SB

21

STATE OF ALASKA

THE LEGISLATURE

BUDGET AND AUDIT COMMITTEE

FINANC. DIVISION
POUCH W -STATE CAPITOL
JUNEAU, ASKA 99811
PHONE: (90 465-3795

M E M O R A N D U M

DATE: January 29, 1981

TO: Honorable Jim Duncan
House of Representatives
Alaska State Legislature

FROM: Milt Barker, Fiscal Analyst MB
Legislative Finance Division

SUBJ: Governor's FY 81 and FY 82 Revenue Estimates

The Governor's revenue estimates for petroleum corporate income tax and interest income stated in "Revenue Sources" appear to be low.

Petroleum Corporate Income Tax

For the petroleum corporate income tax, there are the following estimates ($ millions):

FY	Revenue Sources	AG	Legislative Finance
81	$770	$ 935	$ 795
82	883	1314	1238
Total	$1653	$2249	$2033

Unlike the other two estimates, the Legislative Finance figures do not include income tax on TAPS operations. The difference between the two administration figures is $596 million for the two year total. The AG's figures were developed to analyze possible changes in the tax law.

Interest Income

The FY 82 "Revenue Sources" investment earnings figure is $195 million, the same as FY 81. Based on an average FY 82 permanent fund balance of $2,080 million (this estimate uses Department of Revenue figures and assumes no new appropriations above required contributions) and $350 million in the "Rainy Day" fund, a minimum of $243 million in income would be earned with interest rates at 10%. With the Governor's proposed appropriation of $1.8 billion to the permanent fund, $30 million to an escrow fund, and $350 million to the "Rainy Day" fund, the earnings at 10% on the average FY 82 balances in all these funds would come to $365.5 million.

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POUCH WF–STATE CAPITOL
JUNEAU, ALASKA 99811
PHONE: (907) 465-3795

M E M O R A N D U M

DATE: February 5, 1981

TO: Honorable Sam Cotten
Chairman
House Finance Committee

FROM: Milt Barker, MB Fiscal Analyst
Legislative Finance Division

SUBJ: Funds Available for Appropriation

The attached Table I is a simplification of page 7 in the FY 82 Executive Budget which shows the amount of general funds available for appropriation as presented by the Governor.

However, based on the two attached legislative finance memos, the amounts in Table I could be increased as follows:

	Available for Appropriation	Cash
Table I	$6,014.1 million	$5,665.2 million
Decontrol	185.2	185.2
	$6,199.3	$5,850.4
Underestimates		
Petroleum Corporate Income Tax	596.0	596.0
Interest Income	170.5	170.5
	$6,965.8 million	$6,616.9 million

Total petroleum corporate income tax receipts through FY 82 are estimated at:

"Revenue Sources"	$2,433.0 million
Decontrol	51.1
	$2,484.1
Underestimate	596.0
	$3,080.1 million

These amounts are subject to litigation.

attachment

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TABLE I
GENERAL FUND BALANCES
($ MILLIONS)

	Available for Appropriation	Cash
General Fund Balance 6/30/80	$2,221.6	$1,438.7
FY 81		
Unrestricted Revenue (Net of Permanent Funds)	3,631.0	3,631.0
Appropriations	(4,793.6)[1]	(4,341.6)
Illiquid Investment		(18.0)
General Fund Balance 6/30/81	$1,059.0	$ 710.1
FY 82		
Unrestricted Revenue (Net of Permanent Funds)	$4,955.1	$4,955.1
General Fund Balance (Before 1981 Session Appropriations)	$6,014.1	$5,665.2

Footnote:
1. Certain appropriations to AHFC, AIDA, and for fish processing loan guarantees were made from illiquid assets.

PREPARED BY:
Legislative Finance Division
February 5, 1981

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M E M O R A N D U M

DATE: January 29, 1981

TO: Honorable Jim Duncan
House of Representatives
Alaska State Legislature

FROM: Milt Barker MB
Fiscal Analyst
Legislative Finance Division

SUBJ: Decontrol

According to the Division of Petroleum Revenue, the additional amounts to be received in FY 81 and FY 82 as a result of decontrol are $87.5 million in royalty and $68.5 million in severance, a total of $156.0 million. These figures are corrected from those given in the attached Fairbanks Daily News Miner article. The additional amounts to the general fund and permanent fund would be $134.1 million and $21.9 million respectively.

In addition, petroleum corporate income tax receipts should rise by $51.1 million for a total addition to the general fund of $185.2 million.

