

**ALASKA STATE LEGISLATURE
HOUSE RESOURCES STANDING COMMITTEE**

April 25, 2012

9:08 a.m.

MEMBERS PRESENT

Representative Eric Feige, Co-Chair
Representative Paul Seaton, Co-Chair
Representative Peggy Wilson, Vice Chair
Representative Alan Dick
Representative Neal Foster
Representative Bob Herron
Representative Cathy Engstrom Munoz
Representative Berta Gardner
Representative Scott Kawasaki

MEMBERS ABSENT

All members present

OTHER LEGISLATORS PRESENT

Representative Chris Tuck
Representative Mike Doogan
Representative Alan Austerman
Representative Lance Pruitt
Representative Dan Saddler
Representative Pete Petersen

COMMITTEE CALENDAR

HOUSE BILL NO. 3001

"An Act relating to adjustments to oil and gas production tax values based on a percentage of gross value at the point of production for oil and gas produced from leases or properties north of 68 degrees North latitude; relating to monthly installment payments of the oil and gas production tax; relating to the determinations of oil and gas production tax values; relating to oil and gas production tax credits including qualified capital credits for exploration, development, or production; making conforming amendments; and providing for an effective date."

- HEARD & HELD

PREVIOUS COMMITTEE ACTION

BILL: HB3001

SHORT TITLE: OIL AND GAS PRODUCTION TAX

SPONSOR(S): RULES BY REQUEST OF THE GOVERNOR

04/18/12	(H)	READ THE FIRST TIME - REFERRALS
04/18/12	(H)	RES, FIN
04/20/12	(H)	RES AT 1:00 PM HOUSE FINANCE 519
04/20/12	(H)	Heard & Held
04/20/12	(H)	MINUTE(RES)
04/21/12	(H)	RES AT 10:00 AM HOUSE FINANCE 519
04/21/12	(H)	Heard & Held
04/21/12	(H)	MINUTE(RES)
04/21/12	(H)	RES AT 2:00 PM HOUSE FINANCE 519
04/21/12	(H)	Heard & Held
04/21/12	(H)	MINUTE(RES)
04/23/12	(H)	RES AT 9:00 AM HOUSE FINANCE 519
04/23/12	(H)	Heard & Held
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04/24/12	(H)	Heard & Held
04/24/12	(H)	MINUTE(RES)
04/25/12	(H)	RES AT 9:00 AM HOUSE FINANCE 519

WITNESS REGISTER

KAREN REHFELD, Director
Office of Management & Budget (OMB)
Office of the Governor
Juneau, Alaska

POSITION STATEMENT: During the hearing on HB 3001, provided a PowerPoint presentation entitled, "Alaska's Budget Outlook," dated 4/25/12, and answered questions.

JOHN BOUCHER, Senior Economist
Office of the Director
Office of Management & Budget (OMB)
Office of the Governor
Juneau, Alaska

POSITION STATEMENT: During the hearing on HB 3001, assisted in a PowerPoint presentation entitled, "Alaska's Budget Outlook," dated 4/25/12, and answered questions.

DAVID TEAL, Director
Legislative Finance Division
Legislative Agencies & Offices
Juneau, Alaska

POSITION STATEMENT: During the hearing on HB 3001, provided comments following the presentation by the Office of Management & Budget, Office of the Governor.

ACTION NARRATIVE

[9:08:28 AM](#)

CO-CHAIR PAUL SEATON called the House Resources Standing Committee meeting to order at 9:08 a.m. Representatives Seaton, Feige, Herron, P. Wilson, Kawasaki, Gardner, Dick, and Foster were present at the call to order. Representatives Munoz arrived as the meeting was in progress. In attendance from the House Special Committee on Energy were Representatives Pruitt, Saddler, Petersen, and Tuck. Also in attendance were Representatives Doogan and Austerman.

