

LEG. FINANCE - BILLS 1979 - 1980 1322

SB 266 cont., thru SB 271 1322

greatest capacity for revenue gains from inflation, and local governments can expect few direct benefits from inflation as very few localities utilize a graduated income tax.

The concentration of resources at the state and federal levels could, depending on the policies adopted for the use of those funds, increase the reliance of local governments on federal and state financial assistance and cause more decisionmaking power to flow to those levels of government along with the money. Indexing helps preserve the existing program mix among the levels of government and should help check any deterioration of state and local autonomy.

In summary, while indexing the personal income tax for inflation is not a panacea for all the concerns of American taxpayers, it can be a reasoned, effective first step toward mitigating the burdens imposed by inflation and quieting some of the current discontent among the electorate. The case for indexation is based on several sound economic and policy arguments.

- It removes the automatic, hidden tax increases that would otherwise result from the interaction of inflation and a progressive income tax.
- It prevents arbitrary distortions of the legislated distribution of the tax burden and provides significant tax relief, particularly to those at the lower and upper ends of the income range.
- It improves the ability of the voters to hold elected officials accountable for their taxing and spending decisions.
- It helps slow the rate of growth in government and preserves the current balance of resources between the public and private sector.
- It sustains the current intergovernmental fiscal balance and impedes the flow of resources and decisionmaking to higher levels of government.

The Experience with Indexing

THE STATES

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In response to persistently high inflation rates and taxpayers' calls for fiscal relief, six states have enacted measures to index their personal income taxes in the last two years. Arizona, California, and Colorado passed indexing bills in 1978; they were followed by Iowa, Minnesota, and Wisconsin in 1979. An indexing measure also passed the Montana Legislature, but was vetoed by the Governor. These states demonstrate a number of ways in which indexing can be accomplished. *Table V* compares the major characteristics of the six state indexing laws.

Only three of the statutes are comprehensive indexation measures in the sense that they provide for annually adjusting the three primary fixed-dollar features of the personal income tax—the income brackets, personal exemptions, and standard deduction. Even then, differences among them in the index used to make the adjustment and limitations on the amount of the adjustment mean that the inflation tax will not be fully eliminated.

The *Minnesota* indexing measure was passed as part of a \$715 million tax reform and relief package and provides that the personal credits (the counterpart of personal exemptions in most states), maximum standard deduction, and maximum exclusion level for the low income allowance will be indexed by the annual percentage change in the Minneapolis-St. Paul

CHARACTERISTICS OF

	Arizona	California	Colorado
FEATURES INDEXED	Personal exemption, standard deduction, and property tax and renter's credit.	Personal credits, standard deduction, income brackets, and low income credit.	Personal exemption, standard deduction, and income brackets.
INDEX USED	Percent change in Phoenix area CPI from second quarter 1977 to second quarter of tax year.	Brackets indexed by change in state CPI from June to June minus 3% in 1978-79 and full change in CPI in 1980-81; other features indexed by full CPI change.	Set annually by the general assembly based on various price data.
EFFECTIVE DATE	1978 and 1979 tax years only.	Brackets indexed effective 1978 tax year; other features indexed beginning 1979 tax year. All indexed permanently.	1978 tax year and permanently thereafter.
LEGAL CITATION	Chapter 211, <i>Arizona Laws of 1978</i> and S.B. 1145 as passed by 1979 legislature.	Chapter 569, <i>California Laws of 1978</i> and A.B. 276 as passed by 1979 legislature.	Chapter 105, <i>Colorado Laws of 1978</i> .

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SOURCE: ACIR staff compilation.

Metropolitan CPI beginning in 1981. The income brackets will be indexed effective with the 1979 tax year, but by only 85% of the change in the CPI.

California is implementing its 1978 indexation measure in two steps, and the 1979 legislature has amended the original law. Under the original measure, the income tax brackets were indexed, effective in 1978, by the change in the state CPI minus three percentage points, and beginning with 1979, the personal credits, standard deduction, and low income credits will be adjusted annually by the full change in the state CPI. Under the 1979 amendments, the tax brackets will also be indexed for tax years 1980 and 1981 by the change in the state CPI without the 3% deduction.

The *Colorado* law also indexes the brackets, personal exemptions, and standard deduction, but provides that the General Assembly shall set the annual inflation factor by which they

are adjusted, rather than specifying in law that a particular index be used. The factor is to be based on the "best statistics available" regarding price changes in the previous year and was set at 6.0% for 1978 and 7.0% for 1979. The indexing law specifies that if the assembly fails to establish a new inflation factor by May 1, each year, the department of revenue is to assume it is 6.0% and make the necessary adjustments in the tax tables.

Two states with partial indexation—Wisconsin and Iowa—limit the inflation adjustment to the income brackets and leave the exemptions and deductions unchanged. The Wisconsin law, passed as part of \$940 million tax reform package, calls for indexation of the income brackets by the percentage change in the U.S. CPI up to a maximum of 10% in any one year. The act is effective with the 1980 tax year.

The 1979 Iowa law is the most restrictive. Not only does it pertain to just the income

STATE INDEXING LAWS

Iowa	Minnesota	Wisconsin
Income brackets and maximum annuity excludable from taxable income.	Personal credits, standard deduction, income brackets, and low income allowance.	Income brackets.
Percent change in U.S. CPI for previous calendar year divided by 4 for 1979 and divided by 2 for 1980.	Brackets indexed by 85% of the percent change in Minneapolis-St. Paul CPI from August to August; other features indexed by full CPI change.	Percent change in U.S. CPI from June to June, not to exceed 10% in a single year.
1979 and 1980 tax years only if the June 30 general fund balance exceeds \$60 million in each year.	Brackets indexed effective 1979 tax year; other features indexed beginning 1981 tax year. All indexed permanently.	1980 tax year and permanently thereafter.
S.F. 494 as passed by 1979 legislature.	H.F. 1495 as passed by 1979 legislature.	Chapter 1, Wisconsin Laws of 1979.

brackets, but it is effective for the 1979 and 1980 tax years only, and the amount of the inflation adjustment is quite limited. The inflation factor applied to the brackets for 1979 is one-fourth of the percentage change in the U.S. CPI during calendar year 1978 (approximately 2.0-2.25%); for 1980, the factor is one-half of the change in the CPI during 1979. The maximum federal retirement annuity excludable from taxable income will also be indexed by this factor. The law provides, however, that indexing shall not take effect unless the unobligated general fund cash balance, as certified by the state comptroller, exceeds \$60 million each year. An interim legislative committee will examine expanding this limited indexation to other parts of the income tax and extending it beyond 1980.

As originally enacted, the Arizona indexation law was effective for only the 1978 tax year; it was extended for an additional year by

the 1979 legislature. Under the act, the personal exemption, standard deduction, and property tax and renters' credits, but not the income brackets, are indexed annually by the percentage change in the Phoenix area CPI, 10% in 1978. A special legislative session on tax reform, scheduled for the fall of 1979, will address making indexation a permanent feature of the state tax code, and one state official has stated that because of the tax relief it provides, he has "no doubt" that indexing will be made permanent.¹⁹

The vetoed Montana legislation would have indexed the personal exemptions, standard deduction, and income brackets by the annual change in the U.S. CPI. In his veto message, Governor Thomas Judge listed several objections to the bill including the fact that the revenue effects would be substantially more than contemplated because of a separate enactment increasing the personal exemption level. He

also felt that indexing would make the tax structure more complicated, and since the measure would not have become fully effective until 1981, he considered it best that Montana learn from the experience of other states now implementing indexing laws and reconsider it at the next legislative session. The legislature's Revenue Oversight Committee will, as it did in 1978, study the feasibility of indexing, including the tax on such items as capital gains, interest expense, and business income.

The effect of these laws on tax burdens and state revenues, of course, varies from state to state depending on the progressivity of the tax structure and the proportion of state revenues derived from the personal income tax. The states fall in the high or medium progressivity category used in *Figure II* (p. 12) with the exception of Iowa which is in the low progressivity category. The six states, with the exception of Arizona, also exhibit a high or medium degree of reliance on personal income tax revenues. Personal income tax receipts accounted for 16.4% of Arizona tax revenue in 1977 and approximately 30% to 40% of total tax revenue in the other five states.²⁰

In general terms, then, it can be expected that the impact of indexation on tax burdens and revenues in these six states will be slightly higher than it would be in the "average" state. In addition, low income taxpayers in Minnesota can expect to receive a substantial share of the benefits of indexation because of the drop in progressivity from the high to low progressivity category as income increases in that state. (See *Figure III*, p. 14.)

Some specific estimates are also available. The Colorado Department of Revenue projects that its comprehensive indexation measure, with a 6% inflation factor, will reduce state income tax revenues approximately 6.7% or \$28.3 million in 1979. This amounts to individual tax reductions ranging from 13.8% for taxpayers with incomes below \$5,000 to 1.0% for those with greater than \$100,000 incomes.²¹

A somewhat smaller relative effect is expected in California which relies less extensively on the personal income tax. The California Franchise Tax Board projects a reduction in income tax revenues of approximately \$40 to \$50 million for each 1.0% increase in the CPI in excess of 3.0%. For 1979, revenues are estimated to be about \$273 million, or 4.6%, less

than they would be without indexing, based on a projected change in the state CPI from June 1978 to June 1979 of 8.6% (somewhat less than the probable change in the U.S. CPI because of the effect of Proposition 13).²²

The Arizona Department of Revenue estimates that each percentage point increase in its inflation factor will reduce tax liability in 1979 by approximately \$1.2 million and that with 10% inflation, the tax reduction on a joint return will range from \$2 to \$128.²³ With a 10.1% indexing factor in 1978, personal income tax receipts totalled approximately \$220 million, some \$10.8 million or 4.7% less than they would have been without indexing.²⁴

In Wisconsin, where only the income brackets are indexed, the legislative fiscal office estimates that with 7% inflation, individual tax burdens will be reduced approximately \$39 million. The maximum savings for an individual taxpayer is estimated at \$47.²⁵ Individual income tax collections were \$1.3 billion in 1978.

Thirteen other state legislatures considered indexing bills in 1979—Georgia, Illinois, Kansas, Kentucky, Maine, Missouri, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, South Carolina, and Utah. Most proposals would have indexed the income brackets, personal exemption, and standard deduction by the change in a state, local, or U.S. Consumer Price Index. The Maine and Utah bills, similar to the Colorado statute enacted last year, had the legislature setting the inflation factor based on price index data from executive agencies.

THE CANADIAN INDEXING SYSTEM

While indexing is relatively new in the U.S., a number of foreign countries have indexed their personal income taxes for several years, including Australia, Denmark, the Netherlands, Brazil, Chile, and Canada. The Canadian experience bears some examination because its tax structure is much like that in this country.

The Canadian indexing law was adopted in 1974 primarily in response to a sudden surge in inflation which, after averaging about 1% to 2% throughout the 1960s, hit 9.1% in 1973. Under the law, the personal exemption and the tax brackets are adjusted annually by the rate of inflation as measured by the change in the Canadian Consumer Price Index for the 12

months ending September 30, prior to the tax year. A child tax credit enacted in 1978 will also be indexed beginning in 1979. The actual inflation factor was 6.6% in 1974, 10.1% in 1975, 11.3% in 1976, 8.6% in 1977, 7.0% in 1978, and 9.0% in 1979, for a compound effect amounting to a 65.8% increase in the brackets and exemption in the first six years. Specifically, indexing has increased the personal exemption allowance for a taxpayer with a dependent spouse and two children from \$3,700 in 1974 to \$6,070 for 1979. The maximum tax rate bracket has increased from \$60,000 to \$99,480 in 1979.²⁶

Indexing has provided substantial tax relief to Canadian citizens. The department of finance estimates that indexing will reduce the 1979 federal tax burden by \$1.2 billion, and the total reduction from indexing alone is over \$6 billion since 1974. Moreover, the relief goes largely to low and middle income taxpayers; over 70% of the tax reductions have gone to taxpayers with incomes in the \$15,000-\$25,000 range.²⁷

What is the effect of indexation on government revenues in Canada? The \$1.2 billion reduction in 1979 amounts to approximately 8.0% of the projected \$14.9 billion in individual federal income tax collections and less than 3% of total federal revenue projections of \$40.5 billion.²⁸ Similar revenue reductions can be expected at the provincial level because, with the exception of Quebec, all provincial income taxes are expressed as a percentage of federal tax liability. Through 1978, federal revenues have still increased at a 9.0% annual rate since the introduction of indexing, and provincial revenues have grown at an even faster clip—some 14.2% per year from their 1973 levels.²⁹

In addition, both the national government and the provinces have pursued an expansionist fiscal policy through further discretionary income tax cuts in the years since the personal income tax was indexed.³⁰ Part of this expansionism, however, was financed through a growing federal government deficit which reached a level of roughly \$10 billion in 1978, approximately one-third of which is attributed to the effects of an economic slowdown.³¹

While there are no immediate signs of fiscal stress, there is some concern that the provincial governments may experience some fiscal

problems in the future if inflation is not reduced substantially to limit the upward pressures on government costs and ease the impact of indexing. Nonetheless, it is felt that indexing has become an important and accepted feature of the Canadian tax system, and to abandon it now would be politically quite unpopular.³² The long-run potential for fiscal trouble at the provincial level is not directly applicable to the United States. Unlike the Canadian provinces, only three states (Nebraska, Rhode Island, and Vermont) base their state income tax on a fixed percentage of federal tax liability.