The $51.1 million was determined by multiplying royalties by 8 to get a total increased value of production of $700 million. From this is deducted $156.0 million in royalties and severance before applying the 9.4% state income tax rate.

attachment

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FAIRBANKS
Daily News-Miner
"America's Farthest North Daily Newspaper"

FAIRBANKS, ALASKA, FRIDAY, JANUARY 23, 1981 30¢ Per Copy In F

Decontrol could bring $188.3 million to state

If President Ronald Reagan were to lift federal oil price controls immediately, it would mean an additional $188.3 million in state of Alaska oil royalties and severance taxes this year.

Commissioner of Revenue Thomas Williams told the Daily News-Miner this morning that the action hinted by Reagan administration officials would mean about $30 million more paid into the Permanent Fund and $158 million more into the state general fund this year.

The Carter administration had been lifting federal oil price controls gradually on a schedule aimed at full decontrol in September. Reagan campaigned against oil price limits last year and his aids have said that he might lift all controls immediately by executive order. In recent days, however, Reagan has not stressed that possibility.

Lifting price controls right away also might help Reagan's plans to balance the federal budget since it would generate millions from the federal oil windfall profits tax.

Williams said a computer analysis completed today showed lifting controls Feb. 1 would mean $80.6 million more in royalties and $53.2 million more in production taxes for the state during this fiscal year. The current fiscal year ends June 30.

Lifting controls would affect only the first few months of fiscal year 1982, Williams said, but this would give the state $38.4 million more in royalties and $16.1 million more in production taxes.

Since one quarter of the royalties goes to the Permanent Fund, Williams said, that would leave $158 million dollars in additional revenue the state could spend this year.

On Jan. 15 Martin Anderson, chief domestic policy adviser to Ronald Reagan, told The New York Times that Reagan will carry out a campaign pledge and issue an executive order to speed up the lifting oil domestic crude oil price controls "early" in his administration.

In a story from Washington, the Times quoted Martin Anderson as saying Wednesday that Reagan stood by his oft-declared plan to "deregulate the energy market" and that he would begin moving in that direction early in his term.

Since then congressional sources have speculated that such an order might totally lift oil price controls Feb. 1.

AMERICAN IN THE MIDDLE—Forme hostage Bruce German of Kensington, Md. (parka with fur) is the focus of attentio from journalists and photographers thi

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[redacted]

2/23/81

Vic

Thanks for your most professionally handled program Saturday - and for the privilege of participating in it.

A letter is going to GPC members today - following your comment Saturday.

Note re my written testimony: error, last para, p2; please change "price" to "cost".

If we want to be virtually taxless, get cheap money for homes & business purposes, subdisize hydro to get cheap power and buy non-competitive development in various ways - we will suffer financial disaster soon after Pr Bay. Looked at dispassionately this cant be called anything but plundering Alaska!

I dont care how much we spend if, in the near term, we control our appetites so as to sock massive sums in the PF. ~~in the near term~~.

NB

UNIVERSITY OF ALASKA

FAIRBANKS, ALASKA 99701

Senator Vic Fischer

DATE: 2/25/81

Attached is my testimony before the Senate State Affairs Committee public hearing on 2/21/81. Appreciate the opportunity to appear and record testimony

Scott Goldsmith

1.

2.

Testimony Before Senate State Affairs Committee

of

Scott Goldsmith
Institute of Social and Economic Research

February 21, 1981

Senate Bill 13 - An act to appropriate cash from the general fund to pay for capital improvements approved by G.O. bonds in 1980.

The logic of borrowing to pay for capital projects when the state has the money to pay cash rests upon the idea of "arbitrage." That is the ability to earn money by borrowing at a low rate of return and investing the borrowed funds at a higher rate of return. When arbitrage is possible, income is maximized by borrowing to pay for capital and, in fact, any expenditure. Thus, when the state can effectively invest money at a higher return than it must pay to borrow, paying cash does not maximize state revenue.

There are, however, two considerations which could alter this conclusion in the unique situation which faces the state of Alaska.

1. The arbitrage model assumes rational behavior on the part of government. Although government is composed of rational individuals, their collective decisions on the spending of money are not always rational. In other words, money gets spent on projects which do not yield a positive return, and this is more likely to occur when the state has more money to spend.

   Thus, in analyzing whether paying cash for capital projects makes sense, you should try to determine what spending would be eliminated by such a policy. (Or if the capital project were paid for with borrowed funds, what would actually happen to the funds made available for other purchases.) If unproductive investments are curtailed, then the opportunity cost of paying cash would be zero and no income would be lost. If productive investments are curtailed, then the opportunity cost of paying cash is the lost income from arbitrage.