HB3001-OIL AND GAS PRODUCTION TAX

[9:09:13 AM](#)

CO-CHAIR SEATON announced that the only order of business would be HOUSE BILL NO. 3001, "An Act relating to adjustments to oil and gas production tax values based on a percentage of gross value at the point of production for oil and gas produced from leases or properties north of 68 degrees North latitude; relating to monthly installment payments of the oil and gas production tax; relating to the determinations of oil and gas production tax values; relating to oil and gas production tax credits including qualified capital credits for exploration, development, or production; making conforming amendments; and providing for an effective date."

[9:09:51 AM](#)

KAREN REHFELD, Director, Office of Management & Budget (OMB), Office of the Governor, said she would offer a PowerPoint presentation on Alaska's budget outlook, revenues and expenditures, and the potential impact on future budgets with

passage of HB 3001. Her presentation would also include background on how OMB develops its annual budget; a brief look at the current overall operating and capital budgets; highlights of the 10-year plan; and discussion of some of the projected revenue changes based on the Department of Revenue (DOR) fiscal notes attached to HB 3001.

MS. REHFELD projected slide 2 of the PowerPoint presentation, which displays the governor's vision used by OMB to develop the annual budget: economic growth and strengthening families. Ms. Rehfeld said the future of Alaska rests on responsibly developing its natural resources and creating jobs and economic opportunities, especially in light of declining oil production and the price of oil necessary to balance its budget. As shown on slide 3, she named the four budget principles used by OMB to develop its proposals: fiscal restraint - to spend less and save more for the future; strategic investments - made to grow the economy; cash reserves - the 2011 constitutional budget reserve (CBR) and the statutory budget reserve (SBR) totaled about \$13 billion, with an additional \$2 billion appropriated to the SBR in 2012; and focus on results - agency missions and core services that the public expects to receive from its investment in state programs and services.

MS. REHFELD listed budget priorities - shown on slide 4 - from the state constitution and its statutory framework: resource development - creating jobs for Alaskans; education - to prepare students for success in vocational training or postsecondary education; public safety - for safe homes and strong families; transportation/infrastructure - to support economic development; and military support - for missions and families.

MS. REHFELD presented slide 5 entitled, "FY2012/2013 Revenue & Savings," which provides a chart of the spring forecast and budgets passed by the legislature and awaiting the governor's signature. Projected in fiscal year 2012 (FY 12) is: revenue of about \$9.9 billion; spending of about \$7.4 billion; an available balance of about \$2.5 billion; deposits to the SBR of \$1.75 billion; and possible additional savings of about \$766 million. Projected in FY 13 is: revenue of about \$8.44 billion; spending of about \$7.7 billion; an available balance of \$760 million; deposits to the SBR of about \$250 million; and possible additional savings of about \$510 million. She pointed out that the potential savings for FY 12 and FY 13 under the current spending proposal total \$3.2 billion.

[9:15:49 AM](#)

MS. REHFELD acknowledged the spring forecast is somewhat conservative; if oil prices remain at \$120 per barrel (/bbl) there will be more revenue available. However, it is known that 90 percent of the state's unrestricted general fund (GF) revenue comes from oil production, and production continues to decline, thus high oil prices are masking the effect of this decline, but at the same time present an opportunity for savings. As an aside, she noted that oil prices of approximately \$105/bbl would be required to balance the projected FY 13 budget. Ms. Rehfeld turned to FY 13 proposed budget sources of funds, slide 6, and said the total proposed budget is a little over \$12 billion and, of that, roughly 53 percent is unrestricted GF. About one-quarter of the budget is comprised of federal funds primarily for the Department of Health and Social Services (DHSS), the Department of Transportation & Public Facilities (DOT&PF), the Department of Education and Early Development (DEED), and the Department of Labor & Workforce Development (DLWD), although all departments receive some federal funds. Further federal funds go directly to the state through the U.S. Department of Health and Human Services, Indian Health Service, and military spending. As an aside, she advised that federal funding is expected to decline and its impact on the state is unknown. Permanent fund dividends (PFDs) [earnings] and inflation-proofing contribute about 12 percent to the budget, and designated GF such as University of Alaska receipts and GF program receipts contribute 7 percent. Finally, other funds, such as international airport funds, contribute 4 percent.

