

The Great Alaska Recession¹

by

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*How it began – How it differs from past Alaska recessions –
Why it's shaping up to be the worst economic disaster since
statehood – Why the economic crisis trumps the fiscal crisis as the
biggest challenge facing Alaska – And what can be done to lessen
the economic pain for Alaska households and businesses.*

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Executive summary

A major regional recession began for Alaska in the summer of 2014. Alaska has experienced three previous recessions since it became a state. In contrast to prior recessions, the present Alaska downturn is being driven by a fundamental decline in the value of the region's principal export. In that respect it differs from all previous Alaska recessions.

The current recession is likely be deep and long for two reasons:

- Alaska's economy is so dependent on its number-one export that unless oil prices recover, this recession is likely to be proportionately worse, and last proportionately longer than the typical regional downturn.
- In regional recessions prices for labor, buildings, and real estate tend to decline. That boosts the less important export sectors and helps them grow. In Alaska the less important export sectors – seafood, mineral mining, and federal spending – are threatened or already declining.

Factors driving the recession are the effects of declining oil prices on oil industry outlays, the effect of the oil price slide on state spending, the negative effect of the strengthening dollar on Alaska exports, the negative effect of federal job reductions, the negative effect of continued local government job losses, and the potential for a shrinking Alaska military. Because of these factors, unless oil prices rebound 4,000 or more Alaska jobs will disappear by September, and a total of 20,000 or more will be lost by September 2016.

There is nothing the state government can do that will rescue Alaska from the coming recession, but the state can mitigate the economic distress, soften the hard landing and prepare the economy for the recovery that must eventually ensue by following four principles:

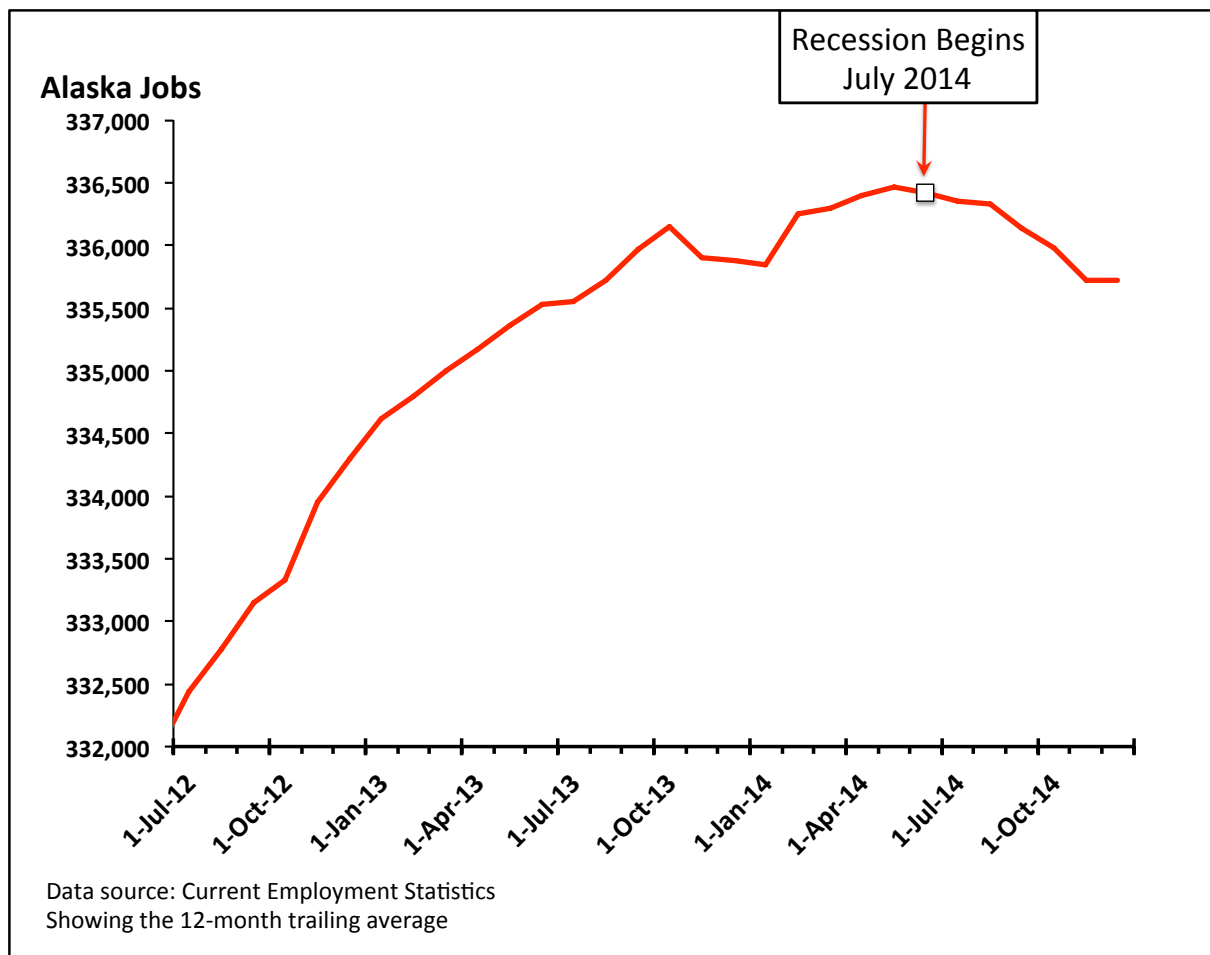
- ***Focus on the economy.*** Reducing spending makes the economic crisis worse. How Alaska will finance its state government is an important issue, and husbanding the state's savings remains an important objective, but in the near term, fashioning a softer landing for the economy may be more important.
- ***Maximize the economic bang-for-the-buck in state spending.*** Adjustments to capital project spending have been the state's traditional approach for managing the ups and downs in its oil revenue. That remains a sensible approach. Medicaid expansion (with negative own-source state outlays in the first year) is the ultimate example.
- ***Maximize federal dollars.*** Federal dollars coming to Alaska bring jobs and economic activity. Medicaid expansion is again an example.
- ***Plan for an Alaska with a fewer people.*** Unless oil prices make a dramatic recovery the state's population and employment will shrink. Planning for this

eventuality can speed the return to growth and lay the groundwork for a more robust recovery.

1. The beginning

What is now recognized as a major regional recession began for Alaska in the summer of 2014. According to the Census of Employment and Wages, in July of 2014 Alaska counted 1,241 more jobs than in July a year earlier. The Alaska economy was still expanding. The next month, in August, the job count was 2,991 *less* than a year earlier. Alaska's economic contraction had begun.²

Figure 1.1



Source: Current Employment Statistics, showing the 12-month trailing average

² These data are from the *Quarterly Census of Employment and Wages* (QCEW) published every quarter by the Alaska Dept. of Labor and Workforce Development (AKDOL) under a program overseen by the U.S. Bureau of Labor Statistics (BLS). The most recent data are through September 2014. Data through December 2014 are scheduled for release in June.

More up-to-date (but less reliable) data from a different source, Current Employment Statistics are shown on the Figure 1-1 above. They confirm the start of the recession.³

The principal initial cause of the recession has been the loss of government jobs – state, local and federal. By August, governments together had shed 3,474 jobs compared with the same month one year earlier. The largest part of this loss, 2,790 jobs, was in the local government sector.⁴

Federal and local government employment has been shrinking since 2011. Until this summer, however, growth in state government offset some of those losses. By August the state sector had also slipped into contraction, losing 203 jobs compared with a year earlier.⁵ The loss of government positions was partially offset by growth in the private sector, which added 483 jobs in August, also compared with a year earlier. By September, however, the engine of private sector growth also ran out of steam, posting a net gain of only 31 private jobs.

