

# Politics, Perceptions & Public Policy

-or-

## Rhetoric and Reality in Solving Alaska's Fiscal Challenge

Mike Navarre

Kenai Peninsula Borough Mayor

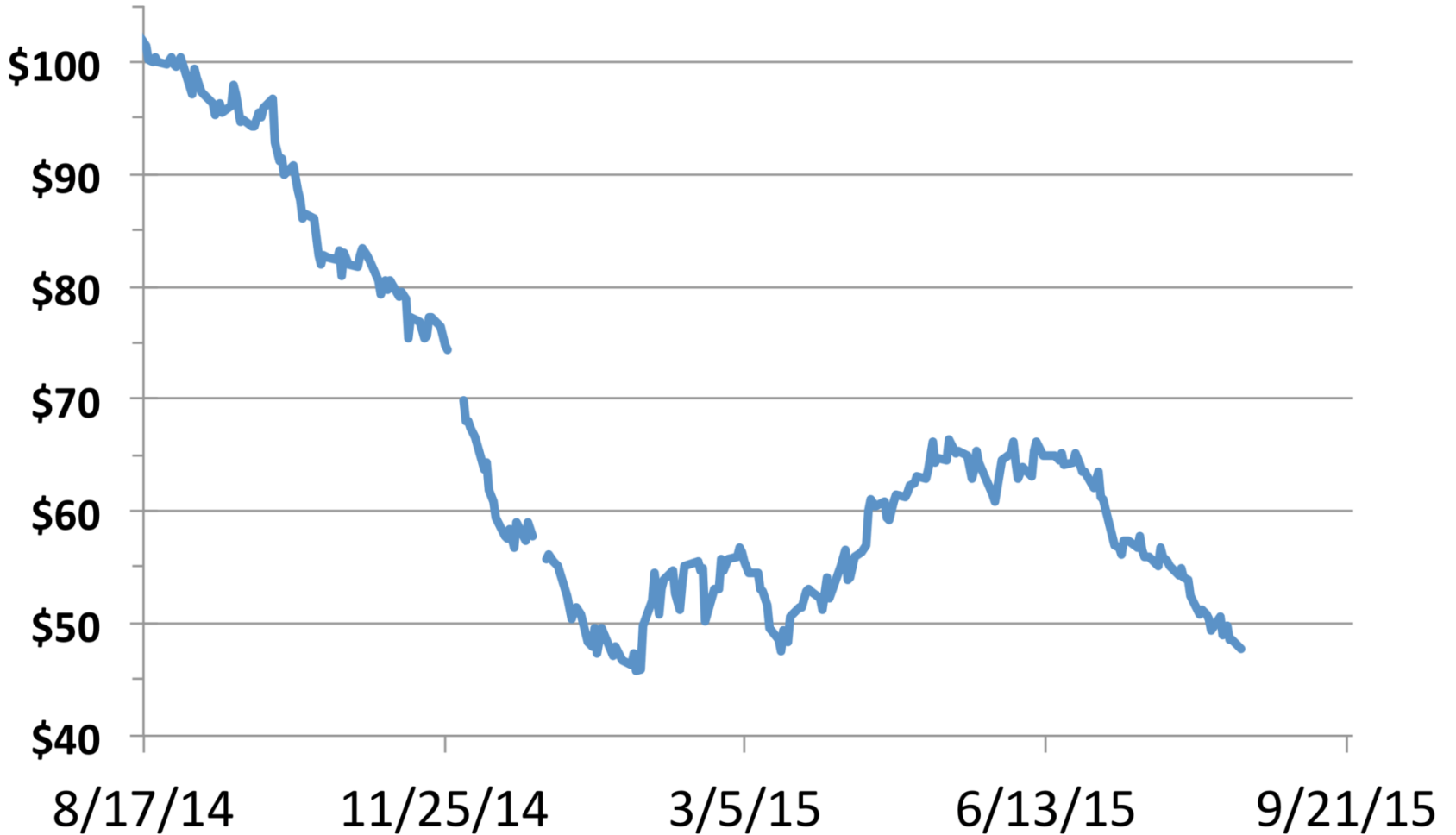
September 1, 2015

## QUESTIONS TO PONDER...

- Does Alaska Have a Budget Crisis?
- Is it an Economic Crisis?
- Has it Happened Before?
- What's Different this Time?
- Can Our Politicians Save Us?
- Can We Save Ourselves?
- Are We Doomed?

## ANS Prices per barrel

# What a difference a year makes!



# Options (Oil Taxes)

FY16 General Fund Revenue (\$ Billions)

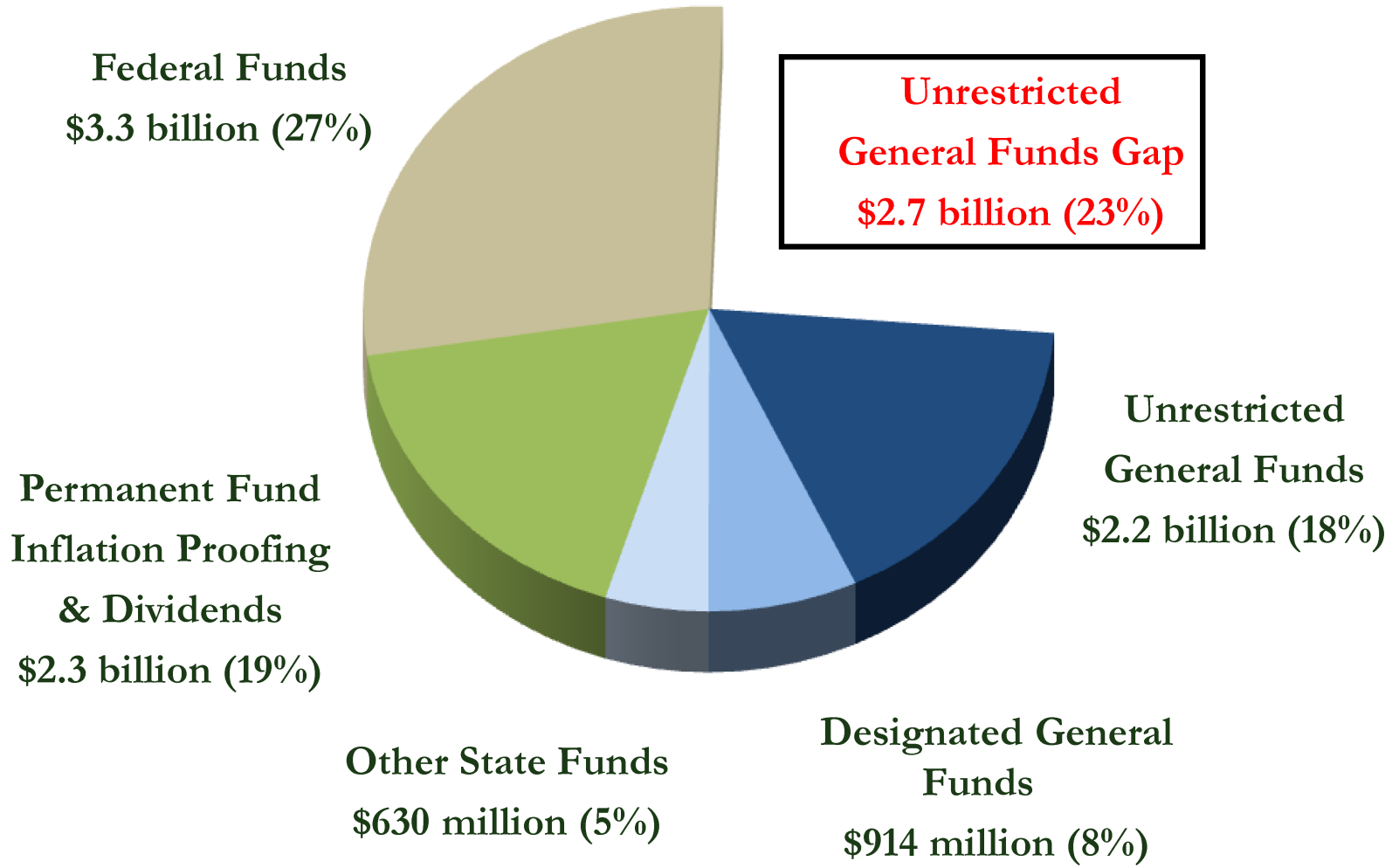
Budget = \$4.9 Billion

Price of Oil	Barrels Per Day			
	500,000	600,000	700,000	800,000
\$40	\$ 1.5	\$ 1.7	\$ 1.9	\$ 2.1
\$50	\$ 1.8	\$ 2.1	\$ 2.3	\$ 2.6
\$60	\$ 2.0	\$ 2.3	\$ 2.6	\$ 2.9
\$70	\$ 2.3	\$ 2.7	\$ 3.0	\$ 3.4
\$80	\$ 2.5	\$ 2.9	\$ 3.3	\$ 3.8
\$90	\$ 3.2	\$ 3.8	\$ 4.4	\$ 4.9
\$100	\$ 4.0	\$ 4.8	\$ 5.5	\$ 6.4
\$110	\$ 4.9	\$ 5.8	\$ 6.8	\$ 7.7
\$120	\$ 5.8	\$ 6.9	\$ 8.0	\$ 9.1