[9:19:09 AM](#)

MS. REHFELD presented slide 7 entitled, "FY2013 Proposed Expenditures by Category," which illustrates that approximately one-half of the state's expenses, about \$6 billion, are nondiscretionary funds, such as formula programs, the Permanent Fund, and items included in statewide costs. The other one-half are discretionary funds and include agency nonformula components and capital spending. She explained that under the nonformula component of 35 percent are the 14 state agencies, the University of Alaska, the Office of the Governor, the legislature, and the Alaska Court System budgets.

[9:20:19 AM](#)

CO-CHAIR SEATON asked whether discretionary funds are a combination of agency nonformula and capital budget funds.

[9:21:01 AM](#)

MS. REHFELD answered yes. Returning to slide 7, she said about 26 percent of the budget is for formula programs and is mostly taken up by the two largest pieces of the formula program: K-12 education and pupil transportation cost \$1.2 billion to support 54 school districts and 129,000 students; and Medicaid costs \$1.64 billion, with \$676 million coming from the GF. The cost of Medicaid is determined by the number of people who are eligible and enrolled, the utilization of the program, and the cost of providing the services. Other elements of the formula program include public assistance, foster care programs, and power cost equalization (PCE). Statewide appropriations represent 12 percent of the total budget and include annual payments of approximately \$613 million to the public employee and teacher retirement systems' unfunded liabilities. She said about \$400 million from statewide appropriations apply to oil exploration tax credits, based on which companies are eligible for credit and outstanding credit certificates that are cashed out in any given year. She said DOR gives OMB those estimates, which are built into the budget. Ms. Rehfeld said about \$300 million apply to debt service; about \$120 million apply to the school debt reimbursement program, which reimburses municipal school districts for a portion of the cost of educational facility projects; and about \$60 million apply to community revenue sharing for 162 incorporated and 150 unincorporated communities, including an additional \$25 million for one-time help with energy costs. The Permanent Fund is about 12 percent of the budget, including funding for PFDs and hold-harmless provisions. Ms. Rehfeld said the capital budget is about 15 percent of the total budget, which was increased by about \$1 billion appropriated by the legislature. She highlighted important elements: resource development; transportation and infrastructure vital for economic development, including highways and aviation; water and sewer projects; the harbor grant program; energy programs for renewable energy, weatherization, and the home energy rebate; rural power system upgrades; deferred maintenance; public safety; school construction and maintenance; and an additional general obligation bond package, appropriated by the legislature, of \$450 million for roads and port improvement projects.

[9:25:18 AM](#)

CO-CHAIR SEATON clarified that the additional capital budget funding, and funding for the bond package, are not included in the pie chart on slide 7.

9:25:28 AM

MS. REHFELD confirmed that is correct. She projected slide 8 entitled, "FY2013 Proposed Budget - Another Perspective," which is a chart indicating another way to look at how the money is used: approximately 60 percent of all funds goes to Alaska communities, individuals, and organizations through Medicaid, PFDs, revenue sharing, school funding, deposits to unfunded liabilities, capital projects, and named recipient grants. About 21 percent goes to services purchased from Alaskan vendors, such as travel, lodging, fuel, equipment, and supplies. Finally, about 19 percent of the total budget goes to salaries and benefits for the state's workforce. Ms. Rehfeld opined this perspective is a way to display the overall budget in context.

CO-CHAIR SEATON asked if capital projects are in the purchased services category.

MS. REHFELD answered that capital projects are represented in the 60 percent category. Typically, many capital projects are for municipalities, and large and small projects are put out to private industry for bid.

MS. REHFELD turned attention to the future and presented slide 9 entitled, "Ten-Year Fiscal Plan," which displays OMB's guiding principles for improving on the evaluation, planning, and delivery of the budget: to develop Alaska's natural resources - economic development vital to the future of the state and creation of jobs and opportunities for Alaskans; to restrain spending - budget discipline to minimize unsustainable automatic increases to formula programs; and to save for the future - done well by the legislature and governor over the last several years, given the environment the state has had.