FEDERAL INDEXING PROPOSALS

A variety of proposals to index the U.S. federal income tax have been presented to Congress since the first indexing bill was introduced by Sen. James Buckley (NY) in 1974. Indexing bills have reached various stages of the legislative process, but none has yet gained the approval of both houses. The most significant actions transpired in 1978.

Late in the year, the House of Representatives approved, by a 249 to 167 vote, an amendment to the Revenue Act of 1978 that would have indexed the basis for computing capital gains effective in 1981. The measure was, however, deleted by the House-Senate conference committee that put together the final tax package. Additionally, a bill to index the personal income tax brackets introduced by Rep. Willis Gradison (OH), along with over 100 co-sponsors, failed to reach the floor on a close vote in the House Ways and Means Committee.

On the Senate side, the Subcommittee on Taxation and Debt of the Finance Committee held hearings in April 1978, on S. 2738, introduced by Sen. Robert Dole (KS). This measure was more far reaching than most indexing proposals; it would have indexed the personal exemptions, tax brackets, and some other parts of the individual income tax, as well as parts of the estate and gift taxes and the capital gains tax. A version of the bill missed adoption in the full committee by two votes.

Interest in indexing has not waned in the 96th Congress. Rep. Gradison and Sen. Dole have gathered over 120 co-sponsors on their "Tax Indexing Act of 1979" (H.R. 365 and S.

12). The bills would index the personal exemptions and the income brackets by the annual change in the U.S. Consumer Price Index. They are awaiting hearings in the House Ways and Means Committee and Senate Finance Committee. Other bills to index the personal income tax have also been introduced in the 96th Congress (e.g., S. 211 by Sen. Hrt (CO)) and indexing is part of a tax stimulus package recently introduced by Republican congressional leaders and a major tax reduction program introduced by Sen. William Roth (DE)

and Rep. Jack Kemp (NY).

In sum, indexation of the personal income tax is not an untried economic theory as a number of foreign countries and several states have successfully implemented indexation systems. With the sudden surge in inflation rates in the last two years has come an increasing interest at both the state and federal level in indexation as a tax reform and relief tool. The experience with indexation to date seems to buttress the economic and policy arguments supporting its adoption.

FOOTNOTES

¹⁸ For further discussion, see John Shannon and Bruce Wallin, "Restraining the Federal Budget: Alternative Policies and Strategies," ACIR, *Intergovernmental Perspective*, Vol. 5, No. 2, Washington, DC, U.S. Government Printing Office, Spring 1979, pp. 8-14.

¹⁹ Neal Trasente, "Income Tax Indexing—Early Experience," paper presented to the 47th Annual Meeting of the National Association of Tax Administrators, Madison, WI, June 1979, p. 5.

²⁰ ACIR, *Significant Features of Fiscal Federalism*, *op. cit.*, p. 14.

²¹ Stanley Schwartz, "Indexation of the Income Tax in Colorado," *Revenue Administration-1978*, Washington, DC, Federation of Tax Administrators, 1978, pp. 167-73.

²² Robert Summers, "An Early Evaluation of State Tax Indexation in California," paper presented to the 47th Annual Meeting of the National Association of Tax Administrators, Madison, WI, June 1979, p. 3.

²³ Neal Trasente, *op. cit.*, pp. 8-10.

²⁴ David Jankofsky, "Income Tax Indexing," paper pre-

presented to the Western States Association of Tax Administrators, Stateline, NV, October 9, 1978, pp. 9-10.

²⁵ Wisconsin Legislative Fiscal Bureau, *Summary of Chapters I and II, Laws of 1979, Tax Reform and Reduction Program*, Madison, WI, Legislative Fiscal Bureau, March 1979, p. 15.

²⁶ Canadian Department of Finance, *Budget Papers*, Ottawa, Ontario, Department of Finance, November 16, 1978, pp. 27-28.

²⁷ *Ibid.*, pp. 29-30.

²⁸ Canadian Department of Finance, *The Budget*, Ottawa, Ontario, Department of Finance, April 10, 1978, pp. 19-21.

²⁹ Canadian Department of Finance, *Economic Review*, Hull, Quebec, Government Publishing Centre, April 1979, pp. 184 and 186.

³⁰ See Canadian Department of Finance, *Economic Review*, *op. cit.*, pp. 87 and 92-94; and ACIR, *Inflation and Federal and State Income Taxes*, *op. cit.*, pp. 74-75.

³¹ Canadian Department of Finance, *Economic Review*, *op. cit.*, pp. 85-86.

³² C.F. Steiss, "Indexation of Canada's Individual Income Tax System," *Tax Review*, Vol. XXXIX, No. 5, New York, NY, Tax Foundation, Inc., May 1978, p. 22.

Indexation: Challenge and Response

The concept of automatically adjusting personal income taxes for inflation does not meet with approval in all quarters. The purpose of this section is to highlight the major arguments made against indexation and to offer a rebuttal to those challenges.

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PERIODIC TAX CUTS SHOULD BE PREFERRED

Challenge: Periodic, ad hoc tax reductions are a superior means of controlling the effects of inflation on individual tax burdens. Previous Congressional tax cuts have, in the aggregate, more than offset inflation-induced tax increases for the last two decades, and Congress has used these opportunities to make the tax system more progressive.

Response: While Congressional tax cuts have kept federal income tax receipts at 9.0% to 10.5% of personal income since 1960, viewing only the total tax burden overstates the record of Congress in compensating for the inflation tax. An analysis of historical tax liabilities by The Brookings Institution in 1975 revealed that the burden on taxpayers with \$25,000 to \$200,000 incomes had increased from 1960 to 1975 despite several tax cuts and that these income groups would have been better off had Congress indexed the 1960 tax code rather than enacting periodic tax reductions.³³

The analysis also found that the stable total tax burden was due primarily to the large 1964

tax cut and that Congress had not kept up with the inflation tax from 1964-75.³⁴ Moreover, the average tax burden is estimated to have increased from 1975-78³⁵ indicating further slippage on the part of Congress. In addition, ACIR's analysis shows nearly all real tax reductions from the Revenue Act of 1978 will be eliminated by 10% inflation in 1979. These developments point up both the difficulty of offsetting the tax effects of high inflation rates through periodic tax cuts and the uncertainty the public faces in relying on discretionary Congressional actions for relief from the inflation tax.

Regardless of whether Congress can or does offset the inflation tax, indexing holds an immense advantage for the taxpayer over the current system of discretionary tax reductions because it is an automatic, annual adjustment for the inflation tax. It removes the uncertainty taxpayers face when Congress seems disposed to use the inflation windfall for other purposes and balances tax cuts against the perceived need for restraint or stimulus in the economy. It insures that taxpayers will not suffer a silent increase in their tax burdens while Congress debates how to use the windfall revenues. With indexing, Congress will be forced to rely on real economic growth, deficit financing, or raising taxes to keep revenues increasing faster than inflation. Its ability to enact tax cuts with the inflation tax revenue will also be curbed. In short, indexing forces policymakers to address income tax issues in a manner for which they can clearly be held accountable by the public.

A similar measure of accountability will be imposed on state legislatures by the adoption of indexing at the state level. Indexing will eliminate the flexibility of legislatures to use inflation tax revenues for other purposes and improve the ability of citizens to focus responsibility for their state tax bills.

Indexing will not, however, eliminate the ability or the need for Congress and state legislatures to enact ad hoc tax cuts and make other adjustments in the tax code. Real income growth will still be taxed more than proportionately to its growth rate, and if the goal is to keep income tax revenues at a stable percentage of personal income, additional tax reductions will be necessary with indexing. Through these actions, such tax policy goals as redistributing income, stimulating savings, or

promoting economic expansion can still be achieved.

In the final analysis, the issue of indexation is more political than economic. That is, the question is primarily whether the increased real tax burden from inflation is eliminated automatically through indexing or whether taxpayers must continue to rely on ad hoc legislative actions for relief. The reduced flexibility and increased accountability imposed by indexing will, no doubt, make political life more difficult, as noted by Nobel Prize winning economist, Milton Friedman:

These reforms [tax indexation, among others] deserve wide support. They would reduce the harm done by inflation and would ease the withdrawal pains from reducing inflation. They would also lower the revenue that the government gets from inflation and hence the government's incentive to engage in inflation. This is at one and the same time a major argument in their behalf and the chief obstacle to their enactment.³⁶

In a representative democracy that rests on the ability of the public to hold elected officials accountable for their decisions, however, removing the unlegislated inflation tax through indexing seems a necessary reform.

LOSS OF FEDERAL REVENUE

Challenge: Indexation will reduce federal revenues substantially. This will limit the ability of government to respond to emerging public problems, impede the balancing of the federal budget, and in all likelihood, reduce the flow of aid to states and localities.

Response: Indexation will not cause federal revenues to decline in absolute terms, but will only slow the rate of growth in federal receipts. If one assumes that the responsiveness of the federal income tax is such that a 10% increase in income creates a 15% growth in tax collections (i.e., the income tax has an elasticity of 1.5), it can be said that indexing will reduce the nominal growth rate from inflation by one-third. Federal revenues will still increase in real terms along with real increases personal

income. If, as the Congressional Budget Office projects, real economic growth totals 14.3% from 1979-82,³⁷ income tax receipts will increase, in real terms, by 21.5% over that period in addition to increases just proportionate to inflation. In other words, indexing will not keep federal revenues from increasing; it only eliminates the windfall revenue bonuses now received from inflation.

The major difference indexing makes in the taxing-spending equation is the increased accountability imposed on elected officials. Congress will not be able to continue enacting tax cuts and still increase spending levels with the frequency and magnitude that it has in recent years. If increased revenues are necessary to balance the budget or implement new programs, Congress may be forced to raise taxes rather than relying on the unlegislated inflation tax for fiscal flexibility. The political constraints posed by tax increases, however, make it likely that federal policymakers will first consider their spending decisions more carefully in an effort to make federal revenues stretch further.

Because indexation will introduce a new measure of fiscal discipline in the budgetary process, the nearly 500 federal aid programs will be forced to operate in a more competitive environment. Indexing, however, would be only one of several factors that have caused federal assistance to states and localities to crest in recent years.³⁸ These constraints may encourage Congress to consolidate related categorical grants and give state and local governments greater flexibility but fewer dollars, a position some state and local policymakers are willing to accept. These belt-tightening developments should work in the right direction—toward a better allocation of federal resources and a healthier intergovernmental system. There is, however, no economic link between indexing and federal aid levels that would lead to an automatic reduction in the aid.

If the revenue effects of indexing are considered too onerous in the short run, it could be phased in over a period of time, or some form of partial indexing adopted. Those states and foreign countries that have enacted indexing measures offer a range of ways a limited or phased indexation could be structured.³⁹ Partial indexing schemes will not, however, accomplish the goal of keeping taxpayers with a

constant real income in the same relative tax position despite ongoing inflation, and the impact of limited indexation on different taxpayer groups will vary substantially depending on the system chosen. The better situation seems to be to phase in full indexation over a relatively short period of time.

STATE AND LOCAL FISCAL STRESS

Challenge: The reduced fiscal flexibility from indexing state income taxes could cause a greater reliance at the state and local level on more regressive property and sales taxes. States cannot resort to deficit financing for operating purposes as the federal government can, and they may be forced to enact sales and use tax increases or cutback on programs such as aid to local governments and state-financed property tax relief to meet growing expenditure needs.

Response: As at the national level, indexing state income taxes will not cause an absolute reduction in state revenues. Income tax receipts will still increase more than proportionately to the rate of real growth in personal income and at a rate just equal to inflation for increases in income related to inflation. The ACIR estimates that if all states were to adopt indexing, income tax collections would still rise at an average annual rate of 13% from 1977-81, a decrease of only 2.5 percentage points from the yearly growth in actual state income tax collections between 1971 and 1975—a period in which several states enacted substantial income tax increases.⁴⁰

The impact of indexation on state revenues will, of course, vary among the states. It seems noteworthy, though, that the revenue effects in the six states that have adopted indexing are likely to be greater than in the majority of states because with few exceptions, their reliance on income tax revenues and the progressivity of their tax structures is above the national average. (See Figure II, p. 12.) Despite this, indexing has not prevented these states from providing additional state and local tax relief. Indexing was adopted as part of major income and property tax relief measures in Arizona, Minnesota, Iowa, and Wisconsin. California's indexation law was enacted the same year that most surplus state revenues were used to re-

place local property tax collections lost as a result of Proposition 13.

In addition, these six states have major property tax circuit-breaker programs financed through the income tax. A circuit-breaker is a property tax relief mechanism wherein property tax payments in excess of a specified percentage of household income are rebated to the taxpayer through an income tax refund or credit.⁴¹ In 1977, circuit-breaker programs in the six states with indexing accounted for over 30% (\$295.7 million) of the total property tax relief provided through the 29 state circuit-breaker programs.⁴² Either these states feel indexing will not impair these programs, or they consider the merits of indexing to outweigh the reduced revenue flexibility.

States would not automatically be forced to raise existing sales and property taxes if additional revenues were needed subsequent to the adoption of indexing. They could use such an occasion to examine the overall state-local fiscal structure as well as make a careful evaluation of existing expenditure programs to provide additional funds. Alternative local revenue sources, user fees, and a thorough review of the income tax structure including such items as the range of the income brackets, the rate structure, and the deductibility of federal income taxes would appear to be candidates for review. If tax increases were necessary, it seems that a public education program on tax reductions and the benefits of indexing would help offset the political liabilities associated with tax hikes.

