The Daily Dish

Alaska, Oil, and Severance Taxation

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Eakinomics: Alaska, Oil, and Severance Taxation

COVID-19 has wrought havoc on world oil markets. The global recession, dramatic drop-off in travel, and a price war produced such a decline in demand that the price of oil futures briefly fell into negative territory this past spring. (AAF's Ewelina Czapla nicely reviewed the policy issues at stake.) Such large declines in oil prices did not just affect investors, however: The volatility had obvious implications for those states that rely heavily on severance taxes – taxes on the extraction of natural resources. And few states rely on such taxes more heavily than Alaska, making it an interesting case study in tax policy during the pandemic.

Last month, Czapla joined with AAF's Gordon Gray to evaluate the impact of severance taxes on state finances. Thirty-four states have severance taxes, and some rely heavily on them for own-source revenue. The unpredictability of oil prices is the source of budgetary uncertainty for these states as a general rule. In the case of COVID-19, some states have reduced their severance taxes to assist the viability of the extraction industry, further exacerbating the revenue issue.

Which brings us to Alaska, a state that does not have either an income tax or a sales tax and is, thus, facing exactly these fiscal pressures. Remarkably, instead of reducing taxes to assist the industry, Alaskans will vote in November on a ballot issue – referred to as Ballot Measure 1 – to raise the level of taxation on oil producers. Czapla and Gray examine the implications of this measure in their latest.

They conclude that Ballot Measure 1 would increase the effective tax rate on oil per barrel by an average of 188 percent; the proposed tax measure would effectively be a sharp increase in a minimum tax on gross revenues. Since Alaska faces strong competition from global markets and, especially in the past 15 years, shale oil in the lower 48, this tax would have to be shifted onto either labor or capital or both. They estimate that the tax increase would reduce future investment activity by over 14 percent, and it would risk the jobs of over 6,300 workers directly and indirectly employed by petroleum producers.

The ultimate irony is that this damage would, in principle, be inflicted in order to raise more state revenue. Unfortunately, Czapla and Gray conclude that the projected new revenue is less than half of that promised by its advocates. Alaska therefore serves as a cautionary tale for those who would increase the reliance on severance taxes in response to the pandemic.