In summary, two factors brought on the recession:

(1) The rate of government job losses got faster as state government shifted from adding jobs to getting rid of jobs.

(2) The rate of job growth in the private sector slowed.

Declining government spending was behind the first factor, and likely played a role in the second.

2. Other forecasts

In most years since 1988 optimism has been the watchword of Alaska economists. Adjectives like “vibrant” and “buoyant” sprinkled their annual forecasts. Now there are new phrases like “pause,” “flattened growth” and “plateau phase.” As a former *Anchorage Daily News* editor long ago remarked, “‘plateau phase’ is a euphemism for hard times.”

Alaska’s mainstream economic forecasters agree that the job growth the state has enjoyed since 2009 is over. Marcus Hartley, chairman and principal economist at Anchorage consulting firm Northern Economics, says, “The Alaska economy is

³ Current Employment Statistics are published monthly by AKDOL under a program also overseen by BLS. Because the data are from a sample rather than a census, they are less reliable and subject to more statistical noise. The 12-month averaging procedure used to build this chart suppresses some of that noise as well as seasonal ups and downs.

⁴ A key factor in the loss of local government jobs is the declining real value of state appropriations for education aid and community revenue sharing. See “Inflation Adjusting and Offsetting the Loss of Selected Education Funding in Ch. 15 SLA 2014,” Legislative Research Service Report 15.266, memorandum by Chuck Burnham, Jan. 23, 2013; see also “Base Student Allocation Compared to the Rate of Inflation,” Legislative Research Service Report 13.151, memorandum by Robert Withington, Jan. 23, 2013.

⁵ “Employment Forecast for 2015,” by Caroline Schultz, in *Alaska Economic Trends* (published by AKDOL), January 2015. The article includes a useful history of Alaska government employment in the 2004 to 2014 period.

transitioning to recession.” He predicts that the first half of 2015 will appear, “pretty normal, ... but the pain will hit around mid-year.” He predicts a net loss of 2050 jobs in 2015.⁶

The Alaska Dept. of Labor and Workforce Development (AKDOL), also in January, proffered a no-growth forecast for 2015. “Alaska is not expected to gain jobs in 2015, as the state faces downward pressure from low oil prices and tightened government budgets.”⁷ The department’s forecaster, who did not have the benefit of the third-quarter QCEW data now available, thought private job growth would continue to offset government job losses.⁸

Neither the Northern Economics nor the AKDOL forecast suggest cause for alarm. The 2050 jobs Hartley expects the economy to shed in 2015 amounts to only 0.6 percent of all jobs.⁹

Is the situation serious? “Yes,” answers Hartley, of Northern Economics. “Time for panic? No! ... 2015 will be a challenge, [and] 2016 more so, but this is not 1988 (yet).”

3. Other recessions

Hartley’s “1988” reference is to the recession that ended in that year, the worst recession in Alaska’s history as a state. Recessions in Alaska are rare: there were only four years in the 54 years since statehood that employment did not grow. The no-growth years encompassed three recessions:

- The 1977 the Post-Pipeline Recession,
- The 1985-88 State Spending Recession,
- The 2009 spillover recession from the Great Recession that hit the U.S. and world in 2008-2009.

Regional recessions can have many causes, but most result from regional specialization, as in the manufacture of airplanes or the production of corn, combined with declining worldwide demand for the specialized product or service. The Seattle area specialized in the manufacture of large commercial jet transport aircraft. In 1970, when demand for that product ebbed, Seattle lost 70,000 jobs in the space of 19 months.¹⁰ In

⁶ “Alaska Economic Outlook 2015,” Marcus Hartley (Northern Economics, Inc.), a presentation with World Trade Center Alaska, January 27, 2015.

⁷ “Employment Forecast for 2015,” *supra*, footnote 7.

⁸ Anchorage-based Northrim Bank, Inc., has published a 2015 state economic forecast. Mark Edwards senior vice-president and bank economist, writes: “Some segments like government, construction and professional services are likely to shrink, but these losses will be offset by gains in tourism, health care, and retail. See “Alaska Economic Update,” *circa* Mar. 2015. <http://alaskanomics.typepad.com/files/page-layout-economic-report-update-3b-bp.pdf> accessed Apr. 7, 2015.

⁹ In a note appended to its forecast, AKDOL describes the department’s forecasting philosophy. “These forecasts are based on the assumption that the dynamic processes governing employment demand in specific industries will not change dramatically, and they don’t attempt to forecast any economic catastrophes (sic) or booms.” Erickson & Associates believe the insights that make a forecast useful *include* those that warn of surprises – especially booms and catastrophes.

¹⁰ *Seattle: Past to Present*, by Roger Sale, University of Washington Press, 1976.

the mid-1980s declining agricultural prices triggered a regional recession encompassing much of the Midwest.¹¹

Hartley's reference to 1988 implies that the current recession is more likely to resemble the mild reversal experienced in 2009. He could be right, but only if oil prices rebound to the plus \$90 per barrel range experienced in 2008 and 2011-2013.

The current Alaska recession started on a path similar to the 1986-87 downturn, but has morphed into a regional recession similar to that typically experienced elsewhere. The following sections summarize the factors that caused the three prior recessions.

3-A. The 1977 Post-Pipeline Recession

Alaska's 1977 recession followed demobilization of the workforce that built the trans-Alaska oil pipeline. The winding down of a world-scale construction project necessarily meant large job losses. Those losses had nothing to do with a fall in the value of oil, seafood, tourist experiences, or the other things Alaska sold (and still sells) to earn its way in the world.

3-B. The 1985-88 State Spending Recession

This recession was rooted in the extraordinary growth of state capital spending in the early 1980s, and the housing and heavy construction bubble the state created. When state spending stopped growing in July 1985, the bubble popped. By the following April the state was losing 1,660 jobs per month, eventually causing the loss of nearly one in every ten jobs.¹²

Declining oil prices played only a small role. Oil prices started to slide in December 1985, three months *after* the recession began, and two years *after* construction employment began to shrink. Speaking in 1988, here is how economist Scott Goldsmith explained the 1985-88 recession:

*It is critically important to recognize that we brought this recession on ourselves, and it was not primarily the result of weakness in the markets for the goods and services that Alaska sells to the rest of the world. This fact distinguishes our recession from those that have occurred in other regional economies.*¹³

¹¹ *The Recession, The Real Estate Crash, and Alaska's Economic Prospects*, by Gregg Erickson, published by the Alaska Division of Policy, Office of the Governor, March 1988. See also "Economy Rebounds from Recession," by John Boucher, in *Alaska Economic Trends* (published by AKDOL), March 1989; Erickson's June 1982 essay, "Managing the Collapse of the Alaska Economy;" and "After the Boom: An examination of Alaska's economic prospects," by Erickson and Arlon Tussing, in the Winter 1984 issue of *Alaska Public Affairs Journal*.

¹² "Economy Rebounds from Recession," by John Boucher, in *Alaska Economic Trends* (published by AKDOL), March 1989.

¹³ "Remarks to the Alaska Policy Forum," Scott Goldsmith, January 7, 1988.

