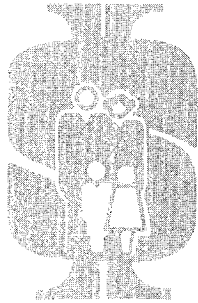


ACTION PAPER

RESOURCE
REVENUES
AND
STATE SPENDING
**ALASKA'S
GOLDEN
OPPORTUNITY**



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**RESOURCE REVENUES
AND
STATE SPENDING**

A REPORT BY
COMMONWEALTH NORTH

Prepared by the Resource Income Committee

December 1980

ALASKA'S GOLDEN OPPORTUNITY

A Commonwealth North Report

First printing....December 1980

935 West Third Avenue
Anchorage, AK 99501

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THE COMMONWEALTH NORTH RESOURCE INCOME COMMITTEE

On October 16, 1979, the Board of Directors of Commonwealth North established the Resource Income Committee to study how best to husband and use the state's projected revenues. Bill Sheffield, President of Sheffield Hotels, was named chairman of a team of fifteen including two former Commissioners of Revenue, two former state legislators and the ex-Director of the Office of Management and Budget of the Anchorage Municipality.

For many months the committee met weekly, heard from key legislators, members of the state administration and representatives of the private sector.

In February 1980, five of the committee testified on the Permanent Fund legislation before the legislature. In March, nearly all of the committee travelled to Juneau to meet with members of both the Senate and House Finance Committees.

In April, as the legislature was finalizing its income tax repeal bill, telegrams were sent to the Governor and every legislator calling for outright tax repeal.

After studying the laws passed by the 1980 legislature as well as the state budget for Fiscal Year 1981, the committee spent weeks hammering out the recommendations included in this report.

Those interviewed by the committee included Governor Jay Hammond, Revenue Commissioner Tom Williams, Senate Finance Chairman John Sackett, Senators George Hohman, Bob Mulcahy, Bill Sumner and Ed Dankworth; House Finance Chairman Russ Meekins, and Representatives Oral Freeman, Ernie Haugen and Hugh Malone; Chairman of the Trustees of the Permanent Fund Elmer Rasmuson and Dean Olsen, trustee of the Alaska Renewable Resources Corporation.

This "Action Paper" includes an examination of a wide range of issues. The result is an analysis of the best ways to invest Alaska's resource revenues for the long-term benefit of the state.

The members of the committee are as follows:

William Sheffield, Chairman
Sheffield Hotels

Robert E. Baer
Totem Realty, Inc.

Bertram B. Beneville
Merrill Lynch Pierce
Fenner & Smith

Edith Bullock
Retired Businesswoman
Former Legislator

David Chatfield
Alaska USA Federal
Credit Union

Harry Donahue
Independent Consultant
Former Director Office of
Management and Budget
Municipality of Anchorage

David Heatwole
Anaconda Copper Company

Max Hodel
Alaska Sales and Service

John Mlakar
Denali Fuel Company

Ron L. Rettig
Alaska Mutual Savings Bank
Former State Senator and
Alaska Commissioner of
Revenue

William Scott
Peat Marwick Mitchell

Judge James Singleton
Appellate Court, State of
Alaska

Paul Wilcox
Paul S. Wilcox Law Firm
Former IBEW Legal Counsel

Renee Murray
Scott Wetzel Services, Inc.

Eric Wohlforth
Wohlforth & Flint
Former Alaska Commissioner
of Revenue

FOREWORD

TRANSCENDING A COLONIAL ECONOMY

Historically, Alaska has always been capital short. Poverty in rural areas sometimes is more bitter than in the villages of India. Sewer, water, electricity and transportation systems are frequently either non-existent or primitive. Our cost of living is the highest in the nation.

Ironically, the most northern state in the union has more in common with the "southern" undeveloped nations of the Third World than it does with the contiguous 48 states. Like the developing nations, Alaska's economy is essentially colonial, characterized by a dual dependence on government expenditure and the export of resources largely in their natural state.

We recommend therefore that our resource revenues be used primarily in a coordinated effort to transcend our colonial economy and hasten the day when Alaska can join its more fortunate sister states in the benefits which a broad-based market economy brings.

