

A Small Tax and a Moderate Dividend: Towards a Sustainable Fiscal Solution



Representative Adam Wool
Presentation to the House Judiciary Committee
June 9, 2021

Where We Are

After oil prices collapsed in late 2014, Alaska needed to accomplish four things in order to establish a sustainable budget:

1. Major budget cuts (mostly implemented 2015-2018).
2. Structured use of Permanent Fund earnings (SB26 passed for FY2019).
3. Revised Permanent Fund Dividend formula to work with new POMV and our fiscal reality. (Formulas were passed by both the House and Senate in separate versions of SB26, but neither survived the conference committee. Other formulas have been since proposed in several bills.)
4. New revenues to fill any remaining gap.

**Thus far, only #1 and #2 have been accomplished.
My proposal resolves the rest.**

What is needed?

Depending on oil prices, Permanent Fund earnings, and future budget sizes, the next couple budgets are likely to be approximately balanced with a relatively small (~\$500) Permanent Fund Dividend.

Unless massive budget cuts can be achieved, two major changes must be made to balance Alaska's budget for the foreseeable future and form the centerpiece of a sustainable fiscal plan:

1. Restructuring the annual dividend formula to set future dividends to about \$1,000 per Alaskan
2. A combination of new revenues (most likely a broad-based tax on individuals) raising approximately \$500 million

If higher dividends are desired, revenues will similarly need to be higher.

...but first a little background

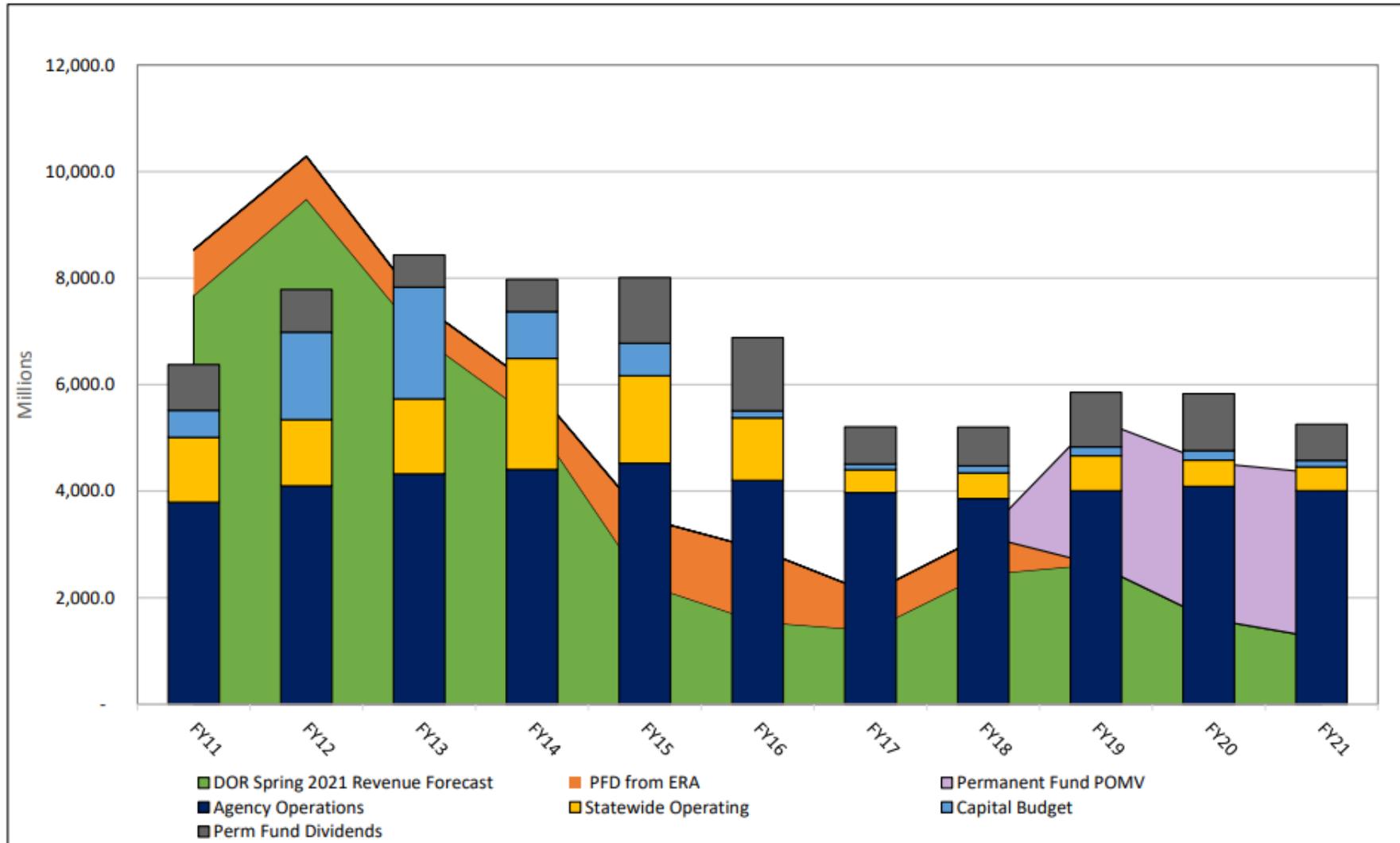
Ways and Means Committee Process Told the Story

- Revenue declines, beginning in 2014
- Budget cuts and major draw-down of savings
- Introduction of POMV as a central revenue feature
- Ongoing structural deficits
- Lack of resolution of the Dividend question
- Alaskans pay the lowest state and local taxes among the 50 states

Once a consensus is reached that we need additional revenue, new questions emerge:

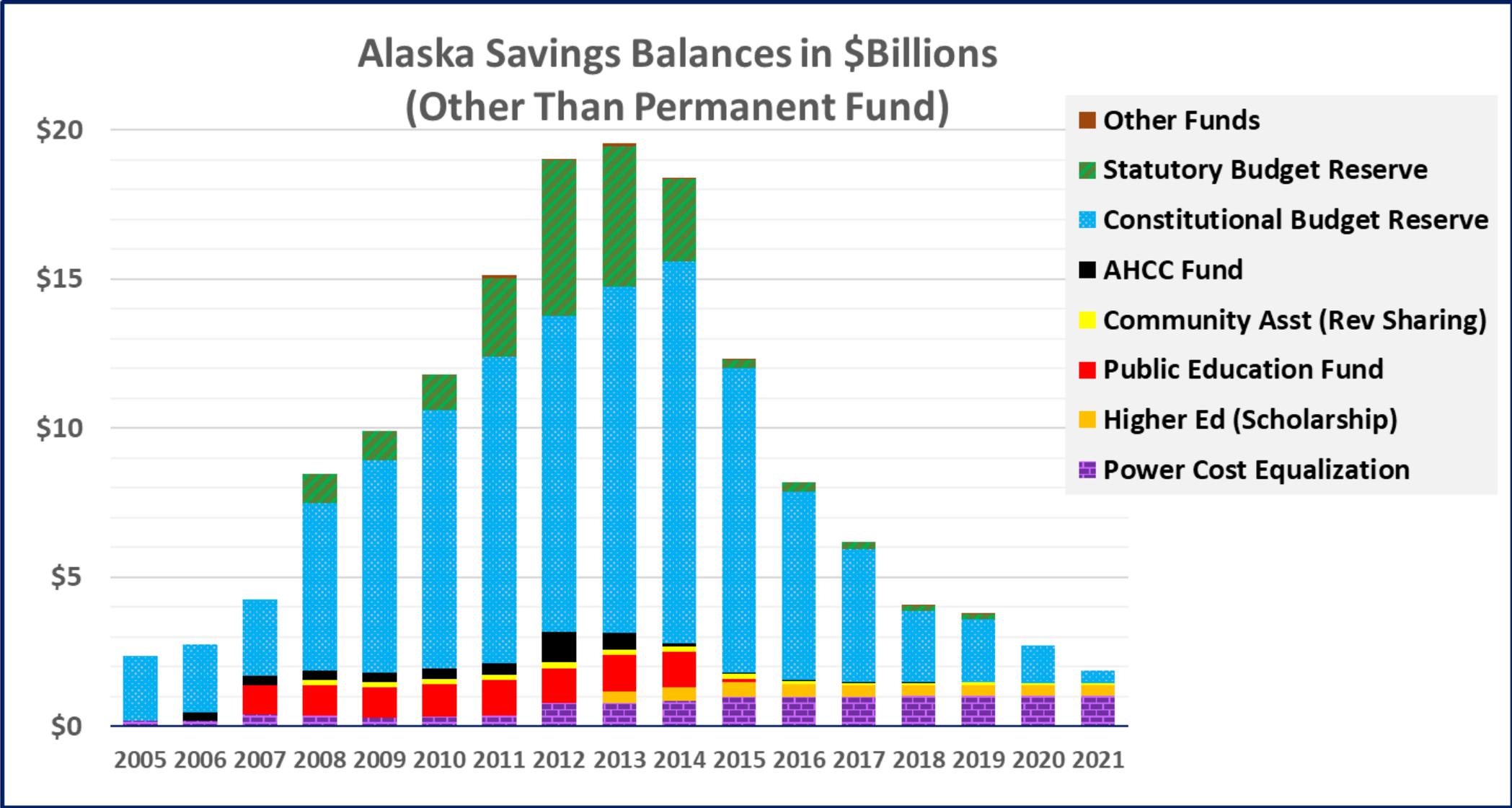
- Pros and Cons of Income Tax vs. Sales Tax vs. Other
- How much revenue to raise / how large should the dividend be?
- Structural and technical details of the bill

Last 10 years: revenue declines, budget cuts, and (beginning in FY19), use of Permanent Fund earnings