3-C. The 2009 Spillover Recession

Alaska's 2009 recession was likewise different from the typical regional downturn. It reflected the drying up of credit and other spillover effects from the national recession of 2008-2009.

4. Deconstructing the storm

Up to now no Alaska recession was caused by a decline in the value of what Alaska produces and sells to the rest of the world. The present Alaska downturn is now a classic regional recession, driven by that fundamental decline in the value of the region's principal export. However, Alaska's current situation differs from the regional model in two unfortunate ways:

- Alaska's economy is so dependent on its number-one export that unless oil prices recover, its recession is likely to be proportionately worse, and last proportionately longer.
- In regional recessions prices for labor, buildings, and real estate tend to decline. That boosts the less important export sectors and helps them grow.¹⁴ In Alaska the less important sectors – seafood, mineral mining, and federal spending – are threatened or already declining.

In the following subsections we analyze the individual elements of Alaska's perfect economic storm.

4-A. The oil price slide

The Alaska economy faces converging threats to the way Alaska and Alaskans earn their way in the world, but of these, the oil price collapse is the most serious. University of Alaska economist Scott Goldsmith estimates that the petroleum industry accounts for half of all Alaska jobs:

- State spending of oil revenue – 31 percent
- Spinoff jobs from oil wealth – 16 percent
- Oil industry jobs – 3 percent.¹⁵

With this dependence on oil the 52 percent drop in world oil prices since July naturally challenges the stability of the Alaska economy. If the low prices persist through FY 17, the effects are likely to surpass those in any previous Alaska recession.

4-A-1. Influence of oil prices on oil industry spending

Although petroleum companies directly generate 3 percent of Alaska's jobs, other companies serving the industry account for 16 percent of Alaska employment. Low oil

¹⁴ This was a key factor in the recovery from the 1985-88 recession, as described in "Recession's Dividends," and "The Real Estate Crash," p. 7-10, in Erickson's 1988 analysis, *The Recession, The Real Estate Crash, and Alaska's Economic Prospects* (see footnote 11).

¹⁵ *The Alaska Economy: How does it Work*, by Scott Goldsmith, Feb. 1, 2012.

prices are already eroding jobs in this second category as oil producers and would-be producers scale back contracts with service companies and other contractors.¹⁶

Oil industry officials insist that “sanctioned” projects are moving forward regardless of oil price changes. Trond-Erik Johansen, president of Conoco-Phillips Alaska Inc. told the audience at the Resources Development Council’s annual meeting in December that the firm’s Alaska projects would remain on track despite reduced company capital spending elsewhere in the world; analysis by Anchorage-based *Petroleum News* of other reports by the parent company suggest some Alaska projects are being delayed.¹⁷

With oil prices at their current level the companies’ Alaska operations are hemorrhaging cash. In December the Alaska Dept. of Revenue (DOR) predicted that the U.S. West Coast price of Alaska crude in FY 16 would average \$66.03 per barrel. Assuming that price and the department’s estimates of companies’ capital and operating spending, the industry’s Alaska operations in FY 16 would lose \$320 million (\$1.47 per barrel), figured on a cash basis.¹⁸

The price of Alaska crude at the end of March was \$14 below the DOR forecast, intensifying Alaska oil producers’ incentive to do everything they can to reduce Alaska outlays. News reports suggest that is what they are doing.¹⁹

Much of the industry’s spending is for sustaining production from existing fields, so cutbacks are likely to foretell further and possibly accelerating production declines.

Alaska isn’t the only place where the collapse of oil prices threatens the regional economy. In December JPMorgan Chief Economist Michael Feroli analyzed the impact of lower oil prices on the Texas economy and found it not good. “We think Texas will, at the least, have a rough 2015 ahead, and is at risk of slipping into a regional recession.” He said the consequences could include job losses and a sharp pullback in home prices in big Texas cities.²⁰ With Alaska’s much greater regional economic concentration in producing oil, the job losses and pullback in Alaska home prices is likely to be more severe than in Texas.

4-A-2. Influence of oil price slide on state spending

Fortunately, propagation of the oil price collapse to state spending, and through spending to lost jobs, will be delayed. Substantial rainy-day reserves relieve legislators of

¹⁶ “Dozens of North Slope workers called for early-morning meeting, laid off,” by Austin Baird, *KTUU-Anchorage*, Mar. 17, 2015.

¹⁷ “Alaska spending on track; global spending down 20% on reduced unconventional,” by Eric Lidji, *Petroleum News*, Dec. 14, 2014.

¹⁸ “Industry cash flow to fall faster than state revenue,” *Alaska Budget Report* (special bulletin), Feb. 10, 2015, and *Revenue Sources Book: Fall 2014*, Alaska Dept. of Revenue, Dec. 2014. DOR revised its forecast on Apr. 3, 2015, but the revision did not update the industry spending forecast or its FY 16 price forecast, so does not change the loss projection.

¹⁹ “Layoffs confirmed: ConocoPhillips reduces workforce in Alaska,” *KTVA-Anchorage*, April 1, 2015.

²⁰ “Is the oil crash about to snuff out the ‘Texas miracle?’” by Michael Hiltzik, blog post, *The Los Angeles Times*, Dec. 22, 2015; also “JPMorgan: Texas at risk of recession next year,” by Collin Eaton, blog post, *The Houston Chronicle*, Dec. 19, 2014.

immediate pressure to cut the FY 15 budget they approved last session, so state outlays are unlikely to be affected at all until after June 30, the end of the fiscal year.²¹ But state officials, including legislators, are concerned about quickly burning through the reserves if they don't reduce spending in FY 16.

Alaska spends more per capita on capital projects than any other state, and 2.5 times the average state.²² With the capital spending so high, Alaska has been able to use capital outlays as its principal adjustment tool for dealing with wide annual variations in its oil revenue. In years of low revenue, capital budgets were reduced, and vice-versa. That pattern appears to be continuing: Gov. Bill Walker's proposed FY 16 capital spending plan would appropriate \$544 million less than the \$1.9 billion authorized in FY 15.²³

Researchers suggest that would cut about 3,600 annual jobs.²⁴ Capital projects are typically built over several years, however, so the immediate impact of this reduction on jobs is likely to be limited. As of last September the state had \$10.6 billion unspent in its capital projects pipeline.²⁵

To the extent that legislators cut the FY 16 operating budget, whether by actual reductions or – as they have in the past – by not increasing appropriations to offset inflation, most of those cuts are likely to have virtually immediate effects, showing up by the end of this summer as a direct and adverse impact on employment.

For example, the governor proposed a \$96.1 million (8.5 percent) reduction in local school aid. Majority legislators in both House and Senate appear to favor the proposal (some want deeper cuts). If the \$96.1 million reduction were approved, its initial signal in the jobs data would show up in the September 2015 CES jobs report. That report would likely show the loss of about 318 local government jobs, reflecting school districts' decisions to hire fewer workers at the beginning of the instructional year. Within 18 months an additional 548 jobs would be lost from other sectors, for a total loss of 866 jobs due to the \$96.1 million spending cut.²⁶

²¹ In December Gov. Bill Walker froze spending on planning for six large capital projects. See "Administrative Order No. 271," State of Alaska, Office of the Governor, December 26 2014. The freeze is unlikely to affect Alaska outlays until after the close of FY 15.

²² "Differences in State and Local Government Public Capital Expenditure Before, During, and After the Great Recession," by Ronald C. Fisher and Robert W. Wassmer, paper presented to the Western Economic Association, Jun. 24, 2013.