To realize this goal, a basic infrastructure must be built. Now, for the first time, with Alaska's resource income, this economic backbone can be put in place. The components should include hydro power projects, a transportation system to reach our people and our natural resources, and ports and harbors to better respond to the opportunities available through international trade and Alaska's resource rich coastal shelf.

While each of the individual recommendations which follow can be defended on its own, they should not be viewed in isolation. Rather they should be seen as component parts of a program of progressive development to a mature and integrated private economy.

CONCLUSIONS

The following points summarize the conclusions of this study:

1. Alaska must free itself from its traditional "colonial economy", an economy characterized by its dependence on the federal government and the export of unprocessed natural resources.
2. Resource revenues must be used skillfully to enhance an integrated market economy sustained by private investment, a healthy local industry and worldwide commerce.
3. To avert a false sense of unlimited wealth, the state should immediately develop and publicize a series of projections illustrating anticipated growth in both state revenues and expenditures.
4. A five- to six-year Capital Improvement Plan, updated on an annual basis, is an urgent priority. This plan will contribute to a more coherent use of state revenues and assist legislative judgement as to annual contributions to the Permanent Fund.
5. In order to strengthen Alaska's private sector, tax burdens must be reduced.
6. Further tax reductions will not only help individual Alaskans but should reduce the size of the bureaucracy and the cost of government.

7. Alaska corporations should be exempted from income taxes on the first \$250,000 of taxable income. This action will help over 90 percent of Alaska's businesses.
8. Municipal taxes, such as sales taxes and real property taxes, should be replaced with state revenue but only if such action is coupled with a lid on local government spending.
9. Corporate income tax and business property tax relief will help the consumer. This action will result in better services, stabilized prices, more employment, and improved facilities for all Alaskans.
10. Transportation fuel taxes for highway, marine and air travel will cost Alaskans an estimated \$28,000,000 in fiscal year 1982. These state taxes are not needed and should be repealed.
11. If the tax repeals recommended above are implemented, some \$278 million will remain with the people each year instead of going to government. Although this will help the people immensely, this sum amounts to less than 4 percent of the projected revenues for FY '82.
12. Companies doing business in Alaska should be encouraged to reinvest their profits in the state. Investment tax credits should be established for this purpose.
13. The windfall profit tax paid by the oil companies should be permitted as an allowable deduction in determining state income taxes to eliminate double taxation.

14. The growth of state and local government operating budgets should be limited by law or by constitutional amendment. The best formula ties government expenditures to the annual fluctuation in personal income of the non-governmental work force.
15. Permanent Fund monies should be invested so that the income from and the value of these dollars keeps pace with inflation. The current Permanent Fund legislation should be amended to allow investments in appreciable assets.
16. In order to finance large, self-liquidating projects, such as ports, harbors, and hydroelectric facilities, an Alaska Investment Fund should be established, along the same lines as the Permanent Fund.
17. Projects built with this Investment Fund will provide the infrastructure needed to move Alaska away from its economic dependence on the rest of the nation. They can be used as collateral for revenue bonds if the state finds itself short of cash in the future.
18. The state government should not jump into the banking business. Loan programs are best administered by existing private lending institutions.
19. State loan programs must be divorced from the temptations of political abuse. Strict accountability through independent audit systems must be established.

SECTION I

THE SIZE OF THE SURPLUS

In order to make wise decisions on the best use of Alaska's revenues, it is imperative that accurate projections are made regarding the state's potential income and predicted expenditures.

According to a November 5, 1980 memorandum by the staff of the legislature's Budget and Audit Committee, there will be \$5,927,600,000 available for appropriation by the legislature for FY '82.

General Fund surplus predictions for the year 2000 range as high as \$184 billion. But the actual surplus (or deficit) will depend on the level of inflation and state spending as well as on the investment policies of the state and the market price of oil and gas.

The state should immediately develop a series of projections illustrating anticipated growth in both government revenues and expenses. These projections should be widely publicized in simple, understandable form.

A false sense of unlimited wealth could badly distort the judgement of the Alaskan people.

