Overview: The Economy & Fiscal Policy

Randall Hoffbeck, *Commissioner of Revenue*

House Finance Committee
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Part I

Focusing the Discussion

Alaska Department of Revenue

The Department of Revenue mission is to collect, distribute and invest funds for public purposes.

State Revenue

1. Permanent Fund Restructure
2. New Revenues
3. Expenditure Reductions

Part II

Current Revenue Issues

IMPACT ON STATE REVENUE OF A NARROW REVENUE BASE

Economics of Taxation

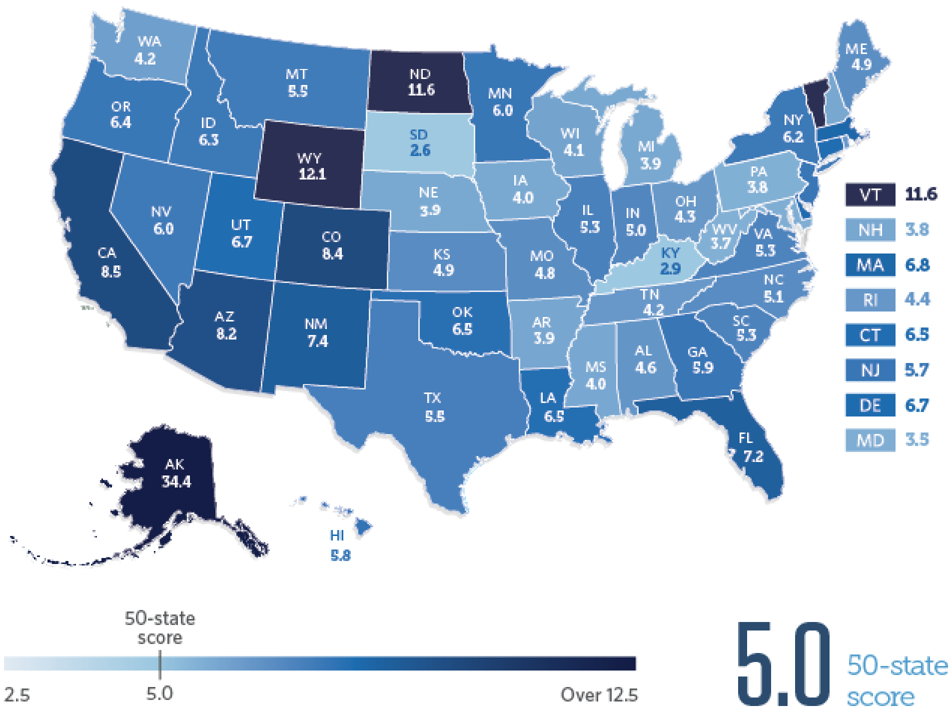
Throughout history, every organized society had some form of government. In free societies, the goals of government have been to protect individual freedoms and to promote the well-being of society as a whole. **Governments pay for these services through revenue obtained by taxing three economic bases: income, consumption and wealth.** The Federal Government taxes income as its main source of revenue. State governments use taxes on income and consumption, while local governments rely almost entirely on taxing property and wealth. More specifically the Federal Government relies mainly on income taxes for its revenue. **State governments depend on both income and sales taxes.** Most county and city governments use property taxes to raise their revenue.

U.S. Department of Treasury Resource Center

IMPACT ON STATE REVENUE OF A NARROW REVENUE BASE

How Volatility of Tax Revenue Compares

Based on FY 1995-2013 tax revenue, adjusted for policy changes



Source: The Pew Charitable Trusts

Volatility scores for each state's total tax revenue were calculated using the U.S. Census Bureau's State Government Tax Collections historical data series for 1994-2013. Data were adjusted to control for the effects of tax policy change using the National Conference of State Legislatures State Tax Action reports for 1994-2012.

Alaska had the highest overall volatility score—34.4—meaning the state's total tax revenue showed wide variability from year to year, typically fluctuating within 34.4 percentage points above or below its overall growth trend. The next most volatile tax revenue streams were in Wyoming (12.1) and in North Dakota and Vermont (both 11.6).

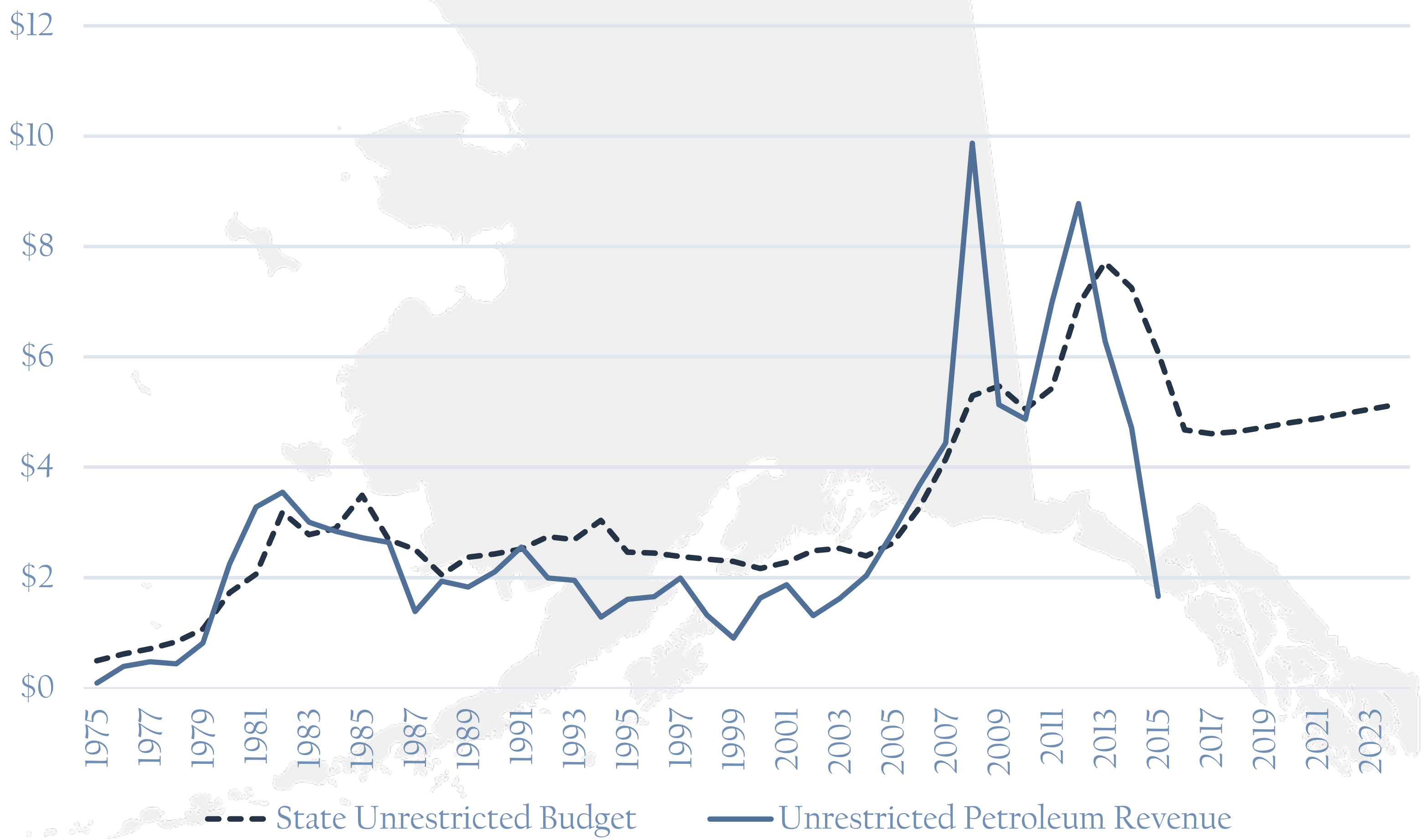
Impact on State Revenue of a Narrow Revenue Base

