

**ALASKA STATE LEGISLATURE
HOUSE SPECIAL COMMITTEE ON WAYS AND MEANS**

March 17, 2022

11:37 a.m.

MEMBERS PRESENT

Representative Ivy Spohnholz, Chair
Representative Adam Wool, Vice Chair
Representative Andy Josephson
Representative Calvin Schrage
Representative Andi Story
Representative Mike Prax

MEMBERS ABSENT

Representative David Eastman

COMMITTEE CALENDAR

PRESENTATION(S): OIL AND GAS UPDATE; GLOBAL MARKETS~
GEOPOLITICS~ HIGH PRICES~ AND OTHER INFLUENCES ON STATE REVENUE
AND PRODUCTION

- HEARD

PREVIOUS COMMITTEE ACTION

No previous action to record

WITNESS REGISTER

DAN STICKEL, Chief Economist
Tax Division
Department of Revenue
Juneau, Alaska

POSITION STATEMENT: Provided a PowerPoint, titled "Spring 2022
Forecast and High Oil Prices Presentation."

CORRI FEIGE, Commissioner
Department of Natural Resources
Juneau, Alaska

POSITION STATEMENT: Provided introductory remarks during the
oil and gas update presentation.

JOHN CROWTHER, Deputy Commissioner
Department of Land and Natural Resources

Juneau, Alaska

POSITION STATEMENT: Provided a PowerPoint presentation, titled "Oil & Gas: Global Markets and Geopolitics and Their Influence on State Production."

LARRY PERSILY, Oil and Gas Analyst

Juneau, Alaska

POSITION STATEMENT: Provided a PowerPoint presentation, titled "Hope of 'normal' oil and gas markets was premature - for multiple reasons, and it's getting a lot more complicated."

ACTION NARRATIVE

[11:37:06 AM](#)

CHAIR IVY SPOHNHOLZ called the House Special Committee on Ways and Means meeting to order at 11:37 a.m. Representatives Schrage, Prax, and Spohnholz were present at the call to order. Representatives Story, Josephson, and Wool arrived as the meeting was in progress.

PRESENTATION(S): Oil and Gas Update; Global Markets, Geopolitics, High prices, and Other Influences on State Revenue and Production

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CHAIR SPOHNHOLZ announced that the only order of business would be the Oil and Gas Update; Global Markets, Geopolitics, High prices, and Other Influences on State Revenue and Production presentation.

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DAN STICKEL, Chief Economist, Department of Revenue, provided a PowerPoint presentation, titled "Spring 2022 Forecast and High Oil Prices Presentation" [hard copy included in committee packet]. He went through the agenda and moved on to slide 4 and discussed the key changes between the Fall 2021 and the current Spring 2022 forecasts. Oil prices increased by almost \$16 per barrel for fiscal year 2022 (FY 22) and \$30 for FY 23. Those reflect tightened supply and demand fundamentals in the market and the impacts of the recent uncertainty concerning the Russian invasion of Ukraine. The total unrestricted revenue forecast increased by \$1.2 billion for FY 22 and by \$2.4 billion for FY 23, which was driven by the increased oil price outlook. Total state revenue, slide 5, comes from four different sources,

including investments, federal receipts, petroleum, and other non-petroleum revenues. Within those four categories there are four levels of distinction as far as restrictions in the budget. Unrestricted General Funds can be appropriated for any purpose. Designated general funds (DGF) are technically available for appropriation but are customarily appropriated for some specific purposes. Other restricted revenues are revenues that are specifically dedicated and cannot be appropriated in any way, for example, the constitutionally dedicated portion of revenues that goes towards the permanent fund dividend (PFD). All federal revenues have provisions around how those must be used. He said FY 21 holds the record for the largest total state revenue in state history at \$29.8 billion. It is forecasted that FY 22 will have just under \$16 billion and just over \$16 billion for FY 23. A near 30 percent return on the permanent fund recorded for FY 21, as well as one-time stimulus money from the federal government, explains why FY 21 was substantially higher than any other year.

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MR. STICKEL explained to Representative Prax that the designated petroleum revenue represents primarily the transfer to the permanent fund above and beyond the constitutionally mandated 25 percent. The other restricted revenue for petroleum revenue reflects settlements to the constitutional budget reserve (CBR) fund as well as the constitutional dedication of royalties for the permanent fund and school fund. The final piece of petroleum revenue under federal revenue represents shared revenues from the federal government for bonuses, rents, and royalties in the National Petroleum Reserve.

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MR. STICKEL mentioned that there are four ways the state gets revenue from oil and gas: property tax, corporate income tax, production tax, and royalties. The property tax is levied on all oil and gas property produced in the state and tends to be a stable revenue source generating a little over \$100 million per year to the state; over \$400 million is generated by municipalities from oil and gas property. The corporate income tax is levied by the state on qualifying corporations doing business in the state. This applies to C corporations and is a tax on profits. The Oil and Gas Production Tax is expected to be the largest source of Oil and Gas Revenue for the Unrestricted General Fund. This is the state's severance tax on oil and gas; it's a net-profits tax with a gross-minimum tax

floor and should exceed \$2.5 billion of revenue in FY 23. Royalties are expected to bring in \$1.3 billion this fiscal year and \$1.4 billion next fiscal year.

