HOUSE FINANCE COMMITTEE
May 1, 2017
1:34 p.m.

1:34:39 PM

CALL TO ORDER

Co-Chair Seaton called the House Finance Committee meeting to order at 1:34 p.m.

MEMBERS PRESENT

Representative Neal Foster, Co-Chair
Representative Paul Seaton, Co-Chair
Representative Les Gara, Vice-Chair
Representative Jason Grenn
Representative David Guttenberg
Representative Scott Kawasaki
Representative Dan Ortiz
Representative Lance Pruitt
Representative Steve Thompson
Representative Cathy Tilton
Representative Tammie Wilson

MEMBERS ABSENT

None

ALSO PRESENT

David Teal, Director, Legislative Finance Division; Rob Carpenter, Analyst, Legislative Finance Division; Alexei Painter, Analyst, Legislative Finance Division; Senator Shelley Hughes, Sponsor; Buddy Whitt, Staff, Senator Shelley Hughes; Representative Bryce Edgmon; Representative Dan Saddler.

PRESENT VIA TELECONFERENCE

Carl Davis, Institute on Taxation and Economic Policy (ITEP), Washington D.C.; Rob Carter, Agronomist, Plant Materials Center, Division of Agriculture, Department of Natural Resources.

SUMMARY

CSSB 6(JUD)
INDUSTRIAL HEMP PRODUCTION

CSSB 6(JUD) was HEARD and HELD in committee for further consideration.

PRESENTATIONS: THE ECONOMY AND FISCAL POLICY OVERVIEW

DAVID TEAL, DIRECTOR, LEGISLATIVE FINANCE DIVISION
CARL DAVIS, INSTITUTE OF TAXATION AND ECONOMIC POLICY

Co-Chair Seaton reviewed the meeting agenda.

^PRESENTATIONS: THE ECONOMY AND FISCAL POLICY OVERVIEW

1:35:49 PM

Co-Chair Seaton acknowledged Representatives Bryce Edgmon and Dan Saddler in the audience. He relayed that SB 26, HB 115, and HB 111 had always been envisioned by the House as a comprehensive fiscal plan, which was the reason SB 26 and HB 115 had initially been combined. He stated that cuts had as much or more of an impact on the economy than taxes. He furthered that presentations from Institute of Social and Economic Research (ISER) and Northern Economics had demonstrated that fact. The goal was to have an Alaska that people wanted to live in, with stable services, strong education, and functioning facilities. He explained there were different ways to balance a budget, both plans under consideration would get the state away from an immediate crisis, but they had different visions of policy changes. He read from a statement:

> The House Majority coalition believes that to help protect the economy and not further deepen the recession we are currently in, we need to provide certainty by eliminating volatility in state budgets, protect key services that are essential to Alaskans and their business, and have a modest capital budget that addresses our deferred maintenance and keeps the construction industry engaged. We want to understand the model assumptions and the levers that are policy choices and the assumptions that we cannot control that we need to be aware of.

1:38:02 PM

DAVID TEAL, DIRECTOR, LEGISLATIVE FINANCE DIVISION, addressed a presentation titled "HCS SB 26/HB 115/HB 111 Fiscal Plan" dated May 1, 2017 (copy on file). He detailed that the co-chairs had asked the Legislative Finance Division (LFD) to talk to the committee about the House version of a fiscal plan. The plan included HCS SB 26 [related to the Permanent Fund], HB 115 related to income tax/education tax, and HB 111 that dealt with oil tax credit reform and other oil tax issues. In the House version all of the items had been rolled into SB 26. He intended to address the entire package as SB 26 for simplicity. He stated the bill touched every Alaskan, not just because it impacted the Permanent Fund Dividend (PFD), but because it impacted the way government would be funded and the levels of service that government could provide. He intended to address why a fiscal plan was needed and whether the House version of SB 26 offered a solution to the fiscal problem.

Mr. Teal turned to slide 2 titled "Budget Reductions Since FY13." A bar chart on the slide demonstrated the fiscal problem facing the state. The black horizontal line represented revenue, which had declined substantially from its $7 billion peak [in FY 13] to less than $2 billion at present. During the same period the state's expenditures had fallen from $7.8 billion to $4.4 billion. He specified that the traditional revenue source - oil - used to be sufficient to cover the state's expenditures, but since FY 13 it had not been. The state faced a $2.5 billion deficit in FY 18. He furthered that in the past the state had been able to absorb deficits of that size, but it was the sixth consecutive year of deficits.

1:40:33 PM

Mr. Teal turned to slide 3 and addressed a chart titled "End-of-Year Budget Reserve Balances, FY07-FY18." The chart showed that the state's reserves (Statutory Budget Reserve (SBR) and Constitutional Budget Reserve (CBR)) had gone from a peak of slightly over $16 billion [in FY 13] to about $2.5 billion at present. There was one year's worth of reserves left after FY 18. The outlook was for continuing deficits. For LFD, anything the legislature may do in the face of continuing deficits with no reserves, was speculation. He explained that the model broke under those conditions. The presentation looked at scenarios that had a

budget that could be funded. He pointed out that the CBR served not only as a shock absorber for budget deficits, but as a cash flow management tool. The Office of Management and Budget (OMB) said that even during years of a surplus, there was typically a significant amount of money flowing out at the beginning of a year before money flowed in; OMB believed the state needed a cash balance of about $2.5 billion in the CBR in order to meet cash management needs. He elaborated the scenario meant borrowing in the short-term from the CBR and paying back the amount during the year.

Representative Grenn asked Mr. Teal to repeat the $2.5 billion deficit information.

Mr. Teal explained that even in the best of times, the legislature had to use CBR draws that were repaid during the year the money had been drawn. He detailed that the state's revenue did not appear on July 1 [the beginning of the fiscal year], but there were significant cash outlays early in the year. The legislature had always used the CBR as a source for cash management, which did not include the shock absorber impact.

1:43:33 PM

Representative Wilson thought the committee had been told there was $4 billion in the CBR at an earlier hearing.

Mr. Teal answered by pointing to a note including assumptions used on slide 3. He detailed the information on the slide assumed traditional withdrawals from the CBR in FY 17 and FY 18. In FY 17 there had been over $4 billion in the CBR. The slide indicated $2.2 billion at the end of FY 18 assuming the entire deficit was drawn from the CBR.

Representative Wilson asked for verification that currently there was $4 billion in the CBR. Mr. Teal answered it was about $4.5 billion.

Vice-Chair Gara asked about the ramifications of going to a $2 billion CBR instead of a $4.2 billion CBR.

Mr. Teal replied that $2 billion may be sufficient for cash management needs, but the legislature may be put in the position of issuing revenue anticipation notes. It was not something the state had done in the past, but every year

the budget contained an appropriation for that purpose, so it was possible the state would issue revenue anticipation notes for the same kind of thing. The notes had to be paid during the year - it was short-term borrowing in anticipation of revenue.

Vice-Chair Gara would personally be more comfortable with a savings account over $4 billion. He asked if it would be wiser to maintain over $4 billion in the CBR.

Mr. Teal replied that in his opinion $5 billion was better than $4 billion; however, that was only his opinion. He reminded the committee that when there was $4 billion or $5 billion cash in the CBR, the state still owed the CBR its full balance. It had been up to about $13 billion; therefore, if the balance was down to $2 billion, the state owed $11 billion to the CBR as specified by the constitution. The chart indicated the cash balance, not the accounting balance of $13 billion.

1:47:53 PM

Representative Ortiz asked when the draw would traditionally take place to bring the fund down to $2.2 billion.

Mr. Teal answered there was no particular date - it was a year-end balance. He detailed that typically there were large outflows, especially for K-12, early in the year. The money was provided to school districts, which depleted the balance. Any time there was a deficit, it cost the state "x" million dollars per day in losses. The losses accumulated and the projected balance at year end was $2.2 billion. He guessed the draw would be June 30.

Representative Guttenberg referred to the topic of where the lowest point the CBR cash balance should be. He was concerned about Mr. Teal's statement that it could be kept at $2 billion or less. He asked about the cost of revenue anticipation notes. He asked for detail.

