

ALASKA LEGISLATURE COMMITTEE FILES 1991-1992 8672
6992 HOUSE JUDICIARY

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terms, obtained after entry of the superior court judgment which is the subject of this appeal.

I. FACTS AND PROCEEDINGS BELOW

In 1985, the Anchorage School District sued W.R. Grace & Co. for damages equal to the cost of removing and replacing fireproofing installed in an Anchorage high school. Although the action was filed in superior court, Grace removed the case to the United States District Court for the District of Alaska, based on diversity of citizenship.

In December 1988, a reporter for the Anchorage Daily News learned that the parties had agreed to settle. School district officials, however, refused to provide the reporter with copies of the settlement documents, because the settlement agreement contained a confidentiality provision. The Daily News sued the school district in superior court, seeking declaratory and injunctive relief granting access to the settlement documents.¹ On December 13, 1988, the superior court ordered the district to disclose the terms of the settlement agreement. Following entry of final judgment, the school district filed this appeal. The superior court stayed enforcement of its production order pending the announcement of our decision.

While the appeal was pending, Grace filed a motion in the United States District Court for an order sealing the settlement documents. Grace did not disclose to the federal court the existence of the state

1. Grace accepted the school district's tender of defense of the public records act claim.
2. The school district did not oppose Grace's motion.
3. AS 09.25.110 provides:

Unless specifically provided otherwise the books, records, papers, files, accounts, writings, and transactions of all agencies and departments are public records and are open to inspection by the public under reasonable rules during regular office hours. The public officer having the custody of public records shall give on request and payment of costs a certified copy of the public record.

AS 09.25.120 provides in part:

court judgment, or the fact that there was an appeal pending in this court. On January 20, 1989, United States District Court Judge H. Russel Holland ordered that the terms of the settlement not be disclosed.²

This court and the Daily News first learned of the federal protective order when the school district appended a copy of the order to its reply brief. We permitted the Daily News and the school district, thereafter, to submit supplemental briefs on the effect of the federal court's order.

On February 16, 1989, following oral argument, we issued an order affirming the decision of the superior court. We instructed the court, however, not to enforce its judgment unless and until the United States District Court vacates or modifies its protective order.

II. THE PUBLIC RECORDS DISCLOSURE STATUTES

The school district argues that it should not be required to produce the settlement documents because the confidentiality agreement was material to the settlement. According to the district, public interest in promoting settlements, coupled with the need for efficiency in conducting government business, outweighs the public interest in disclosure.

[1-4] Alaska's public records disclosure statutes³ apply to records maintained by municipalities. *City of Kenai v. Kenai Peninsula Newspapers*, 652 P.2d 1316, 1318-23 (Alaska 1982). In general, they provide broad public access to municipal

Every person has a right to inspect a public writing or record in the state, including public writings and records in recorders' offices except (1) records of vital statistics and adoption proceedings which shall be treated in the manner required by AS 18.50; (2) records pertaining to juveniles; (3) medical and related public health records; (4) records required to be kept confidential by a federal law or regulation or by state law. Every public officer having the custody of records not included in the exceptions shall permit the inspection, and give on demand and on payment of the legal fees therefor a certified copy of the writing or record, and the copy shall in all cases be evidence of the original.

"books, records, papers, writings, and transactions. The question whether to disclose a particular record by balancing the fundamental public interest in disclosure against the public interest in confidentiality. 642 P.2d at 1323. The fundamental nature of the public's right to know, the municipal government's interest in protecting that record from disclosure. *Id.* Except for disclosure requirements. *Doe*, 721 P.2d 104. Cases are resolved by balancing public interest. *City of Kenai*

[5,6] We recognize the public policy served by encouraging settlements. *Airlines v. Sweat*, 559 P.2d 104 (Alaska 1977); *Interior v. Alaska*, 559 P.2d 104. We recognize also that the public is willing to settle unless the settlement remain confidential. The public's interest in confidentiality's inability to negotiate a settlement, therefore, may, therefore, advise the specific statute which the Daily News determination favor records over the granting settlement. *City of Kenai*, 642 P.2d 1316. *City of Kenai* have stated in the past that it is more important to this type of information remain confidential. A public agency may

4. The court may allow a third party in previous *City of Kenai*, 642 P.2d 1316. Reputation interest in settlement applications. Order entitled *with Doe v. Alaska*, 624 (Alaska 1986) doctrine to exclude settlements).
5. The school district meetings act, AS 4-10-010. Confidential settlement. Permits a public session matters.

"books, records, papers, files, accounts, writings, and transactions." AS 09.25.110. The question whether a municipality must disclose a particular document is resolved by balancing the fundamental public interest in disclosure against the municipal interest in confidentiality.⁴ *City of Kenai*, 642 P.2d at 1323. In recognition of the fundamental nature of the public right to know, the municipality has the burden of proving that the record should not be disclosed. *Id.* Exceptions to the statutory disclosure requirements are narrowly construed. *Doe*, 721 P.2d at 622. Doubtful cases are resolved by permitting public inspection. *City of Kenai*, 642 P.2d at 1323.

[5, 6] We recognize the important public policy served by those measures which encourage settlement. See, e.g., *Alaska Airlines v. Sweat*, 568 P.2d 916, 930 (Alaska 1977); *Interior Credit Bureau v. Bussing*, 559 P.2d 104, 106 (Alaska 1977). We recognize also that some litigants are unwilling to settle unless the terms of settlement remain confidential, and that a municipality's inability to assure confidentiality may, therefore, adversely affect its ability to negotiate a settlement. Nevertheless, the specific statutory provisions upon which the Daily News relies reflect a policy determination favoring disclosure of public records over the general policy of encouraging settlement. *The people of this state, through their elected representatives, have stated in the clearest of terms that it is more important that they have access to this type of information than that it remain confidential.* Thus, we hold that a public agency may not circumvent the

4. The court may also consider the interest of a third party in preventing disclosure. Compare *City of Kenai*, 642 P.2d at 1323-24 (privacy and reputation interests of persons whose employment applications were subject to the disclosure order entitled them to withdraw applications) with *Doe v. Alaska Superior Court*, 721 P.2d 617, 624 (Alaska 1986) (limiting executive privilege doctrine to exclude unsolicited public comments).
5. The school district also argues that the public meetings act, AS 44.62.310-44.62.312, authorizes confidential settlement agreements because it permits a public body to discuss in executive session matters "which would clearly have an

statutory disclosure requirements by agreeing to keep the terms of a settlement agreement confidential. Under Alaska law, a confidentiality provision such as the one in the case at bar is unenforceable because it violates the public records disclosure statutes.⁵

III. THE FEDERAL PROTECTIVE ORDER

The school district argues that the federal court's protective order deprives us of jurisdiction over the Daily News' public records act claim. The Daily News contends that we may affirm the decision of the superior court in its entirety, notwithstanding the conflicting federal order. Neither argument is entirely correct.

Federal and state courts often have concurrent jurisdiction and, as a general rule, try not to interfere with each other's proceedings. *Donovan v. Dallas*, 377 U.S. 408, 413, 84 S.Ct. 1579, 1582, 12 L.Ed.2d 409 (1964). Instead,

[e]ach court is free to proceed in its own way and in its own time, without reference to the proceedings in the other court. Whenever a judgment is rendered in one of the courts and pleaded in the other, the effect of that judgment is to be determined by the application of the principles of res judicata by the court in which the action is still pending in the orderly exercise of its jurisdiction, as it would determine any other question of fact or law arising in the progress of the case.

Kline v. Burke Constr. Co., 260 U.S. 226, 230, 43 S.Ct. 79, 81, 67 L.Ed. 226 (1922);

adverse effect upon the finances of the government unit," AS 44.62.310(c)(1). The purpose of the open meetings act is to assure that government units transact business openly. The people have not delegated to their representatives the power to decide what the public may or may not know. AS 44.62.312(a)(2), (4). Assuming that the district may discuss a proposed settlement in closed session, the act specifically prohibits taking any action during executive session. AS 44.62.310(b); see also *City of Kenai*, 642 P.2d at 1326 n. 29. The open meetings requirement is intended to further the same purpose as the public records disclosure statutes, not to decimate it.

the fact that there was in this court. On January 1989, the District Court ordered that the settlement not be disclosed.

The Daily News first sought a federal protective order. The district court appended a copy of its order to the brief. We permitted the school district to file supplemental briefs in support of the federal court's order. In 1989, following oral argument, the court affirmed the order. We have, however, not to enforce the order and until the United States Court vacates or modifies

PUBLIC RECORDS ACT STATUTES

The school district argues that it should be required to produce the settlement agreement and the confidentiality agreement to the settlement. The public interest in the settlement, coupled with the public interest in conducting government affairs, outweighs the public interest

in public records disclosure. The records maintained by the *City of Kenai v. Kenai Superior Court*, 642 P.2d 1316, 1322. In general, they have access to municipal

records. The right to inspect a public record, including public records in recorders' offices, shall be treated in the following manner: (1) AS 18.50; (2) records of public records; (3) medical and related records; (4) records required by a federal law or executive law. Every public official shall permit the inspection of records not included in the list and on payment of a fee a certified copy of the records and the copy shall in all cases be the original.

see also *Atlantic Coast Line R.R. Co. v. Brotherhood of Locomotive Engineers*, 398 U.S. 281, 296, 90 S.Ct. 1739, 1798, 26 L.Ed.2d 234 (1970) ("lower federal courts possess no power whatever to sit in direct review of state court decisions").

In certain instances, however, a state court must refrain from exercising its jurisdiction. In *Anchorage Daily News v. Anchorage Times Publishing Co.*, 631 P.2d 500 (Alaska 1981), we held that the superior court erred when it enjoined an arbitration proceeding scheduled by the United States District Court. Although the superior court had jurisdiction, under state law, to determine whether the parties had an arbitration agreement, it erred when it granted injunctive relief which interfered with the defendant's effort to obtain arbitration in a federal forum. *Id.* at 503-05. We viewed as "dispositive of the jurisdictional issue" the following statement by the United States Supreme Court:

[A state court] is without power under the United States Constitution to interfere with efforts by [a litigant] to obtain arbitration in federal forums on the ground that [the litigant] is not entitled to arbitration or for any other reason whatsoever. [Such litigant] has an absolute right to present its claims to federal forums.

Id. at 504 (quoting *General Atomic Co. v. Felter*, 436 U.S. 493, 497, 98 S.Ct. 1939, 1941, 56 L.Ed.2d 480 (1978)).

[7] In the case at bar, the Daily News sought a declaratory judgment that the settlement documents which ended the liti-

gation in federal court were open to public inspection under state law.⁶ The Daily News was not a party to the federal litigation and the federal court had not addressed the confidentiality issue when the superior court entered its judgment. Thus, we hold that the superior court had personal and subject matter jurisdiction. The court did not abuse its discretion in exercising its jurisdiction to determine that the Daily News had the right under state law to inspect the settlement documents. The court's declaratory judgment was, therefore, valid.⁷

Had Grace or the school district informed Judge Holland of the state court's judgment, he could have decided whether the substantive law of Alaska precluded him from ordering the settlement documents sealed.⁸ Grace and the school district, however, induced Judge Holland to enter his order while still ignorant of the judgment.⁹ We believe, nevertheless, that the principles discussed in *Anchorage Daily News v. Anchorage Times Publishing Co.*, dictate that the superior court not attempt to enforce that part of its judgment requiring production of the settlement documents, unless and until the federal protective order is vacated or modified.

The Daily News has moved to intervene in the federal case, asking Judge Holland to reconsider his decision. Accordingly, the federal court is now aware of the proceeding in state court. No doubt, it will be made aware of our decision as well. We are confident that Judge Holland will evaluate the Daily News' motions in light of all

Chemicals, 671 P.2d 1273, 1275-76 (Alaska 1983); Alaska R.Civ.P. 54(b).

8. Federal jurisdiction in the litigation between Grace and the school district was based on diversity of citizenship. Therefore, Alaska law governed the substantive legal issues even though the case was removed to federal court. *Erie R.R. Co. v. Tompkins*, 304 U.S. 64, 78-80, 58 S.Ct. 817, 822-823, 82 L.Ed. 1188 (1938).

9. See DR 7-106(B)(1) (lawyer shall disclose "[l]egal authority in the controlling jurisdiction known to him to be directly adverse to the position of his client and which is not disclosed by opposing counsel").

6. AS 22.10.020(g) provides:

In case of an actual controversy in the state, the superior court, upon the filing of an appropriate pleading, may declare the rights and legal relations of an interested party seeking the declaration, whether or not further relief is or could be sought. The declaration has the force and effect of a final judgment or decree and is reviewable as such. Further necessary or proper relief based on a declaratory judgment or decree may be granted, after reasonable notice and hearing, against an adverse party whose rights have been determined by the judgment.

7. A Civil Rule 54(b) judgment is final for purposes of res judicata. *Vertec Corp. v. Reichhold*

applicable principles.

The superior court FIRMED, and the court with instructions to the court to enforce its judgment, unless and until the order is vacated or modified.



Nancy R. CARP

David A. NOVAK

Nos. S-26-

Supreme Court

Sept. 2

Rehearing Granted

Minor child's mother from two orders of Third Judicial District. C. Stewart, J. pro tempore shared legal custody with aunt and child's father in father, and second custody transferred with joint legal custody. Supreme Court, Comp. Superior Court had such award, and (2) of discretion.

Second order affirmed.

1. Divorce \S 312.6(c)

Father failed to order modifying custody insufficiently of evidence properly before Supreme Court.

10. After we issued the decision below, Judge Holland asked the Daily News to intervene in the case. We denied the motion on June 20 protecting the state's interest in the United States.

779 P.2d--27

...urt were open to public
...state law.⁶ The Daily
...rty to the federal litiga-
...ral court had not ad-
...ntiality issue when the
...ed its judgment. Thus,
...perior court had person-
...tter jurisdiction. The
...its discretion in exercis-
...to determine that the
...right under state law
...ment documents. The
...judgment was, there-

...school district informed
...he state court's judg-
...decided whether the
...Alaska precluded him
...settlement documents
...l the school district,
...dge Holland to enter
...ignorant of the judg-
...nevertheless, that the
...in *Anchorage Daily
Times Publishing Co.*,
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...the settlement doc-
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...ge Holland will eval-
...notions in light of all

1273, 1275-76 (Alaska
54(b)).

...the litigation between
...istrict was based on di-
...Therefore, Alaska law
...ive legal issues even
...moved to federal court.
...s, 304 U.S. 64, 78-80, 58
...Ed. 1188 (1938).

(lawyer shall disclose
...controlling jurisdiction
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...i which is not disclosed

applicable principles of law.¹⁰

The superior court's judgment is AF-
FIRMED, and the case is REMANDED
with instructions to the superior court not
to enforce its judgment requiring produc-
tion, unless and until the federal protective
order is vacated or modified.



Nancy R. CARTER, Appellant,

v.

David A. NOVOTNY, Appellee.

Nos. S-2645, S-3049.

Supreme Court of Alaska.

Sept. 8, 1989.

Rehearing Granted Oct. 9, 1989.

Minor child's maternal aunt appealed
from two orders of the Superior Court,
Third Judicial District, Anchorage, David
C. Stewart, J. pro tem., which first award-
ed shared legal custody of child to both
aunt and child's father, with physical custo-
dy in father, and second, ordered physical
custody transferred from father to aunt
with joint legal custody retained. The Su-
preme Court, Compton, J., held that: (1)
Superior Court had jurisdiction to make
such award, and (2) award was not abuse
of discretion.

Second order affirmed.

1. Divorce ⇐312.6(1)

Father failed to file cross appeal from
order modifying custody and, thus, father's
inafficiency of evidence claim was not
properly before Supreme Court.

10. After we issued the order affirming the deci-
sion below, Judge Holland permitted the Daily
News to intervene in the federal case and vacat-
ed the June 20 protective order. Grace appeal-
ed to the United States Court of Appeal, Ninth

779 P.2d-27

2. Parent and Child ⇐2(12)

Parent is entitled to custodial prefer-
ence over nonparent, unless there is clear
evidence that parent is either unfit or wel-
fare of child requires that child be placed in
custody of nonparent.

3. Parent and Child ⇐2(18)

Burden of proving that parent's custo-
dy of child would be clearly detrimental to
child is on nonparent seeking to modify
custody.

4. Parent and Child ⇐2(17)

Superior court had jurisdiction to
award shared custody of minor to both
parent and nonparent. AS 25.20.060.

5. Parent and Child ⇐2(17)

Superior court did not abuse its discre-
tion in awarding parent and nonparent
shared custody of minor child with physical
custody in nonparent, even though court
had determined that it would be detrimen-
tal to child to continue physical placement
with father, insofar as such award was in
best interest of child. AS 25.20.060, 25.24-
150.

Charles Hagans, Hagans, Brown, Gibbs
and Moran, Anchorage, for appellant.

William T. Ford, Anchorage, for appellee.

Ame Ivanov, Anchorage, Guardian Ad
Litem.

Before MATTHEWS, C.J., and
RABINOWITZ, BURKE, COMPTON
and MOORE, JJ.

OPINION

COMPTON, Justice.

The principal issue presentd in this ap-
peal is whether the superior court erred in
awarding shared custody of Heidi Novotny
to David A. Novotny, her father, and Nan-
cy R. Carter, her maternal aunt, after hav-
ing determined that it would be detrimental

Circuit, but dismissed the appeal when the cir-
cuit court refused to grant a stay pending ap-
peal. The settlement documents were released
for public inspection.

HJR

4

FISCAL NOTE

STATE OF ALASKA
1992 LEGISLATIVE SESSION

BILL NO. HJR 4

Revision Date: 01/13/92 Department Affected: Office of the Governor-Elections
 Title: Amendment to the Constitution RE: Capitol Projects/Expenditure BRU: Division of Elections
 Limit: _____ Component: 11-Primary and General Elections
 Sponsor: Representative R. Phillips
 Requestor: House State Affairs

COMPONENT SERIAL NO.

0	0	2	2
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Expenditures/Revenues: (Thousands of Dollars)

OPERATING	FY 93	FY 94	FY 95	FY 96	FY 97	FY 98
PERSONAL SERVICES	0	0	0	0	0	0
TRAVEL	0	0	0	0	0	0
CONTRACTUAL	2.2*	0	0	0	0	0
SUPPLIES	0	0	0	0	0	0
EQUIPMENT	0	0	0	0	0	0
LAND & STRUCTURES	0	0	0	0	0	0
GRANTS, CLAIMS	0	0	0	0	0	0
MISCELLANEOUS	0	0	0	0	0	0
TOTAL OPERATING	2.2*	0	0	0	0	0

CAPITAL	0	0	0	0	0	0
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REVENUE FUND SOURCE:	0	0	0	0	0	0
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FUNDING: (Thousands of Dollars)

GENERAL FUND	2.2*	0	0	0	0	0
FEDERAL FUNDS	0	0	0	0	0	0
OTHER FUND SOURCE:	0	0	0	0	0	0
TOTAL	2.2*	0	0	0	0	0

POSITIONS:

FULL-TIME	0	0	0	0	0	0
PART-TIME	0	0	0	0	0	0
TEMPORARY	0	0	0	0	0	0

Estimate of current year impact: 0

ANALYSIS: (Attach a separate page if necessary.) * This figure covers cost of inclusion of information about this issue in the Official Elections Pamphlet as required by AS 15.58, and programming for DataVote counting of votes cast on this measure. However, only 4 measures can be printed on a single ballot card. Should this measure require printing an additional ballot card, the fiscal impact would be: 53.4.

Prepared by: Elizabeth Ziegler, Deputy Director Phone: 465-4611
 Division: Elections Date: 01/13/92

Approved by Commissioner: *Charles E. Hickel*
 Agency: Office of the Governor Date: 01-13-92

Distribution (by preparer): Leg. Fin., Legislative Sponsor, Requestor, OMB/DBR, Gov. Legis. Ofc., & Impacted Agency(ies).

