

**ALASKA STATE LEGISLATURE
SENATE LABOR AND COMMERCE STANDING COMMITTEE**

January 18, 2017

1:34 p.m.

MEMBERS PRESENT

Senator Mia Costello, Chair
Senator Shelley Hughes, Vice Chair
Senator Kevin Meyer
Senator Gary Stevens
Senator Berta Gardner

MEMBERS ABSENT

All members present

COMMITTEE CALENDAR

INSTITUTE OF SOCIAL AND ECONOMIC RESEARCH PRESENTATION: WHAT DO WE KNOW ABOUT THE ALASKA ECONOMY AND WHERE IS IT HEADING?

- HEARD

NORTHERN ECONOMICS PRESENTATION: FORECASTING ALASKA'S ECONOMY 2016-2017

- HEARD

PREVIOUS COMMITTEE ACTION

No previous action to record

WITNESS REGISTER

DR. RALPH TOWNSEND, Director
University of Alaska Anchorage
Institute of Social and Economic Research (ISER)

POSITION STATEMENT: Provided introductory remarks and introduced Dr. Guettabi.

DR. MOUHCINE GUETTABI, Assistant Professor of Economics
University of Alaska Anchorage
Institute of Social & Economic Research
Anchorage, Alaska

POSITION STATEMENT: Delivered a PowerPoint titled "What do we know about the Alaska economy and where is it heading?"

JONATHON KING, Vice President and Senior Economist
Northern Economics
Anchorage, Alaska

POSITION STATEMENT: Delivered a PowerPoint titled "Forecasting Alaska's Economy 2016-2017."

ACTION NARRATIVE

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CHAIR MIA COSTELLO called the Senate Labor and Commerce Standing Committee meeting to order at 1:34 p.m. Present at the call to order were Senators Stevens, Hughes, and Chair Costello. Senators Meyer and Gardner arrived soon thereafter.

Institute of Social and Economic Research Presentation: What Do We Know About the Alaska Economy and Where is it Heading?

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CHAIR COSTELLO announced the committee would hear presentations from the Institute of Social and Economic Research (ISER) and Northern Economics. She said the state faces serious economic challenges and these hearings are an opportunity for legislators and the public to understand the economy. The presenters' insight will help legislators sort the data, the trends and policy options that are available. The goal is to analyze the changes we're seeing and then move Alaska's economy forward. She reminded listeners about the committee's new Facebook page. She welcomed Dr. Townsend and Dr. Guettabi.

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DR. RALPH TOWNSEND, Director, University of Alaska Anchorage Institute of Social and Economic Research (ISER), explained that a role of public universities in the U.S. is to provide research and public outreach to serve communities in the state to support the economy, the industries, the institutions and the people. ISER has served in that role for years and both the university and the state have been very supportive. He advised that ISER has about 15 lead researchers and an equal number of staff that support the work. About one-third of the staff have PhDs in economics and about half are doing work in economics. He also pointed out that about half the staff do work related to education, health care policy and social service delivery, which is an important part of their mission.

He introduced Dr. Guettabi, an assistant professor of economics whose specialty is urban and regional economics. He noted that Dr. Guettabi also does work in health care economics.

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SENATOR MEYER joined the committee.

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DR. MOUHCINE GUETTABI, Assistant Professor of Economics, University of Alaska Anchorage Institute of Social & Economic Research, reviewed the outline of his presentation. First, he would give an overview of Alaska's economy over the last two years and then discuss how the decline in oil prices reverberated through the economy. Next, he would describe the mechanisms through which a decline in oil prices works its way through the many sectors of the economy, followed by a forecast of where the economy is heading. Finally, he would discuss the extent to which it's possible to reconcile the weakness of the economy with the need to close the budget gap.

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SENATOR GARDNER joined the committee.

