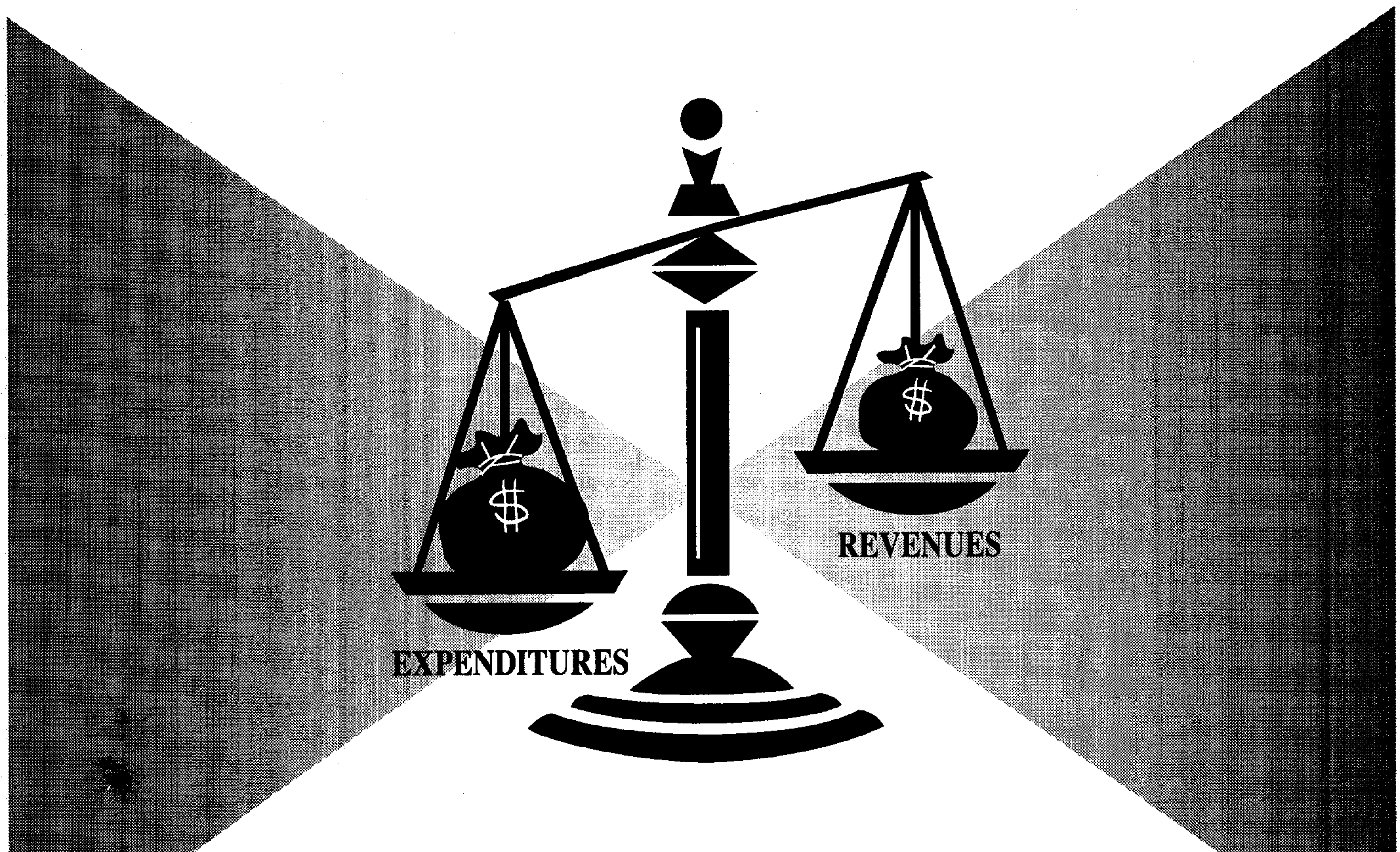
COMMONWEALTH NORTH BUDGET CONFERENCE



CLOSING THE GAP

October 20 - 21, 1993
Anchorage, Alaska

COMMONWEALTH NORTH

February 1994

Dear Conference participant and Commonwealth North member:

I am pleased to present this summary of the proceedings and conclusions of the Commonwealth North Budget Conference held in October, 1993. Over 125 members and guests participated in the Conference. The findings and conclusions are the product of five work groups involving nearly 60 citizens. I commend the work groups for their interest and time in seeking solutions to one of the most critical issues facing Alaska.