HOUSE COMMITTEE REPORT

(7)

Date Referred: January 21, 1991

FURTHER REFERRALS:

Judiciary
Finance

Date of Committee Action: 2/24/92

The STATE AFFAIRS Committee considered:

HJR 4

HOUSE JOINT RESOLUTION NO. 4

CAPITAL PROJECTS/EXPENDITURE LIMIT

Proposing amendments to the Constitution of the State of Alaska relating to capital projects and loan appropriations, and to the expenditure limit.

- RECOMMENDATIONS: [] the same title
 be replaced with _____ [] a new title
 have attached amendments(s)
 do pass
 do not pass
 no recommendations
 individual recommendations
 additional referral to the _____ Committee

ADOPTS: _____ letter of Intent

- ATTACHES NEW FISCAL NOTE(S): (Dept) APPROVES PREVIOUS: (Dept/Date)
 fiscal impact Div of Elections _____ fiscal note(s) _____
 zero fiscal note _____ zero fiscal note(s) _____

SIGNING DO PASS:

SIGNING OTHER RECOMMENDATIONS:

	Check appropriate column:	Do Not Pass	No Rec	Amend
<i>[Signature]</i>	<i>Eugene K. Kubina</i>		X	
<i>[Signature]</i>	<i>[Signature]</i>		X	
<i>[Signature]</i>	<i>[Signature]</i>		—	

Eugene K. Kubina
Chairman's Signature



Alaska State Legislature

Session
State Capitol
Juneau, AK 99801
(907) 465-4949

Interim
P.O. Box 142
Eagle River AK 99577
(907) 694-4949

Member

Randy Phillips
State Representative
House District 15

House Finance Committee

Memorandum

TO: Representative Gene Kubina, Chairman

FROM: Representative Randy Phillips ^{REP}

DATE: February 19, 1992

RE: House Joint Resolution 4, Proposing amendments to the Constitution of the State of Alaska relating to capital projects and loan appropriations, and to the expenditure limit.

HJR 4 would set a limit of \$2.3 billion for appropriations of unrestricted general fund moneys from the state treasury for each fiscal year FY 93 to FY 98. HJR 4 would also provide that at least 10% of the amount appropriated in each fiscal year would be appropriated for capital projects and loans.

Alaska's Constitution Article IX, Section 16 currently contains an "appropriation limit" which was approved by the voters in 1982. The current appropriation limit in the Constitution would allow for general fund spending of more than \$4.5 billion in FY93. Given that unrestricted general fund revenues are predicted to be at or near \$2 billion, it is easy to see that the current appropriation limit makes no sense. Alaska also has a "statutory appropriation limit", AS 37.05.540, passed in 1987 which was intended to limit the growth of spending to equal inflation and population growth. This appropriation limit is not effective for two reasons:

1. Since it is in statute and not in the Constitution, the Legislature can not be bound to it, that is, any appropriation bill that exceeds the limit is a new law that supersedes the law setting the limit.

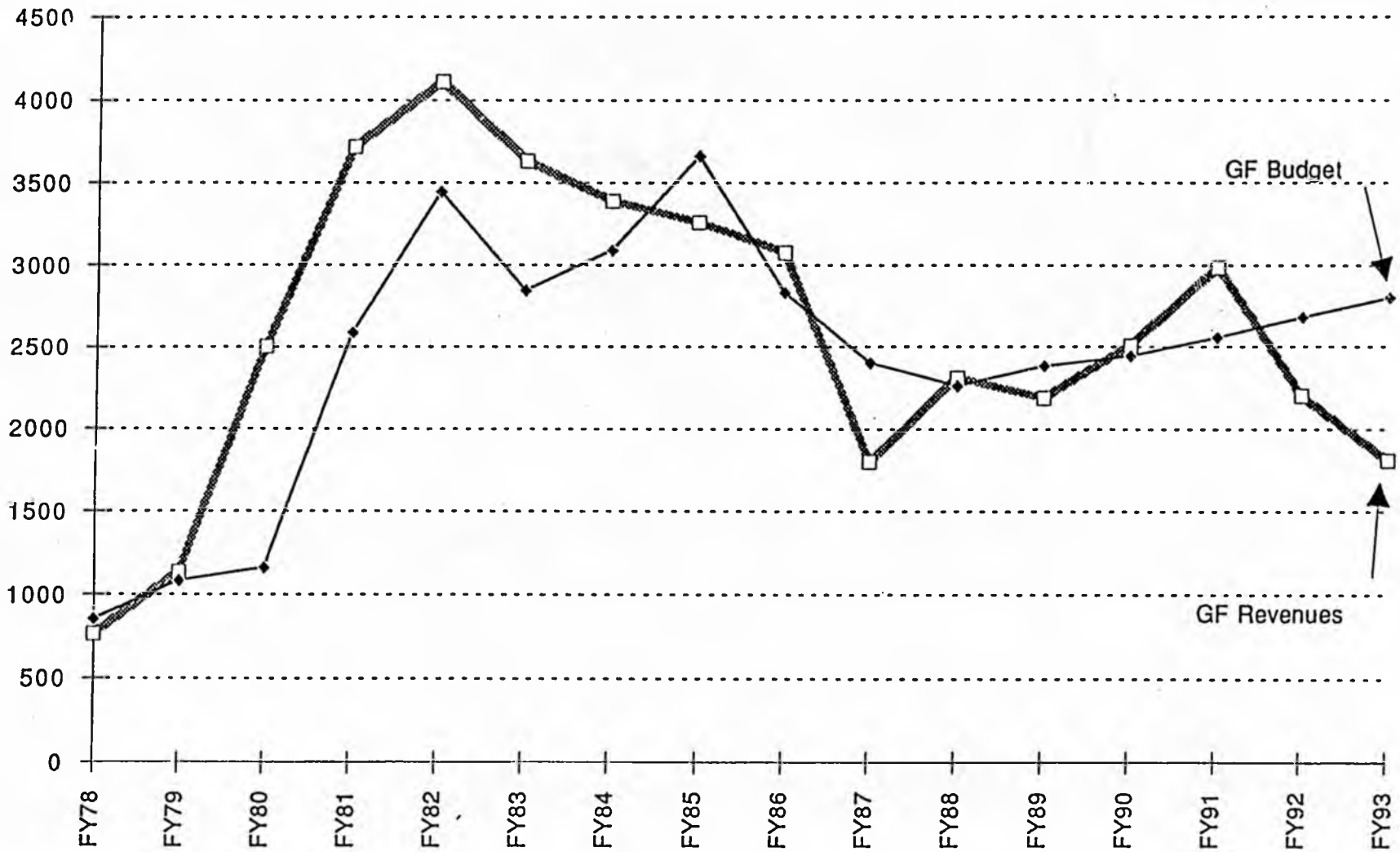
2. The method used to set the appropriation limit in AS 37.05. 540 is confusing and has lead to a situation where the limit has been technically breached even though the Legislature made a conscious effort to keep appropriations within the limit.

Alaska's Constitution does not require a "balanced budget" in the sense that annual expenditures must be balanced to annual revenues. Annual appropriations may exceed annual revenues and have in a number of years, the only real appropriation limit that is faced by the Legislature at this time is the prohibition against long-term borrowing to fund government operations. It would be possible for the Legislature to appropriate all revenues, special accounts, budget reserve funds and the earnings of the permanent fund all in one year.

In a perfect world, there would be no need to establish an appropriation limit in the state Constitution, Legislators would balance the demands of the public against the resources available and plan for the future. In the real world, the pressures brought by the public to fund specific programs makes in nearly impossible to make budget cuts. The need for an appropriation limit has been shown by the fact that the Legislature and the people of the State of Alaska have acted twice to establish appropriation limits. However, neither appropriation limit has been effective. Now is the time to establish an appropriation limit that is in the Constitution, enforceable, and also realistic.

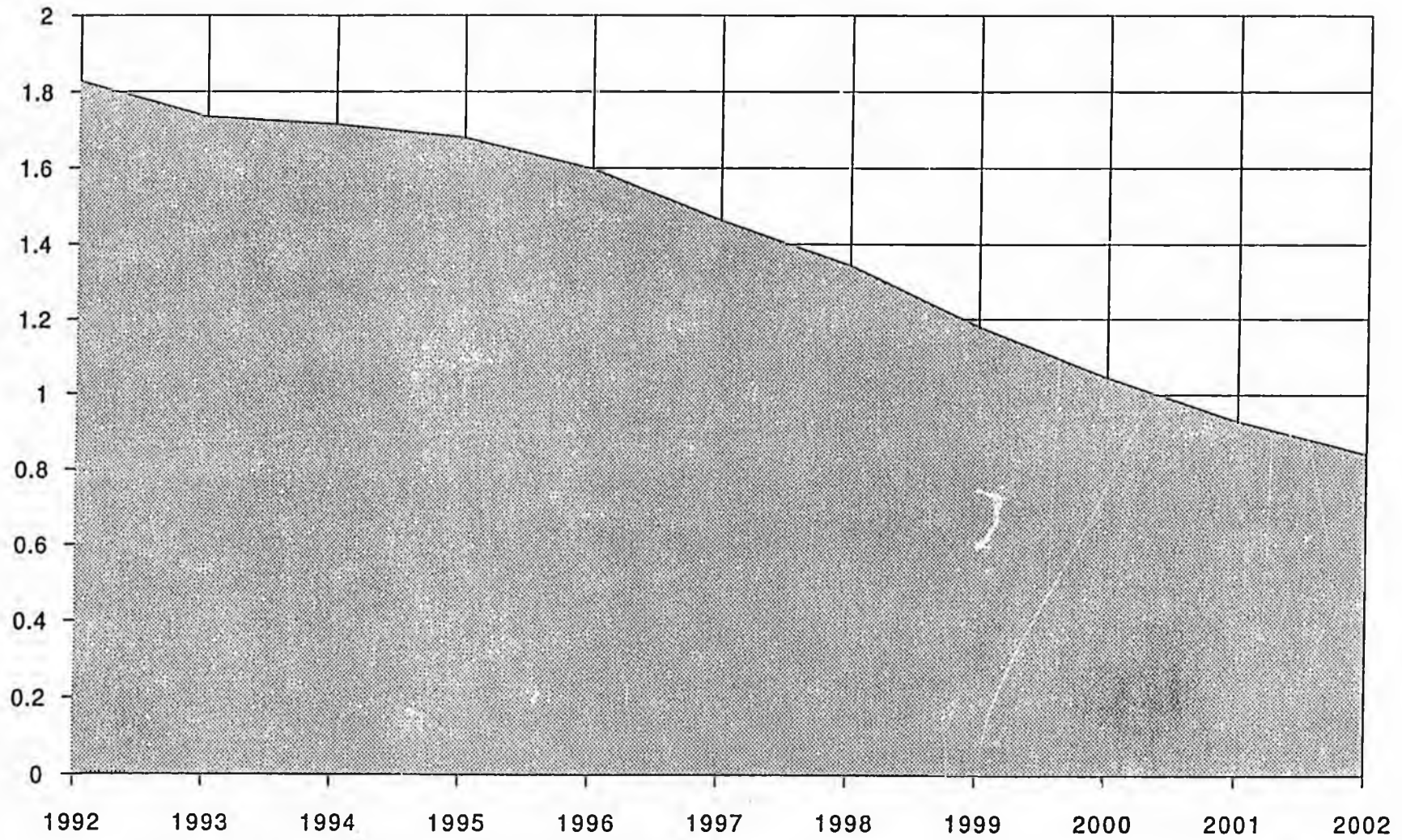
If you have any questions or comments do not hesitate to call me at 4949. Your cooperation is appreciated.

GF Revenues vs GF Budget, FY78-FY92 in millions of dollars



BACKUP

Oil Production in Alaska, FY 1992-FY 2002, millions of barrels per day



Production estimates from the Alaska Department of Revenue, Fall 1991 revenue forecast, midcase projections.

THE FISCAL GAP: FICTION OR REALITY ?

by
SCOTT GOLDSMITH
PROFESSOR OF ECONOMICS
UNIVERSITY OF ALASKA ANCHORAGE

After preparing my remarks for today I realized a better title than Fiscal Gap: Fiction or Reality would have been FISCAL GAP: FACT OR FANTASY ? When we enter the Alaska fiscal world we enter a world of fantasy. Those of us who have lived through the oil boom years know what I mean. Those who have not experienced it will never really comprehend what happened. Events are now forcing us back into the real world, but who wants that? I have tried to pepper my remarks with some glimpses of that reality because, I guess, somebody has to do it. But take heart--reality is not that bad.

To begin we need a definition of the fiscal gap notion. Most simply put it is the question of whether our state government is spending beyond its means. Concern naturally springs from the recognition that 85% of our revenues come from the production of oil, and as anticipated, after a dozen years at record levels, depletion of the main North Slope field has set in. Our tax base is literally being shipped south at the rate of nearly 2 million barrels per day.

I am going to tip my hand right now and confess that for an economist a question like this has at least 4 answers. But before I share them with you lets quickly review the last two years of public consciousness raising on this issue.

We introduced the idea of the fiscal gap to a broad audience in August 1989 with the publication of our first Fiscal Policy Paper. In it we projected a \$400 million gap by 1992 growing to \$1 billion by 2000 under a scenario aptly entitled "Stumble from Year to Year". Five subsequent papers have fleshed out the basic idea. These publications have reached a broad audience, stimulated a great deal of interest and some discussion, but have had only questionable influence on public policy.

I am aware of only 2 challenges to our analysis. Both claim that we have underestimated the petroleum revenues the state will receive during this and the next decade--either through some myopia of vision or some ulterior motive. Let me quickly dispense with these challenges so that we can move ahead to the main topic for today.

The first is that the forecasted decline in petroleum production will not become significant for a long, long time. This is because the official forecasts are based on initial reserve estimates and don't consider the typical subsequent upward revisions. This challenge is buttressed by the fact that the Alaska Department of Revenue has recently boosted their projections of estimated production through the 1990s by about 150 thousand barrels per day. Furthermore when the final numbers are tallied production for 1991 will probably come in a bit higher than 1990.

The upward revision in the forecast, if it pans out, is certainly good news. But the fact is that production peaked in 1988 and has trended down since. By 1990 it was off the peak by 12%. As with most economic processes it is hard to identify the turning point until after the fact, especially for those hoping for continued growth. President Bush was the last to admit the nation was in a recession.

Aggregate oil production is down because we are not replacing the Prudhoe oil with new production from other fields. The average productivity of the five North Slope fields brought on line since Prudhoe is just 7 percent of this super giant. The current forecast says we will be sending only half our current production level out of Valdez in 2000 and only a fourth by late in the next decade.

But we know there is still lots of oil on the slope that technically could be produced and that there are undoubtedly other fields that have not been discovered. That production could ultimately replace today's depleting reserves. Even if that were to happen, the fact is that the replacement production is coming from marginal fields where the tax base per barrel of oil produced is much smaller than today's average. The average well in the Prudhoe field produces over 2,500 barrels per day. The average productivity in the marginal fields is in the range of 200 barrels per day. There seems no escaping the conclusion that the decline in this tax base is real and will continue. The only uncertainty is its rate.

The second challenge has been the notion that an increasing price of oil would offset declining production thus maintaining the value of oil production. This challenge is buttressed by the fact that the average price of oil has, up until now at least, been higher than we assumed in our 1989 analysis.

But high oil price means something different today than it did 10 years ago. If we ignore the 6 months during the Iraqi crisis, the 6 year average price for ANS delivered to the Gulf Coast in today's dollars has been a not very earth shaking \$17.20. And today, in spite of the absence from the market of Kuwait and Iraq, two of the biggest OPEC producers, it is about \$16. The price of oil is in perpetual motion but it lacks direction. In particular it is difficult to see the 7 percent annual growth in the price of oil, after inflation, necessary to offset a 7 percent decline rate in production.

Interestingly, we have not been challenged on our assumption that government spending would continue to increase in our "Stumble from Year to Year" scenario. In fact our assumption that the general fund budget would increase no faster than the rate of inflation from a base of \$2.3 billion in 1989 lacked imagination. This year we are spending \$2.8 billion.

If we combine the higher than anticipated budget levels with the higher than anticipated production and oil price we find state finances in 1992 just about where we had projected. Revenues are in short supply. Why should the precariousness of the state budget concern us. There are 3 reasons.

1--We all benefit from government services and want to make sure our government gives higher priority to needs than luxuries.

2--The economy is addicted to state spending. One in three jobs statewide can be traced to the state budget. When Juneau sneezes the economy gets a cold.

3--Economic development has an aversion to uncertainty. Potential developers trying to guess how Alaska will deal with the loss of petroleum revenues may be scared away by some of the solutions they might imagine.

Let us turn now to answer my question.

IS THERE A FISCAL GAP? ANSWER #1. NO. THERE IS PLENTY OF MONEY IN THE GENERAL FUND.

There is plenty of money in the state general fund to pay for the current year, FY 1992, budget of \$2.8 billion.

Furthermore there is plenty of money in special accounts, in relatively liquid assets, and hidden under assorted rocks to make up any shortfall in the budget for FY 1993, the year after, and perhaps beyond.

The list of these special pots of money includes (in one possible order of political ease of raiding):
the statutory budget reserve

the Railbelt energy fund
the Exxon oilspill settlement money
the constitutional budget reserve
the earnings reserve of the Permanent Fund
the assets of AHFC and other state corporations
settlement proceeds of disputed oil tax and royalty payments

I am 95% convinced that we will spend our way through all of these without taking our foot off the gas. In my mind worse than the fact that this approach amounts to liquidation of assets to pay the operating expenses of government is the wringing of hands and a moaning and groaning that will emanate from Juneau as it happens. We will hear all about the shaky state fiscal condition, the need for constraint, and the tough decisions to be made.

But what message will really be sent to the average citizen who will judge not by what is said, but by what is done? The message will be that there is no problem. The noise is there merely for political or tactical reasons. Perhaps it is to pay lip service to the notion of fiscal responsibility for the sake of organizations such as Common Sense, or perhaps it is to ease the pain for the few unfortunates whose pet projects must be sacrificed.

But what are we really doing here. The current year revenues may be as much as \$2.4 billion, if the price of oil bounces back in the spring as it typically does, but as I have already mentioned we are spending \$2.8 billion. The amazing thing is that we actually planned to spend more than we collected, and furthermore we are planning to do the same thing next fiscal year.

The logical consequence of this strategy is that when all other assets have been liquidated we break into the corpus of the Permanent Fund--not of course by a direct assault, but by the back door, thru a redefinition of investment policy and criteria.

Incredible as it may seem even with \$2.8 billion in spending we are having a hard time scrapping together the cash to pay for the basics--police and fire protection, roads, schools. Anchorage's difficulties in coming up with the money for these valid public services are being played out in communities across the state.

IS THERE A FISCAL GAP? ANSWER #2. YES. WE CAN'T AFFORD TO PAY FOR THE BASICS OF GOVERNMENT.

To find out why we need look no further than 2 popular state transfer programs.

The first is municipal assistance, one of the main sources of money for local governments to pay for basic services. Appropriations for this program have been shrinking at the same time that inflation has been driving up costs and population growth has been increasing needs. In fact the appropriation to this program has declined 40 percent between 1986 and 1991. Anchorage and other communities have responded by tightening their belts.

The second is the Longevity Bonus Program, which pays a cash transfer to all residents over 65. Appropriations for this program have been increasing in response to growth in the over 65 population. Curiously the growth rate for this segment of the population surpassed all others in the last decade. Appropriations increased 25 percent between 1986 and 1991. In 1986 its appropriation was half as large as municipal assistance. Today it is considerably larger.

You might think that the over 65 population has benefited from expansion of this program until I remind you that the payment does not increase with inflation. Even as the total appropriation grows the

value of the payment continuously erodes. If current trends continue in 10 years we will be spending twice as much and each recipient will be receiving a payment worth half of today's. I have a hard time understanding how this scheme best serves the needs of our over 65 population.

And what does the juxtaposition of these two transfer programs demonstrate? That our method of budget making is producing a perverted result. In this example we are squeezing out needs in favor of a poorly targeted program with screwy incentives. We give a subsidy to anyone over the age of 65 for living in the state, regardless of need or worth, while at the same time cutting funding for those local government services that make our communities livable for these very same residents.

Up to this point I have been discussing very recent events, but if we look at what has happened since the mid 1970s then we get the third answer to my question.

