ALASKA’S ECONOMY

A bright future, but... are we prepared?

Mike Navarre, Commissioner
Department of Commerce, Community and Economic Development
Our future is bright...
What’s happening in our economy?

Does Alaska need a fiscal plan?
Oil and Gas GDP has grown, but is volatile

Nominal GDP of Oil and Gas industry in Alaska, 1997-2015

Source - US. Bureau of Economic Analysis
Can we rely solely on oil and gas?

Production Forecast: ANS History and Forecast by Pool

Fiscal Year

Thousand bbls/day


Prudhoe Bay  Kuparuk  PBU Satellites  GPMA  Endicott  Kuparuk Satellites  Alpine  Offshore  Point Thomson  New Fields
Other private sector industries growing steadily

Nominal GDP of All Other (non-petroleum) Private Industries, 1997-2015

- Mining (except oil and gas)
- Education, health care, social assistance
- Other services
- Arts, entertainment, recreation, accommodation, food
- Professional and business services
- Finance, insurance, real estate, rental and leasing
- Information
- Transportation and warehousing
- Retail trade
- Wholesale trade
- Manufacturing
- Construction
- Utilities
- Agriculture, forestry, and fishing

Source - US. Bureau of Economic Analysis
The Disconnect

Our economy is diversifying – but our revenues are not.
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..
Can’t we just wait on oil and gas development?

or

Oil price increases?
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 Mooses Tooth start-up late 2018. ConocoPhillips at Willow, Caelus Energy at Smith Bay, Armstrong, Repsol, Oil Search at Pikka & Nanushu
Maybe even better than good..

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

5. 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

6. LNG Project
The long-awaited North Slope gas line project could add to Alaska’s success stories in the 2020s
4. ANWR Potential
First ANWR lease sale could occur by 2021-2022

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

6. LNG Project
The long-awaited North Slope gas line project could add to Alaska’s success stories in the 2020s.

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

Active oil and gas wells February 2017

- **PERMIAN BASIN**: 50-115 BBOE
- **BAKKEN**: 20-40 BBOE
- **EAGLE FORD**: 35 – 60 BBOE
- **MARIANUS**: >400 TCFG

Alaska’s competition

Oil Production by Geologic Region
Millions of barrels of oil production per day, 2007-2017

Source: Washington Post, February 2017
Alaska’s competition

U.S. Crude Oil Production
Thousand barrels of oil per day, 2007-2017

Source: U.S. Energy Information Administration
Are we competitive?

Production costs per barrel

All numbers 2016. Cost is average of all barrels produced, including operating and capital expenses, transportation, royalty expenses, production and property taxes.

Sources: Alaska Department of Revenue Fall 2016 Revenue Source Book, Rystad Energy UCube
Can we rely solely on oil and gas?

Production Forecast: ANS History and Forecast by Pool

- Prudhoe Bay
- Kuparuk
- PBU Satellites
- GPMA
- Endicott
- Kuparuk Satellites
- Alpine
- Offshore
- Point Thomson
- New Fields
How does Alaska compete?

From an investors perspective...

A growing and diversifying economy

Promising investment opportunities

Uncertainty

Annual political battles over deficit and taxes

Multiple years of drawing down savings

$2.3 billion annual deficit

Overreliance on oil and gas revenues
Private Construction spending in 2017 is supposed to be around 4 billion dollars. Using the 5 to 15% 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?
“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.
“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.

2. “Economic development will save us”
Is economic development alone the solution?
It’s hypothetical!

You seem to be very well educated on stuff that you made up.
Economic development is of vital importance to Alaska.

The purpose of this scenario is to illustrate a fundamental flaw in our revenue structure – the disconnect between development and our ability to fund the services that support it. Talking about the disconnect is not anti-development, doing nothing to fix it is.
1. Hypothesis: A company proposes a major investment in the Kenai Peninsula Borough

2. Evaluation: It must be economically viable for both the state and Kenai Peninsula Borough

3. Criteria: The project must pay its own way — no subsidies
Hypothetical new factory in the KPB

- **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
Kenai Peninsula Borough - the math

- **5,000** new jobs
- **4,000** new families
- **2,500** new students
- **4,000** new homes, **$200,000** per home
- **$1 billion** capital investment

$14 million a year in increased school funding

$2 million a year in borough sales taxes

$8 million a year in borough areawide property taxes on homes

$10 million a year in borough areawide property taxes on factory investment
Kenai Peninsula Borough - the math

- **$5,000** new jobs
- **$4,000** new families
- **$2,500** new students
- **$4,000** new homes, **$200,000** per home
- **$1 billion** capital investment

$14 million a year in increased school funding

$6 million available for other expenses

$10 million a year in borough areawide property taxes on factory investment

$8 million a year in borough areawide property taxes on homes

$10 million a year in increased school funding

$2 million a year in borough sales taxes

$6 million available for other expenses
### Kenai Peninsula Borough - the math

<table>
<thead>
<tr>
<th>Item</th>
<th>Quantity</th>
</tr>
</thead>
<tbody>
<tr>
<td>New jobs</td>
<td>5,000</td>
</tr>
<tr>
<td>New families</td>
<td>4,000</td>
</tr>
<tr>
<td>New students</td>
<td>2,500</td>
</tr>
<tr>
<td>New homes</td>
<td>4,000</td>
</tr>
<tr>
<td>Capital investment</td>
<td>$1 billion</td>
</tr>
</tbody>
</table>

- $200,000 per home
- $1 billion capital investment

### Decision:

Yes! The borough tax base covers the costs of the services that result from the development.