On behalf of Commonwealth North, I want to thank Governor Walter Hickel, former Governors Jay Hammond and Bill Sheffield, the state officials, state legislators and other presenters who shared their views and valuable information with us. We are also indebted to the facilitators, resource people and recorders who worked with each discussion group.

Recent court rulings and falling oil prices have further heightened our awareness of the seriousness of our budget problems. But, these short-term crises and their short-term fixes should not deflect our view from the fundamental long-term "budget gap" and the need for hard choices in the future.

I recommend this budget conference summary to you as a thoughtful set of considerations and recommendations on how Alaska could confront and manage the serious fiscal problems associated with long-term declines in oil production.

Sincerely,

Lee Gorsuch
President

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Introduction

Commonwealth North was founded with the goal of bringing together Alaska's business and civic leaders to learn about, discuss and make recommendations on major public policy issues facing our state. Perhaps no issue affecting the economic and social fabric of Alaska looms larger than the inexorable decline in production from the North Slope oil fields. Taxes and royalties from these fields account for nearly 85% of current revenues to state government.

It is clear that major public policy decisions must be made over the next 10 years to bridge "the gap" expected between current revenue sources and spending levels. UAA's Institute of Social and Economic Research (ISER) laid out five approaches to address this gap: 1) Budget reductions; 2) Use of reserves; 3) Implementatation of new taxes; 4) Use of Permanent Fund earnings; and 5) Increased economic development. Each and all of these involve tough fiscal, economic and political choices.

In November of 1992 Governor Hickel hosted an Economic Summit which brought together leaders from all over the state to review state revenue and spending projections, discuss the ISER fiscal tools and to make recommendations for future actions. Some things have changed since then, but the critical problem created by declining revenues still lies largely unaddressed.

This conference was designed to follow the format of the Governor's Economic Summit. Participants were asked to review and discuss the Summit recommendations, the ISER strategy and events following the Summit. Commonwealth North members and invited guests were asked to develop recommendations for actions needed over the next 10 years. It is believed that the views and recommendations of concerned citizens and civic leaders can influence our public policy makers and shape Alaska's future.

Proceedings

Over 125 members of Commonwealth North and invited guests participated in at least part of the two-day conference held October 20 and 21, 1993. Approximately 60 people participated in one of the five small discussion groups which formulated recommendations (see Appendix I for a list of group participants).

The conference began on October 20 with a two-hour budget and revenue briefing by Shelby Stastny, Director of the Office of Management and Budget, and Chuck Logsdon, Petroleum Economist for the Department of Revenue. A view of future revenues by Tom Williams of BP Exploration (Alaska) and legislative perspectives by Rep. Mark Hanley and Rep. Kay Brown were also presented.

The following morning, October 21, a breakfast briefing was held with Governors Hickel, Sheffield and Hammond who gave their experiences and views on needed budget actions. Following the Governors, the following presentations were made:

- Operating budget overview and reserves, Shelby Stastny, Director OMB
- Revenues and taxes, Darrel Rexwinkel, Commissioner Dept. of Revenue
- The Permanent Fund, Jim Kelly, Alaska Permanent Fund Corporation
- Economic development, Paul Fuhs, Commissioner Department of Commerce and Economic Development
- Defining the "gap" and putting the pieces together, Scott Goldsmith and Lee Gorsuch, UAA ISER

After the presentations people broke into five discussion groups. Members were preassigned groups in an effort to create diverse group memberships. Each group had 11-13 members including a facilitator, a recorder and at least one resource person having budget expertise.

