

SCOMM

101:84



FISCAL POLICY PAPERS

Institute of Social and Economic Research
University of Alaska Anchorage

Number 8
December 1993

Gaining and Losing Under State Fiscal Policies

By Alexandra Hill and Matthew Berman

Sometime soon—just when is uncertain—Alaska's legislators will run short of money to balance the state budget and will have to make big budget adjustments. Those budget adjustments will be especially difficult, because the generous fiscal policies of the 1980s have had major effects on the jobs and incomes of individual Alaskans.

The figure below illustrates one of the most widespread effects of those generous policies: it shows the percentage of income Alaska households get from the state's unique cash distribution programs—the Permanent Fund Dividend program and the smaller Longevity Bonus program.

Those state payments have become major sources of income for the poorest Alaskans and significant sources for nearly half of all households. The poorest 10 percent of households get one-quarter of their income from dividends and bonuses—and the 30 percent of households between the bottom and the middle of the income scale get from 7 to 14 percent of their incomes.

The dividend and bonus programs are reflections of Alaska's oil wealth at the start of the 1980s—and examples of the many ways the legislature used oil money to make life sweeter for Alaskans. It established the Permanent Fund Dividend program to make annual payments to all residents. It expanded the Longevity Bonus program of monthly payments to older Alaskans. It abolished the personal income tax. It increased aid to local

governments, allowing them to cut property taxes while they hired more workers and increased services. And it established loan programs and increased spending for services and facilities, spreading jobs and money throughout the economy.

The problem is that the state's oil revenues for the rest of the 1990s are likely to be smaller on average than they were during the past five years, and much smaller than a decade ago. In recent years the state has balanced its budget by making some budget cuts and by using cash reserves and one-time settlements of back oil taxes. Within a few years the reserves will be gone, and the state will face annual projected budget deficits on the magnitude of \$500 million (see box in foldout). Later on the deficits will likely be larger. An unexpected jump in oil prices or an increase in oil production could allow the legislature to put off making major policy changes for a few more years.

But soon state officials will have to consider making much bigger budget cuts, re-imposing the personal income tax, levying other taxes, and eliminating or reducing the state's unique cash distributions. They have already begun to phase out Longevity Bonuses by reducing payments for new recipients as of 1994.

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. This paper estimates the effects of selected state policies on different types of households and communities in the 1980s, and assesses the likely consequences of specific policy changes.

