

# Presentation to Senate State Affairs Committee

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Jan. 24, 2017



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# Budget context

- FY2017 budget gap: \$ 3.0 billion
- Approx. max sustainable flow from Permanent Fund (incl. ER, CBR):  
 $4.5\% \times \$60 \text{ B} = \$ \underline{2.7 \text{ billion}}$   
\$300 million

So the long run gap:

\$1000 PFD: \$300 M + \$700 M = \$ 1 billion

\$2000 PFD: \$300 M + 1.4 B = \$1.7 billion

# Plus:

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

# 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 per \$100 million change in state budget

- Taxes: 450 to 800 jobs
- Dividend cut: 550 to 900 jobs
- Budget cut: 1000 to 1250 jobs

# Why a multi-year plan?

## I. Both risk and opportunity

- Being forced into a large one or two year adjustment will seriously harm economy.
- Change is inevitable, but Alaska's savings allow a multi-year adjustment.

# Why a multi-year plan?

## II. Business impacts are inevitable and will not be uniform.

- Both further spending cuts and additional revenues seem unavoidable.
- Different cuts and taxes will affect businesses differently.

# Examples of business effects

- 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 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 \$.1225/gal. (Lowest.)
- No personal income tax. (Like 6 other states; 2 tax dividend and interest.)

# Alaska's current 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.

# 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

# Coordinating with Federal Tax

- Only one state uses Federal taxes paid as base.
- Different income/tax bases from Federal income
  - Total income, line 22 of Form 1040
  - Adjusted gross income, line 37
  - Adjusted gross income with further adjustments
  - Taxable income, line 43
  - Tax/alternative minimum tax, lines 44/45
  - Tax after credits, line 56

# 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.

# Permanent Fund Dividend cuts

- PFD is a very progressive program.
- Therefore, cutting PFD has a strongly regressive effect.

# Spending cut effects

- Impacts depend upon what you cut.
- Details matter, such as impact on federal receipts.
- Education cuts will increase local taxes.
- Other cuts (*e.g.*, university) will shift costs.
- Long run goal is to fund services whose value to Alaskans exceeds their cost.

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# 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.

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