

ALASKA LEGISLATURE COMMITTEE FILES 1981-1982 8672

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legislators had at stake, and the greater the governor's ability to gather votes for major policy initiatives. Hammond preferred to trade huge capital budgets for longer run objectives, such as the permanent fund dividend program or the proposed constitutional limit on state spending.

Notes

¹Governor Jay S. Hammond, "Memorandum to the Cabinet," June 15, 1981.

²The Governor's "Policy Themes" are stated in the Policy Budget Instructions as follows:

1. To achieve a sustainable level of necessary public facilities and services which in the long term can be financially maintained by Alaska's citizens.
2. To enhance and protect the quality of life of Alaskans and to enable Alaskans to achieve their full potential.
3. To establish and maintain a tax system which equitably distributes the responsibility for funding government services.
4. To select those public services which are genuinely needed by Alaskans and which cannot be provided by the private sector, and to provide them in an effective and efficient manner.
5. To enhance the safety and security of Alaska's population.
6. To encourage economic development which offers long-term net benefits to Alaskans.
7. To foster the growth of a self-sustaining private economic base in rural communities, wherever practicable.
8. To improve the ability of the private market system to provide needed goods and services.
9. To perpetuate and to distribute equitably to all Alaskans the benefits from Alaska's publicly owned resource wealth.
10. To promote the rational development and maintenance of fish and wildlife for the long-term economic and social benefits of all citizens of Alaska.
11. To achieve long-term energy self-sufficiency.
12. To develop and support viable local government units.

³Jim Stay, personal communication.

⁴SB 17.

⁵Senator Dankworth, Senator Bennett, and Representative Adams, "Letter to Mr. Jay Hogan," July 31, 1981.

The Alaska Special Mortgage Loan Purchase Program

- Is the goal redistributing income to the wealthy? -

For the Senate State Affairs Committee

Senator Victor Fischer, Chair

James Packard Love*
Harvard University
December 1, 1981

*The author would like to acknowledge the contribution of Dr. Matt Berman of the Institute for Social Economic Research, who originally raised the issues discussed in the paper.

Introduction

In the past four years the State of Alaska has experienced a dramatic influx of revenue from production of oil in the prolific Prudhoe Bay oil field. As a direct result of this change in financial fortunes many government programs and services have been expanded, including programs which provide subsidies for housing. The lion's share of all state housing investments now go to a program which provides low interest loans for homebuyers.¹ This memorandum explores the distributional consequences of the allocation of housing subsidies, plus the impact of the program on housing and land prices and on the quality and quantity of housing stock.

Income Distribution

The Alaska Special Mortgage Loan Purchase Program is Alaska's largest individual grant or subsidy program. By next year some \$200 million in state funding is anticipated--approximately four times the amount currently budgeted for AFDC payments.² The exact amount of the subsidy per household is determined exogenously by financial markets--as the State sells housing bonds and then subsidizes the difference between the bond price and a base rate which is set by the legislature.³ In recent months the state rate has approached 11%, while the "cost of funds" has exceeded 19%.⁴ The cost of the subsidy, of course, is also determined by the amount of the loan. (There is no limit on the size of the loan, but the homeowner must pay the market interest rate on the proportion of the loan which exceeds \$90,000.) An estimate of the subsidy per household can be determined by comparing the state's rate of approximately 11 percent to a hypothetical market rate of 17 percent.

SUBSIDY PER HOUSEHOLD*

Price of Home	\$50,000	\$60,000	\$70,000	\$80,000	\$90,000
Subsidy: 1. monthly	237	284	331	379	426
2. annual	2,840	3,408	3,976	4,544	5,112
3. over 30 year life of mortgage	85,203	102,244	119,285	136,325	153,336

*Assumes market rate of 17% and state rate of 11%.

A rough rule of thumb suggests that combined mortgage, insurance and property taxes will amount to 12% of the purchase price of a home, if financed at the 11% state loan rate. Assuming that the homebuyer must earn at least 3 and one half times the annual mortgage payment - the minimum income which qualifies for a loan is about 42% of the price of the home. For a given housing unit this would amount to the following.

Minimum income required to qualify for home purchase.

Price of Home	\$50,000	\$60,000	\$70,000	\$80,000	\$90,000
Required Annual Income	21,000	25,200	29,400	33,600	37,800

Housing prices vary across the state. In Anchorage where half of the population lives, it is difficult to find any condominium or house for less than \$70,000. This suggests that the minimum household income required to participate in the program is just under \$30,000 per year.

The most recent available data on state income distribution are the 1978 income tax filings. In that year more than 73 percent of all tax returns reported earnings of less than \$25,000.⁵ This includes returns from

part time and seasonal employees, and may therefore understate earnings. Another useful comparison is the average wage and salary earnings per worker, estimated to be \$26,500 in 1981.⁶ The latter figure suggests that a household with one breadwinner earning an average wage would be a marginal proposition to purchase a home under the state subsidy program.

The basic thrust of the home mortgage program is to provide subsidies to those in higher income brackets. This is not necessarily intended--but it is an unavoidable consequence so long as the subsidy is tied irrevocable to the act of homebuying. Low and moderate income households are simply unable to participate in the program because they lack the means to purchase a home even at the state interest rate of 11%. Thus, the program not only rewards those who buy larger houses with larger subsidies, but there is an effective income threshold which excludes many wage earners from participating in the program at all.⁷

Impact on the Price, Quantity and Quality of Housing Stock

One important feature of the mortgage subsidy program is the impact on housing prices. The state program has now replaced the conventional mortgage market for most homebuyers. Housing prices, which have seen a sharp dip in the rest of the country, has remained firm during the past year, and the real estate and construction industries, if not booming, are experiencing healthy growth. In essence, the program helps both sellers and buyers of homes. The increased demand for home purchases which is caused by the subsidized interest rate causes a corresponding increase in the price of the available housing stock.

The price of housing is a function of the cost of construction and the

price of land. The construction industry will experience some price inflation over the short run if demand is sharply increased, but it tends to respond rapidly to changing market conditions, and over time it can adjust output without changes in cost. This "constant cost" nature of the construction sector suggests that the greatest proportion of the increase in housing prices is really an increase in the price of land for housing use. The benefits of the subsidy program are thus partly captured by landowners. The significance of this characteristic of the program is that land is generally distributed more unequally than income--and the tendency of the program to help the rich more than the poor is reinforced.

The degree to which the subsidy increases prices of housing in general and land in particular is a complex empirical question and requires estimates of demand and supply elasticities for housing, new construction and land. Interviews with local economists, homeowners and sellers, real estate agents and bank officers suggests that the shift of the benefits to sellers and landowners are substantial--although it remains a largely unexamined area of public policy.⁸

The program also provides incentives for homebuyers to improve the quality of housing stock, but only marginally so. In general, the subsidized mortgage rate gives rise to both an income effect (more money in the household budget which can be spent on housing or other items) and a substitution effect. The substitution effect is the result of the subsidy changing the relative price of housing when compared to other goods and services. The substitution effect, however, is only important if the homebuyer would purchase a home below \$90,000 without the program--because there is no subsidy on the marginal increase in housing stock over that price.

Moreover, both the income and the substitution effect are reduced by the amount of the subsidy which is shifted forward to home sellers and land owners in the form of higher prices.

The net impact of the program is that there will be some increase in the quality of housing stock--although this cannot be considered the primary objective of the program. Indeed, a much better way to improve the quantity or quality of the housing stock would be to target the subsidy to new construction, home improvements, or both. This would have a much different impact on both the availability and quality of housing, and the price of housing. The net increases to the housing stock would tend to drive housing prices down--rather than up. Moreover, this deflationary impact would not depend upon the continuation of the subsidies over time, as the subsidized mortgage rate does, because there would be a permanent improvement in the housing stock itself, and this would provide benefits to the consumer over a much longer period of time.⁹

The program of targeted subsidies to new construction or home improvements would also provide a much different distribution of benefits. All new homebuyers would benefit because the increase in the supply of housing would tend to bring housing prices down. The building sector would continue to receive benefits through wages from construction. Existing owners of residential properties could receive benefits by rehabilitating older housing stock. Sellers of existing homes would, however, be worse-off, because the competition from new construction would mean lower prices.

Policy Recommendations

In its present form, the State of Alaska's program for subsidizing mortgage rates tends to redistribute wealth to the wealthy and does not significantly improve the quantity or quality of housing stock. If this is the primary goal of the legislature then the program is a success. On the other hand, if the goal is to raise incomes equally; to make income distribution more equal; or to improve the quality of housing stock people live in, the program should be restructured. Moreover, the policy recommendations will depend upon which of the alternative goals are chosen.

Consider first the question of raising incomes. If, as many lawmakers suggest, the goal of the program is to give citizens some tangible stake or benefit from the oil revenues, then a program of housing subsidies has great appeal. There are political, tax and legal advantages to disguising cash transfers as in-kind benefits - particularly if this can be accomplished at a level which does not require the issuance of checks or vouchers to individuals.¹⁰ A low interest loan - available regardless of means - does not carry the same symbolic value as a check from the government, although the effect is essentially the same. Moreover, housing is something that almost everyone uses - and thus there is the potential for broad distribution of the subsidies.

The opportunity for broad distribution is not realized, however, when the subsidy is tied to mortgage rates. As noted above, people who buy bigger homes get more, and people who don't buy at all get nothing. A more equal distribution of the benefits would require that the nature of the payment be more explicit. It would require that the subsidy, rather than the interest rate, be specified. Moreover, the eligibility would not be tied to the ability

to buy a home.

There are a number of ways this could be done. The simplest approach is to just mail out checks to each household or citizen - perhaps with some nominal paperwork or other nuance which maintains the necessary references to housing (necessary for political, cultural, legal, or public relations purposes).

If the government check is impractical for metaphysical reasons, the government could disguise the benefits in other ways. For example, it could offer home mortgages where the interest rate was adjusted to reflect a subsidy of a certain dollar amount per homebuyer. In other words, lower each monthly payment by a fixed dollar amount - changing the yield on the mortgage, while treating all homebuyers equally. This in fact is precisely the approach recommended by the Hammond Administration in 1980.¹¹ For individuals who can't afford to buy a home - the State could put the equivalent of their subsidy in an escrow account which could be used later as a down payment on a home. The future homebuyer could even be given the opportunity to borrow against this escrow.

Of course, if the purpose of the program is to help people with low or modest incomes, the subsidy could be limited to, or larger for, people with less money. That programs of this type receive only a small fraction of the funding currently budgeted for the Alaska Special Mortgage Loan Program (ASMLP) is instructive, but perhaps not conclusive. In any event, just making the subsidies equal among households or individuals would tend to make income distribution more equal than is the case under the present system, and for that matter, than would be the case if there were no subsidies at all.¹²

Finally, there is the goal of increasing the quantity and improving the quality of housing stock. As discussed earlier, a program of targeting subsidies to new construction or home improvements would be a more efficient method of accomplishing this goal. There is no reason why this program need be limited to condominium or single family residences. If rental properties were eligible, some of the benefits would be realized by tenants. Moreover, the program of subsidies could be limited to a fixed amount per dwelling unit - thereby insuring that more expensive homes did not capture a larger share of the subsidies. Indeed, the subsidies could be targeted further - limited to, for example, housing units in a given price range.

