Alaska’s Fiscal Challenge

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Alaska faces a fiscal challenge.

What is the challenge?

What are our options
for dealing with the challenge?

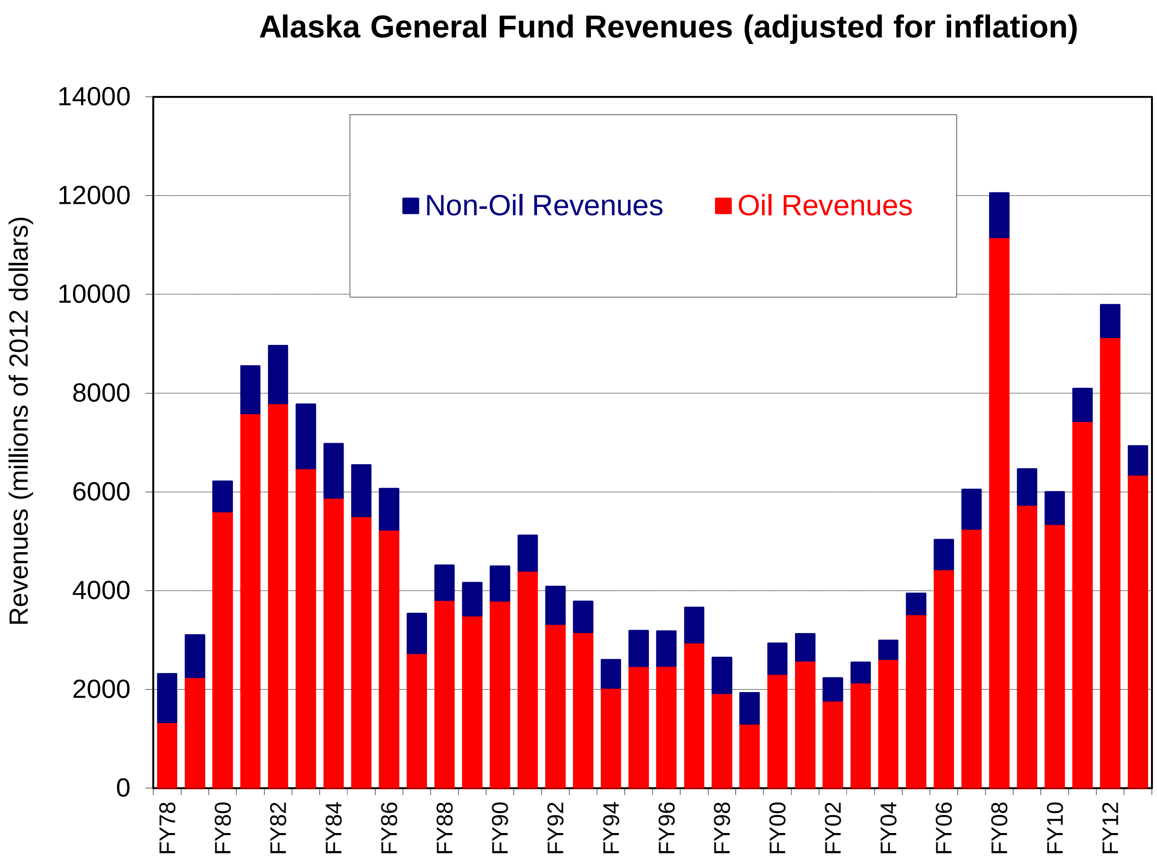
?????

Alaska's fiscal challenge

How will we balance uncertain but probably falling oil revenues with growing demands and obligations for state spending?

Oil revenues matter!

- Oil revenues account for about 90% of the state's unrestricted general fund revenues which pay for most state government services, capital projects, and debt and retirement obligations.



Our oil revenues are driven by . . .

- Oil production
- Oil production costs
- Oil prices

Our oil revenues will probably decline in the future, because

- Oil production will probably decline
- Costs of oil production will probably increase
- Oil prices probably won’t increase enough to offset lower production and higher costs

North Slope oil production will probably decline in the future

- Production from new fields hasn't been enough to offset the decline in production from existing fields
- Maybe new investment will stop or reverse that decline

