

LESSONS LEARNED FROM ALASKA'S OVERDEPENDENCE ON OIL REVENUES

Duke University Energy Initiative workshop – Aug. 31, 2015

Larry Persily, former Federal Coordinator for Alaska North Slope Natural Gas Projects

Reliance on oil started early

2

- Statehood 1959; Prudhoe Bay discovery 1968
- But pipeline delays lead to state cash-flow squeeze
- Oil companies prepaid taxes in 1975 to help out
- Oil pipeline started in 1977, and the money flowed
- Voters created Permanent Fund 1976 to save some
- Legislature in 1980 abolished personal income tax and also eliminated the business gross receipts tax

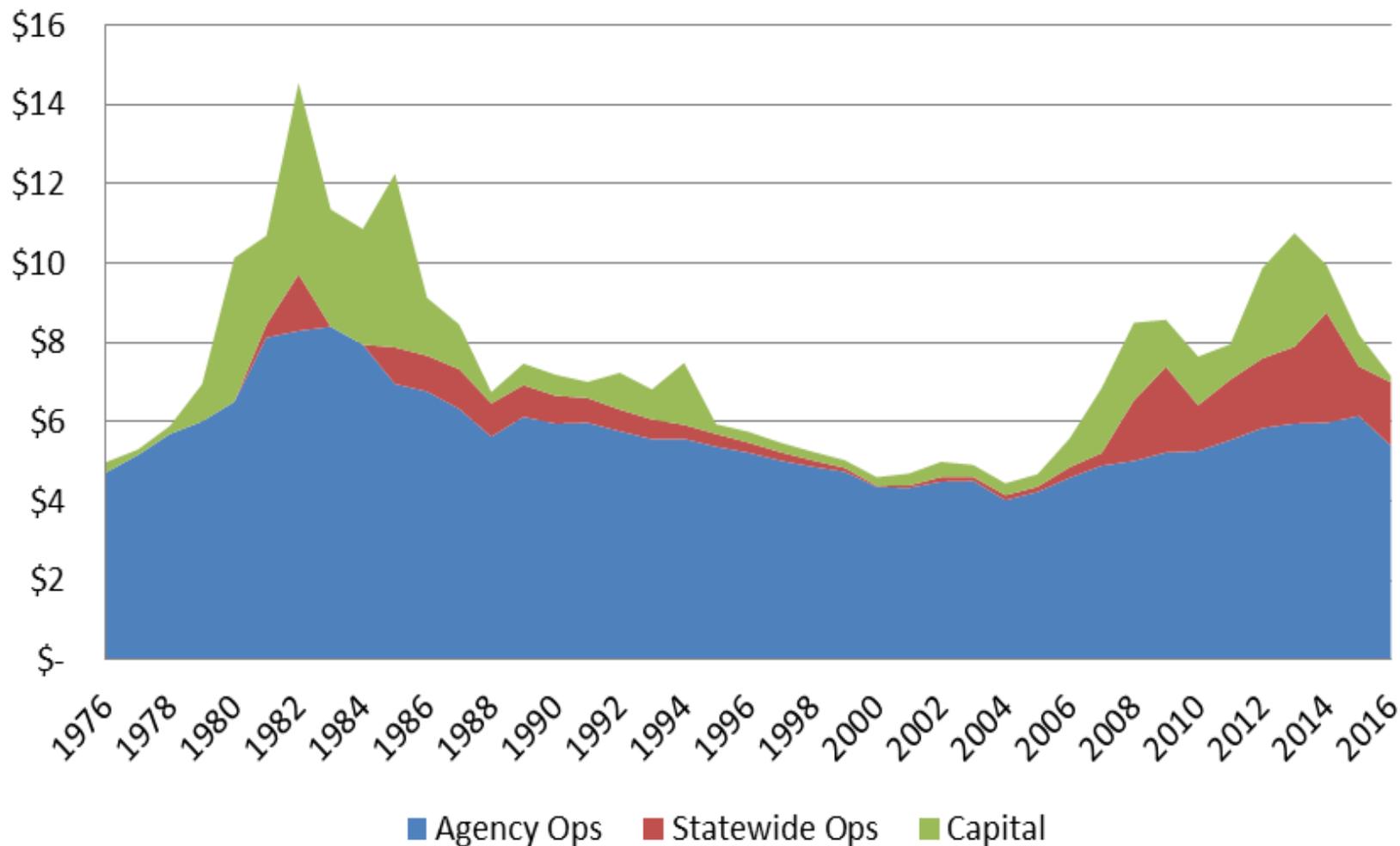
Spending grew to match revenues

3

- Between 1965 and 1985, population doubled as state spending per capita increased eight-fold
- State budget \$6 billion FY16 for 735,000 residents
- The good years saw \$1-billion-plus capital budgets
- Mistakes along the way: Hundreds of millions lost on grain terminal, seafood plant, petrochemical plant, massive hydro dam, barley farming project
- Oil and gas pays for one-third of jobs in Alaska

Real State Budget

Adjusted for Population, In Thousands



Share-the-wealth program

5

- State saves 25% of its oil and gas royalties
- Permanent Fund invests in stocks, bonds, real estate
- About half the earnings are paid to Alaskans
- Annual checks have totaled \$22 billion since 1982
- Almost \$39,000 if you received every dividend
- Legislature approved a \$1,200 bonus in 2008
- Dividends have become essential part of economy

Alaska's overdependence

6

- ❑ Oil and gas revenues provide 90% of state dollars
- ❑ Next largest: smokers, drinkers, insurance premiums
- ❑ Motor fuel taxes lowest in nation; same 8¢ as 1961
- ❑ No state sales tax or personal income tax
- ❑ Oil-wealth Permanent Fund only used for dividends
- ❑ Declining oil production, low prices = budget crisis
- ❑ Local governments hit hardest by state budget cuts

Oil tax battles divide state

7

- North Slope oil production one-quarter of peak
- Best the state can hope for is to stem the decline
- Meanwhile, the state is 'spending' \$1 billion a year in tax credits to encourage oil and gas exploration
- State cut oil taxes 2013; initiative failed to overturn
- Oil tax political battles are monumental in Alaska
- Many Alaskans feel cheated on oil tax revenues because although we got rich — Big Oil got richer

Panic in the Far North

8

- A \$3-billion-plus gap in \$6 billion state budget
- Reserves amassed during oil-price spike are filling that gap, but state could drain reserves in two years
- Legally, morally impossible to cut state budget 50%
- Businesses worry spending cuts could harm economy
- Local governments fear for their own budgets
- After two generations of tax-free living, Alaskans talking taxes and using Permanent Fund earnings

S&P tells the truth

- Ratings agency lowers state to negative outlook
- S&P's stern warning: "The magnitude of the fiscal deficits makes the arrangement unsustainable."
- "By introducing a statewide income or sales tax ... the state could generate several hundred million in unrestricted revenue annually. ... In our view, therefore, the state has sufficient potential fiscal resources — **if it can assemble the political will** — to restore alignment in its ... main operating fund."

Costly fiscal lessons

10

- If it's free, no one asks how much it costs
- No one wins their election telling the public no
- Abolishing personal taxes removes any link between the public's appetite and fiscal restraint
- Municipalities, nonprofits over-reliant on state
- Beware the 'Alaska Disconnect' — without taxes to benefit from increased economic activity, more jobs and more residents are a financial burden on state