

Miscellaneous Taxes

MEMORANDUM

State of Alaska

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SUBJECT: Alternative Means
of Increasing
Revenues

Current revenue projections for fiscal years 1986 through 1988 indicate that revenues generated by petroleum related activities, Oil and Gas Corporate Net Income Tax, Oil and Gas Property Tax, Oil and Gas Severance Tax and Oil and Gas Royalties will comprise over 84 percent of total unrestricted General Fund Revenues for the period. Therefore, state government is presently very dependent on these sources of revenue. In the future as oil production from the Prudhoe Bay field begins to decline, finding sources of additional revenue will become increasingly important. Prudhoe Bay oil production has already peaked and is currently projected to decline from over 1.5 million b/d in fiscal year 1984 to under 300,000 b/d by fiscal year 2000 which represents a compound annual average rate of decline of 10.3 percent. Other North Slope fields which are currently projected to begin producing will only partially offset this decline and total North Slope oil production is currently projected to peak at 1.806 million b/d in fiscal year 1987 and decline thereafter at a compound annual average rate of 10.15 percent with just under 450,000 b/d being produced in fiscal year 2000.⁽¹⁾ These projections are based only on the development of presently known and economically developable reserves. Additional discoveries may be made in the future, but, their development as well as the development of some currently known but high cost reserves is highly dependent on the future growth of real oil prices. In addition, these future discoveries may be made on federal OCS lands from which the state would receive little or no revenues. Future petroleum revenues are therefore both exhaustible and highly uncertain.

The purpose of this memo is to present some alternative means of increasing revenues. Advantages and disadvantages, as well as preliminary estimates of fiscal impact will be outlined for each alternative. It should be noted at the outset, however, that it will be practically impossible to replace petroleum revenues with taxes on

(1) Petroleum Production Revenue Forecast, Quarterly Report December 1985. Alaska Department of Revenue, Petroleum Revenue Division.

individuals or other industrial sectors given the present structure of the Alaskan economy. In fiscal year 1984 the gross wellhead value of North Slope oil production was approximately \$10.6 billion⁽²⁾ while the estimated gross product of all other nongovernmental industrial sectors was only \$8.7 billion and total disposable personal income was \$6.8 billion. In addition, oil production is a very high profit sector and is thus able to support much higher levels of taxation than other more marginal industrial sectors. Also, currently many other industries are supported, directly and indirectly through state government spending of oil revenues, by the oil industry.

The table following on pages three and four summarizes only the projected quantitative impact of these various proposals. In general, the issues which should be considered with respect to measures to increase revenues, i.e., tax law changes are as follows.

Economic Efficiency: What effect does the proposed tax law change have on incentives and economic decision making which may alter consumption, production or resource allocation decisions? Equity: Who bears the burden of the tax and how does that burden compare with ability to pay or benefits received? Is the tax progressive or regressive with respect to income and/or wealth? Elasticity: What is the sensitivity of the tax revenue yield to changes in economic or demographic conditions? As income or population increase and decrease does tax revenue increase or decrease in greater, lesser or equal proportion? Administrative Efficiency: How costly is the tax to administer in terms of resources devoted to administration and compliance relative to the revenue yield of the tax? Who bears the burden of administrative cost, the taxpayer, the State or the tax collector if different from the State? Political Feasibility: How acceptable is a proposed tax law change to the legislature and/or the electorate given existing social, political, and economic conditions? Who benefits, who loses, and who has the most political power?

(2) Ibid.

Summary Table
(Millions of Dollars)

<u>Tax</u>	<u>Change</u>	<u>FY</u>	<u>Projected As Is</u>	<u>With Change</u>	<u>Difference</u>
Individual Income Tax	Reenact	86	-	308.9	+308.9
	Old	87	-	330.0	+330.0
	Law	88	-	352.0	+352.0
Individual Income Tax	Enact New	86	-	86.7	+86.7
	Flat Rate	87	-	88.1	+88.1
	Tax	88	-	89.5	+89.5
	Revenue per One Percent Tax Rate				
Corporate Income Tax	Increase	86	249.8	334.6	+84.8
	Rate In	87	266.4	358.9	+92.5
	Upper Income	88	267.9	360.9	+93.0
	Categories (Both Oil and Gas and non Oil and Gas Corp.)				
Business License Tax	Reinstate	86	2.0	33.7	+31.7
	Gross	87	2.0	38.1	+36.1
	Receipts	88	2.0	40.4	+38.4
	Retain 100%				
	In GF, At	86	2.0	55.9	+53.9
	Old Rates	87	2.0	60.0	+58.0
	and With	88	2.0	64.3	+62.3
	Flat Rates				
Alcohol Tax	Double and	86	14.0	27.1	+13.1
	Add CPI	87	14.0	31.9	+17.9
	Inflator	88	14.1	34.8	+20.7
Cigarette Tax	Add CPI	86	5.7	5.7	+0.0
	Inflator	87	7.8	8.7	+0.9
	Cont. 5¢/ Pack to	88	7.8	9.3	+1.5
	School Fund				

(Millions of Dollars)

<u>Tax</u>	<u>Change</u>	<u>FY</u>	<u>Projected As Is</u>	<u>With Change</u>	<u>Difference</u>
Highway Fuel Tax	Double and	86	22.5	41.2	+18.7
	Add CPI	87	22.5	47.5	+25.0
	Inflator	88	23.0	51.5	+28.5
Aviation Fuel Tax	Double &	86	8.0	15.7	+7.7
	Add CPI	87	8.0	16.3	+8.3
	Inflator	88	8.0	17.6	+9.6
Marine Fuel Tax	Double &	86	4.6	8.7	+4.1
	Add CPI	87	4.7	10.8	+6.1
	Inflator	88	4.7	12.4	+7.7
General Sales Tax	Enact	86	-	40.8	+40.8
	With and	87	-	42.5	+42.5
	Without Food	88	-	44.3	+44.3
	Exemption				
	Revenue Per	86	-	67.9	+67.9
	One Percent	87	-	70.8	+70.8
	Tax Rate	88	-	73.8	+73.8
License & Permits	Add CPI	86	38.3	39.7	+1.4
	Inflator	87	39.4	42.6	+3.2
		88	39.7	45.1	+5.4
	Enact	86	38.3	50.6	+12.3
	1% Vehicle	87	39.4	52.2	+12.8
	License Fee	88	39.7	53.1	+13.4
<u>Individual Income Tax</u>					

The Alaska Net Income Tax AS 43.20.011(a)-(d) could be reenacted to apply to individuals. If this were accomplished with the previous progressive rate schedule unchanged, the following amounts of additional revenue could be generated:

	<u>FY 86</u>	<u>FY 87</u>	<u>FY 88</u>
Individual Income Tax (millions \$)	308.9	330.0	352.0

These estimates are based on the most current REVID employment and income projections combined with previously estimated individual income tax equations.

In terms of equity the individual income tax is generally considered the "fairest" tax. The burden or incidence of the tax falls on the individual taxpayer and there is no opportunity for shifting of

incidence as with the corporate income or business type taxes. Given a progressive rate schedule, the tax burden is based on the "ability to pay" principle of taxation and the nominal incidence is progressive. That is, as income level of the taxpayer increases, the nominal tax rate also increases. It should be noted though that state income taxes are deductible when computing taxable income for federal income tax purposes if the individual itemizes deductions. This has the effect of reducing the burden on individuals with higher incomes who are subject to higher marginal rates at the federal level and are also more likely to be in a position to itemize. The effect is to reduce the progressivity of the tax burden at the state level. This effect will be reduced, however, in light of recent scheduled income tax rate reductions enacted at the federal level.

In terms of economic efficiency the effects of the individual income tax on consumption production and resource allocation decisions should be neutral as the tax is applied uniformly to all individuals. However, steeply progressive rates could result in general disincentives to engage in productive economic activity and incentives to shift income to tax sheltered or favored activities. Since the income tax at the state level is small relative to the federal income tax, this effect is not likely to be significant.

The income elasticity of individual income tax revenues, given progressive rates, is greater than one which is to say a given percentage change in income will produce a larger percentage change in tax revenues. Thus, during periods of income growth, individual income tax revenues will increase more than in proportion to the growth and, during periods of income decline, they will fall more than in proportion to the decline. This makes the individual income tax relatively unstable in terms of yield.

Reinstating the individual income tax after dismantling the administrative and compliance functions in the Department of Revenue could involve considerable start up costs. Audit and collection functions would have to be brought back on line. Personnel would have to be hired and trained, computer programs and procedures developed, etc. However, once the initial start up period was completed, administrative and compliance costs similar to previous levels relative to tax collections would probably be achieved.

The Alaska Net Income Tax law as it applies to corporations and as it applied to individuals before those sections were repealed is "piggy backed" on the federal income tax law. This means basically that the starting point for calculating Alaska taxable income is federal taxable income. The Alaska law follows the federal law as far as allowable deductions and exemptions are concerned unless specified otherwise. The state law specifies its own tax rate schedule which is independent of the federal rate schedules. This "piggy backing" has advantages and disadvantages. The advantages are primarily administrative and relate to audit, compliance and collections functions. When the IRS audits returns

and determines that there should be adjustments made they share this information with the state. This lowers the state's audit costs because it reduces the amount of information on a return the state must verify independently. The disadvantage of "piggy backing" is that when federal tax laws are changed relative to deductions and exemptions there may be an impact on state tax collections unless the state changes its tax law accordingly.

An alternative to reenacting the individual income tax as it was previously constituted might be to enact a flat rate tax on individual income allowing for no exemptions or deductions. Such a tax would be relatively simple to audit and would not be tied in any way to federal tax laws. Based on the assumption that the tax base would be individual wage and salary income, proprietor's income and dividend, interest and rental income, current projections of Alaska personal income indicate that such a tax could generate the following amounts of additional revenues per one percent of flat tax rate:

	<u>FY 86</u>	<u>FY 87</u>	<u>FY 88</u>
Individual Income Tax	86.7	88.1	89.5
Flat Rate			
(millions \$)			

These figures show the projected yield from a one percent tax rate so the yield from a higher tax rate can be calculated accordingly.

In terms of equity the incidence of a flat rate no deduction or exemption tax would be proportional with respect to income. That is, as the income level of a taxpayer increases the nominal tax rate remains the same and thus a constant proportion of income is taxed. Also, since no deductions are allowed there is no possibility of lowering the effective rate as is the case under a tax law with a nominally progressive rate schedule but which allows for deductions which can make the effective incidence of the tax much less progressive.

In terms of economic efficiency this type of tax would be more neutral than a progressive tax which allowed for deductions. There would be no incentive to engage in tax sheltered activities and less general disincentive to engage in productive economic activity and thus earn additional income.

The elasticity of the tax would be unitary with respect to income. This means that a given percentage change in income would result in an equal percentage change in tax revenues.

In terms of political feasibility, it is always difficult to reenact a tax after it has been repealed. This is especially so, as in the case of the individual income tax, when the tax was repealed only a short time before and the electorate has just readjusted their expectations accordingly. It is questionable whether the legislature would reenact

any form of the individual income tax unless an extreme fiscal emergency were to arise, such as a severe and prolonged drop in world oil prices.

Corporate Income Tax - Petroleum & Non-Petroleum

Corporate income tax rates could be raised. The existing graduated rate schedule could be extended by adding additional marginal tax rate categories. Presently all taxable income over \$90,000 is taxed at a rate of 9.4 percent for both petroleum and nonpetroleum corporate tax payers under the Alaska Net Income Tax Act, AS 43.20. If additional categories were added such that taxable income between \$1 million and \$4 million would be taxed at 10 percent, taxable income between \$4 million and \$10 million at 11 percent, taxable income between \$10 million and \$100 million at 12 percent, taxable income between \$100 million and \$500 million at 13%, taxable income between \$500 million and \$1 billion at 14% and taxable income over \$1 billion at 15% the following amounts of additional revenues are projected.

	<u>FY 86</u>	<u>FY 87</u>	<u>FY 88</u>
Corporate Income Tax (million \$)	84.8	92.5	93.0

In terms of equity, the corporate income tax is based on the benefit principle of taxation. Corporations benefit from the privilege of doing business in a state and also from government services provided. Therefore, they should pay part of the costs of government. Also, corporations are considered to have an ability to pay taxes separate and distinct from their owners who receive dividends and who are taxed under the individual income tax. This is especially true of modern large scale corporations which command extensive resources and which are controlled by professional managers who may not be equity owners. The actual incidence of the corporate income tax is uncertain and varies among industries and firms depending on market conditions which may constrain shifting of the tax burden. Although the corporation pays the tax, the burden may fall on equity owners, employees, suppliers or consumers of products produced by the corporation. It is, therefore, not possible to say whether the effective incidence is progressive or regressive even with a nominally progressive rate structure. It is possible, however, that at least part of the burden is shifted out of state to nonresident equity owners and consumers. Also, the total burden of state corporate taxes is diminished by the provisions which allow the deduction of state corporate income taxes from taxable income when computing federal taxable income.

The economic efficiency effects of the state corporate income tax should be neutral vis-a-vis consumption and production decisions as it applies uniformly to all corporations. It is possible that extremely high marginal rates could affect locational decisions by industry, all other factors being equal. This is, however, not likely, especially in

Alaska where locational decisions of major industries tend to revolve around proximity to resources.⁽³⁾ Also the state corporate income tax is relatively insignificant when compared to the level of corporate income taxation at the federal level.

The tax yield from the corporate income tax under AS 43.20 is not entirely or even primarily a function of in-state economic activity, i.e., employment, population and income growth. While there are a number of corporate taxpayers who are totally domestic within Alaska, the majority of the tax is collected from multistate nonpetroleum and petroleum corporations. Since these corporations apportion their worldwide income when computing their state tax liability, the elasticity of tax yield relative to economic growth within Alaska is difficult to determine but probably relatively low. That is, the corporate income tax is probably fairly stable relative to changes within the Alaskan economy. Eliminating the recently enacted graduated rate schedule for the lower income categories would tend to make the tax yield even more inelastic, i.e., stable. Continuing the progression of the graduated tax rates to higher income categories into which the petroleum corporate taxpayers fall would tend to increase the elasticity of the tax yield to changes to worldwide petroleum corporation income.

Changing the tax rate schedule would not entail any significant additional administration and compliance costs. It is likely, however, additional resources devoted to audit and collection compliance relative to the corporate income tax would prove cost effective in generating additional collections.

In light of all changes which have been enacted relative to both petroleum and nonpetroleum corporate taxes over the last several years, the political feasibility of enacting another such change should be considered.

Gross Receipts Business License Tax

The gross receipts tax portion of the Alaska Business License Act, AS 43.70, could be reenacted. Currently under AS 43.70 all persons or businesses must purchase annually a business license costing \$25 for the privilege of engaging in a business in the state. Previously, before it was repealed, businesses with certain exceptions paid a tax on their gross receipts equal to one-half of one percent on gross receipts between \$20,000 and \$100,000 and one-quarter of one percent on gross receipts

(3) As reference see the following: State Taxation and Economic Development, Roger J. Vaughan, Council of State Planning Agencies, 1979. Tax Incentives and Capital Spending, Gary From, Ed., The Brookings Institution, 1971.

in excess of \$100,000. If this gross receipts tax were reenacted with previously existing rates, the following additional revenues would be generated:

	<u>FY 86</u>	<u>FY 87</u>	<u>FY 88</u>
Business License Tax (millions \$)	31.7	36.1	38.4

If the gross receipts tax were reenacted but if the previous regressive rate structure were replaced with a flat rate of one-half of one percent on all gross receipts in excess of \$20,000 the additional revenues would be as follows:

	<u>FY 86</u>	<u>FY 87</u>	<u>FY 88</u>
Business License Tax (millions \$)	53.9	58.0	62.3

It should also be noted that the previous gross receipts tax was shared back 60 percent to local incorporated areas where the receipts were earned. If this aspect were also reenacted, the net to the state would be approximately 40 percent of the above amounts.

In terms of equity, the ultimate incidence or burden of the gross receipts business license tax is uncertain due to possible shifting, as is the case with the corporate income tax. The burden may rest variably on the business equity owners, employees, suppliers or consumers. Therefore, the relative progressivity of the tax burden is difficult to determine. However, it should be noted that the previously existing rates were nominally regressive in and of themselves. Part of the burden is probably exported out of state to nonresident owners and consumers. This tax is supposedly levied on a business for the privilege of doing business in the state. However, it has little justification under either the ability to pay or benefit principals of taxation. Under a net income tax both the ability to pay and the benefit a business derives from doing business in the state are considered. Net income, however, is not necessarily a function of gross receipts. A gross receipts tax discriminates against high volume-low profit or low per unit profit operations, especially those which cannot easily shift the tax to consumers due to competition.

If a gross receipts tax is applied uniformly to all business, it should not distort consumer choices or resource allocation. If the rate, however, were increased much above the previous low levels, the tax could have a significant negative effect on marginally profitable businesses.

The elasticity of the tax yield under a gross receipts tax is uncertain. Sales in some industries are more sensitive to economic

expansion and contraction than others, so overall industry composition would affect elasticity. Also, the rate structure has some effect. Under the previous regressive rate structure, the revenue yield would be less elastic than if a flat rate structure were enacted.

Administration of a reenacted business license gross receipts tax would pose no major problems. The business license fee has been kept in effect so the Department has kept track of potential business taxpayers. Some start up, hiring and retraining, costs would be incurred. Also, additional audit and collection resources may have to be devoted especially if rates were increased significantly.

Politically, reenactment of the gross receipts tax is very questionable. The tax was always very unpopular due mainly to equity considerations mentioned above.

Selective Sales and Excise Taxes
Alcoholic Beverage Excise Tax and Cigarette Tax

The excise tax rates under the Tobacco Tax, AS 43.50, and the Alcoholic Beverage Tax, AS 43.60, could be increased. If the alcohol tax rate was doubled and allowed to increase with inflation, the following additions to revenue would result (assuming an annual inflation rate of 5.5 percent in FY 86 and 6.0 percent in FY 87):

	<u>FY 86</u>	<u>FY 87</u>	<u>FY 88</u>
Alcohol Tax (million \$)	13.1	17.9	20.7

The initial increases which would be equal to the present rates per six pack of beer would be 20¢, per liter of wine would be 22¢, and per fifth of liquor would be \$1.12. These would increase with inflation, so by 1987 the cost difference attributable to tax increases would be 24¢ per six pack of beer, 28¢ per liter of wine, and \$1.38 per fifth of liquor.

If the cigarette tax was allowed to increase with inflation, and the contribution amount per pack to the School Fund held constant at 5¢ per pack, the following additional General Fund amounts would be realized:

	<u>FY 86</u>	<u>FY 87</u>	<u>FY 88</u>
Cigarette Tax (millions \$)	0.0	0.9	1.5

If the contribution rate to the School Fund was held to a constant 5/8 ratio, the above estimates would drop by about 70 percent. The initial increase which would be equal to the present rate per pack of cigarettes times the CY 85 expected inflation rate of 4.0% or 8.32¢. This would rise with inflation to almost 9.1¢ in 1988.

Selective sales taxes on alcoholic beverages and cigarettes are usually justified on two grounds. First, they are sumptuary in nature. They are said to be levied so as to reduce consumption of products which are considered harmful to individuals, especially when consumed in excessive quantities. In practice, however, due to inelastic demand and strong individual preferences for these products, these taxes are not high enough to have this effect. Second, these taxes are said to be justified due to the social costs imposed on society as a whole by drinkers and smokers; auto accidents, crime, alcohol rehabilitation, lung disease, etc. Rates could, therefore, be based on estimates of these social costs. The incidence of these taxes is regressive on consumers of alcohol and tobacco. That is, alcohol and tobacco expenditure represent a relatively larger proportion of income for lower income smokers and drinkers than for those with higher incomes. In addition, these taxes discriminate against individuals based on personal preferences and against businesses which sell these taxed commodities.

In terms of economic efficiency, these taxes have the effect of making alcohol and tobacco relatively more expensive as compared to other commodities, thus altering consumer choices and resource allocation. However, due to inelastic demand for these products, this effect is probably not very great.

As mentioned above, the demand for alcohol and tobacco products is inelastic relative to price. Thus an increase in the tax rates on these products would have a relatively small effect on consumption and the tax yield would increase almost proportionately to the rate change. Tobacco consumption is almost totally a function of population size and tastes. A certain percentage of the population is going to smoke regardless of the price they have to pay, within reason of course. So as population size increases the yield from the tobacco tax should show a stable increase relative to population. Alcohol consumption is also a function of population and tastes, but income also plays a role. As income increases, there is a tendency for individuals to consume more liquor and wine as opposed to beer which are taxed at higher rates. This effect causes the elasticity of the alcohol tax to be greater relative to income.

As the alcoholic beverage tax and the tobacco tax are already in place, changing the tax rates would not increase administration or compliance costs.

The political feasibility of increasing excise taxes on alcohol and cigarettes is uncertain. If increases in rates were tied to estimated social or even governmental costs resulting from smoking and drinking, it might be possible to convince legislators of the validity of such a rate change. However, given the high per capita consumption of these products especially alcohol in Alaska, it is doubtful that a rate increase would be very popular. It should be noted, however, that the rates on alcohol

were increased by approximately 40 percent, from 25¢ to 35¢ per gallon of beer, from 60¢ to 85¢ per gallon of wine and from \$4.00 to \$5.60 per gallon of liquor in July 1983. The legislature enacted these rate changes partly in response to consideration of the increasing social costs of alcohol consumption.

Selective Sales and Excise Taxes
Motor Fuel Tax

If all fuel taxes were doubled and allowed to increase with inflation, the following additions to revenue would result:

	<u>FY 86</u>	<u>FY 87</u>	<u>FY 88</u>
(Million \$)			
Highway Fuel Tax	18.7	25.0	28.5
Aviation Fuel Tax	7.7	8.3	9.6
Marine Fuel Tax	4.1	6.1	7.7

In terms of equity, the Highway Fuel Tax is based on the benefit principle of taxation. An individual's consumption of fuel is generally proportional to their use of state highways and roads and the benefit they derive from state highways and roads is proportional to their use. Thus, the highway fuel tax is usually considered to be a tax in lieu of a charge as it would not be practical to set up every state highway or road as a toll road. The existing tax rates do incorporate a partial refund for off highway use of fuel as in the case of construction, logging, or recreational use. Aviation and marine fuel are taxed at different rates also. The incidence of the tax is on both consumers of highway fuel and consumers in general. A portion of the tax is paid by business on the fuel they use in producing goods and services and is passed on to consumers in general. A common incidence assumption is two-thirds on consumers of fuel and one-third on consumers in general. The incidence is also regressive as fuel expenditures represent a larger percentage of income for low income as compared to high income taxpayers. Part of the incidence is shifted out of state to nonresident tourists who consume fuel within Alaska.

In terms of economic efficiency this tax has the effect of making fuel relatively more expensive as compared to other commodities, thus altering consumer choices and resource allocation. This could be considered a partial justification for the tax as it could encourage conservation of scarce petroleum resources.

In practice the demand for fuel is fairly inelastic relative to price changes over the short term and within a reasonable price range. Thus the yield from this tax should be fairly stable and increase proportionally to any rate increase. Although as we have seen from recent national and worldwide fuel consumption trends, over the long

run demand for fuel is responsive to price changes and the level of the economy in general. The current worldwide over supply of petroleum is due partly to conservation measures in the major consuming nations. As population in Alaska increases, the highway fuel tax should show a proportional increase and yet it should be relatively insensitive to short term changes in income levels.

The administrative and compliance organizations are already in place and changing the rates would not entail any additional costs.

The political feasibility of rate changes in the highway fuel tax should be considered in light of the current decline in fuel prices due to worldwide excess supply of petroleum products relative to demand. Any rate changes could be based on estimated revenue requirements related to state construction and maintenance of highways and roads.

General Sales Tax

A general sales tax could be enacted at the State level. Alaska currently has no sales tax at the State level, however seven boroughs and fifty-nine smaller municipalities do levy some form of sales tax. The rates levied range from one percent to five percent with six percent being the maximum a municipality is allowed to levy under AS 29.53.415. The base upon which these rates are levied also varies with different exemptions being allowed in various communities. If a sales tax were enacted at the State level it would be in addition to the tax at the local level, however, it should be noted that Anchorage and Fairbanks, the two most populous municipalities in the State currently have no sales tax.

Currently forty-five of the fifty states levy some form of sales tax at the state level. Sales taxes are a significant source of state government revenues in most of the states which levy them. The sales tax base varies considerably as to exemptions allowed and the degree to which services are taxed from one state to another. Food purchases, except restaurant meals and alcohol, are exempt in twenty-eight of the forty-five states. Prescription drug purchases are exempt in forty-three states. Gas and electric utility bills are exempt to some degree in thirty-two states. Five states exempt clothing purchases to some degree. Also, nine states allow some credit for sales taxes paid against state income tax liability. These various exemptions and credits are meant to ameliorate the regressive incidence of the sales tax. Services are taxed very comprehensively including all personal and professional services in only three states. Twenty-five states either tax no services or tax services very narrowly and selectively such as laundry and cleaning or advertising and selected business services. The remaining seventeen states tax services to a considerable degree although not comprehensively with most exempting professional services. The rates levied on taxable purchases of goods and services also varies

considerably from state to state with a low of three percent to a high of seven and one half percent. The median rate levied by states which exempt food is five percent and by those which do not exempt food is four percent.

In examining the revenue yield from sales taxes per one percent of tax rate in various states relative to the state's personal income the major distinguishing factor seems to be whether food is exempted from the tax base. In states exempting food the sales tax yield as a percent of personal income per one percent of tax rate averages about 0.45 percent. In states not exempting food the sales tax yield averages about 0.75 percent of personal income per one percent of tax rate. It should be noted that there is considerable variation in the yields within the two groups of states depending on the taxation of services, the allowances for exemptions, the level of tourist activity and the absolute level of per capita personal income. With regard to Alaska the last two factors are of particular interest and may tend to offset one another. Since Alaska has a comparatively high level of tourist activity relative to its population and personal income it would be expected that the yield ratio from a sales tax compared to personal income would tend to be higher than average. However, since Alaska has comparatively high per capita personal income the percentage of personal income spent on taxable consumption purchases and hence the yield ratio from a sales tax relative to personal income would tend to be lower than average. Thus for purposes of estimating the probable yield from a sales tax the average values above were used.

Based on current projections of Alaska personal income the probable revenue yield from a one percent sales tax would be as follows:

	<u>FY 86</u>	<u>FY 87</u>	<u>FY 88</u>
Sales Tax Revenue (millions \$)	40.8-67.9	42.5-70.8	44.3-73.8

The two figures shown for each year represent point estimates of the probable sales tax revenues with and without a food exemption. Also note these figures are for a one percent tax rate so the yield from a higher tax rate can be calculated accordingly.

In terms of equity, the incidence of a retail sales tax is on the individual and business consumers of the taxed goods and services. There is no opportunity for shifting incidence of purchases by individuals. However the portion paid by businesses will ultimately be shifted to consumers of the goods and services those businesses produce. At least part of the burden will be exported to nonresident tourists who make purchases within the state. This can be a significant factor in states with large tourist industries. The incidence relative to income is regressive as the tax is levied on consumption and low income individuals consume a greater percentage of their income. ~~Also the fact that sales~~

~~taxes are deductible when computing taxable income for federal income tax purposes combined with progressive income tax rates has the effect of making the effective incidence of the sales tax even more regressive.~~ Sales taxes also discriminate against individuals on equal income levels who have higher than average consumption due to family size or taste. Thus the sales tax exhibits some inequity both vertically between income levels and horizontally across given income levels. The regressivity of the sales tax has been ameliorated in many states by either exempting food or other necessity purchases from the sales tax or allowing individuals to claim a credit against their state income tax liability. Finally, it should be noted that in a relatively affluent society in which most individuals are consuming at levels far above subsistence, the regressivity of the sales tax may not be a significant factor as far as equity is concerned. This is probably the case in urban Alaskan communities but may not be for some rural/bush areas.

If a general retail sales tax is levied at a uniform rate on all goods and services and is applied to a broad base it should not distort consumer choices or alter resource allocation. Therefore, as concerns economic efficiency, the tax should be neutral. For this reason as well as for administrative and compliance reasons, it is preferable to address the regressivity of the sales tax by allowing individuals to claim a credit against their state income tax liability (if one exists) rather than to grant specific exemptions to certain commodities such as food.

The yield from a retail sales tax is usually fairly stable especially if it is broad based. This is because consumption expenditures are fairly inelastic relative to short term fluctuations in personal income. Individuals tend to hold their consumption at a certain level and allow their savings to vary in the short term. As income, population or prices increase over time the yield from a flat rate sales tax should increase proportionally. If, however, real per capita personal income increases substantially over time, the percentage of personal income spent on taxable consumption as opposed to savings and investment may decline. Thus it can be said that the revenue yield from a flat rate sales tax is relatively inelastic as compared to the yield from a progressive rate individual income tax.

In terms of administrative efficiency, the enactment of a completely new tax at the state level would entail considerable start up costs. In states with well established sales tax procedures, administration costs run about two percent of sales tax collections. In addition, many states also compensate retailers, upon whom the major burden of compliance and collection falls, between one and five percent of collections. Cost in Alaska could be higher due to Alaska's relatively small population size and large geographic area as well as high start up costs. With a sales tax there is a smaller number of taxpaying units (retailers) than with an individual income tax and so, to some extent, administration and compliance costs tend to be lower. Sales taxes, however, do require extensive audit and delinquency programs especially if there are exemptions from the tax base such as food which provide an opportunity

for tax cheating. Alaska currently has some communities with local sales taxes; however, they vary widely in both rate and base. One administrative option would be for the state to collect both local and state sales taxes and return the local portion. This would necessitate consistency in tax base but may allow some local communities to lower their tax rate and still collect the same amount of revenues as the base would be broadened. This option would slightly increase administrative costs to the state compared to without sharing and localities would lose some discretion over their own tax structure.

In terms of political acceptability, sales taxes have been traditionally supported by higher income groups fearing increased property or income taxation. They have been opposed by labor organizations primarily on equity grounds and retailers who feared loss of business and compliance costs. Sales taxes are not as visible as income taxes in that the tax is levied in small bits each time a purchase is made rather than in larger amounts through payroll withholding or payments at year end. Since Alaska has never had a state sales tax, it is questionable whether the legislature would enact such a major new tax on individuals until oil revenues decline significantly.

Licenses and Permits

Licenses and permits, including corporation/occupational licensing fees (AS 02.05, AS 08.01-.99, AS 10.05-.35, AS 21.06-.90), motor vehicle fees and permits (AS 05.30, AS 28.10-.15, AS 42.10), alcoholic beverage licenses (AS 04.10), amusement and gaming fees (AS 43.35) and fishing and hunting licenses (AS 16.05 and AS 16.43), could be increased. If all the licenses and permits were allowed to increase with inflation, the following additional General Fund and Fish and Game Fund amounts would be realized:

	<u>FY 86</u>	<u>FY 87</u>	<u>FY 88</u>
Licenses & Permits (millions \$)	1.4	3.2	5.4

If revenues from licenses and permits are still considered insufficient, a vehicle license fee could be enacted. The vehicle license fee could be levied at the time of registration in lieu of a property or ad valorem tax at a rate of 1% of vehicle market value. The following additional revenues could be generated:

	<u>FY 86</u>	<u>FY 87</u>	<u>FY 88</u>
Vehicle License Fee (millions \$)	12.3	12.8	13.4

Regulatory licenses and permits are not generally included in a tax study since they are not imposed for the purpose of raising revenue due to being insufficient revenue generators. On the other hand, license and permit charges by the state should be sufficient to recover the direct costs of administering and policing the regulatory activities. Further, all costs should be considered, not merely those directly incurred by government in the production of the service. Regulatory charges must include those indirect costs to society such as, in the case of motor vehicle licenses, the costs of highway construction and maintenance and, in the case of alcoholic beverage licenses, the costs arising out of excessive use of alcohol.

In terms of equity, license and permit charges are not mandatory use taxes, but are dictated by the principle that persons pay for what they get. Thus, a person can be excluded from the benefits of the service if he does not wish to pay for it. Although license and permit charges by the state do not result in inequities to lower income groups, equity standards require that these lower income groups be assured of obtaining and affording these services.

The use of charges where possible instead of financing by taxation is regarded as justifiable when demand for the services has some elasticity, so that the use of hunting and fishing fees aids resource allocation and lessens waste. Other services not so easily subject to waste may have inelastic demand, but charges may be warranted on equity grounds alone and by the fact that persons or businesses subject to the provisions generally receive benefits from the state of comparable value.

