

Revenue Options for the State of Alaska

Status Update and Presentation to Alaska Municipal League
Anchorage, Alaska

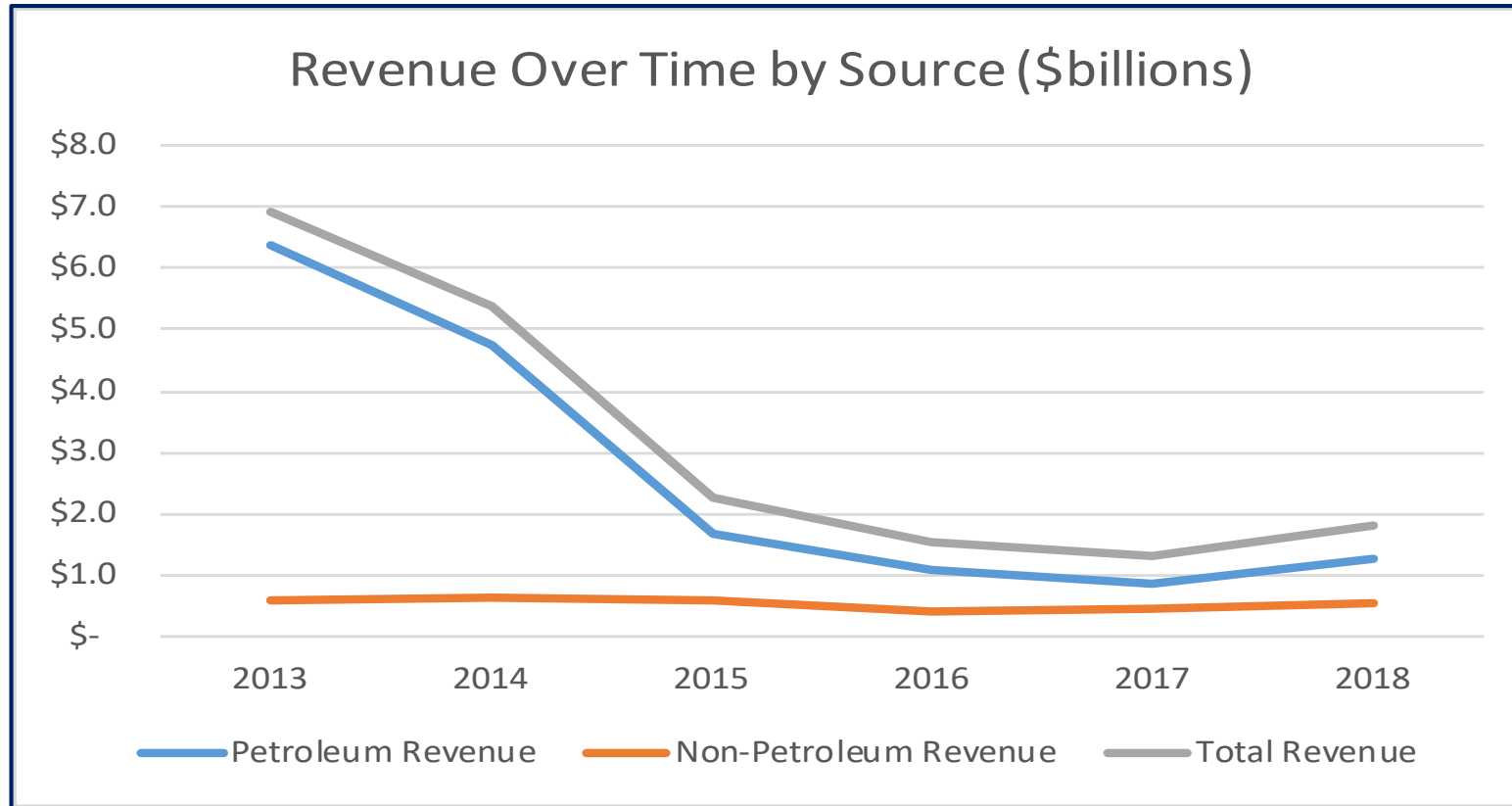


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November 14, 2018

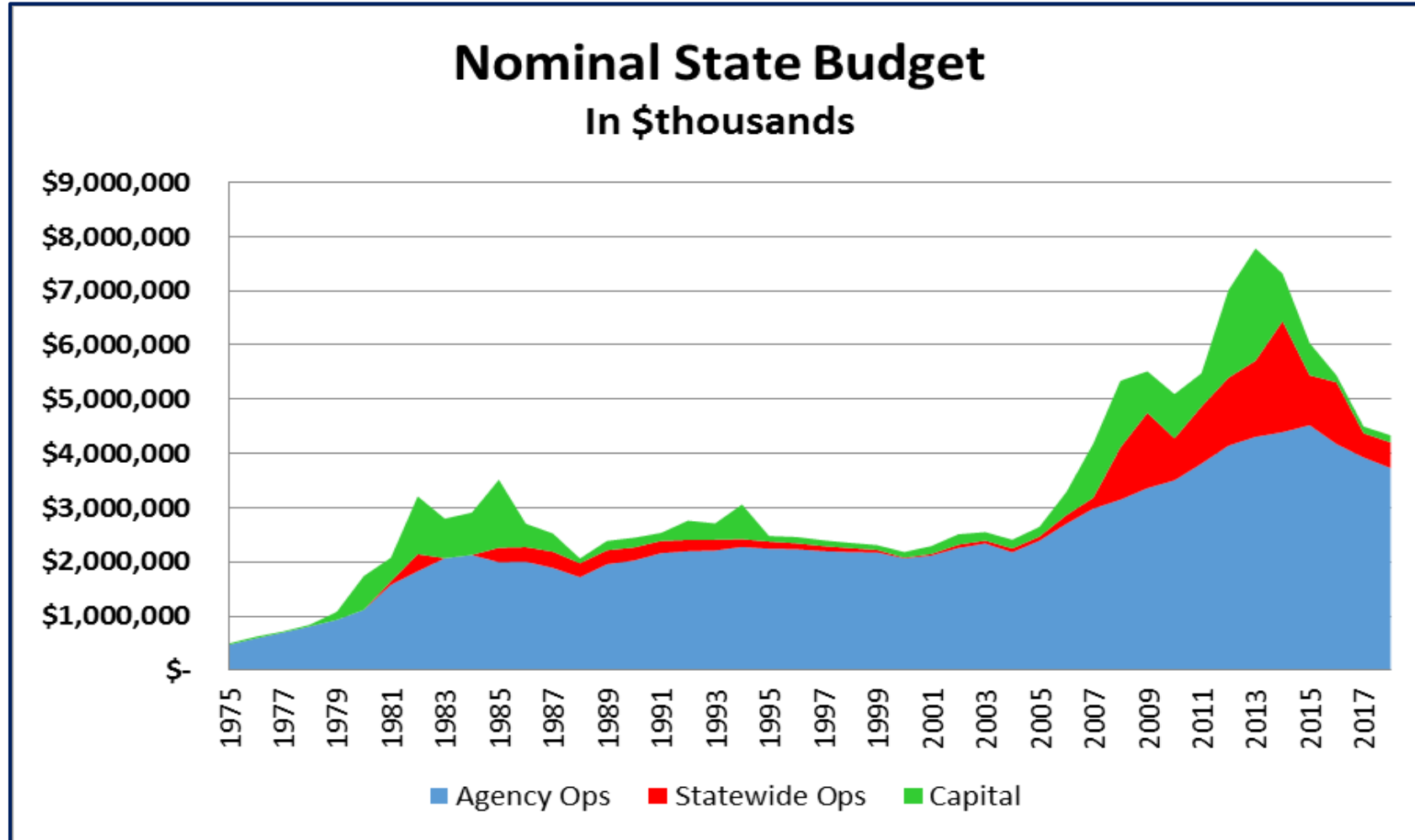
The Budget Situation

Revenue declined rapidly with 2014 oil price collapse



