

HOUSE FINANCE COMMITTEE
March 19, 2018
2:01 p.m.

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CALL TO ORDER

Co-Chair Foster called the House Finance Committee meeting to order at 2:01 p.m.

MEMBERS PRESENT

Representative Neal Foster, Co-Chair
Representative Paul Seaton, Co-Chair
Representative Jason Grenn
Representative David Guttenberg
Representative Scott Kawasaki
Representative Dan Ortiz
Representative Lance Pruitt
Representative Steve Thompson
Representative Cathy Tilton
Representative Tammie Wilson

MEMBERS ABSENT

Representative Les Gara, Vice-Chair

ALSO PRESENT

Sheldon Fisher, Commissioner, Department of Revenue; Dan Stickel, Chief Economist, Economic Research Group, Tax Division, Department of Revenue; Ken Alper, Director, Tax Division, Department of Revenue; Mike Navarre, Commissioner, Department of Commerce, Community, and Economic Development; Representative Gary Knopp.

PRESENT VIA TELECONFERENCE

None

SUMMARY

PRESENTATION: SPRING 2018 REVENUE FORECAST BY THE DEPARTMENT OF REVENUE

PRESENTATION: ALASKA'S ECONOMY BY DEPT. OF COMMERCE,
COMMUNITY, AND ECONOMIC DEVELOPMENT

Co-Chair Foster reviewed the agenda for the day. The committee would be hearing two presentations: one from Department of Revenue (DOR) on the spring revenue forecast and one from the Department of Commerce, Community and Economic Development (DCCED) on Alaska's economy. He asked members to hold their questions until the end.

^PRESENTATION: SPRING 2018 REVENUE FORECAST BY THE
DEPARTMENT OF REVENUE

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SHELDON FISHER, COMMISSIONER, DEPARTMENT OF REVENUE, introduced the PowerPoint presentation: "Spring 2018 Revenue Forecast." He indicated that in the interest of time he would jump over a few slides. He began by reviewing the forecasting methods and timeline on slide 2. He reported accelerating the spring forecast which was usually done in April because of the importance of the discussion that was currently happening in the legislature.

Commissioner Fisher turned to the chart on slide 4 which showed the historical production of the Alaska North Slope (ANS). He highlighted that production was starting to level off.

Commissioner Fisher looked at the chart on slide 5 comparing the ANS FY 17 and FY 18 production forecast. In the fall the department predicted about 533,000 barrels per day of production. The state fell below that number. Alaska's current production was about 518,000 barrels per day. At the bottom of the chart the black figures represented actual numbers, and the red figures were the forecasted numbers for the remainder of the year. Historically, the fourth quarter had accounted for about 24.5 percent of production for the year. The number of 521,800 barrels per day was just over 25 percent, slightly above average but consistent. The department was predicting FY 18 production to be slightly below FY 17 production - essentially flat with FY 17.

Commissioner Fisher turned to the ANS comparison on slide 6 that showed the long-term production forecast. He highlighted that in FY 18 the production was down. However,

for the rest of the 10-year period, he was predicting a flat forecast with modest gains in a few years. Generally, he expected the production to be comparable to what the department predicted in the fall forecast.

Commissioner Fisher discussed the short-term impact of spare capacity as it related to the price forecast on slide 8. He reported that the lines on the chart showed where there was either more supply or more demand. He continued that when the green bars fell below, it meant there was greater demand than supply leading to upward price pressure. Conversely, when the green bars went above the line, it meant supply was greater than demand leading to downward price pressure. He emphasized that the Energy Information Agency (EIA) was predicting in the coming quarters the state would see periods where supply was greater than demand, potentially resulting in a price softening. He would spend a little time reviewing some of the existing forecasts to give legislators a sense of why different forecasters predicted different scenarios for future price.

Commissioner Fisher detailed the forecast comparison between the Brent forecast and DOR ANS forecast for 2018 on slide 9. He indicated that the solid black line represented actual prices. He noted that when the state began FY 18 in July the price was just over \$50 per barrel. The price reached close to \$70 per barrel prior to leveling off where it was currently under \$65 per barrel. The black dotted line was what was predicted for the remainder of the year. The department was predicting just over \$64 per barrel for the remaining months of the year that would lead to a forecasted price for 2018 of \$61 per barrel average. The state's average price year-to-date for the fiscal year was \$59.65 per barrel. The red line represented the futures market. If a person wanted to go into the market to purchase oil, they could buy it over the period of time indicated at the price represented by the red line. The state was essentially consistent with the red line being modestly higher.

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Commissioner Fisher moved to slide 10 that showed the short-term comparison of the Brent forecast and the DOR ANS forecast. He was talking about the near-term versus the long-term because of the different data points available to

the department as it considered short-term and long-term pricing. In the short-term, in addition to the NYMEX [New York Mercantile Exchange] futures market, there was also the EIA Short-Term Energy Outlook (STEO). There were financial analysts who made predictions about pricing. The state's forecast was in line with the analysts' forecast and was higher than the EIA's STEO forecast. He would discuss the EIA's STEO forecast further.

Commissioner Fisher reviewed the short-term price forecast on slide 11. He relayed that the slide represented the information on the previous graph in dollar amounts. He noted that the state's forecast started at \$61 per barrel in FY 18, would increase to \$63 per barrel by FY 19, and would reach \$75 per barrel by the end of the forecast period. He had mentioned a moment ago that the EIA STEO outlook predicted the price of oil would be \$60 per barrel by FY 19. By 2020, the price would move substantially to \$67 per barrel and continue to increase. He would provide the rationale for the climb. He noted that the average analysts' predictions were more in line with the state's. Their price was \$1 more in FY 19, slightly higher in FY 20 and FY 21, and would begin to decline by FY 22. The analysts did not go beyond a 4-year period.

Commissioner Fisher moved to slide 12 reflecting the analyst's short-term comparison of the Brent forecast and the DOR ANS forecast. The slide showed a disparity in the analyst community. He noted that the solid blue line represented the analysts' average, the dotted black line represented the state's forecast, and the two blue dotted lines above and below represented the 25 percent highest analysts and the 25 percent lowest analysts. He pointed out there was a significant range. Some people predicted the price of oil would be well over \$70 per barrel, while others predicted the price would be closer to \$50 per barrel.

Commissioner Fisher indicated that slide 13 showed the differences in analyst forecasts. To a large extent the difference of opinion on demand was narrower. All of the analysts the department reviewed saw demand growing. Those that saw a lower price saw global demand growing more slowly. Those who saw a higher price saw global demand growing more rapidly, particularly in India and China. All of the analysts were within a narrow range with a stable consensus. The larger differences that explained the

varying opinions around pricing had to do with supply. There was a material difference of view in how the world would react regarding supply. Analysts who were on the low end of the forecast saw lower costs of producing oil. He expounded that they thought technology would drive the cost of oil per barrel down resulting in stronger production and very aggressive oil supply in the marketplace. The high analysts saw flat U.S. shale production driven by a discipline in the capital markets and available funding. Some of them saw a disruption in supply from external factors, especially in Venezuela and Iran. They saw that there might be opportunities for a material and rapid decline in terms of supply resulting in higher prices. He noted that EIA had two forecasts, the short-term energy outlook (published on a monthly basis) and a long-term forecast (published on an annual basis). While they were not the same and the short-term forecast accounted for events as they occurred, they shared a long-term thesis that the world was underinvesting in oil production, that there would not be enough supply to meet demand, and that prices would be driven higher.

