

ALASKA LEGISLATURE SPECIAL COMMITTEE/SUBJECT FILES 8672

2376 SCOMM 101 LONG RANGE FINANCIAL PLANNING COMMISSION 1995

System of Sustainable State Spending

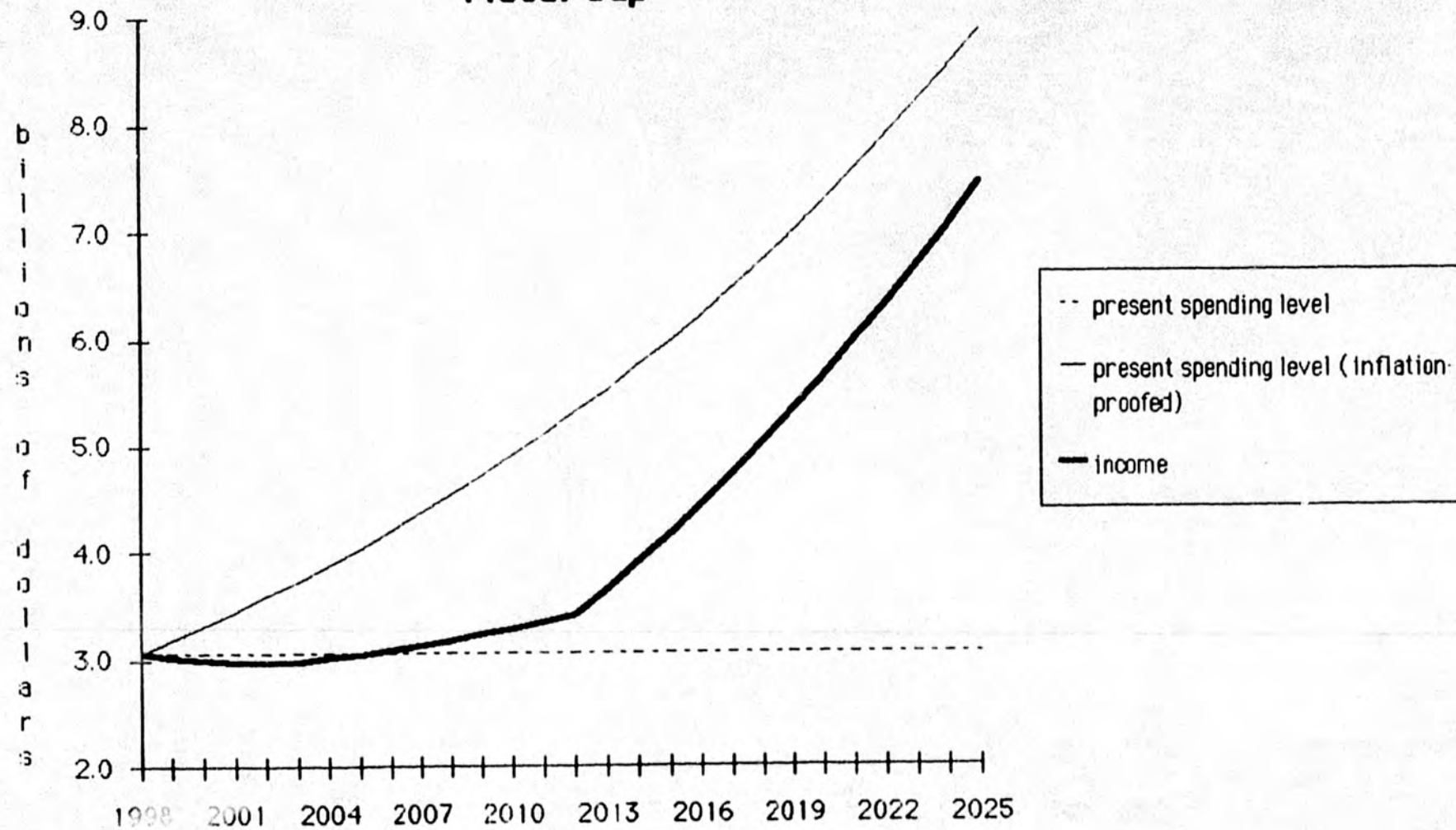
projections: spring 1995

initial year withdrawal: 16.0%

enhancement: 8.0%

final withdrawal rate begins: 2012

Fiscal Gap



Alaska Department of Revenue

Income and Excise Taxes Fiscal Year 1995 (Preliminary)

	<u>FY 95 Preliminary</u>	<u>Revenue Increase</u>		<u>Total</u>
Corporation Net Income	\$195,381,000	\$5,000,000	Note 1	\$200,381,000
Motor Fuel	39,353,000	26,600,000	Note 2	65,953,000
Fisheries Business	38,970,000	0	Note 3	38,970,000
Tobacco	17,079,000	5,300,000	Note 4	22,379,000
Alcoholic Beverages	11,969,000	2,667,500	Note 5	14,636,500
Salmon Enhancement	5,671,000	0		5,671,000
Fishery Resource Landing	7,293,000	0	Note 3	7,293,000
Salmon Marketing	4,711,000	0		4,711,000
Seafood Marketing Assessments	3,208,000	0		3,208,000
Mining License	343,000	0		343,000
Total	<u>\$323,978,000</u>	<u>\$39,567,500</u>		<u>\$363,545,500</u>

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Alaska Department of Revenue

Income and Excise Taxes *Fiscal Year 1995 (Preliminary)*

Note 1 - Revenue increase based on income from Subchapter S corporations being taxable under corporation net income tax statutes (AS 43.20).

Note 2 - Revenue increase based on highway motor fuel tax rate increase from 8¢ to U.S. median tax rate of 17.4¢ per gallon and net tax on fuel used off-highway remaining at 2¢ per gallon.

Note 3 - Half of taxes collected from these tax types are shared to municipalities. The net amount retained in the General Fund after taxes are shared would be as follows: fisheries business tax \$19,485,000 and fishery resource landing tax \$3,646,500.

Note 4 - Revenue increase based on cigarette tax rate increase from 29¢ to 39¢ per pack.

Note 5 - Revenue increase based on alcoholic beverages tax rate increase (per gallon) as follows: liquor from \$5.60 to \$6.00; wine from \$.85 to \$1.00 and beer from \$.35 to \$.50.

Corporation Net Income Tax

Overview

- Corporation net income tax is imposed on corporations which derive income in Alaska.
- Tax is based on federal taxable income with adjustments for Alaska activity.
- Corporations conducting businesses in Alaska and other states apportion income to Alaska using a water's edge formula
- Revenue derived from corporation net income tax is deposited in the General Fund, except that revenue derived from settlements from tax assessments from oil and gas corporations are deposited in the Constitutional Budget Reserve Fund.

Current Tax Burden

- Alaska's corporation net income tax has 10 tax brackets and is graduated in increments of \$10,000 (of income) from 1% to 9%. Tax on income over \$100,000 is 9.4%.
- Tax brackets and rates for other states vary. Most states have 1 tax bracket with rates ranging from 4% in Kansas to 11.5% in Connecticut.
- Alaska's corporation net income tax rates were last changed in 1981 when the graduated rates replaced a 5.4% base and 4% surtax rate structure.

Exemptions

- Corporations recognized under Subchapter S of the Internal Revenue Code generally do not pay corporation net income taxes since income from these corporations are taxed at the individual shareholder level.
- Insurance companies (insurance premium tax paid in lieu of corporation net income tax).
- Electric and telephone cooperatives (electric and telephone cooperative tax paid in lieu of corporation net income tax).

Current and Potential Revenue

- FY 95 General Fund tax revenue is estimated at \$125 million.
- Inclusion of Subchapter S corporations as being subject to the corporation net income tax would yield approximately \$5 million increased revenue.

Administrative Costs

- Current costs to administer the corporation net income tax program is approximately \$1,600,000.

Highway Motor Fuel Tax

Overview

- Highway Motor fuel tax is levied on motor fuel first sold or transferred in Alaska. Revenue derived from the highway fuel tax is deposited in the General Fund.
- Nationally, highway fuel tax is considered as a user fee to cover highway-related operating, maintenance and capital costs incurred by the state.

Current Tax Burden

- Alaska has the lowest highway fuel tax burden (including state sales and other taxes on motor fuel) in the United States at 8¢ per gallon.
- The national median highway fuel tax rate is 21.9¢ per gallon with rates ranging from our 8¢ to Connecticut's 37.9¢ per gallon tax rate.
- Alaska's highway fuel tax rate was last changed in 1970, the oldest dated change of all states.

Exemptions

- The following highway fuel sales are exempt from highway motor fuel tax.

<i>Heating</i>	<i>Exports (as cargo)</i>
<i>Federal and state agencies</i>	<i>Power plants/utilities</i>
<i>Gasohol (at least 10% alcohol)</i>	<i>Charitable institutions</i>
<i>Liquid petroleum gas</i>	
- Federal air quality standards resulted in approximately 22 million gallons of gasohol sales in Anchorage for part of this past winter (initiated January 1995). Due to the gasohol exemption, highway fuel tax revenue was diminished by approximately \$1.8 million in FY 95.
- Fuel used in vehicles that are not operated on public roads and highways is subject to a refund of 8¢ per gallon.

Current and Potential Revenue

- Following is a projection of additional revenue that would be generated if Alaska's highway fuel tax rate was raised to the U.S. median tax rate.

	<i>Tax and Refund Rates as Current</i>	<i>Off-highway Refund Remains at 6¢</i>	<i>Off-highway Refund Increases to 19.9¢*</i>
Taxable Gallons	422,650,000	422,650,000	422,650,000
Tax Rate	0.08	0.22	0.22
Gross Tax Revenue	\$33,812,000	\$92,560,350	\$92,560,350
Less Off-highway Refunds	(8,398,000)	(8,398,000)	(27,853,367)
Net Tax Revenue	\$25,414,000	\$84,162,350	\$64,706,983
Additional Revenue (Increase over FY 95)		\$58,748,350	\$39,292,983

* The net tax rate for off-highway usage is 2¢ per gallon (8¢ tax less 6¢ refund rate). This calculation assumes that the net tax rate would remain at 2¢ per gallon (21.9¢ tax less 19.9¢ refund rate).

- Changes to existing highway fuel tax statutes would generate additional revenue as follows.
- ⇒ Repeal exemption for gasohol.....\$4 million

Administrative Costs

- Current costs to administer the highway fuel tax program is approximately \$200,000.
- A tax rate increase would result in additional administrative costs of \$50,000 to cover increased taxpayer compliance and education with reporting requirements.

Marine Motor Fuel Tax

Overview

- Marine fuel tax is levied on fuel first sold or transferred in Alaska. Revenue derived from the marine fuel tax is deposited in the General Fund.
- Marine fuel tax is considered as a user fee to cover marine-related operating, maintenance and capital costs incurred by the state.

Current Tax Burden

- Marine fuel is taxed at 5¢ per gallon.
- Alaska's marine fuel tax rate was last changed in 1977 when the rate increased from 4¢ per gallon.
 - The old rate had been in effect since 1971.
- For years 1994 through 1998, the marine fuel tax rate for residual (bunker) fuel oil sold to cruise ships decreases from 5¢ to 1¢ per gallon after tax collections on bunker fuel exceed \$205,000.

Exemptions

- The following fuel sales are exempt from marine motor fuel tax.

<i>Exports as cargo</i>	<i>Charitable institutions</i>
<i>Federal and state agencies</i>	

Current and Potential Revenue

⇒ Increase marine fuel tax rate to highway rate (8¢/gallon) \$5 million

Administrative Costs

- Current costs to administer the highway fuel tax program is approximately \$50,000.
- A tax rate increase would result in additional administrative costs of \$5,000 to cover increased taxpayer compliance and education with reporting requirements.

Aviation Motor Fuel Tax

Overview

- Aviation fuel tax is levied on fuel first sold or transferred in Alaska. Revenue derived from the aviation fuel tax is deposited in the General Fund.
- Aviation fuel tax is considered as a user fee to cover aviation-related operating, maintenance and capital costs incurred by the state.

Current Tax Burden

- Jet fuel is taxed at 3.2¢ per gallon and aviation gasoline is taxed at 4.7¢ per.
- Alaska's aviation fuel tax rates were last changed in 1994 when the tax rate for jet fuel increased from 2.5¢ and aviation gasoline from 4¢ per gallon. The old rates had been in effect since 1988.

Exemptions

- The following fuel sales are exempt from aviation motor fuel tax.

<i>Foreign flights</i>	<i>Exports (as cargo)</i>
<i>Federal and state agencies</i>	<i>Charitable institutions</i>

Current and Potential Revenue

⇒ Repeal exemption for foreign flights \$10 million

Administrative Costs

- Current costs to administer the highway fuel tax program is approximately \$50,000.
- A tax rate increase would result in additional administrative costs of \$5,000 to cover increased taxpayer compliance and education with reporting requirements.

Fisheries Business Tax**Overview**

- Fisheries business tax, Alaska's oldest tax type, is levied on persons who process fisheries in Alaska or export *unprocessed* fisheries from Alaska. Revenue derived from the fisheries business tax is deposited in the General Fund.
- Half of fisheries business tax revenue is shared to municipalities based on taxes collected from processing activities in municipalities.
- Fisheries business tax revenue covers costs incurred by the state to monitor and manage its fisheries and administer fisheries-related costs programs.

Current Tax Burden

- Fisheries business tax is based on the value of fisheries paid by processors. Rates vary based on processor type and species processed as follows:

Processor Type	Rate
Established Species	
Floating	5%
Salmon Cannery	4.5%
Shore-based	3%
Developing Species	
Floating	3%
Shore-based	1%

- Fisheries business tax rates were last changed in 1979 at which time tax rates for established and developing species were differentiated (2% break for developing). Floating processor rate increased from 4%, salmon canneries from 3% and shore-based from 1%.

Exemptions

- Commercial fishers who process fisheries to maintain its quality before being sold to a licensed

Current and Potential Revenue

⇒ Eliminate established/developing and tax all fisheries at 4%..... \$2.5 million

Administrative Costs

- Current costs to administer the fisheries business tax program is approximately \$.
- A tax rate increase would result in additional administrative costs of \$ to cover increased taxpayer compliance and education with reporting requirements.

Fishery Resource Landing Tax**Overview**

- Fishery resource landing tax is levied on fishery resources *processed outside* of and first landed in Alaska for transshipment or unloading. Revenue derived from the landing tax is deposited in the General Fund. The legislature may appropriate a portion of revenue to the Alaska Seafood Marketing Institute.
- Half of landing tax revenue is shared to municipalities based on taxes collected from locations where fishery resources were landed.
- Landing tax revenue is considered as a user fee to cover costs incurred by the state to provide infrastructure and benefits to persons landing fishery resources in Alaska.

Current Tax Burden

- Landing tax is 3.3% of the unprocessed value of fishery resources landed in Alaska.
- Landing tax took effect January 1, 1994.

Exemptions

- Unprocessed fishery resources landed in Alaska are exempt from landing tax although they are subject to fisheries business tax.

Current and Potential Revenue

⇒ Increase tax rate to 4%* \$1 million

* Rate equivalent to proposed fisheries tax rate above.

Tobacco Tax

Overview

- Tobacco tax is levied on cigarettes and tobacco first transferred into Alaska.
- Tobacco tax has two components: cigarettes and tobacco products (chewing tobacco and tobacco products other than cigarettes.)
- Revenue derived from the tax on cigarettes is deposited as follows: 82.8% in the General Fund and 17.2% in the School Fund. All revenue derived from the tax on tobacco products is deposited in the General Fund.
- Nationally, tobacco tax is considered as a user fee to cover health-related costs associated with tobacco.

Current Tax Burden

- Tax on cigarettes is 29¢ per pack and on tobacco products is 25% of the wholesale price of the tobacco.
- Alaska's cigarette tax rate is the 23rd highest in the nation. Tax rates on tobacco products are not ranked because of different taxing schemes among states.
- The national median cigarette tax rate is 25.75¢ per pack.
- Cigarette tax rates range from Virginia's 2.5¢ to Hawaii's 60¢ per pack.
- Alaska's cigarette tax rate was last changed in 1989 when the rate increased from 16¢ to 29¢ per pack. The tobacco products tax was enacted in 1988 at its current rate.

Exemptions

- Sales to U.S. military.
- Sales to Indians on Indian land.

Current and Potential Revenue

- FY 95 cigarette tax revenue is estimated at \$15.5 million. Every 1¢ tax rate increase would yield approximately \$535,000 increased revenue.
- FY 95 tobacco products tax revenue is estimated at \$1.4 million. Every 1% tax rate increase would yield approximately \$58,000 increased revenue.

Administrative Costs

- Current costs to administer the tobacco tax program is approximately \$110,000.

