HJR

4

Official Business

Alaska State Legislature

REPRESENTATIVE RANDY PHILLIPS
HOUSE DISTRICT 15
(907) 465-4949

P.O. Box V
State Capitol
Juneau, Alaska 99811

Memorandum

TO: Representative Gene Kubina
Chair, House State Affairs Committee

FROM: Representative Randy Phillips R.E.P.

DATE: February 8, 1991

RE: House Joint Resolution No. 4,
"Proposing amendments to the Constitution of the State of Alaska relating to capital projects and loan appropriations, and to the expenditure limit."

The above referenced resolution has been referred to your committee.

Please consider this as my formal request that H.J.R. 4 be scheduled before your committee for an early hearing.

If you have any questions, please do not hesitate to contact me. Your cooperation is appreciated.

FISCAL NOTE

STATE OF ALASKA
1991 LEGISLATIVE SESSION

BILL NO. HJR 4

Revision Date:

Department Affected: Department of Law

Title: "Proposing amendments to the Constitution...to the expenditure limit."

BRU: Legal Services

Component: Operations

Sponsor: Representative R. Phillips

Requestor: House State Affairs

COMPONENT SERIAL NO. | | | 9 | 3 |

Expenditures/Revenues: (Thousands of Dollars)

OPERATING	FY 92	FY 93	FY 94	FY 95	FY 96	FY 97
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	-0-	-0-	-0-	-0-	-0-	-0-
CAPITAL						
REVENUE						

FUNDING: (Thousands of Dollars)

GENERAL FUND	-0-	-0-	-0-	-0-	-0-	-0-
FEDERAL FUNDS						
OTHER						
TOTAL						

POSITIONS:

FULL-TIME	-0-	-0-	-0-	-0-	-0-	-0-
PART-TIME						
TEMPORARY						

Estimate of current year impact:

ANALYSIS: (Attach a separate page if necessary.)

Please see the attached analysis.

Richard I. Pegues

Prepared By: Richard I. Pegues, Director

Phone: 465-3672

Division: Administrative Services

Date: February 11, 1991

Richard I. Pegues / FOR

Approved by Commissioner: Charles E. Cole, Attorney General

Agency: Department of Law

Date: February 11, 1991

Distribution (by preparer): Legislative Finance, Legislative Sponsor, Requestor, OMB, & Impacted Agency(ies).

Rev 10/90

CONTINUATION of FISCAL NOTE ANALYSIS

For Bill/Resolution No. HJR 4

House Joint Resolution No. 4 proposes permanent and temporary amendments to the state's constitution that would change the state's existing constitutional spending limits. First, a new section would be added to Article IX, which provides that except for the existing provisions of Section 16 not less than ten percent of all money appropriated each fiscal year shall be appropriated for capital projects and loans.

Second, the operation of Section 16 of Article IX would be suspended from July 1, 1993 through June 30, 1998. In its place a temporary section would be adopted which imposes a $2,300,000,00 spending limit. If the inflation since the beginning of a fiscal year is greater than six percent, appropriations for that fiscal year could be made up to the amount necessary to offset the effect of the rate of inflation that exceeds six percent. During a fiscal year, the legislature could exceed the temporary spending limit if each bill that exceeds the limits is passed by an affirmative vote of two-thirds of the membership of each house of the legislature. All money received by the state that exceeds the spending limit, and that is not appropriated would be deposited in the budget reserve fund created under Section 17 of Article IX.

The existing spending limit, under Section 16 of Article IX, is $2,500,000. The existing limit is indexed in population and inflation since July 1, 1981, and may rise or fall based upon the cumulative change after that date.

The resolution would be placed before the voters at the 1992 general election. The resolution will not have a fiscal impact on the Department of Law.

FISCAL NOTE

STATE OF ALASKA
1991 LEGISLATIVE SESSION

BILL NO. HJR4

Revision Date: 01/28/91
Department Affected: Office of the Governor - Electio
Title: Amend. to Constitution-Capital Projects,Loan App.&Expenditure Limit
BRU: Elections
Component: II - Primary and General Elections
Sponsor: Representative R. Phillips
Requestor: State Affairs
COMPONENT SERIAL NO. 0 0 2 2

Expenditures/Revenues: (Thousands of Dollars)

OPERATING	FY 92	FY 93	FY 94	FY 95	FY 96	FY 97
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL		2.2*				
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING		2.2*				
CAPITAL						
REVENUE						

FUNDING: (Thousands of Dollars)

GENERAL FUND		2.2*				
FEDERAL FUNDS						
OTHER						
TOTAL		2.2*				

POSITIONS:

FULL-TIME						
PART-TIME						
TEMPORARY						

Estimate of current year impact: -0-

ANALYSIS: (Attach a separate page if necessary.) * This figure covers cost of inclusion of information about this issue in the Official Election Pamphlet as required by AS 15.58, and programming for DataVote counting of votes cast on this measure. However, only 4 measures can be printed on a single ballot card. Should this measure require printing an additional ballot card, the fiscal impact would be: 53.4.

Prepared By: Linda Edgeworth, Information Officer
Phone: 465-4611
Division: Division of Elections
Date: 01/28/91

Approved by Commissioner: Charles E. Thickstun
Agency: Division of Elections
Date: 1-29-91

Distribution (by preparer): Legislative Finance, Legislative Sponsor, Requestor, OMB, & Impacted Agency(ies).

Rev 10/90

FISCAL NOTE

STATE OF ALASKA
1991 LEGISLATIVE SESSION

BILL NO. HJR4

Revision Date: 01/28/91
Department Affected: Office of the Governor - Elections
Title: Amend. to Constitution-Capital Projects,Loan App.&Expenditure Limit
BRU: Elections
Component: II - Primary and General Elections
Sponsor: Representative R. Phillips
Requestor: State Affairs
COMPONENT SERIAL NO. 0 0 2 2

Expenditures/Revenues: (Thousands of Dollars)

OPERATING	FY 92	FY 93	FY 94	FY 95	FY 96	FY 97
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL		2.2*				
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING		2.2*				
CAPITAL						
REVENUE						

FUNDING: (Thousands of Dollars)

GENERAL FUND		2.2*				
FEDERAL FUNDS						
OTHER						
TOTAL		2.2*				

POSITIONS:

FULL-TIME						
PART-TIME						
TEMPORARY						

Estimate of current year impact: -0-

ANALYSIS: (Attach a separate page if necessary.) * This figure covers cost of inclusion of information about this issue in the Official Election Pamphlet as required by AS 15.58, and programming for DataVote counting of votes cast on this measure. However, only 4 measures can be printed on a single ballot card. Should this measure require printi g an additional ballot card, the fiscal impact would be: 53.4.

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Phone: 465-4611
Division: Division of Elections
Date: 01/28/91

Approved by Commissioner: [signature]
Agency: Division of Elections
Date: 1-29-91

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Alaska State Legislature

Randy Phillips
State Representative
House District 15

Member
House Finance Committee

Session
State Capitol
Juneau, AK 99801
(907) 465-4949

Interim
P.O. Box 142
Eagle River AK 99577
(907) 694-4949

Memorandum

TO: Representative Gene Kubina, Chairman
House State Affairs Committee

FROM: Representative Randy Phillips R.C.P.

JAN 15 1991

DATE: January 15, 1991

RE: House Joint Resolution No. 4
"Proposing amendments to the Constitution of the State of Alaska relating to capital projects and loan appropriations, and to the expenditure limit."

The above referenced resolution has been referred to the State Affairs Committee.

Please consider this as my formal request that H.J.R. 4 be scheduled before your committee for an early hearing.

If you have any questions or comments do not hesitate to call me at 4949. Your cooperation is appreciated.

Alaska State Legislature

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Juneau, AK 99801
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Randy Phillips
State Representative
House District 15

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House Finance Committee

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(907) 694-4949

A

Memorandum

TO: Representative Gene Kubina, Chairman

FROM: Representative Randy Phillips REP

DATE: February 19, 1992

FEB 19 1992

RE: House Joint Resolution 4, Proposing amendments to the Constitution of the State of Alaska relating to capital projects and loan appropriations, and to the expenditure limit.

House Joint Resolution 4 has been referred to the State Affairs Committee.

Please consider this as my formal request that HJR 4 be scheduled before your committee for an early hearing.

If you have any questions or comments do not hesitate to call me at 4949. Your cooperation is appreciated.

Alaska State Legislature

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Memorandum

TO: Representative Gene Kubina, Chairman

FROM: Representative Randy Phillips REP

DATE: February 19, 1992

RE: House Joint Resolution 4, Proposing amendments to the Constitution of the State of Alaska relating to capital projects and loan appropriations, and to the expenditure limit.

HJR 4 would set a limit of $2.3 billion for appropriations of unrestricted general fund moneys from the state treasury for each fiscal year FY 93 to FY 98. HJR 4 would also provide that at least 10% of the amount appropriated in each fiscal year would be appropriated for capital projects and loans.

Alaska's Constitution Article IX, Section 16 currently contains an "appropriation limit" which was approved by the voters in 1982. The current appropriation limit in the Constitution would allow for general fund spending of more than $4.5 billion in FY93. Given that unrestricted general fund revenues are predicted to be at or near $2 billion, it is easy to see that the current appropriation limit makes no sense. Alaska also has a "statutory appropriation limit", AS 37.05.540, passed in 1987 which was intended to limit the growth of spending to equal inflation and population growth. This appropriation limit is not effective for two reasons:

1. Since it is in statute and not in the Constitution, the Legislature can not be bound to it, that is, any appropriation bill that exceeds the limit is a new law that supersedes the law setting the limit.

2. The method used to set the appropriation limit in AS 37.05. 540 is confusing and has lead to a situation where the limit has been technically breached even though the Legislature made a conscious effort to keep appropriations within the limit.

Alaska's Constitution does not require a "balanced budget" in the sense that annual expenditures must be balanced to annual revenues. Annual appropriations may exceed annual revenues and have in a number of years, the only real appropriation limit that is faced by the Legislature at this time is the prohibition against long-term borrowing to fund government operations. It would be possible for the Legislature to appropriate all revenues, special accounts, budget reserve funds and the earnings of the permanent fund all in one year.

In a perfect world, there would be no need to establish an appropriation limit in the state Constitution, Legislators would balance the demands of the public against the resources available and plan for the future. In the real world, the pressures brought by the public to fund specific programs makes in nearly impossible to make budget cuts. The need for an appropriation limit has been shown by the fact that the Legislature and the people of the State of Alaska have acted twice to establish appropriation limits. However, neither appropriation limit has been effective. Now is the time to establish an appropriation limit that is in the Constitution, enforceable, and also realistic.

If you have any questions or comments do not hesitate to call me at 4949. Your cooperation is appreciated.

ISER FISCAL POLICY PAPERS

No. 1, August 1989

Institute of Social and Economic Research — University of Alaska Anchorage

THE ALASKA FISCAL GAP

by Oliver Scott Goldsmith

Alaska faces a problem that will be very tough to solve but is easy to explain: state government is spending more than it collects. The problem will get much worse as time goes on. If state general fund spending stays at the current level of $2.25 billion (in 1989 dollars), we face a fiscal gap—the difference between current spending and projected revenues—that could soon grow to $1 billion annually.

This budget crisis looms because oil production, which supplies 85 percent of the state's general fund revenues, will soon begin dropping as the huge Prudhoe Bay oil field is depleted. Likely new petroleum production, higher oil prices, and other economic activity in the coming decade won't be able to generate nearly enough tax and royalty income to replace the loss of Prudhoe Bay production.

Figure 1 shows projected oil production and state petroleum revenues over the next 20 years, based on the Alaska Department of Revenue's estimates from producing fields and our own estimates of new field production and per barrel revenue. Production is at its peak and will soon begin a long decline. Even assuming production from new fields such as West Sak—the timing of which is uncertain—production in 2000 will be only half of what it is today. Petroleum revenues have already fallen to just half of what they were in the early 1980s, because oil prices are much lower now. If the real price of oil remains in the range where it has been for the last few years, petroleum revenues will drop by half again by 2000.

This figure does not include potential production and revenues from oil fields that may exist in the Arctic National Wildlife Refuge (ANWR). Such revenues would of course help reduce the budget shortfall in the next century. But under any reasonable assumptions (see the box on page 4) they would fall far short of revenues we've enjoyed from Prudhoe Bay, and could not reverse the downward trend. Also, future production from ANWR is extremely speculative right now. Congress would first have to open the refuge to exploration and oil companies would have to discover commercial quantities of oil; after such discoveries it would take years to bring new fields into production.

THE FISCAL GAP

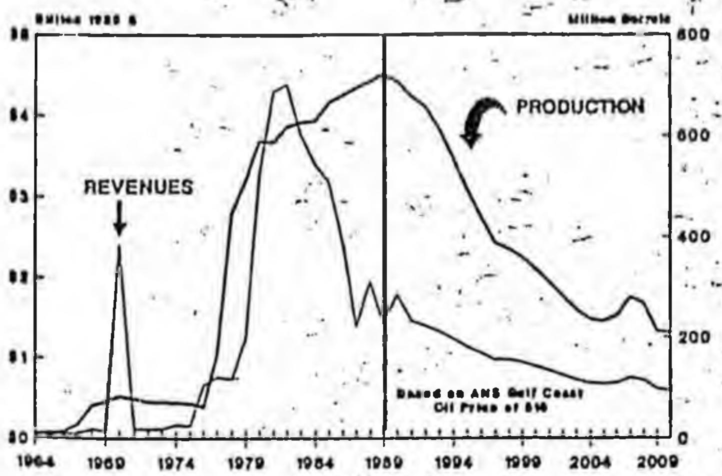
How shrinking production and revenues translate into trouble for Alaska is apparent in Figure 2. It shows the potential size of the future gap

This is the first in a series of *ISER Fiscal Policy Papers* that will examine aspects of state government spending. We intend these papers to focus the attention of state officials and of Alaskans in general on the serious budget crisis we face, and on the necessity for dealing with it soon. We hope this and later papers will provide policymakers with information and analysis they will need when making the difficult decisions ahead.

The author, Oliver Scott Goldsmith, is professor of economics with ISER. He has fourteen years of experience examining state spending. Lee Gorsuch, ISER director, is responsible for the design and presentation of this series. Linda Leask edited the paper.

The *ISER Fiscal Policy Papers* series is financed by a grant from ARCO Alaska.

FIGURE 1. PROJECTED ALASKA PETROLEUM REVENUES AND PRODUCTION



accounts directly and indirectly for more than one in four Alaska jobs.

Below we look at four possible ways to deal with the fiscal gap between now and the year 2010. Briefly, our four cases are: (1) Stumble From Year to Year; this case assumes that the state tries to maintain current spending for as long as possible by using all available reserves except the principal of the Permanent Fund and then cuts spending to match reduced revenues. (2) Deplete the Permanent Fund; this case examines what would happen if the state maintained the current budget level by spending the principal of the Permanent Fund. (3) Freeze the Budget; this case looks at how the fiscal gap would be affected if the state did not adjust the budget for inflation – in effect cutting the budget by the annual rate of inflation. (4) Cut Spending and Raise Taxes; this case describes the combined effects of reducing state spending, reimposing the personal income tax, and eliminating the Permanent Fund dividend.

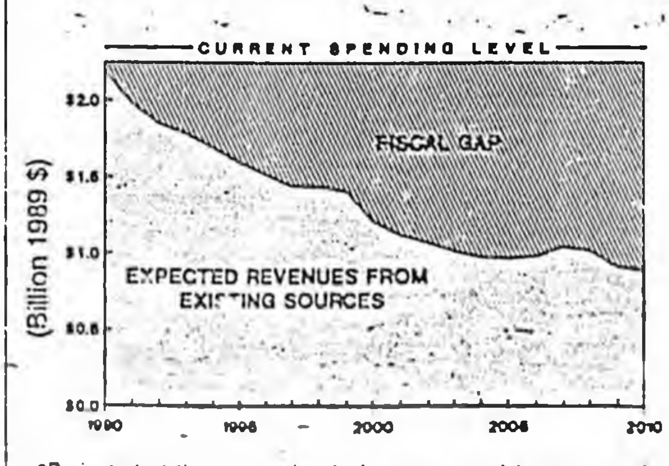
between general fund revenues and spending. If annual spending were held at its current level of about $2.25 billion (in 1989 dollars), the gap between spending and revenues could be several hundred million dollars a year in the early 1990s and more than $1 billion annually after the turn of the century. If future revenues turn out to be larger than we anticipate, the fiscal gap could be reduced for a short time but the overall picture would be the same. (See the box on page 4 for a description of how our results would change under different assumptions about future developments and other factors.)

Such a gap of course can't persist. We'll have to balance the budget by cutting spending, raising taxes, using savings or some combination of the three. These changes will affect not only those who currently enjoy state services, work for state government, or pay taxes. Everyone who benefits from local government services like schools and street maintenance will also be affected. Budget cuts will also affect recipients of government transfers – including Permanent Fund dividends – and businesses that depend on the purchasing power provided by a large public sector.

Balancing the budget will affect all Alaskans, because the economy and people of Alaska are dangerously dependent on state government spending financed by oil revenues. Even now, after several years of recession and a precipitous drop in revenues, state government spending still

There are other possible combinations, but these four scenarios include the main options available to the state. We do not discuss, nor have we attempted to analyze, the enormous political difficulties inherent in exercising any of these options. Some would require changes in law or even amendments to the Alaska constitution. All would generate intense public debate, and most

Figure 2. PROJECTED STATE FISCAL GAP*
(Difference Between Revenues and Spending)



*Projected at the current level of state general fund expenditures. Revenues include oil settlement estimate.

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REAL VS. INFLATED DOLLARS IN FISCAL ANALYSIS

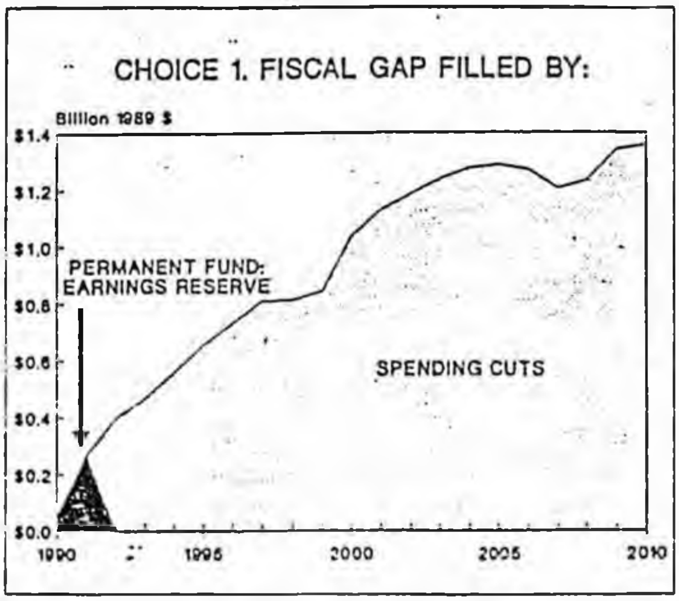
For simplicity and clarity all revenues and expenditures are presented in 1989 dollars. Using this technique eliminates the need to estimate the rate of inflation—the value of which has only a marginal effect on the rest of our analysis—and avoids the confusion that inflation can introduce when we try to compare the purchasing power of dollars received at different times. For example, $1 of revenue collected in 2000 would have the purchasing power of just 61 cents, if inflation were 5 percent annually over the next decade. Our use of 1989 dollars throughout the analysis allows direct comparisons of current and future purchasing power.

The use of real dollars also corrects a misinterpretation that can arise in revenue projections that use nominal dollars. In such projections, the inflation-proofing portion of Permanent Fund earnings can appear to be a source of recurring revenues. In fact, inflation-proofing is just the portion of earnings needed to offset the devaluation of the fund principal by inflation. Because we use real dollars in our analysis, inflation-proofing does not appear as a separate revenue source, and we avoid any potential misinterpretation. This assumption does not preclude the policy option of appropriating inflation-proofing to fund government spending.

would face extremely strong opposition from specific groups or from Alaskans in general. This paper does not endorse any particular strategy to balance the budget. Rather, it describes in general the tradeoffs—who bears the pain—and the ramifications of the various choices.

Doing an analysis like this requires making certain economic assumptions. Those assumptions are summarized in the box on page 4 and in the individual case descriptions. We can't be sure that these assumptions will prove correct, but changing those assumptions in any reasonable way would not substantially alter our findings.

FISCAL CHOICE 1: STUMBLE FROM YEAR TO YEAR



In this case we look at what would happen if the state government budgeted from year to year, trying to maintain the current level of spending ($2.25 billion in 1989 dollars) for as long as possible, using available fund balances but making no changes in current fiscal policies. The dividend program would not be changed, the principal of the Permanent Fund would be retained, and no new tax measures would be enacted.

Revenues from the settlement of disputes with the oil companies over past royalty and tax payments, as well as with the federal government over ownership of leases in the Beaufort Sea, are an important element of our revenue estimates for the 1990s. The amount and timing of any settlement money the state might receive is extremely uncertain, but we assume for this and the other cases that the settlements occur regularly over the next decade in an amount equivalent to $1.7 billion today. (See also the box on page 4 for an example of how changing this settlement total would change the analysis.) In reality the state may not be so fortunate as to receive a steady stream of income from this source, and the budget shortfall would pressure the state to accept quick negotiated settlements in these disputes.

Under these conditions, the Railbelt Energy Fund, the Earnings Reserve Account of the Permanent Fund, and other fund balances could balance the budget for a short time. A fiscal gap of $400 million would open in 1992 and grow to an annual deficit of $1 billion by 2000. In this scenario, state government and the economy would adjust to reduced state spending as discussed below and shown in the graphs on page 7.

Permanent Fund: The Permanent Fund would remain just about the same size (inflation-proofed) that it is today. Contrary to popular belief, future earnings of the Permanent Fund will not be able to replace petroleum revenues in the support of state government. Annual additions to the fund from petroleum revenues—which the state constitution currently requires go directly to the principal of the Permanent Fund—plus earnings would largely be consumed by the Permanent Fund dividend program, with little or nothing left

ECONOMIC ASSUMPTIONS USED IN ANALYSIS

If we changed the economic assumptions used in this analysis, the rate at which the fiscal gap grows would be different but the options for dealing with the gap would be the same. To focus on those options we held the economic assumptions constant throughout the four cases. The most important assumptions are listed below. (Full details on the assumptions are available from the author.)

OIL PRODUCTION: Alaska Department of Revenue estimate, Spring 1989, plus West Sak production scenario developed by author (oil companies recently announced postponement of West Sak exploration)

OIL PRICE: Gulf Coast delivered price for Alaska North Slope (ANS) crude averages $15 a barrel (in 1989 dollars)

RETURN ON PERMANENT FUND: 3 percent annually, net of inflation

EMPLOYMENT GROWTH RATE: 1.75 percent annually, independent of government spending

SETTLEMENT REVENUES FROM PETROLEUM DISPUTES: $1.7 billion (in 1989 dollars), received over 10 years

TAX REGIME: Reflects the Economic Limit Factor (ELF) as revised by the Alaska Legislature in June 1989

INFLATION RATE: 5 percent annually

RECURRING REVENUES (Non-petroleum revenues): 1 percent growth annually, net of inflation

for fund growth. The total amount available to pay dividends and the payments to individual Alaskans would stay fairly constant because population growth would roughly match growth in the total available for dividends. Dividends as a component of government spending would increase because of decreased spending in all other functional areas.