MS. REHFELD talked about focusing on priorities under Alaska's constitutional and statutory framework, looking at the mission and core services that the department has been tasked to carry out, maintaining the level of services with fixed costs, projecting costs of increasing capacity or expanding services, and considering and planning for new initiatives.

9:30:20 AM

MS. REHFELD said the 10-year fiscal plan is published on the OMB website and includes baseline scenarios for individual agencies and new initiatives. Also on the website are four statewide

scenarios based on variables in the price of oil, including \$90 oil, flat-funding of the budget, and a 4 percent increase. Slides 10 and 11 illustrate the effects of OMB Scenario 4: the potential fiscal impact of HB 3001 with a four percent growth in agency operating components; the projected increases in payments to unfunded liabilities; and a \$1 billion cap on capital expenditures. She advised that a reduced capital budget of \$1 billion means the state turns to a specific focus on leveraging dollars with matching federal funds, and the focus would be on funding deferred maintenance and schools.

MS. REHFELD continued to explain that the revenues and expenditures adjusted for HB 3001 - illustrated by slides 10 and 11 - reflect the timeframe of the bill's fiscal note [FY 13 to FY 18]. On slide 10: the top line represents the spring [2012 GF] revenue forecast; the blue line ["General Fund Expenditures (Scenario 4 FY2013 10-year plan)"] represents OMB Scenario 4 projected expenditures, incorporating the budget that was just passed by the legislature, with the "cap scenario" budget coming into effect in FY 14; the green line ["Spring 2012 GF Revenue adjusted by HB 3001 FN dated 4/18/1012)"] represents the change in revenue, based on the fiscal note worst case scenario; the yellow shaded area ["Potential Shortfall"] represents the difference between the revised revenue and the projected expenditures; and the black line ["projected reserve deposit/draw"] represents the amount that would be drawn from reserves to balance the projected expenditures to FY 18. In response to Co-Chair Seaton, she explained the revenue projection was based on oil priced at \$110/bbl.

[9:35:26 AM](#)

CO-CHAIR FEIGE asked for the forecasted level of production.

MS. REHFELD said the forecast was out of the Revenue Source Book and is DOR's revised spring forecast.

REPRESENTATIVE PETERSEN returned attention to slide 5, and asked whether \$110/bbl was the price used for those projections also.

MS. REHFELD answered yes. She returned attention to slide 10, saying that the slide shows the overall impact of the annual draws on reserves; however, if the price of oil stays at the current price of \$120/bbl, the amount of the potential draws will change.

CO-CHAIR SEATON expressed the committee's intent to ask OMB to generate scenarios based on varying production rates and prices of oil. Also, he offered his understanding that the FY 13 budget reflects the actual budget, but the projected budgets for FY 14 and FY 15 reflect a cap at \$1 billion.

MS. REHFELD responded that OMB updated FY 13 based on the budget that just passed; FY 14 and beyond are projections based on OMB Scenario 4 with the capped \$1 billion capital budget. If the committee wants to look at a different level of expenditures, each adjustment would increase or decrease the draw on reserves.

CO-CHAIR SEATON surmised that averaging the capital budget for the past two years would add an additional \$1 billion to the draw from reserves.

MS. REHFELD said that is correct.

[9:38:16 AM](#)

REPRESENTATIVE MUNOZ asked for the reserve balance projected for FY 18, assuming the annual draws take place.