Alcoholic Beverages Tax

Overview

- Alcoholic beverages tax is levied on alcohol first transferred into Alaska.
- Alcoholic beverages tax has three components: liquor, wine and beer.
- Revenue derived from alcoholic beverage taxes is deposited in the General Fund.
- Nationally, alcohol beverages taxes are considered as a user fees to cover health-related costs associated with alcohol consumption.

Current Tax Burden

- Tax (per gallon) on liquor is \$5.60, wine - 85¢, and beer - 35¢.
- Alaska's ranks as follows: liquor - 5th highest; wine - 15th highest, and beer - 10th highest in the nation.
- National median tax rates (per gallon) are as follows: liquor - \$3.25; wine - 73¢, and beer - 19¢.
- Tax rates range as follows.

	<i>State</i>	<i>Rate</i>	<i>State</i>	<i>Rate</i>
Liquor	Florida	\$6.50	Maryland	\$1.50
Wine	Florida	\$2.25	Louisiana	\$0.11
Beer	Hawaii	\$0.89	Wyoming	\$0.02

- Alaska's alcohol tax rates were last changed in 1983 when rates increased as follows: liquor from \$4.00 to \$5.60; wine from 60¢ to 85¢, and beer from 25¢ to 35¢ per gallon.

Exemptions

- Sales to U.S. military.

Current and Potential Revenue

- FY 95 alcoholic beverages tax revenue is estimated as follows: liquor - \$6.1 million; wine - \$1 million, and beer - \$4.7 million.
- Every 10¢ tax rate increase on liquor would yield approximately \$110,000 increased revenue.
- Every 1¢ tax rate increase on wine would yield approximately \$12,500 increased revenue.
- Every 1¢ tax rate increase on beer would yield approximately \$136,000 increased revenue.

Administrative Costs

- Current costs to administer the alcoholic beverages tax program is approximately \$110,000.

07/11/1995

Sales Tax Basics

- ▶ What is the volume of Alaska sales of goods and services?
\$9 billion
- ▶ Typical sales taxes exempt retail food sales and health and social services

07/11/1995

Statewide Sales Tax -

What are the Pertinent Sales Facts?

	(thousand \$)
Retail Trade Sales	\$5,100,903
Less Food Store Sales	(\$1,125,171)
<u>Net Retail Trade Except Food Stores</u>	<u>\$3,975,732</u>
Retail Services Sales	\$2,526,885
Less Health & Social Services	(\$ 612,490)
<u>Net All Other Services</u>	<u>\$1,914,395</u>
Net Retail Trade & Services	
(less food & health & social services)	\$5,891,127

A 1% Tax on Retail Trade & Services (less food and health & social services) Would Raise \$58.9 million.

Not included in this analysis: Agriculture, Mining, Construction, Manufacturing, Transportation, Utilities, Wholesale Trade.

ALASKA DEPARTMENT OF REVENUE
ALASKA STATE SALES TAX OVERVIEW
June 30, 1995

Overview

For every 1% of sales tax levied against retail industry sales and business & personal services, \$58 million would be collected. A sales tax applied to all general commodities but not services would be considered regressive due to higher percentage of disposal income subject to tax.

Tax Program

Payor - Two major tax programs are in use by states; 1) a consumer tax, paid by the purchaser and collected by the seller (most popular), and 2) vendor tax, based on gross sales receipts for the privilege of doing business.

Tax base - Industry standard is to view the economy in nine different sectors:

- | | |
|-----------------------------|---|
| - Agriculture | - Recreational, Professional, Repair & Other Services |
| - Construction | - Retail Trade |
| - Finance, Ins. & Real Est. | - Transportation & Utility |
| - Manufacturing | - Wholesale Trade |
| - Mining | |

Exemptions - The decision of which economic sectors to tax is difficult and controversial. For initial discussion purposes all sectors were exempted except retail trade and recreational, professional, repair and other services. Then within the two economic sectors selected for tax, food and health and social services sales are exempted.

ALASKA DEPARTMENT OF REVENUE
SALES TAX PROGRAM OVERVIEW
June 30, 1995

<u>SIC Code</u>	RETAIL TRADE	1993 Estimated Sales	Estimated Yield of 1% Sales Tax
52	BUILDING MATERIALS	\$ 318,372,920	\$ 3,183,729
53	GEN MERCHANDISE	749,938,760	7,499,388
54	FOOD STORES	1,125,171,470	11,251,715
55	AUTO DLRS (EXCL 554)	839,703,340	8,397,033
554	GASOLINE SVC STA	309,384,720	3,093,847
56	APPAREL & ACCESS	245,538,580	2,455,386
57	FURNITURE	166,120,290	1,661,203
58	EATING & DRINKING	646,893,650	6,468,936
59	MISC RETAIL (EXCL 531)	542,798,920	5,427,989
591	DRUG & PROP	155,180,170	1,551,802
	TOTAL	5,100,902,720	51,009,027
	SERVICES		
70	HOTELS & LODGING	293,722,620	2,937,226
72	PERSONAL SERVICES	89,454,100	894,541
73	BUSINESS SERVICES	323,210,350	3,232,104
75	AUTO REPAIR GARAGES	169,127,890	1,691,279
76	MISC REPAIR SVCS	85,824,330	858,243
78, 79, 84	MPIC, AMUSE, MUSEUM	173,188,580	1,731,886
80	HEALTH SVCS XC HOSP	581,060,920	5,810,609
81	LEGAL SERVICES	262,036,660	2,620,367
82	EDUCATIONAL SVCS	9,985,420	99,854
83	SOCIAL SERVICES	31,429,120	314,291
87	ENGR. ARCH & ACCTG	500,021,480	5,000,215
89	SERVICES, N.E.C.	7,845,330	78,453
	TOTAL	2,526,884,800	25,268,848
	GRAND TOTAL	\$7,627,787,520	\$76,277,875
	EXEMPTIONS		
	FOOD	(1,125,171,470)	(11,251,715)
	Health & Social Services	(612,490,040)	(6,124,900)
	ADJUSTED TOTAL	\$5,890,126,010	\$58,901,260

TABLE 20

STATE GENERAL SALES AND USE TAX RATESDISTRICT OF COLUMBIA: 6.0%LOWER THAN THE DISTRICT
29 STATES

Colorado (4.2%)	3.0%	Arizona	5.0%
VIRGINIA (1%)	3.5%	Idaho	5.0%
Alabama (3%)	4.0%	Indiana	5.0%
Georgia (2%)	4.0%	Iowa (1%)	5.0%
Hawaii	4.0%	MARYLAND	5.0%
Louisiana (5%)	4.0%	Massachusetts	5.0%
Michigan	4.0%	Nebraska (1.5%)	5.0%
New York (4.25%)	4.0%	New Mexico (1.44%)	5.0%
North Carolina (2%)	4.0%	North Dakota (.5%)	5.0%
South Dakota (2%)	4.0%	Ohio (3%)	5.0%
Wyoming (1%)	4.0%	South Carolina	5.0%
Missouri (3.0%)	4.225%	Utah (1.25%)	5.0%
Arkansas (1%)	4.5%	Vermont	5.0%
Oklahoma (2.875%)	4.5%	Wisconsin (.5%)	5.0%
Kansas (1%)	4.9%		

SAME AS THE DISTRICT
9 STATES

California (2.5%)	6.0%
Connecticut	6.0%
Florida	6.0%
Kentucky	6.0%
Maine	6.0%
New Jersey	6.0%
Pennsylvania	6.0%
Tennessee	6.0%
West Virginia	6.0%

NO TAX
5 STATES

Alaska (6%)
Delaware
Montana
New Hampshire
Oregon

HIGHER THAN THE DISTRICT
7 STATES

Illinois (3%)	6.25%
Texas (2%)	6.25%
Minnesota (.5%)	6.5%
Nevada (.5%)	6.5%
Washington (1.7%)	6.5%
Mississippi	7.0%
Rhode Island	7.0%

NOTE: Maximum local rates in parentheses

TABLE 21

STATE GENERAL SALES TAX COLLECTIONS
AS A PERCENTAGE OF STATE PERSONAL INCOME - 1992
U.S. AVERAGE - 2.23%

=====		=====		=====	
LOWER THAN U.S. AVERAGE		NEAR THE U.S. AVERAGE		HIGHER THAN U.S. AVERAGE	
(LESS THAN 2.0%)		(2.00% TO 2.45%)		(ABOVE 2.45%)	
13 STATES		13 STATES		19 STATES AND D.C.	
VIRGINIA	1.24%	Rhode Island	2.02%	South Dakota	2.56%
Colorado	1.40%	New Jersey	2.03%	Minnesota	2.58%
Massachusetts	1.44%	Missouri	2.07%	North Dakota	2.59%
MARYLAND	1.46%	Iowa	2.09%	South Carolina	2.64%
New York	1.48%	Kansas	2.10%	Maine	2.66%
Vermont	1.54%	Michigan	2.10%	Idaho	2.76%
Alabama	1.76%	Wisconsin	2.20%	DISTRICT OF	2.85%
Illinois	1.77%	Georgia	2.33%	COLUMBIA	
North Carolina	1.91%	Wyoming	2.34%	Texas	2.87%
Ohio	1.93%	Nebraska	2.35%	Indiana	2.88%
				Arkansas	2.98%
Pennsylvania	1.95%	California	2.36%	Tennessee	3.08%
Oklahoma	1.97%	Kentucky	2.36%	West Virginia	3.09%
Louisiana	1.98%	Connecticut	2.44%	Utah	3.10%
				Florida	3.30%
				Arizona	3.36%
				Mississippi	3.42%
				Nevada	3.52%
				New Mexico	4.34%
				Washington	5.14%
				Hawaii	5.38%

SOURCE: STATE GOVERNMENT FINANCES:1992, GF/92-3, U.S. Department of Commerce, Bureau of the Census, (October 1993), Table 29

07/11/1995

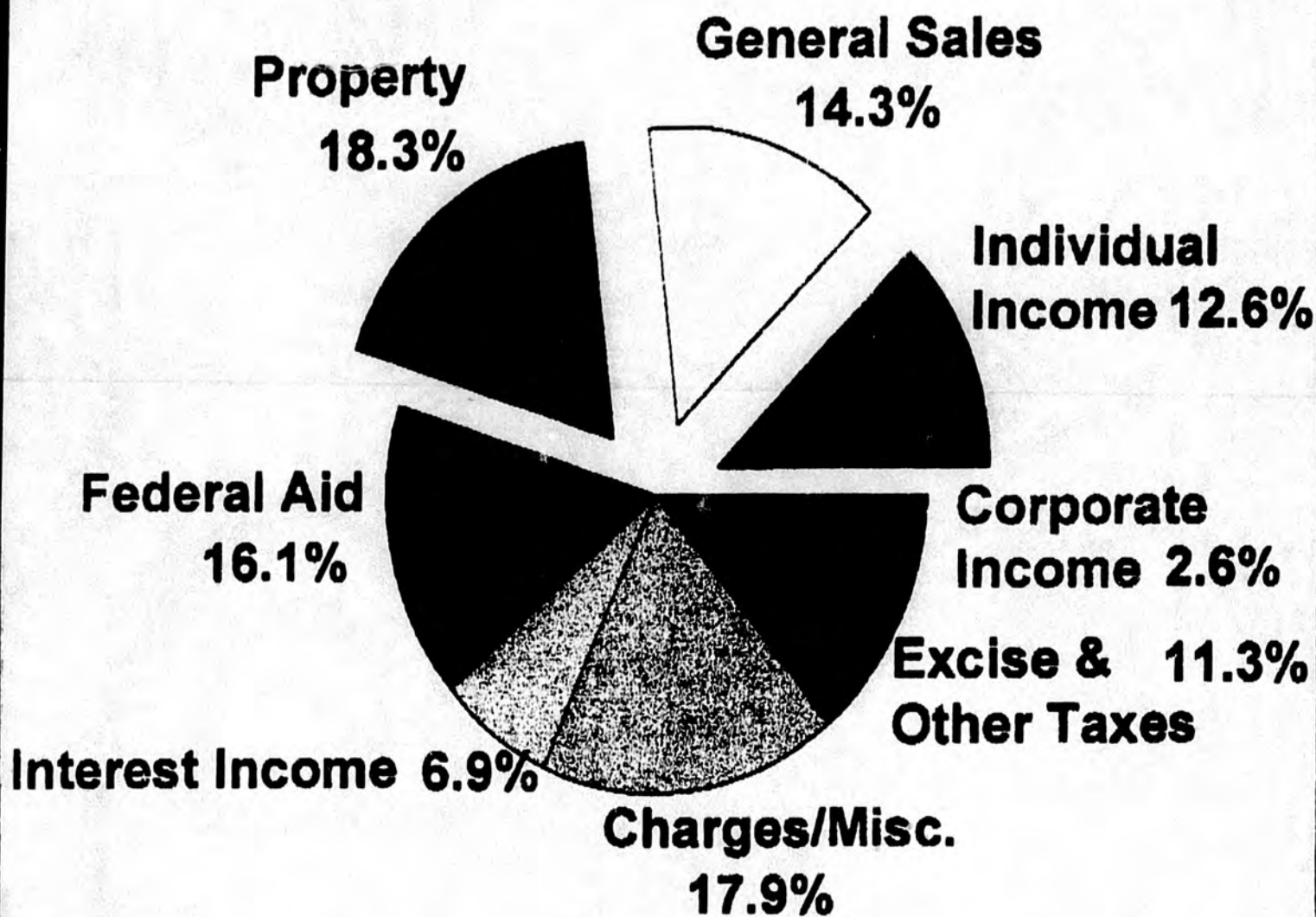
Finances for a "Typical" State are Often Said to Rest on a Three Legged Stool*

1. Personal Income Tax
 - mostly used to finance the State government
2. Sales Tax
 - mostly used to finance the State government
3. Property Tax
 - mostly used to finance Local government and Local schools

* These three legs, though the highest single sources of State and Local revenue, still only make up about 50% of State and Local revenue.

