

Alaska Fiscal Policy—Problem Statement

**Prepared for the
House Fiscal Policy Subcommittee (6/8/10)**

Petroleum has been the foundation of Alaska's economic prosperity

- 1/3 of jobs and income today depend on petroleum
- 2/3 of growth since statehood due to petroleum

Petroleum pays for a generous level of public services in Alaska

- 85% of state general fund revenues from petroleum since 1970s
- Cumulative state petroleum revenues thru 2008 of \$141 billion (2009 \$)
- Alaska public spending per capita is considerably higher than any other state

Alaskans want to maintain the Quality of Life we enjoy

- Preference for living and working in Alaska
- Children and grandchildren who live in Alaska
- Respect and maintain the diversity of life people and life styles

Petroleum has potential to continue as the most important private economic driver for the foreseeable future

- Petroleum employment and payroll have potential to continue strong
- 6 billion barrels of NS oil reserves
- 35 tcf of NS gas reserves
- Potential offshore, NPRA, ANWR resources
- Other current driver industries small
- Undeveloped drivers have uncertain potential

Production falling and easy petroleum gone

- Oil production today at 1/3 of peak (1989) and falling 3-5% annually
- Reserves and new development more technically challenging, in smaller fields, further from infrastructure
- Commercialization of gas challenged by risks—cost, fiscal, market

State Government spending is not sustainable (the Fiscal Gap)

- Projected growth in operations driven by education, Medicaid, PERS-TRS
- Local governments highly dependent on state spending
- Constitutional Budget Reserve a temporary revenue fix
- Federal grants to state face potential accelerated decline
- This is the Fiscal Gap problem

Petroleum revenues will decline

- Revenues dependent price, but ultimately on production
- Expanded federal revenue sharing uncertain
- Revenues from commercialization of gas limited
- Continued current degree of reliance on petroleum revenues to fund state government not feasible
- Complex tradeoff exists between increasing current petroleum revenues and reduced incentives to invest, resulting in fewer jobs and less future revenue

Closing Fiscal Gap will require new revenue sources and spending discipline

- State revenue potential of other industries modest
- Households pay no state income or sales tax
- Permanent Fund holds \$34 billion
- State government needs to do less, and more efficiently

Consequences of inaction would be dramatic loss of quality of life

- Household income down
- Business loss
- Housing crash
- Population decline
- Public services down
- Experience of the Crash of 1986 (many did not experience)

Policies to move toward sustainability should be implemented on a timely basis

- Environment where businesses want to invest and grow
- Place where today's youth will want to call home because of its opportunities and quality of life
- Stability of local economies
- Increasing personal responsibility

Implementation of a solution is challenging

- State government currently has a \$10 billion surplus, so little sense of urgency

- Economy has expanded for 20 years and is currently relatively healthy
- Public resources are a “common property” and no incentive for individual restraint
- Boom-bust economic history impedes long run strategic planning
- The transient population has limited commitment to Alaska's future
- Public skepticism of problem and distrust of public officials who preach fiscal conservatism and yet helpless to control spending
- Many think cutting government spending is a simple matter with no consequences
- Continuous election cycles for elected officials whom Alaskans expect to solve this problem
- Limited public understanding of the problem and consequences of not solving it
- Misconception that gas line will solve economic and fiscal problems
- Sense of entitlement to permanent fund earnings and low tax burden (third rail phenomenon)
- Sense of entitlement to state government capital and operations spending
- Special interest group access to and impact upon politicians
- Natural tendency to avoid making unpleasant decisions
- Urban vs Rural and region vs region competition
- Lack of entrepreneurial spirit
- Short attention span

We have advantages for addressing the problem

- Accessibility