State of Alaska
Office of Management and Budget

Macroeconomic Impact of Fiscal Options

Presentation to the House Finance Committee

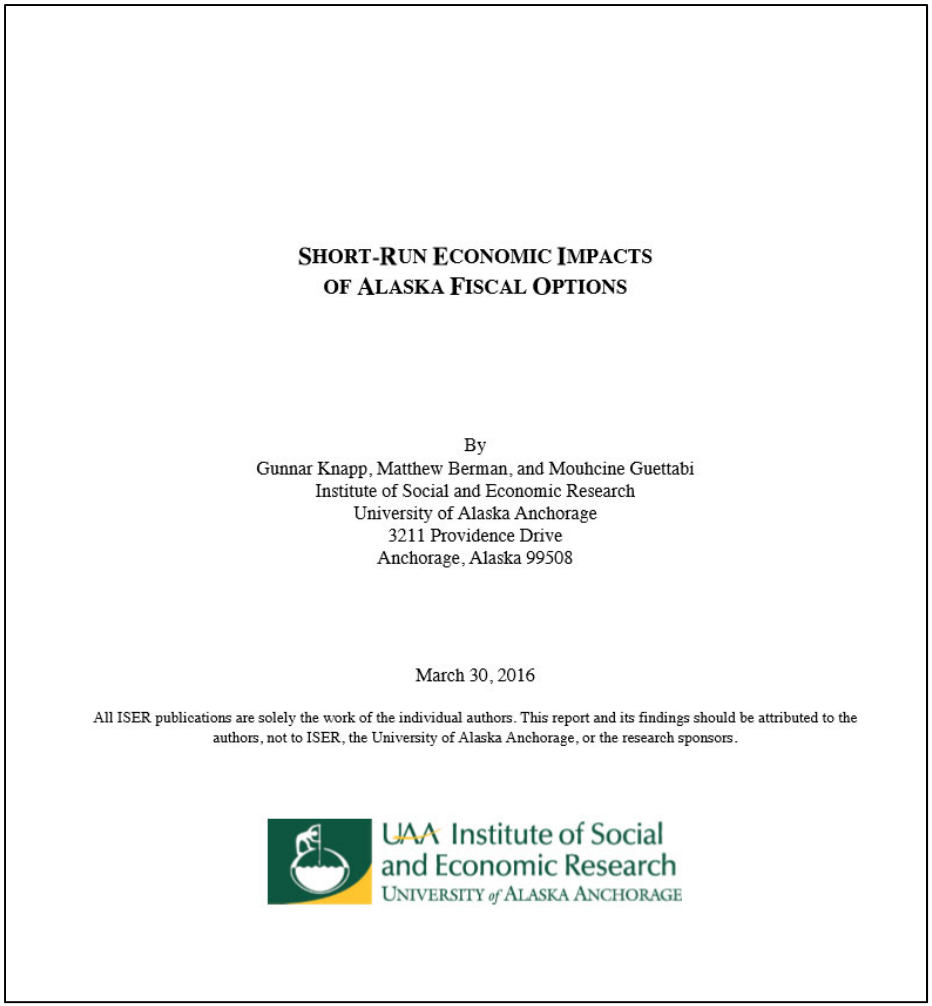
March 6, 2019

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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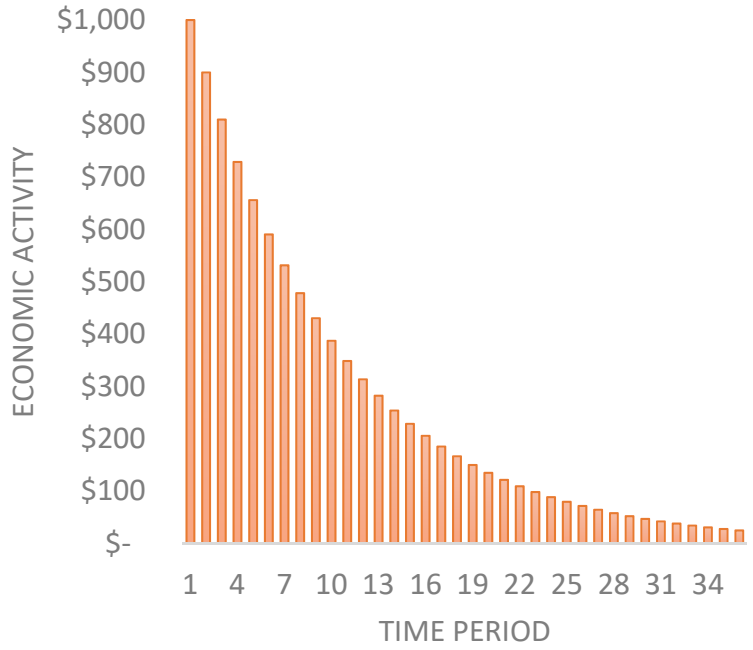
March 30, 2016

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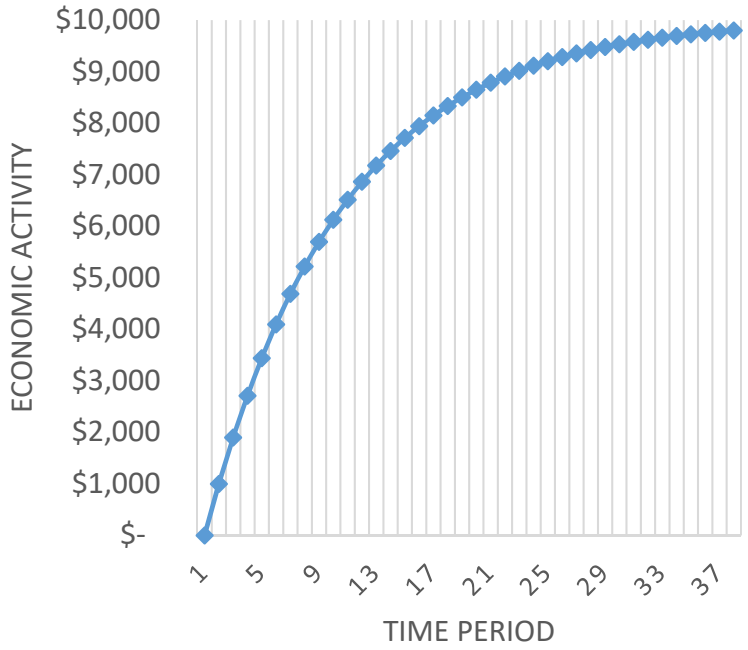
UAA Institute of Social and Economic Research
University of Alaska Anchorage

