ALASKA STATE LEGISLATURE
HOUSE SPECIAL COMMITTEE ON WAYS AND MEANS
April 22, 2021
12:48 p.m.

MEMBERS PRESENT

Representative Ivy Spohnholz, Chair
Representative Adam Wool, Vice Chair
Representative Andy Josephson
Representative Calvin Schrage
Representative Andi Story

MEMBERS ABSENT

Representative Mike Prax
Representative David Eastman

COMMITTEE CALENDAR

PRESENTATION(S): ECONOMIC IMPACT OF FISCAL SOLUTIONS

- HEARD

PREVIOUS COMMITTEE ACTION

No previous action to record

WITNESS REGISTER

MOUHCINE GUETTABI, PhD, Associate Professor of Economics
Institute of Social and Economic Research
University of Alaska Anchorage
Anchorage, Alaska
POSITION STATEMENT: Provided a PowerPoint presentation, titled "What are the Implications of the Fiscal Options? Economy-Wide Effects," dated 4/22/21.

ACTION NARRATIVE

12:48:56 PM

CHAIR IVY SPOHNHOLZ called the House Special Committee on Ways and Means meeting to order at 12:48 p.m. Representatives Wool, Josephson, and Spohnholz were present at the call to order. Representatives Story and Schrage arrived as the meeting was in progress.

PRESENTATION(S): Economic Impact of Fiscal Solutions

12:49:19 PM

CHAIR SPOHNHOLZ announced that the only order of business would be a presentation on the economic impact of fiscal solutions by Mouhcine Guettabi, Institute of Social and Economic Research (ISER).

12:50:07 PM

MOUHCINE GUETTABI, PhD, Associate Professor of Economics, ISER, University of Alaska Anchorage, introduced a PowerPoint presentation, titled "What are the Implications of the Fiscal Options? Economy-Wide Effects" [hard copy included in the committee packet]. He said he would be reviewing the basics of ISER's 2016 analysis of the economy-wide and distributional effects of various state fiscal options. He began by explaining the background on slide 2, noting that the world had changed since 2016. He reminded the committee that 2016 was the first year of a three-year recession that was driven by declining oil prices. At the time, ISER was asked how closing the budget gap would influence economic activity. He stated that the fiscal situation had not changed significantly aside from the exhaustion of state savings. He further noted that the fiscal options in the presentation, such as a tax or a cut to government, had been indirectly compared to the use of savings, which was no longer a realistic option. Slide 3 highlighted the conclusions from the original study, which read as follows:

- 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.

DR. GUETTABI emphasized that the only option that would not take money out of the economy was the use of savings. He expounded that a tax, a permanent fund dividend (PFD) reduction, or a government cut, would all take money out of Alaskans' pockets and would therefore, have negative short-term effects on the economy. Alternatively, using savings or withdrawing money from the Alaska Permanent Fund, would not have short-term effects. Nonetheless, spending from savings would not be without implications, he said, as overdrawing the fund had a significant cost to opportunity. He reiterated that when ISER said it was "costless" to withdraw money from the fund, the indication was that using savings would not have negative short-term effects; however, it would have negative long-term consequences.

CHAIR SPOHNHOLZ inquired about ISER's definition of short-term and long-term impacts. She considered the example of paying back the gap between statutory and funded PFDs from the past several years, which would result in a massive draw from the permanent fund. She recalled that a significant reduction of the fund would have an impact as early as next year.

DR. GUETTABI defined "short-run" as a 12- to 18-month period. He agreed that the world had changed and that a $6 billion draw from the permanent fund would affect the calculation of next year's dividend and the amount of money available for government. He explained that because the state was still drawing from the Constitutional Budget Reserve (CBR) [in 2016], the short-term effects were milder or non-existent. He acknowledged that the negative effects of overdrawing the fund could be seen sooner if the earnings reserve account (ERA) was stressed.

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REPRESENTATIVE STORY recalled that drawing $1 billion from the ERA would equate to losing $50 million in interest earnings, which she characterized as significant. She asked for Dr. Guettabi's perspective on that.

DR. GUETTABI said there was no doubt that the tradeoff existed. He explained that every dollar withdrawn from the fund was a dollar not invested; therefore, withdraws negatively affected the long-term size of the fund and its ability to fund government and distribute dividends. He said the question was how to weigh the potential losses in the size of the fund against short-term effects. He agreed that the option of tapping the permanent fund was not costless, but its exact cost was hard to define objectively. He confirmed that unsustainable draws meant foregoing future growth; however, the imposition of other revenue measures also had costs. He concluded that there was no costless option; further that taking money from savings to protect the economy was no longer as effective as it had been in 2016.

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DR. GUETTABI resumed the presentation on slide 4, which read as follows [original punctuation provided]:

> 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.

