

HOUSE FINANCE COMMITTEE  
May 5, 2017  
1:34 p.m.

[1:34:03 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 David Guttenberg  
Representative Scott Kawasaki  
Representative Dan Ortiz  
Representative Louise Stutes (alternate)  
Representative Lance Pruitt  
Representative Cathy Tilton  
Representative Tammie Wilson  
Representative Mark Neuman (alternate)

MEMBERS ABSENT

Representative Jason Grenn  
Representative Steve Thompson

ALSO PRESENT

Jonathan King, Vice President, Northern Economics; Caroline Schultz, Economic Policy Analyst, Office of the Governor; Representative Bryce Edgmon; Representative Louise Stutes.

SUMMARY

PRESENTATIONS: THE ECONOMY and FISCAL POLICY OVERVIEW  
NORTHERN ECONOMICS  
OFFICE OF THE GOVERNOR

Co-Chair Seaton reviewed the meeting agenda. [Representative Edgmon was present at the committee table at Representative Grenn's seat].

^PRESENTATIONS: THE ECONOMY and FISCAL POLICY OVERVIEW

1:35:50 PM

JONATHAN KING, VICE PRESIDENT, NORTHERN ECONOMICS, provided a PowerPoint presentation titled "An Employment Projection Comparison of Major Fiscal Plans" dated May 5, 2017 (copy on file). He began on slide 2 and provided an overview. He stated that his organization had been contacted by the Office of Management and Budget (OMB) to run their Regional Economic Modeling, Inc. (REMI) model again. OMB had presented the data for the analysis. He remarked that all parties were seeing the information for the first time. He went on to describe the current economic situation, and the effects of reduced spending by consumers. He stated that the duration of the current recession would depend largely on choices made by consumers.

1:39:10 PM

Mr. King moved to slide 3 and 4. He spoke to Dynamic Forecasting with the REMI model, which he described as comparable to the Institute of Social and Economic Research (ISER) Man in the Arctic Program (MAP). This model used year-to-year demographic and fiscal levels and was able to project over a longer time period. Slide 4 showed a table regarding the Joint Base Elmendorf-Richardson (JBER) force reduction example. The graph indicated losses in health and social services, retail, and trade, but fewer in professional services.

1:40:54 PM

Mr. King turned to slide 5 and addressed comparisons related to a progressive income tax and no broad-based tax:

Progressive Income Tax

- \$5.15B Unrestricted General Fund (FY 2018);
- Dividend of \$1,250;
- Progressive income tax starting in January 1, 2019.

No Broad-based Tax

- \$4.83B Unrestricted General Fund (FY 2018);
- Dividend of \$1,000;
- \$185M in cuts in FY 2019; K-12 is 5%, 4%, 3% cuts.

- No broad-based taxes.

Mr. King elaborated that the organization was not advocating for any specific fiscal plan. He advanced to expected economic and demographic trends resulting from a change in fiscal policy at the state level holding all other things constant. The analysis did not say anything about whether either plan addressed an optimal mix of services, whether government was working efficiently, or the value of lost or gained services that were outside the scope of the immediate analysis. He stated that bigger was not always better and efficiency was not good for everyone. He stated that there would be the loss of one to two million trucking jobs in the future due to replacements with unmanned vehicles. The economy would be more efficient but he questioned whether it would be better off. The analysis did contain certain assumptions, such as the U.S. Energy Information Administration (USEIA) oil price forecast, as well as nominal dollar projections. There were no major positive or negative movers outside the change in fiscal policy, however it did presume signature of the recent oil royalty legislation that was awaiting transmission to the governor's office. With regards to the Permanent Fund Dividend (PFD), in general about 60 percent was spent and 40 percent was saved, based on statewide surveying.

[1:45:37 PM](#)

Mr. King continued to address slide 7. Part of the immediate spending was used to pay off credit card bills. Money is spent prior to the arrival of the PFD payment. All dividend checks since 2000 put together and adjusted for inflation came to within \$50 of one another, for an average payment of about \$1,700. Over the long-term, it had been a stable source of revenue. The employment peak was in 2015. All losses in the analysis were compared to 2016 employment. Around 8,000 to 9,000 jobs had been lost in the previous year. He underlined that [by nature] all forecasts were wrong, it just varied by how much.

[1:47:38 PM](#)

Mr. King moved to a table on slide 8 related to 2017 through 2026 employment forecasts. The red horizontal line represented the 2016 employment level. The blue line represented the progressive tax plan, and the yellow dashed

line the "no tax" plan. Both the blue and yellow lines in 2015 showed a rise above that level, then crossed and diverged in 2017, the difference between the PFD amounts that would be paid in October 2017 and the cuts that would occur in the "no tax" plan, or the cuts that occur on the first half of FY 18. The "with tax" plan showed a slight recovery, then a double-dip with the income tax, and no return to 2016 employment levels until 2026.

