

HOUSE/SENATE FINANCE COMMITTEE MINUTES - 1967-1982 2797

dual conservation efforts have reduced total demand and allowed GVEA to defer costly generation additions until after 1990.

The following table lists Alaska Power Authority's projections of needed generation capacity for the next 30 years. This was determined by deducting existing capacity (useful lifespan scheduled in) from forecasted need in that year. The low and moderate forecasts show a relatively modest need for 300 MW to 650 MW of new capacity in this century. The high forecast is not considered appropriate or realistic if adequate attention is given to conservation efforts.

Railbelt Capacity Additions Using ISER Projections (MW)

<u>Year</u>	<u>Lowest Forecast</u>	<u>Low Forecast</u>	<u>Mid Forecast</u>	<u>High Forecast</u>
1995	0	0	300	750
2000	300	475	650	1225
2005	550	860	1110	2100
2010	815	1040	1550	3025

The Railbelt's need for appropriate-sized supply increments is brought out by the APA's latest proposal for Susitna hydro. Instead of choosing the 1500 MW Corps of Engineers design, APA has selected a 1200 MW design to be brought on line in three stages. The first stage would be 400 MW (at Watana) scheduled for use in the early 1990's. The second stage of 400 MW (Watana) is scheduled for the late 1990's and the final stage of 400 MW (Devils Canyon) for sometime after 2000.

This redesign of the Susitna project is encouraging, for it begins to acknowledge the Railbelt's real needs. It is also disheartening, for it acknowledges that Alaskans were misled throughout the 1970's by faulty growth projections. We were told only a project the size of Susitna (1500 MW) could meet our needs. As a result, we still have not looked seriously at the many other power sources available to the Railbelt.

The projections show that developing generation facilities in moderate increments is well suited to meeting the Railbelt's future demand. To meet the Railbelt's demand for this century, Lake Chakachamna and Bradley Lake offer a total of 580 MW of hydro-power. Additional demand could be met through dispersed sources of wind, other hydro, cogeneration, natural gas peaking capacity, load management and conservation measures.

Between the years 2000 to 2010, the low and moderate forecasts project additional needed capacity of 515 MW to 900 MW. With a host of new technologies emerging, we can set long-term goals now and direct policies and funding toward their development. Just as large-scale hydro went through a maturing process, low-head hydro, wind farms, photovoltaics and other power sources will undoubtedly mature by the turn of the century.

Our post-2000 capacity recommendations entail setting a goal of

meeting demand with generation capacity from these sources:

- 1) 200 to 400 MW of additional hydro
- 2) 200 to 400 MW of wind farms
- 3) 100 MW of co-generation
- 4) 50 MW of solid waste generation
- 5) 100 to 200 MW of natural gas peaking generation

TOTAL-550 to 1050 MW of power supply mix.

While the advantages of dispersed supply mix will be assessed by the Battelle N.W. alternative study, some general positive benefits can be stated now:

A) Hydro development of medium-sized sites like Bradley and Chakachamna Lakes avoid many of the major fish and wildlife conflicts encountered with development on the Susitna;

B) Medium-sized power increments reduce the risk of uncertain demand, especially after the year 2000;

C) Medium-sized power increments can oftentimes be brought on line more quickly, which would move the Railbelt toward renewable energy sooner. In addition, a power supply mix avoids Railbelt dependence on Susitna's long construction lead-time and possible construction delays that large projects often incur.

The Battelle N.W. study is the first comprehensive effort to assess other power sources for the Railbelt. But because this alternative study will be relying on limited existing data, its assessment of wind, medium-sized hydro and electrical conservation will be somewhat hindered.

Accordingly, to provide better assessment of the Railbelt's supply options, the following areas need to be addressed:

A) Feasibility study of Lake Chakachamna

The 1962 reconnaissance grade report by the Bureau of Reclamation showed this site to be economically competitive with Susitna. Discussions with ADF&G show relatively minor environmental conflicts, but can only be assessed through the completion of a feasibility study. While Lake Chakachamna is not in itself the complete alternative to Susitna, it could be the basic for this century's needs. At the least, Lake Chakachamna should be assessed as a possible back-up to a delayed or discontinued Susitna project.

B) Feasibility study of Utility-scale Wind Generation in the Railbelt

The Railbelt has five identified wind spots which could likely support utility-scale wind generation. Utility wind generation is becoming a reality with numerous wind farms coming on line in the lower 48. A study directed at first assessing wind potential in the Railbelt and then producing a plan for a demonstration wind farm is desperately needed.

C) Railbelt Electrical End-use Study

Whatever future Railbelt power sources are developed, electrical production should be used efficiently. Only through adequate understanding of electrical end-use can we determine conservation efforts and the best uses of electricity. Community by community electrical end-use assessment is essential in this effort.

As pointed out, Railbelt electrical energy planning is dominated by the on-going Susitna studies. Whether this project is ever built will depend on state and federal approval, financing, litigation and possible voter approval or preference of alternative power sources.

For these reasons, alternative approaches should be pursued as viable power supply sources for the Railbelt. In this sense the Battelle N.W. study is only the beginning. Initiation of technical feasibility studies on the above recommendations would bring alternative energy sources to the demonstration stage - a step that is sorely needed to balance energy planning for the Railbelt.

STATE OF ALASKA

AUDIT DIVISION
POUCH W—ALASKA OFFICE BUILDING

THE LEGISLATURE

FINANCE DIVISION
POUCH WF—STATE CAPITOL

BUDGET AND AUDIT COMMITTEE

JUNEAU 99801

February 25, 1981

SUMMARY OF: A Performance Review of the Department of Commerce and Economic Development, Alaska Power Authority, September 28, 1976 - December 12, 1980.

PURPOSE OF THE REVIEW

In accordance with the provisions of Title 24 of the Alaska Statutes and Chapter 18 of the 1980 Session Laws of Alaska, a performance review of the Alaska Power Authority (APA), Department of Commerce and Economic Development, was conducted to:

1. Evaluate program goals and objectives relative to APA's statutory mandates.
2. Determine the extent to which program objectives are being accomplished.
3. Evaluate APA's operating efficiency, effectiveness, and economy.

FINDINGS AND RECOMMENDATIONS

1. APA should investigate project alternatives in a timely manner.

APA suspected that developing one hydroelectric project, instead of two, to serve two southeastern communities might be more economical. However, APA did not initiate efforts to study the one-project alternative for over a year. Meanwhile APA requested, received, and loaned \$18,000,000 for the questioned project.

PRELIMINARY REPORT

2. APA should amend its regulations to include criteria for all loans and more specific loan terms.

Absence of loan criteria has resulted in inconsistent treatment of borrowers. APA regulations should apply to all loans made by APA.

3. APA should review the expenditure of power project loan proceeds.

Loans approved by the APA Board total \$32,265,000, yet APA does not verify that this money is being utilized in accordance with legislative intent.

4. Employees' salaries should be properly allocated to reflect actual work assignments.

Three APA employees whose salaries are funded by capital projects are performing duties which are not related to these projects.

5. The Public Participation Section should respond to public inquiries in a timely manner.

Only 13 of 33 public inquiries had received a response from APA; eight of these responses were not received for at least six months.

6. Internal accounting control over loan proceeds should be strengthened.

APA has not developed a system of control for power project loan proceeds. Such procedures as check logging, restrictive endorsement, a depository account and reconciliation to the State accounting records are recommended.

7. The Office of the Governor should not transfer funds into vetoed allocations.

\$50,000 was transferred from the Old Harbor project into the Takatz project which had been vetoed by the Governor.

STATE OF ALASKA

THE LEGISLATURE

BUDGET AND AUDIT COMMITTEE

FINANCE DIVISION
POUCH WF-STATE CAPITOL
JUNEAU, ALASKA 99811
PHONE: (907) 465-3795

MEMORANDUM

DATE: March 31, 1981

TO: Honorable Bob Bettisworth
House Resources Committee

FROM: Milt Barker, Fiscal Analyst
Legislative Finance Division

SUBJ: Hydro Financing & Distribution of State Wealth

This memo attempts to analyze financing of hydroelectric facilities first from the standpoint of maximizing net benefits to the state as a whole, and secondly from the standpoint of maximizing benefits to the private sector. In other words, the second viewpoint considers the efficiency and equity of hydro financing methods as a means of distributing state revenues that exceed the requirements of the state operating and capital budgets.

Alternatives

Methods of financing hydro facilities that are analyzed are:

- 1) Governor's plan - per capita equity grants and revenue bonds (rate restructuring loans are disregarded);
- 2) Alaska Power Authority Plan - state subordinated loan and revenue bonds;
- 3) GO Bonds;
- 4) direct appropriation.

In addition, the following are considered as a means of distributing state revenue:

- 1) Permanent Fund dividends - 50% of permanent fund earnings;
- 2) direct grants to citizens.

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Swan Lake as an Example

For purposes of fleshing out the analysis, Swan Lake is used as an example. This memo is not an analysis of the economic or financial feasibility of Swan Lake for several reasons:

- 1) benefits are calculated assuming demand for power is equal to Swan Lake's annual average generation from the beginning of operations;
- 2) the financing methods would affect the demand for power; specifically, the direct appropriation or GO bond methods result in ratepayers paying no capital costs and therefore much lower rates; while such methods might alleviate the surplus of power in the initial years, they might also result in the need for additional hydro facilities before their time; of course it might be cheaper at that point for the state to finance conservation measures rather than the additional hydro;
- 3) diesel is assumed to be the least cost alternative for the entire period; possibly wind, interconnection, or another source would be cheaper at some point;
- 4) economic multipliers and opportunity costs are not considered;
- 5) the analysis is only carried out to 30 years while life of the hydro facility is considerably longer;
- 6) the sensitivity of the project to cost overruns is not examined.

Equity Considerations

In evaluating the alternatives, it may help to keep in mind certain aspects about the distribution of benefits:

- 1) benefits of cheaper power go to residential, commercial and industrial users; in the analysis 50% of the power is assumed to be consumed by residential users¹ to illustrate the distribution of direct benefits to individuals; the benefits of cheaper power for commercial and industrial users would create some spillover benefits to individuals not estimated in the analysis;

¹In 1978, 44% of Ketchikan Public Utilities power sales went to residential users according to Ketchikan Power Market Analysis by the Alaska Power Administration, September 1979.

- 2) benefits of cheaper power are received in proportion to power consumption;
- 3) benefits of cheaper power are received over the life of the project by users of power with the greater benefits received in the later years;
- 4) benefits of permanent fund dividends go to residents;
- 5) benefits of permanent fund dividends are received in proportion to length of residency;
- 6) benefits of permanent fund dividends are distributed in perpetuity;
- 7) benefits of grants to citizens go to residents;
- 8) benefits of grants to citizens are received equally;
- 9) benefits of grants to citizens are distributed entirely in the current year.

Grants to citizens are considered in the analysis to allow other hydro financing alternatives to be compared or executed on a basis more similar to direct appropriation and GO bonds. Direct appropriation or GO bonds involves transfer of the principle of the appropriations to power users. So do citizen grants; permanent fund appropriations do not.

Efficiency

Table I calculates the benefits of Swan Lake power compared to diesel generation. Table II shows that the cheapest way of obtaining these benefits, if we disregard who pays, is the Governor's plan. GO bonds are almost as inexpensive.

The reason these two alternatives are the least expensive is that the tax-exempt rate of interest on the bonds is less than the rate of inflation. The rates assumed in this analysis, namely:

inflation	10%
taxable interest rates	12%
revenue bonds	9%
GO bonds	8%

reflect recent historical experience (see attached charts). However, even if the bond interest rates were above the rate of inflation, consideration of opportunity costs would probably result in the same relative merits for the financing alternatives.

The reason the Governor's plan is cheaper than GO bonds even though revenue bonds bear a higher interest rate is the earning of arbitrage on the reserve fund for revenue bonds, i.e. the reserve fund earns 12% while paying 9%.

Efficiency and Equity

If we now consider hydro financing as an alternative means of distributing state wealth, the objective becomes to maximize the benefits received by the private sector. To compare the alternatives, Tables III through VI consider the appropriation of \$71,550,000. The balance of funds not required for hydro financing goes either into the permanent fund or into citizen grants. Table VII summarizes the results for those cases in which diesel fuel prices escalate at 12% per annum (the relative merits would be the same for the 15% fuel cost escalation cases).

If one is only concerned with distribution of state wealth, it suffices to consider only the total benefits in Table VII. To the extent that there are competing needs, uses or distribution plans to the alternatives presented here, one should consider the benefit/cost ratios in Table VII.

The results in Table VII are due to a confluence of factors:

- 1) the benefits of hydro power;
- 2) the subsidy of tax-exempt bond rates provided by the federal government;
- 3) the amount of leverage, i.e. the percent of facilities financed with debt;
- 4) the absence of federal income taxation on benefits to users of subsidized power.

The following are a few observations that can be made:

- 1) if a power project offers as much benefit relative to alternatives as the example, it is clearly superior to permanent fund appropriations or grants to citizens in such amounts as to preclude undertaking the project;
- 2) if any balances left after hydro financing are to be put in the permanent fund, then GO bonds are the preferred financing method if the objective is purely to disstribute what are perceived to be surplus funds;
- 3) if the objective is to place the maximum dollars directly into individual's pockets, the Governor's hydro financing plan with the balance paid in grants to citizens succeeds the best.

These observations have been made to suggest how to use Table VII. Many other observations can be made based on one's individual evaluation of the equity issues involved, the competing need for state funds, and the desire to leave the state with a debt-free future.

ADDENDUM

Estimate of Alaskan Marginal Tax Rate

The following information from Individual Income Tax Returns, 1977 Statistics of Income by the Internal Revenue Service was used to estimate an average 30% marginal federal income tax rate for Alaskans for tax year 1977:

	<u>Returns</u>	<u>Average Taxable Income</u>	<u>Marginal Rate</u>
Joint	80,734	22,065	32%
Individuals	100,857	10,333	27%

Total persons filing were 262,325.

The tax schedules were revised in 1975 and 1979 so that 1977 may represent the average marginal rate in the future if continued revisions are made to keep the federal share of income from increasing.

attachments

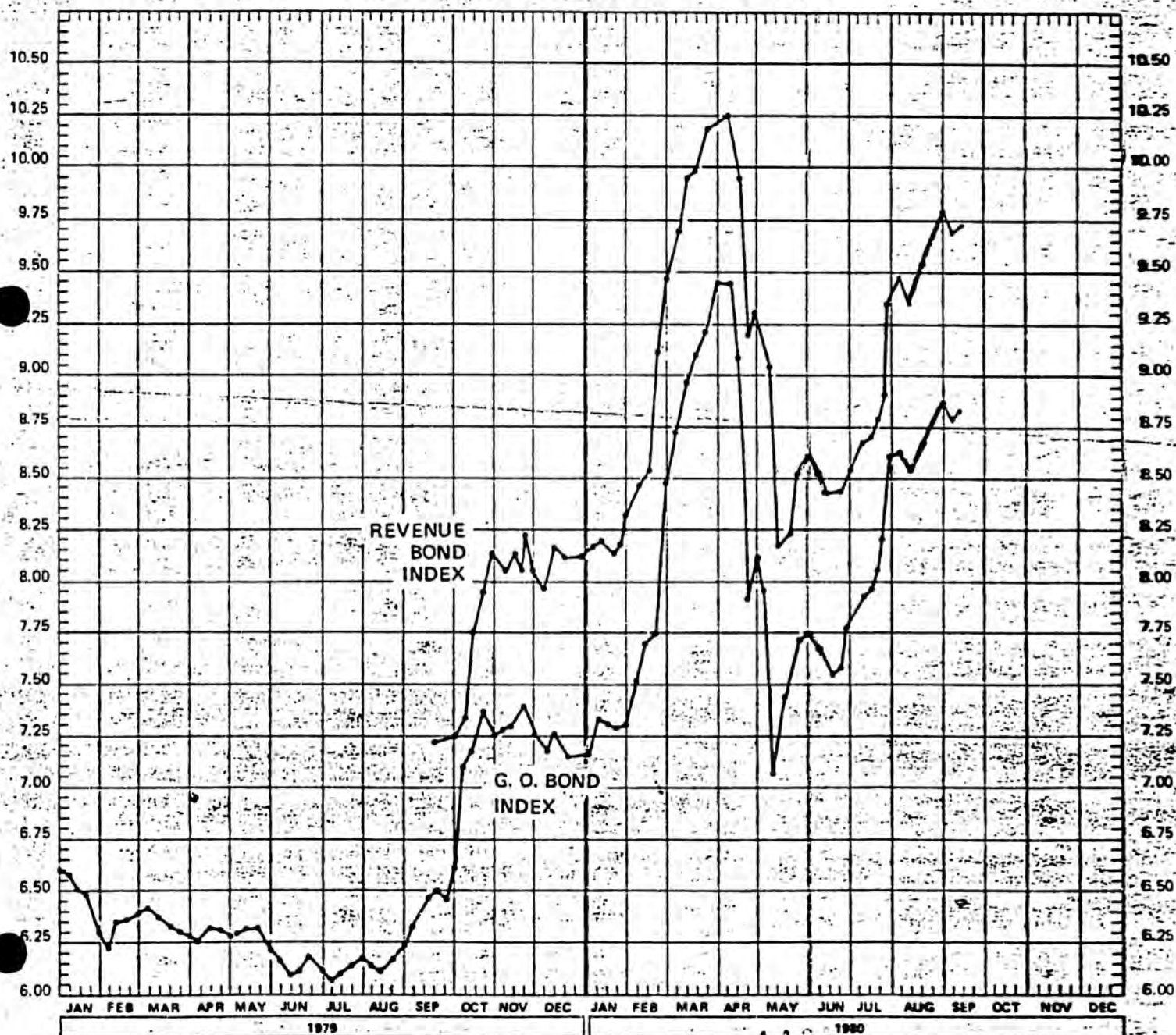
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September 15, 1980

The Bond Buyer's G.O. Index stands at 8.82% and the Revenue Bond index at 9.73%. The last two weeks have seen a leveling of the rapid climb in rates since mid-year, but the supply of new issues coming to market is still heavy, making it less likely that there will be a significant drop in rates by election time.

Municipal issuers needing money now have a difficult decision whether to borrow at these near record interest rates or wait in hopes of some improvement. At the moment, we happen to be on the side of waiting a short time for what could be a slight improvement through the fall. However, don't look for dramatic drops in tax-exempt interest rates in the near future.

