

Alaska Fiscal Facts: An Overview of State Savings, Revenues and Spending

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Note to readers: This January 7 presentation at ISER was a “dry run” of a presentation which I am preparing to help Alaskans understand the facts of the state’s fiscal situation, and which I plan to be giving for various groups around Alaska over the coming months. In response to very helpful comments which I received after the presentation, I am planning several significant modifications to the presentation, including:

- Shortening the material on state revenues (Slides 29-57) to make it less detailed and confusing, and to allow time to cover other topics. I will move some of these slides to an “Appendix” at the end so that people who wish to can read them.
- Expanding the material on state spending (Slides 58-64) to provide considerably more information on what state spending goes for (e.g. which agencies, how much is driven by formulas, how much is attributable to rising health care costs, etc.)
- Adding a number of slides about state funds, including but not limited to the Permanent Fund, as well as on Permanent Fund earnings, inflation proofing, dividends, etc.
- As an appendix, adding detailed materials at the end on data sources, as promised in Slide 8.

If you would like a copy of the revised presentation, send me an email message at Gunnar.Knapp@uaa.alaska.edu and I will send it to you when it is completed.

I also welcome any comments or suggestions.

Introduction

My goal in this presentation

The recent dramatic fall in oil prices has led to growing concern and discussion among Alaskans about the state's fiscal situation

My goal is to help Alaskans understand the facts of the state's fiscal situation, to facilitate informed discussion of the challenges we face and how to address them.

I am *not* advocating for or against any specific choices or policies.

Briefly about myself . . .

- I've been an economics professor at the UAA Institute of Social and Economic Research (ISER) since 1981
- I became Director of ISER two years ago
- I've been studying Alaska's economy for 33 years
- I teach a UAA course on the Economy of Alaska
 - One of the topics I teach about is the state's finances
 - This presentation is part of what I teach for my course

This is a complicated topic.

- Alaska has many different kinds of savings, revenues and expenditures
- Understanding Alaska's fiscal situation isn't easy.
- I've tried to keep this presentation as simple as possible
 - But it's still a complex topic
- There are many other details that I won't have time to talk about

I'd like to improve on this presentation.
I welcome your feedback.

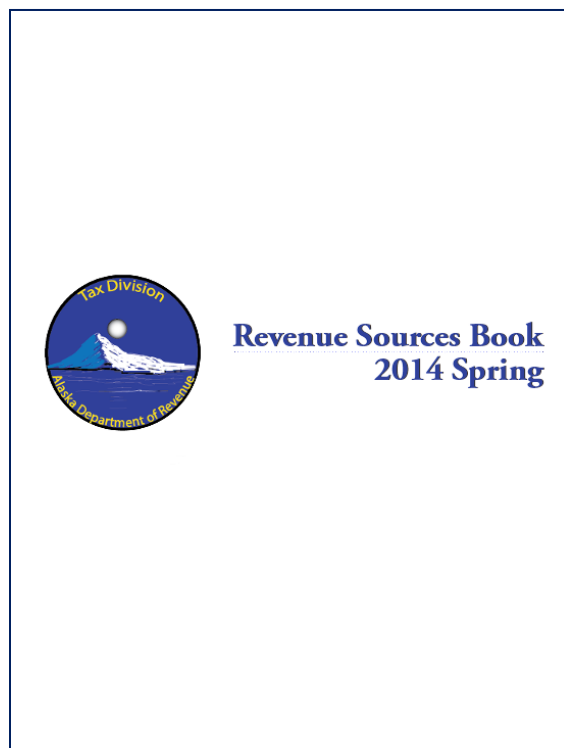
- Parts you found helpful
- Parts you found confusing
- Suggestions for how to improve it
- Anything you thought was “biased”
- Corrections to anything you think is wrong

Data sources

You don't have to rely on "experts" to learn about Alaska's finances.

- All of the data in this presentation are posted on state websites.
- At the end of this presentation I have listed websites where you can find:
 - the data in this presentation
 - a lot of other, more detailed data
 - information about how the data are defined and collected
- Two particularly useful sources of information are:
 - Alaska Department of Revenue's *Revenue Sources Books*
 - Legislative Finance Division's *Fiscal Summaries*

The Department of Revenue puts out *Revenue Sources Books* each fall and spring. These provide detailed data on state revenues, and also include the official state revenue projections that budgets are based on.



The Legislative Finance Division puts out two-page *Fiscal Summaries* which summarize major items in the state's budget and how they are funded.

State of Alaska Fiscal Summary--FY14 and FY15 (Part 1)

(\$ millions)

	FY14 BUDGET						FY15 BUDGET						Change in UGF	
	Unrestricted General Funds	Designated General Funds	Total General Funds	Other State Funds	Federal Receipts	All Funds	Unrestricted General Funds	Designated General Funds	Total General Funds	Other State Funds	Federal Receipts	All Funds	\$	%
REVENUE (Excludes Permanent Fund Earnings) (1)	5,338.9	977.7	6,316.6	589.5	2,971.1	9,877.3	4,522.9	959.6	5,482.5	638.6	3,137.8	9,258.9	(816.0)	-15.3%
Unrestricted General Fund Revenue (Spring 2014) (2)	5,304.0	-	5,304.0	-	-	5,304.0	4,522.9	-	4,522.9	-	-	4,522.9		
Carryforward (3)	34.9	-	34.9	-	1.6	36.5	-	-	-	-	-	-		
Designated General Fund Revenue (4)	-	977.7	977.7	-	-	977.7	-	959.6	959.6	-	-	959.6		
Other State Funds and Federal Receipts	-	-	-	589.5	2,969.5	3,559.0	-	-	-	638.6	3,137.8	3,776.4		
APPROPRIATIONS														
TOTAL OPERATING APPROPRIATIONS	6,438.8	743.8	7,182.6	550.8	2,042.1	9,775.5	5,244.5	772.4	6,016.9	3,573.5	2,019.5	11,609.9	(1,194.3)	-18.5%
Agency Operations	4,394.2	721.8	5,116.0	466.2	2,001.4	7,583.6	4,512.9	751.5	5,264.4	517.6	1,991.8	7,773.9	118.7	2.7%
Current Fiscal Year Appropriations (Includes Fiscal Notes)	4,386.2	721.7	5,107.8	466.2	2,001.4	7,575.4	4,492.9	751.5	5,244.4	517.6	1,991.8	7,753.9	106.8	2.4%
Agency Operations (Non-Formula)	2,297.0	647.8	2,944.8	463.2	914.8	4,322.8	2,246.3	642.9	2,889.2	514.7	903.8	4,307.7	(50.6)	-2.2%
K-12 Formula and Pupil Transportation	1,216.2	10.5	1,226.7	-	20.8	1,247.5	1,200.6	10.0	1,210.6	-	20.8	1,231.4	(15.6)	-1.3%
Other Formula Programs	873.0	63.4	936.3	2.8	1,063.9	2,003.0	877.7	74.9	952.5	2.8	1,067.2	2,022.5	4.7	0.5%
Revised Programs Legislatively Approved	-	-	-	0.2	1.9	2.1	-	-	-	-	-	-	-	-
Fiscal Notes (FY14 notes are included in Management Plan)	-	-	-	-	-	-	168.3	23.8	192.1	0.1	0.1	192.2	-	-
Vetoes (non-additive)	(1.4)	-	(1.4)	(0.1)	(0.3)	(1.8)	-	-	-	-	-	-	-	-
Duplicated Authorization (non-additive) (5)	-	-	-	734.7	-	734.7	-	-	-	736.4	-	736.4	-	-
Supplemental Operating Appropriations	8.0	0.1	8.2	0.0	(0.0)	8.2	20.0	0.0	20.0	0.0	0.0	20.0	11.8	144.6%
Statewide Operations	2,044.6	22.0	2,066.6	84.6	40.8	2,191.9	731.6	20.9	752.4	3,055.9	27.7	3,836.1	(1,313.0)	-64.2%
Current Fiscal Year Appropriations	2,004.2	22.0	2,026.2	61.6	40.8	2,128.5	731.6	20.9	752.4	3,055.9	27.7	3,836.1	(1,272.6)	-63.5%
Debt Service	207.4	20.8	228.2	54.5	17.5	300.1	218.8	19.3	238.1	50.3	5.2	293.7	11.5	5.5%
Fund Capitalization	1,146.0	1.2	1,147.2	7.1	23.3	1,177.5	507.5	1.6	509.1	5.6	22.5	537.1	(638.5)	-55.7%
Local Government Support	60.0	-	60.0	-	-	60.0	52.0	-	52.0	-	-	52.0	(8.0)	-13.3%
Oil & Gas Investment Tax Credits	600.0	-	600.0	-	-	600.0	450.0	-	450.0	-	-	450.0	(150.0)	-25.0%
AIDEA Capitalization (Fiscal Note)	125.0	-	125.0	-	-	125.0	-	-	-	-	-	-	(125.0)	-100.0%
In-State Pipeline Fund	355.0	-	355.0	-	-	355.0	-	-	-	-	-	-	(355.0)	-100.0%
Other Fund Capitalization	6.0	1.2	7.2	7.1	23.3	37.5	5.5	1.6	7.1	5.6	22.5	35.1	(0.5)	-7.0%
Retirement Costs: Actuarial Recommendation	633.8	-	633.8	-	-	633.8	5.2	-	5.2	-	-	5.2	(628.5)	-99.2%
Retirement Costs: Additional Contributions	-	-	-	-	-	-	-	-	-	3,000.0	-	3,000.0	-	-
Special Appropriations	17.1	-	17.1	-	-	17.1	-	-	-	-	-	-	-	-
Duplicated Authorization (non-additive) (5)	-	-	-	42.0	-	42.0	-	-	-	12.1	-	12.1	-	-
Supplemental Statewide Appropriations	40.4	-	40.4	23.0	(0.0)	63.4	-	-	-	-	-	-	(40.4)	-100.0%
Debt Service	(15.4)	-	(15.4)	23.0	(0.0)	7.6	-	-	-	-	-	-	-	-
Other Fund Capitalization	52.3	-	52.3	-	-	52.3	-	-	-	-	-	-	-	-
Judgments, Claims and Settlements	3.5	-	3.5	-	-	3.5	-	-	-	-	-	-	-	-
Duplicated Authorization (non-additive) (5)	-	-	-	(22.9)	-	(22.9)	-	-	-	-	-	-	-	-
TOTAL CAPITAL APPROPRIATIONS	880.4	219.5	1,099.9	36.8	929.0	2,065.7	594.9	164.5	759.4	65.1	1,118.2	1,942.7	(285.5)	-32.4%
Current Fiscal Year Appropriations	796.2	212.8	1,008.9	34.8	929.0	1,972.7	594.9	164.5	759.4	65.1	1,118.2	1,942.7	(201.3)	-25.3%
Project Appropriations & RPLs (Revised Programs)	769.2	212.8	981.9	34.8	929.0	1,945.7	594.9	164.5	759.4	65.1	1,118.2	1,942.7	(174.3)	-22.7%
Fund Capitalization	27.0	-	27.0	-	-	27.0	-	-	-	-	-	-	(27.0)	-100.0%
Projects Funded with Other Debt Proceeds (non-additive)	-	-	-	35.0	-	35.0	-	-	-	172.5	-	172.5	-	-
Duplicated Authorization (non-additive) (5)	-	-	-	58.3	-	58.3	-	-	-	200.9	-	200.9	-	-
Supplemental Capital Appropriations	84.2	6.8	91.0	2.0	0.0	93.0	0.0	0.0	0.0	0.0	0.0	0.0	(91.0)	-100.0%
Capital Projects (net of Duplication)	84.2	6.8	91.0	2.0	-	93.0	-	-	-	-	-	-	-	-
Duplicated Authorization (non-additive) (5)	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Money on the Street (includes all fund sources) (6)	880.4	219.5	1,099.9	95.1	929.0	2,124.0	594.9	164.5	759.4	265.9	1,118.2	2,143.5	(285.5)	-32.4%
Pre-Transfers Authorization (unduplicated)	7,319.2	963.3	8,282.5	587.6	2,971.1	11,841.2	5,839.4	936.8	6,776.2	3,638.6	3,137.8	13,552.6	(1,479.8)	-20.2%
Pre-Transfers Surplus/(Deficit)	(1,980.3)	-37.1%	of UGF Revenue				(1,316.5)	-29.1%	of UGF Revenue					

Legislative Finance Division *Fiscal Summary* (page 2)

State of Alaska Fiscal Summary--FY14 and FY15 (Part 1)

(\$ millions)

	FY14 BUDGET						FY15 BUDGET						Change in UGF	
	Unrestricted General Funds	Designated General Funds	Total General Funds	Other State Funds	Federal Receipts	All Funds	Unrestricted General Funds	Designated General Funds	Total General Funds	Other State Funds	Federal Receipts	All Funds	\$	%
Transfers (7)	(266.3)	14.4	(251.8)	1.9	-	(249.9)	67.7	22.8	90.5	(3,000.0)	-	(2,909.5)	334.0	-125.4%
Current Fiscal Year Transfers	(292.1)	14.4	(277.7)	1.9	0.0	(275.7)	67.7	22.8	90.5	(3,000.0)	0.0	(2,909.5)	359.9	-123.2%
Loan Funds	10.0	-	10.0	-	-	10.0	-	-	-	-	-	-	(10.0)	-100.0%
Designated Reserves (Public Education Fund)	1.3	-	1.3	-	-	1.3	58.4	-	58.4	-	-	58.4	57.1	4400.7%
Undesignated Reserves (Alaska Housing Capital Corp)	(374.1)	-	(374.1)	-	-	(374.1)	(63.1)	-	(63.1)	-	-	(63.1)	311.0	-63.1%
Oil & Hazardous Substance Fund	8.7	13.6	22.3	-	-	22.3	8.4	3.4	11.8	-	-	11.8	(0.3)	-3.4%
REAA School Fund	36.2	-	36.2	-	-	36.2	40.0	-	40.0	-	-	40.0	3.8	10.6%
AMHS Fund	0.8	-	0.8	-	-	0.8	0.1	-	0.1	-	-	0.1	(0.7)	-88.9%
Renewable Energy Fund	25.0	-	25.0	-	-	25.0	20.0	-	20.0	-	-	20.0	(5.0)	-20.0%
Other Funds	-	0.8	0.8	1.9	-	2.8	4.0	19.4	23.4	(3,000.0)	-	(2,976.6)	-	-
Supplemental Transfers	25.9	0.0	25.9	0.0	0.0	25.9	0.0	0.0	0.0	0.0	0.0	0.0	(25.9)	-100.0%
Undesignated Reserves (Alaska Housing Capital Corp)	(37.5)	-	(37.5)	-	-	(37.5)	-	-	-	-	-	-	-	-
AMHS Fund	2.5	-	2.5	-	-	2.5	-	-	-	-	-	-	-	-
AMHS Vessel Replacement Fund	8.4	-	8.4	-	-	8.4	-	-	-	-	-	-	-	-
Permanent Fund Transfers	52.5	-	52.5	-	-	52.5	-	-	-	-	-	-	-	-
Post-Transfers Authorization (unduplicated)	7,052.9	977.7	8,030.7	589.5	2,971.1	11,591.3	5,907.1	959.6	6,866.8	638.6	3,137.8	10,643.1	(1,145.8)	-16.2%
Post-Transfer Balance to/(from) the SBR (8)	(1,714.1)	-32.1%	of UGF Revenue				(1,384.2)	-30.6%	of UGF Revenue					
Permanent Fund	-	2,062.6	2,062.6	7.2	-	2,069.8	-	2,173.0	2,173.0	8.5	-	2,181.5		
Permanent Fund Dividends	-	1,070.0	1,070.0	-	-	1,070.0	-	1,150.0	1,150.0	-	-	1,150.0	-	-
Deposits to Principal	-	934.0	934.0	-	-	934.0	-	965.0	965.0	-	-	965.0	-	-
Alaska Capital Income Fund	-	20.0	20.0	-	-	20.0	-	22.0	22.0	-	-	22.0	-	-
Other Uses of Earnings (included in op or cap budget) (9)	-	38.6	38.6	7.2	-	45.8	-	36.0	36.0	8.5	-	44.5	-	-
Total Authorization (unduplicated)	7,052.9	3,001.7	10,054.7	589.5	2,971.1	13,615.3	5,907.1	3,096.6	9,003.8	638.6	3,137.8	12,780.1	(1,145.8)	-16.2%
FISCAL YEAR SUMMARY	7,319.2	2,987.3	10,306.5	587.6	2,971.1	13,865.2	5,839.4	3,073.8	8,913.2	3,638.6	3,137.8	15,689.6	(1,479.8)	-20.2%
Agency Operations	4,394.2	721.8	5,116.0	466.2	2,001.4	7,583.6	4,512.9	751.5	5,264.4	517.6	1,991.8	7,773.9	118.7	2.7%
Statewide Operations	2,044.6	22.0	2,066.6	84.6	40.8	2,191.9	731.6	20.9	752.4	3,055.9	27.7	3,836.1	(1,313.0)	-64.2%
Total Operating	6,438.8	743.8	7,182.6	550.8	2,042.1	9,775.5	5,244.5	772.4	6,016.9	3,573.5	2,019.5	11,609.9	(1,194.3)	-18.5%
Capital	888.4	219.5	1,099.9	36.8	929.0	2,065.7	594.9	164.5	759.4	65.1	1,118.2	1,942.7	(285.5)	-32.4%
Unduplicated Appropriation of Permanent Fund Earnings	0.0	2,024.0	2,024.0	0.0	0.0	2,024.0	0.0	2,137.0	2,137.0	0.0	0.0	2,137.0	-	-
Transfers (non-additive)	(266.3)	14.4	(251.8)	1.9	-	(249.9)	67.7	22.8	90.5	(3,000.0)	-	(2,909.5)	334.0	-125.4%

Notes:

August 29, 2014

- (1) Although Permanent Fund earnings may be appropriated for any purpose, the legislature traditionally excludes them from the definition of available revenue. Appropriations of Permanent Fund earnings are reported in lines 64-67 of the summary. Permanent Fund earnings and balance information is reported in part 2 of the Fiscal Summary.
- (2) The Department of Revenue's Spring 2014 oil forecast for FY14 is 0.522 mbd at \$106.61 per barrel; the FY15 forecast is 0.498 mbd at \$105.06 per barrel.
- (3) Carryforward is money that was appropriated in a prior year that is made available for spending in a later year via multiyear appropriations or reappropriations. Total carryforward into FY15 will be unknown until the close of FY14.
- (4) Designated general funds include 1) program receipts that are restricted to the program that generates the receipts and 2) revenue that is statutorily designated for a specific purpose.
- (5) Duplicated authorization is in the budget twice, such as when funds flow in and out of a holding account or one agency pays another for services provided. Duplicated authorization also includes the expenditure of bond proceeds when debt service on bonds (which includes repayment of principal) will be reflected in future operating budgets.
- (6) Including duplicated fund sources in the amount of capital spending provides a valuable measure of "money on the street" because it includes projects funded with bond proceeds and other duplicated fund sources.
- (7) "Transfers" refer to appropriations that move money from one fund to another within the Treasury. Although transfers are not true expenditures, they reduce the amount of money available for other purposes so must be included in the calculation of the surplus/deficit. For reserve accounts, a positive number indicates a deposit and a negative number indicates a withdrawal. When money is withdrawn and spent, the expenditure is included in the operating or capital budget, as appropriate.
- (8) The post-transfer withdrawal necessary to balance the budget is anticipated to be \$1.7 billion in FY14 and \$1.4 billion in FY15.
- (9) Amounts shown on line 68 can be considered duplicated appropriations—they are included in the operating or capital budgets above. The Designated General Fund column include amounts associated with the dividend program. Amounts in the Other column reflect gross earnings of the Permanent Fund spent for purposes other than operation of the corporation.