²³ "State of Alaska Fiscal Summary—FY 15 and FY 16," Legislative Finance Division, Feb. 20, 2015.

²⁴ "Estimated number of jobs created from capital spending from FY 2007 through FY 2014," by Susan Haymes, Alaska Legislative Research Services Report No. 14.049.

²⁵ *Statewide Capital Appropriation Status Summary*, Alaska Office of Management & Budget, Feb. 2, 2015. The report shows \$5.2 billion encumbered, \$5.5 billion unencumbered. Also see *2015 Alaska's Construction Spending Forecast*, by Scott Goldsmith and Pamela Cravez for the Associated General Contractors of Alaska and the Construction Industry Progress Fund, Jan. 20, 2015.

²⁶ We used the coefficients that the Institute of Social, Economic and Government Research (ISER) developed using MIG, Inc.'s IMPLAN econometric model. See "Preliminary analysis of impacts of budget cuts on the Alaska Economy," memorandum to Rep. Mark Neuman from Gunnar Knapp, director UAA Institute of Social, Economic and Government Research (ISER), Feb. 2, 2015.

These education job losses are likely to be highly publicized. Taken together with recent reports of job cuts in oil and heavy construction, the news could have a disproportionately large effect on economic confidence, business investment and the real estate market. That could mean a lot of “for sale” signs going up in the fall and winter as those losing their livelihood assess their chances of finding other comparable employment in a shrinking Alaska economy.

Declining home prices in Fairbanks, Juneau and Kenai suggest those real estate markets are especially vulnerable to spillover effects from local job losses.²⁷ Real estate markets in Anchorage, Matanuska-Susitna, and Ketchikan appear solid, but the 1985-88 Alaska recession, and experience from the 2009 national recession demonstrate how quickly solid-appearing markets can falter and collapse.²⁸

Growth in federal operating funds coming to Alaska has a countervailing effect on job losses. Medicaid expansion, for example, by bringing \$147.4 million in new federal money would *add* over 1,200 jobs to the Alaska economy, and it would produce those jobs quickly, by the end of calendar 2016. That would more than offset the 866 jobs lost from the proposed \$96.1 million reduction in education aid.²⁹

4-B. Strengthening dollar, weakening £, €, ¥, ₩, ...

The average value of the dollar against six major currencies is higher now than at any time in the last 11 years, and has advanced 20 percent since last May. Experts say the trend is likely to continue.³⁰ That is good news for Alaskans and other Americans who would like to spend their vacation overseas instead of exploring Alaska, but it’s bad news for the Alaska economy because it hurts the competitiveness of the seafood and visitor services that are the state’s most important exports after oil.

²⁷ See residential median price data for these communities published on <http://www.zillow.com/> accessed Apr. 7, 2015.

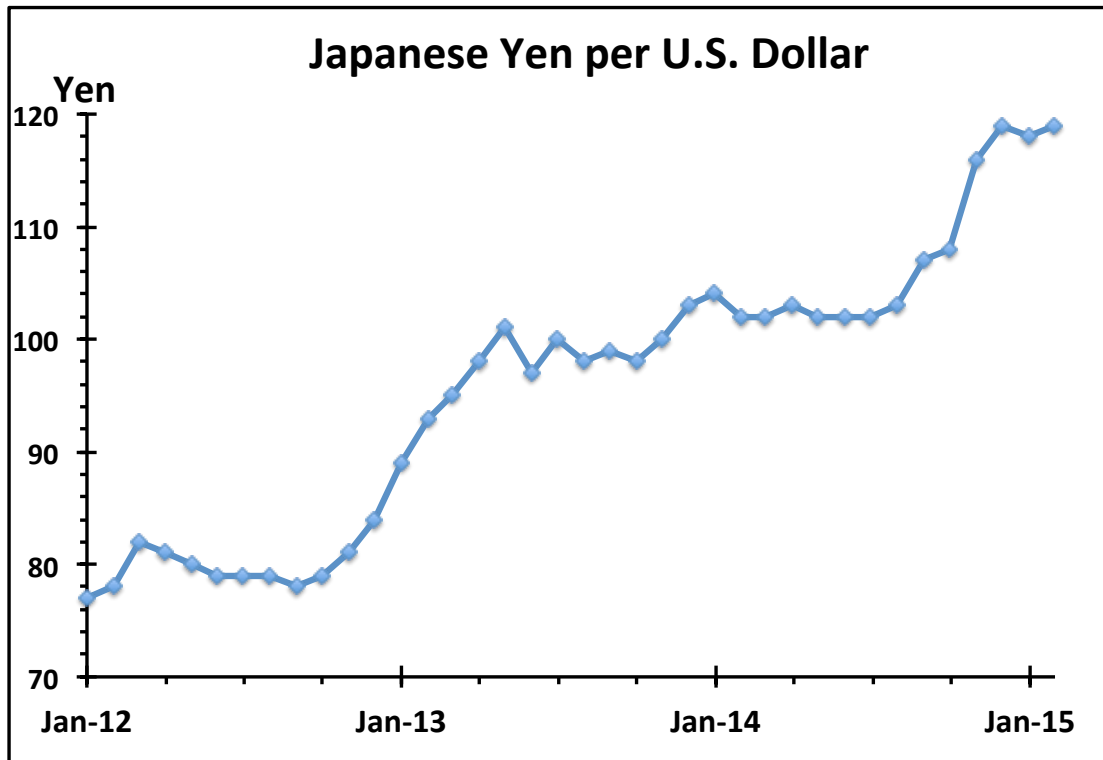
²⁸ See “Alaska Housing and the Recession, by Scott Goldsmith, *et al*, *Alaska Review of Social and Economic Conditions*. University of Alaska, Institute of Social and Economic Research, Feb. 1988; “1987 Anchorage Population Profile,” by Michael Breedlove, *et al*, Anchorage Community Planning Dept. December 1987. For the 2009 national recession see, “After the Fall: An Ex Post Characterization of Housing Price Declines across Metropolitan Areas,” by Richard C. Carson and Samuel Dastrup, *Contemporary Economic Policy*, January 2013.

²⁹ The federal money generated by Medicaid expansion in FY 16 would add 1,226 jobs using ISER’s multiplier estimates (see footnote 26), or 1,309 jobs using estimates derived from a study by Northern Economics, Inc. Avoiding unjustified precision, we describe our estimate of new FY 16 jobs due to expansion as “1,200 to 1,300.” The Northern Economics estimates are published in *Fiscal and Economic Impacts of Medicaid Expansion in Alaska*, Northern Economics, Inc., for the Alaska Native Tribal Health Consortium, February 1, 2013. For our analysis of the many issues in nailing down the fiscal effects of expansion, see “Medicaid Expansion in Alaska: Review and Analysis of Prior Forecasts,” by Milt Barker and Gregg Erickson, Erickson & Associates, April 2015.

³⁰ “Strong Dollar Clouds Forecast at Davos,” *Foreign Policy*, Jan. 16, 2015; “The Dollar Is Soaring: How It Could Help—or Hurt—Your Portfolio,” *BottomlinePersonal.com*, Mar. 1, 2015; and, “The dollar is soaring. Here’s what that should tell us about the economy,” Neil Irwin, *The Washington Post*, Mar. 14, 2015.