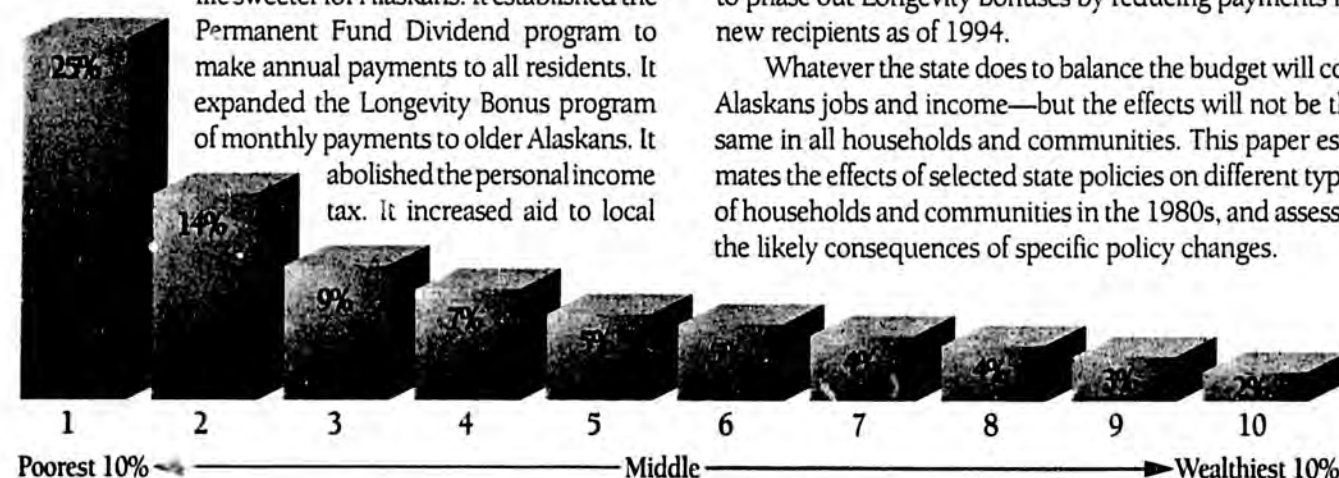


Figure 1. Percentage of Household Income from Dividends and Bonuses
(Households by Decile, Based on 1990 Census)

This paper continues the series examining state spending and revenues and the issues Alaska faces as oil revenues decline. The first seven papers were made possible by a grant from ARCO Alaska. Grants from a number of Alaska businesses have now made it possible to continue the series: National Bank of Alaska, First National Bank of Anchorage, the Anchorage Daily News, Alascom, Inc., Alaska National Insurance Company, Ketchikan Pulp Company, and Lynden Incorporated.

Pages 2 through 4 summarize our findings. The foldout provides more detail, describes our research methods and sources, and discusses the fiscal gap problem.

Our analysis is based on data from the 1980 and 1990 federal censuses. The census is the sole source of detailed information about the distribution of income and the composition of the work force, and detailed 1990 figures were just released this year. More recent data show that economic growth since 1990 has not resulted in big changes that would significantly change the level and distribution of income or the results of our analysis. Population and employment have increased somewhat, but real (adjusted for inflation) per capita income is relatively unchanged.

Effects of State Policies, 1980-1990

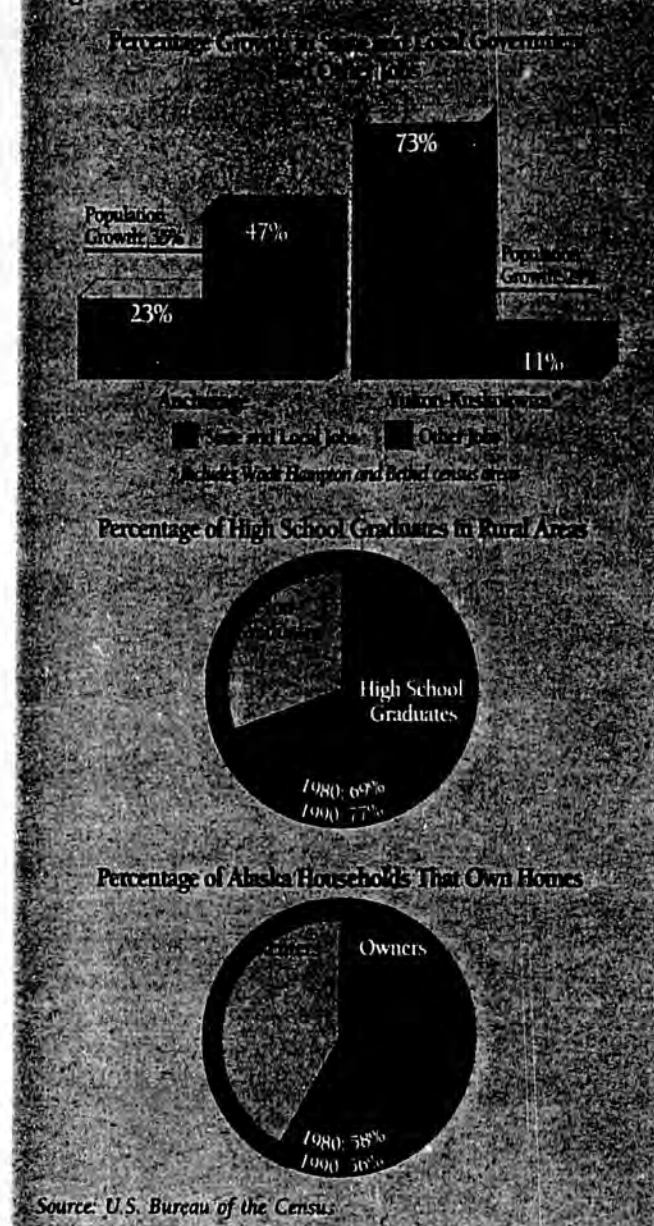
State spending of more than \$30 billion in oil wealth was responsible for much of Alaska's economic growth in the 1980s. Many state policies contributed to that growth, as described in earlier *Fiscal Policy Papers*. This paper does not attempt to sort out the specific effects of all those policies—which might be impossible. Instead we chose several major policies whose effects we could reliably estimate with data from the 1980 and 1990 federal censuses.

