

SENATE FINANCE COMMITTEE

March 22, 2023

9:02 a.m.

9:02:02 AM

CALL TO ORDER

Co-Chair Stedman called the Senate Finance Committee meeting to order at 9:02 a.m.

MEMBERS PRESENT

Senator Lyman Hoffman, Co-Chair
Senator Donny Olson, Co-Chair
Senator Bert Stedman, Co-Chair
Senator Click Bishop
Senator Jesse Kiehl
Senator Kelly Merrick
Senator David Wilson

MEMBERS ABSENT

None

ALSO PRESENT

Senator Cathy Giessel; Dan Stickel, Chief Economist, Economic Research Group, Tax Division, Department of Revenue; Colleen Glover, Director, Tax Division, Department of Revenue.

SUMMARY

PRESENTATION: SPRING REVENUE FORECAST

Co-Chair Stedman relayed that the committee would hear a presentation on the Department of Revenue's (DOR) spring revenue forecast. He referenced a press release from the previous day that indicated there had been substantial changes in the forecast, particularly in the last week. He mentioned conversations with the department and indicated that the numbers being presented were as up to date as possible. He thought there may be a forthcoming update in two weeks. He mentioned that DOR Tax Division Director Colleen Glover and Acting Commissioner Adam Crum were also available for questions, along with other staff.

^PRESENTATION: SPRING REVENUE FORECAST

9:04:09 AM

DAN STICKEL, CHIEF ECONOMIST, ECONOMIC RESEARCH GROUP, TAX DIVISION, DEPARTMENT OF REVENUE, introduced himself. He relayed that the department had released the spring forecast the previous afternoon.

He discussed a PowerPoint presentation entitled "Spring 2023 Forecast Presentation," (copy on file).

Mr. Stickel looked at slide 2, "Agenda":

1. Forecast Background and Key Assumptions
2. Spring 2023 Revenue Forecast
 - Total State Revenue
 - Unrestricted Revenue
3. Petroleum Forecast Assumptions Detail
 - Oil Price
 - Oil Production
 - Oil and Gas Lease Expenditures
 - Oil and Gas Transportation Costs
 - Oil and Gas Credits

Mr. Stickel showed slide 3, "Forecast Background and Key Assumptions."

Mr. Stickel referenced slide 4, "Background: Spring Revenue Forecast":

1. Historical, current, and estimated future state revenue
2. Updates key data from Fall Revenue Sources Book
3. Official revenue forecast used for final budget process
4. Located at tax.alaska.gov"

Mr. Stickel relayed that the spring forecast was an update to the larger Revenue Sources Book (RSB) that was put out by DOR in the fall. He noted that the forecast maintained ten-year forecast revenue models for all the state's major revenue sources. He noted that there were forecasts going back several decades on the Tax Division website.

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Mr. Stickel turned to slide 5, "Spring Forecast Assumptions":

- The economic impacts of financial and geopolitical events are uncertain; DOR has developed a plausible scenario to forecast these impacts.
- Key Assumptions:
 - o Investments: Stable growth in investment markets, 7.00% for FY 2023 and 7.05% for FY 2024+.
 - o Federal: The forecast incorporates stimulus funding as of March 1, 2023, includes updated estimates of IIJA funding.
 - o Petroleum: Alaska North Slope oil price of \$85.25 per barrel for FY 2023 and \$73.00 per barrel for FY 2024.
 - o Non-Petroleum: Continued economic growth. 90% of capacity assumption for 2023 cruise season, minerals prices based on futures markets.

Mr. Stickel qualified that the forecast represented one scenario within a range of uncertainty. He mentioned volatility in the bank markets, bank failures, and volatile oil prices from the previous week. He noted that as a result of the volatility, DOR had pushed out the date for finalizing the oil price forecast as far as possible. The oil price forecast was based on the previous week's futures market prices, which allowed for the full incorporation of the volatility. He mentioned a slight increase in expected federal funding for various agency operations. He noted that the petroleum price assumption was based on eight and a half months of actual prices and estimated that the Alaska North Slope (ANS) prices would average in the low 70's for the remainder of FY 23 to get to the fiscal year average price.

