

# *A Way Forward on the Alaska Budget*

Senate State Affairs Committee  
February 4, 2016

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## *Three Key Points*

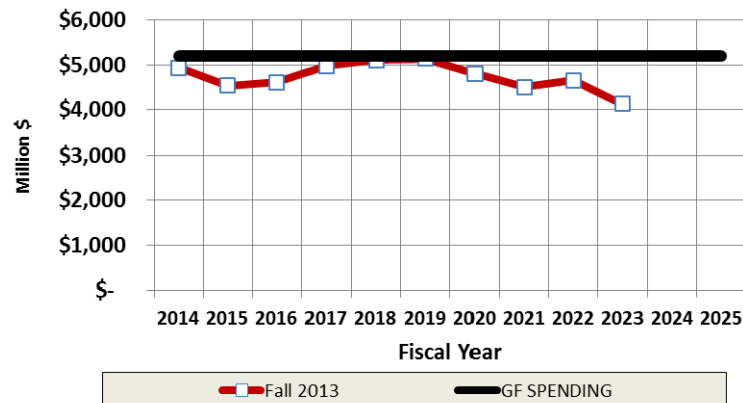
- Alaska is facing a budget challenge, but how big is it
- There is a solid and realistic fiscal alternative that doesn't rely on PFD cuts or taxes
- SB 128 and SB 114 are unnecessary, are imbalanced (between the private and government sectors) and may do more harm than good to the overall Alaska economy

## *First Point*

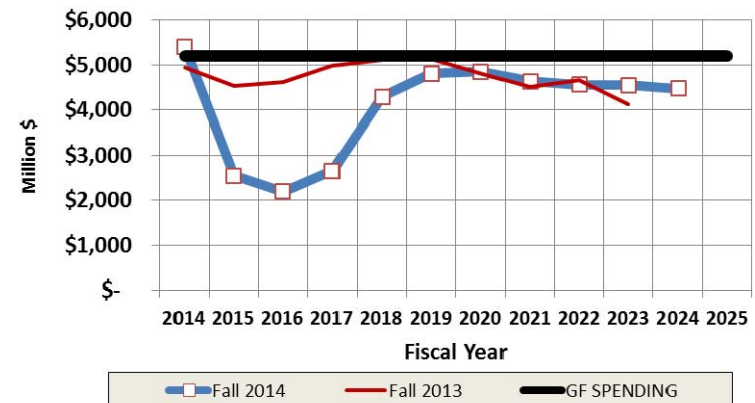
***Alaska is facing a budget challenge,  
but how big is it***

# There is a challenge...

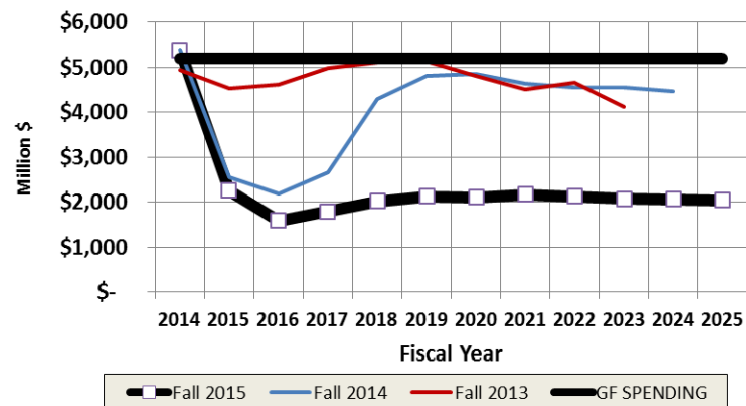
**GENERAL FUND UNRESTRICTED REVENUE:  
FALL 2013 FORECAST**