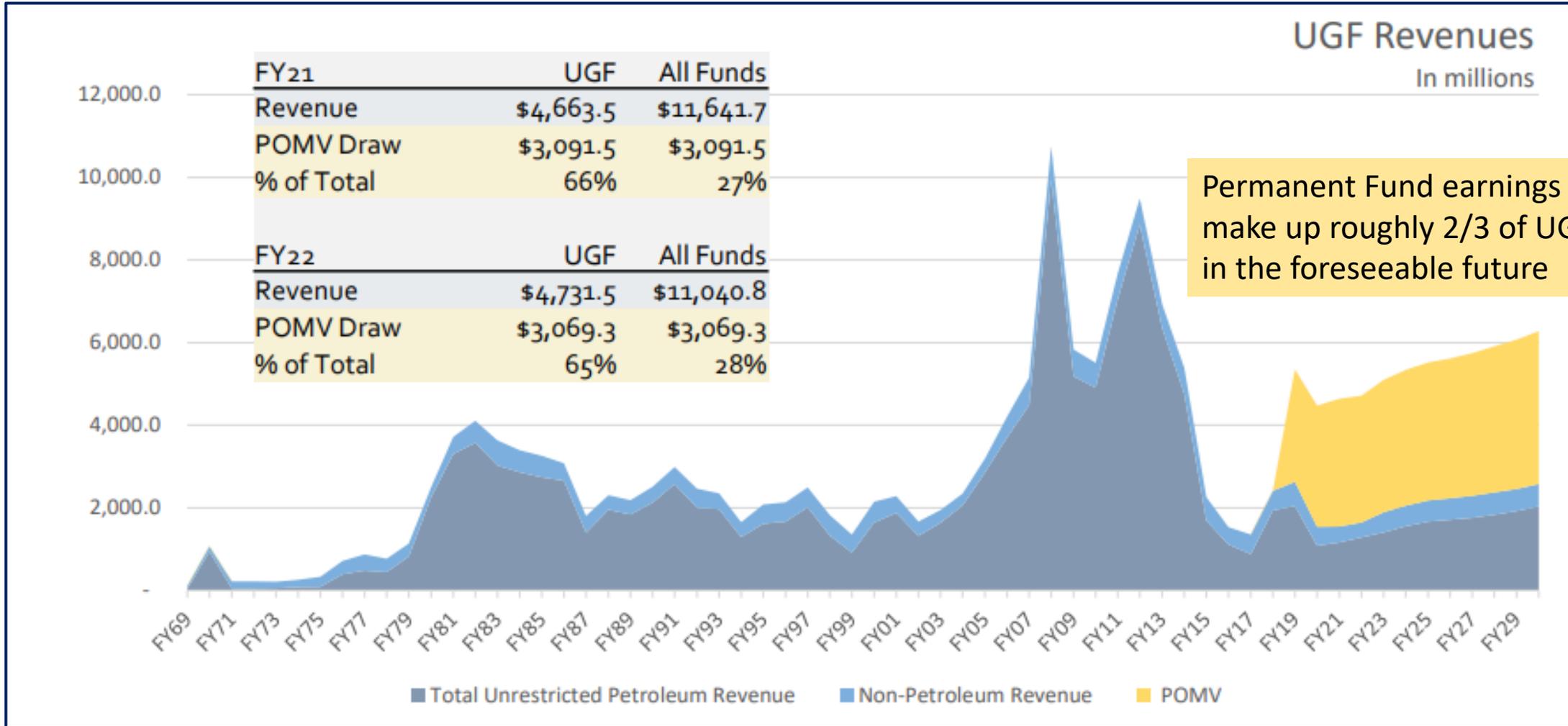


Source: Legislative Finance Presentation to House Ways and Means, 3/30/21

Most of the savings that were drawn down 2014-2021 were set aside during the high oil price years 2007-2013



Permanent Fund Corporation's Forecast



Source: APFC Presentation to House Ways and Means, 4/1/21

Even with higher oil revenue in the Spring forecast, the 10-year plan shows large ongoing shortfalls

Fiscal Year 2022 Ten Year Outlook - March 2021									
<i>(Amounts in millions)</i>									
Unrestricted Revenues	FY2022	FY2023	FY2024	FY2025	FY2026	FY2027	FY2028	FY2029	FY2030
Traditional UGF Revenue	1,662.2	1,921.0	2,085.1	2,223.9	2,282.8	2,346.3	2,436.5	2,531.5	2,658.5
Permanent Fund POMV GF Draw	3,069.3	1,596.9	1,621.0	1,625.9	1,630.4	1,647.1	1,672.2	1,708.7	1,747.7
Other Revenue Sources		787.9	497.4	403.9	397.9	378.8	328.5	257.2	148.4
Total Revenue	4,731.5	4,305.9	4,203.5	4,253.7	4,311.0	4,372.8	4,437.2	4,497.4	4,554.6
Unrestricted General Fund Expenditures	FY2022	FY2023	FY2024	FY2025	FY2026	FY2027	FY2028	FY2029	FY2030
Agency Operations	3,821.4	3,712.7	3,612.7	3,666.9	3,721.9	3,777.7	3,834.4	3,891.9	3,950.3
Statewide Items	483.1	466.3	462.1	456.1	456.4	460.4	466.2	466.7	463.5
Operating Budget	4,304.5	4,179.0	4,074.8	4,123.0	4,178.3	4,238.2	4,300.5	4,358.7	4,413.8
Capital Budget	62.2	126.9	128.8	130.7	132.7	134.7	136.7	138.7	140.8
Total General Fund Appropriations	4,366.7	4,305.9	4,203.5	4,253.7	4,311.0	4,372.8	4,437.2	4,497.4	4,554.6
Budget change from previous year	(294.6)	(60.8)	(102.3)	50.2	57.3	61.8	64.4	60.2	57.2
Surplus/(Deficit)	364.8	0.0							
Savings draw from Constitutional Budget Reserve									
Permanent Fund Dividend	FY2022	FY2023	FY2024	FY2025	FY2026	FY2027	FY2028	FY2029	FY2030
PFD Fund Sources									
Permanent Fund POMV for PFD (50%)		1,596.9	1,621.0	1,625.9	1,630.4	1,647.1	1,672.2	1,708.7	1,747.7
Permanent Fund Earnings Reserves	2,023.9								
PFD Appropriation	2,023.9	1,596.9	1,621.0	1,625.9	1,630.4	1,647.1	1,672.2	1,708.7	1,747.7
Per capita PFD	\$3,057	\$2,382	\$2,416	\$2,410	\$2,404	\$2,417	\$2,441	\$2,482	\$2,527

Source: Office of Management and Budget Presentation to House Ways and Means, 3/30/21

The revised 10-year plan introduced this special session includes larger future POMV draws based on recent market gains

