

Twenty-Five Observations on Alaska Economic Trends and Arctic Economic Development

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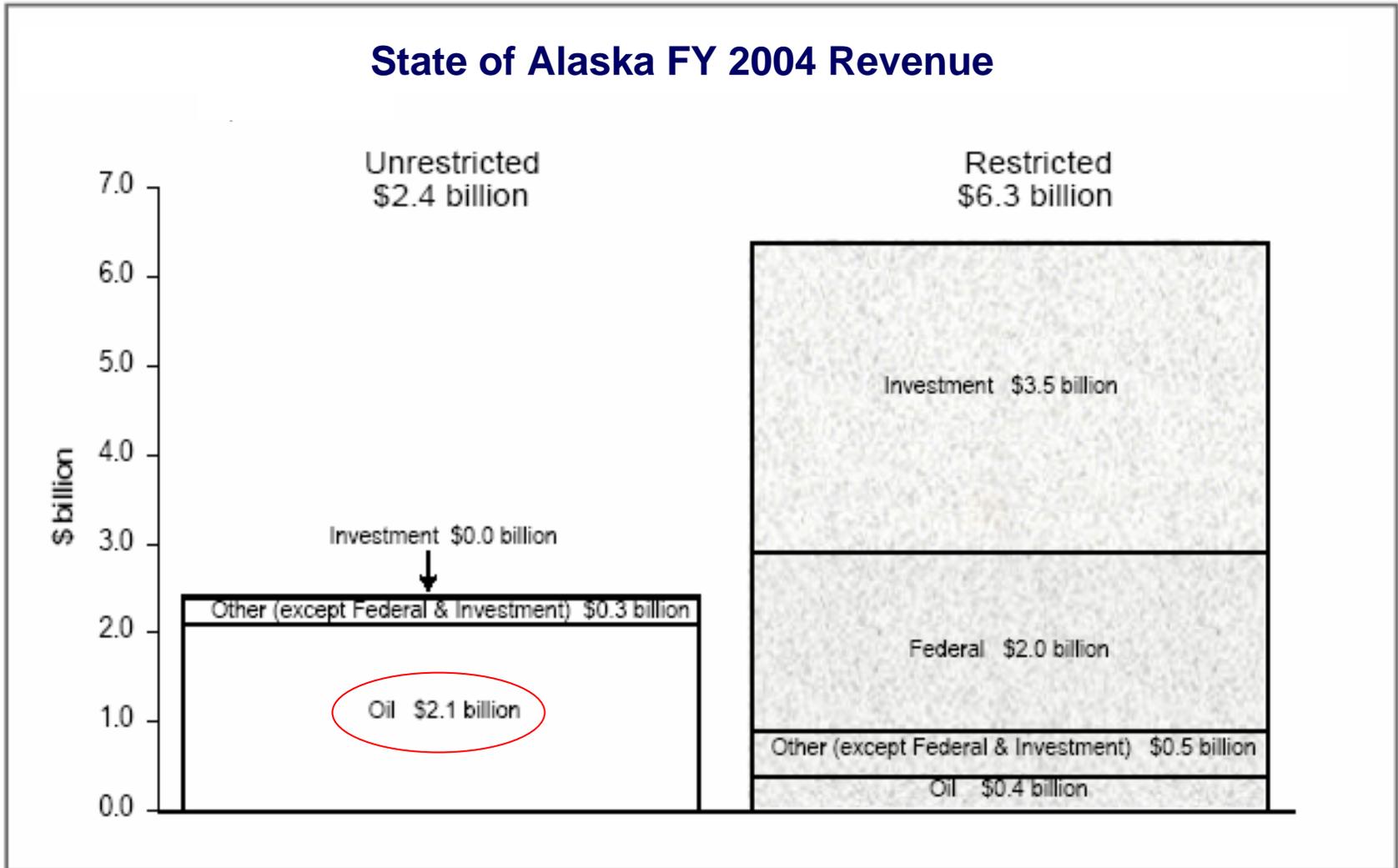
1. Alaska's economy is extremely dependent on the oil industry, state government spending, and federal spending. So are the economies of Alaska's Arctic boroughs.

- About two-thirds of Alaska's economy is driven by the oil industry, state spending, or federal spending.
- State spending is very dependent on revenues from the oil industry.
- The federal government injects billions of dollars into Alaska's economy
 - Military bases
 - Federal agencies
 - Grants to state and local governments and non-profit agencies for education, health and social services
 - Capital projects such as roads and airports
 - Social Security and other transfer payments.

2. Alaska is facing new economic challenges as the oil industry, state spending and federal spending stop growing or decline. So are Alaska's Arctic boroughs.

- The oil industry and state spending are no longer growing.
- Increasing federal spending has helped keep Alaska's economy growing in recent years—but federal spending isn't likely to keep growing.
- Other industries—such as tourism and mining—are growing. But they play a smaller role in Alaska's economy and contribute much less to state revenues.

