

SCOMM

101:17

July 27, 1995

To: Long Range Financial Planning Commission
Att'n: Brian Rogers, Chairman

From: Roger Cremo 

You've been asked to close a fiscal gap. On a graph, two lines start at points about half a billion dollars apart and move much farther apart in the years to come. The upper line represents projected expense, which is present expense increased by one or more of such factors as inflation, population growth, environmental disaster, deferred maintenance and federal parsimony. The lower line represents projected income according to the official forecast. The space between the lines is the fiscal gap.

You're to use various tools to make these lines converge in ten years. The expense line is to be lowered by eliminating or curtailing state programs, or by making them more efficient. The income line is to be raised by adding new income. The space remaining between them is to be filled with what's left of cash reserves.

The objective, of course, is sustainable spending. Closing the fiscal gap is supposed to achieve this.

Assume that it's 2006 and that the fiscal gap has been closed according to plan. The expense and income lines have converged. There is no longer a separate expense line. Spending is following the income line. As the expression goes, we are "living within our means". All is well.

But that's not sustainable spending. That's just spending an amount that equals the year's income. Spending is sustained when it increases every year at least enough to maintain services, considering inflation. If real income were decreasing in 2006 (as it is projected to do), spending would do the same. And if the price of oil were to drop, as it does from time to time, it would make matters worse. Rather than sustainable spending, we would have the same kind of spending we've always had – unsustainable spending.

And this is assuming that the fiscal gap has been closed. Realistically, it would be difficult to define and close the gap, because we would have to rely heavily on the same income that causes our problem. And we wouldn't be doing anything to make that income sustainable. Reducing expense doesn't make income sustainable. Adding new income doesn't either.

In essence, your instructions are to do whatever it takes to make spending sustainable. Since the culprit is the income that comes from natural resources, you have to make that income as sustainable as possible.

Under the System of Sustainable State Spending, previously described to you, the amount withdrawn from the Permanent Fund for spending is sustainable. Even during the transitional period, when the amount withdrawn is gradually changing from unsustainable to sustainable, it is considerably more reliable than the income we have now.

Whether we can define and close the fiscal gap, and keep it closed, depends on the type of income we use. If any substantial part of income fluctuates too much, the task may be impossible.

I hope that these comments are helpful.

System of Sustainable State Spending (also known as the Cremo Plan)

It has been proposed that the constitution be amended for the purpose of converting fluctuating natural resource revenues to comparatively stable income. All natural resource revenues – what has accumulated in various funds and what will be received in the future – would go into the Permanent Fund. All income from investment would remain in the fund. Money in the fund could not be appropriated, except that every year an amount equal to the fund's projected real growth from investment would be withdrawn for appropriation.

During a transitional period, withdrawals from the fund would be at an unsustainable rate that gradually decreases until it is sustainable.

A complete evaluation of the proposal is underway and will include a comparison of the amounts available for appropriation under the present setup and the proposed system.

*From: Roger Cremo
For Report*

cc:Mail for: Melissa Fouse

Subject: Re[2]: LRFPC info on the net?
From: Representative John Davies 7/18/95 12:34 PM
To: Melissa Fouse at LAA_ANC

Dear Melissa:

Thanks for your prompt reply. I'm pleased that you're planning to get onto the net as much as possible. (Eventhough the Legislature is not yet able to access the internet except thru ccMail.) I suggest that you give legislators a briefing as soon as possible with a simple packet of overhead transparencies that would allow them to give briefings to their constituents. Thus the legislators would become educated in the "facts" (as you set them out) and could appear as experts to their constituents as they relay the facts to them.

I would like a short (five, or so) list of the most useful documents which you and the commission have found that lay out the problem and give the options available for solving it. Have you read Tim Bradner's articles in the Summer '95 "Juneau Report" by BP? Any comments? Thanks.

Cheers, Rep. John D.

DEAR REP JOHN D.

