

08/24/15
DISCUSSION
FISCAL
SITUATION
& ECONOMIC
ANALYSES

<TARGET><BILL></BILL><SUBJECT>08-24-15 DISCUSSION
FISCAL SITUATION and ECONOMIC
ANALYSES</SUBJECT><COMM>HFIN29</COMM></TARGET>

A Few Observations on Alaska's Fiscal Choices

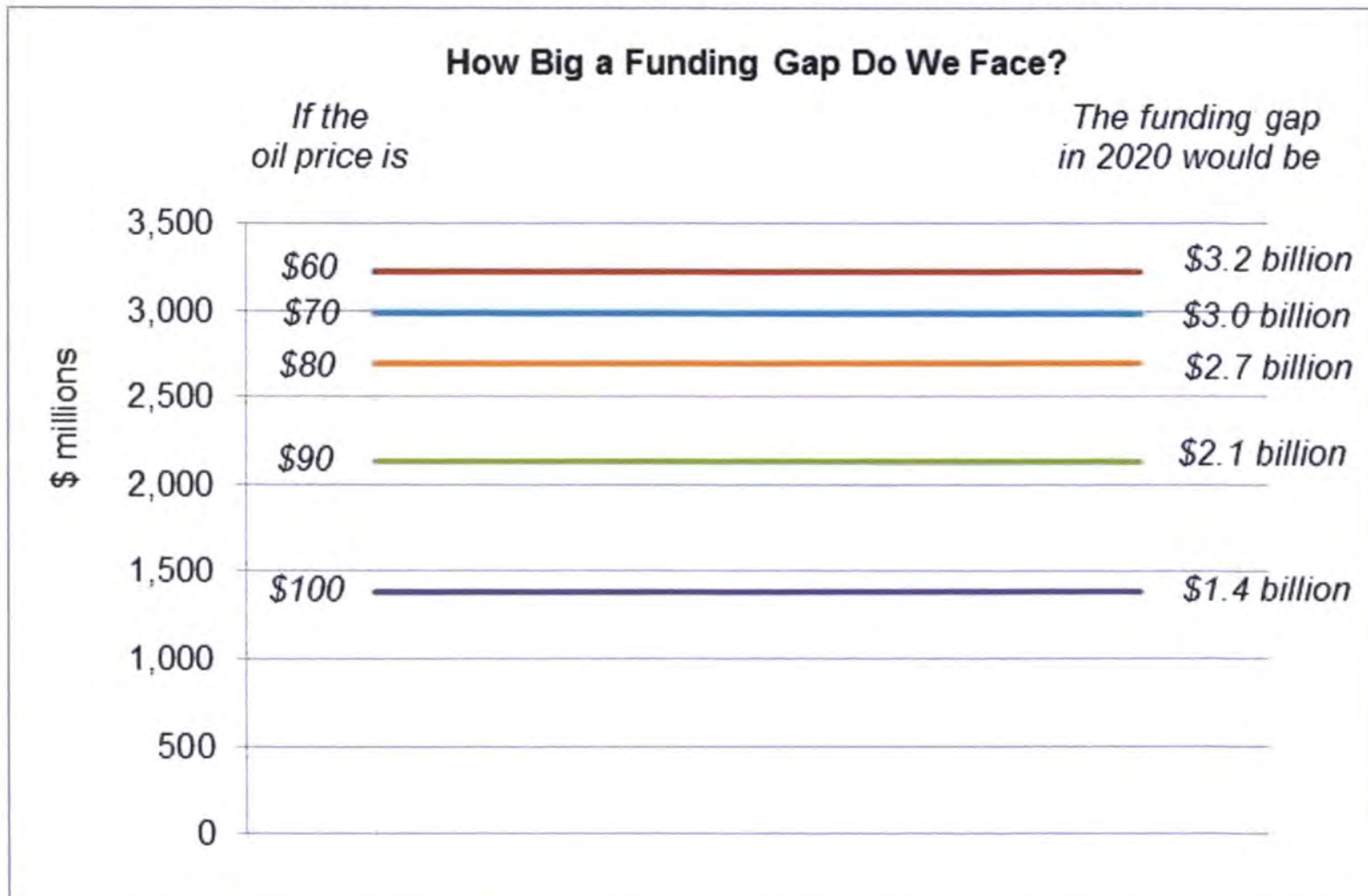
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Prepared for
Alaska Legislature House Finance Committee
August 24, 2015



If we continue to spend at the FY16 level of \$5.2 billion and use only our current revenue sources, we face a large **funding gap** between our spending and our revenues—which we will have to pay for from our savings reserves.

The lower the price of oil, the bigger the funding gap and the sooner we will drain our reserves.



We face two fundamental choices:

WHEN WILL WE FILL THE FUNDING GAP?

HOW WILL WE FILL THE FUNDING GAP?

WHEN WILL WE FILL THE FUNDING GAP?

The longer we delay:

The less the immediate pain
The less unnecessary pain if oil prices unexpectedly recover

but

The sooner we risk **draining our reserves**
The bigger the risk of facing **drastic immediate adjustments**
The greater the risk to our **credit rating**
The greater the risk to **investor confidence**
The lower our future **investment earnings** from savings
The less savings we leave for **future generations**

HOW WILL WE FILL THE FUNDING GAP?

Our only significant and practical options are some combination of:

Spending cuts

New revenues

Use Permanent Fund earnings

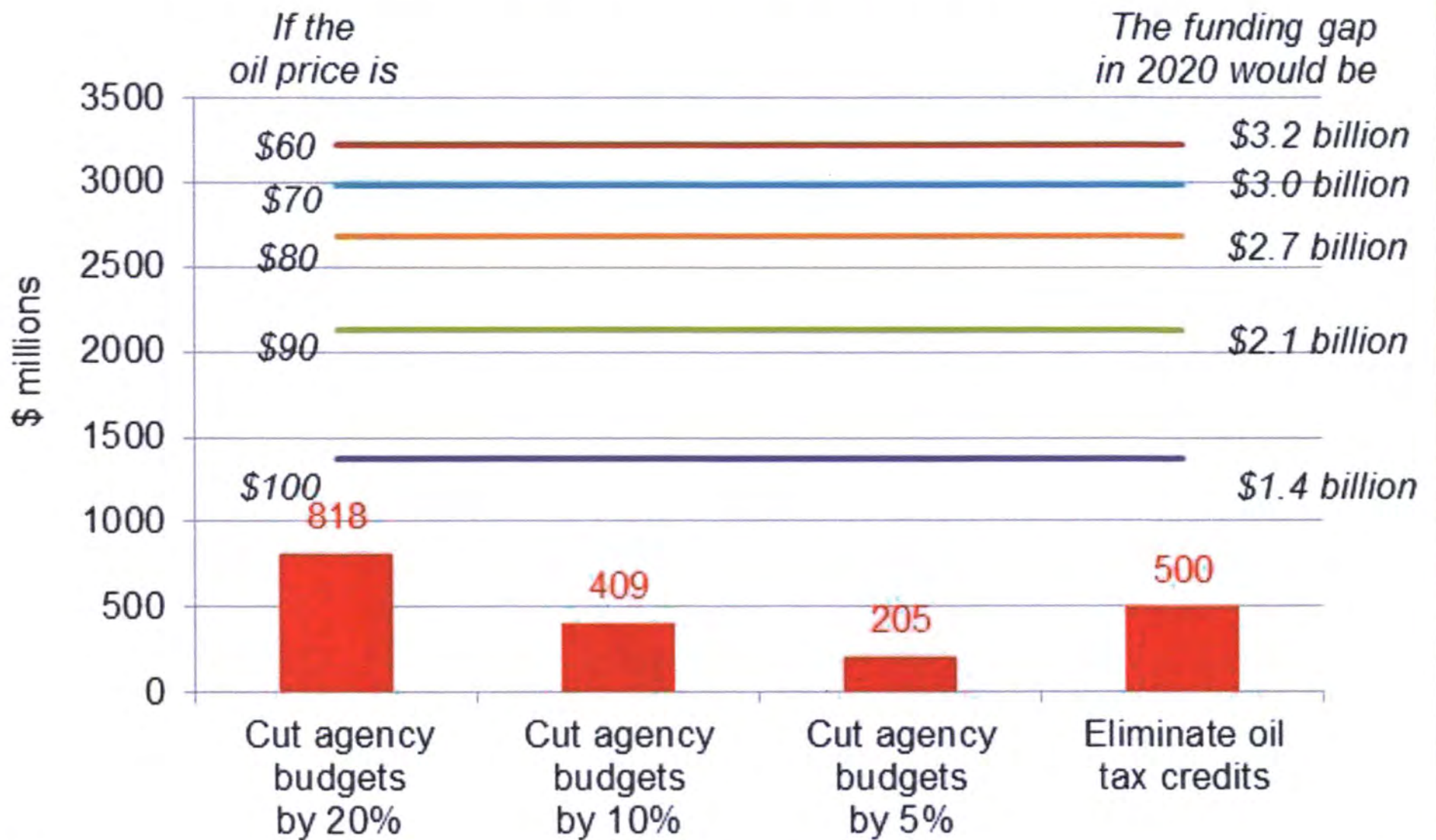
None of these options are easy or popular.

Options for closing the funding gap:

Spending cuts . . .

- Capital budget cuts
 - Very little is left to cut
- Statewide operations cuts
 - We can't cut debt service
 - Cutting retirement contributions would be very difficult
 - We could cut oil tax credits—but that could affect future production
- Agency operations cuts
 - Most cuts would have to come from agency operations
 - Significant cuts would require cutting the largest agencies:
 - Education & Early Development
 - Health and Social Services

How Much Could Spending Cuts Fill the Funding Gap?



Options for closing the funding gap:

New revenues . . .

There are many potential options.

Each option raises questions:

- How much money would it generate?
- How long would it take and what would it cost to implement?
- Who would pay how much of the taxes?
- How would it affect the economy?
- What risks does it pose?

Any revenue option would take time to implement.

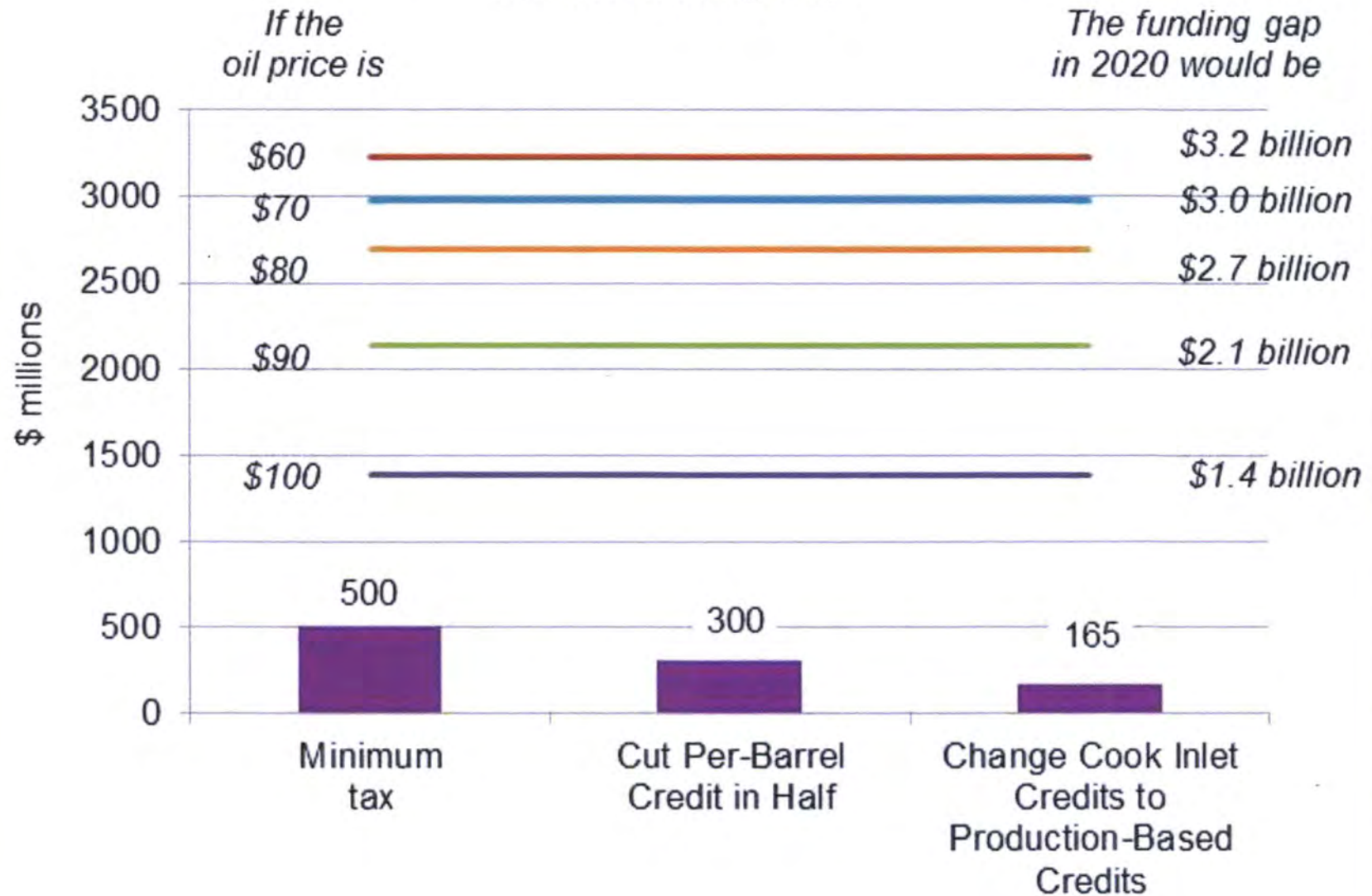
Any revenue option needs careful study and debate.

For any new revenue option, the devil is in the details!!!!