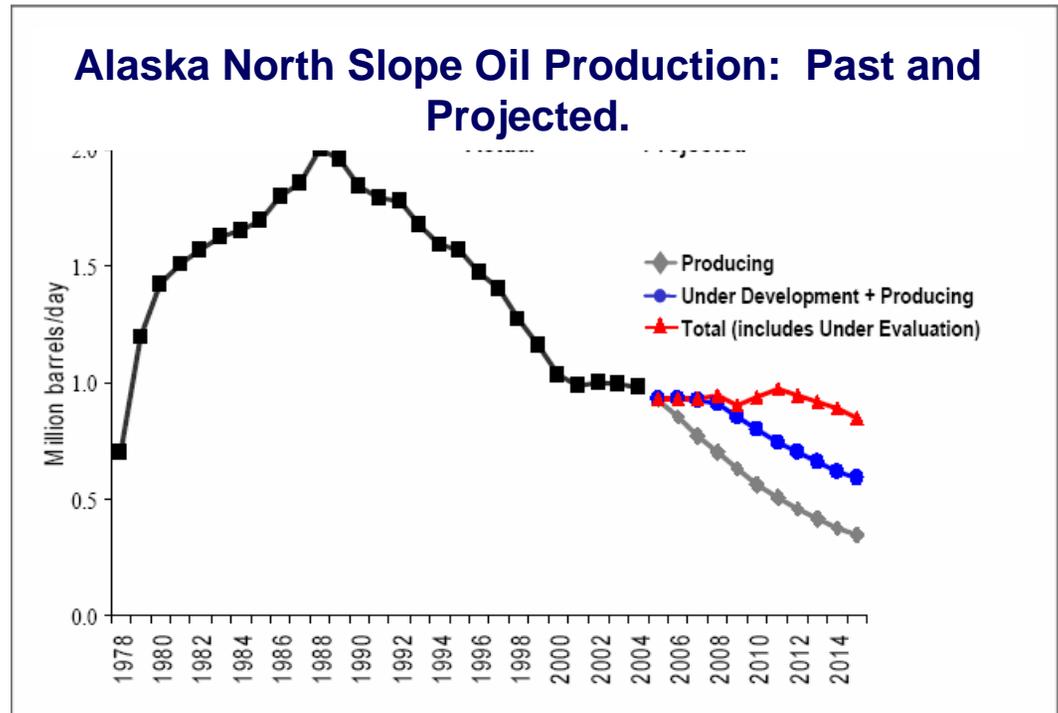
3. The State of Alaska is extremely dependent on oil for unrestricted revenues.



Source: Alaska Department of Revenue, Fall 2004 Revenue Sources Book.
<http://www.tax.state.ak.us/sourcesbook/2004/Fall2004/oil.pdf>. Downloaded February 1, 2005.

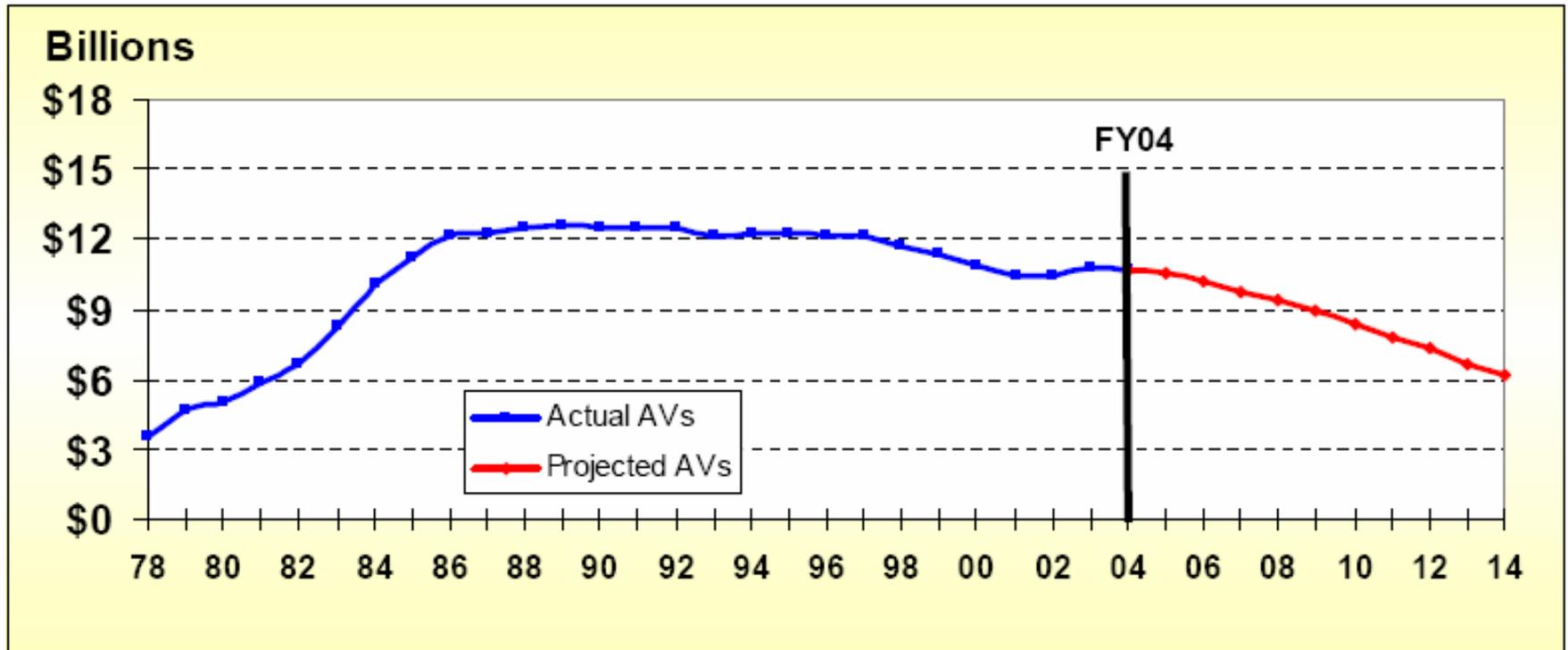
4. North Slope oil production has been declining and will probably continue to decline.

