Appendix II
Historical Perspective

Tax limitations have a long history in America, and anyone proposing these types of constraints would do well to review past efforts. This special section seeks to highlight conditions and public actions in the past which many people today seem to feel are unique to the present.

Proposition 13

In spite of the attention it received, Proposition 13 was directed toward a very limited objective—reduction of property taxes. The proposition was aimed only at this one source of revenue at the local level of government. The proposition had the following principal provisions:

(1) It limited real property taxes to 1 percent of market value—a step designed to cut revenues from this source by more than half.

(2) It set assessable "market value" at that established during the 1975-76 fiscal year, with increases to be made in evaluations only at the time of subsequent new construction or when ownership changed hands—probably the first time in history when values were legally frozen to give preferential treatment to existing property owners over developers and new purchasers.

(3) It placed a limit on increases in assessed values of 2 percent annually, regardless of actual market values.

(4) It prohibited increases in other taxes to offset property tax reductions unless such increases are endorsed by two-thirds of all members of both houses of the state legislature or by two-thirds of those eligible to vote at the local level at a referendum.

Proposition 13 was unique only in its severity and the amount of publicity it received. It was the result of an interesting set of circumstances that bear inspection. Per capita taxes in California increased overall by 151 percent from 1969 through 1978—a lower rate of increase than state and local taxes nationally. However, local governments in California were heavily dependent on the property tax. For example, in 1976, property tax in California was $64 per $1,000 of personal income, compared to a national average of $45. In addition, California communities were very aggressive in reevaluating property. Given the spectacular increases in housing prices in California during the 1970s, local governments were able to reap large dividends in additional receipts while keeping tax rates fairly steady. For the average homeowner who held on to his property and depended on a regular salary, this tax on unearned income became burdensome to the point of intolerability.[1] It is well recognized that property tax is the most unpopular tax nationally, and these circumstances were greatly exacerbated in California. It is little wonder Proposition 13 passed by such a large margin. In many ways, this was a special case.

Early American Concerns

A brief look at the long history of limits on taxation in the United States will help place the California experience in perspective. Since the basic purpose of this report is to provide policy guidance to state legislators considering the adoption of some form of TEL, this retrospective necessarily will be selective and brief; however, it will serve to demonstrate the difficulties inherent historically in the use of statutory and constitutional limits to control spending.

In New York state, the Constitutional Convention of 1846 was concerned with "evidence of local graft, corruption and extravagance." The Convention amended the Constitution to make it the duty of the Legislature "to restrict" the local power to tax and borrow "so as to prevent abuses." In the following years, the New York Legislature set up boards to oversee local expenditures, required submissions to the state of local budgets for review, and established a 2 percent real estate tax limitation on New York City. It was subsequently determined that all of these actions "failed to eliminate or substantially reduce the incidence of graft, corruption and extravagance." As a result, in 1884, a new constitutional provision placed a limit of 2 percent of assessed value (real and personal) on taxes throughout the state, and these limitations were tightened further in 1938.[2] As will be seen, none of these actions achieved the desired results.

New York was not unique in its problems and concerns. Especially after the Civil War, there was a boom in the activities of Northern cities in terms of capital improvements and services. Costs-per-capita for governmental operations soared, and a great deal of debt was incurred. Much of this was "floating debt," carried forward from year to year, to pay for current operating expenses. As the prominent urban historian Ernest S. Griffith explains, "In 1872-73 this had gone so far in Chicago that its tax levies went mostly for interest on the debt and redemption of the scrip."[3]

The "extravagance, overoptimism, and dubious and corrupt decisions" that characterized many state and local governmental activities after the Civil War received a severe jolt with the crash of 1873. This financial panic was a serious blow to every city government in the nation—especially the cities of the South. As a consequence of economic conditions, Pensacola, Fla.; Memphis, Tenn.; Fayetteville, Ark.; Mobile, Ala.; Duluth, Minn.; Elizabeth, N.J.; and a number of other smaller cities forfeited their charters. Selma, Ala., had its charter annulled by the governor, and Nashville's fiscal affairs went into the hands of a receiver. So serious was the situation overall, writes Griffith, that: "During the decade, it was estimated that one-fifth of the total municipal debt at one time or another was at least technically in arrears in interest, and much was in actual default."[4]

The 1873 crash led to demands from many quarters for more economical government by making it "impossible to spend more or to incur a greater debt." These demands led, in the 1870s, to "charter, statutory, or constitutional tax and debt limits." In most instances, limitations on taxes were based upon a percentage of the assessed valuation of property. As a result of these developments, by 1880, 10 states had such limitations, and by 1901, two-thirds of the cities had tax limits. It should be noted that: "One-half of the cities with a legal tax limit taxed up to the limit."[5] This latter observation is interesting because it is often contended that "limits" in fact constitute "floors" for revenue estimation purposes in many jurisdictions today.

With the imposition of these types of limitations on property taxes, cities started looking for alternative sources of revenues; however, they could not easily continue use of debt because: "By 1880, more than half of the states had constitutional limitations of city debt in one form or another."[6] Other methods were pursued. Increased use of charges and fees for services became commonplace. Chicago found itself in a very difficult situation by the turn of the century and began turning to the use of special districts with independent taxing and borrowing powers as a device for getting around restrictions on the city's taxing and borrowing powers. This approach became so popular throughout the nation that these types of districts are far more numerous today than any other form of local government in the United States.

Largely as a result of these pressures to avoid limitations, the reforms of the late nineteenth century, which sought economy in government, did not produce the desired results. As Griffith notes: "A great majority of states continued to employ such tax and debt limits, even though these were impaired or even failing for a number of reasons." For example, a special legislative committee in Massachusetts in 1912-13 concluded that both tax and debt limits were failures, and generally resulted in bond issues for current expenses. In 1913, limits were removed on all local governments in Massachusetts other than Boston.[7]

A number of different devices were being used to control expenditures during the first two decades of the twentieth century. By 1920, several states based tax limitations on the taxes or tax rates of the previous year, varying from the same to 110 percent. As seen in this report, these controls were virtually identical to those imposed by several states in the late 1970s. Indiana was one of these earlier states. In addition to normal limitations, it also established a State Tax Commission to review and, if possible, reduce local budgets. It went through a stormy period between 1919 and 1921 but stayed in business until 1937.

Following World War I, there was much discouragement among reformers about the effectiveness of tax and debt limitations. In 1920 in New York state, the Davenport Committee issued a report that included these observations:

> . . . there is no way in a democracy of blocking a genuine popular demand for increased governmental service through an arbitrary limitation on the tax levy. The only effective method of securing reduction of tax levies lies along the line of centering full responsibility upon a single elected official through (a) a comprehensive budget, (b) a sound bonding act, (c) a wide distribution of the direct tax burden.[8]

Expenditure constraints during the 1920s were not limited to tax and debt limitations. Oregon tried expenditure constraints in the early 1920s whereby a "limitation was fixed at 106 percent of the previous year unless the voters approved an increase above this figure." Interestingly, in 1979 Oregon passed a statute which limits increases in appropriations to the growth in state personal income. Two other states (Colorado and Rhode Island) in 1977 tied increases in appropriations to fixed percentages over the previous year's appropriations.

Modern Developments

Beyond the use of tax and debt limitations, it is difficult to compare governments in the 1870s with those in the 1970s. Griffith makes this very important observation in this respect: "No city in 1880 even approached the imagination and concern for all its citizens that constitute the standards accepted for the American cities of the 1970s."[9] This statement could be extended to all levels of government. Indeed, it is this concern for all citizens that characterizes much of the reason for the modern levels of governmental costs.

As has been seen, people were concerned with extravagant government throughout the nineteenth century; however, the total burden of governmental costs was far below what it has been in modern times. The Tax Foundation recently summarized current trends. In 1950, expenditures for all governments were $70.3 billion—8.4 percent of the 1979 level of $830 billion. Federal expenditures increased from $44.8 billion in 1950 to $531.8 billion in 1979, or 1,087 percent, while state and local expenditures increased from $25.5 billion in 1950 to $297.8 billion in 1979, or 1,069 percent. Of course, for a true comparison, these data should be changed to constant dollars, a step which would reduce the disparity; however, the gross scope of the change in a period of less than 20 years is startling.[10]

A great deal of attention has been given in recent years to the apparently extraordinary increases in state and local expenditures. Between 1968 and 1978, general tax collections (excluding unemployment insurance) increased by nearly 187 percent. During this same period, the nation's population increased by only 9 percent, consumer prices by 88 percent, and personal income by 151 percent. In fact, also during this period, federal tax collections increased by 161 percent—26 percent less than the state and local increases. On the other hand, the Foundation points out the following:

> In the last four years, from 1975 to 1979, Federal spending growth has outpaced that of state and local governments by a significant margin. Federal spending has increased at the rate of 11.8 percent annually, 50 percent faster than the 7.9 percent annual growth in state-local spending.[11]

Some of the reasons for these increases become more apparent in another Tax Foundation report which cites the following conditions with which modern governments are faced:

> . . . from 1950 to 1978 the number of persons aged 65 and over, together with the number of persons of school and college age (5 to 24 years) increased by more than 42 million, or 72 percent. Population in the remaining ages rose by only 24 million, or 26 percent. . . . The 65-and-over age group gained 12 million persons, or a 94 percent increase. For the school-age group, the rise was 31 million, or 66 percent.[12]

As the Foundation went on to observe, "These two age groups traditionally are major beneficiaries of government programs." For example, major programs for the elderly (e.g., OASI, railroad retirement, public employee retirement, Supplemental Security Income, old age assistance, hospital and medical insurance, and Medicaid) increased from $3.26 billion in 1950 to $152.7 billion in 1978, while public education costs increased from $7 billion in 1950 to $103.1 billion in 1978. Nor should it be forgotten that these are only two types of social programs underwritten by American governments. Since 1950, equally impressive increases could be cited in such programs as housing, welfare and health.

The principal point in this brief review is to stress the fact that increases in governmental costs in modern times have not been due to the "graft, corruption and extravagance" that worried the delegates to New York's 1846 Constitutional Convention. The reasons for these increases today are tied to an infinitely intricate web of socioeconomic and demographic circumstances largely beyond the control of governmental officials. The people demand (as do their representatives in local, state and federal governments) that the ravages of poverty and old age be ameliorated, that excellent educational resources be provided to our youth, and that governments otherwise provide for safe and healthy communities. As the 1920 New York Davenport Committee said, given these "popular demands," increased governmental services (and associated costs) are inevitable.

It would be improper to conclude from this summary of pressures for higher levels of governmental costs that limitations on state and local expenditures are useless and a waste of time to impose. In the absence of significant economic changes, sudden increases or decreases in population, or other factors which tend to put unusual strains on the availability of revenue or the demands for services, these types of limitations clearly do influence the decisions of executives and legislators in state and local governments. Budget directors routinely use the prescribed limitations to determine total available resources or expenditure limits, and these constraints are cited constantly in negotiations with governmental employee representatives. Without these limitations over the years, governmental costs undoubtedly would have increased significantly more than they did.

On the other hand, history has shown that significant socioeconomic developments and unremitting demands for increased or improved services will result in the limitations either being changed or avoided in some way. Modern adaptations of these types of limitations attempt to provide for some flexibility in the traditional system. The nature of these new efforts has been the subject of this report. In the years to come, everyone concerned with the costs of government will be watching them, and their successes and failures will continue to be the subjects of studies and reports.

Notes

1. C. Lowell Harriss, "Property Taxation after the California Vote," *Tax Review*, August 1978, p. 35.
2. State of New York, Temporary State Commission on the Constitutional Convention, *Local Finance*, Volume 3 (New York: Temporary State Commission on the Constitutional Convention, 1967), p. 48.
3. Ernest S. Griffith, *A History of American City Government, 1870-1900* (New York: Praeger Publishers, 1974), p. 15.
4. Ibid., p. 5.
5. Ibid., p. 230.
6. Ibid., p. 21.
7. Ernest S. Griffith, *A History of American City Government, 1900-1920* (New York: Praeger Publishers, 1974), p. 179.
8. Ibid., p. 180.
9. Griffith, *American City Government, 1870-1900*, p. 22.
10. Tax Foundation, *Monthly Tax Features*, August 1979, p. 1.
11. Ibid.
12. Tax Foundation, *Monthly Tax Features*, November-December 1979, p. 1.

Appendix III

The following is a list of knowledgeable officials in the 18 states with tax and expenditure limitations. This list is current as of January 1981.

ARIZONA
Hank Reardon
Joint Legislative Budget Committee
1812 W. Monroe, Room 201
Phoenix, AZ 85007
602-255-3042

CALIFORNIA
Bion Gregory
State Legislative Counsel
3021 State Capitol
Sacramento, CA 95814
961-445-3057

COLORADO
Douglas G. Brown, Director
Legislative Drafting Office
Room 30, State Capitol
Denver, CO 80203
303-866-2045

DELAWARE
Nathan Hayward III
Office of Management, Budget
and Planning
Townsend Building, 3rd Floor
P.O. Box 1401
Dover, DE 19901
302-736-4271

HAWAII
Rick Kahle
Legislative Bureau
Rm. 004, State Capitol
Honolulu, HI 96813
808-548-6237

IDAHO
Myron H. Schlechte, Director
Legislative Council
Rm. 334, State Capitol
Boise, ID 83720
208-334-2475

LOUISIANA
Donald Vandal
Deputy Legislative Fiscal Officer
Legislative Fiscal Office
P.O. Box 44097, Capitol Station
Baton Rouge, LA 70804
504-342-7233

MICHIGAN
Douglas C. Drake, Co-Director
House Democratic Research Staff
Office of the Speaker
State Capitol
Lansing, MI 48909
517-373-8615

MISSOURI
Frank M. Masters, Director
Committee on Legislative Research
Rm. 117-A, Capitol Building
Jefferson City, MO 65101
314-751-4223

NEVADA
Ron Sparks, Director
Legislative Fiscal Division
or
Dan Miles, Deputy Fiscal Analyst
Assembly Taxation Committee
Rm. 341, Legislative Building
Carson City, NV 89710
702-885-3640

NEW JERSEY
Maurice Shier
609-292-8872
or
Larry Levit
609-292-8254
Office of Legislative Services
Rm. 232, State House
Trenton, NJ 08625

OREGON
Richard Munn
Legislative Revenue Office
Rm. 140, State Capitol
Salem, OR 97310
503-378-8873

RHODE ISLAND
James F. Mahoney
House Finance Commission
Rm. 306, State House
Providence, RI 02903
402-277-2738

SOUTH CAROLINA
Robert Heilman
Chief Staff Attorney
Legislative Council
P.O. Box 11417
Columbia, SC 29211
803-758-2334

TENNESSEE
Don Borton
Fisal Review Committee
G-19 War Memorial Building
Nashville, TN 37219
615-741-2564

TEXAS
Tom Keel, Director
Legislative Budget Board
P.O. Box 12666, Capitol Station
Austin, TX 78711
512-475-3426

UTAH
Melvin Leslie
Legislative General Counsel
Rm. 403, State Capitol Building
Salt Lake City, UT 84114
801-533-6581

WASHINGTON
Greg Pierce
House Revenue Committee
Rm. 213, House Office Building
Olympia, WA 98504
206-753-3962

31-01LH STATE OF ALASKA

THE LEGISLATURE

BUDGET AND AUDIT COMMITTEE

AUDIT DIVISION
POUCH W—ALASKA OFFICE BUILDING

FINANCE DIVISION
POUCH WF—STATE CAPITOL

JUNEAU 99801

M E M O R A N D U M

SUBJECT: ANALYSIS OF DEFENDANTS' MEMORANDUM - WHO MAY EXPEND FEDERAL AND OTHER UNAPPROPRIATED FUNDS?