Mr. Teal replied it was a better question for the Department of Revenue (DOR). He added it would be a higher interest rate than the state would lose from the CBR, which was slightly under 3 percent. There would also be cost to issuing the notes. He summarized that it would be more

expensive to issue notes than it was to borrow from the CBR.

Co-Chair Seaton spoke to the constitutional provision related to borrowing from the CBR (he pointed to slide 3). He noted the CBR had been $13 billion and at present the balance was $2.2 billion. He asked if there was a designated timeframe for the repayment of funds.

Mr. Teal answered there was no associated timeframe. Any time the state had a liability to the CBR, at the end of the year the General Fund and other accounts were swept into the CBR for repayment. Until the CBR was repaid, any unspent general funds would be swept into the CBR. There was typically a provision referred to as a reverse sweep that put the money back into the accounts it had come from.

1:51:49 PM

Mr. Teal turned to slide 4 titled "What Does a Solution Look Like?" The slide contained numerous questions related to the meaning of healthy reserves. He explained he could not specify what healthy reserves looked like and could not tell the legislature what to do. He questioned whether healthy reserves meant the $2.5 billion minimum the legislature wanted for cash flow purposes. Alternatively, he questioned whether it meant growing and stabilizing reserves and working to get back to a $16 billion balance. There were a number of ways to look at the issue and the answer would be different for everyone. Some may merely want a sustainable and balanced budget and may not particularly care how the solution looked. He had heard that sentiment from members of the public. However, to others the path forward was just as important as the destination. He continued that those questions brought up questions about how big dividends would be, the amount of government that was desired, how much residents would have to pay out of their pocket for the government, and how actions would impact the economy. He stated that all of the questions had major policy implications and he could not tell the committee the answers to any of the questions.

Mr. Teal continued to address slide 4 and stated that the points overlapped some. He had seen point 1 [1. Healthy Reserve Balances?] as a direct response to the problem of vanishing reserves and points 2 [2. A Sustainable Budget?] and 3 [3. A Healthier Economy?] as a better way to

emphasize the paths rather than the destination alone. He asked how fast the balanced budget should be obtained if that was the goal. He questioned whether the budget should be balanced immediately or whether a glide path was acceptable or even preferable to some. He reasoned that the budget could be balanced at any level as long as the state had the revenue to support that level of expenditures. Merely saying the goal was a balanced budget did not provide answers towards reaching the goal. He addressed point 3 and believed everyone was aiming at a healthier economy; however, he questioned whether an income tax would hurt or help the goal. The traditional view was that an income tax took money out of the economy and therefore slowed it down or hurt it. However, it could also be argued that a state tax went right back into the economy. The way the tax in Alaska would probably work was it would add $1 for every $0.80 removed from the economy. He noted that $0.20 of the income tax would come from nonresidents. Choosing the path involved numerous policy decisions and some of those were addressed by SB 26.

1:55:47 PM

Mr. Teal advanced to slide 5 titled "What Does HCS SB 26 Do?" The most significant policy change under HCS SB 26 was a payout from the [Permanent Fund] Earnings Reserve Account (ERA) to the General Fund. The payout that 5.25 percent for a couple of years and dropped to 5 percent further out, greatly reduced volatility in the state's revenue stream. He elaborated that the reduction in volatility made sense when recognizing that the payout was as large as or larger than the state's traditional oil revenue source. He furthered that the payout would reduce the deficit by about $1.7 billion to $2 billion per year.

Mr. Teal addressed the second provision in HCS SB 26 that would mean a payout from the ERA for dividends. Under the bill the payout was 33 percent, which gave annual dividends of about $1,250 in the beginning. He furthered that under the baseline assumptions the dividends were expected to increase towards $1,400 per year. He noted that some may wonder how the dividend amount impacted the problem of vanishing reserves. He detailed that the relationship was fairly straight forward. As dividends increase it cost more money. Since there was a 5.25 percent total payout, more money to dividends meant less money to the General Fund.

Less money to the General Fund meant deficits would increase and reserves would decline.

Mr. Teal addressed the payout (revenue) limit provision included in the bill (slide 5). He explained that the revenue limit kicked in only at revenues above any scenarios facing the state. He elaborated that it did not mean the limit was ineffective; it was designed to work only when revenue was unexpectedly high. He had not included modeling those scenarios, because too much revenue would not be seen as a problem. The bill would also divert some royalties from the Permanent Fund to the General Fund. He specified that the constitution mandated 25 percent of royalties to go to the Permanent Fund. Statutes mandated an additional 25 percent from new fields. The additional 25 percent was diverted to the General Fund under SB 26. Lastly, the bill contained conditional links to a broad-based tax and to oil tax/credit reform.

Mr. Teal turned to slide 6 titled "Baseline HCS SB 26." The slide showed screenshots, which fell under the baseline assumptions; the assumptions were an OMB growth forecast - of about $1 billion between FY 17 and FY 26. He furthered that the budget forecast was flat for FY 19 and grew about 2.5 percent per year after FY 20. The OMB forecast included retirement assistance at the most recent acutarial valuation dated June 2016. The spring revenue forecast had been used for price and a "P10" production forecast had been used. He knew the committee had some issues with DOR's production forecast and LFD believed that using the P10 forecast addressed the issue of the 12 percent decline. He elaborated it provided a revenue number that was very similar to the number released by DOR late the previous week. He stated that unfortunately the information included a number at a particular price, which was insufficient to update the LFD model. He hoped to build the forecast into the model later in the week once DOR had provided the numbers.

2:01:09 PM

Mr. Teal continued that the model used 6.95 percent Permanent Fund investment returns. He cautioned that the model showed projections only; the future was uncertain and LFD expected legislators to understand that their policy decisions have to address the uncertainty inherent in any model and in the future in general. The base scenario used

fairly stable earnings and oil prices despite the fact that both items would most likely be volatile. He emphasized that the precision was not high and LFD believed the model was within a couple hundred million dollars for FY 18 and hopefully within $1 billion by 2026. He noted that the legislature would not witness the limit being exercised and he cautioned that the plans should always be stress tested to see what would occur under less favorable assumptions.

Mr. Teal addressed takeaways from the chart on slide 6. First, the Permanent Fund reached $70 billion, which was about 105 percent of the FY 17 real value. The Permanent Fund was protected, dividends began at about $1,250 and increased to about $1,400 under the baseline assumptions. The CBR was not empty as had been implied on slide 3 that showed reserves of about $2.5 billion remaining in FY 18. He expounded that one more year of a $2.5 billion deficit would have emptied the CBR. The bill did not have that effect - the decline was more gradual. He noted that the gradual decline was not a complete solution and would require coming back in a few years to look at reductions or revenue enhancements. The second screenshot on slide 6 showed increasing the capital budget from $180 million to $250 million. The committee substitute (HCS SB 26) also added the House version of the income tax (HB 115) and the House version of the oil tax bill (HB 111). Under those assumptions the CBR began to grow, deficits were eliminated and surpluses were projected in the early 2020s.

2:04:33 PM

Representative Guttenberg urged the co-chairs to reach out IT Committee and Legislative Council and volunteer the House Finance Committee to access technology that would allow the members to read everything on the charts. He thought it would be beneficial.

Vice-Chair Gara referred to slide 6 and asked about the capital budget assumption. Mr. Teal replied $480 million.

Vice-Chair Gara did not imagine getting back to capital budgets of the past. He detailed that the construction industry had communicated that the constrained capital budget had been part of the reason for the constrained job market. He believed some capital budgets had been in the $600 million to $800 million range over the ten years prior to 2014. He surmised that on the one hand the budgets

seemed much larger than the state could currently afford. He gathered that a $300 million capital budget or closer to those of past years would make the state's savings disappear much more quickly if the plan only used Permanent Fund earnings.

Mr. Teal answered that three slides had not been included because they did not relate directly to SB 26, but a few slides had been included on capital budget, deferred maintenance, and other. He deferred to a colleague for detail.

