will begin with the equivalent of 18 month's of State appropriations in the reserve.

This section further provides that the appropriation reserve balance is to be invested at competitive market rates and that all earnings from these investments will be retained by the reserve fund during the years when contributions are being made to the fund.

Section 3.

This section provides that 8.8 percent of unrestricted revenues received each month will be transferred into the appropriation reserve fund from July 31, 1985 until the reserve fund exceeds 1.5 times the appropriations of the preceding year. In other words, until the appropriation reserve fund contains a balance sufficient to begin cash-based budgeting, monthly contributions equal to 8.8 percent of the previous month's unrestricted revenues are deposited into the reserve fund.

Section 4.

This section provides for an interim appropriation limit to be effective during the period when contributions are being made to the appropriations reserve fund. Except for appropriations to the permanent fund or for bonded debt service, spending is limited under this section to the fiscal year appropriations on the effective date of this section adjusted annually for changes in population and inflation. Appropriations above this limit may be made only in a state of emergency.

A supplementary source of contributions to the reserve fund is provided in this section. These contributions equal 25 percent of any unappropriated revenues remaining at the end of each fiscal year during the contribution period. For example, unappropriated revenues would remain in the event that actual revenues received during the year exceed expectations, and more importantly, exceed total appropriations for the year.

Section 5.

This section establishes an effective date for the appropriation limitation defined in Section 1 of this resolution. The effective date is July 1 of the year following the fiscal year in which the appropriation reserve fund balance exceeds 1.5 times the preceding fiscal year appropriations.

Section 6.

This section provides that the Constitutional amendments proposed in this resolution shall be placed before the voters in the next general election.

HJR 39

BILL HJR0039
PAGE 00538
DATE 03/18/83
CHAMBER HOUSE
TEXT HOUSE JOINT RESOLUTION NO. 39 by Hayes, Abood, Barnes, Bettisworth, Cowdery, Flood, Liska, Martin, Ringstad, Uehling, Ward, Lindauer and Bussell:
Proposing amendments to the Constitution of the State of Alaska creating an appropriation reserve fund.
was read the first time and referred to the State Affairs and Finance Committees.

BILL HJR0039
PAGE 02652
DATE 02/21/84
CHAMBER HOUSE
TEXT The State Affairs Committee has had HOUSE JOINT RESOLUTION NO. 39 (proposing amendments to the Constitution of the State of Alaska creating an appropriation reserve fund), under consideration, recommends it be replaced with COMMITTEE SUBSTITUTE FOR HOUSE JOINT RESOLUTION NO. 39 (State Affairs):
"Proposing amendments to the Constitution of the State of Alaska creating an appropriation reserve fund and limiting increases in appropriations."
and reports it back as follows: Abood (Chairman) and Cowdery recommend do pass; M. M. Miller and Larson have no recommendation. A fiscal note was attached.
HJR 39 was referred to the Finance Committee.
The fiscal note appears in House Journal Supplement No. 95.

BILL HJR0039
PAGE 02901
DATE 03/13/84
CHAMBER HOUSE
TEXT The Finance Committee has had HOUSE JOINT RESOLUTION NO. 39 (proposing amendments to the Constitution of the State of Alaska creating an appropriation reserve fund), recommends it be replaced with COMMITTEE SUBSTITUTE FOR HOUSE JOINT RESOLUTION NO. 39 (Finance):
Proposing amendments to the Constitution of the State of Alaska creating an appropriation reserve fund and limiting increases in appropriations.
and reports it back as follows: Adams (Chairman), Ward, Fritz, Grussendorf, Furnace and Martin recommend do pass. A zero fiscal note was attached.
HJR 39 was referred to the Rules Committee for placement on the calendar.

Appropriation
Reserve Fund
(creation of)

HOUSE JOINT RESOLUTION NO. 39, (see page 333, 1983 report).
Reported back to the House February 21 by State Affairs
recommending it be replaced with a substitute and as follows:
Abood (Chair) and Cowdery recommend it do pass; M. M. Miller and
Larson had no recommendation. To Finance.

The State Affairs CS completely rewrites the resolution:

--Section 1 rewrites Article IX, section 16 of the Alaska
Constitution, "Finance and Taxation. Appropriation Limit." to
establish a limit on appropriations that is the lesser of two
amounts ". . . appropriations from the treasury during a fiscal year
may not exceed the lesser of the amount appropriated in the year
this section takes effect adjusted for the cumulative inflation and
population growth or decline as defined by law or 95 percent of the
unrestricted revenue of the state for the previous calendar year. .
. . .".

Permanent Fund and general obligation debt appropriations would be
exempt, and additional appropriations would be allowed only if the
Governor declares a state of emergency. Section 1 would take
effect on July 1 of a year when the reserve fund reaches its target
balance (balance is defined in section 2, below) thus, this limit
will go in to effect at that point; between June 30, 1986 and that
point, however, there will be a different "interim" appropriations
limit, defined in section 4, below.

--Section 2 adds a new section to Article IX of the Alaska
Constitution, "Finance and Taxation" that establishes a reserve
fund [to receive deposits defined in section 3, below]. It

prohibits the use of the fund for appropriations, with certain
exceptions (such as repelling invasion and meeting natural
disasters), and would require investment of the fund balance [i.e.,
of deposits made to the fund], including retention and reinvestment
of those interest earnings. After June 30 of the year when the
total balance of the fund (including interest earnings) reaches
150% of the amount of unrestricted revenues appropriated in the
previous fiscal year, the fund balance lapses into the treasury
[from which it can then be legally appropriated]. [Note: "150%" =
"Target Balance"].

--Section 3 adds a new section to Article XV of the Alaska
Constitution, "Schedule of Transitional Measures", that provides
for monthly deposits to the reserve fund. The deposits will equal
8.8% of the state's monthly collection of unrestricted revenues
(which are received into the Treasury). The deposits will be
transferred to the fund on the first of each month [note:
"transfer" is a legal term--it means an automatic Treasury
transfer, which is not an "appropriation"--thus, these deposits are
not counted under the limit created in section 1, above.]

The monthly deposits will begin on July 31, 1985 (the first deposit
will thus be 8.8% of unrestricted revenues collected during the
first month of that fiscal year, which begins on July 1, 1985).
Deposits will stop on June 30 of the year when the fund reaches its
target balance (thus, the last deposit made on that June 1).

Allows extra deposits to be made to the fund, in addition to the monthly deposits--these deposits may occur because of the interim spending limit set up on section 4, below, which will be in place from after June 30, 1986 until the fund target is reached; while this interim limit is in effect, at least 25% of any unappropriated (i.e., "excess" or "over the interim limit") revenues must be transferred into the fund; these are the extra deposits ("any balance", p. 2, line 16 of the resolution).

Would allow the amount of the extra deposits to take the place of an equal amount of monthly deposits required in a given year. If the amount of the extra deposits were greater than the total amount of monthly deposits remaining in the year, however, the remainder of the extra deposits would not replace the monthly deposits beginning in (or after) January of the next year (i.e., no matter how large the extra deposit(s) in any year, it/they could never replace more than 12 monthly deposits).

--Section 4 adds a new section to Article XV of the Alaska Constitution, "Schedule of Transitional Measures", that would create an interim appropriations limit, that would be in effect from after June 30, 1986 until June 30 of the year when the fund reaches its target balance. The limit provides that appropriations may not exceed the amount appropriated in the year in which this section becomes effective (presumably 1984, upon voter approval), as adjusted annually for inflation and population growth.

The Permanent Fund appropriations and general obligation debt appropriations are exempted from this interim limit (as with the subsequent limit, after the fund reaches its target balance). Other appropriations over the limit can be made only if the Governor declares an emergency. If there are "excess" or "surplus" unrestricted revenues (i.e., above amount established by this interim limit), at least 25% of them shall be transferred (again: not an "appropriation") into the reserve fund--transferral will occur on the first day of the coming fiscal year (i.e., the one being appropriated/budgeted).

--Section 5 provides that the (later) appropriations limit created in section 1 will go into effect on July 1 of the year in which the fund reaches its target balance. It also provides that everything else in section 1 becomes effective on that same July 1st.

--Section 6 provides that the amendment proposed by this resolution will be placed before the voters at the next general election (November, 1984).

History: the resolution was introduced March 18, '83 by Rep. Hayes and proposed amendments to the state constitution creating an appropriation reserve fund. After July 1, 1992 no money in excess of the balance of the appropriation reserve fund at the close of the preceding fiscal year could be withdrawn from the treasury, except for wars, natural disasters, or redeeming indebtedness at the time the section takes effect.

After July 1, 1992, all state revenues would be required to be placed in the fund and the balance would lapse into the treasury at the close of each fiscal year. Annual appropriations would have started during the 14th Legislature, and continued through the 17th in amounts equal to 15% of the average gross receipts of the general fund (described how amounts are figured).

Offered: 3/13/84
Referred: Rules

Original sponsors: Hayes, Abood,
Barnes, et al

1 IN THE HOUSE BY THE FINANCE COMMITTEE
2 CS FOR HOUSE JOINT RESOLUTION NO. 39 (Finance)
3 IN THE LEGISLATURE OF THE STATE OF ALASKA
4 THIRTEENTH LEGISLATURE - SECOND SESSION

5 Proposing amendments to the Constitution
6 of the State of Alaska creating an
7 appropriation reserve fund and limiting
8 increases in appropriations.

9 BE IT RESOLVED BY THE LEGISLATURE OF THE STATE OF ALASKA:

10 * Section 1. Article IX, sec. 16, Constitution of the State of Alaska,
11 is repealed and readopted to read:

12 SECTION 16. APPROPRIATION LIMITATIONS. Except for appropria-
13 tions ^{for} ~~to the~~ Alaska permanent fund ^{dividends} appropriations of the proceeds of
14 revenue or general obligations bonds and appropriations required to
15 pay the principal and interest on general obligation bonds, ^{other exemption} ~~appropri-~~ ^{in it}
16 ations from the treasury during a fiscal year may not exceed the ^X
17 lesser of the amount appropriated in ^{preceding the FY in which} the fiscal year ^X This section ^{etc}
18 takes effect adjusted for the cumulative inflation and population
19 growth or decline as defined by law or 95 percent of the unrestricted
20 revenue of the state for the previous calendar year. An appropriation
21 in excess of this limit may not be made unless a state of emergency is
22 declared by the governor as provided by law. The governor shall cause
23 any unexpended or unappropriated balance to be invested so as to yield
24 competitive market rates to the treasury.

25 * Sec. 2. Article IX, Constitution of the State of Alaska, is amended
26 by adding a new section to read:

27 SECTION 17. APPROPRIATION RESERVE FUND. An appropriation re-
28 serve fund is established. Appropriations may not be made from the
29 appropriation reserve fund except for the purpose of repelling

1 invasion, suppressing insurrection, defending the state in war, meet-
2 ing natural disasters, or appropriations required to pay the principal
3 and interest on general obligation bonds. On June 30 of fiscal
4 year in which the balance of the appropriation reserve fund exceeds
5 1.5 times the appropriations of unrestricted revenue in the preceding
6 fiscal year, the balance of the appropriation reserve fund shall lapse
7 into the treasury. The balance of the appropriation reserve fund
8 shall be invested at competitive national market rates. All earnings
9 of the fund shall become part of the principal of the fund.

10 * Sec. 3. Article XV, Constitution of the State of Alaska, is amended
11 by adding a new section to read:

12 SECTION 29. APPROPRIATION RESERVE FUND. Beginning July 1,
13 1985, and continuing until June 30 of the fiscal year in which the
14 balance of the appropriation reserve fund exceeds 1.5 times the appro-
15 priations of unrestricted revenue in the preceding fiscal year, an
16 amount equal to 8.8 percent of the unrestricted revenue for each month
17 shall be transferred from the treasury to the appropriation reserve
18 fund on the first day of the succeeding month.

19 ~~Sec. 4. Article XV, Constitution of the State of Alaska, is amended~~
20 ~~by adding a new section to read:~~

21 ~~SECTION 30. APPROPRIATION LIMITATIONS. After June 30, 1986, and~~
22 ~~until June 30 of the fiscal year in which the balance of the appro-~~
23 ~~priation reserve fund exceeds 1.5 times the appropriations of unre-~~
24 ~~stricted revenue in the preceding fiscal year's appropriations from~~
25 ~~the treasury during a fiscal year, except for appropriations to the~~
26 ~~Alaska permanent fund, appropriations of the proceeds of revenue or~~
27 ~~general obligation bonds and appropriations required to pay the prin-~~
28 ~~cipal and interest on general obligation bonds, may not exceed the~~
29 ~~amount appropriated in the fiscal year in which this section becomes~~

1 ~~effective by more than the cumulative inflation and population growth~~
2 or decline as prescribed by law. An appropriation in excess of this
3 limit may not be made unless a state of emergency is declared by the
4 governor as provided by law. The governor shall cause any unexpended
5 or unappropriated balance to be invested so as to yield competitive
6 ~~market rates to the treasury.~~ No less than 25 percent of that portion
7 of the unrestricted revenue of the state which has not been appropri-
8 ated as allowed by this section shall be transferred from the general
9 fund to the appropriation reserve fund on the first day of each fiscal
10 year during the period defined in this section. ~~During the period in~~
11 ~~which this section is in effect the provisions of Section 16 of~~
12 ~~Article IX of this Constitution are superseded.~~

13 * Sec. ~~7.4~~ Section 1 of this amendment takes effect on July 1 of the
14 fiscal year following the fiscal year in which the balance in the appropri-
15 ation reserve fund established in sec. 2 of this amendment exceeds 1.5
16 times the appropriations of unrestricted revenue in the preceding fiscal
17 year.

18 * Sec. ~~7.5~~ The amendments proposed by this resolution shall be placed
19 before the voters of the state at the next general election in conformity
20 with art. XIII, sec. 1, Constitution of the State of Alaska, and the elec-
21 tion laws of the state.

additions
[] deletions

Original sponsors: Hayes, Abood,
Barnes, et al

1 IN THE HOUSE

BY THE FINANCE COMMITTEE

2 CS FOR HOUSE JOINT RESOLUTION NO. 39 (Finance)

3 IN THE LEGISLATURE OF THE STATE OF ALASKA

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14 revenue or general obligations bonds and appropriations required to
15 pay the principal and interest on general obligation bonds,] appropri-
16 ations from the treasury during a fiscal year may not exceed the
17 lesser of the amount appropriated in the fiscal year ^{previous fiscal year} this section
18 takes effect adjusted for the cumulative inflation and population
19 growth or decline as defined by law] or 95 percent of the unrestricted
20 revenue of the state for the previous calendar year.] An appropriation
21 in excess of this limit may not be made unless a state of emergency is
22 declared by the governor as provided by law. The governor shall cause
23 any unexpended or unappropriated balance to be invested so as to yield
24 competitive market rates to the treasury.

↳ state indebtedness and appropriations reserved to pay

25 * Sec. 2. Article IX, Constitution of the State of Alaska, is amended
26 by adding a new section to read:

27 SECTION 17. APPROPRIATION RESERVE FUND. An appropriation re-
28 serve fund is established. Appropriations may not be made from the
29 appropriation reserve fund except for the purpose of repelling

1 invasion, suppressing insurrection, defending the state in war, meet-
2 ing natural disasters, or appropriations required to pay the principal
3 and interest on ^{State indebtedness} general obligation bonds. On June 30 of the fiscal
4 year in which the balance of the appropriation reserve fund exceeds
5 1.5 times the appropriations of unrestricted revenue in the preceding
6 fiscal year, the [balance of the appropriation] reserve fund shall lapse
7 into the treasury. The balance of the appropriation reserve fund
8 shall be invested at competitive national market rates. All earnings
9 of the fund shall become part of the principal of the fund.

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11 by adding a new section to read:

12 SECTION 29. APPROPRIATION RESERVE FUND. Beginning July 31,
13 1985, and continuing until June 30 of the fiscal year in which the
14 balance of the appropriation reserve fund exceeds 1.5 times the appro-
15 priations of unrestricted revenue in the preceding fiscal year, an
16 amount equal to 8.8 percent of the unrestricted revenue for each month
17 shall be transferred from the treasury to the appropriation reserve
18 fund on the first day of the succeeding month. ^{Remove discretion}
^{to reduce 8.8 deposit by 25% end of year deposit}

19 * Sec. 4. Article XV, Constitution of the State of Alaska, is amended
20 by adding a new section to read:

21 SECTION 30. APPROPRIATION LIMITATIONS. After June 30, 1986, and
22 until June 30 of the fiscal year in which the balance of the appro-
23 priation reserve fund exceeds 1.5 times the appropriations of unre-
24 stricted revenue in the preceding fiscal year's appropriations from
25 the treasury during a fiscal year, except for appropriations to the
26 Alaska permanent fund, appropriations of the proceeds of ^{State income} revenue or
27 general obligation bonds and appropriations required to pay the prin-
28 cipal ^{State indebtedness} and interest on general obligation bonds, may not exceed the
29 amount appropriated in the fiscal year in which this section becomes

1 effective by more than the cumulative inflation and population growth
2 or decline as prescribed by law. An appropriation in excess of this
3 limit may not be made unless a state of emergency is declared by the
4 governor as provided by law. The governor shall cause any unexpended
5 or unappropriated balance to be invested so as to yield competitive
6 market rates to the treasury. No less than 25 percent of that portion
7 of the unrestricted revenue of the state which has not been appropri-
8 ated as allowed by this section shall be transferred from the general
9 fund to the appropriation reserve fund on the first day of each fiscal
10 year during the period defined in this section. During the period in
11 which this section is in effect the provisions of Section 16 of
12 Article IX of this Constitution are superseded.

13 * Sec. 5. Section 1 of this amendment takes effect on July 1 of the
14 fiscal year following the fiscal year in which the balance in the appro-
15 priation reserve fund established in sec. 2 of this amendment exceeds 1.5
16 times the appropriations of unrestricted revenue in the preceding fiscal
17 year.

18 * Sec. 6. The amendments proposed by this resolution shall be placed
19 before the voters of the state at the next general election in conformity
20 with art. XIII, sec. 1, Constitution of the State of Alaska, and the elec-
21 tion laws of the state.
22
23
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29



Official Business

Alaska State Legislature

House of Representatives

Office of the Majority Leader

Pouch V
State Capitol
Juneau, Alaska 99811

MEMORANDUM

TO: HOUSE MAJORITY COALITION MEMBERS

FROM: REPRESENTATIVE RAMONA BARNES
HOUSE MAJORITY LEADER

DATE: MARCH 15, 1984

RE: CSHJR 39 (Fin) Proposing amendments to the constitution of the State of Alaska creating an appropriation reserve fund and limiting increases in appropriations.

ISSUE The present system of budgeting is satisfactory, and thus cash based budgeting is an unnecessary gimmick.

ANSWER At present, all state governments and most municipalities prepare annual or biennial budgets based on anticipated income. In Alaska, a few weeks before the beginning of each fiscal year, the legislature completes and the governor signs a budget based on revenues expected to begin coming into the state treasury on July 1. This method of budgeting poses two problems. First, it is possible for the state to fail to fund needed projects because of a low revenue forecast when money actually would have been available. Second, and more seriously, it is possible for the state to fund projects for which money is later not available, with the attendant ramifications of curtailing programs, interrupting operations and dashing expectations.

ISSUE Cash based budgeting is a good idea, but now is not the right time to do it.

ANSWER Because of the lead time necessary in getting a constitutional amendment approved by the voters, and the projections of declining revenue in the late 1980's, this may be the last opportunity the state has to implement cash based budgeting. Constitutional amendments can only be placed on the ballot during general elections. If the amendments contained in this resolution are not placed before the voters this year, they cannot be placed before the voters until 1986. This means that money would not start being put in the fund until FY 1988. Current projections are that state revenue will begin declining in FY 1989. It may be more difficult for the state to deposit 8.8% of its income in the fund for the years 1988 through 1995, when 6 of those 7 years are years of declining income. Thus, this appears to be the last good chance we have to adopt cash based budgeting.