Revenues: With no new recurring revenues, general fund revenues would steadily decline to about $1.2 billion in 2000. Permanent Fund additions and earnings would remain relatively constant because of the stable size of the fund.

Expenditures: Declining petroleum revenues would force significant budget cutbacks beginning in earnest in 1992. The general fund would need to be cut 18 percent that year to balance the budget. Smaller annual cuts would be the rule over the next two decades. Expenditures in 2000 would be $1.2 billion—equal to revenues collected that year. These cuts in state spending would mean underfunding many and eliminating some government programs; reducing transfers to local governments (creating pressure on local governments to increase taxes and try to shift government functions back to the state); and reducing financial support for individuals. Projected population growth would add to the problem of deciding how the cuts should occur. Uncertainty about the timing and magnitude of cuts from year to year would create continuing confusion and negative attitudes both within government and the private sector.

Alaska Employment: During the next decade 26,000 public and private jobs would be lost as

WHAT IF WE CHANGED THE ASSUMPTIONS?

A question likely to be asked is: How much longer could we maintain current spending if revenues turned out to be greater than we have assumed? If we used up the entire Permanent Fund (as discussed in Case 2), we could maintain current spending up until 2003. Alternate assumptions would add to the number of years that the current spending level could be maintained as follows:

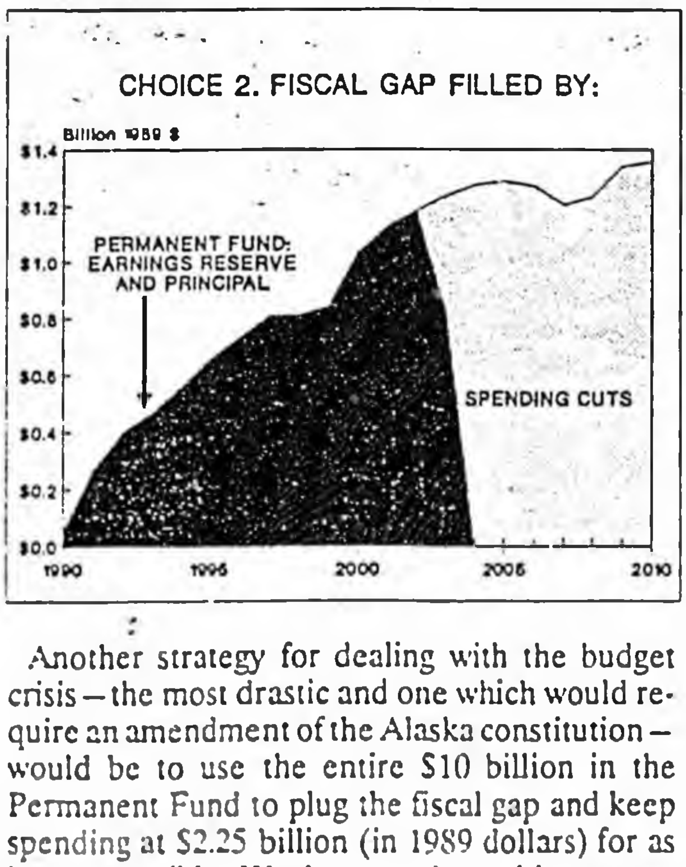
$1 increase in the price of oil	1 year
Gas pipeline in the 1990s	1 year
ANWR production shortly after 2000	1 year
Petroleum settlements of $3.4 billion	2 years

Another likely question is: What would be the cost of a one-year delay in closing the fiscal gap? Our analysis in Case 4 indicates that the state can sustain annual spending of about $1.45 billion (in 1989 dollars) based on the current tax regime, compared with the current spending level of $2.65 billion (including the approximately $400 million paid in Permanent Fund dividends). The difference between current and sustainable spending—$1.2 billion—approximates the loss in state fiscal assets associated with each year of delay in closing the gap.

state general fund spending was cut virtually in half. (For simplicity we assume public sector jobs would be eliminated in proportion to the budget cuts. Wage rate reductions could partially offset this job loss. We also assume that local governments do not raise taxes in response to less state fiscal support.) The drag on the economy created by a job loss of this magnitude would make it difficult if not impossible for the economy to grow, even assuming the private sector could generate new jobs at about the same rate projected for the national economy—1.75 percent annually. Total employment in Alaska in 2000 would be only slightly above what it is today.

Economic Well-Being: Annual percentage changes in employment would hover near zero for most of the next 10 years, with a dramatic drop when government spending was first reduced in 1992. Per capita general fund government spending would fall about 5 percent annually through most of the next 20 years.

FISCAL CHOICE 2: DEPLETE THE PERMANENT FUND



Another strategy for dealing with the budget crisis—the most drastic and one which would require an amendment of the Alaska constitution—would be to use the entire $10 billion in the Permanent Fund to plug the fiscal gap and keep spending at $2.25 billion (in 1989 dollars) for as long as possible. We do not endorse this strategy, but include it to cover the range of options available to the state. Under this scenario, the portion of Permanent Fund earnings now used to protect the principal of the fund from inflation would be spent, as well as the principal of the fund itself.

The first draw—$400 million from inflation-proofing—would be required in 1992. Within two years, however, we would begin taking from the principal of the fund, and the withdrawals would grow rapidly—topping $1 billion for the first time in 2000. The fund principal would be drawn down faster as time went on not only because of the growing fiscal gap but also because the shrinking Permanent Fund would generate less earnings each year. Under this scenario, the effects would be as discussed below and shown in the graphs on page 8.

Permanent Fund: More than $6 billion from the Permanent Fund would be needed to fill the budget gap between 1992 and 2000. The last year of withdrawals would be 2003, when the Permanent Fund would be depleted. The Permanent Fund dividend would be an additional casualty, declining each year as the fund shrank and disappearing when the fund disappeared.

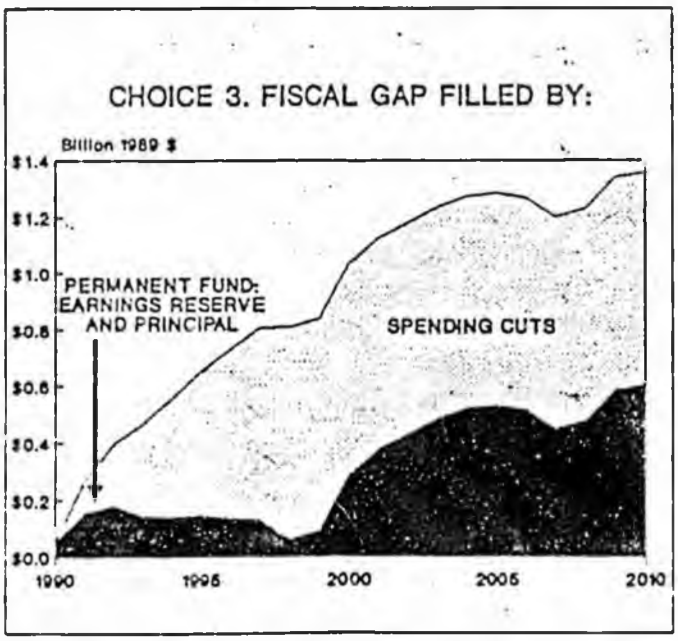
Revenues: Revenues flowing into the general fund would be the same as in Case 1, but the use of Permanent Fund earnings and principal would disguise the shortfall until 2003, when the Permanent Fund would be gone. By 2005, revenues would be about $1 billion—60 percent less than the level expected in 1990. The additions and earnings of the Permanent Fund would fall as the fund itself shrank.

Expenditures: The Permanent Fund would prop up expenditures until 2003. Then a massive "forced transformation" of the public sector and the entire Alaska economy would occur because of the sudden drop in state general fund spending--from $2.25 billion to $1 billion in just two years. All public services at the state and local levels would suffer dramatic cutbacks.

Alaska Employment: Extreme dislocation and a serious economic recession would start in 2003. About 30,000 jobs—both public and private—supported by general fund spending would disappear over a two-year period. (To put such a drop in perspective, job loss during the 1985-1988 recession was about 25,000.) Even assuming private industry would continue to generate jobs at the rate of 1.75 percent annually, by 2010 Alaska would still not have replaced all the jobs lost during the recession.

Economic Well-Being: Alaska employment would increase through 2002 because of growth in the private economy and constant general fund government spending. In the following two years, 12 percent of total state jobs would disappear. Despite constant government spending through 2002, per capita state general fund spending would decline because private economic growth would be drawing people to Alaska. Per capita state general fund spending would be cut nearly in half when the "forced transformation" occurred.

FISCAL CHOICE 3: FREEZE THE BUDGET



The forced transformation of the public sector and the severe recession described in Case 2 could be mitigated under a scenario in which the budget was held constant in nominal dollars – that is, not adjusted for inflation. Such a strategy would reduce the purchasing power of the budget each year by the rate of inflation.

The average annual rate of inflation in the coming years is expected to be in the neighborhood of 5 percent. If the budget were not adjusted for that inflation, the real dollar value (the effective purchasing power) of the budget would fall by 5 percent each year. If the state government implemented a constant budget policy starting in 1991, the budget could be reduced to an arbitrary target level of $1.5 billion (in 1989 dollars) by 1998.

A gradual policy like this would require a large amount of political discipline, but it would have several attractive features--even though it would not entirely solve the state's long-term fiscal problem. Public programs could be phased out on the basis of plans developed to minimize the effects of the budget reductions. The economy would not suffer the kind of massive shock described under Case 2, when state spending would be reduced by half in just two years. The effects of using inflation to cut the budget are discussed below and shown in the graphs on page 9.

Permanent Fund: This strategy at first glance appears to preserve the Permanent Fund, since the balance would hold relatively constant for several years after budget cuts ended. It would require use of portions of the annual appropriations for inflation-proofing during the 1990s. After 2000 continuing declines in revenues would force significant withdrawals from principal. By 2010 the fund principal would be only about $3.5 billion, as compared with $10 billion today. As the Permanent Fund shrank, the amount paid out as dividends would also fall off.

Revenues: General fund revenues would be the same as in Cases 1 and 2. The spending reductions would not be sufficient to produce a general fund surplus; such a surplus could in itself be a new source of earnings. Additions and earnings of the Permanent Fund would taper off after 2000 as the principal of the fund was spent.

Expenditures: State expenditures would fall off gradually but steadily each year until 1998 and then hold steady at $1.5 billion through the next decade – but only because we would be using the principal of the Permanent Fund to supplement other revenues. After 2010 the Permanent Fund would be used up and a smaller "forced transformation" of the public sector and the economy would occur. Under this scenario, dramatic cuts in state spending – as much as 40 percent – would be forced by 2015 (not shown on the graph).

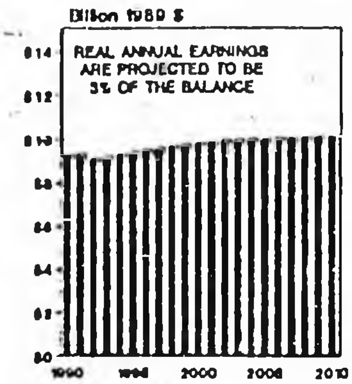
(Text continued on page 11)

Fiscal Choice 1: Stumble from Year to Year

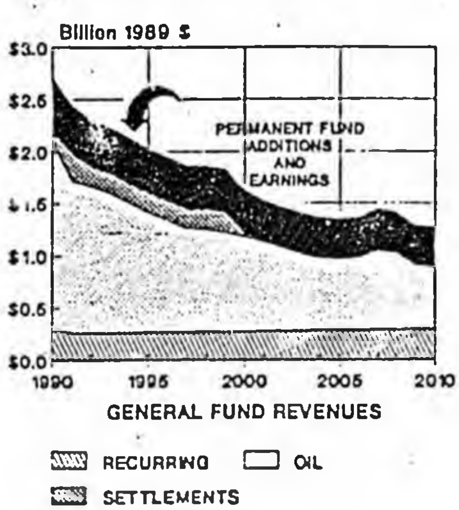
CASE ASSUMPTIONS

- SPENDING: General Fund spending based on availability of revenues up to $ 2.25 billion (1989$)
- TAXES: No new taxes
- DIVIDEND: Retain Permanent Fund dividend
- PERMANENT FUND: Leave Permanent Fund principal intact, continue contributions and inflation proofing, spend earnings reserve account
- OIL PRICE (constant across cases): Average ANS Gulf Coast oil price $15 (1989$)
- SETTLEMENTS (constant across cases): $1.7 billion of oil settlements collected and spent over 10 years

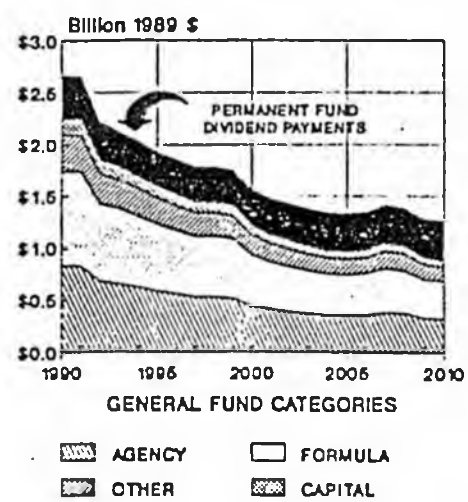
PERMANENT FUND BALANCE



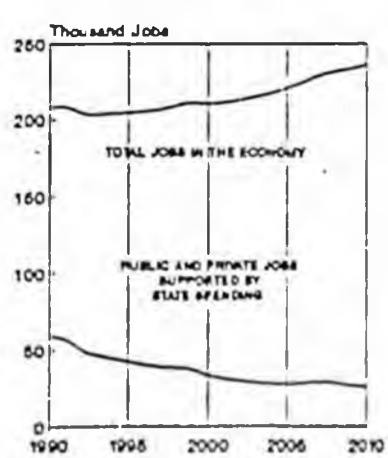
STATE GOVERNMENT REVENUES
(Permanent Fund Included)



STATE GOVERNMENT EXPENDITURES
(Dividend Included)

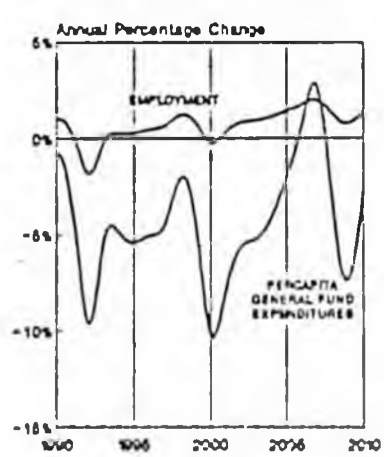


ALASKA EMPLOYMENT



Wage and Salary Employment Only

ECONOMIC WELL-BEING

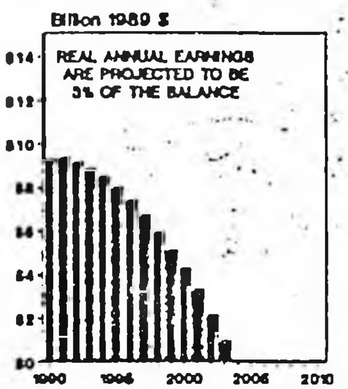


Fiscal Choice 2: Deplete the Permanent Fund

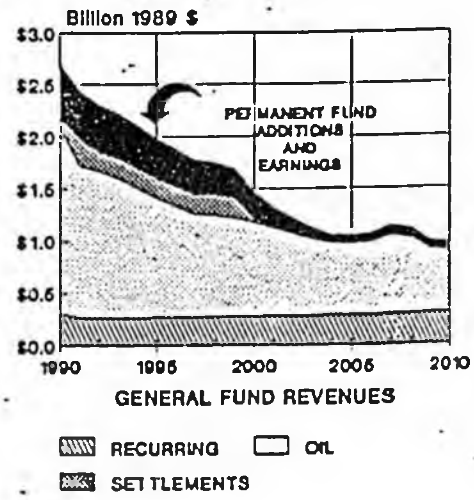
CASE ASSUMPTIONS

- SPENDING: General Fund spending based on availability of revenues up to $ 2.25 billion (1989$)
- TAXES: No new taxes
- DIVIDEND: Retain Permanent Fund dividend
- PERMANENT FUND: Use Permanent Fund principal to maintain spending as long as possible
- OIL PRICE (constant across cases): Average ANS Gulf Coast oil price $15 (1989$)
- SETTLEMENTS (constant across cases): $1.7 billion of oil settlements collected and spent over 10 years

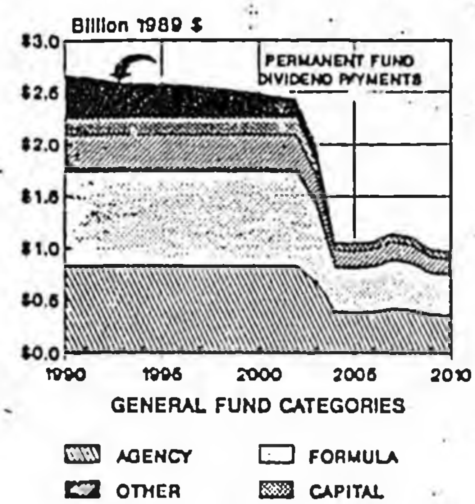
PERMANENT FUND BALANCE



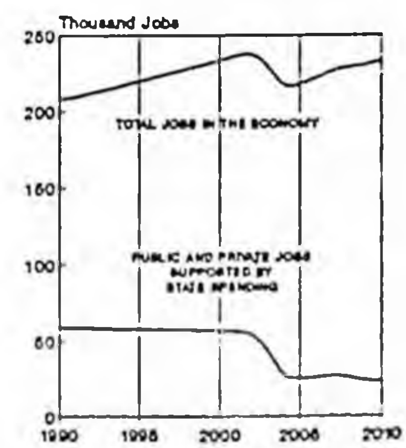
STATE GOVERNMENT REVENUES
(Permanent Fund Included)



STATE GOVERNMENT EXPENDITURES
(Dividend Included)

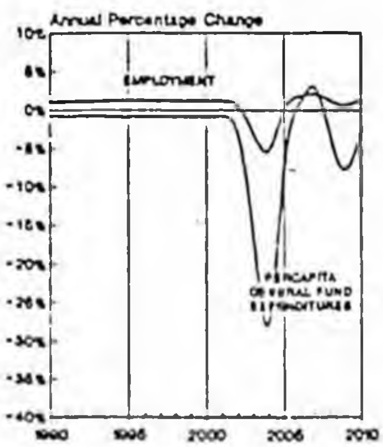


ALASKA EMPLOYMENT



Wage and Salary Employment Only

ECONOMIC WELL-BEING

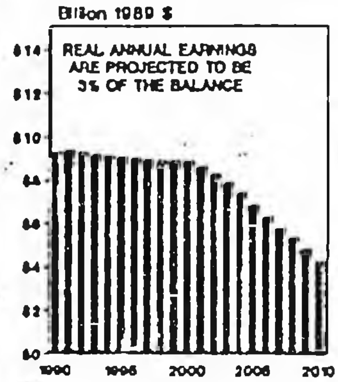


Fiscal Choice 3: Freeze the Budget

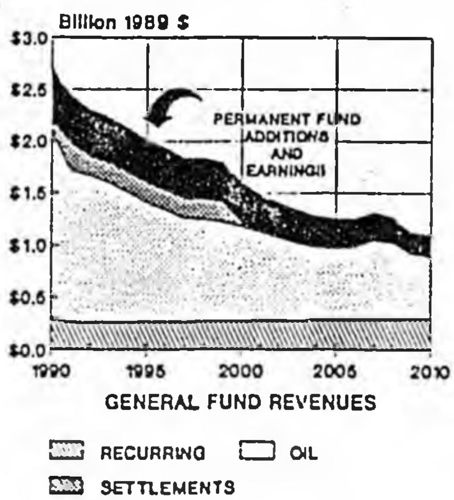
CASE ASSUMPTIONS

- SPENDING: General Fund spending constant in nominal dollars from 1991 to 1998. (The budget declines to a target of $1.5 billion in 1989$)
- TAXES: No new taxes
- DIVIDEND: Retain Permanent Fund dividend
- PERMANENT FUND: Use Permanent Fund principal to maintain spending at targeted level as long as possible
- OIL PRICE (constant across cases): Average ANS Gulf Coast oil price $15 (1989$)
- SETTLEMENTS (constant across cases): $1.7 billion of oil settlements collected and spent over 10 years

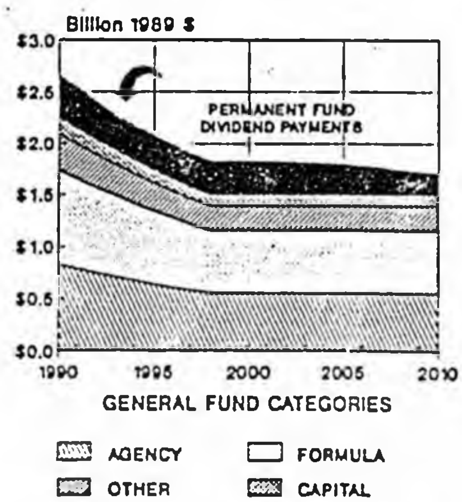
PERMANENT FUND BALANCE



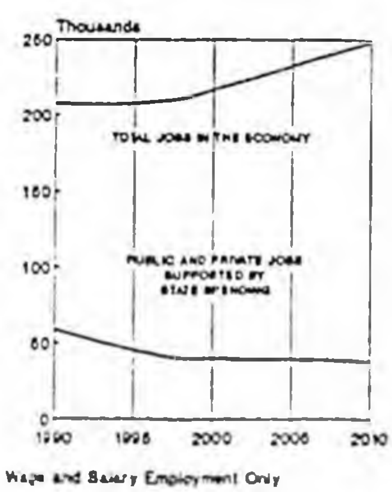
STATE GOVERNMENT REVENUES (Permanent Fund Included)



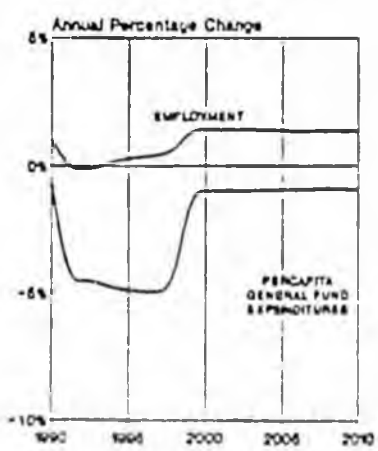
STATE GOVERNMENT EXPENDITURES (Dividend Included)