ROB CARPENTER, ANALYST, LEGISLATIVE FINANCE DIVISION, confirmed that any increase to the capital budget would drain reserves quicker. He provided a chart titled "UGF Capital Budget vs ANS Average $/bbl" (copy not on file) that showed the unrestricted general fund (UGF) capital budget from FY 00 to FY 18. The chart included the size of the capital budget and the price of oil. He relayed that between FY 00 and FY 17 capital budget average was $600 million. From FY 00 to FY 05 the average had been about $160 million. He elaborated that during the "boom years" the average had been about $1 billion. He did not know what the "sweet spot" was in terms of the capital budget size. The $180 million in the LFD model was based on an educated assumption the state would need roughly $50 million per year for deferred maintenance (based on OMB's projection for $70 million to $90 million for deferred maintenance in its 10-year plan, including schools) for state facilities and another $30 million for deferred maintenance for schools, $80 million in federal matching funds (which had averaged about $60 million annually) for highways and aviation, $10 million for grants, and $10 million for other state capital. He noted that there was plenty of demand for capital funding and the funding amount was up to the legislature.

2:10:23 PM

Representative Ortiz spoke to the decline in the capital budget and projections it would remain relatively flat in the future. He asked if there was a way to estimate what the long-term costs of deferred maintenance would be if the capital budget was not addressed in a more robust way.

Mr. Carpenter referenced a chart titled "Deferred Maintenance by Agency (millions)" (copy not on file) that

showed the actual deferred maintenance backlog since FY 12. The backlog had started at $2.3 billion and had declined to about $1.6 billion as of January 2017. The decline was a result of an initiative implemented by the governor and the legislature - beginning in FY 11, $100 million per year had gone towards addressing deferred maintenance. The payments had a significant impact on the backlog. He elaborated that as maintenance continued to be deferred the costs would increase. He detailed that buildings fell into more disrepair as time went on and there was an inflation factor on the general building materials and cost of labor.

Co-Chair Seaton noted it would be possible to put in some of the variables when the committee viewed the LFD model.

Representative Wilson spoke to Mr. Teal's mention of utilizing SB 26 alone without other pieces. She wondered if the LFD modeling included Senate components such as cuts of $750 million in the next three years. She stated she was fairly certain "they" were not looking at a $1 billion increase between "then and 2026." She also mentioned legislation the Senate put in place like a Medicaid bill, crime bill, and an education package that was forthcoming.

Mr. Teal answered that LFD was using the same baseline scenario for the House and Senate, including the same earnings assumptions, forecast, and expenditure. The Senate had requested a reduction in expenditures as part of its plan. Whereas a House committee chair had elected to increase the capital budget from $180 million to $250 million as part of the House plan. He explained that the LFD model would allow a comparison of a Senate scenario to the House scenario. The model could also demonstrate what a reduction to the budget would look like in the House and Senate versions.

2:13:51 PM

Representative Wilson spoke to the importance of including all components of a piece of legislation when viewing the LFD model.

Co-Chair Seaton clarified that slides with the title SB 26 House [HCS SB 26] indicated it was the bill version that passed the House. Likewise, if the slide title showed Senate, it was the Senate's base version.

Mr. Teal noted that the chart was titled "Baseline HCS SB 26."

Representative Wilson underscored that the slides' titles did not reflect what had been stated during the meeting. She explained that there had been discussion about what it would look like if the Senate bill alone was passed. She asked for clarification. She wondered if that statement meant they were talking about the House version of SB 26 without other added components. She wanted the public to be clear on what bill version and components the committee was talking about.

Co-Chair Seaton clarified that the top of the slides indicated what bill version the scenario was addressing (e.g. HCS SB 26).

Mr. Teal clarified that there were many assumptions driving the LFD model - some could not be controlled such as oil prices and Permanent Fund earnings. There were other things that could be controlled, including the size of the capital and operating budgets. Policy choices pertained to the controllable variables and the model's stress test pertained to uncontrollable variables. He furthered that the committee may want to see what the model looked like if there were lower Permanent Fund earnings or a lower price or production forecast. He explained that the scenarios in the model were driven by the assumption - there was no guarantee any of the model's projections would occur. He referred to a scenario that showed declining reserves. He provided examples where the change from one scenario to another was the addition of about $200 million per year in income tax and about $100 million in capital budget. When the expenditures were added, there were also taxes added to pay for the expenditures. He reiterated that there was no guarantee the model's projections would come to fruition. The actual scenario could be worse or better.

2:19:14 PM

Representative Guttenberg noted that the committee had seen a slide pertaining to SB 26 compared with the baseline House version of the bill. Another slide included SB 26 with the other two House bills added in. He believed some of the concerns were about whether comparisons were apples-to-oranges or other.

Co-Chair Seaton clarified that the Senate version was not being discussed. The committee was addressing two versions - a baseline of HCS SB 26 without taxes built in and a HCS SB 26 with a $250 million capital budget and HB 115 and HB 111, which were tied to the House's version of SB 26. Any slides labeled House pertained to all of the fundamentals of the House bill and if the slide had Senate it pertained to the Senate version with its cuts and other.

Representative Thompson remarked that into the future it appeared the state would be more and more dependent on the ERA. He found it worrisome that the legislature had not inflation proofed the Permanent Fund principal in the past two years and the royalties that went into the principal had been reduced by 50 percent. He emphasized that the more the principal could be grown, the more money there would be. He furthered that the legislature was contemplating changing the draw limit from $1.2 billion dollar-for-dollar to $1.4 billion $0.80, plus inflation proofing. He stated that they would never reach a draw limit under that type of scenario. He stressed the importance of growing the principal of the Permanent Fund because it would be needed for the state's functioning into the future unless there were some large unforeseen changes. He was also concerned how the proposals may hurt PFDs.

2:22:53 PM

Mr. Teal answered that the concern was valid. To address those types of concerns he recommended looking at the model with a lower interest rate on the Permanent Fund and to change the inflation proofing assumptions for the Permanent Fund. A higher fund balance meant higher PFDs and a higher payout to the General Fund - the higher the payout the better the state would be in terms of the deficit. He detailed that everything was related, which was the reasoning for using a model to generate graphs. He hoped everyone understood the relationships. He offered to sit down individually with members if they did not understand what went into the model and what the impact of changes would be.

Co-Chair Seaton asked Mr. Teal to address the model. He reminded members that HB 111 was the House version and if it appeared in the model it did not reflect changes made in the Senate. He noted that members all recognized there were two different ways to balance the budget and that both

plans would move the state away from the deficit crisis. He requested to look at price scenarios at the top of the model [shown on a dynamic Excel spreadsheet]. He explained the scenario used the spring forecast and went to $88 in the final year on the chart. He requested to look at a more conservative price range of $50 to $70 and asked what it did to the plan.

2:25:47 PM

ALEXEI PAINTER, ANALYST, LEGISLATIVE FINANCE DIVISION, referred to the model and demonstrated the price difference. He explained components of the model shown on a projector screen. The P60 scenario was slightly more conservative than the spring forecast and started out $4 lower and was $9 lower by FY 26.

Representative Wilson asked if the model was showing a 7 to 9 percent decrease in oil. Alternatively, because an uptick in production had occurred in the past two years, she wondered if the model showed a flat rate. She asked how many barrels of oil they were talking about.

Mr. Painter answered that the LFD model used the P10 forecast, which was the Department of Natural Resources' (DNR) high forecast. He pointed out there was a 9 percent decrease in the first year and somewhat smaller decreases in future years. He detailed that DOR had recently released an alternate revenue forecast using a 4 percent decline curve - it was not built into the model, but was listed for reference. He furthered that the change really only made a difference in the first few years - by FY 22 it was close to the P10 curve. In FY 18 the forecast would be about $70 million more in revenue.

Co-Chair Seaton spoke to the stress test looking at oil prices going to $70 in the outer years and noted it did not substantially change the look of things. He asked if there were any changes that were not obvious. He asked where the balanced budget would occur.

2:28:15 PM

Mr. Painter replied roughly FY 24 or FY 25 depending on the model's accuracy.

Co-Chair Seaton observed "before that we're at 95 percent by FY 23, is that right?"

Mr. Painter returned to the spring forecast and pointed to the difference in several years of when the deficit would be closed.

