Oil Price Decline Forces Alaska Governor to Propose an Income Tax

Alaska's new reality was painfully obvious on Wednesday as Alaska's Governor Bill Walker rolled out his budget for next year: an income tax (for the first time since 1980), further budget cuts (he cut $1 billion out of the state's $5 billion budget last year), increases in the alcohol and cigarette taxes, and a cut in the annual dividend paid to Alaskans from the state's Permanent Fund.

Ever since the Trans-Alaska Pipeline began generating massive revenues in 1976, the state has enjoyed using those revenues to pay for nearly everything. Last year those revenues provided 90 percent of the state government's budget. This year it will be closer to 75 percent, and if oil and natural gas prices continue their freefall, those revenues will decline further.

According to Walker, a 1.5-percent income tax will generate about $200 million, and a cut in the annual dividend payment to Alaskans will save another $650 million. He adds in a generous assumption that there will be another few hundred million to be squeezed out of the government's budget. Walker is still left with a massive deficit approaching $2.5 billion.

So he has proposed raiding the kitty — Alaska's Permanent Fund — which, over the years has, thanks to that oil revenue stream, grown to more than $50 billion. That fund was created not only as a rainy day fund but to fund various state programs when Alaska's oil reserves are gone. It also provides a nice annual dividend to some 645,000 residents. Last year each check was $2,072, the highest since 2008, and for many of Alaska's poorer citizens, represents as much as 10 percent of a family's gross annual income.

Prudhoe Bay is the highest-yielding oil field in the United States, generating about 400,000 barrels of oil every day. But the state's total crude oil reserves have been diminishing, from 10 billion barrels in 1980 to just four billion currently. In addition the state's massive natural gas reserves are also being drawn down.

Walker sees what is coming. If oil and natural gas prices stay low, or move even lower (West Texas Intermediate crude is selling at $37 barrel, while Brent crude just broke below $40 and natural gas is approaching $2 per million British Thermal Units), those reserves and the Permanent Fund itself could be totally depleted in just a few years.

Part of the problem is not only the decline in the price of oil and natural gas, but that production in the state has dropped by 75 percent as well. So Alaska is selling less oil, at ever lower prices. This year's budget deficit, without doing anything, will be $3.5 billion (out of a state budget of $5 billion). Next year, without new taxes or raiding the Permanent Fund or cutting its dividend, the deficit will increase further. Said Walker:

> If we do nothing, we will empty our savings in the constitutional budget reserve and then we will have to tap into the earnings reserve — which means that in five years Alaskans would no longer get dividends.

Walker, a Republican-turned-Independent, faces a hostile legislative body, dominated by Republicans who want further cuts to the state government before instituting an income tax, while minority Democrats fear that Alaskans — especially those in rural areas where unemployment is already 60 percent — will be severely hurt financially.

At present Alaska is burning through its reserves (outside of the Permanent Fund) at the rate of $10 million every day. It's been warned by bond rating services that its credit rating will shortly be in jeopardy unless something is done.

How Walker's proposed budget will be modified remains an open question. What is clear is that, thanks to the decline in oil and natural gas prices and falling production, Alaska is shortly to fall off the list of seven states with no income tax (Florida, Nevada, South Dakota, Texas, Washington, and Wyoming).

A graduate of an Ivy League school and a former investment advisor, Bob is a regular contributor to The New American *magazine and blogs frequently at LightFromTheRight.com, primarily on economics and politics. He can be reached at badelmann@thenewamerican.com.*