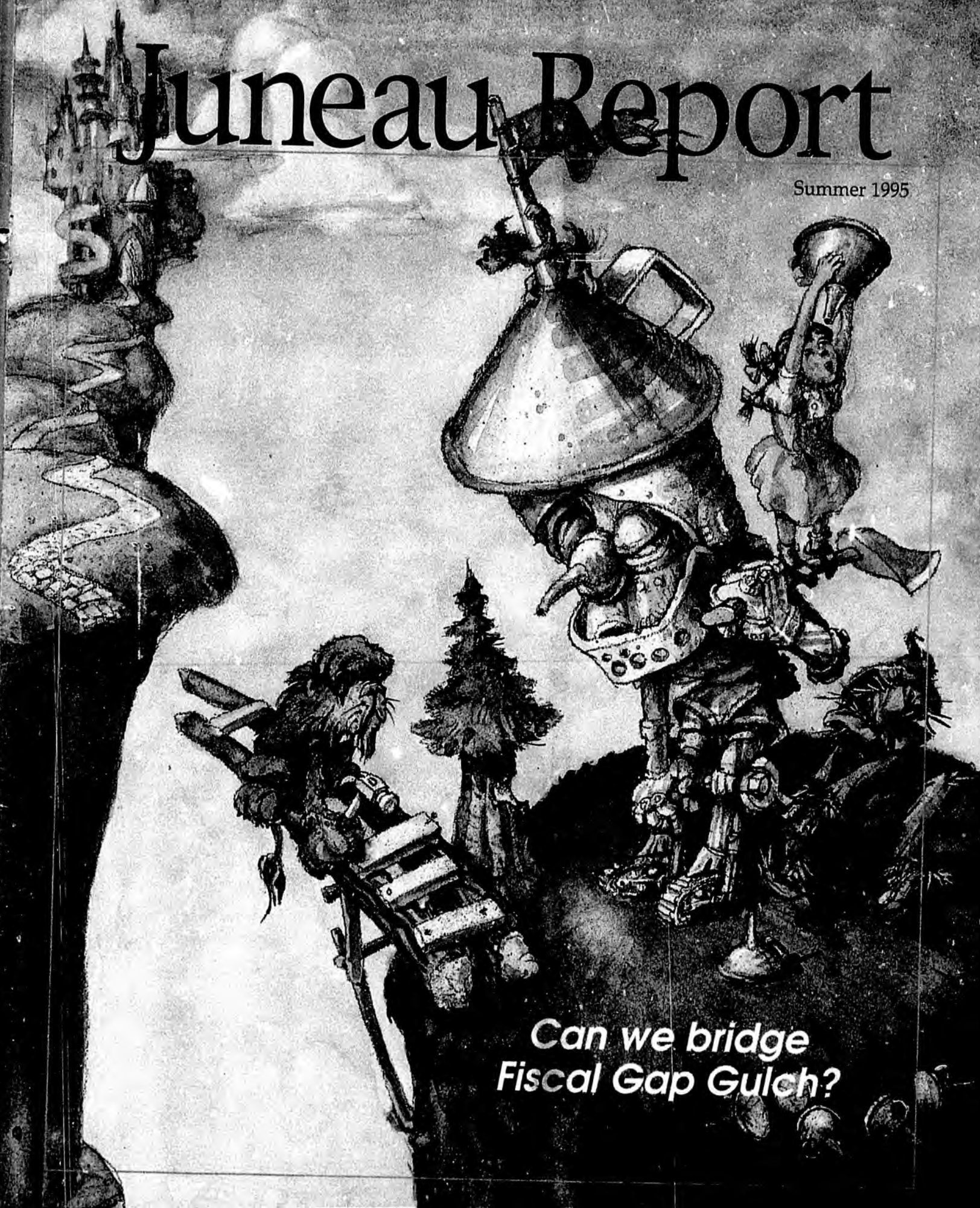


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Juneau Report

Summer 1995



*Can we bridge
Fiscal Gap Gulch?*



BADAMI WELLS COMPLETED—Nabors Rig 18-E drilled one of two appraisal wells this past winter at BP's Badami prospect, on the Arctic coast about 30 miles east of Prudhoe Bay. The other Badami well was drilled by Doyon's Rig 9. Badami is one of several economically marginal prospects being considered by BP and its partners.

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Dear Alaskan:

With this issue, we premier a new format and design for *Juneau Report*, the quarterly public policy magazine published by BP Exploration for its employees, business associates and others. *Juneau Report* articles are written by writers outside BP, to focus attention on important public policy problems facing Alaska. The articles do not represent the opinions of BP's management or its employees, but are intended to foster dialogue, debate and, hopefully, resolution of public policy issues.

In this issue we discuss the state's fiscal gap, and options for its resolution. This is of interest to BP, the state's major taxpayer. But it also has major consequences for all Alaskans.

We welcome your comments.

Jim Palmer
Director, External Affairs
BP Exploration (Alaska) Inc.

The *Juneau Report* is published by the BP Exploration External Affairs Department to provide an overview of issues and legislation as they relate to the petroleum industry. Opinions of authors expressed here do not necessarily reflect the opinions of the company. Inquires should be directed to BP External Affairs: 564-5504 or 564-5489.



Building the Bridge

Tools are available to span the fiscal gap..

If Alaska delays implementing a plan to deal with the fiscal gap, state government will run out of money in five years, according to projections by the University of Alaska. The resulting spending cuts and taxes could severely damage Alaska's economy. The \$15 billion Permanent Fund may be at risk.

But there are options and tools to bridge the gap. They include intelligent spending cuts and new

revenues. With the state's fiscal house in order, one big impediment to new investment will be removed. If we do this right, the future is bright.

Think of it as bridge construction. The chasm to be spanned is "Fiscal Gap Gulch." If Alaska totters into the gulch, bad things happen: the state's economy turns sour (one in three Alaska jobs now depends on its oil-fueled state budget), municipal taxes soar to make up for lost shared revenues, and the quality of public services (particularly schools) sinks.

To paint the picture even darker: At some point, things might get so bad the \$15 billion Permanent Fund may be in jeopardy, as well as its dividends. And then, Alaskans may wind up paying high state taxes anyway.

But things don't have to be like this. Alaska has potential for a very bright future. With the diversity of its resources and the natural beauty of its landscape, there's no reason

ducers can't develop new fields fast enough to replace the declining production. State revenues (85 percent dependent on oil) are dropping. The State of Alaska is now half a billion dollars a year in the red. In a few years, it will be a billion dollars a year in the red.

State leaders have sustained spending by drawing down various state cash reserves and assets. In FY 1995 they took \$518 million. In FY 1996 they will take about \$575 million. At that rate, according to projections by the University of Alaska, the account will be empty in five years, except for, of course, the \$15 billion Permanent Fund. That's why it's vulnerable — if nothing is done about the fiscal gap.

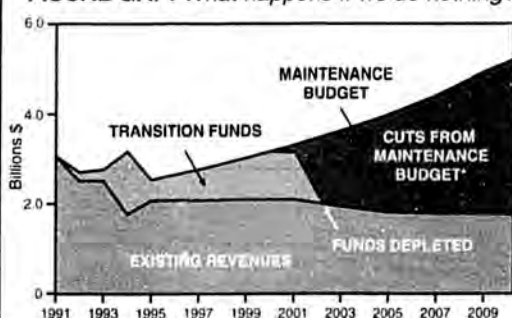
The solutions are only a bit more complex: State leaders have to cut spending. That's already starting to happen. Alaskans then have to think seriously about what they really want government to do, and then cut out the frills, the luxuries, to get to the basics. Alaskans need to "re-invent" government, too, reorganizing many programs to make them function more efficiently.

But cuts alone won't cover the gap without severe damage to Alaska's economy and public services. Cuts alone are not an option.

But an intelligent plan for cutting, combined with an intelligent plan for new revenues, will do the job. In fact, it's really our only option. One way or another, Fiscal Gap Gulch will be bridged.

New revenues" includes new state taxes of some sort, hopefully modest. It should also include some changes to Permanent Fund income management, so that the \$15 billion fund, which earns about a billion dollars a year, can make some meaningful contribution to public services.

FISCAL GAP: What happens if we do nothing?



* Maintenance budget assumes increase for inflation, 1% annual population growth
Source: University of Alaska Institute of Social and Economic Research

Alaska can't have a diversified, prosperous economy, continuing petroleum production, high-quality public services, and be a nice place to live as well. But the fiscal gap threatens all that.

