

SCOMM

62:6

1 IN THE SENATE

BY ADAMS

2

SENATE BILL NO. 97

3

IN THE LEGISLATURE OF THE STATE OF ALASKA

4

SIXTEENTH LEGISLATURE - FIRST SESSION

5

A BILL

6 For an Act entitled: "An Act relating to the oil and gas properties pro-
7 duction tax; and providing for an effective date."

8 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

9 * Section 1. AS 43.55.013(b) is repealed and reenacted to read:

10 (b) The economic limit factor for oil production of a lease or
11 property shall be computed according to the following formula:

12 $(1 - [PEL/TP]) \exp ([55,000,000 \times WD] / [PEL \times TP/Days])$

13 where: PEL = the monthly production rate at the economic limit;

14 TP = the total production during the month for which the tax
15 is to be paid;

16 WD = the total number of well days in the month for which
17 the tax is to be paid;

18 Days = the number of days in the month for which the tax is to
19 be paid; and

20 where "exp" indicates that the expression following it is an exponent.

21 * Sec. 2. AS 43.55.013(d) is amended to read:

22 (d) The monthly production rate at the economic limit for a
23 lease or property is [PRESUMED TO BE] 300 barrels times the number of
24 well days for the lease or property during the month for which the tax
25 is to be paid. [THE TAXPAYER MAY REBUT THIS PRESUMPTION AT A FORMAL
26 HEARING UNDER AS 43.05.240 BY PROVIDING CLEAR AND CONVINCING EVIDENCE
27 OF A DIFFERENT MONTHLY PRODUCTION RATE AT THE ECONOMIC LIMIT FOR THE
28 LEASE OR PROPERTY. THE HEARING SHALL BE HELD BEFORE FEBRUARY 15 OF
29 THE YEAR OR WITHIN SIX MONTHS AFTER COMMENCEMENT OF OIL PRODUCTION FOR

1 A LEASE OR PROPERTY. THE MONTHLY PRODUCTION RATE AT THE ECONOMIC
2 LIMIT FOR THE LEASE OR PROPERTY BASED UPON THE CLEAR AND CONVINCING
3 EVIDENCE OF THE TAXPAYER SHALL BE CALCULATED BY DIVIDING THE VALUE
4 DETERMINED UNDER (f) OF THIS SECTION INTO THE AVERAGE MONTHLY DIRECT
5 OPERATING COST DETERMINED UNDER (e) OF THIS SECTION AND SHALL BE USED
6 FOR PURPOSES OF THIS SECTION FOR ALL OIL PRODUCTION DURING THAT CALEN-
7 DAR YEAR FROM THE LEASE OR PROPERTY.]

8 * Sec. 3. AS 43.55.013(e) and (f) are repealed.

9 * Sec. 4. This Act is retroactive to January 1, 1989, and applies to
10 oil produced after December 31, 1988.

11 * Sec. 5. This Act takes effect immediately under AS 01.10.070(c).

Testimony of the
Alaska Oil and Gas Association
before the
Alaska State Senate
Special Committee on Oil & Gas
on
SB 97, An Act Relating to the
Oil and Gas Properties Production Tax/Changes in ELF

March 17, 1989

My name is Gerald Serena and I am a tax lawyer with Exxon Company, U.S.A. I am here today to present testimony of the Alaska Oil and Gas Association (AOGA). AOGA is a trade association whose member companies account for the majority of oil and gas exploration, production and transportation activities in Alaska.

AOGA believes that it is in Alaska's best interest to encourage responsible exploration and development of its hydrocarbon resources. We oppose the tax increases included in SB 97 since its passage would act to discourage continued development in Alaska's larger fields. In general, marginal developments in these fields that are already at risk due to soft crude price forecasts would be further burdened by the proposed tax increases. Increasing taxes on existing fields, after significant investment decisions have been made under the existing tax structure, is counterproductive to the complete development of these vast resources. In general, changes in the tax structure will require different risk analysis techniques, which could be a hindrance to future exploration and development.

Alaska's current tax structure has our industry paying higher taxes in this state than in any other. As you are probably aware, the production tax rate is the highest in the country, peaking at 15 per cent on gross production value. Taxes and royalties have provided 80 to 90 per cent of the state's unrestricted revenues in recent years and created the \$10 billion Permanent Fund. Surely oil and gas is paying its fair share by any measure.

Turning to the oil industry for more tax revenues would not be an effective approach to solving revenue problems brought on by crude price volatility, and which will be exacerbated in the near future with production declines from the major fields. This would only increase the State's enormous dependence on oil revenues while not addressing the long term problem of state spending levels.

In conclusion, AOGA strongly opposes the increased taxes in SB 97. Passage would unreasonably increase an already high tax burden, and would increase the state's dependence on volatile crude price swings.

ds:T14

Testimony, ELF
Senate Resources Committee
Juneau, AK
March 17, 1989

B. L. Odom
ARCO Alaska, Inc.

Good morning. My name is Ben Odom. I am Senior Vice President of Operations of ARCO Alaska, Inc. I appreciate the opportunity to offer testimony today concerning yet another proposed modification to the Economic Limit Factor of the Alaska Oil and Gas Properties Production Tax.

I feel certain that it will come as no surprise to you that ARCO Alaska opposes any changes to the Economic Limit Factor (ELF) which would have the effect of increasing the oil and gas industry's tax burden. We certainly identify with your problems concerning the potential budget deficit generated by the drop in crude oil prices. We have had to make a number of difficult decisions because of lower crude prices, including organizational restructuring and substantial reductions in costs, because our revenues, like yours, were and are, tied to the price of crude oil.

Our economics for making investment decisions contain two principal components. Estimated prices and estimated costs. We know we can't control prices, and we have learned we don't have the ability to predict them very well either. That leaves only cost. Other than the actual costs of transporting the crude oil, the largest single cost we have in Alaska is not the result of the remoteness of the fields or even the cold. The largest single item of cost we face in Alaska is taxes. Higher costs or lower prices result in exactly the same thing -- more oil left in the ground -- more oil that could be recovered becomes uneconomic to recover. That oil which is left in the ground because it is uneconomic will not return any royalties to the State, and it's from these royalties that the contributions are made to the Permanent Fund. It will not result in the payment of any production tax nor generate any income tax. Oil left in the ground will not create jobs. It will not utilize the facilities already available for its production, therefore, those facilities will generate less ad valorem tax revenues. The ELF helps to reduce the regressive effect of a gross production tax and prevent the premature cessation of oil production. Short-term fixes resulting in higher costs today have the result of removing jobs today and revenue from the future.

High crude prices have meant more tax and more royalty for the state. Those high prices have also equated to more crude oil reserves and more jobs to produce those reserves. However, reserves are not the equivalent of the total amount of crude oil in a reservoir. There is also an economic consideration. Reserves are instead only equal to the amount of crude oil that can be economically produced. Added crude reserves come when prices have been high enough to provide the economic incentive to pay for the technology specific to each reservoir and to pay for workers and equipment to implement that technology in each reservoir. Low prices mean reduced crude reserves; high costs likewise mean reduced crude reserves.

I want to show you this afternoon some information about the Kuparuk River Unit which should give you cause to move carefully in considering changes to the ELF. It is my understanding that the administration has prepared the 1990 budget based on a \$14 Gulf Coast North Slope crude price. I would like to call your attention to Exhibit I, which indicates the impact on the Kuparuk River Unit of a \$14.01 crude oil price. Kuparuk is the second largest oil field in North America with a current daily production rate of around 300,000 barrels. Our studies indicate nearly a billion barrels of oil can be produced with the existing wells and facilities. Half as much again is recoverable with additional capital spending. One might suppose that this field is an extremely profitable investment. But contrary to what you read in the papers or see on television, at \$14 a barrel, Kuparuk is anything but profitable. As the exhibit so clearly shows, the State already, with the current ELF, receives more than 100% of the available net revenue on each incremental barrel of crude.

Even at its current peak production rate, only the State of Alaska, not the Kuparuk investors, receives a profit. These numbers paint a rather bleak picture at \$14 a barrel. How can increasing the production tax burden by 50% over the next ten years, as SB-97 would do, be justified when you look at the economics? The State would certainly appear to be receiving a great deal more than a fair share of the available revenue.

The producer's return on each incremental barrel of oil will determine whether additional investments are made to produce more oil. Kuparuk has no natural

gas cap to force the oil from the ground. From the day the first barrel was lifted, pressure has been decreasing, and production on a per-well basis would decline without extensive additional investment in enhanced recovery projects. These new investments are very costly and can only provide for a slower decline in production than would otherwise occur. The loss per barrel that you see is the amount that must support the economic decision of whether we continue to create additional crude oil reserves in the Kuparuk River Unit. Do we operate a drilling rig to do well workovers to produce more barrels when we lose \$.14 on each barrel? Does it look better to double the production tax and increase the loss to \$.28? There is not a multiplier or an exponent which will convert this loss to an economic incentive to spend more money, to generate more barrels at a loss. What is at issue is the one half billion barrels in the ground that require additional wells and investment to produce.

We are currently looking at a long-range plan for Kuparuk involving what we hope to be a continuing development package. As attached Exhibit II shows, there are many development projects left to be done at Kuparuk, and they would require additional capital of almost \$1.6 billion and would create additional Alaskan jobs amounting to nearly 4000 man years of construction. Many of those projects will stay on the drawing board unless we have higher crude oil prices or lower costs -- or both. We can't do it without your help. The industry can't live with low prices and higher taxes. Among these projects, for example, is a drill site on the periphery of the Kuparuk field. Our plans call for a project consisting of 12 wells to be drilled on the site, providing an additional 12 million barrels of new oil reserves. Under the State's price forecasts and the present tax laws, this project is only marginally economic. If SB-97 is enacted, this project won't happen. Twelve million barrels of oil and effectively \$35 million in State revenue will be left in the ground. Of the \$35 million, \$7 million would go into the Permanent Fund.

The importance of tax burden in a project evaluation cannot be overstated. The ELF plays a pivotal role in mitigating the regressive nature of the Alaska production tax by taking into account the economic realities of oil field operations. Those realities are that it doesn't matter how large or small the field is, what does matter is that each new project must stand on its own by showing a positive net present worth. Although prices are still very low, the current ELF

provides a small but measurable incentive to help reduce some of the costs associated with producing more oil.

When I initially came to Alaska in 1968, the severance tax rate was 1%. A step production tax was introduced in 1974 to help mitigate the production tax burden on wells whose production was at certain low levels. This step methodology was modified in 1977 with the introduction of the ELF, and the maximum statutory rate was increased to 12.25%. Again in 1981 the statutory rate was increased to 15%, the highest production or severance tax rate in the nation. In addition, the application of the ELF was limited during the first ten years of production. As the curves in Exhibit III indicate for the Kuparuk Field, the burden on the production tax has not only changed by calculation method, but it has continually increased. Kuparuk would clearly be paying less production tax under prior laws than it would be paying under SB-97. As the top line of the graph plainly shows, SB-97 does not provide a slowly declining tax rate, or even a step decline, as production drops off. SB-97 is more on the nature of a cliff, where the production of the wells in the field must be so low before any reduction in tax is realized that under North Slope economic realities, the wells could not be operated at these production levels. This can be restated by saying that the Kuparuk Field will shut down before the ELF in SB-97 mitigates anything but an insignificant amount of the production tax.

An increase in taxes also has the direct effect of reducing the amount of capital available for exploration and production in the state. The modification of the ELF embodied in SB-97 is an increase in taxes. This bill provides only a short term revenue boost to cover excessive current government spending. It will not solve the fiscal difficulties the state now faces, and if it is enacted, it will be at the expense of long-term stability and growth. Too much of the oil industry's resources are being drained out of resource development and into government. It is time for the Legislature to set the pace for Alaska by putting into place policies that attract new investment and provide incentives to increase current investments. The current ELF formula does help to provide incentives to increase production, while SB-97 severely limits those incentives and effectively reinstates the regressive inequities of the gross production tax.

In closing, I would like to state that ARCO Alaska believes that SB-97 will not be advantageous to the economy or the citizens of Alaska. Its enactment would place an onerous additional tax burden on the oil industry that would remove to other states or countries funds that could otherwise be spent on additional investment in Alaska. SB-97 would create a disincentive to future Alaska exploration and development and will not maximize the recovery of Alaska's oil resources. ARCO Alaska strongly opposes Senate Bill 97.

**ANS Net Revenue
Kuparuk River Field**

	Current Law \$/bbl	SB-97 \$/bbl
Assumed Crude Price	14.01	14.01
Tanker Freight	2.70	2.70
Quality Differential	0.40	0.40
TAPS Tariff	3.11	3.11
Kuparuk Pipeline	0.70	0.70
Pipeline Loss	0.10	0.10
Wellhead Price	7.00	7.00
Production Cost and Capital Recovery	5.43	5.43
Total Net Revenue	1.58	1.58
State Royalty	0.82	0.82
Severance Tax	0.54	0.75
Property Tax	0.44	0.44
State Income Tax	-0.01	-0.01
Total State	1.79	1.99
Federal Income Tax	-0.07	-0.14
Producer Profit	-0.14	-0.28

Source:

Barclays de Zoete Wedd, September 1988

Alaska Department of Revenue October 1988

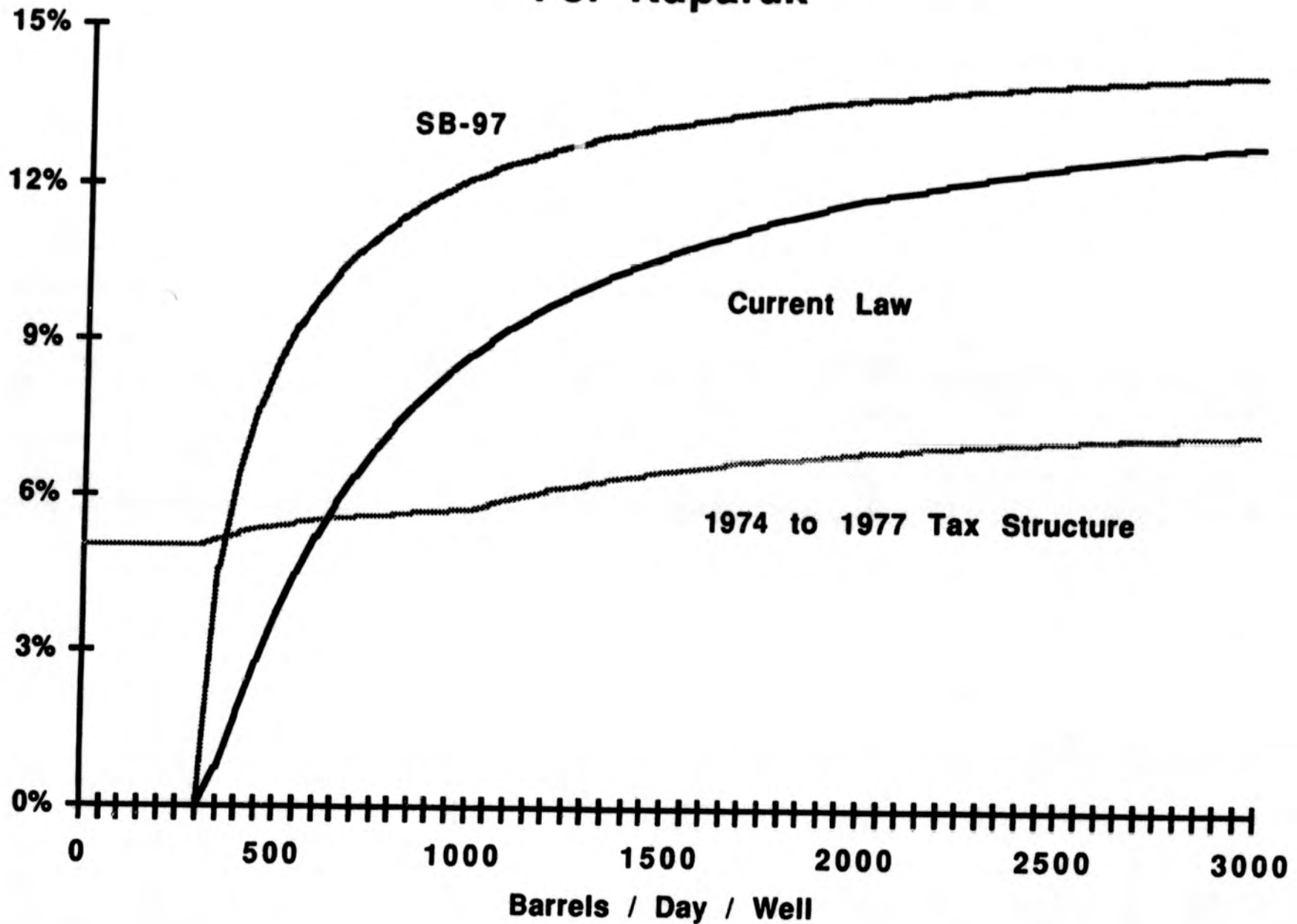
State of Alaska Royalty and Severance Methodology

PROJECT PORTFOLIO

KUPARUK

<u>Project</u>	<u>Description</u>	<u>Timing</u>
<u>Drilling</u>		
• Peripheral Drillsite 2K	Selective peripheral DS development on 160 acre spacing. Total of 98 additional wells	1989 SU
• Peripheral Drillsite 3R		1989 SU
• Peripheral Drillsite 2M		1990 SU
• Peripheral Drillsite 2L		1990 SU
• Peripheral Drillsite 3G		1990 SU
• Flem. Peripheral Dev.	14 drillsite expansions, 6 new drillsites, 180 additional wells 1 rig 1989, 2 rigs thereafter	1990===>
<u>Waterflood/EOR</u>		
• LIP-3 Expansion	Additional water handling capacity @ CPF-3 22 new wells. Improve EOR efficiency 16 wells. Seed for Phase I Infill 160 + 80 acre accelerate reserves 19 drillsites staged over 4 years	1990 SL
• Infill Drill @ DS 1Y/2Z		1989===>
• Infill Drill @ DS 1A		1989 SU
• Phase I Infill Drilling		1991 SU
• Fullfield EOR		1991 SU

Effective Severance Tax Rates For Kuparuk



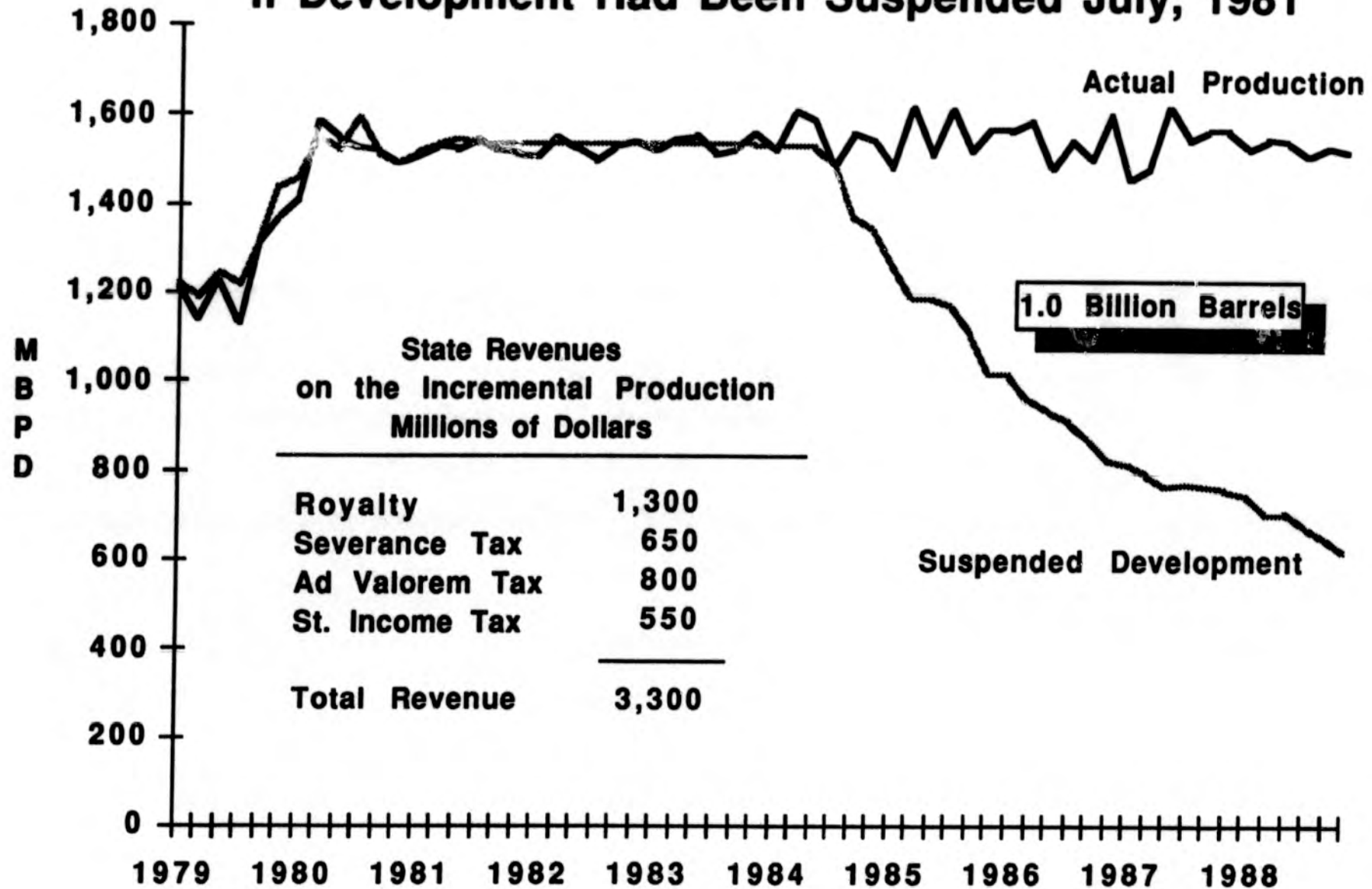
The Rest of the Story on the ARCO Drilling Example

	Without Royalty	Including Royalty	Royalty
Original Kuparuk bbl / Yr.	90,168,000	103,049,143	12,881,143
With New Well	90,277,000	103,173,714	12,896,714
Additional Royalty			15,571
x \$9.00 / bbl			\$140,143
+ Ad Valorem Tax			\$20,000
- ELF Impact			(\$37,846)
Total State Revenue Impact			\$122,297

ARCO Kuparuk Example

	<u>Current Law</u>	<u>Proposed Law</u>
Change in Annual Gross Revenue	\$981,000	\$981,000
Change in Annual Severance Tax	(\$37,846)	\$58,611
Tax Rate on Incremental Production	-3.9%	6.0%
Average Tax Rate Before Drilling	7.820%	10.944%
Average Tax Rate After Drilling	7.806%	10.938%
Percent Change in Average Tax Rate Due to Drilling	-0.180%	-0.055%

Prudhoe Bay Production If Development Had Been Suspended July, 1981



Prudhoe Bay

1981-1988 Industry Investment

		<u>\$ MM</u>
Additional Wells		2,550
Producing Wells	450	
Injection Wells	123	
Other Wells	23	
Waterflood		2,099
Production Facilities		1,475
Gas Handling		470
Enhanced Oil Recovery		620
Other		820
Total		\$8,040

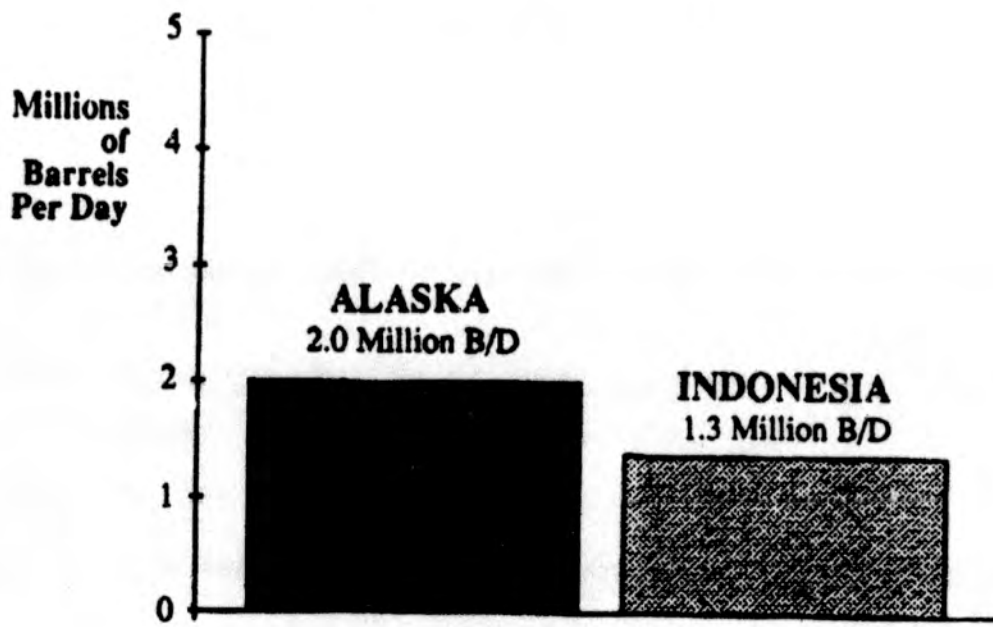
PETROLEUM INDUSTRY CAPITAL INVESTMENT IN ALASKA

\$ Billions
1960 through 1988

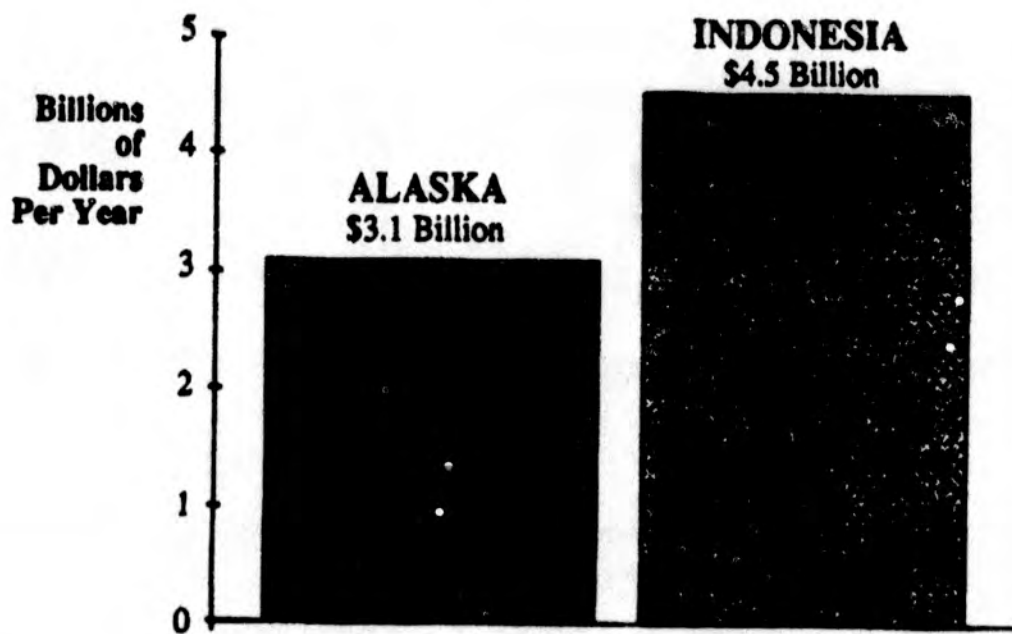
	<u>ARCO Investment</u>	<u>Industry Investment</u>
Prudhoe Bay	3.1	14.3
Kuparuk River	2.3	3.6
Lisburne	.4	1.0
Endicott		1.2
Milne Point		.3
Cook Inlet	.2	.7
Seal Island, Mukluk #1		.2
TAPS	2.0	9.3
Lease Purchases	.6	7.6
Exploratory Drilling	.5	3.6
Seismic/Other Exploration	.4	2.6
COST Wells		.5
Refineries		.4
Marketing/Distribution Assets		.1
Office Buildings/Other	<u>.1</u>	<u>.3</u>
TOTAL	<u>9.6</u>	<u>45.7</u>

PRODUCTION

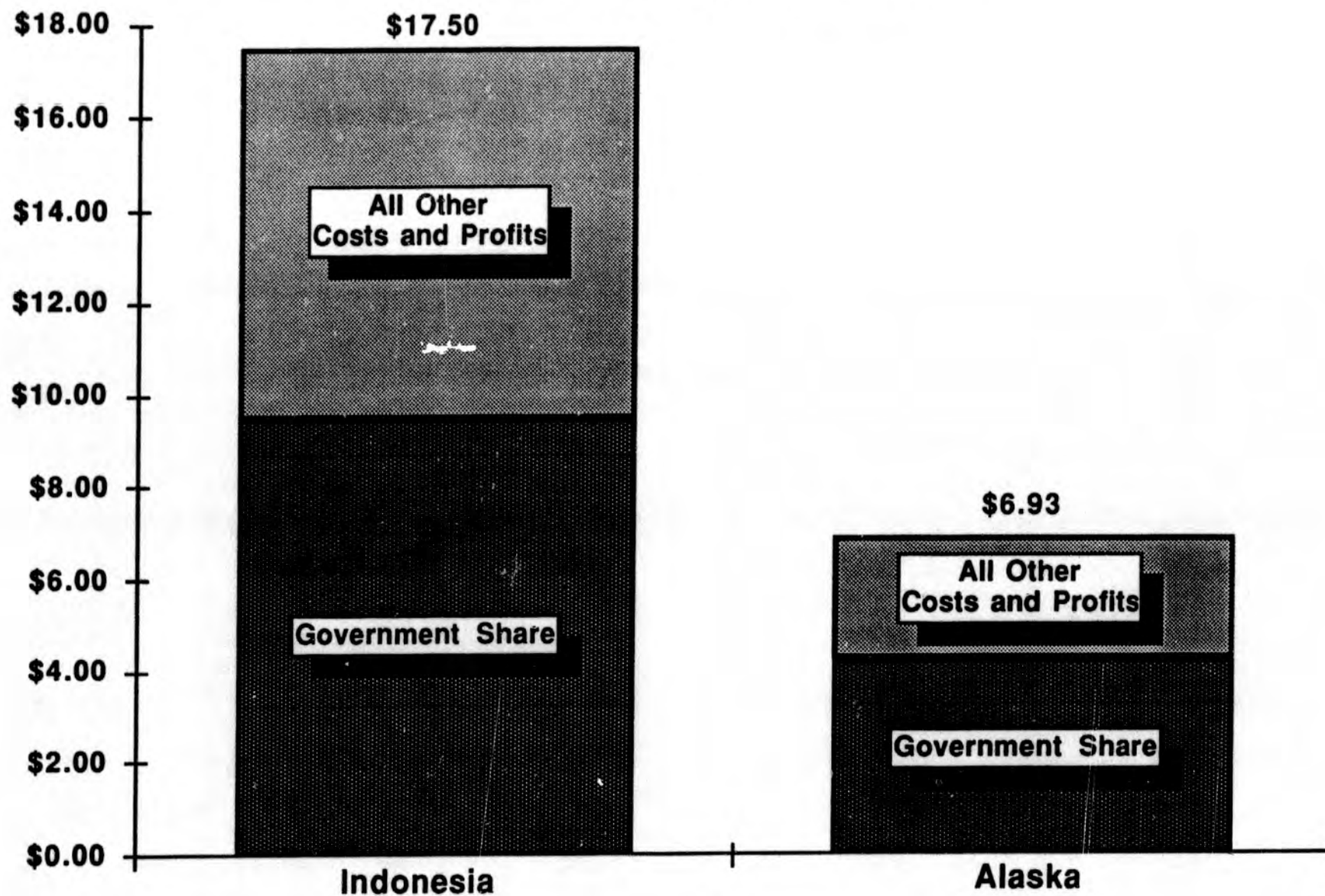
(Calendar Year 1987)



GOVERNMENT REVENUE



**Administration's Indonesia Comparison
On a Dollar per Barrel Basis**



Note: Refer to Administration's testimony; (\$3.1 Billion+2.0 MMBPD, compared to the ADOR wellhead value)

ARCO Alaska, Inc.

ARCO Alaska, Inc.

	1988	1987	1986
Earnings - millions of dollars	\$ 382	\$ 487	\$ 124
Total assets - millions of dollars	\$3,077	\$4,221	\$4,615
Additions to fixed assets - millions of dollars	\$ 214	\$ 136	\$ 506
Liquids production - thousand barrels/day - net	487.3	470.4	429.9
Natural gas sales - million cubic feet/day - net	30	28	35
Average crude price - dollars/barrel	\$ 8.51	\$10.95	\$ 6.43
Average natural gas price - dollars/thousand cubic feet	\$ 1.36	\$ 1.14	\$ 1.16
State taxes - millions of dollars*	\$ 474	\$ 328	\$ 483
Exploration expense - millions of dollars	\$ 56	\$ 45	\$ 44
Net exploratory wells completed	2	0	1
Proved liquids reserves - million barrels	2,064	2,136	2,046
Proved natural gas reserves - billion cubic feet	2,484	2,207	1,965

* Includes production, property and income taxes paid in the State of Alaska, as well as lump sum settlement payments made to the state in 1988 and 1986 for income and production taxes. Does not include the state's approximately 12.5 percent share of production.

During 1988, ARCO Alaska, Inc., achieved record liquids production from the North Slope of Alaska for the third consecutive year. The Company generated net income of \$382 million, despite a significant reduction in crude oil prices.

ARCO Alaska operates the eastern half of the Prudhoe Bay field, the largest oil field in North America, and is the sole operator of the Kuparuk and Lisburne fields. These assets represent the foundation of ARCO's integrated West Coast operations and are among ARCO's most valuable resources for the future.

ARCO Alaska took steps in 1988 to improve its longer term reserve position and production outlook by reactivating an exploration drilling program and working with other Prudhoe

Bay Unit Owners to relieve gas handling capacity constraints in the field. These efforts were very successful. In the exploration program, ARCO Alaska identified a new oil accumulation in the Point McIntyre area near Prudhoe Bay. To address the gas handling issue, the Owners agreed to initiate a gas handling expansion program that will boost Prudhoe Bay field recovery and production.

Prudhoe Bay

Total liquids production was about level with 1987. Gross condensate production increased to 80,000 barrels per day from 64,000 barrels per day in 1987. The Central Gas Facility produced 52,500 gross barrels of natural gas liquids per day compared with 41,000 barrels per day in 1987. Gross crude

Alaska — Major Field Statistics at December 31, 1988

	Prudhoe Bay	Kuparuk	Lisburne
1988 Liquids production* - thousand barrels/day	Gross 1,581	302	43
	Net 321	147	15
Cumulative liquids production - millions of barrels	Gross 6,066	506	36
	Net 1,184	250	13
Cumulative field investment - billions of dollars	Gross \$14.7	\$ 3.7	\$ 1.1
	Net \$ 3.2	\$ 2.3	\$.4
Producing oil wells	Gross 711	333	53
	Net 155	187	21
Remaining proved liquids reserves - millions of barrels	Net 1,398	576	64

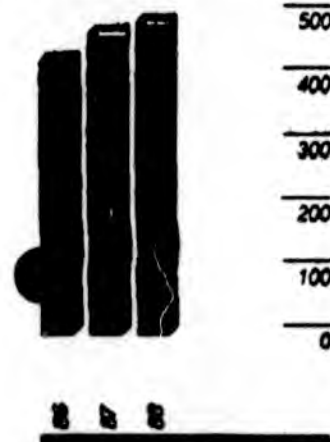
* Includes crude oil, condensate and natural gas liquids.

oil production averaged 1.45 million barrels per day in 1988, versus 1.50 million barrels per day in 1987. The decrease in crude production was due to natural field decline, facility downtime and transportation-related delays. ARCO Alaska has a 21.78 percent working interest in the oil produced at the Prudhoe Bay field and a 42.56 percent working interest in the condensate produced.

The agreement to proceed with a gas handling expansion project was an important decision in 1988. As Prudhoe Bay continues to mature, increasing amounts of gas are produced with every barrel of oil. In order to optimize oil production and increase reserves, the operation needs to increase gas handling capacity. The project, known as GHX-1, is scheduled for startup in late 1990 and will expand the field's gas handling capacity from about 3.7 billion cubic feet per day to 5.1 billion cubic feet per day and boost field production by approximately 90,000 gross barrels per day. Ultimate recovery over the life of the field will increase by some 400 million gross barrels. The project has an estimated total cost of \$400 million, of which ARCO's share is approximately \$88 million.

Alaska Liquids Production thousand barrels/day net

- Other Alaska
- Lisburne
- Kuparuk
- Prudhoe Bay



Prudhoe Bay Unit Owners are already studying the feasibility of a second gas handling expansion project (GHX-2) which could further increase gas handling capacity to approximately 7.5 billion cubic feet per day.

In addition, a total of 57 new development wells were drilled at Prudhoe Bay in 1988, and major efforts continued to optimize well productivity.

Initial development is also under way in two peripheral parts of the field. Production

from the Eileen West End area began as planned in mid-1988 and exceeded 36,000 gross barrels per day by year end. Production from the Hurl State area is slated to start up in late 1989.

Kuparuk

ARCO Alaska has a 56.3 percent working interest in the Kuparuk River field, located 30 miles west of Prudhoe Bay. Kuparuk averaged record crude oil production of 302,000 gross barrels per day in 1988, a 7 percent increase over 1987. ARCO's net production rose by about 18 percent over 1987, partially due to the production payback of 14,000 barrels a day from the Company to other Kuparuk owners which came to an end in the first quarter of 1988.

Some of the major operational factors contributing to the record production were the startup of a clarifier unit at the Seawater Treatment Plant, the drilling of an additional 36 development wells, the initiation of the third phase of immiscible water-alternating-gas injection and 47 well stimulations. Additional drilling at Kuparuk is expected to result in even higher crude oil production in 1989.

Waterflooding, a secondary recovery method, has been in full-field operation at Kuparuk since 1983. In 1988, the Company initiated another step in improving recovery from the Kuparuk field. This involves a small scale enhanced oil recovery project using miscible gas injectant. This process is already in use at Prudhoe Bay. It is envisioned that this enhanced recovery method could ultimately be expanded fieldwide at Kuparuk, enabling production to continue at or above current levels through the early to mid-1990s.

Lisburne

ARCO Alaska has a 40 percent working interest in Lisburne a complex carbonate reservoir underlying the Prudhoe Bay field. Gross liquids production from Lisburne was slightly below 1987 levels, due to expected declines in well productivity. The current outlook is for near-term production to remain at about 40,000 to 50,000 barrels per day.

Exploration

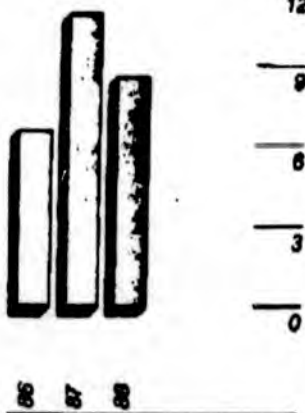
During 1988, ARCO Alaska completed two exploratory wells (one on the North Slope and one in the Cook Inlet) and participated in five major lease sales.

Another exploration well was drilled just outside the Prudhoe Bay participating area in the Point McIntyre area. Preliminary results of this well indicate the presence of a new oil accumulation. In order to evaluate the potential of this accumulation, three additional wells and a three-dimensional seismic program are planned in 1989.

In the lease sales, ARCO Alaska acquired more than 480,000 net exploratory acres at an average cost of about \$43 per acre. Of particular interest is acreage acquired in the Chukchi Sea, a large, high-risk, high-potential area located in the Arctic offshore. The Company is in the initial stages of a long-term exploration plan for this area and is preparing for a follow-up sale in 1991.

The Coastal Plain of the Arctic National Wildlife Refuge (ANWR) remained a focal point for ARCO Alaska in 1988. Congress is continuing to consider legislation that would allow oil and gas exploration and development in the ANWR Coastal Plain, which ARCO and others believe to be a very high-potential area for a significant discovery. ARCO Alaska will have an important strategic position in ANWR development if options which the Company previously negotiated with two Alaska Native Corporations are approved by Congress. During 1988, ARCO Alaska acquired several key tracts in shallow marine waters to the north and east of ANWR through state and federal lease sales. The Company participated in one well drilled in federal waters near ANWR in 1988 and is supporting another well that is currently being drilled.

Average Sales Price — Alaska Crude and Condensate
dollars/barrel



Reserves

In 1988, ARCO Alaska added proved liquids reserves totaling 106 million barrels, which only partially replaced production of 178 million barrels. Reserve additions came primarily from revisions associated with the ongoing development of Prudhoe Bay and Kuparuk. Gas reserve additions of 355 billion cubic feet were associated with projected fuel requirements for North Slope operations.

The startup of a small-scale enhanced recovery project in 1988 has important implications for the future production profile of the Kuparuk River field. Key figures in the project were (left to right) ARCO Alaska Engineers Mike Inghram, Tom Ma and Janet Wales.

West Sak

ARCO Alaska is continuing to move toward development of the West Sak reservoir, a large accumulation of relatively viscous oil overlying the Kuparuk River field. Although the area is not expected to be developed before the mid-1990s, the Company plans to initiate a small scale waterflood and an enhanced oil recovery pilot

project at West Sak in the early 1990s. The study of advanced technology in well completions and reservoir recovery processes is continuing and a test well will be drilled in 1989.

Cook Inlet

ARCO Alaska's 1988 net production from Cook Inlet amounted to 20 million cubic feet of natural gas and 4,800 barrels of oil per day. Production in 1989 is expected to be level with these results. The Company sold its 33 percent working interest in the Middle Ground Shoals field during 1988.

A year-by-year comparison of TAPS profit is shown in Table 9.

Table 9
Annual TAPS Profit
(millions of dollars)

1983 through 1987:

	1987	1986	1985	1984	1983
Revenue	\$2,765	\$3,080	\$3,578	\$3,926	\$3,899
Expenses:					
Depreciation	299	310	309	431	475
Operating and Administrative	255	343	247	387	483
Interest	150	440	411	570	579
Property Taxes	147	164	168	171	165
State Income Taxes	57	55	73	71	66
Federal Income Taxes	<u>631</u>	<u>0</u>	<u>984</u>	<u>610</u>	<u>674</u>
Profit	<u>\$1.226</u>	<u>\$1.768</u>	<u>\$1.386</u>	<u>\$1.686</u>	<u>\$1.457</u>
Profit per barrel:	<u>\$2.08</u>	<u>\$3.07</u>	<u>\$2.44</u>	<u>\$3.17</u>	<u>\$2.77</u>
MMBL	716,662	665,435	649,987		
\$/bbl	1.71	2.66	2.13		

1978 to 1982:

	1982	1981	1980	1979	1978
Revenue	\$3,896	\$3,605	\$3,554	\$2,963	\$2,394
Expenses:					
Depreciation	467	431	503	421	355
Operating and Administrative	498	474	435	330	381
Interest	648	681	720	771	846
Property Taxes	168	171	168	174	174
State Income Taxes	63	203	162	119	60
Federal Income Taxes	<u>802</u>	<u>599</u>	<u>617</u>	<u>129</u>	<u>8</u>
Profit	<u>\$1.250</u>	<u>\$1.046</u>	<u>\$ 949</u>	<u>\$1.019</u>	<u>\$ 570</u>
Profit per barrel:	<u>\$2.42</u>	<u>\$2.15</u>	<u>\$1.95</u>	<u>\$2.49</u>	<u>\$1.64</u>

ADDITIONAL BENEFITS OF ANS OIL

ANS producers receive profits from Alaska oil outside of Alaska which provides an additional bonus beyond what it would cost if they had to purchase imported oil. An additional profit of approximately \$0.7 billion went to the producers through the operation of the U.S. Department of Energy crude oil entitlements program. Producers are believed to earn additional profit through the refining of ANS crude because, among other things, they have access to a secure source of crude oil. If they did not have the ANS crude, it would be necessary for them to acquire crude from foreign sources.