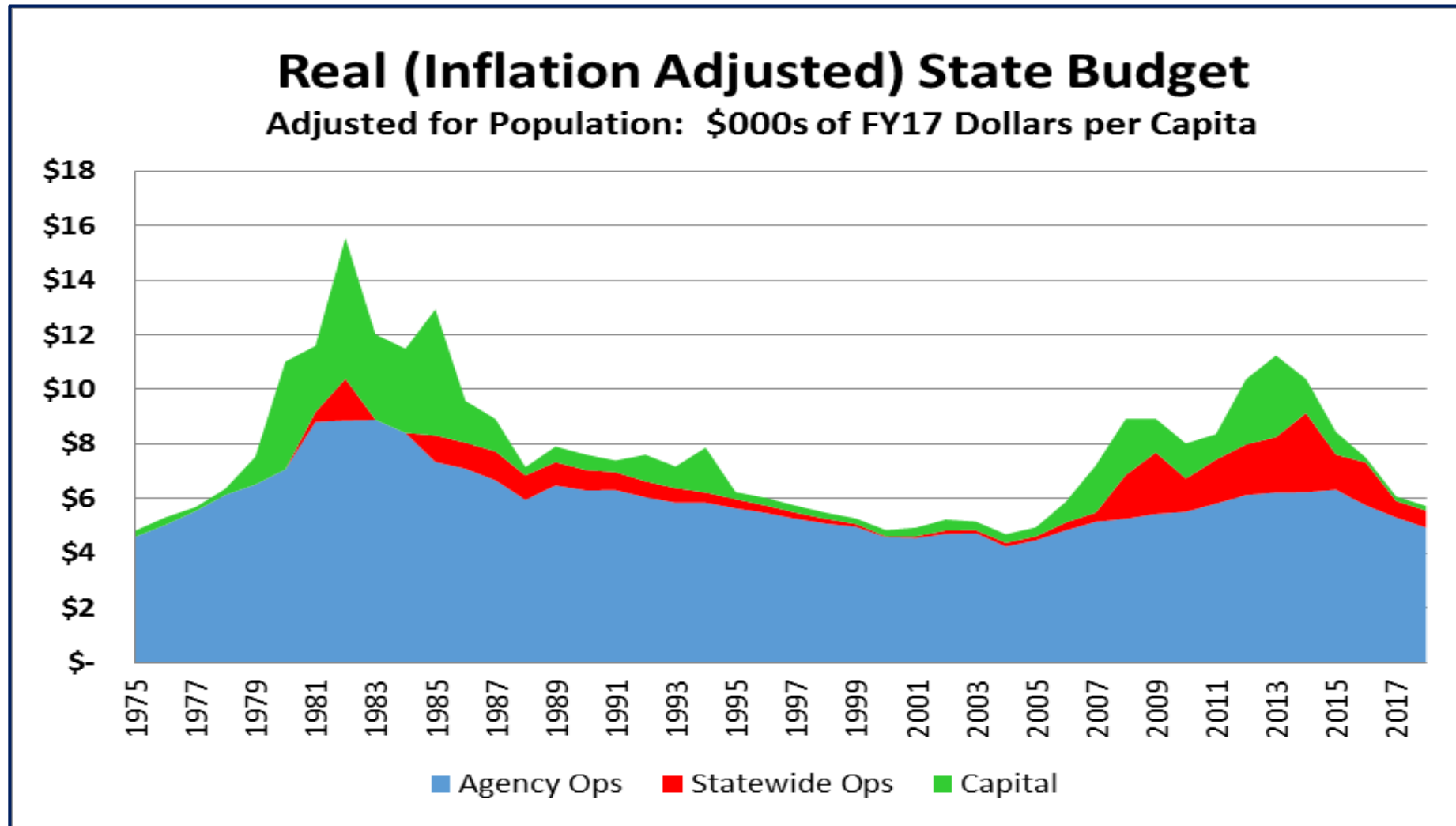
- It was rapidly clear that petroleum revenues could no longer be relied upon to fund the majority of state government services
- Non-petroleum revenues have been flat over time
- Must diversify the state's revenue portfolio

The budget has been cut dramatically...

