

ALASKA STATE LEGISLATURE
SENATE STATE AFFAIRS STANDING COMMITTEE

January 24, 2017

3:30 p.m.

MEMBERS PRESENT

Senator Mike Dunleavy, Chair
Senator David Wilson
Senator Cathy Giessel
Senator Dennis Egan

MEMBERS ABSENT

Senator John Coghill

COMMITTEE CALENDAR

PRESENTATION: Alaska's Economy by Dr. Ralph Townsend, Institute of Social & Economic Research

- Heard

SENATE BILL NO. 1

"An Act making a special appropriation from the earnings reserve account for the payment of permanent fund dividends; and providing for an effective date."

- Heard and Held

SENATE BILL NO. 2

"An Act increasing the amount of the 2016 permanent fund dividend and directing the Department of Revenue to pay a supplemental dividend to eligible individuals; and providing for an effective date."

- Heard and Held

PREVIOUS COMMITTEE ACTION

BILL: SB 1

SHORT TITLE: APPROP: 2016 PFD SUPPLEMENTAL PAYMENT

SPONSOR(S): SENATOR(S) DUNLEAVY

01/09/17	(S)	PREFILE RELEASED 1/9/17
01/18/17	(S)	READ THE FIRST TIME - REFERRALS

01/18/17 (S) STA, FIN

BILL: SB 2

SHORT TITLE: 2016 PFD SUPPLEMENTAL PAYMENT

SPONSOR(s): SENATOR(s) DUNLEAVY

01/09/17 (S) PREFILE RELEASED 1/9/17

01/18/17 (S) READ THE FIRST TIME - REFERRALS

01/18/17 (S) STA, FIN

WITNESS REGISTER

DR. RALPH TOWNSEND, Director and Professor of Economics
Institute of Social and Economic Research (ISER)
University of Alaska-Anchorage
Anchorage, Alaska

POSITION STATEMENT: Presented an overview of Alaska's economy.

GINA RITACCO, Staff
Senator Mike Dunleavy
Alaska State Legislature
Juneau, Alaska

POSITION STATEMENT: Provided an overview of SB 1 and SB 2.

ACTION NARRATIVE

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CHAIR MIKE DUNLEAVY called the Senate State Affairs Standing Committee meeting to order at 3:30 p.m. Present at the call to order were Senators Wilson, Giessel, Egan, and Chair Dunleavy.

PRESENTATION: ALASKA'S ECONOMY BY DR. RALPH TOWNSEND, INSTITUTE OF SOCIAL & ECONOMIC RESEARCH

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CHAIR DUNLEAVY announced the presentation on Alaska's economy by Dr. Townsend.

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DR. RALPH TOWNSEND, Director and Professor of Economics, Institute of Social and Economic Research (ISER), University of Alaska-Anchorage, Anchorage, Alaska, revealed that he has been in public education for 30 years. He asserted that one of the great features of public higher education's mission is providing research and public outreach that also serves the broader

community. He set forth that ISER performs its role in conducting and getting research out for the benefit of Alaskans. He thanked President Johnson and Chancellor Chace for their roles in supporting ISER's work on Alaska's economy and budget.

DR. TOWNSEND addressed an exclaimer that his presentation does not represent the university's policy or any institution at the university. He added that he has only been in Alaska for five months and admitted that he does not have the breadth of Alaskan experience that his predecessor, Gunnar Knapp, had with his 20 years at ISER. He asserted that he does have a long record of participating in public policy originally in the state of Maine where he served for 25 years as well as 3 years with the government of New Zealand.

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He explained that the intent of his presentation is to provide a very high level context on taxation issues due to budget cuts. He added that he would touch quickly on a variety of issues that arise, particularly with taxation as well as decisions on public spending levels. He explained that his intent is to set a context of understanding that addresses the business community's and civic organizations' requests for a long-term plan about the state's budget.

He reviewed page 2 of his ISER presentation, "Alaska's Budget Context" as follows:

- FY2017 budget gap: \$3.0 billion.
- Approximate maximum sustainable flow from permanent fund (including the earnings reserve (ER) and the constitutional budget reserve (CBR)): (4.5 percent x \$60 billion = \$2.7 billion generated/\$300 million gap.)

Long-run gap:

- \$1000 permanent fund dividend (PFD): \$300 million + \$700 million = \$1 billion gap.
- \$2000 PFD: \$300 million + \$1.4 billion + \$1.7 billion gap.