Others estimate that profits on tanker operations and trans-Panama shipment activities added between \$.25 and \$1.00 profit per barrel of ANS crude produced. These additional profits would have been received on the nearly 6 billion barrels of ANS production. These added profits are not included in the \$42.6 billion of total oil industry profit in Alaska covered in this report.

INVESTMENTS MADE ON THE ALASKA NORTH SLOPE

Figure 9 shows the relative amounts of money invested in projects to produce ANS crude. The greatest investment was \$9.4 billion in TAPS. The total investment to date in Prudhoe Bay was \$8.7 billion. This includes the waterflood project and the miscible gas injection project as well as infield drilling. The investment in Kuparuk was \$4.3 billion which includes amounts for the newly installed waterflood project that had not been in operation during the period of this study. Milne Point cost \$575 million. Endicott and Lisburne each cost approximately one billion dollars. As of the end of 1987, Milne Point had been shut in, while Endicott and Lisburne had just begun operations too recently to have a significant impact on the revenue numbers reported here. The investments made in Cook Inlet during this period were not significant relative to the ANS investments during this period.

14.2
3.5

Figure 9
ANS Investments
(billions of dollars)

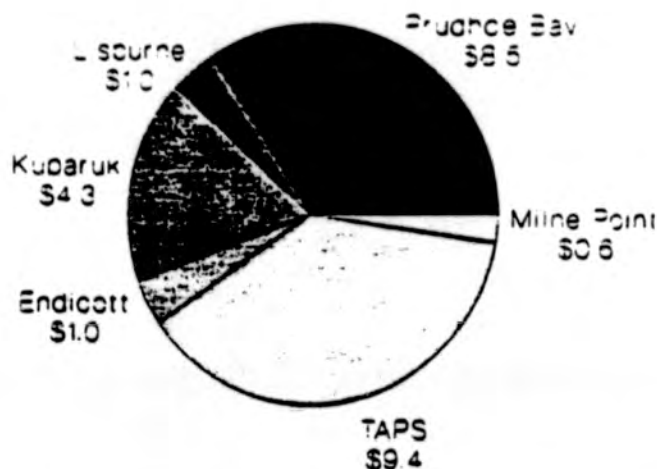


Table 10 shows the timing of the investments in Prudhoe Bay and other ANS projects together with an estimate of the timing of the investment in TAPS. These investment timings are based on information from the producers and may not be exact.

Table 10
ANS Investments
(millions of dollars)

Year	Project	Amount
1987	Prudhoe gas	\$ 720
1987	Kuparuk waterflood	900
1987	Endicott	1,000
1986	Lisburne	1,000
1985	Prudhoe gas plant	720
1984	Milne Point	570
1983	Prudhoe waterflood	2,000
1981	Kuparuk	3,400
1981	Prudhoe drilling	1,100
1980	Prudhoe drilling	250
1979	Prudhoe drilling	250
1977	Prudhoe*	1,850
1977	TAPS*	4,700
1976	Prudhoe*	1,850
1976	TAPS*	4,700
Total		\$ 25,015

1960 - 1988
45.7

*These amounts were spent over the period 1969 through 1977, with the majority of the funds spent later in the construction phase of the project.

ECONOMIC LIMIT FACTOR

G. N. NELSON TESTIMONY

Madam Chairman and Members of the Committee:

For the record, my name is George N. Nelson, and I am President of BP Exploration (Alaska) Inc.

In 1986, you knew us as Sohio Alaska Petroleum Company.

In 1987 and 88, you knew us as Standard Alaska Production Company.

And now in 1989, we are the same company with a new name. Now we're known as BP Exploration and I hope this will be the last name change, as I am sure you will agree. This is not what we think of as stability!

With me today is Tom Williams. Most of you already know him. I consider Tom to be the most knowledgeable person in the state on the subject of the ELF; he fathered it when he was Director of Petroleum Revenue.

You may be wondering why I'm here testifying when he knows more about the history of ELF and the formula. It's because this bill is about producing oil, and that's been my job for the past 30 years.

I started in the oil business in Venezuela in 1955. Back then, Venezuela was viewed a lot like Saudi Arabia is today -- its reserves seemed unlimited. But then a funny thing happened in 1957. The government increased taxes on the oil business retroactively to the tune of \$380 million. And there hasn't been another major oil field discovery since then.

I, like most others, moved on shortly after Venezuela's tax policy changed. I went to Libya, where I stayed from 1967 through 1975. Libya also has taken a high-tax, high-government-control approach. As a result, Libya's production hasn't met its potential, either.

Since 1975, I've worked on the Prudhoe Bay field. Our company has a 50% interest in Prudhoe, a 38% interest in Kuparuk, a 56% interest in Endicott and a 20% interest in Lisburne.

I mention this background because I think we can learn from the past. But we can't *live* in the past, and it appears to me after looking over the testimony in the House version of the most recent ELF bill that there's a dangerous emphasis on the past with no look to the future. Tom can answer your questions about what happened with ELF between 1977 and 1981, but I want to talk about the future.

How important are giant oil fields like Prudhoe Bay, and how much tax and royalty should they pay? Without Prudhoe, there would have been no \$10 billion investment in the Trans Alaska Pipeline. There would be no Kuparuk. No Endicott. No Lisburne.

Without a large, commercial field in ANWR, there will be no pipeline from ANWR to TAPS. Without the potential for a large commercial find in ANWR, there would be no incentive to spend hundreds of millions of dollars to explore there.

Over the next decade, the vast majority of the new oil reserves on the North Slope should come from Prudhoe Bay and Kuparuk. *Should* come from from Prudhoe Bay and Kuparuk. But it will only happen if there's a commercial incentive to fully develop these two giant oil fields.

Senate Bill 97 would accomplish exactly the opposite. We would pay a lower tax rate on Prudhoe production of 1.4 million barrels a day than on 1.5 million barrels a day. The bill is written to reward *less* production from large and small fields alike. The message: Don't invest money to boost recovery. Lower production will be rewarded with lower tax rates.

Is this really what you intended? I don't think so.

Prudhoe and Kuparuk have been characterized as extremely profitable oil fields that can -- and should -- pay as much tax now as they did when prices were twice what they are now. During the first half of the '80s, they *were* highly profitable. *And Alaska shared fully in that profit.* Between 1980 and 1986, the state collected nearly \$25 billion in taxes and royalties. That's more than \$7,000 per resident per year. Put another way, an Alaskan family of four had some \$200,000 in taxes and royalties paid on their behalf by the oil industry during this period.

But the heyday is over, and I, for one, don't think the state *or* the industry will see times like those again, at least not in this century.

Since 1986, our North Slope operations have been far less profitable. Based on our own experience, the oil industry's return on North Slope investment between 1986 and 1988 averaged about 10% a year. Compare that to the Alaska Permanent Fund, which, pursuing a conservative investment policy of avoiding risks, has generated a 12% average annual return over the same period.

During this three-year period, we've reported some \$540 million a year in after-tax profits from North Slope production. During the same period, we paid the State of Alaska and its municipalities some \$750 million a year in taxes and royalties on North Slope production. During the same period, we've reinvested 80% of our production profits in North Slope exploration and development -- an average of more than \$430 million a year.

When the state's oil and gas tax legislation was last overhauled in 1981, there was a consensus between the legislative leadership and the administration that the state's "fair share" of the oil wealth should never fall below 30%. This corresponded with roughly a third for the state, a third for the industry and a third for the federal government.

According to studies by the Alaska Department of Revenue, the state's share was always more than 30% between 1981 and June of 1987. We know, and administration statements confirm, that the state share is still above 30%.

Based on the state's current official price forecast of \$7.36 (wellhead value) for FY'89, the state is receiving almost *half* -- 49% -- of the wellhead value of oil after lifting costs and depreciation are taken out. The industry's share is roughly a third -- 34%. Even using the administration's numbers, which are based on a value at Valdez and include pipeline tariffs, the state's share is 36%.

Plenty of things besides oil prices have a significant impact on the profitability of Prudhoe and Kuparuk. Two of the most important are costs and the level of production.

Prudhoe has been producing oil for nearly 12 years now, and Kuparuk's been producing for more than seven. As you know, the North Slope has one of the harshest climates in the world. Because maintenance costs were higher than anticipated, our expenses surpassed our budget by some \$40 million last year alone. Now that our Prudhoe Bay facilities are operating at capacity, we can no longer make up for production lost due to maintenance, weather conditions or complications with tanker shipments. That means we're spreading higher costs over fewer barrels. Costs will continue to rise, and production will continue to decline.

So what exactly does this have to do with ELF? ELF takes into account the fact that oil production doesn't become marginal overnight. It's a gradual process, and that's how the ELF responds.

Prudhoe Bay currently pays about a 12% production tax. That's a very high rate -- far higher than the 4.9% rate in Texas and 7.1% in Oklahoma, but it's 3% lower than it was. Prudhoe was subject to the 10-year rounding rule until June of 1987. ELF links the payment of taxes to the ability to pay them, and that's good tax policy.

The ELF also contains an incentive to drill new wells and to maximize recovery from existing ones. This incentive will play a key role in slowing the decline in production at Prudhoe Bay and Kuparuk.

It's also creating private-sector jobs for Alaskans and millions of dollars in revenues for Alaskan contractors. Consider the example of our Hurl State development -- a small, marginal development within the huge Prudhoe Bay field.

Hurl State represents an investment of some \$80 million, and it will boost recovery at Prudhoe by 37 million barrels. That's 37 million barrels more for the state to tax and collect royalties.

Just as important, it means jobs for Alaskans. In all, Hurl State will create some 300 construction jobs over a two-year period. And we've already demonstrated our commitment to use Alaskan contractors to perform the work. We recently awarded some \$12 million in contracts to Alaskan firms to perform a portion of the work on Hurl State.

Union *and* non-union firms.

Anchorage *and* Fairbanks.

And there's more work to come -- drilling, installation and other projects.

We've also recently awarded a \$5 million contract to Doyon Drilling, a Native corporation joint venture, to design, build and operate a workover rig at Prudhoe Bay. Workover rigs are used to perform remedial work on older wells to increase recovery. Native firms play an important role in our development activities and in our day-to-day operations -- from catering to drilling, from materials handling to maintenance.

Senate Bill 97 would discourage projects like Hurl State and workovers. It encourages us not to drill. It encourages us not to maximize production. Under certain circumstances, adding production for new wells would increase taxes on all other production. Again, I do not believe that was your intention.

Over in the House, a lot of debate has centered on what the bill would do for small, marginal fields. Smaller North Slope fields should not be ignored, but there is no reason incentives for small fields have to be linked to major tax increases on large fields.

Our experience with Niakuk and Endicott -- two fields that would qualify as "small" and "marginal" under terms of Senate Bill 97 -- has been that permitting can be the biggest hurdle to development.

And I can't overemphasize the fact that the current ELF provides adequate relief from the high normal rate for small fields like Milne Point. Because of the current ELF, Milne Point paid no production tax for several months prior to its shutdown. NO production tax. I can't think of a bigger production tax incentive than paying no taxes at all.

What Milne Point did continue to pay was an effective royalty in excess of 18%. Senate Bill 97 doesn't provide any royalty relief.

Changes proposed in the ELF are not really designed to encourage development and production at small fields. They're intended to raise revenues to support state government spending.

And why does state government spending require so much support in Alaska? For one thing, the number of state employees is growing -- by 1,312 between November 1987 and November 1988, according to the administration's own numbers. And the state budget continues to grow.

Changing the ELF will harm the industry, and it will harm the state. It could force the industry to defer expenditures and investments. It would send a clear message to all potential private investors that this state is determined to tax at any rate necessary to maintain spending at 4-1/2 times the national per capita average.

We currently plan to spend \$2 billion to \$2.5 billion on North Slope development over the next five years. This five-year spending plan is expected to add 750 million barrels for BP alone to produce. And twice as much for the state to tax and collect royalty.

This committee, I'm sure, understands that most of our projects are close to the margin already. Cost increases could force us to forego some of them -- such as Hurl State.

Changing the ELF will also reinforce the industry's fears that every time the State of Alaska has a budget problem, we're going to get the bill for it.

\$30 oil is a thing of the past. It ended years ago. It's 1989 now, and we've got lower prices and higher costs. Soon we'll have less production as well.

But we've also got something else: a broader and stronger support industry, as our current minimodule fabrication and pipe insulation contract work in Fairbanks attests to.

There are many factors influence our decisions on whether to go forward with development projects.

We can't control the price of oil.

We can't control inflation.

We can't stop facilities from aging, and we can't stop reservoirs from declining.

But we *can* try to convince you not to increase our costs by imposing a new tax burden by changing the ELF formula, and that's why we're here. The ELF encourages development -- the kind that helps Alaska build a strong private sector to fuel its future.

TESTIMONY OF

D. E. CORNETT

FOR

EXXON COMPANY, U.S.A.

BEFORE THE

SENATE SPECIAL OIL AND GAS COMMITTEE

SB No. 97

MARCH 17, 1989

MY NAME IS DON CORNETT AND I AM ALASKA COORDINATOR FOR EXXON COMPANY, U.S.A. EXXON IS A WORKING INTEREST OWNER IN THE PRUDHOE BAY, KUPARUK, LISBURNE, AND ENDICOTT FIELDS. WE APPRECIATE THE OPPORTUNITY TO PRESENT OUR VIEWS ON SB 97 THIS MORNING.

SB 97 WOULD CAUSE A MAJOR CHANGE IN LONG-STANDING OIL PRODUCTION TAX POLICY IN ALASKA THAT COULD SERIOUSLY IMPACT CONTINUED DEVELOPMENT OF THE TWO LARGEST OIL FIELDS IN THE UNITED STATES, WITHOUT ADDING ANY MEANINGFUL OFFSETTING BENEFIT TO DEVELOPMENT OF OTHER SMALLER FIELDS IN ALASKA. IT WOULD DO THIS BY REVISING THE ECONOMIC LIMIT FACTOR ("ELF"), WHICH DETERMINES THE EFFECTIVE PRODUCTION TAX RATE, CHANGING THE CALCULATION FROM A WELL PRODUCTION RATE BASIS TO A FIELD PRODUCTION RATE BASIS. THIS WOULD RESULT IN IMMEDIATE INCREASES IN TAX RATE OF MORE THAN 20% AT PRUDHOE BAY AND ABOUT 40% AT KUPARUK. SB 97 DOES NOT CLOSE A "TAX LOOPHOLE"; IT DOES NOT CORRECT A "TAX GIVEAWAY". IT IS AN INCREASE IN THE PRODUCTION TAX RATE FOR MORE THAN 90% OF ALASKA'S OIL PRODUCTION. IT EFFECTIVELY ELIMINATES THE BENEFIT OF ELF, A PROVISION OF THE PRODUCTION TAX LAW THAT WAS DESIGNED BY A PREVIOUS LEGISLATURE TO REDUCE THE PRODUCTION TAX BURDEN ON A FIELD AS IT MATURES AND THE AVERAGE WELL RATE DROPS, A PROVISION THAT HAS BEEN AN ESSENTIAL PART OF ALASKA'S PRODUCTION TAX POLICY SINCE 1977.

LET'S LOOK AT THE HISTORY OF ELF. ELF WAS FIRST ADOPTED IN A MAJOR REVISION OF ALASKA'S PRODUCTION TAX LAWS IN 1977, AT THE TIME WHEN PRUDHOE BAY PRODUCTION BEGAN. PRIOR TO THAT TIME, THE MAXIMUM OIL TAX RATE WAS 8%. THE 1977 CHANGE IN THE LAW SIGNIFICANTLY INCREASED THE BASIC RATE TO 12.25%, BUT ALSO INCORPORATED THE ELF IN RECOGNITION THAT THE BASIC RATE SHOULD BE SCALED DOWN IN APPROPRIATE CASES. ELF RESULTED IN AN EFFECTIVE OIL TAX RATE FOR THE PRUDHOE BAY FIELD OF APPROXIMATELY 11.3% AS OF JUNE 1981.

IN JULY 1981, THE BASIC RATE WAS AGAIN INCREASED, FROM 12.25% TO 15%, AND THE ELF FACTOR WAS FIXED AT 1.0 FOR THE FIRST TEN YEARS OF PRODUCTION FROM THE PRUDHOE BAY FIELD. THIS SUSPENDED THE APPLICATION OF THE ELF FACTOR AT PRUDHOE BAY FOR SIX YEARS UNTIL THE SUMMER OF 1987, TEN YEARS AFTER PRUDHOE BAY PRODUCTION BEGAN. DURING THAT WHOLE TIME WE PAID PRODUCTION TAX AT A 15% RATE -- THE HIGHEST IN THE NATION. IN THE CASE OF THE PRUDHOE BAY FIELD TODAY, THE ELF FACTOR REDUCES THE BASIC TAX RATE OF 15% TO APPROXIMATELY 12.3%.

IN 1988, AVERAGE DAILY OIL PRODUCTION AT PRUDHOE BAY DECLINED TO 1.45MB FROM THE 1.50MB AVERAGE ACHIEVED IN PRIOR YEARS, AND WE ANTICIPATE THAT THIS DECLINE WILL CONTINUE. THIS IS A NORMAL PHYSICAL OCCURRENCE FOR AN

OIL FIELD, WHICH IS A DEPLETING NON-RENEWABLE DEPOSIT OF PETROLEUM. THE FACT OF DECLINE WAS INEVITABLE; THE OCCURRENCE, HOWEVER, WAS DELAYED SIGNIFICANTLY BY AN EFFICIENT AND OPTIMAL DEVELOPMENT PLAN IMPLEMENTED BY THE OWNERS. THAT DEVELOPMENT PLAN CONTINUES TO BE IMPLEMENTED AT PRUDHOE BAY TODAY, WITH FURTHER DEVELOPMENT DRILLING, EXPANDED GAS HANDLING FACILITIES, AND EXPANSION OF ENHANCED OIL RECOVERY ON THE DRAWING BOARD. THESE INVESTMENTS WILL INCREASE RECOVERABLE RESERVES AT PRUDHOE BAY AND WILL MAINTAIN HIGHER LEVELS OF PRODUCTION. THE TYPES OF PROJECTS THAT CONTRIBUTE TO THIS EFFORT ARE BOUNDED ONLY BY TECHNOLOGICAL INNOVATION AND ECONOMIC FEASIBILITY.

MANY FUTURE PROJECTS TO MAINTAIN PRODUCTION AND INCREASE RECOVERABLE RESERVES AT PRUDHOE BAY ARE MARGINAL INVESTMENTS, SIMILAR TO THE PROJECTS TO DEVELOP SMALLER FIELDS ON THE NORTH SLOPE. WHILE SB 97 MIGHT LOWER THE PRODUCTION TAX FOR SOME SMALLER FIELDS, IT WOULD DISCOURAGE MARGINAL PROJECTS AT PRUDHOE BAY. SUCH A TAX POLICY IS HARD TO UNDERSTAND, SINCE IT IS CONCEIVABLE THAT THE UNDEVELOPED MARGINAL RESERVES AT PRUDHOE BAY MIGHT EXCEED THE POTENTIAL RESERVES OF ALL THE SMALLER FIELD PROSPECTS IDENTIFIED TO DATE. THE RESULT WOULD BE LESS TOTAL OIL RECOVERY FROM PRUDHOE BAY AND CONSEQUENTLY LESS ROYALTY AND PRODUCTION TAXES FOR THE

STATE OF ALASKA AND FEWER JOBS FOR ALASKANS. THE ALASKA PERMANENT FUND WOULD SUFFER FROM THE LOWER ROYALTY PAYMENTS.

SINCE THE INITIAL DEVELOPMENT, EXXON HAS EVALUATED AND SUPPORTED SEVERAL PROJECTS TO INCREASE RECOVERY AT PRUDHOE BAY. THESE PROJECTS HAVE INCLUDED WELLS ON CLOSER SPACING, ENLARGEMENT OF FLUID HANDLING FACILITIES, ARTIFICIAL LIFT, AND WATER INJECTION. THE COST PER BARREL FOR THESE PROJECTS TO INCREASE RECOVERY WAS TWICE THE COST OF THE INITIAL DEVELOPMENT.

THIS TREND TOWARD LESS PROFITABLE PROJECTS WILL CONTINUE. FUTURE PROJECTS WHICH ARE BEING PLANNED INCLUDE WELLS ON EVEN CLOSER SPACING AND IN THINNER OIL COLUMNS, ADDITIONAL ENHANCED OIL RECOVERY, DEVELOPMENT OF SMALLER RESERVOIRS, AND NEW IDEAS SUCH AS HORIZONTAL DRILLING. THE COST PER BARREL FOR THESE PROJECTS WILL BE MORE THAN FIVE TIMES AS MUCH AS THE INITIAL DEVELOPMENT. IN THE FUTURE, OTHER MARGINAL PROJECTS WILL BE DEFINED AS RESEARCH CONTINUES.

JUST HOW MANY OF THESE MARGINAL PROJECTS WILL BE JUSTIFIED AT PRUDHOE BAY? HOW MANY OF THE MORE THAN 10 BILLION BARRELS TO BE LEFT AFTER CURRENT DEVELOPMENT IS COMPLETED CAN BE RECOVERED? NO ONE KNOWS FOR CERTAIN

BECAUSE THE ECONOMICS ARE MARGINAL AND A NUMBER OF FACTORS WILL HAVE AN IMPACT ON THE LIMIT TO WHICH SUCH PROJECTS CAN BE JUSTIFIED.

BUT ONE THING IS CERTAIN, SB 97 WOULD PLACE FUTURE MARGINAL PROJECTS AT PRUDHOE BAY IN JEOPARDY. THE PRODUCTION TAX INCREASE PROPOSED BY SB 97 SIGNIFICANTLY REDUCES THE INCENTIVE TO PRODUCE THESE MARGINAL BARRELS.

IT IS AN ECONOMIC FACT OF LIFE THAT COMPANIES LIKE EXXON ENDEAVOR TO COMMIT THEIR CAPITAL AND RESOURCES ONLY TO PRUDENT INVESTMENTS THAT PROVIDE THEIR SHAREHOLDERS WITH A REASONABLE RETURN. THEY ARE MOST SELECTIVE IN THIS PROCESS. TWO DECADES AGO THE QUALITY OF NORTH SLOPE INVESTMENT OPPORTUNITIES CAUSED EXXON TO COMMIT BILLIONS OF DOLLARS IN THE INITIAL DEVELOPMENT OF PRUDHOE BAY AND CONSTRUCTION OF TAPS. AS A RESULT, PETROLEUM DEVELOPMENT IN ALASKA HAS ACCOUNTED FOR ABOUT 85% OF STATE REVENUES DURING THE PAST 12 YEARS AND IN ADDITION HAS ESTABLISHED THE NEARLY \$10 BILLION ALASKA PERMANENT FUND.

MAJOR DEVELOPMENT PROJECTS AT PRUDHOE BAY REQUIRE THE APPROVAL OF ALL THREE OF THE MAJOR OWNERS. EACH OF THE PRUDHOE BAY OWNERS EVALUATES THE ECONOMICS OF A NEW PROPOSED INVESTMENT BASED ON THE NEEDS OF ITS COMPANY, UNDER CRITERIA ESTABLISHED BY ITS MANAGEMENT. EXXON IS NOT PRIVY TO THE

DECISION-MAKING PROCESS AT ARCO OR BP, SINCE OUR COMPANIES ARE IN KEEN COMPETITION, AND I CANNOT COMMENT ON THEIR PROCEDURES. I CAN HOWEVER TELL YOU SOMETHING ABOUT HOW EXXON EVALUATES FUTURE DEVELOPMENT PROJECTS AT PRUDHOE BAY. THIS PROCESS INCLUDES THE EVALUATION OF VARIOUS TYPES OF RISK - GEOLOGIC RISK, RESERVOIR RISK, DRILLING RISK, AND POLITICAL/ECONOMIC RISK INCLUDING CRUDE OIL PRICES AND TAXES. THE INTRODUCTION OF SB 97 ADDS TO THE OVERALL RISK BY AFFECTING OUR PERCEPTION OF FUTURE TAX STABILITY IN ALASKA. UNDER SB 97, THE EFFECTIVE PRODUCTION TAX RATE AT PRUDHOE BAY DURING THE MID-1990'S IS PROJECTED TO BE ABOUT DOUBLE THAT UNDER CURRENT LAW.

EXXON OBVIOUSLY HAS GREAT INTEREST IN OPTIMIZING RECOVERY OF OIL AT PRUDHOE BAY IN VIEW OF THE ENORMOUS INVESTMENTS IT HAS MADE TO DATE. HOWEVER, FUTURE DEVELOPMENT PROJECTS MUST STAND ON THEIR OWN FEET AND THE METHODOLOGY FOR EVALUATING THE QUALITY OF THESE PROJECTS TODAY IS THE SAME AS THAT APPLIED AT THE TIME THE INITIAL INVESTMENT WAS MADE. THEY ARE EVALUATED PRIMARILY ON THE BASIS OF RETURN ON THE FUNDS INVESTED. WE DO A DISCOUNTED CASH FLOW ANALYSIS WHICH OFFSETS ALL PROJECT EXPENDITURES REQUIRED AGAINST ADDITIONAL REVENUES PROJECTED, BASED ON THE ADDITIONAL OIL RECOVERY OUR ENGINEERS PREDICT AND THE PRICE WE ANTICIPATE THAT OIL

WILL BRING IN THE MARKET WHEN PRODUCED. IF THE ECONOMICS ARE ATTRACTIVE, THE PROJECT WILL BE APPROVED; IF NOT, THE PROJECT WILL LIKELY NOT PROCEED.

THERE ARE TWO ELEMENTS OF THIS FORMULA OVER WHICH EXXON HAS LITTLE CONTROL - CRUDE OIL PRICE FORECAST AND ALASKA TAXATION. WITH RESPECT TO CRUDE OIL PRICES, WE TRY TO FORECAST AS ACCURATELY AS POSSIBLE BASED ON ECONOMIC, POLITICAL, AND GEOLOGICAL INTELLIGENCE FROM AROUND THE WORLD. THIS HAS BEEN A LESS THAN PRECISE SCIENCE IN RECENT YEARS. THE VAGARIES OF THE WORLD PETROLEUM MARKETS ARE SURELY ONE OF THE REASONS WE ARE HERE TODAY TALKING ABOUT THIS PRODUCTION TAX INCREASE. WITH RESPECT TO ALASKA TAXATION, WE ASSUME A STABLE TAX POLICY BASED ON FAIRNESS AND UNIFORM ADMINISTRATION.

STATE TAX LIABILITY IS A CRITICAL FACTOR IN APPLYING THE ECONOMIC EVALUATION FORMULA I HAVE DESCRIBED. PRODUCTION TAXES ARE ESPECIALLY SIGNIFICANT SINCE THEY ARE BASED ON GROSS VALUE OF OIL PRODUCED IRRESPECTIVE OF THE PROFITABILITY OF THE PRODUCER. SB 97 SEEMS TO BE BASED ON THE PREMISE THAT PRODUCTION TAXES ARE, IN EFFECT, TAXES ON THE OIL FIELD, NOT ON THE OIL COMPANY, AND THAT LARGER OIL FIELDS SHOULD CONTRIBUTE AT A HIGHER RATE THAN SMALLER FIELDS. BUT, AS YOU KNOW OIL FIELDS DON'T PAY TAXES; OIL COMPANIES PAY TAXES. OIL COMPANIES, LIKE ALL

OTHER COMMERCIAL ENTERPRISES, REQUIRE PROFITS TO STAY IN BUSINESS. WHEN TAXES ARE INCREASED SO AS TO CUT TOO DEEPLY INTO THAT PROFIT, INVESTMENT ACTIVITY WILL INEVITABLY BE TRIMMED BACK.

TAX POLICY MAKERS SHOULD NOT CONFUSE THE PRODUCTION RATE OF A FIELD WITH ITS PROFITABILITY. SB 97 IMPOSES A HIGHER PRODUCTION TAX RATE ON LARGER FIELDS. THE AVERAGE PRODUCTION RATE PER WELL AT PRUDHOE BAY DURING THE MID-1990'S IS PROJECTED TO BE THE SAME AS AT LISBURN TODAY. HOWEVER, SB 97 WOULD IMPOSE AN EFFECTIVE PRODUCTION TAX RATE ON PRUDHOE BAY AT THAT POINT IN TIME WHICH WOULD BE MORE THAN THREE TIMES HIGHER THAN ON LISBURN TODAY. THIS DOESN'T MAKE SENSE.

PROJECTS UNDER CONSIDERATION TODAY TO INCREASE RECOVERABLE RESERVES AT PRUDHOE BAY REPRESENT STATE-OF-THE ART TECHNOLOGY, WITH COST PER BARREL SEVERAL TIMES HIGHER THAN THE INITIAL DEVELOPMENT PROJECTS AT PRUDHOE BAY. THE REDUCTION IN CRUDE OIL PRICES OVER THE LAST FEW YEARS HAS ALREADY CUT THE GO-AHEAD MARGIN SHORT. AN INCREASE IN PRODUCTION TAX AT THIS TIME WOULD ONLY FURTHER COMPOUND THE PROBLEM.

IT IS ESTIMATED THAT OVER 10 BILLION BARRELS OF OIL WILL BE LEFT IN THE PRUDHOE BAY RESERVOIR AFTER CURRENTLY PLANNED DEVELOPMENT HAS BEEN

COMPLETED. TO OBTAIN THE MAXIMUM RECOVERY, MORE AND MORE marginally PROFITABLE PROJECTS MUST BE IMPLEMENTED. FUTURE PROJECTS MAY INCLUDE:

DRILLING ON CLOSER SPACING,
DRILLING IN THINNER OIL COLUMNS,
EXPANDING ENHANCED OIL RECOVERY PROJECTS,
DEVELOPING SMALLER RESERVOIRS, AND
EXPANDING WORKOVER PROGRAMS.

IMPLEMENTING SUCH MARGINAL PROJECTS WILL ALLOW FOR PARTIAL RECOVERY OF THIS 10 BILLION BARRELS. HOW MUCH ADDITIONAL RECOVERY WE MAY EXPECT IS UNCERTAIN. HOWEVER, THESE PROJECTS HAVE TO BE JUSTIFIED BASED ON A SIMILAR RISK ASSESSMENT APPLIED TO EARLIER PRUDHOE BAY PROJECTS. THIS INCLUDES THE RISK OF A CHANGE IN THE TAX STRUCTURE.

WHILE THE CURRENT PRODUCTION TAX RATE IS HIGH COMPARED WITH OTHER STATES, IT HAS REPRESENTED A RELATIVELY STABLE PRODUCTION TAX POLICY, WHICH HAS ENCOURAGED ENORMOUS INVESTMENT. TO ELIMINATE ELF NOW, AT THE HISTORICAL TIME WHEN IT WAS INTENDED TO HAVE ITS IMPACT AND BENEFIT, WOULD BE A DEPARTURE FROM THIS STABLE TAX POLICY AND WOULD SEND A CLEAR MESSAGE TO OIL COMPANIES, AND OTHER INVESTORS, THAT STABILITY AND FAIRNESS ARE NOT

NECESSARILY CHARACTERISTICS OF ALASKA'S TAX POLICY. PLEASE CONSIDER THE LONG TERM IMPACT CAREFULLY BEFORE YOU SEND THAT MESSAGE. ELIMINATION OF ELF WILL MEAN THAT INVESTMENT DOLLARS AND JOBS SLATED FOR MARGINAL NORTH SLOPE PROJECTS ARE MORE LIKELY OVER THE LONG TERM TO GO TO LOWER RISK PROJECTS ELSEWHERE.

EXXON HAS TWO FINAL COMMENTS, ON SECTION 2 AND SECTION 4 OF SB 97.

SECTION 2 OF SB 97 WOULD REPEAL THE PROCEEDING UNDER CURRENT LAW WHEREBY A TAXPAYER CAN REBUT THE STATUTORY PRESUMPTION OF 300 BARRELS PER DAY AS PRODUCTION AT THE ECONOMIC LIMIT. THE TAXPAYER CAN DO THIS UNDER CURRENT LAW BY INTRODUCING EVIDENCE ON THE ECONOMICS OF THE PARTICULAR FIELD. SB 97 WOULD ARBITRARILY FIX THIS RATE AT 300 BARRELS PER DAY FOR ALL FIELDS. THE PROVISION IN CURRENT LAW WAS DESIGNED TO PROVIDE TAX RELIEF FOR MARGINAL FIELDS SO THAT THE PRODUCTION TAX BURDEN WOULD NOT BE A FACTOR IN SHUTTING DOWN THE FIELD. IT WORKS! THE OWNERS OF THE MILNE POINT FIELD APPLIED FOR RELIEF BEFORE THE DEPARTMENT OF REVENUE UNDER THIS PROVISION SUCCESSFULLY IN 1986. IN VIEW OF THE ADMINISTRATION'S DESIRE TO ENCOURAGE DEVELOPMENT OF MARGINAL FIELDS, IT MAKES NO SENSE TO REPEAL THIS PROVISION.

SECTION 4 OF SB 97 WOULD MAKE THE PROPOSED TAX INCREASES RETROACTIVE TO JANUARY 1, 1989. IN THE EVENT THAT SB 97 WERE TO BECOME LAW, IT WOULD BE UNDULY HARSH TO GIVE ITS TAX INCREASES ANY RETROACTIVE EFFECT. SB 97 WOULD EFFECT A MAJOR CHANGE IN ALASKA'S PRODUCTION TAX POLICY. TO APPLY SUCH A CHANGE TO OIL ALREADY PRODUCED, TRANSPORTED, AND MARKETING WOULD BE FUNDAMENTALLY UNFAIR. THE INDUSTRY'S PERCEPTION OF INSTABILITY IN ALASKA'S TAX POLICY WHICH WOULD RESULT FROM PASSAGE OF SB 97 WOULD ONLY BE COMPOUNDED BY RETROACTIVE APPLICATION. FURTHERMORE, RETROACTIVE APPLICATION WOULD RAISE SERIOUS CONSTITUTIONAL ISSUES.

TO SUMMARIZE, EXXON URGES YOU NOT TO SUPPORT SB 97. IT COULD HAVE A PROFOUND EFFECT ON FUTURE DEVELOPMENT INVESTMENT AT PRUDHOE BAY, COMPOUNDING THE ALREADY SERIOUS SITUATION BROUGHT ABOUT BY LOWER CRUDE PRICES. ANY BENEFITS TO ALASKA FROM MARGINAL FIELD DEVELOPMENT PROVIDED BY SB 97 WOULD BE MORE THAN OFFSET BY THE IMPACT ON ROYALTY AND TAX COLLECTIONS FROM MARGINAL PROJECTS AT PRUDHOE BAY AND KUPARUK. TO PASS SB 97 INTO LAW WOULD BE ILL-ADVISED AND SHORT-SIGHTED. CONTINUED STABILITY IN PRODUCTION TAX POLICY WILL STRIKE THE BEST BALANCE BETWEEN FUTURE DEVELOPMENT AND STATE REVENUE COLLECTION. ABOVE ALL, ALASKA MUST REMAIN COMPETITIVE IN THE QUEST FOR FUTURE INVESTMENT DOLLARS.

THANK YOU, THIS CONCLUDES MY TESTIMONY.

TABLE OF CONTENTS

Senate Bill 97

Fiscal Note

Sectional Analysis

The ELF A Policy Perspective-Prepared by OMB 4/88

SB 97--Department of Revenue Presentation

SB 97--OMB Briefing Materials

Resolutions from Communities and Other Interested Groups

1 IN THE SENATE

BY ADAMS

2

SENATE BILL NO. 97

3

IN THE LEGISLATURE OF THE STATE OF ALASKA

4

SIXTEENTH LEGISLATURE - FIRST SESSION

5

A BILL

6

For an Act entitled: "An Act relating to the oil and gas properties pro-
duction tax; and providing for an effective date."

7

8

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

9

* Section 1. AS 43.55.013(b) is repealed and reenacted to read:

10

(b) The economic limit factor for oil production of a lease or

11

property shall be computed according to the following formula:

12

$$(1 - [PEL/TP]) \exp ([55,000,000 \times WD] / [PEL \times TP/Days])$$

13

where: PEL = the monthly production rate at the economic limit;

14

TP = the total production during the month for which the tax
is to be paid;

15

16

WD = the total number of well days in the month for which
the tax is to be paid;

17

18

Days = the number of days in the month for which the tax is to
be paid; and

19

20

where "exp" indicates that the expression following it is an exponent.

21

* Sec. 2. AS 43.55.013(d) is amended to read:

22

(d) The monthly production rate at the economic limit for a

23

lease or property is [PRESUMED TO BE] 300 barrels times the number of

24

well days for the lease or property during the month for which the tax

25

is to be paid. [THE TAXPAYER MAY REBUT THIS PRESUMPTION AT A FORMAL

26

HEARING UNDER AS 43.05.240 BY PROVIDING CLEAR AND CONVINCING EVIDENCE

27

OF A DIFFERENT MONTHLY PRODUCTION RATE AT THE ECONOMIC LIMIT FOR THE

28

LEASE OR PROPERTY. THE HEARING SHALL BE HELD BEFORE FEBRUARY 15 OF

29

THE YEAR OR WITHIN SIX MONTHS AFTER COMMENCEMENT OF OIL PRODUCTION FOR

1 A LEASE OR PROPERTY. THE MONTHLY PRODUCTION RATE AT THE ECONOMIC
2 LIMIT FOR THE LEASE OR PROPERTY BASED UPON THE CLEAR AND CONVINCING
3 EVIDENCE OF THE TAXPAYER SHALL BE CALCULATED BY DIVIDING THE VALUE
4 DETERMINED UNDER (f) OF THIS SECTION INTO THE AVERAGE MONTHLY DIRECT
5 OPERATING COST DETERMINED UNDER (e) OF THIS SECTION AND SHALL BE USED
6 FOR PURPOSES OF THIS SECTION FOR ALL OIL PRODUCTION DURING THAT CALEN-
7 DAR YEAR FROM THE LEASE OR PROPERTY.]

8 * Sec. 3. AS 43.55.013(e) and (f) are repealed.

9 * Sec. 4. This Act is retroactive to January 1, 1989, and applies to
10 oil produced after December 31, 1988.

11 * Sec. 5. This Act takes effect immediately under AS 01.10.070(c).

STATE OF ALASKA
1989 LEGISLATIVE SESSION

Bill Version: SB 97

Publish Date: _____

FISCAL NOTE

REQUEST:

Revision Date: _____

Title: Act relating to the oil and gas
properties production tax

Sponsor: _____

Requestor: _____

Agency Affected: Department of Revenue

BRU: Oil & Gas Audit Division

Components: _____

EXPENDITURES/REVENUES: (Thousands of Dollars)

	FY 89	FY 90	FY 91	FY 92	FY 93	FY 94
OPERATING						
PERSONAL SERVICES	0	0	0	0	0	0
TRAVEL	0	0	0	0	0	0
CONTRACTUAL	0	0	0	0	0	0
SUPPLIES	0	0	0	0	0	0
EQUIPMENT	0	0	0	0	0	0
LANDS & STRUCTURES	0	0	0	0	0	0
GRANTS, CLAIMS	0	0	0	0	0	0
MISCELLANEOUS	0	0	0	0	0	0
TOTAL OPERATING	0	0	0	0	0	0
CAPITAL	0	0	0	0	0	0
REVENUE	43,000	111,000	126,000	141,000	164,000	155,000

FUNDING: (Thousands of Dollars)

GENERAL FUND	0	0	0	0	0	0
FEDERAL FUNDS	0	0	0	0	0	0
OTHER	0	0	0	0	0	0
TOTAL	0	0	0	0	0	0

POSITIONS:

FULL-TIME	0	0	0	0	0	0
PART-TIME	0	0	0	0	0	0
TEMPORARY	0	0	0	0	0	0

ANALYSIS: See attached analysis.

Prepared By: Roger Marks

Division: Dept. of Revenue, Oil & Gas Audit Division

Phone: 277-5627

Date: February 10, 1989

Approved by Commissioner: Hugh Malone

Agency: Department of Revenue

Date: 2/15/89

Distribution (by preparer):

Legislative Finance

Legislative Sponsor

Requestor

Office of Management and Budget

Impacted Agency(ies)

Fiscal Analysis of SB 97

This bill modifies the economic limit factor (ELF) formula used in computing the production (severance) tax on oil.

The bill (1) introduces the rate of field production into the exponent of the current ELF formula; (2) repeals the so-called "rounding rule," the provision of current law which states that for any month during the first 10 years of commercial oil production for which the computed ELF of a lease or property exceeds 0.7 the ELF shall be considered to be one; and (3) fixes the production at the economic limit (PEL) at 300 barrels times the number of well days in the month.

Since the bill carries an effective date of January 1, 1989, this analysis has assumed that the bill will apply to oil produced after December 31, 1988. (Because the severance tax on oil for a given month is due during the following month, a tax change which takes effect on January 1 would not affect revenues until February.)

This fiscal note was calculated using the oil price and production assumptions of the Department of Revenue's Fall 1988 Petroleum Production Revenue Forecast mid-case scenario updated for actual data through November of 1988. ^{1/}

Additional revenues for future years in millions of dollars are as follows:

1995	148
1996	141
1997	133
1998	119
1999	115
2000	107
2001	101
2002	94
2003	85
2004	77
2005	72
2006	61
2007	52
2008	37
2009	26
2010	9

^{1/} Had the fiscal note used the oil price and volume assumptions of the "Consensus Revenue Analysis" of January 24, 1989, the FY 89 fiscal impact would be \$49 million and the FY 90 fiscal impact would be \$117 million.

Size of Field Where Taxes Will Increase or Decrease Under SB 97

SB 97 modifies the ELF statute in two ways which affect the relationship of field size to the tax rate for the field: (1) by modifying the formula; and (2) by repealing the "rounding rule." (Under current law if a field has an ELF of greater than 0.7 for the first ten years of the field, the ELF is elevated to 1.0. This is called the "rounding rule.") The combined effect of these two changes will increase the severance tax on fields producing an average of more than approximately 300,000 barrels per day, and will reduce the severance tax on fields producing an average of less than approximately 300,000 barrels per day. An analysis of these two changes and the underlying assumptions follows.

The change in the formula would raise taxes on fields which produce more than approximately 120,000 barrels per day and for which the rounding rule does not apply. (Only Prudhoe Bay and Kuparuk fit this description. The rounding rule does not apply to them now because Prudhoe Bay is older than ten years, and Kuparuk's current ELF is less than 0.7.) The Bill would cut taxes -- or leave them at zero -- for any field producing less than approximately 120,000 barrels per day. If a field produces an average of less than 300 barrels per well per day, their taxes are zero under current law and the new Bill.