Illustration of a 10x Multiplier Effect*

One Time Injection



Structural Shift

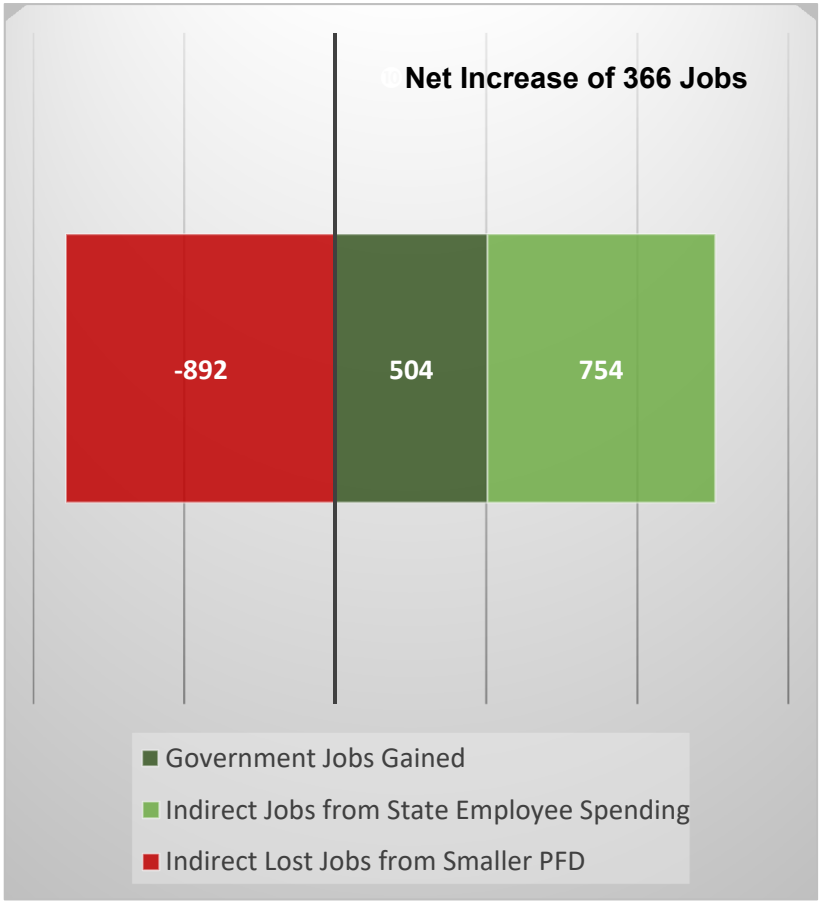


Takeaways:
1. It can takes years for the full indirect and induced effects to materialize
2. Stopping an injection always creates the basis for a recession (spending trap)
3. If the injection comes from a draw elsewhere in the same economy, there are offsetting effects

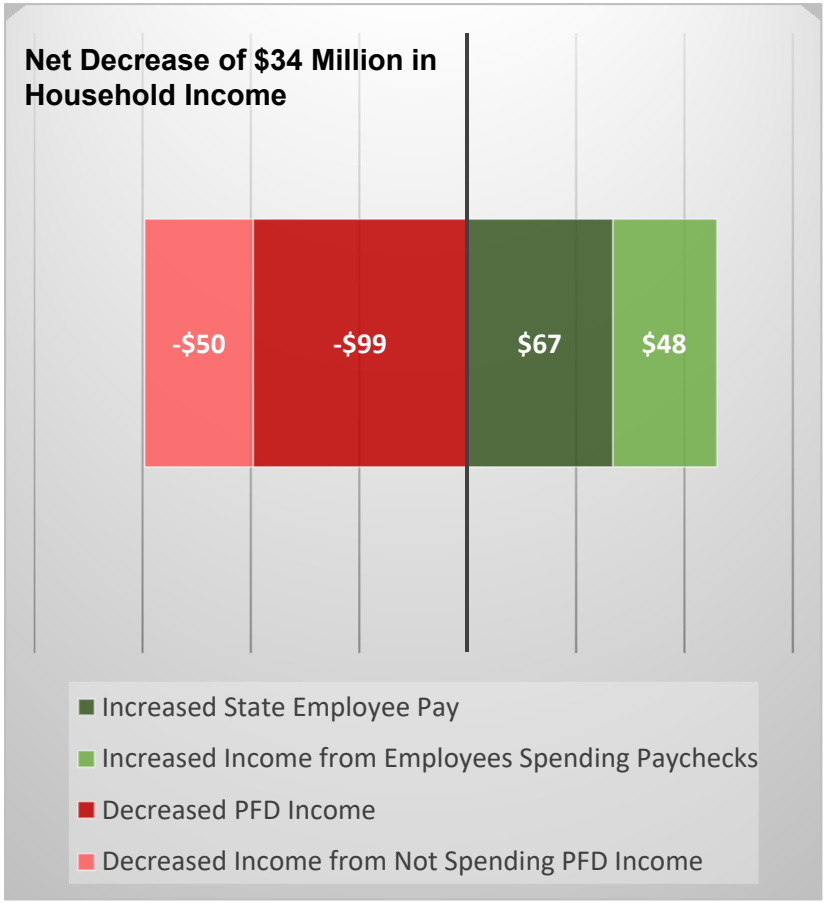
*Reductions have the inverse impact

Implied Net Impact of Increasing Spending by Decreasing PFD (per $100 Million)

Net Jobs



Net Household Income (Millions)



Source: "Short-Run Economic Impacts of Alaska Fiscal Options" ISER, 2016

Comments on ISER Report

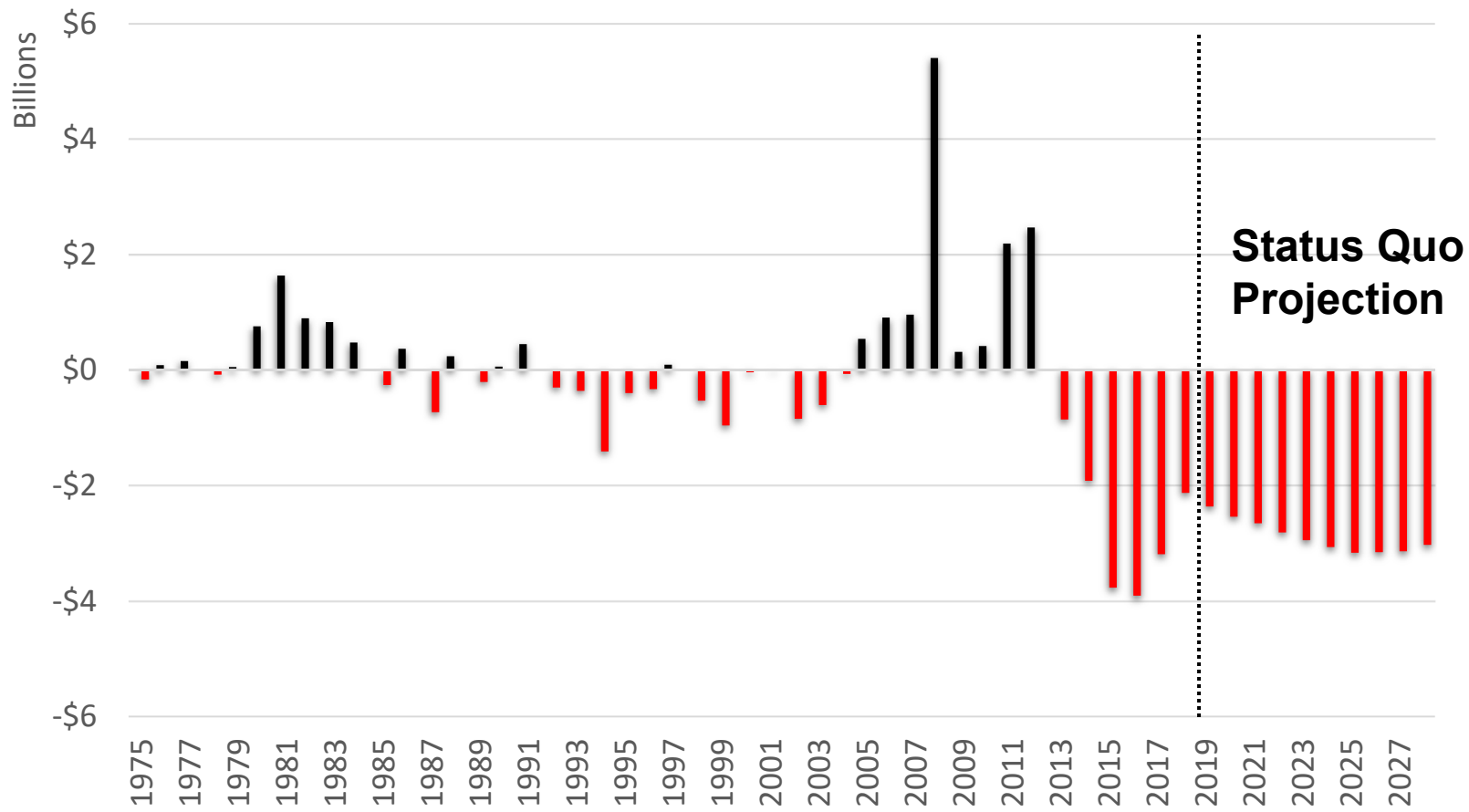
- The numbers in the report are commonly misunderstood
  - Be careful when looking at jobs numbers
  - Ensure you are making a realistic comparison
  - Timing matters
- The *ceteris paribus* assumption only holds in a synthetic environment*
  - Behavioral responses are important
  - Not all dollars/jobs/programs 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

