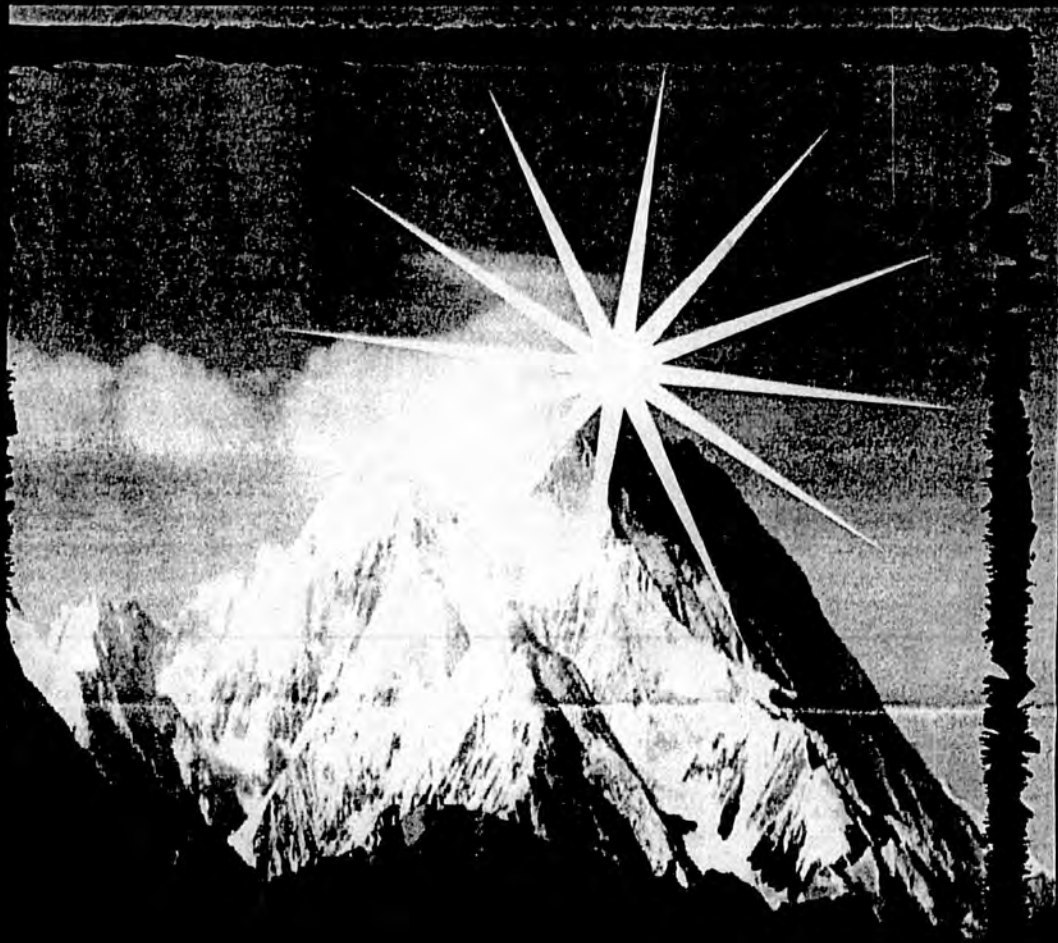


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An Endowment For Alaska's Future

**The State Long Range
Financial Planning
Commission Report**



State Long Range Financial Planning Commission Report

EXECUTIVE SUMMARY

Alaska's fiscal gap is real and growing

The State is spending \$524 million more than it will take in during the current fiscal year. That gap will grow to \$1.3 billion per year in today's dollars by 2005 if we make no changes to the State's spending and revenue policies.

The Long Range Financial Planning Commission was appointed jointly by the Legislature and Governor in March 1995 to recommend ways to close the gap and put Alaska on firm financial ground. This report details our plan and our recommendations.

What does the plan do? It:

- Makes the Permanent Fund the cornerstone of Alaska's fiscal future.
- Closes the fiscal gap by the year 2000.
- Ensures growth of the Permanent Fund to offset declining oil and gas revenues.
- Stabilizes and diversifies revenues.
- Controls State general fund spending.
- Maintains a reserve to dampen the effect of oil price swings.
- Decreases our dependence on volatile oil revenues.

This is a plan for ourselves and our grandchildren. It requires all Alaskans to share in the solution. No action to close the fiscal gap is the greatest threat to Alaska's financial future.

The Commission was asked to recommend a plan for three, five and ten years. To be sure that plans for these time frames did not create a reoccurring fiscal gap after that, the Commission also looked at the likely effects of its plan over a fifteen year period.

The first three years

The key elements of the three-year plan are to:

Cut spending

- Cut current State general fund spending by \$100 million — \$40 million in 1996, \$30 million in 1997, and \$30 million in 1998 — a reduction of \$300 million in today's dollars.
- Reduce per capita State general fund spending from

\$4,020 to \$3,692 in four years — a reduction to \$3,255 in today's dollars.

Increase Revenues

- Increase tobacco taxes by \$1 per pack (\$43 million).
- Increase alcohol taxes by 10 cents per drink (\$20 million).
- Increase motor fuel tax from the 1961 level of 8 cents/gallon to 22 cents/gallon and increase marine fuel tax by 3 cents/gallon (\$44 million).
- Increase user fees by at least \$3 million per year, double motor vehicle license fees, and eliminating motor vehicle license fee exemptions (\$32 million).
- Establish a new tax to generate at least \$20 million from tourists and increase taxes on fisheries and other resources by \$30 million.