DR. GUETTABI offered a snapshot of Alaska's economy over the last two years. In August 2014 Alaska North Slope oil prices stood at over \$100 and the number of employees in the state was 355,638. A year later, oil prices had dropped to just over \$48 but just 100 jobs were lost. He said this lack of job response in that first year is not surprising. That is because many projects that were already under way had to be completed, and much of the generous capital budget allocations in 2012, 2013 and 2014 were still making their way into the economy. The economy has weakened considerably since then and in 2016 the three sectors that have borne the brunt of the decline have been state government, oil and gas, and professional and business services. Specifically, losses in the professional and business sector is an indication that the decline is making its way to non-primary sectors. "That multiplier that we like to speak about is in full effect." He displayed a bar graph of month-to-month Alaska employment numbers that shows that the economy lost 2,261 jobs between March 2014 and March 2016.

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DR. GUETTABI discussed the ripple effects of the decline in oil prices on private employment. He said he finds it helpful to try to isolate where the losses are coming from and to look at the actual sequence of events. "I refer to this as the decomposition

of the effect or of the effect of the decline in economic activity." In the first phase, the most obvious effect is direct jobs losses in the oil and gas sector. In the second phase, oil and gas companies reduce purchases from Alaska companies in multiple sectors. The third phase is the decline in local spending by oil and gas employees as their wages or jobs are cut. This decline in local spending affects the rest of the economy.

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DR. GUETTABI discussed the obvious and hidden effects on government when oil prices decline. He said the most obvious effect reflects the dependence of the state budget on oil revenues. From 2005 to 2014, 90 percent of the unrestricted general fund was coming from oil revenues that significantly declined due to the decline in prices. He said a more hidden factor is the extent to which local governments and the private sector depend on spending by state government. Local government dependence stems from the fact that about 1 in 3 dollars of local government revenues come from the state government. For the private sector, the dependence on state government stems from government contracting and purchases made from private Alaska companies, and spending by state government employees on goods and services provided by the private economy.

He relayed that ISER is investigating the effects to local government in its next Alaska snapshot. "What we're trying to do right now is basically build a panel of revenues by borough and census area to decompose where each borough gets its revenues and what's its share of those revenues that come directly from state government, what's the share that comes from different basic sectors, how many of them have a sales tax and how much money do they get."

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DR. GUETTABI displayed a chart showing the job losses by sector from March 2014 to March 2016. It illustrates that state government and private industry were hardest hit through March 2016, with the state government losing nearly 1,700 jobs. He noted that the most recent numbers from the quarterly census of employment and wages. Private industry lost 1,518 jobs while local governments, including school districts, added 783 jobs. Federal civilian jobs saw an increase of 165. In total, 2,261 jobs were lost. He noted that the latest numbers from the quarterly census of employment and wages shows considerable additional weakness between March and June.

He said compare March 2014 to March 2016 and you can see that state government and the private sector experienced most of the decline. He opined that improvement in local government will not be sustainable. Local government include school districts and given the reliance of local government revenues on the state's health, it's to be expected that local governments will struggle going forward.

A more refined sectoral breakdown in that same period shows job losses in construction, natural resource and mining, other services and professional and business services. Health care and social assistance showed the greatest increase in jobs.

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DR. GUETTABI displayed a state map to show the geographic breakdown of job gains and losses (by number and percentage) from March 2014 to March 2016. He noted that there is considerable heterogeneity across the state and that variation is something to keep in mind because no two places are alike and decisions going forward will impact places differently depending on their basic sectors and relative vulnerability. The depiction clearly shows that most places had already lost jobs by March 2016. The Mat-Su Borough was an exception and the gains in that area were distributed across sectors with gains in health care, construction and retail. One caveat is that most of the gains were in sectors that depend on household spending. He anticipates that as household spending weakens going forward, most of those gains will slow down. He said it's difficult to tease out what is going on in the Aleutians East (-16%) and the Aleutians West (+36%). It is a food manufacturing/processing employment area that demonstrates the importance of the heterogeneity.

He displayed a chart that looks at the share of employment in the hardest hit sectors in each borough and census area, and adds the totals. For example, in Anchorage it shows the share employment in mining, in construction, in professional & business services, in state government and in local government. The last two columns show the total without local government and the total with local government. He said he's spending time on this data to illustrate that most places have 50 percent or 60 percent of these their employment in these six sectors that have already been vulnerable to this recent decline. The other reason is to emphasize the impending local government weakness and what that will do to these different places that have very different economies.