The rising dollar has made Alaska seafood more expensive, especially in the Japanese market where much of Alaska’s fish products are sold.³¹ For purchasers in Japan, the cost of Alaska seafood increased 54 percent since 2012, as illustrated in the Figure 4.1 below.³²

Figure 4.1



Source: *Ecomagic Economic Time Series*

According to the U.S. Bureau of the Census, Alaska seafood exports during 2014 reached over \$2.2 billion. If the dollar continues to strengthen it could also erode Alaska’s competitiveness in other sectors. Mineral ore exports in 2014 totaled \$1.8 billion, and energy exports, mainly Cook Inlet liquid natural gas, reached \$0.6 billion.³³

“Exports now bring between \$4 [billion] and \$5 billion of new money into our economy. New money, not recycled money. Exports also account for nearly \$2 billion in induced and indirect economic benefits,” says Greg Wolf of the World Trade Center Alaska, citing studies by Northern Economics and others. Wolf estimates that foreign trade in commodities directly accounts for about 15,000 Alaska jobs, and indirectly for

³¹ *Alaska Seafood Market Bulletin*, Alaska Seafood Marketing Institute, Apr. 13, 2013.

³² “Japanese Yen to One U.S. Dollar,” *Ecomagic Economic Time Series Page*, <http://www.economagic.com/em-cgi/data.exe/tmp/208-100-165-120!20150402135007> accessed Apr. 1, 2015.

³³ <https://www.census.gov/foreign-trade/statistics/state/data/ak.html> accessed Mar. 31, 2015.

another 10,000 jobs. “These export jobs are high paying jobs, typically paying 13 to 16 percent more than jobs tied solely to domestic economy.”³⁴

Alaska’s visitor industries suffer a double hit from the strengthening dollar:

- U.S. residents find potential holidays in Alaska more expensive compared to vacations overseas.
- Foreigners find Alaska vacations more expensive relative to vacations in Europe or Asia.

Cruise operators set their port call schedules many months in advance, so the soaring dollar won’t have immediate effects on the number of port calls. If passengers are lured away by better deals on foreign destinations, however, passenger loads and company profits could be affected. Following the 2009 recession, operators responded to low bookings with aggressive marketing, including price-cutting.

In the longer run, cruise ship itineraries will reflect where their customers are willing to pay to travel. If the value of the dollar continues to rise companies will shift ships to overseas itineraries, where their customers’ money buys a longer or more upscale holiday.

4-C. Federal job losses, declining grants, shrinking military

Economist Scott Goldsmith estimates that about one-third of Alaska jobs depend – directly or indirectly – on federal spending.³⁵ In 2012 economist Gunnar Knapp predicted that the federal role in Alaska’s economy would wane:

*“Former Alaska Senator Ted Stevens used his political skill and power as one of the most senior members of the Senate to direct a lot of federal spending to Alaska. Future federal spending will probably decline because Alaska’s congressional delegation no long has as much power, there is a lot of political pressure to cut total federal spending, and military spending is likely to decline as the U.S. pulls out of Iraq and Afghanistan.”*³⁶

Knapp’s forecast has played out much as he described.

³⁴ “Alaska’s place In the world: How exports drive the Alaska economy,” Greg Wolf, World Trade Center Alaska, presentation to the Anchorage Chamber of Commerce, January 27, 2015. See also, *The Economic Impacts of International Trade Exports on the Alaskan Economy*, Northern Economics, Inc., for World Trade Center Alaska. July 2010.

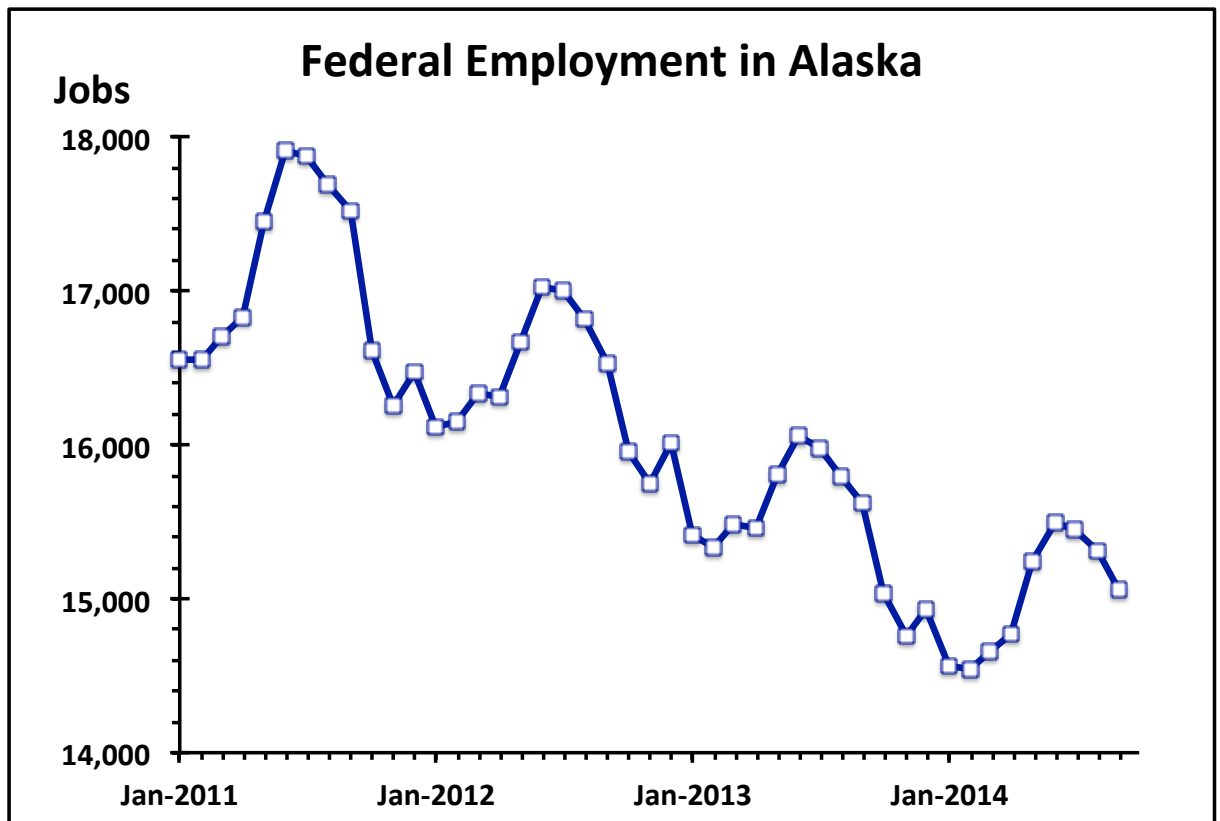
³⁵ “The Alaska Economy: How Does It Work,” by Scott Goldsmith, Institute of Social and Economic Research, Feb. 1, 2012.

³⁶ “An Introduction to the Economy of Alaska,” by Gunnar Knapp, Institute of Social and Economic Research, Feb. 2012.