Use the Permanent Fund as an endowment

- Establish the Permanent Fund as an endowment to partially replace declining oil revenues.
- The endowment will pay up to 4 percent of the Fund's five-year average market value to the general fund for dividends and State services.
- Constitutionally protect Permanent Fund principal by building long-term inflation-proofing into the endowment plan.
- The endowment payout and increased Permanent Fund contribution require voter approval of a constitutional amendment in 1996.

Boost the earning power of the Permanent Fund

- Build Permanent Fund principal by
 - (a) making additional special deposits to fund principal;
 - (b) increasing the minimum annual deposit to the Permanent Fund;
 - and (c) retaining additional earnings in the Permanent Fund.
- Deposit \$600 million from the Constitutional Budget Reserve into the Permanent Fund this year.
- Close out the Permanent Fund Earnings Reserve once the endowment is in place, by depositing it into the Permanent Fund (approximately \$1.2 billion)
- Increase to 50 percent the minimum contribution to the Permanent Fund from certain oil, gas and mineral lease revenues.

- Retain earnings in excess of the 4 percent annual payout in the fund. Since the projected rate of return to the fund is 4.79 percent after inflation, the Fund should retain earnings above inflation-proofing of at least 0.75 percent annually.

Cap the Permanent Fund Dividend pool

- Reduce the total amount spent for the dividend program from \$565 million this year by \$50 million a year for each of the next three years.
- Individual dividends will be about \$900 next year, \$800 in 1997, and \$700 in 1998.

Clarify the purpose of the State's reserves

- Maintain the CBR at \$1.5 billion to cushion oil revenue volatility. Clarify its use and repayment in a constitutional amendment.

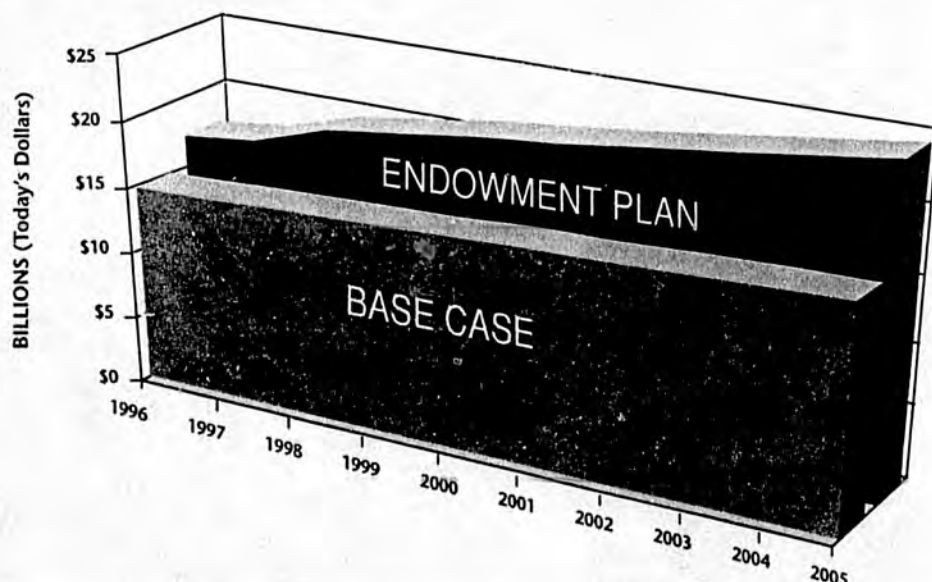
Reform the budget process

- Scrutinize all State spending, not just State general funds.
- Report annually to the public on progress toward closing the fiscal gap.
- Focus on whether programs are needed, cost-effective and achieve their intended results.

The five- and 10-year plan

In 1999, Alaska comes to a fork in the road. By that time the budget is balanced under the Commission's plan. To prevent the fiscal gap from reappearing, we can cut the budget further, institute a personal income tax, increase other taxes, and/or further reduce dividends. The Commission recommends that a follow-up review be done in late 1998 and early 1999 to adjust the overall plan as needed for the succeeding five to ten years. By that time the budget is balanced and we will know more about ANWR, the gas line and federal budget changes. As a result, decisions for first decade of the next century will be less dependent on speculation. Under our plan, after budget cuts, tax increases, the Permanent Fund endowment and dividend reductions have been made, this Commission recommends the State adopt a personal income tax in 2000 to begin in 2002, once the deficit reappears.

Permanent Fund Principal:
Comparison of Base Case To Endowment Plan



State Long Range Financial Planning Commission Report

FINAL REPORT

Alaska's fiscal gap is real, and it's growing

The State of Alaska spends more than it takes in each year, and has done so for six of the past nine years.

This year, the State will spend \$524 million more from the State general fund than it will take in — this is the fiscal gap. That gap will grow to \$768 million in three years, to \$879 million in 5 years, and \$1,253 billion in 10 years (in today's dollars) if we make no changes to the State's spending and revenue policies. Our interim report contains more details about the growing fiscal gap and options available to close the gap.

The Long Range Financial Planning Commission was appointed jointly by the Legislature and Governor in March 1995 to recommend how to close the gap and put Alaska on firm financial ground. In the past six months, as directed by the resolution creating the Commission, the Commission has:

- Reviewed and evaluated State fiscal policy and strategy recommendations and assumptions from reports and publications from similar efforts in the past made by the executive branch, the legislative branch, the University of Alaska, nonprofit organizations, and private individuals and organizations,
- Identified and evaluated all current State income sources and assets, including recurring revenue, reserves, physical resources, and investments,
- Identified systemic changes to stabilize the State's revenue stream,
- Identified major reductions in State expenditures,
- Identified new sources of revenue,
- Projected a sustainable long-range financial plan based on a stable revenue stream,
- Evaluated constitutional, statutory, and regulatory language relating to the budget process,
- Reviewed and evaluated forward funding of the State budget,
- Considered the division of responsibility for providing services and raising revenue between the State and local governments and evaluated the effect of the long-range financial plan on local governments,
- Submitted a preliminary report to the Governor and the Legislature, and
- Disseminated information and solicited public comment.