- Production from smaller new fields is not enough to make up for the continuing decline in Prudhoe Bay production—even with the new fields that are in development.
- Declining oil production means that the State’s oil revenues will keep going down even if oil prices stay high.



5. As North Slope oil production declines and facilities age, North Slope assessed property values are trending down.

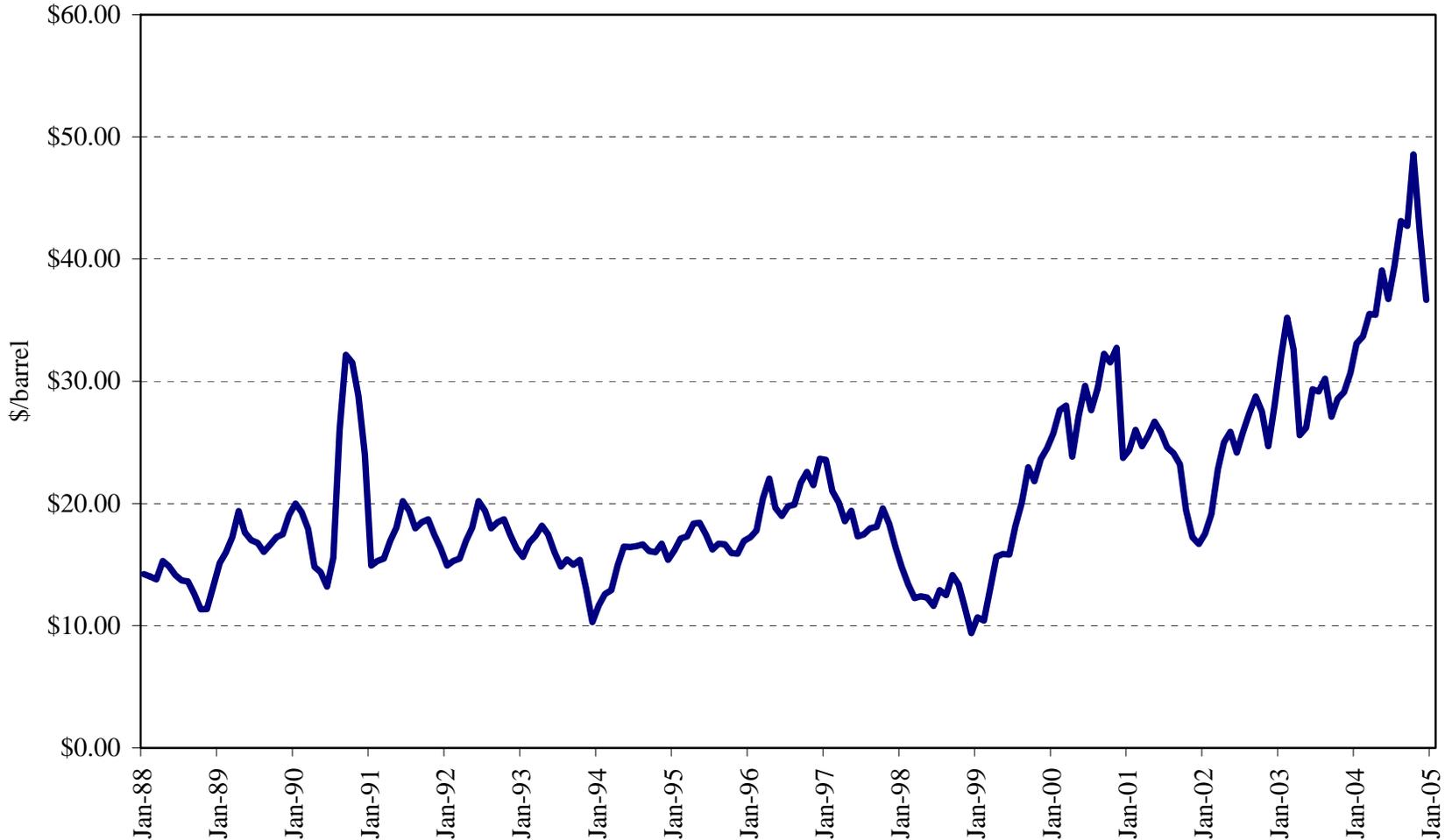
**NSB Assessed Values (AV)
Actual and Projected**



Source: North Slope Borough Strategic Economic Plan, March 1, 2004. Downloaded January 31, 2005 from the North Slope Borough website: www.north-slope.org.