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MR. STICKEL continued to address oil prices, through historical graphs using nominal daily prices. Throughout the 1990s, the price of oil was relatively low compared to more recent prices. From 2004-2008 oil prices were increasing until collapsing during the 2008 recession. The shale oil boom in 2014 resolved supply and demand imbalances which led to an oversupplied market and caused a decrease in prices. Prices increased from then until the pandemic hit. In response to Representative Prax, he mentioned that there is a higher long-term price. Volatility is high and expected to increase but it is difficult to predict.

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CHAIR SPOHNHOLZ highlighted the present-day volatility in the price of oil.

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MR. STICKEL showed slide 9, which shows a more recent graph with oil prices from 2020 to present day. He highlighted the infamous low price of negative \$2.77 on April 20, 2020. Following the price collapse, supply and demand responded to low oil prices, the Organization of Petroleum Exporting Countries (OPEC) agreed to production cuts. Demand rebounded where demand outstripped supply which resulted in higher oil prices.

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MR. STICKEL moved to slide 10, which shows an even more recent graph with oil prices from Feb 15, 2020, to March 14, 2022. The Russian invasion of Ukraine has led to a lot of uncertainty in the market and restrictions on Russian crude oil. Oil prices peaked at \$125.44 per barrel on March 8, 2022. Forecast finalizations occurred shortly after the peak.

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MR. STICKEL showed through the U.S. Energy Information Administration (EIA) Short-Term Energy Outlook from March 2022 that markets were in balance before the COVID-19 pandemic hit, then demand plummeted. Supply was slower to respond to than

demand due to the pandemic shutdowns. Since the recession, supply has been slower to respond to rising demand and there have been several quarters where reserves were drawn. These federal energy outlooks are generated monthly through EIA.

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MR. STICKEL moved to slide 12, which shows changes to the long-term price forecast which expects \$16 per barrel for FY 22 and \$30 per barrel for FY 23. These numbers are presented in the context of high volatility.

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MR. STICKEL directed attention to slide 14 and explained the Oil Volatility Index (OVIX), which uses a statistical formula that uses futures market prices for oil and options market prices to come up with a statistical measure for the range of future prices for the next month, and the likelihood of various pricing. Supply and geopolitical issues have been historical drivers of volatility. The biggest spikes in volatility were at the start of the COVID-19 pandemic and at each of the subsequent COVID-19 variants. The bottom line is that there is a period of heightened volatility around oil prices.

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MR. STICKEL discussed that slide 15 looks at volatility based on options market expectations and gives the 10th, 25th, 75th, and 90th percentiles. For example, in FY 22, the 10th percentile of prices would be about \$81 per barrel and the 90th percentile would be about \$110 per barrel. For FY 23 the range would be \$63 dollars in the 10th percentile and \$163 dollars in the 90th percentile. There is a 20 percent chance that oil prices in FY 23 could average less than \$63 or more than \$163 dollars per barrel; therefore, there is high volatility and uncertainty in the market at present. In response to Representative Spohnholz, he said the average price of oil would need to be about \$114 to reach the forecast for Spring 2022. There is a 50 percent likelihood that the forecast would be reached, but it is difficult to quantify. In response to Representative Prax, he said the department has considered locking in a price through the futures market; hedging would require a statutory change through the legislature. Slide 16 shows that the official forecast was \$101 dollars per barrel, which results in just under \$5 billion in Unrestricted General Fund Revenue before the Permanent Fund transfer. Any increase or decrease could result

in an \$80-85 million change in the unrestricted revenue for FY 23.

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CORRI FEIGE, Commissioner, Department of Natural Resources, provided introductory remarks and mentioned an energy conference she attended in which there were discussions on recent geopolitical influences on the volatility of the oil market. She pointed to underinvestment of the oil and gas industry globally as a cause of tight supply in the last 5-10 years.

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JOHN CROWTHER, Deputy Commissioner, Department of Natural Resources (DNR), delivered a PowerPoint presentation, titled "Oil & Gas: Global Markets and Geopolitics and Their Influence on State Production" [hard copy included in committee packet]. Regional markets may not reflect the global market but can be impacted by it. Slide 2 shows the 10 largest producers and share of world oil production in 2020. Slide 3 shows the net petroleum trade in the United States. As the U.S. has become a crude oil producer, trade has decreased. Because of refining capacity in the U.S., petroleum products have been increasingly exported.

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MR. CROWTHER said that slide 4 shows pricing indexes and metrics that are used for different crude oil qualities in the U.S. Slide 5 shows U.S. domestic oil production, which had an increase in production over the last 10 years. Slide 5 shows a graph from the U.S. Energy Information Administration. In 2010, there was a significant import of oil from Russia; this dramatically dropped to an absolute low in 2014. There has been an increase since then in Russian oil imports driven by various factors. Even as there have been significant changes in oil price, Russian imports have not been influenced by price.

