

ALASKA LEGISLATURE SPECIAL COMMITTEE/SUBJECT FILES 8672

2385 SCOMM 101 LONG RANGE FINANCIAL PLANNING COMMISSION, 1995

SCOMM

101:17

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 Report*

cc:Mail for: Melissa Fouse

Subject: Re[2]: LRFPC info on the net?
From: Representative John Davies 7/18/95 12:34 PM
To: Melissa Fouse at LAA_ANC

Dear Melissa:

Thanks for your prompt reply. I'm pleased that you're planning to get onto the net as much as possible. (Eventhough the Legislature is not yet able to access the internet except thru ccMail.) I suggest that you give legislators a briefing as soon as possible with a simple packet of overhead transparencies that would allow them to give briefings to their constituents. Thus the legislators would become educated in the "facts" (as you set them out) and could appear as experts to their constituents as they relay the facts to them.

I would like a short (five, or so) list of the most useful documents which you and the commission have found that lay out the problem and give the options available for solving it. Have you read Tim Bradner's articles in the Summer '95 "Juneau Report" by BP? Any comments? Thanks.

Cheers, Rep. John D.

DEAR REP JOHN D.

Yes we met July 14th & 15th. There will be a meeting summary (soon, I promise) and yes it is my intention to post same on the bulletin board. There are two giant files full of basic documents of which we are preparing an index even as I write. I will post the index on the BB, with the caveat that only some of them are available through the commission office, others are available from the agencies.

We do plan to get as much into the internet as we can. We are now, or are about to be, hooked up to the world wide web (no one here but us arachnids) and once we get it figured out hope to be able to get the report, which should be done about the first week of August, onto a place from which it can be downloaded. It is running to about 30 pages now and has a number of pieces still missing.

Brian & I are discussing ways to summarize it so that it gets a wider readership, both in hard copy & on-line.

Have you any hot suggestions?

What can I send you now?

Melissa



UNIVERSITY OF ALASKA ANCHORAGE

3211 Providence Drive
Anchorage, Alaska 99508

SCHOOL OF PUBLIC AFFAIRS

ECONOMICS DEPARTMENT
(907) 786-1770 FAX (907) 786-7739

June 29, 1995

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

Dear Melissa:

I have enclosed an extra copy of the article I wrote with Dwight Lee.

Sincerely,

A handwritten signature in cursive script, appearing to read "Steve".

Stephen L. Jackstadt
Professor of Economics

enclosure
SLJ:ds

STATE OF ALASKA

DEPARTMENT OF REVENUE

TONY KNOWLES, GOVERNOR

INCOME AND EXCISE AUDIT
P. O. BOX 110420
JUNEAU, AK 99811-0420
FAX: (907) 465-2375

April 24, 1995

Esther Creech
7040 Abbott Loop Road
Anchorage, AK 99507

Dear Ms. Creech:

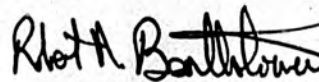
I am responding to your letter to Governor Knowles about creating jobs and making Alaska a business-friendly state. Your letter was referred to the Department of Revenue because you suggested that the state should use the personal income tax as a means of encouraging that jobs in Alaska go to Alaskans and collecting revenue from nonresidents working in Alaska.

As you may be aware, the Governor and legislature formed the Long Range Financial Planning Commission (LRFPC) which is looking at the individual income tax among other sources of revenue in planning Alaska's fiscal future. I will forward a copy of your letter to the Commission for their files on individual income tax. If you wish to correspond directly with the Commission, you may do so at 258-8170 or the following address:

Long Range Financial Planning Commission
716 West 4th Suite 380
Anchorage, AK 99501

If I can be of any further assistance, please feel free to contact me at the address above or 465-2320.

Sincerely,



Robert N. Bartholomew
Deputy Director
Income and Excise Audit Division

cc: Wilson Condon, Commissioner
Melissa Foust, LRFPC—

OFFICE OF THE GOVERNOR
STATE OF ALASKA

April 13, 1995

ROUTE TO:
DEPARTMENT OF REVENUE
ATTN: CTS SECRETARY

RECEIVED
ALASKA DEPARTMENT OF REVENUE

APR 17 1995

COMMISSIONER'S OFFICE

Name Code: CREEE Title:

First: Esther

MI:

Last: Creech

Credential:

Salutation:

Company:

Jobtitle:

Address: 7040 Abbott Loop Road

City: Anchorage
State: AK Zip: 99507

Foreign:

Comment	Tp	DP	Stf	Issue Code	Due	Resp.	CTS #
Personal income tax	RD	04	BPH	0404	05/02/95	/ /	95103016

D+E

Kurd RBV

7040 Abbott Loop Rd.
Anchorage, AK 99507
(907) 344 3953
March 8, 1995

Governor Tony Knowles
P.O. Box 110001
Juneau, Alaska 99811

RECEIVED
GOVERNOR'S OFFICE

Dear Governor Knowles:

After years of hearing aspiring politicians talk about "creating jobs" (government jobs, no doubt), you seem to be on the right track in working to make Alaska a business-friendly state.

One area of concern, however, about which I am skeptical that Alaskans may not benefit as much as we would like is the increasing tendency for Alyeska and the oil companies to contract more of the work. The contractors have chosen shifts of 2 to 4 weeks on, 2 off. Outsiders are delighted. The same old story: make your bundle in Alaska and leave.

One example concerns a segment of work just recently awarded to a contractor. The contractor immediately terminated 2 skilled and qualified Alaskans, then promptly replaced them with two from Louisiana...no more qualified than the Alaskans, just cheaper.

We need jobs for Alaskans! Concessions to businesses are fine. In exchange we need a commitment for preferential hire of Alaskans, not only by the major oil companies and Alyeska Pipeline, but also their contractors. Reciprocal back scratching.

There may be no way to guarantee preference for Alaska residents, but we could and should do as we used to...the personal income tax, with substantial exemptions and deductions for residency.

The mutual exchange of information between the Federal and State Revenue Departments will be of great value in verifying residency for the Alaska Department of Revenue and the Permanent Fund Dividend program in uncovering fraud.

Yours truly,

Esther Creech
Esther Creech

cc: Senator Drue Pearce
Representative Gail Phillips

Written during Gov. Cooper's term.

Chamber's stance against tax against state's best interest

The Alaska State Chamber of Commerce opposes the governor's proposed income tax on individuals. In doing so, the chamber has taken a stance against the best interests of the vast majority of its members. It is true, as far as the statement goes, that lower taxes tend to encourage new business. It is also true North-east and Midwest states lost business for many years to the Sunbelt states in large part because of the Sunbelt's lower taxes. And yes, it is even true that taxes once in place are hard to get rid of. Nevertheless, people who want to maintain or even to raise the level of Alaska economic activity, the members of the Chamber of Commerce, for example, should favor the proposed income tax, not oppose it.

First, let us make it clear that what has been proposed is an individual income tax, not a new tax on businesses. The business part of the Alaska income tax never was repealed. True, all taxes ultimately are paid by the people. However, in a world where business



david reaume

treats retained earnings as a "low cost" source of investable funds, a strong case can be made against business taxes as the greater deterrent to new investment.

Second, if your customers are primarily Alaskans, the story is only partly told by the observation that higher state individual income taxes today mean lower after-tax incomes today. The rest of the story is that

higher state individual income taxes today mean higher — yes, higher — after-tax incomes tomorrow. With one-fourth or more of the yield of the tax coming from the federal treasury and non-residents, the net effect of levying the tax and then spending the proceeds is to increase economic activity. Why do you think Atlantic City, N.J., residents are in love with the property tax? Answer: They know that much of its burden is passed on to outsiders in the form of higher room rates and stiffer prices for drinks.

Even my academic friends from Clemson University who toured the state recently preaching the gospel of lower taxes, admitted that taxes borne by outsiders stimulate the local economy if the proceeds are spent locally. If you missed them you shouldn't have. As entertainment goes they weren't half bad, but as entertainers often will, they did resort to a certain amount of careless generalization.

Those of you who heard them may recall

the discussion of the General Motors decision to locate its new Saturn assembly plant in Tennessee. As the Clemson people made very clear, GM put low state taxes at the top, or at least near the top, of the qualities it most desired in a suitor. Neither climate nor Tennessee cheerleading did much to win the day. What counted was the fact that profits after taxes were expected to be greater because taxes were expected to be lower.

Now as it happens, demand for the new GM Saturn is all but independent of the taxing decisions by the state in which the cars were to be built. Lower taxes were indeed of primary importance to GM because the cars were to be sold on national and international markets largely immune to changes in one state's aggregate demand. As a share of total potential demand, the demand from a single state was (maybe) 1 percent. The change in

See Page C-3, REAUME

REAUME: Chamber would do better to favor — not oppose — proposed income tax

Continued from Page C-1

this demand caused by a decision GM might make was infinitesimal. General Motors was not in the position that most Alaska businesses are in. The demand for Saturn would not increase as the result of one state's increase in government spending.

Which, of course, leads us to the correct conclusion that Alaska businesses who sell primarily outside Alaska certainly should be opposed to higher business taxes because higher business taxes force them to raise prices when their competitors do not or to suffer a loss of profits. Chief among the Alaska businesses who sell their wares Outside are the oil companies. In keeping with this analysis, the oil companies are justifiably

opposed to the proposed changes in the severance tax economic limit factor.

Next in size among the exporters are the forest products companies and the seafood processors, which also should oppose higher business taxes when they are proposed. However, their opposition to the individual income tax is a little hard to understand.

All of these companies — the oil producers, the forest products companies and the seafood processors — are alternative tax targets. To the extent the alternative to the income tax is not lower spending but an increase in some other tax (say, the economic limit factor, the raw fish tax or higher business income taxes), higher individual income taxes ought to look pretty good. As we now know, the individual income tax spreads the burden more widely

and stimulates the economy in the bargain.

Where higher taxes could ultimately hurt is in deterring the formation in Alaska of new export-oriented businesses that have the option of locating elsewhere. When the next one comes along, we certainly ought to consider targeted incentives that fit the particulars of the case. I have argued that point for many years. But opposition today to the individual income tax is misplaced if it stems from the fear that someday we may have to offer targeted business tax incentives.

Finally, there is the question of the size of an effect vs. its direction. As I have said, higher state individual income taxes deter economic growth if the respending of revenue plucked from the U.S. Treasury and outsiders is not an important consideration. But even

this deterrent is buried by higher Alaska construction costs and higher Alaska wages in almost any comparison of Alaska/Outside cost differences an export-oriented investor might care to make. Yes, I know, higher state individual income taxes can raise labor costs. Again, however, there are two effects. Right now I would not be a bit surprised if the net stimulus from spending Outsiders' money did not contribute at least a little to the cause of lower costs by helping to maintain the size of the Alaska economy and its internal competitiveness.

□ David M. Reaume is an economist based in Juneau.

Esther Creech
7040Abbott Loop Rd.
Anchorage, AK 99507



Governor Tony Knowles
P.O. Box 11001
Juneau, Alaska 99811



10 July, 1995

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

Dear Commissioners:

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

Boards, Commissions, Departments and Government Services:

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

Give Away Programs:

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

Incentives

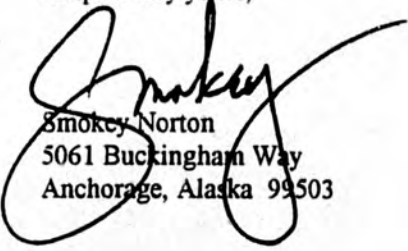
I would recommend you encourage an effort to develop incentives with rewards to citizens/state employees/supervisors/state managers that produce ideas that will make state government more effective and efficient.

Taxes:

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

I am anxious to see the recommendations from your commission.

Respectfully yours,



Smokey Norton
5061 Buckingham Way
Anchorage, Alaska 99503

SCOMM

101:18

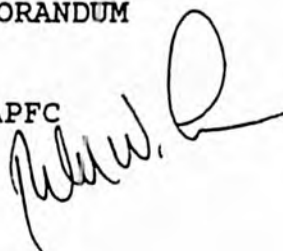
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SIMPSON, TILLINGHAST, SORENSEN & LORENSEN
A PROFESSIONAL CORPORATION

LESLIE LONGENBAUGH
RONALD W. LORENSEN
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ONE SEALASKA PLAZA, SUITE 300
JUNEAU, ALASKA 99801
PHONE (907) 586-1400
FAX (907) 586-3065

MEMORANDUM

To: Byron I. Mallott
Executive Director, APFC

From: Ron Lorensen, STS&L 

Date: December 2, 1995

Re: Need for Proposed Constitutional Amendment to Permanent
Fund Provision to Implement Endowment Concept
Our File No.: 846.2

You recently asked me to address the question raised by Trustee Clark Gruening (November 17, 1995 memorandum) of whether an amendment to the constitutional provision dealing with the Permanent Fund (Art. IX, sec. 15, Alaska Constitution¹) was necessary to implement the endowment concept recommended by the State Long Range Financial Planning Commission ("the Commission") in its Final Report. Subject to one important qualifier, I think the answer is that a constitutional amendment is not legally necessary.²

¹ Art. IX, sec. 15 provides as follows:

SECTION 15. ALASKA PERMANENT FUND. At least twenty-five percent of all mineral lease rentals, royalties, royalty sale proceeds, federal mineral revenue sharing payment and bonuses received by the State shall be placed in a permanent fund, the principal of which shall be used only for those income-producing investments specifically designated by law as eligible for permanent fund investments. All income from the permanent fund shall be deposited in the general fund unless otherwise provided by law.

² Whether it might be desirable, as a matter of policy (or politics), to present the proposed shift to an endowment concept for the Permanent Fund to the voters, be it in the form of a

Byron I. Mallott

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December 2, 1995

Under Art. IX, sec. 15, the Fund's principal (i.e., receipts placed in the Fund, plus any additional monies appropriated to the Fund by the Legislature) may not be drawn upon for any reason--ever. The income of the Fund, on the other hand, is all available for transfer to the general fund, unless the Legislature provides otherwise by law.³ This distinction between principal and income under the constitution provides a clear dividing line in determining what part of the Fund may be paid out by the Legislature to be used for various governmental and other public purposes.⁴

This principal/income distinction does not play a specific role (or serve a particular function) under the endowment approach recommended by the Commission. The goal of endowment-type funds is to establish a rate of withdrawal of assets from the fund that, over the longer term, will maximize the amount available for expenditure while maintaining the purchasing power of the fund. This withdrawal or "payout"⁵ rate for a particular year is typically determined as a percentage of the fund's average market value over a specified number of preceding years. Once established, the payout rate remains constant from year to year, although subsequent experience with a fund's actual performance may lead to later adjustments or "fine-tuning" of the rate. The annual payout rate proposed by the Commission is four percent, applied to the Fund's average market value in the immediately preceding five years.