The Commission's deliberations were aided by substantial work and informative presentations by State agency personnel, the Alaska Permanent Fund Corporation staff, Alaska Municipal League and Conference of Mayors, and private citizens who brought additional perspectives to the table.

The Commission's work focused on elements of State spending which affect the fiscal gap. These include:

- General funds, including program receipts
- Permanent fund earnings
- Funds created by appropriations for specific purposes or as "holding accounts"
- Special revenue funds set out in the constitution or statute.

Certain other funds, while included in the overall budget of the state, are not commonly reported in budget presentations, and do not materially affect the fiscal gap.

These include:

- Federal funds
- Loan amounts and loan administrative costs
- University receipts
- Internal service funds
- Transfers between agencies for contractual obligations, including interagency receipts.

The Commission believes the State budget process should include examination of all spending, regardless of whether the funds affect the fiscal gap. To meet the Commission's charge of closing the fiscal gap, though, we focus on the general fund and Permanent Fund.

The Commission has developed a financial plan for the State of Alaska. It brings Alaska's spending into line with recurring revenues. It balances the needs of current Alaskans with the needs of future generations. It requires that all Alaskans share in the solution.

What the plan does:

Makes the Permanent Fund the cornerstone of Alaska's fiscal future

The plan calls for a constitutional amendment establishing the Permanent Fund as an endowment: fund with an annual payout to the general fund based on a rolling five year average. The Permanent Fund will continue to grow with additional deposits, and retain some of its earnings in the next few years so that its income replaces declining oil revenues in the future.

Closes the fiscal gap by the year 2000

The combination of spending cuts, revenue increases, and uses of Permanent Fund income closes the fiscal gap in four years. With imposition of a State personal income tax in about 2002, the budget balances for another five years.

Ensures growth of the Permanent Fund to offset declining oil and gas revenues

The constitutional dedication of mineral lease revenues, royalties and bonuses to the Permanent Fund increases to 50 percent. The annual payout rate from Permanent Fund earnings is capped at a rate of up to four percent of the five-year average market value of the fund, which will allow additional retained earnings to build up the fund. Earnings in excess of the four percent payout rate will, over the long term, fully inflation-proof the fund, and preserve its earning power. Since the projected earnings rate is 4.79 percent above inflation, continued good performance by the fund will result in additional retained earnings of 0.79 percent.

Stabilizes and diversifies revenues

A reliable payout from Permanent Fund earnings will stabilize Alaska's income during periods of oil price volatility and substitute for declining oil revenues. New consumption taxes and business taxes will provide a portion of the State's revenues. These revenues will grow as the State's population grows, providing some links between State revenues and its service needs. The State personal income tax, once imposed in about 2002, will be related to State population growth, and will bring in revenues from non-resident workers.

Controls State general fund spending

The "bottom line" for general fund spending will shrink by five percent per year in today's dollars for the next four years. Depositing of reserve fund balances and a higher level of oil revenues into the Permanent Fund limits the money available to fuel State spending growth.

Maintain a reserve to dampen the effect of oil price swings

The Constitutional Budget Reserve will be available to cushion oil price decreases, and be used to absorb revenues from oil price increases. The second state reserve, the Permanent Fund Earnings Reserve, will be closed and deposited into the Permanent Fund. The Commission recommends maintaining a level of \$1.5 billion in the Constitutional Budget Reserve fund. That amount is approximately one year's oil revenues. Amounts in excess of the \$1.5 billion level should be deposited in the Permanent Fund. The CBR will be replenished by its own interest income, and we further recommend any excess revenues from temporary oil price increases be deposited in the CBR.

Decreases our dependence on volatile oil revenues

The combination of Permanent Fund income, increased and new taxes and user fees, and the reimposed State income tax, will offset oil revenues as the primary source of funding for State government operations.

The plan closes the fiscal gap with the following steps:

- Cuts spending,
- Increases revenues, and
- Establishes the Permanent Fund as an endowment,
- Caps the Permanent Fund dividend pool.

The first three years

The key elements of the three-year plan are to:

Cut spending

The State cannot continue to spend at the same level it does today. Notwithstanding needs and demands for increased spending and the impending federal transfer of programs to the State, the Commission believes Alaska cannot close the fiscal gap without cutting State spending.

The plan calls for State general fund spending to be reduced by \$100 million in three years — \$40 million in FY97, \$30 million in FY98, and \$30 million in FY99 — a reduction of \$300 million in today's dollars.

This decline of State spending reduces per capita State general fund spending from \$4,020 to \$3,692 in four years — a reduction to \$3,255 in today's dollars.

The Commission believes this level of reduction in State spending will be painful, but is a necessary step toward closing the fiscal gap. Recent legislatures have managed to hold spending level, which has resulted in real reductions to some State programs.

Within these budget targets, the Commission believes the State should give attention to deficits in the State's infrastructure spending, most particularly for maintenance on publicly-owned facilities, roads and highways.

The Legislature and the Administration may wish to con-

The Plan Recommended By This Commission

- **Creates a new philosophy for state revenues**
 - Permanent Fund income begins to replace oil revenues
- **Enhances our ability to save for future generations**
- **Imposes some spending discipline on the State**
- **Defines a role of the Permanent Fund in Alaska's future**
- **Clears up some of the confusion over cash reserves**
- **Suggests embarking upon some structural changes in State government**
- **Involves the public in the decision making process**

State Long Range Financial Planning Commission Report

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sider voter-approved general obligation bond debt as a way to finance capital projects.