*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

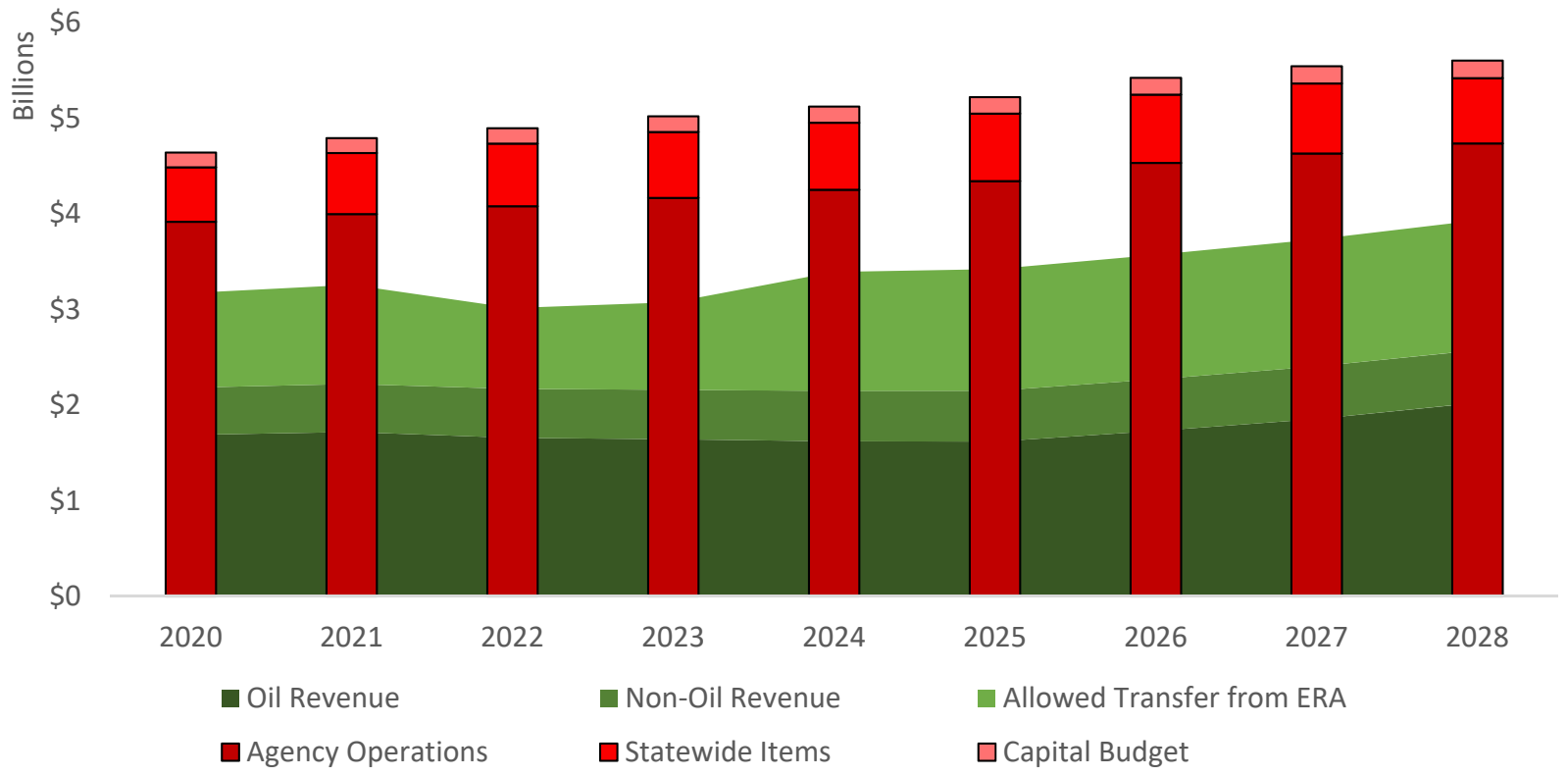
UGF Surplus/Deficit



Sources: Legislative Finance, Department of Revenue, Office of Management and Budget

Status Quo Fiscal Situation

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



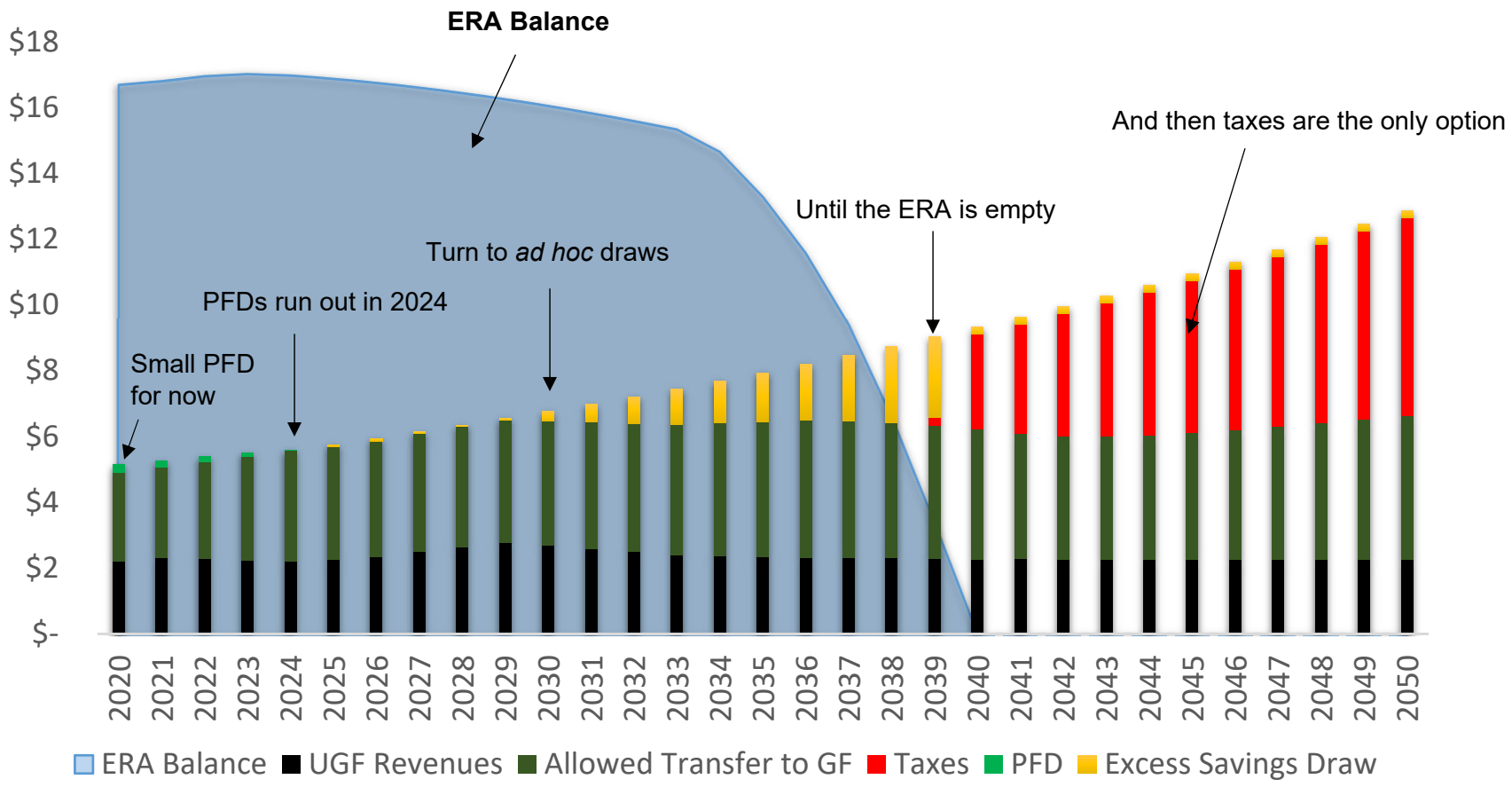
Sources: Legislative Finance, Department of Revenue, Office of Management and Budget

