

Budget options: What are the short term effects?

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Outline

A little bit of background

- Some basics

Short term impact of the proposed budget

- Short term employment effects of the cuts

- Short term employment effects of the higher dividends

What is the current state of the economy?

- Is the recession over?

- 1980's recession

Final thoughts

Background

In 2016, at the request of the Alaska Department of Administration, UAA's Institute of Social and Economic Research's Gunnar Knapp, Matthew Berman, and Mouhcine Guettabi provided an analysis of the economic impact of various state budget options, **“The Short-run Economic Impacts of Alaska's Fiscal Options.”**

The analysis focused on the short term impacts and therefore should not be used to evaluate the long run impacts of the budgetary decisions. I will mainly apply these 2016 estimates to the Governor's FY2020 budget to provide an assessment of the near term employment impacts.

What were our conclusions from the original study?

- Different ways of collecting money from Alaskans affect those with lower and higher incomes in significantly different ways.
- **Anything** the state does to reduce the deficit will cost the economy jobs and money. But spending some of the Permanent Fund earnings the state currently saves would not have short-run economic effects. Saving less would, however, slow Permanent Fund growth and reduce future earnings.
- Because the deficit is so big, the overall economic effects of closing the deficit will also be big.

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What tools did we use?

- To analyze the short term impacts, we relied on a standard input output model which captures linkages across Alaska's economic sectors. This allows us to determine how changes or “shocks” to any sector, or household income reverberate through the economy.
- The technique is therefore very useful in estimating how a change in spending or income attributable to a particular industry or government policy “ripples” through the economy as a result of further changes in spending flows between industries and households.

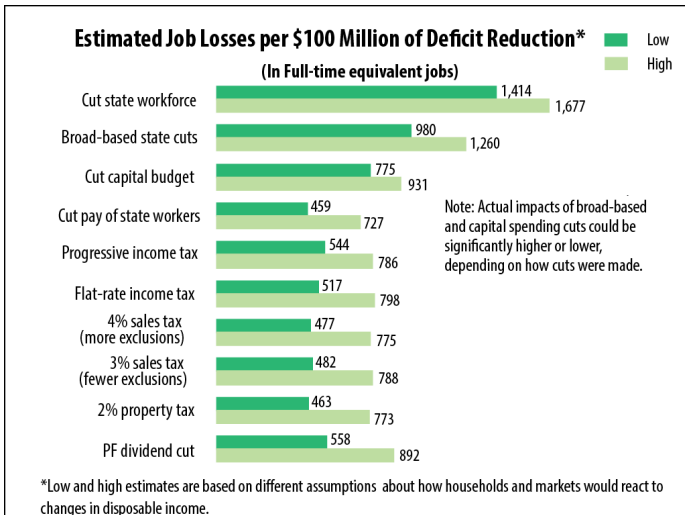
How are the effects estimated?

- It is important to explain that the total effects we estimate for both government cuts and higher PFDs include direct, indirect, and induced effects.
- For a change in income, through a higher a PFD, there are no direct employment effects because the PFD represents an income shock.
- There are, however, induced effects because households spend a portion of their checks which result in retailers employing additional people.
- For a significant number of government cuts, the person laid off loses his or her job which represents a direct effect, and then the economy experiences further employment losses due to the decreased spending.