IS THERE A FISCAL GAP? ANSWER #3. WE HAVE HAD A FISCAL GAP SINCE THE EARLY 1980s.

Not only are we selling off our assets today, we have been living beyond our means since we started draining the Prudhoe field. All through the 1980s as the oil and dollars flowed we were reinvesting, but only a small portion of the proceeds of our asset sales. By one estimate we were selling off \$1 billion a year in assets. In 1977 our primary asset was our ownership share in Prudhoe Bay. Today our primary assets consist of our ownership share of the much smaller pool of oil still remaining at Prudhoe and the Permanent Fund. The combined value of these two is much less than was the value of our share of oil in the ground alone in 1977.

Over the years we have consumed a lot of money under the pretext of investing, but let's face it, when it comes to business type investments the government has a real knack for taxing the winners to invest in the losers. This has not contributed significantly to the asset base of the state.

But let's not dwell on opportunities foregone. When you compare our performance with that of our friends in OPEC and elsewhere who also enjoyed oil windfalls, our \$12 billion Permanent Fund attests to the fact we have done better than most in maintaining our wealth.

Let's take stock of where we are today and look forward. What I see brings me full circle back to my first answer to the fiscal gap question.

IS THERE A FISCAL GAP. ANSWER #4. NO. WHAT WE HAVE IS A FORTITUDE GAP.

We HAVE the resources to restore balance to our fiscal affairs. The question is whether we want it badly enough to make it happen.

I doubt if there is a state in the union that would not trade their own fiscal problems, compounded by the recession, for our own. Our tax base and public resources are more than sufficient to provide for our needs. So why do we feel so bad?

I think it's because we carry with us the legacy of the fantasy time of the 1980s in Alaska when the normal rules governing public sector behavior did not apply. During the decade of the 1980s the state had \$48 billion at its disposal--and we rose to the challenge of disposing of the \$100 thousand allotted to each of us.

In fact there was so much money in the 1980s that no one even noticed when we blew \$2 billion. Not surprisingly \$48 billion attracted a few folks from Outside. We set them up with houses, schools with teachers, the PF Dividend and all the other accoutrements of the good life in the Great Land. But when the state budget stopped growing we pulled the rug out from under a lot of those folks, and there was a mass

outmigration. The bill for those short timers was \$2 billion. \$2 billion we would have saved if we had not created our own boom-bust cycle with petrodollars.

An example of this sense of fantasy occurred to me as I listened to the President of AMAX earlier this week describe their \$150 million purchase of the Fort Knox gold mine outside Fairbanks. Everyone in the audience understood that this was big-time and real money. Today we are talking nonchalantly about billions, rather than millions, and yet I don't think any of us, with the exception of those of you in the oil business, sense these billions to be real money.

In spite of longing for the good old days, the typical Alaska household continues to receive more in cash from state and local government than it pays in taxes. A measure of how we compare to our neighbors Outside is the \$500 million that the application of national average tax rates applied to our households would generate in a year.

On hearing this some Alaskans argue they are already quite heavily taxed because the taxes and royalties paid by the oil companies are really coming out of their pockets since the oil is owned by the people of the state. Any non-Alaskan would find this reasoning preposterous. Future generations of Alaskans have as much right to that oil as the current generation and will not look kindly on those of us ready selfishly to claim their inheritance for ourselves. The oil wealth is ours, but ours as a group, not as individuals.

The truth is the government is paying us to consume its services. Shouldn't this state of affairs embarrass us at least a little? And this has persisted long enough that we now have a whole new generation of Alaskans brought up to believe that it is their birthright to be getting something for nothing from the state. Ask any kid what the justification is for the state sending him a check for \$1000. I've asked a few and 9 out of 10 say they "deserve it".

Looking at the budget are we really so needy that we can justify the state spending 3 times the national average, after inflation, on each of us. Of our \$2.8 billion budget 4 things are clear:

1. Some spending is unique to Alaska. Some is justified based on small population, low population density, resource stewardship and so on. Some unique programs are luxuries. A simple rule of thumb to identify possible luxuries would be to look at new and transformed programs since in the 60s and early 70s when we were spending a more modest double the national average.

2. We pay more than necessary for a lot of our public goods and services. I believe labor falls in that category. Our average wage bill per employee is 25% above the national average after a generous COLA adjustment. This statement could be true even if no single individual is overpaid, in fact it could be true even if each were underpaid. We might just have too many underpaid high salaried managers and not enough underpaid low salaried workers.

Incidentally, this comparison is based on a COLA that ignores the fact that every Alaska worker, private as well as public, gets a residence subsidy in the form of the Permanent Fund Dividend. This is a partial offset to COLA.

3. Service delivery is not always by the most cost effective means. We have been willing to pay extra in order to further other public objectives in the delivery of public services. These include most obviously local control and equality of service regardless of location.

4. Assistance programs are not targeted to those with a need. We have been loath to distinguish the truly needy. A large part of each dollar spent on assistance programs ends up being simply a transfer payment without justification.

If we were serious about controlling the budget, these would be some of the most promising areas to look for savings. Over time a 10% reduction could be engineered with a minimum impact on the quality of service delivery for genuine needs. Spending would still be close to 3 times the national average.

Some combination of budget reductions and contributions from households to support government services would give us a combination of higher public service levels at lower cost to residents than any other state. It would be a big first step in the direction of bequeathing a sustainable public sector to the next generation of Alaskans. The potential is there and the goal is achievable.

How do we get from here to there? It is not going to happen under the current system for reasons that should now be obvious. We are wishing against human nature.

As long as the government is paying us to consume services it should be no surprise that we will demand the maximum while at the same time piously decrying the fiscal irresponsibility of it all. It is naive to continue to think that if we only had rational decision makers who listened to the voters they would trim the budget and adopt a plan of action just as any family or business would if faced with falling revenues.

It will not happen because our collective state financial resources suffer from the "tragedy of the commons". What rational individual or legislator would willingly step forward and volunteer his favorite programs for the budget ax in the full knowledge that the savings would end up funding some other less deserving, or positively wacko, program?

Under current conditions nothing short of a crash in revenues is going to force us to start the process of balancing our public needs and resources. Rational argument won't. The prospect of appropriating \$400 million more than projected revenues won't. The prospect of liquidating our assets won't.

Short of a crash I see only 2 changes to our system that could instill discipline into our fiscal affairs. The first is to get all the money off the table. This won't happen as long as there is free money in accounts under rocks in Juneau that can be tapped. The second is to employ the incentive device that guides our free market system--prices. If public services had a price attached in the form of a tax, people would sit right up and take notice of how public funds were being spent. I think a price of even 5 cents on the dollar would create a significant "price effect" as taxpayers discovered lots of spending that was not even worth 5 percent of the cost.

I don't relish paying taxes and would not suggest such a course of action in the absence of a guarantee of constraint on the size of the budget. But with adequate assurance that government would deliver restraint I would be willing to buy some. I would accept taxation to purchase some fiscal constraint, knowing that others were also paying their share.

Perhaps a compromise could be packaged in which taxpayers would trade \$1 in support of government for each \$1 reduction in the size of the budget from a base level. Perhaps some other scheme would work.

But I am convinced that if we are unwilling to commit to discipline ourselves, it is wishful thinking to believe that others will willingly sacrifice for the common good. The goal is attainable but if we cannot find the means to act together to move toward it we will not act at all. This finally is the reality of the fiscal gap.



ISER FISCAL POLICY PAPERS

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THE ALASKA FISCAL GAP

by Oliver Scott Goldsmith

Alaska faces a problem that will be very tough to solve but is easy to explain: state government is spending more than it collects. The problem will get much worse as time goes on. If state general fund spending stays at the current level of \$2.25 billion (in 1989 dollars), we face a fiscal gap—the difference between current spending and projected revenues—that could soon grow to \$1 billion annually.

This budget crisis looms because oil production, which supplies 85 percent of the state's general fund revenues, will soon begin dropping as the huge Prudhoe Bay oil field is depleted. Likely new petroleum production, higher oil prices, and other economic activity in the coming decade won't be able to generate nearly enough tax and royalty income to replace the loss of Prudhoe Bay production.

Figure 1 shows projected oil production and state petroleum revenues over the next 20 years, based on the Alaska Department of Revenue's estimates from producing fields and our own estimates of new field production and per barrel revenue. Production is at its peak and will soon begin a long decline. Even assuming production from new fields such as West Sak—the timing of which is uncertain—production in 2000 will be only half of what it is today. Petroleum revenues

have already fallen to just half of what they were in the early 1980s, because oil prices are much lower now. If the real price of oil remains in the range where it has been for the last few years, petroleum revenues will drop by half again by 2000.

This figure does not include potential production and revenues from oil fields that may exist in the Arctic National Wildlife Refuge (ANWR). Such revenues would of course help reduce the budget shortfall in the next century. But under any reasonable assumptions (see the box on page 4) they would fall far short of revenues we've enjoyed from Prudhoe Bay, and could not reverse the downward trend. Also, future production from ANWR is extremely speculative right now. Congress would first have to open the refuge to exploration and oil companies would have to discover commercial quantities of oil; after such discoveries it would take years to bring new fields into production.

THE FISCAL GAP

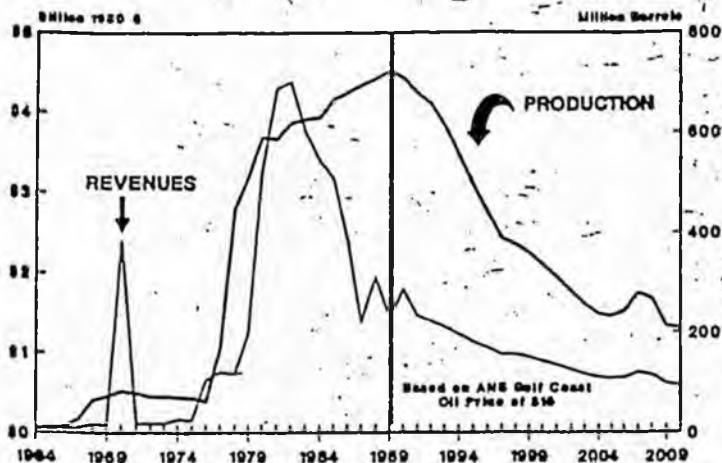
How shrinking production and revenues translate into trouble for Alaska is apparent in Figure 2. It shows the potential size of the future gap

This is the first in a series of *ISER Fiscal Policy Papers* that will examine aspects of state government spending. We intend these papers to focus the attention of state officials and of Alaskans in general on the serious budget crisis we face, and on the necessity for dealing with it soon. We hope this and later papers will provide policymakers with information and analysis they will need when making the difficult decisions ahead.

The author, Oliver Scott Goldsmith, is professor of economics with ISER. He has fourteen years of experience examining state spending. Lee Gorsuch, ISER director, is responsible for the design and presentation of this series. Linda Leask edited the paper.

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FIGURE 1. PROJECTED ALASKA PETROLEUM REVENUES AND PRODUCTION



between general fund revenues and spending. If annual spending were held at its current level of about \$2.25 billion (in 1989 dollars), the gap between spending and revenues could be several hundred million dollars a year in the early 1990s and more than \$1 billion annually after the turn of the century. If future revenues turn out to be larger than we anticipate, the fiscal gap could be reduced for a short time but the overall picture would be the same. (See the box on page 4 for a description of how our results would change under different assumptions about future developments and other factors.)

Such a gap of course can't persist. We'll have to balance the budget by cutting spending, raising taxes, using savings, or some combination of the three. These changes will affect not only those who currently enjoy state services, work for state government, or pay taxes. Everyone who benefits from local government services like schools and street maintenance will also be affected. Budget cuts will also affect recipients of government transfers—including Permanent Fund dividends—and businesses that depend on the purchasing power provided by a large public sector.

Balancing the budget will affect all Alaskans, because the economy and people of Alaska are dangerously dependent on state government spending financed by oil revenues. Even now, after several years of recession and a precipitous drop in revenues, state government spending still

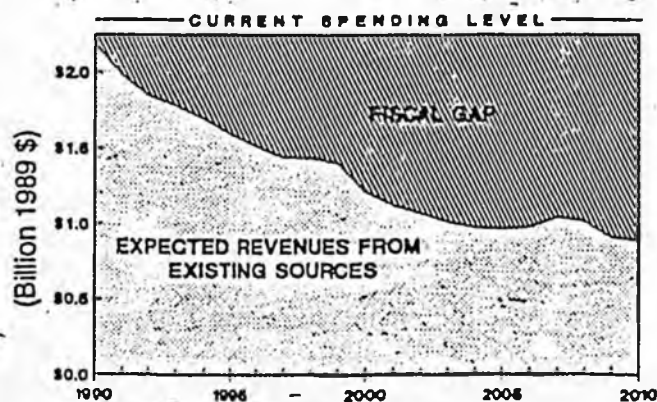
accounts directly and indirectly for more than one in four Alaska jobs.

Below we look at four possible ways to deal with the fiscal gap between now and the year 2010. Briefly, our four cases are: (1) Stumble From Year to Year; this case assumes that the state tries to maintain current spending for as long as possible by using all available reserves except the principal of the Permanent Fund and then cuts spending to match reduced revenues. (2) Deplete the Permanent Fund; this case examines what would happen if the state maintained the current budget level by spending the principal of the Permanent Fund. (3) Freeze the Budget; this case looks at how the

fiscal gap would be affected if the state did not adjust the budget for inflation—in effect cutting the budget by the annual rate of inflation. (4) Cut Spending and Raise Taxes; this case describes the combined effects of reducing state spending, reimposing the personal income tax, and eliminating the Permanent Fund dividend.

There are other possible combinations, but these four scenarios include the main options available to the state. We do not discuss, nor have we attempted to analyze, the enormous political difficulties inherent in exercising any of these options. Some would require changes in law or even amendments to the Alaska constitution. All would generate intense public debate, and most

Figure 2. PROJECTED STATE FISCAL GAP* (Difference Between Revenues and Spending)



*Projected at the current level of state general fund expenditures. Revenues include oil settlement estimate.

REAL VS. INFLATED DOLLARS IN FISCAL ANALYSIS

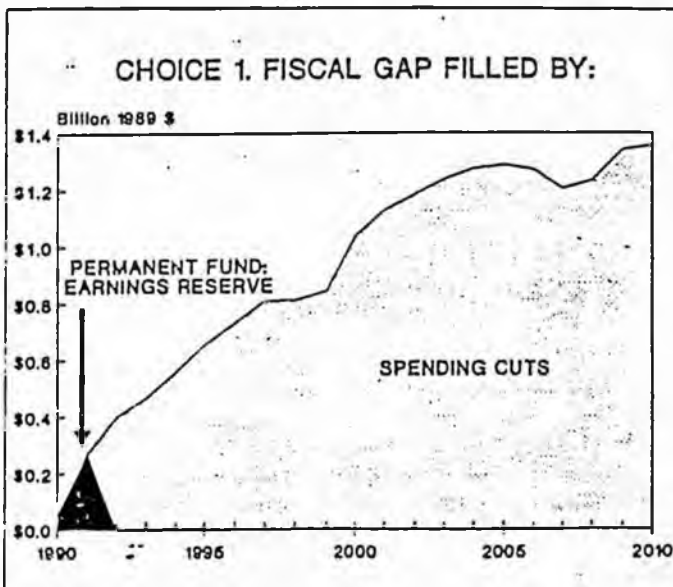
For simplicity and clarity all revenues and expenditures are presented in 1989 dollars. Using this technique eliminates the need to estimate the rate of inflation—the value of which has only a marginal effect on the rest of our analysis—and avoids the confusion that inflation can introduce when we try to compare the purchasing power of dollars received at different times. For example, \$1 of revenue collected in 2000 would have the purchasing power of just 61 cents, if inflation were 5 percent annually over the next decade. Our use of 1989 dollars throughout the analysis allows direct comparisons of current and future purchasing power.

The use of real dollars also corrects a misinterpretation that can arise in revenue projections that use nominal dollars. In such projections, the inflation-proofing portion of Permanent Fund earnings can appear to be a source of recurring revenues. In fact, inflation-proofing is just the portion of earnings needed to offset the devaluation of the fund principal by inflation. Because we use real dollars in our analysis, inflation-proofing does not appear as a separate revenue source, and we avoid any potential misinterpretation. This assumption does not preclude the policy option of appropriating inflation-proofing to fund government spending.

would face extremely strong opposition from specific groups or from Alaskans in general. This paper does not endorse any particular strategy to balance the budget. Rather, it describes in general the tradeoffs—who bears the pain—and the ramifications of the various choices.

Doing an analysis like this requires making certain economic assumptions. Those assumptions are summarized in the box on page 4 and in the individual case descriptions. We can't be sure that these assumptions will prove correct, but changing those assumptions in any reasonable way would not substantially alter our findings.

FISCAL CHOICE 1: STUMBLE FROM YEAR TO YEAR



In this case we look at what would happen if the state government budgeted from year to year, trying to maintain the current level of spending (\$2.25 billion in 1989 dollars) for as long as possible, using available fund balances but making no changes in current fiscal policies. The dividend

program would not be changed, the principal of the Permanent Fund would be retained, and no new tax measures would be enacted.

Revenues from the settlement of disputes with the oil companies over past royalty and tax payments, as well as with the federal government over ownership of leases in the Beaufort Sea, are an important element of our revenue estimates for the 1990s. The amount and timing of any settlement money the state might receive is extremely uncertain, but we assume for this and the other cases that the settlements occur regularly over the next decade in an amount equivalent to \$1.7 billion today. (See also the box on page 4 for an example of how changing this settlement total would change the analysis.) In reality the state may not be so fortunate as to receive a steady stream of income from this source, and the budget shortfall would pressure the state to accept quick negotiated settlements in these disputes.

Under these conditions, the Railbelt Energy Fund, the Earnings Reserve Account of the Permanent Fund, and other fund balances could balance the budget for a short time. A fiscal gap of \$400 million would open in 1992 and grow to an annual deficit of \$1 billion by 2000. In this scenario, state government and the economy would adjust to reduced state spending as discussed below and shown in the graphs on page 7.

Permanent Fund: The Permanent Fund would remain just about the same size (inflation-proofed) that it is today. Contrary to popular belief, future earnings of the Permanent Fund will not be able to replace petroleum revenues in the support of state government. Annual additions to the fund from petroleum revenues—which the state constitution currently requires go directly to the principal of the Permanent Fund—plus earnings would largely be consumed by the Permanent Fund dividend program, with little or nothing left

ECONOMIC ASSUMPTIONS USED IN ANALYSIS

If we changed the economic assumptions used in this analysis, the rate at which the fiscal gap grows would be different but the options for dealing with the gap would be the same. To focus on those options we held the economic assumptions constant throughout the four cases. The most important assumptions are listed below. (Full details on the assumptions are available from the author.)

OIL PRODUCTION: Alaska Department of Revenue estimate, Spring 1989, plus West Sak production scenario developed by author (oil companies recently announced postponement of West Sak exploration)

OIL PRICE: Gulf Coast delivered price for Alaska North Slope (ANS) crude averages \$15 a barrel (in 1989 dollars)

RETURN ON PERMANENT FUND: 3 percent annually, net of inflation

EMPLOYMENT GROWTH RATE: 1.75 percent annually, independent of government spending

SETTLEMENT REVENUES FROM PETROLEUM DISPUTES: \$1.7 billion (in 1989 dollars), received over 10 years

TAX REGIME: Reflects the Economic Limit Factor (ELF) as revised by the Alaska Legislature in June 1989

INFLATION RATE: 5 percent annually

RECURRING REVENUES (Non-petroleum revenues): 1 percent growth annually, net of inflation

for fund growth. The total amount available to pay dividends and the payments to individual Alaskans would stay fairly constant because population growth would roughly match growth in the total available for dividends. Dividends as a component of government spending would increase because of decreased spending in all other functional areas.

Revenues: With no new recurring revenues, general fund revenues would steadily decline to about \$1.2 billion in 2000. Permanent Fund additions and earnings would remain relatively constant because of the stable size of the fund.