Current Production: Break even Price = \$109/ bbl

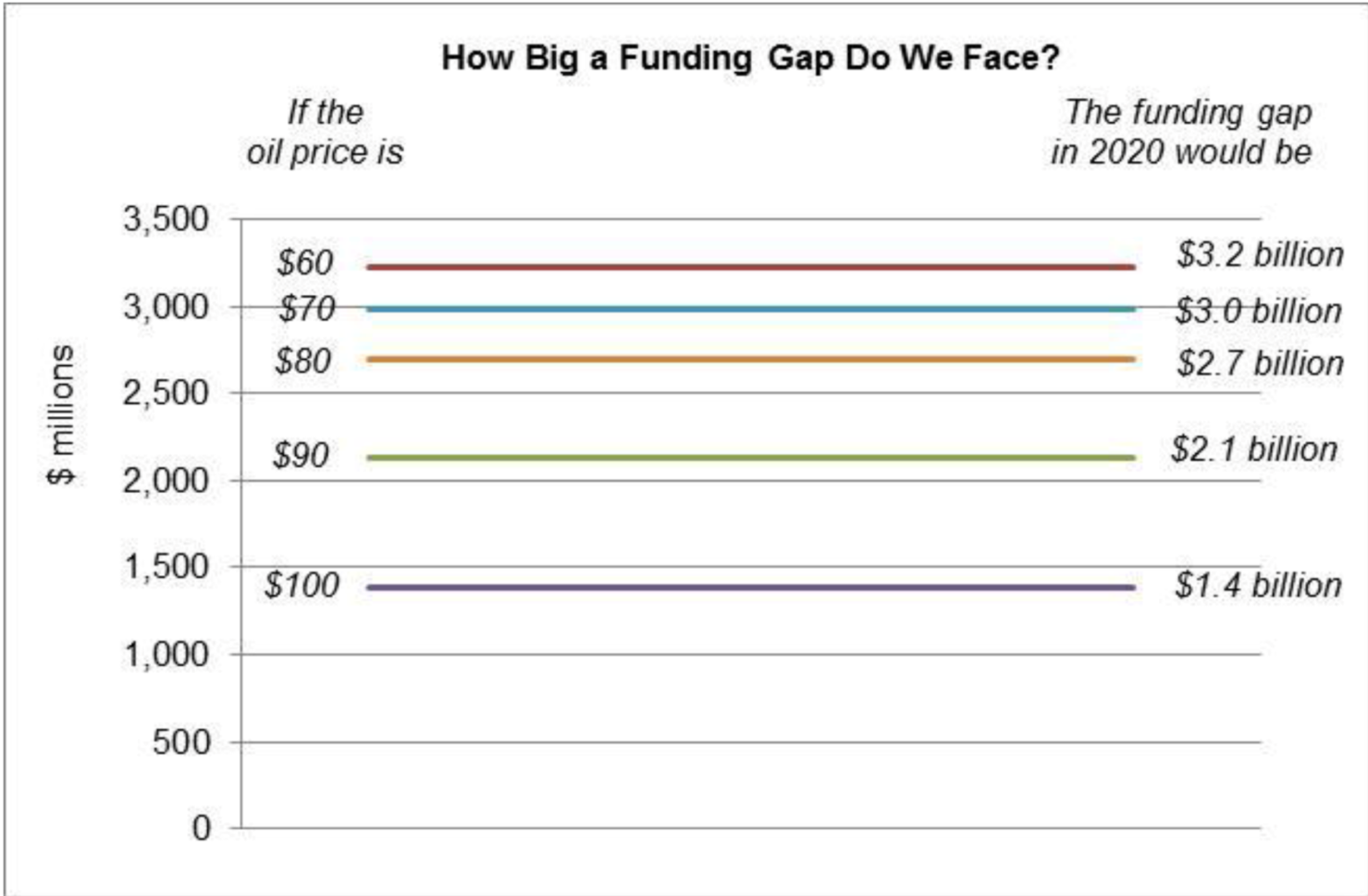
Current Price: Break even Production = 1.6 million bbl/day

# Fiscal Challenge



If we continue to spend at the FY16 level of \$5.2 billion and use only our current revenue sources, we face a large **funding gap** between our spending and our revenues—which we will have to pay for from our savings reserves.

The lower the price of oil, the bigger the funding gap and the sooner we will drain our reserves.



THE OPTIONS... Budget Cuts  
Revenue Increases  
Permanent Funds Earnings

The Rhetoric: Live within our budget?  
No new taxes?  
Cut the budget?  
No new taxes until we “feel the pain”?  
Don’t touch the Permanent Fund?  
Eliminate employees?

## HOW WILL WE FILL THE FUNDING GAP?

Our only significant and practical options are some combination of:

Spending cuts

New revenues

Use Permanent Fund earnings

None of these options are easy or popular.



## Path to Fiscal Stability

**There are no easy answers to balancing a \$3 billion annual deficit.**

**Takes some combination of four things:**

- 1. Continued budgetary restraint**
- 2. Taxes impacting individual Alaskans**
- 3. Changes to oil and gas taxes/credits**
- 4. Strategic use of our legacy assets**

**Next Steps....**

# THE IMPEDIMENTS...

Public Perceptions

Politically Challenging

Election Year

Rhetoric (multiple sources)

Different Perspectives

The “Blame” Game

No Right Answer(s)

No “Easy” Button

*“Interesting point taken is that we all have our own biases, experiences and philosophies that we bring into the debate. When multiplied by the Governor and his staff, 60 members of the legislature, recognizing that the every group consists of vastly different intellectual levels affecting the capacity of some to recognize the magnitude of the problem, then applied to the population masses of Alaska, factoring in talk radio, political parties, election year dynamics, the media, right and left wing splinter groups, lobbyists, special interests and a multitude of constituencies for every item currently in the budget... the problem doesn't seem all that difficult.”*

*Mike Navarre, KPB Mayor*

**”THE FIRST STEP  
TOWARDS GETTING  
SOMEWHERE IS TO  
DECIDE THAT YOU ARE  
NOT GOING TO STAY  
WHERE YOU ARE.”**

**UNKNOWN**

*Sometimes the thoughts in  
my head get bored, and go  
for a stroll out  
through my  
mouth. This is  
never a good  
thing*

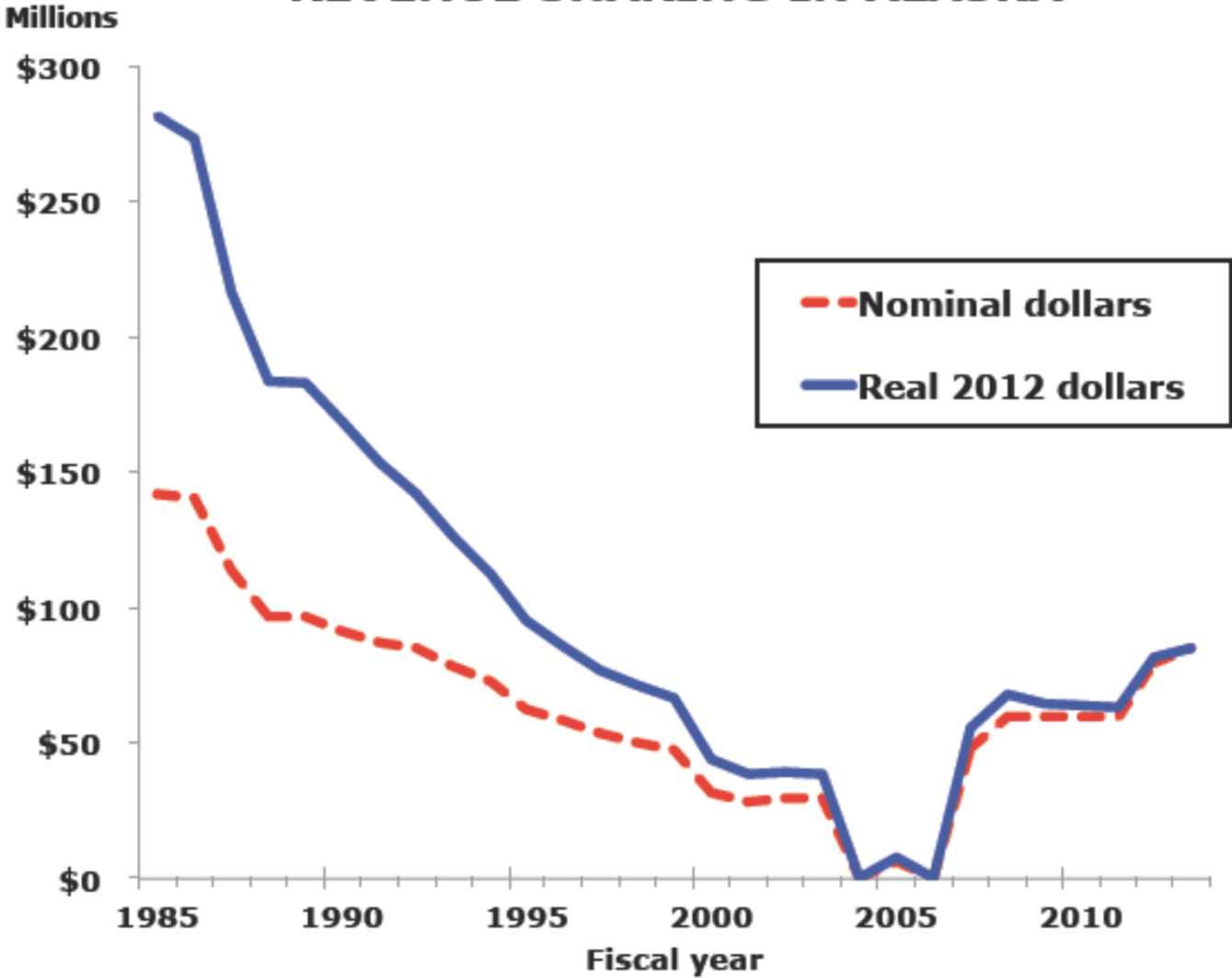


[www.facebook.com/ShutUpImStillTalking](http://www.facebook.com/ShutUpImStillTalking)