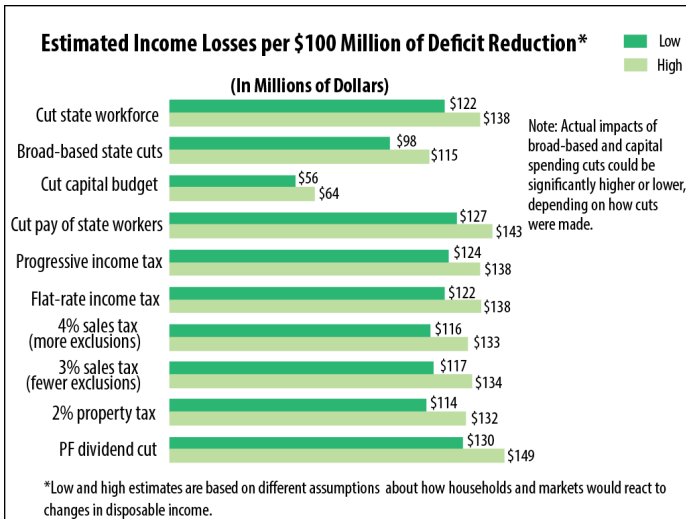
Some important limitations

- Our ability to analyze impacts of spending cuts is limited by uncertainty about how they would be implemented. Therefore our analysis uses generic cuts.
- Our analysis focuses on the short run and therefore does not account for potential behavioral adjustments in spending, wage rates, prices, or migration to and from Alaska. The best way to interpret our estimates is to say that they reflect immediate income and jobs losses resulting from less/more money circulating in the economy.
- **Most importantly**, these changes do not provide us with guidance on the long term ramifications of the changes in services, quality of education/life, and the attractiveness of the business environment.
- The devil is in the details.

Employment losses from deficit reduction measures



Income losses from deficit reduction measures



What are the effects of government cuts?

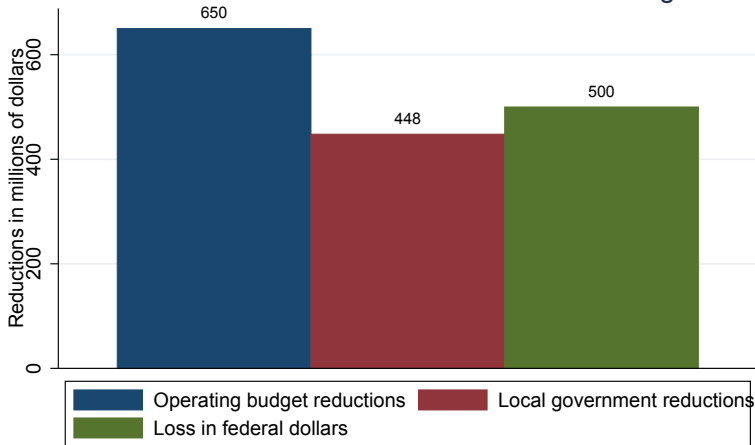
- The employment graph shows that for each \$100 million government related cut, we would expect about 1,086 jobs to be lost.
- This estimate is an average across three scenarios: Government layoffs, broad-based state cuts, and pay cuts for government workers. State government layoffs would result in the greatest job losses: between 1,414 jobs and 1,677 jobs. We estimate broad-based cuts to result in losses ranging between 980 and 1,260 jobs. Pay cuts would result in job losses ranging between 459 and 727 jobs.

What is the goal of the summary?

- This summary attempts to assess the short term employment impacts from the decreases in spending, and increases in the PFDs.
- Given that we are interested in understanding the aggregate economic effects, we need to take into account how the proposed changes influence state spending, local government revenues, federal funds, and households.

Describing the cuts

Reductions in spending
using numbers from legislative finance
and estimated reductions in federal funding



What is not included?

- School debt reimbursement and debt service.
- Capital budget reductions.
- Use of reserves.

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What are the employment impacts?

Employment reductions from declines in state spending, loss of local government revenues, and federal revenues

