

02/25/16
ANALYSIS:
ECONOMIC
IMPACTS OF
ALASKA'S
FISCAL
OPTIONS

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ECONOMIC IMPACTS OF ALASKAS FISCAL
OPTIONS</SUBJECT><COMM>HFIN29</COMM></TARGET>

Economic Impacts of Alaska Fiscal Options

Overview of Draft Conclusions

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Outline

- Summary
- Details
 - Study background
 - Relative contributions of non-residents & the federal government
 - Relative impacts of fiscal options on different income groups
 - Relative impacts of fiscal options on the Alaska economy
 - Total impacts of deficit reduction on the Alaska economy
 - Other impacts

Summary . . .

- Studied economic impacts of ten fiscal options:
 - Spending cuts (four kinds)
 - Taxes (four kinds)
 - Dividend cuts
 - Saving less
- Not advocating for or against any option

Summary . . .

Fiscal Options We Studed

Option	Direct economic impacts
Spending cut: workers	Reduce government jobs & pay
Spending cut: broad-based	Reduce government jobs & pay Reduce other government purchases
Spending cut: capital	Reduce government capital spending
Spending cut: pay	Reduce government employee pay
Income tax: progressive	Reduce Alaskans' disposable income Partly paid by non-residents Partly offset by federal tax deductions
Income tax: flat rate	
Sales tax: more exclusions	
Sales tax: fewer exclusions	
Dividend cut	Reduce Alaskans' income Partly offset by lower federal tax
Saving less	No short-term impacts

Summary . . .

Who is most affected?

Option	Direct economic impacts
Spending cut: workers	Government workers
Spending cut: broad-based	Government workers Government contractors & their workers
Spending cut: capital	Construction industry & their workers
Spending cut: pay	Government workers
Income tax: progressive	Higher income Alaskans
Income tax: flat rate	
Sales tax: more exclusions	Higher & medium income Alaskans
Sales tax: fewer exclusions	
Dividend cut	Lower income Alaskans
Saving less	Future Alaskans

Summary . . .

Short-Run Economic Impacts per \$100 Million of Deficit Reduction

	Income (\$ millions)	FTE jobs
Spending cut: workers	138	1677
Spending cut: broad-based	115	1260
Spending cut: capital	64	931
Spending cut: pay	143	727
Income tax: progressive	138	776
Income tax: flat rate	138	796
Sales tax: more exclusions	132	771
Sales tax: fewer exclusions	135	793
Dividend cut	150	898
Saving less	0	0

Summary . . .

- Saving less has no short-term impacts
- All other options affect the economy:
 - Spending cuts
 - Taxes
 - Dividend cuts
- They vary in:
 - Who is most affected
 - Relative magnitude of impacts

Summary . . .

How fast should we reduce the deficit?

- We will have to greatly reduce the deficit soon
- We can't avoid economic impacts
- The smoothest transition is a significant start this year
- Not making major progress this year would have a big impact
 - Further credit rating downgrades
 - Loss of business confidence
 - Reduced private investment
- Fully closing the deficit this year would have a big impact
 - Economy is already-weakened
- Neither extreme is best
 - Doing nothing this year
 - Doing everything this year

Study background

Study status . . .

- Presentation summarizes draft results
- Draft full report available soon
- Further analysis planned over next month, to address
 - Comments
 - Questions
- Final report in March

What we studied

- Relative contributions to fiscal options of non-residents & the federal government
- Relative impacts of fiscal options on different income groups
- Relative impacts of fiscal options on the Alaska economy
- Total impacts of deficit reduction on the Alaska economy
- Other impacts:
 - Many, varied and important
 - Described but not analyzed

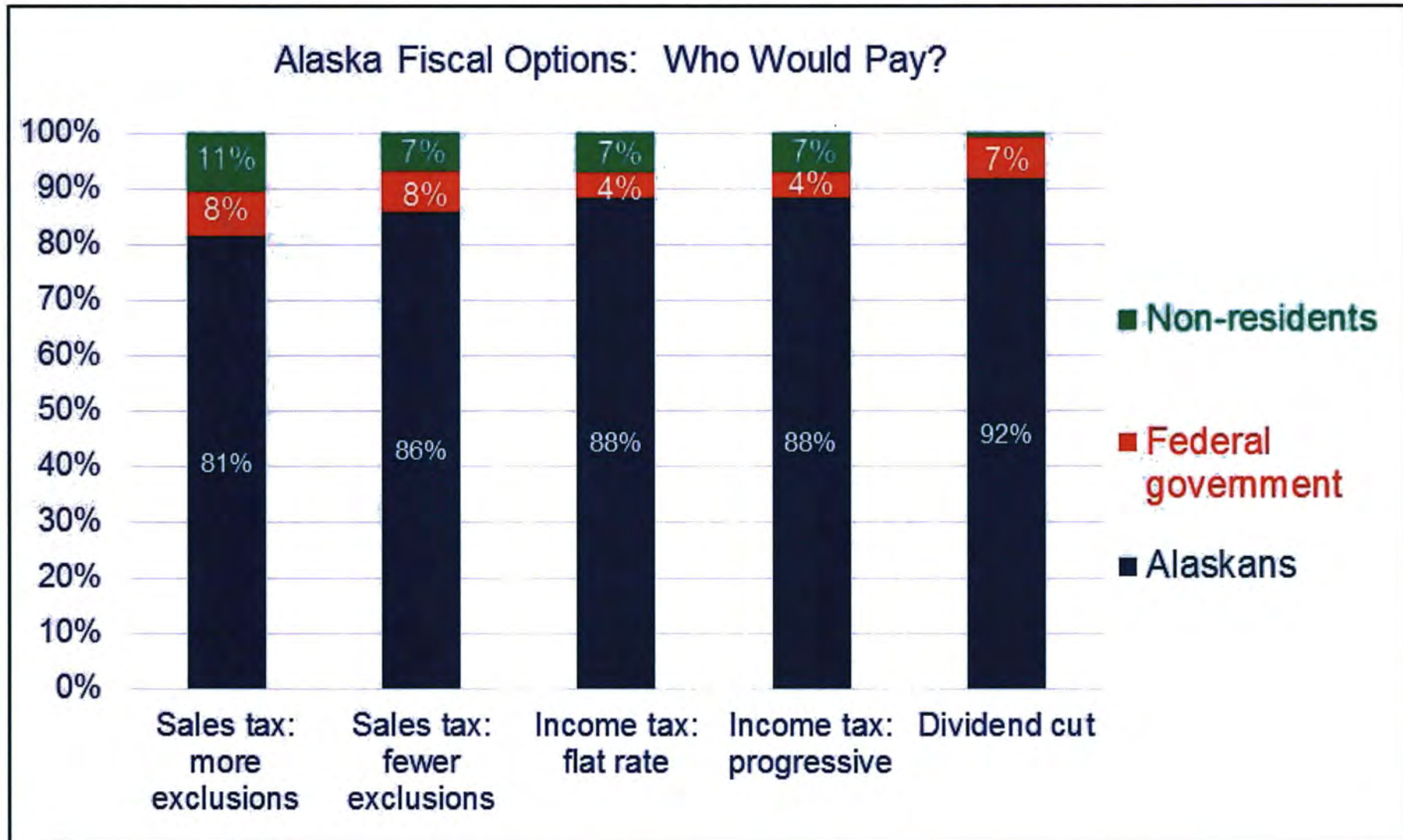
What we didn't study

Options with complex effects which are difficult to predict, including potential changes to:

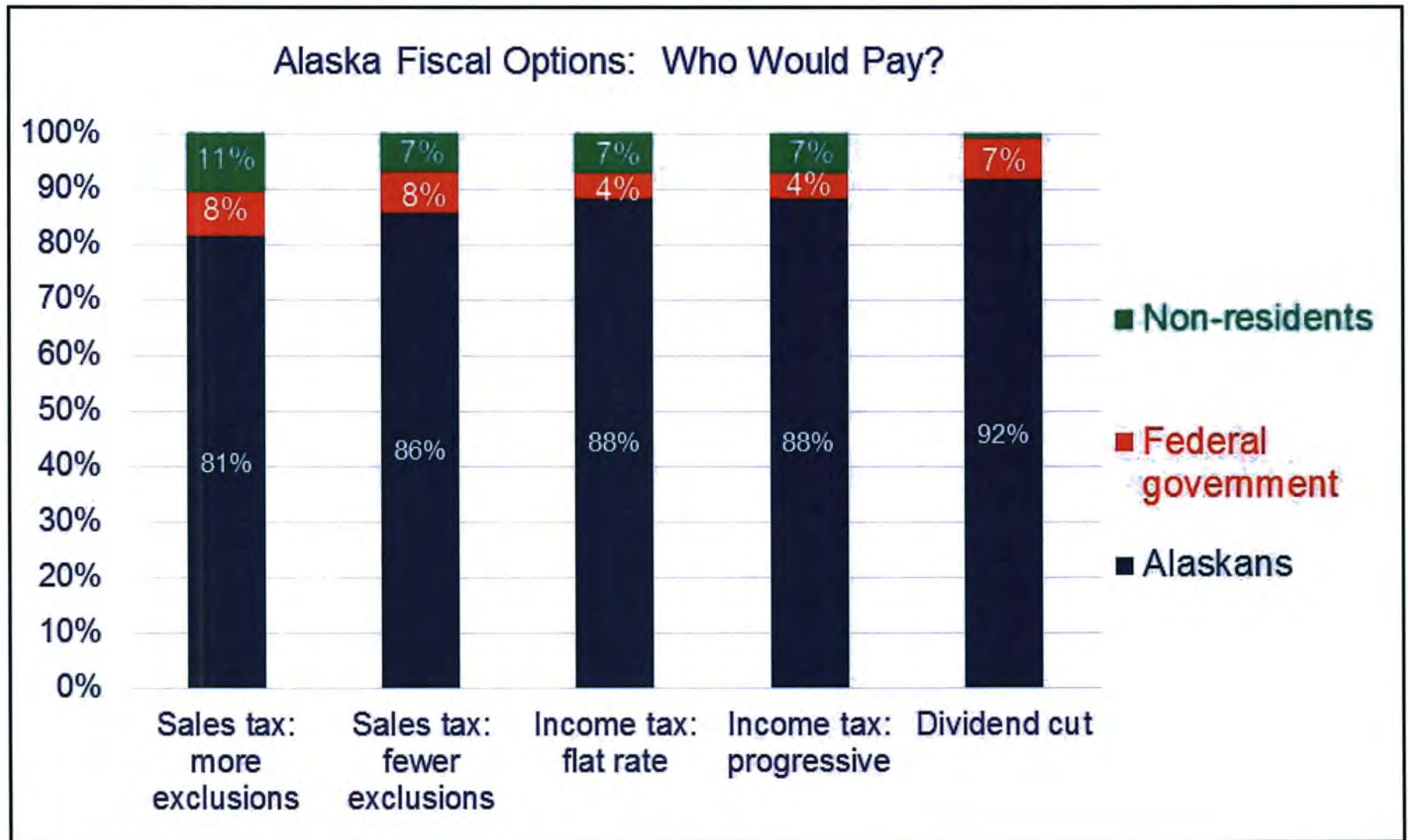
- oil taxes
- oil tax credits
- cuts to specific programs
- how the state delivers services
 - K12 education, University of Alaska, Medicaid, etc.
- “re-plumbing” of state finances (SB114, SB128, etc.)

Relative contributions of non-residents & the federal government

Non-residents would pay about 7-11% of sales taxes
and about 7% of income taxes

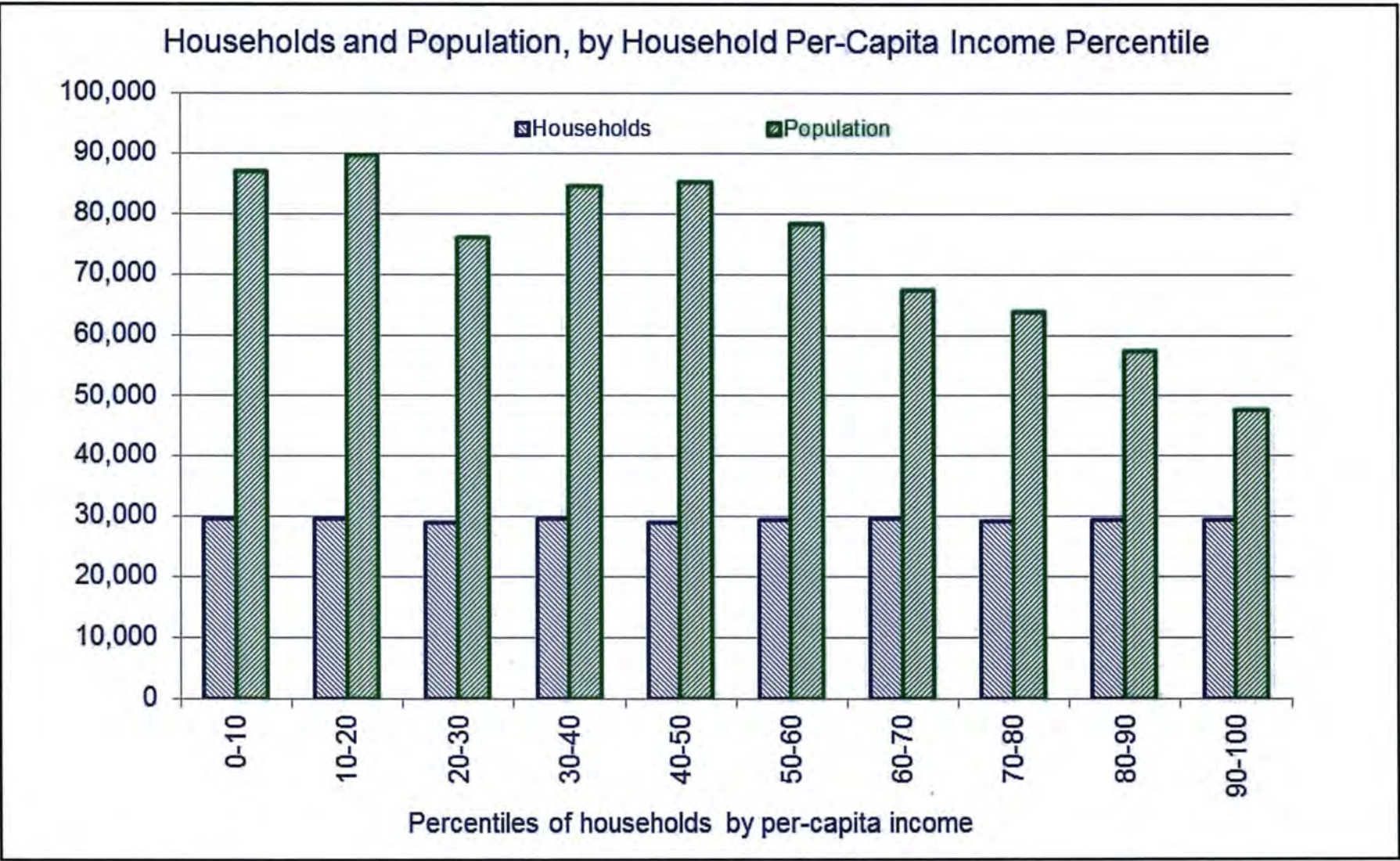


The federal government would help “pay” for taxes and dividend cuts—
because our federal income taxes would be lower.
Higher-income households who pay higher tax rates would benefit most.