Defendants claim (pages 18 through 20) that "no appropriation is required to expend funds received 'in trust' for specific purposes." In support of this, they open with an obscure reference from the Alaska Constitution, Article IX, Section 13: "No money shall [with certain exceptions] be withdrawn from the treasury except in accordance with appropriations made by law."

Taking Article IX, FINANCE AND TAXATION, as a whole, we find there are several powers granted or denied that have specific exception language attached. For example, Section 1, TAXING POWER, provides that the power to tax shall never be surrendered "except as provided in this article." Section 7, DEDICATED FUNDS, provides that the proceeds of any state tax or license shall not be dedicated to any special purpose "except when required by the federal government for state participation in federal programs." Section 8, STATE DEBT, provides that <u>no</u> state debt shall be contracted "unless authorized by law for capital improvements and ratified by a majority of the qualified voters". The section continues by authorizing emergency debt "for the purpose of repelling invasion, suppressing insurrection, defending the State in war, meeting natural disasters. . . ." Section 11, EXCEPTIONS. The restrictions on contracting state debt are waived for "debt incurred through the issuance of revenue bonds by a public enterprise or public corporation". They are further waived for "indebtedness to be paid from special assessments on the benefitted property "and for" refunding indebtedness of the state. . . ." Even Section 13, EXPENDITURES, contains exceptions. It says that no money shall be withdrawn from the treasury "except in accordance with appropriations made by law." It continues, "no obligation for the payment of money shall be incurred except as authorized by law." Does it not seem logical to assume that had the framers of the Alaska Constitution intended to insert the underscored phrase, "No money shall, with certain exceptions, be withdrawn from the treasury except in accordance with appropriations made by law", they could and would have done so? To further substantiate this point, Mr. Leslie Nerland, Chairman of the Constitutional Convention Committee on Finance and Taxation, explained on the floor his committee's thinking on a proposed amendment to the section dealing with dedicated funds:

> "The Committee felt that in inserting the word 'public' after 'all', making it 'all public revenues' would eliminate the question regarding such things as donations or bequests by private individuals that might have specific purposes attached to them."

As stated, this language was proposed for the section on dedicated funds, but it clearly indicates that the Committee on Finance and Taxation had considered differentiating between "public revenues" and "other revenues", the latter specifically described as "donations or bequests by private individuals".

The report of the Committee on Finance and Taxation (attached in full), in the commentary on the proposed section restricting the earmarking of revenues (Sec. 8, p. 11) provides:

"The allocation of certain revenues to special purposes is prohibited, with two exceptions:

(1) <u>If required in order to participate in a federal program</u>, or [emphasis added]

(2) If the earmarking is in existence at the time of ratification of the Constitution."

Again, it seems logical to assume that if the framers of the Alaska Constitution had intended to exempt from appropriation federal and other funds--be they now called "trust funds", "custodial funds", "contractual arrangements", or other similar names--they would have specifically provided for such a bypassing of the appropriations process.

Since the Constitution makes <u>no</u> provision for special classes of money to bypass the appropriation process, (this is emphasized in Article IX, Section 12. BUDGET. "The governor shall submit to the legislature. . .a budget for the next fiscal year setting forth <u>all proposed expenditures and anticipated income of all departments</u>, offices, and agencies in the state. The governor, at the same time, shall submit a general appropriation bill to authorize <u>the proposed expenditures</u>. . . .") how have federal and other program receipts been appropriated since statehood? The procedures are summarized in defendants' memorandum, pages 2 through 4.

From 1963 through 1970, "federal program receipts or other program receipts" received during the year and not otherwise appropriated were made available for expenditure by "budget amendment approved by the Governor". In other words, the Legislature in each General Appropriation Act granted the Governor open-ended authority to receive and expend any amounts of federal or other program receipts that the state could get its hands on. Beginning with the 1971

General Appropriations Act, the Legislature has continued to require that budget amendments for receipt and expenditure of "additional federal or other program receipts" be approved by both the Governor and the Legislative Budget and Audit Committee. Thus, prior to 1971, with the apparent exception of the first two years of statehood, the Governor has not received nor expended federal or other program receipts "except in accordance with appropriations made by law"; nor, with the exception of certain amounts "processed inadvertently" early this fiscal year, has he since.

The defendants argue that by virtue of some implied executive authority or non-statutorily defined receipt categories the Governor should be allowed to receive and expend substantial sums of money without legislative review and approval. This is an interesting concept when viewed in relation to certain other powers and restrictions granted by the Constitution. Article XII, Section 11, discusses law-making powers. It ends with the sentence, "Unless clearly inapplicable, the law-making powers assigned to the legislature may be exercised by the people through the initiative. . . ."

Article XI, Section 1, provides that the people may enact laws by initiative and approve or reject actions of the legislature by referendum. But, Section 7, RESTRICTIONS, provides, "The initiative shall not be used to dedicate revenues, <u>make or repeal appropriations</u>. . . . The referendum shall not be applied to dedications of revenue, to <u>appropriations</u>. . . ." [emphasis added]

Are we now to assume that powers denied the people to make or repeal appropriations by initiative/referendum--appropriation powers specifically provided by Article IX, Section 13, to be "made by law"--are to be given by summary judgment to the Governor?

SUMMARY OF SJR 4 --
CONSTITUTIONAL AMENDMENT ON SPENDING LIMITATIONS

The expenditure limitation proposed by Governor Hammond will constitutionally limit the growth in appropriations of state funds to a rate determined by inflation and population growth. Inflation will be measured by the increase in the consumer price index for the preceding calendar year and population growth will be an annual average calculated from federal censuses or renumerations. These two measures of growth will allow the state to keep up with increasing cost factors, while constraining growth within reasonable and responsible bounds.

Certain exceptions are allowed to provide for particular requirements and circumstances which relate to the Alaska situation. These exceptions are listed below:

1. Contributions to the Permanent Fund (the state's savings account).

2. Payments of the Permanent Fund Dividend (the public's return on those savings).

3. Appropriations to loan funds, provided that any loan subsidies are appropriated and are constrained by the spending limit.

4. Appropriations for capital improvements approved by the voters.

5. Appropriations to repay outstanding general obligation debt of the state.

6. Appropriations to a disaster reserve account (rainy-day account).

7. Appropriations funded through increased user fees.

8. Appropriations required by court orders or federal transfer of functions to state government.

9. Appropriations funded by one-quarter of the earnings which result from extra contributions to the Permanent Fund, i.e., contributions in excess of those required by the Constitution.

10. Appropriations for natural disasters. This includes reserve funds from the account referred to in 6. above. Such appropriations would require a gubernatorial declaration of disaster, passage by a two-thirds majority of membership of each house, and approval by the Governor.

If this proposal is passed by the Legislature, it will go on the 1982 general election ballot and would, if approved by voters, be effective for the fiscal year 1984 budget.

IN THE SENATE

BY THE RULES COMMITTEE BY REQUEST OF THE GOVERNOR

SPONSOR SUBSTITUTE FOR

SENATE JOINT RESOLUTION NO. 4

IN THE LEGISLATURE OF THE STATE OF ALASKA

TWELFTH LEGISLATURE - FIRST SESSION

Proposing an amendment to the Constitution of the State of Alaska relating to limitations on appropriations of state money.

BE IT RESOLVED BY THE LEGISLATURE OF THE STATE OF ALASKA:

* Section 1. Article IX of the Constitution of the State of Alaska is amended by adding new sections to read:

SECTION 16. APPROPRIATION LIMITATIONS. The amount of State money The governor may request or the legislature may appropriate during a fiscal year shall not exceed the amount of $2.5 billion for the base fiscal year of 1982 by more than the cumulative increase in the federal consumer price index for the State for the calendar years preceding the governor's submission of the budget under section 12 of this article plus or minus a percentage equal to the cumulative average yearly growth or loss in the State's population as shown by the last two federal censuses or renumerations. Money appropriated under any exception prescribed by section 17 of this article shall not be included in the base for determining the allowable increase from year to year.

SECTION 17. EXCEPTIONS FROM APPROPRIATION LIMITATIONS. The limitations on increases in appropriations do not apply to money received in trust for a specific purpose; to appropriations of money to be deposited in the permanent fund; money appropriated to pay permanent fund dividends; money appropriated to capitalize loan funds, but only if the money to subsidize these loans at below market interest rates is appropriated separately under the limitations; money appropriated to construct capital improvements, whether of bond proceeds or otherwise, where the appropriation for the capital improvements is approved by the voters; money appropriated to escrow accounts or otherwise to repay general obligation bonds; money appropriated as a reserve for disasters of natural or human origin or other emergencies; money appropriated to coincide with increases in user fees; money appropriated to meet increases in costs to the State resulting from court orders or a transfer of authority or responsibility to the State from the federal government; money derived from one-quarter of the income from those contributions made to the permanent fund which exceed the minimum required by this constitution; or money appropriated by a vote of two-thirds of the membership of each house and approved by the governor to meet disasters of natural or human origin which are declared by the governor.

* Sec. 2. The amendment proposed by this resolution shall be placed before the voters of the state at the next general election in conformity with art. XIII, sec. 1, Constitution of the State of Alaska, and the election laws of the state.

Original sponsor: Rules/Governor

Offered: 5/5/81
Referred: Finance

IN THE SENATE BY THE JUDICIARY COMMITTEE

CS FOR SENATE JOINT RESOLUTION NO. 4 (Judiciary)

IN THE LEGISLATURE OF THE STATE OF ALASKA

TWELFTH LEGISLATURE - FIRST SESSION

Proposing an amendment to the Constitution of the State of Alaska relating to limitations on appropriations of state money.

BE IT RESOLVED BY THE LEGISLATURE OF THE STATE OF ALASKA:

* Section 1. Article IX of the Constitution of the State of Alaska is amended by adding new sections to read:

SECTION 16. APPROPRIATION LIMITATIONS. The amount of State money requested by the governor and appropriated by the legislature during a fiscal year shall not exceed the amount appropriated in the preceding fiscal year by more than the increase in the federal consumer price index for the state for the calendar year preceding the governor's submission of the budget under section 12 of this article plus a percentage equal to the average yearly growth in the State's population as shown by the last two federal censuses or renumerations. Money appropriated under any exemption prescribed by section 17 of this article shall not be included in the base for determining the allowable increase from year to year.

SECTION 17. EXEMPTIONS FROM APPROPRIATION LIMITATIONS. The limitations on increases in appropriations do not apply to appropriations of money to be deposited in the permanent fund; money appropriated to pay permanent fund dividends; money appropriated to capitalize loan funds, but the money to subsidize low interest loans must be appropriated separately and is subject to the limitations; money appropriated to construct capital improvements, whether of bond proceeds or otherwise, where the appropriation for the capital improvements is approved by the voters; money appropriated to escrow accounts or otherwise to repay general obligation bonds; money appropriated as a reserve for disasters of natural or human origin or other emergencies; money appropriated to coincide with increases in user fees; money appropriated to meet increases in costs to the State resulting from court orders or a transfer of authority or responsibility to the State from the federal government; money derived from one-quarter of the income from those contributions made to the permanent fund which exceed the minimum required by this constitution; or money appropriated by a vote of two-thirds of the membership of each house and approved by the governor to meet disasters of natural or human origin which are declared by the governor.

* Sec. 2. The amendment proposed by this resolution shall be placed before the voters of the state at the next general election in conformity with art. XIII, sec. 1, Constitution of the State of Alaska, and the election laws of the state.

Introduced: 1/13/81
Referred: Community & Regional Affairs and Finance

IN THE SENATE BY COLLETTA

SENATE JOINT RESOLUTION NO. 3

IN THE LEGISLATURE OF THE STATE OF ALASKA

TWELFTH LEGISLATURE - FIRST SESSION

Proposing an amendment to the Constitution of the State of Alaska relating to limiting increases in expenditures and requiring payment by the state of mandated increased expenditures of a political subdivision of the state.

BE IT RESOLVED BY THE LEGISLATURE OF THE STATE OF ALASKA:

* Section 1. Article IX, Constitution of the State of Alaska is amended by adding new sections to read:

SECTION 16. APPROPRIATION GROWTH LIMIT. In no year shall the rate of growth of appropriations from state revenues, excepting appropriations to the permanent fund established in Section 15 of this article and excepting appropriations for capital improvements, exceed the estimated rate of growth of the economy of the State as determined by law. An appropriation in excess of this limit shall not be made unless a state of emergency is declared to exist, as provided by law. The appropriation limit for each of the three years following the declaration of emergency shall be adjusted equally so that the total appropriations for the year of the emergency and the succeeding three years do not exceed the appropriations which could have been made under this section if no emergency had been declared. The limit on rate of growth of appropriations for each year shall be calculated without regard to a declared emergency or the subsequent three-year adjustment.

SECTION 17. RETURN OF REVENUES TO TAXPAYERS. Revenues received by the State in excess of the amount appropriated in compliance with this article during a fiscal year shall be distributed to the taxpayers of the State as provided by law. No appropriation is required for a distribution under this section within the succeeding fiscal year.

* Sec. 2. Article II, Constitution of the State of Alaska is amended by adding a new section to read:

SECTION 22. INCREASED COSTS TO POLITICAL SUBDIVISIONS. No general law requiring increased expenditures by a political subdivision shall become effective unless the legislature has provided that the State pay the amount of increased cost to the political subdivision.

* Sec. 3. The amendments proposed by this resolution shall be placed before the voters of the state at the next general election in conformity with art. XIII, sec. 1, Constitution of the State of Alaska, and the election laws of the state.

Introduced: 2/4/81
Referred: Finance and Judiciary

BY THE RULES COMMITTEE BY REQUEST OF THE GOVERNOR

IN THE HOUSE

HOUSE JOINT RESOLUTION NO. 5

IN THE LEGISLATURE OF THE STATE OF ALASKA

TWELFTH LEGISLATURE - FIRST SESSION

Proposing an amendment to the Constitution of the State of Alaska relating to limitations on appropriations of state money.

BE IT RESOLVED BY THE LEGISLATURE OF THE STATE OF ALASKA:

* Section 1. Article IX of the Constitution of the State of Alaska is amended by adding new sections to read:

SECTION 16. APPROPRIATION LIMITATIONS. The amount of State money appropriated during a fiscal year shall not exceed the amount appropriated in the preceding fiscal year by more than the increase in the federal consumer price index for the state for the calendar year preceding the governor's submission of the budget under section 12 of this article plus a percentage equal to the average yearly growth in the State's population as shown by the last two federal censuses or renumerations. Money appropriated under any exception prescribed by section 17 of this article shall not be included in the base for determining the allowable increase from year to year.