General recommendations for budget reductions include:

Public salaries and benefits

- Enact a retirement incentive program to reduce personal services expenditures.
- Enact a new Tier III retirement system to reduce retirement benefits for new State and local government employees.
- Revise geographic pay differentials for non-covered State employees.
- Study geographic cost differentials in Alaska for use during collective bargaining negotiations with covered State employees (and for use in other State formula programs).
- Compare salaries and benefits of public employees to appropriate public and private markets in Alaska and the Pacific Northwest. Use that comparison to move Alaska's public pay system for State employees, local government employees, and school districts to market.
- Examine the publicly funded health plans for State, local government, school district, and University employees as well as those who receive Medicaid. Look for opportunities to save substantial costs through pooling or other mechanisms.

Administrative realignment

- Reengineer the delivery of State services to eliminate excessive administration.
- Consolidate state departments and agencies, and realign administrative services.
- Look for opportunities to privatize State programs or to contract out State services. Allow "insourcing" so groups of State employees can offer their own solutions to reduce costs in programs that may otherwise be contracted out.

Target high-cost programs

- If the current litigation against the Alaska Longevity Bonus is successful (ending the current phase-out), eliminate the program.
- Change the Public School Foundation Formula to reduce the growth in education spending. The required local effort should be reexamined, as well as provisions that allow school districts to obtain greater funding for special category students regardless of the programs offered to those students.
- Enact a welfare reform package to reduce dependency on welfare programs and put current welfare recipients to work.
- Revise fee schedules for services such as Pioneers' Homes to reflect cost and ability to pay.
- Examine areas of State spending with disproportionately high costs when compared with other States and determine whether there are legitimate reasons for such programs.

Shift revenues and responsibilities to local governments

- Repeal the State mandate for senior citizens' and veterans' property tax relief by local municipalities, but allow local option to grant or withhold the exemption.
- Transfer a portion of State motor vehicle and motor fuel tax receipts to local governments together with the responsibility for class III local road maintenance.
- Eliminate or shift some inspections to local governments with the ability to collect fees for program support.
- Eliminate State general fund support of troopers for road patrols in communities of more than 2,500, but allow communities to continue retain such services if they are willing to pay for them.

Avoid new costs

- Freeze issuance of certificates of need for new hospitals and reassess need for additional nursing homes

Funds Which Affect The Fiscal Gap

- General funds, including program receipts
- Permanent Fund earnings
- Created by appropriation for specific purposes or as a "holding account"
- Special revenue funds where specified in the constitution or statute

Funds Which Do Not Affect The Fiscal Gap

- Loan fund administrative costs
- Loan amounts
- University receipts
- Internal service funds
- Transfers between agencies for contractual obligations, including interagency receipts

Funds Which Cannot Be Appropriated To Other Purposes

- Federal funds
- Retirement funds
- Health insurance funds
- Trust funds

Increase Revenues

The Commission believes Alaska cannot balance its budget responsibly without new revenues. The Commission has chosen a short-term package of taxes on consumption that imposes real service costs on the state, with a longer-term plan of reimposing the State personal income tax.

Increases to existing taxes include:

Tobacco taxes

- Increase tobacco taxes by \$1 per pack on cigarettes and comparable amounts on other tobacco products (raises \$43 million annually, beginning in FY97). This tax increase will dramatically lower teenage smoking and tobacco use, and should somewhat reduce tobacco use by adults, both of which will reduce the State's future expenditures on health care costs. The Commission recommends the taxes increase 25 cents per pack every three years.

Alcohol taxes

- Increase alcohol taxes by an average of 10 cents per drink (raises \$20 million annually, beginning in FY97). Testimony before the Commission indicated that a substantial portion of the criminal justice system's costs — for police, prosecution, public defense, the courts, and the correctional system — are a result of alcohol abuse. This tax increase pays a small portion of the State's costs that result from abuse of alcohol. The Commission recommends also that taxes be equalized among beer, wine, and distilled spirits so that all alcohol users share in the tax burden. We further recommend that alcohol taxes increase every three years.

Over time, certain of Alaska's tax rates have fallen below the national norms, or have not kept pace with inflation.

We recommend the following increases:

Motor fuel taxes

- Increase motor fuel tax increases from the 1961 level of 8 cents/gallon to the national median of 22 cents/gallon (raises \$39 million annually, beginning in FY98). This tax should be indexed to inflation, so it rises as consumer prices rise. The Commission believes these tax receipts should be used to fund road maintenance efforts at the State and local level.

Marine motor fuel taxes

- Increase marine fuel taxes by 3 cents/gallon (raises \$5 million annually, beginning in FY98). This tax should be indexed to inflation, so it rises as consumer prices rise. The Commission believes these tax receipts should be used to fund port and harbor maintenance efforts at the State and local level.

Motor vehicle license plates

- Double motor vehicle license fees and eliminate exemptions (raises \$29 million, beginning in FY98). These fees are currently well below the national average.

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User fees

- Raise user fees by approximately \$3 million annually and index fees to inflation where practicable.

Fishery and other resource taxes

- Increase taxes on fisheries and other resources by \$30 million.