The use of regulatory charges appears to have less adverse effect upon behavior than taxes (which are mandatory in nature) and therefore may appear more palatable politically. However, most licenses and permits for Alaska are either already under review and recently increased or comparable with charges in other states. In an attempt to equalize the operating budget with revenue, the occupational licensing fee structure was revised (Ch. 26 & 37, SLA 1985) to provide the additional revenue required. Currently the fee structure is under review and new fees will be implemented in the future. Both alcoholic beverage licenses and amusement and gaming fees could be slightly increased to be more in line with other states; however, current motor vehicle fees are all comparable with other states. Finally, fishing and hunting licenses were increased during the past two years, especially those regarding non-resident licenses. If additional revenue must be generated by substituting regulatory charges for taxes, then the costs must be balanced against the gains from the use of charges to determine the desirability of imposing them.

State of Alaska MEMORANDUM

Office of the Governor

Division of Policy

P.O. Box AM, Juneau, AK, 99811
Tel. 465-3568 / Mail Stop 0164

TO: Mary Halloran
Director

DATE: 16 January 1987

FROM: Gregg Erickson
Senior Economist

SUBJECT: Oil and Gas Property Tax Revisions

Summary

You asked for an analysis of decoupling the state and local taxes (AS 43.56 and AS 29.53.045) on oil and gas property (the "hardware tax"). The state now levys a 20 mill (2 percent) annual tax on the value of oil and gas production and transportation facilities, but local property taxes are allowed as an offset to the state tax: a 15 mill local tax means that the state collects only 5 mills.

Under the decoupling proposal the state would levy a 10 mill tax against which local taxes could no longer be offset. Oil companies would get a tax reduction in any area where local taxes are less than 10 mills (such as the Kenai Borough), but where local taxes exceed the 10 mill level (principally the North Slope Borough and Valdez) tax payments would increase.

If the proposal were adopted with an immediate effective date the state could collect an additional \$84.9 million in FY 87, and a further \$76.7 million in FY 88. The total available for allocation in the current session would thus be \$161.6 million.

Revenue Impacts

Most of the revenue collected under the current property tax is received by the Department of Revenue (DOR) by wire transfer on June 30, the last day of the fiscal year. The actual amount of collections depends on the assessed value of oil and gas property, finally determined in late May, and local mill levies, in most cases also determined in late May. Neither of these factors are known yet for the current year, so the FY 87 estimates include some guesswork. Here are our calculations:

FY 87:

Assessed Value 1/1/87 (OMB est.)	\$17.7 billion
Collections under new tax @ 10 mills	\$177.0 million
Less current revenue (DOR est.)	(\$82.7 million)
Net additional collections	\$94.3 million
Less wellhead reductions (OMB est.)	<u>(\$9.4 million)</u>
NET NEW FY 87 REVENUE	\$84.9 million

The wellhead reductions, calculated here at 10 percent of additional collections, result from the pass-through to TAPS shippers, (in the form of higher tariffs) of additional taxes paid on the pipeline facilities. We figure about 40 percent of the additional tax will be attributable to TAPS, and about 26 percent of that will be passed through to the state as reduced wellhead values ($.26 * .40 = .10$).

The assessed valuation of the pipeline depends in part on the expected flow of future tariff revenue to TAPS owners. The TAPS settlement has reduced this expected revenue stream, and thus will reduce the pipeline's assessed value. Moreover, if world oil prices remain depressed it is unlikely that additional field investments will continue to countervail the depreciation of existing facilities, as has been the case in recent years. Both of these factors suggest rapidly declining assessed values. Our guess is that the FY 88 value (assessed as of 1/1/88) will be down 8.5 percent.

FY 88:

Assessed Value 1/1/88 (OMB est.)	\$16.2 billion
Collections under new tax @ 10 mills	\$162.0 million
Less current revenue (DOR est.)	(\$76.8 million)
Net additional collections	\$85.2 million
Less wellhead reductions (OMB est.)	<u>(\$8.5 million)</u>
NET NEW FY 88 REVENUE	\$76.7 million

The total new state revenue available for expenditure in the current legislative session from the adoption of this proposal, net of royalty and severance tax offsets, is thus:

	FY 87	\$84.9 million
	FY 88	<u>\$76.7 million</u>
TOTAL NET NEW REVENUE THIS SESSION-----		\$161.6 million

Local Tax Limitations

AS. 29.53 allows local taxation of oil and gas property but also contains special limitations related to the ratio of local to statewide per capita assessed values. The new proposal could leave these limits in place or repeal them. Although not currently a constraint on local taxes, in earlier years the special limitations did restrict local access to the oil and gas property tax base. Not suprisingly, the limitations were and are resented by communities in the affected areas.

The limitations, which are in addition to the statewide 3 percent limit on property taxes, date from the 1973 special session. Oil companies threatened that they would cancel pipeline construction unless they were granted concessions, including imposition of special ceilings on local governments' ability to tax oil company property. The limitations were adopted.

Differences in how the limitations should be interpreted have since produced a three cornered dispute between the local governments, DOR, and the Department of Community and Regional Affairs that has been simmering since the mid-70s. Moreover, Valdez, the Fairbanks Borough, and the North Slope Borough are miffed because the state adopted the TAPS Settlement Agreement without (in their view) proper concern for its adverse effects on local revenue. All these issues (and possibly others as well) are likely to be raised if the decoupling proposal is introduced, regardless of whether it repeals the limitations or leaves them untouched.

Why a Property Tax Increase

Property would be valueless but for the benefits conferred by civilized society. Property rights exist only in the context of their enforcement by government. Thus are property taxes justified:

Because the property value is a creature of government, the property values should bear the burden of supporting government.

It is unlikely that the above argument will dominate discussion. The decoupling proposal is a tax increase on the oil industry, and on that basis alone, the usual policy arguments will be advanced against it. The strongest point will probably be that the companies shouldn't be asked to pay any additional taxes to the state when they are not earning profits on their Alaska operations. The counter will be to show that substantial profits are in fact being earned. The industry rejoinder will be that the profits, if earned here, are needed to provide a source of funds for reinvestment in Alaska. The reply will show that they are not being returned to Alaska as investment.

To carry the policy arguments, tax supporters must prove their case on the profits issue. Evidence developed by OMB and others suggests that the facts support this position. Unfortunately, in these technical areas of accounting and economics facts adduced by Alaskan experts are likely to be seen as self-serving. What will be needed, and what is not currently available, is the testimony of unbiased professional experts from outside the state (1) that profits are being earned in Alaska and (2) that those profits are largely being invested outside and overseas.

TO: Governor Steve Cowper

FROM: Budget Transition Team
Oral Freeman, Chairman *Oral Freeman*
Brian Rogers, Vice-Chairman *Brian Rogers*
Dave Rose, Member *Dave Rose*
Bob Poe, Member *Bob Poe*
Richard Fineberg, Member *Richard Fineberg*
Mary Halloran, Member *Mary Halloran*
Senator John Sackett, Member *John Sackett*
John Halterman, Member *John Halterman*

DATE: December 12, 1986

"Major budget issues" is not all included

Enclosed is the final report from the Budget Transition Team. The report is presented in three parts: 1) Identification of the FY87 budget shortfall; 2) Identification of revenue options; and 3) Major budget issues. This report is not purported to be an exhaustive research document, but rather an initial review of the State's revenue potentials and fiscal concerns.

In preparing this report the members divided into subcommittees for review and initial identification of major departmental fiscal issues. Because of time constraints, not all members were able to thoroughly familiarize themselves with the departmental fiscal concerns of the subcommittees. Therefore, the committee has identified the subcommittee members responsible for the departmental review.

The committee has enjoyed the opportunity to assist your new administration through transition. The challenge of directing the state through the next four years cannot be overstated. If there is any way this committee can assist you and your administration further, we will be pleased to do so.

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December 15, 1986

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Section III.

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B. General Budget and Fiscal Policy Issues

C. Shortfall and Financial Plan

Section IV.

Department Reviews

TO: Governor Steve Cowper
FROM: Budget Transition Team
DATE: December 12, 1986
RE: FY 87 Year-End Shortfall

Our best estimate of the FY 87 Unrestricted General Fund year-end shortfall is (\$593.0) million (negative).

Please note that this estimate is subject to final revisions in the State's Annual Financial Report (AFR), currently nearing completion in the Department of Administration. The State Accountant advises that until the report is completed swings up to \$50.0 million in either direction are possible. Wrap-up of the AFR is anticipated by Dec. 22.

This estimate assumes that operating budget appropriation restrictions imposed by the previous administration remain in place until those appropriations lapse, but that capital appropriations (which do not lapse) should be regarded as valid obligations.

We could find no existing computer system (or systems) that calculate the amount available for appropriation during the coming legislative session. The attached worksheets represent the best (and only) existing method to close the gaps that exist in the current budget, revenue and accounting systems.

MEMORANDUM

Office of Management and Budget
465-3568 MS 0164

TO: Budget Transition Team

DATE: Dec. 11, 1986
[revised]

FROM: R.A. Fineberg

SUBJECT: FY 87 Year-End Shortfall

Preliminary estimates place the FY 87 year-end shortfall at approximately negative (\$593.0) million. This estimate may increase or decrease by up to \$50.0 million when the Annual Financial Report tables are completed by the State Accountant during the coming week. In the meantime, this figure should replace the negative (\$299.5) million anticipated by the previous administration in October as a preliminary estimate of the FY 87 shortfall.

Changes in the (\$299.5) shortfall estimate are:

Unrestr. G.F.
(\$ Millions)

Oct. 30 Estimated FY 87 Shortfall:	(\$299.5)
Decrease in FY 87 revenue (Dec. forecast)	(74.4)
Annual Fin. Rpt. V. Budget Estimates:	
Receivables, reserves etc.	34.6
Other (final estimate pending)	
Remove lapse balance	(10.0)
Revision to TAPS refunds estimate	(12.1)
Increase Extraordinary Repayments to GF	1.6
Remove transfers counted in AFR	(13.0)
Add transfers not in AFR	100.0
Remove proposed repeal of capital project and loan fund balances	(81.3)
Net increase operating agency restrictions (DOE: +13.9; Courts, Leg: -[8.3])	5.6
Subtotal:	(348.5)
1986 Session Capital and Loan Restrictions	(219.5)
Contingency for FY 87 Supplemental Appropriations	(25.0)
Dec. 11 Estimated FY 87 Shortfall:	(593.0)

The State Accountant advises that final calculations could alter the final numbers in the Annual Financial Report by \$50.0 million in either direction. The Division of Finance intends to present a semi-final estimate during the coming week.

Fineberg / Budget Transition Team
Shortfall
12/11/8 (Page Two) [rev.]

Note that this estimate excludes current-year operating agency restrictions and operating agency lapse. The Budget Transition Team concluded that operating agency restrictions appear to be effecting valid reductions to the operating budget. Exclusion of lapse from these calculations is consistent with the premise that revenue estimates should be cast conservatively to avoid unnecessary dislocation due to declining revenues.

Attachment #1 contains the summary data; attachment #2 details these calculations in a standardized format that is useful for tracking revenues and appropriations; attachment #3 adds a column to show the current estimate against the calculations that produced the (\$299.5) million negative used by the previous administration; attachment #4 is the latest version of the preliminary FY 86 Annual Financial Report statement from which the FY 87 starting shortfall is taken; attachment #5 shows repeals, appropriated and administrative fund transfers by fiscal year.

(1)

1986-87 Session Revenues and Appropriations

Preliminary estimates based on Budget Transition
Team review of OMB documents; worksheets
attached.

12/11/86

(With Restrictions)
(\$ Millions)
(Unrestricted G.F.)

FY 87 Appropriations Total (1986 session w/restrictions)	\$2,153.5	(2)
Estimated FY 87 Year-End Balance (Shortfall)	(593.0)	(3)
Revenue (1987 Session):	<u>1987 Session</u>	
Carry-forward to FY 88 (Shortfall)	(593.0)	(3)
FY88 Revenues (DOR Jan. 30% case)	1,325.0	
Adjustments to FY 88 Revenue		(4)
Estimated Total Available Revenue (FY 88)	\$732.0	

Notes:

- (1) These numbers reflect 30% December forecast totals and preliminary FY 86 Annual Financial Report data.
- (2) 1986 session operating, capital and loan appropriations of \$2,580.2 million less restrictions of \$415.0 million and \$11.6 FY 86 supplementals. (Source: 1986 Appropriations Digest (OMB; operating restrictions adjusted per DBR 11/24/86 [Leg. & Courts and OMB 12/11 [school debt]).
- (3) Estimated shortfall for FY 88 includes (\$219.5) million for capital and loan restrictions and (\$25.0) million for FY 87 supplementals.
- (4) Anticipated extraordinary repayments to General Fund of \$2.8 million approximate FY 87 well credits; Therefore no adjustments to FY 88 revenue are necessary.

Preliminary 12/11/86

[r]

ATTACHMENT #1

**REVENUES AND APPROPRIATIONS WORKSHEET,
1986 AND 1987 LEGISLATIVE SESSIONS**
(1987 session version; 12/7/86)

12/12/86
30% case

(These figures are preliminary and
subject to revision.)

1986 SESSION

(PRELIMINARY)

1	Estimated Carry-Forward to 1985 Session	/	OMB estimates replaced with Item 5
2	1986 Session Appropriations with FY 85 Effective Dates	/	
	A. FY 86 Operating Program Supplementals	/	
	B. Capital Projects	/	
	C. Loan Programs / Other	/	
3	1986 Session Adjustments to Prior-Year Appropriations	/	
4	Adjustments	/	
	A. Adjustments in FY 86 Annual Financial Report	/	
5	FY 86 Year-End Balance	221.6	FY 86 Preliminary AFR St. 12, 12/9/86 (Adjusted by OMB, 12/9/86)
6	Estimated FY 87 Revenues (DOR 9/86 30% case) (exclude TAPS legal & refunds)	1,334.2	DOR, Dec. 1986 30% case
7	Adjustments to FY 87 Revenues		
	A. Drilling Incentive Credit	(5.0)	OMB estimate (based on FY 86-87 data)
	B. Extraordinary Payments to General Fund	12.4	OMB estimate (per DOR 12/2/86)
	C. Estimated Lapse of FY 87 Appropriations		
	D. TAPS Refunds and Legal	65.0	Amount due; Dec. forecast (fn. 15; net of 138.6 to Budg. Res. Acct.)
	E. Administrative Transfers (not in 1986 AFR)	70.8	70.8 Anticipated Administrative Transfers (see OMB worksheet);
	1986 session statutory transfers (not in 1986 AFR)	100.0	100.0 Statutory (70.0 HAD; 25 HWCF; 5 Vet RLF)
	F. Restrictions of prior capital (6.0)	6.0	(per Sheffield Press Release, 8/1/86)
8	1986 Session Appropriations with FY 87 Effective Dates		
	A. FY 87 Operating Programs (2169.9 - 181.6)	(1,988.3)	HB500, HB574 (Restrictions: Appropri. Digest, Table 10 [rev. 12/3/86])
	Local School Debt Restructuring Gain (12/11/86)	13.9	
	B. Capital Projects (337.6 - 213.4)	(124.2)	SB171, HB574 with restrictions (Appropriation Digest, Overview)
	C. Loan Programs / Other (61.0 - 6.1)	(54.9)	SB171 with restrictions (Appropriations Digest, Overview)
	FY 87 Total Appropriations	<u>(2,153.5)</u>	(8A.+B.+C.)
9	Estimated Unrestricted GF Surplus (Shortfall)	<u>(348.5)</u>	Subtotal
10	Contingent Liabilities:		
	A. 1986 Session Capital, Loan Restrictions	(219.5)	OMB restriction estimate, 7/86
	B. Reserve for essential FY 87 Supplemental Appropriations	<u>(25.0)</u>	Estimate
11	Estimated FY 88 Shortfall:	<u>(593.0)</u>	Estimated FY 88 Shortfall

WORKSHEET: REVENUES, APPROPRIATIONS AND TRANSFERS, 1985 AND 1986 LEGISLATIVE SESSIONS

12/11/86
30% case

10/86
30% case
w/restrictions

(Tracking version)

1985 SESSION

(PRELIMINARY)

1	Estimated Carry-Forward to 1985 Session	/	/	OMB estimates replaced with item 5
2	1985 Session Appropriations with FY 85 Effective Dates	/	/	
	A. FY 85 Operating Program Supplementals	/	/	
	B. Capital Projects	/	/	
	C. Loan Programs / Other	/	/	
3	1985 Session Adjustments to Prior-Year Appropriations	/	/	
4	Adjustments	/	/	
	A. Adjustments in FY 85 Annual Financial Report	/	/	
5	FY 85 Year-End Balance	/	(213.9)	FY 85 Annual Financial Report, St. 12
6	Estimated FY 86 Revenues (DOR 3/12/86 30% case)	/	2,681.9	DOR Oct. actual (preliminary)
	(includes FY 86 TAPS gain; excl. refunds & legal)	/		(includes revenue gain from TAPS settlement, 25.4 8g)
7	Adjustments to FY 86 Revenues	/		
	A. Drilling Incentive Credit	/	(0.7)	OMB estimate
	B. Extraordinary Payments to General Fund	/	50.6	OMB estimate (revised per DOR, DCED information 10/20/86)
	C. Estimated Lapse of FY 86 Appropriations	/	50.0	OMB estimate
	D. TAPS Adjustments:	/		Refunds to Reserve Fund; see Reserves, below
	E. ARCO Production Tax Settlement (1/13/86)	/	243.0	Announced 1/13/86
	F. 8g Settlement (counted in July forecast)	/		Congressional, Presidential approval 4/86
	G. Other (this item merged with 7B. in 8/28)	/		Bond Bank interest & sale gain
8	1985 Session Appropriations with FY 86 Effective Dates	/		
	A. FY 86 Operating Programs	/	(2,274.9)	1985 Appropriation Digest, p. 17
	B. Capital Projects	/	(433.0)	"
	C. Loan Programs / Other	/	(79.6)	"
9	Estimated Carry-Forward to 1986 Session	/	23.4	(5 + 6 + 7 + 8) this entry is analogous to the (\$285.5) figure used during the 1986 session; see attached worksheets.

1986 SESSION

1	Estimated Carry-Forward to 1986 Session	/	23.4	From item 9 (above)
2	1986 Session Appropriations with FY 86 Effective Dates	/		
	A. FY 86 Operating Program Supplementals	/	(11.6)	Estimated (\$B348, 0.04; HB574, 11.52)
3	1986 Session Adjustments to Prior-Year Appropriations	/		
	A. Statutory	/	175.2	1986 Appropriation Digest, OMB Worksheets: 150.2 HB574; 25.0 HB500 (excludes admin. transfers shown with FY 87 adjustments)
4	Adjustments			
	A. Adjustments in FY 86 Annual Financial Report	99.4		12/9 preliminary replaces 11/21 and 12/5 versions
	B. Other (HB 574 Capital Adjustment from Line 8-B., 8D.)	122.2		HB 574 capital in FY 86 AFR (in Lines 8B. and 8D., below)
	Reserves and Other: Adjustment			(+/- \$50.0 per DOA 12/6/86; final due 12/12)
5	Estimated Carry-Forward to FY 87	221.6	187.0	(1+2+3+4)
6	Estimated FY 87 Revenues (DOR 12/3/86 30% case)	1,334.2	1,408.6	DOR Oct., Dec. 1986 30% cases
	(exclude TAPS legal & refunds)			
7	Adjustments to FY 87 Revenues			
	A. Drilling Incentive Credit	(5.0)	(5.0)	OMB estimate (based on FY 86-87 data)
	B. Extraordinary Payments to General Fund	12.4	10.8	OMB estimate (per DOR 12/2/86)
	C. Estimated Lapse of FY 87 Appropriations		10.0	OMB estimate (reduced per DBR estimate, 7/86)
	D. TAPS Refunds and Legal (received after 3/1/86)	65.0	77.1	Amount due; Oct. forecast (footnote 15 net of 138.6 to Rainy Day Acct.)
	E. 1986 Session Administrative Transfers	70.8	83.8	11/27 excludes 13.0 included in AFR preliminary at Line 5
	Repeals anticipated subsequent to 1986 AFR	100.0		Per DOA 11/26/86 (see OMB worksheet)
	F. Repeal prior capital	6.0	87.3	Revised 11/27/86 from Governor's Press Release (8/1/86)
8	1986 Session Appropriations			
	A. FY 87 Operating Programs (2169.9 - 181.3)	(1,974.4)	(1,980.0)	HB500, HB574 (Restrictions: Appropri. Digest, Table 10 (rev. 12/11/86))
	B. Capital Projects (337.6 - 213.4)	(124.2)	(124.2)	SB171, HB574 with restrictions (Appropriation Digest, Overview)
	C. Loan Programs / Other (61.0 - 6.1)	(54.9)	(54.9)	SB171 with restrictions (Appropriations Digest, Overview)
	D. Capital/Loan Restrictions + Contingency for Supplementals	(244.5)		
9	Estimated Unrestricted GF Surplus (Shortfall)	(593.0)	(299.5)	Estimated Year-end Balance (excludes reserves)

BUDGET RESERVE FUND:

Rainy Day Account (without TAPS)	294.9	294.9	Rainy Day Account FY 86 Year-End (without TAPS)
TAPS deposits to RDF	138.6	138.6	(Per Sec. 762, Ch. 105, SLA 85)
Disaster Relief Withdrawals	(4.8)		State portion of Disaster Relief (per OMB 11/28/86)
Total Budget Reserve Fund	428.7	433.5	Budget Reserve Fund (HB 513, HB 574)

GF EXTRAORDINARY PAYMENTS (PRINCIPAL REPAYED, ETC.):

FY 87	12.4	FY 88	2.9
7 B. General Fund Extraordinary Income: (FY 86 = 50.6)		B. General Fund Extraordinary Income:	
Est. Cr. Union Debt certificates paid, FY 87 (DOR, 12/2)	9.6	Debt certificates paid (rev. per DOR, 12/2/86)	
Miscellaneous GF (AHFC, ASHA, etc.)	0.4	Miscellaneous GF	0.4
Small Business Revolving Loan Fund (DCED, 10/21/86)	--	Small Business	--
Tourism Revolving Loan Fund	0.3	Tourism	0.3
ARC	--	ARC	--
0.9 Power Project Loan Fund (from budget form C-21)	1.1	Power Project Loan Fund	1.1
Bond Bank: Interest plus bond sale gain	1.0	Bond Fund (est. interest due GF)	1.0

STATE OF ALASKA
GENERAL FUND
PRELIMINARY ESTIMATE
June 30, 1986
(Stated in Thousands)

12/9/06

	June 30, 1986	June 30, 1985	
ASSETS			
Cash and Investments:			
Cash in Transit	\$ 425	\$ 1,905	1,480
Interest Cash	967	1,432	465
Deposits with State Treasurer	1,595,867	1,675,833	79,766
Deferred Compensation	66,579	54,137	12,442
Total Cash and Investments	\$ 1,663,838	\$ 1,733,307	69,469
Advances:			
Salary, Travel and Other	1,295	998	297
Capital Projects Funds	10,400	10,400	0
Enterprise Funds	1,440	1,466	16
Advances to Other Jurisdictions	440	477	(37)
Total Advances	\$ 13,595	\$ 13,341	254
Receivables:			
Accounts Receivable	\$ 151,796	\$ 1,170	150,626
Due from Federal Government		36,800	(36,800)
Due from Other Governmental Units		7,102	(7,102)
Inter-Agency Receivables		21,578	(21,578)
Accrued Interest Receivable	74,053	47,842	26,211
Loans Receivable	17,090	16,961	129
Total Receivables	\$ 242,939	\$ 131,453	111,486
Inventories, at Cost:	\$ 1,394	\$ 1,514	(120)
Total Assets	\$ 1,921,766	\$ 1,879,615	42,151
LIABILITIES:			
Payroll and Taxes withheld	\$ 36,431	\$ 43,055	(6,624)
Accounts Payable	77,263	144,227	(66,964)
Permanence Percent on Contracts	216	259	43
Due to Other Funds:			
Enterprise Funds	3,014	26,039	(23,025)
Alaska Permanent Fund		2,573	(2,573)
Bond Redemption Fund			
Other Liabilities	13,219	18,526	(5,307)
Total Liabilities	\$ 132,143	\$ 234,679	(102,536)
FUND EQUITIES AND RESERVES:			
Reserves:			
Encumbrances	\$ 402,024	\$ 584,834	(182,810)
Continuing Programs- Operating	21,909	9,947	11,962
Continuing Programs- Capital	603,614	578,793	24,821
Emergency Operating Expenses	431,526	298,000	133,526
Loans to Other Jurisdictions	12,300	12,343	(43)
Retirement & Other Reserves	20,491	18,969	1,522
Total Reserves	\$ 1,491,864	\$ 1,502,886	(11,022)
Available Fund Equity:			
Restricted for Deferred Compensation	66,579	54,137	12,442
Restricted for Non-Liquid Investments	134,760	301,854	(167,094)
Balance Available for Appropriation	99,438	1213,941	(1,114,503)
Total Available Fund Equity	\$ 240,777	\$ 142,932	97,845
Total Fund Equity and Reserves	\$ 1,732,641	\$ 1,645,818	86,823
Total Liabilities, Reserves and Fund Equity	\$ 1,921,766	\$ 1,879,615	42,151

ATTACHMENT #4

(Revised 10/27/86)

1986-1987 Revenues and Appropriations (p.2)

Adjustments to Carry-Forward to 1986 Session	FY87 est. 8/28	FY87 est. 11/27
4/9/86 Estimate	(285.5)	(269.0)
Additional Credit Union Debt Certificates Repaid	2.2	
Additional FY 86 Loan Principal Repayments (Tourism 2.0, Sm. Business 1.6)		3.6
FY 86 Drilling Credits (4/9 est. v. 8/28 est.)	14.3	
Adjusted Carry-Forward to 1986 Session	(269.0)	(265.4)

Adjustments to FY87 Revenue	FY87 est. 8/28	FY87 est. 11/27	FY 88 est. 11/27
Extraordinary Repayments to GF (reflects cr. union prepayments of C.D.'s)	5.3	13.0	2.8
FY87/88 Lapse	10.0	10.0	10.0
FY87 Drilling Credits (4/9 est. v. 8/28 est.)	(5.0)	(5.0)	(5.0)
Total Adjustments to FY87/88 Revenue	10.3	18.0	7.8

Transfers / Other Sources:	(Stated in \$000) (session est.)	(Stated in \$000) (est. 11/27/86)	Comments (Revised 10/86)
APA / DCED Transfers:			
PDRLF cash in suspense (transfer)	9,000.0	9,036.0	AkSAS 7/19/86 (FY 86 GF)
Power Project Fund Lapse (per s. 502, Ch. 105, SLA 85)	4,000.0	4,000.0	AkSAS 2/12/86 (adjust FY 85 account)
Proposed Sale of GF Assets (eff. 7/1/86)			
State Mortgage Loans (to AHFC)	12,800.0	4,500.0	DOR/AHFC est. 10/86 (non-delinq. housing only)
Obligations of State Corporations (to AHFC; eff. date 7/1/86)	28,600.0	3,643.0	Marine View (est. 12/1/86)
		24,957.0	AHFC intends to acquire this amount
ASBA transfers to GF:			
Lease building program surplus	7,000.0	7,000.0	Pending Oct. '86 board meeting (ASHA may hold 10% reserve)
Undesignated Surplus	7,500.0	7,500.0	Spring 1987 (reasons for delay unclear)
Small Business Loans (to AIDA)	20,000.0	23,192.0	Received 5/86 from AIDA
Administrative Lapse from various capital and/or loan funds	2,500.0	0.0	(DCED will transfer c. 11/1) 9 Capital balances duplicate proposed capital lapse 7/16/86
(Note: ASBA lease bldg. and SBA counted in DOR July revenue forecast)			
NON-STATUTORY TRANSFERS (FY 86 SUBTOTAL):		13,036.0	Reference Total:
NON-STATUTORY TRANSFERS (FY 87 SUBTOTAL) 91,400.0		70,792.0	83,828.0

Repeals / Reappropriations (HB 574 as enacted):			
Publ. Facil. Planning Fund (s. 61)	6,000.0	6,000.0	(Fund 13707; in FY86 cash)
ASHA (s. 383; see admin. transfers)			
Veterans Revolving Loan Fund Repeal (s. 39)	5,000.0	5,000.0	Est. 11/1/86 (To confirm contact: C. Green, DCED)
Other Loan Fund Repeals (s. 427):			
Veterans RLF	408.6	408.6	Completed 8/16/86 (AkSAS)
Comm Fish	2,000.0	2,000.0	Completed 8/16/86 (AkSAS)
Mining	13,350.0	13,350.0	Completed 8/16/86 (AkSAS)
Alt. Energy	1,809.0	1,809.0	Completed 8/16/86 (AkSAS)
Res. Energy	1,800.0	1,800.0	Completed 8/16/86 (AkSAS)
Rural Elect.	1,779.9	1,779.9	Completed 8/21/86 (AkSAS)
Power Dev. RLF	18,605.9	8,590.1	Completed 8/16/86 (AkSAS)
SUBTOTAL (s. 427): 39,753.4		10,015.8	Balance from 4-Dam Pool by 8/31/87 (FY86 cash or rcvbles)
PCA/PCE Lapse (s. 453-455)	5,490.0	2,763.3	OMB/AkSAS (s. 455 void)
HALF (s. 551)	70,000.0	70,000.0	Pending AHFC bond sale of 11/25
PFD (s. 553-7; vetoed)			
MAJOR REPEALS (SUBTOTAL):	126,243.4	123,516.7	
CAPITAL REPEALS (Est.; incl. repeals to new projects)	26,989.0	26,989.0	
OPERATING REPEALS	741.2	741.2	
HB 574 TOTAL REPEALS/REDUCTIONS (FY86)		76,246.9	Reference Total:
HB 574 TOTAL REPEALS/REDUCTIONS (FY87)	153,973.6	75,000.0	151,246.9

Other Statutory Repeal (HB 500, s. 16)			
Highway Equipment Working Capital Fund	25,000.0	25,000.0	Fnd. 22652 moved in FY 87

HB 574 Totals: Sectional 8/1/86, Sorted 7/31/86 (Ref.: disks 17, 19)

DSP/OMB 11/27/86

* GF inv. income adjustment to resident tax
entire 23.2 outside funding

ATTACHMENT # 5

INTRODUCTION REVENUE OPTIONS

The attached sheets identify a variety of general fund revenue measures, both one-time and recurring, which could be used to cope with the FY87 year-end shortfall and to bolster state revenues for FY88 and in the future.

This information is presented with several strong caveats:

First, these measures are options, not recommendations by the budget team.

Second, the budget team consistently chose the lowest estimates of revenue generation available. Some of the options, if adopted, might raise more revenue than that which was identified.

Third, some of the options are mutually exclusive. You cannot, for example, choose to phase out AHFC and still receive a yearly income return from AHFC interest flowing to the General Fund.

Fourth, all options are not equal in terms of good public policy, ease of implementation, or political soundness.

Finally, any and all of these options must be thoroughly researched and analyzed before being adopted by the new administration.