Basic fiscal terminology

State revenues and spending are reported by fiscal year.
We are in fiscal year (FY) 2015.

	Last fiscal year	This fiscal year	Next fiscal year
Fiscal year	FY 2014	FY 2015	FY 2016
Start date	July 1, 2013	July 1, 2014	July 1, 2015
End date	June 30, 2014	June 30, 2015	June 30, 2016
Legislative session which prepares the budget	2013	2014	2015
Are actual revenues and spending known yet?	Yes	No	No
Could revenues or spending change still?	No	Yes	Yes

The state has many different funds.

Funds are different accounts of money or other financial assets that the state gets in different ways and are used for different purposes.

- General Fund
 - Pays for most of state government
 - Sort of like the checking account you use to pay for your regular household bills
- Other funds
 - Constitutional Budget Reserve Fund
 - Statutory Budget Reserve Fund
 - Permanent Fund
 - Sort of like other accounts you have to save for retirement, college, etc.

State funds and revenues are either unrestricted or restricted.

We can use unrestricted funds/revenues any way we want to.

We can only use restricted funds/revenues in specified ways.

The degree of restriction varies.

Type of funds or revenue	How we can use them		Analogies in your personal finances	Examples of state revenues and funds
Unrestricted	Any way we want to		Your wages Your lottery winnings	Oil tax revenues
Restricted	Only in specified ways	Relatively less restricted <i>(restricted by custom)</i>	The money you're saving for your kids to go to college Money your dad gave you "to buy a car"	University tuition revenues Permanent Fund earnings
		Relatively more restricted <i>(restricted by law)</i>	Your college scholarship	Oil royalties Permanent Fund principal Federal highway grants

Most of the discussion and debate about the state's finances is about Unrestricted General Fund (UGF) revenues and spending.

Definition of Unrestricted General Fund Revenue

(from the glossary of the Fall 2014 Revenue Sources Handbook)

“Revenue not restricted by the constitution, state or federal law, trust or debt restrictions, or customary practice. This revenue is deposited into the State’s unrestricted general fund and most legislative and public debate over the budget each year centers on this category of revenue.”

Most of this presentation is about the state's
Unrestricted General Fund revenues and spending.

But the last part of the presentation is about
other funds and other spending.

Other funds and other spending are very important
to understanding the full picture of the state's finances
and our future options!

But it's easiest to start by focusing on
Unrestricted General Fund revenues and spending.

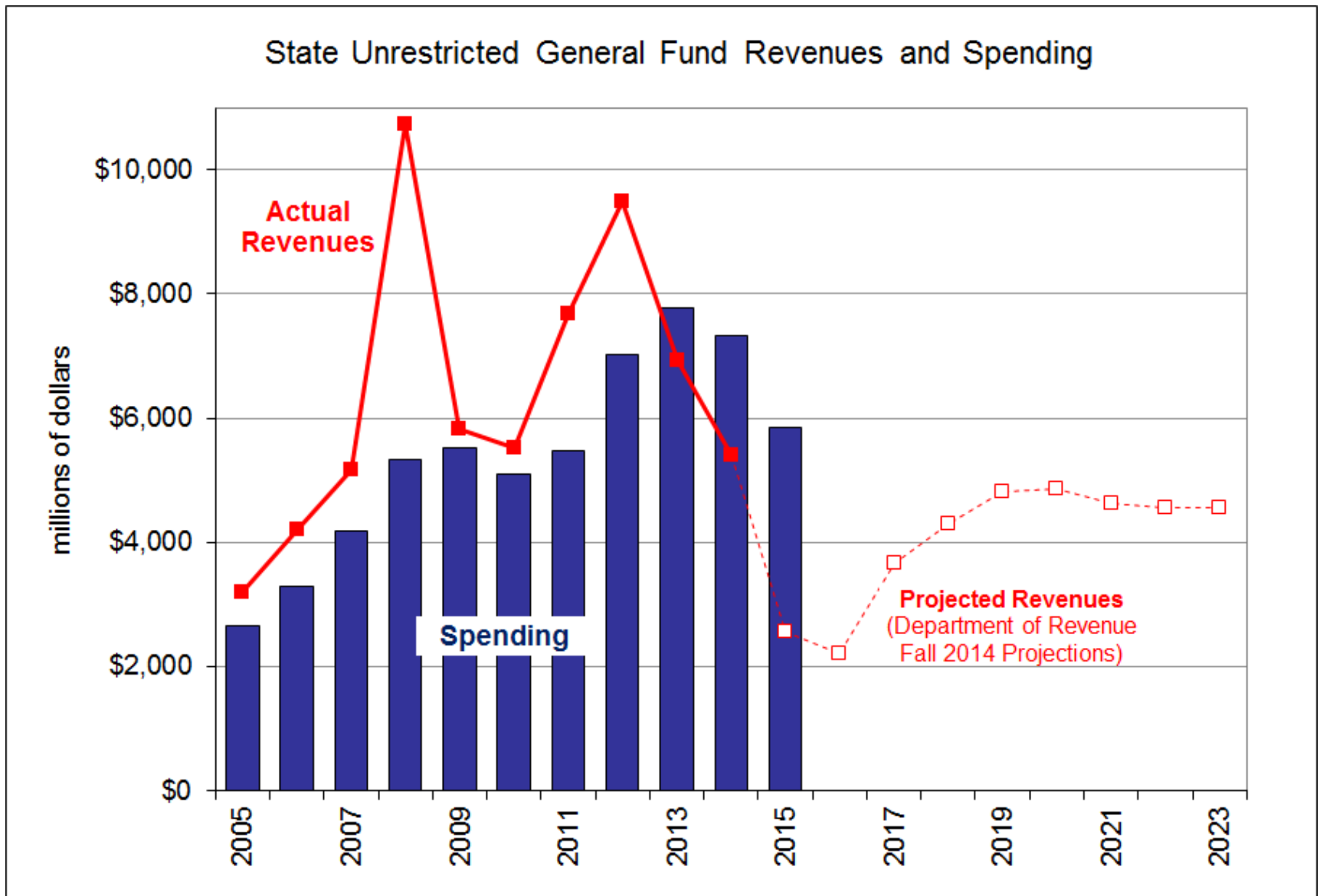
Overview of Alaska's fiscal situation

Overview of Alaska's Fiscal Situation, Fiscal Year 2015

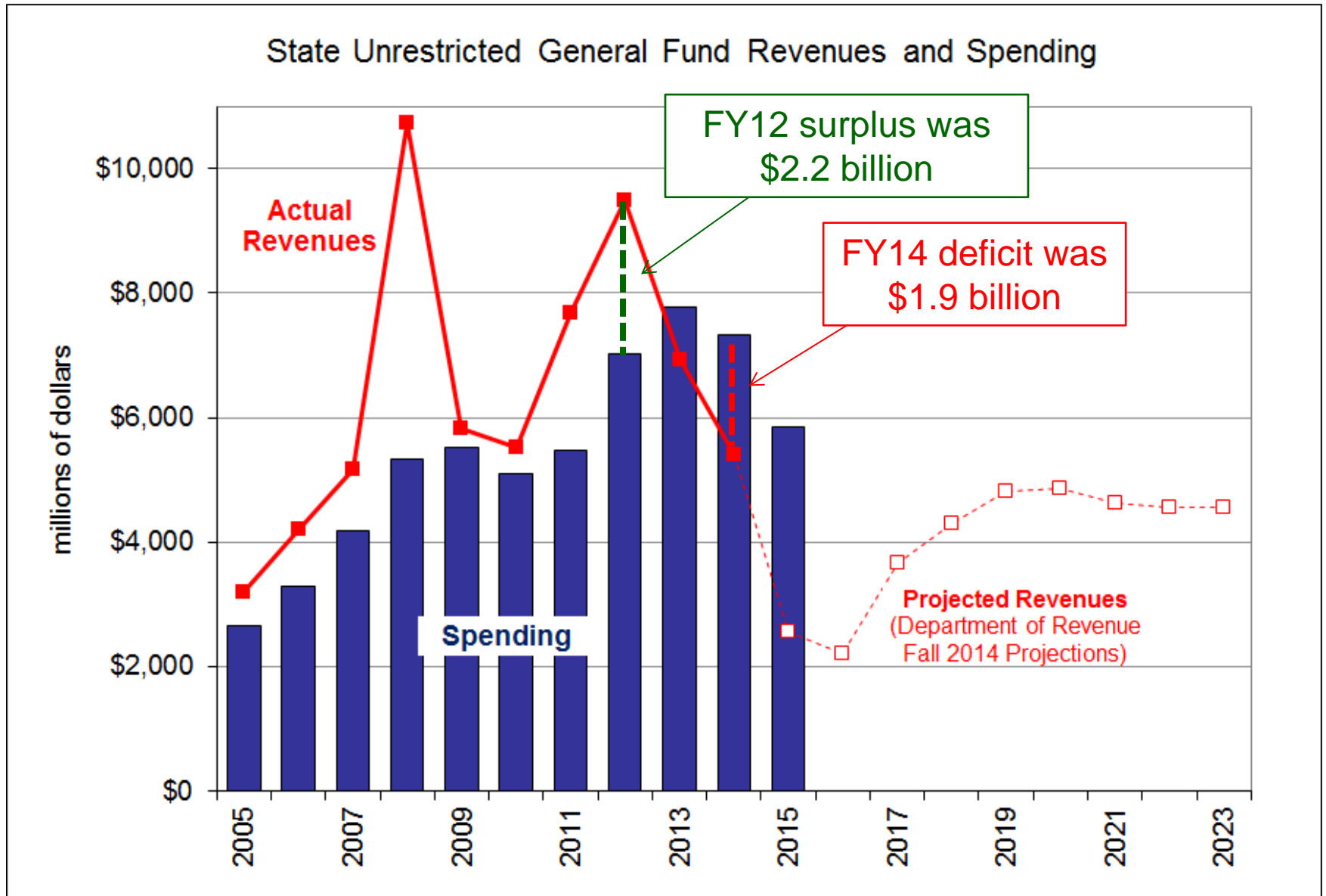
(unrestricted general funds)

	Measured in:	
	\$ billions	\$ per Alaskan
State spending <i>(budgeted level)</i>	5.9	8,022
Projected revenues <i>(Fall 2014 projections)</i>	2.6	3,465
Projected deficit	-3.4	-4,557
Cash savings at the start of the year	12.2	16,616
Years it would take to deplete savings at this year's spending levels <i>(assuming Fall 2014 revenue projections)</i>	7	
Projected deficit as share of spending	-57%	

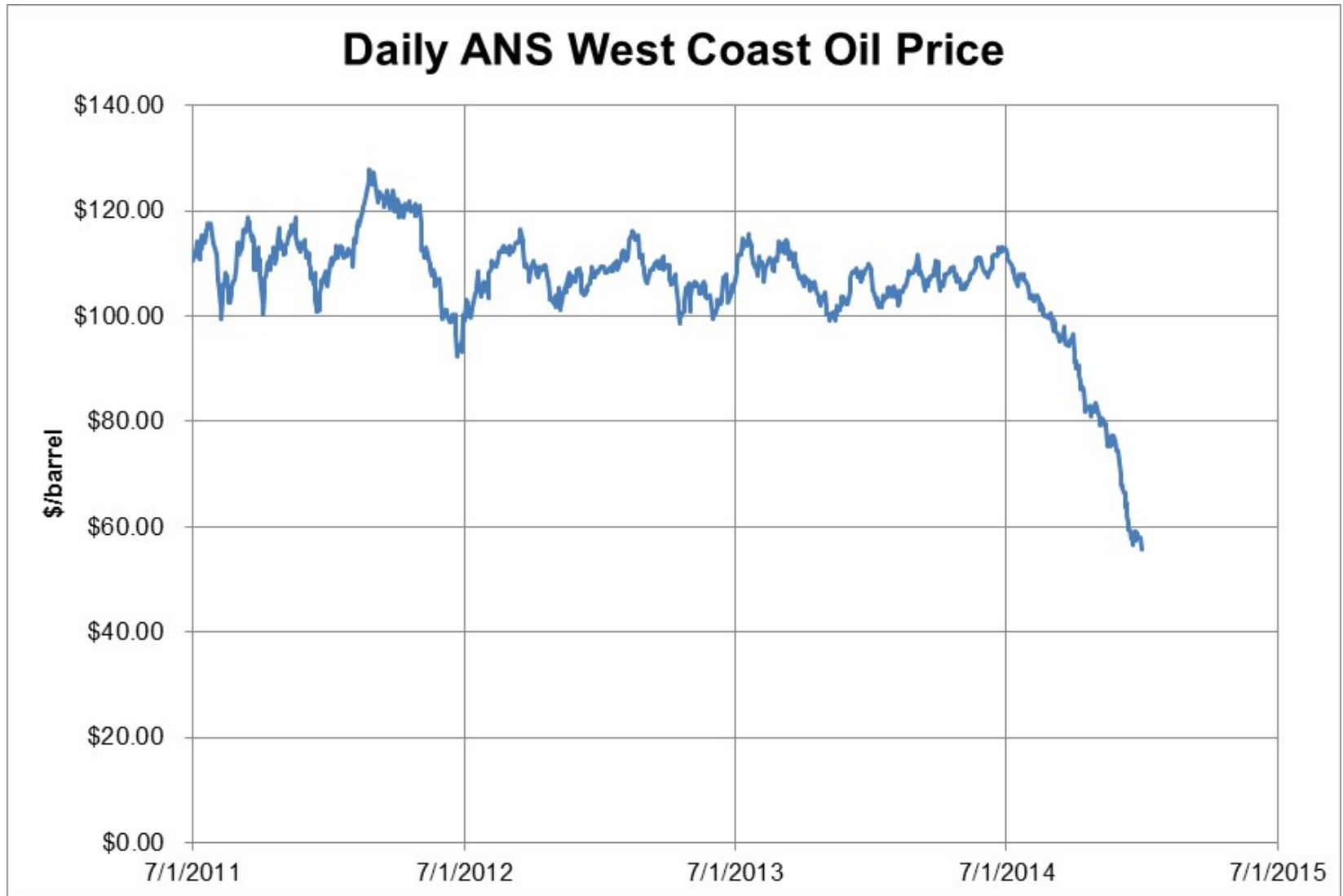
Trends in Alaska's fiscal situation: past and projected



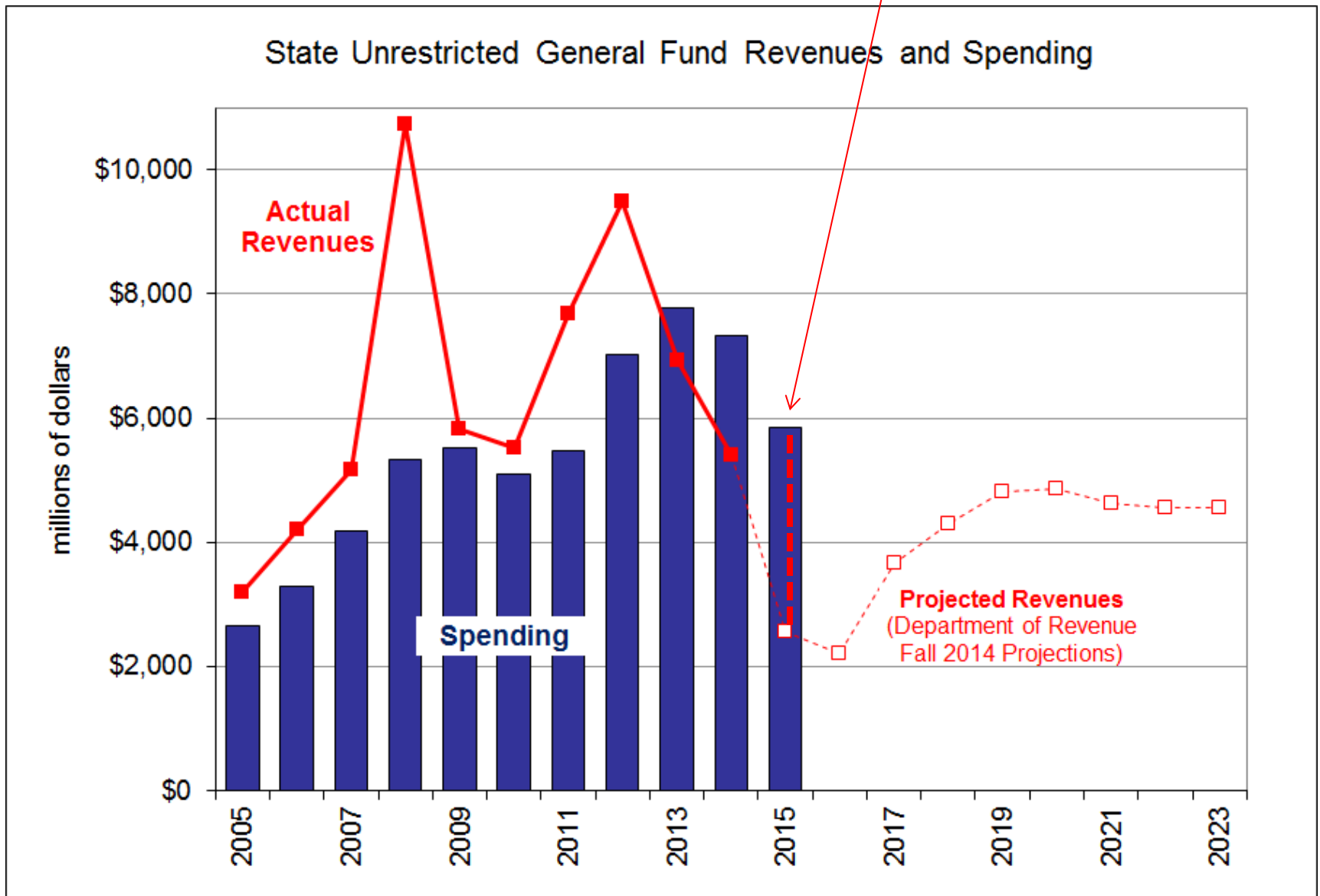
From 2005 to 2012 revenues were high and trending up. Even though spending was growing rapidly, the state ran **surpluses**. Beginning in FY13, revenues fell and the state began to run **deficits**.



