

Charting Alaska's Fiscal Future

"Alaska's elected policy makers must do something about our fiscal situation. Nothing lives long on borrowed time, and our budget has borrowed from our savings account for too long. We have, essentially, one more budget cycle before our savings account is used up, and we are forced to take severe corrective action. I believe the best solution is a more planned approach tempering controlled budget reductions with additional revenue. I am committed to bringing together both majority and minority members and the philosophical factions within each caucus to reach a balanced solution. The ultimate resolution of our fiscal problems will necessitate some degree of compromise from everyone. No one will be totally happy with the solution, whatever it is, but the consequences of not doing what needs to be done are unacceptable. I remain cautiously optimistic we will find the courage and fortitude to implement the necessary fiscal plan. There is no more important task before us for the present and future of our state."



Rep. Mike Hawker
Co-Chair, House Special Committee on Ways and Means

The Republican-led Majority took important steps this session to alleviate the threat of impending fiscal disaster with the creation of the House Special Committee on Ways and Means. We believe it is urgent to bring state spending and revenue into balance in order to continue providing essential state services and to protect the state's economic stability. The Special Committee on Ways and Means was charged with a vital mission: To consider methods to control state spending and identify ways to make state programs more efficient while proposing new revenue raising measures for the state. Although they convened for only the last two months of the session, they passed out of committee proposals to constitutionally limit state spending (HJR 9) and to change the Permanent Fund to an endowment style management (HJR 26). They introduced a state sales and use tax that requires more work in the next session, and, most importantly, they developed the conceptual components for a long-range fiscal policy that will form the basis for the committee's continued efforts.

Background on Alaska's Finances

Although 80% of the state's unrestricted revenues are from oil, this revenue is declining due to a decrease in production at Prudhoe Bay that has not been balanced by increased production in other fields. Because our state government spending has exceeded our revenue by several hundred million for 10 of the last 12 years, previous Legislatures have covered the deficit by withdrawing money from the CBR. Only \$2 billion remain in the CBR, which will last at the most optimistic estimate only until FY '06, depending on the price of oil.

The options for balancing the state's budget are limited to a combination of budget reductions, economic development, business or excise taxes, user fees, Permanent Fund earnings, and sales or income taxes. Budget cuts alone won't solve the problem because small cuts won't approach what is needed and large cuts will compromise or eliminate essential state services. The Institute of Social and Economic Research at the University of Alaska estimates that every \$1 million in state budget cuts will cost \$900,000 in federal funds, 10 state and local government jobs, and eight private sector jobs. Non-oil economic development won't close the budget gap either because Alaska's other resource industries are small and contribute less than 10% percent annually of what oil revenue contributes to the state.

Alaska's fiscal problems are confounded by what is called the "Alaska Disconnect," whereby new jobs cost state and local governments more than they generate in tax revenues. Any long-term solution to Alaska's fiscal situation must incorporate sustainable methods to reduce the drain on the state of new job creation.

The Components of a Long-Range Fiscal Policy

Representatives Jim Whitaker and Mike Hawker, Co-Chairs of the House Special Committee on Ways and Means, published a five-point long-range fiscal plan that set forth a vision for fiscal responsibility:

I. Managing the Cost and Growth of Public Services

Ways and Means Committee worked on and passed out **HJR 9**, a resolution supporting a constitutional spending limit. This is important component of the plan will serve to assure the general public that if they are asked to contribute revenue to the state that it won't be spent frivolously by the Legislature. Although HJR 9 did not pass the Legislature this session, it will continue to be worked on in the next session and hopefully passed in time to be placed before the people of Alaska in the 2004 election.

Additional components to managing the cost and growth of public services are finding reductions in non-essential programs, containing formula growth, outsourcing to the private sector, and reducing statewide administration costs. Department reductions and consolidations can be found in the "Departmental Highlights" of the Operating Budget Section in this book. The House passed several bills this session that also support the goal of managing the cost and growth of state services:

- **HB 154** prohibits districts from constructing curriculums that offer two years of kindergarten as a standard program.
- **HB 171** discontinues the state start-up grants for charter schools beginning FY'05 to be replaced by increased federal funds.
- **HB 165** repeals the grant program to provide assistance to local communities in the initial development, implementation, and operations of community school programs.
- **HB 215** amends the one-percent for art provision of the Art in Public Places program .