Fiscal Year 2022 Ten Year Outlook - Governor's Amended Budget, Spring 2021 Price Forecast, Updated DOR Permanent Fund Outlook										
(Amounts in millions)										Surplus FY27-30
Unrestricted Revenues	FY2021	FY2022	FY2023	FY2024	FY2025	FY2026	FY2027	FY2028	FY2029	FY2030
Traditional UGF Revenue	1,668.0	1,662.2	1,921.0	2,085.1	2,223.9	2,282.8	2,346.5	2,436.5	2,531.5	2,658.5
Permanent Fund POMV Draw	3,091.5	1,534.6	1,658.7	1,742.1	1,813.3	1,885.4	1,970.5	2,002.0	2,046.7	2,085.9
New Revenues/Reductions	0.0	0.0	0.0	150.0	300.0	300.0	300.0	300.0	300.0	300.0
Total Revenue	4,759.5	3,196.9	3,579.7	3,977.2	4,337.2	4,468.2	4,617.4	4,738.5	4,878.2	5,044.4
Total General Fund Appropriations	4,508.1	4,612.6	4,477.8	4,428.9	4,502.4	4,555.0	4,529.2	4,531.0	4,592.6	4,651.2
Draw From CBR Bridge Fund	0.0	1,415.8	898.0	451.8	165.1	86.7	0.0	0.0	0.0	0.0
Budget Surplus	0.0	0.0	0.0	0.0	0.0	0.0	88.5	207.9	286.2	393.6
Constitutional Budget Reserve End B	1,048.4	2,632.6	1,802.2	1,401.5	1,274.4	1,223.2	1,346.2	1,591.0	1,919.0	2,360.9
Unrestricted Revenues	FY2021	FY2022	FY2023	FY2024	FY2025	FY2026	FY2027	FY2028	FY2029	FY2030
50% POMV For PFD (\$millions)	0.0	1,534.6	1,658.7	1,742.1	1,813.3	1,885.4	1,970.5	2,002.0	2,046.7	2,085.9
PFDs (\$/Alaskan)	992.0	2,354.0	2,512.0	2,624.0	2,718.0	2,813.0	2,927.8	2,959.0	3,011.0	3,055.0
Total Spending	4,508.1	6,147.3	6,136.5	6,170.9	6,315.7	6,440.5	6,499.7	6,533.0	6,639.3	6,737.1
Permanent Fund End Balance	FY2021	FY2022	FY2023	FY2024	FY2025	FY2026	FY2027	FY2028	FY2029	FY2030
Updated 5/18/21	77,586.1	76,456.4	79,139.8	80,730.8	82,320.9	83,885.3	85,399.6	86,972.1	88,579.2	90,218.8

After five years (FY2027), when the higher fund value is fully incorporated into the “lookback period” for the POMV, the forecasted draw is \$650 million higher than it was in March.

A “Perfect Storm” is required for all these forecasts to work

1. No major market correction in the next 9 years
2. Oil prices steadily increasing towards \$71 / bbl in 2030
3. Three more years of likely unobtainable operating budget cuts and ongoing minimal capital budgets, with below-inflation growth thereafter

Legislative Finance’s baseline budget is very different than the Governor’s:

Governor Minus LFD Baseline	FY22	FY23	FY24	FY25	FY26	FY27	FY28	FY29	FY30	Total
Agency Ops Difference	(65.7)	(182.2)	(328.2)	(353.6)	(379.9)	(406.9)	(434.8)	(463.5)	(493.1)	(3,107.9)
Statewide Difference	(74.9)	(78.2)	(141.4)	(142.3)	(133.0)	(130.7)	(130.7)	(129.8)	(136.4)	(1,097.4)
Capital Difference	56.5	(27.9)	(29.3)	(30.6)	(32.0)	(33.4)	(34.9)	(36.4)	(38.0)	(206.1)
Fund Transfers Difference	5.3	(14.6)	(14.6)	(14.6)	(14.6)	(14.6)	(14.6)	(14.6)	(14.6)	(111.5)
Supp Difference	(50.0)	(50.0)	(50.0)	(50.0)	(50.0)	(50.0)	(50.0)	(50.0)	(50.0)	(450.0)
Total Difference	(128.8)	(352.9)	(563.5)	(591.2)	(609.5)	(635.7)	(665.1)	(694.3)	(732.1)	(4,972.9)

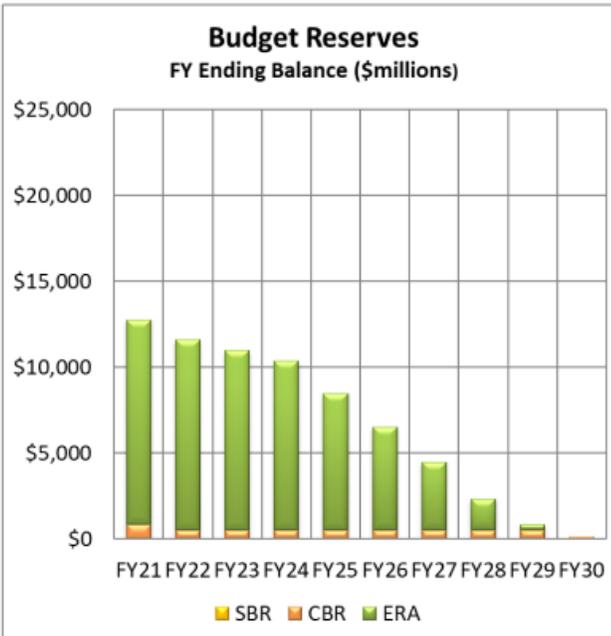
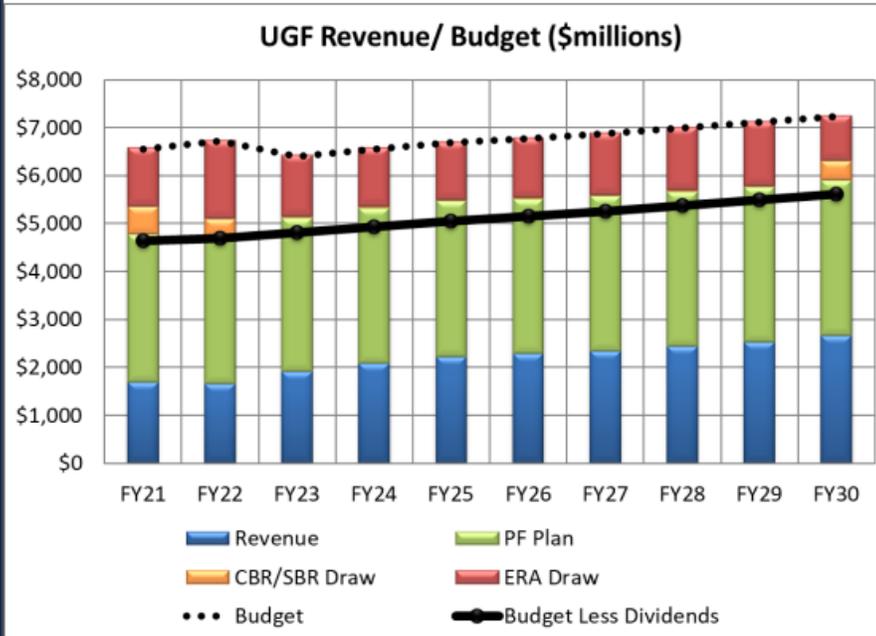
50/50 Dividend Without Revenue Crashes the System

