

# State of Alaska Office of Management and Budget

## Macroeconomic Impact of Fiscal Options

Presentation to the Senate Finance Committee

March 6, 2019

Chief Economist Ed King



THE STATE  
*of* **ALASKA**  
GOVERNOR MICHAEL J. DUNLEAVY

# ISER Report

## **SHORT-RUN ECONOMIC IMPACTS OF ALASKA FISCAL OPTIONS**

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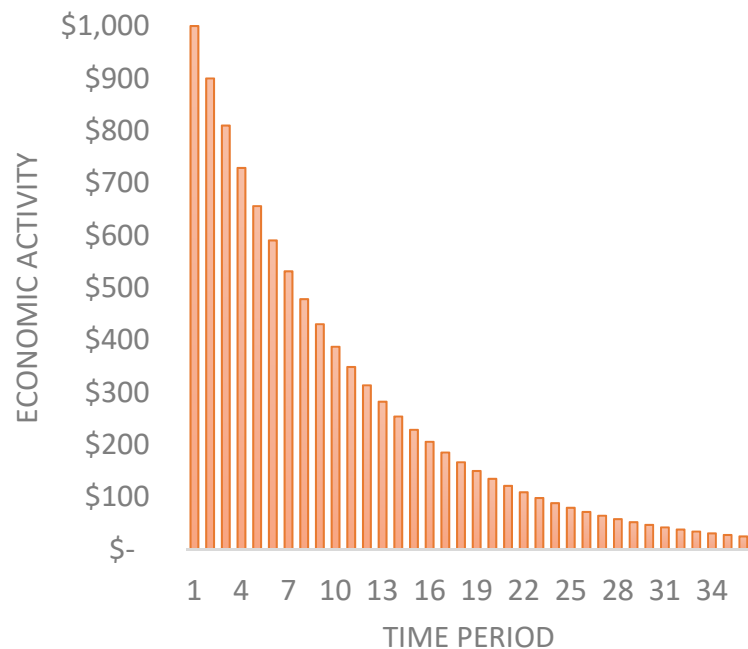
March 30, 2016

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# Illustration of a 10x Multiplier Effect\*

## One Time Injection



## Structural Shift

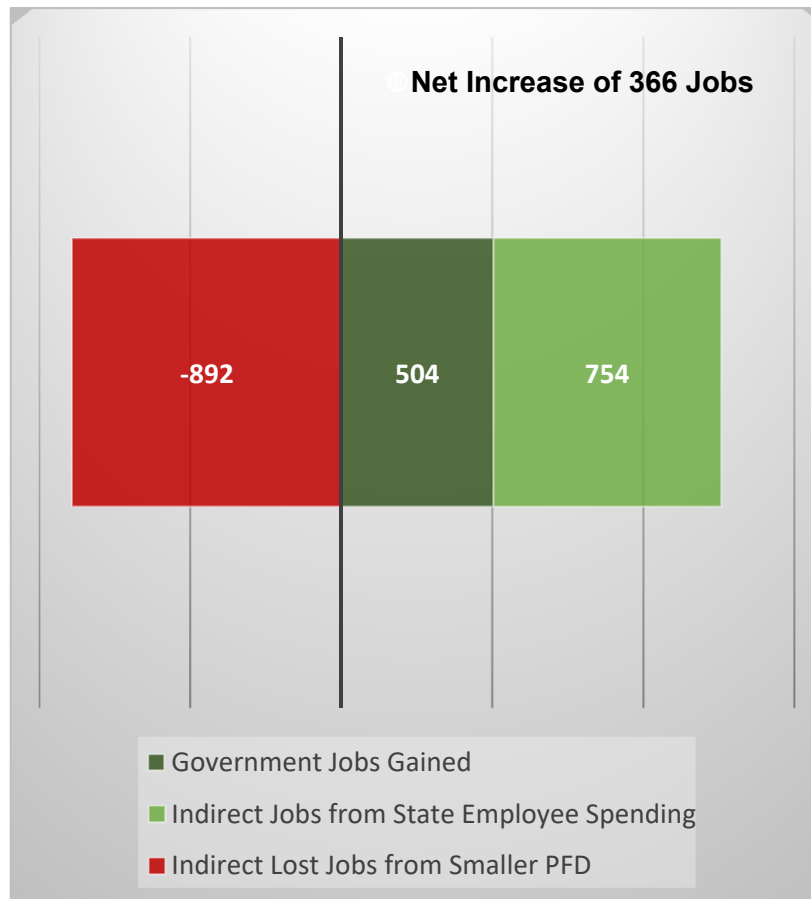


- Takeaways:
1. It can take years for the full indirect and induced effects to materialize
  2. Stopping an injection always creates the basis for a recession (spending trap)
  3. If the injection comes from a draw elsewhere in the same economy, there are offsetting effects

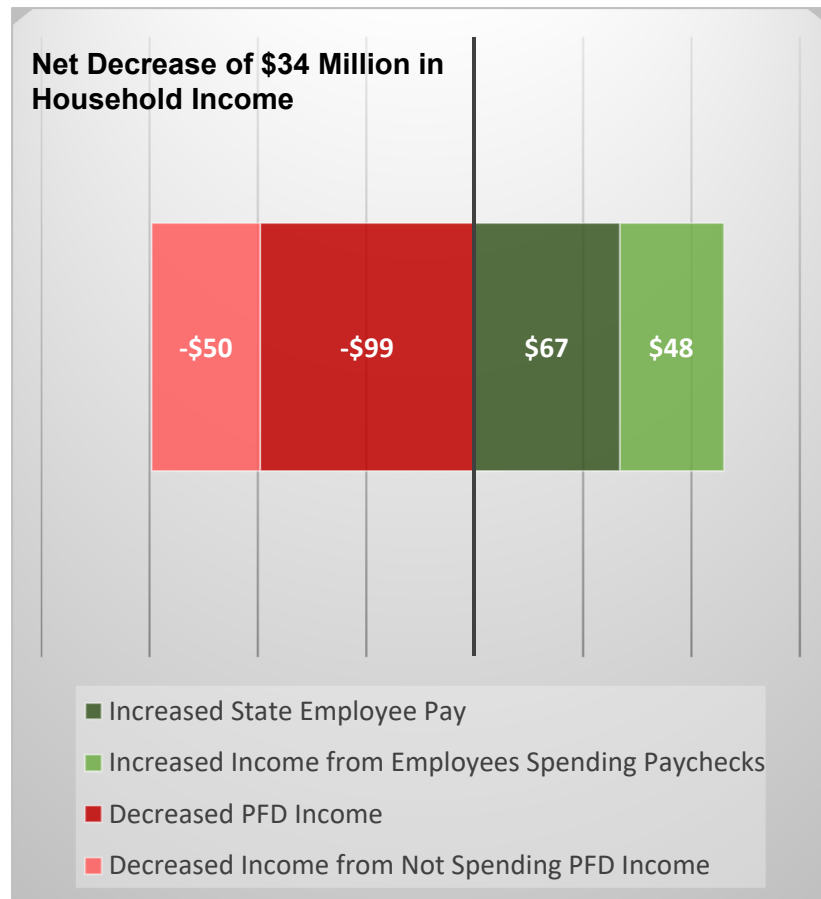
\*Reductions have the inverse impact

# IMPLIED NET IMPACT OF INCREASING SPENDING BY DECREASING PFD (PER \$100 MILLION)

Net Jobs



Net Household Income (Millions)