  —but it looks more likely that production will fall

Figure 4-E: Alaska North Slope Production

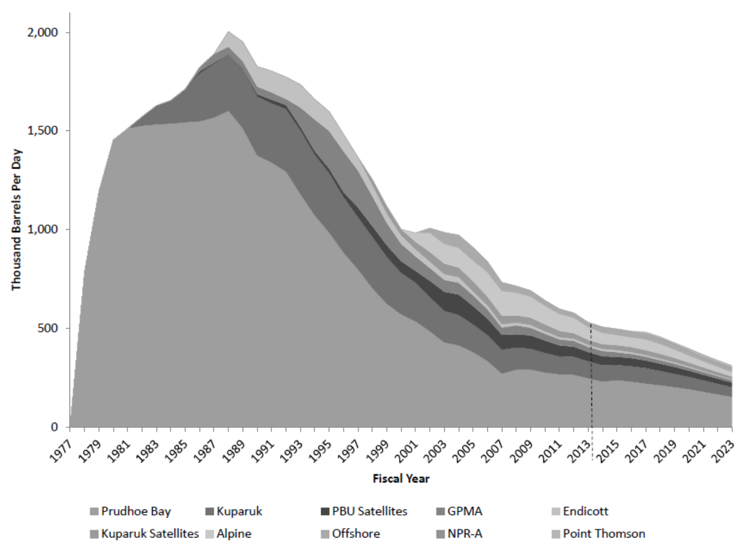
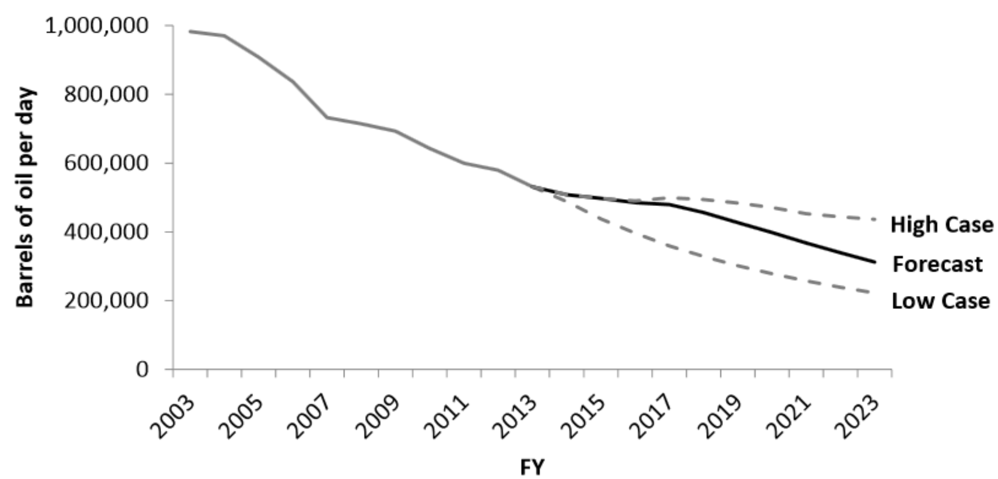


