

ALASKA LEGISLATURE SPECIAL COMMITTEE / SUBJECT FILES 8672

2377 SCOMM 101 LONG RANGE FINANCIAL PLANNING COMMISSION, 1995

DRAFT: 7/25/95

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or capital investment; i.e., through capitalization of reserves).

- *Application of Permanent Fund Earnings*

Approaches for using portions of the Fund's earnings to augment budget revenue,

- *Petroleum Hedging*

Investment banking approaches for reducing risk and maximizing income through the use of security and commodity futures, options, etc.

- *Economic Development Initiatives*

Approaches to further development of North Slope oil and gas resources, oil and gas exports,, etc.

- *Oil and Gas Settlements*

Approaches for striking a balance between current use and deferred use of oil litigation settlement funds.

What about Reserves?

Why do we need reserves?

- To absorb the shock of extraordinary drops in the price or production of oil, the source of 78 percent of our state revenues. Alaska is much more vulnerable to fluctuations in the price of a single commodity — oil — than any other state. Reserves can be used in combination with budget cuts so that the state's economy doesn't suffer as badly as it did in the oil price crash of 1986.
- To provide a "surge tank" for windfall revenues from oil tax settlements and oil price spikes, in order to avoid the spending sprees that might result if these windfall revenues flowed directly into the general fund.
- To have funds available for immediate state response to extraordinary disasters and emergencies.
- To reassure the state's bond market that the state has adequate resources to pay bond debt in the event of a major change in revenues or expenditures as described above.
- In the past, the state has used reserve funds for all of these purposes. However, there has not been a consistent policy for using reserve funds from year to year, and the use of reserves has not been as effective in closing the long-term fiscal gap as it might have been.
- While reserve funds have been used to temporarily fill the fiscal gap for several years, over the long term, this is not a viable use of reserves, because the reserves will soon be depleted.
- If the state adopted a proposal to use a portion of the 5-year average earnings of the Permanent Fund to support government services, reserve funds could be used to offset years of low Permanent Fund earnings, to avoid any reduction in the principal balance of the Fund.

What reserves does Alaska have now?

Alaska's major liquid reserve accounts are the following:

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State of Alaska Fund Balances

(millions of dollars)

<u>Fund</u>	<u>Current Balance</u>	<u>Purpose and Limits on Use/ Impacts of Spending</u>
Constitutional Budget Reserve Fund	\$1,965.3	Purpose: to save windfall revenues and cushion longer term declines in revenues. Fund can be used to offset revenue shortfalls by majority vote under certain conditions; other appropriations require 3/4 vote of legislature. Appropriations from fund are required to be repaid from surplus revenues. Impact of spending from the fund is to reduce the state's ability to offset future revenue shortfalls.
Permanent Fund Earnings Reserve Account	\$818.0	Projected balance as of June 30, 1996. Purpose: to offset potential shortfalls in funds available for inflation-proofing the Permanent Fund. No limits on appropriations for other purposes except for public pressure to protect the Fund. Impact of spending from the ERA is to potentially create a shortfall in inflation-proofing funds. However, this will depend on future earnings of the Permanent Fund and the impact is uncertain.
Science and Technology Endowment Fund	\$101.0	Purpose: to finance development and commercialization of new technologies. No limits on appropriations for other purposes. Impact of spending part or all of the endowment would be to reduce or eliminate the number of projects funded.
Alaska Housing Finance Corporation	\$375.0	This balance is an approximate estimate of the amount that could become available over the next 5 to 6 years as bond issues are paid off. The purpose of AHFC's assets is to reduce the cost of home mortgages and to finance low-income housing. Spending these funds may reduce AHFC's ability to perform these functions.

What is an appropriate level of reserves for Alaska?

Revenues for the next year's state budget are based on the mid case projection of oil prices and production. In any given year there is a substantial chance that oil revenues will be hundreds of millions of dollars less than the mid case projection. The consequences to the state's economy of addressing such a large shortfall exclusively with budget cuts in a single year would be to severely aggravate an already difficult economic downturn. In 1986-87, the combination of low oil prices and sharply curtailed state spending threw the state into a severe recession, with the following impacts:

- Alaska lost 22,000 jobs — 10 percent of the work force;
- Anchorage's population dropped by 29,000 residents (about 9 percent);
- Over 10,000 residential properties were foreclosed on statewide; and
- At the worst point there were over 90 bankruptcies per month in Anchorage.

One potential policy for use of reserve funds is: if anticipated revenues drop more than a predetermined percentage from the mid case projection, a combination of budget cuts and use of reserves should be put into place. The appropriate mix will depend on several factors, such as how late in the fiscal year the revenue drop occurs, private sector economic conditions, the amount of cuts already budgeted for the year and the expected duration of the problem.

To avoid excessive impacts on the economy, it would be prudent to avoid budget cuts (beyond the cuts already planned in the budget) of more than 3-5 percent per year. A 5 percent cut in the total general fund operating budget is equivalent to about \$120 million. For each \$1 per barrel decline in the price of oil, the state loses about \$120 million in revenues. Therefore, cutting \$120 million from the state budget in a single year would offset an oil price decline of only \$1 dollar per barrel. Under this potential reserves policy, a drop in oil prices of more than \$1 per barrel would need to be covered by reserve funds.

How much insurance against oil price declines should the state maintain in the form of reserve funds? One reasonable benchmark would be for the state to be prepared to offset a drop in oil prices from the mid case projection for a given year, to the historical low point in oil prices over the last ten years. This ten-year low point was reached in FY 94 in terms of inflation-adjusted oil prices, with an average for the year of \$14.22 per barrel.

If this benchmark were applied to the FY 96 budget, with a mid case oil price projection of \$16.52 per barrel, the potential drop in revenues to be offset would be about \$275 million. If \$120 million of this amount could be offset by budget cuts, this would leave about \$155 million to be covered from reserve funds. Since lower-than-forecast oil prices could occur in two consecutive years, it may be prudent to maintain about twice this amount, or \$300 million, to offset oil price fluctuations. This amount would also be sufficient to provide cash necessary to handle a major natural disaster or other emergency requiring immediate and extensive state action.

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Other reserve fund issues

To ensure that reserves are replenished, a repayment mechanism is required. The commission believes that the repayment provision of the current Constitutional Budget Reserve is not as clear and workable as it should be. For instance, it does not make sense to completely drain capital replacement funds (for highways, ferries, state equipment, etc.) at the end of the year in order to pay back the CBR. The very purpose of these funds is to provide a rational, planned source of funds to replace aging equipment and facilities.

An alternative approach would be to repay reserves with year end balances in the general fund and future oil revenue increases. As oil revenues are restored, any amount over the mid case projection should be returned to reserves at year end along with any balances from the general fund appropriation. Any settlement income or other "windfall" should also be deposited in reserves. Any changes to the Constitutional Budget Reserve provisions will require a constitutional amendment.

Another potential reserves policy would be that if reserves build up to a level which is more than 1.5 times the amount required under the general rule, the legislature should consider depositing the excess in the corpus of the Permanent Fund. However, an automatic deposit may not be advisable, because under the circumstances it may be more fiscally prudent to build up somewhat larger reserves.

Our experience from the years of dramatic oil price increases tells us that it is absolutely critical that the state not increase spending just because revenues have taken an upturn. This only leads to a level of spending which cannot be sustained when prices return to their more accustomed level, let alone when they drop below the mid case level. Additional revenues from price spikes should be used to replenish reserves or as an addition to the corpus of the Permanent Fund.

How can we stabilize the state's revenues?

INSERT discussion of Cremo plan and other stabilization strategies

Budget Process Improvements

The public, executive branch and legislature will be better served in the budget process if a number of changes are made to improve the quality of information, ease of understanding and accountability. Process improvements under consideration by the commission are briefly noted below:

- Develop a budget format and executive summary that are more understandable to the general public and legislature.
- Establish and track progress on performance measures that relate to the effectiveness of all state services and assets.

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- Show the relationship of state economic performance and outlook as well as state, federal and local government spending in Alaska so the impacts of state decisions are in a more complete budgetary context.
- Give all expenditures, including loan programs, the same high degree of scrutiny from the executive and legislative branches regardless of funding source, i.e. whether a particular program contributes to the general fund fiscal gap or not.
- Make it easier to see the overall budget implications of all funds requiring legislative appropriation for the coming year (e.g. Permanent Fund revenues, reappropriations, power cost equalization, AHFC).
- Require more accurate estimates of the cost of proposed legislation and written explanations of any changes to fiscal notes so cost estimates are not arbitrarily inflated or reduced.
- Except in extraordinary circumstances, do not partially fund normal annual expenditures with the expectation that the remaining funds will be provided later as supplemental appropriations. Include estimates of court judgments and claims in the annual spending plan.
- Establish a consistent system for showing annual revenues and expenditures so accurate year-to-year comparisons can be made.
- Present an annually updated plan for the following five years (six year capital budget plans are required by statute). Include reasonable estimates of future operations and maintenance costs.
- Incorporate ongoing maintenance and routine facility renewal and replacement costs into the state's operating budgets to prevent the accumulation of deferred maintenance backlogs which deteriorate the state's assets and require higher costs in later years. Replacement of computers and communications equipment should also be an integral part of the operating budget.
- Develop some form of per square foot chargeback system for state facilities to ensure efficient use of building space.
- The state needs an accounting system which provides easily accessible management data.
- Have the Office of Management and Budget monitor overall expenditures at least quarterly to ensure that spending levels will remain within department appropriations.
- Design the budget review system to identify and take advantage of investments in prevention that can reduce out year costs.
- Present the annual budget in the context of an annually updated 3-5 year financial plan. This plan should describe the state's economic outlook, population

estimates, projections of state revenues and expenditures, anticipated changes in federal programs and other relevant factors. It should also bring attention to problems which may require more than one year to address adequately, e.g. facility maintenance, replacement of computer equipment or phased changes in the delivery of state services.

- Provide incentives for management efforts to control costs and develop innovative solutions to service delivery problems. Current impediments include the inability to save one year's operating dollars to fund technology improvements the following year, and the relatively small categories of appropriations which restrict managers in some departments from funding needed improvements in one area with savings achieved in another.
- Monitor closely those areas of the budget where the rate of expenditure growth exceeds the population and inflation index to ensure that costs do not simply increase to fill the appropriation level.

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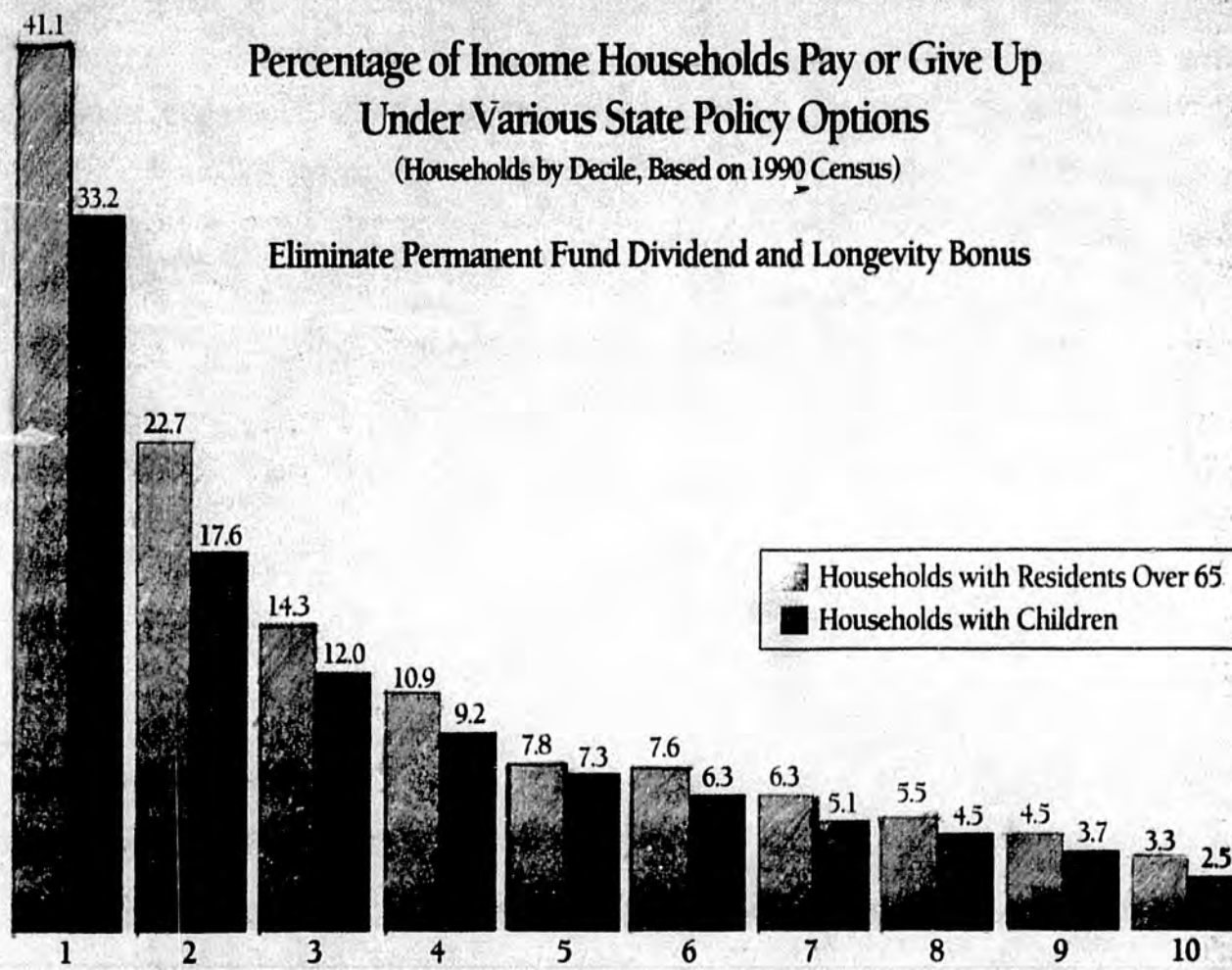
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ending Cuts and New Taxes