REVENUE OPTIONS
(in millions \$)

	<u>FY87</u>	<u>FY88</u>	<u>FY89 & Beyond</u>
G.F. Revenues-unrestricted	\$1,399.2	\$1,325.0	\$1,373.9 (FY89)
Adjustments to G.F.	<u>7.4</u>	<u>0</u>	<u>0</u>
Current Unrestricted G.F	<u>1,411.6</u>	<u>1,325.0</u>	<u>1,373.9</u>
<u>ONE-TIME REVENUE MEASURES:</u>			
Budget Reserve Fund*	428.5		
Railbelt Energy Fund*	281.0		
AHFC Purchase of HAD Loans	100.0		
Bradley Lake (Change of funding source)	95.0		
Cash-out Loan Fund Balances*	37.3		
Sale of Student loan Portfolio	136.0		
Sale of Other Loan Portfolios	122.9		
Dinkum Sands			238.0 (FY89)
Amerada HESS			? (FY90)
Disputed Taxes	?	?	? (\$1,495.0 owed in disputed taxes)
Repeal of Prior Year Cap. Approp.*		? (up to \$950.0)	
Unencumbered AIDA Assets	152.0		
Sale of State Assets			?
(AHFC, Ak Railroad, 4-Dam Pool, AIDA)			
<u>RECURRING REVENUE MEASURES:</u>			
Lottery*		11.8	11.8
Gov't. Loans & Debt:			
Debt Restructuring	50.0	45.0	35.0
AIDA Income Return to G.F.	28.9	28.9	28.9
AHFC Income Return to G.F.	41.8	41.8	41.8
AHFC Phase-out	?	?	?
Permanent Fund:			
Earnings Reserve*	281.0	18.0	0
Inflation Proofing*	138.0	357.0	484.0
Dividends*	362.0	393.0	423.0
Oil Taxes:			
ELF*	31.5	123.4	151.8
Severance Tax*		?	?
Petroleum Corporate Income Tax*			
(See Corporate Income Tax)			
Separate Accounting*		?	?
Reserves Tax*		280.0	280.0
Oil			
Gas			
Property Tax (per 1 mill)*		16.0	16.0

	<u>FY87</u>	<u>FY88</u>	<u>FY89 & Beyond</u>
Other Business Taxes & Licenses:			
Motor Fuel Tax Increase (\$.08/gal inc.)*		20.0	20.0
Aviation Fuel Tax Increase*		7.7	7.7
Waterfuel Tax Increase*		4.1	4.1
Misc. Fees Increase*		35.8	35.8
Licenses & Permits	5.4		
Corp.			
Occ. Lic.			
Motor Vehicles			
Bev. Lic.			
Amuse.			
Fishing & Hunting			
Vehicle License			
(1% of value)	13.4		
APUC	4.0		
Oil & Gas Cons.	2.5		
Bus. Lic. Fees	9.5		
Misc.	1.0		
 Tobacco Tax*		1.5	1.5
Alcohol Tax*		4.8	4.8
Business Gross Receipts*			
Regressive		31.7	38.4
or		or	or
Flat		53.9	62.3
Corporate Income Tax *		93.0	93.0
Household and Individual:			
Income Tax*		125.0	250.0
Sales Tax @ 1% *			
with food		55.4	55.4
or		or	or
excluding food		33.0	33.0
School Head Tax (@ \$25 per person)*		5.0	5.0
 Real Property Tax*		?	?
Personal Property Tax*		?	?
Land Speculation Tax*		?	?

* Legislation Required

ONE TIME REVENUE MEASURES:

Budget Reserve Fund

The "buffer" fund was created last year out of the former "rainy day" fund and \$139 million from settlements of disputed oil tax matters. The current balance of the fund is approximately \$428.7 million. By statute, 25 percent of this amount will be available for spending in the FY88 budget.

[Source: OMB 12/86]

Railbelt Energy Fund

The \$281 million in this account was originally appropriated to assist in financing the now defunct Susitna hydro project. It is argued that the fund should be reserved for energy related capital projects in the railbelt area. For some, this apparently includes the Bradley Lake project, but others argue that project should continue to be financed from the state General Fund. [Source: OMB 10/86]

AHFC Purchase of HAD Loans

The remaining value of Housing Assistance Division loans has not been determined (because of delinquencies and poor market conditions reduce portfolio market value), but the Alaska Housing Finance Corporation estimates that it would purchase the remaining portfolio for approximately \$100 million. This amount could be returned to the general fund.

[Source: Ron Lehr, AHFC, meeting with budget transition team 11/86]

Bradley Lake Reappropriation

The General Fund can realize \$95.0 million through cancellation of the Bradley Lake hydro project. If the project were continued through the Railbelt Energy Fund, the General Fund could realize \$50.0 million appropriated for FY 87 and would be relieved of responsibility for an additional \$50 million proposed for FY 88 to complete the general fund portion of the project. [Source: OMB 12/86]

Cash-out Loan Fund Balances

This amount represents existing cash balances and gain from FY 87 restrictions of lending activity in DCED, APA and DNR loan programs. [Source: OMB 8/86]

Sale of Student Loan Portfolio

The State currently has a portfolio of approximately \$350M in student loans. The sale of the Student Loan Portfolio could realize \$136.0M, given current defaults. The annual income stream from loan repayments to the Post-secondary Education Commission would be lost. [Source: Milt Barker, Dept. of Revenue memo to transition team 12/86]

Sale of Other Loan Portfolios

In addition to the Rural Housing Assistance Loans (see AHFC purchase of HAD loans) and the Student Loan Portfolio (see sale of Student Loan Portfolio) the State also holds Agricultural loans (equity \$96M), Power Development loans (equity \$188M), and other Commerce loans (equity \$148M). The

sale of these loan portfolios could realize \$122.9M, given current default and delinquency rates. The annual income stream to these loan programs would be lost. [Source: Milt Barker, Dept. of Revenue, memo to budget transition team 11/86]

Dinkum Sands

U.S. v. Alaska. This case is a dispute over ownership of the Dinkum Sands area bordering the Arctic Ocean. Oil companies paid the U.S. government for the right to explore for oil in the disputed area. That money, plus interest, now amounts to \$1,150 million, which is being held in escrow by the federal government. The Department of Law says the state has a good chance of securing this outcome. Even under the worst possible outcome the state would receive 27 percent. (Gov. Sheffield sought but did not secure the release of the 27 percent). Assuming no negotiated settlement, the case will probably be resolved in the U.S. Supreme Court in late 1988. [Source: Barbara Hermann, Dept. of Law briefing of budget transition team 11/86]

Amerada Hess

Alaska v. Amerada Hess et al. This litigation concerns the valuation of royalty oil. If all issues are resolved in favor of the state's position Alaska will receive "hundreds of millions" according to the assistant attorney general handling the case. The state hopes to reach trial on the merits in state superior court in early 1988. Assuming no negotiated

settlement, appeals could take several years. [Source: Bob Maynard, Dept. of Law, briefing of budget transition team 11/86]

Disputed Taxes

The Department of Revenue claims that taxpayers owe the state \$1,495 million in back taxes thru 1982. Ninety-seven percent of this amount arises from disputes with oil companies concerning severance tax assessments and disagreements over net income determinations under the oil and gas corporate income tax. The Department believes that it will eventually collect a large proportion of this amount, but will make no estimate of the amounts likely to be collected in any particular fiscal year. [Source of estimate: Dept. of Revenue, budget transition team 11/86]

Unencumbered AIDA Assets

AIDA currently has an estimated \$162.0 million in unencumbered assets which could be utilized to purchase State assets. For example, ASHA issued State Lease Revenue Bonds through 1974 for construction of public buildings which were secured by long-term leases with the State. All structures leased to the State are operated and maintained by the State. A total of \$106M in ASHA bonds was issued. Currently, the debt remaining is less than \$40,000,000. Included in the facilities originally financed by ASHA was the Juneau State Office Building (completely paid off). Refinancing the State

Office Building through an agency such as AIDA would provide an injection of cash on a one-time basis, by increasing future operating costs in lease payments to repay this new debt.

[Source: Budget Transition Team 12/86]

Sale of State Assets

The State holds significant financial and other assets in AHFC, AIDA, the Alaska Railroad and the Alaska Power Authority. These assets could be sold (or the corporations privatized through sale to the private sector). No estimates are available for yield to the state from these actions.

Sale of AHFC - Privatization. In June 1986 the corporation held cash and marketable securities worth over \$2 billion, among total assets of \$6.4 billion. If all the mortgages held by AHFC were paid off, and if AHFC in turn paid back the money it had borrowed in the bond market, \$1.5 billion would remain. If the subsidized loan program were terminated, all of this amount could eventually be returned to the general fund (over a period of 10-15 years). Effects on the housing market and Alaska economy have not been evaluated.

[Source: OMB, AHFC 12/86]

Repeal of Prior Year Capital Appropriations

Capital appropriations do not lapse to the general fund if they are not spent during the fiscal year in which they were appropriated. Repeal of these unspent appropriations

could provide one-time availability of funds for reappropriation. There is a total of approximately \$950 million in unspent capital project appropriations. This total is divided between state agency projects and capital project grants, mostly to local governments.

In the last two years the backlog of unspent capital has been picked over intensively; most of the remaining money is being counted on by some community or agency, though the legislature could still legally reappropriate some portions. [Source: Budget Transition Team, 12/86]

RECURRING REVENUE MEASURES:

Lottery

A state lottery as proposed during the last legislature could yield approximately \$12 million in net income to the state. [Source: Legislative fiscal note 1/86]

G.O. Bond Debt Restructuring

This restructuring action can be accomplished by the Executive Branch through the Bond Committee.

Debt can be rescheduled in various ways to provide for example (1) level debt service, (2) a constant annual percentage of unrestricted revenues, (3) a short maturity schedule of fifteen years duration, (4) a longer schedule which provides for a lower dedication of an annual percentage of unrestricted revenues and provides for future debt

capacity, (5) varying costs or savings on a present value basis dependent upon serial or term maturities and interest rates or (6) the opportunity to capitalize interest if necessary and prudent.

Existing debt could be rescheduled in its entirety or partially. Such rescheduling could reduce debt service payments by up to \$50 million per year. The effect of restructuring would be to lower State debt service payments over the FY 87 - FY 89 period, while increasing those payments in the subsequent years. [Source: Bond Counsel and budget transition team worksheets 12/86]

AIDA/AHFC Income Return to G.F.

Net income for the two agencies for FY 86 was \$28.9M (AIDA) and \$41.8M (AHFC). Both have substantial equity. There is no evidence that new income flow is currently utilized to secure new debt or is pledged to secure existing debt. Automatic retention of earnings by AHFC and AIDA may not pass constitutional muster if challenged. In recent years, earnings from other entities have been appropriated back to the agencies by overt legislative action. [Source: Budget Transition Team, 12/86]

PERMANENT FUND:

Earnings Reserve

By the end of the current fiscal year the reserves are expected to contain a \$281 million excess after transfers for inflation-proofing and payments of dividends. This money, along with a possible \$18 million accumulating during FY88, could be appropriated to the general fund. This transfer would require no change in statute (other than an appropriation). [Source: Alaska Permanent Fund Corporation 12/86]

Inflation Proofing

The Permanent Fund Corporation projects that it will set aside \$138 million for inflation-proofing in FY87 and \$357 million in FY88. If these amounts were diverted to the FY88 budget, by statute the result would be an erosion of the real value in the principal of the permanent fund. [Source of estimate: Alaska Permanent Fund Corporation 12/86]

Dividends

Under current law the Permanent Fund Corporation projects that \$362 million and \$393 million will be available for dividends in FY87 and FY88 respectively. Both amounts could be diverted by statute all or in part, to the General Fund. Currently, dividends are calculated each year based upon one-half of 21% of 5 year earnings of the Fund. [Source: Alaska Permanent Fund Corporation 12/86]

OIL TAXES:

ELF

Elimination or modification of the Economic Limit Factor (ELF) provision could increase FY 88 forecast severance tax revenue by an estimated \$70 to \$150 million. Although, studies by the Department of Revenue suggest that the ELF changes under discussion will cause a small loss of future production, every barrel of forgone future production will yield approximately \$70 in additional tax revenue. There are several options for changes in ELF; this estimate is based on the "field alternative" now under study by the state Tax Policy Committee. [Source: State Tax Policy Committee 12/86]

Severance Tax

The current 15 percent rate on Prudhoe production compares to a range for other fields in Alaska from zero for most Cook Inlet fields to a high of 7.7 percent for the Kuparuk field. [No estimates have been developed for this alternative]

Petroleum Corporate Income Tax (see Corporate Income Tax - Business Taxes)

Separate Accounting

Alaska's oil & gas corporate income tax is forecast to collect \$110 million in FY 87. OMB estimates that return to

some form of the separate accounting method of determining income for oil and gas corporations would increase FY 88 revenue under current forecast scenarios; the amounts would be larger if the change to separate accounting were made retroactive to January 1987. Separate accounting is more sensitive to price than the existing tax and therefore could result in reduced revenue in latter years. The separate accounting method used in Alaska from 1978 to 1981, was withdrawn in the face of a legal challenge that subsequently failed. [No estimates have been developed for this alternative]

Reserves Tax

Alaska does not currently tax the property value of oil and gas reserves. (The state did impose this tax in 1975 and 1976). Reimposition of the reserves tax at the previous 20 mill (2 percent) rate could bring as much as \$280 million annually. [Source: Dept. of Revenue 1/86]

Property Tax

Alaska does tax the property value of facilities and equipment used in oil and gas production and transportation. The tax rate is 20 mills, with a part of the revenue is returned to local governments, depending on the local tax rates. Each one mill increase in the tax rate would increase state property tax revenues by \$18 million, though about 10 percent of this increase would be offset by resulting

decreases in severance tax and royalty revenue. Because of the offsetting reductions, add only \$16 million for each mill (tenth of a percent) increase in the oil and gas property tax. [Source: Dept. of Revenue 1/86]

OTHER BUSINESS TAXES & LICENSES:

Motor Fuel Tax

Aviation Fuel Tax

Waterfuel Tax

If all fuel taxes were doubled and allowed to increase with inflation, the following additions to revenue would result:

	FY87	FY88
(Million \$)		
Highway Fuel Tax	25.0	28.5
Aviation Fuel Tax	8.3	9.6
Marine Fuel Tax	6.1	7.7

The incidence of the tax is on both consumers of highway fuel and consumers in general. A portion of the tax is paid by business on the fuel they use in producing goods and services and is passed on to consumers in general. The incidence is regressive because fuel expenditures represent a larger percentage of income for low income as compared to high

income taxpayers. Part of the incidence is shifted out of state to nonresident tourists who consume fuel within Alaska.

In terms of economic efficiency, this tax makes fuel relatively more expensive compared to other commodities, thus altering consumer choices and resource allocation.

In practice, the demand for fuel is fairly inelastic relative to price changes over the short term and within a reasonable price range. Thus the yield from this tax should be fairly stable and increase proportionally to any rate increase. If population in Alaska increases, the highway fuel tax would show a proportional increase.

Administrative and compliance organizations are already in place and changing the rates would not entail any additional costs. [Source: Dept. of Revenue 1/86]

Miscellaneous Fees Increase:

Licenses and Permits

Licenses and permits, including corporation/occupational licensing fees (AS 02.05, AS 10.05-.35, AS 21.06-.90), motor vehicle fees and permits (AS 05.30, AS 28.10-.15, AS 42.10), alcoholic beverage licenses (AS 04.10), amusement and gaming fees (AS 43.35) and fishing and hunting licenses (AS 16.05 and AS 16.43), could be increased. If all the licenses and permits were allowed to increase with inflation, the following

additional General Fund and Fish and Game Fund amounts would be realized:

	FY 87	FY 88
Licenses & Permits	3.2	5.4

(millions \$)

If revenues from licenses and permits are still considered insufficient, a vehicle license fee could be enacted. The vehicle license fee could be levied at the time of registration in lieu of a property or ad valorem tax at a rate of 1% of vehicle market value. The following additional revenues could be generated:

	FY 87	FY 88
Vehicle License Fee	12.8	13.4

(millions \$)

[Source of estimate: Dept. of Revenue 1/86]

APUC

Changes in APUC funding are available through levying a gross receipts tax on utilities and common carriers, and/or allocating the cost of staff time on specific proceedings. Both options reasonably associate the cost of regulation with the benefits derived from the work of the APUC and of the Department of Transportation. (This option is included in Governor's Budget for the year of Nov. 24, 1986. [Source: Dept. of Transportation])

Oil & Gas Conservation

The existing oil and gas conservation tax in AS 43.57.010 can be increased to cover the amount of the operating costs of the Alaska Oil and Gas Conservation Commission ("commission"). An oil and gas conservation tax is included in most of the conservation Acts of the 30 oil and gas producing states. The tax would be in the amount of four mills per barrel of crude oil and 50,000 cubic feet of natural gas. The commission has calculated that approximately \$2,680,000 would be collected annually if this bill were enacted. (This option was included in Governor Sheffield's draft budget of Nov. 24, 1986).

[Source: Dept. of Revenue 1/86]

Business Licenses

The license fee for each business is currently \$25 for each year or portion of a year for which the license is issued. This option would increase the annual fee to \$100.

[Source: Dept. of Revenue 1/86]

Miscellaneous Fee Increases

Includes user fees increase for parks, museum, etc.

[Source: Budget transition team estimate from new legislation and transition reports]

Tobacco Tax

If the cigarette tax were allowed to increase with inflation, and the contribution amount per pack to the School

Fund held constant at \$.05 per pack, the following additional General Fund amounts would be realized:

	FY 87	FY 88
Cigarette Tax	0.9	1.5
(millions \$		

[Source: Dept. of Revenue 1/86]

Alcohol Tax

If Alaska were to equalize its excise tax rate on wine and beer to the equivalent amount of absolute alcohol contained liquor, it is estimated the revenue gained per year would amount to \$4.7 million. Using the absolute alcohol amount in liquor as the base in an excise tax rate of \$5.60 per gallon, the equivalent rate for wine would be \$1.83 per gallon and for beer would be \$0.58 per gallon. [Source: DHSS memo 10/30/85]

Business Gross Receipts Tax

The gross receipts tax portion of the Alaska Business License Act, AS 43.70, could be reenacted. Currently under AS 43.70 all persons or businesses must purchase annually a business license costing \$25 for the privilege of engaging in a business in the state. Previously, most businesses paid a tax on their gross receipts equal to one-half of one percent on gross receipts between \$20,000 and \$100,000 and one-quarter

of one percent on gross receipts in excess of \$100,000. If this gross receipts tax were reenacted with previously existing rates, the following additional revenues would be generated:

	FY 87	FY 88
Business License Tax	36.1	38.4
(millions \$)		

If the gross receipts tax were reenacted but if the previous regressive rate structure were replaced with a flat rate of one-half of one percent on all gross receipts in excess of \$20,000 the additional revenues would be as follows:

	FY 87	FY 88
Business License Tax	58.0	62.3
(millions\$)		

Sixty percent of the previous gross receipts tax went to local incorporated areas. If this aspect were retained, the net to the state would be approximately 40 percent of the above amounts.

Corporate Income Tax - Petroleum & Non-Petroleum

The existing graduated rate schedule could be extended by adding additional marginal tax rate categories. Presently all taxable income over \$90,000 is taxed at a rate of 9.4 percent for both petroleum and nonpetroleum corporate tax payers under the Alaska Net Income Tax Act, AS 43.20. If additional

categories were added such that taxable income between \$1 million and \$4 million would be taxed at 10 percent, taxable income between \$4 million and \$10 million at 11 percent, taxable income between \$10 million and \$100 million at 12 percent, taxable income between \$100 million and \$500 million at 13 percent, taxable income between \$500 million and \$1 billion at 14 percent and taxable income over \$1 billion at 15 percent the following amounts of additional revenues are projected.

	FY 87	FY 88
Corporate Income Tax	92.5	93.0
(million \$)		

Although the corporation pays the tax, the burden may fall on equity owners, employees, suppliers or consumers of products produced by the corporation. For this reason it is not possible to say whether the effective incidence is progressive or regressive even within this nominally progressive rate structure. It is likely, however, that at least part of the burden is shifted out of state to nonresident equity owners and consumers. The total burden of state corporate taxes is diminished by the provisions which allow the deduction of state corporate income taxes from taxable income when computing federal taxable income. [Source: Dept. of Revenue 1/86]

HOUSEHOLD AND INDIVIDUAL TAXES:

Income Tax

The Alaska Net Income Tax AS 43.20.011 (a)-(d) could be reenacted to apply to individuals. If a measure similar to the previous tax were instituted, the Department of Revenue estimated the following amounts of additional revenue could be generated:

	FY 87	FY 88
Individual Income Tax	330.0	352.0

(millions \$)

These estimates were based on the most current DOR employment and income projections combined with previously estimated individual income tax equations available, Jan. 1986. The budget transition team revised these estimates downward to approximately \$250M based on the revision of federal tax rates and expected lower levels of economic activity in Alaska.

[Source: Dept. of Revenue 1/86 as modified by budget transition team]

General Sales Tax

A general sales tax could be enacted at the State level. Alaska currently has no sales tax at the State level, however seven boroughs and fifty-nine smaller municipalities do levy some form of sales tax. The rates levied range from one percent to five percent with six percent being the maximum a municipality is allowed to levy under AS 29.53.415. The base upon which these rates are levied also varies with different exemptions being allowed in various communities. If a sales tax were enacted at the State level it would be in addition to the tax at the local level.

Currently forty-five of the fifty states levy some form of sales tax at the state level. Food purchases, except restaurant meals and alcohol, are exempt in twenty-eight of the forty-five states. Prescription drug purchases are exempt in forty-three states. Gas and electric utility bills are exempt to some degree in thirty-two states. Five states exempt clothing purchases to some degree. Also, nine states allow some credit for sales taxes paid against state income tax liability. These various exemptions and credits are meant to ameliorate the regressive incidence of the sales tax. The rates levied on taxable purchases of goods and services varies considerably from state to state with a low of three percent to a high of seven and one half percent. The median rate levied by states which exempt food is five percent and by those which do not exempt food is four percent.

Based on Jan. 1986 projections of Alaska personal income the probable revenue yield from a one percent sales tax would be as follows:

	FY 87	FY 88
Sales Tax Revenue	42.5-70.0	44.3-73.8

(millions \$)

The two figures shown for each year represent point estimates of the probable sales tax revenues with and without a food exemption. Also note these figures are for a one percent tax rate so the yield from a higher tax rate can be calculated accordingly. In reviewing these estimates, the Budget Transition Team has discounted the yield from a 1% sales tax to reflect a downturn in the Alaska economy.

[Source: DOR 1/86, revised by Budget Transition Team 12/86]

School Head Tax

The school head tax was a \$10.00 head tax assessed all individuals employed in the State. The tax was repealed at the same time individual income taxes were repealed. Reenactment of a head tax at \$25.00 per head is estimated to result in a collection of \$5M annually, based upon an estimated 200,000 individuals employed in the State annually.

[Source: Budget Transition Team, 12/86]

Real Property Tax

Real and personal Property Tax in Alaska has generally been held to be within the purview of local governments. Many states do, however, levy real and personal property taxes on a statewide basis to be reallocated to local communities through revenue sharing, or some other form of local government assistance, in an effort to equalize local wealth. [No estimates have been developed for this option]

Personal Property Tax

(See Real Property Tax)

[No estimates have been developed for this option]

Land Speculation Tax

A land speculation tax could be developed to tax capital gains on land purchases at the time of sale. [No estimates have been developed for this option]

Subcommittee Report on Revenue Forecasting and Petroleum
Revenue Data

Budget Transition Team
December 12, 1986

Subcommittee Members: Brian Rogers, John Sackett and Richard Fineberg

Summary: In the face of the extremely difficult challenge posed by changing oil prices, it is not clear that the revenue forecasting model and the procedures used by the Dept. of Revenue (DOR) provide timely, useful and accurate information on anticipated State revenues. Non-forecast uses of petroleum revenue data are similarly unwieldy. This report identifies seven problem areas and recommends broad approaches for resolution. None require statutory action.

Five of these problems relate to the Department of Revenue; the final two points are inter-departmental.

1. The DOR forecast system appears slow to respond to major price shifts.

The December 1985 forecast anticipated significant increases from the previous forecast for the fiscal year (then nearing its midpoint) and revenue increases and for each of the next two fiscal years. The March 1986 forecast reflected a significant drop for all three years but failed to reflect the severity of the revenue decline, even though the price slide was nearly complete. (Graphs submitted to the transition team show that the daily spot-market price for ANS crude had reached its 6-month bottom-point at approximately the same time the March forecast was issued.)

In 1982 we note that the forecast was similarly slow to respond to unforeseen declines in oil prices.

RECOMMENDATION: Based on failure to anticipate significant price swings in two of the last five years, the possibility of developing a different forecasting system should be explored.

2. The DOR forecast system produces confusing results.

In the March 1986 forecast, DOR attached this caveat to its 30%-case estimates:

"If there is a chance for error in this forecast it is on the optimistic side, i.e., the downside risk is much greater than any perceived upside potential."

Subcommittee Report: Revenue Forecasting
Budget Transition Team
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A similar warning has appeared in each of the last three forecasts. The warning appears to have been valid: Even the reduced March 1986 forecast figures were significantly higher for FY 87 and FY 88 than the current forecast levels. Nevertheless, we find the forecasters' caveat perplexing. The essence of the 30%-case forecast is that it is conservative -- i.e., there is a 70% chance that revenues will exceed the forecast. How, then, we wonder, can it be that each of the last four supposedly conservative, 30%-case forecasts erred to the optimistic side? We are not aware that DOR has instituted measures or recommended revisions to the forecast system that produced this paradox.

RECOMMENDATION: If conservative forecasting is desired to lessen disruptions to services due to the volatility of oil prices, new bases for revenue forecasting should be developed. (The existing model should be maintained to test simpler systems.)

3. The forecast system seems unresponsive to short-range demands for revenue forecast information.

During the price decline of early 1986, DOR expressed confidence in its December and its March estimates long after other State observers had concluded those forecasts were no longer likely to be valid. And as recently as Nov. 11, 1986, DOR forecasters advised the Budget Transition Team the October forecast was "on-target" now but could slide next spring. Three weeks later, the new forecast reduced current-year revenue by \$74.4 million. This decline would have been greater without the serendipitous aids from tax breaks and a tardy reduction to the TAPS tariff in the forecast model.

RECOMMENDATION: If the current petroleum revenue model is maintained as the primary forecasting device, consideration should be given to updating the quarterly forecast monthly by plugging in new price data on a microcomputer spread-sheet. (Changes could be reported monthly, based on a formula that analyzed reported spot price trends subsequent to that forecast.)

4. DOR system results depend on terms that need closer examination and better public reporting.

Production costs, capital costs, pipeline tariff, tanker charges and market prices are representative of key parameters that affect the State's revenue stream. In some cases, major sums ride on the costs applied to these terms. Because 90% of the North Slope production and its pipeline conduit are owned by three large companies, many of these

cost elements are not determined in normal, open market transactions. For this reason, it is disturbing that these key terms are not recorded in consistent form in one place. For example, the Dept. of Natural Resources publishes monthly field data that are uncorroborated and difficult to reconcile with DOR reports. To develop a comprehensive picture of the three major companies' and the State's share of a barrel of oil, it is necessary to extract data from a variety of reports and data bases.

RECOMMENDATION: In view of this unique economic situation and its fiscal importance to the State and the State's economy, DOR should assemble comprehensive and consistent data through which interested citizens can understand the economics of Prudhoe Bay.

5. DOR systems do not respond well to non-forecast policy demands.

In recent years the Legislature, the Governor's office and other would-be users of public information have experienced difficulty obtaining timely and useful information concerning the mechanics of the forecast model, and to public policy issues relating to State oil revenues. Examples of inadequate public information and inter-agency review include the final review of the TAPS settlement, separate accounting, the ARCO settlement and analysis of the ELF.

RECOMMENDATION: The Governor should take steps to ensure that DOR fulfills its public trust by making maximum information on key petroleum revenue issues available to all involved agencies and to the public in a useful and timely manner.

6. Confidentiality often serves as a bar to information on North Slope economics.

In recent years, many aspects of oil economic questions have been kept behind the screen of confidentiality. For example, the Oct. 23, 1985 confidential decision-document on the TAPS case was modified after decision-meetings were held and before the document was released; the version on which the decisions were made was never made public. In 1986 a North Slope producer expressed dismay that DOR made public the producer's intention to seek revision of existing mechanisms to secure public revenue. While we recognize individual and tax-payer rights to privacy, on the other hand it must be noted that these events are typical of public policy decisions that rightly belong in the public sector.

RECOMMENDATION: Before information is stamped "confidential," the Dept. of Law and the managing state agency should ensure that it is indeed necessary and proper to withhold that information from the public. If confidentiality bars release of individual tax-payer information, the agencies should attempt to assemble and release aggregate data that do not compromise an individual tax-payer's rights.

7. Better inter-agency coordination of outstanding petroleum revenue tax challenges and litigation is needed.

Because the State's royalties are derived from the State's function as steward of the land, this branch of oil revenue is managed by the Dept. of Natural Resources (DNR). Because the economic factors identified in Item 4 (above) affect both royalties and production taxes, multi-department analyses of these factors should be coordinated. (Coordinated analysis was evidently lacking in the trans-Alaska Pipeline rate case.)

With amounts well in excess of \$1 billion depending on the outcome of the Dinkum Sands and Amerada-Hess litigation and an even larger sum dependent on disputed taxes (almost all of which derives from the North Slope operations of the same three companies), the lead department in each of these endeavors needs the best information the other can provide.

RECOMMENDATION: The Governor's office should take steps to insure (1) that petroleum revenue data produced by different agencies are clear and consistent and (2) that legal efforts are coordinated by an inter-agency working group to guarantee a thorough review of all involved agencies before final decisions are made.

ISSUE PAPERS

A series of Issue Papers have been prepared which address a wide range of financial and policy concerns.

Some of the options covered by these Papers appear in a more brief form, elsewhere in this report.

- I. Budget Reduction Timing Strategies - 1988 - 1992
- II. Reduction of State Reimbursement of School Construction Debt
- III. Analysis of the Functions of State Government - Structural Change
- IV. Reduction of Annual General Obligation Debt Service - Rescheduling State Debt
- V. Appropriation of Permanent Fund Earnings
- VI. Sales Tax and Income Tax Options
- VII. Revenue Enhancement - Purchase of Housing Assistance Division (HAD) Community and Regional Affairs Loans From the State By AHFC
- VIII. Disposition of Alaska Industrial Development Authority (AIDA) and Alaska Housing Finance Corporation (AHFC) Earnings
- IX. Revenue and Liquidity Enhancement - Sale and Leaseback of State Facilities
- X. Reduction of Expenditures - Employer's (State of Alaska) Contributions to Employee Retirement Plans

SUBJECT: Budget Reduction Timing Strategies: 1988 - 1992

PROBLEM: Revenue projections indicate that State budgets must be dramatically reduced and, once reduced, must be contained.

A major policy decision centers around the strategy of whether the budget should be brought down in easy stages or whether Alaska will best be served by an abrupt, immediate and steep reduction.

ANALYSIS: Proponents of a gradual budget decline scenario argue that:

1. A major part of the operating budget is comprised of personal services. An abrupt reduction of the work force will increase unemployment and reduce the amount of available disposable in an already faltering economy.
2. Capital construction has been pared to the bone. This sector of the private work force has unprecedented unemployment and business failure. State projects should continue at a reasonable level to protect the existence of this economic sector.
3. Rainy day savings (to include buffer account, litigation settlements, and permanent fund income) should be used to "let down" the budget over a period of years. This will not only continue State provision of essential services but will provide needed economic activity and preclude a statewide economic tailspin. These reserves represent "rainy day" reserves, and the rainy days are here!

Proponents of an abrupt budget decline scenario argue that:

1. Uncertainty brought about by a prolonged and continuous stream of reductions has a devastating effect on lives, careers, programs and performance. Alaskans can deal with known adversity, but you cannot burden them with years of fear and anxiety.
2. Bad news feeds on itself. A steady stream of bad news (over a five-year term) is self-defeating in that it will perpetuate and prolong a poor economic outlook and will have a long-term chilling effect on the economy.

3. An artificial propping up of non-effective or un-needed programs is a luxury the State cannot afford. These types of programs must be discarded without delay.

Many actions designed to integrate, consolidate or eliminate programs and resources can only be implemented by legislative action. While the Executive may formulate proposals and successfully pursue them through the legislative process, the actual realization of a portion of savings will occur over time rather than in the most immediate budget year.

CONCLUSIONS:

1. An abrupt reduction -- and the immediate pain associated therewith -- is more direct and intellectually honest than letting the budget down gently.
2. An abrupt reduction will not occur in any event because of the need to secure statute change through legislative action. Many programs have been legislated for decades and may have well established constituencies. It may be naive to believe that these programs can be consolidated, integrated or abolished in a single legislative session.

OPTIONS:

1. Abruptly and aggressively reduce the 1987 and 1988 budgets within the limits of the authority of the Executive branch of government.
2. Aggressively fashion analyses and legislation (with negative fiscal notes) for legislative consideration which will have an early effect on budget reduction.
3. Budget submissions which anticipate rapid and favorable legislative action set forth in No. 2 above -- and for which public consensus and support are apparent -- should contain projected deletions/reductions.

SUBJECT: Reduction of State Reimbursement of School Construction Debt

PROBLEM: Can the annual reimbursement be reduced thus materially reducing the operating budget? What methodology should be employed?

ANALYSIS: As of June 30, 1985, local governments had incurred general obligation debt in the amount of \$738,493,553 for school construction. Additional debt has been incurred since that date.

Local governments are required to incur this debt, equal to 100% of school construction, since the State desires to frustrate goldplating. It is assumed that if a city must provide for "up front" funding of schools, it will only construct essential facilities.

Under several statutory enactments, the State may reimburse these local governmental units for a percentage of debt service (principal repayments plus interest). This reimbursement ranges from 80 to 100 percent of debt service but may be prorated downward depending upon the level of appropriation. In the sale of bonds, local governmental units disclose the reimbursement procedure and bond buyers rely on representations that the State will honor the commitment made.