MS. REHFELD, in response, drew the committee's attention to slide 11. On slide 11: the orange bar ["Spring 2012 Forecast General Fund Unrestricted"] represents the spring forecast of GF revenues; the green bar ["General Fund Revenues Adjusted for HB 3001"] represents adjusted revenue for HB 3001; and the yellow bar ["Budget Surplus/(Shortfall)"] indicates the required draw from reserves. New information is shown in the gray bar ["Total Reserves"], which indicates that the balance in reserves for FY 13, after the draw, would be \$15.7 billion; in FY 18, the balance would be \$15.6 billion in reserves. Ms. Rehfeld stated the importance of understanding that the combined balances of the CBR and the SBR have grown from \$2.4 billion in FY 06 to a projected \$16.1 billion in FY 13. Ms. Rehfeld said the legislature has excelled in growing significant savings for the state in response to the high price of oil. She suggested the heart of the issue is in figuring out how much should be in savings and how much should be used to incent increased production.

[9:40:52 AM](#)

REPRESENTATIVE HERRON observed HB 3001 seeks to change the taxes and use the dollars saved [by the industry] for expenditures on the North Slope to flatten the decline curve. He acknowledged

that the more the decline curve is flattened, the more revenue the state will generate over time, and he asked if it is possible for OMB to determine how much income is generated by each dollar lost in taxes.

MS. REHFELD advised that a 3-D model is needed to define the aforementioned investment because data on production would be required from the Division of Oil & Gas (DOG), to then be interpreted by DOR, and the expenditures would be modeled by OMB. She deferred to Mr. Boucher.

CO-CHAIR SEATON stated that the committee had requested [DOG] to provide speculation on the number of barrels the state could see from additional fields, if those fields became economic because of the change in tax structure.

[9:43:02 AM](#)

JOHN BOUCHER, Senior Economist, Office of the Director, Office of Management & Budget (OMB), Office of the Governor, reminded the committee that DOR can illustrate what the state may receive back in revenue; however, OMB must also try to quantify the additional private sector activity that might occur otherwise. He agreed with Ms. Rehfeld on the core of the issue.

REPRESENTATIVE HERRON opined that the debate going on is regarding what amount invested would reduce the decline and generate more money for the state. He said he thinks it would be helpful to those on both sides of the debate to see a presentation showing how many dollars might be returned for each dollar invested.

MS. REHFELD responded that the governor's goal is to create jobs and grow the economy, and not necessarily to offset that with more money coming to the state. She urged for looking at a long-range plan that will create a vibrant private sector employing many across the state.

REPRESENTATIVE PETERSEN returned attention to slide 11, and asked for the assumed rates of return on investment for the CBR fund that will continue the projected growth.

MR. BOUCHER answered that OMB used the official returns from DOR, and he recalled that the sub account is in the range of 6 percent, and the long-term for the main account, which is more conservatively invested, is approximately 3 percent. He offered to provide the exact figures.

[9:46:58 AM](#)

REPRESENTATIVE PETERSEN returned to slide 10, and asked whether reducing the capital budget to \$1 billion would affect the rate of unemployment.

MS. REHFELD said there has not been an analysis on unemployment; however, \$1 billion in the GF would be added to federal and other funds of about \$1 billion. In total, without significant changes in federal funding, the capital budget would approach \$2 billion, which would - over time - support the workforce. Although not refined over the long-term, decisions are made on an annual basis, she said.

REPRESENTATIVE PETERSEN recounted having heard from the Alaska Congressional Delegation to expect reductions in funding from the federal government. He requested a long-term projection of the effects reduced funding in the state budget would have on unemployment in Alaska.

MS. REHFELD relayed that the House Special Committee on Fiscal Policy (HFPY) is actively looking at changes to federal funding and other long-term issues, and OMB will focus on whether the state would be in a position to replace any loss of federal funding. In response to Co-Chair Seaton, she clarified that the revenue forecast with a cap of \$1 billion on capital spending was only based on the GF.

MR. BOUCHER suggested that members think of the amount of cash at stake in terms of investment, and that a portion of that would shift from state-purchased construction activity to private sector oil and gas activity. This could mean a different or similar type of work, but it would not necessarily be that a \$1 billion reduction in the state capital budget would mean an equal reduction in purchased construction.

REPRESENTATIVE PETERSEN expressed his understanding that the spending would shift to oil fields from specific state-financed projects around the state.