Percentage of Income Households Pay or Give Up Under Various State Policy Options

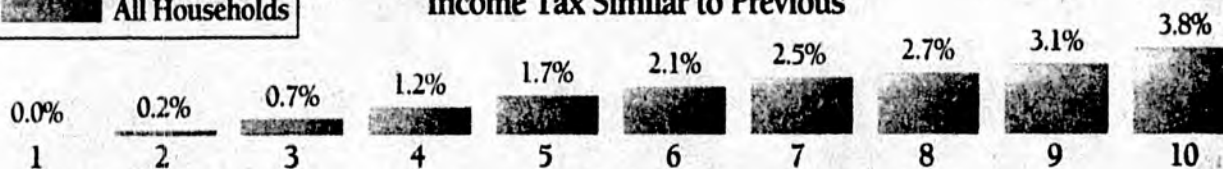
(Households by Decile, Based on 1990 Census)

Eliminate Permanent Fund Dividend and Longevity Bonus

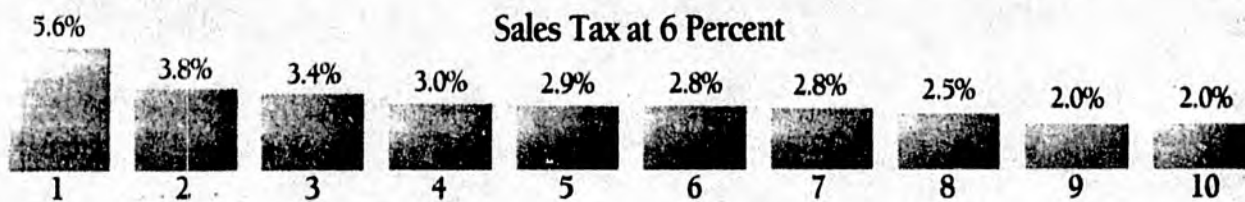


All Households

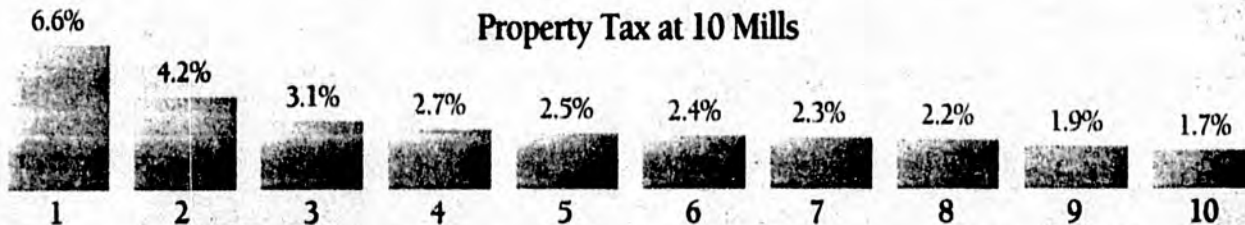
Income Tax Similar to Previous



Sales Tax at 6 Percent



Property Tax at 10 Mills



Poorest 10%

Middle

Wealthiest 10%

Source: U.S. Bureau of the Census and ISER analysis

Work Papers for Reduction Scenarios 1 Categories

Scenario 1											
Program	How Savings Achieved	FY 96 Amount	General Fund Savings by FY 2000	Salary/Benefit Reforms, Pgm Consolidation	Still Remains	Eliminate Program	Grants that benefit Individuals	Grants to Non Profits	Impact on Local Gov	Privatize	Contract Out
Office of the Governor											
Human Rights Commission	10% savings estimated from salary/benefit reforms and streamlining operations	1,086.6	-108.7	-108.7	977.9						
Executive Operations	10% savings estimated from salary/benefit reforms and streamlining operations	7,338.5	-733.9	-733.9	6,604.7						
Office of Management and Budget	10% savings estimated from salary/benefit reforms and streamlining operations	4,206.8	-420.7	-420.7	3,786.1						
Elective Operations	10% savings estimated from salary/benefit reforms and streamlining operations	1,972.0	-197.2	-197.2	1,774.8						
					0.0						
Department of Administration											
Longevity Bonus	Scenario 1-Eliminate; Scenario 2-Make needs based (estimated savings)	72,152.6	-72,152.6				-72,152.6				
Pioneer Homes	Privatize	29,842.3	-29,842.3							-29,842.3	
Other Senior Services Programs	10% savings estimated from salary/benefit reforms and streamlining operations; additional revenues could offset some of the reduction by charging/increasing fees for services	7,632.6	-763.3					-763.3			
Public Defender Agency	5% savings from salary/benefit reforms; streamlining operations	8,104.3	-405.2	-405.2	7,699.1						
Office of Public Advocacy	5% savings from salary/benefit reforms; streamlining operations	7,199.6	-360.0	-360.0	6,839.6						
Centralized Administrative Services	20% savings from salary/benefit reforms; streamline operations	14,814.0	-2,962.8	-2,962.8	11,851.2						
Alaska Oil and Gas Conservation Commission	10% savings from salary/benefit reforms; contract out	1,658.7	-165.9	-165.9	1,492.8						
Alaska Public Offices Commission	Consolidate with Div. of Elections; 75% savings	633.8	-475.4			-475.4					
RATNET	Privatize	794.5	-794.8							-794.8	
Public Broadcasting Radio/TV	50% reduction; consolidate/privatize operations	4,436.5	-2,218.3					-2,218.3			
Leases	20% savings from salary/benefit reforms and streamlining operations; reduced workforce should require less office space	23,171.0	-4,634.2	-4,634.2	18,536.8						
					0.0						

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APPENDIX II
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Work Papers for Reduction Scenarios 1 Categories

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Program	How Savings Achieved	FY 96 Amount	Scenario 1								
			General Fund Savings by FY 2000	Salary/Benefit Reforms, Pgm Consolidation	Still Remains	Eliminate Program	Grants that benefit Individuals	Grants to Non Profits	Impact on Local Gov	Privatize	Contract Out
Department of Law					0.0						
Prosecution	5% savings from salary/benefit reforms and streamlining operations	11,519.6	-579.6	-579.6	10,940.0						
Legal Services	20% savings from salary/benefit reforms; streamline operations	7,306.2	-1,534.3	-1,534.3	5,771.9						
Department of Revenue					0.0						
Permanent Fund Dividend		556,000.0	0.0		556,000.0						
Child Support Enforcement	5% savings from salary/benefit reforms and streamlining operations	1,854.6	-92.7	-92.7	1,761.9						
Alcohol Beverage Control Board	Transfer to local community along with authority to collect fees to pay for enforcement or merge responsibility with Gaming; 75% reduction	639.3	-479.3			-479.3					
Revenue Operations	10% savings from salary/benefit reforms and streamlining operations	8,681.3	-868.1	-868.1	7,813.2						
Administration and Support	20% savings from salary/benefit reforms; streamline operations	854.0	-170.8	-170.8	683.2						
Department of Education					0.0						
K-12 Foundation funding	10% savings based on local school district personnel system reforms; merger of some school districts	660,309.4	-66,030.9						-66,030.9		
School Finance	20% savings from salary/benefit reforms; streamline and eliminate some programs	1,074.6	-214.9	-214.9	859.7						
Education Program Support	20% savings from salary/benefit reforms; streamline/eliminate some operations; privatize Alaska Career Information System	3,348.6	-669.7	-669.7	2,678.9						
Executive Administration	20% savings from salary/benefit reforms; streamline operations	2,331.9	-466.4	-466.4	1,865.5						
Professional Teaching Practices Commission	Contract out (20% estimated savings)	188.2	-47.0								-47.0
Arts Council	Privatize	564.0	-564.0							-564.0	
Kotzebue Technical Center	Privatize	734.0	-734.0							-734.0	
Alaska Vocational Technical Center	Privatize	4,372.3	-4,372.3							-4,372.3	
Mt. Edgecumbe Boarding School	10% savings from salary/benefit reforms and streamlining operations	2,312.1	-231.2	-231.2	2,080.9						
Vocational Rehabilitation	10% savings from salary/benefit reforms and streamlining operations; reduce grants	4,776.6	-477.7	-477.7	4,298.9						

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Work Papers for Reduction Scenarios 1 Categories

Program	How Savings Achieved	FY 96 Amount	General Fund Savings by FY 2000	Scenario 1							
				Salary/Benefit Reforms, Pgm Consolidation	Still Remains	Eliminate Program	Grants that benefit Individuals	Grants to Non Profits	Impact on Local Gov	Privatize	Contract Out
Alaska State Library	10% savings from salary/benefit reforms; streamline operations; eliminate specific cultural programs grants	5,514.0	-551.4	-463.0	4,962.6	-88.4					
Postsecondary Education Commission	10% reduction in programs and number of new students	1,926.2	-192.6				-192.6				
Department of Health and Social Services											
Assistance Payments	10% overall reduction; Expected federal changes provide opportunity to reform all public assistance programs, including ways to control costs.	101,631.1	-10,163.1				-10,163.1				
Medical Assistance	10% overall reduction; Expected federal changes provide opportunity to reform Medicaid programs, including ways to control costs.	150,355.8	-15,035.6				-15,035.6				
Public Assistance Administration	10% savings from salary/benefit reforms and streamlining operations	10,160.9	-1,916.1	-1,916.1	8,244.8						
Medical Assistance Administration	10% savings from salary/benefit reforms and streamlining operations	6,623.8	-662.4	-662.4	5,961.4						
Purchased Services	10% savings from salary/benefit reforms; consolidate and streamline programs	23,321.5	-2,332.2				-1,166.1	-1,166.1			
Family and Youth Services	5% savings from salary/benefit reforms; streamline operations	20,859.5	-2,086.0	-2,086.0	18,773.6						
Youth Facility Services	5% savings from salary/benefit reforms; streamline operations	14,349.9	-717.5	-717.5	13,632.4						
Human Services Community Matching Grants	Eliminate	1,769.6	-1,769.6						-1,769.6		
Regional Non-Profit Grants	10% reduction in grant amounts	10,686.8	-1,068.7					-1,068.7			
State Health Services	10% savings from salary/benefit reforms and streamlining operations; implement/increase fees to offset some of the reductions	23,103.9	-2,310.4	-2,310.4	20,793.5						
Health Grants	10% savings from salary/benefit reforms; grantees streamlining operations; implementation and/or increase of fees to offset some of the reductions	6,986.7	-698.7					-698.7			
Alcohol and Drug Abuse Services	10% savings from salary/benefit reforms; grantees streamlining operations; implementation and/or increase of fees to offset some of the reductions	15,359.1	-1,535.9	-100.0	13,823.2			-1,435.9			

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Work Papers for Reduction Scenarios 1 Categories

Scenario 1											
Program	How Savings Achieved	FY 96 Amount	General Fund Savings by FY 2000	Salary/Benefit Reforms, Pgm Consolidation	Still Remains	Eliminate Program	Grants that benefit Individuals	Grants to Non Profits	Impact on Local Gov	Privatize	Contract Out
Community Mental Health Grants	10% savings from salary/benefit reforms; grantees streamlining operations; implementation and/or increase of fees to offset some of the reductions	25,837.8	-2,583.8					-2,583.8			
Medicaid Community Mental Health Grants	10% savings from salary/benefit reforms; grantees streamlining operations; implementation and/or increase of fees to offset some of the reductions	1,000.0	-100.0					-100.0			
Community DD Grants	10% savings from salary/benefit reforms; grantees streamlining operations; implementation and/or increase of fees to offset some of the reductions	20,562.4	-2,056.2					-2,056.2			
Institutions and Administration	Privatize Harborview; 5% reduction in APH from salary reforms and streamlining operations; 20% cut in other areas	15,160.9	-5,610.4	-1,060.4	9,550.3					-4,550.0	
Mental Health Trust Boards	20% savings from salary/benefit reforms; streamlining operations	710.8	-142.2	-142.2	568.6						
Administrative Services	20% savings from salary/benefit reforms; streamlining operations	3,718.3	-743.7	-743.7	2,974.6						
					0.0						
Department of Labor											
Employment Security	10% savings from salary/benefit reforms and streamlining operations	1,355.9	-135.6	-135.6	1,220.3						
Office of the Commissioner	20% savings from salary/benefit reforms and streamlining operations	7,821.3	-1,835.4	-1,835.4	5,985.9						
					0.0						
Department of Commerce and Economic Development											
Measurement Standards	10% savings from salary/benefit reforms; additional savings from potential to contract out some activities	2,879.3	-287.9	-287.9	2,591.4						
Banking, Securities, Corporations	10% savings from salary/benefit reforms and streamlining operations	1,631.5	-163.2	-163.2	1,468.4						
Insurance	10% savings from salary/benefit reforms and streamlining operations	4,002.0	-400.2	-400.2	3,601.8						
Occupational Licensing	Eliminate licensing some occupations; target 20% savings	3,986.3	-797.3	-200.0	3,189.0	-597.3					
Alaska Public Utilities Commission	10% savings from salary/benefit reforms and streamlining operations	3,515.9	-351.6	-351.6	3,164.3						

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Work Papers for Reduction Scenarios 1 Categories