ISSUE

Other than providing certainty in the budgeting process, there are no other advantages to cash based budgeting.

ANSWER

Under this legislation, an average of 18 months' normal expenditures would be held in reserve, and can be invested in relatively long-term, stable securities. (The additional six months is necessitated by the fact that the legislature operates on a calendar year and the budget is prepared for a fiscal year.) The existence of this reserve would result in approximately \$400 million in additional income for the budgeting process, given anticipated revenue and earnings projections. This extra income would be a valuable resource as state oil revenues decline.

A second major advantage is that subordinate political units which are dependent on the states for a share of their operating budgets each year will have a clearer idea of how much money the state has available to provide to them. Thus, the budgeting process is easier for the municipalities as well as for the state under this proposal.



Official Business

Alaska State Legislature

House of Representatives

Al Adams
Chairman
Committee on Finance

WHILE IN SESSION
Pouch V
State Capitol
Juneau, Alaska 99811
(907) 465-3706

OUT OF SESSION
P.O. Box 333
Kotzebue, Alaska 99752
(907) 442-3320
1024 W. 6th
Anchorage, Alaska 99501
(907) 274-0615

February 6, 1984

TO: Members of the House Finance Committee
FROM: Representative Al Adams
RE: Proposed Letter of Intent for CSHB 524 (Fin)

LETTER OF INTENT CSHB 524 (Fin)

It is the intent of the Legislature that for the purposes of calculating the spending limit in HB 524 the following equation be used:

$$\text{Base} \times (1 + \text{rate of growth in population}) \times (1 + \text{inflation adjustment}) = \text{Limit}$$

The base is \$2,500,000 for fiscal year 1982. For each succeeding fiscal year the base shall be adjusted by the rate of change in population and the Anchorage Consumer Price Index-Urban (CPI-U).

The rate of change in population shall be calculated as the continuously compounded annual rate of change between 1970 and 1980 (April 1) estimates of population established by the U.S. Census Bureau in their decennial censuses. For example, the rate of change for the 1980's is computed as follows:

$$\text{Population}_{1980} = \text{Population}_{1970} \cdot e^{rt}$$

$$\text{Rate of change} = r = \frac{\text{Ln}(\text{population}_{1980} / \text{population}_{1970})}{t}, \text{ or}$$

$$\text{Rate of change} = .0284 = \frac{\text{Ln}(401851/302583)}{10}$$

The rate of change in the Anchorage CPI-U computed as the July to July change in the index as published in the U.S. Department of Labor, Bureau of Labor Statistics.

CS HJR 39 Sectional Analysis
(Finance Committee Substitute)
Prepared by House Research Agency

Chronological Sequence of Provisions

- 1) An appropriation reserve fund is created upon voter approval in the next general election.
- 2) Contributions to the reserve fund (as provided in Section 3 of this resolution) begin July 31, 1985 and continue through June 30 of the year in which the reserve balance exceeds 1.5 times the preceding year appropriations of unrestricted revenues.
- 3) General fund appropriations are limited (as provided in Section 4 of this resolution) during the period of time in which contributions are made to the reserve fund.
- 4) When sufficient funds to begin cash-based budgeting have been collected, the reserve fund balance is transferred into the treasury.
- 5) Once cash-based budgeting begins, a new spending limit (as defined in Section 1 of this resolution) is imposed.

Section 1.

This section replaces the existing State Constitutional spending limit provisions. According to Article 9, Section 16 of the Alaska Constitution, the present appropriation limit is equal to \$2.5 billion adjusted for federal indices of change in population and inflation since July 1, 1981, except for appropriations for permanent fund dividends, revenue bond proceeds, debt service on general obligation bonds, and non-State trust funds. Article 9 Section 16 further provides that within the appropriation limit, "at least one-third shall be reserved for capital projects and loan appropriations." Appropriations for capital projects above the appropriation limit are permitted if approved by the governor or passed by a three-fourths legislative veto override and if approved by the Alaska voters.

Section 1 of CS HJR 39 proposes to substitute for the current appropriation limit one of the following limitations, whichever is less:

- 1) the appropriations for the year that this constitutional limit becomes effective (see Section 5 for effective date), adjusted each year for changes in population and inflation; or
- 2) "95 percent of the unrestricted revenue of the State in the previous calendar year." (In a period of declining revenues, this would likely be the effective limit on State appropriations).

These limitation provisions become effective once cash-based budgeting begins (see Section 5 for the effective date). Appropriations which fall within the limits of this section exclude appropriations "to the permanent fund, appropriations of the proceeds of revenue or general obligations bonds and appropriations required to pay the principal and interest on general obligation bonds..."

Section 2.

An appropriation reserve fund is created in this section and is protected from appropriation except in a state of emergency or for meeting the general obligation bonded debt of the State. During a period of (roughly 7 to 9) years, contributions to the reserve fund will be made from unrestricted revenues as described in section 3 below. The reserve fund will be transferred into the treasury once the balance exceeds 1.5 times the preceding fiscal year appropriations of unrestricted revenue. This automatic termination of contributions to the reserve fund insures that cash-based budgeting will begin with the equivalent of 18 month's of State appropriations in the reserve.

This section further provides that the appropriation reserve balance is to be invested at competitive market rates and that all earnings from these investments will be retained by the reserve fund during the years when contributions are being made to the fund.

Section 3.

This section provides that 8.8 percent of unrestricted revenues received each month will be transferred into the appropriation reserve fund from July 31, 1985 until the reserve fund exceeds 1.5 times the appropriations of the preceding year. In other words, until the appropriation reserve fund contains a balance sufficient to begin cash-based budgeting, monthly contributions equal to 8.8 percent of the previous month's unrestricted revenues are deposited into the reserve fund.

Section 4.

This section provides for an interim appropriation limit to be effective during the period when contributions are being made to the appropriations reserve fund. Except for appropriations to the permanent fund or for bonded debt service, spending is limited under this section to the fiscal year appropriations on the effective date of this section adjusted annually for changes in population and inflation. Appropriations above this limit may be made only in a state of emergency.

A supplementary source of contributions to the reserve fund is provided in this section. These contributions equal 25 percent of any unappropriated revenues remaining at the end of each fiscal year during the contribution period. For example, unappropriated revenues would remain in the event that actual revenues received during the year exceed expectations, and more importantly, exceed total appropriations for the year.

Section 5.

This section establishes an effective date for the appropriation limitation defined in Section 1 of this resolution. The effective date is July 1 of the year following the fiscal year in which the appropriation reserve fund balance exceeds 1.5 times the preceding fiscal year appropriations.

Section 6.

This section provides that the Constitutional amendments proposed in this resolution shall be placed before the voters in the next general election.

THE GENERAL FUND AS A REVENUE SOURCE FOR CASH-BASED BUDGETING
 Based on a 30th Percentile Revenue Projection
 (millions of dollars)

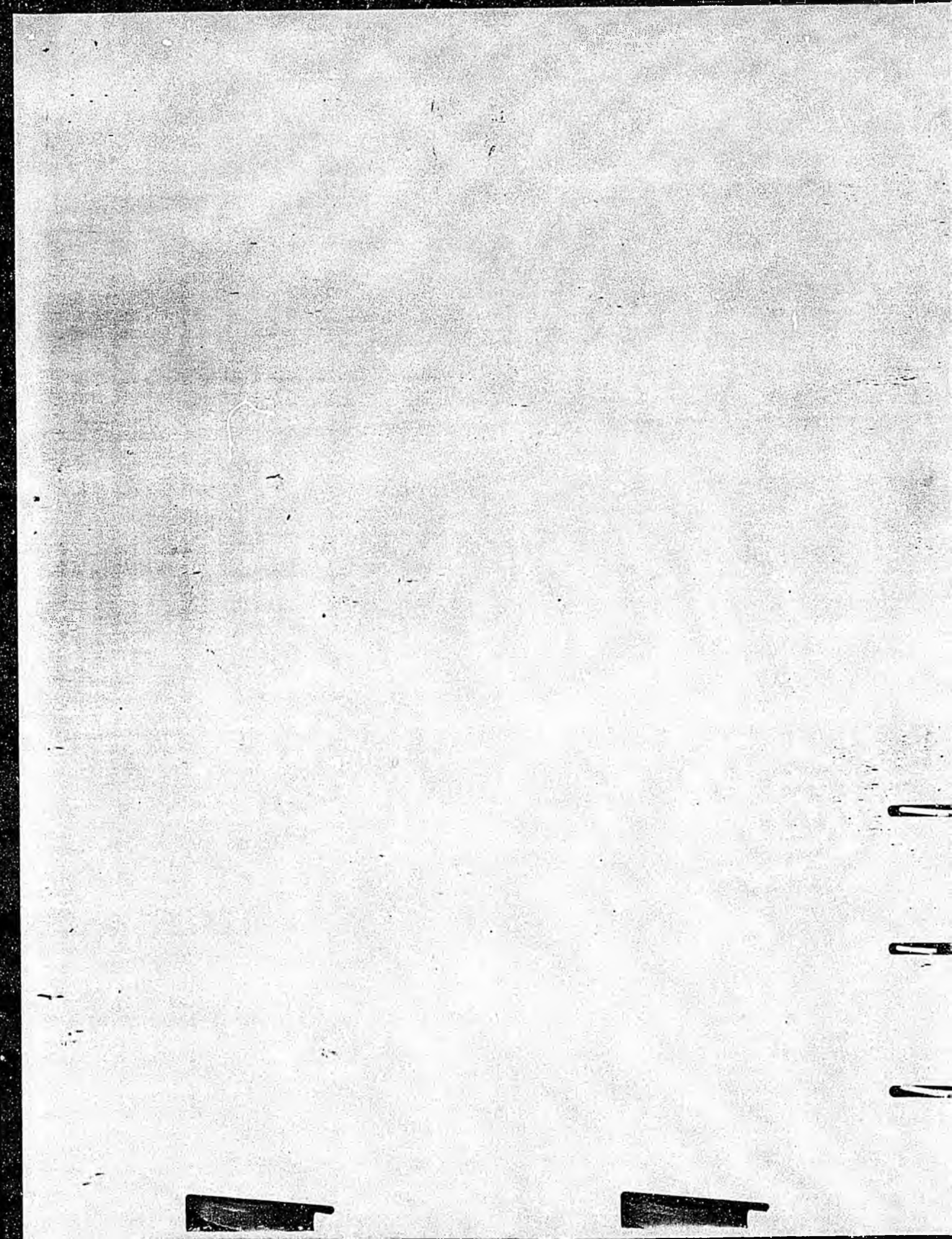
Fiscal Year	DOR Revenue Forecast	Revenue Under CBB	Potential Expenditure Level	General Fund Earnings	General Fund BalanceCash-Based Budgeting Reserve Fund....		
						Contributions	Earnings	Balance
1981	3,769		3,769	201	2,010			
1982	4,174		4,174	254	2,540			
1983	3,624		3,624	266	2,660			
1984	3,233		3,233	300	3,000			
1985	3,219		3,219	250	2,500			
1986	3,365	3,069	3,069	259	2,590	296.1	14	310
1987	3,729	3,401	3,401	288	2,880	328.2	48	686
1988	3,711	3,384	3,384	288	2,880	326.6	87	1,100
1989	4,068	3,710	3,710	318	3,180	358.0	132	1,590
1990	3,880	3,539	3,539	301	3,010	341.4	183	2,114
1991	3,582	3,267	3,267	275	2,750	315.2	236	2,665
1992	3,536	3,225	3,225	270	2,700	311.2	294	3,270
1993	3,405	3,105	3,105	258	2,580	299.6	357	3,927
1994	3,290	3,000	3,000	247	2,470	289.5	425	4,641
1995	3,195	3,644	3,348	685	7,297			
1996	3,033	3,183	3,467	672	7,174			
1997	3,092	3,540	3,564	673	7,180			
1998	3,159	3,617	3,512	687	7,325			
1999	3,213	3,680	3,578	698	7,447			
2000	3,245	3,718	3,648	705	7,527			
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)

col.

- 2 Department of Revenue January, 1984 revenue projection.
- 3 Revenues after effects of cash-based budgeting program. During the CBB reserve contribution period, revenues (coluan 3) are equal to DOR projections minus annual CBB contributions. Starting with the first cash-based budgeting year, revenues (coluan 3) are equal to DOR projections plus additional earnings which accrue to the general fund as a result of transferring the CBB reserve fund balance to the general fund.
- 4 Expenditure levels are presently limited to projected revenues (ignoring the Constitutional appropriation limit). Beginning with the first cash-based budgeting year, expenditures will be limited to the revenues collected in the previous calendar year.
- 5 General fund earnings are DOR projections up to the start of cash-based budgeting, at which point the general fund earnings will be augmented due to the increased earnings capacity of the general fund from that point on into the future.
- 6 Beginning with the first cash-based budgeting year, the general fund balance is substantially increased by the transfer of the CBB reserve fund.
- 8 Reserve fund earnings are calculated at a 10 percent annual interest rate compounded monthly.
- 9 The earnings rate of the CBB reserve fund is compounded monthly using a 10% annual interest rate.

This projection is based on a general fund unrestricted revenue contribution of 8.8 percent.

Prepared by House Research Agency - March 12, 1984



CURRENT APPROPRIATIONS LIMIT

BE IT RESOLVED BY THE LEGISLATURE OF THE STATE OF ALASKA:

* Section 1. Article IX, Constitution of the State of Alaska, is amended by adding a new section to read:

SECTION 16. APPROPRIATION LIMIT. Except for appropriations for Alaska permanent fund dividends, appropriations of revenue bond proceeds, appropriations required to pay the principal and interest on general obligation bonds, and appropriations of money received from a non-State source in trust for a specific purpose, including revenues of a public enterprise or public corporation of the State that issues revenue bonds, appropriations from the treasury made for a fiscal year shall not exceed \$2,500,000,000 by more than the cumulative change, derived from federal indices as prescribed by law, in population and inflation since July 1, 1981. Within this limit, at least one-third shall be reserved for capital projects and loan appropriations. The legislature may exceed this limit in bills for appropriations to the Alaska permanent fund and in bills for appropriations for capital projects, whether of bond proceeds or otherwise, if each bill is approved by the governor, or passed by affirmative vote of three-fourths of the membership of the legislature over a veto or item veto, or becomes law without signature, and is also approved by the voters as prescribed by law. Each bill for appropriations for capital projects in excess of the limit shall be confined to capital projects of the same type, and the voters shall, as provided by law, be informed of the cost of operations and maintenance of the capital projects. No other appropriation in excess of this limit may be made

except to meet a state of disaster declared by the governor as prescribed by law. The governor shall cause any unexpended and unappropriated balance to be invested so as to yield competitive market rates to the treasury.

* Sec. 2. Article XV, Constitution of the State of Alaska, is amended by adding new sections to read:

SECTION 26. APPROPRIATIONS FOR RELOCATION OF THE CAPITAL. If a majority of those voting on the question at the general election in 1982 approve the ballot proposition for the total cost to the State of providing for relocation of the capital, no additional voter approval of appropriations for that purpose within the cost approved by the voters is required under the 1982 amendment limiting increases in appropriations (art. IX, sec. 16).

SECTION 27. RECONSIDERATION OF AMENDMENT LIMITING INCREASES IN APPROPRIATIONS. If the 1982 amendment limiting appropriation increases (art. IX, sec. 16) is adopted, the lieutenant governor shall cause the ballot title and proposition for the amendment to be placed on the ballot again at the general election in 1986. If the majority of those voting on the proposition in 1986 rejects the amendment, it shall be repealed.

SECTION 28. APPLICATION OF AMENDMENT. The 1982 amendment limiting appropriation increases (art. IX, sec. 16) applies to appropriations made for fiscal year 1984 and thereafter.

* Sec. 3. The amendments proposed by this resolution shall be placed before the voters of the state at the next general election in conformity with art. XIII, sec. 1, Constitution of the State of Alaska, and the election laws of the state.

Introduced: 3/18/83
Referred: State Affairs and
Finance

BY HAYES, ABOOD, BARNES,
BETTISWORTH, COWDERY, FLOOD,
LISKA, MARTIN, RINGSTAD,
UEHLING, WARD, LINDAUER
AND BUSSELL

1 IN THE HOUSE

2

HOUSE JOINT RESOLUTION NO. 39

3

IN THE LEGISLATURE OF THE STATE OF ALASKA

4

THIRTEENTH LEGISLATURE - FIRST SESSION

5

Proposing amendments to the Constitution

6

of the State of Alaska creating an

7

appropriation reserve fund.

8 BE IT RESOLVED BY THE LEGISLATURE OF THE STATE OF ALASKA:

9 * Section 1. Article IX, Constitution of the State of Alaska, is amend-
10 ed by adding a new section to read:

11 SECTION 17. APPROPRIATION RESERVE FUND. An appropriation re-
12 serve fund is established. After July 1, 1992, no money in excess of
13 the balance of the appropriation reserve fund at the close of the
14 preceding fiscal year shall be withdrawn from the treasury except for
15 the purpose of repelling invasion, suppressing insurrection, defending
16 the State in war, meeting natural disasters, or redeeming indebtedness
17 outstanding at the time this section becomes effective. After July 1,
18 1992, all revenue of the State shall be placed in the appropriation
19 reserve fund and the balance of the appropriation reserve fund shall
20 lapse into the treasury at the close of each succeeding fiscal year.

21 * Sec. 2. Article XV, Constitution of the State of Alaska, is amended
22 by adding a new section to read:

23 SECTION 26. APPROPRIATION RESERVE FUND. Beginning with the
24 First Session of the Fourteenth Legislature and continuing through the
25 First Session of the Seventeenth Legislature, the legislature shall
26 annually appropriate from the general fund to the appropriation re-
27 serve fund an amount equal to 15 percent of the average gross receipts
28 of the general fund, as determined in accordance with this section.
29 For the purposes of this section, "average gross receipts of the

1 general fund" is determined by dividing the total amount of money
2 deposited in the general fund and in special accounts within the
3 general fund (other than the appropriation reserve fund) from all
4 sources during the four fiscal years immediately preceding the current
5 fiscal year by four.

6 * Sec. 3. The amendments proposed by this resolution shall be placed
7 before the voters of the state at the next general election in conformity
8 with art. XIII, sec. 1, Constitution of the State of Alaska, and the elec-
9 tion laws of the state.

Offered: 2/21/84
Referred: Finance

Original sponsors: Hayes, Abood,
Barnes, et al

1 IN THE HOUSE BY THE STATE AFFAIRS COMMITTEE
2 CS FOR HOUSE JOINT RESOLUTION NO. 39 (State Affairs)
3 IN THE LEGISLATURE OF THE STATE OF ALASKA
4 THIRTEENTH LEGISLATURE - SECOND SESSION

5 Proposing amendments to the Constitution
6 of the State of Alaska creating an
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13 tions to the Alaska permanent fund and appropriations required to pay
14 the principal and interest on general obligation bonds, appropriations
15 from the treasury during a fiscal year may not exceed the lesser of
16 the amount appropriated in the year this section takes effect adjusted
17 for the cumulative inflation and population growth or decline as
18 defined by law or 95 percent of the unrestricted revenue of the state
19 for the previous calendar year. An appropriation in excess of this
20 limit may not be made unless a state of emergency is declared by the
21 governor as provided by law.

22 * Sec. 2. Article IX, Constitution of the State of Alaska, is amended
23 by adding a new section to read:

24 SECTION 17. APPROPRIATION RESERVE FUND. An appropriation re-
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26 appropriation reserve fund except for the purpose of repelling inva-
27 sion, suppressing insurrection, defending the state in war, meeting
28 natural disasters, or appropriations required to pay the principal and
29 interest on general obligation bonds. After June 30 of the year in

1 interest on general obligation bonds, may not exceed the amount
2 appropriated in the year in which this section becomes effective by
3 more than the cumulative inflation and population growth or decline as
4 prescribed by law. An appropriation in excess of this limit may not
5 be made unless a state of emergency is declared by the governor as
6 provided by law. No less than 25 percent of that portion of the
7 unrestricted revenue of the state which has not been appropriated as
8 allowed by this section shall be transferred from the general fund to
9 the appropriation reserve fund on the first day of each fiscal year
10 during the period defined in this section.

