

SENATE FINANCE COMMITTEE

March 30, 2016

9:03 a.m.

[9:03:51 AM](#)

CALL TO ORDER

Co-Chair MacKinnon called the Senate Finance Committee meeting to order at 9:03 a.m.

MEMBERS PRESENT

Senator Anna MacKinnon, Co-Chair
Senator Pete Kelly, Co-Chair
Senator Peter Micciche, Vice-Chair
Senator Click Bishop
Senator Mike Dunleavy
Senator Lyman Hoffman
Senator Donny Olson

MEMBERS ABSENT

None

ALSO PRESENT

Gunnar Knapp, Director and Professor of Economics, Institute of Social and Economic Research, University of Alaska Anchorage.

PRESENT VIA TELECONFERENCE

SUMMARY

SB 114	PERM FUND: EARNINGS, DEPOSITS, ACCOUNTS
	SB 114 was HEARD and HELD in committee for further consideration.
SB 128	PERM. FUND: DEPOSITS;DIVIDEND;EARNINGS
	SB 128 was HEARD and HELD in committee for further consideration.

#sb114

#sb128

SENATE BILL NO. 114

"An Act relating to deposits into the dividend fund; and relating to the Alaska permanent fund."

SENATE BILL NO. 128

"An Act relating to the Alaska permanent fund; relating to appropriations to the dividend fund; relating to income of the Alaska permanent fund; relating to the earnings reserve account; relating to the Alaska permanent fund dividend; making conforming amendments; and providing for an effective date."

[9:04:27 AM](#)

Co-Chair MacKinnon requested that members hold their questions until the conclusion of the presentation.

[9:05:59 AM](#)

GUNNAR KNAPP, DIRECTOR AND PROFESSOR OF ECONOMICS, INSTITUTE OF SOCIAL AND ECONOMIC RESEARCH, UNIVERSITY OF ALASKA ANCHORAGE, introduced the presentation, "Observations on Alaska's Economy and Economic Implications of Alaska's Fiscal Choices" (copy on file).

[9:07:31 AM](#)

Mr. Knapp presented Slide 2, "Outline":

- Overview of Alaska's economy
- Short-run economic impacts of Alaska fiscal options
- Economic implications of how fast we reduce the deficit

I am not advocating for or against any bills or proposals

Mr. Knapp relayed that the presentation would be a general overview of Alaska's economy and would not speak specifically to the pros or cons of any specific legislation.

[9:08:51 AM](#)

Co-Chair MacKinnon reiterated her desire that committee members hold questions until the end of the presentation.

[9:09:16 AM](#)

Mr. Knapp discussed Slide 4, "Thanks to the Alaska Department of Labor and Workforce Development economists who do an excellent job tracking Alaska's economy." He related that economists had provided most of the data and charts used in the presentation, and that he was responsible for the interpretation of the data.

[9:09:51 AM](#)

Mr. Knapp reviewed Slide 5, "Summary of main points about Alaska's economy":

- There is significant concern about:
 - Are we facing a recession?
 - Could what we do to reduce the deficit aggravate the recession?
 - Could we be facing a repeat of the 1980s recession?
- Despite these concerns:
 - The best available evidence is that Alaska's overall economy is not yet in a recession
 - There are important positive indicators in the economy
- Several sectors of Alaska's economy are declining:
 - Oil industry
 - Construction
 - State government
- We probably are facing a recession
- But it is unlikely that it will be as severe or damaging as the 1980s recession

Co-Chair MacKinnon welcomed Senator Dunleavy to the table.

[9:11:27 AM](#)

Mr. Knapp addressed Slide 6, "Alaska has had twenty-five years of almost continuous but slowing economic growth," which showed a graph of the number of jobs in the state over the previous 25 years. He noted that growth had slowed since 2009.

[9:11:43 AM](#)

Mr. Knapp looked at Slide 7, "The best available evidence is that the total Alaska economy—as measured by the number of jobs—is still growing, but at a very slow rate." He indicated that the preliminary data for January and February 2016 showed job increases in 2015 at 0.2 percent. He noted that the state's growth was less than in the Lower 48. He stated that when the economy outside of Alaska was doing well, while the state's economy faltered, it resulted in people seeking opportunities out-of-state.

[9:13:06 AM](#)

Mr. Knapp turned to Slide 8, "The most recent job estimates show total employment higher than a year ago." It showed a bar graph that illustrated month by month, over a year, the percent change in total state employment. He noted that there had been negative changes in the number over the past year, but the most recent three months for which data was available reflected a slight rise in job numbers.