SECTION 17. EXCEPTIONS FROM APPROPRIATION LIMITATIONS. The limitations on increases in appropriations do not apply to appropriations of money to be deposited in the permanent fund; money appropriated to pay permanent fund dividends; money appropriated to capitalize loan funds, but the money to subsidize low interest loans must be appropriated separately and is subject to the limitations; money appropriated to construct capital improvements, whether of bond proceeds or otherwise, where the appropriation for the capital improvements is approved by the voters; money appropriated to escrow accounts or otherwise to repay general obligation bonds; money appropriated as a reserve for disasters of natural or human origin or other emergencies; money appropriated to coincide with increases in user fees; money appropriated to meet increases in costs to the State resulting from court orders or a transfer of authority or responsibility to the State from the federal government; money derived from one-quarter of the income from those contributions made to the permanent fund which exceed the minimum required by this constitution; or money appropriated by a vote of two-thirds of the membership of each house and approved by the governor to meet disasters of natural or human origin which are declared by the governor.

* Sec. 2. The amendment proposed by this resolution shall be placed before the voters of the state at the next general election in conformity with art. XIII, sec. 1, Constitution of the State of Alaska, and the election laws of the state.

Introduced: 5/19/81
Referred: Finance and Judiciary

IN THE HOUSE BY MALONE AND BEIRNE

HOUSE JOINT RESOLUTION NO. 57

IN THE LEGISLATURE OF THE STATE OF ALASKA

TWELFTH LEGISLATURE - FIRST SESSION

Proposing an amendment to the Constitution of the State of Alaska relating to limitations on appropriations of state money.

BE IT RESOLVED BY THE LEGISLATURE OF THE STATE OF ALASKA:

* Section 1. Article IX of the Constitution of the State of Alaska is amended by adding a new section to read:

SECTION 16. APPROPRIATION LIMITATIONS. Except for appropriations to the permanent fund and appropriations required to pay the principal and interest on general obligation bonds, the amount of money appropriated during a fiscal year, from whatever source and for whatever purpose, shall not exceed the amount appropriated in the base fiscal year by more than the cumulative increase in the federal consumer price index for the State for the calendar years preceding the governor's submission of the budget under Section 12 of this article plus or minus a percentage equal to the cumulative average yearly growth or loss in the State's population as shown by the last two federal censuses or renumerations. The legislature may, by affirmative vote of two-thirds of the membership of each house, make appropriations in excess of this limit by enactment of appropriation bills limited to a single item of appropriation for a single purpose but the excess appropriations, if any, shall not be included in calculating the limit for the next fiscal year. The governor shall cause any unappropriated balance to be invested at market rates. The base fiscal year for purposes of this section is the period from July 1, 1980 to June 30, 1981.

* Sec. 2. The amendment proposed by this resolution shall be placed before the voters of the state at the next general election in conformity with art. XIII, sec. 1, Constitution of the State of Alaska, and the election laws of the state.

Senator Arliss Sturgulewski June 4, 1981

SENATE FINANCE

EXPENDITURE LIMITATION ISSUES

WHAT SHOULD BE USED AS THE BASE?

Should we pick a FY budget? What should be exempted from the budget? Should they be the same items exempted from the ceiling or others? If the base is too low, how will agencies handle budget cutbacks? If there are few ceiling exemptions, should the base contain room for innovative new programs (Energy Center, Delta Barley, Etc.)? How will the base account for assistance/revenue sharing for local governments? Should a number be used instead of a base year to allow for adjustments of, for example, income tax refunds, etc. If so, what should the number be?

WHAT FORMULA SHOULD BE USED TO CALCULATE INCREASES?

Should the formula for calculating the increase be a cumulative index applying to a single original base, or should the formula apply as an adjustment to the previous year's actual appropriation?

Should the formula be tied to population growth as well as inflation? Are there alternative indices?

Should the formula have a factor which will reduce the real per-capita spending limit overtime (such as only using .95 of the annual CPI increase)?

WHICH APPROPRIATIONS AND EXPENDITURES SHOULD BE COVERED BY THE LIMITATION?

Should the limit apply to both state and federal funds?

Should increases in user fees be covered? If exempted, what oversight should be available to keep increases reasonable?

Most likely revenue bonds should be excluded, but should General Obligation Bonds? Bond debt service?

Should capital projects be excluded and, if so, how can we manage the operating budget impacts of capital projects?

Should loan capitalization be excluded?

There is agreement that contributions to the Permanent Fund should be excluded, but should Permanent Fund dividends? Should arrangement be made for the possibility of the State losing the law suit, if so of what sort? Should a portion of permanent fund income (or real income) be exempted? Should the Permanent Fund be the only recipient of "surplus" funds, and if so, how can this be insured?

If the base is very inclusive, then the exemptions should be very limited. If the base is restricted, what level of exemptions are reasonable?

Should provision be made for exceeding the limit? If so, should it be by legislative vote--by what majority? Should a referendum be provided for? If provision is made for exceeding the limit, what should be voted on-single appropriations or multiple ones? If provision is made for exceeding the limit, should there be a special prohibition against voting to exceed the limit on items which had previously been appropriated within the limit?

STATE OF ALASKA

THE LEGISLATURE

BUDGET AND AUDIT COMMITTEE

AUDIT DIVISION
POUCH W—ALASKA OFFICE BUILDING

FINANCE DIVISION
POUCH WF—STATE CAPITOL

JUNEAU, ALASKA 99811

May 28, 1981

To: Senator Arliss Sturgulewski
Chairman
Legislative Budget and
Audit Committee

From: Margo Waring MW
Senior Policy Analyst

Subject: Expenditure Limitation

You asked me to provide you with background information on expenditure limitations and specific analysis of constitutional spending limitations.

Background

Throughout the nation taxpayers are concerned about the growth of the public sector, growth that sometimes has outpaced the rate of inflation and the growth in real personal income. This concern translates into debate about the size and scope of government, efforts to increase efficiency and effectiveness of existing governmental services, and sometimes, efforts to inhibit increasing tax burdens by way of limits of the amount of revenues and, therefore, expenditures available to government. Throughout the nation, states have looked at ways to control the growth of government expenditures by curbing state taxes. Generally, this has been done by linking the amount of revenue collected to a measure of economic growth. Those who have looked at this issue use the terms "expenditure limitation" and "tax limitation" interchangeably. Hence, proponents select revenue or expenditure controls for a variety of political reasons, knowing that the same effect will be achieved. Usually, spending limit campaigns have been fought in the context of tax increases. Proponents hope not only to limit expenditures, but also to reduce taxes, permitting no real growth, or even reducing existing size of government. Thus, the availability of excess revenues is seen as inevitably leading to their expenditure: the only way to curb growth is to curb revenues and, thus, expenditures. The relationship is seen as one in which to effect any one element is to effect the others.

Alaska's Tax History

Alaska's tax history is not representative of the experience of other states. Alaskan law defines several personal and business taxes for different levels of government. Each of these has a statutorily defined ceiling. State individual income tax, set at a relatively low rate, brought funds into the state treasury which were spent on state government services, as well as for services which are generally provided at the local level, such as schools and roads. Local property taxes, relatively modest by national standards, fund a narrower range of services than elsewhere. When local governments have elected to provide services at the local level instead of having them provided by the state, these transfers of authority have been accompanied by transfers of funds with which to partially provide for the services.

Government growth, in terms of numbers of state employees and in terms of goods and services provided by the state to the citizens, has been fueled not by personal income tax or by property taxes but by corporate oil taxes, lease sale bonuses, and other forms of petroleum revenues.

As government has grown and as revenues have risen, Alaskans' response has been to cut taxes, not so that government growth will be curbed, but so that others will pay for the goods and services. Gross business receipts tax was effectively eliminated in 1978. Property tax revenues from petroleum properties were shared with local governments in 1973 and 1975. And in 1980, the individual personal income tax was eliminated. During the same year, faced with a decline in revenues from one source, but an increase in revenues from petroleum sources, the legislature significantly increased the extent of state funding to schools, capital projects, revenue sharing to local governments, and so forth. In essence, transfer payments to local governments and to private citizens (in the form of actual checks, subsidized loans, and other benefits) have increased, while non petroleum revenue sources have steadily disappeared.

Petroleum revenues, while increasing substantially over the next few years, will in about 10 years begin to decline substantially. By about 2000, revenues from Prudhoe Bay will have declined to the level of 1978 revenues. Thus, goods and services supported by petroleum revenues will be in jeopardy once petroleum revenues decline.

While some Alaskans seek to limit the growth of government for reasons of political philosophy, others seek such limitations in order to insure that future revenues will meet governmental obligations. Some Alaskans are also advocating repeal of such other non petroleum taxes as the local property tax, shifting that burden to state revenues. Thus, expenditure limitation desires coincide with efforts to reduce taxes paid by residents of the state. If, however, the tax repeal efforts are sucessful, then state government obligations will increase by having a heavier reliance placed on petroleum revenues, even if an expenditure limitation is also enacted. It is estimated that, exclusive of further tax repeals, by FY'82, 94% of the state's revenues will come from petroleum sources of all varieties.

Alternatives

1. Both the legislature and the Governor have, in past years, sought to place a lid on annual appropriations as part of the budget process. In 1978 statutory amendments to AS 37.07.070, the legislature specified for itself an identified ceiling and early production of the budget. The Governor too has identified the administration's upper spending limit. However, these approaches have not been successful, apparently because of constituent pressures to increase governmental spending.

2. There has been discussion of either a statutorily imposed or constitutionally defined ceiling on expenditures. This approach has, apparently, been met with mixed success in other states. A bill, using Tennessee's law as a model, was introduced in the 1980 session to place a limit on expenditures. Some of the issues involved in such a limitation are: the factor on which the limit should be based, the expenditure level that should be sustained, how to avoid shifting tax burdens, what to do with excess revenues, what exemptions should be provided, how to provide for emergencies, and what budgetary items should be included under the ceiling (debt service, capital projects, operating budget, loan programs, etc.) and treatment of the surplus. Opponents have expressed concern that this approach is too inflexible to meet Alaska's needs and that our boom-burst economy is not suited to the factors proposed for defining allowable growth.

3. Since in Alaska an expenditure limitation is not a revenue limitation, other suggestions have been made that would effectively impose an expenditure limitation by reducing the amount of available revenue by not placing that revenue in the general fund. For example, if a higher percentage of all petroleum revenues were automatically to be placed in the Permanent Fund, the amount of revenues available for expenditure would be curtailed. Permanent Fund income could be placed

either in the general fund or plowed back into the Permanent Fund itself. Thus, if 100% of petroleum revenues were placed in the Permanent Fund, expenditures would be limited to recurring revenues and recurring income of the Permanent Fund.

Expenditures could also be limited by increasing the amount of funds funneled into loan programs, although there are significant concerns regarding the ability of Alaska's economy to absorb hugely increased loan funds without under-taking highly risky ventures.

Alternatively, it has been suggested that Alaska use some of its excess petroleum revenues to invest in projects of national interest and benefit, projects supportive of national economic and social goals to "prove" to national critics that Alaska is capable of wise wealth management.

4. If we desire to peg expenditures to recurring revenues, one alternative would be to increase the number and amount of recurring revenues. This is not a particularly viable alternative in Alaska, except to the extent that such revenues are corporate taxes generated by renewable resource development.

<u>Summary</u>

Increased government growth in Alaska has alarmed many people, especially because this growth is based on non-recurring petroleum revenues. Prudence and concern for residents who will be here in 10-15 years indicates that steps should be taken to restrain governmental expenditures to the level that can be sustained by recurring revenues. This could be accomplished by statutorily or constitutionally limiting expenditures, increasing recurring revenues, or placing non-recurring revenues in the Permanent Fund and using Permanent Fund income as a recurring revenue source.

<u>Constitutional Limitations</u>

For those who favor spending limitations, the focus has been on the establishment of constitutionally defined limits to the growth of the budget. While there are certain drawbacks to this approach (lack of flexibility, difficulty in establishing an adequate formula, the "log rolling" that would occur to gather enough votes for an override, etc.), Alaskans have favored this approach as one less likely to be ignored by legislators and more likely to restore "rationality" and prioritization among spending options.

Prior to discussion of the bills currently before the legislature, I will briefly summarize the key issues facing decision makers regarding constitutionally defined spending limitations.

Limitation Components

A. Spending Formula

All spending limitations consist of an expenditure base and an adjustment factor. The base is the selected budget year. Selection of the expenditure base will be a function of the year in which a constitutional limitation is approved by the voters. Delay in this regard can mean significant differences in terms of the base, as the budget has been growing by over 20% per year.

The adjustment factor is the means by which calculations of year to year changes are made. Other states have used such factors as growth in personal income or population changes or the cost of living index.

The use of growth in personal income to determine the growth rate of spending is based on the rationale that personal income is a proxy for ability and willingness to pay for government services; or, alternatively, on the belief that government spending should not become a greater proportion of total economic activity.

Use of an adjustment factor involving population growth and inflation (both of which are also reflected in changes in personal income) allows spending to expand in response to these direct cost pressures. Such a real per capita limit would over time reduce the percentage of state spending to personal income. This would occur to the extent that private economic growth exceeded population changes and inflation. It is to be expected that this formula would be more restrictive than would one depending upon changes in personal income.

Another alternative that has been suggested is to simply select a percentage of budget growth that appears reasonable. The rationale for this approach is the difficulty of finding adequate data for more complex formulae. For example, Commonwealth North and others have suggested basing the adjustment factor on the growth of the private sector in Alaska. The difficulty here would be in determining that figure, and insuring that the figure itself was not a function of state expenditure.

Coverage

A. The formulae generally apply to expenditure of general fund revenues, after exempting federal funds, and occasionally exempting certain capital expenditures and/or local government aid. In general, the more inclusive the base the more effective the limit and the fewer distortions expected in expenditure patterns. The "adjustments" which are made to such limits tend to be a redefinition of activities to fit into the allowable expenditure categories. Since in Alaska the limit impetus comes from a need to reduce rather than redirect spending, a broad limit would appear most applicable. The federal funds exemption seems to be the least damaging, although this might lead to an increased emphasis on federal, as opposed to state, priorities.

Greatest concern focuses on the possible exemption of capital spending. If capital projects are not covered by the limitation, the impact on the operating budget, new operation, maintenance and programs costs may result in either unmet obligations or a decline in funding of those programs not associated with capital facilities.

Another concern in coverage is how to insure that state expenditure burdens are not being deferred to local governments. If services now funded by the state are delegated to local governments, who pays for these services and are those costs to be included in the expenditure limitation? Similarly, the state has been increasingly funding services through grants to non-profit groups. Again, should such grants be included in an expenditure limitation? Assuming a desire to restrict expenditures, changes in service patterns should not be used as an escape valve through which expenditures in excess of the limitation may flow. Some states have specifically stated in their constitutional amendments language that requires the state to fund under the spending limitation services which are being delegated to other levels of government.