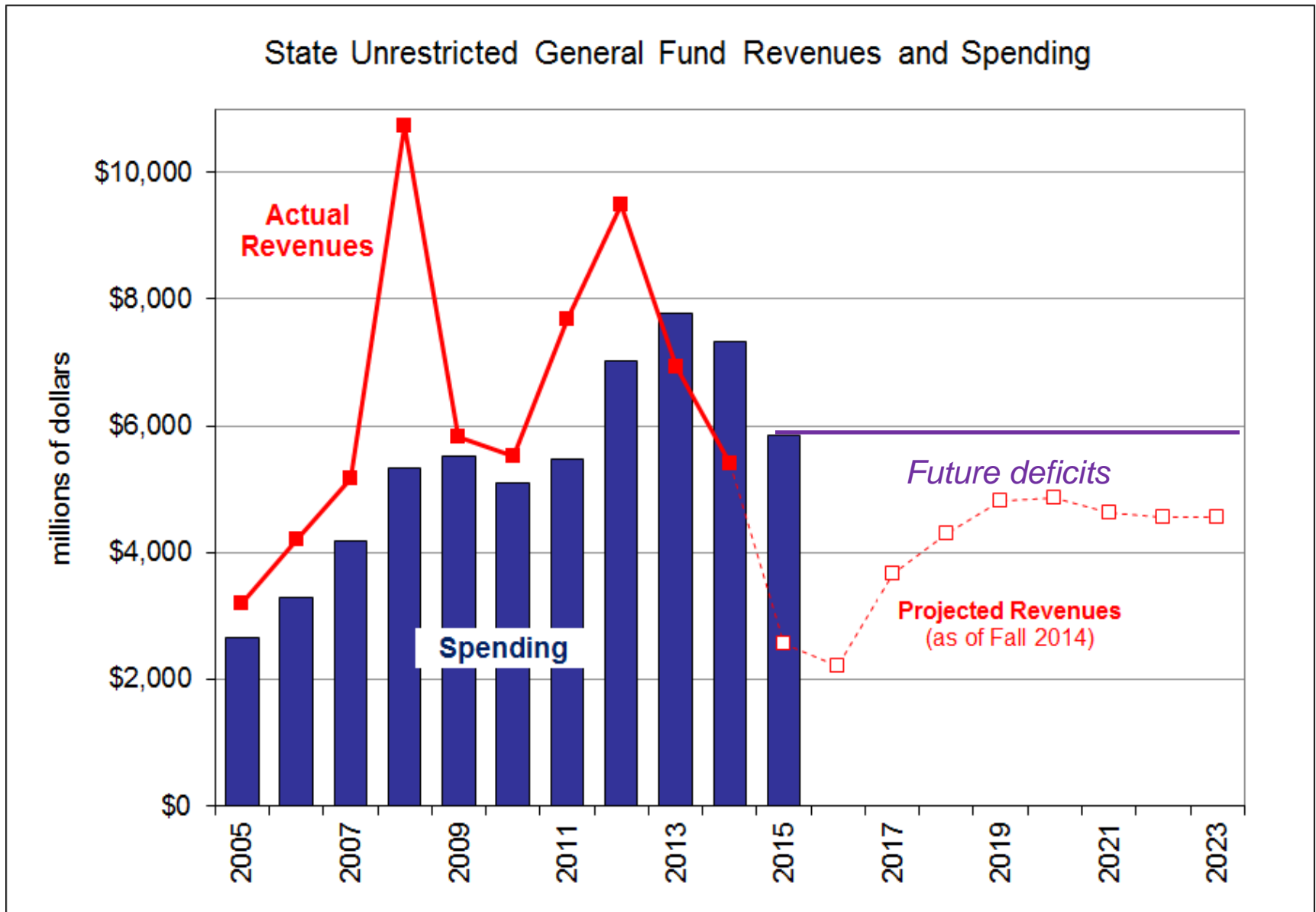
Since the start of this fiscal year,
oil prices have fallen unexpectedly and dramatically.



Because of the fall in oil prices,
FY15 state revenues are projected to fall to less than half of FY14 revenues.
The projected FY15 deficit is **\$3.3 billion**.



If we continued to spend at this year's (FY 15) level, and if the most recent revenue projections are accurate, we would continue to run big deficits for many years.

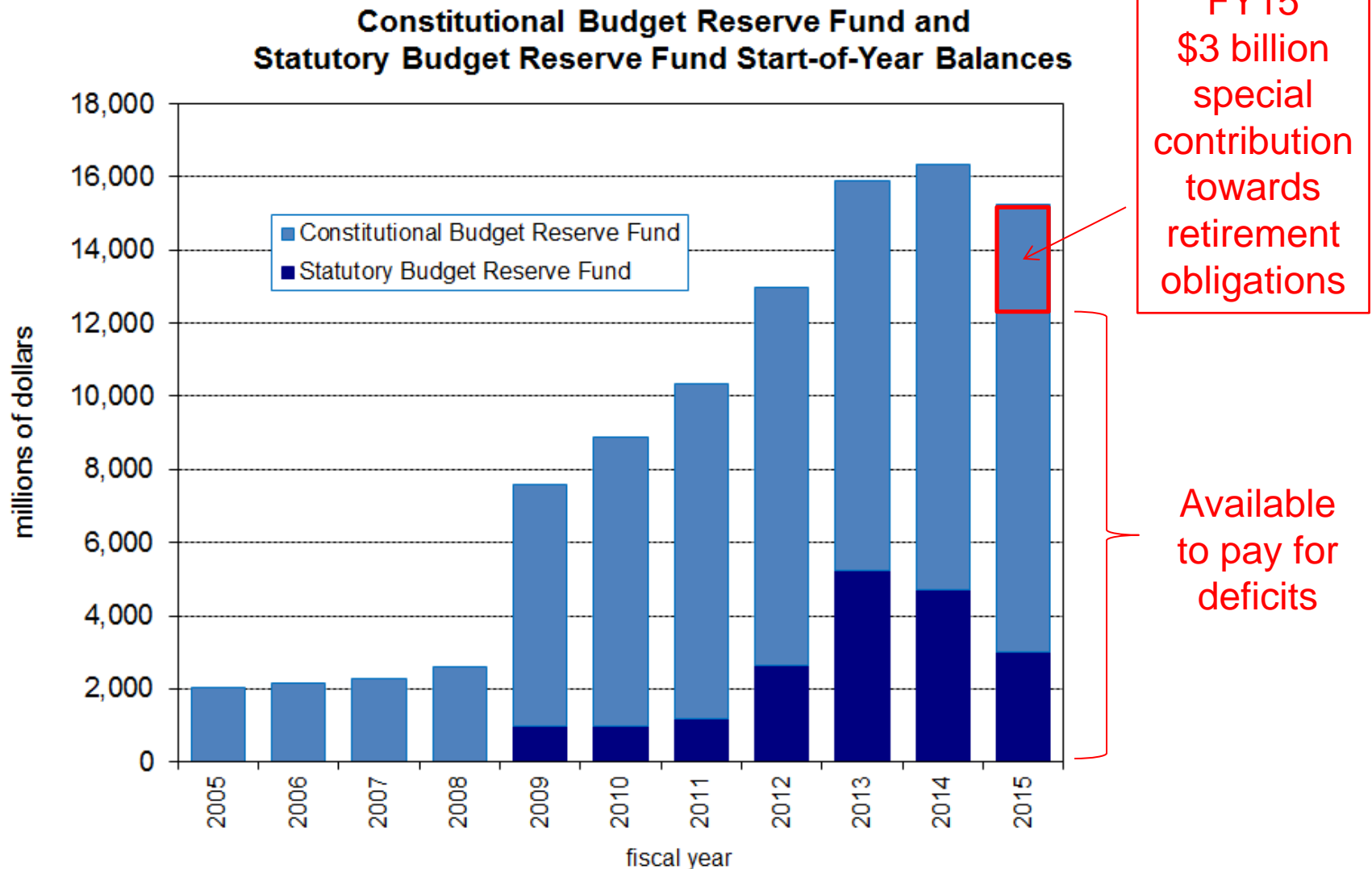


We saved the money from past surpluses in many different funds

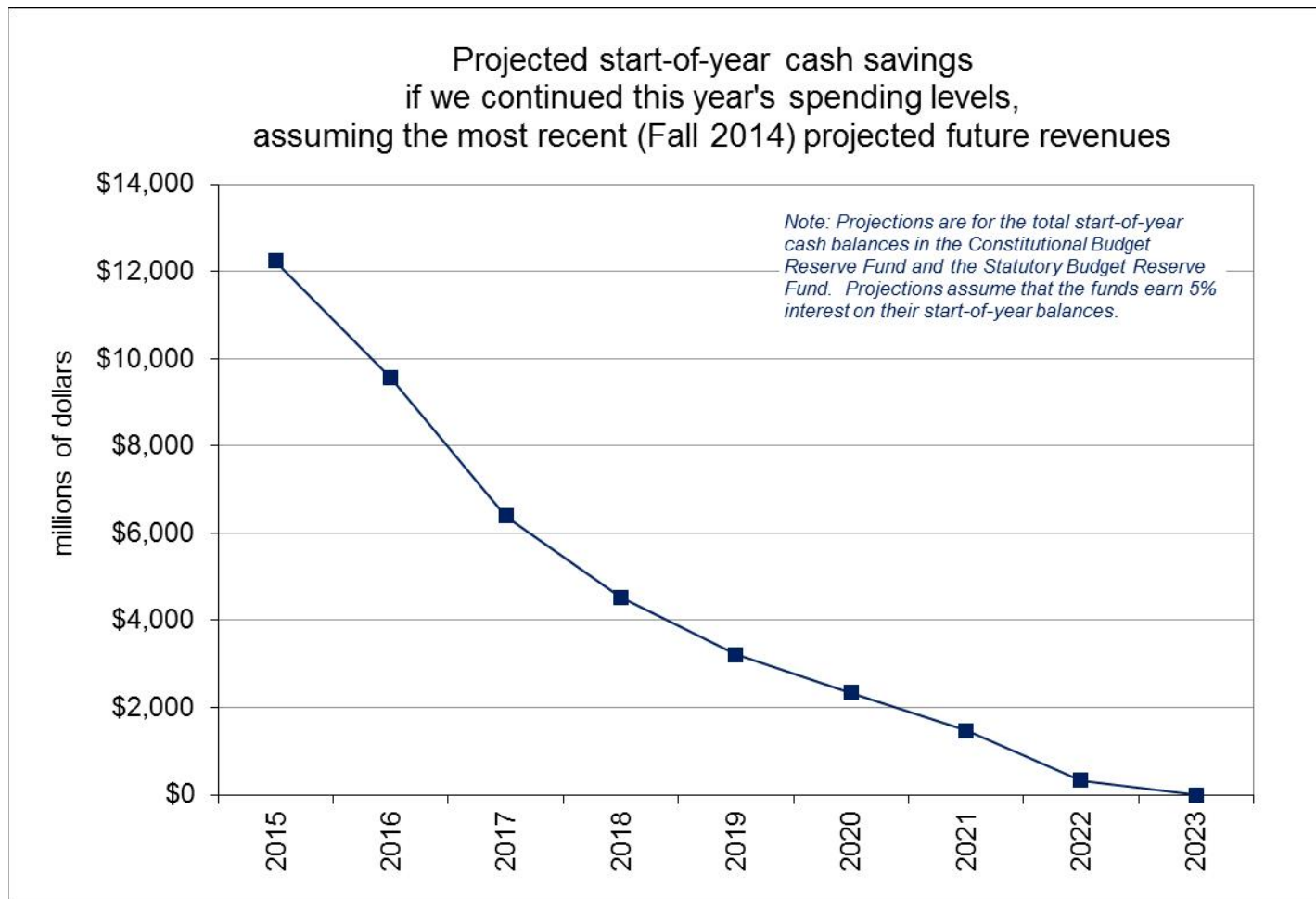
We have been paying for deficits by taking money out of the two
“cash savings” funds that are the most accessible:

The Constitutional Budget Reserve Fund (CBRF)
The Statutory Reserve Fund (SRF)

When we were running surpluses, we built up the value of the CBRF and the SRF. Now we are using those funds to pay for deficits. At the start of FY15, we had about \$12 billion in cash savings in these funds.



If we continued to spend at this year's (FY 15) level,
then if future revenues equal the projections,
we would deplete our cash savings funds in about seven years.
If future revenues are less than projected, our future deficits would be
bigger and we would deplete our savings sooner.



That's the quick overview of state finances.
In the rest of this presentation I'll talk about more details . . .

- STATE REVENUES

- Where do our revenues come from?
- Why did revenues grow so much from 2005 to 2012?
- What caused projected revenues to fall so sharply this year?
- What are the future revenue projections based on?
- How reliable are they?

- STATE SPENDING

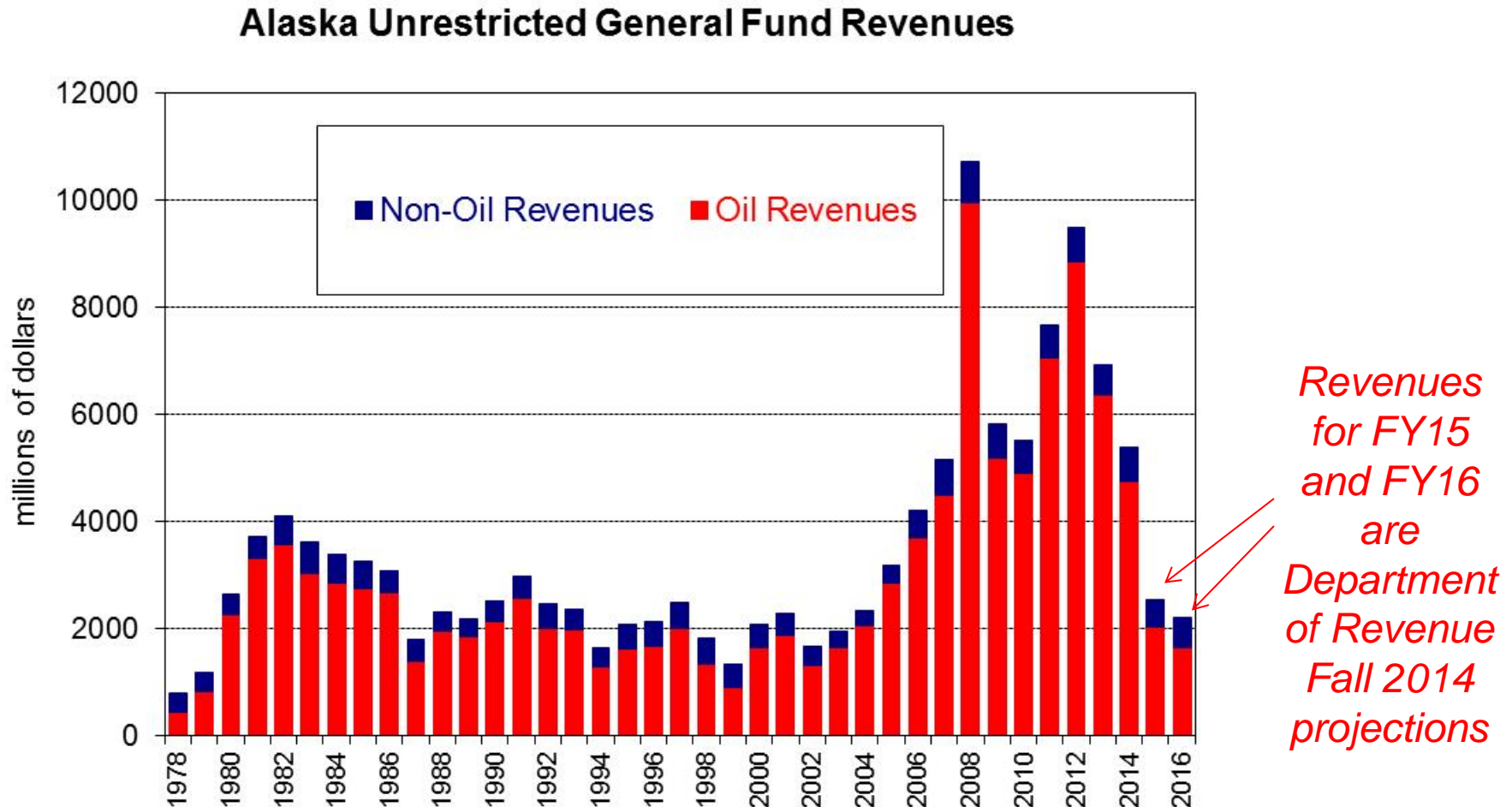
- Where does the money go?
- Why did spending grow since 2005?