NOTES

1. Other state housing programs include public housing projects, "non conforming" housing loans for rural areas, and a program to provide assistance to low income households.
2. The estimate for the fy 1982 budget provided by Milt Barker, Division of Finance, Alaska State Legislature, personal communication.
3. Under the current act the state rate is adjusted as the market rate changes.
4. Interview with officials of the Alaska Housing Finance Corporation (AHFC), which administers the program. October 1981.
5. Alaska State Department of Revenue.
6. Alaska Economic Information and Reporting System, Quarterly Report. October 1981.
7. As noted in the first memorandum, there is a small program to provide loans at interest rates as low as 6% to low and moderate income families - but it has not been funded to any significant degree and is not widely available.
8. One economist who has explored this topic is Matt Berman of the University of Alaska, but to date there is no published analysis of the incidence of benefits between consumers and sellers.
9. One way of thinking about the two approaches is that the subsidized interest rate approach encourages current consumption, while the subsidized construction option provides incentives to invest in capital stock.
10. One important legal question is whether the subsidy would be considered taxable income by the IRS. Many in-kind transfers escape federal taxation, which explains their popularity in some quarters. On the other hand, subsidized mortgage rates directly reduce the homebuyer's deduction for interest payments, and thus are largely taxed indirectly.

11. An illustration of this approach is shown below. Three homes, priced at \$60, \$75 and \$90 thousand are compared. First, the mortgage payment is figured at a hypothetical market rate of 17%. Then, a fixed subsidy of \$300 per month is deducted from the payments, and a new yield is computed. The higher the price of the home, the higher the yield. The subsidy per household, however, is equal.

HAMMOND ADMINISTRATION PROPOSAL FOR MORTGAGE SUBSIDIES

price of home	\$60,000	\$75,000	\$90,000
monthly payment @17%	855	1,069	1,283
less subsidy	<u>300</u>	<u>300</u>	<u>300</u>
adjusted payment	555	769	983
adjusted yield	10.64%	11.96%	12.82%

12. A subsidy of an equal amount will not change the absolute differences in income or wealth, but the same amount of money will increase the low income person's income by a larger percentage, and reduce the ratio of earnings between high and low income individuals.



Alaska State Legislature

Senate Committee on State Affairs

Vic Fischer, Chairman • Pouch V • Juneau, Alaska 99811 • (907) 465-4954

Official Business

M E M O R A N D U M

TO:

FROM: Sen. Vic Fischer *Vic*

DATE: December 20, 1981

RE: Long range planning papers

Enclosed are three papers prepared in support of the Senate State Affairs Committee's interim work on economic policy and long range policy planning. The two basic papers deal with long range revenue and expenditure analysis. The third examines special aspects of the state's mortgage loan program.

I would very much appreciate your comments on these papers by January 11, 1982. Please send any comments you have to Pouch V, Juneau, Alaska 99811.

Draft
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Talman

The Budgeting Process

The following is a brief description of the budget process as it has evolved in the past several years. The discussion is broken into three parts, each distinguished by the nature and character of decision making. They include the operating budget, the cost of new legislation, and the capital budget.

The Operating Budget

The basic system for organizing and presenting the operating budget was developed in 1971 by the MAC Corporation, headed by Grahm Taylor--a well-known national figure in the promotion of systems analysis and Planning, Programming, and Budgeting Systems (PPBS). In recent years the administration has introduced modifications to the system, including an Alaskan version of zero-based budgeting.

It is a program budget, presented in nine basic categories. Each budget category covers a broad area of government services and may include budget requests for several state agencies, including those in different departments of state government. Categories are broken down into 45 "programs," which are in turn disaggregated into 275 "subprograms," also known as "budget review units," or "BRUs." Finally, BRUs are broken down further to 600 "components." The idea is to bring together various agencies and programs which deal with a common problem, so that the priority setting process deals

with the parts in a comprehensive, rather than piecemeal way. The process is supposed to put emphasis on the program objectives, or "outputs" and asks the questions--"is this the best strategy to meet our objectives?" Analytical techniques, such as cost benefit, or cost effectiveness analysis are, in theory, introduced. Supporters of the program budgeting concept argue that it provides a rational framework to review state spending, because it considers simultaneously all government activities which affect a particular state policy objective.

In recent years there have been changes in the timing and organization of the budgeting process. In 1979 the governor introduced the "Policy Budget," as a preliminary priority setting step before the "Detail Budget" was prepared. In 1981 Department heads were asked to provide an initial "Major Items" memorandum prior to the submission of either the "Policy" or the "Detail" budget.

The "major items" memos are due by July 1 and are designed to provide the governor with "feedback" on big ticket items "at an early stage in the process." In his instructions to the cabinet, the governor said:¹

If you intend to request either significant new programs, or major program expansions, please send a memo to me summarizing what your request is, and why you believe it is important. After reviewing these memos, I will meet with each Cabinet member to discuss the proposal and make a decision whether the item(s) should be included as departmental requests in the . . . Policy Budget. . . . [This] does not guarantee inclusion in my . . . budget, but instead will indicate that I would like to review the proposal in more complete form in the . . . Policy Budget.

The Policy Budget is the next step. Agencies must submit paperwork by August 10 to the Division of Budget and Management. Broad spending priorities are shaken down in this stage. Agencies are expected to detail the program outputs, in measurable terms, and relate these to a series of "Policy Themes." In 1983 these "Policy Themes" included such broad topics as:²

- To enhance and protect the quality of life of Alaskans and to enable Alaskans to achieve their full potential.
- To enhance the safety and security of Alaska's population.
- To encourage economic development which offers long-term net benefits to Alaskans.

The policy budget is evaluated by the governor's budget advisors, and priorities are set among programs so that the total budget does not exceed the amount authorized by the Governor. Decisions are finalized by September 18.

This is followed by the "Detailed Budget"--a document which fleshes out the program and dollar amounts in the Policy Budget. Whereas the Policy Budget only breaks down budget requests to the BRU level, the Detail Budget goes the one step further to the "component" level and provides more specific information about agency activities and budget outlays. The Detail Budget is again reviewed by the governor's budget advisors, and final adjustments are made in spending priorities.

In January the governor's budget is finalized and formally submitted to the legislature. By this time a massive amount

of information has been assembled. The complete 1983 operating and capital budget included some 30,000 pages of numbers, forms, exhibits, and narrative, and was bound in 63 binders.³ At least one administration official believes that it contains "too bloody much information." Most legislators only review summaries of the budget.

The legislature goes over the governor's budget methodically, relying to a large degree on a system of subcommittees for the nine different budget categories. In general, however, only small changes are made in the governor's version, with the majority of disputes involving those programs where a particular legislator has an interest, or where some political advantage is perceived by temporarily cutting one of the governor's pet programs, thereby increasing negotiating power with the governor over budget vetoes.

Critics of the program budget approach allege that it provides the administration with too many opportunities to manipulate the budget process and "hide" appropriations. In 1981 the legislature passed, but the governor vetoed, a bill which would require the state to return to line item agency budgeting, which was last used during the Miller administration.⁴ Most argument over the program versus agency approach to budgeting stems from some legislators' desire to gain greater control over the budgets of specific agencies (as opposed to programs). It has not had much to do with the merits of the analytical work which is the basis

for the program budget approach. Indeed, the legislature has given scant attention to the quality of the analysis of budget objectives and alternatives. In the eyes of administration budget officials, certain legislators want to "jerk people around," and see the line item budget as a better way to find "the short hairs." Despite the governor's veto, the issue is still very much alive. On July 31, 1981 the Chairman of the House and Senate Finance Committees jointly signed a letter asking the Director of the Legislative Finance Division to obtain whatever information they could to rearrange the governor's program budget into a budget which is "arranged by agency for review by the standing finance committees during the 1982 legislative session."⁵

The amount of the operating budget has ballooned in recent years. In fy 1980 the legislature appropriated \$952.5 million in operating funds. The fy 1982 governor's budget request was \$1,776.5 million--an increase of \$824 million in two years. The 1981 proposal for a constitutional limit on state spending would limit the operating budget to two-thirds of \$2.5 billion, with future increases limited to inflation and population increases. For 1981 the limit, had it been in effect, would have amounted to \$1.67 billion. Although the limit would have required about \$100 million in spending cuts, it still allows a staggering amount of spending, equal to about \$4,128 per capita.

New Legislation

From year to year the legislature creates new programs with significant fiscal impact. In the past these would include "entitlements" such as the longevity bonus, Medicaid, or AFDC, plus major new programs, such as the system of grants for energy. Future programs might include the proposed state health care subsidies for moderate-income families. Generally such programs receive considerable attention by legislators and the public. In most cases legislation receives at least one committee referral in addition to the Finance Committee, and several public hearings are held. Major programs are often discussed in party caucuses before floor votes and reported extensively in the news media. The administration, if not the initiator of the program, is nonetheless a key player with the power of the veto, and usually well represented in the process. In 1981 the fiscal note for new legislation was \$43 million--equal to about 2.5 percent of the operating budget.

The Capital Budget

The capital budget can include almost any item, including those which are not capital expenditures by any strict meaning of the word. Grants to a local 4-H club, a trip to Europe for a handful of village children for cultural enrichment, a statewide tour of the symphony or repertory theater or a promotional effort to host a world's fair in Alaska all might end up in the capital budget. To the more

esoteric budget items discussed above are added hundreds of park acquisitions, street and road improvements, new schools, swimming pools, and gymnasiums, weather stations, books for libraries, and almost anything which can catch the attention of a friendly legislator.

The capital budget has always been a catch-all for legislative goodies--although in recent years the size of the capital budget has grown at an astronomical rate--and the required "back up" or rationalization for projects has rapidly deteriorated.

In the pre-bonanza budget days, the governor would submit a modest budget including your garden variety capital projections, most of which were road or other infrastructure projects. The governor would generally pick items off a six-year capital improvement plan, with some attention to the geographic allocation of projects. Individual lawmakers would then make some changes. The more influential legislators, including the members of the Finance Committees, would usually get more than others, although it was rare to be overlooked entirely. The capital budget also played a political role, as it was the primary tool for enforcing party discipline and buying votes. Despite its acknowledged role in providing the grease to keep the machine running smoothly, however, most legislators were expected to make a case for their specific projects.

In 1979 the system was modified in an important way, when Representative Russ Meekins, at the urging of Legislative

Finance Director Jay Hogan, initiated a quota for members of the House Majority. In that year, the first following the Iran crisis price increases, each member was given about \$750,000 to add to the capital budget. Members submitted lists, frequently as one page memos only listing the names of projects and the dollar amount. The rationalization for making the political nature of the capital budget more explicit was that it would be "fairer" than the past practice--as each member of the caucus, and hence their constituents, were treated equally. Minority members either had to work with their Senate counterparts or "sell votes" to get items in.

In 1980 the new system was used again, only by now the limit had been raised to about \$2.5 million per member. Again, little back-up was required from members.

As the legislature increased the dollar amounts in the capital budget, it became transformed from a modest but essential method of maintaining party discipline to a major expression of state policy. By 1982 the capital budget totaled \$2.27 billion--a half billion more than the total operating budget and equal to about \$5,400 per capita.

The governor portrayed himself as a fiscal conservative but did little to discourage the growth of the capital budget, choosing instead to use his line item veto power as leverage to achieve his major legislative priorities. The larger the size of the capital budget, the more individual

legislators had at stake, and the greater the governor's ability to gather votes for major policy initiatives. Hammond preferred to trade huge capital budgets for longer run objectives, such as the permanent fund dividend program or the proposed constitutional limit on state spending.