07/11/1995

State and Local Revenue National Average - 1990



7/11/1995

State Revenue

National Average - 1990

General Sales
19.3%

**Individual
Income 18.6%**

Federal Aid
22.9%

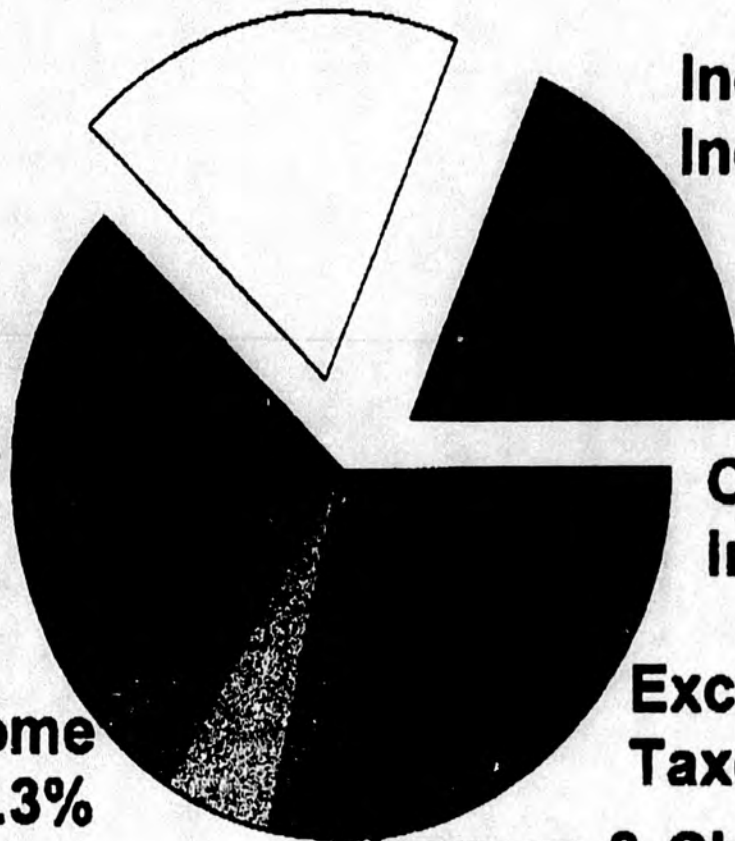
**Corporate
Income 4.2%**

Interest Income
5.3%

**Excise & Other
Taxes 12.4%**

Non-tax Revenue
5.4%

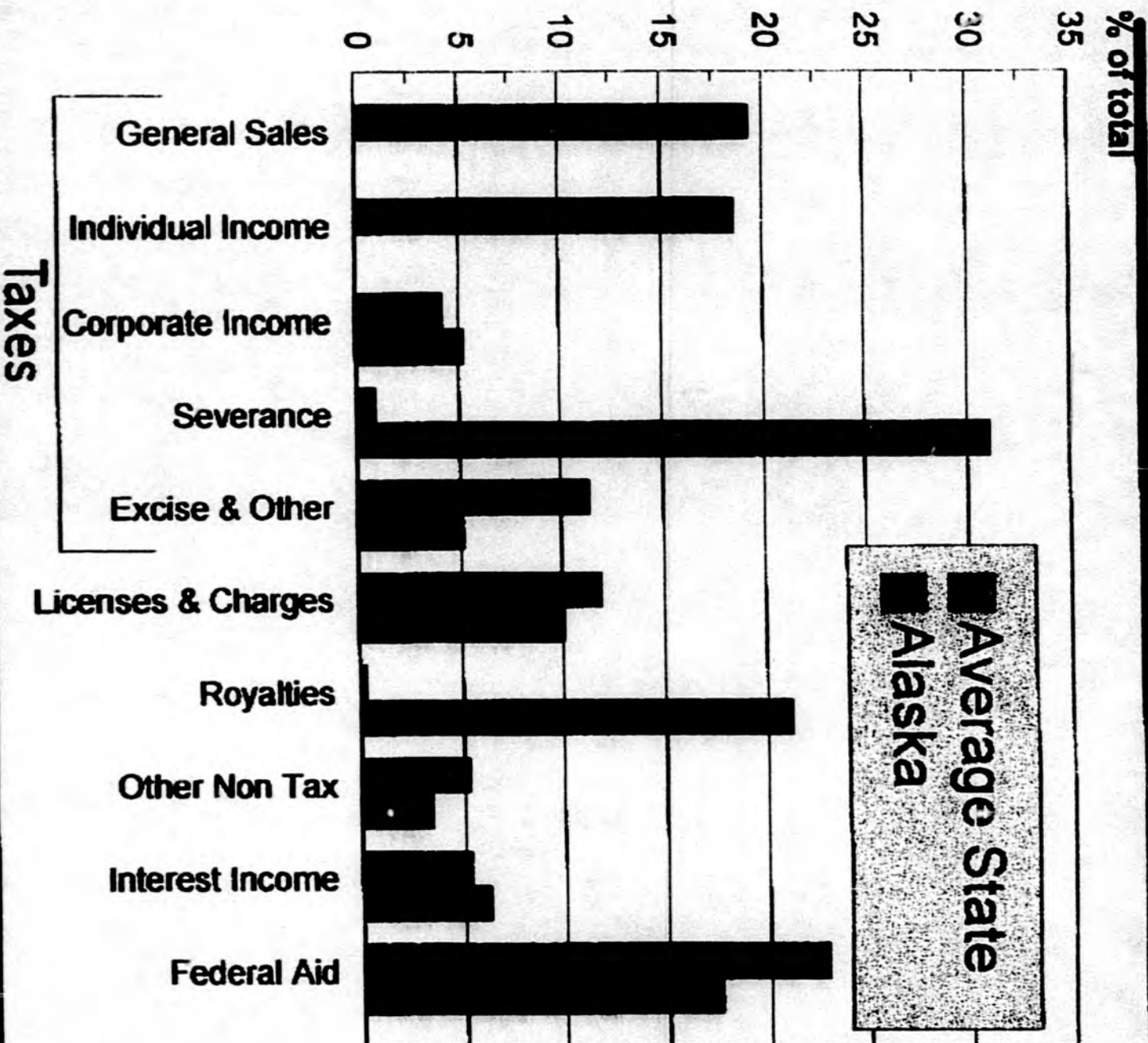
Licenses & Charges
11.9%



07/11/1995

Alaska's Revenue Sources Contrasted with Those of a Typical State

Census Data - 1990



07/11/1995

Individual Income Tax Basics

- ▶ How much personal income is earned in the Alaska economy?

\$11 billion

- ▶ What portion of this is earned by non-residents?

\$1 billion

- ▶ When devising an income tax, the important variables to consider are
 1. Allowable deductions and
 2. Use of a flat or graduated tax rate
- ▶ The following two pages provide a more detailed breakdown of income figures

07/11/1995

Individual Income Tax - What are the Pertinent Income Facts?

Income Class	# of Returns	Adjusted Gross Income (Federal)	Exemptions & Deductions (Including PFD)	Alaska Taxable Income
		(thousand \$)	(thousand \$)	(thousand \$)
\$0 - \$29,999	233,370	\$1,805,391	\$1,133,050	\$672,341
\$30,000 - \$49,999	52,100	2,051,278	675,210	1,376,068
\$50,000 - \$74,999	37,460	2,288,194	615,690	1,672,504
over \$75,000	29,809	3,602,086	650,515	2,951,571
Total	352,739	\$9,746,949	\$3,074,465	\$6,672,484

7/11/1995

Individual Income Tax -

What are the Other Pertinent Facts?

- ▶ A 1% tax on Alaskans would raise
\$67 million
- ▶ Non Residents would add another 11%, or
\$7.5 million
- ▶ The amount which would result from graduated taxes can be calculated from the table on the previous page

INCOME TAX POLICY GUIDELINES

GOALS:

SIMPLICITY
EQUITY
EASE OF ADMIN
NEUTRALITY *(minimum distortion on economy)*

FUNDAMENTAL PRINCIPLE:

BROAD BASE/LOW RATES

STARTING POINT:

OPTIONS - FEDERAL ADJUSTED GROSS INCOME (FAGI)
FEDERAL TAXABLE INCOME
FEDERAL TAX LIABILITY

NOTES: FAGI provides states with the greatest amount of state control and autonomy; many states that have tied to FTI or FTL in the past have regretted their choice when faced with major federal legislation changes such as those in the Tax Reform Act of 1986. However, for most taxpayers tying to FTL is probably the simplest—just multiply FTL by a single flat rate. ✓

RATE STRUCTURE:

OPTIONS - MULTIPLE GRADUATED MARGINAL RATES
SINGLE RATE — *major simplicity*

NOTES: Principal reason for multiple graduated rates is to provide for progressivity in overall tax structure. However, there are many advantages to using a single rate; plus, progressivity under a single rate can match that of multiple graduated rates by proper design and phase-out of standard deduction and exemption levels. In essence, multiple graduated rates offer no advantages over a single rate, whereas a single rate has many advantages discussed below. —> 0

STANDARD DEDUCTION/PERSONAL EXEMPTIONS:

- provided to shelter "subsistence income" from taxation; should be designed to keep "poverty", or "125% of poverty" households off tax rolls, (in Alaska may wish to increase these levels relative to other states' to reflect the significantly higher cost of living in Alaska)

- **Credits vs. Deductions:** The decision of whether to use a personal exemption credit or a personal exemption deduction is relevant only if a graduated rate structure is used. With graduated rates, the deduction provides higher income households with a greater reduction in tax, whereas the credit approach provides each household the same reduction in tax. Use of a credit approach adds progressivity to the tax structure, increases the tax base, and reduces revenue loss when low-income households are kept whole vis-a-vis credit vs. deduction.

With respect to vertical equity, the issue of whether to use credits or a deduction is not relevant when a single rate structure is used!

- **Additional Exemptions:** providing additional exemptions for the aged is difficult to justify—the aged are now one of the wealthiest groups in the US—tax relief should be based on income and ability to pay, not on age. Additional exemptions for the blind may be justified.

personal exemptions and standard deduction may be phased out as incomes rise to add progressivity to effective tax rates under a single rate structure; from one perspective this adds fairness to the tax structure, while from another perspective the perception of fairness is maintained by having every taxpayer pay at the same rate

ADJUSTMENTS TO INCOME (FAGI):

- keep number of adjustments to income at a minimum to maintain broad base, and also to prevent distortion of horizontal equity (e.g., through an exclusion of pension income)
- Only 3 adjustments necessary:
 - 1) interest income on U.S. obligations must be excluded from income for state tax purposes (federal courts); ✓
 - 2) interest income on non-Alaska state, county, and municipal bonds should be added to FAGI to broaden base and maintain Alask bond issue competitiveness with other states; and
 - 3) to the extent included in FAGI, any refund of state income taxes should be excluded.

Any adjustments beyond these brings questions of fairness into play, and erodes the tax base.

ITEMIZED DEDUCTIONS: (TOUGH CHOICES HERE!)

- should they be allowed at all, and if so which should be allowed? Some guidelines:
- *Federal Income Tax*: not much justification for allowing an itemized deduction for federal income taxes; also results in severe erosion of the tax base (In Montana, where individual income tax liability is approaching the \$400 million mark, this deduction reduces state revenue by about \$100 million annually).
- *Home Mortgage Interest*: difficult not to allow for politically; however, is easy to administer and presents few compliance problems as taxpayer must be able to provide documentation through bank statements.
- *Charitable Contributions*. Again, difficult to beat politically; but, can be difficult to administer from compliance aspects.
- *Medical Expense*. Of growing concern given the current fervor over health care reform. Expect issues of where to set the income floor over which deductions for medical expenses are allowed (e.g., Arizona is phasing this floor down from 7.5% of Income--the federal floor-- to no floor); allowing full deduction for health insurance premiums purchased by workers in jobs with no coverage, etc.

TWO-EARNER FILING STATUS:

- the issue here is whether to allow two-earner couples to file separate income tax returns, either on the same or separate forms *(Montana allows filing jointly)*
- if a graduated rate structure is used, allowing separate filing results in taxpayer gamesmanship in which the goal is to provide for equal taxable incomes by shifting non-attributable income sources (e.g., capital gains, dividend and interest income, business income, etc.) to the taxpayer with the lower attributable income (i.e., wages and salaries) in order to reduce the marginal tax rate applied to total income earned in the household. This provides a tax advantage to households with two earners relative to a household with a single earner, but where total household incomes are equal, resulting in horizontal equity problems.

Note, again, that this highly controversial issue disappears if a single tax rate structure is used!

- Also, professional tax preparers in Montana hate this concept!

TAX CREDITS:

- They're unavoidable; but do your best to avoid them like the plague! Montana now has 16 credits on the record; only a couple of them actually work, but we have to have forms and administer all 16 of them. Only credit really needed is a credit for income taxes paid to other states--this is mostly a reciprocity issue.

ALLOCATION OF PART-YEAR AND NONRESIDENT INCOME:

- minor issue, but method of allocating will have to be discussed if graduated rate structure is used; two options - allocation of income before application of standard deduction, exemptions, and rate schedule vs. allocation after tax liability computed using taxpayer's full income (thereby subjecting taxpayer to higher marginal rate).

Once again, note that this issue of allocation methods disappears if a single rate structure is used!

INDEXING

- indexing the income tax personal exemption and standard deduction levels, as well as the cut points of income brackets under graduated rate structures, reduces revenue flows increasingly over time; this revenue reduction is greater when the base components (pers. exemption and std. ded.) are indexed relative to the rate components (the bracket boundaries under a graduated rate schedule).

The reason given for indexing is to prevent "bracket creep". Note that this issue also goes away if there are no brackets to creep up under a single rate structural

STATES WITH INDIVIDUAL INCOME TAX

Per Capita
Income

STATE	1993 Population (thous.)	1993 TPI (millions)	1993 FAGI (thous.)	1993 FTL (thous.)	FY1993 STL (thous.)	TPI/POP	FAGI/TPI	FTL/TPI	FTL/FAGI	STL/FTL	STL/FAGI	STL/TPI	STL/POP
1 ALABAMA	4,187	71,620	49,377,846	6,448,324	1,332,878	17,105	68.9%	9.0%	13.1%	20.7%	2.7%	1.9%	318
2 ARIZONA	3,938	71,317	50,431,204	6,701,498	1,380,653	18,119	70.7%	9.4%	13.3%	20.8%	2.7%	1.8%	351
3 ARKANSAS	2,424	38,776	25,684,608	3,249,651	805,150	15,997	66.2%	8.4%	12.7%	27.9%	3.5%	2.3%	373
4 CALIFORNIA	31,100	100,000	100,000,000	10,000,000	10,000,000	21,883	68.1%	9.4%	14.2%	26.9%	3.8%	2.5%	551
5 COLORADO	3,668	76,581	55,892,523	8,138,012	1,764,738	21,475	73.0%	10.6%	14.6%	21.7%	3.2%	2.3%	495
6 CONNECTICUT	3,277	91,825	67,854,719	11,443,060	2,253,851		73.8%			19.7%	3.3%	2.5%	688
7 DELAWARE	700	15,220	11,423,905	1,572,621	513,138	21,743		10.3%	13.8%	32.6%	4.5%	3.4%	733
8 FLORIDA	6,917	132,832	94,470,361	12,946,742	3,389,921	19,204	71.1%	9.7%	13.7%	26.2%	3.6%	2.6%	490
9 HAWAII	1,172	27,389	18,519,252	2,508,998	922,912	23,369	67.6%	9.2%	13.5%	36.8%	5.0%	3.4%	787
10 IDAHO	1,099	19,279	13,271,689	1,719,483	609,262	17,542	68.8%	8.9%	13.0%	35.4%	4.6%	3.2%	554
11 ILLINOIS	11,697	283,591	186,987,904	28,529,617	4,814,510	22,535	70.9%	10.8%	15.3%	16.8%	2.6%	1.8%	412
12 INDIANA	5,713	109,465	78,734,412	10,882,796	2,808,780	19,161	71.9%	9.9%	13.8%	25.8%	3.6%	2.6%	491
13 IOWA	2,814	51,564	35,718,321	4,848,082	1,467,019	18,324	69.3%	9.0%	13.0%	31.6%	4.1%	2.8%	521
14 KANSAS	2,531	50,295	34,481,822	4,749,185	1,040,385	19,872	68.5%	9.4%	13.8%	21.9%	3.0%	2.1%	411
15 KENTUCKY	3,789	34,237	43,119,227	5,602,738	1,733,415	16,954	67.1%	8.7%	13.0%	30.9%	4.0%	2.7%	457
16 LOUISIANA	4,295	71,252	46,472,002	6,345,386	929,708	16,590	65.2%	8.9%	13.7%	14.7%	2.0%	1.3%	218
17 MAINE	1,239	23,271	15,159,536	1,895,543	614,939	18,782	65.1%	8.1%	12.5%	32.4%	4.1%	2.6%	496
18 MARYLAND	4,965	188,759	86,119,622	11,904,130	3,079,664	23,919	72.5%	10.0%	13.8%	25.9%	3.6%	2.6%	620
19 MASSACHUSETT	6,012	137,148	101,964,611	15,513,521	5,374,911	24,476	69.3%	10.5%	15.2%	34.6%	5.3%	3.7%	894
20 MICHIGAN	9,478	134,687	137,428,632	19,234,274	5,203,599	20,541	70.6%	9.9%	14.0%	27.1%	3.8%	2.7%	549
21 MINNESOTA	4,517	94,942	69,040,004	9,577,140	3,321,955	21,019	72.7%	10.1%	13.9%	34.7%	4.8%	3.5%	735
22 MISSISSIPPI	2,643	38,869	25,435,785	3,090,173	587,589		65.4%	8.0%	13.7%	19.0%	2.3%	1.5%	222
23 MISSOURI	5,234	102,368	68,569,150	9,501,307	2,006,279	19,558	67.0%	9.3%	13.9%	21.1%	2.9%	2.0%	383
24 MONTANA	839	14,617	9,593,841	1,242,721	356,987	17,422	65.6%	8.5%	13.0%	28.7%	3.7%	2.4%	425
25 NEBRASKA	1,607	31,754	21,072,721	2,814,450	885,066	19,760	68.4%	8.9%	13.4%	24.3%	3.3%	2.2%	426
26 NEW JERSEY	7,879	210,622	151,588,226	23,616,357	4,350,485	26,732	72.0%	11.2%	15.6%	18.4%	2.9%	2.1%	552
27 NEW MEXICO	1,616	26,402	18,363,855	2,313,889	526,935	16,338	69.6%	8.8%	12.6%	22.8%	2.9%	2.0%	326
28 NEW YORK	18,197	450,754	293,198,545	45,164,525	15,300,000	24,771	65.0%	10.0%	15.4%	33.9%	5.2%	3.4%	841
29 NORTH CAROLIN	6,945	129,780	92,845,247	11,991,677	3,992,018	18,688	71.4%	9.2%	12.9%	33.3%	4.3%	3.1%	575
30 NORTH DAKOTA	635	10,000	10,000,000	1,029,510	1,029,510	17,121	69.9%	9.5%	13.5%		3.1%	2.2%	198
31 OHIO	11,091	217,693	153,216,631	20,993,250	4,721,854	19,628	70.4%	9.6%	13.7%	22.5%	3.1%	2.2%	426
32 OKLAHOMA	3,231	15,047	36,052,178	4,701,419	1,299,583	17,037	55.5%	8.5%	13.0%	27.6%	3.6%	2.4%	402
33 OREGON	3,032	58,962	41,830,525	5,584,004	2,383,214	19,447	70.9%	9.5%	13.3%				786
34 PENNSYLVANIA	12,048	255,921	171,311,334	24,176,133	4,857,928	21,242	36.9%	9.4%	14.1%	19.3%	2.7%	1.8%	387
35 RHODE ISLAND	1,000	21,204	14,341,042	1,974,642	497,235	21,204	37.6%	9.3%	13.8%	25.2%	3.5%	2.3%	497
36 SOUTH CAROLIN	3,643	61,236	43,494,080	5,326,897	1,494,789	16,809	71.0%	8.7%	12.2%	28.1%	3.4%	2.4%	410
37 UTAH	1,860	30,010	22,508,133	2,787,878	842,098	16,134	75.0%	9.3%	12.4%	30.2%	3.7%	2.8%	453
38 VERMONT		11,193	7,630,597		285,822	19,432	68.2%	8.8%	12.9%	28.9%	3.7%	2.6%	496
39 VIRGINIA	6,491	139,831	101,990,433	14,150,558	3,584,765	21,542	72.8%	10.1%	13.9%	25.3%	3.5%	2.6%	552
40 WEST VIRGINIA	1,820	29,392	18,543,327	2,327,958	621,174	16,149			12.6%	28.7%	3.3%	2.1%	341
41 WISCONSIN	5,038	99,860	72,199,663	9,625,114	3,445,819	19,821	72.3%	9.6%	13.3%	35.8%	4.8%	3.5%	684
MINIMUM	578	13,872	7,599,759	987,530	125,687	14,706	63.1%	7.9%	12.1%	12.2%	1.7%	1.2%	198
MAXIMUM	31,211	683,002	451,175,269	63,907,920	17,200,000	27,900	75.1%	12.5%	16.9%	42.7%	5.7%	4.0%	894
TOTALS/AVE.	210,964	4,419,250	3,044,259,859	430,814,691	112,424,817	20,919	69.0%	9.8%	14.2%	26.1%	3.7%	2.5%	533