- OTHER FUNDS AND RESTRICTED REVENUES

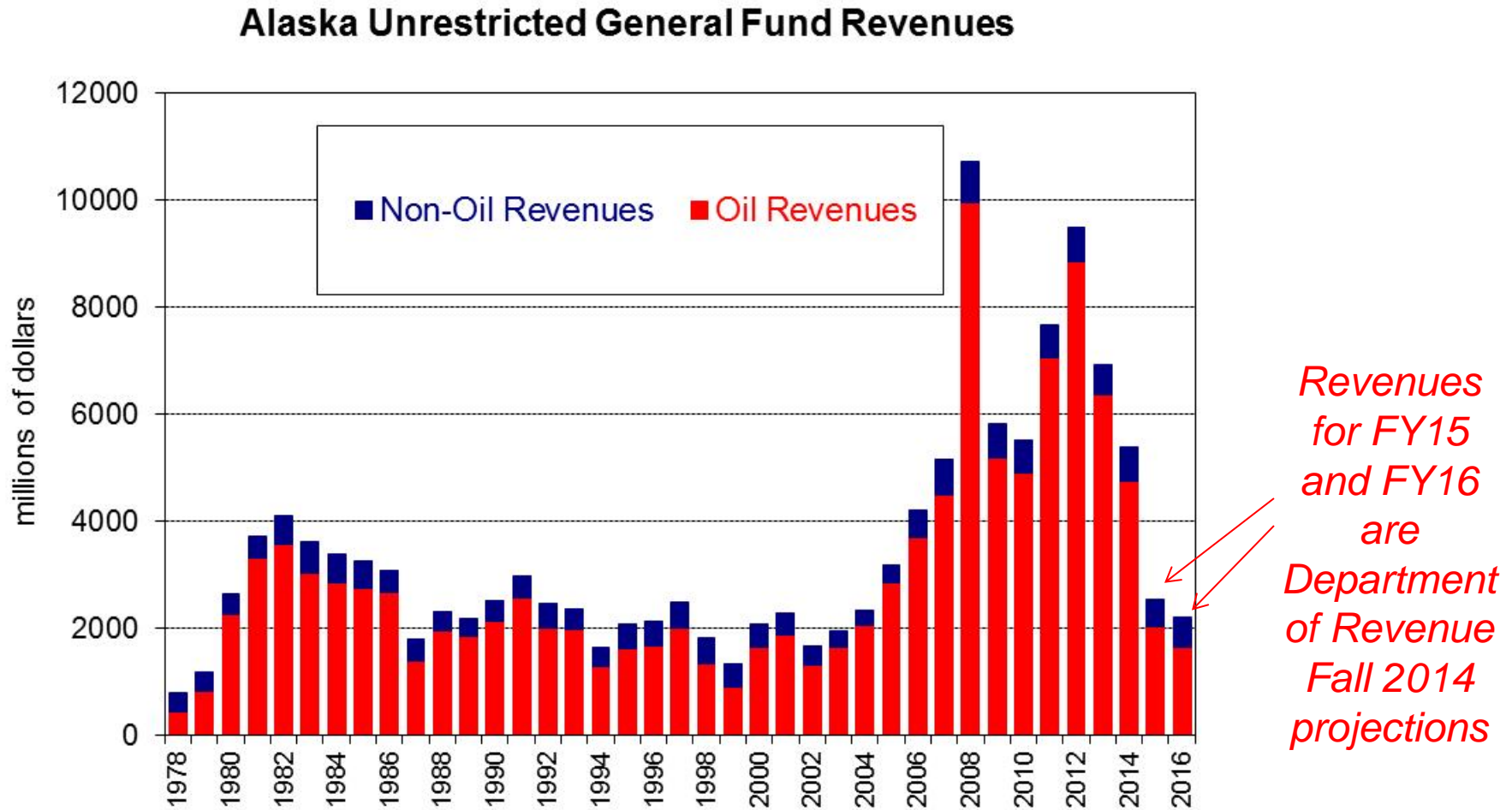
- How much do we have in other funds?
- What are our restricted revenues?

State Revenues

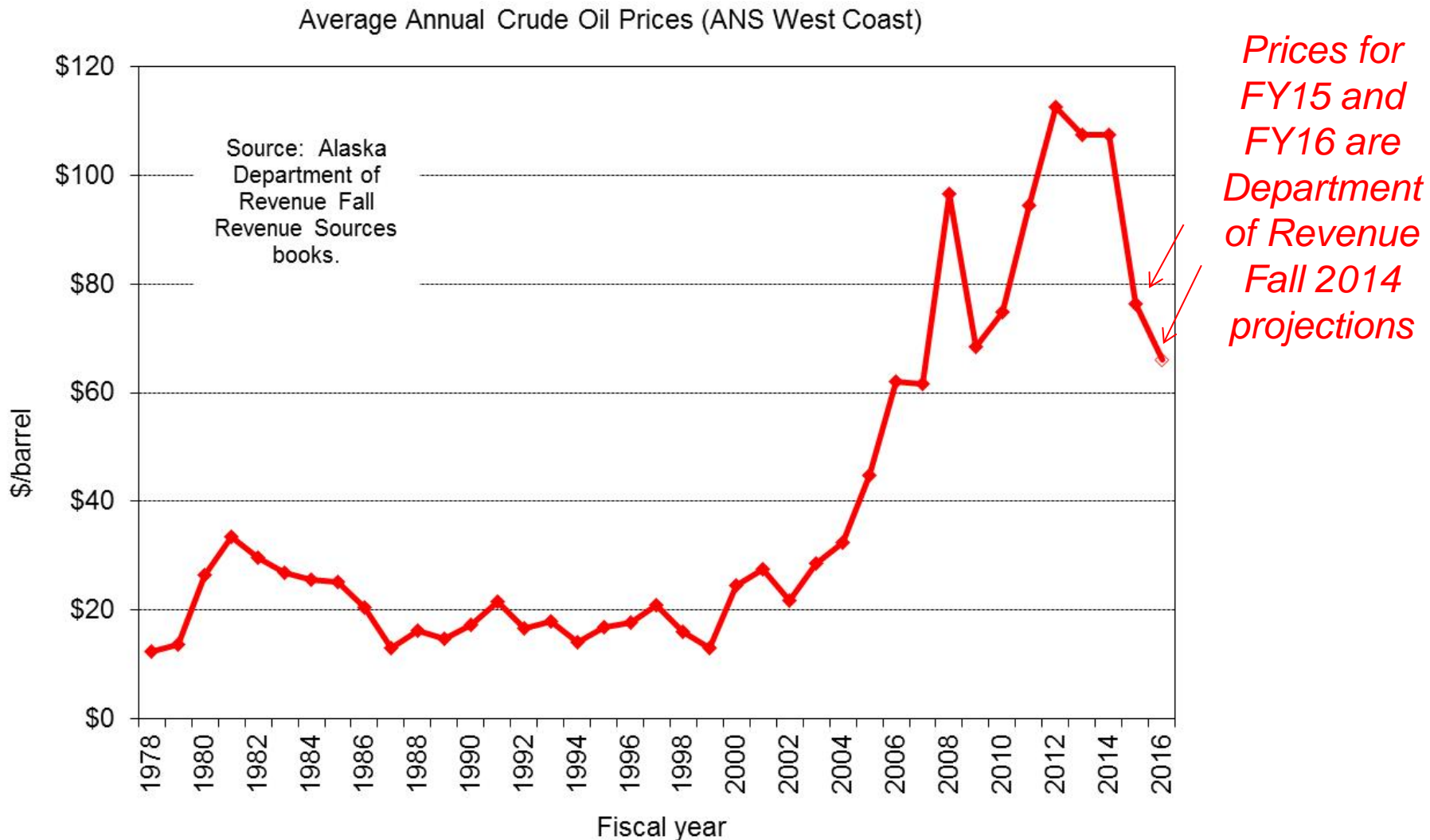
Since North Slope oil production began, oil revenues have accounted for most of Alaska's unrestricted general fund (UGF) revenues. In recent years oil revenues have provided about 90% of UGF revenues.



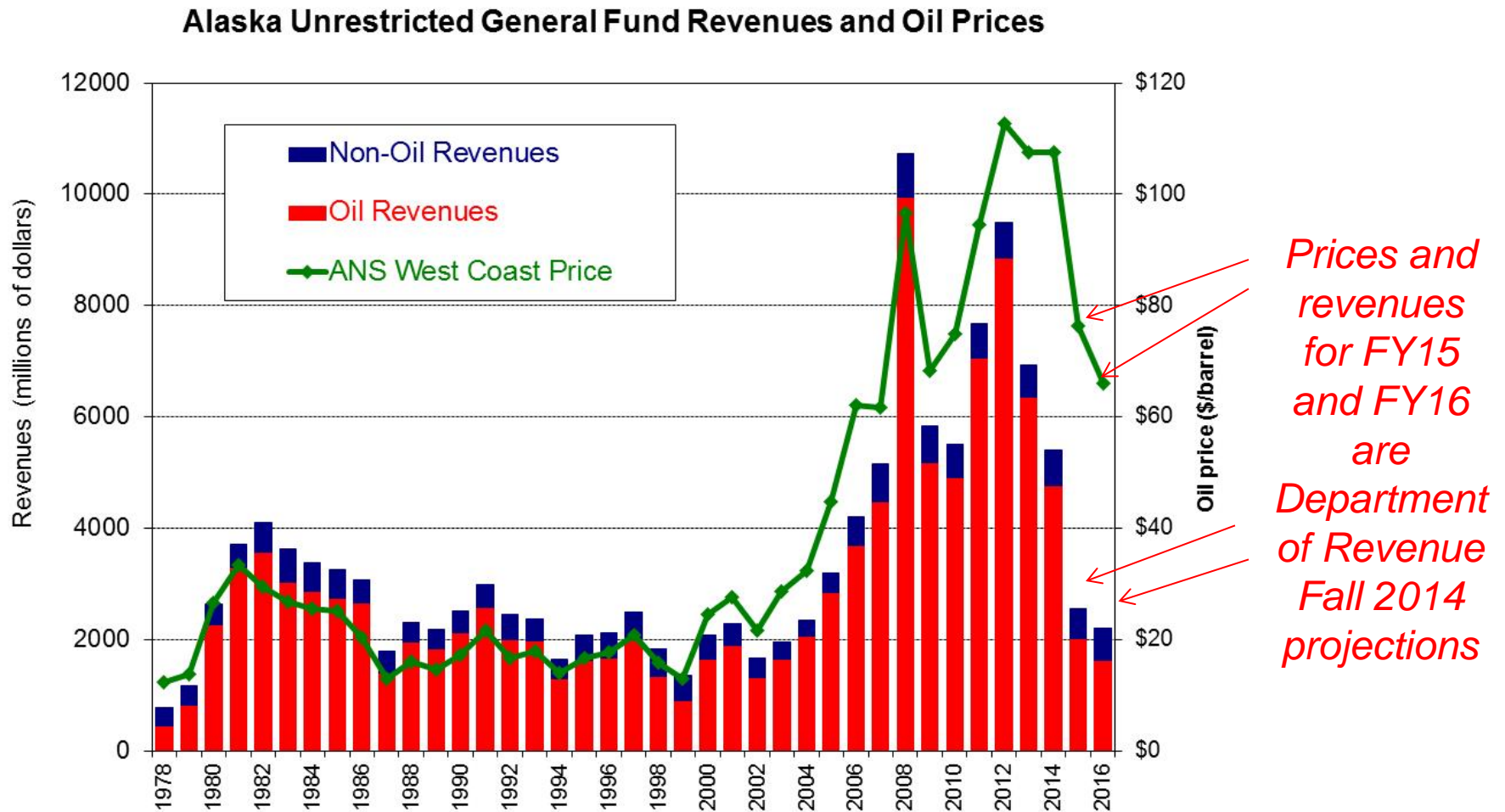
But our oil revenues have fluctuated widely over time!
Why????



Oil prices have been the most important factor in the ups and downs of our oil revenues. Oil prices have fluctuated widely over time. They rose dramatically after 2002—and have fallen dramatically this year.



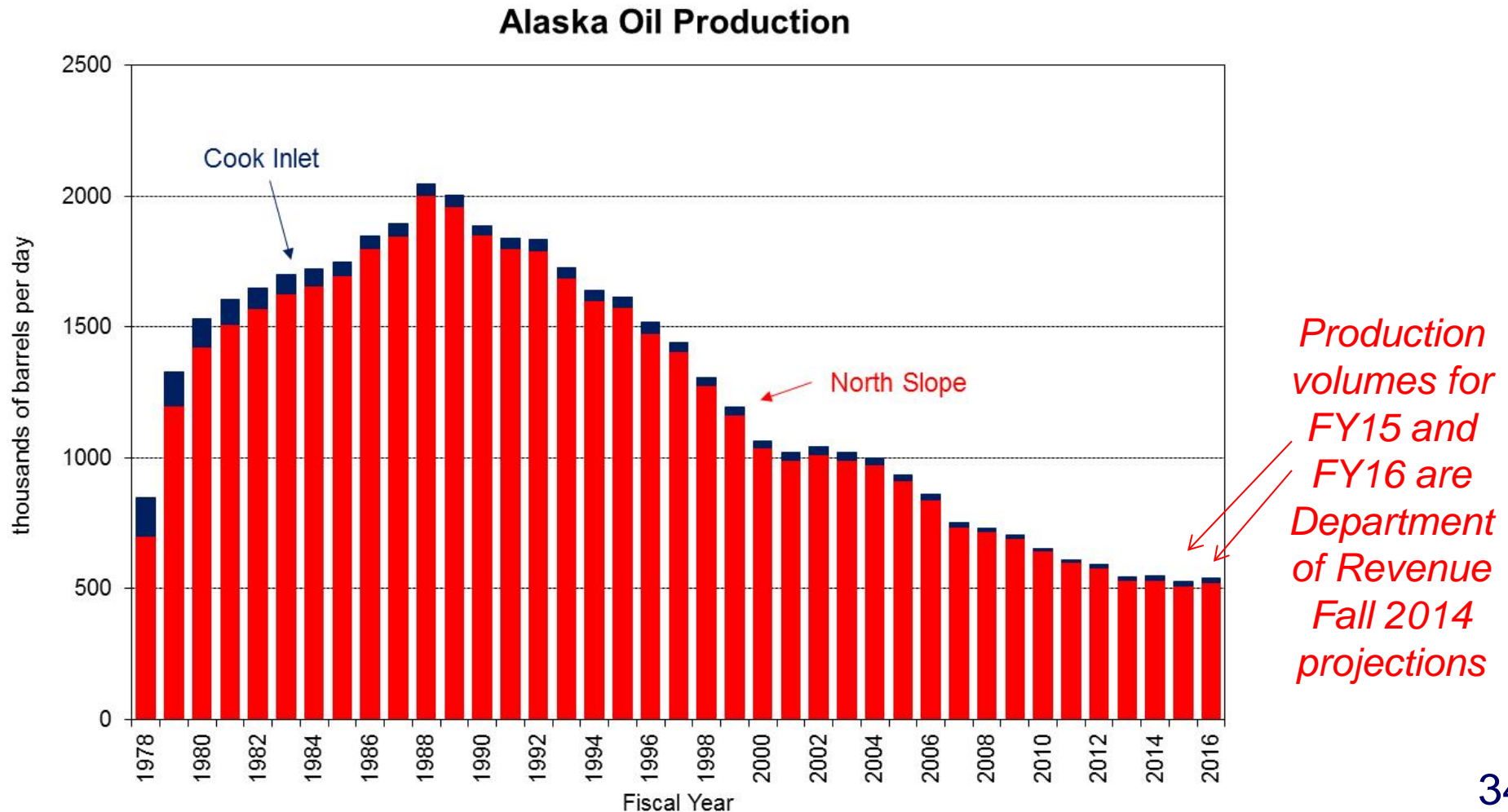
You can see a clear historical relationship between oil prices and oil revenues. But it's not an exact relationship! Other factors have also been affecting Alaska's oil revenues.



Another critical factor affecting oil revenues has been oil production
(which is now almost entirely North Slope oil production).

North Slope production has been declining for many years—from a peak of 2 million
barrels/day in 1988 to just over 500,000 barrels/day last year.

We have a lot less oil to tax than we used to!

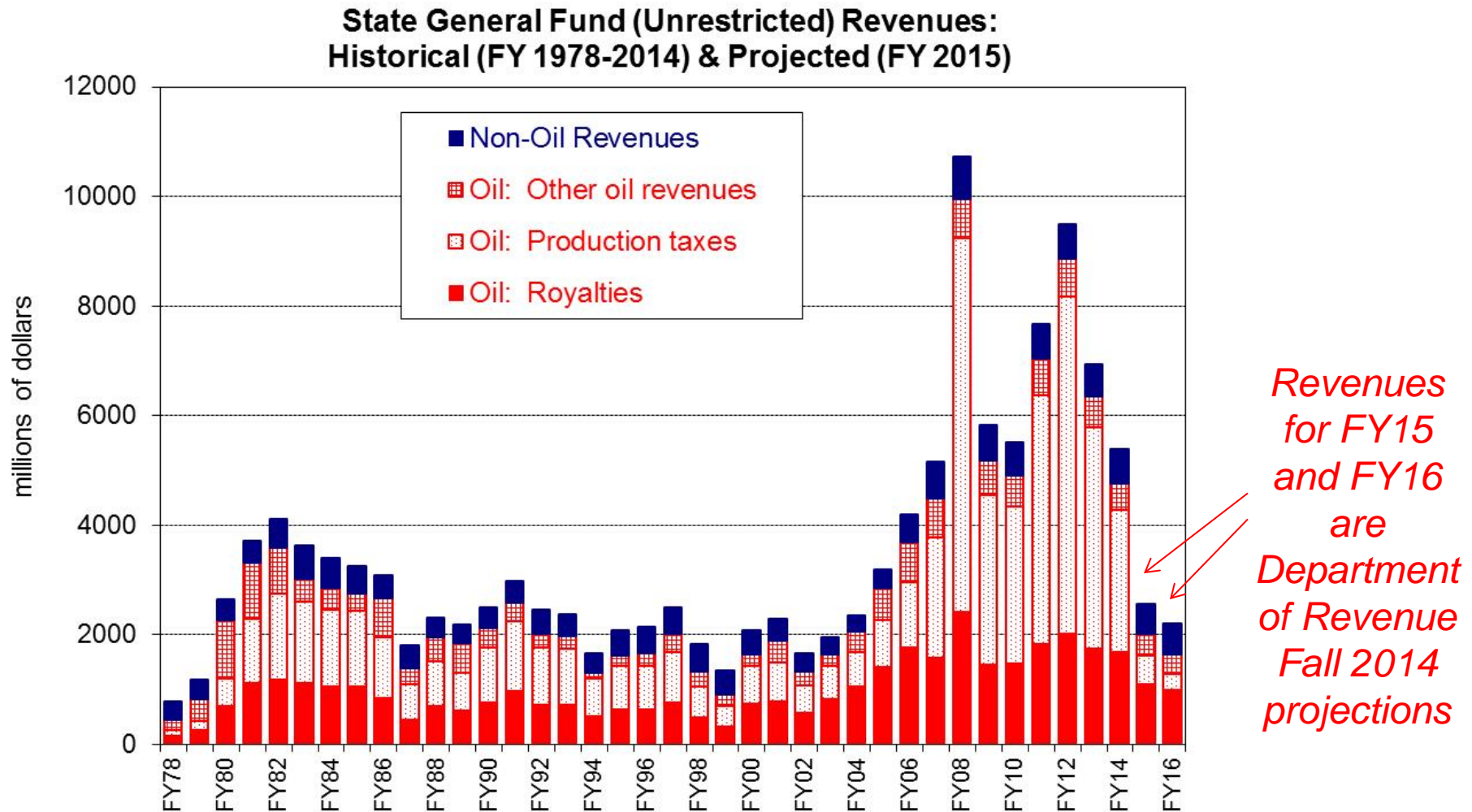


To really understand what has caused the changes over time in our oil revenues, and in particular why our revenues are down so much in FY15, you need to look at the details of our different kinds of oil revenues, and what they are based on.