Fiscal Model: UGF in Place of COVID-19 Funding, Typical Fund Sources (UGF)

Supp. PFD in FY21, Statutory PFD in FY22, 50/50 of POMV PFD FY23-30

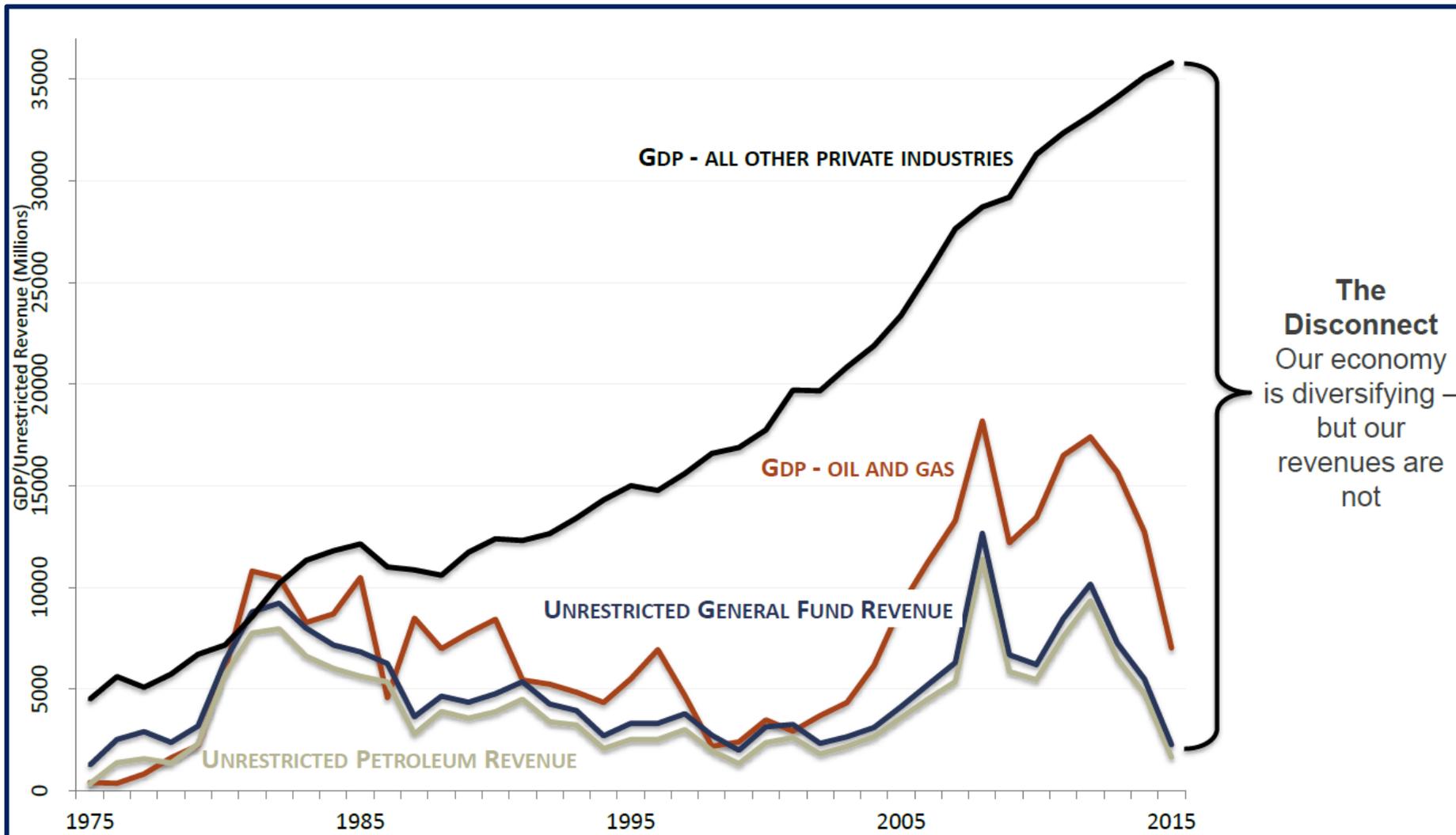
Constant 6.75% Returns

Surplus/(Deficit) (\$millions)	FY21	FY22	FY23	FY24	FY25	FY26	FY27	FY28	FY29	FY30
	-1,814	-2,006	-1,311	-1,246	-1,229	-1,269	-1,313	-1,337	-1,369	-1,346