ALASKA EMPLOYMENT



ECONOMIC WELL-BEING

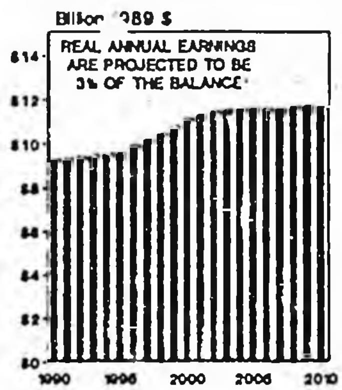


Fiscal Choice 4: Cut Spending and Raise Taxes

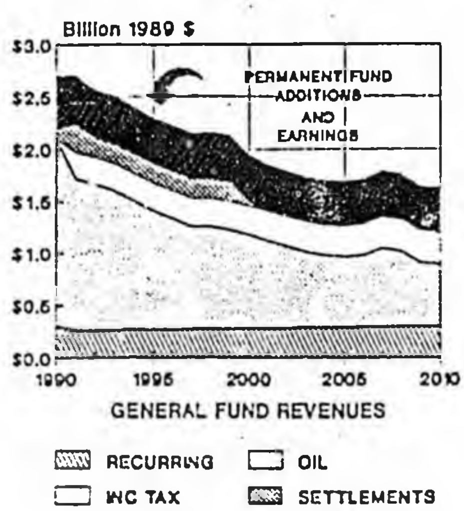
CASE ASSUMPTIONS

- SPENDING: General Fund spending is reduced 2.5% annually (1989$) from 1991 to 2000. (The budget declines to a target of $1.7 billion in 1989$)
- TAXES: Personal income tax reimposed in 1991
- DIVIDEND: Permanent Fund dividend eliminated in 1995
- PERMANENT FUND: Leave Permanent Fund principal intact, continue contributions, spend earnings reserve account. Appropriate real earnings to General Fund. Use inflation proofing to fill revenue gap.
- OIL PRICE (constant across cases): Average ANS Gulf Coast oil price $15 (1989$)
- SETTLEMENTS (constant across cases): $1.7 billion of oil settlements collected and spent over 10 years

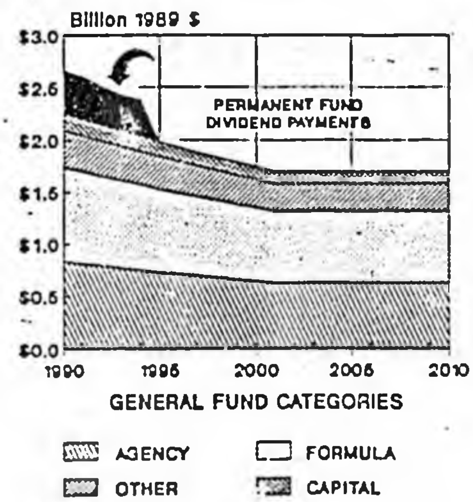
PERMANENT FUND BALANCE



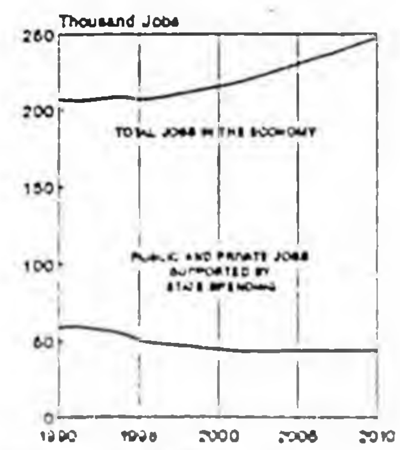
STATE GOVERNMENT REVENUES
(Permanent Fund Included)



STATE GOVERNMENT EXPENDITURES
(Dividend Included)

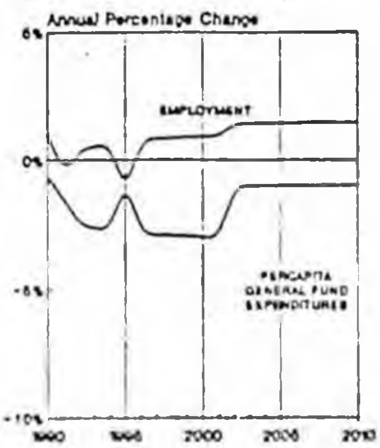


ALASKA EMPLOYMENT



Wage and Salary Employment Only

ECONOMIC WELL-BEING

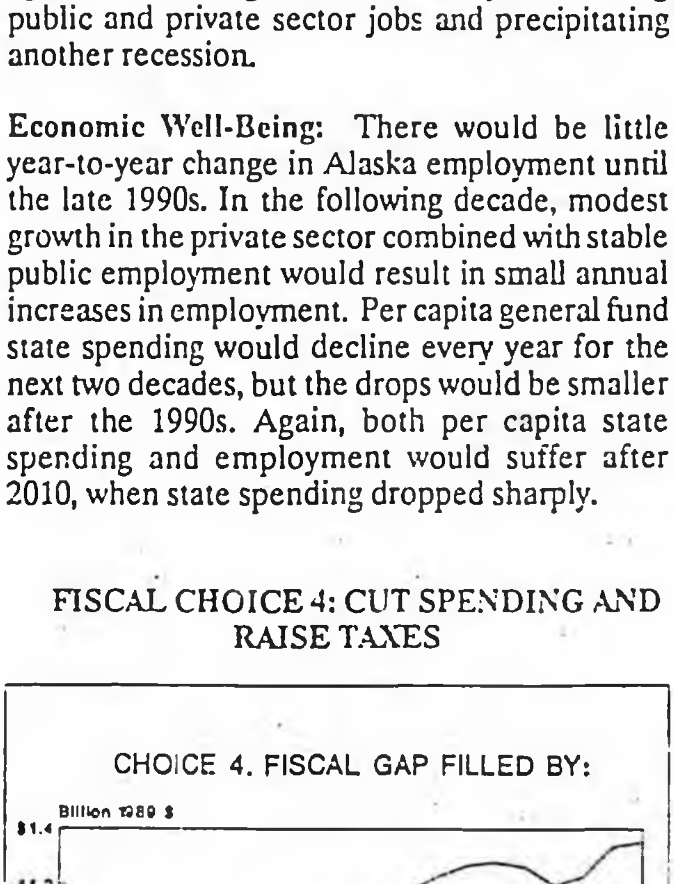


(Text continued from page 6)

Alaska Employment: The number of public and private jobs supported by state spending would suffer gradual attrition throughout most of the 1990s, dropping by about 20,000 over the decade. Private industry would be hard pressed to replace those jobs that had been supported by state spending. Total Alaska employment would stagnate until 1995 and only then begin a gradual increase. However, after 2010, when state spending dropped off very abruptly, a shock wave would again travel throughout the economy, eliminating public and private sector jobs and precipitating another recession.

Economic Well-Being: There would be little year-to-year change in Alaska employment until the late 1990s. In the following decade, modest growth in the private sector combined with stable public employment would result in small annual increases in employment. Per capita general fund state spending would decline every year for the next two decades, but the drops would be smaller after the 1990s. Again, both per capita state spending and employment would suffer after 2010, when state spending dropped sharply.

FISCAL CHOICE 4: CUT SPENDING AND RAISE TAXES



The cumulative budget reductions described in the first three cases, combined with the elimination of the Permanent Fund in the second and third, may be more than Alaskans are willing to endure. An alternative to those kinds of reductions would be for the state government to use new sources of revenues. The most likely sources are a personal income tax and the earnings of the Permanent Fund that now finance the dividend program. Those two together could contribute $650 million annually—$250 million from the income tax and $400 million from the dividend program—to the general fund. In this scenario, we look at what would happen under one possible combination of these two new revenues. We assume the income tax is reimposed in 1991 and that beginning in 1995 the revenues now used to fund the Permanent Fund dividend program are instead used to supplement general fund revenues.

The state would still need to cut the budget, because at the current level of spending the fiscal gap would soon exceed the $650 million generated by these new revenue sources. Furthermore, cutting the budget at the same time new revenues were added would distribute the pain between the taxpayers and the beneficiaries of public spending.

Our analysis suggests that the state is spending $1.2 billion more annually than it can support in the long run, without an income tax ($800 million in general fund spending and $400 million in dividends). If we chose to reimpose the income tax and use the earnings of the Permanent Fund to support public spending, sustainable revenues would increase $650 million annually and $550 million in non-sustainable spending would remain. Thus the general fund budget would need to be cut to $1.7 billion—about a 25 percent reduction. In combination with the revenue generating measures, such a budget cut would eliminate the fiscal gap not only in the 1990s but into the following decades as well—and the Permanent Fund would remain intact.

Depending on when the state receives settlements in tax and other disputes, this scenario might require budget cuts in years of increasing revenues. The state would intentionally collect more than it spent—thus setting aside a small balance of settlement reserves to smooth the transition to a smaller budget. Although that might be a rational decision when we consider the projected revenue decline in the later years, the plan would be tough to justify in the short run, particularly in the presence of fluctuating oil prices. The effects of this fourth scenario are discussed below and shown in the graphs on page 10.

Permanent Fund: The principal of the Permanent Fund would grow slowly through the next two decades, with the addition of revenues from petroleum and withdrawals only of real earnings to fund government. The fund would have a continuing capacity to generate real earnings of $400 million annually that could be used to support public spending. Individual Alaskans would, however, lose their annual dividends in 1995.

Revenues: Even with the addition of new revenues from the income tax, total general fund revenues would still fall under this scenario, because the new taxes would not completely offset lost petroleum revenues. But the drop would not be as dramatic as in the other cases—revenues independent of the Permanent Fund would be $1.5 billion in 2000 and fall to $1.25 billion in 2005. As noted above, the Permanent Fund would produce about $400 million in real earnings annually, some of which could be reinvested in early years.

Expenditures: Annual budget reductions would continue for 10 years, cutting expenditures by 25 percent over the decade. (If the annual rate of inflation averaged 5 percent, then the budget in nominal dollars would be increasing at 2.5 percent in this case.) These cuts would of course reduce the level of government services, but the reductions would be much more gradual than in the other cases we've looked at. After 2000 expenditures could be maintained at the target level indefinitely.

Alaska Employment: About 12,000 public and private jobs supported by general fund spending would disappear as state spending declined. Another 3,000 jobs would be eliminated when the income tax was reimposed and 5,000 more when the dividend program ended. Although the rate of job loss from these government actions over a 10-year period would be gradual, private industry would have to create new jobs at a rate greater than 1.75 percent annually to produce significant total employment growth before 1996.

Economic Well-Being: The economy would contract when the income tax was reimposed, and again when the Permanent Fund dividend was eliminated. Reimposition of the income tax would draw purchasing power out of the private economy. Elimination of the Permanent Fund dividend would shift purchasing power from an activity with a high multiplier to one with a lower multiplier—because the money would be spent not by thousands of individuals but by government. Per capita general fund spending would decline in the 1990s, but the loss would be less than in the other cases. In contrast, per capita discretionary income of Alaskans (not shown on the graph) would fall in this case due to the reimposition of the income tax and the elimination of the dividend.

TRADEOFFS AMONG STRATEGIES

We have described four ways—all of them painful—of dealing with the fiscal gap. In each case the level of public services—both aggregate and per capita—would fall. In each case the private economy would also suffer, since reduced public spending and transfers and increased taxes would mean less buying power. There is no strategy that would close the fiscal gap without creating pain, because the gap can only be filled by taking from somewhere in the economy.

In each case the pain would be distributed among citizens—present and future—in a different way. Those different distributions are the distinguishing features of each strategy. We recognize, of course, that the effects of balancing the budget will vary among individual Alaskans and in different areas of the state. For example, areas where state spending makes up a larger share of economic activity would be harder hit by budget cuts. Similarly, eliminating or reducing Permanent Fund dividends would affect the pocketbooks of low-income Alaskans more than those with higher incomes, while reimposing the personal income tax would have more impact on those with higher incomes. Despite these individual and regional differences, there are broad kinds of tradeoffs all Alaskans will need to consider; some of these are discussed below.

Present vs. Future Public Spending: If we spend less of our petroleum wealth now, more will remain for future needs—our own or those of later generations. Should we discount the needs of the future, because such needs are not easily identifiable or because we think the wealth of future generations is currently underestimated? Or should we weight the needs of the future heavily because new public needs are continually being identified, the population is growing, and we may be overestimating future revenues?

Figure 3 shows state spending levels over the next 20 years under our four choices. All the choices show much lower spending by 2010—but how much we spend along the way varies sharply among the choices. Choice 1 and Choice 2 offer the biggest contrast in spending over the next decade; under Choice 1 we would continue current fiscal policy, using all available reserves except the Permanent Fund; while in Choice 2 we would prop up spending by draining the Permanent Fund. Although spending would obviously be much higher under Choice 2 over the next decade, by 2010 spending under both cases would fall to about the same level—but the Permanent Fund would be gone under Choice 2. Choice 3 also would prop up state spending by using the Permanent Fund, but at a slower rate. Spending under Choice 4 would be highest in 2010—but we would maintain that spending level without drawing on the Permanent Fund principal.

Figure 4 shows how each of our four choices would affect the Permanent Fund, our primary repository of oil wealth. The fund and its earning power would not last long if we opted to use the principal to prop up state spending. In Choice 2, the fund would be used up in 2003; in Choice 3 it would dwindle after the 1990s and be gone by 2015. The fund would increase somewhat under both Choices 1 and 4. But under Choice 1 the fund would be left intact while state spending shrank and the state government and the economy floundered from year to year. Under Choice 4, state spending would be stabilized and the economy would not be jolted by continuing spending cuts over 20 years—but it would be stabilized at the cost of a new personal income tax and the elimination of Permanent Fund dividends.

The most straightforward benefit to the average Alaskan from the Permanent Fund has been the annual dividends paid out of fund earnings. Figure 5 shows how dividend payments would be affected under each of our four choices. Under Choice 1, real dividend payments (in 1989 dollars) to each Alaskan would remain fairly constant over the next 20 years, since population growth would roughly match growth in the amount available for dividends. Under Choice 2, the dividends would shrink over the next decade as the principal of the fund was being drawn down and its earnings reduced; the last dividends would be paid in 2004. The attrition of dividends would be somewhat slower under Choice 3, but the result would be the same: shrinking and then disappearing dividends by 2015. Under Choice 4, the dividend program would end in 1995 and the money that formerly went into that program would be shifted over to the general fund.

To conclude our discussion of spending, we should note that in the past decade the state government has spent part of its oil wealth in ways intended to stimulate future economic growth rather than simply to maintain current programs. Many of these ventures have so far had limited success, and it's outside the scope of this paper to assess their value to the state as investments. But to the extent that the state can use its oil wealth to promote economic growth, that kind of spending should be viewed as investment and distinct from spending that simply creates jobs and income in the present.

Present vs. Future Economic Activity: The Alaska recession that followed the "petrodollar boom" of the early 1980s demonstrated that a large portion of the economic activity stimulated by state spending of oil revenues could be sustained only as long as the flow of oil dollars continued. We can continue to spend oil revenues when we receive them, and immediately receive the benefits of the jobs and income produced by that spending. Alternatively, we can postpone spending some of the revenues and receive the economic benefits at some future time. The choice should depend on when those jobs and income will contribute most to the economy and on what we want to save for future generations. Until we make such a choice, the marketplace—essentially the OPEC cartel and the petroleum production cycle—will continue to dictate the booms and busts of our economy.

Figures 6 and 7 show how the number of jobs supported by state spending—including both public and private jobs—and the total number of jobs in Alaska would vary under our four choices. Under Choice 1, the number of jobs supported by public spending would decline steadily for the next 20 years. Under Choice 2, spending of the Permanent Fund would keep such jobs at about their current level until the fund was exhausted in 2003 – then many jobs would be eliminated quickly, and by 2010 there would be about half as many jobs supported by public spending as there are today. Under Choice 3, which involves more gradual use of the Permanent Fund, the number of jobs created directly and indirectly by state spending would drop somewhat by 2010 – but not shown on the graph is a very sharp drop that would occur after 2010, when the Permanent Fund was depleted. As with the other cases, the number of jobs supported by state spending would also drop under Choice 4, but the decline would be somewhat smaller and the number of such jobs would stabilize after 2000.

How total jobs in the state – including both those supported by public spending and those by private industry – would fare under each of our choices depends largely on the timing of public spending and on whether the Permanent Fund is depleted. We assume in all cases that private industry in Alaska is able to generate new jobs at an average annual rate of 1.75 percent. Under Choice 1, it would take about 10 years for private growth to offset the job loss from reduced public spending. Use of the Permanent Fund would keep the number of jobs growing under Choice 2 – until the fund was used up; then a severe recession would occur. By 2010 Alaska employment would be lowest under Choice 2. Under Choice 3, total jobs would grow slowly but steadily through 2010 – but again, not shown on this graph is a sharp decline in jobs that would happen around 2015. Employment under Choice 4 would be slightly lower than under Choice 3, because in that case spending of the Permanent Fund would not be supporting jobs. However, unlike Choice 3, Choice 4 would not involve a recession in 2015.

Public vs. Private Consumption: How much we are able to consume as a state ultimately depends on the productive capacity of our basic industries – petroleum, seafood, tourism, mining, forest products and federal government spending. The split between public and private consumption does not affect this capacity unless government raises taxes so high that private economic incentives are adversely affected. However, the distribution of the benefits does depend on that split. We have argued that the current rate of consumption can't be sustained (because public spending exceeds sustainable public revenues), but we have not suggested what the proper balance is between public and private consumption. Is public consumption in Alaska too large because of historical accident and because the only constraint on public spending seems to have been the availability of revenues? Or should we increase public consumption relative to private consumption to meet the continuing growth in those needs best served through public action? Do we need a large public sector to balance the dominant economic influence of a single commodity? Or does high public consumption hamper diversification in the private sector?

Gradual vs. Abrupt Transition: A gradual transition to a sustainable level of public spending would allow both the public and private sectors to adjust in ways that would minimize the pain from the loss of public services, income, and employment. At the same time, a gradual transition would be very difficult to manage politically and would have a lasting negative psychological effect on the state and population. A quick transition would not leave much time for adjustments and would cause some inefficiencies as public agencies, businesses, and individuals reorganized in the wake of budget cuts. On the other hand, the detrimental psychological effects would be short-lived.

Figure 8 shows the different rates of spending cuts under the four cases. The most drastic would be Choice 2, where state spending would drop by more than half shortly after 2000. Choice 1 would see sharp cuts in the early 1990s and then a continual downward drift for the next 20 years. Choice 3 would result in a fairly stiff drop in the early 1990s followed by relatively stable state spending through 2010 – but then another sharp cut in the next decade. Under Choice 4 we'd see small but steady decreases throughout the 1990s but a leveling off after that.

Public vs. Private Economic Activity: Delivering public services requires hiring public employees – teachers, construction workers, office workers – and indirectly generates private employment. Delivering private goods and services requires hiring private employees – clerks, construction workers, office workers. Is the mix

Comparisons Across Fiscal Choices

Figure 3

STATE GENERAL FUND EXPENDITURES

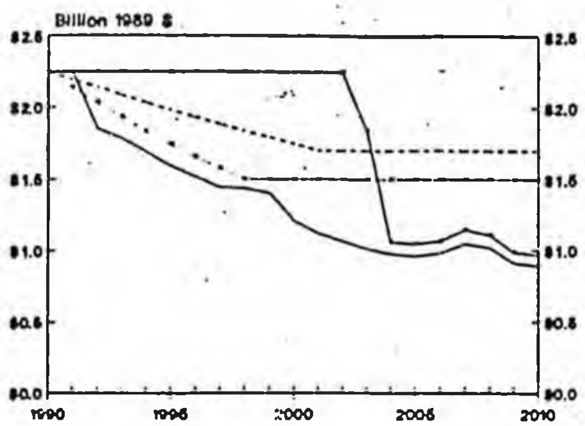


Figure 4

PERMANENT FUND BALANCE

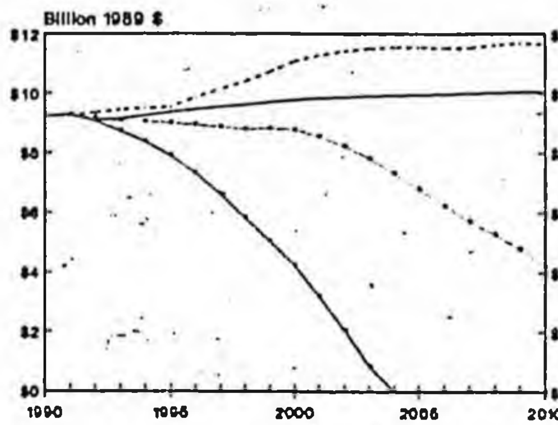


Figure 5

PERMANENT FUND DIVIDEND

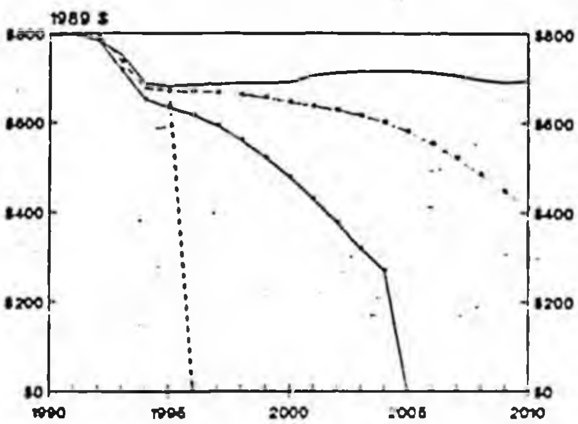


Figure 6

STATE SUPPORTED EMPLOYMENT

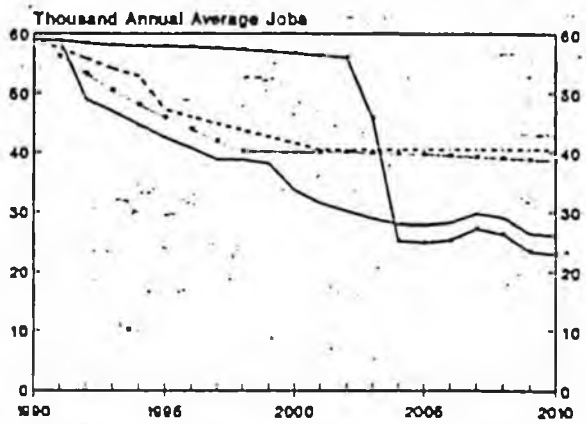


Figure 7

ALASKA WAGE AND SALARY EMPLOYMENT

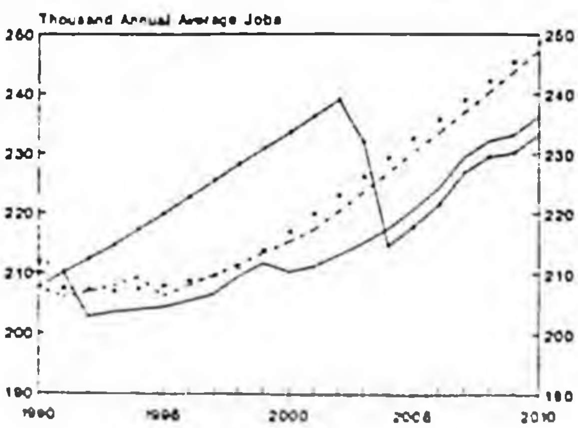
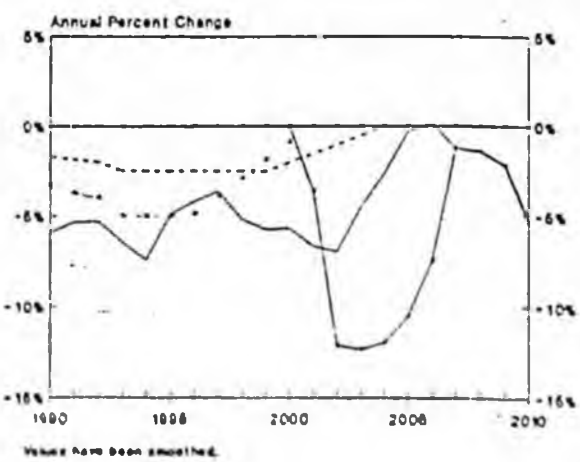


Figure 8

GENERAL FUND SPENDING: YEARLY CHANGE



SCENARIO

1 STUMBLE ALONG — 2 USE PERMANENT FUND

3 BUDGET FREEZE — 4 BUDGET CUT & TAXES

of public and private jobs in the economy an important consideration, independent of the mix of goods and services provided?