The Bill also initially decreases the ELF for new higher-productivity (where average well productivity is greater than 1500 barrels per day) large fields (over the 120,000 barrel per day level). Under current law, fields producing more than an average of 1500 barrels per well per day will have an ELF of greater than 0.7, and would have an initial effective ELF of 1.0 because of the rounding rule. Since the first ten years of the field is when the greatest proportion of oil is produced (upwards of 75 percent), these large fields could have reduced weighted average severance taxes over the entire life of the field under the Bill since it eliminates the rounding rule. The exact size of field that will benefit over the entire life of the field will depend on its well productivity, decline profile, and the discount rate. We estimate that a field with the same well productivity and decline characteristics as Endicott, for example, (which produces 100,000 barrels per day and produces 2800 barrels per well per day average), but with peak production of 1,000,000 barrels per day, would have the same discounted (8%) weighted average effective ELF over the life of the field under the Bill as it would under current law. Fields producing less than that amount would have a lower ELF than under current law.

A weighted average of all field sizes and average per well productivities from all Alaska fields indicates that on average fields which produce less than approximately 300,000 barrels per day will have a reduced severance tax under SB 97.

SECTIONAL ANALYSIS OF SB 97: LEGISLATION REVISING

THE ECONOMIC LIMIT FACTOR

Section 1. This section modifies the severance tax's Economic Limit Factor (ELF) as it relates to oil production.

Under current law and under this section, the ELF statute reduces the effective severance tax rate on oil production by applying a formula which considers productivity. The ELF formula always produces a fraction between zero and one. That fraction is multiplied with the nominal tax rate to get the effective tax rate. This means that the higher the ELF, the higher the actual tax paid; the lower the ELF, the lower the actual tax paid. This also means that if the ELF is zero, the severance tax rate is zero.

This section changes the ELF statute in two ways.

First, this section modifies the formula for calculating the "economic limit" of oil production. The current law considers only average per-well productivity of the field. The formula here adds consideration of total field productivity to the current ELF formula. Second, this section repeals the provision of current law which states

that for any month during the first 10 years of commercial oil production for which a lease or property's computed ELF exceeds 0.7, the ELF shall be considered to be one. This section's repeal of this "rounding" rule of current law would result in initial lower taxes for any field in this situation.

Compared to current law, these two changes raise taxes on fields producing on average more than 300,000 barrels a day and reduce taxes on fields producing on average less than 300,000 barrels a day.

Section 2. This section fixes the monthly production at the economic limit (PEL) at 300 barrels per well per day. The PEL is a rough approximation of the number of barrels a well must produce to cover costs.

Under current law, the PEL is presumed to be 300 barrels a day, and the taxpayer may rebut this presumption at a hearing. This section repeals the provisions for rebutting the 300 barrel per day presumption.

Section 3. This section repeals two provisions of current law which are only necessary for setting a PEL in a hearing.

Section 4. This section makes the legislation apply to oil produced after December 31, 1988.

Section 5. This section sets an immediate effective date.

The ELF

A Policy Perspective

April 1988

**Division of Policy
Office of the Governor**

TABLE OF CONTENTS

	<u>Page</u>
Preface	1
Executive Summary	3
Introduction	6
Background	7
The ELF Formula: Well Productivity & Field Productivity	8
ELF Subsidy Effect	11
ELF And Jobs	13
Profitability	16
Production	19
Comparing Taxes	21
The "Commitment"	23
Revenue Effects	24
Budget Stability and the Economy	26
Appendices:	
A - Fiscal Note	
B - Profitability Analysis from <i>Petroleum Intelligence Weekly</i>	
C - Explanation of 1981 Oil Tax Changes	
D - 1987 ARCO handout and Division of Policy analysis	

will provide a more reliable incentive for marginal field development — the ELF's original purpose — by lowering tax rates on Alaska's smaller fields, such as Milne Point, Endicott, and Lisburne.

This paper attempts to fully discuss the reasons behind our perspective. We have tried to include all the relevant facts. We also have tried to avoid unnecessary complication. If others have additional information and perspectives, we welcome hearing from them.

Mary Halloran
Director, Division of Policy
Office of the Governor

CORRECTION

**THIS DOCUMENT
HAS BEEN REPHOTOGRAPHED
TO ASSURE LEGIBILITY**

TABLE OF CONTENTS

	<u>Page</u>
Preface	1
Executive Summary	3
Introduction	6
Background	7
The ELF Formula: Well Productivity & Field Productivity	8
ELF Subsidy Effect	11
ELF And Jobs	13
Profitability	16
Production	19
Comparing Taxes	21
The "Commitment"	23
Revenue Effects	24
Budget Stability and the Economy	26
Appendices:	
A - Fiscal Note	
B - Profitability Analysis from <i>Petroleum Intelligence Weekly</i>	
C - Explanation of 1981 Oil Tax Changes	
D - 1987 ARCO handout and Division of Policy analysis	

Preface

Since statehood, oil taxes have been a continuing and difficult policy issue for Alaskans. The current debate centers on the state severance tax and the economic limit factor or "ELF." Put simply, the ELF is a tax reduction formula meant to encourage marginal oil field development. The Governor proposed ELF legislation last year, and a bill to make a change in the ELF formula passed the House.¹ The oil companies, with one notable exception, oppose the change, and the bill has now stalled in the state Senate, where the leaders have said they oppose allowing the bill to come to a vote.

In the Alaska legislature oil tax issues have traditionally received intense scrutiny. Each side has had the opportunity to challenge the assertions of the other, bring its experts forward, and present its case. This process has not been perfect, but the legislators and the public have been able to get the facts to make informed decisions. Nothing will substitute for the give and take of a public hearing, but in the face of the Senate's refusal to allow this major policy issue the open debate it deserves, the state administration has a responsibility to make its perspective known.

We believe passage of the new ELF will help stabilize the Alaska economy at a time when it needs the reassurance of stable state spending. More stable revenues from the new ELF will help guarantee that local governments receive the money they need for roads, public safety and other services, and explains why the Alaska Conference of Mayors, among others, supports the ELF bill. Most importantly, passage of the new ELF

¹ House Finance Committee Substitute for House Bill 164, amended [CSHB 164 (Fin.) am].

will provide a more reliable incentive for marginal field development — the ELF's original purpose — by lowering tax rates on Alaska's smaller fields, such as Milne Point, Endicott, and Lisburne.

This paper attempts to fully discuss the reasons behind our perspective. We have tried to include all the relevant facts. We also have tried to avoid unnecessary complication. If others have additional information and perspectives, we welcome hearing from them.

Mary Halloran

Director, Division of Policy

Office of the Governor

Executive Summary

- The immediate revenue loss from the current ELF is about 8 percent of Alaska's oil revenues, or about \$150 million this year. This percentage loss will increase over the next six years to about 14 percent and will erode Alaska's fiscal strength.
- The 1987 application of the ELF to Prudhoe Bay was adopted within 72 hours in the closing days of the 1981 legislative session. Legislators and the Governor were assured the tax changes were revenue neutral — incorrectly as it turned out. In fact, the revenue loss has been over \$1 billion from FY82-FY87.
- Neither the Railbelt Energy Fund nor the Permanent Fund earnings reserve provides a long-term response to the on-going loss of 8 percent to 14 percent of Alaska's oil revenues and the erosion of Alaska's fiscal strength. The new ELF does.
- Prudhoe Bay and Kuparuk are extraordinarily profitable oil fields. Industry journals indicate oil companies make \$6.2 million per day in profits from North Slope operations. Currently, the oil industry is taking \$8 Outside for every \$2 it reinvests in Alaska. Without their Alaska holdings, neither ARCO nor Standard would be as strongly positioned against their industry competitors as they are today.

- The oil industry has one of the poorest resident hire records in the state, with major drilling, exploration and service companies employing about 28 percent non-residents.
- The written record of the 1981 legislative deliberations on oil taxes provides no evidence of any legal, moral, or political commitment by state officials regarding any limit on the state's appropriate share of future oil income. In fact, the legislature and the governor explicitly recognized that today's legislature would have to grapple with the revenue problems caused by the reimposition of the ELF.
- At Prudhoe Bay, at a profit of \$3 per barrel, wells that average over 2,000 barrels per day — more than 100 times greater than the national average of 14 barrels per day — are receiving the benefit of an ELF reduction designed for fields whose economics are marginal.
- The new ELF's consideration of total field productivity, as well as per-well productivity, provides a better incentive for marginal field development than the current ELF and better reflects field profitability.
- By adding **total** field productivity to the ELF calculation, most Alaska fields will receive a larger tax break under the new ELF than under the current ELF. Only the two giant fields, Prudhoe Bay and Kuparuk, will not receive increased tax breaks. Fields with Alaska corporation ownership, such as Endicott, will benefit more under the new ELF than the current ELF.

- The current ELF provides a substantial state subsidy to oil company drilling operations in the nation's two largest and very profitable oil fields by lowering the effective tax rate on an entire field every time a below-average producing additional well is brought on line.

Introduction

The major issue in the current debate over the ELF (economic limit factor) is whether this tax reduction to the oil industry makes sense for Alaska at this time. Among the different perspectives against which Alaskans judge the issue are the ELF's effects on the rate of oil development and jobs, and its impact on state revenue, budget stability and the economy. The purpose of this paper is to fill in as much as possible of the factual background. The following issues are therefore addressed in detail:

- (1) **ELF AND OIL DEVELOPMENT:** Does the current ELF tax subsidy work to increase marginal field development? Are Prudhoe Bay and Kuparuk marginal fields? Do ARCO, Standard and Exxon, the major North Slope producers, need a substantial tax break now to continue production from Prudhoe Bay and Kuparuk? How does Alaska's tax structure compare with that of other states?
- (2) **ELF AND ALASKA'S ECONOMY:** How much does the current ELF contribute to industry drilling activity? What will be the effect of the new ELF on **drilling** activity? Are oil company development dollars spent in Alaska or Outside? How many jobs does ELF create? Who gets those jobs?

(3) **ELF AND ALASKA'S REVENUES:** What is the difference in revenues between the current ELF and the new ELF? How does ELF affect revenue stability? What is the long-term impact of ELF on the state's fiscal strength? What roles do revenue stability and a balanced budget play in creating a stable Alaska economy?

(4) **ELF AND THE PAST:** What happened in 1981? Why was the ELF suspended for Prudhoe Bay? What were the commitments?

Background

The roots of the current tax debate go back to the early days of North Slope oil production. In 1979 several major oil companies sued the state, arguing that the separate accounting form of corporate income tax adopted by Alaska in 1978 was unconstitutional. The state won that lawsuit in 1986, but in 1981, in an attempt to limit the fiscal effects of possibly losing the case, the legislature changed the method for assessing oil and gas corporate income tax from separate accounting to modified apportionment.² That legislation also dealt with the ELF.

The 1981 tax package gave Alaska's oil producers a big reduction in their corporate income taxes, but legislators were assured by then-Revenue

² To tax corporate income, separate accounting focuses on the income a corporation actually produces in the taxing jurisdiction. In contrast, the apportionment formula looks at all the income produced worldwide by the corporation and attempts to attribute a portion of that income to the taxing jurisdiction. Alaska now uses a modified version of the standard apportionment method in assessing corporate tax liability.

Commissioner Tom Williams — incorrectly as it turned out — that most of the state revenue lost from the income tax would be offset by gains from a severance tax increase adopted at the same time. The bill also suspended the applicability of the ELF to Prudhoe Bay "for the first ten years following the commencement of commercial production."

The tenth anniversary came in June of 1987, triggering reinstatement of the ELF to Prudhoe Bay. Since the ELF is a formula that reduces severance tax rates, it gave the oil companies a tax cut in addition to the net tax reduction they won in 1981. The 1987 cut was substantial — worth over \$15,000 per hour to the Prudhoe Bay producers or about 8% of Alaska's revenues from oil operations.

The ELF Formula: Well Productivity & Field Productivity

The ELF bill, CSHB 164 (Fin) am , substitutes a new formula for calculating the "economic limit" — the point at which production is no longer profitable. The new formula will reduce the tax reduction provided to Prudhoe Bay and Kuparuk, and increase the tax reduction afforded to smaller fields, such as Endicott, Lisburne or Milne Point.

The ELF is a number between one and zero that is multiplied by the nominal tax rate, producing the effective tax rate. The nominal severance tax rate at Prudhoe Bay is 15 percent. With the average FY 88 Prudhoe Bay ELF at .82, the field's effective tax rate is 12.3 percent ($.15 \times .82 = .123$).

The current ELF is determined by *per-well productivity* in the field, measured by the number of barrels produced by an average well in an

average day. If well productivity is high, the ELF is relatively close to 1 (.9 for example), and the field gets a small tax reduction. Fields with low per-well productivity have a smaller ELF (.5 for example), and get a larger tax break. Most fields in Cook Inlet are currently paying no severance tax because their very low per-well production gives them ELF's of zero.

(Zero times the nominal tax rate gives an effective tax rate of 0.0 percent.)

In Cook Inlet, the current ELF works properly, encouraging production of marginal fields.

But the super-giant Prudhoe Bay field³ is a different story. At Prudhoe Bay, wells that average over 2,000 barrels per day — more than 14 times greater than the Texas average and more than 100 times greater than the national average — are receiving the benefit of an ELF reduction designed for fields whose economics are marginal.

This inappropriate ELF break results from the fact that the current ELF takes account only of productivity *per well* and not overall *field* productivity. By giving a profitable field a larger tax break than a marginal field, the current ELF distorts the purpose of this tax subsidy.

Consider, for example, the case of Milne Point, a small field near Prudhoe Bay. Soon after the Milne Point field opened in late 1985, revenue officials, state economists and the management team at Conoco, the oil company operating the Milne Point field, discovered that per-well productivity, if used by itself, can be an inadequate measure of a field's ability to pay severance tax.

³ Production from Prudhoe Bay, the largest field in the United States, is five times that of the nation's second largest field (Kuparuk). Industry publications consistently refer to Prudhoe Bay as "super-giant."

The average well in the Milne Point field initially produced 950 barrels per day, giving it an ELF very nearly the same as the Kuparuk field, where the average well produced 1,000 barrels per day. Total Kuparuk production was then 250,000 barrels per day, while Milne Point produced less than one-tenth of that amount.

But due to its smaller size, operators at Milne Point had far fewer barrels of production over which to spread operating costs than the Kuparuk field. Although the two fields had almost identical per-well productivity, the smaller Milne Point field was less profitable, and in January 1987 the owners elected to shut down production. This experience illustrates the deficiency of an ELF formula based solely on per-well productivity.⁴

The new formula incorporated in the ELF bill will correct this perverse and unintended effect *by adding total field productivity to the ELF calculation*. Fields producing less than 120,000 barrels per day, such as Milne Point and Endicott, will have a lower ELF (bigger tax break) than under current law, while fields producing more than that amount will have a higher ELF (smaller tax break). This change will affect estimated FY 89 severance tax rates as follows:

⁴ Under provisions of the current severance tax law, Milne Point producers requested and received additional tax reductions after showing that the field would be uneconomic to operate without the reductions. The administrative uncertainties of this avenue would be eliminated for smaller fields by the automatic reduction provided by the new ELF. Large fields facing similar problems could still apply for and receive the special "hardship" reductions.

EFFECTIVE FY 89 SEVERANCE RATES

	<u>Existing Law</u>	<u>New ELF</u>	<u>Percent Change</u>
Prudhoe Bay	11.9 %	14.8 %	23 %
Kuparuk River	6.9 %	11.3 %	65 %
Endicott	12.3 %	8.9 %	-27 %
Lisburne	6.8 %	3.6 %	-47 %
Cook Inlet Fields	0.0 %	0.0 %	0 %

That this approach benefits producers in smaller fields is reflected in the March, 1987 testimony of Conoco supporting the new ELF: "This legislation is a positive first step in encouraging the development of marginal fields in Alaska."⁵

ELF Subsidy Effect

In the summer of 1987 oil producers increased the rate at which they were drilling additional wells at Prudhoe Bay and Kuparuk. Since total North Slope production is limited by pipeline capacity to just over 2 million barrels per day, more producing wells means that average production per well is being reduced. Lower per-well production, in turn, means a bigger tax break for producers under the current ELF.

⁵ Tom Painter, Conoco Anchorage Division Manager, Transcript of Joint House Finance and House Resources Committees Hearing on House Bill 164, March 19, 1987, pp. 49-54.

Because the drilling increase started about the same time as ELF's application to Prudhoe Bay, state officials investigated the possibility of a cause-and-effect relationship between the two. The ELF's role could not be precisely determined. At the same time, because of the current ELF's sensitivity to per-well productivity changes, the investigation found that the current ELF provides a substantial — and unintended — state subsidy to oil company drilling operations in the nation's two largest and very profitable oil fields.

An example of how this subsidy works was provided by ARCO official James Weeks, during 1987 testimony before the House Finance Committee.⁶ Weeks' example showed how a new Kuparuk well, so long as it produced below the Kuparuk per-well average, would result in a lower severance tax payment on the now-higher total Kuparuk production than the severance tax would have been on the lower total Kuparuk production without the well. In Weeks' example, the result was an overall tax savings or subsidy to the producer of \$37,846 yearly from drilling that single additional well.

Weeks' example showed that the per-well emphasis of the current ELF formula will cause the effective tax rate on an entire field to drop when a below-average producing well is brought on line. Despite the increase in total production, the state will receive less tax revenue than if the well and its production had never occurred. This would be a perverse effect even in a marginal field.

Because this subsidy takes the form of a tax reduction rather than a payment from the state's treasury, the subsidy is restricted to fields paying

⁶ A copy of the ARCO handout and the state's analysis of it are in Appendix D.

severance tax. In short, the subsidy is not available to fields like Cook Inlet, where no severance tax is currently paid.

While Weeks' example was restricted to one hypothetical new well at Kuparuk, and may or may not reflect what is currently happening at Kuparuk or Prudhoe Bay, recent econometric modeling studies by the Department of Revenue estimate the Prudhoe Bay drilling subsidy in the range of \$19 million in FY 88, and about \$40 million in FY 89. The model indicates that a tax break that would have totalled about \$240 million during FY88-89 has been increased to approximately \$300 million by the additional drilling.

Not only is this subsidy going to be costly to Alaska, it is an extraordinarily inefficient way to create jobs or additional oil production.⁷ The overall effect of this subsidy may be that, by accelerating drilling that would have occurred later anyway, it robs jobs and economic stability from the future for the sake of higher production and profits in the short term.

ELF and Jobs

Alaskans are concerned about the effects a change in the ELF may have on jobs. Oil industry proponents have said that the recent increase in drilling **has** created 2,400 new jobs — 800 drilling jobs and 1,600 **additional** jobs. They implied that those jobs would be lost if the proposed new ELF is adopted.

⁷ A March 1988 analysis by the Dept. of Revenue implies that each barrel gained through the subsidy through the year 2000 costs the state \$175 in foregone revenue.

The figure of 2,400 new jobs (or even 800) bears no resemblance to the reality reflected in Department of Labor employment figures taken from employer records. Total oil and gas employment on the North Slope during the fourth quarter of 1987 was 3,994 jobs, down by 122 jobs from a year earlier. Drilling employment at the end of 1987 was actually about 50 jobs less than at the end of 1986. Some modest employment increase may occur this spring, but nothing on the scale of 800 new jobs is conceivable, given that 1987 year-end North Slope drilling employment was only around 500 with 12 rigs operating.⁸ The Department of Natural Resources estimates the rig count will climb to 14 on the North Slope this spring. The resulting rise in employment might be 80 to 100. Each rig employs an estimated 40 to 50 workers, depending on the type of drilling.

In total, the oil industry generates about 8,500 jobs in Alaska, about 4 percent of Alaska's work force — and only about 6 percent of the entire private sector work force. Unfortunately, many of those employed by the oil industry are not Alaska residents.

The drilling companies now operating on the North Slope employ about 28 percent non-Alaskans. The hiring record of the major drilling firms ranges from 57 percent non-residents to 15.4 percent non-residents. The hiring of non-residents by other oil industry segments (exploration and services) also runs about 28 percent , with the exception of the production/management sector, which has trimmed its non-Alaskan hiring to about 11 percent.⁹ These statistics make for one of the poorest resident hire

⁸ Statewide oil industry employment, however, was up by about 200 jobs over this period. For more detail on recent employment trends, see Alaska Economic Trends, Alaska Department of Labor, October 1987.

⁹ The Department of Labor developed the statistics by cross-checking employment records with Permanent Fund dividend records.

records in the state, according to the Department of Labor.

Industry-wide, these non-Alaskans have total earnings of about \$80 million, which is the highest amount of wages paid by any industry to non-residents. Much of this non-resident income, of course, does not circulate in or benefit the Alaska economy.

As oil fields mature, labor required to produce a given amount of oil tends to increase. Over the long run, oil and gas employment is likely to increase in Alaska due to these technical factors, regardless of the state's action on the ELF bill. A huge tax increase might discourage additional field development, but economic studies by the state and others indicate that the economic effects of the ELF change will be marginal.¹⁰ Also, correcting the misapplication of the current ELF to Prudhoe Bay and Kuparuk, while improving incentives for smaller fields, is not likely to adversely affect future field developments. From an Alaskan perspective, given the record of the oil industry to date, a real concern will continue to be whether the jobs generated by additional oil development will be filled by residents or non-residents.

¹⁰ "[T]he economic limit factor in Alaska's severance tax...has limited ability and high revenue cost for conserving oil and gas from producing fields," according to University of Alaska researchers led by Mathew Berman in Alaska Petroleum Revenues: The Influence of Federal Policy, Institute of Social and Economic Research, October 1984, pp. xxvii. See also, "Severance Tax Impact Often Misinterpreted," by John Lohrenz, in Oil and Gas Journal, June 18, 1984, pp. 133-137; "Analysis of ELF Alternatives," by Charles Logsdon, Alaska Dept. of Revenue, October 14, 1986; and "A Model to Assess Economic Feasibility and Optimum Production Volume for North Slope Fields," by R. Marks and J. W. Moore (both with the Alaska Dept. of Revenue) in Journal of Petroleum Technology, August 1987, pp. 943-54.

Profitability

Does the oil industry in Alaska need a tax break now to continue production at Prudhoe Bay and Kuparuk? This question is at the heart of the current oil tax discussions.

Companies with major oil interests in Alaska are all publicly traded on the stock market. Alaska industry operations have attracted the interest of numerous trade publications, investment advisory services, and occasionally academic and government researchers. All the studies indicate that Prudhoe Bay and Kuparuk are extraordinarily profitable oil fields.¹¹

According to a recent study, published February 1, 1988, in *Petroleum Intelligence Weekly (PIW)*, a respected trade journal, oil companies are currently making after-tax profits of \$6.2 million per day from North Slope operations. State and local revenue from North Slope oil, by comparison, is estimated by *PIW* at \$4.7 million per day. (The *PIW* article and the state's analysis of the *PIW* figures are found in Appendix B.)

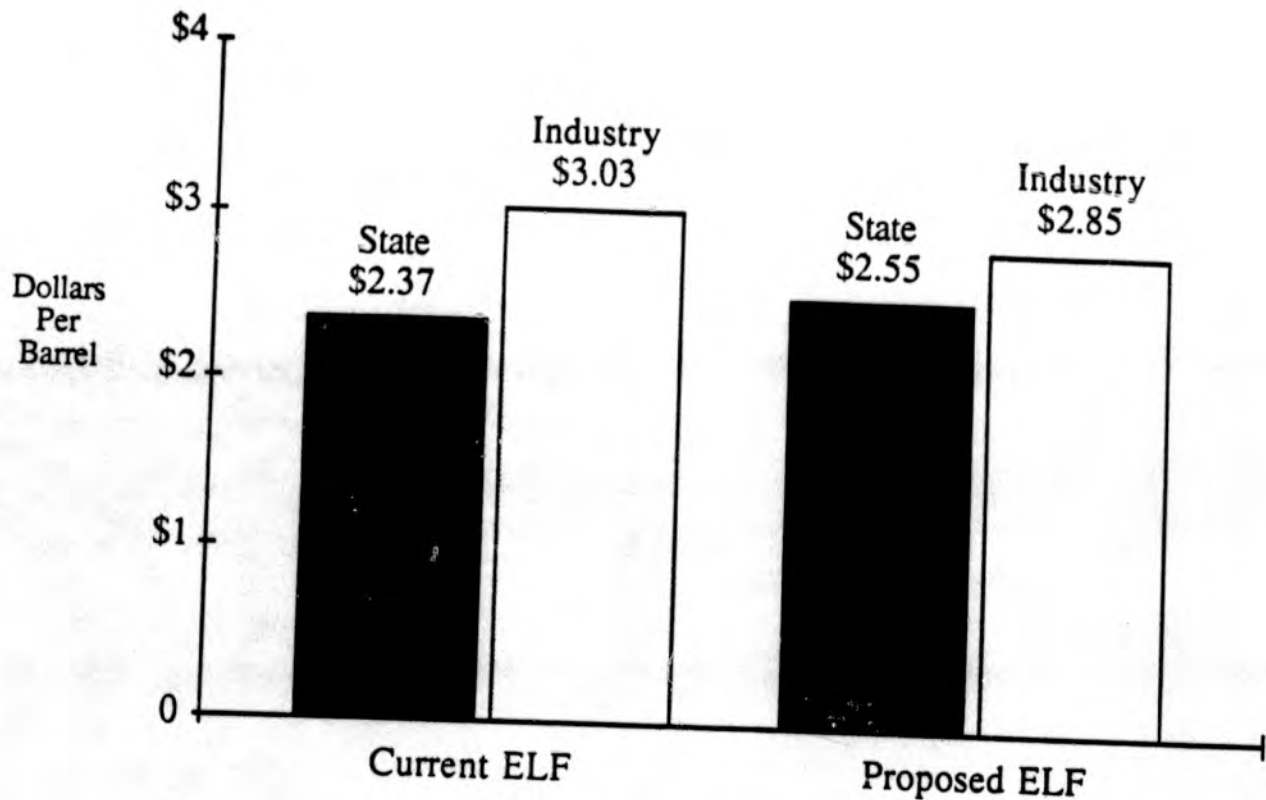
Under the new ELF, oil companies' profits would continue to be larger than state revenue, though not by as big a margin. Industry profits would decline to \$5.6 million daily, after all expenses, taxes and royalties are paid. As Figure 1 shows, the ELF will have only a small impact on the relative shares of revenue going to the state and the producers.

¹¹ In addition to the *PIW* analysis described below, the following studies have been released in 1988: "Alaska's Oil Promise Remains Strong," in *International Petroleum Finance*, March 18, 1988, p. 8; "Alaskan Resource Wealth -- The Inestimable Bounty" in *Atlantic Richfield Company -- Restructured and Resourceful, Part II*, by Salomon Brothers (Bernard Picchi, author), March 31, 1988, p. 3-4; "\$30 a Barrel Profits in an \$18 World," in *Forbes*, March 21, 1988, pp. 110-114; and "Income and Investment Flows From Alaska Oil and Gas Producing Activities," by Edward Deakin, in *Joint Special Committee on Tax Policy, Final Report*, Alaska State Legislature, January 1988.

Figure 1

State and Industry Shares

(Dollars Per Barrel)



Shares under current ELF are from *Petroleum Intelligence Weekly* Feb. 1, 1988; shares under the proposed ELF are by the Division of Policy, April 11, 1987.

Data on the cash flowing to and from North Slope operations suggest that since 1978 in Alaska, only a fraction of the funds generated by North Slope oil have been reinvested in Alaska. According to the *P/W* figures, the companies' current cash flow (profits and depreciation) from the North Slope comes to \$10.6 million per day.¹² The Division of Policy estimates that the rate of oil industry reinvestment in Alaska is \$1.9 million per day. Thus, as shown in Figure 2, the oil industry today is taking \$8 Outside for every \$2 it reinvests in Alaska.

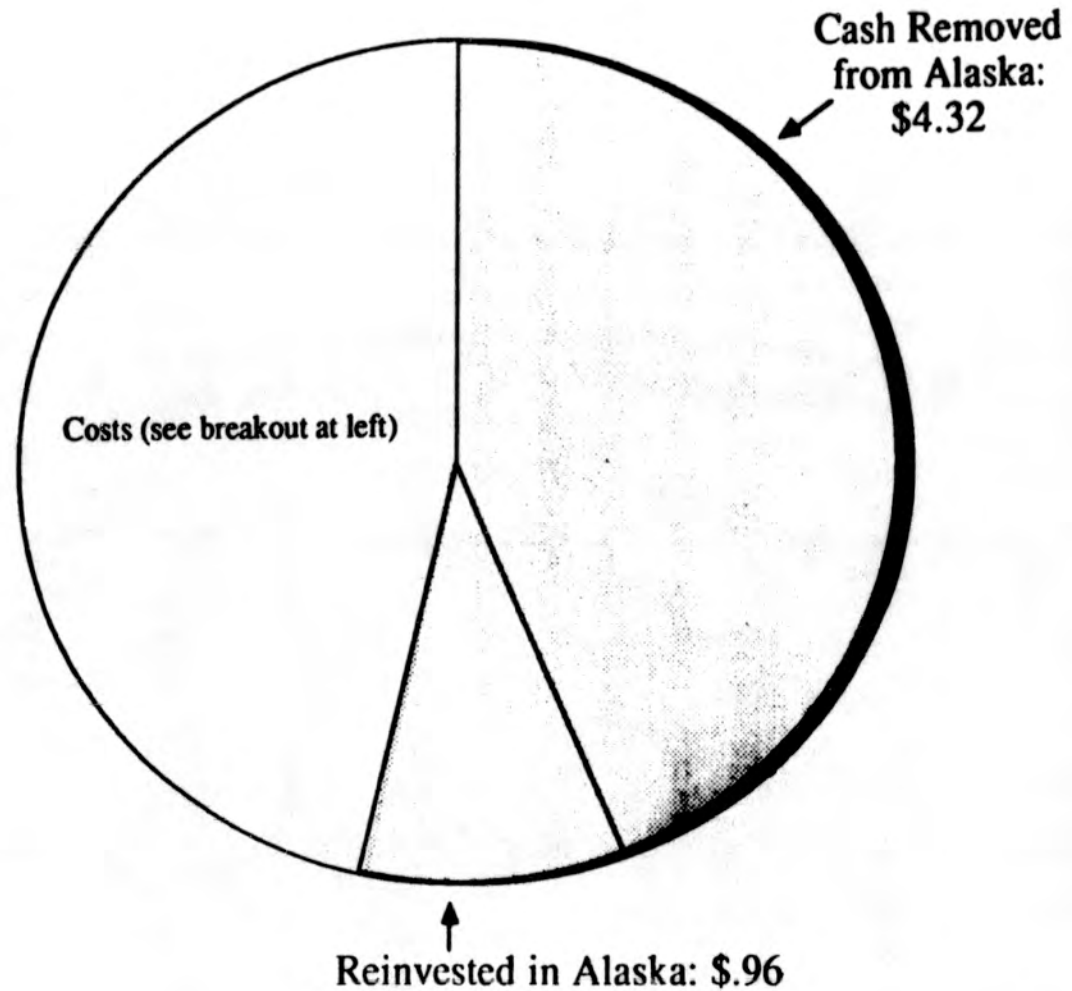
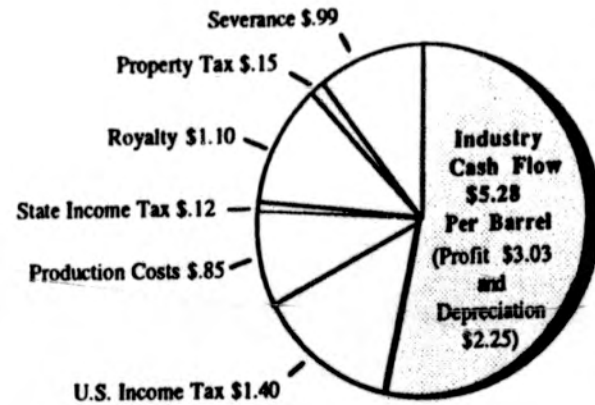
This "takeout" from Alaska's North Slope production has made the major producers in Alaska uniquely successful companies. A March 21,

¹² The *P/W* figures do not include depreciation on the pipeline, so the cash flow to producers from North Slope operations is understated.

Figure 2

The Economics of North Slope Oil

(Dollars Per Barrel)



Source: Division of Policy, based on
Petroleum Intelligence Weekly
February 1, 1988.

Office of the Governor
Division of Policy
4/12/88

1988 *Forbes* article examined ARCO's phenomenal success: "...a return on equity of 23 percent, just about the best in the industry and roughly twice the industry average." Astute corporate management, company restructuring, and its Alaska resources let ARCO "claim the highest per-barrel profit of any marketer on the West Coast." Key to ARCO's current strength, said *Forbes*, "is its commanding position in the U.S. largest oil reserve, the Alaskan North Slope, from which it derived 68 percent of its production last year." With \$3 billion in cash reserves, ARCO is actively investing its Alaskan profits elsewhere.

A report by Salomon Brothers, March 31, 1988, similarly calls ARCO "the premier equity investment in the domestic oil industry." The report goes on to say, "Arco's Alaskan resource base is without parallel in the industry in terms of its size alone. Arco's net share of the original oil in place in its Alaskan oil fields, 20 billion barrels, is equal to 75 percent of the proved oil reserves of the rest of the country." Top ARCO management also cited its Alaska holdings as key to the company's profitability: "ARCO Alaska's low-cost producing ability provides the base for ARCO's West Coast downstream infrastructure: its integrated transportation and refining and marketing assets." ¹³

Production

Oil development patterns are not easily predictable so forecasts of future production should be interpreted cautiously. Department of Revenue modeling studies nevertheless suggest that while the new ELF

¹³ "Alaska Operations," Harold Heinze, President, ARCO Alaska, Inc., Oil Industry Analysts Meeting, March 31, 1987.

could initially cause lower production, any impact would be small. The probabilities are that the new ELF will decrease North Slope output by a cumulative 1 million barrels during the FY 1988-93 period — equal to about 12 hours of flow through the TAPS pipeline. The cumulative production loss through 2005 is estimated at about 21 million barrels, or about 10 days of North Slope production. Losses taper off in later years but become gains sometime after 2020, when the new ELF increases incentives for production in the later stages of oil field life.

The ELF is a minor factor in industry decisions to pursue Prudhoe Bay development. What matters most is oil prices. For example, a spokesperson for ARCO, commenting on that company's plans to drill five Prudhoe Bay development wells in September, 1987, stated, "resuming production drilling in Prudhoe is good news and strictly the result of higher oil prices."¹⁴ A March 31, 1988, stock research report notes, "West Sak field production could start in 1992, because the field is profitable at oil prices of \$15-20 per barrel."¹⁵

How does increased production benefit Alaska? Nearly all manufacturing and assembly of equipment used in the oil industry is done outside Alaska so economic impacts from that sector are small, according to Department of Labor economists. The ARCO newsletter of January 1, 1988, states, "Between 1980 and 1986, North Slope development accounted for approximately \$10.5 billion in hard goods alone, according to ARCO Alaska, Inc., Standard Alaska Production Company and Conoco." The newsletter indicates one-eighth of that amount (\$1.35 billion) was spent in

¹⁴ Alaska Report, p. 1, 7/22/87.

¹⁵ Atlantic Richfield Company---Restructured and Resourceful, Part II, by Salomon Brothers, March 31, 1988, p.1.

Alaska, with the remainder going Outside, with Texas and California the largest beneficiaries.¹⁶ Employment opportunities, however limited, and revenues to the state, are the most readily discernible benefits to Alaska.

Comparing Taxes

Though the existing tax at Prudhoe Bay is 12.3 percent, the *nominal* rate at Prudhoe Bay, without the ELF, is 15 percent. But no field in Alaska pays the full tax rate. Furthermore, the severance tax rate contrasts with the low corporate income tax rate.¹⁷

Each state designs its severance tax structure for its particular conditions in that jurisdiction. The range of profitability among fields in Alaska is very different from any other state. In none of the other states is there an oil field even close to the size of Prudhoe Bay. But because the fields in other states are much nearer to oil markets, the wellhead price of a barrel is much lower in Alaska. Unlike other states, Alaska gains little

¹⁶ On Top of ANWR, ARCO Alaska, Inc., January 1, 1988.

¹⁷ Here is how Alaska's effective severance tax rate compares to other major oil-producing states on a percentage basis:

<u>State</u>	<u>Severance Tax as a Percent of Value</u>
Alaska (Prudhoe proposed)	14.8 %
Wyoming (state & average local)	13.0 %
Louisiana	12.5 %
Alaska (Prudhoe existing)	12.3 %
Alaska (Kuparuk proposed)	11.9 %
Alaska (Kuparuk existing)	8.0 %
Oklahoma	7.0 %
Texas	4.6 %
New Mexico	3.8 %

This chart is based on average effective severance tax rates in FY 1988. Under current law the Prudhoe Bay rate will decline to 11.9 percent in FY 1989.

from the manufacturing and retail sales of most of its petroleum resources — although the producers realize additional profits from transporting, refining, and selling North Slope oil. Differences like these make simplistic comparisons regarding which state has the "highest" or "lowest" severance tax of limited use.

On a dollars-per-barrel basis, for example, Alaska's tax rate is among the lowest of all the producing states.¹⁸ If the oil fields in these states were somehow transported to Alaska, all would find their severance taxes reduced or eliminated. The reason for this apparent paradox is that all are so much smaller than Prudhoe Bay or Kuparuk. Prudhoe Bay wells, according to Standard Alaska, are producing an average 2,300 barrels per day. The average oil well in Texas, in contrast, produces 145 barrels per day. A well producing at that rate in Alaska, like most oil wells in Cook Inlet, would pay no severance tax whatever under either the existing or proposed ELF. Similarly, virtually all the fields Outside that would pay tax under the current ELF would pay less tax under the new ELF.

18

State

Approximate Severance Tax Per Barrel

Wyoming (state & average local)	\$2.02
Louisiana	\$1.94
Alaska (Prudhoe proposed)	\$1.26
Oklahoma	\$1.08
Alaska (Prudhoe existing)	\$1.05
Alaska (Kuparuk proposed)	\$1.04
Texas	\$0.71
Alaska (Kuparuk existing)	\$0.62
Alaska (Cook Inlet)	\$0.00

Estimates for other states are derived from the effective tax rates of other states at a well-head price of \$15.50 (Gulf Coast).

The "Commitment"

The ELF issue in 1988 is the legacy of a 1981 tax bill that passed in an extraordinary hurry. The issue of how to respond to the North Slope oil producers' legal challenge to separate accounting was the focus of attention for much of the 1981 legislative session. However, the proposal that modified the ELF was first unveiled to a free conference committee on June 22, 1981. Two days later, it passed both houses and was on its way to the governor. There was little time to study the bill; moreover, the fiscal note prepared by then-Commissioner Williams included no projections beyond FY 1985. The confusion concerning what legislators and Governor Hammond meant when they adopted the 1981 legislation is not surprising.

A 1981 post-session analysis by the Legislative Finance Division showed that the ELF provision would cause state revenue to fall sharply in FY 1988. When Governor Hammond reluctantly signed the bill, he expressed "full confidence in the ability of the legislature to deal at that time" with any adverse revenue consequences.

Governor Hammond insisted that the oil tax changes adopted in 1981 not reduce the state's share below the 30 percent that was thought to be the rough percentage level of the state's share *at that time*. Hammond sought to insure that the tax changes would be "revenue neutral;" i.e., that the changes would leave state oil revenue largely unaffected. It is now clear that the changes adopted in that bill were far from neutral as to state revenue: between fiscal 1982-87 total tax collections were reduced by over \$1 billion compared with what would have been collected had the changes not been made.

As shown in Appendix C, the 1981 record contains statements by Hammond, then-Rep. Rick Halford, Commissioner Williams and others addressing the future need to revise the 1981 scheme by 1987 or 1988. But the written record of the 1981 deliberations provides no evidence of any legal, moral, or political commitment by state officials to limit the state's appropriate share of future oil income. Additionally, company officials testified to the Legislature that the state's share should equal the industry share.

Revenue Effects

As originally introduced by the Governor in 1987, the ELF legislation would have kept the ELF from applying to Prudhoe Bay for an additional five years. The measure that passed the House and now awaits action in the Senate takes a more comprehensive approach: the new ELF applies at Prudhoe Bay, but the formula for calculating the new ELF includes consideration of field productivity in addition to well productivity. The new formula gives Prudhoe Bay a much smaller tax break now, but a larger tax break later when the giant field finally reaches its marginal years of production. Tax revenue from nearby Kuparuk, the second largest producing field in the United States, would also increase. All other producing fields would either pay no tax at all or receive a bigger tax break than they get under the current ELF.

The net effect of the new ELF, using the Department of Revenue's March, 1988 "mid-case" assumptions, would be \$150 million in additional state revenue in FY 1988, and \$152 million in FY 1989. To put this amount

in perspective, \$150 million is about the amount of the combined annual general fund budgets of the departments of Fish and Game, Labor, Commerce, Natural Resources, Revenue and Environmental Conservation, and about one-quarter of the amount the state spends each year on elementary and secondary education. As the table below shows, the revenue gain from the new ELF depends, in part, on the level of oil prices.¹⁹

<u>Average Oil Prices</u> ²⁰	Incremental FY 89 Revenue From the ELF Bill, <u>CSHB 164 (Fin) am</u>
\$11.00/B	\$114 million
\$12.00/B	\$125 million
\$13.00/B	\$136 million
\$14.00/B	\$146 million
\$15.00/B	\$157 million
\$16.00/B	\$167 million

According to Department of Revenue projections, the dollar gain from the new formula would peak in FY 91 at \$223 million, and then gradually diminish as Prudhoe Bay production declines. The yearly dollar gain from the new ELF will vary with oil prices and total oil production. Over the next six years, the percentage loss to the state's oil revenue from

¹⁹ Other factors would also affect the fiscal effect of the proposed legislation. The table is based on the "mid-case" assumptions in the current Department of Revenue forecast.

²⁰ Weighted average of U.S. West Coast and Gulf Coast selling prices for Alaska North Slope crude.

the current ELF will increase from approximately 8 percent this year to nearly 14 percent in fiscal year 1993. (Complete long-run projections are contained in the ELF legislation fiscal note, in Appendix A .)

Budget Stability and the Economy

In opposing the ELF legislation, one senator argues that "the solution to Alaska's economic problems is not increasing taxes to fuel more government spending," but instead to just cut state spending.

How big a cut would be required to balance the budget? With only weeks to go in the legislative session, Alaska faces a revenue shortfall of about \$150 million to \$400 million, depending on the optimism of the forecaster. Theoretically, the budget could be balanced by cutting hundreds of millions of dollars from spending, but this approach is hard to take seriously in light of the vital impact of state spending on a recovering economy. In fact, the legislature has already recognized the role of state spending in the economy's health in its early passage of the "jobs" bill.

Budget cuts over the last three years have brought per capita real spending down — dramatically. The deepest recession the state has ever experienced was one consequence. Now — as that recession is ending — is not the time for extracting hundreds of millions of dollars from Alaska's economy.