II. Managing the Permanent Fund to Protect its Real Value Over Time While Providing a Substantial Individual Dividend and a Contribution to the Cost of Public Services

The Ways and Means committee passed out **HJR 26**, which, if passed by the Legislature next session and accepted by the voters of Alaska in 2004, will change the Permanent Fund to an endowment style management, otherwise known as the Percent of Market Value (POMV) approach. With a POMV approach, the entire Fund will be constitutionally inflation-proofed; the amount available to appropriate will be limited to real income over time; there is greater stability during volatile markets; it is compatible with a long-term investment strategy of achieving a five-percent real rate of return over time; and annual appropriations will be predictable.

The Ways and Means Committee also worked on but has not yet passed companion legislation that would determine what percentage of the five-percent spending limit should be distributed to dividends and for government services. Currently, data indicates that the best way to both cover the cost of government services and pay a substantial, predictable dividend, without going into deficit spending, is to spend 60% on government services and 40% on dividends. This will continue to receive hearings and move through the committee process in the second session.

III. Structuring a General Revenue System

A structured general revenue system may incorporate revenue from many sources, including excise taxes on alcohol, tobacco, motor fuels and rental vehicles; user fees and program receipts; licenses and permits; public corporation dividends; insurance premium fees; seafood industry taxes and fees; gaming; broad based taxes on income and consumption; and hydrocarbon revenues. In developing such a system, the Ways and Means committee aims to minimize the need for broad based taxation of individuals and to accommodate local governments' tax structures. The committee introduced a bill to levy a sales and use tax that would have raised approximately \$300 million, but it did not have enough support from either body. This and other revenue generating proposals will continue to be worked on through the interim and in the second session.

The House passed important legislation to begin movement on the process of structuring a responsible revenue system:

- **HB 11** returns the percentage of all oil royalty payments to the constitutionally mandated 25-percent and re-directs the additional 25-percent from newer oil fields to the General Fund to reduce our draw from the CBR to balance our state budget.
- **HB 162** increases the fee for a business license.
- **HB 170** equalizes registration fees between pick-up trucks and passenger vehicles.
- **HB 203** stabilizes the AIDEA dividends paid to the General Fund and creates a dividend formula from AIDEA that will provide a \$9-18 million dividend to the state in FY'04.
- **HB 256** maintains the amount of transfer funds from the AHFC at \$103 million for FY'04 through FY'06 and creates a percentage arrangement for the years following.
- **HB 271** helps share the cost of tourism marketing and road maintenance with the visitors who benefit from state contributions by levying a 10-percent sales tax on rental passenger vehicles and a three-percent sales tax on the rental of recreational vehicles.
- **SB 168** more adequately regulates the collection of taxes on cigarettes by affixing a stamp on legally acquired cigarettes. This could result in \$3-20 million in revenue that is currently being lost.

IV. Real Economic Growth

A key element to a sustainable long-range fiscal policy is real economic growth. While encouraging increased exploration of our oil and gas resources is vital to the state's fiscal future, we are also exploring ways to revitalize our other traditional industries of fishing, mining, timber and tourism, while creating and strengthening newer industries. Technology, hydrocarbon, finance, and manufacturing will all play a pivotal role in Alaska's financial future, and we are investigating ways to support these emerging industries.

V. A Balanced Budget Requirement Incorporating a Mechanism to Mitigate the Consequences of Oil Price Volatility on the General Revenue System

In order to mitigate the uncertain consequences of oil price volatility each year, the House Special Committee on Ways and Means has recommended that we maintain a one-year cash reserve approximately equal to the annual General Fund appropriation. They have also suggested a revolving "credit line" concept to which we would repay draws before reducing general revenue system income. In addition, they propose that we should reduce the general revenue system income when our reserves are adequate.

Successful Legislation

House Bill 11: Deposits to the Permanent Fund

Sponsor: Rep. Rokeberg

HB 11 returns the percentage of all mineral lease, royalty, and sale revenues deposited into the Permanent Fund to the constitutionally mandated 25-percent. In 1980, the Legislature decided to deposit 50-percent of those revenues into the fund and has continued to do so; however, the State Constitution requires only 25-percent. Prudhoe Bay currently contributes 25-percent of its oil revenues to the Permanent Fund, while the Alpine and North Star oil fields contribute 50-percent of their revenues to the Permanent Fund. By changing the contribution rate of all fields to 25-percent and directing the remaining funds to the General Fund, Alpine and North Star contributions to the General Fund will replace the declining revenues from Prudhoe Bay. HB 11 will generate an estimated \$42.9 million (average) per year over the next seven years, and \$59.7 million in FY 2004 at an estimate \$25.28 per barrel average. Meanwhile, the decision will not withdraw funds from the Permanent Fund. The Fund will continue to grow.