[1:49:54 PM](#)

Representative Guttenberg looked at the chart on slide 8 and asked about the difference between the parallel lines from 2020 going forward.

Mr. King replied that the maximum gap was about 4,500 jobs. He continued addressing slide 8. Under the [no] broad-based tax plan, there were cuts in the current year and the following year, ending the period of 2026 just slightly under the "with tax" plan, or about 1,500 to 2,000 jobs, which he called within model error. He said a jobs loss was not definitive, but the model pointed that way. He moved to slide 9 and noted the picture was tongue in cheek:

#### Mitigating Factors for the w/Tax Plan

- 15-20% of total tax hit rebated to federal tax itemizers (~\$100M-\$140M)
- With Tax Plan includes a higher dividend payment (~175M)
- Not all of the tax increase would have gone into the Alaska private sector. There will be reductions from savings & outside expenditures.
- Net effect is somewhere <\$400M.

#### Compounding Factor of the W/O Tax Plan

- Cuts would largely take the form of reduced employment, which has a relatively high in-state economic multiplier.

Mr. King spoke to a question about how a \$700 million tax hit could not be worse than a \$400 million cut. Local and state tax was deductible for federal tax itemizers. The Congressional Budget Office estimated an average of about 17.4 percent of tax was returned back to the states, or the equivalent of \$100 million to \$140 million, primarily to high income taxpayers. The funds would flow back into the economy in the form of reduced federal taxes. The federal

government subsidized areas with higher tax, however, not all of the tax increase would go into the Alaska private sector. If that money is used to vacation or to order things from out of state, the money did not necessarily hit the Alaska economy, so the net effect of the tax hit was estimated at less than \$400 million. Another compounding factor of "with[out] tax" plan, as cuts largely took the form of reduced state employment, it is known the state had a relatively high economic multiplier. While many would have expected the "with tax" plan would have a larger effect on the economy, the recession stopped one year sooner under the "with tax" plan, and does not go quite as deep as the "without tax" plan, even though the differences were relatively small.

[1:55:25 PM](#)

Mr. King moved to slide 10. Reducing the dividend amount to \$1,000 would also increase the relative increase of the cost of the plan unless there were offsetting reductions in the amount of cuts in state spending or offsetting reductions in the tax burden. If Alaskans were spending more of the PFD in-state than was estimated, then more of the income that the state was taking under the "without tax" plan would go to PFDs, making the relative cost of that plan higher.

#### Critical Takeaways

- Eliminating the federal deduction of local/state taxes would increase the relative economic cost of the Progressive Tax Plan.
- Reducing the dividend without a corresponding reduction in taxes increases the relative economic cost of the Progressive Tax Plan.
- If Alaskans spend more of their PFDs in-state than we estimate, then the relative cost of the Without Tax Plan is higher.

[1:56:45 PM](#)

Mr. King turned to slide 11 and relayed they expected the population to be smaller under the progressive, broad-based tax plan. Under the "with tax" plan, there were fewer people and more jobs. Under the "without tax" plan, there were more people but fewer jobs. There was higher unemployment under a broad-based tax. He addressed why there would be fewer people under the progressive tax. He

stated that wages tended to be higher in Alaska and there was no income tax. The forecast did expect a reduction in population in the event of an income tax. There were some people for whom the equation no longer falls on the Alaska side. They were making a decision that it was not worth staying in Alaska.

[1:58:36 PM](#)

Mr. King addressed slide 12 titled "Summary Results: 2017-2026." The table highlighted an additional loss of 7,000 jobs, with employment bottomed out in 2017 under the progressive tax. He recalled that Representative Kawasaki had asked how to stop the recession in its tracks - it could not be stopped, but it could be stopped after the coming year. Under the progressive tax, if jobs were lost it would not be to the same degree as was currently occurring. Under the no broad-based tax plan, it was expected there would be 11,500 to 12,000 jobs lost from 2016, with employment expected to bottom out in 2018 and 2019. Looking forward, by 2026 employment was expected to be back at the 2016 peak. He spoke to an increase in 2026 to around 2016 levels, but maybe not above that. There was a bit of advantage with the no broad-based tax plan.

[2:01:59 PM](#)

Mr. King spoke to peak job losses by location on slide 13. The REMI model operated on the borough level. He noted operation of the model at a community level too expensive and difficult. Under the progressive tax plan, the Bristol Bay Borough was impacted far less, as it was driven largely by fisheries. Looking at the percentages, the boroughs of Fairbanks North Star and Juneau saw far higher losses, particularly under the no broad-based tax scenario. It was due to the individual structure of the economy. Juneau's economy was driven not only by tourism and fishing, but also by state government. It was a shopping hub for all of Southeast. Looking at the no broad-based tax column, the losses were higher in all of the regions, but not in the same amount. The Mat-Su Borough was 2.1 times higher because it was a consumer-driven economy. Major employers were retailers and health and social services. The distribution of the losses generally followed population. He then moved to slide 14. It showed the relative power of the PFD and the dependence of those locations on state and K-12 jobs. One thing that did emerge from the analysis but

was not on the table was that coastal communities depending on the fishing industry showed fewer multipliers as they focused on the fishing industry and were less dependent on the PFD.

