It’s Probably Worse than you Think

By Cliff Groh, Nov 4, 2019, Anchorage Press

Alaska’s fiscal outlook is bad due to factors such as drooping oil prices, long-falling Alaska oil production, and an absence of broad-based taxes. The non-partisan Alaska Legislative Finance Division projects that starting next year, the State faces annual deficits exceeding $1 billion under current law and the most likely assumptions.

But that gloomy scenario probably understates our fiscal squeeze. Numerous other factors either threaten future revenues or create pressures for spending to increase.

Let’s start by looking at some of those upward pressures on the budget: the unfunded liabilities of the state government’s pension systems; the capital budget; and refundable oil tax credits.

The State of Alaska is paying off the unfunded liabilities previously built up in the Public Employees’ Retirement System (PERS) and the Teachers’ Retirement System (TRS)

under an officially adopted payoff plan that runs at least until Fiscal 2039.
Actuaries project that the annual installments under that plan will increase
every year but one, and also project that those installments will total more
than $8 billion over the decades. Changing demographics and shifts in financial
markets, however, could increase that total price tag over the next two
decades.

The capital
budget was probably too large in some years of high oil revenues. That spending
for buildings and other infrastructure has fallen substantially in the last half-dozen
years, however, and this year it is less than $150 million in General Fund
spending. Experts see that number as too low. The Office of Management and
Budget estimated in 2018 that the State of Alaska has needs for deferred
maintenance totaling $1.87 billion. One observer's calculation is that the
annual capital budget should be at a minimum tripled to start catching up on
that backlog.

Then there's
refundable oil tax credits, an obligation which the Alaska Department of
Revenue estimated at $700 million in June of 2019. The State has proposed to
pay off the credits through a bond program now in litigation

while paying zero for the credits in the current year's budget. The obligation to pay the oil tax credits is much weaker legally than the obligation to pay in full the pension system benefits, which are explicitly protected in the Alaska Constitution.

Now let's turn to the revenue side of the equation. Climate change poses a systemic fiscal danger to our state.

The evidence of this global phenomenon is all around us. Humans are changing their behavior in reaction to the changing physical world. The use of electric cars may blow past gasoline-powered vehicles by 2040. Oil companies are changing their names to shed their oil-only images and are focusing increasingly on wind, solar, and other renewable sources. Carbon taxes are likely to further reduce the demand for oil worldwide. At least one major energy producer—Norway-based Elsinor (formerly Statoil)—has projected that oil demand could start to decline by 2030, as Alaska Public Media's Elizabeth Harball noted in 2018.

Climate change already appears to be reducing oil production from Alaska's North Slope, as long-time oil industry observer Tim Bradner has pointed out. The Arctic is warming at rates twice as fast as regions further south, and those higher temperatures thaw permafrost and reduce the efficiency of oil-producing facilities.

The climate change news will probably get substantially worse for Alaska. Energy companies recognize that there is a growing possibility that the warming planet will lead to significant amounts of oil now ticketed to be produced to end up in the ground unburned. Some of that oil stranded by climate change is likely to be on the North Slope, in part because that region is expensive to work in and high-cost provinces are most likely to be the home of stranded oil.

Over the next year—and over the next 10 years or so—the downside risks for Alaska on the fiscal front appear to exceed the upside potential. Alaskans should prepare accordingly.

Cliff Groh is an Anchorage lawyer and writer as well as the legislative assistant who worked the most on the bill in 1982 that created the Permanent Fund Dividend we have *today. He also designed a course he taught at the University of Alaska called “Navigating Alaska’s Fiscal and Economic Challenges.” This is the ninth installment of a continuing series on the Permanent Fund Dividend and Alaska’s fiscal system.*