# Funds from the State to KPB!

<u>KPB</u>	<u>FY2015</u>	<u>FY2016</u>
• Revenue Sharing	2,146,014	2,048,004
• Debt Service	2,901,870	2,893,727
• PERS Liability	9,532,675	1,200,000
• Fisheries	852,358	750,000
• Capital and Op. Grants	7,986,000	112,770
<u>School District</u>	<u>FY2015</u>	<u>FY2016</u>
• Foundation Funding	79,159,764	79,262,094
• PERS/TERS Liability	142,459,885	9,559,594
• Transportation	8,092,216	8,071,440
<b>TOTALS</b>	<b><u>\$253,130,782</u></b>	<b><u>\$103,897,629</u></b>

# REVENUE SHARING IN ALASKA



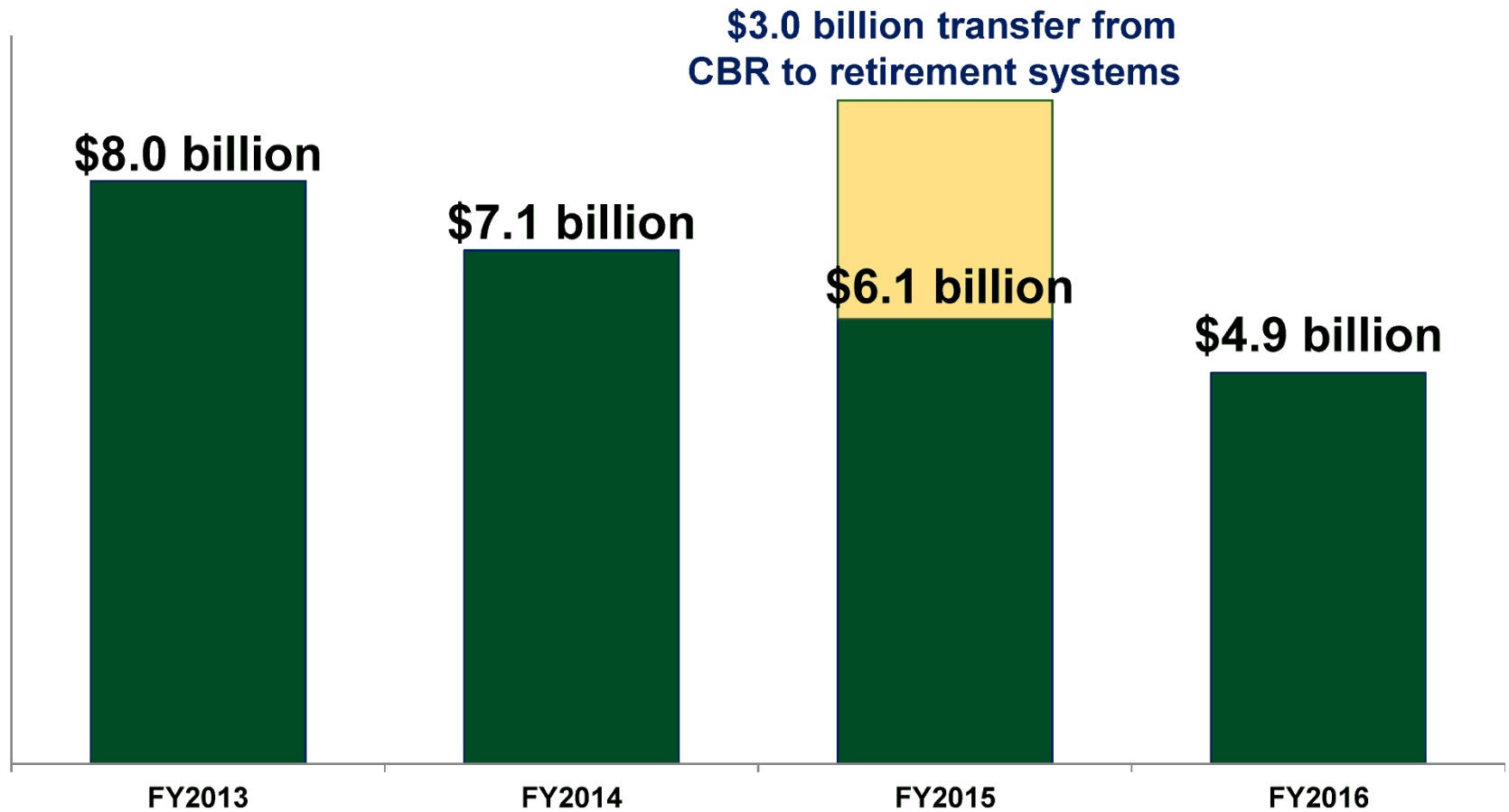
*Options for closing the funding gap:*

**Spending cuts . . .**

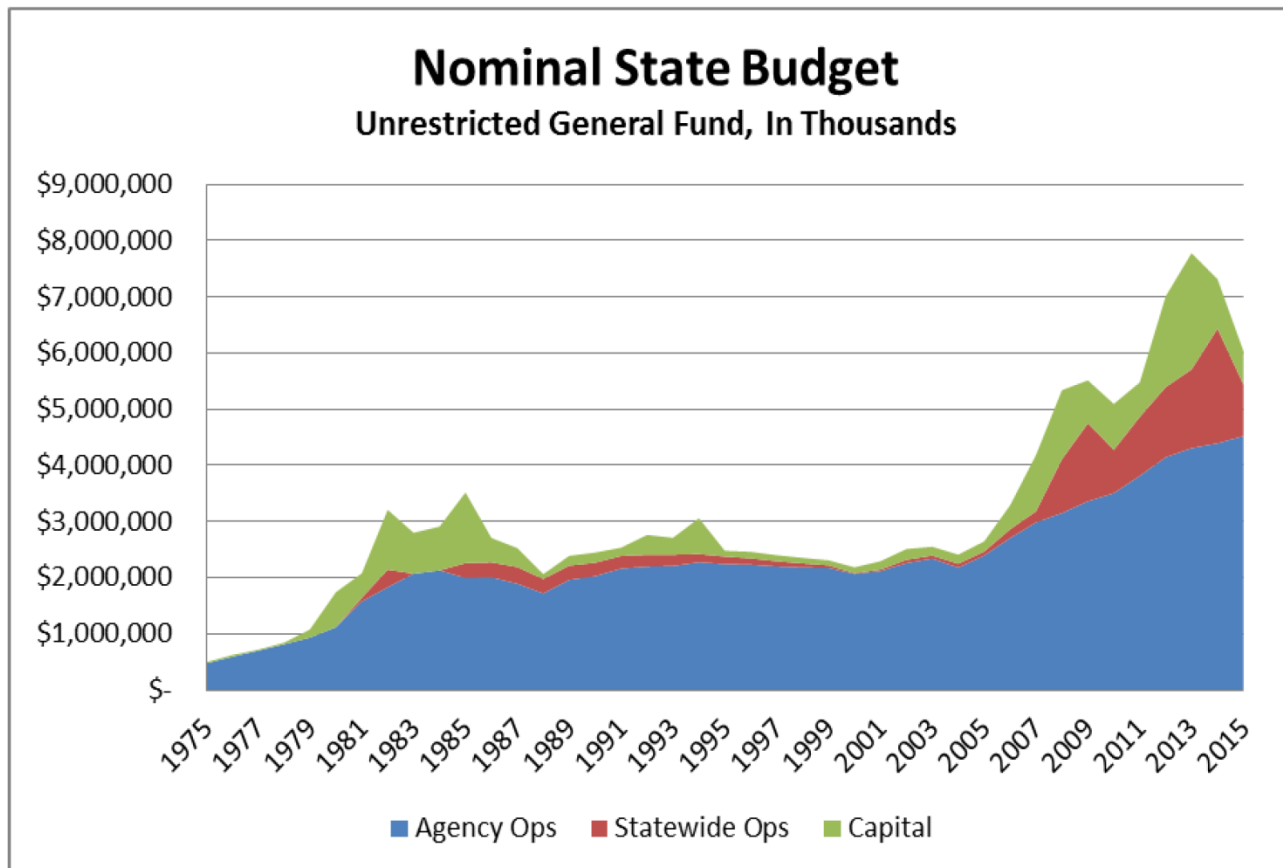
- Capital budget cuts
  - Very little is left to cut
- Statewide operations cuts
  - We can't cut debt service
  - Cutting retirement contributions would be very difficult
  - We could cut oil tax credits—but that could affect future production
- Agency operations cuts
  - Most cuts would have to come from agency operations
  - Significant cuts would require cutting the largest agencies:
    - Education & Early Development
    - Health and Social Services



