

HOUSE FINANCE COMMITTEE
January 27, 2004
2:51 P.M.

TAPE HFC 04 - 13, Side A
TAPE HFC 04 - 13, Side B

CALL TO ORDER

Co-Chair Williams called the House Finance Committee meeting to order at 2:51 P.M.

MEMBERS PRESENT

Representative John Harris, Co-Chair
Representative Bill Williams, Co-Chair
Representative Kevin Meyer, Vice-Chair
Representative Mike Chenault
Representative Eric Croft
Representative Hugh Fate
Representative Richard Foster
Representative Mike Hawker
Representative Reggie Joule
Representative Carl Moses
Representative Bill Stoltze

MEMBERS ABSENT

None

ALSO PRESENT

William Corbus, Commissioner, Department of Revenue; Tom Boutin, Deputy Commissioner, Department of Revenue; Brett Fried, Economist, Tax Division, Department of Revenue

PRESENT VIA TELECONFERENCE

Chuck Logsdon, Chief Petroleum Economist, Tax Division, Department of Revenue, Anchorage

GENERAL SUBJECT(S):

**Department of Revenue
Oil Price Projections**

The following overview was taken in log note format. Tapes and handouts will be on file with the House Finance Committee through the 23rd Legislative Session, contact 465-2156. After the 23rd Legislative Session they will be available through the Legislative Library at 465-3808.

LOG	SPEAKER	DISCUSSION
		TAPE HFC 04 - 13, SIDE A
000	Co-Chair Harris	Convened the House Finance Committee meeting at 2:51 p.m. in order to discuss the Department of Revenue's oil price projections.
		Department of Revenue
		Oil Price Projections
048	WILLIAM CORBUS, COMMISSIONER, DEPARTMENT OF REVENUE	Provided the Committee with a handout: "ANS Spot Price and Forecast Prices Fall 2003 & January NYMEX Future Implied" & the "Alaska Department of Revenue Tax Division Source Book". (Copy on File). He stated that the price of oil on 1/26/04 was \$43.44. The price of gas was \$5.71 per million BTU. He introduced Deputy Commissioner Tom Boutin and Brett Fried, Economist.
150	Commissioner Corbus	Stated that the revenue forecast was prepared last fall and made public on December 12th, 2003. For FY04, it is estimated that the price of oil will be at \$27.50; FY05 estimated at \$24.65; FY06-FY15 estimated at \$22 per barrel, which is at the low end of the Organization of Petroleum Exporting Countries (OPEC) price range. Production forecast estimates a modest increase in daily production between 2004-2007 to 978.0 thousand barrels per day.
400	Commissioner Corbus	Continued, in 2011, about 20% of the production of oil will come from identified reserves but not yet developed reserves.
447	Commissioner Corbus	According to the revenue picture, for FY04 revenues are estimated at \$2.2 billion dollars. That number compares to \$1.946 billion dollars for FY03. For FY05, it is estimated that oil revenues will be \$1.427 billion dollars. Excluded from the FY05 estimate are any revenue enhancements that the Governor may propose. He estimated the Constitutional Budget Reserve (CBR) will run out in May 2007.
547	Commissioner Corbus	The major change in fall forecast is potential production from new sources including Central North Slope, Beaufort Sea, NPRA, & ANWR.
628	CHUCK LOGSDON, CHIEF PETROLEUM ECONOMIST, DEPARTMENT OF REVENUE	Referenced the Revenue Sources Book, and chart "ANS Spot Price and Forecasted Prices Fall 2003." He mentioned the oil price alternatives. Page 1 of the ANS