He pointed out that even though the state's FY2017 budget gap that was covered by the CBR was nearly \$3 billion, Alaska is fortunate in having a large savings account in the form of the permanent fund plus associated funds including the ER and CBR; that total is nearly \$60 billion. He said if the question is asked as to how much money could be used from the \$60 billion on

a sustainable basis, money managers have indicated that the state could afford to take out 4 to 5 percent that would leave the principle in real terms untouched. He specified the he has chosen 4.5 percent that equates to generating \$2.7 billion, leaving a gap of \$300 million not covered. He noted that the permanent fund and ER are also used to pay the PFD; that is also a demand on the state's budget. A \$1,000 PFD costs \$700 million, bringing the total gap to \$1 billion; a \$2,000 PFD would add another \$700 million, bringing the gap to \$1.7 billion.

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DR. TOWNSEND addressed page 3, "Alaska's Budget Context, Plus" as follows:

- Oil and gas tax credits.
- Capital plan.
- Health care cost uncertainty.
- Unfunded liabilities.

He detailed that there are demands in the budget beyond what is represented in the 2017 budget: the outstanding liabilities in future oil and gas tax credits; a long run capital budget of \$100 million is probably not sufficient to sustain the state's infrastructure; strong inflationary pressures in health care costs; and unfunded liabilities with respect to pensions. He summarized that the numbers he shared on page 2 were a little on the optimistic side.

He addressed page 4, "The economic context: wage and salary employment." He noted that the 2016 and 2017 projections are based on analysis from three economists: Dan Robinson, Chief of Research and Analysis, Alaska Department of Labor and Workforce Development; Jonathan King, Vice President and Senior Economist, Northern Economics; and Mouhcine Guettabi, Assistant Professor of Economics, ISER. He detailed as follows:

- 2016: Alaska lost 7500 jobs.
- 2017 ISER forecast: lose another 7500 jobs.
- 2018: With no further changes to state budget, further 2500 jobs lost.
- 2019 and after: return to 2010 job levels and stay flat with no economic drivers to recover lost jobs.

DR. TOWNSEND explained that the three economists where unanimous that Alaska will be down approximately 7,500 jobs

in 2016; the job losses are wage and salary employment, adding self-employment increases the forecast. He added that all three economists forecasted that the state will lose another 7,500 in 2017.

He detailed that ISER forecasted 2,500 jobs lost in FY2018. He summarized that 2019 and after will stay flat because there is nothing outside that is going to drive the economy to recover the lost jobs for the peak the state had in 2010 and 2011. He said the national economy is recovering and the state is benefiting, most notably from tourism; however, the exterior drivers from the recovering economy are not enough to help Alaska lift itself back. He summarized that there is no clear path in the state's future for a strong recovery.

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He addressed page 5, "ISER estimates of effects per \$100 million change" on three types of changes as follows:

- Taxes: 450 to 800 jobs lost.
- Dividend cut: 550 to 900 jobs lost.
- Budget cut: 1000 to 1250 jobs lost.

He detailed that a \$100 million tax increase would cause a loss to the state's economy of 450 to 800 jobs because \$100 million in spending would be removed from the economy, less would be spent and fewer jobs would be generated across the economy. A dividend cut would result in slightly more job losses because tax increases would impact wealthier people who do not spend all of their income; however, dividend cuts come directly from spending. He asserted that a budget cut is largely to reduce jobs directly through the reduction in state employment.

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CHAIR DUNLEAVY asked Dr. Townsend to elaborate on the projected job cuts from a \$100 million change associated with taxes, dividend cut and budget cut.

DR. TOWNSEND specified that if the state is to close the budget gap on the order of \$1 billion, the result will cause job losses in the order of 5,000 to 12,500. He summarized that the forecasted job losses means that the downturn would continue for at least two more years. He set forth that the risk is a prolonged downturn could cause

other negative consequences such as the impact on the housing markets.

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SENATOR EGAN asked Dr. Townsend to verify that his forecasts combine both public and private sector jobs. He inquired how Dr. Townsend calculated salaries.

DR. TOWNSEND explained that the forecasts were expressed in the terms of job losses and not income losses.

SENATOR EGAN asked that Dr. Townsend address projected income loss.

DR. TOWNSEND explained that state-level data is different from national data. He specified that economists tend to focus on the Department of Labor's jobs data. He conceded that a job in the construction industry is not the same as a job in the retail sector. He explained that the reduction in Alaska's jobs is tied to demographic trends where migration out of the state occurs with job losses. He said projections indicate that the state will see some net out-migration if job losses continue.

CHAIR DUNLEAVY noted that Dr. Townsend expressed his concern that losing 1,000 to 1,250 jobs over the next year or two could be problematic. He asked what would occur if the job losses were spread out over the next five years.