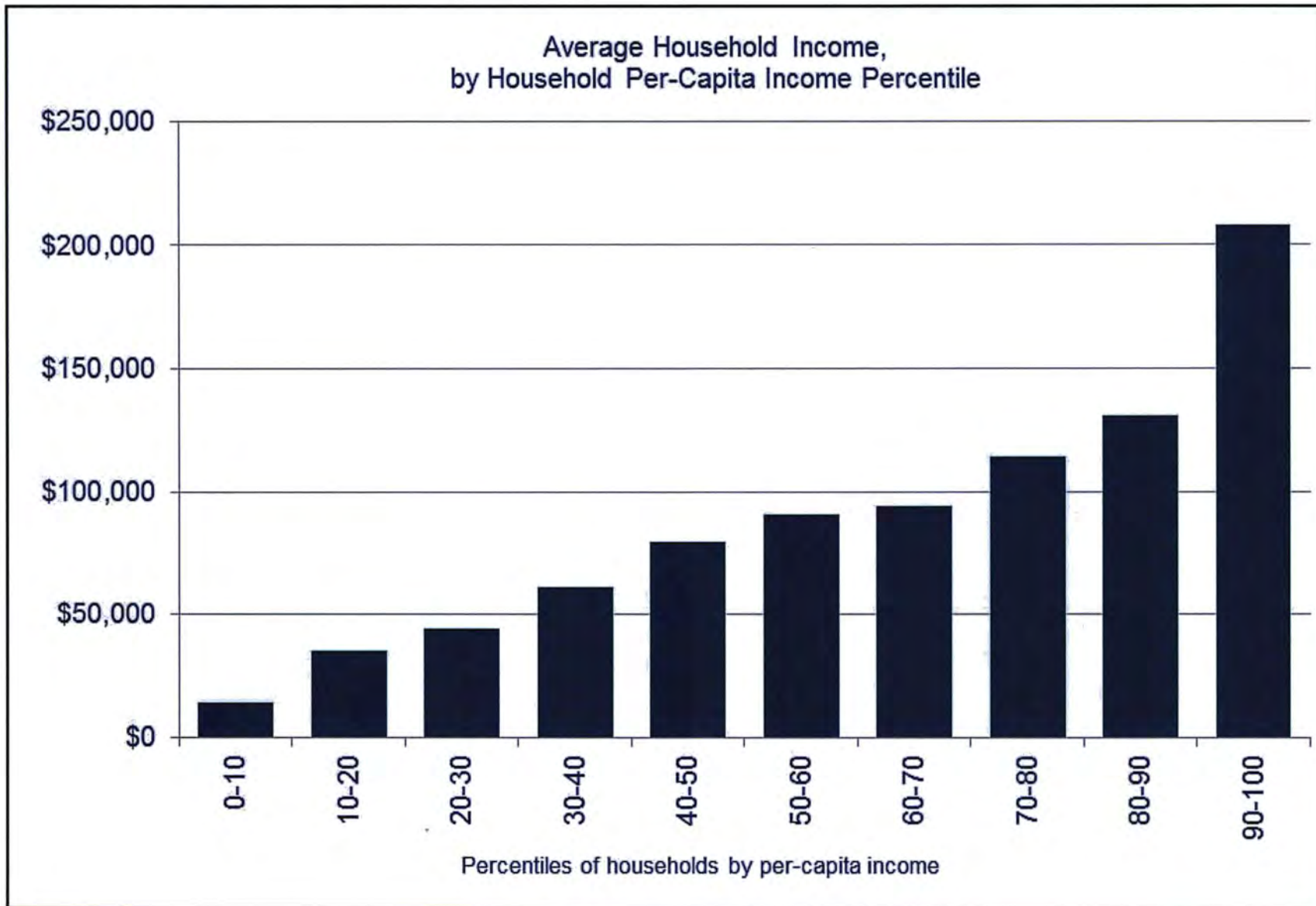


Relative impacts of fiscal options on different income groups

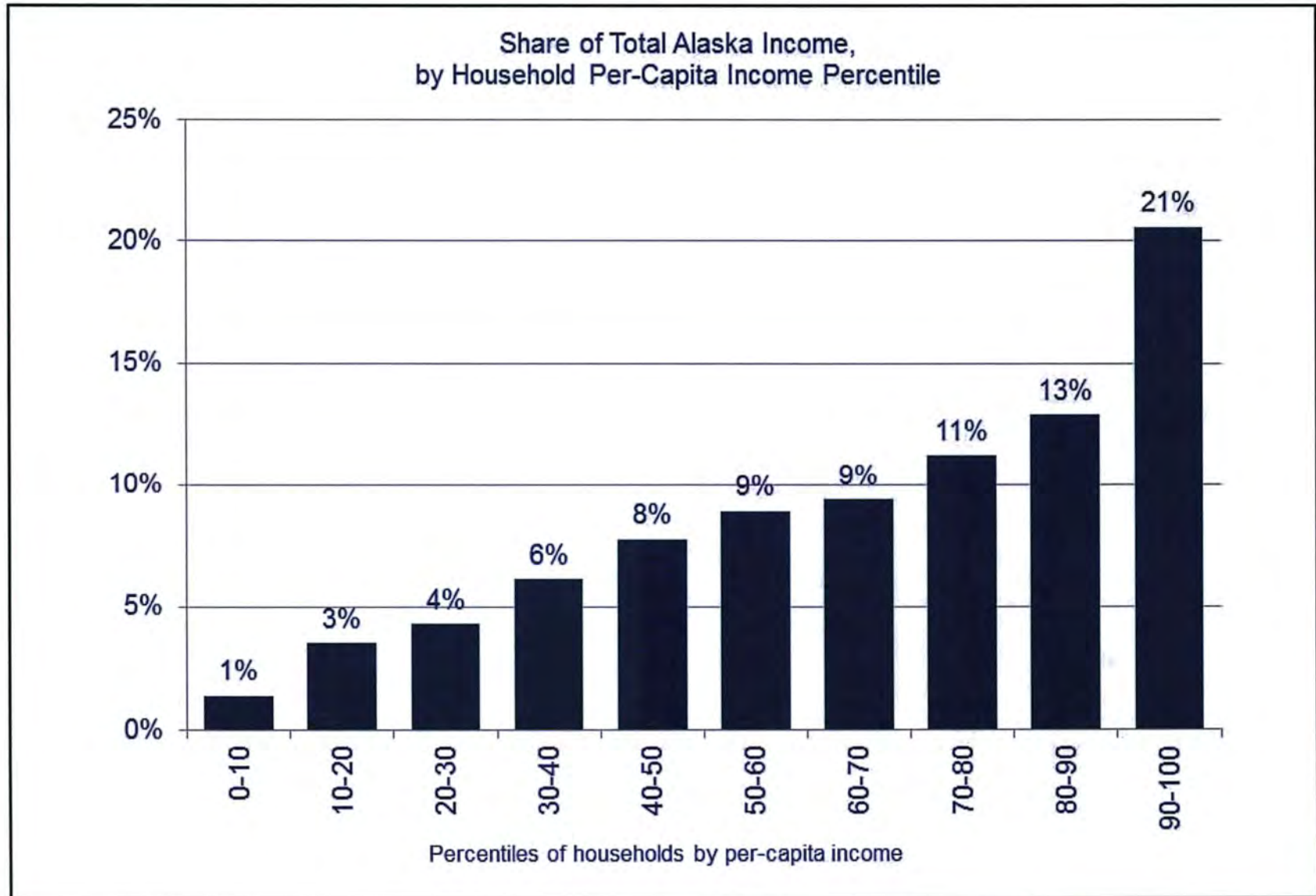
We estimated effects of taxes and dividend cuts for 10 groups of Alaska households, grouped by their per-capita income in 2013, from the lowest 10 percent to the highest 10 percent



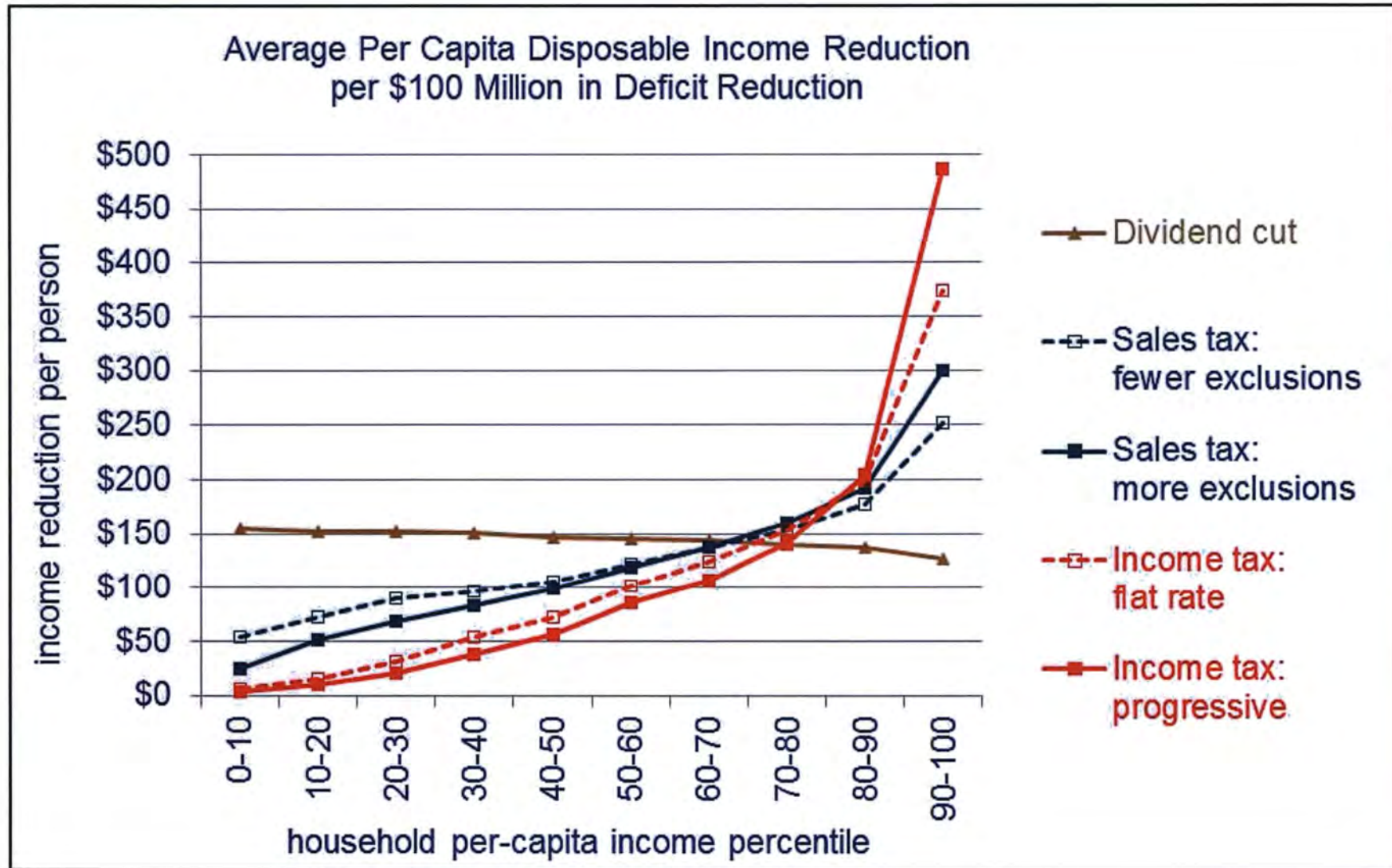
The three lowest-income groups had average household incomes of less than \$45,000. The highest-income group had an average household income of more than \$200,000.