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DR. GUETTABI turned to the old 2016 forecast. He explained that at in January 2016 the Alaska Business Monthly asked Gunnar Knapp and him to write a description of the state of the economy and give a forecast of economic activity. They forecast two percent negative growth in both 2016 and 2017, absent any further budget cuts or imposition of taxes. At that time, they said that any action that takes money out of the economy will make future employment declines either deeper or longer lasting.

He displayed a line graph showing employment growth projections without a pipeline and with a pipeline. He highlighted that there has been slower year over year growth since 2011. The significant declines appear in 2016 and 2017. He emphasized that the upturn in 2016 is not a recovery. Rather, it shows that 2018 losses will be lower than 2017. He noted that information shows more clearly on the updated forecast.

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DR. GUETTABI displayed the updated forecast graph that shows historical and projected annual percentage changes in total Alaska employment. He explained that he is treating 2016 as a forecast because not all the 2016 numbers are available. It anticipates 2.3 percent losses in both 2016 and 2017 and [0.6 percent] losses in 2018. He said, "My anticipation is that most of the cuts in the capital budget, most of the decline in oil and gas activity will have worked its way out of the economy essentially by 2018." However, there will be no significant recovery or a return to previous activity levels. Rather, employment will be back to 2010 levels by the end of 2017. "That will be the new normal of economic activity, because it's difficult to foresee a sector engine that basically pulls us out of this much slower growth." He reminded members that this does not consider any further cuts or imposition of taxes. Anything that takes money out of the economy has the potential of deepening or lengthening the slowdown. A fiscal solution is obviously important, he said.

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DR. GUETTABI discussed the multiplier effect of declines in the most affected sectors under two scenarios. [The sectors listed were construction; oil and gas extraction; professional, scientific and technical services; and management companies and enterprises]. Under both Model 1 and Model 2, the multiplier is close to two. He clarified that this information is not used for the forecast, but it does point to where the losses in 2017 are coming from.

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He explained that in 2016, most job losses were concentrated. In 2017, job losses are expected to spread because of the multiplier effect. In 2017, support industries, retail, accommodation and food services are expected to suffer job losses at a much more rapid pace. He said this is important from a forecasting standpoint because the types of jobs that were lost in oil and gas are very different from the types of jobs that will be lost going forward, both in terms of the people who were holding the jobs and in terms of the likelihood of migration due to losing their jobs.

Empirical literature shows that younger people with higher incomes are much more likely to migrate out than older, lower income individuals. "If we're trying to think about the unemployment rate; if we're trying to think about the response to these negative shocks, from a migration standpoint I think that this difference is going to matter because the profile of the people affected is going to start changing." The decline in activity will also become more visible because the types of places that will be losing jobs are the sectors that we potentially interact with quite a bit more than the ones we were describing up until 2016.

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DR. GUETTABI summarized his thoughts on the future state of the economy. The current forecast anticipates 2.3 percent losses in 2016, 2.2 percent losses in 2017, or 7,500 jobs lost each year. The losses will be distributed across more sectors as the multiplier spreads through the economy. While downside risk remains, 2018 will be a little stronger and potentially better able to absorb a shock stemming from the imposition of taxes or further budget cuts. The long-term health of the economy requires fiscal stability. Most of the available measure will potentially mean exacerbating and extending the current slowdown.

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DR. GUETTABI displayed a bar graph showing the estimated (full time equivalent) job impacts per \$100 million of deficit reduction. He said this is work that ISER did last year, but it goes hand-in-hand to explain the weakness that exists in the economy. For example, an income tax that raises \$100 million would potentially result in between 500 and 800 jobs lost. He said this is important because these losses would be in addition to the job losses previously described. An income tax that

raises \$300 million would potentially result in 1,500 and 2,400 additional job losses in the year the tax is imposed. The overriding question is the extent to which the economy can handle more losses and will something too drastic push it over the precipice.

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DR. GUETTABI reviewed. He said he likes to look at the differences between 1985 and 2015 to emphasize that the economy has cushions that it did not have in 1985. The economy has aged so there is less potential for out migration. Sources of retirement income are insensitive to the Alaska economy. Native corporations are diversified and sheltered from state-specific economic shocks. Some sectors have matured and benefit from a healthy national economy.