MR. BOUCHER responded, "In a very large sense, that's somewhat what I think would occur."

[9:52:15 AM](#)

CO-CHAIR FEIGE recalled the state has had healthy capital budgets in the last three to four years and HB 3001, if enacted, may reduce the capital budget from approximately \$3 billion to \$2 billion. He said the state is not expending \$3 billion in a year; a lot of it is getting rolled over to the future. He explained the state has a kind of rolling reserve of capital projects that represent a lot of jobs; it could have a zero capital budget next year and still be keeping people employed. He asked if OMB could relate "how much is actually from what has already been committed in previous years' capital budgets [and] how much is still left to be spent."

MS. REHFELD said she was unsure; however, she advised there are a number of different components to a capital budget. Typically a simple GF project can be completed in a five-year term. A number of projects are federally funded, such as those that go through DOT&PF. Those projects, she said, typically take more time, because they require permitting and other steps required under the Federal Highway or Federal Aviation program. She ventured that in DOT&PF's budget, there are a significant number of federally authorized projects not yet completed. Ms. Rehfeld said another group of projects are grants to municipalities, the timing of which varies depending on a municipal government's ability to enter into grant agreements. She offered to report on what projects have been authorized, how much has been encumbered, and what balances are remaining, although this information may not answer the question at a high level of specificity, she said.

[9:55:34 AM](#)

CO-CHAIR SEATON asked OMB to prepare a report on the state's history of capital spending during periods of deficit spending from 2001 to 2006. He explained he would like to see a comparison of what the capital spending was during the years when the legislature had to take money out of savings and "since 2006, when we've been under a different regime."

MS. REHFELD suggested that the Legislative Finance Division, Legislative Agencies & Offices, may already have that information.

CO-CHAIR SEATON urged that the committee take a look at responses to deficits other than a \$1 billion cap on spending.

MR. BOUCHER said from an historical perspective, a \$1 billion GF capital budget in deficit spending is extremely high, but it was

chosen as an example because it would be a relatively healthy capital budget assumption and would allow for a fairly significant amount of non-matching, straight GF projects.

CO-CHAIR SEATON said he understood the reason for the \$1 billion cap scenario; however, he said, "I don't think that's been the response of the legislature all the time." He opined that speculating that a \$1 billion capital budget is "healthy" - in the context that it is taken from savings - should be looked at by the committee and not assumed. He re-stated the need to look at all responses.

[9:59:08 AM](#)

REPRESENTATIVE SADDLER, referring to historical spending by the state on operating expenses, asked if agency spending increased following the change in the tax system from production profits tax (PPT) to Alaska's Clear & Equitable Share (ACES) and the concurrent rise in oil prices.

MS. REHFELD stated that some of the big increases were in formula and statewide costs related to oil tax credits, the three-year education funding plan, and direct deposits to the unfunded liability of the retirement system.

CO-CHAIR SEATON advised the committee would be looking at the effect of the state's commitments to capital credits for the oil industry - which are all based on "spend" with disregard to revenue - and which are an ongoing obligation that is independent of the revenue stream.

REPRESENTATIVE SADDLER asked for an estimate of additional state revenue from royalties, income taxes, and severance taxes that would result from the changes made by HB 3001.

MS. REHFELD deferred to DOR.

CO-CHAIR FEIGE returned attention to the production numbers in DOR's Revenue Source Book on which OMB based its budget. He stated that with the effects of HB 3001, one would assume that lowering the taxes makes more money available to industry for investment, and thereby would result in a rise in production. He asked whether OMB accounted for that rise in production and the subsequent additional revenue.

MS. REHFELD relayed that estimates of the potential revenue generated from investment must come from DOR and DNR. She

explained that OMB relies on the expertise of DNR and DOR for the information on which to base its budget decisions, and does not arrive at numbers independently. In further response to Co-Chair Feige, she confirmed the committee would need to ask DOR directly.