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Commissioner Fisher discussed the Bullish Analyst example: Guggenheim, Short-Term on slide 14. He noted the analyst company's high price forecast. The company believed that 2018 would see oil prices in the low \$70 range. In 2019, prices would be as high as \$80 per barrel. The company saw a material increase in demand driven primarily by China and India. The company saw supply being more constrained with potential disruptions.

Commissioner Fisher reviewed the Bearish Analyst example: Citi Short-Term on slide 15. Analysts with Citi Group believed that prices would be in the high \$50 range in 2018 and in the high \$40 range per barrel in 2019. They saw flat demand and a large supply from the U.S. resulting from shale oil. They also believed that a number of segments in the industry, particularly Oil Producing and Exporting Countries (OPEC), were enjoying some material cost reductions making it more profitable and easier to deliver oil at lower prices. He skipped slide 16. The slide reflected a middle-of-the-road forecast.

Commissioner Fisher presented the long-term comparison of the Brent forecasts to the DOR ANS forecast on slide 17. He

conveyed that in real terms the long-term forecast was basically flat, a thesis consistent with the fall forecast. At low \$60 per barrel pricing there were enough sources of oil to meet the demand. The graph showed the analyst forecast and the EIA reference case predicting higher oil prices.

Commissioner Fisher discussed the long-term price forecast for EIA Brent cases from 2018 Annual Energy Outlook on slide 18. He reported that EIA had three forecasts. The first forecast was the reference case, which Alaska had historically shared with the legislature shown in black. The two other cases consisted of a high case and a low case.

Commissioner Fisher reviewed the differences in EIA projection cases on slide 19. He explained that, in terms of demand, the low case had slowing global demand growth. Although there was a growing demand for oil, it was growing at a lower rate. The reference case was more moderate, which was led by the non-Organization for Economic Cooperation and Development (OECD) countries in the world. The high cases reflected strong demand. He thought it was fair to say that the larger issue had to do with supply. He continued that consistent with EIA's view, the world was underinvesting. The Energy Information Agency believed that in the low-price case non-OPEC countries would enjoy some cost savings and would be able to deliver oil at a lower price. Therefore, it was believed that a lower price would be adequate to meet the demand for oil. The moderate case showed OPEC flat in production, but the U.S. producers needed a somewhat higher price to meet the world requirement. Finally, in the high case, OPEC production was seen declining along with higher exploration and development costs in non-OPEC countries. It would potentially lead to significantly high prices, over \$140 per barrel, by the end of the period.

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Commissioner Fisher spoke about the nominal ANS price distribution on slide 20. The nominal price was layered in the new forecast and the different scenarios the department had shared with the legislature in its fall discussion. He reported that the department's underlying thesis was consistent. The department saw that by the end of the forecast period, the new forecast and old forecast would

meet based on the largely flat oil price in the low \$60 per barrel range. In the near-term, the department anticipated higher prices. In the long-term he anticipated a more consistent outlook.

Commissioner Fisher presented the graph of the comparison between the Spring 2018 forecast and the Fall 2017 forecast on slide 21. The Fall 2017 forecast was represented by the dotted line on the bottom versus the state's Spring 2018 forecast represented by the dashed line in the middle of the slide. The state would reach a higher price sooner but would be fundamentally consistent on a long-term basis. He anticipated that \$60 per barrel would be sustainable on a long-term basis.

Commissioner Fisher detailed slide 22: "Price Forecast: UGF Revenue Under Selected Price Paths." The chart showed different prices from different sources. The shaded box at the top was the department's current official forecast. The NYMEX was the futures market. Both of EIA's long-term and short-term scenarios were shown. The analysts' case was also shown. He highlighted the unrestricted general fund revenue (UGF) revenue under each of the scenarios. He thought it provided a chance to see how revenue would change based on different scenarios.

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DAN STICKEL, CHIEF ECONOMIST, ECONOMIC RESEARCH GROUP, TAX DIVISION, DEPARTMENT OF REVENUE, moved to slide 24 that showed the comparison of the cost forecast for North Slope capital lease expenditures to the previous forecast. The department reduced the forecast in FY 18 because of a combination of continued cost efficiencies being realized by the producing companies on the North Slope and deferrals in wells being drilled for some of the new projects. The state expected capital expenditures to rebound in 2019, 2020, and beyond as major spending occurred for some of the new developments included in the forecast.

Mr. Stickel advanced to slide 25 that was a similar slide showing operating expenditures. There was a modest reduction in 2018 and 2019 operating costs due to efficiencies seen by the major producers. Once some of the new developments such as Pikka, Mustang, and Placer came into the forecast in 2026, the department saw a shift up in operating costs for operating the new units.

Mr. Stickel relayed that slide 26 showed the most significant change to the cost forecast. He thought most members were aware of the announcement related to the Trans-Alaska Pipeline. He furthered that the settlement instituted a new methodology for calculating the Trans-Alaska Pipeline System (TAPS) tariff going forward. It resulted in about \$1 per barrel in transportation costs across the time horizon of the forecast. He reported the reference that the \$1 change for FY 19 added \$46 million to the revenue forecast.

Mr. Stickel indicated that the department's discussion on tax credits began on slide 28. The slide provided information about the statutory appropriation and the methodology DOR was using and supported for calculating the statutory appropriation. He noted that the statutory appropriation could be found in Title AS 43.55. There were several subsections having to do with levying the tax dealing with credits and the appropriation. The appropriation guidance could be found in AS 43.55.028 and referenced either 10 percent or 15 percent of revenue from taxes levied under AS 43.55.011. He explained that AS 43.55.011 was the statute that specifically applied the 35 percent tax rate with credits being calculated in other sections (023, 024, and 025). He furthered that when the department first went to calculate the appropriation, it calculated the appropriation based on the 35 percent net tax under AS 43.55.011 without regards to the tax credits. The department had been using the methodology since 2015. He reported that the following two slides were based on that methodology. He conveyed that the final bullet point on the slide spoke to a legislative legal opinion the department was aware of that stated the statutory guidance on calculating the appropriation was ambiguous. Typically, in such a situation, the state would interpret in favor of the tax payer, which the department thought it had done.

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Mr. Stickel reviewed the illustration of tax credit calculations on slide 29. The state was estimating an appropriation of \$184 million for FY 19, a combination of a few different pieces. The largest piece was North Slope oil illustrated on the slide. Another smaller piece was from Cook Inlet. There were also private land owner royalties. He highlighted that the slide showed a 35 percent tax rate

applied to an estimated production tax value of about \$4.7 billion for FY 19. The statutory appropriation would be 10 percent of the estimated tax value or about \$165 million for the North Slope portion.