ECONOMIC STABILIZATION POLICY

Challenge: Indexation will add a degree of instability to the U.S. economy by eliminating the "automatic stabilizer" effect of the graduated income tax. An unindexed progressive tax helps restrain inflation by restricting consumer spending during an expansionary or inflationary period, and similarly, promotes an increase in consumer purchasing during a recession.

Response: Several recent studies have found that indexing will have a negligible impact on the stabilizing attributes of the income tax, and some have concluded that an unindexed tax may, under certain economic conditions, have

a destabilizing effect which indexing would moderate. Indexing may not affect the stabilizing capacity of the income tax because the increased tax collections to keep the economy from overheating during an expansion result from both increases in production and increases in prices (inflation). Recent research suggests that most of the increased tax receipts during an expansion come from production, and thus, indexation, which eliminates only the increased taxes from inflation, will have little effect on economic stability during an expansion.

This was the conclusion of James Pierce and Jared Enzler in their analysis of the U.S. economy under three types of expansionary changes if the income tax were indexed. Although they tried to accentuate the potential impacts of indexing, their conclusion was unequivocal:

There is simply no evidence that indexing the tax system would be harmful to economic stability. . . . In light of the undesirable effects that inflation has on the tax system, it would appear from our results that indexing should be adopted.⁴³

Similar results were achieved by two Canadian economists in an analysis of the issue in that country. They found that prices did not begin to increase until nearly a year after the expansionary change and concluded that nearly all the built-in stability of the income tax was attributable to its responsiveness to changes in production rather than inflation.⁴⁴

In addition, Dr. Thomas Dernburg, in a study for the Joint Economic Committee of the Congress, found that under certain circumstances, the nonindexed graduated tax may be a "destabilizer" and that indexing may, in fact, add stability in such cases.⁴⁵ His conclusion is based on the premise that during periods of inflation caused by cutbacks in supply—such as OPEC oil price increases and poor food harvests—prices and nominal income will increase as they would in periods of excess demand, but real income and real output will decline. This means that without indexation, income tax collections will be increasing at a time when money should be going into the economy to stimulate production. Unless other policies are adopted, this can lead to an eco-

conomic downturn with further production losses and increased unemployment even though inflation remains high—a set of circumstances sometimes called “stagflation.” Dernburg found that, in fact, this did happen during the 1974 recession when both inflation and unemployment were at very high levels. He concluded that by reducing federal tax collections “indexed taxes would have moderated the collapse in 1974.”⁴⁶

A study of the effect of indexing in Canada in 1974 produced the same conclusion:

The additional fiscal drag (increased tax collections) which inflation would have generated . . . without indexation would have been sufficient to plunge the economy into recession in early 1975 unless offset by discretionary fiscal changes.⁴⁷

With the recent recurrence of economic conditions very similar to 1974—a projected economic recession while inflation remains high in the wake of the June 1979 OPEC oil price increases—it seems an appropriate time for the Congress to consider indexation. Indexing might help moderate any recession, and there is little evidence suggesting that it would add instability to the economy under other economic conditions.

EFFECT ON WAGE DEMANDS

Challenge: Indexation will make it advantageous for labor unions with cost-of-living escalators in their contracts to push for greater wage increases in an effort to push up the rate of inflation. The combination of cost-of-living raises and indexing will make unions the beneficiaries of inflation and weaken any desire to bring the rate of inflation down.

Response: On the contrary, there is a reason to believe that indexing will have the opposite effect—that by preserving after-tax purchasing power, indexing may lead to more moderate wage demands and actually help control inflation.

It seems reasonable that indexation will help lessen wage demands because its purpose is to preserve a taxpayer's after-tax purchasing power. To the worker what really matters is

take home pay rather than gross income because this is the money actually at the worker's disposal to spend as he or she wishes. Under an unindexed tax structure where taxes increase more than proportionately to wage gains, the worker and union must push for a higher pre-tax income to achieve a given level of net income. In fact, they must push for a wage gain greater than inflation to keep after-tax purchasing power from being reduced by the inflation tax. Thus, higher income taxes can lead to higher wage demands. With an indexed tax structure, the after-tax income goal can be achieved with a smaller increase in pre-tax income meaning that the effect of union wage demands on inflation should be reduced with indexation.

The recent decision of the Australian government to index the income tax was prompted in no small measure by the demands of labor unions for this remedial action to preserve after-tax purchasing power. There is also evidence in European countries that after-tax income is becoming the bargaining goal of the labor unions. In Austria and Finland, income tax cuts have actually been negotiated by the government and unions as part of their wage discussions, and unions have begun expressing their wage targets on an after-tax basis in Germany and the Netherlands.⁴⁸

While there is less collaboration between unions and the government in this country, it seems plausible that the foreign experience should, in at least some respects, be applicable to the U.S., particularly as the government attempts to gain compliance with its wage-price guidelines and becomes more involved in labor negotiations. Certainly, unions must consider the effect of higher taxes in their wage negotiations.

Professor Dernburg in his study stated that the tax-wage interaction was a problem which should not be “underestimated” in the U.S. He found, from reviewing the history of wage increases after the 1964 tax cut and after the imposition of the tax surcharge in 1968, that higher income taxes may, indeed, stimulate higher wage demands—and lower taxes accomplish the reverse. As he put it:

This is, after all, quite reasonable. To the worker what counts is his net income after tax . . . and he may very rea-

sonably view a tax reduction as a substitute for a wage increase and vice versa.⁴⁹

Dernburg went on to point out that continuation of the higher taxes begetting higher wages cycle could act much the same as an OPEC oil price increase or an "exogenous supply shock" and lead to a period of stagflation with declining production and increasing inflation unless other policies were adopted. He concluded that indexing the income tax should help reduce wage demands and control inflation.⁵⁰

COMPLEXITY AND INEQUITIES

Challenge: Indexation of the personal income tax will add further complexity to an already complicated tax system. It will also lead to gross inequities because it does not address the effect of inflation on property income.

Response: Indexing the personal income tax is not a complex process, and it will not make it more difficult for individual taxpayers to complete their tax forms. It simply requires the tax collection agency to compute an adjustment factor based on the rate of inflation as measured by the change in an established price index, such as the U.S. Consumer Price Index, and multiply the indexed parts of the tax code by the adjustment factor. If, for example, the inflation rate is 10%, the upper and lower boundaries of each income bracket and the personal exemption allowance would be multiplied by 1.10, and all other tax computations would proceed normally.

The inflation factor is generally based on the CPI change for a 12-month period ending prior to the completion of the tax year (e.g., June 30) which allows the tax agency sufficient time to refigure the tax tables and have the tax forms printed so that the taxpayers need not make any additional computations. To recompute the withholding tables in effect throughout the tax year will require the tax agency to estimate the inflation factor before the end of the applicable 12-month period which could result in over or under withholding depending on the accuracy of the forecasted inflation rate. While this obviously entails some additional administrative steps and costs for the tax agency, it is not unlike any other legislative changes in the tax law

made during the tax year.

The second part of this argument is correct in the sense that indexing the income brackets and personal exemptions, as is advocated here, does not eliminate the effect of inflation on items such as capital gains and business income.⁵¹ The effect of inflation on property income involves a complex set of economic, political, and tax accounting arguments about such topics as the measurement of income from capital, the treatment of debt payments during inflation, and the depreciation of capital assets. No consensus exists on how inflation affects these types of income, and they are excluded from the Commission's earlier deliberations and this report as areas in need of further research.

This should not, however, detract from the importance and merits of indexing the personal income tax brackets and exemptions which would eliminate the inflation tax on wage and salary income. As a practical matter, this indexing would solve most of the problem as wages and salaries accounted for 83.5% of the federal personal income tax base in 1976. To deny the benefits of indexing to the majority of American taxpayers because an inflation adjustment for property income cannot be perfected brings to mind the adage that "the counsel of perfection is the counsel of delay."

Indexing the personal exemptions and income brackets might serve as a first step toward attempting the more complex reforms needed for property income. At least, it should allow Congress to devote more attention to grappling with the issue.

YIELDING TO THE INFLATION PSYCHOLOGY

Challenge: By protecting taxpayers from the inflation tax, indexation builds inflation into our economic system and weakens the desire of both the citizens and government to bring it under control. Evidence for this exists in those countries that have indexed their tax codes; inflation continues to be a major problem, particularly in Latin America where 100% or more annual inflation is not uncommon.

Response: This challenge rests not so much on economic theory about inflationary cycles as it

does on certain perceptions about the American public and its governmental institutions. In effect, opponents of indexing are saying that as long as the public is assured it will not fall further behind inflation solely because of an increase in its tax liability, it will no longer consider inflation a problem and will learn to live with it. This seems unconvincing.

While it is true that indexation will enable the taxpayer whose pre-tax income increases at the rate of inflation to maintain his after-tax purchasing power and standard of living, indexing does nothing to assure that the taxpayer will receive the wage increase necessary to keep up with inflation in the first instance. If the taxpayer does not receive a salary increase sufficient to offset inflation, his purchasing power and standard of living will still decline even with indexing; all indexing does in such a case is adjust his tax burden to prevent him from losing even more ground to inflation. To contend that indexing insures the taxpayer against a loss of purchasing power is to credit it with more than it can do.

As syndicated columnist George F. Will stated:

It is preposterous to say . . . that indexing will cause people to become apathetic about inflation. People who suffer from inflation a dozen times a day, at every cash register, will not sink into complacency about inflation just because it no longer injures them in their capacity as federal taxpayers.⁵²

Furthermore, this challenge treats indexing

is if it were a new phenomenon in the U.S. In point of fact, a number of public expenditure programs have been indexed to the cost-of-living for quite some time. A 1976 study by the Congressional Budget Office indicated that approximately 63% of federal expenditures, including such programs as social security and school lunches, were fully indexed or "quasi-indexed" for inflation.⁵³ If indexing implies foregoing the fight against inflation, it seems that the ghost was given up before indexing the personal income tax was given serious consideration.

The contention that persistence of inflation in countries that have indexed their tax codes indicates they have abandoned efforts to control inflation is unpersuasive. Most of these countries continue to pursue anti-inflation programs that are often stronger than those of the U.S. In addition, it is difficult to believe that any industrialized country could have withstood the shock to the international economic system from the OPEC cartel without experiencing some increase in the inflation rate.

Most importantly, this allegation erroneously assumes that the primary aim of indexation is to combat inflation. The primary purpose of indexation is to eliminate one of inflation's many undesirable side effects—namely, the extraordinary increases in tax liability that it causes—rather than bring a halt to inflation. In so doing, however, it may have a beneficial impact in the fight against inflation by slowing the rate of public sector growth and moderating wage demands.

FOOTNOTES

⁵¹ Emil M. Sunley and Joseph A. Pechman, *op. cit.*, pp. 160-61.

⁵⁴ *Ibid.*

⁵⁵ Robert Samuelson, *op. cit.*, p. 157.

⁵⁶ Milton Friedman, *Living with Inflation, Three Essays*, Washington, DC, American Enterprise Institute, 1979, p. 7.

⁵⁷ U.S. Congressional Budget Office, *Five-Year Budget Projections and Alternative Budgetary Strategies for Fiscal Years 1980-1984*, Washington, DC, U.S. Government Printing Office, 1979, p. 2.

⁵⁸ ACIR, *Significant Features of Fiscal Federalism*, *op. cit.*, pp 1-3.

⁵⁹ For a discussion of indexing in foreign countries, see Organization for Economic Cooperation and Develop-

ment, *The Adjustment of Personal Income Tax Systems for Inflation*, A Report of the Committee on Fiscal Affairs, Paris, France, Organization for Economic Cooperation and Development, 1976.

⁴⁰ ACIR, *Inflation and Federal and State Income Taxes*, *op. cit.*, p. 63.

⁴¹ For a complete discussion, see ACIR, *Property Tax Circuit-Breakers: Current Status and Policy Issues*, M-87, Washington, DC, U.S. Government Printing Office, February 1975.

⁴² ACIR, *Significant Features of Fiscal Federalism*, *op. cit.*, p. 63.

⁴³ James L. Pierce and Jared J. Enzler, "The Implication for Economic Stability of Indexing the Individual Income Tax," in Henry J. Aaron, ed., *Inflation and the Income Tax*, *op. cit.*, p. 188.

⁴⁴ John Bossons and Thomas A. Wilson, "Adjusting Tax Rates for Inflation," *Canadian Tax Journal*, Vol. XXI,

No. 3, Toronto, Ontario, Canadian Tax Foundation, May-June 1973, pp. 185-99.

⁴⁵ Thomas F. Dernburg, *Indexing the Individual Income Tax for Inflation: Will This Help Stabilize the Economy?* A study prepared for the use of the Subcommittee on Fiscal Policy of the U.S. Joint Economic Committee, Washington, DC, U.S. Government Printing Office, 1976.

⁴⁶ *Ibid.*, pp. 10-11.

⁴⁷ G.V. Jump and T.A. Wilson, "Macro-Economic Effect of Federal Fiscal Policies: 1974-1975," *Canadian Tax Journal*, Vol. XXIII, No. 1, Toronto, Ontario, Canadian Tax Foundation, January 1975, p. 56.

⁴⁸ Organization for Economic Cooperation and Development, *op. cit.*, pp. 25-26.