[9:13:38 AM](#)

Mr. Knapp discussed Slide 9, "Alaska personal income continued to grow in 2015." The chart showed that in 2015, personal income in the state had grown significantly.

[9:13:52 AM](#)

Mr. Knapp showed Slide 10, "Alaska's housing market is not showing signs of significant weakness." He said that home prices had risen over the past year.

[9:14:13 AM](#)

Mr. Knapp looked at Slide 11, "Alaska's housing market is not showing signs of significant weakness." He stated that the foreclosure rate in the state was significantly lower than in the rest of the country, and was declining.

[9:14:36 AM](#)

Mr. Knapp addressed Slide 12, "Alaska's visitor industry is doing well." He relayed that visitor numbers were strong and were projected to be high for 2016.

[9:14:44 AM](#)

Mr. Knapp turned to Slide 13, "Federal job losses have been a significant drag on Alaska's economy in recent years - but these job losses appear to be easing." He said that there was hope that the state would not continue to see losses in federal employment.

[9:15:24 AM](#)

Mr. Knapp discussed Slide 14, "But job losses are occurring in selected economic sectors..." He said that significant layoffs by oil companies due to low oil prices were affecting hiring in the state.

Mr. Knapp looked at Slide 15, "National Oil Industry Employment" and pointed out a graph that showed that nationally there had been a drop in the oil rig count, which had resulted in a drop in oil industry employment. He said that the state had not experienced the same drop in employment, in fact; through the third quarter of 2015, North Slope employment at Prudhoe Bay was the highest it had ever been. He stated that significant oil industry investment reflected that the oil industry was doing better than expected given the dismal state of the industry.

[9:17:14 AM](#)

Mr. Knapp turned back to Slide 14, which showed that the industry was reporting sizeable, year-over-year, job losses. He expressed that this was an area of concern and uncertainty in the economy due to the unpredictability of the situation.

[9:17:48 AM](#)

Mr. Knapp spoke to Slide 17, "Job losses in selected economic sectors . . ." He thought one factor contributing to the problem, and that was likely to make the loss in construction jobs grow over time, was the fact that that capital budget had been sharply cut over the past four years. He spoke to Slide 18, "The capital budget has been cut very sharply over the past four years." He discussed the dramatic reduction in capital budget, which he believed would result in further reduction in construction jobs in the future.

[9:19:30 AM](#)

Mr. Knapp showed Slide 19, "State Government Job Losses Growing 2015-2016." The graph showed the job losses over 2015 and 2016. He opined that the state could experience further job losses in the future.

[9:20:02 AM](#)

Mr. Knapp referred to Slide 20, "Job losses in selected economic sectors...", which illustrated job losses of 5 percent, year-after-year, into the future.

[9:20:11 AM](#)

Mr. Knapp looked at Slide 21, "We are losing jobs in high-wage sectors of the economy," which showed a bar graph illustrating Alaska's 2014 average annual earnings. He noted that retail trade jobs had been growing, but specified that those jobs paid much lower than oil and gas jobs.

[9:21:01 AM](#)

Mr. Knapp discussed Slide 22, "Alaska's Population Gains Grew With National Recession -- But Now Slowing: Alaska's total 2015 population count was 737, 624." He explained that the reason that the population growth had slowed was that people were leaving the state [represented by the blue bars] and over the past two years Alaska had more people moving out than moving to the state.

[9:21:14 AM](#)

Mr. Knapp turned to Slide 23, "Alaska Migration, U.S. Jobless rate Track Together." He indicated that the reason that people were leaving that state was that the national economy was doing substantially better than Alaska's economy.

[9:22:01 AM](#)

Mr. Knapp moved to Slide 24, "Alaska Department of Labor and Workforce Development economic projections for 2016..." which depicted the annual employment growth in Alaska. He stated that several organizations, looking at the short term future, had projected significant total job losses for Alaska's economy. He said that those projections were based

on predictions for the oil industry, construction industry, and state government.

[9:22:45 AM](#)

Mr. Knapp showed Slide 25, "Alaska Department of Labor and Workforce Development economic projections for 2016", which charted the departments percent employment change from previous years.

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Mr. Knapp spoke to Slide 26, "Alaska Department of Labor and Workforce Development economic projections for 2016", which reflected forecasted loss of 2,500, or .7 percent, jobs in 2016. He reiterated that the projection was based on predicted job losses in government, the oil industry, the construction industry, and professional and business services. He communicated that those losses could be offset by continuing growth in health care, leisure and hospitality, manufacturing, retail trade, and transportation.