ALASKA 599 18,785 10,025,224 1,550,753

23,013 12.7% 11.2% 15.5%

371 million

371 million

g:\123\p\libyst.wk4

SCOMM

101:6

**STATE OF ALASKA
LONG RANGE FINANCIAL PLANNING COMMISSION**

716 West Fourth Avenue, Anchorage, Alaska 99501

Phone: (907)258-8165, Fax (907)258-9869

Internet: LRFPC%legis@state.ak.us

Staff: Melissa Aber Fouse

Bob Walsh

AGENDA

Video Meeting

Thursday, 27 July 1:30 pm to 7:30 pm

UAF-212 B Butrovich, UAA-University Lake Bldg, UAS-Library

Complete drafting of Interim Report

Materials for Commissioners to bring:

Draft Interim Report dated 7-15

Comments & Suggestions

NEXT MEETING-MARK YOUR CALENDAR

Audio Conference

Thursday, August 3rd 4:00 pm to 11:00 pm

or

completion of document

NEXT REGULAR MEETING

Regular Meeting

Friday, 11 August, 10:00 am to 5:00 pm

Saturday, 12 August, 8:30am to 4:30 pm

Stabilization of Revenues

Budget Process

Commissioner Perkins: Dedicated Funds

Sharing of responsibilities, Roads & Harbors, etc.

Impacts

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SCHEDULE

As of 25 July 1995

Video Meeting

Thursday, 27 July 1:30 pm to 7:30 pm

UAF-212 B Butrovich, UAA-University Lake Bldg, UAS-Library

Complete drafting of Interim Report

Audioconference

Thursday, 03 August 4:00 pm to 11:00 pm

or until completion of document

Target Date

05 August, Saturday

Distribution of Interim Report & Survey
Use Month of August for Public Outreach/ie Radio Talk
Shows, Newspaper Interviews, Municipal Meetings,

Regular Meeting

Friday, 11 August, 10:00 am to 5:00 pm

Saturday, 12 August, 8:30am to 4:30 pm

Stabilization of Revenues

Budget Process

Commissioner Perkins: Dedicated Funds

Sharing of responsibilities, Roads & Harbors, etc.

Impacts

Regular Meeting

Friday, 25 August 10:00 am to 5:00 pm

Saturday, 26 August 8:30 am to 4:30 pm

Identify New Revenue
Commissioner Will Condon
Municipal League
Prepare for Public Hearings

11-14 September
Public Hearings

Regular Meeting- Anchorage LIO
Friday, 15 September, 10:00 am to 5:00 pm
Saturday, 16 September, 8:30 am to 4:30 pm

Final Report Preparation

Regular Meeting-Anchorage LIO
Friday, 29 September 10:00 am to 5:00 pm
Saturday, 30 September, 8:30 am to 4:30 pm

Approve Final Report

DRAFT
INTERIM REPORT
LONG RANGE FINANCIAL PLANNING
COMMISSION
as of 27 July 1995
Table of Contents:

Page 1.	Introduction: The Fiscal Gap is Real
Page 3.	What is the LRFPC?
Page 3.	Declining Oil Production
Page 4.	How big is the fiscal gap?
Page 6.	What can be done to fill the gap?
Page 8.	Changes in State Spending.
Page 11.	Current State of Alaska Budget
Page 12	Closing the Fiscal Gap with Spending Cuts
Page 18	Scenario 1
Page 20	Scenario 2
Page 22	Scenario 3
Page 23	What About Revenues?
Page 32	LRFPC User Fees Chart
Page 33	LRFPC Revenues Worksheet
Page 35	Permanent Fund Scenarios
Page 38	Service & User Fees

Page 39	Corporations & Foundations, Loan Funds
Page 41	Excise & Other Taxes
Page 43	Economic Development as a Revenue Generating Tool
Page 49	Budget Stabilization Sections
Page 55	What about Reserves?
Page 56	State of Alaska Fund Balances
Page 58	Budget Process Improvements
APPENDIX I	Chart of Percentage of Income Households Pay or Up under Various State Policy Options
APPENDIX II	Work Papers for Reduction Scenarios

DRAFT! — Interim Report of the Long-Range Financial Planning Commission — DRAFT!

Chair's notes on this draft:

- *New language is shown in italics.*
- *Some new language is based on Commission discussion 7/14-15*
- *New Revenue and Permanent Fund sections come from Revenue Subcommittee, except that (a) references to the subcommittee were changed to the full commission, (b) additional information about excise taxes and user fees was added, (c) portions of subcommittee report on revenues were omitted to avoid repetition of language already in the report.*
- *New section on ISER findings comes from 1987 report*
- *Added to these pages are sections faxed separately as noted at the end*
- *Please bring this draft, together with a version which includes the charts, to the videoconference today.*

INTRODUCTION

The Fiscal Gap is Real

The State of Alaska spends more than it takes in each year, and has done so for six of the past nine years. For the past five years, the legislature and the governor and state agencies have worked to close the gap by cutting expenditures and holding the line on the growth of expenditures, in effect reducing per capita spending by 5 per cent per year in inflation-adjusted terms. Without this steady attention to reducing expenditures, Alaskans would have been faced with drastic reductions in services and programs on the one hand and, on the other, loss of the Permanent Fund Dividend, significant new taxes or other revenue-raising measures. *These efforts have not been enough to offset the decline in revenues because of the decline in Prudhoe Bay oil production.*

Alaska has significant oil reserves and a rapidly growing Permanent Fund. We have a Constitutional Budget Reserve fund that was established to help minimize the effect of declining revenues, but that fund and other savings accounts are being spent at a rapid rate. The CBR and other reserves will be exhausted in five years if we do nothing. Without major changes in spending and revenue now, Alaska could face another recession.

Why the Fiscal Gap Exists

The fiscal gap exists *for two reasons. First, Alaska has based its budget on non-sustainable revenue sources — we have counted on oil revenues to fund a budget which is larger than we can afford on a long-term basis. Second, there has been a real and rapid decline in Prudhoe Bay production. The state is dependent upon oil and gas revenues for half of its income (75% of the state's income if we exclude Alaska Permanent Fund earnings). The decline in production means a decline in state revenues.*

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In trying to come to grips with the fiscal gap, it's important to understand that it's not the same as the problem of Alaska's fiscal instability, although the volatility of Alaska's revenues complicates the fiscal gap. Fiscal instability is the roller-coaster ride caused by unpredictable oil price fluctuations, and the resulting ups and downs in expected state revenue flows. The fiscal gap is how far down the ground is from that roller coaster. The relationship between the two is that the fiscal gap looks closer, and more ominous, when the roller coaster is being whipsawed downward by falling oil prices. By contrast, it looks farther away and less threatening when the roller coaster is being whipsawed upwards, by rising prices.

When the roller coaster is heading downward, people get anxious. Fiscal disaster seems just around the corner, and everyone agrees that an urgent need exists to do something about it. When oil prices and the roller coaster swing upwards, however, the fiscal gap suddenly looks farther away, and less threatening, and both the sense of urgency and the resolve to deal with the problem dissipates. This cycle repeats itself over and over in Alaska, as oil prices and resulting revenue forecasts cycle up and down.

The "moving target" aspect of the fiscal gap problem makes dealing with it extremely difficult, both conceptually — because we don't know just how large the gap may turn out to be, or how much time we may have for dealing with it — and governmentally — because, not knowing these things, it's difficult to make decisions about how or when to resolve the problem.

It's important to keep this in mind as we discuss the fiscal gap, and as we try to develop approaches for dealing with it. While we shouldn't start out assuming that the sky is falling, we also shouldn't kid ourselves that the fiscal gap is not an extremely serious problem.

At Statehood, Congress endowed Alaska with a substantial land base, including underlying oil and gas resources. Alaska was blessed with a super-giant (elephant) oil field at Prudhoe Bay. The barrels of oil began to flow in the Trans-Alaska Pipeline System (TAPS) in 1977. By 1979, after the OPEC price hikes, Alaska began receiving such large amounts of revenue from royalties and taxes that the state abandoned its more traditional methods of obtaining revenue such as the personal income tax and, in some municipalities, sales taxes. Many communities also reduced real property taxes. Oil prices peaked in 1980 and began a steady decline, with an abrupt fall in 1986, triggering the 1986-1989 Alaska recession. Even so, Alaskans still preferred to rely on the probability of a rebound in oil prices than to address the problem of their heavy reliance on declining revenue sources.

The time has come to deal with those issues. The members of the Long-Range Financial Planning Commission hope that this preliminary report to the

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Governor, the Legislature and the People of Alaska will provide the basis for vigorous discussion and debate about our state's future.

What is the Long-Range Financial Planning Commission?

The Long Range Financial Planning Commission was established by Alaska's Legislature and Governor to assess the State's financial condition and to recommend a strategy to balance the State's revenues and expenditures. We are 15 Alaskans, selected by the Governor, the President of the State Senate, and the Speaker of the State House, charged with providing an independent assessment of the state's financial future. We were given little time to finish our work: we convened in mid-April, 1995, and are due to complete our work by October 1.

We were asked to examine the size of the "fiscal gap" — the difference between revenues and expenditures — for a ten-year period, to look for budget reductions and revenue increases, to examine the budget process, to consider the impacts of changes on local governments, and to hear from the public about choices Alaska faces.

In this preliminary report, we will document the size of the fiscal gap, explain the choices available to the state, and discuss the opportunities for cutting expenditures and raising revenues to fill the gap. We will then ask you to let us know what you think is a long-term sustainable state revenue and expenditure strategy which balances the needs for state services with the limited revenues available to Alaska.

Declining Oil Production

Alaskans have known since Prudhoe Bay started producing oil that the oil was a finite resource, and that annual production would eventually begin to fall. Throughout the 1980s, Alaska's oil industry undertook massive investments to keep Prudhoe Bay production rates high. Their efforts were extremely successful — since 1985, the industry has extended the total reserves by one barrel for every barrel produced. Even so, annual production rates started falling in 1991 and will continue to do so until the field is no longer economic to produce.

The chart below shows the current forecast of oil production in Alaska. The Commission has determined that there is little probability of oil production from ANWR during the next ten years, regardless of how soon ANWR is opened for exploration. Some production is expected from currently-marginal fields. While there may be some additional production from fields not listed, we follow the Department of Natural Resources predictions. No production of North Slope natural gas is included, as production is currently not expected before 2005.

CHART 1:

North Slope Production Forecast

How big is the fiscal gap?

The fiscal gap this year is \$500 million. That's equal to all of the salaries and benefits paid to all state employees; it's almost as much as the whole Permanent Fund dividend program; it's almost as much as the entire public school funding program. The Commission's projections, detailed below, show that absent any real changes in spending or revenues, the gap will widen to over \$1 billion (current dollars) in the next 10 years.

We designed a "Base Case" to predict what spending and revenues would be absent any changes in state policy. There are several ways to honestly calculate the size of the fiscal gap. Different assumptions about population growth, about inflation, about oil revenues, and about investment performance, all yield different results. For the Commission's work, we chose the following methodology:

1. All projections are in FY96 dollars. In reality, there will be inflation, which affects both revenues (from taxes and investment income) and expenditures.
2. We adopted the best projections of population growth available from the Department of Labor, and applied those projections to the state's formula programs [formula programs include Longevity Bonus, Medicaid, Aid to Families with Dependent Services, Municipal Assistance and Revenue Sharing, and ???]. We used one-half of the rate of population growth for state agency expenditures. We know that some department budgets would change as a result of population growth. In particular, the Corrections, Health and Social Services, Public Safety, University of Alaska, and Transportation and Public Facilities departmental budgets are largely population-driven. We also know that new technologies are allowing more efficiencies in state government, and should allow reductions in costs. Since there is no real way to predict the combinations of these effects, we are assuming that state agency operating expense would grow at one-half the rate of population growth absent further budget cuts.

3. We used the March, 1995, mid-case scenario for oil revenue projections, based on oil production and price forecasts developed by the State Department of Revenue. While we know that new projections of revenues are developed on a regular basis, and may result in changes to the fiscal gap, we also know the scale of the gap is unlikely to change significantly.
4. We used the March, 1995, forecasts of other state revenues developed by the State Department of Revenue.
5. We used the estimates of Permanent Fund income developed by the *Commission staff based on earlier work by the Alaska Permanent Fund Corporation. Differences between methodology are detailed in Appendix ____.*
6. We assume \$50 million is available annually to the state as a dividend from Alaska Housing Finance Corporation income, as provided in the agreement between AHFC and the Governor.
7. We have assumed federal law is static, which of course it is not. We have assumed no new revenues from ANWR bonuses (ANWR royalties, if any, would probably be outside our ten-year planning horizon), and no increased revenues due to repeal of the Jones Act.
8. We have not accounted for probable changes in federal assistance to the State of Alaska, although it is likely that current Congressional action will result in substantial cost-shifting from the federal to the state budget, particularly in Medicaid, other health and social service expenditures, and transportation expenditures.
9. All revenues which could be spent are considered available for expenditure or other disposition. Thus, all Permanent Fund earnings and earnings of the Science and Technology Endowment are included in the unified budget. Other program receipts, to the extent that (a) they are significant and could be separately defined, and (b) the receipts are not dependent upon specific state-funded activities to generate the receipts, are included in the unified budget numbers.
10. The base case calculates the fiscal gap without use of the Constitutional Budget Reserve (which requires a 3/4 vote of both houses of the legislature), then shows what would happen if the legislature, by a 3/4 vote, used the CBR to fill the gap each year. It shows that the CBR could be used to fill the fiscal gap for four more fiscal years, after which it would be depleted and the state would face an \$800+ million budget gap.

Our projections show the following deficits now, in five years, and in ten years (all numbers in millions of dollars):

	<u>FY96</u>	<u>FY00</u>	<u>FY05</u>
Revenues:			

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Petroleum	1,473.4	1,474.6	1,200.2
Other sources	301.3	281.4	275.7
Permanent Fund	1,218.0	1,372.7	1,530.8
AHFC/adjustments	180.1	79.6	68.0
TOTAL	3,172.8	3,208.3	3,074.9

Expenditures and Transfers:

Agency operations	1,139.9	1,251.9	1,384.7
Formula programs	413.8	427.2	444.6
K-12 education	660.3	728.8	824.6
Debt service	109.4	44.9	10.9
Capital	106.2	106.2	106.2
Loans	22.2	22.9	23.9
PFDs	575.0	632.0	724.1

Transfers:

PF Inflation-proofing	441.0	482.6	516.3
PF Earnings reserve	202.0	258.1	310.7
TOTAL	3,669.8	3,954.7	4,325.6

THE GAP	(497.0)	(817.4)	(1,322.0)
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What can be done to fill the gap?