By looking at the Fund's market value as the basis for computing the annual payout, the distinction between principal and income becomes essentially irrelevant. This is because market value depicts the total value of the Fund's assets, whether they derive from principal or the income generated by it. The fact that the principal/income distinction would become irrelevant does not mean, though, that Art. IX, sec. 15 must be changed. Unless the constitutional provision as it now reads would preclude or otherwise interfere with implementation of the endowment concept

constitutional amendment, an advisory vote, or otherwise, is a question that is beyond the scope of this memorandum.

³ Which it has done, both by general law (e.g. the Permanent Fund Dividend Program under AS 43.23 and "inflation-proofing" under AS 37.13.145(c)) and by special appropriation.

⁴ To date, the principal uses of Fund income by the Legislature have been to "inflation-proof" the Fund and to pay annual Permanent Fund dividends to Alaskans.

⁵ This is the term used by the Commission.

Byron I. Mallott
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December 2, 1995

recommended by the Commission, there would be no legal need to amend it.

Certainly, the Legislature could enact a general law that provided both that all income of the Fund was to be retained in the Fund⁶ and that there would be an annual payout from the Fund to the general fund based on application of a fixed payout rate to the Fund's market value, averaged over a specific period. Nothing in the constitution would have to be changed in order for the Legislature to be able to do either of these things. However, there is at least a theoretical possibility that the computed payout amount for a particular year would exceed available income, necessitating an "invasion" of principal, which is not allowed under Art. IX, sec. 15.

In point of fact, this theoretical possibility is probably just that. Given that the payout is based on a five year average and that the Fund continues to grow each year through additional receipts, the actual payout in a year, expressed as a percentage of the Fund's market value in that same year, will almost certainly be less than four percent.⁷ At the same time, the Fund's historical earnings rate is substantially above four percent. Under the endowment approach, the excess earnings would be left with the Fund, quickly accumulating a substantial cushion of "retained earnings"⁸ from which the payout could be satisfied if necessary.⁹

Rather than amend the constitution to deal with this theoretical conflict, the Legislature could address it as part of

⁶ This provision would be necessary to reverse the effect of Art. IX, sec. 15 that all income of the Fund is to be deposited in the general fund, unless otherwise provided by law.

⁷ The only time this would not be true would be when the market value of the Fund had declined to or below its average value over the previous five years. The Fund has never experienced such a significant loss in value.

⁸ In retaining all income in the Fund by general law, the Legislature might wish to create a separate retainage account in the Fund into which the income would be deposited in order to provide for this cushion, rather than automatically convert retained income into "principal."

⁹ In this regard, it would probably be instructive to perform a historical analysis of the Fund's performance to evaluate whether and how the constitution's proscription against using principal would have been implicated if the endowment concept had been applied to the Fund since its inception.

SIMPSON, TILLINGHAST, SORENSEN & LORENSEN, P.C.

Byron I. Mallott

Page 4

December 2, 1995

an enactment implementing the endowment/annual payout concept. This could be done by a provision saying that the payout for a year would be either the amount computed by applying the payout rate to the Fund's average market value for the specified number of preceding years or the amount of income available for distribution (i.e. without "invading" principal), whichever is less. If this kind of safeguard were incorporated into legislation utilizing the Permanent Fund as an endowment, the potential conflict with the present constitutional provision would be avoided, and there would be no legal need to amend it.

I hope this memorandum has been responsive to your inquiry. If you or any of the Fund's Trustees have any questions about it or would like to discuss the issue further, please do not hesitate to contact me.

cc: Jim Baldwin, AAG
Department of Law

9-LS1319A ✓

Cook

10/20/95

JOINT RESOLUTION NO.

IN THE LEGISLATURE OF THE STATE OF ALASKA

NINETEENTH LEGISLATURE - SECOND SESSION

BY THE _____ RULES COMMITTEE BY REQUEST OF THE LONG RANGE FINANCIAL
PLANNING COMMISSION

Introduced:

Referred:

A RESOLUTION

1 Proposing amendments to the Constitution of the State of Alaska relating to the
2 permanent fund and the budget reserve fund.

3 BE IT RESOLVED BY THE LEGISLATURE OF THE STATE OF ALASKA:

4 * Section 1. Article IX, sec. 15, Constitution of the State of Alaska, is amended to read:

5 SECTION 15. ALASKA PERMANENT FUND. At least fifty [TWENTY-
6 FIVE] percent of all mineral lease rentals, royalties, royalty sale proceeds, federal
7 mineral revenue sharing payments and bonuses received by the State shall be placed
8 in a permanent fund, ~~THE PRINCIPAL OF~~ which shall be used ~~ONLY~~ for those
9 income-producing investments specifically designated by law as eligible for permanent
10 fund investments. Income [ALL INCOME] from the permanent fund shall be
11 retained in the permanent fund, ^{except that} Appropriations may only be made from the
12 ^{INCOME} permanent fund to [DEPOSITED IN] the general fund [UNLESS OTHERWISE
13 PROVIDED BY LAW]. ^{ANNUAL} The total amount of appropriations from the permanent
14 fund that takes effect during a calendar year may not exceed an amount equal to
15 four percent of the average market value of the permanent fund during the
16 immediately preceding five calendar years.

unintegrated
or
imposed?

LEGISLATURE may
Implement
by law

Institutional
Initiation
proceeding

WORK DRAFT

WORK DRAFT

WORK DRAFT

1 * Sec. 2. Article IX, sec. 17(a), Constitution of the State of Alaska, is amended to read:

2 (a) There is established as a separate fund in the State treasury the budget
3 reserve fund. The purpose of the budget reserve fund is to help stabilize State
4 spending from year to year. Except for money deposited into the permanent fund
5 under Section 15 of this article, all money received by the State after July 1, 1990, as
6 a result of the termination, through settlement or otherwise, of an administrative
7 proceeding or of litigation in a State or federal court involving mineral lease bonuses,
8 rentals, royalties, royalty sale proceeds, federal mineral revenue sharing payments or
9 bonuses, or involving taxes imposed on mineral income, production, or property, shall
10 be deposited in the budget reserve fund. Money in the budget reserve fund shall be
11 invested so as to yield competitive market rates to the fund. Income of the fund shall
12 be retained in the fund. Section 7 of this article does not apply to deposits made to
13 the fund under this subsection. Money may be appropriated from the fund only as
14 authorized under (b) or (c) of this section.

15 * Sec. 3. Article IX, sec. 17(b), Constitution of the State of Alaska, is amended to read:

16 (b) If the amount of unrestricted revenue available [FOR APPROPRIATION]
17 for a fiscal year is less than the combined amount of unrestricted revenue and
18 money from the budget reserve fund appropriated for the previous fiscal year, an
19 appropriation may be made from the [BUDGET RESERVE] fund. However, the
20 amount appropriated from the fund under this subsection may not exceed the amount
21 necessary [, WHEN ADDED TO OTHER FUNDS AVAILABLE FOR
22 APPROPRIATION,] to provide for total appropriations of unrestricted revenue and
23 money from the fund equal to the amount of appropriations made from these sources
24 [IN THE PREVIOUS CALENDAR YEAR] for the previous fiscal year. The
25 legislature shall implement this subsection by law. [For purposes of this
26 subsection, "unrestricted revenue" means all money received by the State during
27 a fiscal year except money held in trust, received from the federal government for
28 a particular purpose, or dedicated for a particular purpose as permitted by this
29 constitution.]

30 * Sec. 4. Article IX, sec. 17(d), Constitution of the State of Alaska, is repealed.

31 * Sec. 5. The amendments proposed by this resolution shall be placed before the voters of



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WORK DRAFT

- 1 the state at the next general election in conformity with art. XIII, sec. 1, Constitution of the
- 2 State of Alaska, and the election laws of the state.

MEMORANDUM**State of Alaska**
Department of Law

TO: Deborah Behr
Assistant Attorney General
and Regulations Attorney

DATE: November 2, 1995

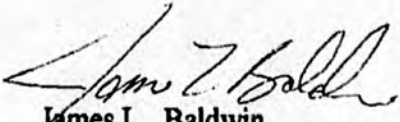
FILE NO: 465-2129

TEL. NO.:

SUBJECT:

Comments concerning constitutional
amendments recommended by Long
Range Fiscal Planning Commission

FROM:


James L. Baldwin
Assistant Attorney General
Governmental Affairs - Juneau

We have reviewed the draft joint resolutions prepared by the Legislative Affairs Agency for the Long Range Fiscal Planning Commission proposing amendments to Article IX, Sections 15 and 17 relating to the Alaska Permanent Fund and the Budget Reserve Fund, respectively. The following comments are offered for consideration by the commission:

Alaska Permanent Fund

(1) It is not clear that appropriations from the fund are intended to be from principal and interest. See, page 1, lines 11 and 12. The sentence could be construed to mean that appropriations are made only from income. The existing wording provides that deposits "shall be used" for investment. While it is true that the word "only", appearing on line 8, would be deleted, the wording remains mandatory and expressly covers use of the deposits. It would be clearer to state that deposits shall be "invested in" and delete "used only for."

(2) Under the proposed amendment, market value must be calculated on a calendar year basis. We are uncertain whether this would present a problem for the APFC. At present, earnings are computed on a fiscal year basis. Further, the endowment payment is limited by an amount determined on a calendar year basis. It may be difficult to make the availability of endowment payments coincide with the budget cycle which is based on a fiscal year. The concept of a five year rolling average market value for determining the endowment payment should be carefully considered in light of the history of permanent fund investments and projections made by consultants to APFC. A longer period may provide a more rational approach to meet the intent of the commission.

(3) The wording of the limit on the amount of the endowment payment may not convey the idea that four percent is a cap amount, not a stipulated amount for the payment. The wording is clumsy in that it provides "may not exceed an amount equal to four percent." This sounds like it could not be less than four percent. In any case, the present wording is ambiguous. Perhaps the provision should be worded positively as follows: "may be an amount not more than four percent"

2. *The Constitutional Budget Reserve Fund.*

The proposed Constitutional amendment changes when a draw can be made from the fund with a simple majority. The inquiry changes from how much is "available for appropriation" to how much "unrestricted revenue" is received. This approach is consistent with much of the history concerning the original intent of the fund. One could argue that this language puts budget surpluses in a higher priority than the budget reserve fund--i.e., the legislature could spend the budget reserve before it would have to spend a budget surplus carry-forward. This does not seem like a major flaw, however--the legislature is free to appropriate the carry-forward first, and in all likelihood, will.

MEMORANDUM

State of Alaska

Office of the Governor
Office of Management and Budget

November 22, 1995

TO: Annalee McConnell
Director

FROM: Brad Pierce
Senior Policy Analyst

SUBJECT: PF Constitutional Amendment Work Group Meeting

Per your request, a staff working group met on Friday November 17 to discuss the practical aspects of a constitutional amendment drafted by the Long Range Financial Planning Commission (LRFPC) that would change the Permanent Fund to an endowment and make changes to the Constitutional Budget Reserve. Our purpose was to think through the mechanics of how these proposals would work and identify any problems that might be encountered in their implementation.

Issues discussed and conclusions arrived at included:

- The effective date on the PF endowment amendment is currently unspecified, meaning that it would go into effect 90 days after voter approval or February 1997. For ease of accounting and administration the effective date should be July 1, 1997 to conform with the state fiscal year.
- There was agreement that the PF amendment language should be clear on how the endowment payout is to be calculated (e.g., 4% of the average of preceding five calendar year's market value). As drafted, the present language is perhaps overly specific and risks legal complications similar to that of the current CBR. "The total amount of appropriations from the permanent fund that takes effect during a calendar year may not exceed an amount equal to four percent of the average market value of the permanent fund during the immediately preceding five calendar years." The intent of the commission was that the legislature would know

*Finance
insert
appr. language
of effective date*

exactly how much revenue it had from the endowment prior to making appropriations for the upcoming fiscal year.

- The payout schedule, repeal of inflation proofing and the earnings reserve, and PFD calculation should be addressed in implementation statutes. A monthly payout schedule would probably work best from the state's cash flow perspective and could allow PF trustees maximum flexibility in liquidating whatever assets necessary to meet the payout obligation. If implementing statutes were not passed, these issues would need to be addressed in the front sections of the annual appropriations bill. *Agree*
- One idea not addressed by the commission but brought up by Jim Baldwin was whether the amendment should provide for the PF to expand its authority to invest according to the prudent investor rule rather than its currently specified list of allowable investments. He felt that this might allow the trustees the same discretion enjoyed by other endowments. *Agree*
- There was general agreement that the amendment language relating to the CBR fixed its problems. Implementation statutes should specify that the state can borrow from the CBR during cash flow shortages and repeal the debt currently owed from previous years, otherwise these issues will need to be annually addressed in the front sections of the appropriations bill. *Not quite*
- Finally, the LRFPC spreadsheet shows a \$607 million transfer from the CBR to PF principal in FY 96 and another \$207 transfer in FY 97. These should probably be moved to FY 98 when the endowment would go into effect as it is unlikely that the governor or legislature would want to significantly reduce liquid reserves absent a comprehensive fiscal gap solution.

TO:

**COMMISSIONERS LONG RANGE FINANCIAL PLANNING
COMMISSION**

FROM:

**MELISSA FOUSE
STAFF, LONG RANGE FINANCIAL PLANNING COMMISSION
FAX: 258-9869
PHONE: 258-8165**

FOLLOWING ARE:

1. DRAFT JOINT RESOLUTION TO AMEND THE CONSTITUTION
 - :ALLOW FOR A 4% PAYOUT FROM THE INCOME OF THE PERMANENT FUND
 - CLARIFY THE PURPOSE OF THE BUDGET RESERVE FUND
 - CHANGE THE TRIGGER FOR APPROPRIATIONS FROM THE CBR
2. COMMENTS BY ATTORNEY GENERAL JIM BALDWIN
3. BRAD PIERCE REPORT OF AN ADMINISTRATIVE BRANCH STAFFERS' MEETING RE: CONSTITUTIONAL AMENDMENT

8 pages

MORE BILL DRAFTS WILL FOLLOW

9-LS1319A
Cook
10/20/95

_____ **JOINT RESOLUTION NO.**

IN THE LEGISLATURE OF THE STATE OF ALASKA

NINETEENTH LEGISLATURE - SECOND SESSION

**BY THE _____ RULES COMMITTEE BY REQUEST OF THE LONG RANGE FINANCIAL
PLANNING COMMISSION**

Introduced:

Referred:

A RESOLUTION

1 **Proposing amendments to the Constitution of the State of Alaska relating to the**
2 **permanent fund and the budget reserve fund.**

3 **BE IT RESOLVED BY THE LEGISLATURE OF THE STATE OF ALASKA:**

4 *** Section 1.** Article IX, sec. 15, Constitution of the State of Alaska, is amended to read:

5 SECTION 15. ALASKA PERMANENT FUND. At least fifty [TWENTY-
6 FIVE] percent of all mineral lease rentals, royalties, royalty sale proceeds, federal
7 mineral revenue sharing payments and bonuses received by the State shall be placed
8 in a permanent fund, [THE PRINCIPAL OF] which shall be used [ONLY] for those
9 income-producing investments specifically designated by law as eligible for permanent
10 fund investments. Income [ALL INCOME] from the permanent fund shall be
11 retained in the permanent fund. Appropriations may only be made from the
12 permanent fund to [DEPOSITED IN] the general fund [UNLESS OTHERWISE
13 PROVIDED BY LAW]. The total amount of appropriations from the permanent
14 fund that takes effect during a calendar year may not exceed an amount equal to
15 four percent of the average market value of the permanent fund during the
16 immediately preceding five calendar years.