Mr. Stickel noted that the forecast assumed fairly stable economic activity and did not include any significant recession. The tourism expectation still forecast 1.65 million cruise ship passenger capacity for the summer, and that the ships would sail 90 percent full. He mentioned the mining industry, which showed improved prices in mineral prices in the futures market, particularly with coal and gold prices.

Co-Chair Stedman asked about the forecast oil price of \$73/bbl for 2024, and thought the forecast was using \$73/bbl through the end of June.

Mr. Stickel affirmed that Co-Chair Stedman was roughly correct.

Co-Chair Stedman mentioned that language in the fast-track supplemental bill was pretty tight in terms of accessing the Constitutional Budget Reserve (CBR) for funds. If the price went below the \$73/bbl number, there might need to make an adjustment. He relayed that the committee would track the price and work with DOR over the following month.

[9:10:35 AM](#)

Mr. Stickel considered slide 6, "Relative Contributions to Total State Revenue: FY 2022," which showed graphical representations of the state's revenue sources for FY 22. He noted that DOR had made a couple of minor adjustments to the slide since the previous time it was shown, including the breakout of corporate income tax revenue and the addition of a small tree to denote the timber industry. He pointed out that in FY 22 federal revenue and petroleum revenue made up the majority of state revenue, while there was a year of net losses on the investment side.

Mr. Stickel displayed slide 7, "Relative Contributions to Total State Revenue: FY 2023," which showed graphical representations of the state's revenue sources for FY 23. He pointed out the big three contributions to state revenue as federal revenue, investment earnings, and petroleum. All other revenue sources added up to about 7 percent of total revenue.

Mr. Stickel displayed slide 8, "Spring 2023 Revenue Forecast."

Mr. Stickel looked at slide 9, "Unrestricted Revenue Forecast: FY 2022 and Changes to Two-Year Outlook," and explained that the slide showed key changes to the unrestricted revenue forecast. Since the fall forecast, based on the current outlook of the futures market, the estimate of ANS oil prices had been decreased by \$3.20/bbl for FY 23 and by \$8/bbl for FY 24. The forecast for the Permanent Fund transfer to the General Fund had not changed. The total unrestricted revenue forecast decreased

by about \$246 million for FY 23, and \$679 million for FY 24. He explained that the lower oil price forecast was the primary reason for the change, and there was also a modest reduction to the production forecast that contributed to the change.

Co-Chair Stedman noted that when the committee had run the numbers, it was not as close as the analysis being presented. He asked if there were other factors that impacted the forecast.

Mr. Stickel relayed that the production forecast had been reduced moderately for both of the fiscal years, and the lease expenditure forecast had been increased moderately (largely due to inflation). He continued that there had been some adjustments on the credit side of things, wherein some credits had been transferred and used against tax liabilities. The impacts compounded the oil price impact. Outside of oil and gas, there were very minimal changes, so the revenue forecast was really a function of the oil and gas.

Co-Chair Stedman asked about quantifying the added components.

Mr. Stickel estimated that the production impact had been about \$30 million, for both FY 23 and FY 24.

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Mr. Stickel addressed slide 10, "Total Revenue Forecast: FY 2022 to FY 2024 Totals," which showed a table of total state revenue from all sources for FY 22, and forecasts for FY 23 and FY 24. The data was a more detailed version of the data shown on slide 6 and slide 7. He explained that he broke revenues into four categories of restriction. He explained that Unrestricted General Fund (UGF) revenues could be appropriated by the legislature for any purpose and were typically the focus of most budget discussions. He continued that Designated General Fund (DGF) revenues were technically available for appropriation but were customarily used for some specific purpose. He gave an example that a portion of alcohol tax revenues were used for alcohol and drug abuse treatment and prevention.