⁴⁹ Thomas F. Dernburg, *op. cit.*, p. 12.

⁵⁰ *Ibid.*, pp. 6 and 12.

⁵¹ The tax on capital gains income would be reduced because it is computed on the basis of the rate brackets that are indexed under this proposal.

⁵² George F. Will, "A Cure for Income 'Taxflation'," *The Washington Post*, Washington, DC, Post Publishing Co., August 16, 1979, p. A-21.

⁵³ U.S. Congressional Budget Office, *The Effect of Inflation on Federal Expenditures*, Background Paper No. 9, Washington, DC, U.S. Government Printing Office, June 1976, p. 1.

The Time is Now

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Indexation of the federal and state personal income taxes is neither a panacea for all the perceived ills besetting the American public nor a cure for inflation itself. To some, it will seem weak medicine in the struggle for less government; others will view it as an overreaction that undermines the ability of government to effectively meet the needs of the people. Neither is an apt characterization. Seen in light of its purposes and limitations, indexing is, as stated at the outset, a reasoned and effective response to the political pressures of the taxpayers' revolt and the economic burdens imposed by inflation.

Indexation simply requires the government to play fair with the taxpayers. It prevents the public from continually losing ground to inflation solely because of the way the tax structure is set in law, and it eliminates the windfall bonus the government now receives from inflation. It shines the spotlight of political accountability on elected officials and forces them to publicly confront the taxing and spending issues of the day in a manner for which they can clearly be held responsible by the voters. In so doing, indexation would go far in easing the impact of inflation and restoring citizen confidence in our representative system of government. The time seems ripe for its adoption.

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5. Bossons, John, and Thomas A. Wilson, "Adjusting Tax Rates for Inflation," *Canadian Tax Journal*, Vol. XXI, No. 3, Toronto, Ontario, Canadian Tax Foundation, May-June 1973, pp. 185-99.

Examines Canadian indexing system. Finds that indexing would be beneficial in removing tax inequities caused by inflation, slowing growth in government revenue, and would not substantially affect macroeconomic stabilization policy.

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Contends that past Congressional actions have offset the effect of inflation on personal and corporate tax burdens. Concludes that indexing must be weighed against the complexity it adds to the tax system and the lack of consensus on measuring income from capital during an inflationary period.

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Examines effect of tax reductions from 1960-75 on individual tax liabilities and effects of indexing on federal revenues. Finds that, in the aggregate, tax cuts have offset the effect of inflation, but with a different distribution among income groups than would have been the case with indexing.

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Analyzes impact of inflation and indexation on federal and state individual income tax burdens and revenues, and examines the intergovernmental issues involved in indexing. Recommends that federal and state governments index their personal income taxes, and until such time as indexation is accomplished, that the amount of inflation-induced federal and state personal income tax increases be estimated and publicized each year.

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Hearings on legislation to index the personal income tax, estate and gift tax, and the asset basis for computing capital gains. Contains testimony from Congressional supporters and testimony of U.S. Treasury Department in opposition to the bill.

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Measures average tax rates for several real income classes for period 1965-72. Finds that Congressional tax cuts during the period offset the inflation-induced tax increases only for the lowest income groups.

34. Will, George F., "A Cure for Income 'Taxflation'," *The Washington Post*, August 16, 1979, p. A-21.

Concise summary of the case for indexing.

An ACIR Legislative Guide to State-Local Financial Management

The Advisory Commission on Intergovernmental Relations has long been concerned with the problems state and local governments have in organizing their financial management systems, especially when these efforts are hampered by outdated, unduly restrictive, or nonexistent state legislation. Recognizing the need for timely assistance in this area, the ACIR, in January 1978, embarked upon a project to encourage state initiatives in local financial management capacity building.

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The initial phase of the project involved drafting and revising 19 pieces of model legislation governing a broad range of financial management topics. The bills are based on a wealth of ACIR policy recommendations and existing state statutes in the financial management field and are intended as a useful reference for state and local officials interested in improving state-local financial management. The model bills fall roughly into three categories — increased accountability; improving administration and oversight procedures; and removing unnecessary shackles on state and local fiscal operations—and cover areas ranging from indexation of the state individual income tax to preventing and controlling local financial emergencies.

In addition, the ACIR is now providing technical assistance to states in the areas covered by the 19 model bills. The types of assistance available include providing drafting assistance to tailor legislation to specific needs, providing

consultants for one or two days of in-depth technical aid, conducting "in-state" seminars, meeting with legislators from several states to discuss specific areas of mutual concern, and providing background research reports and copies of statutes on which the bills are based.

The project is funded by a grant from the U.S. Department of Housing and Urban Development, as part of its Local Financial Management Capacity Sharing Program, and is operated in conjunction with the National Governors' Association and the National Conference of State Legislatures. For more information on the project or copies of the 19 model bills, please contact ACIR, Policy Implementation, 1111-20th Street, NW, Washington, DC 20575.

The model bills in the ACIR financial management legislative package include:

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INCREASED ACCOUNTABILITY

Full Disclosure of Property Tax Increases (Truth in Taxation). Establishes a procedure for local legislative bodies to set the property tax rate each year to produce the same amount of revenue as the previous year with optional allowances for new construction or a specified percentage of revenue growth. In order to raise the rate, the proposed increase must be advertised and a public hearing held.

Indexation of the State Individual Income Tax. Requires annual adjustment of the personal exemptions, low income allowances, maximum limit of the standard deduction, per capita credits, and tax rate brackets by the rate of inflation to prevent the automatic, real tax increases that would otherwise result from inflation-related gains in income. Requires the Governor to highlight in the budget the individual income tax revenues attributable to inflation for the prior year, current year, and upcoming year. The text of this bill follows these summaries.

State Mandates. Provides that costs imposed on local governments by state mandates for new programs, increased service levels, and improved personnel or retirement benefits will be reimbursed, wholly or in part, by the state. Also provides for a catalog of state mandates and a procedure for filing, reviewing, and appealing reimbursement applications.

Legislative Notes on the Fiscal Impact of State Legislative Actions on Local Governments. Requires all proposed legislation and administrative rules affecting local governments to contain a realistic estimate of the effect on local government expenditures and revenues of implementing or complying with the proposed action.

State Compensation to Local Governments for State-Owned Property. Provides for an inventory of state-owned property and compensation to local governments for the tax exempt property under one of three mechanisms: service charges for improved property; tax equivalency for undeveloped land holdings; and shared revenue from revenue-producing property.

State Budgeting and Appropriation of Federal Monies Received by the State. Requires state agencies to notify the state budget officer or appropriate legislative committee chairperson prior to applying for federal monies and prohibits state agencies from expending federal money unless it is appropriated by the legislature. Because of varying state budgetary practices, a variety of exemptions and options is provided as are statutory and constitutional language allowing the legislature to delegate the appropriation authority to a special committee to act when the legislature is not in session.

Citizen Participation in the Budget Process. Requires public notice and hearing on the adoption of the local budget and provides that the full budget is to be made available for inspection after its adoption.

IMPROVED ADMINISTRATION AND OVERSIGHT PROCEDURES

State Aid Administration. Provides for the codification, review, and periodic evaluation of all programs of state aid to local governments. State aid formulas are to be reviewed annually and the performance of all programs is to be reviewed periodically.

Establishment of a Consolidated State-Administered Pension System. Creates a consolidated statewide retirement system to supersede existing state and local programs. Provides alternative procedures for supersession and

armless benefit rights for existing employees absorbed into the new system.

Standards, Review and Assistance Regarding Local Retirement Systems. Establishes pension review commission to provide technical assistance to local retirement systems and to study and analyze existing programs and proposed changes in benefits. Requires periodic actuarial valuations of existing systems and estimates of the cost of all proposed changes.

Preventing and Controlling Local Financial Emergencies. Prescribes the conditions under which a financial emergency shall be declared. Establishes a board to review and supervise the financial management of the affected locality and requires the adoption of a plan for restoring fiscal soundness.

Pooled Insurance. Establishes a voluntary, cooperative risk management program for state and local governments and authorizes local governments to form joint cooperative insurance programs.

Public Deposits and Investment of Idle Funds. Provides for state assistance to local governments in the management of their funds and prescribes qualified investments for local funds. Establishes a state-administered pool for investing idle local government funds on a voluntary basis.

State Supervision and Assistance in Regard to Local Debt Issuances. Authorizes a state agency to set standards governing the issuance of debt instruments by local governments and to provide technical and other assistance in the marketing and management of local debt.

State Regulation of Local Accounting, Auditing and Financial Reporting. Requires local gov-

ernments to comply with generally accepted principles of governmental accounting, to issue an annual financial report in accordance with such principles, and to have an annual audit of financial operations performed. Establishes a commission to promulgate accounting and auditing standards and provide technical assistance in complying with the standards. Provides for a three-year transition period.

Intergovernmental Cooperation in Tax Administration. Provides for the exchange of tax records among states, the federal government, and local governments for tax enforcement purposes and authorizes state officials to require proof of payment of local taxes prior to the issuance of automobile and liquor licenses and papers of incorporation.

REMOVING UNNECESSARY SHACKLES ON STATE AND LOCAL GOVERNMENTS

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Removal of Constitutional Restrictions on State Borrowing. Allows states to incur debt for any public purpose. The debt is to be secured by the full faith and credit of the state.

State Constitutional Restrictions on Local Borrowing Powers. Removes details regarding local government borrowing powers from the state constitution and authorizes the legislature to establish local debt policy through the normal legislative process.

Repeal of Constitutional Restrictions on Local Taxing Powers. Removes details regarding local taxing powers from the state constitution and authorizes the legislature to establish local tax policy through the normal legislative process.

CORRECTION

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holds harmless benefit rights for existing employees absorbed into the new system.

State Standards, Review and Assistance Regarding Local Retirement Systems. Establishes a pension review commission to provide technical assistance to local retirement systems and to study and analyze existing programs and proposed changes in benefits. Requires periodic actuarial valuations of existing systems and estimates of the cost of all proposed changes.

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Pooled Insurance. Establishes a voluntary, cooperative risk management program for state and local governments and authorizes local governments to form joint cooperative insurance programs.

Public Deposits and Investment of Idle Funds. Provides for state assistance to local governments in the management of their funds and prescribes qualified investments for local funds. Establishes a state-administered pool for investing idle local government funds on a voluntary basis.

State Supervision and Assistance in Regard to Local Debt Issuances. Authorizes a state agency to set standards governing the issuance of debt instruments by local governments and to provide technical and other assistance in the marketing and management of local debt.

State Regulation of Local Accounting, Auditing and Financial Reporting. Requires local gov-

ernments to comply with generally accepted principles of governmental accounting, to issue an annual financial report in accordance with such principles, and to have an annual audit of financial operations performed. Establishes a commission to promulgate accounting and auditing standards and provide technical assistance in complying with the standards. Provides for a three-year transition period.

Intergovernmental Cooperation in Tax Administration. Provides for the exchange of tax records among states, the federal government, and local governments for tax enforcement purposes and authorizes state officials to require proof of payment of local taxes prior to the issuance of automobile and liquor licenses and papers of incorporation.

REMOVING UNNECESSARY SHACKLES ON STATE AND LOCAL GOVERNMENTS

43

Removal of Constitutional Restrictions on State Borrowing. Allows states to incur debt for any public purpose. The debt is to be secured by the full faith and credit of the state.

State Constitutional Restrictions on Local Borrowing Powers. Removes details regarding local government borrowing powers from the state constitution and authorizes the legislature to establish local debt policy through the normal legislative process.

Repeal of Constitutional Restrictions on Local Taxing Powers. Removes details regarding local taxing powers from the state constitution and authorizes the legislature to establish local tax policy through the normal legislative process.

4.108 Indexation of the State Individual Income Tax¹

Inflation interacts with any progressive individual income tax to generate increases in tax revenue more than proportionate to the rate of inflation. These increases occur with practically no public debate or disclosure of the fact. Therefore, the Advisory Commission on Intergovernmental Relations recommended, in the interest of complete public information, that the amount of the inflation-induced, state personal income tax increase be calculated and publicized for each tax year. The Commission further recommended that the states give early and favorable consideration to indexation—the annual adjustment of the personal exemptions, the low-income allowance, the maximum limit of the standard deduction, any per capita credits, and the tax rate brackets—of the state individual income tax by the rate of increase in the general price level.

Four major considerations prompted this recommendation:

Fiscal Accountability. Indexation is needed to insure that higher effective income tax rates are the product of overt legislative action rather than the automatic consequence of inflation.

Tax Equity. The maintenance of tax equity requires that increases in tax liability be based on real rather than normal income. Inflation is

especially hard on low-income families and all families with many dependents because it erodes the value of personal exemptions, the low-income allowance, the maximum limit of the standard deduction and per capita credits.

Public Sector Growth. Without indexation, there is a bias in favor of an expanded public sector because inflation automatically pushes taxpayers into higher tax brackets with the consequent unlegislated increase in governmental revenues.

Current Inflation Rates. The significance of the above considerations takes on increased importance in these times when inflation is well above historic rates.

The suggested legislation that follows requires the Governor to estimate and publicize the impact of inflation on individual income tax revenues. It also requires the annual adjustment of tax rate brackets, personal exemptions, credits, and standard deductions by an inflation factor defined as the ratio of the U.S. Department of Labor Consumer Price Index (CPI) for the tax year to the CPI for the previous year. Because the U.S. Department of Labor does not develop a separate CPI for each state, a state may wish to modify the national, regional, and metropolitan area indices to fit its own situation.