- **The Longevity Bonus and the Permanent Fund Dividend programs helped Alaska avoid the national trend toward the rich getting richer and the poor poorer.** In the U.S. as a whole, wealthier households gained a bigger share of total income in the 1980s. But in Alaska, the income distribution remained virtually unchanged between 1980 and 1990—largely because of dividend and bonus payments. Payments under those programs are equal to all recipients, but they contribute a much bigger share to those with low incomes. As of 1990, the poorest 30 percent of Alaska households collected 9 percent of total income, the middle 40 percent of households collected 34 percent, and the wealthiest 30 percent collected 57 percent (see foldout).

The dividend program this year will pay out a total of about \$506 million, with payments of \$949 to each qualified resident. (Payments come from earnings of the Permanent Fund, a state savings account with a current balance of more than \$12 billion). The bonus program currently makes \$250 per month payments to most Alaskans over 65. Bonus payments will total about \$65 million this year.

- **Increased state spending and aid to local governments made rural areas more dependent on state and local jobs.** In the Yukon-Kuskokwim Delta for example (Figure 2), the number of state and local government jobs grew 73 percent, while other jobs grew only 11 percent. As a result, a much bigger share of total jobs in that area is now state and local jobs. In Anchorage, by contrast, state and local jobs grew 23 percent, while other jobs grew about 47 percent.

Figure 2. Effects of Selected State Policies, 1980-1990



- **Dozens of new high schools the state built in small rural communities contributed to growth in percentages of high school graduates in rural areas.** The percentage of high school graduates among adults throughout rural Alaska increased from 69 percent in 1980 to 77 percent in 1990.

- **State mortgage subsidies and other housing policies were unable to increase the percentage of households owning homes.** The state spent about \$1 billion on home mortgage subsidies in the early 1980s, enabling many Alaskans to buy houses. But state policies could not override the economic forces that brought housing prices down and cost thousands of Alaskans their homes in the recession of 1986-88. In 1990, the percentage of households that owned homes was 56 percent, down slightly from 58 percent in 1980.

Effects of Policy Changes

Current estimates are that Alaska will likely soon face annual budget deficits totalling hundreds of millions of dollars. State officials will be able to fill some but not all of the shortfall with more budget cuts, and then they'll look for other ways to raise money. Any actions the state takes will affect jobs and incomes of Alaskans.

We assessed the effects on household income of four potential state policies: (1) eliminating dividend and bonus payments; (2) levying a personal income tax similar to the one in place before 1980; (3) levying a state sales tax of 6 percent; and (4) levying a state property tax of 10 mills (1 percent). We also looked at which communities are most vulnerable to direct job losses from state spending cuts.

Figure 3 shows how each policy would reduce incomes of poor, middle, and upper income households and how much revenue each might raise from households and other sources. Our estimates are based on assumptions (see the methods box in the foldout) about the level and structure of taxes. If the state did decide to levy new taxes, it could structure them in many different ways. Our main goals are to show the distributional effects of various taxes on households with different incomes, and to provide an idea of the magnitude of revenues various policies could raise.

• **Alaska households would give up roughly \$570 million if the state eliminated dividends and bonuses.** But they would no longer owe about \$80 million in federal taxes.

The state would also save about \$30 million it pays to replace federal welfare benefits recipients would otherwise lose.

• **The poorest Alaskans would lose one-quarter of their incomes** if dividends and bonuses were eliminated. Middle income households would lose about 5 percent, and upper-income households 2 percent.

