

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



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Presentation to the Joint Fiscal Plan Working Group
July 26, 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-\$700) 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

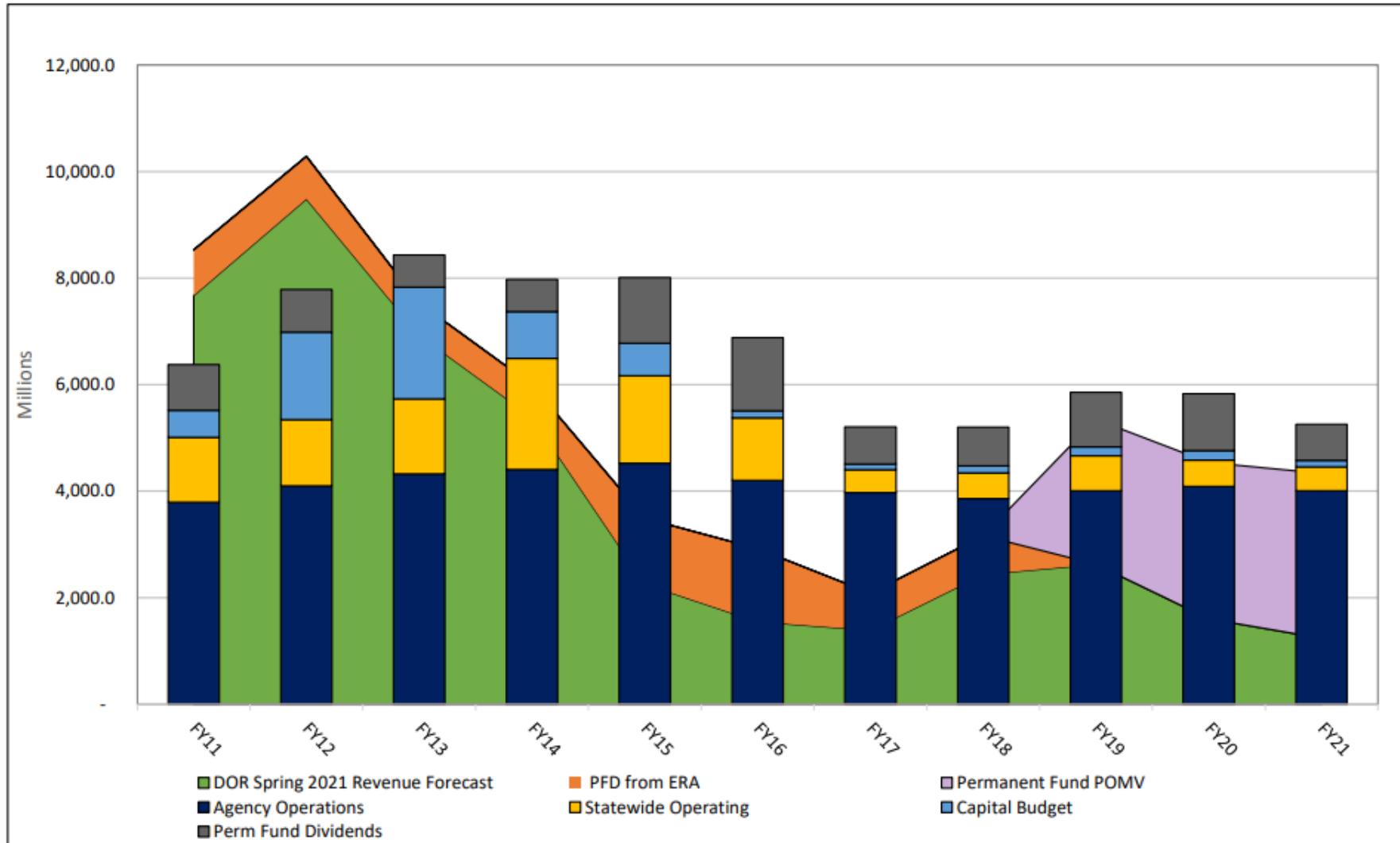
Ways and Means Committee Process Told the Story

- 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:

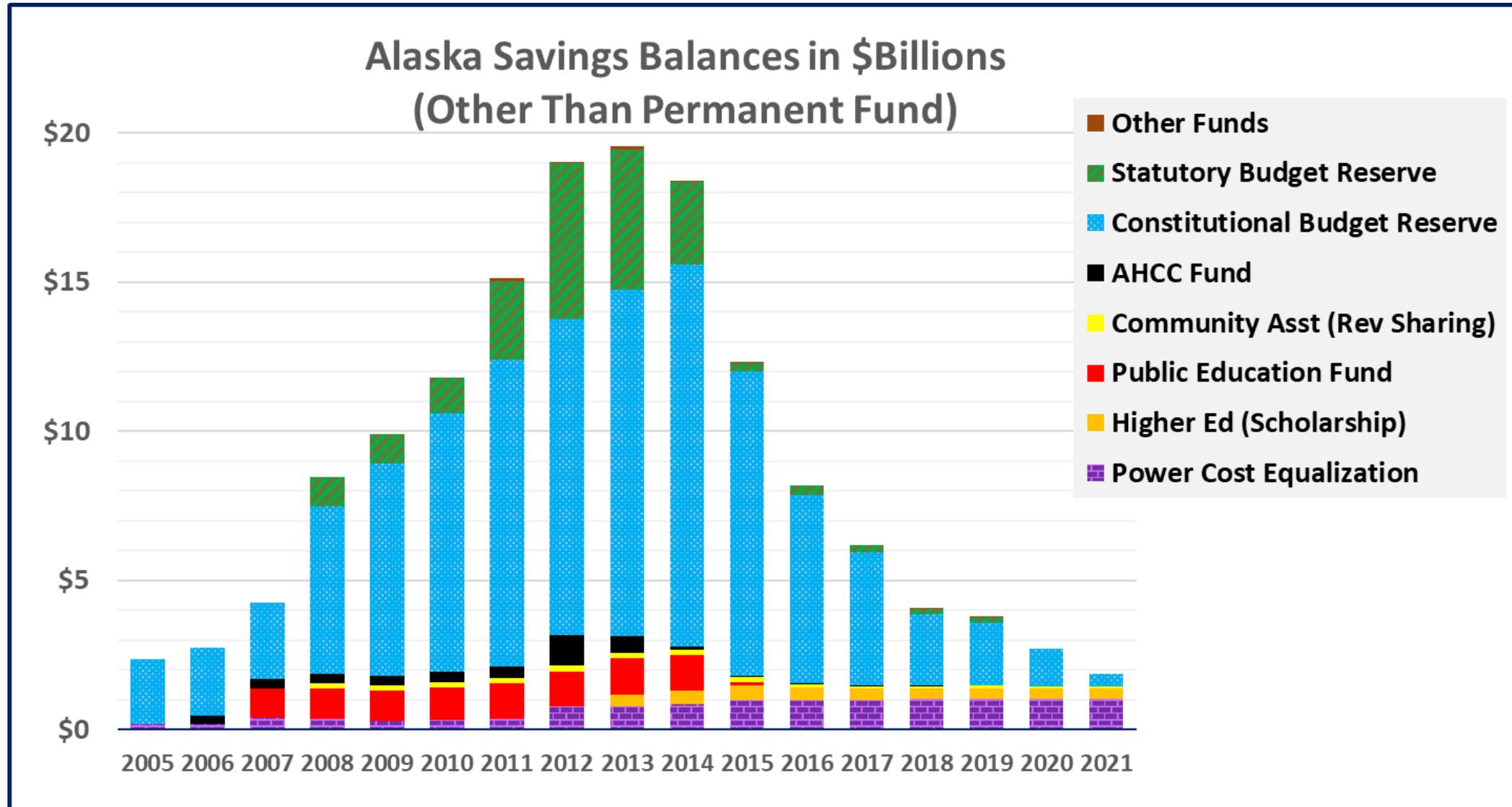
- Pros and Cons of Income Tax vs. Sales Tax vs. Other
- How much revenue to raise / how large should the dividend be?
- Structural and technical details of the bill

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



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 last 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.

