

The Alaska State Budget and the Alaska Economy: Impacts of Taxes and PFD Cuts

Presentation to the Comprehensive Fiscal Plan Working Group

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Managing Alaska's Economic Resources

1. Human capital
2. Private financial and physical capital
3. Public physical infrastructure
4. Public financial assets (primarily the Permanent Fund)
5. Natural resources, esp. oil and gas

Government: Balancing the good and the bad.

1. Government provides things we want:
 - A. Infrastructure that is essential for the economy.
 - B. Things we want, like education and social services.
 - C. Rules structures (e.g., courts to enforce contracts.)
2. Funding government via taxes creates private incentives, which are often negative.

Short run vs long run policy

1. Good policy makes a difference in the long run.
2. Any change creates short-run costs, which can be concentrated on a few. When and how to incur those adjustment costs may matter.
3. But also, important to realize that short-run costs are reduced as people and businesses adjust over time.
4. Uncertainty affects long-run private decisions, like investment.

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

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

Tax Policy 102

Inherent conflicts in tax design.

Equity: 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.

Example of regressive and progressive taxes.

Regressive.

<u>Income</u>	<u>Tax</u>	<u>Percent</u>
\$40,000	\$500	1.25%
\$100,000	\$800	.80%

Progressive.

<u>Income</u>	<u>Tax</u>	<u>Percent</u>
\$40,000	\$500	1.25%
\$100,000	\$2000	2.00%

Examples of trade-offs

- Tobacco taxes discourage smoking, esp. by teens. But tobacco taxes are very regressive.
- Income taxes are easiest to make progressive, but they discourage work in some cases.

Alaska's Current Tax Structure

- State tax structures vary widely, but Alaska's is still relatively unique.
- Alaska has lowest state and local tax burden in US.

Comparing Alaska's current taxes

- Corporate income tax: 9.4 % max. (Among 6 highest.)
- Local property taxes: 10-12 mils. (Slightly above middle of pack.)
- Fuel tax \$.08/gal. (Lowest.)
- 10% car rental tax. (Second highest, with 5 other states.)

Alaska's current taxes...

- No personal income tax. (Like 6 other states; 2 of those tax dividend and interest.)
- No state sales tax. (Like 4 other states.)
- No state lodging tax. (All 4 states without sales tax have lodging tax.)
- Local sales taxes to 7.5%. Local rooms tax to 12%. (38 states have local sales taxes.)

ISER 2016 Study

“Short-run Economic Impacts of Alaska Fiscal Options”