The legislation was drawn in part from bills introduced (but not enacted) in the U.S. Congress and the Illinois General Assembly, and on indexation provi-

¹Derived from ACIR, *Inflation and Federal and State Income Taxes*, A-63, Washington, DC, U.S. Government Printing Office, November 1976. See also suggested state legislation *Full Disclosure of the Effect of Rate and Base Changes on Local Revenue*.

sions of the Canadian income tax act, enacted in 1973, and the Colorado income tax act (H.B. 1194) enacted in April 1978.

Section 1 states the title of the act.

Section 2 is a statement of findings and purpose of the act.

Section 3 defines key terms.

Section 4 requires the Governor to prepare and

publicize an estimate of the inflationary impact on individual income tax revenue.

Section 5 provides for indexation of rate brackets, personal exemptions and credits, and maximum and minimum standard deductions by the rate of inflation.

Sections 6 and 7 are separability and effective date clauses, respectively.

Suggested Legislation

**[AN ACT TO REQUIRE DISCLOSURE OF
THE INFLATIONARY IMPACT ON
INDIVIDUAL INCOME TAX REVENUE
AND TO PROVIDE FOR ANNUAL ADJUSTMENT OF
KEY PERSONAL INCOME TAX ELEMENTS
FOR INFLATION]**

(Be it enacted, etc.)

1 SECTION 1. *Short Title.* This act may be cited as the “[State] Income Tax Indexation Act.”

2 SECTION 2. *Findings and Purpose.*

3 (a) The [legislature] finds that inflation erodes the value of personal exemptions, deductions, and
4 tax credits in the [state] individual income tax structure and distorts fiscal equity among taxpayers. The
5 [legislature] finds, further, that inflation-induced increases in individual income tax revenues result in
6 annual collections that exceed the amounts anticipated by legislative actions establishing rates,
7 exemptions, deductions, and other features of the [state] individual income tax.

8 (b) It is the purpose of this act to correct these situations by:

9 (1) requiring that the Governor prepare an annual estimate of the impact of inflation
10 on individual income tax collections; and

11 (2) requiring that certain elements of the individual income tax structure be adjusted in
12 accordance with annual increases in the Consumer Price Index.

13 SECTION 3. *Definitions.* As used in this act:

14 (a) “Inflation factor” means the ratio of the Consumer Price Index for the 12-month period
15 ending [June 30] [September 30] of the current tax year to the Consumer Price Index for the
16 immediately preceding tax year, rounded to the nearest one-thousandth.

17 (b) “Consumer Price Index” means the average over a 12-month period of the Consumer
18 Price Index published monthly by the Bureau of Labor Statistics, U.S. Department of Labor [as
19 adjusted by the [state statistical or economic development agency]].

20 SECTION 4. *Annual [Biennial] Estimate of Inflationary Impact on Individual Income Tax*
21 *Revenues.* The Governor shall include in the [annual] [biennial] executive budget an estimate for the
22 previous year, the current year and the following [budgeted] year of the amount of actual or anticipated
23 revenue from the individual income tax that can be reasonably attributed to inflation. These estimates
24 shall be highlighted in the budget message, [the economic message, and the state of the state address]
25 and included prominently in press releases relating to the budget.

26 SECTION 5. *Adjustments for Inflation.*

1 (a) The [state statistical agency] [state economic development agency] shall annually by [July 15]
2 [October 15] prepare and promulgate an inflation factor for the tax year for use by the [state
3 department of revenue] in making the adjustments required in subsection (b) of this section. In
4 preparing the inflation factor, the [state statistical agency][state economic development agency] shall,
5 using the best statistical techniques compatible with those used by the U.S. Department of Labor in
6 preparing the monthly Consumer Price Index, adjust the Consumer Price Index to conform most nearly
7 to the situation that exists in this state.

8 (b) Sections [refer to sections of the state individual income tax law relating to tax rate brackets,
9 personal exemptions, per capita credits, and minimum and maximum standard deductions] are amended
10 by adding to the end of each the following new subsection:

11 "(insert codification) Upon promulgation of the inflation factor under Section 5(a) of this act, the
12 [head of the department of revenue] shall multiply each dollar amount set forth in this section, as
13 adjusted under this subsection in the immediately preceding tax year, by the inflation factor. If the
14 inflation factor for the current tax year is less than [1.000] [1.030] [other], no further adjustment shall
15 be made and the [exemption, brackets, deductions, etc.] shall be as determined for the immediately
16 preceding tax year.¹

17 SECTION 6. *Separability.* [Insert separability clause.]

18 SECTION 7. *Effective Date.* [Insert effective date.]

¹The dollar amount to which the inflation factor is applied in each year is the dollar amount determined in the preceding tax year through the use of the inflation factor.

COMMISSION MEMBERS

Private Citizens

Abraham D. Beame, Chairman, New York, New York
Bill G. King, Alabama
Vacancy

Members of the United States Senate

Lawton Chiles, Florida
William V. Roth, Jr., Delaware
James R. Sasser, Tennessee

Members of the U.S. House of Representatives

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Fred E. Anderson, Colorado State Senate
Vacancy
Vacancy

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Lynn G. Cutler, Board of Supervisors, Black Hawk County, Iowa
Doris W. Dealaman, Freeholder Director, Somerset County, New Jersey

What is ACIR?

The Advisory Commission on Intergovernmental Relations (ACIR) was created by the Congress in 1959 to monitor the operation of the American federal system and to recommend improvements. ACIR is a permanent national bipartisan body representing the executive and legislative branches of Federal, state, and local government and the public.

The Commission is composed of 26 members—nine representing the Federal government, 14 representing state and local government, and three representing the public. The President appoints 20—three private citizens and three Federal executive officials directly and four governors, three state legislators, four mayors, and three elected county officials from states nominated by the National Governors' Conference, the Council of State Governments, the National League of Cities/U.S. Conference of Mayors, and the National Association of Counties. The three Senators are chosen by the President of the Senate and the three Congressmen by the Speaker of the House.

Each Commission member serves a two year term and may be reappointed.

As a continuing body, the Commission approaches its work by addressing itself to specific issues and problems, the resolution of which would produce improved cooperation among the levels of government and more effective functioning of the federal system. In addition to dealing with the all important functional and structural relationships among the various governments, the Commission has also extensively studied critical stresses currently being placed on traditional governmental taxing practices. One of the long range efforts of the Commission has been to seek ways to improve Federal, state, and local governmental taxing practices and policies to achieve equitable allocation of resources, increased efficiency in collection and administration, and reduced compliance burdens upon the taxpayers.

Studies undertaken by the Commission have dealt with subjects as diverse as transportation and as specific as state taxation of out-of-state depositories; as wide ranging as substate regionalism to the more specialized issue of local revenue diversification. In selecting items for the work program, the Commission considers the relative importance and urgency of the problem, its manageability from the point of view of finances and staff available to ACIR and the extent to which the Commission can make a fruitful contribution toward the solution of the problem.

After selecting specific intergovernmental issues for investigation, ACIR follows a multistep procedure that assures review and comment by representatives of all points of view, all affected levels of government, technical experts, and interested groups. The Commission then debates each issue and formulates its policy position. Commission findings and recommendations are published and draft bills and executive orders developed to assist in implementing ACIR policies.

STATE OF ALASKA

JAY S. HAMMOND, GOVERNOR

DEPARTMENT OF REVENUE

OFFICE OF THE COMMISSIONER

POUCH 5 - JUNEAU 99811

April 30, 1979

The Honorable John C. Sackett
Chairman, Senate Finance Committee
State Capitol Building
Juneau, AK 99801

Dear Senator Sackett:

File

SENATE BILL NO. 266

Senate Bill 266, an Act relating to indexing of the State income tax, was introduced in the Senate on April 16, 1979 and was referred to the Senate Finance Committee.

For the consideration of the Senate Finance Committee, I am enclosing a copy of a Fiscal Note prepared by Mr. N. David Ziemer, Chief, Audit Services, Department of Revenue, concerning the proposed legislation.

Sincerely,

R. D. Stevenson

R. D. Stevenson
Special Assistant

Enclosure

cc: Thomas K. Williams, Commissioner
Department of Revenue

Gary L. Jenkins, Director
Audit Division
Department of Revenue

N. David Ziemer, Chief
Audit Services
Department of Revenue

THE LEGISLATURE OF THE STATE OF ALASKA
ELEVENTH LEGISLATURE

FISCAL NOTE

I. REQUEST

Bill/Resolution No. Senate Bill No. 266
 Title An Act relating to indexing of the State income tax.
 Requested by Senate Finance Committee Date 4/26/79

II. FISCAL DETAIL

Agency Affected _____ Revenue _____
 Program Category Affected _____ Fiscal Services _____
 BRU, Program, or Subprogram(s) Affected Audit Division

(Note: If more than one budget component is affected, separate line-item amounts and funding for each component in the analysis section.)

EXPENDITURES (Thousands of Dollars)

	FY 79	FY 80	FY 81	FY 82	FY 83	FY 84
100 PERSONAL SERVICES		34.3	37.7	41.4	45.5	50.0
200 TRAVEL		1.0	1.1	1.2	1.3	1.4
300 CONTRACTUAL						
400 COMMODITIES		.5	.5	.6	.6	.7
500 EQUIPMENT		2.5				
600 LAND & STRUCTURES						
700 GRANTS, CLAIMS, ETC.						
TOTAL		38.3	39.3	43.2	47.4	52.1

FUNDING (Thousands of Dollars)

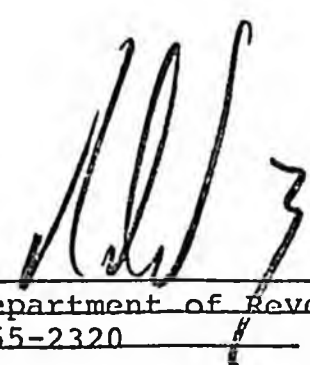
	FY 79	FY 80	FY 81	FY 82	FY 83	FY 84
GENERAL FUND		38.3	39.3	43.2	47.4	52.1
FEDERAL FUNDS						
OTHER (Specify Fund Source)						

POSITIONS

	FY 79	FY 80	FY 81	FY 82	FY 83	FY 84
FULL TIME		1	1	1	1	1
PART TIME		2	2	2	2	2
TEMPORARY						

III. ANALYSIS (See Fiscal Note Preparation Instructions, Section III)

See attached memorandum to R. D. Stevenson dated 4/26/79.

IV. DATE April 26, 1979 PREPARED BY 
 AGENCY Department of Revenue, Audit Division
 PHONE 465-2320

Original: Legislative Finance
 cc: Budget and Management
 Prime Sponsor (First Legislator Named)

STATE
of ALASKA

MEMORANDUM

TO: R. D. Stevenson
Special Assistant
Department of Revenue

DATE: April 26, 1979

FILE NO:

TELEPHONE NO:

FROM: N. David Ziemer
Acting Director
Audit Division

SUBJECT: Senate Bill No. 266

This bill, which is identical to House Bill No. 464, provides for a method of indexing State income taxes by an inflation factor. The bill provides that the tax rates, standard deductions, personal exemptions and tax credits be adjusted annually by an inflation factor of either 110 percent or other amount as set by the Legislative Budget and Audit Committee. This bill will have a marked effect on both the revenue of the State and the operations of the Department of Revenue. Before discussing these effects, one technical clarification needs to be made.

Throughout, the bill calls for an inflation factor of either the amount set by the Budget and Audit Committee or 110 percent, and specifies that that factor should be applied to the rates, deductions and credits for the next tax year. Section 2 of the bill at AS 43.20.025(d) says, "If the Legislative Budget and Audit Committee has not determined an annual inflation factor before October 15 of a tax year, the annual inflation factor for that tax year is 110 percent". The word, "that" should be replaced with the words, the next. This will provide absolute clarity as to which years the bill is referring to.

We estimate, using the 110 percent inflation factor, that the loss of revenue will be approximately \$14,500,000 in the first year. This estimate is based on 1977 tax returns and is merely 10 percent of the total individual collections for that year. A more sophisticated estimate is being prepared by the Research section and should be available soon.

Analysis

While this bill seems like a simple, straightforward act, there are many ramifications due mainly to the complexity of individual income tax administration.

The Department of Revenue is opposed to this bill and finds fault with it for the following reasons:

1. Assuming the default inflation factor of 110 percent, the State Treasury would suffer a loss of approximately \$14,500,000. This estimate is based on the tax statistics for 1977. We are, however, aware that this loss would be offset to some unknown extent by the general growth in the total tax base caused by inflation of wages, etc.

2. The bill provides for the annual inflation rate to be applied to three different levels in the determination of final tax due:
 - A. The minimum deduction and the personal exemption deduction, both of which are deductions from adjusted gross income.
 - B. The tax rate brackets, used to determine tax from taxable income.
 - C. Tax credits, which are offsets to tax determined from rate schedules and are nonrefundable.

It should be noted that by allowing the annual inflation factor to be applied concurrently to all three levels, that the total effect will in all cases be a tax benefit greater than the inflation factor determined by the Legislative Budget and Audit Committee. If the goal of this legislation is to offset the effect of inflation, as measured by the rate they determine, then the total tax benefit should be equivalent to the annual inflation factor. In connection with this, two things should be noted concerning the application to tax credits. First, the bill references the "tax credits" allowed in AS 43.20.036 - 43.20.039. This reference encompasses three sections.