* Sec. 2. Article IX, sec. 17(a), Constitution of the State of Alaska, is amended to read:

(a) There is established as a separate fund in the State treasury the budget reserve fund. The purpose of the budget reserve fund is to help stabilize State spending from year to year. Except for money deposited into the permanent fund under Section 15 of this article, all money received by the State after July 1, 1990, as a result of the termination, through settlement or otherwise, of an administrative proceeding or of litigation in a State or federal court involving mineral lease bonuses, rentals, royalties, royalty sale proceeds, federal mineral revenue sharing payments or bonuses, or involving taxes imposed on mineral income, production, or property, shall be deposited in the budget reserve fund. Money in the budget reserve fund shall be invested so as to yield competitive market rates to the fund. Income of the fund shall be retained in the fund. Section 7 of this article does not apply to deposits made to the fund under this subsection. Money may be appropriated from the fund only as authorized under (b) or (c) of this section.

* Sec. 3. Article IX, sec. 17(b), Constitution of the State of Alaska, is amended to read:

(b) If the amount of unrestricted revenue available [FOR APPROPRIATION] for a fiscal year is less than the combined amount of unrestricted revenue and money from the budget reserve fund appropriated for the previous fiscal year, an appropriation may be made from the [BUDGET RESERVE] fund. However, the amount appropriated from the fund under this subsection may not exceed the amount necessary [, WHEN ADDED TO OTHER FUNDS AVAILABLE FOR APPROPRIATION.] to provide for total appropriations of unrestricted revenue and money from the fund equal to the amount of appropriations made from these sources [IN THE PREVIOUS CALENDAR YEAR] for the previous fiscal year. The legislature shall implement this subsection by law. For purposes of this subsection, "unrestricted revenue" means all money received by the State during a fiscal year except money held in trust, received from the federal government for a particular purpose, or dedicated for a particular purpose as permitted by this constitution.

* Sec. 4. Article IX, sec. 17(d), Constitution of the State of Alaska, is repealed.

* Sec. 5. The amendments proposed by this resolution shall be placed before the voters of

- 1 the state at the next general election in conformity with art. XIII, sec. 1, Constitution of the
- 2 State of Alaska, and the election laws of the state.



FAX COVER SHEET

FAX (907) 465-2029

Mail Stop 3101

**LEGAL SERVICES
LEGISLATIVE AFFAIRS AGENCY
STATE OF ALASKA**

130 Seward Street, Suite 409

Juneau, Alaska 99801-2105

(907) 465-3867 or 465-2450

WARNING: THE INFORMATION CONTAINED IN THIS FAX IS CONFIDENTIAL. IT IS INTENDED TO BE REVIEWED ONLY BY THE INDIVIDUAL NAMED BELOW. IF THE READER OF THIS TRANSMITTAL PAGE IS NOT THE INTENDED RECIPIENT OR A REPRESENTATIVE OF THE INTENDED RECIPIENT, YOU ARE HEREBY NOTIFIED THAT ANY REVIEW, DISSEMINATION OR COPYING OF THIS FAX OR THE INFORMATION CONTAINED HEREIN IS PROHIBITED. IF YOU HAVE RECEIVED THIS FAX IN ERROR, PLEASE IMMEDIATELY NOTIFY THE SENDER BY TELEPHONE AND RETURN THIS FAX TO THE SENDER AT THE ABOVE ADDRESS. THANK YOU.

TO: Melissa Fouse, LRFPFAX: 258-9869 PHONE: _____**NUMBER OF PAGES**(including cover sheet): 4 DATE SENT 10-20-95 TIME 7:50 SENT BY MLDISPOSAL OF ORIGINAL: MAIL ☒ FILE ☐ THROW AWAY ☐ HOLD FOR PICKUP ☐**NOTES/INSTRUCTIONS:**

4652150

FAX COVER

TO:
LEGAL SERVICES,
LAA

FROM:
MELISSA FOUSE
STAFF, LONG RANGE FINANCIAL PLANNING
COMMISSION

PHONE: 258-8165
FAX: 258-9869

ATTACHED IS A ROUGH DRAFT OF A CONSTITUTIONAL
AMENDMENT. THE PURPOSE OF THIS AMENDMENT IS TO
TURN THE PERMANENT FUND INTO AN ENDOWMENT THAT
ALLOWS UP TO FOUR PERCENT OF THE AVERAGE MARKET
VALUE OF THE PRIOR FIVE YEARS TO BE USED FOR
GENERAL FUND SERVICES AND FOR DIVIDENDS.

OF THE FUND

THIS AMENDMENT ALSO INTENDS TO AMEND SEC. 17 TO
CLARIFY THE PURPOSE OF THE BUDGET RESERVE FUND, TO
REPEAL THE SWEEP PROVISION AND TO LIMIT SPENDING.

IN ADDITION, THERE IS A STATEMENT IN OUR FINAL
REPORT THAT SAYS THE COMMISSION RECOMMENDS
THAT THE GENERAL FUND BE ALLOWED TO BORROW FROM
THE BUDGET RESERVE FUND TO MEET CASH FLOW
REQUIREMENTS. IS THAT PERMISSABLE WHEN AN
ACCOUNT IS ESTABLISHED (AND PRESUMABLY LIMITED) BY
CONSTITUTIONAL PROVISIONS?

I WILL CALL AFTER SENDING THIS FAX TO SEE IF YOU HAVE
ANY QUESTIONS.

Deborah Behr

November 2, 1995

Page 2

(4) The proposed amendment adds a new provision that is intended to convey the idea that amounts from the permanent fund are to be exclusively used as a revenue source for the state general fund. However, the wording at page 1, lines 11 and 12, appears to limit the power of the legislature to appropriate amounts into the fund. The report of the commission appears to state a contrary intent.

(5) The proposed amendment leaves untouched the existing provision that authorizes the legislature to set the types of investments that the APFC may make. If the APFC is to become the centerpiece for providing revenue available for appropriation, consideration should be given to moving the APFC away from an investment strategy set by law to one based on standards applicable to a fiduciary which is set out in the constitution. The constitutional basis could be the prudent investor standard. This standard is in existing law applicable to the Alaska State Pension Investment Board and appears to be operating smoothly. To achieve this end, delete [SPECIFICALLY DESIGNATED BY LAW AS ELIGIBLE FOR PERMANENT FUND INVESTMENTS] and insert in which a prudent investor may invest when managing large trust investments.

Budget Reserve Fund

(1) The proposed amendment of the formula for how much may be appropriated from the budget reserve fund needs explaining. The amount is determined by available unrestricted revenue and the amount appropriated from the budget reserve fund for the prior fiscal year. If we have learned anything from our legal battles over the meaning of the existing section 17, it is that a detailed legislative history of the intent of the drafters of the provision is extremely valuable. If the commission is not going to make such a record, it will be incumbent on the legislature to make such a record. Our review of the report of the commission does not disclose any statement of intent to justify the approach used in the draft resolution.

(2) The definition of "unrestricted revenue" set out on page 2 lines 25 - 29 must be carefully considered. It might be better to delete the definition and leave that for the legislature to enact by law.

(3) The draft resolution does not contain a provision that would expressly allow the legislature to appropriate from other sources to the budget reserve fund. The commission's report recommends that amounts attributable to unforeseen oil price increases be deposited in the budget reserve. The legislature may have the implied power to appropriate to any fund it desires. However, it would be better to remove all doubt by authorizing appropriations from other sources.

JLB:clh

2. *The Constitutional Budget Reserve Fund.*

The proposed Constitutional amendment changes when a draw can be made from the fund with a simple majority. The inquiry changes from how much is "available for appropriation" to how much "unrestricted revenue" is received. This approach is consistent with much of the history concerning the original intent of the fund. One could argue that this language puts budget surpluses in a higher priority than the budget reserve fund--i.e., the legislature could spend the budget reserve before it would have to spend a budget surplus carry-forward. This does not seem like a major flaw, however--the legislature is free to appropriate the carry-forward first, and in all likelihood, will.

MEMORANDUM

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

November 22, 1995

TO: Annalee McConnell
Director

FROM: Brad Pierce
Senior Policy Analyst

SUBJECT: PF Constitutional Amendment Work Group Meeting

Per your request, a staff working group met on Friday November 17 to discuss the practical aspects of a constitutional amendment drafted by the Long Range Financial Planning Commission (LRFPC) that would change the Permanent Fund to an endowment and make changes to the Constitutional Budget Reserve. Our purpose was to think through the mechanics of how these proposals would work and identify any problems that might be encountered in their implementation.

Issues discussed and conclusions arrived at included:

- The effective date on the PF endowment amendment is currently unspecified, meaning that it would go into effect 90 days after voter approval or February 1997. For ease of accounting and administration the effective date should be July 1, 1997 to conform with the state fiscal year.
- There was agreement that the PF amendment language should be clear on how the endowment payout is to be calculated (e.g., 4% of the average of preceding five calendar year's market value). As drafted, the present language is perhaps overly specific and risks legal complications similar to that of the current CBR. "The total amount of appropriations from the permanent fund that takes effect during a calendar year may not exceed an amount equal to four percent of the average market value of the permanent fund during the immediately preceding five calendar years." The intent of the commission was that the legislature would know

exactly how much revenue it had from the endowment prior to making appropriations for the upcoming fiscal year.

- **The payout schedule, repeal of inflation proofing and the earnings reserve, and PFD calculation should be addressed in implementation statutes. A monthly payout schedule would probably work best from the state's cash flow perspective and could allow PF trustees maximum flexibility in liquidating whatever assets necessary to meet the payout obligation. If implementing statutes were not passed, these issues would need to be addressed in the front sections of the annual appropriations bill.**
- **One idea not addressed by the commission but brought up by Jim Baldwin was whether the amendment should provide for the PF to expand its authority to invest according to the prudent investor rule rather than its currently specified list of allowable investments. He felt that this might allow the trustees the same discretion enjoyed by other endowments.**
- **There was general agreement that the amendment language relating to the CBR fixed its problems. Implementation statutes should specify that the state can borrow from the CBR during cash flow shortages and repeal the debt currently owed from previous years, otherwise these issues will need to be annually addressed in the front sections of the appropriations bill.**
- **Finally, the LRFPC spreadsheet shows a \$607 million transfer from the CBR to PF principal in FY 96 and another \$207 transfer in FY 97. These should probably be moved to FY 98 when the endowment would go into effect as it is unlikely that the governor or legislature would want to significantly reduce liquid reserves absent a comprehensive fiscal gap solution.**

WORK DRAFT

WORK DRAFT

WORK DRAFT

9-LS1319A ✓

Cook

10/20/95

_____ JOINT RESOLUTION NO.

IN THE LEGISLATURE OF THE STATE OF ALASKA

NINETEENTH LEGISLATURE - SECOND SESSION

BY THE _____ RULES COMMITTEE BY REQUEST OF THE LONG RANGE FINANCIAL
PLANNING COMMISSION

Introduced:

Referred:

A RESOLUTION

1 Proposing amendments to the Constitution of the State of Alaska relating to the
2 permanent fund and the budget reserve fund.

3 BE IT RESOLVED BY THE LEGISLATURE OF THE STATE OF ALASKA:

4 * Section 1. Article IX, sec. 15, Constitution of the State of Alaska, is amended to read:

5 SECTION 15. ALASKA PERMANENT FUND. At least fifty [TWENTY-

6 FIVE] percent of all mineral lease rentals, royalties, royalty sale proceeds, federal

7 mineral revenue sharing payments and bonuses received by the State shall be placed

8 in a permanent fund, [THE PRINCIPAL OF] which shall be used ^{invested consistently} [ONLY] for those ✓

9 ^{with prudent investor practices of long institutional funds} income-producing investments specifically designated by law as eligible for permanent ✓

10 ~~fund investments~~ Income [ALL INCOME] from the permanent fund shall be

11 retained in the permanent fund. ^{except for} Appropriations ~~may only be made from the~~ ✓

12 permanent fund to [DEPOSITED IN] the general fund [UNLESS OTHERWISE

13 PROVIDED BY LAW]. The total amount of appropriations from the permanent

14 fund that takes effect during a calendar year may not exceed an amount equal to ^{the total fiscal be an not more than}

15 four percent of the average market value of the permanent fund during the

16 immediately preceding five calendar years.

WORK DRAFT

WORK DRAFT

WORK DRAFT

1 * Sec. 2. Article IX, sec. 17(a), Constitution of the State of Alaska, is amended to read:

2 (a) There is established as a separate fund in the State treasury the budget
3 reserve fund. The purpose of the budget reserve fund is to help stabilize
4 State revenue volatility. ~~Except for money deposited into the permanent fund~~
5 under Section 15 of this article, all money received by the State after July 1, 1990, as
6 a result of the termination, through settlement or otherwise, of an administrative
7 proceeding or of litigation in a State or federal court involving mineral lease bonuses,
8 rentals, royalties, royalty sale proceeds, federal mineral revenue sharing payments or
9 bonuses, or involving taxes imposed on mineral income, production, or property, shall
10 ~~be deposited in the budget reserve fund.~~ appropriations from other sources Money in the budget reserve fund shall be
11 invested so as to yield competitive market rates to the fund. Income of the fund shall
12 be retained in the fund. Section 7 of this article does not apply to deposits made to
13 the fund under this subsection. Money may be appropriated from the fund only as
14 authorized under (b) or (c) of this section.