It would be if the economic multiplier—the capacity of one job to create other jobs—were significantly different for public and private jobs. However, there doesn't seem to be a significant difference between the multiplier effects of public and private jobs, since most of the multiplier effect in the Alaska economy comes from the successive re-spending of income earned as wages and salaries, independent of who writes the checks.

CONCLUSION: A CALL FOR ACTION

These cases show some of the consequences of four different choices for closing the fiscal gap facing Alaska. As we noted at the outset, we have not assessed the political difficulties of putting budget changes into effect—but of course we recognize that enormous difficulties will accompany any such plan. Further, we don't know whether the assumptions we've used in this analysis will turn out to be accurate. But whether the price of oil is higher or lower than we've assumed, or other circumstances are somewhat different than we project, Alaska faces a serious fiscal problem. Despite the uncertainties always inherent in planning for the future, this analysis suggests positive action is warranted—and the sooner it is taken the better.

Differences among the four choices demonstrate that we can influence outcomes and change tradeoffs through public choices. For example, we can choose whether the Permanent Fund will be a lasting asset, throwing off income for future generations of Alaskans, or whether we will spend it to get ourselves through the next decade without sacrifice. We can decide on the mix of current versus future spending, total public versus private spending, and when to take the inevitable hit on the economy. With advance warning, we have an opportunity to plan spending reductions in an orderly fashion.

It is clear that what actions to take are political rather than economic decisions. Nonetheless, each decision will have significant economic consequences. Policymakers need information about the implications of different choices to make informed political decisions. Future issues of this series will seek to enlarge the scope of public information to help in this important public debate.

ISER Fiscal Policy Papers
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FISCAL NOTE

STATE OF ALASKA
1992 LEGISLATIVE SESSION

BILL NO. HJR 4

Revision Date: 01/13/92
Title: Amendment to the Constitution RE: Capitol Projects/Expenditure Limit
Sponsor: Representative R. Phillips
Requestor: House State Affairs

Department Affected: Office of the Governor-Elections
BRU: Division of Elections
Component: II-Primary and General Elections

COMPONENT SERIAL NO. 0 0 2 2

Expenditures/Revenues: (Thousands of Dollars)

OPERATING	FY 93	FY 94	FY 95	FY 96	FY 97	FY 98
PERSONAL SERVICES	0	0	0	0	0	0
TRAVEL	0	0	0	0	0	0
CONTRACTUAL	2.2*	0	0	0	0	0
SUPPLIES	0	0	0	0	0	0
EQUIPMENT	0	0	0	0	0	0
LAND & STRUCTURES	0	0	0	0	0	0
GRANTS, CLAIMS	0	0	0	0	0	0
MISCELLANEOUS	0	0	0	0	0	0
TOTAL OPERATING	2.2*	0	0	0	0	0
CAPITAL	0	0	0	0	0	0
REVENUE FUND SOURCE:	0	0	0	0	0	0

FUNDING: (Thousands of Dollars)

GENERAL FUND	2.2*	0	0	0	0	0
FEDERAL FUNDS	0	0	0	0	0	0
OTHER FUND SOURCE:	0	0	0	0	0	0
TOTAL	2.2*	0	0	0	0	0

POSITIONS:

FULL-TIME	0	0	0	0	0	0
PART-TIME	0	0	0	0	0	0
TEMPORARY	0	0	0	0	0	0

Estimate of current year impact: 0

ANALYSIS: (Attach a separate page if necessary.) * This figure covers cost of inclusion of information about this issue in the Official Elections Pamphlet as required by AS 15.58, and programming for DataVote counting of votes cast on this measure. However, only 4 measures can be printed on a single ballot card. Should this measure require printing an additional ballot card, the fiscal impact would be: 53.4.

Prepared by: Elizabeth Ziegler, Deputy Director
Division: Elections
Phone: 465-4611
Date: 01/13/92

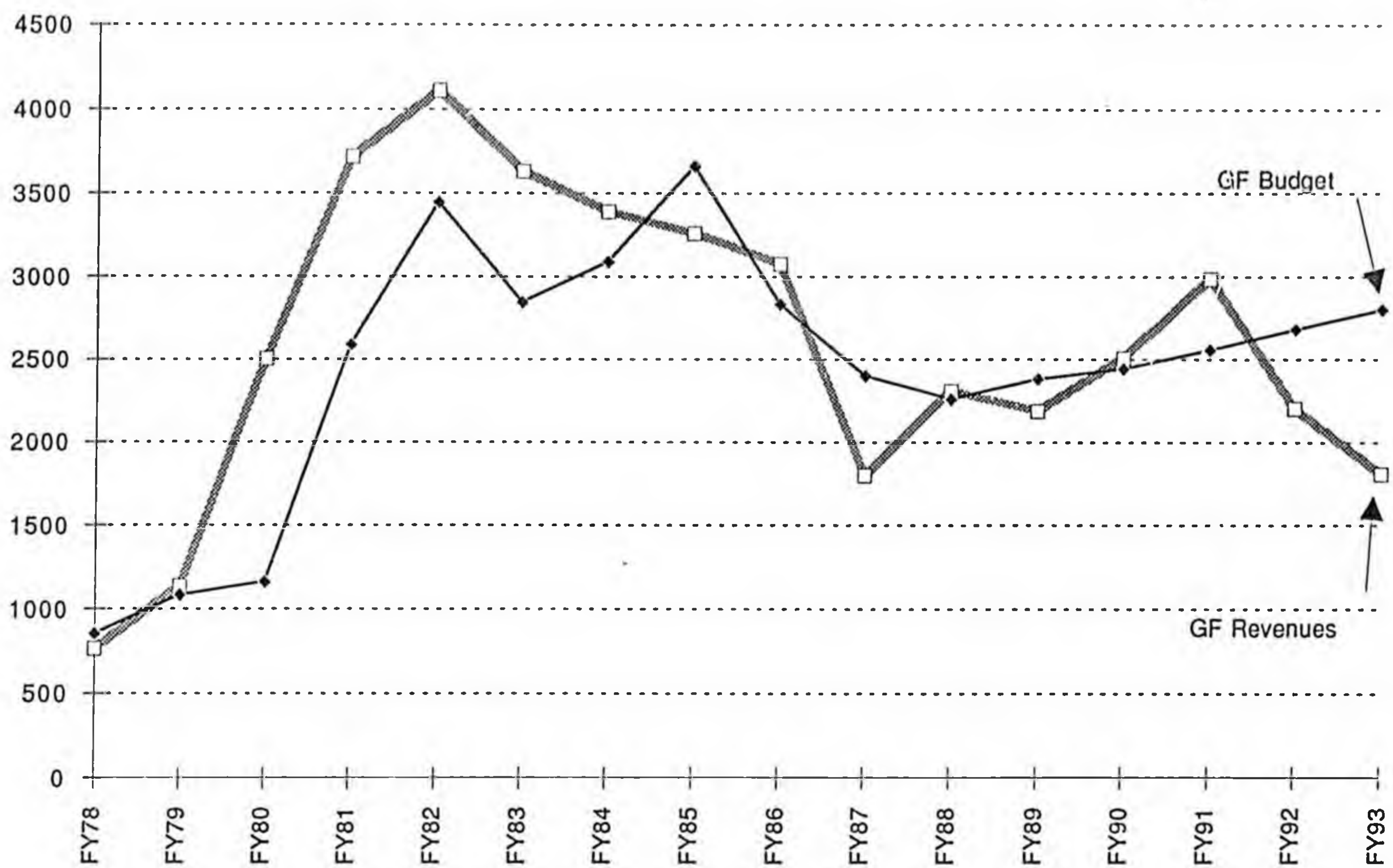
Approved by Commissioner: Charlotte E. Thickstun
Agency: Office of the Governor
Date: 01-13-92

Distribution (by preparer): Leg. Fin., Legislative Sponsor, Requestor, OMB/DBR, Gov. Legis. Ofc., & Impacted Agency(ies).

Rev 10/07/91
HJR4.FN2

FISCAL NOTE

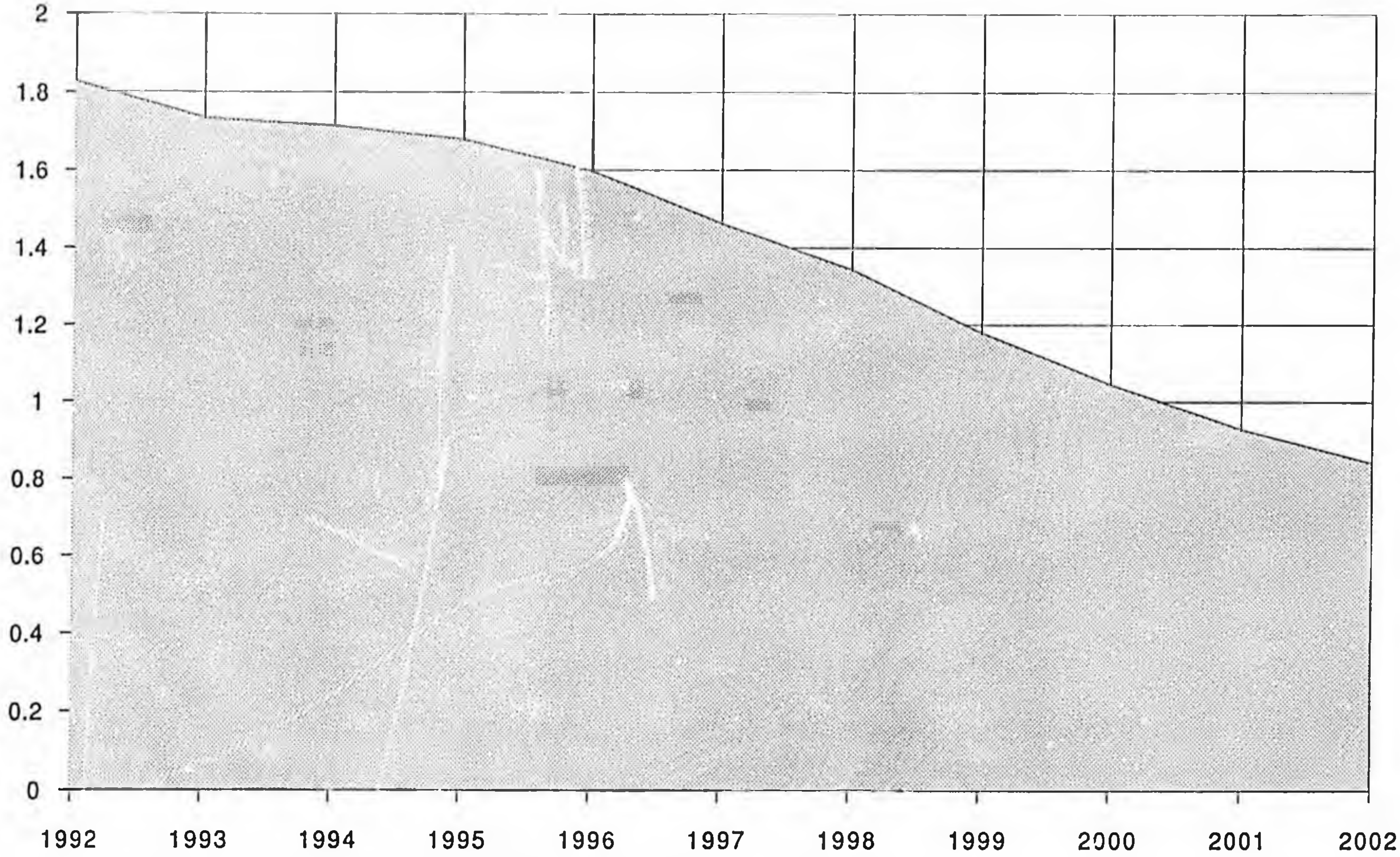
GF Revenues vs GF Budget, FY78-FY92 in millions of dollars



Rep. Randy Phillips, 2/20/92

BACKUP

Oil Production in Alaska, FY 1992-FY 2002, millions of barrels per day



Production estimates from the Alaska Department of Revenue, Fall 1991 revenue forecast, midcase projections.

Rep. R. Phillips, 2/20/92

THE FISCAL GAP: FICTION OR REALITY ?

by
SCOTT GOLDSMITH
PROFESSOR OF ECONOMICS
UNIVERSITY OF ALASKA ANCHORAGE

After preparing my remarks for today I realized a better title than Fiscal Gap: Fiction or Reality would have been FISCAL GAP: FACT OR FANTASY ? When we enter the Alaska fiscal world we enter a world of fantasy. Those of us who have lived through the oil boom years know what I mean. Those who have not experienced it will never really comprehend what happened. Events are now forcing us back into the real world, but who wants that? I have tried to pepper my remarks with some glimpses of that reality because, I guess, somebody has to do it. But take heart--reality is not that bad.

To begin we need a definition of the fiscal gap notion. Most simply put it is the question of whether our state government is spending beyond its means. Concern naturally springs from the recognition that 85% of our revenues come from the production of oil, and as anticipated, after a dozen years at record levels, depletion of the main North Slope field has set in. Our tax base is literally being shipped south at the rate of nearly 2 million barrels per day.

I am going to tip my hand right now and confess that for an economist a question like this has at least 4 answers. But before I share them with you lets quickly review the last two years of public consciousness raising on this issue.

We introduced the idea of the fiscal gap to a broad audience in August 1989 with the publication of our first Fiscal Policy Paper. In it we projected a $400 million gap by 1992 growing to $1 billion by 2000 under a scenario aptly entitled "Stumble from Year to Year". Five subsequent papers have fleshed out the basic idea. These publications have reached a broad audience, stimulated a great deal of interest and some discussion, but have had only questionable influence on public policy.

I am aware of only 2 challenges to our analysis. Both claim that we have underestimated the petroleum revenues the state will receive during this and the next decade--either through some myopia of vision or some ulterior motive. Let me quickly dispense with these challenges so that we can move ahead to the main topic for today.

The first is that the forecasted decline in petroleum production will not become significant for a long, long time. This is because the official forecasts are based on initial reserve estimates and don't consider the typical subsequent upward revisions. This challenge is buttressed by the fact that the Alaska Department of Revenue has recently boosted their projections of estimated production through the 1990s by about 150 thousand barrels per day. Furthermore when the final numbers are tallied production for 1991 will probably come in a bit higher than 1990.

The upward revision in the forecast, if it pans out, is certainly good news. But the fact is that production peaked in 1988 and has trended down since. By 1990 it was off the peak by 12%. As with most economic processes it is hard to identify the turning point until after the fact, especially for those hoping for continued growth. President Bush was the last to admit the nation was in a recession.

Aggregate oil production is down because we are not replacing the Prudhoe oil with new production from other fields. The average productivity of the five North Slope fields brought on line since Prudhoe is just 7 percent of this super giant. The current forecast says we will be sending only half our current production level out of Valdez in 2000 and only a fourth by late in the next decade.

But we know there is still lots of oil on the slope that technically could be produced and that there are undoubtedly other fields that have not been discovered. That production could ultimately replace today's depleting reserves. Even if that were to happen, the fact is that the replacement production is coming from marginal fields where the tax base per barrel of oil produced is much smaller than todays average. The average well in the Prudhoe field produces over 2,500 barrels per day. The average productivity in the marginal fields is in the range of 200 barrels per day. There seems no escaping the conclusion that the decline in this tax base is real and will continue. The only uncertainty is its rate.

The second challenge has been the notion that an increasing price of oil would offset declining production thus maintaining the value of oil production. This challenge is buttressed by the fact that the average price of oil has, up until now at least, been higher than we assumed in our 1989 analysis.

But high oil price means something different today than it did 10 years ago. If we ignore the 6 months during the Iraqi crisis, the 6 year average price for ANS delivered to the Gulf Coast in today's dollars has been a not very earth shaking $17.20. And today, in spite of the absence from the market of Kuwait and Iraq, two of the biggest OPEC producers, it is about $16. The price of oil is in perpetual motion but it lacks direction. In particular it is difficult to see the 7 percent annual growth in the price of oil, after inflation, necessary to offset a 7 percent decline rate in production.

Interestingly, we have not been challenged on our assumption that government spending would continue to increase in our "Stumble from Year to Year" scenario. In fact our assumption that the general fund budget would increase no faster than the rate of inflation from a base of $2.3 billion in 1989 lacked imagination. This year we are spending $2.8 billion.

If we combine the higher than anticipated budget levels with the higher than anticipated production and oil price we find state finances in 1992 just about where we had projected. Revenues are in short supply. Why should the precariousness of the state budget concern us. There are 3 reasons.

1--We all benefit from government services and want to make sure our government gives higher priority to needs than luxuries.

2--The economy is addicted to state spending. One in three jobs statewide can be traced to the state budget. When Juneau sneezes the economy gets a cold.

3--Economic development has an aversion to uncertainty. Potential developers trying to guess how Alaska will deal with the loss of petroleum revenues may be scared away by some of the solutions they might imagine.

Let us turn now to answer my question.

IS THERE A FISCAL GAP? ANSWER #1. NO. THERE IS PLENTY OF MONEY IN THE GENERAL FUND.

There is plenty of money in the state general fund to pay for the current year, FY 1992, budget of $2.8 billion.

Furthermore there is plenty of money in special accounts, in relatively liquid assets, and hidden under assorted rocks to make up any shortfall in the budget for FY 1993, the year after, and perhaps beyond.

The list of these special pots of money includes (in one possible order of political ease of raiding):
the statutory budget reserve

the Railbelt energy fund
the Exxon oilspill settlement money
the constitutional budget reserve
the earnings reserve of the Permanent Fund
the assets of AHFC and other state corporations
settlement proceeds of disputed oil tax and royalty payments

I am 95% convinced that we will spend our way through all of these without taking our foot off the gas. In my mind worse than the fact that this approach amounts to liquidation of assets to pay the operating expenses of government is the wringing of hands and a moaning and groaning that will emanate from Juneau as it happens. We will hear all about the shaky state fiscal condition, the need for constraint, and the tough decisions to be made.

But what message will really be sent to the average citizen who will judge not by what is said, but by what is done ? The message will be that there is no problem. The noise is there merely for political or tactical reasons. Perhaps it is to pay lip service to the notion of fiscal responsibility for the sake of organizations such as Common Sense, or perhaps it is to ease the pain for the few unfortunates whose pet projects must be sacrificed.

But what are we really doing here. The current year revenues may be as much as $2.4 billion, if the price of oil bounces back in the spring as it typically does, but as I have already mentioned we are spending $2.8 billion. The amazing thing is that we actually planned to spend more than we collected, and furthermore we are planning to do the same thing next fiscal year.

The logical consequence of this strategy is that when all other assets have been liquidated we break into the corpus of the Permanent Fund--not of course by a direct assault, but by the back door, thru a redefinition of investment policy and criteria.

Incredible as it may seem even with $2.8 billion in spending we are having a hard time scrapping together the cash to pay for the basics--police and fire protection, roads, schools. Anchorage's difficulties in coming up with the money for these valid public services are being played out in communities across the state.

IS THERE A FISCAL GAP? ANSWER #2. YES. WE CAN'T AFFORD TO PAY FOR THE BASICS OF GOVERNMENT.

To find out why we need look no further than 2 popular state transfer programs.

The first is municipal assistance, one of the main sources of money for local governments to pay for basic services. Appropriations for this program have been shrinking at the same time that inflation has been driving up costs and population growth has been increasing needs. In fact the appropriation to this program has declined 40 percent between 1986 and 1991. Anchorage and other communities have responded by tightening their belts.

The second is the Longevity Bonus Program, which pays a cash transfer to all residents over 65. Appropriations for this program have been increasing in response to growth in the over 65 population. Curiously the growth rate for this segment of the population surpassed all others in the last decade. Appropriations increased 25 percent between 1986 and 1991. In 1986 its appropriation was half as large as municipal assistance. Today it is considerably larger.

You might think that the over 65 population has benefited from expansion of this program until I remind you that the payment does not increase with inflation. Even as the total appropriation grows the value of the payment continuously erodes. If current trends continue in 10 years we will be spending twice as much and each recipient will be receiving a payment worth half of today's. I have a hard time understanding how this scheme best serves the needs of our over 65 population.

And what does the juxtaposition of these two transfer programs demonstrate? That our method of budget making is producing a perverted result. In this example we are squeezing out needs in favor of a poorly targeted program with screwy incentives. We give a subsidy to anyone over the age of 65 for living in the state, regardless of need or worth, while at the same time cutting funding for those local government services that make our communities livable for these very same residents.

Up to this point I have been discussing very recent events, but if we look at what has happened since the mid 1970s then we get the third answer to my question.

IS THERE A FISCAL GAP? ANSWER #3. WE HAVE HAD A FISCAL GAP SINCE THE EARLY 1980s.

Not only are we selling off our assets today, we have been living beyond our means since we started draining the Prudhoe field. All through the 1980s as the oil and dollars flowed we were reinvesting, but only a small portion of the proceeds of our asset sales. By one estimate we were selling off $1 billion a year in assets. In 1977 our primary asset was our ownership share in Prudhoe Bay. Today our primary assets consist of our ownership share of the much smaller pool of oil still remaining at Prudhoe and the Permanent Fund. The combined value of these two is much less than was the value of our share of oil in the ground alone in 1977.

Over the years we have consumed a lot of money under the pretext of investing, but lets face it, when it comes to business type investments the government has a real knack for taxing the winners to invest in the losers. This has not contributed significantly to the asset base of the state.

But lets not dwell on opportunities foregone. When you compare our performance with that of our friends in OPEC and elsewhere who also enjoyed oil windfalls, our $12 billion Permanent Fund attests to the fact we have done better than most in maintaining our wealth.

Let's take stock of where we are today and look forward. What I see brings me full circle back to my first answer to the fiscal gap question.

IS THERE A FISCAL GAP. ANSWER #4. NO. WHAT WE HAVE IS A FORTITUDE GAP.

We HAVE the resources to restore balance to our fiscal affairs. The question is whether we want it badly enough to make it happen.

I doubt if there is a state in the union that would not trade their own fiscal problems, compounded by the recession, for our own. Our tax base and public resources are more than sufficient to provide for our needs. So why do we feel so bad?

I think its because we carry with us the legacy of the fantasy time of the 1980s in Alaska when the normal rules governing public sector behavior did not apply. During the decade of the 1980s the state had $48 billion at its disposal--and we rose to the challenge of disposing of the $100 thousand allotted to each of us.

