

What are the Implications of the Fiscal Options? Economy-wide effects

Mouhcine Guettabi, PhD

Institute of Social and Economic Research

University of Alaska Anchorage

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Background

- I will discuss both the economy-wide effects of the fiscal options on the economy as well as what we know about how the PFD affects poverty, health, employment, and spending.
- 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.
- While the state's fiscal picture remains difficult, it is important to remember that both the economic and savings landscape have changed since the original paper.

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.

What are the Basics of the Study?

- We analyzed how various fiscal options would affect the economy in the short run.
- We examined 11 options.
- These options are: cutting the state work force, making broad-based state spending cuts, cutting the capital budget, cutting pay of state workers, imposing several kinds of taxes—a progressive income tax, a flat-rate income tax, a four-percent sales tax, a three-percent sales tax, and a two-percent property tax—and cutting Permanent Fund dividends.

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

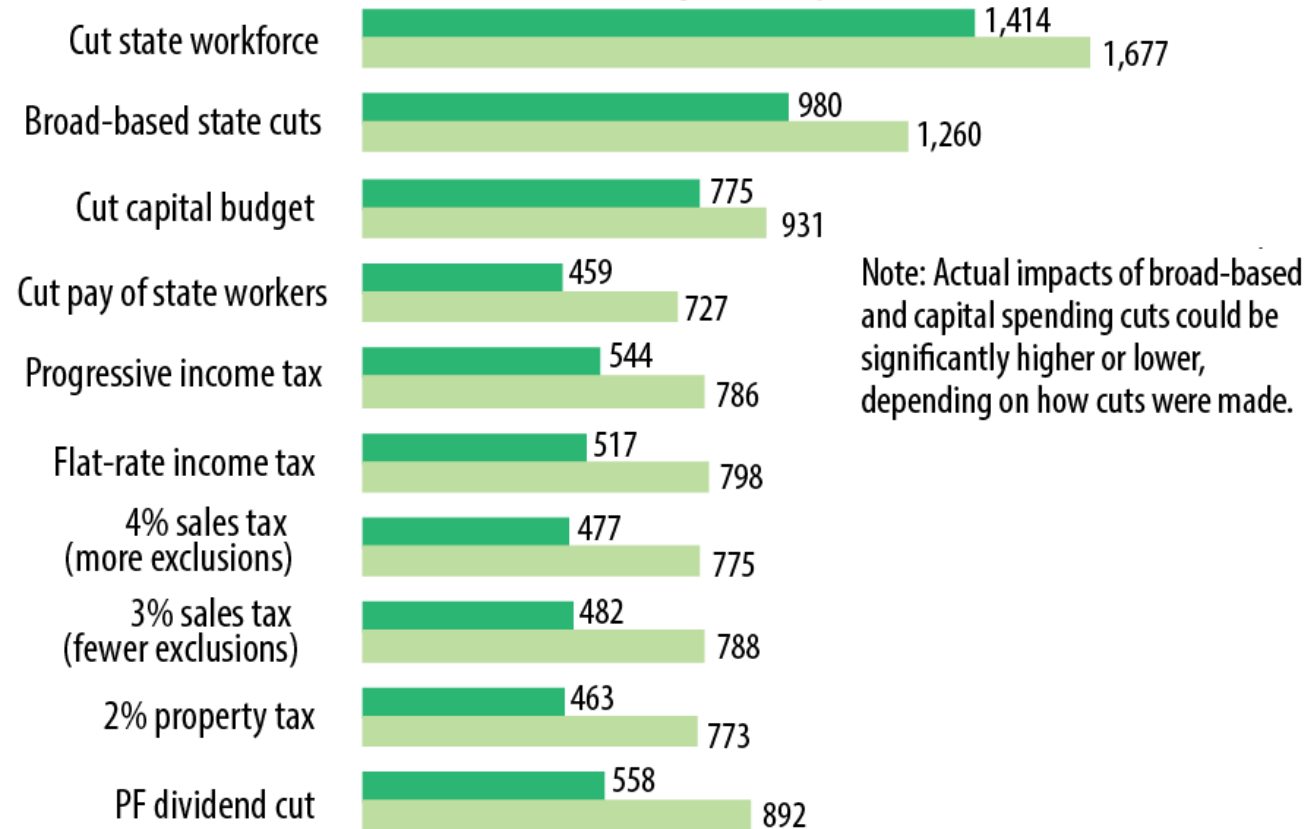
- Our ability to analyze impacts of spending cuts is limited by uncertainty about how they would be implemented. Therefore our analysis uses generic cuts.
- Our analysis focuses on the short run and therefore does not account for potential behavioral adjustments in spending, wage rates, prices, or migration 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