Expenditures: Declining petroleum revenues would force significant budget cutbacks beginning in earnest in 1992. The general fund would need to be cut 18 percent that year to balance the

budget. Smaller annual cuts would be the rule over the next two decades. Expenditures in 2000 would be \$1.2 billion—equal to revenues collected that year. These cuts in state spending would mean underfunding many and eliminating some government programs; reducing transfers to local governments (creating pressure on local governments to increase taxes and try to shift government functions back to the state); and reducing financial support for individuals. Projected population growth would add to the problem of deciding how the cuts should occur. Uncertainty about the timing and magnitude of cuts from year to year would create continuing confusion and negative attitudes both within government and the private sector.

Alaska Employment: During the next decade 26,000 public and private jobs would be lost as

WHAT IF WE CHANGED THE ASSUMPTIONS?

A question likely to be asked is: How much longer could we maintain current spending if revenues turned out to be greater than we have assumed? If we used up the entire Permanent Fund (as discussed in Case 2), we could maintain current spending up until 2003. Alternate assumptions would add to the number of years that the current spending level could be maintained as follows:

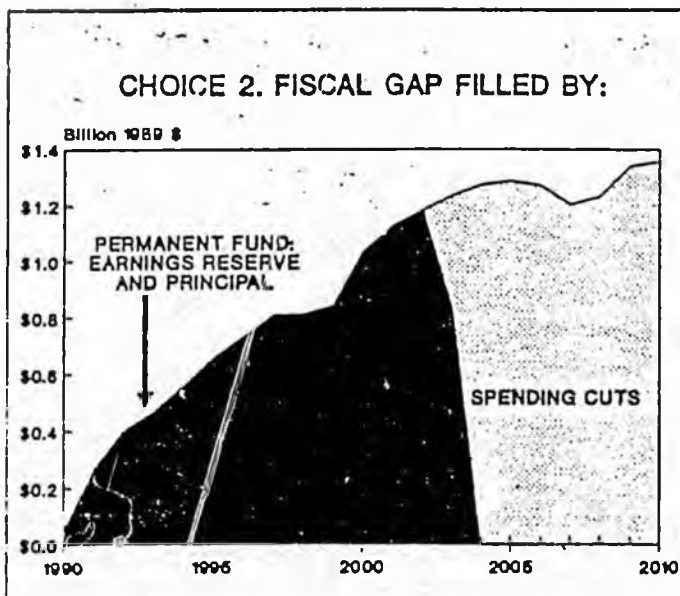
\$1 increase in the price of oil	1 year
Gas pipeline in the 1990s	1 year
ANWR production shortly after 2000	1 year
Petroleum settlements of \$3.4 billion	2 years

Another likely question is: What would be the cost of a one-year delay in closing the fiscal gap? Our analysis in Case 4 indicates that the state can sustain annual spending of about \$1.45 billion (in 1989 dollars) based on the current tax regime, compared with the current spending level of \$2.65 billion (including the approximately \$400 million paid in Permanent Fund dividends). The difference between current and sustainable spending—\$1.2 billion—approximates the loss in state fiscal assets associated with each year of delay in closing the gap.

state general fund spending was cut virtually in half. (For simplicity we assume public sector jobs would be eliminated in proportion to the budget cuts. Wage rate reductions could partially offset this job loss. We also assume that local governments do not raise taxes in response to less state fiscal support.) The drag on the economy created by a job loss of this magnitude would make it difficult if not impossible for the economy to grow, even assuming the private sector could generate new jobs at about the same rate projected for the national economy—1.75 percent annually. Total employment in Alaska in 2000 would be only slightly above what it is today.

Economic Well-Being: Annual percentage changes in employment would hover near zero for most of the next 10 years, with a dramatic drop when government spending was first reduced in 1992. Per capita general fund government spending would fall about 5 percent annually through most of the next 20 years.

FISCAL CHOICE 2: DEplete THE PERMANENT FUND



Another strategy for dealing with the budget crisis—the most drastic and one which would require an amendment of the Alaska constitution—would be to use the entire \$10 billion in the Permanent Fund to plug the fiscal gap and keep spending at \$2.25 billion (in 1989 dollars) for as long as possible. We do not endorse this strategy, but include it to cover the range of options avail-

able to the state. Under this scenario, the portion of Permanent Fund earnings now used to protect the principal of the fund from inflation would be spent, as well as the principal of the fund itself.

The first draw—\$400 million from inflation-proofing—would be required in 1992. Within two years, however, we would begin taking from the principal of the fund, and the withdrawals would grow rapidly—topping \$1 billion for the first time in 2000. The fund principal would be drawn down faster as time went on not only because of the growing fiscal gap but also because the shrinking Permanent Fund would generate less earnings each year. Under this scenario, the effects would be as discussed below and shown in the graphs on page 8.

Permanent Fund: More than \$6 billion from the Permanent Fund would be needed to fill the budget gap between 1992 and 2000. The last year of withdrawals would be 2003, when the Permanent Fund would be depleted. The Permanent Fund dividend would be an additional casualty, declining each year as the fund shrank and disappearing when the fund disappeared.

Revenues: Revenues flowing into the general fund would be the same as in Case 1, but the use of Permanent Fund earnings and principal would disguise the shortfall until 2003, when the Permanent Fund would be gone. By 2005, revenues would be about \$1 billion—60 percent less than the level expected in 1990. The additions and earnings of the Permanent Fund would fall as the fund itself shrank.

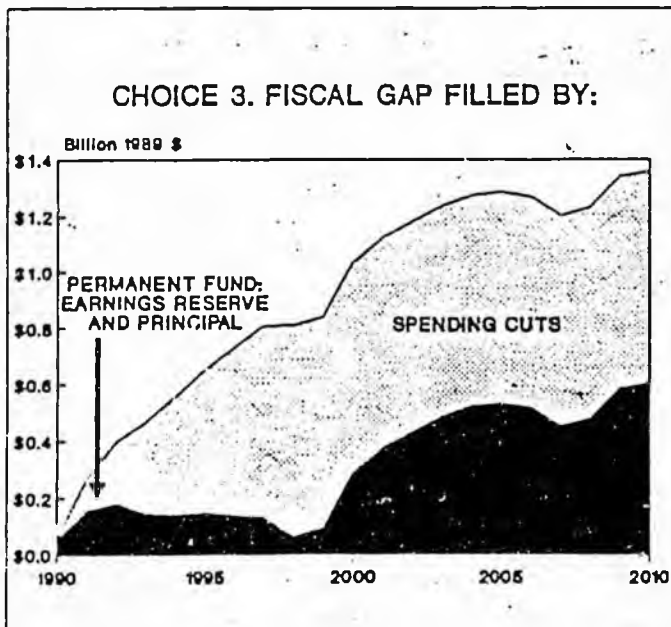
Expenditures: The Permanent Fund would prop up expenditures until 2003. Then a massive "forced transformation" of the public sector and the entire Alaska economy would occur because of the sudden drop in state general fund spending—from \$2.25 billion to \$1 billion in just two years. All public services at the state and local levels would suffer dramatic cutbacks.

Alaska Employment: Extreme dislocation and a serious economic recession would start in 2003. About 30,000 jobs—both public and private—supported by general fund spending would disappear over a two-year period. (To put such a drop in perspective, job loss during the 1985-1988 recession was about 25,000.) Even assuming

private industry would continue to generate jobs at the rate of 1.75 percent annually, by 2010 Alaska would still not have replaced all the jobs lost during the recession.

Economic Well-Being: Alaska employment would increase through 2002 because of growth in the private economy and constant general fund government spending. In the following two years, 12 percent of total state jobs would disappear. Despite constant government spending through 2002, per capita state general fund spending would decline because private economic growth would be drawing people to Alaska. Per capita state general fund spending would be cut nearly in half when the "forced transformation" occurred.

FISCAL CHOICE 3: FREEZE THE BUDGET



The forced transformation of the public sector and the severe recession described in Case 2 could be mitigated under a scenario in which the budget was held constant in nominal dollars—that is, not adjusted for inflation. Such a strategy would reduce the purchasing power of the budget each year by the rate of inflation.

The average annual rate of inflation in the coming years is expected to be in the neighborhood of 5 percent. If the budget were not adjusted for that inflation, the real dollar value (the effective purchasing power) of the budget would fall by 5 percent each year. If the state government imple-

mented a constant budget policy starting in 1991, the budget could be reduced to an arbitrary target level of \$1.5 billion (in 1989 dollars) by 1998.

A gradual policy like this would require a large amount of political discipline, but it would have several attractive features—even though it would not entirely solve the state's long-term fiscal problem. Public programs could be phased out on the basis of plans developed to minimize the effects of the budget reductions. The economy would not suffer the kind of massive shock described under Case 2, when state spending would be reduced by half in just two years. The effects of using inflation to cut the budget are discussed below and shown in the graphs on page 9.

Permanent Fund: This strategy at first glance appears to preserve the Permanent Fund, since the balance would hold relatively constant for several years after budget cuts ended. It would require use of portions of the annual appropriations for inflation-proofing during the 1990s. After 2000 continuing declines in revenues would force significant withdrawals from principal. By 2010 the fund principal would be only about \$3.5 billion, as compared with \$10 billion today. As the Permanent Fund shrank, the amount paid out as dividends would also fall off.

Revenues: General fund revenues would be the same as in Cases 1 and 2. The spending reductions would not be sufficient to produce a general fund surplus; such a surplus could in itself be a new source of earnings. Additions and earnings of the Permanent Fund would taper off after 2000 as the principal of the fund was spent.

Expenditures: State expenditures would fall off gradually but steadily each year until 1998 and then hold steady at \$1.5 billion through the next decade—but only because we would be using the principal of the Permanent Fund to supplement other revenues. After 2010 the Permanent Fund would be used up and a smaller "forced transformation" of the public sector and the economy would occur. Under this scenario, dramatic cuts in state spending—as much as 40 percent—would be forced by 2015 (not shown on the graph).

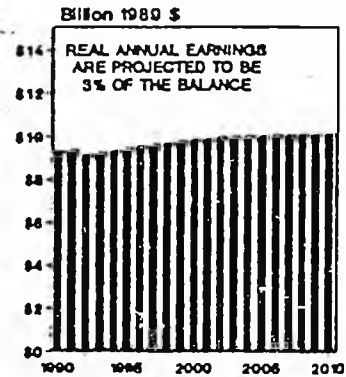
(Text continued on page 11)

Fiscal Choice 1: Stumble from Year to Year

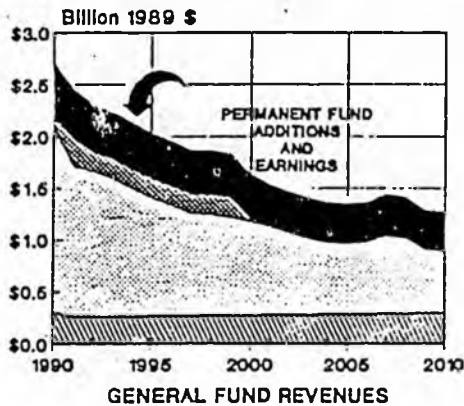
CASE ASSUMPTIONS

- **SPENDING:** General Fund spending based on availability of revenues up to \$ 2.25 billion (1989\$)
- **TAXES:** No new taxes
- **DIVIDEND:** Retain Permanent Fund dividend
- **PERMANENT FUND:** Leave Permanent Fund principal intact, continue contributions and inflation proofing, spend earnings reserve account
- **OIL PRICE (constant across cases):** Average ANS Gulf Coast oil price \$15 (1989\$)
- **SETTLEMENTS (constant across cases):** \$1.7 billion of oil settlements collected and spent over 10 years

PERMANENT FUND BALANCE

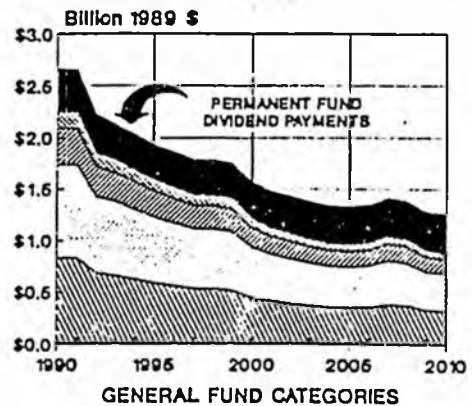


STATE GOVERNMENT REVENUES (Permanent Fund Included)



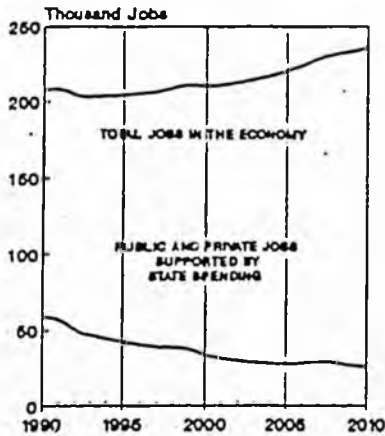
RECURRING OIL
 SETTLEMENTS

STATE GOVERNMENT EXPENDITURES (Dividend Included)



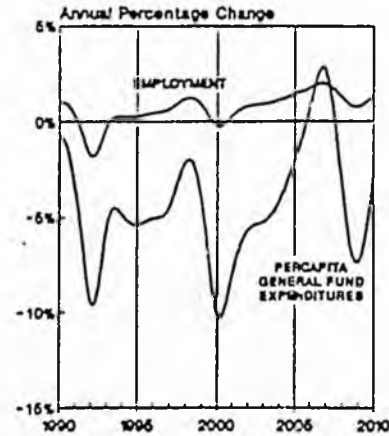
AGENCY FORMULA
 OTHER CAPITAL

ALASKA EMPLOYMENT



Wage and Salary Employment Only

ECONOMIC WELL-BEING

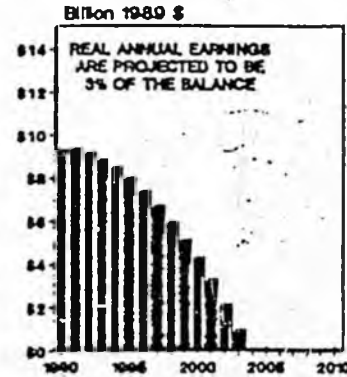


Fiscal Choice 2: Deplete the Permanent Fund

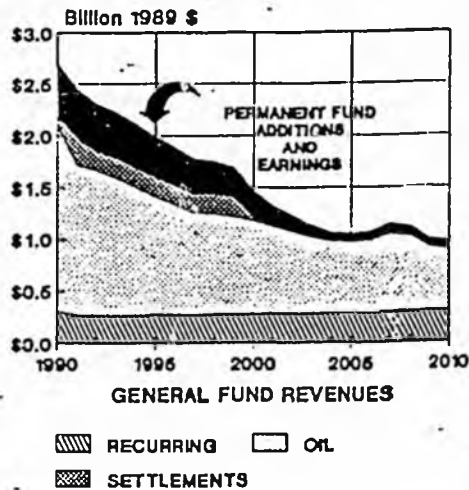
CASE ASSUMPTIONS

- **SPENDING:** General Fund spending based on availability of revenues up to \$ 2.25 billion (1989\$)
- **TAXES:** No new taxes
- **DIVIDEND:** Retain Permanent Fund dividend
- **PERMANENT FUND:** Use Permanent Fund principal to maintain spending as long as possible
- **OIL PRICE (constant across cases):** Average ANS Gulf Coast oil price \$15 (1989\$)
- **SETTLEMENTS (constant across cases):** \$1.7 billion of oil settlements collected and spent over 10 years

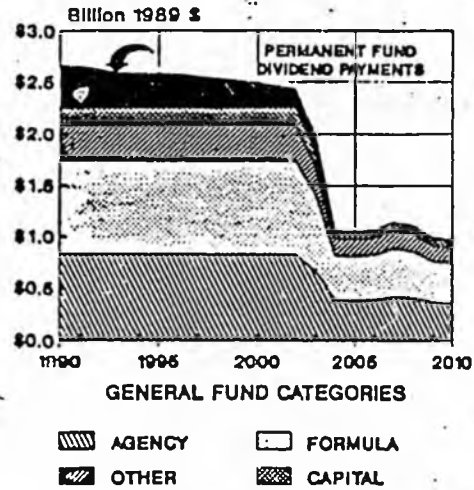
PERMANENT FUND BALANCE



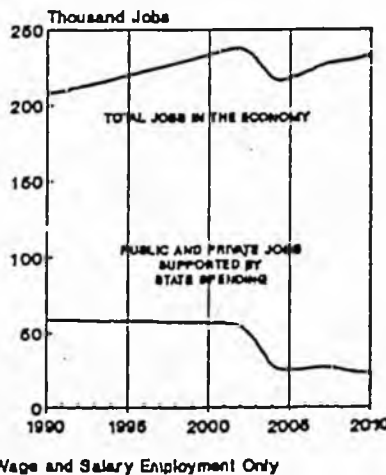
STATE GOVERNMENT REVENUES (Permanent Fund Included)



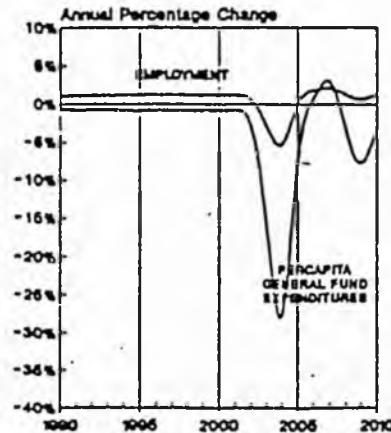
STATE GOVERNMENT EXPENDITURES (Dividend Included)



ALASKA EMPLOYMENT



ECONOMIC WELL-BEING

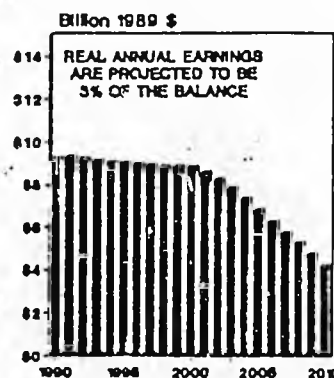


Fiscal Choice 3: Freeze the Budget

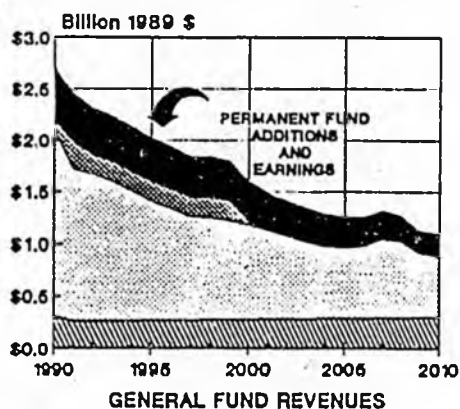
CASE ASSUMPTIONS

- **SPENDING:** General Fund spending constant in nominal dollars from 1991 to 1998. (The budget declines to a target of \$1.5 billion in 1989\$)
- **TAXES:** No new taxes
- **DIVIDEND:** Retain Permanent Fund dividend
- **PERMANENT FUND:** Use Permanent Fund principal to maintain spending at targeted level as long as possible
- **OIL PRICE (constant across cases):** Average ANS Gulf Coast oil price \$15 (1989\$)
- **SETTLEMENTS (constant across cases):** \$1.7 billion of oil settlements collected and spent over 10 years

PERMANENT FUND BALANCE

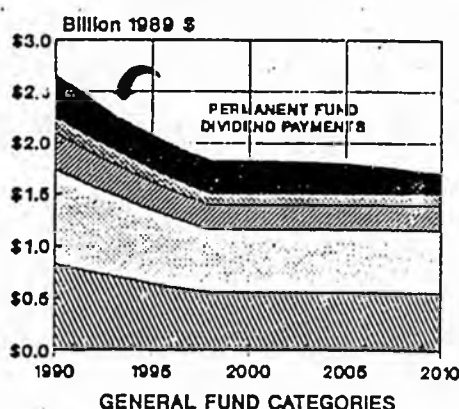


STATE GOVERNMENT REVENUES (Permanent Fund Included)