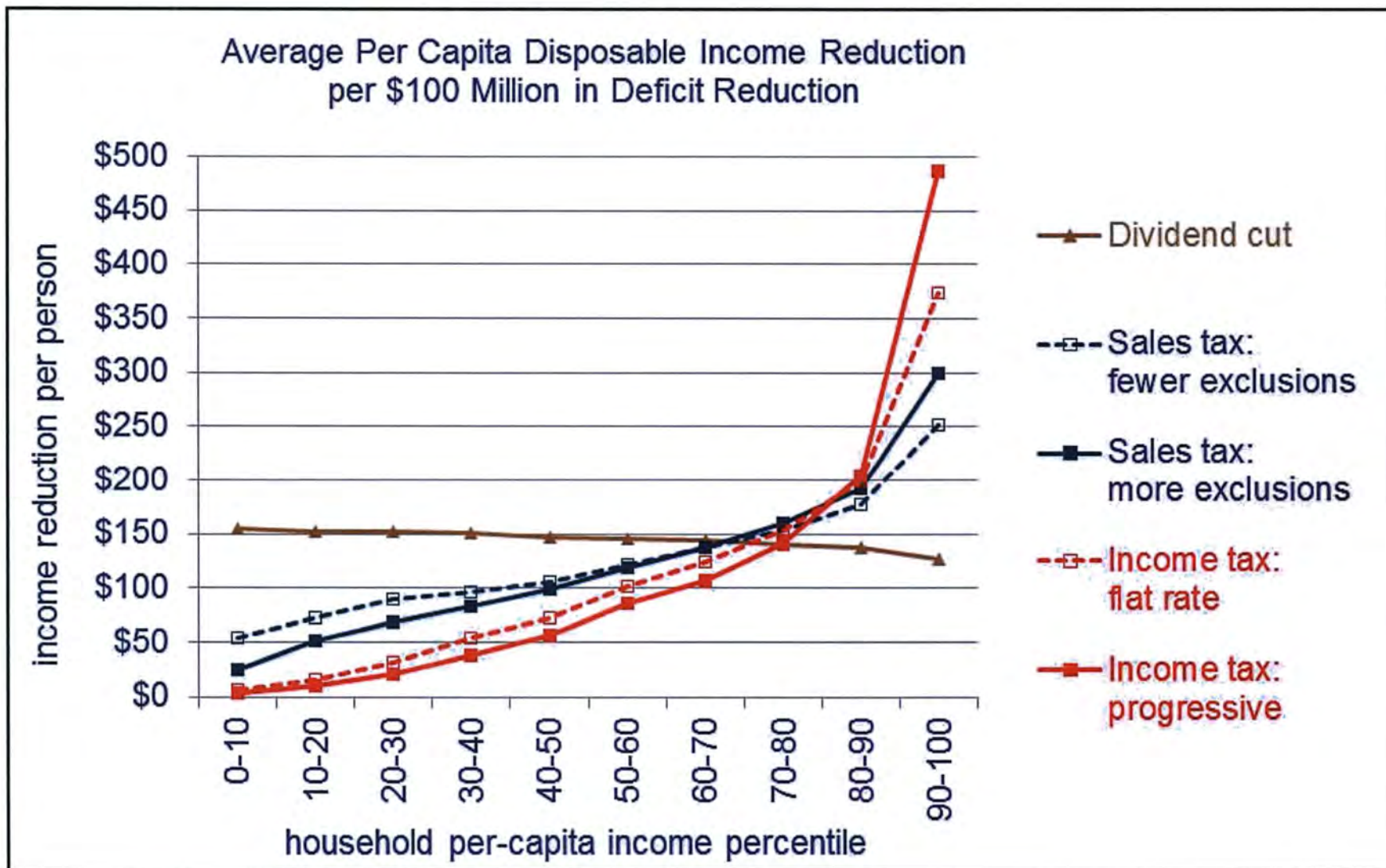
The share of the highest income group in total income (21%) was almost as high as the shares of the bottom five groups combined (22%).



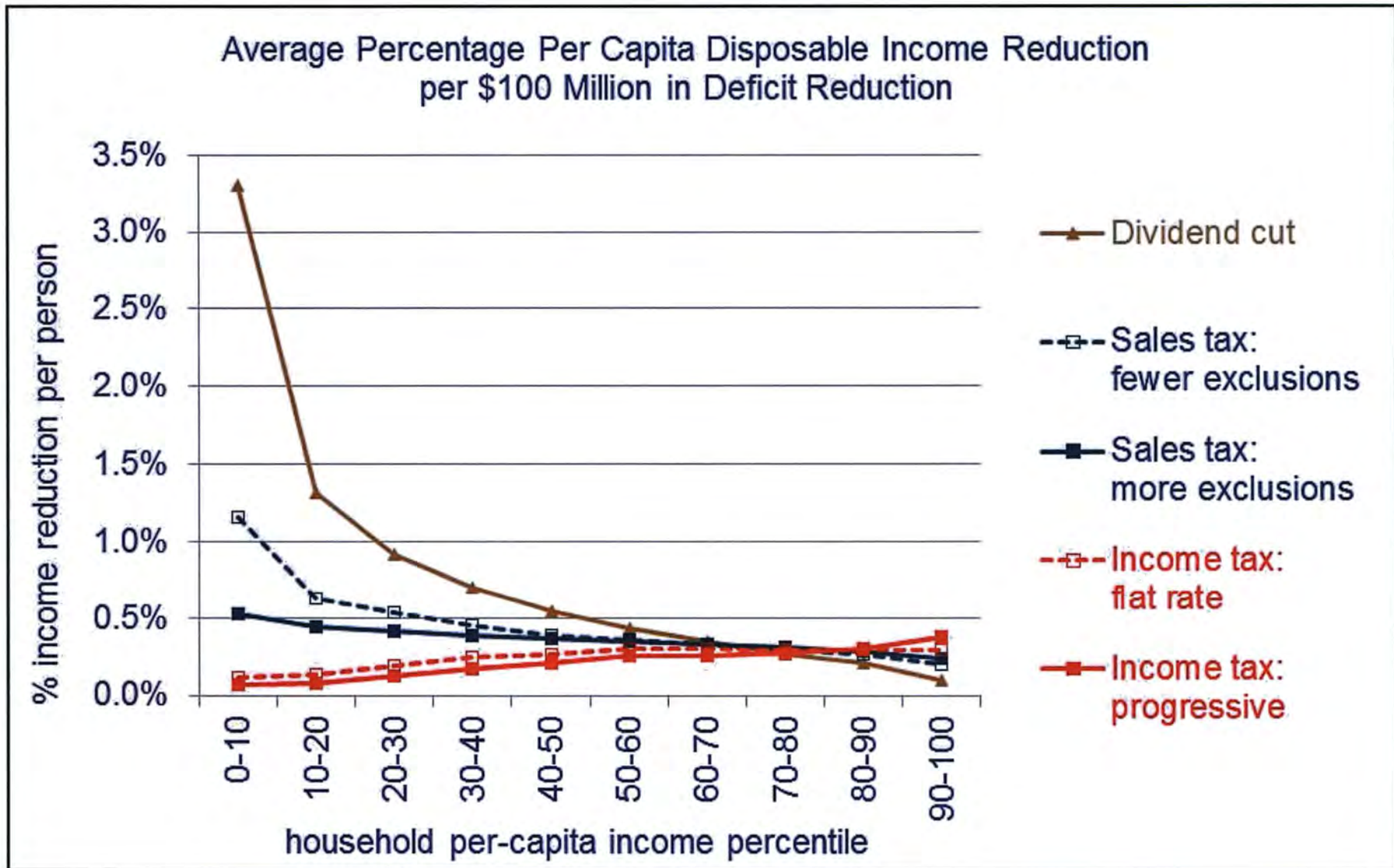
How options affect different groups: income reduction per person



