

SCOMM

101:4

SUMMARY

Task Force on School Funding

June 19 - 20, 1995

Anchorage, Alaska

Call to Order - Stowell Johnstone, chair

Stowell Johnstone, chair of the Task Force on School Funding, called the meeting to order. The following members of the task force were present:

Tim Altman
David Cottrell
Mary Ann Eininger
Senator Lyda Green
Jack Krieheder
Representative Irene Nicholia

Nancy Cannington
Laraine Derr
Senator Steve Frank
Robert Gottstein
Dave Marquez
Bob Weinstein

Shirley Holloway, Commissioner of Education
Dianne Lindback, staff to Representative Elton
Bruce Richards, staff to Senator Judy Salo
John Walsh, staff to Representative Foster

Review May 19 Meeting and May 20 Conference

Tom Freeman, consultant to the task force, reviewed the public conference held May 20 in Anchorage. Over 200 individual responses were given to the question, "What do you think are the major problems with school funding?" Tom analyzed these responses and reported that all five groups identified the following four areas of concern:

- the current formula is inequitable
- lack of inflation proofing
- unfunded mandates for special programs
- unfunded facilities and/or maintenance needs

In addition, Tom indicated that four break-out groups had the following responses in common:

- lack of forward funding
- lack of community awareness
- recognition of the needs of small single sites

Misc Info:

1. Summary Task Force on School Funding
2. Public Testimony from Cliff John Groh
3. Recap of Organization's Activities on State Fiscal Reform

Identify School Funding Problems and Issues Important to the Task Force

The next agenda item allowed the task force members to reflect on all the public comments offered to date and to brainstorm the issues they would like to discuss in further detail. After a lengthy free-flowing brainstorming session, the task force compiled the list that follows:

- single site districts
- massage present formula
- understandable, simple formula
- capital expenditure
- governance
- size and number of districts
- area cost differential
- simplify categorical funding
- set goals - what do we want
- forward funding
- disparity test
- parental involvement
- transportation
- choice
- present limits of funding source
- task force goal
- equalization of wealth
- define equity
- PL 81-874

Discuss Problems and Issues

The committee spent many hours discussing and analyzing the issues identified above. A summary of that discussion follows:

Equalization of Wealth, Local Control, Disparity, PL 81-874

The task force members recognized how closely these concepts are interwoven. State statute limits the amount a local school district may contribute towards school funding so that Alaska meets the federal disparity test. Alaska must be in compliance so that the state can recognize impact aid dollars as a means to equalize wealth between school districts. Individual district wealth needs to be equalized to an acceptable standard to insure that all districts are treated equally.

Although PL 81-874 dollars represent a small percentage of the total amount allocated for school funding (\$43 million in FY96 out of a total of \$711 million), it is highly unlikely that replacement dollars will be available from the legislature.

PL 81-874

Impact aid is received from the federal government for payment in lieu of taxes for individuals working or living on federal lands. The passage of ANILCA removed land from the tax roll and greatly increased the number of students eligible for PL 81-874 support. Kansas, New Mexico, and Alaska are the only three states that are allowed to deduct impact aid from a district's state aid entitlement.

Disparity

The discussion on disparity centered on the need to insure equity between school districts. Even if the federal standard of disparity did not apply, the committee felt that an Alaskan standard should be considered. All students should be treated equally under the formula.

Transportation

The possibility of including transportation costs within the formula was discussed. One task force member indicated that the costs of transporting students was a function of the number of students and the needs of those students. Currently, school districts are reimbursed for the cost incurred with little or no oversight by the department. Possibly a new approach for covering these expenses should be discussed.

Capital Expenditure or School Construction

An alternative to the current method of providing school construction dollars was discussed. The merits of including discretionary funds within the school funding formula for capital and major maintenance expenses was explored. This plan would allow a school district to save and plan for its capital and major maintenance needs. The decision to fund additional projects would be made at the local level.

Single Site District

The task force was briefed on the history of the special appropriations to small single site school districts. In FY96, 21 small single site school districts received additional district support totaling \$3.2 million.

Understandable, Simple Formula

Many members of the task force indicated the importance of proposing a school funding formula that was simple and understandable to the general public. When a formula is too complex to be understood by many people, there is a tendency to wonder if the system is really treating all school districts equally.

Simplify Categorical Funding

During the dialogue on the current categorical funding mechanism, the importance of local decision making was stressed. Several members indicated that it is important to simplify the programs. The current vocational education plan is an allocation per student enrolled in eligible courses. Possibly this approach should be considered for the other special categories.

It was pointed out by one task force member that the growth in categorical expenditures has greatly surpassed the increased student enrollment. Since 1987, student enrollment increased 20%, while the growth in categorical programs has been almost 60%. The task force was encouraged to address this concern.

Area Cost Differential

It was recognized by the task force that the current area cost differential (ACD) is based on a household cost of living study and not on the actual cost of providing an education. The possibility of limiting the ACD to personnel costs was addressed. There was recognition by the task force that incentives may be needed to help control costs.

Massage Present Formula

The task force was informed that when the foundation formula was revised in 1987 an additional \$63 million was required. It appears very unlikely that additional funds for education will be available for this revision. Although several members of the task force acknowledged that the

current formula addresses the uniqueness of Alaska (minimum local contribution requirement and the area cost differential), the vast differences in the cost of providing an education per student is troublesome and should be looked at.

Governance

The members explored a variety governance structures for public education. The task force emphasized the importance of parental involvement in decision making and the value of possibly including incentives within the formula to encourage cooperation between school districts.

Task Force Goals

The group decided that four main goals should drive the revision of the formula; adequacy, equity, local control, and accountability. After considerable free-flowing discussion, the task force agreed to the following basic concepts:

Adequacy (of funding) - maintain, at least, current level of funding, every child's needs must be reasonably addressed, capital expenditures and maintenance of facilities must be considered, mandated programs need to be funded

Equity - equity can be defined in terms of funding, learning outcomes, access and opportunity to education, and tax payer contribution

Local Control - people do a better job of managing their lives than government, local control includes parents and other concerned individuals, local control equals the local education community, ideally vest control in the hands of parents

Accountability - should bubble from the bottom up as in school site decision making, sanctions vs. incentives, local school derives authority from state statutes

Identify Potential Solutions

Several members suggested that any new proposal must be a win-win situation for school districts. If districts are adversely impacted by the change, most likely neither the governor nor the legislature will support the proposal. If the new funding formula is simple and logical and addresses the concerns previously outlined, the new proposal will be viewed with an open mind.

An idea for distributing education dollars on a per student basis was presented to the task force by a committee member. Under the plan presented each individual student would receive funding based on one of three categories depending on the needs of the student. The three categories suggested are *Base*, *Special Needs 1* and *Special Needs 2*. A *Special Needs 1* student would receive 2 times the base and a *Special Needs 2* child would receive 5 times the base.

