

SB

326

STATE TAX POLICY STUDY

OBJECTIVE: PRESENT INFORMATION TO ALLOW THE LEGISLATURE TO DEVELOP A RATIONAL PLAN REGARDING LONG-TERM STATE TAX POLICY TO FOSTER GREATER ECONOMIC GROWTH AND EMPLOYMENT IN ALASKA.

GOALS: BALANCED USE OF ALL CONVENTIONAL REVENUE SOURCES

BROAD TAX BASE FOR EACH TAX SOURCE

UNIFORM TREATMENT OF THE ENTIRE TAX BASE

MINIMUM TAX RATES

RELIANCE ON USER CHARGES WHEN APPROPRIATE

SIMPLICITY OF TAX STRUCTURE

ACCOUNTABILITY

METHODS AND MEANS: FUNDED THROUGH THE LEGISLATURE, THE STUDY WOULD BE DESIGNED TO DEVELOP NEW DATA RATHER THAN A RESULTS-DRIVEN, THE NEW DATA WOULD BE A RESULT OF REVIEW AND ANALYSIS OF ALL EXISTING STATE TAXES AND USER FEES. THE REVIEW AND ANALYSIS WILL EXAMINE THE PURPOSE, AMOUNTS DERIVED AND EFFECTS EACH TAX AND USER FEE HAS ON THE STATE'S ECONOMY.

COST: \$500,000

DURATION OF STUDY: 15 MONTHS

LEAD AGENCY: Office of Management and Budget

OTHER AGENCIES TO WORK WITH OMB: Departments of Commerce, Revenue and Administration. Also, a tax policy consultant(s) selected by the state government agencies working group will be available to provide baseline and policy data/information.

ALASKA CLIPPING
SERVICE
Anchorage Times
Anchorage, AK

JAN 9 1986

Kotzebue legislator seeks tax study

by Dean Feedick
Associated Press

JUNEAU — The legislature would appropriate \$500,000 for a special tax study under a bill prefilled by Sen. Frank Ferguson, who said Wednesday he doubts lawmakers will pass any kind of tax increase in election year 1988.

Ferguson, D-Kotzebue, said nine other states have conducted similar studies.

"All came up with different solutions, but from what I gather, they were the right solutions because it's (tax increase) something the state legislatures have to act on as a policy question," Ferguson said.

"I don't think our revenue situation is going to get any bet-

ter, so we'd better take a hard look at raising new money," he said in a telephone interview from Kotzebue. "I feel we don't need any taxes this year, but we're going to eventually, so we'd better know what we're talking about."

Under Ferguson's measure, a half-million dollars would be appropriated from the general fund for the Office of Management and Budget.

The agency would analyze "the state tax structure to determine the effectiveness of existing state taxes, tax credits, licenses and user fees in providing

a broad, stable, and accountable source of revenue for the state;

"to provide information to the legislature to assist the formulation of long-term tax policy;

"to specifically examine the balanced use of conventional revenue sources, uniformity in taxation among taxpayers, and the relationship between minimizing taxes and fostering economic growth," the bill said.

The agency would report its findings to the legislature by June 30, 1987.

"I'm saying let's not do anything with taxes until this study comes in," Ferguson said. "I

think politically it's the best solution."

Sen. Bob Ziegler, D-Ketchikan, pre-filed a bill last year that would reinstate Alaska's individual income tax.

Alaskans haven't paid a personal income tax since 1978.

Ziegler's measure failed to generate a hearing last session and it awaits action in the Senate Judiciary Committee, the committee of first reference.

"It's to become effective at some date in the future," Ziegler said Wednesday. "It's not a popular idea, of course, but one of these days we'll have to have it."

Editorial writers criticized him last year for trying to reinstate individual income taxes, then they wrung their hands about all the out-of-state workers coming into Alaska, Ziegler said.

"This is one way to do something about it," he said. "We'd tax them."

Capitol observers say House leaders will try to push changing the oil tax formula this year, but that move is expected to run into heavy traffic when it hits the more conservative Senate.

"Oil taxes are up in the air and if Anchorage won't vote in a local sales tax, then it's doubtful you'll

see a statewide sales tax," Ziegler said. "That leaves income taxes. I believe we'd raise \$400 million a year if it were reinstated."

Gov. Bill Sheffield sees no need to reinstate the individual income tax in the near future, press aide John Greely said.

"He's said in the past he thought it was a mistake it was completely repealed," Greely said. "He thought a moratorium would be a more proper and prudent route."

"But it's not something that has engendered a lot of debate within the administration in recent years, because we've been able to generate enough oil revenues," he said.



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JAN 30 1986

442-3401 CITY HALL
442-3157 DAY CARE CENTER
442-3816 GEORGE FRANCIS MEMORIAL LIBRARY
442-3500 MUNICIPAL WATER PLANT
442-3465 PLANNING DEPARTMENT
442-3351 POLICE DEPARTMENT

442-3465 PUBLIC WORKS DEPARTMENT
442-3066 RECREATION CENTER
442-3921 REGIONAL FIRE TRAINING CENTER
442-3779 TEEN CENTER
442-3404 VOLUNTEER FIRE DEPARTMENT

January 24, 1986

The Honorable Senator F. Ferguson
The State Senate
Pouch V
Juneau, Alaska 99811

Dear Senator Ferguson;

The Kotzebue City Council is responding to Senate Bill #326; A bill for an act entitled "An Act making a special appropriation to the Office of Management and Budget for study of tax policy; and providing for an effective date.

We strongly support the above bill and encourage the passage of Senate Bill #326.

Should you require any information or need our assistance please contact us at your convenience.

Sincerely,


Nina K. Dahl
Mayor
City of Kotzebue

cc: File

"GATEWAY TO NORTHWEST ALASKA"

Anchorage Daily News 1-30-86

Hey, wait — more study is needed

The phrase "more study needed" is guaranteed to produce a yawn from most people. But Sen. Frank Ferguson is on target with his bill calling for a comprehensive study of state tax policy. Legislators should embrace the proposal to take a hard look at where and how the state raises its money.

The Kotzebue Democrat wants to spend \$500,000 to analyze how well existing state taxes, tax credits, licenses and user fees serve Alaska. He also wants to know if there is uniformity of taxation among taxpayers. And what about the relationship, and there must be one, between taxes and the state's economic health? Assumptions and prejudices about the important issue abound, but where are the facts?

Declining oil revenues is a hot topic in Juneau this year. And there's plenty of talk about higher oil taxes, altered tax methods, and even a return to the income tax. A comprehensive study, developed by the Office of Management and Budget and supplemented by private consultants, seems essential for formulating a tax policy that provides the state with broad, stable, and measurable revenue sources. After all, if Alaskans don't know how their taxes affect the economy today, how can they determine a realistic tax policy for tomorrow?

Actually, tax review is so fundamental it's hardly a novel government innovation. During the past three years, six states have instituted tax policy studies.

The Alaska State Senate typically moves at a glacial pace. Sometimes the senators get brickbats thrown their way because studies are viewed as expensive but effective delaying tactics. But this is one occasion when senators should join together in support of Sen. Ferguson's proposal and feel perfectly comfortable saving

57326
JAN 23 1986



SOHIO ALASKA PETROLEUM COMPANY

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PRESIDENT

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P.O. BOX 6612
ANCHORAGE, ALASKA 99502-0612

January 17, 1986

The Honorable Frank R. Ferguson
Alaska State Legislature
Pouch V
Juneau, Alaska 99811

Dear Senator Ferguson:

The Alaska Public Interest Research Group (AKPIRG) recently sent you a letter supporting a tax increase on Alaska's petroleum industry. In this letter, AKPIRG's Executive Director repeatedly refers to research reports prepared by that organization this summer. Sohio does not believe their report is completely accurate, and has prepared a brief response which is enclosed for your review.

We continue to strongly believe that a tax increase on our industry is not in the best interest of Alaska.

Sincerely,

A handwritten signature in dark ink, appearing to be "G. N. Nelson", written over a horizontal line.

G. N. Nelson

srv
enclosure
1113L

JUN 26 1986

Capital to Capital

NATIONAL CONFERENCE OF STATE LEGISLATURES

JUNE 2, 1986 VOL. XI NO. 7

NCSL Calls For Retention Of Sales Tax Deduction

NCSL continues to oppose the proposal to eliminate the deductibility of state and local sales taxes as included in the Senate Finance Committee's tax reform plan.

"We applaud the Committee's progress on tax simplification. However, the Committee's vote is somewhat of a contradiction," NCSL President Senator David E. Nething said. "With regard to tax-exempt financing, the Committee recognized that the states are partners in the federal system - the bond provisions allow us greater flexibility to provide necessary services and we strongly support that action. The elimination of the deductibility of sales taxes does just the opposite - state and local governments are treated as (Continued on page 3)

SALES TAX DEDUCTION

(CONTINUED FROM PAGE 1)

just another tax expenditure and not as equal partners. This seriously damages the integrity of the state-federal partnership."

Currently, states derive 32.1% of their revenues from the sales tax. If the elimination of sales tax deductibility is adopted by Congress, states may be encouraged to look more favorably to other taxes such as business taxes as sources of income.

"This proposal would shift the overall composition of state tax systems," according to Tennessee Representative John T. Bragg. Representative Bragg is the Immediate Past President of NCSL. "It is conceivable that state and local governments would turn to increased income and property taxes. In the end, the federal government could lose more revenue than it expects to gain."

NCSL contacts: Michael Bird, Bill Waren, Washington.

June 2, 1986

Rep. Mary Mushinsky, Assistant Minority Leader, (CT)

Rep. Calvin Smyre, Governor's Floor Leader, (GA)

Rep. Donna Sytek, (NH)

Sen. John Traeger, (TX)

Legislative Staff Members

Chair: Vic Hellard, Director, Kentucky Legislative Research Commission

Lynda Davis, Director, Library Division, (MD)

Charles Connor, Legislative Budget Assistant, (NH)

Steven Cross, Revisor of Statutes, (MN)

Mary Noble, Deputy Auditor General, (CA)

Congress Takes First Step On Liability Insurance Legislation

The Senate Commerce Committee has reported the initial piece of legislation that purports to be "a response to one aspect of the overall liability insurance problem: the unavailability and high cost of liability insurance." S. 2129, sponsored by Senator Robert Kasten (R-WI), would authorize public and private sector entities to form self-insurance on collective purchasing groups. S. 2129 would essentially preempt state laws that restrict the operation of purchasing groups and prohibit provision of coverage of captive-type insurance companies to potential members in states other than the licensing state.

The bill's sponsors overcame objections raised by Senator Wendell Ford (D-KY) regarding the need for essential consumer protections and state regulation to make the legislation workable.

The Commerce Committee's report states that S. 2129 is "warranted ... because the commercial insurance market has not demonstrated that it has sufficient capacity to insure all enterprises." The bill's sponsors further contend that S. 2129 "is intended to (Continued on page 3)

State And Local Coalition Meets

NCSL President Senator David E. Nething (ND), President-elect Irving J. Stolberg (CT) and Representative Wilhelmina Delco (TX) represented NCSL at a recent meeting of the State and Local Coalition. The Coalition was formed in 1973 to pursue mutual interests of state and local governments. In addition to NCSL, Coalition members include the National Governors' Association, the National Association of Counties, the National League of Cities and the U.S. Conference of Mayors.

Senator Nething said that three areas of major concern to state legislatures were budget and tax issues, liability insurance and privatization. He said that there was a strong need to revitalize both the state-local relationship and the federal-state-local relationship.

Senator Nething led the Coalition's discussion on tax reform and said that NCSL's major concerns were the deductibility of sales taxes, treatment of tax-exempt bonds, treatment of 401(k) plans and the extensive regulatory requirements that are included in the House bill.

The Coalition members met with U.S. Senators Pete Domenici (R-NM) and Russell Long (D-LA).