# Comments on ISER Report

- The numbers in the report are commonly misunderstood
  - Be careful when looking at jobs numbers
  - Ensure you are making a realistic comparison
  - Timing matters
- The *ceteris paribus* assumption only holds in a synthetic environment\*
  - Behavioral responses are important
  - Not all dollars/jobs/programs are equal
- All models endeavor to provide insight, not instruction
- Consider long-term impacts as well
- The comparisons between tax types is valuable
- The strength of this report lays in the distributional analysis

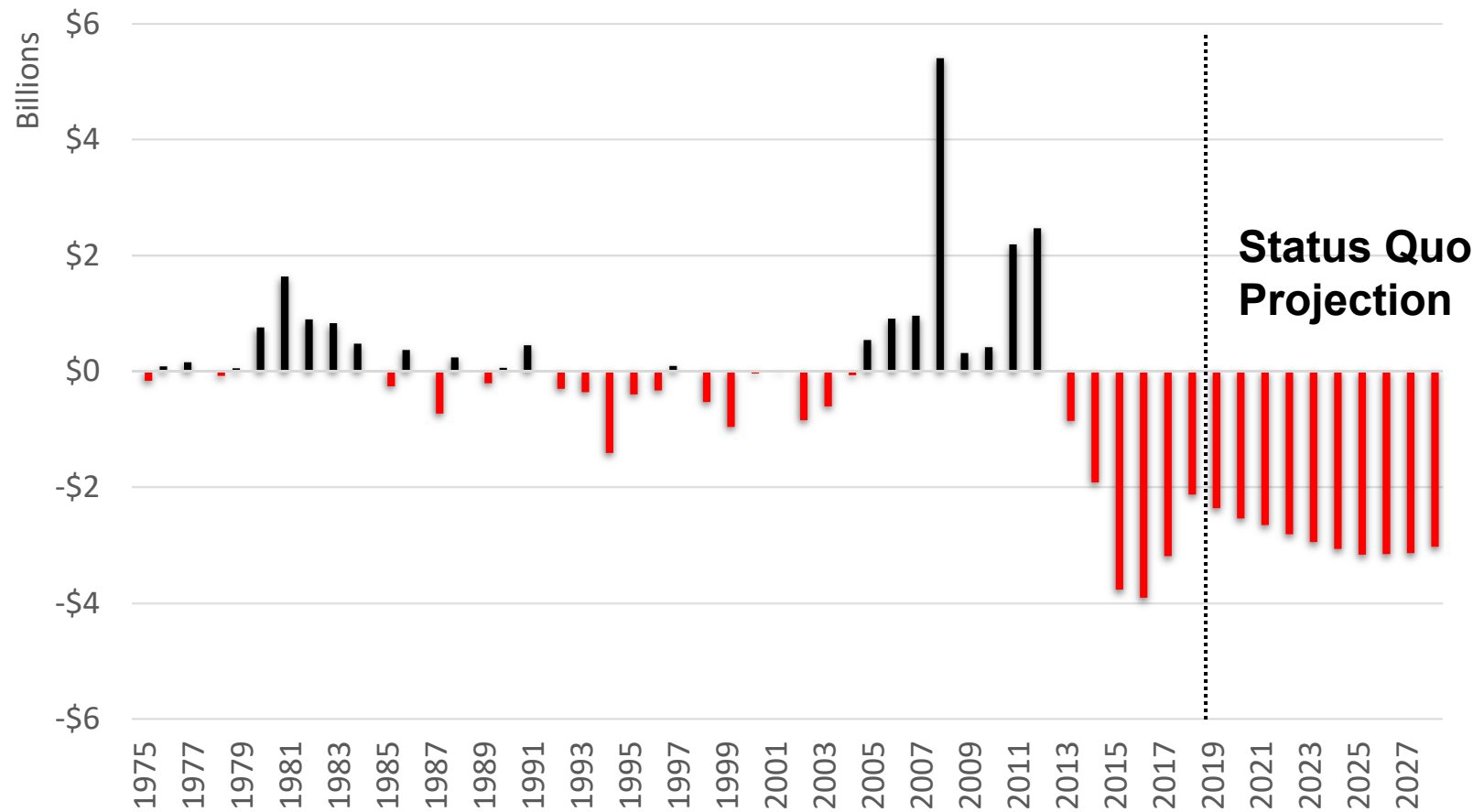
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\*Translation: Economic models assume everything except the variable of interest stays the same.  
In the real world, the economy adjusts to changes – filling the void that was left.

# The No Change Scenario

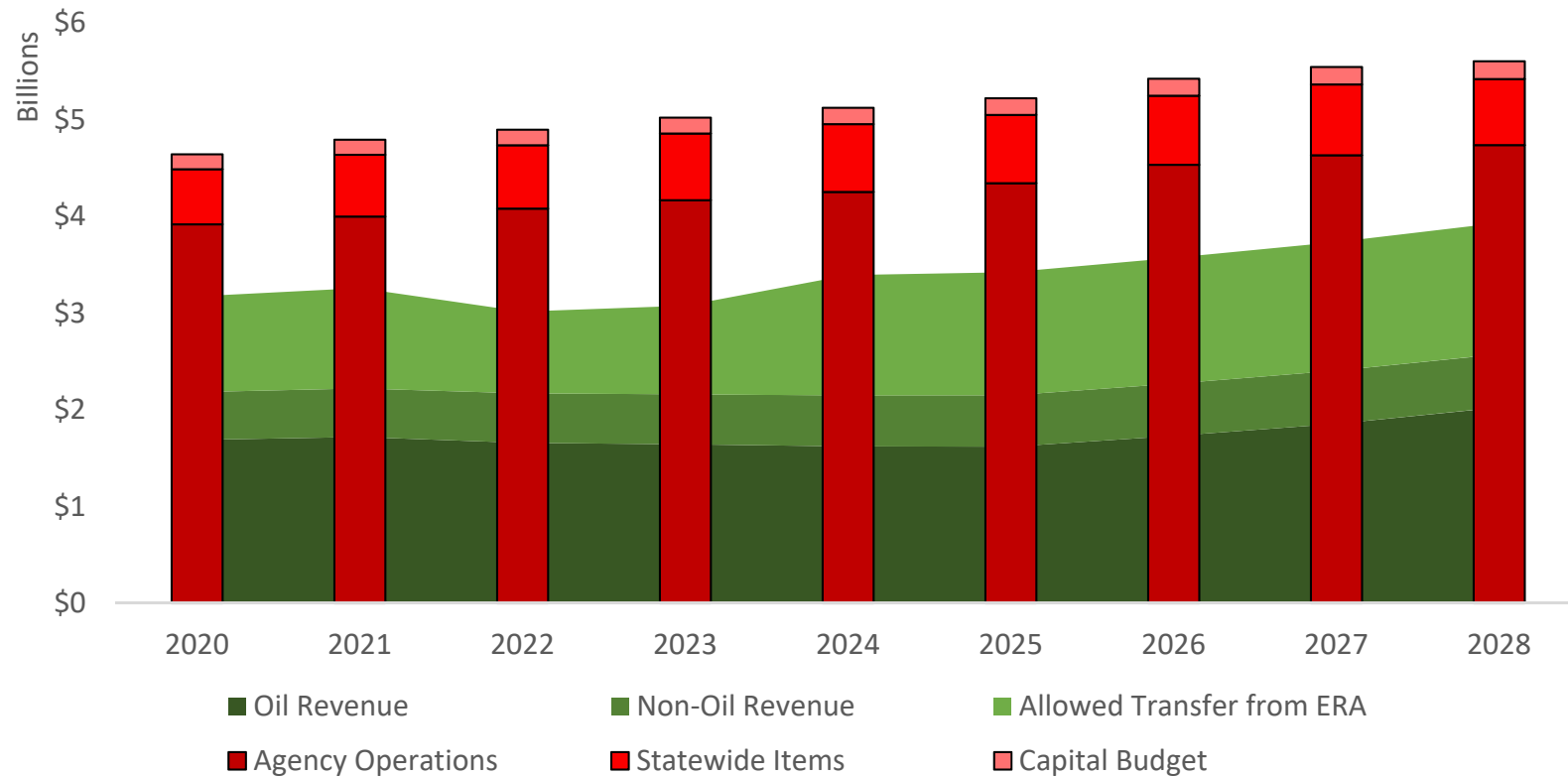
Avoiding budget cuts without addressing the structural issue