States that showed the largest severance tax revenue decreases in were all major oil producers.

	Severance Taxes	Total Tax Collections
Alaska	Decreased of 95.7%	Decreased of 74.6%
Texas	Decrease of 33.4%	Decreased of 0.1%
North Dakota	Decreased of 13.5%	Decreased of 6.2%

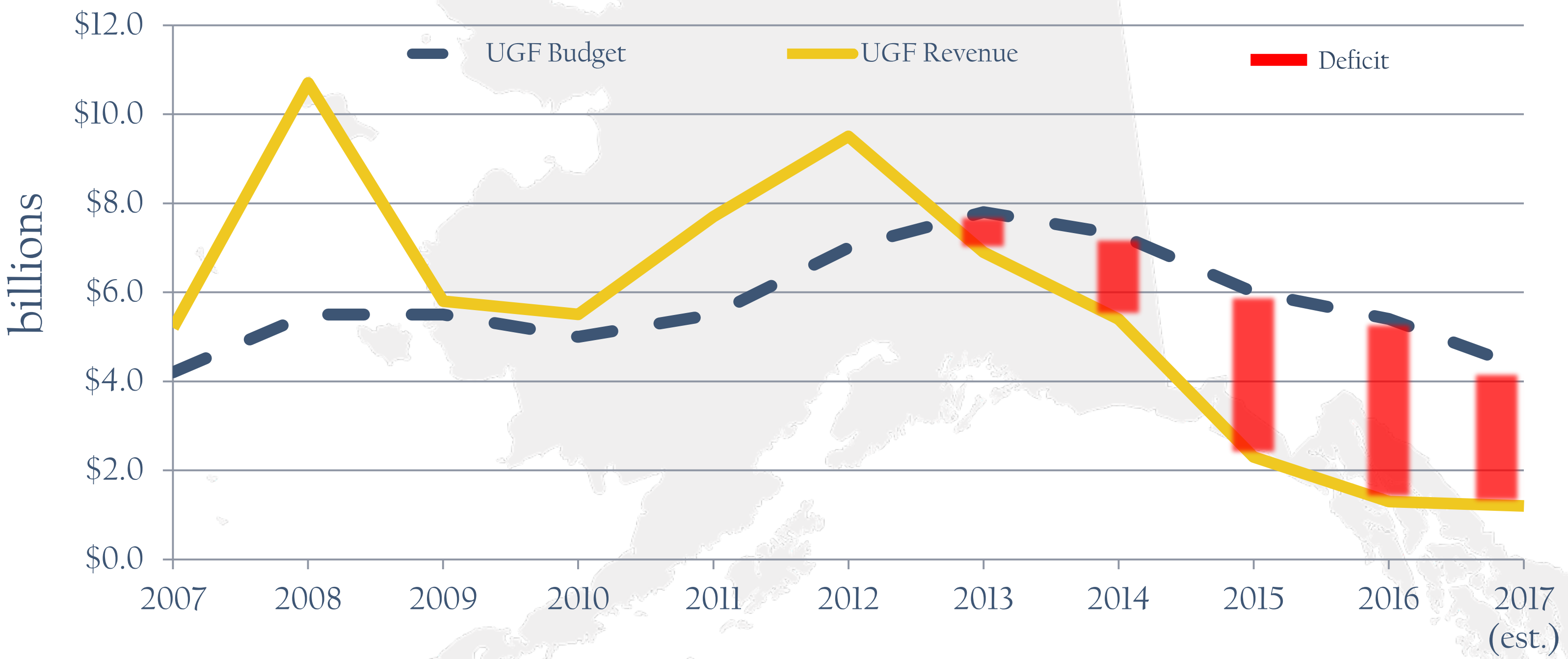
2015 Annual Survey of State Government Tax Collections (US Census Bureau)

IMPACT ON STATE REVENUE OF A NARROW REVENUE BASE



Impact on State Revenue of a Narrow Revenue Base

Although the UGF budget has been cut by 44% since 2013, the deficit remains.