[9:23:31 AM](#)

Mr. Knapp discussed Slide 27, "Alaska Department of Labor and Workforce Development comparison of their economic projections for 2016 ("ours") with other projections..." and qualified that the projections were fairly similar. He noted that the projected job losses varied by region; Southeast Alaska, a government job heavy area, was predicted to have more job losses than other area of the state.

[9:24:16 AM](#)

Mr. Knapp showed Slide 28, "The Extent Of Job Losses During Alaska's "Great Recession" Of The 1980s," which showed a graph of jobs lost and gained between 1985 and 1988.

[9:25:04 AM](#)

Mr. Knapp acknowledged fears that the state would experience a recession similar to the one in the 1980s. He believed that even with the significant negative factors that the state now faced, and the economic consequences that the state would experience as the result of responding

to the current deficit, things would be less dramatic than in the 1980s. He turned to Slide 29, "The 1980s and now: What's different?":

- Economy (as measured by jobs) is about 50% larger
- Older population bringing in much more retirement income
- Alaska Native Corporations bringing significant income to Alaska
- Much larger Permanent Fund dividend a stabilizing factor in the economy
- Visitor industry has grown dramatically
- Bank lending has been more conservative: people are less overextended in their borrowing
- Housing markets are much tighter and stronger
- We have not been experiencing a construction boom

Mr. Knapp turned to Slide 30, "Alaska housing markets are much stronger now than they were in the 1980s":

Anchorage residential building permits issued in 1983:
9082

Total Anchorage residential building permits issued,
2006-2015:
6,808

Mr. Knapp reiterated that housing prices were high and that there were fewer newly built homes than when the recession hit in the 1980s. He noted that another way in which the situation differed from that of the 1980s was that the state had not been experiencing a construction boom. He shared that in the 1980s, employment in construction was high and the economy was being supported by people earning money in that field. He said that the slowing in construction notably contributed to the recession during that time.

[9:29:50 AM](#)

Mr. Knapp spoke to the number of residential building permits that had been issued in 1983: 9082. He pointed out to the committee that the total from 2006-2015 had been 6,808.

[9:30:26 AM](#)

Mr. Knapp discussed Slide 31, "As Alaska's population has aged, retirement income represents a significantly larger share of Alaska income, and a stabilizing component of the economy." He observed that in 1985, the population was much younger.

[9:31:12 AM](#)

Mr. Knapp displayed Slide 32, "ISER's study of Short-Run Economic Impacts of Alaska Fiscal Options."

Mr. Knapp addressed Slide 33, "What we studied, for selected fiscal options...":

- Revenue impacts of taxes and dividend cuts
 - What share would non-residents pay?
 - What share would be offset by lower federal taxes?
 - What would be the relative impacts on different income groups?
- Short run economic impacts of spending cuts, taxes and dividend cuts. Per hundred million of deficit reduction:
 - What would be the impacts on Alaskans' incomes?
 - What would be the impacts on Alaska jobs?
- Total economic impacts of reducing the deficit
 - What would the total short-run impacts on income and jobs of reducing the deficit by different amounts?
- Regional economic impacts
 - How would the impacts of different options vary between regions?

[9:32:21 AM](#)

Mr. Knapp reviewed Slide 34, "We only studied short-run direct economic impacts of fiscal options. There are many other important potential impacts which we didn't study":

- A few examples of impacts we didn't study:
 - Economic impacts of reductions in government services
 - Impacts on investment
 - Impacts on infrastructure development & resource industries
 - Impacts on labor markets & population

- Our fiscal choices will significantly affect Alaska's future
- We should think about not only their short-term economic impacts but also their longer-term economic and social impacts.

Mr. Knapp warned that these short term fiscal option had important, indirect, and longer term impacts on the economy that were more important in the long run. He offered an analogy of choosing from 4 different treatment options for an illness; the treatment that would keep you healthiest, longest, would be the most economical choice.

[9:34:20 AM](#)

Mr. Knapp spoke to Slide 35, "Of all the options for reducing the deficit, only saving less (and using the money to fund government) would have no short-run economic impacts on the Alaska economy,":

- Options for saving less include:
 - Reducing inflation-proofing transfers to PF principal
 - Adding less to the PF earnings reserve
- Saving less would not:
 - take any money out of the economy
 - have any short-run impacts on jobs or income
- But it would reduce:
 - our future investment earnings
 - how much savings we leave for future Alaskans

[9:35:41 AM](#)

Mr. Knapp discussed Slide 36, "From 2010 to 2015, we saved an average of \$1.4 billion annually of Permanent Fund realized earnings." The blue line showed the realized earnings and the brown bars showed that approximately half of the earnings were spent on dividends. He furthered that the rest of the earnings had been saved overtime, represented by the dark blue and lighter blue bars. He noted that the state had been saving approximately \$1.4 billion annually, and could potentially be reduced. He mentioned that the "re-plumbing" proposals from Governor Walker would effectively reduce the amount put into the savings.