# Options (Cut Government)

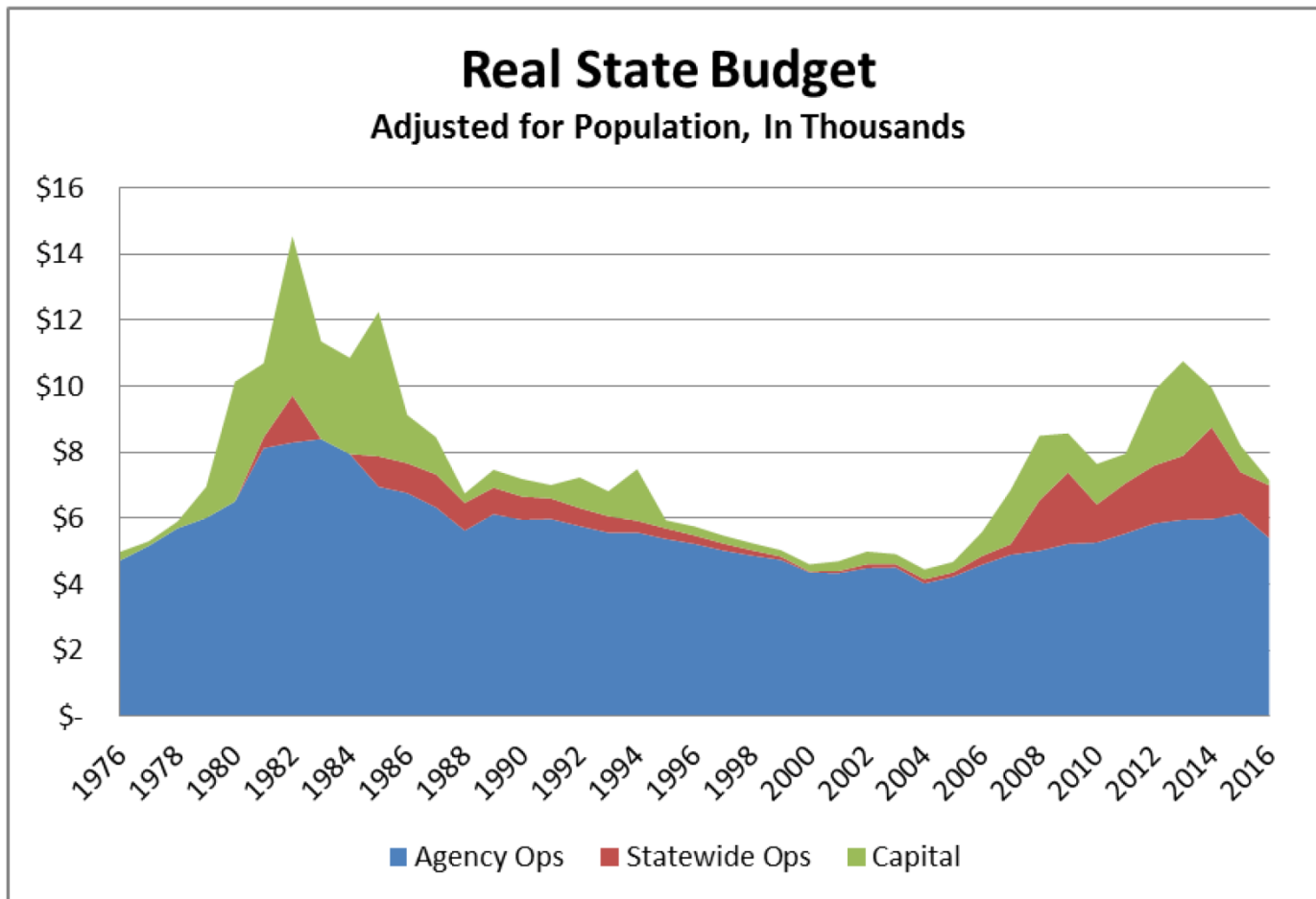


# Options (Cut Government)



In nominal terms, the General Fund budget has increased steadily over time and steeply since the mid-2000's

# Options (Cut Government)



Adjusted for inflation and population, the current budget is lower than most years during the post-pipeline boom

# Alaska State Expenditures Per Capita

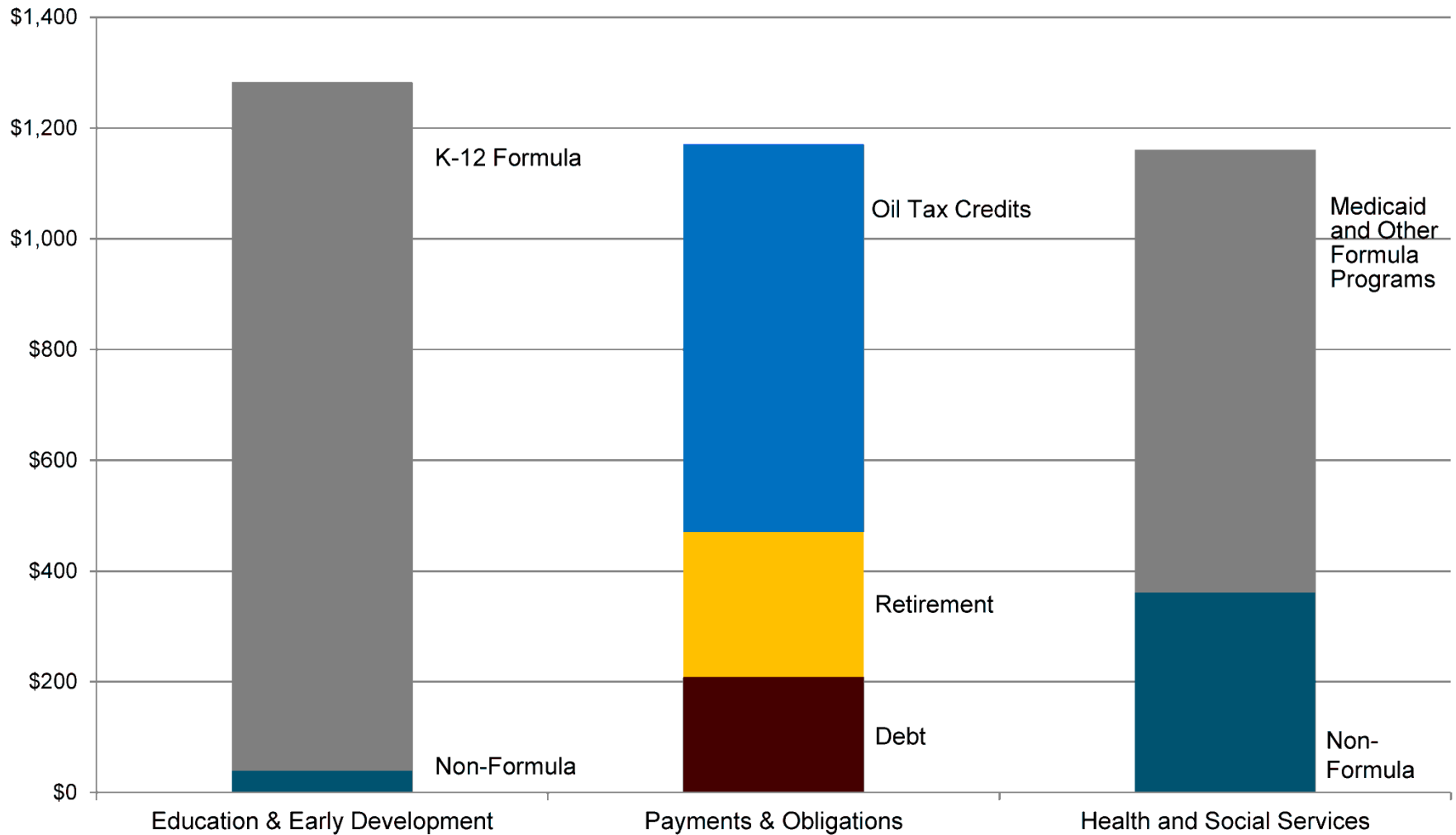
(Real 2014 dollars)

Fiscal  
Year

<b>1975</b>	-----	<b>\$8,466</b>
<b>1983</b>	-----	<b>\$26,549</b>
<b>1992</b>	-----	<b>\$14,380</b>
<b>2012</b>	-----	<b>\$16,886</b>
<b>2014</b>	-----	<b>\$10,982</b>