Co-Chair Seaton asked what happened if the capital budget was increased to $360 million (double the $180 in the model at present). He surmised that under the scenario the budget would still be balanced in FY 24 and it would be 97 percent balanced in FY 22 and the CBR would still be growing. He asked about the growth in the Permanent Fund under the scenario. He stated the Permanent Fund was 105 percent its current value. He asked if the 105 percent meant the fund was growing with inflation and had increased more than inflation.

2:30:23 PM

Mr. Painter replied in the affirmative.

Co-Chair Seaton clarified that 100 percent meant the fund had kept up with inflation and 105 percent meant it had exceeded inflation. The Permanent Fund would be 5 percent greater than it would be in FY 26 if it had just grown with inflation.

Mr. Painter answered in the affirmative.

Co-Chair Seaton asked if other members had questions on the scenario. He addressed a statutory repayment of the oil tax credit and discussed production tax received by the state. He asked about a faster repayment of the credits and asked for an explanation of level.

Mr. Painter explained that the scenario took the current and expected earned balance of the tax credits - with HB 111 (House version) there would be very little earned in future years. It was primarily the existing balance and spread the payments over the next nine years so there would be a level amount of about $150 million per year (up from $70 million or so under the statutory calculation), which would leave no outstanding tax credits to be purchased in FY 26.

Co-Chair Seaton asked for verification that all of the tax credits would have been repaid by FY 26. Mr. Painter answered in the affirmative.

Co-Chair Seaton asked what the budget looked like and for verification that the 95 percent meant the state would anticipate that revenues received were 95 percent equal to payments.

Mr. Painter believed it represented the amount of the current deficit. If nothing was done it would be zero percent, but it filled up as various policy changes were added.

2:33:45 PM

Co-Chair Seaton referred to FY 25 and asked for verification there would be $52 million surplus at that time. He surmised they were talking about rounding errors in the formula because he believed Mr. Painter had stated there was a gap of about $100 million or so in the earlier years.

Mr. Painter answered that by FY 26 the model was not accurate within $100 million. He detailed that the price of oil may be significantly different and production may be significantly different - by that time the model was lucky to be within $1 billion.

Vice-Chair Gara wanted to see the Senate plan of the $1,000 dividend and no other revenue. He wanted to see a jobs program. He elaborated that the state had lost 7,000 jobs in the past year. He did not see how an "only Permanent Fund plan" would do that.

Co-Chair Seaton agreed, but wanted to get through the stress test on the House plan first. He noted that even with a $360 million capital budget, if the discussion was about a jobs program, it was twice as much as a $180 million projected capital budget. The House plan also included a $1,200 dividend compared to a $1,000 dividend. The comparisons would have to be shown sequentially instead of side-by-side.

Representative Wilson asked for clarification on the budget portion. She asked if the model showed the actual budgets

passed in FY 16, the budgeted numbers for FY 17, and the House numbers for FY 18.

Mr. Painter agreed that the FY 16 and FY 17 numbers were the current adopted numbers with the addition of the governor's proposed supplemental budget for FY 17. The baseline OMB 10-year plan scenario was used for FY 18 and beyond (roughly the governor's budget). The House budget was close and there was not a significant difference.

Representative Wilson surmised that the FY 16 numbers were actuals. She asked for verification that the FY 17 figures were actual plus the proposed supplemental. She wondered why the model was not using the current House budget versus the governor's budget for all of the items.

Mr. Painter replied there was no House baseline beyond FY 18. He was not sure how different the number ended up being.

Co-Chair Seaton stated $7 million.

Mr. Painter stated they could add the $7 million in, but it would not be seen on the chart.

2:37:44 PM

Representative Wilson assumed that the bump up shown in FY 19 was OMB's projection for the budget.

Mr. Painter answered that the primary reason was due to the increase in retirement assistance. He elaborated that LFD had recently received information from consultants showing that state assistance for retirement would increase from the current number of $134 million to $353 million. Agency operations were actually slightly lower in the OMB 10-year plan.

Representative Wilson wanted to hear the reason for the large bump [in retirement costs].

Co-Chair Seaton replied that the committee could look at actuarial analysis at some point; he did not believe the committee would have the ability to change them.

Representative Wilson countered that the committee needed to understand the increase.

Co-Chair Seaton returned to the model and asked about a stress test in terms of Permanent Fund returns. He requested to leave the level amount of tax credit repayments and the capital budget.

Mr. Painter addressed an Excel tab that used the actual Permanent Fund investment returns from the period of FY 07 through FY 15, which included the great recession years where there had been a large drop and then subsequent recoveries. The other scenario was for the same years in reverse. He explained that the actual mean investment return over the period had been 6.5 percent, which was not very different. He explained that the sequencing of returns made a large difference.

2:40:43 PM

Co-Chair Seaton noted that in the scenario even though they were looking at the last nine years' return rates, the model indicated the CBR would increase slightly and money would be retained in the ERA at the end of each year. He asked if there would be about $500 million to $1 billion in the reserve under the scenario.

Mr. Painter replied that it was roughly $1 billion in FY 23, which was the lowest year.

Representative Guttenberg asked what the model was using for production and price of oil. Mr. Painter responded they were using the P10 production forecast and the spring forecast for price.

Representative Guttenberg asked for verification the items were built into the assumptions. Mr. Painter agreed. He noted those items were not varied in the current scenario. The only item being altered was the Permanent Fund returns.

Co-Chair Seaton observed that the dividend had been decreasing slightly in the graph due to a substantial correction and loss in the Permanent Fund. He asked for the reason and if it was related to losses in the fund in FY 09.

Mr. Painter replied that in FY 09 the Permanent Fund loss had been minus 18 percent. The information showed the impact of the loss carried through the average.

Vice-Chair Gara asked to compare the difference between the capital budget from last couple of years, the model, and the average.

2:43:43 PM

Mr. Carpenter answered that the capital budget had been $96 million the preceding year and the governor's current proposed budget was $115 million.

Vice-Chair Gara restated the second part of his question. He noted the model assumed a capital budget of $360 million. He asked for the average capital budget over the past 10 years.

Mr. Carpenter agreed that the model showed a capital budget of $360 million. He detailed that chart he had shown earlier in the meeting had shown a $600 million average from FY 00 to FY 17.

Vice-Chair Gara did not see the ability to afford a $600 million capital budget. He wanted to see some growth in construction jobs. He spoke to the $360 million capital budget under the plan. He asked if CBR earnings were growing or remained flat.

Mr. Carpenter pointed to an Excel scenario that assumed a dire financial market - in the scenario the CBR balance was still maintained and the ERA was recovering and growing.

Vice-Chair Gara asked to view the best forecast projection. He surmised the state could afford to increase the capital budget slightly while maintaining a growing CBR balance under the average forecast.

Mr. Carpenter answered in the affirmative. He specified that the scenario on the screen included a capital budget of $360 million per year. He pointed to the upturn in the CBR and growth in the ERA.

Co-Chair Seaton pointed to the reserves growth of about $700 million to $800 million per year between FY 25 and FY 26.

2:46:52 PM

Mr. Teal reminded the members inflation proofing had been built into the bill. Any time the ERA balance was more than four times the amount of the payout, there was a transfer from the ERA to the corpus of the fund. He continued that it kept the ERA balance at roughly four times the payout so it appeared that reserves were flat. He detailed it actually indicated that the corpus of the fund was growing, which would be reflected on the Permanent Fund graph. He pointed to an Excel chart and noted the fund grew to $70 billion. He noted that under any scenario at a 6.95 percent payout - the bill specified that was what it would look like. When reverting to the stress test, it indicated the Permanent Fund would fall substantially and then recover.

Vice-Chair Gara believed it was necessary to see a return of construction jobs to help reverse the recession. He asked if a $360 million capital budget, which was lower than average but higher than the preceding year, seemed like a responsible amount. He noted that the capital budget had not yet been written.

Mr. Carpenter replied that it was a policy call.

2:49:17 PM

Co-Chair Seaton asked to see the model pertaining to SB 26.

Mr. Painter complied and noted the Excel model showed SB 26 with no other changes other than $185 million in budget cuts. He noted the Senate's operating budget was $185 million lower than the governor's budget (but not below FY 17 - the baseline for the model was the governor's proposed budget).