AS 43.20.036 is basically a prohibition section. It lists the federal credits which either are not allowed in the calculation of Alaska income tax due, or which are limited in application.

AS 43.20.038 defines the Residential Fuel Credit as five percent of residential fuel expenses paid during the tax year. There is no maximum ceiling on this credit. Because the credit is based on current dollars spent, if the cost of fuel inflates during the year, the credit will already reflect this rise. To further increase the credit by an artificially determined factor would be needless and redundant.

AS 43.20.039 defines the Residential Fuel Conservation Credit as ten percent of the qualifying expenses subject to a maximum of \$200 or \$100 if married filing separately. Except for the ceiling imposed, the same reasoning applied to AS 43.20.038 applies.

3. Under the current statute construction, the personal exemption deduction allowed in computing Alaska taxable income is tied to the federal personal exemption deduction. For example, when the federal deduction went to \$1,000 in 1979, the Alaska

deduction rose also. The minimum deduction allowed by AS 43.20.031(a)(4) is to be "equivalent in amount to the zero bracket amount defined in Sec. 63(d) of the Internal Revenue Code". If the provisions of this act are adopted in their entirety, it is obvious that from the first year on, neither the personal exemption deduction nor the minimum deduction is going to remotely resemble its federal counterpart. In the case of the minimum deduction, I believe this would call for rewriting AS 43.20.031(a)(4) to incorporate the inflation factor.

4. Since the ultimate result of this act will be to establish a unique tax rate schedule, personal exemption deduction, minimum deduction, and tax credit level for each succeeding tax year, a desirable uniformity is going to be lost. In a time when we are striving to make it possible for the average taxpayer to prepare his/her own return, we would make it more complicated to do so. Especially in the instance of amended returns, multiple year filings, and income averaging schedules, it will be increasingly more difficult for the average taxpayer to prepare his own return. This aspect of the act will undoubtedly have an adverse affect on our Taxpayer Assistance Program.
5. Approximately 28 percent of all filings are from part-year/nonresidents. Since the annual inflation factor reflects the inflation experience of Alaska, it would give a perhaps undue additional tax benefit to this segment of the population, since they presumably spend a healthy portion of their incomes in some other state.
6. Assuming the rate adopted on October 15 applies to the next tax year, the Department of Revenue will need to calculate a new withholding rate for the coming year, to be effective January 1 of the next tax year.
7. In the somewhat unlikely event that the economy takes a turnaround and the inflationary spiral reverses, we would face a rising tax situation (e.g. an inflation factor of .85).
8. In addition to the above comments, there are a couple of technical errors/oversights in the bill, noted below.
 1. In Section 2 of the bill, AS 43.20.025(b) as proposed, provides for adjustment by multiplication by the annual inflation factor for the previous taxable years so the application of the annual inflation factor will be cumulative. First, it should be made clear that this is not retroactive in the first year, i.e., the factor for the first year of application becomes the base. Secondly,

April 26, 1979

it should be pointed out that by multiplying by previous years' factors (e.g. 110% x 108% = 118.80%), the factor becomes compounded, not cumulative. If it were to be cumulative, the above example would result in a second-year factor of 118%.

2. In Section 2 of the bill, AS 43.20.025(d) should read as follows:

"(d) If the Legislative Budget and Audit Committee has not determined an annual inflation factor before October 15 of a tax year, the annual inflation factor for the taxable year beginning after December 31 of that year is 110 percent."

Recommendations:

The goal of compensating taxpayers for inflation is admirable and, in fact, an increasing necessity. However, it could be accomplished much more easily. Let each legislative session adopt a new set of tax tables to be effective on January 1 of the following year. These could be adopted from Budget and Audit Committee recommendations and could compensate only for inflation rather than overcompensation as in the proposed bill. This would have the additional advantage of preserving unto the Legislature its previously sacred duty of setting tax rates.

Budget Impact

Forms costs and preparation would not be significantly impacted as long as the lead time specified in the bill was preserved. We would, however, anticipate that enough confusion about constantly changing rates, deductions and credits would exist to seriously impact our taxpayer assistance function. We expect that due to the added confusion caused by changing tax rates and deductions, our assistance requests will increase 25 to 30 percent over this year. This estimate is based on knowledge of the kinds of questions most frequently asked and the vast number of requests we received last year during the "zero bracket confusion". We estimate that one full time and two five month seasonal Tax Examiner positions will be required. These, together with requisite equipment commodities and travel funds, will cost \$38,300 the first year. See the attached Fiscal Note for details.

Introduced: 4/16/79
Referred: Finance

BY KELLY, DANKWORTH, HACKNEY,
STIMSON AND SUMNER

1 IN THE SENATE

2 SENATE BILL NO. 266

3 IN THE LEGISLATURE OF THE STATE OF ALASKA

4 ELEVENTH LEGISLATURE - FIRST SESSION

5 A BILL

6 For an Act entitled: "An Act relating to indexing of the state income tax;
7 and providing for an effective date."

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

9 * Section 1. AS 24.20.201(a) is amended by adding a new paragraph to
10 read:

11 (8) determine, before October 15 of each year, an annual
12 inflation factor for the taxable year beginning after December 31 of that
13 year for use by the Department of Revenue in making the adjustments to
14 the Alaska net income tax required under AS 43.20.025. In making this
15 determination the committee shall use those statistics which in its
16 judgment best reflect the magnitude of inflation in Alaska, including
17 but not limited to the monthly consumer price index prepared by the
18 Bureau of Labor Statistics, United States Department of Labor and the
19 commodity indexes prepared by Dow Jones and Company and published in the
20 Wall Street Journal.

21 * Sec. 2. AS 43.20 is amended by adding a new section to read:

22 Sec. 43.20.025. INCOME TAX INDEXING. (a) For each tax year the
23 department shall multiply the annual inflation factor determined by the
24 Legislative Budget and Audit Committee under AS 24.20.201(a)(8) for that
25 year, by the

- 26 (1) tax rate brackets set out in AS 43.20.011(a) - (c);
27 (2) the minimum deduction (AS 43.20.031(a)(4));
28 (3) the personal exemption; and
29 (4) the tax credits allowed in AS 43.20.036 - 43.20.039.

1 (b) The calculation made under (a) of this section shall be
2 adjusted by multiplication by the annual inflation factor for the pre-
3 vious taxable years so that the application of the annual inflation
4 factor will be cumulative.

5 (c) The resulting dollar amounts rounded to the nearest one dollar
6 are the tax rate brackets, minimum deduction, credits and personal
7 exemption for the next tax year and shall be incorporated into the
8 income tax forms and instructions of the department.

9 (d) If the Legislative Budget and Audit Committee has not
10 determined an annual inflation factor before October 15 of a tax year,
11 the annual inflation factor for that tax year is 110 per cent.

12 * Sec. 3. AS 43.20.025 enacted by sec. 2 of this Act applies to all tax
13 years beginning after December 31, 1978.

14 * Sec. 4. This Act takes effect immediately in accordance with AS 01.10.-
15 070(c).

Introduced: 4/16/79
Referred: Finance

BY KELLY, DANKWORTH, HACKNEY,
STIMSON AND SUMNER

1 IN THE SENATE

2 SENATE BILL NO. 266

3 IN THE LEGISLATURE OF THE STATE OF ALASKA

4 ELEVENTH LEGISLATURE - FIRST SESSION

5 A BILL

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24 Legislative Budget and Audit Committee under AS 24.20.201(a)(8) for that
25 year, by the

26 (1) tax rate brackets set out in AS 43.20.011(a) - (c);

27 (2) the minimum deduction (AS 43.20.031(a)(4));

28 (3) the personal exemption; and

29 (4) the tax credits allowed in AS 43.20.036 - 43.20.039.

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2 adjusted by multiplication by the annual inflation factor for the pre-
3 vious taxable years so that the application of the annual inflation
4 factor will be cumulative.

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6 are the tax rate brackets, minimum deduction, credits and personal
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13 years beginning after December 31, 1978.

14 * Sec. 4. This Act takes effect immediately in accordance with AS 01.10.-
15 070(c).



RECORDS CERTIFICATION

I, the undersigned, an employee of the State of Alaska, do hereby certify that the microfilm images on this microform are accurate reproductions of the original records of the State of Alaska as accumulated during the regular course of business, and that it is the established policy and practice of this State to microfilm its records and to dispose of the original records after microfilm reproductions have been made.

James A. Smith
Signature of Camera Operator

3/23/90
Date

Date passed to Senate _____

Bill # SB271

SENATE FINANCE COMMITTEE
BILL CHECKLIST

- 1. Committee Copy-Current Bill
- 2. History Cover Form
- 3. Printed Copies:
 - Original Bill
 - Committee Substitutes or Amendments
- 4. SFC Committee Report Form
- 5. Fiscal Information:
 - Note in File _____
 - Note Requested _____ Date _____
 - Other Financial Backup (See Below)
- 6. Backup:
 - Handouts _____
 - Letter from Governor _____
 - Letter from Sponsor _____
 - Completed Committee Reports _____
 - Committee _____
 - Other _____

Letter from Jay Hogan - substantiating the \$100,000,000



Official Business

Alaska State Legislature

Senate

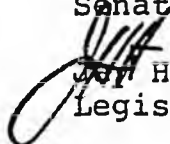
Committee on Finance

Pouch V
State Capitol
Juneau, Alaska 99811

April 11, 1979

MEMORANDUM

TO: John C. Sackett, Chairman
Senate Finance Committee

FROM:  Jay Hogan, Director
Legislative Finance Division

SUBJECT: State Highway Improvements

Rather than adopt the \$18 million stop-gap two year road improvement program proposed by the Governor in HB 396, I have enclosed for your review a draft of a \$100 million general obligation bond bill for improvements to federal primary highway routes throughout the state. The appropriations by region are based on the existing mileage of federal aid primary routes within each highway region (see table enclosed).

Justification for the \$100 million issue is found in the enclosed excerpt from a U.S. Department of Transportation report to the Congress submitted in August 1978. That report based on a 1977 condition survey substantiated a \$46.5 million requirement for road improvements along those routes principally used during the period of pipeline construction. Allowing for 10% inflation in construction costs per year and for coverage of routes not damaged by pipeline traffic (making the bill "statewide") the \$100 million figure would seem to be reasonable.

FEDERAL AID PRIMARY ROUTES
BY DOT REGION

	<u>Miles</u>	<u>Miles</u> <u>%</u>
<u>Central Region</u>		
Sterling Highway	139.38	
Kenai Spur Road	14.00	
Seward Highway	119.31	
Parks Highway	128.92	
Glenn Highway	107.15	
	<u>508.76</u>	31.6
 <u>Interior Region</u>		
Parks Highway	191.75	
Alaska Hwy. (Inc. 95.32 Richardson Hwy)	296.50	
Richardson Highway (Less 95.32)	64.04	
Tok Cutoff	32.52	
	<u>584.81</u>	36.3
 <u>Southeast Region</u>		
Glacier/Douglas Hwy. (Include Thane Rd)	13.83	
Haines Highway	44.40	
Skagway/Carcross Road	15.05	
	<u>73.28</u>	4.6
 <u>Western Region</u>		
Nome-Taylor Road	71.13	
Airport Road	1.32	
	<u>72.45</u>	4.5
 <u>South Central Region</u>		
Glen Highway	69.99	
Richardson Highway	207.70	
Tok Cutoff	92.40	
	<u>370.09</u>	23.0
	 <u>1609.39</u>	 -

Introduced: 4/20/79
Referred: Finance

1 IN THE SENATE

BY SACKETT

2 SENATE BILL NO. 271

3 IN THE LEGISLATURE OF THE STATE OF ALASKA

4 ELEVENTH LEGISLATURE - FIRST SESSION

5 A BILL

6 For an Act entitled: "An Act providing for the issuance of general obligation
7 bonds in the amount of \$100,000,000 for the purpose of paying the cost of federal aid primary highway
8 improvements; and providing for an effective date."
9

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

11 * Section 1. For the purpose of paying the cost of federal aid primary
12 highway improvements, general obligation bonds of the state in the principal
13 amount of not more than \$100,000,000 shall be issued and sold. The full
14 faith, credit and resources of the state are pledged to the payment of the
15 principal of and interest and redemption premium, if any, on these bonds.
16 These bonds shall be issued under the provisions of AS 37.15 as those provisions
17 read at the time of issuance.

18 * Sec. 2. (a) If the issuance of these bonds is authorized by the qualified
19 voters of the state, a special fund of the state to be known as the
20 "1980 Federal Aid Primary Highway Improvement Fund" shall be established, to
21 which shall be credited the proceeds of the sale of the bonds described in
22 sec. 1 of this Act except for the accrued interest and premiums. The amount
23 of \$100,000,000 is appropriated from the "1980 Federal Aid Primary Highway
24 Improvement Fund" to the Department of Transportation and Public Facilities.
25 Notwithstanding the provisions of AS 24.30.037, the proceeds of these bonds
26 are appropriated to the following administrative regions in the amounts set
27 out after each, and the governor shall allocate each regional appropriation
28 to eligible federal aid primary highway routes based upon an assessment by
29 the Department of Transportation and Public Facilities of required road

1 improvements:

2	Central region	\$31,600,000
3	Interior region	36,300,000
4	Southeast region	4,600,000
5	Western region	4,500,000
6	Southcentral region	23,000,000

7 (b) Publication by the lieutenant governor of the allocations made in
8 (a) of this section is sufficient to meet the requirements of AS 15.15.040.