Passed the House and Senate

House Bill 154: Under School Age Students

Sponsor: Governor

HB 154 removes a school district's ability to offer early entry as standard practice to access the foundation formula and provide state funded pre-school programs. HB 154 prohibits districts from constructing curriculums that offer two years of kindergarten as a standard program.

Passed the House and Senate

House Bill 162: Increase Business License Fee

Sponsor: Governor

HB 162 increases the fee for a business license.

Passed the House and Senate

House Bill 165: Community Schools

Sponsor: Governor

HB 165 repeals the grant program to provide assistance to local communities in the initial development, implementation, and operations of community school programs. All school districts currently offer a community schools program.

Passed the House and Senate

House Bill 170: Motor Vehicle Registration Fees

Sponsor: Governor

HB 170 equalizes registration fees between pick-up trucks and passenger vehicles, adjusts commercial and private vehicle registration fees, and updates vehicle recording and lien fees.

Passed the House and Senate

House Bill 171: Repeal Charter School Grants

Sponsor: Governor

HB 171 discontinues the state start-up grants for charter schools.

Passed the House and Senate

House Bill 174: Correspondence Study

Sponsor: Governor

HB 174 extends the life of the Alyeska Central School for one year to allow the students and teachers to transition into other school programs. This bill also eliminates the Alyeska Central School's summer program in summer 2003, which will save \$1.2 million.

Passed the House and Senate

House Bill 203: Definition of Income to AIDEA

Sponsor: Rep. Hawker

HB 203 clarifies the definition of income that is subject to dividends to the General Fund from the Alaska Industry Development and Export Authority. AIDEA has \$789 million in unrestricted net assets and \$356 million of unrestricted cash and investments from which a dividend could be paid. The dividend formula proposed by HB 203 will provide a \$9-18 million dividend for Fiscal Year 2004.

Passed the House and Senate

House Bill 215: Repeal One Percent for Art

Sponsor: Rep. Stoltze

HB 215 amends the one percent for art provision of the Art in Public Places program. It requires one-percent of the first \$10 million of construction costs paid for with state funds be used for art; for the amount above \$10 million, the percentage is reduced to one-half a percent. The bill maintains the one-percent for rural areas.

Passed the House

House Bill 256: Dividend Payment to State by AHFC

Sponsor: House Finance Committee

HB 256 amends and codifies the agreement between the Alaska Housing Finance Corporation and the Legislature calling for the transfer of AHFC's net income to the State General Fund in the form of an annual dividend that funds debt service for certain bonds and capital projects. HB 256 maintains the amount of transfer funds from the Alaska Housing Finance Corporation at \$103 million a year for Fiscal Years 2003 through 2006. HB 256 protects AHFC's bond ratings by giving certainty to the fund. Beginning in FY 2007, a set percentage of the corporation's net income will transfer to the General Fund. In FY 2007, 95-percent of AHFC's net earnings will go to the General Fund. By FY 2009, and in the fiscal years to follow, 75-percent of the net earnings will go to the fund. The percentage arrangement will resemble the plans currently followed by the Alaska Industrial Development and Export Authority and the Alaska Student Loan Corporation.

Passed the House and Senate

House Bill 271: Passenger Vehicle Rental Tax

Sponsor: Rep. Kott

HB 271 levies a 10-percent sales tax on rental passenger vehicles and a three-percent sales tax on the rental of recreational vehicles.

Passed the House and Senate

Senate Bill 168: Cigarette Sale/Distribution

Sponsor: Senate Labor and Commerce Committee

SB 168 more adequately regulates the collection of taxes on cigarettes by affixing a stamp on legally acquired cigarettes. There is an unknown quantity of untaxed cigarettes imported into the state of Alaska every year and existing laws make it difficult to track their numbers. All cigarette purchasers should be paying tax equally, whether purchasing them over the counter or over the Internet. It is estimated that this could bring between \$3-20 million dollars in revenue that is currently being lost through circumnavigation.

Passed the House and Senate