Co-Chair Seaton asked to see the bottom left graph on the screen. He referred to a $300 million deficit in FY 26 indicated on the screen. He noted the bill included a $1,000 dividend ($1,000 was also the dividend floor). He requested a stress test on the price at P60. He stated if the price was running in the $50 to $79 range the CBR was continuing to decline and there would be a deficit of approximately $485 million in FY 26. He asked to see a $360 million capital budget.

Mr. Painter asked if Co-Chair Seaton wanted the scenario to maintain the P60.

Co-Chair Seaton answered in the affirmative. He observed that the CBR would almost disappear in FY 26 if the specific scenario was maintained.

2:52:49 PM

Representative Ortiz spoke to a scenario that included approximately $180 million in budget cuts. He asked if the reductions continued out in the model to the projected $750 [million] over the next three years.

Mr. Painter answered in the negative. He offered to include larger cuts in the scenario if desired. The scenario had started with cuts of $185 million.

Representative Ortiz asked for verification that the $185 million in cuts was assumed year after year in the model. Mr. Painter clarified that the model included a shifting of the OMB line down by $185 million on a one-time basis.

Vice-Chair Gara referred to a bar chart in the model that assumed the Senate's education and university cuts, but it did not assume ever returning the funds to those allocations. He surmised the chart assumed the cuts would take place in the current budget and would be maintained into the future. He asked for the accuracy of his statements.

Mr. Painter replied that the OMB baseline scenario had a flat operating budget for FY 18 through FY 20 and grew at 2.5 percent (slightly more than inflation), meaning there could be some increase. The OMB plan did not distinguish between the various parts of agency operations.

Co-Chair Seaton asked to return to the spring forecast. He asked about the $185 million that included cuts, which would require a supplemental of slightly over $20 million. He asked to reduce the cuts to $150 million. He observed the CBR was declining in the scenario and the deficit was $424 million in FY 26. He requested a stress test on the data. He observed that with the reverse the ERA was used up for two years and the CBR was still declining.

2:56:25 PM

Representative Wilson asked to return to the $180 million capital budget in the model. She did not believe the Senate

was proposing to take $180 million off of the proposed increase, but taking $180 million off of the actual budget in the current year. She clarified there were bills that had been passed by the legislature related to Medicaid, crime, and education reform. She did not believe it was possible to specify the funds would come from a specific area. She asked for verification there was no way the chart could include anything different than a 9 percent decrease related to oil.

Mr. Painter replied that LFD did not have the additional data from DOR, but the hope was to receive the data by the end of the week.

Representative Wilson pointed to the data and surmised it was DOR's actual spring forecast. She wondered what happened with the scenario.

Mr. Painter asked for clarification. He asked if Representative Wilson wanted the model to use a cut of $185 million.

Representative Wilson asked if $185 million was the current cut in the governor's proposed capital budget.

Mr. Teal answered there was another way to show the information. He explained that instead of shifting the entire curve parallel, it could be changed to grow at a rate lower than 2.5 percent. He reminded the committee that it was a policy decision and any number desired could be used. For example, if the legislature believed the budget could be held flat it could put a flat budget in or some growth rate that was less than inflation.

Representative Wilson clarified she was only trying to understand the Senate's plan. She thought it was important to understand whether there would be a $485 million deficit by FY 24. She asked if the governor had included the $180 million in his proposed capital budget.

Mr. Teal answered that the Senate had asked LFD to include the $185 million decrement as its baseline.

Representative Wilson asked how far out the deficit would continue under the scenarios currently presented. She remarked it would be helpful to have personal computers to view the information presented on the screens.

Co-Chair Seaton replied that the scenarios maintained the deficit through FY 26 - the deficit in FY 26 was slightly over $200 million. He requested a change to the statutory [oil credit] payout to a higher level payout in the current scenario. He noted the committee had seen stress tests on both projects, but LFD could only help so far because the remainder was based on policy calls (e.g. whether the legislature wanted to see cuts and job cuts or other). He remarked that the scenario included the Senate's 5 percent education cut. He stated the cut could be characterized in numerous ways including a cut to the Alaska Pioneer's Homes or other places in the Department of Health and Social Services. Alternatively, there was the House's version of the budget that increased funds to take care of a robust economy.

3:02:47 PM

Vice-Chair Gara saw the [Senate's] plan as a "people leave Alaska plan." He asked how fast the CBR would disappear in the Senate's plan if its $70 million education cut and university cut was restored and the construction jobs budget was increased to $360 million.

Mr. Painter asked for clarification on the cut Vice-Chair Gara wanted to see in the model.

Vice-Chair Gara stated the Senate's education cut of $70 million for K-12 and university cut of roughly $21 million were restored. He repeated including a $360 million capital budget. He did not believe the plan would work.

Mr. Painter answered that he had been presenting the level tax credit payments. He mentioned returning the model to the statutory payment.

3:04:47 PM
AT EASE

3:11:27 PM
RECONVENED

CARL DAVIS, INSTITUTE ON TAXATION AND ECONOMIC POLICY (ITEP), WASHINGTON D.C. (via teleconference), provided a PowerPoint presentation titled "Comparing the Distributional Impact of Revenue Options in Alaska" dated

May 1, 2017 (copy on file). He referred to a presentation overview on slide 1, which pertained to a study ITEP had released the prior week using its microsimulation tax model to evaluate the distributional consequences of different revenue options for Alaska:

- The ITEP Microsimulation Model
- Five Revenue Options in Alaska
  - Personal Income Tax
  - Permanent Fund Dividend (PFD) reduction
  - Sales Tax
  - Payroll Tax
  - Payroll Tax + Investment Income Tax
- Comparisons Across Options
- Additional Tax Incidence Research
- Questions?

Mr. Davis explained that the options considered had been compared across families. He moved to slide 2 and provided an introduction to ITEP:

> The Institute on Taxation and Economic Policy (ITEP) is a nonprofit, non-partisan research organization that works on federal, state, and local tax policy issues. ITEP's mission is to ensure that elected officials, the media, and the general public have access to accurate, timely, and straightforward information that allows them to understand the effects of current and proposed tax policies.

Mr. Davis turned to slide 3 titled "ITEP Model Background." He detailed that the model was the company's primary tool it used to do its work, which a team of economists kept up to date. He provided detail from the slide:

- Built in 1994-1996, but still evolving in 2017
- Designed to:
  - Predict the distributional effect of proposed tax changes on taxpayers at different income levels
  - Predict the revenue gain (loss) from proposed tax changes
  - Estimate the impact of current state and local taxes in all 50 states
  - Measure the interaction between state and federal tax changes

- Employs the same technology used by the US Treasury, Congressional Joint Committee on Taxation, Congressional Budget Office, and some state departments of revenue (e.g. TX, MN, ME)
- Consists of four basic modules: personal income tax, property tax, consumption tax, and business tax

Mr. Davis elaborated on slide 3. He explained that many state departments had similar models. For example, Minnesota had a robust model that was used frequently. He noted that Colorado had recently begun using similar models as well. He relayed that the model allowed ITEP to estimate the impact of many types of taxes [listed on slide]. He noted that the company did not typically consider severance or oil taxes and royalties.

3:15:58 PM

Mr. Davis turned to slide 4 titled "ITEP Model Data Sources." The model's foundation was tax return data reported by the IRS [Internal Revenue Service], which was helpful for analytical purposes because there was data on capital gains, dividends, interest, salaries, wages, business income, farming, unemployment, social security, and other. He detailed that IRS data was supplemented with census data, the Joint Committee on Tax, the Congressional Budget Office, state specific data sources, and other. Compiling the information created a profile of the tax paying population in order to have records representing low income households, middle income households, and high income households. He explained it was called a microsimulation model because it started from the ground up - it began with the individual tax payer and a tax calculation was applied. The model could be run based on taxpayers in a specific state or nationwide. The calculations were summed up into tables he would show later in the presentation.

3:18:12 PM

Mr. Davis advanced to slide 5 titled "Research Design":

- Five revenue options, each raising $500 Million per year
    - Revenue amount ($500m) chosen only to allow for comparisons.