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DR. TOWNSEND replied that Alaska does have some choices and noted page 6, "Why a multi-year plan? 1. Both risk and opportunity." as follows:

- Being forced into a large one or two-year adjustment will seriously harm the economy. The business community has talked about a multi-year plan rather than a one or two-year plan that could exasperate Alaska's current recession.
- Change is inevitable, but Alaska's savings allow a multi-year adjustment. Alaska is fortunate due to its large savings accounts that provide choices that other states in the Lower 48 did not have in 2007 and 2008. Some states had "rainy day" funds at 10 percent of their budgets, Alaska's "rainy day" fund is 3 years. Alaska's CBR has one year left for the 2016 budget, but the savings do allow a multi-year adjustment and

that is why the business community is saying the state needs to have a plan that sees a multi-year path with respect for spending and revenues.

CHAIR DUNLEAVY asked that Dr. Townsend address the short term, mid-term and long-term effects of the three types of possible changes: taxes, dividend cut, and budget cut.

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DR. TOWNSEND replied by addressing page 7, "Why a multi-year plan? 2. Business impacts are inevitable and will not be uniform." as follows:

- Both further spending cuts and additional revenues seem unavoidable, the numbers are just too high to close with any one strategy.
- Different cuts and taxes will affect businesses differently.

He addressed page 8, "Examples of business effects." as follows:

- Sales tax impact from internet competition. Businesses that face severe internet competition will be disproportionately concerned about a sales tax.
- PFD cut and impact on the rural cash economy.
- Businesses that rely on PFD spending are going to be concerned.
- Higher property taxes from education cost shift to local government: capital investments face higher taxes/lower returns. Businesses considering large infrastructure investment in a community may be concerned about return on investment due to higher property taxes.
- No capital budget: professional services. Businesses with a whole range of services that may have to downsize due to no capital budget, such as: design services, and environmental assessment.
- Health care cuts: substantial cuts to the health-care sector would have a strong impact on the only part of the economy that has really been growing over the past several years.

He asserted that he is not arguing for any of the possible changes; however, whatever changes the Legislature makes are likely to have disproportionately impacts on some

business sectors. He said businesses want to figure out what the impacts are, particularly when people are making 10 or 20-year investments. He said businesses may hold off on investing until the impact from the effects are known.

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CHAIR DUNLEAVY remarked that the analysis addresses the evaporation of billions of dollars of wealth. Alaska in trying to adjust to the new reality can either downsize to whatever degree or bring in new revenue.

SENATOR GIESSEL questioned the sales tax impact on non-internet businesses by noting that she has been charged a sales tax when shopping online. She pointed out that job losses will result in families moving, ergo less students should decrease the cost of education. She remarked that Dr. Townsend's premise is based on government being the sole factor that affects the economy. She noted that as oil prices have fallen, so have support services for that industry, making it more economic in some cases to make developments go forward.

DR. TOWNSEND replied that his analysis does not say that the public sector is the only determinant. He noted that there have been very large shifts in both the oil and gas industry, but also in state government; that has caused a moderate recession that is not as serious as what the Lower 48 faced. He asserted that government is not the only driver, but government is an important driver in some sectors, particularly in health care. He set forth that business planning decisions depend on knowing what is going on in the broader environment for firms that are directly and less directly dependent on the government. He reiterated that the business community has called for a multi-year plan due to its planning decision process.

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He addressed page 9, "Tax policy 101, Broad and low." He noted that Chair Dunleavy requested a broad overview on the impact of various taxes that results from: changes of taxes, introduction of new taxes, changes in how taxes are levied, and changes in spending. He set forth that ideally, one uses broad-based taxes at low rates; for example, a broad-based sales tax at 2 percent will have less distortion on the economy than a 4-percent tax on a much narrower base that raises the same amount of money.

DR. TOWNSEND pointed out that an unfortunate example of a non-broad-based tax is the federal income tax. He explained that the marginal federal income tax is 33 percent, but the high tax level is needed due to a large percentage of both the capital earnings and salary earnings being exempt from taxation because of various ways the tax code has been structured. He noted that there have been calls to substantially broaden the federal income tax and reduce the tax rate at the same time. He reiterated that broad-and-low is a strongly preferable tax policy.

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He addressed page 10, "Economic consequences of taxes" and explained that taxes effect the economy in other ways. He set forth that the cost of a tax to an economy is more than the amount of money that goes to the government. He noted three issues and added that issue-two and issue-three are the most significant:

- 1. Administrative and compliance costs; for example, cost of running a tax agency, business cost for collecting taxes, and compliance cost.
- 2. People will spend money to avoid taxes.
- 3. People shift their economic activities based on taxes; for example, the preferable treatment of real estate both on favorable depreciation rules with respect to rental properties, and the deductibility of home interest and property taxes. If somebody is investing in real estate because it is profitable to accept a 3 percent return when 6 percent could have been earned someplace else, that 3 percent is a loss to the economy. People shift their economic activity by shifting more productive to less productive uses.