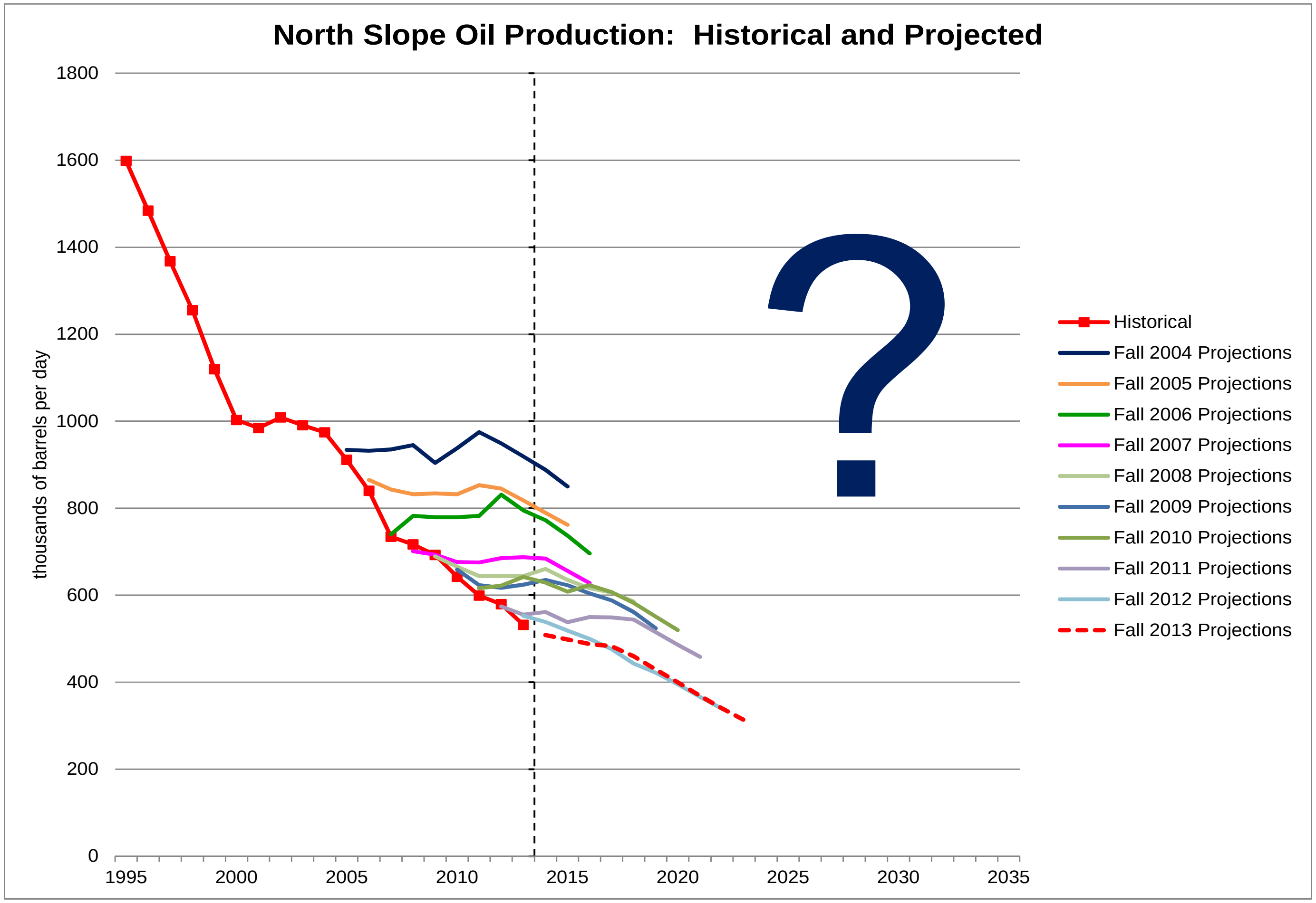
Figure 4-F: ANS Oil Production Forecast



Source: Alaska Department of Revenue, *Fall 2013 Revenue Sources Book*

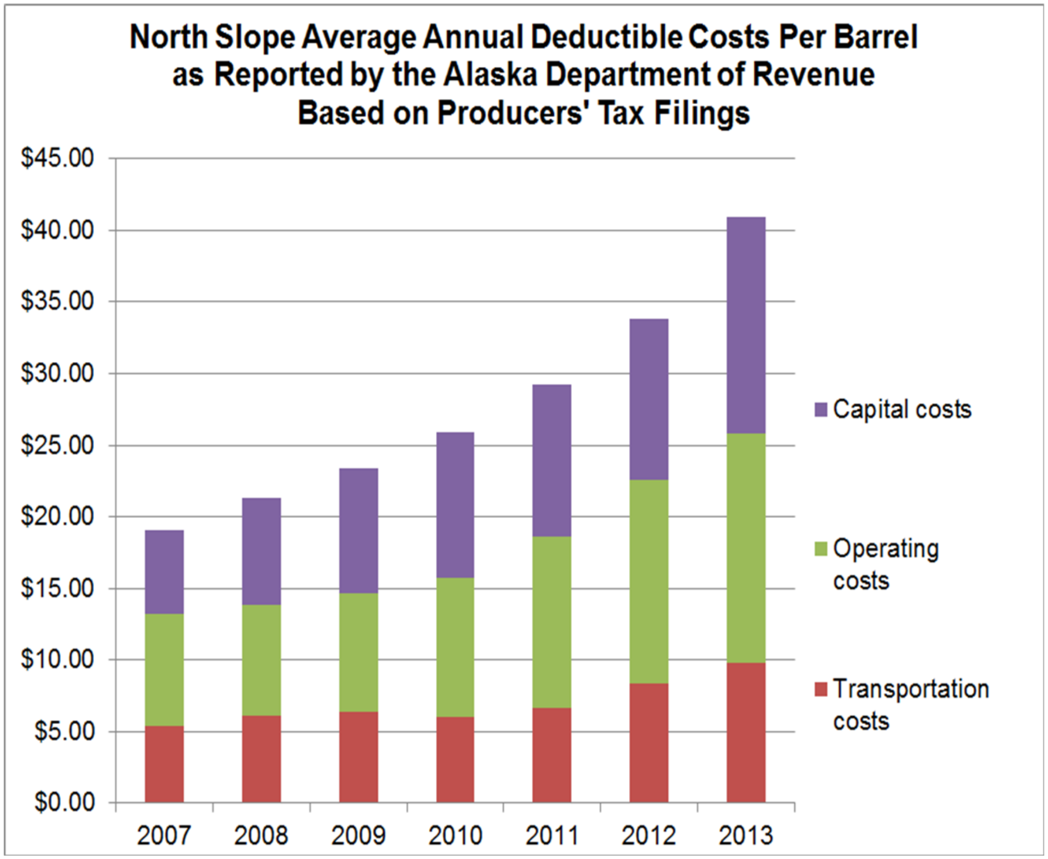
Our future oil production is fundamentally uncertain.
We just don't know how much oil will be discovered and developed.