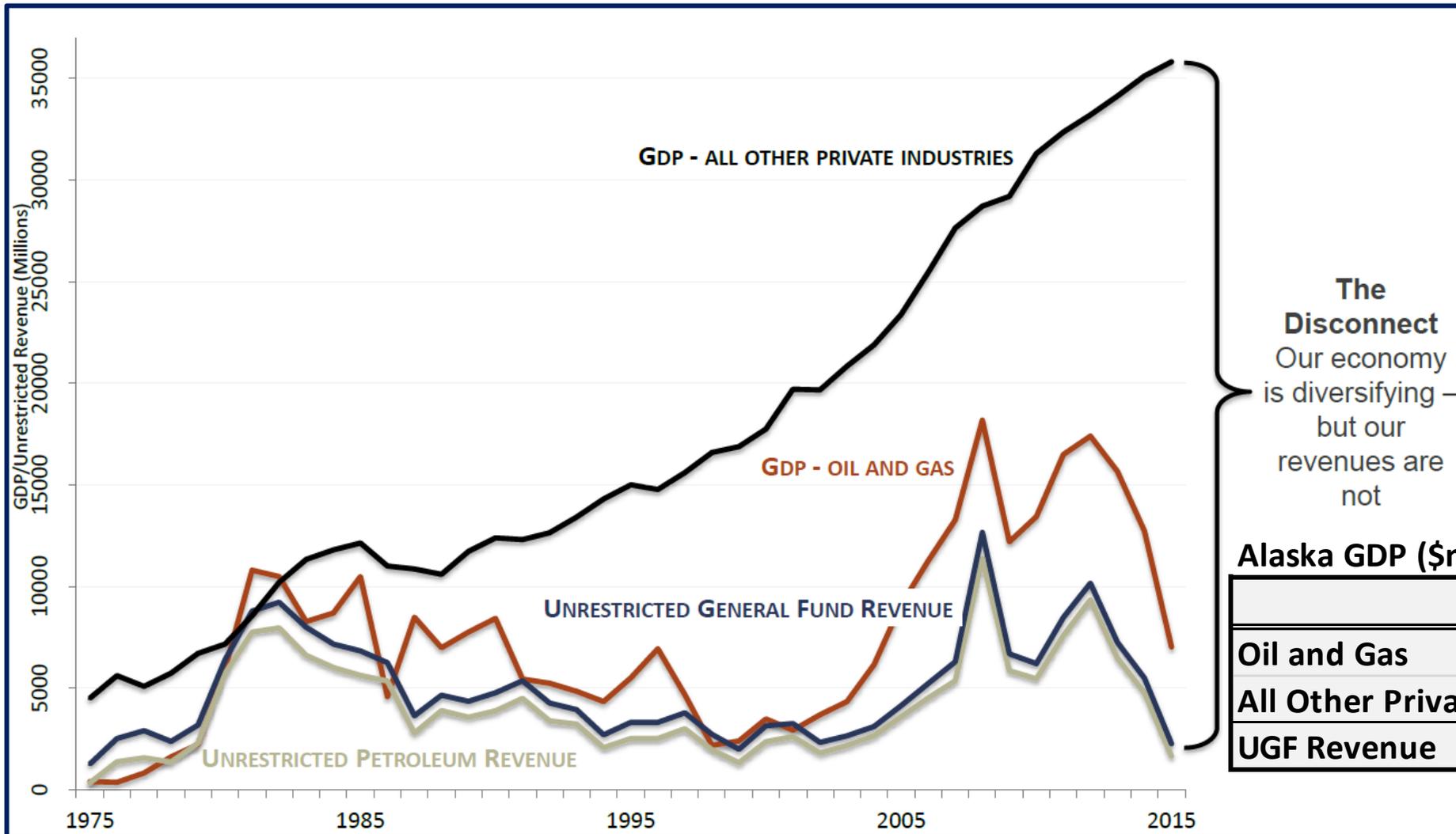
A “Perfect Storm” is required for all these forecasts to work

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 | - | - | - | - | - | - | - | - | 5.3 |
| 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) | (4,856.1) |