In addition, the state would be divided into 3 distinct geographical areas:

Area A - urban communities - approximately 80% of the students

Area B - remote communities that have access to major transportation systems - 5%

Area C - very remote communities, not on a road system - 15% of the students

Area B would receive 25% more than Area A and Area C would receive 75% more than Area A.

The area in which a student's school is located and the needs of that student would determine the funding level. Thus, the funding plan is based on 2-dimensional matrix, the area of the state and the individual student needs. The matrix is shown as follows:

	Area A	Area B	Area C
Base	\$ 5,000	\$ 6,250	\$ 8,750
Special Needs 1	10,000	12,500	17,500
Special Needs 2	25,000	31,250	43,750
Waiver *	50,000	62,500	87,500

* A waiver would be granted if a student needs were not addressed by the funding allocated in the category, *Special Needs 2*.

It was recommended that the payment for education be distributed through a student allocation similar to a public voucher that would be given to the parent or legal guardian of a student. The parent would be able to decide which school his or her student would attend. The public voucher would be taken by the parent or legal guardian to this school. The financial decisions on how to spend the voucher would then be made at the school level, instead of at the district level. The money would flow from the building level to the district administrative level. It was indicated that the use of the public voucher would result in a change in the governance structure of our schools. The funding decisions would be made at the building level; the level most directly impacted by those decisions.

Although the member recommended serious consideration of the public voucher proposal, it was indicated that this plan to distribute school funding based on a per student basis could stand alone, with or without a public voucher.

It was suggested that incentives could be established that would encourage local communities to contribute more local dollars to education. In addition, the cost of transportation and capital expenditures could also be included in the formula.

The task force reviewed the information presented and discussed the proposal in great detail.

Determine Order of Discussion and Align Discussion Topics with Meeting Calendar

The task force requested that John Augenblick, a nationally recognized school finance consultant, be present at the next meeting. After considering the pros and cons of breaking into small subcommittees to study areas of concern in greater depth, the task force decided to continue to function as a committee of the whole and to review each concept as a group.

The task force will continue to review the current formula with possible changes and will begin a study of the proposal to fund education on a per student basis. To assist the committee in its deliberation, the Department of Education was requested to provide the following information:

1. Within the existing foundation formula, look at needed or desired proposals in the following areas utilizing the same governance structure, "district level"
 - a. Single site
 - b. Disparity test-PL 81-874
 - c. Incentives for shared resources/services
 - d. Categorical funding collapse
 - e. Equalization of wealth
 - f. Area cost differential
2. Analyze the formula proposal that was based on a per pupil revenue using the same framework as above and using district level governance
3. Analyze the formula proposal that was based on a per pupil revenue using a "student level" funding
4. Consider the possibility of funding pupil transportation in the school funding formula
5. Prepare an overview of PL 81-874 including analysis of how PL 81-874 is treated today in the current formula and expected future changes
6. Review the possibility of an alternative price index
 - a. Provide an analysis of personnel costs and non personnel costs
 - b. Provide an analysis of O & M vs. Instruction
7. Provide background information on capital project funding for major maintenance and school construction and the long and short term activities of the Bond Reimbursement and Grant Review Committee

OTHER ISSUES

- A. Options for community to support and contribute
- B. Long term plan for the formula, with a periodic review process
- C. Forward funding (to allow districts to plan for a period of time)
- D. Analyze the need for single site additional district support
- E. Analyze proposed versions of SB 70

Adjourn

Before adjourning, the task force indicated that the next meeting would take place July 10 - 11 in Anchorage at the Iliamna Room, Hilton Hotel. The meeting will begin Monday at 10:00 a.m.

UNDERSTANDING THE FISCAL GAP

I. What is the nature of the problem?

II. What are possible solutions?

A. Statutory changes

1. Cut the budget, reduce Permanent Fund dividends (PFDs), raise taxes, use reserves strategically to make the transition to a sustainable balance, aim for a soft landing
Advocates include Scott Goldsmith, Steve Colt, and Pat Pourchot
2. Cut budget and reduce PFDs, but don't raise taxes
Advocates include Steve Rieger
3. Cut budget and raise taxes, but don't cut PFDs
Advocates (at least previously) included Hugh Malone
4. Muddle through--do not amend the constitution, as this could harm representative government
Advocates include John Havelock

B. Constitutional amendments

1. Roger Cremo--put all natural resource revenues (in practice, this would mostly be oil money, including all oil taxes and all oil royalties) into the Permanent Fund (PF) and live off the real (inflation-adjusted) income (assumed to be 6% a year) plus other revenues and budget cuts; the transition to this proposed system would rely on annual withdrawals from the PF; these transitional withdrawals during the transition would be higher than the real income of the PF, but the withdrawals would decline each year until the transition ended
2. Jay Hammond--adopt Cremo plan, modified by guarantee of increased PFDs if voters support budget cuts and a "sliding scale tax" which would have the rate of income tax vary with oil prices and the budget
3. Dave Harbour--put all oil royalties into PF, end PF inflation-proofing, require cash-based budgeting, impose an individual income tax, prohibit tax increases without voter approval; transition would be financed by a one-time voter-approved withdrawal from PF for one-year forward funding of the budget
4. Mike Bradner--adopt a temporary tax increase by adopting a constitutional amendment for a tax increase with a sunset provision

*NOTE: Additional Material
From Mr. Groh available in
LEPPC library.*

Cliff John Groh
April 5, 1995

estimate from the Alaska Department of Revenue indicates a broad-based state general sales tax could raise \$60 million per 1 percent of tax. To raise the same \$330 million as the old income tax would require a sales tax of 5.5 percent. This estimate assumes that the tax would cover all retail sales.

Alaska is one of only a handful of states with no statewide sales tax. (Alaska is the only state without either an individual income or a sales tax.) A 5.5 percent rate would put Alaska among the highest tier of states in sales tax rates.

Federal law currently makes state sales tax non-deductible against the federal income tax, while state income taxes remain deductible. This means that Alaskans would fare worse with a sales tax.

Enacting a statewide sales tax also raises the question of how the state will treat sales in areas that already have local sales taxes. The revenue estimate assumes that the state will neither allow a credit against the state sales tax for local governments which have their own local sales tax, nor will it share revenues with those local governments. If the state takes this approach, businesses within those jurisdictions will be forced to assume a double filing burden. This increases the potential for errors and non-compliance, and substantially increases the political opposition.

The start-up on a general statewide sales tax would be very high, in part because we have never had one.

This tax is regressive, and will hit particularly hard at low-income Alaskans. Non-residents and seasonal workers will largely escape this tax, because they do not buy much here.