11 * Sec. 5. Section 1 of this amendment takes effect on July 1 of the
12 year in which the balance in the appropriation reserve fund established in
13 sec. 2 of this amendment exceeds 1.5 times the appropriations of unre-
14 stricted revenue in the preceding fiscal year.

15 * Sec. 6. The amendments proposed by this resolution shall be placed
16 before the voters of the state at the next general election in conformity
17 with art. XIII, sec. 1, Constitution of the State of Alaska, and the elec-
18 tion laws of the state.

**CASH-BASED BUDGETING:
A Response To Revenue Uncertainty**

**House Research Agency
Alaska State Legislature
January 1984**

House Research Agency Report 83-A

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INTRODUCTION

Following the 1982 legislative session, the House Research Agency undertook a study of policy options for dealing with uncertain revenues.¹ Alternatives presented in the report included: risk-adjusted forecasting, forward funding (cash-based budgeting), revenue indexed budgeting, and the creation of a rainy day fund. The purpose of this report is to analyze more intensively the cash-based budgeting alternative presented in the 1982 study.

Legislative interest in cash-based budgeting initially surfaced with the introduction of two bills: HB 477 (1979) and HJR 39 (1983). These legislative measures proposed the creation of an "appropriation reserve fund" into which 15 percent of annual General Fund unrestricted revenues would be deposited over a period of seven years. With a reserve totaling somewhat more than one year's appropriations, cash-based budgeting would have begun with: 1) a transfer of the reserve fund balance to the General Fund, and 2) the implementation of an appropriation limit equal to the amount of revenues collected in the previous fiscal year. Although neither of these measures was adopted by the legislature, they have formed the basis for subsequent discussion on this concept and have led to a substantially revised version of cash-based budgeting being proposed for the 1984 legislative session.²

There are essentially unlimited ways in which a cash-based budgeting program can be structured. This report will focus on only a few of the many alternative approaches. As a framework for these alternatives, this report responds to the following questions:

- What is "revenue uncertainty" and how does it affect the design of a cash-based budgeting program?
- How can the transition from the current budgeting system to cash-based budgeting be carried out?
- Is cash-based budgeting more than a mechanism for dealing with revenue uncertainty?
- What are the limitations of cash-based budgeting?

¹State Budget Policy Under Uncertain Revenue Forecasts: Options for Legislative Action; House Research Agency Report 82-B.

²A more complete history and analysis of HB 477 and HJR 39 can be found in Appendix A.

Additionally, this report addresses a number of the broader questions surrounding cash-based budgeting which should be pertinent to any legislative analysis of this topic. Our analysis of cash-based budgeting was aided by a series of computer programs developed within the House Research Agency. These programs enable us to assess the sensitivity of the variables and assumptions considered in this study. Moreover, these computer models make possible a fairly rapid response to legislative inquiries about the fiscal impacts of a given set of design parameters for funding a cash-based budgeting program.

CASH-BASED BUDGETING: A RESPONSE TO REVENUE UNCERTAINTY

EXECUTIVE SUMMARY

Cash-based budgeting (CBB) has been proposed as a means of eliminating the budgeting problems created by uncertain and fluctuating State revenues. Cash-based budgeting (also known as "forward funding") would reduce or eliminate uncertainty by tying the State budget for a given year to the amount of revenues already received and deposited in the treasury during a prior year. Before enacting or signing the budget, the legislature and governor would know exactly how much money was actually available to spend.

Conventional budgeting practices in most states (including Alaska) involve forecasting revenues for the coming fiscal year. Appropriations included in the budget are limited to the anticipated revenues for that year. With approximately 85 percent of Alaska's total revenues dependent on oil taxes and royalties, an error in projecting the price of oil or production level for the coming year can result in substantial miscalculations of total available revenues.

In response to the risk associated with any forecast of future revenues for the State of Alaska, the Department of Revenue began issuing a "risk-adjusted" forecast for the FY 84 budget year. The so-called "30th percentile" forecast implies that actual revenues are likely to fall short of the projected amount only 30 percent of the time. This means that there is a 70 percent probability that actual revenues will equal or exceed the forecast for that year.

"Revenue Uncertainty" And The Design Of A CBB Program

Given that the objective of the cash-based budgeting proposal is to resolve the "revenue uncertainty" problem, it is important that the concept of revenue uncertainty be fully understood.³ Revenue certainty relates to the likelihood that incoming revenues will be sufficient to cover budgeted appropriations. If "reasonable certainty" is sufficient for budgeting purposes, one might choose to limit appropriations to the 30th percentile revenue projection (which gives a 70 percent assurance that actual revenues will equal or exceed budgeted appropriations).

³It is important to recognize that the "revenue uncertainty" addressed by cash-based budgeting relates to a 12 or 18-month time period. The revenue uncertainty associated with a projected long-term revenue decline is not the specific target of cash-based budgeting.

Only when a 100 percent probability exists that revenues will be sufficient to offset budgeted appropriations for the next fiscal year can one say that "revenue uncertainty" has been eliminated. This means that the legislature and governor must know that there is "cash in the bank" sufficient to meet expenditures budgeted for the next year.

The major requirement of a cash-based budgeting program is the creation of a cash reserve from which appropriations can be made.⁴ A cash reserve equal to 18-months of expenditures is required if the legislature wishes to begin each session with absolute certainty that there is sufficient cash to meet expenditures budgeted for the next fiscal year. For absolute certainty on July 1 (the start of the budget year), only 12-months of revenues are required in the reserve. Funding of the CBB reserve fund can be structured in two basic ways:

- smaller annual deposits over a period of years would provide for a delayed start of this budgeting system.
- a single very large deposit would allow for a near-term implementation of cash-based budgeting, or

Based on the assumption that the current State government expenditure policy of appropriating total projected revenues applies for the year in which cash-based budgeting begins, an 18-month CBB reserve must contain \$4.829 billion to start cash-based budgeting in FY 86, or \$4.581 billion for a delayed start in FY 94.

Deferred Implementation of Cash-Based Budgeting

During the current session, legislative attention on cash-based budgeting has focused on a long-term payment plan (CS HJR 39) for developing the CBB reserve fund. There are essentially three sources of funding the CBB reserve for deferred implementation of cash-based budgeting: the General Fund, Permanent Fund earnings, and new or higher taxes. Over a period of years, contributions to the CBB reserve would come from one or a combination of these sources (CS HJR 39 targets General Fund unrestricted revenues). A significant feature of CS HJR 39 (and the computer model used in this report) is the automatic start-up of cash-based budgeting once the reserve fund exceeds 1.5 times the appropriations of the preceding fiscal year.

⁴A Constitutional amendment is the generally preferred means of creating the reserve fund and defining its use for budgetary purposes. The Constitution would serve to insulate the cash-based budgeting reserve fund from the political process much as is the case with the Permanent Fund.

The General Fund. In this report, General Fund unrestricted revenues identified as potentially available for contribution to a CBB reserve fund are those revenues "in excess" of the projected operating costs of government. For this purpose, no real growth in the Operating Budget above the FY 84 level (\$2.057 billion) is assumed.

Three mechanisms for obtaining contributions to the CBB reserve fund are considered in this report:

- A percentage of unrestricted revenues deposited into the CBB reserve fund monthly;
- A "grubstake" contribution to the CBB reserve fund appropriated in the 1984 legislative session to become effective contingent on voter approval of the CBB program during the 1984 general election.
- A percentage of the balance of unobligated (unappropriated) revenues remaining in the General Fund at the end of each year.

Assuming that actual revenues match the 30th percentile revenue forecast, annual contributions of 10.3 percent of total unrestricted revenues would enable the CBB reserve fund to attain the 18-month reserve requirement of \$4.581 billion by FY 94. An FY 94 cash-based budgeting start-up could also be achieved with an annual General Fund contribution of 8.9 percent if a front-end (grubstake) contribution of \$300 million were made during the current session. Under these options, annual contributions to the CBB reserve fund would range between \$300 million and \$420 million. General Fund "excess revenues" would be sufficient to meet CBB contribution requirements in every year except FY 92 and FY 93.

Permanent Fund Earnings. Permanent Fund earnings are another potential source of funds for a CBB reserve account. This report assumes the Permanent Fund is restructured to allow annual contributions to the CBB reserve fund.

Under this set of assumptions, Permanent Fund earnings contributed to the CBB reserve fund are projected to increase from \$208 million in FY 86 to \$501 million in FY 94. Given the earnings potential of the CBB reserve fund, cash-based budgeting could be started in FY 96 with Permanent Fund earnings as a source of contributions.

New or Higher Taxes. A third alternative for funding cash-based budgeting is through new or higher taxes. However, this approach is less promising than the General Fund or Permanent Fund earnings options for the following reasons:

- The political feasibility of raising petroleum taxes is a matter of considerable conjecture, especially in light of the Congressional debate over the need to limit the ability of petroleum producing states to increase oil production taxes.
- Given the January 1984 estimate of all nonpetroleum tax revenue of \$131 million, tax rates would have to be three to four times higher than existing rates in order to meet CBB reserve contribution requirements of between \$300 to \$420 million per year.
- A reinstated Alaska individual income tax could potentially raise revenues of around \$436 million per year. This potential source of funds for cash-based budgeting is of a sufficient magnitude to fund a CBB reserve by the late 1990s, but may also be useful as a supplementary source of funds under other implementation options.

Near-Term Implementation of Cash-Based Budgeting

Two methods by which cash-based budgeting could conceivably be implemented soon after voter approval in 1984 are by a loan from the Permanent Fund and by bonding. Both options would require adoption of a constitutional amendment allowing the State to incur debt for purposes other than for capital construction projects. Assuming cash-based budgeting could begin in FY 86, both the Permanent Fund loan and bonding methods would involve a lump sum deposit into the CBB reserve fund of \$4.829 billion.

Permanent Fund Loan. The plan for repayment of the Permanent Fund loan depends on the interest rate and repayment period assumed. Given a 7-year repayment period and an annual interest rate of ten percent, \$479 million per year (in addition to interest earnings on the balance) would be diverted from the General Fund to repay the loan.

The Permanent Fund loan approach to funding the CBB reserve presents difficulties for the following reasons:

- The loan repayment plan stated above assumes perfect liquidity of Permanent Fund investments. In actuality, some Permanent Fund investments are not readily retrievable for contribution into the CBB reserve fund. Consequently, the start-up date for cash-based budgeting may be delayed from 2 to 3 years, and the annual repayment amounts would be increased since the CBB reserve fund target grows in proportion to revenue projections through FY 90.

- A serious drawback of the Permanent Fund loan concept is the precedent that such a use of the Permanent Fund principal would set.
- A Permanent Fund loan would likely be viewed by the bond market as no different than any other general obligation debt of the State. Consequently, this very large outstanding debt might cause the State's AA bond rating to drop to A or A-, making further bond sales for any State agency more expensive while the loan was being repaid. Furthermore, a debt of the magnitude of \$4.8 billion would eliminate any further debt capacity for the State until this loan is repaid.

Bonding. An alternative near-term cash-based budgeting funding source is bonded debt. If \$4.829 billion in bonds could be sold by the State, cash-based budgeting could be started in the near-term with a repayment schedule much like that which would occur under the Permanent Fund loan option. The following potential problems are associated with the bonding alternative:

- According to a recent report of State debt capacity, an additional \$1.2 billion in debt could potentially be incurred by the State through FY 90 only by doubling its current debt service to revenue ratio. This report recommends against such an increase in the debt service/revenue ratio since the State's AA bond rating would be in jeopardy.⁵
- The Internal Revenue Service (IRS) forbids financial arbitrage with regard to revenues raised by sale of tax exempt bonds. This means the State would be prohibited from investing revenues raised by bond sales at interest rates higher than those pertaining to the sale of the bonds. This factor would effectively raise the overall cost of the bonding alternative for funding cash-based budgeting by the amount of foregone interest earnings of CBB reserve fund investments.

The Fiscal Benefits and Limitations of Cash-Based Budgeting

The intent of legislation proposing cash-based budgeting is to create a budgeting system which will allow legislators to know precisely how much money can be appropriated in the budgets that they will prepare. However, cash-based budgeting is more than simply a mechanism for making revenues more certain.

⁵A Review of Debt Capacity and Debt Management for the State of Alaska; August 1983, prepared by Government Finance Research Center-Municipal Finance Officers Association, Washington D.C.

Fiscal Restraint. The implementation of cash-based budgeting would provide for a constitutional prohibition against deficit spending by requiring that appropriations for a given fiscal year may not exceed total revenues already in hand from the prior calendar year. In addition, about \$400 million per year would be diverted from the revenue stream to the CBB reserve fund during the period of reserve fund growth. In those years, less revenues would be available for appropriation for other purposes.

Bringing Certainty To The Budgeting Process. Knowing exactly how much money is available for appropriation each year is different from the task of allocating available funds. Even though the size of the pie will be known under cash-based budgeting, the problems of dividing up the pie will still require difficult political decisions. For local governments and school districts who rely on State appropriations to finalize their budgets, uncertainty over revenues would remain until the legislative allocation process is complete. This source of revenue uncertainty will become an increasing problem for local jurisdictions during a period of declining revenues as a consequence of increasingly intense competition among contenders for a piece of the budget pie.

In addition, cash-based budgeting resolves the "revenue uncertainty" problem for budgeting purposes on a year-to-year basis, it does not eliminate the considerable uncertainty concerning how the State will budget "within its means" during a period of projected declining revenues.

Revenue Stability - Smoothing. With the start of cash-based budgeting, an element of revenue stability would be introduced to the extent that revenues needed to cover future appropriations would be "in the bank." However, cash-based budgeting would do nothing to smooth out an erratic revenue stream (including both sharp increases and dramatic drops) since revenues would presumably be appropriated at the same level at which they were received 18-months earlier.

Cash-Based Budgeting As An Expenditure Limitation. As a limit on expenditures, cash-based budgeting differs from conventional expenditure limitations which are tied to growth in demand for governmental services (population growth) and changes in the costs of goods and services. Instead, cash-based budgeting is simply bound to increases or declines in total State revenues which are predominately determined by changes in the price and production level of petroleum.

CHAPTER ONE

"REVENUE UNCERTAINTY" AND THE DESIGN OF A CASH-BASED BUDGETING PROGRAM

Cash-based budgeting (CBB) has been proposed as a means of eliminating the budgeting problems created by uncertain and fluctuating State revenues. Cash-based budgeting (which is also known as "forward funding") would reduce or eliminate revenue uncertainty by tying the State budget for a given year to the amount of revenues already received and deposited in the treasury during a prior year.⁶ The legislature and governor would know (before enacting or signing the budget) exactly how much money was actually available to spend. Under the present system, the budget is based on revenues expected to be received during the current fiscal year, which requires forecasting revenues a year or more in advance.

Alaska now depends on petroleum taxes and royalties for about 85 percent of total State revenues, so that revenues rise and fall directly with changes in world oil prices. The volatility and uncertain future of oil prices complicate the budget process for the legislature and the administration as well as for local governments, school districts and other entities that rely heavily on State funding.

The revenue uncertainty problem was particularly severe during the 1982 legislative session, when a large unexpected drop in oil prices caused major budget problems. In March 1982, the revenue forecast for fiscal year (FY) 83 was \$1.4 billion less than had been projected only three months earlier. The sharp decline in revenues required frequent budget revisions, contributed to a longer legislative session, and disrupted fiscal planning for local governments and other recipients of State funds.

Because the purpose of cash-based budgeting is to resolve the "revenue uncertainty" problem, it is important that the concept of revenue certainty be clearly understood.

Revenue Certainty Defined

Revenue certainty relates to the likelihood that incoming revenues will be sufficient to cover budgeted appropriations. Only when a 100 percent probability exists that available funds will be sufficient

⁶It is important to recognize that the "revenue uncertainty" addressed by cash-based budgeting relates to a 12 or 18-month time period. The revenue uncertainty associated with a projected long-term revenue decline is not the specific target of cash-based budgeting.

REVENUE UNCERTAINTY

to offset budgeted appropriations for the next fiscal year can one say that "revenue uncertainty" has been eliminated. Therefore, the legislature can be absolutely certain of its revenue posture only if all of the revenues needed for the next fiscal year are in hand before the start of the fiscal year.

This "cash in the bank" budgeting approach, called cash-based budgeting, means that we will behave as though there exists some chance that no revenues will be collected during the upcoming fiscal year. It would seem unlikely, however, that absolutely no revenues would be available to the State, except in the event of a total collapse of the government. If some minimal level of revenues can be assumed, then a budgeting method that involves somewhat less cash in the bank than is required by cash-based budgeting may suffice.

Under all but extreme circumstances, conventional budgeting practices require only reasonable certainty that a specific level of revenues will be available for the upcoming fiscal year. Having reasonable certainty means that a favorable judgment can be made concerning the probability that some anticipated amount of revenues will be forthcoming to the State treasury by the end of the upcoming fiscal year.

Most state governments budget for the next fiscal year based on the most likely forecast of revenues for that year. Although it is difficult for any state to project future revenues with consistent accuracy, most states have a fairly diversified and stable revenue base. This diversification makes an error in forecasting the revenue from any single source tolerable with respect to its impact on total state revenues. On the other hand, with 85 percent of Alaska income dependent on oil-based taxes and royalties, a small error in forecasting oil prices and production levels can result in a relatively large difference in total State revenues.

Administrative Response to the Revenue Uncertainty Problem

Prior to FY 84, the Alaska Department of Revenue had issued a "mean case" forecast of revenues for the coming fiscal year. The mean revenue projection reflects the most likely revenue forecast under a given set of assumptions for the next year. Roughly speaking, with a mean forecast, actual revenues received by the treasury will be lower than the forecast half of the time.⁷

⁷As the forecast year becomes more distant from the present, the statistical probability of actual revenues falling short of the projected amount increases significantly above 50 percent under a mean revenue forecast.

Out of concern for the budgetary difficulties raised by the volatile oil prices during 1981 and 1982, the department began issuing a "risk-adjusted" forecast for FY 84. The so-called "30th percentile" revenue forecast implies that actual revenues will fall short of the projection only 30 percent of the time. In other words, there is a 70 percent probability that actual revenues will equal or exceed the forecast for that year.

The Degree of Certainty and CBB Design

In designing a cash-based budgeting program, the level of revenue certainty desired and the point in the budgeting process at which certainty is desired dictate the amount of cash on hand needed to start cash-based budgeting. If the legislature wants to be absolutely certain as of January 1 (before the start of the legislative session), that available funds will be sufficient for the next fiscal year, the cash-based budgeting reserve fund must contain 18 months of revenues. This reserve level will cover the balance of the current fiscal year (six months) and the appropriations for the coming fiscal year (twelve months).

Any reserve level containing less than 18 months of revenues requires that some revenues be received to offset the expenditures during the coming fiscal year. In this instance, the probability that those revenues will be received is the degree of certainty that one can have for budgeting purposes.

Alternatives to Cash-Based Budgeting

In order to increase the probability that revenues will cover budgeted appropriations, a number of possible alternatives to cash-based budgeting exist: (1) the establishment of a cash-flow reserve fund equal to a partial year of revenues; (2) limiting appropriations to the level of the Department of Revenue's 30th percentile forecast. This budgeting approach provides a 70 percent assurance that revenues will be sufficient to cover budgeted appropriations; and (3) reliance on the rainy day fund as a supplementary source of revenues.