In addition to tax reform, the Coalition members discussed welfare reform and liability insurance.

Coalition members generally praised the bond provisions in the Senate tax plan and agreed to work together on the sales tax issue.

Introduced: 1/13/86
Referred: State Affairs and Finance

Funding Information
General Fund \$500,000
Other Funds -0-
\$500,000

BY FERGUSON, ZIEGLER,
ZHAROFF AND V. FISCHER

1 IN THE SENATE

2

SENATE BILL NO. 326

3

IN THE LEGISLATURE OF THE STATE OF ALASKA

4

FOURTEENTH LEGISLATURE - SECOND SESSION

5

A BILL

6

For an Act entitled: "An Act making a special appropriation to the Office
of Management and Budget for study of tax policy; and
providing for an effective date."

8

9 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

10 * Section 1. The sum of \$500,000 is appropriated from the general fund
11 to the Office of Management and Budget for the purpose of analyzing the
12 state tax structure to determine the effectiveness of existing state taxes,
13 tax credits, licenses, and user fees in providing a broad, stable, and ac-
14 countable source of revenue for the state; to provide information to the
15 legislature to assist the formulation of long-term tax policy; to
16 specifically examine the balanced use of conventional revenue sources,
17 uniformity in taxation among taxpayers, and the relationship between mini-
18 mizing taxes and fostering economic growth; and to report results of the
19 study to the legislature by June 30, 1987.

20 * Sec. 2. The unexpended and unobligated portion of the appropriation
21 made by this Act lapses into the general fund June 30, 1987.

22 * Sec. 3. This Act takes effect immediately in accordance with AS 01.-
23 10.070(c).

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Funding Information

General Fund	\$250,000
Other Funds	-0-
	<u>\$250,000</u>

Original sponsors: Ferguson, Ziegler,
Zharoff and V. Fischer

1 IN THE SENATE

BY THE STATE AFFAIRS COMMITTEE

2 COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 826

3 IN THE LEGISLATURE OF THE STATE OF ALASKA

4 FOURTEENTH LEGISLATURE - SECOND SESSION

5 A BILL

6 For an Act entitled: "An Act making a special appropriation to the Legis-
7 lative Affairs Agency to the Joint Special Committee
8 on Tax Policy for a study of the state's tax policy.

9 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

10 * Section 1. The sum of \$250,000 is appropriated from the general fund
11 to the Legislative Affairs Agency for the purpose of analyzing the state
12 tax structure to determine the effectiveness of existing state taxes, tax
13 credits, licenses, and user fees in providing a broad, stable, and account-
14 able source of revenue for the state; to provide information to the legis-
15 lature to assist the formulation of long-time tax policy; to specifically
16 examine the balanced use of conventional revenue sources, uniformity in
17 taxation among taxpayers, and the relationship between minimizing taxes and
18 fostering economic growth; and to report results of the study to the legis-
19 lature by January 11, 1988.

20 * Sec. 2. The unexpended and unobligated portion of the appropriation
21 made by this Act lapses into the general fund June 30, 1987.

22 * Sec. 3. This Act takes effect immediately in accordance with AS
23 01.10.070(c).
24
25
26
27
28
29



JAN 26 1984

RESEARCH SUMMARY

Institute of Social and Economic Research, University of Alaska

January 1984, R.S. No. 14

The Anchorage Consumer Price Index— How Accurate?

Recent research by the University's Institute of Social and Economic Research has revealed that use of faulty data in the Anchorage Consumer Price Index (CPI) may have caused the rate of inflation in 1982 and 1983 to be underestimated by as much as 25 percent or more. The same problem may have caused the rate of inflation to be significantly overestimated in 1980. As a result, businesses, local and state governments, labor unions and other organizations which extensively use the index in planning and contracting have unwittingly been using an invalid measure, one which may have caused material and labor cost estimations in some instances to be off by millions of dollars.

This problem has resulted from the substitution in the CPI of out-of-state housing data in place of Anchorage housing data. Since 1980, the home ownership component of the CPI has reflected housing markets, not in Anchorage, but in such similar-sized cities of the western U.S. as Bakersfield, Fresno, and Monterey, California; Tucson, Arizona; and Spokane, Washington. Because home ownership costs have comprised between one-fourth and one-third of the CPI in recent years, and because the Anchorage housing market has behaved differently from other areas in recent years, this substitution of data has caused the CPI to significantly misrepresent the overall movement of prices in Anchorage.

The CPI was designed to monitor average retail price changes of food, clothes, shelter, medical care, transportation, and entertainment for various metropolitan areas throughout the United States. The index is supposed to show how much prices have changed since 1967, the base year. For example, if accurate, an Anchorage CPI of 264 for November 1983 means that Anchorage consumer prices for selected goods and services had by this time increased 164 percent since 1967.

To explain how this situation arose and how it tends to distort the CPI, this summary compares information from the Anchorage housing market over the last 4 years with housing market data used in the Anchorage CPI and discusses the potential range of error in the published series. In addition, it reviews the problems associated with different methods used to calculate inflation in housing prices.

Why Outside Housing Market Data is Used in the Anchorage CPI

The Anchorage CPI is produced by the Bureau of Labor Statistics (BLS) of the U.S. Department of Labor. Traditionally, the BLS has calculated the change in the cost of home ownership (the major component of the shelter category) as a weighted average of the interest rate on conventional mortgage loans (as reported by the Federal Home Loan Bank Board) and the sales prices of houses with Federal Housing Administration (FHA) mortgages. However, since 1980 the Alaska Housing Finance Corporation (AHFC) mortgage lending programs have dominated the Anchorage market, and the number of FHA mortgages has been small. Consequently, the BLS has been unable to monitor the price of home ownership in Anchorage because their requirement of national consistency prevented the agency from substituting AHFC for FHA information in its computations.

To fill the information gap left by the absence of conventional loan data for Anchorage, the BLS chose to substitute housing market information from the western U.S. cities mentioned above. The BLS staff is aware of the shortcomings of this approach, but budget constraints prevent them from adopting a better method.

The Anchorage CPI difficulties are merely one manifestation of a general problem that the BLS has experienced in recent years in measuring inflation in the price of home ownership in communities across

the country. Recent BLS releases on the Anchorage CPI contain the following caveat for the user:

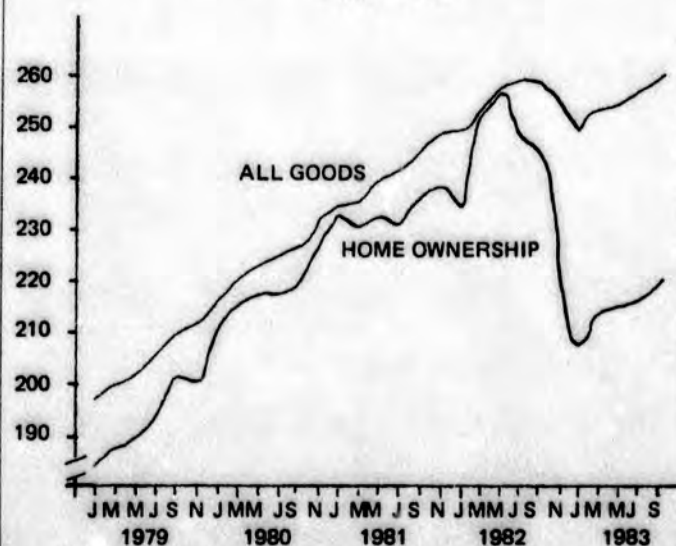
Local area CPI indexes are by-products of the national CPI program. Because each local index is a small subset of the national index, it has a smaller sample size and is, therefore, subject to substantially more sampling and other measurement error than the national index. As a result, local area indexes show greater volatility than the national index, although their long-term trends are quite similar. Therefore, the Bureau of Labor Statistics strongly urges users to consider adopting the national average CPI for use in escalator clauses.

The Anchorage CPI and the Housing Market

According to either version of the Anchorage CPI,¹ prices moved steadily higher between 1979 and 1982, but fell in late 1982 and early 1983 before resuming their upward movement (Figure 1 and Table 1). The urban wage earner index (CPI-W) in late 1983 stood at 260.8, indicating that it now cost \$2.61 to buy what cost \$1 in 1967 (the base year for the index). The home ownership portion of this index, based upon markets in selected western cities, also rose through mid-1982, but then fell abruptly to a level in 1983 that was almost identical to that of 1980. According to this index, the cost of home ownership in Anchorage in September 1983 was no higher in nominal dollars than it was in 1980, even though the general price level was 15 percent higher.

¹Since 1978 there have been two indexes: wage earners and clerical workers (CPI-W) and all urban consumers (CPI-U). Their movements have been roughly parallel.

Figure 1. Anchorage CPI*
(1967 = 100)



*Urban wage earners and clerical workers (CPI-W).

Table 1

Anchorage Consumer Price Index (1967 = 100)

		Urban Wage Earners & Clerical Workers (CPI-W)		All Urban Consumers (CPI-U)	
		Home Ownership		Home Ownership*	
		All Goods	Home Ownership	All Goods	Home Ownership*
1979	Jan.	197.3	184.0	198.1	184.7
	Mar.	200.5	188.2	201.0	188.9
	May	202.5	189.7	203.5	192.1
	July	206.4	193.7	207.4	195.9
	Sept.	210.2	201.9	213.2	204.4
	Nov.	211.8	200.8	213.7	203.3
1980	Jan.	215.9	209.5	218.2	211.9
	Mar.	220.2	215.4	223.5	218.1
	May	223.1	218.6	226.5	221.0
	July	224.8	218.0	228.4	220.6
	Sept.	226.7	220.0	230.9	222.8
	Nov.	232.0	227.8	236.5	230.7
1981	Jan.	235.0	233.8	240.1	237.2
	Mar.	236.2	231.4	241.1	234.3
	May	240.1	232.8	244.6	235.7
	July	241.7	231.4	246.1	235.1
	Sept.	245.9	237.0	250.5	240.5
	Nov.	249.3	238.7	253.7	242.6
1982	Jan.	248.6	235.0	253.0	238.9
	Mar.	254.5	252.8	260.0	257.1
	May	258.0	257.1	263.8	261.6
	July	259.1	248.3	263.6	252.6
	Sept.	258.9	246.5	263.4	250.8
	Nov.	254.4	225.8	257.2	229.5
1983	Jan.	250.6	208.8	257.6	98.3
	Mar.	253.9	214.4	261.0	101.3
	May	254.7	215.8	262.5	103.5
	July	257.5	217.1	265.8	105.0
	Sept.	260.8	221.6	267.9	105.2
	Nov.	264.0	226.6	270.4	105.9

*Conversion to rental equivalency in 1983.

This discrepancy results because the fall in the Anchorage CPI in early 1983 was the direct result of the abrupt drop in the home ownership component, which was based wholly on out-of-state data.