6. A dramatic increase in oil prices has eased the pressure on Alaska's finances—for the moment.

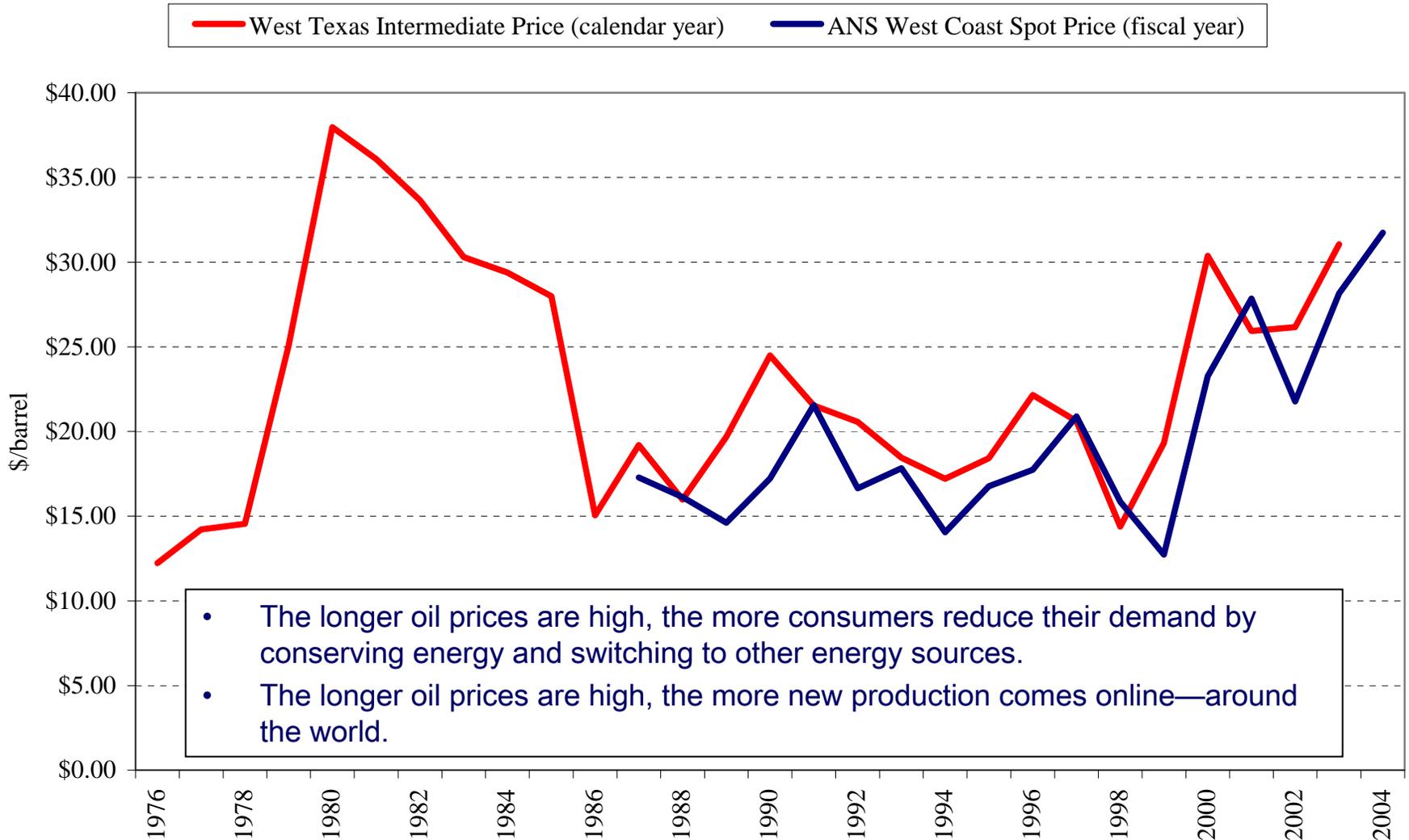
Average North Slope Oil West Coast Monthly Price



Source: Alaska Department of Revenue Tax Division website. www.tax.state.ak.us. Downloaded January 31, 2005.