There is a solution, a bridge over the chasm, so to speak. The tools to build the bridge are available now. They're widely recognized by knowledgeable political and community leaders. But the will to use them is weak. The public is confused.

The problem is fairly simple. Alaska's big North Slope oil fields are running down and oil pro-

Fiscal Gap

Safe landing strategy

What's the impact of \$1 billion state budget cut?

If Alaska fails to adopt a long-range fiscal plan, the state will keep spending until it runs out of money. The sudden, large cut of about \$1 billion in the state budget forced then will have drastic economic effects. The last time Alaska saw \$1 billion suddenly cut from the budget was in 1986, which triggered a sharp economic recession in Alaska. Here were some of those effects:

- State job loss: 22,000 (10 percent)
- Anchorage population loss: 29,000 (9 percent)
- Decline in Anchorage assessed property value: \$7.2 billion (46 percent)
- Residential properties foreclosed on, January 1985-March 1988: 10,429 (7 percent of total)

Source: University of Alaska Institute of Social and Economic Research

This was, after all, what Alaskans had in mind when they created the fund in 1976. The idea was to save part of the oil earnings to help sustain public services, and avoid ruinous taxes, when oil money winds down. The idea of the Permanent Fund dividend came later, in 1980.

But now, dividends and the required "inflation-proofing" of the Permanent Fund consume almost all the fund's income. The way the formulas are constructed in state law, there really won't be any money left to support public services.

So, why not just change the formula so all three goals, dividends, "inflation-proofing" and money for the treasury, are met? It's possible. But politicians are cautious in doing anything that might depress — or even appear to depress — the growth of dividends.

The alternate of devising an intelligent plan — postponing and doing nothing — only makes the pain worse

in five years when the ready cash reserves are gone and Alaskans arrive at the chasm. They had a sample, in 1986, of what happens when a billion dollars a year is suddenly taken out of the state's economy. It could be a portent of things to come.

Developing blueprints for the bridge over Fiscal Gap Gulch is the job of the new state Long Range Financial Planning Commission created this spring by the legislature and Gov. Tony Knowles. The panel is composed of veteran legislators, administration officials and several citizens who have had some experience with business, politics and public sector fiscal management.

The real purpose of the panel, of course, is to provide political "top cover" for the governor and legislators, something like what the Base Closings Commission does for Congress.

When the time comes for the tough decisions, Alaska's leaders feel they will need some support, from at least the citizen members of the commission. They'll need that, and more.



The University of Alaska's Institute of Social and Economic Research, after a lengthy study of the state's pending fiscal gap, developed a "safe landing strategy." It is a plan to cover the gap by gradually reducing spending, raising revenues and using several billion dollars from various reserve accounts to cushion the transition to a sustainable state budget.

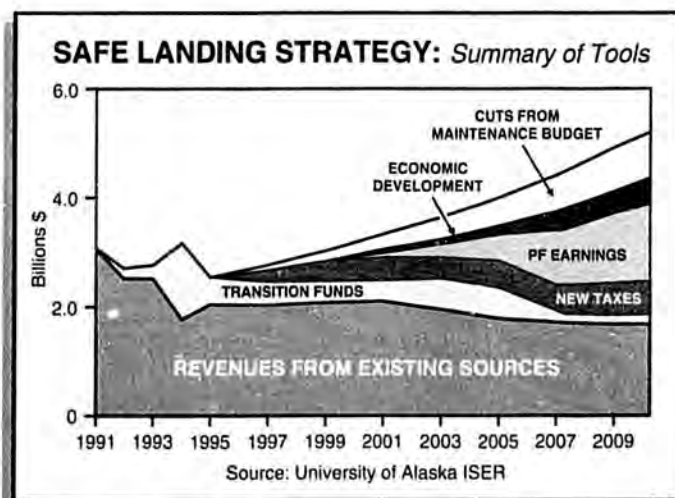
Key elements in ISER's plan:

- Freeze budget growth and constrain increases at less than inflation, effectively shrinking real (inflation-adjusted) state spending by 20 percent by 2000.

- Phase out Permanent Fund dividends. Retained earnings would increase the fund by over \$2.5 billion. After 2002, use a portion of the earnings to pay for government.

- Reinstate an income tax immediately; it would bring in approximately \$250 million

annually, after a two year startup. If local governments choose to increase taxes to national averages, they could offset \$150 million in reduced state revenue-sharing.



Can we cut the budget?

Why is it so hard to cut state spending? Institutional factors partly explain it: There's no incentive for agencies to save and send unspent money back to the treasury, for example.

But more important: constituent groups are quick to organize lobbying for spending, but not for cutting. For elected officials, it's difficult to say "no" with constituents at the door.

Why can't we just cut our \$2.5 billion state budget to live within our means? Alaska spends much more (per capita) than any other state. Surely there's a lot of bureaucratic "fat" to be trimmed.

Easy to say that, from the outside looking in. From the inside, not surprisingly, things look different.

Constituent groups who support particular programs, or projects, are quick to mobilize and lobby their elected officials. But there's no organized lobby for budget cuts. Faced with constituents at the door, it's difficult for a legislator to say no.

Actually cutting the budget raises other problems: Almost half of the operating budget consists of the big formula programs in which state statutes link spending to external factors, like school enrollment growth, inflation, welfare or Medicaid caseloads, or municipal population growth.

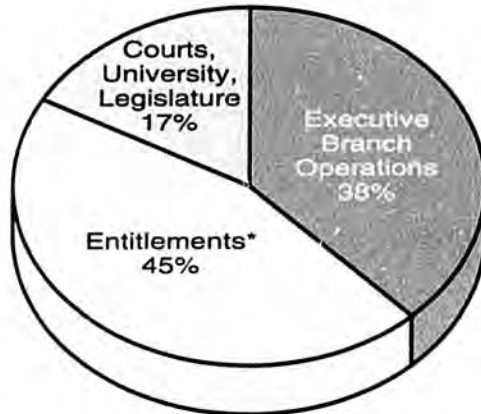
Cuts in the school foundation program, or state money shared with municipalities, result in local service cuts, local tax hikes, or both. Other formula programs, such as welfare and Medicaid, are tied to federal programs. Cuts are possible, but it's a painful, controversial and complex process.

Operating state agencies consume slightly over half the operating budget. Over the last few years, spending for these units—ranging from executive branch agencies to the University of Alaska and the courts—has been reduced. But increases in formula programs, driven mainly by population growth, have eaten up the savings.

State personnel costs also increase continuously. The big public employee unions have been able to bargain for increases when labor contracts come up for renewal, although recently most of these have been less than the rate of inflation.

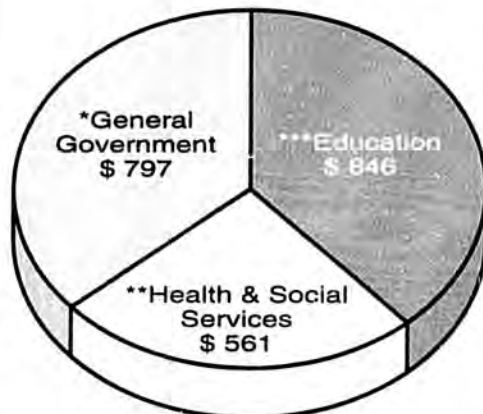
But there are still perks in the system: Most state employees routinely get "merit" increases, to the point they're now considered almost an entitlement.

Fiscal Year 1995 State Operating Budget Breakdown (general funds only)



* Entitlements are in funds transferred to others, mostly in education, welfare, medicaid and senior longevity bonuses.

FY 95 Spending by Service Area (\$ Millions)



* Gen. Government includes: transportation, development, admin. of justice, public protection and natural resource mgt.

** Health & Social Services includes: welfare, medicaid

*** Education includes: state funding to local schools, university

Source: Cheryl Frasca, Fiscal Notes



Where does the money go?



Rep. Mark Hanley, of Anchorage.

Photo Paul Helmar

Public employees, and teachers, also have generous medical benefits and retirement plans.

Why is all this so hard to change? If there's political gridlock in attacking the budget, it is largely institutional, resulting mainly from the way government bureaucracies and elected officials interact with each other. (The problems are familiar in other states and in Congress.)