CHAPTER TWO

DEFERRED IMPLEMENTATION OF CASH-BASED BUDGETING

The major requirement for implementation of cash-based budgeting is the creation of a reserve fund which guarantees "revenue certainty" by allowing legislators to identify revenues available for appropriation in advance of the budget preparation process.⁸ Funding of the CBB reserve fund can be structured in two basic ways: with a single very large deposit which would allow for immediate implementation of cash-based budgeting (discussed in Chapter Three), or with smaller annual deposits over a period of years providing for a delayed start of this budgeting system. During the current session, legislative consideration of cash-based budgeting (CS HJR 39) has focused on the long-term payment plan for developing the CBB reserve fund. To the extent possible, the analysis of deferred implementation of cash-based budgeting in this chapter will parallel the major elements of CS HJR 39.⁹

Reserve Fund Requirements

As stated in Chapter 1, the legislature has considerable latitude in determining what constitutes "revenue certainty" and, therefore, how it might design a cash-based budgeting system to provide the desired degree of certainty. For the purposes of this analysis, revenue certainty is interpreted to require a CBB reserve account which contains funds equivalent to 1.5 times the appropriation level of the fiscal year preceding the start of cash-based budgeting.

Based on this revenue requirement, Table 1 presents the reserve fund target balances needed to begin cash-based budgeting in the corresponding fiscal year. The amounts are predicated on the assumption that the present legislative expenditure policy of appropriating total available revenues (as projected by the Department of Revenue) will continue up to the start of cash-based budgeting.

⁸A Constitutional amendment is the generally preferred means of creating the reserve fund and defining its use for budgetary purposes. The Constitution would serve to insulate the cash-based budgeting reserve fund from the political process much as is the case with the Permanent Fund.

⁹CS HJR 39 contains two appropriation limitation provisions that will not be analyzed in this report. See Appendix A for a copy of CS HJR 39.

DEFERRED IMPLEMENTATION

Because contributions to the CBB reserve fund are treasury transfers rather than appropriations, the reserve target amount projected in Table 1 is equal to total General Fund unrestricted revenues for the preceding fiscal year minus the final year's contribution to the CBB reserve fund. This technique provides a CBB reserve target commensurate with the effective level of appropriation in prior years.

Table 1
Cash-Based Budgeting Reserve Fund Requirements
(for CBB start-up on any year FY 91 through FY 97)

<u>Fiscal Year</u>	<u>DOR Revenue Projection (\$millions)</u>	<u>Minimum Contribution Percentage*</u>	<u>Final Year Contribution*</u>	<u>CBB Reserve Requirement** (\$millions)</u>
1990	\$3,880			
1991	3,582	19.6%	\$761	\$4,679
1992	3,536	15.1	541	4,562
1993	3,405	12.5	442	4,641
1994	3,290	10.3	351	4,581
1995	3,195	8.6	283	4,511
1996	3,033	7.3	233	4,443
1997	3,092	6.1	185	4,272

*The contribution figures shown pertain to a deferred implementation plan for cash-based budgeting (discussed later in this chapter) which assumes that a percentage of General Fund unrestricted revenues is contributed to the CBB reserve each year. With a percentage of General Funds as the only CBB contribution mechanism, the percentages listed above reflect the minimum contribution levels needed to begin cash-based budgeting in the corresponding fiscal year. The contribution amounts shown equal the product of the contribution percentage and the General Fund revenues for the year preceding the start of cash-based budgeting.

**Deferred implementation reserve requirements (1991-1997) for cash-based budgeting are equal to 1.5 times prior year appropriations. Appropriations are assumed to equal revenues minus annual contributions to the CBB reserve fund.

Source: Department of Revenue Jan. 1984 30th percentile forecast.

Prepared by: House Research Agency

Timing of Cash-Based Budgeting

The deferred implementation approach in CS HJR 39 entails the build-up of a CBB reserve fund through periodic contributions. This method requires that a conversion from the present budgeting practice to cash-based budgeting be postponed, but avoids the potential political liability of incurring substantial State debt through a loan from the Permanent Fund or bonding. (See Chapter Three for a discussion of Permanent Fund loan and bonding alternatives for funding cash-based budgeting.)

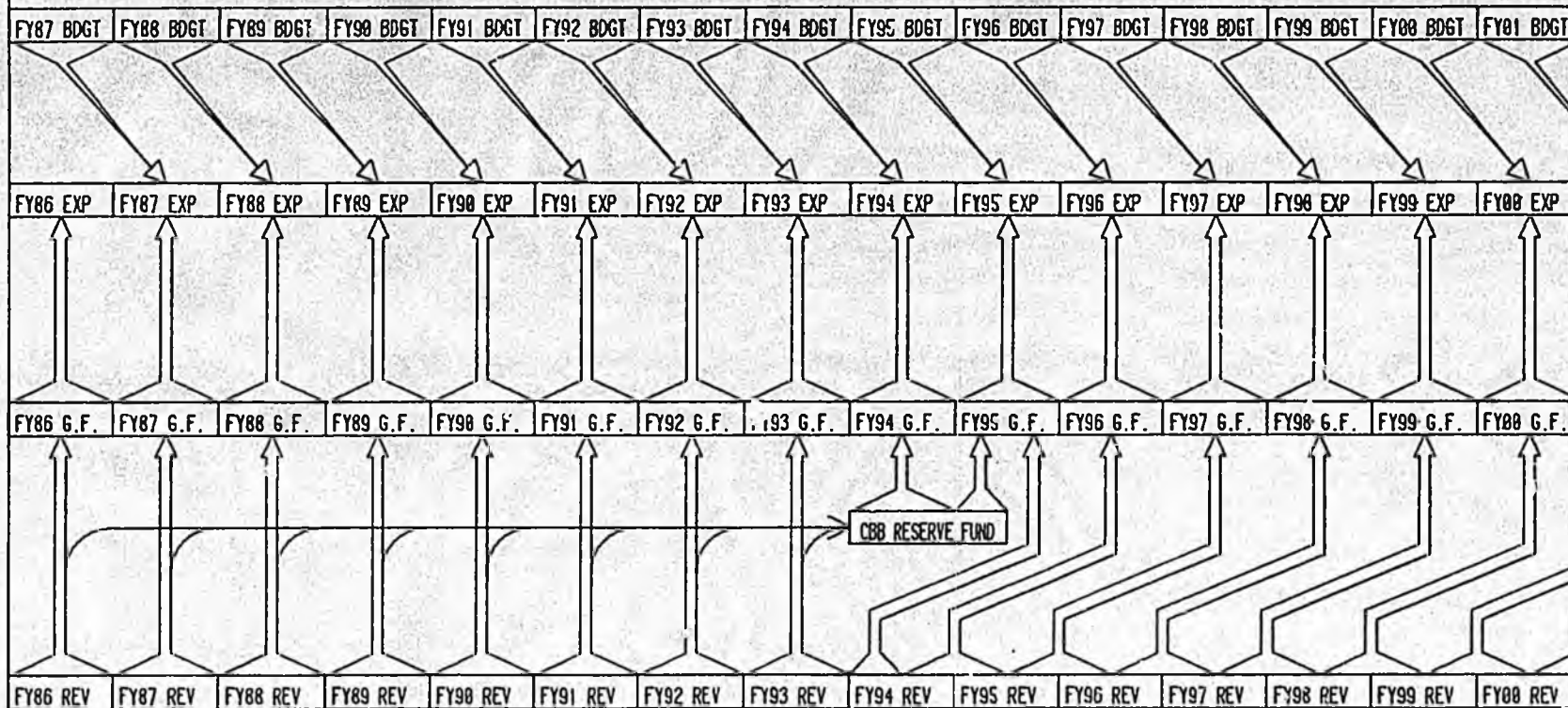
Critical to the deferred implementation plan is the desired target date on which cash-based budgeting is to begin. We will assume a start-up date for cash-based budgeting in the early 1990s which roughly corresponds with a projected decline in State revenues. This should insure that annual contributions to the CBB reserve fund will coincide with the remaining strong revenue years.

An example of how cash-based budgeting can be implemented through periodic contributions to a CBB reserve fund is displayed graphically on Figure 1. This flowchart shows how annual contributions of General Fund unrestricted revenues are diverted into the CBB reserve fund from FY 86 through FY 93. With the start of cash-based budgeting in FY 94 (in this example), State expenditures would be funded directly out of the reserves accumulated during the contribution period. Simultaneously, incoming revenues are deposited into the General Fund, and will not be available for appropriation until 18 months later.

A significant design feature of CS HJR 39 and our CBB computer model provides for an automatic start-up of cash-based budgeting once the size of the reserve fund exceeds 1.5 times the appropriations for the preceding fiscal year. With a fixed start-up date for cash-based budgeting, it is possible that unanticipated revenue shortfalls could result in insufficient contributions to the CBB reserve fund. With a flexible start-up mechanism, cash-based budgeting may begin early if the reserve grows faster than expected, or it may be delayed for a period of time if revenues fall short of projections. Regardless of the revenue outlook, however, this procedure guarantees that the CBB reserve account will contain sufficient funds when cash-based budgeting is implemented.

Figure 1

CASH-BASED BUDGETING FLOWCHART



Top section: annual budget preparation for next year.
 2nd section: fiscal year expenditures.
 3rd section: general fund.
 Bottom section: revenues collected each fiscal year.

Prepared by: House Research Agency
 February 1, 1984

Potential Deferred Implementation Funding Sources

Three sources for funding cash-based budgeting under the deferred implementation plan are considered in this chapter: the General Fund, Permanent Fund earnings, and new or higher taxes. While each of these sources is examined in the following discussion, it is important to note that in CS HJR 39, only the General Fund is utilized as a funding source for cash-based budgeting.

The General Fund. General Funds available for contribution to the CBB reserve fund may be thought of as those funds in excess of Operating Budget requirements. Of course, these "excess" revenues will be the focus of considerable competition for appropriations to the Capital Construction Budget, the Permanent Fund, and to Governor Sheffield's recently proposed Major Capital Projects Fund. Nevertheless, revenues above the operating cost of State government represent the only reasonable measure of General Fund unrestricted revenues potentially available for contributions to the CBB reserve fund.

Figure 2 shows a profile of total General Fund unrestricted revenues in constant FY 84 dollars. These figures are computed from the Revenue Department's 30th percentile projection by factoring out inflation.¹⁰ Superimposed on the revenue profile is a projection of the operating cost of government expressed in FY 84 dollars. In this analysis, we have assumed no real growth in the Operating Budget, which means that no net increases in funding levels above the FY 84 budget are provided to account for additional employees, public services, or programs. Consequently, the projected level of expenditures under this scenario results in a constant value shown by the horizontal line.

Revenue potentially available for funding cash-based budgeting is reflected in Figure 2 by that portion of the revenue profile which lies above the horizontal line (representing a continuation FY 84 level Operating Budget). The numeric values of these "excess" revenues are shown in Table 2. These values have been converted to nominal dollars so that later they can be compared to CBB reserve contributions which will be expressed in nominal dollars.

¹⁰The inflation rate used to discount revenue forecasts in this graph is 6 percent. These January 1984 revenue projections include revenues anticipated from Prudhoe Bay (Sadlerochit and Kuparuk Fields), Cook Inlet and future anticipated production from Milne Point (beginning in FY 87) and Canning River, Flaxman Island and Point Thomson (predicted to begin production in FY 89). A table showing computations for data used in Figure 2 is presented in Appendix B. Calculations and a graph comparable to Figure 2 are also shown for the Department of Revenue mean revenue forecast in Appendix B.

Figure 2
 TOTAL REVENUES VS. OPERATING BUDGET
 (1984 DOLLARS)

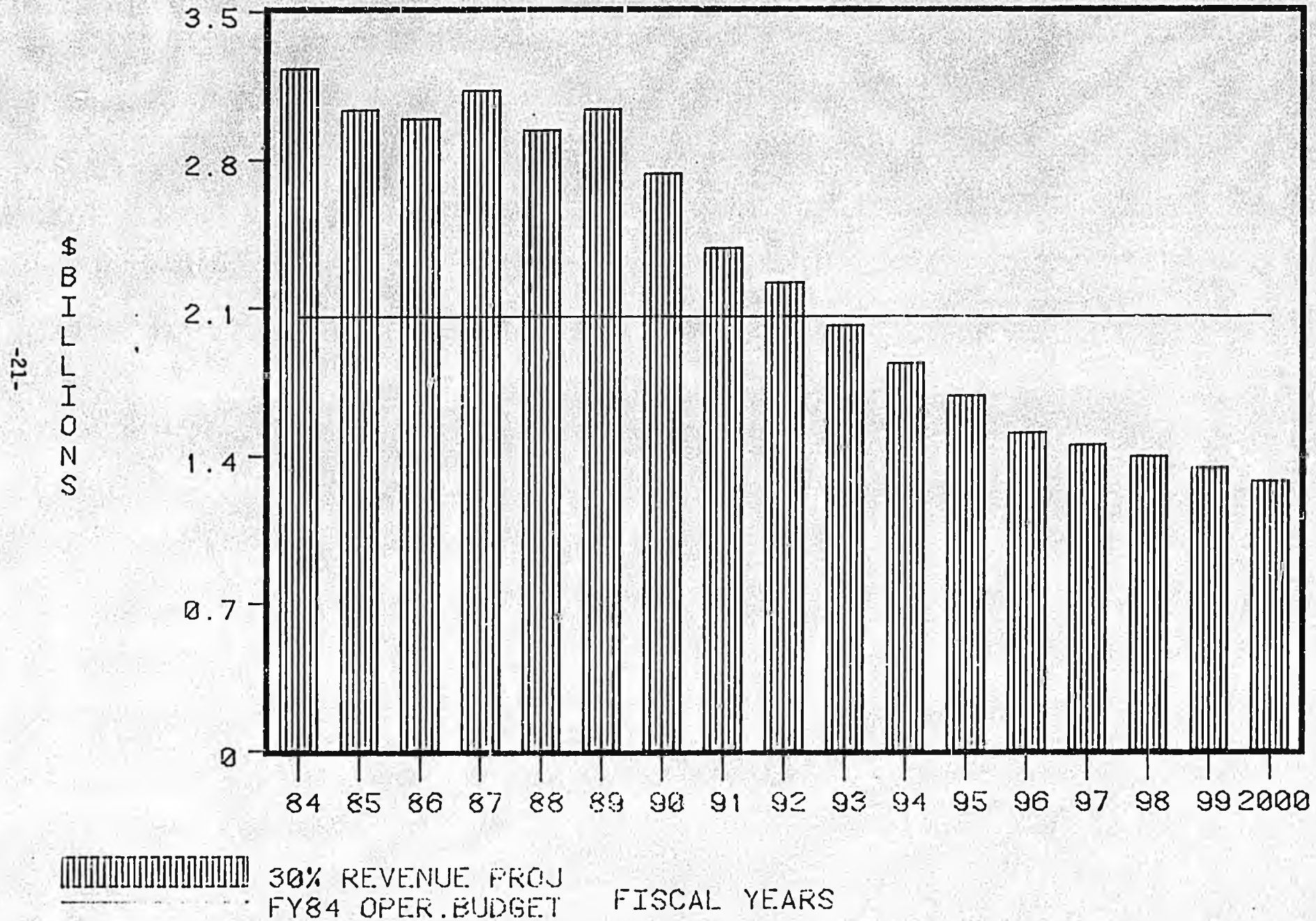


Table 2
 Projected General Fund Unrestricted Revenues in Excess
 of a Continuation (FY 84 Level) Operating Budget
 (millions of nominal dollars)

<u>Fiscal Year</u>	<u>Excess General Fund Revenues</u>
1984	\$1,176
1985	1,039
1986	1,054
1987	1,279
1988	1,114
1989	1,315
1990	962
1991	489
1992	257

Prepared by House Research Agency

The computer model developed for the purpose of analyzing the General Fund as a source of revenues for cash-based budgeting is designed to examine three primary contribution mechanisms:

- A percentage of total General Fund unrestricted revenues deposited into the CBB reserve fund monthly.
- A "grubstake" contribution to the CBB reserve fund appropriated in the 1984 legislative session to become effective contingent on voter approval of the cash-based budgeting program during the 1984 general election.
- A percentage of the balance of unobligated (unappropriated) revenues remaining in the General Fund at the end of each fiscal year. In most instances, this balance would exist to the extent that actual revenues received in a year exceed total appropriations for that year.

The third contribution mechanism is very difficult to model because of the speculative nature of making close-tolerance revenue forecasts (see Appendix C for more on this topic). Although CS HJR 39 utilizes the third contribution mechanism in addition to the General Fund percentage, the most that can be said is that these contributions would supplement other sources and may allow for an earlier start-up of cash-based budgeting.

The General Fund percentage and grubstake contributions are analyzed in the following scenarios. In both scenarios, the contribution mechanisms have been balanced so that the projected start-up date for cash-based budgeting is FY 94.

DEFERRED IMPLEMENTATION

Scenario 1 Percentage of General Fund Receipts

Table 3 shows a projection of how the cash-based budgeting program may be funded using only a percentage of monthly General Fund unrestricted treasury receipts. In this case, the percentage contribution is set to 10.3 percent of monthly revenues based on the Department of Revenue 30th percentile projection.¹¹

Under Scenario 1, annual contributions of between \$347 and \$419 million are being made to the CBB reserve fund during the period FY 86 through FY 93. Both the earnings capacity of the reserve (column 8) and the reserve balance (column 9) continue to grow during this period. In 1994, the balance exceeds 1.5 times the appropriations for FY 93, allowing the State to convert to cash-based budgeting. Beginning in FY 94, the reserve balance (\$4,596 million) is deposited into the General Fund, causing its balance to rise to \$7,327 million (column 6). Similarly, the earnings capacity of the General Fund (column 5) jumps from \$258 million in FY 93 to \$689 million in FY 94 as a consequence of the dramatic increase in the size of the General Fund balance.

The most interesting effect of cash-based budgeting is its impact on the potential expenditure level of the State. Prior to FY 86 when the first contribution is made to the CBB reserve fund, the limit on expenditures (column 4) exactly parallels the projected revenues (column 2). During the 8-year contribution period, revenues available for expenditure are diminished by the amount of CBB reserve contributions. Beginning with the start of cash-based budgeting in FY 94, the expenditure limit increases beyond the revenue level originally forecasted (column 2) because the increased earnings potential of the General Fund makes additional revenues available for appropriation.

The effects of scenarios 1 (and scenario 2 discussed on page 29) on General Fund appropriation levels from FY 84 through FY 2000 are shown in Figure 3. This graph illustrates how cash-based budgeting literally transfers funds from years of strong revenue forecasts to years when State revenues are projected to decline. Beyond the turn of the century, cash-based budgeting would continue to boost revenues by the amount of added General Fund investment earnings, regardless of the revenue outlook for the future.

¹¹See Appendix D for an analysis of Scenarios 1 and 2 under a mean revenue forecast.