Mr. Stickel reported that slide 30 discussed the changes in the statutory appropriation from the fall to the spring. In the fall, the department estimated \$206 million for the FY 19 statutory appropriation. Although oil prices were up, and profits were up, the state was forecasting a slightly lower statutory appropriation in the spring forecast due to statutory language having a trigger price around \$60 per barrel. He elaborated that when the department's price forecast was below \$60 per barrel 15 percent of the tax was taken before credits. He continued that when the department's forecast was above \$60 per barrel 10 percent of the tax was taken before credits. The department was currently forecasting \$63 per barrel for FY 19, therefore, 10 percent was being used. He explained that a smaller multiplier was being used on a larger base which was how the department derived the \$184 million estimate.

Mr. Stickel presented slide 31 that showed the view of the statutory appropriation compared to estimated outstanding tax credit obligations. The department estimated there would be \$946 million of tax credits available for repurchase for FY 19 and beyond. He continued that of those tax credits, the department estimated that \$125 million would be transferred to the major producers offsetting some back taxes related to TAPS, leaving a balance of \$821 million that would be potentially purchased by the state. Assuming that the statutory appropriation per the department's calculation was made in each year, it would exhaust the balance of outstanding credits in FY 23. He mentioned that the estimates were before the introduction of any repurchase bill.

Commissioner Fisher relayed that slide 33 was intended to highlight the changes between the Fall 2017 forecast and the Spring 2018 forecast in terms of oil prices, production, deductible lease expenditures, transportation costs, and the resulting undesignated general funds (UGF) associated with petroleum revenue. The changes resulted in about \$240 million in additional UGF petroleum revenues in FY 18 and \$202 million in FY 19. He would discuss total UGF revenue shortly.

Commissioner Fisher thought slide 34 was a useful tool to help people understand what happened as the price of oil changed. It was interesting that the state's price point was at the inflection point. Up until the present, companies had been paying at the minimum level. For any price below \$63 per barrel, a \$1 change would result in a \$30 million impact to UGF revenue. Based on the current forecast for FY 19 of \$63 per barrel, for every dollar decline in the price of oil there would be \$30 million less in revenue. On the other hand, the curve was steeper to the right of the graph. If the price of oil increased by a dollar, the state could anticipate an additional \$75 million in revenue. The department's estimates were fairly sensitive to the price of oil, particularly as the dollar price increased. There would be material opportunity to increase revenue expectations.

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Commissioner Fisher turned to slide 36 that showed the revenue forecast for FY 18 and FY 19 compared to FY 17. He highlighted that between FY 17 and FY 18 the department forecasted an almost \$1 billion difference between FY 17 and the current year. He noted that FY 19 was flat. The other notably large change was in other restricted revenue and the investment revenue line (about a third up from the bottom of the slide). The investment revenue was primarily associated with the Permanent Fund. He relayed that FY 17 was a very strong year with 12 percent returns. The department took the actual returns for the first 8 months of FY 18 and forecasted a 6.5 percent return for each month going forward. He reported that the return expectation for the fund for FY 19 was also 6.5 percent. He remarked that volatility was associated with the change.

Commissioner Fisher provided a wrap-up of the changes to the 10-year unrestricted revenue outlook on slide 37. The slide showed the changes between DOR's spring forecast compared to the previous fall forecast. He highlighted production, price, and UGF revenue. He noted that for FY 18 the department was forecasting an increase of about \$250 million. In FY 19, the department anticipated just over \$200 million in additional revenues and was consistent in FY 20. He thought the information was positive news for the State of Alaska, but he did not believe it was sufficient to close the fiscal gap. The governor's budget was predicting a fiscal gap of approximately \$477 million for

FY 19 and included some additional revenue from a gas tax. Even with the changes there was a material difference between what the state needed and what the state was predicting would be available from sources. He was completed with his prepared remarks and was happy to take questions.

Co-Chair Foster recognized Representative Knopp in the audience.

Representative Wilson referred to slide 31 and the state's outstanding tax credit obligations. In regard to repurchasing credits, she wondered what formula was being used.

Commissioner Fisher responded that the formula used was the same formula that had been used up through the present. The reason the numbers were slightly less was because at \$60 per barrel the statutory formula changed from a 15 percent calculation to a 10 percent calculation. In other words, it was a 10 percent calculation of a larger amount. The result was reflected on the schedule presented on slide 31. The schedule assumed that the formula was applied consistently as it had been by the department for the prior number of years.

Representative Wilson wondered if the number would decrease substantially in FY 19 if the state used what was currently in the budget. She thought tax credit repurchasing would extend out further in time. Commissioner Fisher responded in the affirmative. He suggested that if the formula currently in the House budget was used, the timeline would extend out for many years. The administration had put forward a proposal to bond and pay for the tax credits which could result in a lower amount in FY 19. However, it was a different scenario.

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Representative Wilson clarified that she was concerned, on behalf of the companies, about the difference between the formula being used presently and the formula used in the budget. She suggested that those companies that did not receive payment would be required to get their tax credits at a discount with the passage of certain legislation rather than receiving the full amount reflected in the budget.

Commissioner Fisher replied that under the proposal by the governor, the tax repurchase plan, a company had the option of waiting and receiving their share of each of the distributions reflected on the chart on slide 31. Alternatively, companies could choose to take a discount presently. Under the administration's scenario companies would have the choice. Under the alternative it came down to the question of how much the legislature would appropriate. Even under the larger appropriation of \$184 million all of the companies would not receive 100 cents on the dollar. They would receive a partial payment and would have to wait for partial payments in the future. Under the lesser appropriation, \$49 million or less, companies would receive an even smaller pro rata share and would wait longer. He did not believe that anyone would receive 100 cents on the dollar under any scenario.

Representative Wilson asked for clarification about 100 percent of the dollar. Commissioner Fisher meant that in FY 19 no one would receive 100 cents on the dollar in any of the scenarios being discussed.

Representative Wilson asked how many companies would be affected by the drop from \$196 million to approximately \$50 million.

KEN ALPER, DIRECTOR, TAX DIVISION, DEPARTMENT OF REVENUE, responded that the number of companies with pending tax credits with either dates from 2016 or 2017 was 37. Some of credits were small amounts. The department had just completed reports the previous Friday listing all of the companies that received cash in calendar year 2017. It was a required annual report by DOR. The number reflected in the report was about 20, because some of the numbers were in the 2017 pool rather than the 2016 pool. All of the money paid the prior year was a pro rata share to everyone in the department's 2016 pool.

Representative Thompson asked for the total number of companies.

Mr. Alper responded that there were 37 companies.

Representative Thompson inquired if the list of companies included companies like Petro Star, which was owed \$15 million for the addition to their plant.

Mr. Alper responded that the money the state spent in the previous year was associated with oil, predominately on the North Slope. There was also a number of Cook Inlet recipients who were in the gas business. Petro Star had a credit in the 2016 pool and received a partial payment. He thought the amount was about \$900,000 in the prior year.

Co-Chair Foster relayed the names of testifiers available online.

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Co-Chair Seaton referred to slide 11. He asked if the numbers were inflated by 2.5 percent like DOR was on slide 10. He pointed out that at the bottom of the slide there was a note about the DOR forecast being inflated by 2.25 percent. He wondered if all of the different indexes on page 11 were all inflated with 2.25 percent.