He concluded saying there are very few easy decisions to get out of the economic decline. Revenue-generating mechanisms or budget cuts take money out of the economy and potentially worsen the economic decline, but they may be necessary. The question is when to implement some of these solutions.

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CHAIR COSTELLO asked if the endowment approach to managing the permanent fund or cuts to government or taxes would have the most positive impact on the budget challenges and the least impact on the economy.

DR. GUETTABI said an approach that uses savings does the least damage. All the tax measures are somewhat similar because they all take money out of the pockets of Alaskans and therefore will have a negative shock. An income tax affects people with higher incomes more than individuals with lower incomes and a sales tax is more regressive. Government cuts look outside because you lose the jobs that are cut plus you lose jobs due to reduced spending. The endowment approach has almost no short-term damage, but isn't sustainable.

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SENATOR GARDNER referred to the slide titled Employment Impacts. She asked if it would be a wash or if there would be more job losses over time if there were no spending cuts and all the jobs were saved. The gap would be bigger, and it would be necessary to raise more revenue with the other options.

DR. GUETTABI said there is no quantitative answer because each of the options were purposely modeled individually. He offered

his opinion that it is myopic to only think of shocks in the short term and ignore long term fiscal stability. "However, based on my estimations, it looks like potentially 2018 is a year where we're better able to absorb shocks," he added.

SENATOR GARDNER asked if there is a multiplier when state workers lose jobs.

DR. GUETTABI answered yes and it's between 1.7 and 1.9 on the class of worker that is laid off.

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SENATOR MEYER referred to the slide titled Employment Impacts and asked if it's safe to say the dividend cut has very little impact.

DR. GUETTABI said the dividend cut has a slightly larger impact than the other tax options. Net net the dividend has a larger negative effect on the health of the economy than an income tax because more Alaskans are affected, and lower income individuals spend a majority of their income. "For every dollar you take out, the economy is losing that whole dollar in addition to whatever the multiplier is."

SENATOR MEYER observed that it is significantly less than the spending cut.

DR. GUETTABI said the spending cut is the largest option because it starts with job losses that result in further job losses.

SENATOR MEYER asked if he suggested waiting until 2018 to make any changes because the economy would be a little stronger.

DR. GUETTABI clarified that he would characterize it as less weak. He anticipates that the bottom of the losses stemming from declining oil prices will have made their way out of the economy by the end of 2018. He said it's important to remember that he's talking about a reversion to the 2010 level.

SENATOR MEYER asked the basis of the notion that the economy will be less weak in 2018.

DR. GUETTABI said the takeaway should be that there is no recovery engine; the slight improvement in conditions means the shock will have resulted in the loss of up to 17,000 jobs and there will be very slight growth going forward.

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SENATOR MEYER asked if he said that losses in the oil and gas extraction sector had the largest multiplier effect.

DR. GUETTABI replied oil and gas jobs have the largest multiplier because of the interdependence of multiple support sectors.

SENATOR MEYER asked if the North Slope small producer tax credits should be continued or stopped.

DR. GUETTABI said ISER has not modeled the tax credits, not because they aren't important but because they didn't think they could model them in a way that would produce defensible results.

SENATOR MEYER asked if it's more efficient to have a stronger private sector versus a large capital budget that comes from state government.

DR. GUETTABI replied there is significant interdependence. A healthy private sector requires a well-functioning state government and vice versa.

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SENATOR HUGHES asked if the multipliers in Model 1 and Model 2 reflect the high and the low.

DR. GUETTABI replied they are completely different models but it shows that the variations are not enough to throw off the estimation.

SENATOR HUGHES recalled that he said the state job multiplier is between 1.7 and 1.9. She asked him to expand on his statement that the permanent fund endowment model would be neutral.

DR. GUETTABI clarified that he was referring to the use of savings to pay for the current size of government, separating the endowment that affects dividends from a dividend cut. Any option that takes income away from Alaskans will have negative consequences. This includes the extent to which the endowment model affects the dividend amount.

SENATOR HUGHES asked if the impact of a state sales tax is really like an income tax when outside money from tourists is factored in.