[2:06:13 PM](#)

Mr. King turned to slide 15 and addressed K-12 related to peak job losses in the no broad-based tax and the progressive tax plans. The slide presented the relative effects of the specific cuts associated with each plan. In Anchorage under the no broad-based tax, there was an expectation to lose 700 to 750 jobs in K-12 jobs, whereas under the progressive tax plan, the forecast was to lose 150 to 200 jobs. These were not all education jobs, but also related private sector jobs. For every 10 public sector jobs lost, 5 to 7 private sector jobs would be lost. He spoke to key takeaways on slide 16. Both approaches were better than what was being considered in January and February 2017. He detailed that at the time one approach considered cutting \$1 billion in unrestricted general funds and another approach included cuts and an income tax. He specified that the operation and mechanism of the income tax could not be implemented by the end of 2017. He referred to testimony by Dr. Townsend and Dr. Guettabi [Ralph Townsend, Director of ISER and Mouhcine Guettabi, Assistant Professor of Economics, ISER] in January and February that if spending stabilized in 2018, then the economy would stabilize and could better handle a tax later. This was essentially what would take place under the "with tax" plan. For the most part, spending was being stabilized. The losses from the first part of the recession should come to a close. That allowed the economy to stabilize and withstand revenue reductions later. In the "without tax" plan there were additional reductions in the current and following years. He detailed that the drain and subsequent shrinkage of the economy continued. The economy would actually begin to recover a bit faster than in the other scenario ["with tax" plan]; however, it was not given time to recover. Injury to the economy would continue, albeit at a much lower level than in the past because cuts would range from \$185 million to \$200 million instead of \$500 million. They were foreseeing a slowing of the recession. Job losses were skewed against government-dependent economies. Relative losses were skewed against PFD-dependent economies. A solution which involved reducing

the PFD would affect some areas of the state more than others under the no-tax plan.

2:11:11 PM

Representative Kawasaki asked about the key assumptions for the size of the budget.

Mr. King returned to slide 5 and explained the main assumption was the \$4.36 billion and \$4.1 billion and from there out to what the Office of Management and Budget (OMB) was able to provide. He recalled that the capital budget moved from \$90 million to \$180 million, departmental spending stable in the "with tax" version, largely growing with CPI [Consumer Price Index] and population.

Representative Kawasaki spoke to the assumptions being used in the modelling. He mentioned the numbers and assumptions used by the Legislative Finance Division. He remarked that the capital spending was incredibly small by comparison with past years.

Mr. King answered that the model he presented followed David Teal's [Legislative Finance Division director] models in terms of projections, but whether or not it was sufficient to meet needs was another issue. He stated the state may have to survive forever on a \$200 million capital budget. Under none of the scenarios were they returning to the days of \$500 million to \$600 million on capital budgets. It was not the same economy that had existed from 2009 to 2014. It was currently a very different world in Alaska than it had been five years earlier. He thought it would be a mistake to interpret not being in a recession with being able to meet the needs or wants of the state.

2:15:00 PM

Co-Chair Seaton shared that the committee had been looking at stress testing models for a \$360 million capital budget. He asked how a capital budget with an additional \$180 million would impact the economy.

Mr. King answered that capital expenditures were a very good way to stimulate the economy. He gave the example of shipping asphalt to the state. Asphalt was made in the state and was used in major projects. The multiplier was about 2.2. Regarding how many jobs per \$100,000 or per \$1

million in expenditures escaped him, but he thought 1 job for every \$100,000 equaled 10 per \$1 million, which meant 2,000 jobs in direct effect, about another 2,000 in indirect effect for a total of about 3,000 to 5,000 jobs in direct and indirect effect.

[2:17:44 PM](#)

Vice-Chair Gara referred to the testimony about 3,000 to 5,000 jobs associated with the capital budget and asked whether that was connected with the increment or the total.

Mr. King answered that it was the marginal gain associated with the incremental \$180 million to \$200 million.

Vice-Chair Gara stated that two years earlier he had not considered that additional budget cuts cost public and private sector job. He asked Mr. King to speak to this in layman's terms.

Mr. King provided a scenario as an explanation. He detailed that when \$1 was given to Fred Meyer or any retailer, that retailer didn't care where that came from. At the basic level, at this point of cutting, after 4 years, there were currently very few places to cut. Most of the jobs cut affected residents. When the job was cut, the income did not flow into the economy. He disputed claims that private money went around the economy seven times and public money went around three times. He stated that no source had a multiplier of more than two. When the state budget was cut, there would be less money flowing into the economy.

[2:21:42 PM](#)

Vice-Chair Gara spoke to the different components that affect jobs. He spoke to the Senate's proposal to cut about \$185 million. He asked about a related cut in jobs.