		Spot Price provides a "snap shoot" of the closing futures prices on the New York exchange on 1/27/04. In 1995, there was a lot of volatility. Between 1995 and 2000, there was an average around \$17 dollars per barrel and the crash of 1999 @ \$12 dollars per barrel. Since 1999, the chart indicates that the price has averaged over \$20 dollars per barrel. The State is doing better.
913	Mr. Logsdon	Discussed OPEC actively managing a price band between \$22 & \$28. There have been 8 or 9 quota changes, which resulted from an agreement in 1999 to get the price moving again. Since 2000, there have been concerns with the uncertainty about political stability in Iraq. Iraq is currently producing about 2 million barrels a day. The third big factor in this decade is the economic growth in China. By next year, China will have surpassed Japan in petroleum consumption.
1044	Mr. Logsdon	He provided information regarding the peak and decline of very large oil reserve discovered during the 1970's. Mr. Logsdon outlined the fundamentals in preparing price forecast. The demand has been far more robust than was anticipated. The economic growth in the U.S. came in strong in the 3rd quarter and accompanying that was the oil consumption in China. Also, the past month has been very cold weather on East Coast creating a stronger than expected demand growth. OPEC offered to cut their quota as of November 1st, 2003 outside of Iraq. Actual production fell and is now back up.
1256	Mr. Logsdon	Stated that Iraq is back up at 2 million barrels per day. They are having trouble getting oil out of their northern fields. They are unable to ship through pipeline they normally use through Turkey to the Mediterranean. OPEC will meet on Feb. 10 to discuss quota, keeping the price between \$22-28 dollars per barrel - they have been outside that range since October.
1421	Mr. Logsdon	Since mid-December, the supply has been outweighing the demand. In the U.S., we are still at the lowest inventory levels we have ever been.
1509	Mr. Logsdon	Commented that currently, the U.S. is

		watching:
		* Global economic growth
		* U.S. currency deflation
		* OPEC's production decisions
		* Iraq and the stabilization there
1628	Mr. Logsdon	Russia and West Africa are two of the big areas that have had rapid expansion. Russia is increasing their production by approximately 10% a year for the past three years. It is expected that West Africa is going to be one of biggest producers in world next year. It is anticipated that oil could be as high as \$30 dollar per barrel this year depending on what OPEC does and the transition between heating and motor fuel tax.
1811	Mr. Logsdon	Spoke to the success of OPEC insuring a price between \$22 to \$28 dollars per barrel. Last week, BP raised it price assumption from \$16 to \$20 per barrel for ANS oil.
1920	Mr. Logsdon	Commented on production. Referenced the chart on Page 2, indicating a drop in production. From 1995 to 2000, averaging the drop was at about 8% a year. That has now changed because of the new fields and production in heavy oil. Forecasting a slight decline over the next ten years around 1%.
2035	Mr. Logsdon	Referenced Page 3, the actual and forecasted revenue from 1995 to 2000, with the lower oil prices and higher production. As a result, prices went up in 2000 after the crash in 1999. Currently, the prices are heading down to the \$2 billion dollars per year mark. He suggested that the next plateau revenue could be \$1.5 billion and the slide down lower than that in the next decade.
2240	Mr. Logsdon	Referenced Page 4 of the handout, the U.S. Crude Oil Stocks. The chart helps interpret the price forecast. The shaded area is the average range of U.S. crude oil stock for the last 15 years. Right now, there are some of the lowest crude oil stocks since 1973 as tracked by the Department of Energy. When that inventory number moves up, the State can expect oil prices to begin to weaken.
2402	Mr. Logsdon	People are holding low inventories, which means that demand stays up and supplies are not sufficient, it keeps cash prices high. Once the inventory numbers come up

		that is a clue to start selling, which is what OPEC fears.
2448	Mr. Logsdon	Referenced the chart that shows "other revenues" for the FY04/FY05 era with a relatively constant non-oil component around \$300 million dollars per year. Mr. Logsdon concluded his briefing on the oil prices.
2536	TOM BOUTIN, DEPUTY COMMISSIONER, DEPARTMENT OF REVENUE	Understood that the Committee wanted information on the background of the Investment Loss Trust Fund, the supplemental benefits system guaranteed investment contract in the amount of about \$132 million dollars taken over by the State of California regulators in 1991. AS 37.14.300 established the investment loss trust fund by borrowing \$138 million dollars. The State has now received from payments back, \$137 million dollars from the investment settlements plus a third party out of court. Additionally, \$36 million dollars. The investment loss trust fund has a cash balance of about \$6.45 million dollars current balance some of which has been appropriated. Some of the money has been invested in a short-term pool - treasury bill.
2657	Mr. Boutin	Continued indicating the money investments. The index is a 90-day T-bill. He inquired if more specifics were needed.
2741	Co-Chair Harris	Asked if there was about \$1 million dollars left in that fund that has not been earmarked. Mr. Boutin responded that was correct and of the \$6 million dollars, \$4.739 million has been appropriated but not spent. \$1.606 is a reserve that is required. Department of Administration provides the liability side of the balance sheet and that Department is responsible for looking after that.
2838	Representative Fate	Noted that the report has indicated that OPEC is in a quandary to get the price back to the \$20 parameter. He questioned if that was possible and what would be the prognosis for the LNG in the next five years & the price of oil.
2942	Mr. Logsdon	Responded that LNG, the issue revolved around supplying the North American market as the price of gas is higher than the rest of the world. With the use of