New taxes and changes to tax apportionment include:

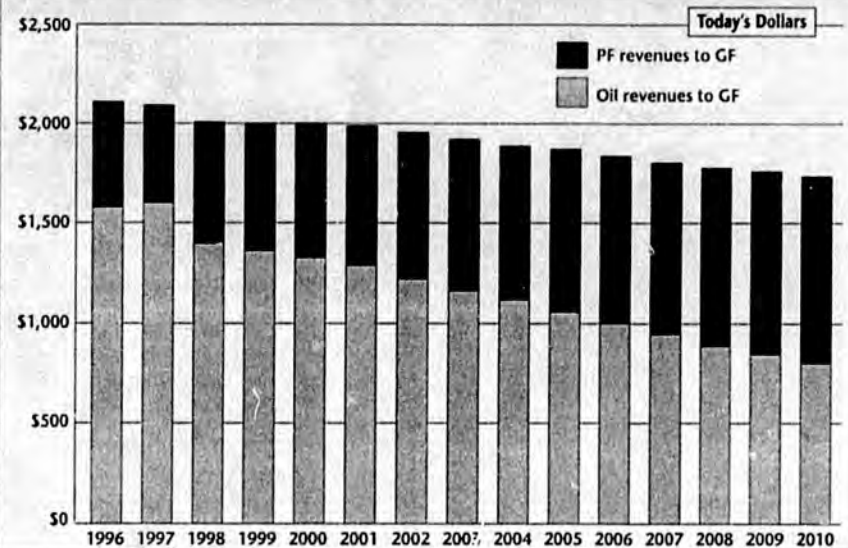
- Establish new taxes to generate at least \$20 million from tourists. While the Commission was unable to reach consensus on the precise method for gaining additional revenue from tourists or the tourism industry, The Commission believes this part of our economy does not fully pay for the State's cost of providing infrastructure and support to the industry.
- The Commission believes the State's oil and gas production property tax, currently set at 20 mills, should benefit both the State and local governments affected by oil development. State law should be amended to limit the local government share to 10 mills on new oil and gas properties built after 1995, ensuring the State receives at least 50 percent of this revenue source.

The Commission considered additional taxes on the oil industry. We found that Alaska is currently in the mid-range of oil taxation nationally. We believe that Alaska is already too dependent upon oil revenues, and that higher oil taxes would create a disincentive to attract and retain petroleum development in Alaska. We believe our plan for closing the fiscal gap and providing a stable revenue and spending climate will ultimately result in increased petroleum revenues as the industry responds by further investment in Alaska oil exploration, development and production.

Establish the Permanent Fund as an endowment

When the Permanent Fund was established in 1976, public debate centered on setting aside a portion of today's oil wealth to meet the needs of future generations of Alaskans. Later, the Legislature adopted the dividend plan to heighten public interest in preserving the fund and guarding its investment performance, and to directly distribute some of Alaska's oil wealth to its citizens. The Commission believes it is time to follow the original intent of the fund, preserving current capital wealth for current and future generations of Alaskans. The Commission believes the best method for doing this is to follow traditional endowment principles. For our Permanent Fund those principles include preservation of the fund, the best possible level of performance of the fund, and the preservation of Alaska's oil wealth for future generations of Alaskans.

Permanent Fund Earnings Replace Oil Earnings



Our plan calls for the Permanent Fund to grow as an endowment for the State.

- The plan establishes the Permanent Fund as an endowment that pays up to four percent of the Fund's five-year average market value to the general fund for the dividend program and State services. This use of Permanent Fund earnings will partially replace declining oil revenues. The Commission recommends a four percent payout based on the experience of other endowment funds in the United States, and takes into account the Permanent Fund's earning experience, asset allocation, and need to protect the principal.
- Earnings of the Permanent Fund in excess of this four percent payout rate are retained in the fund. Years with good investment performance will, over the long run, balance years with poor investment performance in order to more than fully inflation-proof the fund.
- The plan calls for an increase to 50 percent of the minimum contribution to the Permanent Fund from certain oil, gas and mineral lease revenues. The plan calls for an amendment to the constitution to achieve that increase.
- The endowment is further built up by a deposit from the Permanent Fund Earnings Reserve and deposits of any funds in excess of \$1.5 billion in the Constitutional Budget Reserve.

Cap the Permanent Fund Dividend pool

The Permanent Fund Dividend program is an important source of protection for the principal of the Permanent Fund and it is important source of income to Alaskans. Without

changes to the program, however, dividends will grow to take a major share of State revenues — \$965 million in 2005. The Commission recommends:

- Reduce the total amount spent for the Permanent Fund Dividend program from \$565 million this year by \$50 million a year for three years.
- Individual dividends will be about \$900 next year, \$800 in 1997, and \$700 in 1998.

Clarify the purpose of State's reserves

The State maintains two reserve funds that are important in the effort to close the fiscal gap — the Constitutional Budget Reserve (CBR) and the Permanent Fund Earnings Reserve Account (PFER). The CBR consists of funds received in settlements of administrative proceedings or litigation regarding mineral lease bonuses, rentals, royalties, royalty proceeds and taxes. The PFER is a holding account into which is deposited all investment income until the transfers to principal for inflation proofing and to the dividend fund are made. Excess funds in the PFER are held and invested in the same manner as the principal of the Permanent Fund. The Commission determined that under our plan the state needs only one significant reserve.

- The CBR should be maintained at a level of \$1.5 billion to provide stability in the event of a rapid decline in oil prices or production or in the event of a natural disaster. That amount is approximately one year's oil revenues. Funds in excess of that amount should be deposited into the principal of the Permanent Fund. Earnings from CBR investment should continue to flow into the CBR.

Funds in the CBR should be invested in accordance with the prudent investor rule based upon the purposes of the reserve. The commission recommends that the general fund be allowed to borrow against the CBR to even out the flow of funds required to meet monthly cash flow needs.