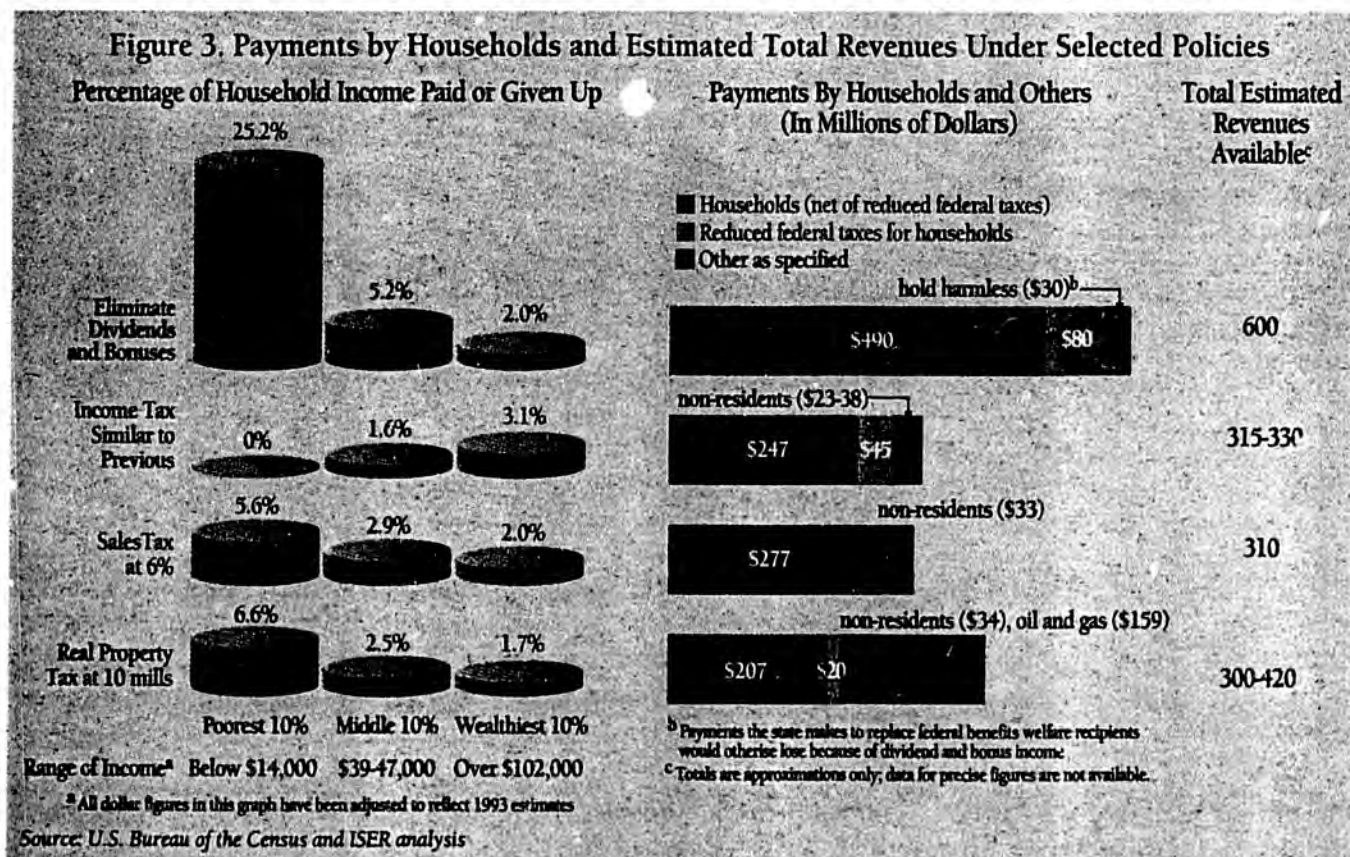
• **An income tax similar to the one in place before 1980 would cost Alaska households today about \$290 million.** Households that itemized their federal income tax returns could save about \$45 million by writing off the state tax. Non-resident workers would likely pay approximately \$30 million in Alaska income taxes.

