

ALASKA LEGISLATURE SPECIAL COMMITTEE/SUBJECT FILES 8672

2375 SCOMM 101 LONG RANGE FINANCIAL PLANNING COMMISSION, 1995

* Annalie/Brad/
- will look at funds to be on table

* Revenue not population driven like
other states

Pop - fastest growing, 65-85 / expensive

Saturday am

SALES TAX

AK will check * part time tax of summer only *
 of two different states

~~mail~~ mail order (in) check volume

Lincoln ~~income~~ incl. dollar figure for income tax
 ratio personal income

Bloggers

Palmer Impacts of Taxes: ie. spending vs.
 saving.

Look for ISEI study

* Each state has ____ a tax *

Kevin
 RITCHIE } Municipal taxation: need to remember taxes
 that munis generate taxes/creatures of state
 municipal assistance, nationwide av. portion
 muni had 32.5%, AK 35% major part of
 of distrib state wealth nationwide N-621%

AK
 * ASK KEVIN to send written test *
 also do

Cheryl Feasea

PCE, Div of Ins.

NOT "off budget" on budget as "OTHER funds."

bond proceeds → "off budget"

* ~~only~~ looking at "OTHER funds" ~~for~~ before next meeting

Goesuch Retirement unfunded liability?

* ~~Must~~ call Gary Bader *

- Earnings assumptions TRS/PERS different

- Amount contributed

Rogers good shape but not fully funded

General discussion re: unfunded liabilities

oil hedging

- don't want to give up spikes

Pg 26

add:

* Petroleum Revenues, High + High will draft language *

* ~~ASK~~ Mary Noedale who she wants @
meeting on 19 July * Mallott/Kelly, etc?

* ~~ASK~~ Discuss Pearce CBL letter w/ Annalee/Brad *

Nordale what do we have now? ** Assets **
triggers to make them work

Gorsuch PF revenue needs to be on hook
reserves as reserves or
" as assets being spent
must be replenishment provision

Riege: Need to have 5yr averaging reserve to
bring stability to reserve fund.

McConnell Reserves for contingency
what it is not.
Should we call reserves "fund balance"

Gorsuch What give up w 5% eee @ 5yr payout
Purpose: inform

me
Nordale: discuss base case revisions

Areas to address

Ex/Sp Section of CAPITAL BUDGET
MORE scenarios

Rev. PF earnings / oil taxes / fish royalty / admin costs

Budprocess Budget reflect accurate
Reserves

Intgov Div of
Responsibilities

Budour Schedule / Survey

New

Ec Dev S/c } Annalee
Jobs } Judy Brady
Mike Savane
Mike O'Connell

expanded oil
production

Stabilization Strategies
draft by revenue s/c

Assets = physical assets & DNE inventory
generation of income

Distill for next meeting - Impacts
& issues / conclusions

Mental Health Trust

Outreach: 

Drafting - s/cs 21st Fri

24th Mon

Mon/Tues do another
edit.

26th - 27th

STATE OF ALASKA
LONG RANGE FINANCIAL PLANNING COMMISSION
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Staff: Melissa Aber Fouse
Bob Walsh

Regular Meeting-Anchorage
Friday, 14 July, 10:00 am to 5:00 pm
Anchorage LIO, 716 West Fourth Avenue, Suite 220

Complete Drafting of Interim Report
Discuss Public Participation

9:00 am	Karen Perdue, Commissioner of the Department of Health & Social Services re: changes in federal funding.
9:45 am	
10:00 am	Review of Base Case Assumptions
11:00 am	Discussion of Budget Cuts Scenarios & Worksheets, Impacts
12:00 to 1:15	Break for Lunch
1:30 pm	Interim Report Outline
3:00 pm	Revenue Sources Review
4:00 pm	Adjourn

Regular Meeting-Anchorage
Saturday, 15 July, 8:30 am to 4:30 pm
Anchorage LIO, 716 West Fourth Avenue, Suite 220

Alaska State Legislature

During Interim:

716 West 4th Avenue, Suite 500
Anchorage, Alaska 99501-2133
(907) 258-8185
Fax (907) 253-0226

During Session:

State Capitol
Juneau, Alaska 99801-1182
(907) 465-4993
Fax (907) 465-3872

Drue Pearce
President of the Senate

June 30, 1995

Mr. Brian Rogers, Chairman
Long Range Financial Planning Commission

Dear Chairman Rogers and Members of the Commission:

The issue of implementation of the Constitutional Budget Reserve Fund (CBR) provisions is one of the more important issues facing Alaska as we look for ways to manage future state spending.

There are a number of issues that need to be resolved before the CBR can work as was intended by the Legislators who voted to put the amendment language on the ballot.

For example, Article IX, Sec. 17(c) states that an appropriation from the budget reserve fund may be made to any public purpose upon affirmative vote of three-fourths of the members of each house of the legislature. When the Constitutional Amendment was drafted, the requirement for a three-fourths vote seemed like the perfect way to avoid frivolous actions by the legislature. The effect has been just the opposite.

It is a nearly impossible to imagine a time in Alaska when one political party may hold three-fourths of the seats in each house. Therefore, under the current provisions it is necessary for members of the minority party to cooperate to access the CBR. The drafters of the constitutional amendment and the voters who adopted the CBR wanted to make it difficult to appropriate the money from the fund and believed that the requirement for a three-fourths vote would protect the fund. I doubt that anyone envisioned that members of the minority could hold access to the CBR hostage in exchange for concessions and special interest projects, the effect of which is a larger state budget rather than a reduced one.

To Long Range Financial Planning Commission
July 12, 1995
Page 2

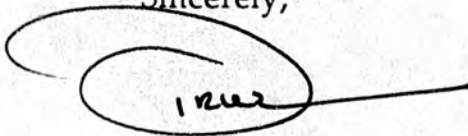
In addition, a number of other issues remain:

1. The "amount available for appropriation" has not been clearly defined.
2. The repayment provision has no implementation guidelines.
3. The court has not given sufficient guidance to identify specific funds included in either "funds available" or the section 17(d) payback requirement.
4. Does section 17(d) need to be implemented by law?

I request that the Long Range Financial Planning Commission schedule discussion of proper implementation of the Constitutional Budget Reserve at one of its meetings and that it include a recommendation in its report to correct this barrier to effective financial management and smaller state budgets.

Thank you for your attention to this matter. Feel free to contact me with any questions you might have.

Sincerely,

A handwritten signature in black ink, appearing to read "Drue Pearce", is enclosed within a large, loopy oval. A horizontal line extends from the right side of the oval.

Drue Pearce
Senate President

jf

buddy -
keep

CONSTITUTIONAL BUDGET RESERVE

History

The Alaska Legislature enacted SJR 5 during the 1990 session, placing a ballot measure before the voters to consider a constitutional amendment to establish a budget reserve fund --which the voters subsequently approved at the November 1990 general election.

The approved ballot measure was incorporated in the Alaska Constitution as Article IX, Section 17 and became effective on January 2, 1991, establishing the constitutional budget reserve as a separate fund in the state treasury. It provides for the deposit of of certain tax and mineral revenue dispute settlements into the fund, established limitations on the appropriation of monies from the fund, and required that such amounts withdrawn from the fund be repaid.

In implementing the provision for the deposit of funds, the Department of Revenue requested an attorney general's opinion to define the term "administrative proceeding" as it is used in Section 17. Specifically, the opinion asked whether the term applied to informal conferences and audits or only to formal hearings and court proceedings. The April 24, 1992 attorney general opinion determined that Section 17 applied only to administrative actions that were similar to litigation, i.e. the formal hearings held by the Department of Revenue. In conformance with the opinion, the Department deposited in the general fund (rather than the budget reserve fund), all settlement monies received as a result of informal tax conferences. These receipts have been generally referred to as "administrative settlement" receipts.

The Governor relied on this opinion in submitting his fiscal year 1994 budget request to the 1993 legislative session, and included these settlement monies as a part of the overall spending plan, i.e., within the amounts available for appropriation in the normal course of the budget process. The Legislature, during the 1993 session thus included \$1.006 billion of these "administrative settlement" monies in the FY93/94 spending plan as available for appropriation.

On July 12, 1993, the Senate majority filed suit seeking judicial review of the attorney general opinion regarding these administrative settlement receipts. On November 19, 1993, the superior court issued its decision which concluded that the term "administrative proceeding" did apply to informal administrative proceedings. The superior court held that an administrative proceeding

commences with the issuance of a tax assessment to a taxpayer, thus invalidating the Attorney General's April 24, 1992 opinion. As a result, those settlement amounts which were reached by virtue of an informal conference should have been deposited in the budget reserve fund.

The superior court decision was appealed to the supreme court, which upheld the lower court and ordered restoration of the amounts it determined properly due to the budget reserve fund with interest payable from the date of receipt of the settlements. The court order put the state in a position in which the general fund did not contain a balance sufficient to repay the amount due to the constitutional budget reserve and provide adequate funding for the FY94/95 budgets.

One part of the proposed solution to the repayment and budget gap problem took the form of HB58, enacted as Ch. 5, SLA 94. It amended Title 37, The Executive Budget Act, to provide guidance in the administration of the constitutional budget reserve fund, particularly in relation to providing definitions of the broad terms used in Section 17, e.g. "administrative proceeding" and "amount available for appropriation." The legislation defined the "amount available for appropriation" as the annually recurring unrestricted general fund revenues, plus general fund program receipts, and any general fund balance carried forward from the previous fiscal year. The courts subsequently found that this definition did not measure up to its view of the constitutional amendment even though this definition had longstanding use in the state budget process and state financial reporting.

The repayment issue was resolved in separate legislation, HB505 enacted as Ch. 14, SLA 94, in the form of a "round trip" appropriation which transferred the amount due from the general fund to the constitutional budget reserve fund (\$1,055.6 million) and then from the constitutional budget reserve fund back to the general fund. It appears this satisfied the courts.

The appropriation out of the CBR was accomplished under the provisions of sec. 17(c) which require a 3/4 vote majority of each body of the legislature as opposed to sec. 17(b) whereby funds may be withdrawn with a simple majority vote. The superior court decision as affirmed by the supreme court states that the sec. 17(b) withdrawal provision is not available to the legislature because the funds available test had not been met, i.e., the legislation failed to include all funds the court would consider available--and the courts have not defined what all those funds may be.

The extent of the judicial guidance is that the supreme court has found that the "amount available for appropriation" includes all monies over which the legislature has retained the power to appropriate and which requires further appropriation before expenditure.

Within this meaning, the court has **included** and specifically mentioned as available for appropriation such funds as:

- trust receipts, e.g. federal funds
- Railbelt Energy Fund (and by its reasoning, also other energy funds like the Power Cost Equalization fund)
- Educational Facilities and Maintenance Construction Fund
- Marine Highway System Vessel Replacement Fund (and by its reasoning, other funds in the general fund like the Marine Highway fund for system operations)
- Permanent Fund Earnings Reserve Account because appropriations may be made from it and is not subject to expenditure without legislative action.

With respect to the Earnings Reserve Account, the court also held that it must be considered as "available for appropriation", but is not to be included in the Section 17(d) repayment provision because it is not in the general fund. The supreme court in its May 27, 1994 decision, did provide some guidance regarding the Section 17(d) repayment provision: "we see no reason to give 'available for appropriation' a different meaning in subsection (d) than we did in subsection (b). We recognize, however, that the **payback provision in section 17(d) is limited only to those funds which are 'available for appropriation' and 'in the general fund'.**" Thus available funds that are not in the general fund, such as the permanent fund earnings reserve account, need not be deposited in the budget reserve.

The supreme court has **excluded** from its definition of "funds available":

- monies which already have been validly committed by the legislature for some purpose.
- illiquid assets owned by the state that are not available so long as they remain illiquid

Under this definition, and by this reasoning, the court says that the oil and hazardous substance release response fund is not counted as available because the entire balance may be expended at any time without further appropriation [once it is in the hands of the commissioner of the department of environmental conservation].

Remaining Issues

1. Is the repayment provision to be implemented by automatic "sweep" of the subject monies by the state accountant or through specific enactment of appropriations to the budget reserve?

2. Does the court give sufficient guidance to further identify specific funds included in either "funds available" and the section 17(d) payback requirement?

The court left it to the executive and legislative branch officials (emphasis added, their words) to apply its general definition to every fund within the treasury of the State of Alaska--who are these officials?

3. To what extent does section 17(d) need to be implemented by law--and how much will the interested parties and the courts allow?

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MEMORANDUM

December 7, 1993

SUBJECT: Budget Reserve Fund (Work Order No. 8-LS1412)

TO: Senator Drue Pearce
Co-chair, Senate Finance Committee

Senator Steve Frank
Co-chair, Senate Finance Committee

FROM: Tamara Brandt Cook
Director

You have asked how money may be appropriated by the legislature from the Budget Reserve Fund established under article IX, sec. 17 of the state constitution. Under subsection (a) it is provided: "Money may be appropriated from the fund only as authorized under (b) or (c) of this section." I take this to mean that these two methods whereby the legislature may appropriate money are entirely independent from each other.

~~Under subsection (b) a formula is set out under which a determination is made as to whether, and how much, money may be appropriated from the budget reserve fund based upon the amount of appropriation made in the previous calendar year for the previous fiscal year. In other words, supplemental appropriations will generally be disregarded.~~

~~If the amount available for appropriation for a fiscal year is less than the amount appropriated for the past fiscal year, the amount of shortfall may be appropriated from the budget reserve fund. No special vote requirement is needed for appropriations under this subsection.~~

~~Under subsection (c) the legislature may appropriate money from the budget reserve fund upon approval of three-fourths of the members of each house. Other than the special vote requirement, no other restrictions apply.~~

Under article IX, section 17(b) of the state constitution amounts may be appropriated from the budget reserve fund when ". . . the amount available for appropriation for a fiscal year is less than the amount appropriated for the previous fiscal year. . ." You have asked specifically how the amount available for appropriation is to be determined.

Senators Pearce and Frank
December 7, 1993
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Unfortunately, since the matter has not yet been considered by the court, any answer I provide to your question will be speculative at best.

At the very least this language includes the balance in the unrestricted general fund available at the beginning of a fiscal year plus revenue received by the general fund during that year and money lapsed into the general fund during that year.

In addition, there are certain statutory funds within the general fund with restrictions on expenditure. Money in these funds may be appropriated, either for the limited uses set out in the statute or for other uses by amending the restrictions contained in the statute or relying upon the legislature's "power of the purse" and ignoring the restrictions. (For the proposition that statutorily imposed restrictions on appropriations from a fund violate the prohibition on dedicated funds, see Sonneman v. Hickel, 836 P.2d 936 (1992)) Since these funds may be appropriated, I believe a court would tend to conclude that amounts in them are "available for appropriation" under section 17(b). An example of such a fund is the Railbelt Energy Fund (AS 37.05.520).

Likewise, federal funds are made available to the state for restricted uses but can only be expended if appropriated. I would think a court would find these to be "available for appropriation," albeit for the limited uses permitted under federal law.

However, because subsection (b) is not limited to money that is available for appropriation from the general fund while subsection (d) specifically requires repayment only from general fund money, I would think that a court would find that money available for appropriation under subsection (b) is not limited to general fund money. If it were, like subsection (d), it could have said so. Therefore, all of the income of the Permanent Fund could be considered available for appropriation. Once a portion of it is appropriated to the dividend fund, that money, I would think, should not be counted as available for appropriation again, since the Department of Revenue has authority to distribute it without further legislative action. You will recall that under article IX, section 16, the earnings of the permanent fund are to be deposited in the general fund unless otherwise provided by law, and the legislature has so provided by denominating the earnings reserve as an account in the permanent fund. Yet the legislature has also regularly made appropriations from the earnings reserve account, so it would seem difficult for a court to find that that money, is not "available for appropriation." On the other hand, the principal of the permanent fund is certainly not "available for appropriation." Article IX, section 15 states specifically that the principal may only be used for income-producing investments.

There are dozens of other accounts and funds established by statute, ranging from loan funds to trust funds to funds required under federal law. Other accounts have been established by administrative agencies. To the extent that those funds contain unencumbered and unobligated balances, they may provide a resource for reappropriation

Senators Pearce and Frank
December 7, 1993
Page 3

purposes, but because they are typically appropriated to the fund for a specific program and can still be expended under the original appropriation, a fair argument could be made for the proposition that they are not balances "available for appropriation" within the terms of the constitution and do not become available until the original purpose is accomplished and the remaining funds are lapsed or the program is repealed.

You have also asked me whether it is possible to make up shortfalls in the FY 1994 budget from the Budget Reserve Fund when the legislature convenes again under article IX, sec. 17(b). The subsection sets limits upon which fiscal year money may be appropriated for (based upon the amount available for appropriation from other sources during that same fiscal year), and sets limits upon the amount that may be appropriated from the fund (based upon the amount appropriated within a specific time period for the prior fiscal year, which was intended to exclude most "supplemental" appropriations). It does not set a limit upon when the money for a fiscal year may be appropriated. In short, the legislature could make a supplemental appropriation just before the end of a fiscal year for that same year and fund it from the Budget Reserve Fund if the mathematical condition is met. So, for example, if state revenue continues to be less than projections for FY 1994 and if the court orders the state to transfer \$900,000,000 during FY 1994 to the Budget Reserve Fund, it may be that some amount of money could be appropriated for FY 1994 under article IX, sec. 17(b) after the legislature convenes this January.

As I pointed out, in determining whether the legislature may make an appropriation from the Budget Reserve Fund for a given fiscal year under section 17(b) it may be necessary to consider amounts available in the state treasury outside of the unrestricted general fund balance as well as the amount of that balance. This figure must then be compared to the amount actually appropriated for the previous fiscal year from all sources, excluding amounts that may have been appropriated after December 31 of that previous fiscal year. So, despite declining revenue received by the state during FY 1994 it is possible, that upon considering other funds available in various accounts, the total amount "available for appropriation" will not be less than the total of relevant appropriations made for FY 1993, in which case the legislature will not be able to appropriate money from the Budget Reserve Fund for FY 1994 under sec. 17(b).

By the way, according to Mike Greany, Director of Legislative Finance, the relevant level of FY 1993 appropriations is just over \$2.7 billion. Repayment to the Budget Reserve Fund from the earnings reserve account would substantially deplete that account, by far the largest source of money available for appropriation outside of the general fund revenue stream. If oil prices stay low, the actual revenue stream for FY 1994 may be around \$1.9 billion. With additional funds, other than the earnings reserve money, taken into account, it looks possible that money available for appropriation in FY 1994 could be around \$2 billion, which would enable the legislature to appropriate up to \$.7 billion for FY 1994

Senators Pearce and Frank
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from the Budget Reserve. Obviously, these are very rough calculations, but they serve as a concrete example of the way sec. 17(b) could come into play for FY 1994.

Despite the foregoing discussion, which I expect was the way sec. 17(b) was intended to function, there is an ambiguity created by the last phrase of that subsection. That phrase states that the amount of appropriations that may be made from the Budget Reserve Fund may only "... provide for total appropriations equal to the amount of appropriations made in the previous calendar year for the previous fiscal year." (Emphasis added.) The calendar year previous to what? If this refers, not to calendar year 1992 with respect to FY 1993, but to the calendar year previous to the year the appropriation from the Budget Reserve Fund is proposed to be made, an entirely different result occurs. For example, if in the calendar year 1994 an appropriation is to be made for FY 1994, do we look to appropriations made in calendar year 1993 (the calendar year previous to 1994) for FY 1993 (the fiscal year previous to 1994)? If so, only supplemental appropriations made for FY 1993 may be considered, so the amount available for appropriation for FY 1994 would have to be less than the \$40 or \$50 million in supplementals enacted during calendar 1993 for FY 1993. This reading appears to lead to an absurd practical result, but the literal language of the constitution could be so interpreted.

TBC:mi
93-166.mai

BRF

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MEMORANDUM

May 16, 1994

SUBJECT: ~~Effect of failure by one house to adopt by three quarter vote appropriations from the budget reserve fund included in the budget~~

TO: Senator Drue Pearce
Co-chair, Senate Finance Committee

FROM: Tamara Brandt Cook
Director TBC

You have asked whether the failure of the House to adopt, by three-quarter vote, appropriations from the budget reserve fund included in the budget invalidates the budget as a whole when those appropriations have already been adopted by the Senate. The Attorney General has concluded that, in this situation, the budget bill is invalid because identical legislation has not passed both bodies. (Letter, May 12, 1994) While it is quite possible that the Attorney General is correct, this is not a foregone conclusion. The court has not considered the matter.