CHAIR DUNLEAVY asked if Alaska's geographic isolation acts as a modifier to the three tax issues previously noted; for example, Alaska does not have neighboring states that impact crossing state lines for employment or shopping.

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DR. TOWNSEND replied that some of the distortions in the Lower 48 differ in Alaska. He pointed out that residents of New Hampshire cross the state line to buy cheaper alcohol. He said there are advantages to being a single entity. He noted that Alaska can take steps that encourages people to invest in one type of investment versus another; for example, an income tax.

CHAIR DUNLEAVY asked to address how Alaska's situation may modify behaviors related to cutting and the PFD.

DR. TOWNSEND agreed and said consideration must be given to the details of individual taxes, spending, and where the state was at.

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He addressed page 11, "Tax Policy 102: Equity and efficiency are often in conflict in tax policy." He said there are inherent conflicts between the goal of having an equitable tax system that has people pay who can most afford to pay and the efficiency consequences. He reiterated that broader tax bases are desirable with respect to avoiding distortions on the economy; however, broader tax bases often mean there is less ability to effect who it is that actually pays the tax.

He addressed page 12, "Regressive vs. Progressive" regarding equity as follows:

- Regressive: percent of income paid in tax falls as income increases. Note, total tax paid may still increase as income increases. A lower-income person may pay a higher percentage of their income on a sales tax than a person that earns more money due to the ability to save money and buy things that are not subject to the sales tax. A higher income person pays more sales tax, but regressive taxation is measured by percentage.
- Progressive: percent of income paid in tax increases as income increases.

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CHAIR DUNLEAVY asked Dr. Townsend to address how behavior will differ in Alaska regarding income tax, sales tax, and property tax.

DR. TOWNSEND addressed page 13, "Alaska's current taxes-I" versus other states as follows:

- Corporate income tax: 9.4 percent maximum; among the 4 highest in the country, but 10 states are at 8.5 percent to 10 percent.
- Local property taxes: 10-12 average "mill rate;" slightly above middle of the pack.
- No vehicle property tax; like 25 other states.
- Fuel tax \$0.1225/gallon; lowest in the country.

- No personal income tax; like six other states, two tax dividends and interest, not wages and salaries.

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CHAIR DUNLEAVY asked if Alaska's land ownership impacts property tax mill rates; for example, lands held in trust, lands held by the federal government, etc.

DR. TOWNSEND answered that Alaska's land ownership impacts how much money is collected by the local property tax. He summarized that Alaska is slightly above average in terms of its collections.

He addressed page 14, "Alaska's current taxes-II," sales-and-use taxes as follows:

- No state sales tax; like four other states, all four states collect lodging tax and most a meals tax. All states do impose a broad sales-and-use tax.
- Local sales taxes to 7.5 percent. Local rooms tax to 12 percent; 38 states have local sales taxes.
- Alaska imposes a 10-percent car rental tax; second highest with 5 other states.

CHAIR DUNLEAVY asked to clarify that Alaska is in the upper quarter of corporate taxes.

DR. TOWNSEND replied that Alaska is in the upper 20 percent.

CHAIR DUNLEAVY asked to confirm that Alaska is on the upper end for car-rental tax.

DR. TOWNSEND answered yes.

CHAIR DUNLEAVY asked to verify that Alaska is in the upper end of property tax.

DR. TOWNSEND answered no. He specified that Alaska is a little above average, between the 50 to 65-percent range. He noted that New Hampshire is on the high range at 20 to 40 mills.

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He addressed page 15, "Sales Tax Effects" as follows:

- Competition from internet sales. People are able to go online and buy from out-of-state and not pay a sales tax.

- Moderately regressive.
- Exemptions, especially food, reduce "regressivity" at the cost of collecting less revenue.
- Federal income deductibility for itemizers; however, most people paying a sales tax do not itemize.

DR. TOWNSEND summarized that Alaska's sales taxes are paid in part by visitors. He added that Alaska has the unique problem of introducing a sales tax when the state already has local sales taxes in place.

CHAIR DUNLEAVY noted that other states have local and state sales taxes.

DR. TOWNSEND answered correct, but pointed out that states typically introduce statewide-sales taxes prior to local taxes.

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SENATOR EGAN pointed out that since Alaska's statehood, the prerogative has always been that sales taxes are left to municipalities and that is why there is no state-sales tax.