# Fiscal Challenge

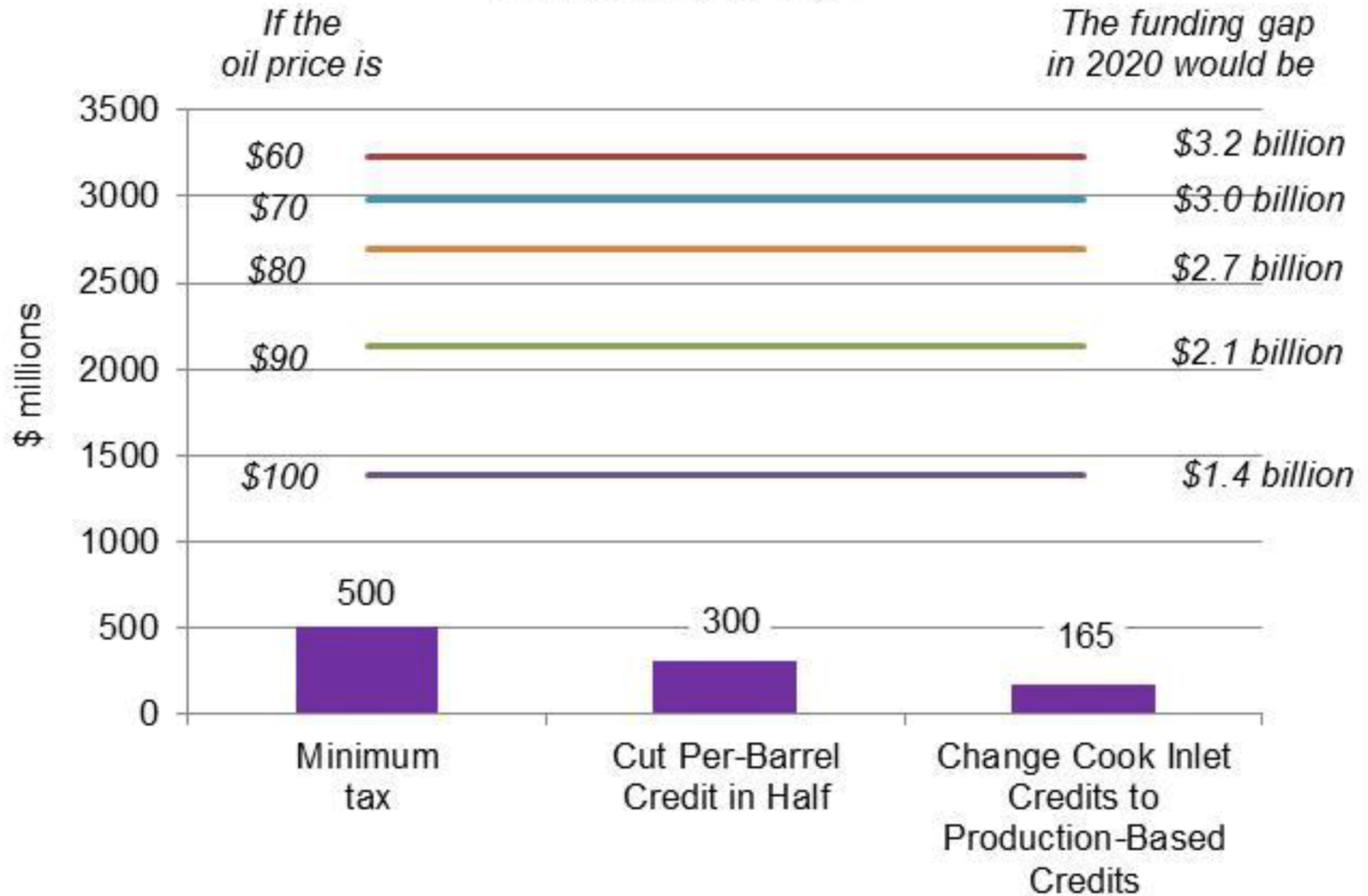
## Top Three Unrestricted General Funds Spending Categories Total \$3.4 billion (\$ Millions)



## Examples of **new revenue** options and some of the issues they raise

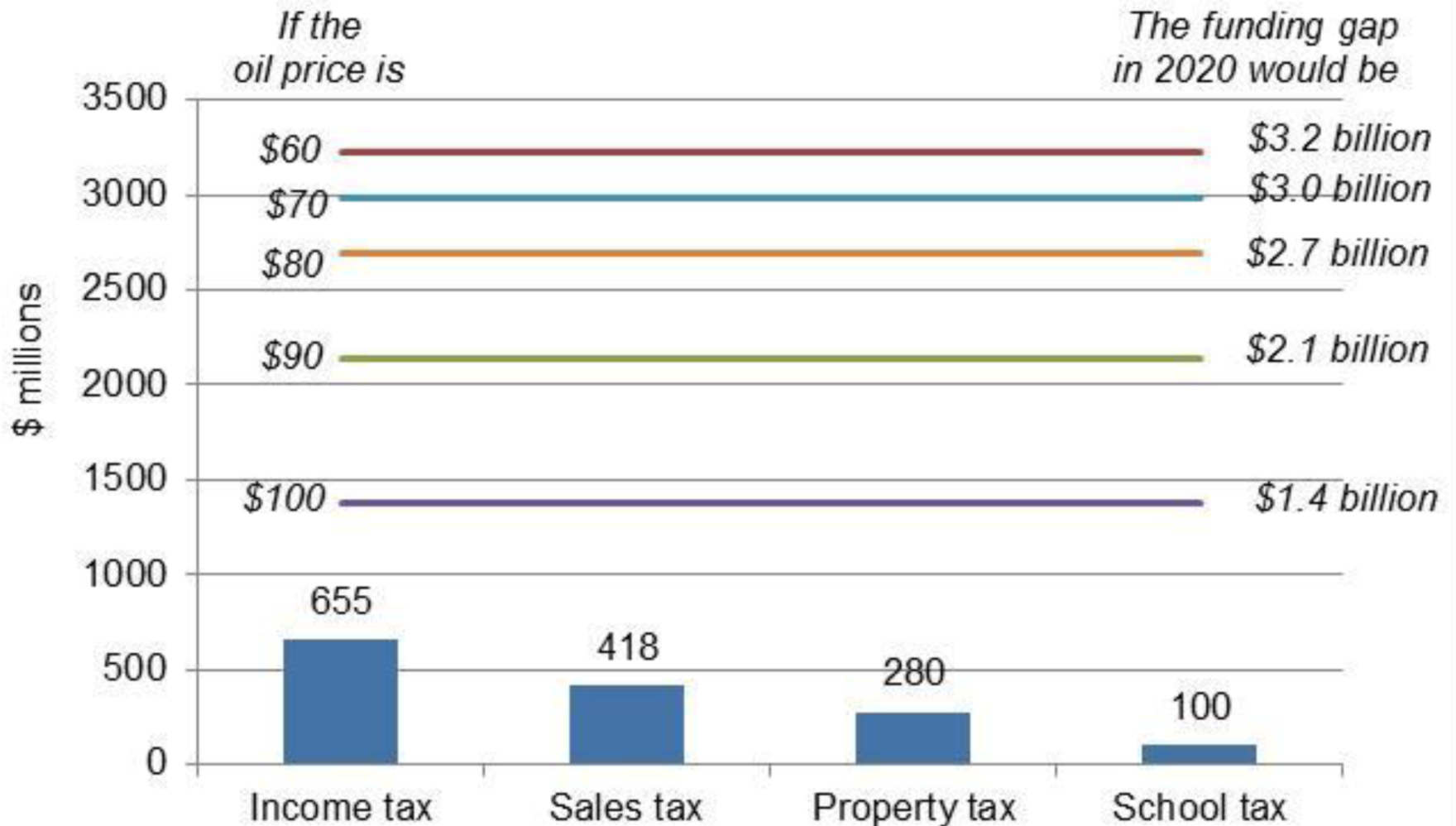
Option	Some of the Issues
Increase oil revenues	Issues which arose in last year's oil tax debate
Income taxes	Who bears the burden? Effects on the economy? Potential to tax non-resident workers?
Sales taxes	Who bears the burden? Effects on the economy? Effects on local government revenues? Potential to tax tourists?
Increase other resource revenues (mining, seafood, tourism, etc.)	Ability of these industries to pay
Economic diversification	What new industries? Ability of these industries to pay
Increase return on state funds	What are the risks?
LNG project	Still a long time away and many uncertainties

## How Much Could Changes to Oil & Gas Taxes Fill the Funding Gap?



Source: Alaska Department of Revenue estimates

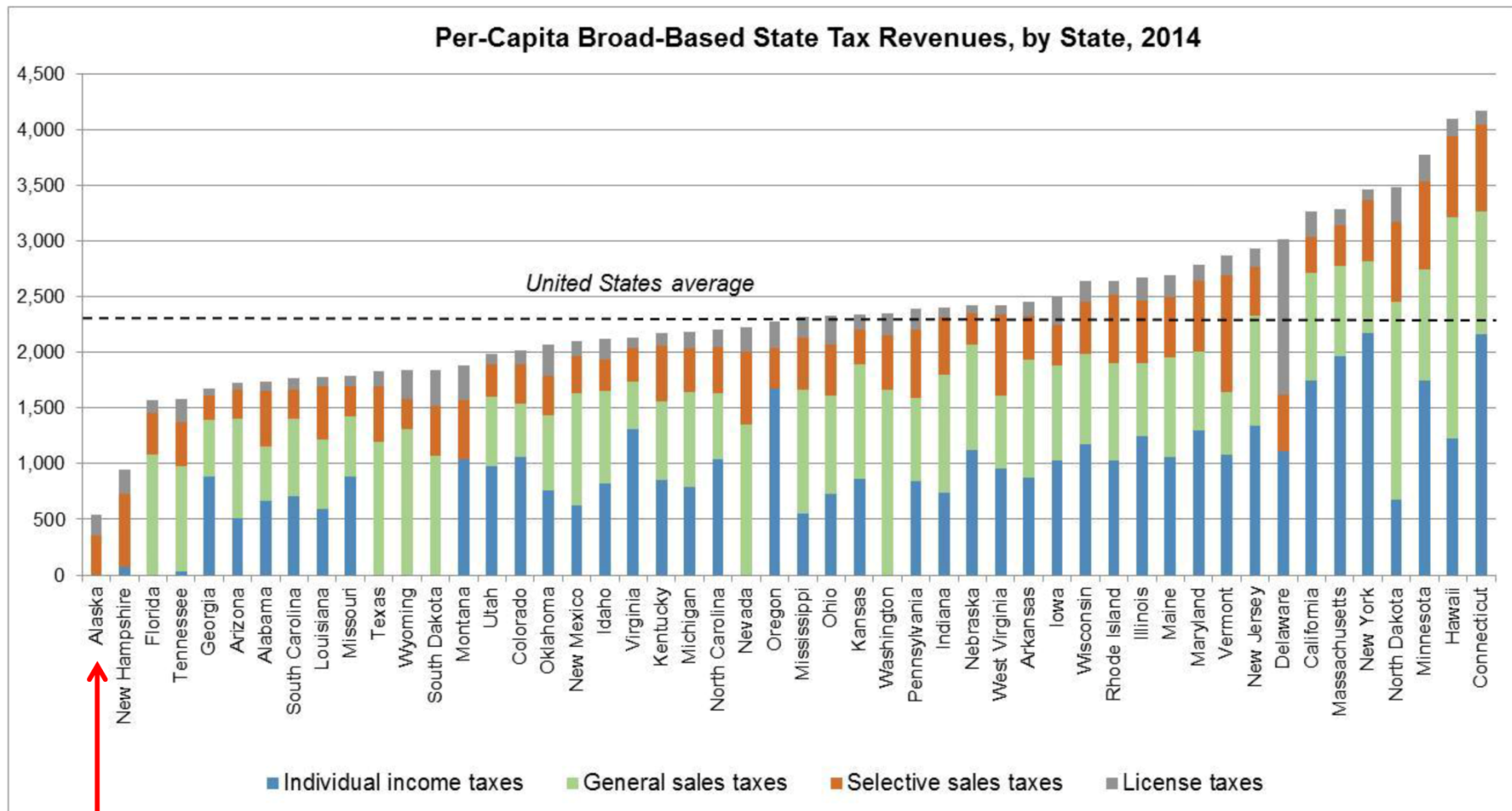
## How Much Could Statewide Taxes Fill the Funding Gap?