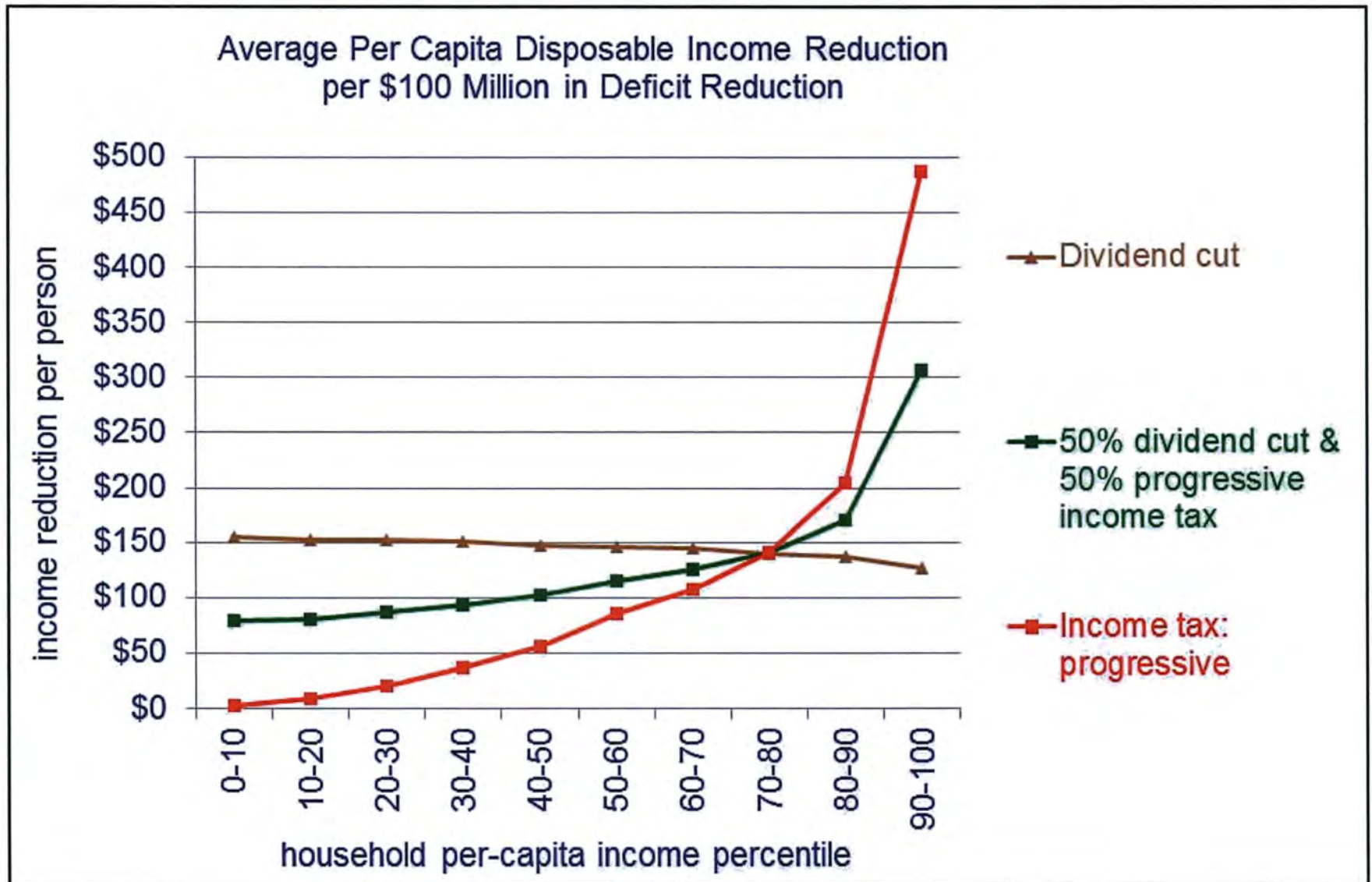
Dividend cuts cost lower-income households more
--because less of their dividends go to federal taxes.



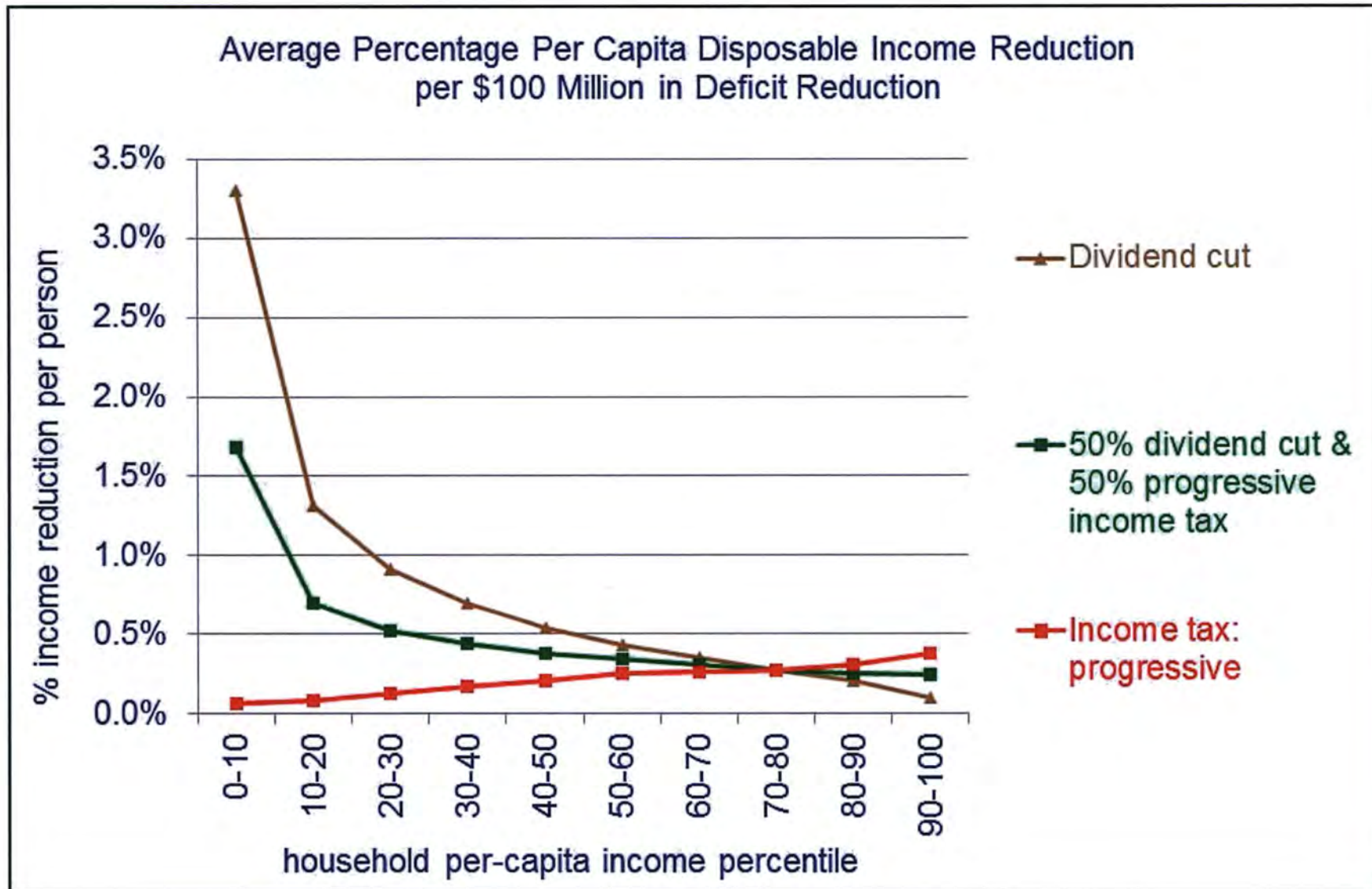
How options affect different groups:
percentage income reduction per person



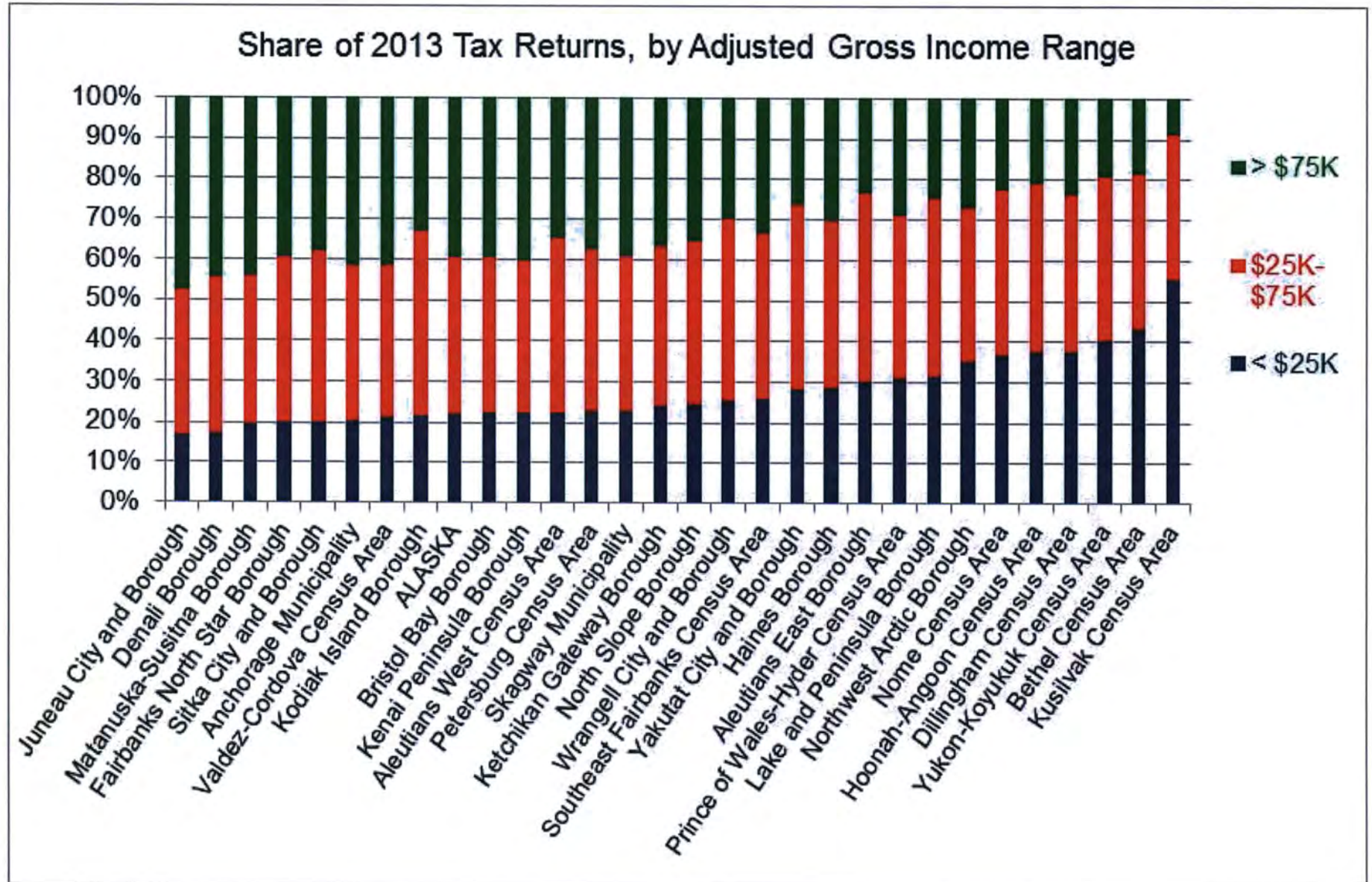
Combinations of options would have intermediate effects on households of different income levels.