4-C-1. Federal jobs

Losses of federal jobs were important in initiating the current recession. As Figure 4-2 below illustrates, Alaska has been losing roughly 750 jobs per year for the last three years.³⁷ The rate slowed a bit lately, but the trend remains firmly negative.³⁸

Figure 4.2



The rate of federal job losses in Alaska is much higher than nationally, 4.9 percent per year, versus 1.0 percent nationally.³⁹

4-C-2. State revenue from the federal government

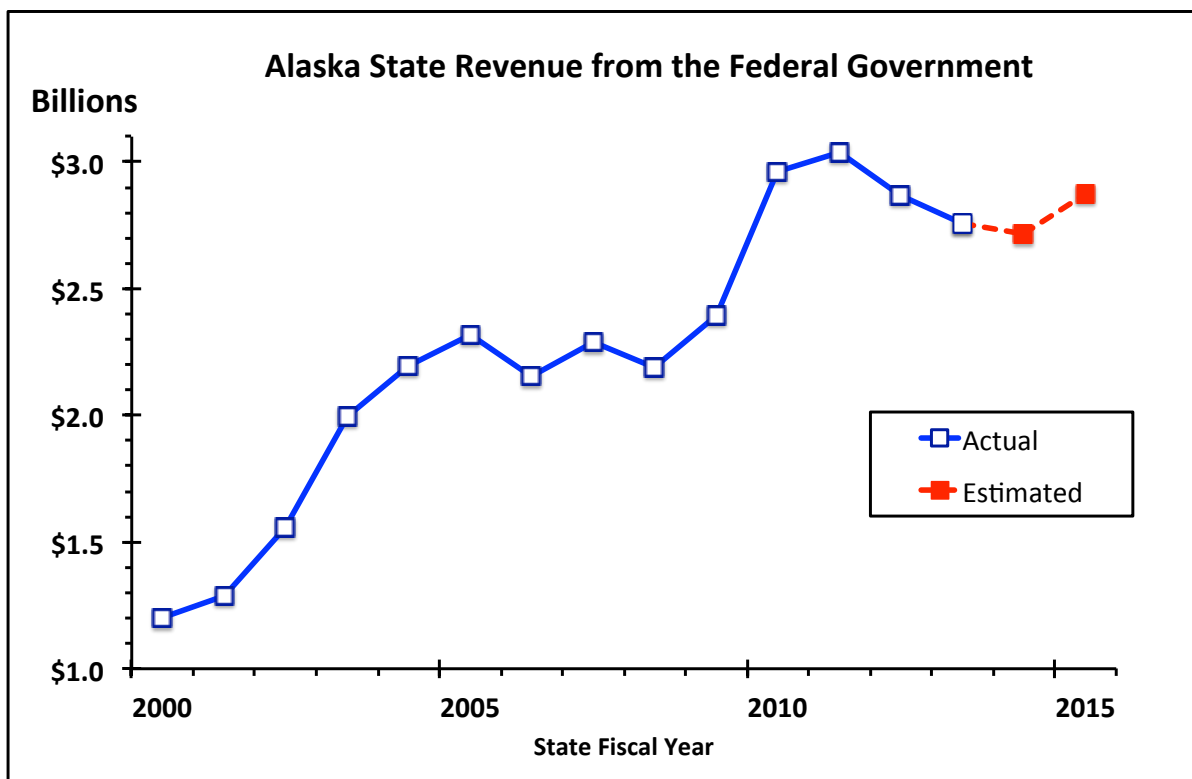
As the Figure 4-3 on the following page shows, federal transfers to the state of Alaska grew rapidly from FY 00 through FY 03, then held relatively stable at around \$2.3 billion through FY 08.⁴⁰

³⁷ Data are from the *Quarterly Census of Employment and Wages (QCEW)*. The most recent datum is September 2014.

³⁸ The loss from Sept. 2013 to Sept. 2014 was 568 jobs. A former federal official who asked not to be identified suggests the Obama administration postponed cutting federal jobs in Alaska during the summer and fall of 2014 to help Sen. Mark Begich in his ultimately unsuccessful reelection campaign. The former official expects federal job cuts to accelerate in 2015, playing catch up for the 2014 postponements.

³⁹ Data are from the *QCEW*, measured from Sept. 2012 to Sept. 2014.

Figure 4.3



Source: *The Fiscal 50: State Trends and Analysis*, by the Pew Charitable Trust, March 15, 2015; estimates by Erickson & Associates from Legislative Finance Division data.

In 2009, following the national recession, Congress approved the American Recovery and Reinvestment Act (ARRA) designed, among other things, to stimulate the economy through accelerated funding of “shovel-ready” capital projects.

As noted in section 3-A-1, Alaska has the largest per-capita capital budget of any state. Moreover, the state had (and still has) a transportation bureaucracy known for its skill in managing federal grants. Furthermore, the state has a long-established practice of dealing with wide swings in its oil revenue through rapid adjustments in capital spending. In 2009, the state had a backlog of approved capital projects totaling more than \$8 billion.⁴¹ All of these factors positioned the state to take full advantage of the ARRA’s accelerated funding. As a result, Alaska’s federal revenue soared by 39 percent, reaching \$3.0 billion in FY 11.

Without new ARRA grants, Alaska’s federal revenue declined 9 percent over the next two years. Our estimates, shown in the chart, suggest Alaska’s federal revenue took

⁴⁰ “The Fiscal 50: State Trends and Analysis,” by the Pew Charitable Trust, March 15, 2015; <http://www.pewtrusts.org/en/multimedia/data-visualizations/2014/fiscal-50#ind1> accessed Mar. 27, 2015. The analysis is based on *Annual Survey of State Government Finances*, U.S. Census Bureau, Feb. 4, 2015.

⁴¹ *Supplemental Schedules to the Comprehensive Annual Financial Report - [Fiscal Year 2008-2009]*, State of Alaska, Dept. of Administration, Dec. 31, 2009.

an additional dip in FY 14, but probably recovered in FY 15.⁴² We believe Alaska will continue to aggressively maximizing federal construction grants. Whether the up-trend continues in FY 16 and beyond depends on whether the state accepts Medicaid expansion, and to a lesser extent what Congress does with respect to the growing shortfalls in the federal highway, aviation and other trust funds.⁴³

4-C-3. Downsizing Alaska's military

For 75 years exporting national defense services has been a mainstay of Alaska's economy. The military role in Alaska's economy is unlikely to decline much in 2015, but draconian reductions are possible in 2016.

In 1960 one-third of the new state's labor force was military.⁴⁴ The military presence in Alaska declined in the early 1960s, and again in the 1990s, as the "end" of the cold war led to the closure of Adak Naval Air Station, King Salmon Air Force Station (AFS), Galena AFS and Eareckson AFS. Restructuring – a euphemism for downsizing – occurred at bases in Anchorage, Fairbanks and at Fort Greely near Delta Junction.

But between 2000 and 2005 the military presence in Alaska increased, a buildup associated with conflict in Iraq and Afghanistan, a new missile defense installation at Fort Greely, and an extraordinarily powerful congressional delegation.⁴⁵

In 2005, faced with military spending growing at double-digit annual rates, Congress created the Base Realignment and Closure Committee (BRAC) and an associated process for making base closure decisions. The committee listed Eielson Air Force Base (AFB) near North Pole at the top of the list of ten Air Force installations bases nominated for closure. Eielson dodged the closure bullet, however, in part because of strong resistance from the state's congressional delegation. BRAC resulted in consolidation of Elmendorf AFB and Ft. Richardson, but with few personnel reductions.

In 2013 the military in Alaska accounted for 6.4 percent of total military and civilian jobs.⁴⁶ The state was home to 23,004 active duty military personnel and 33,052 military

⁴² FY 13 is the most recent datum in the Census' state revenue series. Because of differing definitions, the Census' figures tend 4-15 percent lower than the similar Alaska data compiled by the Legislative Finance Division (LFD). Using LFD data for FY 14 and FY 15, we estimated the comparable Census numbers. We show those estimates in Figure 4-3.