Despite the unfairness of this tax, it is less unpopular than an income tax, because the sales tax is paid in nickels and dimes all year long instead of in a lump-sum check.

- ♦ **Cut Permanent Fund Dividends.** About half of the Permanent Fund's income each year goes for Permanent Fund Dividends. This unique Alaska program puts more than \$500 million into the Alaska economy annually, with each Alaskan getting a check of nearly \$1,000. For every \$20 bill you see in the Alaska economy, about \$1 of it is a dividend dollar.

The dividend program functions as a "negative," or reverse, flat head tax. Eliminating dividends could be considered regressive taxation.

The program was born during the petrodollar surge of the early '80s, and it has several rationales for its existence. Here are five:

(1) Permanent Fund Dividends build a political constituency for the Permanent Fund itself. Special-interest pressure for fund investment in shaky Alaska development schemes would be irresistible without the provision of direct and tangible benefits for individual Alaskans. Dividends provide that direct and tangible benefit, and give the public a powerful incentive to increase the size of the fund and

protect it against special-interest raids.

(2) Dividends are more fair than many of the other uses of the oil money. Subsidized loan programs have been a particularly egregious example of the inequity of other uses of the oil wealth. Loans only go to those who can pay them back — thus cutting out many people — and subsidized loans provide big grants of "subsidy welfare" to those fortunate enough to receive them.

(3) To the degree that government expenditures in Alaska are justified because of the economic effects, dividends stimulate the economy more efficiently than do operating expenditures, capital expenditures, or loan programs. Using a dollar to pay a dividend check increases personal income more and creates more jobs than using that dollar to pay for the operating budget, the capital budget, or a loan program. Permanent Fund Dividends provide a significant portion of the incomes of many Alaskans, particularly village Natives — more than 10 percent in some areas, according to census figures.

(4) Dividends deliver benefits more efficiently to their targeted populations than other methods. Significant chunks of money distributed in other ways leaks out to "middlemen." Dividends allow each Alaskan to receive benefits undiluted by state employees, construction contractors, or bankers.

(5) The payments of the dividend decentralizes decision-making. Individual decisions can often be better than collective decisions. Some Alaskans believe that the money distributed as dividends in the 1980s was better spent than it would have been if the legislature had had that money available to spend.

Some say that these rationales for continuing the dividend mark the program as an antidote for a disease — too much money coming into public hands — which is now gone, and that the antidote itself is no longer necessary and perhaps even harmful. Some say it's time for the state to return to the core functions of government, which do not include per capita direct distributions. And some will say that it would be crazy to restore the individual income tax as long as the Permanent Fund Dividend survives.

There may be merit to these arguments against dividends, but Alaskans should be wary. Permanent Fund Dividends *have* helped protect the Permanent Fund from low-return investments, and they have been a big boon to lower-income Alaskans with large families who were not so poor as to qualify for public assistance. Eliminating the dividend would hurt low-income residents. Keeping the dividend should be considered whether or not the income tax comes back.

The author served as Special Assistant to the Commissioner of Revenue from 1987 to 1990. He is now an attorney in Anchorage.

ORGANIZATIONS' ACTIVITIES
ON
STATE FISCAL REFORM

Compiled from reports at a June 8, 1995 meeting. Attendees: T. Bradner, P. Tielston, Alaska Common Ground; K. Swift, Common Sense for Alaska; P. Neal, C. Frasca, Alaska State Chamber of Commerce; C. Heyman, T. Williams, Anchorage Chamber of Commerce; N. Schoephoester, ARCO; K. Burke, Alliance; J. Brady, A. Gray, AOGA; and M. Fouse, staff, Fiscal Planning Commission.

Alaska Common Ground

- Produced and aired first video program "Running out of Time" this spring.
- Second video program "Pulling Together" airs June 14 on KAKM.
- Sept./Oct. tentatively planning conference--agenda for conference not yet set, may wait to see what Fiscal Planning Commission is doing to set agenda.
- Public Participation and Constitutional Committees looking at ways to get rural areas plugged into the process--looking at using existing organizations to get materials into communities and to get discussion going.

Alaska Support Industry Alliance

- Alliance adopted position supporting forward funding/systemic change.
- Advertising campaign advocating forward funding currently on hold.

Alaska State Chamber of Commerce

- July 28 Seminar "Privatizing Government...Expanding the Options, Trimming the Costs"--Alyeska Resort.
- September 26-28 State Chamber Conference (in Whitehorse)--opportunity to focus on fiscal issues.
- Produces and distributes Fiscal Notes--distribution 10,000.

From: Judy Brady

Anchorage Chamber of Commerce

- August, 1995 Chamber Forum--Brian Rogers will present Fiscal Planning Commission Interim Report.
- Chamber involving rural Alaska through its Rural Partnership forum.
- Fall, 95 Small Business Conference--opportunity to educate small businesses on fiscal issues.

Common Sense for Alaska

- Will continue to focus advocacy efforts on need to cut the budget with emphasis on formula programs--welfare reform and possibly education and/or corrections.
- Plans "road show" program this summer & program before session convenes in Jan. 96.

All organizations represented agreeable to theme "Challenge of Change" and to continued meetings to coordinate efforts.

June 30 Mtg
Work Session Notes

Dave Pearce

will be sending pickers re:

- CBR, should there be changes
and what should they be, how to
get on ballot.

Funds avail

repayment ^{to CBR} ~~not~~

- Settlement / admin hearing trigger

BR: CBR will play a role in any accs to
the legislature

UN: CBR drive realloc \$ / increase \$?

DP: has become force / could lead to
swap of accs SET ASIDE in statute.

BR: Put on shelf?

DP: CR + DP believe long term fiscal health
important, not put off cliff

LG: Super majority $\rightarrow$ now total budget, ^{instead} CBR
should be segregated?

DP: legislative intent that \$ ^{old back taxes} windfall set
aside. Will look for analysis of language.
Steve Rieger interested

★ Brian asked Mary Nordale to look at ★
Ch. Revenue subcommittee.

JB - revisit agreements/assumptions re: base case. concerned about maintenance/adding increased costs

BR - need to discuss/show sep. base case that doesn't show inc. + debt maint. also show what result is.

JB assumptions about lowered funding don't always lead to particular results

BR Total GF 96 24B / 05. - 4350M

Mary Nordale: Prad - incorp KR's numbers into base case? ★
also decline in cap budget to reflect reduced highway spending.
identify consequences cutbacks

Brian & Rogers: look at Ed Form (+160M) inc. - look at
pop #s that lead to current proj. & calculate unit value \$ in 05 w 25% to 30% increase

in number of students.

JB discuss variables (Lee)

LGossuch - revenues drive expenditures +
define gap

in short run defines growth + turning
did not build in entitlement + formula
programs.

earlier proj. understated growth in
corrections, health care etc.