There are six choices, some or all of which can be used in combination:

- Cut spending
- Use reserves
- Raise revenues through economic development
- Raise taxes and user fees
- Use Permanent Fund income
- Increase oil production from new fields

Each of these choices has an effect on Alaska's economy and on the lives of the people of Alaska. The effects can vary, by region of the state, by income level of Alaskans, by the kind of business in which a person works.

To some extent, the choices made will all have an adverse impact on Alaska's economy — for each \$100 million per year removed from Alaska's economy, the gross effect is the same whether it's \$100 million less in state spending, \$100 million less in Permanent Fund Dividends distributed to Alaskans, or \$100 million more collected in taxes and user fees from Alaskans. For any one family, however, the choice could make a big difference.

There are some differences in the economic impact of various choices. A 1987 study for the State Legislature compared the effects of three options — reimposing personal income taxes, reducing Permanent Fund Dividends, or reducing state spending. That study indicated the following effects:

Reimposing the Personal Income Tax

- A personal income tax would reduce Alaskans' disposable personal income by about \$340 million, or 2 percent of Alaskans' overall purchasing power.
- This reduction in Alaskans' purchasing power would reduce business activity and cost the state's private support industries about 2,000 jobs annually — about 1 percent of the average annual employment.
- The drop in employment would reduce disposable personal income in Alaska by an additional \$110 million, or 1 percent of overall purchasing power.

Reducing Permanent Fund Dividends

- Reducing Permanent Fund Dividends by a comparable amount would cost the state \$400 million in disposable personal income.
- This would result in a job loss of 2,700 private industry jobs annually.
- Which would further reduce personal income by another \$140 million.

Cutting State Spending

- If the state cut its spending by reducing costs for all the kinds of expenditures that are represented in current state spending — a mixture of salaries, capital projects, transfers, and others — about 3,000 public and 1,500 private jobs, and about \$320 million in disposable personal income would be lost.

There are differing other effects from these three choices. Two of note are the "federal tax offset" and "tax exporting."

The federal tax offset recognizes that any action which affects personal incomes of Alaskans changes the federal tax liability for Alaskans. Two of these choices have tax offsets which are relatively easy to calculate. First, personal income taxes paid at the state level are deductible from federal income taxes. A state personal income tax which raised \$300 million would reduce Alaskans' federal tax liability by approximately 20%, or about \$60 million. Second, permanent fund dividends are taxable income to Alaskans. A reduction to Permanent Fund dividends would reduce Alaskans' federal tax liability by approximately 15%, or \$45 million. Cutting state spending would have some federal tax offset, since a portion of state employees' salaries are paid in federal income taxes, but it is not easy to calculate or estimate the tax offset for this option.

"Tax exporting" refers to the portion of taxes paid by non-residents. Approximately 8 percent of the income earned in Alaska is earned by non-

residents (not including part-year residents, who count as Alaskan residents). This is a conservative (low) estimate; somewhere between \$25 and \$40 million of a \$300 million personal income tax would be paid by non-resident workers. A sales tax has a similar tax exporting provision — a portion of sales taxes are paid by non-resident workers and by visitors to Alaska.

For the last five years, the State has used pieces of all six choices. In particular, spending has been reduced, reserves used, and user fees increased. The State has attempted to create economic incentives to increase development of oil and gas, timber, and mineral resources. But the size of the problem has continued to grow, primarily due to population growth-driven formula spending and the decline in Prudhoe Bay production.

TABLE 2a

Growth of State Agencies: %

TABLE 2b

Growth of State Agencies: \$

TABLE 2c:

Growth of Formula Programs: %

TABLE 2d

Growth of Formula Programs: \$

Changes in State Spending

The Commission examined the major growth areas of the state budget. We used FY79 as a starting point, because it was the last state budget prepared before the 1979 OPEC-driven oil price increases (and the tripling of state oil revenues). Chart 2 shows that the combination of population growth and inflation would have increased a budget by 155% over that 17-year period. The fastest-growing state agencies, on a percentage basis, were Corrections (604%), the Legislature (213%), Commerce (206%), and Law (160%).

Table 3

FY79 to FY96 GF Budget Comparisons

More significant is Table 3, which shows growth by category of expenditure over the same period of time. The core of state government, agency spending, grew 93%, compared to 150% growth in the budget as a whole. Major spending drivers were grants to individuals (443%), grants to groups (334%), grants to schools (175%) and municipal assistance (165%).

Projections for the future show that the biggest areas of spending growth, absent changes in public priorities, will be these same programs and services — grants to individuals, groups, schools and municipal assistance, and the corrections and criminal law budgets.

Over the past five years, the emphasis in public discourse and in the legislature is on cutting state spending. Some programs have been eliminated or downsized. In others, programs have had to serve more people with the same amount of money. Those that have grown have done so primarily because of increases in the state's population, and due to several programs growing faster than population: criminal justice and corrections, Medicaid, and health and social services. The net result is that per number of state employees per capita is at a 15-year low (see chart 4).

Chart 4

State Employees per 10,000 population

Alaska's population has grown 52 percent over the past 17 years. Thus while the overall budget has grown, services per capita are at the same level as they were in 1979 — prior to the major increases in state spending. Unlike other states, Alaska's revenues do not grow as the population grows. The twin trends of declining revenues due to declining oil production and increasing expenditures due to increasing population work against each other to make our fiscal problems worse. The Department of Labor expects the state population to continue to grow at a 1.6 percent compound rate over the next ten years.

Chart 5

Alaska's population

Per capita spending on the operating budget has been cut over 25% in the past five years on an inflation-adjusted basis (see chart 6). Nonetheless, even excluding Permanent Fund Dividends, Alaska spends more than twice as much per capita as the national average. Part of this is due to Alaska's size and geographic isolation from other states. In part, the high level of wealth in the State of Alaska in the early 1980s, Alaskans came to expect a higher level of services. Comparisons are further made difficult by the fact that Alaska performs many services at the state level that are provided by counties or municipalities elsewhere — Education, criminal prosecution, correctional facilities and road maintenance is primarily state-provided in Alaska, while these services are local in other jurisdictions. Some of the high state

expenditures in Alaska are unique — programs like the Longevity Bonus and Permanent Fund Dividends, which no other states have.

Chart 6
Real Per Capita spending FY79-96

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The Current State of Alaska Budget

The State of Alaska is projected to receive \$3.2 billion in revenues during the coming fiscal year, including \$1.5 billion from petroleum revenues, \$1.2 billion from permanent fund income, and \$480 million from other sources. The budget calls for spending or placing in reserves \$3.7 billion, allocated as follows:

- \$1,120 million State agency operations (excluding formula programs):
 - \$ 195 million Health & Social Services
 - 167 million University of Alaska
 - 130 million Corrections
 - 130 million Transportation & Public Facilities
 - 85 million Public Safety
 - 75 million Administration
 - 46 million Courts
 - 43 million Natural Resources
 - 41 million Fish & Game
 - 37 million Commerce & Economic Development
 - 31 million Legislature
 - 31 million Community & Regional Affairs
 - 31 million Education
 - 20 million Law
 - 18 million Environmental Conservation
 - 15 million Governor
 - 12 million Revenue
 - 6 million Military & Veterans Affairs
 - 9 million Labor
- \$ 660 million K-12 education
- \$ 575 million Permanent Fund dividends
- \$ 441 million Permanent Fund inflation-proofing
- \$ 414 million Formula programs
 - \$ 145 million Medicaid
 - 72 million Longevity Bonus
 - 60 million Local Government Assistance:
 - Municipal Assistance, Revenue
 - Sharing, Property Tax Exemptions & Renter Rebate
 - 59 million Aid to Families with Dependent Children
 - 78 million Other formulae: what are they?????
- \$ 202 million Transfer to Permanent Fund Earnings Reserve
- \$ 109 million Debt service
- \$ 106 million Capital projects
- \$ 22 million Loan programs
- \$ 20 million Supplemental appropriations for emergencies and court judgments

Long Range Financial Planning Committee
Expenditures Subcommittee Report

DRAFT

July 27, 1995

CLOSING THE FISCAL GAP WITH SPENDING CUTS

The Legislature directed this Commission to develop a list of spending cuts which total the existing fiscal gap. This requires identifying how to cut \$500 million, or 20 % , from current state spending. The following scenarios of spending cuts of \$500 million are in response to that charge . While in agreement that spending cuts are an important and necessary tool to solve the fiscal gap, the Committee does not recommend that the fiscal gap should be filled by spending cuts alone.

Spending Cuts Are an Opportunity to Re-Define the "Common Good"

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.

Assumptions

1. Many Alaskans are aware that the Permanent Fund Dividend, the Longevity Bonus and other types of "free" money and services unrelated to need are not available in any other state .
2. The Alaskan public, and our leaders, will continue to have difficulties taking seriously -- and therefore dealing effectively --- with the realities of the fiscal gap, while the State has a \$15 billion Permanent Fund and continues to make payouts of government services and money, unrelated to need, to all individuals, as well as to classes of individuals .
3. Alaskans will not be able to take the fiscal gap seriously or to take the steps necessary to reduce the gap (such as pay increased personal taxes and user fees or accept reduced Dividends) while the state has a \$15 billion Permanent Fund unless state leaders successfully articulate a "vision" for the future that gives a reason for sacrificing now to save the corpus of the Fund for that future.

12

4. Many Alaskans are aware that the state spends more per capita than in any other state -- but if they don't see how they are benefited that much more they conclude the state is spending irresponsibly or ineffectively. (i.e. Alaskans are often reminded that the state spends 2 to 3 times the national average for education, welfare, and other services...so they expect 2 to 3 times the benefit for the extra dollars spent.)
5. Alaskans who believe state government is spending irresponsibly or ineffectively view spending cuts as essential both to solve the fiscal gap and to force reform in how and where state funds are spent.

Conclusions

1. Many Alaskans will not take the fiscal gap seriously or be willing to accept the individual sacrifices to resolve the gap until they believe state government is spending responsibly .
2. Spending cuts are an important and necessary tool to solve the fiscal gap.
3. The State has been accomplishing actual spending cuts by holding a flat budget.
4. Additional spending cuts, over and above a flat budget, will be necessary to solve the fiscal gap.
5. It would be devastating to the economy to attempt to solve the fiscal gap by spending cuts alone.
6. All significant reduction plans should be phased to the year 2000.
7. Spending cuts should be governed by announced fiscal policy goals.
8. Increases in formula programs are only partly explained by population increases; all formula programs must be re-examined or they will overwhelm and defeat all attempts to resolve the fiscal gap problem.
9. All state expenditures, including Permanent Fund earnings and dividends, should be included for review in determining fiscal policy goals for spending cuts.

Rules of the Road

- Although concluding that all state expenditures should be included for review in determining fiscal policy goals, spending cuts in this interim report were made only to programs appropriated by the Legislature and/or supported by the State's general fund.

This means potential reductions in programs funded from other sources (such as Power Cost Equalization, student loans, etc.) were not considered.

It also means that Permanent Fund Earnings Reserve Fund monies were not considered because these are not funds currently appropriated by the Legislature (it would take a majority vote of the Legislature to spend part or all of Permanent Fund earnings each year).

Permanent Fund dividends were considered because they are appropriated each year.

For the Final Report, the Commission will include consideration of the Permanent Fund Earnings Reserve Fund as well as Permanent Fund Dividends.

- The spending cuts discussed here underestimate the impact on local and state economies and services because they do not reflect anticipated reduction in federal funds to the state.

Spending and Spending Cuts Reflect Public Policy Choices

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

- Alaska's revenues should be directed to the state government so it can provide services to all Alaskans.
- Alaska's revenues should be directed to local governments so they can provide services that meet local priorities.
- Alaska's revenues should be directed to individual Alaskans so they can make personal decisions about their individual priorities.

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

- **What If the Legislature decided that Alaska's revenues should be directed primarily to state government ?**

If this was the goal it would mean the top priority would be protecting the amount of money that goes to state agencies so they can continue to deliver the services the same way as they do now.

- Non-needs based grants to individuals would be eliminated (Longevity Bonus and Permanent Fund Dividend) with the savings going to the general fund to maintain the same level of state services.
- State aid to municipalities would be eliminated with the savings going to the general fund to maintain the same level of state services.
- Service levels provided by state government would continue to grow.
- State jobs would be protected.

- **What If the Legislature decided that Alaska's revenues should be directed primarily to local governments?**

If this was the goal it would mean the priority would be to protect, or increase, the amount of funding that goes to local communities. This funding would be in lieu of services the state has been providing.

- Drastic 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 such areas as education, public protection, road maintenance, and capital projects.

- **What If the Legislature decided that Alaska's revenues should be directed primarily to individuals?**

If this was the goal it would mean all wealth sharing programs to individual Alaskans would be protected from cuts .

- Permanent fund dividends and grants to individuals, such as Longevity Bonus, would not be reduced and, in fact, might be increased.
- The number of current state and municipal employees would be dramatically cut
- Drastic reductions would be made in funding to local and state programs that do not provide a direct service to individuals.

The point is that different fiscal goals result in different spending cut scenarios. the kinds of spending cuts that might be made depend on public policy goals, whether or not these goals are articulated. In fact, any one of these goals would mean extreme consequences to current programs and services, to every community and to every Alaskan.

Principles Basic to Any Spending Reduction Goals

• Grants and Services to Individuals

- In the face of community need for basic services, non-needs based grants to individuals should be eliminated.
- In the face of community need for basic services, state and local governments should charge fees for services commonly paid for by citizens of other states at like rates.

• 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 should be tied to providing specific services as opposed to general block grants for local services.
- The trade-off should be full formula funding both to and from local governments and school districts and the state.

• 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 health benefit package for all employees and retirement package for new hires. This will reduce current benefit costs and significantly reduce future retirement costs for new hires.
 - 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.
 - Change the current compensation system to better reward individual performance and limit increases in personal services expenses.

• 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.

The Charge: To Cut the Current Fiscal Gap - \$500 Million!

Obviously, there are many ways to cut Alaska's budget. We choose three scenarios to indicate the kinds of choices available. It should be pointed out that individual Commission members would choose different percentages or 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.

SCENARIO 1: *The policy goal is to protect state government services, in so far as possible.*

- Requires major consolidation and privatization of programs at state level.
- Requires drastic reduction in funds to local governments.
- Has the goal of protecting the number of state jobs with the trade-off of reductions in salary and benefits.
- Requires giving up non-needs based payments to individuals, including Permanent Fund dividends, for community-wide services.
- All reductions would be completed by the year 2000.

Scenario 1			
	Program	Estimated Savings	Amt Remaining in Program
Grants that Benefit Individuals: -\$99,953.9			
	Longevity Bonus (eliminate)	-72,152.6	0.0
	Public Assistance Programs	-10,163.1	91,468.0
	Medical Assistance Programs	-15,035.6	135,320.2
	Permanent Fund Dividend	0.0	556,000.0
	Alaska National Guard Benefits	-226.6	906.3
	Day Care Assistance	-1,017.3	10,193.8
	Other Programs	-1,358.7	1,733.6
Grants to Local Governments: -\$228,072.3			
	K-12 Funding	-66,030.9	594,278.5
	Human Services Matching Grants	-1,769.6	0.0
	Senior Citizens Property Tax Relief	-1,500.0	0.0
	Revenue Sharing	-26,271.7	0.0
	Municipal Assistance	-31,959.0	0.0
	Community Jails	-218.7	4,156.0
	Capital Matching Grants	-20,000.0	0.0
	School Debt Reimbursement	-80,322.4	0.0
Employee Salary/Benefit Reforms and Streamlining Programs: -\$69,892.5			
	State Agency Programs	-47,779.6	1,192,504.6
	Court System	-2,292.1	43,550.3
	Legislature	-3,084.6	27,761.0
	University	-16,736.2	160,625.5
Privatization Opportunities: -\$54,217.4			
	Pioneer Homes	-29,842.3	0.0
	Ratnet	-794.8	0.0
	Alaska Council on the Arts	-564.0	0.0
	Vocational Technical Schools	-5,106.3	0.0
	Harborview	-4,550.0	0.0
	Alaska Tourism Marketing Council	-5,365.3	0.0
	Alaska Seafood Marketing Institute	-7,994.7	0.0

(18)

	Competitive Contracting Out Opportunities: -\$17,879.8		
	Park Management	-1,337.7	4,275.4
	Motor Vehicles	-2,062.5	6,187.3
	DOT Maintenance	-9,090.1	91,911.3
	Corrections	-5,342.6	112,787.4
	Other Programs	-47.0	141.2
	Consolidate/Eliminate Programs: -\$19,894.1		
	Alcohol Beverage Control Board	-479.5	159.8
	Alaska Public Offices Commission	-475.3	158.4
	Cultural Program Grants	-88.4	0.0
	Licensing of Some Occupations	-597.3	3,189.0
	Agricultural Development	-1,034.2	0.0
	Rural Development Grants	-1,119.4	0.0
	General Obligation Debt (obligations fulfilled)	-16,100.0	0.0
	Grants to Organizations to Provide Services: -\$12,690.2		
	Senior Programs	-763.3	6,869.3
	Alaska Public Broadcasting Grants	-2,218.3	2,218.3
	Regional Non-Profit Corporations	-1,068.7	9,618.1
	Health Grants	-698.7	6,288.0
	Alcohol and Drug Abuse Grants	-1,435.9	13,823.2
	Community Mental Health Grants	-2,583.8	23,254.0
	Community Developmentally Disabled Grants	-2,056.2	18,596.2
	Council on Domestic Violence Grants	-224.4	4,262.7
	Child Care Grants	-215.3	2,607.5
	Other Programs	-1,425.7	25,656.6
	Total	-502,600.4	

SCENARIO 2 : *The local policy goal is to try to share the cuts among state, local governments and individuals with all parties sharing the consequences of the fiscal gap.*

- Requires drastic consolidation and privatization of programs at the state level.
- Requires no reduction of funds to local governments.