[9:37:01 AM](#)

Mr. Knapp addressed Slide 37:

All of the other options for reducing the deficit, including spending cuts, taxes, and dividend cuts, would have significant short-run economic impacts.

They would all take significant amounts of money out of the economy.

But they would do so in different ways, with different impacts on different Alaskans and different relative impacts on public and private income & jobs.

Mr. Knapp emphasized that any of these actions taken by the legislature would have an effect on the economy.

[9:38:04 AM](#)

Mr. Knapp looked at Slide 38, "Alaska Fiscal Options: Who Would Pay?" He said that some of the fiscal options would have the effect of reducing how much money Alaskans have, either by taxing them or by cutting dividends. The green bar illustrated the amount of money the state could expect from non-residents; an income tax would capture money from people working in the state, a sales tax would capture money from visitors. He noted that the numbers ranged between 7 and 11 percent, which was a "silver lining" in that non-residents would contribute something. He countered that the contribution from cutting dividends would come entirely from Alaskan residents. He elucidated that the some of the burden felt by residents could be eased by the fact that federal income taxes would be reduced. He explained that the state income tax could be deductible on federal income tax; federal income taxes on dividends would be reduced, which would offset a reduction in the dividend.

[9:40:54 AM](#)

Mr. Knapp addressed Slide 39, "We estimated effects of taxes and dividend cuts for 10 groups of Alaska households, grouped by their per-capita cash income in 2013, from the lowest 10% to the highest 10%." He discussed the graph that divided Alaskan households into 10 groups based on household income. He highlighted that there was a great disparity between the rich and poor in the state. He expounded that the highest, to 10 percent, income

households in the state had an average income of over \$200,000, while the lowest had an average household cash income of \$14,000.

[9:42:04 AM](#)

Mr. Knapp discussed Slide 40, "The three lowest-income groups had average household incomes of less than \$45,000.

[9:42:07 AM](#)

Mr. Knapp looked at Slide 41, "How options affect different groups: income reduction per person." He explained that the graph summarized how the tax and dividend options would affect how much money people would have left over a disposable income. He pointed out to the committee the brown line on the chart, which illustrated that dividend cuts would disproportionately affect the poor. He then pointed out that an income tax would disproportionately affect the highest income families. He summarized that income taxes versus dividend cuts would affect various income groups in different ways. He said that sales taxes and property taxes would reflect more of a middle ground.

[9:44:21 AM](#)

Mr. Knapp turned to slide 42, "How options affect different groups: percentage income reduction per person." He explained that the largest impact would be felt by the lowest income households, who saw their dividends cut.

[9:45:00 AM](#)

AT EASE

[9:45:23 AM](#)

RECONVENED

Mr. Knapp turned to slide 43:

Short-run economic impacts of spending cuts depend on what is cut

What is cut affects the extent to which the cuts directly affect jobs and income of government and contractor workers and the resulting multiplier effects on the economy.

What is cut also affects the extent to which the cuts have other short-run impacts on the economy, such as:

- Transportation (Marine Highway service, road plowing, etc.)
- Resource management (fish catches, mine permitting)

You can't generalize about economic impacts of spending cuts. Our estimates illustrate a range of potential impacts.

Mr. Knapp emphasized that the effect on the economy was very dependent upon the where the cuts were made.

[9:47:21 AM](#)

Mr. Knapp looked at Slide 44, "Income Impacts." The slide contained a bar graph that detailed the estimated income impacts per \$100 million of deficit reduction (\$ millions). The low and high estimated were based on different assumptions about how households and markets would react to changes in disposable income. The slide reinforced the argument that actual impacts of broad-based and capital spending cuts could be significantly higher or lower depending on how cuts were made.

[9:49:15 AM](#)

Mr. Knapp moved to Slide 45, "Job Impacts." The graph estimated job impacts per \$100 million of deficit reduction (FTE jobs). He noted that the job impacts would be highest because of cuts in government spending. He said that cutting out a job through cutting government spending would result in the loss of the job, and the income that would be spent as a result of being paid for the job. He said that both the cutting of jobs and the cutting of dividends would reduce the spending in the economy.

[9:50:16 AM](#)

Mr. Knapp looked at Slide 46, "Alaskan Summary of Fiscal Options & Estimated Impacts per \$100 Million of Deficit Reduction."