Managerial problems are exacerbated at the local level if reimbursement is not consistent with the levels set forth by statutes and representations made to bond holders. The local unit position is even more critical if a deep pro-ration of available funds takes place on short notice.

Local units can restructure this debt. By capitalizing current and/or coming year debt, they can eliminate near-term payments entirely. More reasonably, they can reschedule over a longer payback period and reduce the annual strain on their operating budgets.

The restructure of this debt, discussed above, has a mirror effect on the State operating budget because of the reimbursement factor. If a local unit reduces its debt service in a given year, the State reimbursement is also reduced.

If, however, the State arbitrarily and unilaterally reduces the reimbursement to a level not acceptable to bond buyers prior to local rescheduling, it forecloses the ability of local units to restructure their debt. Thus, such action could place a local unit in a perilous financial position without any sound economic remedy. A reduction of reimbursement must be coordinated so that new debt schedules can parallel new reimbursement schedules.

Quite apart from main line operating budget problems created at both the local and State levels, there are other critical considerations. Some are set forth below:

The employment of the existing scheme to avoid goldplating places a severe strain on the bonding capacity of a city or borough. An overwhelming percentage of debt capacity is consumed by school debt; thus precluding the ability to bond for water, sewer, roads and other essential municipal capital improvements.

If cities could avoid incurring school-related debt, they would have greater debt capacity and no State reimbursement uncertainty which should threaten their credit standing.

If cities could avoid incurring the State's portion -- say, 80 percent -- they would know with certainty what their exact debt service requirements for school construction would be and would not be subject to varying annual appropriations by the State.

The present scheme is self-defeating. Because it destroys city debt capacity, it assures that cities rely on the State for capital appropriations for other capital improvements such as water, sewers and roads. All of these needs are not necessarily State responsibilities, whereas education clearly is.

The present scheme is more costly than it should be. It is clearly established that the State of Alaska has a better bond rating than any city within the State. State bonds carry lower interest costs than city bonds. Clearly, if the State bonds for school construction, the overall cost will be less.

CONCLUSIONS:

Annual operating budgets can be reduced (in the near-term) through debt rescheduling.

The problems surrounding school construction debt reimbursement are numerous and complex and involve not only matters concerning the current year's operating budget but the more basic question of how Alaskans are going to structure the school construction program for the future.

Local governments and the State are inextricably tied to seeking mutually acceptable, articulated solutions to the problems inherent in the current program. Unilateral action by the State could produce even more chaos than currently exists.

OPTIONS:

Convene a panel of Department of Education, State Bond Committee and Municipal Government personnel to:

1. Formulate a specific course of action which provides for rescheduling local debt and State reimbursement on a fully coordinated basis.
2. Prepare statutory/regulatory documentation for enactment/adoption.
3. Address the long-range solution to the several problems addressed above which might include but not be limited to:

- a. State abandonment of the present reimbursement scheme and assumption of all responsibility for school construction in accordance with clearly established construction standards. Since the State bears the cost, cities must accept the standards.
- b. Granting cities the option of exceeding the above-mentioned standards provided they bear the total cost of the enhancement.
- c. Seek voter approval to issue State general obligation bonds, the proceeds of which would be used to defease all or part of the school construction debt of cities. This provides parity between organized municipalities and school districts outside of municipalities, would eliminate future funding uncertainties, and would restore debt capacity of cities for other essential capital projects.

SUBJECT: Analysis of the Functions of State Government - Structural Change

PROBLEM: Falling revenues clearly mandate that the State cannot conduct "business as usual"; some fundamental changes must be made in the functions it performs.

ANALYSIS: Alaskans currently receive services from three sources: (1) directly from the State; (2) directly from borough governments; and, (3) directly from city governments.

The provision of services is not equal. Some residents receive services only from the State - choosing not to fall within an organized unit of government.

Others live within a city and receive city and State services.

Others live within a city located within a borough and receive city, borough and State services.

And others live within boroughs (but not cities) and receive borough and State services.

In addition to unequal provision of services, there is also unequal taxation. Many who live within organized units of government pay high taxes for a specific service (such as education) while those who live within the unorganized borough pay no taxes at all.

As budgets are reduced, inequalities as to taxes and services may become even more imbalanced. It may be necessary for the State to shed itself of some of the functions it performs and pass responsibility for these functions on to local units of government.

Should the State continue providing services directly to individuals?

Should there be at least one level of government between each individual and the State?

Should the local level of government -- that which is closest to the people -- be responsible for all services except those specifically mandated by the State Constitution to the State?

Should the State legislature begin to convene as the Borough Assembly for the unorganized borough; determining what services should be provided and how they will be paid for?

Should the Department of Community and Regional Affairs be charged with the responsibility of reviewing the entire State-city-borough-unorganized borough relationship as it pertains to the delivery of services to the people?

Additionally, Community and Regional Affairs might be directed to formulate methods by which communities can be encouraged to organize units of government. Incentives to be considered should include, but not be limited to revenue sharing formulas based upon services provided.

CONCLUSION: The time is right to inquire whether or not these should be fundamental, structural change in city, State, borough, unorganized borough relationships.

OPTIONS: Direct the Commissioner of the Department of Community and Regional Affairs to develop a study plan directed at reviewing the issues outlined herein.

Develop and execute the study plan with a target date for completion which will permit the formulation of legislation (if required) for enactment in calendar year 1988 impacting the FY89 budget.

SUBJECT: Reduction of Annual General Obligation Debt Service - Rescheduling State Debt

PROBLEM: The State debt service payback schedule requires that an unreasonable amount of available annual revenues be utilized for this purpose.

ANALYSIS: The following chart depicts the total general obligation debt service due to bond holders each year:

<u>Years Ended June 30</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
1986	\$109,265,000	\$ 53,979,162	\$163,244,162
1987	108,380,000	46,512,046	154,892,046
1988	108,685,000	39,220,555	147,905,555
1989	103,727,000	31,784,971	135,511,971
1990	95,560,000	24,746,290	120,306,290
1991	77,499,000	17,983,980	95,482,980
1992	56,149,000	12,052,225	68,201,225
1993	51,363,000	8,325,187	59,688,187
1994	28,398,000	5,531,975	33,929,975
1995	19,096,000	3,987,625	23,083,625
1996	18,610,000	2,864,412	21,474,412
1997	14,865,000	1,800,418	16,665,418
1998	13,380,000	1,008,193	14,388,193
1999	8,640,000	368,931	9,008,931
2000	<u>2,531,000</u>	<u>69,081</u>	<u>2,600,081</u>
Total	\$816,148,000	\$250,235,051	\$1,066,383,051

The next chart -- using the latest available estimates of unrestricted revenues -- depicts the percentage of these revenues which must be utilized for debt service.

<u>Years Ended June 30</u>	<u>Unrestricted Revenue</u>	<u>Debt Service</u>	<u>Debt Service As a percent of Unrestricted Revenue</u>
1977	874.3	41.9	4.8%
1978	764.9	50.0	6.5%
1979	1133.0	60.0	5.3%
1980	2501.2	75.1	3.0%
1981	3718.17	97.6	2.6%
1982	4108.38	97.5	2.4%
1983	3631.00	143.6	4.0%
1984	3390.02	166.3	4.9%
1985	3260.00	169.5	5.2%
1986	2681.91	163.2	6.1%
1987	1408.77	154.9	11.0%
1988	1273.41	147.9	11.6%
1989	1262.64	135.5	10.7%
1990	1352.55	120.3	8.9%
1991	1289.26	95.5	7.4%
1992	1265.20	68.2	5.4%
1993	1255.43	59.7	4.8%
1994	1201.90	33.9	2.8%
1995	1163.90	23.1	2.0%
1996	1139.98	21.5	1.9%
1997	1196.91	16.7	1.4%
1998	1155.19	14.4	1.2%
1999	1096.88	9.0	0.8%
2000	1042.82	2.6	0.2%

A review of the above data clearly indicates that bond maturities were designed to match the "Prudhoe Curve" of projected revenues. That is, payments are compressed into that period in which greatest Prudhoe revenue is generated. Revised revenue data projections reveal that the revenue curve has changed abruptly and an inordinate percentage of revenues must be used for debt service during the period 1987 - 1992.

If this condition continues to exist, an inappropriate strain will be placed upon the operating budget.

It is believed that a restructuring of this debt is appropriate given the known and projected revenue picture, and prudent fiscal management. It is believed that bond rating services will reward rather than penalize good fiscal management and will not downgrade State ratings solely because of restructuring.

This restructuring action can be accomplished by the Executive Branch through the Bond Committee without further legislative approval.

Debt can be rescheduled to provide: (1) level debt service, (2) a constant annual percentage of unrestricted revenues, (3) a short maturity schedule of fifteen years duration, (4) a longer schedule which provides for a lower dedication of an annual annual percentage of unrestricted revenues and provides for future debt capacity, (5) varying costs or savings on a present value basis dependent upon serial or term maturities and interest rates and (6) the opportunity to capitalize interest if necessary and prudent. The iterations are almost infinite.

Existing debt could be rescheduled in its entirety or partially. Lifts of \$200 million should be considered over a scheduled time frame.

CONCLUSION: To the extent possible, State debt should be restructured to provide a level debt service schedule for the period 1988 - 2000 to more closely match revenue projections. In the alternative, the State should consider rescheduling debt so that no more than three percent of unrestructured revenue in any year is utilized for debt service.

OPTIONS: Restructure existing State debt in such a manner that debt service payments are reduced by \$50 million per year.

Restructure existing State debt, capitalizing FY 88 debt service of \$147,905,555, and reducing the FY 88 operating budget by this amount.

If this revenue enhancement option is favorably considered, this matter should be directed to the State Bond Committee for immediate action.

SUBJECT: Appropriation of Permanent Fund Earnings

PROBLEM: Could Permanent Fund earnings be appropriated for operating or capital budget use? What level of appropriation could be considered?

ANALYSIS: All earnings of the Alaska Permanent Fund can, by law, be appropriated. Earnings history and future projections are as follows:

(millions of dollars)

1978A	2	1985A	658
1979A	8	1986A	1,021
1980A	32	1987P	781
1981A	150	1988P	767
1982A	368	1989P	815
1983A	471	1990P	867
1984A	530	1991P	921

A - Actual
P - Projected

Present statutes provide two uses of earnings: (1) The payment of annual dividends; and (2) transfers to principal in an amount necessary to offset the reduction in Fund purchasing power due to inflation.

After earnings are utilized for the above two uses, the remainder (if any) is placed in an earnings reserve account. A breakdown of earnings between these uses is set forth below:

	<u>Earnings</u>	<u>Dividends</u>	<u>Inflation</u>	<u>Earnings Reserve</u>
FY 87	781	362	138	281
FY 88	768	393	357	18

The legislature can, by statute, change any and all of the above.

Both dividend payments and inflation-proofing uses of earnings have occurred for several years. Both uses have become traditional and enjoy widespread support among Alaskans.

The use of funds from the earnings reserve account is another matter. This account was established as a repository for undistributed income so that such income would not flow automatically to the General Fund under the provisions of Article IX, Section 15 of the State Constitution. The automatic flow was impaired to insure that the intended use of such funds would enjoy special public scrutiny. In other words, the money could be appropriated but its use would have to be justified to the Alaskan people. Public consensus would have to exist which supported use of this portion of Fund earnings.

In considering an option which involves appropriating all or part of the earnings reserve account, we should be aware that the existence of both the Fund -- and this account within it -- plays a significant role in the evaluation of the credit worthiness of the State. Bond rating analyses contain repeated references to the Fund. The Permanent Fund Corporation provides to rating services and prospective buyers of bonds, current data indicating levels of principal, annual earnings versus debt service, and undistributed income balances versus debt service.

While it is absolutely clear that the Fund is not a guarantor of debt of the State of Alaska or its instrumentalities, nor does it have any moral obligation to guarantee or liquidate such debt; there exists solace to bondholders that the Fund has unencumbered retained earnings sufficient to meet current debt service.

Current levels of State debt service are in the \$150 million range. Retention of a similar balance within the earnings reserve account -- as a matter of announced continuing State policy -- would continue to support State credit ratings.

CONCLUSIONS:

All earnings of the Fund are available for annual appropriation.

Disruption of the traditional earnings usage for dividend payments and inflation-proofing transfers should be considered only if there is strong public consensus.

Earnings reserve account funds could be appropriated, provided Alaskans believe (1) this "last reserve" should be tapped, and (2) there was manifest need to do so.

If the earnings reserve was utilized, it probably should not be drawn down below the level of the annual general obligation bond debt service of the State.

OPTIONS:

Dividend and inflation-proofing portions of Fund earnings should not be disturbed pending a vote of the electorate.

Use Permanent Fund earnings only as a last resort for financing operating budgets and only a portion of the earnings reserve account balance should be considered for use.

SUBJECT: Sales Tax and Income Tax Options

PROBLEM: Should these two taxing options be considered as revenue enhancements in building the FY 1988 budget?

ANALYSIS: Estimates of revenues generated by imposition of these taxes were formulated by the Department of Revenue (DOR) and documented on January 10, 1986.

The table below shows the DOR estimate of the amount of revenue that would be generated per one percent sales tax, imposed on a state-wide basis.

<u>FY</u>	<u>Food Exempted</u>	<u>Food Included</u>
1987	42.5	70.8
1988	44.3	73.8

The next table shows the DOR estimate of the amount of revenue that would be generated by the re-imposition of a state-wide individual income tax in Alaska. This estimate is based upon the rate schedule previously in effect. The validity of this data is questionable due to the enactment of recent changes in the Federal income tax structure upon which State returns would be based. The DOR data is presented to provide an order of magnitude.

<u>FY</u>	<u>Amount</u>
1987	330.0
1988	352.0

Note: In his briefing of November 24, 1986, Governor Sheffield indicated a potential range of \$200 - 250 million.

Clearly, imposition of a state-wide sales tax and/or re-imposition of a personal income tax could generate substantial State revenues.

Such action would have a major economic, social and political effect on State residents.

Such action will dramatically change and diversify the State's revenue base and will diminish the reliance on oil revenues.

This action will not be accepted by Alaskans unless and until they are convinced that such taxation will not be utilized to sustain a government bloated by un-needed programs and projects.

Taxation will only become viable at such time as State budgets have been reduced, the impact of the reductions are evaluated

by the Alaskan public, and there is a consensus among our people that revenues from this source are acceptable.

Re-imposition of taxation and/or creation of a state-wide sales tax is the best example of an issue that must be dealt with cooperatively. Responsibility falls in three arenas: the Legislature, the Executive and the People.

The Executive has a distinct responsibility to provide analyses of the economic and social impacts of taxation, informing the public of what these impacts are, and participating in the debate which ensues.

CONCLUSION:

Do not anticipate imposition of sales tax or re-imposition of income tax in dealing with budget shortfalls for FY 1987 and FY 1988.

OPTION:

Request the Commissioner of Revenue to prepare updated analyses of what revenues taxation will generate; to include socio-economic analyses. This information should be made available for legislative debate and public comment during the next legislative session.

SUBJECT: Revenue Enhancement - Purchase of Housing Assistance Division (HAD) Community and Regional Affairs Loans From the State By AHFC

PROBLEM: Should the State General Fund sell additional assets -- in the form of home mortgages -- to the Alaska Housing Finance Corporation?

ANALYSIS: As the result of last year's legislative activity, (1) AHFC was to purchase \$70 million of HAD loans (2) AHFC was to purchase up to \$12.8 million of mortgage loans located in the portfolios of the departments of Commerce and Revenue, and (3) AHFC was to pay the State \$28.6 million representing other transactions.

The \$70 million purchase of HAD loans was paid for on December 1, 1986. Commerce and Revenue assets in the amount of \$8 million (\$3 million Commerce - \$5 million Revenue) will be paid for on or about January 1, 1987. It is not expected that the additional \$4.8 million (\$12.8 minus \$8.0) in mortgages will be purchased by AHFC. The balance of \$16.7 million of the \$28.6 million owed to the State will be paid on or about January 1, 1987.

An additional increment of HAD loans exist. Their value has not been determined (because of delinquencies and poor market conditions), but book value is in excess of \$100 million.

AHFC could purchase the remaining assets of HAD for approximately \$100 million. Such action might be a precursor to a phase-out of the HAD Mortgage program and integration of the function into AHFC.

CONCLUSION: AHFC could purchase the remainder of the HAD mortgage portfolio for \$100 million.

OPTIONS: Legislation be drawn permitting the sale of the remainder of HAD mortgages to AHFC with proceeds remitted to the General Fund.

HAD home mortgage functions be integrated into the AHFC programs and the HAD Mortgage unit be phased out.

SUBJECT: Disposition of Alaska Industrial Development Authority (AIDA) and Alaska Housing Finance Corporation (AHFC) earnings

PROBLEM: Should all or a part of net income of these agencies be returned to the State each year?

ANALYSIS: Both agencies have substantial equity as (1) the result of generous State contributions in better economic times and (2) the ability to retain annual earnings.

This equity, regardless of whether it is: liquid; invested in home mortgages or commercial property loans; pledged to secure bonds; or is unencumbered; should be earning market rates of return. Equity account balances are set forth below:

	<u>AIDA</u>	<u>AHFC</u>
<u>Year End Equity</u>		
FY 1984	\$ 274,777,574	\$ 1,381,491,000
FY 1985	305,073,901	1,458,373,000
FY 1986	333,949,102	1,500,208,000

Net income for the two agencies for the past three years is depicted below:

	<u>AIDA</u>	<u>AHFC</u>
<u>Net Income</u>		
FY 1984	\$ 25,269,388	\$ 74,774,000
FY 1985	29,752,227	76,882,000
FY 1986	28,875,201	41,835,000

AHFC and AIDA are not dedicated funds. Automatic retention of earnings may not pass constitutional muster if challenged. In recent years, earnings have been appropriated back to the agencies by overt legislative action.

Retained earnings have been utilized to increase equity in both agencies where substantial equity already exists.

There is no evidence that new income flow is currently utilized to secure new debt or is pledged to secure existing debt.

CONCLUSION: It is not unreasonable to expect that after years of contribution to these agencies, the State is entitled to some reasonable return.

OPTIONS: That all current year earnings of both agencies flow directly to the General Fund for general appropriation usage.

In the alternative, request that the boards of directors of each agency formulate long-term plans which provide for consistent long-term payouts of net income (dividends) to the State in return for its investments. A 3.5 percent return (a level which is similar to the yield of corporate portfolio of dividends) may be appropriate. In normal years this would enable the agencies to retain some earnings.

It should be noted that decisions on the withdrawal of earnings from AHFC and AIDA must be coupled with analyses of the current financial condition of each agency.

SUBJECT: Revenue and Liquidity Enhancement - Sale and Leaseback of State Facilities

PROBLEM: Should the State sell some of its assets to provide a one-time infusion of cash and should it lease back these facilities over time? If so, how can this be accomplished? .

ANALYSIS: The State has recently acquired a full ownership interest in the State Office Building in Juneau. Previously the facility had been leased from the Alaska State Housing Authority. The State paid rent equal to ASHA debt service on the building and took ownership upon maturation of the ASHA bonds.

Another State agency -- the Alaska Industrial Development Authority -- currently has unencumbered assets slightly in excess of \$150 million.

In lieu of extracting this equity from AIDA, an agency which may have to play an expanded role in diversifying the economy or fostering government-private sector joint ventures (similar to Red Dog), this equity might best be left within AIDA and employed both as an investment and debt security leveraging device.

In order to accomplish the above, AIDA could liquidate a portion of its investments representing unencumbered assets. Proceeds could be used to purchase the State Office Building in Juneau. The State would then enter into a long-term lease in an amount sufficient to pay back all principal and provide a market rate of return.

The holding by AIDA of a State of Alaska lease and its corollary income stream will (1) provide an instrument which would be used by AIDA to secure new AIDA debt for economic development purposes, and (2) eliminate short-term pressure to simply extract a portion of AIDA equity for one-time spending.

CONCLUSION: Substantial funds could be realized from a sale of the State Office Building in Juneau to the Alaska Industrial Development Authority and a long-term leaseback of the same facility. There may be other State owned facilities which should be considered for sale and leaseback.

OPTIONS: Determine the value of State owned sale/leaseback candidates using the income approach (lease cash flow). Second, negotiate the sale and leaseback with AIDA, insuring that the lease terms are coordinated with the long-term debt structure of the State. (Long-term leases and general obligation bond debt service are viewed as similar financial obligations.)

SUBJECT: Reduction of Expenditures - Employer's (State of Alaska)
Contributions to Employee Retirement Plans

PROBLEM: Can employer's (State of Alaska) contributions to both PERS and
TRS plans be reduced based upon sound actuarial evaluation?

ANALYSIS: Present (FY87) contribution rates are as follows:

<u>Plan</u>	<u>Rates Currently In Effect - 6/30/85 Evaluation</u>
PERS	11.30 percent
PERS - Police/Fire	15.74 percent
TRS	6.88 percent

The plans' actuaries are currently evaluating the soundness of the plans and their respective actuarial assumptions based on data as of June 30, 1986.

Ordinarily, the actuary's report would be reviewed, considered and adopted by the PERS and TRS Boards at the regular semi-annual meeting held in the Spring of 1987 and the new employer contribution rates would become effective July 1, 1988 -- the first day of Fiscal Year 1989.

The Director of the Division of Retirement and Benefits has had discussions with both the actuary and the budget transition team and has concluded:

1. New rates based upon 6/30/86 data would be:

<u>Plan</u>	<u>Rates Based on 6/30/86 Data</u>
PERS	9.55 percent
PERS - Police/Fire	13.99 percent
TRS	5.88 percent

2. These new rates would produce annual General Fund savings of approximately \$22.5 million (\$20.7 million - PERS and \$1.8 million - TRS)

3. It would be advantageous to the State to accelerate the implementation of the new rates. Savings could be built into the FY88 budget rather than waiting until FY89.

To this end, the Director has scheduled a meeting of both Boards on January 15, 1987. He will recommend to the boards that they adopt the evaluations effective July 1, 1987 (FY88).

The \$22.5 million savings is based on 90 percent of the 1986 payroll. If payroll drops further, savings are less. A \$20 million savings is reasonable and conservative.

CONCLUSION:

The State's (General Fund) retirement contribution for its employees retirement plans can be reduced in the approximate amount of \$20 million.

This reduction can become effective with the FY88 budget provided early action is taken by the PERS and TRS boards.

OPTION:

The Commissioners of Administration and Revenue be requested to pursue early adoption of the actuarial based data of 6/30/86 and its use effective 7/1/87.

a. May create an administrative disparity between government programs.

b. Program receipts may or may not be generated directly as a result of program activities. A reduction in government may result in a reduction in program receipts. However, programs may be funded from receipts generated through such revenues as licensing fees if that program is seen to benefit the constituency from which the program receipts are collected or if that program is designed to counteract some of the negative effects to society as a result of allowing the existence of the constituency group. Program receipts may be available independent of the program operation which it currently funds, and therefore could be used to support other government operations. This may also be true, to a lesser degree, with federal funds. Programs should be reviewed and prioritized to make certain "other funds" are used for the greatest benefit.

4. Department Mission- many departments have had programs included within the department's operations which are not directly related to the mission of the department as it was originally designed. These programs frequently have "stepchildren" status and may not be as fiercely protected from reduction or deletion as "core" department functions. Any department recommendations for reduction must be viewed with the "stepchild" consideration kept in mind.

5. Frequently programs begin to serve a specific need which has evolved to program operations which do many other things as well, or in lieu of, the original intent. The adage "work expands to fill the time allotted" may be applied as "programs expand to serve needs as identified" to this phenomena. In reviewing options for reduction of service, this should be a consideration.

6. Many government programs are interdependent on other programs. A reduction in one program may increase the demand upon another program service. Also, there is an equity consideration among government service, for example the Department of Law's prosecution staff levels in the Department of Administration's public defender/public advocacy offices. Proposed changes in any program levels must be reviewed in the context of the entire governments operations.

7. Implementation of the Classification Study. Current estimates are that \$16 million would be needed for implementation in the first year. This cost may be reduced as a result of negotiated roll backs on state salaries. Union positions should be analyzed and understood relative

GENERAL BUDGET ISSUES

The following issues were identified by individual committee members as important concerns to bear in mind during the budget process:

1. Repeal and reappropriation or lapse of capital project funds.

a. Many capital project funds which have not been expended could be repealed to lapse into the general fund or reappropriated for new capital priorities.

b. Future cost of operations of state facilities, i. e. the Juneau Pioneer's Home, may not be affordable in future years. These projects should be closely reviewed for postponement or cancellation.

c. As a matter of policy, repeal and reappropriations should be handled separately (except for routine house-keeping measures involving receipt of operating federal funds, etc.). The 1985 and 1986 session repeal and reappropriation bills contained over 600 individual sections--more than twice the number of individual repeal, reduction and/or appropriation sections in prior years. In addition to myriad net-zero sections were new appropriations of \$10 to \$20 million in operating items and \$40-\$120 million in capital appropriations. These items are inevitably loaded in at the end of the session; most items receive far less committee scrutiny than they would receive in the normal operating or capital review process; others escape review altogether.

Can the state afford to allow this significant slice of budget activity to take place outside the normal budget process? The simple remedy is to insist that repeal items lapse to the General Fund and new appropriations take place through normal channels.

2. In making a budget reductions, care should be taken to make sure that imposition of target levels does not result in unanticipated effects on services. For example, a 20% reduction in the AFDC component results in a 28% cut in payments to recipients when the projected increased caseload is recognized. Transition team staff calculations indicate that at a 20% target reduction, AFDC payments for a family living at the poverty level would drop from \$616/month to \$445/month. On the other hand, a 10% drop in payment level (to \$554) would require a General Fund increase from existing (FY 87 revised) budget levels.

3. Programs relying on "other funding" sources, be it federal, program receipts, etc., must not be excluded from consideration in any budget reductions.

to the implementation of the study to ascertain any impact implementation or the postponement thereof might have on pending labor negotiations.

8. Many cost-saving measures proposed to effect budget reductions require legislation in order to actually realize any savings. There is an inherent danger in building a budget heavily reliant on legislation revision. Alternatives must be considered for all program levels which are unable to continue without legislative revision, to assure that the budget presented by the Governor to the legislature is balanced within the means available to the executive branch. Any budget revisions as a result of legislation should be funded or defunded through fiscal notes.

MEMORANDUM

TO: Governor Steve Cowper

FROM: R.A. Fineberg

RE: Perspective on State Data Problems

DATE: December 14, 1986

After the Budget Transition Team watched the FY 87 year-end shortfall estimate bounce around from (\$806) million to (\$593) million last week, the majority of the team agreed that we should apprise you of our common concern about the lack of coordination among State data systems. The final measure of the looseness of State data systems is the Budget Transition Team's suggestion that you give the current estimate \$50 million leeway in both directions to allow for final adjustments in the FY 86 Annual Financial Report. After a month battling the problem of budget, revenue and accounting information that do not tie together without an enormously complicated effort, one committee member described the situation Friday as "appalling." Another commented, "All I know is that it doesn't work."

You and the State of Alaska pay the price for this problem in two ways: First, this situation is enormously inefficient. Individuals who attempt to respond to data requests waste an inordinate amount of time gathering information that ought to be readily available in useful form on a data base whose universe is comprehensive (or at least recognizable) and able to be converted to somebody else's needs. Staff and managers tie themselves up gathering, relaying and re-working data that should have been available and usable at first crack. To continue to provide first-rate services as revenues decline, the State cannot longer afford the luxury of these inefficiencies.

The second price is paid in the arena of policy-making. When basic data are suspect, arguments over the data base often obscure the tough policy questions. Moreover, conflicting budget numbers tend to undermine the credibility of the issuers. To guide the State through the fiscal crisis at hand, we need to preserve and promote the confidence of the public. Good numbers help; conflicting numbers undermine public confidence. In short, clean and comprehensive numbers enhance credibility.

The problem is inter-agency in nature. In the course of Budget Transition Team interviews and briefings it became apparent that the data needs of each commissioner are different. For example, the Commissioner of Revenue is

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Perspective on Data Problems
Dec. 14, 1986 / Page Two

concerned primarily with generating and collecting revenue to run this government; the Department of Administration is concerned with data-gathering systems and tracking conventions; the budget-maker is concerned with the politics that drive its product; DOT/PF's drive to design and build projects led it to run afoul of the accounting, revenue and budgeting systems.

To resolve this situation, the Governor must drive the effort to establish clear and comprehensive numbers from an inter-agency perspective. Attempting to find out what's out there in unbuilt capital appropriations, a faster third-party billing system and the recent \$200-million change in funds available as the Dept. of Administration wraps up the Annual Financial Report are examples of problems that should be tackled in a coordinated manner; without close coordination, the system "fix" that solves one of these problems may make the other two worse.

There is another school of thought on this problem. That school holds that public data are always a bit loose and that numbers are always changing. The "business as usual" school does not appear to recognize the difference between revising the shortfall to recognize your decision to restrict an additional (\$13.9) million in local school debt payments and reviewing the entire question of capital project billing and capital project reserves, resulting in a net swing of more than \$100 million in the balance available for appropriation (as the state accounting system did between Nov. 22 and Dec. 10).

The former is the kind of revision that rightly takes place as circumstances change; the latter is a symptom of a system whose discrete parts are not producing reliable results, and whose inter-relation is not properly coordinated. The former is inevitable; the latter causes agency people to waste a good deal of time re-inventing wheels and adding columns manually, delays products and undermines confidence in the numbers that frame public policy discussion. Several transition team reports -- both from this team and from policy groups -- contain statements that poor data present a significant management problem.

In calling your attention to this situation; the Budget Transition Teamh team did not make specific recommendations.

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Dec. 14, 1986 / Page Three

If you would like to consider the implications of data problems -- and possible solutions -- in greater detail, members of the team would be happy to prepare recommendations for you.

MEMORANDUM

TO: Governor Steve Cowper

FROM: R.A. Fineberg
Brian Rogers

RE: Shortfall and Financial Plan

DATE: Dec. 12, 1986

In response to your request that we look at solutions to the budget problem in a multi-year context, attached is one of many possible scenarios:

This scenario funds the current deficit of approximately \$600 million (including restricted 1986 session capital projects) and allows a constant operating budget over a four-year period.

This scenario is presented in nominal dollars (attachment A-1), and in inflation-adjusted or real dollars (attachment A-2).

MEMORANDUM

Division of Strategic Planning
Office of Management and Budget
465-3568 MS 0164

TO: Budget Transition Team DATE: Dec. 11, 1986

FROM: R.A. Fineberg

SUBJECT: Shortfall & Financial Plan

This four-year plan pays off the FY 87 shortfall and balances the budget with a 19-agency operating budget of \$1,500.0 million. G.O. debt service, local school debt, scholarship loans, restricted 1986 capital appropriations and a modest capital budget are all funded, in addition to the existing shortfall and [\$25.0] million for FY 87 supplemental appropriations.

This plan is representative of various routes by which the existing shortfall can be cured without causing the tremendous economic dislocation, hardship and curtailment of services that would result from even harsher cuts to the operating budget. To effect this plan, the following revenue sources are used:

- == Bradley Lake is financed through the Railbelt Energy Fund;¹
- == the ELF is modified in FY 88;²
- == GO debt and local school debt are restructured;
- == the Budget Reserve Fund is used in FY 87-88;
- == cash is withdrawn from loan programs and AHFC purchases an additional \$100.0 million of HAD loans;
- == AIDA and AHFC return income to the General Fund;
- == beginning in FY 89, a personal income tax (or other new revenue sources) adds \$250 million per year to State revenues;
- == miscellaneous licenses and fees listed in the Budget Transition Team report bring in \$51.6 million per year;
- == minimal disputed taxes are paid to the State (FY 88-89 = \$100 million; FY 90-91 = \$150 million).

Attachment 2 presents the same table in real (inflation-adjusted) dollars.

Jack Fagnoli of the OMB strategic planning unit assisted in preparing this format in response to the Governor's request that the transition team take a multi-year approach to the budget; a format such as this one can be used to test all proposed budget solutions.

¹ The Railbelt Energy Fund repays the General Fund the amount that would be realized from cancellation of Bradley Lake project.

² For the ELF, low OMB estimated gains are used. The estimates DOR prepared for the interim legislative tax committee show significantly higher revenue gains.

A-1

Four Year Financial Plan (Session Revenues and Appropriations)

Dec. 1986 30% Revenues, FY 87-89;
Sept. 1986 30% revenues, FY 90-91;
assumed FY 87 shortfall = (\$605) million

(\$ NOMINAL - Millions)
(Unrestricted G.F.)