Yes we met July 14th & 15th. There will be a meeting summary (soon, I promise) and yes it is my intention to post same on the bulletin board. There are two giant files full of basic documents of which we are preparing an index even as I write. I will post the index on the BB, with the caveat that only some of them are available through the commission office, others are available from the agencies.

We do plan to get as much into the internet as we can. We are now, or are about to be, hooked up to the world wide web (no one here but us arachnids) and once we get it figured out hope to be able to get the report, which should be done about the first week of August, onto a place from which it can be downloaded. It is running to about 30 pages now and has a number of pieces still missing.

Brian & I are discussing ways to summarize it so that it gets a wider readership, both in hard copy & on-line.

Have you any hot suggestions?

What can I send you now?

Melissa



UNIVERSITY OF ALASKA ANCHORAGE

3211 Providence Drive
Anchorage, Alaska 99508

SCHOOL OF PUBLIC AFFAIRS

ECONOMICS DEPARTMENT
(907) 786-1770 FAX (907) 786-7739

June 29, 1995

Melissa Fouse
State of Alaska
Long Range Financial Planning
Commission
716 West Fourth Avenue
Anchorage, AK 99501

Dear Melissa:

I have enclosed an extra copy of the article I wrote with Dwight Lee.

Sincerely,

A handwritten signature in cursive script, appearing to read "Steve".

Stephen L. Jackstadt
Professor of Economics

enclosure
SLJ:ds

STATE OF ALASKA

DEPARTMENT OF REVENUE

TONY KNOWLES, GOVERNOR

INCOME AND EXCISE AUDIT
P. O. BOX 110420
JUNEAU, AK 99811-0420
FAX: (907) 465-2375

April 24, 1995

Esther Creech
7040 Abbott Loop Road
Anchorage, AK 99507

Dear Ms. Creech:

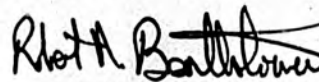
I am responding to your letter to Governor Knowles about creating jobs and making Alaska a business-friendly state. Your letter was referred to the Department of Revenue because you suggested that the state should use the personal income tax as a means of encouraging that jobs in Alaska go to Alaskans and collecting revenue from nonresidents working in Alaska.

As you may be aware, the Governor and legislature formed the Long Range Financial Planning Commission (LRFPC) which is looking at the individual income tax among other sources of revenue in planning Alaska's fiscal future. I will forward a copy of your letter to the Commission for their files on individual income tax. If you wish to correspond directly with the Commission, you may do so at 258-8170 or the following address:

Long Range Financial Planning Commission
716 West 4th Suite 380
Anchorage, AK 99501

If I can be of any further assistance, please feel free to contact me at the address above or 465-2320.

Sincerely,



Robert N. Bartholomew
Deputy Director
Income and Excise Audit Division

cc: Wilson Condon, Commissioner
Melissa Foust, LRFPC—

OFFICE OF THE GOVERNOR
STATE OF ALASKA

April 13, 1995

ROUTE TO:
DEPARTMENT OF REVENUE
ATTN: CTS SECRETARY

RECEIVED
ALASKA DEPARTMENT OF REVENUE

APR 17 1995

COMMISSIONER'S OFFICE

Name Code: CREEE Title:

First: Esther

MI:

Last: Creech

Credential:

Salutation:

Company:

Jobtitle:

Address: 7040 Abbott Loop Road

City: Anchorage
State: AK Zip: 99507

Foreign:

Comment	Tp	DP	Stf	Issue Code	Due	Resp.	CTS #
Personal income tax	RD	04	BPH	0404	05/02/95	/ /	95103016

D+E

Kurd RBV

7040 Abbott Loop Rd.
Anchorage, AK 99507
(907) 344 3953
March 8, 1995

Governor Tony Knowles
P.O. Box 110001
Juneau, Alaska 99811

RECEIVED
GOVERNOR'S OFFICE

Dear Governor Knowles:

After years of hearing aspiring politicians talk about "creating jobs" (government jobs, no doubt), you seem to be on the right track in working to make Alaska a business-friendly state.