Unlike private business, performance in government is usually judged by how much budget an agency administrator can garner. There's no incentive to turn back unspent money. Even if there's a desire among top appointed or elected officials, agency managers know that commissioners, governors and legislators come and go. The technical knowledge of how things really work is in the agency staff. No

matter how dedicated a commissioner might be, his or her tenure is usually too short to bring about substantial change. An example is that during Gov. Hickel's four years in office, there were three commissioners at the helm of the Dept. of Transportation and Public Facilities, the largest and, arguably the most unwieldy state agency.

Except in very crude ways, it's difficult for legislators to make cuts by themselves, because operating agencies have the technical knowledge of how programs work.

Without access to that information, it's hard for lawmakers to make significant program

reductions.

If state employees have ideas for cost savings, they are usually reluctant to share them with the legislature or even with the governor's Office of Management and Budget, the executive branch unit responsible for the fiscal big picture.

One way legislators can force cuts on agencies is through crude across-the-board "unallocated" percentage cuts, which apply to every agency, large and small. Lawmakers have ordered several of these across-the-board cuts on agencies in recent years.

The problem is that these kind of cuts affect agencies in different ways. Small agencies have little flexibility in shifting costs; large ones can spread the pain among several programs. Vital services, like state troopers, are affected along with less traditional programs, such as state subsidies for

(continued on page 8)

Where does all that money go?

The state now spends about \$2.45 billion in general funds yearly. Another \$1.3 billion in other revenues — federal funds and "user fees" — are also spent. Where does all that money go?

- Operating budget: \$2.2 billion this year, to fund state services and programs, employee salaries, building leases, and including grants to organizations, from domestic violence programs to tourism promotion.

- Capital budget: \$109 million this year, mostly for construction projects, including state "matches" for federal highway, airport and harbor funds; repairs to state buildings, and rural water/sewer systems.

- Debt service: \$109 million this year, of which \$80.3 million reimburses school districts for school construction and major repairs. The remaining pays lease costs for state buildings and for voter-approved debt.

About 48 percent of the state budget is in direct grants to others (school districts, municipalities, welfare, senior citizens). Some 30 percent is in employee salary and benefits; 14.2 percent is in contractual services.

Why does Alaska spend so much? Partly because of higher costs, distances and a population scattered in small communities, which defeat any economies of scale.

But mainly it is because of Alaska's "special" programs, the perks remaining from the days of high oil revenues. Until most of these are gone, citizens are unlikely to take the fiscal gap seriously.

(continued from page 7)

rural entertainment TV. Several years of across-the-board cuts have left some state programs approaching non-functional status.

Why does Alaska spend so much in the first place? It's partly because almost all costs are higher, on average, than other states, and partly because a large part of the state's population is scattered across a wide area, clustered in small communities where services can achieve no economies of scale. This has been Alaska's problem since statehood, and is largely the reason why Congress gave Alaska a large endowment of public lands. (The rationale was natural resource income, i.e. Prudhoe Bay, could help offset the lack of a large tax-paying population.)

But mainly, spending is high because Alaska does things no other state does, beginning with annual Permanent Fund dividends paid to every citizen.

There's also the Longevity Bonus Program, which pays senior citizens a \$250 monthly stipend, regardless of assets. There are the state-subsidized Pioneer's Homes, which have evolved from simple retirement homes for seniors to costly nursing facilities.

Suggestions that some of these benefits be available only on a need basis (so that upper-income seniors don't get them or pay their own way) have been fiercely resisted by seniors' groups.

There are other special programs: Multimillion dollar subsidies for high-cost electrical generation are paid to rural utilities; public radio and TV programming is supported; a fleet of state ferry vessels is subsidized.

Legislators did finally crack the Longevity Bonus program. It is now on a gradual phaseout. Next year, for the first time, it will require about \$800,000 less (the current year budget is \$73.4 million). Rural electric subsidies are on a kind of phaseout: Two years ago the legislature set aside a fund sufficient to finance the subsidy, (which takes about \$17 million a year) for five years. That at least defers the political obstacle of terminating the program now and gives rural utilities time to plan for a possible cutoff.

Alaskans also have some perks that no longer require subsidies: Alaska Housing Finance Corp., given a generous \$1.5 billion endowment in the early 1980s, builds rural, low-income and seniors' housing and underwrites many middle-class home mortgages. AHFC is not only self-sufficient, it makes a profit.

In similar good shape is the Alaska Industrial Development and Export Authority, which helps finance private commercial and industrial development in partnerships with banks and private companies. The

In inflation-adjusted dollars, state's operating budget has dropped

State Operating Budgets FY 84-95 in Real FY 95 Dollars (Total General Funds)



Source: State Office of Management and Budget



It's tough to get real cuts



Rep. Gary Davis, of Soldotna. Photo Paul Helmar

state-owned Alaska Railroad Corp. operates freight and passenger trains and makes a profit, although that is because of its revenues from leased lands.

But just stripping state government of its "perk" programs doesn't really save a lot of money — unless the Permanent Fund dividend is included. Ending state ferry subsidies gains about \$35 million; eliminating the Pioneers' Homes gains about \$25 million; cutting rural broadcast subsidies saves about \$1 million; cutting support to public broadcasting would save about \$5 million.

Permanent Fund dividends — at \$550 million per year — are the big-ticket exception to this. But dividends are so popular they will be impossible to get rid of. (They could, however, be "capped" in some manner, so that their annual growth slows or stops.)

The real savings, most who have studied the problem agree, lie in slowing or stopping the growth in the big formula programs. But that means, in the case of school and municipal funding, passing more of the buck back to local governments, which may mean more taxes at that level.

In the case of welfare and Medicaid,

it means reducing the long-established social safety net that is being challenged today in Congress and many other states.

This year, the leadership of the State House pushed a plan to cut money for welfare, and state employees. Many legislators also wanted to hold education funding at current levels. The formula would require \$18 million more next year, to compensate for increasing enrollment.

Education, welfare, Medicaid and state employee costs consume 75 percent of the operating budget. House leaders argue those programs must share in cuts because no significant savings can be gained from the remaining 25 percent of the budget.

This year, the House Finance Committee proposed \$70 million in cuts from current year spending. Gov. Knowles wanted a more gradual approach. He was unenthusiastic about wholesale cuts to education, or welfare, this year. Much of welfare, he points out, is in the Aid to Families with Dependent Children program.

The solution to welfare is not cutting money but helping people find jobs, the governor argues.



Reps. Mike Navarre, Jerry Mackie and Gene Kubina. Photo Paul Helmar

The legislature achieved an estimated \$46.8 million spending cut in Fiscal Year 1996, the budget year beginning July 1, according to figures from the House Finance Committee. Republican leaders in the 1995 session wanted to cut more.

The state operating budget was about \$5 million higher. Within the operating budget, cuts by legislators of \$21 million in state agency budgets were offset by \$26 million in growth by "formula" programs, such as aid to schools and welfare.

Most of the overall reduction came through lower state debt payments resulting from school and general obligation bonds being paid down, and the fact that a large one-time appropriation to a new state Mental Health Trust in the 1994 legislature was not repeated in 1995.

Three areas Republican legislative leaders wanted to cut were in welfare benefits, state employee salaries and in holding education spending flat, not allowing an increase.

Three quarters of the \$2.4 billion state budget is spent in those areas. To significantly reduce the state budget, cuts will be needed, Republicans argued.

But Democrats disagreed. To secure their required agreement to take \$498 million from the state's Constitutional Budget Reserve to balance the FY 1996 budget, Republicans had to agree to an increase in school spending and not to cut welfare and employee pay.

Education: Rising enrollment hikes cost

Alaskans have always been generous in their support of schools. Education support consumes a third of the state budget, including money for elementary and secondary schools, and the state university system.

As school enrollments rise and state revenues fall,

Alaskans face some tough choices: How can they not only maintain the current system, but improve it?

But the real crisis in Alaska education may be rural schools, which have no alternative to state funding.

As state revenues decline and budgets tighten, the battle over education spending will become fierce. The skirmishing is beginning even now, as the state legislature examines the school foundation formula and whether it "tilts" toward rural schools at the expense of urban schools.



Photo Chris Arend

Despite the fall of state revenue, state population and school enrollments continue to increase. School enrollments were up 4.5 percent and 4.8 percent in 1991-92 and 1992-93, although growth has slowed to 3.1 percent in 1992-93 and 1.8 percent in 1993-94.