Mr. Stickel continued that other restricted revenues were more restricted, limiting the legislature's ability to

appropriate the revenues either by constitution, federal law, or debt covenant. He used the example that a portion of state royalties were dedicated to the Permanent Fund by the constitution. He noted that all federal revenues were shown as restricted, as there were provisions placed by the federal government to dictate how the funds were used.

Mr. Stickel cited that in FY 22, total state revenue from all sources was \$8.6 billion. The amount was brought down by the losses by investments in 2022. There was a forecast for a little over \$16 billion in total revenue in FY 23 and a little over \$15 billion in FY 24.

Mr. Stickel advanced to slide 11, "Unrestricted Revenue Forecast: FY 2022 to FY 2024 Totals," which showed a table. He noted that he would focus on the unrestricted venue, which was where most of the flexibility and discretion existed in the budget process. Investment revenue was one of the state's two largest revenue sources and was estimated to contribute \$3.4 billion in FY 23 and \$3.6 billion in FY 24. Petroleum revenue, the other major source of state funds, generated about \$3.5 billion of unrestricted revenue in FY 22, was forecast to generate \$3.1 billion in FY 23, and \$2.2 billion in FY 24. The non-petroleum revenue sources were forecast to contribute \$459 million in FY 23 and \$465 million in FY 24. He noted that the following slides would walk through the categories in more detail.

Mr. Stickel looked at slide 12, "Unrestricted Investment Revenue: FY 2022 to FY 2024 Totals," which showed a table. He cited that the Permanent Fund transfer was expected to account for 48 percent to 60 percent of UGF revenue over the ten-year forecast. He cited transfers of \$3.4 billion in FY 23 and \$3.5 in FY 24. The transfer was based on the average value of the fund for the first five years of the previous six fiscal years. In addition to the Permanent Fund transfer, there was a small amount of other UGF revenues that were primarily earnings on GF cash balances. Due to market conditions, there were slight losses in FY 22, which was unusual. He commented on the rate volatility, and the expectation that the numbers would be positive again in FY 23 and FY 24.

Mr. Stickel showed slide 13, "Unrestricted Investment Revenue: Percent of Market Value (POMV) Transfer Forecast," which showed a graph providing a ten-year forecast for the

POMV transfer. There was also a high and low case included. He noted that the transfer was based upon the 7.05 percent long term annual average and a 5 percent annual payout.

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Mr. Stickel referenced slide 14, "Unrestricted Petroleum Revenue: FY 2022 to FY 2024 Totals," which showed a table. He noted that there were four main sources: petroleum property tax, a state tax that was expected to generate a little over \$120 million per year, a corporate income tax, and a production tax. He cited that there was also a municipal share of the property tax, and any municipal tax was credited against the state tax. He discussed corporate income tax and cited that the oil and gas portion had generated just under \$300 million in FY 22 and was forecast for \$270 million in FY 23 and \$300 million in FY 24.

Mr. Stickel continued that the state's severance tax on oil and gas, known as production tax, was the largest tax on oil and gas. For North Slope production the tax consisted of a net profits tax with a gross minimum tax floor. At current prices it was expected that most companies would be paying above the minimum tax floor throughout the forecast. There was about \$1.5 billion in production tax revenue forecast for FY 23, and a little over \$700 million forecast for FY 24. The reason for the decline was primarily to do with the lower oil price forecast for the next year.

Co-Chair Stedman mentioned an upcoming presentation on the Willow project. He asked Mr. Stickel to highlight what impacts the department expected on the projection for FY 24. He understood that there had been conversations regarding working on more detail.

Mr. Stickel affirmed that the department would be presenting an updated Willow analysis the following day. He explained that the Willow project and other new projects were included in the forecast on a risked basis. He noted that the production as well as the associated costs were included.

Co-Chair Stedman mentioned concerns about expenditures and potential collection of severance tax, which could lower the net revenue to the state.

Mr. Stickel relayed that it was not possible to get into the company-specific forecasts for any particular companies or fields. He noted that the presentation the following day used only publicly available information. He explained that during the first five years of construction, the net negative impacts to the state were expected to be less than \$400 million. Due to risking methodology, the forecast would show the impacts to be even slightly less.