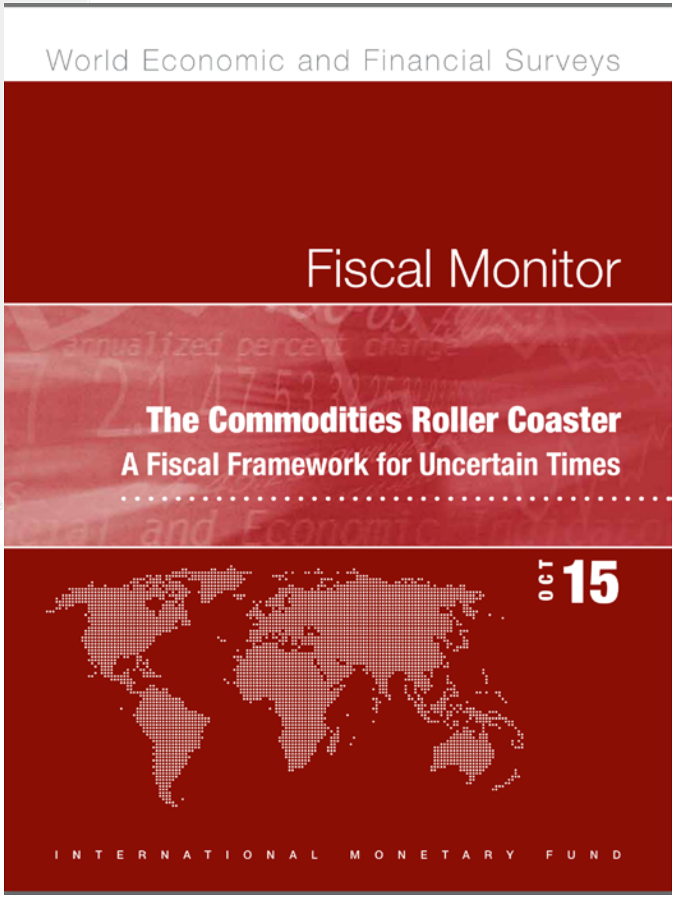
Impact on State Revenue of a Narrow Revenue Base

- *The Commodities Roller Coaster* – the International Monetary Fund studied 85 economies over 3 decades

- Government spending in commodity-based economies tends to move up and down with commodity revenue

- Pro-cyclical government spending stunts economic growth

- Stabilizing fiscal policy has the inverse effect, increasing GDP growth by 0.3% annually



Part III

Benefits to State Revenue of a Broader Revenue Base

Benefits to State Revenue of a Broader Revenue Base

1. Close the Fiscal Gap (Revenue)

2. Spread the Impact of the Fiscal Solution (Fairness)

3. Stabilize the Budget (Certainty)

4. Adjusts Revenues based on Economic Growth (Durability)

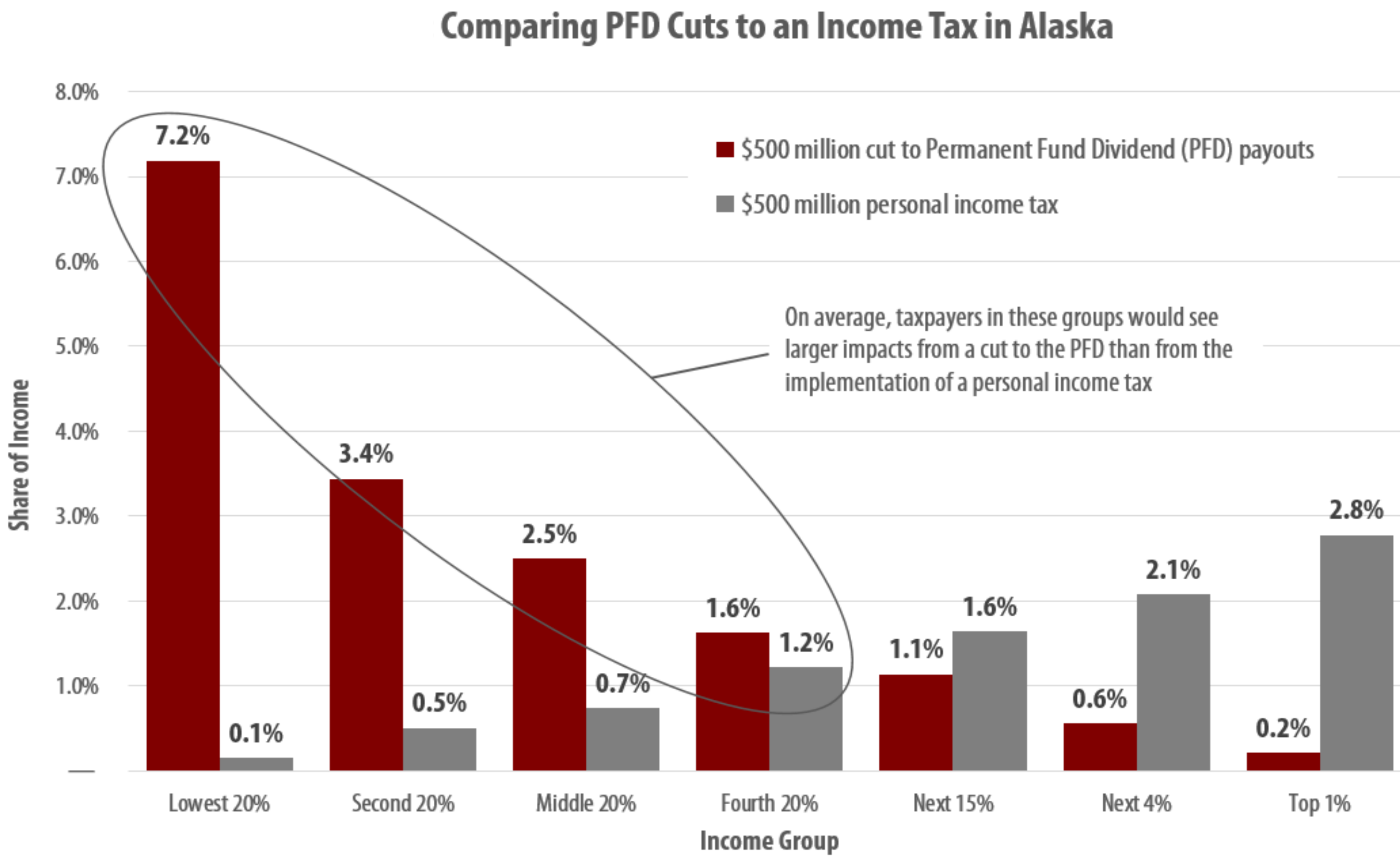
Close the Fiscal Gap

FY18 Budget	$4.3 billion
FY 18 Forecasted Revenues	$ 1.8 billion
FY18 Forecasted Budget Gap	$2.5 billion