Source: Alaska Department of Revenue estimates

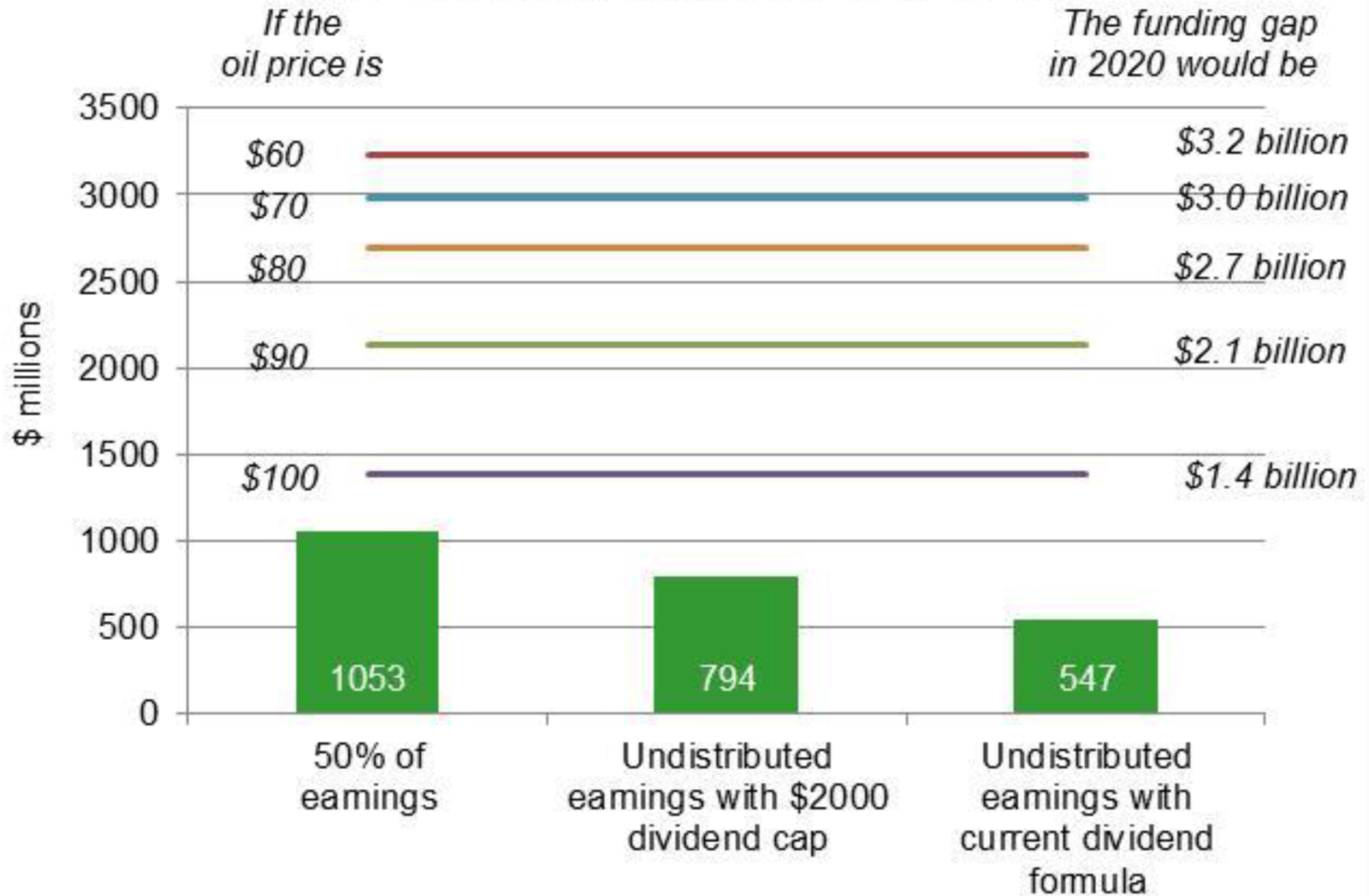


# Alaskans pay much lower broad-based state taxes than residents of any other state.



Alaska

## How Much Could Permanent Fund Earnings (After Inflation Proofing) Fill the Funding Gap?



Source: Gunnar Knapp estimates based on APFC earnings projections

# A LOOK BACK IN HISTORY...

September 14, 1999

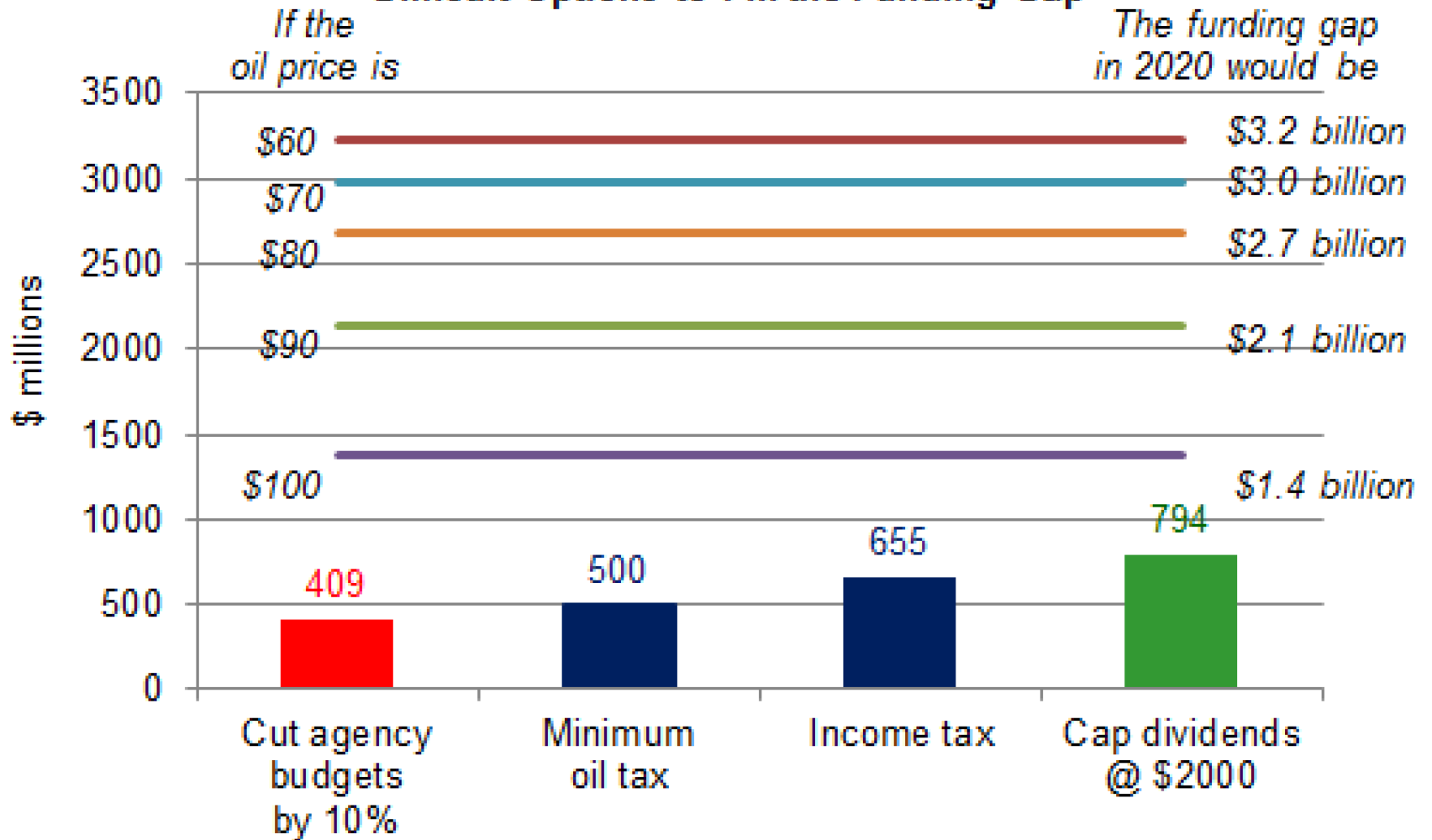
Special Election

- QUESTION: After paying annual dividends to residents and inflation-proofing the permanent fund, should a portion of permanent fund investment earnings be used to help balance the state budget?