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	FY 87 (w/restr.)	FY 88 (Cowper One)	FY 89 (Cowper Two)	FY 90 (Cowper Three)	FY 91 (Cowper Four)
Revenues					
Balance Fwd. from prior year	221.6	0.6	1.7	17.1	193.3
Unrestr. G.F. Revenue	1,297.1 *	1,285.7 *	1,356.6 *	1,352.6 *	1,289.3 *
Adjustments	7.4	0.0	0.0	0.0	0.0
Settlements	65.0				
Reappropriations/Transfers	176.8 **				
Permanent Fund	0.0	0.0	0.0	0.0	0.0
Disputed Taxes		100.0	100.0	150.0	150.0
ELF		66.8	74.0	77.0	80.0
License & Fee Incr.		51.6	53.9	57.2	60.6
Cash from Loan Funds	137.3				
AIDA-AHFC Income to GF	70.7	72.0	75.2	79.7	84.5
Budget Reserve Fund	128.0	300.5			
Railbelt Energy Fund***					
New Revenue Sources****			250.0	250.0	250.0
OTHER					
Total Revenues	2,103.9	1,877.2	1,911.4	1,983.6	2,107.7
Appropriations					
Operating Agencies	1,703.4	1,500.0	1,500.0	1,500.0	1,500.0
Prior-Year Supplementals		25.0			
G.O. Debt					
Existing	155.0	147.9	135.5	120.3	95.5
Restructuring Gain	(50.0)	(45.0)	(35.0)	(20.0)	(15.0)
School Debt*****	115.8	104.2	93.8	90.0	90.0
Bradley Lake*****		(95.0)			
1986 Session Capital	124.2	113.4	100.0		
New Capital		75.0	75.0	75.0	75.0
Loans	54.9	50.0	25.0	25.0	25.0
Total Appropriations	2,103.3	1,875.5	1,894.3	1,790.3	1,770.5
Net Balance	0.6	1.7	17.1	193.3	337.2

- * Adjusted for income changes due to timing of BRF; excludes potential income from Railbelt Energy Fund.
- ** 176.8 existing (see OMB worksheets); 100 HAD purchase + 37.3 loan balances proposed in separate entry.
- *** Funding of railbelt energy projects would not require General Funds.
- **** Potential revenue sources include (but are not limited to): income tax, petroleum taxes, Permanent Fund income and other sources listed in Budget Transition Team report.
- ***** FY 87: 90% of \$128.7 (FY 87 est. revised by DOE 11/25/86); subsequent years reduced by 10% to \$90.0 million cap thru restructuring local debt
- ***** 95.0 of 281.0 in Railbelt Energy Fund used for Bradley Lake; remainder for other REF projects in FY 88-90.

Four Year Financial Plan (Session Revenues and Appropriations)

Dec. 1986 30% Revenues, FY 87-90;
Sept. 1986 30% revenues, FY 90-91
assumed FY 87 shortfall = (\$605) million

(\$ 1987 - Millions)
(Unrestricted G.F.)

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	FY 87 (w/restr.)	FY 88 (Cowper One)	FY 89 (Cowper Two)	FY 90 (Cowper Three)	FY 91 (Cowper Four)
Revenues					
Balance Fwd. from prior year	221.6	0.6	1.6	15.2	161.7
Unrestr. G.F. Revenue	1,297.1 *	1,263.0 *	1,275.3 *	1,199.5 *	1,078.6 *
Adjustments	7.4	0.0	0.0	0.0	0.0
Settlements	65.0				
Reappropriations/Transfers	176.8 **				
Permanent Fund	0.0	0.0	0.0	0.0	0.0
Disputed Taxes		98.2	94.0	133.0	125.5
ELF		65.6	69.6	68.3	66.9
License & Fee Incr.		50.7	50.7	50.7	50.7
Cash from Loan Funds	137.3				
AIDA-AHFC Income to GF	70.7	70.7	70.7	70.7	70.7
Budget Reserve Fund	128.0	300.5			
Railbelt Energy Fund***					
New Revenue Sources****			235.0	221.7	209.2
OTHER					
Total Revenues	2,103.9	1,844.0	1,796.8	1,759.1	1,763.3
Appropriations					
Operating Agencies	1,703.4	1,473.5	1,410.0	1,330.2	1,254.9
Prior-Year Supplementals		24.6			
G.O. Debt					
Existing	155.0	145.3	127.4	106.7	79.9
Restructuring Gain	(50.0)	(44.2)	(32.9)	(17.7)	(12.5)
School Debt*****	115.8	102.4	83.2	79.8	75.3
Bradley Lake*****		(93.3)			
1986 Capital	124.2	111.4	94.0		
New Capital		73.7	70.5	66.5	62.7
Loans	54.9	49.1	23.5	22.2	20.9
Total Appropriations	2,103.3	1,842.4	1,780.7	1,587.7	1,481.2
Net Balance	0.6	1.6	16.1	171.4	282.1

- * Adjusted for income changes due to timing of BRF; excludes potential income from Railbelt Energy Fund.
- ** 176.8 existing (see OMB worksheets); 100 HAD purchase + 37.3 loan balances proposed in separate entry.
- *** Funding of railbelt energy projects would not require General Funds.
- **** Potential revenue sources include (but are not limited to): income tax, petroleum taxes, Permanent Fund income and other sources listed in Budget Transition Team report.
- ***** FY 87: 90% of \$128.7 (FY 87 est. revised by DOE 11/25/86); subsequent years reduced by 10% to \$90.0 million cap
- ***** 95.0 of 281.0 in Railbelt Energy Fund used for Bradley Lake; remainder for other REF projects in FY 88-90.

December 13, 1986

TO: Mr. Oral Freeman
FROM: John Halterman

Please find attached the reports of the Natural Resources Subcommittee of the Budget Transition Team, produced by Mary Halloran and myself. We regret the lack of detail in these documents, however the press of time did not allow us to undertake an in depth analysis of the agencies. Needless to say, each agency presents an opportunity to find new, more efficient, ways of accomplishing its mission. With the able assistance of the of the staff in each department this challenge can be met.

DEPARTMENT OF FISH AND GAME

The Department's FY 87 revised budget of \$70.1 million is supported by three funding sources: the Fish and Game Fund (\$11.4), federal funds for either game or sport fisheries management (\$17.4), and the General Fund (\$41.3). A major problem within the agency appears to be the difficulty in shifting activities between funding sources to optimize program efforts; to the degree this can be done, as in the use of Dingell-Johnson funds to support the FRED division, this should be encouraged.

The department has proposed closing or mothballing several hatcheries in its FY 88 budget. Additional effort should be made to transfer ownership and operation of production hatcheries to aquaculture associations or other entities capable of professional management.

While it is clear the department is stretched thin in meeting its widespread missions, an analysis should be made of the opportunities for combining functions across division lines, including field operations, research and administrative support. Because the department has such a direct effect on the economic and social well being of Alaska's citizens it is important, following the introduction of management efficiencies, that adequate funding be maintained. One obvious source of additional funds is an increase in license fees.

12/11/86

DEPARTMENT OF NATURAL RESOURCES

The level of reduction in the department's FY 88 budget proposal poses serious questions which must be addressed by the new commissioner regarding the minimum level of service which the department must provide the public, as well as degree to the state's resources must be preserved and protected. Some examples of such issues include:

Agency Reorganization

The department has already proposed or initiated the merger of several divisions, however in light of the need for further savings serious consideration should be given to the merger of the remaining three major divisions: Forestry, Parks and Land and Water Management. It may also be feasible to add the Division of Agriculture into an expanded division. An analysis should be performed to determine the degree of commonality in missions within the divisions' field staffs to determine the feasibility of merger.

Fire Suppression Fund

The FY 88 budget requests \$5.79 million in general funds for fire suppression. These costs were previously funded through the Rainy Day Account, but with the creation of the Budget Reserve Fund that practice was discontinued. There must be provision for the funding of fire suppression activities in order to meet the state's commitment to BLM, as well as to protect public resources. If feasible an audit of the historical expenditures against the fund should be made prior to establishing an FY 88 appropriation level.

User Fees

There are a variety of opportunities for the collection of user fees within the Department of Natural Resources, ranging from those for the use of parks to the provision of land status information. All opportunities to generate income should be fully explored.

12/10/86

DEPARTMENT OF ENVIRONMENTAL CONSERVATION

While DEC has reached a point where further reductions are extremely problematic, there are opportunities for additional efficiencies and revenues to be obtained. One possibly fruitful area to explore is the merger of the Facilities Construction division with the Operations division. These divisions have many similar job classifications and with the probable reduction of facilities construction within the state the need for full divisional status is questionable.

Revenue generation opportunities also exist within the department. Legislation has been proposed to establish fees for drinking water plan reviews, wastewater disposal permits, subdivision approvals and on-site wastewater disposal certifications; many of these responsibilities could be delegated to local governments where they exist, or contracts could be negotiated with local governments for DEC to provide the service at cost. Within the Environmental Health Division fees could be instituted for food service permits, bar permits, retail food store permits and seafood processing inspections.

COWPER ADMINISTRATION - BUDGET TRANSITION TEAM

BUDGET TRANSITION REPORT

ALASKA DEPARTMENT OF TRANSPORTATION AND PUBLIC FACILITIES

OVERVIEW OF DOT/PF BUDGET

	<u>FY 86 ACT</u>	<u>FY 87 REV</u>	<u>FY 88 SFL*</u>	<u>FY 88 PRC</u>
Office of the Commissioner	2,108.4	2,302.0	2,510.1	
SW Management and Finance	2,480.0	2,565.6	3,200.6	
SW Information Systems	2,435.4	1,911.8	1,911.8	
Plans Programs and Budget	823.3	0.0	0.0	
SW Research	564.3	711.2	746.2	
SW Eng and Ops Standards	5,195.7	5,548.2	5,496.5	
CR Administrative Services	8,237.3	8,022.0	8,127.3	
CR Planning	2,219.2	1,046.1	1,022.8	
CR Design and Construction	22,492.5	28,279.4	27,837.5	
CR Maintenance and Operation	34,001.2	26,244.0	25,782.4	
Anc International Airport	17,323.5	19,115.0	20,110.1	
NR Administrative Services	12,569.2	12,361.3	12,542.7	
NR Planning	1,524.9	975.6	1,010.6	
NR Design and Eng Mngt	21,220.4	23,991.0	23,870.8	
ID Maint, Highways & Airports	28,885.6	21,493.7	21,226.3	
WD Maint, Highways & Airports	5,099.4	3,718.0	3,611.5	
SCD Maint, Highways & Airports	8,880.3	7,068.6	6,894.5	
Fbks International Airport	6,937.6	7,395.2	8,075.1	
SER Admin Services	3,062.8	2,913.5	2,918.7	
SER Planning	558.1	345.3	345.3	
SER Design and Construction	9,399.3	9,917.1	9,845.9	
SER Maintenance & Operations	13,279.8	10,504.2	9,956.1	
Marine Administration	2,452.2	2,226.7	2,226.7	
Marine Facilities Engineering	1,364.3	1,774.5	1,826.1	
Marine Marketing and Services	4,709.3	4,754.3	4,942.6	
Marine Operations	57,573.6	54,630.5	50,794.5	
Retirement Incentive Program	0.0	0.0	1,143.3	
TOTAL	277,940.7	262,229.9	259,884.9	

*Sheffield Proposed FY 88

KEY BUDGET ISSUES CONFRONTING ADOT/PF

Capital Project Clean-Up:

Description: At the present time ADOT/PF does not know the current financial status of a very large number of capital projects being developed within the Department. It is likely that the appropriations for several of these projects has been over-spent or over-obligated.

COWPER ADMINISTRATION - BUDGET TRANSITION TEAM

BUDGET TRANSITION REPORT

FOR THE FOLLOWING AGENCIES

- DEPARTMENT OF TRANSPORTATION AND PUBLIC FACILITIES
- DEPARTMENT OF COMMUNITY AND REGIONAL AFFAIRS
- DEPARTMENT OF COMMERCE AND ECONOMIC DEVELOPMENT

SUB-COMMITTEE MEMBERS:

ROBERT POE
JOHN HALTERMAN

Discussion: The current status of ADOT/PF CIP projects is due to insufficient accounting controls within past and present accounting systems. The previous statewide accounting system, PBA did not provide enough cost centers (collocation codes) to control the large number of capital projects which had been assigned to the Department. The problem was further compounded by pressure on the Department and project engineers to get the projects out on the "street", and a perception by state project managers that their first priority was to get the project built and secondly to build the project within budget. In fact the legislature has historically appropriated annually over 175 % of the available Federal funds for that year in capital projects to be built by ADOT/PF.

Project managers did not rely on the internal ADOT/PF system, FMS, because the quality of data provided by the system was not considered accurate for a variety of reasons. Unfortunately when the new statewide accounting system came on line, AKSAS, the same cost center problems were carried over to the new system even though this system was quite capable of handling most of ADOT/PF's needs for project financial control.

In 1983 the Sheffield Administration began to give serious attention to this problem. Numerous audits were performed to determine the actual status of the ADOT/PF CIP projects and by June 30, 1985 a fairly solid picture of the status of the projects was developed at a cost of over 1 million dollars. However nothing was done at that time to actually correct the problem. Since then the problem has grown worse due to the accounting control problems which were carried over to AKSAS. The problem still exists and will continue to represent an unknown exposure in terms of over-spent appropriations and missed Federal billings until the problem is finally cleaned up. In addition, some large amounts of general fund money may currently be committed to Federal match projects which have little chance of going into construction in the near term (within the next three years).

A further complication to the above problem is a recent decision by the FHWA not to accept any Federal billings produced by ADOT/PF's FMS system. The FHWA has determined that the FMS system is unreliable and is capable of producing and successfully passing one-sided accounting entries.

Recommendation: ADOT/PF should begin immediately to resolve the problems currently experienced with capital project balance information. Without this immediate action, ADOT/PF project managers will continue to doubt the validity of project data which they receive from the automated systems tracking their respective projects. The Department will also continue to be unable to determine whether project work is proceeding within the law and in an efficient manner. Finally, this clean-up effort may assist in identifying and receiving additional Federal dollars and in freeing up possible general fund dollars which are currently committed to projects which will not be developed in the near future.

Maintaining an Acceptable Level of Maintenance and Operations:

Description: Probably the service provided by the Department which is most immediately noticed by Alaskan residents is the maintenance and operations of our roads, highways, airports and harbors. ADOT/PF's ability to provide a satisfactory level of service in this area is being negatively effected due to overall budget cuts combined with increased capital investment in infrastructure.

Discussion: Maintenance and operations of Alaska's roads, highways, airports and harbors is a very basic service that most Alaskans have come to expect. In addition, the proper maintenance and operation of our public facilities is an important factor in preserving the life of these capital investments.

Currently ADOT/PF maintains many roads which might properly be maintained by local communities. ADOT/PF has recently developed a three tier approach to prioritizing which roads will receive maintenance;

1. Roadways connecting population centers, economic centers, the airports and major intrastate harbors,
2. Roadways built with sufficient federal funds so that the State is contractually bound to provide at least the minimum amount of maintenance necessary to realize the service life anticipated at the time of their construction, and
3. All roadways not in categories 1 or 2.

Further budget cuts to maintenance and operations will follow this prioritization approach in determining which services will be cut first. The Department has also recently suggested raising the motor fuel tax from .08/gal to .16/gal and have further proposed that this revenue be appropriated by the legislature to provide for road maintenance. In addition, several of the State's airports have recently been lighted which has expanded the time over which an airport must be maintained in ready condition. While, at the same time, landing fees are not charged to air carriers who use these airports with the exception of some of the larger airports (e.g., Anchorage, Fairbanks, Juneau).

Recommendation: Since maintenance and operations is required to preserve the life of virtually every capital project the State invests in, the Administration should work toward timing capital investment so that it does not burden the ADOT/PF with an unmanageable load of maintenance and operation responsibilities which cannot be adequately supported under the State's current revenue budget. The State should also work, to the extent possible, to encourage local communities to take over the maintenance on roads, airports and harbors which primarily serve that community. Finally, the State may need to consider which projects that use federal funds should be built by the State. It may be prudent in the current time period, to limit further participation in such projects to ones which repair or otherwise benefit our existing infrastructure.

Operations of the Marine Highway System:

Description: The Alaska Marine Highway (MHS) represents the largest single component of the ADOT/PF's general fund operating budget. The Marine Highway System has often been criticized for inefficient and ineffective operations.

Discussion: Since this function within ADOT/PF represents such a large portion of the operating budget it must be examined very closely to look for ways to deliver the needed services at a significantly lower cost. The MHS has long been criticized for having lost sight of its original purpose. The system has been continually expanded under the guise of making the system profitable and therefore self supporting. This has not yet been accomplished.

Local residents complain that regular passage on the ferries is not available to them on short notice during the summer months because most available space is taken up by visitors to the State. The system has been shown to have significant excess capacity during the non-summer months. The system duplicates an existing highway system from Prince Rupert to Seattle, and has, in the past, displaced private carriers of freight to Southeastern Alaska. The pay structure of state employees on the MHS has also been criticized as unnecessarily high and complex. Finally, the management of the MHS has generally been assigned to retired military personnel who generally have little experience in operating ferry systems for profit.

Recommendation: The Marine Highway System should be reviewed against its original purpose, to serve as a highway system to Southeastern and Southwestern Alaskan communities who did not have access to the existing highway system. Ferry operations which extend beyond this original purpose should be considered for budget cuts. This may include closing the ferry runs between Prince Rupert and Seattle. The system should also examine closely its current capacity relative to projected demand for its originally intended function. Serious negotiations should be conducted with the unions serving the MHS to simplify the salary structure and to lower the cost of personnel on the ferries. The MHS should also consider the contracting for ferry services to private sector companies where the cost of those services is lower than the current cost structures.

Agency "Corporate Culture":

Description: ADOT/PF was in existence within Alaska before Statehood. As a result, this department has one of the strongest "corporate cultures" of any organization within the State bureaucracy. Changing this culture in order to help it deal with the future changes will be key to successfully trimming down the cost of ADOT/PF and helping it run more efficiently.

Discussion: ADOT/PF engineers not only have a strong loyalty to ADOT/PF but also to their profession as engineers. When you combine this professional perspective with the previous flow of funds through ADOT/PF, it is not surprising to learn that many engineers in ADOT/PF do not consider it their responsibility to closely monitor the costs

Adjusting to Smaller CIP Budgets in the Future:

Description: During FY 82, FY 83, FY 84 and FY 85 relatively large amounts of capital projects were appropriated to the ADOT/PF. In order to appropriately support this high level of work the agency built a large in-house staff of planners, engineers, draftsmen, surveyors, etc. In light of the State's current and projected revenue budgets, the Department will need to consider how to trim the current staff complement down in order to more cost effectively complete the smaller capital building programs expected in future years.

Discussion: In light of the the State's current revenue picture the ADOT/PF can probably expect considerably smaller CIP work programs in future years. The current staffing complement and approach to completing projects should be reevaluated to consider how these smaller work programs can best be addressed.

The legislature has historically appropriated more general fund matching money to ADOT/PF than there is federal funds available in a given year to match. Generally this over-appropriation of general fund matching money has been 175% of the available federal funds. This places the burden on the Department to prioritize which of these projects receives federal funds, creates unrealistic expectations among the constituents of the project (since it may never actually be built), and unnecessarily ties up general funds which may be better used in some other area within State operations during that year. This unrealistically high appropriation level also forces the Department to carry a somewhat higher staff complement than may actually be needed to accomplish the work program for that year.

However, the Department will need to maintain a staff complement which is sufficient to meet a minimum competency level from the point of view of the Federal agencies (FHWA and FAA) which distribute funds to ADOT/PF. It is unclear what this level is and whether the competency level may be maintained through contracts with private providers of these types of engineering services. It is also unclear as to whether the Department must maintain its regional structure.

Recommendation: The ADOT/PF should begin now to evaluate the minimum staff levels which are required to address the present and future programs of work. This review will require a great deal of creativity in considering different approaches to accomplish the same level of work. Issues for consideration should include contracting for engineering, drafting and surveying, recentralization of certain functions within ADOT/PF and the use of productivity measures to encourage efficiencies.

The Cowper Administration should also give strong consideration to the question as to whether all federal funds available to the State in a given year should be sought through commitment of general funds. The State should establish a policy to commit general fund match to federal funds which allow for the repair and maintenance of existing facilities before committing to new construction which adds to the State's future maintenance and operation costs. By using federal funds that assist the State in keeping its current infrastructure in good condition we may be able to reduce our overall M & O costs down and avoid adding unnecessary capital projects to the current infrastructure base which tend to drive the State's M & O cost upward.

The positive points regarding developing this system as part of AKSAS is that it would be available to all other agencies who wish to perform federal billing automatically. However, from the ADOT/PF point of view there are a great many negatives. Developing a federal billing system within AKSAS is considerably more complicated and will require some significant redesign to address the system requirements of the other agencies all of which are costly in terms of time and money. Developing FIS as part of AKSAS will also make the FIS system less responsive to changes in the way ADOT/PF is required to perform federal billing in the future.

The positive points with regard to developing FIS outside of AKSAS are that the system can be developed more quickly, for less cost, without redesign and will be more responsive to ADOT/PF's specific requirements as they may change in the future. In addition, ADOT/PF has had real success in developing systems which accurately and effectively interface with AKSAS. The negative to developing the FIS system outside of AKSAS is that it may not take the needs of all other agencies into consideration and may not be available to all other agencies.

Recommendation: The ADOT/PF should begin developing the FIS system as soon as possible. An RFP should be issued which solicits creative input from the vendor community on how to quickly effectively and in a cost efficient manner address the Department's federal billing requirements. This RFP should not be issued with preconceived notions on the part of Department personnel on a specific solution or vendor (Price Waterhouse has received over 16 million in sole-source system development contracts in the State over the last 5 years with no involvement from their Anchorage office). The ADOT/PF should oversee the issuance of this RFP and should contract to meet the specific federal billing needs of ADOT/PF. In the mean time, ADOT/PF should develop a manual system to run parallel to the development of FIS in order to perform continued federal billing. This manual process will also need to exist to support the Capital Project Cleanup effort.

of a project as long as the project is well designed and constructed. This may also be fueled by the past pressure placed on ADOT/PF to get their appropriated capital projects out on the "street" as fast as possible. Under these types of pressures it may seem reasonable for a project manager to focus on building a project quickly and well regardless of the cost.

Project managers within ADOT/PF have complained with some real justification that the project management tools available to them to control project costs have been, at best, unreliable. The previous systems (PBA and FMS), which they have had at their disposal, provided untimely and often erroneous data.

Recommendation: Top level support from the commissioner and the Governor will be necessary to continually encourage ADOT/PF project managers to get control of project costs. The Capital Project Cleanup effort must be completed quickly so that the data the project managers currently receive from AKSAS is accurate, timely and reliable. Appropriate project management tools must also be made available to project managers to help them in getting control of project costs and maintaining control. Getting control of project budgets and expenditures should also help ADOT/PF step up its efforts to generate timely billings to the Federal government. One project management oriented system which the Department has recently brought into place in the Southeastern Region is the Project Cost Information System (PCIS) which should be examined more closely to see if it can be useful agency-wide.

Federal Billing System:

Description: As a result of problems experienced with the ADOT/PF FMS system the Federal Highway Administration, effective 11/28/86, suspended reimbursement of all future ADOT/PF Current Billing claims until the Department can provide assurances that project claims for reimbursement are accurate. Obviously until this problem is cleared up the State will not be able to receive federal funds owed to it for work which could not be billed as a result of this action.

Discussion: Over the last five years the ADOT/PF has spent millions to develop financial information systems for its specific needs. Almost without exception these systems have either not been completed or when they were brought up, were not used. Based on a previous design of a financial information system (FIS) by Price Waterhouse, the Department is now considering the development of this system to address the federal billing problem and the project control issues that presently exist within ADOT/PF.

The ADOT/PF is strongly considering developing the system in conjunction with the Department of Administration so that the system can address the federal billing concerns of other departments as well as those of ADOT/PF. The current thinking on the system is that it would be developed as an integral part of the AKSAS system as opposed to a stand alone system that receives and sends data to AKSAS.

aspect of shifting the tax burden to the local communities is that local officials will need to be more responsive to the voters in their delivery of services since the voter will now view those municipal or borough revenues as coming out of their own pockets. However, communities who have a small tax base or one that is not a strong cash-based economy will be seriously hurt through cuts in this area. They simply do not have any good replacements for these funds from a local source.

Recommendation: Under the current State revenue picture, the State can probably no longer afford to subsidize local communities who have other means at their disposal to fund local programs and services. However, it is very important to remember that the rural Alaskan communities who now receive revenue sharing and municipal assistance do not have real alternatives to this source of funding. The Cowper Administration should give strong consideration to eliminating the revenue sharing and municipal assistance programs but should make provisions to address the needs of rural Alaskan communities who have no real alternative to this funding source. Alternatives available to address the needs of the rural Alaskan communities may be to institute a gross receipts tax, a sales tax within the Unorganized Borough, or a statewide sales tax with rebates to local governments.

Housing Assistance Division

Description: In 1986 the legislature authorized the purchase of up to \$70.0 million in HAD loans by AHFC. With the purchase of these loans the HAD portfolio decreased in size and the revenue stream from the program was reduced by \$14.0 million. One of the revenue options presented in this report suggests to the Cowper Administration that another group of HAD loans be purchased by AHFC.

Discussion: A policy decision will need to be made regarding the provision for home financing in rural Alaska. As the HAD loans are sold to AHFC the revenue stream from this portfolio is significantly reduced which also reduces the amount of funds which are available for rural housing loans.

Recommendation: The Cowper Administration must decide the future of rural housing loans. Options which appear to be available to the Administration include merging the HAD program with AHFC, keeping the same program in DCRA with cash infusions as required, or eliminating the program.

Tax Relief Programs

Description: Currently DCRA provides a number of tax relief programs to local communities. Among these are senior citizen tax relief programs, disabled veterans tax relief programs, and agricultural land exemption programs. Given the current revenue picture for the State, consideration should be given to the discontinuance of at least some of these tax relief programs.

Discussion: Many of the tax relief programs reimburse local communities for the tax revenue which they forego due to the various

COWPER ADMINISTRATION - BUDGET TRANSITION TEAM

BUDGET TRANSITION REPORT

ALASKA DEPARTMENT OF COMMUNITY AND REGIONAL AFFAIRS

OVERVIEW OF DCRA OPERATING BUDGET

	<u>FY 86 ACT</u>	<u>FY 87 REV</u>	<u>FY 88 SPL*</u>	<u>FY 88 PRO</u>
Administration and Support	2,568.6	2,038.9	1,855.6	
Sr Citizens/Dis Vets Tax	4,415.2	3,087.5	0.0	
Child Assistance	13,418.5	11,138.2	11,101.2	
Job Training Partnership	12,869.5	14,466.5	14,151.2	
Displaced Homemakers	527.4	0.0	0.0	
Community Assistance Grnts	3,912.5	5,756.2	4,957.6	
Local Government Assistance	7,282.9	5,555.9	4,994.9	
Energy Programs	3,658.5	2,184.7	2,066.5	
Rural Development	876.9	796.8	766.8	
Block Grants CIP	297.1	77.5	77.5	
Data and Word Processing	293.6	232.4	232.4	
Housing Assistance	2,185.9	2,939.9	2,874.4	
Municipal Revenue Sharing	140,879.8	113,737.6	96,849.3	
Retirement Incentive Prog	0.0	0.0	34.8	
TOTAL	193,186.4	162,012.1	139,962.2	

*Sheffield Proposed FY 88

KEY BUDGET ISSUES CONFRONTING DCRA

Revenue Sharing / Municipal Assistance

Description: The FY 88 operating budget proposed by the Sheffield Administration proposes \$40.8 million in revenue sharing and \$55.9 million in municipal assistance. If the operating budget is to be reduced to sustainable levels, major reductions in these programs will have to be made or new sources of revenue must be developed, either at the local or state level.

Discussion: Many Alaskan communities have depended on the revenue sharing, municipal assistance, school foundation and school debt reimbursement programs for the large majority of their funding. Many have not resorted to their local taxing authority to provide the revenues necessary for their programs and services.

One unfortunate result of this situation is that the local communities and their residents have come to depend on these revenues. Since local services have been provided through other means than local taxation the voters have not been as able to voice their preferences on the services they would like provided to them. Elimination of the municipal assistance and revenue sharing programs may not necessarily hurt communities with a wide tax base, since, in most cases, taxes are currently low in those areas. A positive

exemptions provided for under these programs. While many of the groups who are protected under these programs certainly deserve assistance from government it may now be time, under the current revenue picture, to consider eliminating these programs. The Sheffield proposed budget for FY 88 already proposes eliminating all of the senior citizen and disabled veterans tax relief programs.

Recommendation: The Cowper Administration should give close consideration to eliminating these tax relief programs. If benefits are required to assist certain segments of the Alaskan population then specific programs which provide those needed benefits should be funded and developed.

DCRA Reorganization

Description: The Department of Community and Regional Affairs is a unique collection of services that are offered, in part, by other departments but which are specifically directed to local communities. The Cowper Administration should give strong consideration to moving these programs to agencies who might be better organized to deliver this type of service.

Discussion: If the Administration elects to end municipal assistance and revenue sharing, then the major share of DCRA's operating budget is eliminated. This change would also signal the end to DCRA's specific focus on the local Alaskan communities. Given these changes, it would make better sense to move programs to agencies who presently offer programs which are closely related to the ones provided by DCRA. Some examples of programs which might be moved include;

<u>Program</u>	<u>Agency Moved To</u>
Child Assistance	DH&SS
Job Training Partnership	DOE
Energy Programs	ECDF (new Energy Div)
Housing Assistance	AHFC

Recommendation: The Cowper Administration should give close consideration to slowly disassembling DCRA and transferring its required programs to other agencies who are already providing similar services. These actions will have only minor impact on administrative costs but may result in a more effective delivery of service. Please note that the Department of Community and Regional Affairs is viewed by bush constituents as the only department in state government which has a focus on rural issues. It will be very important to assure that these services are still made available to bush residents, and that bush residents do not feel they are being ignored by state government.

Agency For Rural Alaska

Description: Many residents of rural Alaska perceive that the Department of Community and Regional Affairs is the only department in state government which focuses specifically on the issues of rural Alaska. If DCRA is eliminated and its programs are moved to agencies who already provide similar services, it will be very important to create an entity in state government which has as its primary focus the issues of rural Alaska.

Discussion: The interests and concerns of rural Alaskans may need to be specifically addressed through a single designated entity within state government. One possibility may be to establish an entity in Governmental Coordination within the Governor's Office to coordinate the delivery of services to rural Alaska. Arrangements could be made with other agencies who are best able to deliver specific services through the use of Reimbursable Service Agreements.

Recommendation: The Cowper Administration should provide for the specific delivery of services to rural Alaska. Oftentimes the needs of rural Alaska are significantly different than the needs of the larger Alaskan communities. Some provision should be made in state government so that residents of rural Alaska can go to a single entity in the state bureaucracy with their needs and concerns.

Recommendation: This program should be reviewed to determine its effectiveness in providing electric power to rural communities at a reasonable cost so that these communities can enjoy some of the modern conveniences enjoyed by their more urban counterparts. Consideration should be given to placing a cap on the kilowatt hours which will be subsidized for each household under this program. In addition, local utilities should be audited to suggest ways for them to improve the cost effectiveness with which they deliver power to their rate payers. Consideration should also be given to removing public and private (non-household) entities from the program since they will normally pass the increased cost of electric power on to their customers.

Bradley Lake/Railbelt Energy Fund

Description: The railbelt Energy Fund (REF) currently contains \$ 281 million which was set aside during the past legislative session for the purpose of meeting future Railbelt energy needs. In addition, the APA is currently developing the Bradley Lake Hydro Project on the Kenai Peninsula. This project may require an additional \$ 50 million to complete the project. There exists a close relationship between the REF and the Bradley Lake project since they both directly address the future energy needs of the Railbelt.

Discussion: The Bradley Lake project has been the subject of some controversy in the Railbelt. Many Railbelt utilities argue that the power from this project will be needed by their ratepayers in the very near future. While others argue that the power from Bradley Lake will simply add to the surplus power which currently exists in that region. There has also been some real question as to whether the Bradley Lake will have sufficient water to run the project.