- Requires turning non-needs based programs to needs based.
- Requires capping Permanent Fund Dividend payments at 50% and distributing the funds to local governments for community-wide needs.

Scenario 2			
	Program	Estimated Savings	Amt Remaining in Program
Grants that Benefit Individuals: -\$319,953.9			
	Longevity Bonus (estimated savings if needs-based)	-14,152.6	58,000.0
	Public Assistance Programs	-10,163.1	91,468.0
	Medical Assistance Programs	-15,035.6	135,320.2
	Permanent Fund Dividend	-278,000.0	278,000.0
	Alaska National Guard Benefits	-226.6	906.3
	Day Care Assistance	-1,017.3	10,193.8
	Other Programs	-1,358.7	1,733.6
Grants to Local Governments: No Reductions			
	K-12 Funding	0.0	660,309.4
	Human Services Matching Grants	0.0	1,769.6
	Senior Citizens Property Tax Relief	0.0	1,500.0
	Revenue Sharing	0.0	26,271.7
	Municipal Assistance	0.0	31,959.0
	Community Jails	0.0	4,374.7
	Capital Matching Grants	0.0	20,000.0
	School Debt Reimbursement	0.0	80,322.4
Employee Salary/Benefit Reforms and Streamlining Programs: -\$69,892.5			
	State Agency Programs	-47,779.6	1,192,504.6
	Court System	-2,292.1	43,550.3
	Legislature	-3,084.6	27,761.0
	University	-16,736.2	160,625.5
Privatization Opportunities: -\$54,217.4			
	Pioneer Homes	-29,842.3	0.0
	Ratnet	-794.8	0.0
	Alaska Council on the Arts	-564.0	0.0

	Vocational Technical Schools	-5,106.3	0.0
	Harborview	-4,550.0	0.0
	Alaska Tourism Marketing Council	-5,365.3	0.0
	Alaska Seafood Marketing Institute	-7,994.7	0.0
	Competitive Contracting Out Opportunities		
	Park Management	-1,337.7	4,275.4
	Motor Vehicles	-2,062.5	6,187.3
	DOT Road Maintenance/Fleet Maintenance	-9,090.1	91,911.3
	Corrections	-5,342.6	112,787.4
	Other Programs	-47.0	141.2
	Consolidate/Eliminate Programs: -\$18,774.7		
	Alcohol Beverage Control Board	-479.5	159.8
	Alaska Public Offices Commission	-475.3	158.4
	Cultural Program Grants	-88.4	0.0
	Licensing of Some Occupations	-597.3	3,189.0
	Agricultural Development	-1,034.2	0.0
	Rural Development Grants	0.0	0.0
	General Obligation Debt (obligations fulfilled)	-16,100.0	0.0
	Grants to Organizations to Provide Services: -\$12,690.3		
	Senior Programs	-763.3	6,869.3
	Alaska Public Broadcasting Grants	-2,218.3	2,218.3
	Regional Non-Profit Corporations	-1,068.7	9,618.1
	Health Grants	-698.7	6,288.0
	Alcohol and Drug Abuse Grants	-1,435.9	13,823.2
	Community Mental Health Grants	-2,583.8	23,254.0
	Community Developmentally Disabled Grants	-2,056.2	18,596.2
	Council on Domestic Violence Grants	-224.4	4,262.7
	Child Care Grants	-215.3	2,607.5
	Other Programs	-1,425.7	25,656.6
	Total	-493,408.7	

(21)

SCENARIO 3: *The policy goal is to protect both state and local government service levels, in so far as possible .*

- Requires minimal change in services at state government level.
- Requires minimal reduction in funds to local government.
- Requires eliminating the Permanent Fund Dividend.

Scenario 3			
	Program	Estimated Savings	Amt Remaining in Program
	Grants that Benefit Individuals		-556,000.0
	Permanent Fund Dividend	-556,000.0	
	Total	-556,000.0	

The problem with all of these scenarios is that they would have a significant effect on Alaska's economy. As much as we don't like it, state spending is an important part of the economy: state spending directly and indirectly accounts for close to one-third of all jobs statewide, more than one-fourth of all private sector jobs, almost one-half of local government jobs, and 30% of all personal income in the state. On the other hand, the significant effect on Alaska's economy may happen regardless of what actions are taken -- removing money from individual Alaskans' pockets through taxation or reduced Permanent Fund Dividends to maintain needed state services has a similar net effect on the economy as cutting the services.

What about revenues?

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 and the Railbelt Energy Fund, 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.

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 service that generate approximately \$125 million annually.

The Commission 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 1980 and has traditionally allocated to local government 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. Chart 7 compares Alaska's revenue sources with those of a typical state in 1990.

Chart 7

**Alaska's Revenue Sources Contrasted
with those of a Typical State**

Chart 8 compares the total of state and local taxes in Alaska to that in the rest of the United States. It shows that regardless of income level, Alaskans pay approximately 1/3 of the percentage of family income paid by the average American in state and local taxes. This chart does not take into effect the Alaska Permanent Fund dividend program, under which many families receive more than they pay in state and local taxes.

Chart 8

**1991 State and Local Taxes: US Average vs. Alaska as
Shares of Income of a Family of Four**

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Charts 9a and 9b show the annual tax burdens of Alaskan families with two sample incomes. They show that the net effect of the dividend is that the average Alaskan family making \$50,000 pays \$4,000 to \$5,000 less in taxes than a similar family in Seattle WA or Billings MT; a family making \$100,000 pays \$7,000 to \$10,000 less than similar counterparts.

Chart 9a and 9b

What is the Annual Tax Burden . . .

New Revenues?

The Commission will consider taxes of various sorts as potential sources of revenue to fill a part of the fiscal gap. In doing so, the Commission recognizes 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. The Commission believes that if new taxes are necessary to fill a portion of the fiscal gap, the taxes should be efficient (generating more revenue than they cost to administer).

The Commission 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 personal 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 Commission noted that many states use a statewide real property tax as the primary source of revenue to fund statewide education support.

Four major new taxes could be considered as portions of a solution to the fiscal gap. They are

- a statewide real property tax
- a statewide sales tax
- an individual income tax
- a per capita tax (similar to the old "school tax")

For each of these new taxes, there is no structure in place to collect the tax, and there can be a significant cost to begin collections.

Existing *non-petroleum* taxes which could be increased as portions of a solution to the fiscal gap include

- the corporation net income tax
- the highway motor fuel tax
- the marine motor fuel tax
- the aviation motor fuel tax
- the fisheries business tax
- the fishery resource landing tax
- the tobacco tax
- the alcoholic beverages tax

For each of these existing taxes, there is a structure in place to collect the tax, and there is a small cost to begin the collections.

Statewide Real Property Tax

There are real difficulties in collecting property taxes in rural Alaska — costs of tax administration may exceed collections. Notwithstanding the difficulties, the state could expect to receive approximately \$28 million annually for each real property tax levy of one mill (in addition to the amount the state receives presently from the oil and gas property tax).

Note: the Commission requested additional language on real property taxes, but the Commission chair has been unable to determine from his notes what more was requested.

Statewide Sales Tax

Sales taxes are a popular form of taxation in other states as well as among Alaska's local governments. Some local governments, e.g. Anchorage, have steadfastly resisted the imposition of a sales tax. Fairbanks had a sales tax until the state increased revenue sharing and municipal assistance in the early 1980s. 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. A third, more narrow, argument is that it captures some revenues from non-residents visiting Alaska.

There is one broad argument against sales and use taxes, which is the tax is regressive, that is it is a tax that creates the largest *proportional* burden for those who have *lower incomes*. In recognition of this regressiveness, many jurisdictions exempt food and other categories of essential goods and services. 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.

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The Department of Revenue has estimated that a statewide sales tax that exempted food, health and social services, *each one percent* would generate \$58.9 million annually, not including sales taxes that could be imposed on mail order sales. *The Commission has been unable to get a good estimate the effect of a seasonal (summer-only) sales tax, but assumes that a six-month sales tax would generate about 1/2 of the amount an annual sales tax would generate.*

The Commission is also considering the advisability or feasibility of establishing a statewide sales tax that would supersede local sales taxes, and apportioning the receipts between the state and local governments in which the sales taxes were collected. Either as a part of this tax, or as a separate stand-alone tax, the legislature could act as the borough assembly of the Unorganized Borough and enact a sales tax to support a portion of rural services.

Any statewide sales tax would have differential impacts between communities based on the current differences in sales tax rates. This disparity between communities could cause unintended effects.

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 1980 legislature repealed the tax because the state was awash in oil revenues.

The Department of Revenue estimates that each 1% tax on Alaskans' adjusted gross incomes would raise \$67 million, with non-residents adding another \$7.5 million. The amount which would result from graduated taxes can be calculated from the following table:

Table 10

Individual Income Tax: What are the Pertinent Facts?

Per Capita Tax

The Territory and later the State levied a tax of \$10 per employed person. The proceeds of the tax were used to fund education. Reinstitution of the capitation tax at a level of \$100 would yield approximately \$4 million, based on current laborforce estimates, with approximately 10% of that amount paid by nonresident workers. This tax creates a heavier proportional burden for low wage earners than for persons in high income brackets.

RESOURCE TAXES

As noted above, Alaska taxes natural resources. The Commission has not had the time, staff or other resources to examine the interplay between levels of taxation and resource development. Such an interplay exists. There are diverse views as to what impact taxes have on new resource development or the continuation of existing resource-based industries.

Fish and Game Taxes and Fees

Alaska levies a raw fish tax, a portion of which is shared with communities. Established fisheries bear a larger portion of the tax than "emerging" fisheries. All of the fisheries should be examined to determine if it is reasonable to continue to distinguish between established and emerging fisheries. Whatever that decision may be, the raw fish tax could be doubled without additional administrative expense, leaving the allocation the same. The Department of Revenue indicated if all exemptions were eliminated and all fisheries were taxed at the rate of 4 percent, the additional revenue would be \$2.5 million.

Fish and game license fees should be examined. The mechanisms for collection are in place so administration and collection costs should remain constant. Raising license fees would shift a small portion of the cost of management and preservation of fish and game to those who utilize those resources.

Minerals Industry Taxes

The state presently collects approximately \$343,000 from the mining license tax. This is a tax levied on the net value of resources, primarily gold and coal. Because Alaska's mineral resources, other than oil and gas, are now in an early state of development of both mines and markets, the Commission did not have the time or resources to examine the economic impact of taxes on the minerals industries. It was noted, however, that a minerals exploration incentive was enacted in 1995 to encourage exploration for minerals by granting tax credits for exploration expenses against income after mine development.

Timber

The state's timber resources have received minimal development. Until recently, the federal government's timber resource development programs in Southeastern Alaska were mainstays of many communities in that region. That timber industry has recently been severely curtailed. Again, the Commission had insufficient time and resources to undertake an analysis of the amount of tax and royalty the state's timber resources could support. Such an amount is not considered, however, to be significant in closing the fiscal gap.

Oil and Gas

No discussion of potential revenues would be complete without considering another tax increase on the state's oil and gas industry. However, thought should be given to the fact that Alaska already taxes oil and gas production at a higher rate than any other state. The revenue shortfall this Commission is trying to solve is the result of a major decline in oil production. This means that the oil and gas industry is also suffering from the same decline in revenues and, at the same time experiencing increasing production costs. This Commission believes caution should be exercised before recommending any new and specific oil taxes. Any increase in taxes on the oil industry should only be in the form of broad-based taxes which would result in other taxpayers also contributing to state revenues.

Without consideration of Permanent Fund earnings, the oil and gas industry in Alaska presently generates 75 percent of Alaska's income through royalties, severance taxes, real property taxes and corporate income taxes. Inclusion of Permanent Fund earnings reduces that percentage to about 50 percent.

Royalties are set by contract and in 1995 new legislation gave the Commissioner of Natural Resources the ability to negotiate varying royalty rates for different oil fields. This suggests to the Commission that the economic interplay between royalties and development or continued production is significant. A few years ago, a measure permitting the reduction in severance taxes scaled to the economics of production from a mature or maturing oil field was enacted, again suggesting a close relationship of the level of taxation and the rate of production. Real property tax revenue is a function of the value of the property assessed. With respect to oil and gas property, economic or useful life and, thus, value, is closely tied to the life of the field or fields served. This also suggests a close relationship between the amount of tax applied to the resource and the development or sustained production of the resource.

Alaska's oil and gas resources compete in price on the world market. Even though until recently Alaska could not sell crude oil overseas, the prices received by the producers were tied to world prices. Costs of production in Alaska are markedly higher than costs of production elsewhere. Thus, the margin available to Alaska producers is smaller than for producers elsewhere. Moreover, it appears that rehabilitation of Russian oil fields is underway and China is actively pursuing development of her resources, both for export and domestic markets. Exploration goes on worldwide for new oil and gas fields. Price competition is likely to maintain price levels at or near present levels for several years to come.

The Commission deemed it appropriate to examine other forms of taxation and revenue before more closely examining the issues involved in oil and gas taxation.

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 \$638 million.

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.

Background of Fund

The Alaska Permanent Fund was established by a constitutional amendment adopted in 1976 which allowed the dedication of at least twenty-five percent (25%) of mineral lease rentals, royalties, royalty sale proceeds, federal mineral revenue sharing payments and bonuses to a permanent fund (Article IX, Sec. 15). The principal of the fund is required to be invested in income-producing investments and the income is required to be deposited in the General Fund.□

In 1977 the legislature established the Alaska Permanent Fund Corporation to manage the Permanent Fund. In 1980, the legislature established the practice of issuing dividends to Alaskans who apply for them annually. In order to do this, the legislature has adopted definitions of income and has created allocations of income for the purpose of the dividend program and to permit a portion of the income to be deposited in the principal of the Fund to compensate for the erosion of value of the Fund by inflation, so-called inflation proofing. Earnings in excess of amounts for dividends and inflation proofing are held in

what is called an "earnings reserve account." The sums held in the earnings reserve account are invested in the same manner as the principal of the Fund.

At the present time, the allocation of income is as follows:

1. AS 37.13.140. Net income includes income of the earnings reserve account. It is computed as of the last day of the fiscal year in accordance with generally accepted accounting principles, excluding unrealized gains and losses. Net income available for distribution equals 21 percent of the net income over the last five years, including the fiscal year just ended, but may not exceed net income for the fiscal year just ended plus the balance in the earnings reserve account.

2. AS 37.13.145. Fifty percent (50%) of the income available for distribution is transferred to the dividend account. The balance is used to inflation proof the Fund and, if there is a remainder, it is held in the earnings reserve account.

At the end of FY 1995 (June 30, 1995), the sum to be allocated to dividends was estimated to be \$556 million and the amount required for inflation proofing was estimated at \$344 million.

Allocation Issues

Since its creation, the Permanent Fund has been the subject of much commentary--about its purpose, about the use of its income--what role it should play in the fiscal management of Alaska. Nearly every witness appearing before the Commission included the Permanent Fund as a portion of his or her recommendations. A number of specific plans were presented and the purpose of this document is to compare the various proposals. Before doing so, however, it is important that certain concepts with respect to the Fund be understood.

Income: Article IX, Sec. 15, refers to "all income" as being required to be deposited in the General Fund. The constitution does not distinguish between ordinary income such as dividends and interest and capital gains which accrue by reason of the increase of value over the purchase price of an investment.