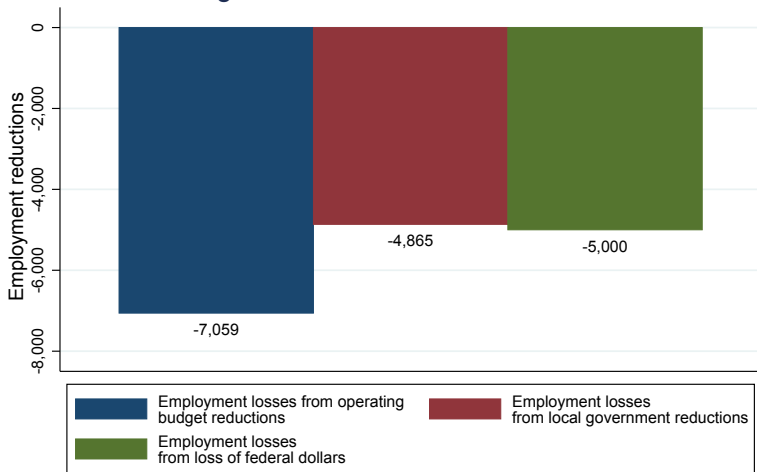


Table: Employment losses summary from reductions

Category	Reductions	Job loss per 100 million	Total job losses
Operating budget reductions	650	1,086	7,059
Local government reductions	448	1,086	4,865
Loss in federal dollars	500	1,000	5,000
All losses	1.598	..	16,924

- The North Slope borough would need to impose a tax equaling 35,972 dollars per person in order to replace the lost revenues.

Table: Oil and gas property taxes

Variable	Fairbanks	North Slope	Kenai	City of Valdez
Local share (in millions)	11.8	372.1	15	38.4
Population	98,957	10,344	58,060	3,862
Tax necessary to replace lost revenues	120	35,972	258	9,943

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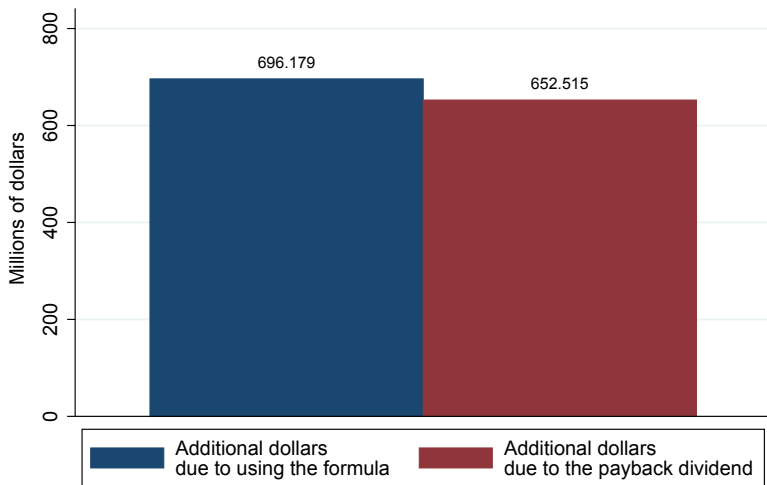
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What about the PFD?

- Under the proposed budget, Alaska residents will receive \$2,932 instead of the \$1,800 that they would have received if the dividends were capped.
- This year, too, most Alaskans will receive an additional 1,061 dollars to pay back for previous capped dividends.
- This will result in a per-person increase of about \$2,193, which translates into an additional \$1.348 billion in the economy if 615,000 people receive the PFD.

Added dollars due to higher PFDs

Additional dollars in people's bank accounts
as a result of using the statutory formula and the first payback dividend



What are the short term impacts of the higher PFDs?

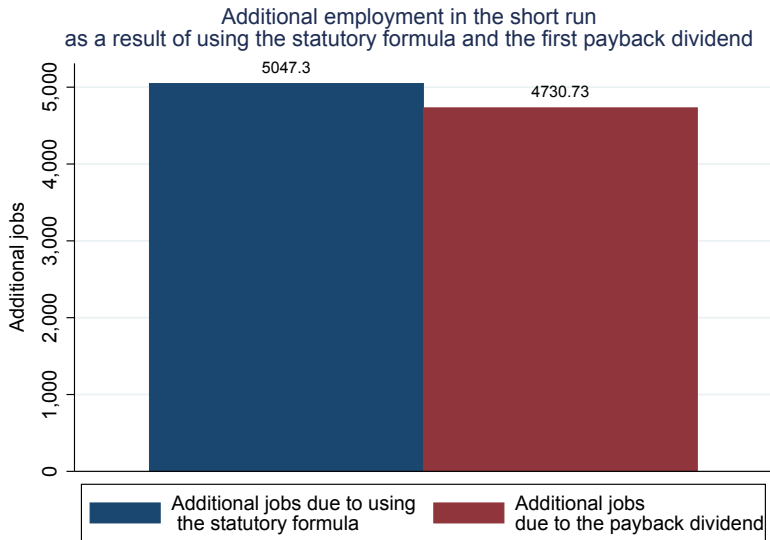
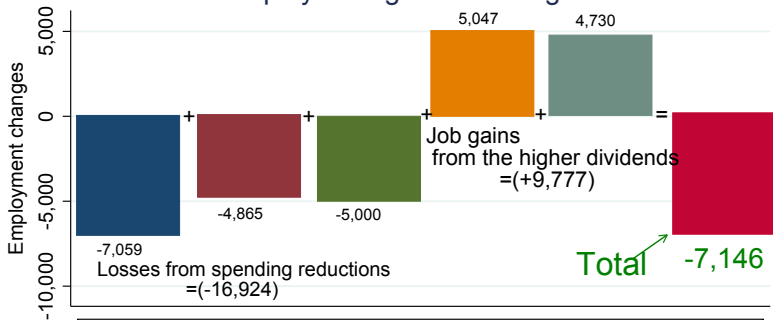