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

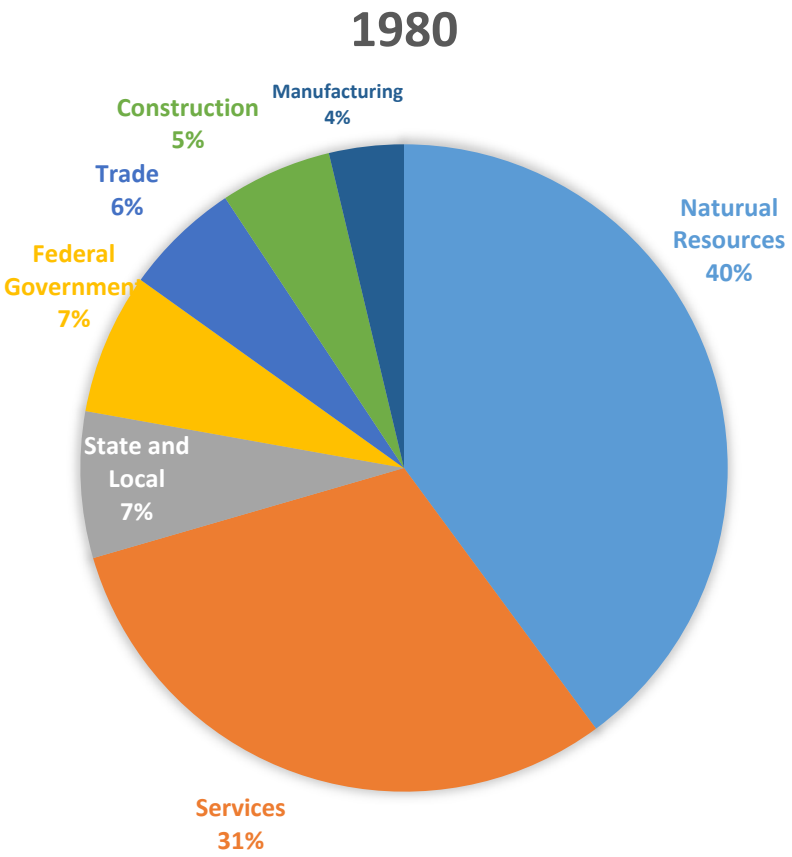


Alaska's Changing Economy

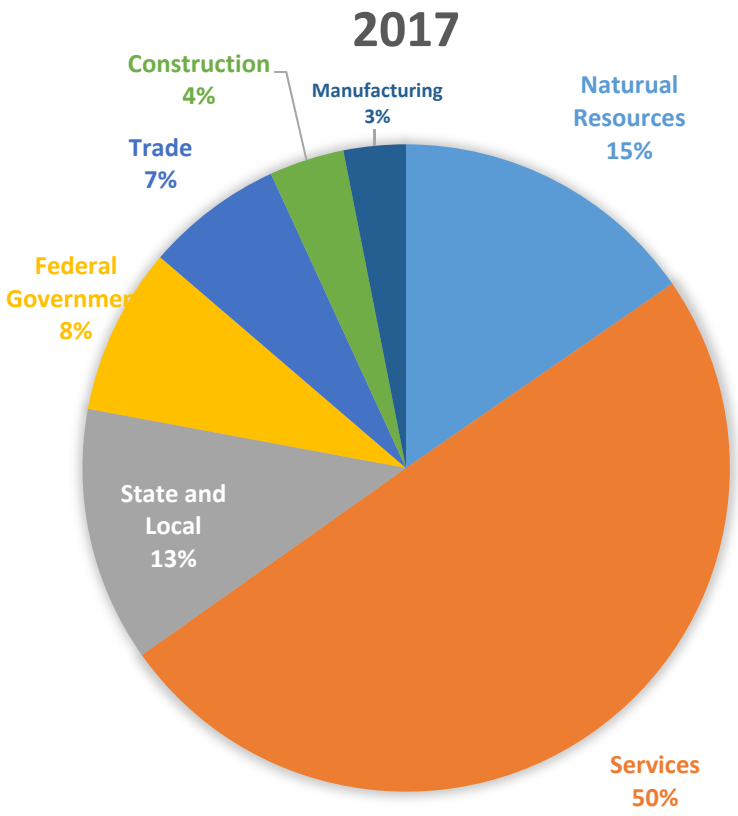
And how it will shape the reaction to the proposal