Authors: Gunnar Knapp, Matthew Berman, and
Mouhcine Guettabi

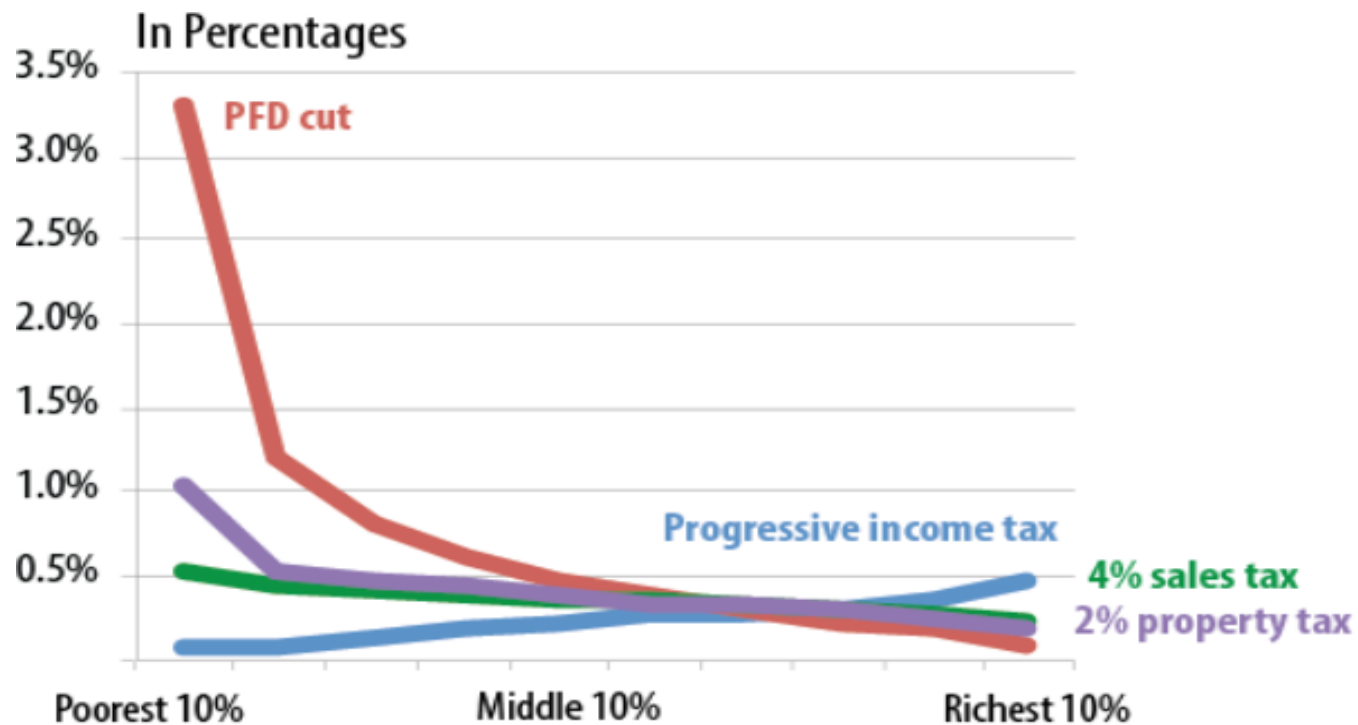
<https://iseralaska.org/publications/?id=1603>

(Funded by Alaska Department of Revenue and Alaska Office of Management and Budget.)

Short run impacts: Taxes & PFD (jobs per \$100 million)

<u>Change</u>	<u>Estimated impact</u>
Flat income tax	544 to 786
Progressive income tax	544 to 786
Sales tax, more exclusions	477 to 775
Sales tax, fewer exclusions	482 to 798
Property tax	463 to 773
Dividend cut	558 to 892

Distributional Impacts



Share “paid” by federal government through lower federal income tax collections.

- State income tax 9% to 11%
- State sales tax 7% to 8%
- Property tax 9%
- PFD cut 16%

Share paid by non-Alaskans

- State income tax 7%
- State sales tax 10%
- Property tax 11%
- PFD cut 0%

Short run impacts: Spending cuts (jobs per \$100 million)

<u>Change</u>	<u>Est. impact range</u>
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Spending cuts targeted at:

--Work force reduction	1414 to 1677
--Capital budget	775 to 931
--Across-the-board pay cut	459 to 727
--"Across the board" cuts	980 to 1200

Takeaways from ISER study

1. PFD cuts have the largest immediate impact on the economy (often cited)
....but the differences are not huge.
2. The differences in collections from non-residents are not large between taxes.
3. More of the PFD cut is offset by federal income tax reductions than by tax increases.
The effects among taxes are similar

Takeaways from ISER study-II

4. The impact of government spending cuts on the economy in the short run is significantly larger than the impact of tax increases or PFD cuts.

..but this is in the short-run. Those spending impacts on employment can be expected to decrease over time.

5. The distribution differences are very large. The biggest single difference among tax and PFD-cut choices is “who pays?” This ethical question looms large.

Economic impacts of various taxes

Widely studied. Considerable consensus.

Income Tax effects

- Rates can be progressive.
- However, increasingly favorable treatment of investment income has reduced progressivity for high income.
- Differential treatment of different types of income can be quite distortionary. *E.g.*, tax-favored investment in real estate.
- Impact on work decisions, esp. for second earners.

Sales Tax Effects

- Slightly to moderately regressive
- Exemptions, esp. food, reduce regressivity at cost of collecting less revenue.
- “Broad” for sales taxes means including services.