Examples of **new revenue** options and some of the issues they raise

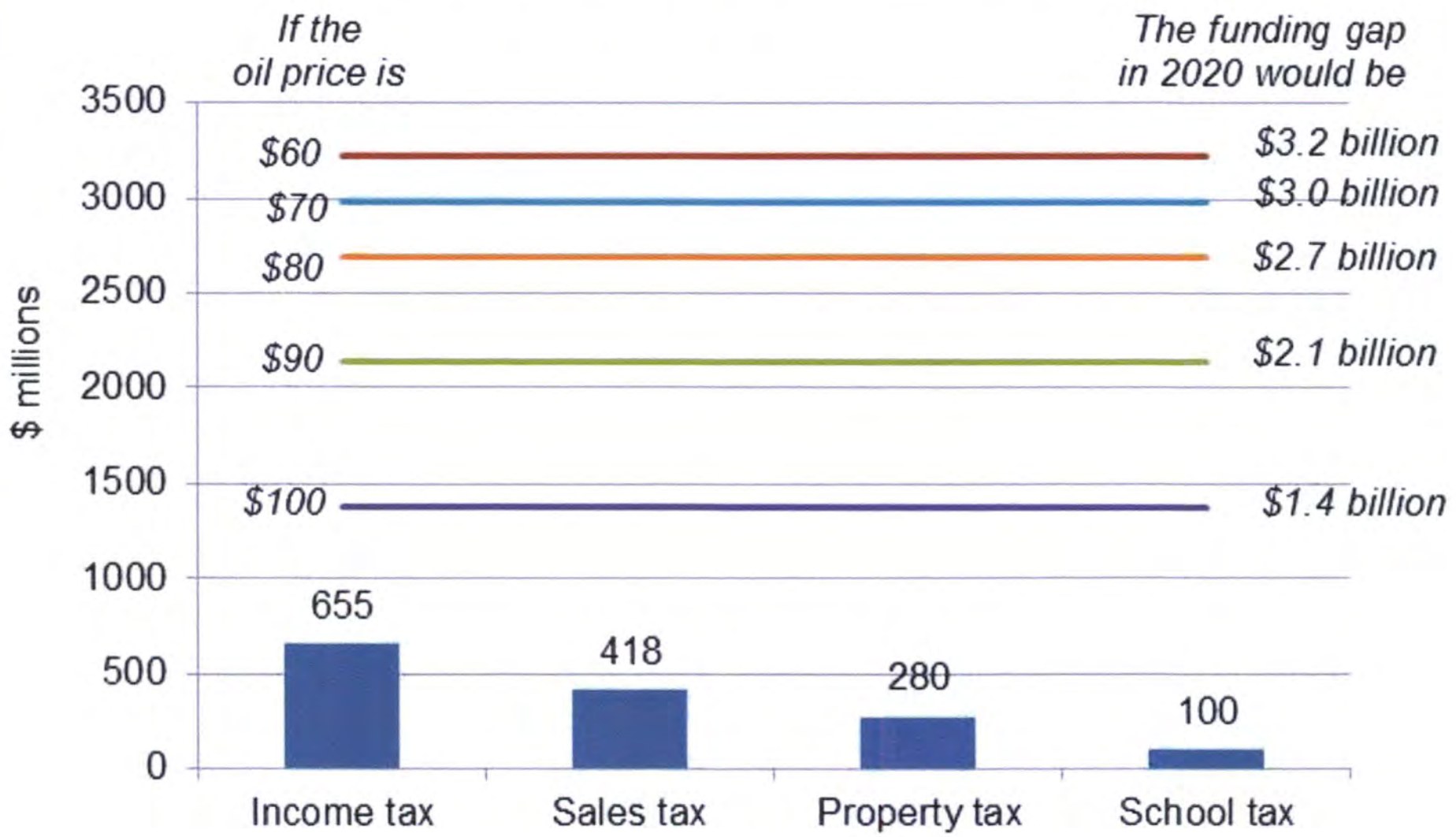
Option	Some of the Issues
Increase oil revenues	Issues which arose in last year's oil tax debate
Income taxes	Who bears the burden? Effects on the economy? Potential to tax non-resident workers?
Sales taxes	Who bears the burden? Effects on the economy? Effects on local government revenues? Potential to tax tourists?
Increase other resource revenues (mining, seafood, tourism, etc.)	Ability of these industries to pay
Economic diversification	What new industries? Ability of these industries to pay
Increase return on state funds	What are the risks?
LNG project	Still a long time away and many uncertainties

How Much Could Changes to Oil & Gas Taxes Fill the Funding Gap?



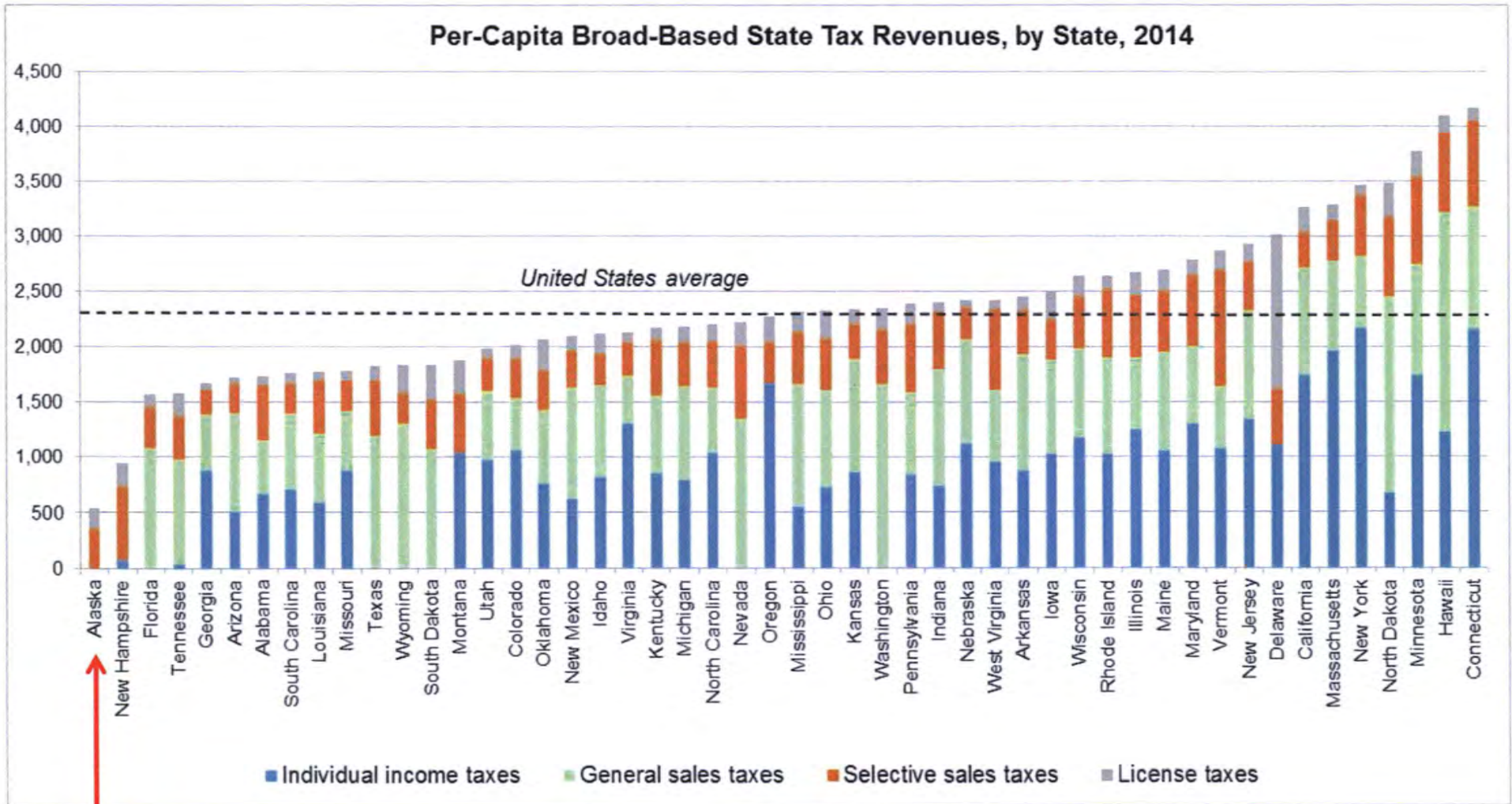
Source: Alaska Department of Revenue estimates

How Much Could Statewide Taxes Fill the Funding Gap?



Source: Alaska Department of Revenue estimates

Alaskans pay much lower broad-based state taxes than residents of any other state.

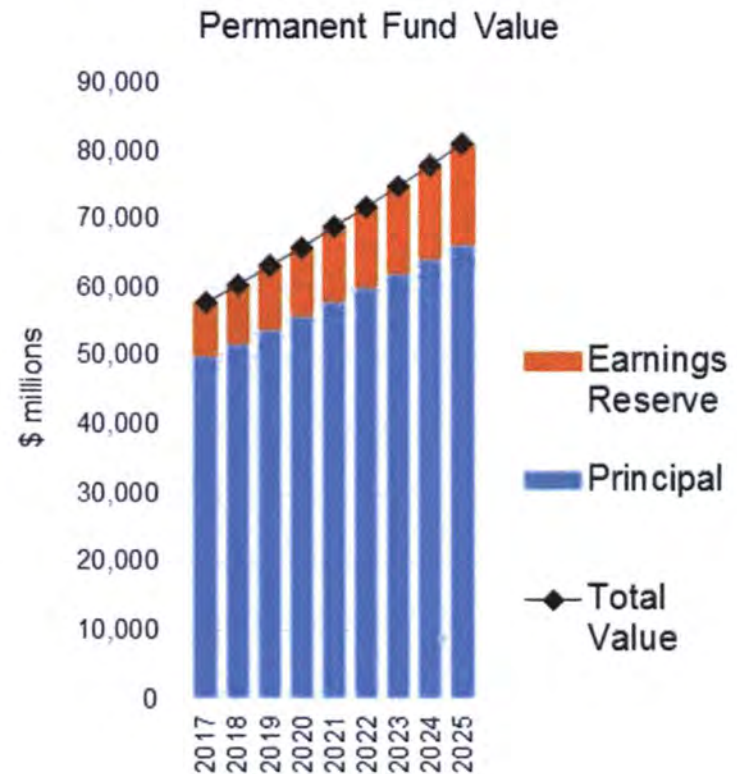
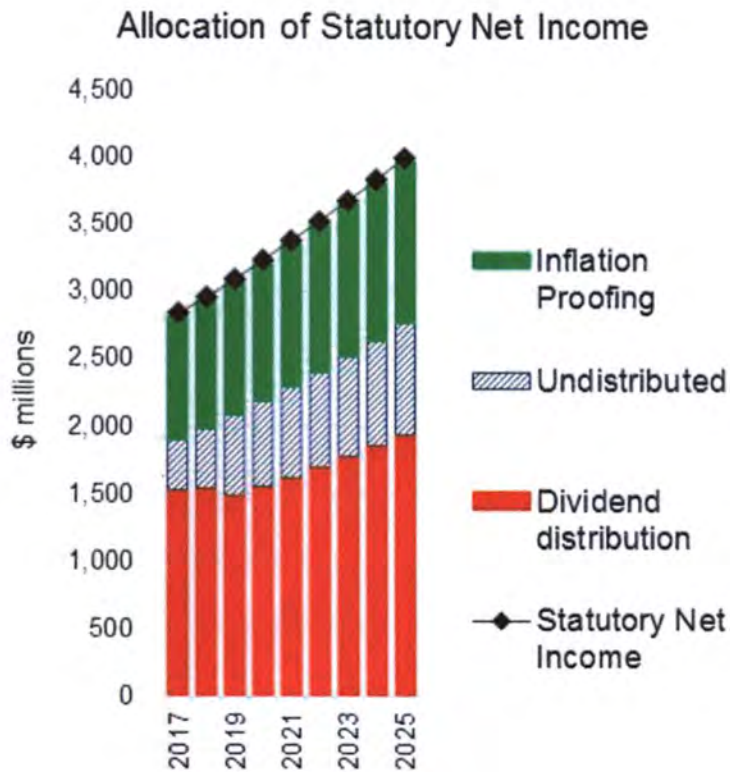


Alaska

Options for closing the funding gap: Use Permanent Fund earnings . . .

- Earnings, dividends and the fund value are all projected to grow
- We haven't been spending all the earnings. We could:
 - Use some earnings and still keep or grow dividends
 - Use more earnings by capping or reducing dividends

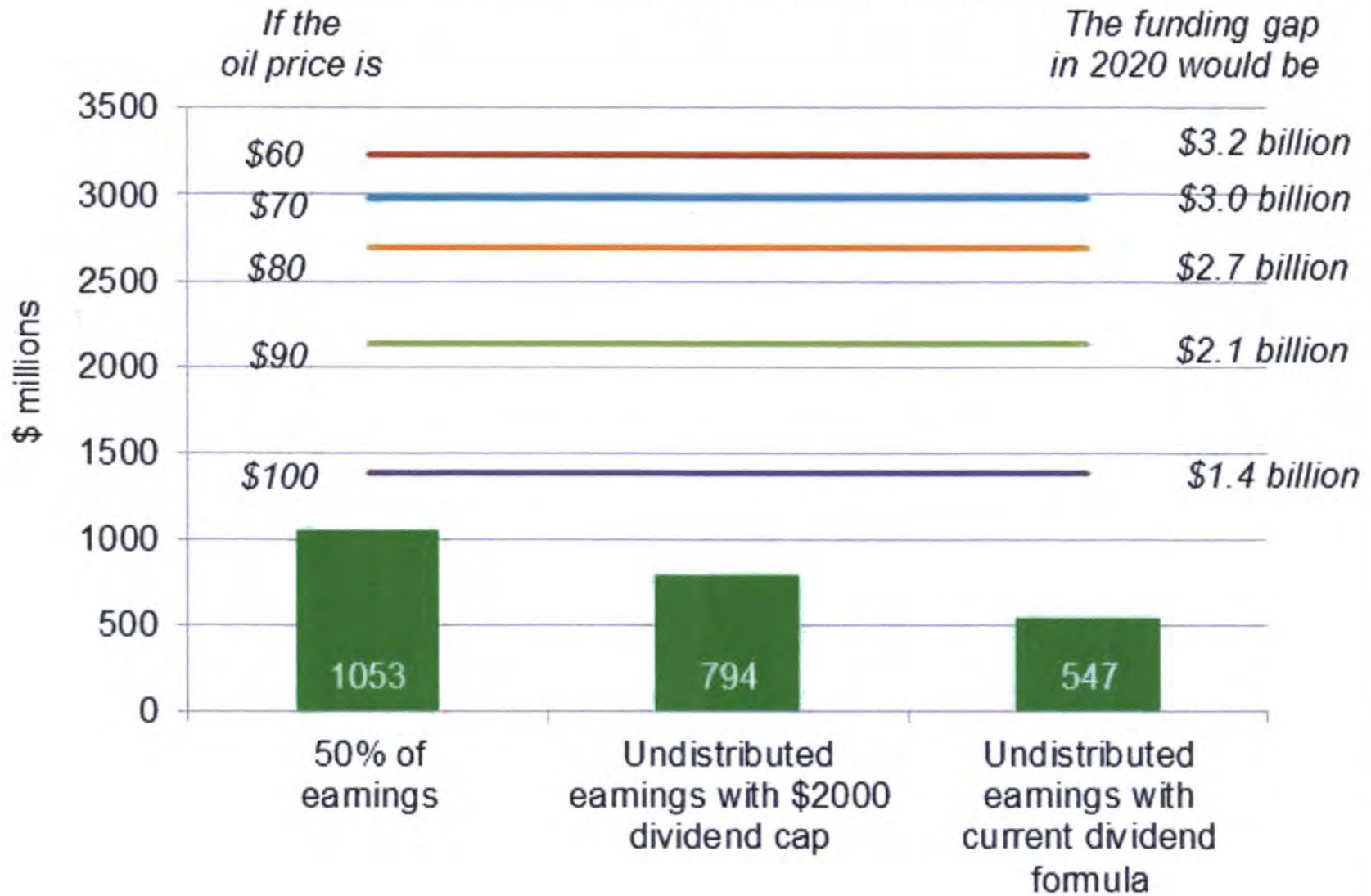
Alaska Permanent Fund Corporation Projections, 2017-2025



