ALASKA STATE LEGISLATURE
HOUSE SPECIAL COMMITTEE ON ECONOMIC DEVELOPMENT, INTERNATIONAL TRADE AND TOURISM
February 2, 2012
10:20 a.m.

MEMBERS PRESENT

Representative Bob Herron, Chair
Representative Neal Foster
Representative Wes Keller
Representative Cathy Engstrom Munoz
Representative Steve Thompson
Representative Berta Gardner
Representative Chris Tuck

MEMBERS ABSENT

Representative Kurt Olson, Vice Chair
Representative Reggie Joule

OTHER LEGISLATORS PRESENT

Representative Paul Seaton

COMMITTEE CALENDAR

HOUSE CONCURRENT RESOLUTION NO. 19
Acknowledging the lessons learned from the 2011 Norway Policy Tour and encouraging investment in the state's oil and gas industry.

- HEARD & HELD

PREVIOUS COMMITTEE ACTION

BILL: HCR 19
SHORT TITLE: OIL & GAS POLICY/NORWAY TOUR
SPONSOR(s): REPRESENTATIVE(s) HERRON

01/17/12	(H)	READ THE FIRST TIME - REFERRALS
01/17/12	(H)	EDT
01/26/12	(H)	EDT AT 10:15 AM BARNES 124
01/26/12	(H)	Heard & Held
01/26/12	(H)	MINUTE(EDT)
02/02/12	(H)	EDT AT 10:15 AM BARNES 124

WITNESS REGISTER

BRIAN HOLST, Executive Director
Juneau Economic Development Council
Juneau, Alaska
POSITION STATEMENT: Testified and answered questions as a participant in the 2011 Norway Policy Tour.

REPRESENTATIVE PAUL SEATON
Alaska State Legislature
Juneau, Alaska
POSITION STATEMENT: Testified as a participant in the 2011 Norway Policy Tour.

MARK MYERS, Vice Chancellor
Research
University of Alaska Fairbanks (UAF)
University of Alaska (UA)
Fairbanks, Alaska
POSITION STATEMENT: Speaking on his own behalf, testified and answered questions during the hearing on HCR 19.

ACTION NARRATIVE

10:20:36 AM

CHAIR BOB HERRON called the House Special Committee on Economic Development, International Trade and Tourism meeting to order at 10:20 a.m. Representatives Herron, Munoz, Keller, Tuck, Gardner, and Thompson were present at the call to order. Representative Foster arrived as the meeting was in progress. Representative Seaton was also in attendance.

HCR 19-OIL & GAS POLICY/NORWAY TOUR

10:21:14 AM

CHAIR HERRON announced that the only order of business would be HOUSE CONCURRENT RESOLUTION NO. 19, Acknowledging the lessons learned from the 2011 Norway Policy Tour and encouraging investment in the state's oil and gas industry.

10:21:28 AM

BRIAN HOLST, Executive Director, Juneau Economic Development Council, gave a brief description of his background. He stated that he participated in the 2011 Norway Policy Tour that was

organized by the Institute of the North primarily to look at the oil and gas industry in Norway. He expressed his belief that although there are many sectors of economic development in Alaska that must be strengthened, special attention must be paid to the oil industry. His work experience included years spent in South America and other countries, and he learned that much can be gained from the experience of others. Norway is ranked in the top 10 to 15 countries worldwide in global competitiveness, and its per capita income is higher than that in Alaska or the U.S. Norway's unemployment rate is about 3 percent and it has a generous government-supported retirement system, universal medical care, and a well-educated population. Mr. Holst said oil and gas is a major factor driving Norway's financial success: Norway has $573 billion in savings from oil and gas income, four times the oil production of Alaska, and ten times the number of jobs in the oil extraction and production services industry. Underlining Norway's success is the way it deals with the government's role in the economy, and he made the following observations regarding oil and gas: Norway has a view that its citizens have a shared ownership of oil and gas resources; it assesses the same level of corporate tax for oil and gas and a 50 percent resource tax; the industry is taxed only on profits; the tax regime is stable, with no significant changes in the last nineteen years; there is no royalty system; there is an alignment between the interests of the industry and those of the government; the government captures 80-85 percent of the value of commercialized oil and gas; Norway has a license application process that replaced bidding with a commitment to explore and develop resources; licensing is based on the expectation of production within three to six years; direct engagement with the industry builds capacity and maximizes financial return; there are high levels of employment in the industry; and there is a high level of expertise in the oil and gas services industry.