BOND BUYER'S INDEX OF MUNICIPAL INTEREST RATES

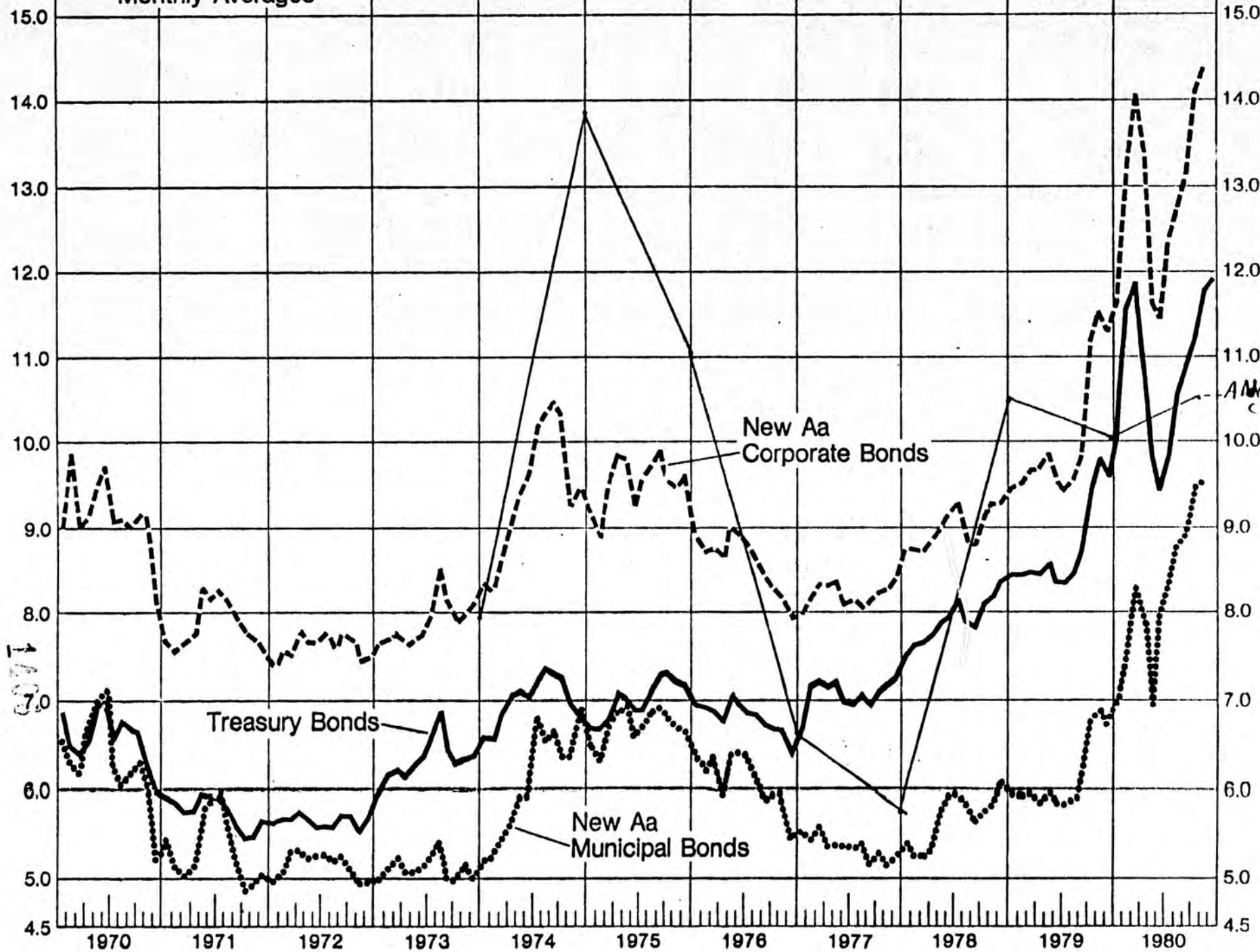


AND MUNICIPAL BONDS

PERCENT

PERCENT

Monthly Averages



AVERAGE YIELDS OF LONG-TERM BONDS

Table I
SWAN LAKE BENEFIT
Disregarding Capital Costs
(\$ millions)

3)	(4)	(5)	(6)= (2+3+4)	(7)= (2+3+5)	(8)= (6-1)	(9)= (7-1)
ing & nance	Diesel Fuel Costs @ 12% Escalation ⁴	Diesel Fuel Costs @ 15% Escalation ⁴	Total Diesel Costs @ 12% Fuel Escalation	Total Diesel Costs @ 15% Fuel Escalation	Benefit to Electrical Users @ 12% Fuel Escalation	Benefit to Electrical Users @ 15% Fuel Escalation
					0	0
					0	0
					0	0
1.25	10.20	11.34	16.30	17.44	14.58	15.72
1.57	11.42	13.04	17.84	19.46	15.97	17.59
1.93	12.79	14.99	19.57	21.77	17.51	19.71
1.32	14.33	17.25	21.50	24.42	19.24	22.16
1.75	16.05	19.83	23.65	27.43	21.16	24.94
5.23	17.97	22.80	26.05	30.88	23.32	28.15
5.75	20.13	26.23	28.73	34.83	25.72	31.82
5.33	22.54	30.16	31.72	39.34	28.41	36.04
5.96	25.25	34.68	35.06	44.49	31.42	40.84
7.66	28.28	39.89	38.79	50.40	34.78	46.39
3.43	31.68	45.87	42.96	57.15	38.56	52.75
9.27	35.48	52.75	47.60	64.87	42.75	60.02
0.20	39.73	60.67	52.78	73.72	47.45	68.39
1.22	44.50	69.77	58.57	83.84	52.70	77.97
2.34	49.84	80.24	65.03	95.43	58.58	88.98
3.58	55.83	92.27	72.26	108.70	65.16	101.60
4.93	62.53	106.11	80.31	123.89	72.50	116.08
6.43	70.03	122.03	89.31	141.31	80.72	132.72
8.07	78.43	140.33	99.35	161.25	89.90	151.80
9.87	87.85	161.38	110.57	184.10	100.17	173.70
1.86	98.38	185.59	139.38	226.59	127.95	215.16
4.05	110.18	213.42	153.37	256.61	140.79	244.03
6.46	123.41	245.43	169.01	291.03	155.18	277.50
9.10	138.22	282.25	186.46	330.49	171.25	315.73
2.01	154.80	324.59	205.95	375.74	189.21	359.00
5.21	173.38	373.28	227.73	427.63	209.32	409.22
8.73	194.19	429.27	252.06	487.14	231.80	466.88
13.51	1,727.42	3,215.46	2,311.91	3,799.95	2,106.10	3,594.14
					297.27	452.62

Table I
SWAN LAKE BENEFIT
Disregarding Capital Costs
(\$ millions)

[illegible]

Table I

Footnotes:

1. 2% of construction costs for first year of generation; escalated @ 10%; Swan Lake construction cost is \$86,000,000; construction begins 6-1-81; interest earned during construction @ 12% on average \$36,500,000 balance.
2. \$1,443/kw capacity in FY 84 times 18,000 kw Swan Lake dependable capacity; levelized charge based on 20-year life @ 9% tax-exempt interest rate; \$9,707/kw installed capacity for replacement diesel generator in 2004.
3. 1.95¢/kwh in FY 85; times 85,400,000 kwh average annual energy delivered to load center by Swan Lake; escalated @ 10%.
4. 85,400,000 kwh requires 6,569,230 gallons of diesel fuel @ 13 kwh/gallon; March 1981 Ketchikan Public Utilities diesel price is 98.7¢ per gallon.

Sources:

1. Swan Lake capacity and average annual generation from Application for License for the Swan Lake Project before the Federal Energy Regulatory Commission, Ketchikan Public Utilities, Ketchikan, Alaska, February 1979.
2. Swan Lake construction cost from "Swan Lake Project" analyses, Nuveen & Co., February 1981.
3. Swan Lake operating and maintenance costs from Swan Lake, Lake Grace, and Mahoney Lake Hydroelectric Projects Appraisal Report, Ketchikan Public Utilities, Ketchikan, Alaska, June 1977.
4. Diesel costs from Ketchikan Power Market Analysis, Alaska Power Administration, September 1979.

Prepared By:
Legislative Finance
March 30, 1981

TABLE II

SWAN LAKE CAPITAL COSTS
(Millions 1981 Dollars)

	GOVERNOR'S PLAN		Construction of Swan Lake APA PLAN		GO BONDS		DIRECT APPROPRIATION	
	12% Fuel	15% Fuel	12% Fuel	15% Fuel	12% Fuel	15% Fuel	12% Fuel	15% Fuel
	<u>Escalation</u>	<u>Escalation</u>	<u>Escalation</u>	<u>Escalation</u>	<u>Escalation</u>	<u>Escalation</u>	<u>Escalation</u>	<u>Escalation</u>
<u>Capital costs</u>								
Payments on Revenue Bonds	(34.20)	(34.20)	(32.20)	(32.20)	--	--	--	--
Subordinated Loan	--	--	(43.00)	(43.00)	--	--	--	--
GO Bond Debt Service	--	--	--	--	(61.93)	(61.93)	--	--
Grant	(26.93)	(26.93)	--	--	--	--	--	--
Direct Appropriation	--	--	--	--	--	--	(71.55)	(71.55)
Total Capital Costs	(61.13)	(61.13)	(75.20)	(75.20)	(61.93)	(61.93)	(71.55)	(71.55)

TABLE II-A

SWAN LAKE
SOURCES AND USES OF FUNDS
FOR CAPITAL COSTS
(\$ Millions)

<u>Uses</u>	<u>Governor's Plan</u>	<u>APA Plan</u>	<u>GO Bonds</u>	<u>Direct Appropriation</u>
Construction (3 years)	86.00	86.00	86.00	86.00
Reserve Fund (15% of Revenue Bonds)	10.11	8.68	--	--
Capitalized Interest on Revenue Bonds and Subordinated Loan (3 years at 9%)	18.20	27.23	--	--
Costs of Bond Issuance (3 1/2% of Bonds)	<u>2.36</u>	<u>2.02</u>	<u>2.58</u>	<u>--</u>
Total Uses	116.67	123.93	88.58	86.00
<u>Sources</u>				
Revenue Bonds	67.42	57.84	--	--
Grant (\$2000 X 13,463 persons)	26.93	--	--	--
Subordinated Loan	--	43.00	--	--
GO Bonds	--	--	73.94	--
Direct Appropriation	<u>--</u>	<u>--</u>	<u>--</u>	<u>71.55</u>
Sources Subtotal	94.35	100.84	73.94	71.55
Interest Earned During Construction (3 years at 12% on reserve funds plus 55% of sources subtotal)	<u>22.32</u>	<u>23.09</u>	<u>14.64</u>	<u>14.45</u>
Total Sources	116.67	123.93	88.58	86.00

Prepared by:
Legislative Finance Division
March 30, 1981

Table III

SWAN LAKE AND PERMANENT FUND OPTIONS
BENEFIT/COST RATIOS FOR ALTERNATIVE USES OF \$71,550,000
(Millions 1981 Dollars)

	Construction of Swan Lake								Appropriation to Permanent Fund	
	Governor's Plan		APA Plan		GO Bonds		Direct Appropriation			
	12% Fuel Escalation	15% Fuel Escalation	12% Fuel Escalation	15% Fuel Escalation	12% Fuel Escalation	15% Fuel Escalation	12% Fuel Escalation	15% Fuel Escalation		
Hydro Benefits to Users (From Table I)	297.27	452.62	297.27	452.62	297.27	452.62	297.27	452.62	---	---
Less: User Payments on Revenue Bonds @ 9% for 27 years repaid 6/1/85 to 6/1/2011	(34.20)	(34.20)	(32.20)	(32.20)	---	---	---	---	---	---
User Payments on Subordinated Loan @ 9% for 27 years repaid 6/1/85 to 6/1/2011	---	---	(27.07)	(27.07)	---	---	---	---	---	---
Plus: Permanent Fund Earnings on \$71,555,000 less amount of grant subordinated loan, GO debt service, or direct appropriation @ 12% 6/1/82 to 6/1/2011	50.47	50.47	32.29	32.29	10.88	10.88	---	---	80.92	
Permanent Fund Earnings @ 12% on repayment of subordinated loan 6/1/85 to 6/1/2011	---	---	30.54	30.54	---	---	---	---	---	
Less: 50% of Permanent Fund Earnings to State	(25.23)	(25.23)	(31.41)	(31.41)	(5.44)	(5.44)	---	---	(10.46)	
30% average marginal rate for individuals' federal income tax on Permanent Fund earnings paid as dividends	<u>(7.57)</u>	<u>(7.57)</u>	<u>(9.42)</u>	<u>(9.42)</u>	<u>(1.63)</u>	<u>(1.63)</u>	---	---	(12.13)	
Total Benefits to Users	280.74	436.09	260.00	415.35	301.08	456.43	297.27	452.62	29.11	

Table III (continued)

SWAN LAKE AND PERMANENT FUND OPTIONS
BENEFIT/COST RATIOS FOR ALTERNATIVE USES OF \$71,550,000
(Millions 1981 Dollars)

Cost to State	Construction of Swan Lake								Appropriation to Permanent Fund
	Governor's Plan		APA Plan		GO Bonds		Direct Appropriation		
	12% Fuel Escalation	15% Fuel Escalation	12% Fuel Escalation	15% Fuel Escalation	12% Fuel Escalation	15% Fuel Escalation	12% Fuel Escalation	15% Fuel Escalation	
Grant	(26.93)	(26.93)	--	--	--	--	--	--	--
Subordinated Loan	--	--	(43.00)	(43.00)	--	--	--	--	--
Less: Subordinated Loan Repayment	--	--	27.07	27.07	--	--	--	--	--
Debt Service @ 8% for 30 years on GO Bonds	--	--	--	--	(61.93)	(61.93)	--	--	--
Direct Appropriation for Swan Lake	--	--	--	--	--	--	(71.55)	(71.55)	--
Appropriations to Permanent Fund	(44.62)	(44.62)	(28.55)	(28.55)	(9.62)	(9.62)	--	--	(71.55)
Appropriation of Subordinated Loan to Permanent Fund	--	--	(27.07)	(27.07)	--	--	--	--	--
Total Cost to State	(71.55)	(71.55)	(71.55)	(71.55)	(71.55)	(71.55)	(71.55)	(71.55)	(71.55)
Less: 50% of Permanent Fund Earnings	25.23	25.23	31.41	31.41	5.44	5.44	--	--	40.66
Net Cost to State	(46.32)	(46.32)	(40.14)	(40.14)	(66.11)	(66.11)	(71.55)	(71.55)	(30.89)
Ratio of Benefits to Net Cost	6.06	9.41	6.48	10.35	4.55	6.90	4.15	6.36	1.00

TABLE IV

SWAN LAKE AND PERMANENT FUND OPTIONS
 BENEFIT/COST RATIOS FOR RESIDENTIAL USERS FOR ALTERNATIVE USES OF \$71,550,000
 ASSUMING 50% OF POWER IS CONSUMED BY RESIDENTIAL USERS
 (Millions 1981 Dollars)

	GOVERNOR'S PLAN		APA PLAN		GO BONDS		DIRECT APPROPRIATION		Appropriation To Permanent Fund
	12% Fuel Escalation	15% Fuel Escalation	12% Fuel Escalation	15% Fuel Escalation	12% Fuel Escalation	15% Fuel Escalation	12% Fuel Escalation	15% Fuel Escalation	
Hydro Benefits to Users (50% of Table I)	148.63	226.31	148.63	226.31	148.63	226.31	148.63	226.31	---
Less: User Payments on Revenue Bonds (50% of Table III)	(17.10)	(17.10)	(16.10)	(16.10)	--	--	--	--	---
User Payments on Subor- dinated Loan (50% of Table III)	--	--	(13.53)	(13.53)	--	--	--	--	---
Plus: Permanent Fund Dividends After-Tax (From Table III)	<u>17.67</u>	<u>17.67</u>	<u>21.99</u>	<u>21.99</u>	<u>3.81</u>	<u>3.81</u>	<u>--</u>	<u>--</u>	28.33
Total Benefits to Residential Users	149.20	226.88	140.99	218.67	152.44	230.12	148.63	226.31	28.33
Net Cost to State (From Table III)	(46.32)	(46.32)	(40.14)	(40.14)	(66.11)	(66.11)	(71.55)	(71.55)	(40.90)
Ratio of Residential Benefits to Net Cost	3.22	4.90	3.51	5.45	2.31	3.48	2.08	3.16	.99

Prepared by:
 Legislative Finance Division
 March 30, 1981

TABLE

SWAN LAKE AND DIRECT CITIZEN GRANT OPTIONS
BENEFIT/COST RATIOS FOR ALTERNATIVE USES OF \$71,550,000
ASSUMING 50% OF POWER IS CONSUMED BY RESIDENTIAL USERS
(Millions 1981 Dollars)

	GOVERNOR'S PLAN		APA PLAN		GO BONDS		DIRECT APPROPRIATION		DIRECT CITIZEN GRANTS
	12% Fuel Escalation	15% Fuel Escalation	12% Fuel Escalation	15% Fuel Escalation	12% Fuel Escalation	15% Fuel Escalation	12% Fuel Escalation	15% Fuel Escalation	
Hydro Benefits to Users (50% of Table I)	148.63	226.31	148.63	226.31	148.63	226.31	148.63	226.31	--
LESS: User Payments on Revenue Bonds (50% of Table III)	(17.10)	(17.10)	(16.10)	(16.10)	--	--	--	--	--
User Payments on Subordinated Loan (50% of Table III)	--	--	(13.53)	(13.53)	--	--	--	--	--
PLUS: Citizens Grants After- Tax (From Table V)	<u>31.23</u>	<u>31.23</u>	<u>38.93</u>	<u>38.93</u>	<u>6.73</u>	<u>6.73</u>	--	--	50.00
Total Benefits to Residential Users	162.76	274.64	157.93	235.61	155.36	233.04	148.63	226.31	50.00
Cost to State (From Table V)	(71.55)	(71.55)	(71.55)	(71.55)	(71.55)	(71.55)	(71.55)	(71.55)	(71.55)
Ratio of Residential Benefits to Cost	2.27	3.84	2.21	3.29	2.17	3.26	2.08	3.16	1.70

PREPARED BY:
Legislative Finance Division
March 30, 1981

Book 4
1981
Continued

TABLE V
SWAN LAKE AND DIRECT CITIZEN GRANT OPTIONS
BENEFIT/COST RATIOS FOR ALTERNATIVE USES OF \$71,550,000
(Millions 1981 Dollars)

	GOVERNOR'S PLAN		APA PLAN		GO BONDS		DIRECT APPROPRIATION		DIRECT CITIZEN GRANTS
	12% Fuel Escalation	15% Fuel Escalation	12% Fuel Escalation	15% Fuel Escalation	12% Fuel Escalation	15% Fuel Escalation	12% Fuel Escalation	15% Fuel Escalation	
Hydro Benefits to Users (from Table I)	297.27	452.62	297.27	452.62	297.27	452.62	297.27	452.62	---
LESS: User Payments on Revenue Bonds (from Table III)	(34.20)	(34.20)	(32.20)	(32.20)	--	--	--	--	
User Payments on Subor- dinated Loan (from Table III)	--	--	(27.07)	(27.07)	--	--	--	--	
PLUS: Citizen Grants of \$71,550,000 less amount of hydro grant, subordinated loan, GO debt service, or direct appropriation	44.62	44.62	28.55	28.55	9.62	9.62	--	--	71.55
Citizen Grants of Subor- dinated Loan Repayments	--	--	27.07	27.07	--	--	--	--	
LESS: 30% average marginal rate for individuals' federal income tax on citizen grants	(13.39)	(13.39)	(16.69)	(16.69)	(2.89)	(2.89)	--	--	(71.55)
Total Benefits to Users	294.30	449.65	276.93	432.28	304.00	459.35	297.27	452.62	50.00
<u>Cost to State</u>									
Hydro Grant	(26.93)	(26.93)	--	--	--	--	--	--	
Subordinated Loan	--	--	(43.00)	(43.00)	--	--	--	--	
Less: Repayment of Subor- dinated Loan	--	--	27.07	27.07	--	--	--	--	
Debt Service on GO Bonds	--	--	--	--	(61.93)	(61.93)	--	--	
Direct Appropriation for Swan Lake	--	--	--	--	--	--	(77.55)	(71.55)	
Citizen Grants	(44.62)	(44.62)	(55.62)	(55.62)	(9.62)	(9.62)	--	--	(71.55)
Total Cost to State	(71.55)	(77.55)	(71.55)	(71.55)	(71.55)	(71.55)	(71.55)	(71.55)	(71.55)
Ratio of Benefit to Cost	4.11	6.28	3.87	6.04	4.24	6.41	4.15	6.32	4.70