Two key questions in any use of Permanent Fund earnings

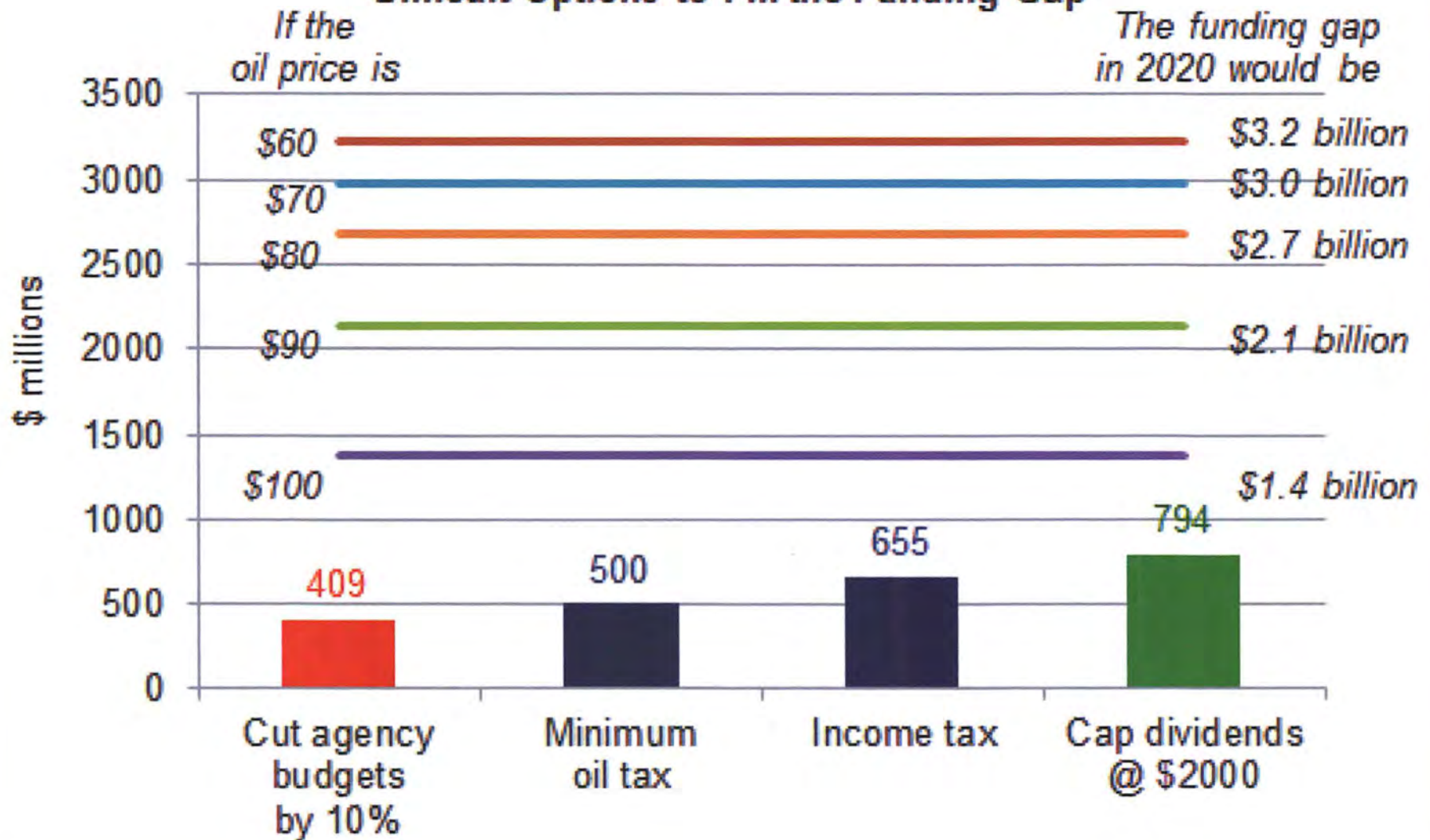
	How much should we distribute from earnings?	How much should go to dividends and how much to government?
What we do now	Distribute half of average statutory net income over the previous five years	100% goes to dividends
Some examples of what we could do	<p>Keep the same formula</p> <p>Distribute a higher share of statutory net income</p> <p>Distribute a fixed percent of market value</p>	<p>Cap the dividends Use the rest for government</p> <p>Keep dividends the same Use the increase in distributions for government</p>

How Much Could Permanent Fund Earnings (After Inflation Proofing) Fill the Funding Gap?



Source: Gunnar Knapp estimates based on APFC earnings projections

At Low Oil Prices, It Could Take a Mix of Difficult Options to Fill the Funding Gap



Our fiscal options aren't so bad compared with most other states.

- Most other states:
 - Don't have any oil revenues
 - Don't have any Permanent Fund earnings
- That's why most other states:
 - Spend less for government
 - Have income taxes and/or sales taxes
 - Don't pay dividends
- Our basic fiscal options are to become more like other states:
 - Spend less for government
 - Tax ourselves more
 - Pay smaller dividends

Economic Impacts of Alaska Fiscal Options: A Study ISER is Starting Some of What We Already Know

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August 24, 2015



UAA Institute of Social
and Economic Research
UNIVERSITY *of* ALASKA ANCHORAGE

Alaska is facing difficult choices between difficult fiscal options.

- We have been running very big deficits
- We have been using reserve funds to pay for the deficits
- Our reserve funds are running out
- Within a few years, we will have to reduce the deficits
- Our only options are:
 - More spending cuts
 - New revenues
 - Using Permanent Fund earnings

One of the issues in making these choices is how different options would affect our economy.

ISER is doing a study of economic impacts of Alaska fiscal options

- \$60,000 study funded by DOR and OMB
- Study is just beginning
- Timeline
 - Mid-September: Preliminary report
 - Mid-December: Draft final report
 - Early January: Final Report

We welcome your advice about this study

- We want the study to be helpful to Alaskans
 - Particularly to the legislature which has to make the hard choices
- We welcome your advice:
 - Today or any other time
 - By email, phone, meetings
 - What fiscal options do you want to know about?
 - What economic impacts do you want to know about?
- We will form an informal study advisory group:
 - Looking for a wide range of perspectives
 - Will meet by teleconference two or three times
 - To advise about study design
 - To review preliminary and draft final reports
 - We would welcome legislative participation

We are not advocating for or against any options

- Our goal is to help inform the discussion
- We will compare impacts of different options in a consistent, objective way

We will study economic impacts of a broad range of fiscal options, including but not limited to:

- SPENDING CUTS
 - Capital budget
 - Operating budget
 - Across the board
 - Specific kinds of spending
- NEW REVENUES
 - Income taxes
 - Sales taxes
 - Resource taxes (fishing, mining, etc.)
 - Changes to oil taxes and credits
- USING PERMANENT FUND EARNINGS
 - By using earnings which would otherwise go to dividends
 - By using earnings which would otherwise be saved

We welcome advice about what fiscal options we should study.

We will study several different types of economic impacts

- Impacts on jobs and income of Alaskans
 - By sector (government and private)
 - By industry
 - By region
 - By income group
- Impacts on Alaska migration and population
 - Migration within Alaska and between Alaska and other states
- Short-run and long-run impacts
 - Short-run effects on jobs and income
 - Long-run “feedback loops” on investment and development
- Who pays for fiscal options:
 - Extent to which they collect revenues from non-residents
 - How they affect our federal income taxes

We welcome advice about what impacts we should study.

We will study both absolute and relative economic impacts of fiscal options

- Absolute impacts:
 - total jobs and income impacts of each option
 - A \$600 million income tax has a bigger impact than a \$100 million school tax
- Relative impacts:
 - Jobs and income impacts per \$100 million saved or raised
 - Per \$100 million raised, the impact of an income tax might be bigger or smaller than a school tax

How we will do the study

- Review major findings of past ISER studies
- Update past ISER studies using current data
- Review other studies
- Use “input-output modeling” to estimate short-run job and income impacts of different options
- Use ISER’s *Alaska Economic and Demographic Model* to estimate long-term economic and demographic impacts
- Use IRS income data to estimate how fiscal options would affect different income groups

Limits to the study

- We will have to make a lot of assumptions
 - How spending cuts would be made
 - How new revenue options would be designed
 - How the Alaska economy works
- Longer-term “feedback” impacts of fiscal options are harder to project and analyze
 - investment
 - migration
 - economic development
- We will provide the best available estimates of impacts given the limits of data
- We will discuss the relative certainty or uncertainty of our estimates

We already know a lot about economic impacts of different fiscal options.

ISER has been studying this issue for a long time.


A COMPARATIVE ANALYSIS OF THE ECONOMIC EFFECTS OF
REIMPOSING PERSONAL INCOME TAXES, REDUCING
PERMANENT FUND DIVIDENDS, OR REDUCING STATE SPENDING

prepared by

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prepared for

Special Committee on Taxation
Alaska State Legislature
Representative John Sund, Co-Chair



May 1987

From ISER's 1987 study . . .
(28 years ago)

How would Alaska's economy be affected if the state government replaced some of its declining oil revenues by reimposing a personal income tax or by reducing the amount paid out in Permanent Fund dividends? Or what if state officials did neither and simply reduced state spending? Would one measure affect the economy more than the others?

The most important fiscal challenge the Alaska Legislature and Governor Cowper face is bringing state spending in line with revenues the state can sustain, while at the same time minimizing further loss of resident jobs and income. We looked at the effects on Alaska jobs and incomes of several proposed ways of balancing the state budget; there are, of course, many other considerations in taxing and spending policies.

What we've learned from past studies

- There are no painless options
- All our fiscal options would affect Alaska's economy
- Different options have different economic impacts
 - Different impacts on industries, income groups and regions
 - Different effects on investment, development and future revenues

From ISER's 1987 study . . .
(28 years ago)

In our examination of these selected fiscal issues, we found that either reimposing income taxes or reducing dividends would reduce purchasing power of Alaskans and, therefore, cost the economy jobs and income. But our analysis shows that a personal income tax at the level proposed by Governor Cowper would cost the state somewhat fewer jobs and less income than would a similar dollar reduction in Permanent Fund dividends. It also demonstrates that state spending of either taxes or dividend money could, if targeted toward certain kinds of expenditures, more than offset the number of jobs initially lost by creating additional public and private jobs.

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This conclusion was because higher-income people, who would pay relatively more in income taxes, tend to spend less of their money in the Alaska economy than average-income Alaskans who would be giving up dividends. Whether this conclusion would still hold depends on how the income distribution and spending patterns of Alaskans may have changed.

From ISER's 1987 study . . .
(28 years ago)

In our examination of these selected fiscal issues, we found that either reimposing income taxes or reducing dividends would reduce purchasing power of Alaskans and, therefore, cost the economy jobs and income. But our analysis shows that a personal income tax at the level proposed by Governor Cowper would cost the state somewhat fewer jobs and less income than would a similar dollar reduction in Permanent Fund dividends. It also demonstrates that state spending of either taxes or dividend money could, if targeted toward certain kinds of expenditures, more than offset the number of jobs initially lost by creating additional public and private jobs.

This conclusion implied (indirectly) that cutting state spending *could* have an even greater effect on jobs than imposing income taxes or cutting dividends—*depending on the type of spending.*

"Cash on the Street" Job Multipliers for 1999

ISER 1999 estimates:

How many jobs are created by \$1 million in state spending?

Category	Govt Jobs	Other Jobs	Total Jobs
Operations: Personnel	15	12	27
Operations: Local Operating Grants	10	12	22
Operations: Local Debt Service	-	-	-
Operations: Grants to Persons	-	11	11
Operations: Contracts	-	12	12
Operations: Debt Service	-	-	-
Operations: Commodities	-	7	7
Operations: Travel	-	8	8
Operations: Equipment	-	7	7
Operations: Misc	-	7	7
Capital	-	10	10
PF Dividend	-	11	11
Other	-	-	-
Public Employee Retirement	-	6	6
Unemployment Comp	-	6	6
AK Railroad	-	11	11
State Shared Taxes	-	17	17

Source: ISER calculation. Annual jobs per \$1 million of state expenditure.

ISER 1999 estimates:

How many jobs are created by \$1 million in state spending?

Spending money on state workers creates the most jobs because you create government jobs directly and then more jobs when the government workers spend their income.

Spending money on dividends creates fewer jobs because you don't create any direct jobs directly—you only create jobs when people spend their dividend income

"Cash on the Street" Job Multipliers for 1999

Category	Govt Jobs	Other Jobs	Total Jobs
Operations: Personnel	15	12	27
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Operations: Travel	-	8	8
Operations: Equipment	-	7	7
Operations: Misc	-	7	7
Capital	-	10	10
PF Dividend	-	11	11
Other	-	-	-
Public Employee Retirement	-	6	6
Unemployment Comp	-	6	6
AK Railroad	-	11	11
State Shared Taxes	-	17	17

Source: ISER calculation. Annual jobs per \$1 million of state expenditure.

**"Cash on the Street" Income Multipliers for
1999**

ISER 1999 estimates:

How much personal
income is created by
\$1 million in state
spending ?

Paying Alaskans
money directly creates
the most income for
Alaskans!

Category	Personal Income
Operations: Personnel	\$1,106
Operations: Local Operating Grants	\$807
Operations: Local Debt Service	-
Operations: Grants to Persons	\$1,323
Operations: Contracts	\$389
Operations: Debt Service	-
Operations: Commodities	\$243
Operations: Travel	\$243
Operations: Equipment	\$243
Operations: Misc	\$243
Capital	\$432
PF Dividend	\$1,323
Other	-
Public Employee Retirement	\$662
Unemployment Comp	\$662
AK Railroad	\$455
State Shared Taxes	\$807

**Source: ISER calculation. Annual personal income
(thousand \$) per \$1 million of state expenditure.**

How you cut spending has a big effect on what the economic impacts are
(Preliminary ISER estimates, February 2015)

Preliminary Estimates of Economic Impacts of Cutting State Spending by \$100 Million

How the \$100 million is cut	Employment Impacts (full-time equivalent jobs in Alaska)			Income Impacts (millions of \$ of labor income earned in Alaska)		
	Direct	Multiplier	Total	Direct	Multiplier	Total
Cutting agency operations by \$100 million*	318	548	866	30	31	61
Cutting capital spending for buildings by \$100 million*	506	425	931	42	22	64
Cutting the state workforce to reduce total pay by \$100 million (<i>cutting about 1466 jobs averaging about \$68K/job</i>)	1466	499	1965	100	22	122
Across the board pay-cuts for state workers totaling \$100 million (<i>cutting all workers' pay by the same %</i>)	0	499	499	100	22	122

From a 1993 ISER study:

“Whatever the state does to balance the budget will cost Alaskans jobs and income—but the effects will not be the same in all households and communities.”