DR. TOWNSEND agreed with Senator Egan and noted that municipalities that do not have a local sales tax will probably have higher property taxes.

He addressed page 16, "Income Tax effects" as follows:

- Rates can be progressive.
- Differential treatment of different income can be quite distortionary; example, capital gains.
- Deductions and credits can be quite distortionary; example, home interest. Cumulative of the substantial effects can destroy the economy and affect the long-run performance of the economy.
- Can influence retirement decisions on the state level.
- Federal tax deduction for itemizers. Most people who pay a federal income tax itemize.
- States do tax the in-state earnings of nonresidents.

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He addressed page 17, "Coordinating with Federal Tax" to pay state income tax. He said there is no question that using the federal tax definitions reduces a state's administrative costs. He detailed as follows:

- Only one state uses Federal taxes paid as base.
- Different income/tax bases from Federal income:
 - Total income, line 22 of Form 1040.
 - Adjusted gross income, line 37.
 - Adjusted gross income with further adjustments.
 - Taxable income, line 43.
 - Tax/alternative minimum tax, lines 44/45.
 - Tax after credits, line 56.

DR. TOWNSEND noted that frequent proposals in Alaska would express the taxes paid in the state as a percentage of federal taxes. He remarked that using a percentage of federal taxes was great in the past, but most states have come up with their own processes for adjustments, deductions, and the tax rates.

He detailed that there are several different figures that the state could take from the Form 1040 as the basis for calculating the state tax. He specified that line 22 of Form 1040 is the sum of one's income and line 37 is adjusted gross income. He noted that most states use adjusted gross income, but further adjustments are made. He informed that income after deductions is indicated on line 43 in the Form 1040, lines 44 and 45 show the alternate rate calculation, and line 56 shows the tax after credits. He pointed out that credits have become very significant for the average taxpayer with child credits and tuition credits.

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He set forth that if the goal of the state is to start from a system at some percentage of the federal tax base, writing that into statute would not be difficult. He pointed out that the reason why states have moved to using their own definitions of deduction adjustments and the rates are twofold: complications with part-year residents and changes to the federal policy. He noted an example of a change to the federal policy occurred 20 years ago where the federal government declared a 10-percent tax credit, a state using the federal definition of taxes would see its revenues go down by 10 percent and a state that simply used the federal definition of taxable income would have been left intact. Sudden changes in the federal-tax code have a destabilizing effect on state budgets and that has led to only one state using the federal taxes paid as the place to start.

DR. TOWNSEND addressed page 18, "Property Tax effects" as follows:

- Arguments over progressive/regressive because half of the property taxes are paid by industrial and business customers; who actually pays those taxes matters.
- Differentially affects those on fixed income.
- "Circuit breaker" provision reduces regressivity on income or age-based residents.
- Can create "tax competition" for industry.
- Federal tax deductibility for itemizers.

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He detailed that property taxes historically in the U.S. have been the primary funding source for local education; that has changed so that most states contribute substantial equalization amounts to fund local K-12 education because the variation in property-tax bases to support education vary widely.

He addressed page 19, "Permanent Fund Dividend cuts" as follows:

- PFD is a very progressive program where lower-income families receive a higher-income percentage from the subsidy.
- Cutting the PFD has a strongly regressive effect.

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CHAIR DUNLEAVY remarked that some Alaskans do not consider the PFD a subsidy.

DR. TOWNSEND recanted "subsidy" for "payment." He exclaimed that he did not intentionally use "subsidy" to describe the PFD payment.

CHAIR DUNLEAVY specified that individuals receive a "dividend."

DR. TOWNSEND continued that the PFD is taxable so the dividend results in the federal government paying part of it through itemizers. He noted that there is a complicated issue that because state taxes are only deductible by itemizers, whether the income tax and the dividend is linked through a credit in some way would make a difference for non-itemizers.

He addressed page 20, "Spending cut effects" as follows:

- Impacts depend upon what you cut.
- Details matter, such as impact on programs such as Medicaid, what the state spends and the amount the federal government is providing. Details can be complicated where

in the short run there is a small effect, but in the longer run there is a cumulative effect.

- Education cuts will almost certainly increase local taxes.
- Other cuts will shift costs; example, universities.
- Long run goal is to fund services whose value to Alaskans exceeds their cost, e.g., court system, criminal justice system, child protection services, etc.

DR. TOWNSEND summarized that Alaskans ultimately must decide what values they get from their services and what services should be funded. He specified that in the long run, services provide things that make Alaska a better place to live. He asserted that the short run matters and noted that Alaskans need to be worried about the effects spending cuts will have on the state's economy because no one wants a serious recession; however, in the long run the goal is to make decisions on services from state and local government when spending cuts are considered.