The groups were to review the information presented by the speakers, the results of the Governor's Economic Summit and subsequent legislative actions. Each participant was given a notebook with written materials tracking the presentations on spending, revenues, taxation, the Permanent Fund, economic development and the ISER strategy. The groups had approximately four and one-half hours to discuss the issues and make recommendations as to actions needed to meet the projected budget "gap." Each group presented a summary of its recommendations to all the reassembled groups at the end of the day.

Appendices II and III illustrate the projected "gap" and major fiscal tools suggested in the ISER strategy. See Appendix IV for summaries and comparisons of the Governor's and other economic summits.

Budget Conference Summary

Areas of General Agreement

- **The "Gap."** All the working groups agreed that there was a fiscal "gap" now, that it was growing, that it will be substantial in the near future and that actions need to be taken now.

- All the groups felt that no single action was sufficient to meet the "gap", but that most, if not all, the fiscal tools identified in the ISER strategy must be implemented by 2005.

- **Spending.** Most groups recognized the real political and programmatic problems of further large budget cuts. However, various approaches were suggested to find efficiencies, re-prioritize and hold the line on future spending increases. Most assumed that savings in real dollars could accrue over time if programs were not allowed to increase with inflation and population growth. No specific programs were consistently targeted for cuts or reductions.

- **Reserves.** All groups recognized the need to use liquid reserves but felt that better mechanisms were needed to capture and husband reserves and non-recurring revenues for future use, rather than spending them as they become available.

- **Taxes.** All groups recommended new taxes for meeting the "gap", and all suggested the reimposition of the personal income tax as the preferred form. It was felt that the income tax was the most progressive (least impact on those with lowest income), could capture non-residents' income earned in Alaska, and was the best method for the state to pay for and benefit from economic developments.

- **Permanent Fund.** All groups recommended that the Permanent Fund principal and inflation-proofing monies not be used. No group recommended eliminating the dividend. However, a majority recommended that the dividends be capped, and that earnings beyond dividends and inflation-proofing be used for general government or deposited in the Permanent Fund to generate future earnings.

- **Economic Development.** Most groups felt that any new economic developments would be based largely on market conditions and economic decisions outside the control of the state. However, a stable tax policy and removal of regulatory hurdles by the state would be helpful. No group believed that large-scale economic development would result in revenues substantially reducing the budget "gap" by 2005.

Other Recommendations

- Two groups gave serious consideration to a proposal by Roger Cremo in which all reserves and natural resource revenues would be deposited in the Permanent Fund. A fixed percentage would be allocated from the Fund for expenditure each year to maintain a stable and predictable budget and economic climate. Permanent Fund dividends would be paid out of the same earnings stream in competition with all other spending. Additional non-resource revenues would be needed to meet expected expenditures.

  There remain questions on the mechanics of the proposal, particularly the method and length of the phase-in until the "pay-out" from the Fund would reach a constant percentage of the principal.

- Two mechanisms were suggested for helping reduce spending. The first was a "Gramm-Rudman" type of forced ratcheting down. The second was the creation of a new Commission similar to the Federal Base Closure Commission. The Commission budget recommendations would have to be accepted or rejected *in toto* by the Legislature or Administration.

Group 1
Summary of Conclusions/Recommendations

The Budget Gap

The "budget gap" is real and it will grow substantially over the next 10 years. A target "gap" of $2.3 billion was utilized by the year 2005.

Spending

An initial budget cut of $300 million or roughly 10% should be made. Then, the budget should be reduced annually by holding it constant or not letting it rise with inflation. Real dollar reductions of $900 million would be targeted for 2005.

Reserves

The group assumed reserves of $2-4 billion from litigation and tax settlements over the next 10 years, and that most would be needed to balance the budget. Approximately $300 million would be needed annually on average.

Taxes

"Like it or not" the group felt increased taxes were required in the next 10 years. Most of the estimated $500 million needed from new taxes would come from reimposition of an income tax. One advantage of such a tax would be the capturing of non-residents who utilize state resources and employment. Other taxes mentioned were increased fish taxes and a school tax.