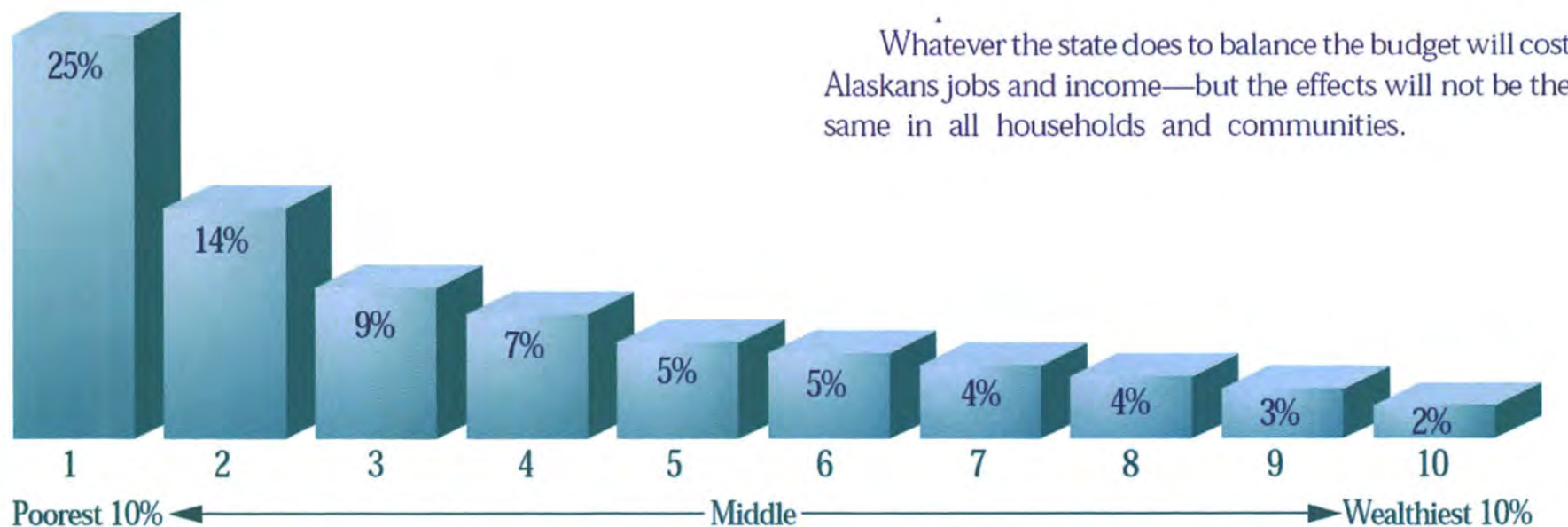
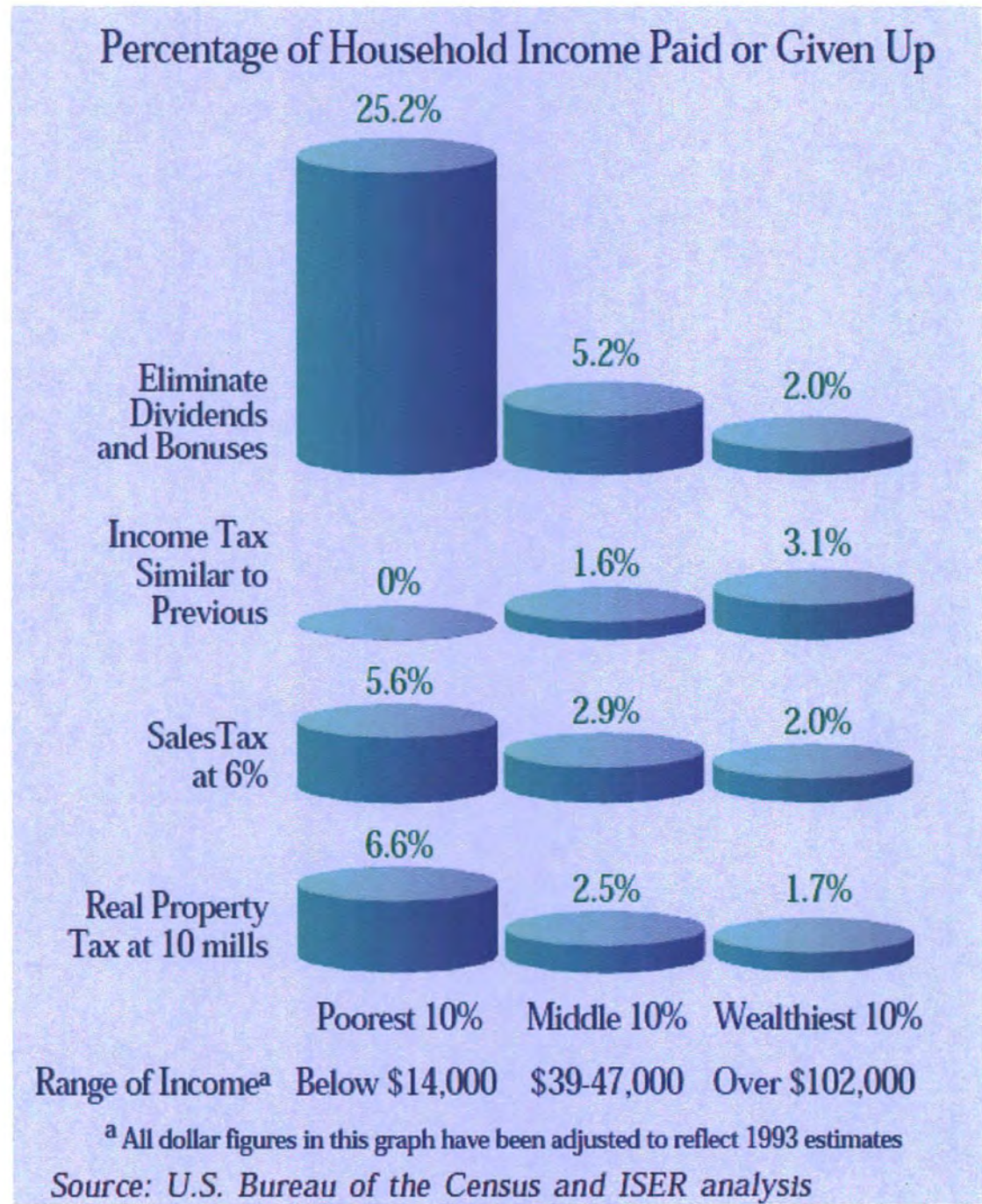


Figure 1. Percentage of Household Income from Dividends and Bonuses
(Households by Decile, Based on 1990 Census)

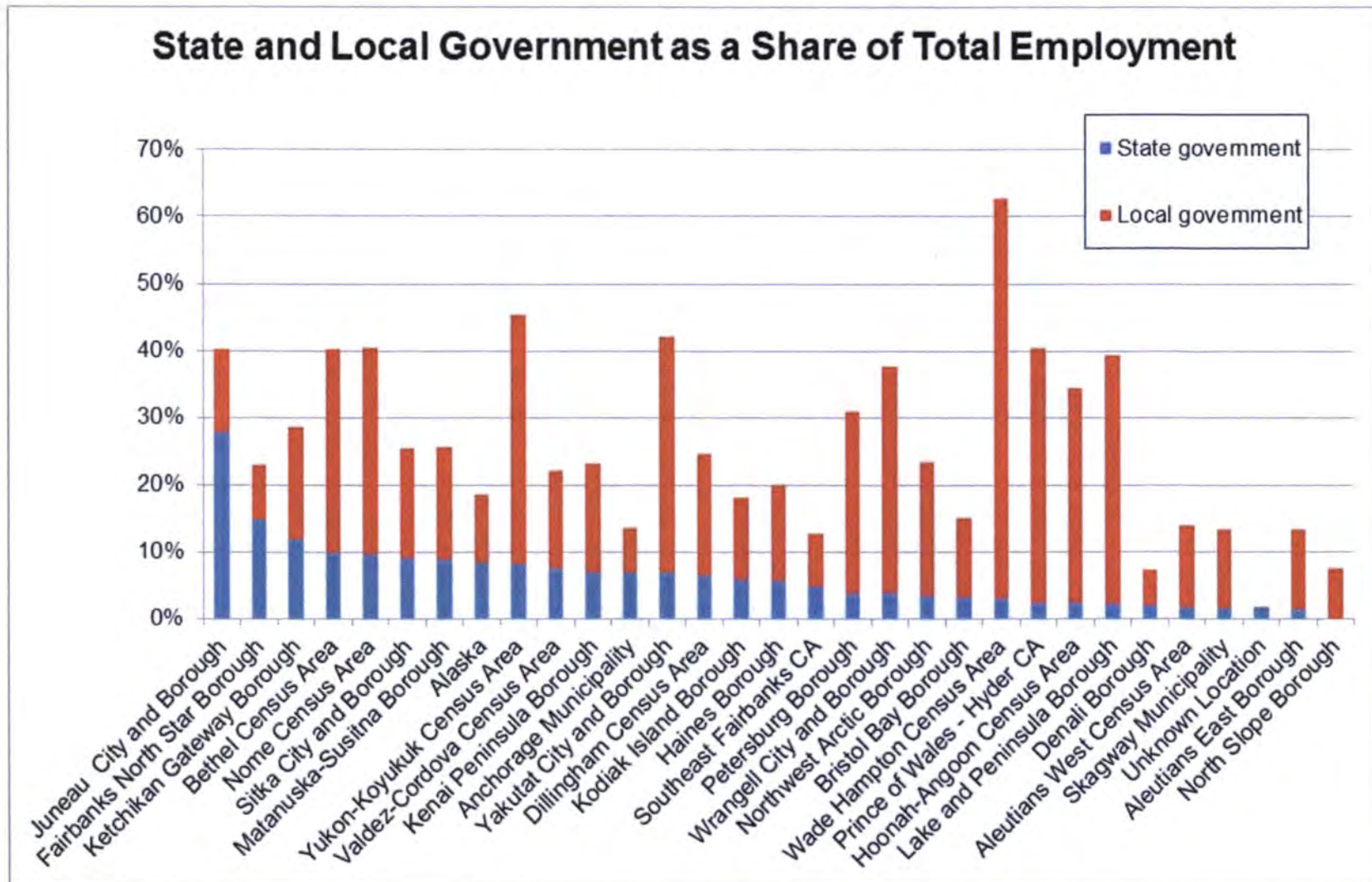
Percentage of Household Income Paid or Given Up

From a 1993 ISER study:

Different fiscal options would have widely different effects on different income groups



Regional economic impacts of spending cuts would depend on how important government jobs and income are in the regional economy. Some regions are much more dependent than others.



BUILDING A
SUSTAINABLE
FUTURE:



conversations with Alaskans

Presentation to House Finance

August 24, 2015



Randall J Hoffbeck, Commissioner
Alaska Department of Revenue

Pat Pitney, Director
Office of Management and Budget

<http://gov.alaska.gov/>



Potential Revenue and Fiscal Options (PDF), Revenue White Paper

Revenue and Expenditure Model (xlsx)

Short Video Alaska Fiscal Situation (Youtube)

The Conversation

It is not the critic who counts; not the man who points out how the strong man stumbles, or where the doer of deeds could have done them better. The credit belongs to the man who is actually in the arena, whose face is marred by dust and sweat and blood... who at the best knows in the end the triumph of high achievement, and who at the worst, if he fails, at least fails while daring greatly, so that his place shall never be with those cold and timid souls who neither know victory nor defeat.