15 * Sec. 3. Article IX, sec. 17(b), Constitution of the State of Alaska, is amended to read:

16 (b) If the amount of unrestricted revenue available [FOR APPROPRIATION]
17 for a fiscal year is less than the combined amount of unrestricted revenue ~~and~~
18 including money from the budget reserve fund ~~appropriated for the previous fiscal year,~~ an
19 appropriation may be made from the [BUDGET RESERVE] fund. However, the
20 amount appropriated from the fund under this subsection may not exceed the amount
21 necessary [, WHEN ADDED TO OTHER FUNDS AVAILABLE FOR
22 APPROPRIATION,] to provide for total appropriations of unrestricted revenue and
23 money from the fund equal to the amount of appropriations made from these sources
24 [IN THE PREVIOUS CALENDAR YEAR] for the previous fiscal year. The
25 legislature shall implement this subsection by law. For purposes of this
26 subsection, "unrestricted revenue" means all money received by the State during
27 a fiscal year except money held in trust, received from the federal government for
28 a particular purpose, or dedicated for a particular purpose as permitted by this
29 constitution.

30 * Sec. 4. Article IX, sec. 17(d), Constitution of the State of Alaska, is repealed.

31 * Sec. 5. The amendments proposed by this resolution shall be placed before the voters of

What happened to language 12

Amounts in the CBR which exceeds the previous years annual oil and gas
revenues are automatically deposited into the AFF at the end of each state
fiscal year.

(As a note, it is the intent of the Commission that the legislature will
maintain a balance in the CBR via voluntary contributions of GP Subur

is this
language
adequate?
does it
include or
exclude
existing
state assets
eg. AFFC,
H. 1007, ASTF
etc.?

WORK DRAFT

WORK DRAFT

WORK DRAFT

- 1 the state at the next general election in conformity with art. XIII, sec. 1, Constitution of the
- 2 State of Alaska, and the election laws of the state.

MEMORANDUM

State of Alaska Department of Law

TO: Deborah Behr
Assistant Attorney General
and Regulations Attorney

DATE: November 2, 1995

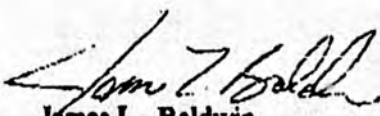
FILE NO: 465-2129

TEL NO.

SUBJECT:

Comments concerning constitutional
amendments recommended by Long
Range Fiscal Planning Commission

FROM:


James L. Baldwin
Assistant Attorney General
Governmental Affairs - Juneau

We have reviewed the draft joint resolutions prepared by the Legislative Affairs Agency for the Long Range Fiscal Planning Commission proposing amendments to Article IX, Sections 15 and 17 relating to the Alaska Permanent Fund and the Budget Reserve Fund, respectively. The following comments are offered for consideration by the commission.

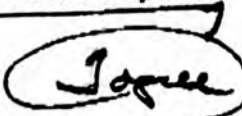
Alaska Permanent Fund

(1) It is not clear that appropriations from the fund are intended to be from principal and interest. See, page 1, lines 11 and 12. The sentence could be construed to mean that appropriations are made only from income. The existing wording provides that deposits "shall be used" for investment. While it is true that the word "only", appearing on line 8, would be deleted, the wording remains mandatory and expressly covers use of the deposits. It would be clearer to state that deposits shall be "invested in" and delete "used only for."

(2) Under the proposed amendment, market value must be calculated on a calendar year basis. We are uncertain whether this would present a problem for the APFC. At present, earnings are computed on a fiscal year basis. Further, the endowment payment is limited by an amount determined on a calendar year basis. It may be difficult to make the availability of endowment payments coincide with the budget cycle which is based on a fiscal year. The concept of a five year rolling average market value for determining the endowment payment should be carefully considered in light of the history of permanent fund investments and projections made by consultants to APFC. A longer period may provide a more rational approach to meet the intent of the commission.

(3) The wording of the limit on the amount of the endowment payment may not convey the idea that four percent is a cap amount, not a stipulated amount for the payment. The wording is clumsy in that it provides "may not exceed an amount equal to four percent." This sounds like it could not be less than four percent. In any case, the present wording is ambiguous. Perhaps the provision should be worded positively as follows: "may be an amount not more than four percent"

*Callahan
said 3 yrs
would be
adequate
more than
5 is
excessive.*



Deborah Behr

November 2, 1995
Page 2

(4) The proposed amendment adds a new provision that is intended to convey the idea that amounts from the permanent fund are to be exclusively used as a revenue source for the state general fund. However, the wording at page 1, lines 11 and 12, appears to limit the power of the legislature to appropriate amounts into the fund. The report of the commission appears to state a contrary intent.

See my revision

(5) The proposed amendment leaves untouched the existing provision that authorizes the legislature to set the types of investments that the APFC may make. If the APFC is to become the centerpiece for providing revenue available for appropriation, consideration should be given to moving the APFC away from an investment strategy set by law to one based on standards applicable to a fiduciary which is set out in the constitution. The constitutional basis could be the prudent investor standard. This standard is in existing law applicable to the Alaska State Pension Investment Board and appears to be operating smoothly. To achieve this end, delete [SPECIFICALLY DESIGNATED BY LAW AS ELIGIBLE FOR PERMANENT FUND INVESTMENTS] and insert in which a prudent investor may invest when managing large trust investments.

Budget Reserve Fund

(1) The proposed amendment of the formula for how much may be appropriated from the budget reserve fund needs explaining. The amount is determined by available unrestricted revenue and the amount appropriated from the budget reserve fund for the prior fiscal year. If we have learned anything from our legal battles over the meaning of the existing section 17, it is that a detailed legislative history of the intent of the drafters of the provision is extremely valuable. If the commission is not going to make such a record, it will be incumbent on the legislature to make such a record. Our review of the report of the commission does not disclose any statement of intent to justify the approach used in the draft resolution. *I suggest Brian prepare a draft or Brad.*

(2) The definition of "unrestricted revenue" set out on page 2 lines 25 - 29 must be carefully considered. It might be better to delete the definition and leave that for the legislature to enact by law. *This would invite year to year manipulations of the definition to suit whoever is in the majority. Nonetheless, I agree that a sound definition is needed.*

(3) The draft resolution does not contain a provision that would expressly allow the legislature to appropriate from other sources to the budget reserve fund. The commission's report recommends that amounts attributable to unforeseen oil price increases be deposited in the budget reserve. The legislature may have the implied power to appropriate to any fund it desires. However, it would be better to remove all doubt by authorizing appropriations from other sources.

JLB:clh

See revised language

Have drafted

Section 15 — Alaska Permanent Fund

At least **fifty** [TWENTY-FIVE] per cent of all mineral lease rentals, royalties, royalty sale proceeds, federal mineral revenue sharing payments and bonuses received by the state shall be placed in a permanent fund, the principal of which shall be used only for those income-producing investments specifically designated by law as eligible for permanent fund investments. **Income from the permanent fund shall be deposited in the permanent fund. Up to four percent of the average market value of the permanent fund for the preceeding five calendar years may** [ALL INCOME FROM THE PERMANENT FUND SHALL] be deposited in the general fund **at the beginning of the next fiscal year** [UNLESS OTHERWISE PROVIDED BY LAW].

Section 17 — Budget Reserve Fund

(a) There is established as a separate fund in the State treasury the budget reserve fund. **The purpose of the budget reserve fund is to help stabilize State spending from year to year.** Except for money deposited into the permanent fund under Section 15 of this article, all money received by the state after July 1, 1990, as a result of the termination, through settlement or otherwise, of an administrative proceeding or of litigation in a State or federal court involving mineral lease bonuses, rentals, royalties, royalty sale proceeds, federal mineral revenue sharing payments of bonuses, or involving taxes imposed on mineral income, production, or property, shall be deposited in the budget reserve fund. Money in the budget reserve fund shall be invested so as to yield competitive market rates to the fund. Income of the fund shall be retained in the fund. Section 7 of this article does not apply to deposits made to the fund under this subsection. Money may be appropriated from the fund only as authorized under (b) or (c) of this section.

(b) If the amount **of unrestricted revenue** available [FOR APPROPRIATION] for a fiscal year is less than the **combined** amount **of unrestricted revenue and money from the fund** appropriated for the previous fiscal year, an appropriation may be made from the budget reserve fund. However, the amount appropriated from the fund under this subsection may not exceed the amount necessary[, WHEN ADDED TO OTHER FUNDS AVAILABLE FOR APPROPRIATION,] to provide for total appropriations **from unrestricted revenue and from the fund** equal to the amount of appropriations made **from these sources** [IN THE PREVIOUS CALENDAR YEAR]

for the previous fiscal year. The legislature shall implement this subsection by law. For purposes of this subsection, "unrestricted revenue" means all money received by the State during a fiscal year except money held in trust, received from the federal government for a particular purpose, or dedicated to a particular purpose as permitted by this constitution.

(c) An appropriation from the budget reserve fund may be made for any public purpose upon affirmative vote of three-fourths of the members of each house of the legislature.

[(D) IF AN APPROPRIATION IS MADE FROM THE BUDGET RESERVE FUND, UNTIL THE AMOUNT APPROPRIATED IS REPAYED, THE AMOUNT OF MONEY IN THE GENERAL FUND AVAILABLE FOR APPROPRIATION AT THE END OF EACH SUCCEEDING FISCAL YEAR SHALL BE DEPOSITED IN THE BUDGET RESERVE FUND.]

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Oct-12-95 10:05 AM

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19074652029	OK	03	Sent	Oct-12	10:03A	00:01:58	002485030022

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SCOMM

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Alaska's Growing Fiscal Gap

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

August 12, 1995

The State of Alaska Long-Range Financial Planning Commission

The State of Alaska Long-Range Financial Planning Commission was established by Alaska's Legislature and Governor in March, 1995, 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.

Commission Members

Brian Rogers, Chair
Fairbanks

Judy Brady, Vice Chair
Anchorage

Lee Gorsuch
Anchorage

Sen. Georgianna Lincoln
Rampart

Robert W. Loescher
Juneau

Bruce Ludwig
Juneau

Annalee McConnell
Juneau

Hugh Motley
Cooper Landing

Mike Navarre
Kenai

Mary Nordale
Fairbanks

Mike O'Connor
Anchorage

Rep. Sean Parnell
Anchorage

Pat Pourchot
Anchorage

Sen. Steve Rieger
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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STATE OF ALASKA
LONG RANGE FINANCIAL PLANNING COMMISSION
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July 15, 1995

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

Dear Governor Knowles, President Pearce and Speaker Phillips:

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

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

The Long Range Financial Planning Commission finds that the fiscal gap is real and growing. Absent changes in the State's financial plan, we project that spending will continue to exceed revenues by a minimum of \$500 million per year, growing to \$1 billion per year over the next 10 years, for a total 10-year deficit in excess of \$6 billion. Our reserves are insufficient to cover a gap of this magnitude. The Commission has found that no one solution responsibly fixes the problem of the fiscal gap; the answer will have a number of elements and may require changes in existing law.

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

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

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

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

Style and Drafting Subcommittee: Draft interim and final reports.

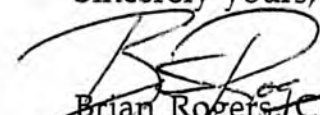
Revenue Sources Subcommittee: Identify potential sources of state revenue, estimate their impacts. Examine earnings of the permanent fund.

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

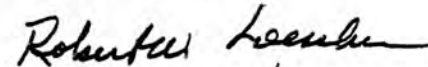
Intergovernmental Subcommittee: Examine impacts from federal and state budget actions. Work with municipalities and school groups.

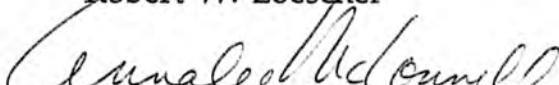
We believe that during the time remaining for the work of the Commission that we will be able to complete our deliberations and produce a responsible long range financial plan for the State of Alaska. Please contact us with any suggestions or concerns. We look forward to continuing to work with you.

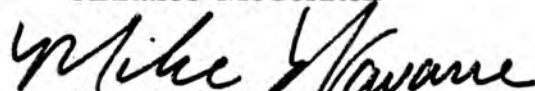
Sincerely yours,


Brian Rogers, Chairman

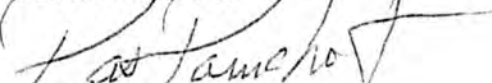

E. Lee Gorsuch


Robert W. Loescher

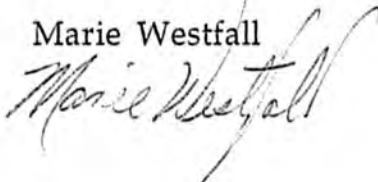

Annalee McConnell

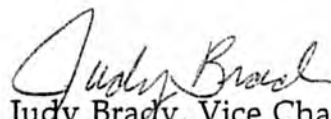

Rep. Mike Navarre

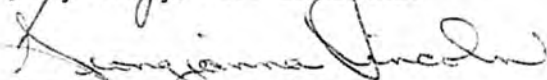

Mike O'Connor

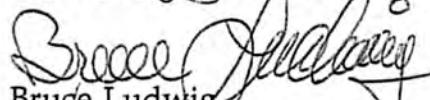

Patrick Pourchot

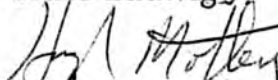
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Judy Brady, Vice Chairman

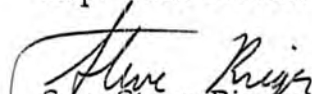

Sen. Georgianna Lincoln


Bruce Ludwig


Hugh Motley


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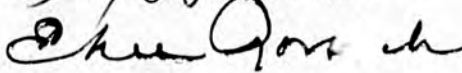
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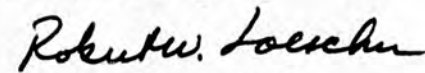
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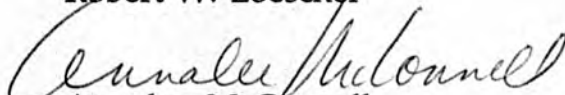
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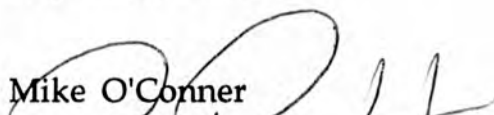

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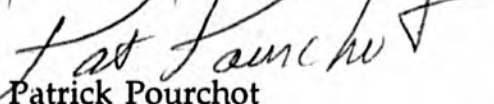

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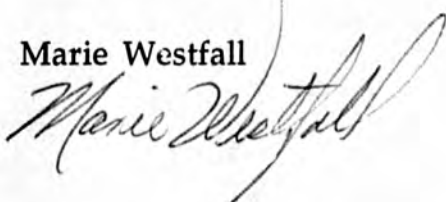

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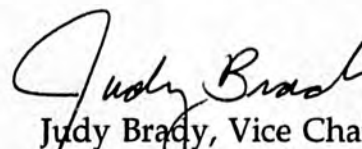
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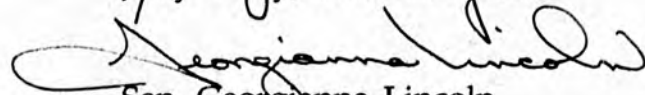

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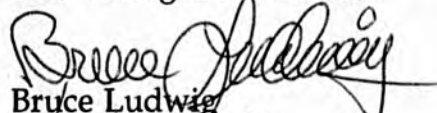

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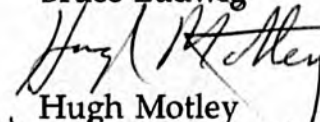
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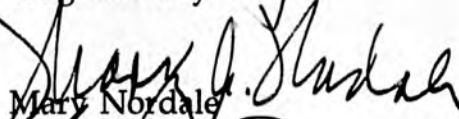



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The fiscal gap is real, and it's growing.