AS 37.13.140 does not mention income, but defines "net income" as including income earned by the earnings reserve account, but excluding unrealized gains and losses. AS 37.13.145 provides for the disposition of the net income. Net income is first deposited in the earnings reserve account. At the end of the year, sums necessary for the payment of dividends and for inflation proofing are required to be transferred and any balance remaining in the earnings reserve account is held there subject to appropriation.

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Sums used to pay dividends and to provide inflation proofing include both ordinary income and capital gains as AS 37.13 does not, for these purposes, distinguish between the two classes of income.

Inflation proofing: AS 37.13.145 requires that the inflation rate determined as directed by the statute be applied "to the value of the principal of the fund on the last day of the fiscal year just ended." The term, "value," is not otherwise defined and the practice of the Alaska Permanent Fund Corporation has been to value the principal of the fund at cost. Thus the investments of the principal are inflation proofed annually against the depreciation of the dollars that originally purchased them.

Issues: Some of the issues that the statutory definition or treatment of income raise are:

- 1. Should capital gains be segregated from ordinary income and only ordinary income be used for the purpose of dividend distribution? If that were done, what would be the consequences?*
- 2. Should capital gains be treated as appreciation of the value of the principal rather than as income available for dividends and inflation proofing? If that were done, what would be the consequences?*
- 3. Should the principal of the Fund be calculated at cost or market for the purpose of determining the amount of money necessary to inflation proof the Fund? If calculated at market value, what would be the consequences?*

Subcommittee Scenarios

The Alaska Permanent Fund Corporation was asked by the Commission to prepare charts and graphs based on possible changes in allocations and classifications of income. The Commission appreciates the cooperation of APFC in helping to clarify the significance of a number of ways to manage the Fund and utilize its income, if necessary, for the purpose of closing the fiscal gap. None of the possible changes have been endorsed by APFC and it should be understood that the proposals were developed to explore the potential of the Fund.

Most of the scenarios proposed that the dividend fund be capped at \$500 million. Although this represents a departure from present practice, it was devised because of the concern that has been evidenced by the Commission on the consequences of population driven expenditure programs. In 1992, the dividend fund was \$488 million. By 1995, the dividend fund had risen to \$556 million. These sums represented annual dividends in amounts of approximately \$900 per applicant, give or take \$50. Capping the dividend fund

LRFP User Fees

Agency	Division	Nature of Fees	1991 Collections	Source of Fees
DOT/PF	Administrative Services	Airport Fees etc	\$24,148,724	Other
Public Safety	Motor Vehicles	Vehicle Registration	\$17,572,608	Statutory
ADF&G	Administration	License & Tag Fees	\$11,474,010	Statutory
Fish & Game	Comm Fish Entry Commission	Entry Permit Fees	\$5,912,800	Regulation
Public Safety	Motor Vehicles	Drivers Licenses	\$3,611,473	Statutory
Commerce	Occupational Licensing	All Occupations	\$2,540,490	Regulation
Commerce	Insurance	Insurer Fees	\$2,022,700	Regulation
Court System	All Courts	Filing Fees	\$1,828,800	Other
Commerce	Occupational Licensing	Business Licenses	\$1,536,000	Statutory
Commerce	Occupational Licensing	Gaming Licenses	\$1,526,000	Statutory
Revenue	ABC Board	Liquor Licenses	\$1,482,700	Statutory
Commerce	Banking Securities & Corps	Security Registration	\$707,438	Regulation
Commerce	Measurement Standards	Oversize/Overweight Vehicles	\$681,900	Regulation
DHSS	Public Health	Vital Statistics	\$612,029	Other
Env. Cons.	Spill Prevention	UST Fees	\$500,000	Statutory
Commerce	Insurance	Agents, Licenses	\$467,800	Regulation
Public Safety	Fire Protection	Plan Review	\$388,400	Regulation
ADF&G	Wildlife Conservation	Permit Hunt Application	\$380,395	Statutory
Commerce	Banking Securities & Corps	Broker Dealers	\$310,790	Regulation
DOT/PF	Administrative Services	Utility Permits	\$272,199	Regulation
Education	Educational Finance	Teacher Certification	\$224,625	Regulation
Commerce	Banking Securities & Corps	Articles of Incorporation	\$223,650	Regulation
Labor	Labor Standards & Safety	Plumber & Electricians		
Commerce	Investments	Certificate of Fitness	\$216,000	Statutory
		Late Fees	\$208,500	Regulation
Labor	Labor Standards & Safety	Boiler & Pressure		
Revenue	ABC Board	Vessel Fees	\$208,000	Regulation
Education	Vocational Rehabilitation	License Application	\$201,400	Regulation
		Vendor Fees	\$200,000	Other
Commerce	Banking Securities & Corps	Agents & Investment Advisors	\$186,030	Regulation
Public Safety	Criminal Records	Fingerprint Processing	\$110,480	Regulation
Governor	Lt. Governor	Notaries Public	\$109,137	Statutory
Other	Statutory Fees	Not listed above	\$2,318,058	Statutory
Other	Fees set by Regulation	Not listed above	\$4,966,345	Regulation
Other	Fees not Statutory or Regulatory	Not listed above	\$10,488,692	Other
Total Fees Listed			\$79,865,078	
Total Other Fees not listed			\$17,773,095	
Total Fees			\$97,638,173	

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32

LRFCP Revenues Worksheet

Excise Taxes	Revenues (\$Millions)	Alaska Tax Rate	Last Raise	Rates in Other States	National Median Rate	Revenues from increase to median	Revenues from increase to highest state rate(s)	Revenues from indexing to inflation since last raise.	Administrative Costs
Corporation Net Income	\$195.4	10 brackets, from 1% to 9%	1981	Vary. Most have one bracket, range from 4% (KS) to 11.5% (CT)	?	?	?	Not applicable - this is a % tax	\$1,600,000
Motor Fuel	\$39.4								
Highway		8¢ per gallon	1970	Vary from low of 8¢ (AK) to 37.9¢ (CT)	21.9¢ per gallon	\$58.8 million	\$126.4 million	about \$60 million	\$200,000
Marine		5¢ per gallon	1977	?	?	?	?	?	\$50,000
Aviation		3.2¢ (jet fuel); 4.7¢ (av gas) per gallon	1994	?	?	?	?	?	\$50,000
Fisheries Business*	\$39.0	3% to 5% for established species, 1% to 3% for developing species	1979	?	N/A	N/A	N/A	Not applicable	?
Tobacco	\$17.1	29¢ per pack on cigarettes, 25% of wholesale price of tobacco products	1989	Vary from 2.5¢ per pack (VA) to 60¢ per pack (HI). AK is 23rd highest.	25.75¢	Alaska is above median	\$16.6 million	?	\$110,000

7/26/95

33

LRFPD Revenues Worksheet

Excise Taxes	Revenues (\$Millions)	Alaska Tax Rate	Last Raise	Rates in Other States	National Median Rate	Revenues from increase to median	Revenues from increase to highest state rate(s)	Revenues from indexing to inflation since last raise.	Administrative Costs
Alcoholic Beverages	\$12.0	Liquor - \$5.60/ gallon, Wine - 85¢/ gallon, Beer - 35¢/ gallon	1983	Liquor - \$1.50 to \$6.50; Wine - \$0.11 to \$2.25; Beer \$0.02 to \$0.89	Liquor - \$3.25; Wine - 73¢; Beer - 19¢	Alaska is above median	\$10.1 million	?	\$110,000
Salmon Enhancement	\$5.7	?	?	?	?	?	?	?	?
Fishery Resource Landing*	\$7.3	3.3% of unprocessed value	1994	?	?	?	?	Not applicable	?
Salmon Marketing	\$4.7	?	?	?	?	?	?	?	?
Seafood Marketing Assessments	\$3.2	?	?	?	?	?	?	?	?
Mining License	\$0.3	?	?	?	?	?	?	?	?

34

7/26/95

would mean that a dividend of nearly the same amount would be distributed annually, slightly diminished each year because of population growth.

All of the scenarios used the same base case based upon information at hand that has been used by the Commission in analyzing expenditures and revenues. Although the base case will be adjusted, it is unlikely that the scenarios would be altered significantly by using the revised base case adopted by the Commission. The APFC uses a different model for estimating revenues, inflation and earnings so a difference appears between the estimates based on the current statutory requirements and the same model applied to the preliminary base case used by the Commission.

Scenario No. 1

This scenario uses the base case and, instead of depositing surplus earnings in the earnings reserve account, transfers those earnings directly to the General Fund. Graphs explaining the result are attached. The amounts of money that would go to the General Fund in 1998, \$268 million; 2000, \$255 million; and in 2005, \$660 million.

Scenario No. 2

This scenario, using the base case, caps the dividend fund at \$500 million and would transfer to the General Fund all earnings in excess of inflation proofing and the dividend. This results in there being available to the General Fund in 1998, \$376 million; in 2000, \$453 million; and in 2005, \$670 million.

Scenario No. 3

This scenario departs significantly from existing law. All of the royalty and rental income received by the state would be deposited in the Fund. All of the realized gains would be added to the principal of the Fund and that amount would be deducted from the amount determined to be required to inflation proof the Fund. Unrealized gains would be excluded from the inflation proofing requirement and the dividend fund would be capped at \$500 million. This results in there being available to the General Fund in 1998, \$310 million; in 2000, \$446 million; and in 2005, \$830 million.

This scenario causes the principal of the fund to grow dramatically to slightly over \$30 billion by the end of FY 2005. However, although by 1998 the General Fund would be receiving \$310 million, it would have lost approximately \$700 million because of the loss of the royalty, rents and other mineral resources income presently being directly deposited in the General Fund. It appears that this would not only not make up a portion of the fiscal gap, but would increase the gap by approximately \$700 by 1998.

Scenario No. 4

This scenario is identical in its assumptions to Scenario No. 3 except that the existing statutory allocations the royalty and rental income would go to the Permanent Fund. This causes the principal of the Permanent Fund to grow slightly more than it would under present law, and would result in there being available to the General Fund in 1998, \$275 million; in 2000, \$339 million and in 2005, \$519 million.

Scenario No. 5

This scenario proposed a dramatic change in the structure of the Permanent Fund. Under this scenario, all rent and royalty income would be deposited in the Permanent Fund. All earnings from investments would be considered part of the principal and, as in an endowment, four percent of the total fund would be made available for dividends and for transfer to the General Fund. There would be no need for inflation proofing. Under this scenario, there would be available to the General Fund in 1998, \$305 million; in 2000, \$459 million; and in 2005 \$900 million. The principal of the Fund would grow to nearly \$34 billion by the end of FY 2005.

Scenario No. 6

This scenario is identical to Scenario No. 5 except that the statutory allocations of the rent and royalty income would go to the principal of the Permanent Fund. This results in the growth of the principal of the Fund to nearly \$25 billion by 2005 and would make available to the General Fund in 1998 \$215 million; in 2000, \$296 million and in 2005, \$527 million.

Other Plans affecting the Permanent Fund

Rieger Plan (SB 51)

Senator Steve Rieger introduced Senate Bill 51 in 1997. SB 51 would incorporate the concept of "real" earnings rather than "nominal" values for determining the value of the Fund and the earnings as a basis for dividend calculation. Another aspect of SB 51 is that the amount required to inflation proof the fund would be calculated as a percentage of the average annual balance of the fund. SB 51 would not change the existing allocation formula for dividends. SB 51 would eliminate the need to have an earnings reserve except for a relatively small amount to insure that the dividend commitment would be met.

The Roger Cremo Plan

Roger Cremo has developed a proposal for use of natural resource revenue as a permanent endowment to be used to fund government. All revenues received by the state from any source would be deposited in the Fund.

Cremo proposes that all revenues including income earned on the the Permanent Fund and reserves be placed in a single fund, to be established, and the fund then invested aggressively to reap a "nominal" return of about 10 percent. The legislature could withdraw up to 20 percent of the fund the first year and the amount of permitted withdrawal declines geometrically each year thereafter until it reaches the base withdrawal rate of 6 percent in 2006.

Without modification, the Cremo plan would significantly reduce present revenues available for appropriation from natural resources and the decline would continue until about 2008. Thereafter, increasing amounts would be available for appropriation. In the period between 1996 and 2008, the Cremo plan requires an increase in other revenues or dramatically reduced expenditures of other revenues cannot be found. Mr. Cremo has proposed a transition period ranging from 10 to 20 years to accomplish the changeover to full funding through the plan. As noted below, new analyses of this proposal using assumptions used by the Commission and the Permanent Fund will be accomplished.

The 40-30-30 Plan

The 40-30-30 Plan was proposed in 1987 by Sen. Jan Faiks and was incorporated in a resolution for a constitutional amendment that would have, in addition to amendment of the Permanent Fund provisions, established a constitutional appropriations limit and created a budget reserve fund.. The plan would have allocated 40 percent of the Permanent Fund income to dividends, 30 percent to inflation proofing and 30 percent to a budget reserve fund. The plan was amended in 1989 to propose the allocation of Permanent Fund income 50 percent to dividends, 30 percent to inflation proofing and 20 percent to a budget stabilization fund.

Base Case Analysis

The Alaska Permanent Fund Corporation is assisting the Commission in creating models of the Rieger, Cremo and 40-30-30 plans so that these plans and the scenarios already prepared by the Corporation may be compared using the same revenue, inflation and growth assumptions.

SUMMARY

The Alaska Permanent Fund must be considered in any long-range financial plan, either as a contributor to closing the gap or as being unavailable for the

generation of funds to pay for government. If the Commission determines that the Alaska Permanent Fund must contribute to closing the gap, legislative or constitutional changes must be enacted to create the revenue stream necessary to make the Fund's contribution meaningful.

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 Commission has requested information showing a comparison of fees and costs. Without such information, the Commission cannot assess the revenue potential of this category of revenues. Likewise, because of time and funding constraints, the Commission 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.

Table ___ shows those user fees which (a) were collected in 1991, (b) brought in at least \$100,000 in 1991, and (c) for which rates were not primarily market-driven. These amounts will be updated in the next version of this draft, and certain items may be moved to the tax list (e.g. insurance taxes are here, not on the list of taxes).

Table ___
LRFPC User Fees List  SEE PG 32

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

Page 32


principles. The Commission 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, Alaska Aerospace Development Corporation, the Alaska Railroad, and the 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 \$70 million per year, to be paid from surplus of the Alaska Housing Finance Corporation, based on the current agreement between the AHFC Board and the Governor's Office. The Commission 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 Commission believes that dividends should be paid by enterprise funds, 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 Commission 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.

Service Agencies

The state offers a number of services, many of which are only partially paid for by the beneficiaries of the services. The Commission 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 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.

Periodically proposals for a statewide lottery emerge. At this time, the evidence indicates that after prizes and expenses of administration and regulation are deducted, a statewide lottery probably yield about \$10-20 million.

Excise Taxes

The state presently levies excise taxes on alcohol, tobacco, and motor fuel. The Commission has not completed its evaluation of these types of taxes as means of closing the fiscal gap. However, it has been noted that Alaskans pay motor fuel taxes substantially below the national average.

Taxes on alcohol and tobacco products appear to be within the range of average compared with other states. Use of alcohol and tobacco products in Alaska, exceeds the national averages.

Other Taxes

The following table shows highlights on existing taxes collected by the State.

*Insert Table ____
LRFPC excise tax table*

**Currently one-half is shared with municipalities*

Other possible changes in the taxes would yield the following additional revenues, with low costs of collections:

Corporation net income tax: inclusion of Subchapter S corporations would yield approximately \$5 million. *Such an inclusion would amount to double taxation if a personal income tax is reimposed.*

Highway motor fuel tax: Repeal of the exemption for gasohol would raise \$4 million.

Aviation motor fuel tax: A repeal of the exemption for foreign flights would raise \$10 million.

Fisheries business Tax: Elimination of the differential between rates on established and developing species, taxing all fisheries at 4%, would raise \$2.5 million.

Fishery Resource Landing Tax: An increase from 3.3% to 4% would raise \$1 million.