Commissioner Fisher thought it would be slightly different. He elaborated that the number on slide 11 reflected the forecast as produced by the various organizations. The slide showed what they were predicting in nominal dollars. The amount was the number they published in their forecasts. He explained that in slide 10, the department took the forecast and translated it into a real dollar forecast. It discounted the amounts by a 2.25 percent expectation for inflation. It was not that the department inflated. Rather, the department took a nominal forecast and turned it into a real forecast to get the state's real forecast numbers.

Co-Chair Seaton asked if all of the numbers were treated in the same way to include an inflation rate. He provided an example. Commissioner Fisher replied that some of the charts were nominal and some were real. The department tried to label them appropriately. He pointed to NYMEX as an example. He explained that the state took the actual NYMEX numbers that were available in the market place, which were reflected on slide 11. The department had not manually taken the numbers and reported them. The department just reported the NYMEX numbers. On slide 10 the department took the reported numbers and discounted them with an inflation rate to result in real numbers. They were consistent. In other words, the nominal numbers on slide 11

were produced the same way. The real numbers on slide 10 were internally consistent.

Representative Guttenberg pointed to slide 13 and asked about the impact of U.S. shale production. He thought it would have a dampening effect.

Commissioner Fisher thought Representative Guttenberg made a good point. He conveyed that how the effect was perceived depended on each one of the different sources. For example, the analysts predicting a low price thought shale oil would respond very quickly to price changes. There would be a strong supply, and shale oil could ramp to meet the demand as it grew. The analysts that predicted a high price saw shale production being flat. They also believed the U.S. was currently in a period of discipline in terms of access to capital for shale producers making it difficult for them to respond quickly to changes. He also noted that the analysts predicting high prices saw that the dynamic was also influenced by disruptions in other markets. He concluded that how a person saw shale playing a role depended on their view of the world. He wanted to share these perspectives with the committee. The impression of the department was that legislators were students of the industry and had a sense of how the industry did or did not respond. He thought providing the information helped members to make their own conclusion. The department's view was that, in real terms, pricing at about \$63 per barrel was sufficient to support many sources of oil and that the supply could largely meet the demand in the market place.

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Representative Guttenberg asked Commissioner Fisher to walk through the mechanics of the TAPS tariff settlement. Commissioner Fisher deferred to Mr. Stickel.

Mr. Stickel referred to slide 26. He qualified that he was not an expert in all of the nuances of the tariff methodology, but he understood that there was a lawsuit related to the calculation of the tariff. It was settled in a way that prescribed a new method of calculating the tariff going forward as well as going backward. He continued that companies were revising their production tax and royalty statements for the previous several years to reflect a lower tariff and a higher tax and royalty liability. They were also using a new calculation method

going forward that resulted in a tariff equal to about \$1 per barrel lower. He would be happy to provide more detailed specifics on the settlement. Representative Guttenberg understood that when the tariffs went down, the wellhead went up.

Representative Grenn asked about the tax credits on slide 30. He inquired whether the estimated statutory appropriation was \$184 million. He wondered if the figure was UGF. Mr. Alper replied that it was a statutory appropriation guideline. Historically, tax credits had been paid for with UGF. However, there was no requirement that it was UGF. He thought in the prior year's budget, the House passed \$57 million to the tax credit fund and \$20 million was added to the capital budget. The amount of \$20 million came out of the statutory budget reserve (SBR). There was no specific fund source requirement. Historically, it had been mostly UGF.

Representative Grenn asked about the administration's bond legislation. He queried the approximate interest cost in FY 19. Commissioner Fisher explained that \$27 million was placed in the governor's budget. As the department refined its expectations around interest, the number declined to about \$24 million. At \$184 million the interest would be slightly less than \$24 million. He would have to get back to the committee with the amount.

Representative Grenn asked about the difference of \$150 million. He wondered if there could be a potential decrease to the state's UGF if the administration's proposal passed. Commissioner Fisher replied that there would be an impact of \$150 million. The governor's budget did not include \$184 million to fund the statutory appropriation. If the credit repurchase program did not pass, the administration and legislature would have to collectively find an additional \$150 million.

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Representative Kawasaki asked the general question of why the production forecast numbers were down from Fall 2017. Commissioner Fisher asked if the representative was referring to slide 5. Representative Kawasaki confirmed that he was looking at slide 5. Commissioner Fisher explained that the state had not had as much production as

expected. It was driven, in part, by warmer weather and field-specific issues that had arisen.

Mr. Stickel explained that Department of Natural Resources (DNR) incorporated the most recent actual production for the previous several months in projecting what would happen for the remainder of the fiscal year. There had been below-prior-year production in several fields including Prudhoe Bay where temperature had a large impact. At Point Thompson there were compressor issues that would keep production down for the following few months. At the Alpine field there had been some technical issues that had arisen. Such issues had been factored in as well as typical decline rates at fields.

Representative Kawasaki commented that at about the time the legislature received the fall forecast, which looked to be higher than the numbers prior. Mr. Stickel responded that Representative Kawasaki was correct. He elaborated that the numbers on the slide were compiled in October. He highlighted that at that point in time the last several months were tracking higher than the prior year. The department also did not know about some of the technical issues that came up. He noted that the state did not know that the time period would be one of the warmest winters on record. The Department of Natural Resources had adjusted to pull in the latest information.

Representative Kawasaki asked about the capital lease expenditures. He referred to slide 24 at the bottom of the page in the numbers section. He wondered if the numbers had been revised down. He noted \$400 million in FY 18 and \$400 million in FY 19. He asked why the numbers had been revised down so sharply. Mr. Stickel replied that there were two aspects to the reduction in the capital expenditures. First, there were deferrals of work being done by some of the explorers and developers - work that the state thought would happen in the current winter and the following winter. The work might get deferred into future years. Another reason was continued cost containment by existing producers. It was not that the producers were forecasting less work at existing fields, but they were finding ways to cut costs.

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Representative Kawasaki wondered if the decreases in capital lease expenditures were inclined to have a flip side on decreased production in the future. Mr. Stickel replied that the reductions at the existing fields were not flowing through to production currently. It was not to say that if there were further reductions, it could not flow through. The reductions in costs the state was seeing at the legacy fields was an example of finding more ways to become efficient.

Representative Kawasaki asked if they had revised employment numbers on the North Slope. Commissioner Fisher would check and get back to the committee. The last time he checked, oil industry employment was down a little more than 30 percent in the peak. He did not know what the new numbers showed.

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Representative Pruitt noted there was an increase in capital expenditures from FY 18 and FY 19. He wondered if there was a rough estimate of anticipated job growth on the North Slope.

Commissioner Fisher did not know whether DLWD or the Institute of Social and Economic Research (ISER) had done any studies on the correlation of spending to employment. He would get back to the committee.