Base case diff Δ high to low price
fluctuation Δ need to separate
contingencies for price fluct - reserves
policy in addition to gap problem.

Blogs: * remove "base case"

- now call "per capita" = current

"freeze case" ^{no major} real FY96\$

"demand case" incl Perdue projections

Brad: if just look at formula separately using
Kauer's Projections and then reinclude

EDFORM
observed rate of inc = 2.5% per yr.

Brady

Rogers: Use case that includes ~~\$300~~ \$500 million
look at "freeze case" still \$900M short

McConnell Pop inc. 750? 711?

Rogers: Brad confirm pop inc. 1.68% new growth
(compounded)

Goesuch: look at ISER forecast*

McConnell: need to note that employment/economy
shifting from public to private sector.

WORKSHEETS

Brady: Needs Based

McConnell: PACE minimal impact on economy

Rogers: effects of pop on program before reduction
is no inc in pop = equals a cut?

BRADNER disc.

BRAD: • avoid across BD cuts, look at separate
functions
• minimize

- life, health, safety need priority.
- constitutionally mandated, federal req.

J Brady: how enhance / protect admin systems

L Goesuch: Net economic benefit

- willingness to pay / user fees / ^{indiv} local govts
- where no ^{capacity} revenue / tax base still needs to consider basic s/c.
- incentives to lower costs

Rogers: budget should not allow agency exp. to use up cap \$ assets.

Noedake: funding in lump sums for maint ~~~~~
Change budgeting method.

Gorsuch: INTERGENERATIONAL EQUITY

[* indiv vs. business *]

transfer pmts vs. subsidies

• need to focus on "budget buster" items

6
*disparity test.

Brady • next three yrs ▶ ed/trans/ will be held while
OTHERS cut

Noedale/
LOECHER committee ^{should} to address comparability/education
issues

Brady : Need goal for permanent fund. in order
to

Goesuch : Need to concentrate on strategic big picture
then GET APPROVAL FM PUBLIC / ? ARE WE
GOING IN RIGHT DIRECTION?

Noedale : ^{YES} Think we do need to set GOAL for
PERM fund.

ALL ASSETS + ALL EXP ON TABLE.

SEND
GREEN

LUNCH

Outline:

Brady : close w questions, i.e. campus / RIEGER plan/
find out what people think?

McConnell: if we haven't had time for public education, how do we gauge public opinion?

Nordale: concentrate on laying out the problem.
public understanding of consequences of reduction.

McConnell: Factors/Ranking to be considered when looking at revenue raising ~~and~~ items.

Nordale: shorter earlier report would generate more + better public response/opinion.

Grosche 1. BASE CASE: ^{EXISTENCE +} SIZE OF GAP
2. Tools
3. DESPITE EFFORTS still growing.

Brady Combos / Plans / Tradeoffs

ROGERS 1. HELD THE LINE
2. CAN'T CLOSE GAP BY CUTTING SPENDING

GOV real per capita terms ^{cut} 8.9% this year

SPDP → RES. IND → APPTS: RES?

REAL SIZE OF
FISCAL GAP →
NEED ALL (+ PF)
ON TABLE.

Motley: PF needs to be part of scenario

★ send travel form to Marie Westfall★

Gorsuch: Hold press conference

Nordale ★ July 14th 8:30 AM Peem Fund Teleconf ★

- GET CLEAR IMPRESSION OF CURRENT
- REVIEW OPTIONS
- HOW GET THERE?

BRADY IF EVERYTHING IS ON TABLE, LET PUBLIC KNOW THAT.

Motley. ↑

Rogers: All our cases show PF EARNINGS + EXP SEPARATE
BASE CASE SHOULD REFLECT ↑

Nordale REVERSE BASE CASE TO REFLECT PROPOSALS.

PROG RECEIPTS

FED \$

OFF BOOK \$s

★ PUBLIC OUTREACH COMM: HOW SHOULD REPORT LOOK? ★

EXP: MEET + MAKE SCENARIOS

STYLE + D. -

IMPACTS OF
ALTERNATIVES. ★

★ LOESCHER

✓ RITCHIE

★

★ GET MATERIAL TOGETHER. ★

STATE OF ALASKA

TONY KNOWLES, GOVERNOR

DEPT. OF HEALTH AND SOCIAL SERVICES

OFFICE OF THE COMMISSIONER

P.O. BOX 110601
JUNEAU, ALASKA 99811-0601
PHONE: (907) 485-3030
FAX: (907) 485-3068MEMORANDUM

DATE: June 21, 1995

TO: Annalee McConnell, Director
Office of Management and Budget
Office of the Governor

FROM: *Karen Perdue*
Karen Perdue
Commissioner

SUBJECT: Long Range Financial Planning Commission
Excise Taxes on Alcohol and Tobacco

Post-It™ brand tax transmittal memo 7571		of pages 13
To <i>Melissa</i>	From <i>Brad</i>	
Co.	Co.	
Dept.	Phone # <i>465-4677</i>	
Fax # <i>258-9869</i>	Fax # <i>3008</i>	

The Department of Health and Social urges the Office of Management and Budget to bring the issue of increasing the excise tax rate for tobacco products and alcoholic beverages to the attention of the Long Range Financial Planning Commission. Alcohol abuse and tobacco use are major health problems in Alaska and the department approaches the issue of excise taxes solely from a public health perspective. The Department of Health and Social Services is not responsible for collection of these taxes which are, and should remain, within the purview of the Department of Revenue. Additional revenues generated would be deposited directly into the state general fund.

Department of Health and Social Services Perspective

While recognizing that the increased revenues generated by an increase in excise taxes would help meet the overall budget shortfall, the Department of Health and Social Services believes that the primary benefit of increased alcohol and tobacco excise taxes would be an improvement in the overall health status of the Alaskans.

Should the Commission choose to examine this issue, the department also suggests that the Commission consider mechanisms for sharing a portion of any additional revenues generated with local communities. The State of Alaska currently shares some taxes and fees with local communities to help local governments deal with the impacts or share in the economic benefits of certain activities. One example is AS 04.11.610 in which fees charged for the license to sell alcoholic beverages are appropriated back to the communities where they were earned.

The Department of Health and Social Services is committed to the goal of encouraging and enabling local communities to plan, finance and implement local solutions to health and social problems created or aggravated by alcohol and tobacco use. Sharing alcohol and tobacco excise tax revenues with local governments would provide increased local resources to further this goal.