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DR. GUETTABI said they made assumptions about the number of Alaskans and non-Alaskans who would pay sales tax and the two options were close. The modeling was based on the distribution of income of Alaskans and it reflects the regressive nature of a state sales tax. Lower income people tend to spend more of their total income, so they are more affected by a sales tax.

SENATOR HUGHES asked why spending cuts are so much more negative than bringing in revenue.

DR. GUETTABI explained that the state government cut option starts with the loss of jobs. Those people in turn reduce their spending and that reduction in spending results in additional job losses.

SENATOR HUGHES expressed difficulty reconciling that with the multiplier.

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DR. GUETTABI said the interdependence is very important. The reduction in spending that results when a state employee loses their job hurts the private sector. An apples to apples comparison would ask, what hurts the economy more, losing 100 jobs in oil and gas or losing 100 jobs in state government. If the multiplier for oil and gas jobs is higher, there would eventually be more job losses in that scenario.

CHAIR COSTELLO asked him to answer the question he posed.

DR. GUETTABI said, based on multipliers alone, there would be more losses stemming from the loss of the oil and gas jobs. They make more money and the multiplier is potentially larger. He clarified that these are sectoral multipliers; they reflect how independent a sector is with the rest of the economy.

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SENATOR STEVENS asked if ISER would be willing to take on the question about the value of oil tax credits; if the legislature could assist in finding an answer; and if an answer could be forthcoming in a reasonable amount of time. "It is so enormously important, and nobody knows the answer right now," he said.

DR. GUETTABI said he understands a report is in progress to explain the mechanics of a tax credit and how it affects companies.

DR. TOWNSEND added that the oil and gas credit program is not a single program. There are multiple pieces that function in different ways and have different impacts on the state budget. ISER has a small project underway to provide an explanation of that. Regarding the specific question, he said ISER could conduct the study, but not in two or three weeks and it would not produce a yes or no answer.

SENATOR STEVENS noted that Legislative Budget and Audit and individual members were talking about working with a consultant to find some answers. He said he'd appreciate hearing from him if this is something ISER is willing to do.

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CHAIR COSTELLO thanked Dr. Guettabi and Dr. Townsend.

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CHAIR COSTELLO reconvened the meeting and welcomed Mr. King with Northern Economics.

Northern Economics Presentation: Forecasting Alaska's Economy
2016-2017

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JONATHON KING, Vice President and Senior Economist, Northern Economics, stated that Northern Economics would be happy to contract with the legislature to look at oil tax credits. He has a very competent oil and gas economist who is currently under employed. He informed the committee that he would talk about the current recession, the timing, where the state is headed, and how health care plays into the current situation.

MR. KING agreed with Dr. Guettabi that this is Alaska's great recession. By the time it is over, job losses will total 6-7 percent. He discussed gross state product (GSP) in Alaska and the reasons economists do not use it to measure recessions. He said if we were to use GSP to estimate recessions it would show that Alaska has been in recession for five years. He displayed a graph that shows that the value of the private economy in Alaska peaked in 2012 and has been shrinking since then.

MR. KING said economists measure recessions by looking at monthly or quarterly changes in employment and comparing it to what happened the year before. He displayed a graph that shows

year-over-year employment changes from 2003 to 2016. Except for a quick dip into negative territory in 2009 and 2010, job gains and losses were above the zero percentile much of this time. He pointed out that job losses dipped below the zero percentile in late 2015 and throughout 2016 there were fewer jobs in the economy than the year before. The economy started to show signs of slowing in 2011 and has continued through 2016. He noted that gross state product was declining during that period, primarily because the oil industry was spending and investing less. Because Alaska was still in a growth mode during that time, not many people noticed the decline.

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MR. KING displayed a graph showing that from 2006 to 2016 Alaskans earned between \$4 billion and \$4.5 billion in real wages every quarter. He pointed out that the red line connects the winter minimums of quarterly wage earnings. What is important is that Alaska has moved from what was very likely an investment recession to a wage recession. The effects of the initial cut backs have spread throughout the Alaska economy.

