RESOURCE review

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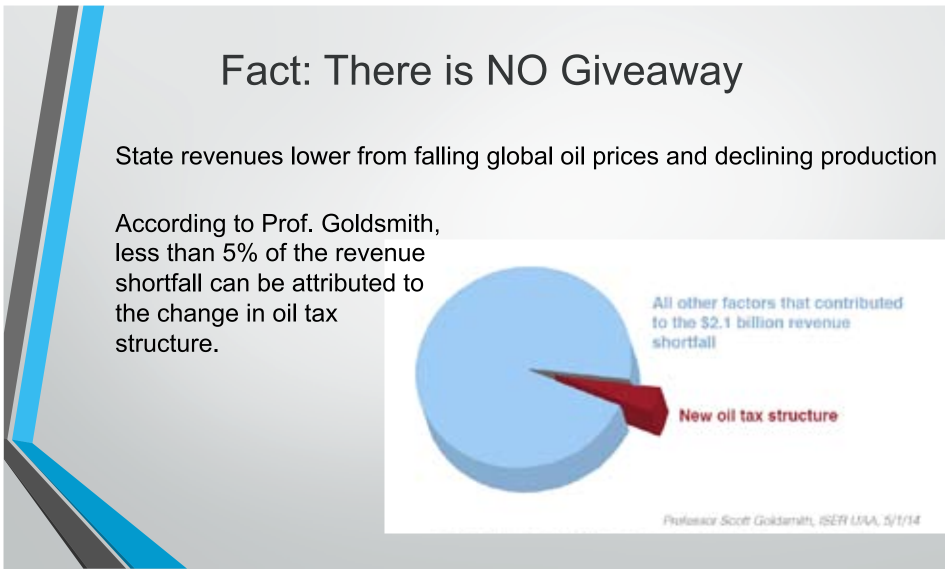
Economist refutes "giveaway" myth

An in-depth study by a highly-respected University of Alaska economist has concluded that the recently-enacted oil production tax reform law has little to do with lower revenues and larger budget deficits the state is anticipating. Rather, the revenue reductions and budget deficits are mainly due to declining oil prices, falling production, and higher costs, said Dr. Scott Goldsmith.

Speaking at a Resource Development Council breakfast meeting in Anchorage last month, Goldsmith said that at current oil prices and costs, the new tax regime, known as the More Alaska Production Act (MAPA), and the former that preceded it, ACES, bring in about the same amount of revenue.

Opponents of MAPA have mislabeled it as a $2 billion "giveaway."

Goldsmith said there is no giveaway. The giveaway figure was the difference between the $7.2 billion the Alaska Department of Revenue (DOR) had forecasted in oil revenues for fiscal year 2014 back in 2012 and DOR's fall 2013 forecast of $5.1 billion. Opponents of the new oil production tax blame the difference on the tax change.



Courtesy Alaska Oil and Gas Association

Goldsmith compared that to concluding the crowing of a rooster in the morning causes the sun to rise. His study found only four percent of the amount in FY 14, $88 million, was due to the change in tax regimes. He said 96 percent was due to other complex forces, including price and production forecasts and costs.

Goldsmith's analysis demonstrated that even without enhanced production, tax revenues could be higher under MAPA than ACES if recent price and cost trends continue, which experts agree is likely. Furthermore, Goldsmith's modeling showed that under reasonable range of assumptions, a modest increase in oil investment would create more state revenues under MAPA than ACES.

While Alaska collected a windfall during the early years of ACES, Goldsmith's report indicates it would be a mistake to assume current conditions would allow a return to those days. Goldsmith's analysis explains that today's market conditions of rapidly increasing costs, a sharp decline in production, and lower oil prices have significantly changed the tax consequences of ACES.

With regard to costs, Goldsmith explained that production expenses have risen sharply, more than doubling in the past decade, and are expected to climb further. He noted a big cost at Prudhoe Bay is water handling. In fact, North America's largest oil field is now producing more water than oil. Goldsmith said Prudhoe Bay is now a giant water field with oil as a by-product, generating four times more water than oil.