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Scenario 1											
Program	How Savings Achieved	FY 96 Amount	General Fund Savings by FY 2000	Salary/Benefit Reforms, Pgm Consolidation	Still Remains	Eliminate Program	Grants that benefit Individuals	Grants to Non Profits	Impact on Local Gov	Privatize	Contract Out
Executive Administration and Development	20% savings from salary/benefit reforms; streamline operations	4,601.0	-920.2	-920.2	3,680.8						
Tourism Development	10% savings from salary/benefit reforms and streamlining operations	3,037.5	-303.8	-303.8	2,733.8						
Alaska Tourism Marketing Council	Privatize	5,365.3	-5,365.3							5,365.3	
Alaska Seafood Marketing Institute	Privatize	7,994.7	-7,994.7							7,994.7	
					0.0						
Department of Military and Veterans Affairs											
Alaska National Guard	10% savings from salary/benefit reforms and streamlining operations	4,667.6	-233.9	-233.9	4,433.7						
Alaska National Guard Benefits	Eliminate retirement and education benefits for new members; estimate 20% savings	1,132.9	-226.6				-226.6				
Veterans' Services	10% reduction in grants	480.0	-48.0					-48.0			
					0.0						
Department of Natural Resources											
Management and Administration	5% savings from salary/benefit reforms	7,045.6	-1,409.1	-1,409.1	5,636.5						
Resource Development	5% savings from salary/benefit reforms; streamline operations	25,515.5	-1,275.8	-1,275.8	24,239.7						
Parks and Recreation Management	Contract out management; 25% targeted savings	5,613.1	-1,337.7								-1,337.7
Agricultural Development	Eliminate; transfer responsibility to Department of Commerce and Economic Development	1,034.2	-1,034.2			-1,034.2					
Statewide Fire Suppression	5% savings from salary/benefit reforms and streamlining operations	3,510.0	-175.5	-175.5	3,334.5						
					0.0						
Department of Fish and Game											
Commercial Fisheries/Sport Fisheries	5% savings from salary/benefit reforms and streamlining operations	30,376.4	-1,531.2	-1,531.2	28,845.2						
Wildlife Conservation	5% savings from salary/benefit reforms and streamlining operations	428.6	-21.4	-21.4	407.2						
Administration and Support	20% savings from salary/benefit reforms; streamline operations	3,439.3	-687.9	-687.9	2,751.4						
Subsistence	5% savings from salary/benefit reforms and streamlining operations	1,297.1	-64.9	-64.9	1,232.2						
Habitat	5% savings from salary/benefit reforms and streamlining operations	2,126.8	-106.3	-106.3	2,020.5						
Limited Entry Program Administration	5% savings from salary/benefit reforms and streamlining operations	2,606.9	-130.3	-130.3	2,476.6						
					0.0						

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III
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Work Papers for Reduction Scenarios 1 Categories

Scenario 1											
Program	How Savings Achieved	FY 96 Amount	General Fund Savings by FY 2000	Salary/Benefit Reforms, Pgm Consolidation	Still Remains	Eliminate Program	Grants that benefit Individuals	Grants to Non Profits	Impact on Local Gov	Privatize	Contract Out
Department of Public Safety					0.0						
Fish and Wildlife Protection	5% savings from salary/benefit reforms and streamlining operations	14,769.9	-738.5	-738.5	14,031.4						
Fire Prevention	5% savings from salary/benefit reforms and streamlining operations	1,804.3	-90.2	-90.2	1,714.1						
Motor Vehicles	Contract out; 25% savings estimated	8,249.8	-2,062.5								-2,062.5
Alaska State Troopers	5% savings from salary/benefit reforms and streamlining operations	40,049.1	-2,002.5	-2,002.5	38,046.6						
Village Public Safety Officer	5% reduction in contract amount	6,685.0	-344.3	-344.3	6,340.8						
Alaska Police Standards Council	5% savings from salary/benefit reforms; additional savings possible if can privatize	494.0	-24.7	-24.7	469.3						
Council on Domestic Violence and Sexual Assault	5% reduction in grants; some savings from salary/benefit reforms	4,487.1	-224.4					-224.4			
Statewide Support	10% savings from salary/benefit reforms and streamlining operations	8,194.3	-819.4	-819.4	7,374.9						
Department of Transportation/Public Facilities					0.0						
Statewide Programs	10% savings from salary/benefit reforms and streamlining operations, contract out fleet maintenance, highway maintenance; explore other options	101,001.4	-10,100.1	-1,010.0	90,901.3						-9,090.1
Marine Highway Subsidy	10% savings from salary/benefit reforms and streamlining operations; potential to increase fees to offset some of reduction	28,263.2	-2,826.3	-2,826.3	25,436.9						
Department of Environmental Conservation					0.0						
Administration	20% savings from salary/benefit reforms; streamlining operations	1,139.8	-228.0	-228.0	911.8						
Environmental Quality	10% reduction from salaries/benefits reforms and streamlining operations	14,662.0	-1,466.2	-1,466.2	13,195.8						
Facility Construction and Operations	10% reduction from salaries/benefits reforms and streamlining operations	2,126.6	-212.7	-212.7	1,913.9						
Department of Community and Regional Affairs					0.0						
Administration and Support	20% savings from salary/benefit reforms; streamline operations	2,737.5	-547.5	-547.5	2,190.0						
Senior Citizens/Disabled Vets Tax Relief	Eliminate; make local option	1,500.0	-1,500.0						-1,500.0		
State Revenue Sharing	Eliminate	26,271.7	-26,271.7						-26,271.7		

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Work Papers for Reduction Scenarios 1 Categories

Program	How Savings Achieved	FY 96 Amount	General Fund Savings by FY 2000	Scenario 1							
				Salary/Benefit Reforms, Pgm Consolidation	Still Remains	Eliminate Program	Grants that benefit Individuals	Grants to Non Profits	Impact on Local Gov	Privatize	Contract Out
Municipal Assistance	Eliminate	31,959.0	-31,959.0						-31,959.0		
Local Government Assistance	10% reduction from salaries/benefits reforms	3,195.9	-319.6	-319.6	2,876.3						
Child Care Grants	10% savings from salary/benefit reforms and streamlining operations; reduce grants to Day Care operators	2,152.8	-215.3					-215.3			
Day Care Assistance Program	10% reduction; adjust income guidelines	10,172.9	-1,017.3				-1,017.3				
Head Start Grants	5% reduction from salaries/benefits and streamlining operations; consolidate grantees; reduce grants	2,232.8	-111.6					-111.6			
Rural Development Grants	Eliminate	1,119.4	-1,119.4			-1,119.4					
Rural Energy Program	10% savings from salary/benefit reforms; streamline operations	2,314.7	-231.5	-231.5	2,083.2						
					0.0						
Department of Corrections											
Administration and Support	10% reduction from salaries/benefits; privatize correctional academy	5,952.1	-595.2	-595.2	5,356.9						
Statewide operations	5% reduction from salaries/benefits and streamlining operations; increase contracting out for care and housing of prisoners	118,723.6	-5,936.2	-593.6	112,787.4						-5,342.6
Community Jails	5% reduction	4,374.7	-218.7						-218.7		
					0.0						
University of Alaska											
Systemwide	10% reduction from salaries/benefits reforms and streamlining operations; consolidate and eliminate some programs	167,361.7	-16,736.2	-16,736.2	150,625.5						
					0.0						
Court System											
Systemwide	5% reduction from salaries/benefits savings and streamlining operations	44,996.6	-2,292.1	-2,292.1	42,704.5						
					0.0						
Legislature											
	10% savings from salary/benefit reforms; streamline operations	30,845.6	-3,084.6	-3,084.6	27,761.0						
					0.0						
	Operating Budget Estimated Savings:		-386,177.8	-69,892.5	1,403,337.1	-3,794.2	-99,953.9	-12,690.2	-127,750.0	-54,217.4	-17,879.8

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Work Papers for Reduction Scenarios 1 Categories

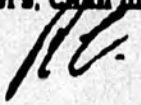
			Scenario 1								
Program	How Savings Achieved	FY 96 Amount	General Fund Savings by FY 2000	Salary/Benefit Reforms, Pgm Consolidation	Still Remains	Eliminate Program	Grants that benefit Individuals	Grants to Non Profits	Impact on Local Gov	Privatize	Contract Out
Reductions in Capital/Debt Appropriations											
Capital Matching Grants program	Eliminate	20,000.0	-20,000.0						-20,000.0		
School debt reimbursement	Eliminate (savings is FY 96 amount)	\$0,322.4	-\$0,322.4						-80,322.4		
G.O. debt savings	Eliminate (obligations will be fulfilled)	16,100.0	-16,100.0			-16,100.0					
	Capital/Debt Estimated Savings:		-116,422.4	0.0		-16,100.0	0.0	0.0	-100,322.4	0.0	0.0
	Total Estimated Savings:		-502,600.2	-69,892.5	1,403,337.1	-19,894.2	-99,953.9	-12,690.2	-228,072.4	-54,217.4	-17,879.8

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July 27, 1995

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

From: Roger Cremo 

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

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

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

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

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

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

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

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

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

I hope that these comments are helpful.

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

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

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

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

*From: Roger Cremo
For: [unclear]*

Brian:
Rogers

STATE OF ALASKA
LONG RANGE FINANCIAL PLANNING COMMISSION

716 West Fourth Avenue, Anchorage, Alaska 99501

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Staff: Melissa Aber Fouse

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cc: Meeting
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as of 31 May 1995

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*Brad
*Brian

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STATE OF ALASKA

DEPARTMENT OF LABOR

ADMINISTRATIVE SERVICES DIVISION

RESEARCH AND ANALYSIS SECTION

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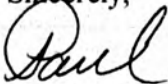
August 3, 1995

Melissa Fouse
Long Range Financial Planning Commission
716 West 4th Room 470
Anchorage, AK 99501

Dear Ms. Fouse:

Enclosed are copies of the graphs used in The Department of Labor employment projections. If they are not sufficient for your needs, please call me at 465-6032 and we will arrange another method of getting satisfactory graphs to you.

Sincerely,



Paul Engelman
Labor Economist

465 6032



**LONG RANGE FINANCIAL
PLANNING COMMISSION
REPORT
PROPOSED NEW OUTLINE**

AS OF 03 AUGUST 1995

**COVER PAGE - NOTE: WE
NEED A TITLE!**

**INSIDE COVER: WHAT IS
THE LONG RANGE
FINANCIAL PLANNING
COMMISSION?**

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Why Does the Fiscal Gap
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How Big is the Fiscal Gap?
How Much Does the State
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How Does this Compare
with Other States?
How is State Spending
Changing?
How Much Does the State
Collect in Revenues?
How Does this Compare
with Other States?
How Big are Our Reserves?
What Can be Done to Fill
the Fiscal Gap?
What Do You Think We
Should Do?

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Choices to Fill the Fiscal Gap**

• Everything is on the Table

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The Charge: Cut \$500
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Part 3: The Permanent Fund
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Part 4: Economic Development

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Reserves Policy
Why Do We Need
Reserves?

Part 6: State Assets
Enterprise Funds
Corporations & Foundations
Loan Programs
Miscellaneous

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Appendix 3: Resolution Creating
the Commission

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WHY THE LONG RANGE FINANCIAL PLANNING COMMISSION?

The Fiscal Gap is Real

The State of Alaska spends more than it takes in each year.

For the past five years, the legislature, the governor, and state agencies have worked to close the gap by cutting expenditures and holding the line on the growth of expenditures, **reducing spending by 5 per cent per year in inflation adjusted terms.**

Without this steady attention to reducing expenditures, Alaskans may have faced drastic reductions in services and programs, loss of the permanent fund or significant new taxes. **These efforts have not been enough to offset the decline in revenues.**

Alaska has significant oil reserves and a rapidly growing Permanent Fund. We have a Constitutional Budget Reserve fund established to 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 DOES THE FISCAL GAP EXIST?

The fiscal gap exists for two reasons. First, Alaska bases its budget on non sustainable revenue sources. We count on oil revenues to fund a budget larger than we can afford in the long term. Second, there is a rapid decline in Prudhoe Bay production. The State of

In this preliminary report, we describe the size of the fiscal gap, explain the choices available to us, and discuss opportunities for cutting expenditures and raising revenues to fill the gap. We ask you to tell us what you think is a long-term, sustainable state revenue and expenditure strategy.

Declining Oil Production

Alaskans have known all along that oil revenues were finite. North Slope oil production rates started falling in 1991 and will continue to do so until the field is no longer economical to produce.

The chart below shows the current forecast of oil production in Alaska with the following assumptions:

- 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 from currently marginal fields is included. 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; production is currently not expected before 2005.

CHART 1: North Slope Production Forecast

CORRECTION

**THE FOLLOWING DOCUMENT(S)
HAVE BEEN REFILMED TO
ASSURE LEGIBILITY OR PAGINATION**



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Alaska depends upon oil & gas revenues for half its income (75% if we exclude Permanent Fund earnings). The decline in production is a decline in state revenues.

At Statehood, Congress endowed Alaska with a substantial land base, including underlying oil and gas resources such as Prudhoe Bay. The state instituted methods by which oil companies could bid on the production of Alaskan oil and that oil began to flow through the Trans-Alaska Pipeline System (TAPS) in 1977.

By 1979, after the OPEC price hikes, Alaska received such large amounts of revenue from royalties and taxes that the state abandoned its more traditional methods of obtaining revenue.

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 appear to prefer reliance on the probability of a rebound in oil prices than to address the problem of the state's dependence on a declining revenue source.

The time has come to confront that issue. The members of the Long-Range Financial Planning Commission hope that this preliminary report to the governor, the legislature, and the people of Alaska will provide the basis for vigorous discussion and debate about our state's future.

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 sources, to examine the state budget process, to consider the impacts of changes on local governments, and to hear from the public about the choices Alaskan's face.

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CHART 1: North Slope Production Forecast

HOW BIG IS THE FISCAL GAP?

The fiscal gap this year is \$500 million.

- Equal to all of the salaries and benefits paid to all state employees.
- Almost as much as the whole Permanent Fund dividend program;
- Almost as much as the entire public school funding program.

Without any changes in spending or revenues, the fiscal gap will widen to over \$1 billion (current dollars) in the next 10 years.

We designed a "base case" to predict revenue and project spending. For the Commission's work, we chose the following assumptions.