There are two situations involving supermajority vote requirements that the court has treated as requiring action separate from that taken on the rest of a bill. Failure by one house to adopt an effective date or to change a court rule does not invalidate the bill as a whole.

With respect to a difference in effective dates, in 1980 in connection with the enactment of ch. 177, SLA 1980 (SCS HB 207 am S (H fld eff date)) the bill adopted by the Senate included an effective date and the bill adopted by the House did not. In that instance, the bill was enrolled and transmitted to the Governor. On July 1, 1980, the Attorney General advised the Governor that the House and Senate did not pass the same bill and the Governor, acting on that advice, returned the bill to the House unsigned. The Governor's transmittal letter is set out in the 1980 Senate Journal at page 1781. Legislative counsel advised that under art. II, secs. 17 and 18, Constitution of Alaska, the bill became law without the Governor's signature, with an effective date of October 5, 1980. By judgment dated March 19, 1981, in Alaska Legislative Council v. Hammond, Case No. 4FA-80-1689, the Superior Court for the

Senator Drue Pearce
May 16, 1994
Page 2

Fourth Judicial District upheld the validity of the enactment. It is true that an ingredient in this ruling was the fact that the failure of or change to an effective date is not an amendment to the substantive provisions of the bill. This is certainly not true in the case of differences in the budget involving an appropriation from the budget reserve fund.

However, in considering whether failure to adopt a court rule change by one house invalidated the bill as a whole, the court did not focus on the fact that substantive provisions of the bill do not differ (they do), but on the fact that a different vote is required for the enactment of legislation than the vote required to change a court rule. The court did not conclude that statutes purporting to change court rules but not receiving a two-thirds majority in each house are invalid, only that they are ineffective in changing the court rule. (Leege v. Martin, 379 P.2d 447 (Alaska 1963)) In a later case, the court cited AS 01.10.030 for the proposition that legislation purporting to change a court rule but failing to receive the vote required in both houses is severable from the rest of the Act. (Galbraith v. State, 693 P.2d 880 (Alaska 1985) at 883, footnote 4)

The Attorney General in the letter based his opinion, at least in part, on the lack of evidence that the legislature intended the CBRF appropriations to be severable from the budget as a whole. AS 01.10.030 provides that evidence.

Clearly, the possibility that the failure of one house to adopt an appropriation from the CBRF by the required three-fourths vote could be deemed to amount to failure to adopt identical legislation is a matter of great concern with the budget itself at issue. The risk of this result could be avoided by refraining from co-mingling appropriations that require different vote levels. However, on balance I believe that a fairly strong argument could be made for the validity of the Act, without the CBRF appropriations, and, I think it is more likely than not that such an argument would prevail.

TBC:pl
94-396.plm

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Bob Walsh

Regular Meeting-Anchorage
Friday, 14 July, 10:00 am to 5:00 pm
Anchorage LIO, 716 West Fourth Avenue, Suite 220

10:00 am	Review & Adoption of Report to Legislature & Governor
10:30 am	Review of Base Case Assumptions
11:00 am	Reports of Subcommittees:
	Revenue - sources of revenue
	Expenditures - budget cut scenarios
	Budget Process - CBR & other reserves
	Style & Drafting - Revise and adopt interim report
	Outreach - public hearing schedule
	Intergovernmental Relations - plans for coordination & format for Aug 26th audioconf
12:00 noon	Lunch brought in
1:00 pm	Continue Subcommittee Reports
5:00 pm	Adjourn

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Regular Meeting-Anchorage
Saturday, 15 July, 8:30 am to 4:30 pm
Anchorage LIO, 716 West Fourth Avenue, Suite 220

8:30 am	Continuation of Friday's Agenda & Adopt Interim Report
11:00 am	Public Testimony
12:00 noon	Break for Lunch
1:30	Unfinished Business New Business

NEXT MEETING:

Video Meeting
Thursday, 27 July
1:30 pm to 7:30 pm
UAF-212 B Butrovich, UAA-University Lake Bldg, UAS-Library

Review Final Document Mark-up
Impacts of Alternatives
Responsibilities of State & Local Governments
Municipal Debt

**Long Range Financial Planning Committee
Expenditures Subcommittee Report**

July 14, 1995

The Legislature asked this Commission to develop a list of spending cuts which total the existing fiscal gap. This means identifying how to cut \$500 million, or 20 % , from current state spending.

Budget cutting is a painful, divisive undertaking, but it does give all of us who live in Alaska the opportunity to re-think what we want government to do . It helps us to decide what services we believe government should provide and how they could be provided at less cost. It forces us to decide what services we are willing to do without and what services we are willing to pay for. Finally, and perhaps most importantly, it requires us to re-define the common good - what are each of us is willing to give up or pay for - in the best interest of all of the people of Alaska.

The following scenerios of spending cuts of \$500 million are in response to the charge by the Legislature to do so. The Committee does not recommend that the fiscal gap could or should be filled by budget cuts alone.

The Committee agrees to the following conclusions:

- 1. Spending cuts are an important and necessary tool to solve the fiscal gap.**
- 2. The State has been accomplishing actual budget cuts by holding a flat budget.**
- 3. Additional budget cuts, over and above a flat budget, will be necessary to solve the fiscal gap.**
- 4. It would be devastating to the economy and poor public policy to attempt to solve the fiscal gap by budget cuts alone.**
- 5. Any significant reduction plan should be phased to the year 2000.**
- 6. Spending cuts should be determined by announced fiscal policy goals.**

Note: It should be pointed out that individual Committee members would choose different percentages or even different programs for cutting, if such a drastic reduction were required. The following scenarios of spending cuts are to demonstrate that there are approaches to reduce the budget; that each approach has its own set of consequences.

Rules of the Road

o Spending cuts were made only to program supported by the State's general fund. This means potential reductions in programs funded from other sources,(such as

Power Cost Equilization , student loans, etc.)were not addressed. One option is to reduce such programs and have the savings go into the general fund to help bridge the gap.

o For purposes of discussion, the Commission agreed to bring Permanent Fund dividends "on budget" since they re an expenditure of state funds. Under Alaska law the legislature would have to vote to use part or all of the earnings for a purpose other than paying dividends. While the Commission is not at this point advocating use of the dividends to fill the fiscal gap, the question of the future of the dividends is central to Alaska's long range fiscal policy.

Current State Spending Philosophies

The state budget reflects the how the Governor and Legislature believe Alaska's revenues should be shared. To date, this spending of Alaska's oil wealth has resulted in three public policy goals which, as state revenues decline, compete against each other. These goals are:

- Alaska's wealth should be shared with the state government so it can provideservices to Alaskans and its communities.
- Alaska's wealth should be shared with local governments so they can provide services that meet local priorities.
- Alaska's wealth should be shared with individual Alaskans so they can make personal decisions about their individual priorities.

One way to cut \$500 million would be to chose one of these philosophies, at the expense of the other two. For example:

- *Alaska's revenues should be shared with the State government* means the top priority would be protecting the amount of money that goes to state agencies so they can continue to deliver the same services the same way as they do now . This would mean:
 - Current state jobs would be protected from elimination (salary and benefits, however, would be reduced in order to maintain as many state jobs as possible).
 - Non-needs based grants to individuals would be cut (Longevity Bonus and Permanent Fund Dividend with the savings going to the general fund to maintain the same level of state services).
- *Alaska's revenues should be shared with local communities* means the priority would be to protect, or increase, the amount of funding that goes to local communities. Local governments would then decide what services their residents want. Such funding and services would not be in addition to what the state provides--it would be in place of what the state has provided. This means:
 - Significant reductions in the number of state employees and state funded services.

- Priority-setting and allocation of funds would shift from the state to local governments in areas such as education, public protection, road maintenance, and capital projects.

- *Alaska's revenues should be shared with individual Alaskans* means the priority would be to protect payments to Alaskans from reduction. This means:

- Permanent fund dividends and grants to individuals would not be reduced.
- Current state employee salary and benefit levels would remain intact.
- Reductions would be made in funding to local governments and in state programs that do not provide a direct service to individuals.

A Practical Approach

Selecting any one of the above options would mean extreme consequences to current programs and services, to every community and to every Alaskan. Instead, a fourth approach could be:

- Alaska's revenues should be shared in such a way that the state can protect and promote the common good of its citizens, our communities can provide the level of services its residents need and are willing to pay for, and individual Alaskans can benefit from receiving necessary services at a reasonable cost.

This more practical approach, and the following principles, were then applied to the current Fiscal Year 1996 budget to reach the assigned task of identifying \$500 million in spending cuts that would be achieved by the Fiscal Year 2000:

Grants and Services to Individuals

- Eligibility for grants to individuals should be based on financial-need.

Grants to Organizations and Local Governments

- Administrative and other costs should be reduced by consolidation of grantee organizations and local governments and school districts. This will stretch the amount of funds available for direct services.
- State funds to local governments will be tied to providing specific services as opposed to general block grants for local services.

(State and local governments should charge for services at a similar rate to that paid in other states. Collection of these increased fees will help offset reduced state funding.

Salaries and Benefits

Significant savings could be realized from reforms to the public employee compensation system. These reforms apply not only to state employees, but also to those employed by local governments and school districts. Reducing the cost of employees will protect current jobs and significantly absorb some of the effects of overall reduced spending. Such cost-saving reforms could include:

- Establishing a different retirement benefit package for new hires. This will reduce current benefit costs for new hires and significantly reduce their future retirement costs.
- Implement a retirement incentive program which will reduce the number of current high-cost employees, cut the overall number of employees, and establish a lower cost for all new employees.
- Changing the current merit system's annual 3.5% increase to a one-time bonus paid annually for outstanding performance. This eliminates continuous build up of an employee's base salary.

Service Delivery Options

Once government agrees certain services should be provided, it doesn't mean government is the only one who can deliver those services. Cost-saving delivery options include:

- Contracting with non-profit and private sector organizations to provide services.
- Privatizing the service by the state selling off an asset for a private entity to operate.
- Providing eligible individuals with a voucher by which they can purchase a service from a private sector vendor.

By applying the above goals and principles, the following savings occur:

Grants to Individuals

Longevity Bonus (non-needs based)	-\$72 million
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Grants to Local Governments

Municipal Assistance/Revenue Sharing	-58.2 million
School Debt Reimbursement	-80.0 million
Capital Matching Grants	-20.0 million

Salaries and Benefit Reforms

-100.5 million

Program Consolidation/Elimination

G.O. Debt (obligations fulfilled)	-16.1 million
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Service Elimination:

-- Human Services Matching Grants	-1.7 million
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Service Delivery Options

Privatize:

-- Pioneer Homes	-29.8 million
-- Tourism/Seafood Marketing	-13.4 million
-- Vocational Education	-5.7 million
Contracting Opportunities	-4.3 million

General Fund Expenditure Reductions

Program	How Savings Achieved	Gen Fund Savings in FY 2000	Amount Remaining
Scenario 1			
\$500 million cut from programs currently funded by general funds.			
Office of the Governor			
Human Rights Commission	10% savings from salary/benefit reforms	-108.7	977.9
Executive Operations	10% savings from salary/benefit reforms and streamline/curtail operations	-733.9	6,604.7
Office of Management and Budget	10% savings from salary/benefit reforms and streamline/curtail operations	-420.7	3,786.1
Elective Operations	10% savings from salary/benefit reforms	-197.2	1,774.8
Department of Administration			
Longevity Bonus	Eliminate	-72,152.6	0.0
Pioneer Homes	Privatize	-29,842.3	0.0
Other Senior Services	10% savings from salary/benefit reforms; grantees charge fees for services	-763.3	6,869.3
Public Defender Agency	5% savings from salary/benefit reforms; contract out	-405.2	7,699.1
Office of Public Advocacy	5% savings from salary/benefit reforms; contract out	-360.0	6,839.6
Centralized Administrative Services	20% savings from salary/benefit reforms; streamline and curtail operations	-2,962.8	11,851.2

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General Fund Expenditure Reductions

Program	How Savings Achieved	Gen Fund Savings in FY 2000	Amount Remaining
Alaska Oil and Gas Conservation Commission	5% savings from salary/benefit reforms; contract out	-82.9	1,575.8
Alaska Public Offices Commission	Consolidate with Div. of Elections; 50% savings	-316.9	316.9
RATNET	Privatize	-794.8	0.0
Public Broadcasting Radio/TV	50% reduction; consolidate/privatize operations	-2,218.3	2,106.8
Leases	20% savings from salary/benefit reforms and streamlining operations; reduced workforce should require less office space; contract out management of some leases	-4,634.2	18,536.8
Department of Law			
Prosecution	5% savings from salary/benefit reforms	-579.6	11,012.0
Legal Services	20% savings from salary/benefit reforms; streamline and curtail operations	-1,534.3	5,771.9
Department of Revenue			
Child Support Enforcement	5% savings from salary/benefit reforms	-92.7	1,761.9
Alcohol Beverage Control Board	Transfer to local community with authority to collect fees to pay for enforcement or merge responsibility with gaming monitoring	-639.3	0.0
Revenue Operations	10% savings from salary/benefit reforms	-868.1	7,813.2
Administration and Support	20% savings from salary/benefit reforms; streamline and curtail operations	-170.8	683.2

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P. 07/15

General Fund Expenditure Reductions

Program	How Savings Achieved	Gen Fund Savings in FY 2000	Amount Remaining
Department of Education			
K-12 Foundation funding	10% reduction based on local school district personnel system reforms; merge some school districts; shift focus to student achievement with cash incentives that reward success	-66,030.9	594,278.5
School Finance	20% savings from salary/benefit reforms; streamline and curtail some operations	-214.9	859.7
Education Program Support	20% savings from salary/benefit reforms, streamline/curtail some operations ; privatize Alaska Career Information System	-669.7	2,678.9
Executive Administration	20% savings from salary/benefit reforms; streamline and curtail some operations	-466.4	1,865.5
Professional Teaching Practices Commission	Privatize or contract out (50% estimated savings)	-376.1	376.1
Arts Council	Privatize	-564.0	0.0
Kotzebue Technical Center	Privatize	-734.0	0.0
Alaska Vocational Technical Center	Privatize	-4,372.3	0.0
Mt. Edgecumbe Boarding School	10% savings from salary/benefit reforms	-231.2	2,080.9
Vocational Rehabilitation	10% savings from salary/benefit reforms	-477.7	4,298.9
Alaska State Library	10% savings from salary/benefit reforms; streamline and curtail some operations; eliminate specific cultural programs grants	-551.4	4,963.0
Postsecondary Education Commission	10% savings from salary/benefit reforms; reduce services	-192.6	1,733.6

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General Fund Expenditure Reductions

Program	How Savings Achieved	Gen Fund Savings in FY 2000	Amount Remaining
Department of Health and Social Services			
Assistance Payments	10% overall reduction; in light of expected federal changes, public assistance program should be reformed with goal of significant cost controls of future growth	-10,163.1	91,468.0
Medical Assistance	10% overall reduction; in light of expected federal changes, medicaid program should be reformed with goal of significant cost controls on future growth	-15,035.6	135,320.2
Public Assistance Administration	10% savings from salary/benefit reforms	-1,916.1	17,244.8
Medical Assistance Administration	10% savings from salary/benefit reforms	-662.4	5,961.4
Purchased Services	10% savings from salary/benefit reforms; consolidate/streamline programs	-2,332.2	20,989.4
Family and Youth Services	10% savings from salary/benefit reforms; consolidate/streamline program	-1,043.0	1,042.5
Youth Facility Services	5% savings from salary/benefit reforms	-717.5	13,632.4
Human Services Community Matching Grants	Eliminate	-1,769.6	0.0
Regional Non-Profit Grants	10% savings from salary/benefit reforms; consolidation	-1,068.7	9,618.1
State Health Services	10% savings from salary/benefit reforms; implement sliding fee scale	-2,310.4	20,793.5
Health Grants	10% reduction; implement sliding fee scale	-698.7	6,288.0
Alcohol and Drug Abuse Services	10% reduction; implement sliding fee scale	-1,535.9	13,823.2
Community Mental Health Grants	10% reduction; implement sliding fee scale	-2,583.8	23,254.0
Medicaid Community Mental Health Grants	10% reduction; implement sliding fee scale	-100.0	900.0
Community DD Grants	10% reduction; implement sliding fee scale	-2,056.2	18,596.2

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General Fund Expenditure Reductions

Program	How Savings Achieved	Gen Fund Savings in FY 2000	Amount Remaining
Institutions and Administration	Privatize Harborview; 5% reduction in APH from salary reforms; 20% cut in other areas	-5,610.4	9,550.5
Mental Health Trust Boards	20% savings from salary/benefit reforms; streamline operations	-142.2	568.6
Administrative Services	20% savings from salary/benefit reforms; streamline and curtail some operations	-743.7	2,974.6
Department of Labor			
Employment Security	10% savings from salary/benefit reforms	-135.6	1,220.3
Office of the Commissioner	20% savings from salary/benefit reforms; streamline and curtail some operations	-1,835.4	5,985.9
Department of Commerce and Economic Development			
Measurement Standards	10% savings from salary/benefit reforms; potential to contract out inspections	-287.9	2,591.4
Banking, Securities, Corporations	10% savings from salary/benefit reforms	-163.2	1,468.4
Insurance	10% savings from salary/benefit reforms	-400.2	3,601.8
Occupational Licensing	Eliminate licensing some occupations; target 20% savings	-797.3	3,189.0
Alaska Public Utilities Commission	10% savings from salary/benefit reforms	-351.6	3,164.3
Executive Administration and Development	20% savings from salary/benefit reforms; streamline and curtail some operations	-920.2	3,680.8
Tourism Development	10% savings from salary/benefit reforms	-303.8	2,733.8
Alaska Tourism Marketing Council	Privatize	-5,365.3	0.0
Alaska Seafood Marketing Institute	Privatize	-7,994.7	0.0

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General Fund Expenditure Reductions

Program	How Savings Achieved	Gen Fund Savings in FY 2000	Amount Remaining
Department of Military and Veterans Affairs			
Alaska National Guard	5% savings from salary/benefit reforms	-233.9	4,443.7
Alaska National Guard Benefits	10% savings from salary/benefit reforms	-113.3	1,019.6
Veterans' Services	10% reduction	-48.0	432.0
Department of Natural Resources			
Management and Administration	5% savings from salary/benefit reforms	-1,409.1	5,636.5
Resource Development	5% savings from salary/benefit reforms; streamline and curtail some operations	-1,275.8	24,239.7
Parks and Recreation Management	Contract Out; 25% targeted savings	-1,337.7	4,275.4
Agricultural Development	Eliminate; leave to private sector	-1,034.2	0.0
Statewide Fire Suppression	5% savings from salary/benefit reforms	-175.5	3,334.5
Department of Fish and Game			
Commercial Fisheries/Sport Fisheries	5% savings from salary/benefit reforms	-1,531.2	28,845.2
Wildlife Conservation	5% savings from salary/benefit reforms	-21.4	407.2
Administration and Support	20% savings from salary/benefit reforms; streamline and curtail some operations	-687.9	2,751.4
Subsistence	5% savings from salary/benefit reforms	-64.9	1,232.2
Habitat	5% savings from salary/benefit reforms	-106.3	2,020.5
Limited Entry Program Administration	5% savings from salary/benefit reforms	-130.3	2,476.6

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General Fund Expenditure Reductions

Program	How Savings Achieved	Gen Fund Savings in FY 2000	Amount Remaining
Department of Public Safety			
Fish and Wildlife Protection	5% savings from salary/benefit reforms	-738.5	14,031.4
Fire Prevention	5% savings from salary/benefit reforms	-90.2	1,714.1
Motor Vehicles	Contract out; 25% savings projected	-2,062.5	6,367.4
Alaska State Troopers	5% savings from salary/benefit reforms	-2,002.5	38,046.6
Village Public Safety Officer	5% savings	-344.3	6,540.8
Alaska Police Standards Council	5% savings from salary/benefit reforms	-24.7	469.3
Council on Domestic Violence and Sexual Assault	5% reduction	-224.4	4,262.7
Statewide Support	10% savings from salary/benefit reforms	-819.4	7,374.9
Department of Transportation/Public Facilities			
Statewide Programs	10% savings from salary/benefit reforms; contract out fleet maintenance and highway maintenance	-10,100.1	90,901.3
Marine Highway Subsidy	10% savings from salary/benefit reforms; increased fees	-2,826.3	25,436.9
Department of Environmental Conservation			
Administration	20% savings from salary/benefit reforms; streamline and curtail some operations	-228.0	911.8
Environmental Quality	5% reduction from salaries/benefits reforms	-733.1	13,928.9
Facility Construction and Operations	10% reduction from salaries/benefits reforms	-212.7	1,913.9