2. At some time, ten-to-twenty years hence, state revenues, because they are so dependent upon Prudhoe Bay oil and gas production, will be considerably smaller than today. It is unlikely that public needs will be less, however. This suggests the public spending opportunities available to the next generation will be limited relative to our own. Further restricting their options with the requirement of retiring a substantial debt may be an unfair burden. In the extreme, state revenues could fall to such a level that they would all be required for debt service, leaving nothing for schools, highway maintenance, etc. Simply put, an <u>ability to pay</u> criterion suggests paying cash for capital projects.

One rationale for debt finance is to pay for the facility over its lifetime, such that those people pay who are actually getting the benefits as the good is consumed. In the Alaskan context, this rationale may break down because of the transient nature of the population associated with the boom-bust character of the economy, combined with the nature of the project "benefits." For example, a benefit advanced for many capital projects is the employment generated in the construction phase. This directly benefits the present population but not the population which may be here in ten-to-twenty years. The people benefiting today may leave Alaska when the boom construction jobs are all gone because state revenues cannot support them. Should they leave behind an unpaid bill in the form of annual debt service payments for those who remain in the state after the bust?

<u>Senate Bills 21 and 68</u> - An act to appropriate general fund money to the permanent fund.

State revenues from Prudhoe Bay should be viewed as a one-time inheritance. From this perspective, rules about the proportion of revenues which should be saved in the permanent fund emerge.

The unique good fortune of Alaska in its ownership of Prudhoe Bay reserves is evident from the attached Table A which compares the initial reserves in the Prudhoe Bay Field with the largest oil fields in North America and the world. At 10 billion barrels, Prudhoe Bay contains the largest reserves in North America, and only two other fields in the United States had over 2 billion barrels. A field of 100 million barrels, which would be one-hundredth as large as Prudhoe, is considered a giant and hailed as a major discovery in the United States. Consequently, the probability of the discovery of additional reserves, <u>on state land</u>, to compensate the state treasury for the eventual decline in Prudhoe Bay oil production is virtually nil.

Thus, Prudhoe Bay state resources are an inheritance, primarily in the form of oil in the ground but partly in the form of money into which some of the oil is annually transformed. This is commonly called revenues but is more properly viewed as a portion of the principal of the inheritance in monetary, rather than physical (oil in place), form.

Using current (FY 1982) estimates of the per barrel revenues from Prudhoe Bay oil as well as current estimates of recoverable oil, the present value (in 1981 dollars) of the state's inheritance is very roughly $80 billion (royalties and various taxes associated with oil production and transportation).

We can easily calculate that if that $80 billion were all invested to earn a 2 percent real rate of return, the state could withdraw $1.6 billion annually from the invested fund without reducing its value. This $1.6 billion (in 1981 dollars) would be the annual annuity which could be withdrawn every year to finance government. Such an annuity could completely finance the 1980 state budget.

This suggests that saving $1.5-to-$1.8 billion out of total revenues of $6.6 billion and spending $4.7-to-$5 billion is cutting into principal to the tune of over $2 billion. Thus, if one objective of financial planning is a sound long-term, revenue-generating base, a policy of saving $1.5-to-$1.8 billion this fiscal year in the permanent fund is inadequate.

It will, of course, be argued that the best way to ensure a stable long-term tax base is through investment in state resources. The truth is that the revenue-generating capacity of other resources does not have any possibility of providing revenues equal to the $1.6 billion annuity available through a savings and investment program of the permanent fund.

For example, consider coal. Demonstrated resources in Alaska are about 4.8 billion tons, primarily centered at the Nenana and Susitna Coal Fields (McGee and O'Connor, Mineral Resources of Alaska and the Impact of Federal Land Policies on their Availability: Coal, Open File Report 051, DNR, USGS, 1975, p. 2).

If the state could get a 30 cent royalty on each ton of coal mined, how many tons would need to be mined annually to generate $1.6 billion from royalties? (The minimum royalty rate on state land is 5¢/ton with recent leases carrying a 30¢-35¢ royalty rate.) The answer is 5.3 billion tons. So each year, more coal would need to be mined than is currently available as reserves in order to match the $1.6 billion annuity. (The mining license tax and corporate income tax would generate some additional revenue but would not substantially alter the conclusion.) It is interesting to note that actual production of coal is presently about one million tons, or about 1/5300 the amount necessary for a tax base dependent upon coal.