- All projections are in FY96 dollars. In reality, there will be inflation, which affects both revenues (from taxes and investment income) and expenditures.
- Population will grow 1.6% per year (compounded) and so will the state's formula programs.
- State agency expenditures will increase one-half of the rate of population growth.
- Department of Revenue projections are accurate for the purposes of calculating the fiscal gap. New projections of revenues are developed on a regular basis, and may result in changes to the fiscal gap but the scale of the gap is unlikely to change significantly.
- **We used the estimates of Permanent Fund income developed by the Commission staff based on earlier work by the Alaska Permanent Fund Corporation.**

- \$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.
- No new revenues from ANWR and no increased revenues due to repeal of the oil export ban (congressional action is imminent on the oil export ban. Projected revenues from repeal are shown in economic development section.)
- No changes in federal assistance to the State of Alaska. It is likely, however, that current Congressional action will result in substantial cost-shifting from the federal to the state budget.
- All revenues that can be spent are considered available for expenditure or other disposition. Thus, all Permanent Fund earnings are included in the unified budget.
- Program receipts are included if (a) they are significant and can be separately defined, and (b) the receipts are not dependent upon specific state-funded activities to generate the receipts.
- 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 uses the CBR to fill the gap each year.

The CBR can be used to fill the fiscal gap for four more fiscal years, after which it is depleted and the state faces an \$800+ million budget gap.

HOW MUCH DOES THE STATE SPEND?

The State of Alaska will receive \$3.2 billion in revenues during the coming fiscal year (FY96).

We will receive \$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 Trans & Pub.Fac.
 - 85 million Public Safety
 - 75 million Administration
 - 46 million Courts
 - 43 million Natural Resources
 - 41 million Fish & Game
 - 37 million Comm& Ec.Dev.
 - 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

* See Glossary for definition of Formula Programs

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 PF Earnings Reserve
- \$ 109 million Debt service
- \$ 106 million Capital projects
- \$ 22 million Loan programs
- \$ 20 million Supplemental appropriations for
emergencies and court judgments

The difference — \$497 million — is the fiscal 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:			
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

* See Glossary for definition of Formula Programs

AHFC/adjustments	<u>180.1</u>	<u>79.6</u>	<u>68.0</u>
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	<u>202.0</u>	<u>258.1</u>	<u>310.7</u>
TOTAL	3,669.8	3,954.7	4,325.6
THE GAP	(497.0)	(817.4)	(1,322.0)

HOW HAS STATE SPENDING CHANGED?

Table 3

FY79 to FY96 GF Budget Comparisons

Alaska's population has grown 52 percent over the past 17 years.

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 tripling of state oil revenues.

While the overall budget has grown, services per capita are at the same level as they were in 1979.

The Department of Labor expects the state population to continue to grow at a 1.6 percent compound rate over the next ten years.

Unlike other states, Alaska's revenues do not grow as the population grows.

The twin trends of declining revenues due to diminishing production and increasing expenditures due to increasing population work together to increase our fiscal problems.

Table 3 shows expenditure growth by category. 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%).

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%). **NOTE: NEED DOLLAR AMOUNTS.**

Projections show that the biggest areas of spending growth will be grants to individuals, groups, schools, and municipal assistance, and the corrections and criminal law budgets.

The recent emphasis during public discussion and in the legislature is on cuts to state spending. Some programs have been eliminated or downsized and other programs serve more people with the same amount of money.

The number of state employees per capita is at a 15-year low.

CHART 4

State Employees per 10,000 population

Chart 5

Alaska's population

The operating budget has been cut over 25% in the past five years on an inflation-adjusted basis

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, because of the wealth of the State in the early 1980s, Alaskans came to expect a higher level of services. In addition, there have been significant and substantial program changes in the past 17 years such as heightened federal requirements for assistance and transfer payments, and more stringent environmental regulations .

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 are primarily state-provided in Alaska, while these services are local in other jurisdictions. Some expenditures like the Longevity Bonus and Permanent Fund Dividends are unique to Alaska.

Chart 6
Real Per Capita spending FY79-96

HOW MUCH DOES THE STATE COLLECT IN REVENUE?

The major sources of revenue to the state are oil and gas rents, royalties and bonuses, oil and gas property's 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 services that annually generate approximately \$125 million. These revenues are paid into the general fund.

Other revenues, such as interest on the Four-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 are not considered part of general fund revenues.

Revenues to the Alaska Permanent Fund Corporation are not generally treated as available for appropriation in the same sense as tax receipts.

The Commission examined other states' revenues not used by Alaska. Most prominent among these 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 however, the state funds certain programs, notably education, that are traditionally considered to be a local

responsibility. Chart 7 compares Alaska's revenue sources with those of a typical state in 1990.

Chart 7

HOW DOES THIS COMPARE WITH OTHER STATES?

Chart 8 compares the total of state and local taxes in Alaska to that in the rest of the United States.

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

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.

What is the annual tax burden for a family of four with a gross income of \$50,000 and a typical house for that income?

	Anchorage	Seattle	Billings
Pers. Inc. Tax	\$ 0	\$ 0	\$2108
Property Tax	\$1421	\$1691	\$1423
Sales Tax	\$ 0	\$ 998	\$ 0
Car Taxes	\$ 93	\$ 538	\$ 493
PermFundDiv.	(\$3932)	\$ 0	\$ 0
TOTAL	(\$2418)	\$3227	\$4024

Chart 9a

What is the annual Tax Burden for a family of four with a gross income of \$100,000 and a typical house for this income?

	Anchorage	Seattle	Billings
Pers. Inc. Tax	\$ 0	\$ 0	\$5418
Property Tax	\$ 2700	\$3214	\$2703
Sales Tax	\$ 0	\$1966	\$ 0
Car Taxes	\$ 158	\$1311	\$1192
PermFund Div	(\$3932)	\$6520	\$9314
TOTAL	\$(1074)	\$6520	\$9314

Chart 9b

HOW BIG ARE OUR RESERVES?

Alaska is fortunate to have over \$3 billion in liquid reserve funds

These substantial reserves constitute one of the primary fiscal tools the state can, and has used, to temporarily fill the fiscal gap. However, these large reserve balances also have a negative side, in that these reserves can delay the difficult actions necessary to close the fiscal gap for several more years, with the potential for suddenly magnifying the state's fiscal and economic problems when the reserves are finally exhausted.

What role should these reserve funds play to create a stable fiscal future for the state?

Potential uses of reserve funds include:

- Use reserves to offset current budget shortfalls, postponing the impacts of the fiscal gap and buying time to develop and implement fiscal solutions;
- Minimize the current use of reserves, in order to maintain substantial reserves for offsetting even larger budget shortfalls that may occur in the future, and to cushion the state's adjustment to lower petroleum revenues;
- Deposit all or some reserves into the Permanent Fund to increase sustainable long-term revenues;
- Use reserves to establish forward funding for the state budget; and,
- Maintain a minimum level of reserves as insurance against oil price volatility, and to meet cash flow requirements.

Additional policy questions regarding the use of reserve funds include:

- In what priority should reserve funds be used, relative to other fiscal tools such as spending reductions, tax increases, and permanent fund earnings?
- Should the state use only its liquid reserves in dealing with the fiscal gap, or should the state consider using some of the assets of state corporations such as the Alaska Housing Finance Corporation, the Alaska Industrial Development and Export Authority, and the Alaska Energy Authority?
- If it is desirable for the state to maintain a minimum level of reserves to guard against sharp declines in oil prices, what is the appropriate level of reserves for this purpose?
- Can major reductions in state services or increases in revenues be justified to the public while the state still has substantial liquid reserves?

Current and Past Use of Reserve Funds

In the current fiscal year — FY 95 — the state will spend about \$240 million in reserves to balance the budget. For FY 96, the state is projected to spend about \$573 million in reserves. The predominant use of reserve funds during the last several years has been to offset current-year budget shortfalls. However, it would not be accurate to say that spending reserve funds has been the state's only response to the fiscal gap. For example, since FY 90, state agency budgets have been cut by 24 percent in nominal dollars and 32 percent in real dollars (adjusted for inflation).

During the past ten years, the State of Alaska has used reserve funds in four of the five roles outlined above (forward funding is the exception).

WHAT CAN BE DONE TO FILL THE FISCAL 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 — imposing personal income taxes, reducing Permanent Fund Dividends, or reducing state spending. That study indicated the following effects:

Imposing the Personal Income Tax

- A personal income tax reduces Alaskans' disposable personal income by about \$340 million, or 2 percent of Alaskans' overall purchasing power.
- This reduction in Alaskans' purchasing power reduces 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 reduces 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 costs the state \$400 million in disposable personal income.
- This results in a job loss of 2,700 private industry jobs annually.
- Which further reduces personal income by another \$140 million.

Cutting State Spending

- If the state cuts spending by reducing costs for all the expenditures 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 are 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 that 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 that raised \$300 million reduces 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 has 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: %
Agencies: \$

TABLE 2b

Growth of State

TABLE 2c:

Growth of Formula Programs: %
Formula Programs: \$

TABLE 2d

Growth of

Budget cutting is a painful, divisive undertaking. It does, however, provide all of us who live in Alaska the opportunity to re-think what we want government to do. It helps us 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 is each of us willing to give up or pay for—in the best interest of all of the people of Alaska.

The Commission agrees to the following conclusions:

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

- Spending cuts should be governed by announced fiscal policy goals.

The Key: Fiscal Stability

Much of the public discussion about Alaska's finances focuses on Alaska's fiscal gap. This is as it should be because the fiscal gap represents the fact that our need for services and our ability to pay for them have fallen out of alignment.

The fiscal gap is hard to define. Shifting oil prices and fluctuating revenue projections make the fiscal gap shrink or grow which changes our perception about the urgency of filling in the gap. Revenue instability contributes to making the gap harder to define.

As long as Alaska's revenue situation remains unpredictable we will make hasty policy choices as the gap changes. When it appears there is more revenue (and a smaller gap) we often increase state spending. When it appears there is less revenue (and the gap is larger) we may make unnecessary program eliminations or cutbacks.

Fiscal stability is the key to developing predictable financial policies. By defining and ensuring a consistent revenue stream and by ratcheting down operating and capital spending we can begin to assess our needs and our resources to meet those needs. Stable state spending will contribute mightily to Alaska's overall economic stability.

The Commission is considering methods by which we can bring fiscal stability to state spending. Among them are

- Development of a Reserves Policy. Approaches for employing reserve funds as budget stabilizers in addition to being shock absorbers. A steady year-to-year level of expenditures will enhance program planning and economic development.
- Application of Permanent Fund Earnings. Approaches for using portions of the Funds earnings to augment ordinary revenue.

- **Economic Development Initiatives.** Approaches to further development of North Slope oil and gas resources, oil and gas exports.
- **Petroleum Hedging.** Investment banking approaches for reducing risk and maximizing income through the use of security and commodity futures, and options.
- **Oil & Gas Settlements.** Approaches for striking a balance between current use and deferred use of oil litigation settlement funds.

WHAT DO YOU THINK WE SHOULD DO?

SCOMM

101:8

Meeting Notes
Aug 11/12

Doc



BETWEEN presentations
PLZ ASK IF SOMEONE
HAS PARKED A BLACK
CAR IN "LID STAFF"
PKY SPACE. I TOOK
CARE OF THE TICKET
PROBLEM SO IF ANYONE
SHOULD GET ONE, THEY
CAN GIVE IT TO ME
& I WILL TAKE CARE OF.

★ Brian ★

ROGER Crew plan
summary by himself

Act Snouder:

1. GORS Crim Justice Working Group

* GET
Recess *

How

Cut budget crim justice system?

Consensus answer: alcohol

- increase taxes to limit consumption
- keep out of hands of kids
- tax alcohol @ local level
- create penalties for giving alcohol to those on probation
- special ID for purchase of alcohol

GORSUCH - sentencing & national average
Juvenile Justice

GAR

VA
GAR Issues

1. Here

2. 5th FL

3. 10th FL

Reductions
Revenue +
PF

OK Uncertainty

Staff - Commission of C & T^{pm}

Editing

* ASAP Emily
McKenzie Distcr
* day fines

ARE YOU GOING
TO GIVE THE
TEAMS A MISSION
OR TOPIC?

★ Noedale

Structural divisions of authority in state ★
Need to discuss

Focus of next meeting

Uncertainty: what elements of addressing
issue must be included?

- Concensus elements in groups as to
solution.

★ . Annual report to public on progress
in filling FISCAL GAP. ★

PTS OF ~~THE~~ TEAMS

McConnell
Nordale

6th Fl

Local govt use ^{sales} taxing capacity
as shared revenue match

• Alcohol tax.

• urge look at sanctions etc.

• Fuel taxes increase put into trust fund.
(accr w/in CF)
incl. off highway fuel (ie generators)

• did not discuss user fees + licenses ^{ie. auto drivers}

5th Fl

FLAT BUDGET FOR 4-5 yrs ^{INCOME TAX CBR TRANSITION}

VOLATILITY

- choices to solve short term volatility
1. STABILITY - FUTURES TO MINIMIZE PRICE
 2. CBR
 3. Fund finding
 4. Crenof endowment PF principal protected
 5. Use EPA as stabilizing factor.

6. Capped PFD, reduce ⁴ ie 711,000 @ 350 = 580 yr
or 10% p/yr

7. Who should pay for education - urban areas should increase mill rate to raise 120M

Go such ^{Run} PF - capped PF Jim Kelly runs of 10 Aug

Box
5th floor
MTG

2ND floor ^{JB} See Frasca sheet

BR Endowment (ie. Cremo, but not quite)
Cremo: too big dip
too much potential? Not said on PF principles

Stabilization important and endowment approach
can bring that

SR Futures:
 • based on not AK oil, West Coast
 • ability of contractor to pay
 • sell Royalty forward but would
 need market developed.

JB How do you ~~keep~~ keep from spending too
much of PF ERA at one time?
Need to limit to percent ea yr so
endow.

10% real reduction ^{in spending} acceptable
over 5 yrs

SR links to taxpayers.

- Therpes - graduated approach
- Too many reserve funds, discuss combining funds, etc.

Navane Group - do something w CBR; not doing what was intended.

Alcorn Get consensus to Mun on

BR EXP:

1. Cuts -10% -15% real terms over 5 yrs
2. Ex. TRS + LF hefty early
3. PF ^{USE} income ~~90% Dividend~~
4. Intax later
5. CBR not using
6. Limit spending from reserves/endowment

Dividend? Cap?

SP Endowment plan first, then look at div.