**GENERAL FUND UNRESTRICTED REVENUE:  
FALL 2014 FORECAST**



**GENERAL FUND UNRESTRICTED REVENUE:  
FALL 2015 FORECAST**

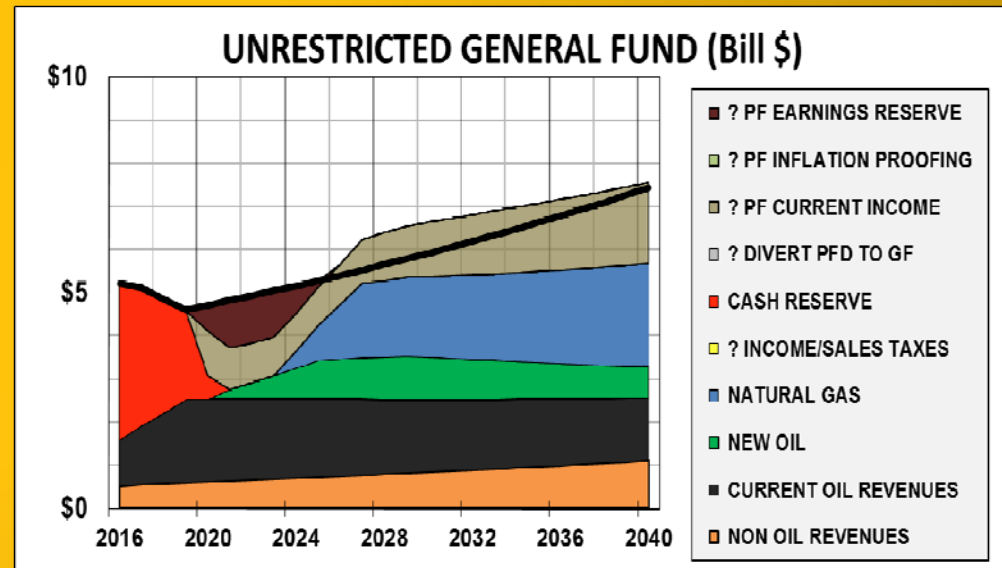


... but how big is it?

***If assumptions are ...***

- \$80/bbl by FY 2020 (v. FY 2022)
- 3% production decline (v. 5%)
- New oil, #AKLNG & use of PFER
- Population growth of 0.5% (v. 1%), then

***... long term sustainable revenue is \$4.3B (w/o PFD cut or taxes)***



CHOOSE ASSUMPTIONS AND USE THE FISCAL TOOLS TO CLOSE THE FISCAL GAP

CURRENT REVENUE ASSUMPTIONS				1 = ASSUMPTIONS FIXED AT BASE CASE WITH DOR PET REV, 2 = USER SUPPLIED				2
FX OIL PRICE	2017	\$ 60	< >	SR GR RATE	15.0%	< >		
	LR GF SWITCH	2020	< >	LR GR RATE	2.5%	< >		
FY 2017 PRODUCTION	BARRELS	550	< >	GR RATE	-3.0%	< >		
GAS PIPELINE	WHEN	2024	< >	\$ / MCF	\$ 1.50	< >		
NEW OIL - ANWR	WHEN	2100	< >	RELATIVE \$ / BARREL	50%	< >	PEAK BARRELS	0 < >
NEW OIL - OCS	WHEN	2100	< >	RELATIVE \$ / BARREL	10%	< >	PEAK BARRELS	0 < >
FY REAL RETURN	RATE	5.0%	< >					
UGF SUSTAINABLE SPENDING FY 2017	\$ 4.31	Based on Current Revenue and use of financial asset income. Spending (including dividend) grows with inflation and population.				inflation	2.30%	
						population grow	0.50%	

## *The concern ...*

- We are formulating fiscal policy projecting out from the bottom of a commodity cycle ...  
... and as a result may be assuming we need to cut more spending – or raise more “new” revenue – than necessary when looked at from a long term perspective  
*... in short, the reverse of the overspending problem we experienced from 2011-14 (when the Gov & Legis assumed oil would rise forever)*
- ***Alaska*** is a commodity based economy and as a result ***needs to take a long term budget view, not a one year snapshot***

## *Second Point*

***There is a solid and realistic fiscal alternative that doesn't rely on PFD cuts or taxes***

## Core Principles ...

- Use an approach that looks at the ***full commodity cycle*** and develops a balanced, sustainable approach that smooths through the revenue highs and lows
- Don't cut the PFD or impose other taxes if avoidable because of ***impact on Alaska's private economy*** – and if not avoidable, only to the extent it does not harm the overall Alaska economy (in short, don't overreact)