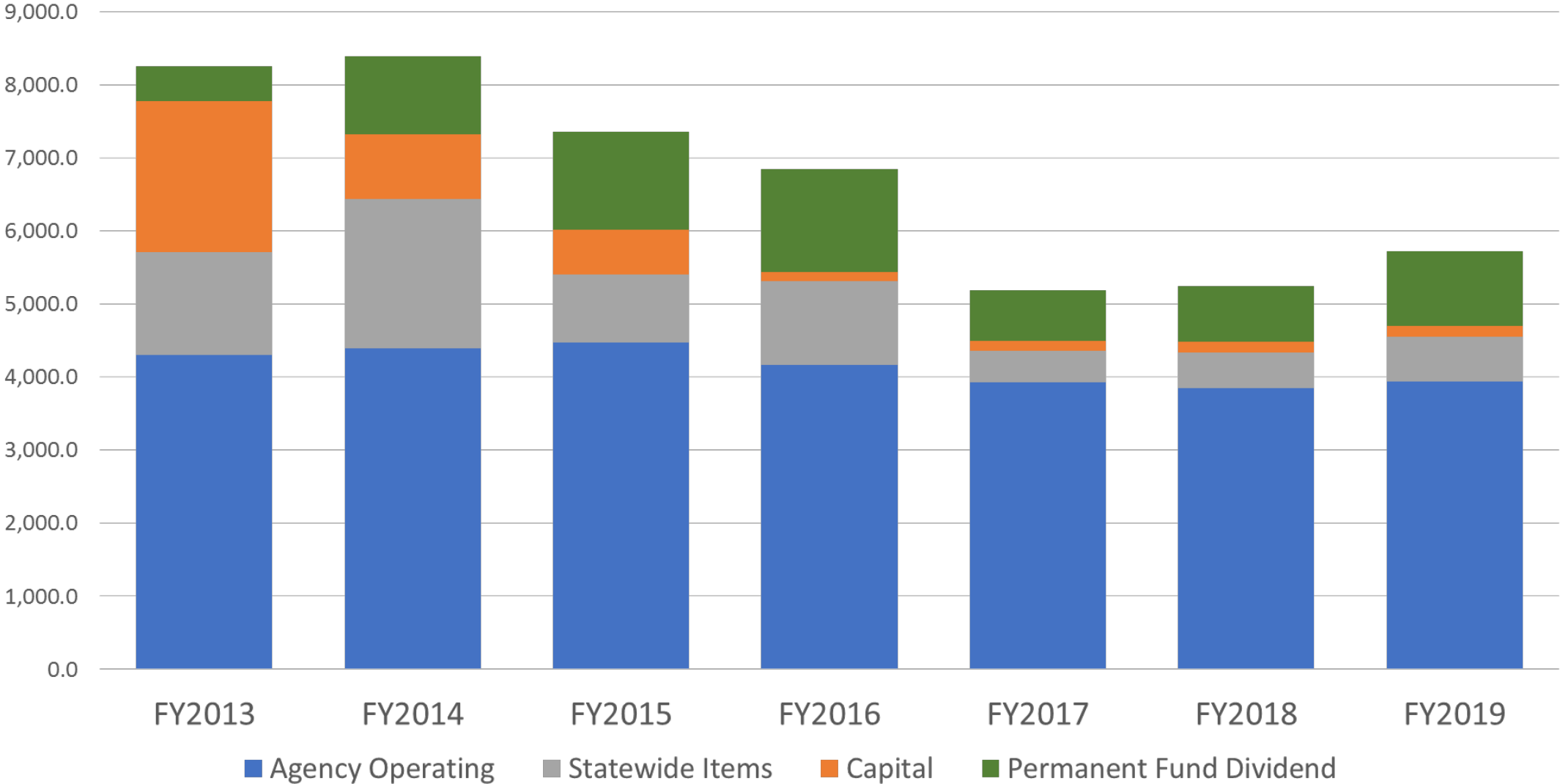


Even without considering inflation or population growth, Alaska's total budget has been reduced to 2008 levels