    - Options are not mutually exclusive. In the real world, the discussion centers around striking the right balance, not picking the “best” single option.
- Distributional impact on Alaska residents, grouped by each tax unit’s income level. For example:
    - Lowest 20 percent = Total income below $25,000
    - Middle 20 percent = Total income between $40,000 and $73,000
    - Fourth 20 percent = Total income between $73,000 and $115,000
    - Top 5 percent = Total income above $228,000
        - Average income for this group = $502,000 per year
- Non-resident impact is considered
    - More revenue from non-residents means lower payments required from Alaskans.

Mr. Davis expounded on slide 5. He underscored that the $500 million figure had only been used as an example. He noted that just because the model looked at options one at a time, it was not an effort to encourage anyone to pick a favorite and run with it. He was aware the conversation was about striking the appropriate balance and about putting together a fiscal package. He explained that his references to low income families included the bottom quintile in Alaska [indicated on slide 5].

Mr. Davis moved to slide 6 that showed a chart pertaining to personal income tax similar to HB 115 (rates reduced by 27.75 percent to conform to $500 million target). He specified that because the example aimed for a $500 million comparison point, it was necessary to scale back the tax rates in order to hit the target. The example was progressive throughout the income distribution. Many low income families would be exempt from an income tax (ones that were not would pay relatively small amounts) and in the middle, things like the zero percent bracket and the $4,000 personal exemption benefitted middle income families significantly - some middle income families would pay under 1 percent of their income. The income tax would top out at about 2.8 percent for high income earners. The statutory rate ITEP modeled for the tax was just over 5 percent at the top, but in practice very few families would pay anything close to that amount due to the graduated rate structure and benefit of the lower rates on early dollars and income.

3:22:00 PM

Mr. Davis moved to a chart on slide 7 related to a reduction of Permanent Fund Dividends by $784 per person, which would raise the same amount - the action should raise about $500 million in savings overall. The slide showed a starkly different distributional effect, with a very high impact at the lowest income level. The $784 represented a larger fraction of a low income household's budget compared to high income earning households. He pointed out that the bars on the chart were quite a bit higher than those in the chart related to personal income taxes. He detailed that there was less income at the bottom overall, therefore the 7.2 percent impact at the bottom would not raise nearly the same amount that 7.2 percent of income at the top would raise.

Mr. Davis advanced to a chart on slide 8 related to a sales tax of 3 percent on most goods and services (exempt were groceries, health care, shelter, child care). He discussed that even though the current debate was largely focused on income taxes, PFDs, gasoline tax, ITEP wanted to look at some other broad-based taxes as well. He discussed that sales taxes were generally regressive for a variety of reasons, even when exemptions for basic necessities were offered. He specified it was partly because every state with a sales tax ended up taxing a significant share of business purchases - it was clear that sales taxes paid by businesses ultimately were passed to consumers. He furthered that even when a state tried to exempt basic necessities such as groceries and shelter, if items used by a grocery store were taxed, the costs were passed on to consumers.

Mr. Davis moved to slide 9 and addressed a payroll tax of 2.43 percent on salaries, wages, and self-employment income (the 2.43 percent was estimated by ITEP to generate $500 million per year). He detailed the tax was relatively flat across the income distribution because it was a flat rate. The tax trailed off at the top because high income families tended to earn a significant share of their income from investments, which would be exempt under a payroll tax.

3:25:09 PM

Mr. Davis referred to an income option of a payroll tax of 2.1 percent on salaries, wages, and self-employment paired with a [6 percent] tax on investment income on slide 10. The idea was to remedy how a standalone payroll tax would exempt investment income. He concluded it would result in a more proportional distribution throughout. He moved to slide 11 and addressed the impact the bottom 20 percent of Alaskans would experience under different revenue options. He pointed to the 7.2 percent impact from a PFD cut and the 0.1 percent impact from a personal income tax (many families would be entirely exempt). He added that payroll and sales taxes fell in between the two [percentage wise].

Mr. Davis turned to slide 11 and spoke to the impact on middle 20 percent of Alaskans. He pointed to the 2.5 percent impact from a PFD cut and the 0.7 percent impact from a personal income tax - he noted the difference was about threefold and was fairly substantial.

3:26:54 PM

Mr. Davis turned to slide 12 and addressed impacts on upper-middle income Alaskans. No matter the option, the impact tended to be fairly consistent. An income tax would amount to about 1.2 percent of income for an upper middle income tax payer and a PFD cut would be somewhat larger at 1.6 percent of income. He noted it had to be considered on a case-by-case basis and it would depend heavily on family size. He detailed that for an upper middle income Alaskan with a family of four or five a PFD cut would be much more significant than a personal income tax. Also, a single taxpayer may actually pay less under a personal income tax than through a PFD reduction.

Mr. Davis to slide 13 and spoke to the impact on the top 5 percent of Alaskans (income over $228,000). He detailed that the group tended to have larger incomes and would pay higher income tax. He moved to slide 14 that included other resources he encouraged committee members to review:

- Gunnar Knapp, Matthew Berman, and Mouhcine Guettabi (ISER)
  - “Short-Run Economic Impacts of Alaska Fiscal Options” (March 2016)
- Berman, Matthew and Random Reamey (ISER)
  - “Effect of Alaska Fiscal Options on Children and Families” (February 2017)

- Minnesota Department of Revenue
  - "2017 Tax Incidence Study" (March 2017)
- Texas Comptroller of Public Accounts
  - "Tax Exemptions & Tax Incidence" (February 2017)
- Colorado Department of Revenue
  - "Tax Profile & Expenditure Report, 2016" (January 2017)

Mr. Davis remarked that he did not believe any of the findings shown in the presentation should be tremendously controversial. He moved to slide 15 and spoke about research economists at ISER had done over the past year or so. An ISER chart indicated that economists had reached very similar conclusions in regard to income taxes, sales taxes, and PFD reductions. He noted that the PFD was a unique feature in Alaska; therefore there was no comparative data from other states. He continued that many state governments had studies on existing income and sales taxes. For example, Minnesota had a very detailed tax report that showed how the impacts varied. He mentioned other states such as Texas and Colorado. He pointed to the gold bar on the chart that indicated a reduction in the PFD - it showed a representing a large fraction of income for low income families. The red lines [flat rate income tax and progressive income tax] were the lowest impact for low income families. The chart reflected that income taxes would generally be lower per dollar (ISER's study used a $100 million annual impact instead of the $500 million impact). He elaborated that the income tax lines in red were below the PFD line in gold; the income tax was generally cheaper for middle income and some upper income families (the impact depended on family size).

3:30:54 PM

Mr. Davis relayed the full study was located at www.itep.org.

Vice-Chair Gara spoke to payroll taxes. He asked if a partnership distribution at the end of a year would be captured by a payroll tax.

Mr. Davis answered that a distribution should be captured. He detailed that the bulk of payroll tax revenue would come from wages and salaries, but it was necessary to include some amount of self-employment and business income under the tax because if there were large discrepancies between

the tax treatment of wages and salaries versus business income, it created opportunities for tax avoidance. The scenario had occurred in the past, especially most recently in states like Kansas.

Vice-Chair Gara asked whether it would be possible for higher income business owners to get around a payroll tax by paying bonuses or shares to a shareholder.

Mr. Davis answered there had to be some policing of the distinction. He noted the topic was not his area of expertise. The line between different categories of income could often be somewhat fuzzy.

3:33:18 PM

Representative Guttenberg spoke to distribution impacts on revenue options. He asked about other locations that had a tax increase or decrease and noted there was typically an existing sales tax or income tax. Alaska did not have either. He asked how that changed the dynamics of the situation facing Alaska.