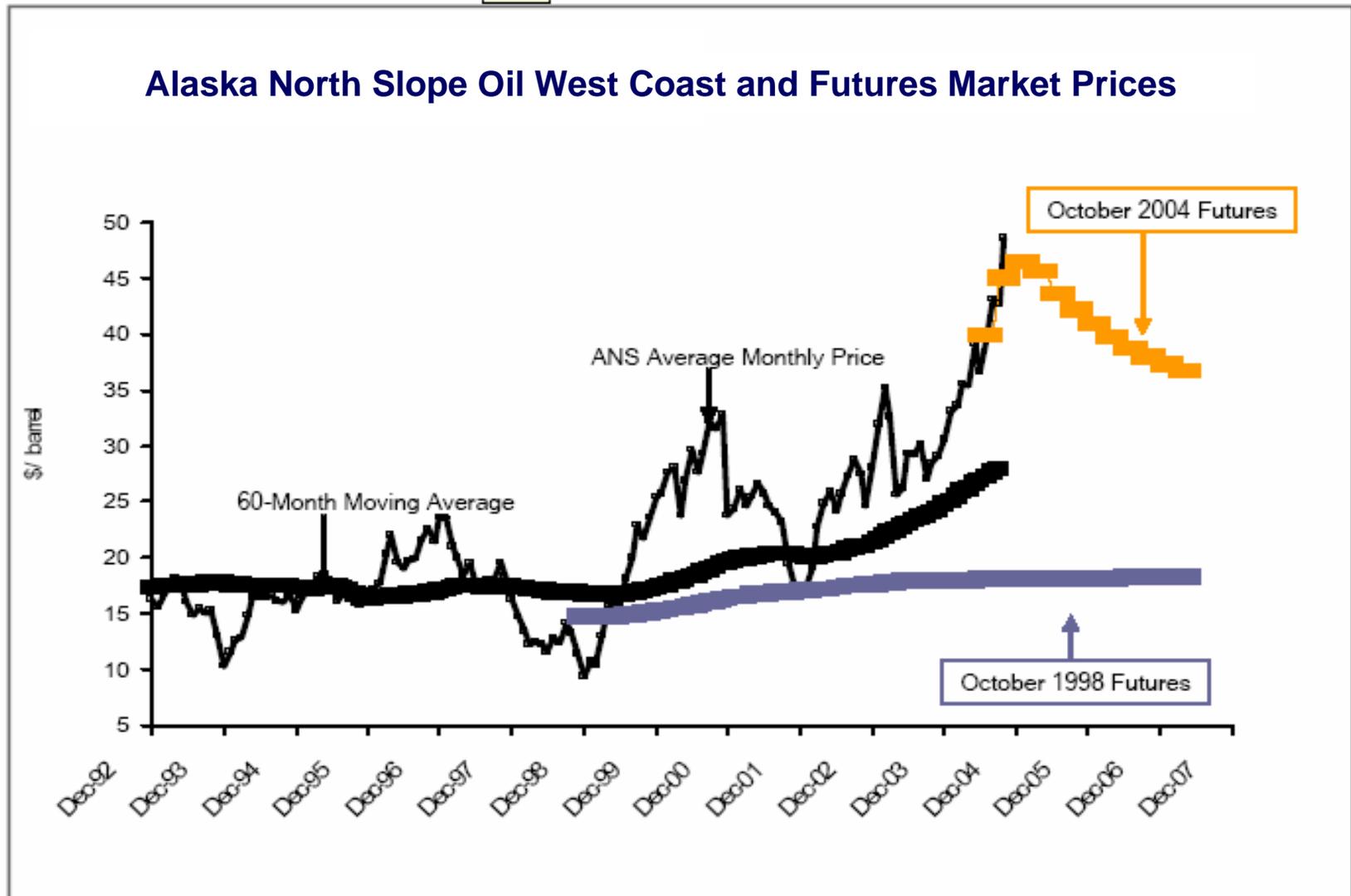
7. Just because oil prices are high doesn't necessarily mean they will stay high.

Average Annual Crude Oil Prices



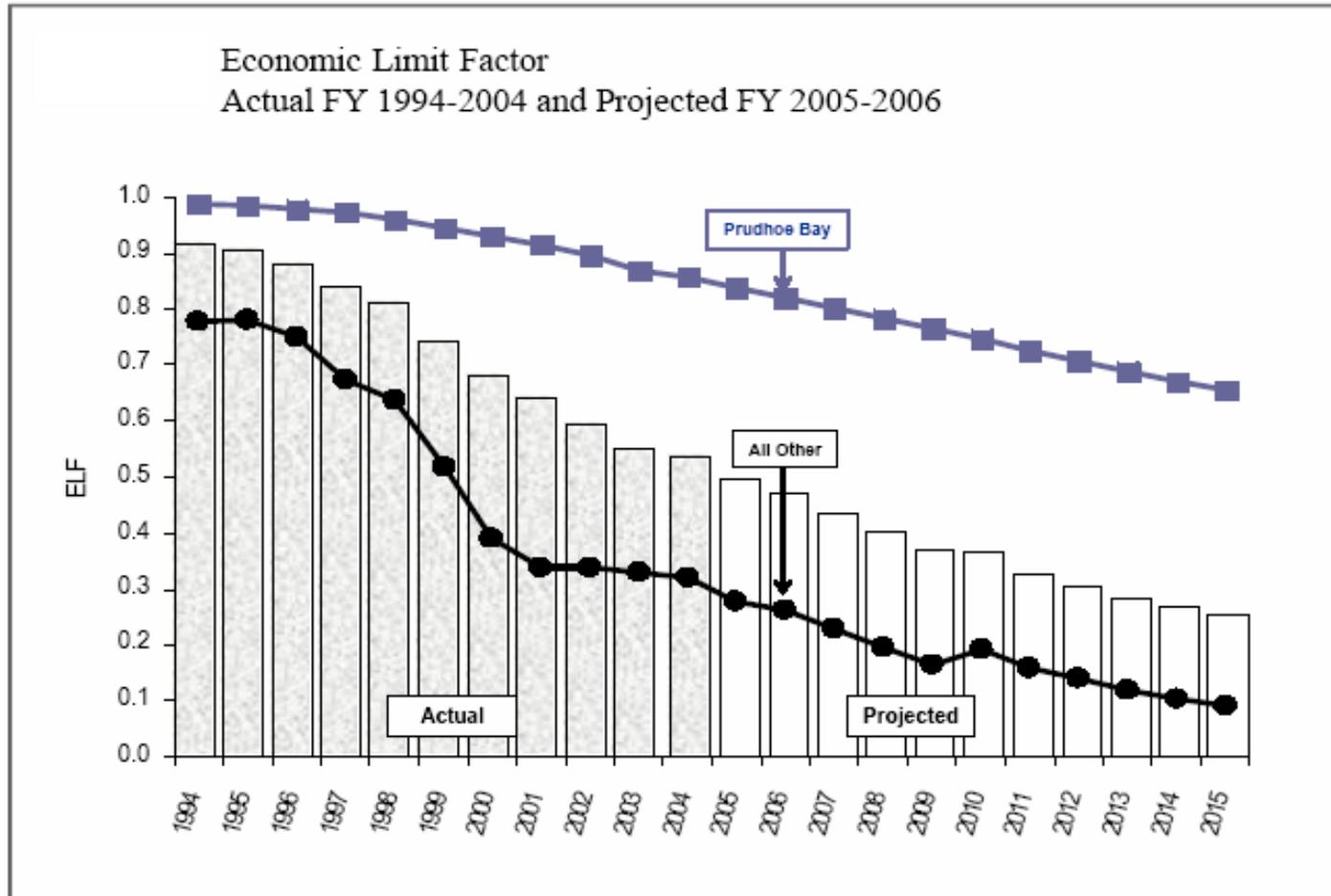
Source: Alaska Department of Revenue Tax Division website. www.tax.state.ak.us. Downloaded January 31, 2005.