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CHAIR DUNLEAVY asked why Dr. Townsend said education cuts "will" raise property taxes rather than "could" raise property taxes.

DR. TOWNSEND specified that he said "almost certainly" because of what happened in the Lower 48 during the most recent recession. He noted that a number of legislatures cut education support and the result shifted costs onto local taxpayers and students.

CHAIR DUNLEAVY pointed out that Alaska has the "Unorganized Borough" that does not have a tax base where there is no local contribution that results in 100 percent contribution from the state, resulting in no ability to impose or increase a tax.

DR. TOWNSEND answered correct and noted that a problem for communities in the Unorganized Borough versus communities that can raise taxes and the change will have differential impacts on the student educational system.

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He addressed page 21, "ISER estimates of effects per \$100 million change in state budget" and impact in the short run as follows:

- Taxes: 450 to 800 jobs.
- Dividend cut: 550 to 900 jobs.

- Budget cut: 1000 to 1250 jobs.

DR. TOWNSEND said there are going to be different budget models and looking at the same numbers going ahead is important.

He remarked that there is increasing recognition that the state is not going to get out of its situation in a year or two and consideration for inflation must be taken into account:

- Inflation needs to be treated identically in revenues, expenditures, and in earnings from the permanent fund for a realistic picture.
- All can be in "nominal" terms, using the same measures and expectations about inflation.
- All can be in "real" terms, which is the same as "today's dollars." Economists typically use "real" calculations. The same answer results either by using "today's dollars" or by inflating everything by the same numbers.

He summarized that important questions to ask when dealing with a budget is how inflation is being dealt with and is it being done consistently.

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He referenced a question from a previous committee where he was asked if Alaska's current recession could be considered the "Great Recession." He said the answer that was given by the economists was, "No, at least not yet." He detailed that the housing market has been surprisingly stable in Alaska. He opined that without upsetting people, some might be saying that the state could be heading into the beginning of Alaska's "Great Recession" if the wrong things are done; for example, a sudden decline in the economy causes the housing market to collapse due to out-migration; that might lead to a cumulative effect that's greater than spreading the effects out.

He opined that the U.S. economy averted another "Great Depression" in 2007-2009 due to aggressive monetary and budgetary response by the federal government. He remarked that the "Great Recession," [2007-2009], dragged on because agreement could not be reached about which of the various solutions to continue the recovery was acceptable; to some extent, the economy ended up being held hostage due to different ideologies. He said he urges Alaskans to look for solutions that will get the state through the challenging times without the kinds of severe impacts that accompanied the "Great Recession" in the Lower 48.

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CHAIR DUNLEAVY pointed out that Dr. Townsend spoke about the "Great Recession" in the Lower 48, asserting that \$5 trillion to \$10 trillion was put on the backs of future Americans as a result of the stimulus actions taken. He remarked that Alaska is currently trying to grapple with how to deal with a state economy that has lost billions of dollars. He said the state has historically hoped for an oil price rebound because Alaska had the production; however, most people now feel that hope is not a very good strategy while the state goes through its savings.

He asked that Dr. Townsend specifically address the short-term, mid-term and long-term impacts of the available tools the state has: reductions, various revenue enhancements, permanent fund restructuring, and taxes. He noted that there is a belief that going down the road of taxes would result in taxes not being repealed again. He inquired if Dr. Townsend's definition of "short term" is one year or five years. He pointed out that economic modeling for the impact from a 1200-job cut would vary if done in one year versus spread over five years.

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DR. TOWNSEND replied that Alaska needs to grapple with Chair Dunleavy's question as it decides a plan. He conceded that economic models are much better at predicting the short term than the long term. He remarked that asking the models to make exact predictions ten years out will provide guidance; however, none of them are going to give an answer that says, "This is the right answer." He remarked that there is an element of using judgement to address what kinds of uncertainty to deal with or to learn with.

He set forth that the short term is where economists can see that 2017 is going to look like 2016, 2018 will still see some job losses from the previous changes; the economy after that will likely stop losing jobs, unfortunately the model does not see anything on the outside that's going to pull the state out. He specified that tourism will not pull the state out because it's not big enough to replace the impact oil had on Alaska's economy. He expressed that there will be a lot of things that change in the future, perhaps in the next few months with the current administration. He added that there is a lot of uncertainty with what might happen with health care. He said people in Alaska are saying that a favorable regulatory environment will provide opportunities for expanded natural resource exploitation that could potentially provide a force to

increase the economy. He pointed out that the state budget has some built-in concerns that tend to pull in the opposite direction; again, the state is spending nothing on capital, roads and infrastructure will have to be replaced at some point. He added that the state has unfunded liabilities and uniquely Alaskan dynamics with health care.