Mr. King answered that the \$200 million in cuts equated to 2,000 indirect jobs lost. For every 10 public jobs, 6 private jobs were lost; \$185 million in job reductions equaled 3,200 to 3,500 in job losses. The difference between peak losses was 4,500 jobs more in the "without tax" scenario. He elaborated that 3,200 of the total was over each of two years, a fair portion of which was associated with cuts, and the remainder was the smaller PFD.

[2:24:03 PM](#)

Vice-Chair Gara asked about increasing the dividend above the amount in the previous year. He wonder what boost to the economy might be created by raising the amount of the dividend payment. He asked why dollar-for-dollar an income tax cost fewer jobs than budget cuts.

Mr. King answered it was very difficult to talk to the dollar-for-dollar Permanent Fund reduction, as no one had ever studied how the dividend was spent. It was thought that about 40 percent went into savings and about 60 percent did get spent, but it was unclear where it was being spent. He continued that ISER would model \$1 of dividend as a regular \$1 of income, whereas Mr. King's organization tended to discount the effect of the PFD. He stated the effect of the income tax was mitigated for some people by the itemization rules of the federal income tax which allowed deductions of local and state taxes. It was necessary to make a choice between sales and income. For those in the 30 percent tax bracket, every additional dollar a state charged in tax, the federal government made a reduction of \$0.30. When the income tax was applied, it removed income from nearly everyone. However, that removal was spread across all taxpayers. This was counteracted with substitution in private spending, such as shorter vacations. On the other hand, cuts to jobs removed the entire income from the economy.

[2:29:06 PM](#)

Mr. King continued to answer the question. He gave the example of someone who lost 4 percent of their income and was adapting, and someone who lost 100 percent of their income and were trying to adapt, but in a recessionary economy the ability to find a new job was limited. The cuts created a greater effect on the economy than an income tax would. He highlighted that the REMI model and the ISER MAP model both bore this out. Two independent, different economist groups were in full agreement on this.

[2:30:38 PM](#)

Representative Wilson pointed to slide 13 regarding job losses and asked whether it included numbers for the North Star Borough with the new planes coming in to Eielson Air Force Base.

Mr. King answered that a full REMI model there would be custom adjustments. The current table did not include the effect of the F-35s arriving. The losses would be about the same. The borough was still below what it would be without cuts and with the F-35s, but the relative pain would not be as much. The F-35s were expected to arrive following the peak loss period.

Representative Wilson asked about the overall effect to the state with Alaskan contractors working on the project, and indicated that even those in Anchorage could benefit from the buildup to the arrival of the F-35s.

Mr. King responded that that was exactly what the model was designed to do. He relayed that he had been among those selected to work on just that modelling.

[2:33:59 PM](#)

Representative Wilson was stuck on the amount being taken out of the government. She wondered about the impact of making cuts to healthcare rather than to education.

Mr. King responded in the affirmative but added that it would depend on where the healthcare dollars were spent. He provided an example. He thought Representative Wilson was accurate to think it would be less than the effects on education. Reducing education was more destructive than reducing healthcare. He continued to explain that while both industries were labor-intensive, a lot of medical equipment and specialists came from out of state. In education, employment tended to come from within the communities. The net effects on the Northwest Arctic Borough were so much higher because a lot of those cuts were coming from education, therefore from those communities. He suggested that if the state were able to get a better handle on healthcare costs, it could have less effect on the economy and a greater effect on the budget.

[2:36:59 PM](#)

Representative Wilson brought up the point because in the Unalaska there was some tracking of people in the emergency room and follow-up to see whether people had gone to Urgent Care first. The same thing would hold true if the state privatized more airports. She summarized that there was a difference between cutting jobs completely and looking to

the private sector to see whether it could pick up some of the slack.

Mr. King relayed that in the case where there was a reduction in state expenditure when the private sector took up the slack. There was a difference. It went back to the question of right-sizing Alaska services. He thought doing so with infrastructure was difficult. He indicated that the Department of Transportation and Public Facilities had privatized the maintenance function of airports. He wondered whether privatizing airports was very different from outsourcing runway maintenance. He stated that a lot of time was needed to find those gems in which such a thing could be carried out.

Co-Chair Seaton recognized Representative Harriet Drummond in the audience. He also acknowledged that Representative Louise Stutes was filling in as an alternate for Representative Ortiz.

[2:39:40 PM](#)

Representative Neuman spoke about how the drop in oil prices had impacted the state, and asked why Alaska was still being seen as a harvest state by industry.

Mr. King responded that the geography of the state was its blessing and its curse. Whether it was fish being processed in-state, then sent to China, or mining activities which also got processed in state then sent out, the other locations had a comparative advantage in terms of energy and labor costs. Final processing also stood to be closer to market. Alaska was an incredibly mineral-rich state. However, the largest challenge was transportation, be it for fish or minerals. The reason that Red Dog Mine worked was because it was at tidewater. He relayed that if the mine were 500 miles away from the tide, the mine would not exist. He also spoke of the transportation of Bristol Bay fish. The cost of moving it from Bristol Bay to Anchorage was greater than from Anchorage to Seattle. The number one way to increase development was reducing the cost of that first mile of transport.