In contrast, the recent trend in the average sales price of homes in Anchorage has clearly been up. It has risen from \$85 thousand in January 1980 to \$115 thousand in January 1983—35 percent. During the same period, mortgage interest rates have fluctuated, but are currently at approximately the same level as in 1980 (Figure 2). Both of these trends are in sharp contrast with the national price and interest rate trends represented in the home ownership part of the Anchorage CPI. Correction of the CPI requires substituting the Anchorage housing information for out-of-state information in the home ownership price equation. Without going through this procedure,

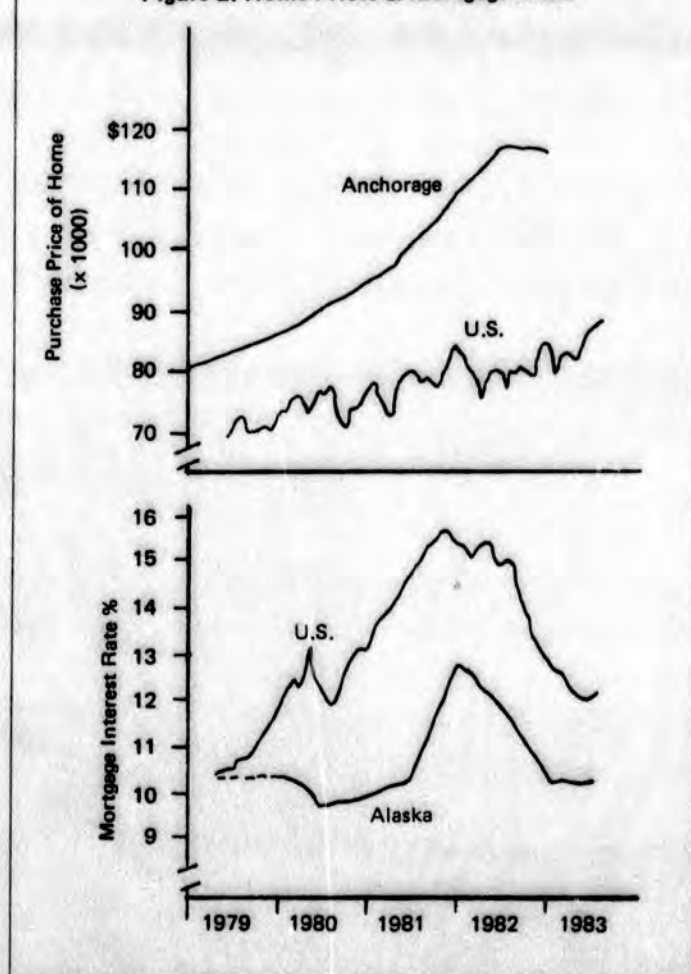
which is a complicated one, it is impossible to determine the exact error in the BLS method.²

Examination of Figure 2 suggests that the Anchorage CPI probably overestimated the inflation rate in 1980 but underestimated it in 1982 and 1983. Consequently, it is not possible to say whether the current index is too high or too low. The overestimation in 1980 would have resulted from the dramatic increase of mortgage rates that year in the nation as a whole. In Anchorage, however, the AHFC mortgage rates had begun to fall below the national trend.

When we look at the period since then, it is clear that if the effective mortgage interest rate is now at the same level as in 1980, and if the average sale price

²The BLS method takes into account changes over time in the quality and size of the average home as well as changes in the characteristics of the average mortgage. These adjustments assure that the BLS is measuring the change in price over time of a constantly defined commodity. The average sales price in Figure 2 is not corrected for changing size or quality and the mortgage interest rate is not corrected for changes in terms of the mortgage.

Figure 2. Home Prices & Mortgage Rates



of \$115 thousand in January 1983 is for a house of size and quality comparable to the average house sold in 1980, then the cost of home ownership is 18 percent higher today than in 1980. This would revise the home ownership index upwards to about 260, or 18 percent higher than it currently stands. As a result, the Anchorage CPI-W in late 1983 would be about 271 instead of 260. This would mean that the rate of inflation in Anchorage averaged more than 25 percent higher over each of the last 3 years than was reported by the Anchorage CPI. However, improvements in the quality of housing and easing of the terms of the average mortgage³ could have partially offset this increase.

Housing Treatment in the CPI

Housing is the most important component of the CPI and comprises three major elements: (1) shelter costs, (2) fuel and other utilities, and (3) household furnishings and operations. Shelter costs in turn is divided into home ownership, residential rent, and other rental costs.

The measurement of home ownership costs has long presented special problems in calculating the CPI because the purchase of owner-occupied housing contains aspects of both consumption and investment. While this is to some degree a common characteristic in the purchase of all durable goods, the long-term nature and greater investment potential of owner-occupied housing makes housing a special case. The practical issue is determining to what extent housing price changes should be included in the CPI as the cost of housing and to what extent excluded as a change in the value of an asset.

In the past, the home ownership component of the CPI was measured by using the purchase price and financing costs of recent home sales. That measure has come under increasing criticism because in periods of quickly rising interest rates and/or housing prices, it overstates actual price changes. Since a small proportion of homeowners purchase a house during any measurement period, the index only measures price change for owners of recently acquired properties and thus overstates the home ownership cost changes to homeowners in general.⁴

³For example, by reducing the down payment.

⁴An additional problem is that the data source traditionally used to measure home ownership costs, FHA-insured loans, is no longer representative of housing markets. FHA-insured loans have become a very small and selective segment of the overall housing market, but alternative data sources neither broadly reflect the market or meet the BLS requirement of nation-wide coverage. Furthermore, new financing instruments such as variable interest mortgages, shorter loan terms, and other special arrangements cannot be handled in the current framework.

Consequently, the BLS is now in the process of converting their method of calculating home ownership to rental equivalency.⁵ Under this procedure, the BLS will use a survey of rents paid for housing units, adjusted for housing quality, to estimate the cost of home ownership. This method measures the consumption cost of housing and therefore will be consistent with the measurement of other components in the CPI.⁶

Conclusion

The CPI, although technically a price index,⁷ is

⁵Rental equivalency was introduced into the all-urban consumer index (CPI-U) in January 1983 but will not become part of the urban wage earners and clerical workers index (CPI-W) until January 1985.

⁶There is some fear that the rental equivalency method will create an initial upward bias in the homeowner index. This is because its introduction occurs at the beginning of a business cycle when housing demand, which may temporarily drive up the rental price of housing, is particularly strong.

⁷The CPI measures the change in the prices of a scientifically selected sample of goods and services, based upon average consumption experiences. It does not adjust that sample as a consumer would when relative prices, preferences, income, or

the most widely used cost-of-living index in Alaska. However, since 1980 it has been misrepresenting the rate of inflation in the housing market; consequently, the whole index can no longer be considered an accurate measure of price change in Anchorage.

Unfortunately, the amount of distortion currently reflected by the Anchorage CPI can only be accurately determined by a detailed study of quality controlled price movements of the Anchorage housing market.

(Footnote 7, continued)

product availability change over time. A true cost-of-living index, on the other hand, would incorporate these changes as they occurred. The Consumer Price Index, therefore, is an accurate measure of the change in the cost of living only to the extent that its product sample reflects actual consumption patterns.

This Research Summary was written by Scott Goldsmith and Phillip Rowe of the Institute of Social and Economic Research, University of Alaska. Address any questions on this summary to Phillip Rowe at ISER, 707 A Street, Suite 206, Anchorage, AK 99501, telephone 278-4621.

★ ★ ★ ★

RESEARCH SUMMARY

Institute of Social and Economic Research
Lee Gorsuch, Director
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Anchorage, Alaska 99501

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Permit No. 540

Sen. Frank R. Ferguson
Senate
State of Alaska
Pouch V, Mail Stop 3100
Juneau, AK

99811

VIII. NOTICES OF PROFESSIONAL SERVICES CONTRACTS

(None this publication.)

IX. BOARDS AND COMMISSIONS VACANCIES

(Issued from the Governor's Office only.)

X. ATTORNEY GENERAL OPINIONS

It is anticipated that computerized access to summaries of Attorney General Opinions will be available in mid-1984. Reference to the data base containing the Opinion summaries will be provided at that time. Summaries of recently indexed Attorney General Opinions are shown below:

02/07/83 The term "Capital Project" used in the appropriation limit must be liberally construed.

If state revenue is less than the adjusted limit for a year, the budget allocations within the limit do not apply.

Appropriations to pay principal and interest on school construction bonds are not subject to the spending limit.

Spending limit must be interpreted to reflect the intentions of the drafters and the meaning understood by the voters.

For purposes of the spending limit, multi-year appropriations will be attributed to the first fiscal year in which it could be expended.

The term "permanent fund dividend" used in the spending limit should be broadly interpreted to include any distribution of permanent fund income to the public.

04/12/84 Not illegal to forfeit good time earned during first of two consecutive sentences after sentence has expired.

04/16/84 Alaska Hire, AS 36.10.010, not applicable in hydro O and M contract.

Uniform purchasing requirements not applicable to operator utility under hydro O and M contract.

Disposal of property under hydro O and M contract governed by terms of bond resolution.

Little Davis-Bacon, AS 36.05, not applicable to hydro O and M contract.

04/24/84 Eggs from nonprofit state hatcheries may only be sold to ADF and G or other nonprofit state hatcheries.

05/02/84 Confidential fish ticket information must be released per

Alaska State Legislature

SENATOR
John C. Sackett

CO-CHAIRMAN
SENATE FINANCE COMMITTEE

MEMBER
COMMUNITY & REGIONAL AFFAIRS COMMITTEE
LABOR & COMMERCE COMMITTEE
BUDGET & AUDIT COMMITTEE
REGULATION REVIEW COMMITTEE



Senate

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POUCH V
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TELEPHONE 465-3753

MEMORANDUM

TO: Senate Finance Committee Members

FROM: John Sackett, Co-Chairman

SUBJECT: Spending Limit

DATE: January 10, 1984

Attached are the following:

1. OMB memo on calculating the spending limit;
2. Legislative Finance memo on calculating the spending limit;
3. Attorney General's Opinion on the operation of the spending limit provisions;
4. A copy of the constitutional amendment.

It appears as though the revenue available for appropriation in FY85 will come very close to exceeding the spending limit and may, depending upon the methodology adopted, be more than can legally be spent. The limit is determined by a combination of population and inflation increases, but the statute does not specify which estimates and indexes should be used. Please read the attached material very carefully so that we may make the most reasonable interpretation of a rather vague provision.

STATE OF ALASKA

Bill Sheffield, Governor

DEPARTMENT OF LAW

OFFICE OF THE ATTORNEY GENERAL

POUCH K - STATE CAPITOL
JUNEAU, ALASKA 99811
PHONE: (907) 465-3800

February 7, 1983

Gene Dusek, Director of Budget
Office of Management & Budget
Pouch AM
Juneau, AK 99811

Re: Appropriation limit
questions
Our file: 366-374-83

Dear Mr. Dusek:

You have asked for our opinion concerning issues relating to the appropriation limit imposed by Alaska Constitution, article IX, section 16. These issues are as follows:

(1) Are appropriations to reimburse a municipality for payment of the principal and interest on general obligation school construction bonds subject to the appropriation limit? We believe they are not.

(2) If the permanent fund dividend law (AS 43.23) is amended or repealed and another plan for the distribution of permanent fund income is enacted, will appropriations to finance the new distribution program be included in the appropriation limit or will those appropriations be outside the limit? Generally, we believe that other distribution plans could qualify as dividends. However, certain limitations should be observed to make sure that the new plan satisfies the intent of the appropriation limit.

(3) How will the appropriation limit be implemented if

anticipated state revenues are less than the limit for a fiscal year? We assume that the appropriation limit will be applied with common sense to empower the legislature to act without regard to allocations imposed by the appropriation limit when economic conditions deplete the state treasury.

(4) How will multi-year appropriations be counted for purposes of the appropriation limit? We believe a multi-year appropriation will be counted against the appropriation limit for the first year in which it could be expended.

(5) What is the definition of "capital project" as that term is used in the appropriation limit? There is some history which supports a liberal interpretation of the term "capital project."