B. Escape Clauses

There are a variety of emergency override provisions contained in other states' spending limits. Over half the limits are statutory and thus may be amended through the usual legislative process. The constitutionally established limits require approval of specific excess amounts by a simple, or a strong majority (3/5 or 2/3); or, by voter approval.

Some provision must be made for unforeseen circumstances. One approach is to include two overrides: one procedure for natural disaster or other similar emergencies and another (perhaps more rigorous) procedure for simply exceeding the formula amount.

C. Treatment of Surplus

Any effort to limit state spending must include provisions for the general fund surplus.

This is probably the most crucial component of an Alaska spending limit and also that area where other states' experience offers the least guidance. Those states which address this question provide for tax rebates or reductions with some allowing for a budget stabilization or rainy day fund. Since the Alaska limit intent is to enhance the long-term fiscal security and stability of the state, it would be inappropriate to return the total unspent windfall oil revenue to individuals. Here are some other possibilities:

1. Increased contribution to the Permanent Fund. The Permanent Fund was conceived and established as a mechanism for preserving our oil wealth in income producing investments which could fund the on-going provision of traditional government services. Depending on the size of the principal and the return on investments, the income from the permanent fund could provide an important source of recurring revenues in the future as our non-recurring mineral revenues decline. One approach would be to provide for an additional contribution to the Permanent Fund of some fixed percentage of the general fund surplus, say 75%. The remainder could be allocated to a budget stabilization fund, emergency fund, or other use.

2. Endowments and a semi-permanent fund. This would involve design of a semi-permanent fund styled after the existing Permanent Fund, but from which expenditures could be made once oil revenues and Permanent Fund interest earnings are insufficient to support even the "limited" state expenditure levels. This would, in essence, be a long-term budget stabilization fund, which would be invested in income earning assets.

Endowments also offer the possibility of providing a funding source for future government services. However, unlike the more general semi-permanent fund concept, endowments, by assuring funding for such specific services as education, raise the possibility of future budget distortions and limitations on the appropriation authority of the legislature.

3. Loans. Direct loans or investments are another possibility. It is assumed that appropriation of funds to increase the capitalization of loan funds (existing or new) and appropriation of loan subsidies would both be covered by the expenditure limit. If this were not the case, the state would be in a situation similar to the recently resolved problem of the general fund balance automatically funneling into loan programs. Most of the existing loan programs are revolving funds, where repayments return to the fund to be reloaned for a similar purpose, though, due to inflation and low interest rates, the fund experiences a "declining balance" over time. Direct loans from the general fund, for industrial development or other purposes, could be designed to repay the general fund on schedules which would help offset declining oil revenues. Another possibility would be to make general fund loans to existing loan programs. This money could then be leveraged, loaned, and repaid to the general fund (i.e. would not be part of the revolving accounts).

4. "Altruistic" expenditures. The question has been raised whether some portion of currently surplus revenues should not be used in a way to furnish long-term, national benefits. Both "investments" in public and private income producing activities in the lower 48 states and contributions to medical, educational and social programs have been suggested. The important elements of such an expenditure would be potential benefits to the nation as opposed to benefits to Alaska. In considering such an approach it must be remembered that this is basically a spending option which would contribute to long-term fiscal security only in so far as to offer an offsetting advantage to the federal government.

Other Issues

In addition to the questions discussed above, there are several other issues that need to be addressed in the design of a spending limit. These are outlined briefly below.

A. Impact on State Credit Rating

If bond buyers become concerned about a spending limit affecting the ability of the state to pay its debts, this could negatively influence the State's credit rating, thus increasing the cost of borrowing. Bond repayment can be guaranteed either by granting such payments first claim on State spending (priority status) or by exempting such payments from the limit. The former method appears preferable, in that a limit exclusion would encourage bonding and discourage the careful evaluation of the impact of debt service on the State's future fiscal health.

B. Unfunded Obligations

Legislation is sometimes passed which creates programs without provisions for funding these activities. A spending limit might create an incentive to design programs without concurrent funding, thus disguising, at least temporarily, the fiscal impact of government actions. An example of such action might be the incremental funding of a large project, or the raising of unemployment benefits. Another aspect of this problem is programs which represent obligations to make future payments. Difficulties arise if these obligations (e.g., pensions or other benefits) are not adequately funded between the commitment time and the time payment is due. This problem can be avoided by the requirement that actuarily sound current appropriations be made for pensions and other future obligations.

C. Treatment of Dedicated Funds and User Charges

Alaska has certain dedicated funds, and the conclusion or exclusion of expenditures from these funds in a limit calculation must be decided. For example, it may be desirable to count expenditures from the Fish and Game Fund and Renewable Resources Funds under the limit. If these expenditures do not "count," there would be a great incentive to refinance programs from these sources rather than from the general fund.

Another consideration of this nature is the treatment of user charges. Some have argued that spending financed from such sources should be excluded from the general limit, where the purchase of such goods or services by the user is discretionary. It would be important to define carefully program receipts, since there would be pressure to inflate and extend user charges as a means of circumventing a limit. Also, since dedication of funds is constitutionally limited, such an exclusion might pose legal difficulties.

D. Mandated or Shifted Costs

Limiting the expenditures of one level of government results in an incentive to transfer expenditures to another (unlimited) government, or to mandate new functions without providing new funding. Some limits, therefore, provide that the current proportion of state expenditures going to municipalities is not to be reduced unless there is a shift of program responsibility; and, if such a shift is made, provide that the expenditure base be appropriately adjusted.

E. Effect on the Economy

Alaska's economic history is characterized by "boom and bust." Depending upon the specific formula selected in a spending limitation, there is concern that insufficient funds will be available when booms occur with their increase in population, inflation, and higher demand for government services. Similarly, when the "bust" occurs, will the formula be based on lagging data? This concern can also be stated in terms of whether the spending limitation formula will function to heat up and cool down the economy at the right or the wrong times.

<u>Proposed Legislation</u>

Bills have been introduced on both the House and Senate sides proposing an amendment to the State Constitution relating to limiting increases in expenditures. Copies of these resolutions are attached.

<u>SJR 4 and CSSJR 4 (Jud)</u>

Formula: growth in appropriations is limited to the amount of increase in the federal consumer price index for Alaska for the preceding calendar year plus "a percentage equal to the average yearly growth in the state's population as shown by the last two federal censuses or renumerations."

Base: the preceding fiscal year appropriations minus exempted expenditures. Exemptions: exempted appropriations include appropriations into the Permanent Fund, Permanent Fund dividends, loan capitalization, capital improvements approved by the voters, accounts for the repayment of general obligation bonds, reserves for disasters, increases in user fees, costs resulting from court orders or from "the transfer of authority or responsibility to the State from the federal government" and money derived from one-quarter of the income from those contributions made to the Permanent Fund which exceed the minimum required by this constitution; or money appropriated by a vote of two-thirds of the membership of each house and approved by the governor to meet disasters of natural or human origin which are declared by the governor."

HJR 4

Formula: growth in appropriations adjusted to the "rate of growth of the economy of the State as determined by law."

Base: the appropriations of the previous year, minus exemptions or appropriations for emergencies.

Exemptions: appropriations as a result of a declaration of a state of emergency.

Coverage: all appropriations except appropriations to the Permanent Fund and loans made by the State.

Other: the title declares this amendment to also require "payment by the state of mandated increased expenditures of a political subdivision of the state."

HJR 5

The same as SJR 4.

HJR 57

Rep. Malone's proposed amendment has a
Formula: cumulative increase in federal consumer price index for Alaska, plus or minus population growth or loss.
Coverage: all appropriations except to the Permanent Fund and to pay principal and interest on GBOs. Includes federal funds.
Override: to exceed the ceiling requires a two-thirds vote of both houses; appropriation bills limited to single items.
Base: FY 81, minus votes in excess of the limitation.
Other: Unappropriated balance invested at market rates.

Please let me know if you would like a more through discussion of the implications and expectatble effects of each of these bills.

SSSJR 4

BASE: 2.5 billion in FY 82
FORMULA: Cumulative increase in federal CPI for Alaska adjusted (plus or minus) for average yearly growth or loss of population. Excludes excepted appropriations.
EXCEPTIONS: Money received in trust, deposits to permanent fund, permanent fund dividends, loan fund capitalization, capital construction if approved by the voters, appropriations for escrow or other GBO debt service, disaster reserve fund, money coinciding with increased user fees, money for court ordered payments or transfer of responsibility to state from federal government, one-quarter of permanent fund income over the constitutional 25%, money approved by 2/3 of each house and the governor to meet disasters declared by the governor.

FOLLOWING IS A SUMMARY OF A PAPER BY:

Mr. John Shannon, Assistant Director of the Advisory Commission on Intergovernmental Relations (ACIR), a man knowledgeable about the experiences of other states which have sought to limit state expenditures. Mr. Shannon addresses the question of "How much state spending is enough? and how should limits be established?" Mr. Shannon says that the big problem faced by states wishing to limit expenditures is the political one: How much should legislative authority be restricted? The issue revolves around whether a simple majority, now required for spending decisions, should be replaced by an extraordinary majority (two-thirds or three-quarters). How to exceed the defined spending level has been as important as the spending level itself. The conservative view favors as a constitutional amendment that can be exceeded only by an extraordinary majority. The liberal view opposes constitutional lids, expressing a fear that when spending is slowed the poor and minorities will suffer most. ACIR takes a moderate view favoring restrictions and greater fiscal discipline, achieved through statutory rather than constitutional change and keeping the simple majority vote.

Mr Shannon states that, after the political issue, the next most important issue is the economic one: Should spending be allowed to go at a faster, slower or the same pace as the state economy? Different states have favored each of these approaches. Mr. Shannon thinks that if Alaska moves to a constitutional lid, the citizens might favor permitting a small amount of per capita real growth in spending because of the fast growth rate of the State and its relative state of early development.

Mr. Shannon identifies two secondary issues. Most local governments have feared that spending limits will adversely affect them. To allay that fear, most states have specified that the state must reimburse local governments for any additional cost mandates, thereby preventing states from shifting responsibilities to local governments without providing adequate funds at the same time. One state has specified that local government receipts could not be reduced. The other issue is what to exclude from a spending lid. Usually states exclude debt service, federal receipts and capital expenditures.

In summary, Mr. Shannon says that, "The task of slowing down or limiting State government expenditures in Alaska will be far more difficult than in any other state in the union for three reasons." In other states the slowdown demand is usually associated with increasing tax burdens. "In Alaska the consideration of a spending slowdown is taking place when real tax burdens are rapidly declining." In all other states, the demand for a showdown has come from the people; only then are leaders willing to build greater fiscal discipline into systems. "In Alaska the demand for effective expenditure lids must come from the leaders, because they alone have responsibility for making sound plans for the future." In other states the "challenge is to hold the pain of taxation down to tolerable levels. Ironically, in Alaska the challege is to maintain at least a semblance of general taxation so that the State does not become completely addicted to the painless taxation of the oil industry."

ADVISORY

COMMISSION ON INTERGOVERNMENTAL RELATIONS

WASHINGTON DC 20575

SLOWING DOWN THE GROWTH OF STATE AND LOCAL EXPENDITURES

Outline of Paper

by

John Shannon, Assistant Director
Advisory Commission on Intergovernmental Relations

and

Robert Lucke, Fellow
Advisory Commission on Intergovernmental Relations

Anchorage, Alaska
September 18, 1980

If a recent report in the New York Times is correct, Alaska is moving into a fiscal Nirvana. The massive growth in your "exportable" oil taxes will permit Alaska to repeal virtually all of the major taxes paid by its residents, to increase state expenditures, and to build up a great reserve for the lean years when the oil reserves are depleted.

The amount that Alaska can set aside for the lean years ahead and for economic development will depend on the degree of spending discipline that can be built into your state and local fiscal system. The need for discipline is especially acute for this state because the rapid growth of "easy tax revenue" is bound to cause the rapid growth of new and expanded expenditure programs. Your situation calls to mind the wisdom of Parkinson's Second Law--"expenditures rise to meet revenues and to exceed them."

Ironically, while growing fiscal affluence has caused increased concern for spending lids in this state, growing fiscal austerity has spurred the demand for an expenditure slowdown in most of the other 49 states. While clearly recognizing the uniqueness of your fortunate position, it may be helpful to trace out the way other states are trying to build greater fiscal discipline into their systems.

This paper, therefore, will analyze: (1) the recent and fairly significant slowdown in the rate of state and local spending in the United States and (2) the key issues involved in any attempt to put a lid on state spending.

PART I: THE GREAT SLOWDOWN IN STATE AND LOCAL SPENDING

A. The Change in Spending Rates

Between 1955 and 1976, the state and local public sector experienced fast growth--expanding at almost twice the rate of the economy. For the last three years there has been a real slowdown as state and local spending has lagged the growth in the economy (Appendix Figure 1 and Appendix Table 1).

B. What are the Causes of This Slowdown?

1. Change in Political Attitudes--from one that either supported or tolerated fast growth to a growing demand that public spending not exceed the growth of the economy. Underpinning this changed political attitude is growing skepticism about the efficacy of public spending (Appendix Figure 2).

2. Change in the Economy--from one characterized by relatively fast growth and low rates of inflation to slow growth and fairly high rates of inflation. This change in the economy strengthens the hands of the fiscal conservatives:

   a. Because the economic pie is no longer expanding. Citizens become more concerned about the relative size of the slice taken by the public sector.

   b. A weak economy spurs growing concern about the care and treatment of the private sector--the "reindustrialization of the economy." Investment incentives for individuals and business firms become the order of the day. Kenneth Galbraith is "out"--Milton Friedman is "in."

3. Change in Demography--from one marked by steadily rising school enrollments to one of declining numbers.

   a. During the 1950s and 1960s, rising school enrollments provided the driving force behind the move to strengthen state revenue systems and to increase property taxes. During this period, 13 states enacted income taxes and 12 states adopted sales tax levies.

   b. The stabilization--if not the actual decline--of enrollments has deprived pro spending forces of one of the most effective arguments for higher taxes.

4. Change in the Fiscal Position of the Federal Government--from one of relative fiscal ease to growing stringency.

   a. In the last few years the federal government has lost three trump cards:

      (1) The Military Trump Card--During most of the post-Korean era, Congress was able to shift resources from the Pentagon to the domestic sector in general and to federal aid programs in particular. As a result, federal military outlays dropped from almost 13% of GNP in 1954 to 6.5%

by 1979. Now the pendulum is swinging the other way--the generals are back in the budgetary arena and they will undoubtedly command an increasing share of federal resources over the next five years.

(2) The Social Security Trump Card--Throughout most of the post World War II period, Congress could repeatedly raise social security tax rates with little public opposition because they were viewed as simply higher premium rates for expanded insurance coverage. Now Congress is running into increasing opposition to scheduled hikes in social security levies and general fund tax revenue will have to be used to finance expanded social security commitments. Because the social security program is the single most important federal domestic responsibility, it will move to the head of the line--well ahead of federal aid programs to states and localities.