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DR. TOWNSEND asserted that thinking about a five-year plan would be wise as to how the state wants to distribute the changes. He conceded that when he talks about a five-year plan, he is realistically saying that the state needs to be adjusting for the next decade because cuts may require reconsideration; example, many states in the Lower 48 reduced support for higher education that resulted in higher student debt. He explained that states in the Lower 48 have admitted that they did not understand why a particular service was important. He set forth that addressing a need for a service also requires finding a way to raise or cut revenues elsewhere. He summarized that a five-year plan is a realistic planning scenario for the state's overall blueprint with respect to managing: new revenue sources, the permanent fund and the funds it is capable of generating, PFD, and spending.

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SENATOR GIESSEL questioned an earlier statement by Dr. Townsend regarding the approximate maximum sustainable flow from the permanent fund. She pointed out that the Legislature can access the ER and CBR, but not the permanent fund.

DR. TOWNSEND replied that his statement addresses what the state can do under the current constitution versus Alaska's economic realities. He asserted that a university would manage its endowment differently. He asked if the state is willing to accept greater budgetary variability and planning difficulty by continuing with the current mechanism. He set forth that Alaska's large and valuable savings account can be used to help the state through the difficult times; however, putting boxes on how the state can use its savings account will make it harder.

[4:47:06 PM](#)

CHAIR DUNLEAVY pointed out that Dr. Townsend continues to emphasize five years.

DR. TOWNSEND set forth that the elements of long-term planning necessitates Alaska to figure out what it is going to do with the permanent fund, the associated funds, and the PFD; that's

going to put a definition on the scope and size of the rest of the problem. He voiced that Alaska faces a very different environment than it got used to for the last 30 years and hard choices need to be made on where to draw the line. He asserted that saying certain choices cannot be included will make it harder to find solutions that minimize the real cost for Alaskans. He remarked:

We don't want Alaskans being unemployed unnecessarily if there's a way for us to manage this. We don't want people feeling that they have to leave the state because of short-run economic downturns, we would like to have it be successful in the long run.

He specified that his calculations simply specify the amount of money that the state has and how it can use it in a sustainable way. He asserted that looking at the variable ER year-to-year is going to make it harder to plan. He asked that Alaska compare itself to the typical state of 2007-2008 where typical budget reserves were 10 to 40 percent of annual spending. He pointed out that Alaska's budget percentage to annual spending is several hundred percent with reserves that provide several years for a "soft landing."

[4:49:33 PM](#)

SENATOR GIESSEL addressed Dr. Townsend's "quantitative" data regarding projected job losses from taxes, dividend cuts or budget cuts. She remarked that she takes Dr. Townsend's quantitative data with a grain-of-salt due to "qualitative" social issues that exist. She asserted that the PFD draws people to Alaska who utilize a high amount of state services and government-dependent individuals would not move to Alaska if there was no PFD; that would affect budget demands for health and social services.

DR. TOWNSEND replied that he has not seen any research on the impact of the PFD. He noted that a person must be in the state for a year to qualify. He revealed that migration data shows that the number of people moving out of Alaska is approximately equal to the net increase, births over deaths. He conceded that a good bit of the migration out is highly skilled and higher-income individuals who are more mobile.

[4:52:33 PM](#)

CHAIR DUNLEAVY pointed out that Dr. Townsend will be invited back to specifically address "behavioral impact." He opined that

Dr. Townsend has written possible newspaper headlines for the next two days:

1. Townsend says, "Great Recession unavoidable."
2. Townsend says, "Reducing the size of the budget will cause catastrophic job loss."

He remarked that having Dr. Townsend return will, most importantly, allow the committee to talk about the behaviors in more detail. He pointed out that Dr. Townsend highlighted where the state is at, but explained that the committee needs additional engagement; for example, what happens if the PFD is eliminated. He noted that Senator Giessel addressed the PFD attracting people to move to the state and pointed out that a person must reside in the state for a minimum of one year to qualify for the PFD, but one day to qualify for welfare. He detailed that a person can be in Alaska for one day and say that they intend to stay and start to apply for welfare programs that, many say, are much more expensive to the state in many respects. He set forth that his previous example shows why it is difficult to get everyone on the same page, but the committee needs to dig a little deeper on behaviors.

DR. TOWNSEND jocosely asked if he could disavow his comment on Alaska's "Great Recession."

CHAIR DUNLEAVY facetiously pointed out that some newspaper will pick up on Dr. Townsends' statement that a five-year plan might lessen the impacts.