One area of concern, however, about which I am skeptical that Alaskans may not benefit as much as we would like is the increasing tendency for Alyeska and the oil companies to contract more of the work. The contractors have chosen shifts of 2 to 4 weeks on, 2 off. Outsiders are delighted. The same old story: make your bundle in Alaska and leave.

One example concerns a segment of work just recently awarded to a contractor. The contractor immediately terminated 2 skilled and qualified Alaskans, then promptly replaced them with two from Louisiana...no more qualified than the Alaskans, just cheaper.

We need jobs for Alaskans! Concessions to businesses are fine. In exchange we need a commitment for preferential hire of Alaskans, not only by the major oil companies and Alyeska Pipeline, but also their contractors. Reciprocal back scratching.

There may be no way to guarantee preference for Alaska residents, but we could and should do as we used to...the personal income tax, with substantial exemptions and deductions for residency.

The mutual exchange of information between the Federal and State Revenue Departments will be of great value in verifying residency for the Alaska Department of Revenue and the Permanent Fund Dividend program in uncovering fraud.

Yours truly,

Esther Creech
Esther Creech

cc: Senator Drue Pearce
Representative Gail Phillips

Written during Gov. Cooper's term.

Chamber's stance against tax against state's best interest

The Alaska State Chamber of Commerce opposes the governor's proposed income tax on individuals. In doing so, the chamber has taken a stance against the best interests of the vast majority of its members. It is true, as far as the statement goes, that lower taxes tend to encourage new business. It is also true North-east and Midwest states lost business for many years to the Sunbelt states in large part because of the Sunbelt's lower taxes. And yes, it is even true that taxes once in place are hard to get rid of. Nevertheless, people who want to maintain or even to raise the level of Alaska economic activity, the members of the Chamber of Commerce, for example, should favor the proposed income tax, not oppose it.

First, let us make it clear that what has been proposed is an individual income tax, not a new tax on businesses. The business part of the Alaska income tax never was repealed. True, all taxes ultimately are paid by the people. However, in a world where business



david reaume

treats retained earnings as a "low cost" source of investable funds, a strong case can be made against business taxes as the greater deterrent to new investment.

Second, if your customers are primarily Alaskans, the story is only partly told by the observation that higher state individual income taxes today mean lower after-tax incomes today. The rest of the story is that

higher state individual income taxes today mean higher — yes, higher — after-tax incomes tomorrow. With one-fourth or more of the yield of the tax coming from the federal treasury and non-residents, the net effect of levying the tax and then spending the proceeds is to increase economic activity. Why do you think Atlantic City, N.J., residents are in love with the property tax? Answer: They know that much of its burden is passed on to outsiders in the form of higher room rates and stiffer prices for drinks.

Even my academic friends from Clemson University who toured the state recently preaching the gospel of lower taxes, admitted that taxes borne by outsiders stimulate the local economy if the proceeds are spent locally. If you missed them you shouldn't have. As entertainment goes they weren't half bad, but as entertainers often will, they did resort to a certain amount of careless generalization.

Those of you who heard them may recall

the discussion of the General Motors decision to locate its new Saturn assembly plant in Tennessee. As the Clemson people made very clear, GM put low state taxes at the top, or at least near the top, of the qualities it most desired in a suitor. Neither climate nor Tennessee cheerleading did much to win the day. What counted was the fact that profits after taxes were expected to be greater because taxes were expected to be lower.

Now as it happens, demand for the new GM Saturn is all but independent of the taxing decisions by the state in which the cars were to be built. Lower taxes were indeed of primary importance to GM because the cars were to be sold on national and international markets largely immune to changes in one state's aggregate demand. As a share of total potential demand, the demand from a single state was (maybe) 1 percent. The change in

See Page C-3, REAUME

REAUME: Chamber would do better to favor — not oppose — proposed income tax

Continued from Page C-1

this demand caused by a decision GM might make was infinitesimal. General Motors was not in the position that most Alaska businesses are in. The demand for Saturn would not increase as the result of one state's increase in government spending.