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



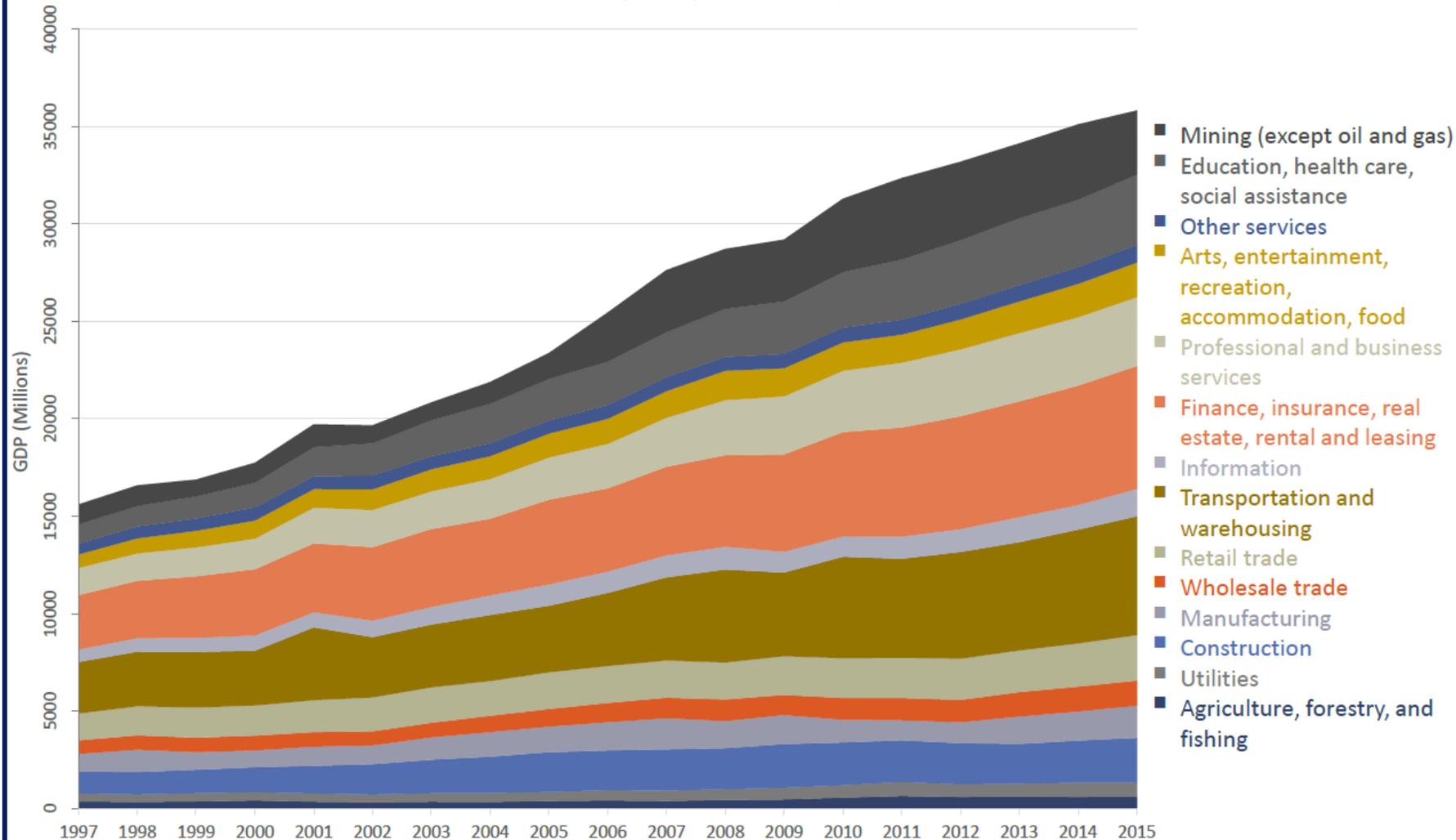
The Disconnect
Our economy is diversifying – but our revenues are not

Alaska GDP (\$millions)