• **Such an income tax would cost the wealthiest households about 4 percent of their incomes,** middle-income households 2 percent, and the poorest households nothing.

• **Alaska households would pay about \$277 million under a 6 percent state sales tax.** About 85 percent would be taxes on household purchases and 15 percent would be higher prices, passed on by businesses paying sales taxes. Tourists would pay an estimated \$30 to \$35 million.

• **A state sales tax would be harder on poor** than on middle and upper income households, because poorer households spend a higher percentage of their total income (sometimes more than their income), while wealthier households save more and spend more on untaxed services.

• **A state property tax of 10 mills would cost households an estimated \$227 million.** Of this, 65 percent would be taxes on dwellings and 35 percent on businesses that



would pass taxes on to customers as higher prices. Households itemizing federal returns could reduce their federal taxes by about \$20 million. Non-residents would directly and indirectly pay about \$35 million. If 10 mills were added to oil and gas property tax, it could yield about \$160 million.

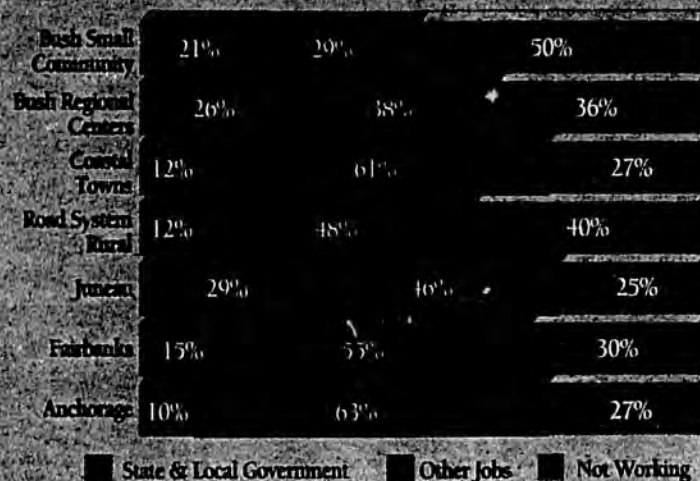
- **A state property tax would be harder on poorer households** than on middle and upper income households because the poorest Alaskans pay a bigger share of their income for housing. These households typically rent rather than own their homes, but we assume landlords pass on part of higher taxes by increasing rents.

- **Some communities are especially vulnerable to spending cuts that eliminate state and local government jobs.** The state can't make big budget cuts without cutting major transfers to local governments. Bush small communities, bush regional centers, and Juneau have the largest shares of adults working for state and local governments. Bush communities in particular have few private jobs. Despite growth in the 1980s, in 1990 only half the adults in small bush communities held jobs (Figure 4).

Conclusions

The state's unique cash distribution programs and other policies had the broad effect—even though it was unintended—of particularly increasing the incomes of poor and rural Alaskans. As state policymakers look for ways to raise money, they need to keep in mind the vulnerabilities past state policies have created. This isn't to say that they can't cut spending or reduce cash distributions or raise taxes because some Alaskans will be hurt. But they do need to consider a mix of strategies to balance the budget equitably.

Figure 4. Percentage of Adults With State and Local and Other Jobs, By Type of Community, * 1990



*Communities included in each category are listed in the foldout.
Source: U.S. Bureau of the Census

Also, before making budget choices, state officials should collect improved data—such as federal tax return information—to provide better estimates of total potential revenues.

Some Alaskans also believe the state can raise money through taxes that somehow fall mainly on tourists and non-resident workers. Our estimates show that Alaskans will pay most taxes, even though in some towns tourists pay a significant share of sales taxes.

Finally, this paper looks only at *direct* income and job effects of major changes in state policies. As described in earlier *Fiscal Policy Papers*, any state policy that directly eliminates income and public jobs will also *indirectly* eliminate more income and more private jobs.

The inside foldout provides more information on projected deficits, on our methods of analysis, and on our findings.