Historically, we haven't been very successful in predicting future oil production.



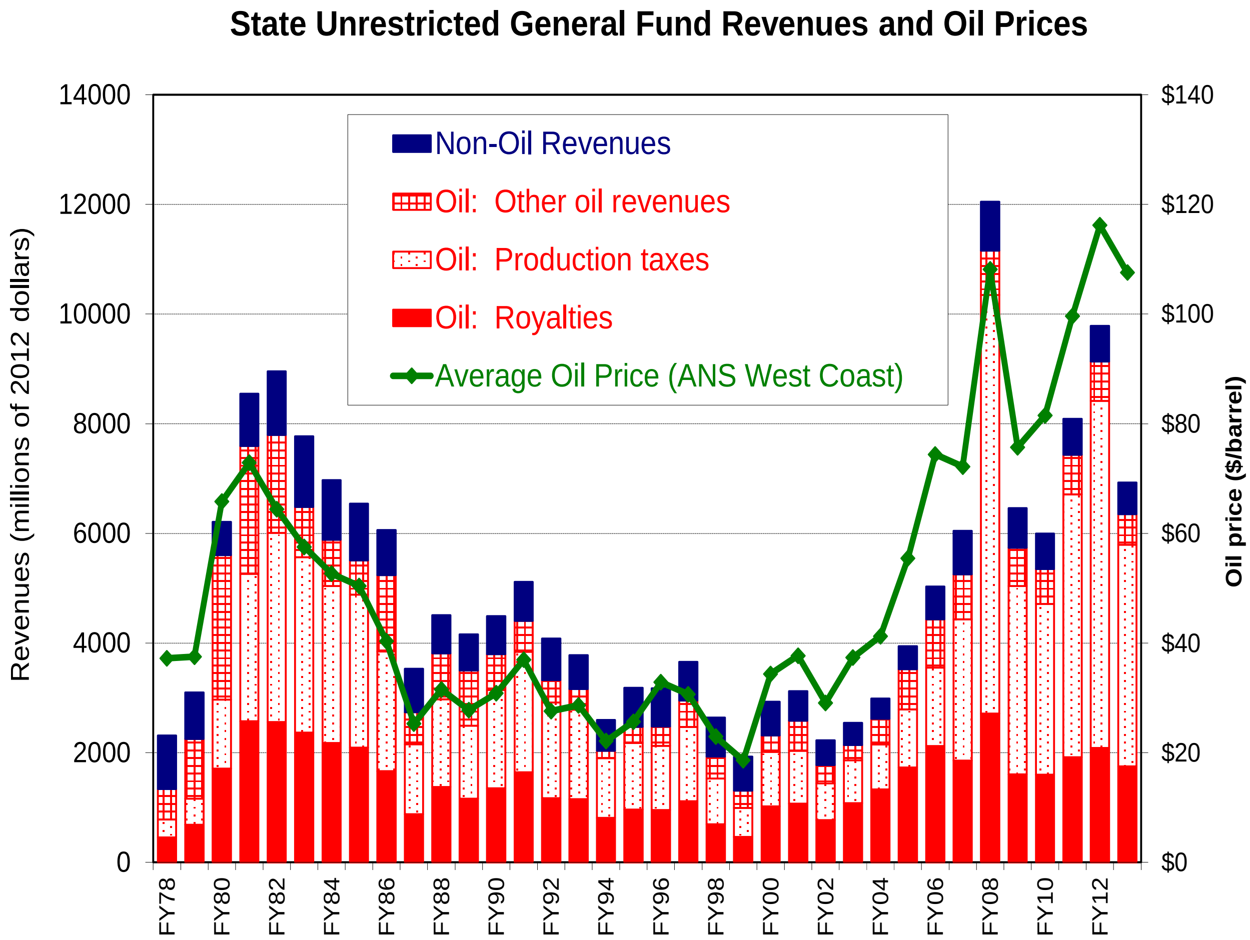
Oil production costs also affect our oil revenues—because our oil production taxes are based on producers' net profits after deducting these costs. Oil production costs have been rising.