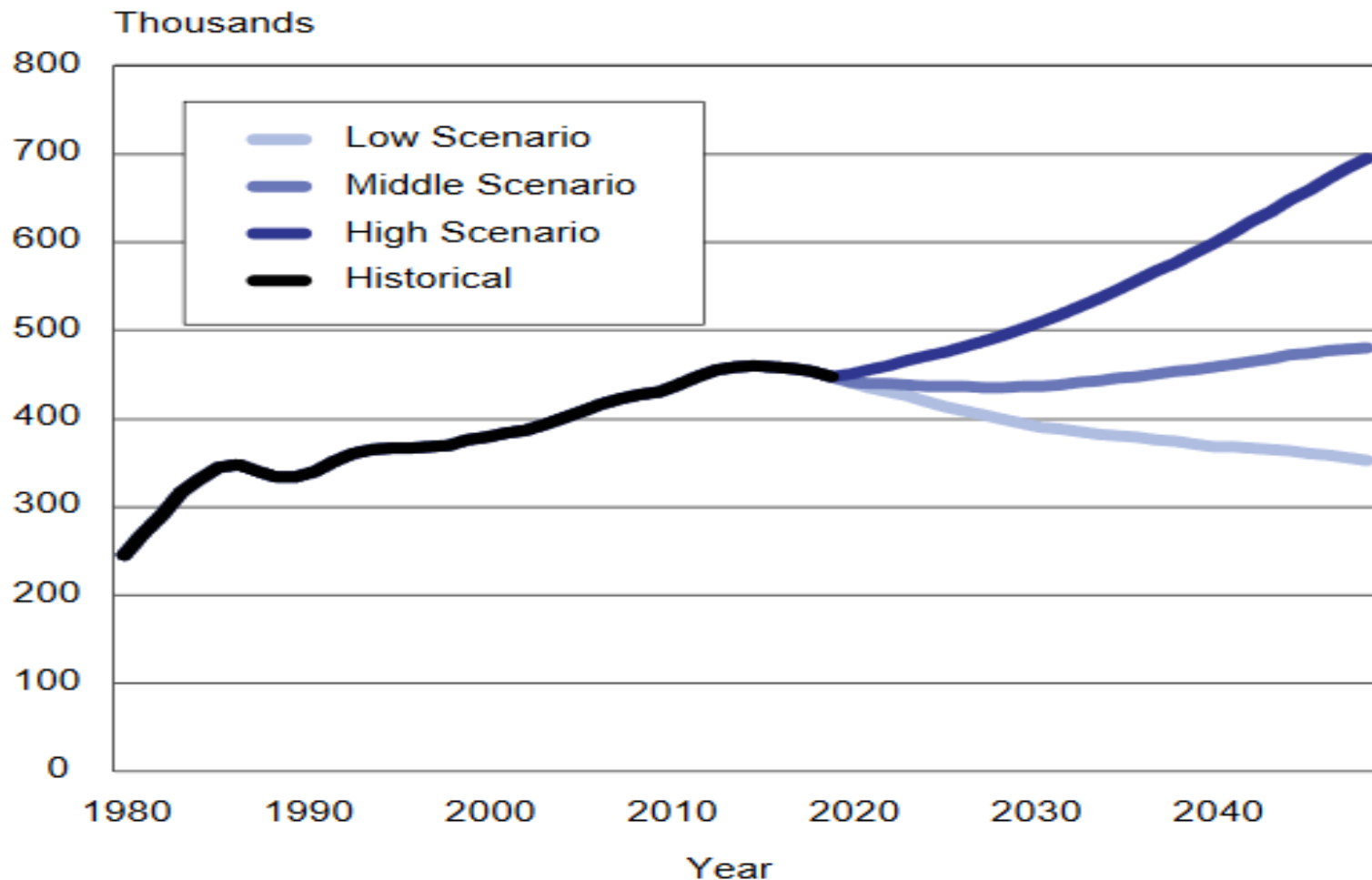
Property Tax effects

- Arguments over progressive/regressive.
- Differentially affects those on fixed income.
- “Circuit breakers” reduce regressivity.
- Can create “tax competition” for industry.