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P. 12/15

General Fund Expenditure Reductions

Program	How Savings Achieved	Gen Fund Savings in FY 2000	Amount Remaining
Department of Community and Regional Affairs			
Administration and Support	20% savings from salary/benefit reforms; streamline and curtail some operations	-547.5	2,190.0
Senior Citizens/Disabled Vets Tax Relief	Eliminate; make local option	-1,500.0	0.0
State Revenue Sharing	Eliminate	-26,271.7	0.0
Municipal Assistance	Eliminate	-31,959.0	0.0
Local Government Assistance	10% reduction from salaries/benefits reforms	-319.6	2,876.3
Child Care Grants	10% savings from salary/benefit reforms; grant reductions	-215.3	2,607.5
Day Care Assistance Program	10% general reduction based on adjusting income guidelines	-1,017.3	10,193.8
Head Start Grants	10% reduction from salaries/benefits and program consolidation	-223.3	2,009.7
Rural Development Grants	Eliminate	-1,119.4	0.0
Rural Energy Program	10% savings from salary/benefit reforms; streamline and curtail some operations	-231.5	2,083.2
Department of Corrections			
Administration and Support	10% reduction from salaries/benefits; privatize correctional academy	-595.2	5,356.9
Statewide operations	5% reduction from salaries/benefits; increase contracting out for care and housing of prisoners	-5,936.2	112,787.4
Community Jails	5% reduction	-218.7	4,156.0

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P. 13/15

General Fund Expenditure Reductions

Program	How Savings Achieved	Gen Fund Savings in FY 2000	Amount Remaining
University of Alaska			
Systemwide	10% reduction from salaries/benefits reforms; consolidation and elimination of some programs	-16,736.2	150,625.5
Court System			
Systemwide	5% reduction from salaries/benefits savings	-2,292.1	43,550.3
Legislature			
Other reductions	10% savings from salary/benefit reforms; streamline operations	-3,084.6	27,761.0
	Operating Budget Estimated Savings:	-384,647.5	
Capital/Debt Appropriation Savings			
Eliminate Capital Matching Grants Funding to local communities		-20,000.0	
Eliminate school debt reimbursement (FY 96 amount)		-80,322.4	
G.O. debt savings (FY 96 amount)		-16,100.0	
	Capital/Debt Estimated Savings:	-116,422.4	
	Total Estimated Savings:	-501,069.9	

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General Fund Expenditure Reductions

Program	How Savings Achieved	Gen Fund Savings in FY 2000	Amount Remaining
Scenario 2			
Permanent Fund Dividend pool is capped at 50 % (\$278 million based on amount in 1994 dividends)			
These funds are distributed to local communities to offset reductions made in scenario one			
Scenario 3			
Permanent Fund Dividend is repealed			
Funds flow into general fund			
Scenario one reductions are not necessary as \$500 million gap is filled			

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FAX NO. 9072798114

P. 15/15

SUMMARY

Task Force on School Funding

June 19 - 20, 1995

Anchorage, Alaska

Call to Order - Stowell Johnstone, chair

Stowell Johnstone, chair of the Task Force on School Funding, called the meeting to order. The following members of the task force were present:

Tim Altman
David Cottrell
Mary Ann Eininger
Senator Lyda Green
Jack Krieheder
Representative Irene Nicholia

Nancy Cannington
Laraine Derr
Senator Steve Frank
Robert Gottstein
Dave Marquez
Bob Weinstein

Shirley Holloway, Commissioner of Education
Dianne Lindback, staff to Representative Elton
Bruce Richards, staff to Senator Judy Salo
John Walsh, staff to Representative Foster

Review May 19 Meeting and May 20 Conference

Tom Freeman, consultant to the task force, reviewed the public conference held May 20 in Anchorage. Over 200 individual responses were given to the question, "What do you think are the major problems with school funding?" Tom analyzed these responses and reported that all five groups identified the following four areas of concern:

- the current formula is inequitable
- lack of inflation proofing
- unfunded mandates for special programs
- unfunded facilities and/or maintenance needs

In addition, Tom indicated that four break-out groups had the following responses in common:

- lack of forward funding
- lack of community awareness
- recognition of the needs of small single sites

Misc Info:

1. Summary Task Force on School Funding
2. Public Testimony from Cliff John Grot
3. Recap of Organization's Activities on State Fiscal Reform

Transportation

The possibility of including transportation costs within the formula was discussed. One task force member indicated that the costs of transporting students was a function of the number of students and the needs of those students. Currently, school districts are reimbursed for the cost incurred with little or no oversight by the department. Possibly a new approach for covering these expenses should be discussed.

Capital Expenditure or School Construction

An alternative to the current method of providing school construction dollars was discussed. The merits of including discretionary funds within the school funding formula for capital and major maintenance expenses was explored. This plan would allow a school district to save and plan for its capital and major maintenance needs. The decision to fund additional projects would be made at the local level.

Single Site District

The task force was briefed on the history of the special appropriations to small single site school districts. In FY96, 21 small single site school districts received additional district support totaling \$3.2 million.

Understandable, Simple Formula

Many members of the task force indicated the importance of proposing a school funding formula that was simple and understandable to the general public. When a formula is too complex to be understood by many people, there is a tendency to wonder if the system is really treating all school districts equally.

Simplify Categorical Funding

During the dialogue on the current categorical funding mechanism, the importance of local decision making was stressed. Several members indicated that it is important to simplify the programs. The current vocational education plan is an allocation per student enrolled in eligible courses. Possibly this approach should be considered for the other special categories.

It was pointed out by one task force member that the growth in categorical expenditures has greatly surpassed the increased student enrollment. Since 1987, student enrollment increased 20%, while the growth in categorical programs has been almost 60%. The task force was encouraged to address this concern.

Area Cost Differential

It was recognized by the task force that the current area cost differential (ACD) is based on a household cost of living study and not on the actual cost of providing an education. The possibility of limiting the ACD to personnel costs was addressed. There was recognition by the task force that incentives may be needed to help control costs.

Message Present Formula

The task force was informed that when the foundation formula was revised in 1987 an additional \$63 million was required. It appears very unlikely that additional funds for education will be available for this revision. Although several members of the task force acknowledged that the

Identify School Funding Problems and Issues Important to the Task Force

The next agenda item allowed the task force members to reflect on all the public comments offered to date and to brainstorm the issues they would like to discuss in further detail. After a lengthy free-flowing brainstorming session, the task force compiled the list that follows:

- single site districts
- massage present formula
- understandable, simple formula
- capital expenditure
- governance
- size and number of districts
- area cost differential
- simplify categorical funding
- set goals - what do we want
- forward funding
- disparity test
- parental involvement
- transportation
- choice
- present limits of funding source
- task force goal
- equalization of wealth
- define equity
- PL 81-874

Discuss Problems and Issues

The committee spent many hours discussing and analyzing the issues identified above. A summary of that discussion follows:

Equalization of Wealth, Local Control, Disparity, PL 81-874

The task force members recognized how closely these concepts are interwoven. State statute limits the amount a local school district may contribute towards school funding so that Alaska meets the federal disparity test. Alaska must be in compliance so that the state can recognize impact aid dollars as a means to equalize wealth between school districts. Individual district wealth needs to be equalized to an acceptable standard to insure that all districts are treated equally.

Although PL 81-874 dollars represent a small percentage of the total amount allocated for school funding (\$43 million in FY96 out of a total of \$711 million), it is highly unlikely that replacement dollars will be available from the legislature.

PL 81-874

Impact aid is received from the federal government for payment in lieu of taxes for individuals working or living on federal lands. The passage of ANILCA removed land from the tax roll and greatly increased the number of students eligible for PL 81-874 support. Kansas, New Mexico, and Alaska are the only three states that are allowed to deduct impact aid from a district's state aid entitlement.

Disparity

The discussion on disparity centered on the need to insure equity between school districts. Even if the federal standard of disparity did not apply, the committee felt that an Alaskan standard should be considered. All students should be treated equally under the formula.

current formula addresses the uniqueness of Alaska (minimum local contribution requirement and the area cost differential), the vast differences in the cost of providing an education per student is troublesome and should be looked at.

Governance

The members explored a variety governance structures for public education. The task force emphasized the importance of parental involvement in decision making and the value of possibly including incentives within the formula to encourage cooperation between school districts.

Task Force Goals

The group decided that four main goals should drive the revision of the formula; adequacy, equity, local control, and accountability. After considerable free-flowing discussion, the task force agreed to the following basic concepts:

Adequacy (of funding) - maintain, at least, current level of funding, every child's needs must be reasonably addressed, capital expenditures and maintenance of facilities must be considered, mandated programs need to be funded

Equity - equity can be defined in terms of funding, learning outcomes, access and opportunity to education, and tax payer contribution

Local Control - people do a better job of managing their lives than government, local control includes parents and other concerned individuals, local control equals the local education community, ideally vest control in the hands of parents

Accountability - should bubble from the bottom up as in school site decision making, sanctions vs. incentives, local school derives authority from state statutes

Identify Potential Solutions

Several members suggested that any new proposal must be a win-win situation for school districts. If districts are adversely impacted by the change, most likely neither the governor nor the legislature will support the proposal. If the new funding formula is simple and logical and addresses the concerns previously outlined, the new proposal will be viewed with an open mind.

An idea for distributing education dollars on a per student basis was presented to the task force by a committee member. Under the plan presented each individual student would receive funding based on one of three categories depending on the needs of the student. The three categories suggested are *Base*, *Special Needs 1* and *Special Needs 2*. A *Special Needs 1* student would receive 2 times the base and a *Special Needs 2* child would receive 5 times the base.

In addition, the state would be divided into 3 distinct geographical areas:

Area A - urban communities - approximately 80% of the students

Area B - remote communities that have access to major transportation systems - 5%

Area C - very remote communities, not on a road system - 15% of the students

Area B would receive 25% more than Area A and Area C would receive 75% more than Area A.

The area in which a student's school is located and the needs of that student would determine the funding level. Thus, the funding plan is based on 2-dimensional matrix, the area of the state and the individual student needs. The matrix is shown as follows:

	Area A	Area B	Area C
Base	\$ 5,000	\$ 6,250	\$ 8,750
Special Needs 1	10,000	12,500	17,500
Special Needs 2	25,000	31,250	43,750
Waiver *	50,000	62,500	87,500

* A waiver would be granted if a student needs were not addressed by the funding allocated in the category, *Special Needs 2*.

It was recommended that the payment for education be distributed through a student allocation similar to a public voucher that would be given to the parent or legal guardian of a student. The parent would be able to decide which school his or her student would attend. The public voucher would be taken by the parent or legal guardian to this school. The financial decisions on how to spend the voucher would then be made at the school level, instead of at the district level. The money would flow from the building level to the district administrative level. It was indicated that the use of the public voucher would result in a change in the governance structure of our schools. The funding decisions would be made at the building level; the level most directly impacted by those decisions.

Although the member recommended serious consideration of the public voucher proposal, it was indicated that this plan to distribute school funding based on a per student basis could stand alone, with or without a public voucher.

It was suggested that incentives could be established that would encourage local communities to contribute more local dollars to education. In addition, the cost of transportation and capital expenditures could also be included in the formula.

The task force reviewed the information presented and discussed the proposal in great detail.

Determine Order of Discussion and Align Discussion Topics with Meeting Calendar

The task force requested that John Augenblick, a nationally recognized school finance consultant, be present at the next meeting. After considering the pros and cons of breaking into small subcommittees to study areas of concern in greater depth, the task force decided to continue to function as a committee of the whole and to review each concept as a group.

The task force will continue to review the current formula with possible changes and will begin a study of the proposal to fund education on a per student basis. To assist the committee in its deliberation, the Department of Education was requested to provide the following information:

1. Within the existing foundation formula, look at needed or desired proposals in the following areas utilizing the same governance structure, "district level"
 - a. Single site
 - b. Disparity test-PL 81-874
 - c. Incentives for shared resources/services
 - d. Categorical funding collapse
 - e. Equalization of wealth
 - f. Area cost differential
2. Analyze the formula proposal that was based on a per pupil revenue using the same framework as above and using district level governance
3. Analyze the formula proposal that was based on a per pupil revenue using a "student level" funding
4. Consider the possibility of funding pupil transportation in the school funding formula
5. Prepare an overview of PL 81-874 including analysis of how PL 81-874 is treated today in the current formula and expected future changes
6. Review the possibility of an alternative price index
 - a. Provide an analysis of personnel costs and non personnel costs
 - b. Provide an analysis of O & M vs. Instruction
7. Provide background information on capital project funding for major maintenance and school construction and the long and short term activities of the Bond Reimbursement and Grant Review Committee

OTHER ISSUES

- A. Options for community to support and contribute
- B. Long term plan for the formula, with a periodic review process
- C. Forward funding (to allow districts to plan for a period of time)
- D. Analyze the need for single site additional district support
- E. Analyze proposed versions of SB 70

Adjourn

Before adjourning, the task force indicated that the next meeting would take place July 10 - 11 in Anchorage at the Iliamna Room, Hilton Hotel. The meeting will begin Monday at 10:00 a.m.

UNDERSTANDING THE FISCAL GAP

I. What is the nature of the problem?

II. What are possible solutions?

A. Statutory changes

1. Cut the budget, reduce Permanent Fund dividends (PFDs), raise taxes, use reserves strategically to make the transition to a sustainable balance, aim for a soft landing
Advocates include Scott Goldsmith, Steve Colt, and Pat Pourchot
2. Cut budget and reduce PFDs, but don't raise taxes
Advocates include Steve Rieger
3. Cut budget and raise taxes, but don't cut PFDs
Advocates (at least previously) included Hugh Malone
4. Muddle through--do not amend the constitution, as this could harm representative government
Advocates include John Havelock

B. Constitutional amendments

1. Roger Cremo--put all natural resource revenues (in practice, this would mostly be oil money, including all oil taxes and all oil royalties) into the Permanent Fund (PF) and live off the real (inflation-adjusted) income (assumed to be 6% a year) plus other revenues and budget cuts; the transition to this proposed system would rely on annual withdrawals from the PF; these transitional withdrawals during the transition would be higher than the real income of the PF, but the withdrawals would decline each year until the transition ended
2. Jay Hammond--adopt Cremo plan, modified by guarantee of increased PFDs if voters support budget cuts and a "sliding scale tax" which would have the rate of income tax vary with oil prices and the budget
3. Dave Harbour--put all oil royalties into PF, end PF inflation-proofing, require cash-based budgeting, impose an individual income tax, prohibit tax increases without voter approval; transition would be financed by a one-time voter-approved withdrawal from PF for one-year forward funding of the budget
4. Mike Bradner--adopt a temporary tax increase by adopting a constitutional amendment for a tax increase with a sunset provision

*NOTE: Additional materials
from Mr. Groh available in
LEPPC library.*

Cliff John Groh
April 5, 1995

-Policy options-

SO YOU SAY YOU WANT TO RAISE REVENUE . . .

A menu of choices for state taxes

An excerpt from "A Practical Guide for Dealing with the Fiscal Gap," written in 1990 and updated for publication here. The guide outlines various fiscal policy options, including cutting the budget and raising oil taxes, and considers the pros and cons of different approaches. The excerpts featured here focus on individual taxes.

By Cliff John Groh

General principles

If taxes on individuals are going to be imposed or raised, it makes a big difference which taxes we rely on. We can measure the desirability of different types of individual taxes and fees in Alaska by four general considerations: revenue potential; progressivity; administrative feasibility; and political acceptability.

- ♦ Revenue potential is obvious. All other things being equal, the best tax is the one that raises the most money.
- ♦ Progressivity is a common goal of taxation. It is based on the idea that richer people should pay a higher percentage of income to support government that should poorer people. Even those who reject the concept of progressivity should at least avoid the opposite. Taxes should be at least proportional, because it cannot be right for the poor person to pay a *greater* percentage of his or her income in taxes than a rich person.
- ♦ Administrative feasibility is a dull subject, but a critical one in government. It's generally easier to raise money by hiking an existing tax than enacting a whole new tax. Start-up costs should be factored into any discussion of the relative potential of different taxes.
- ♦ Political acceptability is tricky. Alaskans have gotten used to paying low taxes. The most popular tax would be either invisible or paid only by non-residents. Given that we cannot attain much revenue from either kind of tax, let's look at ways to make taxes more or less acceptable.

One facet of the political acceptability of a tax is its visibility. Taxpayers resent a tax less if they don't notice it. This is a big problem for the income tax, which requires taxpayers to send in very obvious annual checks.

Another aspect of political acceptability is the visibility of the benefit received for the tax or fee. The most politically acceptable revenue raisers are those linked to a specific and tangible benefit — like an increase in the gasoline tax earmarked for highway repair. Similarly, the idea of a "user fee" is more popular than a tax because the "user fee" seems to cut out the bureaucratic middleman and directly finance a useful activity.

But there are obvious limits to this "fee for service" concept. One big one is that there is no way to charge for welfare. Society has a floor below which it does not want anybody to fall, regardless of ability to pay.

A final test of political acceptability for a tax in Alaska is how much it will hit residents versus non-residents. Alaskans resent people who live somewhere else coming in and making money here. The anger is particularly aimed at oil, fishing, and construction industries. Fishing and construction work is often seasonal, making it easy for non-residents to come in and get it. Work in all three industries in Alaska often occurs at remote sites unsuitable for permanent habitation. The individual income tax is the only tax that can hit significantly at non-residents. (But it is constitutionally and administratively impossible to get only non-residents to pay it.)

Specific tax choices

Three individual tax options offer the possibility of new revenue significant enough to affect the fiscal gap. They are income tax, sales tax, or a permanent fund dividend reduction.

- ♦ **Individual income tax.** Alaska had an individual income tax before 1980, but eliminated it that year in the first wave of petrodollar euphoria. Bringing back the same income tax would raise roughly \$330 million annually, according to a current Legislative Affairs Agency estimate. The rate for the tax was 3.2 percent for incomes under \$50,000 annually and 5.7 percent above that level.

Most states have an individual income tax. Reinstating the old Alaska income tax would cost around \$550 per capita, placing Alaska in the middle range of states for income tax burden.

The major arguments for the income tax are that it raises a significant amount of money, it is progressive, and it is the only tax that hits at non-residents to any significant degree. The major arguments against an income tax are that it is hard to start up, and that its high visibility unlinked to any obvious specific benefits makes it highly unpopular with a large segment of the public.

- ♦ **General sales tax.** Alaska has never had a statewide sales tax. The state has traditionally reserved the general sales tax for local government — although Anchorage, the biggest local government, does not impose one. A current

estimate from the Alaska Department of Revenue indicates a broad-based state general sales tax could raise \$60 million per 1 percent of tax. To raise the same \$330 million as the old income tax would require a sales tax of 5.5 percent. This estimate assumes that the tax would cover all retail sales.

Alaska is one of only a handful of states with no statewide sales tax. (Alaska is the only state without either an individual income or a sales tax.) A 5.5 percent rate would put Alaska among the highest tier of states in sales tax rates.

Federal law currently makes state sales tax non-deductible against the federal income tax, while state income taxes remain deductible. This means that Alaskans would fare worse with a sales tax.

Enacting a statewide sales tax also raises the question of how the state will treat sales in areas that already have local sales taxes. The revenue estimate assumes that the state will neither allow a credit against the state sales tax for local governments which have their own local sales tax, nor will it share revenues with those local governments. If the state takes this approach, businesses within those jurisdictions will be forced to assume a double filing burden. This increases the potential for errors and non-compliance, and substantially increases the political opposition.

The start-up on a general statewide sales tax would be very high, in part because we have never had one.

This tax is regressive, and will hit particularly hard at low-income Alaskans. Non-residents and seasonal workers will largely escape this tax, because they do not buy much here.

Despite the unfairness of this tax, it is less unpopular than an income tax, because the sales tax is paid in nickels and dimes all year long instead of in a lump-sum check.

♦ **Cut Permanent Fund Dividends.** About half of the Permanent Fund's income each year goes for Permanent Fund Dividends. This unique Alaska program puts more than \$500 million into the Alaska economy annually, with each Alaskan getting a check of nearly \$1,000. For every \$20 bill you see in the Alaska economy, about \$1 of it is a dividend dollar.

The dividend program functions as a "negative," or reverse, flat head tax. Eliminating dividends could be considered regressive taxation.