Alaska's Gross Domestic Product Mix

GDP = $15 billion



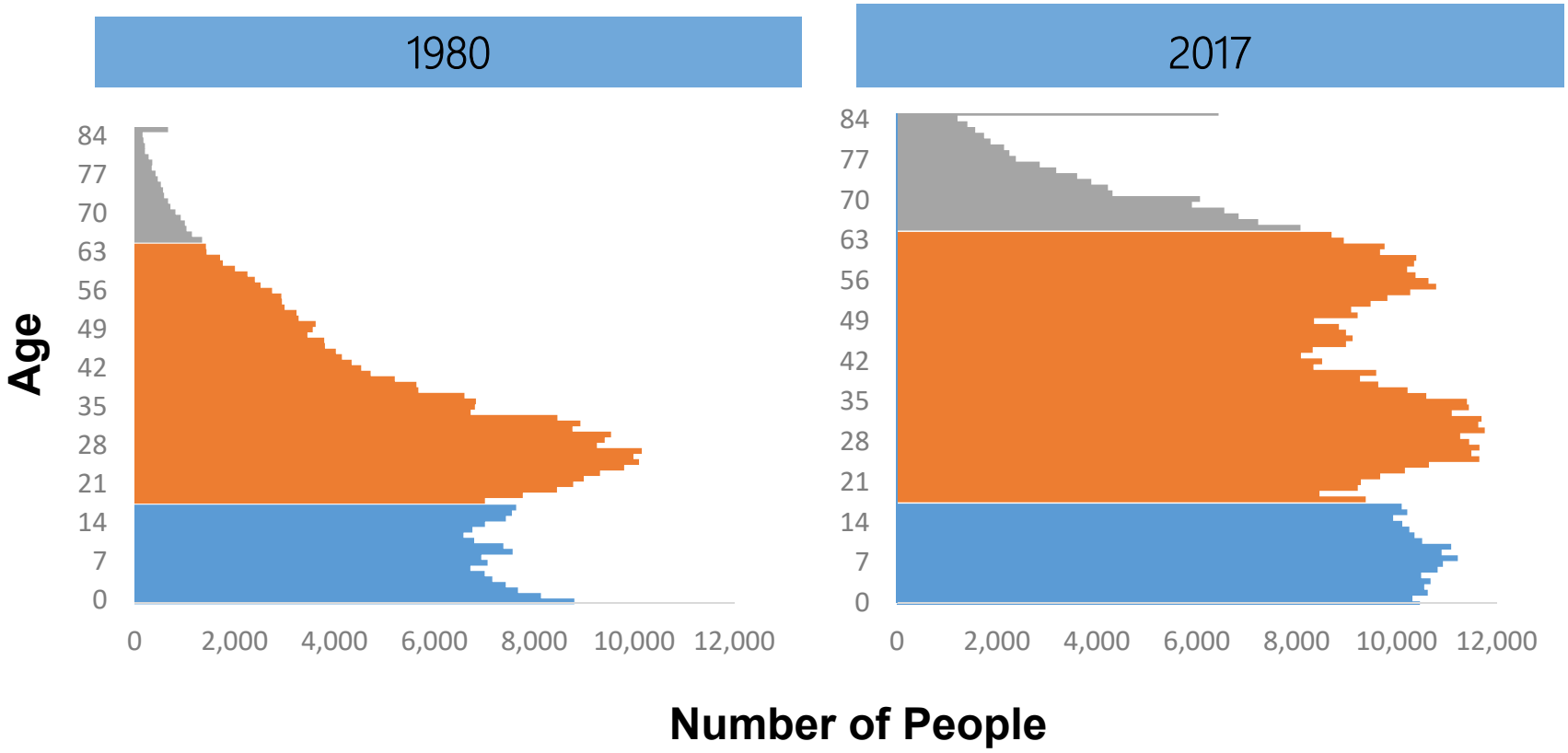
GDP = $51.5 billion



Source: Bureau of Economic Analysis

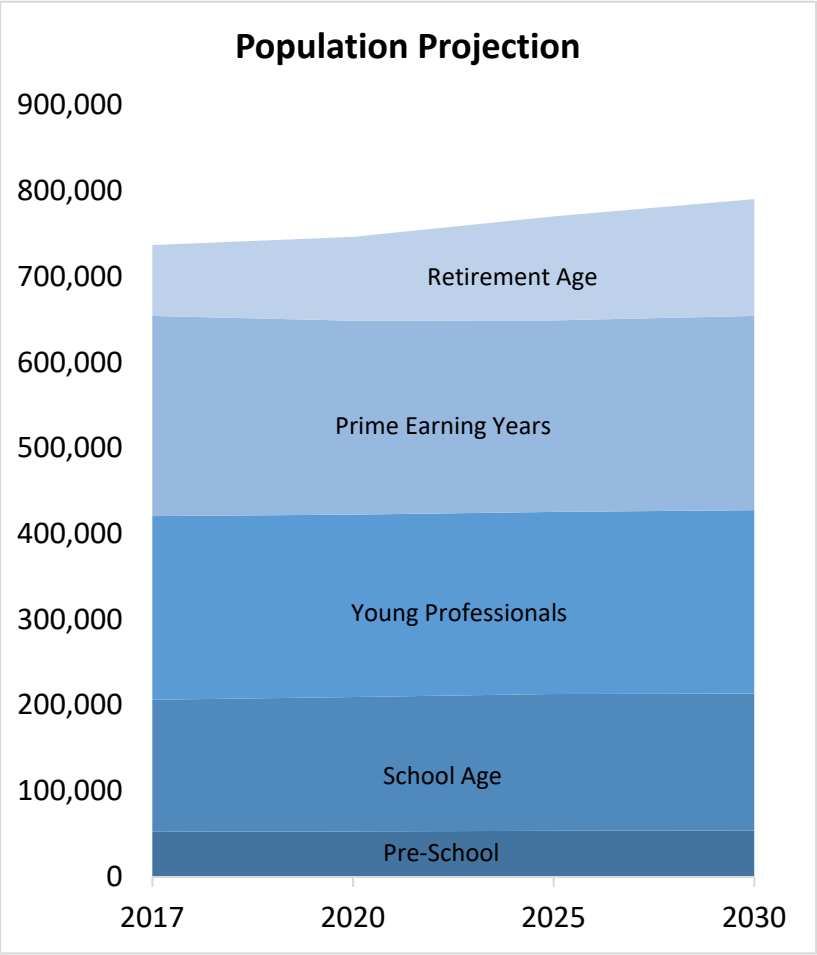
Alaska's Age Distribution Change

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



Source: Alaska Department of Labor

Alaska's Changing Population



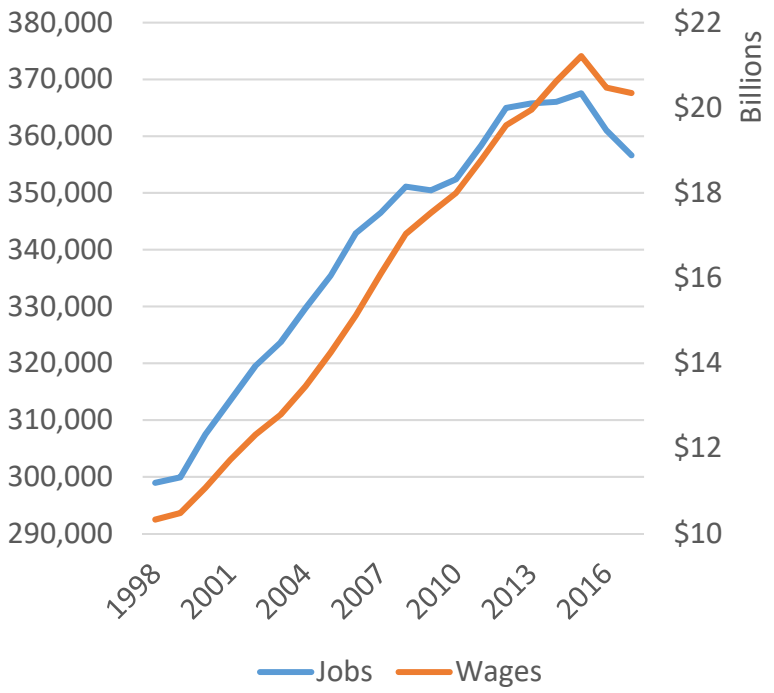
- Population growth based solely on aging Alaskans will:
  - Increase demand for healthcare
  - Increase mortality rates
  - Increase out-migration
  - Increase retirement spending
- Labor force projection is stable
  - But jobs forecast is for 17,000 added jobs by 2026
    - Significant labor needs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