June 20, 1995

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Background on Alcohol Use and Taxation:

Alcohol consumption rates are directly linked with health, safety and social problems. Alaska has for many years had one of the highest alcoholic beverage consumption rates in the United States, ranking fourth highest in per capita consumption. Surveys of Alaskan youth provide startling responses. Over 70% of Alaskan students in grades 10-12 report having used alcohol at some time during their lives compared to only 46% nationally. Only 5% of youth 12-17 years of age in the entire United States use alcohol frequently (at least weekly). In Alaska, this level is reached by the seventh grade and peaks at 25% in grade eleven.

The economic costs to the State and business of alcohol abuse is high. In Alaska this cost has been estimated to be as high as \$500 million annually. Nationally it is estimated that as much as \$34 billion of health care costs are attributable to alcohol abuse each year.

Excise taxes on alcohol were last increased in 1983. Per capita consumption declined significantly after 1983 and continued to decline through 1991. Inflation has since offset the deterrent effect of the last tax increase, however, and consumption has begun to rise. Increasing taxes on alcoholic beverages will assist in reversing the trend of consumption and will assist Alaska in obtaining the goal of 2.0 gallons per capita from the current 3.33 gallons as identified in *Healthy Alaskans 2000*, the initiative aimed at improving the health status of all Alaskans.

Background on Tobacco Use and Taxation:

Tobacco use is an enormous health problem. Tobacco kills one out of three users and disables many more. Causal links have been established between tobacco use and a number of chronic diseases including: stroke, numerous kinds of cancers, coronary heart disease, chronic obstructive pulmonary disease, peripheral artery disease, and low birth weight baby risks.

Nearly 20% of deaths in Alaska are smoking related (one Alaskan dies each day due to smoking attributable causes.) The direct health care costs attributable to smoking in Alaska in one year (1991) were estimated at \$45.6 million for persons 35 years of age or older. This is the equivalent of \$220 per Alaskan 35 or older or \$941 per smoker 35 or older. Indirect costs in that same year, including lost earnings and productivity for persons disabled by smoking-related chronic disease or who died prematurely from smoking related causes was \$82 million.

Although there have been dramatic gains in recent decades in the campaign against tobacco smoking, tobacco use among youth continues to be a public health epidemic. Every day more than 3,000 American teenagers become regular smokers.

The Department of Health and Social Services supports increasing taxes on tobacco because increases in tobacco taxes: (1) saves lives; (2) saves money, especially health care costs; (3) generates revenue; (4) is fair; and (5) is popular. Nearly 90% of smokers start smoking by the age of 21 and increasing the price of tobacco has been demonstrated to decrease the number of users, especially among youth.

STATE OF ALASKA

TONY KNOWLES, GOVERNOR

DEPT. OF HEALTH AND SOCIAL SERVICES

OFFICE OF THE COMMISSIONER

P.O. BOX 110601
JUNEAU, ALASKA 99811-0601
PHONE: (907) 465-3030
FAX: (907) 465-3068

MEMORANDUM

DATE: June 21, 1995

TO: Annalee McConnell, Director
Office of Management and Budget
Office of the Governor

FROM: Karen Perdue
Commissioner

SUBJECT: Long Range Financial Planning Commission
Excise Taxes on Alcohol and Tobacco

Post-It™ brand fax transmittal memo 7671		of pages > 13
To: Melissa	From: Brad	
Co.	Co.	
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Fax # 258-9869	Fax # 3008	

The Department of Health and Social urges the Office of Management and Budget to bring the issue of increasing the excise tax rate for tobacco products and alcoholic beverages to the attention of the Long Range Financial Planning Commission. Alcohol abuse and tobacco use are major health problems in Alaska and the department approaches the issue of excise taxes solely from a public health perspective. The Department of Health and Social Services is not responsible for collection of these taxes which are, and should remain, within the purview of the Department of Revenue. Additional revenues generated would be deposited directly into the state general fund.

Department of Health and Social Services Perspective

While recognizing that the increased revenues generated by an increase in excise taxes would help meet the overall budget shortfall, the Department of Health and Social Services believes that the primary benefit of increased alcohol and tobacco excise taxes would be an improvement in the overall health status of the Alaskans.

Should the Commission choose to examine this issue, the department also suggests that the Commission consider mechanisms for sharing a portion of any additional revenues generated with local communities. The State of Alaska currently shares some taxes and fees with local communities to help local governments deal with the impacts or share in the economic benefits of certain activities. One example is AS 04.11.610 in which fees charged for the license to sell alcoholic beverages are appropriated back to the communities where they were earned.

The Department of Health and Social Services is committed to the goal of encouraging and enabling local communities to plan, finance and implement local solutions to health and social problems created or aggravated by alcohol and tobacco use. Sharing alcohol and tobacco excise tax revenues with local governments would provide increased local resources to further this goal.

June 20, 1995

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Affordability of tobacco appears to be the most important determinant of the number of children who will start smoking. An increase in the cigarette excise tax may be the most effective approach to reducing tobacco use. Teenagers are much more responsive than adults to increases in the price of cigarettes because they have less disposable income and may be three times more sensitive to price increases than adults' consumption. Also children and teenagers are usually less addicted than many adult smokers and, therefore, more likely to be able to stop smoking when prices increase.

The benefits of increasing the tobacco tax will most immediately be seen in the drop in consumption by youth and in the decrease in the number of youth who begin to use tobacco products. Only a very small percentage of tobacco users begin as adults. Reducing the initiation of youth to tobacco use is the most important prevention objective of health professionals. Studies have shown that children and adolescents who start to use tobacco do not understand the nature of tobacco addiction and are unaware of or underestimate important health consequences of tobacco use. Children and adolescents who use tobacco are persuaded to do so through advertising and peer pressure resulting from media images, and because it is readily available as well as inexpensive. Research concludes that higher tobacco excise taxes significantly reduce the number of teenage tobacco users.

Data compiled in the United States, Canada, California, and the United Kingdom indicate that for every 10% increase in the inflation-adjusted price of tobacco, general consumption will fall by about 4% but, more significantly, it will drop by about 10% among youth.

American tobacco taxes are among the lowest percentage of total price of virtually any country in the world. In 1989, California voters approved a citizen's initiative to raise their cigarette excise tax by 25 cents. Cigarette smoking dropped 17% between 1989 and 1991, about twice the U.S. average. In Michigan, on May 1, 1994 the cigarette excise tax was raised from 50 cents to 75 cents per pack. Since then, legal sales of cigarettes have declined approximately 30 percent, and cigarette tax revenue for August 1994 was \$45.9 million, up from \$21.8 million in August 1993.

Conclusion

Alcohol abuse and tobacco use are major health problems in Alaska. Increasing excise tax on these products is a key strategy for decreasing use among Alaskans--particularly among youth. Excise tax increases will also generate additional revenues to the State.

Enclosed are the relevant sections of the state health plan, *Healthy Alaskans 2000*, which provide further information on this subject. If you require additional briefing materials, please don't hesitate to contact my office. The department very much appreciates your willingness to bring this matter to the attention of the Long Range Financial Planning Commission.