Classes are getting larger, which requires more classrooms and teachers. As budgets tighten, some fear a decline in quality of education as the pupil-teacher ratio rises.

Even now, Anchorage schools would be near the bottom of the heap in terms of class size, among U.S. school districts of similar size, were it not for hard-hit California school districts, which are being hammered by recession and Proposition 13 local tax caps.

Despite the criticism of "perks" in Alaska's state budget, Alaskans have always given education a clear priority. A lot of state spending goes to support schools. Even in the lean years before North Slope oil, the legislature voted much of Alaska's more meager public resources to education.

Today about one quarter of the \$2.5 billion state budget goes directly to local school districts for elementary through high school programs. When the University of Alaska is included, education spending reaches about a third of spending.

According to studies by the University of Alaska's Institute of Social and Economic Research, Alaska local governments spend, on average, about a third of their tax revenues to support local school districts.

Schools in organized municipalities vary in their dependence on state funds, but the School Foundation Program (which distributes most state money to local schools) pays about half of all school costs in the state. Anchorage taxpayers, for example, are expected to contribute about \$86.9 million to the municipality's \$352.9 million school budget next year. The rest will be state or federal funds.

Rural schools outside organized municipalities are completely dependent on state, and to a lesser extent, federal funds.

Despite higher Alaskan costs, spending among the state's urban school districts does not seem out of line compared with other parts of the nation. Per-student spending for operations in Anchorage, for example, compares favorably with many school districts of similar size in the higher-cost regions of the U.S. Northwest and



Anchorage school costs about on par

Anchorage's education spending of \$5,965 per student (operating funds only; no capital money) in 1991-92, although well above the national average for similar-sized school districts, was about on par with many northern-state school systems. In that same year, a cluster of school districts in Washington state had expenditures in the same range, from \$6,049 per student in Seattle to \$5,553 in Tacoma, \$4,633 in Kent, \$5,023 in Edmonds.

Schools in Minneapolis spent \$6,886 per student in 1992; nearby St. Paul spent \$6,262. Many southern school districts spent less, like \$3,619 per student in Jackson, Miss., and \$3,561 in Birmingham, Ala. There were exceptions, however: Orleans Parish, La. spent \$7,652; Atlanta spent \$6,161.

Class size statistics, however, paint a different picture: Anchorage's pupil-teacher ratio in 1992 was 22.3, compared with 19.5 in Seattle; 18.1 in Tacoma; 20.7 in Kent; and 21.5 in Edmonds. Even in less affluent schools like Alabama's, pupil-teacher ratios ranged from 17.1 in Birmingham and Huntsville schools to 19.4 in Mobile County.

Source: U.S. Department of Education.

Northeast, according to U.S. Department of Education data.

Several states in the northeastern U.S. spend as much per student statewide (about \$10,000) as does Alaska, although the nationwide average, with the poorer southern states included, is about half what Alaska spends.

As the budget crunch tightens, the public debate will reflect diverse feelings among the public on education policy.

Some critics, for example, propose ending kindergarten — "subsidized" day-care — and suggest elimination of innovative, but costly, educational options, like Anchorage's popular language-immersion programs.

Since 87 percent of Anchorage school costs are in labor, there's also criticism of teachers' salaries and benefits, and unions.

But urban school districts at least have a financial alternative to state funding — the local taxpayer. Rural schools, in small villages with no local tax base, have no alternatives.

Alaska's "bush" schools are expensive because of their remoteness, and small enrollments that create high overheads. There's no hope for the economies of scale enjoyed in urban areas.

Per-student costs in the state-funded Rural Education Attendance Areas averaged about \$15,000 in 1992-93, according to the ISER study, compared with an average of \$9,600 per year in urban schools. In

Anchorage, it is \$7,290 yearly. The figures include operating and capital costs.

Regional boarding schools are an alternative, but they won't save money. The state's one rural boarding school, Mt. Edgecumbe in Sitka, is highly-regarded, but it cost an average of \$15,356 per student in 1992-93, according to the ISER study.

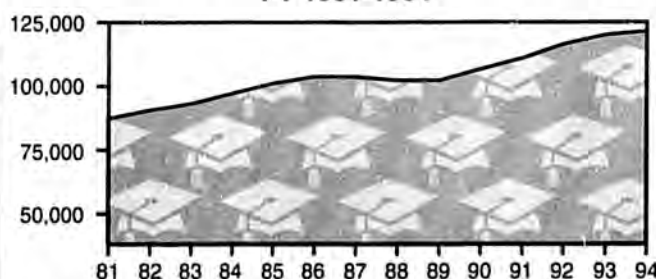
Today many rural students get a poor education because, among other reasons, a variety of teaching specialties are not available in small village schools.

The real crisis in Alaska education is likely to be over rural schools, however, as urban legislators increasingly fight to preserve state education money for their own regions.

That means, whatever else happens, schools will continue to take a big chunk of Alaska's state budget. Unlike most states, where school funding is mainly a local concern, Alaska's constitution makes education in Alaska a state responsibility.

The fight will be over how shares of a dwindling budget "pie" will be divided, and whether the system that remains is relevant to Alaska's unique needs in the emerging global economy.

**Alaska school enrollments are growing
FY 1981-1994**



The rising cost of welfare

Alaska's welfare costs are rising fast. This year state legislators and Gov. Tony Knowles were determined to do something about it.

The legislature wanted to cut benefits but Knowles opposed that because much welfare spending affects children and the disabled.

But Knowles and legislators agreed on getting able-bodied people off welfare and into training and jobs.



Photo Chris Arend

Alaska's welfare costs are growing at alarming rates. The state's benefits are the most generous in the nation. But it's tough for politicians to tackle the problem without striking directly at those society is supposed to care about when they need help: children, the disabled, the blind and the elderly.

This year, Alaska legislators appear ready to take on welfare costs. State House members propose reductions that would lower many benefits to federal minimums. What's unclear is whether the State Senate has the appetite for a cut of that magnitude. Gov. Knowles flatly opposes it, preferring his own plan to get people off the dole and into jobs.

There is some good news, however, in that Alaska has been able to slow welfare cost increases. And a federally-supported program to help get welfare people into jobs is having some success.

Still, the increases are numbing. Between 1990 and 1994, Aid to Families with Dependent Children (AFDC), the largest welfare program, grew 72 percent, from 7,549 families in Fiscal Year 1990 to 12,941 in FY 1994. State contributions (which match the federal contributions) jumped from \$62.4 million in FY 1990 to \$136.1

million in FY 1995. AFDC's cost is projected to decline to \$130.2 million in FY 1996, due largely to cuts in the

program ordered by legislators.

About half of these increases are due to federal mandates requiring two-parent families be included (before, only single-parent families could get AFDC aid). Caseload growth is now slowing, however.

A second major welfare program, Adult Public Assistance (APA), totally funded with state dollars, saw a caseload growth from 6,918 in FY 1990 to 11,176 projected for FY 1996. Expenditures increased from \$24.9 million in FY 1990 to an estimated \$45.4 million in FY 1996. Unlike AFDC, caseloads in the APA program are still growing.

The legislature has shown it can cut welfare. After years of paying generous benefits (Alaska was the last state paying automatic cost-of-living increases) the legislature voted in 1993 to end those automatic increases and roll benefits back to 1992 levels.

Those actions saved \$6.09 million in FY 1994 and \$11.1 million in FY 1995 in the AFDC program. State officials point to another \$4.1 million in savings due to better control of eligibility, fraud control and "enhanced self-sufficiency" (helping people to get jobs).

In Adult Public Assistance, the reductions saved \$3.2 million in the current budget year; next year they will result in a \$4.6 million savings. But APA costs will still grow \$4.2 million because of increased caseloads.

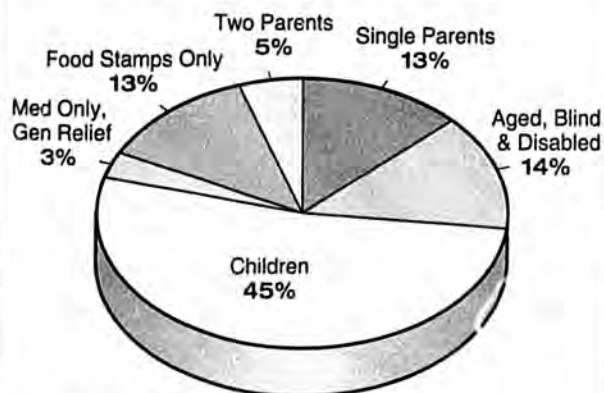
Reducing growth in the APA program will be tough. Unlike AFDC welfare recipients, many of whom are young people needing temporary help and are good candidates for jobs programs, most Adult Public Assistance clients are the disabled or elderly. Employment is not an option, because of physical or mental disability,



Welfare reform

Where does welfare go?