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Co-Chair Stedman asked if the committee would be exposed to any downside surprises or negative impacts to the revenue forecast update to FY 24 due to projects that may accelerate or decelerate.

Mr. Stickel relayed that the way the state's production tax system was set up, companies were allowed to deduct spending against the calculation of the net profits tax. The state also had a minimum tax floor that protected state revenue to some extent. To the extent that a company was paying tax above the tax floor, if a company chose to make additional investments that would reduce the tax liability it was by design of the tax system.

Co-Chair Stedman emphasized the need to be prepared in the case that expenditures were to become accelerated. He thought that there would be a tight budget process for FY 24.

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Mr. Stickel continued to address slide 14 and discussed royalties. He cited that royalties generated about \$1.3 billion in FY 22, and forecast for about \$1.2 billion in FY 23, and a little over \$1 billion in FY 24. The table showed only the unrestricted portion of the royalties. He explained that there was a portion that went to the Permanent Fund with a smaller portion that went to the school fund.

Mr. Stickel turned to slide 15, "Unrestricted Non-Petroleum Revenue: FY 2022 to FY 2024 Totals," which showed a table with additional detail for unrestricted non-petroleum revenue. He noted that the largest of the non-petroleum revenues was taxes, with the most significant piece being the corporate income tax, which generated a little over

\$100 million per year. Other significant taxes included mining license tax, insurance premium tax, fisheries tax, and various excise tax. The numbers on the slide were only the unrestricted portion of the taxes. In total, there was about \$330 million from unrestricted non-petroleum taxes in FY 23 and about \$340 million in FY 24. Other non-petroleum revenue sources included a variety that generated a little over \$100 million per year and included fines and forfeitures, dividends to the state, rents and royalties, and charges for services.

Co-Chair Stedman thought the oil price fluctuation for FY 24 was roughly \$679 million. He commented on the magnitude of the oil price swing, which exceeded the total of all the tax revenues on the list.

Senator Bishop asked about the Mining License Tax decrease from FY 23 to FY 24. He asked if the reason was due to less production and lower commodity prices.

Mr. Stickel relayed that based on the futures market, he was looking for commodity prices to come down a little in FY 24. He made note of the impact of increased costs of fuel and labor, and general inflation. He noted that the Mining License Tax was a net profits-based tax.

Senator Bishop noted that Mr. Stickel had not mentioned production. He asked had stayed flat or if it was down.

Mr. Stickel relayed that the baseline assumption was for stable production from the state's mines.

Mr. Stickel showed slide 16, "Petroleum Forecast Assumptions Detail."

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Mr. Stickel noted that it was the point in the presentation where he would walk through some of the detailed assumptions around the petroleum forecast in the Spring 2023 Revenue Forecast that was released the previous day.

Mr. Stickel considered slide 17, "Petroleum Detail: Changes to Long-Term Price Forecast," and addressed a graph that showed the spring oil price outlook for ANS crude compared with the fall forecast. To produce the forecast, DOR used the recent projections in the futures market outlook as of the previous week. The forecast used projections through FY 29 and applied an inflation adjustment. There was a \$3.20 per barrel reduction in expected oil price for the FY 23 forecast, an \$8.00 per barrel reduction for FY 24, and reductions in the out years as well. The futures market had been holding fairly steady from the fall forecast until the previous week, when there was a lot of volatility due to financial markets and some bank failures. There was also concern in the oil market specifically in recent weeks about building inventories for oil, which might have softened prices.

Mr. Stickel highlighted slide 18, "Petroleum Detail: Nominal Brent Forecasts Comparison as of March 17, 2023," and compared DOR's fall forecast to several other sources. He observed that the forecast was fairly in line with the futures market, but the forecast was a little lower than the most recent outlook for the U.S. Energy Information Administration and the Analyst forecast. He noted that the difference was attributed to timing, and explained that by using the futures market, DOR had a very current price forecast that fully incorporated the volatility from the previous week. The other sources released an outlook once per month and had not yet incorporated the recent volatility. Generally, the other sources projected a slightly higher oil price than DOR.