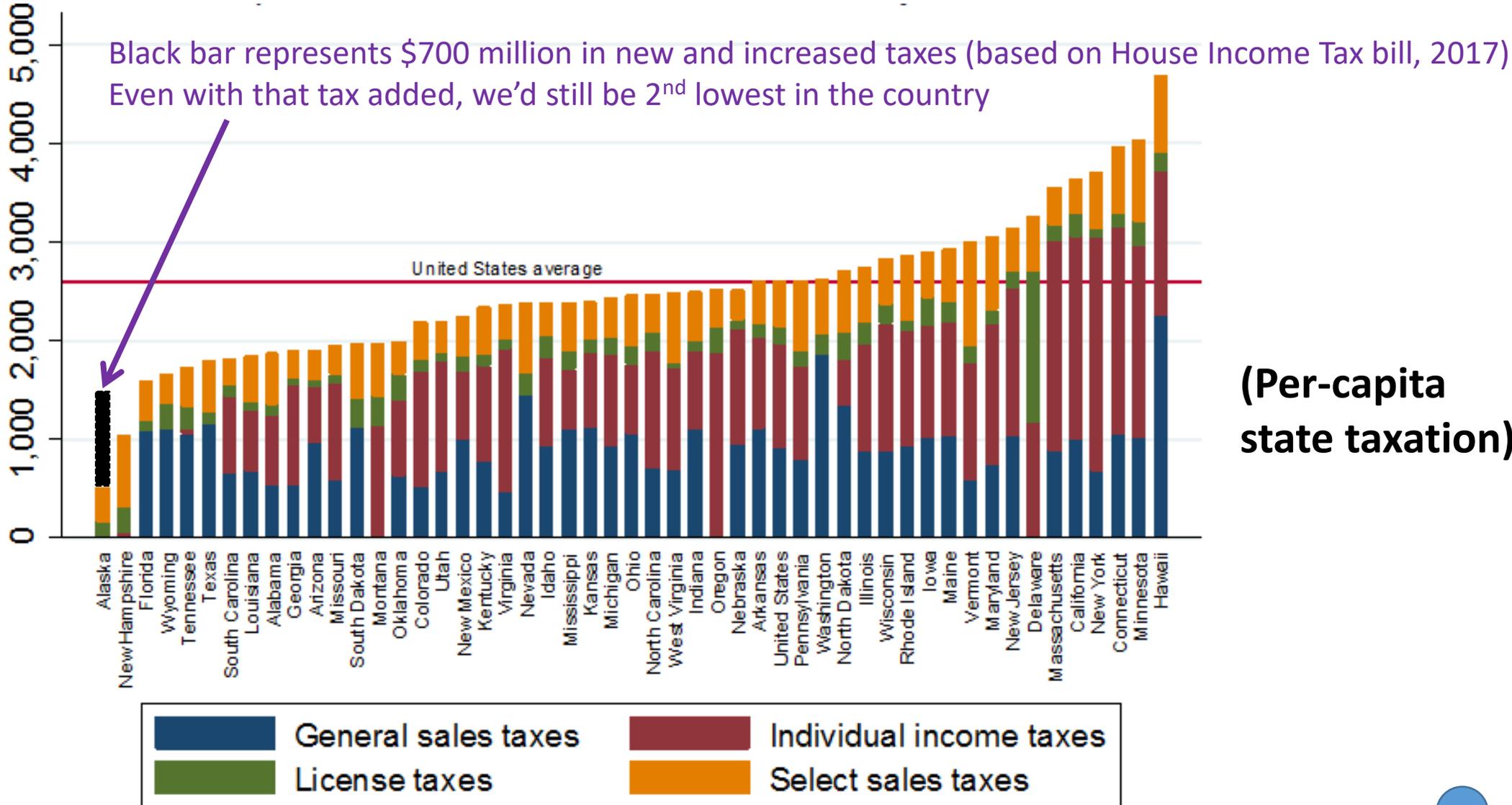
| | 2000 | 2019 | growth |
|-------------------|----------|----------|--------|
| Oil and Gas | 3,463.5 | 4,731.1 | 37% |
| All Other Private | 17,745.6 | 38,066.2 | 115% |
| UGF Revenue | 2,147.6 | 2,642.5 | 23% |

