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Department of Revenue's new forecast, just out

Oil income decline: $1.89 billion budget deficit this year!

Here's some sober news: Thanks to faster-than-expected declines in oil production and lower-than-expected oil prices, state oil revenues will take a big hit in the current fiscal year. The outlook for next year isn't any better. *Don't blame the oil tax change in SB-21. Surprisingly, revenue forecasters now say the tax change will have negligible effects on income compared with the previous tax, mainly because of lower oil prices*. The expectation now is that the state will suffer a $1.8 billion deficit this year, up from a $667 million deficit estimated last May. Luckily, we have ample cash reserve to cushion the blow, but the expected draws on reserves this year and next will be hefty.

Whoa! SB 21 oil tax bill is revenue neutral?

Surprisingly, a new oil and gas production tax adopted by the Legislature last year will have negligible effects on state revenues compared with the old tax, according to the new forecast. The new tax, enacted by Senate Bill 21, takes effect Jan. 1 and replaces the current tax, known as ACES. A key feature of ACES is a "progressivity" formula that hikes the tax rate at higher oil prices. When oil prices are lower the formula reduces taxes. Because the new forecast assumes an average oil sales price in the current fiscal year of $105.68 per barrel, down from a $109.61 per barrel price estimate used in the spring forecast, the effect is to reduce the average per-barrel tax rate under ACES had the tax been in effect for the full Fiscal Year 2014.

Interestingly the average estimated tax rate under the new SB-21 tax is *higher*, at 35 percent, than the 34.9 percent average tax rate estimated if ACES were to remain in effect for the year, according to the estimate. The same thing would happen next year, state Fiscal Year 2015, beginning July 1. For that year the SB 21 tax rate will be 35 percent while the estimated tax rate for ACES would be 32.6 percent, if the tax were to remain in effect. The higher effective rate under SB 21 results mainly because the new tax has a flat rate of 35 percent while the ACES base tax rate is 25 percent but is adjusted by the progressivity formula. If oil prices are high the effective tax rate is higher. If prices go down, the effective tax rate drops. That has now happened.

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Significant decline in state revenues seen

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Much of the criticism of the SB 21 tax change–the charge of a $2 billion "giveaway"–is based on assumptions of higher oil prices. In that case the ACES tax would indeed bring in more revenue.

The new forecast predicts significant declines in Alaska's oil tax and royalty revenues over the next two years. Unrestricted oil and gas revenues totaled $6.35 billion last fiscal year and are now estimated at $4.35 billion in the current year and $3.93 million next year. Alaska depends on oil revenues to pay about 85 percent of its budget, as there are few nonpetroleum taxes and virtually no taxes on citizens. With the lower revenue estimate released Wednesday the state is expected to incur a $1.89 billion deficit in the current year. However, the state has reserves of approximately $16 billion set aside in funds for just such contingencies.

Big decline in oil production last year, but better news this year?

As for North Slope oil production, that declined 8.3 percent in the state's last fiscal year compared with the previous year, but state forecasters now expect a 4 percent decline this year and are estimating 2 percent annual declines in both of the next two years. Revenue officials told us that last year's steep decline was caused by lower well productivity in North Slope fields, more numerous summer shutdowns of production facilities for maintenance and use of more natural gas liquids production for in-field use in Enhanced Oil Recovery.

Actual North Slope production averaged 531,600 b/d in state Fiscal Year 2013, which ended last June 30. In the Fiscal Year 2012 production averaged 579,400 b/d. *The new forecast for FY 2014, the current fiscal year, is 508,200 b/d. This represents a drop from the estimate made last spring for 2014, which was 526,000 b/d*. Better news: Forecasters expect the decline to soften to 4 percent as result of new production from increased drilling by North Slope operators. Four additional rigs are being added in response to the Legislature's action last spring changing the state production tax. More production is expected in the following years as a result of new drill sites ConocoPhillips plans, also a result of the tax change.

Another positive note in the forecast are the projections of increasing Cook Inlet production due to intensive redevelopment work in aging fields by independents. The Department of Revenue expects production to exceed an average of 13,500 b/d in the current fiscal year, a 52 percent increase since 2010. The upward trend for Cook Inlet is likely to continue, the department said in its forecast.