I. BACKGROUND

The appropriation limit, Alaska Const. art. IX, sec. 16, was drafted during a period of anticipated high revenue yields from oil and gas production. In June 1981, the Alaska Department of Revenue forecast that the state would earn approximately \$4,895,300,000 during FY 82. Revenue Sources, Alaska Department of Revenue (June 1981). That forecast did not include the revenue dedicated to the Alaska permanent fund under AS 37.-13.010. The revenue actually earned by the state during FY 82, less the permanent fund contribution, was \$4,108,400,000. Reve-

nue Sources, Alaska Department of Revenue (Jan. 1983). The legislature had exhibited a proclivity for appropriating all available revenue and more. 1/ Former Governor Jay S. Hammond introduced SJR 4 during the first session of the Twelfth Alaska Legislature. However, the legislature failed to enact a version of SJR 4 during the first regular session and on June 25, 1981, Governor Hammond called a special session of the legislature to consider SJR 4. In his address to the legislature, Governor Hammond cited the following circumstances which required the enactment of SJR 4:

- (1) the FY 82 operating budget increased 32 percent over the FY 81 operating budget;
- (2) the FY 82 capital budget increased 127 percent over the FY 81 capital budget; and,
- (3) for FY 82, the legislature appropriated an amount equal to 59 percent of the total spent for capital projects since statehood. 1981 S. Jour., FSS Jour. Supp. No. 1, p. 3.

A second free conference committee (FCC) initially appointed during the regular session met to continue consideration of SJR 4 during the special session. 1981 S. Jour., p. 1744. A

1/ The \$1.8 billion contribution to the Alaska permanent fund (sec. 2, ch. 61, SLA 1981 as amended by sec. 68, ch. 92, SLA 1981 and sec. 16, ch. 101, SLA 1982) is a continuing operating appropriation which literally causes total unobligated appropriations to exceed available state revenues for each fiscal year since enactment.

transcript of the open meetings of the FCC exists and forms a part of the history of the appropriation amendment (the transcript). However, it is evident from review of the transcript that other discussions concerning the intent of the amendment were conducted outside of open committee meetings. While the transcript is helpful, it presents only a partial record of the deliberations of the drafters of the amendment.

The FCC purported to adopt a letter of intent to accompany its report to the house and senate. 1981 S. Jour., FSS, p. 5. However, the letter of intent is not set out in the journal. A search of the bill files of the Department of Law yielded a copy of the missing letter of intent. See Ex. 1.

The campaigns for and against adoption of the appropriation limit began in September of 1982. The Anchorage Daily News criticized the proposed amendment for the following reasons:

(1) the ceiling is too high, revenues will exceed the limit only once before the year 2000; and

(2) the one-third reservation for capital projects and loan appropriations was included because the legislature "failed to make the distinction between a wise public agenda -- on which capital projects and loans surely would appear -- and an effectively timeless state constitution -- in which no such spending demands should be dictated.

Anchorage Daily News, Sept. 3, 1982, at A14, "opinion." The

Daily News based its opinion concerning revenue forecasts on a report made public by the legislative finance division of the Legislative Budget and Audit Committee. Anchorage Daily News, Sept. 2, 1982, at 1. On September 17, 1982, the Daily News urged Governor Hammond to oppose the adoption of the appropriation limit. The Anchorage Times basically took no position on the amendment. However, on October 19, 1982, the Times reported the results of a poll sponsored by supporters of the amendment. The poll, conducted the week of September 16-23, 1982, showed that the amendment was recognized and favored by the public as a "spending limit." The pollsters asked if the respondents had heard of the proposed amendment to the state constitution which sets a limit on increases on state appropriations. By a three-to-one margin, respondents said they were not familiar with the amendment when it was described as an "appropriation limit." Anchorage Times, Oct. 19, 1982, at A-4. On October 26, 1982, the Juneau Empire editorialized in favor of adoption of the amendment. Juneau Empire, Oct. 26, 1982, at 4.

During the week of October 24, 1982, the major dailies of the state published articles on the amendment. Governor Hammond received coverage in most of those stories by saying "It [the adoption of the appropriation limit] may be our last chance to control the juggernaut which otherwise will likely crush us into bankruptcy." Anchorage Daily News, Oct. 29, 1982, at B3.

On Sunday, October 31, 1982, the Daily News in its forum section, published an article by Governor Hammond in which he again strongly advocated adoption of the amendment because revenue projections and the growing vulnerability of the permanent fund compelled him to plead for the support of the people. Anchorage Daily News, Oct. 31, 1982, at K3. On the preceding Friday, the Daily News quoted Governor Hammond as follows: "Don't let anyone tell you that passage of Proposition 4 won't limit spending." Under recently revised revenue estimates, passage of the ballot issue would bar the legislature from appropriating between \$80 million and \$380 million in fiscal 1984 alone. Anchorage Daily News, Oct. 29, 1982, at B3.

At the 1982 general election, the voters approved the adoption of SJR 4 by a vote of 110,669 for the amendment and 70,831 opposed to the amendment. State of Alaska Official Returns by Election Precinct General Election Nov. 2, 1982, Div. of Elections, Office of the Governor.

II. EXCEPTIONS FROM THE LIMIT

The appropriation limit contains seven express exceptions. Five of those exceptions are for appropriations which are completely outside the limit and do not require voter approval. They include:

- (1) an appropriation for Alaska permanent fund divi-

dends;

(2) an appropriation of revenue bond proceeds;

(3) an appropriation to pay principal and interest on general obligation bonds;

(4) an appropriation of money received from nonstate sources in trust for a specific purpose, including revenues of a public corporation that issues revenue bonds; and

(5) an appropriation to meet a state of disaster declared by the governor.

You have requested our interpretation of exceptions (1) and (3) set out above.

A. Alaska Permanent Fund Dividend Exception

The appropriation limit provides: "Except for appropriations for Alaska permanent fund dividends ... appropriations from the state treasury made for a fiscal year shall not exceed \$2,500,000,000...." A question obviously arises as to whether "Alaska permanent fund dividends" means only those cash payments provided to individuals under AS 43.23 or if the word "dividend" encompasses other concepts for the distribution of income earned by the Alaska permanent fund.

We believe the answer to your question concerning appropriations for permanent fund dividends depends on whether the exceptions will be construed strictly or liberally. Usually, .

provisions in a state constitution are construed liberally using the same rules of construction prescribed for other laws with regard given to the broader object and scope of the constitution as a charter of popular government. Eghert v. Dunseith, 24 N.W.2d 907 (N.D. 1946); 168 A.L.R. 621. Professor Sutherland explains the modern view for construing express exceptions as follows:

The older rule strictly interpreted both exceptions and provisos but today the prevailing view favors determining the effects of such provisions according to the usual criteria of decision applicable to other kinds of provisions as well without the use of any artificial presumptions to the effect that qualifying language should be strictly construed.

SUTHERLAND STATUTORY CONSTRUCTION § 47.11 (4th ed. 1974)(footnotes omitted). The FCC did not express an intent to limit this exception to only appropriations to finance cash payments to individuals under AS 43.23.

The appropriation limit must be interpreted consistently with the permanent fund amendment contained in article IX, section 15. Section 15 provides that the legislature may dispose of the income of the Alaska permanent fund "as provided by law." Each legislature may reexamine existing law and enact different laws providing for the use of income earned by the Alaska permanent fund. If section 16 were interpreted so that the exception to permanent fund dividends applied only to appropriations to finance cash dividends under AS 43.23, the legislature would essentially be denied the flexibility to adjust to changing philoso-

phies concerning the propriety of making cash payments directly to residents which section 15 expressly reserves to it. 2/ In interpreting and applying the constitution, it must be remembered that the constitution is not a lifeless or static instrument whose interpretation is confined to conditions and outlooks which prevailed at the time of its adoption. Yakus v. United States, 321 U.S. 414 (1944); Warwick v. State, 548 P.2d 384 (Alaska 1976).

The word "dividend" has no precise legal meaning. Trustees of University v. North Carolina R. Co., 13 WORDS AND PHRASES 107 (Permanent ed.); 22 Am. Rep. 671. Webster defines "dividend" as follows: "an individual share of something distributed among a number of recipients." We are not aware of any legal principle which would preclude the characterization of other distribution programs as "dividends." Rather, the words used

2/ The Thirteenth Legislature may reject direct cash distribution in favor of a plan which it determines will promote public purposes more effectively. During the period of consideration and adoption of the appropriation limit, the permanent fund dividend law was undergoing considerable scrutiny and change by both the legislature and the courts. The legislature adopted the proposed appropriation limit amendment on July 15, 1981. At that time the question of the constitutionality of the permanent fund dividend program as it was then structured was on appeal to the United States Supreme Court. On June 14, 1982, the United States Supreme Court issued an opinion which found the method established for determining the amount of dividends under that program void because the method promoted discrimination based on length of residence in the state. On August 13, 1982, amendments to the dividend law took effect. The people were undoubtedly aware that the dividend law in effect on election day in 1982 was not chiseled in marble.

by the drafters of the amendment afford broad latitude to the legislature to enact new distribution programs which will not be impaired by the appropriation limit.

It is well-settled law that a provision of a state's constitution must receive a liberal, practical construction to meet changed conditions and growing needs of the people. County of Alameda v. Sweeney, 312 P.2d 419, 424 (Cal. 1957). Under the permanent fund amendment, the discretion granted to the legislature to enact, amend, or repeal the present dividend program under AS 43.23 to meet the growing needs of the people is unfettered. However, the operation of exceptions from the appropriation limit must be interpreted consistent with the intent of the framers of the organic law and of the people adopting it. State v. Lewis, 559 P.2d 630, 637 (Alaska 1977).

One important consideration should be carefully observed. The Alaska Supreme Court has found that the purpose of the existing dividend program is to force the legislature to consider the reimposition of taxes when the decline of oil revenue encourages resort to permanent fund income to finance state government. Williams v. Zobel, 619 P.2d 448, 454 (Alaska 1981), rev'd 451 U.S. 905 (1982). The people can be expected to vigilantly protect their dividends by forcing the legislature to seek sources other than the permanent fund to finance state government. If a substitute distribution program accomplishes the same

purpose, it will more likely qualify under the exception in section 16 than if it fails to achieve that purpose. If the constituency benefitted by a dividend is narrow, the dividend may not be a dividend in the sense intended by the drafters of section 16 and the people who adopted it. Proposals soon to be considered by the legislature include replacing the existing distribution to all residents with a distribution of part of the permanent fund income to municipalities and as a substitute for the existing longevity bonus, and use of a part of the income to finance large capital projects.

A vast majority of the population of the state resides in or is served by municipal governments. It is also a fact that we all seek security for our "golden years." The constituents of these proposals seem broad enough to satisfy the purpose of the current dividend law. The use of permanent fund income to finance large capital projects presents a closer question. The character of each project must be considered to determine if it serves a state public purpose, rather than a local special purpose. Additionally, if the project is viewed as merely an alternate way of financing state government operations, the basic intent of the dividend law might not be served.

We cannot advise with certainty whether the financing of large capital projects with permanent fund income would constitute a dividend of the Alaska permanent fund for purposes of

the appropriation limit. Some may argue that the benefits provided by "public works" projects are too localized to approximate the benefits provided by the existing dividend law. However, in State v. Lewis, 559 P.2d 630 (Alaska 1977), the Alaska Supreme Court decided that "[l]egislation need not operate evenly in all parts of the state to avoid being classified as local or special." Lewis at 643. A definite answer will come only when the courts interpret article IX, section 16 of the Alaska Constitution. However, we believe that if the legislature enacts a distribution program which is consistent with the intent of the permanent fund dividend law, any appropriation to implement that program will be exempt from the appropriation limit.

B. Appropriations Required to Pay the Principal and Interest on General Obligation Bonds

Under AS 43.18.100 -- 43.18.135 the state, subject to available appropriations, reimburses municipalities for the payment of a percentage of principal and interest to retire general obligation bonds issued by the municipality to finance school construction costs. Although they have been amended from time to time, these statutes have been in effect since 1971. You have asked whether appropriations to retire municipal general obligation debt are within the exception stated to the appropriation limit.

The exception reads as follows: "Except for ... appro-

priations required to pay the principal and interest on general obligation bonds...." The wording of the exception does not specify whether the bonds must be issued by the state to qualify. Later in section 16, the drafters carefully identified "appropriations of money received from a nonstate source...." Since the drafters could easily have expressly limited this exception to state general obligation bonds, an implication can be drawn that a strict construction limiting the exception to state general obligation bonds was not intended.