# Approach

***Best approach remains Goldsmith model***

## Keys

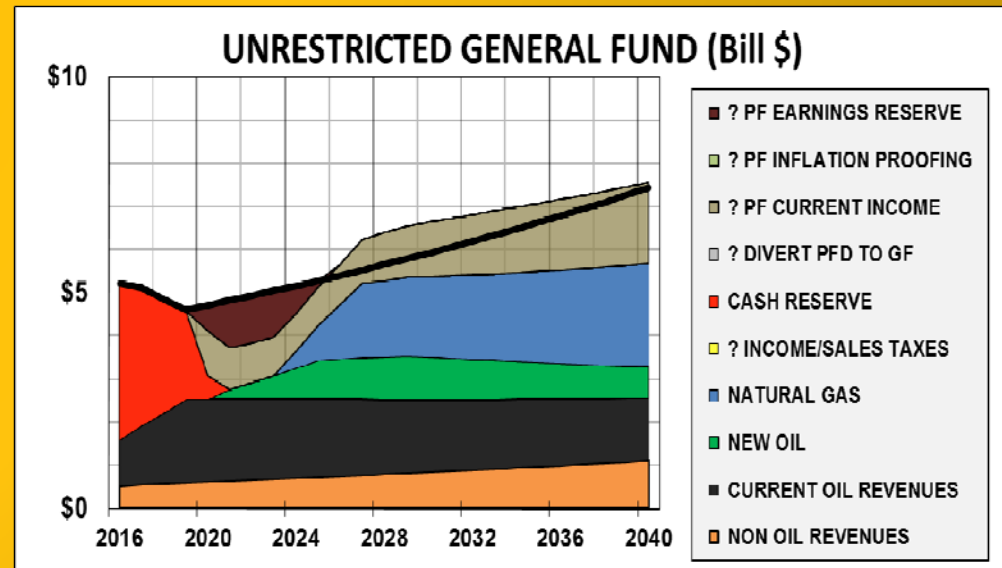
- Set spending at ***long-term sustainable levels*** based on best reasonable long-term forecast
- Use the ***Permanent Fund earnings reserve*** – the part remaining after PFD and inflation proofing – to act as the balancing mechanism
- Remain alert to ***changes in key, long-term forecast variables*** and adjust levels if there are significant, ***long-term*** changes

# Revenues

***If assumptions are ...***

- \$80/bbl by FY 2020 (v. FY 2022)
- 3% production decline (v. 5%)
- New oil, #AKLNG & use of PFER
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***... long term sustainable revenue is \$4.3B (w/o PFD cut or taxes)***