FOR YOUR
INFORMATION
ONLY

AMENDMENT NO. 1

CONTRACT BETWEEN
STATE OF ALASKA
LEGISLATIVE AFFAIRS AGENCY

AND

JAMES PACKARD LOVE

IT IS MUTUALLY AGREED THAT THE CONTRACT BETWEEN THE ABOVE PARTIES DATED
AUGUST 19, 1981, IS HEREBY AMENDED AS FOLLOWS:


CLAUSE II, Paragraph (A), page 2 is amended to read:

(A) The work under this contract shall be performed beginning
July 15, 1981, and will be concluded by November 30, 1981.

IN WITNESS WHEREOF, the parties have executed this amendment to this
agreement on the dates indicated below.

CONSULTANT

LEGISLATIVE AFFAIRS AGENCY



JAMES PACKARD LOVE
SSN# 538-50-1030

10-5-81
Date



M. R. CHARNEY
EXECUTIVE DIRECTOR

10/13/81
Date

Accepted:

Approved as to form:



SENATOR VICTOR FISCHER
PROJECT DIRECTOR

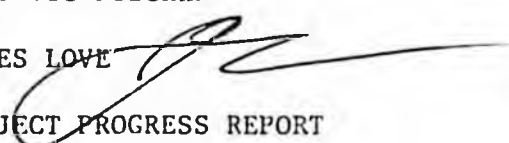
11/1/81
Date



BILLY G. BERRIER
AGENCY LEGAL COUNSEL

10/21/81
Date

MEMORANDUM

TO: SEN. VIC FISCHER
FROM: JAMES LOVE 
RE: PROJECT PROGRESS REPORT
DATE: 8-15-81

Over the past three and one half weeks I have reviewed a good deal of literature on development planning, cost benefit analysis, budgeting, and welfare economics as applied to national and international settings, as well as in Alaska. In addition, I have conducted a number of interviews with Alaskan legislators, legislative staff, budget and planning staff in the administration, municipal officials, employers of non-profit corporations, lobbyists, reporters and other knowledgeable individuals about state budget and planning policies.

BILLING

TO: SENATE STATE AFFAIRS COMMITTEE

DATE 8/19/81

FROM: JAMES LOVE

Research

120 Hours @ \$25

\$3,000.00

Per Diem

4 days @ \$65

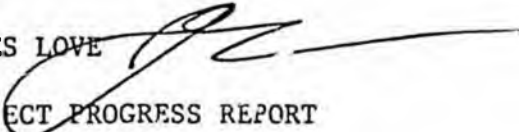
260.00

TOTAL

3,260.00

Approved
Fischer

M E M O R A N D U M

TO: SEN. VIC FISCHER
FROM: JAMES LOVE 
RE: PROJECT PROGRESS REPORT
DATE: 8-15-81

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INVOICE

TO: Senator Victor Fischer, Chair, Senate Committee On State Affairs

From: James Packard Love

Date: December 4, 1981

Labor

9/1/81 through 11/30/81 120 hrs X \$25 = \$3,000

Typing

Invoice dated December 4, 1981 from Joanne Klys \$195.00

Total \$3,195.00

A handwritten signature in cursive script, appearing to read "J. Love", with a long horizontal flourish extending to the right.

INVOICE

TO: Senator Victor Fischer, Chair, Senate Committee On State Affairs

From: James Packard Love

Date: December 4, 1981

Labor

9/1/81 through 11/30/81 120 hrs X \$25 = \$3,000

Typing

Invoice dated December 4, 1981 from Joanne Klys \$195.00

Total \$3,195.00

Joanne Klys

Approved
\$ 1454.00

only
Fischer

December 4, 1981

TO: James Packard Love
287 Harvard Street
Apt. 54
Cambridge, MA

FROM: Joanne Klys
10 Concord Avenue
Cambridge, MA 02138

For typing of three memorandums for Senator Fischer:

\$195.00

Joanne Klys

HARVARD UNIVERSITY
JOHN F. KENNEDY SCHOOL OF GOVERNMENT
79 BOYLSTON STREET
CAMBRIDGE, MASSACHUSETTS 02138

WILLIAM E. TRUEHEART
*Assistant Dean and Director
of the Lucius N. Littauer Master in
Public Administration Program*

Telephone: (617) 495-1353

January 12, 1982

Mr. Victor Fischer
Pouch V
Juneau, Alaska 99811

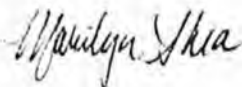
Dear Vic:

Jamie Love dropped by and asked that we send you a copy of the letter of recommendation that you wrote when he applied to the Kennedy School which I am pleased to enclose.

Bill is away on recruitment travel, but I am sure he would want me to send his regards to you and Jane.

Best wishes.

Sincerely,



Marilyn Shea
Assistant Director

MS:cae
Enclosure



UNIVERSITY OF ALASKA
Institute of Social and Economic Research
707 "A" St., Suite 206
Anchorage, Alaska 99501
Phone (907) 278-4621

July 2, 1980

Professor Thomas Schelling
Dean of the Faculty
Kennedy School of Government
Harvard University
79 Boylston Street
Cambridge, MA 02138

Dear Professor Schelling:

I am writing in behalf of James P. Love, who has applied for admission to the MPA program of the Kennedy School. I have known Jamie Love for six years and am familiar with the MPA program from participating in it as a Littauer Fellow in 1961-62 and knowing many of its graduates.

Although not employed in public service, Jamie Love has had tremendous effect on policies and decisions in the public sector. As director of the Alaska Public Interest Research Group, he has fought many battles and has won most. I have personally watched Jamie tackle all sorts of tasks: establishing a community development corporation, fighting utility rate increases, obtaining renegotiation of a sweetheart land lease deal between the state and the Teamsters, promoting fair treatment of the poor by government and financial institutions, reducing oil pipeline tariffs, getting liberals to run for public office and assisting their election, etc. In these and other efforts, he has proved himself not only an effective advocate but also an increasingly respected representative of the public interest. He has thus earned direct access to the governor, legislators, and top echelons of business.

Aside from general familiarity with Jamie Love and his work, I have, over the past year, worked closely with him and been able to observe the qualities important to your consideration of Jamie as a candidate for the MPA program. During this recent period, Jamie performed three research projects for the Alaska Center of Policy Studies, an independent, nonprofit research group, of which I am vice-chairman. The first involved a study of Alaska's state oil and gas leasing policies, with Jamie serving as the project's principal investigator. The project resulted in several memoranda on technical and policy aspects of alternative leasing practices, all of them, in my opinion, of the highest research caliber. Analyses were presented in quantitative terms, using a sophisticated computer model utilized by the oil industry to determine bids under different royalty, profit share, and taxation scenarios.

Jamie evaluated alternatives by comparison of the present value of oil resources to the state under different leasing methods. By using a range of scenarios, he illustrated the sensitivity of leasing systems to subtle changes in risk or timing of development decisions. He prepared an enormously persuasive case for "contingency bid" methods of leasing, as opposed to the conventional methods which collected rents up front as a cash bonus. He critiqued the sliding scale royalty system developed by the U.S. Department of the Interior by showing that the logarithmic curve chosen by the DOI was inappropriate for use in Alaska, where fields are larger, and at a time when prices had changed due to world events.

As part of his overall analysis, Jamie presented a logical measurement of an Alaska "social discount rate" and compared this to the discount rate used by the industry and the federal government. In all, the leasing study featured exactly the type of analytical quantitative analysis that is used by professional economists with far greater educational background than Jamie's. Although study results were subjected to rigorous review by industry groups, critics were unable to refute the major conclusions of the report. The resultant findings and recommendations of the Center's study were largely adopted as state policy.

I also worked with Jamie Love on a study of energy alternatives for the Alaska railbelt area, where three-fourths of Alaska's populations lives. I served as the principal investigator for this study. Jamie Love addressed the economics of energy conservation and solar energy, and supervised the preparation of recommendations for changes in state policy. He presented two different methods of measuring the price or cost of energy conservation and solar energy, including the net present value method. Two separate computer models were utilized to simulate costs and benefits of active and passive solar systems.

At present, Jamie is preparing work plans and recruiting economists and other experts for ten additional Center research projects. He was chosen for this role because of his analytical abilities.

In addition to his work with the Center, it is worth mentioning some of the skills Jamie has developed elsewhere. As a participant in several utility tariff proceedings, he has become a very competent rate of return expert, able to evaluate a utility's overall capital structure and required rate of return. He has analyzed the consolidated tax returns of several large corporations, including RCA and ARCO, to determine the proper effective rate of federal income taxes to be used for the purpose of setting tariffs for regulated telephone and pipeline utilities.

In the area of housing policy, Jamie has proposed systems of financing housing that meet the needs of the largest numbers of low and moderate income persons in the most cost-effective manner. He has presented this information through analysis of the life-cycle cost of various low-income housing subsidy programs. In arguing for changes in housing

policy, he has demonstrated the unfairness of present housing subsidies contained in the tax law, which give the largest subsidies to home buyers with the highest incomes. He proposed a package of new programs that incorporate "alternative mortgage instruments" with front-end government subsidies.

More recently, Jamie has analyzed oil taxation policies, again using computer simulations to show industry profits under different taxation scenarios. Here, as elsewhere, he demonstrated an ability to use the discounted cash flow rate of return methods of economic analysis often used by the petroleum industry.

I have recited at length Jamie's work and performance in order to demonstrate his qualifications for the MPA program. Though lacking an undergraduate degree, he has all the requisites for graduate work. Referring to the rating matrix of your regular recommendation form (of which I don't have a blank copy), I rate Jamie Love "superior" on every item except promise as manager in government, as his orientation is to pursue government programs from outside government itself.

I see Jamie as a serious and responsible student at the Kennedy School. He is a tireless worker and devotes total energy to whatever task he tackles, bringing to all efforts an alive, inquisitive, and constructive mind.

At this point, Jamie is essentially self-taught, though his growth has come about with the help of some top national economists with whom he's had an opportunity to work. The MPA program can be of extreme value to him by providing further exposure to disciplined economic theory and expanding his present analytic capability. As I've discussed with him at length, I believe that Harvard can now give him an opportunity to put in context everything he has learned and provide the foundation for a yet more effective effort in behalf of the public interest.

Conversely, admission of Jamie Love to your program will prove of benefit to Kennedy School. He will challenge and stimulate fellow students, making a better experience for all. And the faculty, too, will find him the kind of student who makes it all worth while.

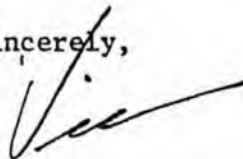
In conclusion, I strongly urge Jamie's admission to the Kennedy School. Don't let his lack of an undergraduate degree stand in the way. Based on ten years as director of this institute, I would rank Jamie's intellectual, research, and communications skills ahead of all individuals we've ever had with Master's degrees, and ahead of many with Ph.D.s (and during my tenure as director, we employed around 300 people, many of the highest caliber).

UNIVERSITY OF ALASKA

I'll be glad to provide any additional information on Jamie Love, if that's needed to facilitate his admission.

Best wishes to old friends.

Sincerely,

A handwritten signature in cursive script, appearing to read "V. Fischer", written in dark ink.

Prof. Victor Fischer

P.S. Enclosed are a couple of pertinent clippings I happened to have lying around.