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Co-Chair Stedman commented that the committee appreciated the forecast put forward by the department. He mentioned that one year previously there had been difficulty with what had been considered overly optimistic expectations. He noted that the price forecast would be used by the committee.

Mr. Stickel commented that the spring forecast from the previous year had been produced when the conflict between Russia and the Ukraine had started, which had been a period of market uncertainty and volatility that made it very difficult to produce a forecast. In the current spring there was also a period of volatility, which was one reason

the department had wanted to delay setting the price in order to provide the best possible forecast.

Mr. Stickel looked at slide 19, "Petroleum Detail: UGF Relative to Price per Barrel (without POMV): FY 2024," which showed a graph that addressed the eventuality of the forecast being wrong. He cited the volatility of oil prices and the likelihood that that the oil price would not come in at exactly at \$73/bbl, which was the forecast for FY 24. The slide showed the sensitivity analysis of how one could expect UGF revenue to vary if prices were higher or lower than the official forecast. Below the forecast price, a \$1 increase or decrease in oil price equated to about a \$50 million change in unrestricted revenue. Above the forecast price, each dollar of difference represented about a \$65 million to \$75 million change in UGF revenue.

Senator Bishop mentioned the footnote at the bottom of the slide and commented on how the committee focused on real-time market discipline rather than getting caught up in the moment. He was appreciative of Mr. Stickel's current slides, and thought the information tampered down people's expectations.

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Mr. Stickel addressed slide 20, "Petroleum Detail: North Slope Petroleum Production Forecast," which showed a line graph depicting a ten-year history of oil production as well as a ten-year forecast. The production forecast was prepared in collaboration with DNR. He cited a decade of fairly stable production around the 500,000 barrels per day (bpd) line, and there was expectation of another decade of fairly stable production at the same level. The chart showed a high and a low case as well, which spoke to uncertainty related to how newly drilled wells would perform. There was a range of uncertainty related to whether reservoirs and wells came in higher or lower than expected. Generally, the graph showed a mature oil basin with expected declines that would be offset by additional drilling and optimization work as well as new oil fields coming online.

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Mr. Stickel advanced to slide 21, "Petroleum Detail: Changes to North Slope Petroleum Production Forecast,"

which showed a line graph of the following five years and a comparison of how the current forecast compared to the prior fall forecast. He referenced minor changes and noted there was a slight reduction that had to do with incorporating some lower-than-expected production trends in the base production at the large existing wells. There had been some new wells and a few wells that were underperforming. There had been some deferred activity with drilling in a couple of fields. While there was a minor reduction, there was an overall picture of minimal change and stable to slightly increasing production over the following years, which was good news and reflective of much work done by the companies.

Mr. Stickel looked at slide 22, "Petroleum Detail: North Slope Allowable Lease Expenditures," which featured a chart that showed a history and forecast for allowable lease expenditures for the North Slope, and a history of data for oil and gas employment. He noted a strong correlation between company investment and industry employment. He explained that the allowable lease expenditures were a deduction in the net profits tax portion of the production tax calculation, and also an important metric of industry activity in the estate. He pointed out continued low spending in FY 22 as a result of companies recovering from the Covid-19 pandemic and the low prices seen in 2020. Capital expenditures were only \$1.4 billion in FY 22, and operating expenditures were only \$2.5 billion. Both numbers were expected to increase.

Mr. Stickel mentioned the effects of inflation and additional operating costs to reach \$3 billion and beyond in FY 26. He noted a significant uptick in activity on the North Slope capital expenditures. He cited a big increase in the current and following year, with capital expenditures stabilizing around \$2.5 billion per year. For the new fields coming online that required significant capital expenditures, the expenditures were included on a risked basis.