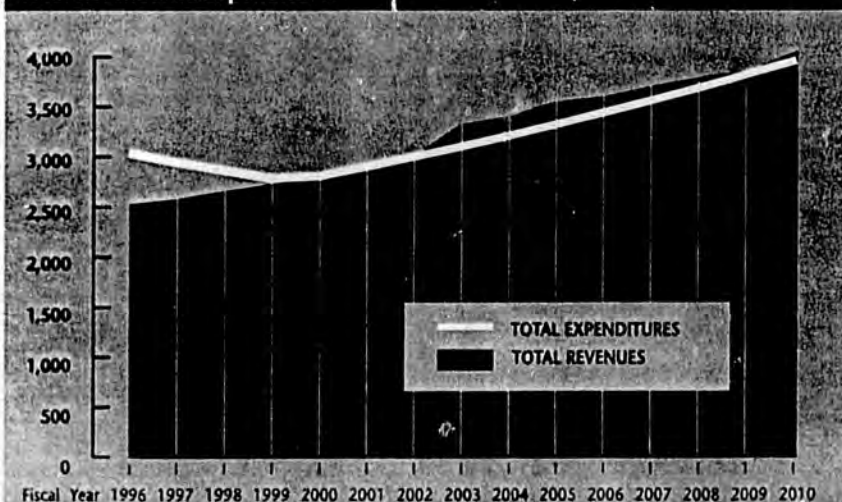
The sweep provisions in the current CBR should be eliminated (Article X, Section 17 (d) of the Constitution). Sufficient controls on the use and withdrawal of funds from the CBR are achieved by limiting withdrawals from the fund to make up for projected annual revenue deficits rather than availability of funds.

Once the constitutional amendment establishing the Permanent Fund as an endowment is in place in FY98, all funds in the Permanent Fund Earnings Reserve should be deposited into the principal of the Permanent Fund. As an endowment, the Permanent Fund will be effectively inflation-proofed. The dividends will be payable out of the automatic annual withdrawal.

Reform the budget process

The Commission found the budget process does not yield

Total Revenues vs Expenditures



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State Long Range Financial Planning Commission Report

FINAL REPORT

How Big Is The Fiscal Gap? \$524 Million in Fiscal Year 1996

- Equal to all the salaries and benefits paid to all state agency employees
- Almost as much as the whole Permanent Fund dividend program
- It equals three-quarters of the entire K-12 public school funding program

Continued From Previous Page

adequate information concerning the State's finances, nor does it describe what we get for what we spend. It discourages appropriate scrutiny of overall State spending. Although the fiscal gap relates to State general fund spending, special funds set aside or collected affect services delivered by the State and require oversight and control.

- The budget process should include review of all State spending, not just State general funds. The executive and legislative branches should establish procedures to provide appropriate scrutiny and disclosure.

- A report to the public should be prepared annually on progress toward closing the fiscal gap. The Commission suggests the spreadsheet format it has used to show the existence or absence of a fiscal gap for the current and succeeding 10 years.

- The legislature should review each program funded or operated by the State, including loans and special appropriations to determine whether or not it meets its intended purpose and whether the program is needed in the 21st century. State programs should also be reviewed to determine if the service is better delivered at the local level.

- Capital improvement funding should be based on a six-year plan to achieve greater efficiencies in funding, planning, construction and maintenance.

The Commission was asked to examine the division of responsibility for providing services and raising revenues between the State and local governments. This area deserves intensive examination, substantially more than the Commission had time to give it. The Commission believes that the State and local governments must continue to work on the issue of the division of State and local responsibilities.

The five- and ten-year plan

In 1999, Alaska comes to a fork in the road. To prevent the

fiscal gap from reappearing, we can cut the budget further, reinstate the State personal income tax, increase other taxes, and/or further reduce dividends. The Commission recommends that a follow-up review be done in late 1998 and early 1999 to adjust the overall plan as needed for the succeeding five to ten years. By that time the budget should balance and we will know more about several things that are now uncertain such as ANWR, the gas line and federal budget changes. As a result, decisions for the first decade of the next century will be less dependent on speculation.

This Commission recommends reimposition of the State personal income tax once the deficit reappears. Under the Commission's plan, after cutting spending and raising revenues, the fiscal gap reappears in about the year 2002. A personal income tax act will require enactment in the year 2000 in order for it to take effect in 2002.

First Session Progress Report on the Financial Plan

Legislation

1. Resolution approving financial plan.
2. Permanent fund endowment constitutional amendment goes to the voters.
3. Constitutional budget reserve constitutional amendment goes to the voters.
4. Retirement incentive program.
5. Tier III to reduce retirement costs for new hires.
6. Geographic pay differential for non-covered employees.
7. Road/harbor transfers to local government and fuel tax increases.
8. Senior/veterans tax exemption becomes local option.
9. New oil & gas property tax has 50/50 split before debt.
10. Tobacco tax increase.
11. Alcohol tax increase.

12. User Fee increases of at least \$3 million

Budget Action

1. Meet fiscal gap target (about \$390 million); \$40 million cut from FY96.
2. Show all funds in State spending plan.
3. Deposit from CBR into Permanent Fund as in plan.
4. Administrative consolidations.
5. Six year capital plan approved.
6. Show Permanent Fund earnings and dividends as part of budget.
7. Do maintenance and deferred maintenance within budget target.
8. Start performance based budgeting.
9. Reduce growth rate of Medicaid and AFDC.

Second Session Progress Report

Legislative Action

1. Fisheries and other resource tax.
2. Tourism tax or self-support of industry promotion.
3. Deposit from CBR to Permanent Fund as in plan.
4. Additional \$3 million in fee increases/indexing.