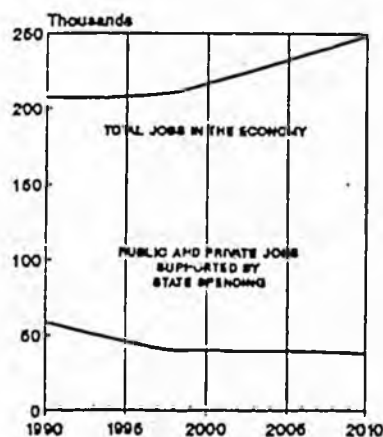
RECURRING OIL
SETTLEMENTS

STATE GOVERNMENT EXPENDITURES (Dividend Included)



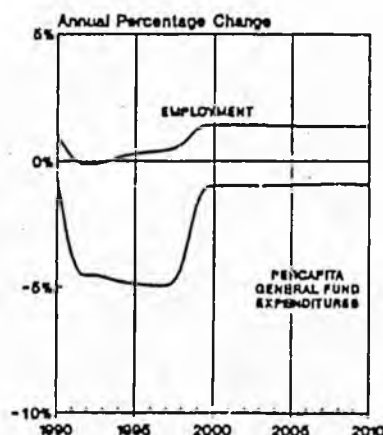
AGENCY OTHER
FORMULA CAPITAL

ALASKA EMPLOYMENT



Wage and Salary Employment Only

ECONOMIC WELL-BEING

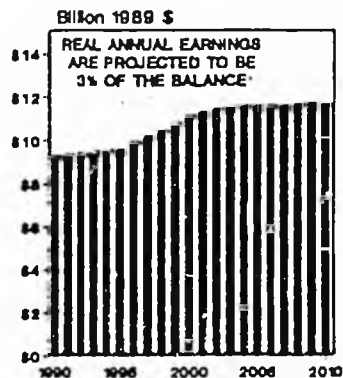


Fiscal Choice 4: Cut Spending and Raise Taxes

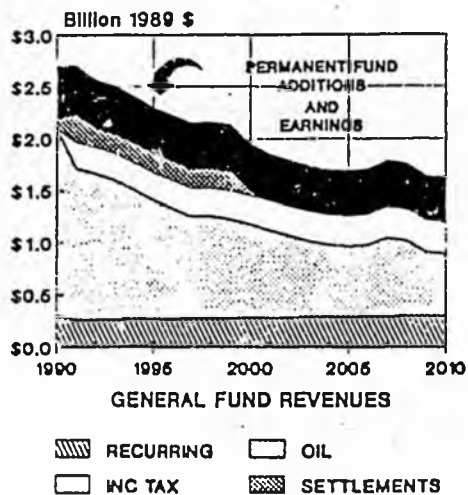
CASE ASSUMPTIONS

- **SPENDING:** General Fund spending is reduced 2.5% annually (1989\$) from 1991 to 2000. (The budget declines to a target of \$1.7 billion in 1989\$)
- **TAXES:** Personal Income tax reimposed in 1991
- **DIVIDEND:** Permanent Fund dividend eliminated in 1995
- **PERMANENT FUND:** Leave Permanent Fund principal intact, continue contributions, spend earnings reserve account. Appropriate real earnings to General Fund. Use inflation proofing to fill revenue gap.
- **OIL PRICE (constant across cases):** Average ANS Gulf Coast oil price \$16 (1989\$)
- **SETTLEMENTS (constant across cases):** \$1.7 billion of oil settlements collected and spent over 10 years

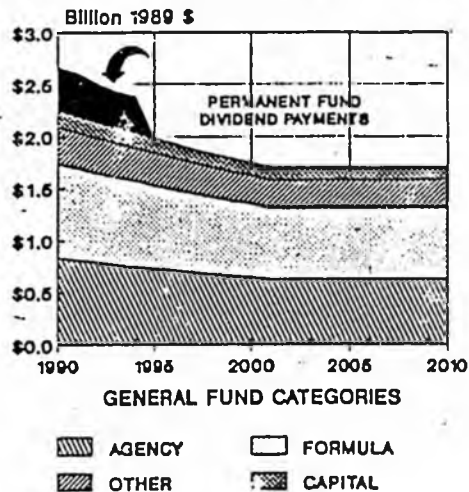
PERMANENT FUND BALANCE



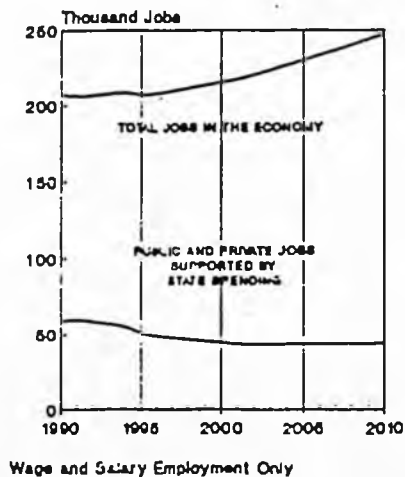
STATE GOVERNMENT REVENUES (Permanent Fund Included)



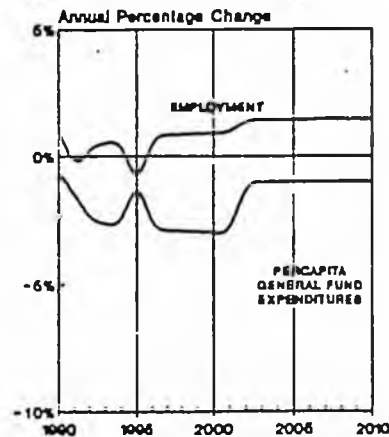
STATE GOVERNMENT EXPENDITURES (Dividend Included)



ALASKA EMPLOYMENT



ECONOMIC WELL-BEING

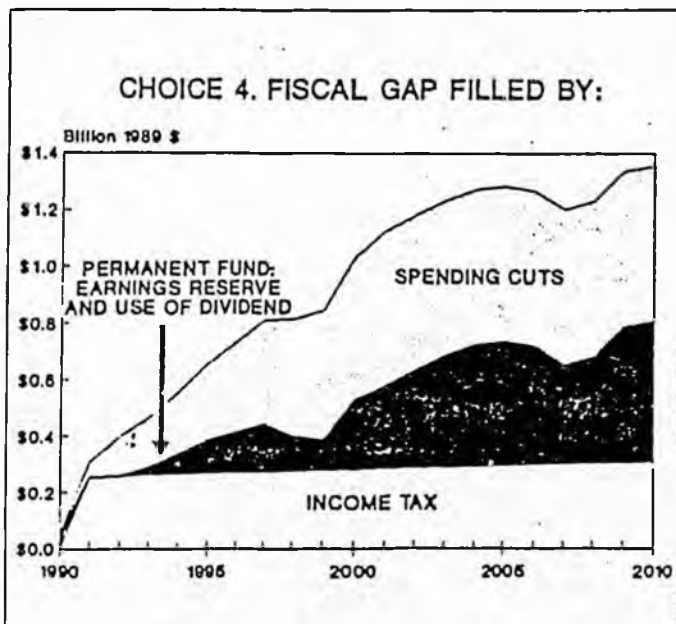


(Text continued from page 6)

Alaska Employment: The number of public and private jobs supported by state spending would suffer gradual attrition throughout most of the 1990s, dropping by about 20,000 over the decade. Private industry would be hard pressed to replace those jobs that had been supported by state spending. Total Alaska employment would stagnate until 1995 and only then begin a gradual increase. However, after 2010, when state spending dropped off very abruptly, a shock wave would again travel throughout the economy, eliminating public and private sector jobs and precipitating another recession.

Economic Well-Being: There would be little year-to-year change in Alaska employment until the late 1990s. In the following decade, modest growth in the private sector combined with stable public employment would result in small annual increases in employment. Per capita general fund state spending would decline every year for the next two decades, but the drops would be smaller after the 1990s. Again, both per capita state spending and employment would suffer after 2010, when state spending dropped sharply.

FISCAL CHOICE 4: CUT SPENDING AND RAISE TAXES



The cumulative budget reductions described in the first three cases, combined with the elimina-

tion of the Permanent Fund in the second and third, may be more than Alaskans are willing to endure. An alternative to those kinds of reductions would be for the state government to use new sources of revenues. The most likely sources are a personal income tax and the earnings of the Permanent Fund that now finance the dividend program. Those two together could contribute \$650 million annually—\$250 million from the income tax and \$400 million from the dividend program—to the general fund. In this scenario, we look at what would happen under one possible combination of these two new revenues. We assume the income tax is reimposed in 1991 and that beginning in 1995 the revenues now used to fund the Permanent Fund dividend program are instead used to supplement general fund revenues.

The state would still need to cut the budget, because at the current level of spending the fiscal gap would soon exceed the \$650 million generated by these new revenue sources. Furthermore, cutting the budget at the same time new revenues were added would distribute the pain between the taxpayers and the beneficiaries of public spending.

Our analysis suggests that the state is spending \$1.2 billion more annually than it can support in the long run, without an income tax (\$800 million in general fund spending and \$400 million in dividends). If we chose to reimpose the income tax and use the earnings of the Permanent Fund to support public spending, sustainable revenues would increase \$650 million annually and \$550 million in non-sustainable spending would remain. Thus the general fund budget would need to be cut to \$1.7 billion—about a 25 percent reduction. In combination with the revenue generating measures, such a budget cut would eliminate the fiscal gap not only in the 1990s but into the following decades as well—and the Permanent Fund would remain intact.

Depending on when the state receives settlements in tax and other disputes, this scenario might require budget cuts in years of increasing revenues. The state would intentionally collect more than it spent—thus setting aside a small balance of settlement reserves to smooth the transition to a smaller budget. Although that might be a rational decision when we consider the projected revenue decline in the later years, the plan would be tough to justify in the short run, particularly in the presence of fluctuating oil

prices. The effects of this fourth scenario are discussed below and shown in the graphs on page 10.

Permanent Fund: The principal of the Permanent Fund would grow slowly through the next two decades, with the addition of revenues from petroleum and withdrawals only of real earnings to fund government. The fund would have a continuing capacity to generate real earnings of \$400 million annually that could be used to support public spending. Individual Alaskans would, however, lose their annual dividends in 1995.

Revenues: Even with the addition of new revenues from the income tax, total general fund revenues would still fall under this scenario, because the new taxes would not completely offset lost petroleum revenues. But the drop would not be as dramatic as in the other cases—revenues independent of the Permanent Fund would be \$1.5 billion in 2000 and fall to \$1.25 billion in 2005. As noted above, the Permanent Fund would produce about \$400 million in real earnings annually, some of which could be reinvested in early years.

Expenditures: Annual budget reductions would continue for 10 years, cutting expenditures by 25 percent over the decade. (If the annual rate of inflation averaged 5 percent, then the budget in nominal dollars would be increasing at 2.5 percent in this case.) These cuts would of course reduce the level of government services, but the reductions would be much more gradual than in the other cases we've looked at. After 2000 expenditures could be maintained at the target level indefinitely.

Alaska Employment: About 12,000 public and private jobs supported by general fund spending would disappear as state spending declined. Another 3,000 jobs would be eliminated when the income tax was reimposed and 5,000 more when the dividend program ended. Although the rate of job loss from these government actions over a 10-year period would be gradual, private industry would have to create new jobs at a rate greater than 1.75 percent annually to produce significant total employment growth before 1996.

Economic Well-Being: The economy would con-

tract when the income tax was reimposed, and again when the Permanent Fund dividend was eliminated. Reimposition of the income tax would draw purchasing power out of the private economy. Elimination of the Permanent Fund dividend would shift purchasing power from an activity with a high multiplier to one with a lower multiplier—because the money would be spent not by thousands of individuals but by government. Per capita general fund spending would decline in the 1990s, but the loss would be less than in the other cases. In contrast, per capita discretionary income of Alaskans (not shown on the graph) would fall in this case due to the reimposition of the income tax and the elimination of the dividend.

TRADEOFFS AMONG STRATEGIES

We have described four ways—all of them painful—of dealing with the fiscal gap. In each case the level of public services—both aggregate and per capita—would fall. In each case the private economy would also suffer, since reduced public spending and transfers and increased taxes would mean less buying power. There is no strategy that would close the fiscal gap without creating pain, because the gap can only be filled by taking from somewhere in the economy.

In each case the pain would be distributed among citizens—present and future—in a different way. Those different distributions are the distinguishing features of each strategy. We recognize, of course, that the effects of balancing the budget will vary among individual Alaskans and in different areas of the state. For example, areas where state spending makes up a larger share of economic activity would be harder hit by budget cuts. Similarly, eliminating or reducing Permanent Fund dividends would affect the pocketbooks of low-income Alaskans more than those with higher incomes, while reimposing the personal income tax would have more impact on those with higher incomes. Despite these individual and regional differences, there are broad kinds of tradeoffs all Alaskans will need to consider; some of these are discussed below.

Present vs. Future Public Spending: If we spend less of our petroleum wealth now, more will remain for future needs—our own or those of

later generations. Should we discount the needs of the future, because such needs are not easily identifiable or because we think the wealth of future generations is currently underestimated? Or should we weight the needs of the future heavily because new public needs are continually being identified, the population is growing, and we may be overestimating future revenues?

Figure 3 shows state spending levels over the next 20 years under our four choices. All the choices show much lower spending by 2010—but how much we spend along the way varies sharply among the choices. Choice 1 and Choice 2 offer the biggest contrast in spending over the next decade; under Choice 1 we would continue current fiscal policy, using all available reserves except the Permanent Fund; while in Choice 2 we would prop up spending by draining the Permanent Fund. Although spending would obviously be much higher under Choice 2 over the next decade, by 2010 spending under both cases would fall to about the same level—but the Permanent Fund would be gone under Choice 2. Choice 3 also would prop up state spending by using the Permanent Fund, but at a slower rate. Spending under Choice 4 would be highest in 2010—but we would maintain that spending level without drawing on the Permanent Fund principal.

Figure 4 shows how each of our four choices would affect the Permanent Fund, our primary repository of oil wealth. The fund and its earning power would not last long if we opted to use the principal to prop up state spending. In Choice 2, the fund would be used up in 2003; in Choice 3 it would dwindle after the 1990s and be gone by 2015. The fund would increase somewhat under both Choices 1 and 4. But under Choice 1 the fund would be left intact while state spending shrank and the state government and the economy floundered from year to year. Under Choice 4, state spending would be stabilized and the economy would not be jolted by continuing spending cuts over 20 years—but it would be stabilized at the cost of a new personal income tax and the elimination of Permanent Fund dividends.

The most straightforward benefit to the average Alaskan from the Permanent Fund has been the annual dividends paid out of fund earnings. Figure 5 shows how dividend payments would be affected under each of our four choices. Under Choice 1, real dividend payments (in 1989 dol-

lars) to each Alaskan would remain fairly constant over the next 20 years, since population growth would roughly match growth in the amount available for dividends. Under Choice 2, the dividends would shrink over the next decade as the principal of the fund was being drawn down and its earnings reduced; the last dividends would be paid in 2004. The attrition of dividends would be somewhat slower under Choice 3, but the result would be the same: shrinking and then disappearing dividends by 2015. Under Choice 4, the dividend program would end in 1995 and the money that formerly went into that program would be shifted over to the general fund.

To conclude our discussion of spending, we should note that in the past decade the state government has spent part of its oil wealth in ways intended to stimulate future economic growth rather than simply to maintain current programs. Many of these ventures have so far had limited success, and it's outside the scope of this paper to assess their value to the state as investments. But to the extent that the state can use its oil wealth to promote economic growth, that kind of spending should be viewed as investment and distinct from spending that simply creates jobs and income in the present.

Present vs. Future Economic Activity: The Alaska recession that followed the "petrodollar boom" of the early 1980s demonstrated that a large portion of the economic activity stimulated by state spending of oil revenues could be sustained only as long as the flow of oil dollars continued. We can continue to spend oil revenues when we receive them, and immediately receive the benefits of the jobs and income produced by that spending. Alternatively, we can postpone spending some of the revenues and receive the economic benefits at some future time. The choice should depend on when those jobs and income will contribute most to the economy and on what we want to save for future generations. Until we make such a choice, the marketplace—essentially the OPEC cartel and the petroleum production cycle—will continue to dictate the booms and busts of our economy.

Figures 6 and 7 show how the number of jobs supported by state spending—including both public and private jobs—and the total number of jobs in Alaska would vary under our four choices. Under Choice 1, the number of jobs supported by

public spending would decline steadily for the next 20 years. Under Choice 2, spending of the Permanent Fund would keep such jobs at about their current level until the fund was exhausted in 2003—then many jobs would be eliminated quickly, and by 2010 there would be about half as many jobs supported by public spending as there are today. Under Choice 3, which involves more gradual use of the Permanent Fund, the number of jobs created directly and indirectly by state spending would drop somewhat by 2010—but not shown on the graph is a very sharp drop that would occur after 2010, when the Permanent Fund was depleted. As with the other cases, the number of jobs supported by state spending would also drop under Choice 4, but the decline would be somewhat smaller and the number of such jobs would stabilize after 2000.

How total jobs in the state—including both those supported by public spending and those by private industry—would fare under each of our choices depends largely on the timing of public spending and on whether the Permanent Fund is depleted. We assume in all cases that private industry in Alaska is able to generate new jobs at an average annual rate of 1.75 percent. Under Choice 1, it would take about 10 years for private growth to offset the job loss from reduced public spending. Use of the Permanent Fund would keep the number of jobs growing under Choice 2—until the fund was used up; then a severe recession would occur. By 2010 Alaska employment would be lowest under Choice 2. Under Choice 3, total jobs would grow slowly but steadily through 2010—but again, not shown on this graph is a sharp decline in jobs that would happen around 2015. Employment under Choice 4 would be slightly lower than under Choice 3, because in that case spending of the Permanent Fund would not be supporting jobs. However, unlike Choice 3, Choice 4 would not involve a recession in 2015.

Public vs. Private Consumption: How much we are able to consume as a state ultimately depends on the productive capacity of our basic industries—petroleum, seafood, tourism, mining, forest products and federal government spending. The split between public and private consumption does not affect this capacity unless government raises taxes so high that private economic incentives are adversely affected. However, the distribution of the benefits does depend

on that split. We have argued that the current rate of consumption can't be sustained (because public spending exceeds sustainable public revenues), but we have not suggested what the proper balance is between public and private consumption. Is public consumption in Alaska too large because of historical accident and because the only constraint on public spending seems to have been the availability of revenues? Or should we increase public consumption relative to private consumption to meet the continuing growth in those needs best served through public action? Do we need a large public sector to balance the dominant economic influence of a single commodity? Or does high public consumption hamper diversification in the private sector?

Gradual vs. Abrupt Transition: A gradual transition to a sustainable level of public spending would allow both the public and private sectors to adjust in ways that would minimize the pain from the loss of public services, income, and employment. At the same time, a gradual transition would be very difficult to manage politically and would have a lasting negative psychological effect on the state and population. A quick transition would not leave much time for adjustments and would cause some inefficiencies as public agencies, businesses, and individuals reorganized in the wake of budget cuts. On the other hand, the detrimental psychological effects would be short-lived.

Figure 8 shows the different rates of spending cuts under the four cases. The most drastic would be Choice 2, where state spending would drop by more than half shortly after 2000. Choice 1 would see sharp cuts in the early 1990s and then a continual downward drift for the next 20 years. Choice 3 would result in a fairly stiff drop in the early 1990s followed by relatively stable state spending through 2010—but then another sharp cut in the next decade. Under Choice 4 we'd see small but steady decreases throughout the 1990s but a leveling off after that.