Railbelt utilities have, at the same time, been discussing what to do with the Railbelt Energy Fund. The projects which appear to have received the widest base of support from the utility community are intertie enhancement projects from the Anchorage/Mat-Su utilities to the Kenai Peninsula and to Fairbanks. The utilities argue for the Kenai intertie project because the present power lines, owned by Chugach Electric, will not be able to carry all of the power generated from the four projects on the Kenai Peninsula to the main intertie maintained by the APA. The utilities claim that if Bradley Lake is constructed approximately 100 megawatts of surplus power will be held captive in the Kenai and will not be available to other Railbelt ratepayers without an enhancement of this intertie.

Enhancement of the Fairbanks intertie has as its primary purpose to allow for more efficient wheeling of power to Fairbanks and to provide a backup if a portion of the intertie went down for a period of time. The Railbelt utilities maintain that an investment into the intertie enhancement projects will make expansion of future power generation in the Railbelt much more economic since extensive power lines will not need to be included in each project to bring the power to the consumer. They contend that, if the intertie projects are constructed, the "power highway" will already exist for an efficient

COWPER ADMINISTRATION - BUDGET TRANSITION TEAM
BUDGET TRANSITION REPORT
ALASKA DEPARTMENT OF COMMERCE AND ECONOMIC DEVELOPMENT

OVERVIEW OF DCED OPERATING BUDGET

	<u>FY 86 ACT</u>	<u>FY 87 REV</u>	<u>FY 88 SFL *</u>	<u>FY 88 PRO</u>
Commissioner/Admin Services	1,838.3	1,880.4	1,465.5	
Measurement Standards	2,090.7	2,125.5	2,122.5	
Banking, Securities & Cor	1,280.4	1,287.0	1,234.6	
Insurance	1,052.7	964.7	888.3	
Occupational Licensing	1,747.0	1,877.8	1,856.6	
Retirement Incentive Prog	0.0	0.0	138.6	
AK Transportation Commission	8.2	0.0	0.0	
AK Public Utilities Comm	4,052.7	3,564.2	3,731.2	
Real Estate Commission	456.9	546.8	546.8	
Oil and Gas Conservation	1,846.3	1,613.9	1,580.7	
Alaska Power Authority	25,882.8	23,544.2	20,626.8	
Economic Development Advo	3,031.5	2,656.3	2,466.8	
Investments	1,268.8	1,349.6	1,349.6	
Accounting and Collection	1,544.5	1,834.5	1,834.5	
Fish Enhancement Tax Rece	3,186.6	4,435.3	3,284.0	
Tourism	6,599.8	6,312.2	8,200.0	
AIDA	1,187.8	1,714.4	1,868.3	
AK Seafood Marketing Inst	3,601.4	3,132.7	3,132.7	
TOTAL	60,686.5	58,839.5	56,438.7	

* Sheffield Proposed FY 88

KEY BUDGET ISSUES CONFRONTING DCED

Alaska Power Authority

Power Cost Equalization

Description: The Power Cost Equalization program represents the largest operating budget expenditure made within the APA's budget as well as the operating budget of the entire Department. This program should be reviewed in depth to determine if it is effectively meeting its intended purpose and whether changes can be made to the structure of the program to improve its effectiveness and to reduce the program's cost to the State.

Discussion: The Power Cost Equalization program is based on a formula which averages the price paid per kilowatt hour in Juneau, Anchorage and Fairbanks. This average rate is then made available to participating rural communities through State subsidies.

This program may not have had the result that was originally intended. While the program has led to the electrification of several rural communities it may have also promoted the inefficient use of more power with no consideration given to the use of conservation measures. Since no cap exists on how much electric energy will be subsidized for each household the demand for electric power at the current rates becomes almost limitless. In addition, since local utility costs, for the most part, will be subsidized through the program there is little incentive for the local utilities to generate and distribute power in a cost effective manner.

and economic means of distributing power throughout the region. Others contend that neither intertie enhancement project is, at present, economic and therefore the REF should be used for other projects.

Regarding the construction of Bradley Lake, many utilities feel that it is a good project and that it should probably be constructed. However there is no concensus of opinion that the project construction and operation should be managed by the AFA. Some utilities have suggested that a portion of the REF be used to complete the financing of the Bradley Lake project. Still others have suggested that the entire REF be appropriated to the Alaska Electric Generation and Transmission (AEG&T), the only recognized Railbelt generation and transmission entity presently recognized by the APUC, and place them in charge of the Bradley Lake project as well as the intertie enhancement projects.

Recommendation: The issues discussed above are complex ones. There exists no unanimous opinion on what action should be taken. In the past the Railbelt utilities have had a difficult time agreeing on many issues, but many utilities feel that by making them responsible for the REF and for planning to meet the future energy needs of the Railbelt a successful organization of these utilities can result.

The long term existence of the APA should be closely examined with the perspective that, at least in the Railbelt, the utilities stand ready to begin planning and developing the energy future for their ratepayers. Strong consideration should be given to placing the Railbelt utilities in charge of the Bradley Lake project and the Railbelt Energy Fund. In addition, the other functions now performed within APA should be moved into a Division of Energy which should be located in the Department of Commerce and Economic Development.

Other APA Programs

Description: In spite of the criticism that APA has received over the recent past, there are several functions performed by the APA which are viewed as important to Alaskan residents. These functions, to the extent possible, should still be provided by the State regardless of the future for the APA.

Discussion: The Alaska Power Authority was formed to provide some key functions in developing electric energy resources within Alaska. Among the functions provided by APA, the following is brief list of some that are often mentioned by utilities as ones they would not wish to lose if APA were eliminated;

1. The APA serves as financing vehicle which has the full faith and credit of the State of Alaska behind it. This can result in significantly better financing arrangements for power projects than would otherwise be available to Alaskan utilities if they were forced to obtain financing for projects entirely on their own.

2. The APA has been providing valuable technical advice to rural communities who are developing their own power generation facilities.
3. The APA has traditionally provided energy planning assistance in Alaska.

Recommendation: These functions, currently provided by the APA, should be strongly considered for inclusion in a Division of Energy contained within the Department of Commerce and Economic Development.

Accounting and Collections / Investments

Description: One of the one-time revenue options proposed in the first section of the Budget Transition Report was for the State to divest itself of its present loan programs. Two of the organizations who are chiefly responsible for these portfolios are the Division of Accounting and Collections and Division Investments which are both contained in the Department of Commerce and Economic Development.

Discussion: If the Governor chooses to raise one-time revenue for the State by divesting the various loan programs which are managed by the Department of Commerce and Economic Development, then there will not be a need for either the Division of Investments or the Division of Accounting and Collections. However, other options may exist to reduce the operating expenses associated with these two divisions.

One option which may be considered is to stop making any additional loans in these loan programs but continue to service the loans and continue to receive the income generated by these loan portfolios. Under this scenario, the Division of Investments would no longer be needed since no new loans were being made, but the Division of Accounting and Collections would be required to continue to service these loan portfolios.

Another option may be, in addition to closing the loan programs down in terms of making new loans, contract out to a financial institution to service the loan portfolio. This second option may have additional merit considering the relatively good condition of the financial records for these loan portfolios and that the state's financial institutions are currently eager to find ways to generate additional cash flow.

Recommendation: Further action regarding the budget of these two divisions should be predicated on a decision by the Governor to begin divestiture of the loan programs managed by the Department of Commerce and Economic Development. There appear to be potential savings which can accrue to the General Fund under any of the scenarios described above. The Cowper Administration should give close consideration regarding the future existence of these organizations in light of the current State revenue picture.

Tourism / Economic Development Advocates / AK Seafood Marketing Institute

Description: As discussed by Governor Cowper throughout his campaign, the future of Alaska is dependent on further economic development and diversification. The above organizations have as their primary function to promote the economic development of the State. Given this perspective it will be important to provide additional support to these organizations even in times of low revenues in order to stimulate future economic development opportunities.

Discussion: One common complaint about these types of organizations is that it is difficult to determine how effective they have really been in stimulating the economy. It is very important that these organizations be held responsible for meeting their goals and objectives. In order to measure the productivity of these organizations, measurable objectives must be established and be used regularly to evaluate performance of the program. It is very important that the performance measurements not be based on how many applications were received or amounts of paper processed, but rather on how successful they were in stimulating new business (i.e., new sales arrangements with Pacific Rim countries, seminars presented on dealing with foreign countries, etc.).

Recommendation: In light of the need for further economic development and diversification in Alaska, now is not the time to cut the budgets of the State organizations which are responsible to help stimulate new business. The budgets of the economic development advocates should be reviewed to see if a further injection of money could have real benefits to the economy. All State organizations who have similar economic stimulation functions should be consolidated under the Economic Development Advocates section in DCED. Finally, these organizations should establish measurable objectives against which their performance can be judged, and the measurements should be evaluated regularly.

Alaska Industrial Development Authority

Description: As described in the text associated with the committee's suggestions for possible revenue generation options, the Governor may want to consider moving the liquid assets of AIDA into the General Fund and asking the legislature to appropriate the earnings from AIDA assets back to the General Fund.

Discussion: AIDA has \$ 162.0 million in unencumbered assets held in short term government securities which can be moved into the General fund through a variety of approaches which are discussed in the section of this report on possible revenue options. AIDA can also provide an annual income to the General Fund of \$ 18.8 million on earnings from its current portfolio.

Recommendation: The Governor should look closely at the revenue opportunities presented by AIDA. These actions will require legislative cooperation and should be done only after careful consideration has been given to the role that AIDA should play in developing the economic future of Alaska.

12. The state cannot afford to implement the new procurement code this year. Legislation should be proposed to defer and/or amend the procurement code passed last year to reduce implementation costs.
13. Additional funding is necessary for catastrophic losses because the state is self-insured to higher levels than in the past. A self insurance fund for payment of losses should be established, or legislation should be passed allowing the administration to use the budget reserve fund for extraordinary losses.
14. While the Supreme Court has ruled that the public defender and public advocacy offices cannot be administered by the court system, the general fund budget for these offices should be transferred to the court system, which would then bear the costs of these offices through RSA to the department.
15. The Alaska Public Broadcasting Commission should examine the feasibility of providing public broadcast services statewide from a small number of broadcast origination sites, including the feasibility of a single statewide public radio and single statewide television station rebroadcast at all existing public broadcasting sites.
16. The telecommunications divisions should continue to consolidate audio and data circuits statewide to minimize costs of communications.
17. The RATNET entertainment channel should be eliminated.
18. Public service programs currently housed in the department should be transferred to more appropriate agencies. The longevity bonus program and other senior programs should be transferred to health and social services; public broadcasting to education; and public offices to elections.
19. There should be a greater degree of coordination between the division of finance and the department of revenue's treasury functions.
20. Additional work is necessary in the division of finance to ensure that the state has an accurate picture of its financial status at all times. Greater coordination between the state accounting system and departmental accounting systems, particularly those in the department of transportation and public facilities, is essential.
21. In keeping with its statutory mandate, the department needs to take a more active role in ensuring that the staff of other agencies have the necessary training to use the new statewide accounting system and that microcomputer systems are being used effectively. Constant attention should be paid to the relative merits of microcomputer systems versus mainframe systems.

Department of Revenue

The subcommittee did not review the department's activities in depth. However, preliminary budget and fiscal analysis leads us to the following recommendations:

1. The permanent fund dividend program is charged for costs of staff who administer the program. The size of this staff and the appropriateness of all charges against the dividend program should be examined.
2. The tax audit staff is critical to state collections of tax revenues. The department should examine the audit division to determine if procedures and staffing levels are appropriate.

**Budget Transition Team
Subcommittee on General Government**

Brian Rogers, Chairman
Richard Fineberg
Robert Poe

Department of Administration

The subcommittee did not review the department's far-reaching activities in depth. However, preliminary budget analysis leads us to the following recommendations:

1. Six collective bargaining contracts expire by the end of FY87. Additional funding may be necessary to hire additional skilled negotiators for what is likely to be a difficult bargaining process.
2. Per diem entitlements should be revised to pay for meals only on the last day of state travel. This revision must be negotiated for all collective bargaining units. Total savings should reach \$1 million annually.
3. State travel policies should be revised to ensure that all frequent flier bonuses accrued for state-paid travel benefit the state. Negotiations may be necessary with the major Alaskan airlines to achieve these benefits, which could reach in excess of \$1 million annually.
4. The classification study should be implemented as soon as possible to avoid future litigation and costs. Changes in pay for affected employees should be implemented at the same time as any general pay reductions.
5. Geographic differential changes should be implemented with collective bargaining units during the current negotiations.
6. TRS Match funding should be eliminated in the state budget; costs of the entire non-employee share should be transferred to school districts and the University.
7. The state Supplemental Benefits System should be revised in legislation which would decrease the state payment by any amounts required by federal law to be paid for Social Security or Medicare.
8. The FY88 budget for all state agencies should reflect anticipated savings in PERS and TRS employer costs based on actions by the retirement systems boards in January 1987.
9. The state cannot afford to operate the Juneau Pioneers' Home. Construction contracts should be cancelled; even with damages paid to affected companies, the state will save money.
10. A major revision to the state's payroll computer system is needed. A search for an appropriate software package should start immediately.
11. Appropriations for leasing of state facilities are insufficient for FY87; a supplemental appropriation will be necessary. The department should actively work toward a reduction of leased space as contracts expire. Departmental needs for leased space should decrease as budgets decline and layoffs continue. The department should attempt to negotiate lease cost reductions with current contractors.

3. Collections functions of state agencies should be consolidated in the department.
4. Licensing functions of state government should be considered for consolidation in the department to allow greater coordination of licenses and permits and to reduce both costs to the state and time demands on the individuals/companies being licensed.
5. The trust functions of the Permanent Fund Corporation and those of the PERS and TRS systems, the mental health trust, and the university trust are similar. Consideration should be given to merging all the trust investing functions of the state under the Permanent Fund Corporation, with policies set for investment of PERS and TRS funds by the appropriate retirement system boards.
6. With appropriate safeguards, confidential petroleum industry data necessary for use in projecting state revenues must be available for use by certain legislators and governor's office staff. Additionally, the department should take steps to ensure that the maximum amount of non-confidential information on Prudhoe Bay economics is available to all for scrutiny. As noted elsewhere in this transition report, changes are needed in the revenue forecasting system.
7. Annual revenues of the Alaska Industrial Development Authority and the Alaska Housing Finance Corporation should be deposited in the general fund, becoming available for appropriation by the legislature.

Department of Law, Governor's Office

The subcommittee did not review these offices in depth. Based on information available, we recommend:

1. The department of law should review the costs and benefits of major criminal cases which involve significant costs to the state. It should be a general policy that supplemental appropriations will not be available for the criminal division to encourage the division to prioritize cases on both policy and budget grounds.
2. The governor and legislature should consider revisions to the presumptive sentencing law, and should consider allowing plea-bargaining in appropriate cases to reduce costs throughout the criminal justice system. Increased use of pre-trial diversion and suspended imposition of sentences will also decrease costs of the justice system.
3. To save state employee time, increase effectiveness, and promote better public information, the governor's office should play a lead role in establishing clear, comprehensive and compatible budget accounting, and revenue reporting systems.

**Budget Transition Team
Subcommittee on Public Protection**

Department of Public Safety

1. Contract negotiations with the Public Safety Employees Association begin immediately. The state should seek significant concessions from this high-cost employee group.
2. The department should consolidate divisions to reduce the number of division directors and deputy directors. The Records and Identification unit should be consolidated in Anchorage.
3. Fish and Wildlife Protection employees should be hired on a seasonal basis for many functions, reducing personnel costs significantly.
4. Greater efforts should be made to put uniformed troopers in the field, transferring clerical and other office functions to civilian employees who require less professional training.
5. The governor should consider transferring domestic violence programs from public safety to health and social services.
6. The department should be given statutory authority to increase fees for motor vehicles, criminal history records, crime laboratory functions, security guard applications, and fire safety inspections. As noted above, inspection functions of several departments should be consolidated.
7. State troopers currently providing principal police functions in organized municipalities, such as Anchorage's Hillside area, should be laid off or transferred to other posts. Municipal governments with police powers should assume these functions.
8. The state should actively work to coordinate dispatch efforts with local governments wherever possible to save costs.
9. The Commission on the Administration of Justice should be abolished.
10. Administrative overhead costs on the Village Public Safety Officer contracts should be reduced. VPSOs should assume additional public protection functions in villages, including inspection functions of various departments.
11. Administration costs of the Police Academy should be reduced.

**Budget Transition Team
Subcommittee on Public Protection**

Senator John Sackett, Chairman
Brian Rogers

Department of Labor

The subcommittee did not conduct an in-depth review of the Department of Labor budget. Based on a brief review, we offer the following recommendations:

1. Costs of administration of the Second Injury Fund should be borne by the fund, rather than by the general fund. This requires a statutory change to return to the pre-1981 method of funding these administrative costs.
2. The department should review fees for inspection services (such as mechanical inspection) and should revise fees to more adequately cover costs of these services. The department should work with other departments which conduct inspections (public safety, transportation and public facilities, environmental conservation, etc.) to consolidate functions.
3. The Youth Employment Service (YES) should be examined in conjunction with youth programs in other state agencies to determine which programs are of highest priority to the state.
4. The department should examine methods of funding workers compensation administration from non-state sources, including a premium tax on workers compensation insurance.
5. The functions of the Governor's Commission on Employment of the Handicapped may be appropriately handled by the Commissioner of Labor and staff.
6. The state demographic functions performed by the Research and Analysis section should be more heavily used by other state agencies in planning and budgeting. The governor should consider moving the Research and Analysis section, or at least the state demographer, to the Office of Management and Budget policy office.

Department of Military and Veterans Affairs

1. The department may not be able to afford opening of the Kotzebue Armory.
2. There may be savings in retirement benefits for the Alaska National Guard due to new PERS rates likely to be adopted by the PERS Board in January.

3. Cost of hold harmless for non-need based programs.

Both Longevity Bonus recipients and Permanent Fund Dividend recipients are held harmless. As the new administration reviews the continuation of all non-needs based programs, it needs to examine this policy.

4. Facilities not in use.

Two youth corrections facilities (Bethel and Fairbanks) have been constructed but not opened, while the Nome facility has been converted to a day program only. The fate of these facilities needs to be examined.

5. Consolidation or coordination of services.

A number of programs in other agencies should be examined for potential transfer to the Department of Health and Social Services:

Youth in Detention in Dept. of Education
Schools for the Handicapped in Dept. of Education
Adult Basic Education in Dept. of Education
Employment Training Grants in Department of Education
Vocational Rehabilitation in Dept. of Education
Environmental Health in Dept. of Environmental Conservation
Senior Citizen's Tax Relief in Dept. of Community & Regional Affairs
Renter's Equivalency Rebate in Dept. of Community & Regional Affairs
Child Care in Dept. of Community & Regional Affairs
Head Start Grants in Dept. of Community & Regional Affairs
Job Training Partnership Act in Dept. of Community & Regional Affairs
Housing Assistance in Dept. of Community & Regional Affairs
Domestic Violence & Sexual Assault in Dept. of Public Safety
Longevity Bonus in Dept. of Administration
Pioneers Homes in Dept. of Administration
Older Alaskans Commission in Dept. of Administration

Under the current structure, the State has several separate agencies responsible for direct social and educational services to people. The new administration should examine ways in which to ensure that those services are provided in a coordinated, holistic way.

This report was prepared by the Health and Social Services Subcommittee: Mary Halloran and John Sackett.

December 15, 1986

DEPARTMENT OF HEALTH & SOCIAL SERVICES
BUDGET REVIEW

BUDGET NUMBERS

FY 87 Authorized	\$345,709.4
FY87 General Fund Only	235,243.9
FY87 Revised General Fund Only	219,574.2

FISCAL ISSUES

1. Lack of flexibility.

The nature of the Department's programs makes it difficult to reach lower budget levels quickly. About half of the department's funding goes to entitlement programs, such as AFDC, while much of the balance funds institutions such as API. The major cost of the institutions is employee compensation. To reach further savings in the institutions, salary reductions and longer work weeks appear crucial, as reductions in the number of staff is not a viable option. Two options have been suggested for funding the entitlement programs: (1) prorating payments after issuing emergency regulations; or (2) seeking supplemental funding. These issues are discussed in detail in the Department's transition report.

2. Increased public assistance caseload (Supplemental request).

As noted above, the Department may be seeking a supplemental to meet rising entitlement program costs. The caseload is increasing 4 to 5% above earlier projections. The Department has yet to see outmigration of its clients -- they may be too poor to move. In addition, three other programs are in deficit spending: API, youth facilities, and foster care. The supplemental request may be more than \$4 million.

At this time, the Department is examining a return to the approach used in 1970, the instructional unit method. Any approach will have to be closely examined for equity and for final cost effects. (See also Educator Salaries, No. 2). A proposal for foundation formula revisions should be available sometime in January.

2. Educator salaries and benefits, TRS Match, and tenure provisions.

About 70% of the foundation formula goes to salaries. These costs have tripled in the last decade, and Alaska educator salary costs exceed those of every other state. The high level of the costs stems, in large part, from educator salary increases over the cost of living. School operating fund expenditures (federal, state and local dollars) have jumped from \$201 million in FY76 to \$606 million in FY84, an increase of \$405 million. According to a 1986 House Research report, in city and borough schools, the cost per student has increased sixty percent (after adjustment for inflation) from FY76 to FY84, and sixty-two percent for rural districts during the same period.

The collective bargaining process has not resulted in significant salary reductions thus far, although it may in the future. A number of approaches have been offered, based on the recognition that Alaska's K-12 educators are, in essence, state employees. One approach to educator salaries might be the implementation of a statewide salary schedule, with its provisions applying only to newly hired teachers. Another approach could be to place a limit on the use of State funds for compensation of individual positions, as proposed in legislation during the 1986 session. Another approach would be to rollback individual compensation ten percent across the board by legislative action. Every one percent rollback would result in approximately \$4.4 million in reduced costs. All these approaches would narrow the collective bargaining process, a major policy step.

Unless a reduction in teacher and administrator compensation is obtained -- and obtained in short time -- education costs will be out of control in relation to state revenues. School districts in organized cities and boroughs can presumably cope to some extent by raising local property and sales taxes. REAAs and school districts in smaller cities are limited in their tax base -- and thus constrained in their capacity to deal with the crisis.

A related issue to examine is teacher tenure, currently granted after only two years of service. Another related issue is TRS Match, a contribution annually by the state to local district and University of Alaska labor costs, and estimated at \$26 million for FY88. The TRS Board recommends that the State discontinue splitting the cost with the employer and that the employer and employee only share contributions to teacher retirement.

December 15, 1986

DEPARTMENT OF EDUCATION BUDGET REVIEW

The Public School Foundation appropriation is the largest single appropriation in the state operating budget; student loans is the largest component of the loans budget; and school debt retirement now almost equals the annual state general obligation debt appropriation. Reduced state aid to local education has brought the fiscal issues inherent in funding for public schools into sharp focus.

THE BUDGET NUMBERS

FY87 Revised Budget General Fund is as follows:¹

K-12 Support	\$423,954.7
Additional Grants	11,020.6
TRS Match	26,856.3
Department Operations	10,769.8
Dept. Operated Schools ²	6,205.5
Boards & Commissions ³	7,262.8
School Debt Retirement	129,837.3
Student Loans	54,100.0

Total	\$670,007.0
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FISCAL ISSUES

1. Education Foundation Formula

The complexity of the current formula, as well as its perceived inequities, need to be addressed. Now, the formula seems to drive district policy and program decisions. That is, districts may make decisions about which programs to offer based on the dollars which the decisions generate -- not on the needs of the students.

Equity is a fundamental consideration, both in terms of policy and for practical reasons. For example, federal funding (PL81-874 receipts) depend on the state meeting federal equalization criteria. Litigation challenging the current formula is already underway.

1. Amount is adjusted for one-time items.

2. Mt. Edgecumbe, AVTEC

3. Arts Council, Professional Teaching Practices Commission, Alaska
Student Activities Association, Postsecondary Commission

3. Fiscal accountability.

Local school districts appear to have differing degrees of fiscal sophistication. Because of legal restrictions hampering districts' efforts to reduce staff, some districts are using current fund balances to absorb this year's state funding reductions. Districts without such fund balances may face early closure or seek supplemental funds this legislative session.

It is not clear at this point how much of the 10% restriction (\$42 million in foundation formula, plus other monies) school districts will be able to handle. A related issue is the lack of comprehensiveness in budget procedures for school districts: There is no requirement that the proposed budget has to be balanced, for example. Nor are school district membership counts audited, although these counts are the basis for distribution of over \$400 million in general funds. Department-level capability to assist districts with fiscal management is limited.

4. Arbitrary deadlines.

Two deadlines drastically affect districts' ability to cope with funding problems: first, the districts must notify teachers of pending layoffs by March 15 of the preceding year. Second, districts are unable to establish their funding level until mid-fall of the school year. With funding levels falling, districts get squeezed between these two timelines. Districts need legislation allowing layoffs after March 15 of the preceding year for financial hardship. The legislation would need to define the term "financial hardship."

5. Pupil transportation costs.

Lack of appropriate data make it difficult to fund pupil transportation except in a reactive manner. More fundamentally, the policy issue remains unexamined: What is the state role in providing transportation for students? Now district contracts drive the cost, with the State simply reimbursing a portion of the cost after the fact. When sufficient data is gathered to construct a defensible equation, this cost should be moved into the foundation formula, so that local districts deal with transportation as part of their overall costs.

6. Duplicative services.- Centralized Correspondence Study

Centralized Correspondence Study provides elementary and secondary programs not only for students in isolated areas, but also to students living in urban settings. A review of the policy needs to take place: Is the program for "real" correspondence study or is it alternative schooling? If the cost of centralized correspondence study exceeds the average cost per student in regular school, should the parents pay the difference if the program is functioning as alternative schooling for their child? Or should the program simply be narrowed to only providing schooling for "real" correspondence study students?

7. Student loan program.

The policy issue is: Does the state want to stay in the loans business, particularly a subsidized non-needs based loans program? If the policy decision is to continue a student loan program, then one approach would be to establish a revenue bonding program. One investment firm has suggested issuing \$25 million in revenue bonds annually for several years to capitalize the program. For the revenue bonding approach to work, the "forgiveness" provision would have to be deleted. Another alternative would be to investigate the possibility of switching to the already-established federal student loans program. This alternative would allow the collections function for the current loans to be shifted to the Department of Revenue, reducing the overhead costs of the program and, in effect, allowing the Postsecondary Commission to be dismantled.

8. Vocational rehabilitation programs - centralization & coordination with Depts. of Labor and HSS.

As dollars become more limited, a thorough interdepartmental review should take place, aimed at providing better delivery of services by the three involved departments.

Federal "maintenance of effort" requirements for vocational education may present another fiscal problem, limiting the state's flexibility in dealing with administrative costs for vocational rehabilitation. Instead of accepting the federal mandate, perhaps the State should explore congressional action to provide Alaska and other states with more flexibility.

9. "Nice but not necessary" programs

Community Schools, RSVP, Alaska State Council on the Arts, Alaska School Activities Association, Professional Teaching Practices Commission, Alaska Career Information System, and the Blue Book -- each of these programs has its advocates and certainly its benefits. Whether they are "necessary" in times of greater fiscal restraint needs to be examined closely.

10. School debt retirement.

A consistent level of state reimbursement for local school debt needs to be determined. School districts, local governments, and the public need to know precisely who is going to pay which portion of the costs before those costs are entered into. One suggestion is that the state's obligation be limited to a specific amount of the principal, with no state dollars going towards reimbursement of the interest accumulated on the school debt. This issue needs to be considered in conjunction with the overriding issue of all debt management.

11. Division of Education Program Support.

Originally, this division primarily passed through federal funds to local districts, and performed monitoring and compliance for federal purposes. As state dollars became more plentiful, monies were added for special program grants and curriculum development. The division should be reviewed to determine the impact of returning to a fully federally funded program.

12. School district consolidation.

Alaska has a number of very small school districts with high administrative costs. The consolidation of administrative functions should be analyzed to see if districts can be combined for administrative purposes while local boards retain program control in local schools.

This report was prepared by the Education Subcommittee: Mary Halloran and John Sackett.

December 15, 1986

UNIVERSITY OF ALASKA
BUDGET REVIEW

BUDGET NUMBERS

FY87 Authorized	\$263,073.2
FY87 Revised	255,098.6

FISCAL ISSUES

1. Restructuring university statewide system.

The proposed restructuring plan is based on the recognition "that the University's administrative structure is extremely complex, extensive, and costly in relation to the size of the University and the clientele that it serves." The proposal is conceptual at this stage, with "numbers" to be worked out later. The core issue is the future role of Alaska's community colleges. By national standards only Kenai, Anchorage, Fairbanks and MatSu have a sufficient population base to maintain a strong community college. Should Alaska continue to strive to be different? And, if so, how can the community colleges be cost-effective?

2. Inability to respond quickly to fiscal problems.

The university has a long lead time for making most personnel changes. Although this policy is part of academic tradition, it leads the university into taking inappropriate measures in dealing with budget cuts. This year, for example, the university absorbed much of its budget reduction by taking one-time cuts in equipment and maintenance. It should be recognized that the university is also constrained in making rapid program changes because of legal obligations to students already in degree programs.

3. Focus on programs important to Alaska's economic future.

The university should be encouraged in its intent to focus on fisheries, international trade, arctic health, and arctic research.

4. Employee compensation and benefits.

The university should investigate the possibility of pay reductions for faculty commensurate to those taken by state agency personnel, with the national market taken into consideration. Any new salary schedule should also take into consideration the Department of Administration's geographic differential study results.

The university should proceed to implement its classification study to remove perceived inequities in its personnel system.

The full costs of TRS match should be absorbed by the university rather than supplemented by an additional appropriation.

Another angle to the employee compensation issue is the student-faculty ratio. The university teaching load is currently 9 credits per semester, versus a nationwide average of 12 credits per semester. Cost-cutting measures need to include an analysis of the appropriateness of the current teaching load versus the need for both basic and applied research.

5. Availability of information.

A frequently expressed concern among both executive and legislative staff was the vagueness of fiscal information provided by the university. The university has its own accounting system and its own personnel system, separate from those of the state. The lack of financial integration with the state system means that fiscal details are not readily available. Apparently the university does not prepare an annual financial report as required, for example. The real issue here is not who governs the university, but the public's right to know what is being purchased with state dollars. The university should be encouraged to increase its provision of detailed information on its fiscal matters.

6. Instate contracting.

State agencies currently contract for research and other services with firms outside Alaska. Some of that work could be performed in Alaska, providing training for Alaska graduate students in practical aspects of their area of study. The state needs to consider adopting a firm policy of granting a contracting priority to the university.

7. "Nice but not necessary."

The university budget funds, as do all state budgets, many programs which need to be reconsidered from the perspective of necessity: KUAC, the University Alumni Association, some cooperative extension service functions, for example.

8. Other issues.

High costs of insurance, falling interest rates, decline of federal research money, lack of sufficient funding for data processing projects already underway, the status of the statewide administration building in Fairbanks -- these and other issues need to be examined.

This report was prepared by the University Subcommittee: Mary Halloran and John Sackett.

December 15, 1986

DEPARTMENT OF CORRECTIONS
BUDGET REVIEW

BUDGET NUMBERS

FY87 Authorized	\$83,919.1
General Fund Only	82,579.6
FY87 Revised	80,631.4
General Fund Only	79,291.9

FISCAL ISSUES

1. Legal and policy changes.

The attached memorandum from the Department of Corrections identifies possible ways to reduce the cost of the corrections system, and provides cost estimates for each item. The proposals must be analyzed in light of their impact on the public, the court system and the rest of the legal system, including the Department of Public Safety.

2. Other issues.

Other issues with fiscal impact have been identified but not researched. They include: level of staffing at each institution; availability of malpractice insurance; scarcity of bed space; leasing rather than building correctional institutions. Underlying the Department's management and fiscal problems is the lack of a longterm plan. Such a plan could, for example, delineate institutions by offender groups, allowing more flexibility in supervision in some institutions.

This report was prepared by the Corrections Subcommittee: Mary Halloran and John Sackett.

MEMORANDUM

State of Alaska

TO: Mary Halloran
Budget Transition Team
Office of the Governor

THRU:

FROM: William W. Ladwig *WJ*
Acting Commissioner
Department of Corrections

DATE: December 10, 1986

FILE NO.:

TELEPHONE NO.: 465-3376

SUBJECT: Cost Implication of Law
and Policy Changes

The attached, Law and Policy Changes Under Review, was presented by the Corrections' Mini-Cabinet to Governor Sheffield for the purpose of identifying some possible ways to reduce the cost of operating the Alaska Correctional System. It was also provided to Governor Cowper's Transition Team for their consideration.

The following is our preliminary estimate, on a point-by-point basis, of the financial impact on this department should some or all of these items be brought to fruition. We cannot comment on the extent, if any, of the financial impact on other executive branch agencies.