Mr. Davis replied that it created a somewhat larger margin of uncertainty in forecasting the revenue impact of different options. He explained that when states with existing taxes were seeking to do revenue projections they began with what they had already collected under the specific tax; it allowed the state's to determine how things had changed since the collections had come in. He relayed that revenue forecasting tended to improve over time. Revenue estimates were likely to be the least accurate at the point when a new tax was established. Over time many types of taxes - including sales and income taxes - tended to become more complicated. It was possible to think through a relatively simple tax carefully when it was being established. For example, many sales taxes were set up close to 100 years ago when the economy looked very different - many personal services were not taxed, but the service sector had grown enormously over the past few decades. He cited streaming video, Airbnb.com, and other items that were relatively new. He referred to historical mistakes that could limit the effectiveness of existing taxes.

3:36:28 PM

Representative Guttenberg spoke to the study of sales tax. He asked if there had been a study on how the implementation of a sales tax impacted the amount of internet sales the local economy.

Mr. Davis asked for clarification. He asked if Representative Guttenberg was referring to the inability for states to tax sales coming into the state from outside the state.

Representative Guttenberg replied that he was interested in a general basis answer.

Mr. Davis spoke to the complexity of a sales tax - it had been extremely slow going to see the reality of state sales tax laws catch up with changes in the economy. He cited e-commerce as an example. In the last two months the nation's largest electronic retailer - Amazon.com - had begun collecting sales tax in every state, but only on direct sales. There were still a large number of sales Amazon facilitated on behalf of third-party smaller sellers where sales tax was not being collected. There were large gaps in state sales tax enforcement pertaining to e-retail. There were a small number of states that taxed personal services. Many states arguably overtaxed the purchases by businesses. He concluded there was currently no ideal sales tax at the state level - they all had fairly fundamental structural problems.

3:38:50 PM

Representative Ortiz asked if a receipts tax was most similar to a sales tax or other. He asked if it would have more or less impact than a sales tax across the board.

Mr. Davis replied that the concept was currently under discussion in states such as Louisiana and Oregon. Receipts taxes were often viewed as business taxes and were sometimes viewed as being interchangeable with corporate income tax. He continued that literature showed a tax on corporate profits - due to the cost structure - would tend to be passed through to corporation shareholders. Whereas, a gross receipts tax was much more likely to be passed through to consumers due to the way it impacted business cost structures. In general, receipts taxes tended to look much like sales taxes in their overall distribution - they often generated large amounts of revenue at relatively low

rates because they tended to be prone to tax pyramiding. He explained that the same purchase was taxed many times throughout the production stream - even though it may have been taxed at a low rate each time, it could ultimately amount to fairly high effective tax rates. He detailed it lead to fairness problems across businesses because businesses that tended to be vertically integrated were able to avoid paying the gross receipts tax, whereas businesses relying on sales and purchases found themselves subject to the tax.

3:41:14 PM

Representative Pruitt asked if ITEP did any economic modeling.

Mr. Davis responded that the data contained static distributional estimates. He detailed that ITEP did not do dynamic economic modeling. The literature on the impact of state level taxes on state economies tended to show fairly small effects. He continued that some studies were not even able to determine the direction of the effect. For example, if an increase to a gas tax lead to significantly more revenue available for construction and the creation of construction jobs. Teasing out the economic effect of state level tax changes was very challenging. They had found that the study was rarely done at the state level because it tended to be more speculative and a more long-term phenomenon. He furthered that when states were trying to balance their budgets on a one or two-year cycle, the effects would generally not show up in that short amount of time.

Representative Pruitt noted that the ISER presentation had included the consideration of nonresidents. He believed that in the past ISER had told the committee about specific methods of taxation that would bring more from nonresidents than others. He wondered if ITEP had identified a category that would have a larger impact from outside of the state.

Mr. Davis answered that the modeling did include nonresident impacts, but the information did not show up visibly in the tables. He noted that in the presentation the sales tax bars were quite a bit lower because the sales taxes raised a much more significant amount of revenue from nonresidents than the PFD reduction would. He did not have the data on hand, but he believed in the ITEP model the

sales tax was one of the more effective measures at generating revenue from outside the state. The income tax would generate a smaller share directly from nonresident workers, but it would tend to generate the largest tax cuts for wealthier Alaskans in the form of a write-off for state and local taxes at the federal level. The PFD was shown as the least effective option in terms of nonresident revenue generation.

3:44:57 PM

Representative Wilson asked why the top 20 percent of earners had been split into three categories.

Mr. Davis answered that the method was used because a very large fraction of income was held by the top 20 percent [of earners]; therefore, it was valuable to do a more fine grained analysis. He elaborated that the top 20 percent in Alaska included everyone from a couple with two incomes of $60,000 to a family earning up to $10 million per year. He explained that the two families were clearly in very different financial circumstances and ITEP believed it was valuable to break out the groups. He referred to the Appendix A on page 15 of the study [titled "Comparing the Distributional Impact of Revenue Options in Alaska" dated April 2017 (copy on file)] that included a column with the information.

Representative Wilson asked for clarification on the document. Mr. Davis replied that the information was in Appendix A of the ITEP study.

Co-Chair Seaton noted the document was in members' backup material.

Representative Wilson wondered how family size was factored in across the income board.

Mr. Davis responded that he did not believe the ITEP distributional charts as the only tool that should be used in evaluating the distributional impact of the options. He believed there was also significant value in supplementing the wider analyses with more fine grain representative taxpayer analysis. He believed Co-Chair Seaton's staff may have prepared some of the information looking at specific taxpayers. He explained it allowed the creation of a hypothetical of a single mother earning $30,000 to

determine what she would owe under the income tax and how the PFD cut would impact her. He referenced an ISER study conducted by Matthew Berman and Random Reamey in February [2017] titled "The Effect of Alaska State Fiscal Options on Children and Families." The study broke the information down by family type. He believed the research was interesting and helpful.

Representative Wilson discussed that some municipalities in Alaska charged property taxes, some had sales taxes or sales taxes only, and other areas had neither. She wondered how to take the ITEP information and apply it across the state that contained areas with different tax levels.

3:49:50 PM

Mr. Davis replied that it was a very important question, especially in Alaska where the variation could be wide. The ITEP information included a statewide average of how a 3 percent sales tax would impact families at different levels, but if the clothing or car repairs or any other taxable service or good was more expensive, the sales tax would be more expensive as well. He relayed that unfortunately, ITEP did not have local-level data in its model; it did not have a unique value-add in the area.

Representative Wilson appreciated the breakdown, but she surmised that in reality, the data would not really show the true effects of adding any of the taxes into Alaska due to the vastly different communities and taxes throughout the state.

Mr. Davis answered that of the options the organization had examined, the sales tax had varied the most by locality due to the difference in prices. Under the income tax, every Alaskan would be subject to the same income tax pools regardless of their location. It may be that certain localities had a higher concentration of low income families and were finding that the bottom 80 percent of the income distribution would pay less under an income tax than a PFD reduction. He added that certain low income areas in Alaska may actually be higher than that. He explained that if there were very few high income taxpayers in a given locality, there may be very few people that would be more impacted by an income tax than they would be by a PFD reduction. The overall chart used a statewide average, but

by locality it would depend on the price of goods and services and on the levels of income.

Co-Chair Seaton thanked Mr. Davis for his presentation. He pointed out that the Juneau Empire had recently published the average salary of every district in the state per capita. He noted that the average salary in a given community was not available or it had not been made available.

3:53:31 PM

Representative Wilson stated it was possible to go by income in each district; however, it was necessary to look at other existing tax obligations in each community and at other things like the cost of goods and other.

#sb6
CS FOR SENATE BILL NO. 6(JUD)

> "An Act relating to the regulation and production of industrial hemp; relating to industrial hemp pilot programs; providing that industrial hemp is not included in the definition of 'marijuana'; and clarifying that adding industrial hemp to food does not create an adulterated food product."

3:55:00 PM

SENATOR SHELLEY HUGHES, SPONSOR, relayed that the preceding year, former Senator Johnny Ellis had introduced a bill about hemp. She recalled receiving a phone call from a farmer who had been very interested in the bill. The bill had been introduced at the tail end of the previous session; therefore, she had committed to introducing a bill in the current session. She noted that when she had initially introduced the bill it had been quite short - it had been simply to remove hemp from the marijuana definition section in statute and place it under the Division of Agriculture defined as an agricultural product. The current bill was slightly different in order to be in compliance with federal law. She was still confident that the Division of Agriculture and individuals interested in farming hemp were comfortable with the bill.