10:28:11 AM

MR. HOLST continued his observations on the effects of Norway's direct financial investment: investment in smaller fields leads to better access for smaller operators; there are over 60 international firms operating in Norway; regulators and policy-makers have greater knowledge; less risk and costs are borne by companies; gas and oil lines are treated as a utility and the owners of utilities are typically insurance companies and long-term investors; and because the government supports seismic and environmental testing, the licensing process is faster. Mr. Holst noted that 99.9 percent of oil and gas production is

offshore, some in the far North, and Norway is producing from wells underwater as a way to deal with ice floes. Regarding other elements of Norway's economy, he said Norway plays a large role in trade and communications in the Arctic, its citizens pay an income tax, there is a strong commitment to alternative and renewable energy, there is a high investment in education, and the second largest industry is oil and gas support services.

10:32:11 AM

CHAIR HERRON asked Mr. Holst what he learned on the tour that surprised him and what disappointed him.

MR. HOLST said he was surprised by the levels of investment by the government and the private sector; in fact, the industry seems compatible with the high level of taxation. He was disappointed by farm fishing.

10:34:04 AM

REPRESENTATIVE MUNOZ observed that in Norway the permitting timeframe is about two years. In Alaska, the timeframe is unclear.

MR. HOLST said he was not an expert on oil and gas, however, he understood that the initial ground-work prior to the licensing and application process is directed by the government and has a high success rate. He pointed out that Norway manages the permitting process without influence from a federal government, but Alaska cannot.

10:36:24 AM

REPRESENTATIVE FOSTER asked for the top two or three things from the Norway model that can be adapted for Alaska.

MR. HOLST advised Norway has made significant investments in the infrastructure needed for access to bring the resource from production to market at a low cost. Also, the scope of the direct investment produces transparency and reduces the risk for smaller operators. These efforts are within Alaska's reach.

10:38:32 AM

REPRESENTATIVE PAUL SEATON, Alaska State Legislature, informed the committee that the House Resources Standing Committee is looking at a model based on lessons learned on the 2011 Norway

Policy Tour; for example, whether state investment to incentivize basins should be in credits, or by state direct financial interest.

10:39:39 AM

MARK MYERS, Vice Chancellor for Research, University of Alaska Fairbanks (UAF), University of Alaska (UA), disclosed the views expressed were his own and not those of UAF. Mr. Myers said he was asked to comment on what parts of the Norwegian model might be applicable to Alaska. He gave his background and experience that began in Alaska as a petroleum exploration geologist 27 years ago, and included his time as the Director of the U.S. Department of the Interior, Geological Survey (USGS) during the publication of the 2008 USGS Circum-Arctic Resource Appraisal. In his current role, he is focused - along with Norway and its key research institutions - on the potential of research to the oil and gas industry. Although he did not participate in the 2011 Norway Policy Tour, Mr. Myers offered his general observations about some of Alaska's challenges and what can, and cannot, be implemented from the Norwegian model. Norway intelligently manages its resources by four major components: Norway keeps a significant tax structure to provide a base source of revenue; it holds a majority ownership in a major oil company - Statoil - which gives the government "immense say into how that company behaves and acts;" there is government-directed financial interest at the time the licenses are issued, giving the government its own investment firm; and there is a very well-educated and professional staff in the Ministry of Petroleum and Energy. These components create an integrated system from the regulators to a commercial entity, to an investment firm, and to a base tax structure. He cautioned that the four components of the Norway model create a stable structure and must be looked at holistically, not piece-by-piece. Norway's stakeholder ownership ensures that Statoil protects the interests of Norway, even though it has international operations. In addition, Norway's ownership in infrastructure avoids Alaska's problem of having one pipeline under private ownership. Alaska's situation makes facility access a challenge for other parties who are trying to develop fields, because the pipeline owners need to maximize their profit, and that creates a tension within Alaska's system. Norway has solved this problem by having an equity share, and by having strong facility-access regulations. The United Kingdom has addressed this problem in the North Sea by the Infrastructure Code of Practice that allows for arbitration to negotiate third-party access. Mr. Myers said Alaska has no

method to intervene in such a negotiation, although it has a critical interest in the use of the infrastructure.