TABLE VII

TOTAL BENEFITS AND BENEFIT/COST RATIOS FOR
ALTERNATIVE USES OF \$71,550,000
ASSUMING 12% ESCALATION IN DIESEL FUEL COSTS
(Millions 1981 Dollars)

	ALL BENEFITS				RESIDENTIAL BENEFITS			
	Balance To		Balance To		Balance To		Balance To	
	Total	Benefit/Cost	Total	Benefit/Cost	Total	Benefit/Cost	Total	Benefit/Cost
	Benefits	Ratio	Benefits	Ratio	Benefits	Ratio	Benefits	Ratio
<u>Construction of Swan Lake</u>								
Governor's Plan	280.74	6.06	294.30	4.11	149.20	3.22	162.76	2.27
Alaska Power Authority Plan	260.00	6.48	276.93	3.87	140.99	3.51	157.93	2.21
GO Bonds	301.08	4.55	304.00	4.24	152.44	2.31	155.36	2.17
Direct Appropriations	297.27	4.15	297.27	4.15	148.63	2.08	148.63	2.08
Appropriation to Permanent Fund	28.11	.92	--	--	28.33	.92	--	--
Appropriation of Grants to Citizens	--	--	50.09	.70	--	--	50.09	.70

PREPARED BY:
Legislative Finance Division
March 30, 1981

Net Opportunity Cost to State for Financing an \$87 Million Capital Improvement
with Various User Repayment Provisions
(\$ Millions)

	<u>Cash Flow to State</u>			<u>Total Value of Payments over Project Life (1981 Dollars)¹</u>		
	<u>Annual Payment (Nominal Dollars)</u>					
	<u>30 year</u>	<u>50 year</u>	<u>100 year</u>	<u>30 year</u>	<u>50 year</u>	<u>100 year</u>
No Principal or Interest Repayment	0	0	0	0	0	0
5% "Equity Return"	4.35	4.35	4.35	60	89	220
10% "Equity Return"	8.70	8.70	8.70	120	178	440
Principal plus 5% Interest	5.66	4.77	4.38	78	98	221
Principal plus 12% Interest	10.80	10.48	10.44	149	214	527
	<u>Opportunity Cost</u>			<u>Total Opportunity Cost (1981 Dollars)³</u>		
	<u>Annual Opportunity Cost (Nominal Dollars)²</u>					
	(10.44)	(10.44)	(10.44)	(149)	(214)	(527)
	<u>Net Cost to State⁴</u>			<u>Total Cost (1981 Dollars)</u>		
	<u>Annual Cost (Nominal Dollars)</u>					
No Principal or Interest Repayment	(10.44)	(10.44)	(10.44)	(149)	(214)	(527)
5% "Equity Return"	(6.09)	(6.09)	(6.09)	(89)	(125)	(307)
10% "Equity Return"	(1.74)	(1.74)	(1.74)	(29)	(36)	(87)
Principal plus 5% Interest	(4.78)	(5.67)	(6.06)	(71)	(116)	(306)
Principal plus 12% Interest	.36	.04	0	0	0	0

¹Annuity value of payments discounted at the assumed inflation rate of 10%.

²12% interest on \$87 million

³\$87 million principal plus 12% annual interest compounded over project life with future value discounted to 1981 dollars at the inflation rate

⁴Opportunity cost less cash flow

HOUSE FINANCE COMMITTEE

June 4, 1981

2:00 p.m.

[Tape HFC 81-106, Side 1, #362]

PRESENT

Vice Chairman Freeman called the meeting to order at 2:00 p.m. All members of the Committee were present. Representatives Cotten, Montgomery and Rogers arrived later in the meeting. Also in attendance: Representative Terry Gardiner; Commissioner Tom Williams, Department of Revenue; Mike Doogan, Administrative Aide to Vice Chairman Freeman; Mark Wittow, Administrative Aide to Representative Malone; Milt Barker, Fiscal Analyst, Division of Legislative Finance.

HJR 4

Vice Chairman Freeman announced the first order of business was consideration of HJR 4:

HJR 4 - Proposing an amendment to the Constitution of the State of Alaska relating to limiting increases in expenditures and requiring payment by the state of mandated increased expenditures of a political subdivision of the state.

Representative Gardiner, sponsor, distributed copies of an amendment (see Attachment 1) to HJR 4. He stated he feels that, rather than listing things to exempt, this language would cover those categories that might be reserved for emergencies. Though still restricted, he said, this does allow more flexibility and also meets the income producing criteria of the permanent fund. Discussion followed.

Representative Adams wondered about exemption for bonds or bond debts. Representative Gardiner advised this would be subject to the General Appropriations Act for exempting bonds. Representative Adams suggested this be amended so that 80% of the revenues derived be placed in the rural areas. Representative Gardiner referred to the statutes regarding the declaration of emergency.

Representative Moss suggested amending page 1, line 22, by adding "and concurred in by the Legislature" after the word "law". Representative Carney mentioned he would hate to think a special session would have to be called. In response, Representative Gardiner indicated he doesn't think this is necessary.

Representative Gardiner stated there has been some concern as to what the spending limit should reflect. It would be tied to estimated growth of the economy of the State, he said, though he

feels there are some problems with how population and inflation compare to the oil pipeline. He considered the possibility that neither standard will work very well and suggested perhaps they ought to write in an either/or standard to provide for more flexibility and take into consideration the wide swings in the economy; i.e., estimated rate of growth should take into account both a negative growth rate as well as positive. He noted Alaska has traditionally been characterized as having a "boom or bust" economy.

There was considerable discussion on the three-year period for emergencies. Representative Gardiner stated the restriction is that it should be spread out and that the Legislature should exercise discretion in declaring a state of emergency. He admitted three years is an arbitrary figure, but he doesn't know how to limit this without providing loopholes for exemptions.

Representative Malone wondered how he (Gardiner) defines income producing investment and if it relates to permanent fund language. Representative Gardiner indicated it will have to be defined in the law or through court cases; however, this language was the result of legal research.

There was further discussion on how emergency is defined and the three-year restriction. Representative Gardiner stated he feels it would be more appropriate to define state of emergency--economic or natural--by statute rather than in the constitution to allow for flexibility.

[Tape HFC 81-106, Side 2, #001]

Representative Haugen asked about the annual debt service, and Representative Gardiner indicated he thinks it is important this be included, as it shouldn't be left open-ended.

(Representative Haugen left the meeting.)

Representative Malone noted he authored a resolution (HJR 57 - Proposing an amendment to the Constitution of the State of Alaska relating to limitations on appropriations of state money.) that is similar to the Governor's (HJR 5 - Proposing an amendment to the Constitution of the State of Alaska relating to limitations on appropriations of state money.) limiting the constitutional spending limit.

At this time, Vice Chairman Freeman presented his "litany" on curtailing growth in State government.

In describing HJR 57, Representative Malone said he views this as an attempt to slow down the rate of spending growth process so that it limits revenues when reached. He stressed it is important to keep in mind that any limitation adopted should be within the usual constitutional scheme of things, regarding the appropriation of funds limited by the Legislature. This basic

premise should be examined very carefully before taking any steps in this direction.

(Representative Haugen returned to the meeting.)

One of the problems, Representative Malone continued, is that any spending limit adopted in 1982, and which pertains to a particular spending year, the question becomes academic when used as a base. He suggested either adopting as a base the current year or decide a figure and not let it roll into FY 83. HJR 57 also contains a provision that allows the Legislature to make the decision that determines if the limit can be exceeded for a single item for a single purpose in a single bill. He strongly urged the Committee not use FY 83 as a base year. In conclusion, he said, the Committee should consider very carefully those points before adopting any constitutional amendment restricting the spending limit.

Representative Meekins called attention to the fact that neither HJR 4 nor HJR 57 covers appropriations for permanent fund dividends. Representative Malone responded the reason is that the resolution does not contain the permanent fund. Representative Meekins commented debt service was put under a limit to slow down the rate of expenditure. Mike Doogan advised both those things would be exempted, at least under HJR 4; and income tax reduction is not an expenditure, while income tax rebate probably would be. Representative Malone agreed Representative Meekins' point on Alaska limitation, so-called "privatization" was a good one.

HJR 4 HELD -- SUBCOMMITTEE APPOINTED

Vice Chairman Freeman appointed a subcommittee--chaired by Representative Malone, and with Representatives Meekins and Haugen--on HJR 4 to look into the matter and report back to the full Committee on Monday, June 8.

RECESS

(Vice Chairman Freeman called a recess at 2:55 p.m. During this time, Representatives Cotten, Montgomery and Rogers--who had been in Free Conference Committee on the Budget/HB 50--joined the meeting. All Committee members were present. Representatives Buchholdt and Freeman returned to the meeting at a later time. Chairman Cotten reconvened the meeting at 3:10 p.m.)

REVENUE PROJECTIONS

At this time, Milt Barker distributed a memorandum packet (see Attachment 2) dated June 1 and presented an overview outlining the current revenue projections, based on three estimates and how this compares to the Department of Revenue's March projections. The reason for the decrease in revenues, he explained, is the continued over-production of oil by Saudi Arabia.

During discussion, Representative Meekins asked if the countries of Libya and Mexico reducing their oil were taken into consideration, and Mr. Barker indicated he would not base estimates on those, as it was more or less anticipated in his estimates.

[Tape HFC 81-107, Side 1, #001]

In response to a question from Representative Rogers, Mr. Barker indicated the \$350 million for the rainy day account is not included in his estimates.

Commissioner Williams made his presentation at this time and referred to his memorandum (see Attachment 3) dated June 3 and his Petroleum Revenue Analysis for FY 82 (see Attachment 4) and discussed cumulative frequency and the differences between mean or average and median. He said they "disagree with Mr. Barker because he indicates we have less." He discussed pricing assumptions and commented Mr. Barker is looking primarily at wellhead prices. There is a 60% likelihood of a price increase in January, he said, and a 25% chance there won't be; and a 13% chance a price increase will take place before January, and a 30% chance that it won't; and a 1% chance that "OPEC will bomb out...or (for) a blow-up in the Middle East..."

He described the current oil glut and explained how Mexico relates to OPEC.

(Representative Adams left the meeting.)

Representative Meekins stated that, in looking at this statistical information, he feels the critical element is that all the things that will happen here are politically determined or are political judgments. Commissioner Williams agreed.

(Representative Buchholdt returned to the meeting.)

Representative Meekins wondered if there weren't a different way to look at this. Commissioner Williams explained the three related factors involved here are what their needs are, when they are producing and the glut of oil as far as looking at the future. There was discussion on the possible stabilization of oil prices at \$34-36.

(Representative Rogers left the meeting.)

Referring to what goes to the municipalities, Representative Moss asked what protection the State has for safeguarding against sudden tax increases. Commissioner Williams explained what the municipalities are limited to and that there is no limitation on bonding authority.

(Representative Haugen left the meeting.)

There was discussion on oil transportation costs from the Gulf to the West Coast.

(Representative Haugen returned to the meeting.)

Based on discussions with Mr. Barker, Commissioner Williams indicated he feels they are in fairly close agreement, perhaps differing by \$1 per barrel. The critical point, he said, is the assumption in the differential in what the North Slope oil will bring in versus Saudi Arabia when delivered to the refineries. He stated they analyzed by district and noted the Gulf and West Coasts are now acting independently. Mr. Barker concurred with this reasoning on where they differ.

(Representative Freeman returned to the meeting.)

{Tape HFC 81-107, Side 2, #001}

Representative Malone requested the Department of Revenue provide the Committee with the median case based on the wellhead price. Representative Meekins requested a statistical analysis that would indicate the probability that these assumptions would be correct, because "You are not comparing any estimates, you are just plugging in assumptions."

RECESS

The meeting recessed 4:25 p.m.

Tape HFC 81-106, Side 1, #362 - End
 Side 2, #001 - End
 HFC 81-107, Side 1, #001 - End
 Side 2, #001 - #274

*Proposed by
Gardiner*

Introduced: 2/4/81
Referred: Finance and
Judiciary

1 IN THE HOUSE

BY GARDINER

2 HOUSE JOINT RESOLUTION NO. 4
3 IN THE LEGISLATURE OF THE STATE OF ALASKA
4 TWELFTH LEGISLATURE - FIRST SESSION

5 Proposing an amendment to the
6 Constitution of the State of Alaska
7 relating to limiting increases in
8 expenditures and requiring payment
9 by the state of mandated increased
10 expenditures of a political sub-
11 division of the state.

12 BE IT RESOLVED BY THE LEGISLATURE OF THE STATE OF ALASKA:

13 * Section 1. Article IX, Constitution of the State of Alaska, is amended
14 by adding a new section to read:

15 SECTION 16. APPROPRIATION GROWTH LIMIT. In no year shall the
16 rate of growth of appropriations from ~~state revenues~~ *the general fund*, excepting ap-
17 propriations ~~to the permanent fund established in Section 15 of this~~ *for income producing investments or reserve for emergency*
18 ~~article and excepting appropriations made for the purpose of loans to~~
19 ~~be made by the State~~, exceed the estimated rate of growth of the
20 economy of the State as determined by law. An appropriation in excess
21 of this limit shall not be made unless a state of emergency is declared
22 to exist, as provided by law. A state of emergency may not be declared
23 if a state of emergency has been declared within the preceding three
24 years. The appropriation limit for each of the three years following
25 the declaration of emergency shall be adjusted equally so that the
26 total appropriations for the year of the emergency and the succeeding
27 three years do not exceed the appropriations which could have been made
28 under this section if no emergency had been declared. The limit on
29 rate of growth of appropriations for each year shall be calculated

STATE OF ALASKA

THE LEGISLATURE

BUDGET AND AUDIT COMMITTEE

FINANCE DIVISION
POUCH WF-STATE CAPITOL
JUNEAU, ALASKA 99811
PHONE: (907) 465-3795

June 1, 1981

MEMORANDUM

TO: Honorable Hugh Malone
House Finance Committee

FROM: Milt Barker, ^{MS} Fiscal Analyst
Legislative Finance Division

SUBJECT: General Funds Available for Appropriation

Based on revised petroleum revenue estimates contained in this memo, Legislative Finance estimates the liquid general funds available for appropriation this session to be:

<u>Estimate</u>	<u>Available for Appropriation (\$ millions)</u>	<u>Reduction from March 1981 Estimate of \$6,061.6 (\$ millions)</u>
High	\$5,648.5	(413.1)
Medium	5,165.2	(896.4)
Low	4,959.7	(1,101.9)

Generally, these reduced estimates result from Saudi Arabian oil production in excess of world demand. The Saudis are doing so in an effort to force other OPEC producers to unify their prices and adopt an index for future price increases. The Saudis are concerned about the effect of upward spiralling prices on long-term demand.

The failure of the Saudis to achieve their goals at last week's meeting of OPEC means there will be continued overproduction by the Saudis and consequent softness in oil markets for some undetermined period of time. The market softness will be magnified by liquidation of inventories until such time as expectations of price declines are reversed.

There are several indications that some immediate reductions may be anticipated in Alaskan oil prices:

- 1) the spot market for comparable oil is tumbling as shown in Chart I (attached);
- 2) posted prices in the U.S. have generally been reduced \$2 in May;
- 3) the first April figure for Alaskan royalty oil sales has been reported by Exxon and shows a decrease of \$1.45 from March;
- 4) Alpetco is rumored to have offered Alaskan royalty oil for sale on the West Coast at \$3 under the market;

The informal OPEC plan that seems to have developed is that the OPEC moderates will freeze their prices at their current \$36 per barrel minimum price until the Saudis, at \$32 per barrel, catch up. How long the Saudis take to do this depends on when current demand for oil firms up and Saudi judgements about whether oil prices are now so high as to radically alter long-term demand.

Assumptions

The difference between the high, medium, and low estimates are attributable to assumptions about three factors:

- 1) the timing and amount of movement in Saudi oil prices;
- 2) the spread between Alaskan and Saudi prices (see Chart I);
- 3) the difference between Gulf Coast and West Coast prices for Alaskan oil. ^{1/} (see Chart II);

Specifically, the cases assume the following:

- 1) High estimate
 - a) Saudi official price for Arabian Light moves from \$32 to \$34 in July 1981 and to \$36 in January 1982;
 - b) the spread between the Alaskan delivered price and the official price for Arabian Light narrows by \$2 in May 1981;

^{1/} In estimating the effect of increasing spreads between Gulf Coast and West Coast prices for Alaskan crude it is assumed that 900,000 barrels per day of North Slope production goes to the West Coast and 600,000 barrels per day to the Gulf Coast. Increasing spreads are assumed to occur through reductions of prices on the West Coast due to re-emergence of the "West Coast oil glut." The difference in tanker costs to these two markets forms a ceiling on potential reductions in West Coast prices.

- c) the spread between Gulf Coast and West Coast prices for Alaskan oil increases \$1 in May 1981;
- 2) Medium estimate
 - a) Saudi official price for Arabian Light moves from \$32 to \$34 in January 1982;
 - b) the spread between the Alaskan delivered price and the official price for Arabian Light narrows by \$2 in May 1981 and is eliminated in July 1981;
 - c) the spread between Gulf Coast and West Coast prices for Alaskan oil increases by \$1 in May 1981 and by another \$1 in July 1981;
- 3) Low Estimate
 - a) Saudi official price for Arabian Light remains at \$32 through FY 82;
 - b) the spread between the Alaskan delivered price and the official price for Arabian Light narrows by \$2 in May 1981 and is eliminated in July 1981; Alaskan crude falls below the official Saudi price by \$1 in January 1982;
 - c) the spread between Gulf Coast and West Coast prices for Alaskan crude increases by \$1 in May 1981, by another \$1 in July 1981, and by another \$1 in January 1982.

All the cases assume that the Saudis are willing and able to reduce their production to the extent necessary to sustain the price of Arabian Light at the assumed levels. In the event that this is not possible due to either Saudi budgetary pressures or falling world oil demand (see attached Wall Street Journal articles "Oil and the Saudi Fairy Tale" and "Oil-Pricing Blunders Now Have Saudis in a Jam"), State revenues could fall far below the amounts estimated in the high, medium and low cases.