Job Impacts

Estimated Job Losses per \$100 Million of Deficit Reduction*

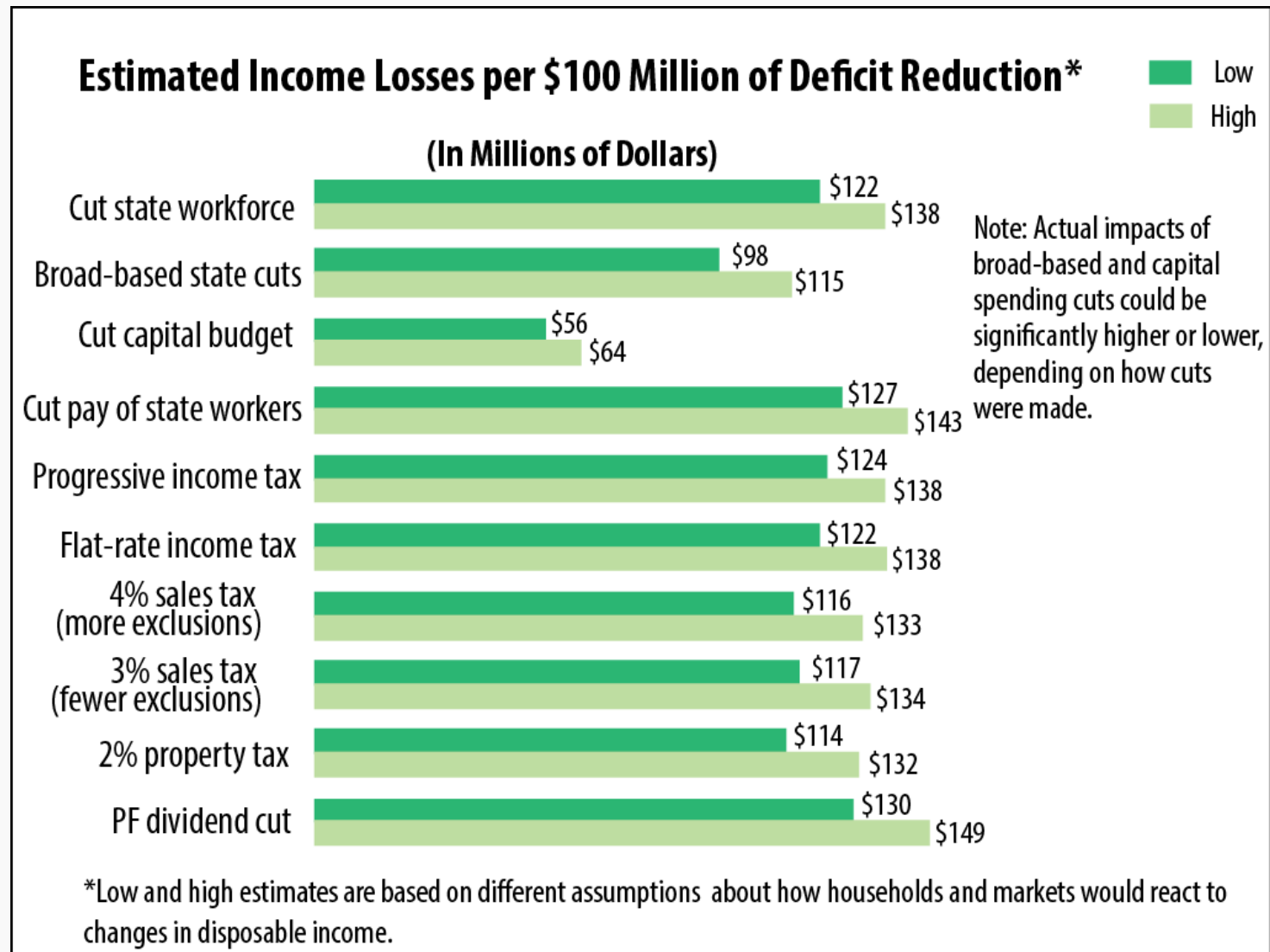
(In Full-time equivalent jobs)

Low
High



*Low and high estimates are based on different assumptions about how households and markets would react to changes in disposable income.

Income Impacts



Regional Effects

- While our analysis does not investigate the regional implications of cuts and taxes, we know the state's boroughs are very different from one another.
- They have varied economic bases, and their government dependence is also very heterogeneous.
- 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. Excessive withdrawals, however, have long term implications that are important to consider.

Policy uncertainty and the cost of using savings

- In a 2018 report, I showed that the direct effects of policy uncertainty is costing the state somewhere between 200 and 600 million in private capital spending. The decline in spending due to policy uncertainty would indicate that waiting is not a costless option. In fact, the losses due to uncertainty are important and similar in magnitude to the ones the economy would experience due to a tax or further government cuts.

What do we know about the socioeconomic effects of the PFD?

- Permanent fund draws now have to support both government services and the Permanent Fund dividend.
- It is clear that the Permanent Fund cannot support the distribution of the statutory dividend and fully funding government services.
- Additionally, higher withdrawal amounts stress the earnings reserve and affect the long term growth of the fund.
- In the next section, I will discuss what we know about the socioeconomic effects of the PFD.

Poverty

- The PFD has resulted in substantial poverty reductions for rural Alaska Natives.
- These effects have been particularly pronounced for the elderly. Interestingly, the poverty reducing effect of the PFD has declined as regional corporation dividends have increased in size over time.

Children's health

- **Birthweight:** The evidence indicates that the PFD has a positive, but modest effect on birth weight. This effect is particularly pronounced for low income mothers.
- **Childhood Obesity:** A paper by Watson, Guettabi, and Reimer (2019) finds that the health benefits extend beyond birth weight. For three-year-olds, there is strong evidence that the PFD reduces obesity.

Employment effects

- Knapp, Berman, and Guettabi (2016) find that a 100 million increase in the aggregate size of the PFD is associated with the creation 725 jobs in the short run.
- Bibler, Guettabi, and Reimer (2019) find that for every 100 million dollars in the total PFD distribution, there are approximately 475 jobs created. On the other hand, they find that women who are already employed tend to decrease the number of hours worked in the three months following the distribution.

Spending effects

- Kueng (2018) finds that consumption increases by 11 cents for each dollar of PFD received in October, 5 cents in November, and another 7 cents in December. Overall, this points to an increase of between 22 and 24 cents for every PFD dollar in the three months post distribution.

Thank You

Mouhcine Guettabi

Phone number: 907-786-5496

E-mail: mguettabi@alaska.edu