Future oil production costs are fundamentally uncertain—but it seems likely that they will keep rising.



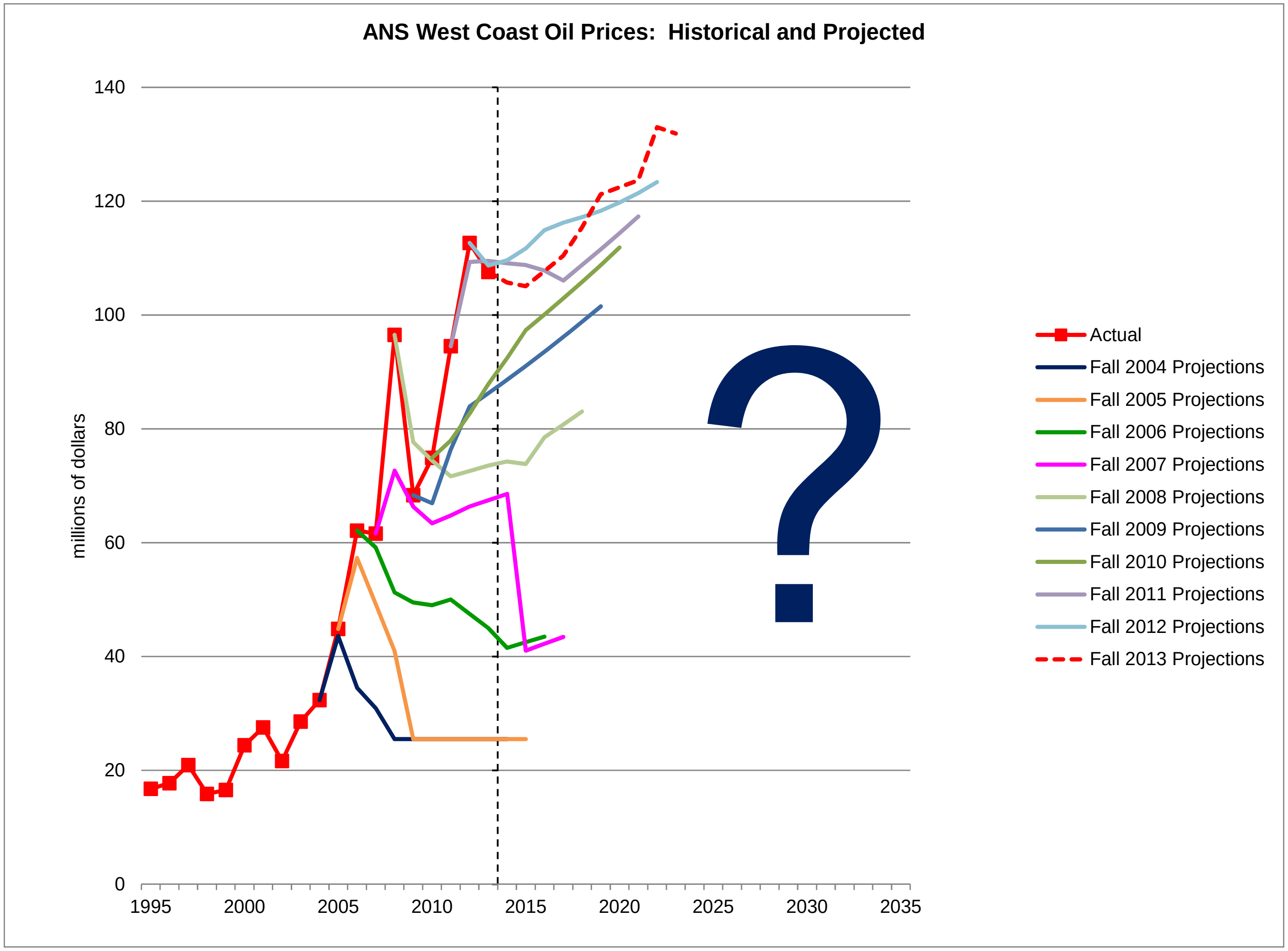
Our oil revenues depend critically on oil prices.
For most of the past decade, the effects of falling oil production on state oil revenues were offset by a dramatic increase in oil prices.

Tax changes which increased the state's share of oil production value also contributed to the rise in revenues.