October 1994 payments in Alaska



Alaska Dept. of Health & Social Services

1,100 families applying for AFDC in October 1993, 19 percent had moved to Alaska within the past year.

The hope is that for an increasing number of recipients the experience will be short-lived. The state's Job Opportunities and Basic Skills Program, or JOBS, is one federal mandate (Family Support Act of 1988) that appears to be working. It steers young AFDC parents who lack skills or basic education into training and educational programs.

Since the program started in 1990, 3,700 AFDC parents have gone through the JOBS program, and 2,000 have gone off welfare, subsequently earning \$4.2 million in wages. The savings to the AFDC program have been \$3.2 million. Total savings, including Medicaid and food stamps, is very likely much more.

State lawmakers and Gov. Knowles pushed through big changes in Alaska's welfare programs in the 1995 legislative session. The governor is unhappy, however, with a new five year maximum time period for dependents in the Aid to Dependent Families (AFDC) program that legislators placed in House 78. He may veto the measure.

As it passed, the bill would also establish pilot programs to test the effectiveness of a "workfare" program that would require dependents to work in community service if they can't find jobs; a new 24-month limit for benefits to dependents in training or education courses; liberalization of asset and income limits for dependents who want to start small businesses; and a program for temporary emergency assistance as an alternative to long-term dependency.

Gov. Knowles and Democrats in the legislature successfully fought an effort by Republican legislative leaders to reduce welfare benefits in some categories to federal minimums. Alaska's entitlements are the highest in the nation.

House Bill 78 was sponsored by Rep. Mark Hanley, but as it passed the bill contained elements of Gov. Knowles' proposals for welfare reform as well as proposals by Sen. Lyda Green.

or age.

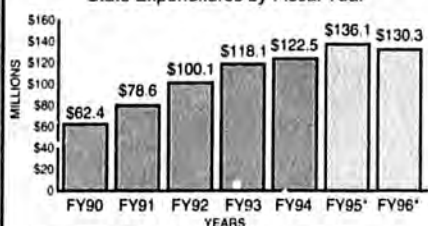
The fastest-growing component of APA is aid to the disabled, which is increasing at an average annual rate of 10 percent. Interestingly, old age assistance, another part of the program, is increasing at a slower rate of 5.3 percent yearly, less than the national average. In fact, the percentage of Alaska's seniors on old age welfare assistance has dropped from 19.3 percent in FY 1980 to 14.2 percent in FY 1994.

For the disabled or seniors needing assistance, the state currently provides a \$362 supplement to a \$458 Federal Supplemental Security Income (SSI) payment.

The rapid increase in Alaska's welfare caseloads during good economic times, and at much higher rates than the increase in the general population, raises the inevitable suspicion that Alaska's generous benefits are actually causing immigration.

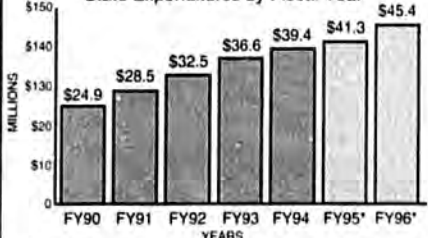
The evidence only hints at this, however. One study did show that of

Aid to Families with Dependent Children
State Expenditures by Fiscal Year



* FY 95 Authorized and FY 96 Projected. Source: Dept. Health & Social Services

Adult Public Assistance
State Expenditures by Fiscal Year



* FY 95 Authorized and FY 96 Projected. Source: Dept. Health & Social Services

Is Medicaid Out of Control?

Alaska's Medicaid costs are soaring, seemingly out of control. Costs are rising faster than health care inflation and population growth.

Medicaid serves those on welfare but its recipients today largely include children, the elderly and disabled.

Medicaid also now finances a major part of Alaska's health care industry. This means efforts at change raises concerns among influential constituent groups.

Among reasons for rising costs:

Congress has liberalized Medicaid for certain groups like the elderly and disabled, and children and pregnant women, while Alaska has added extra services.

Alaska's spending for Medicaid seems out of control. This government-paid health care program was once mainly for low-income people. But it is now expanding into coverage for many middle-income families.

Costs in Alaska have been increasing more than 10 percent yearly for several years, driven by rising health care costs and changes in federal requirements that expand coverage to new groups. The state pays 50 percent of Medicaid costs.

Proposed state Medicaid spending in Gov. Knowles' Fiscal Year 1996 budget is \$154.9 million, up from \$133.8 million in FY 1995. With the federal government's match to Alaska's general fund expenditure, total Medicaid spending in Alaska will be more than \$350 million next year. This makes Medicaid a

key source of income for the health-care industry.

As in welfare, the legislature has made efforts to cut Medicaid's costs. Last year a number of "optional" services were cut, resulting in some savings. (The federal government requires certain core services be provided, but allows states to add options). This year the legislature may refuse to fund all of the program's projected expansion. Administrators will then have to figure out where to make cuts.

The problem in controlling Medicaid costs is partly that it is so large a part of the health-care industry in Alaska. Any attempted change brings influential lobby and constituent groups down on the legislature and the Department of Health and Social Services, which administers Medicaid.

In FY 1994, Medicaid paid 14 percent of total revenues for urban hospitals and physicians. But in smaller communities, where hospitals are often combined with nursing homes, Medicaid paid 70 percent of revenues. One sixth of Alaskans received some sort of help from Medicaid in 1994. Medicaid paid out one eighth of total spending on health care in Alaska that year.

Change is also difficult because any innovation, an idea that either saves money or improves health care,

Photo Chris Arend



Medicaid has grown since 1965 start

Medicaid became part of federal law in 1965, under amendments to the Social Security Act. Every state and U.S. possession participates in Medicaid except Arizona, which is participating in a federally-funded demonstration project that has received waivers from Medicaid requirements. Alaska entered the program in 1972.

The federal government pays 50 percent of Medicaid costs in Alaska, the minimum. Many states receive more than 50 percent.

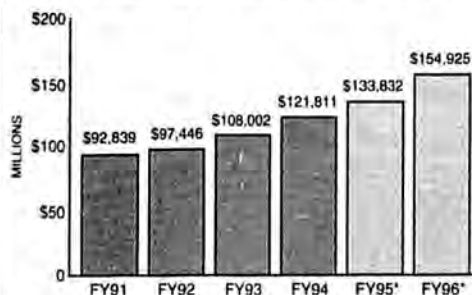
Medicaid began in 1965 as a program to provide health coverage for families or individuals on welfare, or supplementary Social Security disability assistance. Over the years, Congress broadened Medicaid's required coverage and allowed states to add optional services or eligible groups.

In 1984 the federal government expanded coverage for pregnant women and children who met welfare requirements but were not on welfare. In 1986 and 1987 Congress gave states the option of covering pregnant women and children with more liberal income guidelines. Most states took advantage of the change.

In 1993, Alaska exercised another option to pay home-based care for disabled children without regard to parents' income.

Congress also expanded Medicaid coverage for the aged and disabled, a major reason why both federal and state Medicaid expenses are rising.

Medical Assistance / Medicaid



requires a waiver from the federal government. Some critics feel the department hasn't been aggressive enough in pursuing waivers.

After a lengthy process, Alaska did get one waiver that allows Medicaid support for home care of the elderly disabled, a more humane (and cheaper) alternative to nursing homes. But other states have many waivers.

More fundamentally, people are sensitive to change because 35 percent of Medicaid spending goes for services to children, and 20 percent to disabled adults. In fact, nursing homes receive 19 percent of Alaska Medicaid payments. (Hospitals receive 30 percent of all Medicaid payments; physicians receive 18 percent.)

All states are experiencing similar problems, and Medicaid is also a major concern in the federal budget. To a large extent, its growth reflects broad changes in social policy. An example is the decision by Congress to allow children and pregnant women to qualify for Medicaid at higher income and no asset limits. That created access to better care for children and pregnant women, but it also raised costs.

