Resolve the “Disconnect”, take Alaska Forward

Board member Janet McCabe’s Commentary in the Alaska Dispatch News on April 13th, 2017

Alaska is poised on the brink of a severe economic recession, and the state Legislature is about to make decisions that will influence whether the economy topples over this brink into an economic decline that builds on itself and gains momentum, or whether we pick ourselves up and move forward to thrive.

Mike Navarre, former state legislator and current three-term mayor of the Kenai Peninsula Borough, provided insight about this choice in the April 6 Alaska Dispatch News and in recent testimony to the House Finance Committee. He described the Alaska Disconnect, so named by Alaska’s Institute of Social and Economic Research (ISER) over a decade ago. In short, the Alaska Disconnect means that the lack of a broad-based source of tax revenue cripples Alaska’s ability to provide the state services required by the population increases that accompany new development. As a result, the budget gap becomes worse. Another study stated in 2003 that, unless the Alaska Disconnect is solved, “new non-oil-producing employment is a net drag on state finances.”

[Alaska House votes to restructure Permanent Fund and slice dividends]

Multiplier effects must also be considered when the Legislature makes choices about ways to fill the budget gap. When Alaska’s economy is healthy, new money comes into the economy from primary sources such as the oil industry, mining, tourism, other industries and, especially, state spending. These expenditures contribute to the success of secondary businesses that employ people who, in turn, spend in a way that makes other businesses thrive. Under this scenario, the multiplier effect is positive.

State spending and distributions are significant primary sources of new money that stimulate a positive multiplier effect. We are reminded of that annually when Permanent Fund dividend checks arrive. On the other side of the coin, ISER has found that a state budget cut of $100 million results in the loss of 1,000 to 1,250 jobs. Cuts generate negative multiplier effects.

Alaska’s major recession of the late 1980s provides a vivid picture of the way a negative multiplier effect works. In 1986, crude oil prices fell from an inflation-adjusted all-time high of $107 per barrel to $31 per barrel, a 71 percent decline. Alaska was a young state with few other options, so the Legislature and governor cut state spending to balance the 1967 budget.

The effect on the economy was not immediate. Uncompleted “Project 80s” construction projects had a brief sustaining effect, but soon the economy started to wither.

The sudden loss of jobs, from state spending cuts and oil industry cuts, forced many Alaskans to leave the state or reduce their own spending. This loss of new money circulating in the economy impacted the service sector, and owners of restaurants, gas stations, saloons and beauty salons, automobile dealerships, retail stores, architectural firms, and construction and maintenance companies, to name a few, found they had less business. In turn, these businesses were forced to cut staff or close, and more people lost their livelihoods and left Alaska.

As the negative multiplier effect of the late 1980s spread and people left or downsized, the supply of housing exceeded demand. Anchorage streets soon had rows of “For Sale” signs and property values collapsed. Many people found that their mortgage obligations exceeded the value of their property. Frequently, they were unable to sell. If a work-out was possible, the forgiven debt became taxable income in the eyes of the IRS.

Under these circumstances, some homeowners simply drove away. One bank employee told me he hated to open the drop box on Monday because it would be full of house keys. Eight banks, or 40 percent of all banks in Alaska, failed during the late 1980s. The crash had huge human costs in terms of broken dreams and broken relationships. Families split up and friends left forever.

The hard times of the 1980s ended because of the Exxon Valdez oil spill and the resulting infusion of primary spending for cleanup — $2.1 billion, according to Exxon. Alaska was yanked out of the economic doldrums. Still, it took years before oil prices recovered.

[House, Senate need closers for budget deal]

The similarities and differences between then and now are instructive. In the 1980s, the Alaska Legislature saw no option except to cut the budget. They did so, and that approach, in combination with the reduction of spending by the oil industry, resulted in an extremely harmful self-perpetuating economic recession. Thankfully, the current Alaska Legislature has a much wider range of options for solving the fiscal crisis.

Circumstances affecting Alaska's oil industry — the worldwide oversupply of oil, the consequent fall in prices and the declining productivity of Alaska's oil fields — are also very different than they were in the 1980s. Regardless of recent announcements by oil companies, we have reached a time when a major infusion of new oil revenue is insufficiently probable to serve as a basis for the critical decisions that will shape our state's economic future. Most likely, the oil industry will lobby intensely to oppose measures that would free Alaska from dependence on oil revenues. This must be recognized for what it is.

Fortunately, in this session the Legislature can fill the budget gap without further operating-budget cuts. So far, we have seen progress. Both the House and Senate proposals include an annual dividend. The agreement to use a percent-of-market-value draw from the Permanent Fund Earnings Reserve Account for public purposes is a major step forward. In combination with the oil credit and tax measures proposed by the House in HB 111, and a state income tax, legislators could stop the destructive cutting and give businesses and the public a measure of assurance that they are on the way to solving the problem.

Sure, we all hate to pay taxes, but paying the modest graduated or progressive income tax proposed by the House would be fair. Those with high incomes would pay taxes; those with low to moderate incomes would pay nothing or very little. We would be buying a better of quality of life for everyone. We could step off the oil-industry roller coaster, pay our share and, at long last, solve the Alaska Disconnect.

Janet McCabe *and her family have lived in Alaska since 1964. Her education and experience are in community planning. She is actively involved in several nonprofit organizations.*