Scenarios for Energy and Resource Development on the North Slope and Adjacent Seas

Oil and Gas Revenues | Alaska State Economy

Summary

Historically, Alaska's economy has been highly dependent on sectors of the economy that draw money into the state, which directly generates revenues for businesses, wages and other income, and provides jobs for Alaskans. As Alaska businesses and households spend this new money within Alaska, additional revenues, wages, and income is generated. The most important jobs and income generators for the Alaska economy are the petroleum industry, the largest private economic driver in the state, and the federal government. Other sectors bringing in money include fisheries, mining, tourism, air cargo, and retirement as well as non-earned income. The contribution of the petroleum sector comes from production-related economic activity, current petroleum revenues to state and local governments, and spending from savings collected in prior years and deposited into the Alaska Permanent Fund, the Constitutional Budget Reserve and Statutory Budget Reserve. In fiscal year 2012, oil revenue to the state was around $9.2 billion, amounting to more than half of all revenue to the state and 89 percent of the general fund from which the state pays for public services.

The amount of oil revenue collected by the state depends on the price of oil determined by world markets, the barrels of oil produced, and the way Alaska both administers its royalty contracts and taxes the oil industry. The structure of the oil and gas production tax code is an important driver affecting industry decisions for investments and production of North Slope oil and gas.

Overview

The oil and gas produced in Alaska is subject to an oil and gas production tax that provides a significant source of revenue to the State. The tax was first enacted in 1955 assessing 1% of the production value. Since 2006 the production tax has been a net profits tax which takes into account market price, transportation costs, royalties and lease costs. The oil and gas production tax was modified most recently in 2013 with the enactment of the More Alaska Production Act (MAPA, or SB21) which has a constant nominal tax rate of 35%. It replaced the Alaska's Clear and Equitable Share (ACES) which had a progressive nominal tax rate between 25% and 75%.

Changes in oil prices and production costs are difficult to predict, but assumptions to predict the taxable value has resulted in controversy about how the oil and gas production tax code could encourage industry production while also and best serving the Alaska economy.

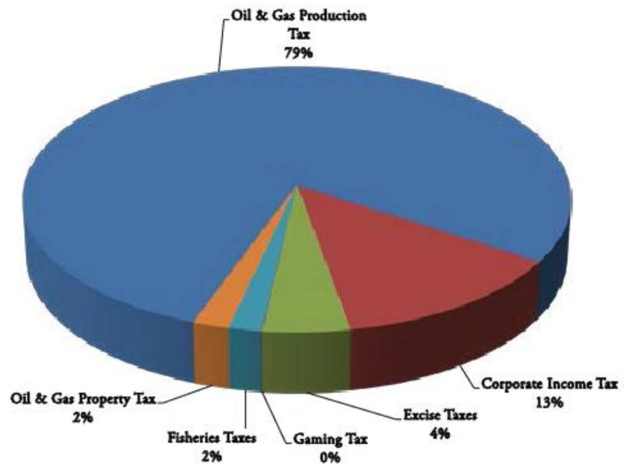

Figure 1. Revenues by tax program. Source: Alaska Department of Revenue Tax Division 2013 Annual Report

Alaska economy: The strength of the Alaska economy depends on the cash coming in, through basic industries in Alaska that sell goods and services elsewhere. Most places in the U.S. bring in cash by manufacturing or providing services but Alaska is different. The Alaska economy is built on the sale of natural resources and inflows of cash from the federal government. For decades, Alaska has had a strong economy, driven by federal spending and oil production.

Alaska's other basic sectors include the seafood, mining, and timber industries exporting commodities as well as tourism and air cargo selling services to people from outside Alaska. Lastly, retirement checks and investment income Alaskans collect from outside sources also generate jobs. Businesses who provide goods and services to Alaska's basic industries provide spin-off jobs and so does local and state government by hiring public employees (NOTE: not always paid for by taxes). If we count all direct and spin-off jobs, then 31 percent of all jobs in Alaska are dependent on the petroleum sector, 35 percent on the federal government, and 34 percent on all other basic sectors (Figure 2) (2).

Besides comparing the different sectors on the basis of jobs, one can use the amount of income generated by each sector as a way of comparison. In 2010/11 income generated by Alaska's basic sectors amounted to $24.5 billion through the oil industry, $10.9 billion through the federal government, and $8.5 billion through the sale of commodities other than oil. Other resource sectors like mining, fishing, and tourism are important, but aren't nearly large enough to carry Alaska's economy in the way federal dollars and oil have. Neither are these sectors likely to provide enough additional tax revenue to offset declines in oil revenue.

However, a growing tourism sector, expanding mining sector, retirees, and growth in air cargo have contributed to job growth in the Alaska economy since 1990. Mining supports nearly 12,000 jobs for Alaskans, compared to the seafood industry 38,000, and timber 6,000. The newer basic industries include tourism supporting 40,000 jobs and air cargo 7,400 jobs (2, 4).

Because of the public ownership of much of the natural resource base, state government plays a key role in fostering economic development and diversification of the economic base. However, the last 25 years of economic growth in Alaska have demonstrated that economic development alone will not produce revenues needed to help balance the state budget without new or higher taxes on individuals, businesses, and oil and gas, to capture a share of that economic activity for the State treasury. Non-oil general fund revenues adjusted for inflation are not much higher today than 25 years ago while total employment in non-oil sectors has more than quadrupled resulting in increased public service needs not being met by additional tax revenues.

Production tax revenue: Between statehood and 2012, the state collected $191 billion in revenue, saved a quarter ($47 billion), and spent more than half ($86 billion) to meet increased public service and infrastructure needs for its growing population. A third ($58 billion) was spent to reduce the tax burden of its citizens and non-oil resource industries. Even though the economic development resulting from the lower tax burden on non-oil resource industries has led to job growth it failed to raise adequate tax revenue to meet the associated increased public service demand associated with the population growth.