9 * Sec. 3. If the issuance of these bonds is authorized by the qualified
10 voters of the state, the amount of \$350,000 or as much of that amount as is
11 found necessary is appropriated from the general fund of the state to the
12 state bond committee to carry out the provisions of this Act and to pay
13 expenses incident to the sale and issuance of the bonds authorized in this
14 Act. The amounts expended from the appropriation authorized by this section
15 shall be reimbursed to the general fund from the proceeds of the sale of the
16 bonds authorized by this Act.

17 * Sec. 4. The amount withdrawn from the public facility planning fund for
18 the purpose of advance planning for the improvements financed under this Act
19 shall be reimbursed to the fund from the proceeds of the sale of bonds autho-
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21 * Sec. 5. The question whether the bonds authorized in this Act are to be
22 issued shall be submitted to the qualified voters of the state at the next
23 general election and shall read substantially as follows:

24 Proposition

25 State General Obligation Federal Aid Primary

26 Highway Improvement Bonds \$100,000,000

27 Shall the State of Alaska issue its general obligation bonds
28 in the principal amount of not more than \$100,000,000 for the
29 purpose of paying the cost of improvements to federal aid

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primary highways?

Bonds Yes []

Bonds No []

* Sec. 6. This Act takes effect immediately in accordance with AS 01.10.-
070(c).



Official Business

Alaska State Legislature

Senate


Committee on Finance

Pouch V
State Capitol
Juneau, Alaska 99811

April 11, 1979

MEMORANDUM

TO: John C. Sackett, Chairman
Senate Finance Committee

FROM:  Jay Hogan, Director
Legislative Finance Division

SUBJECT: State Highway Improvements

Rather than adopt the \$18 million stop-gap two year road improvement program proposed by the Governor in HB 396, I have enclosed for your review a draft of a \$100 million general obligation bond bill for improvements to federal primary highway routes throughout the state. The appropriations by region are based on the existing mileage of federal aid primary routes within each highway region (see table enclosed).

Justification for the \$100 million issue is found in the enclosed excerpt from a U.S. Department of Transportation report to the Congress submitted in August 1978. That report based on a 1977 condition survey substantiated a \$46.5 million requirement for road improvements along those routes principally used during the period of pipeline construction. Allowing for 10% inflation in construction costs per year and for coverage of routes not damaged by pipeline traffic (making the bill "statewide") the \$100 million figure would seem to be reasonable.

FEDERAL AID PRIMARY ROUTES
BY DOT REGION

	<u>Miles</u>	<u>Miles</u> <u>&</u>
<u>Central Region</u>		
Sterling Highway	139.38	
Kenai Spur Road	14.00	
Seward Highway	119.31	
Parks Highway	128.92	
Glenn Highway	107.15	
	<u>508.76</u>	31.6
 <u>Interior Region</u>		
Parks Highway	191.75	
Alaska Hwy. (Inc. 95.32 Richardson Hwy)	296.50	
Richardson Highway (Less 95.32)	64.04	
Tok Cutoff	32.52	
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Glacier/Douglas Hwy. (Include Thane Rd)	13.83	
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Glen Highway	69.99	
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REPORT TO CONGRESS

ALASKA ROADS STUDY

AUGUST 1978

PREPARED BY THE STAFF OF
THE FEDERAL HIGHWAY ADMINISTRATION
U.S. DEPARTMENT OF TRANSPORTATION

ALASKA ROADS STUDY

Introduction

This is the final report on the Department of Transportation's study of the damage to Alaska highways caused by heavy truck traffic associated with the construction of the trans-Alaska oil pipeline. The study was conducted in accordance with Section 151 of the Federal-Aid Highway Act of 1976. The report presents the Department's final conclusions concerning the costs and responsibility for repair of the damaged highways.

For the purpose of this final report, March 7, 1978, is considered as the date of completion of pipeline construction. This date coincides with the restoration of Pump Station No. 8 to continuous operation.

An initial report of study findings was sent to the Congress on November 11, 1976. A copy is attached to this report as Appendix B. New information which became available after transmittal of the initial report is contained in the Addendum to Initial Report attached to this report as Appendix A.

Initial Findings

The initial report found that there was no commitment or responsibility on the part of the Federal Government for repair of the damaged highways. The total cost of repairing the damaged highways was determined to be \$65.5 million, of which \$40.0 million was found which could be attributed to pipeline construction traffic. The repair costs were determined on the basis of restoring the damaged surfaces to current structural pavement standards used in Alaska.

Final Conclusions

Subsequent to the initial report, a condition survey of Alaska highways was conducted by the State in 1977. Data from the 1977 survey shows the total estimated cost of repair to be \$46.5 million of which \$22.5 million can be attributed to the pipeline construction traffic. This decrease in repair costs from the 1976 estimate is the result of State construction and maintenance efforts in repairing the damaged highways. While the mileage of damaged highways did not appreciably change, the nature of the damage was less serious because of improvements made by the State. The costs to repair the damaged highways will continue to decrease as the State continues its construction and maintenance efforts since the pipeline construction has been completed.

The Congress, in passing the trans-Alaska Pipeline Authorization Act (PL 93-153), did not indicate a willingness or intent that the Federal Government assume any financial responsibility for the work or any related costs attributable to the work.

The State of Alaska recognized in their comments on the environmental impact statement prior to construction of the pipeline, that highway damage would occur and increase costs of highway maintenance and construction but that ". . . the benefits to be derived from the development in terms of long range revenues available to construct, reconstruct and maintain highways would far outweigh such temporary excesses."

Revenues being received by the State of Alaska from development of the North Slope oil resources have increased the State's General Fund balance from \$406.8 million in 1975 to an estimated \$755.7 million in 1977.

The State has made significant accomplishments in reducing the magnitude of the costs to repair the highways damaged by pipeline construction traffic with existing funds. The occurrence of the damage and the costs of repair were anticipated and acceptable to the State prior to pipeline construction considering the benefits to be received from completion of the pipeline. Expectations as expressed in the State's comments on the environmental impact statement with regards to costs versus benefits are being realized. There is no moral burden or legal commitment on the part of the Federal Government to assume the costs of repairing Alaska highways damaged by pipeline construction traffic.

Figure 2
 Estimated Costs of Repairs
 Required on the Study Routes
 1977 Condition Survey

Route No. and Termini	Total Route Costs (Millions of Dollars)	*Cost of Repair by Condition Rating (Millions of Dollars)			
		7	6	5	Below 5
FAP-21 Sterling Highway, Homer to Jct. FAP-31	3.086	1.470	0.863	0.753	0
FAP-31 Seward Highway, Seward to Anchorage	4.263	2.094	1.196	0.973	0
FAP-35 Parks Highway, Jct. FAP-42 to Jct. FAP-37	0.575	0.575	0	0	0
FAP-37 Parks Highway, Jct. FAP-35 to FAP-62	0.240	0	0.240	0	0
FAP-42 Glenn Highway, Anchorage Airport to Jct. FAP-71	3.554	1.512	1.309	0.733	0
FAP-46, Tok Cut-off Jct. FAP-71 to FAP-62	3.620	2.566	1.054	0	0
FAP-62 Alaska Highway, Canadian border to Delta Jct.	6.360	5.985	0.375	0	0
FAP-71 and 62, Richardson Highway, Valdez to Fairbanks	9.141	6.650	1.502	0.989	0
FAP-95 Haines Highway, Haines to Canadian Border	0.908	0.908	0	0	0
FAS-680 Elliott Highway, Jct. FAP-62 to Taps Road	0.916	0	0	0	0.916
Total Pavement Repair Costs	\$32.663	21.760	6.539	3.448	0.916
FAS-680 Elliott Highway, Gravel Section Repair Costs	3.700				
Bridge Repairs	0.076				
Additional Repairs Est. at Completion of Pipeline	4.000				
Ingr. and Cont. (15%)	6.066				
TOTAL EST. COSTS OF REPAIR	\$46.505				

*Rating Number	Unit Cost Per Mile (1976 Prices)
7	40,000
6	60,000
5	100,000
Less Than 5	400,000

Introduced: 4/20/79
Referred: Finance

1 IN THE SENATE

BY SACKETT

2 SENATE BILL NO. 271

3 IN THE LEGISLATURE OF THE STATE OF ALASKA

4 ELEVENTH LEGISLATURE - FIRST SESSION

5 A BILL

6 For an Act entitled: "An Act providing for the issuance of general obliga-
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9 improvements; and providing for an effective date."

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13 amount of not more than \$100,000,000 shall be issued and sold. The full
14 faith, credit and resources of the state are pledged to the payment of the
15 principal of and interest and redemption premium, if any, on these bonds.
16 These bonds shall be issued under the provisions of AS 37.15 as those provi-
17 sions read at the time of issuance.

18 * Sec. 2. (a) If the issuance of these bonds is authorized by the quali-
19 fied voters of the state, a special fund of the state to be known as the
20 "1980 Federal Aid Primary Highway Improvement Fund" shall be established, to
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22 sec. 1 of this Act except for the accrued interest and premiums. The amount
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24 Improvement Fund" to the Department of Transportation and Public Facilities.
25 Notwithstanding the provisions of AS 24.30.037, the proceeds of these bonds
26 are appropriated to the following administrative regions in the amounts set
27 out after each, and the governor shall allocate each regional appropriation
28 to eligible federal aid primary highway routes based upon an assessment by
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1 improvements:

2	Central region	\$31,600,000
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4	Southeast region	4,600,000
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7 (b) Publication by the lieutenant governor of the allocations made in
8 (a) of this section is sufficient to meet the requirements of AS 15.15.040.

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14 Act. The amounts expended from the appropriation authorized by this section
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25 State General Obligation Federal Aid Primary

26 Highway Improvement Bonds \$100,000,000

27 Shall the State of Alaska issue its general obligation bonds
28 in the principal amount of not more than \$100,000,000 for the
29 purpose of paying the cost of improvements to federal aid

1 primary highways?

2 Bonds Yes []

3 Bonds No []

4 * Sec. 6. This Act takes effect immediately in accordance with AS 01.10.-
5 070(c).
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ALASKA STATE LEGISLATURE

ELEVENTH Legislature FIRST Session

SENATE BILL NO. 271

By SACKETT

"An Act providing for the issuance of general obligation bonds in the amount of \$100,000,000 for the purpose of paying the cost of federal aid primary highway improvements; and providing for an effective date."

Introduced in the Senate 4/20/1979

HISTORY IN THE SENATE

19 79

4 20

Read first time and referred to Committee on Finance

Reported back with recommendation that

Read second time and

Read third time and

PASS	Effective Date
Yeas	Yeas
Nays	Nays
Absent	Absent
Excused	Excused

Reconsideration

PASS	Effective Date
Yeas	Yeas
Nays	Nays
Absent	Absent
Excused	Excused

Reported correctly engrossed
Signed by President
Sent to House

SECRETARY OF THE SENATE

HISTORY IN THE HOUSE

19

Read first time and referred to Committee on

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PASS	Effective Date
Yeas	Yeas
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PASS	Effective Date
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Absent	Absent
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Reported correctly engrossed
Signed by Speaker
Returned to Senate

CHIEF CLERK OF THE HOUSE

HISTORY IN THE SENATE

19

Received from House

To enrolling

Reported correctly enrolled

Sent to Governor

..... by Governor

Filed with Lt. Governor

Chapter No.



Official Business

Alaska State Legislature

Senate

Committee on Finance

Pouch V
State Capitol
Juneau, Alaska 99811

April 11, 1979

M E M O R A N D U M

TO: John C. Sackett, Chairman
Senate Finance Committee

FROM: *[Signature]* Jeff Hogan, Director
Legislative Finance Division

SUBJECT: State Highway Improvements

Rather than adopt the \$18 million stop-gap two year road improvement program proposed by the Governor in HB 396, I have enclosed for your review a draft of a \$100 million general obligation bond bill for improvements to federal primary highway routes throughout the state. The appropriations by region are based on the existing mileage of federal aid primary routes within each highway region (see table enclosed).

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Introduced: 4/20/79
Referred: Finance

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BY SACKETT

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7 (b) Publication by the lieutenant governor of the allocations made in
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primary highways?

Bonds Yes []

Bonds No []

* Sec. 6. This Act takes effect immediately in accordance with AS 01.10.-
070(c).

April 1, 1980


ANALYSIS OF CS FOR SB 275: An Act relating to the payment
of judgments or claims by insurance companies

AS 21.89.030 provides that insurance companies doing business in the state must pay judgments and settle claims with negotiable bank checks.

The amendment would permit a claim up to \$1,000 for loss or damage to property to be settled with a bank draft.

Claims can be settled more promptly with a draft issued by an agent. A check would have to be authorized prior to issue-- a procedure which normally results in a delay. (A draft issued by an agent is not actually paid until it has been accepted by the company but unless it were refused by the company the claimant would not be affected.)

NOTE: The request for the bill originated in the State Division of Insurance. Its purpose is to permit claims to be paid quicker. Insurance Agents seem to favor the change. (Information secured from Mr. Frank Lee, Senate Commerce Committee Aide.)