In fact there was so much money in the 1980s that no one even noticed when we blew $2 billion. Not surprisingly $48 billion attracted a few folks from Outside. We set them up with houses, schools with teachers, the PF Dividend and all the other accoutrements of the good life in the Great Land. But when the state budget stopped growing we pulled the rug out from under a lot of those folks, and there was a mass outmigration. The bill for those short timers was $2 billion. $2 billion we would have saved if we had not created our own boom-bust cycle with petrodollars.

An example of this sense of fantasy occured to me as I listened to the President of AMAX earlier this week describe their $150 million purchase of the Fort Knox gold mine outside Fairbanks. Everyone in the audience understood that this was big-time and real money. Today were are talking nonchalantly about billions, rather than millions, and yet I don't think any of us, with the exception of those of you in the oil business, sense these billions to be real money.

In spite of longing for the good old days, the typical Alaska household continues to receive more in cash from state and local government than it pays in taxes. A measure of how we compare to our neighbors Outside is the $500 million that the application of national average tax rates applied to our households would generate in a year.

On hearing this some Alaskans argue they are already quite heavily taxed because the taxes and royalties paid by the oil companies are really coming out of their pockets since the oil is owned by the people of the state. Any non-Alaskan would find this reasoning preposterous. Future generations of Alaskans have as much right to that oil as the current generation and will not look kindly on those of us ready selfishly to claim their inheritance for ourselves. The oil wealth is ours, but ours as a group, not as individuals.

The truth is the government is paying us to consume its services. Shouldn't this state of affairs embarrass us at least a little? And this has persisted long enough that we now have a whole new generation of Alaskans brought up to believe that it is their birthright to be getting something for nothing from the state. Ask any kid what the justification is for the state sending him a check for $1000. I've asked a few and 9 out of 10 say they "deserve it".

Looking at the budget are we really so needy that we can justify the state spending 3 times the national average, after inflation, on each of us. Of our $2.8 billion budget 4 things are clear:

1. Some spending is unique to Alaska. Some is justified based on small population, low population density, resource stewardship and so on. Some unique programs are luxuries. A simple rule of thumb to identify possible luxuries would be to look at new and transformed programs since in the 60s and early 70s when we were spending a more modest double the national average.

2. We pay more than necessary for a lot of our public goods and services. I believe labor falls in that category. Our average wage bill per employee is 25% above the national average after a generous COLA adjustment. This statement could be true even if no single individual is overpaid, in fact it could be true even if each were underpaid. We might just have too many underpaid high salaried managers and not enough underpaid low salaried workers.

Incidently, this comparison is based on a COLA that ignores the fact that every Alaska worker, private as well as public, gets a residence subsidy in the form of the Permanent Fund Dividend. This is a partial offset to COLA.

3. Service delivery is not always by the most cost effective means. We have been willing to pay extra in order to further other public objectives in the delivery of public services. These include most obviously local control and equality of service regardless of location.

4. Assistance programs are not targeted to those with a need. We have been loath to distinguish the truly needy. A large part of each dollar spent on assistance programs ends up being simply a transfer payment without justification.

If we were serious about controlling the budget, these would be some of the most promising areas to look for savings. Over time a 10% reduction could be engineered with a minimum impact on the quality of service delivery for genuine needs. Spending would still be close to 3 times the national average.

Some combination of budget reductions and contributions from households to support government services would give us a combination of higher public service levels at lower cost to residents than any other state. It would be a big first step in the direction of bequeathing a sustainable public sector to the next generation of Alaskans. The potential is there and the goal is achievable.

How do we get from here to there? It is not going to happen under the current system for reasons that should now be obvious. We are wishing against human nature.

As long as the government is paying us to consume services it should be no surprise that we will demand the maximum while at the same time piously decrying the fiscal irresponsibility of it all. It is naive to continue to think that if we only had rational decision makers who listened to the voters they would trim the budget and adopt a plan of action just as any family or business would if faced with falling revenues.

It will not happen because our collective state financial resources suffer from the "tragedy of the commons". What rational individual or legislator would willingly step forward and volunteer his favorite programs for the budget ax in the full knowledge that the savings would end up funding some other less deserving, or positively wacko, program?

Under current conditions nothing short of a crash in revenues is going to force us to start the process of balancing our public needs and resources. Rational argument won't. The prospect of appropriating $400 million more than projected revenues won't. The prospect of liquidating our assets won't.

Short of a crash I see only 2 changes to our system that could instill discipline into our fiscal affairs. The first is to get all the money off the table. This won't happen as long as there is free money in accounts under rocks in Juneau that can be tapped. The second is to employ the incentive device that guides our free market system--prices. If public services had a price attached in the form of a tax, people would sit right up and take notice of how public funds were being spent. I think a price of even 5 cents on the dollar would create a significant "price effect" as taxpayers discovered lots of spending that was not even worth 5 percent of the cost.

I don't relish paying taxes and would not suggest such a course of action in the absence of a guarantee of constraint on the size of the budget. But with adequate assurance that government would deliver restraint I would be willing to buy some. I would accept taxation to purchase some fiscal constraint, knowing that others were also paying their share.

Perhaps a compromise could be packaged in which taxpayers would trade $1 in support of government for each $1 reduction in the size of the budget from a base level. Perhaps some other scheme would work.

But I am convinced that if we are unwilling to commit to discipline ourselves, it is wishful thinking to believe that others will willingly sacrifice for the common good. The goal is attainable but if we cannot find the means to act together to move toward it we will not act at all. This finally is the reality of the fiscal gap.

INITIAL REPORT

of the

HOUSE FINANCE FISCAL POLICY SUBCOMMITTEE

prepared by:

Representative Kay Brown, Chair
Representative C.E. Swackhammer
Representative Steve Rieger

February 7, 1989

Table of Contents

OVERVIEW OF SUBCOMMITTEE WORK

The House Finance Fiscal Policy Subcommittee has been meeting since early in the session to address issues arising from the state's critical financial circumstances. This initial report summarizes the Subcommittee's work to date, including the development of potential budget reduction scenarios, an approach for identifying specific cuts, and information about alternative revenue options. The Subcommittee also has initiated a bi-partisan public information effort.

Subcommittee members are Reps. Brown, Swackhammer, and Rieger. The informal fiscal policy working group includes Reps. Larson, Hoffman, Ulmer, Boucher, Cotten, Koponen, Boyer, Goll, Davidson, Navarre, Grussendorf, Davis, Leman, and Miller.

SUBCOMMITTEE RECOMMENDATIONS*

- Enact a balanced budget that delivers essential public services and meets constitutional responsibilities.

- Adopt a long-range fiscal plan that reduces spending, increases revenues, or both, to bring the budget to a level that can be sustained with recurring revenues.

- Reduce General Fund spending in the range of $150 to $175 million in FY90, and continue reductions over the next three years. To minimize impacts on resident jobs and the economy, make reductions over several years.

- Spread use of reserve funds over several years.

- Expeditiously review revenue options so that they can be considered along with the budget cuts.

- Make reductions to entitlements, personal services (salaries /benefits), and non-essential programs; cut costs of essential programs through efficiency improvements and reorganization.

- Do not rely excessively on uncertain litigation revenue.

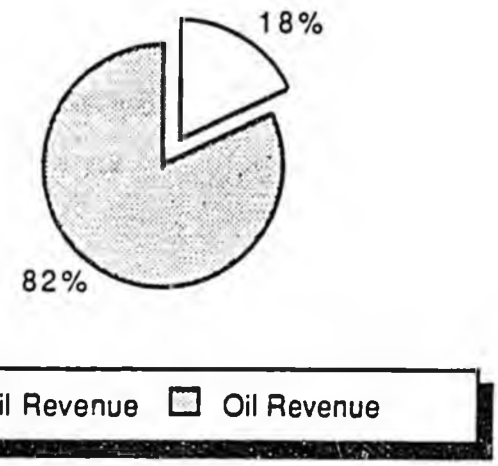
* These points reflect a consensus of the three Subcommittee members. However, several members of the working group felt it was premature to select a specific level of reduction at this time.

THE PROBLEM

In Fiscal Year 1989 petroleum revenues will be about 82% of state general fund revenues. Alaska's dependence on oil was underscored in 1986 when the world price of oil collapsed and state general fund revenues dropped by about 40%.

Figure 1

GENERAL FUND
PETROLEUM VS. NON-PETROLEUM REVENUES
Fiscal Year 1989



Source: Legislative Finance Division

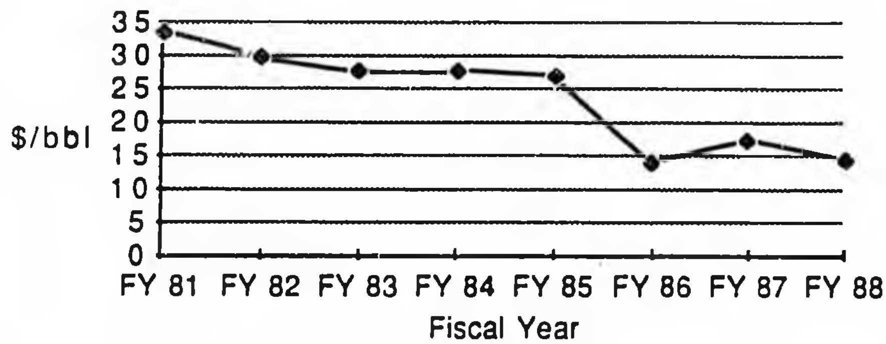
Although the world price of oil appears to have stabilized recently, price fluctuations integrally affect the state's financial status. Moreover, the state faces a significant decline in oil revenues because production of oil from the huge North Slope fields will decrease substantially during the 1990s. As we move down the slope of the Prudhoe production curve, the gap between spending and income will widen unless action is taken to reduce spending and/or raise revenues.

The graphic presentations on the following pages illustrate the problem.

The decline in state petroleum revenues is attributable to a combination of factors, including the drop in world oil prices as shown in Figure 2.

Figure 2

ALASKA NORTH SLOPE CRUDE OIL
at the U.S. Gulf
Fiscal Year 1981 - 1988
(dollars per barrel)

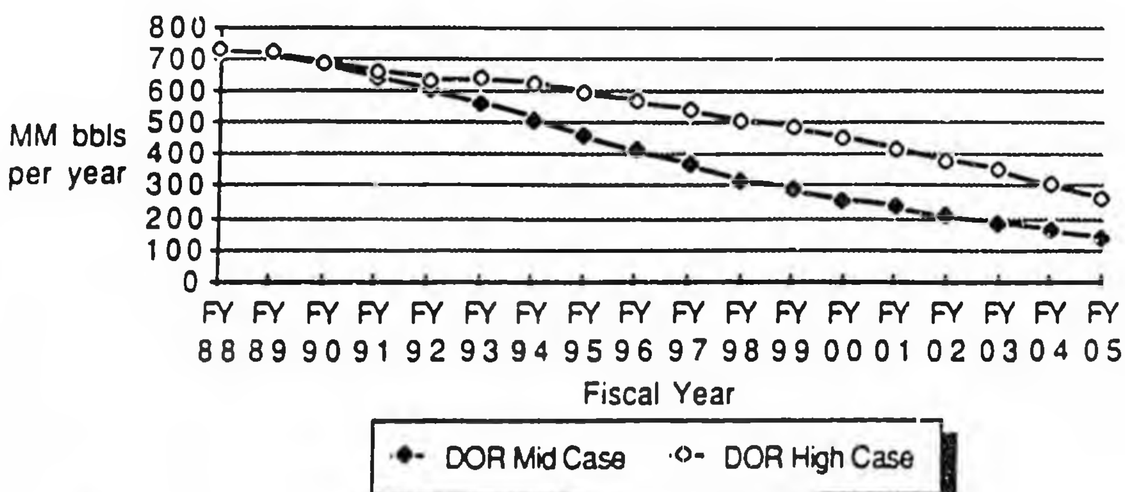


Source: Department of Revenue

Also, the state's total oil production is projected to decline substantially throughout the remainder of the century.

Figure 3

PROJECTED ALASKA OIL PRODUCTION
Fiscal Year 1988 - 2005
(millions bbls/year)

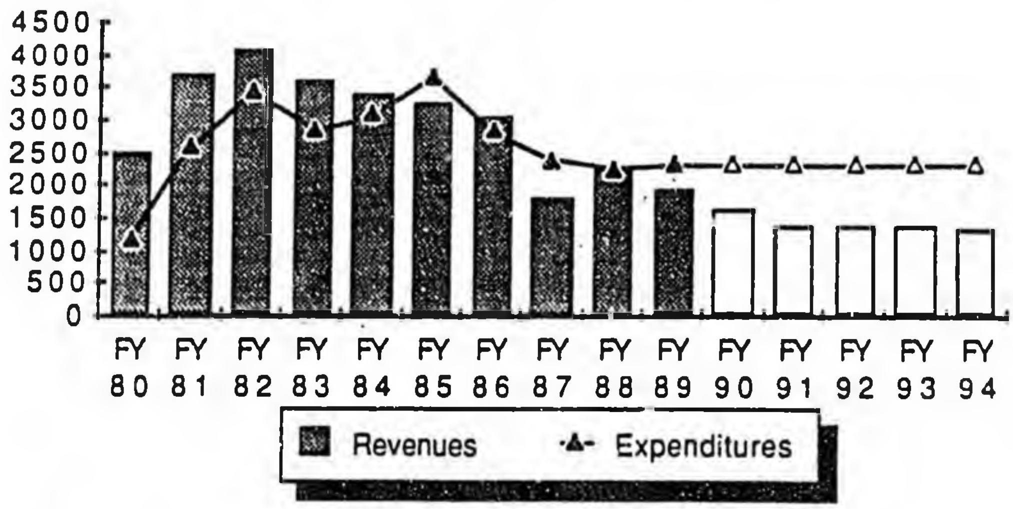


Source: Department of Revenue

As illustrated by Figure 4, thể state is confronted by a substantial "gap" between projected state revenues and the level of revenue that would be required to maintain the state budget at current (FY 89) levels.

Figure 4

REVENUES AND EXPENDITURES
Unrestricted General Funds
Fiscal Year 1980 - 1994
(millions $)



Source: Department of Revenue and Legislative Finance Division

POSSIBLE SOLUTIONS

REDUCE SPENDING

Two major approaches to reduce spending have been suggested:

• Reduce all spending (or categories of spending) by a set percentage (across-the-board cuts); and

• Reduce individual programs based on objective and subjective criteria.

The Subcommittee suggests the following framework for consideration of budget reductions:

- Evaluate policy issues;
- Identify essential state functions;
- Improve efficiencies of service delivery and administration (consolidation, reorganization);
- Make cuts fairly with respect to regions of the state; and
- Minimize adverse impacts on the Alaska economy.

Criteria for evaluation of individual programs in the Finance Subcommittee process:

- Law:
  - Constitution
  - Statutes
  - Court order or settlement (e.g., Cleary decision)
  - Federal requirements
- Tradition:
  - Life, health, safety
  - Existed prior to statehood
  - Existed prior to FY80 (oil revenue spike)
- Appropriate level of responsibility:
  - Federal/state/local/private
  - Individual initiative v. government action
- Cost/benefit:
  - Consequences of discontinuation or reduction
  - Who is affected?
  - Ability to be self-sustaining through user fees

Ability to generate surplus income

Administrative overhead burden

- Administrative/organizational characteristics:

Candidate for consolidation/reorganization due to:

Overlapping responsibilities

Duplication of effort

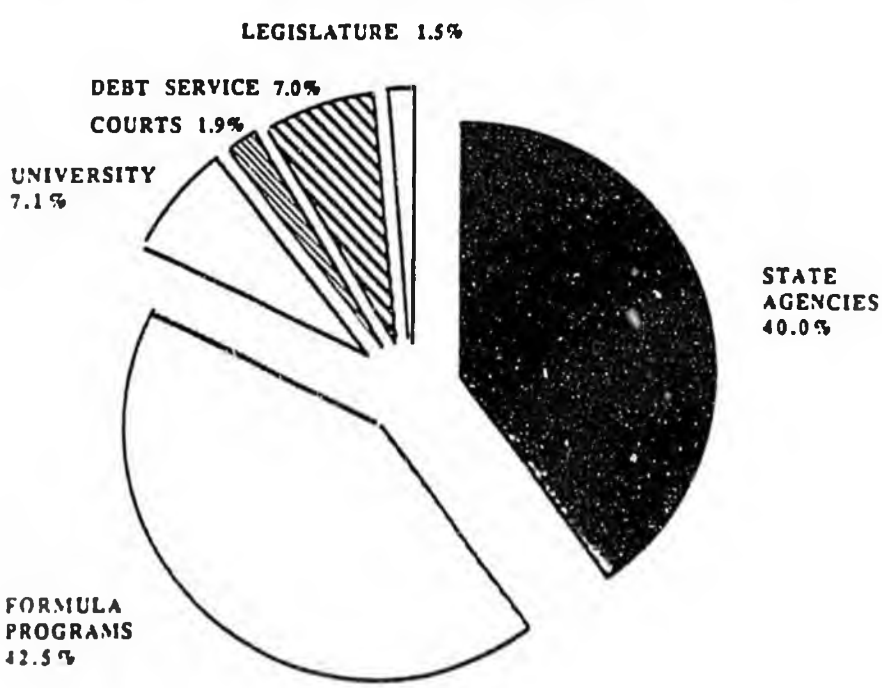
Organizational misfit

Decline in demand for services

Spending Analysis

The following graphic illustrations provide a variety of perspectives on state spending.

Figure 5
GENERAL FUND OPERATING BUDGET CATEGORIES
Fiscal Year 1989
($2,129.7 million)

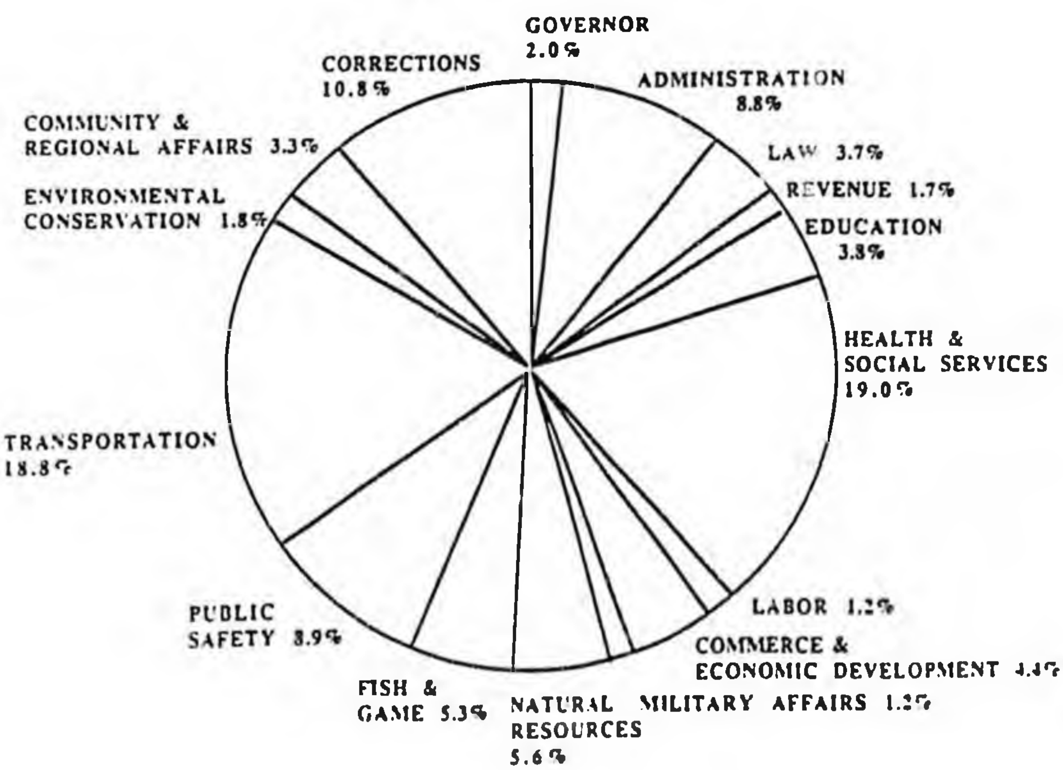


Source: Legislative Finance Division

As shown by Figure 5, about 58% of FY1989 general fund operating budget appropriations went to support executive operations, the legislature, court system, university and debt service. About 42% of the budget was used to pay for formula-funded grants, direct benefit payments and other "pass through" programs (eg, payments to school districts, Longevity Bonus, low income assistance programs, Municipal Assistance and Revenue Sharing).

As shown by Figure 6, state agency expenditures for executive operations in FY 89 totaled $854.8 million.

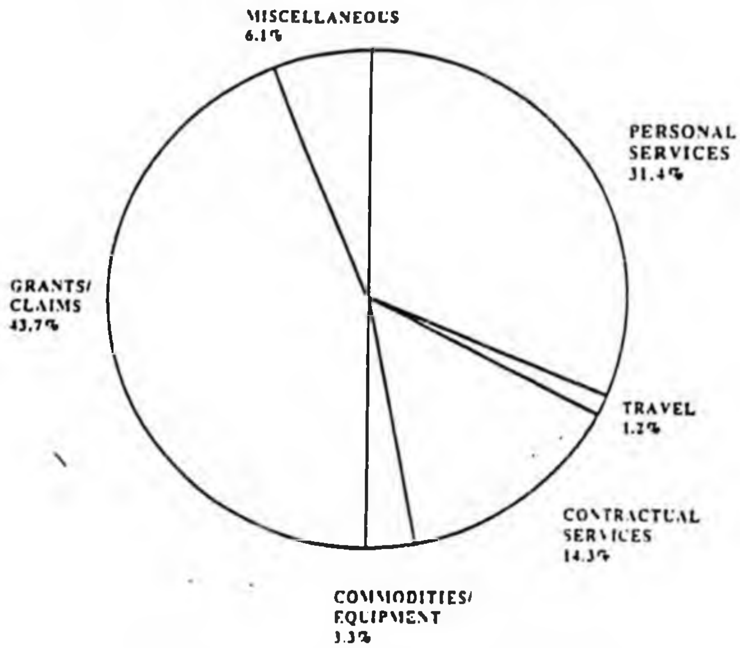
Figure 6
EXPENDITURES FOR EXECUTIVE OPERATIONS
Fiscal Year 1989
($854.8 million)



Source: Legislative Finance Division

Figure 7 breaks down total FY 89 operating expenditures by line item.