8. No one really knows what will happen to oil and gas prices in the future.



Source: Alaska Department of Revenue, Fall 2004 Revenue Sources Book.
<http://www.tax.state.ak.us/sourcesbook/2004/Fall2004/oil.pdf>. Downloaded February 1, 2005.

9. Under the current “Economic Limit Factor” (ELF) law, effective severance tax rates for Alaska oil production are declining as the Prudhoe Bay field ages and other fields which are taxed at a lower rate become a larger share of total production.



Source: Alaska Department of Revenue, Fall 2004 Revenue Sources Book.
<http://www.tax.state.ak.us/sourcesbook/2004/Fall2004/oil.pdf>. Downloaded February 1, 2005.

10. The State of Alaska will face increasing financial pressure in coming years.

- Declining oil production
- Declining effective severance tax rates because of the “ELF.”
- Growing demand for services as Alaska’s population expands.
- The “Alaska Disconnect”: Because we have no broad-based taxes, the more the economy “develops” and the more population expands, the more costs the state faces—without any corresponding increase in revenues.
- Short-term high oil prices this year are only a temporary fix: these problems have not gone away.

11. As the State faces increasing financial pressure, the State will look for new revenues from businesses, local governments and residents.

- The Governor's recent announcement of tax increases for certain North Slope oil fields.
- Proposals for State sales tax
- Proposals for State income tax
- Proposals for using part of Permanent Fund earnings for State spending (rather than Permanent Fund Dividends)
- New attempts to limit property tax collections by Boroughs??

12. As the State faces increasing financial pressure, the State will continue to look for ways to cut expenditures.

- Decrease in revenues sharing for local communities
- Decrease in share of rural education expenditures paid for by the State

13. Federal spending in Alaska grew very rapidly in recent years—but it's not likely to keep growing.

- As chairman of the Senate appropriations committee, Ted Stevens was able to direct a huge amount of money to Alaska because of his political skill and power.
- Ted Stevens is no longer chairman of the appropriations committee.
- Ted Stevens will eventually retire from the Senate.
- The federal government is facing growing budgetary pressure:
 - Iraq war
 - Social security
 - Tax cuts

14. A gas pipeline will take a long time to happen and won't necessarily make Alaska or Alaskans rich.
- It will probably be about ten years before construction on a natural gas pipeline would start
 - It will take a long time to settle the political and financial issues
 - It will take a long time to plan the project, obtain permits, and prepare for construction
 - A gas pipeline will be extremely expensive and risky—because of the uncertainty about future natural gas prices
 - Whoever takes on the risks—producers, pipeline owners, or customers—will want a large share of the profits
 - There will be less revenue for the State—in the form of royalties, taxes, or returns on an ownership share—unless the State also assumes a large share of the risk
 - A gas pipeline will probably be an important part of Alaska's long-term economic future—but it won't solve the economic challenges we face over the next decade.

15. Just because everyone's talking about a resource development project doesn't necessarily mean it will happen.

- Just because natural resources are physically present doesn't mean that they can be developed profitably.
- Just because a project would be profitable at today's market prices doesn't mean that it will be profitable over the long-term.
- Markets and politics make resource development in Alaska—and Arctic Alaska—risky. Higher risk means that investors require higher profits before they are interested.
- Alaska resource development projects compete with other projects all around the world.
- Be skeptical of great-sounding resource development projects that require government subsidies.

16. The Internet and other technological changes mean new economic development opportunities for Alaska--and for Arctic Alaska.

- As communication links improve, distance and remoteness matter less and less.
- More and more kinds of work can be done from anywhere in the world.
- To take advantage of these opportunities we need to:
 - Invest in technological infrastructure: all Alaskans should have access to good computers and good internet connections
 - Invest in technology education: all of our children should be capable and confident in using computers and the internet
 - Invest in EDUCATION—the jobs that can be done from anywhere in the world require knowledge and the ability to think and write well.

17. Oil wealth, mineral wealth, and federal and state spending may be mixed economic blessings for Alaska and Alaska's arctic.