[2:44:38 PM](#)

Representative Neuman suggested that due to location, the state also needed to create a better business environment.

Health care costs were much higher. He discussed substantial regulation reform to make it more attractive to industry. He asked whether industry was vocal about the regulatory costs of doing business in the state.

Mr. King replied that Representative Neuman was correct in pointing out that every location had a basket of attributes. He stated that Alaska had to work that much harder due to location and high costs to get the industries to work in the state. Regulations were certainly an issue. Regulatory reform however ranked below work force and health care availability and cost as well as transport costs.

[2:48:42 PM](#)

Representative Edgmon had a sense of the Northern Economics client base. He asked what he thought the downturn was doing to affect their business prospects.

Mr. King answered that traditionally Northern Economics was on the front end of projects. It helped people make decisions before they implemented projects. If there was no forward planning from businesses, then organizations at the front end did not have work. It had been his experience over the past 18 months that there was a total collapse in various sectors of their business. With the submittal of the Federal Energy Regulatory Commission (FERC) licensing for the Alaska oil and gas project, there was no oil and gas work to be done. Thankfully, there was still legislative and fisheries work. Recently they had lost two employees and had not replaced those jobs. Current employees were on 80 percent of their salaries and had been since the previous November. It was not merely stressful, but a deeply distressing time to be a small business owner in professional services.

Representative Guttenberg brought up Alaska's geography and infrastructure and discussed that sea ice was melting and the transportation routes were changing. He felt Alaska was not preparing for the future. He asked what Alaska should be doing.

[2:54:58 PM](#)

Mr. King answered that Northern Economics helped society make better decisions. He had to choose to do what he does

best. He would tell the state to figure out what it does best and find its comparative advantage. He mentioned Arctic sciences and fisheries management. He felt that with the state's limited resources it risked making cuts more in places where it should not and less in places it should. He gave the example of tidewater nearing coast and less need for transport infrastructure inland. Even when a business was in crisis, it was still necessary to think about the future.

Representative Guttenberg asked which study Mr. King would commission Northern Economics to do.

Mr. King answered that if he could do one thing, it would be related to healthcare given the importance of the issue in Alaska. He thought the university should be commended for determining what it did well, and should be encouraged to find where it could be the best and given the resources to do that.

^PRESENTATION: ALASKA'S ECONOMY and THE IMPACTS OF A BROAD-BASED TAX

[2:59:43 PM](#)

CAROLINE SCHULTZ, ECONOMIC POLICY ANALYST, OFFICE OF THE GOVERNOR, addressed a PowerPoint presentation titled "Alaska's Economy and the Impacts Of A Broad-Based Tax" dated May 5, 2017 (copy on file). She began on slide 2 and addressed a chart showing the year-over-year percentage change in monthly employment. She pointed to a growth trend showing losses beginning 2015. This indicated 18 consecutive months of job losses. She turned to slide 3 and spoke to seasonally adjusted unemployment rates. She discussed that before the recession in the rest of the U.S., Alaska's unemployment rate was very high. Alaska was second highest as of March of the current year, behind New Mexico, for unemployment. Alaska's rate was seasonal and there was very high unemployment in the non-urban areas. Alaska was in a recession because it had been losing jobs for 1.5 years.

[3:04:11 PM](#)

Ms. Schultz spoke to three factors that cause the unemployment rate to look more stable, including lost jobs

held by non-residents, residents who had moved out of state or the lost job could have been through retirement and retirees did not count as unemployed. These factors contributed to unemployment rate to appear stable while unemployment numbers were falling.

Ms. Schultz turned to slide 4 that looked back at Alaska's modern economic history. She spoke to boom and busts in the 1970s and 1980s, the 21 years with moderate job growth in 1990s and early 2000s, as well as the current contraction in 2016 and 2017. She addressed the fairly tepid growth in 1988 and the connection with the Exxon Valdez oil spill. She wished to dispel the myth that it took a big event to bring an economy out of the recession. She moved to slide 5 regarding state recessions:

#### A word on state recessions

- While there is no official definition of recession at the state level, a suggested measure is 9 consecutive months of year-over-year job loss.
- By this definition, Alaska has had three recessions since 1961, not including the current contraction.
- There have been 259 state recessions, many associated with the six national recessions that have occurred since 1961.
- It is much more common for states to be adding jobs - for all states, 82% of the time, and 89% for Alaska.

[3:07:59 PM](#)

Ms. Schultz moved to slide 6 and spoke to two pie charts related to the typical duration of recessions and to the length of recoveries. Michigan had the most severe, with an economy that was still recovering to its pre-recession levels. There had been only two recessions that had lasted over two years.