10:45:03 AM

MR. MYERS turned to the Alaska model and observed that - in the past - Alaska's relationship with industry relied on the nature of competition, and since there was a lot of competition between the major oil companies on the North Slope, leasing worked well at that time. Competition also needs a level playing field because a smaller operation is disadvantaged in information, capacity, and market; for example, a large operation like Shell can plan operations in the Outer Continental Shelf. After the companies merged on the major infrastructure on Alaska's North Slope, there was a dramatic decrease in competition, thus the system does not work as well. Mr. Myers said the design of the Norwegian model provides some solutions to the lack of competition. He pointed out that Alaska's structure must adhere to the Alaska State Constitution that specifies that the development of resources is for the maximum benefit to the people of Alaska. Therefore, adapting components of the Norway model must take into consideration Alaska's goals, and what its residents want to achieve. Norway has chosen a very long-term goal by building on a stable base of governmental support to sustain and increase revenue over a long period of time. He opined, however, that Alaska has a hard time defining its goals; in fact, the goals are difficult to define: Should revenue come from new sources or existing sources? Should the state invest for a stabilized rate of production or for a short-term maximum rate of production? He cautioned that reaching for an increased rate from an oil field can mean a loss of production over a longer period of time, thus an analysis of tax structure must consider all of these elements. Another of the state's goals is jobs for Alaskans, and he advised that there must be a greater investment in education if Alaska wants industry jobs to go to Alaskans, or to export trained labor. With investment, state-of-the-art research could also be done in the state by Alaskans under certain circumstances. In addition, a big goal for Alaska is affordable energy, so fundamental decisions must be made on how to balance the revenue from the export of energy with the cost of importing energy; in fact, confusion on this issue is demonstrated by the multiple gas pipeline proposals. Norway's solution to this problem was for the government to develop hydroelectric power, but Alaska has not made a clear and consistent choice. Norway is also ahead of Alaska in producing value-added products; for example, Alaska lacks a petrochemical industry. Another opportunity for Alaska is to develop its

hydroelectric energy and export its natural gas. Mr. Myers expressed his belief that another challenge for Alaska is to decide philosophically what is appropriate for government to do; as a matter of fact, a state agency that is building a major gas pipeline puts the government in the gas pipeline business, whether or not the state clarifies its role in infrastructure development. Finally, there is debate about whether the industry, the administration, the legislature, or the federal government drives investment in the oil and gas industry and energy planning in Alaska. Norway has "harmonized" the roles of each of those forces, but Alaska has not. Turning to actions Alaska could take, he suggested Alaska could drive investment in the areas of new development - where there is no infrastructure - through credits or direct investment. However, transferring tax and royalty revenue to an equity interest in existing development through the Stranded Gas Act is difficult because the state is not able to evaluate the worth of the value of the resource, or to force a sale. Many questions arise surrounding the conversion of the resource value of existing developments.

10:54:00 AM

MR. MYERS continued to explain that there may still be an opportunity on the North Slope to put an equity interest in the field at Pt. Thomson. A satellite development could lead to significant other exploration, but the state needs data and the professional management of its interest. Also, reclamation costs on the North Slope for the Trans-Alaska Pipeline Systems (TAPS) and facilities will be significant, and the state will have to allow discounts there. He advised these issues are very complicated, although not without merit. Finally, the state could invest in research and development in order to acquire needed data on water, ecosystems, and habitat, thereby saving years on the permitting process. In fact, the state and the companies working in the state are not employing the latest and greatest technology available on new processes such as on shale gas and shale oil. State investment in research and development should be combined with education.

10:57:53 AM

REPRESENTATIVE TUCK observed that government needs to take an active role in development, but there is an attitude that government "gets in the way of things, ... government needs to be removed." He asked whether the industry or the government advanced the shale oil and gas technology that led to

development in North Dakota. Alaska relies on the industry to implement technologies.