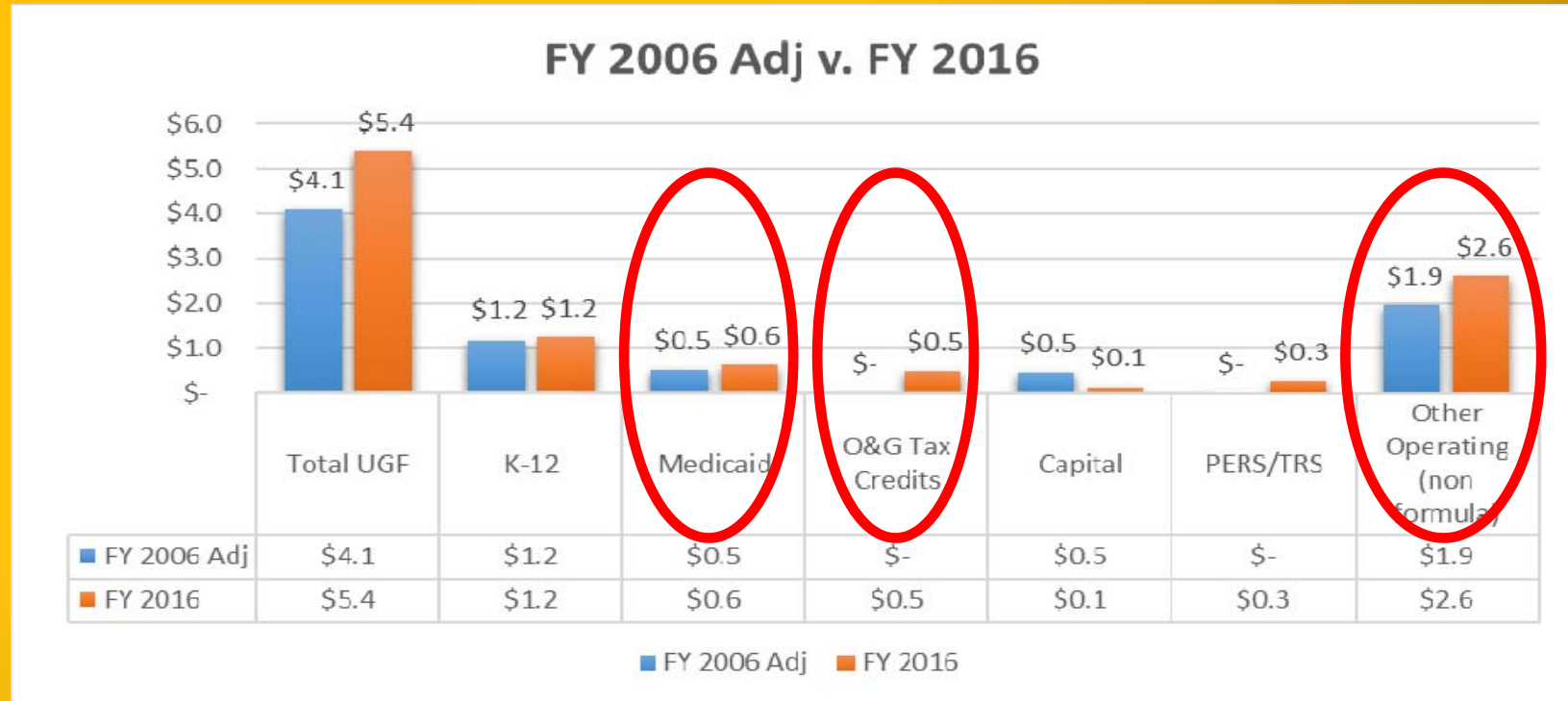


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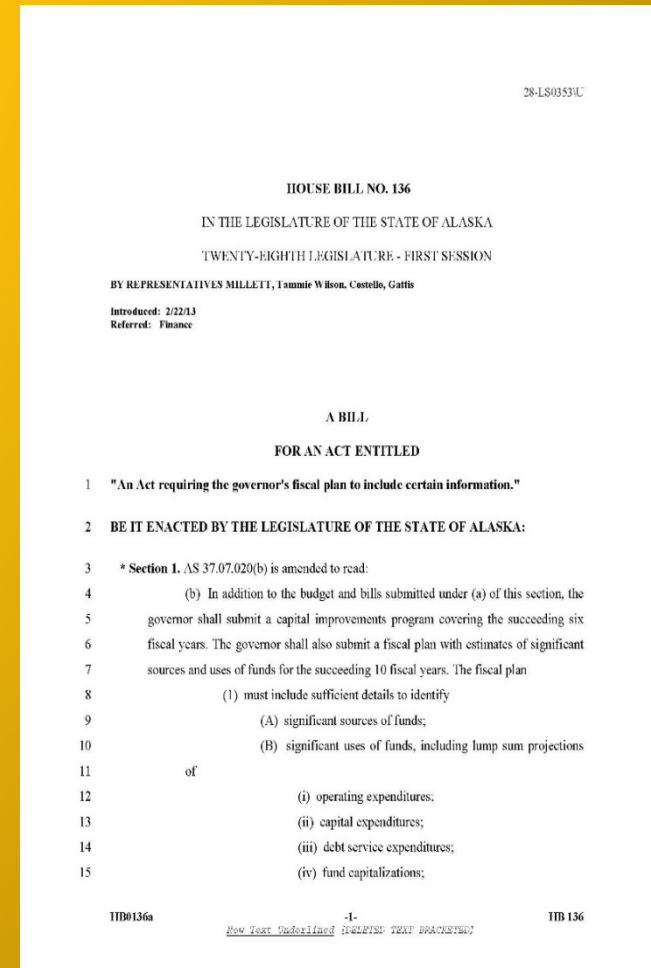
# Spending Cuts

*FY 2016 compared to FY 2006 adjusted for inflation and population growth ...*



# Implementation

- Starting point: HB 136 (28<sup>th</sup> Legislature):  
*“An Act requiring the governor's fiscal plan to include certain information”*
- Reworked into an appropriate form, could be used as a substitute for Const. Art 9, Sec. 16 (“Appropriation Limit”)