Teddy Roosevelt 1910

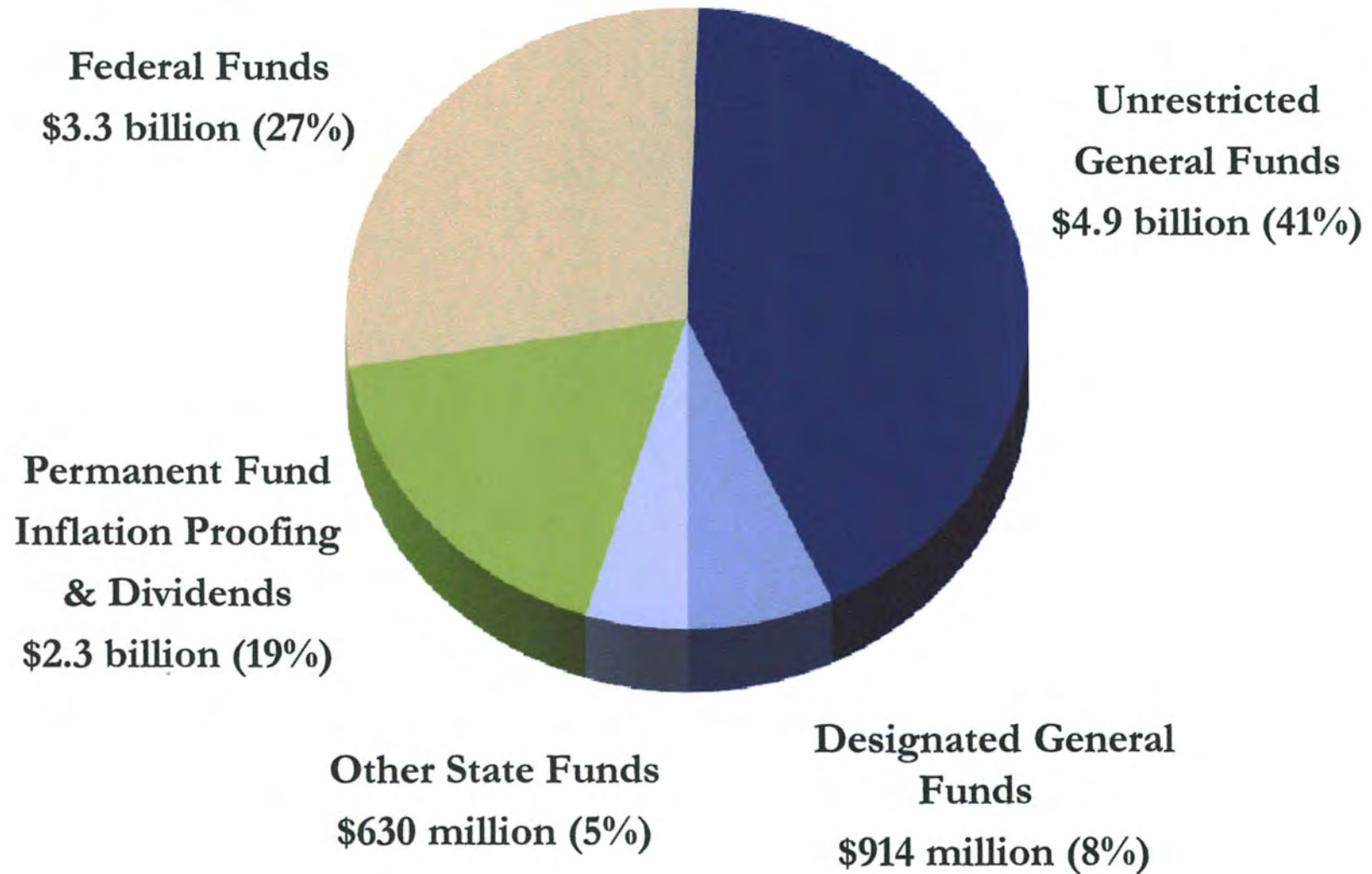
The Conversation

Fiscal Challenge

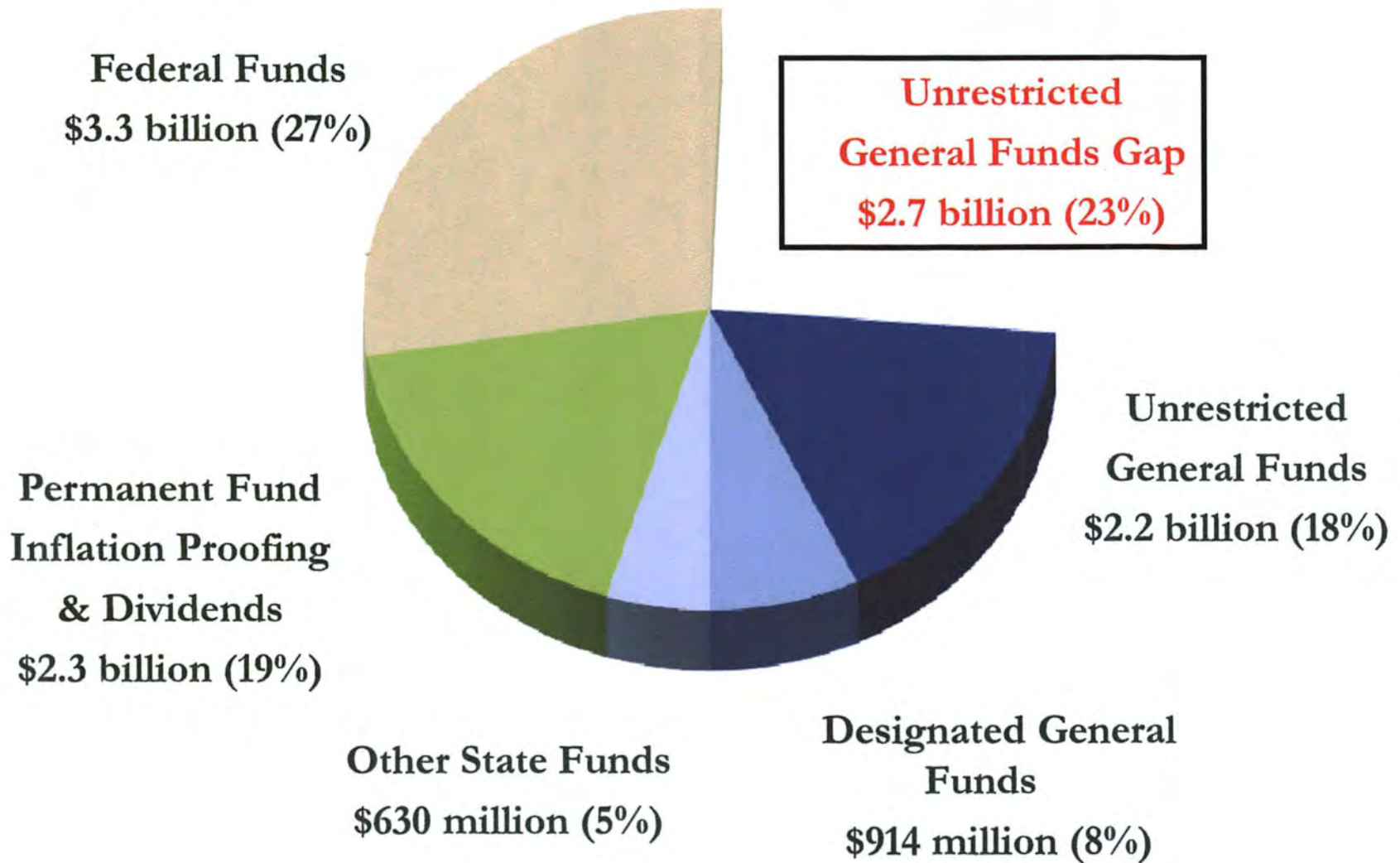
Options

Path to Fiscal Stability

Fiscal Challenge

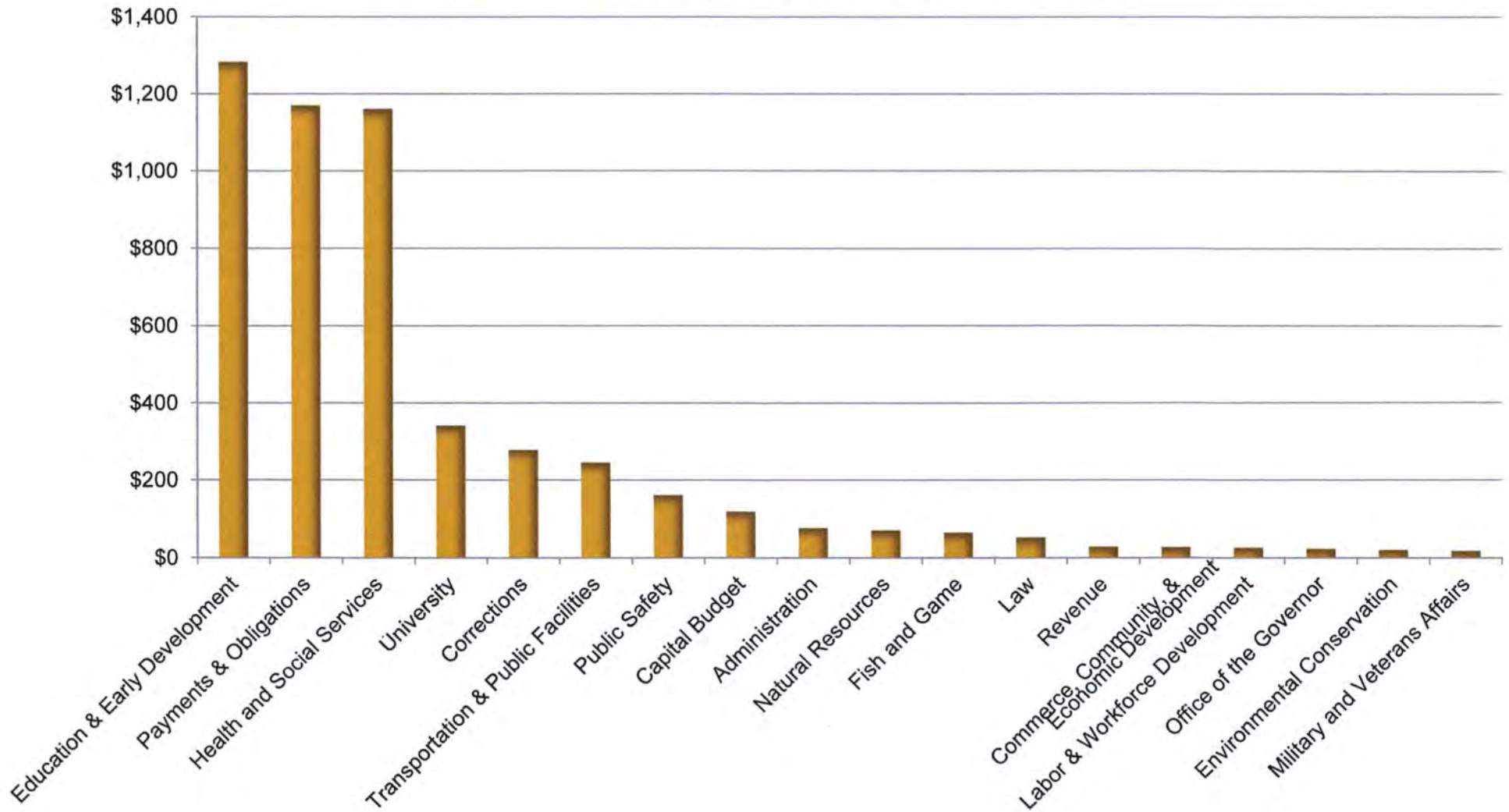


Fiscal Challenge



Fiscal Challenge

Executive Branch Agencies and Payments & Obligations Unrestricted General Funds (\$ Millions)



Fiscal Challenge

Agencies reductions FY15-FY16

Most significant % reductions

20-35%: Commerce, Military & Veterans Affairs, Labor & Workforce, Natural Resources, Governor's Office

12-20%: Fish and Game, Revenue, Law, Administration, Transportation, Environmental Conservation

Most significant \$ reductions

Health and Social Services: \$88 million (+ \$1 million fuel cut)

Transportation: \$34 million (+ \$15.5 million fuel cut)

Corrections: \$20 million (+ \$1.8 million fuel cut)

University of Alaska: \$20 million (+ \$4.5 million fuel cut)

Fiscal Challenge

Efficiency Initiatives:

Maximizing service delivery under the new budget reality

Cross Agency Efforts

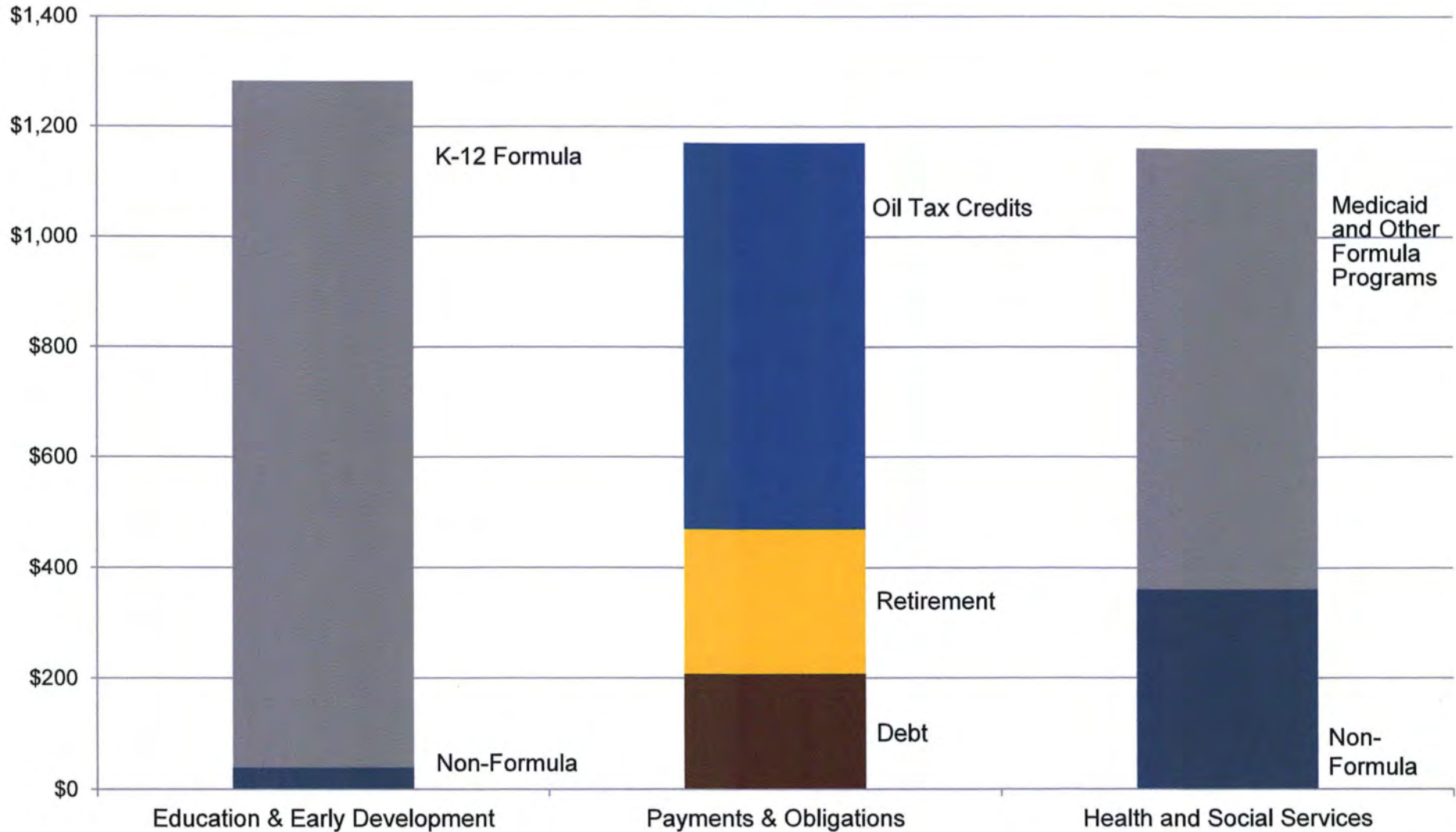
- Smart justice reforms
- Unified state facilities management
- Lean/continuous process improvement management
- Shared services for functions such as procurement and travel
- Travel process redesign
- Statewide IT consolidation, call centers, disaster recovery, security, desktop support and data storage
- Re-examining charge back systems and streamlining internal billing
- Re-negotiating procurement and lease contract
- Centralize collection of fines, debts, and attachments

Intra-Agency efficiency efforts are on-going within each agency

Executive Agencies: 500 fewer full-time permanent employees - December 2014 to July 2015

Fiscal Challenge

Top Three Unrestricted General Funds Spending Categories Total \$3.4 billion (\$ Millions)