Mr. Alper added that a large component of the increase the state would be seeing in the following two years had to do with the Pikka field - the Armstrong discovery. There were other new discoveries, but Pikka was the largest. The field had a new partner and a new operator. The field had deferred the current year's and the following year's work. The state was still seeing the field moving forward with a significant amount of work ramping up in the later part of 2019 or 2020. The work was not happening as quickly as anticipated. He did not know the number of jobs associated with the field, but it was a large number.

Representative Pruitt returned to the tax credit discussion. He wondered if some work was not being done because some of the companies were expecting certain payments. He asked if there were companies that could not be capitalized to be able to continue. He wondered if the state was up against the challenge of people wanting to

invest based on the state not knowing what to do, including the way the state was calculating the tax credits.

Commissioner Fisher responded that there had been a material reduction in spending, particularly with the smaller companies. He reminded the committee that the major oil companies were not eligible for the credits, did not benefit, and were not impacted by the state's decisions on the issue. However, small producers were impacted, as the state strategically wanted to attract more competition in the oil segment. The state had seen a meaningful decline in oil company spending which impacted direct hiring and oil service companies. In conversations with lenders, they confirmed they were not lending presently largely due to the uncertainty and disruption that had occurred. The producer companies relied on the expectation that the state would pay them cash for their credits. However, they were unable to meet their payment obligations to lenders.

Commissioner Fisher continued that the banks were in forbearance and were not willing to lend future money. He explained that the small producer section of the industry was frozen and thought uncertainty was a large contributor. He suggested that if the legislature changed the tax structure again, it would have a further chilling effect on the industry's perception about certainty. He relayed that the purpose of the oil tax credits was to stimulate economic growth and employment in Alaska. He reported that the administration continued to believe it was a viable strategy with credits.

Commissioner Fisher returned to a previous question from Representative Pruitt about how many jobs to expect. He relayed that there had been some work done by ISER around capital spending by the state. It was not a perfect analogy, but it looked at different scenarios for balancing the budget between cuts in different areas. There was a range in which \$100,000 of spend translated to between 500 to 1000 jobs.

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Representative Pruitt thought, based on what the commissioner had highlighted, there would be an increase of about 4000 high-paying jobs anticipating an increase in spending of around \$800,000 between FY 18 and FY 19. He noted that the state had seen an increase in Medicaid

partly because of the job losses in the state. He believed an increase of 4,000 jobs would help reduce the state's budget. He thought discussions about revenue sources went hand-in-hand with policy discussions. He supposed there were companies looking to capitalize. However, lenders did not trust capital investment in Alaska based on the history of other transactions. He suggested that it would be prudent not to change the mechanisms that would help investors to get needed capital.

Commissioner Fisher thought what Representative Pruitt had stated was the foundation behind the governor's bond legislation. He mentioned that at least one representative from the banks would be in Juneau in the coming week. He indicated he would be happy to bring the lenders around to legislative offices or to have them testify.

Representative Pruitt suggested hearing from some of the lenders to know what it would take to free up capital. He wanted to ensure that additional capital was available in the future. It would translate to more jobs and helping the state's budget in the long-term.

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Representative Guttenberg observed that on DLWD's webpage it reported that non-resident workers in the Alaska oil and gas industry, including the Kenai area, made up 36.5 percent of the workforce in 2015. He calculated that about \$500 million in payroll was remaining in the state. In 2016 the percentage of non-resident oil industry workers went up by 1 percent totaling 37.5 percent. He commented that the loss of jobs in Alaska's oil and gas fields was higher for residents than non-residents.

Co-Chair Foster thanked the presenters.

Representative Wilson announced she would not be staying for the next part of the presentation. She was concerned with Fairbanks being used as an example in the following presentation. She commented that if the word factory was replaced with military the example would imply that the state could not afford the military because of a \$30 million loss. She referred to slide 29 of the following presentation. She did not want to send such a message to the military, therefore, she would not be staying for the presentation.

Co-Chair Seaton commented on DOR's presentation. He wanted to return to numbers that had been quoted. He noted \$143 million. He clarified that if the state were to appropriate the first statutory amount, it would be different than the calculation the House had used. He conveyed that \$143 million did not equate to 4,000 jobs. He disagreed with the idea that the lenders would reestablish lending. The lenders were lending because of cashable credits which had been eliminated from any future programs. If lending was based on cashable credits, it was unlikely lenders would come back and start lending. He noted that there were loss carry-forwards as well. He wanted to make sure the committee considered all factors going forward.

Representative Pruitt suggested bringing a lender before the committee to testify. He thought if a company had been capitalized by a bank and the basis for which the company was able to borrow was no longer available, a company would not be able to access capital if it could not meet its obligations. He wanted to understand the impact of lenders' decision making by hearing from them.

Co-Chair Foster directed Commissioner Navarre to begin his presentation.

^PRESENTATION: ALASKA'S ECONOMY BY DEPT. OF COMMERCE, COMMUNITY, AND ECONOMIC DEVELOPMENT

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MIKE NAVARRE, COMMISSIONER, DEPARTMENT OF COMMERCE, COMMUNITY, AND ECONOMIC DEVELOPMENT, indicated his presentation was similar to a presentation he gave in the prior year. However, there were several differences. He had several slides and asked for questions to be held to the end. He appreciated watching DOR's presentation and discussion and thought it was completely relevant to his presentation and Alaska's overall economy.

Commissioner Navarre introduced the PowerPoint presentation: "Alaska's Economy - A bright future, but are we prepared?" He thought his presentation was a perspective that would provide opportunities for everyone on the committee to agree with and disagree with. He looked forward to questions and a discussion.

Commissioner Navarre began with slide 2: "Our future is bright". He thought Alaska had incredible economic opportunities because of the state's vast natural resources including world class mining, fishing, tourism, agriculture, timber, and oil and gas. However, there were common misconceptions.

Commissioner Navarre continued to slide 3: "Misconceptions":

"We don't need a fiscal plan because..."

1. "The status quo is ok; oil and gas will save us"
2. "Economic development will save us"
3. "Cutting government will save us"

Let's review these statements

Commissioner Navarre posed the question on slide 4: "can't we just wait on oil and gas development or oil price increases?" He had heard discussions from people who were fairly well educated and versed in state and local governments issues. He reported hearing comments from them suggesting that oil prices would increase again, and the state would be fine.

Commissioner Navarre advanced to slide 5 "Good news in oil and gas":

1. Modest increases in production
North Slope oil production forecast in 2018 at 533,000 barrels/day – up for the third year in a row
2. NPR-A beating expectations
Conoco beat its flow projections at CD5 within NPR-A
3. New prospects on the horizon
Conoco's Greater Moose's Tooth start-up late 2018.
ConocoPhillips at Willow, Caelus Energy at Smith Bay, Armstrong, Repsol, Oil Search at Pikka and Nanushu

Commissioner Navarre read slide 6: "Maybe even better good news":

1. ANWR Potential
First ANWR lease sale could occur by 2021-2022

2. North Slope future looks bright

With more leasing in NPR-A, plus ANWR, plus new discoveries west of Prudhoe Bay, the North Slope has decades of production potential

3. LNG Project

The long-awaited North Slope gas line project could add to Alaska's success stories in the 2020s

Commissioner Navarre turned to slide 7 "Maybe even better than good":

All of this will require billions in private investment. When making a decision, investors look closely at profit potential and fiscal stability.