[9:50:41 AM](#)

Mr. Knapp turned to Slide 47, "The Permanent Fund "re-plumbing" proposals would reduce the deficit through a combination of cutting dividends and saving less." He postulated that some of the funds from the ERA would be diverted in order to pay for state government. He believed that the dividend cuts would have a high effect on the economy, while saving less would have no effect on the economy.

[9:51:41 AM](#)

Mr. Knapp spoke to Slide 48, "Examples of Ranges of Estimated Economic Impacts Per \$100 Million of Deficit Reduction Resulting from Selected Potential Combinations of Fiscal Options." The slide showed a table that plotted examples of potential combinations of options and the range of estimated impacts.

[9:52:18 AM](#)

Mr. Knapp moved to Slide 49, "Estimated income and job impacts of reducing the deficit by different amounts using different options."

[9:53:01 AM](#)

Mr. Knapp addressed Slide 50, "How big is Alaska's economy?" He noted that in 2014, personal income in the state was \$39 billion and total employment was 465,130.

[9:53:34 AM](#)

Mr. Knapp looked at the table on Slide 51, "Estimated percentage income impacts of reducing the deficit by different amounts using different options." He explained that the table offered ball-park estimates of the scale of impacts from reducing the deficit at different magnitudes.

[9:54:53 AM](#)

Mr. Knapp discussed Slide 52, "Estimated percentage job impacts of reducing the deficit by different amounts using different options."

[9:55:21 AM](#)

Mr. Knapp looked at Slide 53, "Income distribution varies for different regions of Alaska." He noted that Juneau was the highest income region in the state and the Kusilvak Census Area was the lowest - in the state and in the country. He reiterated that dividend cuts would have a greater effect on lower income Alaskans and an income tax would affect more high income Alaskans.

[9:56:26 AM](#)

Mr. Knapp spoke to Slide 54. The chart listed the share of state government jobs in wage and salary earnings. Regional economic impacts of state spending cuts would depend on how important state government jobs and income were in the regional economy. Some regions were much more dependent than others. He pointed out that Juneau was highly dependent on state government jobs, more so than the North Slope Borough - which had no state jobs.

[9:56:56 AM](#)

Mr. Knapp looked at Slide 55. The chart listed the share of local government jobs in wage and salary earnings. Regional economic impacts of cuts to revenue sharing, K-12 education, and other ways that state spending helped fund local government would depend on how important local government jobs were in the regional economy. Some regions were much more dependent than others. He noted that the poorer areas of Western Alaska had a relatively far greater dependence on local government, much of which was school district employment.

[9:58:07 AM](#)

Mr. Knapp looked at Slide 57, "We have lost billions of dollars of oil revenues":

We will experience significant economic impacts of adjusting to lower oil revenues.

- Impacts of spending cuts we've already made:
 - Impacts of capital budget cuts on construction industry
 - Delayed because capital projects take several years
 - Actual capital spending will decline as money from past large capital budgets runs out

- Impacts of future adjustments we will have to make
 - Spending cuts
 - Taxes
 - Dividend cuts

- It's not a question of whether we will face these impacts.
 - It's only a question of when.

Mr. Knapp asserted that the most optimistic projections showed the state having billions of dollars less in oil revenue than in the recent past. He contended that the state would need to adjust to the loss of oil revenue sooner rather than later.

[9:59:49 AM](#)

Mr. Knapp showed Slide 58, "Alaskans are justifiably concerned about the impacts of deficit reduction on an already weakened economy":

- We are already experiencing the impacts of:
 - Oil industry job losses
 - Past state capital budget reductions
 - State government job losses
 - Mining industry downturn
 - Low salmon prices

- These impacts would be increased by large:
 - Spending cuts
 - New taxes
 - Dividend cuts

[10:00:43 AM](#)

Mr. Knapp moved to Slide 59:

We can reduce the direct short-run economic impacts of reducing the deficit by continuing to draw down our savings.

BUT

Continued large deficits and draws from our savings would also have significant negative economic impacts.

[10:01:25 AM](#)

Mr. Knapp looked at slide 60, "Negative economic impacts of continued large deficits..." He stated rating agencies would certainly downgrade the state's credit rating if the state continued to run large deficits and did not show creditably that it had if financial house in order, which would increase future borrowing costs.

[10:01:50 AM](#)

Mr. Knapp discussed Slide 61, "Negative economic impacts of continued large deficits..." The slide reflected the loss of future investment income for every \$1 billion that the state drew down from savings.

[10:02:48 AM](#)

Mr. Knapp spoke to Slide 62, "Negative economic impacts of continued large deficits...":

Potential future insufficiency of cash in Permanent Fund earnings reserve to cover otherwise sustainable payouts of Permanent Fund investment earnings in low-earnings years.