FISCAL POLICY PAPERS

Institute of Social and Economic Research
University of Alaska Anchorage
E. Lee Gorsuch, Director
3211 Providence Drive
Anchorage, Alaska 99508

Non-Profit Organization
U.S. Postage
PAID
Anchorage, Alaska
Permit No. 540

Changes in Alaska Jobs and Income 1980-1990

Percentage Growth in Population and Jobs 1980-1990

(By Census Area)

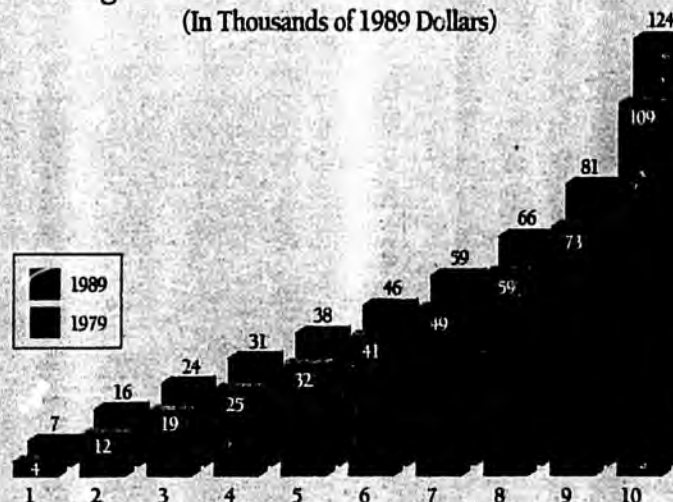
CENSUS AREA*	POPULATION	STATE AND LOCAL GOVERNMENT JOBS	OTHER JOBS
Alaska	39.4%	39.1%	51.5%
Alutian Islands	72.2	27.1	136.6
Anchorage	35.2	22.8	47.0
Bethel	25.4	68.3	13.7
Bristol Bay	47.2	171.6	48.6
Dillingham	20.9	41.2	21.0
Fairbanks	40.7	49.6	51.1
Haines	31.3	5.0	51.2
Juneau	36.9	29.6	46.9
Kenai Peninsula	62.8	69.8	180.0
Ketchikan	22.7	25.2	29.1
Kobuk (NW Arctic Boro.)	21.5	9.7	75.4
Kodiak Island	29.1	36.2	42.7
Matanuska-Susitna	121.7	132.0	195.5
Nome	25.6	64.6	37.7
North Slope	39.8	86.0	9.6
Prince of Wales	66.3	53.9	64.3
Sitka	12.7	15.1	19.5
Skagway/Yakutat/Angoon	27.0	7.3	78.3
Southeast Fairbanks	16.4	4.7	35.8
Valdez/Cordova	20.6	39.4	24.2
Wade Hampton	21.8	83.9	4.4
Wrangell-Petersburg	13.1	1.1	24.8
Yukon-Koyukuk	8.7	41.3	10.1

Source: U.S. Bureau of the Census

*1990 census areas adjusted for comparison with 1980

- Alaska real (adjusted for inflation) median household income at all levels increased between 1980 and 1990.
- The distribution of Alaska household income among low, middle, and upper income households remained virtually unchanged from 1980-1990—mostly because Permanent Fund Dividends and Longevity Bonuses increased incomes of poorer households by a much larger percentage.
- In the U.S. as a whole, the share of total income going to the wealthiest families increased between 1980 and 1990, while the shares of poorer and middle income families declined.
- In Alaska and most of its census divisions, the number of jobs grew as fast or faster than population between 1980 and 1990—meaning that the percentage of working adults increased in most areas.
- In several rural areas, however, most or all of the job growth was in state and local government jobs, making those areas more dependent on state spending.

