Part 1: Economic Effects of Policy Uncertainty

Part 2: What are the Implications of the Fiscal Options?

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On the effects of policy uncertainty

A quick summary

-This short presentation will summarize what we know about the economic effects of policy uncertainty.

-I will also briefly discuss what we know about the short-term effects of the fiscal options and the socioeconomic effects of the PFD.

-I will, however, not be evaluating the merits of the 50-50 proposal and its potential economic consequences.

How does uncertainty affect economic activity?

-Baker, Bloom, and Davis (2013) construct a novel index of economic policy based on a diverse array of metrics, performing tests of the index's validity through a human audit of 3,500 newspaper sources and other common-sense measures.

-They find that the increase in policy uncertainty that followed the onset of the Great Recession had significant negative effects on aggregate investment and on employment as well as on consumption expenditures.

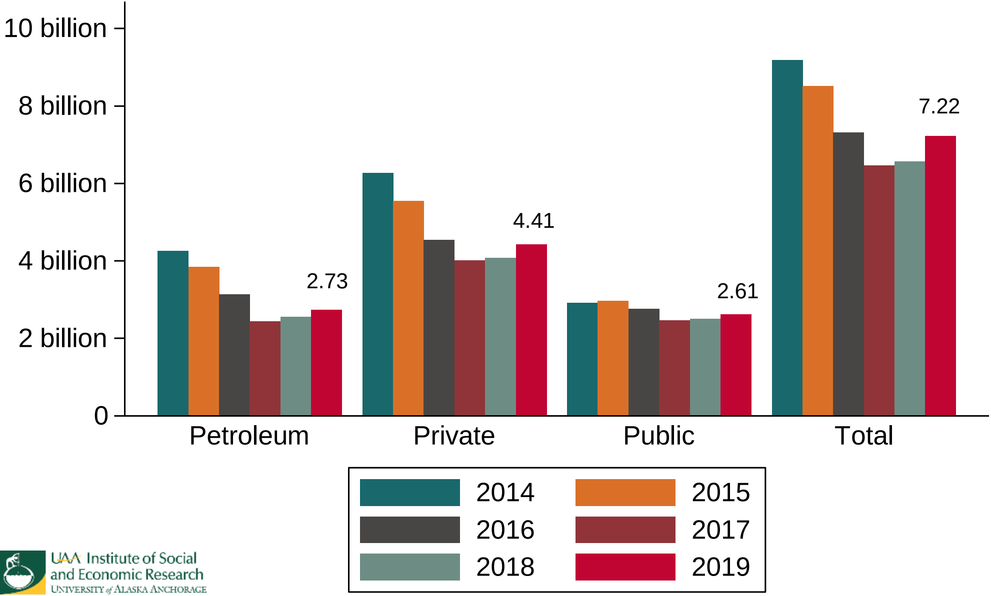
-Matching firm-level data with the data series of this index, Gulen and Ion (2013) find that economic policy uncertainty can explain up to 32% of the drop in corporate investment over the 2007-2009 time period.

More on the economic effects of uncertainty

-Gao and Qi (2012) find that municipal bonds issued by state governments immediately before a gubernatorial election pay a premium of 6 to 8 basis points due to this electoral proximity.

-Jens (2013) estimates the investment-suppressing effect of a gubernatorial election on the state-level investment during the quarter of the election at between 5% and 15% depending on the subsample, with the closeness of an election exacerbating the decline.

Alaska's construction spending between 2014 and 2019



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What can we say about the effects of uncertainty on Alaska activity?

-Private Construction spending in 2019 is supposed to be around 4.41 billion dollars. Using the 5 to 15% estimated by Jens (2013), we would conclude that the direct effects of policy uncertainty is costing the state somewhere between **220 and 660 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.

Short-term economic effects of the fiscal options

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.

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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.

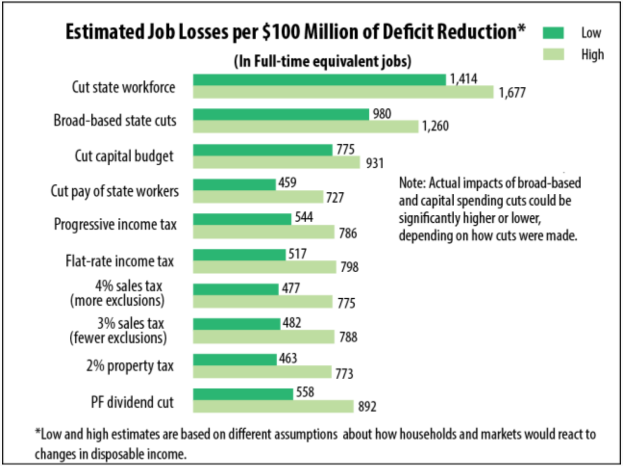
How are the effects estimated?

- It is important to explain that the total effects we estimate 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



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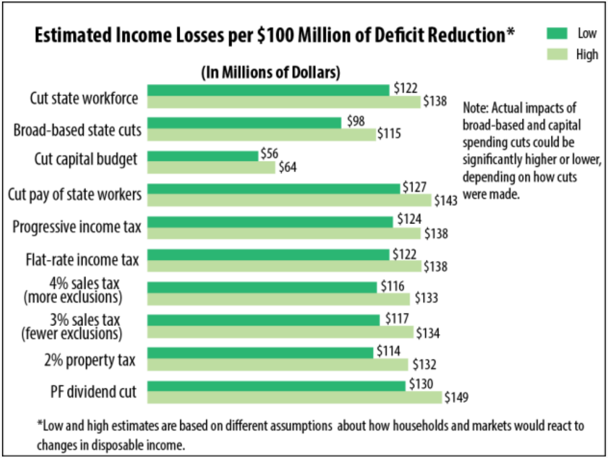
Income Impacts



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.

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

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