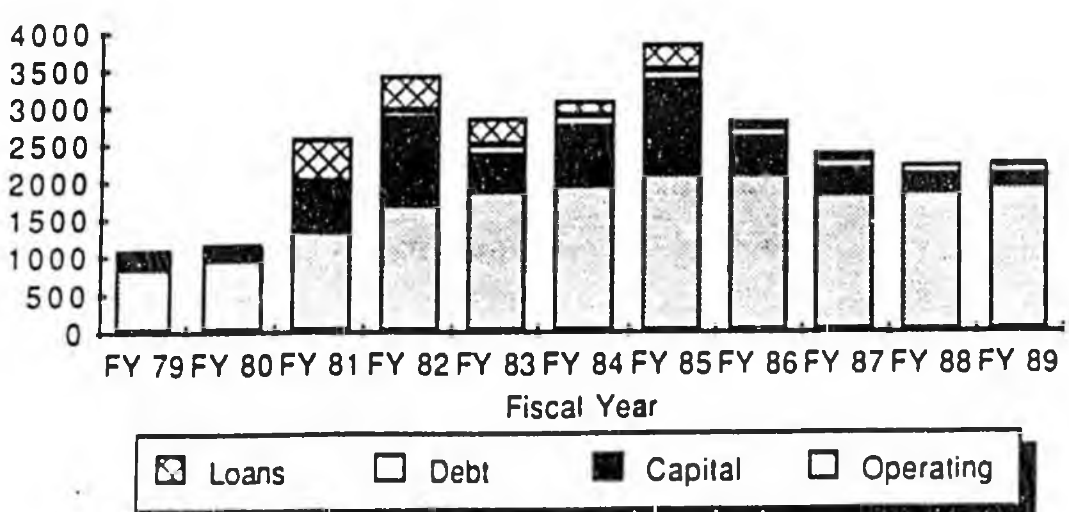
Figure 7
OPERATING BUDGET EXPENDITURES BY LINE ITEM
Fiscal Year 89 - Total Funds



Source: Legislative Finance Division

Figure 8

STATE GENERAL FUND APPROPRIATION HISTORY
Fiscal Year 1979 - 1989
(millions $)



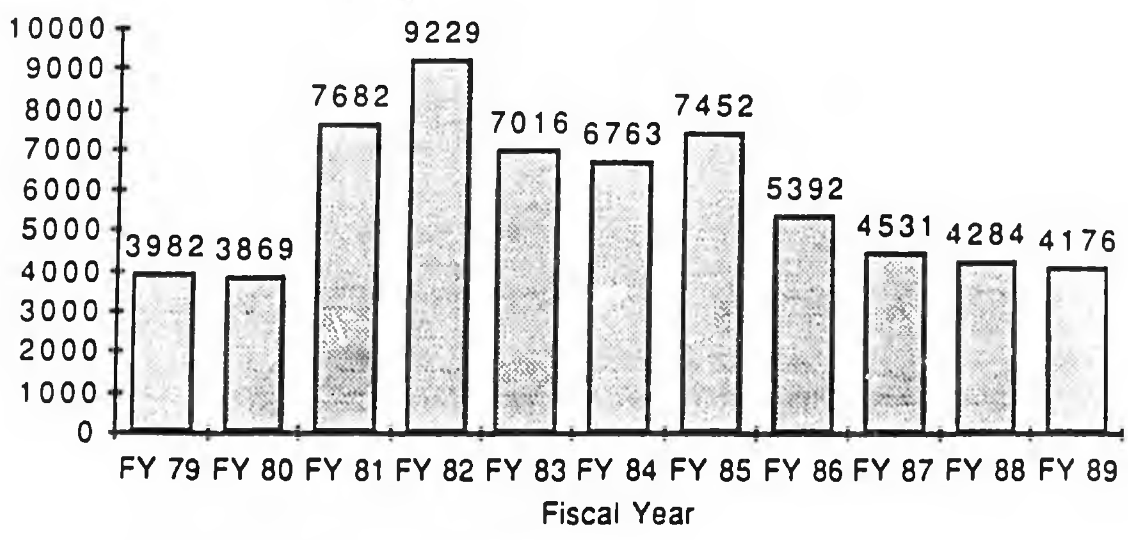
Source: Office of Management and Budget

As shown by Figure 8, state spending over the past decade grew rapidly during the early 1980's with the availability of surplus petroleum revenues. Following the collapse of oil prices in 1986, general fund appropriations have since fallen back to a level below FY 81.

When measured in real (ie, inflation-adjusted) terms on a per capita basis, as shown in Figure 9, the current state spending level is once again close to the FY 79 level.

Figure 9

REAL PER CAPITA GENERAL FUND APPROPRIATIONS
Fiscal Year 1979 - 1989
(1989 $)



Source: Legislative Finance Division

Potential Spending Cut Scenarios

Subcommittee members developed hypothetical scenarios for budget reductions of **$100 million, $175 million, $300 million and $822 million,** relative to the Governor's FY 90 proposal.

The **$100 million** scenario proposed 5% across-the-board reductions in the major entitlement programs, with the remainder of the reduction in "non-essential" programs and.personal services.

The **$175 million** scenario proposed selective reductions in state agencies, legislature, university, court system and entitlements.

The **$300 million** scenario proposed a roll back in non-formula programs to the FY88 level, added an increase for new facilities, and made a further cut of 12.5% in state agencies and entitlements.

The **$822 million** scenario would completely eliminate many "non-essential" programs, and in addition would reduce state agencies by 30-40%.

In addition, the Subcommittee also considered major reductions in support for local governments (**municipal assistance/revenue sharing**). A 20% cut would reduce local government support by **$19.3 million**; a 50% cut would reduce it by **$48.4 million**.

INCREASE REVENUE

Considerations for analyzing the state's revenue system include its

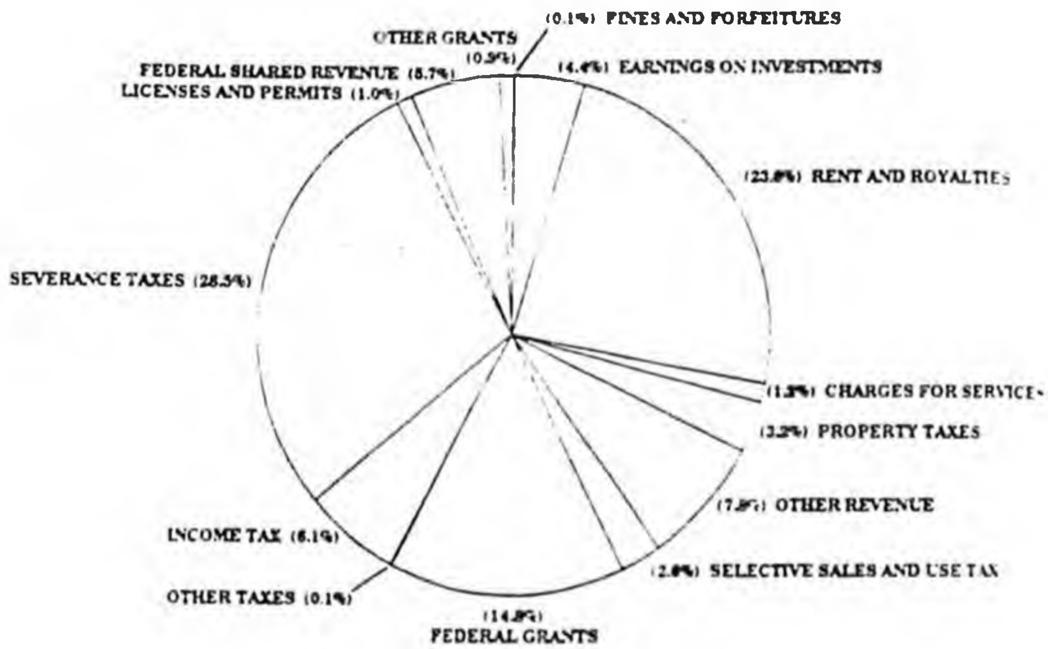
- Sufficiency
- Diversity
- Fairness
- Adequacy for local governments

- Reliability
- Ease of Administration.

Revenue Analysis

Figure 10 shows the sources of state revenue.

Figure 10
REVENUE SOURCES BY TYPE
Fiscal Year 1989



Source: Legislative Finance Division

Potential New Revenue Sources

The Subcommittee has gathered information on a variety of suggestions for raising new revenue. Most of the proposals have not been introduced as legislation, but are being discussed as general concepts. Amounts shown for tax proposals are estimates of the annual revenue that could be generated. Reserve amounts shown indicate current account balances.

• <u>Taxes</u>

ELF $100 million (eff. date 7/1/89)

The proposal in HB 118 would lower the severance tax on marginal fields and increase it on the Prudhoe Bay and Kuparuk fields.

Personal Income Tax: $100 million (first year)

Under one proposal put forward to the subcommittee, tax rates would be 3.2% and 5.7%, with lower effective rates for residents due to exemptions and credits. Lower income people would pay less due to the progressive rate structure. Under certain structures, up to 30% of revenue generated could come from non-residents.

State Sales Tax: $ 49 million

Under one proposal, the tax rate would be 1% and would be in addition to any sales tax levied at the local level. No exemption for food, medicine, or utilities; no credit for local sales tax.

School Tax $ 10 million

Under one proposal, the tax would be $50 annually per member of the work force regardless of residency, with a credit of up to $50 for local school taxes paid. Non-residents would contribute about 30% of the estimated revenues.

Motor Fuel Tax $ 34 million

There is a proposal to double the current motor fuel tax of eight cents per gallon; the six cents per gallon exemption for off-road use would continue.

Tobacco Tax $ 4.3 million

The proposal in HB 80 increases the levy from 5.5 mills per cigarette to 10 mills per cigarette.

• **User Fees/Program Receipts** $5-50 million

Fees for state services could be instituted or increased to directly charge all or part of the cost of the service to the beneficiary or user.

• **Reserves**

The state has no money held specifically as a reserve for operating purposes.

Budget Reserve Fund $000

Created in 1985 from the Rainy Day Fund and oil tax settlement money. The balance of $432 million was appropriated in FY 88.

• Other Funds

Railbelt Energy Fund $234 million
Originally established to fund energy projects.

Permanent Fund Earnings Reserve $601 million
Earnings in excess of the amounts needed to date for dividends and inflation-proofing.

• **Litigation Revenue and Uncollected Oil and Gas Taxes**
The timing of receipt of any litigation or settlement monies is uncertain. Major cases pending include:

Amerada Hess unknown
Dispute with producers over the value of the state's royalty share of North Slope oil production. Lawsuit pending in State Superior Court. Some of the proceeds are constitutionally dedicated to the Permanent Fund.

Dinkum Sands $930 million (in escrow)
Dispute with federal government over ownership of Beaufort Sea leases. Lawsuit pending in U.S. Supreme Court. Some of the proceeds are constitutionally dedicated to the Permanent Fund.

Oil and Gas Taxes $1.4 billion ($2.7B w/ interest)

Disputes with producers over unpaid tax obligations assessed by the Department of Revenue. Under administrative review in the department.

- <u>Permanent Fund Income Stream</u>

Numerous ideas have been suggested for use of the Permanent Fund income stream, including capping the dividend at various levels, designating a percentage of the income for operating expenses, and designating a portion of the stream for an education endowment.

- <u>Other Proposals</u>

Repayments to General Fund from AHFC, AIDEA, etc.

A return on the capital invested in state corporations could be repaid to the General Fund on a regular basis.

Illegal Substances Tax

HB 32 would impose a tax of $150 per ounce on marijuana by requiring purchase of tax stamps when a transaction occurs. Non-payment of the tax would result in a 100% penalty. Provisions that would extend coverage to other illegal substances are under consideration. This type of tax would, in effect, generate revenues through enforcement efforts.

Alcohol, Fish, Insurance -
Increased or new taxes on alcohol, processed fishery resources, and insurance premiums have been suggested and will be investigated by the Subcommittee.

Observations on Revenue Measures

ELF Change

- progressive
- encourages certain marginal field development
- raises taxes on the oil industry
- increases reliance on petroleum revenue
- may impede development of marginal deposits within Prudhoe Bay and Kuparuk

Income Tax

- is designed to take different percentages of income at different income levels
- can be structured to capture non-resident income currently escaping the state; as much as 30% of the income tax revenues could come from out-of-state workers
- deductible from federal income tax payment
- traditional source of state revenues (Alaska had one from 1959 - 1981; 43 other states have a personal income tax)
- unpopular politically

- removes dollars from disposable income of individuals that otherwise may be spent in the local economy

State Sales Tax

- new revenue source
- does not distinguish on basis of ability to pay
- difficult to administer and enforce
- interferes with municipal revenue source options

State School Tax

- generates more revenue than allocated for school construction in FY 90 budget proposed by the Governor
- affects resident and nonresident workers uniformly; captures income from nonresident workers
- puts a new tax burden on workers
- exempts some workers

Motor Fuel Tax

- easy to understand
- in line with proposals at national level
- makes gasoline more expensive
- raises issue regarding Alaska Railroad fuel

Tobacco Tax

- discourages use, especially among younger people
- makes small contribution to revenue needs

User Fees

- beneficiaries pay cost of service
- increases cost of doing business
- increases administrative burden for agencies

AHFC Funds

- $1.5 + billion Fund Equity
- $479.6 million liquidity
- most equity is not liquid
- use may jeopardize State Bond Rating unless carefully done
- potential for bond holders to bring suit

AIDEA Funds

- $347.7 million Fund Equity
- not all equity is liquid
- some liquid assets in long term treasury bonds
- use may jeopardize State Bond Rating unless carefully done
- potential for bond holders to bring suit

Illegal Substance Tax

- creative revenue source
- added drug enforcement tool
- discourages drug use
- can be misinterpreted as condoning drug use

ECONOMIC IMPACTS OF SPENDING/REVENUE OPTIONS

Several efforts have been made to analyze the economic impacts associated with reducing state expenditures and/or raising new revenues. Three separate reports have been prepared by the University of Alaska, Institute of Social and Economic Research (ISER).

A May 1987 ISER report prepared for the legislature's Joint Special Committee on Tax Policy provided a comparative analysis of the economic effects, as measured in terms of employment and disposable income, of **reimposing personal income taxes; reducing permanent fund dividends; and reducing state spending by an equivalent amount of $467 million.** The analysis concluded that while reimposition of income taxes or lowering dividends would both reduce the purchasing power of Alaskans and therefore cost the economy jobs and income, reducing dividends would cost the state somewhat more jobs and reduce disposable income more than reimposition of income taxes. The economic impact of reducing state expenditures by $467 million would vary greatly depending upon the nature of the reductions.

A June 1987 ISER study prepared for the Senate Finance Committee compared the effects of **reducing state employee compensation by $100 million versus employee layoffs that would accomplish the same level of savings.** The report found that layoffs would have a significantly larger economic impact than across-the-board compensation reductions.

A January 1989 ISER analysis of regional economic impacts of state budget reductions prepared for the Office of Management and Budget analyzed the **potential effects of a reduction of $349 million in state appropriations.** In summary, budget reductions of $349 million would reduce personal disposable income of Alaskans by $325 million and average annual employment by a total 8,481 (with 4,688 jobs lost in the public sector and 3,793 lost in the private sector). The study also examined the regional effects of reductions.

LONG-RANGE FISCAL PLANS

The Subcommittee reviewed the Governor's proposed 20-year fiscal plan and several other alternative plans.

Figures 12A and 12B:	New Revenues/No Cuts (Governor)
Figure 13:	ELF/Income Tax/Phased Cuts
Figure 14:	FY'90 10% Reduction/Cap Dividend at $1000/ELF Retroactive

OBSTACLES TO SOLUTION

The Subcommittee believes decisive action is needed to close the gap between spending and revenues. However, obstacles to resolution remain, including:

Complexity;

Legal constraints;

Time require to implement changes;

Conflicting political views;

Inertia/history;

Preference for delaying unpopular action; and

Need for information on the effects of budget cuts and taxes.

OBJECTIVES

The Subcommittee will continue its work effort with the following objectives:

- Continue analysis, including the timing and impact, of budget reductions and revenue options.
- Make timely recommendations to House Finance Committee, other House members and Budget Summit.
- Inform community leaders and the public about spending and revenue alternatives.

    Public Forums

        Review of fiscal situation

        Discussion of alternatives

- Public television
- Public radio

- Lay groundwork for future work
  - Tax structure study
  - Public forums
  - Role of Permanent Fund
  - Role of state government (what further cuts to make)
  - Develop 5-, 10- and/or 20-year plans

Figure 12 A GOVERNOR COWPER'S LONG RANGE PLAN

FY 1990 - FY 2010

*$13.50 Per Barrel Scenario **

($ Millions - Current Dollars)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
BASE REVENUE:																					
Forecast Unrestr. G.F. Revenue	1,691	1,389	1,405	1,396	1,367	1,322	1,293	1,268	1,222	1,182	1,149	1,122	1,081	1,041	1,001	964	935	907	879	851	822
EXPENDITURES:																					
Appropriations	(2,310)	(2,310)	(2,310)	(2,310)	(2,310)	(2,360)	(2,410)	(2,460)	(2,510)	(2,560)	(2,610)	(2,660)	(2,710)	(2,760)	(2,810)	(2,860)	(2,910)	(2,960)	(3,010)	(3,060)	(3,110)
ANNUAL BALANCE:	(620)	(921)	(905)	(914)	(943)	(1,037)	(1,117)	(1,192)	(1,288)	(1,378)	(1,461)	(1,538)	(1,628)	(1,719)	(1,809)	(1,896)	(1,975)	(2,053)	(2,131)	(2,209)	(2,288)
OTHER REVENUE:																					
Educ. Fund Rev.												[illegible]	722	779	836	894	955	1,018	1,083	1,149	1,218
ELF	141	114	129	162	157	160	153	148	140	123	94	69	72	58	34	37	29	27	20	25	8
Motor Fuel Tax	34	35	37	38	40	42	44	46	48	50	52	54	57	60	62	65	68	71	74	77	81
Income Tax		104	317	301	362	282	256	280	280	292	308	319	334	340	364	381	398	416	434	454	474
PF Earnings	575	205	160	144	127	107	108	112	121	131	140	147	151	155	159	163	167	172	177	181	186
Sales Tax	49	51	53	55	58	60	63	66	69	72	75	79	82	86	89	93	98	102	107	111	116
ANWR								292	714	772	825	884	948	1,010	1,072	1,139	1,201	1,117	1,166	1,207	1,239
Gas Line						81	161	201	220	239	258	275	270	264	258	252	246	241	235	229	223
Litigation Gains	150	400	300	300	200	200	200														

* FY 90 revenue based on ANS $13.50 weighted average;
FY 91-2010 – DOR 11/88 mid case forecast

Office of the Governor, Division of Policy 01/31/89

Figure 12B- GOVERNOR COWPER'S LONG RANGE PLAN (DETAIL)

FY 1990 - FY 2010

$13.50 Per Barrel Scenario *

($ Millions - Current Dollars)

	1990	1991	1992	1993	1994
BASE REVENUE:					
Forecast Unrestr. G.F. Revenue	1,691	1,389	1,405	1,396	1,367
EXPENDITURES:					
Appropriations	(2,310)	(2,310)	(2,310)	(2,310)	(2,310)
ANNUAL BALANCE:	(620)	(921)	(905)	(914)	(943)
OTHER REVENUE:					
Educ. Fund Rev.					
ELF	141	114	129	152	157
Motor Fuel Tax	34	35	37	38	40
Income Tax		104	217	301	352
PF Earnings	575	205	160	144	127
Sales Tax	49	51	53	55	58
ANWR					
Gas Line					
Litigation Gains	150	400	300	300	200

* FY 90 revenue based on ANS $13.50 weighted average;
FY 91-2010 = DOR 11/88 mid-case forecast

Office of the Governor, Division of Policy 01/31/89

Figure 13

FY 90-94: ELF/Income Tax/Phased Cuts

Sources of Revenue	FY90	FY91	FY 92	FY 93	FY 94	TOTALS
Carry Forward	-12.5	0.0	0.0	2.6	80.3	70.4
UGF Revenues (1)	1,640.9	1,389.0	1,405.5	1,395.8	1,366.8	7,198.0
Other Adjustments (2)	57.8	57.8	57.8	57.8	57.8	289.0
New Program Receipts (3)	20.0	20.0	20.0	20.0	20.0	100.0
Reserves	188.9	118.3	0.0	0.0	0.0	307.2
ELF	115.0	129.0	148.0	172.0	171.0	735.0
Income Tax (4)	104.0	250.0	260.4	271.2	282.5	1,168.0
Sales Tax	0.0	0.0	0.0	0.0	0.0	0.0
Litigation Revenue	50.0	100.0	100.0	100.0	100.0	450.0
TOTAL REVENUE	**2,164.1**	**2,064.1**	**1,991.7**	**2,019.4**	**2,078.3**	**10,317.6**

TOTAL EXPENDITURES	**2,164.1**	**2,064.1**	**1,989.1**	**1,939.1**	**1,914.1**	**10,070.5**
Reduction from previous FY (5)	-150.0	-100.0	-75.0	-50.0	-25.0	-400.0
Reduction %	-6.5%	-4.6%	-3.6%	-2.5%	-1.3%	
Carry Forward/(Deficit) (6)	**0.0**	**0.0**	**2.6**	**80.3**	**164.2**	
BALANCE w/o New Revenue (7)	-477.9	-617.3	-525.8	-482.9	-409.2	-2,513.1

(1) FY 90 revenue at $13.50 price plus the FY 90 production adjustment.
FY 91 estimate and beyond from DOR mid-case scenario (October 1988).
(2) Program reciepts estimated at 49.8 and other minor adjustments as budgeted in Governor's FY 90 proposal.
(3) Increased user fees.
(4) FY 90 income tax only partial year; thereafter at 250.0/year adjusted for inflation at 4.15%.
(5) Total FY 89 expenditures at 2314.1 from Consensus Revenue Analysis FY 89/90 Balance Sheet.
(6) No allowance has been made for the annual $34 million payment to the Ak. Science and Technology
(7) Shows level of reductions required if no new revenues adopted.

REP. K. BROWN - 2/6/89 elm

Figure 14

10% Reduction/Cap. Dividend at $1000/ELF Retro

Sources of Revenue	FY90	FY91	FY92	FY93	Totals	
Carry Forward	0.0	100.0	150.0	322.3		
UGF Revenue (1)	1,640.9	1,389.0	1,405.0	1,396.0	5,830.9	
Revenue Adj. (pgm. rcpts & other)	57.8	60.0	60.0	60.0	237.8	
Capital Project Cleanup	14.0	0.0	0.0	0.0	14.0	
PF Earnings to GF	0.0	16.1	0.0	0.0	16.1	
PF 1000/50/50 GF portion (2)	0.0	191.0	191.0	197.0	579.0	
ELF (3)	181.0	115.0	148.0	172.0	616.0	
Income Tax	0.0	0.0	0.0	0.0	0.0	
Sales Tax	0.0	0.0	0.0	0.0	0.0	
Litigation Revenue (4)	100.0	150.0	200.0	200.0	650.0	
Railbelt Energy Fund	179.5	57.1	0.0	0.0	236.6	
TOTAL REVENUE	**2,173.2**	**2,078.2**	**2,154.0**	**2,347.3**		
TOTAL EXPENDITURES	**2,073.2**	**1,928.1**	**1,831.7**	**1,740.1**		
Reduction from previous FY	230.4	145.1	96.4	91.6	563.5	Total reduction in dollars
Yearly Reduction %	10%	7%	5%	5%	24%	Total % red. from Gov's FY90
Carry Forward/(Deficit) (5)	**100.0**	**150.0**	**322.3**	**607.2**		

NOTES:

(1) Revenue figures for FY89 & FY90 are from Concensus Revenue Analysis 1/24/89 with FY90 at $13.50. FY91 - FY 93 is at DOR mid-case, October 88 forecast.
(2) Dollar amounts represent 1000/50/50 Plan. Dividend capped at $1000 after FY90.
(3) ELF Amounts for FY90 represents a 1/1/89 effective date. (preliminary estimate from DOR)
(4) Since litigation revenue is uncertain, it will be spent the following year as carry forward allows.
(5) No allowance has been made for the annual $34 million payment to the Ak. Science and Technology Endowment as provided in Sec. 189, Ch. 173, SLA 1988.