MBB:pw

Attachments

1426

TABLE I
GENERAL FUNDS AVAILABLE FOR APPROPRIATION
(\$ Millions)

	<u>Table II Estimates</u>			<u>Dept. of Revenue March 1981 Estimate</u>	<u>Difference</u>		
	High	Medium	Low		High	Medium	Low
<u>FY 81</u>							
Royalty (Net of Permanent Fund)	1128.7	1128.7	1128.7	1085.4	43.3	43.3	43.3
Severance	1179.7	1179.7	1179.7	1169.9	9.8	9.8	9.8
Petroleum Corporate Income Tax	767.6	767.6	767.6	839.3	<u>(71.7)</u>	<u>(71.7)</u>	<u>(71.7)</u>
TOTAL					(18.6)	(18.6)	(18.6)
<u>FY 82</u>							
Royalty (Net of Permanent Fund)	1513.8	1329.0	1236.6	1671.5	(157.7)	(342.5)	(434.9)
Severance	1487.9	1297.5	1202.3	1640.3	(152.4)	(342.8)	(438.0)
Petroleum Corporate Income Tax	1176.1	1068.0	1050.1	1260.5	<u>(84.4)</u>	<u>(192.5)</u>	<u>(210.4)</u>
TOTAL					(394.5)	(877.8)	(1083.3)
TOTAL FY 81 and FY 82					(413.1)	(896.4)	(1101.9)
<u>Amount Available for Appropriation (Liquid General Funds)</u>							
March 1981 Dept. of Revenue Estimate					6061.6	6061.6	6061.6
Current Legislative Finance Estimate					5648.5	5165.2	4959.7

1427

6-4-81

Attachment 2

Attachment 2

TABLE II
PROJECTED PETROLEUM REVENUES
FY 81 and FY 82
(\$ Millions)

	North Slope		Cook Inlet	Kuparuk	TAPS	Field Cost Settlement	Royalty Auction	Total		
	Medium	Low						High	Medium	Low
.6	1414.6	1414.6	60.4	—	—	30.0	—	1505.0	1505.0	1505.0
.9	1152.9	1152.9	26.8	—	—	—	—	1179.7	1179.7	1179.7
.3	759.3	759.3	23.3	—	187.2	(2.8)	—	767.6	767.6	767.6
.9	1554.5	1431.3	113.8	24.0	—	—	79.7	2018.4	1772.0	1648.8
.9	1235.5	1140.3	43.4	18.6	—	—	—	1487.9	1297.5	1202.3
.8	827.6	803.7	73.2	9.8	191.1	—	—	1176.1	1068.0	1050.1

ance, and income tax figures based on: production, prices, and field costs in Table III; severance
e 5 of "Fiscal Analysis of the Proposed Backstop Tax Legislation", May 1981, prepared for Department
son; and income tax deductions other than royalty and severance from "Erickson", Table 9.

TAPS figures from Tables 12, 10 and 11 of "Erickson".

12¢ per barrel on 979 million barrels of pre-1980 production and 55¢ per barrel on 277 million
first half of calendar 1980 compared to company charges of 64¢ per barrel.

barrels per day during FY 82 at an average bonus over prevailing value of \$2.57.

estimated collections for the fiscal year. For FY 81, the total is estimated at 4/3 the actual
nine months of the fiscal year. The FY 82 total is 3/4 of the estimated income tax liability
estimated income tax liability for FY 81.

1428

6-4-81

TABLE II
PROJECTED PETROLEUM REVENUES
FY 81 and FY 82
(\$ Millions)

	North Slope			Cook Inlet	Kuparuk	TAPS	Field Cost Settlement	Royalty Auction	Total		
	High	Medium	Low						High	Medium	Low
<u>FY 81</u>											
Royalty	1414.6	1414.6	1414.6	60.4	--	--	30.0	--	1505.0	1505.0	1505.0
Severance	1152.9	1152.9	1152.9	26.8	--	--	--	--	1179.7	1179.7	1179.7
Petroleum Corporate Income Tax	759.3	759.3	759.3	23.3	--	187.2	(2.8)	--	767.6	767.6	767.6
<u>FY 82</u>											
Royalty	1800.9	1554.5	1431.3	113.8	24.0	--	-	79.7	2018.4	1772.0	1648.8
Severance	1425.9	1235.5	1140.3	43.4	18.6	--	--	--	1487.9	1297.5	1202.3
Petroleum Corporate Income Tax	971.8	827.6	803.7	73.2	9.8	191.1	--	--	1176.1	1068.0	1050.1

- Sources:
1. North Slope royalty, severance, and income tax figures based on: production, prices, and field costs in Table III; severance tax ELF factors from Table 5 of "Fiscal Analysis of the Proposed Backstop Tax Legislation", May 1981, prepared for Department of Revenue by Gregg Erickson; and income tax deductions other than royalty and severance from "Erickson", Table 9.
 2. Cook Inlet, Kuparuk, and TAPS figures from Tables 12, 10 and 11 of "Erickson".
 3. Field cost settlement at 42¢ per barrel on 979 million barrels of pre-1980 production and 55¢ per barrel on 277 million barrels of production for first half of calendar 1980 compared to company charges of 64¢ per barrel.
 4. Royalty auction of 85,000 barrels per day during FY 82 at an average bonus over prevailing value of \$2.57.
 5. Income Tax total is the estimated collections for the fiscal year. For FY 81, the total is estimated at 4/3 the actual collections for the first nine months of the fiscal year. The FY 82 total is 3/4 of the estimated income tax liability for FY 82 plus 1/4 of the estimated income tax liability for FY 81.

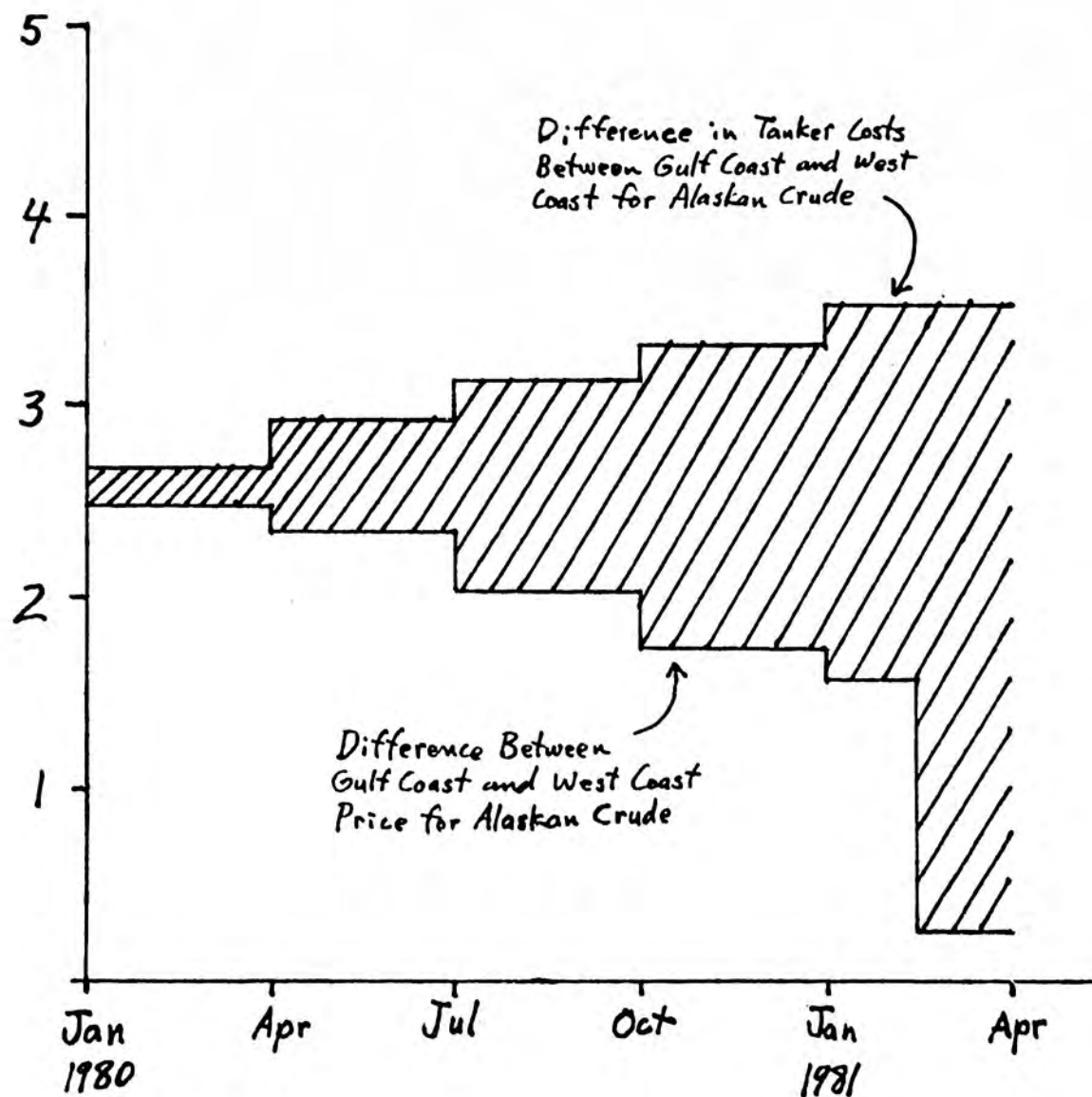
TABLE III
NORTH SLOPE CRUDE
ACTUAL AND PROJECTED PRODUCTION AND PRICES
FY 81 and FY 82

	Actual ^{1/}			Projected				
	Production (Millions of Barrels)	Royalty Price	Field Cost	Production (Millions of Barrels)	Royalty Price			Field Costs
					High	Medium	Low	
<u>FY 81</u>								
July	46.9	\$15.43	\$.55					
August	47.0	16.49	.55					
September	45.5	17.19	.55					
October	46.2	16.94	.55					
November	44.0	17.48	.55					
December	46.7	19.57	.55					
January	46.9	21.62	.62					
February	42.8	25.34	.62					
March	47.5	25.91	.62					
Total	413.7							
Weighted Average		\$ 19.53	\$.57					
April - June				133.8	\$24.18	\$24.18	\$24.18	\$.62
Total FY 81				547.5				
FY 81 Weighted Average					20.67	20.67	20.67	.58
<u>FY 82</u>								
July-September				136.9	25.31	21.71	21.71	.62
October-December				136.9	25.31	21.71	21.71	.62
January-March				136.9	27.31	23.71	20.11	.67
April-June				136.9	27.31	23.71	20.11	.67
Total FY 82				547.6				
FY 82 Weighted Average					\$ 26.31	\$ 22.71	\$ 20.91	\$.65

^{1/} Actual data from Division of Minerals and Energy Management, Alaska Department of Natural Resources

Potential Reduction in West Coast Price for Alaskan Crude
Which Would Yield the Same Wellhead Price as Gulf Coast Sales
(Shaded Area)

\$ / Barrel

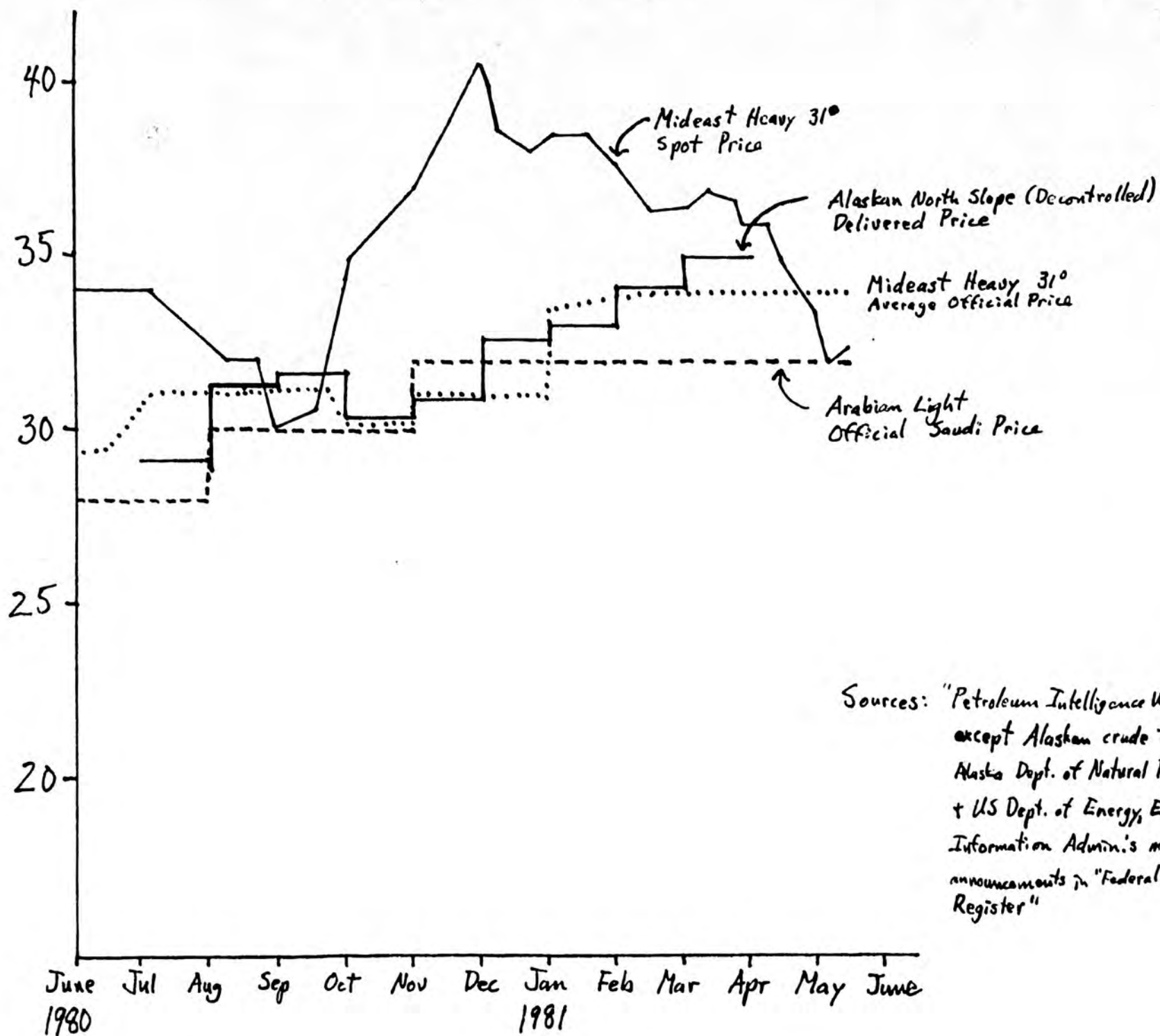


Source: "Petroleum Intelligence Weekly"
March 16, 1981

Oil Prices

I.

\$/Barrel



Sources: "Petroleum Intelligence Weekly" except Alaskan crude from Alaska Dept. of Natural Resources + US Dept. of Energy, Energy Information Admin.'s monthly announcements in "Federal Register"

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Oil and the Saudi Fairy Tale

By ELIYAHU KANOVSKY

It is widely believed that Saudi Arabia has been doing the West a favor by sustaining its oil production at a high level of 10.3 million barrels a day, and that by granting this favor the Saudis have created the world's current glut of crude oil. This grateful attitude toward the Saudis derives in great part from the fear that the Saudis will make good on their often-stated threat to use the "oil weapon" by cutting the country's oil production to 5 mbd.

What seems to undergird the persistence of these notions is the apparent belief that Saudi Arabia is a country unlike any other, that it is a sort of fairy tale land in which Arab princes sit in grand palaces amidst bags of gold. One of the nice things about fairy tales is that one never has to look too closely at what is going on in the rest of the kingdom. Perhaps it is time to look clearly at the kingdom of Saudi Arabia.

Saudi Arabia is an underdeveloped country. The Saudi population, well aware of the oil revenue flowing into the country and of their rulers' opulence, have strong expectations of higher living standards. Since under the existing regime there is no prospect of income redistribution from the haves to the have-nots, the Saudi solution has been simply to buy the country's way into the developed world.

Saudi Arabia is a casebook study of a country whose expenditures chase — and push — its revenues. Its recently available budget figures indicate the Saudis' plan to spend \$90 billion during their current fiscal year, which began earlier this month. If these Saudi expenditure figures hold, their spending will have increased almost five-fold since fiscal 1976 (during its 1975-80 development plan, Saudi spending actually overshot planned figures by about 50%).

Large-Scale Spending

After the Iranian revolution, some observers said the Saudis would realize that such large-scale spending tends to augment destabilizing social forces and that the Saudis would curtail spending. But in an interview with this paper last January the Saudi minister of planning said, "The problems in Iran weren't caused by economic development, but by the lack of it. . . . I don't think our development has been too fast. . . . If I had to do it over again, I would do it the same way."

Saudi Arabia's development began in earnest with the second development plan of 1975-80, which called for total expenditures of \$142 billion, an average annual outlay of \$28 billion.

What ensued was an influx of foreign contractors and a foreign labor force to build the plan's projects—roads, ports, airports, electric power plants, water desalination, telephones, schools, hospitals and so forth. The bureaucracy mushroomed. There were huge and expensive imports of military equipment and the construction of "military cities." Social welfare programs were expanded.

Various industries have been established, or are in process, and a special government commission was set up with a mandate to develop two major industrial complexes—in Jubail on the east coast and in Yanbo on the west coast. A 1979 U.S. congressional report estimated that the costs of construction in Saudi Arabia were 2.5 to 3 times those in the U.S.

The Saudi authorities were eager to persuade large multinationals to come in as partners in these ventures, to benefit from their managerial, technical and marketing expertise. But before 1979 (the year in

which the Saudis offered extremely attractive participation incentives to the companies), this strand in the Saudi strategy was snagged on what has been one of the most difficult, and costly, drags on the country's development—its labor force.

The Saudi population and its potential labor force are small. Unofficial estimates of the population indicate about four million Saudis. Because women are almost completely excluded from the labor force, the potential force is about one million. And this includes the armed forces, internal security and the huge bureaucracy.

Thus, the authorities have laid the greatest emphasis on the development of capital-intensive industries, which require a high level of technical and managerial skill. Though individual Saudis have acquired education and administrative and

Saudi Arabia's many financial 'needs' will do what the record shows they have always done — rise rapidly. And there is only one source for satisfying those needs—oil revenue.

managerial competence, they are few in number. In this respect Saudi Arabia is similar to many other developing countries: Its huge oil revenues and the system they have created provide powerful disincentives to acquiring the sort of skills that enhance a country's long-term productive capacity.

The Saudis have built technical schools in the hope that Saudi youth would pass out of them and into industrial jobs for on-the-job training with foreign technicians, but few Saudis are interested. Far more lucrative alternatives exist for capable Saudis: One can enter government service and use "connections" for private gain, join business ventures with foreigners or act as middlemen for foreigners seeking contracts (Saudi laws require business ventures to have majority Saudi ownership, thus the need for local partners).

Determined to push forward with their development programs, the Saudis are increasingly dependent on a large, growing foreign labor force—unskilled and semi-skilled workers from the poor Arab countries, Asia and Africa. According to the director general of the Saudi labor ministry, three-fourths of the labor force was foreign by the end of 1979. Back in 1975 Saudi planners said that by 1980 only 35% of the labor force would be foreign. As with their spending plans, it was an optimistic projection.

Apprehensive about these foreigners, the Saudis from time to time apprehend and expel tens of thousands of Muslims from poor countries, who enter as pilgrims and stay illegally, looking for jobs. The result of such measures is an upsurge in wage rates for laborers, another expense.

At the same time, the reluctance of highly skilled personnel, mainly from the West, to live in Saudi Arabia requires foreign contractors to pay three to four times the going rates in the U.S.

The country's work force difficulties put into serious question the viability of its diversification plans, and the Saudi leadership knows it. "The problem now in Saudi Arabia," the deputy minister of industry has said, "is manpower." Current plans call for a standstill in the size of the for-

eign labor force, with planned increments coming from the Saudi population, but prospects appear dim. Under the best of circumstances it takes decades or generations to educate and train a modern, industrialized labor force.

All these problems notwithstanding, the Saudis' new five-year plan for 1980-85 is costlier still. Total planned expenditures, including military, are \$391 billion, a 275% increase over the previous plan. Actual spending for the last plan was about \$200 billion, with many projects cut back or dropped. It should come as no surprise if the new plan's actual expenditures again far exceed published estimates.

Lifeline of the Economy

In short, Saudi Arabia's many financial "needs" will do what the record shows they have always done—rise rapidly. And there is only one source for satisfying those needs—oil revenue, the lifeline of the Saudi economy. It is this fact of life that lies at the root of Saudi Arabia's relative price moderation.