- RESULTS:

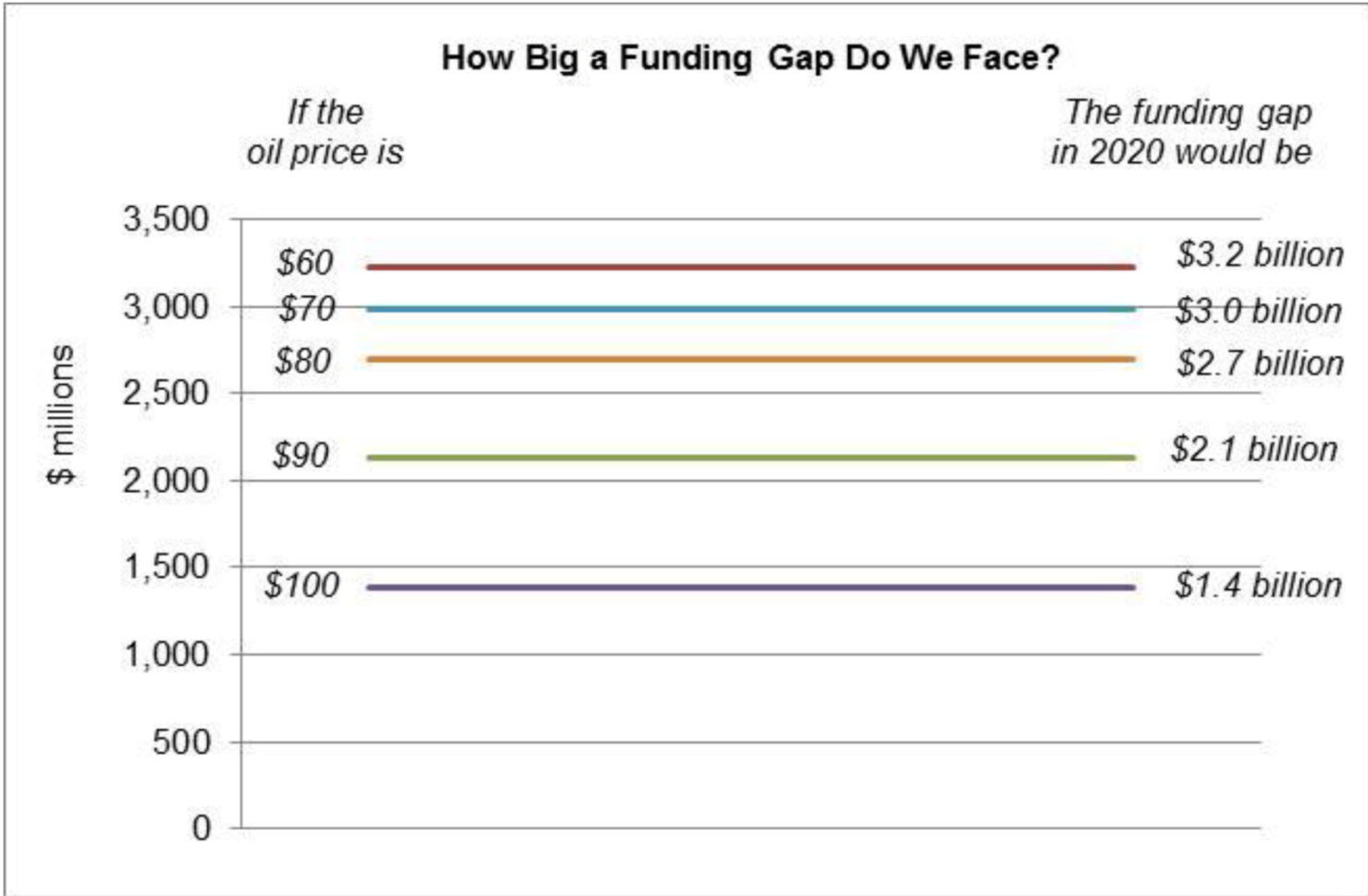
Yes	30,994	16.75%
No	153,996	83.25%

## At Low Oil Prices, It Could Take a Mix of Difficult Options to Fill the Funding Gap



If we continue to spend at the FY16 level of \$5.2 billion and use only our current revenue sources, we face a large **funding gap** between our spending and our revenues—which we will have to pay for from our savings reserves.

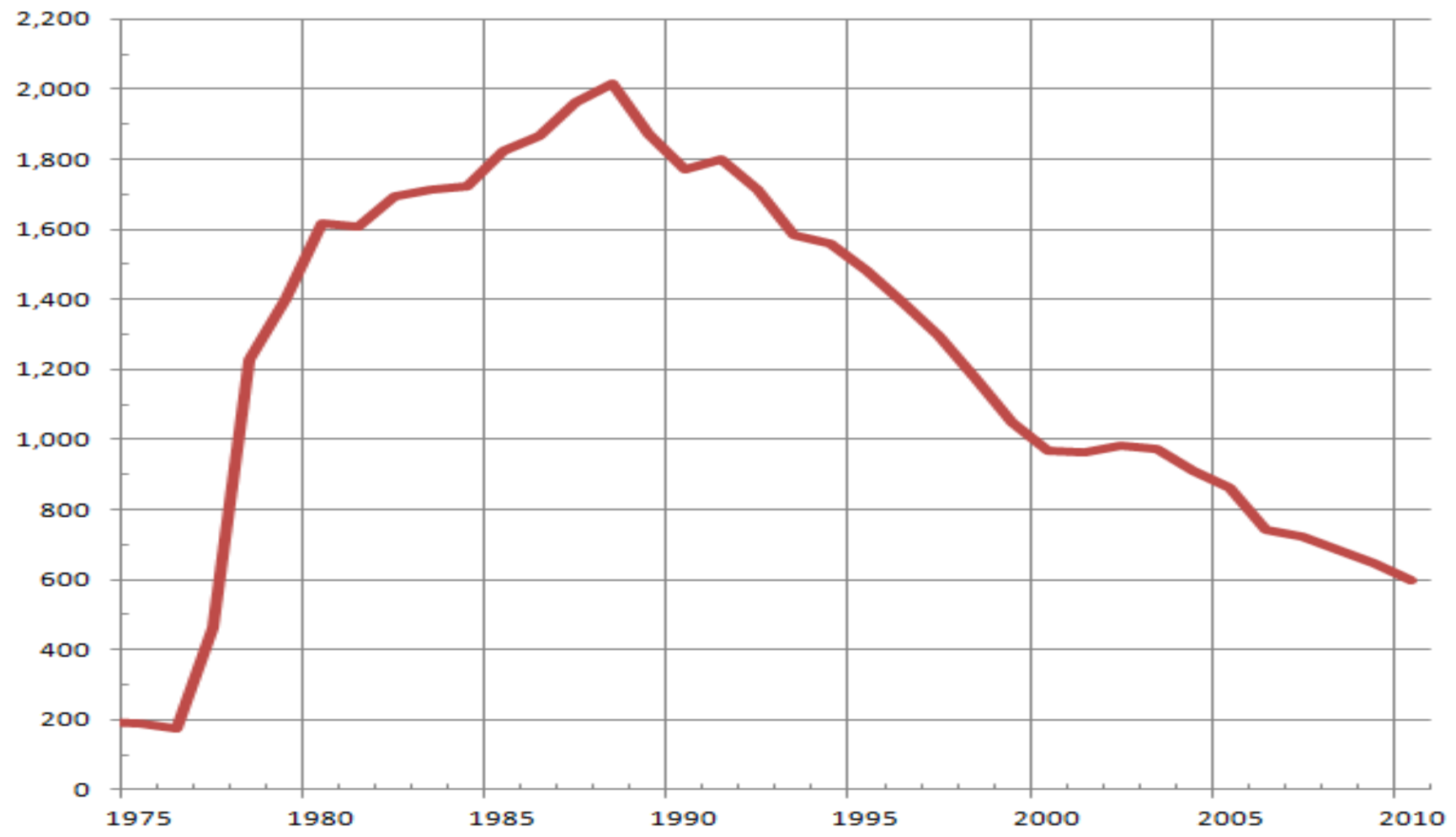
The lower the price of oil, the bigger the funding gap and the sooner we will drain our reserves.