Manpower costs have also risen, tripling since 2005. These costs and others are spread

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Alaska better off under new oil production tax

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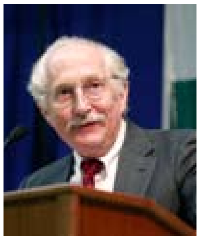
across fewer barrels of oil being produced. In 1980, the average North Slope well produced 3,500 barrels per day compared to about 250 barrels per day in 2014. Higher costs and lower production drives up the cost of production per barrel, affecting the net value of the oil against which production taxes are levied.

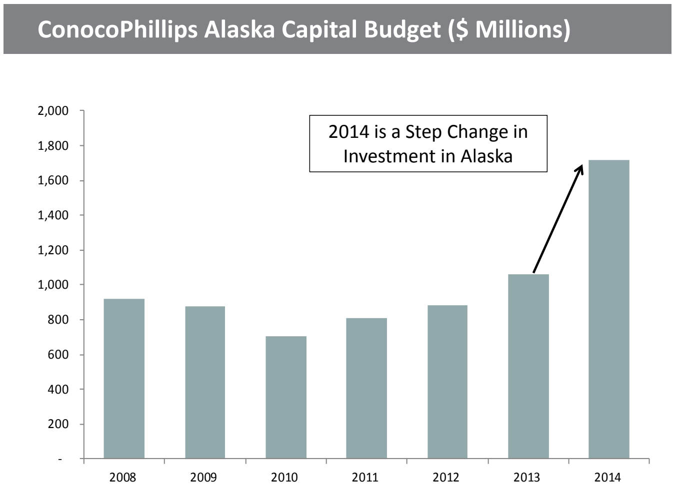
Goldsmith also acknowledged why some would question an oil company's rationale of embracing a new tax regime that could potentially result in a higher tax bill. The senior economist said MAPA can be modeled more efficiently and is more predictable in planning for long-range investments. He explained that required monthly calculation and substantial fluctuation in tax liabilities contributed to an unstable and unpredictable fiscal climate under ACES. Moreover, with the extreme progressivity of ACES at high oil prices, companies captured very little of the upside value to offset the investment risk taken to increase production.



Scott Goldsmith

Goldsmith said that with new investment coming into Alaska's oil patch, thousands of new long-lasting jobs would be generated, resulting in enhanced consumer purchasing power benefitting the entire economy. He noted that each industry job generates a lot of other jobs across the state.

Goldsmith found that $4 billion in new industry investment would result in 5,000 new public and private sector jobs per year in the state over 20 years, with more than $300 million annually in additional wages and salaries.



The new oil production tax law is already encouraging more investment on the North Slope, resulting in new jobs, more production, and increased economic activity across the state. For 2014, ConocoPhillips is budgeting twice what it spent in 2012 and BP is aggressively pursuing new production, reinvesting 90 cents of every dollar in Alaska.

Goldsmith's study attracted much attention statewide, given the hotly contested referendum on Alaska's primary election ballot in August to repeal MAPA. Those supporting MAPA and opposing the referendum say oil production tax reform was needed to encourage production-generating investments and stem declining North Slope oil production, which accelerated under ACES.

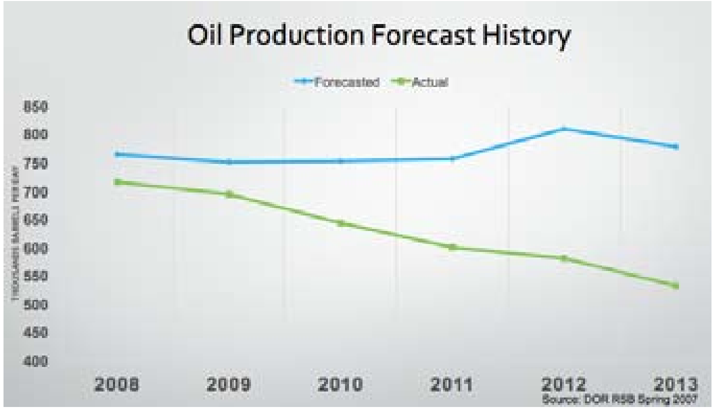
Since the Legislature approved the tax change in 2013, industry activity on the North Slope has surged, $4 billion in new investments have been announced, thousands of barrels of new oil is coming online, and hundreds of new jobs have been created. In addition, projects that have sat on the shelf for years are now being re-evaluated and could be sanctioned this fall. Oil production is now expected to decline only two percent this year and could be trimmed to one percent in 2015, after declining eight percent last year.