Source: Alaska Department of Labor

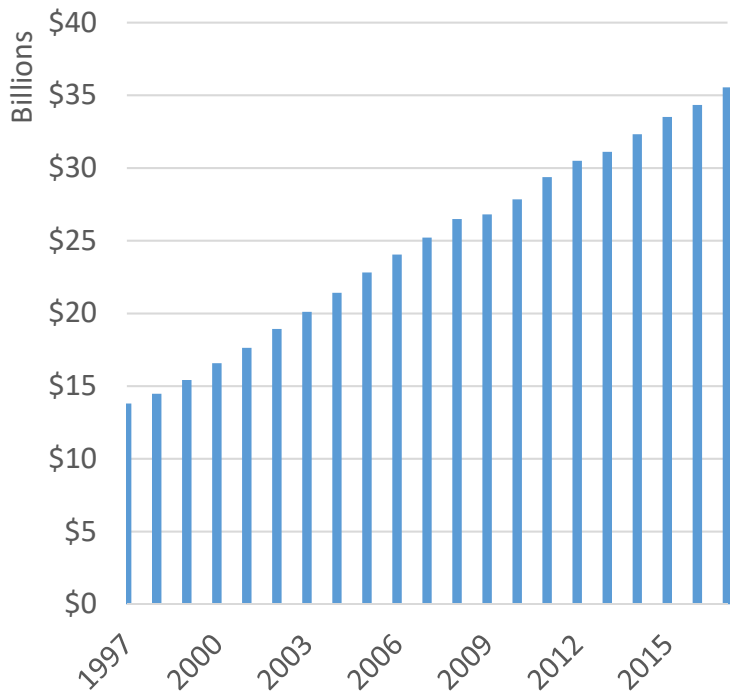
Retirement Income Helped Cushion the Impact of Oil Price Crash