In particular, you need to look at:

Oil royalties
Oil production taxes

Alaska collects several different kinds of oil revenues. The most important are royalties and production taxes. Other oil revenues include oil property taxes and corporate income taxes. They represent an important but smaller source of income.



Oil royalties . . .

- Oil royalties are not taxes.
- They are payments oil companies make to the state for oil leases.
- We can't change how oil royalties are calculated.
 - They were set by the lease contracts we made with the oil companies.
- For most oil leases royalties are calculated as:

12.5% of the “wellhead value” of the oil production from the lease.

The “wellhead value” used to calculate royalties is the estimated value of the oil at the “wellhead” (on the North Slope).

Estimated wellhead value =

Market value of the oil on the west coast
(where most of it is sold)

minus

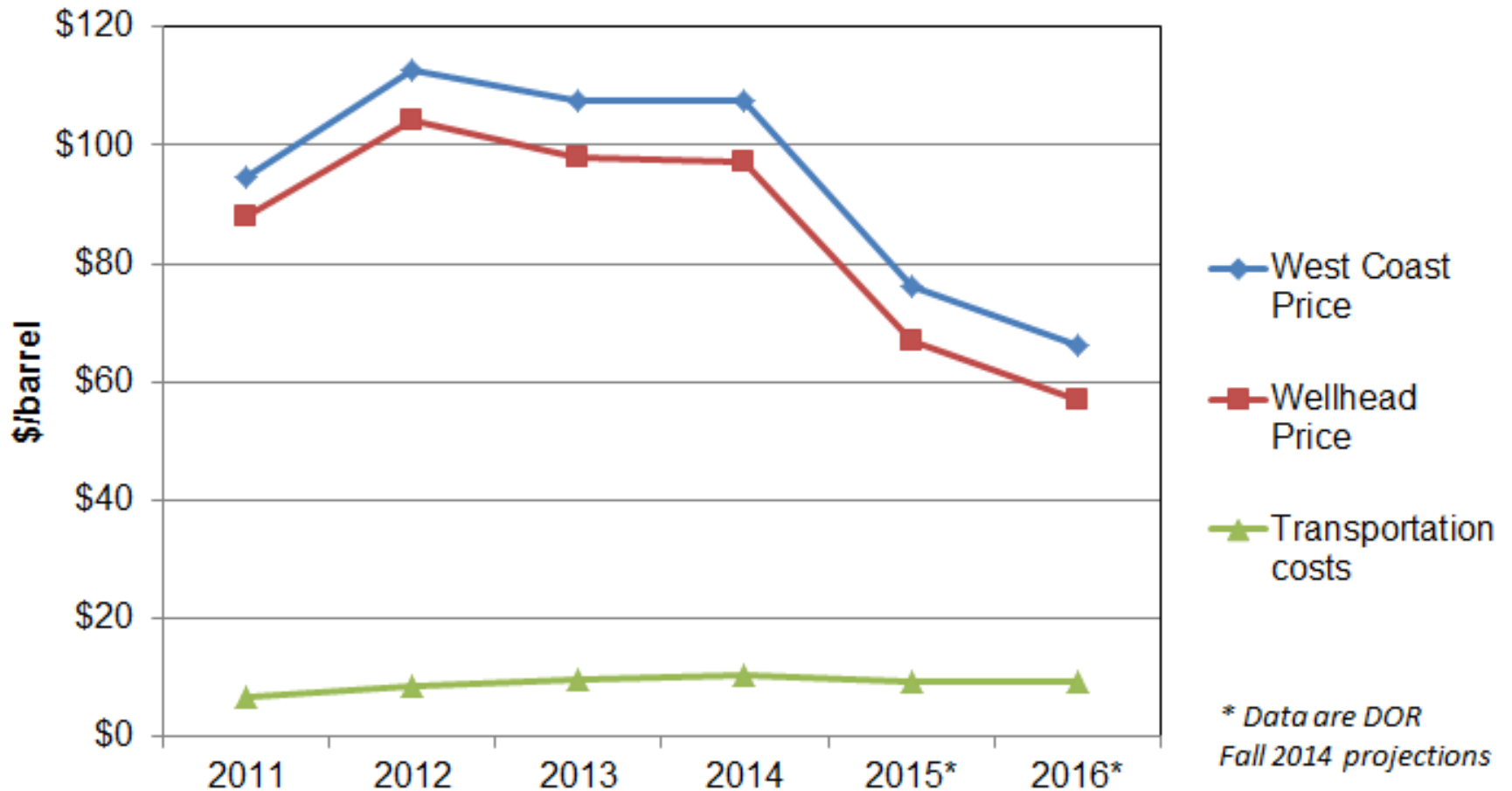
Cost of transporting the oil
from the North Slope to the west coast
by pipeline and tankers

Oil royalties . . .

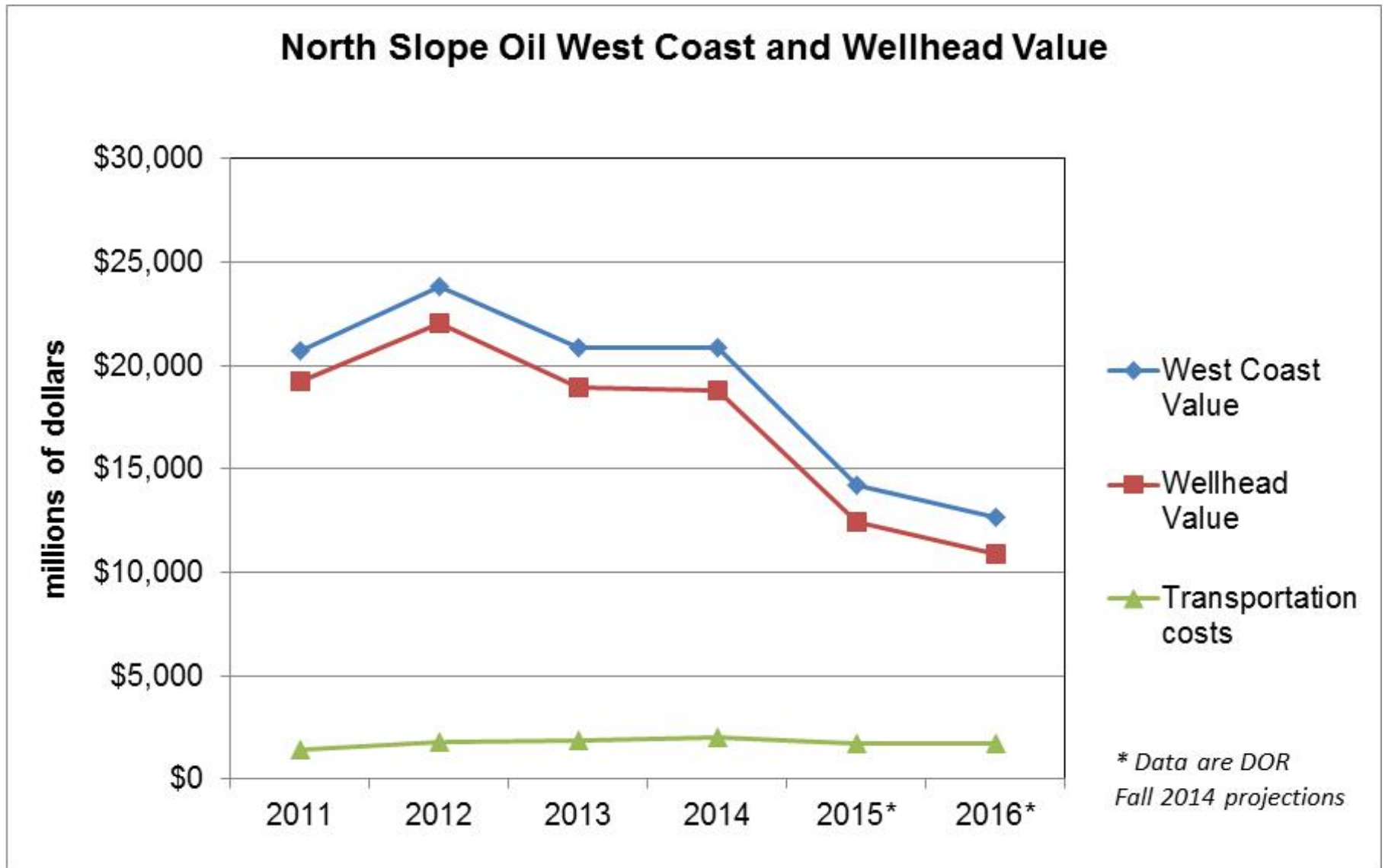
- Because transportation costs affect the wellhead value and oil royalties there has been a lot of debate and legal cases about how transportation costs are estimated.
- Under the constitution, 25% of oil royalties must be deposited into the Permanent Fund.
 - So only 75% of oil royalties are unrestricted general fund revenues

Actual and Projected Wellhead Prices, FY11-FY16

North Slope Oil West Coast and Wellhead Prices

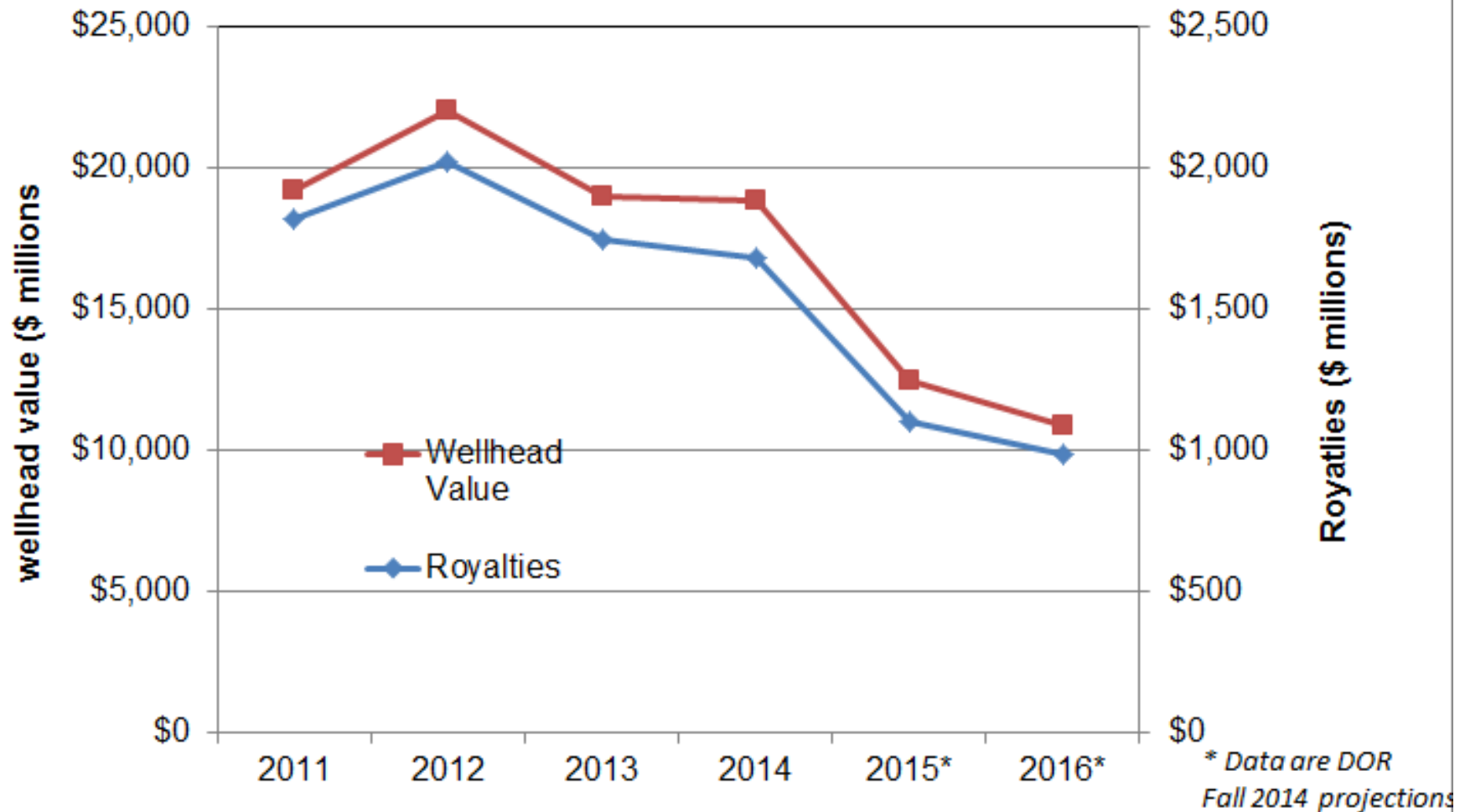


Actual and Projected Wellhead Value, FY11-FY16



As oil prices have fallen,
royalties have declined proportionally to wellhead value

Wellhead Value and Unrestricted General Fund Royalties



Production taxes are taxes the state collects from oil companies, over and above royalty payments.

Unlike royalties, production taxes can be changed.

Alaska has made several significant changes to oil production taxes since North Slope oil production began.

Alaska Petroleum Tax Regimes Since 1977

Acronym	Name	Years in effect
ELF	Economic Limit Factor <i>(several different versions; was changed several times)</i>	1977-2006
PPT	Petroleum Profits Tax	2006-2007
ACES	“Alaska’s Clear and Equitable Share”	2007-2013
MAPA	“More Alaska Production Act” (SB21)	2014

Last year we had a major debate about whether to keep SB21 or to go back to the earlier ACES tax.

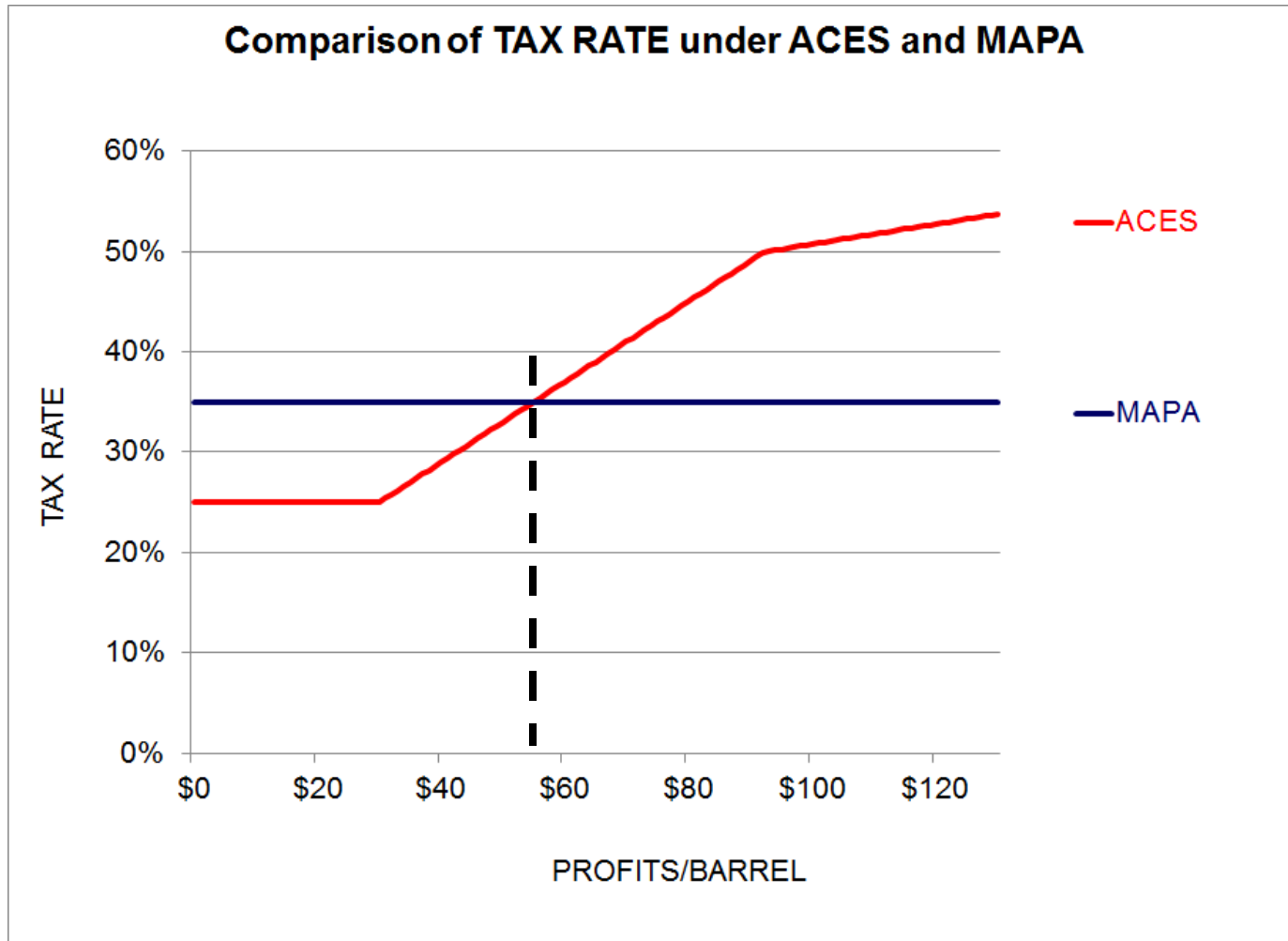
We ended up voting to keep SB21.