Society is also changing. The population is aging. The cost of long-term elder care is skyrocketing beyond the means of many middle-income

families. The result is major growth of Medicaid coverage in nursing homes.

Some felt Alaska was too quick to add optional services, like chiropractic care, in the days when oil revenues were high, and has been slow to remove them as revenues fell. Since the services covered are set in statute, what's put on or taken off the list gets highly political (chiropractic care was taken off last year).

Another criticism is that Medicaid has been allowed to become an indirect subsidy for small hospitals in outlying communities. Many of these have added long-term care beds largely supported by Medicaid. (The Division of Medical Assistance recently warned legislators that a number of Alaska health care facilities are planning new additions of long-term care capacity, which are estimated to cause state Medicaid expenditures to increase another \$10 million.)

Since the Department of Health and Social Services must issue Certificates of Need for new health facilities, some feel the department's certification authority should be strengthened so it can influence the growth or duplication of health care facilities that impact the budget.

Another option, for Alaska, is to get the federal government to pick up more than 50 percent of the tab, as it does in many states. If federal law is changed so that Alaska's higher costs are factored into the Medicaid formula, the federal share would jump to 62 percent instead of 50 percent, a savings of \$55.3 million to the state budget. But the cost is then just passed on the federal budget.

New Revenues

Alaska has options, but taxes will be a tough sell

Many Alaskan leaders realize new revenue measures — taxes, or reduced Permanent Fund dividends — may lie in our future. The challenge is how to sell this to the public.

People will demand, quite reasonably, that what they consider excessive public spending, particularly "giveaway" programs, be cut before they pay new taxes or agree to lower dividends.

The political problem of enacting a personal income tax and changing (but most likely never ending) the dividend program is a huge challenge, mainly in which comes first.

Meanwhile, people are often willing to pay taxes when they see where the money goes and recognize a benefit. They do not want to pay taxes into a bureaucratic black-hole.

But how far will spending have to be cut until people agree there is a "need"?

Politicians are deathly afraid of the "T-word" — taxes — on citizens at least. And with good reason: In local elections voters in some communities have rejected sales taxes and pushed "caps" on property taxes. Several Alaskan leaders in recent years have been willing to discuss such unpopular subjects. They include former governors Bill Sheffield and Steve Cowper, former legislator Fran Ulmer (now lieutenant governor) who actually introduced legislation to reinstate the personal income tax, and Mike Navarre, a current legislator, who proposed raising state motor fuel taxes, now the lowest in the nation. Former Gov. Walter Hickel also proposed a higher fuel tax, as well as a "royalty" on salmon harvests and a modest increase in "sin" taxes (tobacco and alcohol). None of these proposals were enacted into law.

University of Alaska studies show Alaskans not only pay the lowest taxes in the nation, they actually get more cash directly from government than they pay. The average Alaska family (2.6 people) pays \$2,000 in taxes (mostly local) and receives \$2,600 in cash, mainly the Permanent Fund dividend, according to studies by the university's Institute of Social and Economic Research. Thanks to oil, the amount of public services the average family receives (\$19,600 per year, not including the

dividend) is almost 10 times the taxes they pay, the ISER calculates.

Many political and community leaders believe Alaska will need additional sources of revenue, from somewhere, as oil production and revenues decline. They also say that the link between taxes and government — that citizens will better watch government and demand accountability when they pay part of the tab — must be reestablished in Alaska.

In a detailed study of the fiscal problem, the ISER finds that except for oil and gas, development of industry and natural resources will create jobs but relatively little state revenue. With some changes, the Permanent Fund's \$1 billion-plus annual income can make a substantial contribution to the gap, ISER says. But in the end, they point out, Alaskan citizens may have to start paying taxes again.

For the state's political leaders, the challenge is



Photo Chris Arend



how to sell this to the public.

It has often been demonstrated that people are willing to pay taxes as long as they perceive they are getting their money's worth, and that government isn't blowing the money.

The problem in Alaska is that too many still see government blowing money in perceived "giveaway" programs. It's reasonable for an average taxpayer to question the government's need for an income tax when Permanent Fund dividend checks are still being mailed out.

"Waste" in public spending is also a matter of perception. The public's perception is that politicians give in too easily in granting pay and benefits increases to public employee unions. For their part, public employees feel they shouldn't be asked to sacrifice when legislators fund "wasteful" (in their eyes) capital projects.

Taxpayers are quite willing to pay for services they can see, and depend on. For example, while some Alaska communities repealed sales taxes when oil revenues flooded the state treasury in the early 1980s, most municipalities maintained them.

Voters in some communities even supported temporary sales tax increases tied to specific projects, such as a new community swimming pool or recreational ski project.

Last year Alaskan air carriers accepted an increase in state aviation fuel taxes as an alternative to higher landing fees to help maintain state airports. Two years ago, commercial fishermen did not strenuously object to a new state tax on salmon because the legislation

contained a provision that the money would go to support fisheries marketing (the law is not legally binding, however).

There are other examples: Trucking companies have voiced support for an increase in the motor fuel tax if the added revenues could be dedicated to improved road maintenance. Tour operators say they are willing to pay special tourism taxes if part of the money could be tied to tourism marketing.

Alaska's constitution now prohibits such "dedicated" funds, except for the Permanent Fund. But there have been several recent proposals for constitutional amendments allowing tax revenues to be dedicated for specific projects. These were proposed to get support from influential constituencies.

Early in his administration, Gov. Hickel supported a fund for highway and airport maintenance, to which fuel taxes would be dedicated. Gov. Cowper proposed a dedicated fund for schools, with revenues from a restructured Permanent Fund dividend program.

But a series of dedicated funds in the constitution could be a heavy price to pay to get citizen support for selected revenue measures because they could also lock Alaska's state government into a rigid funding structure that would see politically-popular programs funded well but others (welfare, environmental protection) starved for resources. This has been indeed the experience of other states with dedicated funds.

The need for new revenues can be "sold" to the public, but it will take, somehow, a restoration of voter confidence that the money is really needed, and that it will be used well. That's the real challenge facing Alaska's leaders.

Commonwealth North's plan

Several Alaskan citizen groups have reviewed the problem of the state's fiscal gap, including an "economic summit" of the state's business and community leaders called together by former Gov. Hickel in 1992; Alaska Commonwealth Ground, a citizen public policy group, in 1993; and Commonwealth North, the Anchorage-based group that often tackles policy issues, also in 1993, and others.

After extensive discussions, all of these groups suggested variations of the "safe landing strategy" developed by the university's Institute of Social and Economic Research, involving spending cuts, changes to the Permanent Fund dividend and new taxes.

Key elements of Commonwealth North's plan:

- Freeze the operating budget below current levels
- Cut capital spending
- Cap Permanent Fund dividends, then reduce expenditures for dividends \$50 million yearly
- Increase some taxes such as alcohol, tobacco, motor fuel, fisheries
- Create an income tax commission to analyze taxes, and submit a proposal to the legislature
- Create a financial planning commission to develop a long-term finance plan

Commonwealth North's recommendations laid the foundation for creation of the Long Range Financial Planning Commission created by the legislature in the 1995 session.

Will the Permanent Fund help cover the gap?

Alaska's Permanent Fund, the big bank account of saved oil revenues, is viewed by some as Alaska's salvation in bridging the looming fiscal gap. The \$15 billion fund now earns about a billion dollars a year, enough to pay 40 percent of state spending. But changes would have to be made in how the fund's income is used. About half of it now goes to pay for annual dividends to the state's citizens. What's left goes to "inflation-proof" the fund, offsetting the effect of inflation for the year.

Changes in earnings management of the fund, to make money available for public services, will be highly controversial because they are likely to reduce the citizen dividends.

It's ironic, but Alaska's \$15 billion Permanent Fund, which earns a billion dollars plus each year, won't do much to help the state bridge its looming fiscal gap. At least not the way the fund's income is now used.

When Alaska voters approved the constitutional amendment creating the Permanent Fund in 1976, the understanding was that it was to be a way of saving a portion of the state's "non-renewable" oil revenue for the day oil revenues ran down, to support

help finance Alaska development projects?