1. ~~SAVINGS FROM CITATIONS INSTEAD OF BOOKING~~

There appears to be savings in this policy change. During November 1986, there were 595 persons statewide, who could have been served citations and released instead of being booked. Extrapolating this data for 12 months and assuming an average 8 hour hold, we could save 2,380 mandays per year at an average cost of \$74.97 per day (not including medical or statewide program costs) or \$178,400. By also enforcing the offenses of Failure to Appear and Failure to Satisfy Judgment by making them subject to citation instead of incarceration, an additional 698 mandays could be saved. This would represent an additional savings of \$51,600.

It appears that the Alaska State Troopers and the local police departments are making use of citations in such a way that they are not overburdening the Department of Corrections.

The per year statewide impact could be the saving of \$230,000 and reducing our population count by 8-9 full time persons.

2. ~~DEVELOPING A BAIL SCHEDULE~~

We cannot provide any data regarding the actual bail amounts on which people are being released around the state, only the original amount of bail set, but we do know that varying policies and rates are set by the presiding judge in each jurisdiction. In many instances, bail schedules do not exist or are flexible and judicial intervention is required so people are held until they are arraigned, assigned a Public Defender, have a bail hearing, arrange bail with the bondsman and are released.

This is an issue to be decided by the courts through the advice of the Chief Justice and Art Snowden, Administrative Director for the Court System. They are generally receptive to all suggestions.

3. Significantly increase the number of probation and parole cases.

This proposal refers to the maintenance of people on probation or parole who are doing well and no longer need supervision. If it can be determined that supervision is no longer needed, it is suggested that the court or the Parole Board be petitioned for approval of termination of supervision. Currently 665 of the 2753 probation/ paroles are on minimum supervision for an average of 5 years. If the court or Parole Board could be approached for termination after one year, considerable probation officer time in aggregate could be saved and applied to additional intensive supervision cases who could then be released from institutional custody. These 665 cases require .8 work unit hours/mo. $\times 12 = 6,384$ units per year. Intensive supervision cases requires about 120 hours per year. Thus $6,384 \div 120 = 53$ intensive supervision clients that could then be released from institutional care. Savings:

Cost of institutional care:	$53 \times \$86.33^* \times 365 =$	\$1,670,100
Cost of intensive supervision probation care:	$53 \times \$15.98 \times 365 =$	309,100
	Savings	\$1,361,000

4. Move all sentenced misdemeanants to private sector contract beds.

This would free up approximately 130 institutional beds. It is assumed that the private sector can provide these minimum security beds at a lower cost than the state though the actual cost per day is unknown.

Current average cost of 130 beds = $130 \times \$86.33^* \times 365 = \$4,096,359$
Private sector beds @ \$35.00/day $\times 130 \times 365 = \$1,660,750$ for a saving of \$2,435,609 or
Private sector beds @ \$40.00/day $\times 130 \times 365 = \$1,898,000$ for a saving of \$2,198,359

The cost variable is provided as some or all of these 130 offenders may require some treatment programming such as alcohol or substance abuse.

* This average daily cost of care includes average statewide cost of institutional care of \$74.97 plus average daily cost of medical care of \$6.02 and other statewide programs of \$5.34.

5. Reinstate the pre-trial diversion program.

There is no real savings to us with this program since the tight screening process diverts very few people and these are then likely to be picked up on probation. Thus any savings are offset by cost of misdemeanor supervision, the considerable cost of preparation of misdemeanor pre-sentence reports on all eligibles, and the cost of collection of restitution and supervision of community service work.

6. Return parole eligibility to all first felony offenders sentenced presumptively.

The impact of this is very substantial; the estimated 247 first-time felons admitted to serve presumptive sentences in FY88 will serve 990 prisoner-years, whereas if this suggestion was implemented, they would serve a total of 792; 198 fewer, with parole eligibility. Since the average cost of incarceration is \$86.33 X 365 or \$31,510 per year per offender and the average cost of probation/parole supervision is \$5.20 X 365 or \$1898 per offender year, there is an average savings of \$29,612 per offender year. Thus savings in FY88 could be as much as \$29,612 X 198 or \$5,863,200 if it were possible for this change to affect current population. Should this change be implemented it would take place over time. The savings per year are shown here to show the magnitude that could be achieved.

7. Amend Title 33 to allow placement of felons in contract housing at the discretion of the Department of Corrections.

There are currently 427 felons classified as minimum custody and 74 classified as community custody or a total of 501 felons who could be eligible for placement in contract beds. The savings:

501 inmates X \$31,510/year in institutions	=	\$15,786,500
501 inmates X \$17,611 /year		
specialized contract beds	=	8,823,200
Saving		\$ 6,963,300

** Currently paying \$48.25 per day for specialized CRC beds

8. Amend Title 33 to permit placement of some "violent" offenders in restitution centers.

There are currently 240 inmates classified as minimum or community custody serving sentences for sexual offenses and other violent crimes.

Cost of institutional care: 240 X \$31,510/year	=	\$7,562,400
Cost of specialized CRC beds: 240 X \$17,611/year	=	4,226,600
Savings		\$3,335,800

9. Replace the five-member Parole Board with a Parole Commission of three full-time professionally qualified members.

The many legal and policy changes suggested will greatly effect the work load of the Parole Board. Cost implications for the Parole Board are dependent upon which, if any, of these items are implemented. It is quite possible that their cost of operation will be increased.

10. Permit mandatory releasees with probation sentences to serve the mandatory release and probation time concurrently.

Current population will serve 6 months mandatory release parole plus 3 years' probation. The above change in the statutes would reduce this period of supervision from a total of 3.5 years to 3.0 years. The savings could be: 2500 clients X .5 years X \$1,898/year (at an average cost of \$5.20 per day) or \$2,372,500 over three years or \$790,800 per year.

11. Amend the Good Time portion of Title 33 to remove Parole Board discretion in regard to 1/3 vs. 1/4 award.

The saving from this change is in staff time, i.e., the time required for institutional Probation Officers completing screening forms for the Parole Board and Parole Board review time. The Parole Board has only exercised this discretion three times and those resulted in the persons serving approximately one month additional time.

12. Review all sentencing practices implemented since the criminal code implementation of 1980 with particular attention to judicial and prosecutorial discretion.

According to a study made during November of 1984, felons sentenced presumptively for Class A, B and C felonies were serving 29% more man-years than those who had been sentenced non-presumptively. Felons sentenced presumptively for unclassified crimes will serve 39% more man-years than those sentenced non-presumptively. At the time of this study, 368 felons were serving a total of 2,210 man-years of presumptive sentences. Had they been eligible for early release, they would serve 1,714 man-years, a difference of 496 man-years. The average FY86 cost of 496 man-years at \$31,510 per year is \$15,629,000.

13. Establish a criminal justice sentencing commission which annually balances justice system resources, i.e., police, prosecution, judiciary, corrections, defense.

The cost effect of this proposal is not known at this time.

14. Develop a fast track prosecution program for implementation as soon as possible.

We cannot estimate cost impact at this time for this item. It would allow offenders to move through the Criminal Justice System faster at least up to the point of incarceration. Financial impact here appears to be in the Department of Law and the Court System.

Mary Halloran
Page 5
December 10, 1986

15. Provide alternative to incarceration for Title 47 non-criminal bookings/detainees.

There were a total of 2,724 non-criminal bookings from 12/85 through 11/86, 66% of the statewide bookings were at Yukon-Kuskokwim and Anchorage Annex; 44% of which were at Bethel (the second highest cost institution in the state). These non-criminal bookings when costed by institution represent \$253,400 during that one year period of time, not including medical costs. Savings to the Department of Corrections would be offset by the cost of alternative care.

16. Return the 6th and "C" Correctional Center to the Municipality of Anchorage for the purpose of holding municipal offenders.

The "savings" from this is to allow the department to channel 53 staff and \$3,142.5 to other uses thereby making future budget requests for this department smaller. The distribution of these resources is detailed in our FY88 budget request in lieu of requesting "new" dollars.

The above items portray a course of action that could have substantial impact, over time, on the State's operating budget. Also, by diverting offenders to probation or less costly housing, the State will be able to avoid the necessity for capital expenditures of millions of dollars required to build new prison facilities.

None of the above can be accomplished without the full participation of the Legislature, Court System, Executive Branch and last, but not least, the public.

WWL:cc
Attachment
cc w/attachment:
Pete Jeans
Mike Maher

Law and Policy Changes Under Review:

1. Increase the use of citations in lieu of arrest for minor offenses.
2. Develop and implement a statewide bail schedule.
3. Significantly increase the number of probation and parole releases.
4. Move all sentenced misdemeanants to private sector contract beds. This would free up approximately 130 institutional beds.
5. Reinstitute the pre-trial diversion program.
6. Return parole eligibility to all first felony offenders sentenced presumptively.
7. Amend Title 33 to allow placement of felons in contract housing. (Corrections' discretion).
8. Amend Title 33, restitution center statute, to permit placement of some "violent" offenders in restitution centers.
9. Develop a Parole Commission of three full time professionally qualified members.
10. Permit mandatory releasees with probation sentences to serve the mandatory release and probation time concurrently.
11. Amend the Good Time portion of Title 33 to remove Parole Board discretion in regard to 1/3 vs. 1/4 award.
12. Review all sentencing practices implemented since the criminal code implementation of 1980, with particular attention to judicial and prosecutorial discretion.



ALASKA MINERAL TAXATION

**Compared to Taxes on
Mines in Eleven States**

**January
1982**

Prepared for the Alaska Department of Commerce and Economic Development

Office of Mineral Development

**Governor
Jay S. Hammond**

**Commissioner
Charles R. Webber**

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John F. M. Sims**

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PREFACE

The Alaska Mineral Taxation report is an extension of a study done for the Wisconsin Association of Manufacturers & Commerce completed in January 1981. The Wisconsin study provided an opportunity to quickly and inexpensively compare Alaska's tax structure with the tax structures of eleven other states.

Whitney & Whitney, Inc., of Reno, Nevada, who prepared the Wisconsin study, was contracted by the Office of Mineral Development to "plug" Alaska tax data into the identical computer mine models used in the Wisconsin study. While there are some qualifications necessary in evaluating the results, the study gives a reliable comparison of Alaska's present mineral taxation structure with the taxation structure of states with viable mining industries.

Section 1

INTRODUCTION

GENERAL COMMENTS

This report was prepared by Whitney & Whitney, Inc., at the request of the Office of Minerals Development, Department of Commerce & Economic Development in Alaska. The report provides a review of the mineral tax structure for the State of Alaska and a comparison of that structure with eleven other mining states. Since its inception in 1977, Whitney & Whitney, Inc., has specialized in economic modeling of mining projects. Corporate studies have included the analysis of mineral policy and the effects of mineral taxation on mining company profitability in a number of different countries in different parts of the world. In the course of this work, Whitney & Whitney, Inc. developed the MINeral ECONomic ANALysis (MINECAN) Mine Project Cash Flow modeling system. The system has been licensed by Control Data's CYBERNET Timesharing System, and three country specific tax modules: South Africa, Western Canada, and the United States are available worldwide for use by resource analysts on a timesharing basis. The MINECAN System was designed specifically for modeling mining projects, has been extensively tested, and is available to experienced mine project analysts for use via timesharing. Thus, experienced analysts who may be interested in the results presented herein may use the modeling system to prepare similar analyses for other types of deposits, or different assumptions as to tax regimes.

The Office of Minerals Development requested that Whitney & Whitney, Inc., use a comparative tax study prepared for the Wisconsin Association of Manufacturers (WMC) in late 1980 as the basis for the analysis. That study, titled "Wisconsin Taxation of Metallic Mining as Compared to 10 Major Mining States," was published by the WMC in January, 1981. In the WMC study, Whitney & Whitney, Inc., used discounted cash flow mine model economic analysis to determine the effect of state tax structure on a specified deposit type and a defined range of mine sizes. The modeling methodology is described in the WMC report, and the reader should contact them for a copy if he is interested in the details of the mine models, mine model construction methods, and the underlying assumptions.

It should be noted that the models developed for the WMC report include capital and operating cost assumptions which were based on information relative to mining activity in "the lower 48" states, particularly those states included in the study. Therefore, a number of these cost assumptions do not hold true for Alaska, especially the costs of exploration and mine development. In addition, infrastructure costs have not been included since infrastructure consisting of power, roads, railroads, etc., are generally available in the lower 48 states.

The results of this study demonstrate that, based on the WMC mine models, the Alaska mineral tax structure provides a relatively attractive tax environment for mining investment. However, this conclusion should be reconsidered in light of higher exploration and development costs throughout Alaska. Suggestions for further study, including revision of the existing WMC models, are addressed in the final section of this report.

SCOPE OF WORK

In comparing the Alaska mineral tax structure with that of the eleven other states, a number of tasks were completed. These tasks are listed below and are discussed in detail in succeeding section of this report.

- Methods used and the base models developed in the WMC study were reviewed;
- The Alaska mineral tax structure was researched and the Alaska tax input was added to the existing WMC models;
- Tax input was checked and the models were run;
- Generated output included in Appendix A was analyzed;
- Comparative tax burden bar charts and mining investment tables were updated to include Alaska;
- A discussion of the study results was completed.

Section 2

BACKGROUND ON THE WMC STUDY

GENERAL DESCRIPTION

In January 1981, a report on the "Wisconsin Taxation of Metallic Mining as Compared to 10 Major Mining States" was prepared by Whitney & Whitney, Inc. for the Wisconsin Association of Manufacturers and Commerce. In the WMC study, mine models were used to provide an analysis of exploration, development and mine construction investment levels, annual sales levels, and tax revenues generated for the federal, state and local governments.

Six mine models for each site were prepared: three underground and three open pit. Three mine sizes were used: 10,000, 5,000, and 3,000 tons of ore production per day. A "base case" for each of the six models was developed which required decisions concerning deposit type and geometry, mining and milling assumptions are included in Table 1 and capital cost assumptions are listed in Table 2.

The analysis differed significantly from previous studies in that detailed inflation forecasts were incorporated and a detailed investment timing schedule was prepared for each mine model. A brief overview of study methods is included in Table 3.

WMC TAX TYPES

Since state tax is the focus of the Alaska study, a review of state tax types defined in the WMC study is necessary. State taxes used for the comparative analysis were divided into five types: (1) severance tax; (2) net proceeds tax; (3) property tax; (4) sales and use tax; and (5) state income tax. The functional definition of each of these tax types is given below.

Severance Tax

This tax is variously described as a tax on the privilege of mining and may be called a severance tax, a production tax, a mining license tax, or an occupation tax. Method of application: it may be a tax on the gross value of ore extracted; a tax on the units of ore extracted; or a tax on the gross value of production less certain allocable costs.

Net Proceeds Tax

As used in many states, this tax is a tax in lieu of property tax on ore reserves contained in the orebody being mined. It may be described as a property tax and is assessed on the basis of defined gross proceeds, or net proceeds. Method of application: the tax basis may be the net present value of future cash flows and the Hoskold formula or present value formula may be used; the tax basis may be gross proceeds (gross value of sales less certain allowable costs); the tax basis may be net proceeds (gross sales less defined costs that typically include marketing, processing, transportation to a smelter or refinery, milling costs, mining costs, and depreciation; depletion may or may not be allowed, and federal income tax may or may not be allowed). The tax is generally assessed on the defined measure of value at the property tax rate for the location.

TABLE 1 - BASIC ASSUMPTIONS FOR WMC BASE CASE MINE MODELS

DEPOSIT TYPE: A zinc-copper massive sulfide deposit.

ORE RESERVES: 10,000 TPD Mines - 102 million tons
5,000 TPD Mines - 51 million tons
3,000 TPD Mines - 30.6 million tons

MINE LIFE: 42 years with a productive life of 30 years

GRADES: 1% copper, 5% zinc, 1.1 oz. per ton silver and .029 oz. per ton gold, 0.4% lead

NET RECOVERY: Copper .7923, Zinc .6804, Silver .5816, Gold .4618, Lead .239

DISCOUNT RATE: 18%

COST ESCALATION FACTOR: 7%

ORE MINING COSTS:

10,000 TPD UG - \$16.476/ton
5,000 TPD UG - \$18.54/ton
3,000 TPD UG - \$21.92/ton

All open pit mines - \$1.165/ton

MILL SPENDING COST:

10,000 TPD UG - 11.176/ton
5,000 TPD UG - \$12.52/ton
3,000 TPD UG - \$13.152/ton

10,000 TPD OP - \$11.15/ton
5,000 TPD OP - \$12.494/ton
3,000 TPD OP - \$13.152/ton

OVERHEAD COSTS:

10,000 TPD UG - \$4.284/year
5,000 TPD UG - \$5.44/year
3,000 TPD UG - \$6.966/year

10,000 TPD OP - \$3.78/year
5,000 TPD OP - \$4.795/year
3,000 TPD OP - \$6.151/year

RECLAMATION EXPENSES:

10,000 TPD UG - \$685,000/year Start Year 12
5,000 TPD UG - \$685,000/year Start Year 12
3,000 TPD UG - \$685,000/year Start Year 11

10,000 TPD OP - \$1,370,000/year Start Year 11
5,000 TPD OP - \$1,370,000/year Start Year 11
3,000 TPD OP - \$1,370,000/year Start Year 10

ROYALTY PAYMENTS: 7% of net smelter return

STATE TAXES: Dependent on State under consideration

FEDERAL TAXES: 46%

TABLE 2 - WMC BASE CASE SELECTED CAPITAL COST ASSUMPTIONS

TOTAL EXPLORATION COST:

10,000 TPD UG - \$3.010 million
5,000 TPD UG - \$2.733 million
3,000 TPD UG - \$2.6 million

10,000 TPD OP - \$3.010 million
5,000 TPD OP - \$3.010 million
3,000 TPD OP - \$2.6 million

TOTAL DEVELOPMENT EXPENSE:

10,000 TPD UG - \$344.795 million
5,000 TPD UG - \$259.99 million
3,000 TPD UG - \$202.33 million

10,000 TPD OP - \$131.07 million
5,000 TPD OP - \$ 95.79 million
3,000 TPD OP - \$ 73.33 million

INFRASTRUCTURE INVESTMENT: None

TOTAL MINE & PLANT INVESTMENT:

10,000 TPD UG - \$681.84 million
5,000 TPD UG - \$461.55 million
3,000 TPD UG - \$321.93 million

10,000 TPD OP - \$588.82 million
5,000 TPD OP - \$400.89 million
3,000 TPD OP - \$278.08 million

REPLACEMENT EQUIPMENT:

10,000 TPD UG - \$715.47 million
5,000 TPD UG - \$337.543 million
3,000 TPD UG - \$327.204 million

10,000 TPD OP - \$1118.119 million
5,000 TPD OP - \$693.912 million
3,000 TPD OP - \$369.448 million

WORKING CAPITAL:

10,000 TPD UG - \$56 million/year**
5,000 TPD UG - \$33 million/year**
3,000 TPD UG - \$20 million/year**

10,000 TPD OP - \$41 million/year*
5,000 TPD OP - \$12 million/year*
3,000 TPD OP - \$15 million/year*

* Start Year 10

** Start Year 11

TABLE 3 - MINE MODELING METHODOLOGY OVERVIEW

1. Choice of States and deposit type;
2. Three underground mine models prepared;
3. Three open pit mine models prepared;
4. Six mill models prepared;
5. Smelter schedules examined;
6. Inflation and price forecasts prepared;
7. Detailed state tax analysis conducted;
8. WMC mining tax proposal reviewed;
9. All input data reviewed;
10. Total of seventy-two models run;
11. Analytical results studied.

Property Tax

As used in most states this is the tax that is assessed on real property such as equipment and buildings. It is assessed at the prevailing property tax rate. The tax basis in many states is the depreciated value.

Sales and Use Tax

Sales and use taxes are generally levied on mine supplies, and on equipment and materials. Sales and use taxes are also levied on materials and equipment used in mine construction. Use taxes are levied on equipment and supplies purchased out-of-state but used within the state. This is to eliminate tax avoidance through out-of-state purchases. Method of application: the tax base is the purchase price of the item before addition of tax which is usually a percentage rate.

State Income Tax

Income taxes are levied by most states and they often use the federal income tax base, although a different method of depreciation may be specified, and depletion may or may not be allowed. Method of application: the tax base is defined net income which is usually taxed at a percentage rate; some states have graduated tax rates. Most mining operations fall into the top bracket because the dollar volume of income may be large even though the mine may not be profitable from a "return on investment" point of view. Some states allow deduction of federal income tax before calculation of net income for state tax purposes. States may have both net proceeds taxes and net income taxes. The tax rates may be additive if the net proceeds tax is defined so that it equates to an income tax.

Historically, property taxes have provided a major source of income for states and municipalities. Special taxes have been devised for mines due to the difficulty of defining a value for an orebody. In addition, at times taxes have been applied to mining to compensate the state for depletion of a state's natural resources, without consideration of the economic benefits that the state realizes from the incremental and related economic activities generated by mining. For example, it has been estimated that in Arizona the economic activity resulting from copper mining is at least four times the value of the copper metal extracted and sold as a result of the mining activity. Another reason for imposing special taxes on mining has been to provide monies to local municipalities and state agencies to offset negative economic impacts that may result from new mine developments during the pre-production stages.

A summary of states included in the WMC report and their tax types is listed in Table 4. Alaska has been added to the summary.

TABLE 4 - SUMMARY OF STATE TAX TYPES

STATES	SEVERANCE	NET PROCEEDS	PROPERTY TAX	SALES TAX	INCOME TAX
Alaska		x	x		x
Arizona	x	Special type	x	x	x
Colorado		x	x	x	x
Idaho		2 types	x	x	x
Michigan	special type	special type	x	x	x
Minnesota	x	x	x	x	x
Missouri			x	x	x
Montana	x	x	x	x	x
New Mexico	2 types	x	see net proceeds	x	x
Tennessee		special type	x	x	x
Utah	x	x	x	x	x
Wisconsin		x	x	x	x

Section 3

ALASKA MINERAL TAX STRUCTURE

ALASKA TAX TYPES

Mining operations in Alaska are subject to three different taxes: a mining license tax, a state corporate income tax, and local property taxes. Each of these taxes is described below.

Mining License Tax

This is a special tax on mining activity in Alaska which requires that all new mine operators obtain licenses. New operations are exempt from the tax for three and one-half years after production begins (except for sand and gravel operations). (AS Sec. 43.65.010(a))

The tax is based on net income. Deductions allowed in the calculation of net income include: operating costs, royalties, depreciation, depletion, development costs, and taxes except mining license tax and federal income tax. (AS Sec. 43.65.010(c))

Depletion is a percentage of the gross income from the property during the tax year. The percentage allowed is:

Coal Mines	10%
Metal mines, fluorspar, flake graphite, vermiculite, beryl, feldspar, mica, talc, lepidolite, spodumene, barite, ball and sagger clay, or rock asphalt mines and potash mines or deposits	15%
Sulphur Mines or Deposits (AS Sec. 43.65.010(e))	23%

The depletion allowance may not exceed 50% of the net income of the taxpayer without allowance for the depletion. (AS Sec. 43.65.010(f))

Net income is taxed at the following rates:

Over \$40,000 and not over \$50,000 - 3%
Over \$50,000 and not over \$100,000 - 5% of the excess over \$50,000 plus \$1,500
Over \$100,000 - 7% of the excess over \$100,000 plus \$4,000

The mining license tax is essentially a net proceeds tax.

Corporate Income Tax

Corporations operating in Alaska are taxed on net income derived from sources within the state. (AS Sec. 43.20.011) Net income does not include an allowance for federal income taxes. The Alaska corporate tax rates, which were recently revised, are included in Table 5.

TABLE 5 - ALASKA CORPORATION TAX RATE TABLE

Effective 1-1-78

The tax is 5.4% times taxable income (TI), plus 4% times the remainder of TI less \$50,000 i.e.

$$\text{Tax} = (5.4\% \times \text{TI}) + (4\% \times [\text{TI} - \$50,000.00]).$$

Effective 1-1-81

If TI is:	\$ 10,000 or more, but less than:	\$ 20,000 then tax is:	\$ 100 plus:	2% of TI over:	\$ 10,000
	20,000	30,000	300	3%	20,000
	30,000	40,000	600	4%	30,000
	40,000	50,000	1,000	5%	40,000
	50,000	60,000	1,500	6%	50,000
	60,000	70,000	2,100	7%	60,000
	70,000	80,000	2,800	8%	70,000
	80,000	90,000	3,600	9%	80,000
	90,000	1,000,000	4,500	9.4%	90,000
	1,000,000	4,000,000	90,040	10%	1,000,000
	4,000,000 or more	then tax is:	390,040	11%	4,000,000

Effective 1-1-82

If TI is:	\$ 0 or more, but less than:	\$10,000 then tax is:	\$ 0 plus:	1% of TI over:	\$ 0
	10,000	20,000	100	2%	10,000
	20,000	30,000	300	3%	20,000
	30,000	40,000	600	4%	30,000
	40,000	50,000	1,000	5%	40,000
	50,000	60,000	1,500	6%	50,000
	60,000	70,000	2,100	7%	60,000
	70,000	80,000	2,800	8%	70,000
	80,000	90,000	3,600	9%	80,000
	90,000 or more	then tax is:	4,500	9.4%	90,000

Source: Department of Revenue, State of Alaska

Property Tax

The state administers no general property tax but municipalities and boroughs are authorized to levy taxes on real and personal property. Property is assessed January 1st of each year at its "full and true value" which is defined as "the estimated price which the property would bring in an open market and under the prevailing market conditions in a sale between a willing seller and a willing buyer both conversant with the property and with prevailing general price levels." (AS Sec. 29.53.060)

The tax rates are fixed locally with a maximum rate of 3% for cities. The different borough and city tax rates can vary substantially from year to year.

TAX DATA INPUT

The previously defined tax information which was compiled by an outside expert for Whitney & Whitney, Inc. was adjusted to the data input format required by the mineral economic analysis (MINECAN) program used to run the WMC models.

For the purposes of this study, the mining license tax was included in the "net proceeds" tax type. The mining license tax rate of 7% was added to each WMC base case since the lower tax rates were not applicable to the levels of net income generated in each of the models. An adjustment was made for the 3½ year exemption period and a depletion rate of 15% was used. The input record for each of the models is included in Appendix A. Lines 01030 and 01032 are for the net proceeds tax.

The 1982 state corporate income tax rate of 9.4% for income exceeding \$90,000 was used in running the six Alaska models. The 1980 and 1981 tax rate schedules were not considered since there was no income reported during those years. The input records for state corporate income tax for each model are included in Appendix A, Line 01040.

A statewide conservative estimate of 3% was used to assess the effects of property tax on mining profit. These rates are set locally and will vary from year to year to meet budget needs. Mines are typically located in areas outside the cities where the lower tax rates apply. The input record for property tax is Line 01010 for each of the six models in Appendix A.

Section 4

COMPARATIVE MINERAL TAX ANALYSIS

COMPARISON OF STATE TAX BURDENS

Total taxes generated by each of the models over the project life were calculated and aggregated into three categories for presentation purposes: (1) income tax, (2) other tax which includes property and sales tax, and (3) mining specific tax which is composed of net proceeds and severance taxes. The comparative state tax burdens for each of the six mines are illustrated in Figures 1 through 6. The total amount of tax over the project life for each of the mines is summarized by state in Table 6.

Taxes in Alaska range from \$.4 billion for the 3,000 TPD open pit mine to \$2.4 billion for the 10,000 TPD underground mine. For the six models, income tax generally represents 35%-40% of the total burden. The mine license tax ranges from 20% of total taxes for the smaller mines to just over 35% for the large underground mine.

Examination of Figures 1 through 6 and Table 6 illustrates that Alaska's total tax burden is average when compared with that of other states. The total state tax burden for the life of the six mines is generally higher in Alaska than in Idaho, Michigan, Montana, New Mexico, and Tennessee. Tax burdens in Alaska are generally lower than in Arizona, Colorado, Utah and Wisconsin. Minnesota and Missouri taxes are similar to those in Alaska.

MINING INVESTMENT IN ALASKA

Measures used to assess competition for mining business among states include: tax on mining as a percent of sales; effective state tax rates; effective state and federal tax rates; and rate of return on investment. Each of these measures is discussed below.

Tax as a Percentage of Sales

States that have the lowest tax on mining as a percent of sales are deemed to be most competitive in terms of attracting mining investment. Table 7 provides a summary of mineral specific taxes as a percent of sales for each of the states studied. The most attractive state with the lowest percentage is Missouri. The next most attractive states are Minnesota and Idaho followed by Tennessee and Alaska.

Effective Rates and Taxation

Another measure of business competitiveness is the effective rate of taxation. Two measures of effective taxes are defined: (1) effective rate of total state taxes, and (2) effective rate of combined state and federal taxes. The effective tax rates as a percent of operating (book) income were calculated and are presented in Tables 8 and 9. For this study, the effective rate of state taxation in Table 8 is most important.