- We tend to look to government to provide economic development for us.
- We put much of our effort into influencing government rather than creating services and goods competitively.
- Government jobs attract the most talented people away from private sector economic development.
- Well-paying government jobs push wage rates up, making it harder to start other kinds of economic development.
- The more infrastructure government builds, the more it costs to maintain it.

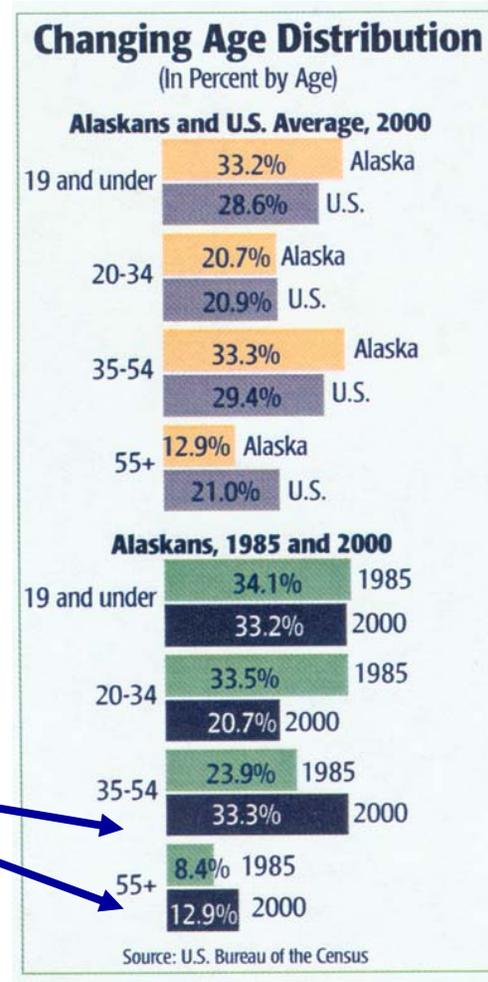
18. Surprises have played a major role in the economy of Alaska and Arctic Alaska. Expect more surprises.

- Some of the biggest events in Alaska's economic history were surprises. No one expected:
 - World War II
 - The 1964 earthquake
 - The 1967 discovery of the Prudhoe Bay oilfield
 - The 1989 Exxon-Valdez oil spill
 - September 11, 2001
- Think about surprises that could affect Arctic Alaska's economic future:
 - Another Prudhoe Bay? Another Red Dog?
 - Terrorism? At Prudhoe Bay? The pipeline?
 - Earthquakes? Breaks in the pipeline?
 - Global climate change? Arctic ice melting?

19. As the number of older Alaskans increases, health care spending for older people will increase—creating more jobs but also more costs.

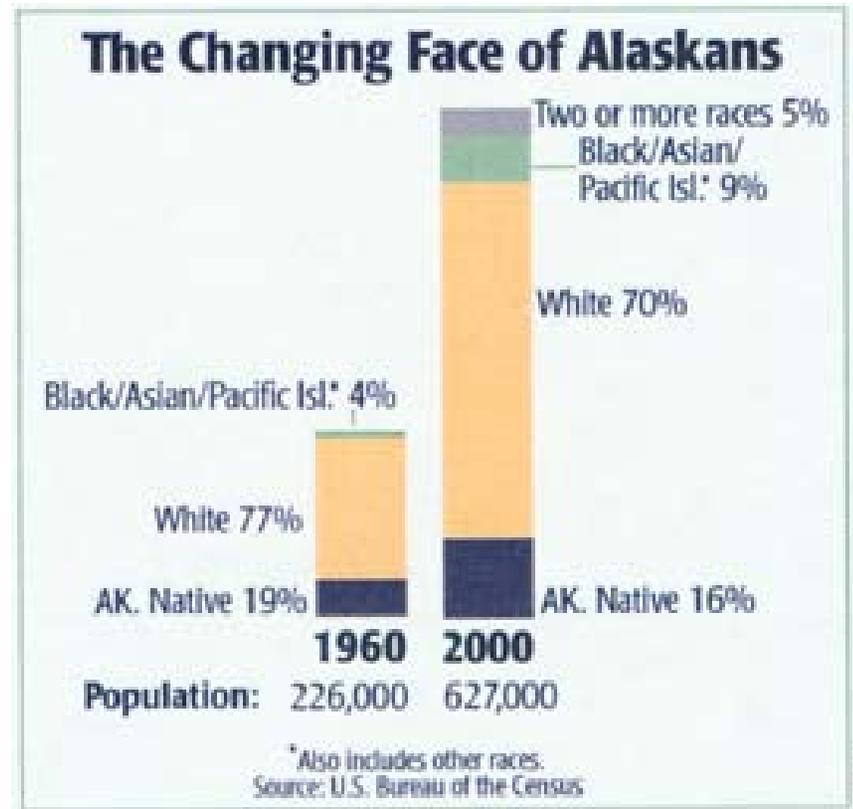
Alaska's population is younger than the average for the United States.

But the Alaska population is getting older. More and more Alaskans are in the 35-54 age group and the 55+ age group.



