NAVIGATING ALASKA'S FISCAL CRISIS

BY JARED WALCZAK

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INTRODUCTION

Alaska has a history of blazing its own path. It forgoes both an income tax and a state sales tax, a distinction shared only with New Hampshire. Many sparsely populated jurisdictions forgo property taxes, and some jurisdictions—including large cities like Anchorage and Fairbanks—go without a local sales tax. Alaska is, therefore, the only state in which some residents lack exposure to any of the legs of the traditional three-legged stool of income, sales, and property taxes.

The state's constitution contains an entire article, with 18 sections, on natural resources, and provides for common ownership of mineral estate. During the oil boom years of the early 1980s, the state reversed course from imposing an individual income tax[1] to becoming the only state in the nation to write a check to each resident each year, the famous Permanent Fund Dividend.

The vast landscape and mineral wealth makes Alaska a state like no other; so, too, does its low population density. Take, for instance, the Bering Strait School District, which serves fewer than 2,000 students across 15 schools covering 77,000 square miles—roughly the size of Minnesota, which has 340 school districts. The district's smallest school educates a mere 16 students.[2]

For decades, Alaska paired high per capita expenditures—the product both of a vast, low-density state and little incentive to keep costs in check—with a seemingly inexhaustible revenue stream. Then, one day, that stream was interrupted.

At its most recent peak in 2012, oil and gas production taxes generated $6.15 billion; rents and royalties brought in another $2.04 billion; the petroleum property tax contributed another $111.2 million; and the petroleum corporate income taxes added $568.8 million—with oil and gas taxes yielding $8.86 billion of the state's $9.49 billion unrestricted general fund ($9.9 billion of $10.6 billion in current dollars), an astonishing 93 percent of the fund's revenues.[3] By 2019, non-petroleum revenue stood at $491.4 million—a 15 percent decline from 2012 in real terms—while petroleum revenues plummeted from an inflation-adjusted $9.9 billion to a mere $2.05 billion. And if anything, that represented a *recovery*, the first time such revenues exceeded $2 billion since 2014.

Oil revenues have plummeted before. They have, moreover, hovered around $2 billion a year for extended stretches, including much of the 1990s and the early 2000s. The boom of the late aughts, which saw petroleum-derived revenues soar to almost $12 billion in 2008 and remain above $5 billion a year until 2014, was never sustainable, and should have been regarded as an anomaly—a welcome one, to be sure, but not something on which to hang the state's budget.

The inevitable decline is always painful, but predictable budget fluctuations can be smoothed, given the political will to set aside surpluses in the good years. But what if this time is different? What if what Alaska has experienced in recent years is not the trough of an economic cycle but a new normal—or worse, a temporary reprieve in the ongoing secular decline in energy markets? How does a state that has relied primarily on oil and gas revenues adjust to a world where such revenues are considerably less robust?

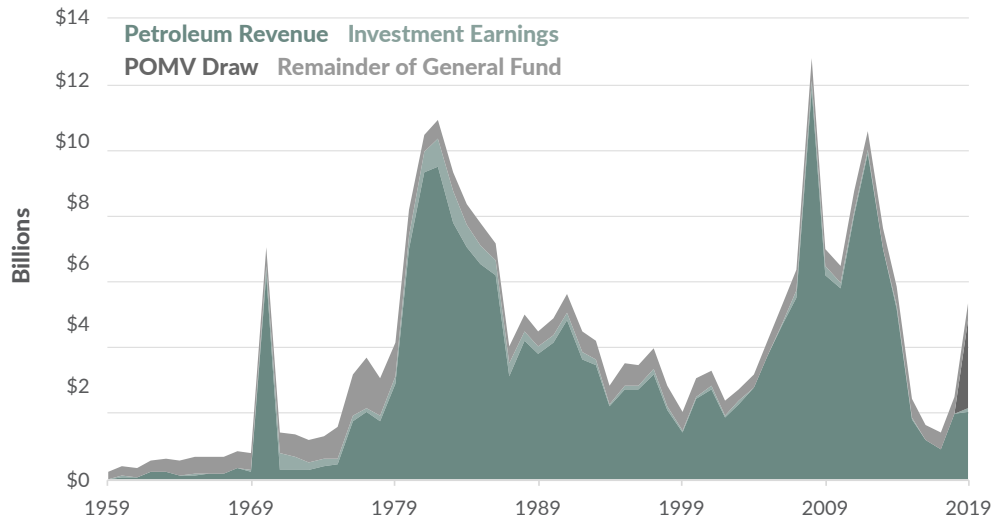
1 Alaska State Legislature, "History of Alaska Individual Income Tax," http://www.akleg.gov/basis/get_documents.asp?session=30&docid=17151.

2 Casey Leins, "Alaska's Rural Schools Struggle to Attract Teachers Despite High Salaries," *U.S. News & World Report*, Nov. 26, 2019, https://www.usnews.com/news/best-states/articles/2019-11-26/alaskas-rural-schools-struggle-to-attract-teachers-despite-offering-high-salaries.

3 Alaska Department of Revenue, "Revenue Sources Book, Fall 2018: 60 Years of Revenue, 1959 – 2018," Dec. 14, 2018, 31, http://tax.alaska.gov/programs/documentviewer/viewer.aspx?1491r.

FIGURE 1.

Unrestricted General Fund Revenue by Year and Source



Source: Alaska Department of Revenue, "Revenue Sources Book," multiple years.

How, moreover, does a state like *Alaska* make that transition? Because Alaska is not just any other state. It is the only state to repeal an income tax in the modern era. A state that takes pride in forgoing major taxes and keeping individual tax burdens low. A state with unique challenges and a cost of living that is not comparable with the states of the Lower 48. It is a difficult question, but with Alaska facing a $2.5 billion hole in the general fund budget, it is no longer an academic one.

The state's vast reserves have provided a valuable buffer but waiting until those funds are exhausted to make difficult choices is a dangerous game. In this publication, we review the state's revenue and weigh options for closing the budget gap with an eye toward Alaska's continued economic competitiveness. This will require a balanced approach, pairing new revenues with additional spending cuts and further reliance on the state's reserves. We review four revenue options—a sales tax, an income tax, a motor fuel tax increase, and modifications to the state's oil and gas taxes—weighing the pros and cons of each.

Our analysis suggests that, should additional revenues be necessary, a state sales tax is the most viable approach, perhaps paired with a motor fuel tax increase, and we provide recommendations on optimal tax structure along with preliminary revenue projections. The *status quo* is no longer an option, but as Alaska charts a new course, policymakers should not mimic the mistakes of other states, but instead follow its own compass, North to the Future.

ALASKA'S REVENUE CRISIS

Origins of the Crisis

Alaska's unrestricted general fund (UGF) revenue jumped in fiscal year (FY) 2019, doubling revenue for the previous year, but this was not the good news it might initially appear to be. Tax and fee revenues were relatively flat, at $2.63 billion compared to the prior year's $2.48 billion. The boost came in the form of a transfer from the Permanent Fund's Earnings Reserve Account (ERA) in the amount of $2.72 billion, more than all other general fund revenue combined. This was the first of the so-called POMV draws, under which a certain percentage of the market value (POMV) of the ERA is transferred to the general fund each year to help Alaska fund general government operations.

Petroleum revenues have outstripped all other components of the general fund every year since FY 1976, not counting the newly implemented POMV draws. The revenue has been an undeniable boon for Alaska, but the inherent volatility of the energy industry makes budgeting an enormous challenge.

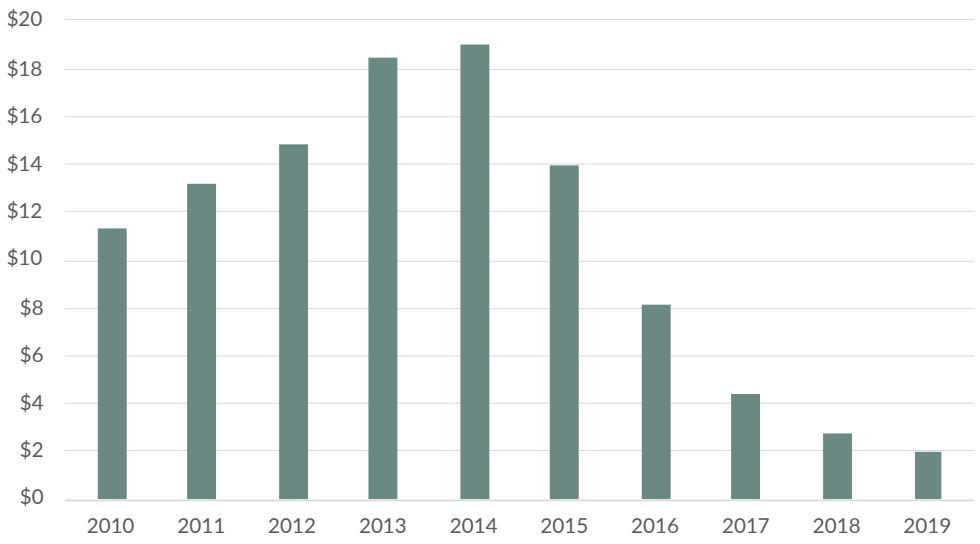
The state's response has been a prudent one. In 1990, voters approved the creation of a Constitutional Budget Reserve Fund into which revenues generated in settling disputes about oil, gas, and other mineral-related income would be deposited, as an early—and sizable—rainy day fund.[4] Lawmakers also set aside excess revenues in a statutory budget reserve, with both funds intended to help the state weather inevitable downturns, whether in energy markets or in the economy more broadly. At their peak in FY 2014, the two accounts had accrued nearly $19 billion (in present dollars) in reserves, more than adequate to see the state through the typical cycles of energy markets.[5]

Even this magnificent sum was not, however, adequate to the task ahead: seeing Alaska through a long, precipitous decline in energy markets. The national economy has experienced an extraordinarily long run of growth; the energy sector, by contrast, is effectively in recession and has been for some time. And no amount of reserves can turn around a long-term negative trend. Reserves are intended to smooth fluctuations, not replace collections that have little prospect of recovering in the foreseeable future.

In the five years following the close of FY 2014, the combined value of the Constitutional Budget Reserve and the Statutory Budget Reserve plummeted, in real terms, from $19 billion to $2 billion.[6] What once looked like an almost inexhaustible reserve is all but depleted, and this while the broader national economy is still growing. Coping with a broader recession would be almost unimaginable right now—but prudence dictates that policymakers prepare for just that eventuality.

FIGURE 2.

Combined Value of CBR and SBR by Year



Source: Alaska Department of Revenue, Treasury Division.

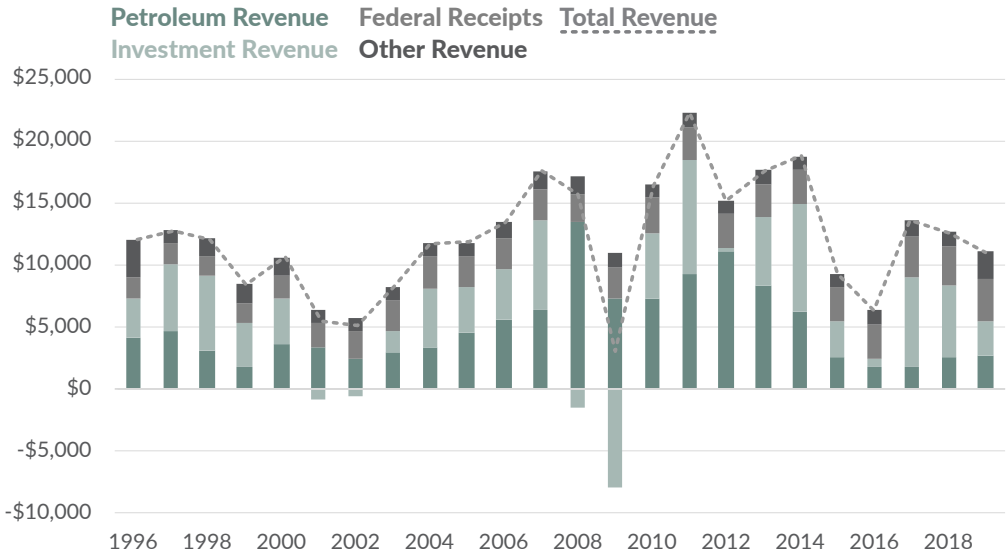
4 Alaska Const. art. IX, § 17.

5 Alaska Department of Revenue, Treasury Division, "Constitutional Budget Reserve," https://treasury.dor.alaska.gov/Investments/Constitutional-Budget-Reserve.aspx; Id., "Statutory Budget Reserve," provided to author.

6 Id.

FIGURE 3.

Total Alaska UGF and NGF Revenue by Source



Source: Alaska Department of Revenue, "Revenue Sources Book," multiple years.

These two reserves, along with the Permanent Fund's Earnings Reserve, comprise Alaska's "general use savings," moneys available for appropriation by the legislature. There are also designated savings for specific purposes, like the Public Education Fund, along with the fund that makes Alaska unique among states, the Permanent Fund itself, which cannot be used to fund government operations.[7]

The Permanent Fund, as every Alaskan knows, was established as a storehouse of the value of developing the state's nonrenewable resources and is funded by transfers of 25 percent of all oil and gas royalties and proceeds. This principal is beyond the reach of legislation, though interest that accrues is part of the separate Earnings Reserve, from which Permanent Fund Dividends (PFDs) are drawn, and which can be used for other purposes as well.

The Permanent Fund Dividend is an outgrowth of Alaska's distinctive approach to natural resources. A latecomer to statehood, Alaska received 103 million acres of land from the federal government as part of the Statehood Act, but with the condition that if the state transferred mineral rights, the land would revert to the federal government.[8] State law, therefore, reserves mineral rights to the state,[9] the common possession of all Alaskans. In the absence of private ownership of mineral estate, Alaskans receive what might be envisioned as uniform compensation in the form of annual dividends.

But the PFD fluctuates from year to year based on the health of the ERA, which is the funding source for dividends. In 2018, lawmakers exercised their authority over the disposition of the ERA, allowing annual appropriations from the account based on the average of its market value over the first five of the prior six fiscal years.[10] For fiscal years 2019 through 2021, this draw is in the

7 State of Alaska House Special Committee on Fiscal Policy, "Understanding Alaska's Savings," from Understanding Alaska's Budget, http://www.alaskabudget.com/savings/.

8 Charles Wohlforth, "Who Owns Alaska? Not You. Our Wealth Was Meant to Share," *Anchorage Daily News* (op-ed), Aug. 10, 2016, https://www.adn.com/opinions/2016/08/10/who-owns-alaska-not-you-our-wealth-was-meant-to-share/.

9 AS 38.05.125(a). See also Kyle W. Parker, "Reservation of Mineral Rights to Alaska," Attorney General Opinion 661-93-0641, May 6. 1993, http://www.law.state.ak.us/pdf/opinions/opinions_1993/93-019_661930641.pdf.

10 Alaska S.B. 26 (2018).

amount of 5.25 percent of the five-year market value, after which it declines to 5 percent, an amount intended to allow projected deposits and investment returns to exceed the amount of the annual draw,[11] though a recession could upend those expectations. The dividend is funded within this appropriation, and adjustments have been made to the amount of those payments to see the state through the downturn. Some have proposed a 50/50 draw, where half the appropriated amount is dedicated to paying out PFDs and the other half is available to supplement the state budget.[12]

When all of Alaska's revenue, both general and non-general fund, is taken into consideration, the result is far more chaotic than what one typically hopes to see in government revenue. In 2009, at the height of the Great Recession, Alaska's investment returns—typically such a substantial part of total revenues—were so sharply negative that they actually wiped out all gains from petroleum revenue.

The Permanent Fund and its Earnings Reserve are diversified, with nearly a quarter of holdings in bonds and cash,[13] but exposure to market fluctuations is significant given that the state relies so heavily on investment returns.

TABLE 1.

Permanent Fund and Earnings Reserve Investment Diversification

Portfolio Class	% of Fund
Stocks	39.3%
Bonds	22.3%
Real Estate	8.4%
Private Equity	13.5%
Hedge Funds	6.4%
Infrastructure and Real Assets	3.6%
Cash	1.6%
Other	5.0%

Source: Alaska Permanent Fund Corporation.

Budgeting for FY 2021 and Beyond

Alaska's proposed FY 2021 budget is $10.18 billion, of which $4.53 billion is appropriated from the unrestricted general fund (UGF), meaning that it is not derived from federal dollars or other designated funding sources. The state's projected UGF revenue for FY 2021 is a mere $1.97 billion, which comes up more than $2.5 billion short.[14]

In *David Copperfield*, the Charles Dickens novel, there is a character by the name of Wilkins Micawber—a man who always insisted, seemingly despite the odds, that "something will turn up." But Micawber, who saw his share of times when something did not, in fact, turn up, articulated what has come to be known as the Micawber Principle: "Annual income twenty pounds, annual expenditure nineteen pounds nineteen and six, result happiness. Annual income twenty pounds, annual expenditure twenty pounds ought and six, result misery."[15]

11 Alaska Department of Revenue, "Revenue Sources Book, Fall 2019," Dec. 6, 2019 (last updated Jan. 21, 2020), http://tax.alaska.gov/programs/documentviewer/viewer.aspx?1573r.

12 Alaska State Legislature, "Financials for 50/50 POMV PFD Based on Right-Sized Budget," http://www.akleg.gov/basis/get_documents.asp?session=31&docid=47388.

13 Alaska Permanent Fund Corporation, "Our Performance," https://apfc.org/our-performance/.

14 Alaska Office of Management and Budget, "Fiscal Year 2021 Fiscal Summary," Dec. 11, 2019, https://omb.alaska.gov/ombfiles/21_budget/PDFs/FY2021_Governor_Fiscal_Summary_12.11.19.pdf.

15 Charles Dickens, *David Copperfield* (New York, New York: Penguin Books, 2004), Penguin Classics edition, 186.

For Alaska, it is annual income $1.97 billion, annual expenditure $4.53 billion. It is not pleasant to speculate with Micawber about the result of this problem, elementary in mathematics but extraordinarily complex as a budgetary question. For several years now, the solution has been to postpone, waiting for something to turn up—but time is running out on that strategy of inertia.

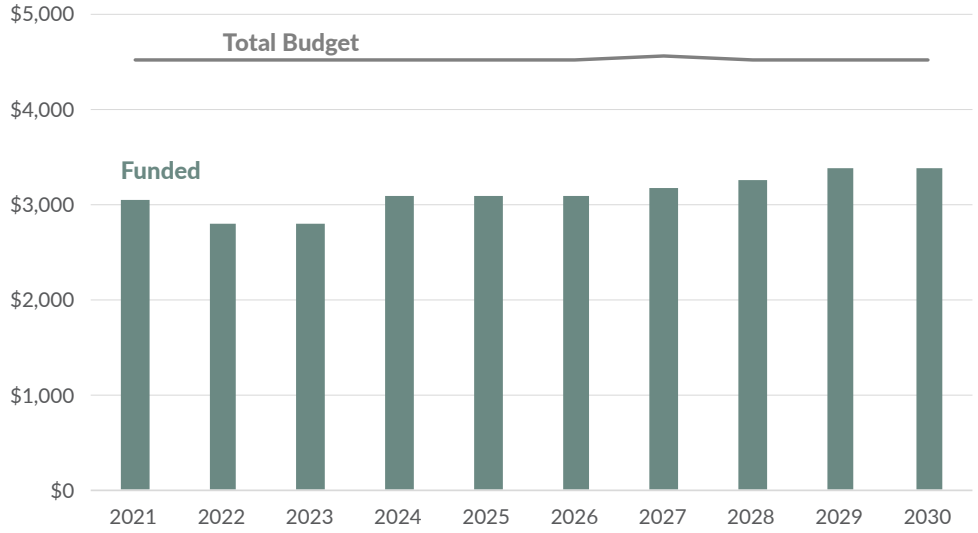
A POMV draw will help close the gap, contributing an estimated $1.09 billion to the general fund in FY 2021 after just over $2 billion is applied to the payout of statutory Permanent Fund Dividends. Some modest revenue can be expected from royalties to the Permanent Fund in excess of the protected 25 percent. All told, the Alaska Office of Management and Budget (OMB) projects $3.12 billion in available UGF dollars, including the POMV draw, which still leaves a deficit of $1.55 billion after expenditures and an obligatory $137 million transfer to the Constitutional Budget Reserve Fund.[16]

Nor are conditions expected to improve. The OMB anticipates deficits of $1.12 billion to $1.73 billion each year through FY 2030, and this on the basis of the assumption that general fund expenditures remain essentially flat in nominal terms, and decline in real terms, over the decade.[17]

All these figures, moreover, include the net of the POMV draw after the payment of dividends, ranging from a low of $847 million in FY 2022 to a high of $1.14 billion in FY 2030. Projected deficits before transfers average $2.47 billion a year, in present dollars, over the next decade.[18] That, therefore, is Alaska's challenge: how do you plug a $2.5 billion budget gap (about $1.5 billion a year after accounting for the continuation of the new POMV draw), and not just once, but every year for the foreseeable future? There are no easy answers, and certainly no pleasant ones, but answers there must be. This publication is intended to help policymakers and other interested parties think through the difficult choices that lie ahead.

FIGURE 4.

UGF Revenue and Total Budget Projections, Fiscal Years 2021-2030



Source: Alaska Office of Management and Budget.

16 Alaska Office of Management and Budget, "Fiscal Year 2021 Fiscal Summary."

17 Id., "FY2021 Budget Overview and 10-Year Plan," Dec. 11, 2019, 5, https://omb.alaska.gov/ombfiles/21_budget/PDFs/FY2021_10_Year_Plan_12-11-19.pdf.

18 Id.

FINDING BALANCE

Alaska's budget crisis is sufficiently dire that no one solution will suffice. Focusing solely on a single expediency would yield untenably high taxes, unpalatably deep spending cuts, or unsustainably large transfers. Instead, Alaska must select from multiple options, a sort of new Three Rs: reallocations, reductions, and revenues.

Within these Three Rs, there are no painless choices. However, a balanced approach can help ease the transition to a more stable system of funding and executing the business of government.

The First R: Reallocations

The first R, reallocations, would involve a further rebalancing of the POMV draw. While imperfect, the POMV draw provides a much-needed infusion into the general fund and is reasonably sustainable. Although the draw interferes with the ability to inflation- and recession-proof the Permanent Fund, it is designed, under normal economic circumstances, to maintain the value of both the untouchable Permanent Fund and the Earnings Reserve from which the draw is made. Although the amount of the transfer will fluctuate somewhat, it is projected to increase UGF revenue by approximately $1 billion each year, closing the typical gap to $1.5 billion—still an extraordinary sum, representing about a third of the UGF budget and about 6 percent of statewide adjusted gross income (AGI).

A 50/50 POMV approach could, at least for the short term, provide additional revenue with which to balance the budget, though at the expense of permanent fund dividends. The appeal of this approach for taxpayers, in addition to reduced pressure to raise taxes or cut services, is that it operates more as a time shift than a PFD loss, as dedicating 50 percent of the POMV draw to dividend payments would, during an economic downturn, result in higher payouts than provided for by the current statutory formula, on the order of an additional $500 million a year. That is, however, also its source of budgetary risk: it helps shore up the state's finances so long as the broader global economy is performing well, but at the cost of reduced funding available to the state during any coming recession, when budgetary pressures could be strongest.

Adjusting the statutory formula to reduce the PFD is more difficult, since reduced dividends now would not be compensated for by higher ones later. It is, however, more consistent with the needs of Alaska government. A sudden spike in the PFD during a recession would create an even greater budget crisis, and PFD payments can recover in good times, while taxes, once imposed, are more difficult to change.

Importantly, were energy markets to mount an unexpected recovery, policymakers should regard this as excellent news, but not as a permanent solution. A responsible approach would involve prioritizing replenishment of depleted funds before reconsidering any policies adopted to reposition Alaska for the long term.

The Second R: Reductions

The second R, reductions, may be even more difficult. Alaska's budget is $14,475 per capita, over twice the national average, which suggests the possibility of reductions. However, as recent years' efforts have demonstrated, few cuts are painless, and Alaska has unique needs that renders a direct comparison with the per capita expenditures of other states somewhat inapt. Still, it is difficult to see a way forward without new spending constraints, given a budget in excess of 18 percent of state GDP, well above the national average of 10 percent.[19]

19 Alaska Office of Management and Budget; U.S. Bureau of Economic Analysis; U.S. Census Bureau; Tax Foundation calculations.

With the Constitutional Budget Reserve nearly exhausted, Alaska cannot balance budgets for the long term without controlling spending. This will require further spending reductions as well as a serious commitment to spending discipline, which might well be embodied in the adoption of a constitutional spending cap.

The majority of states impose tax or expenditure limits, though their stringency varies.[20] Alaska has a statutory appropriation limit, but at 5 percent expenditure growth plus the change in population and inflation,[21] it is too generous to be effective, and as a statutory constraint, it is easily waived. Particularly if Alaskans are asked to pay a new tax, they should have assurances that the state lives within its means. A constitutional cap with more stringent limitations would offer a basis on which to establish a balance among taxes, the Earnings Reserve, and spending restraint.

The Third R: Revenues

The third R, revenues, is understandably equally unpopular, but Alaska may soon reach a point where new revenue must be on the table. In considering revenue options, policymakers should prioritize all that the current revenue system lacks: a revenue source that is neutral, stable, predictable, and broad-based, and that has the least possible impact on economic growth or location or investment decisions. The bulk of this publication is dedicated to the exploration of these options.

Should a new tax prove necessary, a statewide sales tax is most consistent with these goals, offering the greatest revenue stability and the least economic dislocation among options capable of raising an adequate amount of revenue. The broader its base of personal consumption, the lower the resulting rate and the degree of economic inefficiency associated with the tax. Raising the state's low motor fuel tax rate could also be a source of revenue, though its contribution would be insufficient on its own. Bringing back an individual income tax or doubling down on oil and gas taxation would be more harmful economically, and, in the latter case, fails to diversify revenue streams to address the narrow focus that has contributed so greatly to Alaska's current crisis.

Bringing the Three Rs Together

The three Rs operate best in tandem. Balancing the entire budget on reduced expenditures while preserving core services would be difficult and painful; doing so entirely through new taxes would be economically harmful and, in the absence of spending constraint, potentially inadequate. Policymakers should not look to taxpayers for additional revenue without having a plan to spend that revenue responsibly, under a plan which meaningfully addresses projected deficits. With the state facing a $1.5 billion hole each year even after the existing POMV draw, a balanced approach, with $500 million each coming from reallocations, reductions, and revenues, is the most viable option.

With the proviso that any new tax will create economic drag, there are, nonetheless, better and worse ways to raise a dollar of revenue—or 500 million of them. The remainder of this publication evaluates those options.

20 Kim Rueben and Megan Randall, "Tax and Expenditure Limits: How States Restrict Revenues and Spending," Urban Institute, November 2017, https://www.urban.org/sites/default/files/publication/94926/tax-and-expenditure-limits_5.pdf.

21 AS 37.05.540.

REVENUE OPTION 1: IMPLEMENTING A STATE SALES TAX

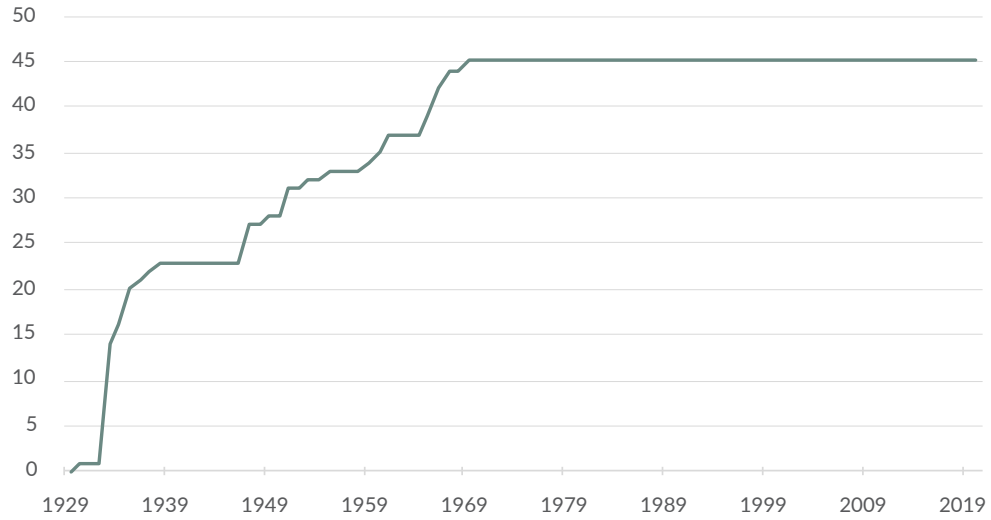
Alaska statehood came too late to catch the primary wave of sales tax adoption. The sales tax began as a revenue instrument of the Great Depression, with 23 states adopting a sales tax during the 1930s; upon Alaska's admission to the union in 1959, 33 states plus Hawaii—which adopted a sales tax in 1935, while still a territory—had a general sales tax on the books. Another 11 states adopted sales taxes in the 1960s, when Alaska's revenue needs were still quite modest, bringing the total to 45 states and the District of Columbia by 1969. And since then: nothing.[22]

Alaska and the four other states which forgo a sales tax—New Hampshire, Oregon, Montana, Alaska, and Delaware—have maintained their isolated position for over 50 years, five NOMAD states (a mnemonic device for the five) separated from the rest. But that resolution is beginning to weaken. In Alaska, certainly, there are rumblings of a sales tax as one way to address the state's revenue needs. In Montana, a sales tax is one option on the table as the state undertakes two parallel studies of its tax code. And in Oregon, some opponents of a new gross receipts tax would prefer to see a sales tax. Alaska differs from the other NOMAD states inasmuch as it does permit localities to impose their own sales taxes, which is not possible in the other four states without a state sales tax.

Should Alaska consider a major new tax, the sales tax has its attractions. Because the tax is largely collected by retailers, not individuals, tax administrators deal with far fewer payors—a genuine concern in a large, sparsely populated state where administration and enforcement can be costly. Because it is imposed on consumption rather than on labor (in contrast to an individual income tax), its economic impact is smaller and collections are less volatile than under an income tax. An above-average portion of the sales tax can be exported to nonresidents in a state like Alaska, which swells with both tourists and seasonal workers domiciled elsewhere. And, while it is equal parts challenge and opportunity, adopting a state sales tax would also provide a chance to unify the collection and administration

FIGURE 5.

States with a Sales Tax by Year



Source: Advisory Commission on Intergovernmental Relations, *Significant Features of Fiscal Federalism*, Vol. 1 (1995).

22 U.S. Advisory Commission on Intergovernmental Relations, *Significant Features of Fiscal Federalism*, Vol. 1, Budget Processes and Tax Systems, M-197 (September 1995).

of local sales taxes, easing burdens on sellers and facilitating online sales tax collections.

How Much Could a Sales Tax Raise?

With all taxes, collections are a function of both the rate of tax and the base on which that tax is imposed. As discussed later, sales tax bases in most states have been eroding for years as a share of personal consumption, the consequence of both (1) conscious policy choices to carve out select transactions and (2) changes in the economy, and particularly a greater consumption of services, which were far less significant as a percentage of personal consumption when most state sales taxes were designed.

In this publication, we argue that any sales tax should be imposed on a broad base, and that Alaska, in designing a sales tax, should avoid the carveouts and omissions that characterize sales taxes elsewhere. How much the state could generate with a sales tax depends considerably on sales tax breadth, since—particularly given existing local sales taxes—there are likely practical and political, and certainly economic, constraints on the rate.

There are two ways to think about how much Alaska could generate from a sales tax. One is to compare Alaska to other states which already impose a sales tax, and another is to calculate revenues directly from statistics about state personal consumption expenditures.

On average, states with a statewide general sales tax generate tax revenue worth 2.3 percent of personal consumption in the state (see Table 2). Were all personal consumption taxed, and nothing else, the resulting figure would be the average state sales tax rate, but (1) states exempt vast swaths of personal consumption, (2) states tax a significant percentage of intermediate transactions which do not constitute personal consumption, (3) a certain percentage of personal consumption as reported by federal sources is

TABLE 2.

State Sales Tax Collections as a Percentage of Personal Consumption Expenditures (PCE)

State	% of PCE
Alabama	1.7%
Alaska	n.a.
Arizona	3.0%
Arkansas	3.4%
California	1.9%
Colorado	1.3%
Connecticut	2.4%
Delaware	n.a.
District of Columbia	3.4%
Florida	3.4%
Georgia	1.5%
Hawaii	5.1%
Idaho	2.8%
Illinois	2.0%
Indiana	3.1%
Iowa	2.7%
Kansas	3.0%
Kentucky	2.3%
Louisiana	2.5%
Maine	2.5%
Maryland	1.7%
Massachusetts	1.7%
Michigan	2.4%
Minnesota	2.2%
Mississippi	3.8%
Missouri	1.5%
Montana	n.a.
Nebraska	2.4%
Nevada	4.1%
New Hampshire	n.a.
New Jersey	2.2%
New Mexico	2.7%
New York	1.4%
North Carolina	2.2%
North Dakota	2.5%
Ohio	2.5%
Oklahoma	2.0%
Oregon	n.a.
Pennsylvania	1.9%
Rhode Island	2.2%
South Carolina	1.9%
South Dakota	2.8%
Tennessee	3.0%
Texas	3.2%
Utah	1.9%
Vermont	1.3%
Virginia	1.1%
Washington	4.5%
West Virginia	2.0%
Wisconsin	2.2%
Wyoming	2.8%
All Sales Tax States	*2.3%*

n.a.: Not applicable.
Sources: U.S. Bureau of Economic Analysis; Tax Foundation calculations.

not associated with a transaction and thus not properly subject to a sales tax,[23] and (4) states never achieve full compliance.

It follows, then, that there are better and worse ways to collect taxes equal to 2.3 percent (or any other percent) of personal consumption, and that those with broader bases will achieve such collections with lower rates—and a more equitable, pro-growth system of taxation. If Alaska were, however, to match the national average, collecting state sales taxes equivalent to 2.3 percent of state personal consumption, it would raise about $852 million a year. Generating $500 million a year would require collections equal to 1.35 percent of personal consumption, and $1 billion a year would require 2.7 percent.

TABLE 3.

Projected Revenue by Sales Tax Collections as a Percentage of PCE*

% of PCE	Revenue
1.0%	$370.6 million
1.1%	$407.6 million
1.2%	$444.7 million
1.3%	$481.7 million
1.4%	$518.8 million
1.5%	$555.8 million
1.6%	$592.9 million
1.7%	$629.9 million
1.8%	$667.0 million
1.9%	$704.0 million
2.0%	$741.1 million
2.1%	$778.1 million
2.2%	$815.2 million
2.3%	$852.2 million
2.4%	$889.3 million
2.5%	$926.3 million
2.6%	$963.4 million
2.7%	$1.00 billion
2.8%	$1.03 billion
2.9%	$1.07 billion
3.0%	$1.11 billion

*—Personal Consumption Expenditures
Sources: U.S. Bureau of Economic Analysis; Tax Foundation calculations.

These calculations can provide a rough sense of what Alaska can expect based on the experience of other states. But Alaska need not be limited to the approaches reflected in sales taxes that are, at minimum, a half century old. It is more helpful, therefore, to build from the ground up, projecting revenues based on what Alaska might elect to tax.

The broadest possible well-structured sales tax base would include all final consumption except for housing, financial services furnished without payment, social services, religious activities, and legally or functionally untaxable purchases like internet access, postal services, and other purchases from government sellers, along with grocery purchases made with SNAP and WIC benefits. This base would include both goods and services when purchased for final consumption, rather than as intermediate products in the process of production. With this very broad sales tax base, Alaska could generate an estimated $1 billion with a state rate as low as 3.1 percent, or $500 million with a 1.6 percent rate.

In practice, Alaskans are likely to adopt certain exemptions for policy purposes, for instance for medical services, or insurance premiums, or pharmaceutical drugs. Many such exemptions are popular. With each additional carveout, however, the resulting rate on taxed transactions must be higher. Table 3 provides a rough estimate of how high a state sales tax rate would have to be to generate $1 billion, $750 million, and $500 million under a variety of base assumptions. It is, of course, entirely possible to structure these exemptions in a different order, but Table 4 (see next page) offers a general sense of the revenue forgone with each decision.

23 Most notably, federal definitions of personal consumption expenditures include implicit rents on housing, meaning that the use value of a person's home is considered consumption. No sales tax applies to the value of a person's home, nor are there any serious proposals to do so.

TABLE 4

Revenue Implications of Sales Tax Rate and Base Options

	Rate to Generate...		
Sales Tax Base	**$1 billion**	**$750 million**	**$500 million**
Broadest possible base*	3.1%	2.3%	1.6%
Except hospital services	3.6%	2.7%	1.8%
... *and* physician services	4.0%	3.0%	2.0%
... *and* all other medical services	4.5%	3.4%	2.2%
... *and* insurance premiums/fees	4.7%	3.5%	2.3%
... *and* private education	4.9%	3.6%	2.4%
... *and* pharmaceuticals	5.1%	3.8%	2.6%
... *and* financial services fees	5.3%	4.0%	2.7%
... *and* unprepared foods	6.2%	4.7%	3.1%
... *and* household utilities	6.7%	5.0%	3.3%
... *and* professional services	6.9%	5.2%	3.5%
... *and* motor fuel and fuel oil	7.4%	5.6%	3.7%
... *and* clothing	7.8%	5.8%	3.9%

* All final consumption except housing, financial services furnished without payment, social services, religious activities, and untaxable purchases like internet access, postal services and other purchases from government, and grocery purchases made with SNAP and WIC benefits.
Note: Assumes 85 percent collections rate.
Sources: U.S. Bureau of Economic Analysis; Tax Foundation calculations.

The Sales Tax Consensus

There is, for every tax, a textbook version—pure, straightforward, and exactly as economists would design it—and then, in contrast, the forms that tax takes in the real world. Although economists and public finance scholars differ on many points, the divergences in their ideal designs generally pale in comparison to the wide gulf between an "ideal" tax and what that tax looks like when filtered through decades of political wrangling.

Alaskans should be under no illusions about the prospects of adopting an "ideal" tax, but by entering the game late, Alaska policymakers do have a unique opportunity to learn from other states, avoiding the pitfalls they have encountered and bypassing the accretion of special interest exemptions that have filled most states' tax codes over the decades. It is often said of the sales tax, in particular, that no one would select the current prevailing sales tax bases if the tax were designed today. Alaska has an opportunity to demonstrate what exactly such a tax *would* look like if designed with the modern economy in mind.

The sales tax, more than most subjects in taxation, is an area of broad consensus among public finance scholars. Decades ago, tax scholar John Due wrote that "sales tax structure should produce a uniform distribution in consumption, should be neutral regarding methods of production and distribution, and should be collected at a reasonable cost."[24] Another leading tax scholar, Charles McLure, identifies the ideal sales tax as a destination-based tax on all final consumption (but only final consumption).[25] These standards are broadly accepted, as are several related precepts and observations:

24 Quoted in John Mikesell, "A Quality Index for State Sales Tax Structure – Measuring the States Against an Ideal Standard," *Tax Notes*, Jan. 26, 2005, https://www.taxnotes.com/state-tax-today/sales-and-use-taxation/corrected-full-text-states-mind-quality-index-state-sales-tax-structure-measuring-states-against/2005/01/26/4c5r?highlight=Mikesell%20%22Quality%20Index%22.

25 Charles E. McLure Jr., "Rethinking State and Local Reliance on the Retail Sales Tax: Should We Fix the Sales Tax or Discard It?" *BYU Law Review* 2000:1 (March 1, 2000), 77, https://digitalcommons.law.byu.edu/cgi/viewcontent.cgi?article=2052&context=lawreview.

1. An ideal sales tax is imposed on all final consumption, both goods and services;

2. An ideal sales tax exempts all intermediate transactions (business inputs) to avoid tax pyramiding;

3. Sales taxes should be destination-based, meaning that tax is owed in the state and jurisdiction where the good or service is consumed;

4. The sales tax is more economically efficient than many competing forms of taxation, including the income tax, because it only falls on present consumption, not saving or investment;

5. Because lower-income individuals have lower savings rates and consume a greater share of their income, the sales tax can be regressive, though broader bases that include consumer services (much more heavily consumed by higher-income individuals) push in a progressive direction;

6. The sales tax scales well with ability to pay, because it grows with consumption and is therefore more discretionary than many other forms of taxation; and

7. Consumption is a more stable tax base than income, though the failure to tax most consumer services in many states is leading to a gradual erosion of sales tax revenues as services become an ever-larger share of consumption.

Most states impose their sales taxes on bases that consist of most goods—with economically significant policy carveouts—and relatively few services. With limited exceptions, most state sales taxes are imposed on transactions involving tangible property: appliances but not apps, light fixtures but not landscaping. This was less a conscious choice than an accident of history, a relic of the fact that so many sales taxes were imposed during the Great Depression, when services comprised a far smaller share of the economy. It was administratively simpler in that earlier era to focus almost exclusively on retail sales, and even the later ones tended to follow their lead.

Fortunately for the nation's economy but unfortunately for the reliability of most states' sales taxes, today's economy has little in common with that of the 1930s or even the 1990s. Higher incomes and changing consumer tastes have shifted a greater share of consumption to services, while a digital economy is upending traditional categories.

We subscribe to streaming services rather than buying DVDs, VHS tapes, CDs, or records (all of which were taxable in most states); we purchase e-books (often untaxed) rather than paperbacks (taxable); we obtain programs and games through digital downloads rather than physical media (disks or cartridges). Increasingly, younger generations purchase "experiences" more than tangible goods—and most of those experiences involve services, whether it's fitness classes or cooking lessons or excursions.

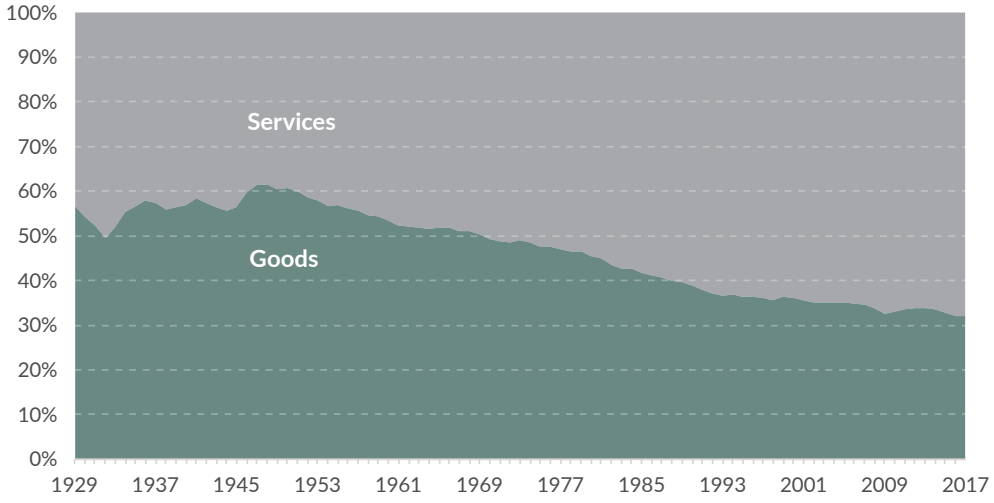
But it's not just new services; it's also a matter of older services taking on greater importance in the modern economy. Domestic help has all but vanished, but increasingly, there's an app for that, or at least a number to call: house cleaning services, dog walking and pet-sitting, ridesharing as an alternative to car ownership, or landscaping services in lieu of buying a lawn mower, to name just a few. The mower was taxed; its replacement (the lawn care service) is not. It is a story that can be told many times over. It is the story of state sales tax codes built around an economy that no longer exists.

Alaska need not make that mistake.

FIGURE 6.

Percentage of Total Personal Consumption Expenditures

Goods vs. Services, U.S., 1929-2017



Source: Bureau of Economic Analysis, "Regional Economic Accounts."

Taxes should apply to all final consumption in service of economic neutrality, the idea that taxes should not interfere with economic decision-making any more than is strictly necessary, nor should they pick winners and losers. It is not the role of the tax code to favor piano lessons over baseball bats or e-books over hardcovers. It makes little sense to tax the purchase of a lawn mower but not tax the purchase of lawn care services that obviate the need to own a mower. Yet, in many states, these distinctions still govern, relics of a goods-dominant economy that no longer exists.

The sales tax should also be broad-based in service of tax equity.[26] Sales taxes have two potential sources of regressivity: one, the propensity of lower-income individuals to consume a greater share of their income, and two, a scope of taxable consumption that is more likely to fall on the sorts of transactions which dominate the consumption of lower- and middle-income individuals.

Policymakers often exempt or lower rates on certain classes of consumption as a progressive reform. The exemptions many states provide for groceries are one such example—though there is reason to believe it may not be terribly effective. Prepared foods are taxed at the standard rate and most of the regressivity of taxing unprepared foods is addressed by the exemption for SNAP (food stamps) and WIC purchases, while the exemption is enjoyed by high-income earners as well—who often spend considerably more on groceries.

In fact, while not enough work has been undertaken to establish a consensus, there is research finding that lower-income taxpayers would actually be better off if groceries were fully included in sales tax bases (while retaining the federally-indicated exemption of SNAP and WIC purchases), allowing for a lower overall sales tax rate.[27] The lower grocery rate is designed to create progressivity but largely fails to do so. Yet, at the same time, policymakers in most states have largely neglected a much more straightforward way to promote equity within the sales tax.

26 See generally, Nicole Kaeding, "Sales Tax Base Broadening: Right-Sizing a State Sales Tax," Tax Foundation, Oct. 24, 2017, https://taxfoundation.org/sales-tax-base-broadening/.

27 Anna L. Johnson and Steven M. Sheffrin, "Rethinking the Sales Tax Food Exclusion with SNAP Benefits," *State Tax Notes*, Jan. 11, 2016, 157, https://pdfs.semanticscholar.org/6f18/cca38dfaa9591be264e4bff539573dae6d7c.pdf.

Consumption of personal services tends to be more discretionary than consumption of goods. Consequently, higher-income individuals spend a greater share of income on services, which are frequently untaxed. Unfortunately, most existing state sales taxes are levied on all tangible property (goods) unless expressly exempted, but only apply to services if expressly enumerated in statute.

States have been gradually expanding their sales tax bases, but tax policies are frequently path dependent. Expanding the sales tax base to new transactions can be nearly as difficult as creating the tax in the first place. Should Alaska opt to impose a sales tax, therefore, the state should begin with as broad a base of personal consumption as possible, avoiding politically challenging battles down the road. In so doing, policymakers would adopt a more stable sales tax than that which exists in most other states, but more than that, one that does not commit the accidental wrongs that favor some transactions over others and tend to favor the wealthiest consumers.

With a very broad base, the sales tax could generate $1 billion on a rate as low as 3.1 percent, or $500 million at 1.6 percent; but even with certain exclusions, Alaskans could prioritize a broad sales tax base and a relatively low rate to generate substantial revenue. A broader-than-average base could yield $500 million at a state rate of less than 3 percent.

Consolidating Local Sales Tax Administration

Alaska is unique among states in authorizing local, but not state, sales taxes. Municipalities enjoy broad authority to define their own sales tax bases and set their own rates, and even to bifurcate them, with five local governments adopting seasonal rates, where the rate is higher during the peak tourist season and lower when most consumption is by residents.

Currently, 107 municipalities levy a local sales tax,[28] at rates ranging from 1 percent in White Mountain to 7 percent in Kodiak and Wrangell, or 7.5 percent in the case of the top seasonal rate, levied in Seldovia, a very small city in the Kenai Peninsula accessible only by plane or boat. Neither Anchorage nor Fairbanks levies a sales tax, though Juneau, Ketchikan, and Wasilla do. Local sales taxes generated about $245 million in 2018 despite their omission in the state's two largest cities, among other jurisdictions.[29] (See Table 5 on the following page).

In the absence of a state sales tax, municipal governments have been obligated to establish their own sales tax administration and to define their own sales tax bases, meaning that what is taxable in one jurisdiction may not be taxable in another. This lack of unitary administration or a unified base is an impediment to Alaska local governments requiring remote sellers to collect and remit sales tax in the wake of the U.S. Supreme Court's 2018 decision in *South Dakota v. Wayfair*, though at least one jurisdiction (Nome) is attempting to move forward on its own, in an ordinance that raises serious federal constitutional concerns.[30]

28 Alaska Department of Commerce, Community, and Development, Office of the State Assessor, "Alaska Tax Facts," https://www.commerce.alaska.gov/web/dcra/OfficeoftheStateAssessor/AlaskaTaxFacts.aspx.

29 Alaska Department of Commerce, Community, and Development, "Alaska Taxable 2018," Vol. LVIII, January 2019, https://www.commerce.alaska.gov/web/Portals/4/pub/OSA/Alaska%20Taxable%202018_ReducedSize.pdf.

30 Nome City Council, "An Ordinance Amending Nome Code of Ordinances Chapter 17.10 to Clarify Remote Sellers' and Marketplace Facilitators' Obligation to Collect and Remit Sales Tax," O-19-08-01, Aug. 26, 2019, https://www.nomealaska.org/egov/documents/1566607495_82874.pdf.

TABLE 5.

Municipal Sales Tax Rates and Collections, 2018

Municipality	Sales Tax Rate	Sales Tax Collections
Adak	4%	$522,804
Akutan	1.5% (a)	$3,337,019
Alakanuk	4% (a)	$146,535
Aleknagik	5% (a)	$105,931
Ambler	3% (a)	$30,887
Angoon	3% (a)	$54,036
Aniak	2%	$50,978
Bethel	6%	$6,275,835
Brevig Mission	3% (b)	$48,201
Buckland	6% (a)	$99,802
Chefornak	2% (a)	$44,588
Chevak	3% (c)	$113,669
Cordova	6%	$3,118,848
Craig	5%	$1,548,306
Deering	3% (b)	$29,344
Dillingham	6%	$2,273,753
Diomede	4% (b)	$13,047
Eek	2%	$36,000
Elim	3%	$75,799
Emmonak	4% (a)	$257,655
False Pass	3% (a)	$30,077
Fort Yukon	3%	$145,557
Galena	3%/6% (d)	$240,000
Gambell	3% (a)	$100,316
Gustavus	3%	$361,827
Haines Borough	5.5%	$3,134,948
Homer	4.5%	$7,848,136
Hoonah	6.5%	$1,526,515
Hooper Bay	4% (a)	$310,899
Houston	2%	$341,254
Hydaburg	6%	$464,682
Juneau	5%	$48,145,921
Kake	5% (a)	$166,234
Kenai	3%	$6,873,397
Kenai Peninsula Borough	3%	$31,508,914
Ketchikan	4%	$11,950,853
Ketchikan Gateway Borough	2.5%	$8,665,718
Kiana	3% (a)	$25,058
King Cove	6% (a)	$758,638
Kivalina	2%	$38,174
Klawock	5.5% (a)	$661,952
Kobuk	3%	$10,740
Kodiak	7%	$11,886,157
Kotlik	3%	$112,486
Kotzebue	6%	$3,886,457
Koyuk	2% (c)	$44,847
Kwethluk	5% (b)	$17,270
Larsen Bay	3%	$45,725
Manokotak	2% (a)	$137,647
Marshall	4% (a)	$95,513
Mekoryuk	4% (a)	$16,483
Mountain Village	3%	$141,307
Napakiak	5%	$75,142
Napaskiak	3% (a)	$19,280
Nenana	4% (a)	$179,368
Nightmute	2% (a)	$769
Nome	5%/7% (d)	$5,449,449
Nondalton	3% (a)	$272
Noorvik	4% (c)	$116,042
North Pole	3%	$3,626,352
Nunam Iqua	4%	$48,060
Nunapitchuk	4%	$55,955
Old Harbor	3%	$23,417
Ouzinkie	3%	$6,832
Palmer	3%	$6,999,693
Pelican	4%	$39,814
Petersburg Borough	6%	$2,958,686
Pilot Station	4%	$110,221
Point Hope	3% (b)	$188,126
Port Alexander	4%	$18,953
Quinhagak	3%	$148,539
Russian Mission	4% (a)	$72,496
Saint Mary's	3%	$149,500
Saint Michael	4% (b)	$127,429
Saint Paul	3.5%	$344,276
Sand Point	4%	$683,075
Savoonga	3% (b)	$90,000
Saxman	4% (b)	$107,556
Scammon Bay	6% (a)	$132,868
Selawik	6.5% (a)	$153,934
Seldovia	5%/7.5% (d)	$134,881
Seward	4%	$5,160,344
Shaktoolik	4%	$59,256
Shishmaref	3% (a)	$74,744
Shungnak	2% (b)	$25,496
Sitka	5%/6% (d)	$11,592,306
Skagway	3%/5% (d)	$8,109,415
Soldotna	3%	$7,730,181
Stebbins	3% (a)	$68,492
Tanana	2% (a)	$21,497
Teller	3% (b)	$26,267
Tenakee Springs	2%	$14,442
Thorne Bay	6%	$430,416
Togiak	2% (b)	$121,579
Toksook Bay	2%	$22,265
Unalakleet	5%	$396,943
Unalaska	3%	$10,754,944
Wales	3% (a)	$33,176
Wasilla	3%	$16,013,165
White Mountain	1%	$11,925
Whittier	5%	$591,887
Wrangell	7%	$3,111,485
Yakutat	5%	$1,029,421

(a) Rate as of 2017 (most recently reported rate).
(b) Rate as of 2016 (most recently reported rate).
(c) Rate as of 2015 (most recently reported rate).
(d) Seasonal rate structure, with higher rate during peak season.
Note: Dataset only includes 103 of a reported 107 municipalities with local sales taxes.
Source: Alaska Department of Revenue, "Alaska Taxable."

Separately, the Alaska Municipal League is working with local governments to promulgate a uniform Remote Sellers Sales Tax Code and related intergovernmental agreements to establish a single point of administration and uniform statewide thresholds,[31] though localities would continue to be free to use their own discrete sales tax bases, with exemptions that differ from those of their neighbors.[32] Were the state to adopt its own sales tax, it would

31 Alaska Municipal League, "Online Sales Tax," https://www.akml.org/member-services/online-sales-tax/.

32 Id., "Remote Sales Tax Code – Final Draft," https://www.dropbox.com/s/wbc9y4s5a60hrip/Remote%20Sales%20Tax%20Code%20-%20Final%20Draft.docx?dl=0.

immediately solve the administration problem the Alaska Municipal League seeks to address, but the state should go a step further, following in the footsteps of nearly every state with a sales tax by establishing a uniform base that is used by the state as well as local governments.[33]

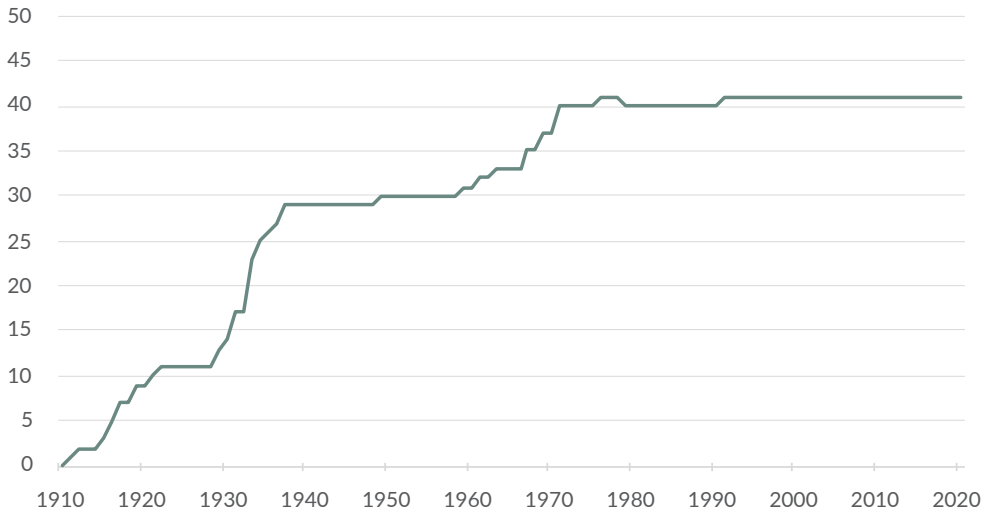
REVENUE OPTION 2: REESTABLISHING AN INDIVIDUAL INCOME TAX

Forty-two states and the District of Columbia adopted broad-based individual income taxes that apply to wage income,[34] but Alaska is alone in having repealed an income tax once adopted. Whereas sales taxes began as a Depression-era measure to stabilize tax collections as the value of property plummeted (at the time, property taxes were the primary source of state tax revenue), state income taxes were an outgrowth of the progressive era. The first state income taxes preceded the ratification of the Sixteenth Amendment to the U.S. Constitution in 1913, and their initial spread came fast on the heels of the new federal income tax, though the Great Depression did spur on their adoption in many additional states.[35]

Alaska itself adopted an income tax pre-statehood in 1949, originally set at 10 percent of federal income tax liability, rising to 16 percent by 1961. Following the enactment of the federal Tax Reduction Act of 1964, commonly known as the Kennedy tax cut,[36] an adjustment was made to keep Alaska's rates tied to the old, higher federal rates. This convoluted approach gave way to an independent graduated rate tax in 1975, with an astonishingly high top marginal rate of 14.5 percent, but the tax was repealed outright in 1980 as oil revenues poured in.[37] Over the subsequent four decades, only one additional state (Connecticut) has implemented an income tax, while Alaskans have remained resolute against one—until recently.

FIGURE 7.

States with a Wage Income Tax by Year



Source: Advisory Commission on Intergovernmental Relations, *Significant Features of Fiscal Federalism*, Vol. 1 (1995).

33 The exceptions are Alabama, Colorado, and Louisiana, all of which are struggling with online sales tax regimes. See Jared Walczak and Janelle Cammenga, "State Sales Taxes in the Post-Wayfair Era," Tax Foundation, Dec. 12, 2019, https://taxfoundation.org/state-remote-sales-tax-collection-wayfair/.

34 New Hampshire and Tennessee both tax interest and dividend income, but not wage or other forms of income, and Tennessee is in the process of phasing out its tax.

35 Kossuth Kent Kennan, "The Wisconsin Income Tax," *The Quarterly Journal of Economics* 26:1 (November 1911), 170; and Jared Walczak, "Local Income Taxes in 2019," Tax Foundation, July 30, 2019, https://taxfoundation.org/local-income-taxes-2019/.

36 President John F. Kennedy proposed the rate reductions in 1963, though the final bill was signed by his successor, Lyndon B. Johnson, in 1964.

37 Alaska State Legislature, "History of Alaska Individual Income Tax."

There is a certain incongruity in the very idea of an income tax paired with the Permanent Fund Dividend, because the dividend operates as a sort of "negative income tax." Were Alaska to ever impose an income tax, this large cash transfer to taxpayers might eliminate the need for provisions common to income taxes elsewhere, like standard deductions, personal exemptions, and the earned income tax credit, since all these provisions from other states—designed to limit liability for low-income earners—pale in comparison to the transfer taxpayers receive from the Permanent Fund.

Compared to a well-structured sales tax, an income tax is more volatile and less economically efficient. Like the sales tax, some of an Alaska income tax could be exported to nonresidents, chiefly seasonal workers (who would also incur sales tax liability, were the tax to be adopted). Unlike the sales tax, the income tax would not export taxes to tourists. In 2016, the Institute of Social and Economic Research at the University of Alaska Anchorage estimated that nonresidents would pay 9.6 to 10.5 percent of a state sales tax, depending on how many exemptions it contained, and 6.7 percent of a single-rate income tax.[38]

How Much Could an Income Tax Raise?

Most states use federal adjusted gross income (AGI) as the starting point for levying an individual income tax, though they typically further reduce the taxable base by additional deductions and exemptions. Progressive rate structures also serve to reduce liability in many states. Accordingly, although top marginal rates are most frequently between 5 and 7 percent, income tax collections as a percentage of AGI average 4.4 percent in the 41 states that impose a wage income tax. Were Alaska to generate tax revenue consistent with the average national percentage of AGI, the state could raise about $925 million a year, and 4.7 percent of AGI would represent $1 billion in tax revenue. (See Table 6).

What a tax worth 4.7 percent of AGI looks like can vary widely. That would put Alaska in the same range as Hawaii, with a top marginal rate of 11 percent; Massachusetts, which now has a 5.0 percent flat tax; North Carolina, with a current flat rate of 5.25 percent;[39] and West Virginia, with a top rate of 6.5 percent. In other words, single-rate taxes and broader income tax bases keep rates in check, whereas narrower bases and highly progressive structures require much higher top rates to achieve similar revenue as a percentage of income.[40]

Given modest exemptions, it might therefore be possible to raise $1 billion with a rate below 5 percent. A rate of just under 3.7 percent would likely be sufficient to generate $750 million, and a 2.4 percent rate could bring in around $500 million. Adopting deductions, exemptions, credits, or a progressive rate structure would all increase the tax rate necessary to generate that revenue. Pennsylvania serves as a good model; although the state excludes retirement income, it taxes almost all other income without deduction or exemption, raising significant revenue (3.0 percent of AGI) on a 3.07 percent flat tax.

38 Gunnar Knapp, Matthew Berman, and Mouhcine Guettabi, "Short-Run Economic Impacts of Alaska Fiscal Options," Institute of Social and Economic Research, University of Alaska Anchorage, Mar. 30, 2016, II-6, https://iseralaska.org/static/legacy_publication_links/2016_03_30-ShortrunEconomicImpactsOfAlaskaFiscalOptions.pdf.

39 Although revenue data are adjusted for inflation, source data are from a year in which Massachusetts' income tax rate was 5.15 percent, and when North Carolina's income tax rate was 5.499 percent.

40 Some have suggested the possibility of raising $1 billion or more in Alaska with far lower rates. These proposals appear to assume that the tax would be imposed on a much broader measure, Personal Income, rather than Adjusted Gross Income. Personal income is about 70 percent higher than AGI but is an inappropriate tax base, because it includes employer contributions to pension and insurance funds, transfer payments, investment income retained in insurance or pension plans, fringe benefits, and other forms of income—much of it not actually realized by the taxpayer—that is not properly subject to an income tax. See Mark Ledbetter, "Comparison of BEA Estimates of Personal Income and IRS Estimates of Adjusted Gross Income," U.S. Bureau of Economic Analysis, *Survey of Current Business*, November 2007, https://apps.bea.gov/scb/pdf/2007/11%20November/1107_pi_agi.pdf.

TABLE 6.

Income Tax Collections as a Percentage of Adjusted Gross Income (AGI)

State	% of AGI	State	% of AGI
Alabama	3.2%	Montana	4.2%
Alaska	n.a.	Nebraska	4.0%
Arizona	2.3%	Nevada	n.a.
Arkansas	4.1%	New Hampshire	n.a.
California	6.0%	New Jersey	3.8%
Colorado	3.5%	New Mexico	2.9%
Connecticut	4.9%	New York	5.8%
Delaware	4.0%	North Carolina	4.5%
District of Columbia	6.1%	North Dakota	1.3%
Florida	n.a.	Ohio	2.6%
Georgia	4.1%	Oklahoma	3.4%
Hawaii	4.9%	Oregon	6.8%
Idaho	4.0%	Pennsylvania	3.0%
Illinois	3.0%	Rhode Island	3.6%
Indiana	3.1%	South Carolina	3.3%
Iowa	4.1%	South Dakota	n.a.
Kansas	2.8%	Tennessee	n.a.
Kentucky	4.2%	Texas	n.a.
Louisiana	2.6%	Utah	4.3%
Maine	4.1%	Vermont	3.9%
Maryland	4.0%	Virginia	4.5%
Massachusetts	4.9%	Washington	n.a.
Michigan	3.3%	West Virginia	4.7%
Minnesota	5.6%	Wisconsin	4.4%
Mississippi	3.0%	Wyoming	n.a.
Missouri	3.7%	*All Wage Income Tax States*	*4.4%*

Sources: U.S. Bureau of Economic Analysis; Tax Foundation calculations.

Arguments Against Income Taxation

All taxes are not created equal. Any tax creates a certain amount of economic drag; this is unavoidable. There is truth to the adage that "whatever you tax, you get less of," so it makes sense for policymakers to think carefully about what they choose to tax, and how. Individual income taxes fall on labor; on the margin, they lower the payoff to work, decreasing the supply of labor while increasing its cost.

An income tax can be conceptualized as a tax on consumption plus the change in savings, while a well-structured sales tax is a tax on income less the change in savings. An income tax reduces capacity for future consumption; economically, it acts like a sales tax that increases the cost of future consumption, with each additional hour of labor producing fewer goods in the future. Consumption taxes are much more economically neutral by comparison, and the economic literature consistently finds that sales taxes are less of an impediment to economic growth or location decisions than are income taxes.[41] As a practical matter, moreover, sales tax revenues flow more quickly and consistently than do individual income taxes.

Consumption taxes also fall on suppliers of labor and capital, like income taxes, but they do so neutrally and—at least when well-designed—avoid

41 See Joseph Bankman and David A. Weisbach, "The Superiority of an Ideal Consumption Tax over an Ideal Income Tax," *Stanford Law Review* 58:5 (April 2010), 1413; and Jens Matthias Arnold, Bert Brys, Christopher Heady, Åsa Johansson, Cyrille Schwellnus, and Laura Vartia, "Tax Policy For Economic Recovery and Growth" *The Economic Journal* 121:550 (February 2011), F59-F80.

double-taxing these factors. Sales taxes are destination-sourced, meaning that they are taxed where a good or service is consumed, not where it is produced. Thus, unlike income taxes, they do not discourage investment or job creation.[42] This is, however, only true insofar as the tax falls on final consumption; when the tax falls on business inputs, it increases the cost of investing in-state.

Evidence of the adverse impact of individual income taxes has been documented at the local, state, federal, and even international level. In a series of Organisation for Economic Co-operation and Development (OECD) working papers, OECD-affiliated economists concluded that corporate income taxes are the most harmful to growth, followed by individual income taxes, while consumption and property taxes are less economically damaging. They found that a 1 percent shift of tax revenues from income taxes to consumption and property taxes would increase gross domestic product (GDP) per capita by as much as 1 percent in the long run, and that income taxes were more strongly associated with lower incomes than were sales or consumption taxes.[43] A Canadian study, meanwhile, found that increases in sales taxes are generally associated with increases in economic growth, because they often replace income taxes and other taxes on investment.[44]

One interesting local tax study concluded that a 1 percentage-point increase in a state individual income tax rate reduces annual population growth rates by 0.81 percentage points, while a similar 1 percentage-point increase in local sales tax rates actually *increases* the annual growth rate by 0.83 percent,[45] evidently because residents favor the services provided by sales taxes more than they dislike the tax, whereas the opposite is true for local income taxes. The study's authors also speculated that residents considered the sales tax to be more exportable,[46] though the degree to which this is true may be greater for a locality than it is for a state. Still, Alaska's popularity as a tourist destination and its attraction of part-year workers creates interesting parallels.

Adopting an income tax would, therefore, be a considerably more momentous step for Alaska, despite its history with one. Sales taxes have less of an effect on investment and growth or the location decisions of individuals or businesses. Adopting an income tax would give up one of Alaska's distinct advantages.

REVENUE OPTION 3: RAISING THE MOTOR FUEL TAX

Alaska's motor fuel tax has barely changed in half a century, meaning that it has not come even close to keeping up with the costs of maintaining Alaska's transportation infrastructure. A low gas tax—the nation's lowest—has come to be seen as a perk of living in an oil-producing state, but there's no clear connection between the two, no reason why the cost of roads and bridges should be subsidized so heavily by other taxes and revenue sources.

It was not always this way. The current gas tax is 8 cents per gallon plus a surcharge of 0.95 cents for a total excise tax of 8.95 cents per gallon plus any applicable local sales tax. The excise rate first hit 8 cents per gallon in 1961, when it was the

42 Douglas L. Lindholm and Karl A. Frieden, "After Wayfair: Modernizing State Sales Tax Systems," *State Tax Notes*, May 14, 2018, 667, https://cost.org/globalassets/cost/state-tax-resources-pdf-pages/cost-studies-articles-reports/after-wayfair-modernizing-state-sales-tax-systems.pdf.

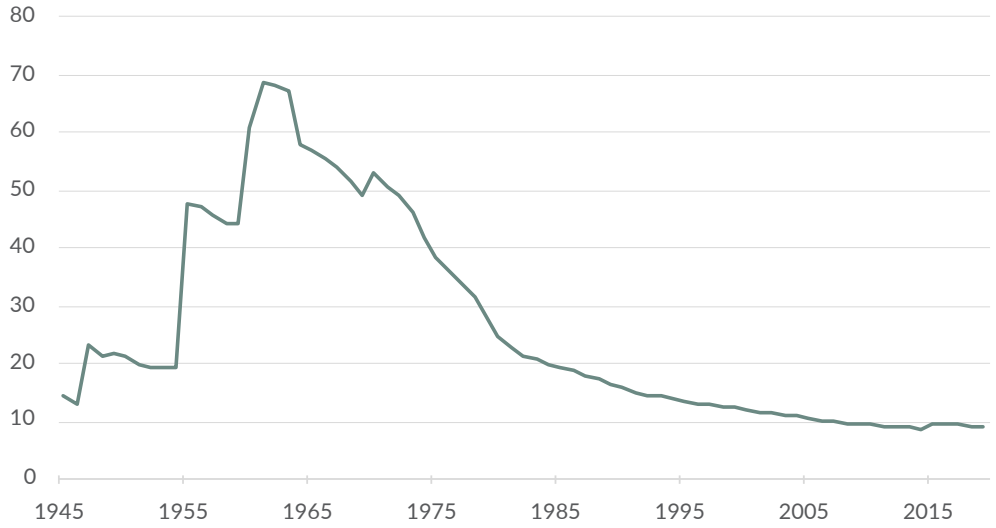
43 Åsa Johansson, Christopher Heady, Jens Arnold, Bert Brys, and Laura Vartia, "Tax and Economic Growth," OECD Economics Department Working Papers No. 620 (2008); Jens Arnold, "Do Tax Structures Affect Aggregate Economic Growth? Empirical Evidence from a Panel of OECD Countries," OECD Economics Department Working Papers No. 643 (2008).

44 Ergete Ferede and Bev Dahlby, "The Impact of Tax Cuts on Economic Growth: Evidence from the Canadian Provinces," *National Tax Journal* 65:3 (September 2012), 563-594.

45 Stephen T. Mark, Therese J. McGuire, and Leslie E. Papke, "The Influence of Taxes on Employment and Population Growth: Evidence from the Washington, D.C. Metropolitan Area," *National Tax Journal* 53:1 (March 2000), 114-116, https://www.ntanet.org/NTJ/53/1/ntj-v53n01p105-24-influence-taxes-employment-population.pdf.

46 Id.

FIGURE 8.
Alaska's Inflation-Adjusted Gas Tax Rate (Cents Per Gallon)



Sources: Alaska Department of Revenue; U.S. Bureau of Economic Analysis; Tax Foundation calculations.

equivalent of nearly 69 cents per gallon in today's dollars. Today's tax is a mere one-seventh of its value at its peak, and with each passing year, inflation further erodes that value.

When oil production was booming, it was possible to pay for Alaska's transportation infrastructure with those revenues, without much resort to imposing a tax on others using the roads. That luxury should be reevaluated given the new revenue environment. Should additional tax revenue be necessary, the motor fuel tax is a responsible option, as it is essentially a user fee which helps defray the cost of wear-and-tear on Alaska's roads.[47]

In 2016, then-Governor Bill Walker proposed tripling the base excise rate from 8 to 24 cents per gallon,[48] which would produce an estimated $80 million in additional annual revenue.[49] No motor fuel tax increase is sufficient to be the driving force behind an effort to close the state's budget gap, but an increase could be part of the solution, particularly since its effects on the state's overall competitiveness would be modest, and the tax increase would be well-targeted, based on road use. The country's median motor fuel tax rate is Nebraska's tax of 30.2 cents a gallon, and the national average is 36.13 cents per gallon.[50] Were Alaska's base excise tax increased to 24 cents per gallon, the estimated total average rate (including local sales taxes) would be 30.35 cents per gallon.

The revenues a motor fuel tax could raise are insufficient to the task of closing Alaska's revenue gap, but an increase could make sense as a component of broader reform. Moreover, should Alaska adopt a statewide sales tax, motor fuel should be included in its base even if the motor fuel tax rate also rises, though it is appropriate to take the sales tax into account in determining capacity for a gas tax increase.

And a road user fee is how it should be treated. Should the gas tax be raised, it would be appropriate to pair the increase with provisions dedicating the revenue to transportation. Since

47 Motor fuel taxes can also help price other externalities, like congestion and pollution, though these may be less substantial considerations in Alaska.

48 James Brooks, "Walker Proposes Tripling Gasoline Tax to Take a Bite out of Alaska Budget Deficit," *The Juneau Empire*, Dec. 19, 2016, https://www.adn.com/alaska-news/2016/12/19/walker-proposes-tripling-gasoline-tax-to-take-a-bite-out-of-alaska-budget-deficit/.

49 Alaska Office of Management and Budget, "FY2021 Budget Overview and 10-Year Plan," 19.

50 American Petroleum Institute, "State Motor Fuel Taxes: Notes Summary," Jan. 1, 2020, https://www.api.org/~/media/Files/Statistics/State-Motor-Fuel-Notes-Summary-January-2020.pdf.

so much of Alaska's road funding comes from other sources at present, this would still free up revenue in the general budget but would ensure that taxes on motorists retain their character as a user fee.

A sales tax is a tax on the privilege of consumption, and buying gasoline (and driving on roads) is a form of consumption, just like any other purchase. The motor fuel tax is not simply a duplication of effort; it is an excise tax intended to set a price on a particular consumptive activity that creates direct state costs (through road wear-and-tear) in a way that many other forms of consumption do not. It is, appropriately, taxed as general consumption, and also subject to the gas tax, which is essentially a road user fee.

TABLE 7.

State Motor Fuel Tax Rates (January 2020)

State	Total State Gas Taxes/Fees	State	Total State Gas Taxes/Fees
Alabama	27.21 cpg	Nebraska	30.20 cpg
Alaska	14.35 cpg	Nevada	33.78 cpg
Arizona	19.00 cpg	New Hampshire	23.83 cpg
Arkansas	24.80 cpg	New Jersey	41.40 cpg
California	60.60 cpg	New Mexico	18.88 cpg
Colorado	22.00 cpg	New York	45.03 cpg
Connecticut	40.13 cpg	North Carolina	36.35 cpg
Delaware	23.00 cpg	North Dakota	23.00 cpg
Florida	42.29 cpg	Ohio	38.51 cpg
Georgia	34.47 cpg	Oklahoma	20.00 cpg
Hawaii	48.37 cpg	Oregon	36.82 cpg
Idaho	33.00 cpg	Pennsylvania	58.70 cpg
Illinois	53.65 cpg	Rhode Island	35.00 cpg
Indiana	46.62 cpg	South Carolina	22.75 cpg
Iowa	30.50 cpg	South Dakota	30.00 cpg
Kansas	24.03 cpg	Tennessee	27.40 cpg
Kentucky	26.00 cpg	Texas	20.00 cpg
Louisiana	20.01 cpg	Utah	31.11 cpg
Maine	30.01 cpg	Vermont	30.81 cpg
Maryland	36.70 cpg	Virginia	21.95 cpg
Massachusetts	26.54 cpg	Washington	49.40 cpg
Michigan	41.98 cpg	West Virginia	35.70 cpg
Minnesota	28.60 cpg	Wisconsin	32.90 cpg
Mississippi	18.79 cpg	Wyoming	24.00 cpg
Mississippi	18.79 cpg	District of Columbia	23.50 cpg
Missouri	17.42 cpg	*U.S. Average*	*36.13 cpg*
Montana	32.75 cpg		

Source: American Petroleum Institute.

REVENUE OPTION 4: REVISITING THE OIL AND GAS TAX

States often tinker with tax rates, but states rarely overhaul an entire tax as frequently or as completely as Alaska redesigns its tax on oil and gas production. What began as a 1 percent tax on the gross value of oil produced, less transportation costs, has taken many forms over the years. Although it has primarily been an *ad valorem* tax, imposed as a given percentage of oil and gas value, a minimum tax implemented in the early 1970s was what is known as a specific tax, denominated in cents per barrel regardless of the price of oil. This provision had the effect of ensuring a revenue baseline even if oil prices plummeted. The state also implemented a statewide property tax on oil and gas equipment.[51]

At times, the tax has been graduated based on production factors, and later subjected to an Economic Limit Factor (ELF), which reduced tax liability as production costs rise. Functionally, this transformed a tax on gross value at the wellhead into something closer to a tax on net value, by reducing the effective tax rate as profitability waned. Then, in 2006, the state replaced this rough approximation of a tax on net value with an actual one, with a base rate of 22.5 percent of net value of production and a progressivity component that increased the rate in tandem with rising oil prices.[52]

This system, termed the Petroleum Production Tax (PPT), was replaced by a system known as Alaska's Clear and Equitable Share (ACES), which, among other things, raised both the base rate and the progressivity factor. Still later, in an effort to encourage additional production (particularly in the North Slope), production-based credits were introduced, offset by a higher base rate of 35 percent of production value and the elimination of the progressivity factor.[53] Finally, under the previous governor, the base rate returned to 25 percent, paired with the elimination of some production credits, and with provision for an increase to 40 percent at higher oil prices. Although the tax is primarily assessed on net value, a minimum tax is pegged at 4 percent of gross value.[54]

The decline in oil prices and the net proceeds of oil extraction in Alaska have hammered the state's finances, with Alaska experiencing far greater volatility than states with specific taxes or severance taxes based on gross revenues. At the same time, Alaska's rates clearly reflect a net value regime: whereas Colorado's severance tax rate maxes out at 5 percent, Texas's oil tax rate is 4.6 percent (natural gas is taxed at a higher rate of 7.5 percent), and Wyoming's oil and gas rate is 6 percent, Alaska's oil and gas tax can reach 40 percent. Such a rate would be ruinous—in fact, impossible—were it imposed on gross revenue, as is common in other states.

That is why, even when gross value served as the state's oil and gas tax base, the effective rate was attenuated by production factors or the Economic Limit Factor. Today, Alaska's minimum tax, at 4 percent of gross value, is modestly lower than the taxes of its peers, but the tax it imposes when conditions are better vastly outstrips those of competing states. It should be noted, moreover, that Alaska's peer states also have deductions and credits, which can reduce the effective tax rate well below the sticker rate, whereas the 4 percent gross value minimum in Alaska is the lowest the effective rate can fall.

The choice Alaska has made, then, is to accept a tax rate at, or perhaps slightly lower than, the level of its peers when (1) the value of oil is

51 Andrew C. MacMillan, "Oil Production Tax in Alaska: An Evolution Away from a 'True' Production Tax," *Alaska Law Review* 34:2 (2017), https://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=1536&context=alr, 321-324.

52 Jonathan E. Iversen, "Alaska's Production Tax in a State of Change," *State Tax Notes*, Oct. 9, 2017, 145-146.

53 Id.

54 Alaska H.B. 247 (2016).

low and (2) companies are heavily reinvesting in Alaska, but to generate dramatically higher returns than its peers in better years. Tax liability on long-term investments like those made by the oil and gas industry are evaluated based over a longer time horizon, so companies weigh the effect of these economy-driven fluctuations across the business cycle. Alaska could modify its oil and gas production taxes to generate somewhat more revenue in leaner years, but this comes at a cost, as it increases the price of new investment and makes Alaska's energy sector less competitive—something that is particularly relevant if companies still face the same high taxes if and when prices rise.

More fundamentally, however, changes to the oil and gas production tax, or other taxes on the oil industry, do not address Alaska's core challenge, an abject lack of diversification in the state's tax code. Alaska's revenue is excessively reliant on a single industry and thus at the mercy of that industry's fortunes and misfortunes. If, as experts fear, the domestic energy industry is in secular decline and not just at the trough of a business cycle from which it can expect to recover, then tying Alaska's revenue system even more intensely to the oil and gas industry is a fool's errand. The state currently generates less than $500 million from all sources other than oil and gas, leaving it incredibly exposed—as recent years' revenues amply demonstrate.

Current state projections, unfortunately, do not anticipate any significant increase in the price of oil in the foreseeable future. State analysts expect the price per barrel of Alaska North Slope (ANS) crude prices to slide in 2020 and 2021, and to take until 2029 to recover to already-low 2019 levels. Projections (Table 8) have ANS prices per barrel ranging from a low of $59 in fiscal year 2021 to a high of $71 in fiscal year 2029, just barely above the $69.46 actual average price for fiscal year 2019. Average daily production across Alaska (ANS and Cook Inlet), moreover, is expected to follow a similar trajectory, with slightly fewer barrels per day in fiscal year 2029 (503,700) as 10 years earlier (511,800), and a falloff in the early-to-mid 2020s.[55]

Daily production exceeded 650,000 barrels a day in 2010, and first purchase prices approached $100 per barrel in 2011 and 2012 (about $112 per barrel in real terms).[56] These prices and production levels are unlikely to be seen again in the foreseeable future, and there is a very real risk of further decline. Doubling down on oil and gas taxes not only has the potential to disincentivize further investment or price out some production, which would be counterproductive, but also serves to lock in the state's current revenue woes, further increasing reliance on a rapidly declining revenue stream.

TABLE 8

Projected Price Per Barrel and Daily Production of Alaska Crude Oil

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
Price Per Barrel	$69.46	$63.54	$59.00	$61.00	$62.00	$63.00	$65.00	$66.00	$68.00	$69.00	$71.00
Daily Production (thousands)	511.8	508.3	506.1	473.8	452.1	445.7	460.4	468.7	478.4	492.0	503.7

Source: Alaska Department of Revenue, "Revenue Sources Book, Fall 2019."

55 Alaska Department of Revenue, "Revenue Sources Book, Fall 2019," 12.

56 U.S. Energy Information Administration, "Alaska North Slope First Purchase Price," https://www.eia.gov/dnav/pet/hist/LeafHandler.ashx?n=pet&s=f005071__3&f=a.

A BALANCED APPROACH TO A BALANCED BUDGET

Barring a dramatic and sustained reversal in oil and gas fortunes, Alaska will be forced to acclimate itself to a new normal. There is no way to do so without pain—or without significant political compromises. It is often said that one sign of good policy is when no parties are entirely happy, and Alaska may soon be forced to test that notion. Certainly, the state would far prefer not to, but given this new reality, it is difficult to see a path forward that does not involve further spending cuts, further draws upon the state's reserves, and, ultimately, new sources of revenue.

For many years, the state has been able to export most of the tax burden to nonresidents. While much of that burden will continue to be exported however policymakers choose to respond to the present budget crisis, it is likely that a greater share will have to be borne by Alaskans themselves to ensure revenue stability and maintain necessary public expenditures.

If that is to be the case, it is vital that (1) the new revenue sources have the least adverse impact on the state's economy and on the ability of Alaskans to continue to live and work in the state, and (2) Alaskans have confidence that these new burdens are necessary, and that state expenditures (which could be allowed to soar when state coffers were overflowing with oil and gas money) have been scrutinized. Since it would be hazardous to close the deficit through a single measure, be it tax increases, budget cuts, or digging deeper into reserves, some combination of approaches will be necessary. A three-way split among the Three Rs—Reallocations, Reductions, and Revenues—is a good place to start.

As we have argued in this publication, a broad-based statewide sales tax, perhaps paired with a motor fuel tax increase, represents the most neutral and economically efficient way to raise additional revenue. Collections will begin faster than an income tax, and feature greater stability, particularly in an economic downturn. A greater share can be exported to nonresidents, both tourists and seasonal workers. And, importantly, a sales tax has less of an impact on employment, investment, or economic growth than the alternatives.

Policymakers will have to grapple with these and other considerations as they decide how to navigate a lower revenue future. But Alaska's star has not dimmed, and lawmakers still have an opportunity to chart a course due north, to a bright and stable future.

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Alaska does things differently—always has, always will. Alaska prides itself on a different way of life, so it comes as no surprise that the state's tax code is as unique as the state itself. Only Alaska forgoes both an income tax and a state sales tax, and in some parts of the state, Alaskans have no exposure to any part of the traditional three-legged stool of income, sales, and property taxes.

None of this would have been possible without the state's vast mineral wealth, and with oil revenues sharply lower than just a few years ago, Alaska policymakers must increasingly ask whether the current revenue structure is sustainable. Oil revenues have plummeted before, and the state has survived on its reserves. But what if this time is different? What if this is the new normal—or worse, a temporary reprieve in the ongoing secular decline in energy markets? How does a state that has relied primarily on oil and gas revenues adjust to a world where such revenues are considerably less robust?

In this publication, we review the state's revenue and weigh options for closing the budget gap with an eye toward Alaska's continued economic competitiveness. This will require a balanced approach, pairing new revenues with additional spending cuts and further reliance on the state's reserves. We review four revenue options—a sales tax, an income tax, a motor fuel tax increase, and modifications to the state's oil and gas taxes. We weigh the pros and cons of each, providing recommendations for optimal tax structure and offering preliminary revenue projections.

The *status quo* is no longer an option, and there are no easy choices. But Alaska's star has not dimmed, and lawmakers still have an opportunity to chart a course due north, to a bright and stable future.

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