SB21—like the earlier ACES and PPT laws—taxes oil production based on companies net profits.

This is an important difference between royalties and production taxes!

- Royalties are calculated based on the wellhead value
- Production taxes are calculated based on companies' net profits, or production tax value (PTV) after subtracting deductible costs from wellhead value, including:
 - Capital costs of oil production (CAPEX)
 - Operating costs of production (OPEX)

ACES had a progressive tax rate which increased as profits increased
SB 21 has a flat tax rate of 35% of production tax value

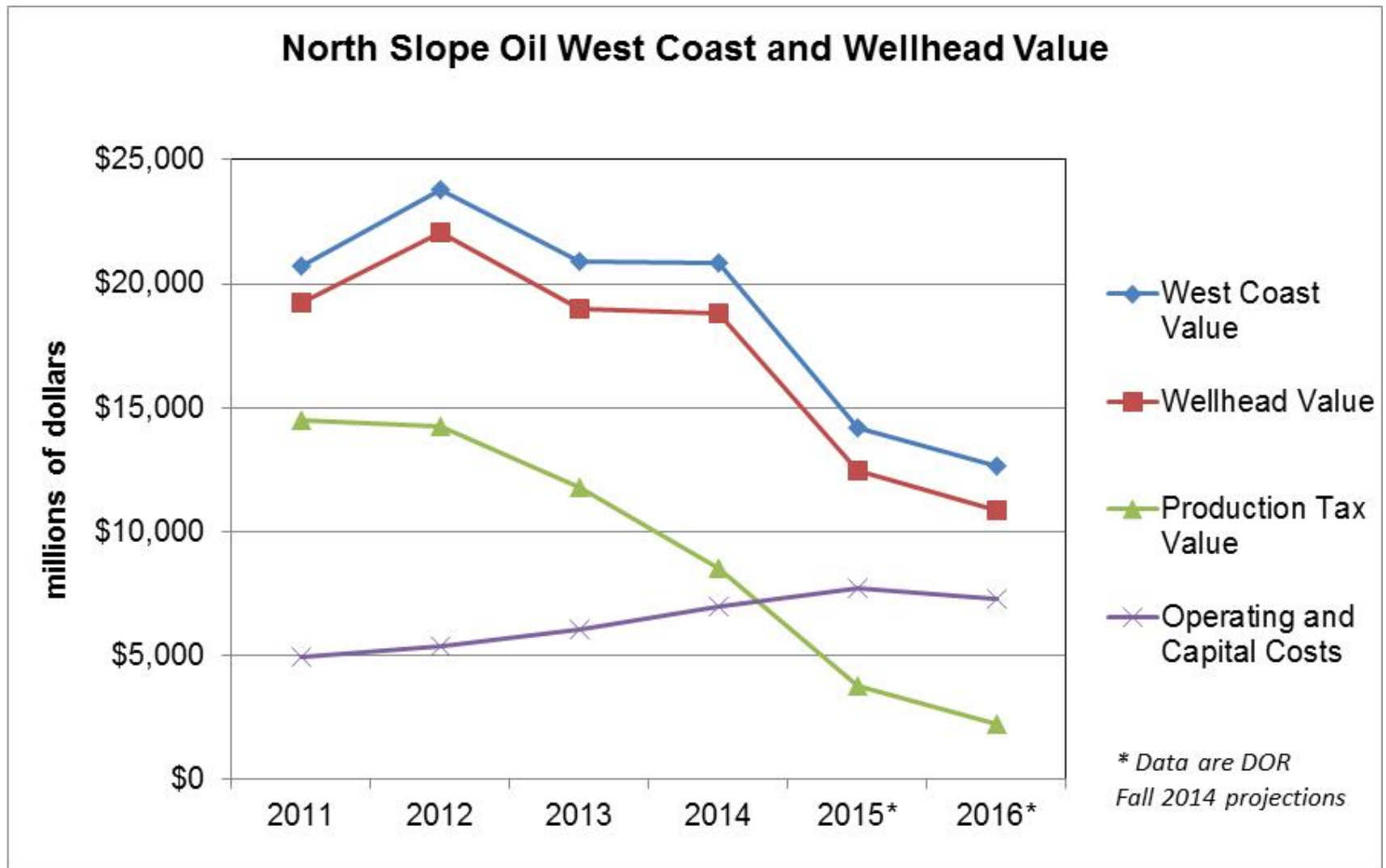


Source for graph: Gunnar Knapp calculations based on the tax formulas.

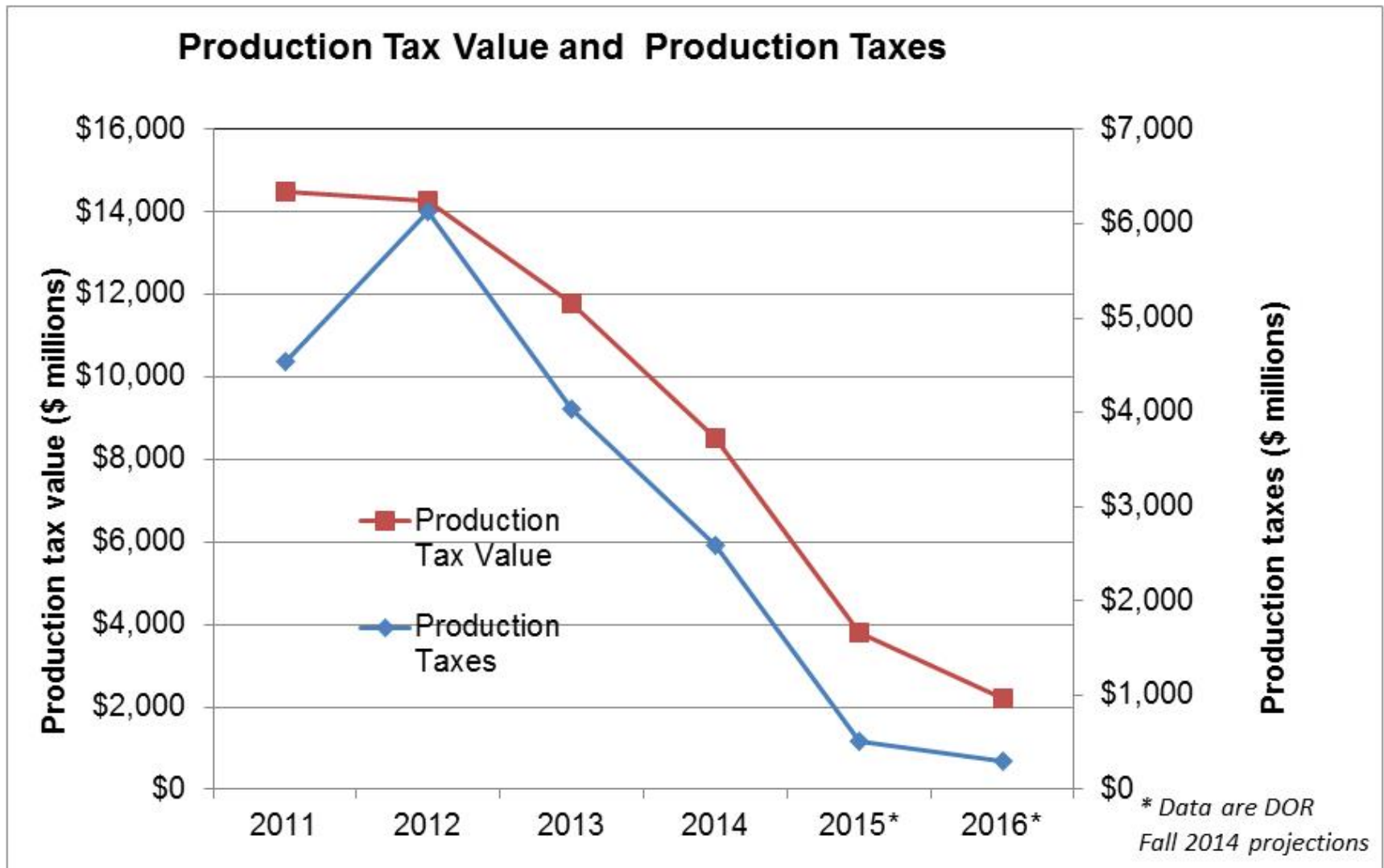
The SB21 and ACES laws also differed in other important ways

- Credits producers could receive as incentives for new investments or production
- Special treatment for production from some fields
- Minimum tax provisions if oil prices were low

Since 2012, operating and capital costs (as reported to DOR by producers) have risen significantly—while the wellhead value has fallen. This has led to a drastic decline in production tax value!



The drastic decline in production tax value was the main factor contributing to a drastic decline in production taxes.

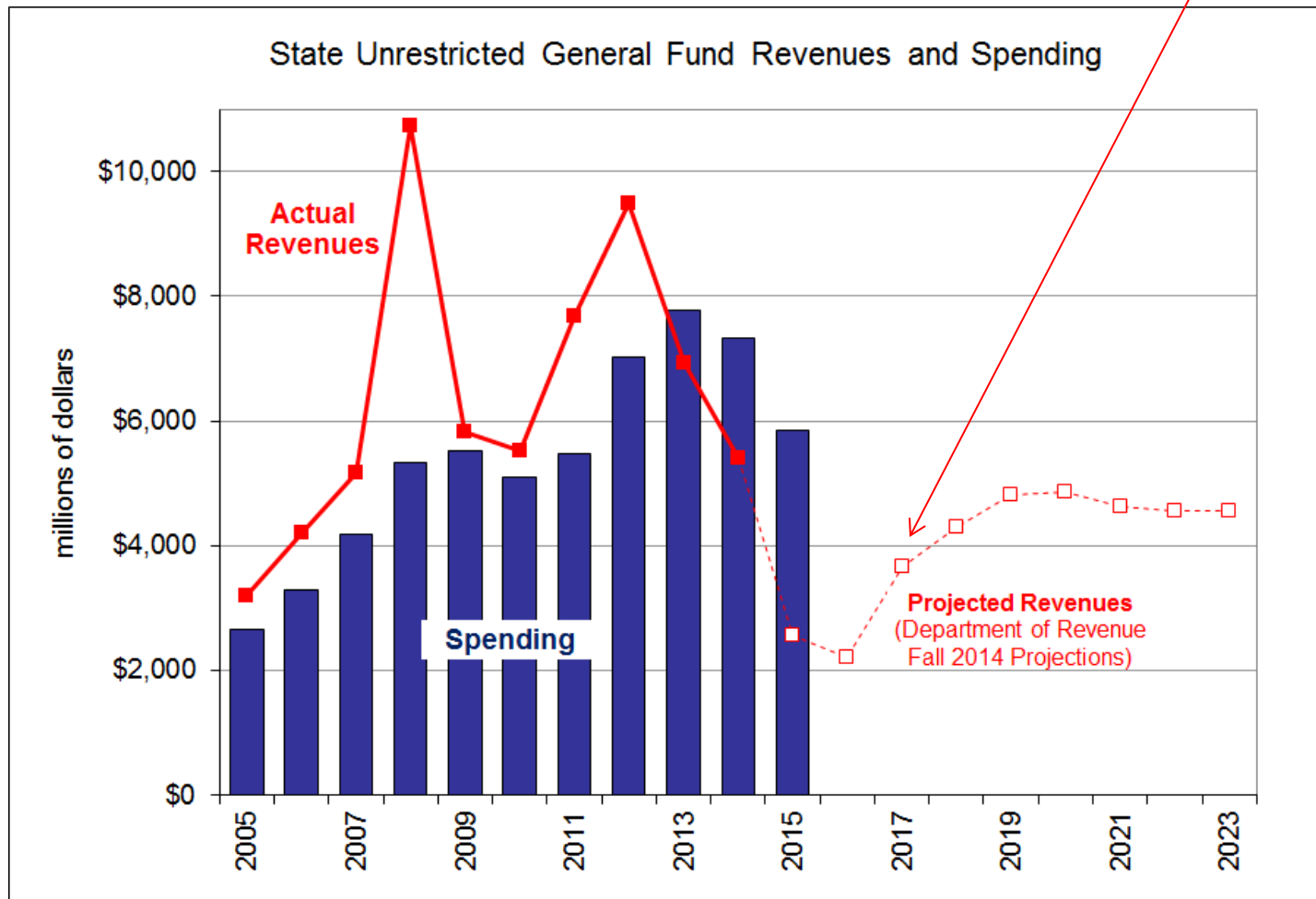


Other factors also played a role in the decline in production taxes

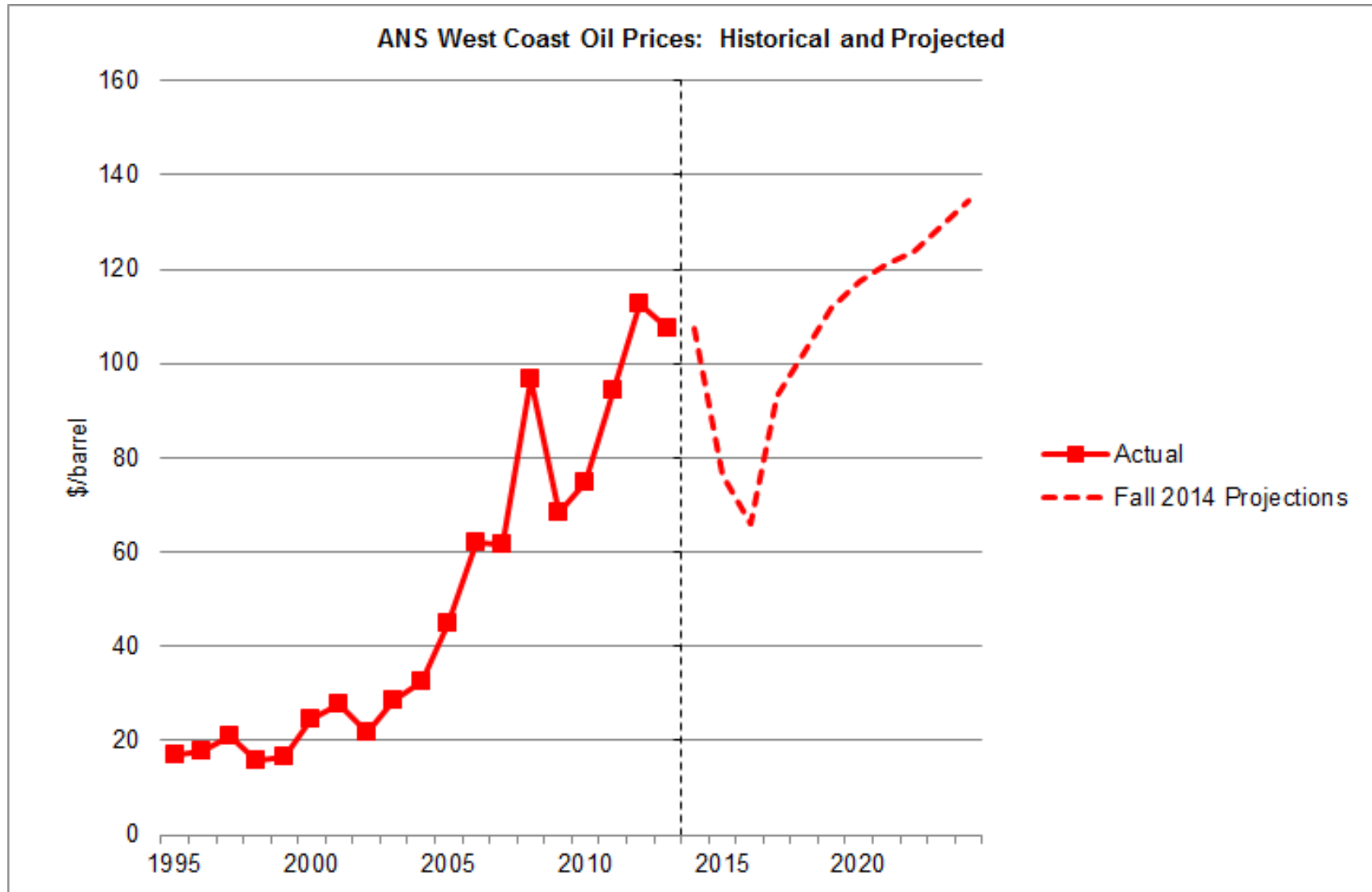
- A lower tax rate
- Increased tax credits
- But the change from ACES to SB21 is not the main reason our projected oil revenues have fallen so dramatically.
 - The main reason was the fall in production tax value
 - At the current very low oil prices, SB21 was not a “tax cut.”
- Regardless of whether you love or hate SB21, it is our current oil tax law and what drives what our current oil production tax revenues

The Department of Revenue projects that oil revenues and unrestricted general fund revenues will rebound significantly beginning in FY17.

What are these projections based on?
How reliable are they?