[10:04:05 AM](#)

Mr. Knapp addressed Slide 63, "Negative economic impacts of continued large deficits . . .":

Lack of time for new taxes to begin to bring in revenues before we really need the money.

[10:04:37 AM](#)

Mr. Knapp spoke to slide 64, "Negative economic impacts of continued large deficits . . .": He said that the biggest negative impact of continued large deficits would be the continued and growing uncertainty about Alaska's fiscal and economic future among Alaskans, Alaska businesses, Resource industries, and Public and private employees.

[10:05:23 AM](#)

Mr. Knapp turned to slide 65, "Economic implications of uncertainty":

- Alaska businesses postpone investment
- Alaskans postpone spending and investment
- Young Alaskans leave
- The best employees leave
- Resource industries invest elsewhere

People focus on the negative impacts of what is coming rather than on moving forward.

[10:06:39 AM](#)

Mr. Knapp addressed Slide 66:

We face a tradeoff between the short-run negative economic impacts of reducing the deficit and the significant short-run and longer-run economic impacts of not reducing the deficit.

[10:07:08 AM](#)

Mr. Knapp looked at Slide 67, "How can we minimize the economic impacts of adjusting to permanently lower oil revenues?":

- Probably not by fully closing the deficit this year.
- Certainly not by running another huge deficit this year.

[10:07:51 AM](#)

Mr. Knapp turned to Slide 68, "We will have a smoother economic transition to the reality of lower oil revenues if we...":

- Significantly reduce the deficit this year
- Make real choices about how we will reduce the rest
 - Even if we implement them over several years
- Reduce uncertainty and build confidence about our economic future

[10:08:28 AM](#)

Mr. Knapp addressed Slide 69:

If the fall in our oil revenues was temporary then it would make sense to run deficits to help support the

economy. But the fall in our oil revenues is not temporary. We can't indefinitely support the economy by running deficits.

[10:09:17 AM](#)

Mr. Knapp concluded with Slide 70:

Not paying for what we spend this year means that our children will pay for what we spend this year.

[10:09:59 AM](#)

Co-Chair MacKinnon thanked Mr. Knapp for his presentation.

[10:10:09 AM](#)

Senator Dunleavy asked how many years, realistically, the process would be for Alaska to regain economic footing. He wondered what kind of action the state should take immediately. He believed more reductions were necessary before revenue measures were considered.

[10:12:12 AM](#)

Mr. Knapp thought there was a trade-off, negative economic impact of acting immediately versus the negative economic impact of doing nothing. He said that there was an advantage to taking time in making important decisions about taxes and spending cuts; however, the state's savings were down to a level that did not allow for much time to delay. He stated that he did not know the answer. He guessed that since there was an urgency to make significant progress in reducing the deficit, the thing that would have the biggest, most obvious, impact should be done first. Leaving the most complicated, and/or minimally effective in raising revenue, for a later date.

Mr. Knapp urged the committee to limit the amount of time spent on the exact way to design a tax that would bring in \$20 million. He thought that focusing on the Permanent Fund proposals was a smart place to begin because that was where very large amounts of money, that could make a meaningful reduction in the deficit, would be realized.

[10:15:43 AM](#)

Mr. Knapp stated he was very cognizant of the complexity of the Permanent Fund proposals.

[10:16:10 AM](#)

Senator Dunleavy asked whether waiting a year would result in lost opportunities or gained opportunities.

Mr. Knapp thought one year was both a lost and gained opportunity. He said that billion dollar deficits were a major lost opportunity for the future. He countered that a year could also buy time for clearer thinking and making better choices.

[10:16:51 AM](#)

Co-Chair MacKinnon stated that Mr. Knapp's approach to the problem mirrored that of the committee. She relayed that in a press conference the committee had committed to taking the highest priority issues, with the largest impact, first at the table.

[10:17:13 AM](#)

Vice-Chair Micciche pointed out that early ISER studies had counted on revenue that was no longer a possibility. He said that the study made the claim that the state could do a sustainable draw without requiring new taxes to fill the deficit. He wondered whether it would be possible to fix the fiscal gap problems without additional taxes.