TABLE A

I. LARGEST OIL FIELDS IN NORTH AMERICA

			Billion Barrels
1.	Prudhoe Bay	USA	10.014
2.	Chiapas	Mexico	6.513
3.	East Texas	USA	5.999
4.	Wilmington	USA	2.418
5.	Poza Rica	Mexico	2.028
6.	Pembina	Canada	1.742
7.	Midway Sunset	USA	1.603
8.	Yates	USA	1.600
9.	Wasson	USA	1.508
10.	Kern River	USA	1.453
11.	Panhandle	USA	1.415
12.	Swan Hills	Canada	1.315
13.	Ebano-Panuco	Mexico	1.304
14.	Sho-Vel-Tum	USA	1.300
15.	Elk Hills	USA	1.296
16.	Naranjos Cerro Azul	Mexico	1.177
17.	Huntington Beach	USA	1.076
18.	Santa Ynez	USA	1.000

II. LARGEST OIL FIELDS IN THE WORLD

1.	Burgan	Kuwait	68.900
2.	Ghawar	Saudi Arabia	60.273
3.	Safania	Saudi Arabia	17.051
4.	Kirkuk	Iraq	16.320
5.	Samotlorskoye	USSR	14.600
6.	Romashkino	USSR	14.040
7.	Rumaila	Iraq	13.635
8.	Gachsaran	Iran	11.435
9.	Marun	Iran	10.887
10.	Lagunillas	Venezuela	10.732
11.	Agha Jari	Iran	10.034
12.	Prudhoe Bay	USA	10.014

Oil and Gas Journal, August 1977, Vol. 75, No. 35, p. 102.

SENATE STATE AFFAIRS COMMITTEE HEARING

ON

1. DEPOSITS IN THE PERMANENT FUND: 2. PAYING CASH FOR CAPITAL IMPROVEMENTS

February 21, 1981

Testimony by Harold E. Pomeroy

Our future is bright if we don't spend billions and billions of dollars unproductively trying to create an artificial destiny for Alaska.

Right now we are misreading the signals.

There is popular belief that if we just do the right things we can achieve a prosperous, diversified and renewable resources economy, including renewable resource production and processing-manufacture. This means, of course, producing goods for export.

We are negligible producers of processed-manufactured goods - with few exceptions, relative to our resource production and services economy, due to far higher costs here than elsewhere - costs that cannot be cured by spending money. Where the potential for competitive position in the market is lacking, direct and indirect aid is only creating artificial viability that can last only until the money runs out.

The wrong signal is that somehow, if we just put enough money into artificial viability in the direction of diversification and renewable resource processing we can turn a liability into an asset. The result is the false assumption that taxes generated out of these areas of activity will be able to make up for less oil income in the future.

The hard fact is that there is no basis whatever for believing the aggregate of all tax revenue from all sources, other than oil production will increase the approximate 1/10 of our expenditures such revenues now pay, by an appreciable amount, if at all - unless taxes are raised drastically.

Testimony, 2/21/81
Harold E. Pomeroy

Take the molybdenum mine soon to be established near Ketchikan. Though one of the largest deposits anywhere, molybdenum won't be made there; the concentrate will go Outside for processing for reasons of economy. Would we increase taxes on the plant two or three or more times in the future to make both ends meet due to less oil income?

Our future economic stability rests heavily on the reason the question has to be asked.

There will be a few individual exceptions to the revenue potential overall - plants with profits coming from huge investments and very few workers.

We can be encouraged about the future if we take the right signal from the dramatic increase in the amount of oil income from even two years ago. A Permanent Fund that generates a substantial part of future needed revenue is practical - with room also for such benefits as no personal income tax and some desirable capital improvements that are cost effective.

Our tremendous good fortune in quantity of oil money is that we can make massive early years deposits in the Permanent Fund, accumulate the interest and arrive at a total of as much as $125 billion to produce $13 billion or $14 billion in annual revenue from then on.

We should place the highest priority on action to secure as strong a financial future as possible, rather than to grab more toward a taxless society and what amounts, indirectly, to colossal price support for economic enterprise that simply isn't economically viable in the open market.

	PERMANENT FUND		BUDGET GROWTH	
	I.	II.	III.	IV.
	$2 Billion at 11% compounded	$4 Billion	$2 Billion - at 11% rate of increase	$2 Billion - at 15% rate of increase
Yrs				
5	$3.37	$6.74	$3.37	$4.02
10	$5.68	$11.36	$5.68	$8.09
15	$9.57	$19.14	$9.57	$16.27
20	$16.12	$32.29	$16.12	$32.73

I. At the end of 20 years the $16.12 would produce $1.67 billion yearly - from then on.

III. The $1.67 billion would not go very r toward funding the $16.12 billion budget. The 11% rate of increase may not be enough for inflation and population growth and would allow zero for real growth.

IV. At 15% growth, $120 billion in the Permanent Fund would produce about $13 billion in earnings revenue toward the $32.73 billion budget

February 21, 1981
Harold E. Pomeroy