Permanent Fund

The principal and inflation-proofing should not be spent or altered. However, monies from the Earnings Reserve Account and current dividends would be needed. By 2005, $200 million would be expended annually from the earnings reserve and $200 million from monies that would otherwise go to the dividends (currently about $530 million goes to dividends).

Economic Development

Revenues from new or increased economic development were not substantially relied upon to fill the "gap." New revenues of $20 million each year would result in $200 million in revenues in 2005.

Group 1

Facilitator:

Jane Angvik	Alaska Native Heritage Park

Participants:

Mike Abbott	Alyeska Pipeline Service Company
Bill Blessington	Port of Anchorage
Julius Brecht	Wohlforth, Argetsinger
Louann Cutler	Preston, Thorgrisom
Dick Green	Natural Garden Supply
Mark Holland	Exxon Company USA
Jim Maley	Alaska Children's Services
Joe Marks	Marenco/Anchorage School Board
Craig Renkert	UAA Small Business Development Center

Resource:

Scott Goldsmith	University of Alaska Anchorage/ISER

Recorder:

Alice Galvin	Anchorage Telephone Utility

Group 2
Summary of Conclusions/Recommendations

The Budget Gap

The "budget gap" is real and it will grow substantially over the next 10 years.

Spending

While no target numbers were used, it was generally felt that some type of "Gramm-Rudman" approach to the budget was necessary to force cuts and let the system "sort out" and look for efficiencies and priorities. A target of 1-2% real cuts annually was discussed. A review of programs is needed to institute needs-based standards, including student loans and pioneer homes. Institute a mechanism to reward efficiencies, especially in the school foundation program.

Reserves

No specific recommendations were made, although there was considerable interest in a proposal advocated by Roger Cremo wherein all reserves and natural resource revenues would be placed in the Permanent Fund. A fixed amount of earnings would be earmarked annually for expenditure.

Taxes

While most felt reimposition of an income tax would be needed in the next 10 years, there was considerable debate on the timing of enactment. A point of agreement was that the framework of an income tax should be established in the near future at a zero rate which could be increased later as needed. One advantage of such a tax would be the capturing of non-residents who utilize state resources and employment. Other taxes mentioned were increased taxes on fisheries and tourism.

Permanent Fund

No specifics were recommended, however, as mentioned above, there was considerable interest in the Cremo proposal. Under this plan the Permanent Fund dividend would be paid out of the same annual earnings allocation forcing competition with all other budget items.

Economic Development

There should be efforts to "Alaskanize" our industries such as fishing and tourism to increase employment and revenue opportunities. There appears little beyond a good business climate that will significantly alter decisions to develop new resources.

Group 2

Facilitator:

Tim Bradner	Alaska Economic Report Alaska Journal of Commerce

Participants:

Dick Decker	United We Stand
Gene Dusek	Municipality of Anchorage
Harold Heinze	
Joe Henri	Southcentral Timber/UA Regent
Carol Heyman	Anchorage Chamber of Commerce
Gary Light	ARCO, Alaska
David Roderick	
John Wheatley	Willis Coroon Corporation
Esther Wunnicke	

Resource:

Kay Brown	Alaska State Representative

Recorder:

Teeny Metcalfe

Group 3

Summary of Conclusions/Recommendations

The Budget Gap

The "budget gap" is real, is here now, is getting bigger and needs to be addressed.

Spending

There needs to be a new way of dealing with spending cuts to avoid political traps and to maintain a long-range view. It was recommended that a new Commission be established similar to the Federal Base Realignment and Closing Commission. This Commission would review all programs from a bottom-up, zero-base budgeting standpoint. It would look at alternative delivery systems. Recommendations would have to be accepted or rejected *in toto* by the Legislature and the Administration. If rejected, the recommendations would go to the voters.

Reserves

All reserves should be deposited in the Permanent Fund pursuant to a plan similar to that proposed by Roger Cremo. They would then be part of the principal from which earnings would then be allocated annually for the expenses of government.

Taxes

The income tax should be reimposed immediately and proceeds placed in the Permanent Fund. Earnings would then be used under a "Cremo-type" plan. A severance tax on our fisheries should be investigated.