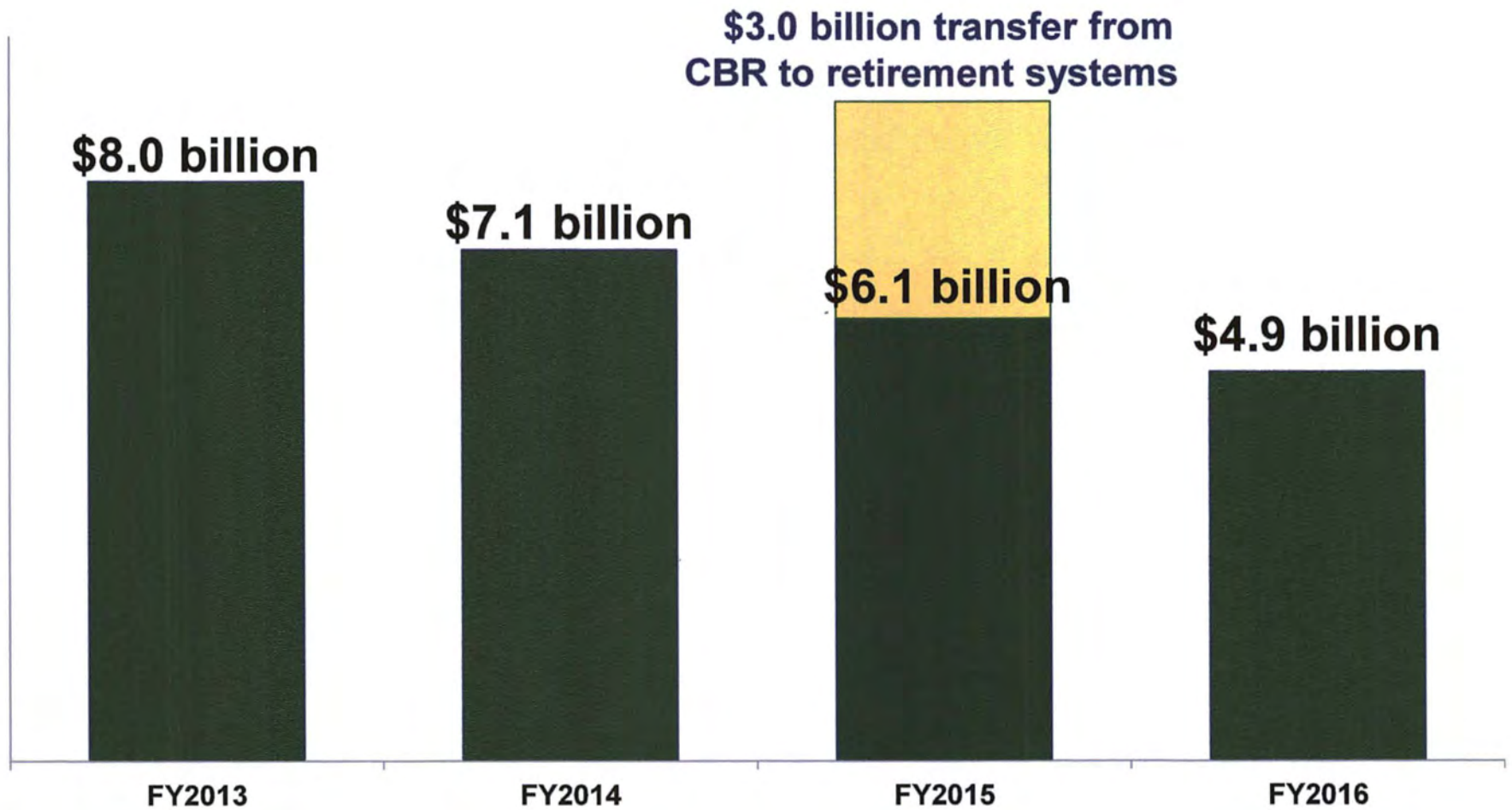
The Conversation

Fiscal Challenge

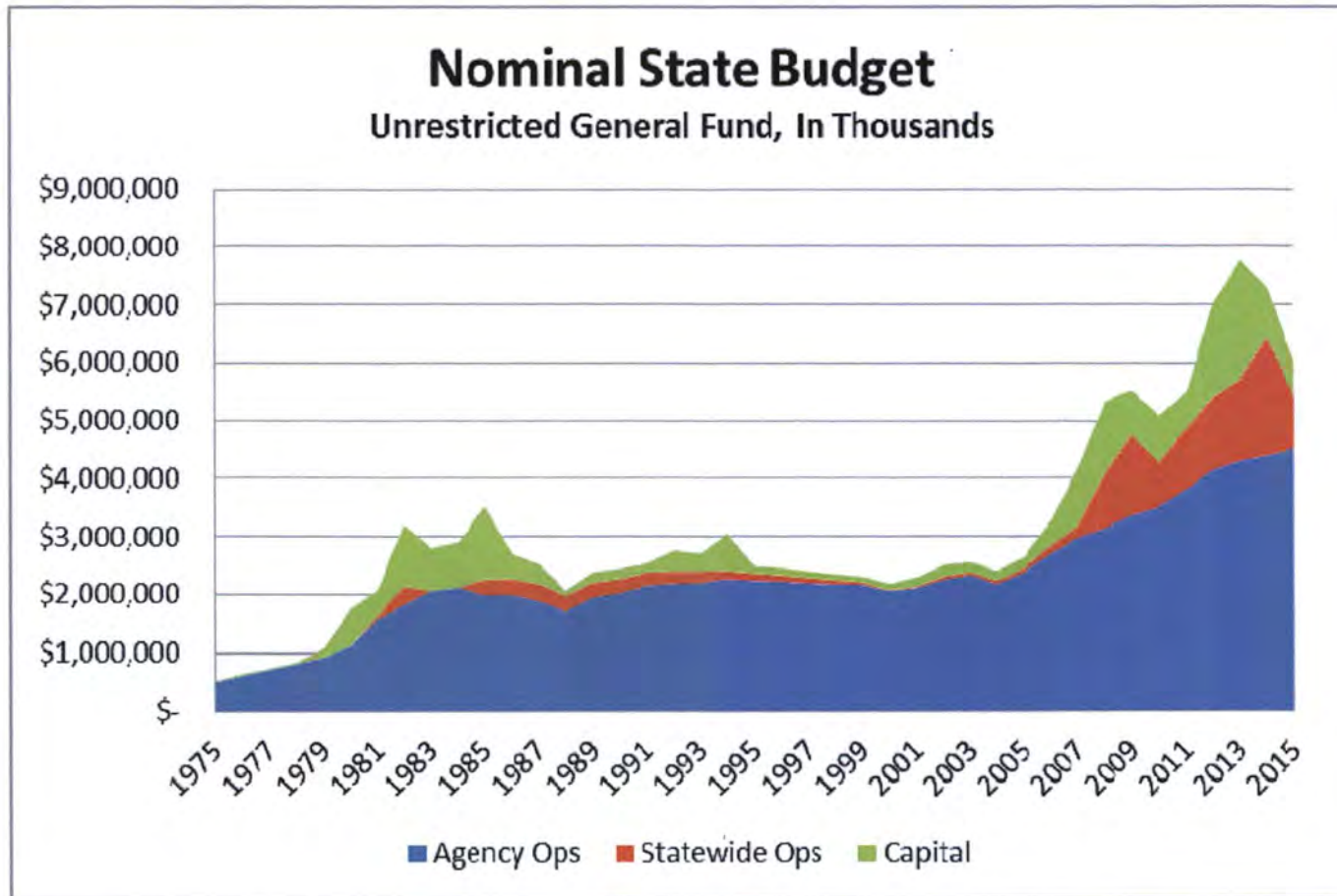
Options

Path to Fiscal Stability

Options (Cut Government)

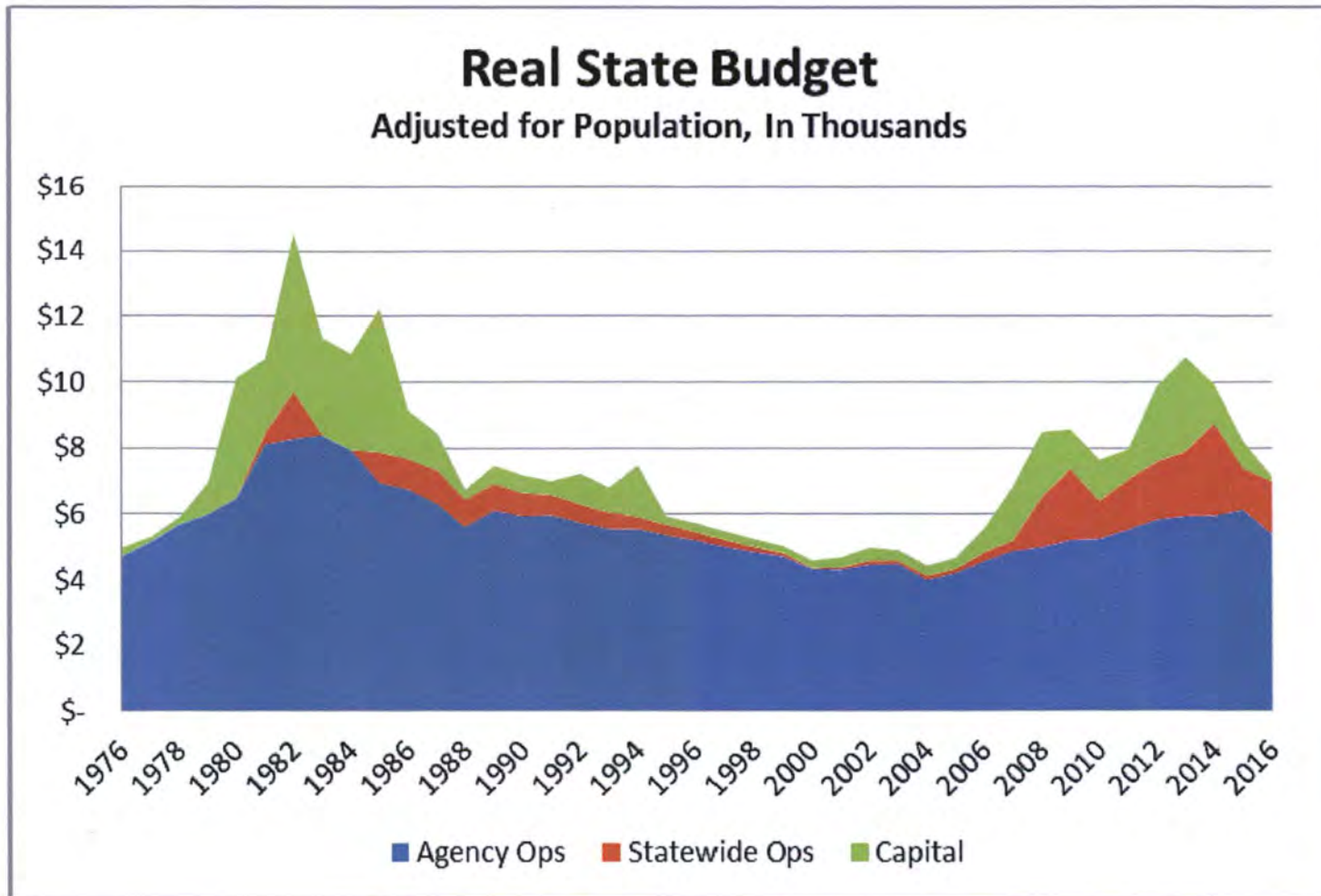


Options (Cut Government)



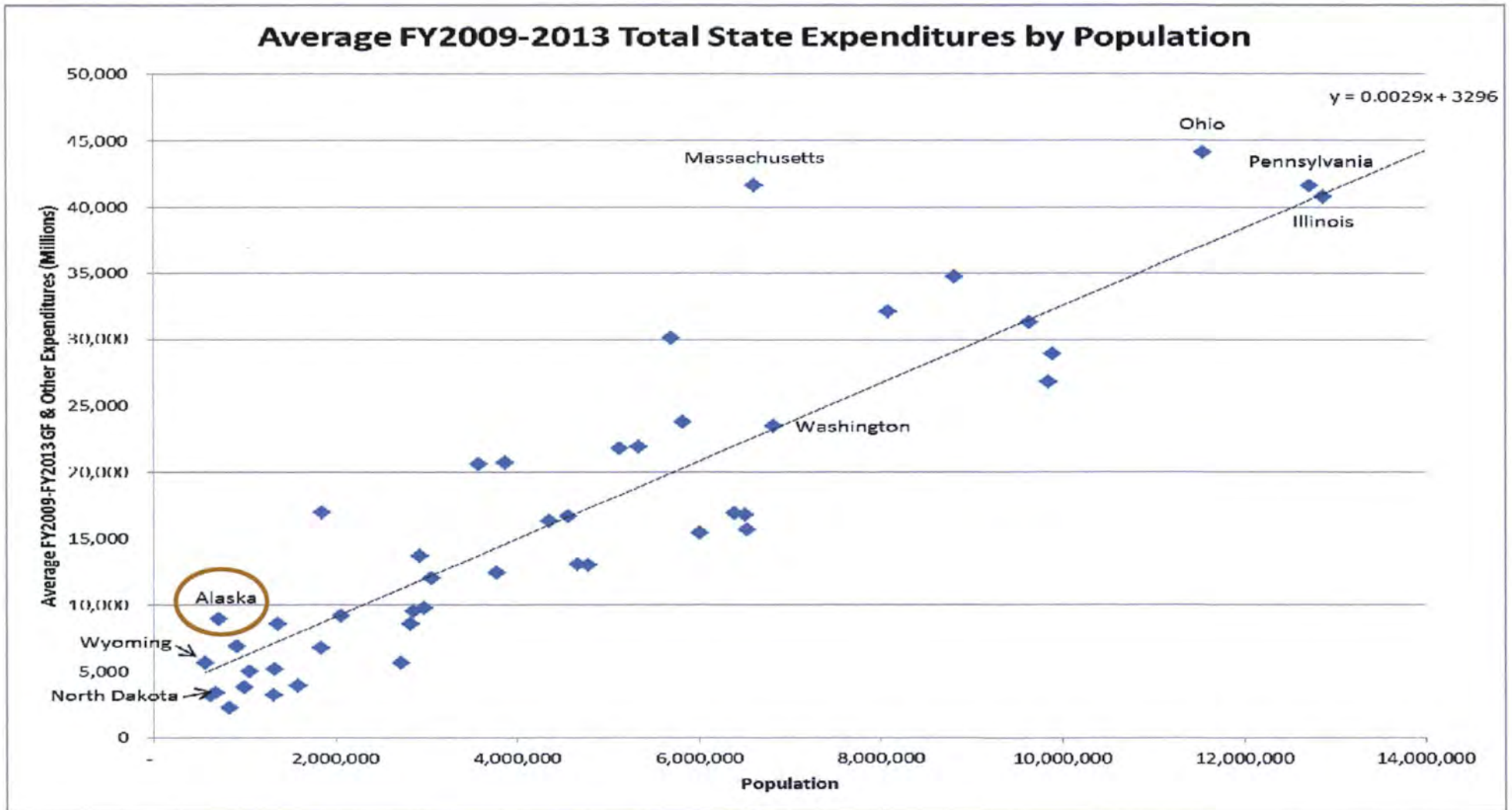
In nominal terms, the General Fund budget has increased steadily over time and steeply since the mid-2000's

Options (Cut Government)



Adjusted for inflation and population, the current budget is lower than most years during the post-pipeline boom

Options (Cut Government)



For purposes of displaying Alaska better, the display of data points for CA, FL, TX and NY are outside the chart axes but are included in the regression line.

Options (Cut Government)

Governor Protected Life, Health & Safety. (\$2 billion)

What is Missing:

- Education (All Foundation Formula) (\$1 billion)
- HSS (Half of Expected Cost) (\$550 million)
- Public Retirement Contributions (\$250 million)
- Oil and Gas Tax Credits (\$700 million)

What is Still Missing:

- General Agency Spending (Funded at 27%)

Options (Oil Taxes)

FY16 General Fund Revenue (\$ Billions)

Budget = \$4.9 Billion

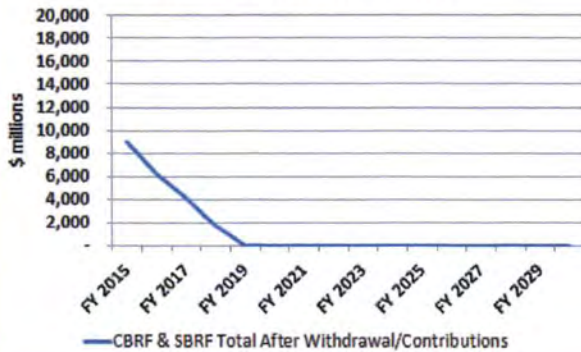
Price of Oil	Barrels Per Day			
	500,000	600,000	700,000	800,000
\$40	\$ 1.5	\$ 1.7	\$ 1.9	\$ 2.1
\$50	\$ 1.8	\$ 2.1	\$ 2.3	\$ 2.6
\$60	\$ 2.0	\$ 2.3	\$ 2.6	\$ 2.9
\$70	\$ 2.3	\$ 2.7	\$ 3.0	\$ 3.4
\$80	\$ 2.5	\$ 2.9	\$ 3.3	\$ 3.8
\$90	\$ 3.2	\$ 3.8	\$ 4.4	\$ 4.9
\$100	\$ 4.0	\$ 4.8	\$ 5.5	\$ 6.4
\$110	\$ 4.9	\$ 5.8	\$ 6.8	\$ 7.7
\$120	\$ 5.8	\$ 6.9	\$ 8.0	\$ 9.1

Current Production: Break even Price = \$109/ bbl

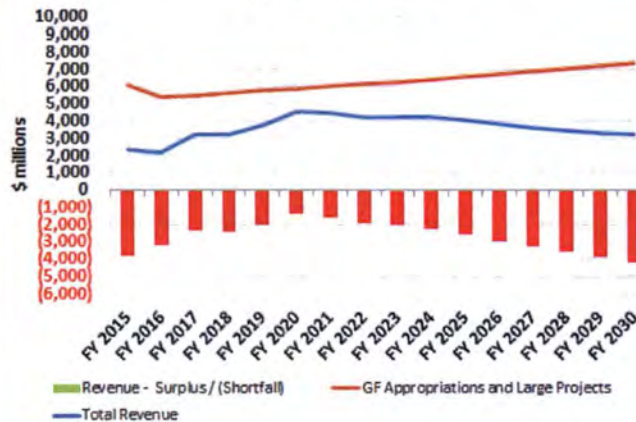
Current Price: Break even Production = 1.6 million bbl/day

Options (Increase Revenue)