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 five percent per year for the past five years (in inflation adjusted terms). The legislature, the governor, and state agencies are working 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.

Efforts to date have not been enough to offset the decline in revenues. However, without this steady attention to reducing expenditures, the gap could soon have forced 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?

Alaska depends upon non-sustainable revenue sources and faces 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.

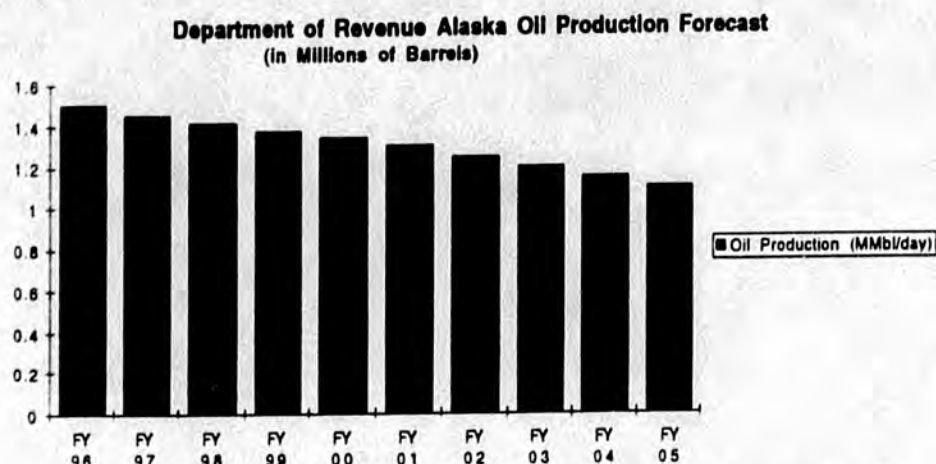
By 1979, after the OPEC price hikes, Alaska received such large amounts of revenue from royalties and taxes that the state abandoned most of its more traditional methods of obtaining revenue.

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 more determined 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

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 shoots up-

- 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

wards 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; the sense of urgency and the resolve to deal with the problem dissipate. 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 rapid growth of 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.

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.

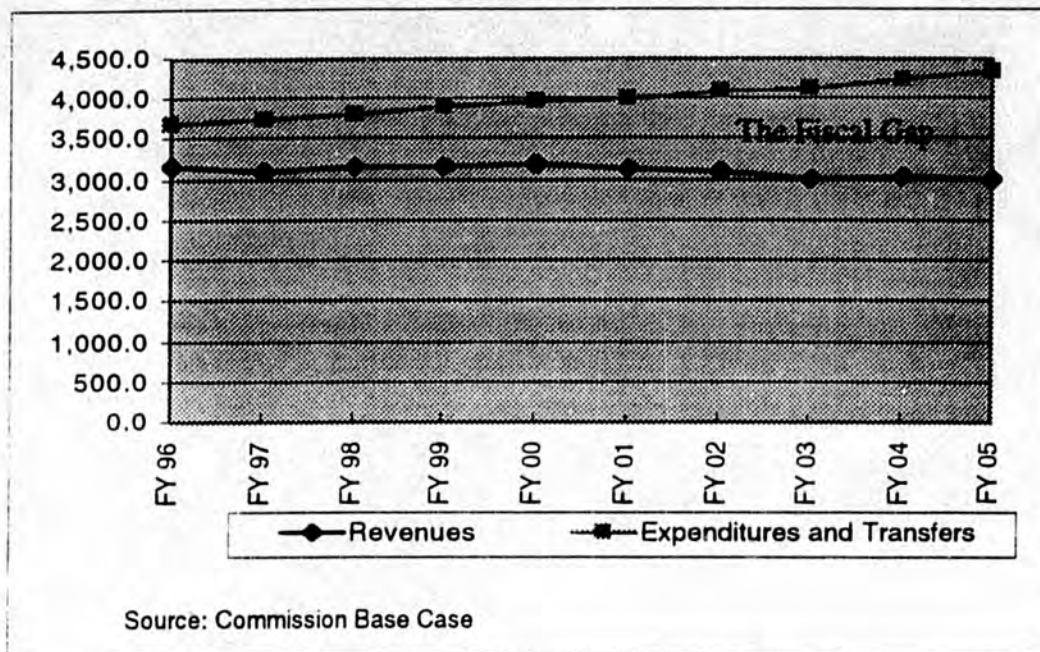
- It is almost as much as the whole Permanent Fund dividend program;

- It equals 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 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.

The size of the problem continues to grow due primarily to formula programs driven by population growth and the bydecline 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?

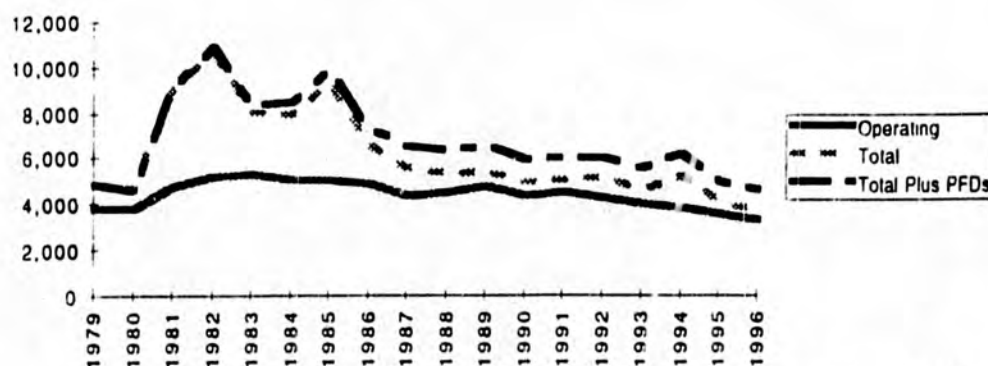
The Commission examined the major growth areas of the state budget. We used FY79 as a starting point, because it was the first full year of petroleum revenues from TAPS and the last state budget prepared before the tripling of state oil

revenues. The bottom chart shows that the largest increases in the 1980s 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

LRFPC BASE CASE PROJECTION

(FY 96 Dollars)

		<u>FY 96</u>	<u>FY 97</u>	<u>FY 98</u>	<u>FY 99</u>	<u>FY 00</u>	<u>FY 01</u>	<u>FY 02</u>	<u>FY 03</u>	<u>FY 04</u>	<u>FY 05</u>
1	Average Oil Price (\$/bbl)	16.52	16.14	16.39	16.39	16.48	16.57	16.66	16.75	16.84	16.92
2	Oil Production (MMb/day)	1.503	1.457	1.418	1.375	1.342	1.304	1.246	1.195	1.146	1.103
AVAILABLE REVENUES (\$ Millions):											
3	PETROLEUM (Severance, Royalty, Property & Income Tax)	1,553.4	1,582.9	1,607.6	1,584.9	1,546.2	1,506.3	1,429.8	1,368.9	1,312.9	1,253.1
4	OTHER SOURCES	221.3	205.1	202.6	198.1	194.7	191.3	187.9	182.9	178.8	174.8
5	NONRECURRING SOURCES	188.4	87.4	84.7	82.1	79.6	77.1	74.7	72.4	70.2	68.0
6	PERMANENT FUND NET INCOME	1,218.0	1,251.6	1,284.5	1,319.7	1,372.7	1,395.5	1,387.9	1,400.6	1,493.4	1,530.2
7	TOTAL REVENUES	3,181.1	3,126.9	3,179.4	3,184.9	3,193.2	3,170.2	3,080.2	3,024.8	3,055.3	3,026.1
EXPENDITURES (\$ Millions):											
8	OPERATING - AGENCY	1,157.8	1,186.5	1,214.8	1,242.8	1,270.4	1,297.7	1,324.7	1,351.3	1,377.8	1,403.9
9	FORMULA	413.8	417.1	420.4	423.8	427.2	430.6	434.1	437.5	441.0	444.6
10	K - 12 EDUCATION	660.3	676.8	693.7	711.1	728.8	747.1	765.7	784.9	804.5	824.6
11	DEBT SERVICE	109.4	84.1	76.7	66.4	44.9	28.6	17.0	13.3	11.9	10.9
12	CAPITAL	116.1	116.1	116.1	116.1	116.1	116.1	116.1	116.1	116.1	116.1
13	LOANS/TRANSFERS	18.7	22.4	22.6	22.7	22.9	23.1	23.3	23.5	23.7	23.9
14	PERMANENT FUND INFLATION PROOFING	441.0	428.2	454.5	461.5	482.6	490.0	496.5	503.7	510.1	516.3
15	PERMANENT FUND DIVIDENDS	575.0	581.6	578.7	592.8	632.0	650.2	669.2	688.0	707.4	724.1
16	TRANSFER TO EARNINGS RESERVE	202.0	241.8	211.3	265.4	258.1	255.3	222.2	208.9	276.0	289.8
17	TOTAL EXPENDITURES	3,694.1	3,754.5	3,828.8	3,902.6	3,983.1	4,038.7	4,068.8	4,127.3	4,268.3	4,354.1
18	INFRASTRUCTURE MAINTENANCE		71.1	71.1	71.1	71.1	71.1	71.1	71.1	71.1	71.1
19	PROJECTED ANNUAL FISCAL GAP	-513.0	-698.7	-720.5	-788.8	-861.0	-939.5	-1,059.6	-1,173.6	-1,284.1	-1,399.1
20	CONSTITUTIONAL BUDGET RESERVE BALANCE	1,992.5	1,839.3	1,299.6	700.9	0.0	0.0	0.0	0.0	0.0	0.0
21	DRAW FROM EARNINGS RESERVE					165.4	763.5	1,059.6	301.1	276.0	289.8
22	PF EARNINGS RESERVE BALANCE	844.0	1,040.9	1,260.1	1,486.6	1,517.3	962.3	95.2	0.0	0.0	0.0
23	UNFILLED FISCAL GAP								-872.4	-1,008.1	-1,109.3
24	CUMULATIVE GAP AFTER CBR AND ERA ARE DRAINED										-2,989.8

Note: Reserve balances and draws may not add exactly due to rounding.
Office of Management and Budget

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Page 7

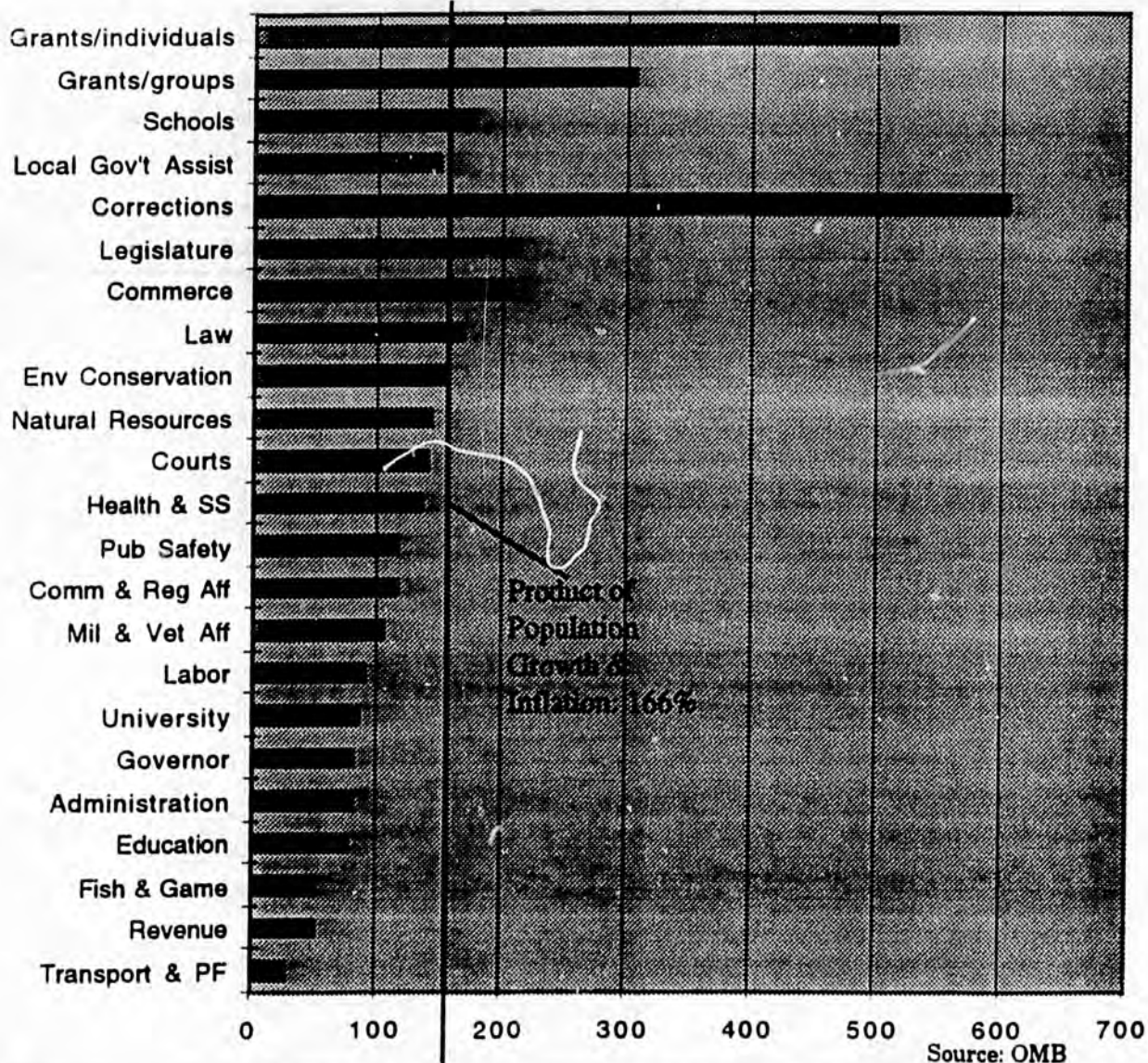
**FY1979 to 96 General Fund
Budget Comparisons
(million \$)**

	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

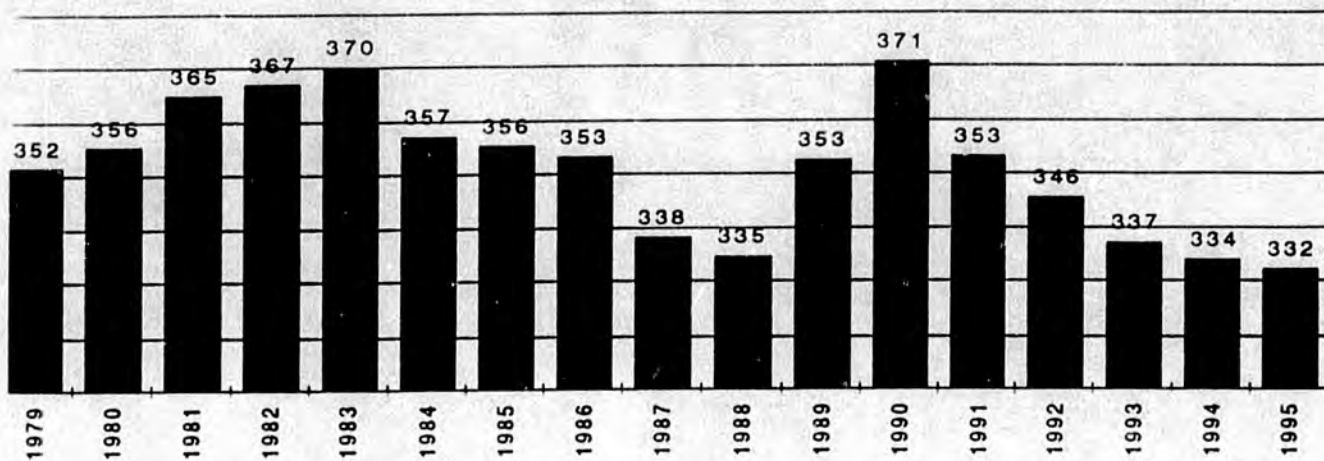
Growth of State Government: FY79 to FY96

Percentage Changes



Source: OMB

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.