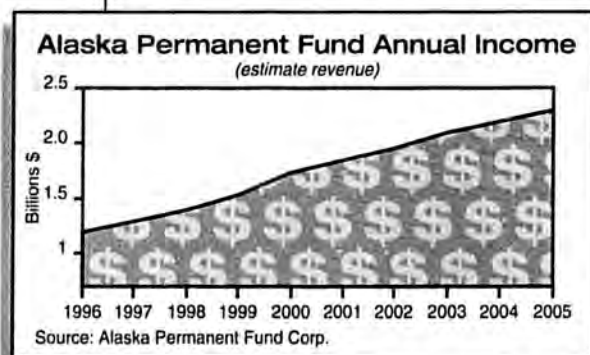
Legislators looked at Alberta's Heritage Fund, a similar oil revenue savings account, which had been depleted by investment in politically-popular but money-losing projects within the province. The trust concept finally won out in Alaska, and became the guiding principle for the Permanent Fund investment policy.

The citizen dividend program, virtually unique in the world, became law in 1980. Since it is created in state law, it can be changed by the legislature.

Two ideas were behind the dividend: First, at the time Alaska was rolling in surplus oil revenue (oil price hikes had far exceeded expectations) So, legislators felt, why not share a bit of the wealth directly with citizens? Most analysts at the time believed prices would remain high. Alaskans believed they were permanently wealthy.

Secondly, Jay Hammond, then governor, felt giving citizens a direct stake in the performance of the fund would create a powerful watchdog constituency for the fund, encouraging good management and discouraging legislators from devising any scheme to "raid" the fund. (Even with constitutional protection, there are ways the fund's value can be depleted, such as soft "loans" to the state or to uneconomic development projects.)

At first, the dividend program was tied to length of residence in Alaska, so that a lifelong Alaskan, for example, would receive a larger dividend than a new arrival. That was successfully challenged in court, however. Now the dividend is paid equally to all Alaskans, regardless of length of residency.



basic public services without imposing ruinous taxes on Alaska's citizens. (In the days before North Slope oil, Alaska local and state taxes were very high.)

In 1976, no one was thinking of the Permanent Fund dividend. The constitutional amendment provided only that a portion of oil royalties and bonuses be saved. What to do with the income, and how the fund should be managed, were decisions left to the legislature.

In 1979 and 1980, fierce debates raged in the legislature over the basic investment policy of the fund. Should it be a "trust" type fund, invested in very safe, conservative investments, which almost by definition meant mostly outside Alaska? Or should it be at least partly a "development" fund that could, among other investments,



Senator Rieger's plan for fund

In 1980, the legislature also provided for special "inflation-proofing" payments to be made from earnings to the protected body of the fund, to offset the effects of inflation.

Another decision the legislature made that year was to have the dividend payment made first, and inflation-proofing second, from the earnings. If the earnings fall short, dividends have priority over inflation-proofing. Between these two claims on the earnings — dividends and inflation-proofing — there isn't much left for the general treasury.

There have been small surpluses in recent years, however, and these have accumulated in the present \$1.2 billion Earnings Reserve Account (a part of the general fund, not the fund itself).

But with the size of the fund increasing, two things happen: The amount needed to inflation-proof grows larger each year, and dividends are also likely to grow. The Permanent Fund Corp. anticipates that in a few years the fund's earnings won't be sufficient to cover both. Then inflation-proofing will begin to suffer, at the expense of increasing dividends.

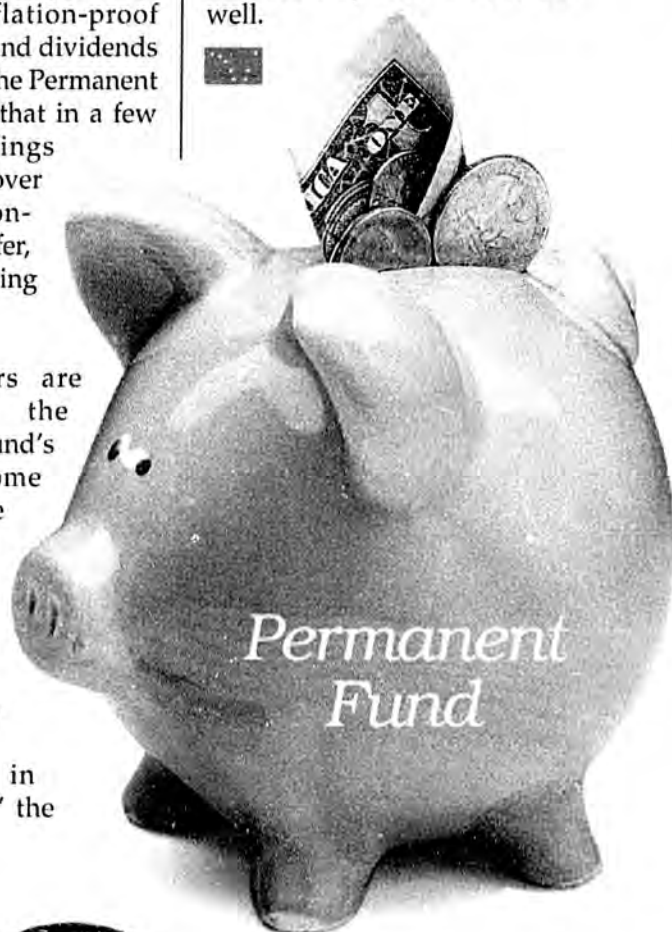
Many legislators are aware of the intricacies of how the fund's earnings are split. Some privately agree with the University of Alaska's Institute of Social and Economic Research that Permanent Fund earnings should be a central part of a plan to span the fiscal gap.

One idea discussed in recent years is to "cap" the

dividend at some level, halting its growth. One suggestion is at \$1,000; another is a "rollback" to \$500. Over time, this would create increasing "wedge" of earnings available to the general treasury.

In its "safe-landing strategy" plan to bridge the fiscal gap, the university's ISER recommended a gradual phaseout of the dividend. The savings would accrue at first to the corpus of the fund, so that it would grow faster and increase its earnings. The income would then be available to support public services.

The problem for state leaders is how to somehow change the distribution of the earnings without angering a public that has come to view the dividend as an entitlement. Gov. Hammond's strategy of creating a constituency for the fund may have worked too well.



If the Permanent Fund is to be an important part of Alaskans' strategy to bridge the fiscal gap, the first task should be to more fully protect the principal of the Fund against erosion by inflation. State Sen. Steve Rieger proposes to do this in Senate Bill 51.

Basically, the bill would reverse the current practice of paying dividends from the Fund's annual earnings before the required inflation-proofing payment is made. Current law requires that part of the yearly earnings be deposited into the body of the Fund, to offset inflation for the year.

Current law also provides that dividends be paid first. But as the Fund grows, the time will come when there won't be enough earnings to do both. At that time, inflation-proofing will be shorted to sustain a larger dividend payout.

That's unwise policy, Rieger argues, because it will lead to a gradual, long-term erosion of the Fund. A better policy is to inflation-proof first and pay dividends second. Senate Bill 51 would do that.

The legislation would lead to a temporary dip in the dividends, but Rieger feels that would be acceptable to give the Fund long-term protection against inflation.



Can Development Raise New Revenues?

Alaska has great potential for development of its natural resources. Despite its cycles, fisheries is an enduring industry with potential for growth. New mines are opening up. Demand is hot for Alaskan timber products, although timber is increasingly inaccessible. Tourism is steadily increasing. There is potential for new oil development, most likely small to medium-sized deposits.

But these cannot cover cover the fiscal gap. In fact, the gap threatens their potential. All of them, including tourism, work on thin margins in highly competitive markets. New taxes could easily price them out of the market.

Some think a solution to the fiscal gap is to simply "grow" our way out of the problem, to either find a new Prudhoe Bay (very unlikely) or to stimulate development of Alaska's other natural resources.

Those resources are indeed rich and varied. Off Alaska's coasts is one of the world's great fisheries. Its minerals potential is huge. There is vast acreage of virgin forests. Tourism increases at a steady clip. This mix could bring a diversified, prosperous private economy to Alaska. But it won't cover the fiscal gap. Not by itself.

Fisheries, tourism and, to lesser extent, mining and timber, are significant employers. But they also operate on razor-thin margins in highly competitive world markets.

Some can afford to pay more taxes. In fact, fisheries now pays more than it

did just a few years ago. But it's peanuts compared to petroleum: Fisheries paid \$75 million into the state treasury in Fiscal Year 1992, compared with \$2.5 billion paid by oil and gas production.

Most natural resource industries can't afford the kind of taxes that oil and gas pays.

Any significant tax risks pricing these other products, even tourism (Alaska's natural beauty is a kind of commodity) out of the market.