The purpose of the exception recognizes that appropriations to retire general obligation bonds may be to the state's "great advantage." Governor's transmittal letter, 1981 FSS S. Jour., p. 16. Presumably the advantage accrues from the state's enhanced credit rating which results in lower debt service charges for subsequent bond issues. It is probable that the existence of the school construction debt assistance provisions of AS 43.18 have the same effect upon the bond rating assigned to municipalities. The identical purpose is achieved by appropriations made to finance the reimbursement program. Less state assistance will be necessary in the future if local bond ratings remain favorable.

There are some considerations which weigh against this construction. Debt service for general obligation bonds is financed by a continuing appropriation. AS 37.15.012. General

obligation bonds are debts of the state secured by contracts (trust indentures); the impairment of contracts is prohibited by the state and federal constitutions. The reimbursement program under AS 43.18 does not transform municipal general obligation bonds into debts of the state. AS 43.18.130(a). However, the financial burden imposed on municipalities, if their local tax effort were increased to compensate for the loss of assistance under AS 43.18, could be devastating to the local taxpayer. According to the Department of Education, for fiscal year 1984 the estimated total entitlement for school debt retirement is \$36,900,000. This total is estimated to increase to \$44,300,000 by fiscal year 1988.

Accordingly, we believe that appropriations to retire municipal general obligation school bond indebtedness under AS 43.18 are "required" and qualify as an exception to the spending limit. We believe that the appropriation for school bond indebtedness can be represented as a moral obligation of the state for the following reasons:

- (1) the appropriation is made under a statute of general application;
- (2) the statute has been in effect since 1971; and
- (3) the reimbursement program is heavily relied upon by municipalities when they establish the local tax effort necessary to support local bonded indebtedness.

III. REVENUE SHORTFALL

You have also asked how to interpret the appropriation limit if the amount of state revenues subject to the limit is less than the amount determined to be the limit for a fiscal year, as provided in section 16. You wish to know specifically how the allocations within the limit for operating expenses and capital projects would be interpreted. As we have indicated, section 16 imposes an appropriation limit rather than a spending limit. We have earlier advised that the legislature may make appropriations which exceed available revenues. 1981 Inf. Op. Att'y Gen. (June 24; J77-159-81). However, obligations may not be paid under those appropriations unless there is enough surplus money available in the treasury.

Theoretically, the amount of anticipated state revenue should have no effect on the operation of the appropriation limit. However, under AS 37.07.020(c), the governor's proposed budget may not exceed estimated revenues for the succeeding fiscal year. Also, the amount of surplus revenues anticipated to be received by the state was an issue hotly publicly debated before adoption of section 16. The newspaper articles written about the appropriation limit before the election commonly referred to the amendment as a "spending limit." These articles were undoubtedly instrumental in forming the voters' understanding of the effect of the proposed amendment.

Section 16 provides, in part: "Within this limit, at least one-third shall be reserved for capital projects and loan appropriations." This wording is ambiguous when applied for a year in which revenue available for appropriations falls short of the adjusted limit for that year. Under those circumstances, it is not clear whether the reservation for capital projects and loan appropriations is calculated based on the total amount actually appropriated for that fiscal year (i.e., less than the limit) or on the limit amount (\$2.5 billion) for that fiscal year adjusted for population and inflation. Apparent ambiguities contained in the state constitution may be resolved by the contemporaneous construction by law or by the administrative agency charged with implementation of the provision. Amador Valley Joint Union High School District v. State Board of Equalization, 583 P.2d 1281 (Cal. 1978).

A review of the FCC transcript reveals no discussion of the intention of the drafters when they used the phrase "within this limit." Revenue projections at the time painted a rosy picture for the future. No history is available to indicate that the FCC even considered the effect of the amendment if the state suffers a sharp decline in revenue. Former Governor Hammond was clearly concerned by the possibility of a spendthrift legislature with an overflowing treasury at its disposal.

Under the circumstances, we believe it would be unwise .

to blindly apply the allocations imposed by the appropriation limit when conditions impose an even more stringent limit than intended by the FCC. 3/ The appropriation limit drastically alters the most significant power of the legislature: the power to appropriate. The power to enact general law is largely nullified unless the money to finance enforcement or implementation of the law is appropriated. Consequently, we believe that an interpretation which restricts the legislature's power to respond to the needs of the state during unanticipated periods of revenue decline will not be endorsed by the courts. See State ex rel. Columbus v. Keterer, 189 N.E. 252 (Ohio 1934). Rather, we believe that the courts will recognize that the evil which the appropriation limit was designed to remedy does not exist when revenues are below the limit. Under those circumstances, a court would probably affirm an interpretation that restores the full lawmaking powers of the legislature to make appropriations in the best interests of the state. We believe the best way to resolve the ambiguity is to disregard the one-third allocation reserved for

3/ The reservation for capital projects and loan appropriation effectively restricts appropriations to finance the operating budget without restricting the relative share for capital projects. The operating budget finances all manner of essential programs for the preservation of the public health, safety, and welfare. Some of these expenditures are for so-called entitlement programs (aid for families with dependent children, for example) which for fiscal year 1982 comprised 42 percent of the operating budget.

capital projects and loan appropriations when economic conditions impose a limit which is more restrictive than that set out in section 16. 4/ The literal language of the constitution may be disregarded to avoid absurd results and to fulfill the apparent intent of the framers. Sturges v. Crowninshield, 17 U.S. 122, 202 (1819). Where the general welfare is involved, constitutional questions should be approached from the pragmatic, rather than from a legalistic point of view. State v. Board of Administration, 25 So. 2d 880 (Fla. 1946).

IV. ATTRIBUTION OF CAPITAL APPROPRIATION TO A FISCAL YEAR

Another question you have raised is how the words "appropriation ... made for a fiscal year" should be applied to appropriations for capital projects. AS 37.25.020 provides "An appropriation made for a capital project is valid for the life of the project and the unexpended balance shall be carried forward to subsequent fiscal years." This provision recognizes that capital projects often span more than one fiscal year before completion. The balance of the appropriation remains available in sub-

4/ Another possible interpretation would limit the operating budget allocation for a fiscal year to two-thirds of the total limit (\$2.5 billion) adjusted for inflation and population. This interpretation is consistent with our earlier observation that there may be no relationship between appropriations and revenue. However, even under this interpretation, in a fiscal year with depressed revenues, the one-third reservation for capital projects is meaningless.

sequent fiscal years and is carried forward to those succeeding fiscal years. According to the Department of Administration, as of June 30, 1982, the total of all "carry forward" capital appropriations was: approximately \$1,591,000,000, and the total of all "carry forward" operating appropriations was \$1,862,000,000.

The FCC debated the intent of the limit concerning this issue. Transcript at 47-55. It is clear that the FCC was aware that multi-year appropriations are made. There was an attempt by Representative Hugh Malone to amend the proposal so that a legislature could not appropriate for a fiscal year subsequent to the upcoming fiscal year. This amendment was not adopted. Senator Bill Ray observed that the intent of the amendment was to include only those appropriations which are expended during the fiscal year. According to Senator Ray, appropriations which remain unexpended at the end of a fiscal year should lapse. Transcript at 52. Representative Rick Halford interpreted the proposed amendment to make multi-year appropriations count against the limit each year because each succeeding legislature could amend or repeal these appropriations at will. During all of these discussions, no distinction was made between operating and capital appropriations. However, these comments probably referred only to multi-year operating appropriations. See Transcript at 65-66.

The debate on this issue discloses that the FCC was confused about the operation of carry forward appropriations.

They formulated the \$2.5 billion base by taking the fiscal year 1982 appropriation total and reducing that amount by \$60 million. Transcript at 2-5. However, 1982 appropriations were made based on forecasts of anticipated surplus for that fiscal year, reduced by expected expenditures for "carry forward" appropriations. We assume, therefore, that the drafters did not intend to count carry forward appropriations in the limit established for each fiscal year.

We believe that a commonsense way to interpret the appropriation limit, which is supported by past practice, is to count appropriations that are available for expenditure in a fiscal year only against the limit for the first fiscal year during which they could be completely expended. This should be done even if an unexpended balance is carried forward into the next fiscal year. That balance must be considered obligated for the purposes of the appropriation limit. Unexpended balances of a prior year appropriation should not be counted with the current year appropriations in complying with the limit for the current year. If the legislature provides that an appropriation may not be expended until a later fiscal year, the appropriation should be counted only against the limit for that later fiscal year.

V. DEFINITION OF THE TERM "CAPITAL PROJECT"

The appropriation limit amendment introduces the term .

"capital project" to the glossary of words used in the Alaska Constitution. This new term causes some concern because a similar term, "capital improvement," is used in other sections of article IX setting out the general obligation bonding authority for local governments and the state. There are two Alaska Supreme Court cases which address the meaning of "capital improvement." See City of Juneau v. Hixon, 373 P.2d 743 (Alaska 1962); Wright v. City of Palmer, 468 P.2d 326 (Alaska 1970). The supreme court did not adopt an all-inclusive definition of capital improvement in those cases. Rather, the court concluded that there was nothing in the history of municipal bonding in Alaska or in the minutes of the constitutional convention that indicates that the term "capital improvement" was intended to denote projects radically different than those for which municipalities had been permitted to incur bonded indebtedness in the past.

When former Governor Hammond first introduced SJR 4, the proposed amendment consistently used the term "capital improvement." It was not until the second FCC took up consideration of the proposal that the term capital project was used. Senator Ray defined capital projects to be "what the definitive judgment of a majority of the legislature determines they are." Transcript at 22. This was in response to an observation by Representative Malone that many appropriations designated as capital differ little from items set out in the operating budget. Tran-

script at 21. Former assistant attorney general Rodger W. Pegues explained to the FCC that "we're using the term capital project which pretty much means the capital budget - areas where you are dealing with capital investment or long-term financing and the bulk of your spending. That's a broader term than 'capital improvement.'"

There appears to be support in the history for an interpretation of "capital project" which includes more objects of expenditure than "capital improvement," which traditionally has been limited to public works of a permanent nature. 5/ It is possible, though, that the two terms will be construed to have the same meaning. The supreme court left room for the term "capital improvements" to acquire new meanings to accommodate the changing activities of state government. However, the appropriation limit implies that a general obligation bond may be issued for capital projects. 6/ It is probable that a court would find that not all capital improvements may be characterized as capital

5/ In recent years, opinions of the attorney general have somewhat broadened this interpretation to permit the use of bond proceeds to finance some unique activities under the Village Safe Water Act, see Inf. Op. Att'y Gen. (April 2; J-99-078-81); and to rehabilitate a leased jail facility. See Inf. Op. Att'y Gen. (Mar. 19; A66-398-78).

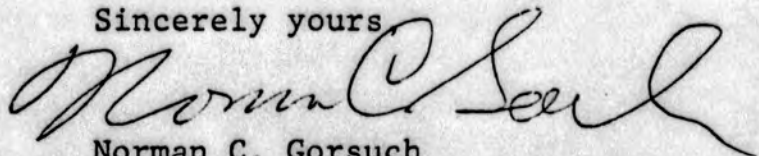
6/ Article IX, section 16 provides: "The legislature may exceed this limit in bills for appropriations to the Alaska permanent fund and in bills for appropriations in capital projects, whether of bond proceeds or otherwise, ..." (Emphasis added.)

projects. A distinguishing factor may be that the constitution requires some permanent thing of value to show for the public debt incurred. A more liberal construction may be warranted when public debt is not incurred.