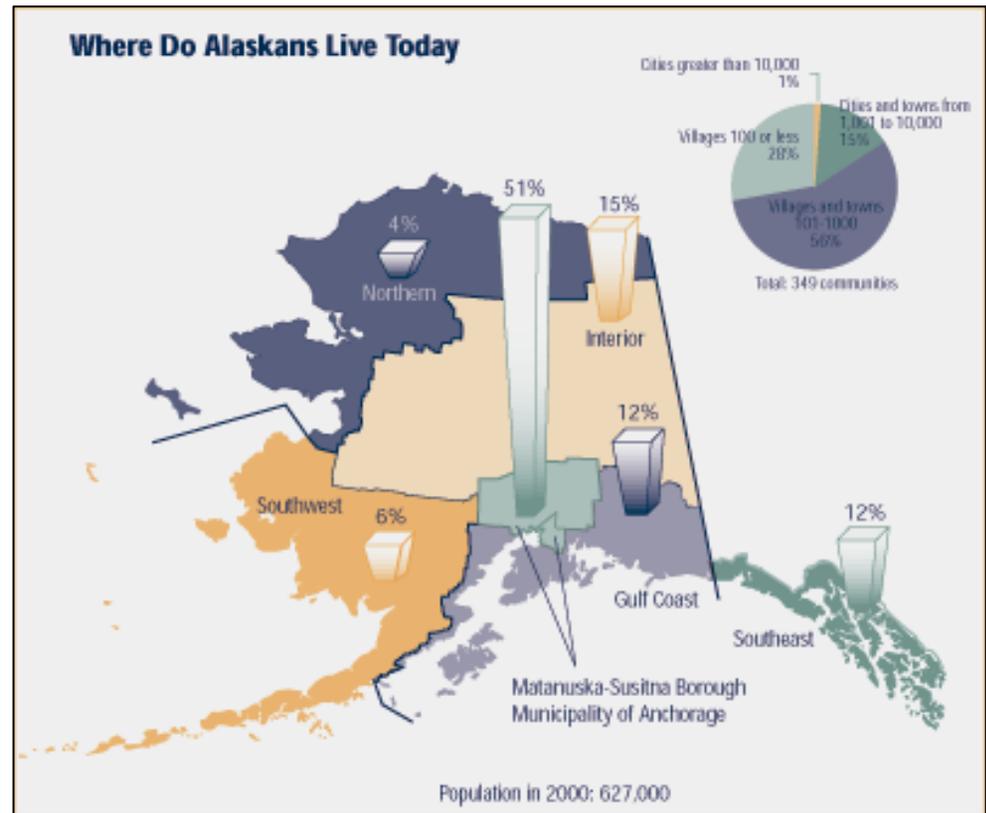
20. The ethnic mix of Alaska and Arctic Alaska is changing.

- Although the Alaska Native population is growing, Alaska Natives are becoming a smaller share of the total population.
- More people who are not Native or White—Blacks, Asians, and Pacific Islanders--have been moving to Alaska.
- Many immigrants come from places that are poorer than Alaska and poorer than Arctic Alaska.
 - They are willing to work hard and for lower wages than many Alaskans.
 - They may take advantage of new job opportunities—especially for lower-paying private sector jobs.



21. As Alaska becomes more urbanized, Alaska politics is changing.

- A larger and larger share of Alaskans live in a few urban areas.
- Urban Alaskans know less and less about rural Alaska
- Urban-rural tensions are increasing
 - Urban residents want their “fair per-capita share”
 - Rural residents want services urban residents take for granted
- Changing politics will likely affect the share of state spending which goes to rural areas and the extent to which state policies address rural concerns.



22. Politics will play a critical role in the economic future of the Arctic.

- State politics will play a critical role in:
 - what kind of tax revenues the Arctic boroughs will be able to collect from resource developments in the Arctic
 - State spending for programs in the Arctic
 - State revenue sharing for local governments in the Arctic
 - what kinds of State taxes Arctic residents may have to pay
 - the future of the Permanent Fund Dividend program
- Federal politics will play a critical role in:
 - how much future oil and gas development occurs in the Arctic, and where it occurs
 - federal spending for programs in the Arctic
- State *and* federal politics will play a critical role in:
 - what kind of gas pipeline gets built, when it gets built, and how much the North Slope Borough may be able to tax it
- Arctic residents been very skilled and effective in State and Federal politics in the past. You will need to continue to be as skilled and effective in the future.
- One way in which Arctic residents can increase their political influence is by voting.

23. Much of the economic future of Alaska is beyond Alaskans' control.
Much of the economic future of Arctic Alaska is beyond your control.

- Alaskans can't control:
 - World market prices for oil, natural gas, zinc or other natural resources
 - Investment returns on the Permanent Fund
 - World climate
 - Federal political decisions (although we can influence them)
 - IWC whaling decisions (although we can influence them)

Arctic residents also can't control:

- State political decisions (although you can influence them)
- The challenge for Alaska—and for Arctic Alaska--is to make the best possible future for ourselves in changing circumstances that we can't fully control.

24. Economic opportunities for Arctic Alaskans are not limited to the Arctic or Alaska.

- If your children can't find jobs at home, there are economic opportunities elsewhere in Alaska or America.
- There are opportunities to work seasonally in other places.
- Even if you have to move away, you don't have to lose touch with your family or your community—or stay away forever.
- To take advantage of opportunities elsewhere requires getting an education.

25. Education is the key to children's success and opportunities
—in Arctic Alaska and everywhere.