With state spending now well below its 1979 level and the economy starting its recovery, Governor Cowper has proposed a maintenance level budget. The House and Senate can reduce the budget shortfall by eliminating proposed expenditures. But, close to half the budget is pass-

through entitlement programs to local governments, schools, and individuals, politically difficult areas to cut. It appears the majority of Senators and Representatives do not believe this is the time for inflicting the stress of another multi-million dollar spending cut on the Alaska economy. Although reductions and reallocations will certainly occur, deep cuts are not a realistic possibility.

So what options are left? The use of the Railbelt Energy Fund has been proposed. But many Railbelt voters rebel against "their" money being spent to solve a statewide problem, and the construction industry opposes any non-construction use of the money.

Another option is to use the cash reserves (earnings reserve account) of the Permanent Fund. Using the reserves would reduce future dividends. However, the necessary appropriation could be a "loan" with a promised but problematical payback in the future. Combined, the Railbelt Energy Fund and the Permanent Fund earnings reserves are the state's cash reserves since last year the Budget Reserve Fund was emptied to help meet last year's revenue shortfall. Without these funds as backstops, Alaska is left with no emergency monies to meet another precipitous drop in oil prices.

Leaving aside the obvious difficulties inherent in the use of either the Railbelt Energy Fund or Permanent Fund earnings to fill the budget shortfall this year, there remains the issue of revenue stability. This issue deserves very serious consideration for two reasons. First, Alaskans desire and need public services. Second, there clearly exists a now-demonstrated tie between Alaska's revenue stability and Alaska's economic stability.²¹

²¹ For evidence of the relationship of state budget stability to economic activity in Alaska, see "Can State Spending Speed Alaska's Recovery," by Professor Scott Goldsmith and Lee Gorsuch, Institute of Social and Economic Research, University of Alaska, December 8, 1987.

Both reserve sources are only stop-gap measures, providing one or two years of fiscal relief, at most. Neither fund provides an answer to the ongoing loss of more than 8 percent of Alaska's oil revenues and the erosion of Alaska's fiscal strength year after year. The new ELF does. It's a long-term solution to what will otherwise be a long-term loss.

Finally, the legislature simply could pretend that there is no problem. Led by the Senate, the legislature gambled last year that oil price increases would cover the shortfall in the budget with extra revenue. It worked then, due in part to the unexpected receipt of some monies owed the state by the federal government.²² The legislature could roll the dice again. The risk is that the extra revenue will not materialize and that the state will be unable to pay its bills. If oil prices don't rise, current cash flow projections show that the risk could become reality as early as February or March 1989.

Division of Policy

April, 1988

²² The funds received were \$160 million which had been held in escrow by the federal government pending resolution of the Dinkum Sands boundary dispute.

Appendix A

STATE OF ALASKA
1988 LEGISLATIVE SESSION

BILL VERSION: CSHB164 (fin) am
PUBLISH DATE: _____

REQUEST:

FISCAL NOTE

Revision Date: April 4, 1988

Title: An Act Relating to the Oil and

Gas Properties Production Tax & Effective Date

Sponsor: Rules/Governor

Requestor: _____

Agency Affected: _____

BRU: _____

Components: _____

EXPENDITURES/REVENUES: (Thousands of Dollars)

OPERATING	FY 88	FY 89	FY 90	FY 91	FY 92	FY 93
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING						
CAPITAL						
REVENUE	150,150	152,330	203,450	222,850	213,940	207,490

FUNDING: (Thousands of Dollars)

GENERAL FUND						
FEDERAL FUNDS						
OTHER						
TOTAL						

POSITIONS:

FULL-TIME						
PART-TIME						
TEMPORARY						

ANALYSIS: (Attach a separate page if necessary)

See Attached

Prepared by: Charles L. Logsdon
Division: Oil and Gas Audit

Phone: 277-5627

Date: April 4, 1988

Approved by Commissioner: _____
Agency: Revenue

Date: 4/4/1988

Distribution (by preparer):

Legislative Finance

Legislative Sponsor

Requestor

Office of Management and Budget

Impacted Agency(ies)

This bill would effectively increase the severance tax rate on fields producing greater than approximately 120,000 barrels per day. At the same time, fields producing less than this amount would be taxed at a lower rate. The relative increase or decrease would depend on the relative per well productivity of the field. The estimates contained in this fiscal note are based on the Department of Revenue March 1988 mid scenario assumptions about production, wells, and oil prices.

The attached tables illustrate the revenue and tax rate impact of the bill by North Slope oil field. The sensitivity of the tax revenues to change in oil prices is also illustrated.

FY 1989 PRICE/REVENUE SENSITIVITY OF CSHB164(fin) am
(Millions \$)

	\$10.00/bbl	11.00	12.00	13.00	14.00	15.00	16.00	17.00
Prudhoe	93.16	102.47	111.79	121.10	130.42	139.73	149.05	158.36
Kuparuk	21.54	23.69	25.84	28.00	30.15	32.30	34.46	36.61
Milne	0	0	0	0	0	0	0	0
Endicott	-6.49	-7.14	-7.79	-8.43	-9.08	-9.73	-10.38	-11.03
Lisburne	-3.72	-4.10	-4.47	-4.84	-5.21	-5.59	-5.96	-6.33
TOTAL	104.48	114.93	125.37	135.82	146.27	156.72	167.17	177.61

CHANGE IN REVENUE CSHB164
(Millions \$)

YEAR	PRUDHOE	KUPARUK	MILNE	ENDI	LISB	W SAK	PT THOM	SEAL IS	NIARUK	TOTAL
1988	130.03	30.30	0.00	-4.27	-5.93	0.00	0.00	0.00	0.00	150.15
1989	135.82	31.40	0.00	-9.46	-5.43	0.00	0.00	0.00	0.00	152.33
1990	172.12	39.56	0.00	-2.04	-5.19	0.00	0.00	0.00	0.00	203.45
1991	190.27	40.37	0.00	-2.25	-5.53	0.00	0.00	0.00	0.00	222.85
1992	183.74	39.51	0.00	-2.40	-7.01	0.00	0.00	0.00	0.00	213.94
1993	180.52	38.38	0.00	-5.24	-6.27	0.00	0.00	0.00	0.00	207.49
1994	176.59	36.55	0.00	-5.55	-5.74	0.00	0.00	0.00	0.00	199.74
1995	171.39	30.60	0.00	-7.41	-7.18	0.00	0.00	0.00	0.00	187.40
1996	162.93	22.19	0.00	-7.50	-7.83	0.00	0.00	0.00	0.00	169.69
1997	164.10	14.09	0.00	-7.32	-8.17	0.00	0.00	0.00	0.00	162.70
1998	157.08	6.98	0.00	-5.84	-8.44	0.00	0.00	0.00	0.00	148.78
1999	144.16	2.76	0.00	-4.29	-8.30	0.00	0.00	0.00	0.00	134.33
2000	137.86	1.22	0.00	-2.29	-8.44	0.00	0.00	0.00	0.00	129.35
2001	127.38	0.46	0.00	-0.61	-9.29	0.00	0.00	0.00	0.00	117.94
2002	118.80	0.08	0.00	0.00	-9.79	0.00	0.00	0.00	0.00	109.09
2003	122.08	0.06	0.00	0.00	-9.43	0.00	0.00	0.00	0.00	112.71
2004	116.55	0.04	0.00	0.00	-9.28	0.00	0.00	0.00	0.00	107.32
2005	103.90	0.03	0.00	0.00	-8.50	0.00	0.00	0.00	0.00	95.03
2006	91.47	0.00	0.00	0.00	-9.36	0.00	0.00	0.00	0.00	82.11
2007	80.19	0.00	0.00	0.00	-7.52	0.00	0.00	0.00	0.00	72.67
2008	69.43	0.00	0.00	0.00	-5.12	0.00	0.00	0.00	0.00	63.31
2009	61.76	0.00	0.00	0.00	-4.73	0.00	0.00	0.00	0.00	57.03
2010	55.85	0.00	0.00	0.00	-3.28	0.00	0.00	0.00	0.00	52.48

CHANGE IN SEVERANCE TAX RATE PERCENT OF VALUE CSHB164

YEAR	PRUDHOE	KUPARUK	MILNE	ENDI	LISB	W SAK	PT THOM	SEAL IS	NIARUK
1988	0.0249	0.0391	0.0000	-0.0258	-0.0282	0.0000	0.0000	0.0000	0.0000
1989	0.0281	0.0448	0.0000	-0.0332	-0.0321	0.0000	0.0000	0.0000	0.0000
1990	0.0323	0.0481	0.0000	-0.0040	-0.0324	0.0000	0.0000	0.0000	0.0000
1991	0.0373	0.0513	0.0000	-0.0023	-0.0281	0.0000	0.0000	0.0000	0.0000
1992	0.0394	0.0539	0.0000	-0.0023	-0.0277	0.0000	0.0000	0.0000	0.0000
1993	0.0421	0.0550	0.0000	-0.0098	-0.0270	0.0000	0.0000	0.0000	0.0000
1994	0.0450	0.0545	0.0000	-0.0194	-0.0282	0.0000	0.0000	0.0000	0.0000
1995	0.0488	0.0491	0.0000	-0.0251	-0.0282	0.0000	0.0000	0.0000	0.0000
1996	0.0548	0.0405	0.0000	-0.0315	-0.0289	0.0000	0.0000	0.0000	0.0000
1997	0.0548	0.0234	0.0000	-0.0353	-0.0314	0.0000	0.0000	0.0000	0.0000
1998	0.0574	0.0171	0.0000	-0.0375	-0.0345	0.0000	0.0000	0.0000	0.0000
1999	0.0593	0.0083	0.0000	-0.0320	-0.0368	0.0000	0.0000	0.0000	0.0000
2000	0.0597	0.0042	0.0000	-0.0231	-0.0373	0.0000	0.0000	0.0000	0.0000
2001	0.0595	0.0017	0.0000	-0.0102	-0.0391	0.0000	0.0000	0.0000	0.0000
2002	0.0585	0.0001	0.0000	0.0000	-0.0413	0.0000	0.0000	0.0000	0.0000
2003	0.0569	0.0000	0.0000	0.0000	-0.0425	0.0000	0.0000	0.0000	0.0000
2004	0.0553	0.0000	0.0000	0.0000	-0.0433	0.0000	0.0000	0.0000	0.0000
2005	0.0509	0.0000	0.0000	0.0000	-0.0440	0.0000	0.0000	0.0000	0.0000
2006	0.0462	0.0000	0.0000	0.0000	-0.0475	0.0000	0.0000	0.0000	0.0000
2007	0.0409	0.0000	0.0000	0.0000	-0.0434	0.0000	0.0000	0.0000	0.0000
2008	0.0344	0.0000	0.0000	0.0000	-0.0411	0.0000	0.0000	0.0000	0.0000
2009	0.0289	0.0000	0.0000	0.0000	-0.0357	0.0000	0.0000	0.0000	0.0000
2010	0.0209	0.0000	0.0000	0.0000	-0.0214	0.0000	0.0000	0.0000	0.0000

APPENDIX B
ALASKA NORTH SLOPE ECONOMICS *
 Weighted Average of West and Gulf Coast Sales as Reported in PIW

<u>REVENUE, COSTS & INCOME PER BARREL</u>				
	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>
Wellhead price/barrel	\$16.72	\$10.17	\$7.54	\$9.47
LESS:				
Royalty/barrel	\$2.01	\$0.73	\$0.86	\$1.10
Severance/barrel	\$2.21	\$0.87	\$1.00	\$0.99
Property tax/barrel	\$0.21	\$0.18	\$0.16	\$0.15
Producing cost/barrel	\$0.90	\$0.75	\$0.80	\$0.85
Depreciation/barrel	\$1.53	\$2.17	\$2.21	\$2.25
State income tax/barrel	\$0.29	\$0.06	\$0.08	\$0.12
US income tax/barrel	\$4.54	\$0.84	\$0.89	\$1.40
PLUS:				
Pipeline profit/barrel	\$2.18	\$0.64	\$0.58	\$0.43
EQUALS:				
Industry profit/barrel	\$7.22	\$1.56	\$2.13	\$3.03
<u>NET INCOME SHARES</u>				
<u>Shares in dollars per barrel</u>				
Industry profits/barrel	\$7.22	\$1.56	\$2.13	\$3.03
State & local rev./barrel	\$4.71	\$1.84	\$2.10	\$2.37
Federal rev./barrel	\$4.54	\$0.84	\$0.89	\$1.40
<u>Shares in billions of \$ per year</u>				
Industry profits/year	\$5.004	\$1.102	\$1.530	\$2.211
State & local revenue/year	\$3.269	\$1.294	\$1.512	\$1.728
Federal revenue/year	\$3.148	\$0.592	\$0.640	\$1.022
<u>Shares in percent of total</u>				
Industry profits	43.8%	36.9%	41.6%	44.6%
State & local revenue	28.6%	43.3%	41.1%	34.8%
Federal revenue	27.6%	19.8%	17.4%	20.6%
<u>ALASKA REINVESTMENT PERFORMANCE</u>				
<u>Reinvestment in billions \$/year</u>				
Cash flow (billions \$/year)	\$6.065	\$2.630	\$3.119	\$3.853
Reinvestment (billions \$/year)*	\$0.860	\$1.322	\$0.650	\$0.700
<u>Reinvestment in \$/barrel</u>				
Cash flow per barrel	\$8.75	\$3.73	\$4.34	\$5.28
Reinvestment per barrel*	\$1.24	\$1.88	\$0.90	\$0.96
Percentage reinvested in Alaska	14%	50%	21%	18%

* Revenue, costs and income data from *Petroleum Intelligence Weekly* (attached);
 reinvestment performance estimated by the Division of Policy.
 See the following page for additional notes.

Division of Policy, 4/11/88

Notes to analysis of *PIW* data on North Slope economics:

1. *PIW* data for the first and second half of 1986 and 1987 were averaged using equal weights to produce the average annual values shown on the preceding page.
2. *PIW* values stated separately for U.S. West and Gulf coasts were combined to provide weighted average figures; the following weighting factors were used (West/Gulf): 1985-50%/50%; 1986-52.5%/47.5%; 1987-56.66%/46.67%; 1988-60%/40%.
3. Annual revenue figures assume production levels of 1.90 MMB/D, 1.93 MMB/D, 1.96 MMB/D, and 2.00 MMB/D in 1985-88 respectively.
4. Data for 1988 are extrapolated assuming costs and revenues continue at the per barrel levels reported in *PIW* for the first two months of 1988.
5. Reinvestment estimates for 1985-6 are from Income and Investment Flows From Alaska Oil and Gas Producing Activities, by Edward Deakin, May, 1987. Estimates for 1987-8 are Division of Policy estimates based on industry statements of current and planned project activity.
6. Cash flow is understated by an estimated \$2.00 per barrel because depreciation on pipeline investments are not accounted for separately in the *PIW* data. (Pipeline tariffs are deducted before determining the wellhead price per barrel.)

Division of Policy
11 April 1988

PETROLEUM INTELLIGENCE WEEKLY®

Reproduction of PIW news for internal distribution is strictly prohibited. © Copyright 1988 Petroleum & Energy Intelligence Weekly, Inc.

Reproduced by permission from Petroleum Intelligence Weekly.
Copyright © 1988 by Petroleum & Energy Intelligence Weekly.
Office of the Governor, Juneau 3/23/88

• Living With \$15 Oil p.5 • Shift In Tanker War p.7

Short-Haul Sales By Saudis Key To Overseas Stockbuild

RECEIVED

FEB 01 1988

LEGISLATIVE AFFAIRS
Reference Library

Alaskan Oil Profits Staying Buoyant Amid Volatile Prices

Oil markets should be very careful in drawing grand conclusions about Saudi Arabia's oil policies on the basis of its latest foray to charter ships for moving crude oil into its overseas stockpile. The fact is that Saudi Arabia is in the process of placing a large chunk of stockpile crude with several of the Aramco partners on a delivered basis, and it chartered the tankers almost entirely to replenish those supplies, according to well informed PIW sources in shipping circles. The stockpile moves say more about Riyadh's wish to retain a basic presence as a short-haul crude supplier in the Caribbean and Europe (p5) than about its long-term goals or role within Opec (PIW Jan.25,p1). PIW confirms that the Saudis have lined up five ships to move 10-million barrels of oil into overseas storage in the coming weeks, plus at least one other vessel to supply non-Aramco clients like Ashland and Marathon. In the past, the Saudis have used the Western Hemisphere stockpile for occasional spot sales, and more routinely to supply term customers on a prompt basis.

By taking nearby crude from the stockpile now, the Aramco partners get the benefit of the oil in the heart of the winter season, rather than in late March or early April when oil loaded today in Saudi Arabia would arrive at Atlantic Basin destinations. The stockpile barrels are within the overall 1.4-million b/d of crude the partners obtained from the Saudis in January, and are expected to take in February. They do not represent any extra supply. Overall Saudi output volume is still below Opec quota in the 3.8- to 4-million b/d range (excluding the Neutral Zone). This suggests Riyadh is willing to cautiously and temporarily stick with other Opec producers in sharing some of the burden of

(continued on p.4)

With oil markets again threatening a possible sharp drop in prices, US Alaskan production looks surprisingly well positioned to cope with a repeat of the collapse of 1986. Despite high transport costs that would appear to make Alaskan North Slope output highly vulnerable to lower prices, it is currently making good profits at \$14.50-\$15.50 delivered prices, and has shown it can break even at \$10 a barrel. Profits also bounce back quickly as prices recover, according to a PIW analysis of Alaskan North Slope economics (see table). Producers briefly suffered losses of a few pennies a barrel in mid-1986 when the delivered price at the Gulf Coast fell to \$10. But profits rebounded to an average \$3.50 in 1987, and even managed to average over \$1 a barrel in disastrous 1986 ANS crude — which is one-fourth of US production — realizes a healthy \$2.60-\$3.20 a barrel now, depending on sales destination.

Even if prices dropped below \$10, very little North Slope production would be shut in, mainly because of the large amounts already invested in current output and its importance to US supply. What's more, the oil is primarily absorbed into the refining and marketing systems of producing companies, and low crude prices usually provide

Reproduced by permission from Petroleum Intelligence Weekly.
 Copyright © 1988 by Petroleum & Energy Intelligence Weekly.
 Office of the Governor, Juneau 3/23/88

offsetting improvements in the profitability of downstream refining. Meanwhile, the long-term outlook for Alaskan North Slope crude is encouraging a continuing buildup of production capacity, in sharp contrast to plunging production in other US areas. ANS output surged over 2-million b/d in late 1987 as Alaska displaced Texas for the first time as the largest source of US crude. The North Slope is still regarded as holding the best potential for finding big new fields. But discoveries have to be large to offset growing development and operating costs, already apparent at the Kuparuk River and Endicott fields, and for enhanced recovery in super-giant Prudhoe Bay (PIW Jan.25.p10).

Since the 1986 price collapse, the economics for Alaskan North Slope crude sold on the West Coast have become relatively more profitable than the longer shipments to the Gulf and East Coasts, which used to earn almost as much. As a result, more North Slope crude is moving to the California market, with the West Coast absorbing 60% of last year's higher production versus 50% in 1985. Profits on West Coast sales are now about 65¢ a barrel higher than those to Atlantic ports, compared to a gap of 10¢ in 1985. This mainly reflects the much larger \$11.66 a barrel drop in ANS prices to Gulf and East Coast destinations in the last two years compared to a drop of just under \$10 on the West Coast. The bigger decline in the east is hard to explain but is probably only partly due to the highly competitive Atlantic Basin crude oil market.

THE COMPARATIVE ECONOMICS OF ALASKAN NORTH SLOPE PRODUCTION (in dollars per barrel)

	Sales To US Gulf Coast						Sales To US West Coast					
	1988	1987	1986	1985	1984	1983	1988	1987	1986	1985	1984	1983
Delivered Price	Current	2nd H	1st H	2nd H	1st H	Year	Current	2nd H	1st H	2nd H	1st H	Year
Sohio Price	\$15.50	\$18.45	\$17.00	\$12.00	\$16.80	\$27.00	\$14.50	\$17.45	\$16.00	\$11.00	\$15.80	\$25.00
Average Price(a)	15.25	18.82	18.99	12.31	15.72	26.91	14.25	15.48	15.56	10.75	14.54	24.23
Less:												
Shipping Cost	3.35	3.21	3.19	3.38	3.72	4.21	0.99	0.96	0.94	0.94	1.14	1.29
Valdez f.o.b.	11.90	13.61	13.80	8.93	12.00	22.70	13.26	14.52	14.62	9.81	13.40	22.94
Less:												
Pipeline Loss	0.05	0.10	0.05	0.05	0.05	0.10	0.05	0.10	0.05	0.05	0.05	0.05
Pipeline Tariff	3.20	3.95	3.95	4.50	4.50	6.00	3.20	3.95	3.95	4.50	4.50	6.00
Wellhead Price(b)	8.65	9.56	9.80	4.38	7.45	16.60	10.01	10.47	10.62	5.26	8.85	16.84
Less:												
Royalty(c)	1.00	1.11	1.14	0.47	0.85	1.99	1.17	1.23	1.24	0.58	1.02	2.02
Severance(d)	0.91	1.00	1.30	0.59	0.99	2.19	1.05	1.09	1.40	0.70	1.17	2.22
Property Tax	0.15	0.15	0.15	0.18	0.18	0.21	0.15	0.15	0.15	0.18	0.18	0.21
Producing Cost	0.85	0.85	0.85	0.75	0.75	0.90	0.85	0.85	0.85	0.75	0.75	0.90
Depreciation(e)	2.25	2.25	2.25	2.17	2.17	1.53	2.25	2.25	2.25	2.17	2.17	1.53
Pre-Tax Profit	3.49	4.20	4.11	0.23	2.51	9.78	4.54	4.90	4.72	0.88	3.56	9.96
Less:												
State Income Tax(f)	0.10	0.13	0.12	0.01	0.08	0.29	0.14	0.15	0.14	0.03	0.11	0.30
US Windfall Tax(g)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
US Income Tax(h)	1.19	1.43	1.40	0.11	1.16	4.50	1.54	1.67	1.61	0.41	1.64	4.58
Oil Profit	2.20	2.64	2.59	0.12	1.28	4.99	2.86	3.09	2.96	0.45	1.81	5.08
Pipeline Profit	0.43	0.53	0.53	0.64	0.64	2.18	0.43	0.53	0.53	0.64	0.64	2.18
Overall Profit	2.62	3.17	3.12	0.76	1.92	7.17	3.29	3.62	3.51	1.09	2.45	7.26

a) Average of all producers. b) Price at Pump Station #1. c) Royalty 12.5% after deduction of gathering costs (63¢ 1988, 66¢ 1987 & 1986, 65¢ 1985). d) Severance Tax based on wellhead price after deduction of royalty (11.94% from 2nd Half 1987 to present, 14.96% 1985 to 1st Half 1987. e) Includes depletion. f) Average state income tax rate of 3% for all producers. g) Windfall profits tax not applicable at lower wellhead prices. h) US income tax rate 34% 1987 to present and 46% previously, after deduction of costs, state taxes.

Another big change in the last few years is the more even split between producing company profits and the tax take of federal and state governments. With Alaskan wellhead prices well below the floor level of US "windfall" taxation, the tax burden has shrunk to an estimated \$3.35 a barrel currently. Reduced corporate income tax rates from 46% to 34% starting in 1987 has also helped producers. However, Washington claims that the companies may owe \$200-million in "windfall" profits taxes for 1984 and 1985 due to disparities in pricing and pipeline charges among the various Alaskan oil producers (PIW June 13,'83,p3).

The settlement of a 7-year legal dispute over Alaskan pipeline tariffs has also put an extra squeeze on profits since 1986, with the Trans-Alaskan Pipeline providing 15% of North Slope profits now compared to 30% in 1985. Aimed at fostering greater competition for North Slope leases, the resolution with the seven owners (BP 50%, Exxon and Arco

**US
End
For**

Reproduced by permission from Petroleum Intelligence Weekly.
Copyright © 1988 by Petroleum & Energy Intelligence Weekly.
Office of the Governor, Juneau 3/23/88

**in't
ans
ole**

20% each, and the rest split between Mobil, Phillips, Union and Amerada Hess) sharply reduced tariffs, settled back claims of overcharges and put the pipeline on a real-rate-of-return basis starting in 1986 (PIW Nov. 4, '85, p8).

The existence of a semi-secret and unofficial "mini-Brent" North Sea market might help London's International Petroleum Exchange win a central role in the globalization of oil futures dealing. Mini-Brent could provide a model for the IPE as it prepares another relaunch for its failed Brent futures contract following the New York Mercantile Exchange's refusal to trade US crude futures in London as a joint venture (PIW Jan. 25, p8). Shocked and disappointed by Nymex's rejection of joint trading of West Texas Intermediate futures, the IPE is considering a number of alternative options, with a restyled 1,000-barrel Brent contract based on cash settlement rather than physical delivery at the top of the list (PIW Jan. 25, p8). Other possibilities include a London-based West Texas Intermediate contract administered independently of Nymex, and a link to another US exchange such as the Chicago Board of Trade, which dabbled with oil futures several years ago.

Steady but largely unpublicized trade in the unregulated mini-Brent market leaves little doubt that demand exists for a financial tool of this type geared to European crude. Also known as the Brent partial market, and only reluctantly revealed to PIW by major players, mini-Brent is the brainchild of US investment banks. But its future is now in doubt due to new UK laws which may leave room for the IPE to take over instead. Mini-Brent works because the investment banks are willing to buy and sell futures contracts for part-cargoes of Brent in 50,000 barrel increments under their own set terms, normally closing out at an agreed cash-settlement price as 600,000-barrel forward Brent cargoes begin to trade in the physical market. However, this trading could fall foul of the forthcoming UK Financial Services Act (PIW Jan. 11, p2). The IPE, as a recognized futures exchange, might win approval of a similar standard contract, using well-established procedures of exchange-of-futures-for-physicals for participants wanting to take delivery. The IPE is now seeking industry advice on how to tailor a new contract, but there's virtually universal agreement that simply restyling the existing 1,000-barrel contract won't work.

Even with its poor track record in marketing and planning, the London futures exchange is still eager to launch its own crude contract that will spark trade both locally and from Mideast and Far East time zones, largely out of New York's normal reach. It plans "some form of significant trading incentive scheme to encourage initial participation" and scope for broader membership, aimed at attracting more active floor traders. While Nymex boasts almost 800 members and last year traded an average 40-million b/d, there are currently just 57 authorized IPE dealers. There's general dismay in European trading circles over the Nymex's "parochial" decision not to come to London, coupled with the recognition that Eastern Hemisphere traders increasingly want to use crude futures (PIW Dec. 7, p6). The IPE has already been approached by the Singapore International Monetary Exchange on possible broad cooperation.

**In Opec
tives To
counting**

Like the big Mideast exporters, Opec's key African members are moving fast to cushion themselves against rapid swings in output even in a weak market. But they are using very different means to achieve the same ends. Resisting straight market-related pricing, the Africans are looking to product sales, processing deals of various kinds and enhanced margins for foreign equity producers to sustain volumes. Though techniques differ, almost all Opec exporters are adapting to an oil market in which some price volatility is seen as inevitable, making maintenance of sales to key customers in ways that cause the least market disruption a top priority (PIW Jan. 25, p1). The various methods reflect marketing strengths of individual producers and preferences of traditional customers, among other factors.

Among African producers, Libya appears to have significantly reduced its vulnerability to short-term market swings. Though volume has fallen somewhat, Tripoli seems to be offsetting much of the recent loss of up to 200,000 b/d in third-party crude sales to traders without flooding the Mediterranean with discounted crude. "They've

APPENDIX C -- EXPLANATION OF 1981 OIL TAX LAW CHANGES

I. Introduction

The 1981 oil tax legislation (ch. 116, SLA 1981) replaced the separate accounting oil and gas corporate income tax, enacted in 1978, with a modified apportionment-based corporate income tax. To make up the substantial loss in revenues caused by this shift, the legislation also raised the severance tax rate on Prudhoe Bay from an effective rate of just over 11% (with the ELF) to 15%. This increase was accomplished by raising the nominal rate from 12.25% to 15% and effectively suspending the ELF until the tenth anniversary of Prudhoe Bay production in 1987. (For fields beginning production after June 1981, the nominal rate was set at 12.25% for the first five years of production.) Taken together, the two changes were intended to be revenue neutral.

In addition to the two primary changes -- eliminating separate accounting and increasing the severance tax -- the 1981 law also:

- (a) made retroactive technical amendments (known as the "warts" amendments) to state tax laws in order to improve the retrospective constitutionality of separate accounting;
- (b) corrected tax problems posed by the sharing of oil and gas revenues among Native corporations under §7(i) of the Alaska Native Claims Settlement Act;
- (c) allowed for the retroactive deduction of federal windfall profit tax payments; and
- (d) instituted a graduated, stair stepped rate, beginning at 1%, for the taxation of corporate income under \$100,000, and raised the top rate from 9.4% to 11% for one year.

Tax "stability" was not the issue in 1981. The 1981 law was passed solely in response to litigation filed by the oil industry challenging the 1978 separate accounting corporate income tax. Unlike the separate accounting law, which was passed after nearly a decade of study, discussion, and debate, the 1981 oil tax changes were not designed to make the state's tax system fair and predictable, or to encourage future exploration and production. Instead, the 1981 law was designed to limit the state's potential liability as a result of the oil companies' legal challenge to the 1978 separate accounting law. Because the oil industry benefitted from the 1981 law, it did not object to the changes in the state's oil tax structure.

At the time the 1981 law passed, many assumed that the oil tax issue would be revisited, after a decision on the 1978 law was made, and before the June 1987 reimposition of the ELF. The state won the separate accounting litigation in the trial court in May 1983 and on appeal to the Alaska Supreme Court in August 1985. The statute's constitutionality was affirmed by the U.S. Supreme Court in January 1986.

II. How It Happened

A. Activity Before 1981

The 1977-78 Alaska Legislature and Hammond Administration, confronted with the prospect of the first commercial production from Prudhoe Bay, instituted a comprehensive revision of the state's oil and gas tax structure. In 1977, the legislature, with the active support of the governor, increased the maximum severance tax rate from 8% (first put in effect in 1970) to 12.25%. An economic limit factor [ELF] formula replaced the statutorily-reduced rates for well production less than one thousand barrels per day (from 1973-1977, a well's first 300 barrels were taxed at 5%, and the next 700 barrels at 6%). The ELF was designed to give the severance tax a curved or sliding scale, instead of stair stepped, rate.

In 1978, the separate accounting oil and gas corporate income tax was enacted. The law was developed and passed in response to detailed analyses, prepared for the legislature and administration from 1970-78, showing that the state's existing apportionment-based corporate income tax would result in Prudhoe Bay oil producers paying less than a third of the statutory rate of 9.4% of net income. The apportionment tax also had the inequitable effect of imposing different tax levels on producers with the same profits in Alaska, in effect penalizing producers with a larger degree of investment and employment in Alaska.

In early 1979, the major Prudhoe Bay oil producers filed suits challenging the constitutionality of the 1978 separate accounting law. Concerned over the amount of revenues at risk in the litigation, in the fall of 1980 the Hammond Administration engaged in substantive settlement discussions with those companies. The options proposed would have required the sacrifice of several hundred million dollars of state revenue in order to settle the litigation.

B. The 1981 Session -- Policy Background

At the beginning of the 1981 session, House and Senate leaders urged the Administration to pursue solutions to the problems posed by the oil industry suit that would not require revenue losses to the state. On March 18, 1981, the leadership of

both chambers, including Senate President Kerttula and Finance Chairmen Dankworth and Bennett, House Speaker Duncan and Finance Chairman Cotten, and Governor Hammond, Attorney General Condon, and Revenue Commissioner Tom Williams, joined in a statement declaring that "any significant decreases in state oil and gas revenues appear both unwarranted and unsupported by a majority of Alaskans. . . . All agree that any changes which would give large sums of money to the oil industry at the expense of the people of Alaska are unacceptable."

House leaders did not agree with the Administration's view that existing law needed to be changed. They were more optimistic that the separate accounting statute would be upheld, as it was in 1986. They believed that the tax structure put in place in 1977-78 was sound, and preferable to the alternatives of a higher severance tax or an apportionment-based income tax. They also believed any changes to state tax laws should be made after, not prior to, any unfavorable court decision, and that the potential problem of having to refund money to the oil industry was better left to the future, if and when it was more than a hypothetical possibility.

C. The 1981 Legislation

Because the Administration felt that some action was required to limit the risk posed by the separate accounting lawsuit, the House developed a "backstop" bill (in conjunction with the Administration), which set an oil and gas reserves tax in place to take effect and preserve state revenues if the 1978 separate accounting law were to be found unconstitutional.

Governor Hammond introduced the backstop bill in May 1981 (as SSHB 200). It passed the House (as SB 524) in early June. A free conference committee, consisting of Senators Ray, Bennett, and Dankworth, and Reps. Gardiner, Vaska, and O'Connell, first met on June 11.

During the latter half of the session, Senator Dankworth had attempted to develop a bill that would succeed in settling the separate accounting litigation while preserving, in substantial part, past and future state oil revenues. He was unsuccessful, and gave up the idea of ending the existing separate accounting litigation. He then attempted to craft a bill that would repeal the separate accounting law prospectively and maintain future state oil revenues at a level roughly comparable to those collected under the separate accounting law.

On June 17, following the reorganization of the House, Rep. Halford replaced Rep. Vaska on the conference committee and became the House chair. At that time, the oil industry circulated a settlement proposal which repealed separate accounting, increased severance taxes, and instituted a 10% investment tax credit. The oil

industry estimated the proposal's revenue loss to the state for FY 82-85 at \$1.37 billion; legislative staff estimates of revenue losses ranged from \$1.5 to \$2.1 billion.

Senator Dankworth prepared a draft bill embodying the settlement proposal, and distributed it to the conference committee on June 22. At a later point in the June 22 meeting, he also distributed a draft bill that modified the settlement proposal in two important ways, in order to make the bill as revenue neutral as possible. He abandoned the 10% investment credit and suspended the application of the ELF during a field's first ten years of production in order to achieve a 15% effective severance tax rate at Prudhoe Bay. As a result of these changes, the oil industry was not willing to settle the litigation, and stated in testimony that they would continue the separate accounting litigation even if the modified proposal were enacted.

Prior to the next meeting of the conference committee on June 23, Governor Hammond wrote a letter to all legislators clarifying his position on the oil tax issue. He stated his preference was for a public vote on the backstop bill versus the oil industry settlement proposal. Alternatively, he urged the Senate to pass the backstop bill, and stated he preferred passage of any proposal to doing nothing. He noted that legislative action should "[r]educe the likelihood that the oil tax issue will continue to be a perennial political liability for those in public office."

On June 23, Senator Dankworth submitted to the conference committee the legislation ultimately signed by Governor Hammond, described on the first page of this appendix. The June 23 bill, known as "Dankworth 3," retained the basic characteristics of Senator Dankworth's earlier proposal, but suspended the application of the ELF during the first ten years of production only if the ELF was greater than .7. The change did not affect Prudhoe Bay, but did provide a tax break for Kuparuk.

The June 23 legislation received only cursory examination in the free conference committee and on the floor of the House and Senate before its passage on June 24. No committee report or written analysis was provided by either the bill's sponsor, Senator Dankworth, or the Administration. A bare bones fiscal note, which projected total revenue losses from FY 82-85 of \$141 million, did accompany the bill during the legislature's deliberations. Specifically, the note showed revenue losses of \$21 million in FY 82, \$117 million in FY 83, \$18 million in FY 84, and a gain of \$15 million in FY 85. No figures for the effect of the reimposition of the ELF on Prudhoe Bay in 1987 were provided. Revenue Commissioner Williams personally prepared the fiscal note and provided no supporting documentation for it, other than stating the estimates were based on confidential figures provided by the oil industry.

Speaker Hayes refused to allow a minority report opposing the legislation,

authored by Rep. Gardiner, to be published in the House Journal. At pages 2-3 of the minority report, after questioning the validity of the \$141 million estimate, Rep. Gardiner stated the fiscal note "failed to point out an even more significant revenue loss which will occur in the latter half of this decade, due to the sharp decline in severance tax collections from Prudhoe Bay after the reimposition of the economic limit factor in 1987. This loss is on the order of two billion dollars." (The two billion dollar estimate was based on the optimistic oil price assumptions prevailing at the time.) The bill passed over the strenuous objections of the former House majority.

At the time he signed the 1981 law, Governor Hammond noted that the new law would only reduce state income by .6%, relying on the figures in the fiscal note.

The key arguments made in opposition to the 1981 law were:

- (a) It was not revenue neutral, because the estimates for the amounts to be collected by the new apportionment formula were overstated and speculative.
- (b) A future legislature and administration would be saddled with a huge drop in revenues by the reimposition of the ELF in 1987.

Other arguments concerned the harmful effects of a shift from a net income-based separate accounting tax to a gross revenue severance tax.

Both Commissioner Williams and Governor Hammond explicitly recognized that a future legislature would have to deal with the post-1987 revenue effects from reimposition of the ELF. In the press statement issued on July 21, 1981, at the time he signed the oil tax bill, Governor Hammond declared, "As for the possible revenue effects in 1988 and beyond, I have full confidence in the ability of the Legislature to deal at that time with whatever is required to retain the state's 'fair share' of our oil wealth."

In responding to a question about the post-1987 ELF revenue loss at the June 23 conference committee meeting, Commissioner Williams noted that a future legislature would have the option of reimposing separate accounting if it proved constitutional. A newspaper account of the meeting reported that "If the projected revenue loss proves true, Williams said the Legislature would have the option of hiking taxes." (*Anchorage Daily News*, June 25, 1981, p. A4, "Lawmakers Pass Revision of Oil Tax Law.")

During the June 24 House floor debate on the 1981 bill, Rep. Gardiner noted the ELF factor would cause multi-hundred million dollar losses after 1987. Rep. Halford responded that "by that time [1987], if the companies continue to challenge the portion of funds that are in the state's hands under chapter 21 [separate accounting], we should have an answer to that lawsuit. And with that answer, we should be able to develop possibly a more consistent taxing policy at that time. That's

pretty far in the future, but we'll have more information available to us at that time."

III. Postscript

The revenue losses resulting from the shift to the modified apportionment method have exceeded considerably the \$141 million estimate for FY 82-85 made in 1981 by Commissioner Williams. Analyses by the Department of Revenue shows the FY 82-85 revenue loss of the 1981 law at over seven hundred million dollars. Through FY 87, the state lost over one billion dollars in revenue as a result of passage of the 1981 law.

The problems arising from the reimposition of the ELF are the subject of the main body of this report.

Appendix D

DRILLING/WORKOVER DISINCENTIVE COMMITTEE SUBSTITUTE HB 164

SEVERANCE TAX CALCULATION

CURRENT LAW

Field Rate x Wellhead Price x Severance Tax x ELF

90,168,000 BOPY x \$9/BO x 0.15 x 0.52134

= \$63,461,050/year

Addition of 1 well:

90,277,000 BOPY x \$9/BO x 0.15 x 0.5204

=\$63,423,203/year

A decrease of \$37,846 year

PROPOSED LAW

Field Rate x Wellhead Price x Severance Tax x ELF

90,168,000 BOPY x \$9/BO x 0.16 x 0.7296

=\$88,811,873/year

Addition of 1 well:

90,277,000 BOPY x \$9/BO x 0.15 x 0.7292

=\$88,870,484/year

An increase of \$58,611 year

[Copy of ARCO Handout, March 27, 1987]

TECHNICAL NOTE ON ARCO'S KUPARUK EXAMPLE

Tax Effects of Drilling an Additional Well Under Current Law

Mr. James Weeks, Kuparuk Unit Manger for ARCO, provided testimony to the House Finance Committee on March 27, 1987. Examples of severance tax effects (see preceding page) accompanied his testimony. The examples compare the severance tax effects of adding one additional well in the Kuparuk field under the current ELF and under the proposed ELF. The examples show that the addition of one well producing just under 300 barrels per day would increase output from 90,168,000 barrels of oil per year (BOPY) to 90,277,000 BOPY. At the \$9.00 per barrel price assumed in ARCO's example, annual gross revenue to the owners increases by \$981,000.

$$\begin{aligned} & (90,277,000 \text{ BOPY} - 90,168,000 \text{ BOPY}) * (\$9/\text{barrel}) = \\ & \quad (109,000 \text{ BOPY}) * (\$9/\text{barrel}) = \$981,000 \end{aligned}$$

The first of ARCO's two examples shows how under current law the owners would collect an annual severance tax *rebate* of \$37,846 on this additional revenue. The effective severance tax rate on the new production is thus -3.9 percent. The effect is analagous to a personal income tax where the effective tax rates become lower as increasing income moves the taxpayer into a higher bracket.

The second ARCO example illustrates how this will be changed under the proposed law. Instead of giving the owners a \$37,846 windfall, the proposed law will collect \$58,611 (6.0 percent) of the incremental \$981,000 for the state in severance tax. The table below summarizes the effects under the current and proposed severance tax laws, as shown in the ARCO examples.

TAX EFFECTS OF DRILLING ONE ADDITIONAL WELL
(ARCO Kuparuk Example)

	Change In Annual Gross Revenue	Change In Annual Severance Tax	Tax Rate On Incremental Production	Average Tax Rate Before Drilling	Average Tax Rate After Drilling	Percent Change In Average Tax Rate Due To Drilling
Current Law	\$981,000	(\$37,846)	-3.9%	7.820%	7.806%	-0.180%
Proposed Law	\$981,000	\$58,611	6.0%	10.944%	10.938%	-0.055%

Prepared by Division of Policy, April 1987.

SB 97

LEGISLATION REVISING THE ECONOMIC LIMIT FACTOR (ELF)

Presented to the
Senate Special Committee on Oil and Gas
by the
Department of Revenue

March 16, 1989

INDEX

I. QUESTIONS AND ANSWERS ON SENATE BILL 97

II. SEVERANCE TAX AND THE ELF

- A. Definition of the Severance tax
- B. Importance of the Severance Tax to Alaska's Revenues
- C. Definition of the ELF
- D. Application of ELF to Produce the Effective Severance Tax Rate

III. HISTORY OF ELF

- A. The Tax Rate on Prudhoe Bay Has Dropped Sharply
- B. How Revenue Neutral Were the 1981 Changes?
- C. Selected Petroleum Revenues, FY 79 - FY 88
- D. General Fund Unrestricted Revenues, FY 88
- E. Severance Tax Receipts as Percentage of Gross Wellhead Value -- Prudhoe Bay

IV. SB 97

- A. Legislation
- B. Fiscal Note
- C. Size of Fields Where Taxes Will Increase or Decrease Under SB 97
- D. Sectional Analysis of SB 97: Legislation Revising the Economic Limit Factor

V. ELF'S EFFECTS ON ALASKA FIELDS

- A. Approximate Field Locations (Current and Prospective Fields)
- B. The Tax Rate on Prudhoe Bay Has Dropped Sharply
- C. Fields Where Taxes Would Increase Under SB 97
- D. Fields Where Taxes Would Decrease Under SB 97 (For Representative Years)
- E. Synopsis of Alaska Fields and Top Ten Lower 48 Fields
- F. U.S. Fields With Reserves Exceeding 100 Million Barrels (Oil and Gas Journal, January 30, 1989)

VI. ELF AND ALASKA'S REVENUES

- A. SB 97 Raises More Severance Tax Revenue From Prudhoe Bay and Kuparuk
- B. SB 97 Gives a Tax Savings For Producers At Oil Fields Other than Prudhoe Bay and Kuparuk
- C. Comparative Severance Tax Payments in 1987 For 10 Top Oil Producing States

QUESTIONS AND ANSWERS ON

SENATE BILL 97

Why should the Legislature modify the ELF?