Public vs. Private Economic Activity: Delivering public services requires hiring public employees—teachers, construction workers, office workers—and indirectly generates private employment. Delivering private goods and services requires hiring private employees—clerks, construction workers, office workers. Is the mix

Comparisons Across Fiscal Choices

Figure 3

STATE GENERAL FUND EXPENDITURES

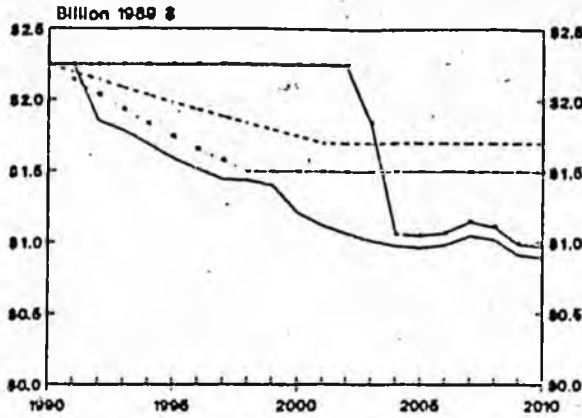


Figure 4

PERMANENT FUND BALANCE

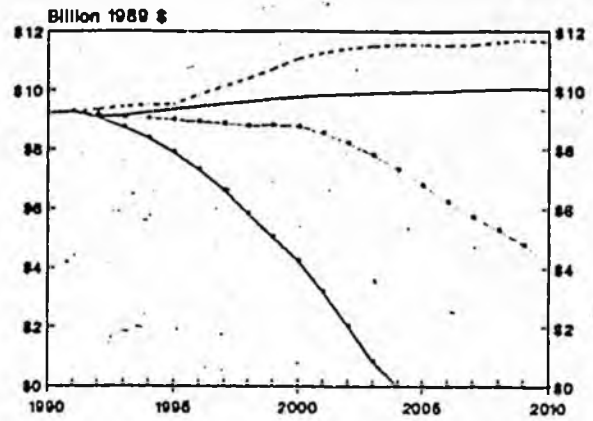


Figure 5

PERMANENT FUND DIVIDEND

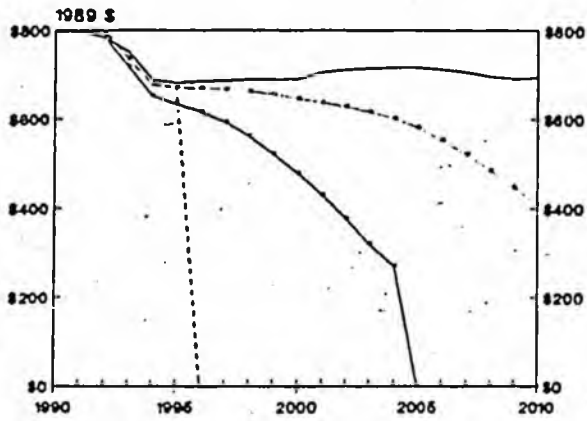


Figure 6

STATE SUPPORTED EMPLOYMENT

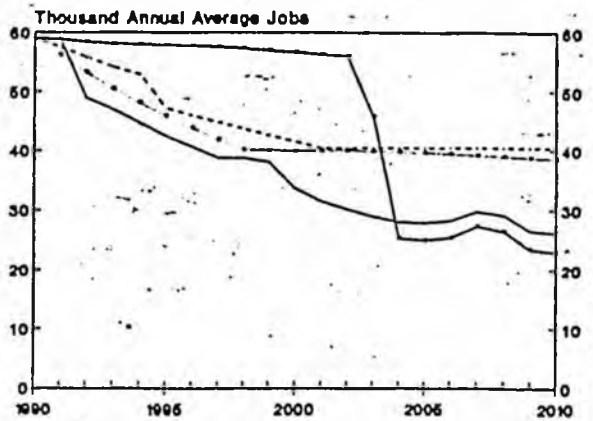


Figure 7

ALASKA WAGE AND SALARY EMPLOYMENT

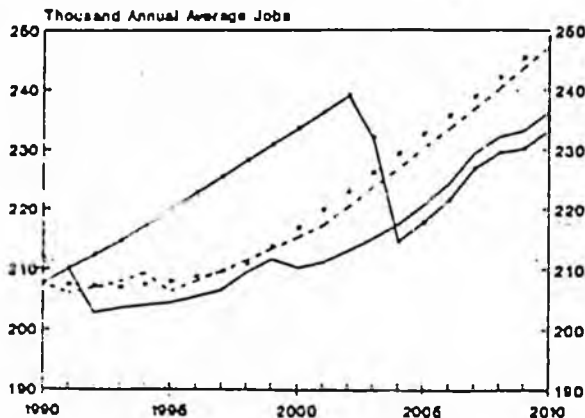
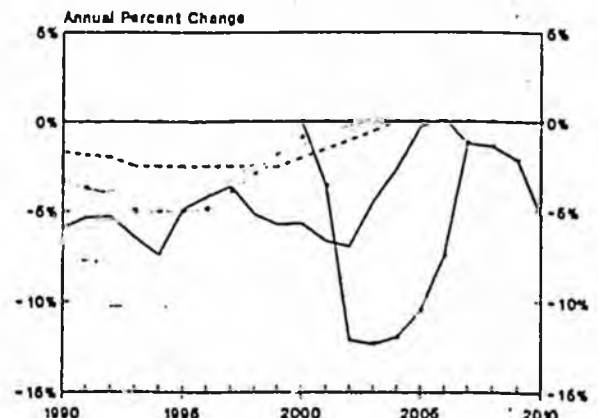


Figure 8

GENERAL FUND SPENDING: YEARLY CHANGE



Values have been smoothed.

SCENARIO

- 1 STUMBLE ALONG
- 2 USE PERMANENT FUND
- - - 3 BUDGET FREEZE
- - - 4 BUDGET CUT & TAXES

of public and private jobs in the economy an important consideration, independent of the mix of goods and services provided?

It would be if the economic multiplier—the capacity of one job to create other jobs—were significantly different for public and private jobs. However, there doesn't seem to be a significant difference between the multiplier effects of public and private jobs, since most of the multiplier effect in the Alaska economy comes from the successive re-spending of income earned as wages and salaries, independent of who writes the checks.

CONCLUSION: A CALL FOR ACTION

These cases show some of the consequences of four different choices for closing the fiscal gap facing Alaska. As we noted at the outset, we have not assessed the political difficulties of putting budget changes into effect—but of course we recognize that enormous difficulties will accompany any such plan. Further, we don't know whether the assumptions we've used in this analysis will turn out to be accurate. But whether the price of oil is higher or lower than we've assumed, or other circumstances are somewhat

different than we project, Alaska faces a serious fiscal problem. Despite the uncertainties always inherent in planning for the future, this analysis suggests positive action is warranted—and the sooner it is taken the better.

Differences among the four choices demonstrate that we can influence outcomes and change tradeoffs through public choices. For example, we can choose whether the Permanent Fund will be a lasting asset, throwing off income for future generations of Alaskans, or whether we will spend it to get ourselves through the next decade without sacrifice. We can decide on the mix of current versus future spending, total public versus private spending, and when to take the inevitable hit on the economy. With advance warning, we have an opportunity to plan spending reductions in an orderly fashion.

It is clear that what actions to take are political rather than economic decisions. Nonetheless, each decision will have significant economic consequences. Policymakers need information about the implications of different choices to make informed political decisions. Future issues of this series will seek to enlarge the scope of public information to help in this important public debate.

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INITIAL REPORT
of the
HOUSE FINANCE FISCAL POLICY SUBCOMMITTEE
prepared by:

Representative Kay Brown, Chair
Representative C.E. Swackhammer
Representative Steve Rieger

February 7, 1989

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OVERVIEW OF SUBCOMMITTEE WORK

The House Finance Fiscal Policy Subcommittee has been meeting since early in the session to address issues arising from the state's critical financial circumstances. This initial report summarizes the Subcommittee's work to date, including the development of potential budget reduction scenarios, an approach for identifying specific cuts, and information about alternative revenue options. The Subcommittee also has initiated a bi-partisan public information effort.

Subcommittee members are Reps. Brown, Swackhammer, and Rieger. The informal fiscal policy working group includes Reps. Larson, Hoffman, Ulmer, Boucher, Cotten, Koponen, Boyer, Goll, Davidson, Navarre, Grussendorf, Davis, Leman, and Miller.

SUBCOMMITTEE RECOMMENDATIONS*

- Enact a balanced budget that delivers essential public services and meets constitutional responsibilities.
- Adopt a long-range fiscal plan that reduces spending, increases revenues, or both, to bring the budget to a level that can be sustained with recurring revenues.
- Reduce General Fund spending in the range of \$150 to \$175 million in FY90, and continue reductions over the next three years. To minimize impacts on resident jobs and the economy, make reductions over several years.
- Spread use of reserve funds over several years.
- Expeditiously review revenue options so that they can be considered along with the budget cuts.
- Make reductions to entitlements, personal services (salaries /benefits), and non-essential programs; cut costs of essential programs through efficiency improvements and reorganization.
- Do not rely excessively on uncertain litigation revenue.

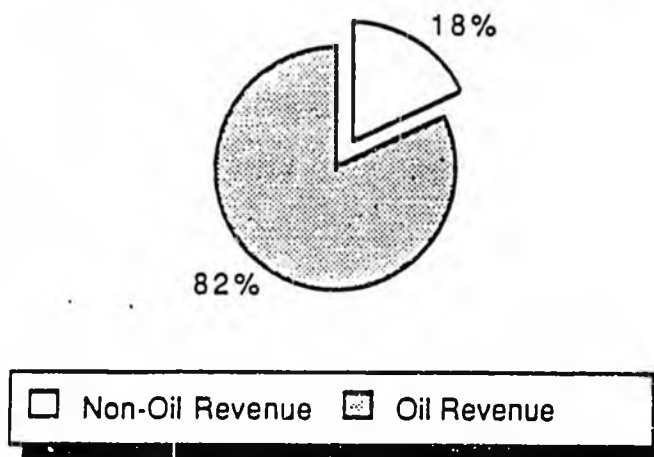
* These points reflect a consensus of the three Subcommittee members. However, several members of the working group felt it was premature to select a specific level of reduction at this time.

THE PROBLEM

In Fiscal Year 1989 petroleum revenues will be about 82% of state general fund revenues. Alaska's dependence on oil was underscored in 1986 when the world price of oil collapsed and state general fund revenues dropped by about 40%.

Figure 1

**GENERAL FUND
PETROLEUM VS. NON-PETROLEUM REVENUES
Fiscal Year 1989**



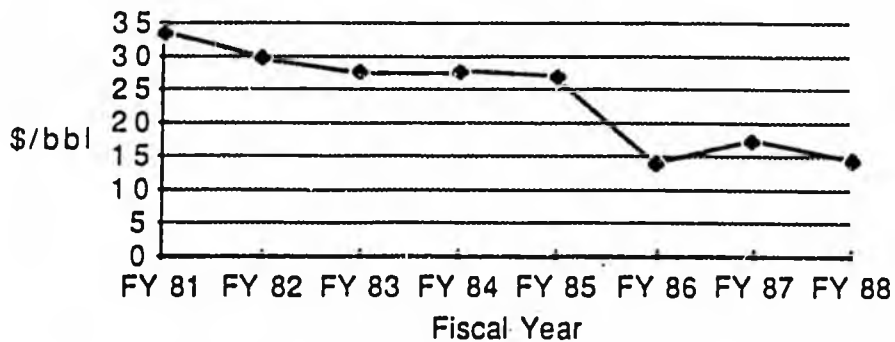
Source: Legislative Finance Division

Although the world price of oil appears to have stabilized recently, price fluctuations integrally affect the state's financial status. Moreover, the state faces a significant decline in oil revenues because production of oil from the huge North Slope fields will decrease substantially during the 1990s. As we move down the slope of the Prudhoe production curve, the gap between spending and income will widen unless action is taken to reduce spending and/or raise revenues.

The graphic presentations on the following pages illustrate the problem.

The decline in state petroleum revenues is attributable to a combination of factors, including the drop in world oil prices as shown in Figure 2.

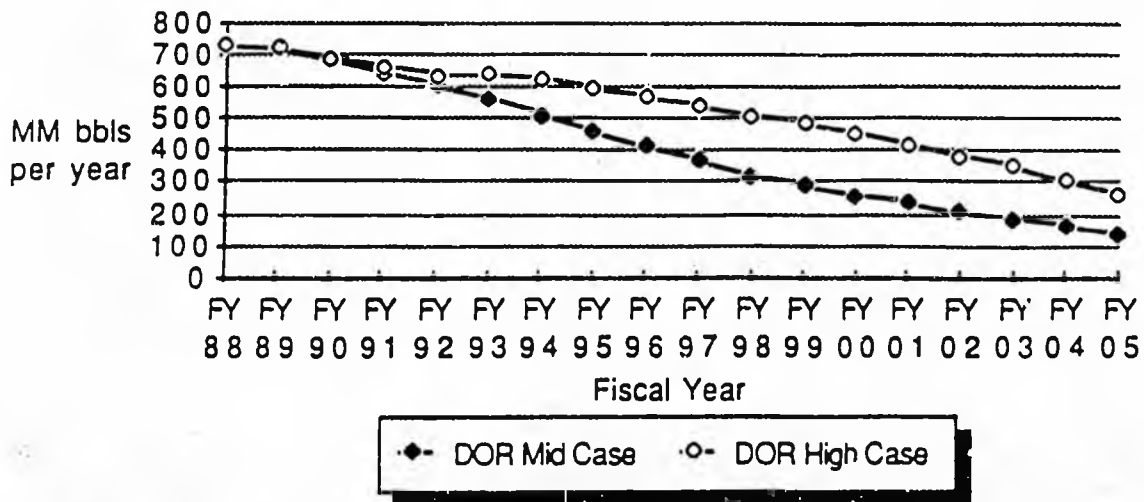
Figure 2
ALASKA NORTH SLOPE CRUDE OIL
 at the U.S. Gulf
 Fiscal Year 1981 - 1988
 (dollars per barrel)



Source: Department of Revenue

Also, the state's total oil production is projected to decline substantially throughout the remainder of the century.

Figure 3
PROJECTED ALASKA OIL PRODUCTION
 Fiscal Year 1988 - 2005
 (millions bbls/year)

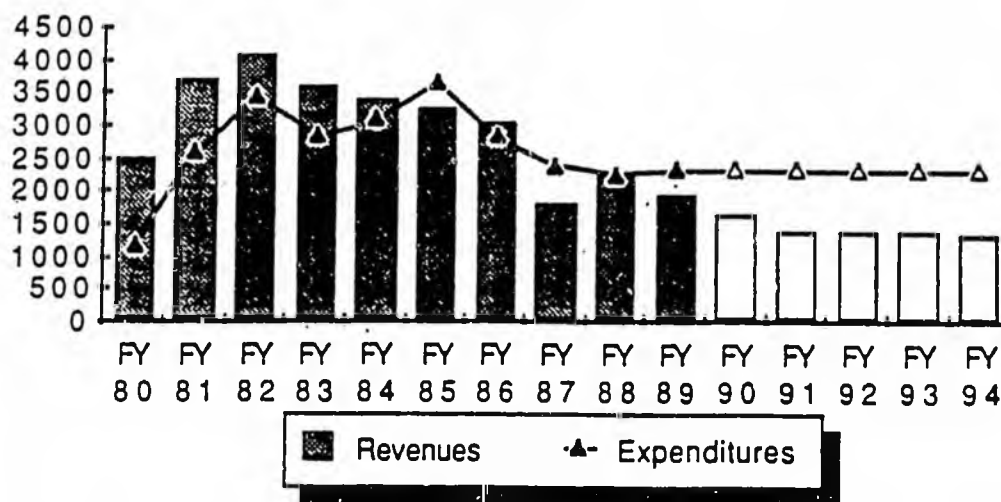


Source: Department of Revenue

As illustrated by Figure 4, the state is confronted by a substantial "gap" between projected state revenues and the level of revenue that would be required to maintain the state budget at current (FY 89) levels.

Figure 4

REVENUES AND EXPENDITURES
Unrestricted General Funds
Fiscal Year 1980 - 1994
(millions \$)



Source: Department of Revenue and Legislative Finance Division

POSSIBLE SOLUTIONS

REDUCE SPENDING

Two major approaches to reduce spending have been suggested:

- Reduce all spending (or categories of spending) by a set percentage (across-the-board cuts); and
- Reduce individual programs based on objective and subjective criteria.

The Subcommittee suggests the following framework for consideration of budget reductions:

- Evaluate policy issues;
- Identify essential state functions;
- Improve efficiencies of service delivery and administration (consolidation, reorganization);
- Make cuts fairly with respect to regions of the state; and
- Minimize adverse impacts on the Alaska economy.

Criteria for evaluation of individual programs in the Finance Subcommittee process:

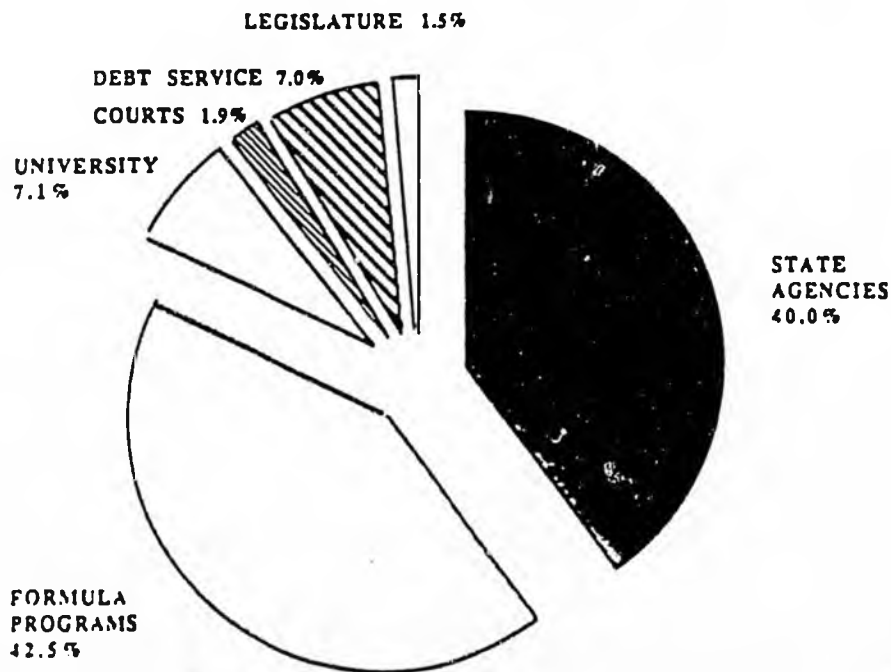
- Law:
 - Constitution
 - Statutes
 - Court order or settlement (e.g., Cleary decision)
 - Federal requirements
- Tradition:
 - Life, health, safety
 - Existed prior to statehood
 - Existed prior to FY80 (oil revenue spike)
- Appropriate level of responsibility:
 - Federal/state/local/private
 - Individual initiative v. government action
- Cost/benefit:
 - Consequences of discontinuation or reduction
 - Who is affected?
 - Ability to be self-sustaining through user fees

- Ability to generate surplus income
- Administrative overhead burden
- Administrative/organizational characteristics:
 - Candidate for consolidation/reorganization due to:
 - Overlapping responsibilities
 - Duplication of effort
 - Organizational misfit
 - Decline in demand for services

Spending Analysis

The following graphic illustrations provide a variety of perspectives on state spending.