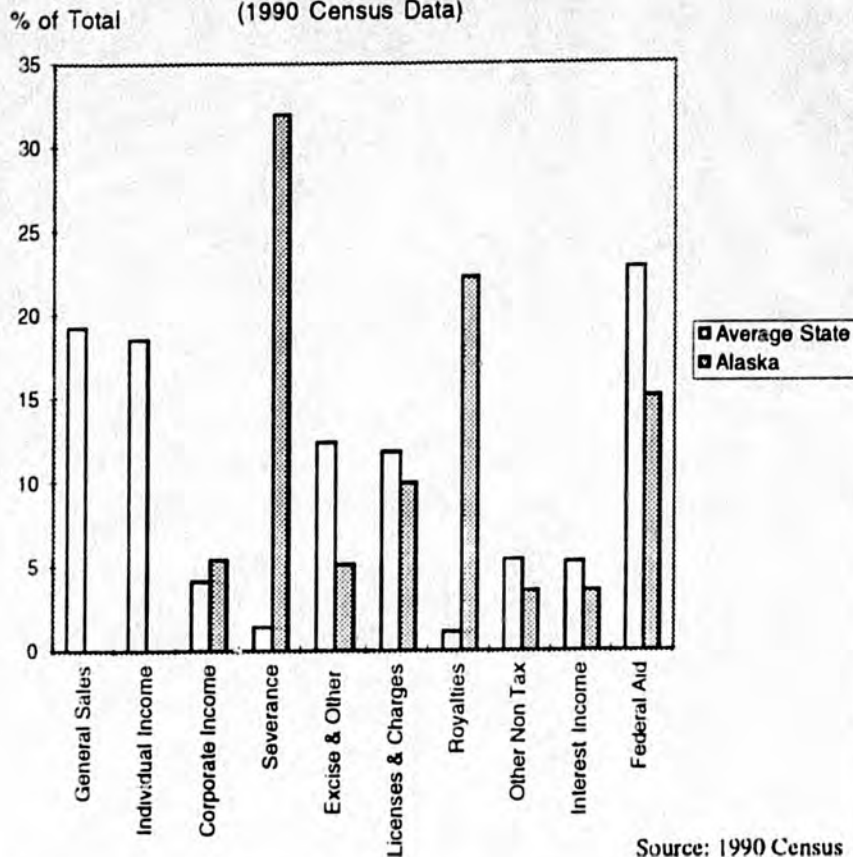
Before the oil years, Alaska spent nearly three times the national average per capita of other states to provide public services. In the 1980s this ratio increased to four times the national average. It has since declined to about the same as in Fiscal Year 1979.

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.

Alaska Revenue Sources vs. U.S. Average

(1990 Census Data)



Source: 1990 Census

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 properties tax, severance taxes; and corporate income taxes. The state has a number of small sources of revenue, gener-

Comparisons are made more 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?

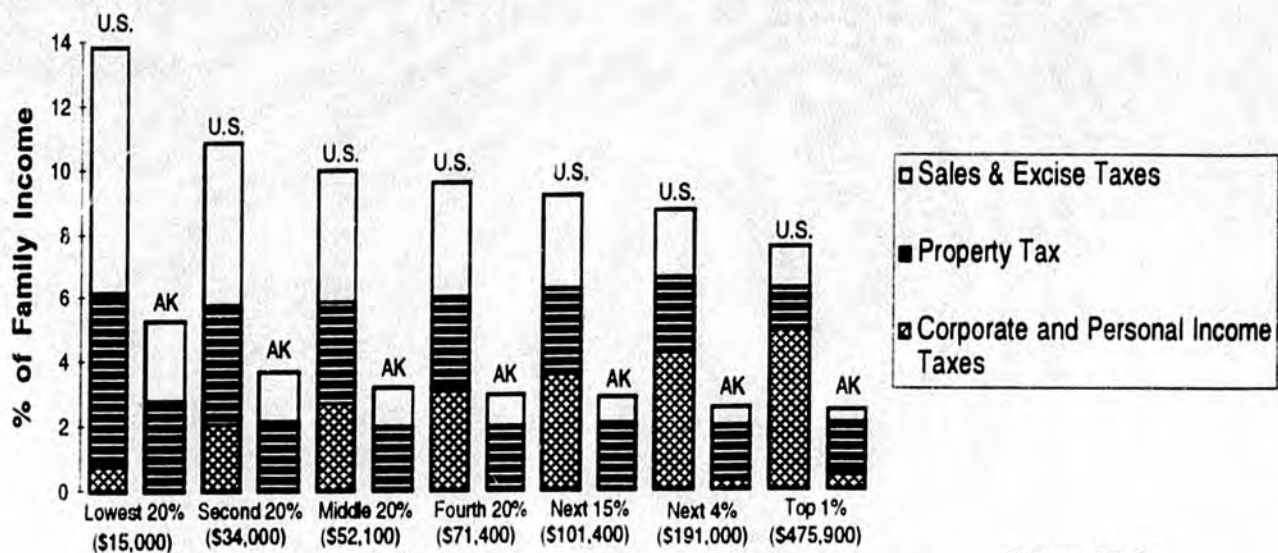
The State of Alaska will receive \$3.2 billion in general fund revenues and permanent fund earnings during FY96.

ally 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.

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

Source: Alaska Department of Revenue

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

Source: Alaska Department of Revenue

\$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

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

of Alaskans changes the federal tax liability for Alaskans. The federal tax offset is 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 similar tax exporting provision — a portion of sales taxes are paid by non-resident workers and by visitors to Alaska.

The effects of these options can also be differentiated by income level. Reimposing a state income tax hits upper income residents higher than lower income residents; reductions to the permanent fund dividends are proportionally greater on lower income residents.

What do you think should be done to close the fiscal gap?

Alaskans have the opportunity to respond to the issues raised in this report.

The Commission is interested in public comment upon the issues raised in this report.

You can contact the Commission by mail at:

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

or by electronic mail at:

LRFPC%legis@state.ak.us

The Commission will hear public comment during the following hearings:

Sept. 11	7:00 p.m.	Interior/North
Sept. 12	7:00 p.m.	Southcentral
Sept. 13	7:00 p.m.	Anchorage
Sept. 14	7:00 p.m.	Southeast

Each hearing will be held at the Legislative Information Office Conference Room at 716 West Fourth Avenue, Anchorage and teleconferenced to other LIO sites. If you live in a community which is not served by a Legislative Information Office, to get information on participation in the process please contact the Commission staff at (907) 258-8165.

The Commission will also hear from the public during its regular meetings at the Anchorage LIO on the following dates:

Aug. 26	11:00 a.m.
Sept. 16	11:00 a.m.
Sept. 30	11:00 a.m.

The Commission is particularly interested in hearing about fiscal choices which are not listed in the appendices — other spending cuts, new revenues, uses of Permanent Fund income, uses of reserves, or other economic development strategies.

We want to know which fiscal choices are preferable to others, and why. We believe that in order to close the fiscal gap, Alaska will have to use portions of several choices, and we want to know if Alaskans have suggestions on timing of these fiscal choices — what should come first, and why?

Appendix One

Catalog of policy choices to close the fiscal gap

Part One: Spending Cuts

This appendix is a working document containing policy suggestions developed by the Commission and its subcommittees. It contains some of the information that was prepared for the Commission. It is not complete — we expect additional policy choices to come from the public and to be developed by the Commission. Individual members of the Commission may disagree or agree with any policy listed herein. Readers should feel free to add new policy choices to this catalog.

The Legislature directed the Commission to develop a list of spending cuts that equal the current fiscal gap. This means identifying how to cut more than \$500 million, or 15 percent, from state spending.

Budget cutting is a painful, divisive undertaking.

It does, however, provide us who live in Alaska the opportunity to re-think our expectations of government. It helps us consider what we believe government should provide and how it can 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.

It requires Alaskans to redefine the State's responsibility.

The following scenarios of more than \$500 million in spending cuts are in response to the charge by the Legislature. The subcommittee does not recommend that the fiscal gap could or should be filled only by budget cuts to government operations.

The following represents considerations used in developing reduction scenarios:

- 1. Many Alaskans will not take the fiscal gap seriously or be willing to accept the individual sacrifices to resolve the gap until they believe state government is spending responsibly.**
- 2. Spending cuts are an important and necessary tool to solve the fiscal gap.**
- 3. The State has been accomplishing actual budget cuts by holding the budget flat (which means that the agency or recipient has been absorbing additional costs due to inflation).**

effectiveness of service delivery, who should be providing these services, and who should be paying for them.

The important point is that fiscal policy goals are critically important to the kind of reductions contemplated under any scenario.

Considerations in Making Spending Cuts

Spending cuts require careful attention to both the immediate impact of the cut (loss of federal funds or state jobs, less aid to local governments, smaller grants to individuals and organizations, etc.) and the long term effects (condition of state facilities, impacts on citizens' health and safety, results for economic development, etc.).

In some cases, cuts at the state level might only shift problems to local communities, just as federal cuts will shift burdens to the State.

In other cases, cuts may not result in loss of services to the public. For instance, continued state efforts to streamline programs, and improve technology can produce further cost savings.

Reduction scenarios could incorporate a number of cost-saving ideas, such as:

Grants and Services to Individuals

- In the face of community need for basic services, non-needs based grants to individuals are eliminated.

Grants to Organizations and Local Governments

- Reduce administrative and other costs by consolidation of grantee organizations, local governments and school districts to stretch funds for direct services.
- State directed mandates to local governments could be fully funded or made optional.
- Tie grants to local governments to provide specific services rather than general block grants for local services.

Note: If state and local governments charge for services and at a rate similar to that in other states, these increased fees would help offset reduced state funding.

Salaries and Benefits

Significant savings would be realized from reforms to the public employee compensation system. These reforms apply not only to state

4. **Additional budget cuts, over and above a flat budget, probably will be necessary to solve the fiscal gap.**
5. **Spending cuts should be governed by announced fiscal policy goals.**
6. **Increases in formula programs are only partly explained by population increases; all formula programs must be re-examined or they will overwhelm and defeat all attempts to resolve the fiscal gap problem.**
7. **All state expenditures, including Permanent Fund earnings and dividends, should be included for review in determining fiscal policy goals for spending cuts.**

Note: It should be pointed out that individual Commission members would choose different percentages or even different programs for cutting, if such drastic reductions were required. The following scenarios of spending cuts are to demonstrate that each option has its own set of consequences.

Rules of the Road

- Spending cuts were made only to programs supported by the state general fund. This means potential reductions in programs funded from other sources (such as Power Cost Equalization, student loans, etc.) were not identified as potential reductions. An option is to reduce such programs and have the savings go into the general fund to help bridge the gap.
- For purposes of discussion, the Commission agreed to bring appropriations of Permanent Fund earnings "on budget" since they are an expenditure of state funds. The question of the future of the earnings is central to Alaska's long range fiscal policy.
- The spending cuts discussed here underestimate the impact on local and state economies and services because they do not reflect the anticipated reductions to federal funds.

The Important of State Fiscal Policy Priorities

The state budget reflects what the Governor and Legislature believe to be public policy priorities in terms of needs and services. It also reflects what decision makers believe about who should provide the services and who should share in Alaska's revenues.

As revenues decline, we simply can't pay for all of the things we have been doing in the past nor can we continue to share revenues in exactly the same way. Alaskans are going to have to re-think our fiscal priorities, the

employees, but also to those employed by local governments and school districts. Such cost-saving reforms could include:

- A different health benefit package for all employees and different retirement package for new hires to reduce current benefit costs and future retirement costs for new hires.
- A retirement incentive program to reduce the number of current high-cost employees, cut the overall number of employees in conjunction with a lower cost for all new employees.
- Changes to the current compensation system to better reward individual performance and limit increases in personal services expenses.

Service Delivery Options

State government services could be delivered in different ways. Options include:

- Contract with non-profit and private sector organizations to provide services.
- Privatize the service by selling an asset to a private entity to operate.
- Provide eligible individuals with a voucher so they can purchase services from a private sector vendor.

Four Scenarios to Cut Over \$500 Million—or 15% of the Budget

To accomplish the assigned task of cutting over \$500 million, these considerations were incorporated into four scenarios. They are for illustration and the Commission will not necessarily be recommending any of these.