... to 1990s levels when adjusted for inflation and population

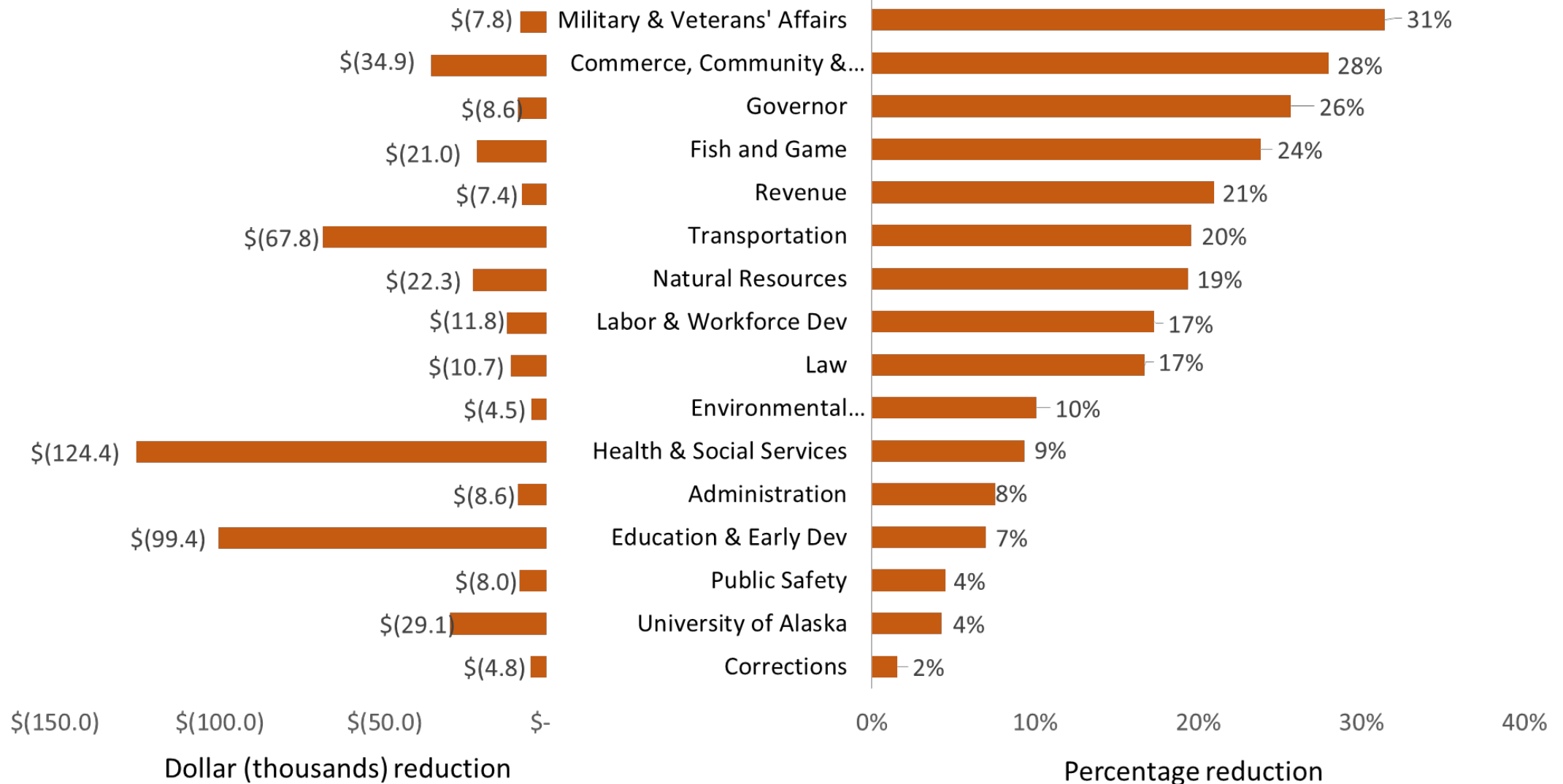


Budget cuts since FY2013, including PFDs



Cut Details by Agency

Agency General Fund Budget Reductions: FY15 to FY19



Cuts Impact Everyone: State Funds Matter Locally

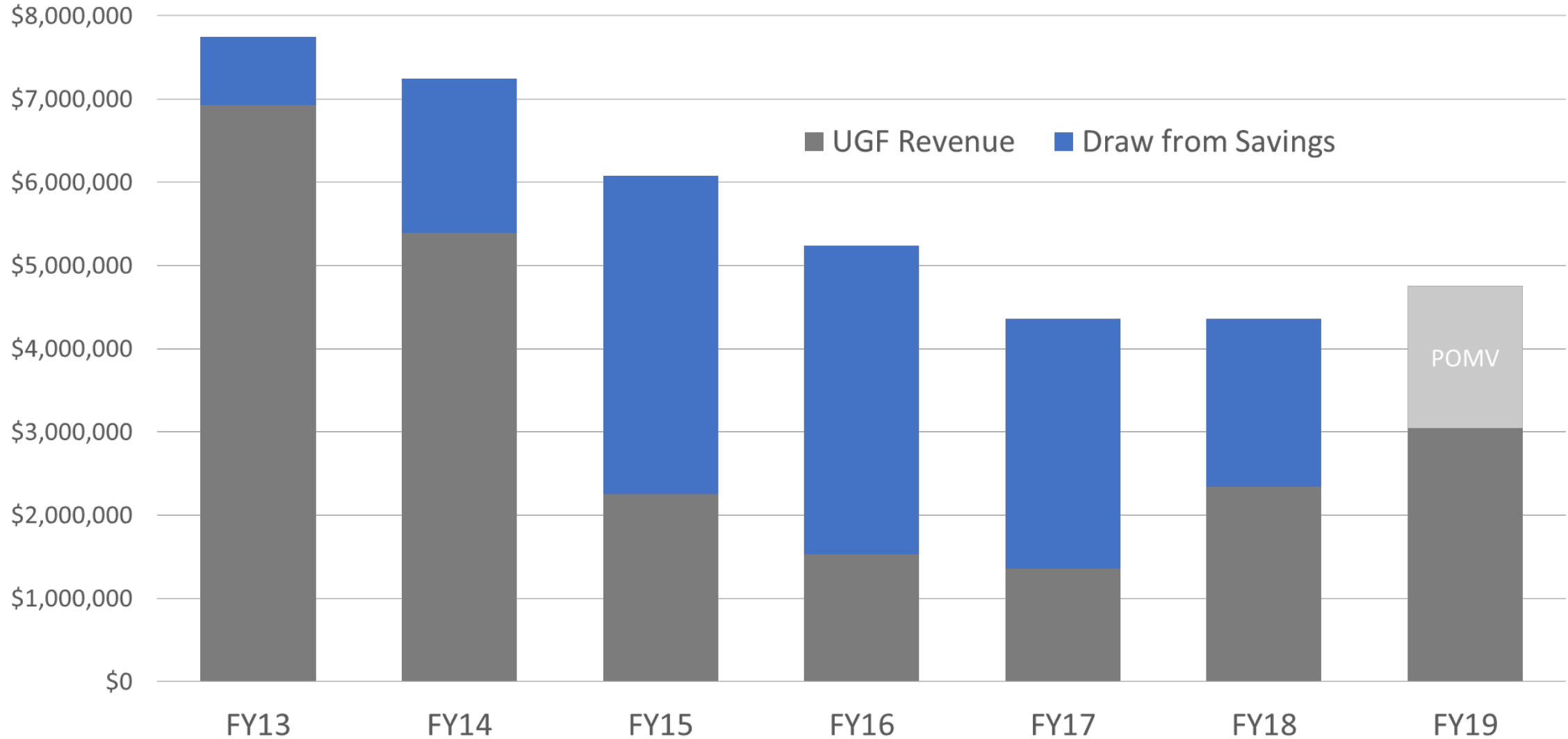
More than half of the state budget is paid directly to citizens, communities, and businesses

Payments are for items such as:

- Medicaid payments to providers on behalf of citizens
- K-12 Schools
- Retirement payments on behalf of communities and schools
- School Debt Reimbursement
- Senior Benefits
- Public Assistance
- Foster Care
- Oil and Gas Tax Credits
- Permanent Fund Dividends

Less than 50% of the state budget is spent on government services like troopers, road maintenance, ferries, airports, prisons, the Legislature, Pioneer Homes, the Courts, the Governor's Office, Fish and Game, etc.

