

March 2, 2017

Senator Mike Dunleavy
Chairman
Senate State Affairs Committee
Alaska State Capitol
Juneau, AK 99801

Chairman Dunleavy and distinguished Members of the Senate State Affairs Committee:

Thank you for the opportunity to testify today. My name is Matthew Mitchell and I am a senior research fellow at the Mercatus Center at George Mason University. For several years now, my colleagues and I have been studying state fiscal policies and the institutions that govern them. We have consulted decades of peer-reviewed academic research and conducted our own analyses using comprehensive datasets and cutting-edge empirical techniques. I am delighted to have the opportunity to share some of the lessons that we have learned.

Lesson 1: Institutions Matter. States often find themselves in fiscal trouble. They frequently wrestle with unsustainable spending patterns, recurrent shortfalls that necessitate painful decisions, and long-term obligations that cannot be met. Though short-term remedies such as tax increases, skipped pension contributions, or ill-conceived budget cuts can turn red ink into black ink, problems often reemerge. Our research suggests that sustainable solutions require institutional change.

That is, solutions require modifications to the rules that shape the political, legislative, and budgeting process. Simply put, states with good institutions are more likely to make good budgetary decisions.

Lesson 2: The Details Matter. One of the most popular mechanisms for ensuring prudent fiscal policy is a tax and/or expenditure limit (TEL). In my attached 2010 study, “TEL It Like It Is: Do State Tax and Expenditure Limits Actually Limit Spending?,” I examined 30 years of data to see how various TELs performed. A few lessons are clear. The most effective TELs

1. Target spending (as does Alaska’s) rather than revenues,
2. Limit budget growth to the sum of inflation and population growth (as Alaska’s does),
3. Are codified in the constitution (as Alaska’s is),
4. Require a supermajority or public vote to be overridden (as Alaska’s does),
5. Prohibit unfunded mandates to lower-level governments (Alaska’s TEL does not have this provision), and
6. Refund immediately revenue that is collected in excess of the limit to taxpayers (Alaska’s TEL does not have this feature).

As you can see, Alaska's TEL has many of the features that make for a stronger and more effective limit. There is room, however, for some improvement. For example, the state might prohibit unfunded mandates on lower levels of government (about a dozen states have such a prohibition). Or, it might immediately refund to taxpayers any revenue that is collected in excess of the limit (about 5 states currently do this). In addition, the state might reassess the date on which the limit is based. If lawmakers deem real per capita spending in 1981 to be excessive, then they ought to consider a different base date.

Lesson 3: There Are Other Tools. Tax expenditure limits are neither the only nor the most-effective means of ensuring prudent fiscal policy. For example, research suggests that item-reduction vetoes,¹ strict balanced-budget requirements, and supermajority requirements for tax increases are all more effective in restraining spending than TELs. For your reference, I have included my survey with Olivia Gonzalez, "State Budget Institutions," which reviews some of this research.

One institutional difference that seems to have a significant effect on state budgets is discussed in the third attachment, "A House Divided against Itself Cannot Spend (as Much): The Fiscal Effect of Separate Taxing and Spending Committees in State Legislatures." This paper, which I coauthored with Pavel Yakovlev of Duquesne University, explores the effect of having separate committees oversee taxing and spending decisions. Controlling for other factors that might confound the estimate, we conclude that states with separate spending and taxing committees spend between \$300 and \$450 less per person per year relative to other states. This effect—about 9 to 13 percent of annual per capita spending—is larger than almost any other institutional effect. Alaska's House and Senate Finance Committees currently oversee both spending and taxing decisions. Our research suggests that the state could significantly reduce spending by separating these functions into separate committees in each chamber.

I hope that this research helps you think through institutional changes that might set Alaska on an even more prudent fiscal path. I am happy to answer any questions you might have.

Sincerely,

Matthew Mitchell, PhD

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Attachments

¹ This is a special variety of veto authority that allows the governor to spend less on an item than the legislature is calling for. In contrast to the more-common line-item veto, the governor need not eliminate the item altogether if he or she opposes it.