10:59:16 AM

MR. MYERS described how the oil and gas industry grew in North Dakota, beginning with a USGS resource estimation of 3.2 billion barrels of resource found in the Bakken formation. Because North Dakota's road system was in place, and the industry had existing infrastructure, smaller companies were able to come in and transport oil by pipelines and trucks. There is a complex lease system, and the risks taken by the companies were high, but oil prices stayed high. So, there was a combination of higher oil prices, emerging technologies, an open basin, public awareness, and a sufficient water supply for the hydraulic fracking process. Mr. Myers concluded that the open, competitive model is working in North Dakota largely because of the access to market, full-year drilling, and infrastructure.

11:01:56 AM

REPRESENTATIVE TUCK asked whether North Dakota will lose the open competition at some point.

MR. MYERS opined that if oil prices stay high, the small, individual leaseholders will not merge. This is not a similar situation to Alaska because there are trucking options for delivery.

11:03:46 AM

REPRESENTATIVE GARDNER stated that the oil industry in Alaska credits the success in North Dakota only to low taxes.

MR. MYERS said there has to be real analysis of what the profitability in Alaska is by looking at benchmarks on real rates-of-return, at incentives, and at the federal taxes; however, in-depth analysis on taxes has not been done, and the profit margin in North Dakota cannot be compared to the profit margin in Alaska on an equivalent field. Alaska does have higher costs, a massive reserve base, a single landowner, and factoring in the "royalty piece matters a lot," so there must be a specific tax-to-tax comparison. Also, when considering incentives for a capital-intensive development such as shale oil and gas, the credits given by Alaska are immense. This cannot be compared to the tax rate on an existing field with minimal investment, but must be compared to a field that is actively

being built. In fact, Alaska's structure is more favorable than North Dakota's on development for shale oil. The data is simply not there for "apples to apples comparisons;" furthermore, it is common for states to add a severance tax once successful production is well-established.

11:06:30 AM

REPRESENTATIVE THOMPSON asked whether there was ongoing research on heavy oils.

MR. MYERS said more data and information that will shorten permitting time is needed. With this information the state can make choices on infrastructure and sort out the benefits and risks of projects. The university has the capacity to do more research than it is doing, and he advised Alaska is not capitalizing on its resource base the way Norway does.

REPRESENTATIVE FOSTER asked how Norway achieved consensus towards a common goal.

11:08:42 AM

MR. MYERS restated Norway's vision of a series of long-term goals for societal benefits and sustainability for the resources and the environment, along with an understanding of the integration from oil and gas exploration through to the delivery of a refined product. Norway has also been successful at depoliticizing the oil and gas industry, and has a much higher level of professional engineers, geoscientists, economists, and commercial analysts in the government who are insulated from political appointment. In Alaska, on the other hand, technical experts are often political appointees, which limit the job pool significantly. Mr. Myers warned that looking at other models is complex, and "if you aren't careful, a good philosophical idea can turn into a terrible investment decision."

CHAIR HERRON encouraged further discussion of related constitutional issues. Public testimony on HCR 19 was closed.

11:11:40 AM

REPRESENTATIVE KELLER introduced a conceptual amendment to page 4, line 5, that after the word "generation," insert:

> private sector job expansion, affordable energy options, and value-added options,

REPRESENTATIVE KELLER said the amendment expands and incorporates the goals of the resolution.

11:12:54 AM

REPRESENTATIVE GARDNER observed that the amendment is related to her belief that the testimony today raised the aspect that having a trained workforce, and focusing on increasing jobs for Alaskans, also must acknowledge that Norway has a pre-kindergarten to Ph.D. free education for its citizens. She pointed out that education is part of the lessons learned in Norway. She then expressed her objection to the inclusion of the word "competitiveness" because the word "has been co-opted to be sort of a code for reducing taxes on the industry."

11:14:15 AM

CHAIR HERRON announced HCR 19 was held.

11:15:15 AM

ADJOURNMENT

There being no further business before the committee, the House Special Committee on Economic Development, International Trade and Tourism meeting was adjourned at 11:16 a.m.