The Saudi leaders are well aware that the sharp oil-price increases in 1973 and 1974 induced trends in world oil and energy markets adverse to long-run Saudi interests. The far greater price increases of 1979-80 greatly accelerated the trend away from oil and toward conservation and energy substitutes like coal and nuclear power.

The Saudis have been very shrewd in successfully capturing a growing share of what is now clearly seen as a shrinking OPEC market. In sharp contrast with the situation in 1978, when others undersold them, the Saudis since 1979 have pursued a policy of keeping their official prices a few dollars below those of other oil exporters and low enough not to speed up the trend to substitutes.

The Saudis' possession of huge oil reserves and their ongoing, far-from-completed plans to diversify the economy—plans that will require a lot of money for a long time—makes them intent on assuring that the future of the oil market is consonant with their needs. In this light, Saudi Arabia would not gain from uniform oil pricing, which would induce a number of OPEC members to offer discounts, as they did in 1978, and capture part of the Saudi market.

The Saudis' "cushion" of accumulated official foreign assets is indeed much larger than in 1978 (somewhat over a year's public expenditures), but so are their needs. In the absence of any other significant source of income and in view of OPEC's genuinely shrinking market, the Saudis' most prudent option is to enhance oil production and exports, both to increase their current revenues and to moderate oil prices.

Secretary of State Haig and many writers in the American press may persist if they wish in believing that Saudi Arabia is doing the Western world a favor by holding its production at more than 10 mbd. But perhaps one would be paying the Saudis a more straightforward compliment by saying that by keeping production high and prices moderate, they are acting prudently and in the very best interests of a wealthy, underdeveloped country.

Mr. Kanovsky is professor of economics at Bar Ilan University, Israel, and visiting professor at Queens College, New York. This article is adapted from a study to appear in the fall issue of "Middle East Contemporary Survey."

Oil-Pricing Blunders Now Have Saudis in a Jam

By S. FRED SINGER

It is now evident from the OPEC meeting just ended in Geneva that Saudi Arabia made a strategic blunder in 1979 by allowing the world oil price to more than double. With this jump, oil priced itself out of a large market.

Nearly two-thirds of the world's oil consumption of 160 million barrels per day (mbd), simply goes to make heat and steam; it can be replaced by cheaper substitutes. In the residential and commercial sectors, conservation as well as fuel switching to natural gas and even electricity will now become increasingly important. Even before 1979, with oil at \$13 a barrel, coal and nuclear fuel provided a lower-cost boiler fuel for new plants.

Now, \$32 oil has finally made it worthwhile to retrofit existing oil-fired installations. For example, replacing the 10 million barrels of oil used every year by a 1,000 megawatt electric plant with coal-water mixtures would save nearly \$150 million a year.

Most countries are now making investments to replace high-priced oil. These changes are less noticeable in the United States, where over 50% of oil is used for transportation. Just the same, U.S. oil consumption is expected to decline in 1981 for the third consecutive year. U.S. oil imports will decline again, too—down to about 6 mbd, 30% below the 1977 peak of 8.8 mbd.

Similar trends in other consuming nations suggest that oil is being backed out at a rapid rate. Even the transportation sector will show a slight decline during the coming years because of more efficient fuel use; world oil use should be cut by a factor of two or more by the next decade.

The conservation of oil OPEC spokesmen so widely advocated—in public at least—has finally come to pass. The result: OPEC oil production has already dropped from a peak of 32 mbd in September 1978 to about 24 mbd by the end of 1980.

As world demand falls to below 30 mbd by the 1990s, and as the already emerging production inside countries around the world increases, the volume of exported oil must decline drastically. If North America produces 10 to 15 mbd (conservatively), and the East Bloc about 10 mbd, this leaves little for the rest of the world, including OPEC. The Geneva OPEC meeting gives us the flavor of their major problem for the future: whether and how to cut production or prices. In either case, OPEC faces a shrinking oil income.

On "Meet the Press" last month, the Saudi oil minister, Sheikh Yamani, made light of these matters. He told his interviewers that talk of a drop in oil consumption was just "wishful thinking." But Mr. Yamani knows full well that Saudi Arabia, as the world's largest oil exporter and holder of the largest reserves, has the most to lose if the price becomes too high too soon.

The cause of the 1979 increase was psychological rather than structural (unlike the 1974 price increase), and was based on fear of shortages following the collapse of the Shah's regime. Supply never dropped; there was only an increase in purchases. The fall-off in Iranian exports that began in October 1978 was smoothly taken up by production increases, mainly by Saudi Arabia. Its share of OPEC oil jumped from 31% to over 40%.

According to M.A. Adelman of M.I.T., the Saudis could have prevented the panic that escalated spot prices, but their actions haven't squared with their oft-stated policy of maintaining low oil prices. As Mr. Adelman pointed out in a recent letter to the Journal, the Saudis slashed production in January 1979 and again at the end of March that year. In each instance spot prices leaped upward and, in the ensuing panic, purchasers accumulated larger stockpiles of oil.

Why did the Saudis let the price rise in 1979? The reasons for their miscalculation may be complex. It is likely that the fiscally conservative Saudi family was disturbed by the country's budget deficit in 1978, which followed years of large surpluses. It is also possible that Saudi planners misjudged the extent to which a price run-up would precipitate a drop in demand. If so, they were in tune with most Western economists at the time. James Eyssell, in a recently published paper, points out that adopting a more appropriate econometric analysis of the data gives elasticities twice as large as those published in studies during the past few years.

Whatever the reason for their actions, it is probably too late for the Saudis to correct their error. Any attempt to bring down the price now to discourage fuel switching would also bring down the wrath of their neighbors.

The 1979 doubling of prices in this way now poses three difficult hurdles for Saudi Arabia—short-term, medium-term (one to three years) and long-term (10 to 20 years).

Sometime soon it should become evident that oil prices really are no longer increasing. This will cause holders of excess oil stocks to sell these to reduce their carrying charges and avoid losses. The sell-off, in turn, will weaken prices further and induce a more rapid dumping of the stocks. (The downward spiral of prices corresponds to the upward spiral that was experienced when the stockpiles were laid in. This simple economic conclusion follows, since the 1979 price increase was not due to a permanent, sudden shift in either production or actual consumption.) To keep up the

price, pressure will be put on Saudi Arabia to reduce its output by 2 or 3 mbd. The Saudis, however, will be trying to persuade others to make more meaningful cuts from their current production levels. Riyadh apparently still believes that it is possible to institute a "uniform pricing strategy" in which prices can be raised.

The medium-term problem for Saudi Arabia is much more serious. Sometime within the next year or two, Iraq and Iran may decide to stop fighting and concentrate on selling oil. They need money to replace what has been destroyed, and they still want to buy more arms. But for them to re-enter the market, someone else will have to cut production. They are likely to pressure the Saudis.

The Saudis would have to cut production down to 4½ mbd, the "magic" level that they generally quote as allowing them to sustain an acceptable level of income. But with oil demand falling and world supplies rising, the cut may have to be deeper. If the Saudis cut oil income too much, however, they may not be able to contain their domestic tensions.

And finally, if the Saudis should survive the medium-term hurdle, they still face the long-term drop in oil demand. To maintain exports, they will probably want to cut prices, along with other exporters, to compete for a shrinking market. And at that stage the consuming nations may erect barriers, such as import quotas or tariffs, to protect the domestic energy investments they've made in response to high oil prices.

The U.S. will face the political pressure of thousands of small independent oil producers. Perhaps even more daunting is the fact that in Japan and other countries nuclear plants will have been built, representing sunk costs. For oil to regain this expanded nuclear market, it would have to be considerably cheaper than the marginal cost of nuclear power, and the cost of nuclear fuel now corresponds to about \$4 oil.

The Saudis have gotten themselves into a difficult dilemma. Their dramatic doubling of oil prices in 1979 is bound to kill the long-term oil market, and in time may be viewed as the proverbial straw that broke the camel's back.

Mr. Singer is a member of the Energy Policy Studies Center of the University of Virginia. He earlier served as deputy assistant secretary of the Interior and has studied oil economics and oil security problems as a consultant to the Energy and Treasury departments and to the energy industry.

STATE OF ALASKA

DEPARTMENT OF REVENUE

OFFICE OF THE COMMISSIONER

June 3, 1981

JAY S. HAMMOND, GOVERNOR

POUCH 5
JUNEAU, ALASKA 99811

The Honorable Russ Meekins.
House Majority Leader
Pouch V
Juneau, AK 99811

Re: Liquid Funds Available Through FY 82

Dear Representative Meekins:

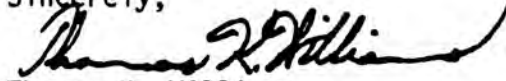
Last Friday I sent you a letter advising you that our revised estimates of oil and gas revenues indicated that the liquid funds available for appropriation through the end of FY 82 are \$5,746,400,000.

Since then we have had the opportunity to update our forecast of non-petroleum revenues. In addition, I have this morning received word that the North Slope Borough has raised its local millage rate from its 1980 level of 60.81 mills to 91.54 mills. The local levy on oil and gas "hardware" is credited against the State tax under AS 43.56, and our March forecast had assumed that the Borough would remain about at its 1980 level (it had gone from 59.61 to 60.81 mills between 1979 and 1980). This major increase in the local levy reduces our estimate of AS 43.56 receipts for this fiscal year by \$40.3 million; if it stays at the 91-mill level next year as well (which we now expect), then the FY 82 reduction in AS 43.56 receipts to the State will be \$50.2 million. Fortunately, this reduction is largely offset by an upward revision in the projected investment earnings during FY 82 (up by \$75.0 million).

The liquid funds available for appropriation through the end of FY 82 are now estimated to be \$5,730,700,000. Now that all revenue sources have been updated, I expect no further revisions in this figure before the next regularly scheduled update in September.

Attached is a table showing in more detail what the revisions are and how the \$5,730,700,000 figure has been calculated. I hope this may be of use to you in the remainder of the Session.

Sincerely,



Thomas K. Williams
Commissioner of Revenue

TKW:tw

Enclosure

1484

LIQUID FUNDS AVAILABLE FOR APPROPRIATION THROUGH FY 1982

(\$ millions)

3/81 ESTIMATE OF LIQUID FUNDS AVAILABLE FOR APPROPRIATION.....6,061.6

FY 1981 Changes

6/81 revision in production tax.....	+15.4
6/81 revision in royalty (net of Perm. Fund).....	-18.6
6/81 revision in AS 43.21.....	+11.6
6/81 revision in AS 43.56 due to North Slope Borough's increase in local millage.....	-40.3
6/81 revision in other taxes.....	-6.1
6/81 revision in other revenue.....	<u>-7.4</u>

NET REVISION FOR FY 1981..... -45.4

FY 1982 Changes

6/81 revision in production tax.....	-114.0
6/81 revision in royalty (net of Perm. Fund).....	-124.1
6/81 revision in AS 43.21.....	-85.5
6/81 revision in AS 43.56 due to North Slope Borough's increase in local millage.....	-50.2
6/81 revision in other taxes.....	+0.6
6/81 revision in investment earnings.....	+75.0
6/81 revision in other revenue.....	<u>+12.7</u>

NET REVISION FOR FY 1982..... -285.5

REVISED ESTIMATE OF LIQUID FUNDS AVAILABLE FOR APPROPRIATION.....5,730.7

OPEC Aide Says Oil Price May Have Hit Ceiling It Should Not Top for Some Time

WSJ 6-2-81

By YOUSSEF M. IBRAHIM

Staff Reporter of THE WALL STREET JOURNAL

LONDON—A leading official of the Organization of Petroleum Exporting Countries said the price of oil may have reached a ceiling from which it shouldn't increase for some time.

Sheik Manaa Saeed Al-Oteiba, the oil minister of the United Arab Emirates, fresh from last week's OPEC conference in Geneva where most of the oil exporters froze their top prices for the rest of the year, also said the freeze should extend until the end of 1982. Relative pricing stability will continue beyond that, he seemed to suggest.

"In the past, we in OPEC have worked to adjust our price to the level of demand and inflation, and to get an adequate return for our resource. Now, we have to think about whether the current level of \$35 to \$41 a barrel is, in fact, very close to the reasonable price for our crude and take it easy from now on," Mr. Oteiba said in an interview. He made the remarks following a speech in London to senior oil-industry executives at a conference about the outlook for oil supplies and demand.

Aside from reinforcing a growing view within OPEC, the Arab oil minister's theme coincided with similar views expressed by Western oil-industry observers attending the two-day conference entitled "Energy Supplies—Feast or Famine?" organized by the Financial Times of London.

John Lichtblau, executive director of the Petroleum Industry Research Foundation Inc., New York, said that demand for OPEC oil in the industrialized West and in Japan peaked as far back as 1978. He said any further increase in real, or inflation-adjusted, prices charged by OPEC will threaten the existence of the 20-year-old organization.

"OPEC's survival as a policymaking organization may well depend on the extent to which it will reflect or ignore market trends in its future pricing decisions," Mr. Lichtblau said.

All the participants agreed, however, that the stabilization of oil prices largely depends on the absence of radical changes in supply. A sudden decision by Saudi Arabia, OPEC's largest producer, which has kept its output at a record 10.3 million barrels a day for more than a year, would alter the scenario, experts in London noted.

Mr. Al-Oteiba, whose country is a close ally of Saudi Arabia, said he expected a "gradual decrease" in Saudi production—one that wouldn't pose any jolting price rises or shortages until December. At that time, OPEC is scheduled to meet again in the United Arab Emirates for another attempt to agree on a pricing structure.

He also said that he expected the Saudis by December to raise their low minimum price of \$32 a barrel closer to the \$36-a-barrel minimum charged by others in OPEC.

These views, coming from representatives of producers and Western consumers, carry added weight following the failure in Geneva last week of OPEC oil ministers to reach a unified price, or an effective policy to manage an oil glut that is pushing down prices. That failure has considerably strengthened spreading optimism for at

least short-term stability for oil prices.

In Geneva, Saudi Arabia refused to go along with a plan proposed by the other 12 members of OPEC to reduce oil production. Ten OPEC members said they would reduce output a minimum of 10%. Iraq and Iran were exempted to allow their diminished oil exports a chance to recover from their eight-month war.

Experts in London, however, said they doubted the cuts in production would even come close to the announced goal of eliminating about 1.5 million barrels a day from the market.

They said the most that can be expected would be reduction of 400,000 barrels a day or so, unless the Saudis, who produce more than 40% of OPEC's 24 million barrels a day, decide to join the action.

As proposed, the cuts would make hardly a dent in the oil glut, estimated at between two and three million barrels a day above current demand.

There were several warnings sounded in London yesterday that the low demand for oil and the difficulty that several OPEC members are having in marketing their high-priced crude is leading to complacency by oil consumers in efforts to develop alternative energy sources.

Former U.S. Energy Secretary James R. Schlesinger, scheduled to speak today, noted that political upheavals in the Middle East on the scale of the Iranian revolution of 1979 could reverse instantly the relaxed outlook on oil supplies by taking large quantities of crude off the market.

John C. Sawhill, former chairman of the Federal Synthetic Fuels Corporation, said that efforts to open more federal land in the U.S. to exploration by oil companies must be speeded up. He added that financial incentives must be maintained to encourage extension of coal as an energy source and as a permanent alternative to oil.

1400

Attachment 3

6-4-81

OILGRAM PRICE REPORT

AN INTERNATIONAL DAILY OIL/GAS PRICE AND MARKETING LETTER

Vol. 59 No. 86 Page 1-A Wednesday, May 6, 1981 Prices for May 5, 1981

MARKETS POISED FOR MAJOR COLLAPSE

"Economic collapse often has the character of a cumulative process. Let it go beyond a certain point, and it will tend for a time to gain strength from its own development as its effects spread and return to intensify the process of collapse. Because no great strength would be required to hold back the rock that starts a landslide, it does not follow that the landslide will not be of major proportions."

Milton Friedman used these words to describe the process of economic collapse which culminated in the banking holidays of 1933, but the description also applies to oil markets during the 70's, and is pointedly applicable today. To be blunt, oil markets are poised for a major collapse, the most obvious indication being the excessive supply of crude which is documented daily on these pages. The recent Saudi announcement that the production will continue at better than ten million barrels per day means that the excess will grow.

The process of collapse amounts to reversal of the process observed during the 1979 price run up. During the initial stage, netbacks computed at Rotterdam or some other spot market begin to show large losses to buyers who take delivery of crude at current contract prices, and these buyers begin to walk away from crude. Falling netbacks also mean losses on inventories, so

stocks are liquidated, which intensifies the pressure on spot markets.

In time, declining values on spot markets force petroleum exporters to reduce prices. However, the adjustment is slow because OPEC follows the market. According to econometric calculations we have made at Yale, buyers may expect adjustments of between \$0.25 and \$0.35 in official prices for each dollar increase or decrease in Rotterdam prices, with the adjustment occurring with the one quarter lag. Further adjustments follow in subsequent quarters, so that the increase of \$0.25 is followed in the next quarter by a \$0.19 increase in the third quarter by a \$0.14 increase.

The relationship appears to work both on the way up and on the way down. (Many econometric models are deserving the criticism they have received recently because of a tendency to over-sell their accuracy.

(Continued on Page 2-A)

CONTINUED WEAKNESS SEEN ACROSS THE BARREL

London 5/5—With traders back at work, both on the continent and the U.K., market trends were somewhat more evident. All the signals are to weaker levels across the barrel with mogas joining the decline.

Gasoil barges fell back from yesterday's high levels under pressure from the strong dollar. EEC barges sold as high as \$275.00 FOB ARA in the morning though by afternoon offers near \$274.00 remained unsold. Non-EEC barges dropped as well, but to a lesser extent: buyers reported near \$268.00 FOB ARA in the afternoon with sellers near \$270.00. Cargo prices remained stable both in the Med and NWE. Buyers in the Med reported near \$279.00 FOB (for non-EEC avails) and found offers as low as \$281.00. If anything, CIE indications

MAJORS SPECULATE ENTITLEMENTS PROGRAM MAY SOON SELF-DESTRUCT

Washington 5/5—As refiners anxiously await issuance of the January Entitlements Notice—now enjoined by a New York District Court through May 19—speculation is growing that the domestic old oil supply ration (DOSR) will be negative for the final month of the program.

If the DOSR goes negative, Economic Regulatory Administration must face the prospect of not issuing the long-awaited January Notice and closing down the program before final settlements are made. But ERA has several options available that could prevent premature termination and a series of court-ordered injunctions are giving it time to decide how to proceed.

At least five major oil companies are convinced the

OILGRAM PRICE REPORT

AN INTERNATIONAL DAILY OIL/GAS PRICE AND MARKETING LETTER

Vol. 59

No. 86

Page 1-A

Wednesday, May 6, 1981

Prices for May 5, 1981

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"Economic collapse often has the character of a cumulative process. Let it go beyond a certain point, and it will tend for a time to gain strength from its own development as its effects spread and return to intensify the process of collapse. Because no great strength would be required to hold back the rock that starts a landslide, it does not follow that the landslide will not be of major proportions."

Milton Friedman used these words to describe the process of economic collapse which culminated in the banking holidays of 1933, but the description also applies to oil markets during the 70's, and is pointedly applicable today. To be blunt, oil markets are poised for a major collapse, the most obvious indication being the excessive supply of crude which is documented daily on these pages. The recent Saudi announcement that the production will continue at better than ten million barrels per day means that the excess will grow.

The process of collapse amounts to reversal of the process observed during the 1979 price run up. During the initial stage, netbacks computed at Rotterdam or some other spot market begin to show large losses to buyers who take delivery of crude at current contract prices, and these buyers begin to walk away from crude. Falling netbacks also mean losses on inventories, so

stocks are liquidated, which intensifies the pressure on spot markets.