Commissioner Navarre elaborated that they had a fiduciary responsibility to their owners and shareholders to do their due diligence.

Commissioner Navarre read the quote on slide 8: "Uncertainty is the enemy of investment":

"Private Construction spending in 2017 is supposed to be around 4 billion dollars. Using the 5 to 15 percent estimated by Jens (2013), we would conclude that the direct effects of policy uncertainty is costing the state somewhere between 200 and 600 million in private capital spending. The decline in spending due to policy uncertainty would indicate that waiting is not a costless option."

- Mouchine Guettabi, ISER (February 2018) What do we know to date about the Alaska recession and the fiscal crunch?

Commissioner Navarre indicated that the quote came from a presentation by ISER talking about the impact of policy uncertainty, which was likely creating a cost of between \$200 million and \$600 million in private capital spending. The conclusion by ISER was that the losses due to uncertainty were important and similar in magnitude to the losses the economy would experience due to a tax or further government reductions.

Commissioner Navarre discussed slide 9: "How does Alaska compete? From an investor's perspective." He asserted that the state had prominent investment opportunities and a growing and diversifying economy. However, the state had an overreliance on oil and gas revenues, an annual deficit of \$2.7 billion, multiple years of drawing down savings, and annual political battles over the deficit and taxes. All of the items he listed were somewhat of a disincentive to investment.

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Commissioner Navarre moved to slide 10: "Alaska's competition." The slide showed where Alaska's competition existed. The slide was from a presentation by ConocoPhillips from the previous year. It had been updated slightly. The slide showed the fields Alaska was competing with in the Lower 48 for investment dollars. He highlighted the size of fields. He noted the Bakken field and the Permian Basin field in particular. He mentioned the Marcellus gas play on the East Coast. He highlighted the 400 trillion cubic feet of gas (TCFG) compared with Alaska's estimate of 100 TCFG on the North Slope.

Commissioner Navarre explained slide 11 "Alaska's competition." The slide showed the fields in the Lower 48. He highlighted the production trends. In the Permian field production had increased significantly to where it was almost at 33 million barrels per day. The other fields were mostly shale placed. It was not the same as conventional oil. He explained that shale oil production required more wells and a quicker decline period. However, the return on investment remained significant. The fields indicated who Alaska was competing with for investment dollars and why Alaska could not count on oil price increases bailing it out. He opined that there was too much production potential that was growing because of investment. It was estimated that more than \$40 billion would be invested in the Permian Basin by 2022.

Commissioner Navarre reviewed the chart on slide 12: "Alaska's competition: U.S. Crude Oil Production: Thousand barrels of oil per day, 2017-2013." The slide showed the investment in the Lower 48 compared to Alaska. Alaska was represented by the yellow line at the bottom of the chart. He relayed that Alaska used to be the largest producer in the US. Currently, Alaska saw flat or declining production

and had for a significant period. The U.S. was expected to be importing oil for the foreseeable future just a few short years prior. However, it was looking like the U.S. would become a net oil exporter.

Commissioner Navarre discussed the bar graph on slide 13: "Are we competitive? Production costs per barrel." He relayed that the cost comparison differential was another hurdle to investment in Alaska.

Commissioner Navarre continued to slide 14: "Can we rely solely on oil and gas? Production Forecast: ANS History and Forecast by Pool." He conveyed that the slide showed an investment decline in Alaska. Significant investment was needed to slow the decline or to create an incline. The chart also showed why Alaska was able to get by without taxes for a long time. He pointed to the orange section representing the Prudhoe Bay field, the largest in Alaska. At one time, the field was the largest in the U.S. It had significantly declined and had experienced a flattening. It remained Alaska's largest field and was still declining. It was also the reason why oil price increases had less impact.

Commissioner Navarre spoke of his time in the legislature when the price of oil went up \$1 per barrel. The rule of thumb was that for every \$1 increase per barrel of oil, the state generated additional revenues between \$150 million to \$170 million. He suggested that currently the figure would be significantly less because production was down.

Commissioner Navarre reviewed slide 15: "We don't need a fiscal plan because":

1. "The status quo is ok; oil and gas will save us"
We have to compete with larger more accessible plays throughout the country and world. Our fiscal situation is a real and significant disincentive to investment.

Commissioner Navarre advanced to slide 16: "We don't need a fiscal plan because":

2. "Economic development will save us"

Commissioner Navarre posed the question whether economic development, alone, was the solution. He indicated he

included slide 18 to reinforce that the next slide showed a hypothetical scenario.

Commissioner Navarre reviewed the hypothetical scenario on slide 20: "Economic development scenario":

1. Hypothesis: A company proposes a major investment in the Fairbanks North Star Borough
2. Evaluation: It must be economically viable for both the state and Fairbanks North Star Borough
3. Criteria: The project must pay its own way – no subsidies

Commissioner Navarre read slide 20: "Hypothetical new factory in Fairbanks":

- 5,000 new jobs (1,000 jobs filled by local residents)
- 4,000 new residents, some with families
- 2,500 new students for the school district
- \$1 billion capital investment
- 4,000 new housing units at an average taxable value of \$200,000 per home

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Commissioner Navarre continued to slide 21: "Fairbanks decision: New Revenues":

- \$10 million a year in borough areawide property taxes on the new homes
- \$12 million a year in borough areawide property taxes on capital investment

TOTAL: \$22 million / year

Commissioner Navarre used the current Fairbanks/NorthStar Borough tax structure.

Commissioner Navarre turned to slide 22: " Fairbanks decision: More expenses":

- 2,500 students would be more than an 18 percent increase over current school district enrollment.

The state pays almost 2/3 of the school district budget. An 18 percent-plus increase in the local share of K-12 funding would cost the borough about \$10 million a year.

TOTAL: \$10 million / year

Commissioner Navarre detailed slide 23: "Fairbanks - the math." He concluded that, for Fairbanks, it would cost \$10 million in new school funding. The borough would receive \$22 million in new revenues. The result would be that the borough would receive a net of \$12 million available for other expenses in the community.

Commissioner Navarre drew the conclusion in slide 24 that the borough would have new revenues to cover the costs of new development.

Commissioner Navarre asked about the potential for new revenues in the state on slide 25: "State - new revenues." The state currently did not have any new revenue.

Commissioner Navarre moved to slide 26: "State - new expenses":

- \$5 million a year in higher expenses for troopers, highways, courts, prisons, agency operations, etc.
- \$25 million a year in increased school funding costs (18 percent gain in enrollment)

Commissioner Navarre elaborated that the increased school funding costs were based on an increase to the formula program required in order to pay the cost of new students.

Commissioner Navarre talked about the expenses versus new revenues for the state on slides 27 and 28. He reported that in the scenario, the state would incur \$30 million in additional budget expenses without any new revenues.

Commissioner Navarre presented his conclusions on slide 29: "The math." He offered that for the Fairbanks North Star Borough it was a positive \$12 million and made good sense. On the other hand, for the State of Alaska it was a negative -\$30 million to its budget, and it was

questionable whether this type of economic development was beneficial.