Budget Action

1. Meet fiscal gap target of about \$220 million; \$70 million cut from FY96.

Third Session Progress Report

Legislative Action

1. Resolution creating financial planning Commission to review progress and make new recommendations.

Budget Action

1. Meet fiscal gap target of about \$60 million; \$100 million cut from FY96.

What The Plan Does

- Makes the Permanent Fund the cornerstone of Alaska's fiscal future
- Closes the fiscal gap by the year 2000
- Ensures growth of the Permanent Fund to offset declining oil and gas revenues
- Stabilizes and diversifies revenues
- Controls state general fund spending
- Maintains a reserve to dampen the effect of oil price swings
- Decreases our dependence on volatile oil revenues

State Long Range Financial Planning Commission Report

FINAL REPORT

LONG-RANGE FINANCIAL PLANNING COMMISSION	(Today's Dollars)									
	FY 1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
AVAILABLE REVENUES (\$ Millions):										
General Fund Source	1,952	1,882	1,669	1,641	1,607	1,575	1,509	1,464	1,414	1,362
Permanent Fund Earnings (Net of inflation proofing & ERA deposits)	565	500	630	648	677	700	727	759	785	810
NEW TAXES AND FEES (\$Millions)										
Highway Motor Fuel Tax (@ \$.219/gal., indexed)	-	38	39	39	40	41	41	42	43	43
Marine Motor Fuel Tax (\$.08/gal., indexed)	-	5	5	5	5	5	5	5	5	6
Tobacco Tax (\$1/pkg cigs; 75%chewing; +25c triennially)	-	42	41	40	50	49	48	57	56	55
Motor vehicle license fees (double)	-	-	27	27	26	26	26	25	25	24
User fee increases	-	3	6	8	11	13	12	12	12	11
Fishery and other resource tax increases	-	-	28	28	28	28	28	28	28	28
Tourism tax increases	-	-	19	19	19	19	19	19	19	19
Alcohol taxes (increase triennially)	-	19	19	19	22	22	22	21	25	25
Income tax	-	-	-	-	-	-	58	224	227	230
TOTAL REVENUE	2,517	2,490	2,483	2,475	2,485	2,478	2,495	2,656	2,639	2,614
EXPENDITURES (\$ Millions):										
Total GF spending on current programs	2,476	2,365	2,264	2,167	2,118	2,135	2,152	2,169	2,186	2,204
PF Dividends	565	500	438	378	367	356	345	334	324	314
TOTAL EXPENDITURES	3,041	2,865	2,702	2,546	2,485	2,490	2,496	2,503	2,510	2,517
PROJECTED ANNUAL FISCAL GAP (\$ Millions)	(524)	(376)	(219)	(71)	1	(12)	(1)	153	129	97
CONSTITUTIONAL BUDGET RESERVE ENDING BALANCE (\$ Millions)										
	1,500	1,456	1,412	1,368	1,326	1,285	1,245	1,207	1,170	1,134
PERMANENT FUND EARNINGS RESERVE ENDING BALANCE										
	922	1,194	-	-	-	-	-	-	-	-
PERMANENT FUND MARKET VALUE (\$ Millions)										
	17,766	17,625	19,391	20,131	20,804	21,459	22,110	22,897	23,657	24,379
PER CAPITA PERMANENT FUND DIVIDEND										
	990	852	727	611	582	553	526	501	475	452
PER CAPITA SPENDING										
	4,938	4,579	4,250	3,941	3,786	3,735	3,685	3,636	3,589	3,543

Special Acknowledgements

The members of the Long Range Financial Planning Commission acknowledge with thanks the contribution of its staff: Brad Pierce, Melissa Fouse, and Bob Walsh. Thanks are due also to House Speaker Gail Phillips, Representative Richard Foster, and OMB Director Annalee McConnell for sharing their staff resources with the Commission.

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The State Long Range Financial Planning Commission Members

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State Long Range Financial Planning Commission Report

DISSENTING OPINIONS

By State Sen. Steve Rieger

The Long Range Financial Planning Commission has identified a series of measures which would balance revenues and expenditures over the next ten or more years. However, the final Commission Report goes beyond that task, and recommends additional taxes beyond those which are part of closing the fiscal gap, and which instead serve to place additional money into the corpus of the Permanent Fund. These additional measures are excessive.

The major reason for concern about the fiscal gap was the prospect that, if action was not taken, there would be a crisis reached which would trigger a sudden drop in state spending and threaten the economy and people's jobs, or a major (in the nine figures) new tax such as an income tax or statewide sales tax, or both. These outcomes are all avoided in the Minority Report's plan. However, a major new tax is included in the Commission report.

The Composite Scenario

A set of meaningful but non-precipitous budget cuts, a series of smaller taxes and fees, and use of a portion of the Permanent Fund's earnings after inflation-proofing, closes the gap entirely for about a decade. Under a "Composite Scenario"

developed during the Commission's deliberations, (and using the Commission's assumptions), by the year 2010 these measures would also result in a Permanent Fund balance of almost \$30 billion and additional cash reserves of over \$5 billion. In today's dollars these numbers would be over \$19 billion and \$3 billion respectively. The Composite Scenario represents a reasonable course for Alaska.

Where the Commission Report and the Minority Report part company most dramatically is the extent to which they pursue the goal of making the Permanent Fund an "endowment" for future government spending. To pursue this thought, the Commission Report recommends diverting an additional \$250 million of today's royalties away from the general fund and into the Permanent Fund, thereby cutting the present state revenue stream by approximately \$250 million per year and actually increasing the fiscal gap; by dumping most present or forecast cash reserves into the Permanent Fund; reducing the dividend payout more than in the "Composite Scenario" referred to above; imposing an additional \$40 million to \$50 million per year in small taxes over those used in the Composite Scenario; and by imposing a major new personal income tax generating \$385 million per

year by the year 2010. These measures, including the smaller reserves, result in a Permanent Fund which is a little over \$40 billion in the year 2010, or the equivalent of \$26 billion in today's dollars.