In time, declining values on spot markets force petroleum exporters to reduce prices. However, the adjustment is slow because OPEC follows the market. According to econometric calculations we have made at Yale, buyers may expect adjustments of between \$0.25 and \$0.35 in official prices for each dollar increase or decrease in Rotterdam prices, with the adjustment occurring with the one quarter lag. Further adjustments follow in subsequent quarters, so that the increase of \$0.25 is followed in the next quarter by a \$0.19 increase in the third quarter by a \$0.14 increase.

The relationship appears to work both on the way up and on the way down. (Many econometric models are deserving the criticism they have received recently because of a tendency to over-sell their accuracy.

(Continued on Page 2-A)

CONTINUED WEAKNESS SEEN ACROSS THE BARREL

London 5/5—With traders back at work, both on the continent and the U.K., market trends were somewhat more evident. All the signals are to weaker levels across the barrel with mogas joining the decline.

Gasoil barges fell back from yesterday's high levels under pressure from the strong dollar. EEC barges sold as high as \$275.00 FOB ARA in the morning though by afternoon offers near \$274.00 remained unsold. Non-EEC barges dropped as well, but to a lesser extent: buyers reported near \$268.00 FOB ARA in the afternoon with sellers near \$270.00. Cargo prices remained stable both in the Med and NWE. Buyers in the Med reported near \$279.00 FOB (for non-EEC avails) and found offers no lower than \$281.00. If anything, CIF indications are somewhat lower than FOB levels in the Med though trade is virtually non-existent. NWE prices remained stable with trade light.

Heavy fuel weakened further for both low and high sulfur material. 1% buyers reported no higher than \$270.00 CIF Scandinavia with sellers not far above them. Barges sold near \$226.00 FOB ARA in very limited volumes with most buyers holding for lower levels. 3.5% cargo offers reported near \$194.00 FOB NWE with buyers extremely difficult to find. In the Med, FOB material reported sold near \$199.00 in an equally calm buying market. CIF avails continued to weaken with added pressure from material ex-Carib. 3.5% barges reported offers near \$195.00 FOB ARA with few sales concluded.

Naphtha sold sharply lower in NWE with Med indications also weak. In the north, buyers are generally no higher than \$308.00 Both CIF and FOB for ordinary material, though N+A avails might command a slightly higher price. Offers in the Med reported unsold near \$300.00-306.00 CIF with buyers holding near \$300.00.

(Continued on Page 3-A)

MAJORS SPECULATE ENTITLEMENTS PROGRAM MAY SOON SELF-DESTRUCT

Washington 5/5—As refiners anxiously await issuance of the January Entitlements Notice—now enjoined by a New York District Court through May 19—speculation is growing that the domestic old oil supply ration (DOSR) will be negative for the final month of the program.

If the DOSR goes negative, Economic Regulatory Administration must face the prospect of not issuing the long-awaited January Notice and closing down the program before final settlements are made. But ERA has several options available that could prevent premature termination and a series of court-ordered injunctions are giving it time to decide how to proceed.

At least five major oil companies are convinced the DOSR for January is negative, based on their own calculations and scorekeeping of a dozen or so entitlements exceptions recently approved by the Office of Hearings & Appeals. The real culprit pushing the DOSR down, representatives of Mobil, Exxon, Cities Service, Chevron and Conoco agree, is the expected massive number of Tertiary Incentive Program recertifications on the January Notice.

One refiner predicts, based on the tremendous surge in recertifications from the November to December Notices, about \$1-billion in recertifications alone will be claimed on the January Notice. The monthly entitlements notice usually covers transactions of \$700-800-million in runs credits, he says.

Another factor is that the Entitlements Program has been drained of significant amounts of old oil, according to a Mobil analyst, because of the increasing number of "disappearing oil" that is, crude not properly booked into refinery receipts prior to Jan. 28. Mobil conservatively estimates \$4-billion in entitlements on price-controlled oil was not paid into the program.

(Continued on Page 2-A)

MAJOR COLLAPSE

(Cont'd from P. 1-A)

However, if one observes the prediction errors of this model during 1979 and 1980 as indicated in the table below, it is apparent that our approach has captured the process of adjustment in the past.)

Comparison of Forecasted and Actual
Official Prices of Arab Light Type Oil

	Actual Price*	Predicted Price	Error
1979:1	\$13.66	\$13.48	-0.18
1979:2	16.53	15.96	-0.57
1979:3	19.70	19.63	-0.07
1979:4	23.30	22.16	-1.14
1979:1	27.14	25.96	-1.18
1979:2	29.04	28.49	-0.55
1979:3	29.93	29.67	-0.26

* Actual prices are a weighted average of Government Sales Prices for Saudi Arabian, Iranian and Iraqi 34 deg. gravity oil.

If the relationship is symmetrical (works the same way on the way down as it did on the way up), then reunification of oil prices at \$32.00 a barrel may be impossible. To achieve such reunification, spot crude values based on refiners' yields would have to fall well below \$32.00 for some time, forcing exporters to reduce their contract prices. Once this happened, the market would be to induce immediate increases in spot market crude values back towards the \$32.00 level. This could be engineered by a compensating adjustment in production which left world supply and demand in balance at a price of \$32.00. This would, however, require that producers demonstrate a greater sensitivity to changes in product prices than they have heretofore shown.

If the past is any indication of what we can expect, it is more likely that the initial cutbacks in production will be inadequate and values and official prices will continue to spiral downward. Alternatively, the cut in supply may be so great as to cause prices of products and spot supplies of crude to shoot back towards the stratosphere.

In summary, the Saudis have embarked on a course which probably portends large gyrations in oil prices for some months to come. Refiners, jobbers and marketers should be aware that the journey may be much rougher than in the past.—Phillip K. Verleger, Jr., senior research scholar at Yale School of Organization and Management.

JANUARY ENTITLEMENTS

(Cont'd from P. 1-A)

during 1980 alone. Finally, the factor believed to have tipped the DOSR negative for January is a mid-April Mississippi District Court decision placing Northland Oil Co./VGS Corp. onto the last Notice as a net seller of nearly \$15-million, pending its entitlements appeals to OHA.

How ERA Responds

ERA says it is standing by the position it announced in January when the Office of General Counsel determined if the DOSR became negative the program would cease to function "because by the terms of (the Federal regulations) ERA could not 'issue' to a refiner a number of entitlements less than zero" (Jan. 22 PR).

An ERA spokesman said the January Notice could still be issued, as provided in the proposed rulemaking for the clean-up notice. One solution, he said, would be to combine numbers from November, December, and January to achieve a positive DOSR. This action, he admitted, would penalize small refiners who would be "paying back" runs credits and not have any tertiary recertifications to claim. Another option, he said, would be to eliminate adjustments—including recertifications—submitted by refiners for the January Notice and shuffle them onto the clean-up notice.

finers have other concerns about the end of the program. One by one, members of the latter group are continuing to turn to U.S. District Courts throughout the country to halt issuance of the January Notice until they receive assurances money will be available to settle any disputes over entitlements obligations. ERA's rulemaking on clean-up procedures has not yet been finalized and small refiners fear if the January Notice is issued prior to the clean-up rules, no mechanism will exist to recover funds.

A string of independent refiners have won court-ordered temporary restraining orders keeping the January Notice enjoined for the past six weeks. And even a major refiner, Mobil, has taken its turn in keeping the January notice enjoined with a decision last week in U.S. District Court for the Northern District of New York. Mobil wants ERA to review all entitlements transactions from November 1974 through Jan. 28, 1981, checking to find unreported price-controlled oil. The refiner was granted a temporary restraining order last week keeping the January Notice under wraps at least through May 19.

In the meantime, Tosco Corp., frustrated with the injunctions granted by District Courts, has filed suit at Temporary Emergency Court of Appeals in Washington, D.C. to override the lower court's action and get the January Notice out as soon as possible. Tosco claims it is suffering from enjoinder of the Notice because it estimates it will qualify to sell \$7-9.9-million worth of entitlements.

Finally, closing down the Entitlements Program may be taken out of DOE's hands altogether, some refiners believe, because the Reagan Administration is reportedly growing irritated with DOE's handling of the

tertiary recertification and disappearing old oil problems. At least one refiner, Union Oil Co. of Calif., has asked the Administration outright to review DOE Ruling 1981-1 on tertiary recertifications and is expecting the Office of Management and Budget or Dept. of Justice will take action (April 28 PR). "The flap," predicts one refinery analyst, "is about to surface."

TOSCO ADJUSTS 'GAS,' OILS

Houston 5/5—Tosco Corp.'s eastern division, effective May 5, lowered gasoline postings 0.25 to 1.25 cts over a wide portion of its market. At the same time, distillates went down 0.25 to 1.5 cts. In both cases, some markets did not change.

The high cut on mogas came in the Lake Charles-Baton Rouge market. The low was in Little Rock. Atlanta received the highest distillate cut.

MARATHON CUTS MOGAS, FUELS

Houston 5/5—Marathon Oil Co., effective May 5, lowered prices on all grades of gasoline 1 ct in PAD 1, 3 and the state of Tennessee. PAD 2 postings went down 1.5 cts, ex Tennessee.

At the same time, distillate prices were cut 2 cts throughout Marathon's system.

CHAMPLIN ADJUSTS MOGAS

Houston 5/5—Champlin Petroleum, effective May 5, reduced all grades of gasoline 1.5 cts throughout PAD 2, 4 and the portion of 3 served by Enid, Okla. facilities.

CORRECTION

A typographical incorrectly stated Champlin

MAJOR COLLAPSE

(Cont'd from P. 1-A)

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Alpetco's collapse has lessons for budget planners

The era of dramatic oil-price increases that began in 1973 appears to be over, dramatized by Charter Co.'s decision Thursday to abandon its proposed Valdez refinery.

Charter's decision to back out of the project is the first blow to Alaska's economic development plans, which have been based on the premise that a seller's market for oil would always exist. But an even more important effect will be a drastic reduction in Alaska's oil-revenue projections and, eventually, a significant reduction in government spending.

The new oil price outlook does not necessarily mean that Alaska's economy will stagnate, and fall back on federal spending as its mainstay, as it did before the discovery of oil at Prudhoe Bay. Alaska's oil and gas profits still will give it the highest per-capita state revenues in the U.S., and they still will seem obscenely high to many residents of other parts of the country. The problem, however, is that the Alaska legislature is about to adopt a fiscal 1982 budget, and a program of capital projects extending many years into the future, that are based on wildly unrealistic income projections.

There may simply not be enough money two, three, or five years from now to continue the programs, finish the capital projects or support the hothouse industries that the legislature hopes to initiate this year. Alaska's citizens, like the Dutch five years ago or the Shah of Iran three years ago, may discover too late that they have committed more money than they actually had and, at the same time, stimulated an artificial economic boom that was bound to collapse.

Three months ago, I wrote in this column that "consumers simply can't or won't pay prices as high as the crude oil producers are asking," and predicted that the 1981 oil price outlook "is more favorable to dramatic price declines than it is for another leap upward."

At that time, U.S. refiners and distributors already were feeling painful consumer resistance to mounting fuel costs. Last December's OPEC price increases, coupled with President Reagan's cold turkey decontrol of oil prices sent



arlon tussing

raw-materials costs for U.S. refiners above the average prices for refined products. The result has been a massive refinery shutdown; more than one-third of the nation's oil processing capacity is now out of service because of reduced product demand.

Charter's Alpetco project never made economic sense, and it is amazing that idle refining capacity in the United States had to exceed five million barrels per day before the Charter Co. recognized that there was no place in the market for an exceptionally expensive new refinery in Alaska. The only justification for the Valdez project was the mystique of a permanent world oil shortage, in which any refinery that had long-term crude oil supplies could make money. The emergence of a buyer's market in oil has destroyed this mystique for now, and Alaska's ability to offer royalty oil on long-term contract can no longer attract offers to build otherwise uneconomic refineries or petrochemical plants.

By March of this year, the combination of a world oil glut and consumer resistance had begun to reach backward from oil product markets into the markets for crude oil, and prices have recently been sliding at a startling rate.

Several OPEC nations already have had to give up the \$2-to-\$3 per barrel premiums they had been getting above their own "official" prices, and at least two exporting countries — Ecuador and Mexico — have reduced official prices in the first such downward adjustment

since 1971.

In mid-May, some U.S. oil companies started to post Lower 48 wellhead prices in the \$31-\$36 range — \$2 below the price they set at the end of 1980. Alaska North Slope crude oil has recently been selling on the U.S. Gulf Coast at prices between \$33 and \$34 — a level at which Charter Oil was probably losing \$2 or \$3 on every barrel of royalty oil it bought from the state.

This turnaround in world oil markets is not just a whim of Saudi Arabian diplomacy, or fallout from the global economic slowdown. Both factors have indeed contributed to the present oil glut, but even without them, the world's oil supply would have vastly exceeded demand within a year or so, because there is nothing the Saudis or any combination of producer nations can do to reduce world oil production as fast as consumption is falling in a delayed, but inevitable, reaction by consumers everywhere to the last eight years of price increases.

Not many authorities are predicting a catastrophic collapse of OPEC prices, but it is clear that today's prices are too high to be maintained. Unless there is a major war in the Middle East or a coup in Saudi Arabia (which cannot be completely ruled out), no force in sight can prevent the price slide from continuing for months or years, or to turn world oil prices upward again any time in the foreseeable future.

The Alaska Department of Revenue, in its most recent petroleum revenue projections (March, 1981), assumed that the average wellhead price of Prudhoe Bay oil would be about \$30 per barrel in fiscal 1982 (July 1981 through June 1982), increasing at a compound rate of about 12 percent per year for the rest of the century. In truth, the average wellhead price today is \$25 and falling.

If Prudhoe Bay prices bottomed out at \$24 later this year and then began rising again at the same rate as general inflation, Alaska's oil-production revenues (royalties and severance taxes) would be about \$700 million less in fiscal 1982 and \$4.4 billion less in 1990 than the state now regards as its "most likely" forecast.

The revenue outlook may be worse yet. In the new buyer's market for crude oil, the North Slope producers may not be able to preserve the two-tier price system for Alaska oil that they have maintained since 1977. Alaska oil refined on the West Coast now sells at the wellhead for \$2 to \$4 more per barrel than the identical oil shipped through the Panama Canal to Gulf or East Coast refineries.

In the absence of federal price controls and entitlements, competition among the North Slope producers and with California heavy-oil producers is likely to depress West Coast oil prices to the point where all North Slope crude sells for the same price regardless of its destination.

Thus, the average wellhead price at Prudhoe Bay could easily drop to around \$23 per barrel, even without any further fall in OPEC prices. If prices again begin to rise from that level, at the rate of general inflation, Alaska's "most-likely" projections of fiscal 1982 oil revenues would turn out to be about \$900 million too high, and the 1990 projections would be on the order of \$5.3 billion too high. And if the wellhead prices increased at a rate only one percentage point per year LESS than general inflation, the state will have overestimated its oil-production income by about \$1 billion in 1982 and \$5.7 billion in 1990 — for a total of \$30.6 billion over the nine-year period.

The foregoing projections are very rough, and they do not include the effect of lower oil-company income taxes on the state's revenue. Moreover, they do not, by any measure, represent the most pessimistic plausible scenarios.

But, imprecise as these estimates are, they do illustrate the need for great caution on the part of Alaska's leaders in committing future income that may or may not materialize.

This year, with the markets for crude oil so unsettled, is not the year to embark on massive new spending programs.

□ Arlon Tussing is a Seattle-based economic consultant and an associate professor at the University of Alaska's Institute for Social and Economic Research.

PETROLEUM REVENUE ANALYSIS FOR FY 82

(\$ billions)

Cumulative Frequency*	Median										
	0%	10%	20%	30%	40%	50%	60%	70%	80%	90%	99.8%
FY82 Royalty**	1.22	1.38	1.41	1.45	1.49	1.53	1.57	1.62	1.67	1.73	2.20
FY 82 Production Tax	1.20	1.34	1.39	1.42	1.47	1.51	1.55	1.60	1.65	1.71	2.20
FY 82 AS 43.21	0.93	1.03	1.07	1.09	1.13	1.16	1.19	1.23	1.27	1.31	1.68
TOTAL	3.35	3.75	3.87	3.96	4.09	4.20	4.31	4.45	4.59	4.75	6.08
Liquid Funds Available Thru' FY82 With This Level of Revenue	4.83	5.23	5.35	5.44	5.57	5.68	5.79	5.93	6.07	6.23	7.56

	Revenue's Forecast (mean)	Legislative Finance Estimate		
		"Low"	"Medium"	"High"
FY82 Royalty**	1.55 (54th %-ile)	1.24 (1st %-ile)	1.33 (7th %-ile)	1.51 (45th %-ile)
FY82 Prod. Tax	1.53 (54th %-ile)	1.20 (0th %-ile)	1.30 (7th %-ile)	1.49 (45th %-ile)
FY82 AS 43.21	1.17 (55th %-ile)	1.05 (15th %-ile)	1.07 (20th %-ile)	1.18 (57th %-ile)
Total	4.25 (54th %-ile)	3.49 (3rd %-ile)	3.70 (9th %-ile)	4.18 (48th %-ile)
Liquid Funds Avail- able With This Level of Revenue	5.73	4.97	5.18	5.66

*Based on range of outcomes generated in 500 separate forecasts by PetRev model

**Net of 25% mandatory contribution to the Permanent Fund

HOUSE FINANCE COMMITTEE

June 4, 1981

4:40 p.m.

(Tape HFC 81-107, side 2 #274)

PRESENT

All Members of the Committee were present except Representatives Malone and Buchholdt. (Representatives Freeman and Meekins arrived later in the meeting.) Present to testify were: Representative Gardiner; and Commissioner Tom Williams, Department of Revenue.

HB 200

Chairman Cotten called the meeting to order and brought HB 200 up for consideration.

SSH 200 -- "An Act relating to oil and gas taxes; and providing for an effective date."

REPRESENTATIVE GARDINER explained his testimony will lead up to the Bill, and the Commissioner will cover what is actually in the bill. He explained the oil and gas corporate income tax was passed in 1978 after three years of extensive study in a cooperative fashion between the House, Senate and Administration. He said they had been advised for at least the preceding ten years that someday the State was going to have to address the income tax question because its existing corporate income tax didn't deal with situations like the multi-national corporations and the way they do their books and account for the profits.

Representative Gardiner said they then passed the oil and gas income tax, setting the same rate, but better defining what the actual profits from oil and gas production in Alaska were. He said with the passage of that bill, many felt the process the State had gone through in developing a modern oil/gas taxation and leasing policy and statute was over, and the State could go on to something else. At that point, Representative Gardiner said, they were looking at a figure of 30% of the profits from the oil and gas development state that would go to the State. He said he thinks that can be considered a fair portion from the development of those resources coming from State land.

Representative Gardiner said the bill passed, and after awhile the companies decided to file suit against it, stating it is unconstitutional and on other basis. He said, by some estimates, what is at stake is approximately \$8 or \$9 billion from the inception of the tax to 1985.

Representative Gardiner said he is confident the State will win the suit. He said the State has never lost any major oil tax

cases, and just because someone files suit isn't a sign the state should "role over and play dead". He said he thinks the State has written good laws and he doesn't see that they are going to lose this case. Representative Gardiner said there is still some risk, and that is the reason for this bill -- the so called "back-stop bill".

Representative Gardiner said by 1985 \$8 billion or \$9 billion of State revenue under 43.21 will be at risk if the State were to lose the case. He said he doesn't think they can afford that in terms of State planning and what the people want done regarding development of the State.