Table: Employment gains summary from higher PFDs

Category	Additions	Job gain per 100 million	Total job gains
Statutory instead of capped dividends	696.179	725	5047
Payback dividends	652.515	725	4,730
All gains	1.348	..	9,777

Let's put all numbers together

Employment changes from declines in state spending, loss of local government revenues, federal revenues, and employment gains from higher PFDs



Employment losses from 650 million in operating budget reductions	Employment losses from local government reductions
Employment losses from 500 million loss in federal dollars	Employment gains from using the statutory formula
Employment gains from 1,061 dollars in payback dividends	Total impact

A few notes about the comparison

- It is important to note that the jobs created from the stimulative effects of the PFDs may be different than the ones lost through government cuts.
- Additionally, the employment effects of the PFD may be short lived. Our recent (yet to be published) work shows that the employment effects are concentrated in the three months post distribution.
- There is also the question of how uncertainty may influence household spending patterns.
- On the spending reduction side, there is significant uncertainty about how communities will respond and if/how much federal spending the state will actually forgo.

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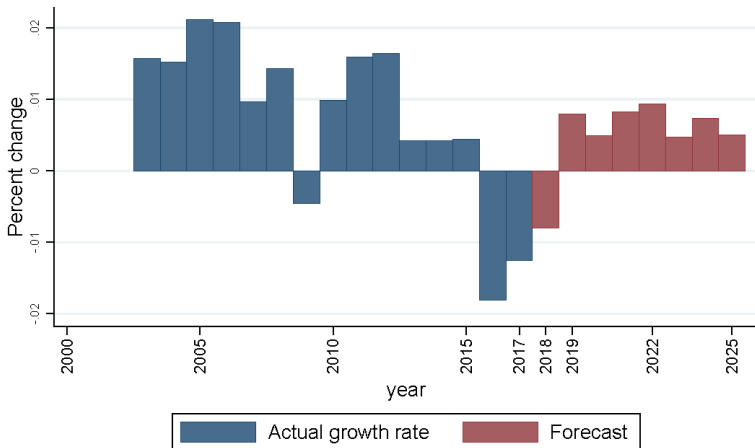
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Alaska employment outlook

Employment growth in Alaska
2002-2017 History, 2018-2025 Forecast



QCEW Data

What is the current state of the economy?

- Since the start of the recession, the state lost 1.82% of its jobs in 2016 and another 1.25% in 2017.
- While we only have preliminary data, we expect employment to decline by 0.8% in 2018. Before the announced cuts, our forecast for 2019 showed positive growth equaling close to 0.8%. Between 2019 and 2025, we anticipated employment growth to average 0.68% per year.

Short summary of employment losses

- The state lost between 12,500 and 13,000 jobs between 2015 and 2018.
- The projected job losses from the spending cuts, higher PFDs, loss of federal dollars, and loss of local government revenues would potentially result in an additional 7,000 jobs lost.
- If that happens, this recession-oil induced plus spending reductions-would potentially be Alaska's most pronounced one.

What about the 1980's?