He said that Northern Economics has run a household confidence index since the first quarter of 2010. Each quarter 800 Alaska households are asked how they feel about the state economy, the local economy, their personal finances, and their expectations going forward. The Alaska confidence index went up from 2010 to the third quarter of 2014. He noted that coincided with the vote on Senate Bill 21. It has come down since then and broke through the recessionary line in 2016. State and local expectations for the economy have rebounded somewhat but the rating is still 35 out of 100.

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MR. KING displayed a graph of the year-over-year change in jobs in high earning sectors. He pointed out that in 2013 the oil and gas sector was not adding jobs. Between 2013 to the third quarter of 2014 jobs were added but things started to slow. In early 2015, the oil and gas sector fell below the zero percentile and is still shedding jobs. The construction sector transitioned to negative growth at about the same time as oil and gas, but it is now in positive territory. That could be a data blip or related to the F-35 construction in Fairbanks, he said.

He relayed that the professional and business services sector did not add jobs during 2013 and 2014 and it transitioned below the zero percentile in 2015. He opined that this sector has

another year of accelerating losses because there is not any spending coming out of the oil and gas industry or state government and those are the drivers for that sector.

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MR. KING displayed a graph showing year-over-year changes in jobs from 2013 through 2016 for state government and retail. He pointed out that retail recently went negative which reflects the multiplier effect. Retail shopkeepers are noticing less economic activity and they are cutting back. State government, excluding education, started shedding jobs in early 2015 but the losses have leveled off.

He said health care is the only sector that showed consequential growth in the Alaska economy last year. He displayed a chart showing that this sector was slowing down in 2013 and 2014 and started growing again the month after the decision to expand Medicaid in 2016.

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MR. KING discussed where Alaska's economy is headed. He said the state brings money into the economy primarily through oil and gas and the federal government, but it is not very good at holding onto its money. This goes to the multiplier effect, he said. Alaska imports much of what it uses, particularly in rural Alaska.

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He described Northern Economics' Regional Economic Model Incorporated (REMI) and relayed that in 2015 the company used that model to do an economic forecast of the state's recession. Total employment, which is wage and salary jobs and self-employment, was expected to be between 450,000 and 460,000 for 2013 and 2014. He noted that this is federal data. The expectation was to drop to about 440,000 jobs in 2020 or 2021 and rise thereafter. The driver that was predicted to pull the state out of recession was the Alaska LNG pipeline. It was a reasonably foreseeable event at that time.

What happened is that employment in 2015 was better than expected because it took longer for the capital budgets to come out of the economy than expected. He noted that the actuals for 2016 are close to what was predicted.

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He said the forecast has been updated and they've run three scenarios.

Scenario 1 is a \$4.2 billion unrestricted general fund and a reduced permanent fund dividend. The general fund currently is \$4.35 billion this fiscal year so it is a small reduction, but the money comes out of Alaskans' pockets through a PFD reduction.

Scenario 2 is a \$4.2 billion unrestricted general fund and a broad-based tax, probably some combination of sales and income tax. He did not differentiate within the modeling because they are similar as proposed and both remove money from the economy.

He explained that a sales tax and an income tax would generate about the same amount of money only because the governor proposed the tax be 6 percent of federal liability. The average U.S. state with an income tax taxes at 6 percent to 6.5 percent of gross income. If that metric were used, the revenue projection would be between \$1.2 billion and \$1.5 billion.

Scenario 3 is a \$3.3 billion unrestricted general fund that steps the budget down \$500 million this year and next fiscal year.

He listed the caveats and assumptions. A strong oil price recovery is not predicted, which follows the U.S. Energy Information Agency (USEIA) predictions. Everything is in nominal dollars. There are no overall positive economic movers such as the gas pipeline and there is no significant oil production beyond what the state is already modeling in its own forecasts. Also, it does not account for potential black swans such as issues in health care. He said situations change but this does give an idea of what the future could look like, he said.

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MR. KING displayed a line graph of the 2017 to 2026 employment forecast under the three budget scenarios. It shows the peak in 2015 the decline in 2016 and continued job losses until 2019 under Scenario 1 and Scenario 2. Scenario 3 bottoms out in 2020, primarily because of the two-stage \$500 million reductions this year and next year. Total employment in this scenario is significantly lower. That goes directly to the discussion about multipliers. State government employment is in the top one-third of all occupations and sectors in the economy. It spends a lot on

people and it does not spend a lot of money on things that come from out of state.