Senator Hughes relayed that she had worked on a number of policies to help bring the state into the 21st century in

terms of technology and other. She remarked that the state had basically gone silent on the topic for a number of years and it was now going back to catch up. She continued that in the 1600s, hemp had been a stable crop in the United States. She elaborated that the sails of European ships traveling to America had been made of hemp. Additionally, some early drafts of the Declaration of Independence had been drafted on hemp paper and covered wagon canvas had been made of hemp. In 1937 the product had been made illegal nationwide; therefore there had been little usage until the product had been redefined at the federal level by the 2014 Farm Bill [the Agricultural Act of 2014]. She elaborated that 30 states had passed legislation - there were 17 states that were conducting a pilot act. There were tens of thousands of products that could be made from hemp.

Senator Hughes continued that a meat plant in Palmer was currently being privatized. She elaborated that hemp was a nutritional forage for livestock - in order to make the meat plant work, the farmers needed to grow their livestock herds. Hemp grew easily in Alaska, it was nutritious, and was good for the soils. She had heard from others throughout the state interested in using the product. She referred to a person interested in using hemp for building insulation and another person using hemp to make soaps and body products. She highlighted that the sponsor statement in members' packets was printed on hemp paper.

Senator Hughes explained that SB 6 defined hemp as cannabis with a THC content of 0.3 percent. She shared that 1 percent was the threshold of intoxication. When growers were trying to produce marijuana they aimed for 20 to 30 percent THC. The bill would also define hemp as an agricultural product and would remove it from controlled substances statutes. She furthered that the bill would create a pilot program, which was part of the federal requirement, and would allow registrants to participate. The Division of Agriculture would have the regulatory authority and would create a fee structure to have the program be self-sustaining. The bill also removed CBD oils. She noted her staff and others were available to speak to the bill. She remarked that her office had been working with an attorney at Hemp Law LLC who had worked across states and helped her office understand legal requirements in terms of compliance with federal law. She thanked the committee for its time and noted the next day was Alaska

Agriculture Day. She believed hemp was an economic opportunity the state should promote.

4:02:11 PM

Representative Guttenberg was supportive of the bill, but he had concern with the conflict between hemp and pot in outdoor growing fields. He mentioned pollen as an issue. He thought there needed to be an understanding about the two crops. He wondered if the Division of Agriculture or the bill sponsor had been approached about the issue.

Senator Hughes deferred to her staff for detail.

BUDDY WHITT, STAFF, SENATOR SHELLEY HUGHES, relayed that the sponsor's office had been approached with the concern. He directed attention to page 3, lines 4 through 7 of the bill and explained that the provision had been added to address the concern - it fell under the Division of Agriculture's responsibility to adopt regulations related to industrial hemp. The provision stated the division was required to establish isolation distances for the production of industrial hemp. The reason a specific distance had not been identified was to give the division the leniency to decide what the distance should be. The sponsor's office had determined it would be better for the division to establish the distance through regulation rather than the legislature including a distance in statute that may not be workable or ideal. He deferred to the department for further detail.

4:04:48 PM

Representative Guttenberg stated it was his impression there were a limited number of outdoor facilities and farmers - most were located in controlled greenhouses. He shared that he had been asked to visit a garden that had a strain growing outside. He surmised the issue may not apply to greenhouses or inside commercial growers.

ROB CARTER, AGRONOMIST, PLANT MATERIALS CENTER, DIVISION OF AGRICULTURE, DEPARTMENT OF NATURAL RESOURCES (via teleconference), referred to isolation distances and relayed they were a minimum separation required between two or more varieties of the same species. The current discussion pertained to cannabis sativa industrial hemp and cannabis sativa recreational marijuana. The purpose of the

isolation distance was to keep seeds pure in the production process. Additionally, in the case of recreational marijuana, the purpose was to keep female crops from being seed-free in order to have a viable product to sell. The isolation distances were set for a multitude of other crops (e.g. alfalfa, barley, oats, wheat, and other) that met the federal certified seed standards; the distances were set in accordance with documented global scientific research. He spoke specifically to the bill and relayed that the Division of Agriculture would conduct its due diligence to ensure it had explored other opportunity from Colorado, Manitoba, Saskatchewan, Canada, and the European Union (that had been growing industrial hemp for a significant amount of time), to make sure the isolation distances were set in order to prevent a hemp crop from impeding the production of a recreational crop.

4:07:37 PM

Representative Guttenberg understood that Colorado was considering 5 or 10 miles and he recognized the federal government had probably done no research on the specific topic. He asked about the parameters set by other jurisdictions.

Mr. Carter answered that Colorado had started looking at the aforementioned ideals [5 to 10 miles between two similar species]. The Division of Agriculture looked at the issue from the purity standards of setting seed tolerance isolation distances. Colorado had established its recommendation for its isolation distances required for cannabis production. He detailed that it depended on the type, which was unique to this crop. There were dioecious and monoecious types and hybrids that were all female - each one had a different isolation distance. The recommended isolation distance in Colorado for the highest quality and most pure was called the foundation or registered seed, was 16,150 feet. He furthered that distances were set regionally based on wind patterns because cannabis sativa is highly wind pollinated and also pollinated by insect. Isolation distances in Canada were anywhere between 1 meter and 5,000 meters. He believed there would need to be regional isolation distances for Alaska and he believed there would need to be strong communication with registered and recognized commercial growers through the marijuana control board in order for the division to identify where the outdoor recreational

cannabis was being produced in order to give everyone the right to produce crops.

4:10:05 PM

Representative Grenn referred to fiscal note OMB Component 2204 that mentioned the division anticipated the registration of possibly 25 farms in the first year. He asked if regulations would prohibit someone from growing recreational marijuana and industrial hemp.

Mr. Whitt answered there was no provision in the bill that would preclude someone from growing both; however, it would be highly risky for a person to do both in terms of ensuring the viability of the commercial marijuana.

Representative Kawasaki asked when states started to legalize the manufacturing and growing of hemp.

Senator Hughes answered that the law had been changed by the federal Farm Bill in 2014. She deferred to her staff for further detail.

Mr. Whitt replied there were a few of states that started their process before federal law had allowed it. He could not speak about each state, but he relayed that when the cart was put before the horse, states were having to make some changes to fit federal guidelines. He referenced the 2014 Farm Bill and a 2016 omnibus bill, which had allowed transportation of industrial hemp across state lines. There was also the USDA Statement of Principles [on Industrial Hemp], which had been published in 2016 and specified how the USDA would treat the product. There were a number of states that had put the effort in prior to the release of federal guidelines. He offered to follow up with more detail on the timeline.

Representative Kawasaki relayed there had been six states prior to 2006 that had passed laws including California. The Industrial Hemp Act had passed in 2009. He asked why it had taken Alaska so long to get to the point it was considering industrial hemp farming. He believed Alaska would be the 33rd or 34th state to take on the activity.

Senator Hughes responded that although some states began early, there had been some colonies that started early - she relayed that George Washington, Thomas Jefferson, and

John Adams had all grown hemp. She relayed that she would probably have worked on the issue earlier if it had been brought to her attention earlier.

4:14:27 PM

Representative Kawasaki recalled that as a former councilperson, the council [Fairbanks City Council] had introduced a resolution supporting industrial hemp around 2006. He supported the bill and thought it would be a boon for the agricultural and scientific community in Alaska.

Representative Thompson relayed that he had tried to get something similar to the bill going in 2011. He had spoken with the University of Alaska Fairbanks Agriculture Department. He provided further detail about the past effort to do an experimental grow with the community's 24-hours of sunlight to see how the product would do in Northern Alaska. The goal had also been to check the oil and fiber content. The effort had ceased because it had not been possible to obtain the seeds at that time. He was glad to see the bill and believed hemp was a possible cash crop that could be an economic boon for Alaska.

CSSB 6(JUD) was HEARD and HELD in committee for further consideration.

Co-Chair Foster addressed the agenda for the following day.

#
ADJOURNMENT

4:16:26 PM

The meeting was adjourned at 4:16 p.m.