⁴³ Federal gas tax revenue, a major funding source for surface transportation, declined by 31 percent in real terms between 2002 and 2012, while infrastructure needs and construction costs increased. Congress has been unwilling to raise the federal gasoline tax, unchanged since it was set 21 years ago at 18.4 cents-per-gallon. See "Intergovernmental Challenges in Surface Transportation Funding," The Pew Charitable Trusts, Sept. 23, 2014. <http://www.pewtrusts.org/en/research-and-analysis/reports/2014/09/intergovernmental-challenges-in-surface-transportation-funding> accessed Apr. 3, 2015.

⁴⁴ *The Future of Alaska: The Economic Consequences of Statehood*, by George Rogers, Johns Hopkins Press, 1963.

⁴⁵ *Alaska Population Overview 2005-2006 Estimates*, Alaska Dept. of Labor and Workforce Development, Sept. 2008.

⁴⁶ The percentage is approximate. The denominator in our calculation is the sum of jobs reported in QCEW (which excludes military) and active duty military personal estimated by the Alaska Dept. of Labor and Workforce Development.

dependents, representing 7.6 percent of the state's total population. Since 2013 the number of military personal appears to have slipped, especially in the Interior, where Fairbanks' recent loss of 2.4 percent of its population has been ascribed to military reductions.⁴⁷ Active duty military and dependents in Fairbanks North Star Borough (Eielson Air Force Base and Fort Wainwright) accounted for 20 percent of that area's population in 2013.⁴⁸

President Barack Obama has several times proposed reactivating the BRAC process, most recently in his proposed budget for the federal fiscal year starting in October. Congress has resisted. The 2011 Budget Control Act, also known as sequestration, blocked reactivating BRAC without specific congressional authorization. The same legislation, however, set strict constraints – called sequestration – on total defense spending.

“In the next five years, we will cut 500 airplanes from our Air Force,” said Air Force Chief of Staff Gen. Mark Welsh, speaking to congressional lawmakers last year on the impacts of sequestration: “We will cut around 20,000 people from our Air Force. That is a huge impact on who we are as an institution. It will create more facilities that are not fully manned or installations that are not fully utilized, which will create more of a discussion about BRAC and the future. It's going to have an impact.”⁴⁹ Others have suggested that if the BRAC process is restarted, it will likely be authorized to happen in a non-election year – like 2015.⁵⁰

The Army, also responding to the constraints of the 2011 Budget Control Act, published an Army 2020 Force Structure Realignment plan that would shrink the Army's total force from 570,000 soldiers to 450,000 by 2017.⁵¹ In a worst-case scenario, military officials estimate restructuring could cut the civilian and uniformed population at Ft. Wainwright by 5,800,⁵² and at Joint Base Elmendorf-Richardson (JBER) in Anchorage by 17,300.⁵³

⁴⁷ “Alaska Population Estimates by Borough, Census Area, City, and Census Designated Place (CDP), 2010 to 2014,” Alaska Dept. of Labor and Workforce Development, Jan. 2015.

⁴⁸ *Alaska Population Overview 2013 Estimates*, Alaska Dept. of Labor and Workforce Development, Feb. 2015.

⁴⁹ “Too many bases: The plan to sidestep Congress' opposition to closures,” by Brian Everstine, *Air Force Times*, Apr. 14, 2014.

⁵⁰ “What the president's proposal means for Huntsville,” by David Kumbroch, *WNHT News*, Feb. 3, 2015.

⁵¹ “Army 2020 Force Structure Realignment Supplemental Programmatic Environmental Assessment,” U.S. Army Environmental Command, June 2014. See also, “Army hears from Alaska on force cuts,” by Elwood Brehmer, *Alaska Journal of Commerce*, Feb. 26, 2015.

⁵² “Army 2020 Force Structure Realignment Supplemental Programmatic Environmental Assessment,” U.S. Army Environmental Command, June 2014.

⁵³ “Anchorage leaders prepare to fight possible JBER cuts,” by Devin Kelly, *Anchorage Dispatch News*, Jan. 22, 2015. In February Anchorage officials put the potential loss of Army personal from JBER at 5,000, with 9,000 dependents.

Local officials estimate the population of Fairbanks would decline by 15 percent (14,633 people) from the proposed Ft. Wainwright reduction,⁵⁴ and that Anchorage would lose 4.4 percent (13,372) from the JBER army cuts.⁵⁵ The potential impact of Air Force cuts, if any, is not known.

5. Four principles

Alaskans face a perfect storm of converging threats to the way they earn their way in the world. The collapse in the value of the state's oil is the most serious, but piling on top are the effect of the declining U.S. dollar on the state's seafood and tourist industries, and the rapid contraction of government spending. Unless oil prices stage a dramatic recovery, Alaska faces the deepest recession in its history as a state.

What steps can Alaska take to mitigate the economic trauma and set the stage for recovery?

While there is nothing the state government can do to save Alaska from the coming recession, the state can mitigate the economic distress, soften the hard landing and prepare the economy for the recovery that must eventually ensue. Fortunately, the general principles for managing a regional recession like Alaska's are well understood and uncontroversial, at least among economists.

5-A. Focus on the economy

The oil market collapse has created multiple problems. Many policymakers see the biggest problem as its effect on the state's finances. That is not true for Alaskans as a whole. For households the biggest fear is losing a job. For those in business the biggest fear is evaporation of the real and intangible investments in their businesses. And everyone who owns an Alaska residence rightly fears loss of their equity in their home.

The first and most important thing policymakers can do is understand that reducing spending *makes the economic crisis worse*. More breadwinners will lose their jobs, more businesses will fail, and more "for sale" signs will sprout on Alaska streets. Raising taxes also makes the economic crisis worse.

If taxes are increased, some have worse economic effects than others, just as some kinds of spending cuts are worse than others.

How Alaska will finance its state government is an important issue, and husbanding the state's savings remains an important objective. But in the near term, fashioning a softer landing for the economy may be more important.

5-B. Maximize the economic bang-for-the-buck in state spending

Adjustments to capital project spending have been the state's traditional approach for managing the ups and downs in its oil revenue. *That remains a sensible approach.*

⁵⁴ See Fairbanks Economic Development Corporation, <http://www.investfairbanks.com/projects/military> Accessed on April 3, 2015.

⁵⁵ "Leaders rally against Army force reductions," by Tim Bradner, *Alaska Journal of Commerce*, Feb. 19, 2015.

Whatever their longer-term benefits, capital projects produce less near-term economic bang-for-the-buck than state operating spending, and their curtailment doesn't produce as much economic and social disruption.⁵⁶

5-C. Maximize federal dollars

Federal dollars coming to Alaska bring jobs and economic activity. That is why cuts to the capital budget during times of reduced oil revenue have traditionally not extended to the state's matching money required to leverage federal grants for highways, airports, public works, Medicaid, education, and housing. This is sensible policy, and one that policymakers for the most part, with the possible exception of Medicaid expansion, appear to be continuing.