# UGF Surplus/Deficit



# Status Quo Fiscal Situation

**Takeaway: We have a structural fiscal problem, not a temporary budget problem**



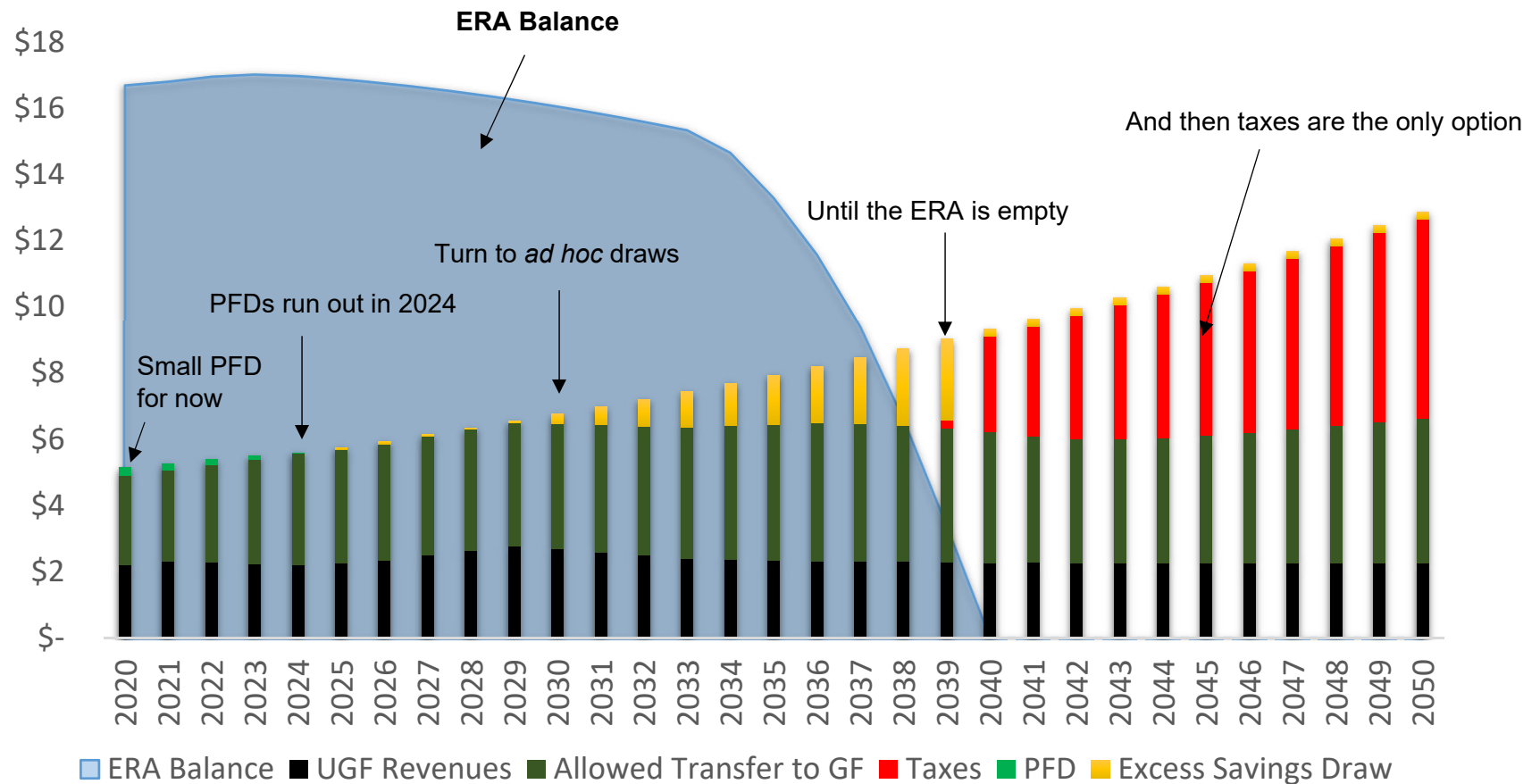


# Fiscal Options

- Reduce Spending
  - Lost government jobs, lower level of services
- Raise Taxes
  - Lost economic activity, lower standard of living
- Cut PFD
  - Lost economic activity, lower standard of living
- Deplete Assets
  - Lower future earnings, bigger future problems