Since the companies have filed suit, Representative Gardiner said, there have been negotiations going on with the companies. He said he thinks the bottom line of the negotiations is if the State were to accept any of the settlement offers, it would mean losses of several billions of dollars. He said there is no reason to do that, unless one is scared, and he doesn't see that they should be. He said there was consideration this year on whether or not they should settle, and the leadership in both houses and the Governor issued a statement saying the bottom-line from the State of Alaska's point of view was the State should not give up its existing levels of revenues; that the 30% share they receive from the oil and gas development is fair and should continue. On the other hand, the statement said, the figure should not increase.

Representative Gardiner said they then sat down with various consultants, and staffs of the legislature and administration, to look at the options. He advised that former commissioner of Revenue John Messenger, with the assistance of others, did a study to look at all the options that would maintain what was laid out in the joint statement -- continuing revenues at the existing level and reducing the liability and risk the State presently has. Representative Gardiner said they came up with a recommended report, and the joint committee recommended that a bill be introduced -- and that is SSHB 200.

(Representative Freeman arrived at this time.)

COMMISSIONER WILLIAMS, Department of Revenue, said the basic idea of the back stop legislation both in the sponsor substitute and in the CS, which is an improved version of the SS, is to revive the reserves tax. He said the reserves tax is among the safest forms of tax one can have. He said that tax will be revived and used as a revenue source, and provide a back stop against the income tax by allowing the income tax that is actually paid to be a credit, dollar for dollar, against the reserve tax liability. He said the purpose of the credit is to keep from doubling up. He explained the companies are paying "x-dollars" under the income tax and it is not their intent to make them pay two times "x-dollars" by passing the legislation. He said that is why the credit only means they still come up with the "x-dollars".

Commissioner Williams said the back-stop works because if there is an adjustment in the tax liability under the income tax (if it is thrown back under Chapter 20, or there is an audit and it is adjusted, or whatever it may be), the adjustment changes the credit directly dollar for dollar. He explained if there was a refund of the income tax, it lowers the credit dollar for dollar by the same amount; thus, there is an increase in the exposure to the reserves tax dollar for dollar.

Commissioner Williams explained the bill is so long primarily because it also incorporates a number of technical changes that they believe are advisable to make in the income tax itself. He said there are some consequences in the present income tax law which they think are unintentional, some of which are issues which probably should not be addressed at this time. Consequently, he said, the first several sections of the bill reflect changes in the present law that will help improve the litigation and, at the same time, assure more equitable administration of the tax laws, as was originally intended. He advised these changes eliminate some of the glitches that have come up.

Commissioner Williams said "the guts of the back-stop part" begins on page 9 of the bill -- the imposition of the advalorem tax. He said this is the reserves tax. He advised certain exemptions of property are made -- the state's own property is exempt; the property of the United States is exempt; property the State is pre-empted under federal law from taxing, such as the Native Land, is exempt; and gas reserves are exempt. He said the reason the gas reserves are exempt is because there are projects "on the drawing board" both for North Slope and Cook Inlet gas that have a very shaky future. He said there are definitely marginal prospects -- which always get dangled out as a threat that they don't want the marginal prospects to be pushed off the edge by the taxation policy. He said these are truly marginal prospects, both in Cook Inlet and Prudhoe Bay, the State's two primary areas where they have gas. He said since they are marginal it is not appropriate to tax them at this time.

(Representative Meekins arrived at this time.)

Commissioner Williams said third party interests in the exempt properties -- if the United States leases to an oil company, or if the State leases to an oil company, or a native corporation leases its exempt land to an oil company -- that interest to the oil company is taxable. He said the exemptions would follow; if any other exemptions are someday exacted by federal law, the state would follow along with those.

On page 10 of the bill, Commissioner Williams said, are the credits. He said this is the essential back-stop part of the bill. He explained it allows for the income tax that has already been paid to give rise to a credit against a reserves tax in the future. He said it also allows for future income tax payments to give rise to credits against the reserves tax in the future.

Commissioner Williams said on page 11 is the redetermination of liability. He said this is the section where if there is an adjustment of the income tax liability, then there is a corresponding reduction or adjustment in the amount of credit that is allowed against the reserves tax, and a redetermination of the reserves tax liability on the basis of whatever the adjustment is in the income tax.

Commissioner Williams said these two sections together are the real heart of the back stop legislation. He said the other sections are essentially borrowed from the old reserves tax statute; it has been reenacted for the purpose of eliminating any question about what the effect was in the old reserves tax that said the act expired on December 31, 1977.

Representative Rogers said the fiscal note dated May 18 is for the Sponsor Substitute. He asked if the Gas Pipeline Committee Substitute had any impact on the dollars in the fiscal note, and what the impact of the new revenue projections on the fiscal note was. Commissioner Williams said, given the underlying assumptions in the fiscal note, the Committee Substitute makes the fiscal note more correct because the fiscal note calculated the reserves tax using an assumed rate of discount of 19%. He commented further on the fiscal note. He said the purpose of this legislation is not to effect a tax increase but to establish approximate parity overall, and back up and provide a "safety net" for the level of income the State has now.

(Tape change, HFC 81-108, side 1.)

There was brief discussion on the bill and fiscal note.

ADJOURNMENT

The meeting adjourned at 5:15 p.m.

Tape HFC 81-107, side 2 #274 to end
HFC 81-108, side 1 #001 to end

HF0607911010

HOUSE FINANCE COMMITTEE

June 7, 1981

10:10 a.m.

(Tape HFC 81-109, side 2 #001.)

PRESENT

All Members of the Committee were present except Representative Meekins. (Representative Montgomery arrived later in the meeting.) Present to testify were: David Gottstein; Bob Speed and John Sund, Aides to Representative Gardiner, Resources Committee; Rodger Painter, United Fishermen of Alaska; and Tom Williams, Commissioner, Department of Revenue.

SB 25, SB 26

Vice Chairman Freeman called the meeting to order and brought SB 25 and SB 26 up for consideration.

CSSSB 25 (Fin) am -- "An Act establishing a power project development fund in the Alaska Power Authority and amending the Alaska Power Authority Act; and providing for an effective date."

CSSSB 26 (Fin) -- "An Act making special appropriations to the Alaska Power Authority for energy projects and for the power production cost assistance program; and providing for an effective date."

Vice Chairman Freeman presented proposed House Finance CS's for SB 25 and SB 26. He said he and his staff worked with the Resources Committee staff and come up with an approach that could get 21 votes on the House Floor. He said he thinks these versions would do that. He said the bills are clean and pristine and ready to go if the Committee can live with them. He said there are whole stacks of amendments to the bill; his concern is if they start going through amendments they will "end up with another HB 487", and he would rather not to that.

Vice Chairman Freeman commented the Committee has heard between 70 and 80 witnesses. He said there is one more person who wished to testify and has not yet had an opportunity to do so. He invited Mr. Gottstein to testify at this time.

MR. DAVID GOTTSTEIN presented his testimony. (See attachment #1.)

RECESS

Chairman Cotten called for a recess at 10:25 a.m. Vice Chairman Freeman recalled the meeting to order at 10:35 a.m.

SB 25

Representative Haugen MOVED AND ASKED UNANIMOUS CONSENT that HCS CSSSSB 25 (Fin) (new title -- "An Act relating to energy; and providing for an effective date.") be reported out. There being NO OBJECTION, it was so ordered.

Representative Rogers said his understanding is the fiscal notes are being prepared at this time, and will be available to the Committee later in the day. Vice Chairman Freeman said this was correct.

SB 26

The proposed House Finance CS for CSSB 26 was before the Committee.

Chairman Cotten MOVED on page 8, line 16 to delete "and Delta-Greely" and on line 17 to change "areas" to "area". There being NO OBJECTION, it was so ordered.

Chairman Cotten MOVED on page 11 to add a new Sec. 56 as follows:

"Sec. 56. The sum of \$600,000 is appropriated from the general fund to the Legislative Council for the House Special Committee on Coal for a feasibility study concerning site selection and rail and road connections for a major coal export facility."

There being NO OBJECTION, it was so ordered.

Representative Haugen MOVED on page 1, line 11, after "\$265,900,000" to add "and the interest which may be earned on that sum". He said this would mean that the earnings from projects wouldn't go into the general fund, they would go back to the project being constructed.

Representative Rogers expressed concern that this might not be constitutional. He said it would be a dedication of funds. There was further discussion.

Representative Haugen said he will withdraw the motion with the understanding that this will be addressed in the Free Conference Committee on the bills. Representative Haugen WITHDREW his motion.

Representative Adams MOVED on page 8, line 8, to delete the language in Sec. 38, and insert the following in its place:

"Sec. 38. The sum of \$1,300,000 is appropriated from the general fund to the Department of Natural Resources for phase III and IV of the Northwest Alaska Coal Resources Investigation, including reconnaissance drilling at the Chicago Creek, Point Hope, Point Lay and Kiana (Kobuk River) areas."

He said this is just a clarification of that section. There being NO OBJECTION, it was so ordered.

Chairman Cotten MOVED to report out the HCS CSSB 26 (fin) incorporating the amendment made at today's meeting. There being NO OBJECTION, it was so ordered. HCS CSSB 26 (Fin) (new title: "An Act making appropriations to various state agencies for energy-related programs and projects, and repealing a 1980 appropriation for a power project; and providing for an effective date.") was reported out with a "do pass" recommendation.

SB 25

Chairman Cotten presented the following proposed amendment to HCS CSSS SB 25 (Fin):

Page 32, following line 14, insert a new section:

"Sec. 35. The Alaska Power Authority may design, acquire easements for, and construct a high voltage electrical transmission system connecting Anchorage and Fairbanks. Notwithstanding other provisions of law, the transmission system authorized by this section shall be considered a use that is compatible with the purposes of the Denali State Park. Within the boundaries of the Denali State Park, the transmission system authorized by this section shall be routed in consultation with the division of parks."

Renumber following sections accordingly.

On page 32, line 15 Delete "32-34" and insert "32-35".

Representative Rogers MOVED that this amendment be reported out as a Finance amendment to HCS CSSSSB 25 (Fin). There being NO OBJECTION, it was so ordered.

HCS CSSSSB 25 (Fin) amended was reported out with a "do pass" recommendation.

RECESS

A recess was called at 10:55 a.m. and Vice Chairman Freeman recalled the meeting to order at 11:15 a.m.

(Representative Montgomery arrived at this time.)

SB 137

SB 137 was brought up for consideration at this time.

SB 137 -- "An Act approving the issuance of revenue bonds by the Alaska Municipal Bond Bank Authority; and providing for an effective date."

Chairman Cotten commented this bill has been in Committee all year. He said it is a concern of the Municipal Bond Banking Authority. He said it gives the Municipal Bond Bank authority to sell up to \$20 million in packaged municipal bonds.

Chairman Cotten MOVED to report SB 137 out of Committee. There being NO OBJECTION, it was so ordered. SB 137 was reported out with a "do pass" recommendation.

SB 422

The next bill to be considered was SB 422.

SB 422 -- "An Act amending grant limits for certain programs of the Department of Community and Regional Affairs; and providing for an effective date."

Vice Chairman Freeman said the bill has a zero fiscal note. There was brief discussion.

Chairman Cotten MOVED that SB 422 be reported out of Committee. There being NO OBJECTION, it was so ordered. SB 422 was reported out with a "do pass" recommendation.

SB 111

The next bill to be considered was SB 111.

CS SSSB 111 (Res) an -- "An Act relating to fishing and hunting license fees and fishing permits; and providing for an effective date."

Chairman Cotten explained the difference between the Senate bill and the House Resources CS (new title: "An Act relating to fishing and hunting licenses, big game tags, and fishing permits; and providing for an effective date.") is that the House Resources CS adds a new section 6 repealing AS 16.05.340(a)(20).

Representative Buchholdt said she is interested in legislation to repeal the \$10 licenses completely, so all sport fishermen could fish for free. She commented further.

Representative Rogers expressed concern over the new fee schedule. He said with the new fees of \$36 and \$96, those selling licenses will have to give \$4 change, and that can be a problem in some rural areas. He suggested changing the \$36 fee to either \$35 or \$40, and the \$96 fee to either \$95 or \$100. There was brief discussion.

Representative Moss MOVED that the bill be reported out of Committee. Chairman Cotten OBJECTED. He said Representative Rogers has a good point.

Representative Carney said he thinks Representative Buchholdt's suggestion is a good one. Representative Adams said he would

object to that suggestion. He said they can't have every John Doe going out and fishing. Representative Rogers said he would object to losing federal monies which are appropriated as matching funds.

There was further discussion.

Chairman Cotten asked if there was any objection to reporting the bill out of Committee. There being NO OBJECTION, HCS CSSSSB 111 (Res) was reported out with individual recommendations.

RECESS

A recess was called at 11:30 a.m., and Vice Chairman Freeman recalled the meeting to order at 11:35 a.m. (Representatives Buchholdt, Malone and Cotten were not present at this time.)

SB 140

The next bill to be considered was SB 140.

CSSB 140 (Fin) am -- "An Act establishing a fishery product revolving loan fund and providing for loans and loan guarantees for commercial fish purchasers; and providing for an effective date."

MR. JOHN SUND, Aide to Representative Gardiner, presented and explained the House Resources CS for the bill.

(Tape change, HFC 81-109, side 2.)

Mr. Sund presented a Memo from Representative Gardiner regarding amendments that should be made to the House Resources CS (see attachment #2). There was brief discussion.

Representative Moss suggested amending the Bill on page 1, line 14, after "fund" add "not to exceed \$40 million". Mr. Sund said there is no money being appropriated to the revolving loan fund this year. Representative Moss said there will probably be some money appropriated next year, and he would like to see a limit put on it now. There was discussion.

In answer to a question from Representative Rogers, Mr. Sund said section one puts the revolving loan fund on the statutes, but there is no money being put in the fund this year. Representative Rogers asked why. Mr. Sund said this is the way the bill arrived from the Senate.

MR. RODGER PAINTER, Executive Director, United Fishermen of Alaska, said the bill was prepared this way with the intent of trying to get loans out very quickly; however, the bill ended up sitting in Committee for several months. He said they felt there was a need to get the money out as expeditiously as possible. He said he supports putting money in the revolving loan fund. At

this point though, he said, he thinks there is a need to try and get the money out very quickly. He commented further.

Representative Rogers asked if they knew what the level of demand is going to be since the bill is so late in passing. Mr. Painter said the bill started out at \$100 million. He said the value of fish PAC's in Alaska is roughly \$1.2 billion a year, so \$40 million will barely scratch the surface. There was further discussion.

(Representatives Buchholdt, Cotten and Malone arrived at this time.)

Representative Rogers MOVED that the proposed amendment by the Resources Committee (Attachment #2) be accepted. There being NO OBJECTION, it was so ordered.

Representative Rogers MOVED that the House Resources CS be amended on page 5, lines 20-21 and line 24, and on page 6, line 1 to delete "commercial bank" and insert "state or federally chartered financial institution". There being NO OBJECTION, it was so ordered.

Representative Rogers MOVED that a House Finance CS be prepared incorporating the House Resources CS and these amendments. There being NO OBJECTION, it was so ordered.

Representative Rogers MOVED that the House Finance CS be reported out of Committee. Representative Moss OBJECTED.

Representative Moss MOVED TO AMEND to motion to amend the bill on page 1, line 15 after "fund" add "not to exceed \$40 million". Chairman Cotten OBJECTED. There was brief discussion. The question was called for. Three in favor, seven opposed. The motion to amend FAILED.

The main motion was before the Committee. Representative Malone MOVED TO AMEND the motion to amend the bill on page 6, line 6 (Resources amended language) to change "transferred" to "appropriated". There being NO OBJECTION, it was so ordered.

The main motion as amended was before the Committee. There being NO OBJECTION, it was adopted. HCS CSSP 140 (Fin) was reported out with a "do pass" recommendation.

SB 141

The next bill to be considered was SB 141.

CSSB 141 (Fin) -- "An Act making a special appropriation to the Department of Revenue for loan guarantees for commercial fish purchasers; and providing for an effective date."

Representative Rogers MOVED on page 1, line 12 to delete "(sec. 2(c), ch. 32, SLA 1980)". There being NO OBJECTION, it was so ordered.

Representative Rogers MOVED that this amendment be incorporated into a House Finance CS and that HCS CSSB 141 (Fin) be reported out. There being NO OBJECTION, it was so ordered. The bill was reported out with a "do pass" recommendation.

SB 524

The next bill to be considered was SB 524.

SB 524 -- "An Act relating to an investment tax credit allowed against the state corporate income tax; and providing for an effective date."

Chairman Cotten said his proposal is to incorporate the language of CSSSB 200 (GP) ("An Act relating to oil and gas taxes; and providing for an effective date.") into SB 524. He said the contents of SB 524 will be altered to the extent there will be no retroactive effective date on the contents originally provided for in the bill. In addition, Chairman Cotten said, there will be some amendments to be considered to the Finance CS being proposed.

COMMISSIONER TOM WILLIAMS, Department of Revenue, said in the original version passed by the Senate the limit would be raised on qualified investments from \$500,000 to \$20 million. He said there is no limit on that being an investment in the State of Alaska. He further explained, and suggested amending the bill on page 1, line 15 after "use" to add "in the state".

Representative Malone MOVED to adopt a House Finance CS for SB 524 incorporating the text of CSSSB 200 (GP). There being NO OBJECTION, it was so ordered.

Representative Malone said there is no credit provision under statute 43.21 at present, and he would recommend adding a credit section for investment in the State as follows:

"Add a new section to read:

Sec. 43.21.045. CREDITS. For purposes of calculating the income tax payable under this chapter, the taxpayer may apply as a credit against his tax liability the investment credit allowed under AS 43.20.021 (d) and 43.20.036 (b)."

Commissioner Williams said he thinks this amendment makes good sense.

Chairman Cotten MOVED that the amendment be adopted. There being NO OBJECTION, it was so ordered.

Chairman Cotten MOVED on page 2, line 2 between "use" and "for" to add "in the state". There was brief discussion. There being NO OBJECTION, it was so ordered.

There was discussion on the effective date of the tax credit.

(Tape change, HFC 81-110, side 1.)

Representative Malone MOVED AND ASKED UNANIMOUS CONSENT that the following amendment be adopted:

New Section 15 to CSSHB 200 (GP):

"Sec. 15. TRANSITIONAL SECTION. During the first year of the annual tax levied under 43.58.021, the value of taxable property shall be assessed as of the effective date of this Act. During the first year of the tax levied under AS 43.58.021 the return required under AS 43.58.141 shall be submitted no later than 30 days after the effective date of this Act, and the Department shall send the notice of assessment required under AS 43.58.081 no later than sixty days after the effective date of this Act."

Delete Section 16.

Representative Rogers OBJECTED. He MOVED TO AMEND the motion to delete "section 16" and insert "section 17". Representative Malone agreed to the correction. There being NO OBJECTION, it was so ordered.

There being NO OBJECTION to the main motion as amended, it was ADOPTED.

Representative Malone proposed the following as a letter of intent for HCS CSSB 524:

"HCS SB 524 (Fin) provides an increase in the investment tax credit allowed for in-state investments for corporations doing business in Alaska. In addition, the House Finance CS includes the revisions to tax chapters AS 43.20, AS 43.21, AS 43.55, and AS 43.58 introduced by the Governor in SSHB 200, and the record and report of the Special Gas Pipeline Committee on SSHB 200 is incorporated as part of the House Finance Committee record and report on HCS SB 524 (Fin).