Despite cuts, we've had six years of deficit spending



Savings Update

Most of the secondary pots have been drained
Savings were reduced by \$15 billion from FY2013 through FY2018

As of the End of FY18 (6/30/18) we had:

- CBRF (3/4 vote to access) \$2.9 billion
- SBR (simple majority) \$0.2 billion
- Public Education Fund \$0.0 billion

OMB recommends maintaining a minimum of \$2 billion for emergencies and seasonal cash flow

Plus some “hard to touch” funds

- Community Assistance (Revenue Sharing) \$0.1 billion
- Higher Education Fund \$0.3 billion
- Power Cost Equalization \$1.0 billion

Savings Update

**Of the savings we've spent, about \$9 billion was from the Constitutional Budget Reserve Fund (CBRF)
This requires a $\frac{3}{4}$ vote from both legislative bodies (30 and 15)**

- The fund includes a mandatory "payback" (Art. IX, Sec. 17(d)) of any remaining general funds at the end of each fiscal year.
- Includes both any budget surplus (revenue less expenditures). It also includes the balance of multiple designated "subfunds" (sweep)
- Because of ~\$500 million in multiple general fund "subfunds" that have strong political support, every year the legislature makes a $\frac{3}{4}$ vote called the "reverse sweep" to replace these amounts every July 1

For as long as an unpaid balance remains (possibly forever), this will be a required annual process

Summary of FY2019 Budget (Unrestricted GF)

Forecasted Revenues (Spring '18)	\$2.4 billion
<u>Enacted Budget</u>	<u>\$4.7 billion</u>
Forecasted Deficit (without Permanent Fund Earnings)	(\$2.3 billion)
<u>Permanent Fund POMV Draw Per SB26</u>	<u>\$1.7 billion</u>
Expected Deficit (when Budget Passed)	(\$0.6 billion)
<u>Additional Revenues due to higher oil prices (prelim Fall '18)</u>	<u>\$1.0 billion</u>
Expected Surplus (as of today)	\$0.4 billion

Budgetary Pressures for FY2020 and Beyond

Upward Pressures on Budgets

Legislative Finance has identified close to \$200 million including:

- \$78 million “one time” money in FY19 budget
- \$50 million short funded projects
- \$38 million estimated increase in retirement contributions

These funds would have to be added just to maintain the same level of services.

We also have about \$2 billion in accumulated deferred maintenance and capital needs (including the University)

Big Picture Budget Issue- Elasticity

The following items increase or decrease the size of future deficits (\$millions):

- \$10 oil price shift above ~\$65 / bbl \$800
- \$10 oil price shift below ~\$65 / bbl \$300
- Near term major market correction \$300
- One-time drawdown of 10% of PF assets \$300
- 10% of annual PF draw shifted to / from dividends \$275
- Increases to capital budget / deferred maint. \$50+
- \$100 increase to Base Student Allocation \$25
- Major disaster response Indeterminate

Revenue Efforts during Walker Administration

Revenue Efforts during Walker Administration

By the spring of 2015, it was clear that the oil price collapse was likely to last for a while

- April 2015: DOR releases Spring Revenue Forecast Update
The FY2018 oil price forecast was reduced from \$103 to \$89
(By fall '15, the FY18 forecast price was \$63. Actual was \$63)
- June 2015: Governor convenes weekend conference in Fairbanks
Wide ranging conversation about budget and revenue options,
supported by modeling.
Consensus supported budget cuts, use of PF earnings, and new revenue
- Fall 2015: Development of what became a nine-part legislative package for the 2016 session

Elements of 2016 Fiscal Package

Item	Est. Revenue Impact (\$millions)	Result
Permanent Fund Restructuring	\$2,700 - \$3,300	SB26 (2018)
Oil and Gas (credit reform)	\$100	HB247 (2016) HB111 (2017)
Mining (1% increase to top rate)	\$6	did not pass
Fishing (1% increase to all rates)	\$18	did not pass
Tourism (elim. \$15 credit for muni taxes)	\$15	did not pass
Motor Fuel (8 cents / gallon)	\$49	did not pass
Alcohol (10 cents / portion)	\$40	did not pass
Tobacco (\$1.00 / pack)	\$29	did not pass
Income Tax (6% of federal liability)	\$200	did not pass