Alaska State Legislature

Senator Vic Fischer • Pouch V • Juneau, Alaska 99811 • (907) 465-4954

MEMORANDUM

TO: Sen. Ed Dankworth
FROM: Sen. Vic Fischer *Vic*
DATE: January 15, 1982
RE: Revenue and expenditures study, ISER

Attached for your concurrence is a copy of a proposed contract with ISER in the amount of \$20,000 to provide a long-range perspective on the state's revenue and expenditures patterns. The work will include: a detailed calculation of the asset value to the state of future Prudhoe Bay revenues; an analysis of potential revenues from other natural resources, including other petroleum revenues that may be available when Prudhoe Bay income is reduced; calculation of the level of state expenditures that could be made and still maintain certain asset levels; analysis of likely timing and impacts on private and public sectors of forced reductions of expenditures and/or increases in taxes to compensate for reductions in future revenues; and similar issues.

A report on this project will be published by ISER for the legislature and the general public. Dr. Scott Goldsmith will be project director under this proposed grant.

I believe this is a most worthwhile project and worth the expenditure. Since no state agency is in a position to fund it and ISER does not have the money to do so directly, I think expenditure of available senate contracting funds would be justified.

Thanks for your consideration.

CONTRACT BETWEEN
STATE OF ALASKA
LEGISLATIVE AFFAIRS AGENCY
AND
THE INSTITUTE OF SOCIAL AND ECONOMIC RESEARCH

The parties to this agreement are the LEGISLATIVE AFFAIRS AGENCY, on behalf of the Legislative Council's Senate State Affairs Committee, hereinafter referred to as the "AGENCY," and the Institute of Social and Economic Research, hereinafter referred to as the "Consultant."

THE PURPOSE OF THIS AGREEMENT is to provide the Senate State Affairs Committee with projections of the State of Alaska's long term fiscal condition under varying policy choices pertaining to the disposition of projected state revenues.

IT IS THEREFORE MUTUALLY AGREED THAT:

CLAUSE I. - STATEMENT OF WORK

- (A) The Consultant shall produce a concise report containing the projections, analyses, and findings of the State of Alaska's long term fiscal condition.
- (B) In conducting its analysis, the consultant shall construct discrete sets of policy choices pertaining to the use and disposition of projected state revenues and discrete sets of state revenue projections.

CLAUSE II. - PERIOD AND DATES OF PERFORMANCE

- (A) The work under this contract shall be performed by March 30, 1981.

(B) This contract may be terminated by either party upon written notice to the other.

(C) Unless extended by written agreement, this contract expires on March 30, 1981.

CLAUSE III. - PROJECT DIRECTOR

The Project Director shall be Senator Victor Fischer, acting on behalf of Senate State Affairs Committee.

CLAUSE IV. - COMPENSATION AND METHOD OF PAYMENT

(A) For the work specified in this contract, the Consultant shall be compensated at the fixed price of \$20,000.

(B) The Consultant shall be reimbursed for travel and other expenses authorized in advance by the Project Director, except that per diem shall be paid at prevailing State rates, and all air travel shall be reimbursed on the basis of coach class fares.

(C) Billings may be submitted by the Contractor monthly, and should note thereon progress made to date.

(D) Total payments under this contract, including expenses, shall not exceed \$20,000.

CLAUSE V. - OFFICE SPACE, EQUIPMENT, CLERICAL SUPPORT, TRAVEL

Office space, equipment and clerical support, and the expenses of authorized travel of the Consultant that will be necessary to carry out his obligations under this contract shall be supplied by the Institute of Social and Economic Research at no cost to the Senate State Affairs Committee.

CLAUSE VI. - RECORDS, DOCUMENTS, AUDIT

The Consultant shall maintain accurate records, including detailed time records, as may be required by the Project Director. The records are subject to inspection by the Agency or the Project Director at all reasonable times. All documents, reports and writings generated as a consequence of work done under this contract shall become the property of the State of Alaska and, on completion of the work or at the termination of this contract, shall be delivered to the Project Director.

CLAUSE VII. - REPORTS

The Consultant shall keep the Project Director informed as to the progress of the work performed under this agreement and shall provide progress reports as specified by the Project Director.

CLAUSE VIII. - ALL WRITINGS CONTAINED HEREIN

This agreement contains all the terms and conditions agreed upon by the parties. No other understandings, oral or otherwise, regarding the subject matter of this agreement shall be deemed to exist or to bind either of the parties of this agreement.

IN WITNESS WHEREOF, the parties have executed this agreement on the dates indicated.

PATRICK RODEY
ANCHORAGE

315
601 W. 5TH AVE. SUITE 420
ANCHORAGE, ALASKA 99501

Alaska State Senate
JUNEAU, ALASKA 99811

DURING SESSION
POUCH V
JUNEAU, ALASKA 99811

MEMORANDUM

DATE: December 2, 1981
TO: Senator Fischer
FROM: Senator Rodey *PMR*
RE: Contract approval request

I have received your request for approval of the contracts with ISER and will be happy to sign off on them.

I have not been contacted by Jay concerning this however, so unless you already have authorization, I would follow up with his office on this matter.

PMR/ds



Interim office: 511 West 4th Avenue, Suite 5, Anchorage,
Alaska 99501 phone: 278-3654

MEMORANDUM

TO: Senators Jalmar Kerttula
Don Bennett
Ed Dankworth
Tim Kelly
Pat Rodey

FROM: Senator Vic Fischer

DATE: November 16, 1981

RE: Contract approvals

I would appreciate your concurrence, when polled, in the following two contracts with the Institute of Social and Economic Research.

The first is \$15,000 for publication of the Citizens Guide to Alaska's Constitution. The Guide has already been written under a previous contract funded by the Legislative Joint Committee on the Constitutional Convention. Since the joint committee was not extended, no funds were allocated to publish and distribute the guide.

In 1982, Alaska voters will be faced with the critical question of whether or not to hold another constitutional convention. Several other states have found that public understanding of the constitution is a basic element of their action on revising the document. That is why the joint committee commissioned preparation of the Citizen's Guide. Since nothing else is being done to prepare for the 1982 referendum, I believe it critical to get out the Citizens Guide to Alaska's Constitution, and suggest that \$15,000 be allocated through the State Affairs Committee. Publication would be through the Institute of Social and Economic Research, which can readily integrate this into other projects and publications that they manage. The \$15,000 amount would include editing, graphics, photos, and publication and distribution of 5,000 copies.

The second proposed contract with ISER is in the amount of \$200,000, and will provide a long-range perspective on the state's revenue and expenditures patterns. The work will include: a detailed calculation of the asset value to the state of future Prudhoe Bay revenues; an analysis of potential revenues from other natural resources, including other petroleum revenues that may be available when Prudhoe Bay income is reduced; calculation of the level of

state expenditures that could be made and still maintain certain asset levels; analysis of likely timing and impacts on private and public sectors of forced reductions of expenditures and/or increases in taxes to compensate for reductions in future revenues; and similar issues.

A report on this project will be published by ISER for the legislature and the general public.

Dr. Scott Goldsmith will be project director under this proposed grant.

I hope all of you will concur in approval of these two contracts when you are polled by Senator Kerttula's office. (Jay has already okayed bbb.)

Thanks, and best personal regards,

/lf

LRP:LP
FOR YOUR
INFORMATION
ONLY

CONTRACT BETWEEN
STATE OF ALASKA
LEGISLATIVE AFFAIRS AGENCY
Pouch Y
Juneau, Alaska 99811
AND
JAMES PACKARD LOVE

The parties to this agreement are the LEGISLATIVE AFFAIRS AGENCY, on behalf of the Senate State Affairs Committee, hereinafter referred to as the "Agency", and JAMES PACKARD LOVE, hereinafter referred to as the "Consultant".

THE PURPOSE OF THIS AGREEMENT is to provide the Senate State Affairs Committee with professional research services in support of its interim work on economic policy and long-range policy planning.

IT IS THEREFORE MUTUALLY AGREED THAT:

CLAUSE I - STATEMENT OF WORK

- (A) The Consultant shall examine alternatives for long-range economic and policy planning dealing with the use of Alaska's wealth, economic development, natural and human resources, etc. Experience of other states and foreign countries will be examined in terms of applicability to Alaska. Pertinent literature will be evaluated.
- (B) The Consultant shall provide a draft report to the Project Director covering work to be carried out under (A). The Consultant shall include appropriate conclusions and may include recommendations for action by the State of Alaska, particularly dealing with institutionalizing appropriate processes within the executive branch and establishing means whereby the legislature can deal with broad economic policy issues on a continuing basis.
- (C) The Consultant shall provide the Project Director with a final report after approval of the draft report under (B) by the Project Director.

CLAUSE II - PERIOD AND DATES OF PERFORMANCE

(A) The work under this contract shall be performed beginning July 15, 1981, and will be concluded by September 30, 1981.

(B) This contract may be terminated by either party upon written notice to the other.

(C) Unless extended by written agreement, this contract expires on December 31, 1981.

CLAUSE III - PROJECT DIRECTOR

The Project Director shall be Senator Victor Fischer, acting on behalf of the Senate State Affairs Committee.

CLAUSE IV - COMPENSATION AND METHOD OF PAYMENT

(A) For the work specified in this contract, the Consultant shall be compensated at the rate of \$25.00 (Twenty-five Dollars) per hour, with total compensation for this work not to exceed \$6,000.00 (Six Thousand Dollars).

(B) The Consultant shall be reimbursed for travel and other expenses authorized in advance by the Project Director, except that per diem shall be paid at prevailing State rates, and all air travel shall be reimbursed on the basis of coach class fares.

(C) The Consultant may submit monthly billings to the Project Director. All billings should be accompanied by a statement and description of the work accomplished to the date of the billing.

(D) Payment of \$1,000.00 (One Thousand Dollars) will be made to the Consultant upon execution of this contract.

(E) Total payments under this contract, including expenses shall not exceed \$6,000 (Six Thousand Dollars).

CLAUSE V - OFFICE SPACE, EQUIPMENT AND CLERICAL SUPPORT

Office space, equipment and clerical support of the Consultant that will be necessary to carry out his obligations under this contract shall be supplied by the Agency.

CLAUSE VI - RECORDS, DOCUMENTS, AUDIT

The Consultant shall maintain accurate records, including detailed time records, as may be required by the Project Director. The records are subject to inspection by the Agency or the Project Director at all reasonable times. All documents, reports and writings generated as a consequence of work done under this contract shall become the property of the State of Alaska and, on completion of the work or at the termination of this contract, shall be delivered to the Project Director and the Agency.

MEMORANDUM

TO: Richard Berg, Director
Administrative Services
Legislative Affairs Agency

FROM: Sen. Vic Fischer

DATE: July 22, 1981

RE: Interim Contracts

Here is the contract ~~whiwhiwhs~~ spoken of when I met with you and Senator Kerttula during the special session. I look forward to it being executed ~~deas~~ as soon as possible and know that you will contact me if any obstacles arise as I attempt to get initial payment to Joe McKinnon, Jamie Love, and William Salamenta, all of whom ~~had~~ on contract this summer. If there is anything my office can do to expediate these things, please give my secretary, Laura Fleming, a call at 278-3654.

Thank you and best regards,

LAURA re: Love's CONTRACT

TOTAL - 6,000.00

(ALREADY PAID)

World travel 2861

per diem 260

ADVANCE 1,000 (Aug-20)

WARRANTS 3,000 (8-19)

Balance \$1454.00

(MAXIMUM) they can pay

Need 3 typewriters - our 3
are not working - 2 of
them were screwed up before
the move.