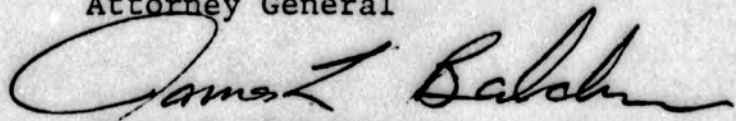
VI. CONCLUSION

The wording of the appropriation limit does not begin to live up to the high standards of clarity and simplicity adopted by the original framers of the Alaska Constitution. There are many who will regard this opinion as mere justification to exploit "loopholes" woven into the fabric of the amendment. However, we hope this opinion will provide the impetus to either adopt amendments to clarify the ambiguities noted or to enact legislation which interprets the amendment so that the ambiguities are avoided. We hope this opinion has answered your questions.

Sincerely yours



Norman C. Gorsuch
Attorney General



James L. Baldwin
Assistant Attorney General

JLB:NCG:pjg

LETTER OF INTENT

2nd Free Conference Committee on SJR 4

The basic problem faced by Alaska is runaway growth in spending for state government operations and for capital projects. This growth is generated by revenues from resources which are nonrenewable and finite. Some limitation is therefore essential. The constitutional amendment proposed by the 2nd Free Conference Committee will provide a realistic limitation and yet allow, by popular approval, for expenditures in excess of the limitation for capital projects and for contributions to the permanent fund. Those who favor such expenditures can have no reasonable objection to the voters determining which capital projects and contributions are worthwhile and which are not.

The term "capital project" is used rather than the term "capital improvement" in order to have a broader reach. Capital improvements are pretty much limited to public facilities having a more or less permanent nature. Highways, airports, buildings, and ferries are examples. Capital projects include capital improvements and also other expenditures which require a multi-year investment or otherwise tend to fall into the category of capital costs as opposed to day-to-day expenses. Computers, large-scale resources inventories, and high-cost special equipment and instruments for libraries, schools, and museums are some examples.

In addition to limiting the excess appropriations to capital projects and contributions to the permanent fund, the proposed amendment requires bills for capital projects to be confined to capital projects of the same type. This is somewhat more narrow than the single-subject rule. It will require projects in a bill to be parts of an overall system. This will inhibit the packaging of diverse projects into one bill. As a further restraint on logrolling, the bills for excess appropriations are subject to the item veto, including the appropriation of general obligation bond proceeds which are in excess of the limit. Bond proceeds which are not in excess of the limit are not subject to an item veto.

There are three exclusions from the limitation. Debt service is necessarily excluded. An additional exclusion is provided for appropriations for permanent fund dividends. Non-state money, that is, money received from the United States or others to be used for specific purposes, is also excluded. This exclusion includes revenue bond proceeds, the revenues generated by the international airports, and other public enterprises which operate on revenue bonds. The first exclusion is required by the federal constitution's prohibition against impairing contracts. The other exclusions are provided because the use of the money for those purposes is not a part of the problem.

The proposed amendment requires the governor to cause any unexpended and unappropriated balance to be invested .

so as to yield competitive rates to the treasury. The words "as prescribed by law" were not included so that the clause will be self-executing. However, the governor performs all executive functions in the manner prescribed by law, and the statutes on loan programs and investments will control here so long as they are consistent with the constitution's requirements.

Additionally, so as to eliminate any reasonable grounds for opposition by those who wish to relocate the capital, the resolution includes a transitional measure to exclude relocation costs, if they are approved at the 1982 general election, from the requirement of additional voter approval under the amendment. Another transitional measure provides for the amendment to take effect beginning with the budget for fiscal year 1984.

Finally, still another transitional measure places the amendment on the ballot again at the 1986 general election to allow it to be repealed by the electorate should it prove to be unworkable. If it is unworkable, the people will repeal it. If it works, they will not.

Sen. Bill Ray

Rep. Richard W. Halford

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National Conference of State Legislatures

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November 14, 1985

Mike Scott
c/o The Honorable Frank R. Ferguson
P.O. Box 131
Kotzebue, Alaska 99752

Dear Mr. Scott:

In response to your request for information concerning state tax study commissions, I have enclosed the following materials:

- o An outline of the remarks Steven Gold of NCSL made to the New Jersey State and Local Expenditure and Revenue Policy Commission, October 1985
- o A list of those who headed recent state tax study commissions
- o A chart prepared by the NCSL summarizing the major recommendations of state tax study commissions
- o Legislative Finance Paper #48C: "State Tax Study Commissions: An Overview of Four Approaches"

If we can be of further assistance, please do not hesitate to call.

Sincerely yours,

Barbara Yondorf
Program Director
Fiscal Affairs

enclosures

by/BY

Overview of Experience with Recent State Tax Studies

Steven D. Gold
Director of Fiscal Studies
National Conference of State Legislatures

New Jersey State and Local Expenditure and Revenue Policy Commission
Trenton, New Jersey
October 18, 1985

I have been requested to cover four topics today:

- o General objectives of state tax studies and areas covered;
- o Mechanics of the studies, including budget, duration, procedures, etc.;
- o General and specific problems encountered;
- o Short and long term benefits realized or anticipated.

To address these issues, it is necessary to emphasize the diversity of experiences that come under the rubric "tax study." You should realize that your New Jersey study resembles those elsewhere in some respects and also differs from many studies that have been conducted recently elsewhere. Here are some of the ways in which tax studies differ:

- o Purpose: some are broad, covering a wide variety of tax issues; others are narrow.
- o Context: some are highly political; others operate in a virtual political vacuum.
- o Resources: some have had budgets in excess of \$600,000; others have had \$25,000 or less.
- o Time horizon: some have lasted for only a few months; others have been in existence for more than three years (e.g., New York).
- o Organization: some have relied primarily on internal staff; others have used many consultants, and one delegated the work to a consulting firm. I recommend the use of consultants working with a core staff with several professionals.
- o Membership: some have been composed solely of legislators; others have had a mixture of public officials and private citizens, and others have been completely private citizens.
- o Thoroughness: some have been relatively thorough and systematic in explaining their assumptions, procedures, and objectives; others have been partial and unsystematic, with policy recommendations not well grounded in supporting analysis. I commend to you the explicit discussion of assumptions and principles in Minnesota and Hawaii. I recommend that the New Jersey commission discuss underlying assumptions and principles at an early stage of its work.
- o Care in presenting analysis and recommendations.
- o Innovativeness of analysis.
- o Results: some have had major success in having their recommendations implemented; others have been partially successful; and yet others have had no success yet. A major caution is that significant reform often takes years to accomplish; it is too early to conclude anything about the long-run effects of most recent tax studies.

Objectives

The most important motivation for recent tax studies has probably been state fiscal problems. Important focuses of the recommendations have been tax simplification, modernization of outdated provisions, and stimulating economic development. Coping with technological change, actual or prospective federal tax changes, and legal challenges to tax provisions have been relatively minor objectives. Some tax studies have also been concerned with improving tax administration. Equity concerns have frequently been addressed, but they have seldom been a principal motivator for initiating the tax study. It is probably accurate to say that equity has receded as a primary concern of state tax policy.

Mechanics

I suggest that you consult with persons who have worked on tax study commissions in other states for advice about mechanics. It would probably be wise to consider both successful and unsuccessful tax studies for guidance on mechanics. I would identify the following studies as among the more successful ones:

- o Minnesota: produced recommendations that have been approved by many parties, although in most important respects not yet by the majority of the legislature; and produced well-researched reports, including some innovative analyses in areas like the role of taxes in influencing employment trends and the long-run prospects for various taxes.
- o Hawaii: produced well-constructed analysis of tax system based on explicit premises; however, recommendations failed politically in first year.
- o Pennsylvania: produced good analysis of issues under study and resulted in reform of a major business tax; however, operated under numerous constraints that limited issues that could be studied.
- o New York: produced strong analyses in numerous areas, including both administration and policy areas, particularly related to simplification and modernization; however, produced no unified report and continues to be of indefinite duration.
- o West Virginia: resulted in reform of major business taxes.

The reason I single out these states is that they had tax studies that either had strong analyses that could be helpful in New Jersey or they resulted in significant reforms. In addition, this year's Wisconsin income tax reform is an important outcome that was helped along by a recommendation from that state's strategic development commission.

My impression is that New Jersey is off on the right foot: it has a reasonable timeframe and budget, an executive director who can successfully manage the study, and a commission membership reflecting important state interest groups. These ingredients are necessary but not sufficient for a successful tax study. Tax reform is a political process, and many pitfalls could derail it.

The budget necessary for a tax study depends upon the types of issues to be considered. Construction of large data bases such as Bob Strauss developed in West Virginia and Pennsylvania is expensive. The breadth of the tax issues to be considered also will have an important effect on the necessary budget.

My final comment about mechanics is that no universal pattern is applicable to all tax studies. What is successful in one state may fail in another state, and vice versa.

Problems Encountered

The problems encountered can be divided into the technical and the political.

Technical: It is important to identify the principal issues to be investigated and to devote sufficient resources to exploring these issues. Some tax studies have attempted to do too much and therefore spread their resources too thin. Time may be as much of a constraint as money.

A thorny issue is how detailed to make recommendations. As discussed below, a commission can be helpful by dealing with issues that are too sensitive for the legislature to confront. Considerable benefit can result from attention to a large number of relatively minor issues. But a danger exists of dissipating influence and attention if too many issues are addressed.

A common technical problem is that researchers may not be sufficiently familiar with the fine points of a particular state's tax system. A related problem is that the cooperation between the tax study's staff and the tax department may leave something to be desired.

Political: Timing is a key to the receptivity for tax reform. It is probably most feasible to implement reform at times when a state has a large surplus or is threatened by a deficit.

Implementing reform is a very difficult political process. If the reform involves significant issues, it is likely to encounter opposition from powerful entrenched interests. An important issue is the extent to which the commission's recommendations are shaped by perceived political constraints. Unless the commission ignores some political factors that have governed the legislature in the past, its recommendations may not be sufficiently bold. On the other hand, if too many politically unrealistic proposals are endorsed by the commission, it may be quickly written off.

The media are frequently a major problem for tax study commissions. They tend to report recommendations in a superficial manner, emphasizing "gainers" and "losers." Many people get the impression that they will lose due to particular proposals (e.g., eliminating tax preferences), while the gains that come from other proposals (e.g., tax rate reductions) are less appreciated.

With skillful leadership and a cooperative attitude among interest groups, a feasible compromise that embodies tax reform can be developed.

Benefits of Tax Studies

1. Raising the level of discourse about tax issues.
2. Addressing issues that are too politically sensitive for the legislature to confront, thereby broadening the scope of the politically feasible (e.g., property tax classification in Kansas this year).
3. Producing new data.
4. Producing new research.
5. Breaking a political logjam that has thwarted improvements in tax policy.
6. Taking a fresh look at how the tax system has gradually developed as a result of economic change and incremental legislative decisions. (According to Richard Pomp, state tax systems tend to "mutate" over time.)
7. Producing sensible recommendations that may not be adopted at once but will be referred to in the future when a crisis situation develops.
8. Taking an in-depth look at emerging issues that are not handled well in the customary legislative process, e.g., reform of state-local relations, impacts of federal tax reform, and technological changes. The tax study commission can take a longer term view than is customary and may be less concerned about how a proposal affects the outlook for the next election.