*All options hurt, but doing nothing is not an option*

# The “Avoid Budget Cuts and Taxes” Scenario

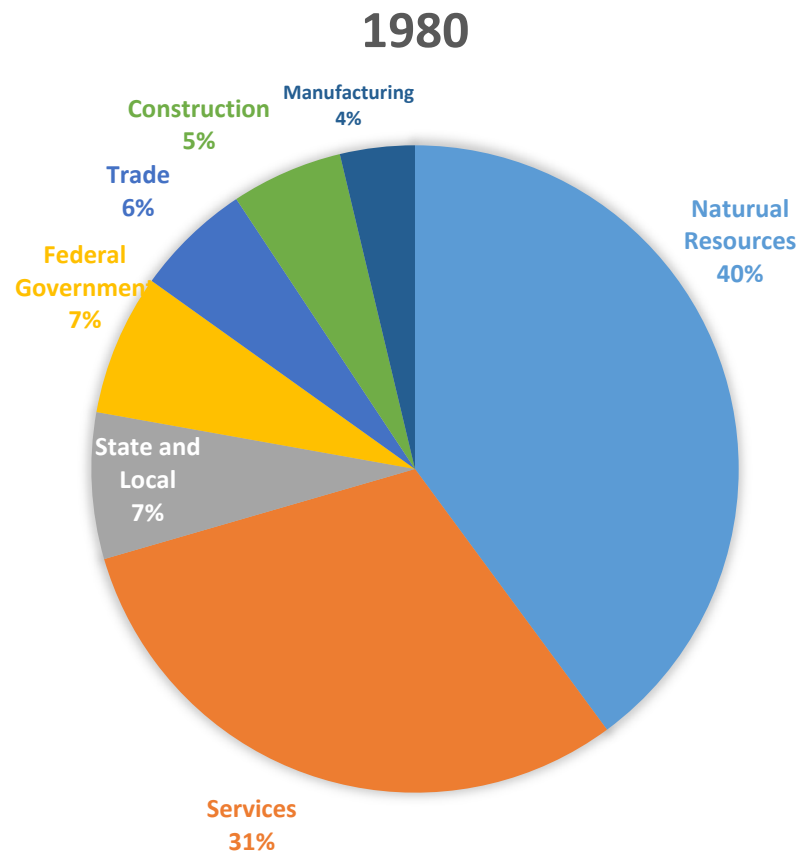


# Alaska's Changing Economy

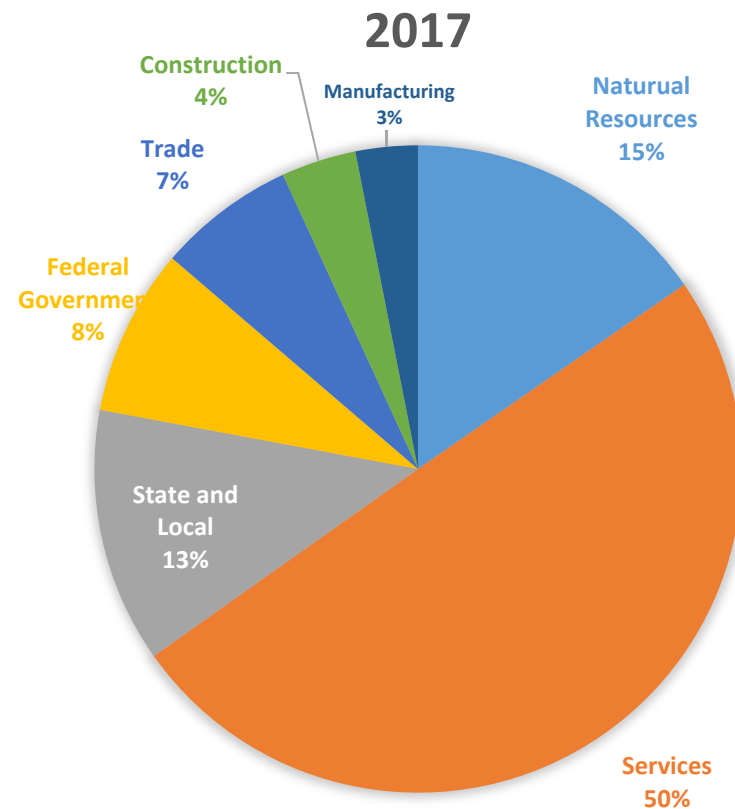
And how it will shape the reaction to the proposal