[4:55:06 PM](#)

At ease.

[4:56:19 PM](#)

SB 1-APPROP: 2016 PFD SUPPLEMENTAL PAYMENT
SB 2-2016 PFD SUPPLEMENTAL PAYMENT

[4:56:20 PM](#)

CHAIR DUNLEAVY called the committee back to order. He announced the consideration of SB 1 and SB 2. He explained that SB 1 is a bill that he introduced in the fall of 2016. He detailed that SB 2 is the enabling portion to SB 1.

He noted that the 2016 Legislature passed an appropriation bill that was to fully fund the entire PFD. He detailed that half of the PFD was vetoed by the governor, approximately \$700 million. He specified that the governor said his veto was an effort to

help with the state's fiscal situation. He revealed that the approximate \$700 million from the veto resides in the earnings reserve and not in the general fund.

CHAIR DUNLEAVY contended that the dividend is a very unique issue that is not seen in other states or countries. He opined that Alaskans believe the PFD is a way of receiving a royalty from the state of Alaska due to the Statehood Act and a subsequent constitution that has the state owning the resources in a socialized manner. He explained that the method of paying a dividend from the permanent fund allows all Alaskans to partake in the state's mineral rights. He specified that the bill simply restores the second half of the PFD that was vetoed by the governor. He asserted that the belief is the PFD is a decades-old tradition or right.

He stated that he believes restoring the second half of the PFD is the right thing to do due to the current economy's condition as well as comments from his constituents who noted that their dividend was planned to be used for fuel oil, college, medical bills, vehicles, etc. He opined that there are different ways to deal with the ongoing fiscal issue and the bill addresses a need to fix the 2016 PFD and allow the Legislature to move on to bigger and more important issues in terms of fixing the fiscal issues.

[4:59:13 PM](#)

GINA RITACCO, Staff, Senator Dunleavy, Alaska State Legislature, Juneau, Alaska, provided an overview of SB 1 and SB 2 as follows:

There are two bills because one is an appropriation bill, which is SB 1, SB 2 is the directive bill and both are required in order to issue check immediately before the next payout in October. SB 1 gives the appropriation amount and then SB 2 directs the Department of Revenue to actually go ahead and make those checks available.

[5:00:02 PM](#)

At ease.

[5:00:12 PM](#)

CHAIR DUNLEAVY called the committee back to order. He announced that there is a committee substitute (CS) for SB 1.

[5:00:21 PM](#)

SENATOR GIESSEL moved that the committee adopt the CS for SB 1, version: 30-LS0042\D.

[5:00:36 PM](#)

CHAIR DUNLEAVY objected for discussion purposes.

MS. RITACO provided an overview of the CS as follows:

The sectional change with Section 1 changes the amount appropriated from \$660,350,000, which was just an estimate at the time that we had the bill drafted, to reflect the statutory calculated amount vetoed by the governor which is \$683,234,813.

CHAIR DUNLEAVY asked to verify that there were no other changes.

MS. RITACCO replied that there were no other changes.

[5:01:19 PM](#)

At ease.

[5:01:31 PM](#)

CHAIR DUNLEAVY called the committee back to order. He announced that he removed his objection to the CS for SB 1. He declared that the CS for SB 1 is adopted. He asked that Ms. Ritaco provide a sectional analysis.

[5:01:48 PM](#)

MS. RITACO provided a sectional analysis as follows:

SB 1, Section 1: restores approximately \$1,032 to every Alaskan.

SB 1, Section 2: makes SB 1 contingent on SB 2; the reason for this is that if you don't make that contingent on each other, you could have the appropriation pass and it will just sit there until the next payout goes, which would be in 2017, therefore it actually would be in addition to 2017's payment rather than a supplemental to the 2016 payment.

SB 2 is the directive, Section 1: the commissioner of the Department of Revenue is directed to make the payment immediately.

SB 2, Section 2: contingent on SB 1 passing, so if SB 1 does not pass, SB 2 does not go into effect.

We put an effective date of May 1, 2017 to give time for the Department of Revenue to actually make the checks and send them out with FY2017's funds rather than FY2018.

MS. RITACO summarized that SB 1 and SB 2 are interconnected and are contingent on one another.

[5:03:11 PM](#)

CHAIR DUNLEAVY announced that [SB 1 and SB 2] are held in committee. He reminded the committee that public testimony will be held at an upcoming committee meeting and the intent is to move the two bills the following week.

[5:04:35 PM](#)

There being no further business to come before the committee, Chair Dunleavy adjourned the Senate State Affairs Committee at 5:04 p.m.