Presentation to Commonwealth North

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Changing strategies to manage 4 key assets

1. Petroleum and other natural resources
2. Financial assets (and liabilities)
3. Built infrastructure
4. Human capital

Budget context

FY2017 budget gap: $ 3.0 billion

less est. sustainable flow from
Permanent Fund (incl. ER):
4.75% x $57 B = $ 2.70 billion
$300 million

plus $1000 PFD x 700,00 $700 million

"Medium term fiscal gap" $ 1 billion

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Plus:

- Oil and gas tax credits
- A capital budget
- Health care cost uncertainty
- Unfunded pension liabilities

Comparing Budgets: Inflation

- Inflation needs to be treated identically in revenues and expenditures.
- All can be in “nominal” terms, using the same measures and expectations about inflation.
- All can be in “real” terms, which is the same as “today’s dollars.” Economists typically use real calculations.

The economic context: Wage and salary employment

- 2016: Alaska lost 7500 jobs
- 2017 ISER forecast: Lose another 7500 jobs
- 2018: With no further changes to state budget, further 2500 jobs lost.
- 2019 and after: Return to 2010 job levels, and stay flat with no economic drivers to recover lost jobs.

ISER estimates of effects of $100 million change in state budget

- Income or sales taxes: 450 to 800 jobs
- Dividend cut: 550 to 900 jobs
- Budget cut: 1000 to 1250 jobs

Likely Components of a Plan

1. A multi-year (perhaps 5-year) plan. Use earnings reserve to fund “glide path.”
2. Strategy for how Permanent Fund earnings will be used for PFD and for government services.
3. Resolve oil and gas credits.
4. Multi-year budget plans/reductions based upon value of services.
5. If significant new revenue source(s), phase in no earlier than January 2019.

Components of a plan: Phase II

- A strategy for a capital budget.
- A strategy for unfunded liabilities.
- A strategy for health care costs.

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Why businesses want a plan.

- Sales tax: Impact from Internet competition.
- PFD cut: Impact on rural cash economy
- Higher property taxes from education cost shift to local government: Capital investments face higher taxes/lower returns
- No capital budget: Professional services
- Health care cuts: Health sector

Tax policy 101

Broad and low

Economic consequences of taxes.

1. Administrative and compliance costs
2. People spend resources to reduce taxes
3. People shift economic activity to less productive uses to reduce taxes

(2) and (3) are hidden, but often the real cost of poor tax policy. Hence “broad and low.”

Tax Policy 102

Equity and efficiency are often in conflict in tax policy.

Regressive vs. Progressive

- Regressive: percent of income paid in tax falls as income increases. *(Note that total tax paid may still increase as income increases.)*

- Progressive: percent of income paid in tax increases as income increases.

Alaska’s current broad taxes-I

- Corporate income tax: 9.4 % max. (Among 4 highest, but several at 8.5%-9%)
- Local property taxes: 10-12 mils. (Slightly above middle of pack.)
- No vehicle property tax. (Like 25 others.)
- Fuel tax $.08/gal. (Lowest.)
- No personal income tax. (Like 6 other states; 2 tax dividend and interest.)

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Alaska’s current broad taxes-II

- No state sales tax. (Like 4 other states.)
- Local sales taxes to 7.5%. Local rooms tax to 12%. (38 states have local sales taxes.)
- No state lodging tax. (All 4 states without sales tax have lodging tax.)
- 10% car rental tax. (Second highest, with 5 other states.)

Sales Tax Effects

- Competition from Internet sales.
- Moderately regressive
- Exemptions, esp. food, reduce regressivity at cost of collecting less revenue.
- Federal income deductibility for itemizers.
- Share paid by visitors, part-year employees.
- Competition with local sales taxes, but possible savings in local admin costs. Would need time for towns to conform.

Income Tax effects

- Rates can be progressive.
- Differential treatment of different income can be quite distortionary. *E.g.,* capital gains.
- Deductions and credits can be quite distortionary. *E. g.,* home interest.
- Can influence retirement decisions.
- Federal tax deduction for itemizers
- Share paid by part-year employees.

Property Tax effects

- Arguments over progressive/regressive.
- Differentially affects those on fixed income.
- “Circuit breakers” reduce regressivity.
- Can create “tax competition” for industry.
- Federal tax deductibility for itemizers.
- Competition with local taxes.
- Partially paid by non-residents and out-of-state firms.

Permanent Fund Dividend cuts

- PFD is a very progressive program.
- Therefore, cutting PFD acts like a strongly regressive tax.

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