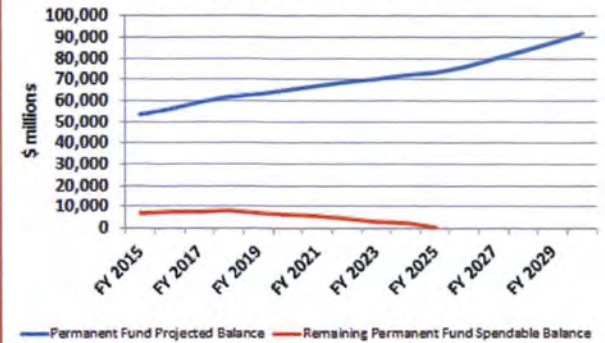
CBRF & SBRF Balance



Budget Overview



Permanent Fund Balances



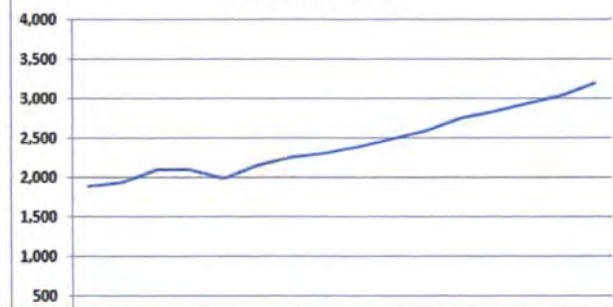
Revenue Options

Inflation Assumption	2.25%
Long Run Price Of ANS Crude	Official Forecast
Financial	
PERS/TRS "Net" Arbitrage Bonds	<input type="checkbox"/> Add
Current PF Revenue Methodology	<input checked="" type="radio"/> Status Quo PF Revenue Methodology
Percentage of Market Value	<input type="radio"/> Implement POMV Methodology
POMV @ X%	4.0%
State Share of PF Revenues	0%
PF Cap	No Cap
SB 114	<input type="radio"/> Implement SB 114
Collateralization Revenues	<input type="checkbox"/> Implement
Loan to Value Ratio	20%
Securitization Revenue (Only When Collateralization Enabled)	<input type="checkbox"/> Implement
Petroleum	
Flat Tax for Non-CIT Petroleum Companies	<input type="checkbox"/> Add
Net Severance Tax - Additional Revenue	
Net Severance Tax - Current Base Rate 35%	<input type="checkbox"/> Change 35%
Gross Value Reduction	<input type="checkbox"/> Remove

Fund Changes

Total Cuts From Budget (in Billions)	\$0.00
Total additional revenue generated (in Billions)	\$0.00

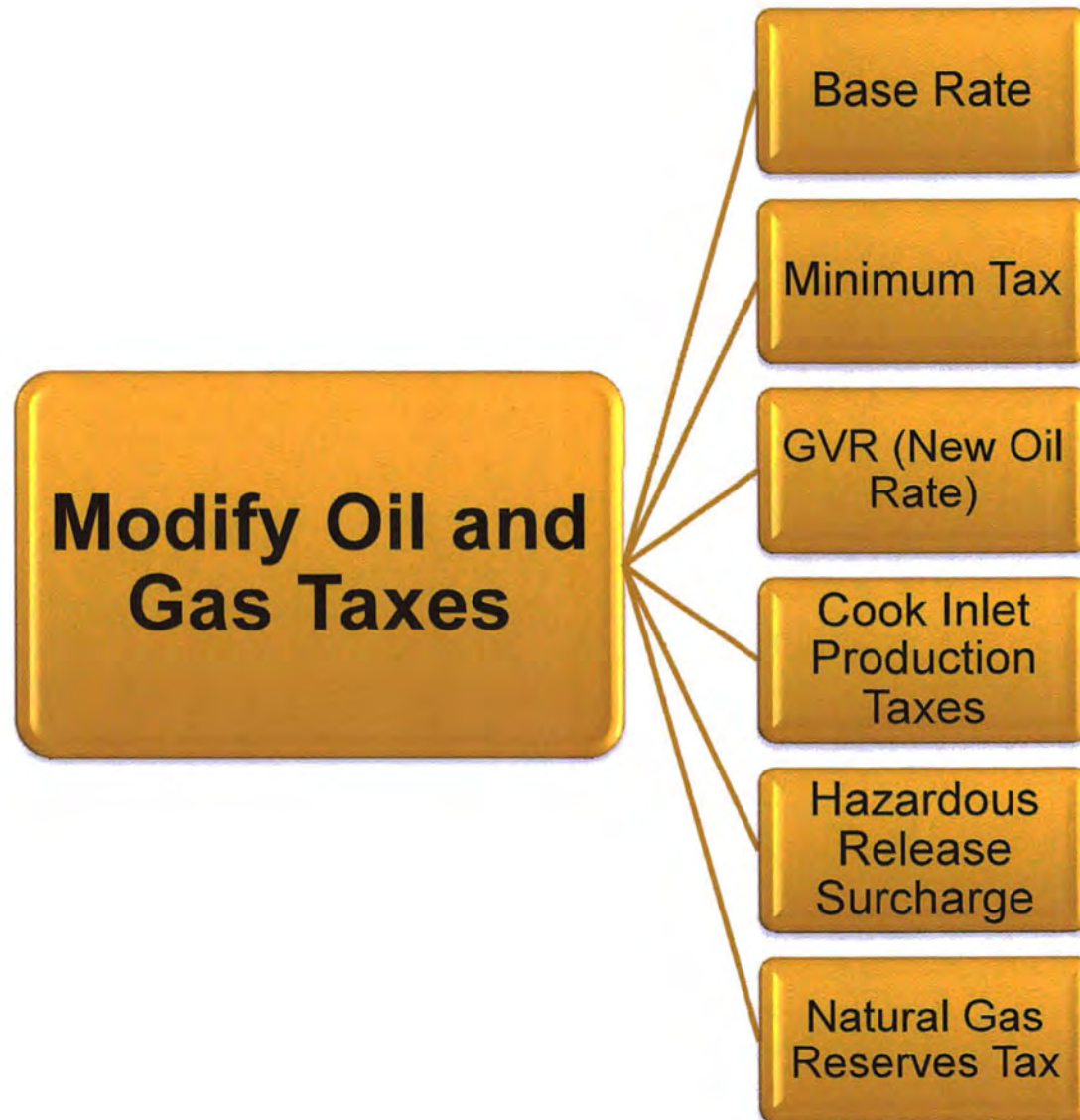
Individual PFD Values



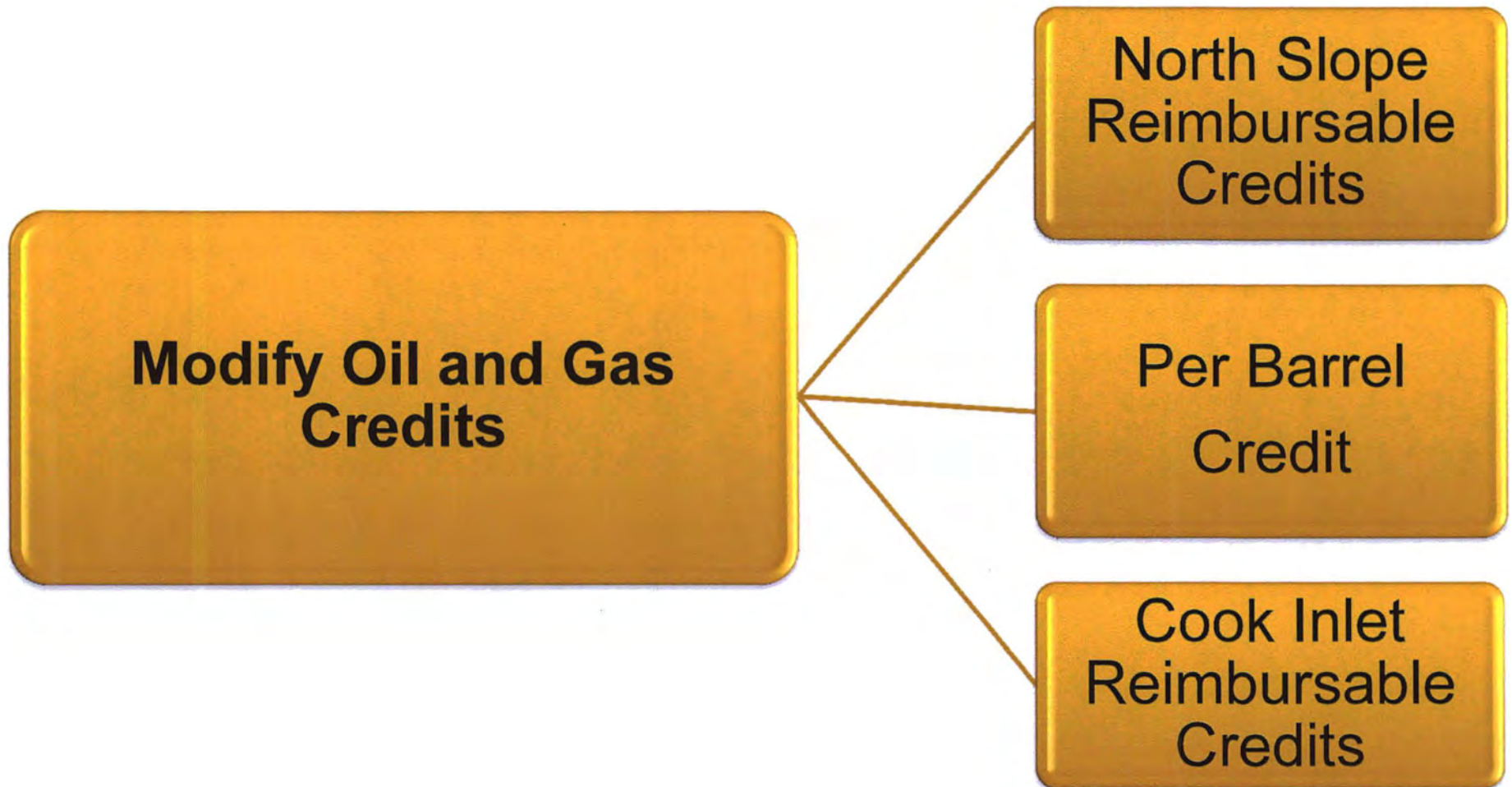
Budget Options

State Budget General Funds Unrestricted	
DEPARTMENT OF ***	DEPARTMENT CUT AMOUNT
Administration	0%
Commerce, Community and Economic Development	0%
Corrections	0%
Education and Early Development	0%
Environmental Conservation	0%
Fish and Game	0%
Health and Social Services	0%
Labor and Workforce Development	0%
Law	0%
Military and Veterans' Affairs	0%
Natural Resources	0%
Public Safety	0%
Revenue	0%
Transportation and Public Facilities	0%
University of Alaska	0%
Office of the Governor	0%
Branch-wide Unallocated Appropriations	0%
Alaska Court System	0%

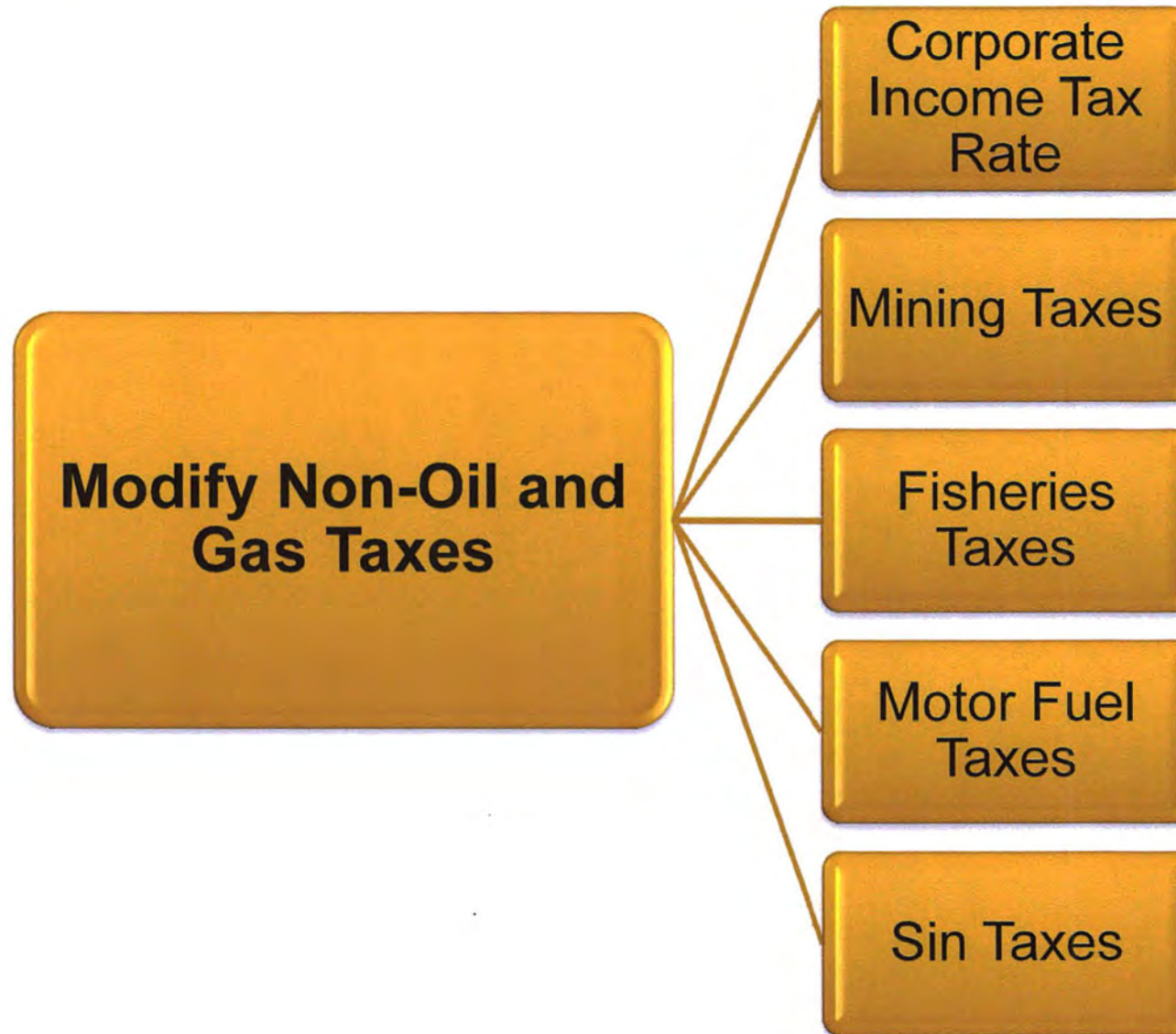
Options (Increase Revenue)