W. HOGAN

COMMITTEE REPORT
SENATE

FURTHER: Finance

4/23/79

Date: Feb 5, 1980

Mr. President:

The Committee on COMMERCE has had SB 275
payment of judgments or claims by insurance companies

under consideration and (a majority of the committee) (the committee)
reports it back with the following recommendations:

- do pass do not pass
- do pass with attached amendments(s)
- replace with CS for SB 275 same title
 new title
- and recommends Amg. do pass
- AND attaches a "Letter of Intent" New Fiscal Note
- reports it back without recommendation
- referred to the _____ Committee

MEMBERS SIGNING
DO PASS

MEMBERS HAVING
OTHER RECOMMENDATIONS:

Curtis Sturgulinski
Tom Keel
Donald Bradley

Do Pass Ferguson notes

Donald Bradley
CHAIRMAN

Original sponsor: Commerce Committee
by Request

Offered: 3/19/80
Referred: Finance

1 IN THE SENATE

BY THE COMMERCE COMMITTEE

2 CS FOR SENATE BILL NO. 275

3 IN THE LEGISLATURE OF THE STATE OF ALASKA

4 ELEVENTH LEGISLATURE - SECOND SESSION

5 A BILL

6 For an Act entitled: "An Act relating to the payment of judgments or claims
7 by insurance companies."

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

9 * Section 1. AS 21.89.030 is amended to read:

10 Sec. 21.89.030. PAYMENT. No insurance company doing business in
11 this state may pay a judgment or settlement of a claim in this state for
12 a loss incurred in this state with an instrument other than a negotiable
13 bank check payable on demand and bearing even date with the date of
14 writing except that a claim up to \$1,000 for loss or damage to property
15 may be settled with a bank draft.
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Introduced: 4/23/79
Referred: Commerce and
Finance

1 IN THE SENATE

BY THE COMMERCE COMMITTEE
BY REQUEST

2 SENATE BILL NO. 275

3 IN THE LEGISLATURE OF THE STATE OF ALASKA

4 ELEVENTH LEGISLATURE - FIRST SESSION

5 A BILL

6 For an Act entitled: "An Act relating to the payment of judgments or claims
7 by insurance companies."

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

9 * Section 1. AS 21.89.030 is amended to read:

10 Sec. 21.89.030. PAYMENT. No insurance company doing business in
11 this state may pay a judgment or settlement of a claim in this state for
12 a loss incurred in this state with an instrument other than a negotiable
13 draft or bank check payable on demand and bearing even date with the
14 date of writing.

ALASKA STATE LEGISLATURE

ELEVENTH Legislature FIRST Session

SENATE BILL..... NO. 275..

By THE COMMERCE COMMITTEE
BY REQUEST

"An Act relating to the payment of judgments or claims by insurance companies."

Introduced in the Senate 4/23/19.....

HISTORY IN THE SENATE

19	79	Read first time and referred to Committee on Commerce and Finance												
4	23													
3	19	Reported back with <i>Commerce</i> recommendation that <i>replace w/CS, if do pass, 1 no rec to fin.</i>												
		Read second time and												
		Read third time and												
		<table border="0"> <tr><td>PASS</td><td>Effective Date</td></tr> <tr><td>Yeas</td><td>Yeas</td></tr> <tr><td>Nays</td><td>Nays</td></tr> <tr><td>Absent</td><td>Absent</td></tr> <tr><td>Excused</td><td>Excused</td></tr> </table>	PASS	Effective Date	Yeas	Yeas	Nays	Nays	Absent	Absent	Excused	Excused		
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Nays	Nays													
Absent	Absent													
Excused	Excused													
		Reported correctly engrossed Signed by President Sent to House												

SECRETARY OF THE SENATE

HISTORY IN THE HOUSE

19		Read first time and referred to Committee on												
		Reported back with recommendation that												
		Read second time and												
		Read third time and												
		<table border="0"> <tr><td>PASS</td><td>Effective Date</td></tr> <tr><td>Yeas</td><td>Yeas</td></tr> <tr><td>Nays</td><td>Nays</td></tr> <tr><td>Absent</td><td>Absent</td></tr> <tr><td>Excused</td><td>Excused</td></tr> </table>	PASS	Effective Date	Yeas	Yeas	Nays	Nays	Absent	Absent	Excused	Excused		
PASS	Effective Date													
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		<table border="0"> <tr><td>Reconsideration</td><td></td></tr> <tr><td>PASS</td><td>Effective Date</td></tr> <tr><td>Yeas</td><td>Yeas</td></tr> <tr><td>Nays</td><td>Nays</td></tr> <tr><td>Absent</td><td>Absent</td></tr> <tr><td>Excused</td><td>Excused</td></tr> </table>	Reconsideration		PASS	Effective Date	Yeas	Yeas	Nays	Nays	Absent	Absent	Excused	Excused
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Yeas	Yeas													
Nays	Nays													
Absent	Absent													
Excused	Excused													
		Reported correctly engrossed Signed by Speaker Returned to Senate												

CHIEF CLERK OF THE HOUSE

HISTORY IN THE SENATE

19		Received from House
		To enrolling
		Reported correctly enrolled
		Sent to Governor
	 by Governor
		Filed with Lt. Governor
		Chapter No.

Introduced: 4/23/79
Referred: Commerce and
Finance

1 IN THE SENATE

BY THE COMMERCE COMMITTEE
BY REQUEST

2 SENATE BILL NO. 275

3 IN THE LEGISLATURE OF THE STATE OF ALASKA

4 ELEVENTH LEGISLATURE - FIRST SESSION

5 A BILL

6 For an Act entitled: "An Act relating to the payment of judgments or claims
7 by insurance companies."

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

9 * Section 1. AS 21.89.030 is amended to read:

10 Sec. 21.89.030. PAYMENT. No insurance company doing business in
11 this state may pay a judgment or settlement of a claim in this state for
12 a loss incurred in this state with an instrument other than a negotiable
13 draft or bank check payable on demand and bearing even date with the
14 date of writing.

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Original sponsor: Commerce Committee
by Request

Offered: 3/19/80
Referred: Finance

1 IN THE SENATE BY THE COMMERCE COMMITTEE

2 CS FOR SENATE BILL NO. 275

3 IN THE LEGISLATURE OF THE STATE OF ALASKA

4 ELEVENTH LEGISLATURE - SECOND SESSION

5 A BILL

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12 a loss incurred in this state with an instrument other than a negotiable
13 bank check payable on demand and bearing even date with the date of
14 writing except that a claim up to \$1,000 for loss or damage to property
15 may be settled with a bank draft.

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A M E N D M E N T

OFFERED IN THE SENATE:

BY: COMMERCE COMMITTEE

To: _____ SENATE BILL No. 275

HOUSE BILL No. _____

PAGE: 1

LINE: 12

Rephrase from line 12 as follows:

a loss incurred in this state with an instrument other than
a negotiable bank check payable on demand and bearing even date
with the date of writing except that fire and physical damage
insurance claims up to \$1,000 may be settled with drafts.

SB-275
Testimony by the Division of Insurance
Before the Senate Commerce Committee
February 5, 1980

AS 21.89.030 was added to the Insurance Code in 1968 in an attempt to cure a problem which existed at that time. The intent, as expressed in the House Journal for February 17, 1968, read as follows:

This bill seeks to prevent the delay, inconvenience, financial loss and frustration experienced by insurance claimants when payment by the insurance company is made in the form of an instrument not readily exchangeable for cash. The intent is to prohibit the use of what is commonly called a "sight draft," still used by some insurance companies, which requires an additional "acceptance" by the company before actual payment is made.

After passage of the bill, the Director of Insurance discussed it with Ted Stevens, who, at the time, was a member of the Alaska Legislature. Ted Stevens stated that the purpose of the bill was twofold. The purpose was:

1. to force insurance companies to maintain bank accounts in this state; and
2. to eliminate delay in clearing drafts.

These purposes have not necessarily been accomplished. Insurance companies have not been forced to maintain accounts in Alaska. The concerns of the Legislature in 1968 have still not been corrected. While the use of drafts have been, for the most part, discontinued, delays still occur.

When the bill was adopted, there was confusion as to the meaning of a "negotiable bank check payable on demand." The Director requested an opinion from the attorney general which concluded that the term "bank check" is identical to the term "check" and does not imply that a check is to be treated as either a cashier's check or a certified check.

The concerns expressed in the 1968 Letter of Intent related to payment of a claim with an instrument not readily exchangeable for cash. The truth of the matter is that checks are not always readily exchangeable for cash. A bank may be willing to accept a check only for collection, which means that the check must first clear the bank on which it was drawn before it was cashed. If the check is drawn on a northwest bank, it is sent to the Federal Reserve Clearinghouse in Seattle, in which case, the claimant must wait at least a week before he can receive cash. This situation has been marginally improved by the use of a mini clearinghouse in Anchorage to clear local items in about 48 hours.

EXHIBITS

1. Request for Attorney General's Opinion - April 26, 1968.
2. Attorney General's Opinion - June 24, 1968.
3. House Journal page 246 - Letter of Intent - February 17, 1968.
4. Definition and characteristics of checks - Excerpts from "The Law of Bank Checks" by Henry J. Bailey - Fourth Edition - 1969.
5. Definitions from "The Encyclopedia of Banking and Finance" by Munn and Garcia - Seventh Edition - 1973.
 - A. Bank Draft - page 76.
 - B. Cashier's Check - page 173.
 - C. Certified Check - pages 179-180.
 - D. Check - page 182.
 - E. Draft - pages 282-283.
 - F. Federal Reserve Check Collection System - pages 343-345.
 - G. Negotiable - page 626.
 - H. Negotiable Instruments - page 627.

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If the check is drawn on an eastern bank, the clearing process generally takes three or more weeks. This, of course, is not acceptable and any move back to a draft will not necessarily improve the situation.

One reason that an insurer might wish to use a draft in this State is because the company will often give draft authority to an agent or adjuster to settle smaller claims such as any claims under \$500 or \$1,000. These are almost always "sight drafts" requiring approval by the company before any cash is made available. The wording of the statute, even with the inclusion of the proposed change, would appear to bar such an instrument in view of the presence of the words, "payable upon demand."

It is our opinion that a draft used in small claims may actually speed the payment process and may tend to reduce claims cost. Accordingly, we recommend that AS 21.89.030 be amended by adding a sentence which would read:

↘ "Except that fire and physical damage loss up to \$1,000 may be settled with a draft.

This amendment would require checks on all claims and judgements for other than fire and physical damage loss under \$1,000 to be continued to be settled by check. We would be opposed to draft authority for large claims since these are generally settled by the company or its adjuster and draft authority would give them a second look and an opportunity to change their minds resulting in claims delay.

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 - G. Negotiable - page 626.
 - H. Negotiable Instruments - page 627.

EXHIBIT

1.

HB 365

FORM SA-18
125.5M 9/67

MEMORANDUM

State of Alaska
DEPARTMENT OF COMMERCE

TO: OFFICE OF ATTORNEY GENERAL
G. Kent Edwards
Deputy Attorney General

DATE : April 26, 1968

FROM: W. W. Fritz
Director of Insurance

SUBJECT: HOUSE BILL 365
"Negotiable Bank Check Payable On Demand"

We are requesting your opinion on House Bill 365 that passed both the House and the Senate and has been signed by the Governor. A copy of the Bill is attached hereto for your information.

We are specifically requesting your interpretation of the term "negotiable bank check payable on demand." The use of the word "bank" in the Bill needs clarification. The original Bill as submitted called for payment by Cashier's Check or Certified Check.

It is specifically requested that a determination be made as to whether the words "negotiable bank check payable on demand" means a check issued by a bank in the form of either a Cashier's Check or some other instrument made by the bank.

Please rush your opinion as I must notify all of the insurance companies immediately.

Enclosures - 2
WWF:hc

EXHIBIT 2.

FORM 3-18
125.51 8/67

MEMORANDUM

State of Alaska *1/2/68*
365

TO:

Department of Commerce

Attn: Mr. W. W. Fritz
Division of Insurance

DATE : June 24, 1968

FROM:

G. Kent Edwards
Attorney General

SUBJECT: House Bill No. 365
"Negotiable Bank Check
Payable on Demand"
Our File No. COM-129

By: Vernon L. Snow
Assistant Attorney General

Reference is made to your memorandum dated April 26, 1968, requesting our opinion as to the meaning of the term "negotiable bank check payable on demand" used in House Bill No. 365.

You state that the original bill read "Cashier's check or certified check". The Legislature amended the wording of the bill to read "negotiable bank check payable on demand".

Enclosed herewith is a xerox copy of Black's Law Dictionary covering the definition of "bank cneck" and "checks". You will note that the dictionary states under "bank check" "See 'check'". The definition of "check" in that dictionary does not lend much help in determining the meaning of the term "negotiable bank check". However, it is noted that the following statement is made regarding "check" and "draft":

"The term 'check', within the ordinary meaning of that term includes 'draft', the only distinction being that in a draft the drawer is a bank, while in the ordinary check the drawer is an individual. Leach v. Mechanics' Sav. Bank, 202 Iowa 899, 211 NW 506, 508, 50 A.L.R. 388."

Bank check is defined in 11 Am. Jur. 2d., Bills and Notes, §17, p. 47, as follows:

"The term 'bank check' means nothing more than 'check'. It merely designates a check which is drawn on a bank and thus is generally tautological, although it may be used to distinguish checks for money from such things as baggage checks, or from some travelers' checks which are not always drawn on a bank."
(Emphasis added)

In 10 C.J.S., Bills and Notes, §5, p. 409, the following reference is made to a "bank check":