# A LOOK BACK IN HISTORY

- 1971 Cook Inlet Production Peaks
- 1968 Prudhoe Bay Discovery Announced
- 1969 North Slope Lease Sale Nets \$900 m
- 1974-77 TAPS Construction
- 1977 NS Oil Production Begins
- 1980 Alaska State Income Tax Repealed
- 1986 Oil Price Plummets from \$26 to \$9 / barrel
- 1988 Alaska NS Oil Production Peaks (Jan 14)

## Alaska Crude Oil Production (thousand barrels per day)



Source: US Energy Information Administration

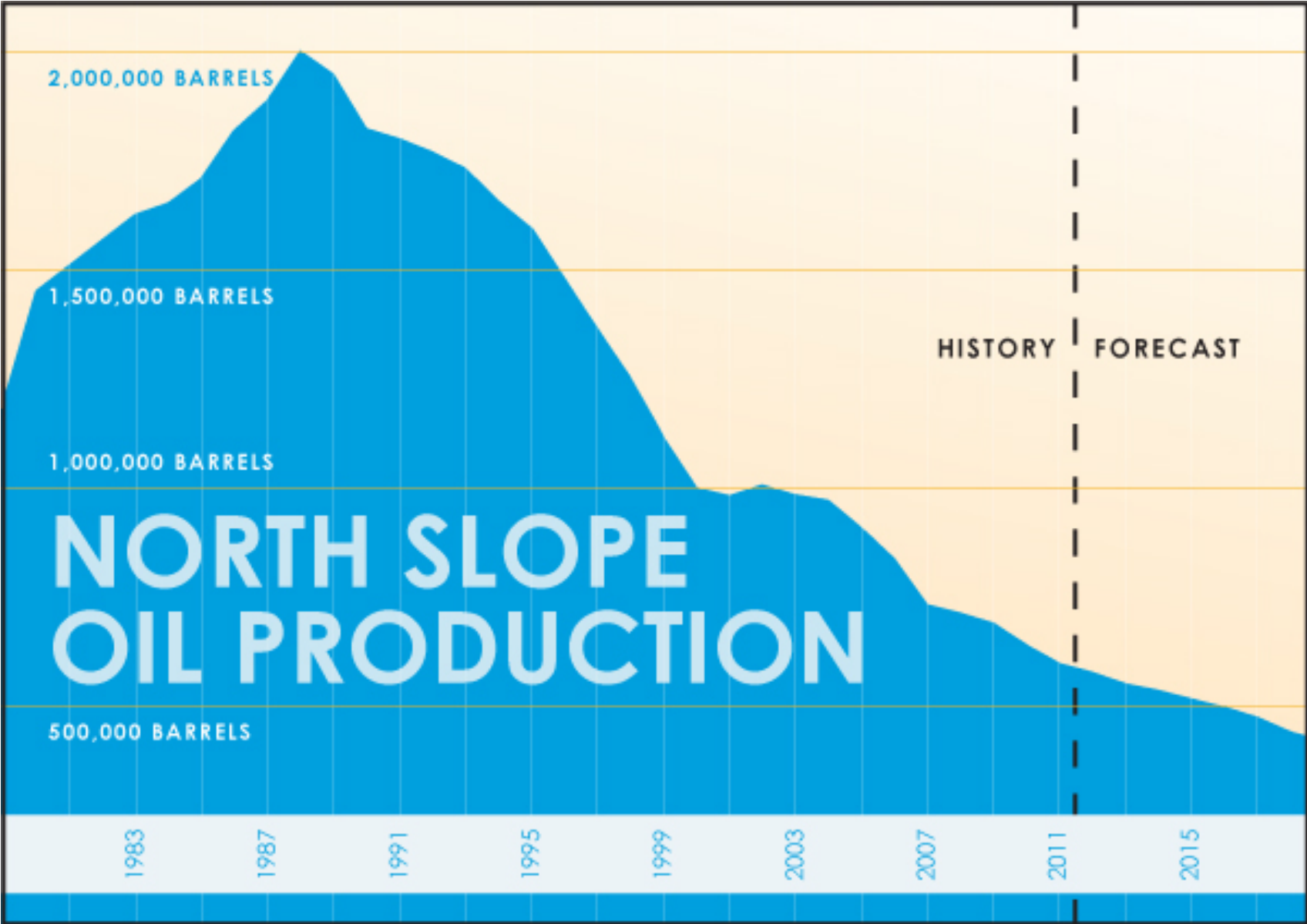
WHAT'S DIFFERENT?

WHY CAN'T WE WAIT TO SEE IF OIL PRICES GO UP?

AKLNG?

SHELL OFFSHORE?





## Path to Fiscal Stability

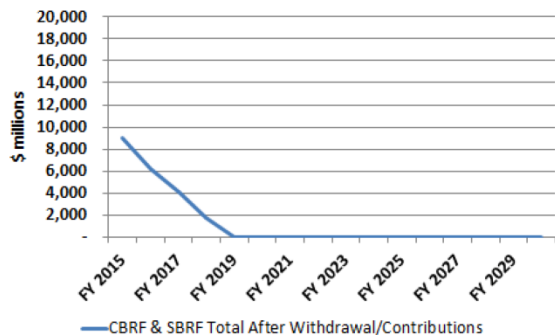
*“We expect that if lawmakers do not enact significant fiscal reforms to reduce the imbalance within the next year, the state’s rating could begin transitioning downward. The rating migration lower would likely persist and accelerate if lawmakers continued to fail to act...”*

**Alaska Rating Outlooks Revised To Negative  
Reflecting Its Large Structural Deficit**

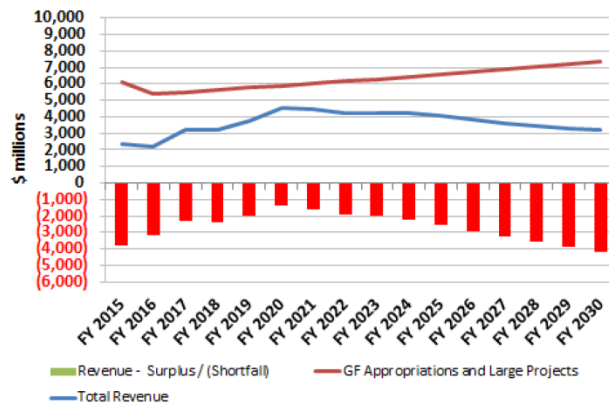
Standard and Poor’s Rating Service  
August 18, 2015 Report

# Options (Increase Revenue)

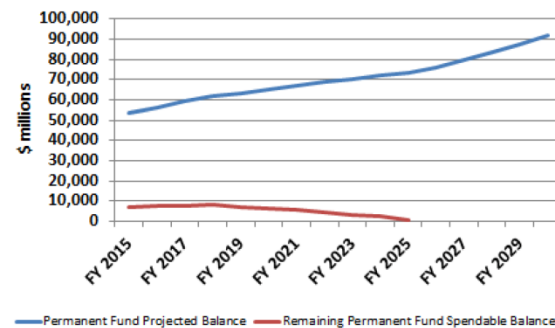
### CBRF & SBRF Balance



### Budget Overview



### Permanent Fund Balances



### Revenue Options

Inflation Assumption	2.25%
Long Run Price Of ANS Crude	Official Forecast

#### Financial

PERS/TRS "Net" Arbitrage Bonds	<input type="checkbox"/> Add
Current PF Revenue Methodology	<input checked="" type="radio"/> Status Quo PF Revenue Methodology
Percentage of Market Value	<input type="radio"/> Implement POMV Methodology
POMV @ X%	4.0%
State Share of PF Revenues	0%
PFD Cap	No Cap
SB 114	<input type="radio"/> Implement SB 114
Collateralization Revenues	<input type="checkbox"/> Implement
Loan to Value Ratio	20%
Securitization Revenue (Only When Collateralization Enabled)	<input type="checkbox"/> Implement

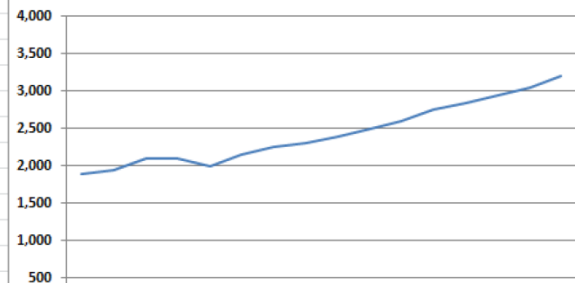
#### Petroleum

Flat Tax for Non-CIT Petroleum Companies	<input type="checkbox"/> Add
Net Severance Tax - Additional Revenue	
Net Severance Tax - Current Base Rate 35%	<input type="checkbox"/> Change 35%
Gross Value Reduction	<input type="checkbox"/> Remove

### Fund Changes

Total Cuts From Budget (In Billions)	\$0.00
Total additional revenue generated (In Billions)	\$0.00

### Individual PFD Values



### Budget Options

State Budget General Funds Unrestricted	
DEPARTMENT OF ""	DEPARTMENT CUT AMOUNT
Administration	0%
Commerce, Community and Economic Development	0%
Corrections	0%
Education and Early Development	0%
Environmental Conservation	0%
Fish and Game	0%
Health and Social Services	0%
Labor and Workforce Development	0%
Law	0%
Military and Veterans' Affairs	0%
Natural Resources	0%
Public Safety	0%
Revenue	0%
Transportation and Public Facilities	0%
University of Alaska	0%
Office of the Governor	0%
Branch-wide Unallocated Appropriations	0%
Alaska Court System	0%

## WHEN WILL WE FILL THE FUNDING GAP?

*The longer we delay:*

The less the immediate pain  
The less unnecessary pain if oil prices unexpectedly recover

*but*

The sooner we risk **draining our reserves**  
The bigger the risk of facing **drastic immediate adjustments**  
The greater the risk to our **credit rating**  
The greater the risk to **investor confidence**  
The lower our future **investment earnings** from savings  
The less savings we leave for **future generations**