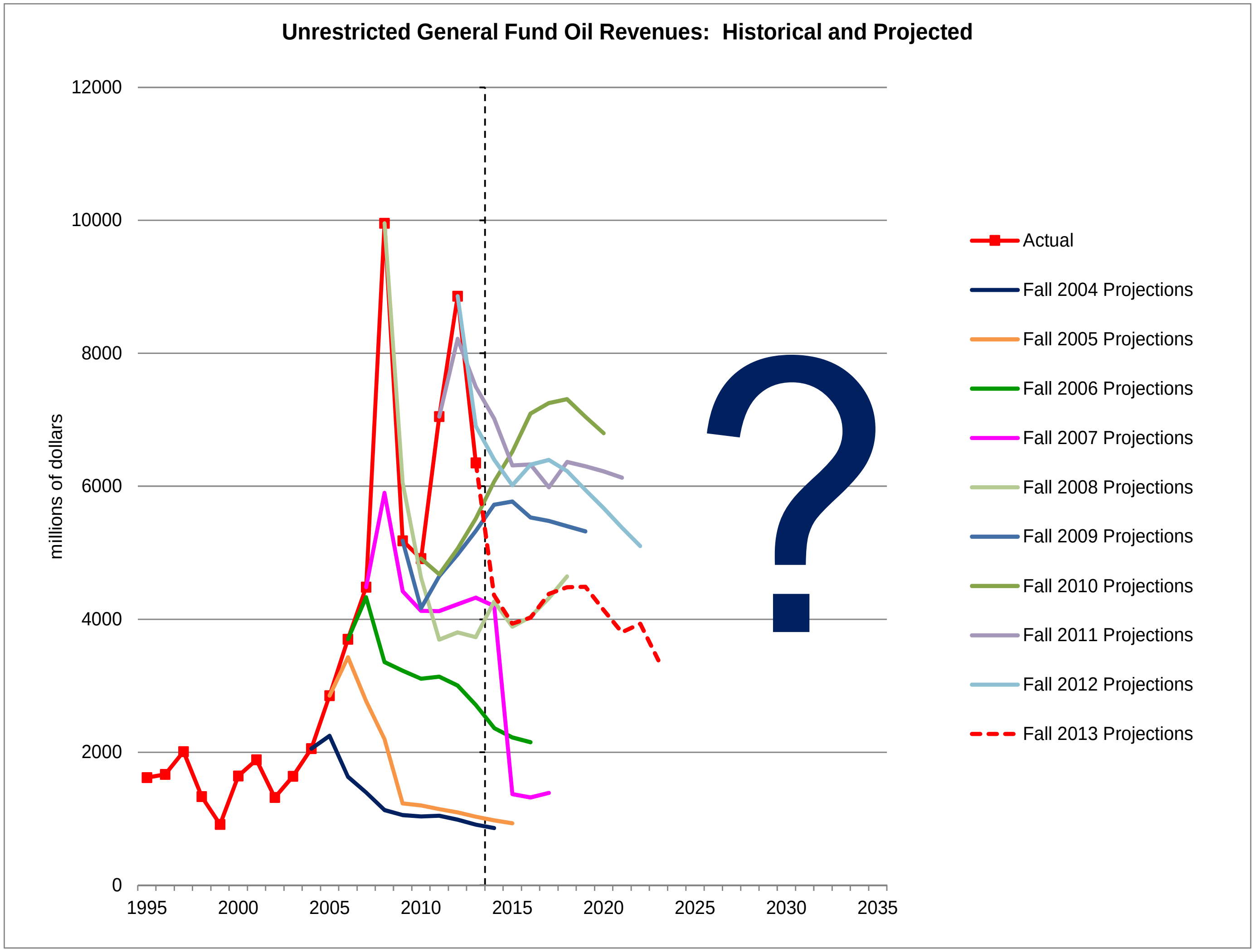
Future oil prices are fundamentally uncertain!
We just don't know how oil prices will change.

Historically, we haven't been very successful in predicting future oil prices!



Because oil production, prices and costs are all fundamentally uncertain, our future oil revenues are fundamentally uncertain!

Historically, we haven't been very successful in predicting future oil revenues!



Even though future revenues are uncertain, it seems likely that Alaska oil revenues will decline in the future, beause.

- North Slope oil production will probably decline
- Oil production costs will probably rise
- World market conditions suggest that oil prices aren’t likely to rise dramatically—and might fall.

We don’t know for certain that oil revenues will decline.