# Alaska's Gross Domestic Product Mix

GDP = \$15 billion



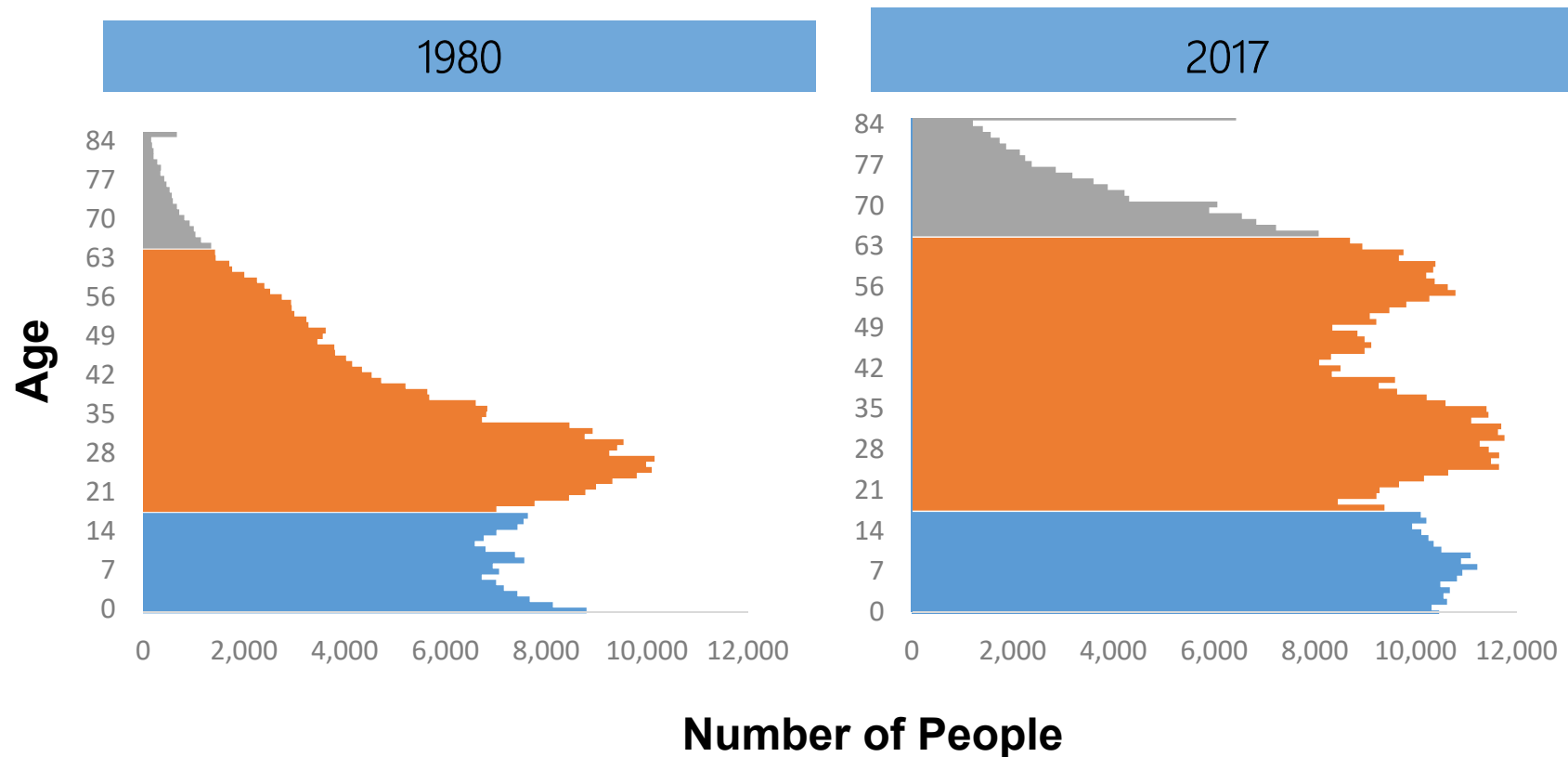
GDP = \$51.5 billion



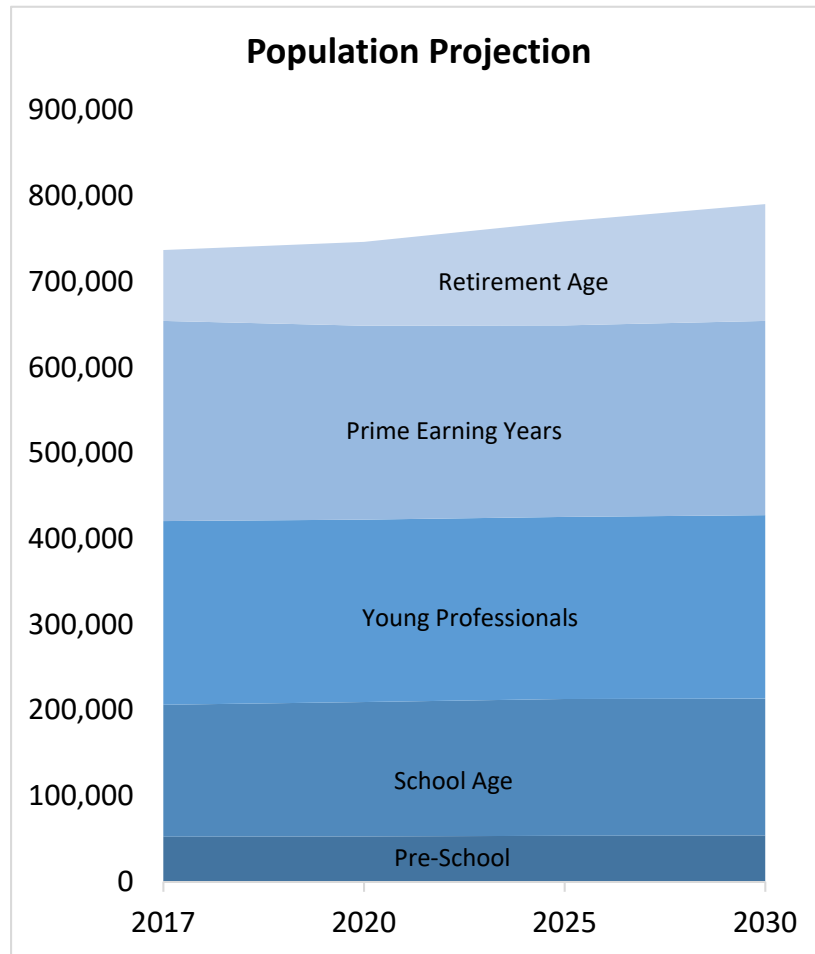
Source: Bureau of Economic Analysis

# Alaska's Age Distribution Change

- Takeaways:
1. Alaska's population is much older and more rooted than in the past
  2. A large number of residents are near retirement age, which will have economic impacts



# Alaska's Changing Population

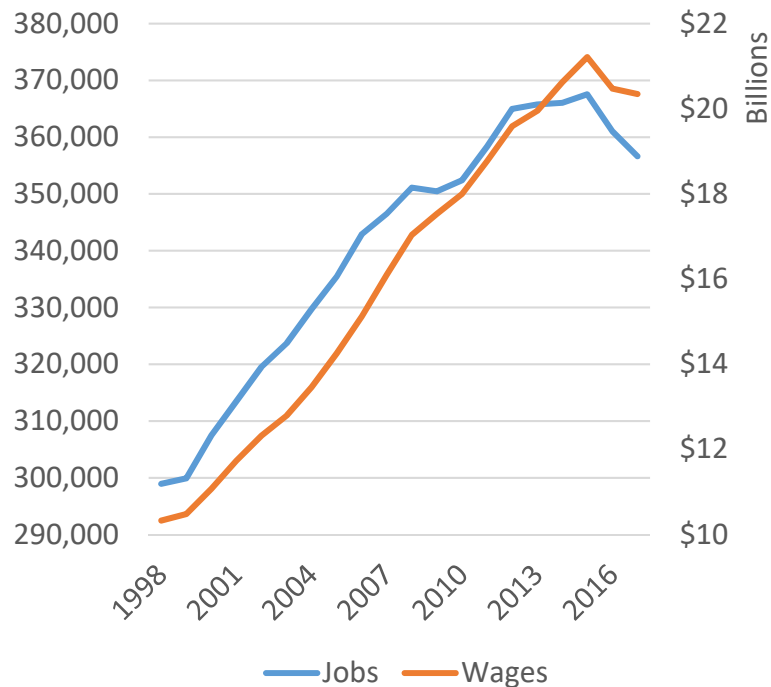


- Population growth based solely on aging Alaskans will:
  - Increase demand for healthcare
  - Increase mortality rates
  - Increase out-migration
  - Increase retirement spending
- Labor force projection is stable
  - But jobs forecast is for 17,000 added jobs by 2026
    - Significant labor needs for new oil and mining projects not included in forecast
  - Future labor shortages are likely, which provides seeds for growth
- Child population stable

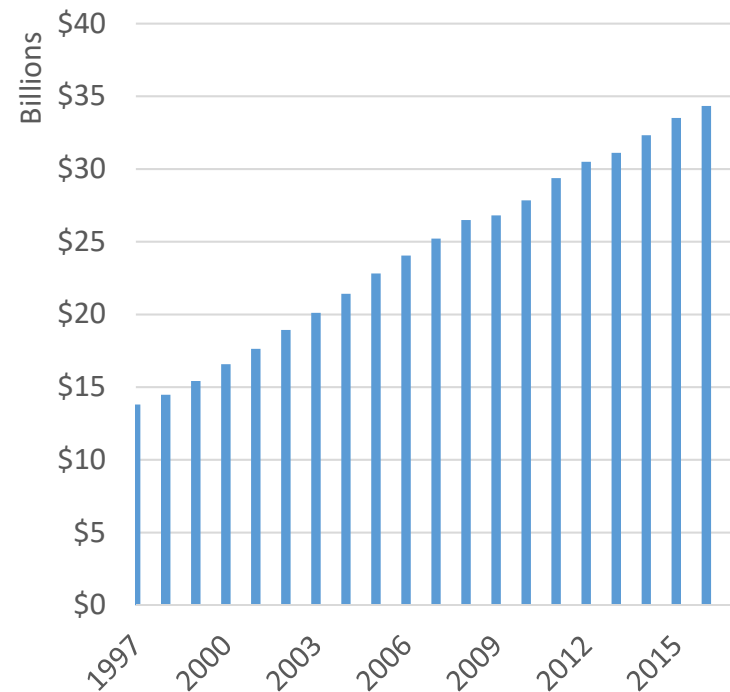
# Retirement Income Helped Cushion the Impact of Oil Price Crash

- Takeaways:
1. The multiplier effects did not manifest, because people adjusted to the shock without reducing spending;
  2. The lack of spending reduction suggests that retirement was a more likely reaction than migration