This legislation promotes economic development, creates jobs, raises revenue, and protects the interests of the people of Alaska in their resources.

What tax does the Economic Limit Factor formula affect?

The Economic Limit Factor (ELF) formula affects the severance tax on oil. The severance tax — also called the production tax — is a tax on oil removed from the ground. The tax compensates for the depletion of the state's non-renewable resources. The severance tax has provided more than a third of the state's unrestricted General Fund revenue in the past decade.

What is the Economic Limit Factor?

The ELF is a formula which reduces the severance tax actually paid on oil. The ELF formula produces a fraction which reduces severance taxes as the productivity of a well declines. This reduced severance tax rate is the "effective" severance tax rate — that is, it is the rate the producer actually pays. The effective severance tax rate is the "nominal" severance tax rate (the one set out, or "named" in statute, which is normally 15 percent for mature fields) multiplied by the ELF. Here's an example which shows the tax rate on Prudhoe Bay now:

15% nominal tax rate

multiplied times ELF of 0.824

equals an effective severance tax
rate of 12.36%

The higher the ELF, the higher the actual tax paid. The lower the ELF, the lower the actual tax paid. A low ELF provides a large tax break.

Why do we have the ELF?

The ELF was originally created in 1977 to encourage oil companies to develop marginal oil fields, and to extend the life of producing fields when production at those fields became marginal.

How did we get to where we are today?

In 1981, the Legislature sharply reduced the state's corporate income tax on oil and gas producers by abandoning separate accounting. (The changes were made because the separate accounting law had been challenged in court, but the state later won the lawsuit.) In an attempt to compensate for the expected loss of revenues from the changes made in the corporate income tax, the Legislature raised the severance tax rate from 12.25% to 15%. Because the ELF formula would have cut into this needed revenue, the Legislature as a stopgap measure —
- suspended the ELF at Prudhoe Bay until 1987.

Even at the outset, this attempt to compensate failed. The 1981 changes in the income tax and severance tax had the net effect of costing the state more than \$1 billion in lost revenues between fiscal years 1982 and 1987.

In 1987, the impact of the 1981 tax changes became even more negative for the state. When the stopgap provision ended in 1987, this additional tax break caused the effective severance tax rate at Prudhoe Bay to drop sharply. (Graphic #1 shows this sharp drop for Prudhoe Bay.) This sharp drop immediately cut Alaska's total revenue by \$135,000,000 in FY88, and has cost the state more than \$70 million more for FY 89 by the middle of March of 1989.

Why do people want to change the ELF now?

The current ELF is not giving Alaska an attractive enough tax climate to encourage development of marginal oil fields. Instead of helping marginal fields, the ELF formula now mostly provides a massive and unnecessary tax break to two fields which are not marginal at all — Prudhoe Bay and Kuparuk. These are the largest oil fields in the United States, and two of the most profitable as well.

Senate Bill 97 would target tax breaks toward marginal fields and away from these two large, high-profit fields. The bill would give tax breaks to currently producing marginal fields such as Endicott and Lisburne and to prospective marginal fields at Niakuk, Point Thomson, Milne Point, and Seal Island. It would leave taxes at zero at West Sak and all the Cook Inlet fields. (See Graphic #2.)

In fact, SB 97 would cut — or leave at zero — the taxes on every oil field in Alaska except Prudhoe Bay and Kuparuk.

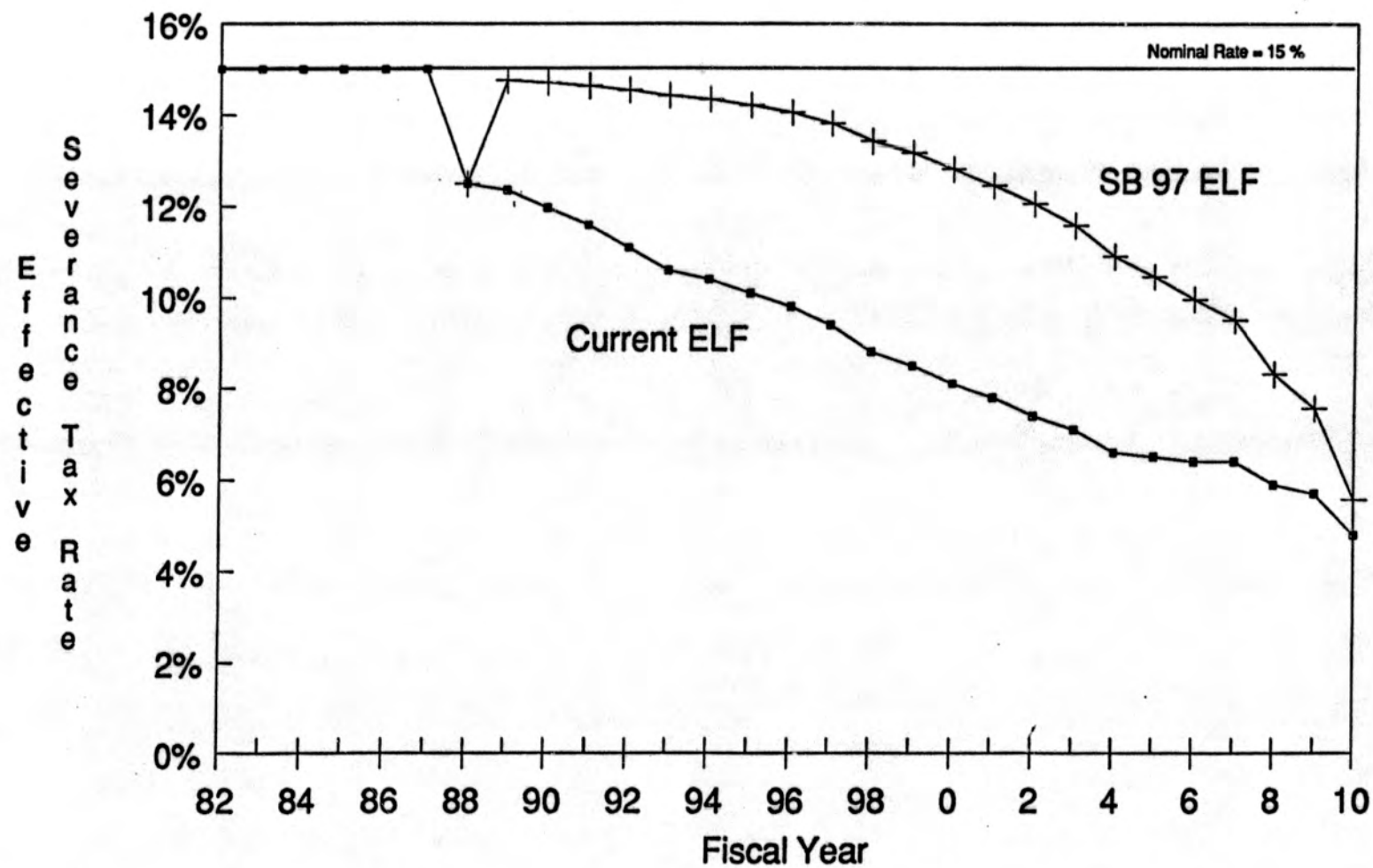
SB 97 would reduce the tax breaks given to Prudhoe Bay and Kuparuk. The current ELF gives a 20 percent tax break to Prudhoe Bay, and more than a 40 percent tax break to Kuparuk. SB 97 would reduce — but not eliminate — the tax breaks given to these two large fields.

Graphic #3 shows the tax savings provided by SB 97 for producers at all other fields except Prudhoe Bay and Kuparuk. Graphic #4 shows the increased revenues generated from Prudhoe Bay and Kuparuk by SB 97. The legislation on balance raises substantial revenues.

How much revenue would SB 97 raise?

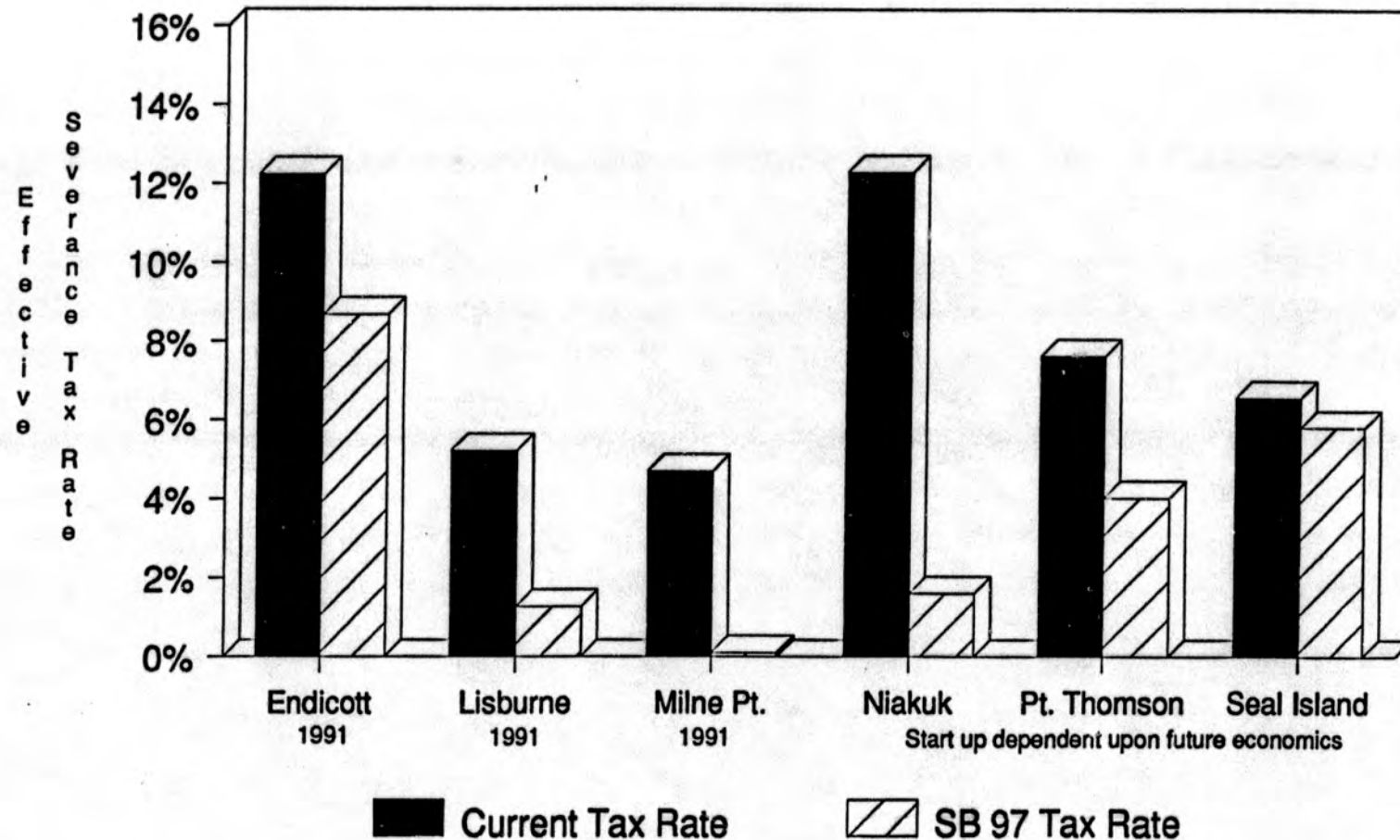
SB 97 would raise a total of \$154 million for FY 89 and FY 90. For the FY 91-FY 95 period, the legislation would raise \$734 million.

The Tax Rate on Prudhoe Bay Has Dropped Sharply



Date: March 3, 1989

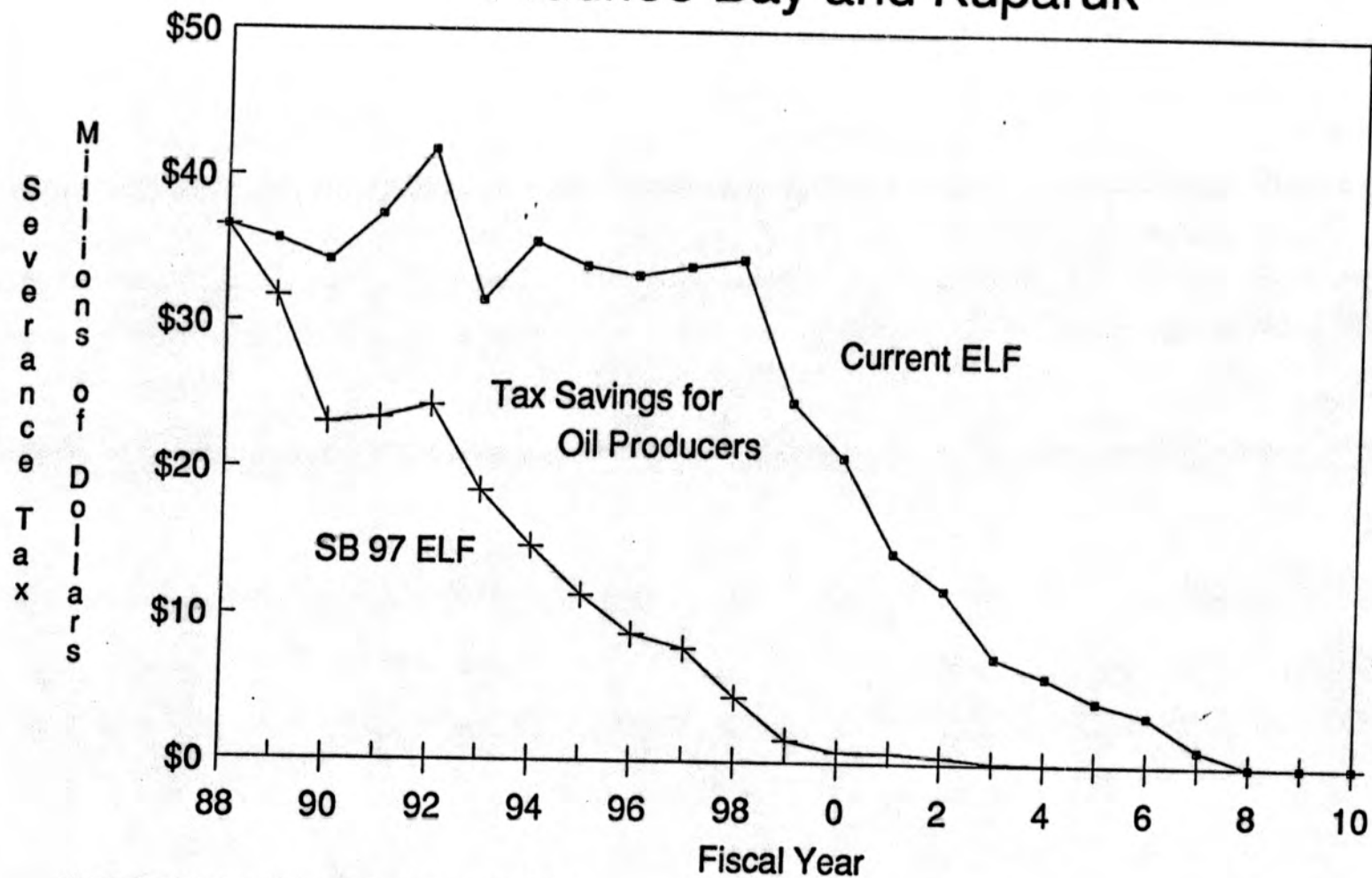
Fields Where Taxes Would Decrease Under SB 97 (For Peak Years)



Date: March 3, 1989
Source: Department of Revenue

Note: Cook Inlet and West Sak pay no severance tax under either tax rate. Endicott, Lisburne and Cook Inlet are currently producing. Milne Point is assumed to start production in April 89. Other fields are prospective.

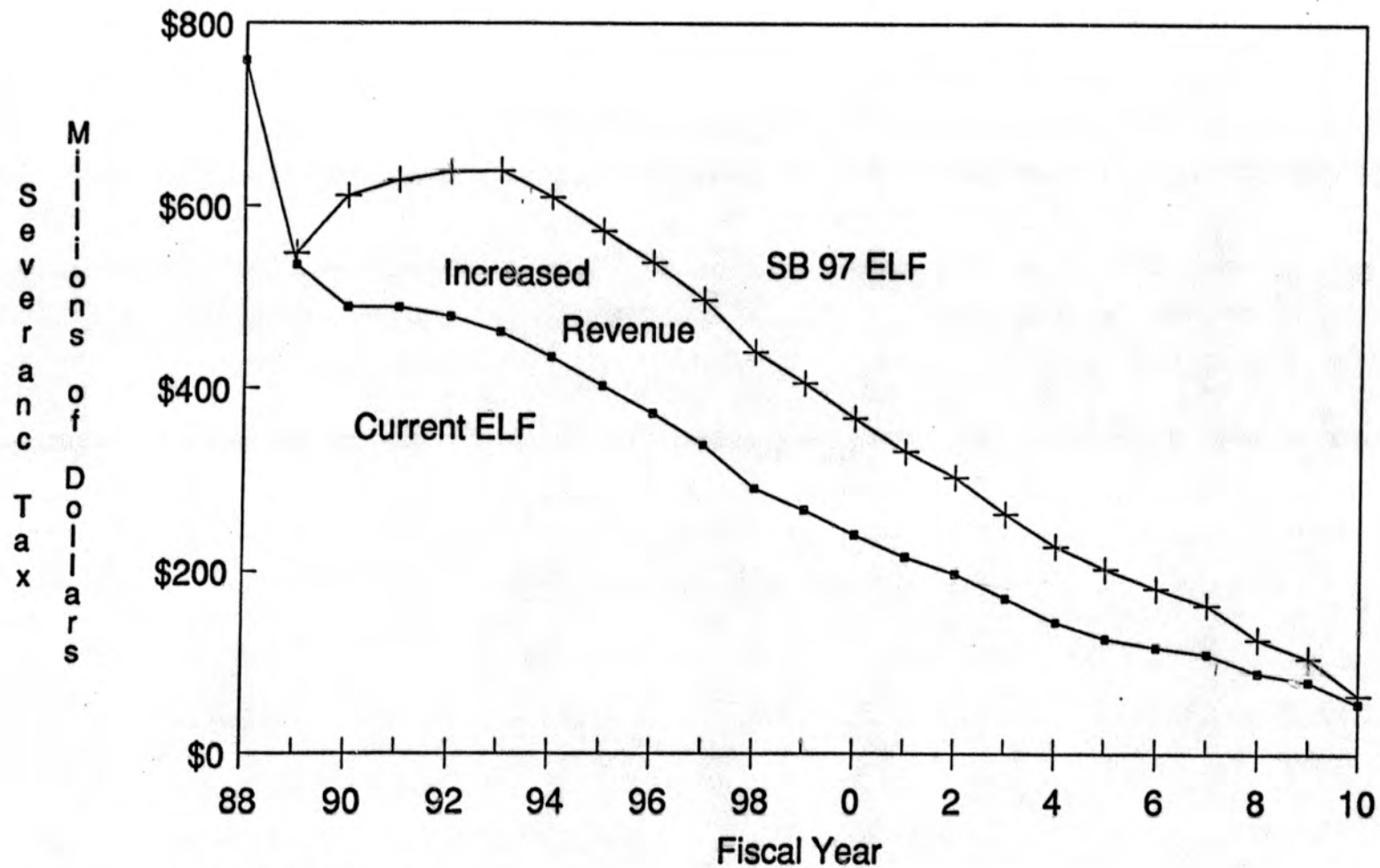
SB 97 Gives a Tax Savings for Producers at Oil Fields Other than Prudhoe Bay and Kuparuk



Note: Revenues are from severance taxes on fields
other than Prudhoe Bay and Kuparuk

Date: March 9, 1989

SB 97 Raises More Severance Tax Revenue from Prudhoe Bay and Kuparuk



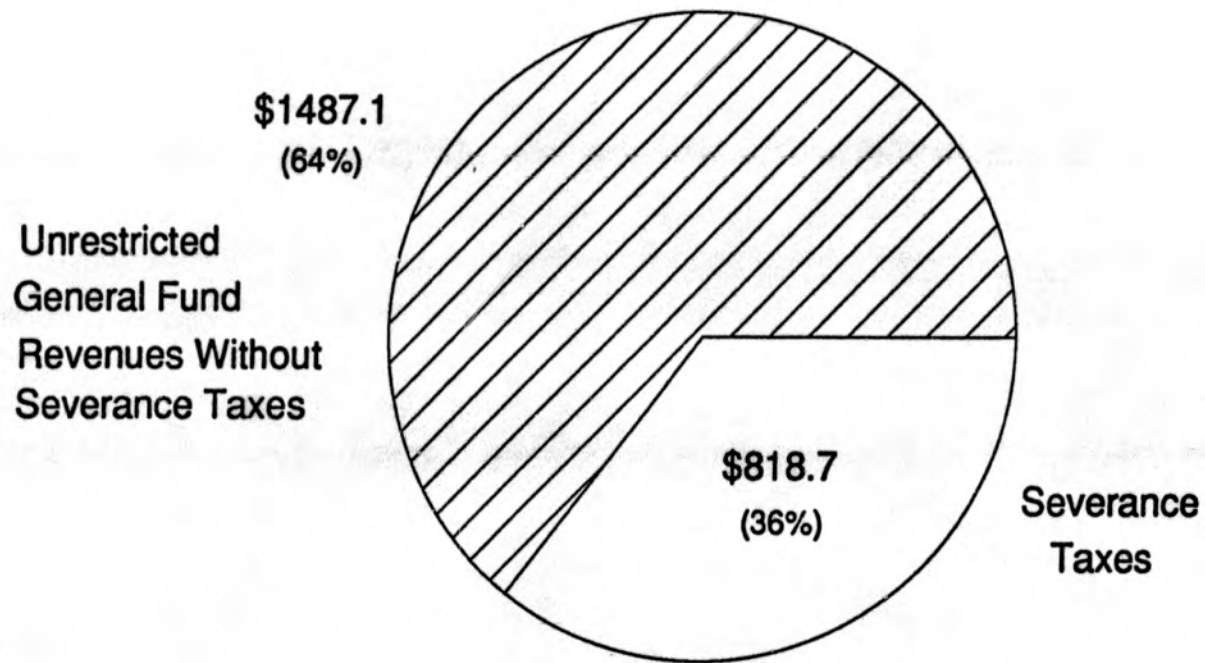
Note: Revenues are from severance taxes on Prudhoe Bay and Kuparuk

Date: March 3, 1989

SEVERANCE TAX, also called production tax, is a tax on oil removed from the ground. The tax compensates for the depletion of the state's non-renewable resources.

Date: February 7, 1989

Severance Taxes are an Important Part of Alaska's Revenues



\$2305.8
Total Unrestricted General Fund
Revenues For Fiscal Year 1988

Date: February 7, 1989

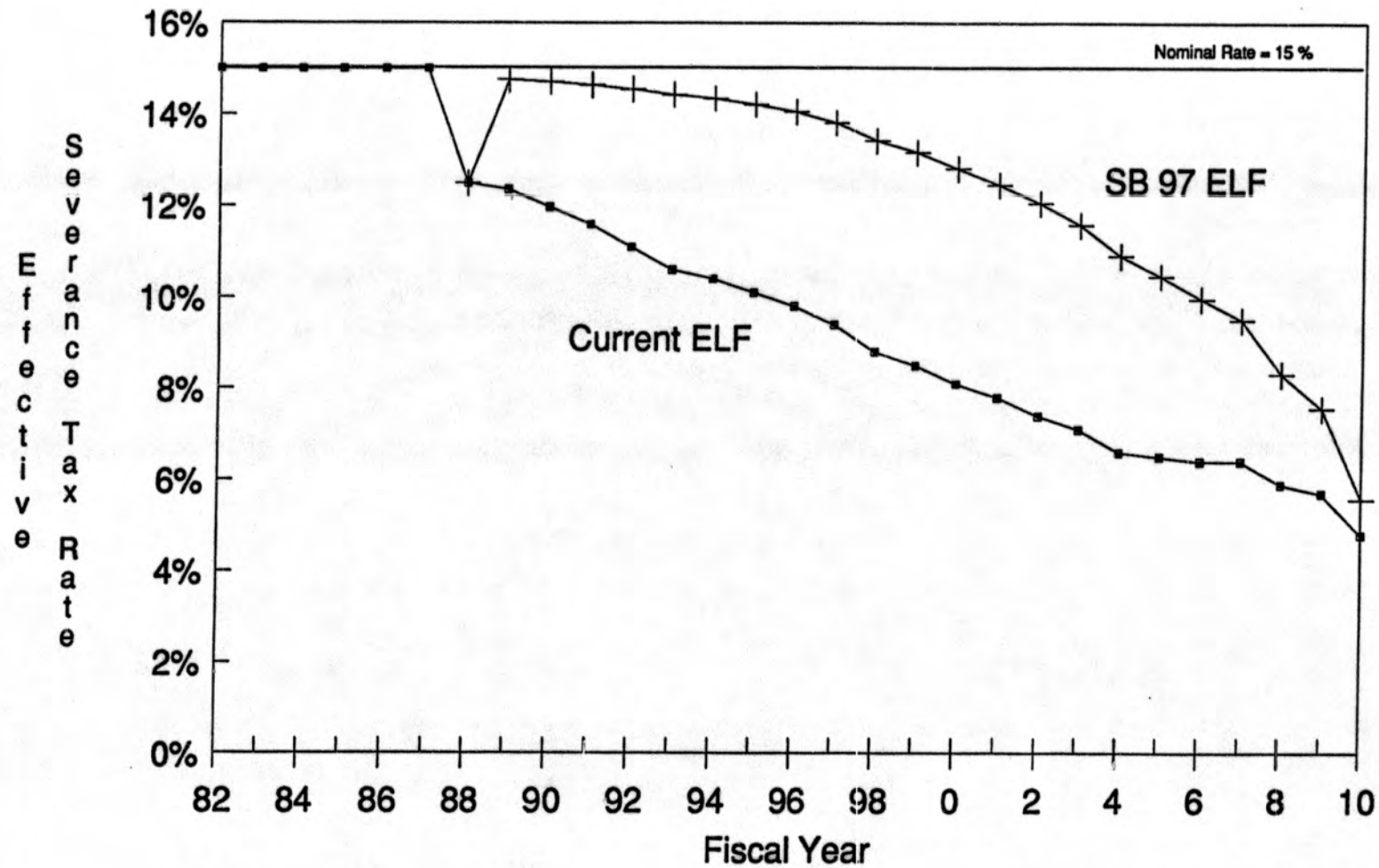
The Economic Limit Factor or ELF is a fraction which reduces severance taxes as well productivity declines.

Date: February 7, 1989

EFFECTIVE SEVERANCE TAX RATE
equals nominal severance tax rate times ELF.

For example, 15.00% times 0.824 equals
an effective severance tax rate of 12.36 %

The Tax Rate on Prudhoe Bay Has Dropped Sharply



Date: March 3, 1989

HOW REVENUE NEUTRAL WERE THE 1981 CHANGES?
(\$mm)

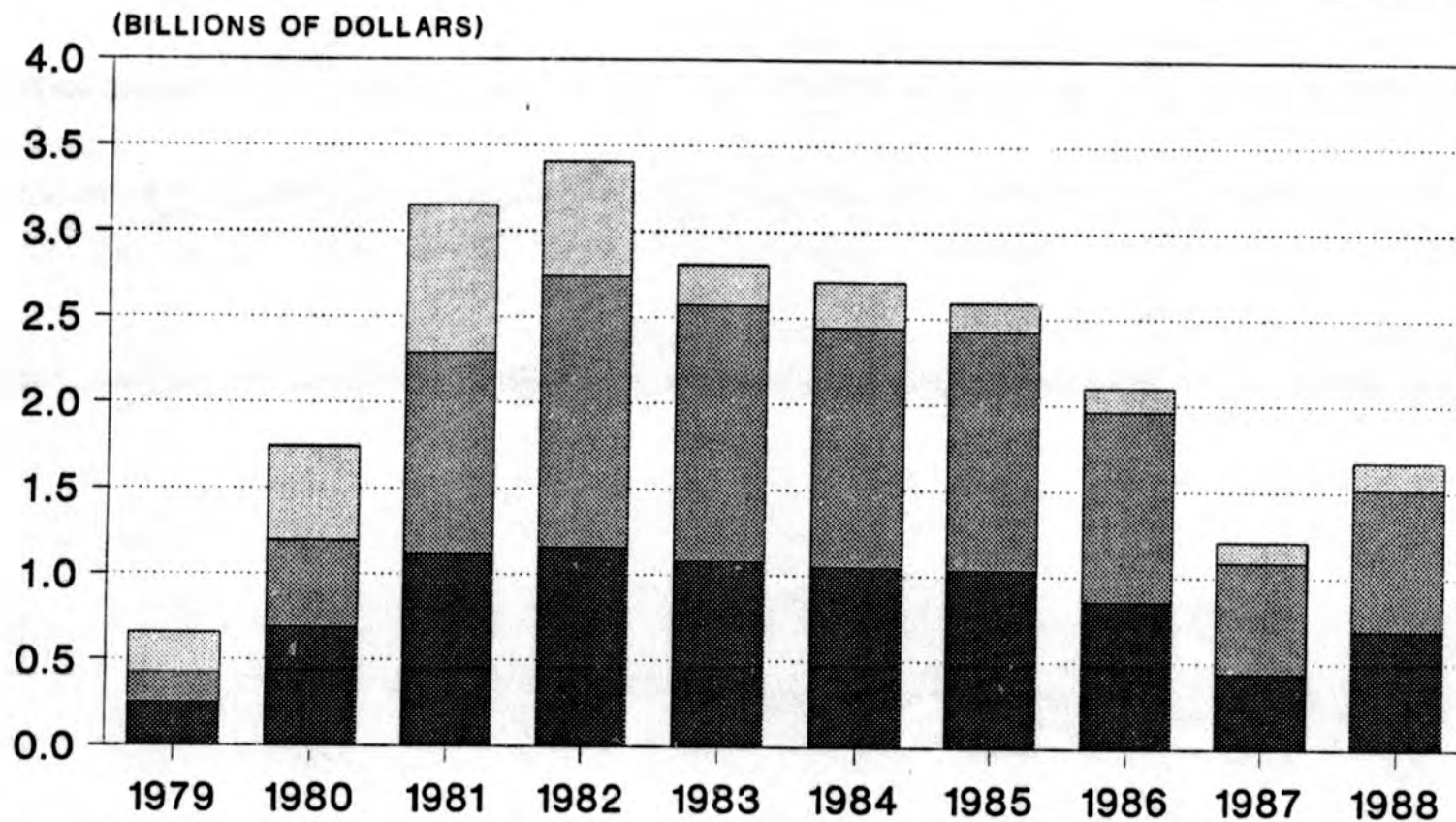
	<u>What collections would have been under pre 1982 Law</u>			<u>Actual Collections</u>			<u>Loss from change in Law</u>
	<u>Petro. Corp. Income Tax</u>	<u>Sev. Tax</u>	<u>Total</u>	<u>Petro. Corp. Income Tax</u>	<u>Sev. Tax</u>	<u>Total</u>	
1982	980	1219	2199	669	1582	2251	52
1983	915	1099	2014	236	1494	1730	(284)
1984	836	1033	1869	265	1393	1658	(211)
1985	812	1014	1826	169	1389	1558	(268)
1986	658	805	1463	134	1108	1242	(221)
1987	<u>375</u>	<u>464</u>	<u>839</u>	<u>120</u>	<u>649</u>	<u>769</u>	<u>(70)</u>
Total	4576	5634	10210	1593	7615	9208	(1002)*

*Had the Legislature authorized deduction of the Federal Windfall Profits Tax the total loss over the period would have been \$670 mm

SELECTED PETROLEUM REVENUES

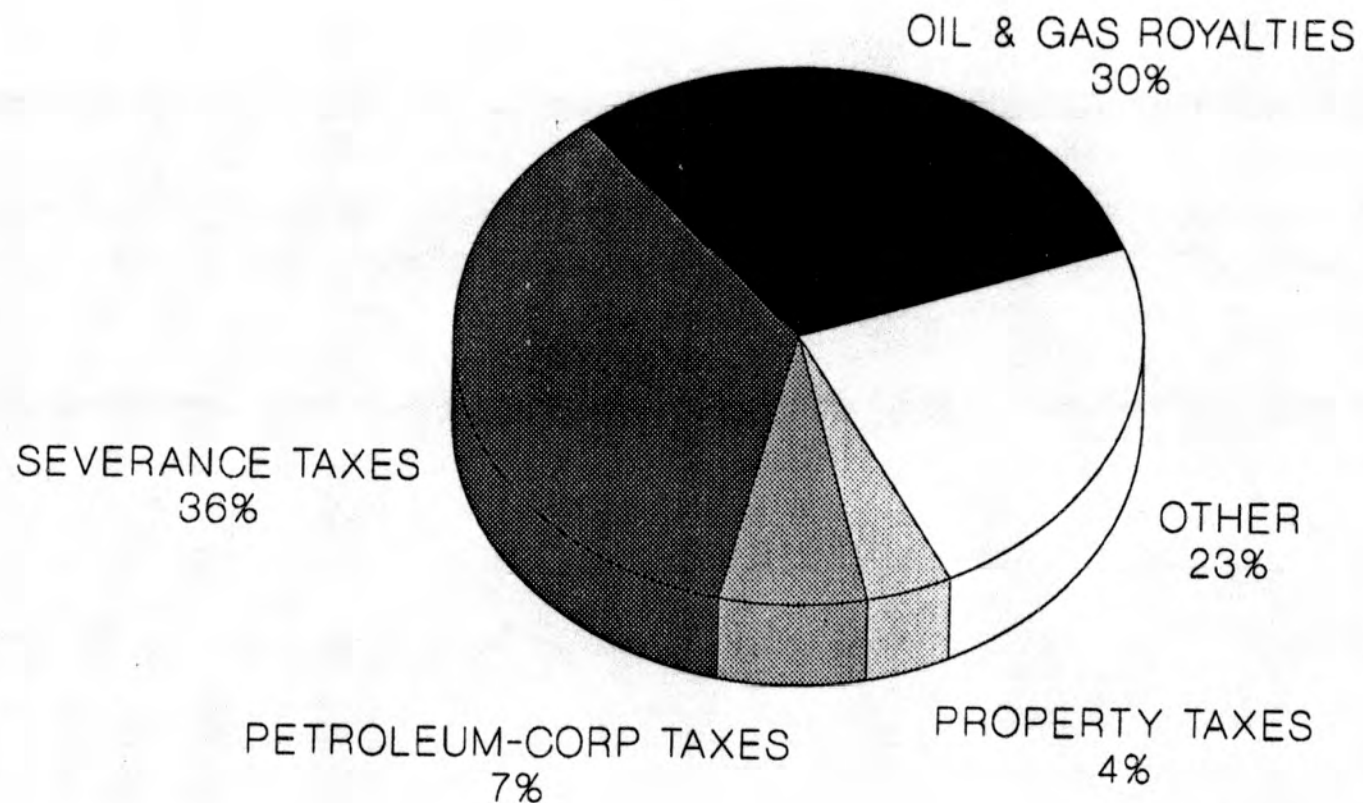
(FY 1979 - 1988)

ROYALTIES SEVERANCE PETROLEUM-CORP



(Alaska Department of Revenue-Research)

GENERAL FUND UNRESTRICTED REVENUES (FY 1988)



(Alaska Department of Revenue-Research)

1 IN THE SENATE

BY ADAMS

2

SENATE BILL NO. 97

3

IN THE LEGISLATURE OF THE STATE OF ALASKA

4

SIXTEENTH LEGISLATURE - FIRST SESSION

5

A BILL

6 For an Act entitled: "An Act relating to the oil and gas properties pro-
7 duction tax; and providing for an effective date."

8 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

9 * Section 1. AS 43.55.013(b) is repealed and reenacted to read:

10 (b) The economic limit factor for oil production of a lease or
11 property shall be computed according to the following formula:

12 $(1 - [PEL/TP]) \exp ([55,000,000 \times WD] / [PEL \times TP/Days])$

13 where: PEL = the monthly production rate at the economic limit;

14 TP = the total production during the month for which the tax
15 is to be paid;

16 WD = the total number of well days in the month for which
17 the tax is to be paid;

18 Days = the number of days in the month for which the tax is to
19 be paid; and

20 where "exp" indicates that the expression following it is an exponent.

21 * Sec. 2. AS 43.55.013(d) is amended to read:

22 (d) The monthly production rate at the economic limit for a
23 lease or property is [PRESUMED TO BE] 300 barrels times the number of
24 well days for the lease or property during the month for which the tax
25 is to be paid. [THE TAXPAYER MAY REBUT THIS PRESUMPTION AT A FORMAL
26 HEARING UNDER AS 43.05.240 BY PROVIDING CLEAR AND CONVINCING EVIDENCE
27 OF A DIFFERENT MONTHLY PRODUCTION RATE AT THE ECONOMIC LIMIT FOR THE
28 LEASE OR PROPERTY. THE HEARING SHALL BE HELD BEFORE FEBRUARY 15 OF
29 THE YEAR OR WITHIN SIX MONTHS AFTER COMMENCEMENT OF OIL PRODUCTION FOR

STATE OF ALASKA
1989 LEGISLATIVE SESSION

Bill Version: SB 97
Publish Date: _____

FISCAL NOTE

REQUEST:

Revision Date: _____
Title: Act relating to the oil and gas
properties production tax
Sponsor: _____
Requestor: _____

Agency Affected: Department of Revenue
BRU: Oil & Gas Audit Division
Components: _____

EXPENDITURES/REVENUES: (Thousands of Dollars)

	FY 89	FY 90	FY 91	FY 92	FY 93	FY 94
OPERATING						
PERSONAL SERVICES	0	0	0	0	0	0
TRAVEL	0	0	0	0	0	0
CONTRACTUAL	0	0	0	0	0	0
SUPPLIES	0	0	0	0	0	0
EQUIPMENT	0	0	0	0	0	0
LANDS & STRUCTURES	0	0	0	0	0	0
GRANTS, CLAIMS	0	0	0	0	0	0
MISCELLANEOUS	0	0	0	0	0	0
TOTAL OPERATING	0	0	0	0	0	0
CAPITAL	0	0	0	0	0	0
REVENUE	43,000	111,000	126,000	141,000	164,000	155,000

FUNDING: (Thousands of Dollars)

GENERAL FUND	0	0	0	0	0	0
FEDERAL FUNDS	0	0	0	0	0	0
OTHER	0	0	0	0	0	0
TOTAL	0	0	0	0	0	0

POSITIONS:

FULL-TIME	0	0	0	0	0	0
PART-TIME	0	0	0	0	0	0
TEMPORARY	0	0	0	0	0	0

ANALYSIS: See attached analysis.

Prepared By: Roger Marks

Division: Dept. of Revenue, Oil & Gas Audit Division

Phone: 277-5627

Date: February 10, 1989

Approved by Commissioner: Hugh Malone

Agency: Department of Revenue

Date: 2/15/89

Distribution (by preparer):

Legislative Finance

Legislative Sponsor

Requestor

Office of Management and Budget

Impacted Agency(ies)

Fiscal Analysis of SB 97

This bill modifies the economic limit factor (ELF) formula used in computing the production (severance) tax on oil.

The bill (1) introduces the rate of field production into the exponent of the current ELF formula; (2) repeals the so-called "rounding rule," the provision of current law which states that for any month during the first 10 years of commercial oil production for which the computed ELF of a lease or property exceeds 0.7 the ELF shall be considered to be one; and (3) fixes the production at the economic limit (PEL) at 300 barrels times the number of well days in the month.

Since the bill carries an effective date of January 1, 1989, this analysis has assumed that the bill will apply to oil produced after December 31, 1988. (Because the severance tax on oil for a given month is due during the following month, a tax change which takes effect on January 1 would not affect revenues until February.)

This fiscal note was calculated using the oil price and production assumptions of the Department of Revenue's Fall 1988 Petroleum Production Revenue Forecast mid-case scenario updated for actual data through November of 1988. 1/

Additional revenues for future years in millions of dollars are as follows:

1995	148
1996	141
1997	133
1998	119
1999	115
2000	107
2001	101
2002	94
2003	85
2004	77
2005	72
2006	61
2007	52
2008	37
2009	26
2010	9

1/ Had the fiscal note used the oil price and volume assumptions of the "Consensus Revenue Analysis" of January 24, 1989, the FY 89 fiscal impact would be \$49 million and the FY 90 fiscal impact would be \$117 million.

Size of Field Where Taxes Will Increase or Decrease Under SB 97

SB 97 modifies the ELF statute in two ways which affect the relationship of field size to the tax rate for the field: (1) by modifying the formula; and (2) by repealing the "rounding rule." (Under current law if a field has an ELF of greater than 0.7 for the first ten years of the field, the ELF is elevated to 1.0. This is called the "rounding rule.") The combined effect of these two changes will increase the severance tax on fields producing an average of more than approximately 300,000 barrels per day, and will reduce the severance tax on fields producing an average of less than approximately 300,000 barrels per day. An analysis of these two changes and the underlying assumptions follows.

The change in the formula would raise taxes on fields which produce more than approximately 120,000 barrels per day and for which the rounding rule does not apply. (Only Prudhoe Bay and Kuparuk fit this description. The rounding rule does not apply to them now because Prudhoe Bay is older than ten years, and Kuparuk's current ELF is less than 0.7.) The Bill would cut taxes -- or leave them at zero -- for any field producing less than approximately 120,000 barrels per day. If a field produces an average of less than 300 barrels per well per day, their taxes are zero under current law and the new Bill.

The Bill also initially decreases the ELF for new higher-productivity (where average well productivity is greater than 1500 barrels per day) large fields (over the 120,000 barrel per day level). Under current law, fields producing more than an average of 1500 barrels per well per day will have an ELF of greater than 0.7, and would have an initial effective ELF of 1.0 because of the rounding rule. Since the first ten years of the field is when the greatest proportion of oil is produced (upwards of 75 percent), these large fields could have reduced weighted average severance taxes over the entire life of the field under the Bill since it eliminates the rounding rule. The exact size of field that will benefit over the entire life of the field will depend on its well productivity, decline profile, and the discount rate. We estimate that a field with the same well productivity and decline characteristics as Endicott, for example, (which produces 100,000 barrels per day and produces 2800 barrels per well per day average), but with peak production of 1,000,000 barrels per day, would have the same discounted (8%) weighted average effective ELF over the life of the field under the Bill as it would under current law. Fields producing less than that amount would have a lower ELF than under current law.

A weighted average of all field sizes and average per well productivities from all Alaska fields indicates that on average fields which produce less than approximately 300,000 barrels per day will have a reduced severance tax under SB 97.