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COMMISSIONER FEIGE offered clarification by noting that imports from Russian crude required a blend stock due to the grade needed for the refining process. When Texas refineries came online, Russian crude was offset because shale oil tends to be light, and the Russian crude imported at the time had the same character.

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MR. CROWTHER resumed on slide 7 and defined spare capacity as the ability to bring production up quickly and keep that production level for a protracted period, usually 90 days. Spare capacity takes time and money to build and maintain. It takes spare capacity to ramp up production quickly. Companies typically maintain little or no spare capacity. They work to produce the most they can economically produce and, together with state law and regulations, support the long-term health and productivity of the reservoir in the process. Globally, most spare capacity is maintained by nation states for strategic reasons. Spare capacity is different from prospectivity. Alaska continues to have significant potential and prospectivity.

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MR. CROWTHER described on slide 8 that producers are generally known to be producing all resources considered economic at an optimal pace. Higher oil prices make marginally economic barrels feasible to produce. Ramping up production may be possible on different timelines with considerations like new wells in existing fields, repairing broken wells, and processing improvements to de-bottleneck facilities that enable production. Permitting timelines impact project timelines. Medium to long-term levers include permitting approval timelines, legislation under debate, and funding. The commissioner has advocated for financing projects in Alaska. Historically, projects have taken from a few years to decades to come online after discovery, depending on numerous factors such as commercial alignment, market and economic conditions, funding, and permitting.

MR. CROWTHER, in response to Representative Spohnholz, referred to the Willow and Pikka projects as two near-term large projects. Both projects are at advanced stages and have unique factors affecting their progress to full development. There is an active miscellaneous land use permit application from Oil Search Alaska Santos, the project developer for Pikka. Transportation issues will be dealt with among Oil Search Alaska and ConocoPhillips.

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LARRY PERSILY, Oil and Gas Analyst, provided a PowerPoint presentation, titled "Hope of 'normal' oil and gas markets was

premature - for multiple reasons, -and it's getting a lot more complicated" [hard copy included in committee packet]. Mr. Persily summarized slide 2 and said that before Russia attacked Ukraine, prices were increasing due to production quotas. Russia's production capacity is short. In January, OPEC Plus was falling short of its targets by 600,000 barrels a day, which drove up prices before the war. It turns out that last year's so-called "missing barrels" were consumed.

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MR. PERSILY, responding to Representative Spohnholz, said that Canada can accelerate production faster than Alaska. Geopolitics plays a factor in pricing and production. He referenced a quote from Helima Croft, head of global commodity strategy, who said, "The White House has embarked on the oil equivalent of a scavenger hunt."

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MR. PERSILY said that Russia used to export about 40 percent of their production. It is unclear what their exports will be now that the war in Ukraine is underway. Exports to the U.S. averaged 200,000 barrels a day last year.

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MR. PERSILY showed slide 12 which details geographic refinery constraints such as a lack of pipeline capacity to move U.S. crude oil to the West Coast, and limitations of shipping crude from the Gulf Coast to the West Coast. Roughly half of the West Coast refinery input comes from imports from Canada, Iraq, Saudi Arabia, and Brazil. The U.S. Gulf Coast refinery capacity is tuned for heavier crude rather than lighter U.S. shale crude, which is often exported. Hawai'i gets its oil from Russia. Self-imposed sanctions have been adopted by ship owners, insurers, and refiners. Meanwhile, Russia is looking towards China and India as the best options for buying cargo. For a refinery to retool to process different types of oil would take extra time and money.

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MR. PERSILY said that Russia previously supplied as much as 40 percent of Europe's natural gas. Coal is making a comeback in Germany and China. Europe is more committed to solving climate change than the United States, but there is still an imperative

for energy. Analysts call coal a "safety valve" to meet Europe and Asia's power needs. Germany decided to build its first liquified natural gas (LNG) terminal, which will be completed in two years. Spain has spare capacity at its import terminals but lacks pipeline capacity to move more gas to central Europe.

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MR. PERSILY said that in the United States, due to low oil prices in the past, there have been more than 600 bankruptcies totaling more than \$321 billion in debt. The United States is now the largest LNG exporter in the world and became thus in just six years after constructing seven LNG ports by converting unused import terminals into export terminals. In response to Representative Spohnholz, he mentioned that high prices are referred to as "demand destruction." For example, if gas is too expensive, people may drive less. This accelerates the debate between relying on Russia to increase supply versus swapping for renewables. He mentioned that most analysts agree that oil prices are likely to exist between \$90-100 based on the current situation.

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CHAIR SPOHNHOLZ further noted the volatility of oil prices and provided closing remarks.

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ADJOURNMENT

There being no further business before the committee, the House Special Committee on Ways and Means meeting was adjourned at 1:05 p.m.