Table 3
Scenario 1
THE GENERAL FUND AS A REVENUE SOURCE FOR CASH-BASED BUDGETING
Based on a 30th Percentile Revenue Projection
(millions of dollars)

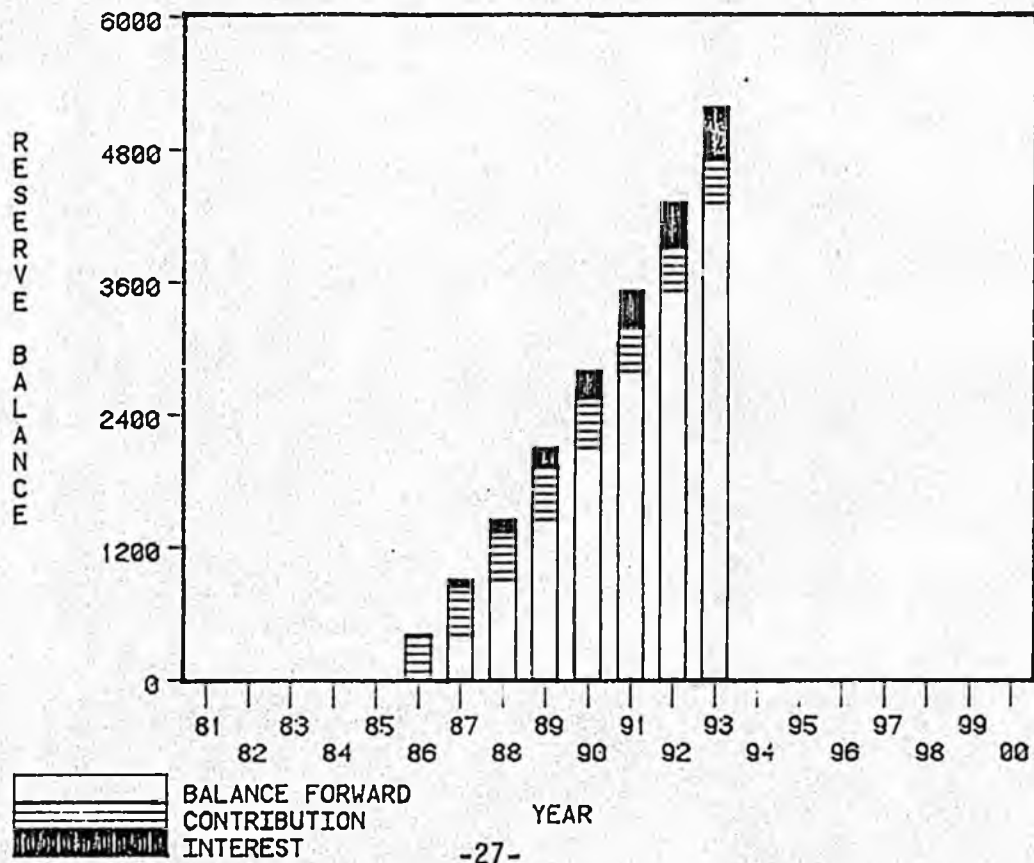
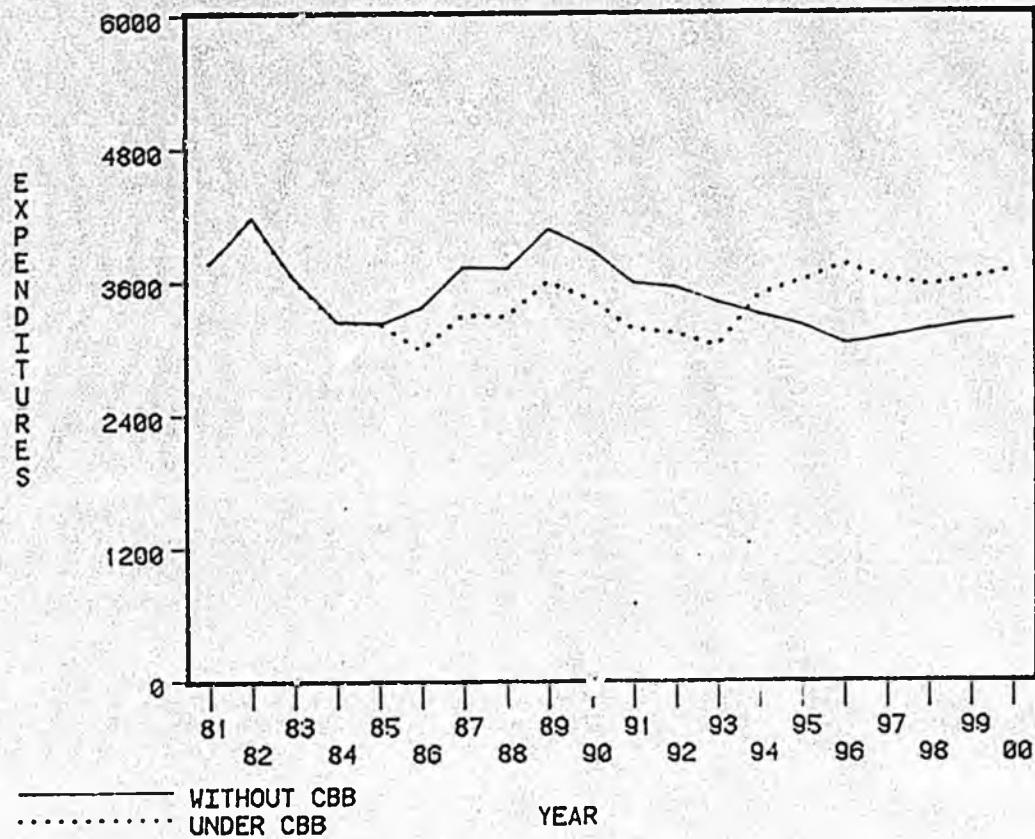
Fiscal Year	DOR	Revenue	Potential	General	GeneralCash-Based Budgeting Reserve Fund....		
	Revenue Forecast	Under CBB	Expenditure Level	Fund Earnings	Fund Balance	Contributions	Earnings	Balance
1981	3,769		3,769	201	2,010			
1982	4,174		4,174	254	2,540			
1983	3,624		3,624	266	2,660			
1984	3,233		3,233	300	3,000			
1985	3,219		3,219	250	2,500			
1986	3,365	3,018	3,018	259	2,590	346.6	16	363
1987	3,729	3,345	3,345	288	2,880	384.1	56	803
1988	3,711	3,329	3,329	288	2,880	382.2	102	1,287
1989	4,068	3,649	3,649	318	3,180	419.0	155	1,861
1990	3,880	3,480	3,480	301	3,010	399.6	214	2,474
1991	3,582	3,213	3,213	275	2,750	368.9	276	3,120
1992	3,536	3,172	3,172	270	2,700	364.2	344	3,828
1993	3,405	3,054	3,054	258	2,580	350.7	417	4,596
1994	3,290	3,732	3,471	689	7,327			
1995	3,195	3,643	3,568	684	7,292			
1996	3,033	3,461	3,687	650	6,925			
1997	3,092	3,517	3,552	650	6,920			
1998	3,159	3,593	3,489	663	7,064			
1999	3,213	3,656	3,555	674	7,186			
2000	3,245	3,695	3,625	682	7,266			
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)

col.

- 2 Department of Revenue January, 1984 revenue projection.
- 3 Revenues after effects of cash-based budgeting program. During the CBB reserve contribution period, revenues (column 3) are equal to DOR projections minus annual CBB contributions. Starting with the first cash-based budgeting year, revenues (column 3) are equal to DOR projections plus additional earnings which accrue to the general fund as a result of transferring the CBB reserve fund balance to the general fund.
- 4 Expenditure levels are presently limited to projected revenues (ignoring the Constitutional appropriation limit). Beginning with the first cash-based budgeting year, expenditures will be limited to the revenues collected in the previous calendar year.
- 5 General fund earnings are DOR projections up to the start of cash-based budgeting, at which point the general fund earnings will be augmented due to the increased earnings capacity of the general fund from that point on into the future.
- 6 Beginning with the first cash-based budgeting year, the general fund balance is substantially increased by the transfer of the CBB reserve fund.
- 8 Reserve fund earnings are calculated at a 10 percent annual interest rate compounded monthly.
- 9 The earnings rate of the CBB reserve fund is compounded monthly using a 10% annual interest rate.

This projection is based on a general fund unrestricted revenue contribution of 10.3 percent.

Figure 3
 EXPENDITURES AND RESERVES UNDER CASH BASED BUDGETING
 (IN MILLIONS OF \$)



Scenario 2
Percentage of General Fund Revenues Plus Upfront Contribution

Table 4 displays a projection of the CBB computer model assuming an annual contribution of 8.9 percent of General Fund unrestricted revenues and a \$300 million upfront (grubstake) contribution. A significant difference in this projection as compared to the projection shown in Table 3 is that the initial contribution year is FY 85 instead of FY 86.

Table 5 presents a summary of how "General Fund revenues in excess of the operating costs of government" (from Table 2) compare to the contribution requirements for cash-based budgeting.

Table 5
 The General Fund As A Source For Cash-Based Budgeting
 (millions of dollars)

Fiscal Year	General Fund Excess Over Operating Budget*	Scenario 1** CBB Required Contributions	Scenario 2*** CBB Required Contributions
1985	\$1,039		\$300
1986	1,054	\$347	300
1987	1,279	384	332
1988	1,114	382	330
1989	1,315	419	362
1990	962	400	345
1991	489	369	319
1992	257	364	315
1993	-70	351	303

*These projections assume a 30th percentile revenue forecast with an inflation rate of 6 percent annually. Excess revenues equal projected General Fund unrestricted revenues minus a continuation FY 84 level Operating Budget.

**Scenario 1 assumes a cash-based budgeting program with annual General Fund unrestricted revenue contributions of 10.3 percent.

***Scenario 2 assumes a cash-based budgeting program with annual General Fund unrestricted revenue contributions of 8.9 percent and an upfront (grubstake) contribution of \$300 million.

Prepared by: House Research Agency

Table 4
Scenario 2
THE GENERAL FUND AS A REVENUE SOURCE FOR CASH-BASED BUDGETING
Based on a 30th Percentile Revenue Projection
(millions of dollars)

Fiscal Year	DOR Revenue Forecast	Revenue Under CBB	Potential Expenditure Level	General Fund Earnings	General Fund BalanceCash-Based Budgeting Contributions	Reserve Fund Earnings	Reserve Fund Balance
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
1981	3,769		3,769	201	2,010			
1982	4,174		4,174	254	2,540			
1983	3,624		3,624	266	2,660			
1984	3,233		3,233	300	3,000			
1985	3,219	3,919	2,919	250	2,500	300.0	15	315
1986	3,365	3,066	3,066	259	2,590	299.5	47	662
1987	3,729	3,397	3,397	288	2,880	331.9	85	1,078
1988	3,711	3,381	3,381	288	2,880	330.3	128	1,537
1989	4,068	3,706	3,706	318	3,180	362.1	178	2,077
1990	3,880	3,535	3,535	301	3,000	345.3	234	2,656
1991	3,582	3,263	3,263	275	2,750	318.8	293	3,268
1992	3,536	3,221	3,221	270	2,700	314.7	357	3,940
1993	3,405	3,102	3,102	258	2,580	303.0	427	4,670
1994	3,290	3,739	3,471	696	7,408			
1995	3,195	3,651	3,572	692	7,378			
1996	3,033	3,469	3,695	658	7,011			
1997	3,092	3,524	3,560	657	7,006			
1998	3,159	3,601	3,496	671	7,150			
1999	3,213	3,664	3,563	682	7,271			
2000	3,245	3,702	3,632	689	7,351			

col.

- 2 Department of Revenue January, 1984 revenue projection.
- 3 Revenues after effects of cash-based budgeting program. During the CBB reserve contribution period, revenues (column 3) are equal to DOR projections minus annual CBB contributions. Starting with the first cash-based budgeting year, revenues (column 3) are equal to DOR projections plus additional earnings which accrue to the general fund as a result of transferring the CBB reserve fund balance to the general fund.
- 4 Expenditure levels are presently limited to projected revenues (ignoring the Constitutional appropriation limit). Beginning with the first cash-based budgeting year, expenditures will be limited to the revenues collected in the previous calendar year.
- 5 General fund earnings are DOR projections up to the start of cash-based budgeting, at which point the general fund earnings will be augmented due to the increased earnings capacity of the general fund from that point on into the future.
- 6 Beginning with the first cash-based budgeting year, the general fund balance is substantially increased by the transfer of the CBB reserve fund.
- 8 Reserve fund earnings are calculated at a 10 percent annual interest rate compounded monthly.
- 9 The earnings rate of the CBB reserve fund is compounded monthly using a 10% annual interest rate.

This projection is based on a general fund unrestricted revenue contribution of 8.9 percent.
A 'grubstake' contribution is assumed in this projection for FY 85 in the amount of \$ 310 million.

From Table 5, it can be seen that only in the last two years of the contribution period (FY 92 and FY 93), would the funding demands under scenarios 1 and 2 exceed the projected "excess General Fund revenues" available. Unless a supplementary source of revenues were employed in those years, the automatic General Fund transfers to the CBB reserve would cut into the share of total State revenues identified for the Operating Budget.¹² Of course, these projections assume that operating expenditures and actual revenues received will match the 30th percentile revenue forecast. It should be remembered that CS HJR 39 contains a second contribution mechanism: a percentage of the unappropriated General Fund balance. If expenditures are kept below the level of total revenues received during the CBB contribution years, this contribution mechanism may reduce or eliminate the projected shortage of "excess General Funds" shown for scenarios 1 and 2.

On the other hand, if the operating costs of government are permitted to increase during the CBB contribution period, the amounts of "excess" General Fund revenues would be reduced. An earlier shortfall in "excess" General Funds means that the CBB contributions would cut more deeply into the share identified for the Operating Budget.

Contributions to the CBB reserve may also impact the Operating Budget share of total appropriations as a consequence of provisions in the present Constitutional Appropriation Limit. Of the total annual appropriation, "at least one-third shall be reserved for capital projects and loan appropriations," according to Article IX, Section 16 of the State Constitution. If transfers of State revenues to the CBB reserve cut too deeply into total available revenues, the Operating Budget share may have to bear part of the burden along with "excess" General Funds (which includes the Capital Budget and loans appropriations).

Permanent Fund Earnings. The Permanent Fund is a source of revenues which could be used to supplement General Fund contributions in those years when a shortage in "excess" General Funds occur. Because of the considerable earnings capacity of the Permanent Fund, however, the fund might serve equally as well as the primary source of funds for cash-based budgeting, with the General Fund as a supplementary source. In the following discussion, emphasis will be placed on the latter perspective.

Before we begin assessing the development of a cash-based budgeting reserve fund using the Permanent Fund earnings as a revenue source, a

¹²See Appendix E for a discussion of how cuts in the Operating Budget could be used as a fiscal management tool to bring the operating costs of government within the level of projected revenues in the 1990s.

categories of the fund. Moreover, a decision to use the Permanent Fund earnings as a source for contributions to the CBB reserve fund constitutes a significant change in the laws governing the existing Permanent Fund program.

Consequently, for purposes of this analysis, we have assumed that the Permanent Fund is restructured in a way that will simplify calculations of funds required to inflation-proof the Permanent Fund principal, make contributions to the cash-based budgeting reserve fund and allocate funds for dividend payments. Our Permanent Fund model is defined by the following considerations:¹³

- Inflation-proofing of the Permanent Fund principal is the number one priority. Consequently, an amount necessary to inflation-proof the Permanent Fund principal is deducted from total Permanent Fund earnings each year.
- The second priority for earnings under the restructured Permanent Fund program is the cash-based budgeting reserve fund. Therefore, after deductions are made for inflation-proofing the Permanent Fund principal, any remainder is available for contribution to the CBB reserve fund.
- Should any money remain after deductions are made for inflation-proofing and contributions to the reserve fund, the balance is made available for Permanent Fund dividend distribution.

Given the Permanent Fund restructuring described above, it is a comparatively simple matter to project that portion of Permanent Fund earnings available for CBB reserve contributions. Table 6 shows such a projection for the Department of Revenue 30th percentile revenue forecast. Given a transfer of Permanent Fund earnings (in excess of inflation-proofing requirements) to the CBB reserve at the end of each fiscal year, this projection shows that the CBB reserve will be sufficiently large to begin cash-based budgeting in FY 96.

¹³Although the undistributed income account is legally vulnerable to appropriation by the legislature for any purpose, this source of funds is not used as a grubstake for cash-based budgeting in this restructured Permanent Fund model. The procedure of averaging income over five years with surpluses deposited into the undistributed income account serves to insulate the managers of the Permanent Fund from pressures to adopt high risk investment policies or the temptation to sell assets of the Corporation prematurely in order to boost the Permanent Fund financial image over the short term.

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discussion of the complexities of the Permanent Fund as it is currently constructed is in order. The monies of the Permanent Fund and associated accounts are treated as a unit for purposes of investment and computation of earnings, though for accounting purposes there are, in effect, three separate accounting categories under the management of the Permanent Fund Corporation, and one administrative account managed by the Department of Revenue for the purpose of dividend distribution.

The largest and most important account is the Permanent Fund principal balance into which contributions are made annually from a portion of all oil royalties, rentals and lease bonuses. For purposes of computing Permanent Fund dividends, the current year net income earnings on the Permanent Fund are averaged with the yields of the four previous years. The resultant quantity is referred to as "income available for distribution." An amount equal to fifty percent of the distributable income is transferred into a special administrative dividend account. The balance of the present year's total income earnings is available to offset the effects of inflation of the Permanent Fund principal. While the Permanent Fund Corporation uses a national standard inflation index to determine the sums needed each year to inflation-proof the Permanent Fund, the Department of Revenue uses an annual inflation factor of six percent in their long-term projections.

If a surplus from the present year's total income earnings remains after making the statutory allotment for dividends and inflation-proofing the fund, the remainder is transferred to the second major account of the Permanent Fund: the undistributed income account (UIA). The purpose of the undistributed income account is to provide a repository for surplus Permanent Fund income created by the five-year averaging procedure, but it also provides a reserve for inflation-proofing the Permanent Fund in future years when and if available earnings are insufficient for that purpose.

Earnings that accrue to the undistributed income account annually are accounted for separately from the principal of the UIA and thus constitute the fourth accounting category. UIA earnings are subject to separate accounting from the UIA principal because the UIA earnings are not legally designated for legislative appropriation to inflation-proof the Permanent Fund. As a matter of practice, the UIA earnings are the first funds to be allocated to the dividend account, with the balance required taken from the Permanent Fund principal earnings.

The Department of Revenue uses a sophisticated computer model to project the Permanent Fund balance, fund income earnings, dividend payments, requirements for inflation-proofing and the undistributed income account balance. Because of the very involved nature of the Permanent Fund program, it is difficult to dip into various categories of the Permanent Fund without seriously altering the projections for other

categories of the fund. Moreover, a decision to use the Permanent Fund earnings as a source for contributions to the CBB reserve fund constitutes a significant change in the laws governing the existing Permanent Fund program.

Consequently, for purposes of this analysis, we have assumed that the Permanent Fund is restructured in a way that will simplify calculations of funds required to inflation-proof the Permanent Fund principal, make contributions to the cash-based budgeting reserve fund and allocate funds for dividend payments. Our Permanent Fund model is defined by the following considerations:¹³

- Inflation-proofing of the Permanent Fund principal is the number one priority. Consequently, an amount necessary to inflation-proof the Permanent Fund principal is deducted from total Permanent Fund earnings each year.
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Table 6

PERMANENT FUND EARNINGS AS A REVENUE SOURCE FOR CASH-BASED BUDGETING
Based On A 30th Percentile Revenue Projection
(millions of dollars)

Fiscal Year	Perm. Fund Jobs.	Perm. Fund Balance	Perm. Fund Earnings	Inflation Proofing	Perm. Fund Dividend	CBB Reserve Contribs.	CBB Reserve Balance
1986	335	5,948	544	337	0	208	208
1987	374	6,701	613	379	0	234	463
1988	402	7,529	690	426	0	264	773
1989	464	8,473	776	480	0	297	1,147
1990	440	9,447	869	535	0	335	1,596
1991	411	10,450	965	592	0	374	2,129
1992	413	11,515	1,066	652	0	414	2,756
1993	402	12,632	1,172	715	0	457	3,488
1994	392	13,805	1,283	781	0	501	4,338
1995	373	15,029	1,399	851	386	163	4,935

This projection assumes that the Permanent Fund program is revised as described in Chapter Two. Permanent Fund earnings are based on a real rate of return of 4 %, and an inflation rate of 6 %.

In the final contribution year, only the amount needed to raise the CBB reserve to a level equal to 1.5 times the appropriations of the prior fiscal year is shown.

Obviously, as the Permanent Fund continues to grow over the years, both the inflation-proofing requirement and the earnings capacity of the fund increase. Since the Permanent Fund earnings rate is projected to exceed the inflation rate over this period of time, increasingly larger contributions to the CBB reserve fund are possible, ranging from \$208 million in FY 86 to \$501 million in FY 94. Notice that in the final contribution year (FY 95), only \$163 million need be contributed to the CBB reserve fund in order to reach the target (equal to the 1.5 times the appropriations of the preceding fiscal year). This leaves \$386 million to be distributed as Permanent Fund dividends in that year. Once the need for contributions to the CBB reserve end, the Permanent Fund dividend program would be restored to substantially higher levels.