- Xerox 4th Floor
Please fix

OIL REVENUE
DISTRIBUTION/
WEALTH
SHARING:
MCKINNON
PROJECT

TO: Senate State Affairs Committee

FROM: Joe McKinnon

FINAL BILLING Sept. 12 to Dec. 12, 1981

120 hours @ \$25	3,000
Less Advance	<u>-1,000</u>
	2,000

Work performed during period included research and preparation of draft and final report.

ok

V. Fischer

INTRODUCTION

Ever since completion of the pipeline when large amounts of oil revenue began flowing into the state treasury, Alaskan policymakers have been faced with the dilemma of determining the most equitable way of sharing the state's natural resource wealth.

One attempt at wealth sharing resulted in the enactment of the Permanent Fund Dividend Program in 1980. The program would annually distribute one-half of the earnings of the Permanent Fund directly to Alaskans. The fact that the distribution is based on length of residency, however, has resulted in a legal challenge to its constitutionality which has delayed its implementation.

Numerous other proposals have also been offered. Some are put forth as options to be considered if the dividend program is invalidated. Others are intended to supplement it. And still others are entirely independent approaches to the wealth sharing objective.

This paper discusses several of the principal alternative proposals for the sharing of state wealth. Included are various forms of direct cash distribution, annuities, royalty trusts, the Portfolio of Alaskan Citizen Enterprise, grants to municipalities, and public endowments. Also suggested are several criteria which need to be evaluated in the design of any form of distribution program.

Annual Per Capita Cash Distribution

The simplest change to the current Permanent Fund Dividend program would be an annual per capita cash distribution plan, as discussed in the Governor's Report --- "Policy Analysis Paper No. 81-24."¹ Money in the Permanent Fund dividend account, a special account within the General Fund would be divided up equally and distributed to eligible "state residents." Under current law, 50% of the earnings from the Permanent Fund principle go directly to the account. If the Legislature decided to increase annual dividends, additional monies could be appropriated from the general fund.

Appropriations to supplement dividend payments would no doubt be required at first, because Permanent Fund earnings are not yet sufficient to pay any sizable dividends. Any appropriation must be paid back according to AS 43.23.050, because the program would not be intended to distribute General Fund or Permanent Fund principle. At present the Permanent Fund dividend account contains only \$27 million.²

An annual per capita cash distribution plan would be the easiest way to repair the current Permanent Fund dividend program if it is struck down by the U.S. Supreme Court. Each Alaska resident would receive an equal share. The major legislative change would be amending the durational residency provision. Hopefully, ~~the Supreme Court decision will~~ ^{an adverse} ~~provide~~ ^(would at least) guidelines on a constitutionally acceptable definition ~~of~~ residency.

¹Policy Analysis Paper No. 81-24 "Option 1," Discussion Paper Permanent Fund Dividend Alternatives, October 12, 1981, State of Alaska, Office of the Governor, Division of Policy Development and Planning.

Contributions to the Permanent Fund dividend account are made on a "cash basis" and averaged in with prior year's contributions. This keeps down contributions to the account during the first few years, thereby, protecting the Permanent Fund principle.

Under this program, Permanent fund earnings could be distributed to State residents, thereby establishing a link between the size of the Permanent Fund and individual personal incomes. An annual per capita cash distribution might not encourage long-term state residency as the current plan attempts. In fact, it may encourage short-term residency if the residency provision is ~~only~~ ^{of relatively short} ~~duration~~ ^{duration}. This plan also has two other policy implications; first, the dividend would be ^{fully} subject to ~~the Federal Income Tax~~ Federal Income taxation; and second, distributing cash may effect the eligibility of individuals receiving public assistance.

Federal Income Tax. A permanent fund cash dividend would be considered taxable income by the Internal Revenue Service (IRS). Currently the average marginal tax rate in Alaska is 35%. This means at least 35% of the Permanent Fund earnings paid out in dividends will end up in the Federal treasury. In fact, a cash distribution may actually bump up the average marginal tax rate, by moving some individuals into a higher tax bracket. Many people won't care, and will still prefer cash. However, Alaskans with a marginal tax rate above 50% might want to defer this extra income.

The current dividend plan attempted to get around this problem by allowing residents to defer receipt of the dividend. Unfortunately, the IRS issued a ruling that the permanent fund dividend was subject to "constructive receipt." Constructive receipt requires payment of taxes on the dividend even if you don't elect to receive it. The IRS has allowed State employees the option to defer a portion of their wages, thereby, sheltering the amount deferred from Federal Income Tax. However, regarding the Permanent Fund dividend the IRS reasoned:

"Dividend payments are available to all applicants who meet the age and residency requirements, and who file timely applications. Since Act dividends are not paid as compensation for services, the rationale and conclusions stated in Rules 6-31 and 69-50 do not apply..."

And further,

"We conclude that an individual reporting on the cash receipts and disbursement method of accounting who elects to defer the dividend by

selection of either the postponed payment method or the twelve monthly installment method will be required to include the amount of such dividend in gross income for the taxable year in which the dividend would have been received..."³

This ruling is not final and does not necessarily mean that it is impossible to shelter the Permanent Fund dividend. The IRS letter also states:

"However, income is not constructively received if the taxpayers control of its receipt is subject to substantial limitations."

The term "substantial limitation" is not defined, at least in the letter, and its meaning would no doubt be decided upon by the IRS on a case by case basis. To take advantage of this "loophole" the state could require that all the dividends be placed into a retirement account. In this way a person would not be able to receive it until some time in the future. This might work. If a person has the right to take the cash upon issuance of the dividend it becomes more difficult to get around constructive receipt, however, it may be possible. At any rate, it will take a lot of work to develop a suitable tax shelter.

Public Assistance. Another adverse effect of distributing a cash dividend is the effect of increasing the resources or income of residents eligible for Public Assistance. The current Permanent Fund dividend plan exempts dividends up to a maximum of \$1,500 from inclusion as income for certain State public assistance programs.⁴ However, for many of the programs subject to Federal rules and guidelines, cash dividends will simply replace Federal dollars with State monies.

³Letter dated February 27, 1981 from the U.S. Department of Treasury, Internal Revenue Service to the State of Alaska, Department of Revenue. The ruling is directed only to the requestor, and may not be used or cited as precedent.

⁴See: AS 43.23.080.

Public Assistance Another adverse effect of annual direct distribution is that for many of the state's poor the plan amounts to almost a hoax. While it is often cited as a means of improving the living conditions of the poor, the reality of the situation is that for most of the state's truly needy, the plan may result in no perceptible benefit.

The problem arises from the fact that the dividends would be classified as a financial resource or income under those Public Assistance programs which are subject to Federal rules and guidelines. The effect is that money received from the State will simply disqualify a public assistance recipient from receiving Federal aid on a dollar-for-dollar basis. The result is that the recipient shows no net gain from having received the dividend.

For example, a permanent fund dividend could make a recipient under the state/federal program - Aid to Families With Dependent Children (AFADC) - ineligible for benefits. Currently, if a parent or guardian's "gross income" exceeds \$762/mo., or their "net income" exceeds \$508/mo., the family is not eligible. If the family received a permanent fund dividend of \$1,200 as a lump sum, the payment would count as "excess" income. According to regulations, the money would have to be averaged over a certain period by dividing the dividend received by the limit for "net income." With a \$1,200 dividend, the family would become ineligible for assistance for 2.36 months ($\$1,200/\508). An additional negative impact is that the child would be made ineligible for Medicaid as well. If the dividend were paid in monthly installments, it might make the family ineligible all together. And even if it didn't, the monthly dividend would be subtracted from the benefits due.

It appears that the only possible way for the poor to benefit from a dividend program would be to take the payment in a lump sum and spend it immediately. Under Federal regulations the funds would not be counted against the recipient's resource limit in the month during which they were received. However, any of the dividend which remained at the end of the month would be counted against the recipient's resource limit for the following month. This incentive for the poor to spend their dividend as fast as possible is hardly something which should be encouraged, but it may represent the only practical manner by which they may participate in the system.

The current Permanent Fund Dividend plan attempts to deal with the problem by exempting dividends up to a maximum of \$1,5000 from inclusion as income for certain State public assistance programs.⁴ But the number of programs financed without assistance from the Federal Government is extremely small, consisting primarily of General Relief and General Relief Medical. The bulk of the State's public assistance recipients, however, receive their payments through a federally financed program.

It seems ironic that the Permanent Fund Dividend could actually hurt the poor rather than help. This problem may have a solution, but it will require a careful study of all state/federal public assistance programs to devise appropriate exemptions.

For example, a permanent fund dividend could make a recipient under the state/federal program - Aid to Families With Dependent Children (AFADC) - ineligible for benefits. Currently, if a parent or guardian's "gross income" exceeds \$762/mo., or their "net income" exceeds \$508/mo., the family is not eligible. If the family received a permanent fund dividend of \$1,200 as a lump sum, the payment would count as "excess" income. According to regulations, the money would have to be averaged over a certain period by dividing the dividend received by the limit for "net income." With a \$1,200 dividend, the family would become ineligible for assistance for 2.36 months ($\$1,200/\508). An additional negative impact is that the child would be made ineligible for Medicaid as well.

If the dividend were paid in monthly installments, it might make the family ineligible all together. And even if it didn't, the monthly dividend would be subtracted from the benefits due. This would have the effect of 'acking out Federal aid dollars with Permanent Fund dividends. It seems ironic that the Permanent Fund dividend could actually hurt the poor rather than help. This problem may have a solution, but it will require a careful study of all state/federal public assistance programs to devise appropriate exemptions.

Royalty Oil Premiums Payments

A program similar to the annual cash distribution system was proposed during the Twelfth Legislature. Governor Hammond introduced, and later withdrew, House Bill 67, an act relating to royalty oil payments. The bill would have distributed equally to each state resident a share of the "premium," the amount the State received above the "in value" price, from the December 1980 royalty auction. The auction netted the State \$77 million more than the in value price -- about \$193 for each Alaska resident.

Governor Hammond's transmittal letter stated that the purposes of HB 67 were twofold:

"By distributing the premium obtained over current in-value prices directly to residents of the state, residents will gain an increased awareness that the state's natural resources belong to them..."

And further;

"A second purpose of the distribution is to fulfill to some degree the expectations raised by enactment of the permanent fund dividend program, implementation of which continues to be delayed by litigation..."⁴

While these goals sound reasonable, it is clear from the Legislative Purpose and Findings Section of HB 67, the royalty premium payment was definitely not Governor Hammond's first choice. Those findings state in part:

"Unlike the permanent fund dividend program, however, this per capita distribution does not provide an incentive for long-term residency in the state; it does not help assure that the state will benefit in the future from a stable population; it does not encourage a long-term interest in prudent management of the Alaska Permanent Fund and the state's natural resources; and it does not recognize the many contributions, both tangible and intangible, that individuals have made to the Alaska community during their previous periods of residence in the state. Thus, the method of distribution provided in this Act is not the method preferred by the legislature."⁵

It seems unlikely the Governor or the Legislature will revive HB 67. However, the royalty oil auction coupled with distribution of the proceeds raises some interesting points. First, the royalty oil auction was the first time Prudhoe Bay oil was sold in a competitive auction, and it netted the state a sizable premium—a premium above what the state normally receives for its oil. Second, the Administration was at least willing to consider distributing the premium, even though it arguably represents principal rather than investment earnings.