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…



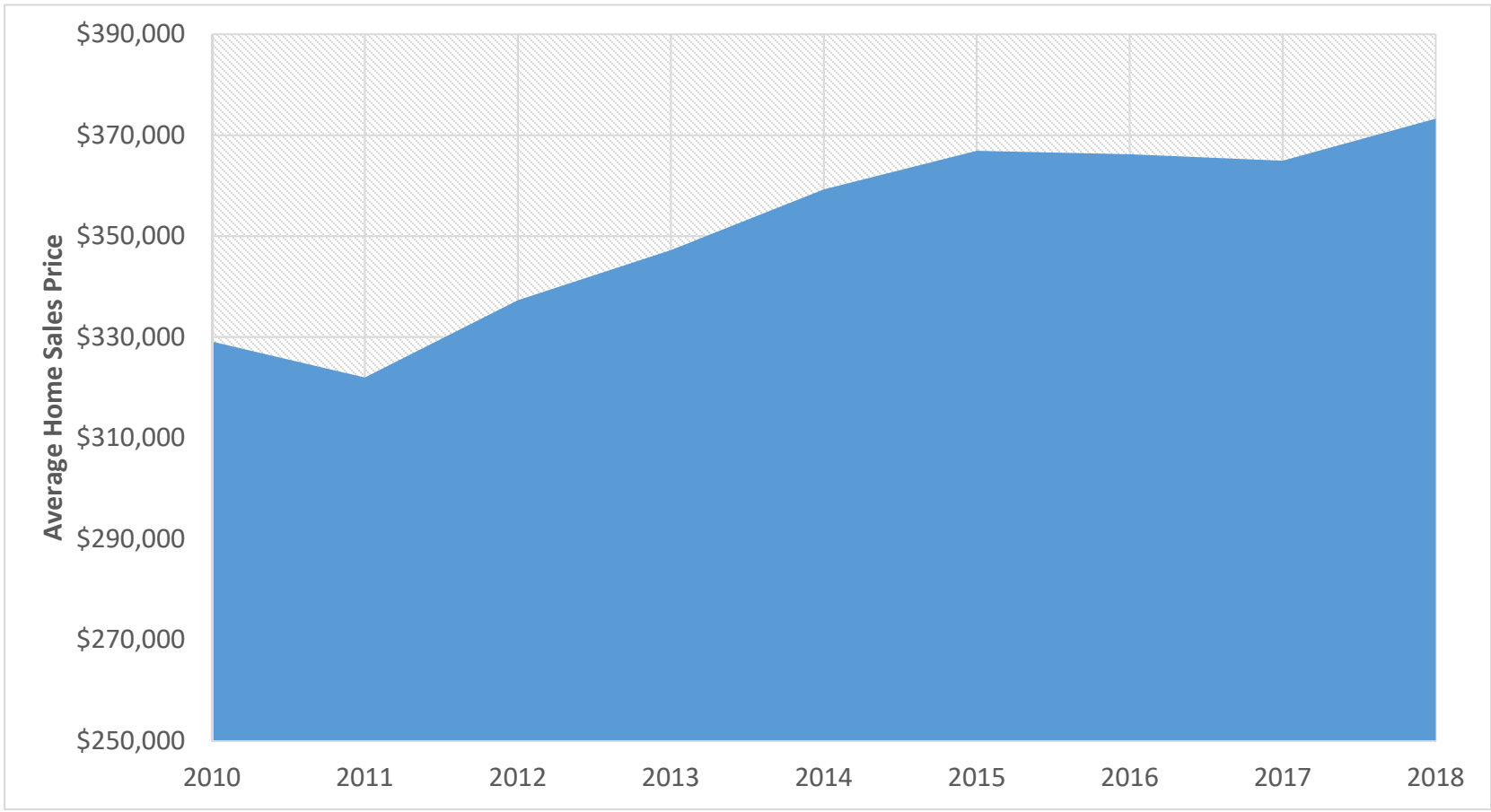
…But Personal Consumption Did Not



Source: Bureau **of Economic Analysis**

Retirement Income Helped Cushion the Impact of Oil Price Crash

Housing Prices Did Not Crash

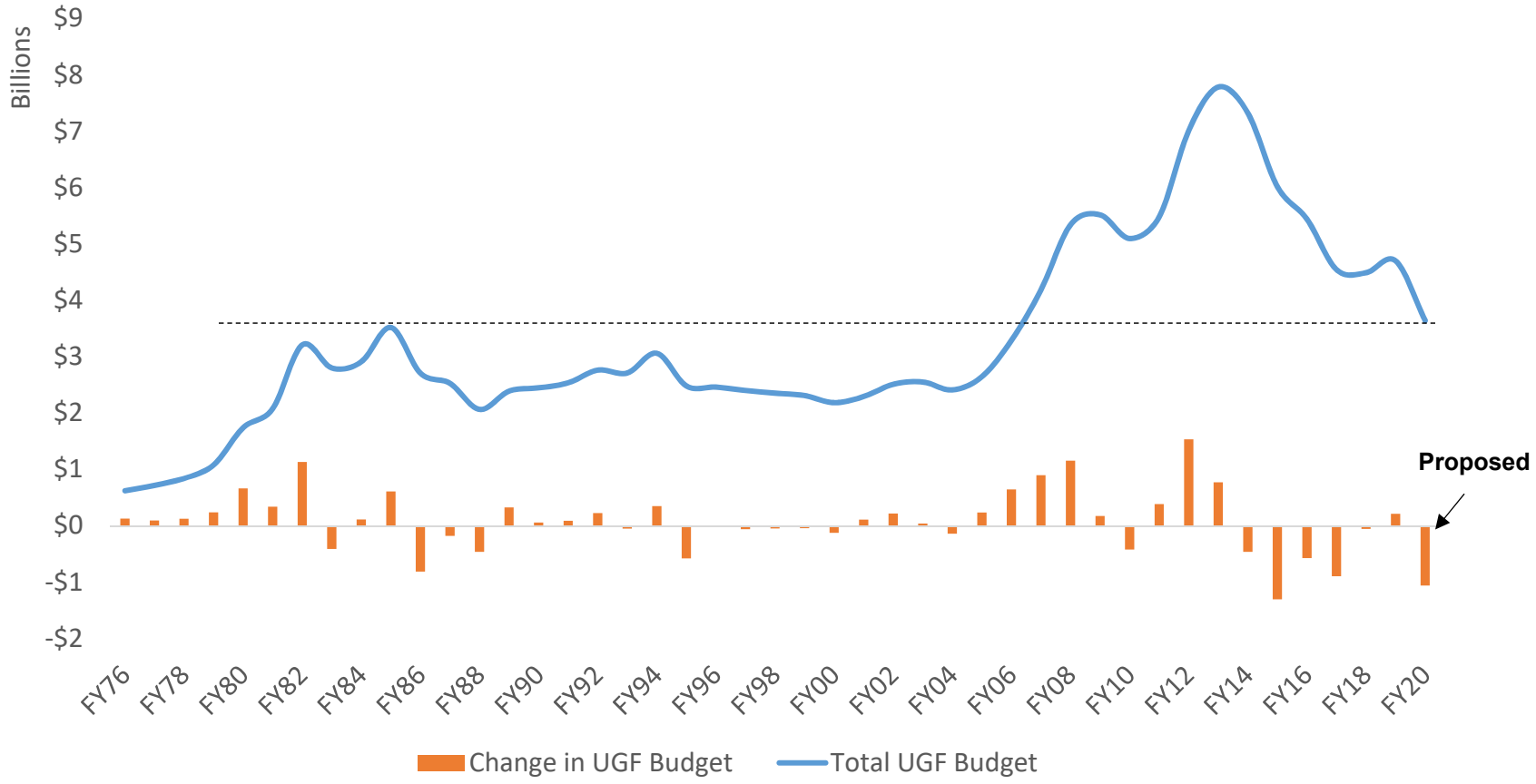


Source: https://www.alaskarealestate.com/Consumer/PublicStatistics.aspx

Impact of Proposed Budget

State Budget Volatility

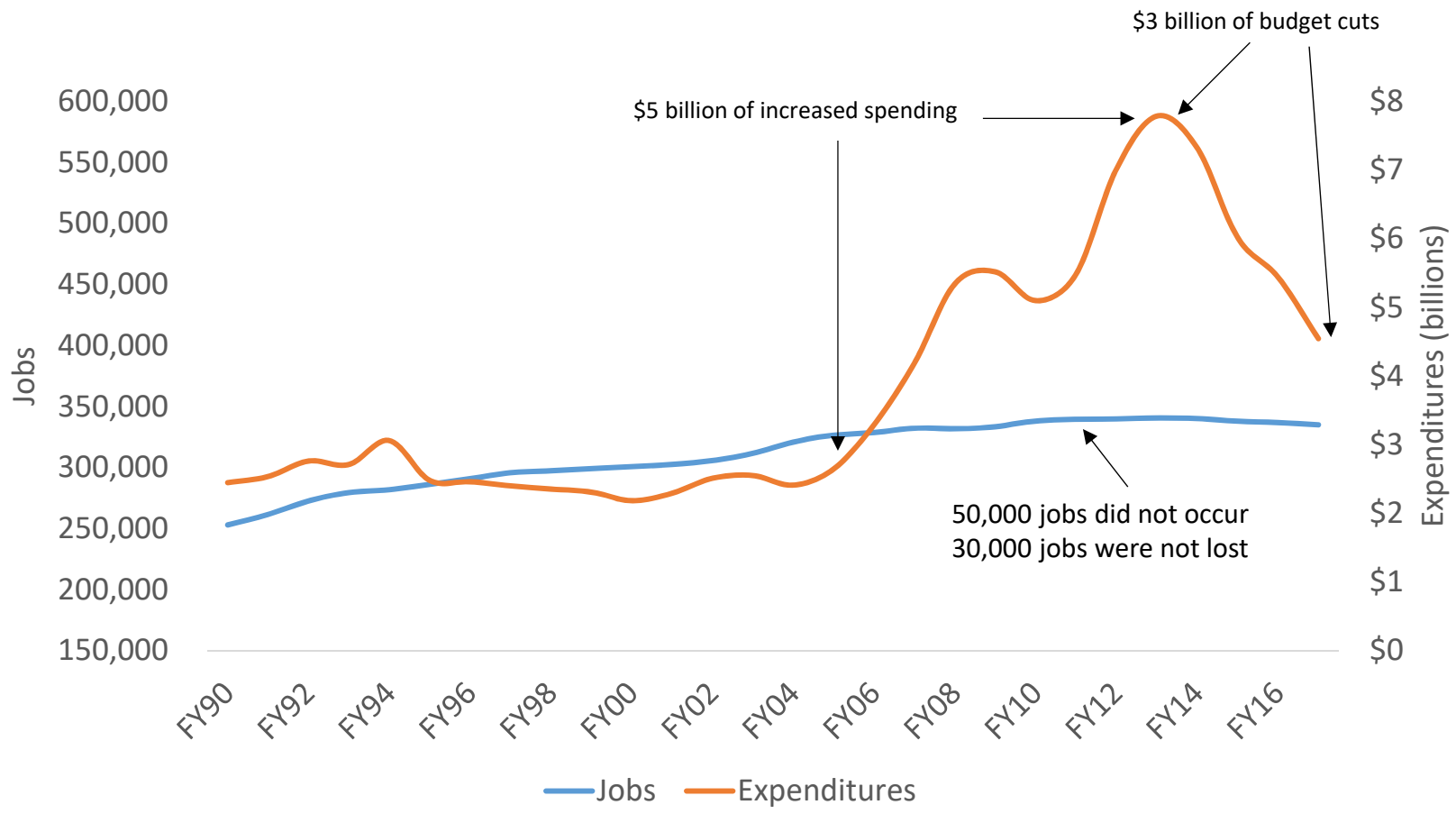
Takeaways: 1. This proposal is not unprecedented in terms of total spending;
2. This budget returns the state to 2005 levels of inflation adjusted spending