[3:11:07 PM](#)

Ms. Schultz turned to slide 7 titled "Stage One: Industries directly tied to oil." The graph showed the oil and gas industry in green, construction in blue, and the orange dotted line related to professional and business services. These industries continued to lose jobs but the losses had bottomed out. Oil-related losses started in late 2015.

Ms. Schultz shifted to stage two impacts on slide 8.

Co-Chair Seaton asked about the bottom line between negative 4 percent and negative 6 percent showing an upturn in 2017, and asked whether that indicated an increase in job losses.

Ms. Schultz answered in the affirmative that state government tended to lose jobs at a decreasing rate. Typically losses tended to slow down because the previous year was already low and it started to level out.

Co-Chair Seaton asked for verification that the sectors appearing below the line indicated a loss, and if they appeared above the line, it showed an addition in jobs.

Ms. Schultz replied that state government had been one of the leaders in job losses and one of the first to show losses. Losses in the secondary industries had not yet leveled out. She highlighted that small businesses which tended to rely on household consumption also showed losses which were still accelerating.

[3:14:44 PM](#)

Vice-Chair Gara referred to slide 8 and spoke to teaching and school jobs. He asked where they would fit in.

Ms. Schultz answered that local government employment had not been included on the two graphs. There had not been significant loss or gains in recent years. There had been downward pressure on school districts. Schools typically budgeted for the school year and shifts were typically seen then.

[3:16:02 PM](#)

Ms. Schultz moved to slide 9 and a graph from Gunnar Knapp [ISER] comparing fiscal systems across states. Alaska was the only state without a broad-based tax. Even with the addition of \$700 million in new and increased tax, it would still be the second lowest in the country. She highlighted that 43 states had an income tax and 6 had a sales tax.

Representative Guttenberg believed the chart did not include the dividend.

Ms. Schultz answered in the affirmative.

Representative Guttenberg indicated that it was possible to calculate how the dividend would affect the graph.

Ms. Schultz addressed slide 10 titled "Do broad-based taxes hurt states' economies?":

Do broad-based taxes hurt states' economies? What the experts say:

- Economic theory can be murky on the impacts of taxes on employment, productivity and output.
- There is a lack of consensus on the empirical data, even on whether or not there's a lack of consensus.
- The two main schools of thought on the impacts of taxation are at odds with each other.
- Some economists and policy analysts say the complexities of the real world make it too hard to decisively say.

Ms. Schultz relayed that economic theory applied to the margins. An income tax essentially lowered wages. It was the foundation of economic labor market theory there was a trade-off between labor time and leisure time. If taxes removed money, there is one theory that states that employees feel less inclined to work as they value their leisure. This was called the substitution effect. Another theory states that they have to add hours to offset losses in income. This was called the income effect. It was generally acknowledged that the substitution effect was stronger. Even the very foundations of neo-classical labor market theory were not clear on the issue. When countries or states changed tax policy, there was a lack of consensus as to whether economies were hurt by taxes. The policy decisions did not happen in a vacuum. The ability to identify the impacts of fairly infrequent changes in tax policy, given all of the other things happening in state's economies makes it very difficult to determine what the effects are.

[3:20:37 PM](#)

Ms. Schultz advanced to slides 11 and 12 showing studies comparing select state economic performance between 2002 and 2011. States on the left of slide 11 were those with higher income taxes, and those on the right had only sales

tax. In the given time period, the states in both columns had good economic metrics, however those with higher income tax had higher per capita gross state product growth, and higher median household income growth, and lower unemployment rates. The states with no income tax had higher population growth rates, higher gross state product, and higher employment growth rates. The point was that looking at different economic factors, any result can be arrived at.

[3:22:17 PM](#)

Co-Chair Seaton recognized Representative Jonathan Kreiss-Tomkins in the audience.

Ms. Schultz turned to slide 13 and addressed Alaska's neighbors Washington and Oregon in the years 2010 to 2016. Washington had high income and no sales tax, while Oregon had high sales tax and no income tax. Both had 14 percent job growth. Washington displayed 37 percent per capita personal income growth, while Oregon showed 27 percent in growth in the same area. These results compared to 23 percent per capita personal income growth in the U.S. overall, with 11 percent employment growth. Alaska showed only 14 percent per capita income growth and 2 percent employment growth.

Representative Wilson asked for an expansion on the other things that mattered more.

Ms. Schultz replied that Washington and Oregon had both done well with urban technology centers. They also had a good quality of life. Both states' rural areas in general had not done as well as urban areas in the post-recession recovery. Alaska would not do as well in the high technology centers, and she emphasized that it was not a fair comparison.

[3:25:21 PM](#)

Ms. Schultz moved to slide 14 and continued to address whether broad-based taxes hurt states' economies with the example of Kansas:

Do broad-based taxes hurt states' economies?