Alaska's effective tax rate (tax as a percent of operating income) for each of the six models ranges from 11.16% to 13.83%. At the 10,000 TPD levels, the Alaska tax system is less competitive than at the lower levels of production. For example, for the 10,000 TPD underground mine, Alaska has higher taxes than all the other states except Utah, Wis-

FIGURE 1

TOTAL STATE TAX BURDEN

(UNDERGROUND 10,000 TPD MODEL)

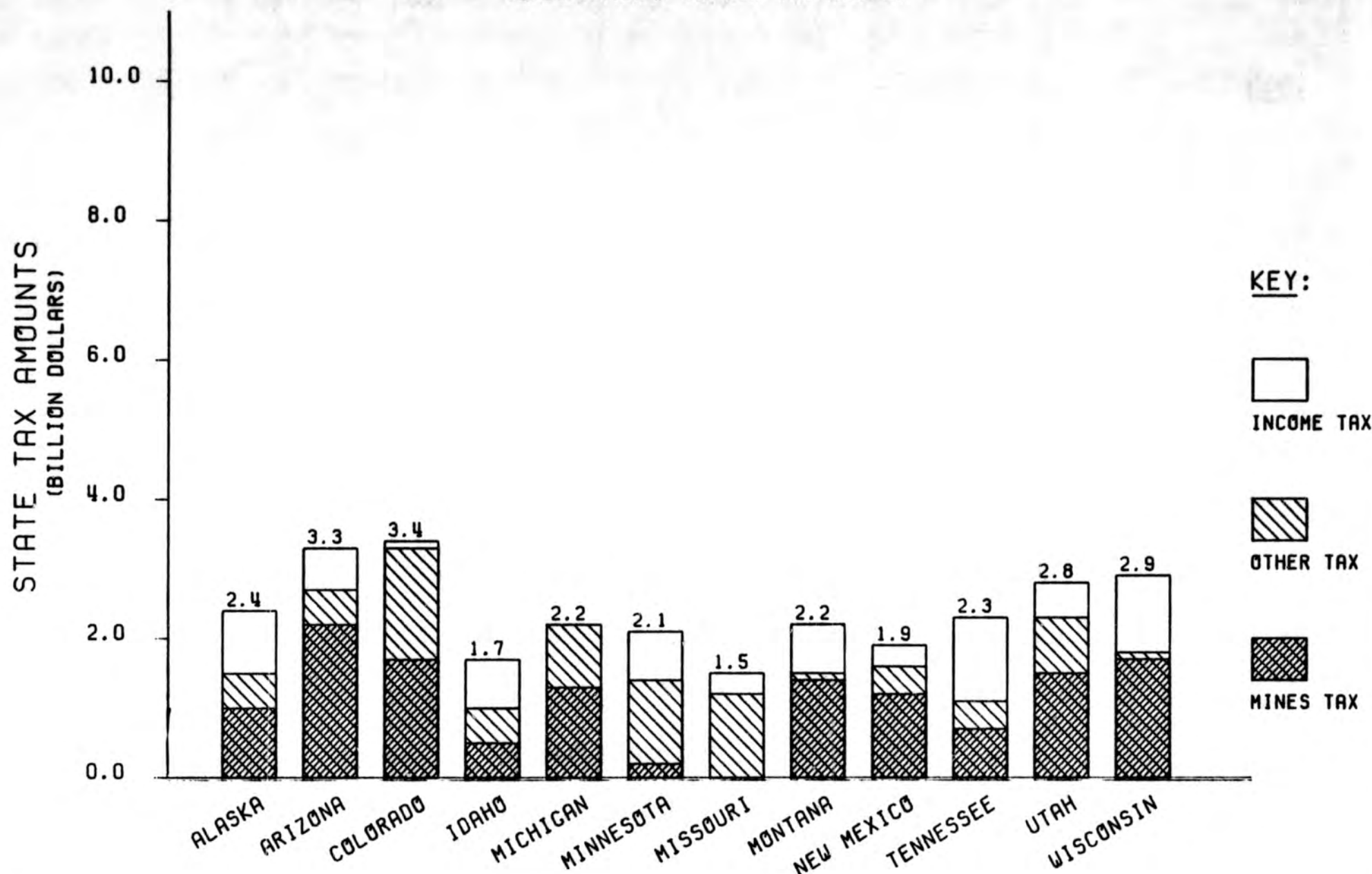


FIGURE 2

TOTAL STATE TAX BURDEN

(UNDERGROUND 5,000 TPD MODEL)

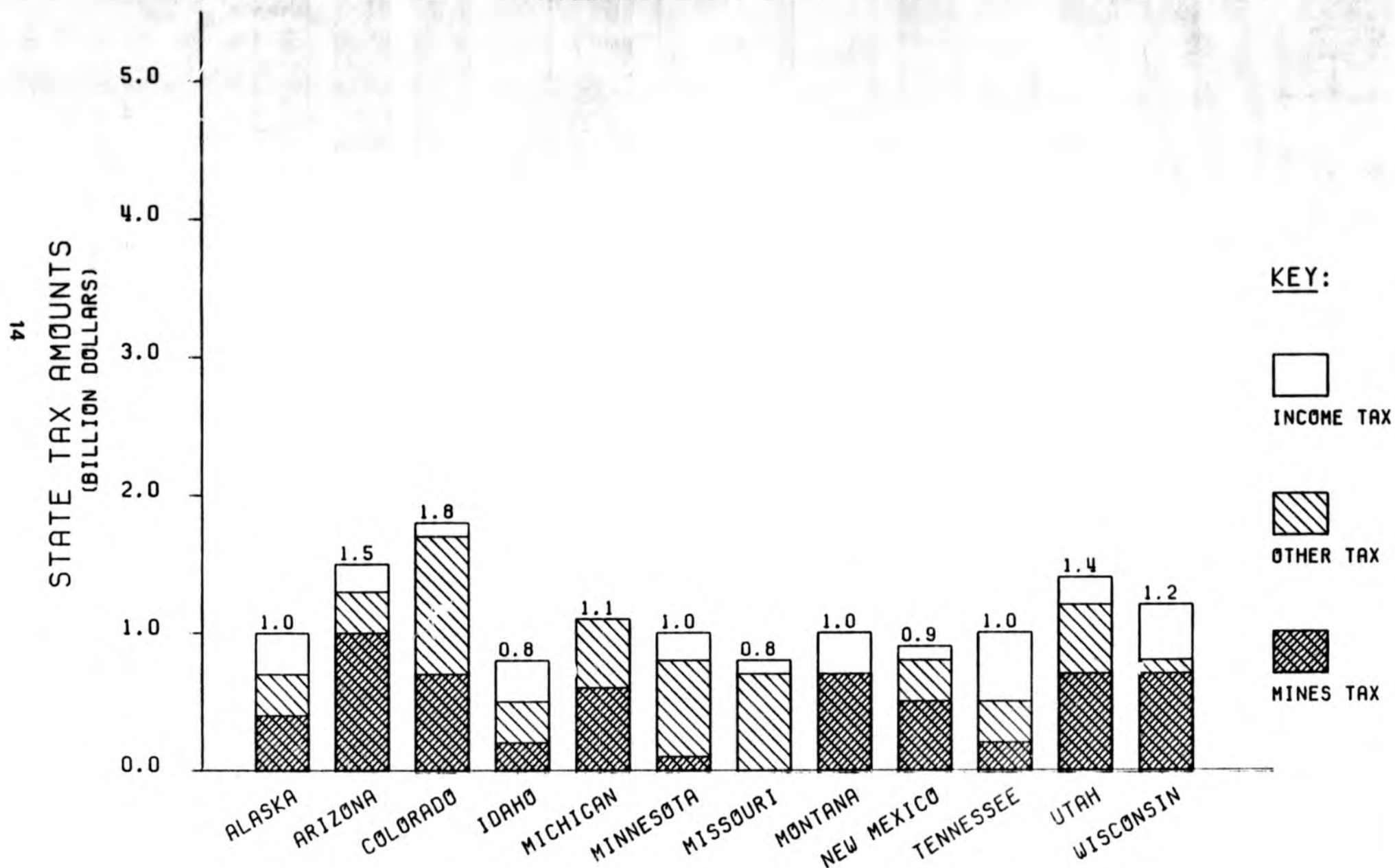


FIGURE 3

TOTAL STATE TAX BURDEN

(UNDERGROUND 3,000 TPD MODEL)

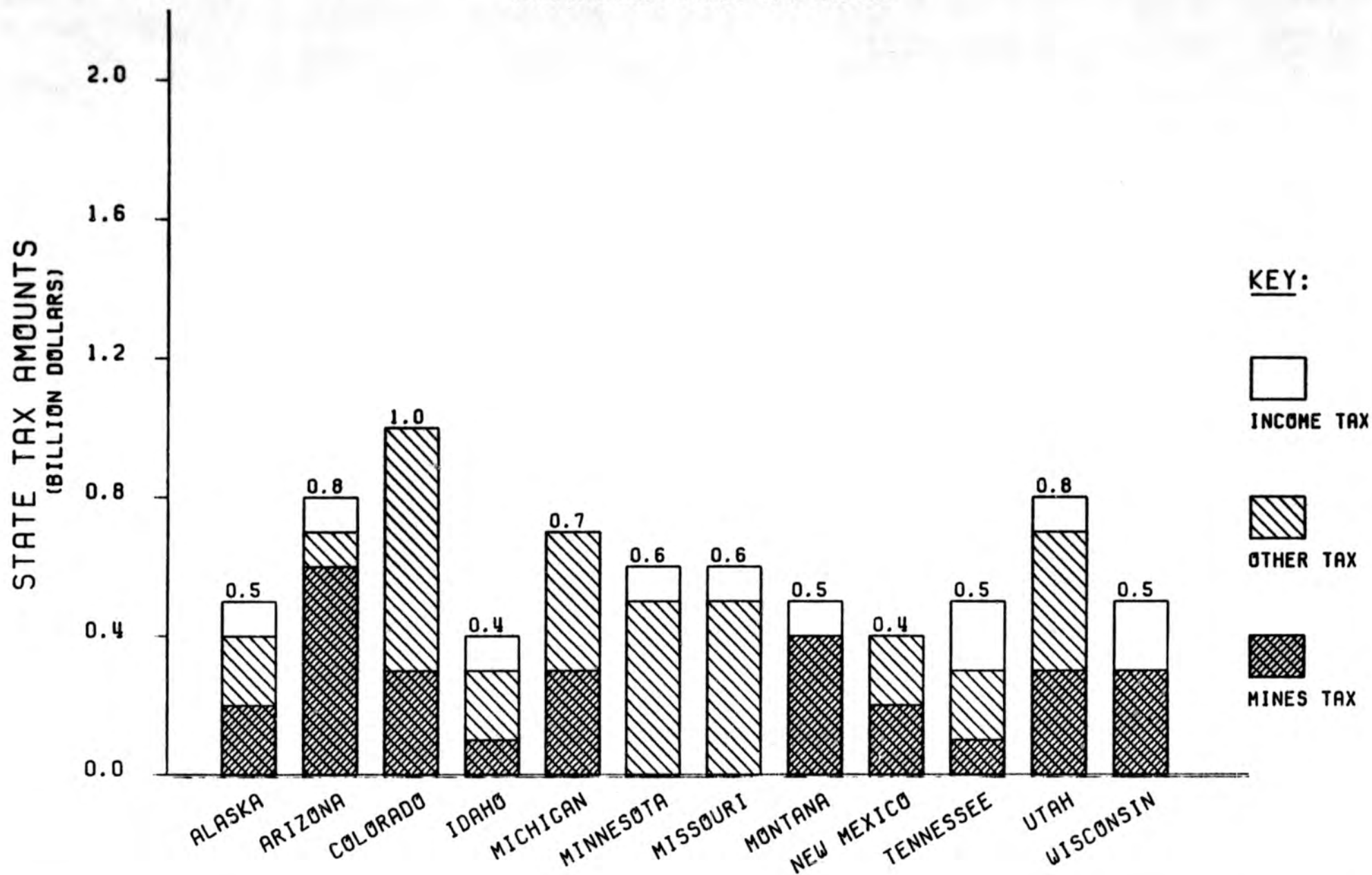


FIGURE 4

TOTAL STATE TAX BURDEN

(OPEN PIT 10,000 TPD MODEL)

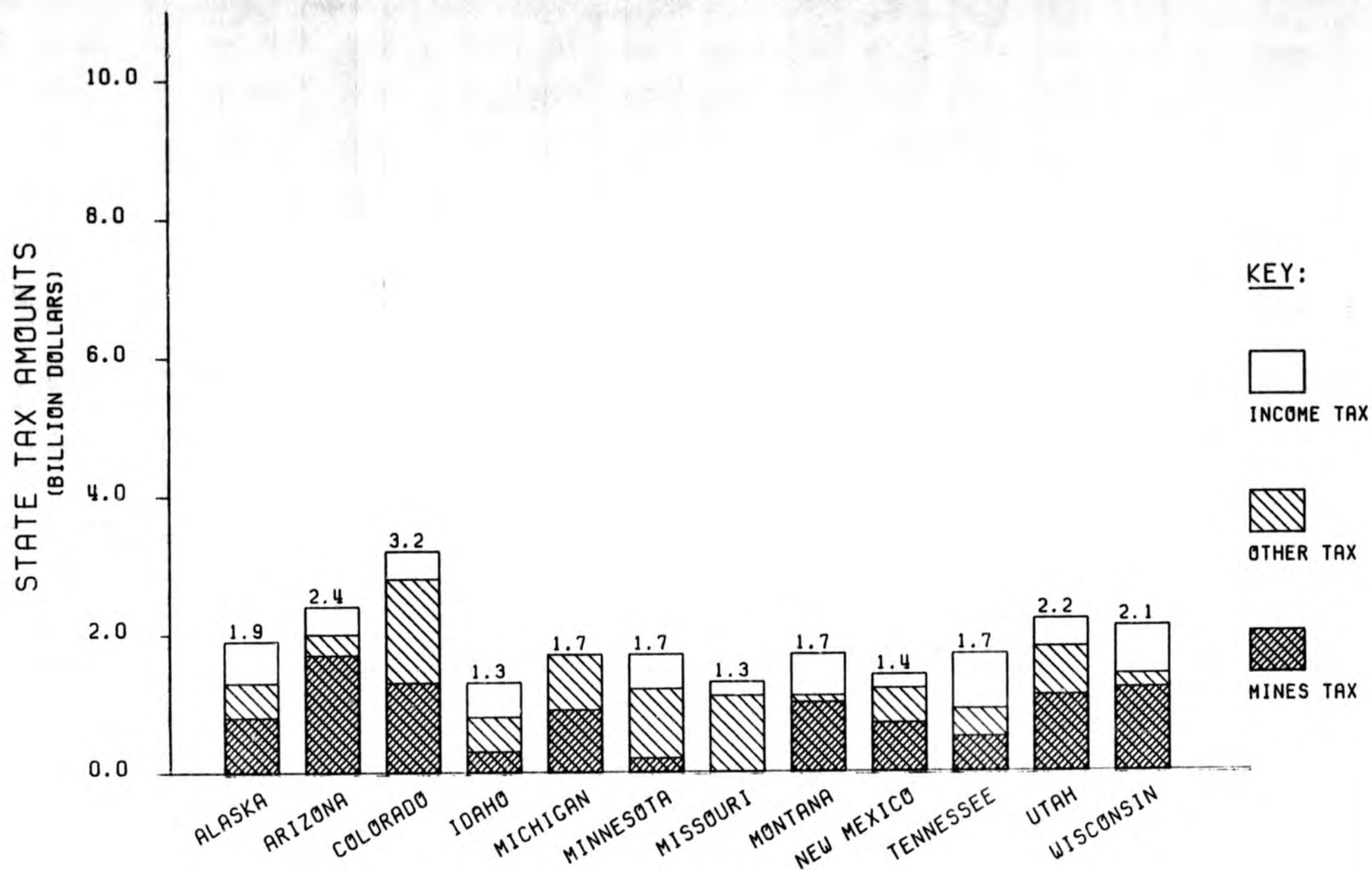


FIGURE 5

TOTAL STATE TAX BURDEN

(OPEN PIT 5,000 TPD MODEL)

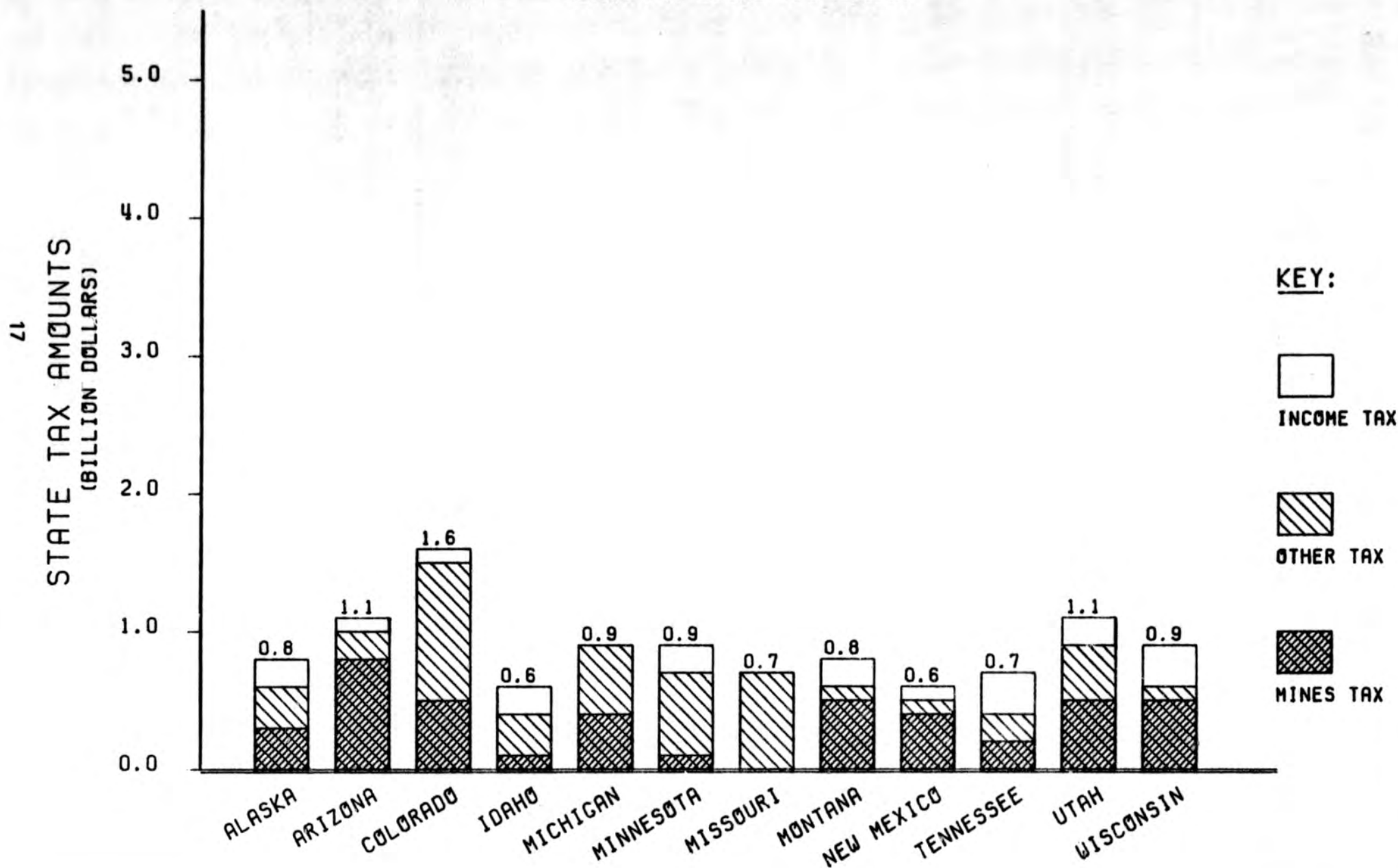


FIGURE 6

TOTAL STATE TAX BURDEN

(OPEN PIT 3,000 TPD MODEL)

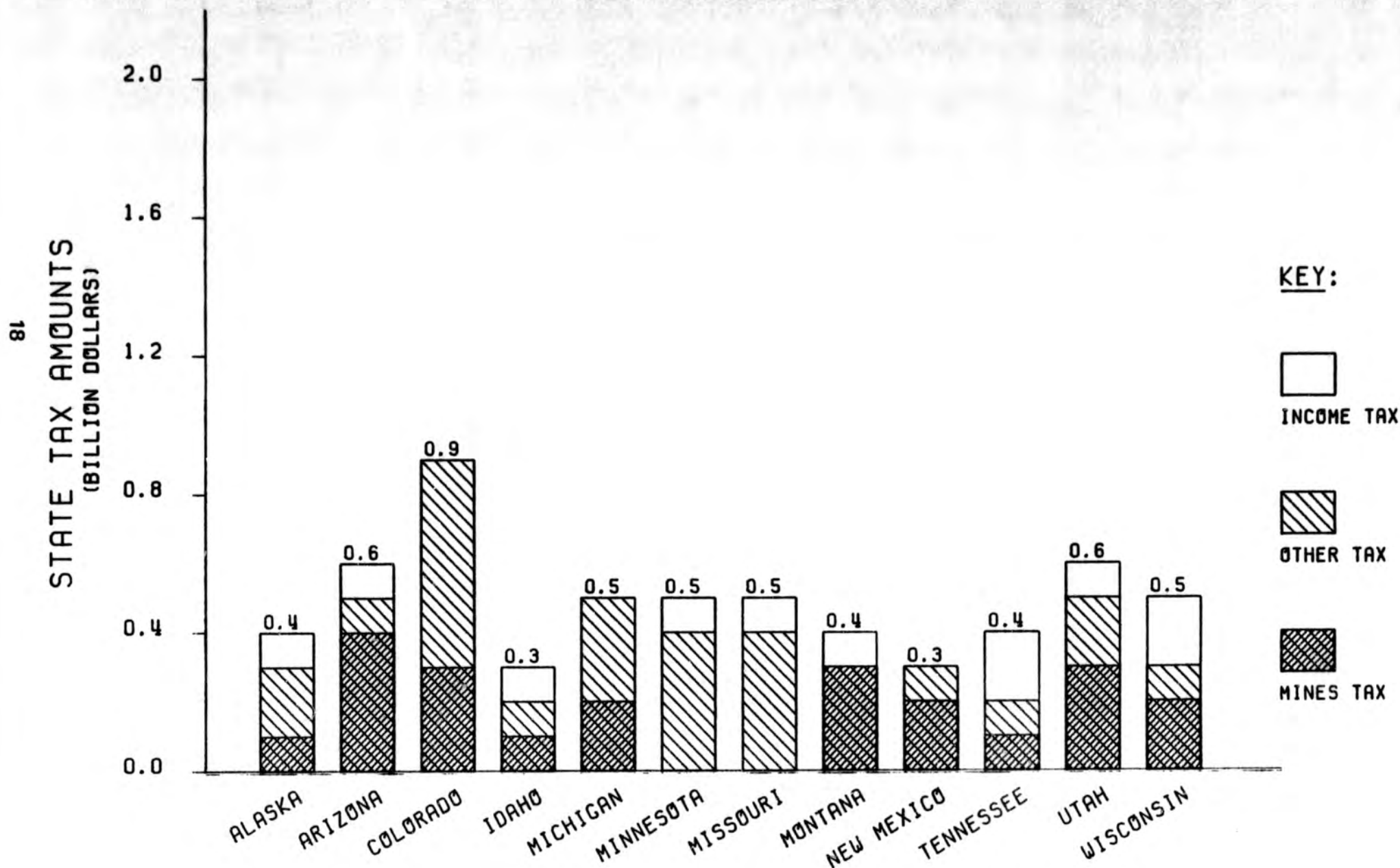


TABLE 6 - MINE LIFE TOTAL STATE TAX BURDEN (\$ BILLION)

STATE	UNDERGROUND MODELS			OPEN PIT MODELS		
	10,000	5,000	3,000	10,000	5,000	3,000
Alaska	2.4	1.0	0.5	1.9	0.8	0.4
Arizona	3.3	1.5	0.8	2.4	1.1	0.6
Colorado	3.8	1.8	1.1	3.2	1.6	0.9
Idaho	1.7	0.8	0.4	1.3	0.6	0.3
Michigan	2.2	1.1	0.7	1.7	0.9	0.5
Minnesota	2.1	1.0	0.6	1.7	0.9	0.5
Missouri	1.5	0.8	0.6	1.3	0.7	0.5
Montana	2.2	1.0	0.5	1.7	0.8	0.4
New Mexico	1.9	0.9	0.4	1.4	0.6	0.3
Tennessee	2.3	1.0	0.5	1.7	0.7	0.4
Utah	2.8	1.4	0.8	2.2	1.1	0.6
Wisconsin	2.9	1.2	0.5	2.1	0.9	0.5

TABLE 7 - STATE MINERAL SPECIFIC TAXES AS A PERCENT OF SALES

STATE	UNDERGROUND MODELS			OPEN PIT MODELS		
	10,000	5,000	3,000	10,000	5,000	3,000
Alaska	1.22	.88	.57	1.23	.93	.71
Arizona	3.15	2.96	2.96	3.25	3.05	2.95
Colorado	2.38	1.96	1.43	2.44	2.08	1.81
Idaho	.66	.50	.35	.67	.54	.45
Michigan	1.76	1.64	1.49	1.68	1.56	1.48
Minnesota	.30	.24	.17	.30	.25	.21
Missouri	.000	.000	.000	.000	.000	.000
Montana	1.97	1.94	1.89	1.97	1.94	1.92
New Mexico	1.69	1.49	1.23	1.68	1.50	1.36
Tennessee	.92	.67	.44	.94	.73	.58
Utah	2.09	1.91	1.71	2.18	2.05	1.93
Wisconsin	2.33	1.96	1.36	2.32	1.96	1.64

TABLE 8 - EFFECTIVE STATE TAX RATE*

STATE	UNDERGROUND MODELS			OPEN PIT MODELS		
	10,000	5,000	3,000	10,000	5,000	3,000
Alaska	11.16	11.32	13.85	12.01	12.47	13.63
Arizona	15.43	17.60	24.05	15.46	17.06	19.40
Colorado	17.77	21.16	31.06	20.03	23.87	29.36
Idaho	8.19	8.75	11.16	8.40	8.92	9.80
Michigan	10.26	13.07	20.22	10.60	13.12	16.34
Minnesota	9.79	11.93	18.40	10.90	13.18	16.40
Missouri	7.22	9.70	16.60	8.50	11.16	14.74
Montana	10.58	11.70	15.37	10.70	11.65	13.02
New Mexico	8.93	9.97	13.06	8.76	9.52	10.55
Tennessee	10.67	11.33	13.54	10.65	11.14	11.96
Utah	13.38	15.75	22.28	14.03	16.36	19.25
Wisconsin	13.49	14.39	15.63	13.54	14.16	14.84

*Tax as a percent of operating income

TABLE 9 - EFFECTIVE STATE AND FEDERAL TAX RATE*

STATE	UNDERGROUND MODELS			OPEN PIT MODELS		
	10,000	5,000	3,000	10,000	5,000	3,000
Alaska	33.71	30.42	29.76	34.39	31.94	30.57
Arizona	36.06	34.83	37.77	36.26	34.61	35.17
Colorado	37.61	37.16	42.33	39.11	39.48	42.13
Idaho	32.07	28.84	27.82	32.37	29.77	27.76
Michigan	33.25	31.51	34.53	33.64	32.33	32.58
Minnesota	33.01	30.87	31.64	33.84	32.45	32.55
Missouri	31.57	29.48	31.88	32.46	31.15	31.42
Montana	33.39	30.59	31.12	33.63	31.32	30.23
New Mexico	32.47	29.49	29.34	32.56	30.06	28.36
Tennessee	33.42	30.30	29.61	33.59	30.98	29.39
Utah	34.95	33.28	36.15	35.52	34.20	34.84
Wisconsin	34.94	32.32	31.20	35.16	32.68	31.58

*Tax as a percent of operating income

consin, Arizona and Colorado. However, for the 3,000 TPD underground mine, only Idaho, New Mexico and Tennessee have lower effective tax rates. This suggests that the Alaska tax structure is less regressive than a number of the other state tax systems; that is, the effective rate of state taxation is not significantly higher for the small mines than it is for the large mines. The slight regressiveness of the state tax system is shown in Table 10. Two of the three major taxes in Alaska are based on net income, so mines are only taxed when they are profitable. The combined federal and state effective tax rates for Alaska shown in Table 9 are progressive: taxes increase as the level of net income increases. This is important since when prices fall and mines become unprofitable, mines in states where taxes do not decline proportionately will be shut down sooner than mines in states where the tax burden declines as the mine's profitability declines. Thus, those states that have progressive tax structures and whose tax burdens are otherwise comparable will keep their mines in production longer under adverse conditions than those states which have regressive tax structures.

For purposes of this comparative analysis, it should be pointed out that Idaho, Missouri and Tennessee are states that are characterized by active mining industries and whose mines are typically underground mines. These states have a relatively low tax burden on mining. In the case of Idaho and Tennessee, the combined federal and state tax structure is progressive; that is, small mines are treated no less favorably than large mines.

Previous studies on the Alaska mineral tax structure report that the state mining license tax and the state corporate income tax in Alaska represent 34% of net income after depletion and taxes. Whitney & Whitney calculations using this measure resulted in a range of 32% to 34% for the six models. When local property taxes are included, the total tax revenue generated as a percent of net income ranges between 40% and 61%.

Rate of Return on Investment

The rate of return as used here is the implicit return on investment provided by the project out of cash flows generated over the project life.

Using this measure, Alaska is compared to the eleven states in the WMC study in Table 11. This table illustrates that the most attractive state in terms of rate of return is Idaho, followed by New Mexico, Montana, Tennessee, Missouri, Wisconsin and Alaska. Alaska's rates of return range from 18.9 to 10.2. This measure of business competitiveness indicates that Alaska is not as attractive in terms of return on investment as six of the other states studied. The WMC study suggests that states which provide the highest rate of return on mining are generally the states that have the most mining activity.

It has been argued that metal prices are a greater determinant of investment decisions than a specific tax regime. While that may be partially true, it should be remembered that when prices rise the comparative tax burden will remain about the same. Other things being equal, investment dollars will still flow to those areas where the best return can be obtained.

TABLE 10 - DISTRIBUTION OF TOTAL BOOK INCOME (\$ MILLION AND % OF INCOME BEFORE TAX)

	UNDERGROUND MODELS						OPEN PIT MODELS					
	10,000 TPD		5,000 TPD		3,000 TPD		10,000 TPD		5,000 TPD		3,000 TPD	
	\$ Million	%	\$ Million	%	\$ Million	%	\$ Million	%	\$ Million	%	\$ Million	%
Book Income*	21,219		8,666		3,397		15,814		6,693		3,195	
State Taxes												
Mining License	869	4	316	4	114	3	643	4	243	4	104	3
Property	456	2	281	3	212	6	479	3	292	4	197	6
State Income	1,045	5	385	4	145	5	779	5	300	5	134	4
Total State Taxes	2,370	11	982	11	471	14	1,901	12	835	13	436**	14**
Federal Income Taxes	4,785	23	1,655	19	540	16	3,539	22	1,303	19	541	17
Total Taxes	7,155	34	2,637	30	1,011	30	5,440	34	2,138	32	977	31
Income After Tax	14,064	66	6,029	70	2,386	70	10,374	66	4,555	68	2,218	69

*BI = Gross Sales - PC Charges - Royalties - Operating Expense - Depreciation

**Rounding errors

TABLE 11 - MINING INVESTMENT ATTRACTIVENESS OF 12 STATES

State	Zinc	% of U.S. Production			RATE OF RETURN (%)					
		Copper	Lead	Silver	UNDERGROUND MODELS			OPEN PIT MODELS		
					10,000 TPD	5,000 TPD	3,000 TPD	10,000 TPD	5,000 TPD	3,000 TPD
Alaska	-	-	-	-	18.6	14.3	10.2	18.9	15.9	12.1
Arizona	-	65	-	17	18.5	14.1	10.0	19.0	15.6	12.1
Colorado	-	-	3	11	16.8	12.5	8.4	16.8	13.3	10.0
Idaho	10	-	8	47	19.0	14.7	10.7	19.6	16.1	12.8
Michigan	*	2	*	-	18.3	13.9	9.7	18.7	15.2	11.8
Minnesota	*	*	*	*	18.2	13.8	9.6	18.5	15.0	11.5
Missouri	19	-	78	-	18.8	14.3	10.1	19.3	15.7	12.1
Montana	-	5	-	-	18.9	14.6	10.5	19.5	16.0	12.6
New Mexico	-	9	-	-	19.0	14.6	10.7	19.6	16.2	12.9
Tennessee	29	-	-	-	18.8	14.5	10.6	19.4	16.0	12.7
Utah	-	14	1	-	18.2	13.8	9.6	18.6	15.0	11.7
Wisconsin	*	*	*	*	18.6	14.3	10.5	19.2	15.8	12.5

Source: U.S. Bureau of Mines, **Commodity Data Summaries, 1979.**

Note a (-) indicates that the production is either not significant or that the information is not available.

A (*) indicates that there is no production.

Section 5

CONCLUSIONS AND RECOMMENDATIONS

Discounted cash flow analysis has been used to compare six different models for a zinc-copper deposit in Alaska with those same models in eleven other states including: Arizona, Colorado, Idaho, Michigan, Minnesota, Missouri, Montana, New Mexico, Tennessee, Utah, and Wisconsin. The Alaskan computer printouts generated by Whitney & Whitney's MINE-CAN program used for these analyses appear in Appendix A. The parameters used to differentiate between the six base models were: the size of the mine (large or small); and the mining method (underground or open pit). The parameter used to differentiate between the sets of models for each state was the individual states' mineral tax structure. The models used were the base cases from the WMC study and the basic assumptions used in the modeling are listed in Tables 1 and 2. Results of the analyses are summarized below.

Mining operations in Alaska are subject to three taxes: a mining license tax, a state corporate income tax, and local property taxes.

Alaska's total mineral tax burden is average compared with the eleven states in the WMC study. Measures of competitiveness among the twelve states indicate that Alaska is surpassed by approximately one-half the states in terms of its ability to attract mining investment.

Given the constraints of this study, it might be suggested that the Alaska mineral tax structure acts as neither a deterrent nor an incentive in attracting mining investment. However, one important factor must be considered. The WMC modeling effort did not include the higher costs of mining activity in Alaska which stem in part from the colder climate, the frequently remote locations of mineral deposits, and the general lack of a developed infrastructure.

Cost assumptions for the WMC study were developed for the lower 48 states using flow-sheets and standard cost estimation methods. A number of these assumptions are subject to revision when the deposit location is changed to Alaska.

Previous studies have shown that operating and capital costs of mining activities are substantially higher in Alaska than for the lower 48 states. Higher capital costs relate to the remote location of deposits and the need for construction of support facilities including power, townsites and transportation. Greater operating costs result from the higher wage rates, corresponding higher payroll costs, and the greater number of staff needed for maintenance of facilities. Property tax levels may also be higher depending on infrastructure requirements. Cost levels vary depending on the location of the deposit within the state.

Whitney & Whitney, Inc. recommends that the economic viability of mining investment in Alaska be studied further to provide a more realistic assessment of mine profitability, effective tax rates and rates of return on investment.

The optimal study would include a total of 18 models, 3 sets of 6 models. The parameter used to differentiate between the sets would be deposit location. Set 1 would be located in the southeastern part of Alaska. Set 2 would be located in the central part of the state, and Set 3 would be located in northern Alaska. Each set would include the 6 WMC models

which vary according to size and mining method. Capital and operating costs would be adjusted in each model depending on regional location. Whitney & Whitney preliminary estimates suggest that costs in southeastern Alaska range from one to two times more than costs in the lower 48 states; costs in central Alaska range from 1½ to 2½ times more than costs in the lower 48 states; and costs in the northern part of the state range from two to three times more than costs in the lower 48 states.

Results of the study would be useful to investors, businessmen, and planners at the state, borough and city levels. If the revised models indicate that mine development in Alaska is not competitive due to cost factors which are only partially controllable, then the Alaska tax system which presently seems competitive may require incentives if increased mine development is desired.