Mr. Knapp replied that the state needed to determine a sustainable level of spending that could be reached without taxes or dividend cuts. He said that the answer depended on assumptions about future oil revenues. He lamented that there was no sure answer, only an either optimistic or pessimistic attitude toward the oil revenue outlook and the future of Permanent Fund investment earnings. He opined that the state did not have a better handle on the future revenue outlook. He reiterated that an agreement on what size budget was sustainable was imminent. He counselled the committee to determine what a long term savings goal for the state. He thought that a semantic conversation on the word "sustainable" could help. He said that these variables meant that the amount that would need to be saved for the future could vary widely. He said that his best guess for future oil revenue was \$2billion to \$2.5 billion in oil

revenue moving forward and \$2.5 billion on potential Permanent Fund earnings, which meant \$4 to \$4.5 billion was the amount of money that would be available for both dividends and government combined.

[10:21:53 AM](#)

Mr. Knapp relayed that if the committee did not want to change dividends there would be approximately \$3 billion to fund government. He thought that number was low and that new revenues would be needed. He said the only way to find out if the gap could be filled without taxing Alaskans would be to determine a realistic spending limit moving forward, while also determining a goal for dividends.

[10:23:33 AM](#)

Mr. Knapp stated that his instincts told him the state could not solve the problem without new revenue measures.

[10:23:41 AM](#)

AT EASE

[10:24:22 AM](#)

RECONVENED

Vice-Chair Micciche referred to Slide 67, which referred to not running a large deficit in the current year. He asked how to differentiate between a sustainable draw and a "relatively" sustainable draw. He asserted that no draw would be deficit spending and unsustainable.

[10:25:21 AM](#)

Mr. Knapp stated that sustainably saving less meant, on average, what the expected earnings would be from the Permanent Fund, and what the average savings would be. Drawing down the ERA would not equate to sustainable savings.

[10:25:59 AM](#)

Senator Bishop commented that Page 4 of the presentation. He relayed that he appreciated the sentiment on Page 69. He agreed that the state could not indefinitely support the economy by running deficits. He believed that the legislature needed to act immediately because a dollar

spent in deficit spending today was a dollar that would not be recovered.

[10:28:20 AM](#)

Co-Chair Kelly referred to Page 68 of the presentation. He asserted that Mr. Knapp's original presentation had not been embraced by the administration. He quoted the original presentation:

"We will have a smoother economic transition to lower oil revenue if we make significant progress this year than if we fail to make significant progress at all, or if we fully close the deficit this year."

Co-Chair Kelly was concerned that Mr. Knapp had adjusted his rhetoric in response to feedback from the administration. He encouraged Mr. Knapp not to get pulled in to the politics of the situation. He referred to recent layoffs in the oil industry. He asked whether the job losses discussed on Slide 24 used a 20 to 1 multiplier.

[10:31:18 AM](#)

Mr. Knapp responded that anytime multipliers were discussed it was necessary to define what was meant by a multiplier. He said that every time an oil company stated that they had laid off a certain number of employees it was safe to assume each job loss affected several more jobs in the state. He felt that a 20 to 1 multiplier was too large a number.

Mr. Knapp asserted that he believed in the rhetoric of his current presentation. He thought that there were significant, negative economic impacts of reducing the deficit this year. He added that he had been troubled that this had been interpreted as nothing needed to be done immediately. He clarified that the state faced a difficult and uncertain trade-off; he thought that something needed to be done this year, but that doing everything this year that the administration suggested would not be the best solution. He stated that he had focused on the problem as a professional economist, examining the different ways that all of the different choices would affect the economy, and had given his best professional opinion. He assured the committee that he was not trying to say what was

politically popular on either side of this complicated debate.

[10:33:39 AM](#)

Co-Chair Kelly expressed confidence in Mr. Knapp's conclusions. He felt that all options should be on the table and at a certain point revenue measures would need to be discussed. He believed a serious progress needed to be made this in in budget reductions and use of investments so that the state could provide a shock absorber to fluctuating oil prices. He expressed concern that people were uncomfortable discussing systemic change to government, which he believed should be one of the issues on the table. He spoke of legislation under discussion in committee that dealt with some of the "dumb that was hardwired into government." He believed that the administration was trying to protect the current size of government, which he did not believe needed to be sustained at current levels. He thought that the discussion about reducing the size of government had to occur, as well as discussions surrounding using investment income.

[10:37:01 AM](#)

Senator Hoffman referred to Slide 5, which discussed a summary of main points about Alaska's economy. He noted that there had been no mention of local governments in the presentation. He asked Mr. Knapp to comment where he saw local governments and their economies in the current fiscal environment.

Mr. Knapp thought that local governments were going to play an important role in the matter. He said that local governments, including school districts, were major drivers of the economy. He felt that it would be important into the future to clearly define the responsibilities of state and local governments. He relayed the state could reduce spending by shifting more responsibility to local governments, which could result in an increase in local taxes, user fees, and other revenue measures. He thought that the legislature made concerning state government would directly impact local governments.