Which, of course, leads us to the correct conclusion that Alaska businesses who sell primarily outside Alaska certainly should be opposed to higher business taxes because higher business taxes force them to raise prices when their competitors do not or to suffer a loss of profits. Chief among the Alaska businesses who sell their wares Outside are the oil companies. In keeping with this analysis, the oil companies are justifiably

opposed to the proposed changes in the severance tax economic limit factor.

Next in size among the exporters are the forest products companies and the seafood processors, which also should oppose higher business taxes when they are proposed. However, their opposition to the individual income tax is a little hard to understand.

All of these companies — the oil producers, the forest products companies and the seafood processors — are alternative tax targets. To the extent the alternative to the income tax is not lower spending but an increase in some other tax (say, the economic limit factor, the raw fish tax or higher business income taxes), higher individual income taxes ought to look pretty good. As we now know, the individual income tax spreads the burden more widely

and stimulates the economy in the bargain.

Where higher taxes could ultimately hurt is in deterring the formation in Alaska of new export-oriented businesses that have the option of locating elsewhere. When the next one comes along, we certainly ought to consider targeted incentives that fit the particulars of the case. I have argued that point for many years. But opposition today to the individual income tax is misplaced if it stems from the fear that someday we may have to offer targeted business tax incentives.

Finally, there is the question of the size of an effect vs. its direction. As I have said, higher state individual income taxes deter economic growth if the respending of revenue plucked from the U.S. Treasury and outsiders is not an important consideration. But even

this deterrent is buried by higher Alaska construction costs and higher Alaska wages in almost any comparison of Alaska/Outside cost differences an export-oriented investor might care to make. Yes, I know, higher state individual income taxes can raise labor costs. Again, however, there are two effects. Right now I would not be a bit surprised if the net stimulus from spending Outsiders' money did not contribute at least a little to the cause of lower costs by helping to maintain the size of the Alaska economy and its internal competitiveness.

□ David M. Reaume is an economist based in Juneau.

Esther Creech
7040Abbott Loop Rd.
Anchorage, AK 99507



Governor Tony Knowles
P.O. Box 11001
Juneau, Alaska 99811



10 July, 1995

State of Alaska
Long Range Financial Planning Commission
716 West Fourth Avenue
Anchorage, Alaska 99501

Dear Commissioners:

I want to encourage you to consider the following suggestions as you develop your report. Every suggestion you offer will produce critics. The path of least resistance would have you focusing your efforts on the least politically offensive options. I think that would be a mistake. I would encourage you to have the conviction to get everything on the table regardless of its political sensitivity. The citizens of Alaska need a prescription for the best medicine even if swallowing the pill might choke us a bit.

Boards, Commissions, Departments and Government Services:

I would encourage you to review every level of government with an eye toward paring down and eliminating those services that aren't rightly the role of government.. Our state government is fat and you can prescribe the diet.

Give Away Programs:

Can we afford to be as generous as we've been in the past. The answer is no! I would much sooner see these funds reallocated for the purpose of funding services that are the legitimate responsibility of government. It is time to sunset some popular programs.

Incentives

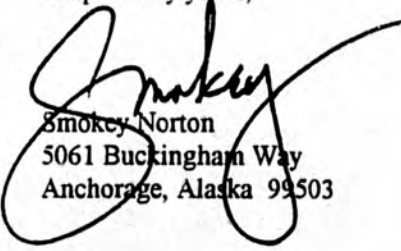
I would recommend you encourage an effort to develop incentives with rewards to citizens/state employees/supervisors/state managers that produce ideas that will make state government more effective and efficient.

Taxes:

Once there has been an effort to cut government flab then I believe taxing our citizens for State government services will be a more painless pill to swallow. Offering taxing schemes to support the existing needs of State government without addressing the root problems would be a grievous and irresponsible mistake. Don't miss this opportunity to improve our State government.

I am anxious to see the recommendations from your commission.

Respectfully yours,



Smokey Norton
5061 Buckingham Way
Anchorage, Alaska 99503