In the Minority Report's view, these additional measures are not worth the sole accomplishment of a Permanent Fund which is 1/3 larger in size. They do not succeed in creating an endowment for state spending, and impose taxes where they are not needed. The Permanent Fund can be a very substantial source of stability and cash for the future. However, in neither the plan advanced by the Commission nor in the Composite Scenario does it come even close to being the sole source of funding for state government.

The fiscal gap can be closed satisfactorily for the next decade with a much more modest set of measures. These measures would be similar to those shown in the Composite Scenario referred to above. A full version of this Minority Report and the Composite Scenario spreadsheet are available by calling 258-8188—we will mail it to you.

State Sen. Steve Rieger, R-Anchorage, was a member of the State Long Range Financial Planning Commission.

By State Rep. Sean Parnell and Hugh Motley

The Commission's Plan Failed to Recognize and Address Alaska's Fundamental Problem: Unstable, Unpredictable Revenues

- Alaska depends upon volatile natural resource revenues for state spending.
- Alaska spends those resources, under the current system, at an unsustainable rate.
- A sustainable level of government spending cannot be defined until Alaska has a *stable* source of revenue.
- The Commission spent the majority of its time grappling with how to close the present fiscal gap rather than focusing on how to stabilize Alaska's revenue stream.
- Alaska's revenue stream must be stabilized and made sustainable for a healthy future: long range planning is impossible without a predictable revenue stream.

The Commission's Plan Is Unacceptable to the General Public

- The plan assumes the current level of government

spending is acceptable and sustainable.

- The public does not accept this premise and will not accept the plan's recommendations for new taxes, cuts in permanent fund dividends, and expending permanent fund earnings to increase state government unless more meaningful reductions are made.
- The Commission's plan recommends creating a partial endowment using the permanent fund to increase spending.
- The Commission's partial endowment fails to stabilize revenues and fails to define a sustainable level of spending.
- The Commission's plan relies on "faith in the Legislature" rather than building fiscal restraint into the legislative budget process.

The Benefits of a True Endowment System

- The true endowment establishes a stable and sustainable level of revenues for state funding.
- The true endowment constitutionally forces fiscal restraint upon the Legislature and Governor.
- The true endowment strengthens and protects the permanent fund.

- The true endowment constitutionally protects future windfalls (ANWR taxes and royalties, for example) by depositing them in their entirety to the corpus of the permanent fund.

Principles to Use for Closing the Present Fiscal Gap

- Once resource revenues have been stabilized through a system, a long range financial plan can be developed.
- A fiscal plan should prioritize meaningful budget reductions before taxes.
- State agencies should be consolidated to operate more efficiently.
- Voters, not the Legislature, must approve an income tax.

State Rep. Sean Parnell, R-Anchorage, was a member of the State Long Range Financial Planning Commission.

By Senator Georgianna Lincoln

A Different Opinion

While I believe the Long Range Financial Planning Commission did an admirable job identifying the options for closing Alaska's ever-widening fiscal gap, I have concerns that lead to this opinion. I did vote to advance the final document to the Governor and the Legislature, as did the majority of the Long Range Financial Planning Commission. However, I do not believe any commission member considered this to be an endorsement of *everything* within the report. It must be pointed out the commission was given a huge task to accomplish within a very short time and with an extremely small budget.

I applaud the commission for giving the public the opportunity to participate in its work, with serious attention paid to the comments throughout our deliberations. One subject which received, in my opinion, strong public support has not been incorporated into the commission's recommendations and that is reinstitution of the state income tax now. During my years in the legislature, I have wrestled with the wisdom of such an action. Since 1990, Alaska has grown by approximately 100,000 residents with as much as 25 percent of our

work force being non-resident; non-residents contribute little to our economy but take much from it. The current plan recommends immediate introduction of a number of smaller taxes based on use with the state income tax implemented after the year 2000. I believe a state income tax, which taxes everyone (resident and non-resident) equitably, would result in a reduction to the state's fiscal gap, but would not result in such a huge, immediate reduction in state government programs as proposed by the commission. Recommended cuts to these programs would devastate those who can least afford them — our youth, our elders, and the disadvantaged. Again, it was my sense in listening and talking to citizens across the state that folks are willing to reinstate the state income tax now and not later as the commission report recommends.

We do not know specifically what Washington D. C. will do within the next year in terms of revisions and/or reductions to programs such as welfare reform, Medicaid, and the transfer of federal responsibility for services such as transportation and education to the State. We do know many of these decisions will have a major negative fiscal impact on our Alaska citizens.

Further, I believe economic opportunity is another key to closing the fiscal gap. Jobs, jobs, jobs!!! This plan does not go far enough in providing incentives for entrepreneurship or enhancing economic opportunity throughout our state. In failing to do so, the plan does not propose solutions to diversify the economy, create jobs, and end the vicious cycle of welfare. We must analyze, in the proper perspective, the impacts of closing the fiscal gap in a rational manner. Without question, the state must cut spending to close the fiscal gap. Although I support many of the commission's current recommendations, I caution those responsible for implementing a final plan to ensure cuts are spread equitably and economic and job development reaches the smallest of communities throughout our great state.

State Sen. Georgianna Lincoln, D-Rampart, was a member of the State Long Range Financial Planning Commission.