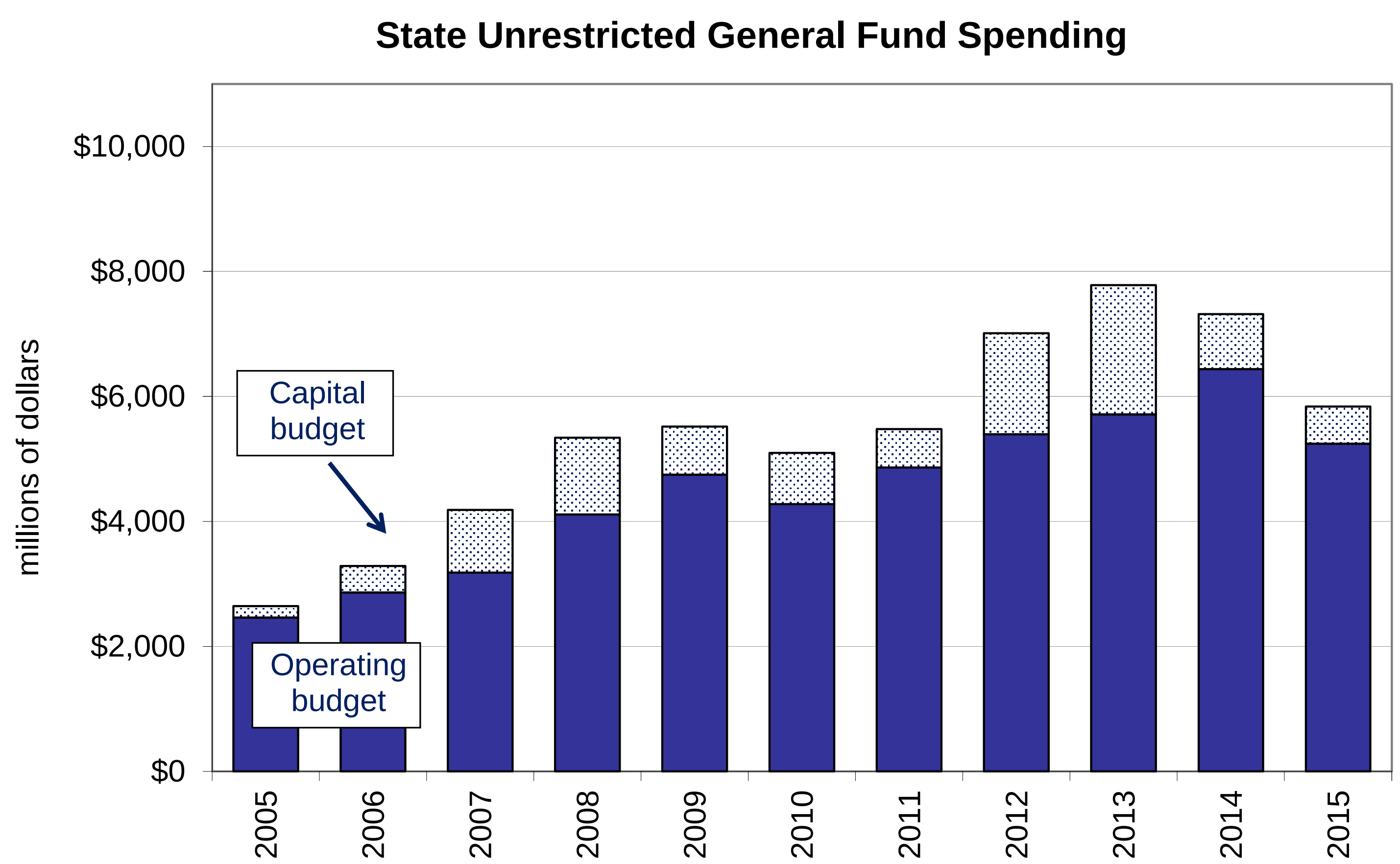
- *Maybe* oil production will stabilize or increase.
- *Maybe* prices will rise—it happened before.
- But we can’t ignore the possibility that oil revenues will fall!

Regardless about how optimistic you are about future Alaska oil production or prices, it would be foolhardy to deny that our future state oil revenues could decline significantly.

While state oil revenues are likely to decline, demands for state spending are likely to grow.