Scenario 1: *If the decision were made that services provided by the State should be maintained, in so far as possible given the size of the reductions, the following kinds of cuts could be considered. Local governments would then have to decide what services--formerly funded by the State--they are willing to provide and pay for.*

- **Transfer and increase services and fiscal responsibilities to local governments.**
- **The Permanent Fund Dividend would continue to be paid while other non-needs based payments to individuals would be eliminated.**
- **Consolidate and privatize programs at the state level.**

	Estimated Savings by FY 2000	Amount Remaining
Grants that Benefit Individuals: -\$100,002.0		
Longevity Bonus	-72,152.6	0.0
Permanent Fund Dividend	0.0	556,000.0
Public Assistance Programs	-10,163.1	91,468.0
Medical Assistance Programs	-15,035.6	135,320.2
Alaska National Guard Benefits	-226.6	906.3
Day Care Assistance	-1,017.3	10,193.8
Other Programs	-1,406.8	1781.9
Grants to Local Governments: -\$228,072.4		
K-12 Funding	-66,030.9	594,278.5
Human Services Matching Grants	-1769.6	0.0
Senior Citizens Property Tax Relief	-1,500.0	0.0
Revenue Sharing	-26,271.1	0.0
Municipal Assistance	-31,959.0	0.0
Community Jails	-218.7	4,156.0
Capital Matching Grants	-20,000.0	0.0
School Debt Reimbursement	-80,322.4	0.0
Employee Salary/Benefit Reforms and Streamlining Programs: -\$96,150.8		
State Agency Programs	-74,037.9	1,166,246.3
Court System	-2,292.1	43,550.3
Legislature	-3,084.6	27,761.0
University	-16,736.2	150,625.5
Privatization: -\$54,217.4		
Pioneer Homes	-29,842.3	0.0
RATNET	-794.8	0.0
Alaska Council on the Arts	-564.0	0.0
Vocational Technical Schools	-5,106.3	0.0
Harborview	-4,550.0	0.0
Alaska Tourism Marketing Council	-5,365.3	0.0
Alaska Seafood Marketing Council	-7,994.7	0.0
Competitive Contracting Opportunities: -\$11,799.7		
Park Management	-1,672.1	3,941.0
Motor Vehicles Division	-2,062.5	6,187.3
Road and Vehicle Maintenance	-5,050.1	1115,161.9
Other Programs	-47.0	141.2
Consolidate/Eliminate Programs: -\$19,296.8		
Alcohol Beverage Control Board	-479.5	159.8
Alaska Public Offices Commission	-475.4	158.4
Cultural Program Grants	-88.4	0.0
Agricultural Development	-1,034.2	0.0
Rural Development Grants	-1,119.4	0.0
General Obligation Debt (debt obligations fulfilled)	-16,100.0	0.0
Grants to Organizations who Provide Services: -\$11,837.7		
Senior Programs	-954.1	6678.5
Alaska Public Broadcasting Grants	-1,109.1	3,327.5

Regional Non-Profit Corporations	-1,068.7	9,618.1
Health Grants	-698.7	6,288.0
Alcohol and Drug Abuse Grants	-1,435.9	13,823.2
Community Mental Health Grants	-2,583.8	23,254.0
Community Developmentally Disabled Grants	-2,056.2	18,596.2
Council on Domestic Violence Grants	-224.4	4,262.7
Child Care Grants	-269.1	2,553.7
Other Programs	-1,437.7	25,644.6

TOTAL **-\$521,376.9**

Scenario 2: *If the decision were made that, even though massive reductions in state services will occur with \$500 million in cuts, the State should continue to fund services through local governments, the following kinds of cuts could be considered. In this scenario, individuals would share in the responsibility of closing the fiscal gap by foregoing half of their Permanent Fund Dividend.*

- **Major consolidation and privatization of programs at the State level.**
- **Eliminate all but needs-based payments to individuals.**
- **Cap Permanent Fund Dividend payments at 50% and distribute the funds to local governments for community needs (\$278 million based on 1994 dividend amount).**

	Estimated Savings by FY 2000	Amount Remaining
Grants that Benefit Individuals: -\$320,002.0		
Longevity Bonus (needs-based)	-14,152.6	58,000.0
Permanent Fund Dividend	-278,000.0	278,000.0
Public Assistance Programs	-10,163.1	91,468.0
Medical Assistance Programs	-15,035.6	135,320.2
Alaska National Guard Benefits	-226.6	906.3
Day Care Assistance	-1,017.3	10,193.8
Other Programs	-1,406.8	1781.9
Grants to Local Governments: No Reductions		
K-12 Funding	0.0	660,309.4
Human Services Matching Grants	0.0	1769.6
Senior Citizens Property Tax Relief	0.0	1,500.0
Revenue Sharing	0.0	26,271.1
Municipal Assistance	0.0	31,959.0
Community Jails	0.0	4,384.4
Capital Matching Grants	0.0	20,000.0
School Debt Reimbursement	0.0	80,322.4
Employee Salary/Benefit Reforms and Streamlining Programs: -\$96,150.8		
State Agency Programs	-74,037.9	1,166,246.3
Court System	-2,292.1	43,550.3
Legislature	-3,084.6	27,761.0
University	-16,736.2	150,625.5

Privatization: -\$54,217.4

Pioneer Homes	-29,842.3	0.0
RATNET	-794.8	0.0
Alaska Council on the Arts	-564.0	0.0
Vocational Technical Schools	-5,106.3	0.0
Harborview	-4,550.0	0.0
Alaska Tourism Marketing Council	-5,365.3	0.0
Alaska Seafood Marketing Council	-7,994.7	0.0

Competitive Contracting Opportunities: -\$11,799.7

Park Management	-1,672.1	3,941.0
Motor Vehicles Division	-2,062.5	6,187.3
Road and Vehicle Maintenance	-5,050.1	1115,161.9
Other Programs	-47.0	141.2

Consolidate/Eliminate Programs: -\$19,296.8

Alcohol Beverage Control Board	-479.5	159.8
Alaska Public Offices Commission	-475.4	158.4
Cultural Program Grants	-88.4	0.0
Agricultural Development	-1,034.2	0.0
Rural Development Grants	-1,119.4	0.0
General Obligation Debt (debt obligations fulfilled)	-16,100.0	0.0

Grants to Organizations who Provide Services: -\$11,837.7

Senior Programs	-954.1	6678.5
Alaska Public Broadcasting Grants	-1,109.1	3,327.5
Regional Non-Profit Corporations	-1,068.7	9,618.1
Health Grants	-698.7	6,288.0
Alcohol and Drug Abuse Grants	-1,435.9	13,823.2
Community Mental Health Grants	-2,583.8	23,254.0
Community Developmentally Disabled Grants	-2,056.2	18,596.2
Council on Domestic Violence Grants	-224.4	4,262.7
Child Care Grants	-269.1	2,553.7
Other Programs	-1,437.7	25,644.6

TOTAL

-\$513,304.6

Scenario 3: *If the decision were made that the level and kind of services provided to Alaskans by state and local governments are essential to the economy and well-being of the State, the following reduction could be considered.*

- **No reduction in services at state or local government levels.**
- **No reduction in funds to state or local governments**
- **Permanent Fund dividend eliminated.**

	Estimated Savings by FY 2000	Amount Remaining
Grants that Benefit Individuals: -\$556,000.0		
Permanent Fund Dividend	-556,000.0	0.0

Scenario 4: *If the decision were made only to fund services that meet basic life, safety, education and health needs, the following reductions could be considered.*

- **Only programs known to be constitutionally mandated, necessary for basic departmental functions or required by federal law would be retained.**
- **All functions that could be privatized would be eliminated.**
- **Permanent Fund Dividend would be retained.**

Program effects of these potential reductions are summarized by broad service areas:

Education: \$-64,508,000

- K-12 foundation funding and court mandated-educational services are retained as well as state supported school debt. Instructional, nutritional, and facilities support is eliminated.
- Anchorage and Fairbanks campuses of the University of Alaska are retained. State support to other university campuses and programs are eliminated.
- Eliminate general fund support to the Post secondary Education Commission.
- Eliminate nearly all vocational education programs.
- Eliminate RATNET, public broadcasting, state museums, library, archives, and cultural programs.

Social Services: -\$161,694,000

- Eliminate virtually all special senior programs including state support of pioneer homes, the longevity bonus, senior support, and tax exemption programs.
- Eliminate most family and children's services currently provided by non-profits. Retain centralized services.
- Retain basic welfare programs such as AFDC required by federal law.
- Eliminate special Alaska welfare options such as waivers for additional benefits and longevity bonus.
- Eliminate all programs for disabled, developmentally disabled, and veterans.

Health: -\$26,002,000

- Retain basic state health services such as lab, nursing, epidemiology and the medical examiner.
- Retain mental health services included under terms of the Mental Health Trust settlement.

- Eliminate state support for prevention services such as mental health, child abuse, and public health.
- Eliminate most outpatient and institutional services provided by private non-profits.
- Eliminate all health care administrative services not required by federal law.

**Natural Resources Management and
Environmental Conservation: -\$66,687,000**

- Retain most restoration and protection functions.
- Eliminate nearly all general funded resource management functions with the exception of the boards of fish and game.

Public Protection: -\$28,763,000

- Retain essential licensing functions.
- Retain sanitation and health inspections.
- Retain basic state safety functions, eliminate all outreach programs.
- Eliminate all civil rights functions.
- Eliminate special state national guard retirement benefits.
- Eliminate regulatory functions with the exception of alcohol and public utilities.

Administration of Justice: -\$28,437,000

- Retain state troopers, fish and wildlife protection and village public safety officer programs.
- Retain probation and child support enforcement.
- Eliminate domestic violence and sexual assault program.
- Retain prosecution, courts, and incarceration with minimal cuts.
- Eliminate contract jails.

Development: -\$25,875,000

- Eliminate all promotional assistance, financing, and rural economic development aid programs.
- Eliminate all but minimal maintenance from statewide facilities and transportation services.

General Government: -\$111,034.0

- Retain revenue collection, elections, and debt service.
- Eliminate all but minimal general administrative and support services.
- Eliminate all general fund support of local governments.
- Decrease capital spending to fill remainder of the gap.

TOTAL -\$513.0 million

Appendix One

Catalog of policy choices to close the fiscal gap

Part Two: New Revenues

This appendix is a working document containing policy suggestions developed by the Commission and its subcommittees. It contains some of the information that was prepared for the Commission. It is not complete — we expect additional policy choices to come from the public and to be developed by the Commission. Individual members of the Commission may disagree or agree with any policy listed herein. Readers should feel free to add new policy choices to this catalog.

Taxes are potential sources of revenue to close part of the fiscal gap.

The Commission recognizes that taxes impose costs on both individuals and businesses. Economic burdens on individuals and businesses can impair economic development, although it is widely known that most accept the necessity of paying taxes and ask only that the burdens be imposed fairly and for important services.

The Commission examined revenue sources used in other states that Alaska does not use. Most prominent among these sources are statewide property taxes, statewide sales taxes, and individual income taxes. Alaska repealed its personal income tax in 1980, and has traditionally allocated to local government use of property and sales taxes.

At the same time, the state funds certain programs, notably education, that are traditionally considered a local responsibility. The Commission notes that many states use a statewide real property tax as the primary source of revenue to fund statewide education support.

Four major new taxes can be parts of a solution to the fiscal gap.

- statewide real property tax
- statewide sales tax
- individual income tax
- employment tax (similar to the old "school tax")

Statewide Real Property Tax = \$28 million per mill

The state can expect to receive approximately \$28 million annually for each one mill of real property tax in addition to the amount the state receives now from the oil and gas property tax.

There are difficulties in collecting property taxes in the unorganized borough and costs of tax administration may exceed collections.

Statewide Sales Tax = \$58.0 million each 1 percent

The Department of Revenue estimates that each one percent of statewide sales tax that exempts food, health and social services, would generate \$58.9 million annually, excluding sales taxes that could be imposed on mail order sales.

Sales taxes are easy to collect because the seller, in effect, is the tax collector and it spreads the tax burden widely to all purchases of goods and services. In addition, it captures some revenues from non-residents visiting Alaska.

Sales taxes are a preferred form of taxation in other states as well as among Alaska's local governments. Some local governments, e.g. Anchorage, have steadfastly resisted the imposition of a sales tax. Fairbanks had a sales tax until the state increased revenue sharing and municipal assistance in the early 1980s. Juneau imposes a four percent sales tax. In contrast, the State of Washington imposes a sales tax of approximately 8 percent.

An argument against sales and use taxes is the tax creates the largest proportional burden for those who have lower incomes. In recognition of this, many jurisdictions exempt food and other categories of essential goods and services. Notwithstanding, sales taxes are increasingly supported by all income groups, including those upon whom the burden of a sales tax falls most heavily.

Another option is to establish a statewide sales tax that supersedes local sales taxes and apportions the receipts between the state and the local government in which the sales taxes are collected. Either as a part of this tax, or as a separate tax, the legislature can act as the borough assembly of the Unorganized Borough and enact a sales tax to support a portion of rural services.

Individual Income Tax = \$74.5 million @ 1 percent

The Department of Revenue estimates that each 1% tax on Alaskans' federal taxable incomes would raise \$67 million, with non-residents adding another \$7.5 million. The amount which would result from graduated taxes is estimated in the following table:

Estimated Individual Income Tax (on Alaska residents)

Income Class	# of Returns	Adjusted Gross Income (Federal) (\$000)	Exemptions & Deductions (\$000)	Alaska Taxable Income (\$000)
\$0— \$29,999	233,370	\$1,805,391	\$1,133,050	\$672,341
\$30,000— \$49,999	52,100	2,051,278	675,210	1,376,068
\$50,000— \$74,999	37,460	2,388,194	615,690	1,672,504
over \$75,000	29,809	3,602,086	650,515	2,951,571
Total	352,739	\$9,746,949	\$3,074,465	\$6,672,484

Employment tax @\$100 each employee = \$40 million

The Territory and later the State levied a tax of \$10 per employed person. The proceeds of the tax were used to fund education. Reinstitution of this tax at a level of \$100 would yield approximately \$40 million, based on current labor force estimates, with approximately 8% of that amount paid by nonresident workers. This tax creates a heavier proportional burden for low wage earners than for persons in high income brackets.

There is no structure in place for collection of these taxes and there can be significant costs incurred for tax collection. The Commission believes that if new taxes are necessary to close a portion of the fiscal gap, the taxes should generate more revenue than costs.

Existing other taxes can be increased as parts of a solution to the fiscal gap

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

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

Possible changes in the taxes would yield the following additional revenues.

Raise highway motor fuel tax to U.S. median = \$58.7 million

Highway motor fuel tax: an increase from 8¢ per gallon to the US. median tax rate of 21.9¢ per gallon would yield \$58.7 million (if the off-highway exemption stays at 6¢) or \$39.3 million (if the off-highway tax remains at 2¢). Repeal of the exemption for gasohol would raise \$4 million.

Raise marine motor fuel tax to U.S. median = \$28.1 million

Marine motor fuel tax: an increase from the current 5¢ per gallon tax to the highway rate of 8¢ per gallon would raise \$5 million; an increase to the average US. median tax of 21.9¢ per gallon would raise \$28.1 million.