Combinations of options would have intermediate effects on households of different income levels.



Income distribution varies for different regions of Alaska

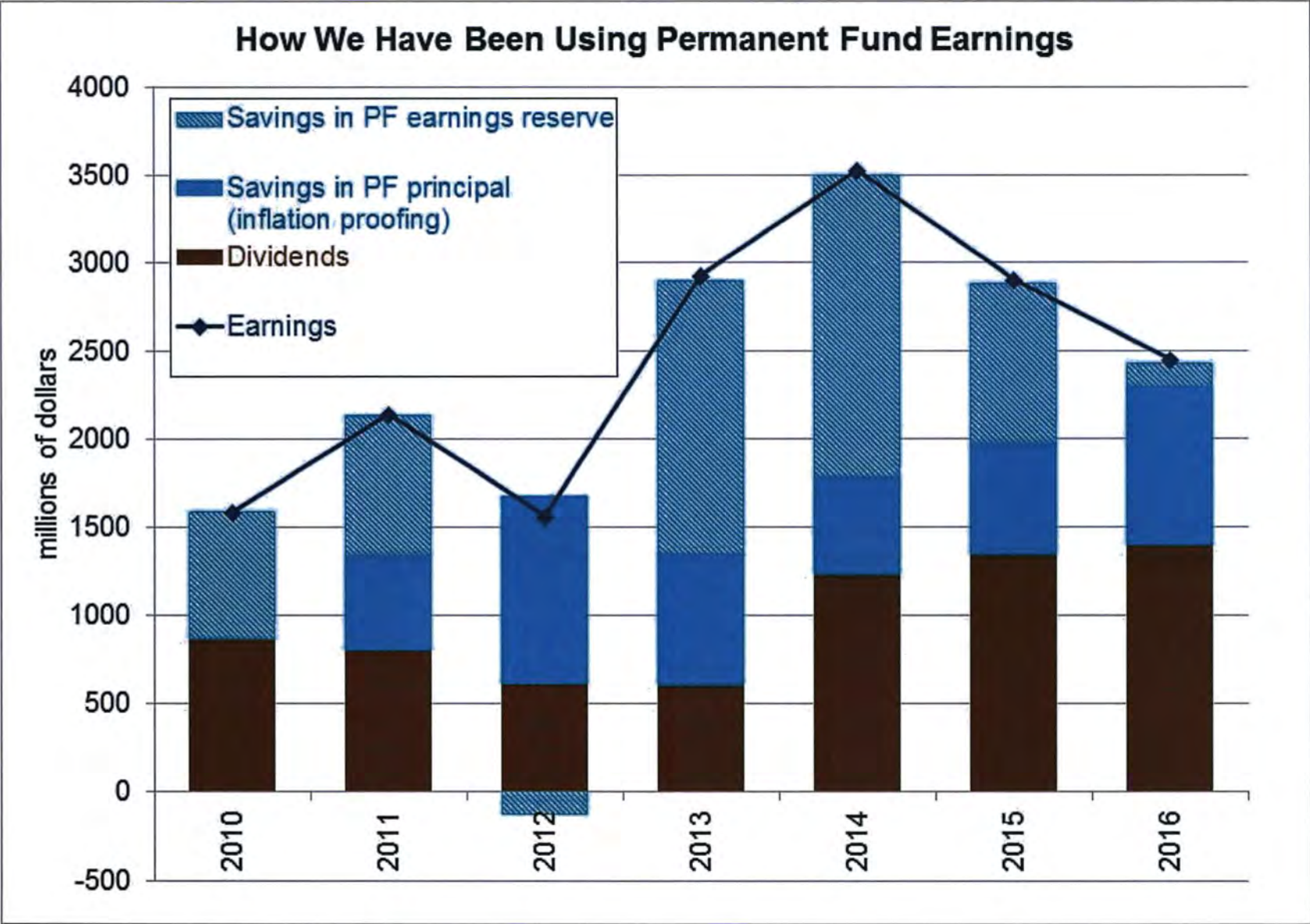


Relative impacts of fiscal options on the Alaska economy

Saving less (and using the money to fund government) would have no short-run economic impacts on the Alaska economy.

- Options for **saving less** include:
 - Reducing inflation-proofing transfers to PF principal
 - Adding less to the PF earnings reserve
- **Saving less** would not:
 - take *any* money out of the economy
 - have *any* short-run impacts on jobs or income
- But it would reduce:
 - our future investment earnings
 - how much savings we leave for future Alaskans

From 2010 to 2015, we saved an average of \$1.4 billion annually of Permanent Fund realized earnings



All our other fiscal options—
cutting spending, cutting dividends, and **increasing revenues**—
would have significant short-run economic impacts.

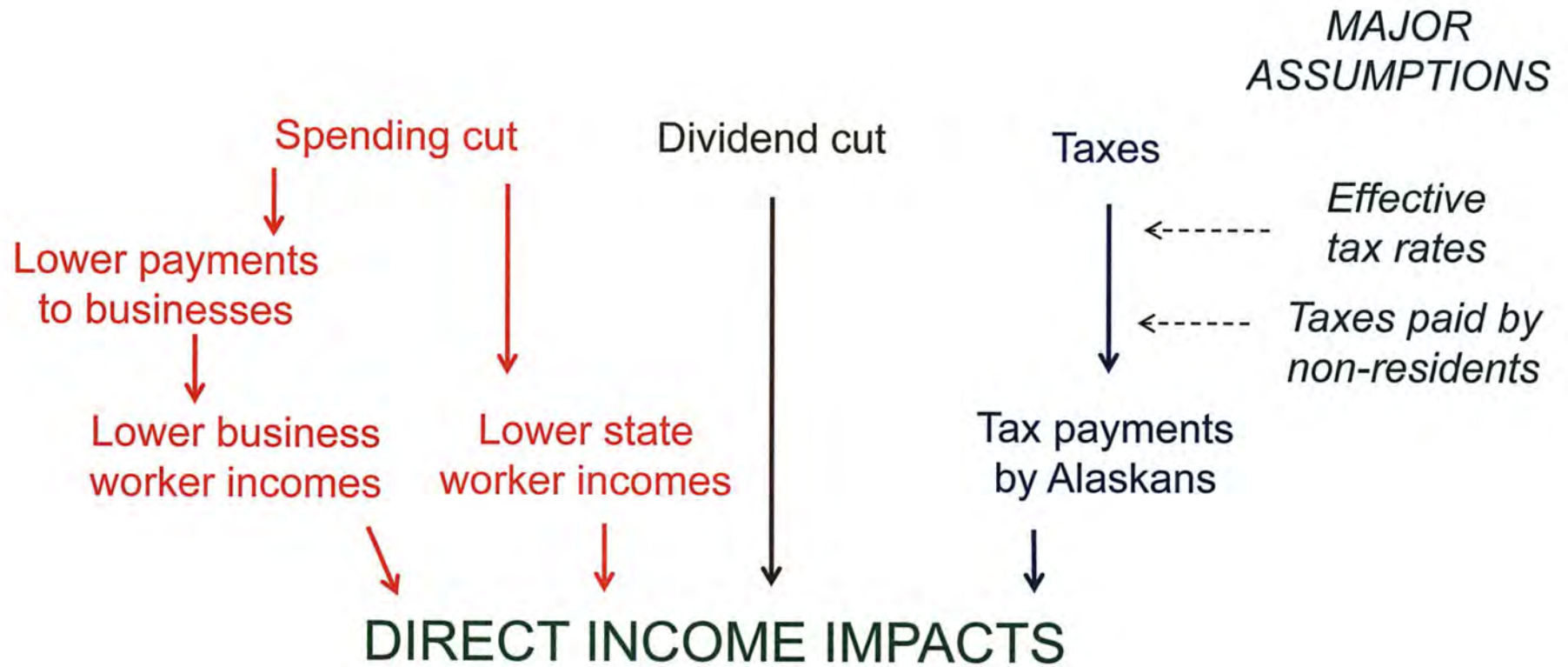
They would *all* take significant amounts of money out of the economy.