## Jobs and Wages Saw a Decline...

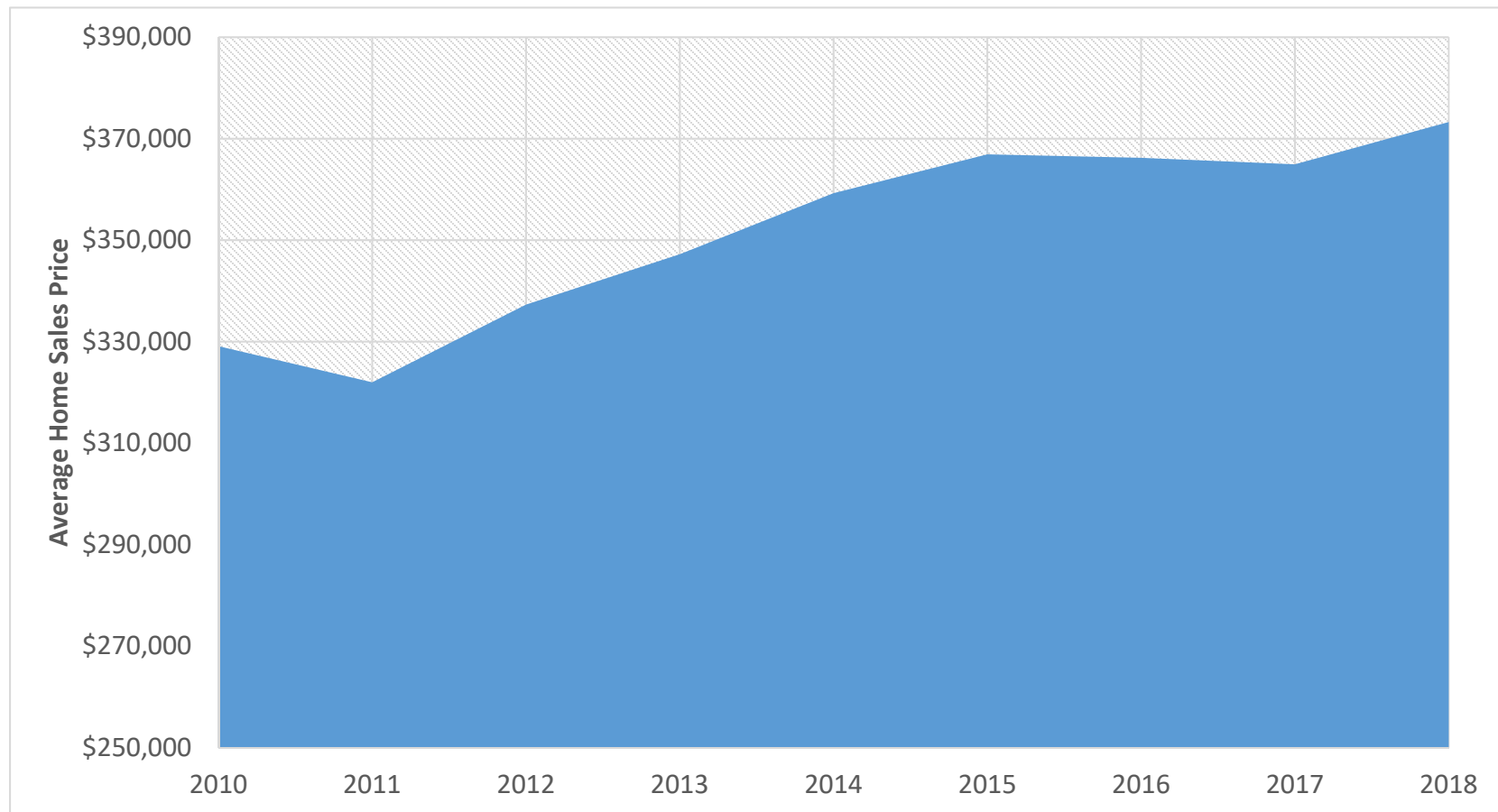


## ...But Personal Consumption Did Not



# Retirement Income Helped Cushion the Impact of Oil Price Crash

## Housing Prices Did Not Crash



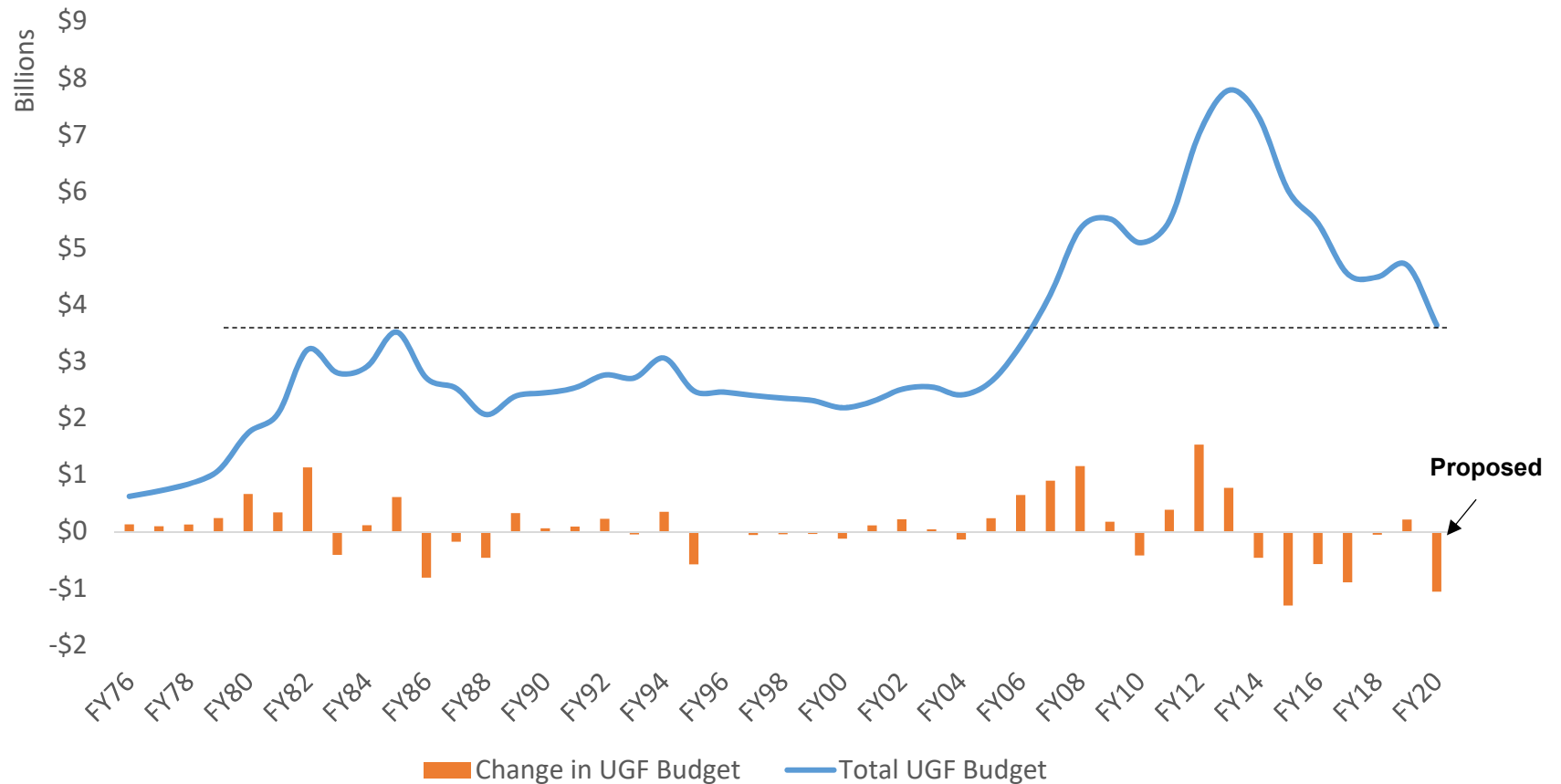
Source: <https://www.alaskarealestate.com/Consumer/PublicStatistics.aspx>