<u>Potential Tools to Close the Gap</u>

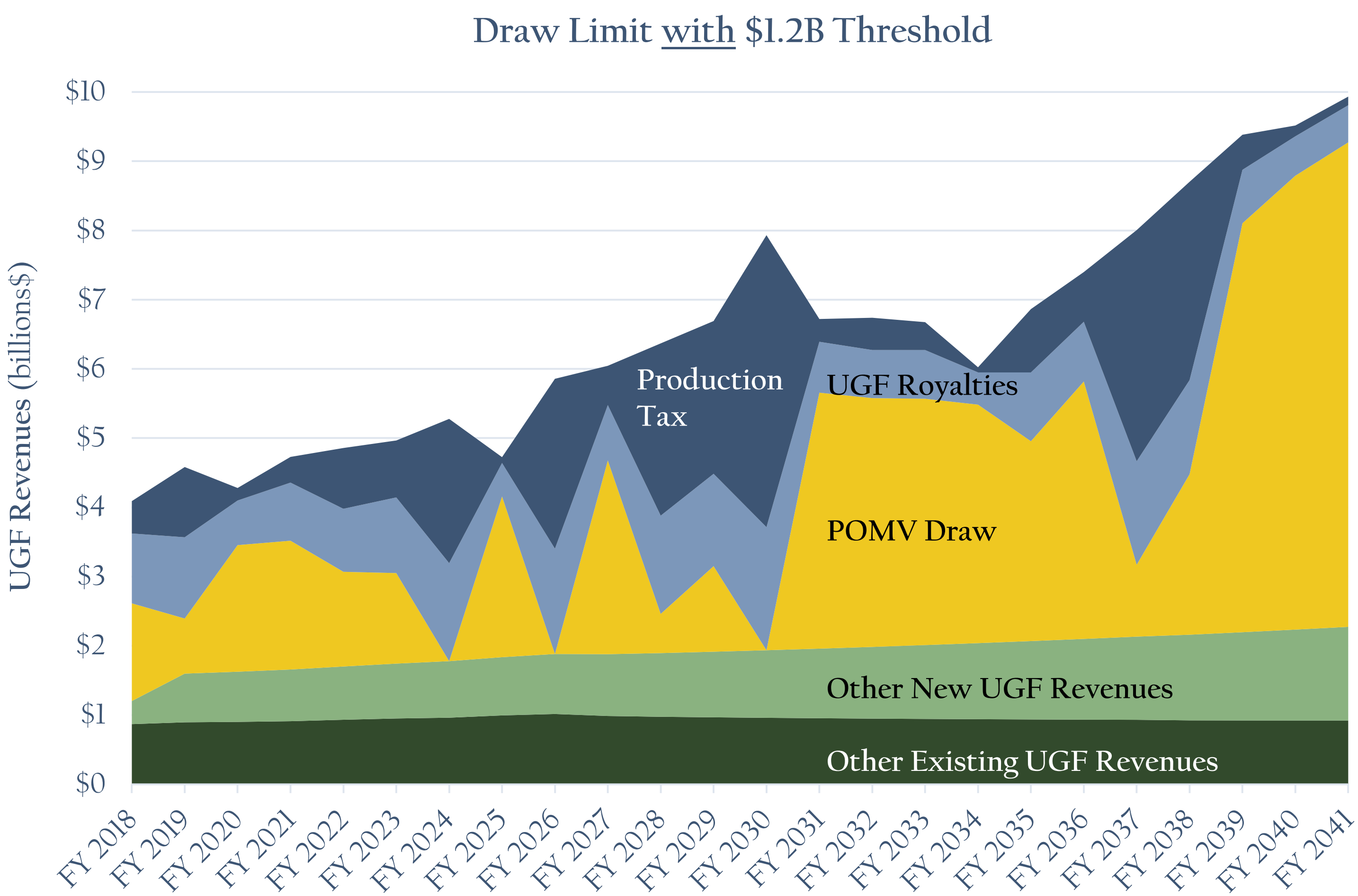
Motor Fuels Tax Increase (Immediate)	$0.08 (over 2 years)
CSHB 115 (CY 19)	$0.68
CSHB 111 (CY 18)	$0.20 (price dependent)
CSSB26 (Immediate)	$1.90 (net of Dividend)

