

SCOMM

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Some food for thought from Jack Fargnoli of OMB

4/8/95

To date, efforts addressing the fiscal gap problem have focused on asking the question, "How can we solve it?"

It might be more fruitful, however, to ask the question, "Why has it been difficult to solve it?"

Responses to such a question might include:

- It's not because we don't know the nature and size of the fiscal gap.
- It's not because we don't know the nature and size of the tools available for filling the fiscal gap.
- Rather, it's because of dilemmas such as:
 - the "Moving Target" problem - viz., the fact that the revenue "cliff" is always 4-5 years off in the future, which has made it difficult to develop political will
 - the "Sheriff With One Bullet" problem - viz., the fact that no one wants to go first, and take the political bullet, on proposing specific budget cuts, taxes, or uses of the Permanent Fund
 - the "Which Tool First" problem - viz., the question of whether spending cuts must precede the use of taxes or the Permanent Fund, and how much in spending cuts
 - the "Sleeping Giant" problem - viz., the fact that the public has not to date been truly engaged in the fiscal gap debate (engaged the way a clutch is engaged, i.e., put into play)
 - the "How Much Is Enough?" problem - viz., the failure to address "needs" in the fiscal debate, and thus falling into a war of words about whether there is too much or too little revenue, or whether too much or too little has been cut from spending
- These are essentially problems of process - specifically, a problem of impediments in the public decision process.

From this perspective, the relevant question is: How can a governor, a legislature, and a public, deal with problems like these? What options exist?

- This topic - the impediments facing the public decision process on the fiscal gap issue - arguably should be a central part of the Commission's agenda.

WOHLFORTH, ARGETSINGER,
JOHNSON & BRECHT

MEMORANDUM

TO: Long Range Financial Planning Commission
FROM: Wohlforth, Argetsinger, Johnson & Brecht *EEW*
DATE: April 14, 1995

(1) The Committee should consider the important State fiscal tool of long term borrowing through the issuance of general obligation bonds for capital improvements. From statehood until 1984 general obligation bonds were regularly authorized by the legislature and approved by the voters under Article IX, Section 8 of the Alaska Constitution. The State has not in fact issued any general obligation bonds in over ten years and its outstanding debt has gone from \$924 million in 1984 to \$78 million in 1994. Net general obligation bond indebtedness per capita has gone from \$1,766 in 1984 to \$176 in 1994. Furthermore, all State general obligation debt will have been retired by October 1, 1999, as a result of the efforts of the State to limit maturities to conform with projected oil production of the North Slope field (Alaska Public Debt, Department of Revenue, March 1994, p.2).

(2) The failure to authorize State general obligation bonds over the last ten years has been due, of course, to the State's very large general fund income. Unlike other states and unlike Alaska's municipalities and state agencies which have continued during this period to issue general obligation and revenue bond debt, the State has adopted the conservative view that preservation of its AA bond ratings was more important than any program of general obligation bond issuances. Indeed, until recently the State Bond Committee held to the view that state debt should be retired by 2000 when the so-called "Prudhoe curve" indicated that North Slope revenues would be sharply diminished.

(3) Because no general obligation bonds have been issued since 1984 all State capital improvements have been financed out of cash. Even this year, when potential cuts are being proposed in the general fund operating budget, a cash-funded capital budget of \$135 million is under consideration. Intelligent fiscal planning indicates that consideration should be given to borrowing some portion of these capital needs.

(4) The withdrawal of the State from a capital borrowing program has meant that capital markets and the ratings services no longer have regular input into the State legislature or political debate. This has diminished the level of public understanding of the demands of outside credit markets. An example of this is a recent Legislative Budget & Audit report which indicated that very large amounts

could be withdrawn from AHFC, a major State agency public borrower, to fund the current State budget. The report's warnings on the adverse effect of such withdrawals were mild. This report and legislative statements resulted in Standard & Poor's placing AHFC on "creditwatch" with negative implications. In a letter to the Alaska Legislature they stated that additional withdrawals from the reserves would result in the downgrading of the agency's bond rating. A downgrade of rating for this reason could effect Alaska borrowing for many years. However, except for Governor Knowles, reaction to this statement by public figures and the media was mild.

(5) The Long Range Financial Planning Commission can play a significant role in advancing consideration of the appropriate use of long term capital borrowing as an appropriate fiscal tool. It can stimulate informed public debate on the assumptions which underlie the pro-borrowing and anti-borrowing position. For example, is the conservatism which led to the determination to pay off all of the State debt because it was feared that North Slope revenues would no longer be available after 1999 justified today? Recent reports to the legislature indicate the substantial probability that long term revenue estimates have been far too conservative and that amounts may be available for debt service into 2010 or 2015.

(6) Beside public debate there needs to be a better understanding of the entire State debt situation. For example, while the State has withdrawn from the general obligation bond market, its agencies and the municipalities of the State have continued to borrow substantial amounts. Alaska municipalities have approximately \$2.3 billion in general obligation and revenue debt outstanding. At least until 1990 municipalities were substantial issuers of debt. Municipal debt outstanding now is only 15% less than it was in 1985. State agencies and the University have \$3.5 billion in bonds outstanding (Alaska Public Debt, p. 16). The current budget calls for appropriation of \$80 million for municipal school bond debt service. (OMB Division of Budget Review, 2/27/95). These are municipal bonds on which the State pays debt service. Thus, the State is in the public debt business in all but the issuance of general obligation bonds.

(7) These and other considerations indicate the desirability of intensive review of resumption of a capital borrowing program by the State. Our firm pioneered as Alaska bond counsel. We have been active in this area since 1967 and have substantial background and a considerable library of material. We will be glad to supply you with information on what the borrowing pattern is in other states, and more detail on Alaska agency, state agency, or municipal debt. We will undertake research assignments as you indicate as you proceed in your most important task.