- We can look at other states that have experimented with putting economic theory into practice, like Kansas.
- Kansas made significant cuts to state tax rates, particularly business taxes and income taxes for upper-income households, which has led to years of growing budget shortfalls.
- Kansas's economic growth by a variety of indicators has been slow compared to the U.S. as a whole and its neighbors, with the exception of Oklahoma.

Ms. Schultz turned to slide 15:

Do broad-based taxes hurt states' economies?

- There is a wider consensus in the economic literature on the problems associated with deficit spending (or for states, spending from reserves)
- The U.S. can borrow money to spend at a deficit, which can provide a short-term economic stimulus, but hurts economic growth in the long term for two reasons:
  - ◆ Deficit spending now creates an expectation that taxes will be raised later
  - ◆ Increased demand for borrowed money increases the price of borrowing money (interest rates), all else being equal

Ms. Schultz moved to slide 16

Do broad-based taxes hurt states' economies?

- There is a wider consensus in the economic literature on the problems associated with deficit spending (or for states, spending from reserves)
- The U.S. can borrow money to spend at a deficit, which can provide a short-term economic stimulus, but hurts economic growth in the long term for two reasons:
  - Deficit spending now creates an expectation that taxes will be raised later
  - Increased demand for borrowed money increases the price of borrowing money (interest rates), all else being equal

- States can't deficit spend, but they can pull from reserves.
- In the short term, this can insulate an economy from shocks, either from increased taxation or budget cuts
- But it can also raise the expectation that taxes will be increased later, when savings run out, which dampens business and consumer spending.
- Pulling from savings is like pulling from retirement - it can stave off hard choices now, but it forces harder choices later.

[3:27:49 PM](#)

Ms. Schultz spoke briefly to volatility on slide 17:

- Much has been said about the negative impacts of uncertainty for Alaska's economy, and volatility is the major driver of uncertainty.
- Alaska has the most volatile tax revenue system of any state.
- Moving toward a less volatile revenue system will decrease uncertainty and increase efficiency, all else being equal.

Ms. Schultz continued to slide 18 titled "The Alaska Disconnect":

- Economic development that grows and diversifies Alaska's economy is widely recognized as a good thing.
- But adding people to the state means increased demand for public services - more students in the classroom, more roads to be plowed and patrolled, and increased use of state services and programs.
- Without a broad-based tax, Alaska has no means to recoup the increased costs to government, diminishing the state's ability to pay for required services and infrastructure.

[3:28:35 PM](#)

Ms. Schultz concluded on slide 19:

Why a broad-based tax, and why now?

- Spending down savings has a measurable cost and does not reduce uncertainty - we will have spent close to \$10 billion from savings by the end of this year, sacrificing \$500 million in annual earnings on those reserves.
- A broad-based tax ensures SB26 works - we need to maintain \$2.5 - \$3 billion in CBR for cash flow.
- A progressive income tax coupled with PFD reductions ensures an equitable fiscal solution.
- A PFD-only solution takes only from Alaskans - nonresidents who use Alaska services do not contribute.

Ms. Schultz stated the answer was not about picking a solution that resulted in fewer job losses in the long term, rather it was about deciding what kind of government the state wanted.

Vice-Chair Gara stated he had been "flabbergasted" to hear some legislators say that with a broad-based tax there would be too much money and they were supportive of the \$1,000 Permanent Fund Dividend (PFD) plan only. He commented there was almost no construction budget. He asked Ms. Schultz what she thought about that.

Ms. Schultz replied that it was not something that had been widely studied, mostly because the situation in Alaska was unique. Alaska residents would be more hawkish of state spending if they were participating in the state budget.

[3:32:34 PM](#)

Vice-Chair Gara asked if the \$1,000 PFD Percent of Market Value (POMV) plan from the Senate would get to a sustainable budget.

Ms. Schultz answered in the negative. She stated that as it was currently articulated the plan was not a sustainable budget plan.

Representative Guttenberg stated the plan in the other body had manipulated numbers and lowered the PFD. He asked how important volatility was in building the economy.

Ms. Schultz answered that volatility would always be a part of economies. Alaska had an order of magnitude more volatility than most states - she had not included the volatility index that had been in a recent presentation by

Commissioner Hoffbeck with the Department of Revenue. Volatility made it difficult to plan. Volatility put tough to define, but very real downward economic pressure on the state economy. The concepts were tough to define numerically, but real.

[3:36:31 PM](#)

Ms. Schultz added that she had been an economist with the Department of Labor and Workforce Development (DLWD) for almost ten years and had recently transferred to the Office of the Governor.

Representative Edgmon asked about third-quarter/fourth-quarter indicators for Alaska related to a net loss of population.

Ms. Schultz anticipated continued losses of employment through third and fourth quarter 2017. The DLWD numbers were only through third quarter 2016 and the estimates did not come out until January of the following year. She believed there would be positive outmigration in 2017.

[3:38:38 PM](#)

Representative Edgmon spoke to discussion about moving into the second stage of recession. He spoke to job losses in the oil industry. He asked if it was expected another 1,600 oil industry jobs would be lost in the current year.