Spread the Impact of the Solution

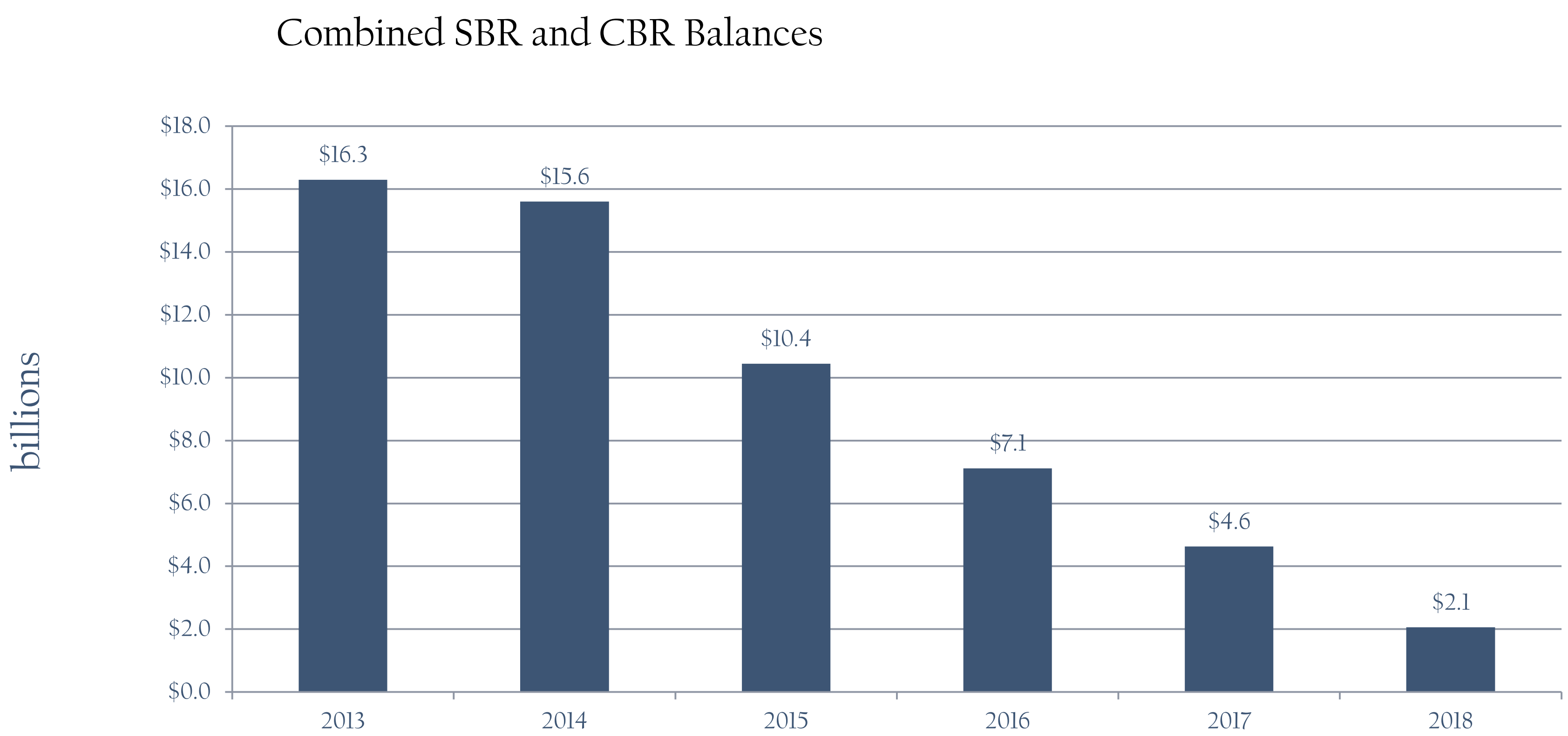


Source: Institute on Taxation and Economic Policy, April 2017. Modeled in a Tax Year 2016 economy, modified to assume a baseline Permanent Fund Dividend payout of $2,200 per person. In the PFD scenario the payout is reduced to $1,416 per person. In the personal income tax scenario, the tax is assumed to be very similar to House Bill 115 of Alaska's 2017 legislative session, though its rates have been reduced by 27.75% across the board to reduce its yield to $500 million per year.

Stabilize the Budget



Stabilize the Budget



ADJUSTS REVENUES BASED ON ECONOMIC GROWTH

10,000 new jobs

10,000 new families

5,000 new students

10,000 new homes, **$200,000** per home

$1 billion capital investment

$5 million a year in additional borough sales taxes

$27.5 million a year in increased school funding

$20 million a year in borough and service area property taxes on homes

$10 million a year in borough and service area property taxes on widget factory investment

Adjusts Revenues based on Economic Growth

10,000 new jobs

10,000 new families

5,000 new students

10,000 new homes, **$200,000** per home

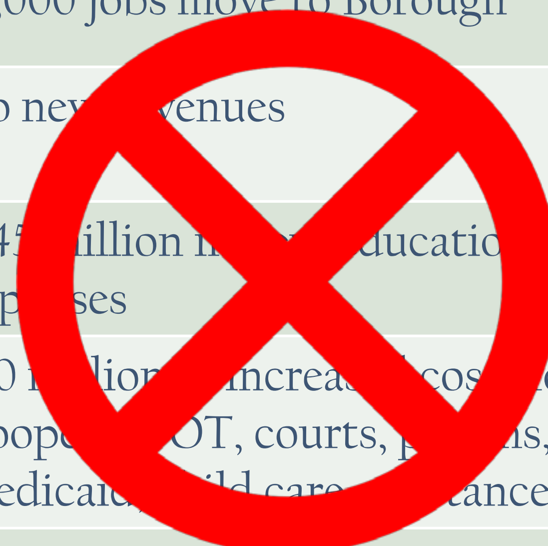
$1 billion capital investment

$10 million a year in higher expenses for troopers, highways, courts, prisons, Medicaid, child care assistance, etc.

$45 million a year in increased school funding costs

Adjusts Revenues based on Economic Growth

Borough	State of Alaska
10,000 jobs move to Borough	10,000 jobs move to Borough
$35 mil[illegible] sales tax re[illegible]	No ne[illegible]venues
$ 27[illegible] exp[illegible]	$ 4[illegible]illion i[illegible]ducatio[illegible] exp[illegible]ses
$7.5 [illegible] emerg[illegible]	$10 [illegible]lion[illegible]increa[illegible]cos[illegible]or troop[illegible]OT, courts, [illegible]s, Medicai[illegible]ld care[illegible]tance, etc.
New revenues sufficient to match new expenses	$55 million in additional expenses, no new revenues
Decision: YES	**Decision: NO**