Repeal aviation motor fuel tax foreign exemption = \$10 million

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

Fisheries business tax: eliminate differential = \$2.5 million

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

Increase fishery resource landing tax: .7% = \$1 million

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

Increase tobacco tax \$1.00 per pack = \$57 million

Tobacco Tax: Alaska has the fifth highest rate of smoking nationally and the highest rate of chewing tobacco use. Experience in Canada has shown that total revenue from tobacco taxes have continued to rise even though total consumption dropped when the tax was increased to \$3.00 per pack. After factoring in expected decreases in cigarette consumption, an increase of \$1 per pack in Alaska would bring in an additional \$42 million annually. An increase in the tax on chewing tobacco to 55¢ would bring in \$370,000 annually.

Increase alcohol tax rate = \$19 million

Alcohol Tax: A raise in the tax on alcoholic beverages from 3-4 cents a drink to 10 cents a drink would raise an additional \$19 million.

Resource taxes and royalties

Alaska taxes natural resources. The Commission notes that any proposal to create or increase resource taxes requires serious consideration of the interplay between levels of taxation and resource development. There are diverse views as to what impact taxes have on new resource development or the continuation of existing resource-based industries.

Minerals Industry Taxes

The state presently collects approximately \$343,000 from the mining license tax. This is a tax levied on the net value of resources, primarily gold and coal. Because many of Alaska's mineral resources, other than oil and gas, are now in an early state of development of both mines and markets, the Commission notes that a thorough examination of the economic impact of taxes or royalties on the minerals industries is needed.

Timber

The Commission did not undertake an analysis of the tax and royalty the state's timber resources could support. Such an amount is not likely, however, to be significant in closing the fiscal gap.

Oil and Gas

No discussion of potential revenues would be complete without considering a increased taxes or royalties on the state's oil and gas resources. Alaska's revenue shortfall is the result of a major decline in oil production. This means that the oil and gas industry is also suffering from the same decline in revenues and, at the same time experiencing increasing production costs.

Without consideration of Permanent Fund earnings, the oil and gas industry in Alaska presently generates 80 percent of Alaska's income through royalties, severance taxes, real property taxes and corporate income taxes. Inclusion of Permanent Fund earnings reduces that percentage to about 50 percent.

Royalties are set by contract and in 1995 new legislation gave the Commissioner of Natural Resources the ability to negotiate varying royalty rates for different oil fields.

A few years ago, a measure changing the reduction in severance taxes scaled to the economics of production from a mature or maturing oil field was enacted. Real property tax revenue is a function of the value of the property assessed. With

respect to oil and gas property, economic or useful life and, thus, value, is closely tied to the life of the field or fields served.

Fish royalty tax @ oil and gas rate = \$60 million

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

New revenue sources — non-tax

Service and User Fees

At the present time, the state imposes service and user fees in approximately 170 different categories. Some fees are mandated by federal programs, some are fixed to cover regulatory costs and others are designed to fund services, such as occupational licensing.

Programs which are fully supported by fees and other charges seldom receive adequate scrutiny by both the legislature and the administering agencies to determine if the service can be less expensive or if the service can or should be fully supported by fees and charges. The Commission has requested information showing a comparison of fees and costs.

Table 2, attached, shows those user fees which (a) were collected in 1991, (b) brought in at least \$100,000 in 1991, and (c) for which rates were not primarily market-driven. These amounts will be updated in the next version of this report and certain items may be moved to the tax list (e.g. insurance taxes are here, not on the list of taxes).

Statewide lottery = \$10 to \$20 million

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

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

AGENCY	DIVISION	NATURE OF FEES	1991 COLLECTIONS	SOURCE OF FEES
DOT/PF	Admin Svcs	Airport Fees, etc	\$24,148,724	Other
Public Safety	Motor Vehicles	Vehicle Registration	\$17,572,608	Statutory
ADF&G	Administration	License & Tag Fees	\$11,474,010	Statutory
ADF&G	Comm Fish Entry C.	Entry Permit Fees	\$5,912,800	Regulation
Public Safety	Motor Vehicles	Drivers Licenses	\$3,611,473	Statutory
Commerce	Occ. Licensure	All Occupations	\$2,540,490	Regulation
Commerce	Insurance	Insurer Fees	\$2,022,700	Regulation
Court System	All Courts	Filing Fees	\$1,828,800	Other
Commerce	Occ. Licensure	Business Licenses	\$1,536,000	Statutory
Commerce	Occ. Licensure	Gaming Licenses	\$1,526,000	Statutory
Revenue	ABC Board	Liquor Licenses	\$1,482,700	Statutory
Commerce	Banking, Sec & Corps	Security Registration	\$707,438	Regulation
		Oversize Overweight		
Commerce	Measurement Stds.	Vehicle Registration	\$681,900	Regulation
DHSS	Public Health	Vital Statistics	\$612,029	Other
Env.Cons.	Spill Prevention	UST Fees	\$500,000	Statutory
Commerce	Insurance	Agents, Licenses	\$467,800	Regulation
Public Safety	Fire Protection	Plan Review	\$388,400	Regulation
ADF&G	Wildlife Conservation	Permit Hunt App	\$380,395	Statutory
Commerce	Banking, Sec., & Corps	Broker Dealers	\$310,790	Regulation
DOT/PF	Admin Services	Utility Permits	\$272,199	Regulation
Education	Educational Finance	Teacher Certification	\$224,625	Regulation
Commerce	Banking Sec. & Corps	Incorporations	\$223,650	Regulation
Labor	Labor Stds & Safety	Certs. of Fitness	\$216,000	Statutory
Commerce	Investments	Late Fees	\$208,500	Regulation
Labor	Labor Stds & Safety	Boiler Fees	\$208,000	Regulation
Revenue	ABC Board	License Application	\$201,400	Regulation
Education	Vocational Rehab	Vendor Fees	\$200,000	Other
Commerce	Banking, Sec. & Corps	Agents & Invest. Advs.	\$186,030	Regulation
Public Safety	Criminal Records	Fingerprinting	\$110,480	Regulation
Governor	Lt. Governor	Notaries Public	\$109,137	Statutory
Other	Statutory Fees	Not listed above	\$2,318,058	Statutory
Other	Fees set in Regulation	Not listed above	\$4,966,345	Regulation
Other	Fees not statutory or regulatory	Not listed above	\$10,488,692	Other

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

- The CBR should be maintained at a level of \$1.5 billion to provide stability in the event of a rapid decline in oil prices or production or in the event of a natural disaster. That amount is approximately one year's oil revenues. Funds in excess of that amount should be deposited into the principal of the Permanent Fund. Earnings from CBR investment should continue to flow into the CBR.
- Funds in the CBR should be invested in accordance with the prudent investor rule based upon the purposes of the reserve. The commission recommends that the general fund be allowed to borrow against the CBR to even out the flow of funds required to meet monthly cash flow needs.
- The sweep provisions in the current CBR should be eliminated (Article X, Section 17 (d) of the Constitution). Sufficient controls on the use and withdrawal of funds from the CBR are achieved by limiting withdrawals from the fund to make up for projected annual revenue declines rather than availability of funds.
- Once the constitutional amendment establishing the Permanent Fund as an endowment is in place in FY98, all funds in the Permanent Fund Earnings Reserve should be deposited into the principal of the Permanent Fund. As an endowment, the Permanent Fund will be effectively inflation-proofed. The dividends will be payable out of the automatic annual withdrawal.

Reform the budget process

The Commission found the budget process does not yield adequate information concerning the State's finances, nor does it describe what we get for what we spend. It discourages appropriate scrutiny of overall State spending. Although the fiscal gap relates to State general fund spending, special funds set aside or collected affect services delivered by the State and require oversight and control.

- The budget process should include review of all State spending, not just State general funds. The executive and legislative branches should establish procedures to provide appropriate scrutiny and disclosure.
- A report to the public should be prepared annually on progress toward closing the fiscal gap. The Commission suggests the spreadsheet format it has used to show the existence or absence of a fiscal gap for the current and succeeding 10 years.
- The legislature should review each program funded or operated by the State, including loans and special appropriations to determine whether or not it meets its intended purpose and whether the program is needed in the 21st century. State programs should also be reviewed to determine if the service is better delivered at the local level.
- Capital improvement funding should be based on a six-year plan to achieve greater efficiencies in funding, planning, construction and maintenance.

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

The five- and ten-year plan

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

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

First Session Progress Report on the Financial Plan

Legislation

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

Budget Action

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

Second Session Progress Report

Legislative Action

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

Budget Action

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

Third Session Progress Report

Legislative Action

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

Budget Action

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

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mailers*

THE STATE LONG RANGE FINANCIAL PLANNING COMMISSION REPORT

An Endowment For Alaska's Future The State Long Range Financial Planning Commission Report

EXECUTIVE SUMMARY

Alaska's fiscal gap is real and growing

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

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

What the plan does:

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

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

Closes the fiscal gap by the year 2000

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

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

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

Stabilizes and diversifies revenues

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

Controls State general fund spending

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

Maintain a reserve to dampen the effect of oil price swings

The Constitutional Budget Reserve will be available to cushion oil

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

Decreases our dependence on volatile oil revenues

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

The plan closes the fiscal gap with the following steps:

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

The first three years

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

Cut spending

- Cut current State general fund spending by \$100 million — \$40 million in 1996, \$30 million in 1997, and \$30 million in 1998 — a reduction of \$300 million in today's dollars.
- Reduce per capita State general fund spending from \$4,020 to \$3,692 in five years — a reduction to \$3,255 in today's dollars.

Increase Revenues

- Increase tobacco taxes by \$1 per pack (\$43 million).
- Increase alcohol taxes by 10 cents per drink (\$30 million).
- Increase motor fuel tax from the 1961 level of 8 cents/gallon to 22 cents/gallon and increase marine fuel tax by 3 cents/gallon (\$44 million).
- Increase user fees by at least \$5 million per year, double motor vehicle license fees, and eliminating motor vehicle license fee exemptions (\$32 million).
- Establish a new tax to generate at least \$20 million from sources and increase taxes on fisheries and other resources by \$30 million.

Use the Permanent Fund as an endowment

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

Boost the earning power of the Permanent Fund

- Build Permanent Fund principal by
 - (a) making additional special deposits to fund principal;
 - (b) increasing the minimum annual deposit to the Permanent Fund;
 - and (c) retaining additional earnings in the Permanent Fund.
- Deposit \$600 million from the Constitutional Budget Reserve into the Permanent Fund this year.
- Close out the Permanent Fund Earnings Reserve once the endowment is in place, by depositing it into the Permanent Fund (approximately \$1.2 billion).
- Increase to 50 percent the minimum contribution to the Permanent Fund from certain oil, gas and mineral lease revenues.
- Retain earnings in excess of the 4 percent annual payout in the fund. Since the projected rate of return to the fund is 4.79 percent after inflation, the Fund should retain earnings above inflation-proofing of at least 0.75 percent annually.

Cap the Permanent Fund Dividend pool

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

Clarify the purpose of the State's reserves

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

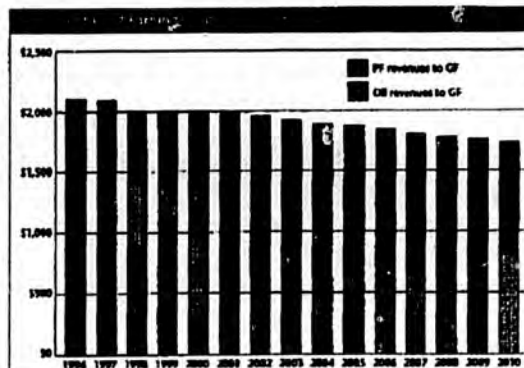
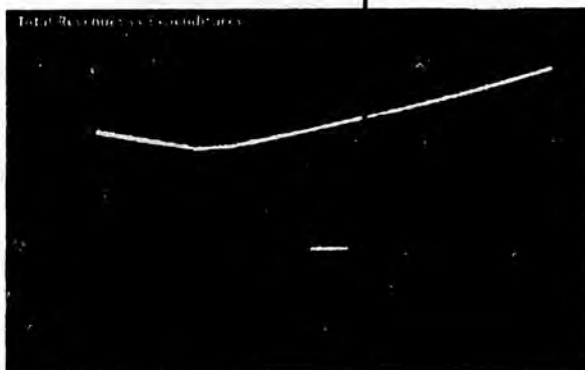
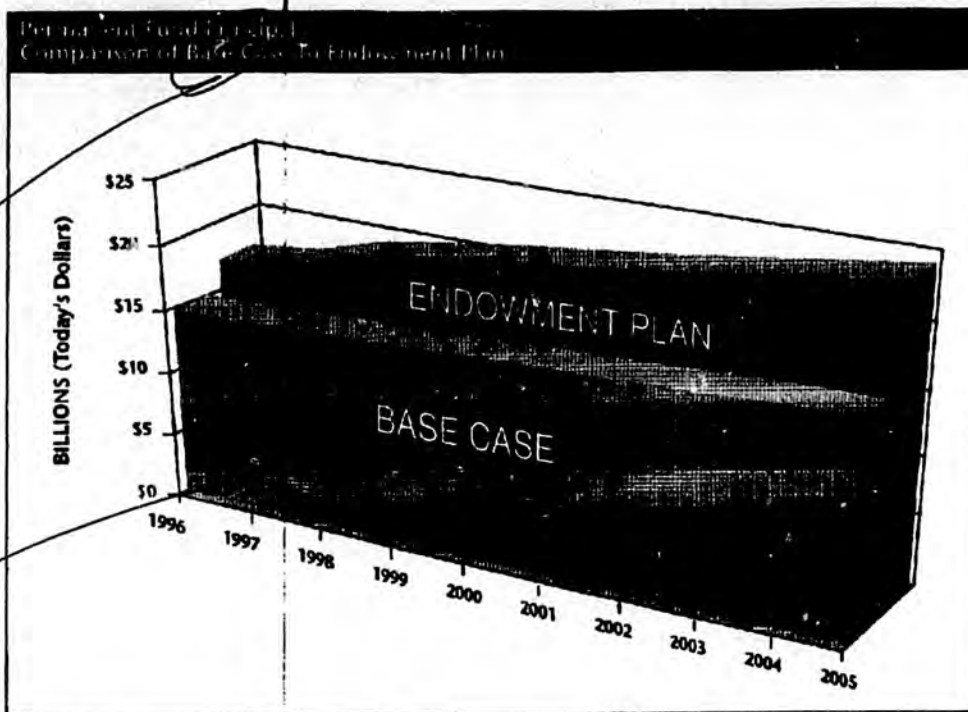
Reform the budget process

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

The five- and 10-year plan

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

THE STATE LONG RANGE FINANCIAL PLANNING COMMISSION REPORT



Special Acknowledgements

The members of the Long Range Financial Planning Commission who have provided their expertise and assistance in the preparation of this report are:

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In addition, the members of the Commission acknowledge the contribution of the following individuals and organizations: