

**ALASKA STATE LEGISLATURE**  
**HOUSE LABOR AND COMMERCE STANDING COMMITTEE**

February 29, 2016

3:19 p.m.

**MEMBERS PRESENT**

Representative Kurt Olson, Chair  
Representative Shelley Hughes, Vice Chair  
Representative Jim Colver  
Representative Gabrielle LeDoux  
Representative Cathy Tilton  
Representative Andy Josephson  
Representative Sam Kito

**MEMBERS ABSENT**

Representative Mike Chenault (alternate)

**COMMITTEE CALENDAR**

PRESENTATION: ECONOMIC IMPACTS OF ALASKA FISCAL OPTIONS -  
INSTITUTE OF SOCIAL & ECONOMIC RESEARCH

- HEARD

**PREVIOUS COMMITTEE ACTION**

No previous action to record

**WITNESS REGISTER**

GUNNAR KNAPP PhD, Director/Professor of Economics  
Institute of Social and Economic Research  
University of Alaska Anchorage  
Anchorage, Alaska

**POSITION STATEMENT:** Provided a PowerPoint presentation entitled, "Economic Impacts of Alaska Fiscal Options Overview of Draft Conclusions" dated 2/29/16.

MATTHEW BERMAN PhD, Professor of Economics  
Institute of Social & Economic Research  
University of Alaska Anchorage  
Anchorage, Alaska

**POSITION STATEMENT:** Answered questions during the presentation entitled, "Economic Impacts of Alaska Fiscal Options Overview of Draft Conclusions" dated 2/29/16.

## **ACTION NARRATIVE**

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**CHAIR KURT OLSON** called the House Labor and Commerce Standing Committee meeting to order at 3:19 p.m. Representatives Olson, Hughes, LeDoux, Colver, Tilton, Kito, and Josephson were present at the call to order.

### **PRESENTATION: ECONOMIC IMPACTS OF ALASKA FISCAL OPTIONS - INSTITUTE OF SOCIAL & ECONOMIC RESEARCH**

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CHAIR OLSON announced that the only order of business would be a presentation on the Economic Impacts of Alaska Fiscal Options by Professor Gunnar Knapp, Director of the Institute for Social & Economic Research, University of Alaska Anchorage. Chair Olson provided brief background information regarding Dr. Knapp.

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GUNNAR KNAPP PhD, Director and Professor of Economics, Institute of Social and Economic Research (ISER), University of Alaska Anchorage (UAA), said he would provide an overview of the draft conclusions of a report on the economic impacts of Alaska fiscal options. He began with a summary, followed by a detailed presentation. Dr. Knapp and his colleague, Dr. Matthew Berman, studied the economic impacts of ten fiscal options under consideration to reduce the state budget deficit: spending cuts, taxes, dividend cuts, and saving less, although they made no recommendation [summary slide 3]. Summary slide 4 listed the ten fiscal options that were studied. Dr. Knapp noted that options vary in direct economic impact, which is the initial way they impact the economy. For example, spending cuts reduce government jobs and pay, and other types of spending cuts, such as broad-based or capital cuts, affect government purchases and have direct impact on industries that supply the government. The direct impacts of taxes are to reduce Alaskans' disposable income, and he pointed out that tax options are partly paid by non-residents and are partly offset by reductions in federal tax obligations. In addition, a cut to Alaskans' permanent fund dividend (PFD) is partly offset by lower federal tax obligations. Saving less has no short-term impacts except it slows the growth of the Alaska Permanent Fund (PF) and lowers its future earnings. Summary slide 5 listed who is most

affected by the different fiscal options: spending cuts most affect government workers and contractors; income tax variations most affect higher-income Alaskans; sales taxes affect all; a dividend cut most affects lower-income Alaskans; and saving less most affects future Alaskans.

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DR. KNAPP continued to summary slide 6 which illustrated estimates of short-run economic impacts per \$100 million of deficit reduction. Based on the foregoing standardized unit of reduction, cutting dividends has the greatest impact. Tax options affect Alaskans' income to a lesser extent because non-residents pay taxes. The effect of spending cuts is smaller with capital cuts, however, spending cuts have the greatest impact on jobs. Summary slide 7 indicated that of all of the options, only saving less has no short-term impacts; all others affect the economy but vary in who is most affected and the relative magnitude of impacts. Summary slide 8 listed points on how fast the deficit should be reduced. Dr. Knapp advised that the smoothest transition would be to make a significant start this year to avoid increased household and business loss of confidence, reduced investment, further credit rating downgrades, and reduced private investment. He strongly urged for significant action to be taken this year, however, an argument can be made that fully closing the deficit this year may not be in the state's best interest, and to "continue to make progress, rapid, steady, and complete progress over the next couple of years."

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REPRESENTATIVE LEDOUX returned attention to summary slide 5 and expressed her understanding that a sales tax is a regressive tax that would most impact lower-income Alaskans.

DR. KNAPP explained that a sales tax is regressive, but has a higher impact in that higher income residents buy more and pay more.

REPRESENTATIVE LEDOUX commented that lower-income residents would "feel it the most."

REPRESENTATIVE JOSEPHSON returned attention to summary slide 7, and questioned whether depleting savings in the earnings reserve by more than \$1 billion, and not fully balancing the budget this

year, undermines the governor's proposal that savings must be used in prudent ways to protect future options.

DR. KNAPP responded that most years the PF has earnings and saving less means saving less of the current year earnings of the PF, as opposed to reducing the existing balance of the earnings reserve. He gave an example of reducing inflation-proofing and reducing deposits to the earnings reserve from the PF.

REPRESENTATIVE HUGHES returned attention to summary slide 6, and asked for clarification.

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DR. KNAPP explained that raising \$100 million by cutting dividends reduces the income of workers in Alaska by \$150 million because of direct and indirect effects, such as residents spending less. In further response to Representative Hughes, he said the spending cuts mean Alaskans end up with \$138 million in less income, which will be explained in detail later in the presentation. Dr. Knapp continued to slide 10, and said the final report is due in March, 2016. Slide 11 listed what was studied in the report. Slide 12 indicated what options were not studied such as changes to oil taxes, oil tax credits, cuts to specific programs, how the state delivers services, and the potential of proposed fiscal legislation. Slide 14, illustrated percentages of the contributions of non-residents and the federal government; for example, non-residents working in Alaska would contribute about 7 percent to income taxes, and non-resident workers and visitors contribute 7 percent to 11 percent of sales taxes. Slide 15 illustrated that a portion of an income tax imposed on Alaskans would be offset when taxpayers deduct their state income tax from federal income taxes and reduce their federal obligation, and he provided an example. Furthermore, the amount of one's PFD is reduced by federal income tax and a reduction in the PFD reduces one's obligation to the federal government. In addition, slide 15 further illustrated estimates of how much the federal government would contribute to the revenue options in the form of reduced federal tax obligations. He pointed out that higher-income Alaskans benefit more from the reduction of federal taxes; lower-income Alaskans with no income or no federal tax obligations would not have a reduction.

REPRESENTATIVE COLVER observed that conventional wisdom is that an income tax would garner revenue from non-residents; however,

slide 15 indicates that they would pay 11 percent in sales tax with more exclusions.

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MATTHEW BERMAN PhD, Professor of Economics, ISER, UAA, responded that the main exclusion is a sales tax on food at home, which is paid less by visitors than residents.

REPRESENTATIVE COLVER asked how an exclusion on food would affect the revenue derived from a sales tax.

DR. BERMAN said a 3 percent tax that includes food and a 4 percent tax without food would raise about the same amount of money. In further response to Representative Colver, he estimated this would equal raising the tax rate by about one-third, and said he will provide an exact number.

REPRESENTATIVE KITO questioned the effect of the sales tax exclusions that were illustrated by slide 15.

DR. BERMAN said that fewer exclusions means including food so non-residents pay less and residents pay more.

DR. KNAPP restated that the percentages are per \$100 million raised: if the state taxes food at home and collects \$100 million in taxes, a larger share is from Alaskans and visitors pay less; if the state excludes food at home, more is paid by non-residents.

REPRESENTATIVE KITO questioned why a sales tax deduction would have more impact on an Alaskan's federal tax burden than an income tax.

DR. BERMAN said he would verify the percentages in that regard.

DR. KNAPP also noted that the percentage details are related to estimates of tax rates for different income groups, which are very complicated. Furthermore, higher income groups who pay more tax also have a higher savings rate; he said the study authors will further investigate.

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REPRESENTATIVE LEDOUX stated that the City and Borough of Juneau (CBJ) has a sales tax exemption for senior citizens that is

limited to residents of Juneau; she asked whether the state could constitutionally assess a sales tax on non-residents.

DR. KNAPP said he would defer to legal advisors.

DR. BERMAN added that it is constitutional to have a seasonal sales tax; the study did not estimate the effects of a seasonal sales tax.

DR. KNAPP observed that if the state were to contemplate a sales tax it would make sense to carefully study the details thereof. He turned to the relative impacts of fiscal options on different income groups, and directed attention to slide 17, which illustrated ten groups of Alaska households grouped by per capita income in 2013. Each group contained about 30,000 households. Slide 18 showed the average household income within each group. Slide 19 illustrated that the share of the highest income group in total income was almost as high as the shares of the bottom five groups combined.

REPRESENTATIVE JOSEPHSON remarked:

Am I right that, this graph is actually, in terms if one is an egalitarian, this is better than what's going on in the Lower 48?

DR. KNAPP deferred to Dr. Berman.

DR. BERMAN agreed that income is more equal than that of other states, however, a contributing factor is the PFD. Twenty-five years ago, the income distribution in Alaska was more equal, so the trend is the same as that at the national level.

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DR. KNAPP continued to slides 20 and 21, which were graphs that showed the estimated effects of taxes and of dividend cuts on per capita disposable income, per \$100 million in deficit reduction. A reduction in the PFD of \$155 would result in a reduction of \$155 in income per person for those in the lowest-income range; however, the reduction would be less for those in the highest-income group. An income tax would not reduce income for those in the lowest-income group, but would reduce income for those in the highest-income group, and a sales tax falls in the middle. Slide 22 translates the information on slides 20 and 21 to percentage of income reduction per person. He restated that a dividend cut makes a much higher impact on a

household with a lower income, and a progressive income tax is designed to take more from a household with a higher income. The sales tax with more exclusions is "flattest." Slide 23 indicated that combinations of deficit measures result in intermediate effects on household income; in fact, a 50 percent dividend cut and 50 percent income tax result in an intermediate effect "between the two extremes."

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REPRESENTATIVE JOSEPHSON asked whether the "sweet spot" is indicated on the green line on slide 23.

DR. KNAPP cautioned that political judgement is needed to determine whether a compromise is best.

REPRESENTATIVE KITO asked whether the study considered market reductions which may affect the amount of the PFD.

DR. KNAPP said the study defined deficit reduction by state action; although, there may be factors that affect the deficit reduction and state budget, a dividend cut is a reduction in what a resident would be getting no matter what the market does.

DR. BERMAN suggested that regardless of earnings from the stock market, the legislature could divert \$150 from 700,000 residents to fund state government.

DR. KNAPP said that slide 24 transfers the information from slide 23 into percentage terms of household income. Slide 25 illustrated the income distribution for different regions of Alaska. As different regions have different income levels, regions such as Juneau would be more affected by an income tax, and regions such as the Kusilvak Census Area would be more affected by a dividend cut.

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REPRESENTATIVE JOSEPHSON questioned whether the study considered the cost of living in each region.