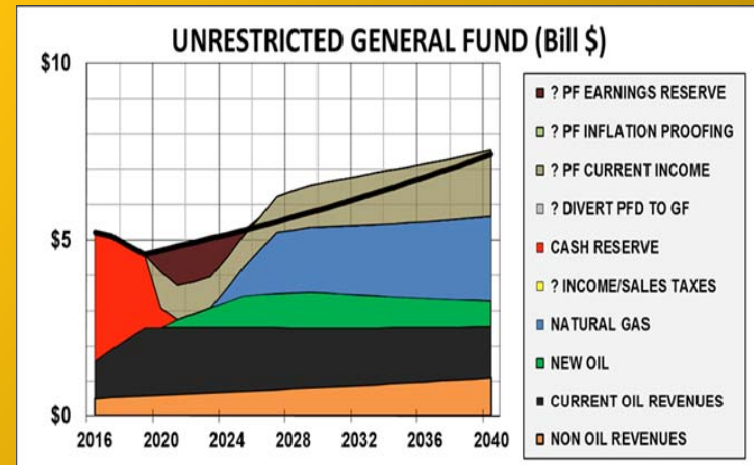


## *Third Point*

***SB 128 and SB 114 are unnecessary, are imbalanced (between the private and government sectors) and may do more harm than good to the overall Alaska economy***

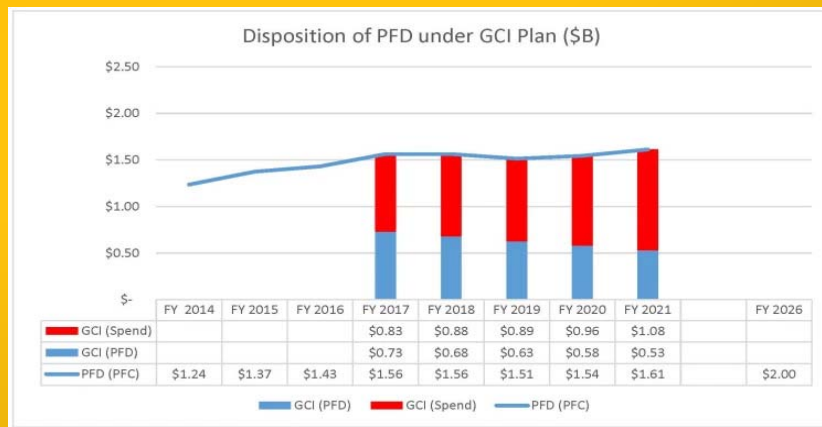
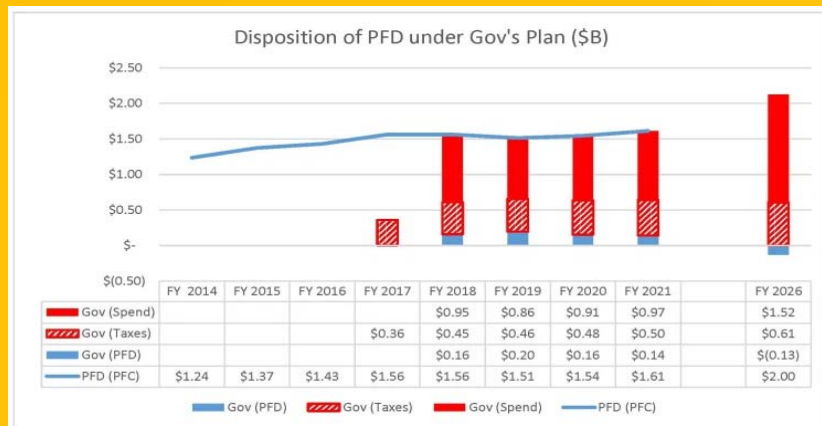
# Unnecessary

- If the long-term sustainable revenue level is ~\$4.3 billion – and we can cut spending to that level – do we need to be adding revenue?
- ***Until we have a better feel for where long-term oil and gas markets are headed, there is no compelling case for long-term PFD cuts and taxes (i.e., overreacting)***