		natural gas as the most efficient way to generate electricity and the demand for electricity tends to soar, the utility market will absorb much of the LNG. To date, there has not been a breakthrough of the use of oil. He admitted that there is potential for competition.
3115	Mr. Logsdon	OPEC has cut into the projection. Saudi Arabia has decided to accept lower market share for prices. It is as low as it has been since 1986. There is a major difference now. Then the Saudis had fallen to less than 300 million barrels a day; today they are producing well over 8 million barrels a day. The market is moving forward at a rigorous pace. He spoke to the dollar inflation.
3246	Mr. Logsdon	He claimed that they would keep production about where it is. Whether or not there will need to be a correction made for the short-term oil production is a wait and see what happens. That will happen in March & April.
3332	Representative Fate	Referenced NPRA as a source of revenue and impact in the future. He asked if consideration had been made to the percentage that the State will receive given the impact litigation settlements.
3353	Mr. Logsdon	Stated that they have not done that. The State is assuming that under the current negotiations, 50% of any given royalties will come to the State and the production will be subject to the severance tax.
3449	Vice Chair Meyer	Commented on the lunch with the Alaska Oil and Gas Association. The theme was that in order to increase oil production and investing in the State of Alaska, there would need to be a stable tax rate. Additionally, recommended not "messing" with the ELF formula. He thought ELF was successful. He asked as more production comes from the smaller fields, has that been factored into the revenue forecast.
3556	Mr. Logsdon	Responded that the forecast before the Committee does make a projection of what the ELF will be for each field going into the future. Because much of the expected production will be from fields with older ELFS, it has been factored at a percentage of severance tax into the future.
3650	Representative Hawker	Commented on the short-term price prospects. He asked about the longer-

		term profile of \$22 dollar per barrel. He noted that historically, the industry has predicted more conservative numbers than the State for the revenue forecast.
3760	Mr. Logsdon	Advised that at present time there is a process in place to look at the long-term number once a year in the fall. Mr. Logsdon was comfortable with \$22 dollar per barrel for this year and that high prices often result in a correction. There are opportunities and commitments made to start spending if it is projected too high and then there is a correction, many problems result. There can be "robust" oil prices for a while. At this time, there is no decision to change the projected "\$22" dollars per barrel price.
4025	Vice Chair Meyer	Followed up on the comments made by Representative Hawker. He asked how Alaska's price compared to other countries prices for capital dollars.
4056	Mr. Logsdon	For developments on shore, our cost structures are fairly competitive. One of the big concerns is that Alaska is viewed as a "mature" oil province. The price is probably smaller for a given dollar outlay in Alaska. The opportunity for the big "bonanza" could be more exciting in other places.
4359	Co-Chair Harris	Commented that other countries have a reserve tax. He noted that Alaska does not have that. Co-Chair Harris asked what other countries do in that respect.
4450	Mr. Logsdon	Did not know about those agreements. He thought that only Texas had that at the local level. He did not think it was common. He offered to look into that and provide that information.
4550	Co-Chair Harris	Suggested that if other countries are doing that and we are not, it could be better for our economy.
4618	Representative Hawker	Commented on the short and long term prices. He referenced Page 44 from the 2003 Revenue Source Book.
		TAPE HFC 04 - 13, Side B
4653	Representative Hawker	Asked about the variable the number provided by Department of Revenue. He emphasized the "sensitivity" of that number. He stressed that these are "real money" numbers. A small change in the price of oil can have a significant effect on the numbers of the budget situation. He reiterated how estimates

		affect the legislative budget process.
4419	Representative Hawker	Questioned if the State was being too conservative with the numbers being used.
4353	Mr. Logsdon	Explained that the forecast is a group process and attempts to arrive at a consensus. He asked that Commissioner Corbus answer the question as there is a policy consideration.
4301	Commissioner Corbus	Noted that there is a group of 15 people that participate in these negotiations. They attempt to make the best judgment and conclusion toward a more conservative side.
4200	Representative Hawker	Commented on the group meetings at predictable intervals. He asked if they should be considering the input variable in the budgeting process before the next meeting or should the variable be used that was provided from the fall meeting.
4107	Commissioner Corbus	Recommended taking the variable provided in the fall forecast and operate from it.
4045	Representative Hawker	Stated that he was not comfortable accepting that as fixed point of reference.
4004	Co-Chair Harris	ADJOURNMENT: The meeting was adjourned at 3:47 P.M.