But they would do so in different ways,
with different impacts on different Alaskans
and different relative impacts on public and private employment.

How we compared relative impacts of other fiscal options

- Standard “economic impact analysis” using IMPLAN model
- Impacts per \$100 million of deficit reduction

*Calculating economic impacts:
direct income impacts*

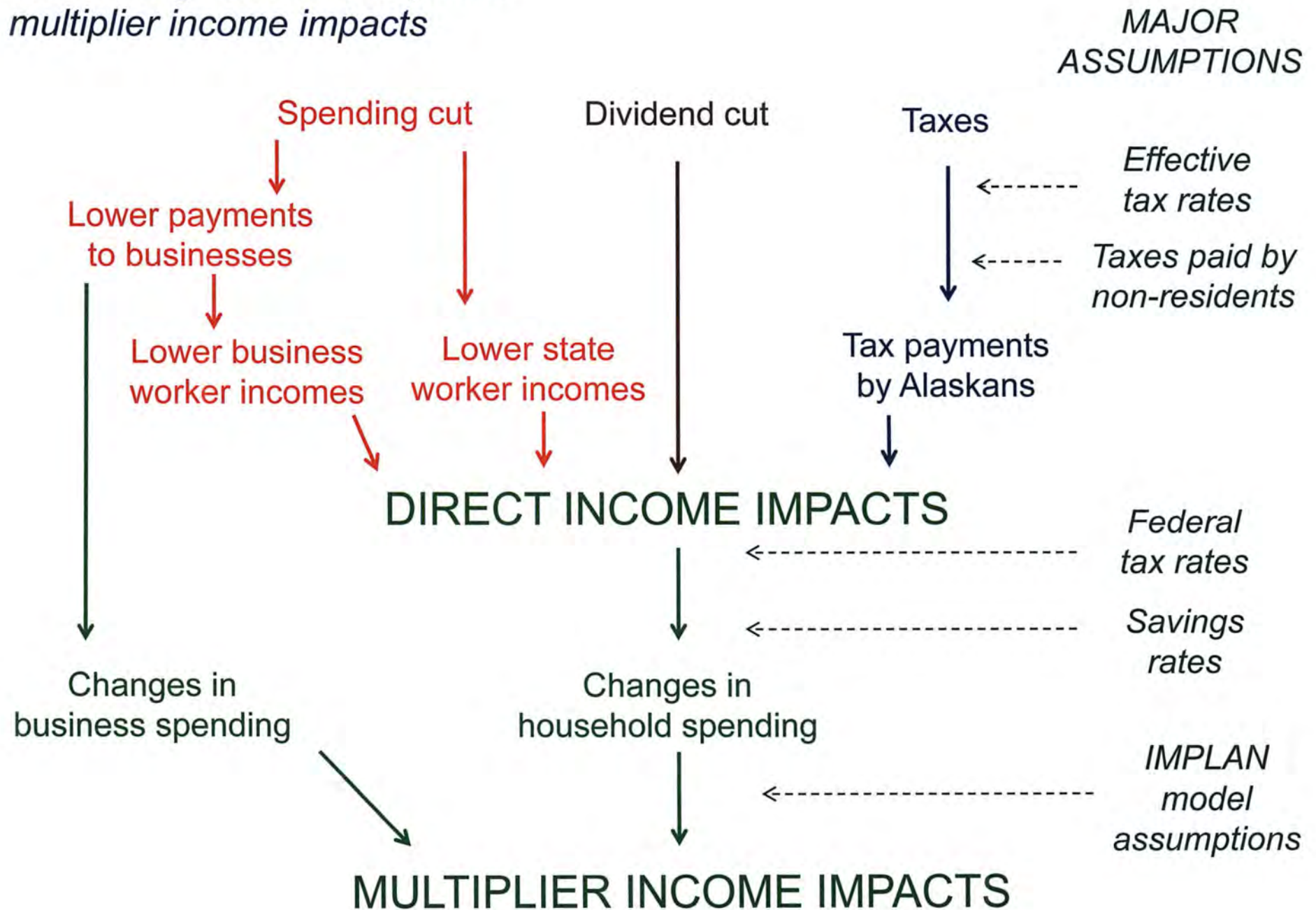


*Calculating economic impacts:
direct income impacts*

Short-Run Economic Impacts per \$100 Million of Deficit Reduction

Option	Direct earned income (\$ millions)	Direct other income (\$ millions)	<i>Why the direct income impact is less than \$100 million</i>
Spending cut: workers	95		<i>Not all of the cut is to worker pay</i>
Spending cut: broad-based	67		"
Spending cut: capital	42		"
Spending cut: pay	100		
Income tax: progressive		93	<i>Non-residents pay part of the tax</i>
Income tax: flat rate		93	"
Sales tax: more exclusions		89	"
Sales tax: fewer exclusions		90	"
Dividend cut		99	<i>Some dividend recipients leave</i>
Saving less		0	

Calculating economic impacts:
multiplier income impacts



*Calculating economic impacts:
multiplier income impacts*

Short-Run Economic Impacts per \$100 Million of Deficit Reduction

Option	Income Impacts (millions of \$ of income)			
	Direct earned	Direct other	Multi-plier	Total
Spending cut: workers	95		43	138
Spending cut: broad-based	67		48	115
Spending cut: capital	42		22	64
Spending cut: pay	100		43	143
Income tax: progressive		93	45	138
Income tax: flat rate		93	46	138
Sales tax: more exclusions		89	44	132
Sales tax: fewer exclusions		90	45	135
Dividend cut		99	51	150
Saving less				0



Pay cuts have a smaller multiplier impact than dividend cuts because more of pay goes to federal taxes and savings

*Calculating economic impacts:
job impacts*

**Short-Run Economic Impacts
per \$100 Million of Deficit Reduction**

Option	Job Impacts (FTE jobs)		
	Direct	Multi-plier	Total
Spending cut: workers	962	715	1677
Spending cut: broad-based	504	754	1260
Spending cut: capital	506	425	931
Spending cut: pay		727	727
Income tax: progressive		776	776
Income tax: flat rate		796	796
Sales tax: more exclusions		771	771
Sales tax: fewer exclusions		793	793
Dividend cut		898	898
Saving less			0

Job impacts are biggest for **cutting government workers** because they include direct losses of government jobs

Taxes and dividend cuts have only multiplier impacts on jobs.

Short-Run Economic Impacts per \$100 Million of Deficit Reduction

Option	Income Impacts (millions of \$ of income)				Job Impacts (FTE jobs)		
	Direct earned	Direct other	Multiplier	Total	Direct	Multiplier	Total
Spending cut: workers	95		43	138	962	715	1677
Spending cut: broad-based	67		48	115	504	754	1260
Spending cut: capital	42		22	64	506	425	931
Spending cut: pay	100		43	143		727	727
Income tax: progressive		93	45	138		776	776
Income tax: flat rate		93	46	138		796	796
Sales tax: more exclusions		89	44	132		771	771
Sales tax: fewer exclusions		90	45	135		793	793
Dividend cut		99	51	150		898	898
Saving less				0			0

The economic impacts of reducing the deficit will depend on what combination of options we use.