Figure 5
GENERAL FUND OPERATING BUDGET CATEGORIES
 Fiscal Year 1989
 (\$2,129.7 million)

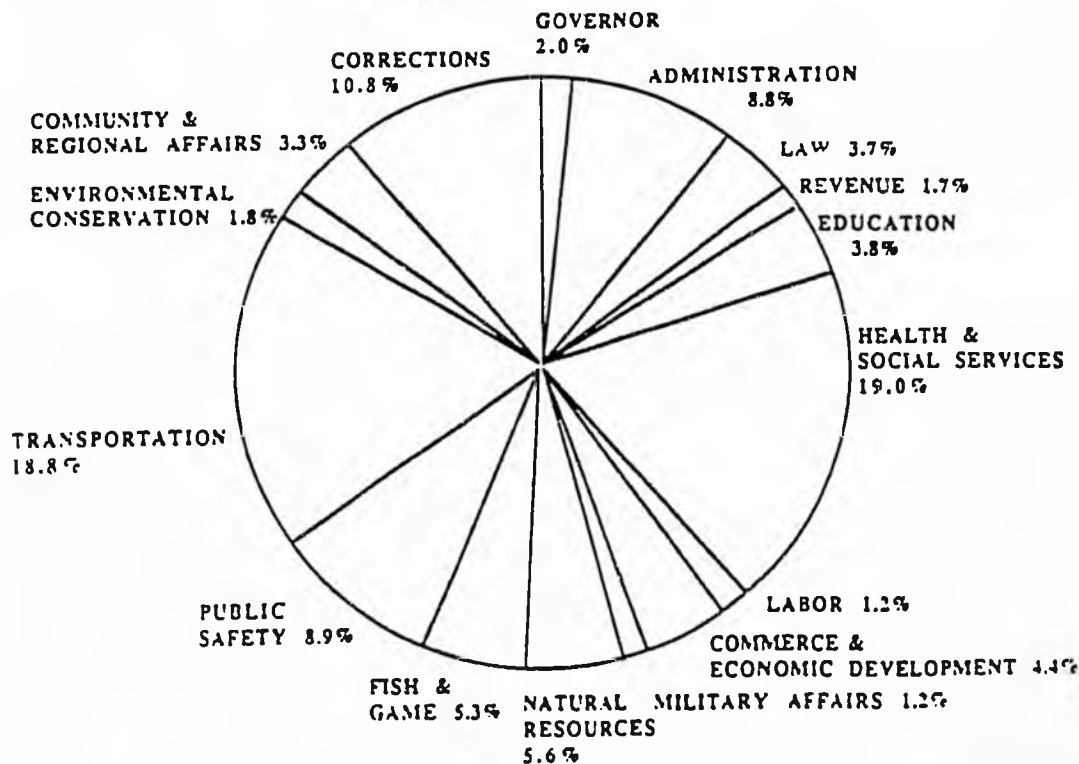


Source: Legislative Finance Division

As shown by Figure 5, about 58% of FY1989 general fund operating budget appropriations went to support executive operations, the legislature, court system, university and debt service. About 42% of the budget was used to pay for formula-funded grants, direct benefit payments and other "pass through" programs (eg, payments to school districts, Longevity Bonus, low income assistance programs, Municipal Assistance and Revenue Sharing).

As shown by Figure 6, state agency expenditures for executive operations in FY 89 totaled \$854.8 million.

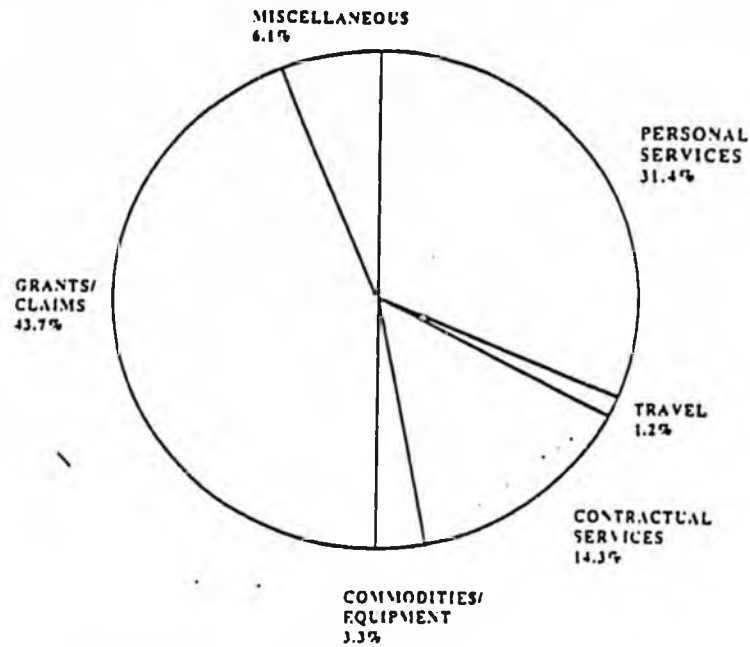
Figure 6
EXPENDITURES FOR EXECUTIVE OPERATIONS
 Fiscal Year 1989
 (\$854.8 million)



Source: Legislative Finance Division

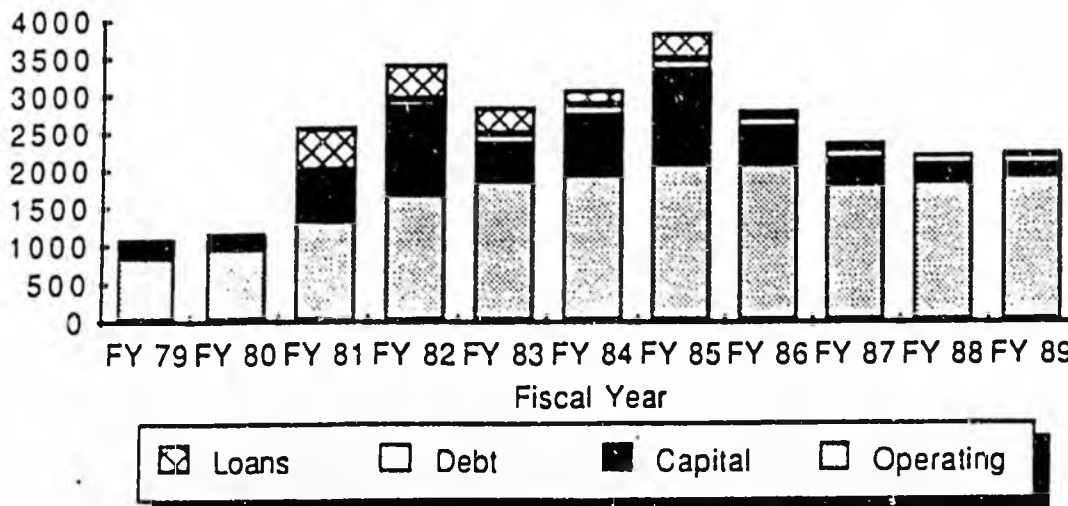
Figure 7 breaks down total FY 89 operating expenditures by line item.

Figure 7
OPERATING BUDGET EXPENDITURES BY LINE ITEM
 Fiscal Year 89 - Total Funds



Source: Legislative Finance Division

Figure 8
STATE GENERAL FUND APPROPRIATION HISTORY
 Fiscal Year 1979 - 1989
 (millions \$)



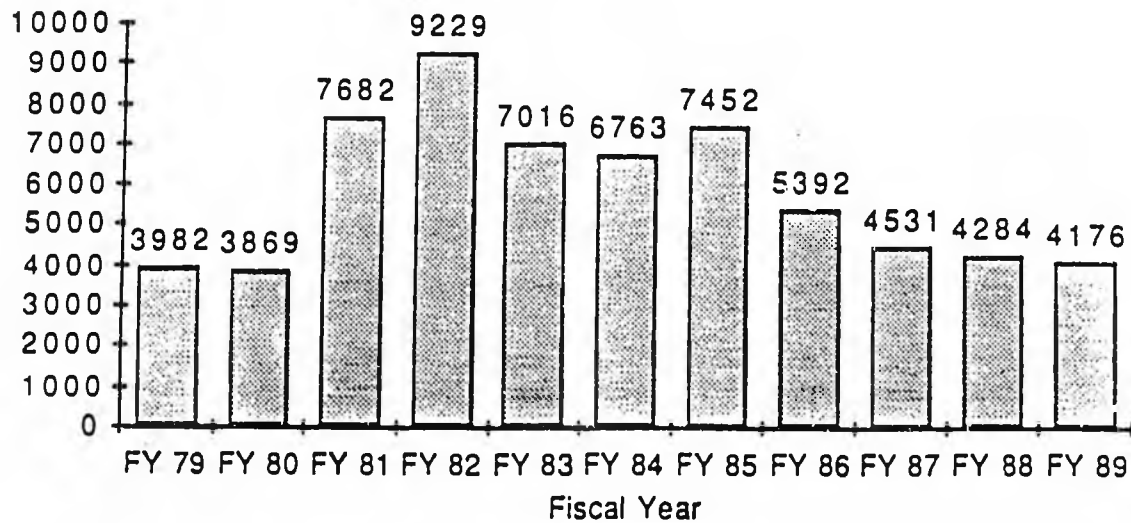
Source: Office of Management and Budget

As shown by Figure 8, state spending over the past decade grew rapidly during the early 1980's with the availability of surplus petroleum revenues. Following the collapse of oil prices in 1986, general fund appropriations have since fallen back to a level below FY 81.

When measured in real (ie, inflation-adjusted) terms on a per capita basis, as shown in Figure 9, the current state spending level is once again close to the FY 79 level.

Figure 9

REAL PER CAPITA GENERAL FUND APPROPRIATIONS
Fiscal Year 1979 - 1989
(1989 \$)



Source: Legislative Finance Division

Potential Spending Cut Scenarios

Subcommittee members developed hypothetical scenarios for budget reductions of \$100 million, \$175 million, \$300 million and \$822 million, relative to the Governor's FY 90 proposal.

The \$100 million scenario proposed 5% across-the-board reductions in the major entitlement programs, with the remainder of the reduction in "non-essential" programs and personal services.

The \$175 million scenario proposed selective reductions in state agencies, legislature, university, court system and entitlements.

The \$300 million scenario proposed a roll back in non-formula programs to the FY88 level, added an increase for new facilities, and made a further cut of 12.5% in state agencies and entitlements.

The \$822 million scenario would completely eliminate many "non-essential" programs, and in addition would reduce state agencies by 30-40%.

In addition, the Subcommittee also considered major reductions in support for local governments (municipal assistance/revenue sharing). A 20% cut would reduce local government support by \$19.3 million; a 50% cut would reduce it by \$48.4 million.

INCREASE REVENUE

Considerations for analyzing the state's revenue system include its

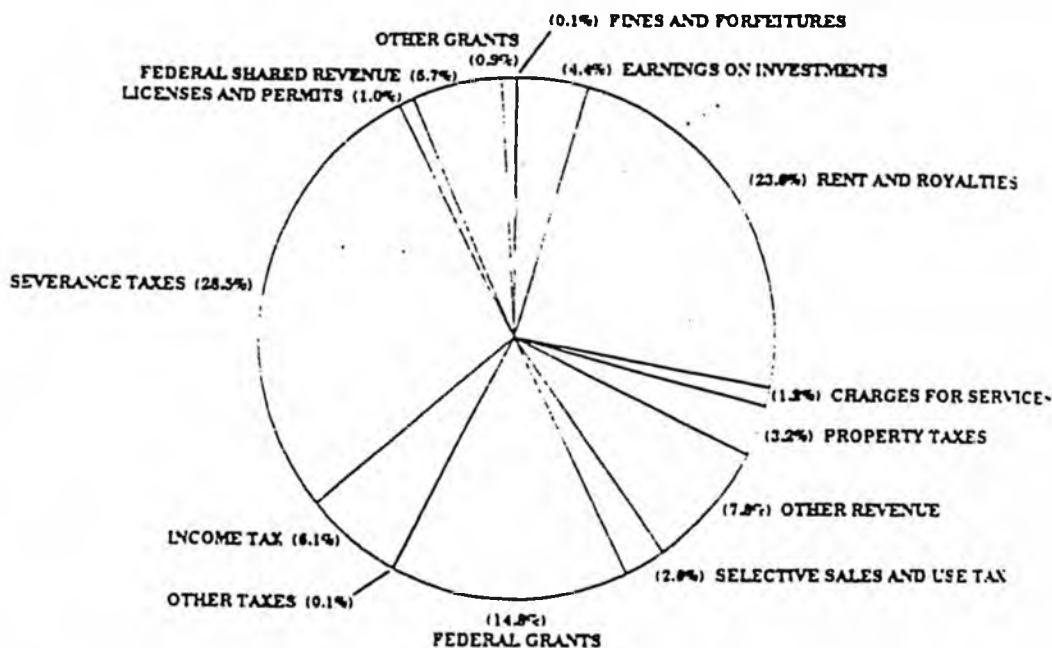
- Sufficiency
- Diversity
- Fairness
- Adequacy for local governments

- Reliability
- Ease of Administration.

Revenue Analysis

Figure 10 shows the sources of state revenue.

Figure 10
REVENUE SOURCES BY TYPE
Fiscal Year 1989



Source: Legislative Finance Division

Potential New Revenue Sources

The Subcommittee has gathered information on a variety of suggestions for raising new revenue. Most of the proposals have not been introduced as legislation, but are being discussed as general concepts. Amounts shown for tax proposals are estimates of the

annual revenue that could be generated. Reserve amounts shown indicate current account balances.

• Taxes

ELF \$100 million (eff. date 7/1/89)

The proposal in HB 118 would lower the severance tax on marginal fields and increase it on the Prudhoe Bay and Kuparuk fields.

Personal Income Tax: \$100 million (first year)

Under one proposal put forward to the subcommittee, tax rates would be 3.2% and 5.7%, with lower effective rates for residents due to exemptions and credits. Lower income people would pay less due to the progressive rate structure. Under certain structures, up to 30% of revenue generated could come from non-residents.

State Sales Tax: \$ 49 million

Under one proposal, the tax rate would be 1% and would be in addition to any sales tax levied at the local level. No exemption for food, medicine, or utilities; no credit for local sales tax.

School Tax \$ 10 million

Under one proposal, the tax would be \$50 annually per member of the work force regardless of residency, with a credit of up to \$50 for local school taxes paid. Non-residents would contribute about 30% of the estimated revenues.

Motor Fuel Tax \$ 34 million

There is a proposal to double the current motor fuel tax of eight cents per gallon; the six cents per gallon exemption for off-road use would continue.

Tobacco Tax \$ 4.3 million

The proposal in HB 80 increases the levy from 5.5 mills per cigarette to 10 mills per cigarette.

• User Fees/Program Receipts \$5-50 million

Fees for state services could be instituted or increased to directly charge all or part of the cost of the service to the beneficiary or user.

• Reserves

The state has no money held specifically as a reserve for operating purposes.

Budget Reserve Fund \$000

Created in 1985 from the Rainy Day Fund and oil tax settlement money. The balance of \$432 million was appropriated in FY 88.

• Other Funds

Railbelt Energy Fund \$234 million

Originally established to fund energy projects.

Permanent Fund Earnings Reserve \$601 million

Earnings in excess of the amounts needed to date for dividends and inflation-proofing.

• Litigation Revenue and Uncollected Oil and Gas Taxes

The timing of receipt of any litigation or settlement monies is uncertain. Major cases pending include:

Amerada Hess unknown

Dispute with producers over the value of the state's royalty share of North Slope oil production. Lawsuit pending in State Superior Court. Some of the proceeds are constitutionally dedicated to the Permanent Fund.

Dinkum Sands \$930 million (in escrow)

Dispute with federal government over ownership of Beaufort Sea leases. Lawsuit pending in U.S. Supreme Court. Some of the proceeds are constitutionally dedicated to the Permanent Fund.

Oil and Gas Taxes \$1.4 billion (\$2.7B w/ interest)

Disputes with producers over unpaid tax obligations assessed by the Department of Revenue. Under administrative review in the department.

• Permanent Fund Income Stream

Numerous ideas have been suggested for use of the Permanent Fund income stream, including capping the dividend at various levels, designating a percentage of the income for operating expenses, and designating a portion of the stream for an education endowment.

• Other Proposals

Repayments to General Fund from AHFC, AIDEA, etc.

A return on the capital invested in state corporations could be repaid to the General Fund on a regular basis.

Illegal Substances Tax

HB 32 would impose a tax of \$150 per ounce on marijuana by requiring purchase of tax stamps when a transaction occurs. Non-payment of the tax would result in a 100% penalty. Provisions that would extend coverage to other illegal substances are under consideration. This type of tax would, in effect, generate revenues through enforcement efforts.

Alcohol, Fish, Insurance -

Increased or new taxes on alcohol, processed fishery resources, and insurance premiums have been suggested and will be investigated by the Subcommittee.

Observations on Revenue MeasuresELF Change

- progressive
- encourages certain marginal field development
- raises taxes on the oil industry
- increases reliance on petroleum revenue
- may impede development of marginal deposits within Prudhoe Bay and Kuparuk

Income Tax

- is designed to take different percentages of income at different income levels
- can be structured to capture non-resident income currently escaping the state; as much as 30% of the income tax revenues could come from out-of-state workers
- deductible from federal income tax payment
- traditional source of state revenues (Alaska had one from 1959 - 1981; 43 other states have a personal income tax)
- unpopular politically

- removes dollars from disposable income of individuals that otherwise may be spent in the local economy

State Sales Tax

- new revenue source
- does not distinguish on basis of ability to pay
- difficult to administer and enforce
- interferes with municipal revenue source options

State School Tax

- generates more revenue than allocated for school construction in FY 90 budget proposed by the Governor
- affects resident and nonresident workers uniformly; captures income from nonresident workers
- puts a new tax burden on workers
- exempts some workers

Motor Fuel Tax

- easy to understand
- in line with proposals at national level
- makes gasoline more expensive
- raises issue regarding Alaska Railroad fuel

Tobacco Tax

- discourages use, especially among younger people
- makes small contribution to revenue needs

User Fees

- beneficiaries pay cost of service
- increases cost of doing business
- increases administrative burden for agencies

AHFC Funds

- \$1.5 + billion Fund Equity
- \$479.6 million liquidity
- most equity is not liquid
- use may jeopardize State Bond Rating unless carefully done
- potential for bond holders to bring suit

AIDEA Funds

- \$347.7 million Fund Equity
- not all equity is liquid
- some liquid assets in long term treasury bonds
- use may jeopardize State Bond Rating unless carefully done
- potential for bond holders to bring suit

Illegal Substance Tax

- creative revenue source
- added drug enforcement tool
- discourages drug use
- can be misinterpreted as condoning drug use

ECONOMIC IMPACTS OF SPENDING/REVENUE OPTIONS

Several efforts have been made to analyze the economic impacts associated with reducing state expenditures and/or raising new revenues. Three separate reports have been prepared by the University of Alaska, Institute of Social and Economic Research (ISER).

A May 1987 ISER report prepared for the legislature's Joint Special Committee on Tax Policy provided a comparative analysis of the economic effects, as measured in terms of employment and disposable income, of **reimposing personal income taxes; reducing permanent fund dividends; and reducing state spending by an equivalent amount of \$467 million.** The analysis concluded that while reimposition of income taxes or lowering dividends would both reduce the purchasing power of Alaskans and therefore cost the economy jobs and income, reducing dividends would cost the state somewhat more jobs and reduce disposable income more than reimposition of income taxes. The economic impact of reducing state expenditures by \$467 million would vary greatly depending upon the nature of the reductions.

A June 1987 ISER study prepared for the Senate Finance Committee compared the effects of **reducing state employee compensation by \$100 million versus employee layoffs that would accomplish the same level of savings.** The report found that

layoffs would have a significantly larger economic impact than across-the-board compensation reductions.

A January 1989 ISER analysis of regional economic impacts of state budget reductions prepared for the Office of Management and Budget analyzed the **potential effects of a reduction of \$349 million in state appropriations.** In summary, budget reductions of \$349 million would reduce personal disposable income of Alaskans by \$325 million and average annual employment by a total 8,481 (with 4,688 jobs lost in the public sector and 3,793 lost in the private sector). The study also examined the regional effects of reductions.

LONG-RANGE FISCAL PLANS

The Subcommittee reviewed the Governor's proposed 20-year fiscal plan and several other alternative plans.

- Figures 12A and 12B: New Revenues/No Cuts (Governor)
- Figure 13: ELF/Income Tax/Phased Cuts
- Figure 14: FY'90 10% Reduction/Cap Dividend at
\$1000/ELF Retroactive

OBSTACLES TO SOLUTION

The Subcommittee believes decisive action is needed to close the gap between spending and revenues. However, obstacles to resolution remain, including:

- Complexity;
- Legal constraints;
- Time require to implement changes;
- Conflicting political views;
- Inertia/history;
- Preference for delaying unpopular action; and
- Need for information on the effects of budget cuts and taxes.

OBJECTIVES

The Subcommittee will continue its work effort with the following objectives:

- Continue analysis, including the timing and impact, of budget reductions and revenue options.
- Make timely recommendations to House Finance Committee, other House members and Budget Summit.
- Inform community leaders and the public about spending and revenue alternatives.