CO-CHAIR SEATON acknowledged that the committee is asking some speculative questions; however, it can question the oil companies on their historic application of capital, especially that of ConocoPhillips Alaska, Inc. In fact, in 2010 and 2011, the committee can see ConocoPhillips' allocation of profits and where its profits went on a percentage basis. He suggested asking the industry Representative Herron's question, and also asking for the historic perspective of asset allocation by the oil companies. He acknowledged that is a difficult question to ask OMB, and ventured that DOG's perspective numbers on additional oil production would be helpful.

[10:05:47 AM](#)

REPRESENTATIVE SADDLER returned to slide 11 and pointed out that the total estimated reserve funds in FY 18 are about the same as in FY 13, because funds are taken from the SBR. He asked for the stated purpose of the SBR, and whether it is appropriate to use SBR funds "to fill this hole in revenue."

MS. REHFELD responded that the SBR and the CBR are the state's savings accounts. She opined there is no limitation on the state's use of the SBR; language in the annual appropriation bill allows the state to use the SBR if the balance is insufficient to cover expenditures. The reason that funds are taken from the SBR in the forecast is that in order to use CBR funds, there must be a supporting vote by three-quarters of the legislature; therefore, SBR funds have become the savings account accessed first.

REPRESENTATIVE SADDLER asked for confirmation that SBR funds are designed for this use.

MS. REHFELD responded that is correct. She concluded that at the end of [FY 18] - the period anticipated in the HB 3001 fiscal note - there would still be a healthy reserve balance. She said the governor's goal for HB 3001 is to grow the economy, create jobs, and turn around the production decline.

CO-CHAIR SEATON spoke of the need for additional analysis of scenarios assuming the price of oil at \$20/bbl higher, and

\$20/bbl lower, than the price in OMB's Scenario 4. He said he presumes this analysis would more accurately reveal the impact of volatile oil prices.

CO-CHAIR FEIGE requested OMB add production numbers to the analysis.

MS. REHFELD agreed.

REPRESENTATIVE MUNOZ stated that the HB 3001 fiscal note estimates forecasts with 5 percent, 10 percent, 15 percent, and 20 percent increases in production. She asked for an analysis on the impact of those changes on savings and other figures provided in OMB's PowerPoint.

MS. REHFELD agreed.

[10:12:14 AM](#)

DAVID TEAL, Director, Legislative Finance Division, Legislative Agencies and Offices, cautioned that the Legislative Finance Division does not take a position on bills; however, he offered to comment on the presentation by OMB. He directed attention to slide 3, noting that one of OMB's budget principles is building cash reserves. He affirmed that the legislature should be aware that building cash reserves is important for the future because of the projected deficits, which will occur without changes to the production tax structure, and which will become even larger with changes to the tax structure.

MR. TEAL agreed with members of the committee that the legislature needs to see how the deficit changes if production increases. Referencing slide 7, he pointed out that the PFD program is discretionary spending, and he said if deficits continue to eat into reserves, the PFD program may not be affordable; in fact, the \$1 billion cost of the PFD program is about the same amount that is lost in revenue under HB 3001. He stressed that the state cannot continue to have a cash flow deficit forever and, although reserves will help the state for a period, funding for the PFD program can be used instead to fund government operations.

MR. TEAL turned to the subject of savings, noting on slide 11 the total reserves in FY 13 are \$15.7 million and are projected to be basically the same in FY 18. In fact, the SBR is declining because it is being used to fund deficits; the reserves don't decline with the SBR because CBR earnings are

offsetting the expenditures. He said the point is that Alaska is like a person nearing retirement; declining earnings must be replaced by earnings from savings, thus cash reserves are critical as oil production declines.

MR. TEAL, in response to the previous questions stated by Representatives Herron and Petersen, regarding whether money invested on increased production is recovered, acknowledged that OMB makes a good point about jobs, but jobs also come from keeping tax revenue for spending as capital budget. The question remains whether the state would benefit more from that than letting the oil companies keep the money and invest "just in one way." He suggested turning the question around and asking how much more production would be required in order to break even, because the approximate costs of the tax change are known and it is possible to see the negative cash flow. He offered an example of figuring out whether a 2 percent annual increase in production would generate enough cash flow over a period of years to produce a net present value (NPV) back up to zero, or whether it would take a great percent increase, and whether that level of production would be reasonable.