LG:
AM

Volatility Issue
Pruned PF? No
• Pruned reserves

BR 3 ways to build political settlement Dinkum Sands

All
ANWR Bonus to PR

Nat. Gas to CBL

BL | Fuel taxes devoted to maint?

**Presentation to
Long Range Fiscal Planning Commission**

Department of Transportation/Public Facilities

Commissioner Joe Perkins

8/10/95

Transportation Funding Issues

- With the general decline in state general funds for maintenance of roads, airfields and harbors the facilities are gradually deteriorating and the state will lose valuable assets.
- Continued lack of adequate state funded maintenance will directly affect the public's use of the facilities and a solution to the shortfall in maintenance funding is needed.
- Based on historical appropriations by the legislature and the current projected budget short fall, it is highly unlikely that sufficient funds to perform the required maintenance will be provided in the future.
- DOT/PF continues to work to increase efficiencies
 - M & O Review
 - Administration Review
- DOT/PF lacks a stable and reliable funding source to maintain our transportation system.

Operational and Deferred Maintenance

Maintenance (federal funds are not available for maintenance)

- Operational
 - * snow plowing
 - * pot holes
 - * safety
- Deferred
 - * sealing
 - * ditch cleaning

The DOT/PF priority is operational maintenance. Other maintenance is deferred when revenue is short. Due to the budgetary cycle a funding shortage occurs between May and June each year when the weather is best for maintenance activities.

Examples of deferred facilities maintenance:

- Asphalt surface repairs and ditching virtually eliminated
 - * water table rises causing surface to break-up much faster requiring major reconstruction
- Brush cutting reduced to safety minimum
 - * brush roots will break down sub-base sooner requiring major reconstruction
- Most stock piles of aggregate for patching will be used-up by the end of this summer
 - * because of reduced supplies some areas are trucking remaining aggregate up to 50 miles
- South of Alaska Range where perma-frost a major problem, leveling and patching of frost heaves has been reduced by nearly 80% in the last 5 years
- Asphalt pavement life could be extended by 4+ years by application of an armor coat of asphalt and chips. Funds are not available to provide armor coats. Consequently, major capital projects are required to reconstruct.

HIGHWAY MOTOR FUEL TAX

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 cents per gallon.
- The national median highway fuel tax rate is 21.9 cents per gallon with rates ranging from our 8 cents to Connecticut's 37.9 cents per gallon tax rate. Northwest state average is 22.3 cents per gallon.
- Alaska has the same fuel tax rate as it had in 1961.
- If adjusted for consumer price index (Anchorage) the rate would be 31 cents per gallon today.
- Gasohol was exempted from motor fuel tax in 1980. Gasohol sales were initiated in Anchorage in January 1995 as a measure to stay within compliance with the federal Clean Air Act. There were approximately 30.3 million gallons of gasohol sold during FY 95. Approximately \$2.4 million in revenue would have been generated in FY 95 if gasohol was taxed.

Revenue options

Each \$.01 per gallon of Hwy gas..... \$2 million
Each \$.01 per gallon of Hwy diesel..... \$582 thousand

★ JOE PERKINS - OTHER STATES
↓
TOLL CHARGE ON
AK ROADS?

★ GASOHOL FOR BRIAN
★ LICENCE & REGISTRATION FEES
★ MAF. EXEMPTIONS - FOLLOW UP W PUBLIC SAFETY

HIGHWAYS RELATED REVENUE¹

		(in thousands)		
FY 95 Fuel Taxes Gallons	Rate	Revenue	Revenue per \$.01	
Gas	209,390.4	\$.08	\$16,751.2	\$2,093.9
Off-Hwy Gas	1,922.6	\$.02	\$38.5	\$19.2
Diesel	58,280.8	\$.08	\$4,662.5	\$582.8
Off-Hwy Diesel	132,877.4	\$.02	\$2,657.5	\$1,328.7
FY 95 Est. Gross License/Registration		\$29,110.0		
FY 95 Other Fees (e.g., collections for damages)		\$1,186.5		
Total Highway Related Revenue		\$54,406.2		

HIGHWAYS RELATED EXPENSES

		(in thousands)		Shortfall	Rate/Gal Increase Needed ²
FY 95 Actual M&O Operating Budget	\$59,032.0	\$	4,626.0 ³		\$.02
FY 95 Adjusted from FY 90 base (Anch. CPI & added Lane miles)	\$ 9,788.0	\$	9,788.0		\$.05
Capital M&O/deferred maintenance (5 yr. av.)	\$ 4,609.0	\$	4,609.0		\$.02
Indirect Costs (other budget components)					
Administration	\$10,100.0	\$10,100.0			\$.04
Hwy related Buildings	\$ 3,000.0	\$ 3,000.0			\$.01
Muni Rev Sharing (@ \$1,500) ⁴	\$ 7,280.0	\$ 7,280.0			\$.03
Related Costs:					
• Dept. Revenue					
Collection cost for fuel tax	\$ 200.0	\$ 200.0			\$.00
Increased cost if rate increased	\$ 50.0	\$ 50.0			\$.00
• Dept. Public Safety					
Collection cost license/registration	\$ 8,000.0	\$ 8,000.0			\$.02
Total Highway Expenses	\$102,059.0	\$60,053.0⁵			\$.174
Federal CIP Match (5 yr. av.)	<u>\$20,400.0</u>	\$20,400.0			\$.08

=25.4¢
ADDITION TOTAL
TAX

STATE'S SHARE @ 9% CIP

¹ This chart does not include any revenue or expenses related to the Alaska Marine Highway System

² Using the FY 95 gallons for highway gas and highway diesel only for the \$.01 increase. Increase Needed rounded to whole cents.

³ This number represents the difference between FY 95 Actual and Total Highway Related Revenue

⁴ Full funding to the statutory limit of \$2,500 per mile would be \$13,133.3. FY 95 was funded @ \$922.50 per mile for a total of \$4,447.2. Does not include ice miles.

⁵ Does not include maintenance that has been deferred in the past or that is being deferred beyond the available budget.

AVIATION FUEL TAX

Current Tax Burden

- Jet fuel is taxed at 3.2 cents per gallon and aviation gasoline is taxed at 4.7 cents per gallon.
- Alaska's aviation fuel tax rates were last changed in 1994 when the tax rate for jet fuel increased from 2.5 cents to 3.2 cents and aviation gasoline from 4 cents to 4.7 cents per gallon. The old rates had been in effect since 1968. When the fuel tax rates were increased, a provision in statute restricting the collection of landing fees at rural airports was attached. If landing fees are reimposed, the aviation fuel tax rate will be reduced to the pre-1994 level.
- For those states with fuel taxes the 1994 national median jet fuel tax rate was \$.06 per gallon and for aviation gasoline was \$.03 per gallon with the rates for both ranging from zero in Texas to \$.28 in Rhode Island. Many airports in the U.S. utilize other fees such as landing fees, or a portion of state sales taxes to finance their operations. Additionally, passenger facilities charges (PFC) are charged by many airports to partially fund capital improvements. Alaska does not receive PFCs although all of Alaska's interstate passengers are paying the fee. These funds are currently being paid to lower 48 airports. If PFCs are implemented in Alaska, we would receive a large portion of the PFC currently being collected.
- Fuel used by aircraft travelling to other countries is exempt from taxes. For FY 95, the tax collected would have been \$10 million.

Revenue options

\$.01 per gallon of aviation gas	\$248 thousand
\$.01 per gallon of jet fuel	\$2.6 million

AVIATION RELATED REVENUE¹

(In Thousands)

FY 95 Fuel Taxes	Gallons	Rate	Revenue	Revenue per \$.01
Aviation Gas	24,800.0	\$.047	\$1,117.1	\$248.0
Jet Fuel	260,000.0	\$.032	\$7,356.8	\$2,600.0
Rural Airport Leasing			\$2,400.0	
Total Aviation Related Revenue			\$10,873.9	

AVIATION RELATED EXPENSES

(In Thousands)

		Shortfall (Total Rev. minus)	Rate/Gal ² Increase Needed
FY 95 Actual M&O Operating Budget	\$16,370.0	\$5,496.0	\$.02
FY 95 Adjusted CPI & Lane miles FY 90 base	\$ 2,980.0	\$2,980.0	\$.01
Capital M&O/deferred maintenance (5 yr. av.)	\$ 658.0	\$ 658.0	\$.00
Indirect Costs			
Administration	\$2,900.0	\$2,900.0	\$.01
Buildings	\$ 600.0	\$ 600.0	\$.00
Leasing	\$1,300.0	\$1,300.0	\$.01
Related Costs:			
• Dept. Revenue Collection cost for fuel tax	\$ 50.0	\$ 50.0	\$.00
Total Aviation Expenses	\$24,858.0	\$13,984.0	\$.049

¹ Does not include Fairbanks and Anchorage International Airports

² The rate increase needed is assessed equally against aviation gas and jet fuel. Increase needed is rounded to full cents.

MARINE MOTOR FUEL TAX

Current Tax Burden

- Marine fuel is taxed at 5 cents per gallon. A \$.01 increase would yield \$1.7 million.
- Alaska's marine fuel tax rate was last changed in 1977 when the rate increased from 4 cents per gallon. The old rate had been in effect since 1971.
- If adjusted for Consumer Price Index (Anchorage) the rate would be 15 cents today.
- For years 1994 through 1998, the marine fuel tax rate for residual (bunker) fuel oil sold to cruise ships decreases from 5 cents to 1 cent per gallon after tax collections on bunker fuel exceed \$205,000.

HARBORS RELATED REVENUE

(In Thousands)

<u>FY 95 Fuel Taxes</u>	<u>Gallons</u>	<u>Rate</u>	<u>Revenue</u>	<u>Revenue per \$.01</u>
Marine Gas	8,935.9	\$.05	\$446.8	\$89.3
Off-Hwy Marine Gas	222.5	\$.02	\$4.5	\$2.2
Marine Diesel	127,656.7	\$.05	\$6,382.8	\$1,276.5
Off-Hwy Marine Diesel	2,715.8	\$.02	\$54.3	\$27.1

Total Harbors Related Revenue \$6,888.4

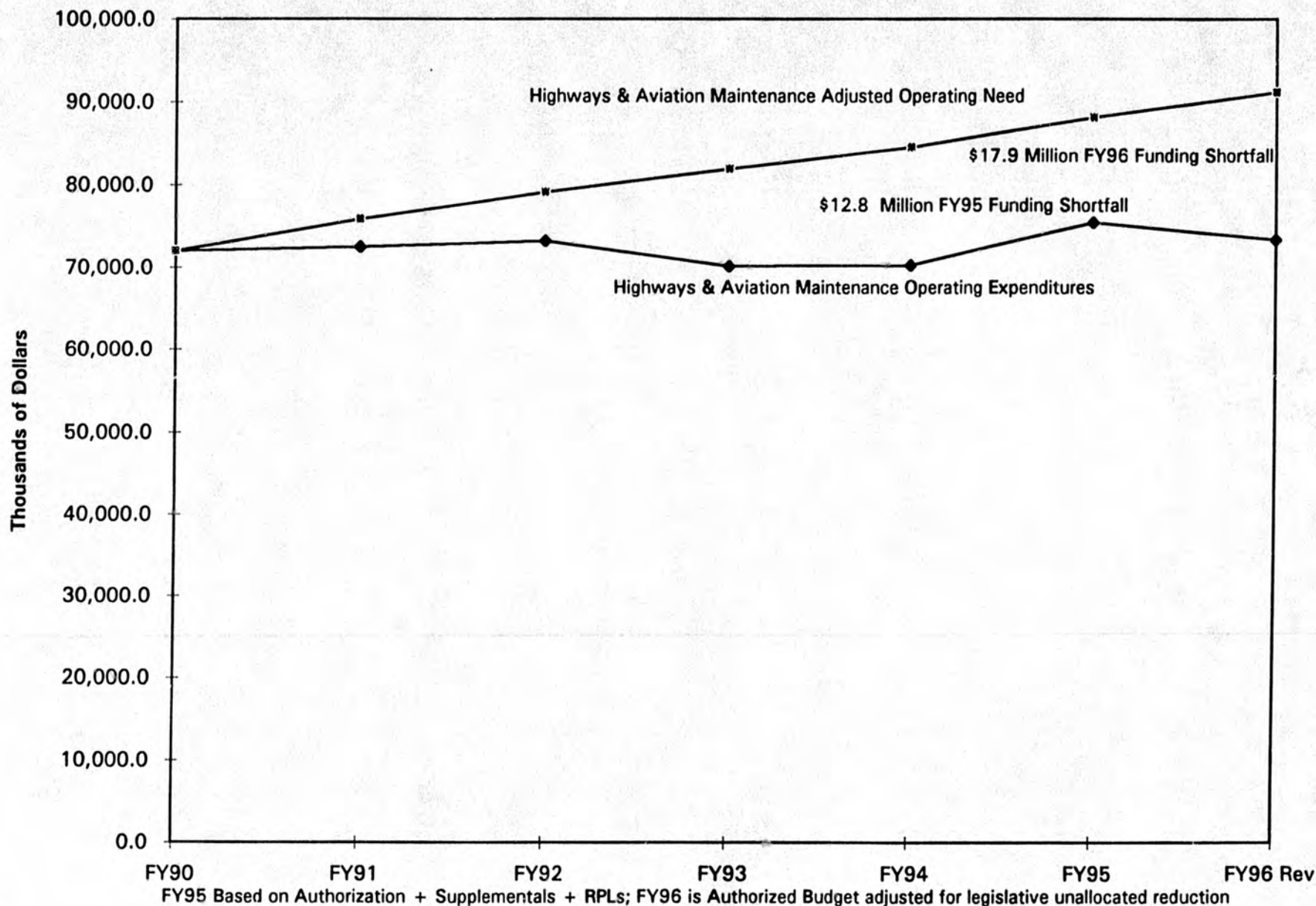
HARBORS RELATED EXPENSES

- The state can not implement a long term structured Harbors Program for maintenance and operations or capital improvements due to funding changes by each legislature. Approximately \$12 million is required each year to provide maintenance, operations and new minor construction
- The State of Alaska owns 80 harbors; 53 of which are operated by individual communities under a management agreement with DOT/PF.
- Approximately \$12 million in fees is collected annually by communities for maintenance and operations. The State does not collect fees for use of the remaining 27 harbors, primarily due to their remote locations.
- Many of the state-owned harbors were built in the early 1960's and are now approaching the end of their useful lives.
- Maintenance of the harbors has historically been deficient, generally occurring as an emergency response or a major capital improvement.
- Corps of Engineers harbor construction programs are slow and being reduced. Construction is limited to breakwater and entrance channel dredging. Proposals in Congress would eliminate all Corps of Engineer maintenance activity except for Anchorage Harbor.