A mean revenue projection of Permanent Fund earnings used to fund cash-based budgeting is presented in Appendix F. The major difference between the mean forecast and the 30th percentile forecast is that a longer contribution period is required under the mean forecast assumption. Under the mean forecast, cash-based budgeting would not be projected to begin until FY 98.

To summarize the effects of using Permanent Fund earnings as a source of funds for cash-based budgeting, the following points can be made:

- Cash-based budgeting could be fully funded from Permanent Fund earnings (after inflation-proofing the Permanent Fund principal) by FY 96 under a 30th percentile revenue forecast, or by FY 98 under a mean revenue forecast.
- Unlike the General Fund source of contributions to cash-based budgeting, the Permanent Fund earnings approach has the advantage that the level of General Fund appropriations would not be diminished by \$300 to \$400 million per year.
- The major disadvantage of the Permanent Fund earnings source for funding cash-based budgeting is that the dividend distribution program would be eliminated over the 9 to 11-year CBB reserve contribution period.

New Or Higher Taxes. In their quarterly publication, Revenue Sources, the Department of Revenue distinguishes between two broad classes of tax revenues: petroleum taxes and nonpetroleum taxes. Considering that nearly 85 percent of total State revenues come from petroleum taxes and royalties, it is conceivable that additional revenues, sufficient to meet the necessary contributions for the CBB reserve fund, could be raised through increased petroleum taxes. The political feasibility of raising petroleum taxes is, on the other hand, a matter of considerable conjecture, especially in light of the Congressional debate over the need to place a limit on the ability of petroleum

Other partial funding options for cash-based budgeting include various forms of front-end funding for the CBB reserve:

- A General Fund appropriation such as the \$300 million grubstake described earlier in this chapter.
- The Permanent Fund undistributed income account balance of \$353.8 million (June 30, 1983 audited figure).
- The rainy day fund with a June 30, 1983 balance of \$316 million.
- Other State funds such as the Public Employees' and Teachers' Retirement Funds are comparatively large sources of funds that could be invested in the cash-based budgeting program. The State contributions to cover the unfunded liabilities of the Public Employees' and Teachers' Retirement Funds could be reduced from the present level with the corresponding savings available for CBB reserve deposits.

These possible funding alternatives are mentioned here to provide a more complete picture of the many funding methods potentially available for cash-based budgeting. These sources will not be the subject of further analysis in this report.

Obviously, as the Permanent Fund continues to grow over the years, both the inflation-proofing requirement and the earnings capacity of the fund increase. Since the Permanent Fund earnings rate is projected to exceed the inflation rate over this period of time, increasingly larger contributions to the CBB reserve fund are possible, ranging from \$208 million in FY 86 to \$501 million in FY 94. Notice that in the final contribution year (FY 95), only \$163 million need be contributed to the CBB reserve fund in order to reach the target (equal to the 1.5 times the appropriations of the preceding fiscal year). This leaves \$386 million to be distributed as Permanent Fund dividends in that year. Once the need for contributions to the CBB reserve end, the Permanent Fund dividend program would be restored to substantially higher levels.

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- Unlike the General Fund source of contributions to cash-based budgeting, the Permanent Fund earnings approach has the advantage that the level of General Fund appropriations would not be diminished by \$300 to \$400 million per year.
- The major disadvantage of the Permanent Fund earnings source for funding cash-based budgeting is that the dividend distribution program would be eliminated over the 9 to 11-year CBB reserve contribution period.

New Or Higher Taxes. In their quarterly publication, Revenue Sources, the Department of Revenue distinguishes between two broad classes of tax revenues: petroleum taxes and nonpetroleum taxes. Considering that nearly 85 percent of total State revenues come from petroleum taxes and royalties, it is conceivable that additional revenues, sufficient to meet the necessary contributions for the CBB reserve fund, could be raised through increased petroleum taxes. The political feasibility of raising petroleum taxes is, on the other hand, a matter of considerable conjecture, especially in light of the Congressional debate over the need to place a limit on the ability of petroleum

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producing states to increase oil production taxes. Further analysis of this CBB reserve funding option is beyond the scope of this report.

The potential for funding cash-based budgeting by raising existing nonpetroleum taxes is also questionable but for a different reason. Unlike petroleum taxes, nonpetroleum taxes make up such a small portion of total State revenues that only massive increases in tax rates would produce a sufficient amount of additional revenue to cover the cost of funding a CBB reserve fund. Given the January 1984 Department of Revenue estimate of all nonpetroleum tax revenue at about \$131 million, tax rates would have to be three or four times higher than existing rates in order to meet CBB reserve contribution requirements of between \$300 million and \$420 million per year. It appears unlikely that nonpetroleum tax bases could sustain such high increases in tax rates.

A more promising possibility for funding cash-based budgeting would be through the imposition of a new tax or the resurrection of an old tax such as the individual income tax (repealed in 1980). Although deserving of careful analysis in order to produce an accurate measure of the potential of a newly imposed State individual income tax, a rough estimate based on earlier data collections would place the revenue generating potential of this tax in the vicinity of \$136 million for FY 85.¹⁴ Ignoring the obvious political considerations, a reinstated individual income tax appears to have sufficient revenue generating potential to fund cash-based budgeting by FY 94.

Combination Of Revenue Sources. A simple alternative to relying on a single source of revenues for the funding of cash-based budgeting is to combine sources. A combination of General Fund unrestricted revenues, Permanent Fund earnings, and revenues from a reinstated State individual income tax would clearly be sufficient to cover the funding requirements of cash-based budgeting, based on the preceding analysis. A combination source approach to cash-based budgeting would have the decided benefit of mitigating the impact of CBB reserve contributions on the capital budget or the Permanent Fund dividend program inherent in programs which rely solely on a single revenue source such as General Funds or Permanent Fund earnings.

¹⁴This estimate was reported in an April 20, 1982, memorandum from the Research Section of the Department of Revenue entitled "Alternative Means of Increasing Nonpetroleum Revenues."

Other partial funding options for cash-based budgeting include various forms of front-end funding for the CBB reserve:

- A General Fund appropriation such as the \$300 million grubstake described earlier in this chapter.
- The Permanent Fund undistributed income account balance of \$353.8 million (June 30, 1983 audited figure).
- The rainy day fund with a June 30, 1983 balance of \$316 million.
- Other State funds such as the Public Employees' and Teachers' Retirement Funds are comparatively large sources of funds that could be invested in the cash-based budgeting program. The State contributions to cover the unfunded liabilities of the Public Employees' and Teachers' Retirement Funds could be reduced from the present level with the corresponding savings available for CBB reserve deposits.

These possible funding alternatives are mentioned here to provide a more complete picture of the many funding methods potentially available for cash-based budgeting. These sources will not be the subject of further analysis in this report.

CHAPTER THREE

NEAR-TERM IMPLEMENTATION OF CASH-BASED BUDGETING

Two methods by which cash-based budgeting could conceivably be implemented soon after voter approval are by a loan from the Permanent Fund and by bonding. Since the Alaska Constitution (Article 9, Section 8) presently prohibits the State from incurring debt except for voter approved capital construction projects, both the Permanent Fund loan and bonding methods of funding cash-based budgeting would require the passage of Constitutional amendments.

Under either option, the reserve required for initiation of cash-based budgeting for FY 86 is \$4.829 billion as shown in Table 7. With a reserve fund of this size, the FY 86 budget could be prepared with appropriations limited to the amount of revenues collected in the previous calendar year (1984). Beginning with the FY 86 budget, appropriations would have to be made each year to service the \$4.829 billion debt owed either to the Permanent Fund or to the bond buyers.

Table 7
Cash-Based Budgeting Reserve Fund Requirements
(for CBB start-up on any fiscal year through FY 90)

<u>Fiscal Year</u>	<u>Projected Revenues (\$millions)</u>	<u>CBB Reserve Requirement* (\$millions)</u>
1986	\$3,365	\$4,829
1987	3,729	5,048
1988	3,711	5,594
1989	4,068	5,567
1990	3,880	6,102

*Reserve requirements for near-term start-up of cash-based budgeting are equal to 1.5 times the appropriations of the preceding fiscal year. Appropriations are assumed to equal revenue projections.

Source: Department of Revenue 30th percentile forecast (Jan. 1984).

Prepared by: House Research Agency

NEAR-TERM IMPLEMENTATION

Permanent Fund Loan

Except for problems associated with the liquidity of Permanent Fund investments, the Permanent Fund principal provides a potential source of funds for initiation of cash-based budgeting.¹⁵ A recent Department of Revenue forecast projects a \$5.3 billion balance in the Permanent Fund at the beginning of FY 86. This means that the required loan to the CBB reserve fund would nearly exhaust the investment potential of the Permanent Fund.

An immediate question is what would this do to Permanent Fund dividend distributions. Assuming that the interest rate on the loan were allowed to float from year to year at the average rate of return of all other Permanent Fund investments, the effect would be negligible. In this vein, the CBB reserve fund loan can be thought of as just another investment of Permanent Fund principal, anticipated to provide a reasonable rate of return. Since the dividends are dependent only on the total earnings of the Permanent Fund investments, and not on the balance in the fund, the annual dividends would remain unchanged.

A schedule of estimated loan repayments to the Permanent Fund once cash-based budgeting begins is shown in Table 8. This repayment schedule assumes monthly payments at an interest rate on the unpaid balance of 10 percent per annum.¹⁶

¹⁵It is likely that some Permanent Fund investments would not be immediately convertible to the cash-based budgeting reserve. The full CBB reserve requirement may not be available for 2 to 3 years. Consequently, the FY 86 CBB implementation presented above should be thought of as the most optimistic case, especially when it is noted that with each year delay, the CBB reserve requirement grows as shown in Table 7.

¹⁶Officials of the Alaska Permanent Fund Corporation have expressed the point of view that a 10 percent rate of return on a loan to fund cash-based budgeting is too low in comparison to the rate that would be expected on the open market. They suggest that a true market rate of 12.5 to 13 percent is more appropriate for an investment of comparable risk to the CBB reserve loan. With market interest rates, the annual debt service on a Permanent Fund loan would be increased by about \$84 million assuming a 7-year loan maturity.

Table 8
Cash-Based Budgeting
Annual Permanent Fund Loan Repayments Beginning FY 86
(millions of dollars)

<u>Repayment Period (years)</u>	<u>Final Payment</u>	<u>Annual Debt Service To Permanent Fund</u>	<u>Annual GF Contribution Beyond Added Earnings Capacity of General Fund</u>
6	FY 91	\$1,073.5	\$591
7	FY 92	962.0	479
8	FY 93	879.3	396
9	FY 94	815.8	333
10	FY 95	765.8	283

Prepared by: House Research Agency

Assuming a 10 percent rate of return on investments, a Permanent Fund loan of \$4.829 billion to the General Fund would increase the earnings capacity of the General Fund by \$482.9 million. Consequently, \$482.9 million of the annual debt service can be covered by the increased General Fund earnings. The remaining debt service for various loan maturities is shown in the last column of Table 8. These residual debt service amounts can reasonably be compared to the annual General Fund contributions to the CBB reserve discussed earlier under the deferred implementation option to cash-based budgeting.

A serious drawback to the Permanent Fund loan approach is the precedent that such a use of the Permanent Fund principal would set. The Alaska Constitution makes no prescriptions for the use of the Permanent Fund with respect to State government budgeting practices. The only reference to uses of the fund relate to constraints on the type of investments of Permanent Fund principal ("... the principal of which shall be used only for those income-producing investments specifically designated by law ..." [Article IX, Section 15]).

A loan from the Permanent Fund to the CBB reserve fund could be viewed as a simple transfer of money from one of the State's pockets to another. It is more likely, however, that the bond market would view such a loan as general obligation debt of the State. Consequently, a \$4.829 billion debt to the Permanent Fund would eliminate further debt capacity (for capital construction projects) during the entire period that the Permanent Fund loan was being repaid.

Moreover, there would be a serious threat that the State's bond rating would drop from the current AA rating to A or A-. This fall in the State's bond rating would affect all State agencies which rely on bond sales for program operations. Consequently, agencies such as the

NEAR-TERM IMPLEMENTATION

Alaska Housing Finance Corporation, the Alaska Power Authority, the Alaska Industrial Development Authority, the Municipal Bond Bank, etc., would find themselves paying a higher interest rate on all bonds sold during the Permanent Fund loan repayment period.

The Permanent Fund loan approach to funding cash-based budgeting is also potentially vulnerable to legal challenge under the "prudent man rule." According to AS 37.13.120, "the prudent-man rule as applied to investments of the corporation means that in making investments the board shall exercise the judgment and care...which an institutional investor of ordinary prudence, discretion, and intelligence exercises in the management of large investments..."

Under this rule, an Alaskan resident or organization could challenge the \$4.829 billion Permanent Fund loan under the following considerations:

- AS 37.13.120 (c) requires the Permanent Fund Corporation board to "maintain a reasonable diversification among investments." Clearly, a loan encompassing over 80 percent of total Permanent Fund assets falls short of the diversification requirement.
- AS 37.13.120 (L)(1) permits in-state investments only when the investments "have a risk level and expected yield comparable to alternate investment opportunities." A loan repayment to the Permanent Fund based on a market rate of 12.5 to 13 percent would presumably meet the yield requirement of this section, while a lower rate could be construed as a subsidy to the General Fund.
- Considering that the creation of the Permanent Fund was intended to provide financial support to the State after oil revenues are depleted, there is a considerable question as to whether a loan to the State General Fund meets the test for comparable risk to other investments. A Permanent Fund loan to the State treasury is consequently a paradoxical investment policy since the State's ability to repay the loan is in large measure dependent on oil revenues.

Bonding

An alternative to the Permanent Fund loan approach which potentially offers an immediate or near-term start-up of cash-based budgeting is the sale of bonds. Presumably, if \$4.829 billion in bonds could be sold to finance the CBB reserve fund, cash-based budgeting could be started immediately, followed by a debt service plan very much like the schedule considered for Permanent Fund loan repayment.

The difficulty with the bonding approach is that the State's debt capacity may not be sufficient to accommodate the CBB reserve requirement of \$4.829 billion. According to a recent report, the State has presently exhausted its capacity to incur further debt.¹⁷ The report suggests that an additional \$1.2 billion in debt could potentially be incurred by the State through FY 90 only by doubling its current debt service to revenue ratio. Recommendations against such an increase in the debt service/revenue ratio were made in the report since the State's AA bond rating would be in jeopardy under such a move.

A further problem arises due to Internal Revenue Service (IRS) constraints on tax-exempt bond sales which forbids financial arbitrage. This means that revenues raised through tax-exempt bond sales may not be reinvested at interest rates higher than those applying to the sale of the bonds. This restriction could seriously hamper the investment alternatives of the General Fund balance and increase the relative cost of this approach to cash-based budgeting.

Although the bonding alternative presents serious obstacles as a source for full funding of cash-based budgeting, bonds could offer a means of supplementing revenues from other sources. Aside from the sale of conventional general obligation bonds, the State could potentially offer up to \$600 or \$700 million in one-year revenue bonds at a 6 percent tax-exempt rate. Revenue bonds would have to be repaid within one year but offer a low-cost borrowing option for upfront funding. Moreover, IRS arbitrage restrictions are generally not strictly enforced on revenue bond sales. This means that funds generated by this method could conceivably be invested at higher market rates of around 12 or 13 percent.

In summary, although the Permanent Fund loan and bonding alternatives offer the advantage of a near-term start-up of cash-based budgeting, or the prospect of a relatively low-cost source for supplementary front-end funds, they appear to present serious difficulties with respect to the bonding capacity of the State and potential legal problems.

¹⁷See the August 1983 report prepared by Government Finance Research Center (Municipal Finance Officers Association), Washington D.C. entitled A Review of Debt Capacity and Debt Management for the State of Alaska.

CHAPTER FOUR

THE FISCAL MANAGEMENT BENEFITS AND LIMITATIONS OF CASH-BASED BUDGETING

The original intent of legislation proposing cash-based budgeting was to create a budgeting system in which the revenues available for appropriation were known in advance of preparing the budget. With sufficient revenues in the CBB reserve fund, appropriations can be limited, under cash-based budgeting, to the total revenues actually collected in the previous calendar year. In this way, the legislature will know by the start of the session precisely how much money can be appropriated in the budget that they will prepare. However, cash-based budgeting is more than a simple mechanism for dealing with revenue uncertainty.

Prohibition Against Deficit Spending

At present, State law does not prohibit deficit spending in the manner of the various "balanced budget" laws enacted recently in other states.¹⁸ Nevertheless, if cash-based budgeting were enacted by a constitutional amendment, a very specific prohibition against deficit spending would become part of State law. Deficit spending under cash-based budgeting is prohibited because appropriations are limited to cash on hand. The only exception to this prohibition against deficit spending (which also applies to the contraction of State debt) would be "for the purpose of repelling invasion, suppressing insurrection, defending the state in war, meeting natural disasters,..."

Fiscal Restraint

Cash-based budgeting is a device for instituting fiscal restraint in the budgetary process in two ways. In the first case, because annual appropriations of between \$300 and \$420 million would effectively be taken off the top of the revenue stream, fewer funds would be available for appropriation for other purposes during the years when contributions

¹⁸The Alaska Constitution (Article IX, Section 8) does prohibit the State from incurring debt except for the purposes of funding capital improvements which have been approved by a majority of qualified voters. Furthermore, The Executive Budget Act (AS 37.07.020 c) states that "proposed expenditures may not exceed estimated revenues for the succeeding fiscal year."

BENEFITS AND LIMITATIONS

or debt service payments were being made.¹⁹ Relative to Governor Sheffield's recommended capital budget for FY 85 totaling about \$1 billion (including the \$300 million major projects fund), CBB reserve fund contributions would represent roughly one-third of this annual capital budget figure.

A second form of fiscal restraint provided by cash-based budgeting relates to the delay between the time that a major revenue fluctuation might occur and the point at which those revenues might be appropriated. For example, if a major oil field would be expected to begin production in the coming fiscal year, this might substantially increase the revenues projected for that fiscal year. Unlike present budgeting practices, however, the legislature would be prohibited from raising appropriations for the coming fiscal year in anticipation of these revenues, since under cash-based budgeting, appropriations are limited to revenues collected in the prior calendar year.

Of course, one year later, the increased revenues caused by higher oil production levels could be rolled into the budget for the following fiscal year. Consequently, the form of fiscal restraint imposed by cash-based budgeting has only a temporary effect created by delaying access to revenues for one year.

CBB Effects On Declining Revenues

It is important to view cash-based budgeting in the larger context of the long-term financial prospects of the State. The central question from this perspective is how would cash-based budgeting affect State finances in view of a projected revenue decline?

- Although cash-based budgeting resolves the "revenue uncertainty" problem for budgeting purposes on a year-to-year basis, it does not eliminate the considerable uncertainty concerning how the State will budget "within its means" during a period of projected declining revenues.

¹⁹On the other hand, it should be realized that in addition to the capital projects potentially foregone as a consequence of annual contributions to the CBB reserve, there are the opportunity costs associated with these foregone appropriations. Examples of these opportunity costs include lost momentum in accelerating sectors of the fisheries, mining, timber, coal, or tourism industries that might have come with new harbors, highways, railroad spurs, and airports, or increased loans for businesses or resource enhancement. A slowing of efforts to upgrade health standards across the State through upgraded water and sewage systems, are other potential opportunity costs of funding a cash-based budgeting system.