(3) The Deficit Finance Trump Card--For 19 of the last 20 years, Congress has been able to paper over revenue shortfalls with deficit financing. Now that inflation has become one of the nation's major domestic problems it is becoming increasingly difficult for the Congress to take a relaxed view of budget deficits.

b. The aging of our population is also working against the federal government because the feds have the primary responsibility for providing income support to the elderly and also for paying for their doctor and hospital bills.

c. The federal fiscal condition is made even more difficult because of the growing demand for income tax relief for individuals and business firms to offset, partially, both inflation-induced income tax hikes and scheduled increases in the social security levy. Income tax cuts will also be urged to revive an ailing economy by providing greater incentives for private investment.

C. How Has the Slowdown Been Effected?

Four general policies have been used to effect this spending slowdown.

1. Ad Hoc Decisions--to pursue more conservative fiscal policies. This approach has probably had the most significant effect to date. This policy is pursued at the federal level by President Carter and at the state and local levels by many governors and mayors (Appendix Table 2, track II).

2. Statutory Reforms--to strengthen legislative accountability. This middle-of-the-road approach has been favored by the ACIR and many moderates. For example, it calls for indexing the income tax to prevent income tax windfalls (Appendix Table 2, track III).

3. Constitutional Spending Constraints--to slow down the growth in spending. This approach is favored by the economist, Milton Friedman (Appendix Table 2, track IV).

4. Constitutional Cut-Back Provisions--to reduce the size of government. This general policy can be labeled the Jarvis or Proposition 13 approach (Appendix Table 2, track V).

D. Is This Slowdown in State-Local Spending Likely to Persist Over the Next Five Years?

Yes, because:

1. The basic economic, demographic, and political factors that have combined to produce this slowdown are not likely to disappear. It would take a dramatic lessening of international tensions, rapid economic recovery, and a major breakthrough on the energy front.

2. The pacesetters in state-local spending during the 50s and the 60s--New York, Massachusetts, and many of the other frostbelt states--are suffering from high and rising fiscal blood pressure readings. They will be forced to cut back their tax and spending programs in an effort to become more competitive.

3. Most of the sunbelt states will probably continue to exhibit a rather conservative taste for public goods and services despite the fact that their economies will experience above average economic growth.

4. Most of the energy-rich states can also be expected to pursue fairly conservative spending policies because of the fear of the day of reckoning when the petroleum or coal reserves play out.

PART II: SPENDING LIMITATION CONSIDERATIONS: KEY ISSUES AND STATE EXPERIENCES

A. The Primary Political Issue--How tightly should legislative authority be restricted? There are three general views of legislative budgetary behavior which dictate radically different forms of restraints on government expenditures.

1. The Traditional Liberal View: This is the "Galbraithian" perspective which argues that the public sector is under-funded. Those who hold this view are fearful that a slowdown in public spending is most likely to adversely effect low income and minority groups. Thus, they oppose all proposals--statutory or constitutional--that would make it more difficult for legislative bodies to tax and to spend.

2. The New Moderate View: This school of opinion believes that government spending has increased too rapidly due largely to the shortcomings in the way legislators are held politically accountable for their tax and spending decisions. Inflation, for example, enables the income tax states and the federal government to reap a tax windfall as taxpayers are automatically pushed into higher brackets by inflation. This painless form of taxation encourages overspending in the absence of rigorous fiscal self discipline.

   Supporters of this moderate view favor reforms that strengthen fiscal discipline and accountability--primarily statutory in nature--that can be changed if necessary by the vote of a simple majority of the state's legislature.

   Even constitutional constraints that can be changed by majority vote of the legislature would fall in this moderate category. For example, Tennessee and Texas have established spending lids which tie state spending to the growth in the state economy with the proviso that the ceiling can be exceeded throught a majority vote of the legislature. Thus, the growth in the state's budget will receive greater public scrutiny than it has in the past and thereby increase a legislator's accountability for its spending decisions. However--

and this is or critical importance--this restriction does not permit a conservative minority in the legislature to exercise a veto power over spending decisions.

3. The Conservative View: This view, characterized by Milton Friedman and the "public choice" theorists, postulates that there is a fundamental defect in the democratic budget-making process which results in too large a public sector. Even in the absence of economic conditions which are condusive to expenditure growth (inflation, oil royalties), the legislature will continue to overspend because of the power of the special interests.

According to this analysis, the special interests are able to pressure legislative bodies to accept their proposals which have relatively narrow benefits, but whose costs are diffused over all taxpayers. Because the benefits to the taxpayer of opposing any specific program are small, the power of the vested interests is not counterbalanced by taxpayer concerns. In this scenario, the legislator is presumed to succumb to lobbying pressure and neglect his/her fiduciary responsibility to the state's taxpayers.

The public choice advocates argue that stringent expenditure limitations are necessary in order to control spending. Constitutional restrictions which can only be exceeded by extraordinary legislative majorities (e.g., two-thirds) are needed to protect the taxpayer and offset special interest pressures. Such extraordinary majority requirements permit a minority to veto expenditure growth, and ensure that all budget increases are the result of substantial bipartisan agreement.

Two states which have strict provisions for exceeding their caps are Arizona and New Jersey. Arizona's law is written into the Constitution and can only be exceeded by a two-thirds vote of the legislature. New Jersey, on the other hand, requires a majority vote on a referendum in order to increase the expenditure ceiling.

While these types of restrictions make it exceedingly difficult for legislatures to yield to spending pressures, they are very inflexible except in times of emergency.

The National League of Cities sums up the restrictiveness of requirements for extraordinary majorities this way:

> "In the state legislature, the use of extraordinary majority to pass new tax bills is devastating to the likelihood of passing new taxes. Although a greater-than-simple majority was required to pass appropriation bills in California, the pork barrel phenomenon of adding a little something for everyone allowed the building of a constituency. No such phenomenon allows legislatures to build support for any tax bill."1/

B. <u>The Key Economic Issue: Should government be allowed to grow at a faster clip, the same pace, or at a slower rate than a state's economy</u>? Depending on which measure is used as an index, an expenditure limitation law can be made more or less restrictive relative to the economy. There are basically three types of indices which have been used by states so far.

1. <u>Least Restrictive Expenditure Limitation</u>--Tie the growth of state spending to that of the economy (Tennessee and Hawaii). An indicator of economic activity, such as personal income, will allow a state's expenditures to vary in direct relation to population changes and real and inflationary growth. As a result, govenment spending is effectively constrained to remain a constant percentage of a state's economic well-being. Under such an expenditure ceiling, government is allowed to expand, but not at a rate faster than the economy. Essentially, this kind of indexation is consistent with the view that government is currently the "right"

1/ The National League of Cities, <u>Tax and Expenditure Limitations: A Plea for Governmental Reform</u>, Washington, D.C., 1978, p. 5.

size relative to the private sector and should be permitted to expand in line with society's ability-to-pay.

2. Moderately Restrictive--Limit the growth in state expenditures to changes in the cost of living and population (California and Nevada). While such a ceiling would maintain government services at the present level, this strategy would cause government expenditures to decline slowly relative to the economy. It is based on the presumption that the current level of real services is optimal and should not expand even if economic growth takes place. As a consequence, any budget proposal that seeks to increase the real per capita level of government services must withstand open debate and public review.

3. Most Restrictive--Limit expenditures to a rate of growth below that of changes in the cost of living index adjusted for population. Utah limits the rate of growth in spending to 85% of the change in personal income. Colorado has set a maximum rate of growth in spending of 7% which is currently well below the inflation rate. These types of expenditure restrictions will reduce the real level of per capita government services. Public choice adherents endorse these restrictive policies based on their proposition that the current size of government is too large and must be reduced in real terms.

C. Secondary Issues

1. Definition of the Relevant Expenditure Base. In order to make a fiscal constraint effective it is important to design it so that it is as comprehensive as possible. However, there are certain types of appropriations whose exclusion from the expenditure base should be considered.

a. Federal Funds. Without exception, federal grants are currently excluded from expenditure ceilings imposed on states. By excluding federal transfers, the ceiling will more effectively control the percentage of the state's income allocated to government.

b. Debt Service Funds. Limitation proposals usually exclude payments for debt service from the expenditure ceilings. Where debt service payments have been included within an expenditure limit, bond repayments have first claim on state revenues in order to protect their marketability.

c. Other Exclusions. Capital and pension expenditures might be excluded from a spending limitation. Their exclusion depends in part on whether the legislature can be "trusted" not to use them to avoid hard budget decisions.

2. The Local Government Issue. Local officials are usually very fearful that a lid on state spending will adversely effect their fortunes. To allay their worst fears, the framers of state spending lids usually provide that the state must reimburse local governments for any additional costs imposed on them by state legislative mandates. The drafters of the Michigan constitutional spending lid went even farther--"The state is hereby prohibited from reducing the state financed proportion of the necessary costs of any existing activity or service required of units of local government by state law." (Section 29)

PART III: SUMMARY

The task of slowing down or limiting state government expenditure in Alaska will be far more difficult than for any other state in the union.

A. In all other states, the demand for a slowdown arises in a period of increasing tax burdens. Here in Alaska, your real tax burdens are rapidly declining.

B. In all other states, the demand for the slowdown comes from the people--only then are their leaders willing to build greater fiscal discipline into their systems. In Alaska, the demand for effective expenditure lids must come from the leadership because it alone has the responsibility for making sound plans for the future.

C. In virtually all other states, the challenge is to hold the pain of taxation to tolerable levels. In Alaska, the challenge is to maintain at least a semblance of general taxation so that the state does not become completely addicted to the "painless" taxation of oil production.

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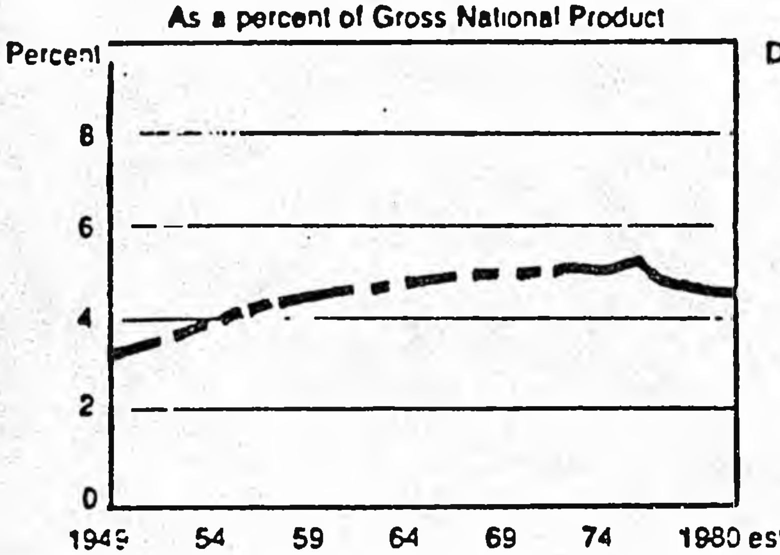
APPENDIX FIGURE 1

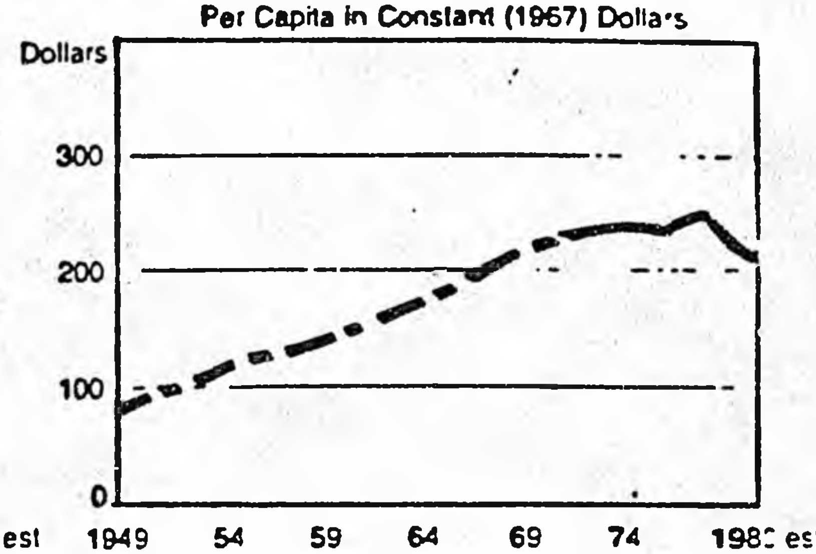
STATE AND LOCAL GOVERNMENT EXPENDITURE, AND FEDERAL AID, SELECTED FISCAL YEARS 1949-80
(State-Local Spending Slowdown)

Local Expenditure (from own funds)

As a percent of Gross National Product

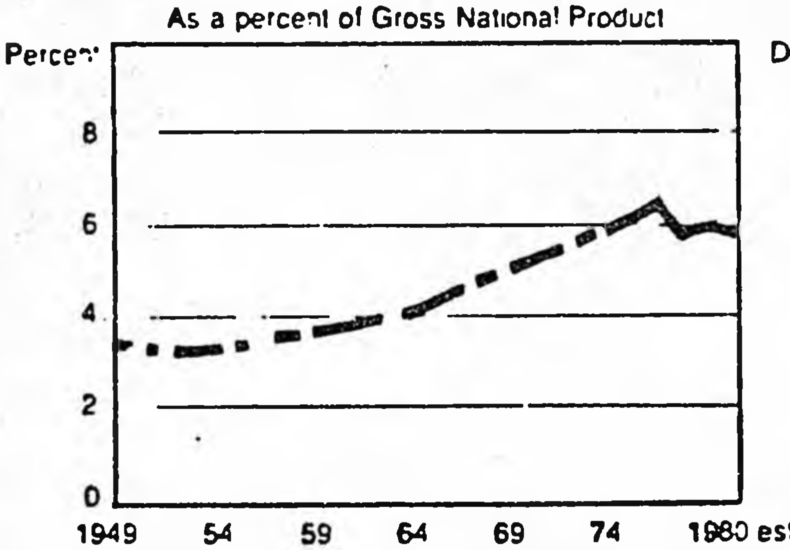


Per Capita in Constant (1967) Dollars

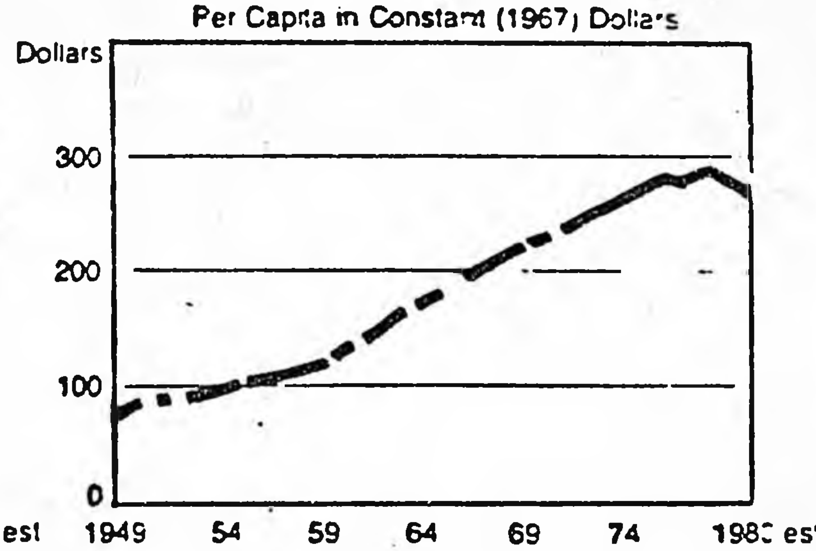


State Expenditure (from own funds)