Enclosures

cc: Commissioner Condon, Dept. of Revenue
Pat Pourchot, Office of the Governor
Peter Nakamura, Director, Div. of PH
Loren Jones, Director, Div. of ADA

June 6, 1995

IMPACT OF CAPS ON FEDERAL SHARE GROWTH RATE TO ALASKA'S MEDICAID PROGRAM

Summary

Alaska expects its Medicaid program to grow at a conservative 10.6% each year from Fiscal Year 1996 through 2002. Yet Congress is considering capping the annual growth of federal Medicaid expenditures at 8% for FY 96, 7% for FY 97, 6% for FY 98, and 4% for FY 99 and each year thereafter. These caps on Medicaid expenditures would reduce health care funding in Alaska by approximately \$467 million over seven years. Further, under current law, the caps would end Medicaid payment for all optional services, including long term home-based care and inpatient psychiatric services in five years. Services for medically complex children, and services for some non-AFDC minors will be eliminated by the 7th year. Finally, if reductions are managed by reducing rates paid to providers instead of or in addition to eliminating optional benefits, several rural hospitals may be forced to close.

The following discussion summarizes the potential service and budget impacts on Alaska's Medical Assistance program from growth rate caps. The impacts are based on an expenditure model which projects Medicaid costs:

- over seven years;
- growing at 10.6% each year;
- under current program conditions;
- with no significant facility expansions; and
- proceeding with planned program changes.

A 10.6% growth rate was selected based on historical growth rates ranging between 10 and 20 percent, recent reductions in state revenues, and Alaska's limitations in achieving savings from managed care and other popular cost containment strategies.

Background

Approximately one sixth of Alaska's population - 85,000 people - are eligible to receive Medicaid services. The federal government pays half of program benefits, and 50 to 90% of administrative costs. Overall, federal funds are 51% of expenditures. Administrative costs represent 4% of the Medicaid budget.

In 1994:

70,000 of these eligible Alaskans actually used services, which include everything from prescriptions, to preventive care for children, to nursing home care for the elderly.

From DHSS

Medicaid Cap Impact
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In 1994 - cont'd:

- Alaska spent \$273 million in the Medicaid Program, 50% federal funds; 50% state, as follows.

- nursing home services	18%
- hospital services	31%
- physician services	18%
- prescription drugs	4%
- inpatient psychiatric care	5%
- community mental health	5%
- Early childhood screening and immunization.	2%

Medicaid eligibility is based on income. Children in families receiving public assistance comprise 38% of all Medicaid-eligible Alaskans. However, only 17% of expenditures are made for children. In contrast, elderly Alaskans represent only 6% of Medicaid-eligible residents, but represent 14% of the expenditures.

The Department may limit services so long as the services provided are adequate in "amount, duration and scope" to meet the recipients' medical needs. The medical provider and the patient decide the medical need to be met, and the Department then pays the provider directly. While the Department may set reasonable prices to be paid for services, the payments must be high enough to insure continued access to medical services.

Alaska Statutes

Alaska's Medical Assistance Statute (AK 47.07.035) requires the Department to pay for mandatory services for eligible individuals, as described in federal law. It also lists *optional* services and optional groups of eligible individuals in order, with #1 being the lowest priority and #31 the highest (see attached list, page 5). Under current law, if the state and federal funds together cannot pay for all mandatory and optional services, DHSS meets its budget by cutting optional services, beginning with #1. These optional services are mostly adult-only services, and do not affect care for children, until the end of the list is reached. The state legislature eliminated the first ten services during 1995, and required the Department to institute co-payments by recipients.

Some optional services replace more expensive mandatory services. For instance, experience shows that treatment for substance abuse dramatically decreases medical costs for these patients later on. By eliminating treatment or targeted case management for substance abuse and mental health clients, appropriate needed medical services may not be received, and more expensive acute care services may eventually be required.

Another example is home and community based care for medically complex children, mental health and developmentally disabled patients. Non-institutional long term care, provided at home or in a community clinic, is far less expensive than institutional care, and meets the

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Department's policy to provide services as close to home as possible. Also, as home based services are strengthened, the state reduces its bed capacity for institutional care. Therefore as the optional services are cut, home-based long term care may be eliminated. This would then require patients to be treated in the more expensive institution setting, which no longer has room for them! Because of these paradoxes, the impacts described here are not precise nor all-inclusive.

Projected Impacts With a 8%, 7%, 6%, 5%, 4% Growth Caps

Given the above assumptions, Alaska's Medicaid budget will experience a cumulative shortfall of more than \$500 million over seven years (see attached table and chart) if the growth of the federal share is capped at 8% in FY 96, 7% in FY 97, 6% in FY 98, 5% in FY 99 and 4% in 2000 and each year thereafter. The impact estimate improves by \$15 million per year by if the IHS Medicaid expenditures are not capped.

The first year will produce an \$4.3 million shortfall which the state may manage by reducing services, or paying for them totally with state general funds. By year three, FY 98, the additional funding (or cuts) needed for one year is \$41 million; by 2002 it is \$164 million.

If the state does not or cannot pay for program growth, all optional services may be eliminated by FY 2001. Given the current fiscal gap, we believe the legislature will not replace these funds.

Optional services eliminated federal growth caps (assume IHS funds are capped):

By FY 98, physical therapy, and half of the personal care services will be cut off.

By FY 99 all prescribed drugs and 2/3 of the home and community-based waiver services are eliminated.

In FY 2000 residential care for the mentally retarded will be eliminated.

During the first quarter of 2002, all optional services are eliminated, including skilled nursing for patients under 21, and home-based services for medically complex children. The remaining six "options" on the list are really eligibility groups, whose costs are captured in the services estimates.