# Impact of Proposed Budget

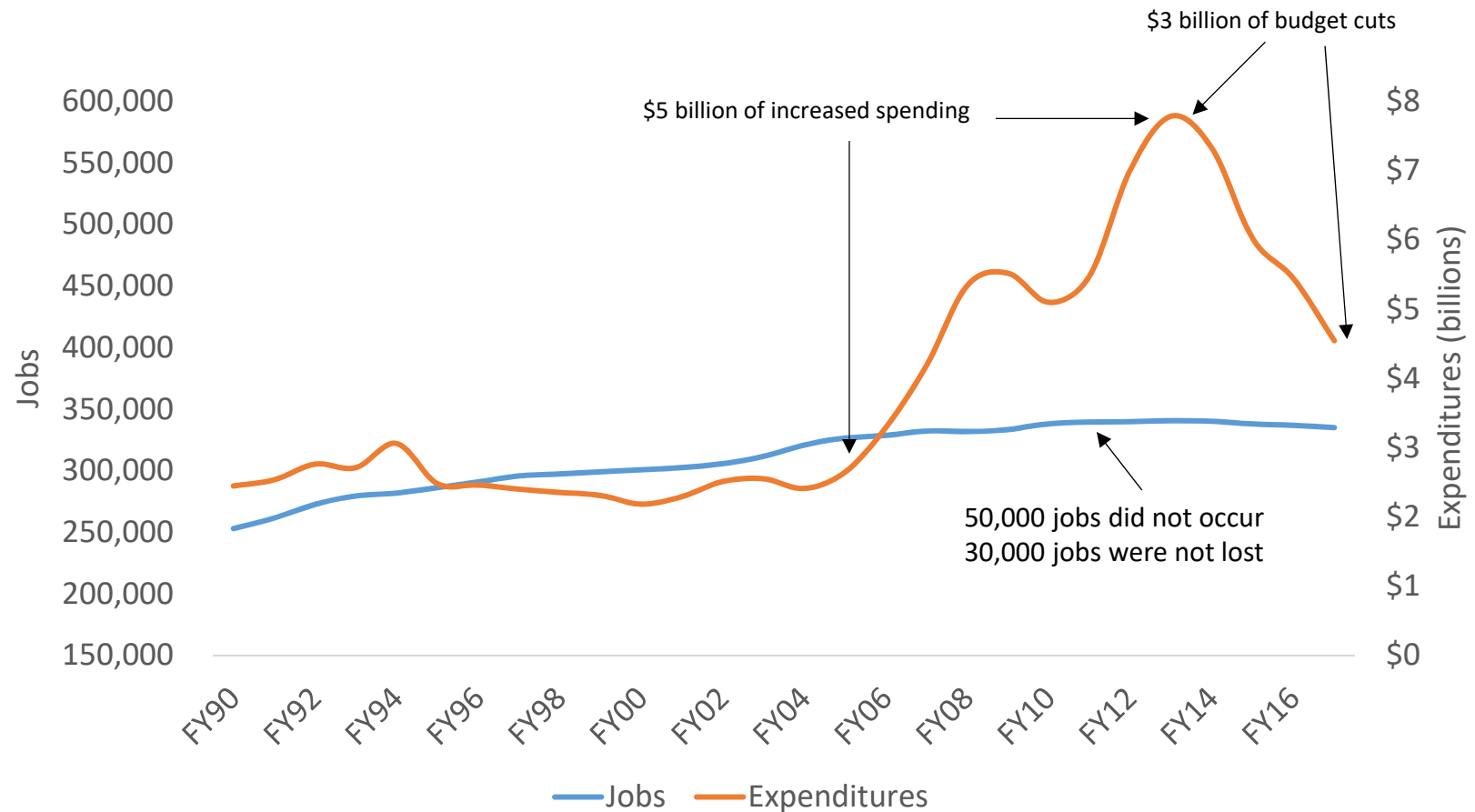
# State Budget Volatility

- Takeaways:
1. This proposal is not unprecedented in terms of total spending;
  2. This budget returns the state to 2005 levels of inflation adjusted spending



