Import Substitution in Alaska

A recent report and a paper by staff members of the University's Institute of Social and Economic Research state that one of the most important sectors of economic growth in Alaska during the last decade was that of goods and services produced locally for local consumption. The importance of this growth, however, was overshadowed by resource sector expansion (primarily Prudhoe Bay) and was largely ignored by economic policymakers. Yet, the expansion of goods and services produced for local consumption—such as telephone communications, health services, and retail food sales—accounted for a significant share of total employment growth in the 1970s.

The report, originally written for the office of the Governor, and the paper, given at the 1984 Western Regional Science Conference, further suggest that the local goods and services area has not yet realized its full potential growth and, for that reason, may actually be more responsive to state government policy than the resource sector.

Economists refer to growth in this local goods and services sector as "import substitution," or the replacement by local production of previously imported goods and services. A broader definition of this process might include the expansion of the support sector of the economy (the sector which serves local residents) to include local production of goods and services which had not previously been consumed in the region because of their high import costs.

As a region grows, the goods and services sector supporting the local population also grows, not simply in depth, but also in variety. Nor is the increase proportionate to the increase in export activity; instead, it expands at a faster rate than the export sector.

Import substitution has provided an important source of growth in Alaska. Between 1970 and 1979, Alaska nonagricultural civilian employment grew by almost 74,000, an expansion of approximately 80 percent. Import substitution, as broadly defined in this paper, accounted for almost 20 percent of the growth in employment and it occurred in sectors accounting for 38 percent of total employment. The extent of import substitution was measured by comparing the growth in employment in an industry to the growth in the market. Market growth was assumed to equal the growth in real Alaska income adjusted for a change in the structure of demand at the national level.

Those sectors exhibiting import substitution in Alaska are primarily producers of services rather than goods. The industries where import substitution accounted for the greatest growth during the period examined were telephone communications (1,752 employees), health services (1,614), miscellaneous retail (1,073), retail food (683), business services (569), banking (566), insurance carriers (523), and legal services (484). Producers of goods for the local market have experienced only limited expansion in Alaska.

Although import substitution has been important in Alaska's past growth, there are reasons to believe that it has not occurred at the rate made possible by market expansion. This hypothesis holds that Alaska is underserved in certain support sectors and supports less market activity than it might. This is important since it suggests that this sector may be responsive to economic development policy.

If the size of a region's market were the only determinant of support sector activity, we would expect similar sized markets to have similar support sectors. However, when we compare Alaska to twelve market areas with similar populations and per capita incomes, we find large differences in the level of support sector activity. Employment per thousand population was used as the indicator of support sector activity. The average number of employees per thousand population in the areas similar in size to Alaska's market exceeded the Alaska level by more than 50 percent in personal services, amusement and recreation services, medical and health services, wholesale trade, autodealers and service, apparel and accessories, and furniture and home furnishings.
While employment is not a perfect indicator of local production (since cost conditions may differ between regions), the great difference between Alaska and other areas suggests that Alaska's support sector may be underserved in some areas.

This comparison suggests that import substitution does not necessarily take place automatically. It suggests further that the Alaska goods and services sector may have failed to respond to opportunities and grow to its full potential. Three likely reasons for the less-than-optimum growth are:

Relatively Limited Supply of Entrepreneurs. Entrepreneurs may be relatively limited in regions like Alaska. The small population and the opportunities to earn large incomes in other occupations may result in there being more opportunities than entrepreneurs.

The Immobility of Outside Entrepreneurs. The existence of opportunities in frontier regions may not necessarily attract enough entrepreneurs from outside the region. Entrepreneurs are not perfectly mobile; strong preferences for familiar areas limit their flow to frontier regions. Entrepreneurs generally depend on their knowledge of an area; frontier areas are unknown.

Lack of Information. Research has shown that information on entrepreneurial activities does not flow freely. Knowledge about opportunities in Alaska may not necessarily reach outside entrepreneurs, just as information on product and technology innovations may not flow immediately to Alaska.

In conclusion, import substitution continues to be an important component of Alaska economic growth, and some evidence suggests that it may not automatically respond to growth opportunities, as is usually assumed. This raises the question: should the government intervene to encourage the process of import substitution? One argument supporting such intervention holds that expansion in the support sector reduces the cost of living and doing business in Alaska. In addition, government intervention to encourage growth in the support sector could be relatively inexpensive. For example, policy aimed at increasing growth through the improved flow of information both to and from Alaska would cost little compared with programs directly aimed at increasing resource exploitation.

This research does not suggest that resource development is unimportant or should be ignored, or that the local support sector can exist without it. However, expansion of the local support sector, while not as dramatic as resource development, offers a potentially profitable area for policy intervention.