Total Highways & Aviation M&O Operating General Funds							
FISCAL YEAR	ACTUAL EXP \$000'S	HWYS ONLY		Anch CPI % CHANGE from prev year	ADJUSTED NEED adjusted for CPI & lane miles	Shortfall to Equal Level of FY90 Funding	
FY90	72,003.0	LANE MILES			\$ 72,003.0	\$ 0.0	
FY91	72,459.1	12,797		4.5%	\$ 75,841.6	\$ 3,382.5	
FY92	73,191.7	12,895		3.4%	\$ 79,055.0	\$ 5,863.3	
FY93	70,085.6	13,001		3.1%	\$ 81,875.6	\$ 11,790.0	
FY94	70,257.3	13,060		2.1%	\$ 84,562.9	\$ 14,305.6	
FY95	75,402.0	13,206		2.9%	\$ 88,169.4	\$ 12,767.4	
FY96 Re	73,280.3	13,316		2.9%	\$ 91,140.4	\$ 17,860.1	
		13,383					
Highways General Funds (includes Traffic Signal Mgt)							
FISCAL YEAR	ACTUAL EXP \$000'S	HWYS ONLY		Anch CPI % CHANGE from prev year	ADJUSTED NEED adjusted for CPI & lane miles	Shortfall to Equal Level of FY90 Funding	M&O Operating Budget Highways and Aviation
FY90	56,495.7	LANE MILES			\$ 56,495.7	\$ 0.0	Total Need: 91,140.4
FY91	58,478.7	12,797		4.5%	\$ 59,507.7	\$ 1,029.0	FY96 Authorized: 73,280.3
FY92	56,170.8	12,895		3.4%	\$ 62,029.0	\$ 5,858.2	Total Shortfall: 17,860.1
FY93	55,260.9	13,001		3.1%	\$ 64,242.1	\$ 8,981.2	
FY94	55,354.1	13,060		2.1%	\$ 66,350.6	\$ 10,996.5	
FY95	59,031.9	13,206		2.9%	\$ 68,819.5	\$ 9,787.6	
FY96 Re	57,184.1	13,316		2.9%	\$ 71,150.6	\$ 13,966.5	
		13,383					
Aviation General Funds							
FISCAL YEAR	ACTUAL EXP \$000'S	HWYS ONLY		Anch CPI % CHANGE from prev year	ADJUSTED NEED adjusted for CPI & lane miles	Shortfall to Equal Level of FY90 Funding	
FY90	15,507.3	LANE MILES			\$ 15,507.3	\$ 0.0	
FY91	13,980.4	12,797		4.5%	\$ 16,334.0	\$ 2,353.6	
FY92	17,020.9	12,895		3.4%	\$ 17,026.1	\$ 5.2	
FY93	14,824.7	13,001		3.1%	\$ 17,633.5	\$ 2,808.8	
FY94	14,903.2	13,060		2.1%	\$ 18,212.3	\$ 3,309.0	
FY95	16,370.1	13,206		2.9%	\$ 19,350.0	\$ 2,979.8	
FY96 Re	16,096.2	13,316		2.9%	\$ 19,989.8	\$ 3,893.6	
		13,383					
- Need to Equal FY90 Level of Funding is FY90 Actual Expenditures adjusted by the Anchorage Consumer Price Index and the % Increase in Area Maintained as measured by increased lane miles of highways.							
- Based on Actual Expenditures (not Authorized) except FY95 Actual Expenditures not available as of 8/2/95, so authorization + RPLs + supplementals is utilized. FY96 Rev utilized authorized budget adjusted by leg. unallocated reduction + anticipated program receipts for Sitka Airport.							
- FY95 & FY96 Need further adjusted to reflect the new responsibility of Sitka Airport.							

Highways & Aviation Comparison of Maintenance Actual Expenditures to Adjusted Need *

*Need Based on FY90 Actuals Adjusted by Anchorage CPI and % Increase Area Maintained



Fax to Melissa Fouse
Fax 258-9869

Long Range Fiscal Planning Commission

4

Dear Members of the Commission,

During my testimony to the Commission on August 11, 1995 several questions were asked concerning subjects which I ~~did~~ could not provide answers. ~~At~~ I would like to provide the following information concerning those ^{unanswered} questions:

Question: What taxes are charged by other states for Gasohol?

Answer:

Question: How ~~do other states compare~~ does Alaska compare with other states on license fees?

Answer:

+ REGISTRATION

Question: ~~Of the roads maintained by the DA~~ What percent of the roads maintained by the department can be considered "local" roads?

Answer:

Question: Can the Department change tolls on our highways?

Answer:

Question: ~~What is~~ How does Alaska's ~~with~~ without fuel tax rate compare with other States?

Answer:

I enjoyed testifying before the Commission and if any other
information concerning the Department please contact me at 465-3901.

J. R.

Department of Transportation & Public Facilities
Commissioner's Office
Voice Telephone: (907) 465-3900
Text Telephone: (907) 465-3652
Fax Number: (907) 586-8365

FAX

TO: Melissa Fouse

Phone: _____

FROM: Joe Perkins

Phone: _____

Number of Pages (Including this Cover Sheet): 3

Comments:

Alaska's Growing Fiscal Gap

**The Preliminary Report
of the
State of Alaska
Long-Range Financial Planning Commission**

August 10, 1995

The State of Alaska 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. It consists of 15 Alaskans, five each appointed by the Governor, the Speaker of the house, and the President of the Senate.

We were asked to

1) examine the size of the "fiscal gap" - the difference between the State's revenues and expenditures - for a ten-year period,

2) to look for budget reductions and revenue increases,

3) to examine the budget process,

4) to consider the impacts of changes on local governments, and

5) to hear from the public about the choices Alaskans face.

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 the Alaska public to let us know what you think is a long-term sustainable state revenue strategy which balances the needs for state services with the limited resources available to Alaska.

After hearing from you, on October 1, 1995 we will make our recommendations to the Legislature, the Governor, and the people of Alaska.

Brian Rogers, Chair
Fairbanks

Judy Brady, Vice Chair
Anchorage

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Anchorage

Marie Westfall
Ketchikan

Alaska's Growing Fiscal Gap

The Preliminary Report of the State of Alaska Long-Range Financial Planning Commission

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Appendix 1: Catalog of fiscal choices to close the fiscal gap

Part 1: Spending Cuts

Spending Reflects Public Policy Choices

Basic Principles

The Charge: Cut \$513 Million

Four Scenarios

Part 2: Revenues

New Taxes

Existing Taxes

Service & User Fees

Excise Taxes

Part 3: The Permanent Fund

Allocation Issues

Four Scenarios

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Part 5: State Assets and Reserves

Fiscal Instability

Reserves Policy

Why Do We Need Reserves?

Enterprise Funds

Corporations & Foundations

Loan Programs

Miscellaneous

Appendix 2: The Budget Process

Appendix 3: Resolution Creating the Commission

The fiscal gap is real, and it's growing.

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

This year, we estimate the state will spend \$513 million more than it takes in - this is the fiscal gap. Over the next ten years, this gap will grow. Based on the assumptions adopted by the Commission, we believe it will grow to over \$1.3 billion by 2000 unless the state takes corrective action.

State spending has been reduced by 5 percent per year for the past five years (in inflation adjusted terms). The legislature, the governor, and state agencies have worked to close the gap by cutting expenditures and holding the line on the growth of expenditures. The fiscal gap exists in spite of these efforts.

These efforts have not been enough to offset the decline in revenues. However, without this steady attention to reducing expenditures, Alaskans may have faced drastic reductions in services and programs, loss of the permanent fund or significant new taxes.

Alaska has significant oil reserves and a growing Permanent Fund. We have a Constitutional Budget Reserve fund established to minimize the effect of declining revenues, but that fund and other savings accounts are being spent at a rapid rate. The Constitutional Budget Reserve will be exhausted in five years if we do nothing. Other reserves will be depleted shortly thereafter.

Why does the fiscal gap exist?

Dependence upon non-sustainable revenue sources and declining oil production

There are two primary reasons for the fiscal gap. First, Alaska bases its budget on non-sustainable revenue sources. We count on reserves to fund a budget larger than we can afford in the long term. Second, there is a rapid decline in Prudhoe Bay oil production. The State of Alaska depends upon oil & gas revenues for half its income (80% if we exclude Permanent Fund earnings). The decline in production brings a decline in state revenues.

At Statehood, Congress endowed Alaska with a substantial land base, including underlying oil and gas resources such as Prudhoe Bay. The state instituted methods by which oil companies may bid on the production of Alaskan oil and that oil began to flow through the Trans-Alaska Pipeline System (TAPS) in 1977.

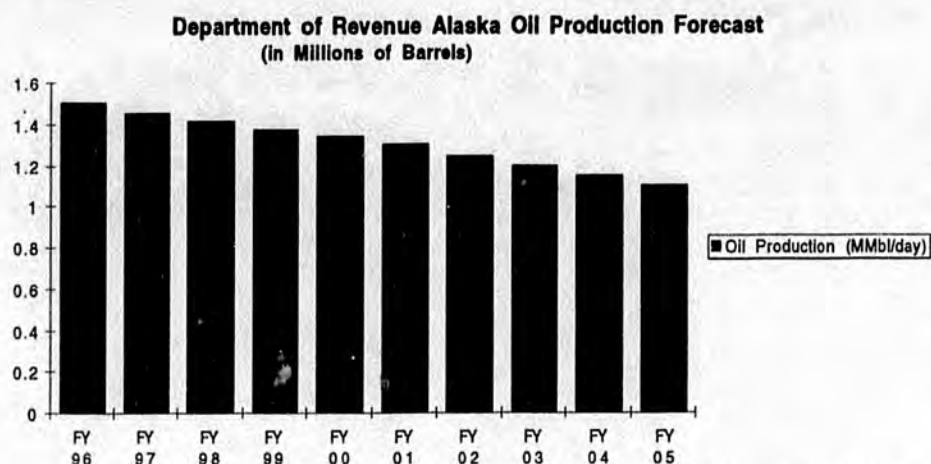
By 1979, after the OPEC price hikes, Alaska received such large amounts of revenue from royalties and taxes that the state abandoned most of its more traditional methods of obtaining revenue.

Oil prices peaked in 1980 and began a steady decline. The abrupt fall in 1986, and the dramatic cut in state and oil industry spending contributed to the 1986-1989 Alaska recession. Even so, Alaskans seemed to rely on the probability of a rebound in oil prices than to address the problem of the state's dependence on a declining revenue source.

Alaskans have known all along that oil revenues were finite. Prudhoe Bay production peaked in 1988. North Slope oil production rates started falling in 1991 and will continue to do so until the fields are no longer economical to produce. Potential new fields are unlikely to replace the loss in production from the North Slope.

The chart below shows the current forecast of oil production in Alaska with the following assumptions:

barrel change in oil prices causes a \$120 million shift in state revenues.



Source: Spring 95 DOR

- There is little probability of oil production from ANWR during the next ten years, regardless of whether ANWR is opened for exploration or how much of the oil that may be discovered there is commercially recoverable.

- Some production from currently marginal fields is included. While there may be some additional production from fields not listed, we follow the Department of Revenue projections as the best currently available.

- No production of North Slope natural gas is included; production is currently not expected before 2005.

Fiscal Instability

The volatility of Alaska's revenues complicates the fiscal gap by creating fiscal instability. Fiscal instability is the roller-coaster ride caused by unpredictable oil price fluctuations (from a low of \$8 per barrel to a high of \$32 per barrel in the past 15 years), and the resulting ups and downs in expected state revenue flows. At today's oil production rates, each \$1 per

upwards by rising prices.

When the roller coaster heads downhill, people get anxious. Fiscal disaster seems just around the corner, and everyone agrees that there is an urgent need to fix the problems caused by the fiscal gap. When oil prices and the roller coaster swing upwards, however, the fiscal gap suddenly looks farther away, and less threatening, and 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 twin trends of declining revenues due to diminishing production and increasing expenditures due to increasing population combine to increase our fiscal problems each year in the foreseeable future.

The "moving target" aspect of the fiscal gap problem makes it more difficult to fix, because we don't know how large the gap may actually turn out to be, or how much time we have to fix it.

It's time to get off the roller coaster.

One could consider the fiscal gap as the distance from the roller coaster to the ground. The fiscal gap looks closer, and more ominous, when the roller coaster is whipsawed downward by falling oil prices. By contrast, it looks farther away and less threatening when the roller coaster is whipsawed

How big is the fiscal gap?

The fiscal gap this year is \$513 million.

Alaska will take in \$3.2 billion this year from petroleum revenues, other taxes and user fees, and permanent fund net income. We will spend or transfer \$3.7 billion for agency operations, formula programs, debt service, Permanent Fund dividends, inflation-proofing, and the earnings reserve.

This fiscal gap is a significant portion of the state budget.

- It is equal to all of the salaries and benefits paid to all state agency employees.