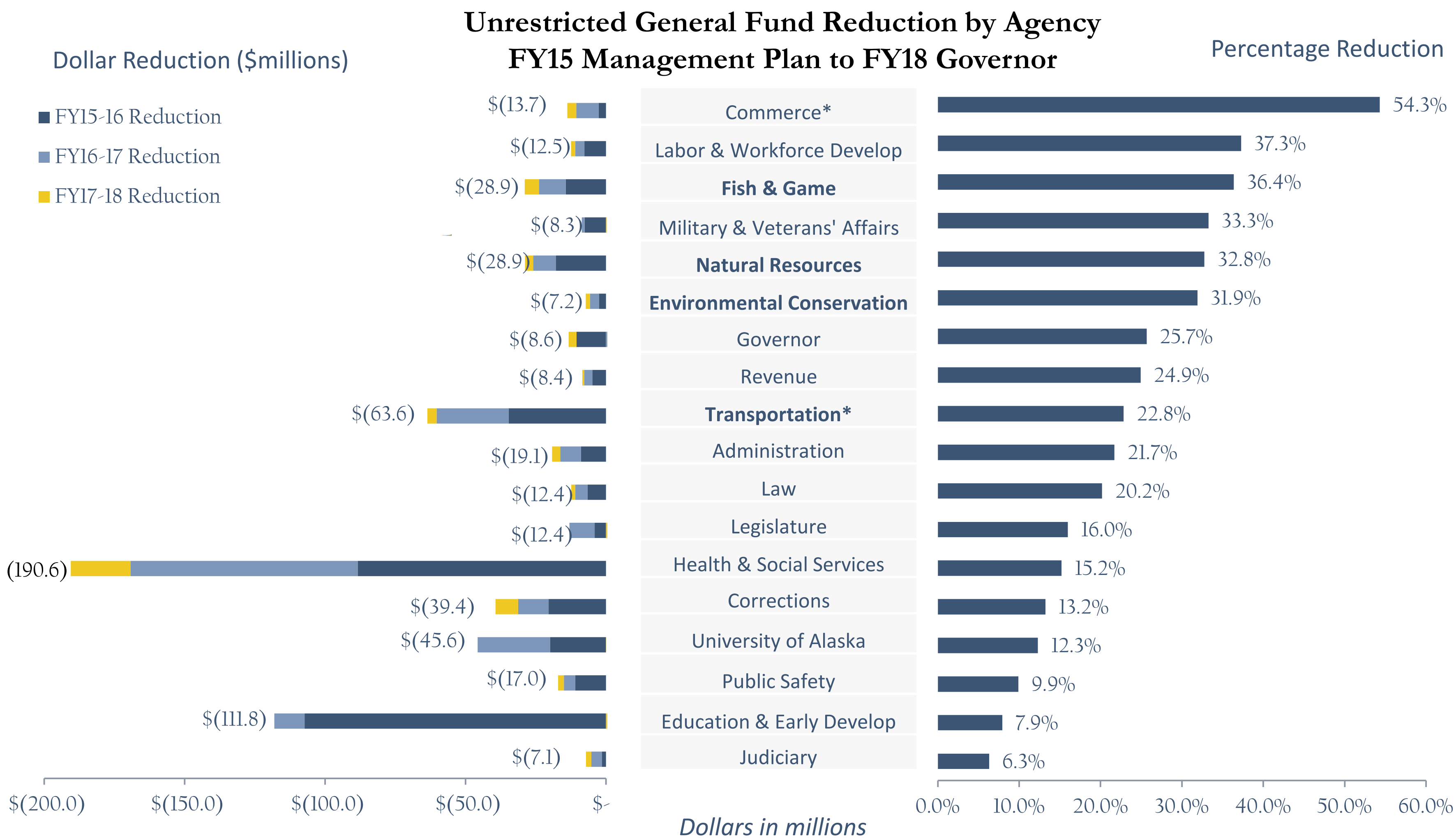
Part IV

Current Expenditure Issues

Expenditure Reductions to Date

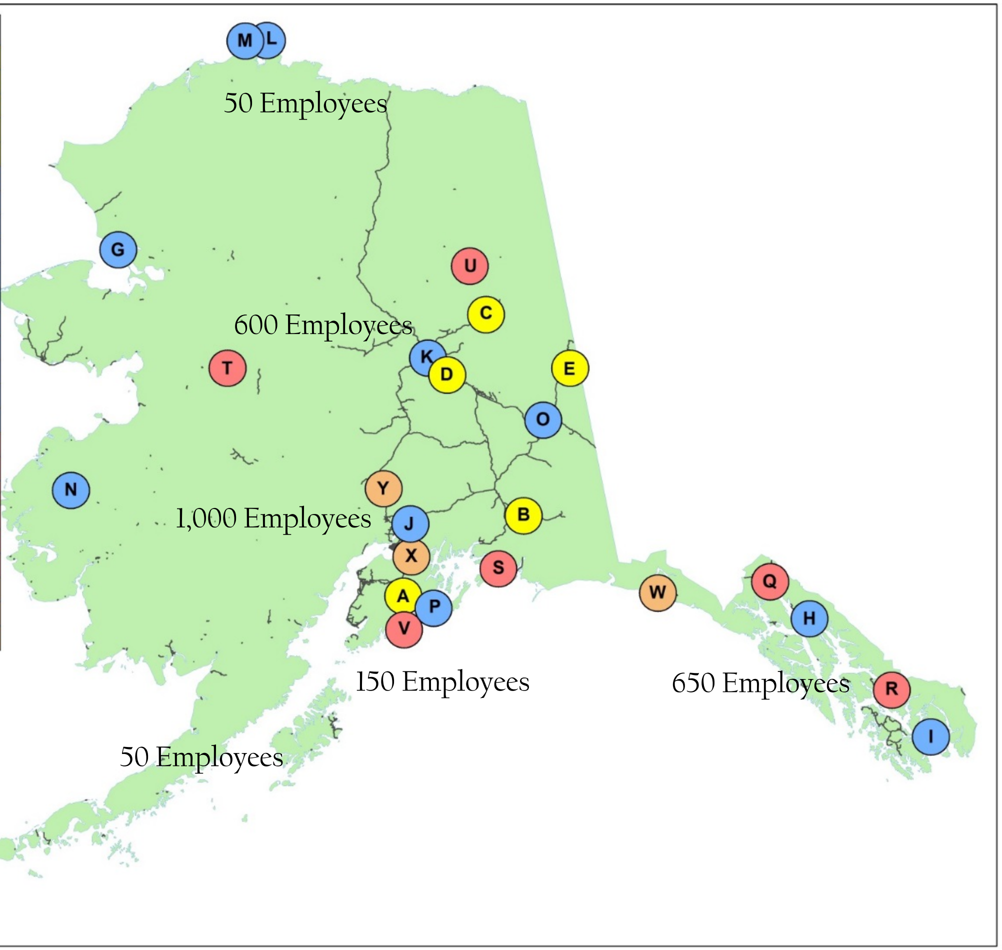
Expenditure Category	Reductions To Date	FY18 Gov. Funding
Capital	$1.8 B	$0.1 B
Operating (not including k12 formula)	$1.6 B	$2.5 B
Direct Community Payments:		
PRS/TRS (on-behalf)	$0.00 B	$0.2 B
Community Assistance	$0.03 B	$0.0 B
School Debt Reimbursement	$0.01 B	$0.1 B
Education Funding (k12 formula)	$0.10 B	$1.3 B