A look at the numbers is revealing: Mining is a high-wage industry that creates good jobs, and the prospects are good for new mines. But in FY 1992 the state received only \$3.48 million in all types of revenues from mining, according to data collected by the House Research Agency, an arm of the legislature.

Today mines are more important as taxpayers to municipalities than state government. Red Dog Mine, for example, is the primary taxpayer to the Northwest Arctic Borough. The AJ Mine, if it reopens, will provide about 10 percent of the City and Borough of Juneau's budget.

Fisheries comes closer than any industry other than petroleum in paying for itself. According to state Dept. of Fish and Game data, the industry now pays slightly more than it costs the state to manage. Like mining, fisheries pays good wages, and is an important source of taxes to coastal communities.

Timber, also a high wage-paying industry, ought to be a booming industry for Alaska, given the state's vast forest resources and the looming shortage in wood supply (and rising prices) in Pacific markets. But sadly, it appears to be a shrinking industry, mainly because of land-use conflicts with environmental groups. In FY 1992, timber generated \$1.6 million in revenues to the state treasury, mostly receipts from state timber sales, according to the House Research Agency.

Tourism is a steady-growth industry, every year notching up 3 to 6 percent growth. While highly seasonal and somewhat lower paying, the industry's economic benefits are spread widely around the state. Interestingly, the industry acknowledges tourists can



Photo Chris Arend



The tools are there; can we really do it?

afford to pay more tax, but tour operators would like the tax structured in a way that fairly taxes all segments of the industry — cruise lines, airlines, lodge operators — fairly. One way to do this is a seasonal sales tax which kicks in during summer when the tourists come north, although Alaskans would also pay a share. But the overall revenue gain is modest.

The only new economic development likely to bring major new state revenue is the old

enough for commercial gas sales to be economically viable) but a gas pipeline system will pay the state oil and gas property tax and other taxes. Potential revenues were estimated by former Gov. Hickel, an ardent supporter of the project, to be in the range of \$300 million to \$400 million yearly. That's significant, but not enough to cover the gap.

As for finding another Prudhoe — it's not a possibility a prudent person would plan on, even in the Arctic National Wildlife Refuge. Alaskans

The University of Alaska's Institute of Social and Economic Research, Commonwealth North and others have laid out the array of tools available, and needed, to bridge the fiscal gap: spending cuts, economic development, new sources of revenue.

The question now is whether Alaskans can carry out a plan to span the gap, because parts of that plan will be unpopular.

There are also proposals, however, to help force the issue:

- Anchorage attorney Roger Cremo proposes a constitutional amendment to convert the Permanent Fund, and other state reserves, into an endowment-type fund, with forced spending reductions. Earnings from the fund could then support many state government's expenses.

- House Speaker Gail Phillips proposes "forward funding" the state budget with existing cash reserves to stabilize funding for state programs. It doesn't address the fiscal gap directly, but forward funding could force decisions sooner by taking reserve funds "off the table."

The new state Long-Range Financial Planning Commission is now wrestling with these issues. Its report is due in October.

Potential Additional Economic Development Revenues

(An "optimistic" case, annual revenues in millions)

	FY 96	FY 97	FY 98	FY 99	FY 00	FY 01
Optimistic						
Mining	5.0	7.0	9.0	11.0	12.0	13.2
Timber	0.8	0.9	1.1	1.2	1.5	1.7
Seafood	3.6	3.9	4.1	4.4	4.7	5.1
Tourism	1.1	1.1	1.1	1.2	1.2	1.2
Other	30.6	32.8	35.1	37.6	40.3	43.2
Total	41.0	45.6	50.4	55.4	59.7	64.4

Source: State OMB; prepared for Gov. Hickel's 1992 "Economic Summit"

standby, petroleum. There are good prospects, but the kind of new oil and gas fields likely to be developed, ones Alaskans can reasonably be able to count on, are medium-sized to small discoveries. They can contribute a modest amount of "new oil" and will play a vital role in sustaining the economic viability of the Trans-Alaska Pipeline. But they won't replace Prudhoe Bay.

There is, most likely, an Alaska natural gas pipeline in the future — someday. Gas will not duplicate what oil pays to the treasury (it is difficult

have seen too many expectations fizzle (the Mukluk and Kuvlum wells on the North Slope, to name two).

Alaska undoubtedly has a bright future. But, as former state Commerce and Economic Development Commissioner Paul Fuhs has pointed out, the looming fiscal gap, and the uncertainty of how the state will deal with it, now serves to actually chill new resource investment.

When resources companies see the state's fiscal house is in order, they will see Alaska as a stable and inviting place to invest.

Update - Alaska state legislature 1995 session

Oil and gas development incentives

State legislators approved a proposal by Gov. Tony Knowles to give the Commissioner of Natural Resources authority to modify state oil and gas royalty on marginally economic undeveloped oil and gas deposits.

The bill is important because it gives the state a new tool to encourage companies to develop marginal oil discoveries. House Bill 207 is the first step in making Alaska more competitive in the world energy arena.

For many years state law has given the commissioner the ability to modify royalty on producing oil and gas fields and even, under certain circumstances, undeveloped discoveries. HB 207, which passed in the final hours of the 1995 legislature, clarifies that authority.

The bill came under close scrutiny in both the State House and Senate. Legislators were mainly concerned with the delegation of authority to the commissioner to reduce royalty on undeveloped fields without some mechanism for oversight by elected officials other than the governor.

Proposals for outright legislative approval were rejected, but the final version of HB 207 gives the legislature's Budget and Audit Committee the authority to review the agreements.

As it finally passed, the bill includes a provision to "sunset," or automatically terminate, after 10 years unless extended by the legislature. That is intended to allow lawmakers to review effectiveness of the program.

In 1996, the legislature may consider other oil and gas incentive



House Speaker Gail Phillips and Rep. Al Vezey.

Photo Bob Tkacz

proposals intended to broaden the tools the state has to attract new industry investment.

These include Senate Bill 114, which grants special tax and royalty credits for continued production of very high-cost wells or wells drilled in heavy oil deposits; and SB 112, which reenacts a five percent "discovery" royalty as an incentive for exploration (the state's royalty on most oil and gas leases is 12.5 percent).

The Senate Resources Committee, chaired by Sen. Loren Leman will hold work sessions on those proposals in the interim between legislative sessions. The House Oil and Gas Committee, under chairman Rep. Norm Rokeberg, and the House Resources Committee, chaired by Rep. Joe Green, will consider other proposals. In addition, Gov. Knowles' Oil and Gas Policy Council will review other recommendations toward improving Alaska's competitive position.



House Minority Leader Jerry Mackie.

Photo Paul Helmar

Minerals exploration incentive

The legislature also approved a new minerals exploration incentive program, which allows mining companies to credit certain "up front" costs in exploring or evaluating a new discovery against present or future state mining taxes or royalties.

House Bill 197 passed both the House and Senate by wide margins.

The Department of Revenue has certain problems with the bill; HB 197 is now under review by Gov. Tony Knowles.

Permanent Fund deposit

State lawmakers also voted to deposit about \$1 billion of accumulated surplus Permanent Fund earnings into the corpus of the Fund, which now has about \$15 billion (before the deposit). Once in the Fund the money cannot be appropriated for state operations.

Some lawmakers argue the action takes state cash reserves "off the table," and forces the fiscal gap to be dealt with sooner. If the \$1 billion in Permanent Fund earnings is deposited (Gov. Knowles may veto it or reduce the amount) the state will have \$2.2 billion left in the Constitutional Budget Reserve, or due to be paid in, by the end of FY 1996. At current spending rates, those reserves will be exhausted by 2000.

New business legislation

A number of business-related bills passed the 1995 legislature. One important bill making major changes in Alaska's "tort," or liability, laws, passed the State House and will be reviewed by the Senate in the 1996 legislature.

Business legislation approved included House Bill 115, giving judges flexibility in awarding punitive damages in lawsuits brought on overtime wage claims.

Also passed was HB 237, making changes in workers' compensation laws and granting immunity from

liability for insurance companies and industry trade associations who participate in workplace safety inspections.



JUNEAU REPORT



Top: Rep. Joe Green.
Photo Paul Helmar

Middle: Sen. Mike Miller.
Photo Heidi Bradner

Bottom: Rep. Brian Porter.
Photo Heidi Bradner

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