Despite HB 67's almost apologetic legislative purpose section and a generally negative response, distributing the premium would establish a direct link between personal incomes and the price the state receives for its royalty oil.

As an alternative, the Legislature may wish to consider appropriating the premium from the December 1980 royalty oil auction and premiums from any future

⁵See: House Journal, February 4, 1981, pp. 146-147.

auctions directly to the Permanent Fund dividend account. This would tend to increase the awareness of state residents to the price received for royalty oil.

Portfolio of Alaskan Citizen Enterprise

An Act establishing the Portfolio of Alaska Citizen Enterprise, House Bill 1006, was introduced during the second session of the Eleventh Legislature. The proposal became commonly known as PACE and was a system by which income producing assets could be distributed or sold to Alaskan residents. "Portfolio Plans," as these investments were called, could be state investment funds, business enterprises acquired by the State, energy resource trusts, real estate investment trusts, and GSOCs.

PACE. The idea of a PACE came from British Columbia's experience in "privatization." Privatization was a means of transferring assets held by the public sector to private individuals. In 1977 at the urging of Premier Bennett, the British Columbia legislature created the British Columbia Resource Investment Corporation (BCRIC), and handed over the following government owned assets:

Oil and gas exploration rights to some 2.3 million acres of crown land in British Columbia.

81 percent of the common shares of Canadian Cellulose Limited, a large scale forest products firm, 100 percent of the common shares of Kootenay Forest Products Limited, a medium sized lumber and plywood manufacturer,

100 percent of the common shares of Plateau Mills Limited, a mid-sized lumber producer.

About 10 percent of the share of Westcoast Transmission Company, which operates a major pipeline in B.C. and is also a partner in the Alaska Highway gas pipeline project.

After passage and transferene of these assets to BCRIC, eighty percent of

the stock in BCRIC, or 12 million shares, was transferred to the public. Each resident received five shares. The B.C. government retained 20% of the stock, but did not become involved in management of the corporation. While political **pundits** and financial experts viewed the program askance, BCRIC became immensely popular among B.C. residents.

BCRIC and PACE bear a striking resemblance to the Alaska General Stock Ownership Plan, or AGSOC as it was popularly referred to. In fact, in many respects they are identical. Ownership of shares is limited to avoid concentration, distributions are limited to residents, board members are elected by the shareholders, etc. AGSOC and PACE are not, however, exactly alike.

AGSOC and PACE. One of the motivations behind PACE was to void the initiative petition to create AGSOC. AGSOC, as most will remember, was the Kelso-Gravel plan to distribute wealth from Alaska investments. Whether PACE would have voided the petition is moot, since PACE did not pass the Legislature and the AGSOC initiative was defeated by the voters.

While the purpose of AGSOC and PACE are similar, to distribute wealth to Alaska residents, there is a fundamental difference in their make-up. PACE can own income producing assets. AGSOC, on the other hand, must acquire investments with 100% debt financing. After servicing the debt, the income left over must be distributed, if there is any. AGSOC is a conduit for funneling income to Alaskan residents. In exchange, AGSOC is exempt from corporate income tax. PACE can actually own the assets, although this does raise some difficult tax questions.

Under the draft legislation creating PACE, the Department of Revenue was required to present at least one and not more than three "Portfolio Plans" specifying which assets were to be transferred to PACE. Some shares would be distributed free and some would be sold. Before the assets could become part of PACE, however, approval from the Legislature was necessary - another significant difference between PACE and AGSOC. The first "portfolio plan" to be considered for PACE was a royalty trust.

Royalty Trust. The royalty trust would be a trust or trusts to which the royalty income from specific state leases would be pledged. The trust would then act as a conduit funneling royalty oil income to the trust beneficiaries, who in this case would be state residents.

The PACE royalty trust would be similar to some publicly held royalty trusts like the North European Oil Royalty Trust, the Mesa Trust and the Tidelands trust. The value of the income from a royalty trust is, of course, tied to oil prices.

Since royalties are taken off the top, trust beneficiaries bear none of the development risks. Also, royalty trusts receive special tax consideration by the IRS. As long as the trust remains "passive" (bears no risk) and pays out all of the earnings, the trust is not subject to Federal income tax. Trust beneficiaries can also claim a depletion deduction which reduces an individual's tax liability. While the concept of a royalty trust appears attractive, its implementation raises a host of difficult legal questions.

Dedication of Revenues. One legal obstacle appears to be Article IX, § 7 of the Alaska Constitution. Article IX, § 7 of the state's constitution prohibits the dedication of "taxes, licenses and fees." A literal reading of Article IX might be interpreted to exclude royalties, because they are not specifically a tax, license or fee. However, this is a pretty weak argument and was not tried with the Permanent Fund. The Permanent Fund receives 25% of the state's royalty income pursuant to a constitutional amendment.

The PACE legislation attempted to get around this problem by structuring the transference of royalty trust shares as a sale. The money received by those purchasing the shares at a conservatively appraised value would then go to the general fund. This might work, but it makes the royalty trust more like an investment than a means of distributing the state's oil wealth.

Statehood Act. Another problem is section 6(i) of the Statehood Act which requires the state to retain all minerals in lands conveyed to the state by the Federal government. If the state attempts to convey the mineral estate, the Attorney General of the United States may bring an action for the forfeiture of the lands affected by the purported conveyance.

Whether a royalty trust is a conveyance in violation of section 6(i) is subject to legal debate. The PACE legislation attempted to remedy this problem by expressly requiring the Commissioner of Natural Resources to retain the mineral estate. It was not clear, however, whether this provision was sufficient. One clear means of avoiding a problem is to convey the royalty interest to a trust from lands obtained under the Submerged Lands Act of 1953. These lands are not subject to forfeiture and hence would allow the creation of, for example, a Beaufort Sea royalty trust.

Windfall Profits Tax. Another problem appeared to be the Federal windfall profit tax (WPT). Under provisions of the WPT Act, producers must pay an effective marginal tax rate of 30% on Prudhoe Bay oil. State royalty oil is, however, exempt. It was not clear at the time the legislature was deliberating over PACE whether this exemption applied to royalty oil transferred to a trust.

The WPT problem may have been resolved, however, because of certain amendments to the Act. The Economic Recovery Tax Act of 1981 provides certain exemptions for payment of the WPT. The conference agreement provided a \$2,500 credit against WPTs paid in 1981. Between 1982-1984 royalty owners could exempt 2 bpd of production from the tax, and 4 bpd thereafter. If the royalty trust consisted of a royalty trust for each beneficiary (state resident), this exemption might be sufficient.

The idea of a royalty oil trust deserves some further consideration. It would clearly create a constituency concerned with prudent fiscal management of the state's oil and gas resources. One suggestion would be to deal with a royalty trust separate from PACE. On its own, royalty trust would be a very complicated piece of legislation.

Direct Wealth Distribution

Recent proposals have advocated a radically different approach to state spending and wealth distribution. These plans propose a direct distribution of Alaska's wealth. Where the Permanent Fund Dividend Program distributes interest earnings, direct distribution would give away revenues which now accrue to the general fund.

Proponents of direct distribution argue that Alaska can build a more productive economy and better provide for its citizens by allowing them to decide how State wealth should be spent. Under these proposals, state government would provide only essential services and remaining revenues would be distributed through various mechanisms directly to the people.

The simplicity of this approach is appealing. Alaska's FY 1982 budget totaled approximately \$6 billion dollars. Proponents of direct distribution point out that when divided equally, \$6 billion comes out to about \$15,000 per person. Accordingly, a family of four could have a very comfortable income of \$60,000 a year. Even after allowing for the funds necessary to provide essential governmental services, there would still be a distribution of substantial amounts of money to Alaskans.

While this approach may sound far-fetched, direct distribution has been advocated by several prominent economists, among them Professor Donald F. Gordon of the Center for the Study of Business and Government, City University of New York. In his paper, The Problems of Wealth, submitted to the Board of Trustees of the Alaska Permanent Fund, Dr. Gordon iterates "Option 1" called "Give it to the People." He states:

"The first option is stunningly simple in principle and by a great margin the most desirable in terms of our criterion. It answers the question what can be done with it? by another question: Why not give it to the people?⁶

Dr. Gordon's criterion is that the wealth of this state "morally" belongs to the people. He suggests Alaska create a corporation and pledge all future oil and gas revenues to it. The state could issue 100 shares to each and every Alaskan and send them out in the mail immediately.

The Board of Trustees for the Alaska Permanent Fund has begun to study the effect of the influx of oil dollars into the Alaskan economy and has commissioned several papers. All of them conclude that a political system of revenue allocation which results in subsidized loan programs and that attempts

⁶The Problems of Wealth, p. 6.

to spur industrial development by buying infrastructure for marginally economic projects will result in waste of the state's resources.

Richard B. Coffman, author of Capital Shortage, Public vs. Private Allocation of Capital and Alternative Ownership Systems for Alaska's Oil Wealth, one of the papers prepared for the Permanent Fund Board of Trustees, states unequivocally "all state loan programs should be abolished" and "all usury and interest rate ceilings should be removed." In other words, the capital markets should be deregulated. Dr. Coffman also recommends redistribution of some part of the oil revenues as cash grants. Taken together, the arguments present a fairly strong case for private allocation of the state's wealth as opposed to a political/bureaucratic system of allocation.

Dr. Malcolm Gillis, professor at Harvard University and author of the paper, The Effects of In-State Investment: Lessons from Oil-Fired Development in Other Parts of the World, warns of dangers in stimulating industrial development based on criteria other than "good economics." He cites the Krakatau steel project, a \$3 billion "boondoggle" intended to free Indonesia from having to import steel. "This freedom," Dr. Gillis states, "will cost that society nearly \$80 million annually for another decade (in addition to the \$1.5 billion already invested)."

Dr. Gillis also remarks that crash programs to expand infrastructure have often involved substantial waste, by creating facilities that have been "grossly" underutilized. Funding infrastructure is, however, politically attractive as Dr. Gillis points out by quoting a campaign speech by Mr. Velasco Ibarra, President of Ecuador off and on during the 1960s:

"And finally, when I am elected again, we will build the biggest bridge in Ecuador, right here in Dos Gatos.

'But Senor Presidente, there is no river in Dos Gatos.'

"Then we will also build the biggest river in Ecuador, right here in Dos Gatos.'"

No doubt implementation of direct distribution poses numerous political, legal and technical hurdles. However, the Legislature may wish to retain a nationally recognized accounting firm to examine the idea.

CAPITAL PROJECTS

Another proposal which has received considerable support in the Legislature is the concept of expanding Alaska's economic infrastructure through the construction of capital projects such as roads, ports, airstrips, and hydroelectric facilities. Not only has the idea received substantial support, it has received a certain degree of implementation through record capital appropriations in each of the past two years. Proponents of increased capital spending argue that the creation of this economic infrastructure will promote increased economic development which will provide an improved standard of living for all Alaskans.

But Dr. Malcolm Gillis, a professor at Harvard University and author of the paper, The Effects of In-State Investment: Lessons from Oil-Fired Development in Other Parts of the World, warns that crash programs to expand infrastructure often involve substantial waste by creating facilities that are grossly underutilized. He cites Indonesia's Krakatau steel project as an example of the dangers involved in stimulating industrial development based on criteria other than "good economics". The \$3 billion project was intended to free Indonesia from having to import steel. "This freedom", Dr. Gillis states, "will cost that society nearly \$80 million annually for another decade (in addition to the \$1.5 billion already invested)".