Recommendation for Action

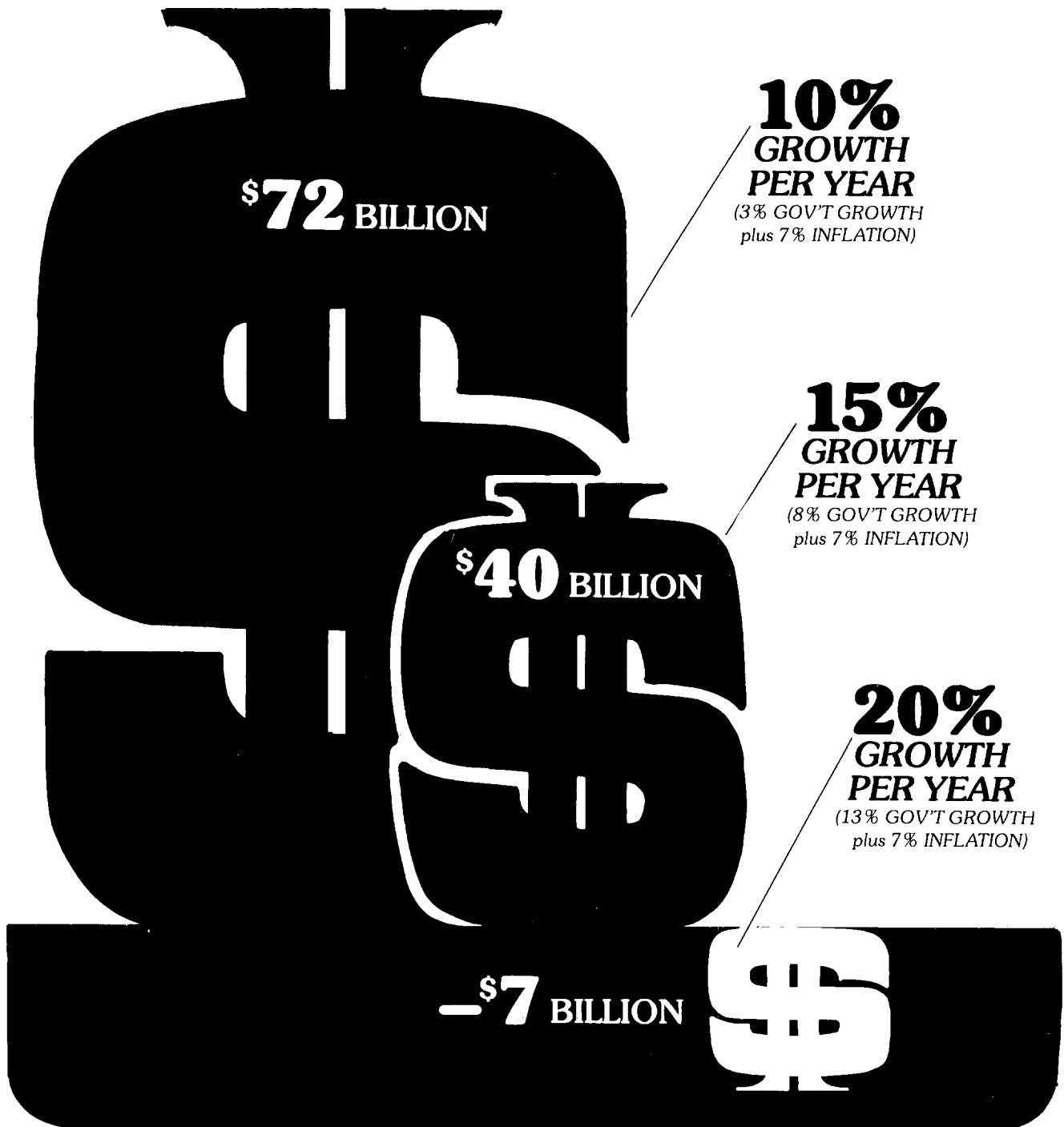
The state should immediately develop a series of projections illustrating anticipated growth in both government revenues and expenses.

Such information is necessary to avert a false sense of unlimited wealth which could badly distort the judgement of the Alaskan people and their leadership and to provide some touchstones for gauging the effect of state spending decisions.