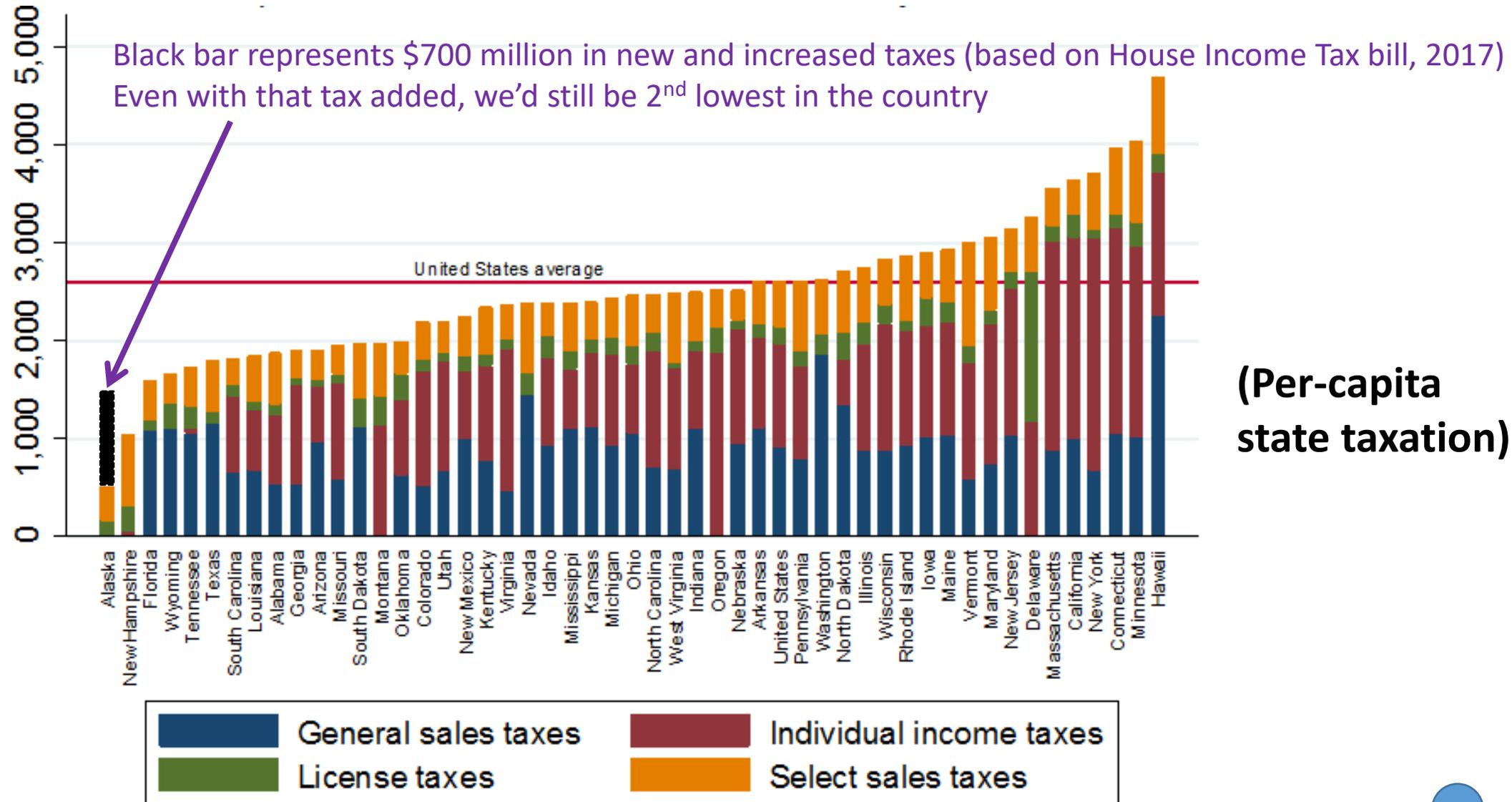
Effective POMV Draw Rate	FY21	FY22	FY23	FY24	FY25	FY26	FY27	FY28	FY29	FY30
	7.33%	7.65%	7.01%	6.88%	6.86%	6.93%	7.00%	7.03%	7.08%	6.45%

Alaska's current revenue structure hasn't kept pace with our changing economy



Source: DCCED Commissioner Mike Navarre, Presentation to House Finance 3/20/18

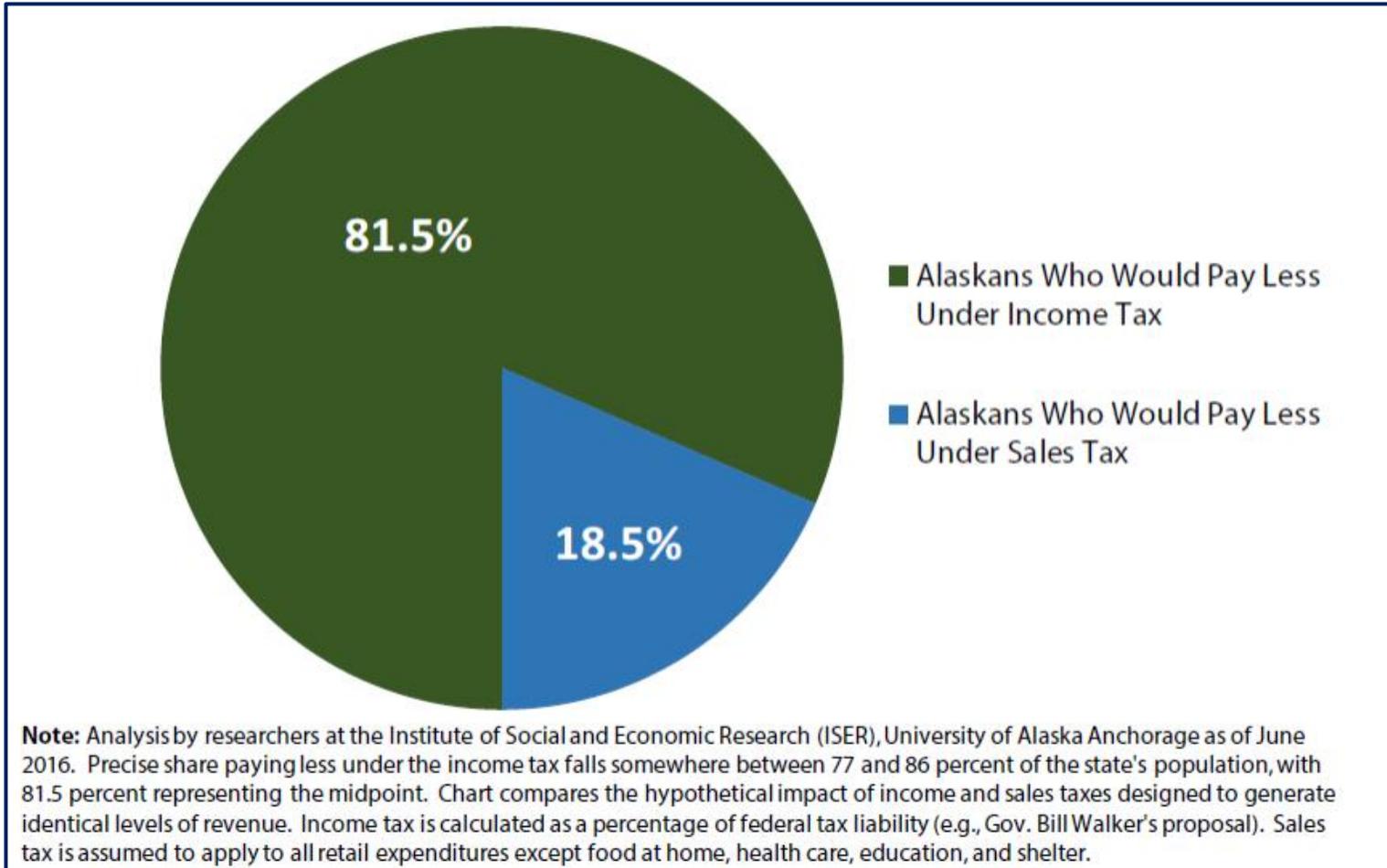
Adding a moderate tax would not change that much