The most important factor in the Department of Revenue's projections for future oil revenues are their assumptions for future oil prices



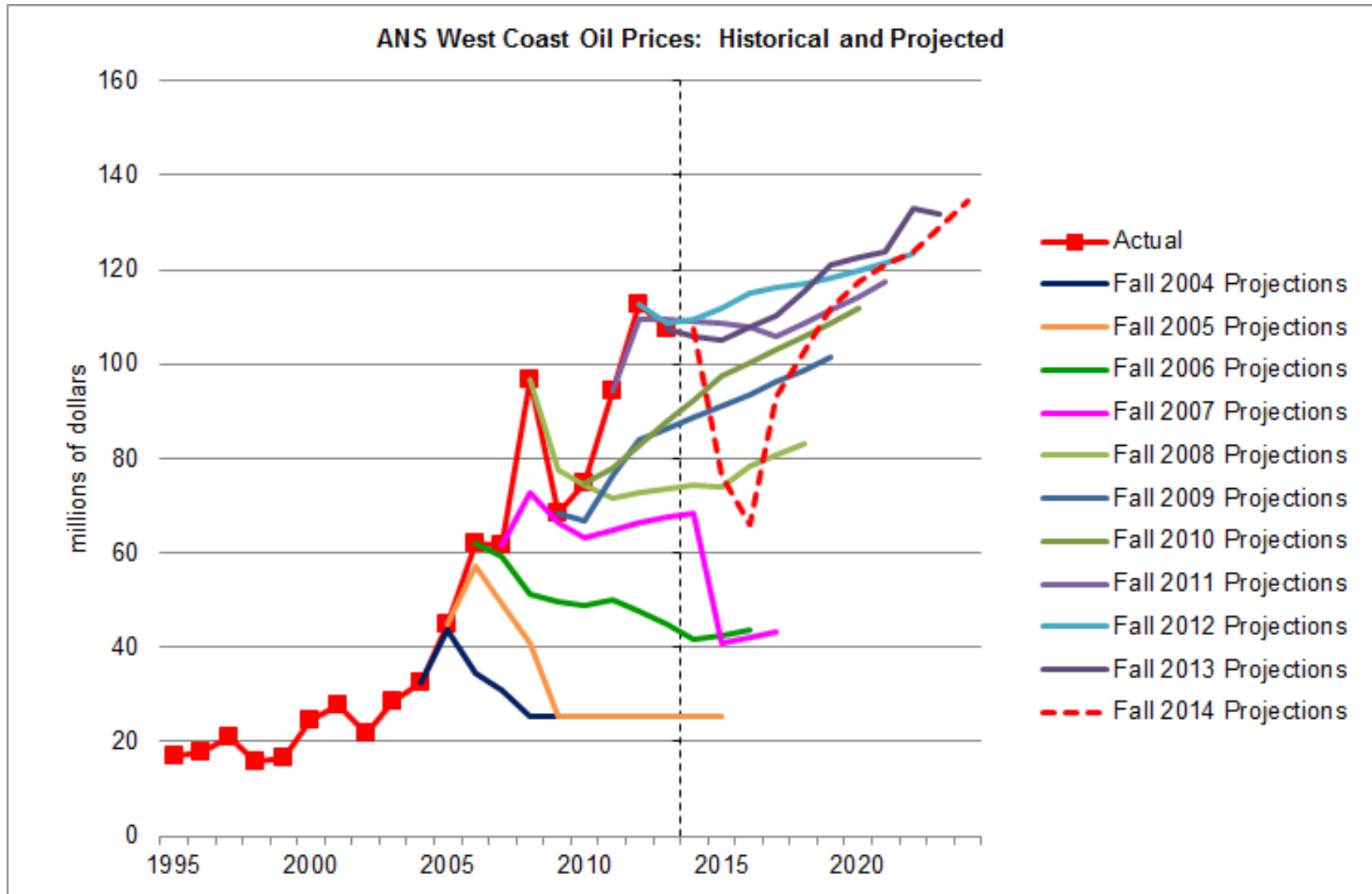
But predicting future oil prices is extremely difficult!

- Most “experts” think that:
 - Oil prices fell because world oil production has grown so rapidly that supply now exceeds demand
 - Unlike in the past, Saudi Arabia is no longer willing to reduce its production to keep oil prices high
 - Slowing world economic growth could make things worse by reducing demand
 - Oil prices won’t rebound until higher-cost producers reduce production because it isn’t profitable enough to reduce the excess supply that has dragged prices down
- But none of these “experts” predicted that oil prices would fall so dramatically this year!
- No one knows for sure what will happen with oil prices in the future!
- The Department of Revenue doesn’t know either
 - Their price assumptions might be right—or they might be wrong

The Department of Revenue has never been able to accurately predict future oil revenues.

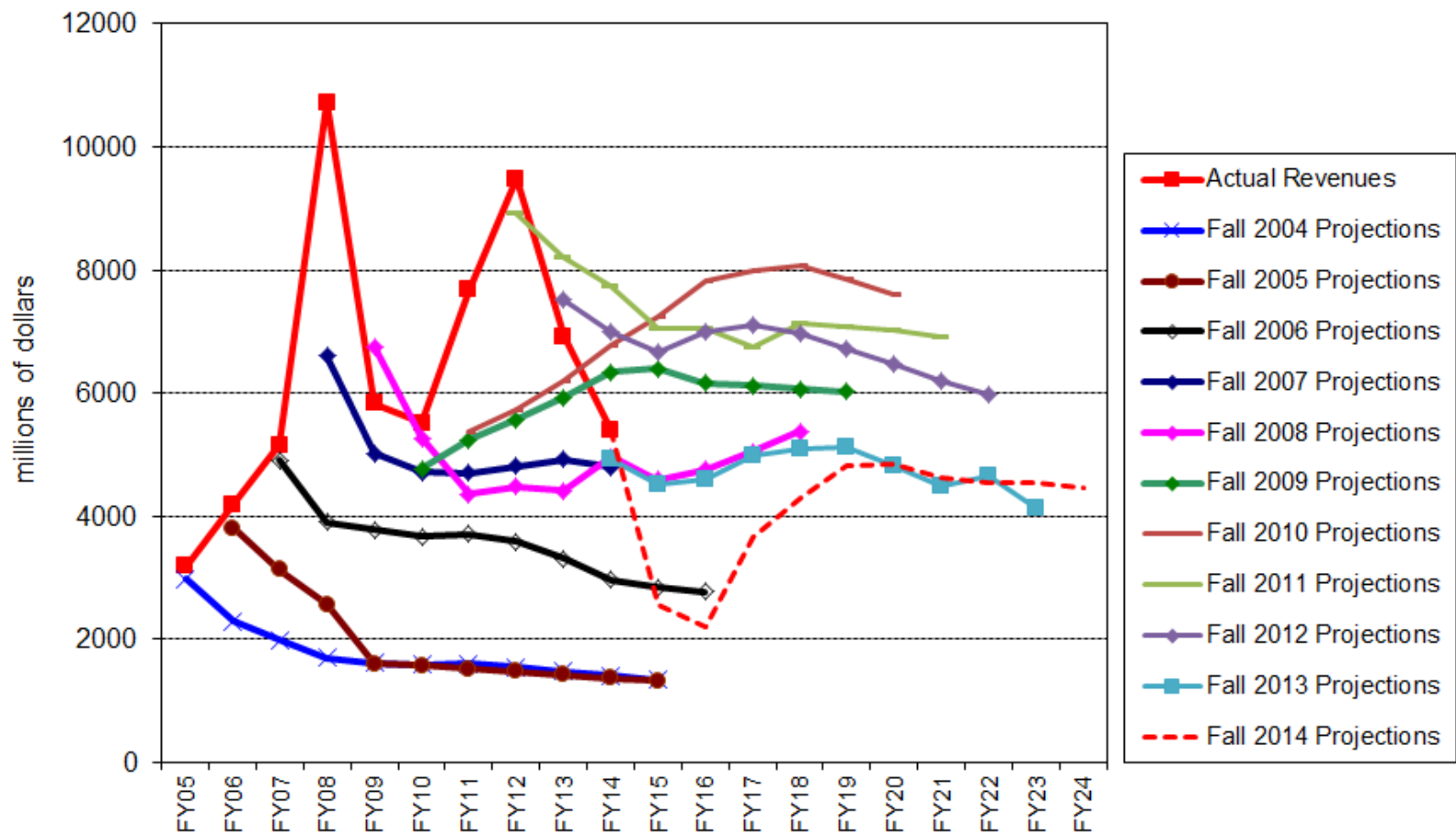
This is not intended as a criticism!

The reality is that it is impossible to accurately predict future oil revenues.

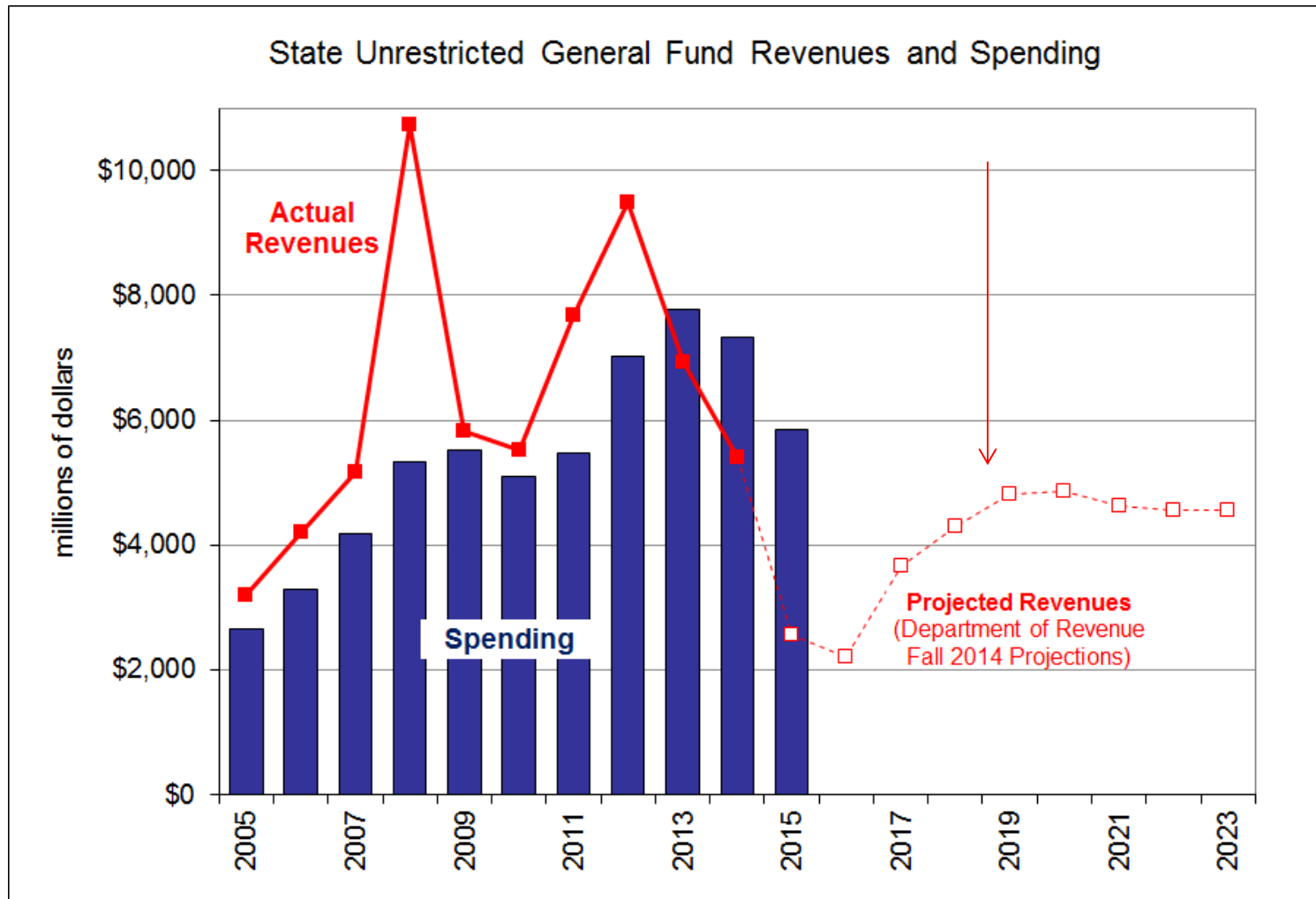


Mostly because they have not been able to accurately predict future prices, the Department of Revenue has also not been able to accurately predict future revenues

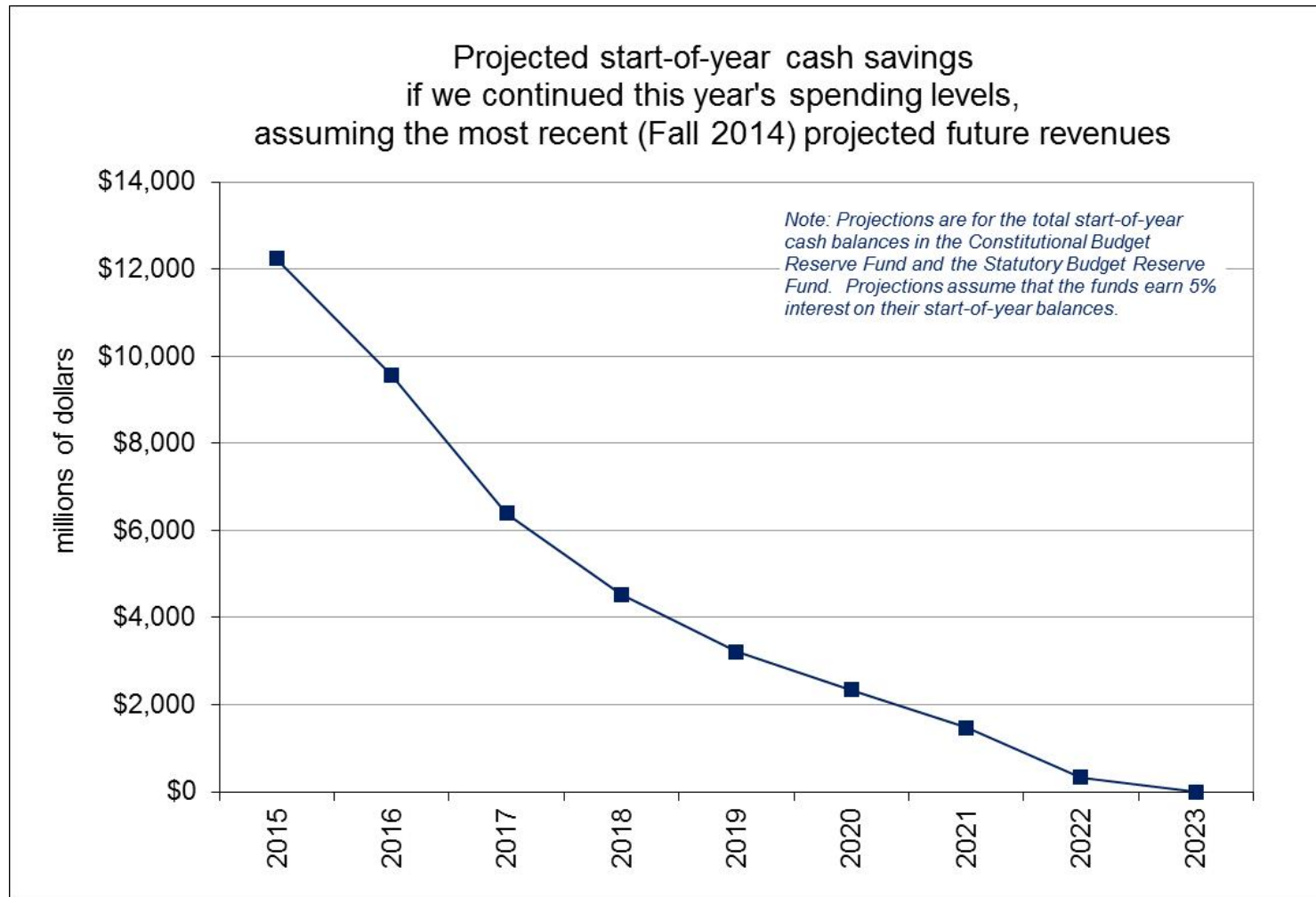
**State General Fund (Unrestricted) Revenues:
Alaska Department of Revenue 10-Year Projections**



We cannot assume that the Department of Revenue's projections of future revenues will be correct!
History suggests they almost certainly will not be correct.
Future revenues could be significantly higher—or lower!—than these projections.



We cannot assume that projections of when we might deplete our cash savings—based on projections of future oil revenues—will be correct. If we continued this year's spending levels, we might deplete our savings much later—or sooner!—than 2023.



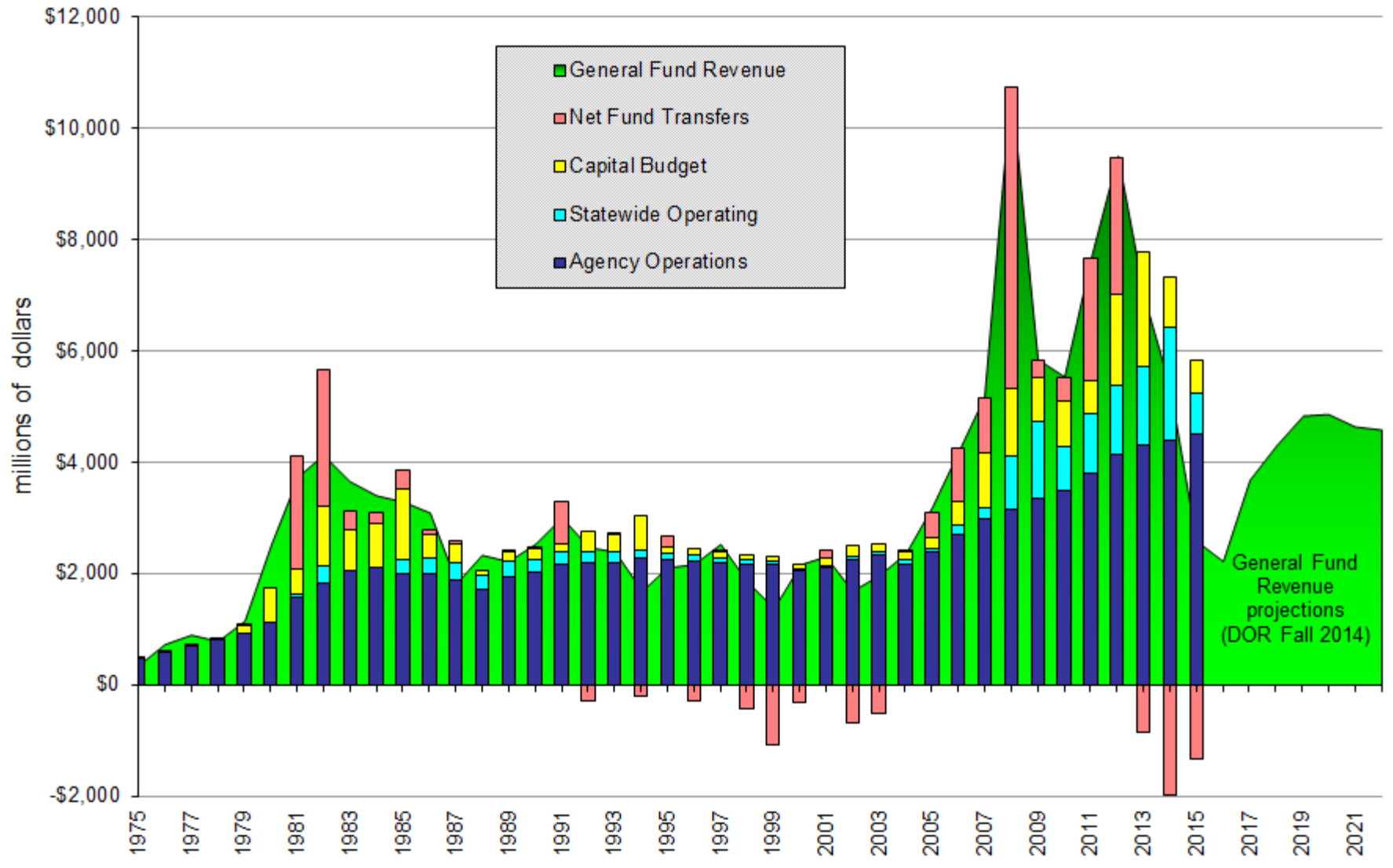
State spending

State unrestricted general fund spending includes operating spending and capital spending.