Figure A

1995

Shrinkage of the size of the projected General Fund by 1995 if government growth is not contained.



COMMONWEALTH NORTH CHART

DATA SOURCE: State of Alaska Legislative Working Document Budget Forecasting Model February 20, 1980

Figure A illustrates the devastating impact inflation and government spending could have on Alaska's optimistic revenue projections. The most extreme case charted in the 1980 Legislative Budget Forecast Model was 13 percent real budget growth plus 7 percent inflation, for a total of 20 percent. That rate would place the General Fund \$7 billion in arrears by 1995.

The growth of the operating budget this year alone was 23.9%.

This gloomy prediction based on 20 percent growth, is not unreasonable. The growth in the operating budget alone this year was 23.9 percent.* Capital expenditures jumped 306 percent.

Future income can be projected by several methods advanced by the Department of Revenue and the Budget and Audit Committee. Operating budgets can also be estimated, especially if spending growth is limited by state statute. But, in addition, the state must develop projections for capital improvement budgets. Unless this is done, it will be impossible to manage the state's revenues with a realistic, business-like approach.

Next year, for example, the Governor and the legislature will have about \$5.9 billion of revenue to work with. If \$1.8 billion is placed in the Permanent Fund, as recommended by Representative Oral Freeman, and if the operating budget is in the vicinity of \$2 billion, what will be done with the remaining \$2.1 billion?

*According to the General Operating Budget, expenditures went up 20.7 percent. But when the category "New Legislation" is reviewed, at least \$42 million additional operating expenses can be identified, bringing the total increase to 23.92 percent.

To begin with, the top priority should be large scale capital improvements to upgrade the basic infrastructure of the state.

To implement this, a five- to six-year state Capital Improvement Plan should be prepared and updated on an annual basis. This plan should include municipal improvements that are to be funded, in whole or in part, by state revenues.

When combined with a controlled level of growth in the operating budget, the Capital Improvement Plan will contribute to better-informed decisions regarding the size of contributions to state loan programs and the Permanent Fund.

Recommendation for Action

A five-to six-year state Capital Improvement Plan should be prepared and updated on an annual basis.

Budgets often balloon beyond expectations because maintenance and operating costs are ignored.

Primary consideration should be given to those statewide capital improvements which are the components of the infrastructure necessary to support a multi-faceted economy. Ten and twenty year projections should also be made, similarly updated on an annual basis.

It is imperative that the Capital Improvement Plan include the cost of maintenance and operations of new facilities. Too often future operating budgets balloon beyond expectation because these inevitable on-going costs are ignored.

SECTION II TAX POLICY

There is no better, clearer or faster way to nurture a market economy than to eliminate personal and corporate taxes. No other single action bears more promise for creating a sustainable broadbased economy to complement the extractive industries. If Alaska is truly dedicated to developing a diversified economy, tax relief is the most direct and expeditious route to take.

There is no better way to nurture a market economy than to eliminate taxes.

A. PERSONAL INCOME TAX REPEAL

As a result of the action of the September 1980 special legislative session, income tax repeal will enable the people of Alaska to channel additional disposable income into the economy and savings into investments. It is encouraging to consider what will happen when the thought and energy of the current generation of Alaskans are released in this manner.