As a percent of Gross National Product

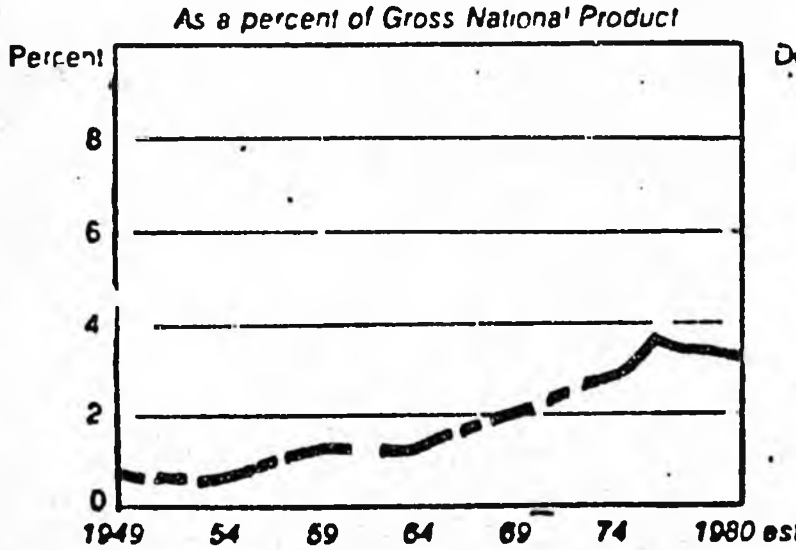


Per Capita in Constant (1967) Dollars

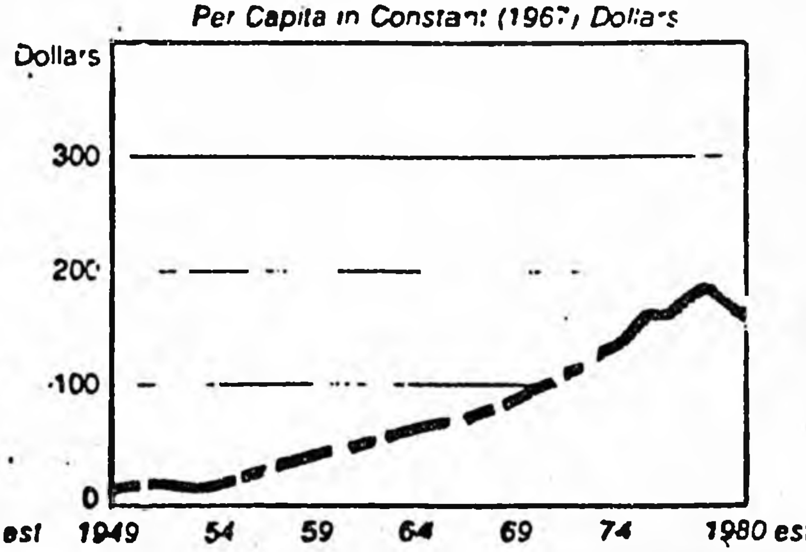


Federal Aid

As a percent of Gross National Product

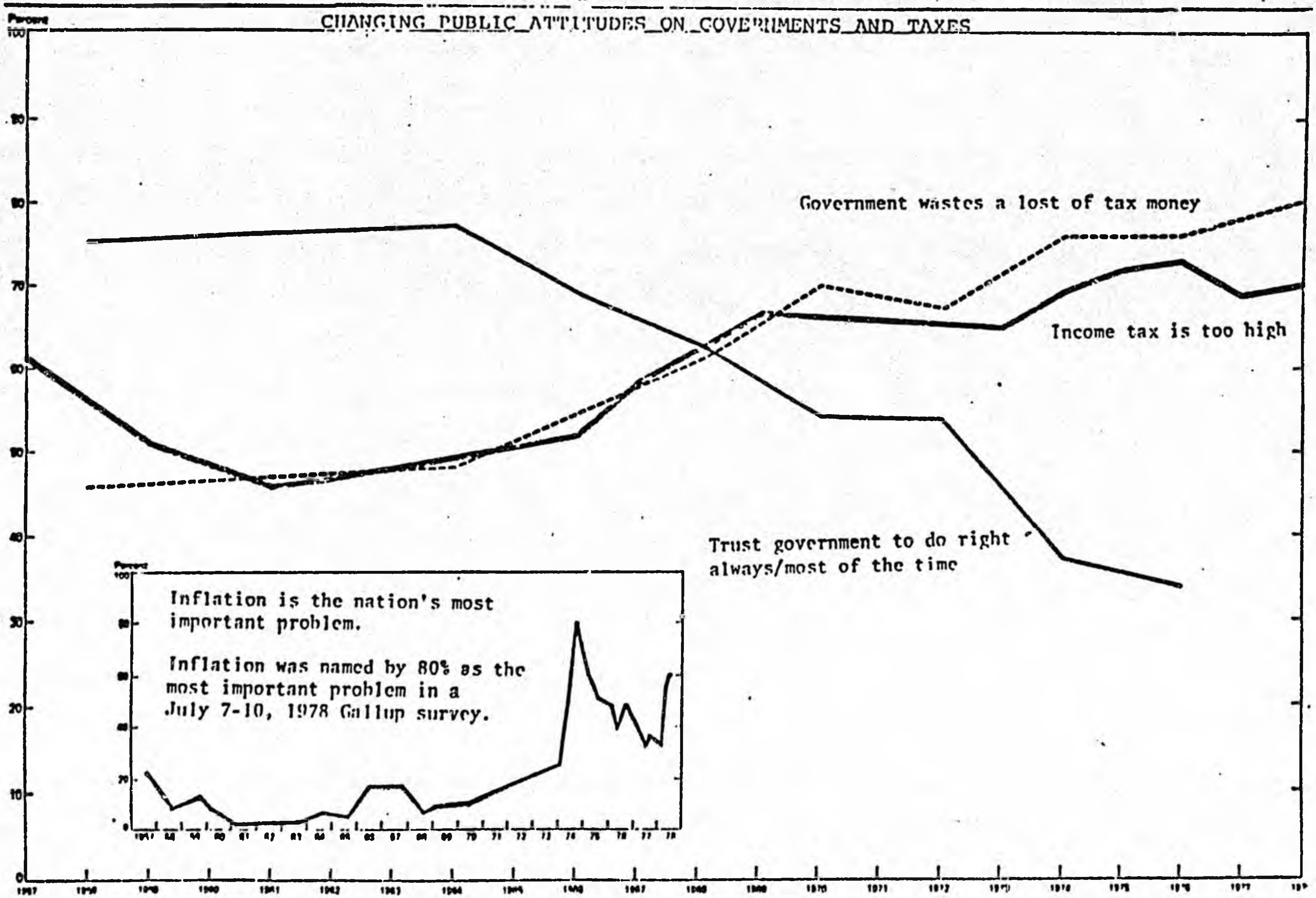


Per Capita in Constant (1967) Dollars



APPENDIX FIGURE 2

The Coming of the Tax Revolt



PUBLIC OPINION, JULY/AUGUST 1978

APPENDIX TABLE 1

STATE AND LOCAL EXPENDITURES, INCLUDING FEDERAL AID, FOR THE UNITED STATES AND ALASKA, SELECTED YEARS 1959-1979

	As Percent of Personal Income			Per Capita (Current Dollars)		
		Alaska			Alaska	
Fiscal Years	United States	Percent	% of U.S.	United States	Amount	% of U.S.
1959	15.9	15.9	100	$ 332	$ 437	132
1969	18.6	34.5	185	652	1,443	221
1975	22.2	41.7	188	1,249	3,534	283
1976	23.3	39.1	168	1,422	3,951	278
1977	22.4	35.6	159	1,500	3,718	248
1978	21.5	38.7	180	1,590	4,172	262
1979 Prel.	21.1	46.2	219	1,740	5,084	292

Source: ACIR staff computations based on various reports of U.S. Bureau of the Census, Governments Division.

APPENDIX TABLE 2

A COMPARATIVE ANALYSIS OF FIVE POLICY POSITIONS CONCERNING THE GROWTH IN FEDERAL-STATE-LOCAL SPENDING OR THE SHIFT TO THE POLITICAL RIGHT

POLICY POSITION	PRO-FAST GROWTH: ANTI-LEGISLATIVE CONSTRAINTS I	AD HOC SLOWDOWN ANTI-LEG. CONSTRAINTS II	SLOWER GROWTH THRU GREATER LEG. ACCOUNTABILITY III	SLOWER GROWTH THRU TIGHTER LEG. CONSTRAINTS IV	GOVERNMENT CUT-BACK & TIGHTER LEG. CONSTRAINTS V
RATIONALE	Our "affluent society" in general & the poor & minorities in particular benefit from rapid growth of domestic programs voted by unfettered legislative bodies.	Govt. spending should accelerate or slow down in response to public opinion changes. Leg. bodies, therefore, should be given wide leeway in order to make ad hoc budgetary adjustments.	Public sector "fast' growth can be attributed in part to serious shortcomings in the way elected officials are held accountable for tax and spending decisions.	Public sector growth can be attributed in large part to the inability of a simple majority of legislators to balance off the general interest of taxpayers against the expenditure demands of the various special interest groups.	Public sector has grown too large because a simple majority in the legislature could not say "no" to all of the demands of the various special interest groups.
GENERAL PRESCRIPTION	Resist current efforts (ad hoc) to slow down domestic public sector growth and oppose all proposals (moderate or severe) that would make it harder to raise tax and spending levels in the future.	In view of the current conservative mood, go along with ad hoc slow down policies but resist all proposals (moderate or severe) that would make it harder to raise tax and spending levels in the future.	Support current slowdown policies and reform efforts (mostly statutory) that would focus a brighter accountability spotlight on tax and spending decisions. Resist the more drastic constitutional constraints on legislative majorities.	Support current slowdown policies, accountability reforms, and the more far-reaching constitutional changes that would make it more difficult for a simple legislative majority to raise tax and/or spending levels in the future.	Support accountability reforms and fairly drastic constitutional changes that would cut back existing tax and spending levels and make it more difficult for legislative bodies to raise tax and spending levels in the future.
EXAMPLES	"Fast" growth is reflected in the fact that domestic government spending grew consistently faster than the economy between 1949-1975.	Ad hoc state tax increases (1959-1975) when the public supported fast growth policies.1/ Ad hoc state tax cuts and "hold the line" expenditure policies now that the public wants a "slow down"--that is government spending that just keeps pace or slightly lags the growth of the economy.2/	Accountability Reforms: LOCAL: Truth-in-property taxation laws.3/ STATE AND FEDERAL: Indexation of the income tax.4/ Fiscal notes and reimbursement for expenditure mandates.5/ Budget reform. Tax and spending lids (both statutory and constitutional) that can be raised by majority vote of the legislature.6/ "Sunset" provisions.7/	LOCAL,8/ STATE,9/ & FEDERAL10/: Tax and spending ceilings and balanced budget controls that can be raised only with the approval of extraordinary majority of legislative body or the electorate voting in a referendum.	California's Proposition 13 (Jarvis I) which cut the property tax by more than half prohibits raising the property tax, and requires popular referendum at the local level and extraordinary majorities at the state legislative level to raise other taxes.
COMMENTARY	Liberalism's high spending citadel is experiencing serious erosion of support. Many of the Great Society followers have gone underground or defected to the right as inflation generates a new breed of born again budget balancers.	Traditionally, the great gathering place of the moderates before many of them lost confidence in ability of legislative bodies to cope with special interests. This sector is increasingly peopled by liberals who have burrowed in waiting for the high gales of fiscal austerity to blow over. Their motto--"If you can't lick 'em, ad hoc 'em."	The new moderate position--the rallying grounds for some liberals and many moderates hoping to check deeper penetration by the resurgent right by striking a better balance between the competing claims of the private and public sectors for the Nation's resources.	The traditional conservative stronghold now joined by the new radical chic of the right--Milton Friedman and his growing band of "right thinking" intellectuals. More significantly, the ranks of this sector are being swelled by the growing number of plain citizens defecting from the liberal and moderate camps.	The new far right--allegedly, reactionary "redneck" country controlled by Howard Jarvis. To the dismay of the establishment, Leader Jarvis has widespread support, particularly in the populist West where the citizenry can bypass the legislature and through direct initiative and referendum can change the basic (constitutional) rule of the fiscal game.*

*Under the traditional rules of the game, a simple majority of the legislature can raise tax and spending levels as high as it deems necessary.

See next page for footnotes.

John Shannon (April 15, 1980)

APPENDIX TABLE 2 (Continued)

Footnotes

1/ Between January 1, 1959, and December 1, 1976, 12 states adopted general sales taxes and in 76 instances states increased existing state sales tax levies. During the same period 13 states enacted personal income taxes and on 74 occasions states raised income taxes.

2/ Since 1976, there has been a virtual moratorium on raising state income and sales taxes and in 1979 about half of the states reduced one or the other.

3/ Truth in property tax provisions require automatic property tax rollback to offset most or all of the annual increase in the assessment base in the absence of a rigorous full disclosure procedure, i.e., paid announcement of proposed tax increase and public hearings. Since 1971, ten states have enacted this statute--Arizona, Florida, Hawaii, Maryland, Montana, Texas, Virginia, Kentucky, Rhode Island, and Tennessee.

4/ Since 1977, seven states have indexed their income taxes so as to prevent taxpayers from being automatically pushed into higher tax brackets through the silent action of inflation. These states are: California, Colorado, Arizona, Iowa, Minnesota, Oregon, and Wisconsin.

5/ About half of the states now attach fiscal notes to proposed legislation that would impose added expenditure responsibilities on local governments. Seven states have gone further down the path of fiscal accountability; state government either reimburses local governments for certain types of state expenditure mandates or refrains from enacting such mandates.

6/ Since 1976, 10 states have adopted limitations on state revenue or expenditure growth that can be set aside by majority vote in both houses of the legislature. In eight instances these limitations are statutory and in the other two cases (Tennessee and Texas) they are constitutional provisions. The limitation usually ties the growth in state taxes or spending to the growth in state personal income.

7/ In the last several years over 30 states have adopted some version of "Sunset"--a general statutory requirement that provides for the automatic termination of government programs and/or regulatory agencies at some point in time in the absence of explicit legislative reauthorization.