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MR. KING said the three 2017 to 2026 population scenarios are very similar but the line for Scenario 3 drops slightly more at the end of the period. He explained that population numbers are similar for all three models even when employment numbers differ because Alaska is becoming a more multi-generational society. People tend to stick around after the loss of a job if they have family ties in the area. He agreed with Dr. Guettabi that the people who leave are the ones who are highly educated, have skills that are in demand in the Lower 48 economy and perhaps they do not have as strong a cultural tie as the individuals who stay.

MR. KING summarized the REMI results. For Scenario 1 and 2 employment bottoms out in 2019 to 2020 and 25,000 and 24,000 jobs are lost respectively. He noted these numbers are about the same because they model a lower percentage of PFD money being spent than ISER has modeled. This is based on Northern Economics' quarterly survey on the household index. "We've found out that about 40 percent of PFD money is not spent in that first year." By comparison, ISER models 100 percent of that money hitting the Alaska economy. This more conservative viewpoint of the PFD is balanced with the broad-based taxes. The other thing that helps the broad-based tax scenario 2 is that non-Alaskans pay into that system. Sales taxes and income taxes are deductible from your federal income tax, so the federal government picks up some of the effect of having those broad-based taxes. Under Scenario 3, the expectation is to lose 33,000 jobs and employment will not recover meaningfully until 2026.

Population losses are expected to start in 2017 and continue through 2026. Scenario 1 predicts the loss of 32,000 citizens, Scenario 2 predicts the loss of 31,000 citizens and Scenario 3 predicts the loss of 34,000 citizens. The statewide population is about 700,000 so this means a 3-4 percent population loss, a 5-6 percent loss in the number of jobs.

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MR. KING reviewed the key takeaways. Without stimulus, there are years left in this recession. In aggregate, there isn't much difference between a PFD reduction and a broad-based personal income tax because both reduce income for all or nearly all Alaskans. However, there is a very different effect on the population at the individual level in terms of who pays

and what percent of their income that is. The PFD has outsized effects in rural/poorer areas while the income tax captures income from non-Alaskans. The likely solution is somewhere in the middle, he said.

The \$3.2 million unrestricted general fund plan has the greatest overall effects because it involves directly cutting about 18,000 state supported jobs with indirect effects accounting for an additional 12,000 job losses. People who have lost their jobs are more likely to sell their homes and leave. Unless those people have moved into retirement, that income is unlikely to be replaced immediately, particularly in an economy that is in recession. Whereas if everyone's income is replaced a little bit, it leaves everyone a little poorer, but the broader economy is still intact.

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MR. KING displayed a line graph of year over year employment growth from 2016 to 2025 to put the ISER and Northern Economics forecasts in perspective. This reflects Scenario 2 projections with a full PFD and broad-based taxes. He noted that including the tax makes the Northern Economics projections a little more negative than ISER's going forward. Taking that into account, ISER and Northern Economics are saying basically the same thing about the recession and the economy going forward. Job losses going forward are on the same order of magnitude.

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MR. KING said he wanted to shift gears a bit and talk about health care costs because it is the next big thing that will affect the Alaska economy. He said the state insures roughly 400,000 lives through its management of health care. Four major groups profit from health care. These are: insurance companies, drug companies, hospitals and providers. These are essentially oligopolies because they have price-setting power, but insurance profits are capped under the Affordable Care Act. The maximum gross margin for insurance companies is 20 percent.

Alaska has among the highest per capita expenditures for health care of any state. The reason is that Alaska ranks the highest or close to the top for hospital, physician and clinical services costs. Charges for prescription drugs and other nondurables are in line with other states. To illustrate the rising cost of services in Alaska, he displayed a bar graph of

2006 consumer price index adjusted charges for knee surgery. In 2006, Alaska surgeons charged roughly \$6,000 which was equivalent to the 2006 CPI adjusted cost. By 2016 Alaska surgeons charged nearly 160 percent of the 2006 CPI adjusted amount.