Permanent Fund

No use of the principal or inflation-proofing except as transition funding. In accord with the "Cremo-type plan" dividends would be paid out of the annual earnings allocation along with all other budget items.

Economic Development

Large block economic leasing should be undertaken. Actions taken for development must be related to market-driven programs. An in-depth review of the existing regulatory environment should identify regulations inhibiting economic development. Ensure a stable tax policy to foster a stable business environment.

Other Recommendations

A plan similar to that advocated by Roger Cremo should be adopted. Under this plan all reserves and all natural resource revenues would be deposited in the Permanent Fund. Each year a certain percentage of the Fund would be allocated for budget expenditures, including the dividend program. The Fund would build to have a constant earnings stream to fund most functions of government, perhaps in conjunction with non-natural resource revenues. The goal is to "smooth" annual revenues and expenditures fostering a more predictable and stable economy.

There should be term limits for the Governor and legislators. But, longer lengths of terms are needed to ensure expertise and a longer-view. One six-year term for Governor is recommended. House terms should be extended from two to three years. Senate terms would remain at four years. Service would be limited to two consecutive terms in each body.

Group 3

Facilitator:

Joe Griffith	Chugach Electric Association, Inc.

Participants:

Jerry Anderson	Municipality of Anchorage
Milton Byrd	Charter College
C. Joe DiMatteo	Alaska Council for the Prevention of Drug and Alcohol Abuse
Walt Furnace	Alaska Support Alliance
Norman Levesque	Alaska Municipal Bond Bank Authority
Loren Lounsbury	International Management Group
Sharon Macklin	Sharon Macklin - Government Relations
Sayoko Mimoto	Anchorage School District
Tom Williams	BP Exploration (Alaska)

Resource:

Cheryl Frasca	Office of Management and Budget

Recorders:

Tom Wilson	Hughes, Thorness *et.al.*
Cindy Pieper	Commonwealth North

Group 4
Summary of Conclusions/Recommendations

The Budget Gap

The "budget gap" is real, it is big and getting bigger.

Spending

There was a recognition that the need and demand for state services and programs were growing, and that some spending increase was inevitable with inflation and population growth over time. When looking for cuts, look where most of the money is going—education, social services, corrections. Growth in spending should be controlled through re-prioritization of resources, less-costly preventative strategies, looking at life cycle costs of capital expenditures and requiring local matches and personal contributions to programs.

Reserves

We need to get reserves off the table to allocate them more judiciously. Half of all liquid reserves and future settlements should go into the Permanent Fund. The other half should be placed in the Constitutional Budget Reserve, but the rules changed to require access only by 2/3 vote (rather than current 3/4, or 51% escape clause).

Taxes

The income tax should be reimposed as preferable to other kinds of taxes. Income taxes have the advantage of capturing non-residents who benefit from Alaskan employment, resources and services. Increased taxation on our fisheries is justified.

Permanent Fund

Instituting an income tax and capping the Permanent Fund dividend are not mutually exclusive. It was recommended that the PFD be capped at $500 and that the balance of dividend monies be deposited in the Permanent Fund. Extra earnings would yield approximately $500 million to the General Fund in 2005.

Economic Development

Stable taxation is critical to economic development. New development must pay its own way. The method of paying for added government services needs to be identified and planned for up-front of any developments. An income tax seems a preferable "capture" mechanism.

Group 4

Facilitator:

Clay McDowell	Anch. Assembly Policy and Budget Office

Participants:

Bruce Carr	Alaska Railroad Corporation
Jo Fenety	Senator Drue Pearce's Office
Prent Gazaway	Gazaway and Associates
Alicia Iden	
Ken Reither	Exxon Company USA
Steven Shropshire	Northern Forum/Green Connection, Inc.
Kym Swift	Common Sense for Alaska

Resource:

Jim Kelly	Alaska Permanent Fund Corporation
Mark Hanley	Alaska State Representative

Recorder:

Nancy Schoephoester	ARCO Alaska, Inc.