Public Forums

- Review of fiscal situation
- Discussion of alternatives

Public television -

Public radio

- Lay groundwork for future work

Tax structure study

Public forums

Role of Permanent Fund

Role of state government (what further cuts to make)

Develop 5-, 10- and/or 20-year plans

Figure 12 A GOVERNOR COWPER'S LONG RANGE PLAN

FY 1990 - FY 2010

\$13.60 Per Barrel Scenario *

(\$ Millions - Current Dollars)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
BASE REVENUE:																					
Forecast Unres. G.F. Revenue	1,891	1,389	1,405	1,398	1,387	1,223	1,263	1,268	1,222	1,182	1,148	1,122	1,061	1,041	1,001	984	935	907	879	851	822
EXPENDITURES:																					
Appropriations	(2,310)	(2,310)	(2,310)	(2,310)	(2,319)	(2,380)	(2,410)	(2,460)	(2,510)	(2,560)	(2,610)	(2,660)	(2,710)	(2,760)	(2,810)	(2,860)	(2,910)	(2,960)	(3,010)	(3,060)	(3,110)
ANNUAL BALANCE:	(620)	(921)	(905)	(914)	(943)	(1,037)	(1,117)	(1,192)	(1,288)	(1,378)	(1,461)	(1,538)	(1,629)	(1,719)	(1,809)	(1,898)	(1,978)	(2,053)	(2,131)	(2,209)	(2,288)
OTHER REVENUE:																					
Educ. Fund Rev.											688	722	778	835	894	955	1,018	1,083	1,148	1,218	
ELF	141	114	129	152	157	188	153	148	140	123	94	89	72	58	34	37	29	27	20	25	8
Motor Fuel Tax	34	35	37	38	40	42	44	46	48	50	52	54	57	59	62	65	68	71	74	77	81
Income Tax		104	117	301	362	392	258	298	280	292	308	310	334	348	364	381	398	419	434	454	474
PY Earnings	575	205	180	144	127	107	108	112	121	131	140	147	151	155	159	163	167	172	177	181	186
Sales Tax	48	51	53	55	58	60	63	66	68	72	75	78	82	86	90	94	98	102	107	111	116
ANWR								282	714	772	825	884	948	1,010	1,073	1,138	1,201	1,117	1,168	1,207	1,239
Gas Line						81	181	201	220	239	258	275	270	284	288	282	248	241	235	229	223
Litigation Gains	150	400	300	300	200	200	200														

* FY 90 revenue based on ANS \$13.50 weighted average;
 FY 01 2010 - DOR 11/88 mid case forecast

Figure 12B- GOVERNOR COWPER'S LONG RANGE PLAN (DETAIL)

FY 1990 - FY 2010

\$13.50 Per Barrel Scenario *

(\$ Millions - Current Dollars)

	<u>1990</u>	<u>1991</u>	<u>1992</u>	<u>1993</u>	<u>1994</u>
BASE REVENUE:					
Forecast Unrestr. G.F. Revenue	1,691	1,389	1,405	1,396	1,367
EXPENDITURES:					
Appropriations	(2,310)	(2,310)	(2,310)	(2,310)	(2,310)
ANNUAL BALANCE:	<u>(620)</u>	<u>(921)</u>	<u>(905)</u>	<u>(914)</u>	<u>(943)</u>
OTHER REVENUE:					
Educ. Fund Rev.					
ELF	141	114	129	152	157
Motor Fuel Tax	34	35	37	38	40
Income Tax		104	217	301	352
PF Earnings	575	205	160	144	127
Sales Tax	49	51	53	55	58
ANWR					
Gas Line					
Litigation Gains	150	400	300	300	200

* FY 90 revenue based on ANS \$13.50 weighted average;
FY 91-2010 = DOR 11/88 mid-case forecast

Figure 13

FY 90-94: ELF/Income Tax/Phased Cuts

Sources of Revenue	FY90	FY91	FY 92	FY 93	FY 94	TOTALS
Carry Forward	-12.5	0.0	0.0	2.6	80.3	70.4
UGF Revenues (1)	1,640.9	1,389.0	1,405.5	1,395.8	1,366.8	7,198.0
Other Adjustments (2)	57.8	57.8	57.8	57.8	57.8	289.0
New Program Receipts (3)	20.0	20.0	20.0	20.0	20.0	100.0
Reserves	188.9	118.3	0.0	0.0	0.0	307.2
ELF	115.0	129.0	148.0	172.0	171.0	735.0
Income Tax (4)	104.0	250.0	260.4	271.2	282.5	1,168.0
Sales Tax	0.0	0.0	0.0	0.0	0.0	0.0
Litigation Revenue	50.0	100.0	100.0	100.0	100.0	450.0
TOTAL REVENUE	2,164.1	2,064.1	1,991.7	2,019.4	2,078.3	10,317.6

TOTAL EXPENDITURES	2,164.1	2,064.1	1,989.1	1,939.1	1,914.1	10,070.5
Reduction from previous FY (5)	-150.0	-100.0	-75.0	-50.0	-25.0	-400.0
Reduction %	-6.5%	-4.6%	-3.6%	-2.5%	-1.3%	
Carry Forward/(Deficit) (6)	0.0	0.0	2.6	80.3	164.2	
BALANCE w/o New Revenue (7)	-477.9	-617.3	-525.8	-482.9	-409.2	-2,513.1

(1) FY 90 revenue at \$13.50 price plus the FY 90 production adjustment.

FY 91 estimate and beyond from DOR mid-case scenario (October 1988).

(2) Program receipts estimated at 49.8 and other minor adjustments as budgeted in Governor's FY 90 proposal.

(3) Increased user fees.

(4) FY 90 income tax only partial year; thereafter at 250.0/year adjusted for inflation at 4.15%.

(5) Total FY 89 expenditures at 2314.1 from Consensus Revenue Analysis FY 89/90 Balance Sheet.

(6) No allowance has been made for the annual \$34 million payment to the Ak. Science and Technology

(7) Shows level of reductions required if no new revenues adopted.

Figure 14

10% Reduction/Cap. Dividend at \$1000/ELF Retro

Sources of Revenue					Totals		
	FY90	FY91	FY92	FY93			
Carry Forward	0.0	100.0	150.0	322.3			
UGF Revenue (1)	1,640.9	1,389.0	1,405.0	1,396.0	5,830.9		
Revenue Adj. (pgm. rcpts & other)	57.8	60.0	60.0	60.0	237.8		
Capital Project Cleanup	14.0	0.0	0.0	0.0	14.0		
PF Earnings to GF	0.0	16.1	0.0	0.0	16.1		
PF 1000/50/50 GF portion (2)	0.0	191.0	191.0	197.0	579.0		
ELF (3)	181.0	115.0	148.0	172.0	616.0		
Income Tax	0.0	0.0	0.0	0.0	0.0		
Sales Tax	0.0	0.0	0.0	0.0	0.0		
Litigation Revenue (4)	100.0	150.0	200.0	200.0	650.0		
Railbelt Energy Fund	179.5	57.1	0.0	0.0	236.6		
TOTAL REVENUE	2,173.2	2,078.2	2,154.0	2,347.3			
<hr/>							
TOTAL EXPENDITURES	2,073.2	1,928.1	1,831.7	1,740.1			
Reduction from previous FY	230.4	145.1	96.4	91.6	563.5	Total reduction in dollars	
Yearly Reduction %	10%	7%	5%	5%	24%	Total % red. from Gov's FY90	
Carry Forward/(Deficit) (5)	100.0	150.0	322.3	607.2			

NOTES:

(1) Revenue figures for FY89 & FY90 are from Concensus Revenue Analysis 1/24/89 with FY90 at \$13.50.

FY91 - FY 93 is at DOR mid-case, October 88 forecast.

(2) Dollar amounts represent 1000/50/50 Plan. Dividend capped at \$1000 after FY90.

(3) ELF Amounts for FY90 represents a 1/1/89 effective date. (preliminary estimate from DOR)

(4) Since litigation revenue is uncertain, it will be spent the following year as carry forward allows.

(5) No allowance has been made for the annual \$34 million payment to the Ak. Science and Technology Endowment as provided in Sec. 189, Ch. 173, SLA 1988.

OTHER: Governor's FY90 Spending Plan has been reduced to \$2303.6 (by \$13.5) to reflect the reduction in the proposed supplemental, HB 154.

SECOND REPORT

of the

HOUSE FINANCE FISCAL POLICY SUBCOMMITTEE

prepared by:

Representative Kay Brown, Chair

Representative C.E. Swackhammer

Representative Steve Rieger

April 3, 1989

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INTRODUCTION

Since the Fiscal Policy Subcommittee's initial report February 7, much discussion has occurred about the state's fiscal condition and circumstances. A consensus is developing within the Legislature that substantial cuts must be made in state General Fund spending in FY 90 and beyond.

The members of the Budget Summit have agreed the proposed FY 90 budget of \$2.3 billion should be reduced by at least \$150 million, and they are to present specific proposals at a meeting the first week in April. A new long-range revenue forecast by the Department of Revenue narrowed the budget gap for FY 90 to approximately \$250 - \$300 million. No consensus has yet developed on new revenue sources or use of reserves to close the remaining gap in FY90.

The fiscal policy issues confronting the state include spending and revenue options that must be decided in the context of the FY 90 budget, as well as long-term implications that require further review and analysis. This report summarizes spending and revenue measures under consideration, including options with long-term fiscal impact, and makes recommendations for addressing the state's

fiscal situation. In addition, this report includes a review of the status of the public information process initiated by the House Finance Fiscal Policy Subcommittee during the first three months of this year.

RECOMMENDATIONS:

The House Finance Fiscal Policy Subcommittee recommends:

Long-term Budget Approach:

Spending should be reduced by approximately \$400 million over the next four years in order to arrive at a more sustainable annual budget of about \$1.9 billion. In addition to required spending reductions, revenues should be increased by approximately \$300-500 million so that recurring revenues are sufficient to fund the budget.

Spending:

- Make reductions of approximately \$200 million in the Governor's FY 90 budget.
- Evaluate state employee compensation and reduce health benefit costs (HCR 24).
- Study government reorganization and/or privatization:
Alaska Housing Finance Corporation, Agricultural Revolving

Loan Fund, Alaska Industrial Development and Export Authority, Post Secondary Education Commission, Oil and Gas Conservation Commission, Data Processing, Matanuska Maid Dairy, Alaska Railroad, and other state-run operations.

- Revise the funding mechanism for school debt reimbursement to local governments so that the cost to the state declines over time (HB 37).
- Restructure pass-through programs, including longevity bonus and power cost equalization, so that program costs decline over time.

Revenue:

- Rely on litigation or settlement revenue only to the extent that realistic estimates of timing and amount can be obtained.
- Pass ELF revision (CS HB 118 Resources) Note: the Subcommittee supports this recommendation 2-1.
- Pass tobacco and alcohol tax increases (HB 80 and HB 246).

- Increase user fees (HB 85).
- Reinstitute school tax (HB 215).
- Study equality of resource taxation: fish, timber, coal and other minerals.
- Study personal income tax.

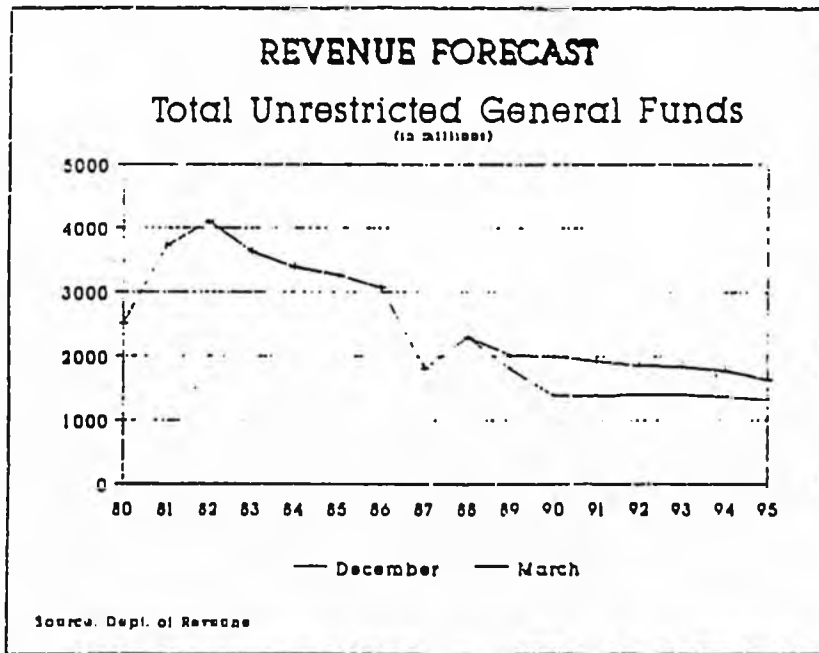
Other fiscal issues:

- Establish requirement for long-range budget/revenue plan (HB 87).
- Permanent Fund:
 - * Establish priority of inflation-proofing over dividends (HB 249).
 - * Study use of permanent fund earnings.
- Address need for budget reserve.
- Use Railbelt Energy Fund for railbelt-area projects in FY 90 and 91.

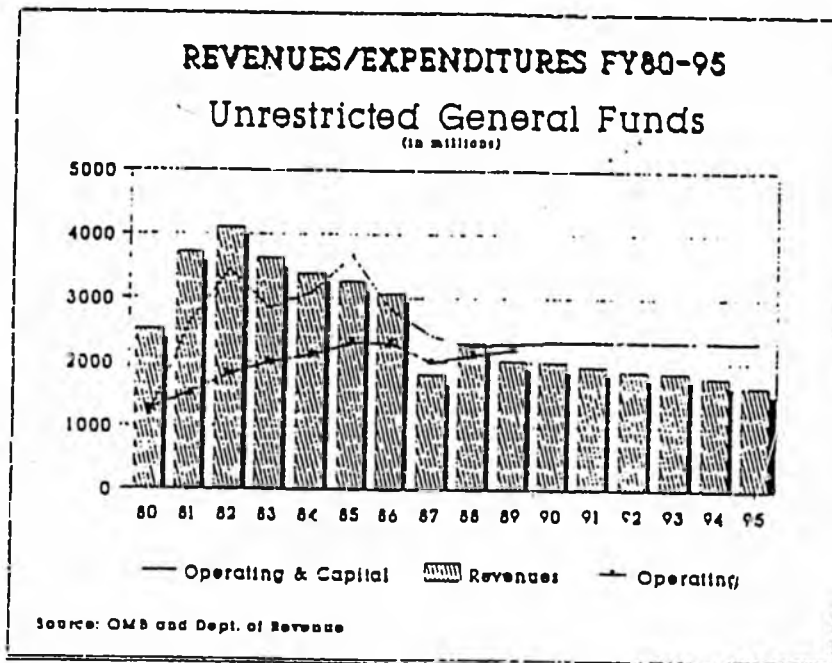
REVENUE FORECAST

The Department of Revenue long-range revenue forecast issued on March 31, 1989 indicates continued stability in world oil prices with Alaska North Slope (ANS) crude selling in the range of \$12 to \$19 per barrel for FY 90. Using the mid-case forecast (ANS average lower 48 price of \$15.66 per barrel), total FY 90 unrestricted general fund revenues would exceed the February Summit consensus forecast by about \$200 million.

The following graph shows the difference between the Department of Revenue long-range forecasts for December and March:



The revised revenue forecast narrows the budget gap to approximately \$250 to \$300 million in FY 90. The following graph shows current projected revenues and expenditures using the Department of Revenue forecast of March 31, 1989 and the Governor's Office of Budget Review long-term budget projections.



OPTIONS FOR CLOSING THE REMAINING BUDGET GAP

Necessity for immediate reductions:

Although the gap is smaller, reductions in spending, as well as additional sources of funding, are required to balance the budget in FY 90 and beyond. While petroleum revenues have stabilized at least temporarily at a higher level, expected revenues will not fund existing government operations. The state has no cash reserves set aside to help offset projected budget deficits or to respond to changes in the price of oil. The state cannot rely indefinitely on the use of other reserves to cover the gap between spending and income.

The long-term implications of continuing reductions:

Continued reductions in spending in future years will require substantial structural changes to state government programs. Some operations cannot be reduced significantly because of 24-hour staffing requirements, other functional characteristics, or because they are essential to protect public health and safety. Shutdown of whole components or facilities may be necessary in the future.

SPENDING OPTIONS

House Finance Committee FY 90 Budget Balancing Approach:

1. Total General Fund reduction target: \$150-200 million from Governor's FY 90 proposed budget.
2. FY 90 proposed transfers, increases, decreases analyzed by subcommittees.
3. Reduction/elimination and increase priorities recommended by subcommittees to full committee.
4. Increases for all agencies prioritized by subcommittee chairs.
5. Facilities operations reviewed by special subcommittee.
6. Discussion of selected pass-through and other programs by Majority and Minority Caucuses.
7. Personal services percentage reduction applied by full committee to agencies and pass-throughs.
8. Adoption of budget by full Finance Committee.

The Co-Chairmen of the House Finance Committee have provided the following guidance for Subcommittee Chairs:

- Total General Fund reduction target: \$150-200 million from Governor's FY 90 proposed budget (Summit agreed at least \$150 million for FY 90).
- Personal services will be reduced 5-10% in all agencies by the full Finance Committee, and equivalent reductions will be made in pass-throughs to municipalities, school districts and non-profits.
- Analyze proposed FY 90 transfers, increases and decreases for:
 - acceptability of proposed transfers,
 - possibility for modification of proposed change,
 - possibility for rejection of proposed change.
- Determine whether high priority increases can be funded by deleting lower priority items from the base.
- Prioritize agency programs within the FY 89 base budget and identify whole programs or sub-programs that are least valuable to the public and could be recommended for reduction or deletion.
- Prioritize items for inclusion which are above FY 89 base level.

-- Review the following programs for discussion within the House Majority and Minority Caucuses:

Longevity bonus

Senior citizens and veterans tax exemptions

Municipal assistance

Revenue sharing

Shared taxes

School debt retirement

Education operation

Pupil transportation

Facilities (referred to special subcommittee)

and additional miscellaneous agency pass-

through programs in the Departments of

Administration, Education, Labor, Commerce,

Military and Veterans Affairs, Natural

Resources, Public Safety, Transportation, and

Community and Regional Affairs.

Public Employee compensation and benefits:

Employee compensation and benefits have been identified as a key factor that must be evaluated in budget reductions. The legislature has passed SCR 23 which establishes a Health Care Cost Containment Task Force to study state statutes, practices of health insurers, and to determine ways of

reducing state and local government employee health insurance costs. The following proposals are under consideration:

HCR 24 - Establishes a personal services cost containment task force to study state statutes and practices and to determine ways of reducing costs of personal services.

HB 241 - Reduces the salaries of state employees who are not members of collective bargaining units; freezes judicial salaries.

Formula funded programs:

Programs funded using mathematical formulas have been identified as an element of the budget that should be examined.

HB 242 - Allows agencies administering benefit payment programs to make reductions on a pro rata basis to equitably distribute money available if sufficient funds are not available for full payment.

General obligation debt:

General obligation debt has been cited as another area of concern in the budget reduction process. The need for funding to pay general obligation debt will decline in future years if no additional debt is incurred. If new debt is incurred in amounts in excess of annual debt reduction, additional

revenue will have to be raised to cover it. The following table shows the amount of funding available as a result of reduction of general obligation debt over the next five years:

GENERAL OBLIGATION DEBT

Fiscal Year 89-95

FISCAL YEAR	ANNUAL PAYMENT	FUNDING AVAILABLE
89	135.512	
90	120.306	15.206
91	95.483	24.823
92	68.201	27.282
93	59.688	8.513
94	33.930	25.758
95	23.084	10.846

(000's)

Source: FY 88 State Annual Report

REVENUE OPTIONS

A number of revenue possibilities are under consideration and are discussed below.

Increase existing revenues:

Alcohol

Tobacco

User fees

Petroleum

New revenue sources:

School tax

Personal income tax.

Reserves:

Budget Reserve

Railbelt Energy Fund

Permanent Fund Earnings Reserve

Other:

Alaska Housing Finance Corporation (AHFC)

Alaska Industrial Development & Export Authority (AIDEA)

Litigation and settlement funds

Privatization of state-run operations