[10:40:10 AM](#)

Senator Hoffman referred to Slide 38, which discussed Alaska's fiscal options and who should pay, and asked what flat rate had been used in the flat tax projection.

Mr. Knapp replied that he did not know.

Senator Hoffman had heard that the flat rate was approximately 6 percent of the federal rate.

[10:41:09 AM](#)

Mr. Knapp agreed to get back to the committee with the information. He added that the numbers in the presentation had been standardized to the effect per \$100 million raised.

[10:41:25 AM](#)

Senator Bishop requested clarification on Mr. Knapp's statement that, "doing everything is not best." He concurred that the state should not implement a broad based suite of taxes all at one time, but they should be meted out over time.

Mr. Knapp believed that if the state tried to eliminate the deficit with a combination of spending cuts, taxes, and smaller dividends all this year, the impact on the economy would be enormous very quickly. He thought that phasing in the solutions, while using savings to fill gaps, could be less harsh. He asserted that the state was not broke; the state had savings enough to reduce the deficit for a while.

[10:44:13 AM](#)

Senator Hoffman referred to his statement that the state was broke, and he clarified that in the current and subsequent fiscal year, the state would burn through \$7.7 billion. He thought that the state needed to take drastic measures or the state would be bankrupt. He hoped that the people of Alaska realized the state was in a fiscal crisis.

[10:45:20 AM](#)

Senator Olson asked Mr. Knapp what specific action the legislature should take to begin to solve Alaska's economic problems.

Mr. Knapp said that he practiced neutrality in his role as ISER director. He thought that the choices would reflect political value judgements and well as hard numbers. He did not think that it was his place to answer the question. He advised that the state begin partially using the investment earnings of the permanent fund to address the deficit. He pointed out to the committee that the investment earnings were higher than oil revenues. He believed that great thought should be given to the use of the earnings, but that time was of the essence. He highlighted that people who believed that Permanent Fund earnings should not be touched by definition believed that drastic cuts to state government should be made and taxes increased. He urged the committee to develop a responsible, sustainable way to use the earnings that would provide for the needs of Alaskans for state services.

[10:50:33 AM](#)

Senator Olson wondered which bill Mr. Knapp would have his own child invest in: SB 114 or SB 128.

Mr. Knapp replied that he leaned toward the POMV approach. He believed that strong arguments could be made for both pieces of legislation.

[10:51:38 AM](#)

Co-Chair MacKinnon referenced Slides 41 and 53, which looked at how the options affected different groups: income reduction per person, and how income distribution varied for different regions of Alaska, respectively. She wondered whether data on which individual Alaskans were receiving services from programs that received the most government funds. She highlighted that some Alaskans were more dependent on government subsidies; beyond the dividend or their work they were receiving food stamps, Medicaid services, or other services for which the state was contributing. She said that when looking at the income base and comparing a dividend impact on an individual, versus an income tax, when 48 percent of Alaskan's would not pay. She wondered about the 48 percent that would not pay the income tax and queried the impact percentage for subsidies that they received from state government. She believed it was a question of fairness.

Mr. Knapp stated that ISER had not studied the topic, but thought it was an important question. He thought it was important to look at the distribution of benefits of services.

[10:53:51 AM](#)

Co-Chair MacKinnon asked who paid for the study of the data on Slide 41.

Mr. Knapp replied that he had approached the Commissioner of DOR, who had provided \$30,000 of the funds to research the data, and the Office of Management and Budget (OMB) had contributed \$30,000; both DOR and OMB had left the design of the study to ISER.

[10:55:56 AM](#)

Co-Chair MacKinnon wanted to know if DOR and OMB could do some research and answer her question about how much the state was already investing in certain individual families livelihoods, before valuing a dividend deduction versus a state income tax.

Mr. Knapp assured Co-Chair MacKinnon that he thought the topic was important.

[10:56:48 AM](#)

Co-Chair MacKinnon referred to Slide 54. She requested the actual number of state jobs deployed in each region.

Co-Chair MacKinnon referred to Slide 55. She requested the dollar value of the percentage in order to augment the information as the committee considered the information.

Dr. Knapp replied that he would provide the information to the committee.

SB 114 was HEARD and HELD in committee for further consideration.

SB 128 was HEARD and HELD in committee for further consideration.

[10:57:08 AM](#)

Vice-Chair Micciche hoped to ask Dr. Knapp more questions at a later date.

Co-Chair MacKinnon stated that she would be sure that he was available to the committee for further discussion.

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ADJOURNMENT

10:58:01 AM

The meeting was adjourned at 10:57 a.m.