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MR. KING listed the reasons that medical costs in Alaska are higher. First, limited competition makes it easy to price set. Another reason is that the state passed the 80 percent rule in the early 2000s. This greatly expanded the number and type of services in state, but made it easy for specialists to set prices and avoid networking. Also, the state does not have a law regarding price transparency. Providers are not required to disclose their prices so there is no opportunity for comparison shopping. Finally, the system is not set up to accommodate flying to Seattle or another location for a procedure. He related a personal story.

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MR. KING listed the key takeaways. Without stabilization, the economy will stay in recession until 2018 to 2020. Without some stimulus, the population recession could last much longer. The economic differences between the analyzed policy options is relatively slight between the PFD and income tax scenarios, but the "on the ground" societal implications are very different. The \$3.2 unrestricted general fund scenario is likely to remove about 20 percent more jobs from the economy than the other two scenarios. Finally, Alaska's health care system is an economic driver, but it takes money away from the rest of the economy.

CHAIR COSTELLO expressed appreciation for the discussion on the cost of health care, because it's information that policymakers need as they consider ways to face the budget challenges.

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SENATOR STEVENS asked him to comment on continuing to offer oil tax credits and the impact of Congress's apparent decision to repeal the Affordable Care Act.

MR. KING said the early estimates show that a full repeal of the Affordable Care Act would result in the loss of an additional 3,000 to 5,000 Alaska-based jobs. Regarding continuing the oil tax credits, his answer would be the same as Dr. Townsend's. It is a complex program and it

would be a difficult connection to say exploration happened because of tax credits and that resulted in production. He reiterated his interest in working with ISER to research the question. Responding to a further question, he said he could prepare a proposal by next week. He agreed with Dr. Townsend's estimate that it would be difficult to arrive at any conclusions in 60 days. He cautioned that a rushed product impacts quality.

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SENATOR MEYER noted that an economist or lawyer in the building suggested the legislature cut the budget by another \$1 billion and not touch the PFD. But if he understood the three scenarios, it would be better to reduce the dividend than cut the budget by \$1 billion.

MR. KING clarified that the Northern Economics modeling shows it's better to use the earnings reserve or initiate broad-based taxes than to essentially cut 20 percent from the unrestricted general fund. He added that it might be time to look at cutting entire programs instead of continuing to make horizontal cuts. Critical services must be provided for and it's up to policymakers to figure out what those are.

SENATOR MEYER commented on Alaska's three-legged economic stool and asked if there is a "Trump effect" that could provide the needed stimulus.

MR. KING replied it's too early to tell because the statements and tweets from the president-elect might not be what he decides to do.

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SENATOR HUGHES asked how Scenario 3 would be affected if the cuts were strictly to formula spending. She clarified that she'd be interested in hearing about cuts to both education and Medicaid.

MR. KING reminded members that last year one of the larger trusts said it was no longer following the 80 percent rule. It would pay Medicare rates plus 50 percent. That is anticipated to save thousands of dollars. If the large insurance pool that is run by the Department of Administration were to adopt that same policy, it would help rein in health care spending. He added

that getting a handle on why Medicaid spending is increasing on a per unit basis will help to bend the curve and buy the state some breathing room.

SENATOR HUGHES asked, "The multiplier effect for cutting formula spending, is it as high as the multiplier effect for the worker cut, pay cut or the broad-based cut across the board."

Mr. KING suggested she pose that question to the regional economists on the panel tomorrow.

CHAIR COSTELLO added that Lori Wing-Heier the director of the Division of Insurance would be in committee next week to talk about the health care markets. She said her understanding is that the department is accepting public input on suggested changes to the 80 percent rule. It is something that can be changed through regulation.

SENATOR HUGHES asked if other states have a similar ratio of health care workers to population as Alaska.

MR. KING said he would follow up with an answer by email.

CHAIR COSTELLO asked him to send the answer through her office and she would distribute it to the committee members. She thanked Mr. King for the presentation and listed the participants and agenda for the next meeting. She asked anyone who has a question to send it to the committee Facebook page and she would pose it to the panelists.

She expressed satisfaction with the discussion and optimism about its direction.

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There being no further business to come before the committee, Chair Costello adjourned the Senate Labor and Commerce Standing Committee meeting at 3:58 p.m.