Medicaid expansion raises policy issues that transcend economics. The economics, however, are clear: expansion in FY 16 would bolster a shrinking Alaska economy with between 1,200 and 1,300 new jobs.⁵⁷

There are indications that expansion would aid the economy apart from its direct and indirect effects on job formation.⁵⁸ Testimony from the Alaska State Hospital and Nursing Home Association suggests that some hospitals are at risk of closing if Alaska refuses the federal dollars available under expansion. Closure would not only affect the availability of health care, but cause additional job losses and prejudice the eventual recovery.⁵⁹

5-D. Plan for an Alaska with a fewer people

Finally, it is important to understand that unless oil prices make a dramatic recovery it is likely that state population and employment will shrink and eventually stabilize at a level below what it is today. Planning for this eventuality can speed the eventual return to growth. Alaska's governments, non-profits and businesses should focus on preserving existing assets rather than new investments.

⁵⁶ The governor's proposed FY 16 capital spending plan would appropriate \$544 million less than the \$1.9 billion appropriated for FY 15, a 28 percent reduction. Operating spending, by contrast, would increase. See "[Governor's Request] State of Alaska Fiscal Summary, FY15 and FY16," Legislative Finance Division, Feb. 12, 2015. Our calculation compares "Total Operating Appropriations" proposed for FY 16 with the same figure FY 15 after subtracting the FY 15 transfer of \$3 billion from the constitutional budget reserve to the state's retirement funds.

⁵⁷ This includes direct, indirect and induced jobs. See footnote 29, above, and "Preliminary analysis of impacts of budget cuts on the Alaska Economy," memorandum to Rep. Mark Neuman from Gunnar Knapp, director UAA Institute of Social, Economic and Government Research (ISER), Feb. 2, 2015, and *Fiscal and Economic Impacts of Medicaid Expansion in Alaska*, Northern Economics, Inc. for the Alaska Native Tribal Health Consortium, February 1, 2013.

⁵⁸ "States that expanded [Medicaid] have seen substantially faster growth in healthcare jobs than those that did not since the first expansions began last January. If this trend continues, Fitch Ratings says it could support a broader economic and tax base for state budgets and improve nonprofit hospital finances in those states." *Fitch Ratings*, Feb. 15, 2015.

⁵⁹ "Medicaid Expansion: Questions and Choices," Becky Hultberg, Alaska State Hospital and Nursing Home Association, March 19, 2015.

6. Medicaid expansion and the great recession

Dozens of studies have addressed economic or fiscal effects of Medicaid expansion in Alaska and nationwide. This report was commissioned to examine how recent changes in Alaska's economic situation may have affected the validity and relevance of the findings reported in these earlier studies.⁶⁰

We found that Alaska had entered a new recession, the fourth in its 57 years as a state. More troubling was our second conclusion: low oil prices combined with a constellation of adverse economic events had fundamentally changed the trajectory of the Alaska economy. Unless oil prices recover, Alaska is headed for the deepest recession in its modern history, and one of the deepest regional recessions in modern American experience.

The radical change in Alaska's prospects has not necessarily discredited the conclusions in the earlier studies, but it changes their economic context. Northern Economics' 2013 study of the fiscal and economic effects of expansion in Alaska concluded that the first year of Medicaid expansion would produce between 1000 and 1800 new jobs, depending on the ratio of eligible participants to the population as a whole.⁶¹

In our opinion the analysts at Northern Economics' selected an appropriate econometric methodology, implemented that methodology correctly, and adopted reasonable assumptions about external factors such as population growth. Their estimates are within the range of our own.

What's different today is the economy. When Northern Economics published its forecast Alaska had just added 5,300 in a year. State economists were predicting another 4,200 jobs in 2013.⁶² Residential real estate in Anchorage and Fairbanks was trending up.⁶³ Alaska's crude averaged \$113 per barrel, and forecasters said to expect \$109 in 2013.⁶⁴ In that economy, 1,000 or 1,800 jobs wasn't something to get excited about.

⁶⁰ The previous Alaska studies include: *An Analysis of the Impact of Medicaid Expansion in Alaska, Final Report*, The Lewin Group, April 12, 2013; *Healthier Alaskans Create a Healthier State Economy*, Alaska Native Tribal Health Consortium (ANTHC), February 1, 2013; *Fiscal and Economic Impacts of Medicaid Expansion in Alaskan*, Northern Economics, February 1, 2013; *Medicaid in Alaska Under the ACA*, The Urban Institute, February 1, 2013; "Memorandum Re: Projected Population, Enrollment, Service Costs and Demographics of Medicaid Expansion Beginning in FY2016," to Valerie Davidson, Commissioner, Alaska Department of Health and Social Services, from Ted L. Helvoigt, Evergreen Economics, February 6, 2015; and *The Healthy Alaska Plan: A Catalyst for Reform: Healthy Alaskans – Healthy Economy – Healthy Budgets*, Alaska Dept. of Health and Social Services, Feb. 2015.

⁶¹ Under their mid-participation scenario Northern Economics estimated 1,600 jobs in 2014; after seven years of expansion, in 2020, they project between 2,600 and 4,500 new jobs, with the mid-participation estimate at 4,000. See p. ES-8, *Fiscal and Economic Impacts of Medicaid Expansion in Alaskan*, Northern Economics, February 1, 2013.

⁶² "Employment Forecast for 2013," by Carolyn Schultz, *Alaska Economic Trends* (published by AKDOL), January 2015.

⁶³ In 2012 the median single-family home sales price in Anchorage grew by 5 percent; multiple listing service data reported at <http://oceanviewblog.com/2013/01/10/2012-year-end-anchorage-area-real-estate-activity-report/> accessed Apr. 11, 2015.

⁶⁴ *Fall 2012 Revenue Source Book*, Alaska Dept. of Revenue, Dec. 4 2012.

Now Alaska is losing jobs. Unless oil prices rebound, 4,000 or more Alaska jobs will disappear by September. Considering the effects of the oil price slide on oil industry outlays, the effect of the slide on state spending, the negative effect of the strengthening dollar on Alaska exports, the negative effect of continued federal job losses, the negative effect of continued local government job losses, and the potential for a shrinking military, by September 2016 Alaska will be lucky if it hasn't lost a total of more than 20,000 jobs.⁶⁵

Much of the discussion about Medicaid expansion doesn't have much to do with economics. Whatever our opinions on these issues, we leave those discussions to others. As economists, our expertise is the Alaska economy. In that context, it is clear that Medicaid expansion is a concrete means for mitigating Alaska's economic trauma and setting the stage for Alaska's economic recovery.

- *Expansion's immediate effects focus on the economy.* By our estimates between 1,200 and 1,300 jobs will be created in FY 16 offsetting an equal number of jobs lost to the recession.
- *Expansion maximizes the economic bang-for-the-buck from state spending.* Indeed, the fiscal notes show that expansion will *reduce* FY 16 state outlays of its own money by \$4.9 million.⁶⁶
- *Expansion maximizes support for the state economy from federal dollars.* Expansion brings \$147.3 million in new FY 16 federal money coming into the state. Of that money, roughly every \$115,000 will create a new job in FY 16.
- *Expansion will aid Alaska's return to growth.* Expansion is probably an essential element if Alaska is to have a sound health care system when the recession ends. In today's world, such a system is essential to a growing and healthy economy.

⁶⁵ These forecasts are from a base of 351,357 jobs recorded by QCEW in Sept. 2014, the most recent datum.

⁶⁶ "HB 148 / SB 78 - Medical Assistance Coverage; Reform," (two spreadsheets), Alaska Office of Management and Budget (OMB), March 20, 2015. We count as "the state's own money" all except federal funds.