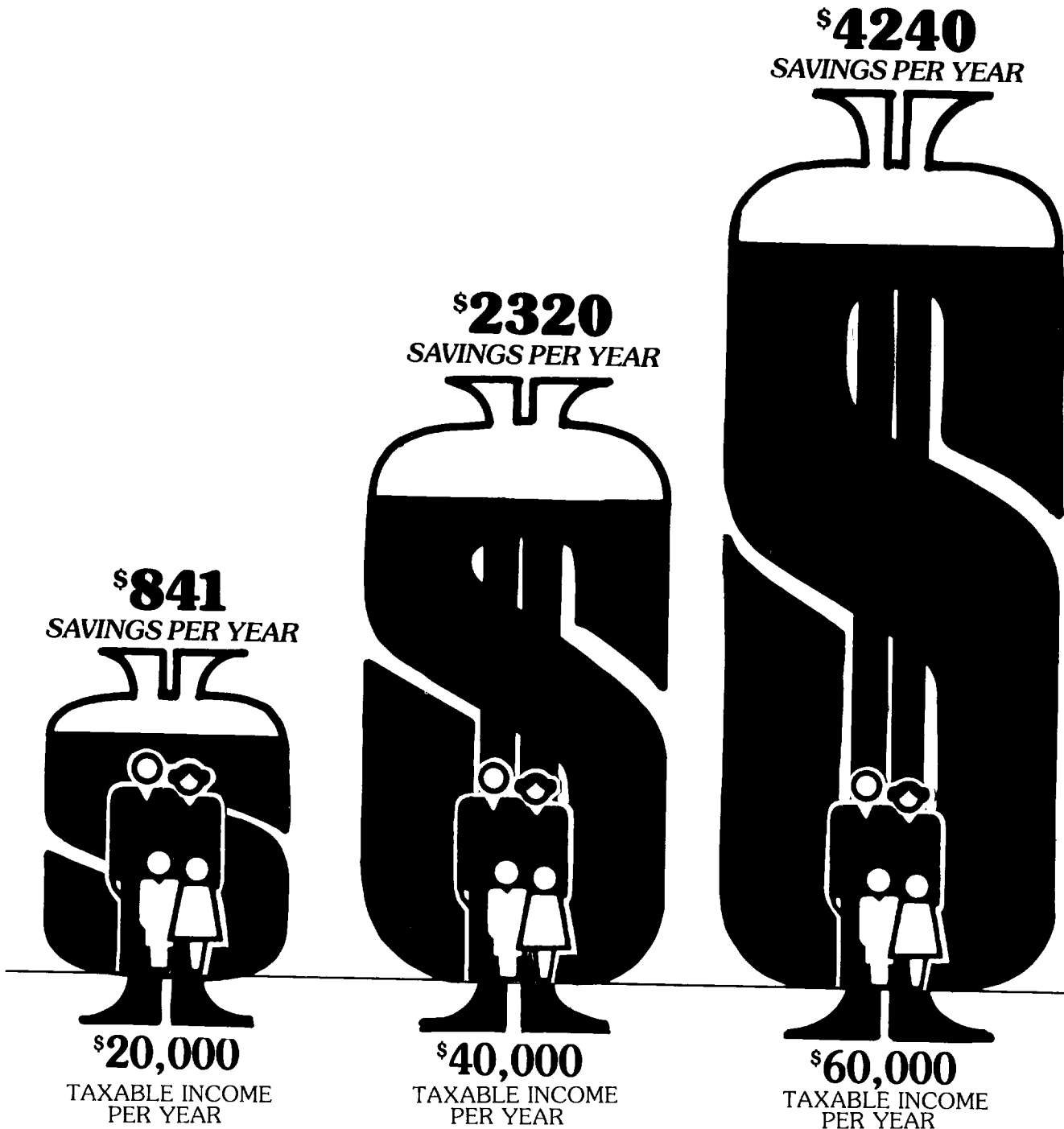
Figure B illustrates the amount of savings personal income tax repeal will accrue to typical Alaskan families before federal income tax.

As the take-home pay of Alaskans increases, additional taxes must be paid to the federal government. But in all cases, real income will increase.

The debate over tax relief in Alaska has raised numerous questions. Some have feared that the repeal of income taxes will create a backlash in the federal government and make it tougher for Alaska to participate in federal programs. In reality, the federal government has no legal basis to discriminate against Alaska; nine other states have no state income taxes.

Figure B

The Advantages of State Income Tax Repeal for Typical Alaska Families



COMMONWEALTH NORTH GRAPH

DATA SOURCE: Based on Alaska state tax tables, for married taxpayers filing jointly who do not itemize.

Others believe we will lose interest in government if we don't pay taxes, but there is no empirical data to support this proposition. It portrays a misconception of where sovereignty lies and a lack of appreciation for the high level of concern and involvement typical of the Alaskan people.

The most efficient way for government to handle money is not to take it from the people in the first place.

Some others wonder if there are better ways to help people receive the benefits of resource revenues. But the most efficient way for government to handle money is not to take it from the people in the first place. Tax repeal not only helps the individual but also reduces the size of the bureaucracy and the cost of government.