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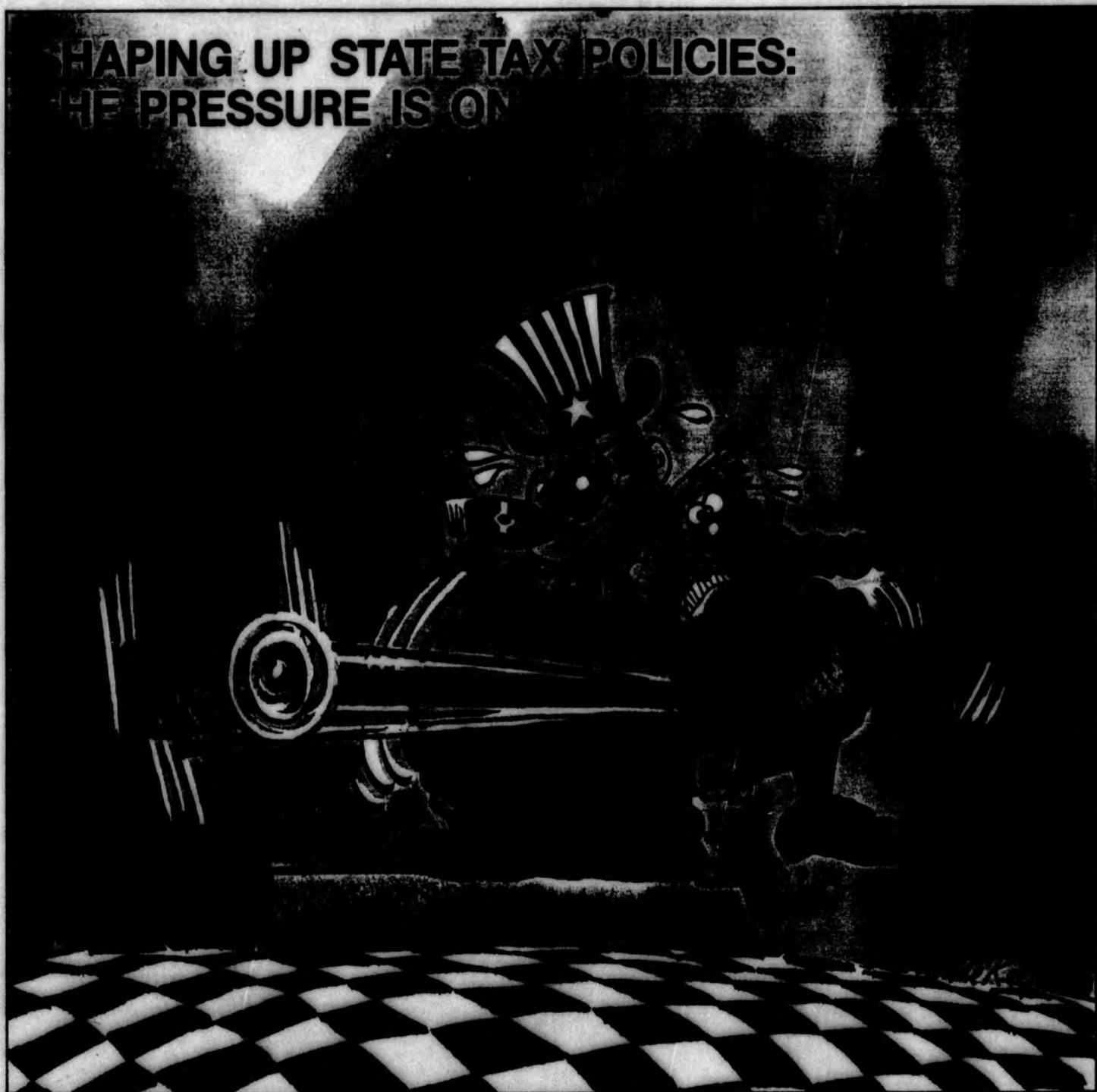
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The National Conference of State Legislatures



**HAPING UP STATE TAX POLICIES:
THE PRESSURE IS ON**



**Preachers and Politics • Purchasing a Computer System
Child Abuse and the Law**

Taxing Problems Spark State Reforms

By Steven D. Gold

Ironically, the odds for improving tax policy could increase if state fiscal conditions worsen.

A guiding principle in many legislative arenas is, "if it ain't broke, don't fix it." Applied to tax policy, however, this dictum can cause serious problems because often a provision is considered "broke" only when important constituents decide it is. Although benign neglect is not necessarily the best policy, it often seems to reign in tax deliberations.

But this attitude may be changing. During the past decade, extreme strain was placed on state tax systems by a set of problems that either are continuing or could resurface in the near future: the tax revolt, the severest recession since the Great Depression, federal aid cutbacks and interstate tax competition.

On top of these carry-over concerns, a new one has emerged during the past two years—federal tax reform, which could have profound impacts on the climate in which states must raise money.

State tax systems are much stronger today than they were 30 years ago. In the 1950s, '60s and '70s, states took major steps to improve the fairness and productivity of their tax systems by adopting many new income and sales taxes. These actions were responses to fiscal crises caused in part by the passage of the baby boomers through public education systems.

But since the early 1970s, many of the important changes in tax structures have occurred through inertia. Inflation, rising income and shifting production and consumption patterns have had perhaps more to do with the level and distribution of taxes than deliberate new policies.

Five crucial facts about state tax systems stand out.

They bring in a great deal of revenue. During the current fiscal

year, state tax collections should top \$225 billion, more than 10 times as much as in 1962 and 3½ times as much as in 1972.

Their growth can be likened to a roller coaster. Tax revenue rose faster than personal income for a quarter century, from the end of World War II to the early 1970s, as states assumed new responsibilities in the federal system. The growth of revenue plunged when the tax revolt hit in the late 1970s and then recovered in 1983 as three-fourths of the states raised tax rates. Since then tax cuts have predominated.

Every state tax system is different.

incomes. Tax levels also differ a great deal. The ratio of state tax revenue to personal income is more than twice as high in 30 states as it is in New Hampshire.

Local taxes are also major parts of state tax systems. States dictate which taxes cities, counties and school districts may use and also influence the level of local taxes by giving financial aid or by paying for local functions. Local tax revenue this fiscal year will be close to \$140 billion. The role of localities in raising revenues differs greatly from one state to another, with local taxes representing only 16 percent of total state and

State and Local Tax Revenue per \$100 of Personal Income, 1970 to 1985

Fiscal Year	Total	State	Local	Property ¹	State	
					General Sales	Personal Income
1985	\$11.45	\$7.08	\$4.37	\$3.43	\$2.27	\$2.11
1984	11.71	7.22	4.49	3.53	2.30	2.16
1983	11.07	6.69	4.38	3.47	2.09	1.94
1982	11.07	6.79	4.28	3.41	2.10	1.91
1981	11.31	6.95	4.36	3.47	2.15	1.90
1980	11.57	7.13	4.45	3.55	2.24	1.93
1979	12.03	7.34	4.69	3.80	2.32	1.92
1978	12.75	7.49	5.26	4.37	2.33	1.93
1977	12.81	7.39	5.42	4.55	2.26	1.86
1976	12.47	7.13	5.34	4.53	2.18	1.71
1975	12.28	6.99	5.29	4.47	2.16	1.64
1974	12.36	7.05	5.31	4.51	2.15	1.62
1973	12.95	7.31	5.63	4.84	2.13	1.68
1972	12.69	7.02	5.67	4.92	2.07	1.52
1971	11.89	6.48	5.40	4.74	1.95	1.28
1970	11.66	6.47	5.19	4.57	1.91	1.24

¹At least 95 percent of property tax revenue is raised by local governments but some state governments also levy a property tax, usually on specific classes of property.

Source: U.S. Census Bureau

Alaska and New Hampshire manage to get along without either a general sales or a personal income tax. Eleven other states have only one or the other. The remaining 37 states levy both but each in its own way. In total, 26 states rely on the sales tax more than the income tax, and 22 get more from the tax on

local revenue in Alaska but 50 percent or more in Colorado, New Hampshire and New York.

The shape of state and local tax systems has changed considerably in the past 15 years. The property tax has been sharply de-emphasized, declining from 4.9 percent of personal in-

Steven D. Gold is director of NCSL's Fiscal Studies program.

come in 1972 to 3.4 percent in 1984. One of the main reasons for this trend was increased reliance on personal income taxes, which jumped from 1.2 percent of personal income to 2.1 percent between 1970 and 1985. States used much of their new income tax money to boost aid for local schools and assume other financial burdens from localities, such as welfare programs.

Despite the diversity in taxes, some important developments are occurring that are common to most states—interstate tax competition, erosion of tax bases, increasing instability and reduced responsiveness to economic growth.

State and local governments seem to be competing with each other more avidly than in the past to make themselves attractive to industrial investment. This intensified competition has arisen from many sources, including the especially high unemployment of the early 1980s, the decline of heavy industry in the Rust Belt and agriculture in the Farm Belt, and the increased exposure to international competition everywhere.

Interstate tax competition has resulted in a proliferation of exemptions for business and downward pressure on personal income tax rates. For example, at least a dozen states have exempted inventories from the property tax since 1980. Most of the states with the highest income taxes have been cutting them recently. As Lowell Norland, majority leader of the Iowa House of Representatives, says, "Because of our overriding economic development crusade, we're afraid to be out of step in taxation with other states."

Erosion of tax bases undermines the productivity of tax systems just as soil erosion reduces the yields from farmland. One source of tax base erosion

is new exemptions granted by states, particularly from the sales, property and income taxes. Economic trends may also erode the tax base. Two examples: A portion of pension income is often exempt from income tax; as the population ages, pension income tends to grow faster than wages. Most services are usually exempt from the sales tax; as the service economy develops, exempt sales

tend to grow more rapidly than taxable sales. Result: an eroded tax base. John Mikesell, a sales-tax expert at the University of Indiana, estimates that each penny of sales tax levied in 1984 yielded only 85 percent as much as it did in 1960, per dollar of personal income.

Ben Rose, assistant House minority leader in Ohio, helped put together a proposal for substantially broadening

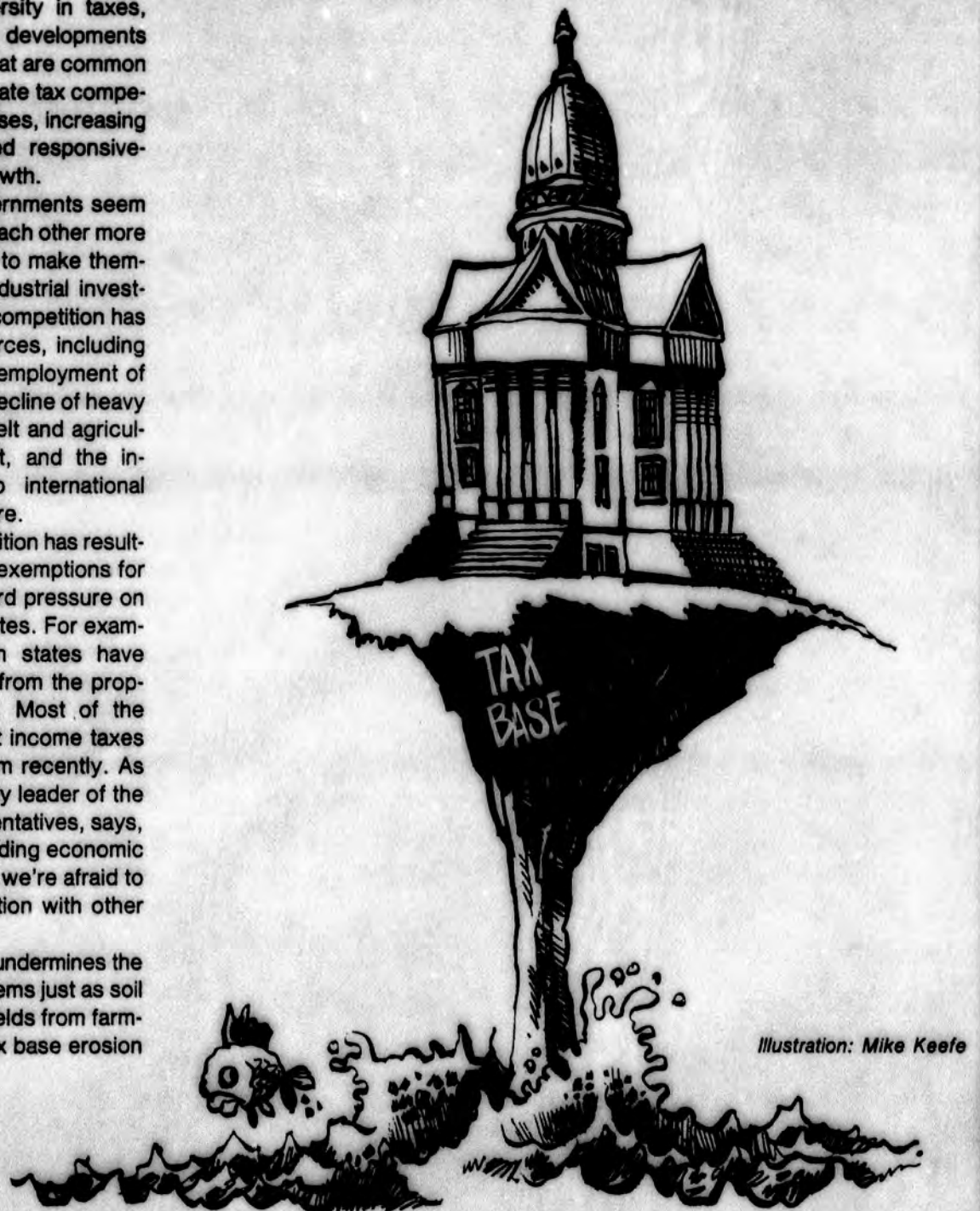


Illustration: Mike Keefe

Erosion of tax bases—from such factors as exemptions granted by states from sales, property and income taxes as well as from larger economic trends—undermines the productivity of tax systems just as soil erosion reduces the yields from farmland.