SECTIONAL ANALYSIS OF SB 97: LEGISLATION REVISING
THE ECONOMIC LIMIT FACTOR

Section 1. This section modifies the severance tax's Economic Limit Factor (ELF) as it relates to oil production.

Under current law and under this section, the ELF statute reduces the effective severance tax rate on oil production by applying a formula which considers productivity. The ELF formula always produces a fraction between zero and one. That fraction is multiplied with the nominal tax rate to get the effective tax rate. This means that the higher the ELF, the higher the actual tax paid; the lower the ELF, the lower the actual tax paid. This also means that if the ELF is zero, the severance tax rate is zero.

This section changes the ELF statute in two ways.

First, this section modifies the formula for calculating the "economic limit" of oil production. The current law considers only average per-well productivity of the field. The formula here adds consideration of total field productivity to the current ELF formula. Second, this section repeals the provision of current law which states

that for any month during the first 10 years of commercial oil production for which a lease or property's computed ELF exceeds 0.7, the ELF shall be considered to be one. This section's repeal of this "rounding" rule of current law would result in initial lower taxes for any field in this situation.

Compared to current law, these two changes raise taxes on fields producing on average more than 300,000 barrels a day and reduce taxes on fields producing on average less than 300,000 barrels a day.

Section 2. This section fixes the monthly production at the economic limit (PEL) at 300 barrels per well per day. The PEL is a rough approximation of the number of barrels a well must produce to cover costs.

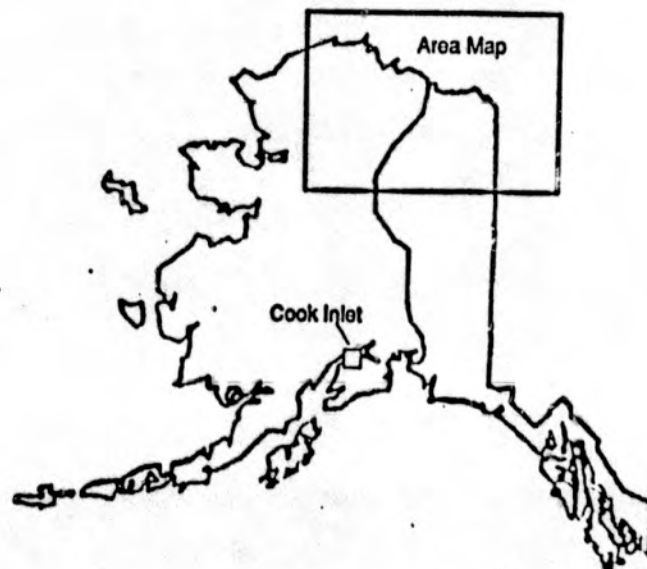
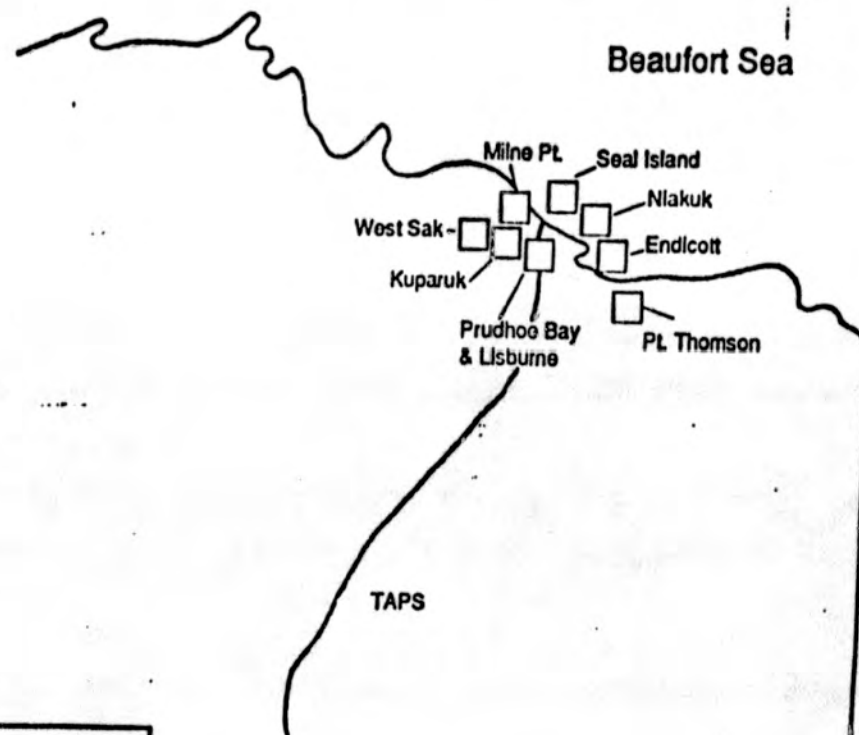
Under current law, the PEL is presumed to be 300 barrels a day, and the taxpayer may rebut this presumption at a hearing. This section repeals the provisions for rebutting the 300 barrel per day presumption.

Section 3. This section repeals two provisions of current law which are only necessary for setting a PEL in a hearing.

Section 4. This section makes the legislation apply to oil produced after December 31, 1988.

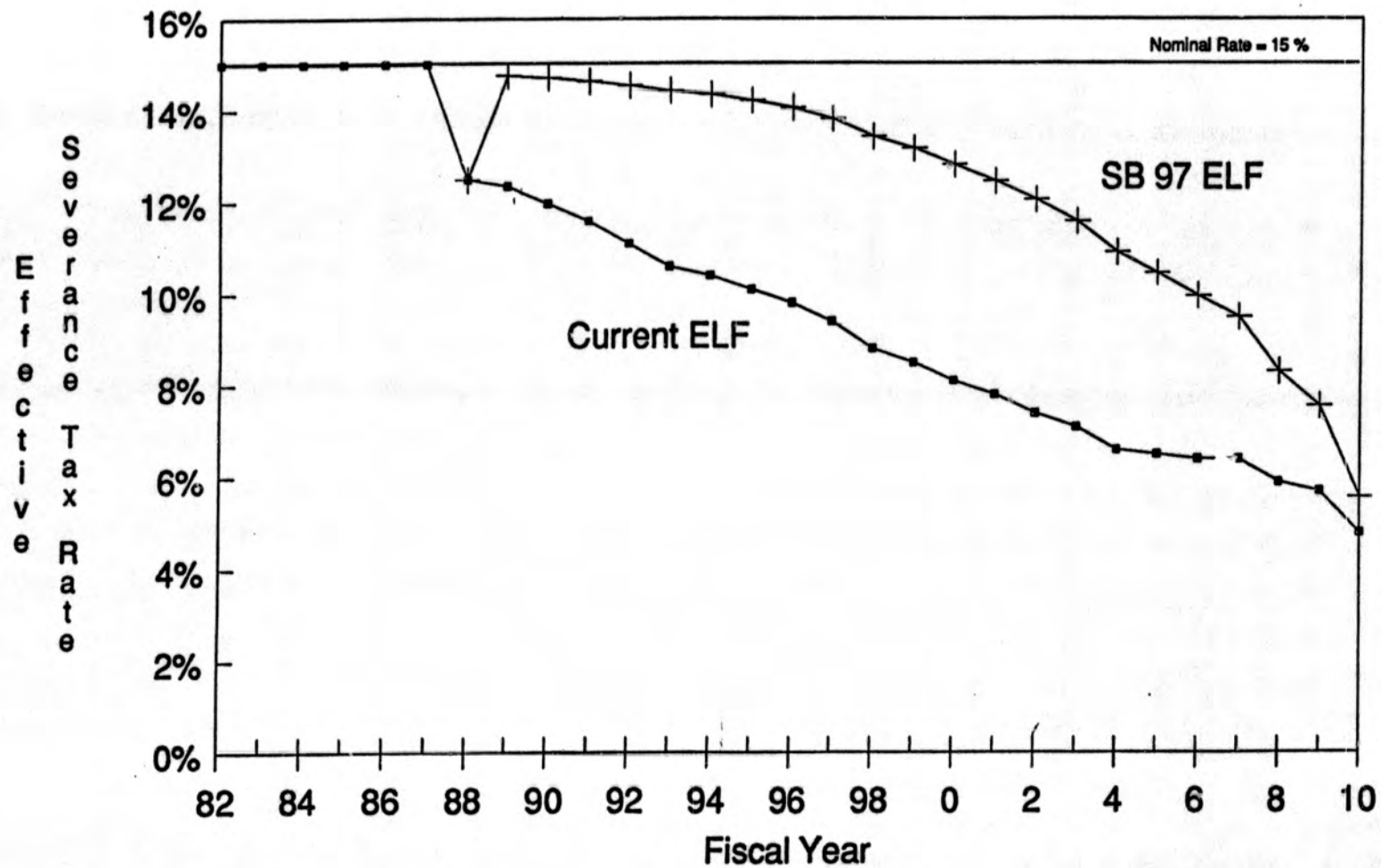
Section 5. This section sets an immediate effective date.

State of Alaska
Approximate Field Locations
(Current and Prospective Fields)



Date: February 7, 1989

The Tax Rate on Prudhoe Bay Has Dropped Sharply



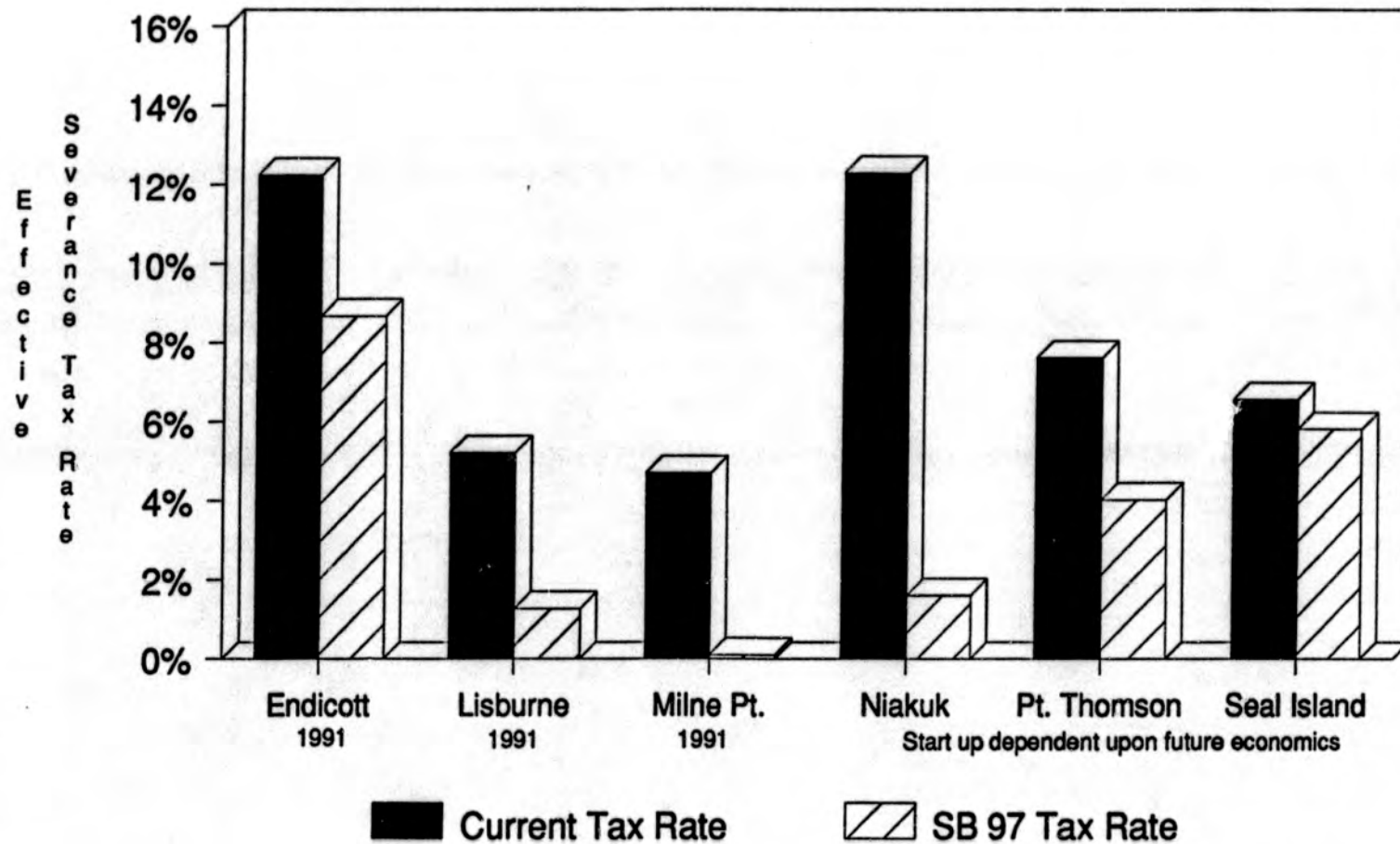
Date: March 3, 1989

Fields Where Taxes Would Increase Under SB 97

<u>Field</u>	<u>Current Tax Rate¹</u>	<u>HB 118 Tax Rate¹</u>
Prudhoe Bay	11.59	14.64
Kuparuk	8.36	11.91

¹ Estimated effective severance tax rate for 1991.

Fields Where Taxes Would Decrease Under SB 97 (For Peak Years)



Date: March 3, 1989
Source: Department of Revenue

Note: Cook Inlet and West Sak pay no severance tax under either tax rate. Endicott, Lisburne and Cook Inlet are currently producing. Milne Point is assumed to start production in April 89. Other fields are prospective.

Synopsis of Alaska Fields

<u>Field</u>	<u>Volume (bbls/day)</u>	<u>Wells</u>	<u>Daily Volume p/well</u>	<u>Effctv Sev Tax Rate Under Current Law</u>	<u>Effctv Sev Tax Rate Under SB 97</u>
<u>Current Fields</u>					
<u>North Slope</u>					
Prudhoe Bay	1,526,932	691	2210	11.97%	14.71%
Kuparuk	320,685	337	952	8.58%	12.03%
Lisburne	38,293	51	751	5.65%	1.58%
Endicott	98,099	35	2803	12.25%	9.45%
<u>Cook Inlet</u>					
Beaver Creek	263	2	132	0.00%	0.00%
Granite Pt.	7,454	29	257	0.00%	0.00%
McArthur River	19,053	76	251	0.00%	0.00%
Middle Ground Shoals	7,913	44	180	0.00%	0.00%
Swanson River	5,684	27	211	0.00%	0.00%
Trading Bay	2,310	34	68	0.00%	0.00%
<u>Prospective Fields</u>					
Milne Pt.	30,000	40	750	5.77%	0.01%
West Sak	260,000	4000	65	0.00%	0.00%
Pt. Thomson	50,000	45	1111	7.62%	4.02%
Seal Island	100,000	112	893	6.57%	5.81%
Niakuk	20,000	12	1667	12.25%	1.61%

For current fields actual November 1988 data. For prospective fields the expected values at peak production.

Top Ten Lower 48 Fields

	<u>Volume (bbls/day)</u>	<u>Wells</u>	<u>Daily Volume p/well</u>	<u>Effctv Sev Tax Rate- Current Alaska Law</u>	<u>Effctv Sev Tax Rate- SB 97</u>
1. Belridge South (CA)	165,981	6000	28	0.00%	0.00%
2. Midway-Sunset (CA)	157,526	9180	17	0.00%	0.00%
3. Kern River (CA)	128,490	6709	19	0.00%	0.00%
4. East Texas (TX)	111,225	9363	12	0.00%	0.00%
5. Elk Hills (CA)	107,244	1099	98	0.00%	0.00%
6. Yates (TX)	91,890	1146	80	0.00%	0.00%
7. Wilmington (CA)	81,975	2050	40	0.00%	0.00%
8. Wasson (TX)	78,510	2152	36	0.00%	0.00%
9. Spraberry Trend (TX)	60,585	7321	8	0.00%	0.00%
10. Slaughter (TX)	55,792	3001	19	0.00%	0.00%

FEB 08 '89 11:17 PENNWELL. - TULSA

P.2

U.S. fields with reserves exceeding 100 million bbl

State	Field	Disc. date	1988 prod.	Cum. prod. 1-1-89	Est. rem. reserves	Est. No. wells
-------	-------	------------	------------	-------------------	--------------------	----------------

ALABAMA

Citronelle, 1955	1.827	147,861	7,000	435
------------------	-------	---------	-------	-----

ALASKA

Endicott, 1978	36,092	43,098	324,902	37
Granite Point, 1965	2,787	109,535	16,213	29
Kuparuk River, 1969	112,055	503,357	994,945	328
Lisburne, 1967	14,800	35,600	175,689	49
McArthur River, 1965	7,040	529,040	34,950	76
Middle Ground Shoal, 1962	2,737	155,889	5,263	42
Prudhoe Bay, 1967	578,335*	6,053,018*	3,533,665	691
Swanson River, 1957	2,154	209,490	8,846	29

*Includes about 30.66 million bbl of condensate. †Includes about 138.66 million bbl of condensate.

ARKANSAS

Smackover, 1922	2,654	556,907	9,097	2,100
-----------------	-------	---------	-------	-------

CALIFORNIA

San Joaquin Valley				
Bainbridge South, 1911	60,593	677,083	435,286	6,000
Buena Vista, 1909	1,574	647,274	38,271	895
Coalinga, 1890	10,212	753,545	161,198	2,174
Coalinga Nose, 1923	1,285	458,685	17,370	78
Coles Levee North, 1938	442	160,432	2,748	85
Cuyama South, 1949	469	213,191	6,938	105
Dynmic, 1909	8,479	199,303	40,000	1,013
Edison, 1929	1,470	134,591	25,670	674
Elk Hills, 1911	39,144	693,574	579,776	1,099
Fruitvale, 1923	577	115,553	13,709	274
Grealey, 1935	237	112,547	1,763	27
Kern Front, 1912	1,500	173,066	55,230	950
Kern River, 1939	46,639	1,204,479	743,000	6,709
Kettleman North Dome, 1928	172	456,648	1,299	44
Lost Hills, 1910	5,627	173,293	61,603	1,634
McKittrick, 1926	2,551	266,822	90,919	931
Midway-Sunset, 1934	57,497	1,879,347	373,953	9,180
Mount Pass, 1925	5,620	263,230	79,230	411
Rio Bravo, 1937	151	115,051	1,319	15
Yorba Linda, 1974	6,570	81,353	27,015	65
Coastal Area				
Carpinteria, 1966	2,650	88,101	29,289	114
Cat Canyon E. & W., 1908	2,735	298,235	46,930	512
Des Cadenas, 1959	4,371	212,924	54,140	140
Elwood, 1923	317	105,705	2,283	7
Hondo, 1959	9,952	89,621	112,223	130
Orcutt, 1901	906	165,874	10,235	26
Point Pedernales, 1992†	6,515	11,715	331,544	10
Rincon, 1927	1,118	148,759	14,832	240
San Ardo, 1947	4,541	408,351	122,903	600
Santa Maria valley, 1934	1,751	198,131	40,408	172
South Mountain, 1915	727	145,584	12,035	352
Ventura, 1919	7,072	894,742	97,025	570
Los Angeles Basin				
Beta, 1976	6,013	40,423	173,825	60
Beverly Hills, 1900	2,024	122,515	42,356	116
Brea Clinda, 1880	2,143	383,394	54,787	720
Coyote East, 1909	524	103,553	13,212	103
Coyote West, 1909	808	249,559	7,481	113
Dominguez, 1923	607	269,256	7,448	113
Huntington Beach, 1920	5,816	1,066,353	72,044	990
Inglewood, 1924	2,790	345,453	54,149	386
Long Beach, 1921	2,466	909,757	17,216	410
Montebello, 1917	525	192,357	10,267	155
Richfield, 1919	1,494	189,165	27,412	203
Santa Fe Springs, 1919	987	613,077	9,035	151
Sear Beach, 1924	876	203,118	14,119	168
Torrance, 1922	1,693	212,023	35,247	365
Wilmington, 1932	23,921	2,292,229	495,633	2,020

COLORADO

Rangely, 1933	12,492	739,418	35,000	488
---------------	--------	---------	--------	-----

FLORIDA

Jay, 1970	4,676	360,612	55,944	121
-----------	-------	---------	--------	-----

ILLINOIS

Clay City, 1938	2,449	393,960	6,000	2,600
Lawrence, 1906	2,919	394,521	5,500	2,700
Louden, 1938	1,345	388,237	3,555	1,340
Main, 1906	2,066	233,273	5,000	3,356
New Harmony, 1939	1,072	153,545	4,000	1,140
Salem, 1938	2,167	386,993	4,500	1,325

KANSAS

Bemis-Shutts, 1929	1,169	244,247	4,405	973
Chase-Silica, 1930	1,018	301,003	4,499	1,103
El Corado, 1915	839	296,734	2,615	822
Hall-Gurney, 1931	1,032	145,677	4,051	1,130
Trapp, 1929	1,200	225,958	4,643	1,000

LOUISIANA

Offshore				
Bay Marchand Blk. 2, 1949	5,547	596,972	53,758	120
Eugene Island Blk. 330, 1930	7,859	269,090	55,920	169
Grande Isle Blk. 16, 1948	1,659	263,729	85,645	44
Grande Isle Blk. 43, 1955	4,312	272,256	85,688	126
Mississippi Canyon Blk. 194, 1920	4,929	116,958	76,311	44
Main Pass Blk. 41, 1957	2,585	237,854	23,334	112
Main Pass Blk. 305, 1969	1,776	201,869	78,335	94
South Pass Blk. 27, 1954	1,659	125,317	73,198	118
South Pass Blk. 21, 1968	9,140	152,151	45,000	156
South Pass Blk. 62, 1965	3,331	106,364	91,594	73
South Pass Blk. 55, 1969	4,032	100,875	89,252	61
Ship Shoal Blk. 204, 1968	1,591	66,070	38,930	40
Ship Shoal Blk. 207, 1957	1,023	87,818	38,000	25
Ship Shoal Blk. 208, 1952	4,117	160,169	65,274	67
South Timberline Blk. 21, 1939	1,324	216,239	47,133	45
South Timberline Blk. 135, 1956	1,390	139,337	25,663	37
West Delta Blk. 30, 1949	6,754	446,083	47,375	153
West Delta Blk. 73, 1952	4,469	188,700	86,291	73
Onshore South				
Bay de Chene, 1941	390	96,382	17,952	24
Bay St. Elaine, 1928	321	164,508	25,292	18
Bayou Sole, 1941	769	161,369	3,417	20
Black Bay West, 1953	1,971	144,799	10,432	94
Callico Island, 1930	2,308	602,231	74,020	135
Cote Blanche Bay West, 1940	741	181,594	46,374	85
Delta Farms, 1944	293	115,351	7,019	13
Garden Island Bay, 1934	1,406	221,261	31,954	144
Golden Meadow, 1938	894	135,439	4,290	176
Grand Bay, 1938	454	170,514	3,750	61
Hackberry, East, 1927	777	109,087	7,603	60
Hackberry, West, 1928	1,771	141,895	6,492	107
Iowa, 1931	134	99,303	697	25
Jennings, 1901	315	116,409	700	181
Lafitte, 1935	1,665	255,304	9,550	111
Lake Barre, 1929	941	204,023	20,051	31
Lake Pelto, 1929	477	117,000	17,415	23
Lake Washington, 1931	2,353	242,390	16,376	93
Leeville, 1931	447	141,646	7,221	37
Paradise, 1939	725	126,650	8,600	31

FEB 08 '89 11:19 PENNWELL - TULSA

P.3

State	Field	Disc. date	1988 prod.	Cum. prod. 1-1-89 1,000 bbl	Est. rem. reserves	Est. No. wells
Quarantine Bay, 1937...			761	172,672	1,654	71
Timbalier Bay, 1938						
Venice, 1937			858	181,978	7,590	59
Vinton, 1910			287	161,001	800	96
Weeks Island, 1945			816	225,939	21,355	33
West Bay, 1940			1,349	228,246	16,355	79
North						
Caddo-Pine Island 1905			3,310	360,899	12,898	10,688
Delhi, 1944			673	211,707	34,651	58
Haynesville, 1921			761	168,237	2,373	166
Homer, 1919			434	98,375	1,908	193
Rodessa, 1935			331	106,027	1,506	67

MISSISSIPPI

Baxterville, 1944	2,609	239,154	10,391	316
Heidelberg, 1944	2,829	174,809	12,171	316
Tinsley, 1939	834	29,677	3,197	173

MONTANA

Bell Creek, 1957	938	128,836	22,984	91
Cut Bank, 1925	994	162,459	37,165	575
Pine, 1951	1,302	105,145	5,657	96

NEW MEXICO

Denton, 1949	652	138,693	3,000	179
Empire-Abo, 1957	1,424	219,933	50,017	405
Eunice-Monument, 1929	2,500	125,414	10,854	879
Hobbs, 1928	8,460	297,482	20,000	613
Majamar, 1926	1,859	144,961	5,070	851
Vacuum, 1929	12,359	432,242	40,000	1,556

NORTH DAKOTA

Beaver Lodge, 1951	1,704	111,574	16,684	132
Billings Nose, 1979	2,550	61,659	51,744	153
Little Knife, 1977	3,392	51,437	57,924	131
Mondak, 1976	439	13,165	82,537	55

OKLAHOMA

Burbank, 1920	1,135	536,746	8,377	1,105
Eola-Robertson, 1920	746	153,124	8,210	603
Fitts, 1934	2,963	199,594	12,000	589
Glenn Pool, 1905	1,170	327,885	5,000	714
Golden Trend, 1945	4,333	474,100	28,000	1,396
Healdton, 1913	1,938	334,645	9,553	1,000
Hewitt, 1919	3,152	266,371	13,615	923
Oklahoma City, 1928	802	816,170	5,955	174
Poste, 1955	1,216	106,393	14,921	226
Shovel-Turn, 1905	18,398	1,167,379	60,000	7,616
Sooner Trend, 1945	4,147	255,544	20,000	4,746

TEXAS

District 2				
Greta, 1933	746	147,570	12,530	100
Lake Pasture, 1953	2,184	87,784	12,544	143
Tom O'Connor, 1934	10,380	747,849	55,000	646
West Ranch, 1938	2,640	350,034	8,504	307

District 3				
Anahuac, 1935	1,068	264,886	15,112	106
Canoe, 1931	3,864	727,215	33,728	278
Giddings, 1971	8,658	278,570	148,032	2,281
Hartogs, 1934	3,084	697,237	72,764	205
Magnet Withers, 1935	1,234	110,960	5,000	150
Oyster Bayou, 1941	864	160,204	18,036	39
Thompson, 1931	3,972	472,540	27,350	262
Tamcat, 1932	400	121,055	9,658	85
Webster, 1937	5,304	573,192	20,000	243

District 4				
Agua Dulce-Stratton, 1928	360	146,623	24,751	94
Bonrepos, 1945	192	114,021	20,186	40
Kelsey, 1938	200	114,359	36,247	60

State	Field	Disc. date	1988 prod.	Cum. prod. 1-1-89 1,000 bbl	Est. rem. reserves	Est. No. wells
Plymouth, 1925			400	122,823	3,300	60
Seeligson, 1925			156	271,483	55,544	42
TCB, 1944			456	112,700	52,358	30
White Point E, 1938			60	104,034	6,340	21

District 5				
Alabama Ferry, 1983	3,600	14,600	86,400	253
Van, 1928	3,096	521,960	15,000	366

District 6				
East Texas, 1930.....	40,597	5,008,747	988,759	9,363
Fairway, 1950.....	2,424	192,591	17,777	100
Hawkins, 1940.....	8,244	821,644	42,372	442
Heches, 1953.....	1,416	103,930	6,036	163
Quintan, 1948.....	1,680	121,346	8,440	208

District 8				
Anector, 1946.....	1,500	181.888	6,500	28
Block 31, 1945.....	3,555	220.069	12.000	325
Cowden, N., 1930.....	13,596	488.032	40,000	1,210
Sum, S. 1946.....				

Cowden, S. Foster, Johnson, 1932	9,696	500,796	40,000	1,593
Dollarhide, 1945	2,568	193,780	11,448	202
Dune, 1938	2,928	183,000	18,704	771
Fulkerton, 1942	7,452	348,200	22,000	870
Goldsmith, 1934	7,248	755,516	33,752	2,036
Howard Glasscock, 1925	5,844	404,508	26,000	2,203
Iatan, E., 1926	3,372	142,955	12,000	1,304
Jordan, 1937	480	128,976	2,520	135
Keystone, 1930	1,872	313,650	9,374	812
McElroy, 1926	7,894	468,349	56,800	1,600
Means, 1934	7,020	228,193	20,000	713
Midland Farms, 1944	4,608	241,980	18,615	415
Sand Hills, 1931	2,760	248,207	21,600	1,312
TAL, 1944	2,004	262,515	6,500	600
Wadwell, 1927	708	100,712	3,792	168
Ward Estes, N., 1929	3,408	364,177	76,436	1,562
Westbrook, 1923	2,000	83,000	16,000	718
Yates, 1926	33,540	1,171,820	782,695	1,146

District 8-A					
Anton-Insh, 1944.....	3,554	175,910	24,150	239	
Cogwell Area, 1949.....	1,656	252,219	41,234	103	
Diamond M., 1948.....	1,903	239,415	16,053	474	
Kelly-Snyder, 1948.....	11,552	1,234,962	115,038	805	
Levelland, 1938.....	17,328	484,144	50,000	3,012	
Prentice, 1951.....	6,216	161,036	20,000	437	
Salt Creek, 1950.....	10,404	247,340	12,552	173	
Seminole, 1935.....	17,004	524,765	35,000	624	
Slaughter, 1935.....	20,254	1,029,800	50,000	3,001	
Spraberry Trend, 1951..	22,212	653,389	50,000	7,321	
Wasson, 1935.....	28,656	1,711,898	60,000	2,152	
Weich, 1942.....	3,324	144,223	14,000	651	

District 10				
Pannagle, 1921.....	7,812	1,423,286	41,240	11,643

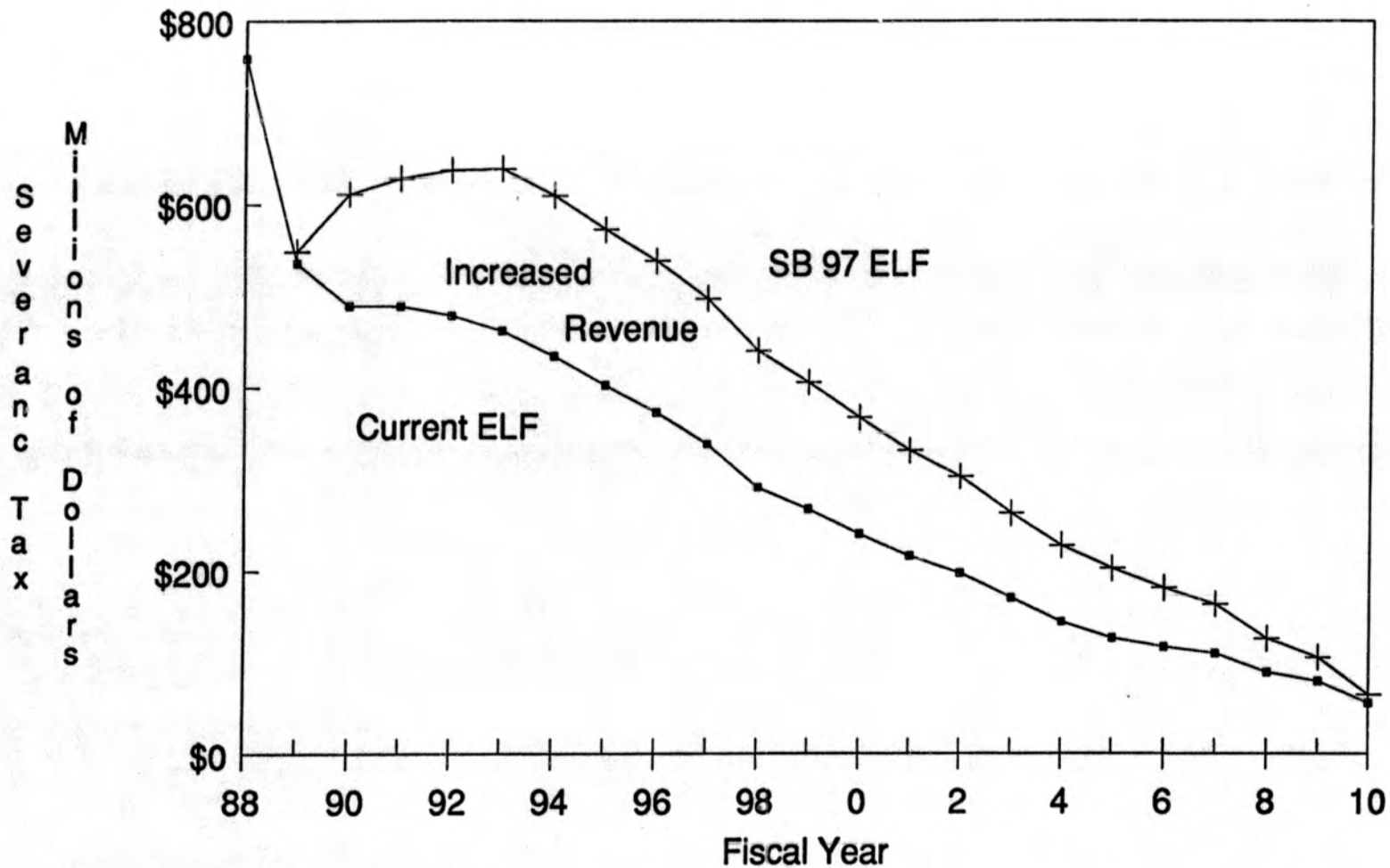
UTAH

Altamont, 1955	3,047	89,493	231,216	227
Aneth, 1955	5,340	354,004	30,000	461
East Anschutz Ranch, 1979	12,755	80,355	727,799	28
Red Wash, 1951	1,075	77,511	13,377	146

WYOMING

Brady, 1960	2,438	54,537	49,251	22
Byron, 1918	1,119	120,628	7,656	67
Eli Basin, 1915	2,968	446,695	25,750	170
Frannie, 1928	1,122	116,020	5,000	63
Garland, 1906	2,625	154,835	6,000	225
Grass Creek, 1914	2,414	185,120	9,000	288
Hamilton Dome, 1918	2,853	269,103	6,000	239
Hartwig Draw, 1976	6,647	66,722	283,739	157
Hilite, 1969	541	75,416	55,885	93
Lance Creek, 1918	163	107,605	400	24
Little Buffalo Basin, 1914	2,666	118,653	9,389	154
Lost Soldier, 1916	2,308	192,073	6,000	71
Oregon Basin, 1912	8,669	388,180	30,000	500
Painter Reservoir, 1979	1,739	31,674	80,674	31
Salt Creek, 1906	5,210	629,689	25,000	1,217
Wertz, 1920	3,500	99,695	15,000	65
Whitney Canyon, 1980	1,652	10,379	105,485	29

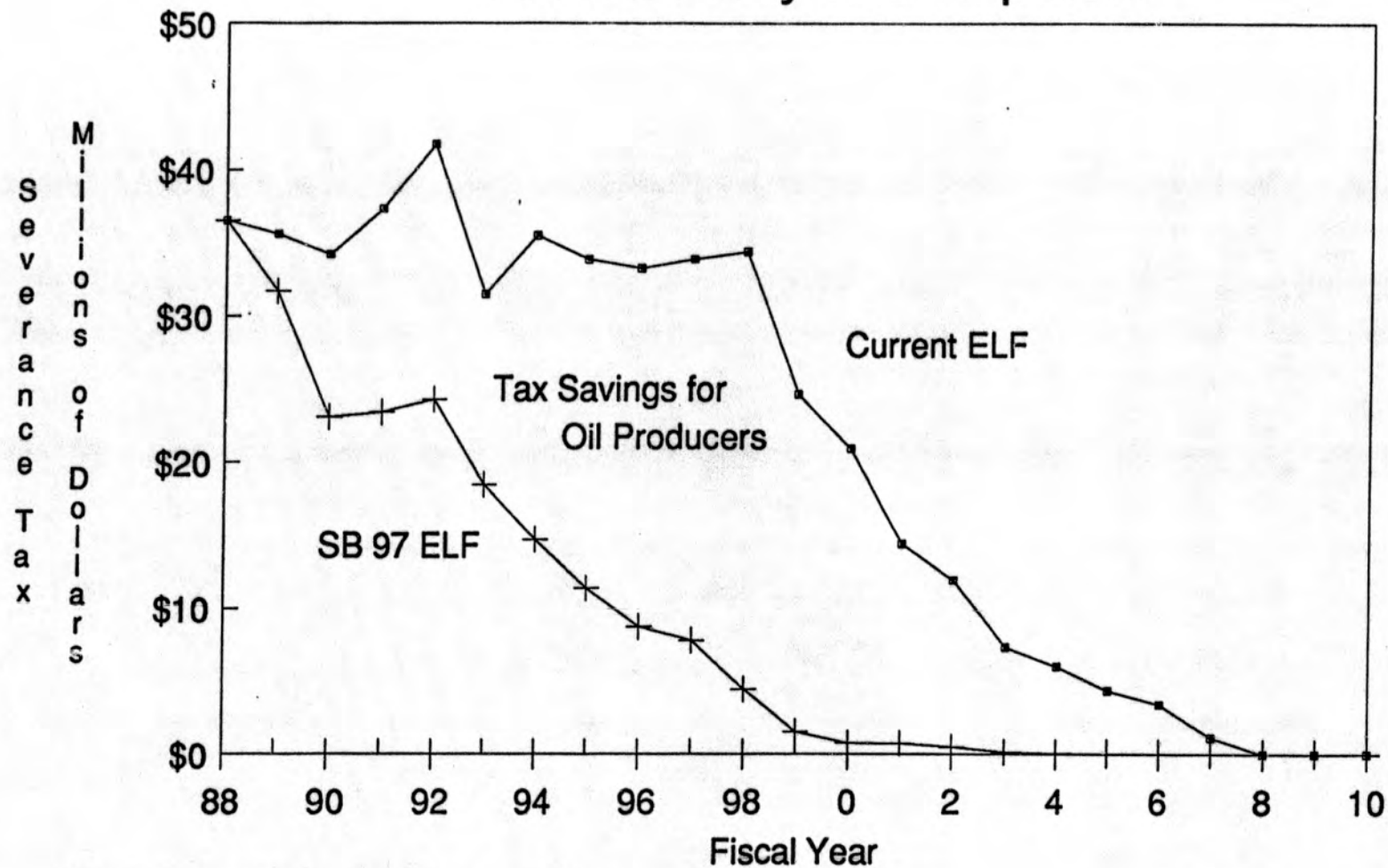
SB 97 Raises More Severance Tax Revenue from Prudhoe Bay and Kuparuk



Note: Revenues are from severance taxes on Prudhoe Bay and Kuparuk

Date: March 3, 1989

SB 97 Gives a Tax Savings for Producers at Oil Fields Other than Prudhoe Bay and Kuparuk



Note: Revenues are from severance taxes on fields
other than Prudhoe Bay and Kuparuk

Date: March 9, 1989

Attachment 3

**Comparative Severance Tax Payments
1987 Production and Collections
10 Top Oil Producing States**

	Production ¹ (1000's of bbls)	Severance Tax ² (1000's of \$)	\$/Bbl	Severance Tax Rank
Texas	760,145	1,178,052	1.55	6
ALASKA	715,855	648,500	0.91	8
California	364,572	14,600	0.04	10
Louisiana	173,409	439,237	2.53	4
Oklahoma	132,970	372,883	2.80	2
Wyoming	112,597	138,915	1.23	7
New Mexico	71,533	262,290	3.67	1
Kansas	59,120	159,952	2.71	3
North Dakota	41,351	90,665	2.19	5
Utah	35,477	22,781	0.64	9

¹ Source: Department of Energy

² Source: Petroleum Independent, September 1988

ELF DEJA VU

Some oil companies argue the existing ELF should not be changed. Ten years ago oil companies were also talking about the ELF, which was then being considered by the legislature. Here is a sample of what was being said then.

The ELF is "too complex, unrealistic, and fails to allow reasonable operating costs."

Larry Vavra, spokesman for Union Oil Co.

Fairbanks News-Miner, April 22, 1977

If it adopts the ELF, "Alaska will ... tip the scales against future development."

Monte Taylor, Exxon, USA

Anchorage Times, March 19, 1977

The proposed ELF legislation "would wipe out any remaining incentives for future development in Alaska."

Richard Donaldson, Standard Oil Co. of Ohio

Fairbanks News-Miner, March 25, 1977

The severance tax bill [with the ELF] will "result in significant losses in state income and fewer jobs...."

Monte Taylor, Exxon USA

Fairbanks News-Miner, March 26, 1977

"The [ELF] bill would increase state oil and gas severance tax revenues from the North Slope by \$7.2 billion over the 20 year life of the field...[T]he magnitude of the increase will cause a congressional backlash"

Ken Showalter, Standard Oil Co. of Ohio

Anchorage Times, April 22, 1977

The tax bills could make "subsidiary fields at Prudhoe Bay impossible to produce."

Richard Donaldson, Standard Oil Co. of Ohio

Alaska Advocate, April 21, 1977

"The only bitterness of the hearings came during an effort by Union Oil Co. spokesman Larry Wilson to read a lengthy and complex analysis of Alaska's tax structure. After about 40 minutes on the stand [House finance chairman Steve] Cowper cut him off with the observation that his testimony was going on too long.

"'You said your testimony was going to take 30 minutes,' Cowper said. 'Its been 40 minutes and now you say it will take another hour.'"

"'There are a couple of sides to this question you know,' Wilson shot back. 'We've got a lot of money at stake.'"

Anchorage Daily News, April 22, 1977

SB 97

Modifying the ELF

Briefing materials prepared for:

Senator Al Adams

**Office of the Governor
Division of Policy
March 13, 1989**

**TAX RATES UNDER PROPOSED LEGISLATION
SHOWING CHANGES FROM CURRENT LAW**

	HB 118		SB 97	
	<u>Tax Rates</u>	<u>Change From Current Law</u>	<u>Tax Rates</u>	<u>Change From Current Law</u>
Existing fields				
Prudhoe Bay	14.91%	29%	14.71%	27%
Kuparuk	13.18%	58%	12.03%	44%
Lisburne	0.36%	-93%	1.58%	-70%
Endicott	8.68%	-29%	9.45%	-23%
Cook Inlet Fields	0.00%	<i>no change</i>	0.00%	<i>no change</i>
Prospective Fields				
Milne Point	0.00%	-100%	0.01%	-100%
West Sak	0.00%	<i>no change</i>	0.00%	<i>no change</i>
Pt. Thompson	2.43%	-68%	4.02%	-47%
Seal Island	5.75%	-12%	5.81%	-12%
Niakuk	0.01%	-100%	1.61%	-87%

Division of Policy, 3/14/89

"The session of the 15th Territorial Legislature just concluded brings out more clearly than ever the basic issue that confronts the people of Alaska. That issue is whether Alaska shall be built up for Alaskans..., or whether it shall continue to be governed for and by outside interests whose sole concern is to take out of Alaska as much as they can, as fast as they can, and leave as little as possible."