APPENDIX TABLE 2 (Continued)

8/ Since 1970, 20 states have imposed local property tax levy and/or general spending ceilings that can be raised only with the approval of an extraordinary majority of the local legislative body or (far more frequently) the approval of the local electorate voting in a referendum. These states are Alaska, Delaware, Indiana, Iowa, Kansas Kentucky, Louisiana, Minnesota, Ohio, South Carolina, Utah, Washington, Wisconsin, Florida, Massachusetts, New Mexico, New Jersey, Nevada, California, and Nebraska. Maryland allows these fiscal lids to be applied on a local option basis.

9/ Constitutional revenue and spending lids that require the approval of an extraordinary majority in both houses before fiscal ceilings can be lifted--Arizona, Hawaii, and Michigan in 1978 and California in 1979.

10/ At the present time there are numerous proposed constitutional amendments that would limit the federal government's tax and spending powers and others that call for a balanced budget. Thirty states have adopted resolutions directing the Congress to call a constitutional convention for the purpose of drafting a balanced budget amendment to the U.S. Constitution--34 state resolutions are needed to require the calling of a constitutional convention.

APPENDIX TABLE 2 (Continued)

Footnotes

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7/ In the last several years over 30 states have adopted some version of "Sunset"--a general statutory requirement that provides for the automatic termination of government programs and/or regulatory agencies at some point in time in the absence of explicit legislative reauthorization.

APPENDIX TABLE 3

RECENT STATE AND LOCAL REVENUE/EXPENDITURE LIMITATIONS
JANUARY 1, 1976-JANUARY 1, 1980

State	Year	Constitutional or Statutory	State Limitation	Local Limitation	Remarks
New Jersey	1976	S	X	X	State expenditure growth is limited to the increase in state personal income. Municipalities cannot increase their budgets by more than 5% per year. Both limits can be exceeded only by a majority vote on a referendum.
Colorado	1977	S	X		State general fund expenditures are limited to a 7% annual increase. An additional 4% may be allocated to a reserve fund, but amounts over 11% must be refunded to taxpayers.
Michigan	1977	S	X		A Budget Stabilization Fund was established, with provisions for pay-in to the fund during periods of economic growth, and pay-out during recessionary periods. It is now used in conjunction with the 1978 state spending limitation.
Rhode Island	1977	S	X		The legislature adopted a non-binding "suggested" 8% cap on the annual growth of budget appropriations.
Tennessee	1978	C	X		Increases in appropriations from state tax revenues are limited to the estimated growth in the state's economy. The lid may be exceeded by majority vote of the legislature.
Arizona	1978	C	X		State spending is limited to 7% of total state personal income. The limit may be exceeded by 2/3 vote of the legislature.
Hawaii	1978	C	X		Increases in state general fund appropriations are limited to the estimated growth in the state's economy. Larger increases must be approved by a 2/3 vote of the legislature.
Michigan	1978	C	X		State tax revenues can increase only as fast as the growth in personal income. If revenues exceed the limit by more than 1%, the excess is refunded through the income tax. If the excess is less than 1%, it is placed in the Budget Stabilization Fund. The limit may be exceeded if the Governor specifies an emergency and 2/3 of the legislature concur.
Texas	1978	C	X		Increases in appropriations from state tax revenues are limited to the estimated growth in the state's economy. The limit may be exceeded by a simple majority of the legislature.
California	1979	C	X	X	Increases in state and local appropriations are limited to population growth and inflation. The limits may be exceeded, but appropriations in the following three years must be reduced to prevent an aggregate increase in expenditures. The limits may be changed by the electorate, but the change is effective only for three years.
Louisiana	1979	S	X		State tax revenues can grow only as fast as the increase in personal income. Proceeds from severance taxes are not included in the limitation.
Massachusetts	1979	S		X	Increases in local government expenditures are limited to 4%. Override provisions are included. The limitation expires December 31, 1981.

APPENDIX TABLE 3 (Continued)

RECENT STATE AND LOCAL REVENUE/EXPENDITURE LIMITATIONS JANUARY 1, 1976-JANUARY 1, 1980 (Cont'd.)

State	Year	Constitutional or Statutory	State Limitation	Local Limitation	Remarks
Nebraska	1979	S		X	No political subdivision may adopt a budget in which the anticipated receipts exceed the current year's by more than 7%. Further allowances are included for population growth exceeding 5%. The limit may be exceeded in the event of an emergency or upon voter approval.
Nevada	1979	S	X	X	The state budget is limited to the 1975-77 biennium budget adjusted for population changes and inflation. Local budgets are tied to 1979 fiscal year budgets adjusted for population changes and a partial inflation allowance. The limits may be exceeded "to the extent necessary to meet situations in which there is a threat to life or property."
Oregon	1979	S	X		The increase in state appropriations for general governmental purposes for the 1979-81 biennium is limited to the growth in state personal income in the preceeding two years.
Utah	1979	S	X	X	The annual increase in state appropriations is limited to 85% of the percentage increase in state personal income. The increase in local revenues may not exceed 90% of the percentage increase in state personal income, with further adjustments for population growth allowed. The limits may be exceeded by a two-thirds vote of the legislative body of a unit of government.
Washington	1979	S	X		State tax revenues can grow only as fast as the average increase in state personal income over the three previous years. The limit may be exceeded by a 2/3 vote of the legislature.
TOTALS			15	6	

NOTE: C-Constitutional. S-Statutory.

NOTE WELL: Only the six state actions that placed overall limitations on local government revenues and expenditures are included in this table. Since 1970, states have imposed approximately 35 other restrictions on the ability of local authorities to raise property taxes.

SOURCE: ACIR staff compilations based on: Commerce Clearing House, State Tax Reporter; National Conference of State Legislatures, A Legislator's Guide to State Tax and Spending Limits, March 1979.

TABLE I

ANNUAL COMPOUND GROWTH RATES

Period	Anchorage Consumer Price Index	Alaska Population	General Fund Appropriations	General Fund Appropriations in Constant Dollars	General Fund Appropriations Per Capital in Constant $
1960 - 1980	4.73%	2.90%	23.78%	18.19%	14.87%
1960 - 1969	1.72	3.03	14.40	12.49	9.18
1970 - 1980	7.60	2.85	26.40	17.47	14.22
1969 - 1980	7.26	2.78	32.01	23.08	19.75
1970 - 1979	7.39	3.33	14.49	6.62	3.18

PREPARED BY:

Legislative Finance Div.
5-25-81

TABLE II

Calendar Year	Anchorage Consumer Price Index October 1967-100.0	Alaska Pop. 2/	General Fund Appropriations ($ millions) 3/	General Fund Appropriations in Constant Dollars ($ millions)	Per Capita General Fund Appropriations in Constant Dollars $
1960	92.0	226,167	45.9	49.8	220
1961	92.9	238,000	52.3	56.3	236
1962	92.6	246,000	65.8	71.0	289
1963	93.3	256,000	82.9	88.8	347
1964	93.9	263,000	79.1	84.2	320
1965	94.2	271,000	86.1	102.0	337
1966	97.9	271,000	93.8	95.8	354
1967	100.0	278,000	113.1	113.1	407
1968	102.6	285,000	124.1	120.9	424
1969	107.3	296,000	154.1	143.6	485
1970	111.5	302,361	314.2	281.7	932
1971	114.4	316,000	292.1	255.3	808
1972	116.9	326,000	333.5	285.2	875
1973	123.8	332,000	379.3	306.3	923
1974	140.0	343,000	451.3	322.3	940
1975	157.4	379,000	590.3	375.0	989
1976	167.6	405,000	692.3	413.0	1020
1977	177.3	408,000	819.1	462.0	1132
1978	194.8 1/	411,000	1071.7	550.2	1339
1979	211.8	406,000	1062.3	501.6	1235
1980	232.0	400,331	3270.8	1409.8	3521

1. 1978-1980 figures are Anchorage price index for urban wage earners and clerical employees as of November.

2. 1960, 1970, and 1980 figures based on April 1st census; other figures refer to estimated July 1st population of the U. S. Bureau of the Census.

3. (a) The figures are for the fiscal year following the listed calendar year, e.g., in 1960 the fiscal year 1961 appropriations act of $39.8 million in general funds was signed into law.

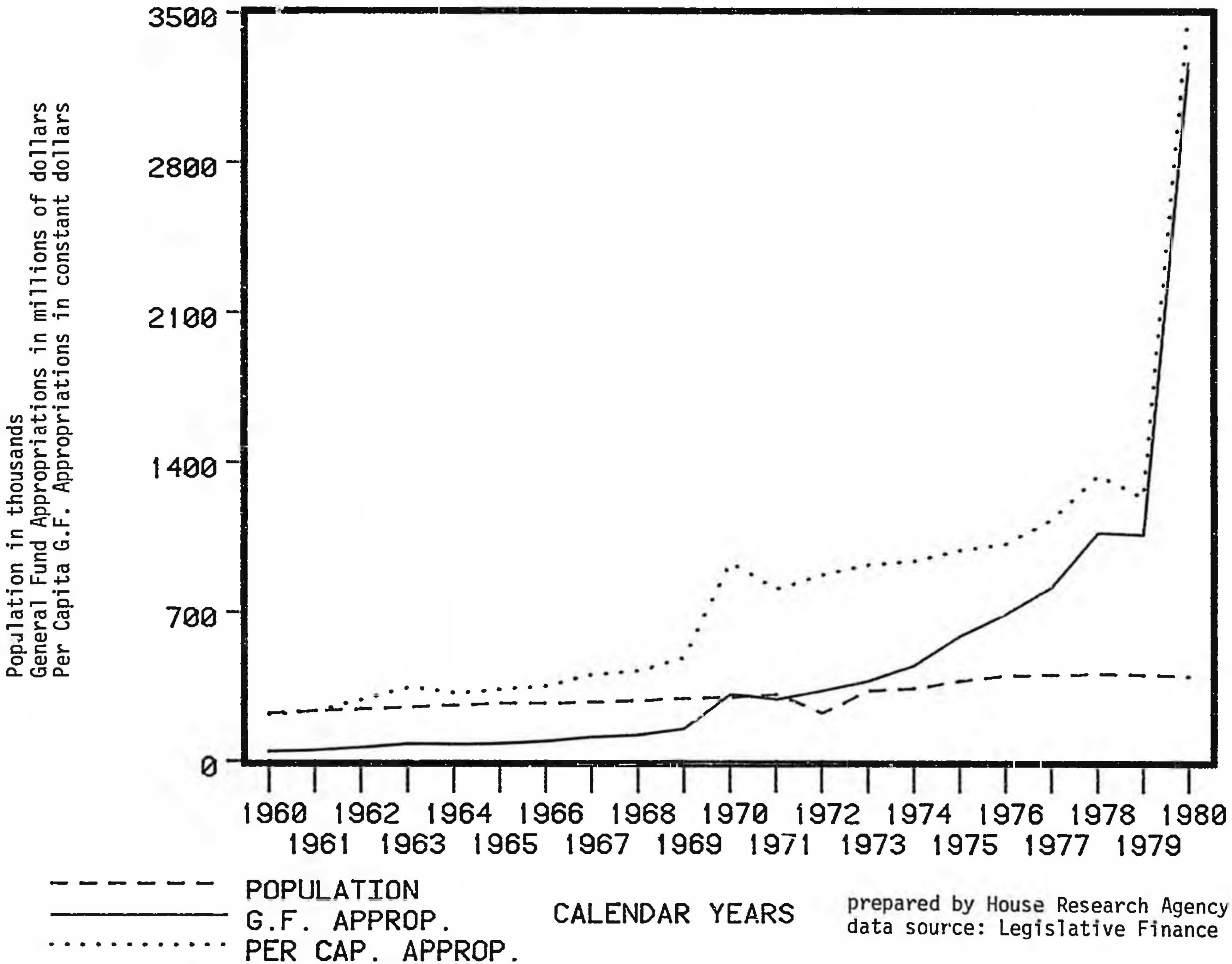
   (b) 1960-1972 figures from Governor's Budget Document; 1973-1980 figures from Free Conference Committee Report on the Budget.

   (c) Supplemental appropriations are excluded except for a $580.8 million capital projects supplemental in 1980.

   (d) Appropriations to the Permanent Fund and general reserve which are strictly for investment are excluded.

Prepared by:
Legislative Finance
5-25-81

HISTORICAL GROWTH IN GENERAL FUND PER CAPITA APPROPRIATIONS
FROM CALENDAR YEAR 1960 TO 1980



prepared by House Research Agency
data source: Legislative Finance

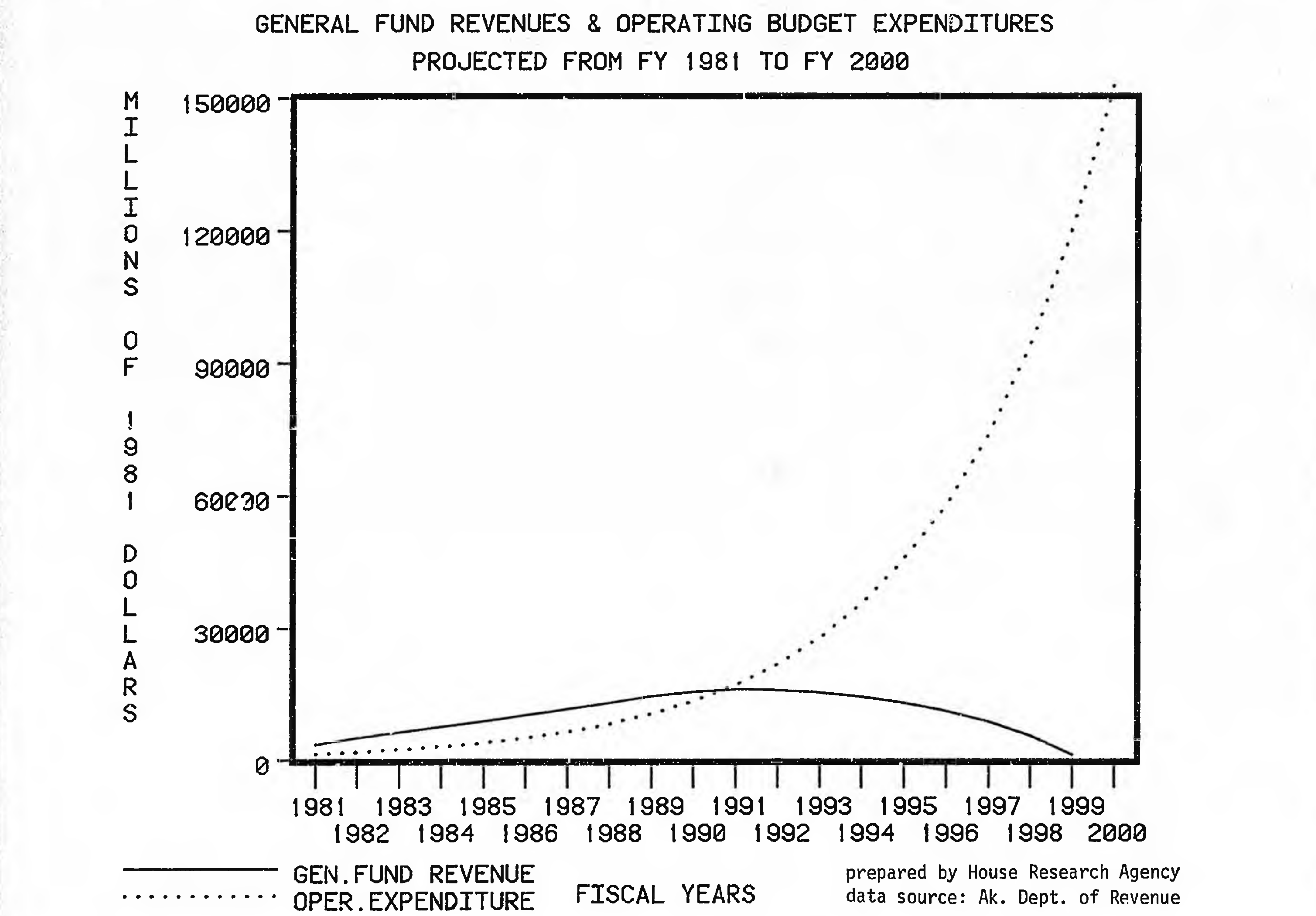
4/14/81

Department of Revenue - Research

REVENUES-EXPENDITURES

NO GAS LINE
25% PERMANENT FUND
(MILLIONS OF CURRENT DOLLARS)
16% REAL EXPENDITURE GROWTH RATE (+10% inflation = 26% nominal growth rate)