[10:19:23 AM](#)

CO-CHAIR SEATON asked whether [the Legislative Finance Division] has those calculations or can provide them.

[10:19:48 AM](#)

MR. TEAL answered no. He said DOR and DNR have to generate those numbers.

[10:19:52 AM](#)

CO-CHAIR SEATON clarified that his question related to Representative Herron's previous question: How much production, at estimated costs, would it take to get back \$1 billion in tax relief?

MR. TEAL said he did not know. He explained that the oil tax issue has not involved his division, because of its neutral position, and although he could do more modeling, the source of the numbers would be DNR and DOR.

CO-CHAIR SEATON said he would inquire as to who can provide answers.

MR. TEAL offered to provide the graph on the state's historical spending patterns which was prepared for the House Special Committee on Fiscal Policy. He advised the state endured 20 years in deficit spending with no increase in capital and operating spending. He agreed with Mr. Boucher that a \$1 billion capital budget is high; on the other hand, the state and legislature can be fiscally conservative if there is no money to spend in the operating budget.

CO-CHAIR SEATON requested the information on historical spending patterns.

[10:23:17 AM](#)

REPRESENTATIVE PRUITT referred to DOR's Revenue Source Book, page 39, which shows "the total North Slope production from 2011," and he indicated that DOR included opportunities related to development, valuation, and "what we potentially could have total." He said OMB used numbers "off of what's projected in here." He recommended asking DOR what changes it anticipates from the effects of HB 3001, so that OMB can adjust its projections and come back before the committee. He said, "Because right now, if you just look at from 2011 to 2018, it's a 48,000 per day barrel drop. How is this going to change that?" He said he thinks that will help the committee understand, because the information would clarify the situation if a change is made with no new production.

CO-CHAIR SEATON observed that the committee is constrained by DOR's estimates that are simply various percentages. He remarked:

That's why we've asked the Division of Oil & Gas to come back and say what, in addition to these plans of development that are listed, do they speculate would be out there because [DOR] said that they don't have ... that information. So, hopefully, we can ... get that information from [DOG] ... although, the caveats are from them that it's going to be speculative. Yeah, speculation by [DOG] is much better than most of us sitting here trying to guess off a ... 5, 10, 15, 20 percent range with no ... knowledge of what fields are even potentially available.

REPRESENTATIVE PRUITT opined all the information presented is speculative, and he called for a better estimate for comparison

of "what we saw today with ... those new numbers thrown in the same projections."

CO-CHAIR SEATON explained he used the term speculative in order to prevent a misunderstanding of guaranty.

[10:27:34 AM](#)

REPRESENTATIVE P. WILSON recalled having to cut the state budget year after year in the past, and described doing so as "no fun." She encouraged the committee to seriously consider how to sustain the present budget before adding programs.

CO-CHAIR SEATON expressed appreciation for Mr. Teal's perspective that the surplus is not just to "tide us over," but that the CBR and the SBR are the earnings that will generate some of the state's flow of capital in the long-term. He said it is a perspective that had previously not been discussed.

REPRESENTATIVE PETERSEN returned attention to the chart on slide 11 and said that added together, the HB 3001 fiscal note adjustments from [FY 13 through FY 18] equal \$8.125 billion, and if that is added to the total reserves, it would put the state's reserves at \$27.243 billion in 2018, and that is not counting any lost interest on investments over those six years. He said, "It would be probably pushing in the neighborhood of \$30 billion that we would have in our reserve accounts." He explained that he wants the committee to consider that as one of many scenarios.

[HB 3001 was held over.]

[10:32:27 AM](#)

ADJOURNMENT

There being no further business before the committee, the House Resources Standing Committee meeting was adjourned at 10:32 a.m.