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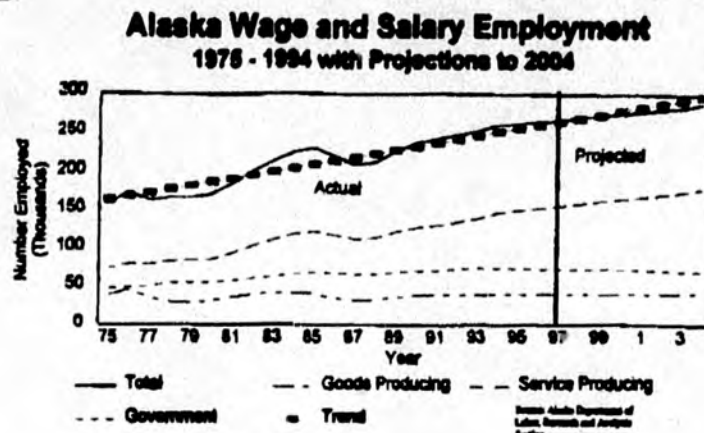
Tobacco Tax: Alaska has the fifth highest rate of smoking nationally, and the highest rate of use of chewing tobacco. Experience in Canada has shown that total tax revenues from tobacco taxes have continued to rise even though total consumption dropped when the tax was increased to \$3.00 per pack. After factoring in expected decreases in cigarette consumption, an increase of \$1 per pack in Alaska would bring in an additional \$57.7 million annually. An increase in the tax on chewing tobacco to 55% would bring in \$1.8 million annually.

Alcohol Tax: A ten percent increase in alcohol taxes (to \$6.16 per gallon on liquor, 94¢ per gallon on wine, and 39¢ per gallon on beer) would raise \$1.18 million. Every 10¢ increase in the rate on liquor would raise \$110,000; every 1¢ on wine \$12,500, and every 1¢ on beer \$136,000.

Fish Royalty Tax: This is not an existing tax, but is modelled after the existing royalties on non-renewable resources. A four percent royalty on fish would recover approximately \$19 million annually, and would provide the state a return on its gift to commercial fishermen of valuable limited entry permits. Establishing royalty rates on fish comparable to those on oil and gas would raise \$60 million annually from commercial fishermen.

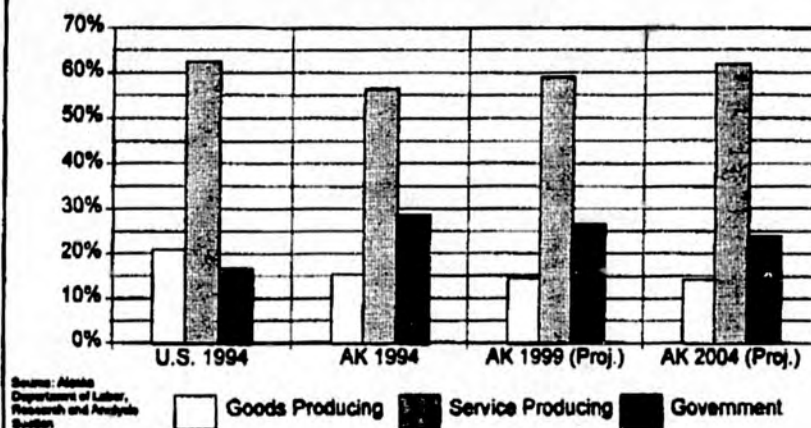
Economic Development as a Revenue Generating Tool

The Department of Labor forecasts that the overall state economy will grow by about 11% over the next 10 years. This is a somewhat slower rate of growth than has been experienced to date during the post pipeline period.



The primary reason for slower growth will be reduced expenditures by both the state and federal governments, which will be reflected in direct employment and reduced growth in the construction and service producing industries. The average wage earned in Alaska is expected to decline as jobs are shifted from higher paying government and goods producing positions to lower paying service industries, i.e., Alaska's economy will begin to more closely resemble that of other states.

Share of Wage & Salary Employment by Major Sector



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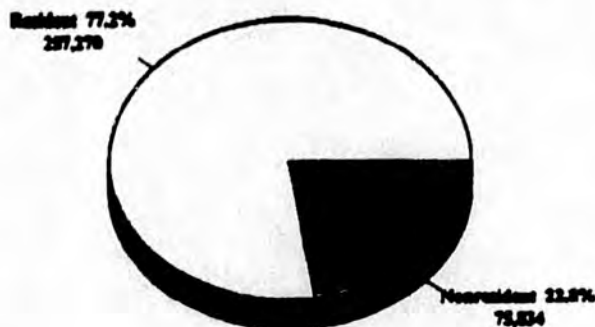
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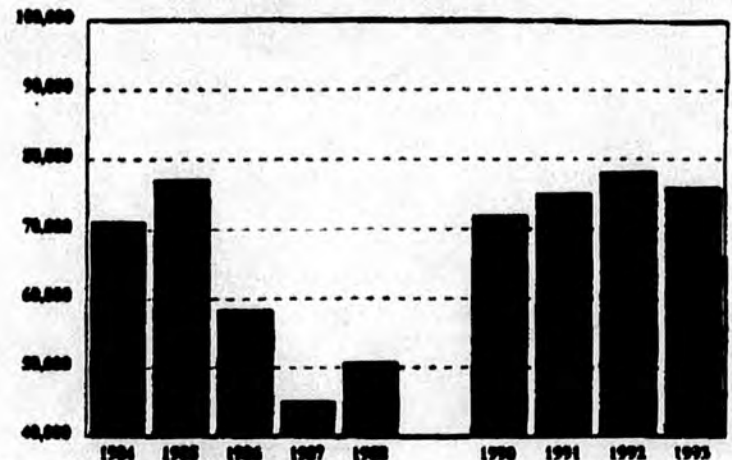
A review of the most recent data available shows that the number of nonresident workers has begun to decline for the first time since 1986 as the state's rate of economic growth has slowed. Still about 23% of the labor force is composed of nonresidents and earnings of nonresidents in 1993 totaled \$883 million.

Total Private Sector, State and Local Government Workers Alaska 1993



Source: Alaska Department of Labor, Research and Analysis

Number of Nonresident Workers Alaska 1984-1993



Source: Alaska Department of Labor, Research and Analysis
Note: Includes private sector, state and local government workers.

Population/Demographic Factors

Population growth is expected to average about 1.6% per year during the next decade, down from the 2-3% rates experienced since the mid-'80s recession. Natural increase will account for 86-88% of population growth, with net migration accounting for the rest. Growth of the elderly as a proportion of the working age population will increase. The number of persons over 65 is expected to almost double during the next 10 years, primarily as a result of the aging of the resident population. The proportion of the elderly is expected to rise from 4.5% to 6% and will be concentrated in the urban areas of the state. Both youth and elderly dependents are expected to increase relative to the working age population. The Department of Labor forecasts that by 2005, every 100 working age persons will have to support 63 older or younger persons compared with 55 today.

The pressure for jobs will be strongest among younger state residents. To the degree that job growth lags behind population increase, there may be an increase in the out-migration of young adults or a failure of young adults to return to Alaska following college, military service or other out-of-state post secondary training. Changing job

composition is also likely to change the social character of Alaskan communities. Decline in the growth of higher pay, higher skill federal and state government employment opportunities in favor of lower paying service occupations fosters a decline in the average education among younger adults migrating to or remaining in communities.

In and out migration to Alaska is most affected by employment opportunities within the state relative to opportunities in our key "feeder" states - Washington, California, Oregon and to a lesser degree, the Mountain states. One-third of the migration to/from Alaska originates in these three key feeder states and half of our migration originates in the West. Alaska has the highest turnover of any population of any state except the District of Columbia and Nevada.

Military and their dependents have made up about 10% of Alaska's population in recent years and contribute to the transient nature of the population. By 2005 the military and dependent proportion of the population is expected to shrink to 6.5% or less. The population of rural Alaska is expected to grow more slowly than the urban or bush populations. Of projected population growth between 1995 - 2005, 84% is in urban Alaska, 12% in the bush and 4% in rural regions.

Potential Economic Development Revenues

All of the previous fiscal policy summits have recognized that economic development will play some undefined role in generating additional future state revenues. Work for the Hickel summits (see table below) demonstrated that at current rates, even a very optimistic projection of potential economic development revenues reveals that non-petroleum growth in the economy can only play a marginal role in balancing revenues with expenditures during the next 10 years. Revenues from non-petroleum economic growth can be expected to provide an increment of perhaps \$30 - \$70 million per year. Lifting the oil export ban will be of much greater significance, at least in the short term. U.S. Department of Energy projections are much higher than those of the Alaska Department of Revenue shown in the table - in the \$140 million per year range.

Potential Additional Economic Development Revenues FY 96 – 2005
(In millions of FY 96 \$)

	FY 96	FY 97	FY 98	FY 99	FY 00	FY 01	FY 02	FY 03	FY 04	FY 05
Speculative										
Lift Export Ban	80.0	40.0	20.0	20.0	20.0	20.0	20.0	20.0	20.0	20.0
Optimistic										
Mining	0.4	0.4	0.5	0.5	0.6	0.7	0.9	1.1	1.3	1.5
Timber	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.1
Seafood	1.9	1.9	2.0	2.1	2.2	2.3	2.4	2.5	2.6	2.7
Tourism	2.6	2.7	2.9	3.1	3.2	3.4	3.6	3.9	4.1	4.3
Other	28.6	30.9	33.4	36.1	38.9	42.1	45.4	49.1	53.0	57.2
Total	113.5	75.9	58.8	61.8	64.9	68.5	72.3	76.6	81.1	85.8

Assumptions: Export ban lifted in FY 96 with later revenues corresponding to forecast of West Coast crude surplus.
Mining—all projects currently in the development stage go into production by 2000, with revenue from additional projects increasing at a real rate of 10% per year thereafter.
Timber—FY 95 revenues of \$400,000 projected to grow at the 10 yr. real industry average of 6%.
Seafood—FY 95 revenues (net of pass thrus) = \$44 million. Growth occurs at 10 yr. real average of 4%.
Tourism—FY 95 revenues estimated at \$40.4 million with visitor growth increasing at 6% per yr.
Other—FY 95 non petroleum revenues=\$331.3 million projected to increase at 10 yr. real rate of nonpetroleum GSP growth (8%).

4/28/95 OMB/BP

The conclusion reached by all of the fiscal policy forums to date is that while economic development will play a significant role in our fiscal future, it is not possible for the state to simply grow out of the current fiscal gap.

Key Issues Identified in Other Fiscal Policy Forums

- The official Department of Revenue position is that the TAGS project and development of ANWR are unlikely to occur within the commission's ten year time horizon. (In fact, the three main North Slope gas owners have recently stated that gas sales are not projected to become economically feasible before 2005.)
- Other fiscal policy forums have acknowledged that the state has chosen to take its return on the development of public resources (other than oil) in the form of private sector jobs, personal income and corporate profits

rather than public revenues.

- Several forums have noted that it often costs more to support, manage and regulate our natural resource industries than they return to the state in the form of general fund revenues. Recent studies by the Legislative Research Agency confirm that of Alaska's main basic sector industries (those that bring money into the state from outside), only petroleum pays for itself in terms state revenues vs. expenditures. The rest – mining, tourism, timber and fisheries do not provide any net revenue return to the state, though these industries are very important revenue producers at the local level. (Fishing and tourism come closest to paying for themselves. Depending on one's accounting methodology, fishing and tourism may be shown to contribute a small amount of net revenues.)
- Since the state and local governments provide far more in terms of the cost of public services than citizens pay for in taxes, economic development efforts tend to have a perverse effect on the fiscal gap. The more jobs that are created and resulting in-migration of families, the greater the drain on the state treasury (e.g., schools, infrastructure, social services, public protection costs, etc.) and the larger the fiscal gap. This fundamental conflict in the state's approach to economic development has been brought up repeatedly in other forums.
- Other fiscal policy forums have concluded that additional taxes on natural resource industries are insupportable and would have a negative effect on the state's business climate, with the possible exception of the commercial fishing industry. (Some tax on the value of government-created wealth in the form of limited entry permits or IFQs has been mentioned by commission members the LRFPC meetings to date.) Another industry often singled out as able to support additional taxation with minimal economic impact is tourism.
- Virtually every other fiscal policy forum has concluded that indirect taxation of income, payroll and/or consumption are more appropriate means of collecting state revenues from most kinds of economic development than additional direct taxes on business.
- Several fiscal policy forums have concluded that the state gets by far the most bang for it's economic development buck by orienting its efforts towards policies that promote high paying resource development related jobs, specifically petroleum industry employment. For example, annual earnings per worker for Alaska residents in the petroleum industry (\$62,877 in 1993) are nearly five times that of the seafood processing industry (\$13,652) and almost eight times that of eating and drinking establishment employees (\$8,302). (Of course most seafood processing and tourism jobs are highly seasonal.)

Key Issues for the Commission

- In light of the state's fiscal condition, what should the state's role be in promoting economic development? Possibilities include:
 - providing a positive business climate;
 - allowing tax credits and exemptions (so called tax expenditures);
 - providing subsidies to certain industries or businesses;
 - generic promotion, e.g., ASMI, Tourism Marketing Council;
 - disseminating information and/or providing market research for businesses;
 - providing or facilitating financing;
 - other?
- How should future state and local revenue generation be factored into the state's economic development policies?
- Should the state demand a net revenue return to the public on its government financed economic development efforts?

~~Economic Impacts of Various Fiscal Options~~

~~The University of Alaska Institute of Social and Economic Research has prepared an analysis of the impacts of state spending reductions and new taxes (see table below).~~

DRAFT: 7/25/95

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Interim Report
Long Range Financial Planning Commission**STABILIZATION SECTIONS**

(Insert, P. 1)

Substitute the following paragraph for the second paragraph that follows the heading, "Why The Fiscal Gap Exists":

In trying to come to grips with the fiscal gap, it's important to understand that it's not the same as the problem of Alaska's fiscal instability, though the latter certainly complicates it. Fiscal instability is the roller-coaster ride caused by unpredictable oil price fluctuations, and the resulting ups and downs in expected state revenue flows. The fiscal gap is how far down the ground is, from that roller coaster. The relationship between the two is that the fiscal gap looks closer, and more ominous, when the roller coaster is being whipsawed downward by falling oil prices. By contrast, it looks farther away and less threatening when the roller coaster is being whipsawed upwards, by rising prices.

When the roller coaster is heading downward, people get anxious. Fiscal disaster seems just around the corner, and every one agrees that an urgent need exists to do something about it. When oil prices and the roller coaster swing upwards, however, the fiscal gap suddenly looks farther away, and less threatening, and both the sense of urgency and the resolve to deal with the problem dissipates. This cycle repeats itself over and over in Alaska, as oil prices and resulting revenue forecasts cycle up and down.

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49

DRAFT: 7/25/95

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This "moving target" aspect of the fiscal gap problem makes dealing with it extremely difficult. Both conceptually - - because we don't know just how large the gap is (or may turn out to be), or how much time we may have for dealing with it. And governmentally - - because, not knowing those things, it's difficult to make decisions about how (or when) to resolve it.

It's important to keep this in mind as we discuss the fiscal gap, and as we try to develop approaches for dealing with it. Because while we shouldn't start out assuming that the sky is falling, we also certainly shouldn't kid ourselves that the fiscal gap is not an extremely serious problem.

(Insert, P. 28)

To go under the heading, "How Can We Stabilize The State's Revenues?", and substitute for it:

"The Key: Fiscal Stability"

Much of the public discussion about Alaska's finances, and most of this interim report, focuses on Alaska's fiscal gap. This is as it should be, because the fiscal gap represents the fact that Alaska's level of state government activity, its need for services, and its financial resources, are increasingly falling out of alignment. This is the crux of Alaska's fiscal dilemma.

DRAFT: 7/25/95

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If Alaska's fiscal gap can be viewed as the crucial "foreground" issue, however, the crucial "background" issue is unquestionably our lack of fiscal stability.

This foreground-background distinction is not trivial. For one thing, shifting oil prices and fluctuating revenue expectations are precisely the factors that make it difficult to define the fiscal gap - - either its dimensions or its timing. This, in turn, dramatically affects the perceived sense of urgency (or lack of it) about dealing with the gap. Which in turn complicates the task of developing (and sustaining) a consensus among decision-makers for making choices about how to start dealing with the gap. In this sense, the background issue of revenue instability complicates our understanding of the gap, and directly impedes our ability to deal with it.

From another perspective, however, lack of clarity or certainty about our revenue expectations also can lead to waste and inefficiency in decision-making, and thus contribute directly to the size of the fiscal gap. There is an especially high risk of this at the "turns" - - i.e., those points in time when, because of shifting oil prices and revenue forecasts, it looks like there will be more (or less) money available than previously thought. When it looks like there will be more, the risk arises of "false positives" - - e.g., increased State spending for projects that aren't truly necessary, or whose long-term costs the State can't afford. Conversely, when it looks like there will be less money available than thought, the risk arises of "false negatives" - - e.g., excessive or unnecessary program eliminations or cut-backs (usually followed later by some form of restoration of services). Both of these kinds of inefficiency entail a waste of scarce fiscal (and other) resources, but they will remain part of the mix so long as our revenue situation remains unpredictable.

DRAFT: 7/25/95

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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

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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,