EXPENDITURE REDUCTIONS TO DATE



EXPENDITURE REDUCTIONS TO DATE

ID	Closure
A	Seward DOT Maintenance Station
B	Chitina DOT Maintenance Station
C	Central DOT Maintenance Station
D	Salcha - Birch Lake DOT Maintenance Station
E	O"Brien Creek DOT Maintenance Station
F	Unalaska OCS Office
G	Kotzebue Job Center
H	Juneau Child Support Office
I	The Ketchikan Regional Youth Facility
J	Palmer Correctional Center
K	Fairbanks Vital Statistics Center
L	Barrow District Attorney
M	Barrow Job Center
N	St. Mary's Court
O	Tok Visitor Center
P	Seward Job Center
Q	Haines Public Health Center
R	Wrangell Public Health Center
S	Cordova Public Health Center
T	Galena Public Health Center
U	Fort Yukon Public Health Center
V	Seward Public Health Center
W	Yakutat Trooper Post
X	Girdwood Trooper Post
Y	Talkeetna Trooper Post



2,500 October 2014 through October 2016 State Employee Job Losses

Expenditure Analysis

Special Alaskan Circumstances

Permanent Fund Dividend	$ 1,022.00
County Programs	$ 516.31
Unique Alaskan Programs	$ 1,205.32
Higher Wages	$ 105.00
Higher Health Insurance	$ 148.00
Oil & Gas Tax Credits	$ 100.00
Education	$ 623.31
Fisheries	$ 165.04
Resource Management	$ 42.37
Fuel	$ 13.20
	$3,940.86 per person

Expenditure Analysis

National Comparison:

Alaska per capita spend	$9,096.80
Less special circumstances	($3,940.86)
Adjusted Comparison	$5155.94 per person*

* Within 7.2% of the US average ($4,808.40)

Part V

Impacts of not Having a Broader Revenue Base

IMPACTS OF NOT HAVING A BROADER REVENUE BASE

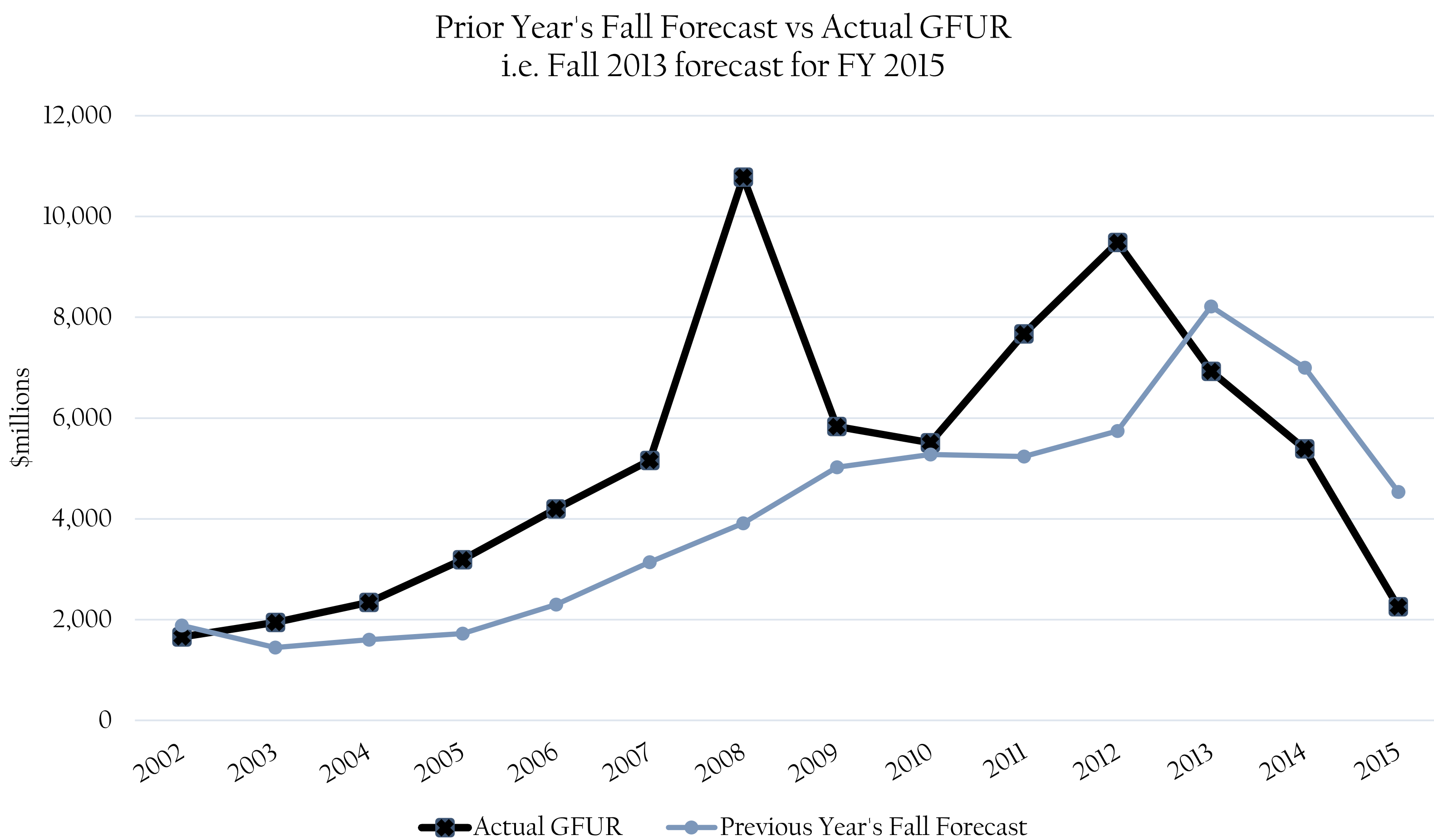
1. Requires reliance on accurate forecasting of volatile revenues (Uncertainty)