Source data: Mouhcine Guettabi, ISER

Revenue Options: Sales vs. Income

The great majority pay less with an income tax vs. a sales tax



The 81st percentile Alaska household makes about \$100,000 / year

Details of My Proposal

Permanent Fund Changes

- **Replaces the current Dividend formula to one based on 10% of the annual Percent of Market Value draw plus 30% of oil and gas royalties**

FY2023 POMV Draw:	\$3,194 million
10% towards the dividend	\$319 million
FY2023 Royalty Forecast (\$62 oil)	\$1,192 million
<u>30% towards the dividend</u>	<u>\$358 million</u>
Total Dividend Funding	\$677 million
Per Capita Dividend	\$995

The roughly \$1,000 dividend should grow to \$1,200-\$1,300 by 2030

Permanent Fund Changes

Future dividends are tied to both our accumulated savings (the permanent fund itself) as well as the health of the industry (oil royalties)

Other Permanent Fund changes in the bill

- Repeals the statutory 50% “corpus” deposit of royalties from leases signed after 1979
 - The 25% constitutional requirement remains: 25% of all royalties, bonus payments, etc. will continue to be deposited.
 - The additional 25% is approximately \$57 million in FY2021; this amount would remain in the general fund available for appropriation
- Repeals the “Amerada Hess” set-aside, where the annual earnings on a specific \$420 million settlement from the early 1990s are excluded from the POMV and dividend calculations
 - About \$27 million / year currently goes to the Capital Income Fund

Income Tax

Flat rate 2.5% tax based on federal “Adjusted Gross Income” (AGI)

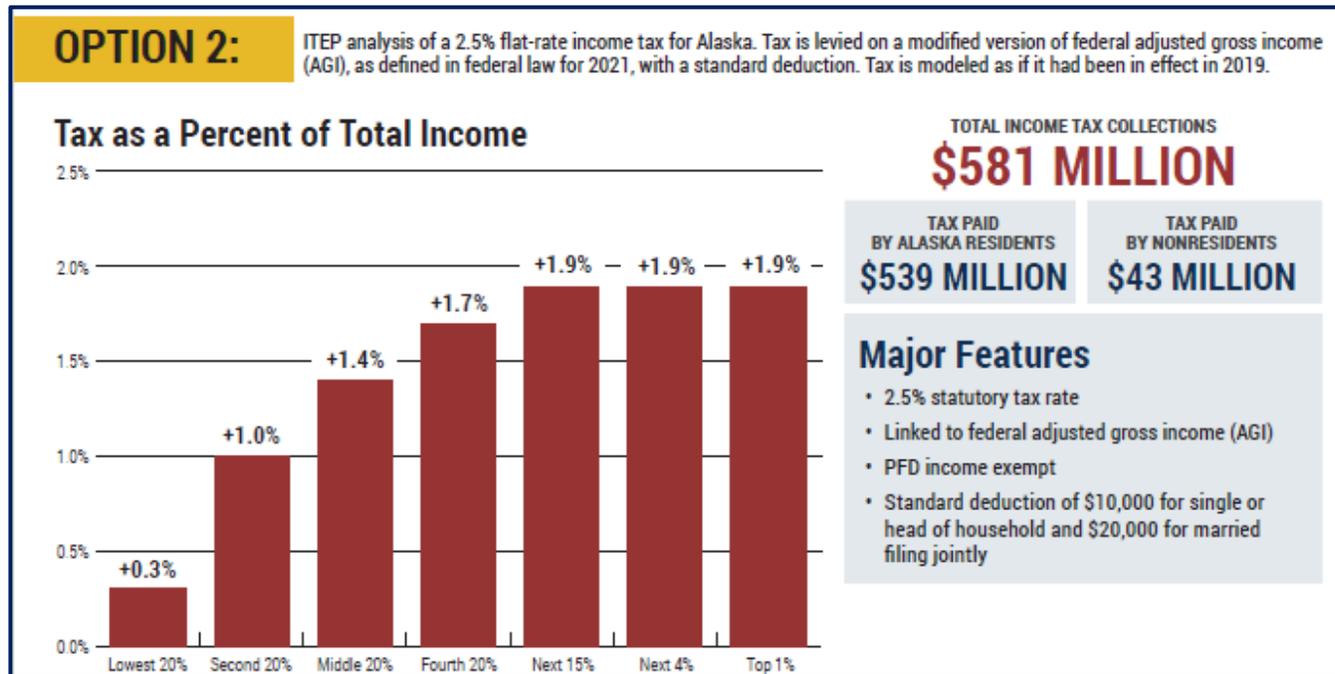
- Metric that is the most widely used among states with income taxes
- Includes all income: wages, self employment, earnings of partnerships and S-corps, capital gains, retirement, etc.
- “Adjustments” to income (i.e. non-taxed items) include retirement contributions, student loan interest, and alimony payments.
- So-called “itemized” deductions, like mortgage interest, are taken after AGI and would therefore be taxed