OTHER: Governor's FY90 Spending Plan has been reduced to $2303.6 (by $13.5) to reflect the reduction in the proposed supplemental, HB 154.

Representative Lyman Hoffman - HFC 2/5/89

SECOND REPORT

of the

HOUSE FINANCE FISCAL POLICY SUBCOMMITTEE

prepared by:

Representative Kay Brown, Chair

Representative C.E. Swackhammer

Representative Steve Rieger

April 3, 1989

TABLE OF CONTENTS

INTRODUCTION

Since the Fiscal Policy Subcommittee's initial report February 7, much discussion has occurred about the state's fiscal condition and circumstances. A consensus is developing within the Legislature that substantial cuts must be made in state General Fund spending in FY 90 and beyond.

The members of the Budget Summit have agreed the proposed FY 90 budget of $2.3 billion should be reduced by at least $150 million, and they are to present specific proposals at a meeting the first week in April. A new long-range revenue forecast by the Department of Revenue narrowed the budget gap for FY 90 to approximately $250 - $300 million. No consensus has yet developed on new revenue sources or use of reserves to close the remaining gap in FY90.

The fiscal policy issues confronting the state include spending and revenue options that must be decided in the context of the FY 90 budget, as well as long-term implications that require further review and analysis. This report summarizes spending and revenue measures under consideration, including options with long-term fiscal impact, and makes recommendations for addressing the state's fiscal situation. In addition, this report includes a review of the status of the public information process initiated by the House Finance Fiscal Policy Subcommittee during the first three months of this year.

RECOMMENDATIONS:

The House Finance Fiscal Policy Subcommittee recommends:

Long-term Budget Approach:

Spending should be reduced by approximately $400 million over the next four years in order to arrive at a more sustainable annual budget of about $1.9 billion. In addition to required spending reductions, revenues should be increased by approximately $300-500 million so that recurring revenues are sufficient to fund the budget.

Spending:

- Make reductions of approximately $200 million in the Governor's FY 90 budget.

- Evaluate state employee compensation and reduce health benefit costs (HCR 24).

- Study government reorganization and/or privatization: Alaska Housing Finance Corporation, Agricultural Revolving

Loan Fund, Alaska Industrial Development and Export Authority, Post Secondary Education Commission, Oil and Gas Conservation Commission, Data Processing, Matanuska Maid Dairy, Alaska Railroad, and other state-run operations.

- Revise the funding mechanism for school debt reimbursement to local governments so that the cost to the state declines over time (HB 37).

- Restructure pass-through programs, including longevity bonus and power cost equalization, so that program costs decline over time.

Revenue:

- Rely on litigation or settlement revenue only to the extent that realistic estimates of timing and amount can be obtained.

- Pass ELF revision (CS HB 118 Resources) Note: the Subcommittee supports this recommendation 2-1.

- Pass tobacco and alcohol tax increases (HB 80 and HB 246).

- Increase user fees (HB 85).

- Reinstitute school tax (HB 215).

- Study equality of resource taxation: fish, timber, coal and other minerals.

- Study personal income tax.

Other fiscal issues:

- Establish requirement for long-range budget/revenue plan (HB 87).

- Permanent Fund:
    * Establish priority of inflation-proofing over dividends (HB 249).
    * Study use of permanent fund earnings.

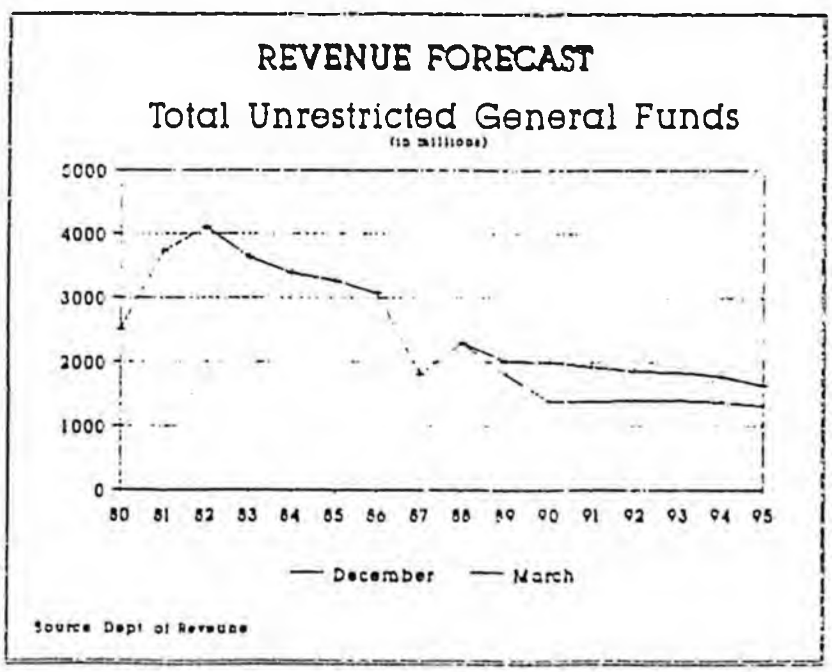
- Address need for budget reserve.

- Use Railbelt Energy Fund for railbelt-area projects in FY 90 and 91.

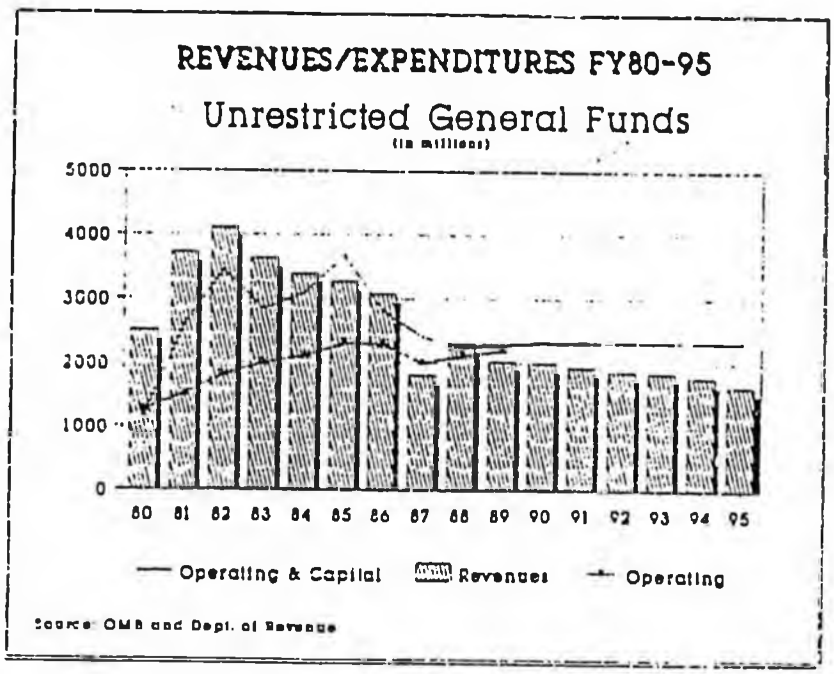
REVENUE FORECAST

The Department of Revenue long-range revenue forecast issued on March 31, 1989 indicates continued stability in world oil prices with Alaska North Slope (ANS) crude selling in the range of $12 to $19 per barrel for FY 90. Using the mid-case forecast (ANS average lower 48 price of $15.66 per barrel), total FY 90 unrestricted general fund revenues would exceed the February Summit consensus forecast by about $200 million.

The following graph shows the difference between the Department of Revenue long-range forecasts for December and March:



The revised revenue forecast narrows the budget gap to approximately $250 to $300 million in FY 90. The following graph shows current projected revenues and expenditures using the Department of Revenue forecast of March 31, 1989 and the Governor's Office of Budget Review long-term budget projections.



OPTIONS FOR CLOSING THE REMAINING BUDGET GAP

Necessity for immediate reductions:

Although the gap is smaller, reductions in spending, as well as additional sources of funding, are required to balance the budget in FY 90 and beyond. While petroleum revenues have stabilized at least temporarily at a higher level, expected revenues will not fund existing government operations. The state has no cash reserves set aside to help offset projected budget deficits or to respond to changes in the price of oil. The state cannot rely indefinitely on the use of other reserves to cover the gap between spending and income.

The long-term implications of continuing reductions:

Continued reductions in spending in future years will require substantial structural changes to state government programs. Some operations cannot be reduced significantly because of 24-hour staffing requirements, other functional characteristics, or because they are essential to protect public health and safety. Shutdown of whole components or facilities may be necessary in the future.

SPENDING OPTIONS

House Finance Committee FY 90 Budget Balancing Approach:

1. Total General Fund reduction target: $150-200 million from Governor's FY 90 proposed budget.
2. FY 90 proposed transfers, increases, decreases analyzed by subcommittees.
3. Reduction/elimination and increase priorities recommended by subcommittees to full committee.
4. Increases for all agencies prioritized by subcommittee chairs.
5. Facilities operations reviewed by special subcommittee.
6. Discussion of selected pass-through and other programs by Majority and Minority Caucuses.
7. Personal services percentage reduction applied by full committee to agencies and pass-throughs.
8. Adoption of budget by full Finance Committee.

The Co-Chairmen of the House Finance Committee have provided the following guidance for Subcommittee Chairs:

- Total General Fund reduction target: $150-200 million from Governor's FY 90 proposed budget (Summit agreed at least $150 million for FY 90).
- Personal services will be reduced 5-10% in all agencies by the full Finance Committee, and equivalent reductions will be made in pass-throughs to municipalities, school districts and non-profits.
- Analyze proposed FY 90 transfers, increases and decreases for:

  acceptability of proposed transfers,
  possibility for modification of proposed change,
  possibility for rejection of proposed change.
- Determine whether high priority increases can be funded by deleting lower priority items from the base.
- Prioritize agency programs within the FY 89 base budget and identify whole programs or sub-programs that are least valuable to the public and could be recommended for reduction or deletion.
- Prioritize items for inclusion which are above FY 89 base level.

- Review the following programs for discussion within the House Majority and Minority Caucuses:

    Longevity bonus

    Senior citizens and veterans tax exemptions

    Municipal assistance

    Revenue sharing

    Shared taxes

    School debt retirement

    Education operation

    Pupil transportation

    Facilities (referred to special subcommittee) and additional miscellaneous agency pass-through programs in the Departments of Administration, Education, Labor, Commerce, Military and Veterans Affairs, Natural Resources, Public Safety, Transportation, and Community and Regional Affairs.

Public Employee compensation and benefits:
Employee compensation and benefits have been identified as a key factor that must be evaluated in budget reductions. The legislature has passed SCR 23 which establishes a Health Care Cost Containment Task Force to study state statutes, practices of health insurers, and to determine ways of

reducing state and local government employee health insurance costs. The following proposals are under consideration:

HCR 24 - Establishes a personal services cost containment task force to study state statutes and practices and to determine ways of reducing costs of personal services.

HB 241 - Reduces the salaries of state employees who are not members of collective bargaining units; freezes judicial salaries.

Formula funded programs:

Programs funded using mathematical formulas have been identified as an element of the budget that should be examined.

HB 242 - Allows agencies administering benefit payment programs to make reductions on a pro rata basis to equitably distribute money available if sufficient funds are not available for full payment.

General obligation debt:

General obligation debt has been cited as another area of concern in the budget reduction process. The need for funding to pay general obligation debt will decline in future years if no additional debt is incurred. If new debt is incurred in amounts in excess of annual debt reduction, additional revenue will have to be raised to cover it. The following table shows the amount of funding available as a result of reduction of general obligation debt over the next five years:

GENERAL OBLIGATION DEBT
Fiscal Year 89-95

FISCAL YEAR	ANNUAL PAYMENT	FUNDING AVAILABLE
89	135.512	
90	120.306	15.206
91	95.483	24.823
92	68.201	27.282
93	59.688	8.513
94	33.930	25.758
95	23.084	10.846

(000's)

Source: FY 88 State Annual Report

REVENUE OPTIONS

A number of revenue possibilities are under consideration and are discussed below.

Increase existing revenues:

- Alcohol
- Tobacco
- User fees
- Petroleum

New revenue sources:

- School tax
- Personal income tax.

Reserves:

- Budget Reserve
- Railbelt Energy Fund
- Permanent Fund Earnings Reserve

Other:

- Alaska Housing Finance Corporation (AHFC)
- Alaska Industrial Development & Export Authority (AIDEA)
- Litigation and settlement funds
- Privatization of state-run operations

Alcohol tax:

Between 1983 and 1988 more than 7.5 million gallons of alcohol were sold in Alaska. Currently, beer is taxed at 35 cents per gallon, wine is taxed at 85 cents per gallon, and spirits are taxed at $5.60 per gallon. Alcohol taxes were last increased in 1983. One of the rationales offered for a higher rate of taxation is that alcohol abuse results in increased health care costs and causes incalculable damage to affected individuals and families. The State Office of Alcoholism and Drug Abuse estimates that the state spends about $13 for alcohol related services for each $1 of revenue collected on alcoholic beverages.

Options:

HB 246 - Increases the tax on beer to 75 cents per gallon, on wine to $2.34 per gallon, on spirits to $7.20 per gallon; estimated revenue is $9 million.

Tobacco Tax:

More than 54 million packs of cigarette were sold in Alaska in 1988. The current cigarette tax is 16 cents per pack. Since 1988 other tobacco products have been taxed at 25% of the wholesale price. Five cents per pack of the cigarette tax is dedicated to school construction.

Options:

CS HB 80 (HESS) - Increases the tax on cigarettes to 30 cents per pack and permits local governments to tax tobacco products at rates higher than the existing 6% general limit on local sales tax; estimated revenue is $9 million.

User fees:

The state provides certain services that directly benefit users who are able to pay for these services. Some fees do not cover the full cost of the services and result in an unnecessary subsidy to the user.

Options:

HB 85 - Provides authority to state agencies to recover the costs associated with the providing certain services; e.g. airport fees, loan programs fees, school rentals, etc. Estimated revenues have not been determined. Increases in or establishment of the following user fees should be considered:

- inspections of seafood and agricultural products processing

- toxic waste inspections
- state park use
- legal records (state recorders office)
- tuition at state-run educational institutions
- ferry ticket prices
- commercial fisheries permit fees
- motor vehicle registration

HB 124 - Increases sport fishing and hunting license fees and big game tag fees; estimated revenue $948,000.

HB 247 - Revises special license plate fees and registration fees to remove exemptions for some types of vehicle uses and to establish exemptions for others; estimated revenue is $81,000.

HB 248 - Repeals 25 cent hunting, fishing, and trapping license fees; estimated savings have not been determined.

HB 250 - Doubles all annual license fees for retail, wholesale, and all other types of alcoholic beverage dispensers; estimated revenue is $2 million.

Petroleum:

The primary focus of debate this session has been on the Economic Limit Factor (ELF). Measures to modify the ELF so that it does not apply to Prudhoe Bay and Kuparuk have been introduced in the House and the Senate. After lengthy consideration and debate in the House, CS HB 118 (Resources) passed March 23 by a vote of 21 to 19. Supporters argued that development of marginal fields would be enhanced by the change and that it is not reasonable to give the oil industry a tax break by treating Prudhoe Bay and Kuparuk as if they are marginal fields now. Opponents cited the need for a stable tax policy and argued against imposing higher taxes on the industry simply because of its profitability.

Options:

CS HB 118 (Resources) - Lowers the severance tax on certain marginal fields and increases it on the Prudhoe Bay and Kuparuk; estimated revenue $131 million (with effective date 9/01/89).

SB 97 - Revises the ELF using a different formula than HB 118· estimated revenue has not been determined.

SB 114 - Increases the cents per barrel amount for oil production tax from 60 cents to $1. Estimated revenue has not been determined.

School tax:

The Alaska constitution requires the state to maintain a system of public schools but does not specify methods or levels of funding. Currently the state spends more than $500 million per year on public education. The $10 annual school tax payable by each Alaskan employee was repealed in 1980.

Options:

HB 215 - reinstitutes the school tax paid by each employed person over 19 years of age and sets the amount at $50; estimated revenue is $17 million.

Personal income tax:

Alaska's revenue system does not have substantial diversification of sources over reasonably broad bases. More than 80% of revenues are petroleum based. In addition, repeal of the personal income tax in 1981 reduced one element of public accountability for state spending. Personal income tax covers out-of-state residents who are currently escaping Alaska taxation entirely and is deductible on federal income tax returns.

Options:

HB 252 - Reinstitutes the personal income tax with rates of: 3.2% for taxable income under $30,000, $960 plus 5.7% of taxable income of $30,000 or more for individuals and includes similar provision for heads of households, married couples, surviving spouses, as well as provisions for deductions, exemptions, and credits. Estimated revenue has not been determined.

Railbelt Energy Fund:

A comprehensive study of energy alternatives by the Alaska Power Authority is underway to investigate the costs and benefits of proposed interties and energy conservation projects. The study is to be completed in April. Meanwhile, there is a need for funding local capital projects and other projects in the Railbelt area because of reductions in capital spending since 1987. The estimated balance in the fund is $234 million.

Options:

CS HB 161 (L&C) - Appropriates $11 million to the Dept. of Commerce and Economic Development neighborhood revitalization and development fund.

HB 209 - Appropriates $6 million for tourism/recreation projects.

HB 227 - Appropriates $150 million for various railbelt economic investment projects and for federal project matching funds.

HB 237 - Appropriates $30 million to AIDEA for coal cogeneration project at Healy contingent on federal funding, power sales agreements, and a financial plan.

SB 90 - Repeals the Railbelt Energy Fund and appropriates the fund balance to the general fund.

SB 132 - Appropriates $80 million to the Dept. of Administration for the Railbelt economic assistance and recovery fund.

SB 224 - Same as HB 227.

The following proposals are also under consideration:

- Use the Railbelt Energy Fund to balance the FY 90 budget.
- Do not use the Railbelt Energy Fund this year.

Permanent Fund Earnings Reserve:

Under Alaska Permanent Fund Corporation projections, the Earnings Reserve will be drawn down by about $120 million for inflation-proofing this year, and the balance of the Earnings Reserve will be used by FY 97. Alternatively, the Dept. of Revenue projects a lower inflation rate and a higher rate of return; under those assumptions, it would not be necessary to use any of the Earnings Reserve for inflation-proofing in the near future. The models used to project changes in principal, dividends, and inflation- proofing are sensitive to the assumptions used for future interest and inflation rates. Projections can vary widely when estimates of inflation or interest rates are changed by just 1% or 2%. However, if funds are withdrawn from the Earnings Reserve, the principal of the Permanent Fund likely will not increase as rapidly in the future as it would if the Earnings Reserve is left in the Permanent Fund. The estimated balance in the earnings reserve account is $601 million.

Options:

HB 50 - Establishes the Commission on the Future of the Permanent and provides for public testimony on the use that should be made of the income of the Permanent Fund.

HB 158 - Deposits all reserves in principal of Permanent Fund.

HB 207 - Deposits reserves in a public school foundation reserve account.

HB 249 - Gives inflation-proofing highest priority use for earnings.

SB 214 - Same as HB 158.

SB 218 - Appropriates $200 million for a special dividend.

HJR 6 - Proposes a constitutional amendment to allow the earnings to be used to increase principal, pay state and local bonded debt, or for extraordinary public expenses in an emergency.

HJR 13 - Proposes a constitutional amendment to create an endowment for education.

In addition, several proposals effecting the Permanent Fund Earnings Reserve (PFER) have been discussed.

- Move PFER to the Budget Reserve Fund.
- Leave PFER alone until a broader public consensus has developed regarding its use, or until an advisory vote is held.
- Use PFER to fund the FY 90 budget.

Alaska Housing Finance Corporation:

The Legislature has appropriated $1.03 billion to AHFC since its inception. AHFC equity was $1.5 billion on 6/30/88. AHFC's finances are complicated by bond agreements, investment practices, and insurance claims, as well as by the substantial number of foreclosed properties it must maintain, manage and/or dispose of.

A 1985 Attorney General's Opinion stated that the legislature could appropriate unencumbered assets held outside the state treasury; however, it also suggested statutory changes to implement such a reappropriation. Regardless of the use of reserves, it appears likely that changes in AHFC programs will be necessary.

Options:

SB 200 - Reduces AHFC interest rate subsidy from 3% to 1%.

SB 245 - Transfer of at least $60 million in loans from the housing assistance loan fund to AHFC (a similar proposal was vetoed last year).

SCR 28 - Establishes a Housing Finance Task Force to review and recommend changes to publicly-assisted residential finance programs.

Several other proposals involving AHFC have been made:

- Reappropriation of funds directly from AHFC to the general fund.
- Periodic payment of dividends from AHFC to the general fund as a return on capital invested.
- Do not change AHFC this year.

Alaska Industrial Development & Export Authority (AIDEA):

The Legislature has appropriated $341 million to AIDEA since its inception. AIDEA equity was $490 million on 6/30/88. AIDEA has been involved in financing a wide range of commercial real estate and economic development projects and now has many foreclosed properties it must maintain, manage and/or dispose of. Availability of AIDEA reserves is uncertain.

HB 123 - Expands AIDEA investing powers to include partnerships, joint ventures, and other types of agreements relating to ownership, operation, or construction of facilities; also revises or amends provisions relating to certain loan fund accounts, loan and bond limitations, delinquent loans, guarantees, and definitions. Several other proposals involving AIDEA have been made:- Reappropriation of AIDEA funds directly to the general fund.

- Periodic payment of dividends from AIDEA to the general fund as a return on capital invested.
- Do not change AIDEA this year.

Litigation and Settlement Revenue:

Timing and amounts of revenue from future litigation and tax dispute settlements are uncertain and difficult to estimate. A mechanism to handle future litigation and settlement revenues could be enacted in order to spread their use over several years. The budget should be built on anticipated litigation or settlement revenues only to the extent that realistic estimates of timing and amount can be obtained.

Options:

HB 190 - Appropriates any litigation or settlement money from Dinkum Sands or Amerada Hess cases to an education forward funding account.

Also, future revenues from litigation and settlements could be deposited in:

- the Public School Fund
- the Budget Reserve Fund
- the Permanent Fund

Sale of state-run operations:

State efforts to stimulate economic development have resulted in the creation or acquisition of a number of entities or operations which could be transferred into the private business sector. Because of the complicated nature of the state's ownership relationships, privatization will be a long-term process. The following entities have been discussed as candidates for privatization:

- Alaska Housing Finance Corporation (AHFC)
- Alaska Industrial Development and Export Authority (AIDEA)
- Matanuska Maid Dairy
- Alaska Railroad

PUBLIC INFORMATION PROCESS

In January, the House Fiscal Policy Subcommittee initiated a public information process on the state budget with the following objectives:

- inform and educate community leaders and the public
- stimulate debate
- receive public comment on spending priorities and revenue measures

During February and March the House, the Senate and the Office of the Governor cooperatively participated in a statewide series of budget workshops. They also mailed out a statewide public opinion survey on the budget.