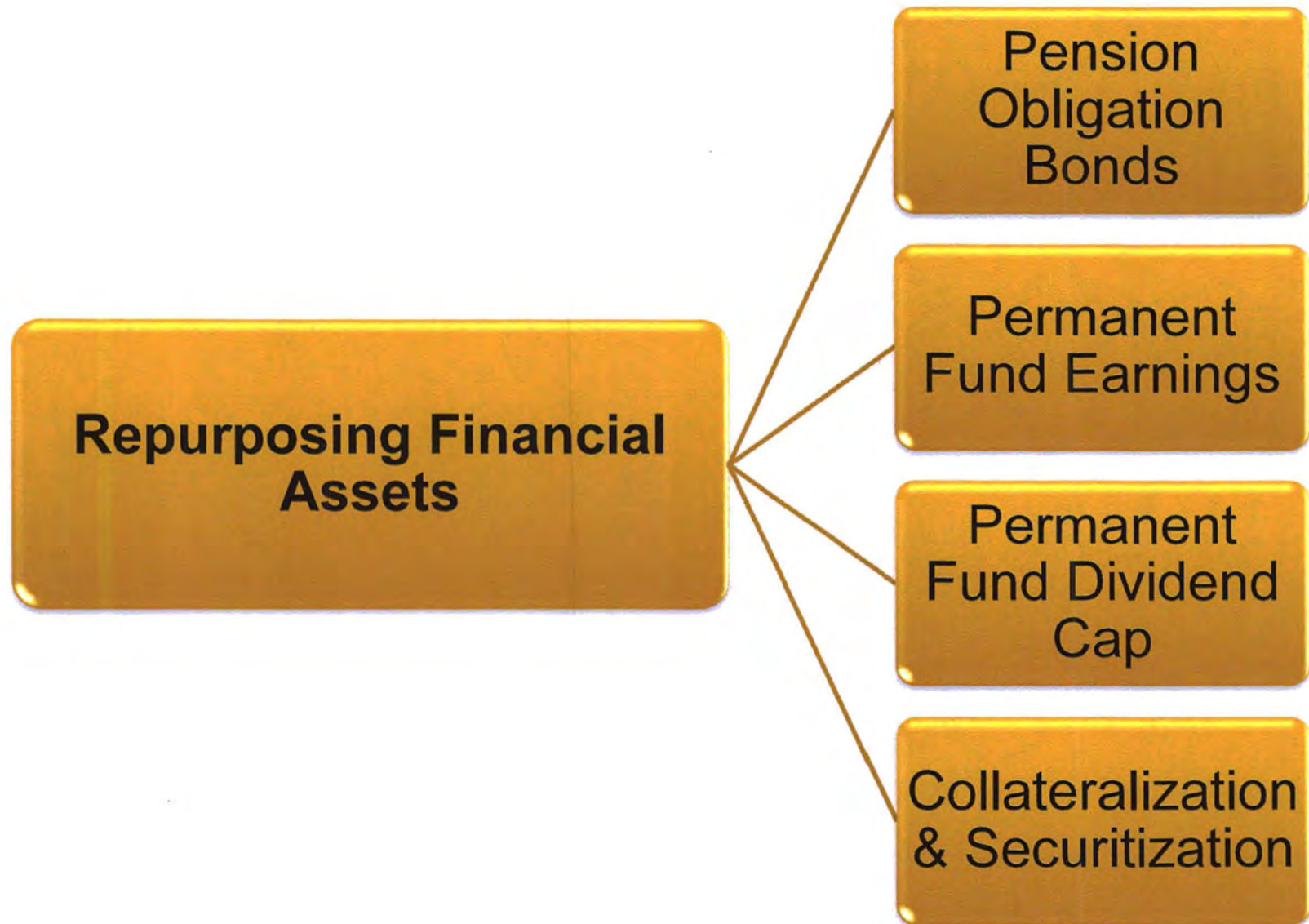
Options (Increase Revenue)



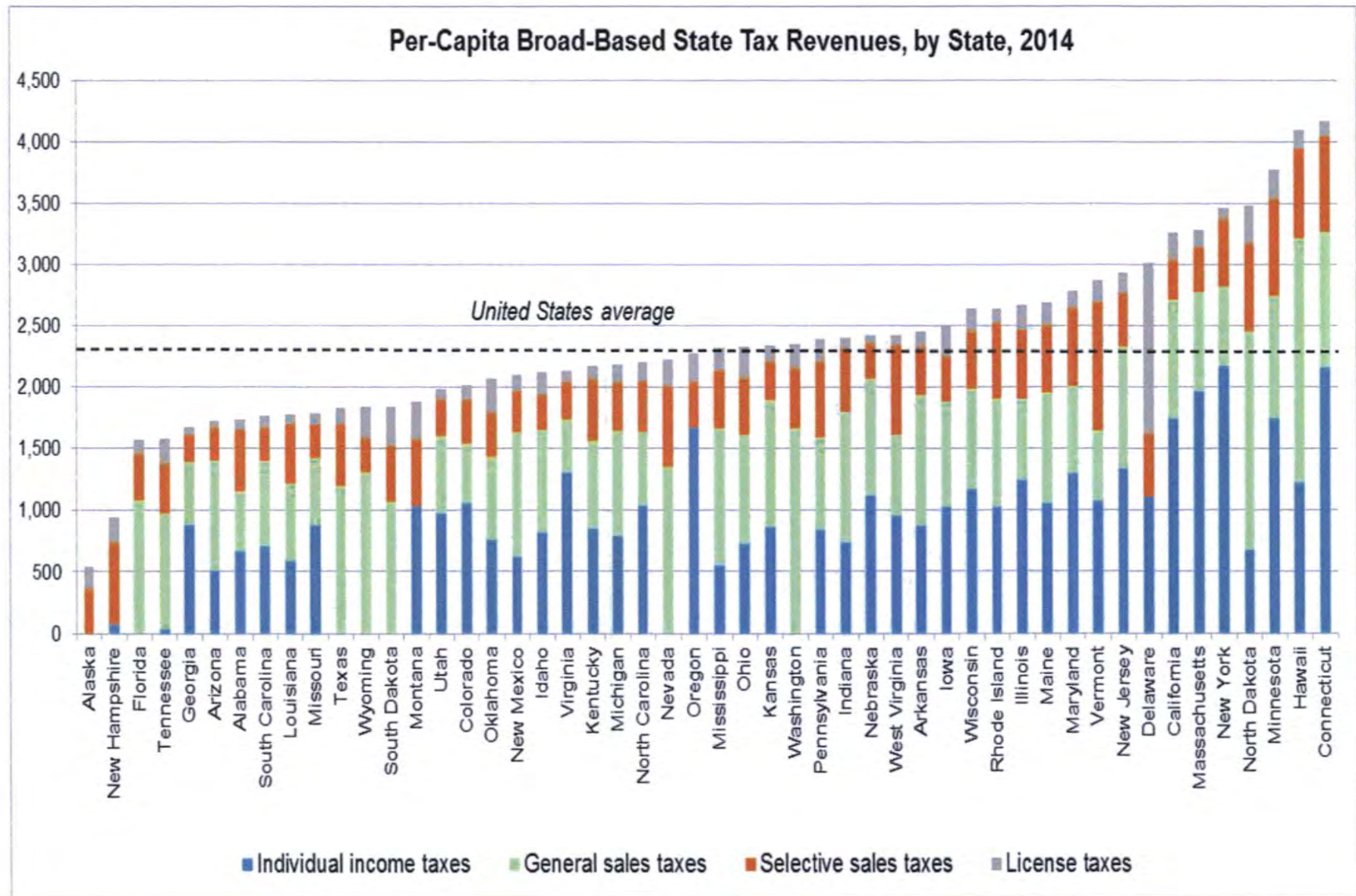
Options (Increase Revenue)



Options (Increase Revenue)



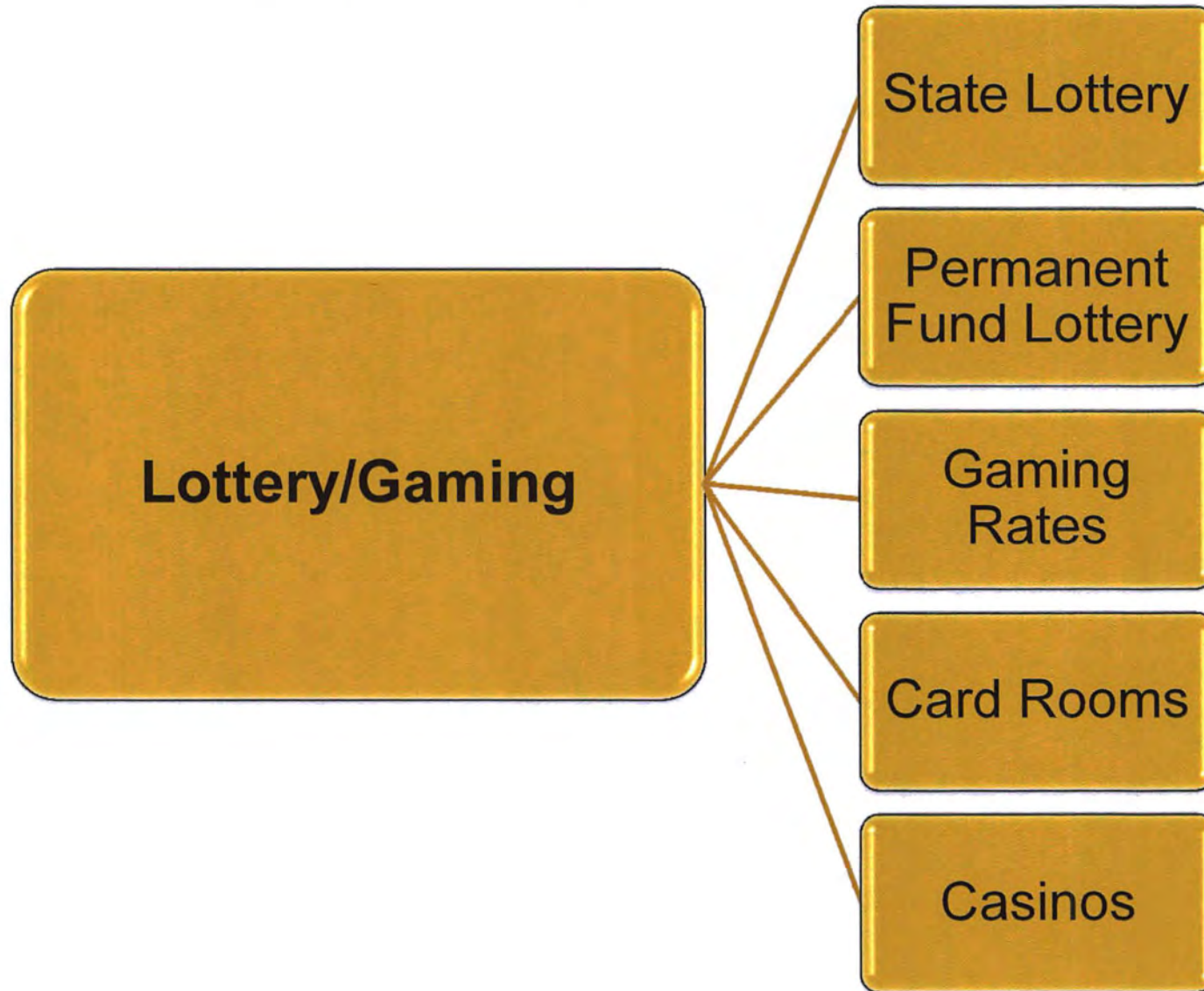
Options (Increase Revenue)



Options (Increase Revenue)



Options (Increase Revenue)



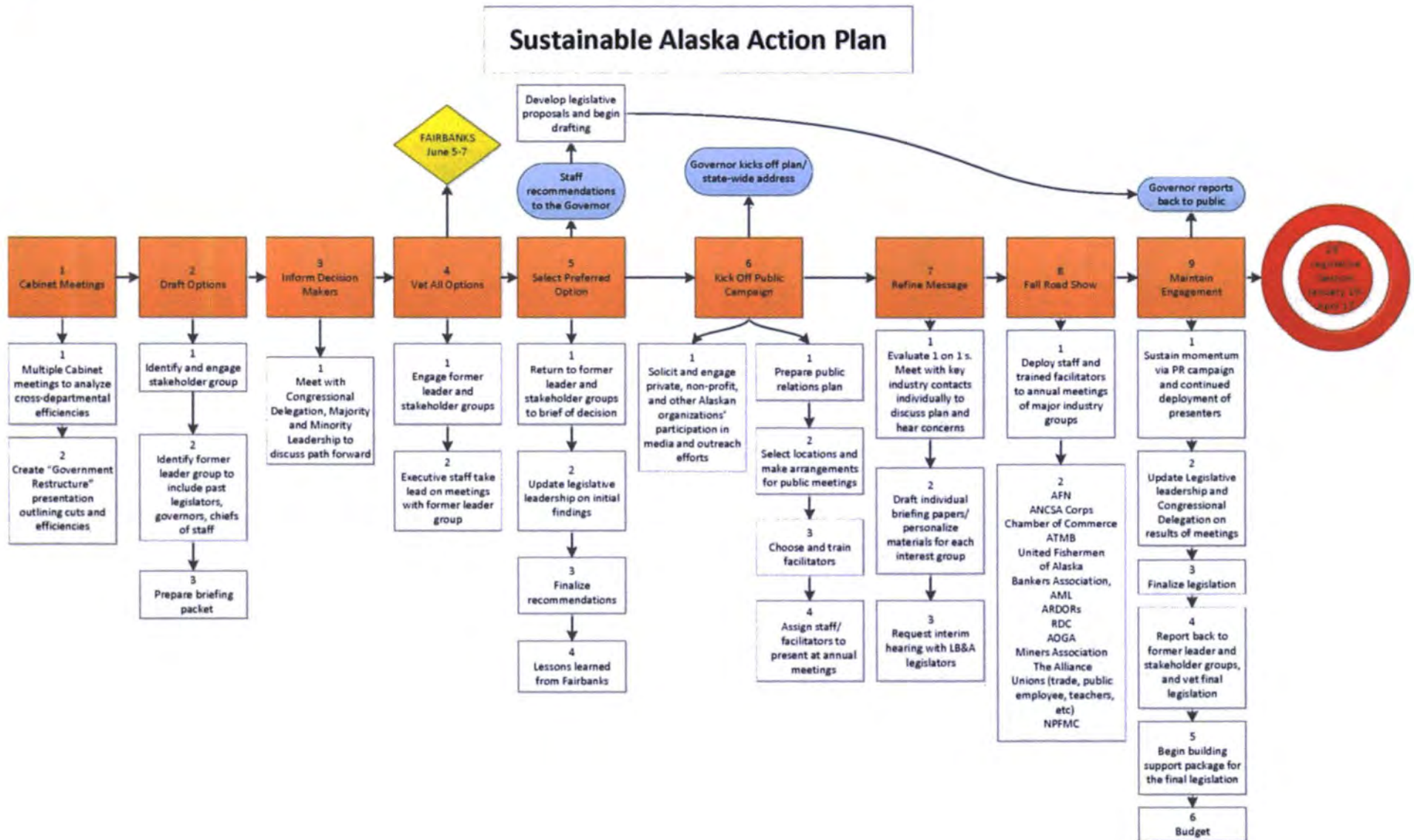
The Conversation

Fiscal Challenge

Options

Path to Fiscal Stability

Path to Fiscal Stability



Sustainable Future Dialogues

Kick-Off: Building a Sustainable Future: Conversations with Alaskans - June 5-6, 2015

June – August

- Anchorage, Ketchikan, Juneau, and Kenai/Soldotna Chambers of Commerce
- Rotary Clubs in Juneau, Anchorage, Fairbanks
- Fairbanks Economic Development Corporation
- Alaska Association of School Boards
- Anchorage Board of Realtors
- Alaska Superintendents Association
- Alaska Municipal League
- City of Palmer / City of Wasilla
- UAF e-Learning
- Alaska CHARR

**Events To
Date: 17**

September - December

- Fairbanks and Homer Chamber of Commerce
- Alaska State Chamber of Commerce
- Alaska Commission on Aging
- Fairbanks League of Woman Voters
- Institute of the North
- Homer/Ninilchik Town Hall Meetings
- Commonwealth North
- Southeast Conference
- Alaska Municipal League
- Pioneers of Alaska
- UAA Faculty & Staff Association
- The Island Institute and more...

**Upcoming
Events: 25+**

Path to Fiscal Stability

There are no easy answers to balancing a \$3 billion annual deficit.

Takes some combination of four things:

- 1. Continued budgetary restraint**
- 2. Taxes impacting individual Alaskans**
- 3. Changes to oil and gas taxes/credits**
- 4. Strategic use of our legacy assets**

Next Steps....

Path to Fiscal Stability

“We expect that if lawmakers do not enact significant fiscal reforms to reduce the imbalance within the next year, the state’s rating could begin transitioning downward. The rating migration lower would likely persist and accelerate if lawmakers continued to fail to act...”

**Alaska Rating Outlooks Revised To Negative
Reflecting Its Large Structural Deficit**

Standard and Poor’s Rating Service
August 18, 2015 Report

Further Conversations

BUILDING A
SUSTAINABLE
FUTURE:



conversations with Alaskans

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