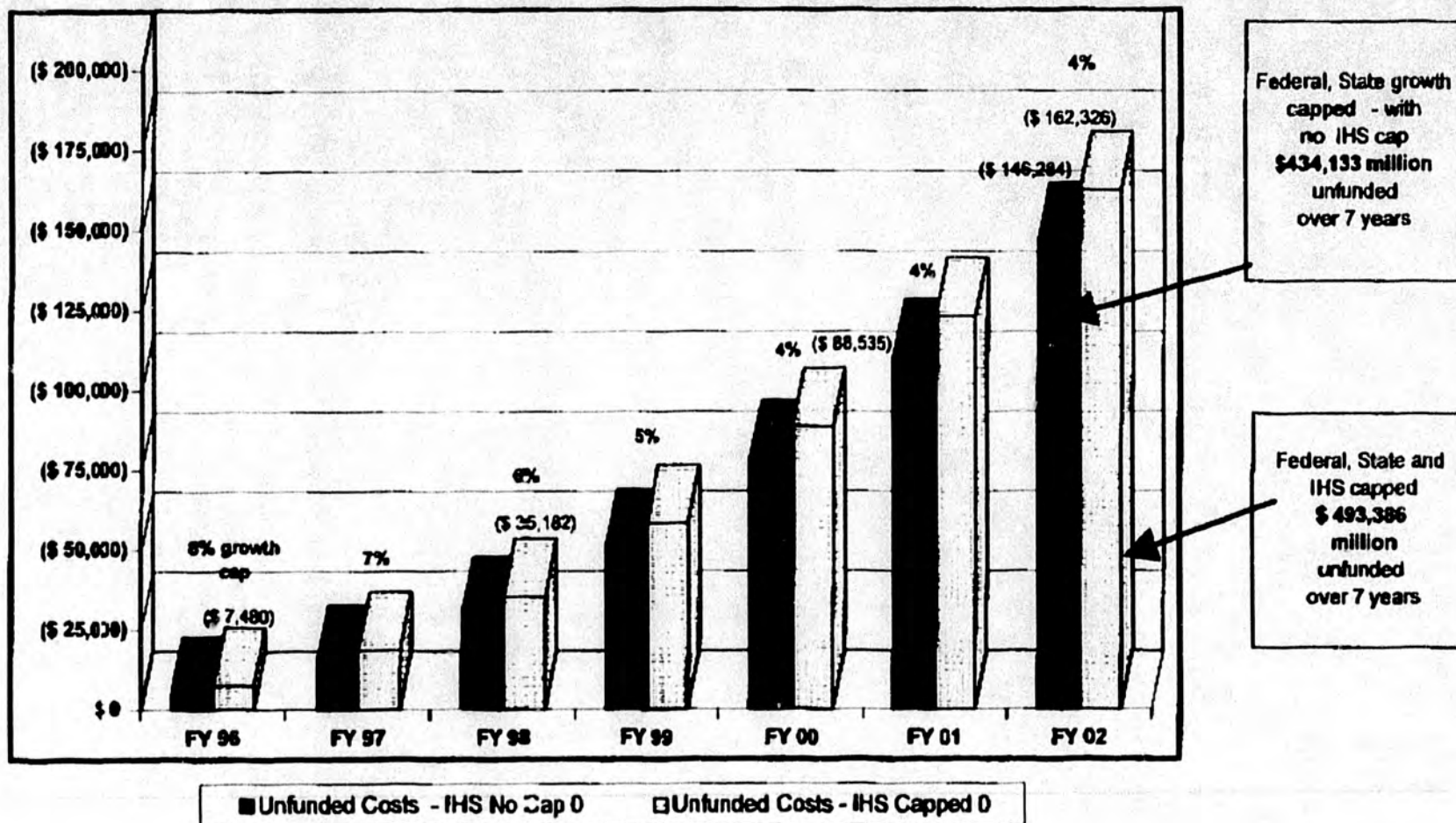
So, ironically, Alaska could have a Medicaid program that moves Medicaid recipients into institutional care - the most expensive kind of health care. Adults who need hospital psychiatric care may not receive it, while children who could be served at home may have to be treated in institutions.

Further reductions to achieve the overall spending reductions will have to be made by adjusting rates for mandatory services.

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Dollars Lost with Medicaid Growth Caps

(amounts in thousands of dollars)



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Boren Amendment

Over half of the Medicaid expenditures in Alaska are payments to health facilities. Medicaid payments to hospitals and nursing homes must conform to the Boren Amendment, which is a part of federal Medicaid law. Because of this federal mandate, states are not able to adjust their Medicaid payments to reflect available funds. The result is that as available funds are reduced, a larger percentage of health care spending is diverted from less expensive community services to more expensive institutional services. Relief from the Boren amendment will give states greater flexibility in adjusting to funding reductions.

FY96 - FY02 Medicaid Expenditure Growth Cap Analysis
Department of Health and Social Services
Division of Medical Assistance
(Amounts in thousands of dollars)

BRU/Component	FY95 Authorized	8% FY96 Budget	7% FY97 Projected	6% FY98 Projected	5% FY99 Projected	4% FY00 Projected	4% FY01 Projected	4% FY02 Projected	Total 96 - 02
Medicaid Facilities	125,387.3	145,270	160,669	177,700	196,536	217,369	240,410	265,894	1,403,848
Medicaid Non-Facility	133,892.6	135,333	149,679	165,545	183,092	202,500	223,965	247,706	1,307,820
Indian Health Service	19,822.0	24,433	27,023	29,887	33,055	36,559	40,434	44,720	236,110
Medicaid State Programs	19,385.2	19,946	20,544	21,160	21,795	22,448	23,122	23,816	152,829
Waiver Services	<u>8,881.6</u>	<u>11,249</u>	<u>12,441</u>	<u>13,760</u>	<u>15,218</u>	<u>16,832</u>	<u>18,616</u>	<u>20,589</u>	<u>108,705</u>
Total Medical Assistance	307,368.6	336,231	370,355	408,051	448,697	495,708	540,547	602,724	3,209,313
Net Percent Change			10.15%	10.18%	10.21%	10.23%	10.26%	10.28%	Avg. 10.22%
Current Shares									
State Funds	141,348.1	149,449	165,022	182,239	201,272	222,315	245,579	271,300	1,437,176
Federal Funds	166,020.5	186,782	205,333	225,812	248,424	273,393	300,968	331,424	1,772,137
Shares with Capped Growth									
State Funds Capped	141,348.1	149,449	159,910	169,505	177,980	185,099	192,503	200,203	1,234,648
Federal share - IHS No Cap	166,020.5	182,327	195,970	208,971	221,093	232,118	243,816	256,237	1,540,532
Federal - IHS Capped	166,020.5	179,302	191,853	203,364	213,533	222,074	230,957	240,195	1,481,279
Unfunded Costs - IHS No Cap		(4,455)	(14,476)	(29,576)	(50,624)	(78,491)	(110,228)	(146,284)	(434,133)
Unfunded Costs - IHS Capped		(7,480)	(18,592)	(35,182)	(58,184)	(88,535)	(123,087)	(162,326)	(493,386)

ASSUMPTIONS:

1. 10.6% annual rate of growth in the Medicaid program across the projection period. This very conservative growth rate is used with consideration given to the unprecedented interest in health care spending, trends toward capitation and managed care, and the Alaska Legislature's interest in slowing Medicaid program growth together with its incongruent interest in refinancing state programs with federal Medicaid dollars. The program expenditure growth in the Medical Assistance components therefore continues at 10.6%, unless otherwise noted below.
2. Medicaid State Programs grow by 3% annually. This component funds reimbursable services agreements with other state agencies for Medicaid services, which the Legislature will ensure grows at a much slower rate than the balance of the program. This slightly reduces the 10.6% growth rate.
3. The amount of change to the program continues at the same historical rate. For example, changes in the amount, duration and scope of services offered, both positive (expansions) and negative (contractions) will continue at the same level as they have historically.
4. Growth rate includes modest changes in the Legislature's appropriation levels as well as health care inflation.
5. The eligibility caseload growth will continue at historical rates. For example, it reflects the addition of the next year of children born after January 1983 in compliance with the mandates of OBRA90.
6. No dramatic shifts will occur during the period. Dramatic swings in any one area are not included in the model and would invalidate projections.
7. No other cost shifts are made by the federal government to the state. An example would be if the Indian Health Services no longer provided outpatient hospital care. This model assumes that IHS Medicaid charges are not capped.
8. The Boren Amendment is not repealed by Congress. Additionally, not only is the Certificate of Need Moratorium statute passed; but when released, no new nursing home beds will be constructed.