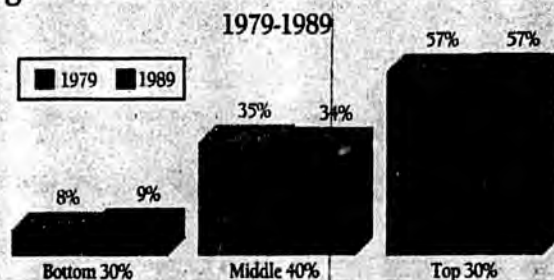
Change in Real Alaska Household Mean Income (In Thousands of 1989 Dollars)



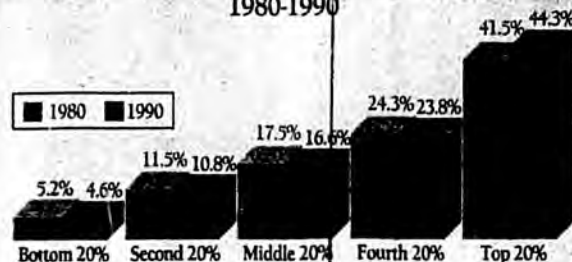
Households by Decile, From Poorest to Wealthiest

Note: Numbers are mean income for each decile of households

Change in Distribution of Alaska Household Income



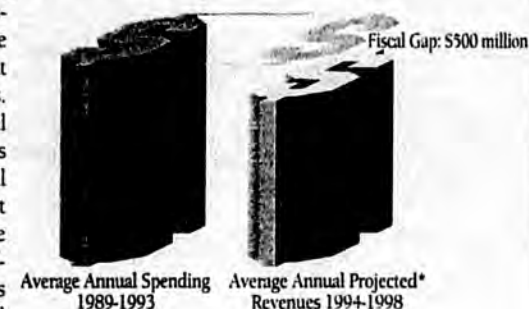
Change in Distribution of U.S. Family Income 1980-1990



Source: U.S. Bureau of the Census

Estimating the Fiscal Gap in the 1990s

The adjacent figure illustrates the magnitude of the fiscal gap the state government faces over the next five years. It shows that average annual revenues from existing sources between 1994 and 1998 will fall about \$500 million short of average spending for the past five years. The actual difference between revenues and spending each year will depend on the price of oil, one-time settlements, and other factors.



Alaska's income is falling over the long run because petroleum revenues, which pay for most of state government, are declining and will most likely continue to decline as the huge Prudhoe Bay field is depleted. New production can replace some but not all of the loss. Higher oil prices could offset the drop in production for a while. In recent years, the state has balanced its budget by making spending cuts and using reserves and one-time settlements of back oil taxes. At some point in the near future, the reserves will be gone and the state will face big deficits that will most likely get larger over time.

*Projections of Alaska Department of Revenue, Spring 1993. Values in 1993 dollars.

Sources and Methods

The 1980 and 1990 federal censuses provided the basis for most of our analysis of changes in the distribution of income and the composition of jobs in Alaska, and of the potential distributional effects of various state policies. To estimate potential 1993 revenues from various kinds of taxes and from elimination of state transfers we relied on Alaska's budgets, the U.S. Consumer Expenditure Survey, and Alaska Department of Revenue income tax forms and statistics about income tax paid in 1979.

The results of our analysis depend heavily on available information and assumptions about the level and structure of various kinds of taxes. Our estimate of sales tax is based on household consumption. Property tax payments include increased taxes on dwellings and an estimate of the increased taxes that businesses would pass on as higher prices to their customers. We also attempted to estimate households' reduced federal taxes, as a result either of lower income if transfers were eliminated, or of increased federal deductions for higher property and income taxes. All these policy options would have other effects that might shift taxes onto or away from Alaska households—but calculating the ultimate incidence of taxes is beyond the scope of this paper. Assumptions include:

Elimination of Dividends and Bonuses: Because many Alaskans apparently did not report their Permanent Fund Dividends and Longevity Bonuses as income on their census forms, we allocated that income to individuals most likely to be eligible.

Personal Income Tax: We constructed a tax similar to the one in place in 1979. The estimated 10 percent paid by non-residents is the share they paid in 1979.

Sales Tax: We assumed a 6 percent tax with groceries and most services exempt. Alaska Visitor Industry Statistics allowed us to estimate taxes from non-residents.