2. Leaves a Structural Deficit (Depletes savings and creates uncertainty)

3. Concentrates the Impact of the Fiscal Solution (Less pay More)

4. Destabilizes the Budget (ERA at Risk)

REQUIRES ACCURATE FORECASTING OF VOLATILE REVENUES



Leaves a Structural Deficit

S&P Global Outlook

The negative outlook reflects our view of the large structural budget deficit in Alaska's unrestricted general fund. Currently, the state is able to finance its operating deficits by withdrawing funds from its budgetary reserves. Alaska had built up large budget reserves that thus far have shielded the state's credit quality from the degradation that the large deficits would inflict on most states' credit quality. But the magnitude of the fiscal deficits, even with the governor's vetoes for fiscal 2017, makes the arrangement unsustainable and, unless corrected, inconsistent with the current rating. On their current trajectory, the state's deficit financial operations would eventually deplete its budget reserves. Therefore, without structural fiscal reform in the 2017 legislative session, we would likely lower the state debt ratings.

If lawmakers succeed in putting the state on what we view as a glide path to a sustainable fiscal structure, with its strong reserve balances intact, we could revise the outlook to stable.

Concentrates the Impacts

- Just because the State stops funding a program or service doesn't mean that the needs for that service go away. However, the Federal funding match often does go away causing severe collateral damage to the programs, services and the economy.

- Cuts flow down hill. If the State stops funding a program or service the burden often falls to the local governments and then to non-profits, the private sector, or finally to the individual.

- State expenditure cuts that don't recognize on going needs are a "pass through" solution. The expense doesn't go away it just shifts to an ever smaller pool of resources.

- A statewide solution, such as a broad based sales or income tax, broadens the funding for the delivery of programs and services by capturing revenues from out of state workers and visitors.

Destabilizes the Budget

Provides no funding source for timely payment of close to $1 Billion in oil and gas cashable credits. It would take 10-20 years at the statutory rate. (results in the immediate loss of some of the smaller companies)

Provides no funding source to deal with nearly $2 Billion in deferred maintenance or to support a level of capital spending that is necessary for a healthy construction industry in the state (results in construction job loss, business failures and higher maintenance costs in the future)

Destabilizes the Budget

No ability to deal with increased annual prs/trs on behalf payments due to an FY18 experience review of mortality, salary base and return assumptions. (3 thousand less employees and reduced salary inflation means less revenues into the retirement system, likely to reduce target returns below 8%, and a switch to generational mortality will likely increase assumed benefit years)

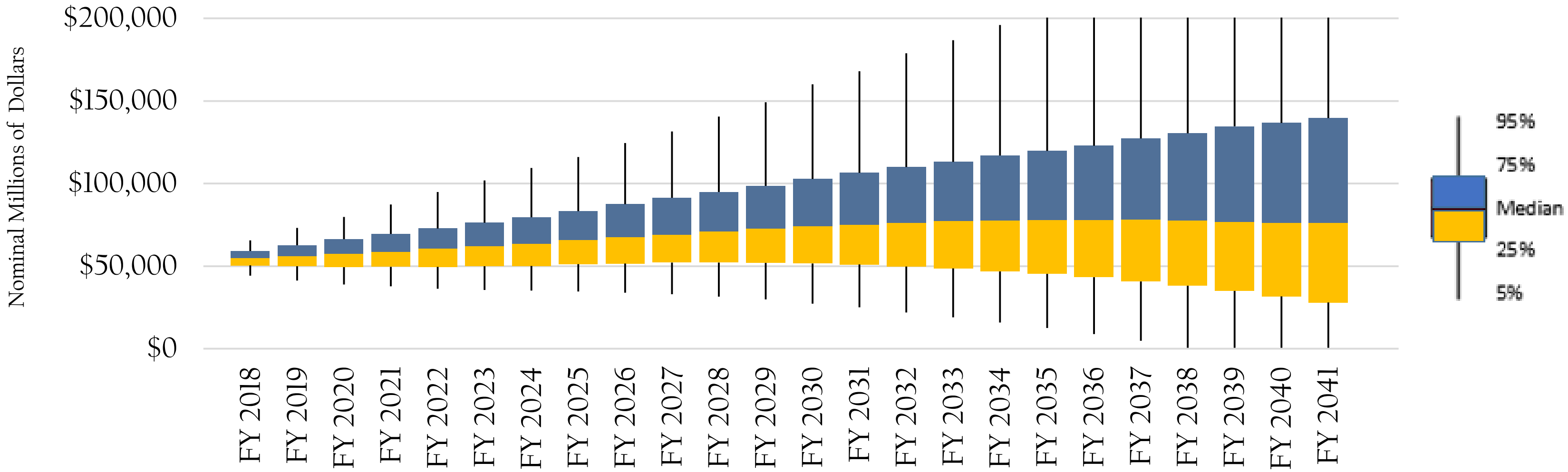
Doesn't account for formula program growth. (requires legislative action to permanently reduce these payments)

Doesn't account for health care cost escalation in excess of inflation.

Has no buffer to deal with cuts at the federal level that trickle down to the state.

Destabilizes the Budget
ERA at Risk

APFPA with transfer, No Fiscal Plan Nominal Fund Size



2041 median value: $76,047 nominal ($44,582 real) million

ER Fail Rate over 24 Years: 45.38%