“Standard Deduction” tied to federal code: First \$12,550 (single), \$18,800 (head of household), and \$25,100 (joint) is not taxed

- PFD payments are also non-taxable income
- Largely eliminates the tax burden on lower-income Alaskans and provides a form of “means testing” for the dividend

Revenue and Impacts

- The LB&A Committee hired the Institute on Taxation and Economic Policy (ITEP) last fall, to look at several different “flat rate” income tax options
- The original bill (2.5%, \$10k/\$20k standard deduction) was “Option 2”
- The consultant estimated \$581 million annual revenue (**Fiscal note: \$580 million**)
- The amended bill, with a higher standard deduction, is estimated at \$545 million



Even after paying a tax, most Alaskans would still receive a dividend

- The forecasted FY2023 POMV draw is just under \$3.2 billion
- A dividend based on 10% of that plus 30% of oil royalties would be a \$677 million appropriation, working out to roughly a \$995 dividend per person
- **For the majority of Alaskans, their tax burden will be less than their dividend, meaning they will still receive a net payment from the state**

Tax Liability in 2023 for Different Household Types and Income Levels

Taxpayer Type		\$25,000	\$50,000	\$100,000	\$200,000
Single Person	Dividend	\$995	\$995	\$995	\$995
	Tax	\$286	\$911	\$2,161	\$4,661
	Net Dividend	\$709	\$84	(\$1,166)	(\$3,666)
Single Parent / 1 Kid	Dividend	\$1,990	\$1,990	\$1,990	\$1,990
	Tax	\$105	\$730	\$1,980	\$4,480
	Net Dividend	\$1,885	\$1,260	\$10	(\$2,490)
Married Couple	Dividend	\$1,990	\$1,990	\$1,990	\$1,990
	Tax	\$0	\$573	\$1,823	\$4,323
	Net Dividend	\$1,990	\$1,417	\$167	(\$2,333)
Married / 2 Kids	Dividend	\$3,980	\$3,980	\$3,980	\$3,980
	Tax	\$0	\$523	\$1,773	\$4,273
	Net Dividend	\$3,980	\$3,457	\$2,207	(\$293)

Other options: partial list of specific dividend proposals from the last few years

Year	Bill	Sponsor	PF Draw Formula	Dividend Formula	Est. 2021 Dividend	Note
2016	SB128	Gov. Walker	\$3.3 billion fixed + inflation	50% of oil royalty	\$1,000	Most current oil revenue deposited into the Permanent Fund
2017	SB21	Sen. Stedman	4.5% POMV / prev 5 yrs	50% of POMV	\$2,100	
2017	SB26	Gov. Walker	5.25% / first 5 of prev 6 yrs	20% POMV + 20% oil royalty	\$1,300	Original introduced version
2017	SB26	Gov. Walker	5.25% / first 5 of prev 6 yrs; to 5% after 3 years	25% of POMV	\$1,200	Senate-passed version
2017	SB26	Gov. Walker	5.25% / first 5 of prev 6 yrs; to 5% after 3 years	33% of POMV	\$1,600	House-passed version
2018	SB26	Gov. Walker	5.25% / first 5 of prev 6 yrs; to 5% after 3 years	none	n/a	FINAL CONFERENCE COMMITTEE
2019	HB132	Rep. Wool	SB26 POMV	lesser of 33% of oil royalty + tax or \$1,800	\$1,800	
2020	HB300	Rep. Wool	SB26 POMV	15% of POMV	\$700	Allocated rest of POMV
2020	HB306	Rep. Kopp	SB26 POMV	20% of POMV	\$1,000	
2021	HB37	Rep. Wool	SB26 POMV	10% of POMV + 30% of oil royalty	\$1,000	Income tax bill. CS from W&M. Original was 20% of POMV.
2021	HB229	Rep. Merrick	SB26 POMV	30% of oil royalty	\$500	
2021	SJR1	Sen. Wielechowski	SB26 POMV	Higher of current formula or 50% POMV	\$3,500	
2021	SJR18	Sen. VonImhof	SB26 percentages with split funds	50% POMV from new "ARORA" fund	\$500	ARORA endowed with \$6.7 billion based on past short-payments

Conclusions

A \$2,500 dividend, as proposed by the governor, is risky and unaffordable.

A \$500 dividend, which is what we can afford without taxes or major budget cuts, is too low to be acceptable to most Alaskans.

A moderate tax bill, such as the one I introduced, is the cleanest way to resolve the entire fiscal deficit.

The two pieces are roughly equal in size and impact:

- Adds approximately \$600 million / year in new revenue
 - \$545 million in tax revenue plus \$57 million in additional UGF royalties
- Clarifies and reduces the state's commitment to PFDs
- New dividend payment will be about \$677 million
- Budget would be balanced at any oil price greater than about \$50 / bbl

This enables us to afford the dividend into the future while maintaining a stable state budget

THANK YOU



Feel Free to Call or Email with Any Questions

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