*Governor Ernest Gruening
Message to the people of Alaska
March 28, 1941*

"We must have stable tax policies in order to make the risks associated with marginal fields worth taking."

*Mr. George Nelson
Sohio Alaska Petroleum Company
as quoted in the Alaska Journal of Commerce and Pacific Rim Reporter
March 11, 1985*

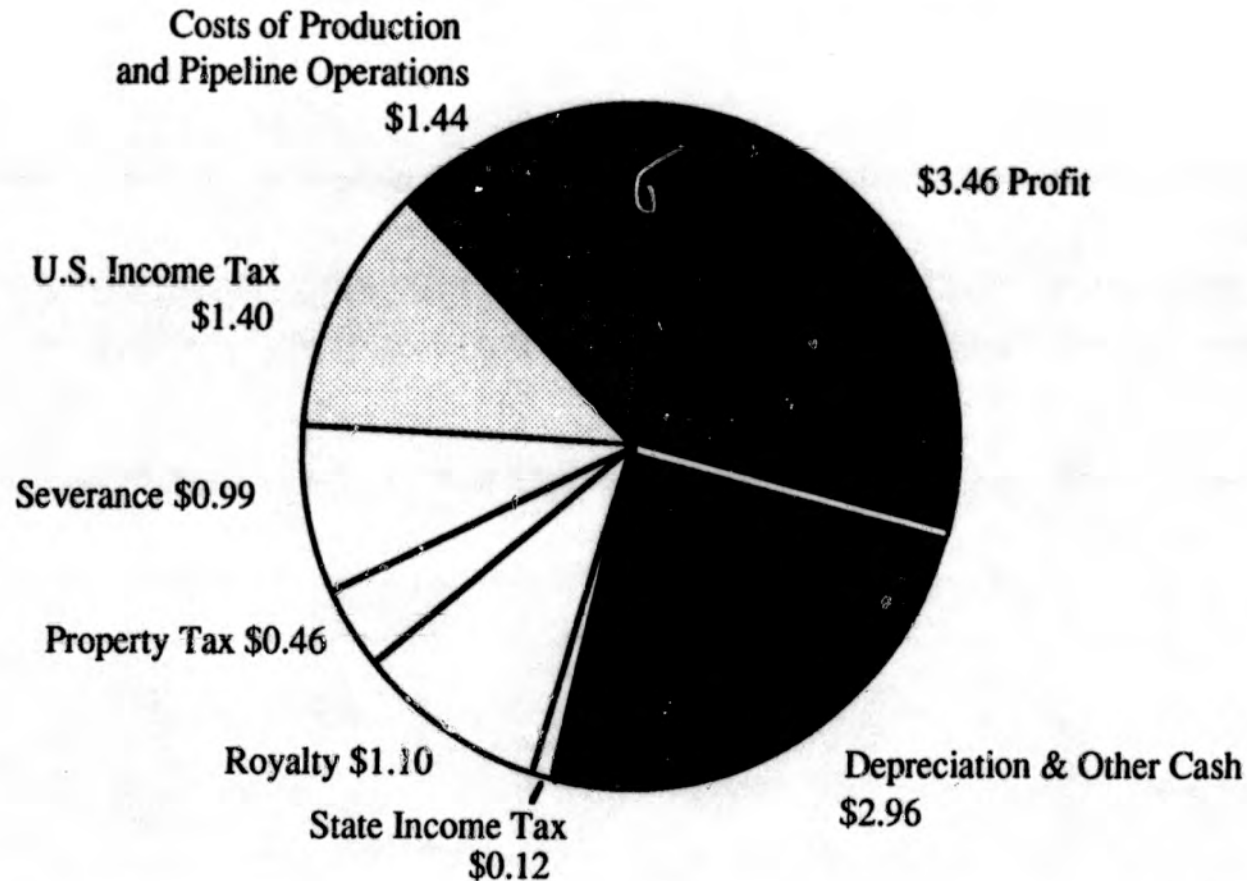
"The state must provide an investment climate that will encourage oil companies and other businesses to develop new ventures....[S]maller fields already have been discovered on the North Slope. But they are marginal fields...."

*ARCO Alaska Inc.
newspaper advertisement
Alaska Journal of Commerce and Pacific Rim Reporter
October 14, 1985*

Chart 1

In February 1988, A Barrel of Oil at Valdez Was Worth \$11.93.

This is how the \$11.93 Was Divided:



Costs of Operations To the Feds To the State To the Oil Companies

"[A]s my profit decreases I have less money to invest....But what is a reality and what you need to understand is that the amount of money I have to spend affects the pace at which things happen. And the pace at which things happen, in terms of employment, means the Alaskan economy. If we slow down our investment pattern because of a lack of funds, because of discouragement of investment in Alaska...that has an effect on the economy of Alaska."

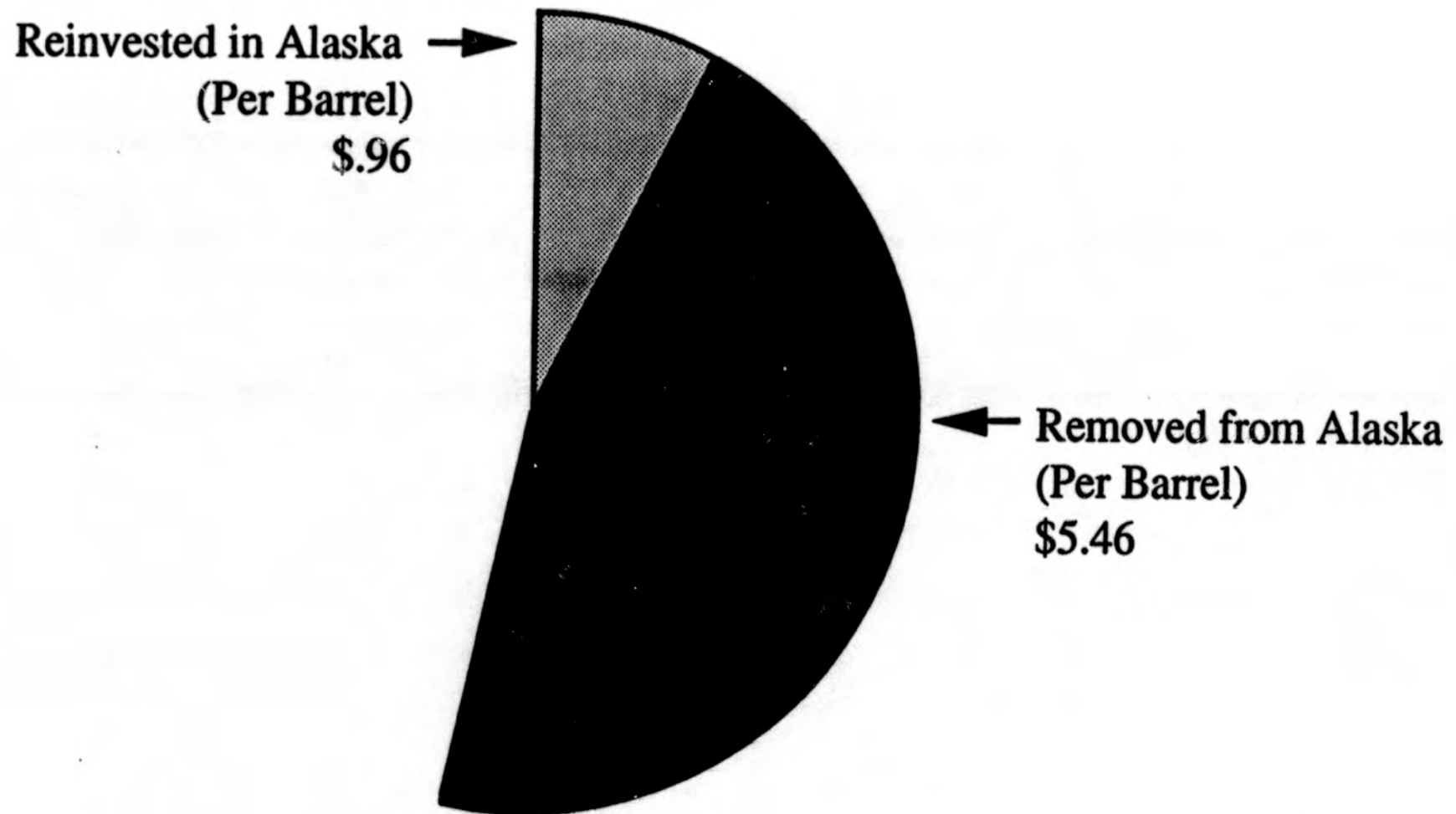
*Mr. Harold Heinze
ARCO Alaska Inc.
Testimony to the House finance Committee
April 12, 1985*

"If the state government increases our taxes we will have less cash to develop new fields."

*ARCO Alaska Inc.
newspaper advertisement
Alaska Journal of Commerce and Pacific Rim Reporter
October 7, 1985*

Chart 3

How Much Money Do The Oil Companies Reinvest in Alaska?



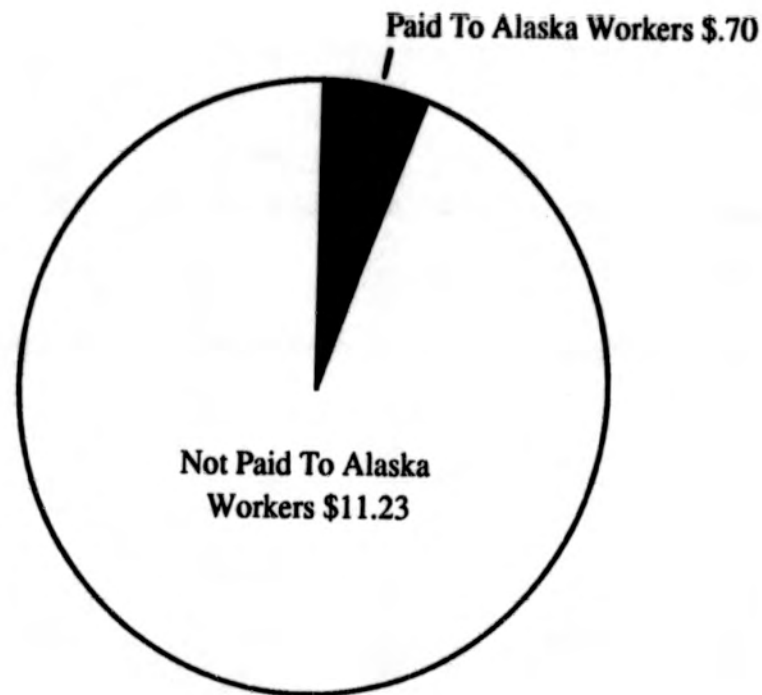
Division of Policy, 9/9/88

U.S. oil companies are in the process of liquidating. U.S. oil reserves are the leftovers of an enormous feast. Faced with a relentlessly declining reserves base, a good management is one that can intelligently liquidate its asset base.

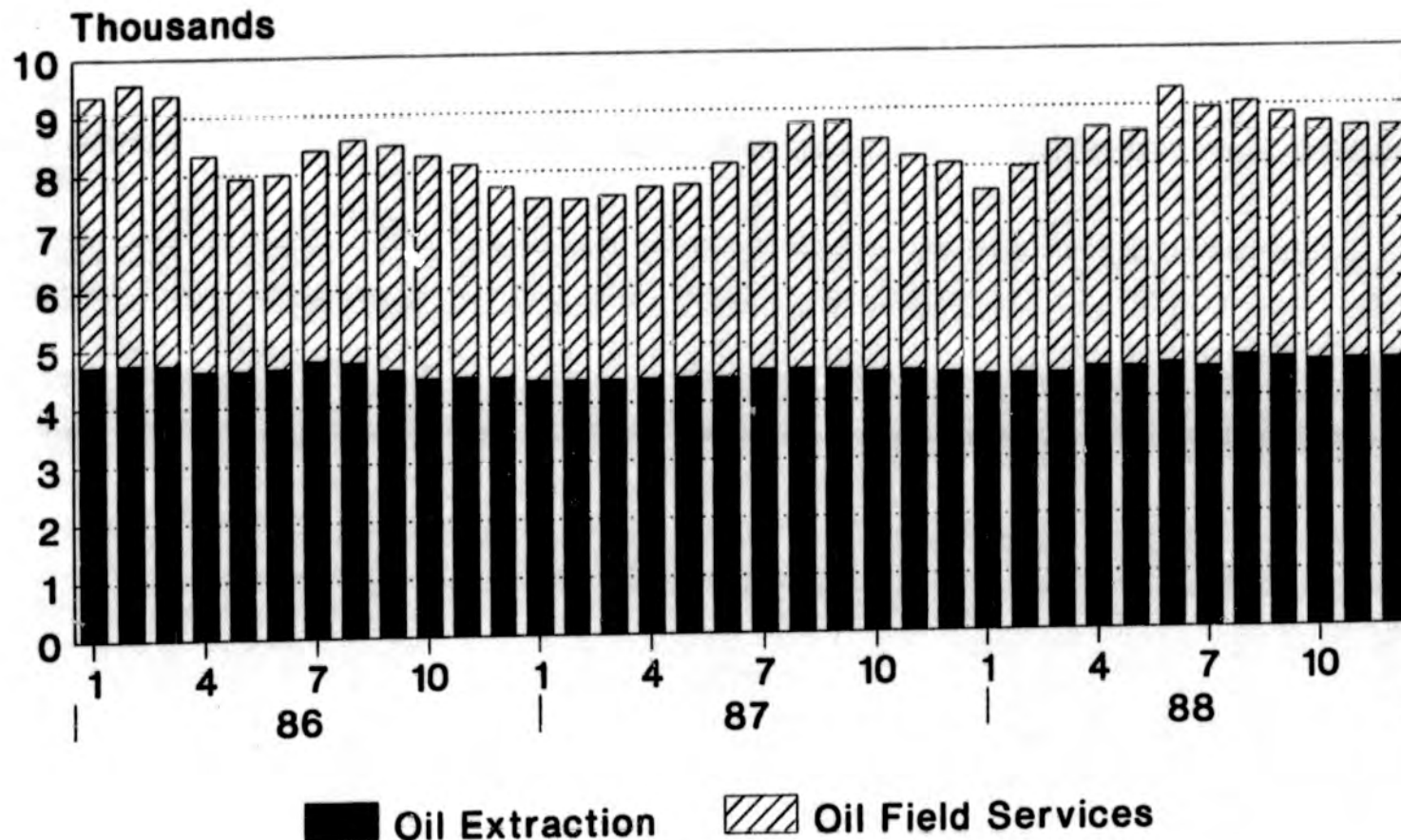
*Robert O. Anderson
former chairman and CEO
Atlantic-Richfield Co.
January 14, 1988*

Chart 4

How Much of The \$11.93 Revenue Per Barrel Gets Paid To Alaska Workers?
(\$/Barrel)



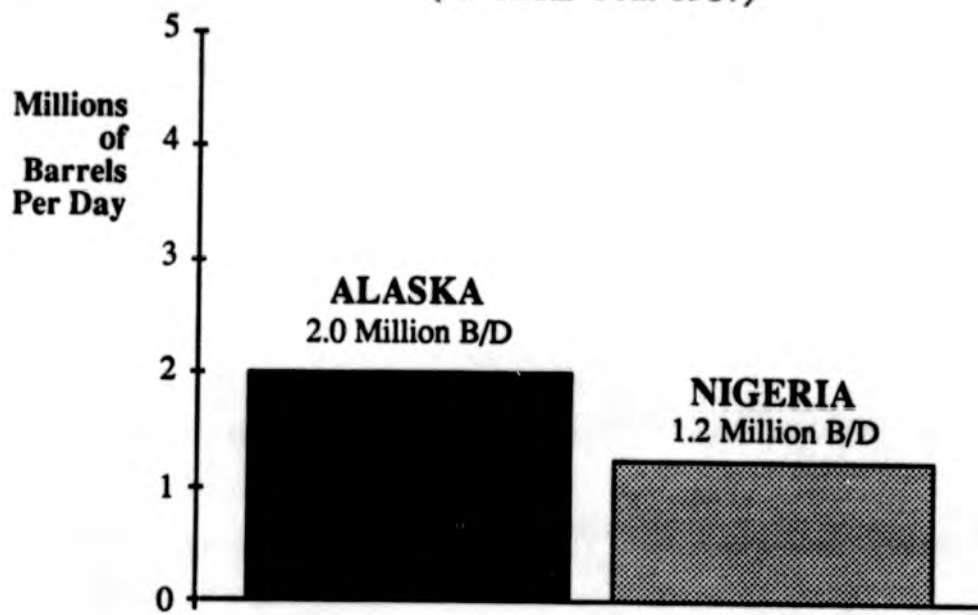
Alaska Oil Industry Employment 1986-1988



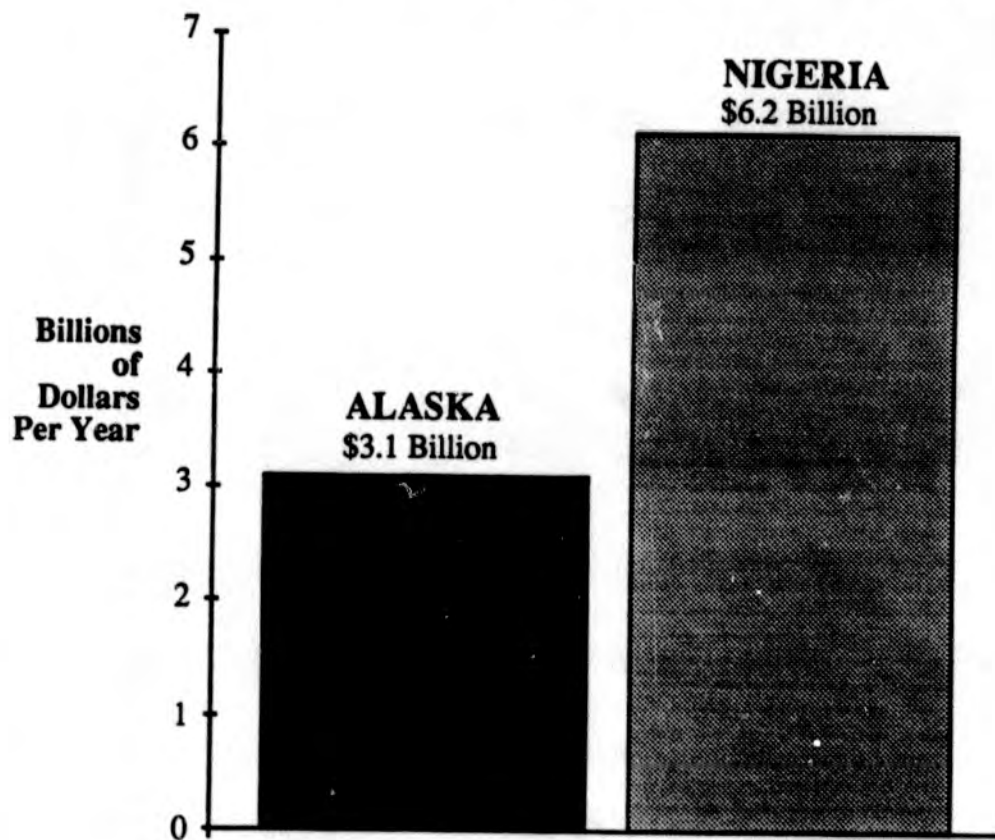
Source: Alaska Dept. of Labor
BLS 790 Survey

PRODUCTION

(Calendar Year 1987)

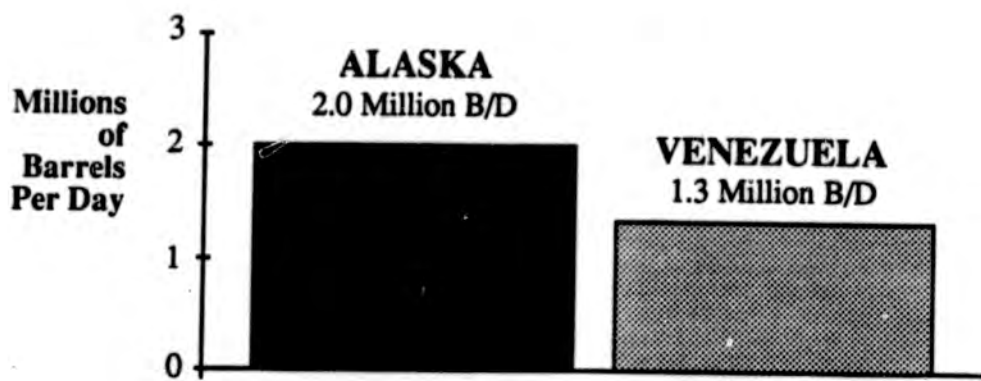


GOVERNMENT REVENUE

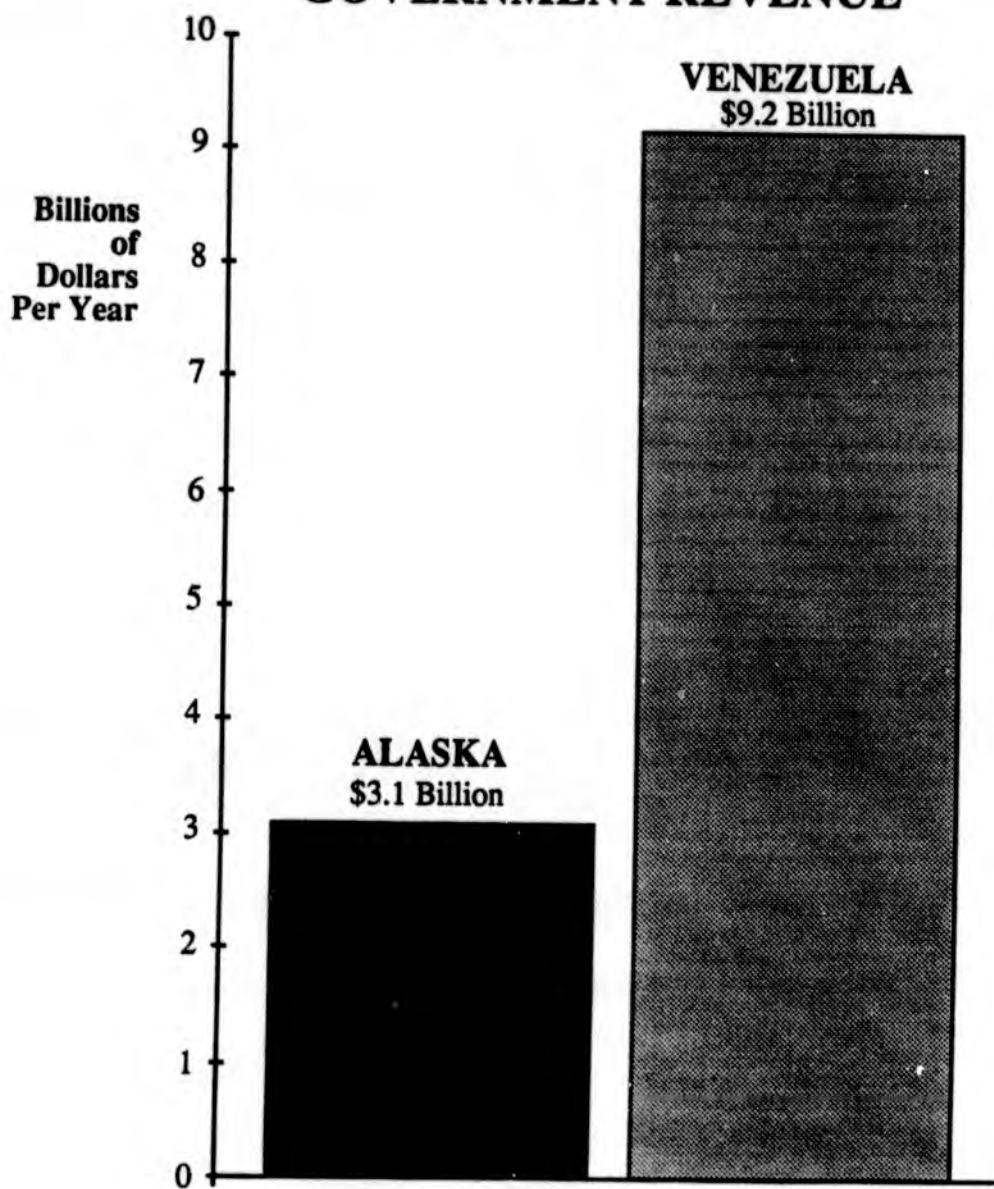


PRODUCTION

(Calendar Year 1987)

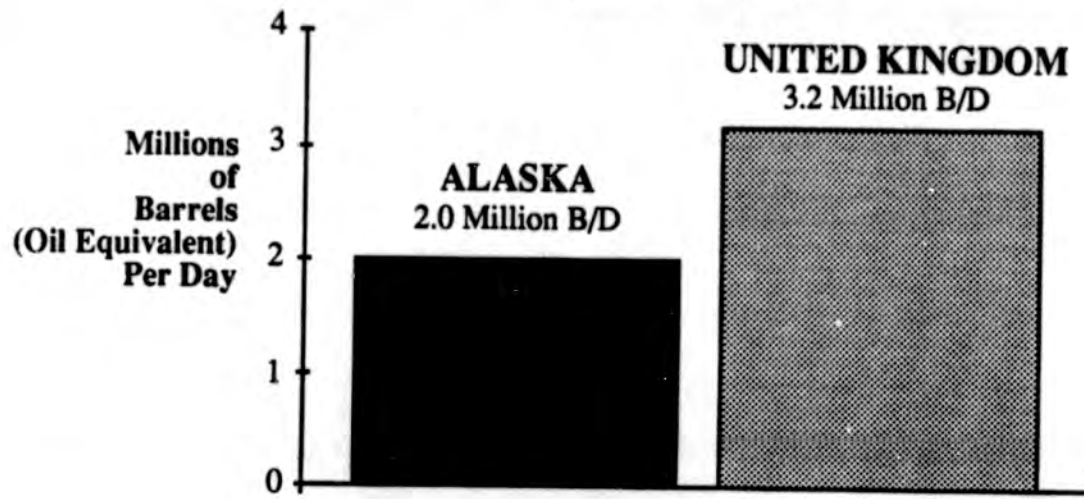


GOVERNMENT REVENUE

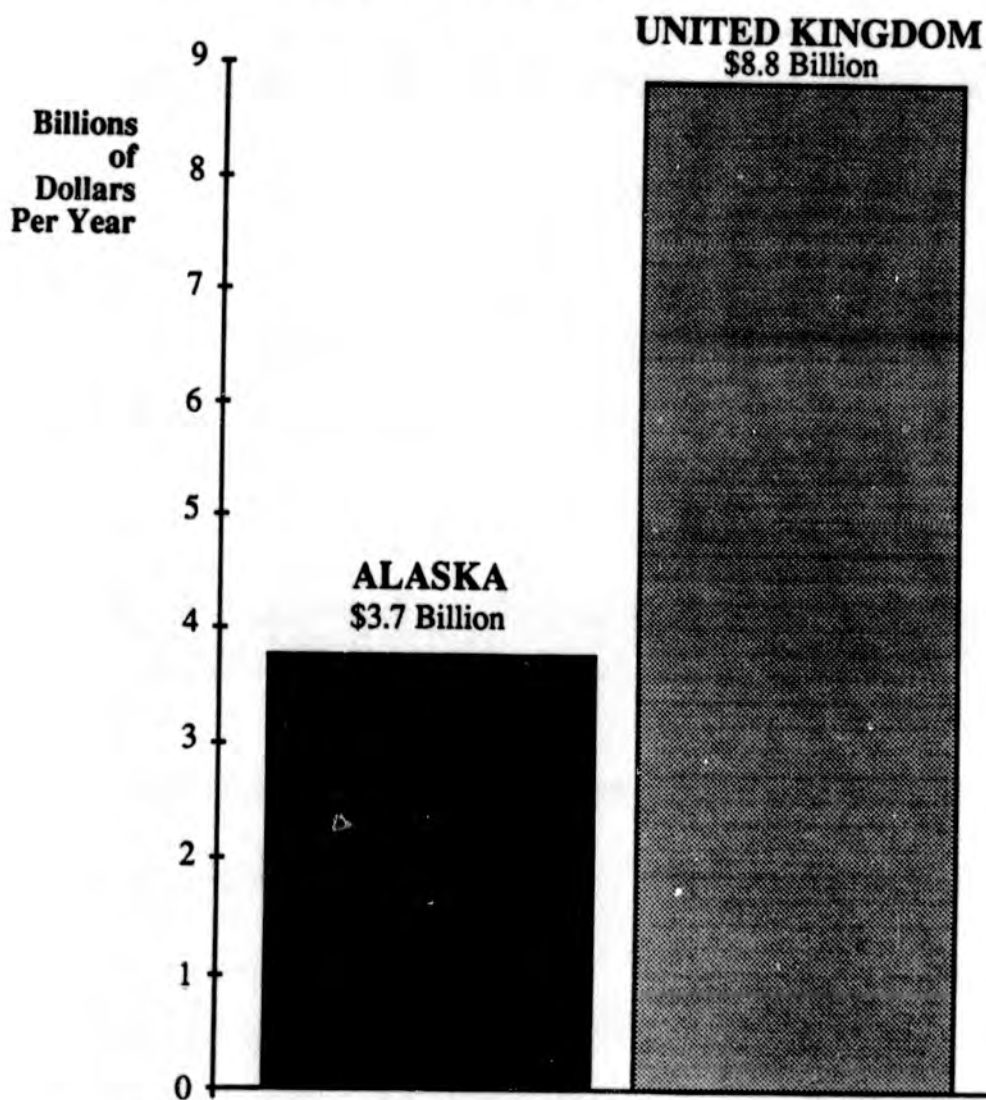


PRODUCTION

(Fiscal Year 1987)

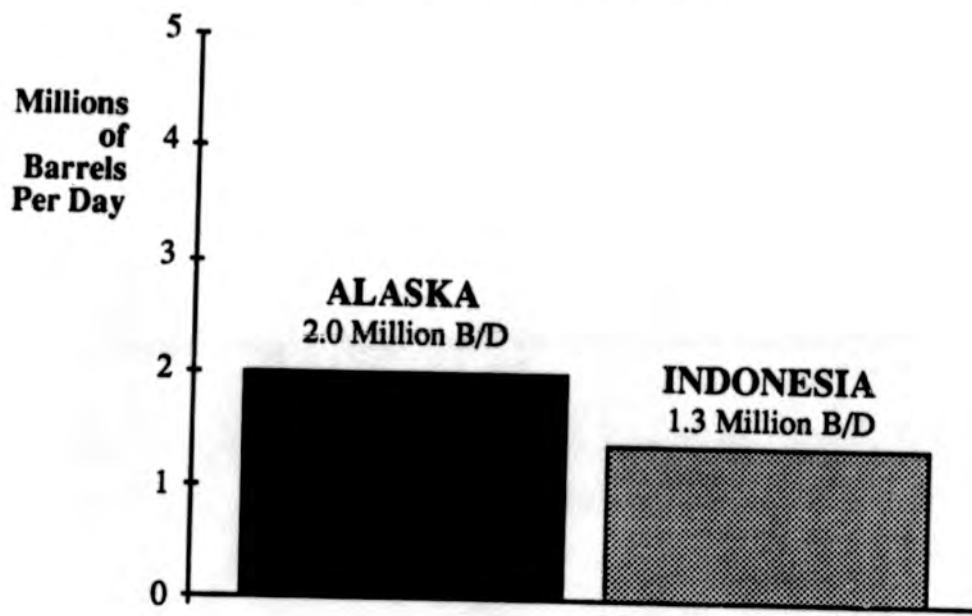


GOVERNMENT REVENUE

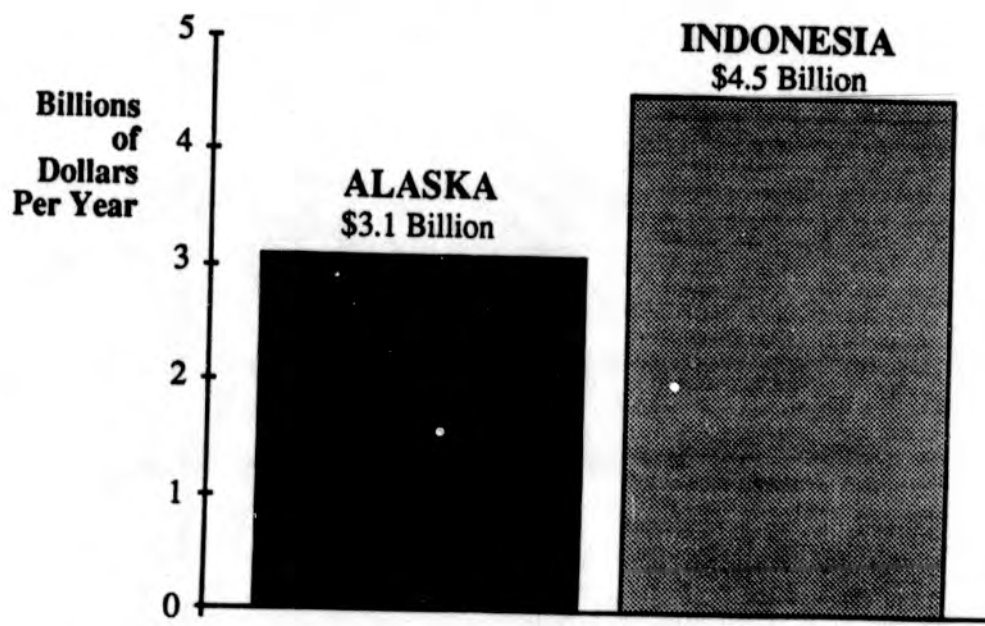


PRODUCTION

(Calendar Year 1987)



GOVERNMENT REVENUE



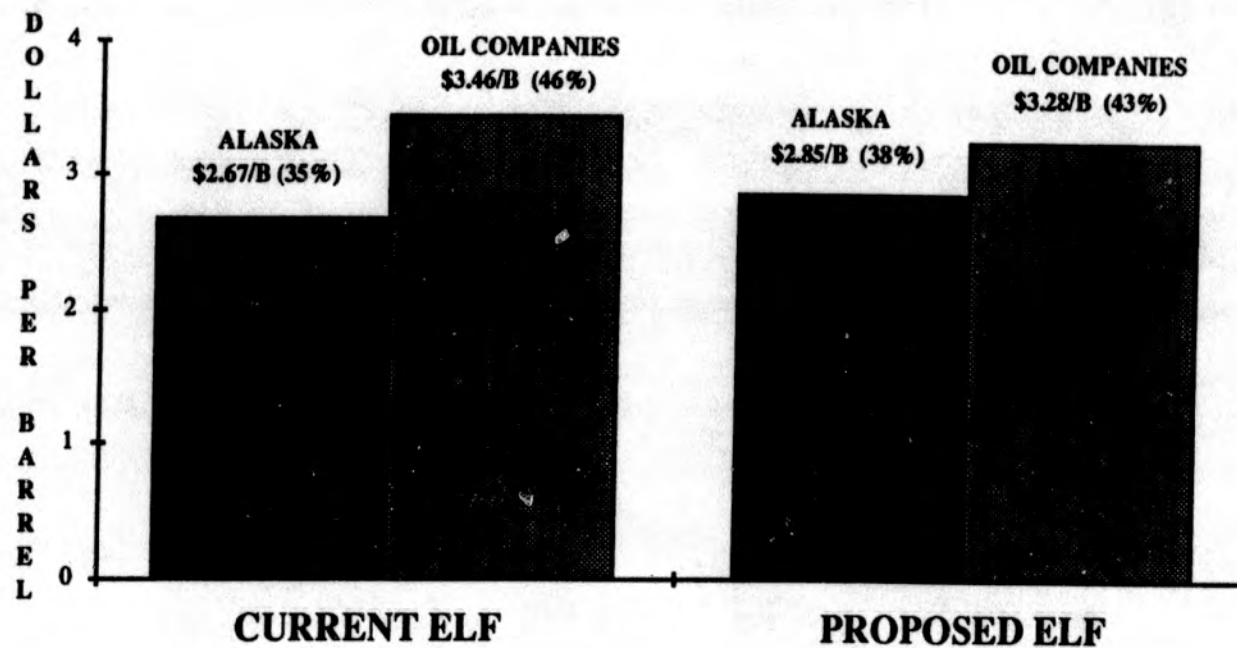
"We have also found [in Indonesia] to an almost unprecedented degree the very desirable and somewhat uncommon qualities of stability, honor, and fair dealing. In the turbulence of the international oil business, Indonesia has been an island of rationality and wisdom."

*Robert E. Wycoff
President, Atlantic-Richfield Co.
address to the Indonesian Petroleum Association
October 20, 1987*

ARCO Kuparuk Example

	<u>Current Law</u>	<u>Proposed Law</u>
Change in Annual Gross Revenue	\$981,000	\$981,000
Change in Annual Severance Tax	(\$37,846)	\$58,611
Tax Rate on Incremental Production	-3.9%	6.0%
Average Tax Rate Before Drilling	7.820%	10.944%
Average Tax Rate After Drilling	7.806%	10.938%
Percent Change in Average Tax Rate Due to Drilling	-0.180%	-0.055%

How Would SB 97 Affect Profits And Shares ?



"The power of taxation shall never be surrendered. This power shall not be suspended or contracted away...."

The Alaska Constitution

Legislator: "...[W]hat percent do you think they [the state] should collect?

Mr. Taylor: "Something a little lower than it is now. About half the income tax for instance.... I think it would be much more fair for the industry and the state to get about the same share out of Prudhoe Bay even though we are paying the expenses and we made the investment...."

Legislator: "So you think it should be brought down to the point where the state and the industry get roughly equal shares in this. You like that better?"

Mr Taylor: "Yes, sir."

Mr. Monte Taylor
Exxon USA Alaska Operations Manager
Joint Gas Pipeline Committee, May 21, 1981

Legislator: "Did I hear you say you would concur on that?"

Mr. Donaldson: "I think that if you get rough parity with the state...we would have to think a long time as an industry, as a company, before we said that is not a pretty fair piece of middle ground."

Mr. Richard Donaldson
SOHIO vice-president for government/public affairs
expressing agreement with Mr. Taylor,
Joint Gas Pipeline Committee, May 21, 1981

"Alaska is not unfamiliar with the activities and importance of lobbies. But it is important to bear in mind that lobbying activity on a scale never before seen will take place in the capital when Alaska becomes a state....

"The taking of Alaska's mineral resources without leaving some reasonable return for the support of Alaska governmental services and the use of all the people of Alaska will mean a betrayal in the administration of the people's wealth."

*Congressional Delegate E.L. "Bob" Bartlett
Address to the Alaska Constitutional Convention
November 8, 1955*



Resource Development Council for Alaska, Inc.

807 "G" Street, Suite 200, Anchorage, Alaska 99501-3440
Box 100516, Anchorage, Alaska 99510-0516 - 907/276-0700

EXECUTIVE DIRECTOR
Becky L. Gay

EXECUTIVE COMMITTEE
J. Shelby Stastny, President
John Forcaskie, Vice Pres.
Ethel H. "Pete" Nelson, Vice Pres.
Stephen M. Ellis, Secretary
Larry L. Laughman, Treasurer
Sharon E. Anderson
Rex I. Bishopp
Mano Frey
O.K. "Easy" Gilbreth
Uwe L. Gross
Joseph R. Henri
Robert W. Loescher
E. Thomas Pargeter
Gail Phillips
Steve Seley
Lin S. Sloane
R.D. Stock
Joseph E. Usibelli, Jr.
Lyle Von Bargen
Doug M. Webb
Charles R. Webber

DIRECTORS
Larry G. Anderson
Lenny Arsenault
Richard Barnes
James K. Barnett
Earl H. Beistline
Steven C. Borell
Janna Brattain
Robert A. Breeze
Kelly M. Campbell
Alexander J. Capasso
Diane Carpenter
J.J. Cincotta
Don Cornett
Ric Davidge
John Davens
Larry Dinneen
James V. Drew
Don L. Finney
Lee E. Fisher
Curtis W. Foster
A. Debbie Fullenwider
Ray D. Gardner
Paul Glavinovich
Randy Goodrich
John L. Hall
Jon Halliwell
W. Ralph Hargrave
Alan E. Hastings
Hazel Heath
Charles F. Herbert
Stephen C. Hillard
H.A. "Buz" Hoffman
Karen J. Hofstad
Phil R. Holdsworth
Dorothy A. Jones
Dan H. Keck
John T. Kelsey
Janet M. Loberg
Phillip L. Locker
Chris McAfee
Len McLean
Stephen M. Rehnberg
John Rense
William E. Schneider
Jerome Selby
Leighton H. Thetford
Harold K. Thompson
Barry Thomson
Clement V. Tillion
Richard W. Tindall
Paul M. Tweten
William R. Whiteside
William R. Wood

EX-OFFICIO MEMBERS
Senator Ted Stevens
Senator Frank Murkowski
Congressman Don Young

RDC Comments on Senate Bill 97

The Resource Development Council for Alaska, Inc., appreciates the opportunity to testify on SB 97. A public interest, pro-development organization, RDC supports responsible resource development.

Our broad-based membership has long advocated for a stable tax policy in the 49th state - a policy that fosters new investment and development, but provides a return to the state.

It is a sentiment that echoes across Alaska, a point brought home by the budget workshop of last Saturday. There, Alaskans spoke out strongly against any increased taxes - from ELF to an income tax - instead turning to fiscal cuts as a way to balance the state budget.

All Alaskans understand state government is facing a fiscal crunch. Without perpetuating the finger-pointing syndrome, RDC respectfully suggests that while massive cuts are not the answer neither are increased taxes, particularly on the one industry which fuels so much of Alaska's budget. When all the smoke and mirrors fade, the reality is that Alaska needs a healthy, productive oil industry, and the best way to foster that is through a stable tax structure.

We need to stop thinking about the short-term quick-fixes, such as increasing the cash flow into the treasury through SB 97, and start thinking about the long-term ramifications of such a move. Those include the job losses associated with higher taxes, projects being stalled or shelved completely, the loss of long-term state revenue from marginally economic projects, as well as the loss of oil and gas reserves due to early abandonment, and delays in technological advances which would otherwise extend the lifespan and productivity of all Alaskans fields.

Mary Halloran with the governor's policy division said recently that "You can't cut the budget without hurting someone." Likewise, you can't increase taxes without hurting the people of Alaska. Just as the governor would like to move Alaska away from thinking of the construction industry as a basic industry, so would the private sector like to wean Alaska away from thinking of state government as a basic industry.

State government is "big business" in Alaska because of resource development revenues. Private sector jobs will replace government jobs and that is a vital message being sent to the legislature by the citizens of Alaska.

Gary E. Light
8211 Summerset Dr.
Anchorage, AK 99518

March 15, 1989

Senator Drue Pearce
P. O. Box V
Juneau, AK 99811

RE: ELF and State Finances

Dear Drue:

I have been doing some studying of our great state's financial situation and, in particular, the effects of modifying the Economic Limit Factor (ELF) applied to the statutory severance tax rates. As you know, I am personally opposed to changing the ELF, not just because of its positive effect on future development of oil and gas projects, nor just because of the fair return the state is currently receiving of 30+% of the value of oil produced in Alaska, but also because of the positive effect on all business in Alaska of more stable taxation practices.