Budget Workshops:

Workshops were held in the following locations:

Fairbanks	Eagle River	Anchorage	Juneau
Homer	Seward	Valdez	Kodiak
Kenai	Barrow	Dillingham	Nome
Soldotna	Kotzebue	Unalaska	Palmer

Each workshop opened with a presentation on the state of the budget based on the Initial Report of the House Fiscal Policy

Subcommittee and other information provided by members of the legislature who participated. Workshop participants were then organized into small groups (5 to 30 people) to work on balancing the state budget. Each group chose its leader and began working with the "Closing the Budget Gap" worksheets prepared by the Office of the Governor in cooperation with the legislature. After about two hours of discussion and debate, each group summarized its consensus points for presentation to the assembled groups, legislators, and representatives of the Governor. Group leaders reported on areas of agreement and disagreement and also frequently commented on the workshop process itself.

Public Opinion Survey:

The House and Senate leadership and the Office of the Governor prepared a survey based on the Initial Report of the House Fiscal Policy Subcommittee and "Closing the Budget Gap" worksheets. The survey was mailed to 250,000 households on March 7. More than 7500 Alaskans had responded as of March 31. Due to the large number of responses, tabulation of the results is not yet complete.

House Finance
Fiscal Policy Subcommittee

Report No. 3

Representative Kay Brown, Chair
Representative C.E. "Swack" Swackhammer
Representative Steve Rieger

January 1990

Fiscal Policy Report # 3

PREFACE

The Fiscal Policy Subcommittee of the House Finance Committee was formed early in 1989 to address issues arising from the state's critical financial circumstances. The subcommittee members are Representative Kay Brown, Chair; Representative C.E. Swackhammer and Representative Steve Rieger. In the course of developing its recommendations, the Subcommittee has been assisted by an informal fiscal policy Working Group which includes Representatives Larson, Hoffman, Ulmer, Finkelstein, Boucher, Cotten, Koponen, Boyer, Goll, Davidson, Navarre, Grussendorf, Davis, Leman, and Miller.

The Subcommittee's initial report, published February 7, 1989, included:

- potential budget reduction scenarios for FY 90;
- an approach for identifying specific reductions; and
- information about alternative revenue options.

As part of its initial effort, the Subcommittee also promoted a bi-partisan information effort that included a series of public workshops and a statewide survey sponsored by the Governor and the leadership of both the House and the Senate.

By early April, 1989 when the Subcommittee's Second Report was published, a new revenue forecast by the Department of Revenue narrowed the anticipated budget budget gap for FY 90 to approximately $250 - $300 million. In order to address the projected budget gap and put the state budget on a sustainable, recurring revenue basis, the Subcommittee recommended spending be reduced over four years to achieve an annual budget of about $1.9 billion. Additionally, in recognition that these budget reductions alone would not fully close the budget gap, the Subcommittee recommended that annual revenues be increased by $300 - $500 million. The April report also reported on the public information process.

On October 16-17, 1989 the Subcommittee met for briefings on the Prudhoe Bay production decline, OMB's mid-October Fiscal Review, the status of DNR's Oil and Gas Lease Sales, and the first in a series of Fiscal Policy Papers entitled "The Alaska Fiscal Gap" by the Institute of Social and Economic Research. In a public hearing October 16th, the Subcommittee heard testimony on state participation in economic development efforts with an emphasis on the identification of criteria for the Legislature to use in evaluating the merits of state participation in specific economic development proposals.

This report, as well as previous reports of the Fiscal Policy Subcommittee, reflect the general consensus of the subcommittee members but not necessarily unanimity of opinion on each specific point.

EXECUTIVE SUMMARY

Alaska is confronted with an impending fiscal crisis as a result of an inevitable "gap" between general fund revenues and present state spending. Current levels of state spending cannot be sustained.

Even assuming significant additional new oil and gas development and strong growth in the state's non-petroleum sectors, the decline in production from Prudhoe Bay will eventually necessitate substantial reductions in the state budget. The Executive Branch and legislative response to the looming fiscal gap will influence the severity of the economic impacts associated with the decline in state revenues.

The House Finance Fiscal Policy Subcommittee recommends that the Legislature:

- adopt a target spending level of $1.9 billion (1989 $) to be achieved by FY 1994;
- enact a constitutional amendment to reduce spending by 3-5% each year over the next 4 years in order to achieve the target spending level;
- where realistic and likely to create new employment opportunities, pursue measures to strengthen and expand the state's private economy; and
- identify and develop new sources of recurring revenue with a priority on "user fees" that will allow recovery of the cost of providing public services directly from the beneficiaries of those services.

INTRODUCTION

While the Alaska Department of Revenue's most recent short-term "mid-case" forecast ($ 2.25 billion) projects sufficient revenue to support a "maintenance level" budget for the coming fiscal year (FY 91), over the long term state revenues are expected to deteriorate rapidly with the production decline of Prudhoe Bay.

Petroleum revenues already have fallen to just half of what they were in the peak revenue years of the early 1980's. If real (inflation-adjusted) oil prices remain in their current range, oil revenues will drop by half again by the year 2000.

If annual state General Fund spending were held at present levels of approximately $2.3 billion (1989 $), the projected "fiscal gap" between expenditures and revenues likely would be several hundred million dollars a year in the early 1990s and more than $1 billion annually after the turn of the century.

The decline in Prudhoe Bay will compel a reduction in state spending. Even if one were to assume that a decision was made to deplete the entire Permanent Fund, state spending can not be maintained at current levels.

All credible analysis leads to the same conclusion: the current state spending level of approximately $2.3 billion (in 1989 $) cannot be sustained. The state budget will have to be reduced, not as a matter of choice, but as a matter of necessity. The only substantial point of policy debate concerns how deeply to cut the budget and how soon substantial reductions should be made.

Even assuming substantial new oil and gas development in Alaska and significant expansion of the state's non-petroleum economic sectors, the decline of Prudhoe Bay, North America's largest oil field, will have a dramatic impact on the Alaska economy.

The Executive Branch and legislative response to the inevitable decline in state spending and the type of action taken (or not taken) to reduce state spending over the next few years will have a significant influence on magnitude and severity of the economic impacts associated with the downturn in petroleum revenues.

The most important issue confronting the Governor and the legislature is how to manage the transition to a smaller, sustainable state budget in order to minimize the adverse economic impacts that will necessarily attend the reduction in available revenues. Recognizing that a failure to take decisive action in the near-term will only result in unnecessarily harsh economic impacts in the long-term, **the Fiscal Policy Subcommittee recommends that the Legislature adopt a "target spending level" of $1.9 billion (1989 $) to be achieved within 5 years.**

In order to realize these spending reductions in an orderly manner, the Subcommittee recommends that a constitutional spending limit be enacted that will enforce a gradual and orderly reduction in state spending of about 3-5% per year to achieve the $1.9 billion (1989 $) "target" budget level.

THE NECESSITY TO REDUCE SPENDING

In a recent analysis of the state's impending budget gap, the University of Alaska's Institute for Social and Economic Research (ISER) developed and evaluated four possible fiscal policy scenarios. Without endorsing or recommending any particular policy scenario, ISER developed the options in order to describe a broad range of fiscal choices (see The Alaska Fiscal Gap, ISER Fiscal Policy Papers No. 1, August 1989). The four scenarios can be briefly summarized briefly as follows:

Scenario 1: "Stumble from Year-to-Year"

This case assumes an effort is made to maintain current spending levels for as long as possible drawing on all available reserves (i.e.,, Railbelt Energy Fund, Earnings

Reserve Account) except the principal of the Permanent Fund. No new tax measures would be enacted. In this scenario, declining revenues would force significant budget cuts by 1992 with a cut of approximately 18 percent that year. Expenditures in the year 2000 would be $1.2 billion (1989 $), equal to revenues collected that year.

Approximately 26,000 public and private jobs would be lost over the next decade as state general fund expenditures were cut roughly in half.

Scenario 2: "Deplete the Permanent Fund"

The most drastic scenario developed would be to use the entire $10 billion in the Permanent Fund (Earnings Reserve, Inflation-Proofing and, eventually, the corpus of the Fund) to sustain the current spending level. No new tax measures would be enacted. Draws on the Permanent Fund would begin in 1992 and the Permanent Fund would be depleted by the year 2003. At that point, the budget would collapse to a level of about $1 billion.

While Alaska employment would increase in the near term, severe economic and a recession would start in 2003. Approximately 30,000 public and private jobs would be lost over a two year period. (By comparison, job loss during the 1985-1988 recession was about 25,000.)

Scenario 3: "Freeze the Budget/Spend Permanent Fund"

Under this scenario, the budget is held constant in nominal terms (i.e., not adjusted for inflation) and the entire $10 billion Permanent Fund would be spent to maintain this level of spending. The effect of this scenario would be to reduce the "purchasing power" of the budget by the annual rate of inflation (estimated at 5% annually). No new tax measures would be enacted. By 1998 the budget would be reduced to a level of $1.5 billion (1989 $). This scenario assumes that after 1998 the budget would be held constant at $1.5 billion (1989 $). The Permanent Fund would be depleted shortly after the year 2010 and further major reductions in spending would be required thereafter.

This scenario would result in the gradual loss of about 20,000 public and private jobs over the next decade. After 2010, when spending was sharply curtailed upon depletion of the Permanent Fund, a "shock wave" of reduced employment would travel through the economy.

Scenario 4: "Cut Spending and Raise Taxes"

This scenario calls for meeting the projected fiscal gap through a combination of spending cuts and the establishment of new recurring revenues. This scenario contemplates a 25% cut in the General Fund budget over a 10-year period to $1.7 billion (1989 $), coupled with action to increase sustainable recurring revenues by $650 million annually. Under this scenario it is assumed that the personal income tax is reimposed ($250 million/year) in 1991 and Permanent Fund earnings currently used for dividends ($400 million/year) are diverted to support general public services in 1995. This scenario indicates that a General Fund budget level of $1.7 billion/year could be sustained through the 1990s and beyond into the following decades. After the year 2000, expenditures could be maintained at the target level indefinitely. This scenario also would require near-term budget cuts even while state revenues are still on the increase over the next few years.

About 12,000 public and private jobs would be lost as spending cuts were made. Another 3,000 would be lost as the income tax was reimposed and 5,000 more when the Permanent Fund dividend program was terminated.

ECONOMIC IMPACTS OF ALTERNATIVE FISCAL SCENARIOS

In comparing these fiscal scenarios, it is evident that state spending must be reduced. While these reductions can be avoided in the near term, eventually they must be confronted. Even if the personal income tax were reimposed and revenues now used for PFDs were diverted to support basic government services, the ISER analysis conclude that state general fund spending still would have to be cut by approximately 25% in order to achieve an indefinitely sustainable budget level of $1.7 billion (1989 $).

Accordingly, even if substantial new taxes were imposed and/or there was support for use of the Permanent Fund for basic services, significant cuts in state spending still would be inescapable. **The only significant point of policy debate concerns how deeply to cut the budget and how soon substantial reductions should be made.**

Further, it is apparent from the ISER analysis that the fiscal policy choices made in the near-term by the legislature will have a significant influence on the nature and extent of the eventual economic impacts experienced by the state economy as spending declines.

Gradual reductions in state spending would have the least traumatic effect as measured in total job loss while also allowing for maximum state-supported employment over the long term. By contrast, the avoidance or forestalling of budget cuts in the near-term eventually will lead to a larger total job loss when spending reductions become unavoidable, as well as a lower overall, long-term level of state-supported employment.

In summary, the near-term actions taken (or not taken) by the Governor and the legislature to reduce state spending will significantly influence the eventual severity and extent of the public and private sector employment supported by state spending. If the public policy objective were to maximize Alaska employment, the ISER analysis indicates that the scenario assuming a combination of budget reductions and new revenue measures (i.e., Scenario 4: "Cut Spending and Raise Taxes") would result in the lowest total job loss attributable to reduced revenues while also yielding the highest overall sustainable level of Alaska employment in the long term.

POLICY PRINCIPLES TO GUIDE THE TRANSITION

In the view of the Fiscal Policy Subcommittee, several fundamental principles should be used to guide decision-making as the Legislature undertakes the effort to make the transition to a smaller annual state budget based on annually recurring revenue streams. During recent hearings information was provided to the subcommittee concerning work of the Council on Economic Policies established by former Governor Jay Hammond. Several of the following principles are derived from the Council's work.

Principal No. 1: The State should separate subsidies from investments.

Investments are those that are projected to yield a return of principal and interest directly to the State treasury, through the imposition of taxes or user fees. Subsidies, on the other hand, are State expenditures that support a given project or service which has some broad public purpose, but provides less than a market financial return to the State treasury. Subsidies should be explicit, and should be budgeted. Apart from special projects, it is important to remember that in the absence of a broad-based tax structure, all households and all businesses, with the exception of oil and gas producers, are being subsidized by the state because they are not paying the full cost of the services and facilities they require.

Principle No. 2: The State should have in place a tax structure that captures a portion of the wealth attributable to economic growth.

Increased economic activity generates additional needs for governmental services and infrastructure, as the resulting population increases. However, the tax mechanisms commonly found in other states needed to support these additional expenditures (such as the income tax or sales tax) are not currently in place. Therefore, additional growth means increasing deficits in terms of industry paying its own way. Unless economic growth includes payment for required services, the state finds itself in the position of subsidizing the creation of jobs and then subsidizing the services that these new jobholders require.

Principal No. 3: The State should not engage in purely speculative development of infrastructure.

The state should evaluate speculative infrastructure development proposals very carefully as the risk is high and the experience of other developing countries that have attempted this approach, as well as Alaska's own experience, has been abysmal. The state must ensure that its money is spent wisely on the most needed development projects that have the greatest chance of facilitating private sector development. State involvement in the case of infrastructure development for economic development should be conditioned on a clear commitment by private parties to share in the cost and responsibility for project development.

MANAGING THE TRANSITION

Although the need to reduce state spending clearly is recognized by the Legislature, widely different budget priorities among the many regions of the state and the availability of "surplus revenues" during the recent past have frustrated recent attempts to reduce spending.

Constitutional Limit on State Spending

In recognition of the inevitability of general fund reductions and the need to ensure an orderly reduction in spending that minimizes adverse economic impacts, the Subcommittee recommends enactment a constitutional amendment to compel spending reductions.

This amendment would

- target a spending level of $1.9 billion (1989 $) within 4 years; and

- reduce spending by 3-5% each year over that period in order to achieve the target spending level by FY 1995;

The proposed constitutional amendment would limit appropriations to $2.2 billion or a maximum equal to appropriations of the previous fiscal year, whichever are less, with certain exceptions as stipulated. These exceptions would include:

- appropriations to the Permanent Fund
- appropriations for Permanent Fund Dividends

- appropriations of revenue bond proceeds
- appropriations for payment of General Obligation bonds
- appropriations of non-state "pass-through" funds
- appropriations to meet a state of disaster declared by the Governor as prescribed by law

A partial exception to this "spending cap" would be allowed if inflation were determined to be above 6%. If, in the session following a given fiscal year appropriation, inflation was determined to be in excess of 6%, an appropriation above the cap would be allowable -- but only to the extent necessary to offset the effects of inflation above 6% -- and then subject to a two-thirds vote of the membership of the Legislature.

Existing language in the state constitution concerning the allocation of appropriations between operating and capital expenditures would be repealed.

The appropriation limit would be in effect for four years and expire at the end of Fiscal Year 1995 (i.e., June 30, 1995).

<u>Fiscal Effect of Spending Limit</u>

Capping spending at $2.2 billion would have the effect of reducing the budget (in terms of effective purchasing power) by the rate of inflation, estimated at approximately 5% per year. Still further reductions would be required under a $2.2 billion cap in order to "absorb" the cost increases driven by formula program increases (e.g., additional students in the foundation formula, increased power consumption under the Power Cost Equalization program, additional applicants for the Longevity bonus) absent "cost containment" changes to these formula programs. Also, increased federal program responsibilities (e.g.,, welfare reform) without increased federal funding would necessitate further cutbacks to existing state services or programs.

Although there is no consensus at the present time regarding an appropriate level of state spending, it is clear that current levels can not be sustained. The proposed constitutional amendment would substantially reduce the budget to a level of approximately $1.9 billion (1989$) by the end of FY 1995 when the amendment would expire.

Although current analysis indicates that even this substantially lower level of spending is not supportable without new or increased recurring revenues, the "fiscal gap" will have been significantly reduced and the general public, the Governor and the legislature will be able to reassess the state's fiscal condition at that time.

Windfalls Off the Table

Whether or not the effort to enact a constitutional amendment is successful, it will be imperative for the Legislature to take action to take "windfall" revenues such as one-time litigation settlements "off the table."

Several proposals have been advanced toward this end. These proposals include:

- re-establishment of a budget reserve fund;
- appropriation to provide "forward funding" of education;
- use of near-term surplus revenues to pay off the state's General Obligation bonded indebtedness; and

- appropriation to the Permanent Fund.

Regardless of what specific mechanism is chosen, action should be taken either to "save" these surplus revenues for future spending or commit them to a purpose that will preclude their use in a way that will frustrate the long-term objective of reducing state spending in a gradual and orderly fashion. Passage of the proposed constitutional amendment would accomplish this goal.

Expanding the Private Economy

Although it is widely accepted that there are no realistic opportunities available to replace Prudhoe Bay as the state's dominant source of revenue, it is still imperative to support the continued exploration and development of Alaska's oil and gas resources in an environmentally responsible manner with particular emphasis on the prevention of future oil spills through the rigorous regulation and enforcement of the state's oil pollution control laws.

At the same time, while recognizing the limited contribution to be made from the non-petroleum sector of the state economy relative to the oil industry (see summary of the Alaska State Chamber of Commerce "Export Model" below), there are actions that the Legislature can and should take to expand and strengthen the state's non-petroleum economy.

In particular, efforts should be focused on expanding the state's tourism economy; strengthening our fishing industry; capitalizing on Alaska's global geopolitical location as part of the worldwide transportation and distribution industry; encouragement of new international and domestic investments in Alaska through changes to the state's unitary tax law; facilitating development of a state information industry; and continued efforts to expand international trade.

An economic development legislative agenda developed by the House Majority Economic Development Working Group is attached as Appendix A.

Budget Reduction Strategies and New Revenue Options

The Fiscal Policy Subcommittee addressed the issue of potential budget reductions and new revenue options in its previous reports.

No significantly new information is available to modify the Subcommittee's earlier findings.

SUMMARY OF EMPLOYMENT IMPLICATIONS
ALTERNATIVE FISCAL SCENARIOS

<u>Stumble Along</u>

- 33,000 public and private jobs lost by 2010
- state-supported jobs in 2010: 26,000
- wage/salary employment 2010[1]: 236,000

<u>Deplete Permanent Fund</u>

- 35,000 public and private jobs lost by 2010
- state-supported jobs in 2010: 23,000
- wage/salary employment 2010[1]: 233,000

<u>Freeze/Spend Permanent Fund</u>

- 21,000 public and private jobs lost by 2010
- state-supported jobs in 2010: 38,000*
- wage/salary employment 2010[1]: 249,000*

(* about 2015, state-supported employment would experience a dramatic drop as the Permanent Fund was exhausted)

<u>Cut Spending & Raise Taxes</u>

- 19,000 public and private jobs lost by 2010
- state supported jobs in 2010: 40,000
- wage/salary employment 2010[1]: 247,000

Note:

(1) exclusive of military and self-employed

Source: Goldsmith, S., "The Alaska Fiscal Gap," Institute of Social and Economic Research, University of Alaska Anchorage (August 1989) and personal communication.

EXPORT MODEL OF THE ALASKA ECONOMY
(in millions)

Oil and Gas		$ 4,000
Fishing		300
Timber		200
Minerals		100
Coal		25
Travel/Tourism		500
Defense	1,600	
Other Federal	1,300	
	2,900	
Less Federal Taxes	(2,000)	900
Permanent Fund Dividend		300
Total Estimated Value		**$ 6,325**

Source: Alaska State Chamber of Commerce (January 1988)

12/21/89 DRAFT

APPENDIX A

HOUSE MAJORITY ECONOMIC DEVELOPMENT WORKING GROUP

Premise: Expansion of the private sector economy should be enhanced by specific actions taken by the Legislature.

ECONOMIC DEVELOPMENT STRATEGIES

■ **Continue to develop the most viable and promising existing resource extraction industries -- which include oil and gas, coal, minerals, and timber.**

■ **Double the number of visitors to Alaska by the year 2000.**

Maintain support for domestic marketing program. Increase emphasis on independent and highway travelers, fall-winter-spring seasons.

Initiate expanded, multi-year international tourism marketing program.

Fund tourism infrastructure projects, such as

* State park repairs, maintenance/expansion of basic facilities
* Ship Creek re-development
* Denali development
* Girdwood water/sewer system
* Project 92 (50th anniversary of Alaska Highway)
* Juneau cruise ship port development

Pass legislation (SB 213/HB 290) to facilitate the leasing of state land for recreational facilities.

■ **Expand the management capability and marketing of Alaska's fisheries resources.**

Undertake assessment of fisheries that could be more intensely harvested consistent with the sustained yield principle.

Target and support enhancement programs to compliment commercial and sport fisheries expansion.

Increase management capability so that adequate information and enforcement efforts can maximize economic harvest.

- **Expand transportation/distribution industry (capitalize on Alaska's strategic geographic location).**

  Maintain port and airport facilities; expand facilities to accommodate viable economic activity.

  Support DOTPF effort to **establish a Statewide Port and Harbor Development Program.**

- **Encourage international and domestic capital investments in Alaska.**

  Support unitary tax change (HB 281/SB119).

- **Encourage development of an information industry.**

  Undertake assessment of public and private efforts to develop this industry and prepare a strategic plan for implementation, including actions such as establishing a University Center for Information Technology.

  Support university programs generally.

- **Continue efforts to expand international trade.**

  Expand Pacific Rim language courses in the state school system (HB 6) and the university.

CAPITAL SPENDING PROPOSAL

To implement several of the strategies identified above, to protect prior investments, and to fulfill statutory and constitutional responsibilities, continue to make capital investments in maintenance and public infrastructure.

- **Goals:**

  Meet highest statewide and regional priorities.

  Enhance development of the private sector economy.

- **Criteria:**

  Will the project serve a public purpose? Is it a constitutional or statutory responsibility?

  Is there evidence of public and local community support?

  Is the project ready for development?

Will the project provide for the basic maintenance of an existing capital investment; what are the long-term O&M cost implications?

Will the project leverage non-state investment?

Will the project generate a direct return to the state treasury in terms of new revenues?

Will the project will have a quantifiable positive economic benefit for the state, or a region of the state, considering all costs and benefits (such as jobs created, royalties and taxes captured, and ancillary economic or other benefits)?

Is the project compatible with maintenance of environmental quality; does it enhance, or at least not degrade, the quality of life for those directly affected?

Will the project enhance the development of private enterprises?

Proposed total capital budget:

$250 million.

Funding sources:

$125 million GF and $125 million RBEF.

Proposed allocation:

$125 million -- Governor's capital budget (statewide projects, agency capital projects, roads, schools, repairs, etc.)

$125 million -- Railbelt economic development projects

Process:

Orderly process and consideration of projects on merit and criteria.