- The 2015-current recession has been longer but milder than Alaska's most severe recession which lasted from 1985 to 1987.
- That recession resulted in significant outmigration, and a severe collapse of the housing market.

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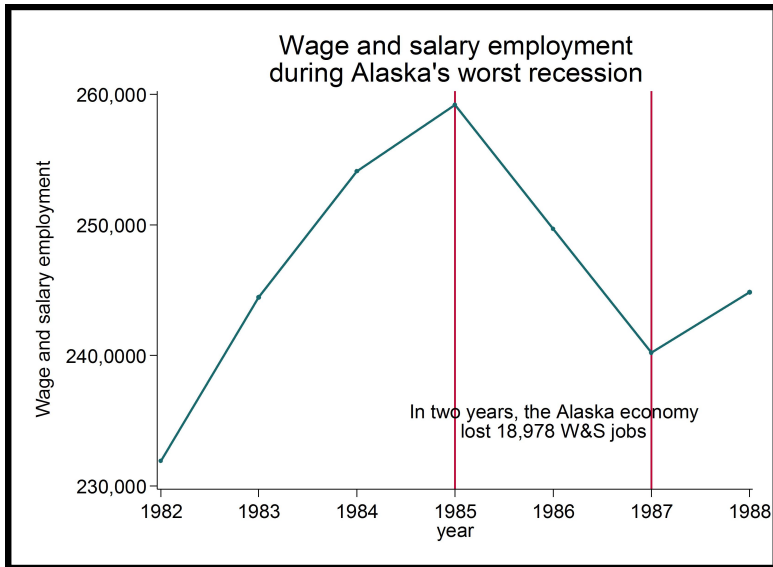
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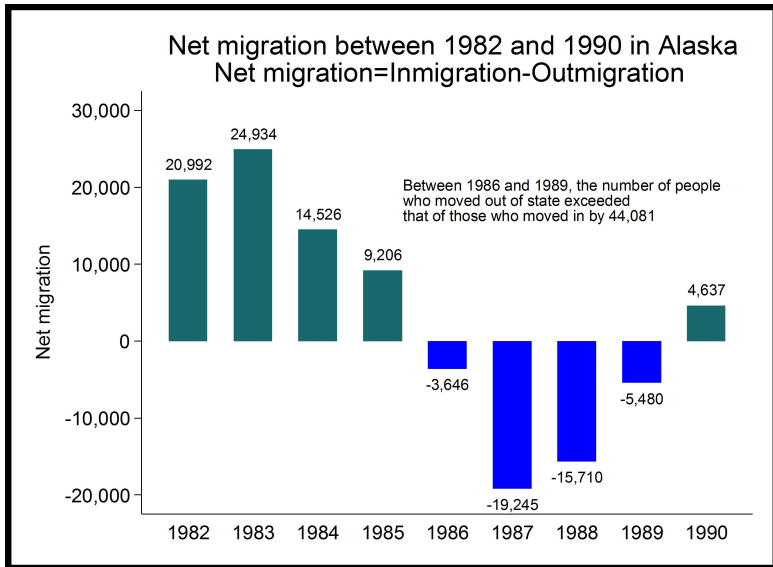
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Employment



Migration



Housing

- The Alaska housing market experienced a long downturn with a significant number of vacancies and foreclosures. According to an ISER analysis from 1988 , there were 14,000 vacant housing units in Anchorage alone.
- The Alaska department of labor has also summarized the housing experience in the 1980's stating that "Over 40 percent of Alaska banks failed, and Alaska led the nation in bank failure rates for the decade. Foreclosures peaked in 1988 at 6,821, and by the end of the decade, more than 30,000 foreclosures"

More questions than answers

- It is important to reiterate that all options to close the budget gaps will result in short term negative consequences. Therefore, it is important to think about the cost of the alternatives.
- The economy is still in a fragile state as it has experienced employment decline for 39 straight months.
- There is still considerable uncertainty on which changes will actually take place.
- While understanding the recessionary effects is necessary, the long run implications are far more important.
- Many of these decisions are about priorities and values.

Thank You

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