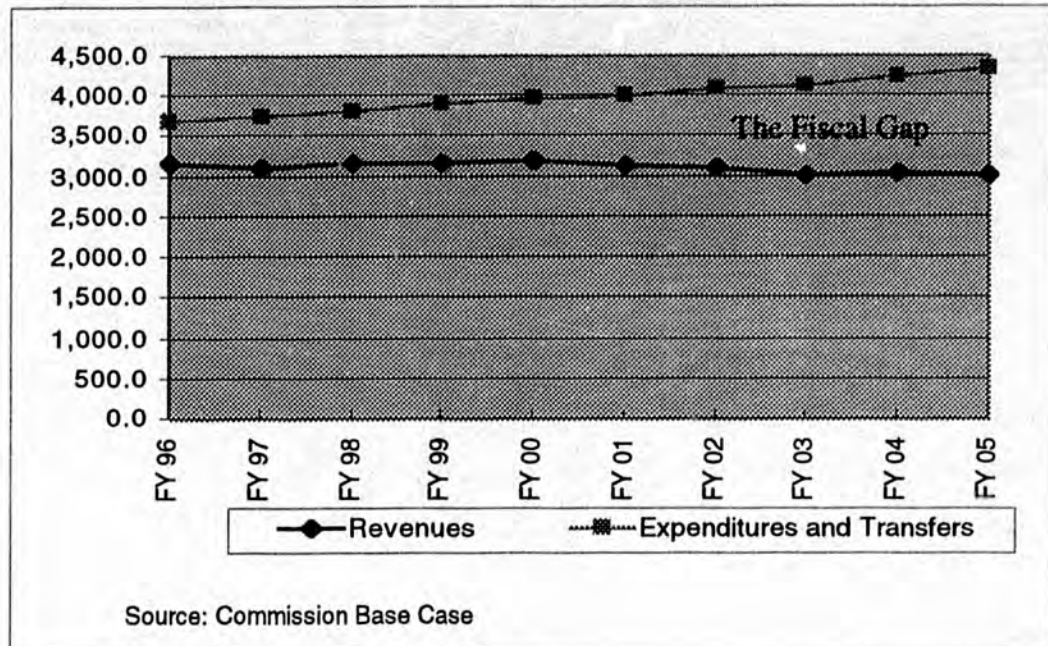
- It is almost as much as the whole Permanent Fund dividend program;

- It is three-quarters of the entire K-12 public school funding program.

The fiscal gap will widen to over \$1.3 billion (current dollars) in the next 10 years if no changes are made to state spending and revenues. The Commission developed a "base case" to predict revenue and project spending.

The Commission adopted the following assumptions in order to reach this estimate of the fiscal gap.

Alaska's Growing Fiscal Gap (\$ Millions)



- All projections are in FY96 dollars. In reality, there will be inflation, which affects both revenues (from taxes and investment income) and expenditures.

- Population will grow 1.6% per year (compounded) as estimated by the Alaska Department of Labor.

- Absent a change in state policy

- The state's formula programs, except education formula spending, will grow at this rate of population growth.

- Education formula spending will grow at the projected student population growth rate of 2-1/2 %.

- State agency expenditures will increase at one-half of the rate of population growth.

- Department of Revenue state revenue projections as of March 1995 are reasonable for the purposes of calculating

the fiscal gap. New projections of revenues are developed on a regular basis, and may result in changes to the fiscal gap, but the scale of the gap is unlikely to change significantly.

- Estimates of Permanent Fund income and dividends developed by Commission staff based on earlier work by the Alaska Permanent Fund Corporation are reasonable for our purposes.

- \$50 million will be available annually to the state as a dividend from Alaska Housing Finance Corporation income, as provided in the agreement between AHFC and the Governor.

- The base case does not include new revenues from ANWR nor increased revenues due to repeal of the oil export ban (congressional action is imminent on the oil export ban. Projected revenues from repeal are shown in economic development section.)

- These projections assume federal assistance to the State of Alaska will not change. We expect current Congressional action will result in substantial cost-shifting from the federal to the state budget.

- All revenues that can be spent are considered available for expenditure or other disposition. Thus, Permanent Fund earnings are included in the unified budget, although changes to use of earnings are not.

- 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 uses the CBR to fill the gap each year.

- The approximately \$567 million in federal and other funds received and expended by the state are not shown, since most cannot be used to close the gap.

These assumptions are debatable. Nonetheless, any reasonable set of assumptions will show there is a significant fiscal gap, and the fiscal gap will grow absent action by the State.

What can be done to close the fiscal gap?

The commission is considering six categories of fiscal choices, some or all of which can be used in combination:

- **Cut spending**
- **Use reserves and other state assets**
- **Raise revenues through economic development**
- **Raise taxes and user fees**
- **Use Permanent Fund income**
- **Increase oil production from new or existing fields**

For the last five years, the State has used pieces of all six fiscal 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, minerals, fishing, and tourism.

But the size of the problem continues to grow, primarily due to formula programs that are driven by population growth and the decline in North Slope oil production.

Each of these fiscal 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.

For this initial report, the Commission has compiled a "catalog" of fiscal

choices, which are contained in Appendix Two.

The first part of the appendix contains four scenarios for making budget reductions equivalent to the current fiscal gap. The second analyzes options for raising revenues through new taxes, increases to existing taxes, user fees and excise taxes.

The third discusses use of Permanent Fund income to support government operations and transfers. The fourth reviews state income opportunities from economic development. The final section covers reserves and state assets and opportunities for budget stabilization.

The Commission is not at this time endorsing any specific recommendations, but expects to make its recommendations from among the choices listed in the appendix, supplemented by any ideas which come out in public hearings.

How much does the state spend now?

The FY96 state budget calls for spending or placing in reserves \$3.7 billion in general funds and permanent fund income as follows:

•\$1,157,800,000 for state agency GF operations (excluding formula programs):

\$195 million	Health & Social Services
167 million	University of Alaska
130 million	Corrections
130 million	Transportation and Public Facilities
85 million	Public Safety
75 million	Administration
46 million	Courts
43 million	Natural Resources
41 million	Fish & Game

37 million	Commerce and Economic Development
31 million	Legislature
31 million	Community & Regional Affairs
31 million	Education
20 million	Law (plus \$16.8 million from the CBR)
18 million	Environmental Conservation
15 million	Governor
12 million	Revenue
9 million	Labor
6 million	Military & Veterans Affairs

•\$1,488,000,000 for GF Formula Programs and other expenditures:

\$660 million	K-12 education
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	Miscellaneous, Leases, Power Cost Equalization
109 million	Debt service (including \$83 million school debt)
116 million	Capital projects
19 million	Loan programs/Transfers
20 million	Supplemental appropriations for emergencies and court judgments

•\$1,218,000,000 for Permanent Fund Allocations:

\$575 million	Permanent Fund dividends
441 million	Permanent Fund inflation-proofing
202 million	Transfer to PF Earnings Reserve

In addition the state receives approximately \$567 million in federal and other funds. The receipt and expenditure of these funds has no effect on the fiscal gap.

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

How has state spending changed?

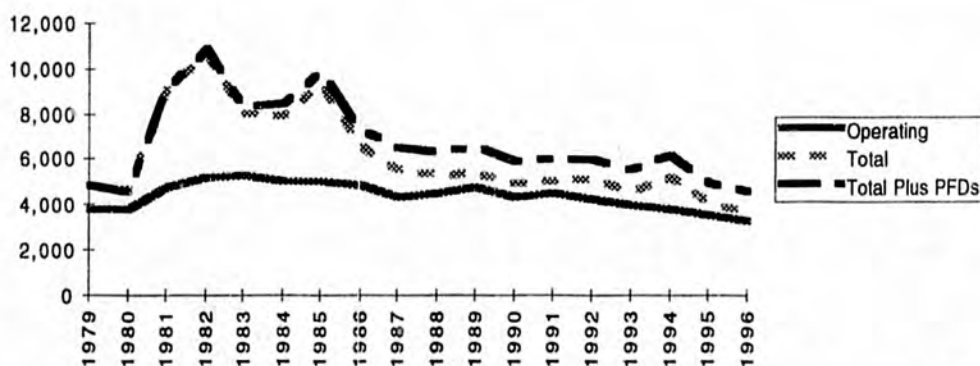
The Commission examined the major growth areas of the state budget. We used FY79 as a starting point, because it was the first full year of petroleum revenues from TAPS and the last state budget prepared before the tripling of state oil

revenues. The bottom chart shows that the largest increases in the 1980's were for capital spending and Permanent Fund Dividends. Operating budgets have been relatively flat.

Alaska's population has grown 52 percent since 1979. Unlike other states, the state's revenues do not grow as population grows. While the overall budget has grown, real

Base Case Summary (millions of \$FY96)			
	FY96	FY00	FY05
Revenues:			
Petroleum	\$ 1,553.4	\$ 1,546.2	\$ 1,253.1
Other sources	221.3	194.7	174.8
Permanent Fund	1,218.0	1,372.7	1,530.2
Other	<u>180.1</u>	<u>79.6</u>	<u>68.0</u>
TOTAL	\$ 3,172.8	\$ 3,208.3	\$ 3,074.9
Expenditures and Transfers:			
Agency operations	\$ 1,157.8	\$ 1,270.4	\$ 1,403.9
K-12 education	660.3	728.8	824.6
Other formula programs	413.8	427.2	444.6
Debt service	109.4	44.9	10.9
Capital	116.1	116.1	116.1
Loans	18.7	22.9	23.9
Permanent Fund dividends	575.0	632.0	724.1
Transfers:			
PF Inflation-proofing	441.0	482.6	516.3
PF Earnings reserve	<u>202.0</u>	<u>258.1</u>	<u>289.8</u>
TOTAL	\$ 3,694.1	\$ 3,954.7	\$ 4,325.6
Required Maintenance	0.0	71.1	71.1
The Fiscal Gap	(513.0)	(861.0)	(1,399.1)

Real Per Capita Spending FY 79 - 96



Source: OMB

base case

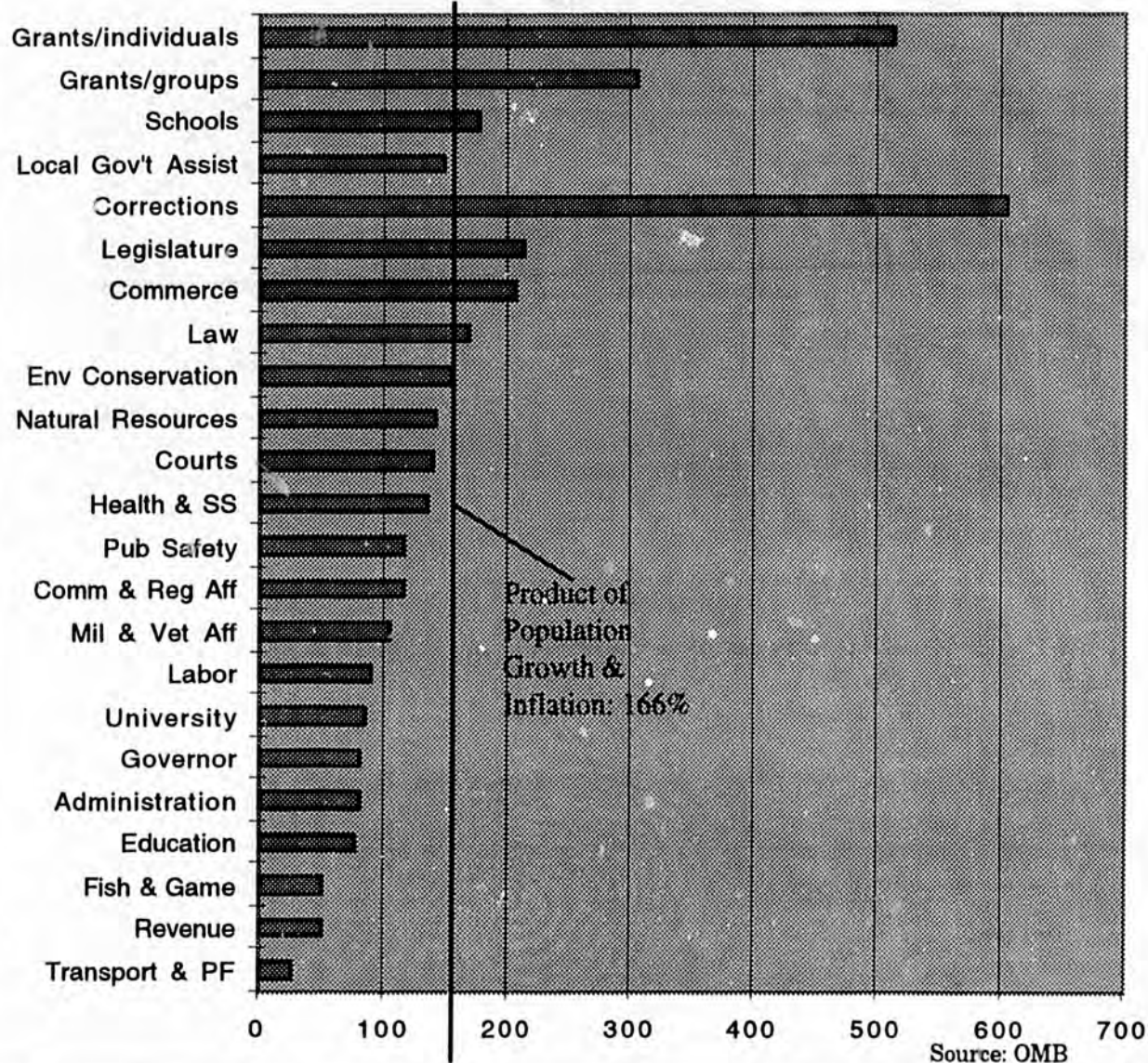
**FY1979 to 96 General Fund
Budget Comparisons
(million \$)**

	1979	1996	% Increase
University	\$89.6	\$167.3	87.2%
Core State Government	\$445.5	\$875.9	97.0%
Local Government Aid	\$37.5	\$92.8	147.0%
Grants to Schools	\$269.3	\$740.6	174.9%
Grants to Groups	\$35.8	\$144.8	305.0%
Grants to Individuals	\$56.9	\$349.4	514.0%
Total	\$935.7	\$2,371.0	153.0%
Consumer Price Index	77.6%	135.8%	75.0%
Population	398,000	606,300	52.3%
CPI * Population	N/A	N/A	166.0%