- $14 million a year in increased school funding
- $10 million a year in property taxes on factory investment
- $8 million a year in borough areawide property taxes
- $14 million a year in increased school funding
- $2 million a year in borough sales taxes

**Decision:** Yes! The borough tax base covers the costs of the services that result from the development.
5,000 new jobs

4,000 new families

2,500 new students

4,000 new homes, $200,000 per home

$1 billion capital investment

State - new revenues?
5,000 new jobs

4,000 new families

2,500 new students

4,000 new homes, $200,000 per home

$1 billion capital investment

$4 million a year in higher expenses for troopers, highways, courts, prisons, agency operations, etc.

$22.5 million a year in increased school funding costs (25% gain in enrollment)
5,000 new jobs

4,000 new families

2,500 new students

4,000 new homes, $200,000 per home

$1 billion capital investment

$4 million a year in higher expenses for troopers, prisons, courts, etc.

$22.5 million a year in increased school funding costs (18% gain in enrollment)

$4 million a year in higher expenses for troopers, prisons, courts, etc.

$26.5 million in additional expenses

$0 in new revenue
State - the math

- **5,000** new jobs
- **4,000** new families
- **2,500** new students
- **4,000** new homes, $200,000 per home
- **$1 billion** capital investment

Decision:
The state budget would increase without **any** new revenues to support those services.

$4 million a year in higher expenses for troopers, prisons, courts, etc.

$22.5 million a year in increased school funding costs (18% gain in enrollment)

Decision: The state budget would increase without any new revenues to support those services.
KPB Impact  +$6 Million
• Resounding support for the investment
• Political certainty that the development is supported

State Impact  -$26.5 Million
• Support for the investment, but a debate over how to pay for it
• Political battles and value judgements of different industries
• Political uncertainty impacting potential investors in the new industry
• Political uncertainty also impacting O&G investment
Across communities, it’s the same

<table>
<thead>
<tr>
<th>Alaska Community</th>
<th>Local Impact</th>
<th>State Impact</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kenai Peninsula Borough</td>
<td>+6M</td>
<td>-26.5M</td>
</tr>
<tr>
<td>Fairbanks North Star Borough</td>
<td>+12M</td>
<td>-30.0M</td>
</tr>
<tr>
<td>Mat-Su Borough</td>
<td>+20M</td>
<td>-27.0M</td>
</tr>
<tr>
<td>City and Borough of Juneau</td>
<td>+13M</td>
<td>-25.0M</td>
</tr>
<tr>
<td>Municipality of Anchorage</td>
<td>+9M</td>
<td>-20.0M</td>
</tr>
</tbody>
</table>
That was a hypothetical scenario

...but diversifying Alaska’s economy is not hypothetical...
Other private sector industries growing steadily

Nominal GDP of All Other (non-petroleum) Private Industries, 1997-2015

Source - US. Bureau of Economic Analysis
The Disconnect

Our economy is diversifying – but our revenues are not.

GDP - Oil and Gas
GDP - All Other Private Industries
Unrestricted General Fund Revenue
Unrestricted Petroleum Revenue

Source: US. Bureau of Economic Analysis, Legislative Finance
Can we rely solely on oil and gas?

Production Forecast: ANS History and Forecast by Pool

- Prudhoe Bay
- Kuparuk
- PBU Satellites
- GPMA
- Endicott
- Kuparuk Satellites
- Alpine
- Offshore
- Point Thomson
- New Fields

Fiscal Year

Thousand bbls/day
“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.

2. “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.
“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.

2. “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.

3. “Cutting government will save us”
Can’t we just cut expenses more?
$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)
Cuts have real impacts on services.

Top Three Unrestricted General Fund Spending Categories (FY19 Proposed)
Total $2.9 billion

- K-12 FORMULA
- MEDICAID AND OTHER FORMULA
- H&SS NON-FORMULA

Source – AK OMB
State funds matter locally

<table>
<thead>
<tr>
<th>Municipality and School District</th>
<th>Fiscal Year 2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Municipal community assistance</td>
<td>$1.9 million</td>
</tr>
<tr>
<td>State reimbursement of school bond debt</td>
<td>$2.3 million</td>
</tr>
<tr>
<td>State assistance for retirement liability</td>
<td>$9.1 million</td>
</tr>
<tr>
<td>Foundation formula funding K-12 schools</td>
<td>$81.6 million</td>
</tr>
<tr>
<td>Pupil transportation reimbursement</td>
<td>$8.1 million</td>
</tr>
</tbody>
</table>

$103 million state funds for Kenai Peninsula Borough
State funds matter locally

**Municipalities and schools depend on state help**

<table>
<thead>
<tr>
<th>Local Governments</th>
<th>Fiscal Year 2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kenai Peninsula Borough</td>
<td>$103 million</td>
</tr>
<tr>
<td>Fairbanks North Star Borough</td>
<td>$155 million</td>
</tr>
<tr>
<td>Mat Su Borough</td>
<td>$223 million</td>
</tr>
<tr>
<td>City and Borough of Juneau</td>
<td>$59 million</td>
</tr>
<tr>
<td>Municipality of Anchorage</td>
<td>$443 million</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$ 983 million</strong></td>
</tr>
</tbody>
</table>
“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 disincentive to investment.

2. “Economic development will save us”
   The state needs to be able to cover the costs associated with development. Our economy is developing and diversifying, our revenues are not.

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.
The perfect solution?
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
Our future is bright...
The Disconnect

Our economy is diversifying – but our revenues are not.
Contact our office:
Alaska Department of Commerce, Community and Economic Development

Commissioner Mike Navarre
mike.navarre@alaska.gov
(907) 465-2500

Angela Ramponi, Policy Analyst
Office of the Commissioner
angela.ramponi@alaska.gov
(907) 465 - 6466