Ms. Schultz replied that she had been involved in the analyses that had forecast fewer job losses in the oil and gas industry in 2017 compared to 2016.

Representative Wilson asked whether the estimate on the oil fields was based on the House version of HB 111.

Ms. Schultz replied in the affirmative.

Representative Wilson asked if DLWD had revisited the numbers since the Senate changed the bill.

Ms. Schultz replied in the negative. She stated it was difficult to identify the impact of taxes. She used an example related to the PFD. Alaska's employment was seasonal, especially in October when the checks went out, and it was impossible to assess the actual value of jobs because of factors like seasonality in the economy.

3:42:01 PM

Representative Wilson stated that Alaska had changed its policy a lot. She asked about the rising healthcare costs and asked if those were looked at by the governor's office as they would not merely impact state government but might trickle down to local and individual policies.

Ms. Schultz answered that when she had transferred from DLWD healthcare had been a bright spot and it had remained so. The Office of the Governor was actively trying to determine what could be done to shift the cost downwards - the costs were crippling Alaska. While job growth and healthcare was helping, the costs needed to be shifted or cut in such a way as to avoid crippling job growth.

3:45:08 PM

Representative Wilson commented that she knew of companies that were hiring their own doctors to avoid sending people out of state to lower costs. She remarked that population affected the availability of specialists in the state. She felt there was more that could be done to address the issue.

Representative Guttenberg stated that seeing job growth in the healthcare sector was great, but not when it was crippling the economy. He spoke to oil taxes. Many times they see a change in oil tax structure and there is an immediate effect in production, then credit is given to the tax structure change. He asked if the governor's office examined what turned an oil field around and increased production.

Ms. Schultz answered that she was not aware of the study.

Co-Chair Seaton clarified that jobs had not been lost under Alaska's Clear and Equitable Share (ACES) on the North Slope. The state had gained jobs every year under ACES.

Representative Wilson replied she was referring to Fairbanks had lost jobs that went to the North Slope, and not to the North Slope itself.

Co-Chair Seaton spoke to the economic impacts of ACES on the economy. He had tried to allow all members of the

committee to ask the questions. He believed there had been a good vetting, but was certainly willing to put more questions forward. He wanted to find the answers to any questions in order to prevent delaying policy. He suggested to all legislators following the presentations that they submit any questions and they would be addressed.

[3:51:51 PM](#)

Representative Edgmon referred to a statement made by Mr. King that no one had studied the economic impact of dividends. He asked if the study had not occurred because there had been oil revenue since 1980 and it had never been needed in the past.

Ms. Schultz believed the statement was reasonable.

Representative Edgmon asked whether the smaller dividend in 2016 impacted the economy.

Ms. Schultz answered in the affirmative. She detailed that based on the data it was impossible to parse the impact out from other factors. She asked for a clarification that he was referring to the 2016 dividend.

Representative Edgmon nodded in the affirmative.

Ms. Schultz replied that the dividend had gone out in October and that so far there were no results on the economic impacts.

Representative Edgmon found it interesting and believed that ISER had examined it. He was a strong proponent of a bigger dividend. He described the difference between the PFD in current legislation as \$170 million and he thought it would be interesting to know how much that \$170 million reverberated around the Alaska economy. He believed there should be some sense of the multiplier impact.

[3:55:35 PM](#)

Ms. Schultz responded that it was possible, even probable, they had not yet seen the data or the data was not available yet as it regarded fourth quarter 2016.

Co-Chair Seaton surmised that qualitatively it was possible to assume that having an extra \$175 million in the economy

should make a difference, but it would be difficult to measure the impact.

Ms. Schultz answered in the affirmative.

Vice-Chair Gara referred to Mr. King's testimony about the losses of his business. He had friends in state government who were thinking about leaving or who had left due to budget cuts and the effect on job security. He asked if the specter of continued cuts had an impact on business in the state.

[3:58:19 PM](#)

Ms. Schultz replied that she did believe it was putting downward pressure on the private sector growth. The wait and see attitude had been heard from banks related to commercial and mortgage lending. People appeared to be waiting for some sort of fiscal solution sooner rather than later.

Co-Chair Seaton spoke to the impact of budget cuts versus a plan with a \$500 million deficit over the following years. He asked if businesses were reacting to cuts themselves or to a deficit and the anticipation of future cuts.

Ms. Schultz believed the reaction was to both. She referred to an economist who spoke about how fear and uncertainty, as well as hope and enthusiasm, impacted the economy as well.

[4:00:39 PM](#)

Co-Chair Seaton thanked Representatives Stutes, Edgmon, and Neuman for participating as committee alternates. He went through the calendar for the following day. He recessed the meeting [note: the meeting never reconvened].

#  
ADJOURNMENT

[4:01:29 PM](#)

The meeting was adjourned at 4:01 p.m.