FY	GENERAL FUND SUSTAINABLE REVENUES	UNRESTRICTED REVENUES GENERAL FUND	EXPENDITURES GENERAL FUND operating budget only	SURPLUS OR DEFICIT GENERAL FUND	GENERAL FUND BALANCE	PERMANENT FUND CONTRIBUTION	PERMANENT FUND BALANCE
81	330.8	3607.0	1500.0	2107.0	1677.0	1261.8	1796.0
82	423.2	5191.1	1914.0	3277.1	4954.1	557.2	2446.2
83	637.6	6435.8	2442.3	3993.5	8947.5	679.3	3248.7
84	888.0	7660.5	3116.3	4544.2	13491.8	807.1	4223.6
85	1213.4	8939.6	3976.4	4963.2	18455.0	914.4	5319.8
86	1566.9	10326.5	5073.9	5252.6	23707.6	1068.5	6592.8
87	1945.0	11687.1	6474.3	5212.8	28920.4	1190.7	8019.1
88	2341.3	13133.7	8261.2	4872.5	33792.9	1320.9	9606.9
89	2742.8	14647.3	10541.3	4106.0	37898.9	1451.2	11356.7
90	3130.5	15621.4	13450.6	2170.8	40069.7	1523.6	13208.7
91	3450.9	16169.7	17163.0	-993.2	39076.5	1555.5	15116.6
92	3646.6	15829.6	21900.0	-6070.4	33006.1	1501.5	16985.2
93	3628.3	15346.8	27944.3	-12597.5	20408.6	1455.1	18811.2
94	3327.2	14303.0	35656.9	-21353.9	-945.4	1376.7	20554.1
95	2639.6	12919.7	45498.2	-32578.5	-33523.8	1304.2	22213.5
96	1452.2	11124.1	58055.6	-46931.5	-80455.4	1240.7	23795.2
97	-376.2	8663.6	74078.8	-65415.2	-145870.6	1191.0	25312.4
98	-3030.9	5421.5	94524.4	-89102.9	-234973.5	1142.3	26766.9
99	-6744.7	1149.1	120613.0	-119463.9	-354437.4	1095.7	28161.4
0	-11815.9	-4481.9	153902.0	-158383.9	-512821.3	1050.9	29498.8



GENERAL FUND REVENUES & OPERATING BUDGET EXPENDITURES
PROJECTED FROM FY 1981 TO FY 2000
MILLIONS OF 1981 DOLLARS
150000
120000
90000
60000
30000
0
1981
1982
1983
1984
1985
1986
1987
1988
1989
1990
1991
1992
1993
1994
1995
1996
1997
1998
1999
2000
GEN.FUND REVENUE
OPER.EXPENDITURE
FISCAL YEARS
prepared by House Research Agency
data source: Ak. Dept. of Revenue

1/

DRAFT

ESTIMATED FY 82 APPROPRIATION CEILING UNDER SJR4 & HJR57

Governor's Office

SJR4	HJR57		
($mil GF)	($mil GF)	($mil Tot. Funds)	
$4772.5	$4772.5	$5545.1	Executive Budget Book I Total FY 81 Adjusted Authorizations Book
			Exemptions
(900.0)	(900.0)	(900.0)	Permanent Fund Contribution
(129.4)	0	0	Permanent Fund Dividends
0[1]	0	0	Loan Capitalizations
0	0	0	Voter Approved Capital Projects
0	0	0	Escrow Accounts
(93.7)	(93.7)	(96.8)	Debt Service
(350.0)	0	0	Reserve for Disaster/Emergency
0	0	0	User Fee Increase
0	0	0	Court Orders
0	0	0	Transfer of Fed. Responsibility
0	0	0	Quarter Income from P.F. Contributions
0	0	0	Two-thirds vote of Legislature for Disaster Needs
			Other Possible Exemptions[2]
-	-	-	Income Tax Relief
-	-	-	Native Land Claims
$ 3299.4	$ 3778.8	$ 4548.3	
x 1.1298	x 1.1298	x 1.1298	Estimated Growth Rate [3]
$ 3727.7	$ 4269.3	$ 5138.7	Estimated FY 82 Appropriation Ceiling

DRAFT

FOOTNOTES

1. Assume capitalizations for loans, which will be made at Market Rates, are exempt from limitation of appropriation increases. Capitalizations for loans which will be made at interest rates below the market rate are NOT exempt from limitation of appropriation increases.

2. The income tax relief appropriation $186.4 million and the Native Land Claims appropriation $292.6 million may also be considered possible exemption items. However, neither SJR4 nor HJR57 specifically recognizes these items.

3. 12.98% Growth Rate = 2.84% Av (1970-80) Pop. Increase + 10.14% Av 1980 CPI.
   NOTE: 10.14% is a weighted average of the CPI for all Urban Consumers, based on Anchorage and Fairbanks data. (Anchorage, population 173,992 with 1980 CPI increase of 10.0%; Fairbanks population 53,799 with 1980 CPI increase of 10.6%).

STATE OF ALASKA

THE LEGISLATURE

BUDGET AND AUDIT COMMITTEE

FINANCE DIVISION
POUCH WF–STATE CAPITOL
JUNEAU, ALASKA 99811
PHONE: (907) 465-3795

MEMORANDUM

TO: Honorable Ed Dankworth,
Co-chairman
Senate Finance Committee

FROM: Milt Barker, MB Fiscal Analyst
Legislative Finance Division

DATE: January 22, 1981

SUBJECT: FY 82 Budget Under Proposed Constitutional Limits

Following are estimates of what FY 82 budgets would be permitted if various proposed constitutional limits on budget growth were now in effect.

SJR 3 by Colletta

This limits growth of appropriations, except those for capital projects and contributions to the permanent fund, to growth of the economy. For calendar 1979, Alaska personal income grew 4.55%. Applied to an FY 81 operating budget of $1,282.0 million (see attached Table I), this would permit an FY 82 operating budget of $1,340.3 million. The Governor has proposed a general fund operating budget of $1,826.5 million.

HJR 5 & SJR 4 by Request of the Governor

This limits growth of appropriations to inflation in the calendar year preceding the Governor's budget submission plus the average yearly growth in the State's population as measured by the last two federal censuses. Using the most recent Anchorage consumer price index figures and the 1970 and preliminary 1980 census data, the permitted growth rate for the FY 82 budget would be 12.8% to 14.0%, depending on which of two Anchorage consumer price indices is used.

The limitation does not apply to:

1) permanent fund contributions
2) permanent fund dividends
3) loan fund capitalization (but loan subsidies are limited)
4) capital projects approved by voters
5) debt service
6) disaster reserve funds
7) increases in state expenditures resulting from court order or federal law
8) 1/4 of the income from contributions to the permanent fund above the 25% minimum

Referring to Table I again, the following FY 81 expenditures would be subject to growth limits:

Operating	$ 1,282.0
Capital	72.1
Special Appropriations	64.7
Renewable Resources	125.0
HB 60	580.8
Loan Subsidies 1/	144.7
TOTAL	$ 2,269.3

The 12.8% or 14.0% growth rates applied to this figure, plus 1/4 of 10% interest on $900 million excess permanent fund contributions, would permit FY 82 budgets for restricted expenditures of $2,582.2 or $ 2,609.5 million. The Governor's FY 82 budget for such items totals $2,286.9 million:

Operating	$ 1,826.5
Loan Subsidies 1/	233.0
Capital	227.4
TOTAL	$ 2,286.9

HJR 4 - by Gardiner

This limits growth of appropriations, except for appropriations to the permanent fund and for loans, to growth of the economy. Using the 4.55% growth in personal income in 1979 and an FY 81 base from Table I of $2,474.6 million,

Operating	$ 1,282.0
Capital (less native claims)	72.1
Special Appropriations (includes general fund reserve)	414.7
HB 60	580.8
Renewable Resources	125.0
TOTAL	$ 2,474.6

1. Figures provided by Budget and Management.

the permitted FY 82 budget would be $2,587.1 million. For these same restricted items, the Governor's FY 82 budget proposes $2,703.9 million:

Operating	$ 1,826.5
Capital	227.4
Rainy Day Funds (general fund reserve)	350.0
Escrow Account	300.0
TOTAL	$ 2,703.9

MB:dh

January 13, 1981

The Honorable Jalmar Kerttula
President of the Senate
Pouch V
Juneau, AK 99811

Dear Mr. President:

Under art. III, sec. 18, of the Alaska Constitution, I am transmitting a proposed constitutional amendment on spending limitations for the consideration of the legislature.

My proposal would amend the constitution's finance article to add two sections, one setting forth spending limitations and the other prescribing ten specific exceptions. Each of the exceptions is reasonably necessary, and some of them are for appropriations of money to be invested rather than expended, and, to that extent, do not really involve actual expenditures.

The proposed amendment limits annual increases in appropriations of state money -- but not of money from other, non-state sources such as federal money -- to the increase in the federal consumer price index for Alaska for the preceding year plus a percent equal to the state's average yearly growth in population.

At the present time, the only federal consumer price index for Alaska is that done for the Anchorage area. It appears that one will also be prepared for Fairbanks sometime soon. And indexes may also be prepared for other Alaskan cities in the future. The index for the state will consist of the weighted average of those indexes, that is, in proportion to each community's relative population.

The measure of the state's average yearly population growth is the federal decennial census and the interim renumeration to be taken at five year intervals. The latter, while called for by federal law, has yet to be funded. Nevertheless, even without a renumeration, the decennial census provides an accurate measure of the state's average yearly growth.

The use of data prepared exclusively by the United States is deliberate and essential. The pressure to shape cost and population data to justify increased expenditures would be enormous if those data were prepared by state or local agencies. Using data developed by an independent and separate government avoids that problem completely.

These two measures of growth, while not always coincident with all governmental needs, will allow the state to keep abreast of most needs and yet hold growth to reasonable and responsible limits. To the extent that the state still lags behind its sister states in some areas of governmental services and facilities, the exceptions prescribed by the second section will allow it to catch up, if that is what the electorate wants. Each of these exceptions will be discussed in turn, below.

The first exception is for appropriations of money to be deposited in the permanent fund, and the second is to pay permanent fund dividends to the people. It is self-evident that neither needs to be limited. The third exception is to capitalize loan funds, that is, appropriations of the money which will be loaned and repaid with interest under the state's loan programs. To the extent that low interest loans are subsidized, the appropriations for that purpose must be separate, and they are not within the terms of the exception. The fourth exception is for appropriations for capital improvements which have been approved by the voters. This includes those funded by appropriation from the general fund and those funded by bond proceeds. Voter approval is a must for the appropriations to be within the exception. But if the voters approve, there are no limits on appropriations for capital improvements.

The term "capital improvements" is used in the amendment in the same sense as it is used in sections 8 and 9 of the finance article relating to state and local debt. It refers, generally speaking, to public works or facilities of a permanent character as described in the case of <u>City of Juneau</u> <u>v</u>. <u>Hixson</u>, 373 P.2d 743 (Alaska 1962).

The fifth exception is for appropriations made to escrow accounts or otherwise to repay general obligation bonds. As a practical matter, it may be to the state's great advantage at any time to make a large payment, either into escrow or directly, to repay outstanding general obligation bonds. That kind of a payment would not constitute a true increase in expenditures, and it is, therefore, made one of the exceptions.

The sixth exception is for money appropriated as a reserve account for disasters of natural or human origin.

The device has been called a rainy-day account, and it is simply a means of setting aside a financial cushion for the state during a fiscal year in case of exceptional need. At the present time the Reserve for Emergency Operating Expenses Account has been established under AS 37.05.159 to meet this need. It will be superseded by this amendment, and in order to spend money appropriated to the reserve account, the provisions of the tenth exception will have to be followed.

The seventh exception is for money appropriated to coincide with increases in user fees. The term "user fees" includes all kinds of taxes or charges which are levied upon those who use a government facility or service. They range from hunting and fishing licenses to boiler inspection fees. So long as users are paying the money, no purpose would be served by placing this category within the limitations on expenditures. No big increases are foreseen at this time, but should users wish to have them, there is no reason to place a constitutional bar in their way.

The eighth exception is for appropriations required by court orders or by a transfer of functions from the federal to the state government. Transfers from local to the state government are within the legislature's control, and therefore are subject to the limitation. Court orders -- and that would include judgments for damages or orders for future relief -- are not within the legislature's control and could cause significant, temporary increases from time to time. The same could happen if the federal government were, for instance, to shift all of the social services or education burden to states. While one hopes this exception will be little used, prudence dictates its existence.

The ninth exception is for appropriations of money derived from one-quarter of the income from extra appropriations made to the permanent fund. The purpose of this exception is to encourage those who would spend more money to save more money. The more money that is placed in the fund, the more money there will be available under this exception to spend.

The tenth and final exception is for natural disasters. As safeguards against spurious spending under this exception, the disaster must be declared by the governor in the first instance and the appropriation bill must be passed by a two-thirds majority of the membership of each house and approved by the governor. If the governor does not approve the appropriation or vetoes it to reduce or strike any item, his veto is final. The purpose of the absolute veto is to preclude any excess spending on non-emergency items in a bill appropriating money for disaster relief. Without an absolute veto, this exception would create an unacceptably large loophole.

The proposed amendment is conservative, responsible, and workable. It will not hobble the state or prevent the performance of any needed governmental function. It will set limits where they are needed, and it will not set limits where they are not needed. It will be good for both the private sector and the public sector, and I urge its favorable consideration.

Sincerely,

S/JSH

Jay S. Hammond
Governor