DR. GUETTABI noted that these were fairly generic options. He explained that the analysis was limited by data availability and factors that ISER could speak to with confidence given the information available. He defined "cuts to government" as a generic cut, as specifics were lacking. Similarly, the tax model in the analysis was generic, using either a sur charge over the federal tax or some sort of sales tax that excluded certain categories. He reiterated that ISER's goal was to see what would happen to economic activity in the short run if money were removed from the economy through these different options. He noted that cutting the PFD was also an option that was considered. He summarized the three fiscal options as follows: the government cut component, the tax component, and the PFD cut. He emphasized that each option would allow the state to close a portion of the budget gap; however, each option would take money from some group of the economy, consequently putting short-term pressure on economic activity. Nonetheless, he shared his belief that the sort-term effects were not the only ones that needed to be accounted for. He noted that limbo, or policy uncertainty, was very costly as well.

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REPRESENTATIVE WOOL sought to confirm that when Dr. Guettabi said "taking money out of people's homes would have a negative effect," he meant cutting the PFD. He asked whether that was correct.

DR. GUETTABI clarified that he had said "taking money out households' pockets," which meant a cut to the PFD, a tax, or anything that would reduce disposable income or the amount of money that people have.

REPRESENTATIVE WOOL contended that reducing the dividend would give people less money as opposed to taking money away from them.

DR. GUETTABI responded that his statement was not a judgement. He clarified that he meant less money circulating in the economy, which is what was modeled in the analysis.

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DR. GUETTABI resumed the presentation on slide 5, explaining that the analysis considered the indirect and induced effects of less money circulating in the economy as a result of cutting the government, implementing a tax, or reducing the PFD. He skipped slide 6, noting that the reason the effects of government cuts were so big was because layoffs, which was a direct effect, resulted in job losses plus the loss of income associated with the layoff. He explained that there were no direct effects associated with taxes or dividend cuts, only income shocks.

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DR. GUETTABI advanced to slide 7 and highlighted the last bullet point, "the devil is in the details." He reiterated that the analysis considered generic fiscal options. He explained that slides 8-9 were important, as they modeled two scenarios using several different data sets. The input/output model followed the shocks to the economy through the system, whereas the U.S. census data was used to estimate these reductions in a slightly different way. Slide 8 addressed job impacts, or in other words, estimated job losses per $100 million of deficit reduction. He indicated that the significant takeaway was that there was not a big difference in terms of job losses between the PFD and tax options. He said he was not a fan of ranking the options, emphasizing that there would be consequences for all three. He pointed out that the effects of the government reduction were significant because a layoff resulted in both the loss of the job and the income associated with that job. He suggested thinking about how many consequences would be tolerable in the short run and who would bear the burden in terms of cost. He reiterated that the short-run effects were not the main priority, as there were more pressing concerns.

1:19:36 PM

CHAIR SPOHNHOLZ asked Dr. Guettabi to discuss the characteristics of the job losses. She surmised that the compensation level for job losses created by a cut to the PFD would be different than those of a state employee.

DR. GUETTABI replied that no two job losses were created equal. He explained that most of the job gains as a result of PFD distributions tended to be retail jobs and temporary positions. ISER's analysis found that there were around 600 jobs created in the short run for every $100 million in the dividend. Therefore, a dividend reduction could potentially result in a loss in temporary jobs. Alternatively, government cuts tended to be permanent and higher paying jobs, which was reflected in the results. He acknowledged that the composition of the jobs would vary depending on the option. He continued to explain that the options affecting lower-income houses would result in more job losses; however, those job losses would be concentrated in retail, leisure, and hospitality. He noted that the average wage of a government worker was around $50,000, which was considerably higher than the retail-type jobs that would be lost due to PFD cuts.

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REPRESENTATIVE WOOL asked whether it would be a "wash" if the state were to secure $1 million and spend it on the PFD.

DR. GUETTABI said Representative Wool had made an important point. He explained that in order to think about the long-term and true effects of these options, one had to think about how the money raised (by tax or otherwise) would be used. He stated that it would be a wash if the money raised from a tax was spent in the same way that households would have spent it. He reiterated that differences would emerge based on how the money would be allocated, who it would be taken from, and how the government would spend it.

1:24:44 PM

DR. GUETTABI resumed the presentation on slide 9, which highlighted the estimated income losses per $100 million of deficit reduction. He indicated that a PFD cut would remove the most income from the economy because it fell entirely on residents, whereas the other options were distributed more to nonresidents. He stated that the differences between the options were not very large. He reiterated that the primary question would be how to raise money to fill the deficit and which demographic would bear the burden.

1:26:13 PM

CHAIR SPOHNHOLZ thanked Dr. Guettabi and provided closing remarks.

1:27:09 PM

ADJOURNMENT

There being no further business before the committee, the House Special Committee on Ways and Means meeting was adjourned at [1:27] p.m.