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Senator Kiehl asked about the rebound in operating and capital expenditures not tracked as closely by jobs numbers. He recognized that Mr. Stickel had mentioned inflation and increased costs. He asked if the department was predicting some break in the usual and historic

connection between the two, and wondered if there were shifts in the industry.

Mr. Stickel relayed that there were projections for oil and gas employment that came from the Department of Labor and Workforce Development (DLWD), which could address the matter in more detail. He continued that DLWD was expecting an upward trend. He shared that companies were becoming more efficient, and pressures from oil prices were causing companies to consider how to bring down the cost structure. He thought it had been publicized that some new operators were trying to run as efficiently as possible and commented that for a given level of work things were becoming more efficient.

Mr. Stickel spoke to slide 23, "Petroleum Detail: North Slope Transportation Costs," which showed a bar graph that showed a similar history and forecast for transportation costs, which reduced the value of the oil for all parties. He commented that transportation costs included all the costs of getting oil to market, with primary elements including feeder pipeline tariff and marine transportation costs. The average transportation cost was \$9.97/bbl for FY 22, and DOR expected the cost to stay just under \$10/bbl until FY 31. He noted that relatively flat transportation costs were a factor in any increasing costs of doing business being offset by stable to increasing production. For a pipeline such as the Trans-Alaska Pipeline System (TAPS), there was a set operating expense that was reduced per barrel by increased barrels through the pipeline. He continued that the chart would look very different if there was a forecast with decreasing production.

[9:53:35 AM](#)

COLLEEN GLOVER, DIRECTOR, TAX DIVISION, DEPARTMENT OF REVENUE, referenced slide 24, "Petroleum Detail: Tax Credits for Purchase Detail," which showed a table of oil and gas cashable tax credits. She offered the context that the tax credits had been earned in the past and at one point in time there were statutory provisions that allowed the state to purchase the credits back with cash. The provision had changed and there was no longer any eligibility for any new credits to earn cash from the state. She noted that the slide was different than slides in the past and offered more detail.

Ms. Glover noted that the tax credit details were grouped in annual tranches due to how the law was written regarding how the funds were dispersed. She highlighted that the 2016 credits were paid off in July using the \$60 million supplemental appropriation for FY 22 and a portion of the FY 23 appropriation. The FY 23 appropriation was based on a statutory formula based on oil prices. As of the fall forecast the appropriation was \$281 million, reduced to \$252 million with the updated forecast. A portion of \$136 million had already been disbursed.

Mr. Glover noted that the credit certificates could be used against taxes, transferred, or adjusted at audit. There had been some movement down since the beginning of the fiscal year, which had reduced the total outstanding balance by about \$22 million. She relayed that ideally, the credits were paid off in a year's time frame. There had been a change in law and there was a provision that the credits had to be paid in order of local hire of employers and contractors. She made note that if oil prices stayed at the status quo for the remainder of the fiscal year, it should be possible to pay the tax credits for 2017. The forecast indicated that \$56 million would need to be appropriated for FY 24 to pay off the current balance.

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Co-Chair Stedman asked if the \$55.7 million signified if prices ranged in the \$77/bbl range.

Ms. Glover relayed that the \$55.7 million was the remaining balance.

Co-Chair Stedman asked if the \$56 million call on the treasury would be unaffected by price fluctuations between the current day and June.

Ms. Glover answered affirmatively. She relayed that the \$56 million would be needed as a FY 24 appropriation and was an increase from the fall forecast. She continued that if oil prices changed, based on the unique budget language in the FY 23 budget, the state could pay off more than the \$252 million depending upon where actual production taxes came in for the fiscal year.

Co-Chair Stedman looked forward to an update on the numbers.

Mr. Stickel turned to slide 25, "THANK YOU":

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Co-Chair Stedman thanked Mr. Stickel and Ms. Glover. He discussed the agenda for the following day when the committee would hear a presentation on the Willow Project. He considered that the update on the Willow Project would be informative for new legislators, new staff, and the public.

ADJOURNMENT
[10:00:44 AM](#)

The meeting was adjourned at 10:00 a.m.