BENEFITS AND LIMITATIONS

- On the other hand, cash-based budgeting would mitigate the impact of declining revenues by supplementing total revenues with interest earnings on the CBB reserve balance. After cash-based budgeting begins, the General Fund would be increased by the transfer of the CBB reserve fund (projected to be about \$4.5 billion by FY 94). Assuming an average investment earnings rate of 10 percent, the General Fund should generate an additional \$450 million each year as a consequence of this transfer.
- During the period when contributions are being made to the CBB reserve fund (FY 86 through FY 93), revenues available for appropriation would be diminished by the amount of annual contributions (between \$300 and \$420 million). This effective reduction in revenues potentially makes government growth more difficult. To the extent that government growth is curbed during the CBB contribution period, the adjustment to a period of declining revenues should require somewhat less drastic measures than would be necessary if further growth were permitted.
- Should a dramatic drop in revenues occur during a single year, cash-based budgeting would provide a one-year delay in the impact of that decline before a fiscal adjustment would have to be made. Under cash-based budgeting, revenues must accumulate in the General Fund over a full calendar year before they are made available for appropriation, thus providing a cushion of time in which to react to changes in revenue trends. However, the effect of a dramatic fall in revenues cannot be avoided under cash-based budgeting, only deferred for one year.
- As a savings account to mitigate the impact of declining revenues in the future, cash-based budgeting offers little that is not offered by the Permanent Fund. Moreover, the earnings rate on funds set aside by cash-based budgeting may not match the rate possible on investments of the Permanent Fund. In the event that revenues fell sharply over a period of a few years, funds reserved under cash-based budgeting would have to be readily available to cover previously made appropriations of these funds. Consequently, investments of cash-based budgeting reserve funds must remain fairly liquid for this purpose, which means that the investment options of CBB funds and possible rates of return would be somewhat limited in comparison to Permanent Fund investments.
- The only advantage of cash-based budgeting over the Permanent Fund for this purpose is that the budgetary support function would presumably be more clearly spelled out in the enacting Constitutional provisions of cash-based budgeting.

BENEFITS AND LIMITATIONS

Uncertainty In The Allocation Process

Knowing exactly how much money is available for appropriation each year is different from the task of allocating available funds. Even though the size of the pie will be known under cash-based budgeting, the problems of dividing up the pie will still require difficult political decisions. For local governments and school districts, which rely on State appropriations to finalize their budgets, uncertainty over revenues would remain until the legislative allocation process is complete. This source of revenue uncertainty will become an increasing problem for local jurisdictions during a period of declining revenues as a consequence of increasingly intense competition among contenders for a piece of the budget pie.

The Constitutional provision (Article IX, Section 16) which stipulates that no less than one-third of the total annual appropriation must be reserved for capital projects and loans introduces additional allocation uncertainty under cash-based budgeting. During the years when General Fund contributions are being transferred into the CBB reserve fund, the remaining revenues available for appropriation are consequently diminished by the amount of the contribution. As total State revenues begin to decline around 1990, it is possible that the Constitutional constraints on the allocation of total appropriations may cause part of the burden of funding the CBB contribution to be borne by the Operating Budget since one-third of the total funds are reserved for the Capital Budget and loans.

Revenue Stability - Smoothing

With the start of cash-based budgeting, an element of revenue stability would be introduced to the extent that revenues needed to cover future appropriations will be "in the bank." However, cash-based budgeting would do nothing to smooth out an erratic revenue stream (including both sharp increases and dramatic drops) since revenues would presumably be appropriated at the same level in which they were received 18 months earlier.

The cash-based budgeting program outlined in this report could be modified so that appropriation levels would follow smooth trends. The appropriation level could be tied to an average of revenues estimated for several years into the future. On the other hand, the appropriation level could be a function of the average appropriations over the past several years. Unfortunately, both smoothing techniques present substantial problems:

- When tied to an estimated average of future revenues, the smoothing technique defeats the purpose of cash-based budgeting, which is to eliminate the need to base budget preparation plans on forecasts of future revenues.

- When based on the average of past appropriation levels, the smoothing feature of cash-based budgeting fails to be effective under declining revenues. During a period of declining revenues, the average of past appropriations will always be higher than the amount of revenues available for appropriation in the coming budget year (if one assumes that all revenues are appropriated each year). In this instance, no smoothing will occur since the appropriation level each year will exactly track the revenues received.

Cash-Based Budgeting As An Expenditure Limitation²⁰

The expenditure limitation concept inherent in cash-based budgeting is simply that appropriations are limited to cash on hand (revenues actually collected during the prior calendar year). Therefore, cash-based budgeting does not limit expenditures in the conventional sense. Expenditure limitation measures normally constrain appropriations to a level adjusted to account for changes in demand for government services (changes in population) and for changes in the cost of goods and services used by government (inflation). By contrast, the expenditure limit imposed by cash-based budgeting is simply bound to increases or declines in total State revenues which are in turn predominately dependent on changes in the price and production level of petroleum.

The Role of Cash-Based Budgeting in Fiscal Management

The potential for cash-based budgeting to serve as a fiscal management tool for addressing the concerns of deficit spending, fiscal restraint, expenditure limitation, revenue stability and the uncertainty of budgeting in a period of declining revenues has been outlined in this chapter. However, the concept of fiscal management requires an analysis of long-term budgeting considerations that should be a companion to this analysis of cash-based budgeting.

A conclusion which can be drawn from this report is that a comprehensive fiscal management analysis which examines all of the management tools at the State's disposal should be undertaken.

²⁰The concept of cash-based budgeting as an expenditure limitation mechanism discussed here relates only to those characteristics inherent in the concept of cash-based budgeting. CS HJR 39 contains two expenditure limitation provisions which differ from the concept described here. One of these provisions addresses the conventional link to population and inflation changes.

Appendix A

LEGISLATIVE INTEREST IN CASH-BASED BUDGETING

Legislative interest in cash-based budgeting in recent years has centered around two bills: HB 477 (1979) and HJR 39 (1983). These initiatives came in response to considerable legislative concern over the turmoil surrounding the budgetary process resulting from unprecedented volatility in revenue forecasts.

HB 477

As early as 1979, legislation was introduced to implement a forward funding plan. The bill would have established a "budget and appropriations reserve account" and required annual appropriations to this account equal to 15 percent of the average gross receipts of the General Fund. These appropriations would have been required from 1980 until 1986, when the budget and appropriations reserve account would have been roughly equal to the prior year's budget. Beginning with FY 87, this account would lapse into the General Fund and the budget from that point on would have been based on revenues collected during the previous fiscal year.

HB 477 made little progress during the 1979 session, but by FY 82, interest in forward funding had revived when nearly 90 percent of the State's revenues were generated by levies on oil and gas production and the volatility of oil prices resulted in substantial uncertainty over future State revenues. In the three-month period from December 1981 to March 1982, the Department of Revenue forecast of FY 83 petroleum revenues fell nearly 40 percent from \$3.6 billion to \$2.2 billion. This unexpected, large drop in forecast revenues forced the legislature and the administration to make major, rapid revisions and spending reductions in the FY 83 budget. In addition, \$1 billion in FY 82 special Permanent Fund contributions was deferred to avoid a deficit in that year.

The unexpected decline in revenues and uncertainty over future income at the State level was in turn felt throughout Alaska. Local governments, school districts and other organizations which receive major State support found their funding levels difficult to predict until the FY 83 budget was finally enacted.

LEGISLATIVE INTEREST

In order to provide more certain revenue forecasts for budget purposes, the Department of Revenue modified its forecast presentation for FY 84 so that there would be only a 30 percent chance of revenues falling lower than their forecasts. Before this change, the department had issued forecasts which had a 50 percent chance of being too high. The more conservative estimates are termed the "risk-adjusted forecast" by the department, recognizing the substantial risk of lower oil prices and revenues and the negative effects that unexpected revenue declines have on the State budget process.*

In spite of the efforts of the administration to deal with the revenue uncertainty problem, the legislature continued to search for a solution which insures stability in the budgetary process.

HJR 39 (Cash-Based Budgeting)

The most recent legislative activity dealing with revenue uncertainty came with the introduction of HJR 39 in March 1983. HJR 39 would place a constitutional amendment to establish a cash-based budgeting system on the November 1984 ballot. If approved by the voters, two new sections would be added to the Alaska Constitution. The first section would establish an "appropriation reserve fund" and specify how the reserve fund is to be used. The second section would require the legislature to appropriate 15 percent of the General Fund revenues to the appropriations reserve fund each year for seven years, from FY 86 to FY 92. At the end of the seven-year period, the reserve would be large enough to fund the State's entire budget for the following year.

On July 1, 1992 (the start of FY 93), the transition to cash-based budgeting would be made, and only the amount of money contained in the appropriations reserve fund as of this date could be spent during the fiscal year (certain exceptions would be made for wars, natural disasters and other cases). After this date, all State revenues would be placed in the reserve fund, and at the end of each succeeding fiscal year the balance of the reserve fund would lapse into the treasury. HJR 39 made no mention of the investment of reserve fund holdings or of the disposition of interest earnings resulting from the investments.

Using the Department of Revenue January 1984 revenue projections, the provisions of HJR 39 are translated into dollar terms on Table A1.

Two projections of the implications of HJR 39 are shown; one for the 30th percentile revenue projection and another for the mean revenue

*Most other governments rely on 50th percentile revenue projections for budget purposes.

projection. Notice that the cash-based budgeting (CBB) reserve contributions are shown in the far right column, with the reserve fund totals indicating the funds available for expenditure when cash-based budgeting commences in FY 93. Specifically, under the provisions of HJR 39, \$3.779 billion will be available for expenditure in FY 93 assuming a 30th percentile revenue forecast, while \$4.249 billion would be available in the CBB reserve fund assuming a mean revenue forecast.

Table A1

HJR 39 RESERVE FUND CALCULATIONS
(millions of dollars)

Fiscal Year	Unrestricted General Fund Revenues	4-Year Moving Average Revenues	15 Percent Revenue Contribution
1982	4,174		
1983	3,624		
1984	3,233		
1985	3,219		
1986	3,365	3,563	534
1987	3,729	3,360	504
1988	3,711	3,387	508
1989	4,068	3,506	526
1990	3,880	3,718	558
1991	3,582	3,847	577
1992	3,536	3,810	572
1993	3,405		3,779 (Total)

(Based On A 30th Percentile Revenue Projection)

1982	4,174		
1983	3,625		
1984	3,331		
1985	3,432		
1986	3,697	3,641	546
1987	4,170	3,521	528
1988	4,278	3,658	549
1989	4,848	3,894	584
1990	5,077	4,248	637
1991	4,886	4,593	689
1992	4,828	4,772	716
1993	4,947		4,249 (Total)

(Based On A Mean Revenue Projection)

HJR 39 requires that contributions to the reserve fund begin in FY 86 and continue for 7 years. The reserve fund contributions are calculated as 15% of the average revenues from the 4 preceding years. No provisions are made for investment earnings on the reserve fund balance.

Original sponsors: Hayes, Aboud,
Barnes, et al

IN THE HOUSE

BY THE STATE AFFAIRS COMMITTEE

CS FOR HOUSE JOINT RESOLUTION NO. 39 (State Affairs)

IN THE LEGISLATURE OF THE STATE OF ALASKA

THIRTEENTH LEGISLATURE - SECOND SESSION

Proposing amendments to the Constitution of the State of Alaska creating an appropriation reserve fund and limiting increases in appropriations.

BE IT RESOLVED BY THE LEGISLATURE OF THE STATE OF ALASKA:

* Section 1. Article IX, sec. 16, Constitution of the State of Alaska, is repealed and reenacted to read:

SECTION 16. APPROPRIATION LIMITATIONS. Except for appropriations to the Alaska permanent fund and appropriations required to pay the principal and interest on general obligation bonds, appropriations from the treasury during a fiscal year may not exceed the lesser of the amount appropriated in the year this section takes effect adjusted for the cumulative inflation and population growth or decline as defined by law or 95 percent of the unrestricted revenue of the state for the previous calendar year. An appropriation in excess of this limit may not be made unless a state of emergency is declared by the governor as provided by law.

* Sec. 2. Article IX, Constitution of the State of Alaska, is amended by adding a new section to read:

SECTION 17. APPROPRIATION RESERVE FUND. An appropriation reserve fund is established. Appropriations may not be made from the appropriation reserve fund except for the purpose of repelling invasion, suppressing insurrection, defending the state in war, meeting natural disasters, or appropriations required to pay the principal and interest on general obligation bonds. After June 30 of the year in

which the balance of the appropriation reserve fund exceeds 1.5 times the appropriations of unrestricted revenue in the preceding fiscal year, the balance of the appropriation reserve fund shall lapse into the treasury. The balance of the appropriation reserve fund shall be invested at competitive national market rates. All earnings of the fund shall become part of the principal of the fund.

* Sec. 3. Article XV, Constitution of the State of Alaska, is amended by adding a new section to read:

SECTION 29. APPROPRIATION RESERVE FUND. Beginning July 31, 1985, and continuing until June 30 of the year in which the balance of the appropriation reserve fund exceeds 1.5 times the appropriations of unrestricted revenue in the preceding fiscal year, an amount equal to 3.8 percent of the unrestricted revenue for each month, as determined in accordance with this section, shall be transferred from the treasury to the appropriation reserve fund on the first day of the succeeding month. Any balance transferred to the appropriation reserve fund under section 30 of Article XV shall reduce by the balance transferred the amount required to be transferred in a year by the provisions of this section but no excess amount transferred may be carried forward to reduce the amount required to be transferred in another fiscal year.

* Sec. 4. Article XV, Constitution of the State of Alaska, is amended by adding a new section to read:

SECTION 30. APPROPRIATION LIMITATIONS. After June 30, 1986, and until June 30 of the year in which the balance of the appropriation reserve fund exceeds 1.5 times the appropriations of unrestricted revenue in the preceding fiscal year appropriations from the treasury during a fiscal year, except for appropriations to the Alaska permanent fund and appropriations required to pay the principal and

2 interest on general obligation bonds, may not exceed the amount
3 appropriated in the year in which this section becomes effective by
4 more than the cumulative inflation and population growth or decline as
5 prescribed by law. An appropriation in excess of this limit may not
6 be made unless a state of emergency is declared by the governor as
7 provided by law. No less than 25 percent of that portion of the
8 unrestricted revenue of the state which has not been appropriated as
9 allowed by this section shall be transferred from the general fund to
10 the appropriation reserve fund on the first day of each fiscal year
11 during the period defined in this section.

12 * Sec. 5. Section 1 of this amendment takes effect on July 1 of the
13 year in which the balance in the appropriation reserve fund established in
14 sec. 2 of this amendment exceeds 1.5 times the appropriations of unre-
15 stricted revenue in the preceding fiscal year.

16 * Sec. 6. The amendments proposed by this resolution shall be placed
17 before the voters of the state at the next general election in conformity
18 with art. XIII, sec. 1, Constitution of the State of Alaska, and the elec-
19 tion laws of the state.
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Introduced: 3/18/83
Referred: State Affairs and
Finance

BY HAYES, ABOOD, BARNES,
BETTISWORTH, COWDERY, FLOOD,
LISKA, MARTIN, RINGSTAD,
UEHLING, WARD, LINDAUER
AND BUSSELL

1 IN THE HOUSE

2 HOUSE JOINT RESOLUTION NO. 39

3 IN THE LEGISLATURE OF THE STATE OF ALASKA

4 THIRTEENTH LEGISLATURE - FIRST SESSION

5 Proposing amendments to the Constitution
6 of the State of Alaska creating an
7 appropriation reserve fund.

8 BE IT RESOLVED BY THE LEGISLATURE OF THE STATE OF ALASKA:

9 * Section 1. Article IX, Constitution of the State of Alaska, is amend-
10 ed by adding a new section to read:

11 SECTION 17. APPROPRIATION RESERVE FUND. An appropriation re-
12 serve fund is established. After July 1, 1992, no money in excess of
13 the balance of the appropriation reserve fund at the close of the
14 preceding fiscal year shall be withdrawn from the treasury except for
15 the purpose of repelling invasion, suppressing insurrection, defending
16 the State in war, meeting natural disasters, or redeeming indebtedness
17 outstanding at the time this section becomes effective. After July 1,
18 1992, all revenue of the State shall be placed in the appropriation
19 reserve fund and the balance of the appropriation reserve fund shall
20 lapse into the treasury at the close of each succeeding fiscal year.

21 * Sec. 2. Article XV, Constitution of the State of Alaska, is amended
22 by adding a new section to read:

23 SECTION 26. APPROPRIATION RESERVE FUND. Beginning with the
24 First Session of the Fourteenth Legislature and continuing through the
25 First Session of the Seventeenth Legislature, the legislature shall
26 annually appropriate from the general fund to the appropriation re-
27 serve fund an amount equal to 15 percent of the average gross receipts
28 of the general fund, as determined in accordance with this section.
29 For the purposes of this section, "average gross receipts of the

1 general fund" is determined by dividing the total amount of money
2 deposited in the general fund and in special accounts within the
3 general fund (other than the appropriation reserve fund) from all
4 sources during the four fiscal years immediately preceding the current
5 fiscal year by four.

6 * Sec. 3. The amendments proposed by this resolution shall be placed
7 before the voters of the state at the next general election in conformity
8 with art. XIII, sec. 1, Constitution of the State of Alaska, and the elec-
9 tion laws of the state.

Introduced: 4/25/79
Referred: Finance

BY HAYES, BARNES, BEIRNE, BETTISWORTH,
BRANSON, CARNEY, ELIASON, FREEMAN,
FULLER, HALFORD, HAUGEN, HURLBERT,
MCKINNON, MALONE, MARTIN, METCALFE,
MILES, MILLER, MONTGOMERY, MOSS,
O'CONNELL, PHILLIPS, RANDOLPH AND
ROGERS

1 IN THE HOUSE

2 HOUSE BILL NO. 477

3 IN THE LEGISLATURE OF THE STATE OF ALASKA
4 ELEVENTH LEGISLATURE - FIRST SESSION

5 A BILL

6 For an Act entitled: "An Act relating to state fiscal procedures; and pro-
7 viding for an effective date."

8 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

9 * Section 1. INTENT. It is the intent of the legislature in establishing
10 the budget and appropriations reserve account in this Act to provide a mech-
11 anism to eventually allow the state to prepare its annual budget based upon
12 revenues that have actually been received during the previous fiscal year
13 rather than basing it upon estimated revenues to be received during the
14 succeeding fiscal year. By placing a portion of the state's annual receipts
15 into the budget and appropriations reserve account for each of the next seven
16 years, it is intended that the amount in the budget and appropriations
17 reserve account will be sufficient to cover all of the state's operating and
18 capital expenses for fiscal year 1987, thus allowing a transitional period in
19 which the receipts deposited in the general fund during fiscal year 1987 will
20 be available to meet the state's operating and capital expenses for fiscal
21 year 1988.

22 * Sec. 2. AS 37.05 is amended by adding a new section to read:

23 Sec. 37.05.156. BUDGET AND APPROPRIATIONS RESERVE ACCOUNT. (a)

24 There is created as a special account within the general fund the budget
25 and appropriations reserve account.

26 (b) The legislature shall appropriate money from the general fund
27 to the budget and appropriations reserve account as provided in (c) of
28 this section. Amounts appropriated to the budget and appropriations
29 reserve account shall be treated as surplus of the general fund and

shall be invested in accordance with AS 37.10.070. Income from investment of the budget and appropriations reserve account shall be deposited in the general fund.

(c) Beginning with the Second Session of the Eleventh Legislature and continuing through the Second Session of the Fourteenth Legislature, the legislature shall annually appropriate from the general fund to the budget and appropriations reserve account an amount equal to 15 per cent of the average gross receipts of the general fund, as determined in accordance with this subsection. Each appropriation shall include a provision stating that the amount appropriated to the budget and appropriations reserve account lapses into the general fund on July 1, 1986, notwithstanding AS 37.25.010. For the purposes of this subsection, "average gross receipts of the general fund" is determined by dividing the total amount of money deposited in the general fund and in special accounts within the general fund (other than the budget and appropriations reserve account) from all sources during the four fiscal years immediately preceding the current fiscal year by four.

* Sec. 3. AS 37.07.020(a) is amended to read:

(a) The governor shall prepare and submit to the legislature before the fourth legislative day a budget for the succeeding fiscal year which shall cover all estimated receipts, including all grants, loans, and money received from the federal government, and all proposed expenditures of the state government. The budget shall be accompanied by a general appropriation bill to authorize the proposed expenditures, and a bill or bills covering recommendations in the budget for new or additional revenues. After July 1, 1986, the budget shall also be accompanied by a statement of all receipts, including all grants, loans and money received from the federal government, deposited in the general fund during the previous fiscal year.