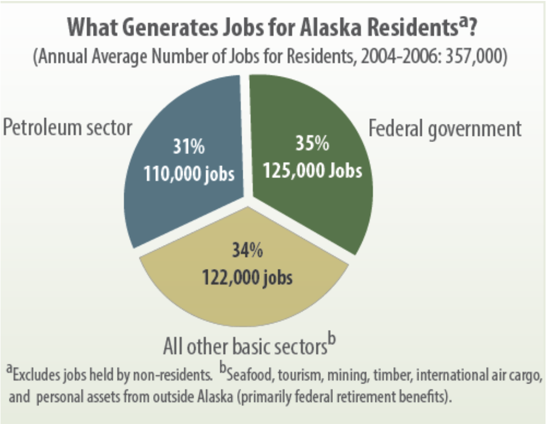

Figure 2. Number of Alaskan jobs by sector. Source: ISER

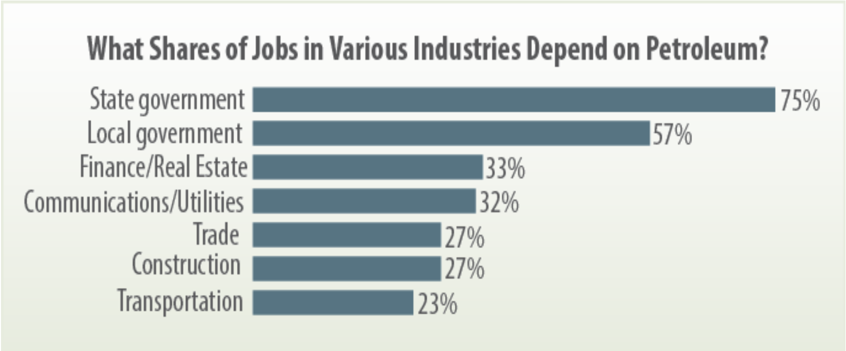

Figure 3. Share of industry jobs dependent on petroleum. Source: ISER

Trends and Uncertainties

Even in times of high oil prices, Alaska's economic future is uncertain. Historically, Alaska state government has been over-relying on oil revenues, yet North Slope oil production has declined between three and eight percent annually in recent years. This decline rate is not reversible by favorable fiscal policy alone or taxation in other resource sectors. Even though high oil prices for many years have sheltered state government from the budget gap, the oil production tax alone cannot fill the fiscal gap given current oil price and production projections.

Also, federal spending can no longer be depended on (3, 5). Despite the economic growth fostered, all non-oil resource sectors are not large enough to compensate for any budget shortfall due to much reduced federal spending, decreasing oil production as well as stable or lower oil prices. Given projected future oil prices, Alaska will face a fiscal gap regardless of what the petroleum production tax code looks like unless the state drastically reduces spending and finds other revenue sources to balance the budget. Some of the continuing challenges and uncertainties related to future economic development in Alaska that have shaped the Alaska economy in the past include (1, 2, 6):

- *Distance to markets*:
  Alaska's geographic location places it far from markets and suppliers, resulting in high transportation costs.
- *Difficult access:*
  Alaska's large land mass and few road miles create difficult and costly access to resource development.
- *Harsh environment:*
  Severe winters and permafrost, for example, increase costs for development.
- *Small population:*
  Alaska's population and jobs are concentrated in Southcentral Alaska, a comparably small area, leaving the rest of the state with very low population density.
- *Seasonality:*
  Alaska has the highest seasonality in jobs nationwide. Private sector jobs in the summer are a quarter higher compared to the annual average number of jobs.
- *Dependence on oil:*
  The economy is highly dependent on just one resource, oil, leaving the Alaska economy less diversified compared to other states and more vulnerable to declines and/or swings related to income from oil production.
- *Federal Funding:*
  Since statehood, Alaska has benefited from large per capita transfer payments from the Federal government to fund state services and development of infrastructure.
- *Remote enclave production:*
  Most resource development occurs in enclaves, remote locations, where the lack of adequately trained local labor hampers the benefits for local small-scale economies and the establishment of a locally owned support services industry.
- *Strong political influence:*
  Because of its dominant impact on the Alaska economy, the oil and gas industry, led by a small set of multi-national companies, plays a significant role in political and policy debates in Alaska. And because of Alaskans' overwhelming reliance on oil and gas dollars, they are dependent on the industry and its continued spending and support.

Many Alaskans hope for a natural-gas pipeline, which will be an important piece of the state's future development. But it remains an uncertain prospect, and by itself is not enough to provide a healthy economic future. However, Alaskans can invest in their current resource base to build physical and human assets that are able to generate the private-sector jobs and the public-sector tax base that together can bring Alaska prosperity in future decades.

Driver interactions

The size of the Alaska economy, to a large degree, is related to the amount and price of petroleum production linked to global petroleum markets. Petroleum resource development has a large impact on job and wealth creation in Alaska's economy through direct and spin-off economic activity. In addition, over three quarters of state and local government jobs are dependent on the petroleum sector underlining widespread overreliance on oil revenues for public services throughout Alaska (Figure 3).

Declining petroleum production can result in government budget cuts. Businesses providing goods and services to the oil industry and local and state governments would lay off workers. With the loss of employees, the loss of income would further cause a reduction of spending, jobs, and income and could lead to a contracting economy. At the same token, large increases in resource development spending in Alaska can create and support direct and related spin-off jobs. A big change in the Alaska economy since statehood has been the growth of industries providing goods and services that as recently as the 1960s, were unavailable locally. To a large degree, this diversification is traceable to spending by the petroleum sector and federal government.

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