Short-Run Economic Impacts per \$100 Million of Deficit Reduction

	Total impacts of each option		Impacts of a combination of options		
	Income (\$ millions)	FTE jobs	% of deficit reduction	Income (\$ millions)	FTE jobs
Spending cut: workers	138	1677			
Spending cut: broad-based	115	1260	25%	29	315
Spending cut: capital	64	931			
Spending cut: pay	143	727			
Income tax: progressive	138	776	25%	34	194
Income tax: flat rate	138	796			
Sales tax: more exclusions	132	771			
Sales tax: fewer exclusions	135	793			
Dividend cut	150	898	25%	37	225
Saving less	0	0	25%	0	0
Combination of options	0	0		101	734

Economic impacts of spending cuts depend on what is cut

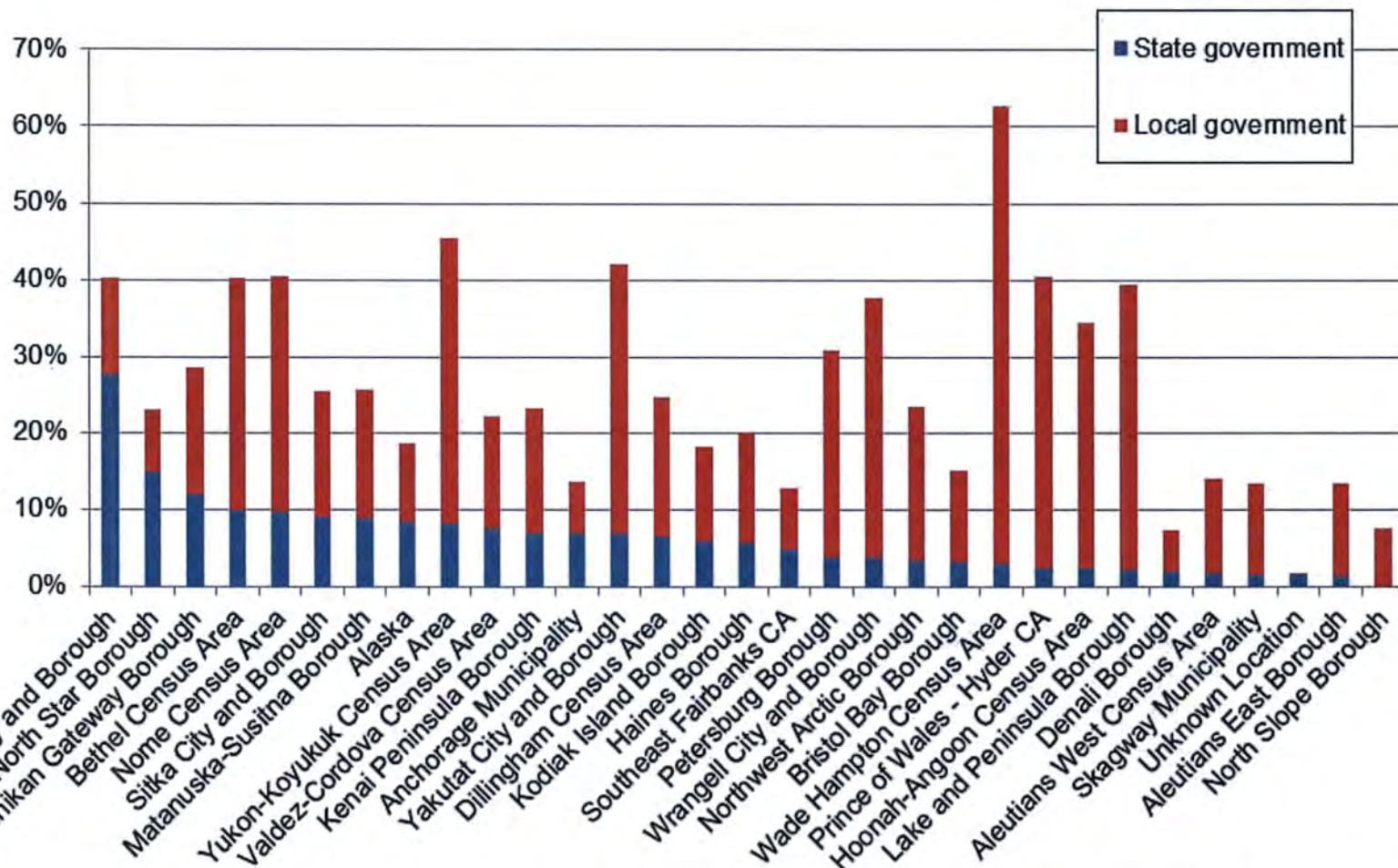
What is cut affects:

- Direct impacts on workers' incomes and jobs
 - Government workers
 - Contractor workers
- Impacts on contractor sales and spending
- Impacts of reductions in state services
 - Infrastructure development and maintenance
 - Resource management (fish catches, mine permitting)
 - Transportation (Marine Highway service, road plowing, etc.)
 - Quality of social services (schools, health care, parks, etc.)

You can't generalize about economic impacts of spending cuts.

Regional economic impacts of spending cuts would depend on how important government jobs and income are in the regional economy. Some regions are much more dependent than others.

State and Local Government as a Share of Total Employment



Total impacts of deficit reduction on the Alaska economy

How fast should we reduce the deficit?

What can we do to reduce the economic impacts?

Regardless of what we do,
we will experience impacts of spending cuts we've already made

- Impacts of past capital budget cuts on construction industry
 - Delayed because capital projects take several years
 - Actual capital spending will decline as money from past large capital budgets runs out

We can't avoid significant further impacts.

We have lost billions of dollars of oil revenue
which used to pay for most of state government.

We will have to adjust to having much lower oil revenues.

Adjusting will significantly impact Alaska's economy
—regardless of how we do it.

Our options for reducing the deficit are some combination of:

Spending cuts

New taxes on households or businesses

Dividend cuts

Saving less

Potential short-run impacts of reducing the deficit by \$1, \$2 and \$3 billion

Potential Total Short-Run Economic Impacts of Deficit Reduction

Option	Share of option in deficit reduction					
	100%	100%	50%	50%	33%	25%
Spending cut: workers	100%					
Spending cut: broad-based		100%	50%	50%	33%	25%
Income tax: progressive			50%		33%	25%
Dividend cut				50%	33%	25%
Saving less						25%
Total job impacts of reducing deficit by:						
\$1.0 billion	17,000	13,000	10,000	11,000	10,000	7,000
\$2.0 billion	34,000	25,000	20,000	22,000	20,000	15,000
\$3.0 billion	50,000	38,000	31,000	32,000	29,000	22,000
Total income impacts (\$ millions) of reducing deficit by:						
\$1.0 billion	1,400	1,200	1,300	1,300	1,300	1,000
\$2.0 billion	2,800	2,300	2,500	2,700	2,700	2,000
\$3.0 billion	4,100	3,500	3,800	4,000	4,000	3,000

In 2014, there were about 367,000 full and part-time jobs in Alaska. Total income was about \$40 billion. Total wage income was about \$27 billion.

We will have a smoother economic adjustment to lower oil revenues if we make significant progress this year.

Negative economic consequences of
not making significant progress this year

- Further draining of reserve funds
 - Lower future investment earnings
 - Future Alaskans are paying for our deficits
- Business and consumer uncertainty, resulting in:
 - Reduced business and consumer confidence
 - Reduced investment
- Downgrading of Alaska's credit rating
- Delay in when we could receive new tax revenues
 - Time lag from when taxes are adopted to when they collect revenue

Running deficits rather than adjusting to lower revenues
can reduce economic impacts
if the reasons for lower revenues are temporary.

If the reasons for the deficit aren't temporary,
running deficits only delays economic impacts—
and has other negative consequences.

Government can temporarily support an economy by running deficits.
Government can't permanently support an economy by running deficits.

Other impacts of fiscal options

All of our fiscal options have many other potential impacts
beyond those that we studied

- Indirect
- Longer-term
- Harder to estimate
- Potentially much more important to Alaska's future

Examples of other potential impacts of **spending cuts** . . .

- Increases in local taxes in response to shifted responsibilities
- Increases in user fees in response to budget cuts
 - university tuition, marine highway fares, park fees, etc.
- Loss of matching federal revenues—multiplying the impacts of cuts
- government services affecting the economy
- Economic impacts of reduced capital budgets
 - infrastructure & future resource development
 - future costs of deferred maintenance
- Impacts on government & university workforce
 - Morale and quality of workers
 - Turnover

Examples of other potential impacts of **spending cuts** . . .

- Economic impacts of reduced services
 - Reduced tourist travel on Marine Highway
 - Reduced ADFG research on fisheries management leading to more conservative management & lower catches
 - Higher transportation costs and times due to reduced snow-plowing and road maintenance
 - labor markets
 - Whether young Alaskans stay in Alaska to attend college
 - Effects on “quality of life” and how hard it is to find and keep good employees
 - Migration from rural villages if schools are closed
 - Higher potential future costs
 - Of education if early childhood services are cut?
 - Of crime and corrections if education is cut?
 - Of health care if primary health care services are cut?
 - Of social service costs if people leave villages

Examples of other potential impacts of **income taxes** . . .

- Incentives for
 - businesses to invest
 - Individuals to invest
- Wage rates needed to attract workers
 - Costs of fish processing labor
 - Impacts on fish prices & fishermen

Examples of other potential impacts of sales taxes . . .

- Administrative costs
- Impacts on local government sales tax collections
- Higher impacts in higher-cost rural communities
- Impacts on visitor spending

Example of other potential impacts of **dividend cuts** . . .

- Wages people need to earn to live in Alaska
 - Effects on wage rates
- Ability of Alaskans to
 - Purchase gear needed for subsistence
 - Accumulate wealth
- Incentives for people to move to or leave Alaska
 - Particularly larger or poorer families

Examples of other potential impacts of fiscal choices . . .

- Effects on labor markets
- Effects on Alaska population
 - Effects on costs of providing government services
- Effects on real estate markets
- Effects on the type of people who want to live in Alaska
- Effects on equity of Alaska income distribution
- Extent to which Alaskans have “skin in the game” and interest in restraining state spending
- Extent to which Alaskans support preserving and growing the Permanent Fund

Alaska's fiscal choices will significantly affect
Alaska's future economy and society.

We should think not only about their short-term economic impacts
but also about their longer-term economic and social impacts.