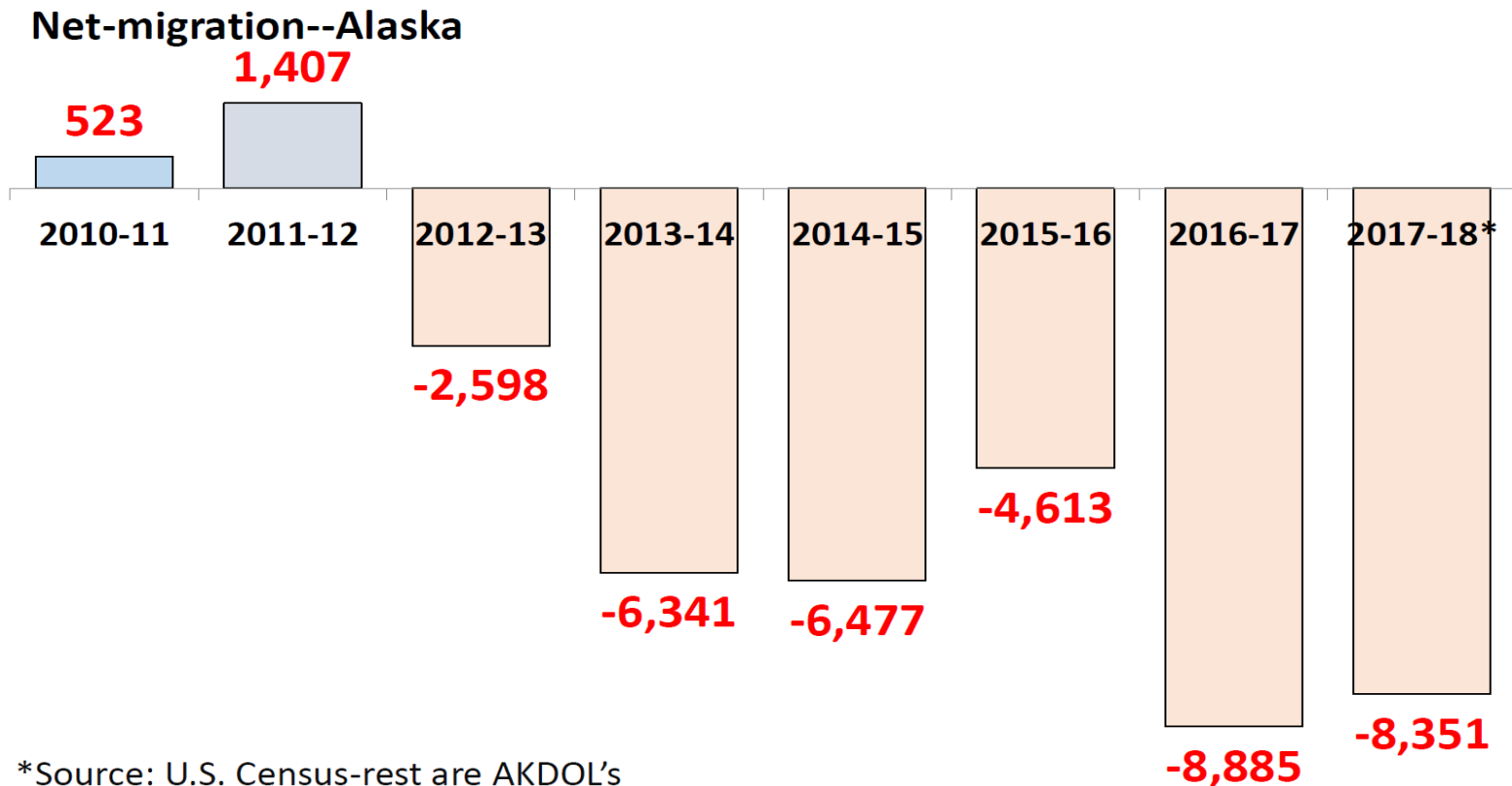
Closing thought: Economic Policy and Alaska's Workforce

1. Tax and spending choices may significantly affect the human capital that will power Alaska's economy.
2. Alaska's workforce (like the rest of the US) is undergoing huge changes.
3. Migration is crucial to the future of Alaska's workforce.

Population Age 20 to 64, Alaska, 1980 to 2045



Net Migration for Alaska



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