Some capital projects, such as Krakatau, can generate an emotional or political appeal that results in their being funded regardless of their economic justification. Dr. Gillis points out the political attractiveness of funding capital projects by quoting the campaign speech of a presidential candidate campaigning in Dos Gatos, Ecuador. After promising to build Ecuador's biggest bridge in Dos Gatos, he was reminded by someone in the crowd that the city had no river. The candidate solved the problem by promptly responding with an additional promise to build Ecuador's biggest river in Dos Gatos.

While this may seem like an extreme example, it does provide a certain insight into the degree to which political commitments to needless or unfeasible capital projects can generate spending far beyond the mere cost of construction. That danger exists in Alaska too. Capital spending may require commitments of the state's wealth far in excess of the initial construction costs. Life cycle costing reveals that maintenance costs for many projects often soon exceed the project's original cost. And construction of one capital project may lead to the construction of other capital projects needed as support facilities.

Capital projects already authorized may represent a hidden commitment of Alaska's wealth of tremendous magnitude. Last legislative session a record \$1.38 billion was appropriated for capital projects. That was in addition to the \$707.4 million

combined total of 1980's FY81 budget and HB 60. And on top of that is the \$289.7 million in general obligation bonds for capital projects approved by the voters in 1980. Capital appropriations of this size may be approaching the limit of state government's ability to administer and the private sector's ability to construct in a cost-efficient manner. Already there are indications of an inflationary trend in construction costs which will exceed the estimates used in determining costs for all those projects included in the above appropriations. The result will be substantial cost overruns.

No certain plans can be made for the distribution of the state's wealth until the Legislature has an understanding of the extent to which our wealth has already been committed. The Legislature should undertake a systematic appraisal of all capital projects authorized during the last three years. This review should not be a simple status report but should include projections of anticipated cost overruns and expected annual operating costs for each project.

PROPERTY TAX REDUCTION

Proposals have been made by several legislators to use state revenues to reduce or eliminate property taxes levied by local municipalities. These proposals reflect the recent national trend towards reducing the tax burden imposed by local governments. This "taxpayers' revolt" has resulted in initiative drives in several states to reduce the level of property taxes. Proposition 13 in California and Proposition 2 $\frac{1}{2}$ in Massachusetts are probably the most well-known.

The argument in support of these proposals is relatively straightforward-- Alaskans should not pay property taxes while there are revenue surpluses coming into the state treasury. Critics base their opposition on the inequities of the resulting distribution of the state's wealth. The reason for their concern is demonstrated by the distribution among Californians of the tax savings resulting from Proposition 13. Several generalizations can be made. First, the rich benefitted more than the middle class in terms of the total taxes saved per household. Secondly, renters received little or no benefit because property tax reductions were generally pocketed by landlords rather than being passed on in the form of lower rents. Finally, residents of rural areas benefitted much less than urban residents because of the lower level of services provided and the corresponding lower level of property taxes.⁷ Unless some of these problems are

⁷ Property Tax Relief. Steven Gold, D.C. Heath and Co., Lexington, Massachusetts, 1979.

addressed, serious inequities may result in distribution of wealth through property tax relief.

Sales Tax Legislation aimed at relieving the local tax burden must also take into consideration the fact that in many cases the local burden consists of a sales tax instead of, or in addition to, a property tax. Seven of eleven boroughs levy a sales tax. Over one-third of the Fairbanks North Star Borough's revenues and more than 50% of the Ketchikan Borough's revenues are derived from the sales tax. In addition there are dozens of smaller municipalities which use only the sales tax to raise revenues.⁸ Providing only property tax relief will penalize those communities which levy a sales tax in place of the property tax. An equitable distribution of tax relief can only be achieved if the legislation includes comparable benefits for those who have chosen to finance local services by means of a sales tax.

Renters Renters pay a substantial portion of the property taxes collected in many communities. Property taxes are a cost of doing business for the owner of rental property and, like any other cost of doing business, is included in the amount of rent to be charged the tenant. But most tax relief formulas proposed so far have overlooked this fact. As indicated above, renters received little of the benefits associated with the tax savings resulting from Proposition 13.

⁸Alaska Taxable 1990, January 1991, State of Alaska, Department of Community and Regional Affairs, Division of Local Government Assistance.

The most effective way of assuring equity for renters in any tax relief scheme would be to enact it in the form of a tax refund program. Property owners would be eligible to apply for a refund of a portion of the taxes paid on the unit which they occupy. Renters would be entitled to a refund for a similar portion of that part of the rent which represents the tax on the unit which they occupy. The program could be easily adapted from the tax breaks now provided for senior citizens under AS _____.

The least effective way of providing tax relief for renters would be to give the money directly to municipalities which in turn would provide a general property tax reduction. First, a general millage rate reduction would spread available revenues over all forms of property, including commercial property and vacant land, rather than targeting residential property. Secondly, under such a system, particularly in times of low rental vacancy rates, it is unlikely that much tax relief would be passed on to renters in the form of lower rents.

Restrictions on Municipalities In 1970 the Legislature passed the state revenue sharing program, AS _____, and began the flow of state oil revenues to local governments. Sponsors of the program declared that these funds would be used by municipalities to reduce taxes so that Alaskans could benefit in a direct fashion from the state's oil wealth. In many cases, however, the

result was not lower taxes, but increased government programs which quickly ate up the new source of revenue.

Because of the inequitable effect on renters, channeling property tax relief directly to municipalities should be avoided. But if that system is chosen, then provisions should be included in the legislation to insure that funds sent to local governments are actually used for tax relief. Finance Committee Substitute for House Bill 4 takes one approach to the problem by limiting municipalities receiving state aid to increases in taxes of no more than 2% plus the increase in the consumer price index for the previous year. Another approach is that advocated in House Bill 22. Under HB 22 municipalities would receive an annual entitlement from the State in place of levying a property tax and that entitlement would be reduced by the amount of increases in any other municipal taxes.

Supplemental Benefit System

Another option for distributing income from the Permanent Fund is to establish for all Alaskans a program of benefits similar to the Supplemental Benefits System (SBS) for state employees. SBS replaced Social Security when state employees opted out of the system in 1980. It is a very sophisticated system offering employees a combination of insurance benefits and a retirement annuity. The system is unique and is well administered given its complexity.

Under SBS, 12.26% of an employees wages goes into the system, up to the social security maximum wage base, which is \$29,700 for 1981. Hence, up to \$3,641.22 could be contributed. One-half of the contribution (6.13%) is wage reduction, the rest is contributed by the state. The concept may be applicable to Permanent Fund dividend distribution whether it be done on a longevity, equal amount per capita, or some other basis.

Annuity. The annuity is a retirement account. All or part of the 12.26% of a state employees contribution to the SBS can go into the annuity account, but at least 6.13% must go in to retain the special tax treatment afforded the system. Special tax treatment by the IRS is perhaps the most attractive feature of the SBS. Contributions are not taxed, nor is the interest earned. The annuitant is able to defer taxes until he begins to draw on the annuity, after age 55. The annuity can be withdrawn in a lump sum or installments. Presumably, the tax rate for retirees will be lower than for those earning a regular salary.

The idea of structuring a retirement annuity funded by a Permanent Fund dividend may be attractive for some Alaskans, particularly those in higher tax brackets. However, structuring a program to shelter dividends and their earnings from the Federal Income Tax will not be easy to do. The current Permanent Fund Dividend program contains provisions for the deferral of dividends; but even if the program had not been tied up in a court challenge, its unlikely they would have been approved by the IRS. Amendments to the IRS code liberalizing the doctrine of "constructive receipt," however, were contained in the Economic Recovery Tax Act of 1981. It may be worth exploring this concept further.

Benefits. The other parts of SBS are benefits. These benefits include survivor, disability, death, and health insurance. Because of the fact that one-half of the contribution comes from the State, only one-half (6.13%) of an employee's contribution can be chosen by a beneficiary and still remain tax free.

The idea of providing benefits, particularly health insurance, is discussed as "Option 2" in the Governor's Policy Analysis Paper No. 81-24, combined with an option of taking cash. A recent report by Battelle Research showed that 11% of Alaskans have no health care coverage at all. The idea of giving a person the choice of taking cash or health insurance may be an acceptable approach. There are potential problems with allowing a choice between the two, though they may not be insurmountable. The Governor's "Option 2" made health insurance mandatory if a person was not already covered. This may encourage employers to stop carrying health insurance for their employees. Secondly, if a person has the option of taking cash but doesn't, there may be "constructive receipt" which might make health care benefits taxable. This area should be reviewed in more detail as part of an examination of the tax implications of various distribution plans.

Municipal Assistance

Another suggest approach to state wealth distribution is to distribute Permanent Fund earnings to communities. This program was recently endorsed by the Hammond Administration as an option to consider. The plan would be similar to FCCSSB 236, "an Act relating to assistance to municipalities." FCCSSB 236 passed during the first session of the Twelfth Legislature.

The provisions of FCCSSB 236 allow for payment of an "entitlement" to each "municipality" or "unincorporated community." The entitlement would be \$1,000 times the number of people residing within the boundaries of the community, subject to the limits of the appropriation. The sum received as an entitlement could be used only for social services, capital projects, or operating expenses of capital projects.

Under Governor Hammond's new proposal, communities would have more flexibility in the use of the funds. The Division of Policy Development and

Planning suggests the following uses; (1) capital projects, (2) tax reduction, (3) establishment of a mini permanent fund (note: Valdez has one), (4) power production assistance, (5) operational expenditures, (6) direct cash distribution, and (7) and others.

The response to this program from municipal officials was understandably quite positive.

Public Endowments

One concept which has been discussed by state officials is the creation of public endowments. An endowment would be similar to the Permanent Fund in that it would involve the dedication of a percentage of revenues to a fund separate from the General Fund. The earnings would be used to fund education, public works, or other specified state programs. The creation of an educational endowment was proposed last session and is currently under review by an interim study group which will report its findings to the Legislature during the 1982 session.

To actually dedicate part of the state's revenues to a fund for a specific public use so that it could be used for no other purpose would require a constitutional amendment. It is possible, however, to create a statutory endowment. The Legislature could establish a separate fund and each year appropriate to it the "dedicated" percentage of revenues.

Creation of such endowments, however, would be no different than creating another of the special funds which have proliferated in recent years. One example which has been previously discussed is the municipal assistance fund under AS 43.20.016, Subsection (a) states that:

"The Legislature may appropriate to the fund during each fiscal year an amount equal to or greater than 10% of the income tax received under AS 43.20.011(e) and AS 43.21. (emphasis added)

Creation of a statutory fund, however, does not guarantee that it will actually function as conceived. The Legislature can appropriate 100%, 50% or

.0% of the formula amount. The Legislature can even appropriate money out of the fund for non-dedicated purposes. Or, ultimately, it can abolish the fund. Thus, AS 43.20.016(a) carries no real legal weight and is little more than a target figure.

Special funds, however, do create political constituencies which work to see that the Legislature appropriates the full level of funding. In the case of the municipal assistance fund, public officials from every community in the state will argue that their municipalities are entitled to this money. And perhaps they are. But the reality of the situation is that the constituencies of these special funds are just one more "special interest group" competing for available revenues.

If the Legislature feels that there is a particular public purpose which is of such priority that it wishes to create a public endowment, it should do so constitutionally with the consent of the voters.