Commissioner Navarre discussed the effects across several Alaskan communities on slide 30: "Across communities, it's the same." He noted that it did not matter where the development took place. In local governments there was a tax base that allowed them to generate more revenues than the cost associated with economic development. It was a positive in the communities. The state impact was negative because there was no drawback on the economic activity that took place.

Commissioner Navarre indicated that, although the scenario he had presented was hypothetical, diversifying Alaska's economy was not.

Commissioner Navarre discussed state revenues on slide 32: "FY 18 state revenues":

\$1.801 billion

Unrestricted petroleum revenue

\$536 million

Non-petroleum unrestricted revenue (e.g. fishing, mining, motor fuel, alcohol, tobacco and marijuana taxes, corporate income taxes)

Commissioner Navarre reported that the chart on slide 33 showed the oil and gas gross domestic product (GDP), which had grown over time but was volatile. He highlighted that the numbers had trended downward over the prior couple of years because it was price sensitive.

Commissioner Navarre continued to slide 34: "Other private industries growing steadily: Nominal GDP of All Other (non-petroleum) Private Industries, 1997-2015." He pointed out that the gross domestic product (GDP) had grown from \$15.1 billion in 1997 to \$34.1 billion in 2015, which was a 125 percent increase in growth in other industries in 18 years.

Commissioner Navarre reviewed the graph on slide 35 which showed a disconnect. He pointed to the GDP for oil and gas in Alaska [shown in red] and the UGF petroleum revenue associated with the GDP in the development of oil and gas

[shown in grey]. The blue line showed other UGF revenue added to the line, which barely moved the line upward. He pointed to the GDP of all other private industries from 1975 to 2015 [shown in black]. He emphasized that the blue line and the greenish [grey] line were almost equivalent which meant that the economy was diversified, the state did not have much oil and gas development. As the state saw oil and gas development increase, the state eliminated most taxes in the state. The disconnect was due to the state's economy which had diversified, but revenues had not.

Commissioner Navarre advanced to slide 36: "We don't need a fiscal plan because":

"Economic development will save us"

The state needs to recognize the costs associated with economic development and determine how we're going to pay for them. Our economy is developing and diversifying, our revenues are not.

Commissioner Navarre added that economic development without a source to pay for the associated costs would create additional funding challenges.

Commissioner Navarre moved to slide 37: "We don't need a fiscal plan because":

"Cutting government will save us."

Commissioner Navarre posed the question whether the state could simply cut expenses more. He thought it was possible. He knew that for every year he was in the legislature and every year he had observed the legislature, there had always been discussion about cutting the budget further. He thought cuts were much easier said than done.

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Commissioner Navarre discussed the impact of cuts on services referring to the bar graph on slide 39. He noted of the state's \$4.5 billion budget, about \$2.4 billion was spent in 2 areas: K-12 formula education and Medicaid and other formula programs in health and social services. He reinforced that the money was not spent on bureaucrats. In the area of K-12 education, the formula paid for teachers in the local schools - people who volunteered in the

communities and coached little league. In the area of health and social services, the Medicaid formula program paid for providers, hospitals, and created significant jobs in Alaska's communities. He opined that the areas he discussed could be cut, but there would be significant impacts.

Commissioner Navarre advanced to slide 40: "State funds matter locally: Municipalities and schools depend on state help":

Fairbanks North Star Borough and School District FY 17

- Municipal community assistance
\$3 million
- State reimbursement of school bond debt
\$9.6 million
- State assistance for retirement liability
\$13.6 million
- Foundation formula funding K-12 schools
\$116.7 million
- Pupil transportation reimbursement
\$12.3 million

\$155 million state funds for Fairbanks Borough

Commissioner Navarre explained that slide 41 showed state funds were provided to communities in the amount of \$983 million. The slide only reflected 5 communities. The impact was much greater when funds were allocated to all communities.

Commissioner Navarre read slide 42: "We don't need a fiscal plan because":

3. "Cutting government will save us"

Cuts have real impacts that must be weighed. Cutting government means cutting services, cutting local funding, and real economic impacts.

Commissioner Navarre commented that it was not that cuts could not be applied, but it was important to recognize the impact of those cuts.

Commissioner Navarre wondered if there was a perfect solution on slide 43. He had spent a significant time talking to economists, legislators, local government officials, and business men and women. He had researched data and brain-stormed with a multitude of diverse interests to develop the perfect solution. He turned to slide 44, a blank page. He suggested there was not a solution. He thought the legislature would be debating these issues for several years. He recalled talking about them when he was in the legislature. He believed the legislature would be talking about taxes, in terms of which ones and at what level. He mentioned oil taxes, income taxes, property taxes, and sales taxes. The legislature would also be discussing spending decisions; how much to spend on education, health and social services, public safety, capital. and infrastructure. The discussion would continue about where and how to promote economic development and how to pay for the associated costs.

Commissioner Navarre reviewed the options on slide 45: The options":

Budget Cuts?

- Easier said than done
- Priorities
- Philosophical differences
- Rhetoric
- Negative economic impacts

Taxes?

- Easier said than done
- Takes time
- Philosophical differences
- Rhetoric
- Negative economic impacts

Permanent Fund Earnings?

- Public Perceptions
- Political consequences
- Impacts to Permanent Fund growth
- Impacts to PFD

- Negative economic impacts

Commissioner Navarre wanted to end on a high note. He thought Alaska had tremendous opportunities. The state had vast natural resources and was still very young. If the people of Alaska wanted to take advantage of the opportunities in mining, timber, fishing, and oil and gas, the state had to fix its economic foundation to be positioned to attract investment to Alaska.

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Commissioner Navarre turned back to the earlier disconnect slide. He thought members should be particularly concerned with the contents of the slide. He suggested that if the state was going to expect that oil and gas or other resources were going to pay the entire cost of all aspects of economic activity in the state, it would be a significant and ongoing disincentive to investment in Alaska. He opined that decisions that were being made currently about where to invest in Alaska, especially in oil and gas, would lead to whether the state would see an incline in production. He reiterated that everyone should be concerned. He suggested that if Alaska did not fix its economic foundation, it would struggle along in a recession and perhaps go into a depression. The state had been spending down its reserves, which he thought would be limited in a time of depression where drawing from them might be necessary. He advocated for balance, spreading the tax burden so the state could create incentives for investment in Alaska.

Representative Grenn thanked the commissioner for his presentation. He noted Commissioner Navarre had not mentioned tourism. He referred to slides 25 and 26 and the commissioner's comments about economic development. He thought the point the commissioner made was about the lack of revenues to the state. On slide 26 there was a list of all of the expenses the state would incur. He thought the expenses had to do mostly with the state's statutory and constitutional obligations. He asked if he was correct. Commissioner Navarre explained that the information was extrapolated from the amount of money being spent in the categories listed based on a population increase associated with the development scenario.

Representative Grenn suggested that the State of Alaska was unique in some ways in terms of what the state paid for as opposed to other states that might have a county expense or other obligations. Commissioner Navarre responded affirmatively. He remarked that there were many areas of the state that were not incorporated, other areas that were incorporated based on a mandatory borough act in 1964, and others that had incorporated as a tax base was developed or identified in communities.