Data Source: Legislative Finance Division

Impact of Budget on Labor Market

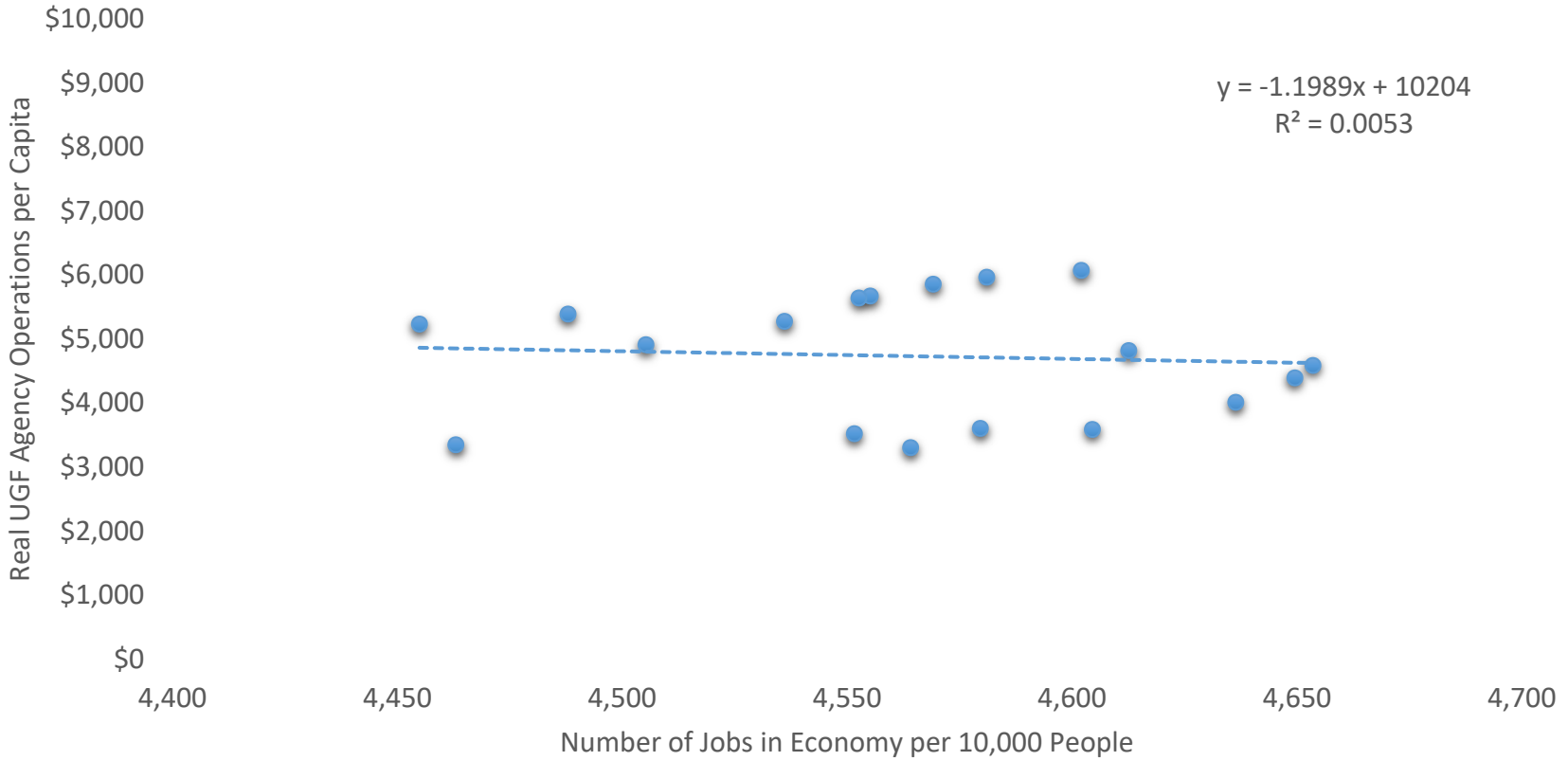
Takeaway: Prior increases/decreases did not generate the type of impacts being discussed



Data Source: Legislative Finance Division and Department of Labor

Budget Impact on Total Jobs

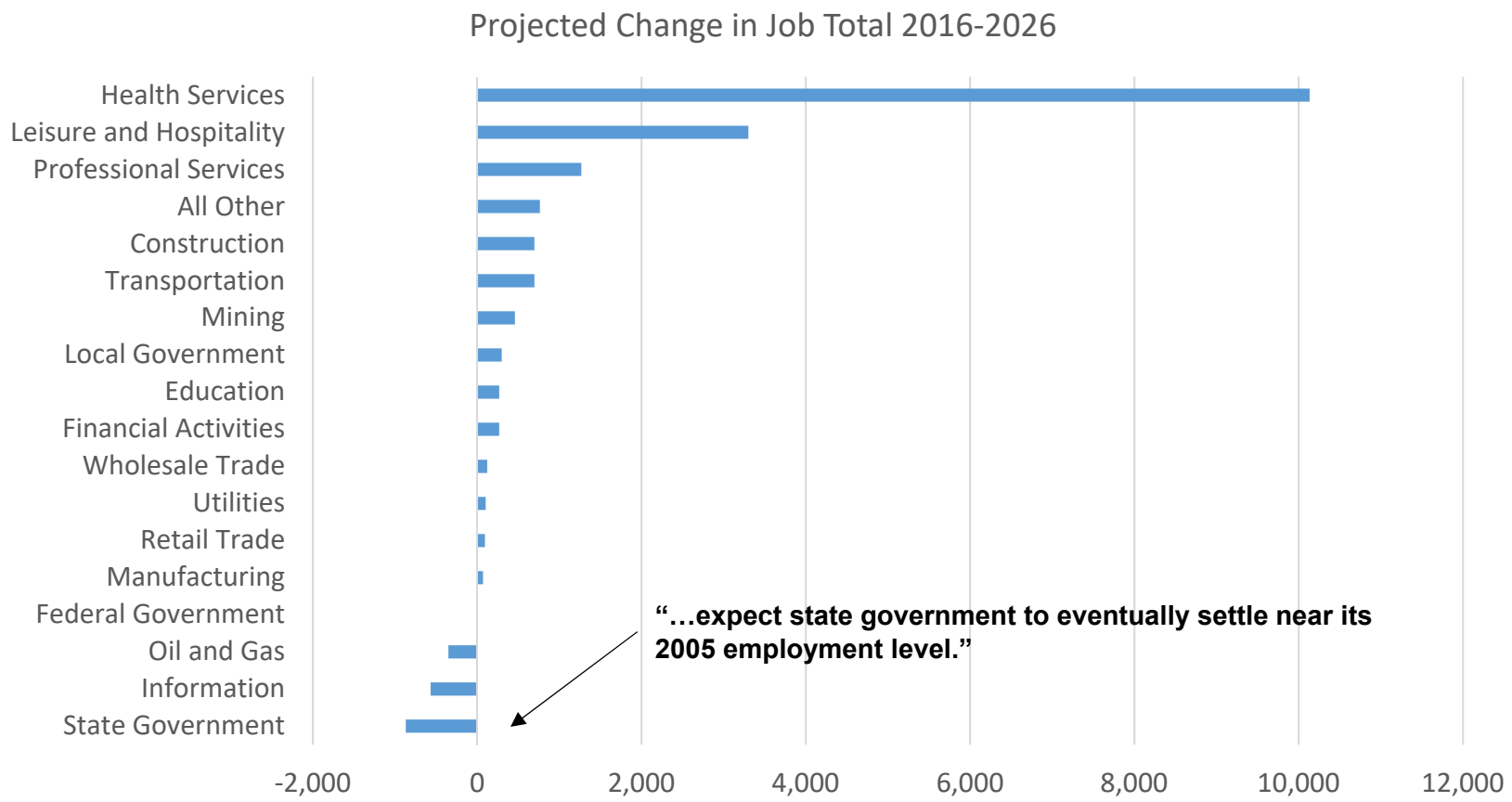
Takeaway: There is no statistically significant relationship between State spending and jobs in Alaska's history, once controlling for inflation and population growth



Data Sources: OMB, LFD, DOL

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



Source: Department of Labor, October 2018 "Trends"

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 loses 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



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