1 * Sec. 4. AS 37.07.020(c) is amended to read:

2 (c) Before July 1, 1985, proposed [PROPOSED] expenditures may not
3 exceed estimated revenues for the succeeding fiscal year. Between
4 July 1, 1985 and July 1, 1986, proposed expenditures may not exceed
5 estimated revenues for the succeeding fiscal year excluding the amount
6 lapsed into the general fund from the budget and appropriations reserve
7 account under AS 37.05.156(c). Between July 1, 1986 and July 1, 1987,
8 proposed expenditures may not exceed the amount lapsed into the general
9 fund from the budget and appropriations reserve account under AS 37.05.-
10 156(c). For fiscal years beginning after June 30, 1987, proposed expen-
11 ditures may not exceed the amount of revenues deposited in the general
12 fund in the preceding fiscal year. The expenditures proposed in the
13 six-year capital improvements program and financial plan shall not
14 exceed the estimated revenues and bond authorizations passed and
15 proposed.

16 * Sec. 5. This Act takes effect July 1, 1979.
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Appendix B

STATE REVENUE FORECAST IN NOMINAL AND FY 84 DOLLARS
(millions of dollars)

Fiscal Year	30th Percent. Rev.Proj.		Excess Revenues		Mean Rev. Proj.		Excess Revenues		Discount Factor
	Nominal \$	FY 84 \$	FY 84 \$	Nominal \$	Nominal \$	FY 84 \$	FY 84 \$	Nominal \$	
1984	3,233	3,233	1,176	1,176	3,331	3,331	1,274	1,274	1.000
1985	3,219	3,037	980	1,039	3,432	3,238	1,181	1,252	0.943
1986	3,365	2,995	938	1,054	3,697	3,290	1,233	1,386	0.890
1987	3,729	3,131	1,074	1,279	4,170	3,501	1,444	1,720	0.840
1988	3,711	2,939	882	1,114	4,278	3,389	1,332	1,681	0.792
1989	4,068	3,040	983	1,315	4,848	3,623	1,566	2,095	0.747
1990	3,880	2,735	678	962	5,077	3,579	1,522	2,159	0.705
1991	3,582	2,382	325	489	4,886	3,249	1,192	1,793	0.665
1992	3,536	2,219	162	257	4,828	3,029	972	1,549	0.627
1993	3,405	2,015	-42	-70	4,947	2,928	871	1,472	0.592
1994	3,290	1,837	-220	-394	4,995	2,789	732	1,311	0.558
1995	3,195	1,683	-374	-710	4,762	2,509	452	857	0.527
1996	3,033	1,507	-550	-1,106	4,632	2,302	245	493	0.497
1997	3,092	1,450	-607	-1,295	4,886	2,291	234	499	0.469
1998	3,159	1,397	-660	-1,492	4,992	2,208	151	341	0.442
1999	3,213	1,341	-716	-1,717	5,056	2,110	53	126	0.417
2000	3,245	1,277	-780	-1,980	5,131	2,020	-37	-94	0.394

Nominal dollar revenue forecasts are Department of Revenue projections released January, 1984.

FY 84 Operating Budget = \$2,057 million

Discount Factor assumes 6% inflation rate.

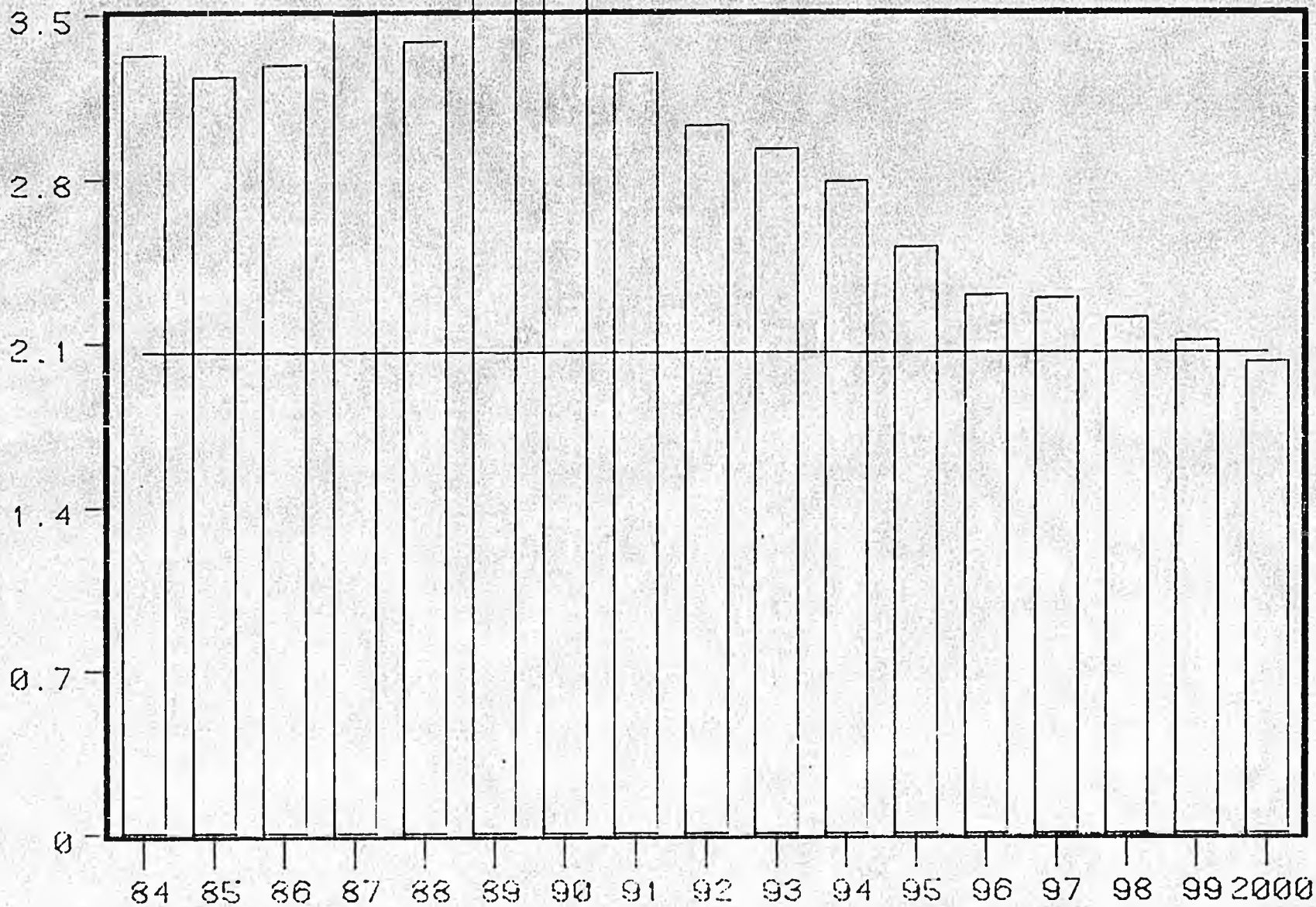
FY 84 \$ revenue projection = nominal amount x discount factor.

FY 84 \$ excess revenues = revenues (84\$) - Operating Budget.

Nominal \$ excess revenues = FY 84 \$ excess revenues / discount factor.

TOTAL REVENUES VS. OPERATING BUDGET

(1984 DOLLARS)



\$ BILLIONS
-72-

MEAN REVENUE PROJ
FY84 OPER. BUDGET FISCAL YEARS

Appendix C

YEAR-END GENERAL FUND UNAPPROPRIATED BALANCE CONTRIBUTION

Of the three cash-based budgeting contribution mechanisms, the percentage of the year-end General Fund unappropriated balance is the most difficult to model. A presumption could be made that on the average, the amount contributed to the CBB reserve under this mechanism is roughly equal to the difference between the Department of Revenue mean forecast and their 30th percentile revenue forecast. This estimate is possible if the legislature consistently budgeted using the 30th percentile forecast as an appropriation ceiling. However, it must be recognized that the 30th percentile forecast and the mean forecast tend to converge as the projection period shortens.

For example, by comparing the 30th percentile and mean forecasts shown in Appendix B, one can see that the forecasts for FY 84 (\$3,233 and \$3,331 million respectively) differ by only 3 percent. However, the forecasts for FY 2000 (\$3,245 and \$5,131 million respectively) differ by 58 percent. Put simply, the closer one gets to a forecast period, the greater the certainty that one can have over the revenue estimate for that year.

Taken one year at a time, the difference between the 30th percentile and mean forecasts made by the Department of Revenue should be fairly small, resulting in a modest General Fund balance on the average from which a percentage contribution to the reserve can be made. The most that can be said is that contributions from this mechanism could potentially cause the size of the CBB reserve fund to grow sufficiently large so that cash-based budgeting could be started one year earlier than it otherwise would.

For example, assuming that on the average, the actual revenues received exceeded the level of appropriations each year by about 5 percent, a 25 percent contribution of unappropriated General Fund balance would add approximately \$45 million each year to the CBB reserve fund. Over an eight-year contribution period, this mechanism would have an impact on the reserve fund roughly equivalent to the \$300 million grubstake contribution shown in Table 4.

Appendix D

Scenario 1

THE GENERAL FUND AS A REVENUE SOURCE FOR CASH-BASED BUDGETING
Based on a Mean Revenue Projection
(millions of dollars)

Fiscal Year	DOR	Revenue	Potential	General	GeneralCash-Based Budgeting Reserve Fund....		
	Revenue Forecast	Under CBB	Expenditure Level	Fund Earnings	Fund Balance	Contributions	Earnings	Balance
1981	3,769		3,769	201	2,010			
1982	4,174		4,174	254	2,540			
1983	3,625		3,625	266	2,660			
1984	3,331		3,331	300	3,000			
1985	3,432		3,432	250	2,500			
1986	3,697	3,316	3,316	259	2,590	380.8	18	399
1987	4,170	3,740	3,740	288	2,880	429.5	62	890
1988	4,278	3,837	3,837	288	2,880	440.6	114	1,445
1989	4,848	4,349	4,349	318	3,180	499.3	175	2,119
1990	5,077	4,554	4,554	301	3,010	522.9	247	2,889
1991	4,886	4,383	4,383	275	2,750	503.3	326	3,718
1992	4,828	4,331	4,331	270	2,700	497.3	413	4,628
1993	4,947	4,437	4,437	258	2,580	509.5	509	5,646
1994	4,995	4,481	4,481	247	2,470	514.5	615	6,776
1995	4,762	5,419	4,971	693	9,584			
1996	4,632	5,297	5,207	887	9,534			
1997	4,886	5,570	5,358	909	9,776			
1998	4,992	5,700	5,434	937	10,083			
1999	5,056	5,777	5,635	952	10,245			
2000	5,131	5,864	5,739	965	10,380			

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- 2 Department of Revenue January, 1984 revenue projection.
- 3 Revenues after effects of cash-based budgeting program. During the CBB reserve contribution period, revenues (column 3) are equal to DOR projections minus annual CBB contributions. Starting with the first cash-based budgeting year, revenues (column 3) are equal to DOR projections plus additional earnings which accrue to the general fund as a result of transferring the CBB reserve fund balance to the general fund.
- 4 Expenditure levels are presently limited to projected revenues (ignoring the Constitutional appropriation limit). Beginning with the first cash-based budgeting year, expenditures will be limited to the revenues collected in the previous calendar year.
- 5 General fund earnings are DOR projections up to the start of cash-based budgeting, at which point the general fund earnings will be augmented due to the increased earnings capacity of the general fund from that point on into the future.
- 6 Beginning with the first cash-based budgeting year, the general fund balance is substantially increased by the transfer of the CBB reserve fund.
- 8 Reserve fund earnings are calculated at a 10 percent annual interest rate compounded monthly.
- 9 The earnings rate of the CBB reserve fund is compounded monthly using a 10% annual interest rate.

This projection is based on a general fund unrestricted revenue contribution of 10.3 percent.

Scenario 2

THE GENERAL FUND AS A REVENUE SOURCE FOR CASH-BASED BUDGETING Based on a Mean Revenue Projection (millions of dollars)

Fiscal Year	DOR Revenue Forecast	Revenue Under CBB	Potential Expenditure Level	General Fund Earnings	General Fund Balance	...Cash-Based Budgeting Reserve Fund....		
						Contributions	Earnings	Balance
1981	3,769		3,769	201	2,010			
1982	4,174		4,174	254	2,540			
1983	3,625		3,625	266	2,660			
1984	3,331		3,331	300	3,000			
1985	3,432	3,132	3,132	250	2,500	300.0	15	315
1986	3,697	3,368	3,368	259	2,590	329.0	48	693
1987	4,170	3,799	3,799	288	2,880	371.1	90	1,154
1988	4,278	3,897	3,897	288	2,880	380.7	139	1,673
1989	4,848	4,417	4,417	318	3,180	431.5	196	2,300
1990	5,077	4,625	4,625	301	3,010	451.9	262	3,014
1991	4,886	4,451	4,451	275	2,750	434.9	336	3,785
1992	4,828	4,398	4,398	270	2,700	429.7	417	4,631
1993	4,947	4,507	4,507	258	2,580	440.3	506	5,577
1994	4,995	4,550	4,550	247	2,470	444.6	605	6,627
1995	4,762	4,338	4,338	236	2,360	423.8	714	7,765
1996	4,632	5,384	4,879	974	10,490			
1997	4,886	5,694	5,073	1,033	11,141			
1998	4,992	5,826	5,539	1,063	11,469			
1999	5,056	5,903	5,760	1,078	11,632			
2000	5,131	5,990	5,865	1,091	11,767			
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)

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- 2 Department of Revenue January, 1984 revenue projection.
- 3 Revenues after effects of cash-based budgeting program. During the CBB reserve contribution period, revenues (column 3) are equal to DOR projections minus annual CBB contributions. Starting with the first cash-based budgeting year, revenues (column 3) are equal to DOR projections plus additional earnings which accrue to the general fund as a result of transferring the CBB reserve fund balance to the general fund.
- 4 Expenditure levels are presently limited to projected revenues (ignoring the Constitutional appropriation limit). Beginning with the first cash-based budgeting year, expenditures will be limited to the revenues collected in the previous calendar year.
- 5 General fund earnings are DOR projections up to the start of cash-based budgeting, at which point the general fund earnings will be augmented due to the increased earnings capacity of the general fund from that point on into the future.
- 6 Beginning with the first cash-based budgeting year, the general fund balance is substantially increased by the transfer of the CBB reserve fund.
- 8 Reserve fund earnings are calculated at a 10 percent annual interest rate compounded monthly.
- 9 The earnings rate of the CBB reserve fund is compounded monthly using a 10% annual interest rate.

This projection is based on a general fund unrestricted revenue contribution of 8.9 percent.
A 'grubstake' contribution is assumed in this projection for FY 85 in the amount of \$ 300 million.

Appendix E

THE EFFECTS OF DECLINING REVENUES ON STATE OPERATING COSTS

It is unknown at this time what effects projected revenue declines in the 1990s will have on the State Operating Budget. Obviously, the impact of declining revenues on the Operating Budget will depend on the severity of actual drops in petroleum revenues. It will also depend on the availability of supplementary revenue sources such as Permanent Fund earnings or cash-based budgeting reserve earnings. As a measure of how critically projected revenue declines may affect the State Operating Budget if other mechanisms are not employed, this section will focus on how the size of the Operating Budget may be cut to remain within the means of projected revenues.

It should be pointed out that under the conservative Department of Revenue forecast (30th percentile projection), revenues are projected to fall below the amount needed to maintain Operating Budget expenditures at the current level (FY 84) as early as FY 93. If one assumes that the department's mean revenue forecast is more likely to compare to actual revenues received by the State, a shortfall below current Operating Budget levels is not projected to occur until FY 2000.

Consequently, this analysis will focus on the "worse" case 30th percentile forecast. Assuming that neither Permanent Fund earnings nor cash-based budgeting reserve earnings are used to supplement declining revenues, Table E1 shows how simple across-the-board Operating Budget cuts may be reflected in terms of total State employment. It is assumed in this table that a 5% cut in the overall Operating Budget translates into a 5% cut in State employment. On this basis, cuts in the number of State employees would range from a low of 384 in FY 93 to a high of between 1,400 and 1,600 employees for each of the three following years. Again, this projection assumes that as revenues fall from year to year, the Operating Budget will be reduced by a like amount.

Another alternative of the Operating Budget cut approach to keeping the costs of government within the means of the State, involves a gradual cut of the budget over the long term. With this method, the size of the Operating Budget could be slowly reduced so that when projected revenue shortfalls occur, no drastic (large) cuts will be necessitated. Table E2 shows how a 2% Operating Budget cut starting in FY 85 would affect State employment.

Table E1

PROJECTION OF STATE EMPLOYEE POSITIONS CUT
IN PROPORTION TO DECLINING REVENUES
(Assumes A 30th Percentile Revenue Forecast)

Fiscal Year	Projected Revenues	Positions Cut	Percentage Cut	Total Positions
1984	3,233			18,788
1985	3,037			18,788
1986	2,995			18,788
1987	3,131			18,788
1988	2,939			18,788
1989	3,040			18,788
1990	2,735			18,788
1991	2,382			18,788
1992	2,219			18,788
1993	2,015	384	2.0	18,404
1994	1,837	1,626	8.8	16,778
1995	1,683	1,407	8.4	15,372
1996	1,507	1,608	10.5	13,764
1997	1,450	521	3.8	13,244
1998	1,397	484	3.7	12,760
1999	1,341	511	4.0	12,248
2000	1,277	585	4.8	11,664

FY 84 total positions equal full-time equivalent positions.

The projection of positions cut is based on a decrease in the size of State employment in proportion to the decline in the Operating Budget below the present level of \$2,057 million.

This projection assumes no 'real' growth in the Operating Budget prior to the revenue decline.

Table E2

IMPACT OF A 2% ANNUAL CUT IN THE OPERATING BUDGET
ON THE NUMBER OF STATE EMPLOYEES

Fiscal Year	Total Number of State Employees	Positions Cut
1984	18,788	0
1985	18,412	376
1986	18,044	368
1987	17,683	361
1988	17,329	354
1989	16,983	347
1990	16,643	340
1991	16,310	333
1992	15,984	326
1993	15,664	320
1994	15,351	313
1995	15,044	307
1996	14,743	301
1997	14,448	295
1998	14,159	289
1999	13,876	283
2000	13,599	278

FY 84 total number of employees equals full-time equivalent positions.

This projection assumes that a 2% Operating Budget cut translates into a 2% cut in total State employment.

Appendix F

PERMANENT FUND EARNINGS AS A REVENUE SOURCE FOR CASH-BASED BUDGETING Based On A M e a n Revenue Projection (millions of dollars)

Fiscal Year	Perma.Fund Contribs.	Perma.Fund Balance	Perma.Fund Earnings	Inflation Proofing	Perma.Fund Dividend	CBB Reserve Contribs.	CBB Reserve Balance
1986	380	6,045	551	342	0	209	209
1987	433	6,867	626	389	0	237	468
1988	481	7,789	711	441	0	270	784
1989	575	8,866	808	502	0	306	1,168
1990	606	10,040	917	568	0	349	1,634
1991	587	11,264	1,033	638	0	396	2,193
1992	592	12,568	1,156	711	0	445	2,857
1993	621	13,980	1,288	791	0	497	3,639
1994	644	15,502	1,430	877	0	553	4,556
1995	622	17,091	1,581	967	0	614	5,625
1996	622	18,776	1,740	1,063	0	677	6,865
1997	672	20,615	1,911	1,167	744	0	7,551

This projection assumes that the Permanent Fund program is revised as described in Chapter Two. Permanent Fund earnings are based on a real rate of return of 4 %, and an inflation rate of 6 %.

The earnings capacity of the CBB reserve fund alone is sufficient to reach the target amount, consequently, a zero contribution for permanent fund earnings is shown.