Representative Thompson had attended many meetings in Fairbanks. He did not agree with the information on Commissioner Navarre's slide. Fairbanks did not have a new factory coming online, it had the military coming. He disagreed with the commissioner's numbers. They were very different from the numbers economists had worked on to determine how many new students to account for and how many new housing units would have to be built (approximately 800 was estimated). He did not like the commissioner's implications about not wanting the military in Fairbanks because it would cost the state money. He provided some other possible examples. He disagreed with Commissioner Navarre's report and thought he had attempted to skew it one direction or another. He did not appreciate it.

Commissioner Navarre had wanted to stimulate a discussion. The fact was that Representative Thompson was correct that the military and the F-35s in Fairbanks would be an excellent opportunity for investment in Alaska. However, in looking at the Tiger Team report regarding the cost of education and the increase in new students (1,800-2,000), the source identified for funding was the state foundation formula.

Commissioner Navarre continued that while local government would be able to pay their share and local government would receive payments in lieu of taxes (PILT) and other monies that were shared from the federal government, the state would not because there was the recognition that the state had a taxing ability in order to collect the cost associated with economic development to pay for associated services required.

Commissioner Navarre concluded that because the funding source was identified as the state foundation formula, there would likely be a cost of \$20 million to the state budget with no source of revenues associated with the cost.

It was not to say that Alaska did not support the military. He supported the military along with the governor and Representative Thompson. He believed everyone in Alaska supported the military. The fact of the matter was that what the people of Alaska expected that oil and gas in a declining production scenario would pay for the cost associated with the diversification of the rest of the economy. It was a premise that was not sustainable and would be a disincentive to investment. He reiterated that he used the slide to show that Alaska's economy had been diversifying, but the state's revenue sources had not.

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Representative Pruitt agreed that there was a fiscal gap and the legislature needed to come up with a solution. He commented that the debate had been about how to handle the deficit. He believed there was no way to get around using some of the state's earnings reserve to fill the budget gap. He remembered in Commissioner Navarre's presentation from the prior year there had been more focus on taxes. He wondered whether the fact that there were several people inside Alaska without jobs was contemplated when the commissioner put his presentation together. He spoke of the unemployed requiring additional state services and driving up state costs. He suggested that one of the best ways to decrease the cost of government was to allow private sector investment, as it would lead to fewer people needing Medicaid, unemployment, or other state services. He thought that working towards more jobs for Alaskans and using a portion of the earnings reserve account would get the state within striking distance of a manageable budget gap. He commented on the knee-jerk response of having to implement taxes. He reasoned that using a portion of the earnings reserve needed to be discussed first. He appreciated the commissioner's points but did not think the focus should be on new investment and the drag it could have on the state. He emphasized that the state had a resource to draw on to address the state's fiscal gap.

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Commissioner Navarre agreed with Representative Pruitt. The largest state asset was the Permanent Fund. He embraced the idea that there was no economic plan that currently worked without using earnings from the Permanent Fund. He had written and talked about the use of the earnings reserve 3

years prior and wrote about it 20 years previously when he served in the legislature. He believed that the legislature needed to recognize that the Permanent Fund was a growing asset and was currently the state's largest income source. His point was that economic development in Alaska could not continue with oil production decline and diversification of the economy, even with using the earnings from the Permanent Fund. He opined that there would still be a gap. He offered that without spreading the burden, the investment the state was seeking would be put at risk. He explained that there would be a disincentive for investment because there would be a growing gap.

Commissioner Navarre also agreed with Representative Pruitt about the Medicaid program. He surmised that a contracting economy and an increase in unemployment had driven up certain areas of the budget. If the economy improved, the state could begin to see an improvement in those costs. However, he thought the state was a long way off from recovering.

Representative Pruitt did not believe oil could save the state from its current gap. He thought the decline in production within 7 or 8 years would be a difference of about 20,000 barrels per day, a dramatic change from the production forecasts from previous years of 300,000 barrels per day. He opined, that the sources book before the committee confirmed that good tax policy and a good business climate could help to maintain the oil production level. Previously in conversation, oil production was nearing its end. Even though the state could never return to the days of 2,000,000 barrels per day, he suggested that maintaining or increasing oil production was possible. It had the potential to fill the fiscal gap along with managing government spending. He noted a presentation from a special session in the prior year that suggested that controlling government growth coupled with increased revenues did not require additional taxes. He did not want to write off oil and gas. Instead, he wanted good tax policy in place, which did not change every couple of years. He also wanted to continue to invest in commerce, put people back to work, and reduce people's reliance on state government. He did not think the state needed to resort to dire consequences regarding the fundamental foundation of the state's economy.

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Commissioner Navarre thought oil and gas had a bright future in Alaska. However, based on the slides from the Lower 48 fields, additional investments were needed. He agreed that the state needed a stable tax policy. The state could not have a legitimate debate about other taxes, increased oil taxes, or budget cuts without talking about production decline. He thought the state peaked in production in 1988. He did not feel Alaska would ever reach that peak number again. If the state peaked to previous levels, it would generate significant expansion in Alaska requiring additional services. He emphasized that the other areas where there had been expansion in the state's economy were being subsidized. It was okay if the state wanted to utilize the earnings of the Permanent Fund or by resource industries. It was also okay to look at the way the state did things when he was a kid (he recalled paying income tax in Alaska), to spread out the burden. He thought people needed to change their outlook.

Representative Guttenberg noted that term "The Alaska Disconnect" was not new. He remembered paying income tax. He made clear he would love to diversify Alaska's economy without an income tax. He had heard the dialogue about the damage the state did to the economy and to oil and gas development because of the payback period for tax credits. However, Commissioner Navarre's presentation talked more about a stable economy and not going through swings. He argued that the conversation should not only be around oil and gas tax credits, but on the economy as a whole. He believed without a sensible fiscal plan, people would continue to accuse the legislature of not having its game together. He mentioned a recent article he had read about the expected trillion-dollar investment in a new arctic development. It was his understanding that the state was not in a position to take advantage of it. He asked the commissioner about the stability of Alaska's economy and future investment.

Commissioner Navarre responded that there were several different perspectives on the state's economic outlook. He commented that Alaska was poised to see a significant amount of investment. He speculated that when Alaska saw construction activity and there was economic investment unrelated to oil and gas, there were also resulting costs to the state. He mentioned seeing various budget plans, most of which underestimated the costs of capital

investment (infrastructure) in Alaska. He provided a couple of examples including building year-round roads. The state owned incredible assets requiring further investment. He opined that the state did not have nearly enough to invest where it should in infrastructure. Deferred costs would not go away but would manifest into significant increases in the future.

Co-Chair Foster reviewed the agenda for the following day. He reported that there would be 3 bills before the committee and public testimony would be heard.

Co-Chair Seaton commented that the committee schedule was uncertain due to the floor session taking up the operating budget on the following day. He advised members and the public to check for updates on the committee schedule.

#

ADJOURNMENT

[3:50:57 PM](#)

The meeting was adjourned at 3:50 p.m.