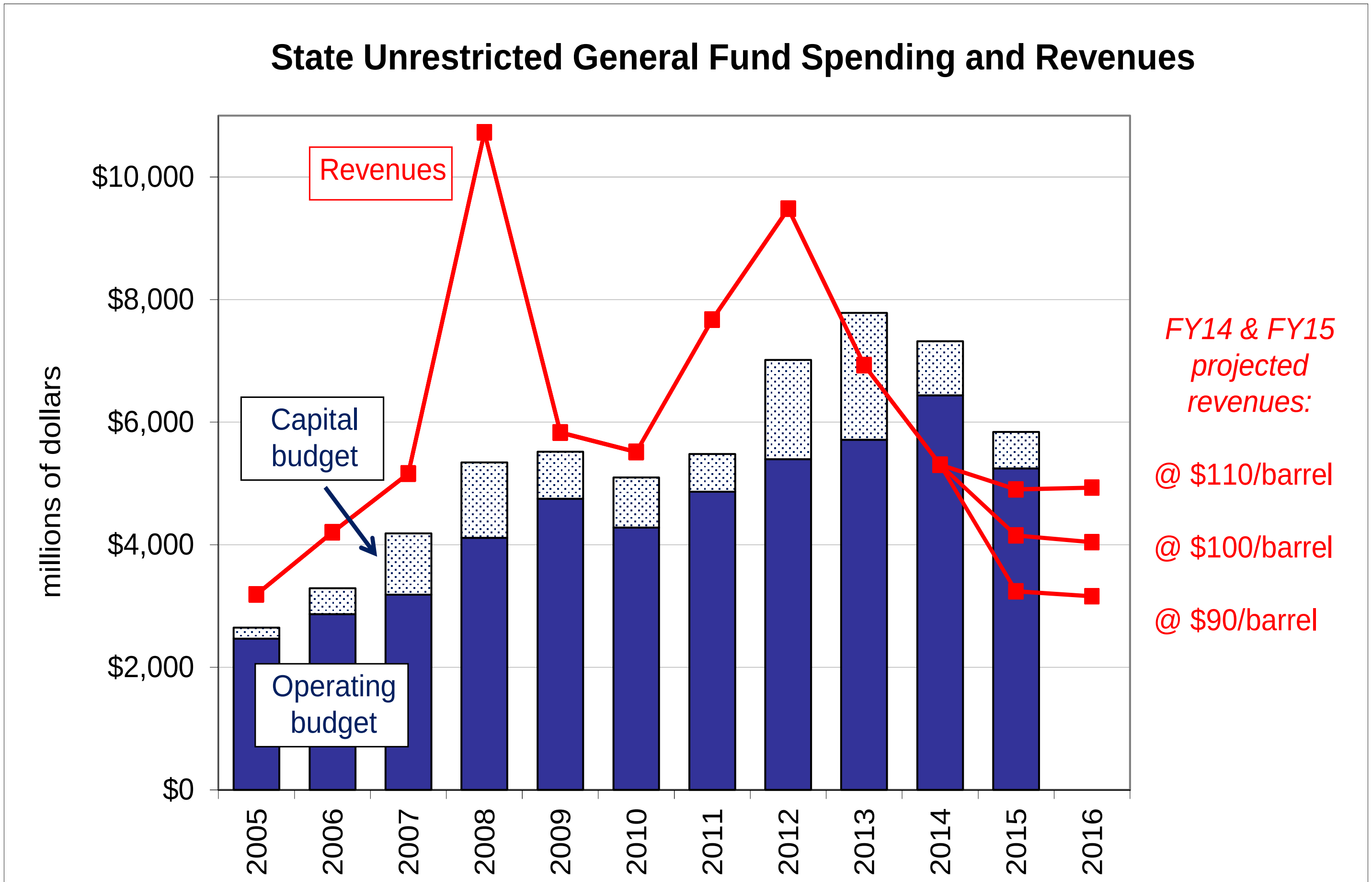
- Inflation—costs keep rising
- Alaska's population keeps growing
- Health costs keep risking
- Our debt and retirement obligations are likely to grow
- We face growing operations and maintenance costs for the roads and buildings we've built in the past
- Many Alaskans <u>want</u> more spending
  - More and better state services . . .
    - Education
    - Public safety
  - New capital projects
    - Roads, bridges, energy projects
    - A huge natural gas export project.

Growing demands are why—even after big cuts the past two years--state general fund spending is more than twice as high as it was in 2005.



Sources: Legislative Finance Division (spending data) and Department of Revenue (Fall 2013 revenue projections). Current oil prices are about $95/barrel.

Lower oil revenues combined with higher spending are why we are now facing big deficits.



Sources: Legislative Finance Division (spending data) and Department of Revenue (Fall 2013 revenue projections). Current oil prices are about $90/barrel.

We cay pay for deficits by drawing down our savings reserves.
But we can’t go on paying for deficits indefinitely.

At current projected revenues, our savings reserves of $15 billion could run out in less than ten years—or a lot sooner if oil prices fall farther.

We can't go on indefinitely spending more than our revenues.

Unless we are very lucky with oil production, production costs and oil prices, within a few years we will probably face difficult fiscal choices between unpopular options.

- Spending less money
- Imposing new taxes
- Using Permanent Fund earnings
- Other options?

The longer we delay in making hard fiscal choices,
the harder they will become.

- Bigger cuts in spending
- Higher new taxes
- Using more of Permanent Fund earnings
- Other options?