Detail on which sectors have grown the most in the last 20+ years

Nominal GDP of All Other (non-petroleum) Private Industries, 1997-2015



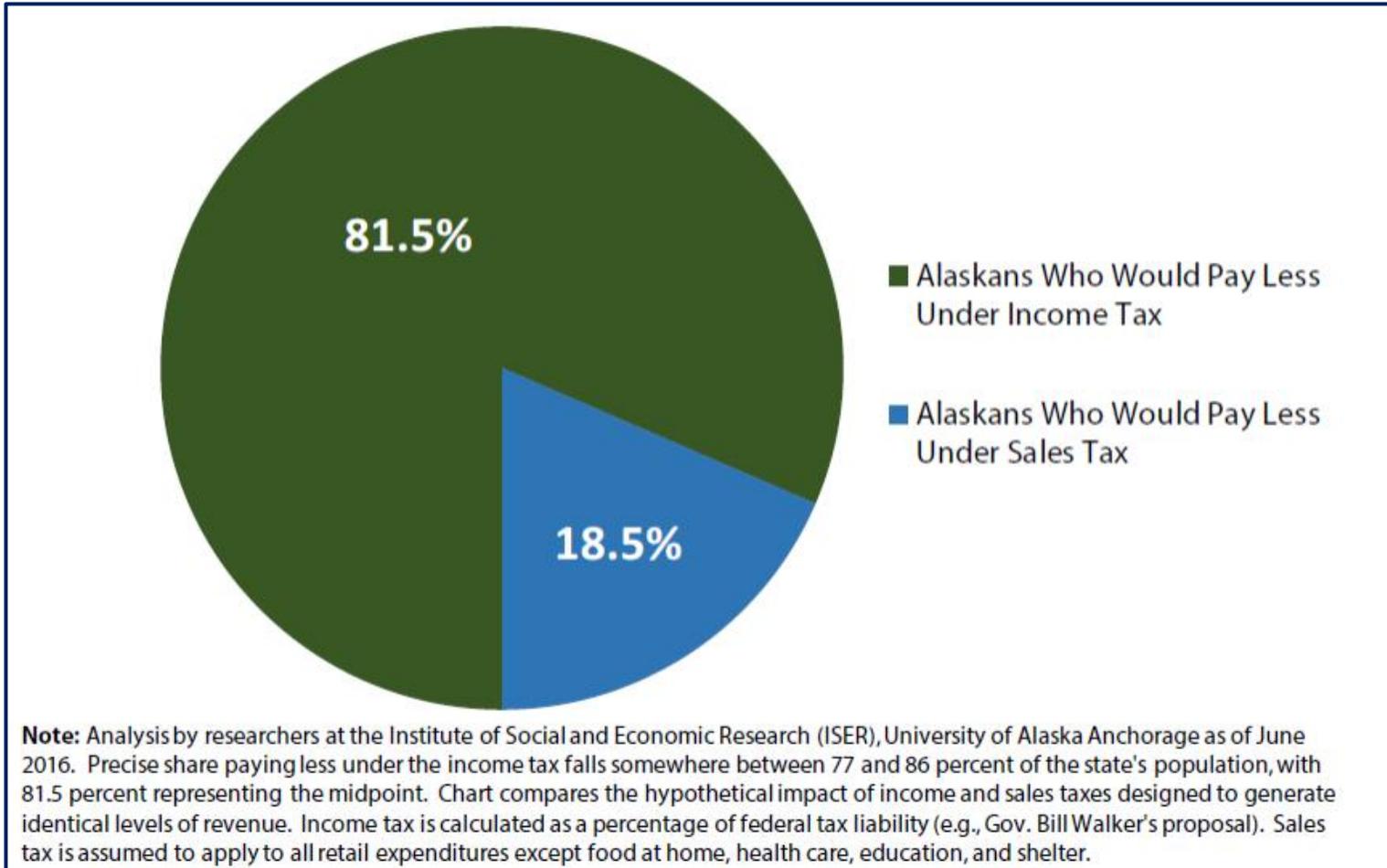
Adding a moderate tax would not change that much



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: | \$3,347 million |
| 10% towards the dividend | \$335 million |
| FY2023 Royalty Forecast (\$62 oil) | \$1,192 million |
| <u>30% towards the dividend</u> | <u>\$358 million</u> |
| Total Dividend Funding | \$692 million |
| Per Capita Dividend | \$1,019 |

Per current forecasts, the roughly \$1,000 dividend will grow to \$1,400-\$1,500 by 2030

*** POMV adjusted based on 7/20 Leg Finance presentation**

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)