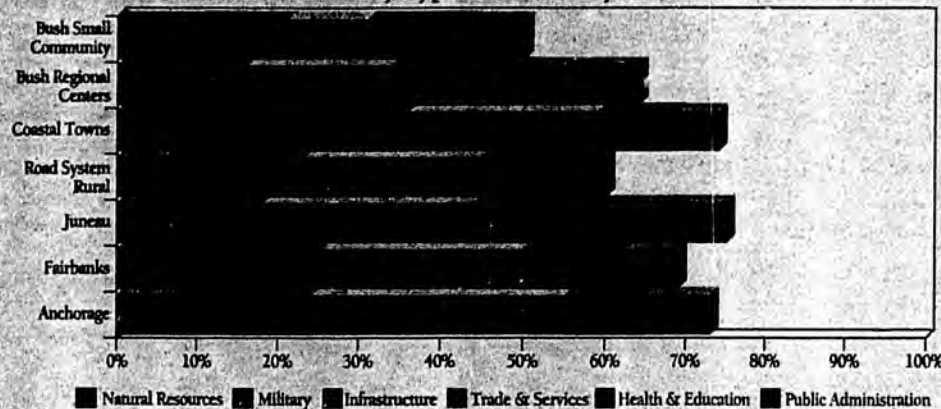
Property Tax: The census provided values for owner-occupied homes; we estimated the value of rental units based on the rent paid.

Taxes Paid by Business: Some sales and property taxes would fall on businesses as well as households. We assumed businesses would pass these taxes on to customers in higher prices, and so have allocated them to households. The oil, timber, and fishing industries, which must sell at world prices, would have to pass increased taxes on as reduced wages or returns to shareholders. We did not allocate their taxes to households.

Potential Effects of State Spending Cuts and New Taxes

- Jobs in natural resource industries provide only a small part of total Alaska employment. Even in coastal towns, where the commercial fishing industry provides many jobs, only about one job in four is in natural resources.
- Trade and service industry jobs are the most common jobs throughout the state, except in bush small communities.
- Health and education jobs, many of which are government funded, are the largest source of employment in small bush communities, and the second largest in bush regional centers.
- Households with residents over 65 and those with children would lose a higher percentage of their incomes than households on average (shown in Figure 1 on page 1) if the state eliminated Permanent Fund Dividends and Longevity Bonuses. This is true at every income level.
- Loss of the dividend and bonus would cost the poorest households with residents over 65 just over 40 percent of their income and the poorest households with children more than 30 percent.
- In general, even though high income households pay smaller percentages of their incomes in property and sales taxes, they pay a much larger share of total tax dollars—because their incomes are so much higher.
- Although some property, income and sales taxes would fall on high-income residents, they would pay most of the taxes under all of these policy options.
- If the state used the dividend as a credit on an income tax, the results would be virtually the same as if it imposed the tax but continued to pay the dividends—an option we analyzed. (We assume the U.S. would not take the dividend, whether it came as a tax credit or as a check.)

Percentage of Adults Employed by Industry, 1990
(By Type of Community*)



* Bush Small Community includes communities with populations below 1,000 and not connected by road to Anchorage or Fairbanks.
 Bush Regional Centers include Bethel, Kotzebue, Nome, and Barrow.
 Coastal Towns include communities with populations above 1,000 and significant commercial fishing: Craig, Ketchikan, Metlakatla, Sitka, Petersburg, Wrangell, Cordova, Kodiak, Unalaska, and Dillingham.
 Road System Rural includes all other communities with highway or railroad access to Anchorage or Fairbanks.
 Excludes persons living on Adak Station, Fort Greely, Eielson Air Force Base, and Kodiak Station.

Source: U.S. Bureau of the Census, STF #3.

About the authors: All the authors and contributors to this paper are staff members of ISER. Alexandra Hill is a research associate and Matthew Berman is an associate professor of economics. Other contributors are Scott Goldsmith, professor of economics, Lee Gorsuch, ISER's director, Teresa Hull, research associate, Linda Leask, editor, and Monette Dalsfoist, editorial assistant.

Percentage of Income Households Pay or Give Up Under Various State Policy Options
(Households by Decile, Based on 1990 Census)

Eliminate Permanent Fund Dividend and Longevity Bonus