Conclusion

This discussion of wealth distribution alternatives analyzes only some of the principal proposals which have been made to date. The wide range of alternatives demonstrates the fact that there is no consensus on the direction to take if the legal challenge to the Permanent Fund Dividend Program is sustained or if the Legislature wishes to provide some form of additional or alternative wealth distribution.

State policymakers must begin to narrow their options so that detailed considerations can be given to likely proposals. That way the legal, technical, and political problems can be addressed in an orderly manner.

If cash distribution is to be a priority, through either continuation of the Permanent Fund Dividend Program or establishment of some other mechanism, there are two fiscal matters that must be dealt with. First, a relatively low annual cash distribution of, for example, \$1,000 may actually hurt low income Alaskans by making them ineligible for state/federal public assistance

programs. Secondly, of Permanent Fund earnings distributed as dividends, at least 35% will be taxed away by the federal government unless the State can devise a tax shelter acceptable to the Internal Revenue Service. Consequently, cash distribution can have the perverse fiscal impact of making indigent Alaskans worse off and taxing away benefits from those in high marginal tax brackets. If the Legislature wishes to consider these problems, it should undertake these specific tasks:

Task 1. Review all state and federal public assistance programs to determine if and how Permanent Fund Dividends can be exempted from "income" and "resource" guidelines for each and;

Task 2. Retain tax counsel, possibly through the Department of Revenue or the Attorney General, to advise on the preliminary design of a tax shelter mechanism, probably a trust or annuity, acceptable to the IRS.

This work should begin as soon as possible. If the Permanent Fund Dividend Program is invalidated, the Legislature will be under great pressure to provide an alternative. Even if it is sustained, these problems will still have to be dealt with to assure that Alaskans achieve the maximum benefit possible from the sharing of the state's natural resources wealth.

BOB WILLIAMS as I

INTRODUCTION

Executive Summary

This is not a summary

The conclusion of this report, which discusses some Permanent Fund Dividend Alternatives and income distribution in general, is that there are too many proposals this late in the game. If the current dividend program is thrown out, the Legislature will probably have to deal with a new program this session.

NEED BETTER LEAD FOR WHAT FOLLOWS IN THIS PAPER

I use, want explain it's kind support.

No - that doesn't emerge from this paper.

The Administration is discussing Cash Distribution, Health Insurance, Guaranteed Minimum Wage, Public Endowments, Cash Grants to Municipalities and a host of others. In the past the Legislature has dealt with the Portfolio of Alaska Citizens's Enterprise, AGSOC, a royalty trust, permanent fund dividends, state health insurance, cash grants to municipalities, a royalty premium payment ..., and a lot of other ideas, some of which passed, some of which didn't, and some of which are still being talked about. There are so many ideas, the problem is narrowing them all down.

don't say these

more official looking... need to be more official looking... more official looking...

clearly indicate that this paper discusses the principles of alternatives - and why

If everyone agrees that cash distribution is the answer, there are two fiscal matters state policymakers may wish to deal with. Number one, a dividend of say \$1,000 may actually cause financial distress to Alaskans on public assistance by making them ineligible. Number two, and on the other side of the coin, a lot of the dividends will be taxed away from well to do Alaskans by the U.S. Department of the Treasury unless a suitable tax shelter can be devised. There may be ways around these problems, and we refer you to the appendix.

more so

If state policymakers choose a different approach, let's find out what it is. That way the legal, technical and political bugs can be worked out beforehand. There is a real danger that more problems, like the one's facing the existing Permanent Fund dividend program, will undermine the public support and respect for the Permanent Fund itself.

too much... need more professional

This whole page/introduction must relate to this whole paper

BE CAREFUL NOT TO BE BREEZY - IT SOUNDS NON-FACTUAL, TOO LOOSE

Annual Per Capita Cash Distribution

The simplest change to the current Permanent Fund Dividend program would be an annual per capita cash distribution plan, as discussed in the Governor's Report --- "Policy Analysis Paper No. 81-24."¹ Money in the Permanent Fund dividend account, a special account within the General Fund would be divided up equally and distributed to eligible "state residents". Under current law, 50% of the earnings from the Permanent Fund principle go directly to the account. If the Legislature decided to increase annual dividends, additional monies could be appropriated from the general fund.

Appropriations to supplement dividend payments would no doubt be required at first, because Permanent Fund earnings are not yet sufficient to pay any sizable dividends. Any appropriation must be payed back according to AS 43.23.050, because the program would not be intended to distribute General Fund or Permanent Fund principle. At present the Permanent Fund dividend account contains only \$27 million.²

An annual per capita cash distribution plan would be the easiest way to repair the current Permanent Fund dividend program if it is struck down by the U.S. Supreme Court.

¹ Policy Analysis Paper No. 81-24 "Option 1", Discussion Paper Permanent Fund Dividend Alternatives, October 12, 1981, State of Alaska, Office of the Governor, Division of Policy Development and Planning.

² Contributions to the Pemanent Fund dividend account are made on a "cash basis" and averaged in with prior year's contributions. This keeps down contributions to the account during the first few years, thereby, protecting the Permanent Fund principle.

Each Alaska resident would receive an equal share. The major legislative change would be amending the durational residency provision. Hopefully, the Supreme Court decision will provide guidelines on a constitutionally acceptable definition for residency

Under this program, Permanent fund earnings could be distributed to State residents, thereby, establishing a link between the size of the Permanent Fund and individual personal incomes. An annual per capita cash distribution might not encourage long-term state residency as the current plan attempts. In fact, it may encourage short-term residency if the residency provision is, say, only 30 days. This plan also has two other policy implications; first, the dividend would be subject to the full brunt of Federal Income taxation; and second, distributing cash may effect the eligibility of individuals receiving public assistance.

Federal Income Tax. A permanent fund cash dividend would be considered taxable income by the Internal Revenue Service (IRS). Currently the average marginal tax rate in Alaska is 35%. This means at least 35% of the Permanent Fund earnings paid out in dividends will end up in the Federal treasury. In fact, a cash distribution may actually bump up the average marginal tax rate, by moving some individuals into a higher tax bracket. Many people won't care, and will still prefer cash. However, Alaskans with a marginal tax rate above 50% might want to defer this extra income.

The current dividend plan attempted to get around this problem by allowing residents to defer receipt of the dividend. Unfortunately, the IRS issued a ruling that the permanent fund dividend was subject to "constructive receipt". Constructive receipt means you have to pay taxes on the dividend even if

you don't elect to receive it. The IRS has allowed State employees the option to defer a portion of their wages, thereby, sheltering the amount deferred from Federal Income Tax. However, regarding the Permanent Fund dividend the IRS reasoned ⁽²⁾: *colom here & elsewhere*

"Dividend payments are available to all applicants who meet the age and residency requirement, and who file timely applications. Since Act dividends are not paid as compensation for services, the rationale and conclusions stated in Rules 60-31 and 69-50 do not apply..."

And further,

"We conclude that an individual reporting on the cash receipts and disbursement method of accounting who elects to defer the dividend be selction of either the postponed paymen' method or the twelve monthly installment method will be required to include the amount of such dividend in gross income for the taxable year in which the dividend would have been received..."³

This ruling is not the final word, and does not necessarily mean that is is impossible to shelter the Permanent Fund dividend. The IRS letter also states ⁽ⁱ⁾:

"However, income is not constructively received if the taxpayers control of its receipt is subject to substantial limitations"

³ Letter dated February 27, 1981 from the U.S. Department of Treasury, Internal Revenue Service to the State of Alaska, Department of Revenue. The ruling is directed only to the requestor, and may not be used or cited as precedent.

The term "substantial limitation" is not defined, at least in the letter, and its meaning would no doubt be decided upon by the IRS on a case by case basis. To take advantage of this "loophole" the state could require that all the dividends be placed into a retirement account. In this way a person would not be able to receive it until some time in the future. This might work. If a person has the right to take the cash upon issuance of the dividend it becomes more difficult to get around constructive receipt, however, it may be possible. At any rate, it will take a lot of work to figure out a suitable tax shelter.

Public Assistance Another adverse effect of distributing a cash dividend is the effect of increasing the resources or income of residents eligible for Public Assistance. The current Permanent Fund dividend plan exempts dividends up to a maximum of \$1,500 from inclusion as income for certain State public assistance programs.⁴ However, for many of the programs subject to Federal rules and guidelines, cash dividends can either cause hardship or simply replace Federal dollars available for assistance with State monies.

For example, a permanent fund dividend could make a recipient under the state/federal program - Aid to Families With Dependent Children (AFDC)- ineligible for benefits. Currently, if a parent or guardian's "gross income" exceeds \$762/mo., or their "net income" exceeds \$508/mo., the family is not eligible. If the family received a permanent fund dividend of \$1,200 as a lump sum, the payment would count as "excess" income. According to regulations, the money would

⁴ See: AS 43.23.080.

have to averaged over a certain period by dividing the dividend received by the limit for "net income". With a \$1,200 dividend, the family would become ineligible for assistance for 2.36 months ($\$1,200/\508). Maybe this doesn't seem to bad, except the child would also be made ineligible for Medicaid as well.

If the dividend were paid in monthly installments, it might make the family ineligible all together. And even if it didn't, the montly dividend would be subtracted from the benefits due. This would have the effect of backing out Federal aid dollars with Permanent Fund dividends. It seems ironic that the Permanent Fund dividend could actually hurt the poor rather than help. This problem may have a solution, but it will require a careful study of all the state/federal public assitance programs and their regulation to devise appropriate exemptions.

Royalty Oil Premium Payments

proposed A program similar to the annual cash distribution system was ~~tried~~ during the Twelfth Legislature. Govenor Hammond introduced HB 67, *and* act relating to royalty oil premium payments, *which* ~~HB 67~~ would have distributed the "premium", or the amount of the State received above the "in value" price from a royalty oil auction held in December 1980, equally to each state resident. The royalty auction netted the state an extra \$77 million, about \$193 for each Alaska resident.

In Govenor's Hammond's transmittal letter he stated the purposes of HB 67 were twofold: *to* ~~the~~ *colony*

"By distributing the premium obtained over current in-value prices directly to residents of the state, residents will gain and increased awareness that the state's natural resources belong to them..."

and further;

"A second purpose of the distribution is to fulfill to some degree the expectations raised by enactment of the permanent fund dividend program, implementation of which continues to be delayed by litigation..."⁴

While these goals sound reasonable, it is clear from the Legislative Purpose and Findings Section of HB 67, the royalty premium payment was definitely not Governor Hammond's first choice. Those findings state in part;

"Unlike the permanent fund dividend program, however, this per capita distribution does not provide an incentive for long-term residency in the state; it does not help assure that the state will benefit in the future from a stable population; it does not encourage a long-term interest in prudent management of the Alaska Permanent Fund and the state's natural resources; and it does not recognize the many contributions, both tangible and intangible, that individuals have made to the Alaska community during their previous periods of residence in the state. Thus, the method of distribution provided in this Act is not the method preferred by the legislature."⁵

It seems unlikely the Governor or the Legislature will revive HB 67. However, the royalty oil auction coupled with distribution of the proceeds raises some interesting points. First, the royalty oil auction was the first time Prudhoe Bay oil was sold in a competitive auction, and it netted the state a sizable premium, a premium above what the state normally receives for its oil. Second, the Administration was at

⁵ See: House Journal, February 4, 1981, pp. 146-147.