B. CORPORATE INCOME TAXES

Last year, non-petroleum businesses in Alaska paid less than \$18,000,000 in corporate income taxes. This sum is not large when measured against the state's revenues, projected to be nearly \$6 billion next year.

For those in the legislature who are sincere about assisting Alaska's business community in a time of recession, reduction or elimination of this tax should be a top priority.

Recommendation for Action

All Alaska businesses should be exempted from state income taxes on the first \$250,000 of taxable income.

A wise formula is to exempt all corporations from income taxes on the first \$250,000 of taxable income. Such an act would virtually eliminate taxes for over ninety percent of all Alaskan businesses, which in time will benefit all Alaskans.

Business tax relief will help stabilize prices in a time of inflation, and increase both employment and inventories. Consumers will benefit through improved services, as businesses become more efficient, hire more people and upgrade their facilities.

C. PROPERTY AND OTHER LOCAL TAX RELIEF

The burden of local property taxes, which hits hard at Alaskans of every income level, must also be lifted. The state would need to reimburse local governments approximately \$100 million annually to replace property taxes, and the positive effect of using surplus funds in this manner would be enormous.

This action must be taken only if it is done concomitantly with the establishment of a lid on local government spending. (See Section III)

The mechanism for property tax relief already exists in the legislation which forgives Alaskans over the age of 65 from paying taxes on their homes. The municipalities compute the projected property taxes and then are reimbursed by the state for these revenues.

Recommendation for Action

Both residential and business property taxes should be eliminated, if coupled with a lid on local government spending.

A number of legislative candidates running for election in the fall of 1980 endorsed property tax repeal, but in general they referred only to residential, not business, property taxes.

Both types of property taxes should be eliminated. To illustrate, the total for the greater Anchorage area predicted by the Municipal staff for 1981 comes to \$59,311,560. Roughly 60 percent of that amount is from residential property and 40 percent from business.

The statewide total is less than double the Anchorage amount.

As presently levied, property taxes are required of all businesses whether they make a profit or not. Business property tax relief, therefore, may be the key to whether a small business survives or goes under.

Visitors sometimes criticize the appearance of some of Alaska's towns and villages. They don't understand that the high cost of doing business here, the narrow margin of profit, and the high percentage of business failures have left little room for maintenance costs and visual appeal.

Many of these problems can be solved if more earnings are left with the people instead of being taken by government.

In June 1978, California's Proposition 13 amended the state constitution, rolling back property taxes and indirectly putting a lid on spending by local governments.

Immediately after the election, predictions of a disastrous aftermath poured forth from Proposition 13's opponents.

An analysis a year later by the U. S. Department of Commerce disclosed a wholly different picture. Although 100,000 jobs in the public sector were eliminated, only 17,000 public employees had to be laid off. The remaining positions were vacated by attrition or retirement. The

In Alaska, property tax relief will especially help the long-term resident who plans to stay in the state.

attrition was accelerated because thousands of public employees switched to attractive new jobs which opened up in the private sector as a result of the injection of private capital made possible by Proposition 13.

The statewide unemployment rate was reduced by a full percentage point, as over a half million new jobs were created in the private sector. Yet, the consumer price index for the state increased only eight percent, a lower rate than the national average.

In Alaska, residential property tax relief would especially help permanent residents, those who own homes and plan to remain in the state.

Figure C shows how much monthly house payments can be reduced on homes of differing values, using the maximum Anchorage mill levy of 12.06.

Reduced monthly house payments will help the young qualify for home loans.

Reduced payments, such as above, will help people (especially the young) to qualify for home loans. Normally, a home buyer is expected to earn four times the estimated monthly house payment. In the case of the \$80,000 home, for example, an Alaskan could qualify with almost \$3,900 less annual salary than currently required.