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DR. KNAPP said that the cost of living was not included in the study; he cautioned that a sales tax that does not address the cost of living, would have a great effect on those in areas of lower-income residents and a relatively high cost of living.

REPRESENTATIVE COLVER questioned the income statistics for the Kenai Peninsula Borough.

DR. KNAPP said the data was supplied by the Internal Revenue Service (IRS), U.S. Department of the Treasury.

REPRESENTATIVE LEDOUX expressed interest in obtaining income distribution data broken down by house districts.

DR. KNAPP said he may be able to locate data broken down by zip code, and he offered to provide further analysis in the final report.

CHAIR OLSON expressed his understanding that the report was previously expected to include socioeconomic data related to other pending tax legislation.

DR. KNAPP stated that the study was never intended to be that detailed. Slide 27 restated that saving less and using savings to fund government would have no short-run economic impacts on the Alaska economy. He stressed that saving less does not include drawing down the balance of the PF earnings reserve, but does reduce future investment earnings and how much savings is left for future Alaskans. Slide 28 illustrated that from 2010 to 2015, the state saved an average of \$1.4 billion annually of PF realized earnings, and divided said savings into PF earnings reserve, PF principal, and dividends. He restated that using PF earnings to fund government does not take any money out of the economy, but would reduce the growth of the PF.

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REPRESENTATIVE LEDOUX inquired as to whether using only the PF earnings would close the budget gap.

DR. KNAPP said no, because the budget deficit is \$3.6 billion, and if all the savings were diverted to paying for government, that would total about \$1.4 billion per year on average. He directed attention to slide 29, which indicated that all of the other fiscal options have significant short-run economic impacts. Dr. Knapp said ISER tried to compare the relative impacts of fiscal options by a standard method of economic impact analysis using the IMPLAN model [slide 30]. The first step was to determine direct income impacts such as spending cuts, dividend cuts, and taxes [slide 31]. Slide 32 listed the

effects of direct income impacts by \$100 million of deficit reduction.

REPRESENTATIVE KITO returned attention to slide 31, and asked how the reduction in pay to workers would occur.

DR. KNAPP explained that the slide only illustrated "the way things would play out if you did these things." He returned to slide 32, and pointed out that cutting the PFD also takes money away from Alaskans, however, income and sales taxes take less income from Alaskans because non-residents pay part of the tax.

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REPRESENTATIVE JOSEPHSON asked for an example of a broad-based spending cut.

DR. KNAPP gave an example of a department faced with a budget cut that may reduce some positions, and also travel less, thus part of the cut would affect other sectors of the economy. Slide 33 showed that the next step in the economic impact analysis is to determine multiplier income impacts such as reductions in household and business spending that affect the economy. He stressed that reductions in household savings affect the economy less than reductions in spending. Slide 34 illustrated the multiplier impacts to various options as calculated by the IMPLAN economic model. Slide 35 illustrated that direct economic impacts are highest on jobs, and taxes and dividend cuts have multiplier impacts on jobs. Slide 36 illustrated all of the different economic impact numbers that were previously discussed.

DR. KNAPP presented slide 37, which illustrated the total economic impact of each spending cut option and the calculated effect of a combination of options. Slide 38 listed the economic effects of spending cuts on income and jobs depending on what is cut, and he noted that economic impacts of spending cuts cannot be generalized, but must be identified. Also, cuts to government spending may affect the economy at a higher level because some government services are vital. Slide 39 illustrated the regional economic impacts of spending cuts to government jobs, since different regions are more or less dependent upon government spending. For example, in Juneau, the loss of a government workforce would be felt more than in some regions. Further, school employees represent a significant share of total employment in small communities.

CHAIR OLSON announced the presentation would continue during the House Labor and Commerce Standing Committee meeting of 3/2/16.

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**ADJOURNMENT**

There being no further business before the committee, the House Labor and Commerce Standing Committee meeting was adjourned at 5:00 p.m.