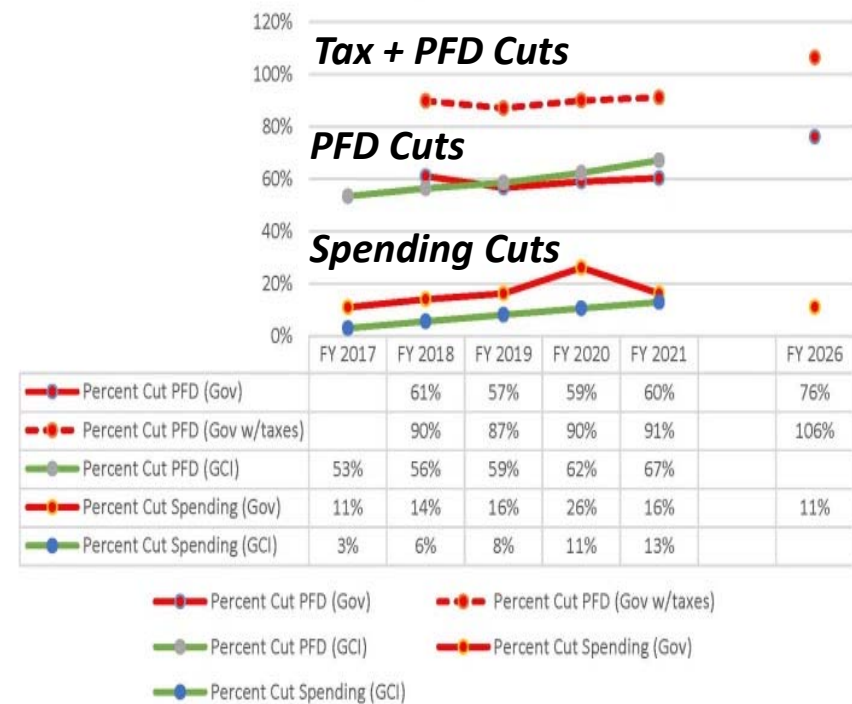


# SB 128 and SB 114

*SB 128 and SB 114 are imbalanced between spending (gov't sector) and PFD (private sector) cuts ...*



Percentage Cuts (PFD v. Spending) under Plans  
(including Gov's tax)





# *Need to consider overall economy*

*PFD cuts could do more harm than good ...*

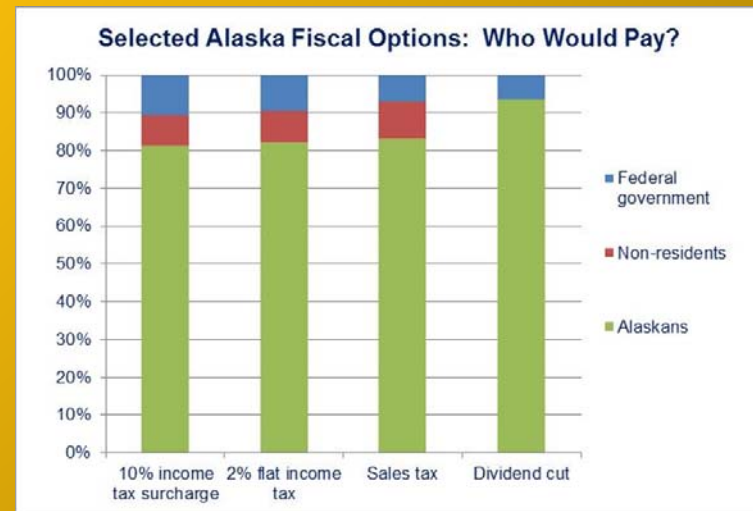
*“[M]ost of the cash from dividends will ultimately find its way into the Alaska economy to increase employment, population, and income. ... **[If the dividend instead had been diverted to state government,]** the most likely alternative use of the PFD would probably have been to increase capital spending by state government. ... Capital spending **would have generated less employment and increased income inequality.**” -- Dr. Scott Goldsmith (2010, looking back on prior experience)*



*If new revenues are required, taxes do less harm than PFD cuts...*

***“Reducing dividends to produce the same amount of revenues as would the proposed income tax would actually cost Alaska more jobs and income than would re-imposing an income tax ....” – Dr. Scott Goldsmith (1987)***

*“... Alaskans are more likely to spend the Permanent Fund dividends ...; almost all of the dividend money is paid to persons actually living in Alaska; and Permanent Fund dividends are generally taxed at a lower rate ...”*



## *My point ...*

- If the long term sustainable revenue level is \$4.3 billion and we reasonably can reduce spending to that level, SB 128 and SB 114 are unnecessary
- The proposals also are imbalanced: They take much more from the private sector – through PFD and taxes – than they cut spending
  - While that helps the *government economy*, it comes at the expense of Alaska's *private economy*, which at \$30 oil is rapidly developing its own problems
  - Tradeoffs between the two are not a zero sum game (regional differences and can hurt the overall economy)

## *Three Key Points*

- Alaska is facing a budget challenge, but it may not be as big as some suggest
- There is a solid and realistic fiscal alternative that doesn't rely on PFD cuts or taxes
- SB 128 and SB 114 are unnecessary, are imbalanced (between the private and government sectors) and may do more harm than good to the overall Alaska economy