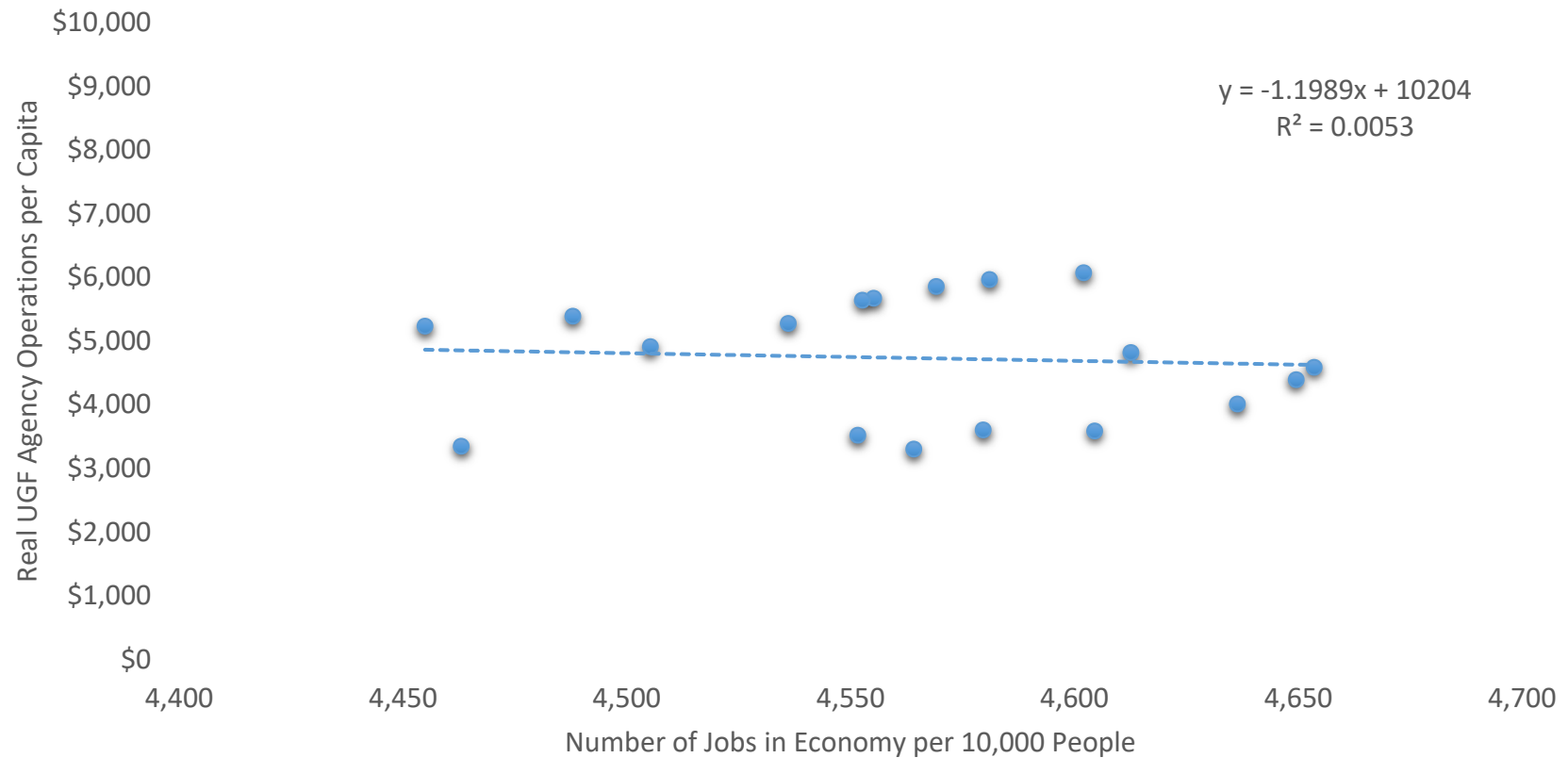
# Impact of Budget on Labor Market

Takeaway: Prior increases/decreases did not generate the type of impacts being discussed



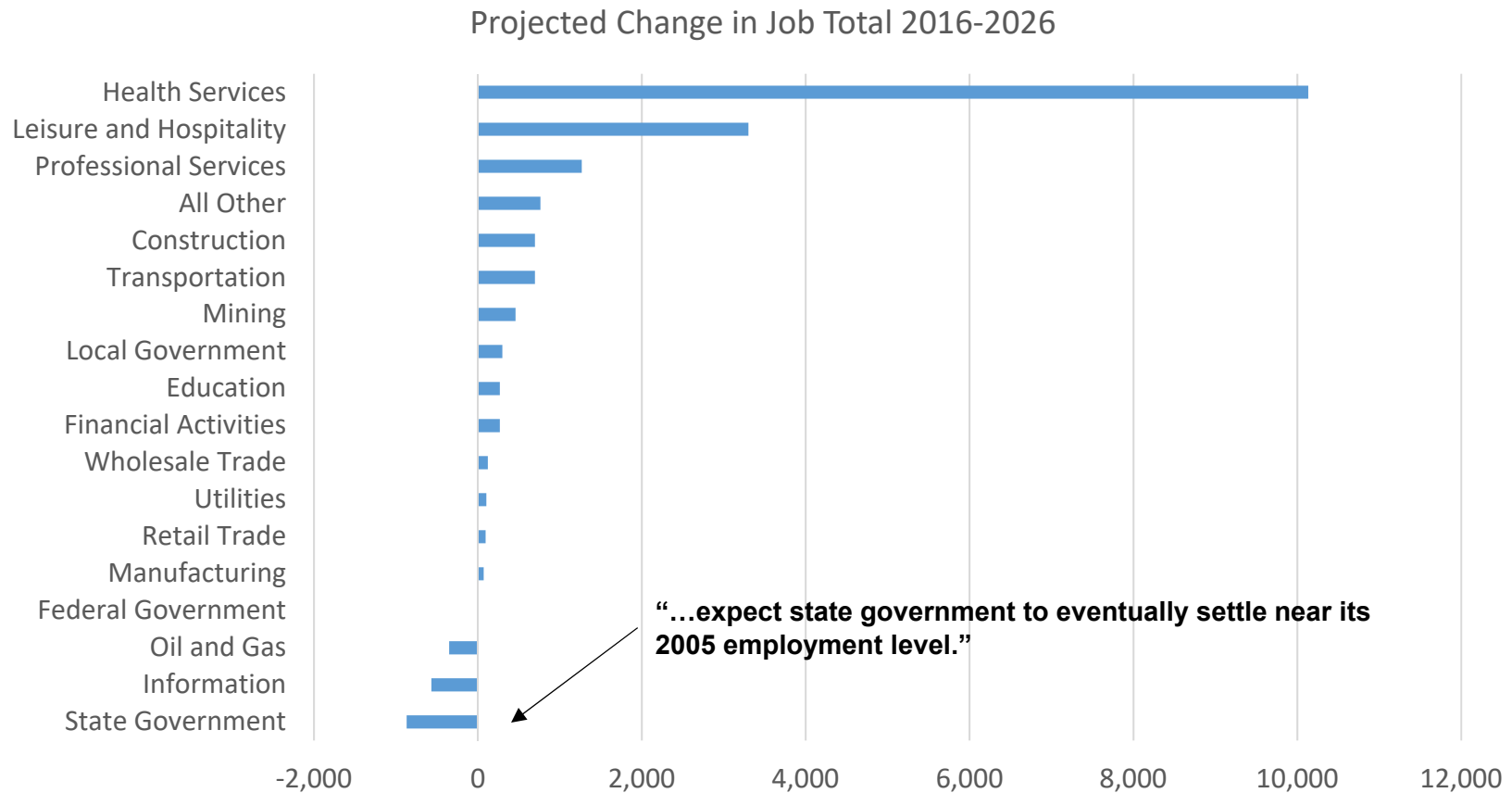
# Budget Impact on Total Jobs

Takeaway: There is no statistically significant relationship between State spending and jobs in Alaska's history, once controlling for inflation and population growth



# 10-Year Jobs Forecast

Takeaway: The pre-budget forecast of 17,000 job growth included some expectation of future budget cuts, meaning that simply subtracting those jobs from this forecast is improper



# Expected Jobs Impacts

- State Jobs
  - Unclear – depends on privatization efforts
    - Up to 1,000
- Education related jobs
  - Unclear - depends on school board decisions (instruction vs non-instruction vs efficiencies) and change in local contributions
    - Up to 3,000 jobs
- University related jobs
  - Unclear – depends of board of regents decisions (close campuses vs horizontal cuts vs raise revenue)
    - Up to 1,500 jobs
- Healthcare related jobs
  - Unclear – depends on market reaction to changing payment system
    - Industry projected to grow regardless, so slower growth is more likely than net job losses
- Trade related jobs
  - Injection from larger PFDs will spur more spending and create more labor demand
    - ISER estimate is 14,272 jobs (892 jobs per \$100 million x \$1.6 billion)
  - Reduced employment from budget reductions will offset part of this increase
  - Improved fiscal stability should generate additional investment (although timing is uncertain)

Note: Jobs counts are not the best measurement of economic impacts

# Expected Impacts

- Regional impacts will be more pronounced than total State impacts
- Every individual will be impacted differently, regardless of fiscal solution
- There will be initial job losses from smaller budget
  - It will not be 17,000 jobs
- There will also be additional jobs from larger PFDs
- Some job losses will result in retirement, relocation, new employment, and new businesses
  - Net job losses will be smaller than anticipated by static models
  - Indirect effects will be smaller than anticipated as a result
- Household income will be higher, as a result of larger PFDs
  - Alaskans will decide how to best improve their quality of life
- Local governments will replace some spending reductions
  - Mitigates some of the direct effects
  - Brings spending and revenue decisions closer to user groups
- Economic growth will still occur through increased resource development, tourism, military, retirement spending, health care demand, and private investment

# Sustainable, Predictable, Affordable