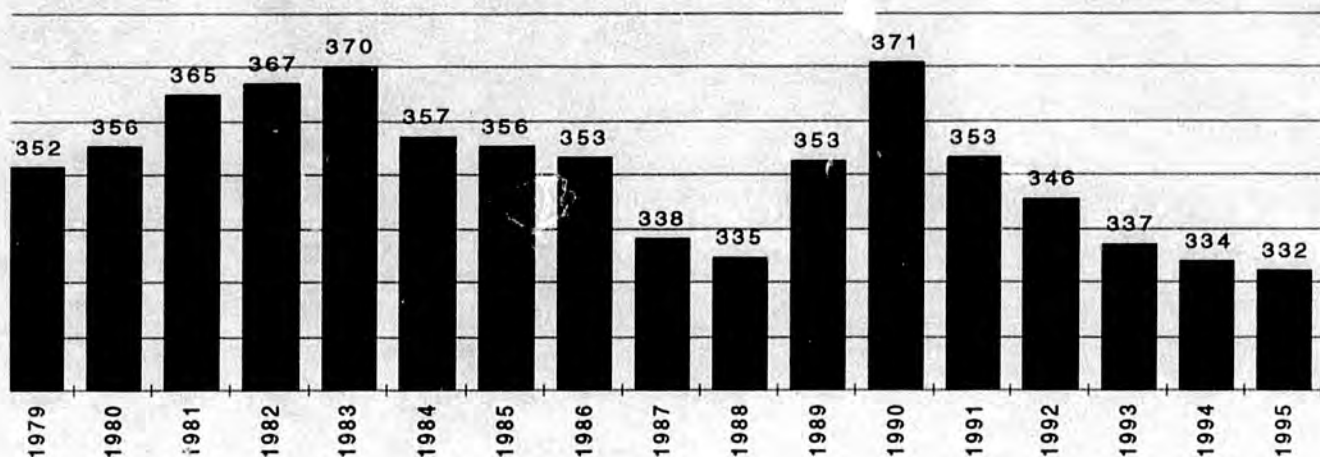
Source: OMB

Growth of State Government: FY79 to FY96

Percentage Changes



State Employees Per 10,000 Population



Source: OMB

per capita spending is at the same level as it was in 1979.

The table at the top of page 8 shows expenditure growth by category. 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%) (not including permanent fund dividends) grants to groups (334%), grants to schools (175%) and local government assistance (165%).

The figure at the bottom of page 8 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%). The largest dollar increases were for the University, Transportation and Public Facilities, Health and Social Services, and Corrections.

Projections for future years show that the biggest areas of spending growth will be formula grants to individuals, groups, and schools, and the corrections and criminal justice budgets.

Emphasis in public discussions and in the legislature has been on cuts to state spending. Some programs have been eliminated or downsized and other programs serve more people with the same amount of money.

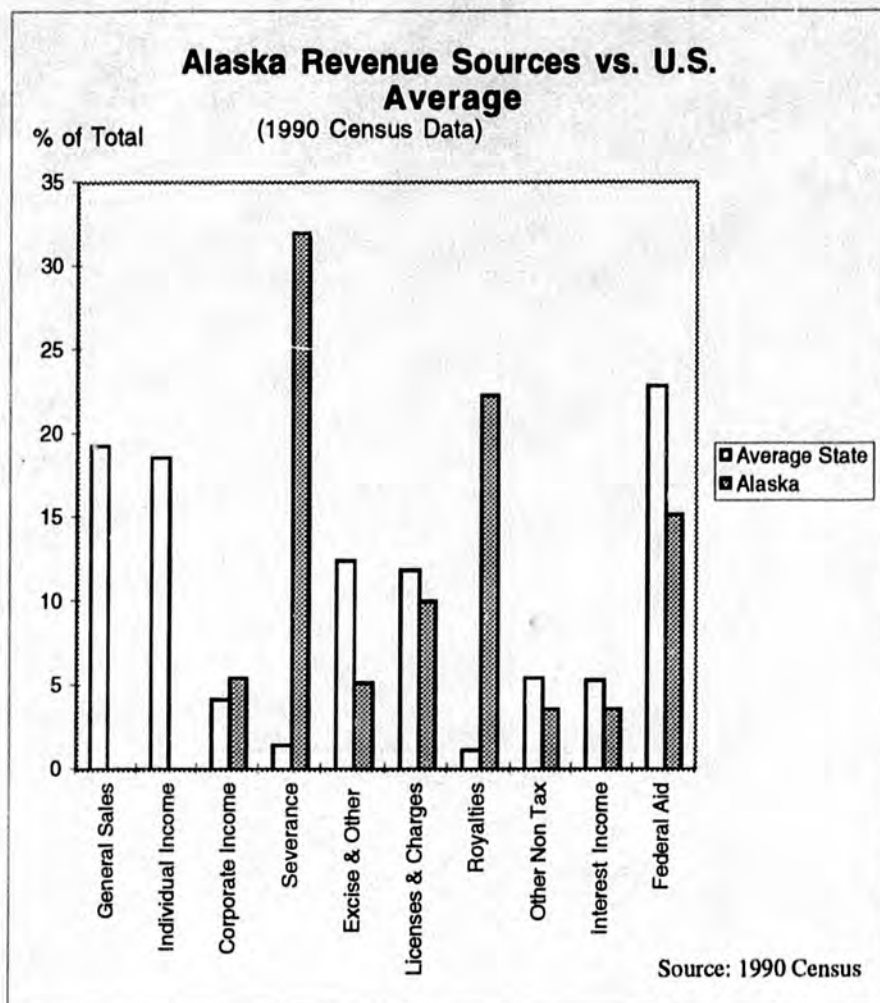
The number of state employees per capita is at a 15-year low.

The operating budget has been cut over 25% in the past five years on an inflation-adjusted basis.

Even before the oil years, Alaska spent nearly three times the national average per capita of other states to provide public services. In the 1980s this ratio increased to four times the national average. It has since declined to about the same as Fiscal Year 1979.

Nonetheless, even excluding Permanent Fund Dividends, Alaska spends more than twice as much per capita as the national average.

Part of this might be due to Alaska's size and geographic isolation from other states. In part, because of the wealth of the State in the early 1980s, Alaskans came to expect a higher level of services.



We will receive \$1.5 billion from petroleum revenues, \$1.2 billion from permanent fund income (including the \$441 million reserved for inflation-proofing), and \$480 million from other sources. In addition to the \$3.2 billion dollars in general fund and permanent fund revenue, the state also receives and expends federal funds and other funds derived from revenue generating activities.

The major sources of revenue to the state are oil and gas rents, royalties and bonuses, oil and gas property's tax, severance taxes; and corporate income taxes. The state has a number of small sources of revenue, gener-

ally excise taxes or charges and fees for services that annually generate approximately \$125 million. These revenues are paid into the general fund.

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 are primarily state-provided in Alaska, while these services are local in other jurisdictions. Some expenditures like the Longevity Bonus and Permanent Fund Dividends are unique to Alaska.

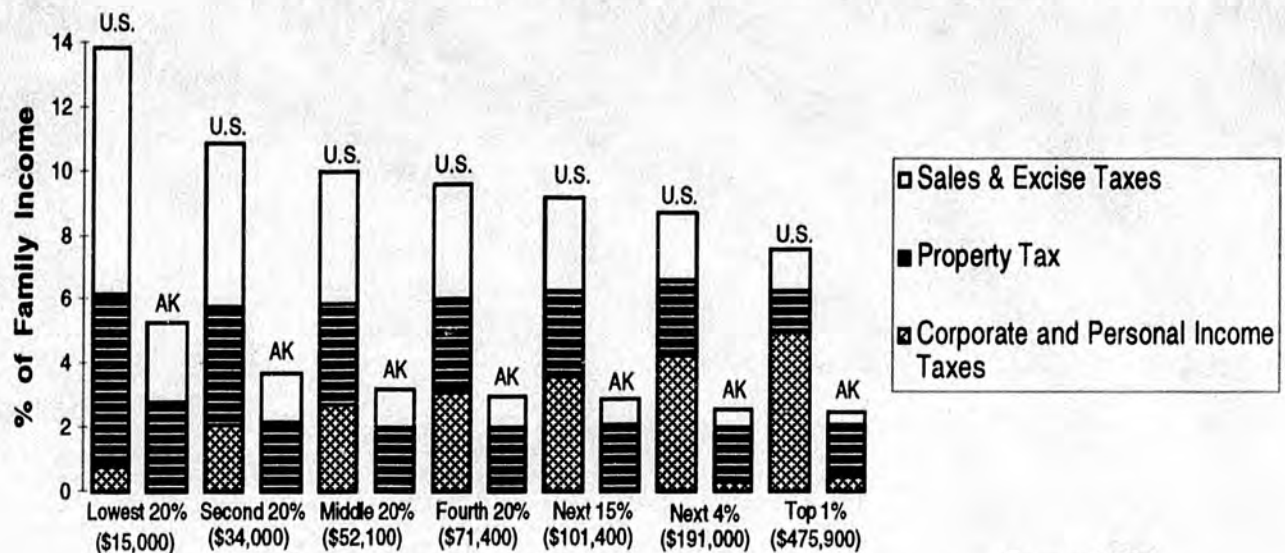
How much revenue does the State of Alaska receive?

The State of Alaska will receive \$3.2 billion in general fund revenues and permanent fund earnings during FY96.

Other revenues, such as interest on the Four-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 are not considered part of general fund revenues.

The Constitution directs the earnings of the Alaska Permanent Fund to be deposited into the General Fund unless otherwise provided by law. The Legislature has not treated those earnings as available for appropriation in the same sense as tax receipts and the earnings remain in the reserve account until appropriated for dividends or inflation-proofing.

1991 State and Local Taxes: U.S. Average vs. Alaska as Shares of income of a Family of Four



Source: OMB

The Commission examined other states' revenues not used by Alaska. Most prominent among these 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 however, the state funds certain programs, notably education, that are traditionally considered to be a local responsibility. This chart compares Alaska's revenue sources with those of an average state in 1990.

How do Alaska's revenues compare with other states?

Alaskans pay approximately a third of the state and local taxes paid by the average American.

The chart at the top of this page compares taxes on the average Alaskan family with those paid by the average American family. It does not take into

account payments to households under the Alaska Permanent Fund dividend program, which more than offsets the combined state and local tax burden for most families.

The two charts on the next page 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 pays significantly less in taxes than a similar family in Seattle WA or Billings MT.

How large are the State's cash reserves?

Alaska is fortunate to have over \$3 billion in cash reserve funds

These substantial reserves constitute one of the primary fiscal tools the state can, and has used, to temporarily fill the fiscal gap. However, these large reserve balances also have a negative side, in that the use of these reserves can delay for several more years the difficult actions

What is the annual tax burden for a family of four with a gross income of \$50,000 and a typical house for that income?

	Anchorage	Seattle	Billings
Pers. Inc. Tax	\$ 0	\$ 0	\$2,108
Property Tax	\$ 1,421	\$1,691	\$1,423
Sales Tax	\$ 0	\$ 998	\$ 0
Car Taxes	\$ 93	\$ 538	\$ 493
PermFundDiv.	(\$3,932)	\$ 0	\$ 0
TOTAL	(\$2,418)	\$3,227	\$4,024

What is the annual tax burden for a family of four with a gross income of \$100,000 and a typical house for this income?

	Anchorage	Seattle	Billings
Pers. Inc. Tax	\$ 0	\$ 0	\$5,418
Property Tax	\$ 2,700	\$ 3,214	\$2,703
Sales Tax	\$ 0	\$ 1,966	\$ 0
Car Taxes	\$ 158	\$ 1,311	\$1,192
PermFund Div	\$ (3,932)	\$ 0	\$ 0
TOTAL	\$ (1,074)	\$ 6,520	\$9,314

necessary to close the fiscal gap, with the potential for suddenly magnifying the state's fiscal and economic problems when the reserves are finally exhausted.

Economic Impacts of Fiscal Choices

Any fiscal choice made will have an adverse impact on Alaska's economy. Failure to make fiscal choices will have a worse impact on Alaska's economy when reserves run out.

For each \$100 million per year removed from Alaska's economy, the gross economic effect is similar 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 or region of the state, 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.

The study compared some special effects from these three choices, including the "federal tax offset" and "tax exporting."

The federal tax offset recognizes that any action that affects personal incomes of Alaskans changes the

federal tax liability for Alaskans. The federal tax offset was largest for reimposition of the personal impact tax; approximately 20% of the increase in state taxes becomes a decrease in federal taxes. Approximately 15% of a decrease in permanent fund dividend payments would be offset by a decrease in federal taxes paid by Alaskans. Cutting state spending has some federal tax offset, since a portion of state employees' salaries are paid in federal income taxes, but it is difficult to estimate that tax offset.

"Tax exporting" refers to that 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 Alaska residents). A sales tax has a

* Raw Fish Tax - DOUBLED, $\frac{1}{2}$ of orig. back to
muni (new total)
check USE 380M (NOTE TO LOOK AT) → POLICY ANALYSIS RE FISH TAXING
* Road - incremental difference highway motor LANDING
fuel tax *
✓ DOR

- NOTE STATUTE, ETC + SOURCE

* ON TABLE: LIQUOR Dispensary Licenses

RUN FIGURES OUT TO 210

SCHOOL TAX - ON HOLD

SHOW PFBALANCE + EARNINGS RESERVE

OTHER FUNDS:

DISCUSSION

RIEDEL: DONT affect gap

DEBTSIC: LEVEL OR DECREASE

MOTOR FUELS Tax: use to close gap or use for
maintenance

BASE CASES

- List of commonalities
- Footnote differences / reason + philosophy
- total

↑ DO BY MON

TELECONF w/ chores assignments

- 13th 20th ~~EMER~~ RIVER COFC MIKE NAVEGEE will do

Navare: Sept 30th Kenai Chapter:

Beady + O'Connor

Ⓟ Include DOR "WHY WE HAVEN'T
CRASHED"