6/14/95

Funding Loss Estimates	
5 Year Total	Comment

Title I	Cash Assistance AFDC, JOBS	(\$64,262,800)	Estimates range from \$60 - \$75 million. Level depends on whether or not the federal calculation includes Native JOBS funds. It appears not to include Native funds. However, not clear what is in base, so exact calculation not yet feasible.
Title II	Child Welfare	(\$5,000,000)	Federal estimate. Combines 23 programs; not yet clear what is in the base for each.
Title III	Child Care	(\$7,921,223)	Federal estimate may not include Native JOBS in base calculations.
	Nutrition	(\$40,000,000)	School-based meals, day care meals, WIC
Title IV	Immigrant Provisions	(\$17,225,018)	Legal and illegal aliens ineligible for benefits.
Title V	Food Stamps	(\$37,000,000)	
	Food Stamp Offsets	\$14,000,000	Savings created by reducing recipients in other titles.
Title VI - Social Security Provisions		(\$13,000,000)	Removes eligibility for some developmentally disabled children and adults whose disability is materially related to alcohol or drug addiction.
Medicaid Cap on Growth Rate		(\$207,874,000)	By 2002 this number grows by \$285,400,000 to (\$493,400,000). This assumes that state also caps its share at federal rate.
Total Federal Funding Loss Over 5 Year		(\$378,383,041)	

Estimated Federal Funding Loss By Program Area Under HR 4							
Federal \$	1994	1995	1997	1998	1999	2000	5-Year Totals
Title I - Cash Assistance Block Grant							
# of Families - FY 94	12,042	13,787	14,455	15,178	15,937	16,734	102,213
# of Children	24,590	28,157	27,485	28,838	30,280	31,794	194,205
Block Grant Allocation ^{1,2}	\$61,669,000	\$61,669,000	\$61,669,000	\$61,669,000	\$61,669,000	\$61,669,000	\$308,345,000
Baseline Funding ³ & Projected Need ⁴ W/O Native	\$61,731,975	\$67,332,000	\$71,023,000	\$73,574,800	\$78,368,000	\$82,820,200	\$372,807,800
Baseline Funding ³ & Projected Need ⁴ W/ Native	\$62,865,451	\$69,309,180	\$72,774,818	\$76,413,349	\$80,234,016	\$84,245,717	\$382,978,861
Dollar Increase (Cut) in Funding ⁵ W/O Native in Base	(\$62,975)	(\$5,663,000)	(\$9,354,000)	(\$11,905,800)	(\$16,699,000)	(\$20,651,200)	(\$64,262,800)
Dollar Increase (Cut) in Funding ⁵ W/ Native in Base	(\$1,198,451)	(\$7,640,180)	(\$11,105,818)	(\$14,744,349)	(\$18,565,016)	(\$22,578,717)	(\$74,831,861)
Funds Reduction Based on Projected Need ⁴	-0.10%	-8.41%	-13.17%	-18.18%	-21.30%	-25.06%	-17.25%
Funds Reduction Based on Projected Need ⁴	-1.90%	-11.02%	-13.17%	-18.18%	-21.30%	-25.06%	-17.25%
Title II - Child Protection Block Grant							
# of Children - Average/year	9,972	10,984	11,904	18,510	19,991	21,590	
Block Grant Allocation ⁶	\$9,000,000	\$9,000,000	\$9,000,000	\$9,580,000	\$8,122,500	\$7,718,375	\$42,389,875
Baseline Funding ⁷ and Projected Need	\$7,539,587	\$9,000,000	\$9,000,000	\$9,499,500	\$10,259,460	\$11,080,217	\$48,839,177
Dollar Increase (Cut) in Funding ⁸	\$1,460,413	\$0	\$0	(\$949,500)	(\$2,136,960)	(\$3,363,842)	(\$4,989,889)
Funds Reduction Based on Projected Need		19.37%	0.00%	-10.00%	-20.83%	-30.36%	-10.22%
Title III - Child Care & Nutrition Block Grants							
Child Care Block Grant							
Avg. # of Families/month - FY 95	1,888	2,078	2,284	2,512	2,763	3,040	
Avg. # of Children/month - FY 95	3,080	3,388	3,703	4,073	4,480	4,928	
Block Grant Allocation ^{1,9}	\$6,757,000	\$6,757,000	\$6,757,000	\$6,757,000	\$6,757,000	\$6,757,000	\$33,785,000
Baseline Funding ^{7,10} and Projected Need ⁸	\$6,907,579	\$9,318,935	\$9,444,692	\$7,598,383	\$7,076,202	\$6,375,012	\$41,708,223
Dollar Increase (Cut) in Funding	(\$2,150,579)	(\$2,566,935)	(\$1,687,692)	(\$939,383)	(\$1,219,202)	(\$1,618,012)	(\$7,921,223)
Funds Reduction Based on Projected Need	-24.14%	-27.45%	-19.98%	-11.05%	-15.29%	-19.32%	-18.99%

SEN: State of Alaska : 6-26-95 : 3:25PM : UMB/BUDGET REVIEW : 150723050006.073

- 5/15/95



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JUN 19 1995

CHANCELLOR

June 16, 1995

Chancellor E. Lee Gorsuch
3211 Providence Drive
Anchorage, AK 99508

Melissa Fournier
LRFPC C/O Leg. Ligo Ofc.

Dear Lee:

For your information I am enclosing an article that I wrote with Dwight Lee about Alaska fiscal policy. You may find it useful in your important work on the Long Range Financial Planning Commission.

Yours truly,

SLJ
Stephen L. Jackstadt
Professor of Economics

enclosure
SLJ:ds

Melissa

*You may want to call Steve and ask for
a dozen copies to share w/ Commission members.*

28 June 95

left msg

★ he sent one to each member ★ -

—★ kee

*FVI
29 June 95*