See the attached ad from the March 3, 1989, Forbes magazine on the tax rates in the State of Georgia. This is a positive message to all companies in that state and to those considering operations in that state. Can the State of Alaska say that it has ever given this positive message to businesses? Stable tax rates, at whatever level, reduce the uncertainty and, thus, the risk that companies takes to operate their businesses.

Also attached are a number of other documents, charts, and graphs that I hope may be useful to you as Chair of the Oil and Gas Committee and as a member of the Finance Committee. I have talked with your aide, Judi Jordon, and she has been helpful in directing me to new sources of data and is currently searching for additional information that I have requested. This information will be used to factually tell the story that the administration is distorting, of where we as a state are financially vis-a-vis other states.

I look forward to testifying before the Oil and Gas Committee on Saturday. I believe the facts of economic reality support stable taxation policies and business incentives, which in turn creates jobs. Unfortunately, we have created too many public employee jobs that consume wealth, rather than creating it. Please let me know when you receive this package and I will be glad to answer any questions you may have.

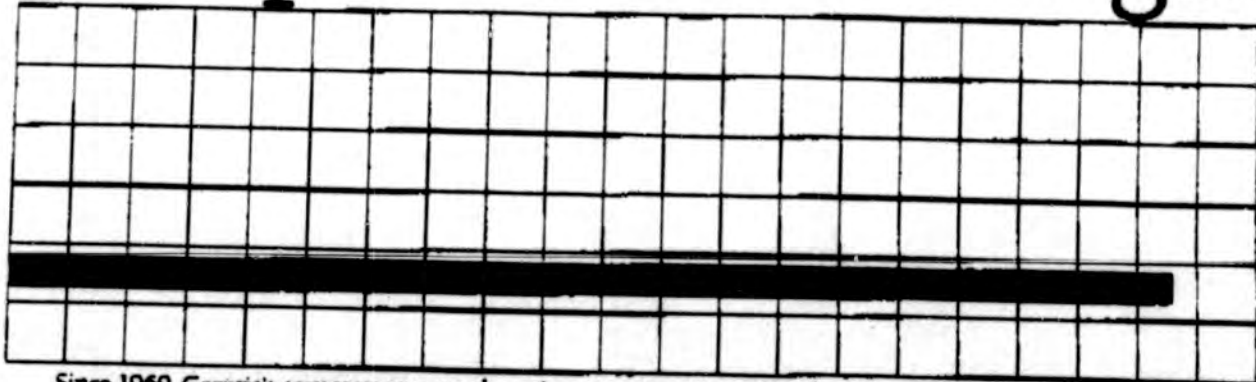
I appreciate your understanding and sensitivity to the economic realities of Alaska today. Your support of what is right and best for all Alaskan's is important because it is obviously misunderstood by others. I would be happy to help in this understanding in any way that I can. My telephone numbers are: 265-6044 (work) and 344-2218 (home).

Sincerely,



Gary E. Light

The rise and fall of corporate taxes in Georgia.



Since 1969, Georgia's corporate tax rates haven't gone up one penny. We don't know of another state that can say the same. And how many states do you know of that went to business and asked for guidance in restructuring their tax systems? Georgia did in 1971. The result was a zero-based budget that has allowed us to increase our quality of life every year—without raising corporate taxes.

Yet Georgia is still able to invest a billion dollars over the next three years in a statewide education reform program that is one of the most comprehensive in American history. And we pioneered a one-stop environmental permit process that helps companies get started in just 90 days.

So before you bet your company's future on the promise of a new location, look into Georgia. The State of Business Today.

Write the Georgia Department of Industry and Trade, Dept. FBS, 230 Peachtree St., N.W., Atlanta, GA 30303. Or call 404-656-9306.

GEORGIA

The State of Business Today

FORBES, MARCH 6, 1989

85

Drue -

I hope this tells you something. As a businessman, it tells me a lot.

Gary

History of the Oil & Gas Severance Tax in Alaska

<u>Time</u>	<u>Tax Rate</u>	<u>Description</u>
1958	1%	Production tax imposed upon statehood.
1968	3%	Tax raised in response to 1967 Fairbanks flood.
1970	max 8%	Stair-stepped rates with a maximum tax rate on production greater than 2500 bopd/well on a fieldwide basis.
1974	8%	Same as above with production greater than 1000 bopd.
1977	12.25%	Flat tax on all production.
1981	15%	Raised tax with the promise of a later economic limit factor (ELF).

SEVERANCE TAX RATES BY STATE (MARCH 1988)

ARKANSAS	4 TO 5 %
COLORADO	2 TO 5 %
KANSAS	8 % (w/ a credit for ad valorem tax)
LOUISIANA	3.125 TO 12.5 %
MISSISSIPPI	3 TO 6 %
MONTANA	2.5 TO 5 %
NEBRASKA	2 TO 3 %
NEW MEXICO	3.75 %
NORTH DAKOTA	5 %
OKLAHOMA	7 % (w/ credit for marginal wells)
TEXAS	4.6%
UTAH	4 %
WYOMING	4 TO 6 %
ALASKA	15% (IF ELF IS ELIMINATED)
PRUDHOE BAY	12.6 % EVEN WITH ELF

1987 Revenue Source Comparison Alaska vs Louisiana vs U.S. Average

With the oil price collapse and resulting revenue declines in states with natural resource based economies, there has been considerable attention paid to the situation in the State of Louisiana. Louisiana is a state known for its populist traditions and its current unemployment rates, the highest in the nation for over a year.

According to recent Anchorage Daily News articles titled "Bad Times on the Bayou", a populist system is one in which individuals are entitled to a free ride at the expense of business. We thought it would be interesting to compare state general revenue sources in Louisiana to those in Alaska. The attached table does that for 1987 (the most recent year data is available) both with and without general revenues from non-individual and business sources.

As the table shows, even in populist Louisiana where revenues from individuals are far below U.S. averages, state revenue from individuals exceeds those collected from businesses. And the percentage collected from individuals far exceeds that percent collected from Alaskans. Conversely, the percentage of Louisiana's revenue obtained from businesses is not only below that collected from their individuals, but substantially below that percent collected from Alaska business. While in Alaska, almost all of the individual and business revenues were collected from businesses (93%), and when you net out the permanent fund payments to individuals, the net collected from Alaskans is negative.

In a recent Business Week article on Louisiana's fiscal future (2/27/89), Governor Charles Roemer says, "To survive we have to build an infrastructure for business" The governor wants to build a tax structure that would lure new business, and thus jobs, to his state. Among other things, Governor Roemer has proposed reducing the corporate income tax rate in Louisiana from 8% to 6% (currently 9.4% in Alaska). The Anchorage Daily News article on Louisiana on March 12, 1989, quotes economists as saying the way of doing business that Huey Long helped build is crippling the state now. "It's ironic. What is supposed to be good for the people now acts to their detriment," said University of New Orleans economist Tim Ryan."

It's interesting that a state not known in the past as pro-business is now realizing that their economic future depends on business and the State of Louisiana is fighting for economic reform and business tax relief. While the State of Alaska, which currently derives virtually all of its tax revenues from business, wants to increase taxes on its primary businesses.

1987 General Revenue Source Comparison
Alaska vs Louisiana vs U.S. Average - \$M

	A. General Revenues From Individuals	B. General Revenues From Businesses	C. General Revenues From Other Sources	Total General Revenues
ALASKA	\$122,683 (2.9%)	\$1,743,944 (41.1%)	\$2,378,530 (56.0%)	\$4,245,157
LOUISIANA	2,744,776 (35.6%)	1,956,450 (25.3%)	3,017,386 (39.1%)	7,718,612
U.S. AVERAGE	4,336,186 (51.7%)	1,188,262 (14.2%)	2,865,266 (34.1%)	8,389,734

A. Includes all general sales tax revenues, tobacco and alcohol sales taxes, individual income tax, hunting and fishing licenses, and education revenues.

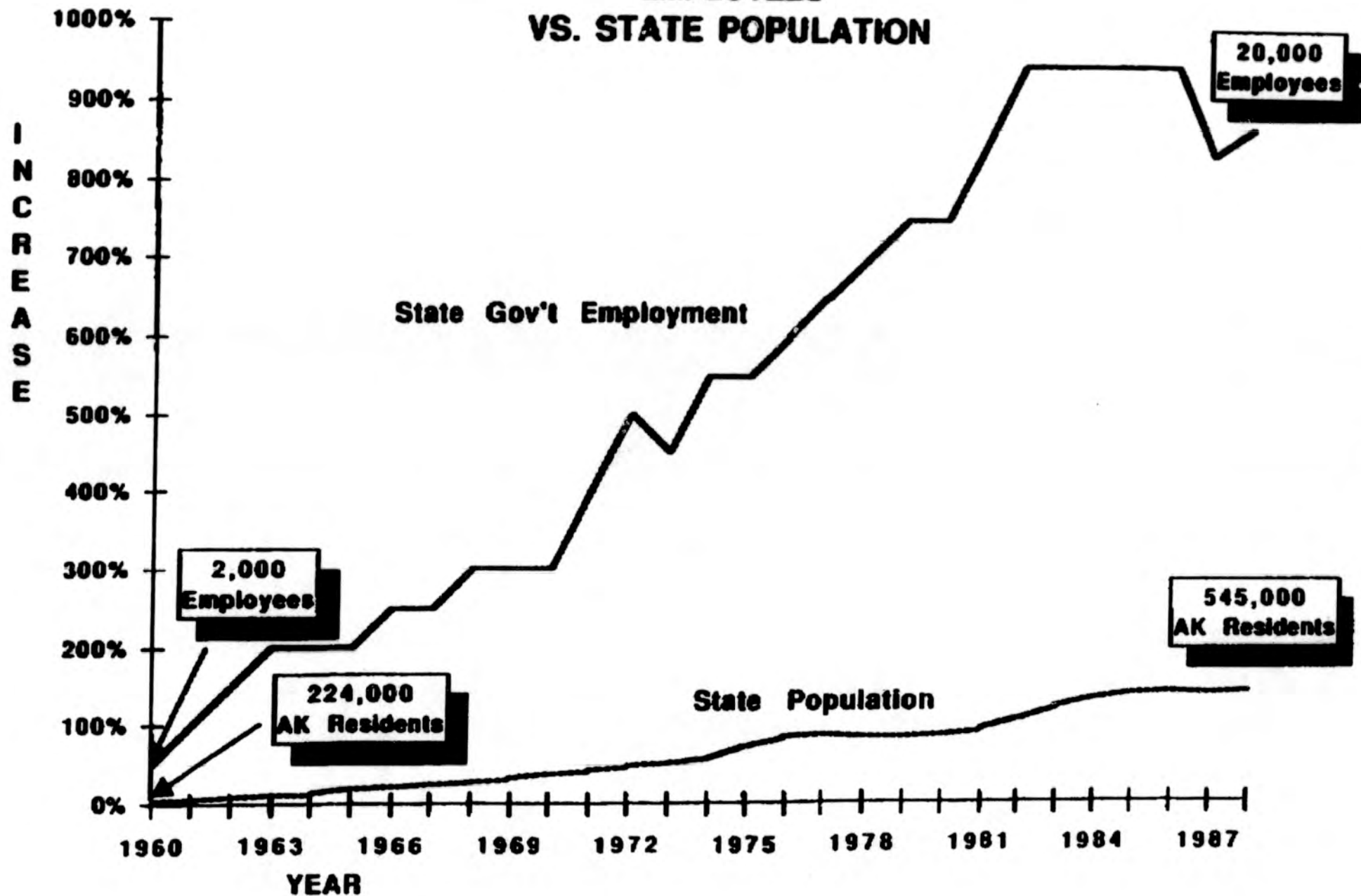
B. Includes insurance gross receipts tax, corporate income tax, business licenses, severance tax, all property taxes, and rents and royalties.

C. Primarily federal government proceeds and interest earnings.

	General Revenues From Individuals	General Revenues From Businesses	Total
ALASKA	\$122,683 (6.6%)	\$1,743,944 (93.4%)	\$1,866,627
LOUISIANA	2,744,776 (58.4%)	1,956,450 (41.6%)	4,701,226
U.S. AVERAGE	4,336,186 (78.5%)	1,188,262 (21.5%)	5,524,448

Source: US Department of Commerce, Bureau of Census Publications: State Government Tax Collections in 1987 (GF-87-1) and State Government Finances in 1987 (GF-87-03).

% INCREASE IN STATE GOVERNMENT EMPLOYEES VS. STATE POPULATION



State of Alaska
Excessive State Spending Examples

Personal Subsidies

Fiscal Year 1990 Budget
General Fund (\$ Millions)

Longevity Bonus	56.5
Power Cost Equalization	18.0
Home Mortgages (AHFC)	6.0
State Student Loans	13.0
Pioneers Homes	25.7
Rural Alaska Television Network (RATNET)	2.7
Senior Citizens Tax Relief	3.0
"Hold Harmless" Payments	16.4
Municipal Revenue Sharing	40.8
Municipal Assistance	56.1
State Employee Health Care Insurance Coverage	32.0
(excess over \$72 million private sector benefit level)	
	270.2

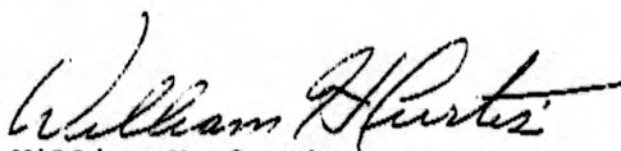
State of Alaska
Excessive State Spending Examples

<u>Industry Subsidies</u>	<u>Fiscal Year 1990 Budget General Fund (\$ Millions)</u>
Tourism Promotion	11.2
Seafood Marketing	4.8
Agriculture Loans / Subsidies	2.7
Marine Highway	54.8
Public Broadcasting Commission	7.2
Fish Enhancement	6.4
Commercial Fisheries	23.7
Mariculture	0.7
Arts Funding (1% of capital projects)	<u>2.7</u>
	114.2

Being a lifelong Alaskan and present Soldotna resident it is my opinion that the State of Alaska should take an across the board cut in spending, excluding public safety services, in the amount of 25%.

In the event State government is reduced, then, and only then, should any change in any taxes be considered.

Government wants industry and it's support companies to take all the cuts and provide more dollars for government to spend. It's time our government takes the same cuts we, the people, have had to take.



William H. Curtis
P.O. Box 91
Soldotna, AK 99669

262-3816

March 18, 1989

To: Members of the Special Committee on Oil and Gas

From: Kristine Funk
PO Box 940
Sitka, AK 99835

I have been a resident of Sitka and Alaska for 10 years.

I believe that increased taxation of the oil industry should be considered only if you believe that there should be no limits on state spending and if you believe that our state government has the right to spend every dime of revenue and demand more when that runs out.

It is my opinion that the oil industry is paying its fair share of taxes and I do not support change to the ELF equation. My position has to do with credibility. Our state government made a commitment to the oil industry when the ELF was enacted. It is my position that a deal is a deal and state government has no business trying to renege on the agreement now which would send a signal to other industries and foreign corporations to beware of Alaska because they make deals and don't honor them. Our governor is supposedly trying to attract investors to Alaska while at the same time he is trying to kick in the backside one of the few industries which is operating here.

We see the same thing happening to the timber industry in SE Alaska. Deals made between the federal government and the industry with government not honoring the deal. Deals broken will cost Alaskans jobs.

I oppose change to the ELF and request your careful consideration on this important matter.

cc: Senator Dick Eliason
Representative Ben Grussendorf

By
 JOHN J. Williams
 PRES- ALASKA CONFERENCE OF MAYORS

March 17th 1989
 Before the committee hearing on ELF
 Senate Bill 97

Members of the Legislature and fellow citizens of the State of Alaska. My Name Is John J. Williams. I am here on behalf of the Alaska Conference and serving as this years president. I present to you the Mayors position as taken in a statewide survey during this legislative session. The position is that the ELF should be modified from the present position relative to taxation of marginal fields. Without any doubt the fields of Prudhoe and Kuparuk are by no means marginal and are in fact the largest in North America. But the reason for modification lies not in the size of the field but in the fairness of taxation as it represents the return to the people of Alaska. When the taxation policies of the State of Alaska were first put in place, the producers had no problem living within the guide lines at that time but now that there seems to be a possibility of increasing already substantial profits we here the cry of foul from what is already the oil companies most profitable venture in north America in their history. The issue here is really what is the proper amount to be distributed to the people of the State of Alaska and that proper amount is what has been agreed upon in the past, not what they the oil companies want to have take place now.

Let us examine the position of expenditures and the philosophies of those expenditures for just a moment. We the citizens of Alaska have often been critized for our spending habits and the estatic value we have created in the construction and building of facilities for the benifit of our people, both this generation and of those to come. But let us pause for a moment and see where the difference lies between responsibility for those actions both here and for example those in Texas. In Texas facilities of all sorts were built in large part by the oil companies both big and small because the oil came from a different method of disbursement than here in Alaska. There individuals own the oil and sell it on the free market and thus those individuals have a moral obligation to their fellow man to share in the god created welth with their fellow man. The Bunker Hunts, the Placid group, the Diamond Shamrocks and all the independants have done that and done it well. Here in Alaska because of our uniqueness and the constitution of the State of Alaska this oportunity does not exist. Rather the oportunitiy exists for all of us, each and every citizen of Alaska, to represent ourselves as the Bunker Hunts, the Arco's and and the Exons of the State because we all own the oil beneath the lands of Alaska. It is therefore our right and our undenied responsibility to do that which we have done.

Let us examine now the fairness of taxation as it exists. We in Alaska came into this world oil production picture uneducated in the ways of the oil companies who had nearly a hundred years of experience in these matters. I say to you that from the very beginning the State of Alaska and its people have been at a disadvantage and may never have been receiving what should have been rightfully ours because we were told by others that this is the way it should be done. I give to you the absolute and undeniable fact that among the ten top oil producing states in America we are next to the bottom of the list in taxation. I give to you the absolute and undeniable fact that among the top producers of oil in the world we are at or near the bottom of the list in taxation, sometimes almost insultingly low. The oil companies ask for concessions. Let me list the concessions that we give the oil companies. For every employee that works for an oil company we give that employee the equivalent of a free vacation every year in the form of dividend checks. We extend this concession to each and every member of their families no matter how young or old. We say to each and every employee, would you like to have your mother and father come and live with you. When they reach the considered age of retirement we will pay them \$250.00 per month to come and live in Alaska and we will give every one of them a free vacation each year. We will educate all of your children and pay for that to the tune of nearly 80% as well. We have created loan systems for them to buy homes, send their children to college, and share in power cost equalization in many parts of the state. We will not tax them for personal income, we will, through a sharing of wealth with local government see to it that their home and property tax is among the lowest in the nation. We ask not an undue corporate income tax of any of the service companies or others doing business in Alaska. And what does this cost. \$766 million dollars for state contribution to education alone, \$431 million dollars in shared dividends to the people, \$57 million dollars to the senior citizens retirement program \$97 million dollars to communities for lower local taxation \$160 million dollars for transportation and public facilities that are all shared by the oil companies. No traffic jams for the executives who we now face to be caught in at the end of the working day. These figures alone amount to \$1 billion 511 million dollars or 75% of the expenditures of the state of Alaska. Since we collect 85% of our income from oil I submit to you that we give back virtually every dime of it. Where else in the world can a company go and do business and expect any fairer treatment than that. I submit to you that taxation of the oil companies by the State of Alaska is grossly unfair. The State of Alaska is being ripped off at every turn. I submit to you that instead of further concessions being considered for the oil companies we should have long ago ask for our due share. Members of the committee, on behalf of the Conference of Mayors of the State of Alaska, and all of the people that we represent we urge modification of ELF to more fairly represent a true value and return to the people of the State of Alaska.



Alaska State Legislature

Please enter into the record my testimony to the Senate Special Comm on Oil and Gas
committee name
committee on Production tax, dated 3-18-89
bill/subject

The question is not state spending, it is a question of fair taxation. The oil companies should be expected to pay a fair tax. Why is it the tax burden on Alaskan oil companies less than any other state? Or any other country?

We as Alaskans deserve an adequate share of the oil revenues, at least equal to any other field in the United States.

The oil companies are not going anywhere, call the bluff. Stand up for the people who elected you. Don't bully up to big oil, wash the oil off and come clean.

Signed:

Jonathan McCoy

Testifier

concerned Alaskan

Representing (Optional)

1407 Leta St. Fairbanks, Alaska 99709

Address

455-6787

Phone No.



Alaska State Legislature

Please enter into the record my testimony to the _____
committee name
committee on SB 97, dated 3/18/89
bill/subject

If no other states give tax breaks to oil companies why should Alaska? Granted state spending probably could be cut, but that is no reason Alaska should not get its fair share from its non-renewable resources. In the long run, the state has to be paid for the resource while it is there, one day it will be gone. With no local mine laws & most of the money made from Alaskan oil going outside the state, taxation seems to be the only way Alaska will see any oil money.

Signed: _____

Testifier

Representing (Optional)

Box 73195, Fbks, 99707

Address

452-1201

Phone No.

ALASKA SUPPORT INDUSTRY ALLIANCE
1989 PUBLIC POLICY PRIORITY

CONTINUE A STABLE TAX CLIMATE

DURING THE LAST THREE YEARS, THE PRIVATE SECTOR IN ALASKA HAS SUFFERED SEVERE ECONOMIC LOSSES. TENS OF THOUSANDS OF ALASKANS HAVE LEFT THE STATE IN SEARCH OF EMPLOYMENT ELSEWHERE.

PROPOSALS TO EXTRACT MORE REVENUES FROM A PRIVATE SECTOR ALREADY DEVASTATED BY THE CURRENT RECESSION MUST BE RESISTED AT ALL COSTS, LEST SHORT-TERM EXPEDIENCY PAVE THE WAY FOR GRAVE LONG-TERM ECONOMIC CONSEQUENCES.

UNTIL STATE GOVERNMENT EXPENDITURES HAVE BEEN REDUCED TO REFLECT CURRENT ECONOMIC REALITY, NO NEW TAXES SHOULD BE IMPLEMENTED.

ALLIANCE MEMBERS ADAMANTLY OPPOSE INITIATIVES WHICH WOULD RESTRUCTURE THE ECONOMIC LIMIT FACTOR (ELF); INCREASE TAXES ON GASOLINE; CREATE A STATE-WIDE SALES TAX AND RESTORE THE PERSONAL INCOME TAX.

CUT STATE SPENDING, DO NOT INCREASE TAXES.



THE ALLIANCE

4220 'B' Street, Suite 200 / Anchorage, Alaska 99503-5911

ALASKA SUPPORT INDUSTRY ALLIANCE
1989 PUBLIC POLICY PRIORITY

STIMULATE DEVELOPMENT OF MARGINAL FIELDS

CURRENT ECONOMIC CONDITIONS FACING THE STATE OF ALASKA CALL FOR BOLD AND EFFECTIVE ACTION BY BOTH ELECTED AND APPOINTED GOVERNMENT LEADERS IN ORDER TO STIMULATE THE DISCOVERY AND DEVELOPMENT OF ALASKA'S MARGINAL OIL AND GAS FIELDS.

SPECIFIC STRATEGIES MUST BE DEVELOPED THAT SEND A CLEAR MESSAGE TO THE PETROLEUM INDUSTRY THAT ALASKA IS A PREFERRED LOCATION IN WHICH TO INVEST EXPLORATION AND DEVELOPMENT DOLLARS.

REPRESENTATIVES OF THE EXECUTIVE AND LEGISLATIVE BRANCHES OF GOVERNMENT SHALL SOLICIT COMMENT FROM THE OIL AND GAS INDUSTRY TO IDENTIFY POLICY INITIATIVES WHICH WILL FOSTER THIS KIND OF INVESTMENT AND LONG TERM COMMITMENT IN ALASKA.

ALLIANCE MEMBERS BELIEVE THAT REAUTHORIZATION OF THE DISCOVERY ROYALTY PROVISION IS AN IMPORTANT FIRST STEP IN ACCOMPLISHING THESE OBJECTIVES.



THE ALLIANCE

4220 B' Street, Suite 200 / Anchorage, Alaska 99503-5911



CITY OF KOTZEBUE
P.O. BOX 46 • KOTZEBUE, ALASKA 99752

RECEIVED
JAN 30 1989

January 25, 1989

GOVERNOR'S OFFICE

City Hall
442-3401
Police Dept.
442-3351
Fire Department
442-3404
Public Works
Dept.
442-3465
Day Care Center
442-3157
Planning Dept.
442-3465
Building Inspector
442-2623
George Francis
Morial Library
442-3916
Recreation Center
442-3066
Teen Center
442-3979
Regional Fire
Training Center
442-3921

The Honorable Steve Cowper
Governor
State of Alaska
P.O. Box A
Juneau, Alaska 99811-0101

Dear Governor Cowper;

Enclosed please find Resolution No. 89-3; A Resolution supporting adjustment of the Economic Limit Factor (ELF) which was unanimously passed by the Kotzebue City Council at it's January 19th, 1989 meeting.

The City Council feels the State's municipalities support could be generated if municipal assistance and revenue sharing funding was tied to the ELF repeal.

Sincerely,

Michael Scott
Michael Scott
City Manager

MS/zkl

Enclosure

cc: City Council

CITY OF KOTZEBUE
RESOLUTION NO. 89-3

A RESOLUTION SUPPORTING ADJUSTMENT OF THE ECONOMIC LIMIT FACTOR (ELF).

- WHEREAS; the State of Alaska will loose approximately \$200 million this fiscal year from the application of the Economic Limit Factor (ELF) to Prudhoe Bay, and;
- WHEREAS; revenue losses to the State due to the tax break allowed by the ELF are projected to total more than \$1 billion during the next five years, and;
- WHEREAS; the Alaska economy is beginning to emerge from the deepest recession in 30 years. Yet, without additional sources of revenue, public spending this year and next likely will be severely reduced or in the red; and
- WHEREAS; cuts of this magnitude would have a devastating effect on the entire economy and on Alaska's local governments, and;
- WHEREAS; the ELF was originally intended to serve as a tax break to encourage oil production in marginal fields. Prudhoe Bay and Kaparek are the largest and second largest oil fields in North America and are in no sense marginal fields, and;
- WHEREAS; the application of ELF in its current form actually discourages oil production at some truly marginal fields; and
- WHEREAS; while oil prices have dropped, oil company profits continue to climb.

BE IT RESOLVED that the City of Kotzebue support adjustment of the Economic Limit Factor (ELF) to make it work as originally intended so as to encourage oil production at marginal fields and not give an unneeded tax break to the largest fields on the continent.

Alaska Conference of Mayors
March 24, 1988
Juneau, Alaska

ALASKA CONFERENCE OF MAYORS

RESOLUTION NO. 88- 20

A RESOLUTION OF THE ALASKA CONFERENCE OF MAYORS
SUPPORTING ADJUSTMENT OF THE ECONOMIC
LIMIT FACTOR (ELF).

WHEREAS, the State of Alaska will lose approximately \$200 million in the next fiscal year from the application of the Economic Limit Factor (ELF) to Prudhoe Bay; and,

WHEREAS, the revenue losses to the State are projected to total more than \$1 billion over the next five years; and,

WHEREAS, the Alaska economy is only now beginning to emerge from the deepest recession it has suffered in 30 years; and,

WHEREAS, without the additional revenue the state budget for FY 89 will be almost \$400 million in the red; and,

WHEREAS, cuts of this size would have a devastating effect on the economy and on Alaska's local governments; and,

WHEREAS, the economic limit factor (ELF) was originally intended to serve as a tax break to encourage oil production in marginal fields; and,

WHEREAS, the Prudhoe Bay oil field is in no sense a marginal field, but is instead the largest oil field in North America, and appears to be one of the most profitable oil fields in the world; and,

WHEREAS, the application of the Economic Limit Factor to the Prudhoe Bay oil field is thus wasteful and unnecessary; and,

WHEREAS, the application of the Economic Limit Factor actually discourages oil production at a truly marginal field such as Milne Point;

NOW, THEREFORE, BE IT RESOLVED that the Alaska Conference of Mayors urges the Alaska Legislature to enact legislation that would adjust the Economic Limit Factor to make it work as originally intended so as to encourage oil production at marginal fields and not give an unneeded tax break to the Prudhoe Bay field, the largest and most valuable field in North America.

ADOPTED this 24th day of March 1988.



Erling Johansen, President
Alaska Conference of Mayors

Attest:



Scott A. Burgess

United Brotherhood of Carpenters and Joiners of America

LOCAL UNION NO. 1243



Farthest North Local in the World

DON K. SWARNER
Business Representative
Financial Secretary-Treasurer

907 452-5308
907 452-3862

315 FIFTH AVENUE
P.O. BOX 347
FAIRBANKS, ALASKA
99707

A RESOLUTION URGING THE ALASKA STATE LEGISLATURE TO
REVIEW AND ADOPT HB 118 AN ACT
RELATING TO THE OIL AND GAS PROPERTIES PRODUCTION TAX

WHEREAS, the Economic Limit Factor (ELF) as enacted by the Alaska State Legislature in 1981 was intended to promote continued development of marginal oil fields; and

WHEREAS, unbeknownst to legislators in 1981, both the Prudhoe Bay and Kuparuk Oil Fields are in no sense of the word marginal fields; and

WHEREAS, the application of the Economic Limit Factor (ELF) actually discourages oil production at a truly marginal field such as Milne Point; and

WHEREAS, the people of the State of Alaska own the oil resources of the State and should be fairly & equitably compensated for their extraction; and

WHEREAS, the economic conditions in Alaska do not warrant a tax break for the oil companies; and

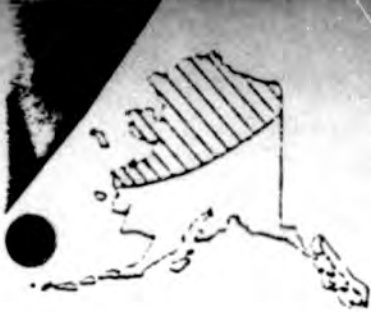
Whereas, the Alaskan work force is not receiving its fair share of employment in the development of their oil and gas resources;

THEREFORE, be it resolved that Local Union 1243 of the United Brotherhood of Carpenters and Joiners of America urges the Alaska State Legislature to complete its review of HB 118 and to bring this bill to the floor and furthermore, we urge its adoption.

UNANIMOUSLY passed this 28th day of February, 1989 by the General Membership.

Murray L. Baldwin
Murray Baldwin
President

Don K. Swarner
Don Swarner
Business Representative
Financial Secretary-Treasurer



North & Northwest Mayor's Conference

P.O. Box 68
Unalakleet, Alaska 99684



President: Albert Washington (907) 923-3771
Secretary: Robert Foote (907) 624-3655

RESOLUTION NO. 89 - 22

Second Session of the Ninth Annual
NORTH AND NORTHWEST ALASKA MAYORS' CONFERENCE
Unalakleet, Alaska
February 9 & 10, 1989

A RESOLUTION OF THE NORTH AND NORTHWEST ALASKA MAYORS' CONFERENCE
SUPPORTING LEGISLATION ADJUSTING THE ECONOMIC LIMIT FACTOR.

WHEREAS, the State of Alaska will lose approximately \$200 million this fiscal year from the application of the Economic Limit Factor (ELF) to Prudhoe Bay; and

WHEREAS, revenue losses to the State due to the tax break allowed by the ELF are projected to total more than \$1 billion during the next five years; and

WHEREAS, the Alaska economy is beginning to emerge from the deepest recession in 30 years, yet, without additional sources of revenue, public spending this year and next likely will be severely reduced; and

WHEREAS, cuts of this magnitude would have a devastating effect on the entire economy and on Alaska's local governments; and

WHEREAS, the ELF was originally intended to service as a tax break to encourage oil production in marginal fields. Prudhoe Bay and Kuparuk are respectively the largest and second largest oil fields in North America and are in no sense marginal fields.

NOW THEREFORE BE IT RESOLVED BY THE NORTH AND NORTHWEST ALASKA MAYORS' CONFERENCE: hereby urges the Alaska State Legislature to enact legislation that would adjust the Economic Limit Factor to make it work as originally intended so as to encourage oil production at marginal fields and not give an unneeded tax break to the largest fields on the continent.

Passed and approved by the SECOND SESSION OF THE NINTH ANNUAL NORTH AND NORTHWEST ALASKA MAYORS' CONFERENCE THE 10th DAY OF FEBRUARY, 1989.

President

Secretary

INTRODUCED BY: Kotzebue

VOTE: YES Unanimous

SECONDED BY: Barrow

NO _____

DIRECTED TO: Governor Steve Cowder

Alaska State Legislature

King
Tallman
Cote
Chenhall
Bartholomew
Westfall
None

Voting "No"

Absent:

4 votes required for passage

Effective Date: 1/16/89

KETCHIKAN GATEWAY BOROUGH

RESOLUTION NO. 821

A RESOLUTION OF THE ASSEMBLY OF THE KETCHIKAN GATEWAY BOROUGH, ALASKA, SUPPORTING LEGISLATION ADJUSTING THE ECONOMIC LIMIT FACTOR; AND ESTABLISHING AN EFFECTIVE DATE.

RECITALS

A. The State of Alaska will lose approximately \$200 million this fiscal year from the application of the Economic Limit Factor (ELF) to Prudhoe Bay.

B. Revenue losses to the State due to the tax break allowed by the ELF are projected to total more than \$1 billion during the next five years.

C. The Alaska economy is beginning to emerge from the deepest recession in 30 years. Yet, without additional sources of revenue, public spending this year and next likely will be severely reduced.

D. Cuts of this magnitude would have a devastating effect on the entire economy and on Alaska's local governments.

E. The ELF was originally intended to serve as a tax break to encourage oil production in marginal fields. Prudhoe Bay and Kuparek are respectively the largest and second largest oil fields in North America and are in no sense marginal fields.

F. While oil prices have dropped, oil company profits continue to climb.

Section 1. The Assembly of the Ketchikan Gateway Borough urges the State of Alaska Legislature to enact legislation that would adjust the Economic Limit Factor to make it work as originally intended so as to encourage oil production at marginal fields and not give an unneeded tax break to the largest fields on the continent.

Section 2. The Borough Clerk is directed to send copies of this resolution to the Governor and District Legislators.

Section 3. Effective Date. This resolution is effective upon adoption.

ADOPTED this 16th day of


BOROUGH MAYOR

City council endorses

Cordova Times 1/12/88

The Cordova City Council met in a special session Saturday morning to debate the Economic Limit Factor (ELF). For the past two years, the Cowper Administration has been seeking to adjust ELF. Opponents to adjusting ELF say it would not promote economic development. The Cowper Administration believes differently and is currently soliciting support from cities around the state.

The fiscal crisis the state finds itself in now may bring the results Cowper seeks. Oil

revenues comprise close to 85 percent of the government's revenues, according to the revenue commissioner's office.

For an hour, councilmembers debated whether to approve a resolution endorsed by the Cowper Administration requesting the legislature to enact legislation adjusting ELF to encourage oil production at marginal fields and remove the tax break to the two largest and profitable oil fields on the continent. In essence the adjustment

will remove Prudhoe Bay and Kuparek from ELF tax breaks.

Mayor Erling Johansen circulated copies of a letter and model resolution he received from Gov. Cowper's office. The administration says the State of Alaska will lose approximately \$200 million this fiscal year from the application of ELF to Prudhoe Bay, according to the letter.

"Essentially the legislature is split," Johansen told the council. "Democrats are for revising it

ELF tax changes

and Republicans are against that."

Johansen informed the council he needed to know the city's stance on ELF prior to his attendance at the Annual Conference of Mayors Jan. 12 and 13 where the Governor, Lieutenant Governor and Commissioner of the Department of Community and Regional Affairs will be in attendance. The council unanimously passed the resolution. Councilmembers Dave Rawlins and Doug Lape were absent.

According to Cliff Groh, special

assistant to Revenue Commissioner, Hugh Malone, an adjustment in ELF would enhance economic development and raise more revenues for the state. "It's (been) a bitter and controversial fight," Groh said. "The nominal tax rate is 15 percent. In some cases, ELF reduces that to zero. Prudhoe Bay sometimes pays 12 percent. By adjusting ELF, we would raise the effective rate closer to 15 percent. Higher oil prices would bring in more state revenues and if prices drop the state's loss is less."

*mailed
F41*

GREATER JUNEAU DEMOCRATIC PRECINCT COMMITTEE

RESOLUTION

WHEREAS, Alaskan oil belongs to all the people of Alaska, and

WHEREAS, the Economic Limit Factor (ELF) was created by the Alaska Legislature in 1977 to encourage oil companies to develop marginal oil fields and to extend the life of producing fields when production at those fields become marginal, and

WHEREAS, the current ELF formula does not currently give Alaska an attractive enough tax climate to encourage development of marginal oil fields, and

WHEREAS the current ELF formula provides an unintentional and unnecessary massive tax break to the highly profitable Prudhoe Bay and Kuparuk oil fields, and

WHEREAS, the Prudhoe Bay and Kuparuk oil fields are not marginal oil fields, and

WHEREAS, Alaska is currently suffering from revenue shortfalls due in part to the current ELF formula, and

WHEREAS, HB 118 would create a more attractive tax climate for the development of truly marginal old fields, reducing or eliminating altogether taxes on every oil field in Alaska except Prudhoe Bay and Kuparuk, and

WHEREAS, HB 118 would eliminate unintended tax breaks for the two highly profitable oil fields in Alaska (Prudhoe Bay and Kuparuk), and

WHEREAS, the net result of the enactment of HB 118 in its present form would increase revenues to the State of Alaska by an estimated \$848 million over the next five years, and

WHEREAS, the increased revenue generated by the enactment of HB 118 would greatly assist Alaska in providing necessary services that would otherwise have to be drastically reduced, and

WHEREAS, the enactment of HB 118 would otherwise create jobs, raise other revenue, promote economic development and protect the interests of the people of Alaska,

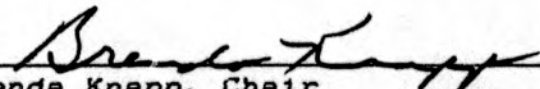
NOW, THEREFORE, by unanimous vote (one abstention) on February 7, 1989, by the Greater Juneau Democratic Precinct Committee, be it hereby

RESOLVED: that the Greater Juneau Democratic Precinct Committee urges expeditious enactment into law of HB 118 in its present form.

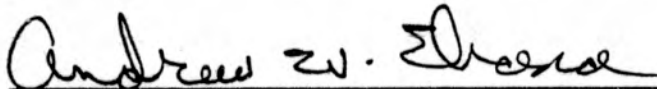
BE IT FURTHER RESOLVED that a copy of this resolution be provided to each member of the Alaska State Legislature and the Governor of Alaska.

DATED this 7th day of February, 1989.

GREATER JUNEAU DEMOCRATIC PRECINCT COMMITTEE


Brenda Knapp, Chair

ATTEST:


Andrew W. Ebona, Secretary



Greater Fairbanks

Chamber

of commerce
P.O. Box 74446
Fairbanks, Alaska 99707

709 Second Avenue

(907) 452-1105

February 13, 1989

The Honorable Al Adams
Alaska State Senate
P.O. Box V
Juneau, AK 99811

Dear Senator Adams:

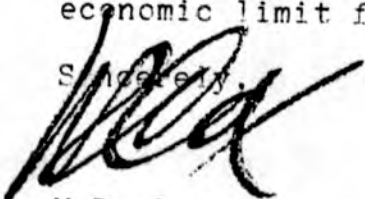
The Greater Fairbanks Chamber of Commerce has consistently opposed any legislative initiative to unduly increase taxes on individuals or businesses. Specifically, we have opposed modification of the Economic Limit Factor to increase the severance tax oil producers pay since that strategy has emerged.

With increasing frequency, we see demonstrations that ELF is fulfilling it's intended purpose. Oil company investment is stimulated. Jobs are on the increase. Enhanced recovery methods are employed to maximize production. Planned capital programs are moving forward. All this because ELF is working.

When oil prices decline: when significant growth in administration staffing occurs: when new social programs are proffered or existing programs expanded; when the basis of revenues to support the budget is not sufficiently diversified: mature government must prevail. Tough decisions are required. Demand efficient cost effective operation. Vigorously negotiate expiring labor contracts. Implement a reduction in force. Courses of action to reduce cost of government are many, with services still provided.

Responsible and mature government recognizes that to retain or attract industry a stable tax philosophy must prevail. Industry should be able to expect that. We oppose House Bill No. 118 and any other legislation which would modify the current structure of the economic limit factor.

Sincerely,


W.R. Cox
President and CEO

WRC:ldm



City and Borough of Sitka

304 LAKE STREET. SITKA, ALASKA. 99835

RECEIVED
JAN 12 1989

*sc copy
return to me*

January 9, 1989

GOVERNOR'S OFFICE

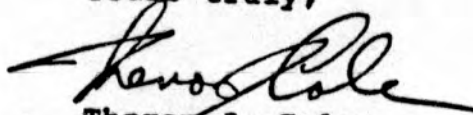
The Honorable Steve Cowper
Governor of the State of Alaska
P.O. Box A
Juneau, Alaska 99811-0101

Dear Governor Cooper:

The Assembly of the City & Borough of Sitka requested that I write to you expressing their support of your position on the Economic Limit Factor (ELF). They are also concerned with the future funding of education and wish to study the matter further before expressing a position on that matter. The Assembly appreciates your giving them the opportunity to respond to these issues.

Thank you for your consideration.

Yours truly,


Theron J. Cole
Municipal Attorney

TJC:COOPER:klw

By: Jeff Weltzin
Valerie Therrien
Introduced: 03/26/87
Advanced: 03/26/87
Amended: 04/09/87
Adopted: 04/09/87
Reconsideration
Filed: 04/10/87
Reconsidered: 04/23/87
Substituted by Phil
Yunker: 04/23/87
Adopted: 04/23/87

RESOLUTION NO. 87-043

A RESOLUTION ADDRESSING THE STATE OF ALASKA'S
ECONOMIC LIMIT FACTOR

WHEREAS, the Economic Limit Factor enacted by the legislature
in 1981 was intended to promote marginal oil field development; and

WHEREAS, the fields currently producing oil in Alaska differ
from one another with regard to production costs and profitability; and

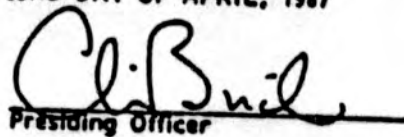
WHEREAS, it is good public policy to encourage commercial
production at marginal fields and avoid premature shut-downs in
production; and

WHEREAS, a fair and equitable form of oil taxation is beneficial
to the residents of the state and the industry; and

WHEREAS, the existing statute dealing with the Economic Limit
Factor is faulty in a number of technical aspects and does not fulfill its
intended purpose.

NOW, THEREFORE, BE IT RESOLVED that the Fairbanks North
Star Borough Assembly urges the Governor and the Legislature to examine
each oil field individually, evaluate the economic characteristics of each
field, and set taxes accordingly.

PASSED AND APPROVED THIS 23RD DAY OF APRIL, 1987


Presiding Officer

ATTEST:


Clerk of the Assembly