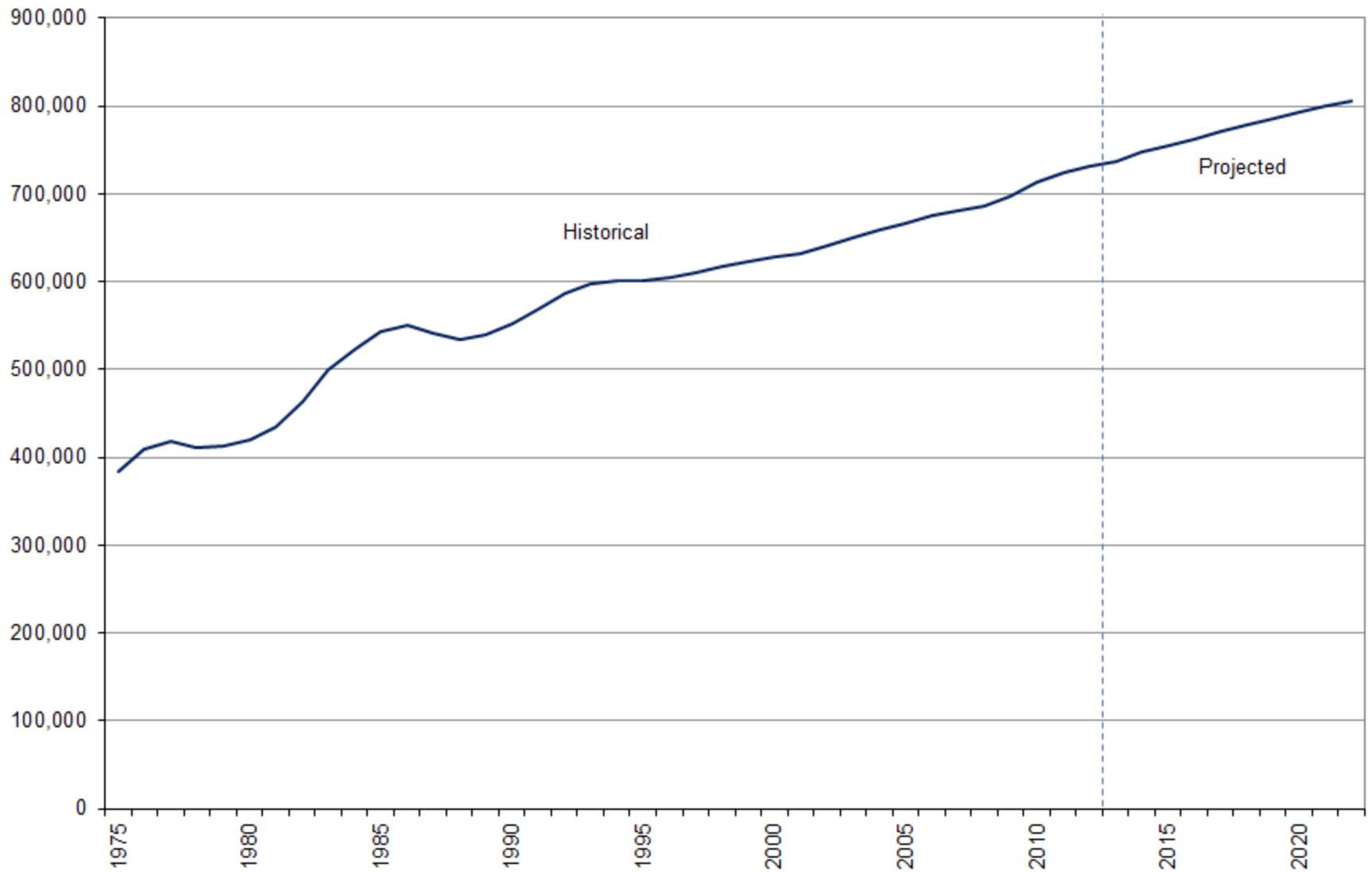
Operating spending includes agency operations and statewide operations.

Budget category	FY 2015 budget	Pays for
OPERATING	\$5,244.5 million	
Agency operations	\$4,512.9 million	Budgets of state government departments (Education, Fish & Game, etc.)
Statewide operations	\$731.6 million	Payments not attributable to specific departments (debt service, retirement fund payments, etc.)
CAPITAL	\$594.9 million	Capital projects (buildings, roads, etc.)
TOTAL	\$5,839.4 million	

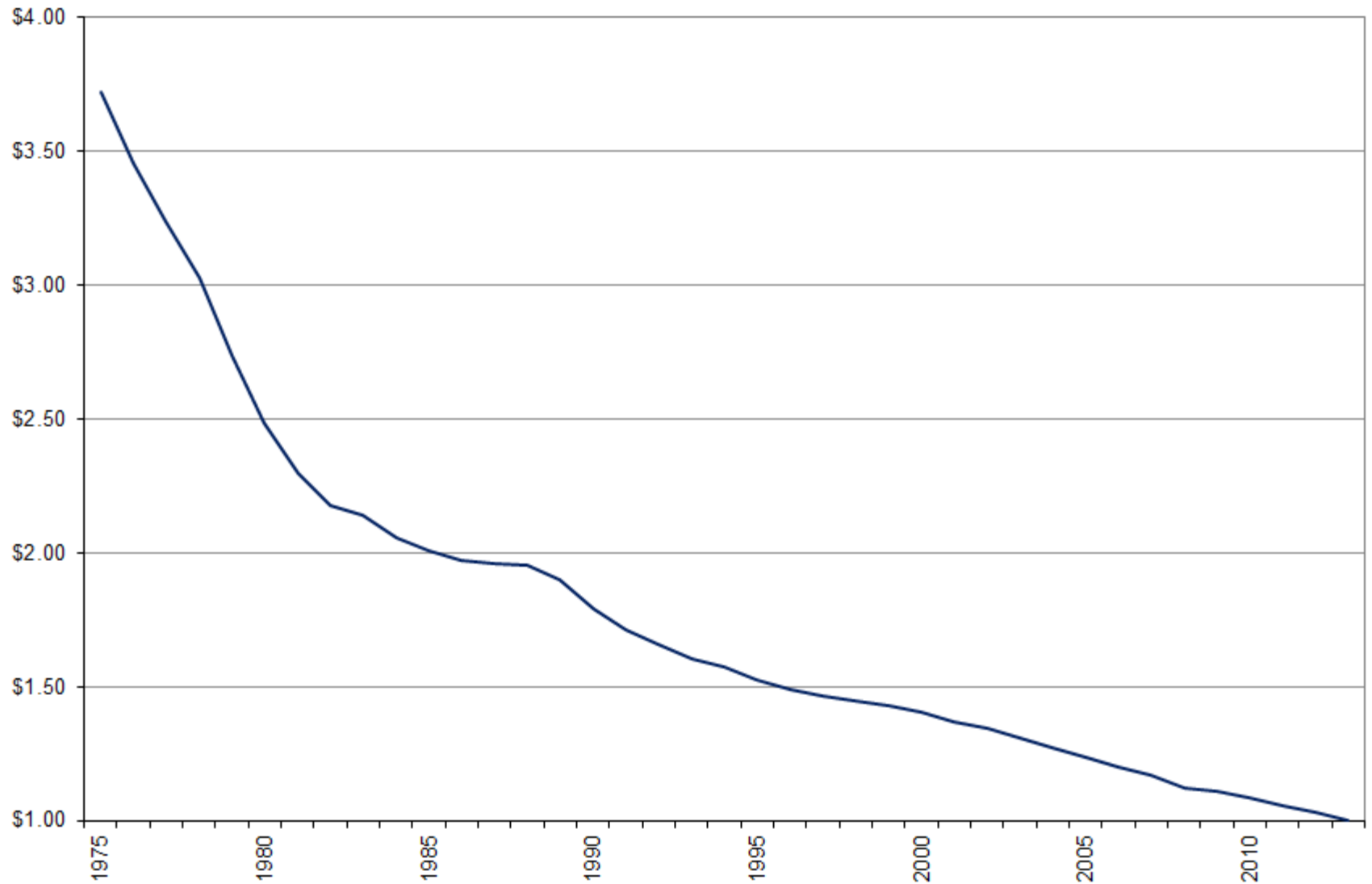
Unrestricted General Fund Revenues and Budget History



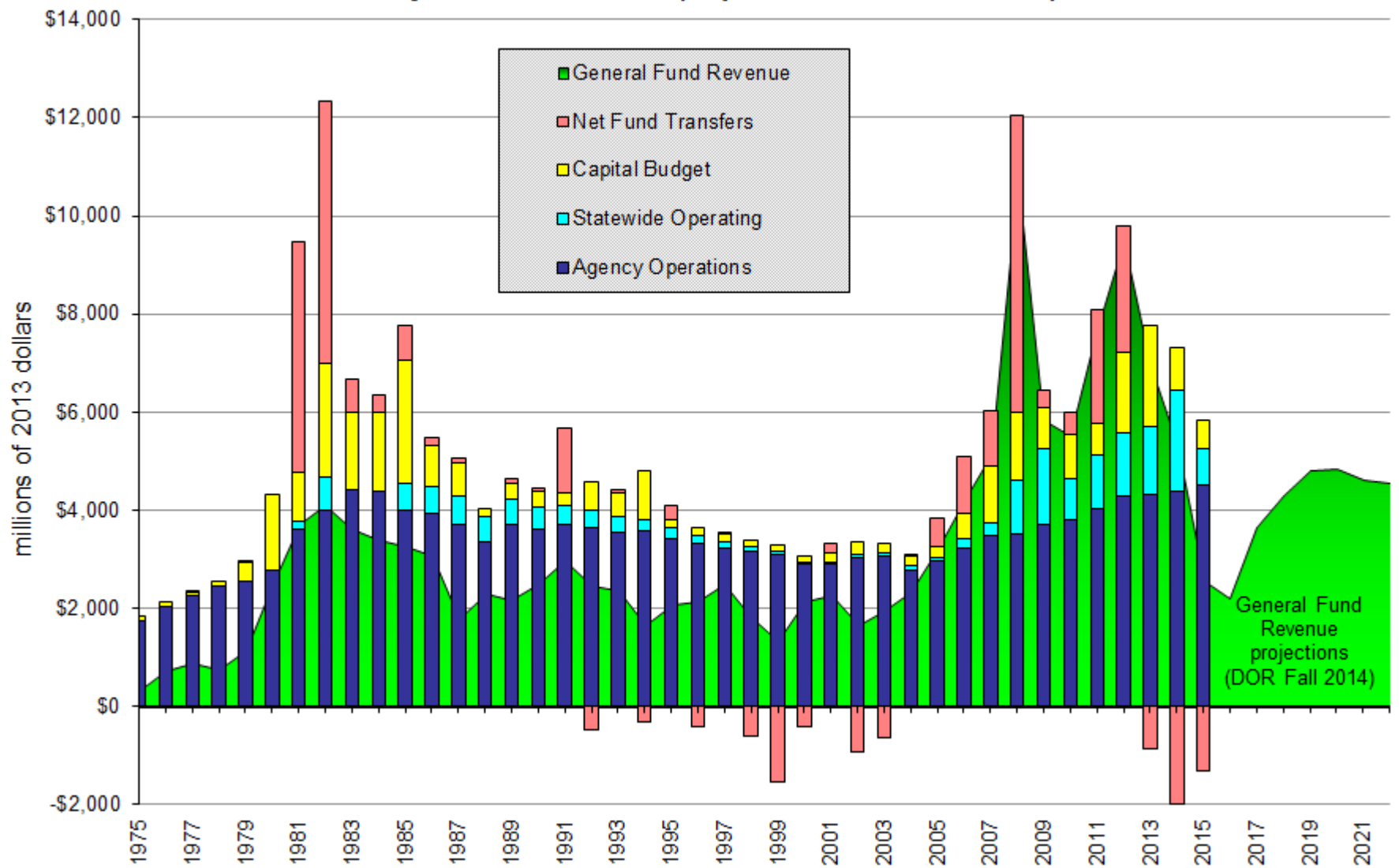
Alaska Population: Historical and Projected



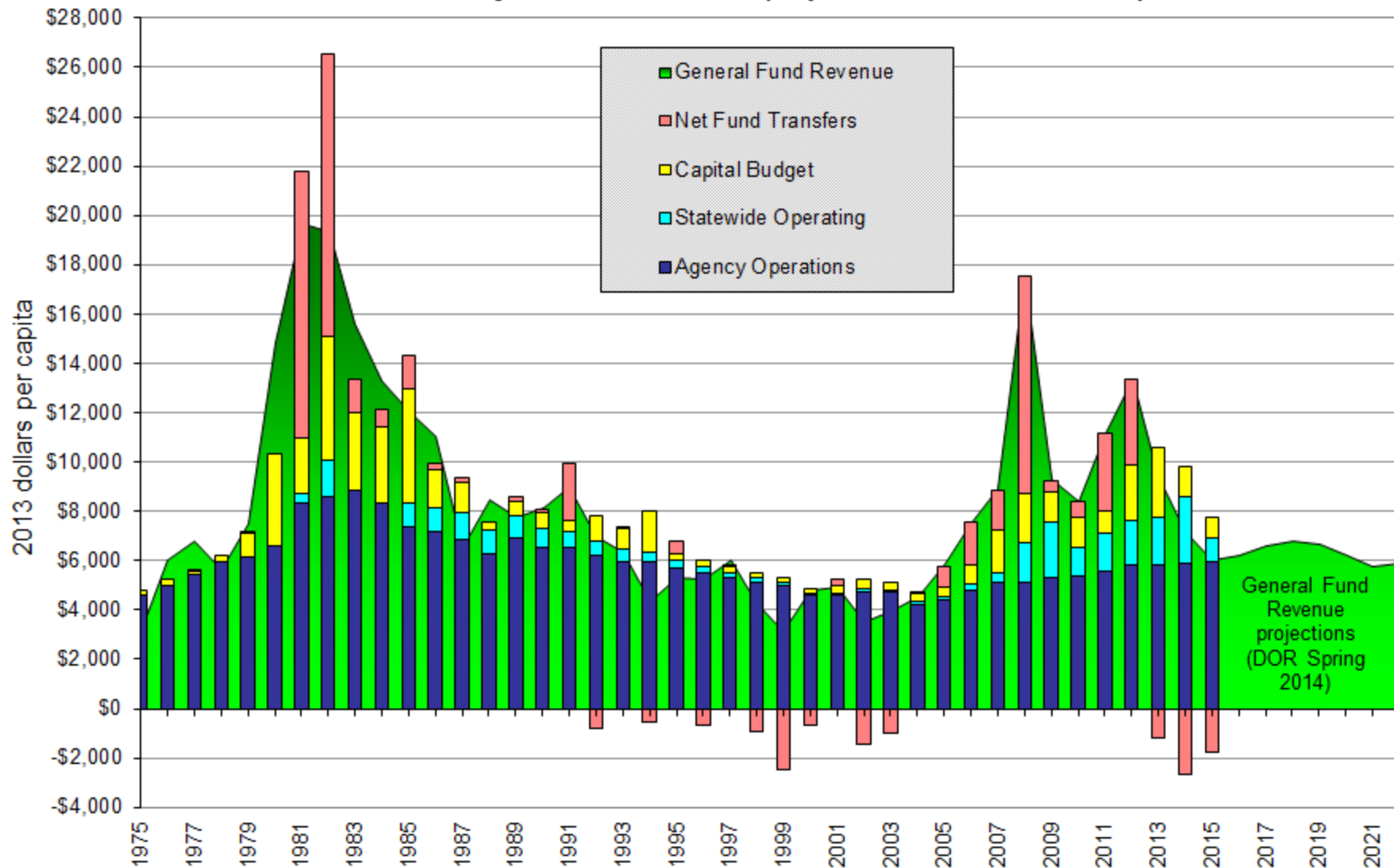
**Alaska Inflation 1975-2013:
Value of One Historical Dollar in 2013 Dollars**



Unrestricted General Fund Revenues and Budget History adjusted for inflation (expressed in 2013 dollars)



Per Capita Unrestricted General Fund Revenues and Budget History adjusted for inflation (expressed in 2013 dollars)



Alaska's fiscal challenge

Alaska's fiscal challenge

Unless we are very lucky and
oil prices rise dramatically and unexpectedly . . .

- We will not be able to continue for more than a few more years with “business as usual” revenues and spending”
 - Depending on the same sources of revenues
 - Spending money in the same ways
- With “business as usual” revenues and spending we would
 - Deplete our savings within a few years
 - Be forced (by lack of money) to either:
 - Cut spending
 - Raise new revenues
 - Use other funds
 - This could happen by when today's first-graders are eighth-graders—or possibly much sooner

We could continue with “business as usual” for a few more years. But there are arguments for acting immediately to address our fiscal challenge.

- If we spend our savings now we (and our children) may wish that we hadn’t when we need them even more in the future
- Our cash savings earn interest (more than \$1 billion in FY14). The more we draw down our savings, the less interest we will earn in the future.
- Our credit rating and costs of borrowing are affected by whether rating agencies think we have our finances under control.
- Business confidence and willingness to invest is affected by whether businesses think we have our finances under control

We are now beginning a major and critical debate about how—and how quickly—we should address our fiscal challenge

- Our options include:
 - Cut spending
 - Raise new revenues
 - Use other funds
- None of these options are popular
- It would be very difficult to fully address the challenge through any one option
 - Our FY15 deficit is \$4500 per Alaskan

In addition to our fiscal challenge, we also face other challenges

- Economic challenge: How to develop the economy and create jobs and income for Alaskans
- Social challenge: How to improve the lives of Alaskans

The fiscal, economic and social challenges are inter-related

- If we cut spending too much or raises taxes too much it could
 - Harm our economy
 - Harm services which matter to Alaskans
 - Education, public safety, etc.
- Solutions to our economic and social challenges are not necessarily solutions to our fiscal challenges
 - They are only solutions if they add to state revenues or reduce state costs
 - Growing our economy and population could increase state revenues
 - It could also increase state government costs