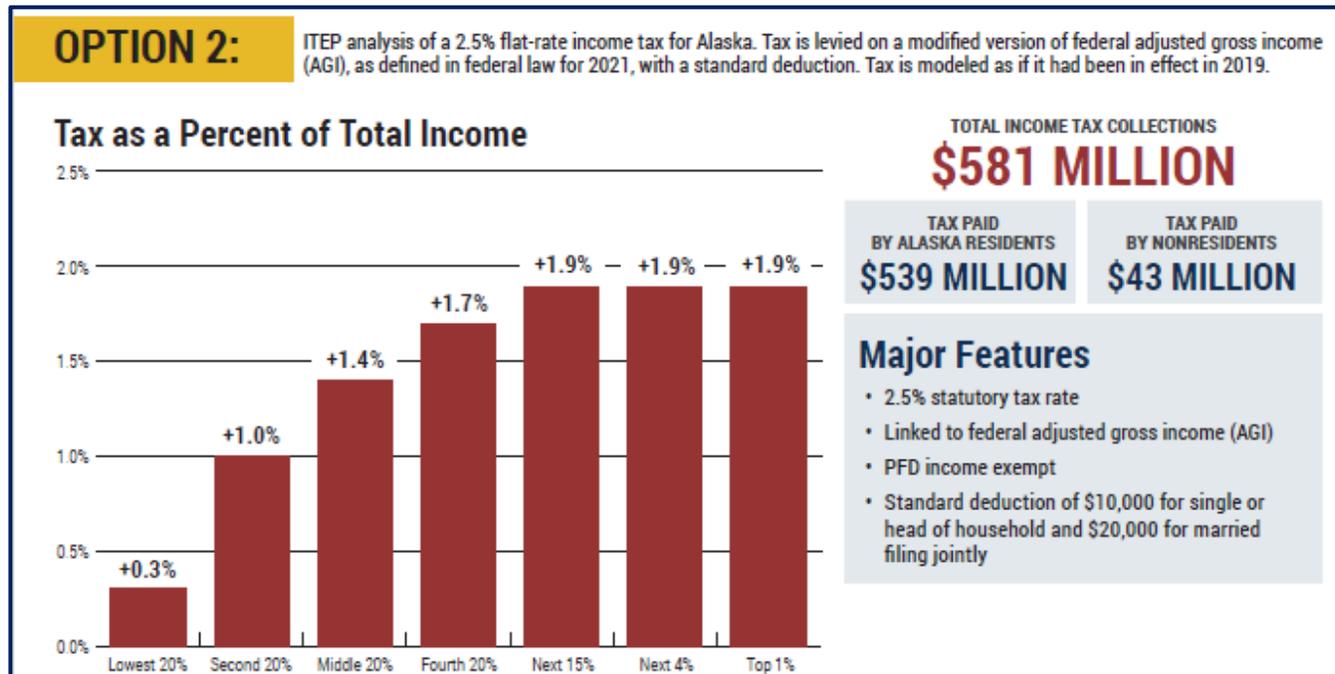
- Metric that is the most widely used among states with income taxes
- Includes all income: wages, self employment, earnings of partnerships and S-corps, capital gains, retirement, etc.
- “Adjustments” to income (i.e. non-taxed items) include retirement contributions, student loan interest, and alimony 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 about \$3.35 billion
- A dividend based on 10% of that plus 30% of oil royalties would be a \$692 million appropriation, working out to roughly a \$1,019 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

Tax Liability in 2023 for Different Household Types and Income Levels

| Taxpayer Type | | \$25,000 | \$50,000 | \$100,000 | \$200,000 |
|-----------------------|---------------------|----------------|----------------|------------------|------------------|
| Single Person | Dividend | \$1,019 | \$1,019 | \$1,019 | \$1,019 |
| | Tax | \$286 | \$911 | \$2,161 | \$4,661 |
| | Net Dividend | \$733 | \$108 | (\$1,142) | (\$3,642) |
| Single Parent / 1 Kid | Dividend | \$2,038 | \$2,038 | \$2,038 | \$2,038 |
| | Tax | \$104 | \$729 | \$1,979 | \$4,479 |
| | Net Dividend | \$1,934 | \$1,309 | \$59 | (\$2,441) |
| Married Couple | Dividend | \$2,038 | \$2,038 | \$2,038 | \$2,038 |
| | Tax | \$0 | \$572 | \$1,822 | \$4,322 |
| | Net Dividend | \$2,038 | \$1,466 | \$216 | (\$2,284) |
| Married / 2 Kids | Dividend | \$4,076 | \$4,076 | \$4,076 | \$4,076 |
| | Tax | \$0 | \$521 | \$1,771 | \$4,271 |
| | Net Dividend | \$4,076 | \$3,555 | \$2,305 | (\$195) |

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 \$692 million in FY2023
- 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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