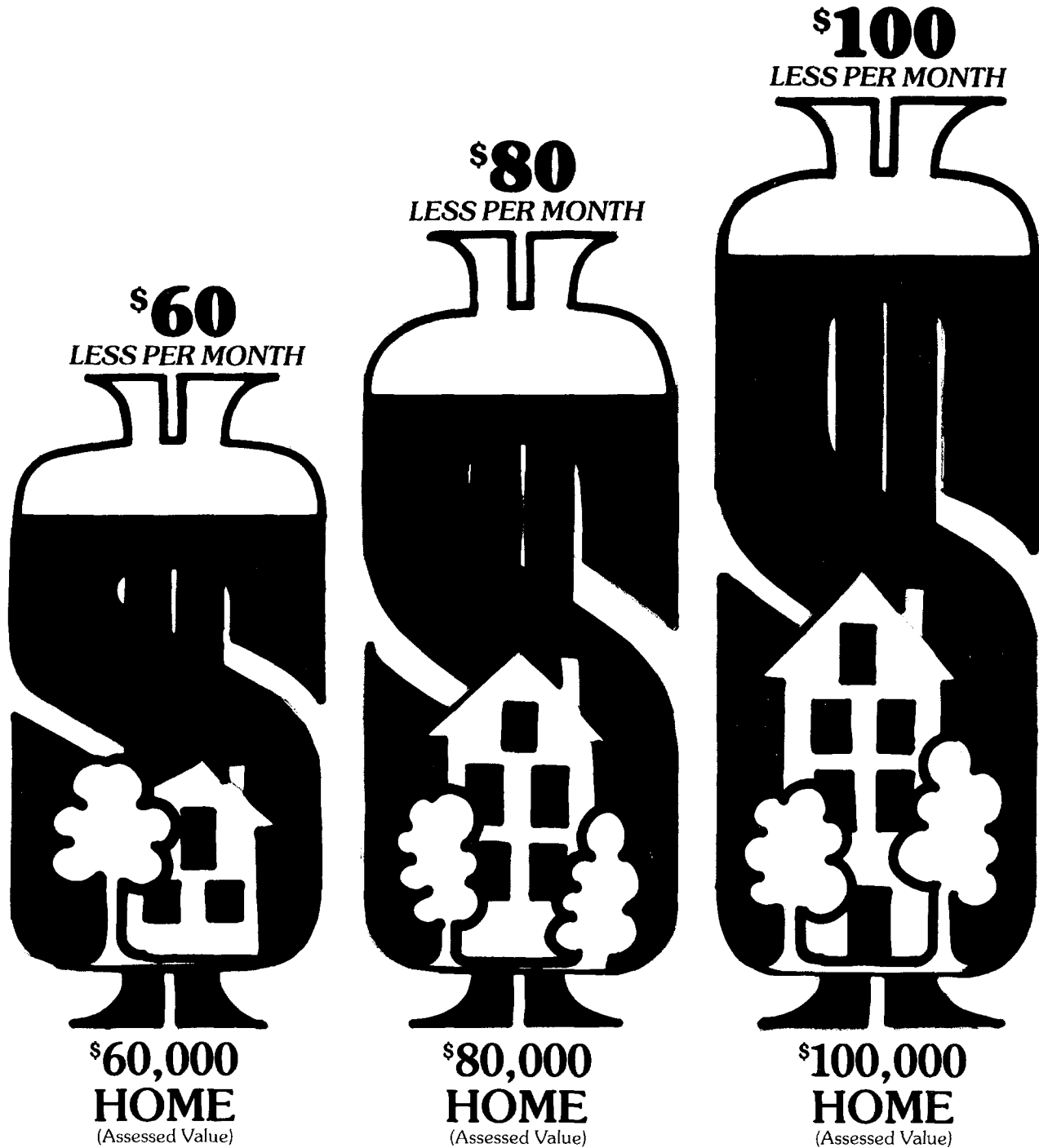
The same rebate system used for property taxes should be applied equitably to those communities using sales taxes. The formula is not complicated and can be used in every Alaskan community currently taxing its citizens for local services.

D. TRANSPORTATION FUEL TAXES

Of the remaining state sales and use taxes, fuel taxes for transportation should be repealed as an obvious

Figure C

The Impact of Repeal of Property Taxes on Monthly House Payments



COMMONWEALTH NORTH GRAPH
DATA SOURCE: Based on 12.06 mil rate.