Permanent Fund Restructuring- Governor's SB26

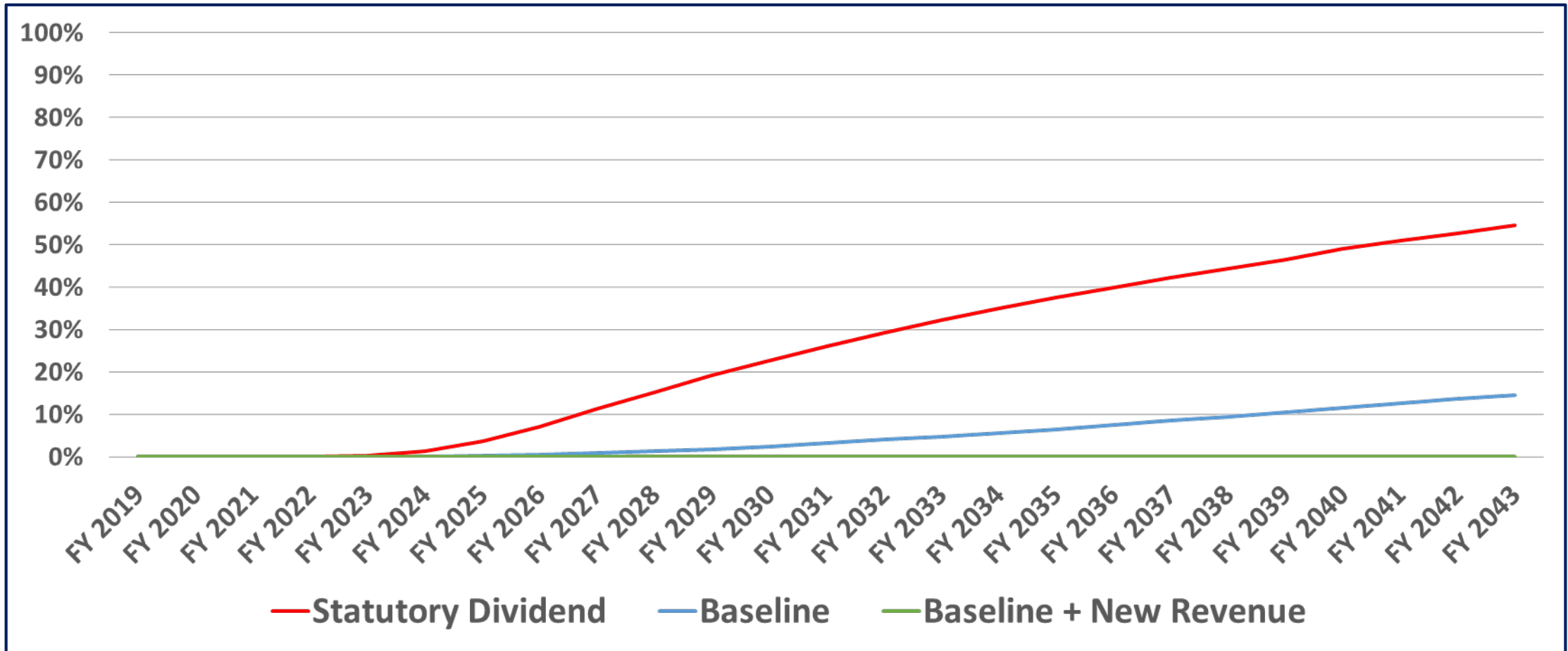
- Modified "Percent of Market Value" (POMV)
- Annual draw is 5.25% of the average fund balance over past five years (drops to 5% in 2021). FY2019 draw is \$2.7 billion
- SB26 does not address the GF vs. Dividend split, but the FY2019 budget included a \$1,600 dividend (\$1.0 billion) leaving \$1.7 billion for GF
- Historic compromise three years in the making
 - Many, including House leadership, viewed a fiscal plan that primarily relies on the fund, and reduced dividends, as a regressive tax disproportionately impacting children, the poor, and rural residents
 - Wanted to pass this with taxes that impact high earners and / or oil industry**
 - Many, including Senate leadership, were prepared to make more dramatic dividend cuts to balance most of budget, and rely on remaining CBRF savings while waiting to see if the fund grows sufficiently to balance future budgets
 - Wanted to pass it with more budget cuts and a spending cap**

Permanent Fund Restructuring

- The most important idea is: once a sustainable draw amount is agreed to, this is all that can be taken out each year for both dividends and government
- Regardless of the amount in the earnings reserve, draws in excess of the sustainable number could irrevocably damage the fund itself
- Three scenarios modeled with the same assumptions:
 - 1. “Full Fiscal Plan” (Baseline + New Revenue)**
 - After POMV payout, budget is balanced with additional new revenues if needed
 - 2: Baseline POMV**
 - After POMV payout, budget is balanced with savings draws if needed (CBRF until exhausted, Earnings Reserve thereafter)
 - 3: Statutory Dividend:**
 - After POMV payout, budget is balanced with savings draws
Full statutory dividend is paid with additional draws from the ERA

Failure rate is the chance that at least once in the next 25 years the ERA balance will drop to zero

Scenario Analysis – Cumulative ERA Failure Rate



What happens if oil prices drop again?

Theoretical Scenario for FY2020:

- Budget is cut \$200 million to \$4.5 billion (requires \$400 million in new cuts to offset the \$200 million in structural increases)
- POMV is \$2.9 billion. Consensus dividend is a 50/50 split
- Oil prices are only \$65 for the year

Regular GF Revenue: \$2.15 Billion

Permanent Fund Revenue \$1.45 Billion

Total Revenue \$3.60 Billion

Budget \$4.50 Billion

Deficit \$900 Million (CBRF gone in 3 years)

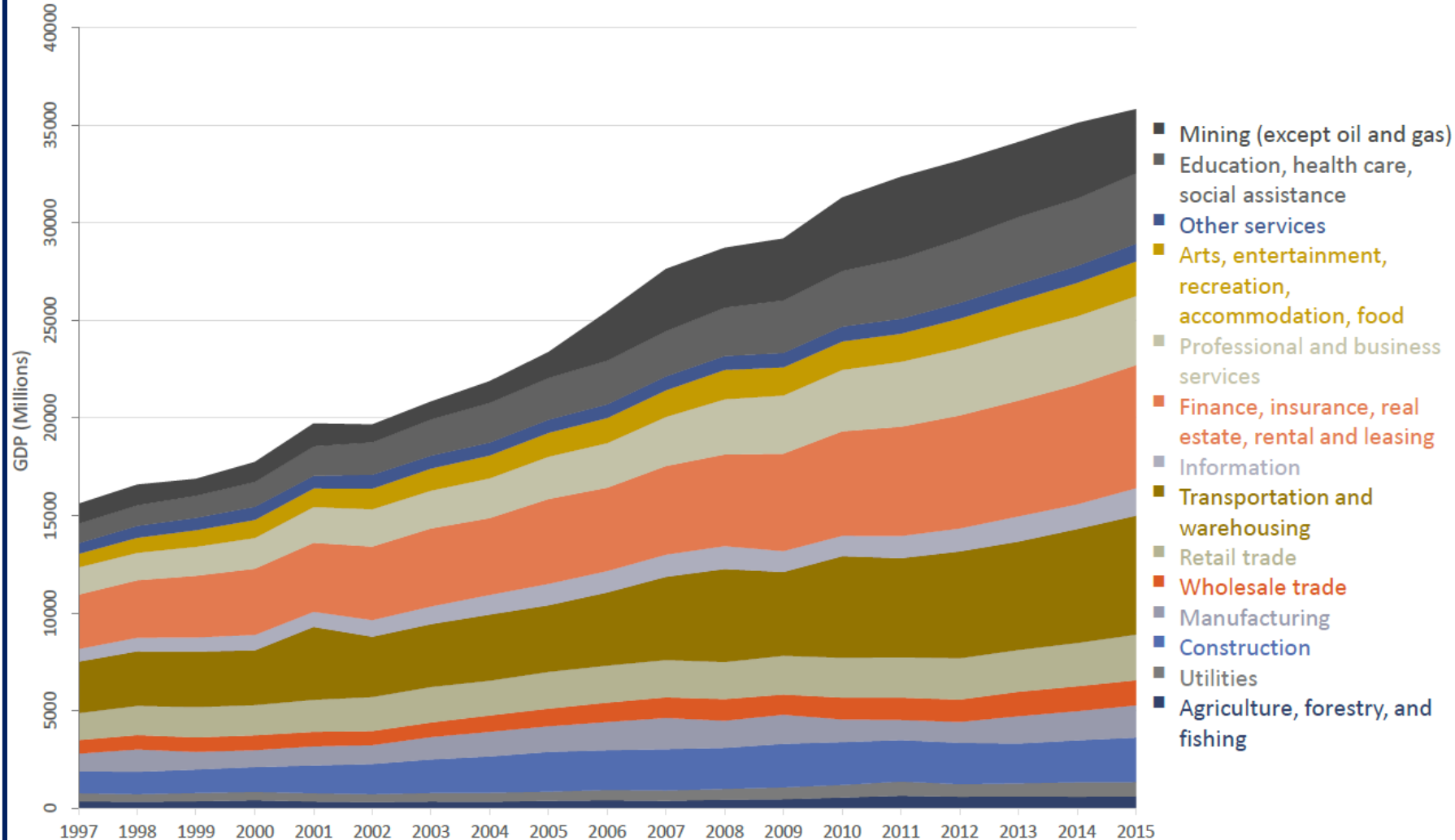
Continuing Issues: The Alaska Disconnect

Debate on a Major Statewide Tax may be deferred for a while

- The new Permanent Fund structure is a major adjustment for Alaskans
- Oil prices have been higher than forecasted in recent months, which makes the current budget situation less dire
 - **SB26 reduced the “break even” oil price from \$91 to \$72 for FY2019**
- Issues are still unresolved regarding continued budget cuts, deferred capital and maintenance spending, and industry taxation
- If resolving these issues results in continued deficits, the remaining non-permanent fund savings cannot cover the difference for many more years
- At that point, the conversation will revert to broad based taxes

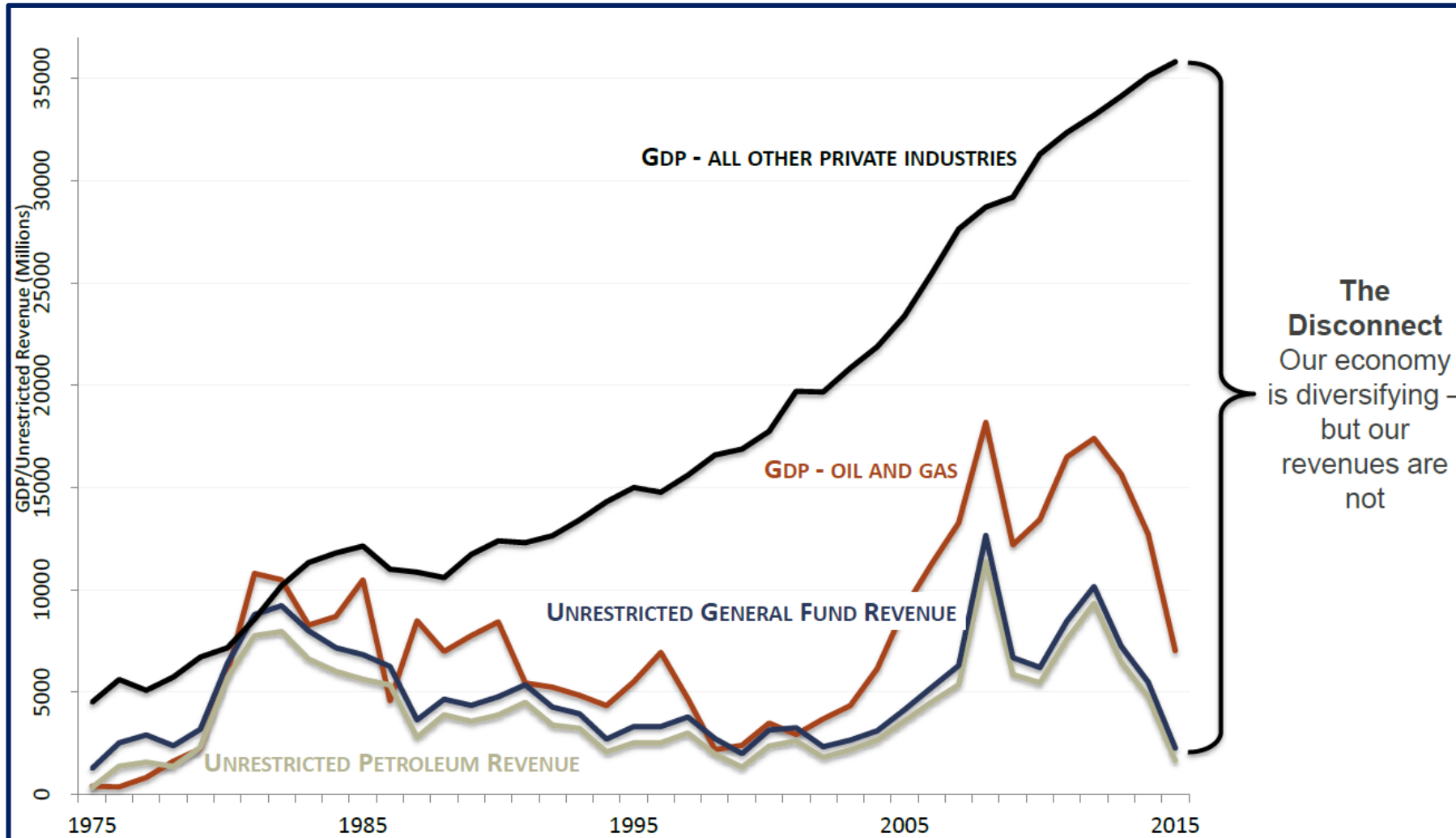
From Commissioner Navarre's 3/20 Presentation in House Finance

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



**The overall
Alaska economy
has grown
steadily...**

From Commissioner Navarre's 3/20 Presentation in House Finance



...while the state's revenue has tracked closely with just the oil and gas industry

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

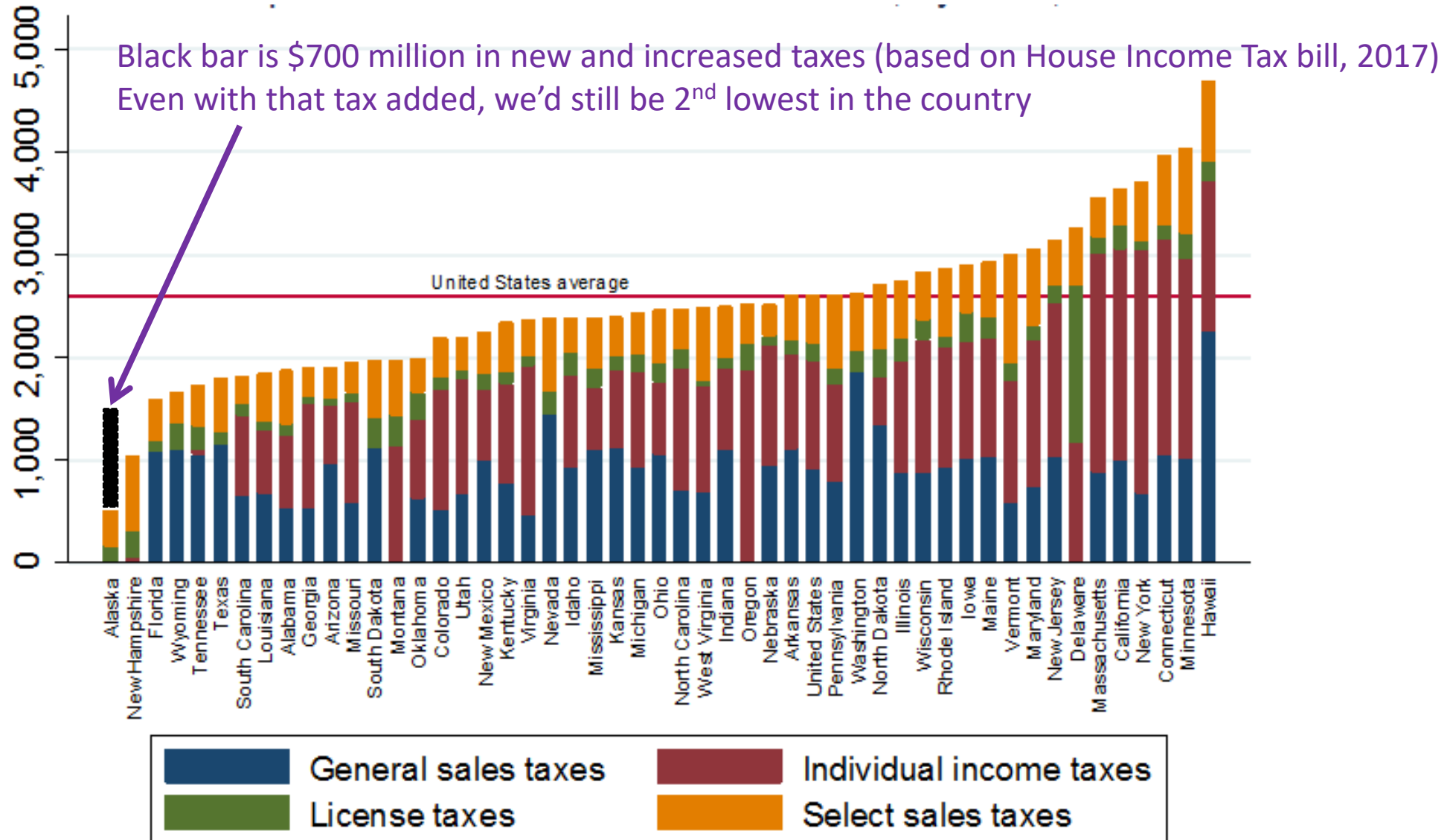
Major Statewide Tax: Income vs. Sales?

Several factors could make income tax preferable:

- 1) Many consider any dividend cap or reduction as a regressive tax that disproportionately impacts the poor, rural Alaskans, children, etc.
 - Income tax is inherently more progressive as high earners tend to put more money into activities exempt from a sales tax (savings, investment, travel)
- 2) Municipal concerns about sales tax impacts
 - Interface with about 105 different municipal taxes
 - Does the state take over statewide collection? Caps on local rates? Unified exemptions? Transaction cap?
- 3) Regional price disparities would hurt rural residents with a sales tax
- 4) Based on most recent (2002-04) history of sales tax legislation, we'd expect aggressive exemption-seeking by various interest groups

Governor's most recent revenue proposal was a modified, capped tax on wages and self-employment that would have raised about \$300 million

Impact of a Broad Based Tax



Source: Mouhcine Guettabi, ISER

Impact of Wayfair Decision

The Supreme Court has said states (and municipalities?) can compel online retailers to collect and remit sales taxes

If Alaska seeks to take advantage of this, most likely we will need a single point of contact / clearinghouse

- Set strong threshold for ease of implementation and undue burden
- Possible need to unify “tax base” (i.e. exemptions and caps)
- Tax thresholds (minimums), marketplace taxation (indirect vendors)
- How to fund administration of a central organization
- Independent agency or the state?
- Avoid slippery slope towards state administration and / or a state tax

THANK YOU

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