Chairman Cotten MOVED AND ASKED UNANIMOUS CONSENT that the Letter of Intent be adopted. There being NO OBJECTION, it was so ordered.

RECESS

Chairman Cotten called for a recess at 12:30 p.m. and recalled the meeting to order at 12:40 p.m.

SB 524

Representative Rogers MOVED on page 19, line 13 to delete "January 1, 1982" and insert "September 1, 1981". There being NO OBJECTION, it was so ordered.

Representative Rogers MOVED to report out a House Finance CS for SB 524 incorporating the amendments adopted at today's meeting. There being NO OBJECTION, it was so ordered. HCS SB 524 (Fin) (new title: "An Act relating to taxes; and providing for an effective date") was reported out with a "do pass" recommendation AND a Letter of Intent.

ADJOURNMENT

The meeting adjourned at 12:45 p.m.

Tape HFC 81-109, side 1 #001 to end
 side 2 #001 to end
HFC 81-110, side 1 #001 to #217

MY NAME IS DAVID GOTTSTEIN, AND I WANT TO MAKE IT CLEAR THAT I REPRESENT MYSELF AND NOT ANY OTHER GROUP OR INDIVIDUAL ASSOCIATED WITH THE LEGISLATURE.

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE, YOU HAVE HEARD ENOUGH PROPOSALS OVER THE LAST SEVERAL ^{days} TO MAKE YOUR HEADS SPIN. YOU HAVE HEARD FROM SOME WHO TAKE RELATIVELY SIMPLE CONCEPTS AND MAKE THEM SOUND COMPLICATED IN ORDER TO JUSTIFY THEIR HIGH SALARIES. WHAT I HOPE TO DO IN THE NEXT SEVERAL MINUTES IS TO SUGGEST TO YOU A FRAMEWORK WITHIN WHICH POLITICAL DECISIONS CAN APPROPRIATELY BE MADE.

FIRST AND FOREMOST I BELIEVE IT IS NECESSARY TO SEPARATE THE ISSUES OF COSTS OF A POWER PRODUCTION PROJECT, AND THE RATES YOU CHARGE FOR THAT POWER, FOR THEY ONLY HOLD A CASUAL RELATIONSHIP. THE DETERMINATION OF WHEN AND IF A PARTICULAR PROJECT SHOULD BE BUILT SHOULD BE BASED UPON WHETHER OR NOT TOTAL TRUE COSTS FOR A PARTICULAR PROJECT ARE LOWER THAN ALL OTHER ALTERNATIVE POWER PRODUCTION PROJECTS ^{for a region} IF THERE EXISTS ANY BIAS TOWARDS HYDRO DEVELOPMENT IN THESE BILLS, IT ONLY COMES ABOUT AFTER FEASIBILITY ^{studies} SHOW THERE EXISTS ^{an} ECONOMIC BIAS. IT MUST BE NOTED THAT IN AREAS WHERE HYDRO IS CONSIDERED AS A VIABLE ALTERNATIVE, IT IS IMPORTANT, I BELIEVE, TO INCLUDE IN THE COST OF ALTERNATIVES, THE TOTAL COSTS OF PRODUCING EQUIVALENT AMOUNTS OF POWER FOR 100 TO 150 YEARS. SINCE DAMS HAVE AN ECONOMIC LIFE OF AT LEAST THAT TIME FRAME, YOU MUST COMPARE THAT WITH THE COSTS OF PRODUCING THE SAME AMOUNT OF POWER FOR 150 YEARS USING ALTERNATIVE SOURCES. THOSE WHO SUGGEST THAT HYDRO PROJECTS MUST BE PAID FOR IN 30 TO 40 YEARS ARE BEING VERY SHORT SIGHTED.

Attachment #1

1454

6/7/81

IT WOULD BE LIKE SAYING ONCE A HOUSE'S MORTGAGE IS PAID FOR AFTER 30 YEARS, THE HOUSE HAS NO VALUE. WE ALL KNOW THAT THE HOUSE STILL DERIVES AN ECONOMIC VALUE AND WILL BE USED FOR AT LEAST 30 OR 40 MORE YEARS. LONG RANGE THINKING IS THE WHOLE CONCEPT BEHIND DAMS, AND THAT IS EXACTLY THE KIND OF FINANCIAL ANALYSIS THAT SHOULD ACCOMPANY IT. SINCE THE COSTS OF OPERATING A GAS FUELED ELECTRICITY PLANT WILL RISE AT A FASTER RATE THAN THE COSTS OF OPERATING A DAM, IT IS NOT A QUESTION OF IF THE TOTAL HYDRO COSTS ARE LOWER THAN A GAS OPERATION, BUT WHEN IT BECOMES SO. AS LONG AS THAT POINT IN TIME IS LESS THAN THE ECONOMIC LIFE OF THE DAM, THEN THE DAM SHOULD BE BUILT. SINCE THE REAL COST ADVANTAGES OF HYDRO COMES IN ITS LATER YEARS, ANY ANALYSIS THAT INCLUDES A PAYOUT OF THIRTY TO FIFTY YEARS IS PAINFULLY SHORTSIGHTED.

THE QUESTION OF RATE STRUCTURING HOWEVER IS NOT RELATED TO COSTS, EXCEPT IN AN AREA I WILL OUTLINE IN A FEW MOMENTS. AFTER IT IS DETERMINED THROUGH COSTING ANALYSIS WHAT IS THE CHEAPEST WAY TO PRODUCE POWER, WE ARE, IT SEEMS TO ME, FACED WITH THE QUESTION OF HOW MUCH TO CHARGE. HERE WE MUST BE CONCERNED WITH A NUMBER OF THINGS. IF WE CHARGE MORE THAN THE TOTAL TRUE COST OF A PROJECT, WE DERIVE A PROFIT, AN APPROACH VERY FEW PEOPLE I SUSPECT ARE IN FAVOR OF AT THE OUTSET. IF ON THE OTHER HAND WE CHARGE SOMETHING LESS THAN TRUE COSTS, WE EXERCISE A DISTRIBUTION OF WEALTH. THE RATES THEMSELVES WILL DETERMINE, WHO WILL RECEIVE THE WEALTH, WHEN, AND HOW MUCH. THE LEGITIMATE AREA WHERE RATES ARE RELATED TO COSTS LIE IN THE CASES WHERE CHEAP RATES INVITE EXTRA DEMAND FOR POWER, REQUIRING EXPENDITURES IN ADDITIONAL, AND POSSIBLY MORE COSTLY POWER PRODUCTION CAPACITY.

BECAUSE OF THIS, AND THE FACT THAT THE AMOUNT OF INDIVIDUAL SUBSIDIES WILL BE BASED UPON CONSUMPTION, A GRADUATED CONSUMER RATE SCHEDULE THAT marginally charges the heavy consumer closer to true costs, might be deemed more appropriate. This has the benefits of a more equitable distribution of wealth, discourages waste and removes *most* uneconomical incentives. There exists another question concerning equitable distribution of wealth. What is fair? Certainly it sounds fair to subsidize people statewide on a per capita basis. And doesn't it also seem fair to charge all people across the state the same rate. With these two seemingly fair proposals we have an inherent conflict. I would guess that the ultimate rate will fall somewhere between the two. For if we charge people the same rate, we create incentives for development and consumption in truly less economical areas. This approach, as a result, will create a larger and ever increasing level of subsidy. On the other hand, if we subsidize on a per capita basis, we fall shamefully short of recognizing legitimate needs in many regions of the state. For this reason, a cheap statewide wholesale rate, with true distribution costs added on, strikes a balance between the two. This does not preclude additional subsidies through such mechanisms as the power cost assistance program in cases where distribution costs make consumer prices exorbitantly high.

IN A RELATED ISSUE, IT SEEMS TO ME MR. CHAIRMAN, FROM A PRACTICAL POINT OF VIEW, SINCE ONE LEGISLATURE CANNOT BIND A FUTURE ONE, THAT OVER THE LIFE OF THESE PROJECTS, HYDRO IN PARTICULAR, WITH LIFETIMES OF ONE HUNDRED TO ONE HUNDRED AND FIFTY YEARS, IT IS LIKELY THAT THE LEGISLATURE WILL FIND IT NECESSARY MANY TIMES TO RECONSIDER THE RATES IT CHARGES ITS RESIDENTS. JUST AS IT HAS FOUND *1* IT NECESSARY IN THE PAST TO REVIEW OTHER TYPES OF FISCAL AUTHORITY.

THERE MAY COME A TIME, 20 OR 30 YEARS DOWN THE ROAD FOR INSTANCE, THAT THE VALUE OF THE ELECTRICITY IS SO HIGH THAT APPROPRIATE RATES COULD PROVIDE SUBSTANTIAL ENOUGH REVENUES TO THE STATE TO OFFSET DECLINING OIL REVENUES. IN THAT REGARD, CHEAP POWER COULD BECOME A MAJOR FACTOR IN A STABLE ECONOMY BEYOND OUR OIL AND GAS DAYS. WITH THAT IN MIND, I BELIEVE, ALL YOU CAN SAY IS THAT IN THE SAME WAY THAT THE PROPOSAL TO FUND 5 BILLION DOLLARS OVER THE NEXT SEVERAL YEARS IS A POLICY STATEMENT, SO ARE ANY RATES YOU CURRENTLY PROPOSE. SO IN MY OPINION, THE QUESTION OF BINDING FUTURE LEGISLATURES DOES NOT APPLY. IF IT DID, ONE COULD ARGUE THAT ANY LONG RANGE PLAN WOULD HAVE TO APPROPRIATE ALL ITS PROJECTED BUDGET DURING A SINGLE LEGISLATURE, VOID OF ANY ADDITIONAL INFORMATION THE FUTURE WOULD HOLD.

ANOTHER NOTE, I COMMEND REPRESENTATIVE ADAMS AND OTHERS WHO SUGGEST THE BILL GUARANTEES NO ASSISTANCE FOR THE BUSH AFTER 1992, AND THAT PRIOR TO THAT TIME THEY MUST RELY ON TRANSFER PAYMENTS TO LOWER POWER COSTS. I CAN ONLY SUGGEST THAT THE SPEED WITH WHICH THE VIABLE ALTERNATIVE FORMS OF POWER PRODUCTION ARE IDENTIFIED AND CONSTRUCTED FOR THE REMOTE AREAS WILL BE LARGELY A FUNCTION OF THE HUMAN AND CAPITAL RESOURCES EXPENDED IN ANY REGION. FOR THAT REASON, ALL EFFORTS MUST BE MADE ON THE PART OF THE POWER AUTHORITY TO PUT FORTH A BALANCED DEVELOPMENT PROCESS THROUGHOUT ALL REGIONS OF THE STATE. IF AFTER CAREFUL AND LEGITIMATE REVIEW, IT IS DETERMINED THAT IN SOME AREAS OF THE STATE, THE COST OF POWER PRODUCTION CANNOT BE SIGNIFICANTLY REDUCED, THEN BETTER LONG TERM COST EQUILIZATION FORMULAS MUST BE CONSIDERED. IN THE MEAN TIME, THE POWER COST ASSISTANCE PROGRAM IS A GOOD SHORT RUN ALTERNATIVE TO USE UNTIL EITHER CHEAPER POWER PRODUCTION PROJECT CAN BE BUILT, OR BETTER LONG TERM COST EQUILIZATION FORMULAS CAN BE DEVELOPED.

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IT MIGHT TOO BE NOTED THAT MANY REMOTE AREAS ARE ALREADY RECEIVING ASSISTANCE FROM THE PROGRAM, WHILE MANY MORE DENSELY POPULATED AREAS WON'T RECEIVE ANY RELIEF UNTIL THEIR POWER PROJECTS ARE COMPLETED MANY YEARS DOWN THE ROAD.

IF PEOPLE CONSIDER THESE BILLS AS ONLY A PARTIAL ANSWER TO OUR ENERGY PROBLEMS, THEY WILL BE CORRECT. UNTIL SOCIETY AS A WHOLE REPLACES THE FOSSIL FUEL DRIVEN INTERNAL COMBUSTION ENGINE, WE WILL CONTINUE TO RELY HEAVILY ON CARBON BASED FUELS. THESE BILLS TAKE A BIG STEP IN PROVIDING ALTERNATIVES FOR THINGS WE HAVE CONTROL OVER. THE QUESTION IN MY MIND IS NOT HOW MUCH ELECTRICITY CURRENTLY PLAYS A PART IN OUR ENERGY CONSUMPTION, BUT HOW MUCH IT CAN PLAY, GIVEN RATIONAL ECONOMIC CONSTRAINTS.

THAT BRINGS ME TO MY FINAL ARGUMENT OF THE DAY IN SUPPORT OF THE CONCEPTS BEHIND THESE BILLS. WE ALASKANS ARE FACED OVER THE NEXT DECADES WITH THE QUESTION OF DEVELOPMENT VERSUS CONSERVATION. AS A LIFELONG ALASKAN I AM GRAVELY CONCERNED THAT THE LAND WE ALL LOVE MAY BE DRAMATICALLY TRANSFORMED. WE MUST BE CAREFUL TO INSURE THAT ALL COSTS AND ALL BENEFITS TO DEVELOPMENT PROJECTS ARE PROPERLY IDENTIFIED AND WEIGHED BEFORE A DECISION IS REACHED. I AM NOT OF THE OPINION THAT WE CAN STOP DEVELOPMENT. IN A WORLD OF EVER INCREASING DEMANDS UPON A FINITE NUMBER OF RESOURCES, I AM AFRAID THAT OUR ONLY HOPE IS TO INSURE THAT WHAT DEVELOPMENT TAKES PLACE, RIGOROUSLY ADHERES TO OUR GUIDELINES. CHEAP POWER ON A STATEWIDE BASIS CAN BE AN IMPORTANT PART. IF WE CREATE A COMPARATIVE ECONOMIC ADVANTAGE THROUGH THE AVAILABILITY OF CHEAP POWER RELATIVE TO OTHER PARTS OF THE WORLD, WE WILL BE DEALING FROM A POSITION OF STRENGTH. AS SUCH WE WILL BE ABLE TO DICTATE AS TO WHAT KINDS OF DEVELOPMENT TAKES PLACE THROUGH SUCH THINGS AS RATE STRUCTURES AND LAND MANAGEMENT POLICIES. THE RESULT COULD BE A LONG TERM STABLE ECONOMY BASED UPON RENEWABLE RESOURCES.

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IF ON THE OTHER HAND WE WAIT OR DO NOTHING, WE STAND THE RISK OF BEING FORCED TO ACCEPT OTHERWISE UNACCEPTABLE FORMS OF DEVELOPMENT DUE TO HIGH UNEMPLOYMENT, HIGH INTERNATIONAL RESOURCE DEMANDS, AND AN UNSTABLE ECONOMY.

THE TIME TO ACT IS NOW. IF YOU WAIT UNTIL YOU PRODUCE THAT ELLUSIVE PERFECT BILL THAT ATTEMPTS TO ACCURATELY FORECAST THE SPECIFIC NEEDS OF FUTURE GENERATIONS OF ALASKANS, ONE WHICH WOULD TAKE YEARS TO FORMULATE AND STILL NOT PROVIDE ALL THE RIGHT ANSWERS, YOU WILL INCREASE COSTS PERHAPS BILLIONS OF DOLLARS IN ADDED CONSTRUCTION COSTS AND LOST OPPORTUNITIES. THE IMPORTANT POINT IS THAT WE GET UNDER WAY BUILDING A CHEAP POWER PRODUCTION INFRA-STRUCTURE, WHETHER IT INCLUDES HYDRO, BIO-MASS, WIND, TIDAL, OR ANY OTHER LEGITIMATE FORM. WE CAN WAIT UNTIL THE YEAR 2000 TO DETERMINE WHAT THE CIRCUMSTANCES DICTATE THEN AS THE MOST APPROPRIATE RAILROAD STRUCTURE.

MR. CHAIRMAN, IT IS A TIME WHEN PEOPLE ALL ACROSS THE COUNTRY ARE WATCHING TO SEE HOW ALASKA SPENDS ITS MONEY, DECIDING WHETHER OR NOT TO ALLOW US TO KEEP IT. DURING THESE TIMES OF FISCAL CONSTRAINT, WHEN TENS OF THOUSANDS OF NEEDY AMERICANS WILL HAVE FOOD STAMPS TAKEN AWAY FROM THEM, I FIND IT DIFFICULT TO JUSTIFY EXPENDITURES ON HUGE SPORTS STADIUMS BEFORE SUCH THINGS AS POWER PRODUCTION PROJECTS, SCHOOLS, SEWERS, TRANSPORTATION SERVICES, HOSPITALS AND OTHER EMERGENCY SERVICES ARE ADEQUATELY FUNDED. IT SEEMS TO ME THAT THERE IS HARDLY ANYTHING ELSE THE LEGISLATURE CAN DO THAT WOULD HAVE AS GREAT A LONG TERM COST BENEFIT PAYOUT THEN THIS PROGRAM WOULD. ESPECIALLY WHEN YOU CONSIDER THE FACT THAT WHEN THE OIL RUNS OUT, ALL WE WILL BE LEFT WITH IS A BAREN WHOLE IN THE GROUND AND AN EMPTY PIPELINE. HYDRO AND OTHER POWER PRODUCTION PROJECTS WILL GUARANTEE A FUTURE FOR ALASKA. WHAT OTHER PROGRAMS CAN WE SAY THAT ABOUT.

THANK YOU FOR YOUR TIME, I AM PREPARED TO ANSWER ANY QUESTIONS YOU MAY HAVE.



Alaska State Legislature

House of Representatives

Committee on Resources

Terry Gardiner, Co-Chairman
Fred F. Zharoff, Co-Chairman
465-3715

Pouch V
State Capitol
Juneau, Alaska 99811

MEMORANDUM

TO: Finance Committee
FROM: Rep. Terry Gardiner
DATE: May 29, 1981
RE: Amendments, CS SB 140

The Resources Committee made amendments to CS SB 140 to expand the use of the loan guarantee account from the ~~Commercial Fish and Agriculture Bank~~ to include all other commercial banks in the state. The bill, as drafted when arriving in the committee, provided that only the Commercial Fish and Agriculture Bank could use the loan guarantee account which is identical to the bill that was passed last year, Sec.2(c), Ch.32, SLA 1980. Thus the bill only referred back to that 1980 session law.

When expanding the use of the loan guarantee account from the CFAB to include all of the commercial banks, a drafting error was made in failing to realize that the 1980 law would also need to be amended.

Rather than using a cumbersome process of amending a 1980 law which was temporary legislation, it seems to me that it would be much easier just to recreate a fish processing loan guarantee account in this legislation and delete all references to the prior 1980 law. Thus I offer the following amendments which would accomplish that purpose.

Page 6, line 6-11: Delete the entire sub-section (c).

Page 6, line 6: Add the following:

"(c) There is created as a separate account in the general fund the fish processing loan guarantee account. The fish processing loan guarantee account consists of assets transferred to it from the general fund. The Commissioner of Revenue shall administer the fish processing loan guarantee account and may enter into agreements with the Commercial Fish and Agriculture Bank or a state or federally chartered financial institution which has offices in Alaska to use the assets of the fish processing loan guarantee account to provide guarantees for loans under (a) (3) of this section. The total amount of the guaranteed portion of loans

appropriated

Attachment #2

1480

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guaranteed under (a) (3) of this section may not exceed
\$40,000,000."

A compatible amendment must also be made with the CS SB 141, the appropriation bill.

Page 1, line 12: Delete "(Sec. 2(c), Ch. 32, SLA 1980)"