the sales-tax base several years ago. Ohio eventually did extend the sales tax to repairs and data processing services. He warns that trying to tax services is "a tough political thicket," and that interstate tax competition limits the extent to which services can be taxed.

Erosion of the sales-tax base has led to exemption of food and utility outlays in about two-thirds of the sales-tax states and prescription drugs in virtually all states. The result of exempting these and other "necessities" has been to increase the instability of state tax revenue. Formerly when the economy went into a recession, the sales tax continued to produce revenue from such "necessities" while sales of discretionary products plummeted. Now this firm base is no longer taxable in most states.

State tax revenue does not respond as strongly to economic growth as it did in the 1970s because, among other reasons, 10 states adopted income tax indexation, marginal tax rates for high income taxpayers were reduced and exempt income grew relatively rapidly. The U.S. Treasury Department estimates that each 10 percent increase in personal income now produces only 14 percent growth in personal income tax revenue as opposed to 16 percent before 1978.

Because of these problems, as well as the severe fiscal problems experienced in the early 1980s, nearly half of the states have recently conducted major studies of their tax systems. Despite high hopes for these studies, they have not yet resulted in significant reform in most states.

Why has the implementation of tax reform been so poor?

First of all, reforming state tax systems is not as easy as it used to be. In the 1950s and 1960s the solution to a state's fiscal problems was usually obvious—adopt an income or a sales tax, whichever the particular state was missing. Most states followed that prescription, and now the answers are not so simple.

Secondly, tax reform produces losers as well as winners. Tax commis-

sions often recommend broadening the base of the income and sales taxes and lowering tax rates. These steps tend to even out the tax burden and "provide a level playing field" for business and individuals. But the beneficiaries of tax exemptions that would be eliminated frequently put up a stiff fight in defense of their tax breaks, while the winners from reducing exemptions and lowering rates tend to be silent for two reasons: They may not realize that they are winners, and there are many small winners and a small number of big losers. The political calculus makes it tough to broaden tax bases. Nowhere is this more evident than in extending the sales tax to services. Many legislators and governors contemplated such a policy in the 1980s, but when the dust settled, little had been done to change the status quo. "Politically, you don't want to create any losers, but it's next to impossible to have reform without some losers," says Bill Schreiber, chair of Minnesota's House Tax Committee.

Finally, it takes time to develop a consensus for a major tax change. States don't tinker with the fundamentals of their tax systems very often, so it is not surprising that it could take four or five years to build a coalition for a big tax change. Many of the new income and sales taxes of the 1950s, '60s and early '70s were adopted only after such a prolonged period of discussion, education and controversy.

Recent experience demonstrates that reform is not impossible. Last year two states did enact important reforms: Wisconsin simplified its income tax and West Virginia overhauled its business taxes. The chairman of the West Virginia House Finance Committee, George E. Farley, reports that it took three years of research and persuasion, a lot of patience and an "exorbitant number of meetings" to push reform through. Even with all that effort, the proposal appeared to be a "long shot" before it was enacted.

The biggest battle in the state tax wars now is not about restructuring taxes, but rather about the role of the personal income tax. Because of tax rollbacks and reductions effective in

1984, income tax revenue rose only an estimated 7.5 percent in fiscal year 1985 compared with an estimated 10.5 percent rise in sales tax revenue. On top of that, 14 states lowered their income taxes during 1985 legislative sessions. Many of these reductions were rollbacks of increases in 1982 or 1983, but four were in states where tax rates had not been increased in the 1980s and three were reductions in rates to below the pre-1982 levels. By contrast, Connecticut was the only state to lower its sales tax, by exempting clothing priced at \$75 or less.

The income tax cuts of 1985 were concentrated in the states with the highest income taxes. Seven of the eight states with the top effective rates reduced their income taxes last year. These actions were at least partly in response to the growing belief that high income taxes deter business investment. While there is some empirical support for this belief, many economists and state officials question the strength of the adverse impact of income taxes on the economy. Special attention is often focused on the highest marginal income tax rate in the state. Wisconsin trimmed its highest rate from 10 percent to 7.9 percent; Delaware's went from 10.7 percent to 9.7 percent; Minnesota's fell from 16 to 14 percent (equivalent to 7 percent for high-bracket taxpayers because federal taxes are deductible) and New York's dipped from 10 percent to 9 percent on earned income over three years.

The flight from income taxes is worrisome to some legislators because the personal income tax is the only major state revenue source that is progressive. Reducing the income tax implies shifting the tax burden away from the well-to-do. Another progressive tax, on inheritances, has also been repealed or reduced recently in a large number of states. New York and Massachusetts targeted special relief to low-income families as part of their income tax cuts, but most states did not do so.

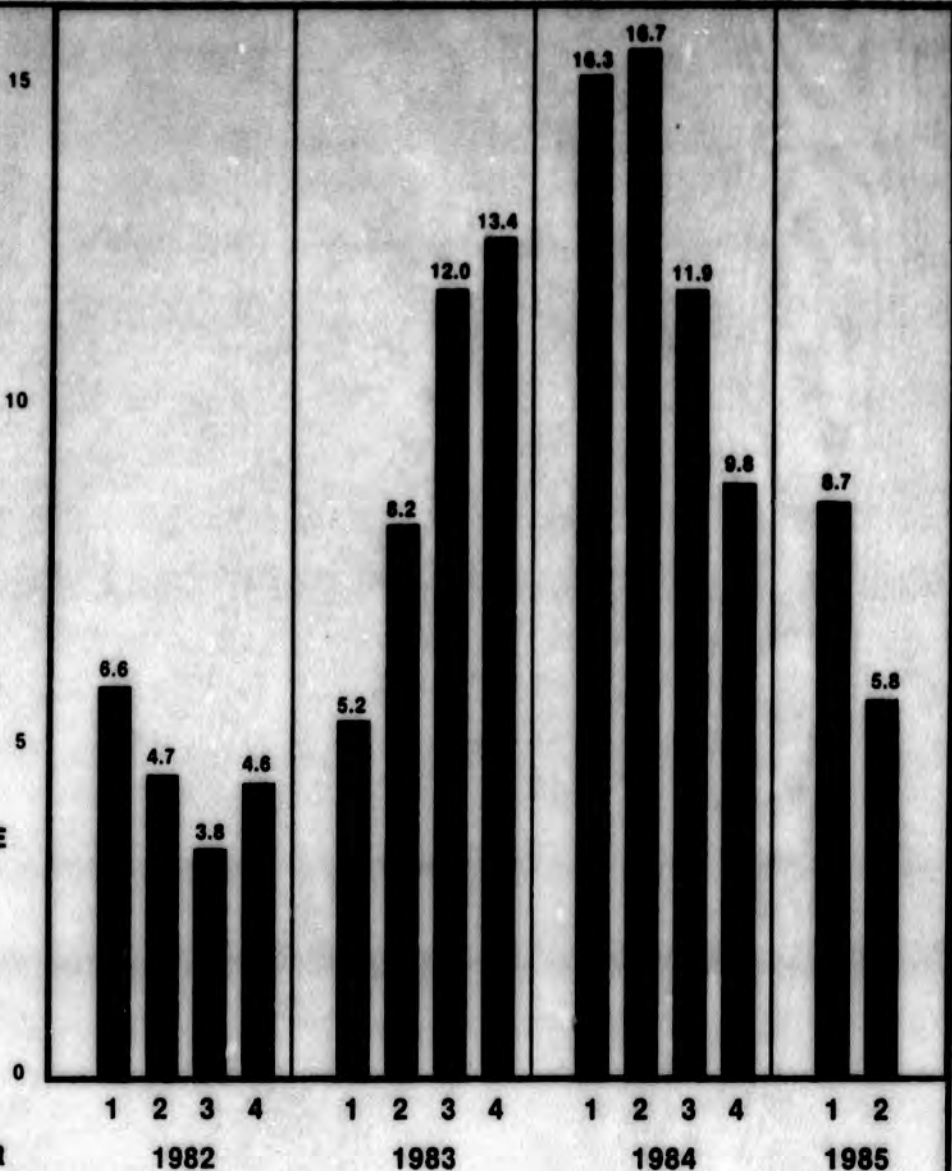
Are there any grounds for optimism that states will begin to take tax reform more seriously

Instability of State Tax Revenue

The chart demonstrates the instability of state tax revenue over the past few years by showing the percentage increase in each three-month period from the beginning of 1982 to the middle of 1985, compared to the corresponding period a year earlier. The growth rate of total state tax revenue fell in early 1982 because of the recession, bottomed out in the third quarter of 1982 and then rose steadily until it peaked at 16.7 percent in the second quarter of 1985. These ups and downs reflect two factors—the speedups and slowdowns of the economy and the imposition and later the lifting of a tax rate increase.

PERCENTAGE INCREASE

YEAR AND QUARTER



—abandoning the path of eroding tax bases and allowing tax systems to develop by inertia? Ironically, the odds for improving tax policy could increase if state fiscal conditions worsen. Adverse factors can still place stress on state tax systems.

The tax revolt, for instance, is not dead but dormant and contributed to the decision to lower income taxes last year. The economy is sure to experience another recession at some point, and it could be a serious one because of the fragility of the domestic and international financial systems. In addition, federal-aid cutbacks could become more severe than they have been since 1982.

Another source of stress is the intense interstate tax competition, which shows no signs of abating. Federal tax reform also could create new dilemmas for states by curtailing, or eliminating, the deduction for state and local taxes or simply by reducing tax rates. If federal tax rates are lowered significantly, the importance of interstate tax rate differentials would grow, spurring even greater competition among states, particularly to lower the income tax.

In such an environment, interest in tax policy might well increase because the importance of finding revenue to fund popular programs shows no signs of lessening. As Joe Clarke, the chair

of the Kentucky House Appropriations and Revenue Committee, observes, "There is a growing recognition on the part of legislators that taxes have been enacted or modified in a manner that has no rhyme or reason. Like Topsy, the changes have just grown. These decisions have been based on politics rather than on any coherent policy."

The chairman of Ohio's House Ways and Means Committee, Dean Conley, adds, "When there are budgetary problems, the interest in tax policy is much greater."

With all the potential fiscal problems on the horizon, taxes may have their day in the spotlight before long.