The program was born during the petrodollar surge of the early '80s, and it has several rationales for its existence. Here are five:

(1) Permanent Fund Dividends build a political constituency for the Permanent Fund itself. Special-interest pressure for fund investment in shaky Alaska development schemes would be irresistible without the provision of direct and tangible benefits for individual Alaskans. Dividends provide that direct and tangible benefit, and give the public a powerful incentive to increase the size of the fund and

protect it against special-interest raids.

(2) Dividends are more fair than many of the other uses of the oil money. Subsidized loan programs have been a particularly egregious example of the inequity of other uses of the oil wealth. Loans only go to those who can pay them back — thus cutting out many people — and subsidized loans provide big grants of "subsidy welfare" to those fortunate enough to receive them.

(3) To the degree that government expenditures in Alaska are justified because of the economic effects, dividends stimulate the economy more efficiently than do operating expenditures, capital expenditures, or loan programs. Using a dollar to pay a dividend check increases personal income more and creates more jobs than using that dollar to pay for the operating budget, the capital budget, or a loan program. Permanent Fund Dividends provide a significant portion of the incomes of many Alaskans, particularly village Natives — more than 10 percent in some areas, according to census figures.

(4) Dividends deliver benefits more efficiently to their targeted populations than other methods. Significant chunks of money distributed in other ways leaks out to "middlemen." Dividends allow each Alaskan to receive benefits undiluted by state employees, construction contractors, or bankers.

(5) The payments of the dividend decentralizes decision-making. Individual decisions can often be better than collective decisions. Some Alaskans believe that the money distributed as dividends in the 1980s was better spent than it would have been if the legislature had had that money available to spend.

Some say that these rationales for continuing the dividend mark the program as an antidote for a disease — too much money coming into public hands — which is now gone, and that the antidote itself is no longer necessary and perhaps even harmful. Some say it's time for the state to return to the core functions of government, which do not include per capita direct distributions. And some will say that it would be crazy to restore the individual income tax as long as the Permanent Fund Dividend survives.

There may be merit to these arguments against dividends, but Alaskans should be wary. Permanent Fund Dividends have helped protect the Permanent Fund from low-return investments, and they have been a big boon to lower-income Alaskans with large families who were not so poor as to qualify for public assistance. Eliminating the dividend would hurt low-income residents. Keeping the dividend should be considered whether or not the income tax comes back.

The author served as Special Assistant to the Commissioner of Revenue from 1987 to 1990. He is now an attorney in Anchorage.

ORGANIZATIONS' ACTIVITIES
ON
STATE FISCAL REFORM

Compiled from reports at a June 8, 1995 meeting. Attendees: T. Bradner, P. Tielston, Alaska Common Ground; K. Swift, Common Sense for Alaska; P. Neal, C. Frasca, Alaska State Chamber of Commerce; C. Heyman, T. Williams, Anchorage Chamber of Commerce; N. Schoephoester, ARCO; K. Burke, Alliance; J. Brady, A. Gray, AOGA; and M. Fouse, staff, Fiscal Planning Commission.

Alaska Common Ground

- Produced and aired first video program "Running out of Time" this spring.
- Second video program "Pulling Together" airs June 14 on KAKM.
- Sept./Oct. tentatively planning conference--agenda for conference not yet set, may wait to see what Fiscal Planning Commission is doing to set agenda.
- Public Participation and Constitutional Committees looking at ways to get rural areas plugged into the process--looking at using existing organizations to get materials into communities and to get discussion going.

Alaska Support Industry Alliance

- Alliance adopted position supporting forward funding/systemic change.
- Advertising campaign advocating forward funding currently on hold.

Alaska State Chamber of Commerce

- July 28 Seminar "Privatizing Government...Expanding the Options, Trimming the Costs"--Alyeska Resort.
- September 26-28 State Chamber Conference (in Whitehorse)--opportunity to focus on fiscal issues.
- Produces and distributes Fiscal Notes--distribution 10,000.

From: Judy Brady

Anchorage Chamber of Commerce

- August, 1995 Chamber Forum--Brian Rogers will present Fiscal Planning Commission Interim Report.
- Chamber involving rural Alaska through its Rural Partnership forum.
- Fall, 95 Small Business Conference--opportunity to educate small businesses on fiscal issues.

Common Sense for Alaska

- Will continue to focus advocacy efforts on need to cut the budget with emphasis on formula programs--welfare reform and possibly education and/or corrections.
- Plans "road show" program this summer & program before session convenes in Jan. 96.

All organizations represented agreeable to theme "Challenge of Change" and to continued meetings to coordinate efforts.

Draft Transmittal Letter for Exclusive Access Fishery Royalty Tax

*HAND OUT By Hugh Morley
7.15.95*

The Honorable Ramona Barnes
Speaker of the House
Alaska State Legislature
Room 208, State Capital
Juneau, AK 99801-1182

Dear Speaker Barnes:

Under the Authority of art. III, sec. 18, of the Alaska Constitution, I am transmitting a bill instituting an exclusive access fishery royalty tax to apply to the gross earnings of permit holders in commercial fisheries to which the state has limited entry.

This royalty tax bill is one of four relatively modest revenue proposals I am offering this session to help offset the large revenue shortfalls the state is facing in fiscal year 1995 and in the years to follow. Passage of this legislation will also correct a long-standing imbalance in the state's fiscal system with respect to natural resource development. The fundamental idea underlying this proposal is that whenever the state grants exclusive harvest rights to a common property resource, it has an obligation as owner to collect a rent on behalf of the public for that privilege. This is the same rationale that the state has traditionally applied to oil leases.

When limited entry was established twenty years ago, it was never intended to develop into an exclusive club or to create artificial wealth for permit holders. The purpose of limited entry was to allow the state to better manage its fisheries resources in accordance with the sustained yield principle embodied in the Alaska Constitution. This bill will collect a premium from those who enjoy a special harvest privilege according to the amount of benefit they derive from their exclusive rights. The tax rate will be gradually increased over a four year period beginning with a two percent rate in 1995, increasing to five percent by 1998 and thereafter. Recognizing the great diversity in Alaska's fisheries, and the fact that a large percentage of permit holders have low incomes, especially in rural areas, those permit holders with less than \$10,000 per year

1 June 23, 1995 12:50 PM

aggregate gross earnings in limited fisheries would receive a refund of their royalty payments.

In recent years, Alaska's limited entry system has come under increasing legal attack, both from the Internal Revenue Service, which considers limited entry permits to be property that can be seized for back taxes, and from individuals who have been denied permits and challenge the constitutionality of the law as creating a privileged class of citizens. The clear trend of court decisions affecting the status of the present system is to treat a limited entry permit as a property right conferred by the state. Without collecting some rent for the right of exclusive harvest, it appears that the legal status of the entire limited entry system is becoming increasingly precarious. Given the court cases now pending, the proposed royalty tax will help protect the system from further constitutional challenges.

The royalty tax will be collected at the point of first sale to a processor or fish buyer and deducted from gross revenues on the fish ticket, similar to the way in which the fisheries business tax is currently administered. Buyers and processors will be responsible for collecting the royalty and remitting the receipts to the Department of Revenue. All limited entry permit holders will pay the royalty, but those earning less than \$10,000 per year in limited fisheries can apply to the Department of Revenue for a refund.

Based on the gross earnings in limited fisheries during the 1982 - 92 period and assuming that the estimated 30% of all permit holders eligible for refunds actually receive them, the royalty can be expected to generate the following revenue stream:

<u>Calendar Year</u>	<u>Royalty Rate</u>	<u>Estimated Revenue</u>
1995	2%	\$ 9.5 million
1996	3%	\$14.2 million
1997	4%	\$18.9 million
1998	5%	\$23.6 million

12/26 *60 111*

Certainly the imposition of a royalty means that the state is taking a larger share of the value of the resource and will cause some changes in fishing behavior. It is also likely to reduce the market value of some limited entry permits. In many of Alaska's salmon fisheries, participants who have recently purchased permits have experienced a

significant capital loss during the past few years due to low prices and gross earnings. This will be somewhat offset by new Internal Revenue Service regulations that treat limited entry permits as depreciable capital assets. The phase in aspect of the royalty tax proposal should help recent entrants to limited fisheries by giving them some time to adjust their finances and the refund provision is designed to protect permit holders with low earnings. Thus the royalty should not contribute to permit migration out of rural areas of the state.

Some have argued that the commercial fishing industry in Alaska already pays more in taxes than other renewable natural resource industries and therefore should not bear any additional tax burden. The facts are that the state has never charged a rent for exclusive harvest rights and even after the royalty tax is fully implemented in 1995, the effective tax rate on the ex-vessel value of the limited fisheries harvest will be about half of the rate applied to the wellhead value of petroleum. I think most legislators will agree that the public deserves a fair share of the value of its fisheries resource and I urge your support of this legislation.

Sincerely,

Walter J. Hickel
Governor

STATE OF ALASKA
LONG RANGE FINANCIAL PLANNING COMMISSION
716 West Fourth Avenue, Anchorage, Alaska 99501
Phone: (907)258-8165, Fax (907)258-9869

July 15, 1995

The Honorable Tony Knowles, Governor of Alaska
The Honorable Drue Pearce, President of the Senate
The Honorable Gail Phillips, Speaker of the House

Dear Governor Knowles, President Pearce and Speaker Phillips:

The Long Range Financial Planning Commission, established by Legislative Resolve 1, was directed to send you a preliminary report by today. Due to the extremely short time allowed to the Commission to complete its work, we have chosen to submit a more complete interim report to you and the people of Alaska in mid-August.

In this preliminary report to you, we summarize the process the commission has used to come to its interim conclusions, report our findings, and describe our plan for the time remaining before the final report is due on October 1, 1995.

The Long Range Financial Planning Commission finds that the fiscal gap is real and growing. We project that spending will exceed revenues by a minimum of \$500 million per year, growing to \$1 billion per year, over the next 10 years. This gap is caused primarily by reduced revenues due to decreasing oil production from Prudhoe Bay, combined with expenditures driven primarily by increased state population. While you have done a good job in holding the line on spending for the past five years, the fiscal gap will continue to grow absent changes in the state's financial plan. The Commission has found that no one solution responsibly fixes the problem of the fiscal gap; the answer will have a number of elements and may require changes in existing law.

In our interim report to the public to be published in August, we will outline the causes of the fiscal gap, describe the tools to close the gap, give examples of ways in which the gap can be closed, and ask for public comment. After spending the month of August giving the report the widest possible distribution, in September we will hold a series of public hearings with statewide participation. After the public hearings we will give you our recommendations for closing the state's fiscal gap.

The commission has met regularly since its first meeting on April 8, 1995. There are six subcommittees that meet and make recommendations to the full commission. The subcommittees and their areas of responsibility are as follows:

Public Outreach Subcommittee: Identify methods and costs for informing the public and receiving public comment.

Expenditures Subcommittee: Examine budget expenditures and make recommendations as to methods or principles by which to reduce or increase expenditures.

Style and Drafting Subcommittee: Draft interim and final reports.

Revenue Sources Subcommittee: Identify potential sources of state revenue, estimate their impacts. Examine earnings of the permanent fund.

Budget Process and Reserves Subcommittee: Examine the method by which state government builds and presents its budget. Examine reserves and their possible uses. Review constitutional budget reserve.

Intergovernmental Subcommittee: Examine impacts from federal and state budget actions. Work with municipalities and school groups.

We believe that during the time remaining for the work of the Commission that we will be able to complete our deliberations and produce a responsible long range financial plan for the State of Alaska. We look forward to continuing to work with you .

Sincerely,

Brian Rogers, Chairman

Judy Brady, Vice Chairman

E. Lee Gorsuch

Sen. Georgianna Lincoln

Robert W. Loescher

Bruce Ludwig

Annalee McConnell

Hugh Motley

Rep. Mike Navarre

Mary Nordale

Mike O'Conner

Rep. Sean Parnell

Patrick Pourchot

Sen. Steve Rieger

10 July, 1995

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

Dear Commissioners:

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

Boards, Commissions, Departments and Government Services:

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

Give Away Programs:

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

Incentives

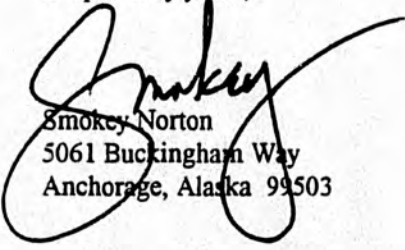
I would recommend you encourage an effort to develop incentives with rewards to citizens/state employees/supervisors/state managers that produce ideas that will make state government more effective and efficient.

Taxes:

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

I anxious to see the recommendations from your commission.

Respectfully yours,



Smokey Norton
5061 Buckingham Way
Anchorage, Alaska 99503

"NEW BASE CASE" PROJECTION

(FY 96 Dollars)

	<u>FY 96</u>	<u>FY 97</u>	<u>FY 98</u>	<u>FY 99</u>	<u>FY 00</u>	<u>FY 01</u>	<u>FY 02</u>	<u>FY 03</u>	<u>FY 04</u>	<u>FY 05</u>
Average Oil Price (\$/bbl.)	16.52	16.14	16.39	16.39	16.48	16.57	16.66	16.75	16.84	16.92
Oil Production (MMbbl/day)	1.503	1.457	1.418	1.375	1.342	1.304	1.246	1.195	1.146	1.103
AVAILABLE REVENUES (\$ Millions):										
PETROLEUM	1,473.4	1,495.5	1,526.7	1,508.3	1,474.6	1,439.5	1,367.5	1,309.3	1,256.8	1,200.2
OTHER SOURCES	301.3	284.3	282.1	282.1	281.4	280.5	279.5	278.2	276.9	275.7
NONRECURRING SOURCES	180.1	87.4	84.7	82.1	79.6	77.1	74.7	72.4	70.2	68.0
PERMANENT FUND NET INCOME	1,218.0	1,251.6	1,284.5	1,319.7	1,372.7	1,409.3	1,445.5	1,480.6	1,516.1	1,551.0
TOTAL REVENUES	3,172.8	3,118.7	3,178.0	3,192.3	3,208.3	3,206.4	3,167.3	3,140.6	3,120.0	3,094.9
EXPENDITURES (\$ Millions):										
OPERATING – AGENCY	1,119.9	1,128.9	1,137.9	1,147.0	1,156.2	1,165.4	1,174.7	1,184.1	1,193.6	1,203.2
FORMULA	413.8	417.1	420.4	423.8	427.2	430.6	434.1	437.5	441.0	444.6
K – 12 EDUCATION	660.3	676.8	693.7	711.1	728.8	747.1	765.7	784.9	804.5	824.6
DEBT SERVICE	109.4	84.1	76.7	66.4	44.9	28.6	17.0	13.3	11.9	10.9
CAPITAL	106.2	106.2	106.2	106.2	106.2	106.2	106.2	106.2	106.2	106.2
LOANS/TRANSFERS/SUPPS.	42.2	22.4	22.6	22.7	22.9	23.1	23.3	23.5	23.7	23.9
PERMANENT FUND INFLATION PROOFING	441.0	428.2	454.5	461.5	482.6	490.0	496.5	503.7	510.1	516.3
PERMANENT FUND DIVIDENDS	575.0	581.6	578.7	592.8	632.0	650.2	669.2	688.0	707.4	724.1
TRANSFER TO EARNINGS RESERVE	202.0	241.8	251.3	265.4	258.1	269.0	279.8	288.9	298.7	310.7
TOTAL EXPENDITURES	3,669.8	3,687.0	3,742.0	3,796.9	3,859.0	3,910.3	3,966.6	4,030.2	4,097.0	4,164.3
PROJECTED FISCAL GAP	-497.0	-568.3	-564.0	-604.7	-650.6	-703.9	-799.3	-889.6	-977.0	-1,069.4
CONSTITUTIONAL BUDGET RESERVE										
BALANCE IF FISCAL GAP	2,008.5	1,867.3	1,386.9	876.3	198.7	0.0	0.0	0.0	0.0	0.0
FILLED ENTIRELY WITH CBR										
REMAINING FISCAL GAP						505.2	799.3	889.6	977.0	1,069.4
PF EARNINGS RESERVE BALANCE	844.0	1,040.9	1,260.1	1,486.6	1,698.9	1,915.6	2,136.3	2,359.4	2,586.1	2,816.3
INFRASTRUCTURE MAINTENANCE		71.1	71.1	71.1	71.1	71.1	71.1	71.1	71.1	71.1

MEMORANDUM

State of Alaska
Office of the Governor
Office of Management and Budget

July 13, 1995

TO: Members
 Long Range Financial Planning Commission

FROM: Brad Pierce
 Senior Policy Analyst

SUBJECT: Updated Fiscal Models

The attached spreadsheets are my interpretation of the changes to our base case that the group agreed upon at the last meeting. Listed below are the pertinent changes to the three cases.

All three scenarios share the following assumptions

- Oil price, production and revenue figures are from the DOR "Revenue Sources" Base Case. Inflation projections come from the same source.
- Population projections of 1.6% average annual growth were supplied by the Department of Labor Research and Analysis Section.
- Permanent Fund net income, inflation proofing, PFDs, Earnings Reserve Account Balance and transfers to the ERA were computed by OMB staff via the Permanent Fund Corporation projection model.
- Debt service and Constitutional Budget Reserve balance were computed by OMB staff.
- No out year supplemental appropriations after FY 96.

Freeze Scenario assumptions:

- Agency operations, formula programs and education expenditures are frozen at their FY 96 level in inflation adjusted "real" terms.
- No additional infrastructure maintenance (assumed to be \$73 million in FY 97 in previous models).
- The CBR is completely drained by FY 2002.

Per Capita Projection

- Spending is assumed to increase at the rate of population times inflation growth
- Education increases at the rate of enrollment and inflation.
- Infrastructure maintenance increases at the rate of inflation.
- A base of \$125 million (in FY 96 dollars) in capital spending is assumed for FY 97.
- The CBR is drained by FY 2000.

Demand Projection

- Uses per capita projection as the base.
- Corrections increment to operating agency projections assumes an average annual growth rate of 8%, per DOC estimates of need.
- DHSS formula program increment assumes that the state will pick up all proposed federal reductions.
- The CBR is drained by FY 2000 but the shortfall is \$500 million greater than the per capita case.

"FY 96 FREEZE" PROJECTION

(FY 96 Dollars)

	<u>FY 96</u>	<u>FY 97</u>	<u>FY 98</u>	<u>FY 99</u>	<u>FY 00</u>	<u>FY 01</u>	<u>FY 02</u>	<u>FY 03</u>	<u>FY 04</u>	<u>FY 05</u>
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REVENUES (\$ Millions):										
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EXPENDITURES (\$ Millions):										
OPERATING - AGENCY	1,119.9	1,119.9	1,119.9	1,119.9	1,119.9	1,119.9	1,119.9	1,119.9	1,119.9	1,119.9
FORMULA	413.8	413.8	413.8	413.8	413.8	413.8	413.8	413.8	413.8	413.8
K - 12 EDUCATION	660.3	660.3	660.3	660.3	660.3	660.3	660.3	660.3	660.3	660.3
DEBT SERVICE	109.4	84.1	76.7	66.4	44.9	28.6	17.0	13.3	11.9	10.9
CAPITAL	106.2	106.2	106.2	106.2	106.2	106.2	106.2	106.2	106.2	106.2
LOANS/TRANSFERS/SUPPS.	42.2	22.2	22.2	22.2	22.2	22.2	22.2	22.2	22.2	22.2
PERMANENT FUND INFLATION PROOFING	441.0	428.2	454.5	461.5	482.6	490.0	496.5	503.7	510.1	516.3
PERMANENT FUND DIVIDENDS	575.0	581.6	578.7	592.8	632.0	650.2	669.2	688.0	707.4	724.1
TRANSFER TO EARNINGS RESERVE	202.0	241.8	251.3	265.4	258.1	269.0	279.8	288.9	298.7	310.7
TOTAL GENERAL FUND EXPENDITURES	3,669.8	3,658.1	3,683.6	3,708.5	3,740.0	3,760.3	3,784.9	3,816.3	3,850.4	3,884.3
PROJECTED FISCAL GAP	-497.0	-539.3	-505.6	-516.3	-531.7	-553.9	-617.7	-675.8	-730.4	-789.4
CONSTITUTIONAL BUDGET RESERVE										
BALANCE IF FISCAL GAP	2,008.5	1,896.3	1,473.4	1,048.6	484.5	84.3	0.0	0.0	0.0	0.0
FILLED ENTIRELY WITH CBR										
REMAINING FISCAL GAP							533.4	675.8	730.4	789.4
PF EARNINGS RESERVE BALANCE	844.0	1,040.9	1,260.1	1,486.6	1,698.9	1,915.6	2,136.3	2,359.4	2,586.1	2,816.3

04/24/2000

"PER CAPITA" PROJECTION *ONLY Population*

(FY 96 Dollars)

	<u>FY 96</u>	<u>FY 97</u>	<u>FY 98</u>	<u>FY 99</u>	<u>FY 00</u>	<u>FY 01</u>	<u>FY 02</u>	<u>FY 03</u>	<u>FY 04</u>	<u>FY 05</u>
Average Oil Price (\$/bbl.)	16.52	16.14	16.39	16.39	16.48	16.57	16.66	16.75	16.84	16.92
Oil Production (MMbbl/day)	1.503	1.457	1.418	1.375	1.342	1.304	1.246	1.195	1.146	1.103
AVAILABLE REVENUES (\$ Millions):										
PETROLEUM	1,473.4	1,495.5	1,526.7	1,508.3	1,474.6	1,439.5	1,367.5	1,309.3	1,256.8	1,200.2
OTHER SOURCES	301.3	284.3	282.1	282.1	281.4	280.5	279.5	278.2	276.9	275.7
NONRECURRING SOURCES	180.1	87.4	84.7	82.1	79.6	77.1	74.7	72.4	70.2	68.0
PERMANENT FUND NET INCOME	1,218.0	1,251.6	1,284.5	1,319.7	1,372.7	1,409.3	1,445.5	1,480.6	1,516.1	1,551.0
TOTAL REVENUES	3,172.8	3,118.7	3,178.0	3,192.3	3,208.3	3,206.4	3,167.3	3,140.6	3,120.0	3,094.9
EXPENDITURES (\$ Millions):										
OPERATING - AGENCY	1,119.9	1,137.8	1,156.0	1,174.5	1,193.3	1,212.4	1,231.8	1,251.5	1,271.5	1,291.9
FORMULA	413.8	420.4	427.1	434.0	440.9	448.0	455.1	462.4	469.8	477.3
K - 12 EDUCATION	660.3	676.8	693.7	711.1	728.8	747.1	765.7	784.9	804.5	824.6
INFRASTRUCTURE MAINTENANCE		71.1	71.1	71.1	71.1	71.1	71.1	71.1	71.1	71.1
DEBT SERVICE	109.4	84.1	76.7	66.4	44.9	28.6	17.0	13.3	11.9	10.9
CAPITAL	106.2	121.4	123.3	125.3	127.3	129.3	131.4	133.5	135.6	137.8
LOANS/TRANSFERS/SUPPS.	42.2	22.6	22.9	23.3	23.7	24.0	24.4	24.8	25.2	25.6
PERMANENT FUND INFLATION PROOFING	441.0	428.2	454.5	461.5	482.6	490.0	496.5	503.7	510.1	516.3
PERMANENT FUND DIVIDENDS	575.0	581.6	578.7	592.8	632.0	650.2	669.2	688.0	707.4	724.1
TRANSFER TO EARNINGS RESERVE	202.0	241.8	251.3	265.4	258.1	269.0	279.8	288.9	298.7	310.7
TOTAL EXPENDITURES	3,669.8	3,785.7	3,855.4	3,925.3	4,002.8	4,069.8	4,142.1	4,222.1	4,305.8	4,390.2
PROJECTED FISCAL GAP	-497.0	-667.0	-677.4	-733.1	-794.4	-863.4	-974.9	-1,081.6	-1,185.8	-1,295.4
CONSTITUTIONAL BUDGET RESERVE										
BALANCE IF FISCAL GAP	2,008.5	1,768.6	1,177.9	545.3	0.0	0.0	0.0	0.0	0.0	0.0
FILLED ENTIRELY WITH CBR					249.1	863.4	974.9	1,081.6	1,185.8	1,295.4
REMAINING FISCAL GAP										
PF EARNINGS RESERVE BALANCE	844.0	1,040.9	1,260.1	1,486.6	1,698.9	1,915.6	2,136.3	2,359.4	2,586.1	2,816.3

"DEMAND" PROJECTION

(FY 96 Dollars)

	<u>FY 96</u>	<u>FY 97</u>	<u>FY 98</u>	<u>FY 99</u>	<u>FY 00</u>	<u>FY 01</u>	<u>FY 02</u>	<u>FY 03</u>	<u>FY 04</u>	<u>FY 05</u>
Average Oil Price (\$/bbl.)	16.52	16.14	16.39	16.39	16.48	16.57	16.66	16.75	16.84	16.92
Oil Production (MMbbl/day)	1.503	1.457	1.418	1.375	1.342	1.304	1.246	1.195	1.146	1.103
AVAILABLE REVENUES (\$ Millions):										
PETROLEUM	1,473.4	1,495.5	1,526.7	1,508.3	1,474.6	1,439.5	1,367.5	1,309.3	1,256.8	1,200.2
OTHER SOURCES	301.3	284.3	282.1	282.1	281.4	280.5	279.5	278.2	276.9	275.7
NONRECURRING SOURCES	180.1	87.4	84.7	82.1	79.6	77.1	74.7	72.4	70.2	68.0
PERMANENT FUND NET INCOME	1,218.0	1,251.6	1,284.5	1,319.7	1,372.7	1,409.3	1,445.5	1,480.6	1,516.1	1,551.0
TOTAL REVENUES	3,172.8	3,118.7	3,178.0	3,192.3	3,208.3	3,206.4	3,167.3	3,140.6	3,120.0	3,094.9
EXPENDITURES (\$ Millions):										
OPERATING - AGENCY	1,119.9	1,147.9	1,186.6	1,236.4	1,297.6	1,370.7	1,455.9	1,553.9	1,665.0	1,789.8
FORMULA	413.8	434.3	470.3	521.6	590.0	676.6	782.7	883.9	991.6	1,102.6
K - 12 EDUCATION	660.3	676.8	693.7	711.1	728.8	747.1	765.7	784.9	804.5	824.6
INFRASTRUCTURE MAINTENANCE		71.1	71.1	71.1	71.1	71.1	71.1	71.1	71.1	71.1
DEBT SERVICE	109.4	84.1	76.7	66.4	44.9	28.6	17.0	13.3	11.9	10.9
CAPITAL	106.2	121.4	123.3	125.3	127.3	129.3	131.4	133.5	135.6	137.8
LOANS/TRANSFERS/SUPPS.	42.2	22.6	22.9	23.3	23.7	24.0	24.4	24.8	25.2	25.6
PERMANENT FUND INFLATION PROOFING	441.0	428.2	454.5	461.5	482.6	490.0	496.5	503.7	510.1	516.3
PERMANENT FUND DIVIDENDS	575.0	581.6	578.7	592.8	632.0	650.2	669.2	688.0	707.4	724.1
TRANSFER TO EARNINGS RESERVE	202.0	241.8	251.3	265.4	258.1	269.0	279.8	288.9	298.7	310.7
TOTAL EXPENDITURES	3,669.8	3,809.6	3,929.2	4,074.9	4,256.2	4,456.6	4,693.8	4,946.0	5,221.1	5,513.4
PROJECTED FISCAL GAP	-497.0	-690.9	-751.1	-882.6	-1,047.8	-1,250.3	-1,526.6	-1,805.5	-2,101.1	-2,418.5
CONSTITUTIONAL BUDGET RESERVE										
BALANCE IF FISCAL GAP	2,008.5	1,744.7	1,081.0	301.8	0.0	0.0	0.0	0.0	0.0	0.0
FILLED ENTIRELY WITH CBR					746.0	1,250.3	1,526.6	1,805.5	2,101.1	2,418.5
REMAINING FISCAL GAP										
PF EARNINGS RESERVE BALANCE	844.0	1,040.9	1,260.1	1,486.6	1,698.9	1,915.6	2,136.3	2,359.4	2,586.1	2,816.3

Correct = 8% growth
Fed cost shifting

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LONG RANGE FINANCIAL PLANNING COMMISSION

Report of Subcommittee on Revenues

The Long Range Financial Planning Commission is charged under House Concurrent Resolution No. 1 with a number of tasks related to the revenues that are or could be available to the state to support state government at the present or at either a reduced or increased level. The Subcommittee on Revenues, composed of Mary A. Nordale, chairman, Pat Pourchot, Legislative Director in the Office of the Governor, Rep. Mike Navarre (D, Dist. 9, Kenai), Lee Gorsuch, Chancellor of the University of Alaska Anchorage, and Marie Westfall, retired Gateway Borough Finance Director, has prepared this preliminary report to present information on revenue sources and to suggest on a preliminary basis the advantages and disadvantages of existing sources and new sources.

The Long Range Financial Planning Commission is charged with, among other duties, the following:

- ***
- (2) identify and evaluate all current state income sources and assets, including recurring revenue, reserves, physical resources, and investments;
- (3) identify and prioritize systemic changes to stabilize the state's revenue stream;
- ***
- (6) identify and prioritize new sources of revenues;
- ***
- (9) consider the division of responsibility for providing services and raising revenue between the state and local governments and evaluate the effect of the long-range financial plan on local governments;

EXISTING REVENUE SOURCES

The identification of sources of revenues, while not difficult, is somewhat complicated. Some revenues are paid directly into the General Fund, such as corporate income and severance taxes. Other state revenues are not accounted for as General Fund sources, such as interest on the 4-Dam Pool which funds the Power Cost Equalization Program and repayments on mortgages received by the Alaska Housing Finance Corporation. Likewise, revenues to the Alaska Permanent Fund Corporation are not generally treated as available for appropriation in the same sense as tax receipts. The Commission must adopt a policy for the purpose of determining revenue sources of considering such fund earnings as revenue sources, considering such fund earnings as not available for appropriation or distinguishing among the various funds and accounts to specify which funds should be accounted for as revenue sources to the General Fund and which should not be considered as sources for the purposes of achieving a long-term revenue stream.

At the present time, the major sources of revenue to the state are oil and gas rents, royalties and bonuses; oil and gas properties tax; severance taxes; and corporate income taxes. The state has a number of small sources of revenue, generally excise taxes or charges and fees for services¹, that generate approximately \$300 million annually.²

The Commission has adopted for its use a base-case revenue sources and projections. A copy of the base case, in both nominal and real³ terms is attached to this report. In FY 1996, the amount of revenue estimated to be received by the General Fund is as follows:

Petroleum	\$1,473.4
Other Sources	301.3
Nonrecurring Sources	197.1
Total	\$1,971.8

The base case has projected a fiscal gap, that is, a difference of \$498.3 million between revenues and expenditures, for FY1996. This fiscal gap has been filled by appropriations from the Constitutional Budget Reserve fund. The base case also projects fiscal gaps, in nominal dollars, of \$469.3 million in FY 1997 to \$1,258.0 million in 2005. The base case projects that these gaps cannot be filled entirely from the Constitutional Budget Reserve after FY 1999 and that starting in FY 2000, the amount that must be made available by expenditure cuts and new revenue sources, again in nominal dollars, will be \$540.0 million, rising to \$1,258.0 million in FY 2005.

The Subcommittee on Revenue has not, for the purposes of its work, considered expenditure cuts as a revenue source. The Subcommittee has proceeded on the basis that its responsibilities are to identify existing and new revenue sources and that the full Commission will, in the preparation of its plan, make recommendations as to what new sources of revenue will be needed if expenditure cuts alone cannot fill the budget gap.

¹Fees and charges for services are generally termed "program receipts." Federal law requires, for example, that the Alaska Department of Environmental Conservation generate enough funds through fees and charges to support the costs of administration of the state's clean air program. Other services, for example, the Recording Offices, charge fees, but the revenue received does not fully support the services. All funds from such fees are deemed revenues to the general fund and are available for appropriation for any budget category.

²An excise tax is a tax applied directly to a commodity used or consumed within the taxing jurisdiction. Examples in Alaska are: alcohol taxes, motor fuel taxes and cigarette taxes.

³"Real terms" or "real dollars" means, in this report, the amount of revenue received adjusted for inflation, using FY 1995 dollars as the measure. The purpose of using "real dollars" is to portray the relative purchasing power of the amount of dollars received as compared to the FY 1995 purchasing power.

NEW REVENUE SOURCES - TAXES

The Subcommittee on Revenues examined revenue sources utilized by other states that Alaska does not use. Most prominent among these sources are statewide property taxes, statewide sales taxes and individual income taxes. Alaska repealed its individual income tax in 1979 and has traditionally allocated to local government units use of property and sales taxes. At the same time, the state funds certain programs, notably education, that have been traditionally considered to be a local responsibility. The subcommittee noted that many states use a statewide real property tax as the primary source of revenue to fund statewide education support.

The Subcommittee considered taxes of various sorts as potential sources of revenue to fill the budget gap. In doing so, the Subcommittee recognized that taxes impose burdens on both individuals and businesses. Economic burdens on individuals and businesses can impair economic development, although it is widely known that most businesses and individuals accept the necessity of paying taxes and ask only that the burdens be imposed fairly and for important services. With respect to large economic developments, taxes generally are not a deterrent, unless they are deemed confiscatory.

In considering taxes, tax efficiency should be considered. Taxes may be efficient, neutral or inefficient. Efficient taxes are those that generate more revenue than the costs of collection. Neutral taxes collect revenue equal to the cost of collection and inefficient taxes are those that cost more to collect than the revenue received. The Subcommittee considers that if new taxes are necessary to fill the budget gap, the taxes should be efficient and should not be imposed to accomplish social engineering purposes rather than to raise revenue.

This preliminary report considers only three major new taxes, all of which are considered to be efficient to one degree or another. They are a statewide real property tax, a statewide sales tax and an individual income tax. Raises in the levels of excise taxes has been postponed until the Department of Revenue has been able to complete work on its study of the revenue that could be expected if the rates of excise taxes were raised. At the present time, the major excise taxes are levied on motor fuel, alcohol and tobacco products.

Statewide Real Property Tax

Local government units do not exist throughout vast areas of the state. The urban areas are organized into home rule first and second class boroughs. Some boroughs have been formed in the so-called bush areas after introduction of a property base of sufficient size to support local government. In those areas where economic development has not occurred to such a degree, local government formation is weak or nonexistent.

The Department of Community and Regional Affairs publishes a report annually entitled, "Alaska Taxable." This report attempts to set forth the real property values of all parts of the state, within organized boroughs and cities as well as within the unorganized borough. This

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report reveals that substantial values would appear to exist in the rural areas to support in part local government functions such as education. Closer examination reveals, however, that vast areas of the state could not support a local, let alone a statewide, property tax. In these areas, although values in property exist, incomes of property owners are insufficient to bear the burden that the payment of real property taxes would cause. Moreover, a number of people in rural areas who can place their real property in restrictive titles⁴ have done so, so that any real property tax levied would be paid only by those who are ineligible for such protective status.

The Subcommittee requested the assistance of Mr. Steve Van Sant, the State Assessor, in determining the availability of a statewide real property tax. Attached is a copy of his response which more clearly sets out the difficulty a statewide real property tax would pose in those areas of the state where job opportunities and employment are limited and, consequently, where cash income for the payment of such taxes is very limited. After concluding that the major values in real property that would support a statewide real property tax lie along the road system and in Southeastern Alaska, he pointed out that:

The other areas of the state may have taxable value, but certainly not to the extent of these areas. Regardless of this fact, however, the data would have to [be] collected, analyzed, property record cards would have to be created and assessment rolls would have to be finalized and the appeal process would have to be in place. This entire process would be extremely expensive to set up and maintain. The initial set up process could take up to three or four years to complete, depending on the amount of revenue allocated and the total number of personnel hired or contracted for the project.

Notwithstanding the difficulties, Mr. Van Sant stated that the state could expect to receive approximately \$28 million annually based on a real property tax levy of one mill in addition to the amount the state receives presently from the real property tax levied on oil and gas properties. No analysis has been performed to determine if a real property tax would be an efficient tax on a statewide basis.

AS 29.45.090 presently limits local governments to a property tax of not more than three percent (3%) of value. This is the equivalent of 300 mills.⁵ A tax of 300 mills levied against a residence valued at \$100,000 would yield \$3,000 in revenue. A tax of one mill levied against the same residence would yield \$100 in revenue. AS 29.45.090 further limits the tax levy to \$1,500 per person if more than one taxing entity can levy a tax on the same property. Alaska Taxable shows that millage rates vary among Alaska's taxing jurisdictions, from *** to ***.

⁴Alaska Natives may place legal title to their real property in the federal government, while retaining beneficial or equitable title. When the federal government holds legal title, the property is not taxable.

⁵A mill is one one-hundredth of a cent. Real properties are traditionally taxed at rates of mills instead of percentages: the millage rate.

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The Subcommittee considered the real property tax as a potential new source of state revenues on the basis that each one-mill levy would yield \$28 million in revenue. In order to fill the fiscal gap solely on the basis of state real property taxes, a levy of 30 to 100 mills would be necessary.

Statewide Sales Tax

Sales taxes are a popular form of taxation in other states as well as among Alaska's units of local government. Some local government units, Anchorage for example, have steadfastly resisted the imposition of a sales tax. Fairbanks had a sales tax at one time, but repealed it. Juneau imposes a four percent sales tax. In contrast, the State of Washington imposes a sales tax of over 13 percent.

There are two broad arguments for a sales tax. One is that it is easy to collect because the seller, in effect, is the tax collector. The other is that it spreads whatever tax burden there is widely to all purchases of goods and services.

At the present time, the state does not impose a sales tax, but in AS 29.45.650 et seq. authorizes local government units to impose sales and use taxes. Sales taxes are useful in those areas in which real property taxes are unrealistic because it enables local government units to generate revenues based on the community's ability to pay.

There is one broad argument against sales and use taxes and this is that the tax is regressive. A regressive tax is a tax that creates the largest burden for those who have the least ability to pay. In recognition of this, many jurisdictions exempt food and other categories of essential goods and services. The federal government requires, and the state has adopted such legislation, that items purchased by food stamps be tax exempt. Notwithstanding its regressivity, sales taxes are increasingly supported by all income groups, including those upon whom the burden of a sales tax falls most heavily.

Commissioner Wilson L. Condon of the Department of Revenue has supplied the Subcommittee with the department's estimate of revenue from a statewide sales tax. A copy of the report is attached. In summary, the department has estimated that for every one percent of sales tax imposed, the state would receive approximately \$80 million per year in revenue if food is included. If food is excluded from the tax, annual revenues are estimated to be approximately \$69 million. This estimate is based on the proposition that the tax would be imposed on all sales and uses, with no exemptions. If exemptions are created, revenues per one percent of tax would, of course, be less. Municipalities levying sales taxes have created maximum limits on the amount of tax payable for any one transaction. In addition to any other exemption, such as prescriptions and medical services, such a cap on the amount of tax would limit the amount of revenue the state could expect annually from a sales tax.

The Subcommittee considered the role sales taxes play at the present time and probably in the future in funding local government. The Subcommittee considered the impact on buyers of goods and services in those communities in which sales taxes are imposed and also considered that the ability to impose sales taxes may offer a powerful incentive to areas in the unorganized borough to organize into units of local government.

In considering a sales tax, the Subcommittee members discussed the advisability or feasibility of establishing a statewide sales tax that would supersede local sales taxes and apportioning the receipts between the state and the local government units in which the sales taxes were collected. For areas within the Unorganized Borough, the legislature would act as the borough assembly for the purpose of appropriating the "local" portion of the sales tax receipts. The Subcommittee members recognized that an increase in the bureaucracy at the state level would be required and that the decrease in the bureaucracy at the local level could not be recognized as a reduction of state expenditures for purposes of closing the fiscal gap. The Subcommittee members considered that if a statewide sales tax were adopted, auditing and collection enforcement could be a service paid for by the state but performed either by existing municipal sales tax collectors or performed by private accounting and collection firms under contract.

Individual Income Tax

From 1949 to 1979 Alaska imposed an individual income tax that, until the advent of oil and gas revenues, was the single largest source of revenue to the Territory and then to the State. The citizens of the Territory of Alaska were originally persuaded that an income tax was necessary because of the increasing costs of territorial government and the fact that employment in Alaska, other than government, was seasonal and an income tax was a method of capturing a portion of individual income earned in Alaska before it was exported to other states. When it became clear that oil and gas revenues were going to be greater than the state's requirements, the individual income tax was repealed.

The Subcommittee requested and received assistance from the Department of Revenue in estimating the potential of an individual income tax to generate enough revenue to close the fiscal gap in the present as well as in the future, at least until 2005. The department estimates that if an individual income tax were imposed using the same formula that was in effect in 1978, the amount of revenue that would be generated would be approximately \$285 million⁶ per year.

The Subcommittee also had available to it the studies performed by the Institute of Social and Economic Research (ISER) covering a number of subjects, but principally ISER's studies of

⁶The Department of Revenue is preparing a study of the potential revenue to be derived from an individual income tax. The number used for the purposes of this report is a "best guess" number. The Subcommittee on Revenues does not consider this number to be reliable and will rely upon the report of the Department of Revenue.

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the fiscal gap and sources of revenue to close the gap. A number of ISER studies compare the tax burdens borne by Alaskans with those borne by citizens of other states. Those studies make it clear that on an individual or per capita basis, the tax burden borne by Alaskans is very light, less than one-half of the U. S. average.

The Subcommittee, therefore, considers that the individual income tax represents a significant and, probably, essential new source of revenue to close the fiscal gap. However, it believes that imposition of an individual income tax cannot be undertaken without reference to other major sources of both state and individual income. However, an individual income tax reaches all income earned in Alaska and, therefore, imposes the burden of funding state government on all of those who take advantage of work and investment opportunities here who have not contributed to the cost of government over the past nearly 20 years.

The Subcommittee has heard representations that an individual income tax should not be imposed as long as the state pays to each citizen who applies a dividend from the Permanent Fund earnings. The Subcommittee does not consider an individual income tax to be an alternative to the annual dividend, but recognizes that in the minds of most Alaskans, it is. Notwithstanding the political linkage, the Subcommittee considers that imposition of an individual income tax is probably necessary if expenditure cuts and other revenues cannot close the fiscal gap.

The Subcommittee considers the method of calculation of the income tax that was in effect in 1978 may now not be appropriate. The Subcommittee believes that the Department of Revenue should be requested and funded to develop models of an individual income tax system that would be fair, efficient and reasonably simple for people to calculate.

NEW REVENUE SOURCES - NON-TAX

Alaska Permanent Fund

The Alaska Permanent Fund was established in 1977 by a constitutional amendment adopted in 1976. It is designed to act as a savings account to capture a portion of the revenue received by the state from state and federal mineral rents, royalties and bonuses. At the beginning of FY 1996 (July 1, 1995), it is estimated to have a principal value of approximately \$13.5 billion.

The constitution requires that the principal of the Fund be "used only for...income-producing investments...designated by law..." and that the income be deposited in the General Fund unless otherwise provided by law. At the present time, instead of depositing the income into the General Fund, AS 37.13 requires that the income be used to inflation proof the fund and to pay to each citizen applying for it a dividend. Any surplus that exists after these purposes have been satisfied is retained in an account designated as the "earnings reserve account." As of the end of FY 1995 (June 30, 1995), the earnings reserve account holds \$1.138 billion.

Since 1980, the Permanent Fund Dividend has become imbedded in the culture and economy of the state. The amount of the annual dividend has risen from approximately \$300 per applicant to approximately \$950 per applicant. Surveys conducted by the Alaska Permanent Fund Corporation, the state entity that manages the Fund, indicate that recipients of dividends use the money for a variety of purposes including payment of bills, education, travel and investment. Since issuance of the dividend commenced, approximately \$5 billion in dividends has entered the Alaska economy.

The Subcommittee believes that the Alaska Permanent Fund is able to contribute a minimum of \$500 million annually to the General Fund without major sacrifices in the dividend or disturbing the concept of inflation proofing the Fund. To do this would, of course, require statutory change. It is the intent of the Subcommittee to continue to evaluate the potential of the Fund to make such a contribution to closing the fiscal gap, and it is not, at this time, ready to recommend to the Commission the specific statutory changes that would be necessary to accomplish this.

Service and User Fees

The state provides services to citizens that either should be paid for or should be paid for in an amount that will fund the service. At the present time, the state imposes service and user fees in approximately 170 different categories. Some fees are mandated by federal programs, some are fixed to cover regulatory costs and others are designed to fund services, such as occupational licensing. According to information furnished by the Office of Management and Budget, the service and user fees are categorized by the source of the mandate for their collection. For example, if fees are required to insure participation in a federal program, those fees are deemed to have a category I priority. Sales of publications would, on the other hand, be deemed to have only a category III priority.

It is difficult to determine in many cases if the fees fully support the program costs. Programs believed to be fully supported by fees and other charges seldom receive adequate scrutiny by both the legislature and the administering agencies to determine if the service is required and if the service can or should be fully supported by fees and charges. The Subcommittee has requested information showing a comparison of fees and costs. Without such information, the Subcommittee cannot assess the revenue potential of this category of revenues. Likewise, because of time and funding constraints, the Subcommittee has been unable to examine programs or services for which the state does not charge fees that could be supported in whole or in part by fees and charges.

Enterprise Funds

The state has established several corporations, foundations, funds and programs that can be deemed "enterprise funds." The term, "enterprise funds", is usually applied to funds or

corporations that perform services or produce goods that yield profits or are operating on business rather than government principles. The Subcommittee on Revenues has categorized these various funds into corporations and foundations, loan programs, pension funds and service agencies. Each entity receives funding in whole or in part from private or non-state sources. Some are expected to operate without state support, but it appears that all began because of initial capitalization by the state. We have not determined if all of the initial capital has been returned.

Corporations and Foundations

Alaska Housing Finance Corporation, Alaska Industrial Development and Export Authority, Aerospace Development Corp., Alaska Railroad, and Science and Technology Foundation were established to provide important services which were not otherwise available to Alaskans at the time the entities were created. No consistent policies have been established that govern the repayment of capital or the payment of dividends or a portion of earnings. The base case adopted by the Commission includes some revenues, approximately \$90 million per year, to be paid from surplus of the Alaska Housing Finance Corporation. The Subcommittee has not been able to determine if this amount is appropriate and whether or not the other corporations and foundations can or should pay some portion of their earnings to the state. The financial structures of each of the corporations and foundations should be examined to determine whether or not they perform a service not otherwise obtainable at a reasonable cost and whether or not they can contribute from earnings a reasonable dividend on an annual basis. Although the Subcommittee believes that dividends should be paid, the amount of such dividends in the aggregate cannot be estimated.

Loan Programs

The agricultural revolving loan program, the student loan program and business and veterans loan programs were established to provide capital to businesses and individuals who had difficulty in obtaining credit on a reasonable basis. The veterans loan program was established to allow veterans to acquire capital at reduced interest rates in recognition of their service to the country and to Alaska. The student loan program has in recent years been operated through funding provided by revenue bonds. The funding sources for the agricultural revolving loan program and the business development loan programs were general fund moneys at the inception of the programs. The Subcommittee does not at this time have information that shows how much is outstanding in loans, how much of the appropriated capital has been returned and whether any new loans have been made. Each loan program should be scrutinized to determine if the borrowers could obtain loans from other sources at equal or nearly equal costs and if the programs were terminated, if all of the capital contributed by the state can be returned.

If the programs are continuing to provide loans that are not available from other sources, the programs should be reviewed to determine if the programs should be allowed to grow through the retention of all earnings or a portion of the earnings can be paid to the general fund on an ongoing basis.

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Pension Funds

The state and local governments contribute to the state pension fund, which is the successor to earlier separate funds established for the benefit of state workers and teachers. The Subcommittee believes that the earnings of the pension fund should be reported as income to the state as the income may, in part, reduce the amount of contributions the state and local governments should make to insure that the fund is fully funded.

Service Agencies

The state offers a number of services, many of which are only partially paid for by the beneficiaries of the services. The Subcommittee on Revenues includes in this class the Pioneer Homes, Public Defender, Public Advocacy and Public Broadcasting Commission; the Seafood Marketing Institute, Tourism Marketing Council, Alaska Correctional Industries, the various fish hatcheries, the Marine Highway System, and the International Airport System.

Each of these services or programs should be examined to determine if the charges made for them are appropriate and if a greater portion of the cost of the services could or should be borne by the recipients of the services. In any event, the revenue and expenditures of these programs and services should be reported.

Miscellaneous

In addition to the categories listed above, there remain a few entities or programs for which no suitable classification exists. One such entity is the Alaska Municipal Bond Bank Authority. This agency serves as a coordinator for local governments in the sale of municipal bonds, both general obligation and revenue bonds. It charges a fee for its services that supports the agency. Additionally, it may receive income from the bond trustees. The income and expense of the AMBBA should be reported so it can be determined if AMBBA possesses capital that should be returned to the general fund and if AMBBA receives income, a portion of which should be paid on a regular basis to the general fund.

Charitable gaming represents a potential new source of income to the state. At the present time, the state receives a small percentage of gaming receipts to cover the cost of licensing and audits. The balance of the receipts are shared by operators and the charities the operators serve. From time to time, this activity has been examined to determine if a fair share of proceeds reach the hands of the charities, but no examination has been made with the goal to determine if the state receives a fair share.

SUMMARY

The Subcommittee on Revenue has reviewed the existing sources of revenue to the state and has reviewed the more traditional sources of revenue utilized by other states, but not by

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Alaska. No one source yields sufficient revenue to close the fiscal gap. A variety of sources must be created in order to fill the gap through the year 2005.

The size of the fiscal gap is relatively easy to calculate using the base case. Use of the base case does not, of course, account for savings that may be achieved by the elimination of programs and the curtailment of others. It does, however, show that regardless of extraordinary and, perhaps, draconian expenditure cuts, the gap persists and can be filled only with new sources of revenue.

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To recapitulate the potential revenues, the existing and potential sources would yield revenue (stated in 1995 dollars) as follows:

	1997	1998	1999	2000	2001
Petroleum	1,452.0	1,482.4	1,464.5	1,431.8	1,397.7
Other	276.0	273.9	274.0	273.3	272.3
Nonrecurring	84.9	82.2	79.7	77.2	74.9 ⁷
TOTAL	1,812.9	1,836.5	1,818.2	1,782.3	1,744.9
Gap	-469.3	-678.2	-731.1	-789.6	- 854.4
Const. Budget Res. ⁸	1,639.6	957.0	249.2	-0-	-0-
Real Prop. Tax	28.0	28.0	28.0	28.0	28.0
Sales Tax @ 1%	80.0	80.0	80.0	80.0	80.0
Ind. Income Tax	285.0	285.0	285.0	285.0	285.0
SUBTOTAL	393.0	393.0	393.0	393.0	393.0
Remaining Gap	-0-	-0-	-0-	-396.6	-461.4

This illustration ~~uses~~ uses funds in the Constitutional Budget Reserve. If the use of CBR funds is subtracted a sharper and clearer picture of the fiscal gap emerges. Subtraction of CBR funds in fiscal years 1997-1999 is appropriate for illustration purposes because it shows that without such extraordinary funds, the fiscal gap is real and cannot be filled with present streams of revenue. It also shows that no one source of revenue is large enough to close the gap alone. A variety of sources must be developed and by 2005 must equal approximately \$1.3 billion.

The Subcommittee on Revenue, after reviewing the reports of other Subcommittees, especially the Subcommittee on Intergovernmental Relations, intends to make specific recommendations for the creation of revenue sources. It is clear that the relationship between the state and local government units must be more clearly defined. Until that is done, uncertainty as to the wisdom and desirability of sales and real property taxes for closing the fiscal gap must be recognized.

⁷This amount is the estimated potential for the payment of a dividend from Alaska Housing Finance Corporation. This is apparently the amount that has been estimated as being available without impairment of the bond ratings for AHFC bonds.

⁸The estimated amounts available from the Constitutional Budget Reserve are based on the expectation that some funds from settlements of tax cases will be added until approximately 1998. After 1998 it is expected that there would be no remaining unresolved tax cases that would yield funds for the CBR

MEMORANDUM

State of Alaska

*Office of the Governor
Office of Management and Budget*

July 13, 1995

TO: Members
Long Range Financial Planning Commission

FROM: Brad Pierce
Senior Policy Analyst

SUBJECT: Updated Fiscal Models

The attached spreadsheets are my interpretation of the changes to our base case that the group agreed upon at the last meeting. Listed below are the pertinent changes to the three cases.

All three scenarios share the following assumptions

- Oil price, production and revenue figures are from the DOR "Revenue Sources" Base Case. Inflation projections come from the same source.
- Population projections of 1.6% average annual growth were supplied by the Department of Labor Research and Analysis Section.
- Permanent Fund net income, inflation proofing, PFDs, Earnings Reserve Account Balance and transfers to the ERA were computed by OMB staff via the Permanent Fund Corporation projection model.
- Debt service and Constitutional Budget Reserve balance were computed by OMB staff.
- No out year supplemental appropriations after FY 96.

Freeze Scenario assumptions:

- Agency operations, formula programs and education expenditures are frozen at their FY 96 level in inflation adjusted "real" terms.
- No additional infrastructure maintenance (assumed to be \$73 million in FY 97 in previous models).
- The CBR is completely drained by FY 2002.

Per Capita Projection

- Spending is assumed to increase at the rate of population times inflation growth
- Education increases at the rate of enrollment and inflation.
- Infrastructure maintenance increases at the rate of inflation.
- A base of \$125 million (in FY 96 dollars) in capital spending is assumed for FY 97.
- The CBR is drained by FY 2000.

Demand Projection

- Uses per capita projection as the base.
- Corrections increment to operating agency projections assumes an average annual growth rate of 8%, per DOC estimates of need.
- DHSS formula program increment assumes that the state will pick up all proposed federal reductions.
- The CBR is drained by FY 2000 but the shortfall is \$500 million greater than the per capita case.

"FY 96 FREEZE" PROJECTION

(FY 96 Dollars)

	<u>FY 96</u>	<u>FY 97</u>	<u>FY 98</u>	<u>FY 99</u>	<u>FY 00</u>	<u>FY 01</u>	<u>FY 02</u>	<u>FY 03</u>	<u>FY 04</u>	<u>FY 05</u>
Average Oil Price (\$/bbl.)	16.52	16.14	16.39	16.39	16.48	16.57	16.66	16.75	16.84	16.92
Oil Production (MMbbl/day)	1.503	1.457	1.418	1.375	1.342	1.304	1.246	1.195	1.146	1.103
REVENUES (\$ Millions):										
PETROLEUM	1,473.4	1,495.5	1,526.7	1,508.3	1,474.6	1,439.5	1,367.5	1,309.3	1,256.8	1,200.2
OTHER SOURCES	301.3	284.3	282.1	282.1	281.4	280.5	279.5	278.2	276.9	275.7
NONRECURRING SOURCES	180.1	87.4	84.7	82.1	79.6	77.1	74.7	72.4	70.2	68.0
PERMANENT FUND NET INCOME	1,218.0	1,251.6	1,284.5	1,319.7	1,372.7	1,409.3	1,445.5	1,480.6	1,516.1	1,551.0
TOTAL GENERAL FUND REVENUES	3,172.8	3,118.7	3,178.0	3,192.3	3,208.3	3,206.4	3,167.3	3,140.6	3,120.0	3,094.9
EXPENDITURES (\$ Millions):										
OPERATING - AGENCY	1,119.9	1,119.9	1,119.9	1,119.9	1,119.9	1,119.9	1,119.9	1,119.9	1,119.9	1,119.9
FORMULA	413.8	413.8	413.8	413.8	413.8	413.8	413.8	413.8	413.8	413.8
K - 12 EDUCATION	660.3	660.3	660.3	660.3	660.3	660.3	660.3	660.3	660.3	660.3
DEBT SERVICE	109.4	84.1	76.7	66.4	44.9	28.6	17.0	13.3	11.9	10.9
CAPITAL	106.2	106.2	106.2	106.2	106.2	106.2	106.2	106.2	106.2	106.2
LOANS/TRANSFERS/SUPPS.	42.2	22.2	22.2	22.2	22.2	22.2	22.2	22.2	22.2	22.2
PERMANENT FUND INFLATION PROOFING	441.0	428.2	454.5	461.5	482.6	490.0	496.5	503.7	510.1	516.3
PERMANENT FUND DIVIDENDS	575.0	581.6	578.7	592.8	632.0	650.2	669.2	688.0	707.4	724.1
TRANSFER TO EARNINGS RESERVE	202.0	241.8	251.3	265.4	258.1	269.0	279.8	288.9	298.7	310.7
TOTAL GENERAL FUND EXPENDITURES	3,669.8	3,658.1	3,683.6	3,708.5	3,740.0	3,760.3	3,784.9	3,816.3	3,850.4	3,884.3
PROJECTED FISCAL GAP	-497.0	-539.3	-505.6	-516.3	-531.7	-553.9	-617.7	-675.8	-730.4	-789.4
CONSTITUTIONAL BUDGET RESERVE										
BALANCE IF FISCAL GAP	2,008.5	1,896.3	1,473.4	1,048.6	484.5	84.3	0.0	0.0	0.0	0.0
FILLED ENTIRELY WITH CBR							533.4	675.8	730.4	789.4
REMAINING FISCAL GAP										
PF EARNINGS RESERVE BALANCE	844.0	1,040.9	1,260.1	1,486.6	1,698.9	1,915.6	2,136.3	2,359.4	2,586.1	2,816.3

"PER CAPITA" PROJECTION

(FY 96 Dollars)

	<u>FY 96</u>	<u>FY 97</u>	<u>FY 98</u>	<u>FY 99</u>	<u>FY 00</u>	<u>FY 01</u>	<u>FY 02</u>	<u>FY 03</u>	<u>FY 04</u>	<u>FY 05</u>
Average Oil Price (\$/bbl.)	16.52	16.14	16.39	16.39	16.48	16.57	16.66	16.75	16.84	16.92
Oil Production (MMbbl/day)	1.503	1.457	1.418	1.375	1.342	1.304	1.246	1.195	1.146	1.103
AVAILABLE REVENUES (\$ Millions):										
PETROLEUM	1,473.4	1,495.5	1,526.7	1,508.3	1,474.6	1,439.5	1,367.5	1,309.3	1,256.8	1,200.2
OTHER SOURCES	301.3	284.3	282.1	282.1	281.4	280.5	279.5	278.2	276.9	275.7
NONRECURRING SOURCES	180.1	87.4	84.7	82.1	79.6	77.1	74.7	72.4	70.2	68.0
PERMANENT FUND NET INCOME	1,218.0	1,251.6	1,284.5	1,319.7	1,372.7	1,409.3	1,445.5	1,480.6	1,516.1	1,551.0
TOTAL REVENUES	3,172.8	3,118.7	3,178.0	3,192.3	3,208.3	3,206.4	3,167.3	3,140.6	3,120.0	3,094.9
EXPENDITURES (\$ Millions):										
OPERATING - AGENCY	1,119.9	1,137.8	1,156.0	1,174.5	1,193.3	1,212.4	1,231.8	1,251.5	1,271.5	1,291.9
FORMULA	413.8	420.4	427.1	434.0	440.9	448.0	455.1	462.4	469.8	477.3
K - 12 EDUCATION	660.3	676.8	693.7	711.1	728.8	747.1	765.7	784.9	804.5	824.6
INFRASTRUCTURE MAINTENANCE		71.1	71.1	71.1	71.1	71.1	71.1	71.1	71.1	71.1
DEBT SERVICE	109.4	84.1	76.7	66.4	44.9	28.6	17.0	13.3	11.9	10.9
CAPITAL	106.2	121.4	123.3	125.3	127.3	129.3	131.4	133.5	135.6	137.8
LOANS/TRANSFERS/SUPPS.	42.2	22.6	22.9	23.3	23.7	24.0	24.4	24.8	25.2	25.6
PERMANENT FUND INFLATION PROOFING	441.0	428.2	454.5	461.5	482.6	490.0	496.5	503.7	510.1	516.3
PERMANENT FUND DIVIDENDS	575.0	581.6	578.7	592.8	632.0	650.2	669.2	688.0	707.4	724.1
TRANSFER TO EARNINGS RESERVE	202.0	241.8	251.3	265.4	258.1	269.0	279.8	288.9	298.7	310.7
TOTAL EXPENDITURES	3,669.8	3,785.7	3,855.4	3,925.3	4,002.8	4,069.8	4,142.1	4,222.1	4,305.8	4,390.2
PROJECTED FISCAL GAP	-497.0	-667.0	-677.4	-733.1	-794.4	-863.4	-974.9	-1,081.6	-1,185.8	-1,295.4
CONSTITUTIONAL BUDGET RESERVE										
BALANCE IF FISCAL GAP	2,008.5	1,768.6	1,177.9	545.3	0.0	0.0	0.0	0.0	0.0	0.0
FILLED ENTIRELY WITH CBR					249.1	863.4	974.9	1,081.6	1,185.8	1,295.4
REMAINING FISCAL GAP										
PF EARNINGS RESERVE BALANCE	844.0	1,040.9	1,260.1	1,486.6	1,698.9	1,915.6	2,136.3	2,359.4	2,586.1	2,816.3

"DEMAND" PROJECTION

(FY 96 Dollars)

	<u>FY 96</u>	<u>FY 97</u>	<u>FY 98</u>	<u>FY 99</u>	<u>FY 00</u>	<u>FY 01</u>	<u>FY 02</u>	<u>FY 03</u>	<u>FY 04</u>	<u>FY 05</u>
Average Oil Price (\$/bbl.)	16.52	16.14	16.39	16.39	16.48	16.57	16.66	16.75	16.84	16.92
Oil Production (MMbbl/day)	1.503	1.457	1.418	1.375	1.342	1.304	1.246	1.195	1.146	1.103
AVAILABLE REVENUES (\$ Millions):										
PETROLEUM	1,473.4	1,495.5	1,526.7	1,508.3	1,474.6	1,439.5	1,367.5	1,309.3	1,256.8	1,200.2
OTHER SOURCES	301.3	284.3	282.1	282.1	281.4	280.5	279.5	278.2	276.9	275.7
NONRECURRING SOURCES	180.1	87.4	84.7	82.1	79.6	77.1	74.7	72.4	70.2	68.0
PERMANENT FUND NET INCOME	1,218.0	1,251.6	1,284.5	1,319.7	1,372.7	1,409.3	1,445.5	1,480.6	1,516.1	1,551.0
TOTAL REVENUES	3,172.8	3,118.7	3,178.0	3,192.3	3,208.3	3,206.4	3,167.3	3,140.6	3,120.0	3,094.9
EXPENDITURES (\$ Millions):										
OPERATING - AGENCY	1,119.9	1,147.9	1,186.6	1,236.4	1,297.6	1,370.7	1,455.9	1,553.9	1,665.0	1,789.8
FORMULA	413.8	434.3	470.3	521.6	590.0	676.6	782.7	883.9	991.6	1,102.6
K - 12 EDUCATION	660.3	676.8	693.7	711.1	728.8	747.1	765.7	784.9	804.5	824.6
INFRASTRUCTURE MAINTENANCE		71.1	71.1	71.1	71.1	71.1	71.1	71.1	71.1	71.1
DEBT SERVICE	109.4	84.1	76.7	66.4	44.9	28.6	17.0	13.3	11.9	10.9
CAPITAL	106.2	121.4	123.3	125.3	127.3	129.3	131.4	133.5	135.6	137.8
LOANS/TRANSFERS/SUPPS.	42.2	22.6	22.9	23.3	23.7	24.0	24.4	24.8	25.2	25.6
PERMANENT FUND INFLATION PROOFING	441.0	428.2	454.5	461.5	482.6	490.0	496.5	503.7	510.1	516.3
PERMANENT FUND DIVIDENDS	575.0	581.6	578.7	592.8	632.0	650.2	669.2	688.0	707.4	724.1
TRANSFER TO EARNINGS RESERVE	202.0	241.8	251.3	265.4	258.1	269.0	279.8	288.9	298.7	310.7
TOTAL EXPENDITURES	3,669.8	3,809.6	3,929.2	4,074.9	4,256.2	4,456.6	4,693.8	4,946.0	5,221.1	5,513.4
PROJECTED FISCAL GAP	-497.0	-690.9	-751.1	-882.6	-1,047.8	-1,250.3	-1,526.6	-1,805.5	-2,101.1	-2,418.5
CONSTITUTIONAL BUDGET RESERVE										
BALANCE IF FISCAL GAP	2,008.5	1,744.7	1,081.0	301.8	0.0	0.0	0.0	0.0	0.0	0.0
FILLED ENTIRELY WITH CBR					746.0	1,250.3	1,526.6	1,805.5	2,101.1	2,418.5
REMAINING FISCAL GAP										
PF EARNINGS RESERVE BALANCE	844.0	1,040.9	1,260.1	1,486.6	1,698.9	1,915.6	2,136.3	2,359.4	2,586.1	2,816.3

June 27, 1995

To: Long Range Financial Planning Commission
Attn: Brian Rogers, Chairman

From: Roger Cremonesi *RC*

You've been asked to tell the State how to change over from unsustainable to sustainable spending - without causing too much damage. That's a tall order. But you can fill it with the system that the enclosed constitutional provision would establish. That system would gradually bring spending to a sustainable level. And it would prevent unsustainable spending in the future.

The mechanics are simple:

- (1) revenue (accumulated and future) from the sale and taxation of natural resources goes into the Permanent Fund;
- (2) income from investment is retained in the fund;
- (3) money in the fund is not available for appropriation;
- (4) every year an amount equal to the projected real growth of the fund, from investment, is withdrawn for spending; and
- (5) during a transitional period an amount greater than investment growth is withdrawn for spending, but the rate of withdrawal is gradually reduced until the investment growth rate is reached.

Although the constitutional provision is complete, you shouldn't consider adopting it without checking out some of the values I have temporarily assigned to the system. I refer to

- (1) the permanent rate at which money would be withdrawn from the fund (I like 6% a year, because a well-managed fund should average at least ten percent a year in total return and the average inflation rate probably will not exceed four percent a year);
- (2) the number of years for which the fund's value is averaged to determine the amount withdrawn;
- (3) the length of the transitional period (which affects the size of the fiscal gap); and
- (4) the rate of withdrawal in the first transitional year (you could just use whatever rate produces the amount that, when combined with projected revenue from sources outside the fund, equals spending at its present level).

Because of the structure and discipline provided by the system, the Legislature would be forced to change over to sustainable spending. Your remaining task, therefore, would be to help it decide where to cut spending and how to enhance revenue. If you were to attempt to do that without the system, you would be operating under the illusion that sustainable spending is achieved by cutting to the level of projected revenues, as enhanced - that there can be a "soft landing" after which all we have to do is "live within our means". The fact is that before and after that landing the state would be exposed to the reductions in oil revenue that occur when prices fall or production declines.

Under the present setup a substantial decrease in the price or production of oil could reduce spending in a given year by hundreds of millions of dollars. Under the proposed system, however, as you saw from the graphs presented at your last meeting, spending can continue to rise despite extremely adverse conditions.

CONSTITUTION OF THE STATE OF ALASKA

ARTICLE IX, SECTION 15 — ALASKA PERMANENT FUND

(a) Revenue derived by the state

- (1) from the disposition, by the state or the United States, of land, minerals, forestial resources or biological marine resources; and
- (2) from taxes on
 - (A) minerals produced, processed or in reserve;
 - (B) property used in exploration, production, transportation or processing of minerals;
 - (C) income from production, transportation or processing of minerals;
 - (D) forestial resources produced or processed;
 - (E) biological marine resources produced or processed; and
- (3) from claims, against the United States or others, for deprivation of that revenue, or that land or those natural resources

constitutes the Alaska Permanent Fund, which is invested and reinvested for long-term appreciation. Investment income, including realized appreciation, is retained in the fund and reinvested. Investments are made in accordance with standards prescribed by law.

(b) Money in the fund cannot be appropriated. Every fiscal year an amount equal to six percent of the average of the fund's market value at the end of each of the quarters of the three calendar years immediately preceding permanently withdrawn from the fund and is appropriable.

(c) A corporation that is a separate branch of government manages the fund. Its powers are provided by law and can include the power to delegate investment authority to independent managers. Its acts and records are audited and public, as provided by law. Its expenditures are authorized by appropriation.

(d) The corporation is governed by seven trustees appointed by the governor, subject to confirmation by a majority of the members of the legislature in joint session. Two are heads of principal departments in the executive branch and serve at the pleasure of the governor. Five are appointed from the public and serve for five-year terms that are staggered so that only one expires each year. A vacancy is filled for the remainder of the term in the manner of the original appointment. A trustee can be reappointed, subject to reconfirmation. As and to the extent provided by law, trustees are compensated, reimbursed their expenses, immune from civil liability and removable for cause.

(e) For the purposes of (a), minerals include, without limitation, oil, gas, coal, sand, gravel, stone and water.

(f) This section does not affect other dedications permitted by Section 7 of this article.

ARTICLE XV, SECTION 29 — ALASKA PERMANENT FUND TRANSITION

(a) The percentage prescribed in Article IX, Section 15, as amended in 1996, for determining the amount of money withdrawn annually from the Alaska Permanent Fund, is inapplicable in fiscal years 1998 through 2000. In the first year of that period the applicable percentage is sixteen. It decreases each fiscal year thereafter geometrically, until the first year after that period, when it attains its permanent value.

(b) The assets of the following are added to the fund on the effective date of this section: the Budget Reserve Fund (Article IX, Section 17), the Earnings Reserve Account (AS 37.13.145), the Railbelt Energy Fund (AS 37.05.540) and the Budget Reserve Fund (AS 37.05.540). For the purpose of determining the average of the fund's market value, as required by Article IX, Section 15, as amended in 1996, those assets are treated as if they had been added to the fund three years before the period in (a).

(c) In addition to the revenue and investment income described in Article IX, Section 15, as amended in 1996, the fund consists of the assets carried on its books on the effective date of this section and the assets added by (b).

(d) Those public members of the board of trustees of the Alaska Permanent Fund Corporation in office on the effective date of this section continue for the remainder of their terms as trustees of the corporation that manages the fund.

(e) Article IX, Section 15, as amended in 1996, and this section are effective July 1, 1997.

ARTICLE XV, SECTION 30 — REPEAL

Article IX, Sections 16 & 17, and Article XV, Sections 27 & 28 are repealed. This section is effective July 1, 1997.

System of Sustainable State Spending

projections: spring 1995

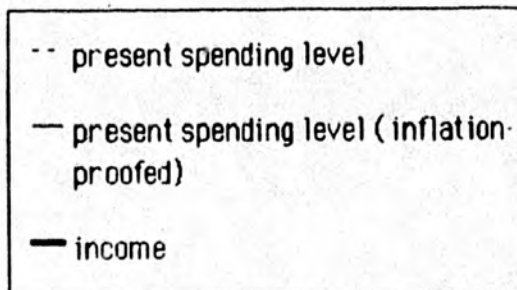
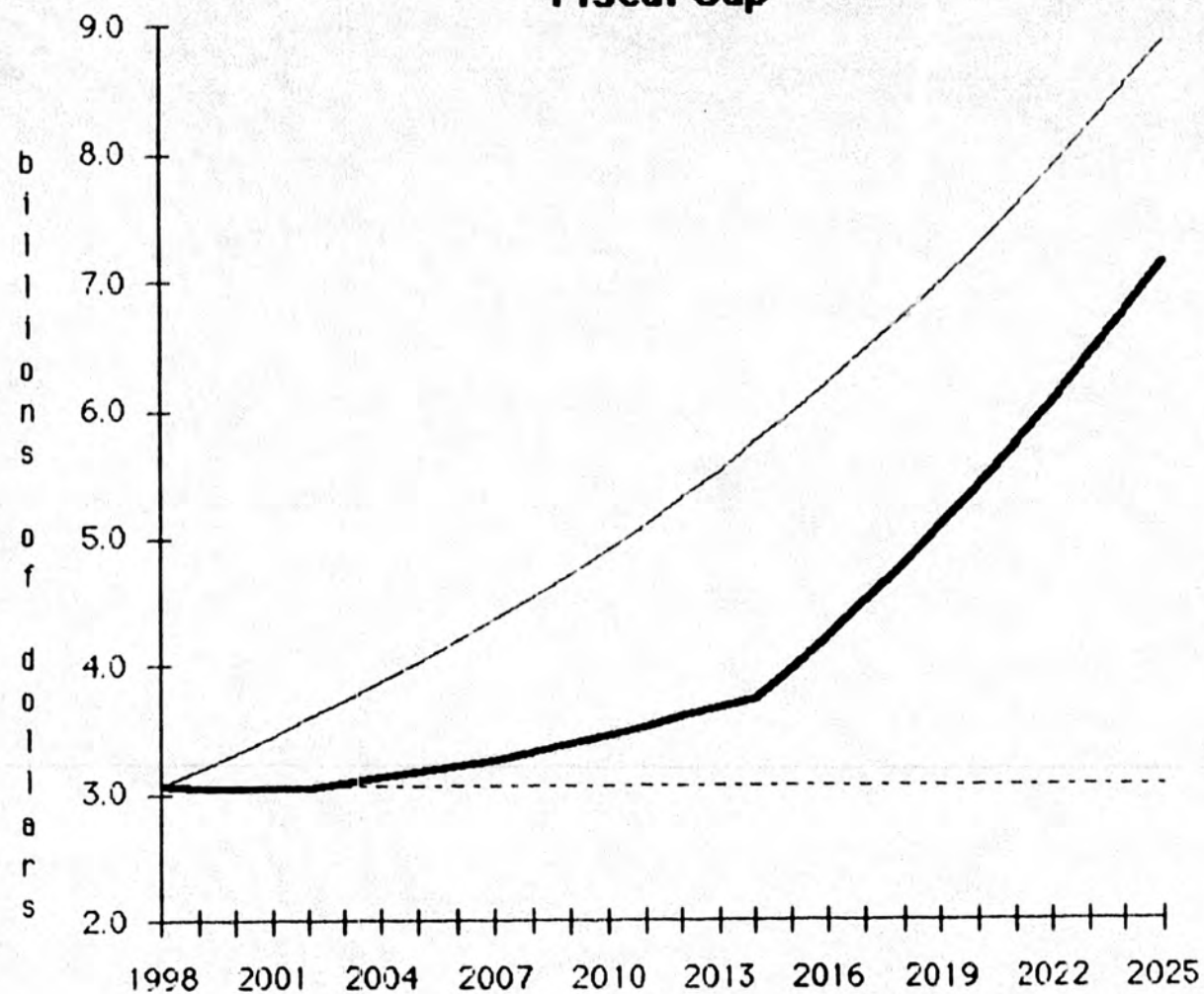
initial year withdrawal: 16.0%

enhancement: 8.0%

final withdrawal rate begins:

2014

Fiscal Gap



Cremo

6.0000

System of Sustainable State Spending

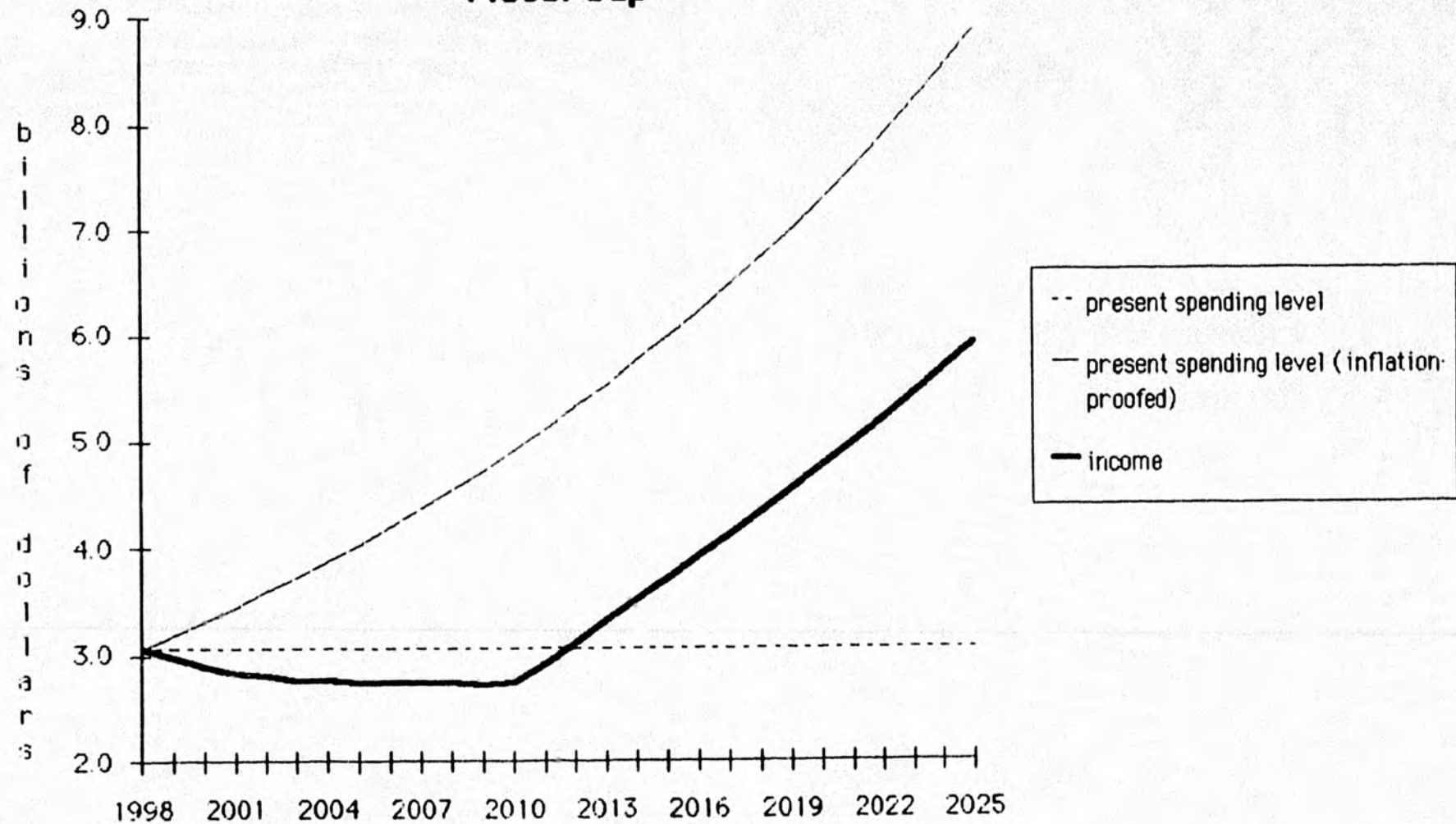
projections: spring 1995

initial year withdrawal: 16.0%

enhancement: 0.0%

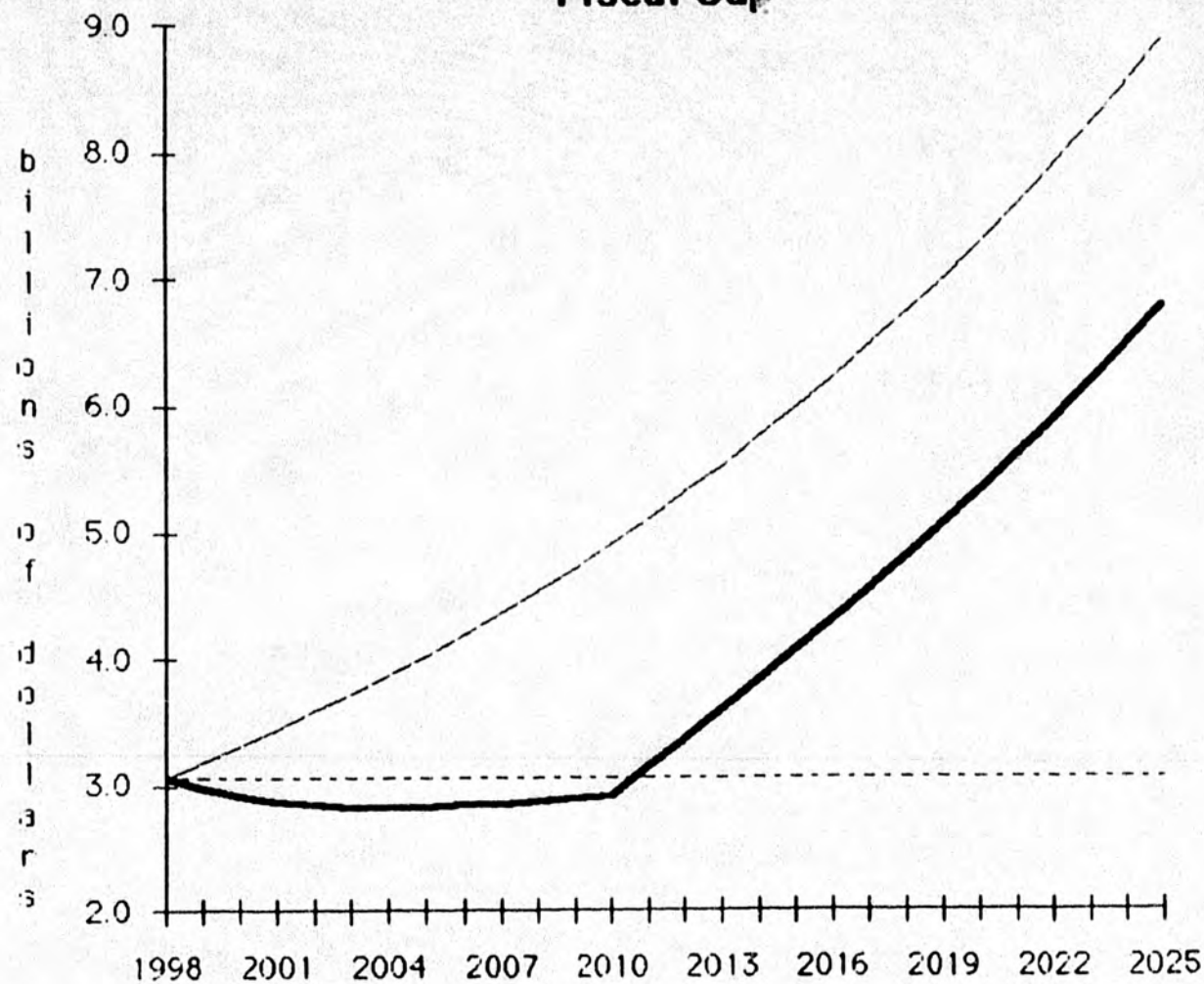
final withdrawal rate begins: 2010

Fiscal Gap



System of Sustainable State Spending

Fiscal Gap



projections: spring 1995

initial year withdrawal: 16.0%

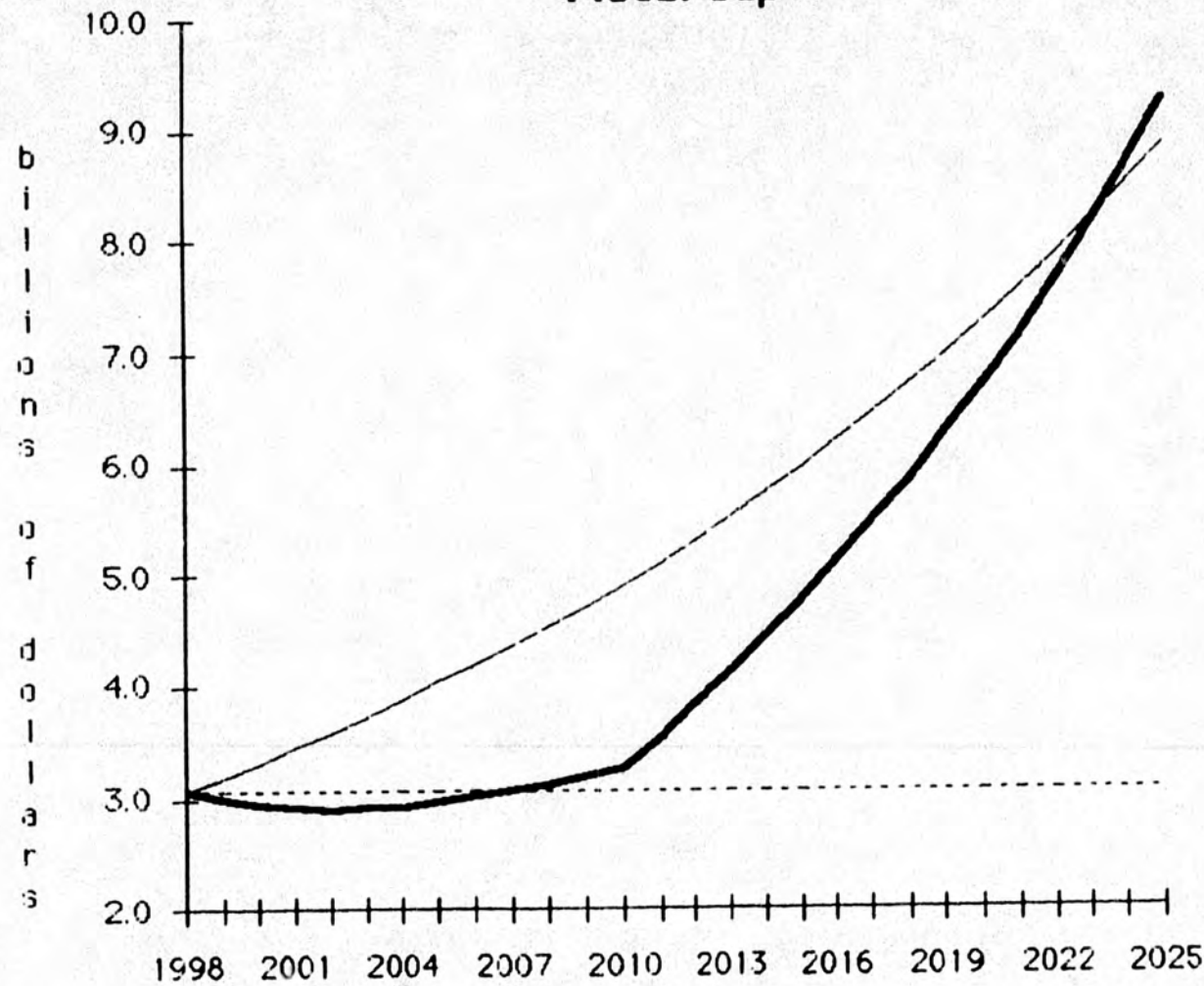
enhancement: 6.0%

final withdrawal rate begins: 2010

-- present spending level
— present spending level (inflation-proofed)
— income

System of Sustainable State Spending

Fiscal Gap



projections: spring 1995

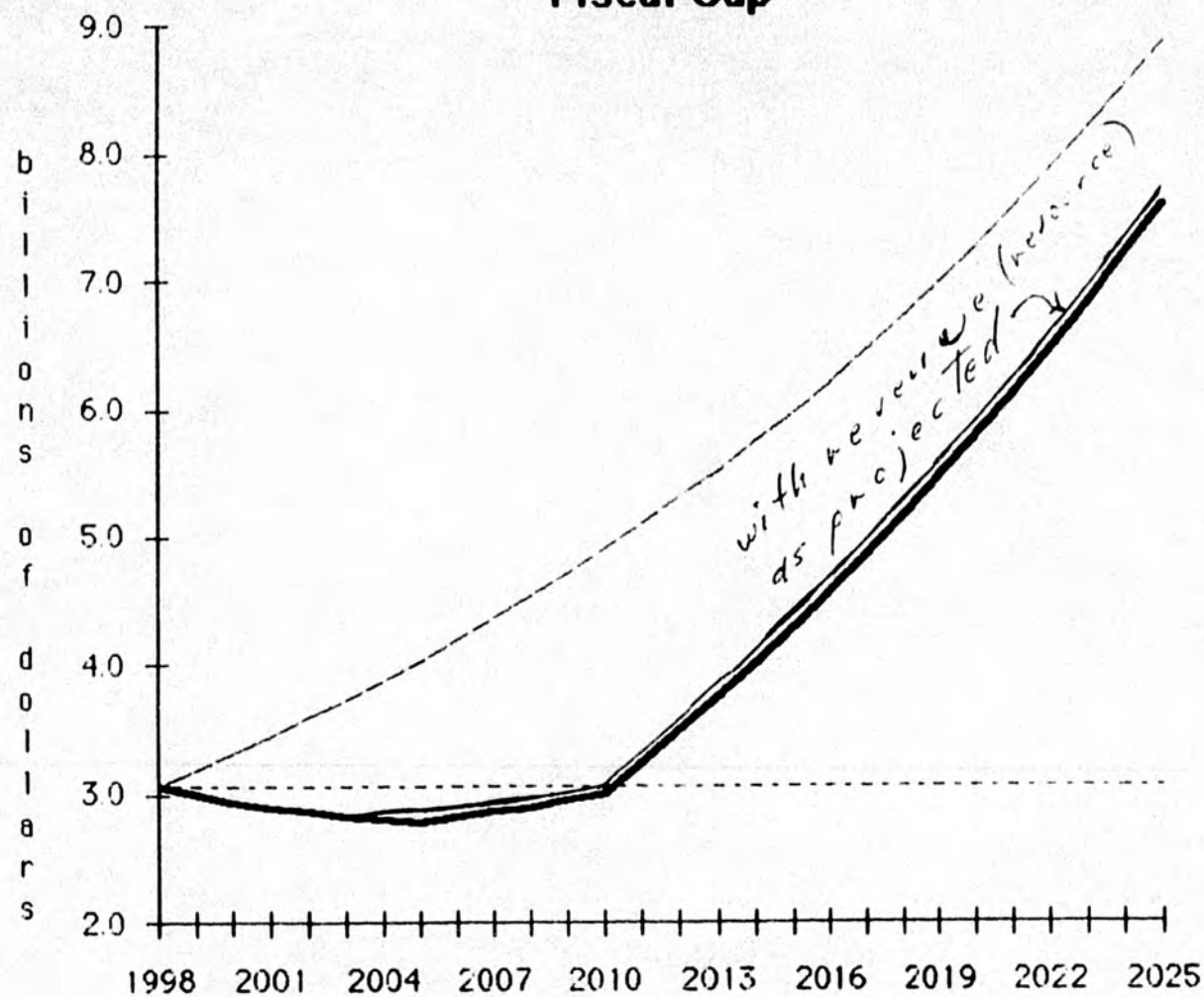
initial year withdrawal: 16.0%

enhancement: 10.0%

final withdrawal rate begins: 2010

System of Sustainable State Spending

Fiscal Gap

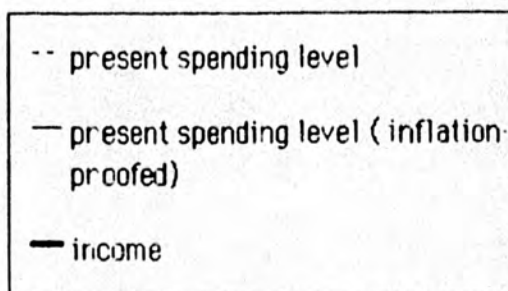


projections: spring 1995

initial year withdrawal: 16.0%

enhancement: 8.0%

final withdrawal rate begins: 2010



Resource revenue at 50% in 2002

System of Sustainable State Spending

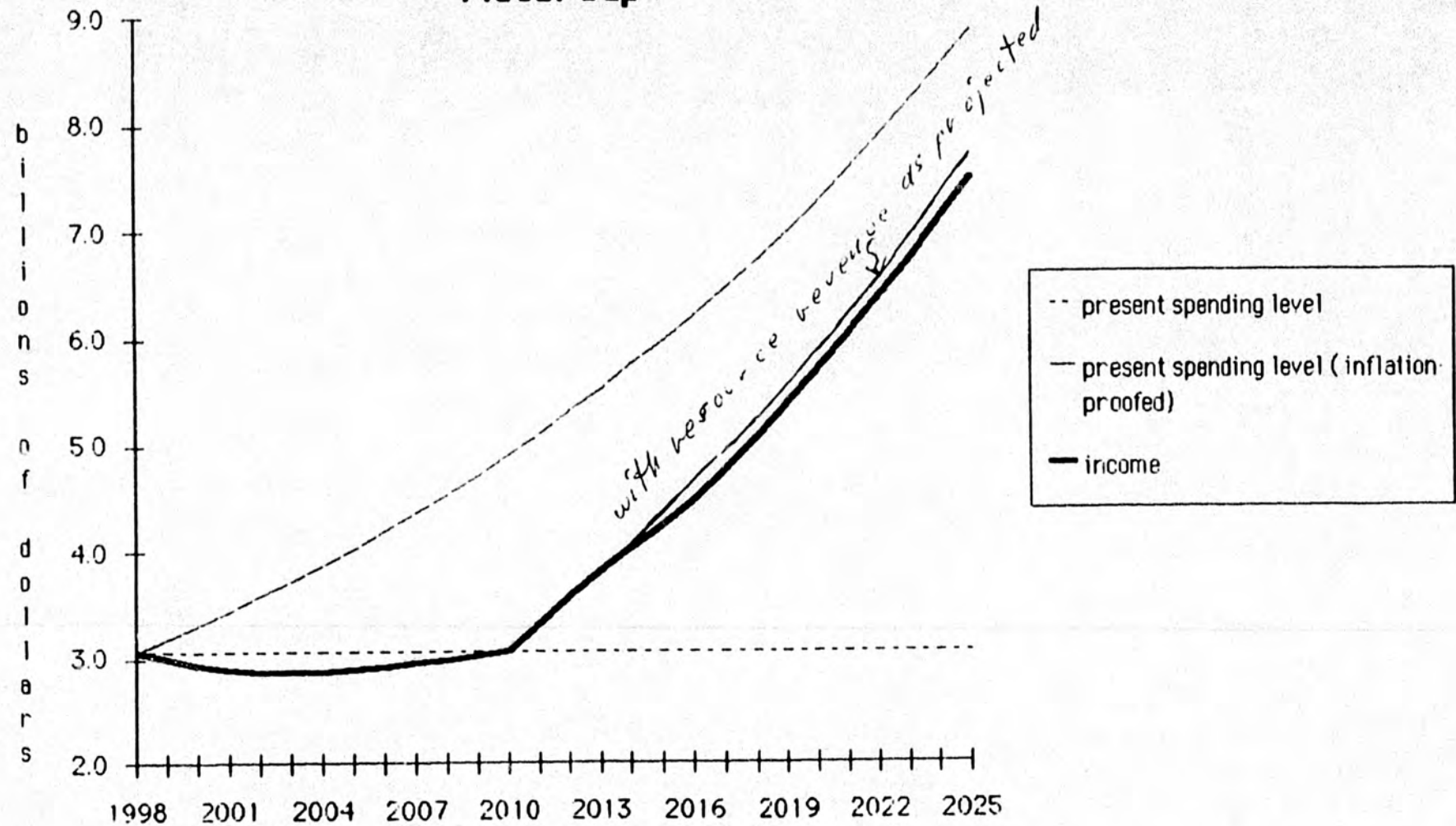
Fiscal Gap

projections: spring 1995

initial year withdrawal: 16.0%

enhancement: 8.0%

final withdrawal rate begins: 2010



No resource revenue in 2012 & 2013

System of Sustainable State Spending

Fiscal Gap

projections: spring 1995

initial year withdrawal:

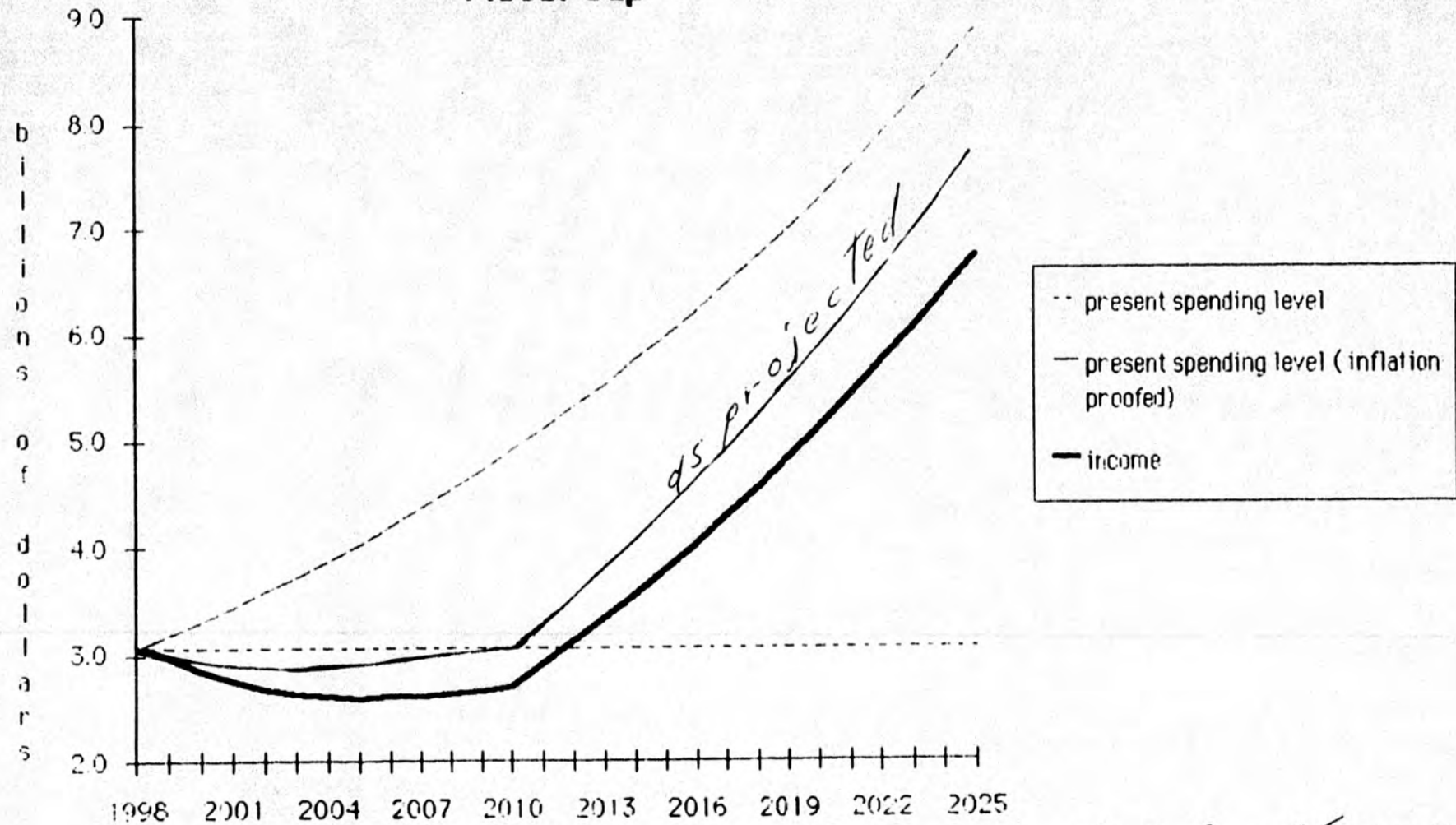
16.0%

enhancement:

8.0%

final withdrawal rate begins:

2010



Resource revenue at 3/4 of projected in all years

DRAFT: 7/25/95

JF

What is needed, therefore - - both as a means of concretely dealing with the fiscal gap, and as a means of not unnecessarily contributing to it - - is for the fiscal gap to be operationalized, or operationally defined. That is, it needs to be given a particular size and shape. Once that is done, and not before, it can be fitted with a specific strategy (or set of strategies) for solving it.

For example: If the Budget Reserve Fund were to be capitalized to yield a scheduled stream of investment income for the general fund for a set number of years, operating and capital budget expenditures were ratcheted down over the same period via a separate schedule, and a mix of tax provisions adjusted to yield yet a different scheduled flow of tax revenue in the same time period, the remaining "fiscal gap" (if any) would thereby have been imparted a specific size and shape, "X" dollars high and "Y" years long. It would no longer be something vague, or constantly changing. In short, to the degree that these fiscal flows were scheduled (agreed upon, enacted, appropriated, etc.) - - i.e., stabilized - - the gap would, in effect, have been defined, at least over the period. The defined gap might be small for the first year or two, small in the middle several years, and very large in the last few out years; or vice versa; or whatever. The point is, stabilization of revenues and expenditures would prove to be the key to developing the strategy, and to achieving and maintaining a consensus for implementing it.

This is an important point: until the fiscal gap is operationally defined, it will be difficult if not impossible to develop and settle upon a strategy or plan for dealing with it. So long as our sense of the fiscal gap remains vague and shifting, it will be very difficult to either lay out a strategy or plan of action, or to obtain (and maintain) agreement on it.

DRAFT: 7/25/95

JF

The key to developing an operational definition of the fiscal gap, as shown in the example, is to approach it through stabilization of the State's revenue and expenditure streams. The reason for this is that stabilization will provide the one thing currently missing that is indispensable for solving the problem of the fiscal gap: it will impart a size and shape to the gap that does not keep changing; and which, therefore, is amenable to a continuing solution strategy that itself need not change from year to year.

This will provide two crucial things, in particular: (1) a solution strategy that can be applied gradually, over a number of years; and, (2) a basis for achieving and maintaining public support for - - and a political consensus for - - that strategy. In addition, it will allow a measured assessment of our needs and problems, and thus establishment of a good "fit" between our needs and our resources. In the broader scheme of things, it will also contribute mightily to overall economic stability in the state, insofar as Alaska's economy is affected hugely by State fiscal policy decisions.

To achieve this operationalization of the fiscal gap, many approaches are possible. The Commission is exploring all of them. Under review at present are the following:

- *Development of a Reserves Policy*

Approaches for employing existing and future reserve funds not just as a "shock absorber" (e.g., for dealing with sudden or short-term revenue decreases), but also as a "stabilizer" (e.g., to enhance program planning and economic development through provision of a steady year-to-year level of expenditures,

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