Following Goldsmith's presentation to RDC, former Governor Tony Knowles said Alaska's future would best be served by closely monitoring the effect of new investments on production and tax revenues. "SB 21 (MAPA) has been in effect for four months, and we need to give it a chance to work," Knowles said. "There will be ample opportunity to make needed changes if the companies' commitments do not generate more production. The referendum is not about the oil companies it is about Alaska's economic future. Now that we have the facts, I'm voting no on Ballot Measure One."

Tony Knowles

Goldsmith's study is on UAA's Institute of Social and Economic Research website as Web Note No. 17, "Alaska's Oil and Gas Production tax: Comparing the Old and the New." His presentation to RDC is also available at akrdc.org.

The study was funded by a grant from Northrim Bank, which has supported a broad range of ISER economic studies over the past 20 years focusing on issues important to Alaska's economy.



In the spring of 2007, the state projected Alaska would be producing 777,000 barrels per day in 2013. In reality, production was 531,000 b/day. Under ACES, production fell by more than 240,000 b/day while rising in every other oil-producing state.

New fabrication shop bustles with activity to support BP projects

NANA's Fabrication Shop north of Anchorage near Big Lake was a flurry of activity in mid-April as crews worked on oil field modules and other equipment to support BP Alaska's multi-million dollar oil field development and expansion projects on the North Slope. Pictured is NANA worker Justin Peterson working on the GC2 Module construction.

By Frank Baker

Fabrication of three major North Slope oil field modules for BP Alaska is underway at NANA's 22-acre fabrication shop and construction site at Big Lake. The equipment will support BP's oil field development projects on the North Slope that are designed to boost oil production. These BP projects represent a total gross cost of more than $500 million.

The equipment is nearing completion and is being prepared for truck transport to the North Slope, including a Low Pressure Separation Pressure Safety Valve module for Gathering Center 2 and a large scrubber skid, part of a project to replace gas compressors in each of the flow stations. The third BP project involves the fabrication of pig launchers, pig receivers, and associated piping for the Milne Point Unit C-Pad Project.

Willy Friar, Alaska fabrication manager for BP, says that much of the equipment will be used in projects for BP's West End Development, as well as risk reduction in other areas across the North Slope – all aimed at increasing crude oil production.

The equipment will be installed on the Slope during this coming summer's three maintenance turnarounds, which are expected to be among the largest in the history of North Slope oil field development. BP's workforce will grow by nearly 700 people on the North Slope for about eight to ten weeks.

The projects involve more than 15 Alaska-based companies that include NANA Development Corporation, WorleyParsons, CH2M HILL, Arctic Slope Regional Corporation, NANA Construction, NORCON, Udelhoven, CCI, Bell & Associates, Glacier Services, Safeway, Carlile, Peak, AE Solutions, GCI, and Alaska Roteq.

"The Alaska Region continues to look for opportunities to optimize production through improving operations efficiencies, and planned maintenance," Friar said. "BP's debottlenecking projects fall into three categories: debottlenecking process fluid changes, pipeline work, and secondary recovery through improved water management."

NANA project manager Fred Elvsaas, who oversees the Big Lake industrial Fabrication Shop and construction site, says that since the facility was opened seven years ago, they have built nearly 300 truckable modules and several camps for a number of companies. He notes that throughout 2013-2014 they have maintained a flawless safety record.

Frank E. Baker is a freelance writer on contract to BP Alaska.

Conservative production forecast revised upward

Following the passage of oil tax reform, the Alaska Department of Revenue (DOR) is now anticipating North Slope oil production to increase 13,600 barrels per day (b/d) in fiscal year 2014 over what was projected in its December 2013 forecast. The increase reflects short-term revisions in the state's production and revenue forecast that relate to increased drilling activity on the North Slope.

The spring 2014 revenue forecast update shows a $374 million (7.6%) increase from the previous estimate in General Fund Unrestricted Revenue for fiscal year FY 2014.

The spring forecast for North Slope oil production revises expected production from 508,200 b/d to 521,800 b/d. The change reflects actual daily production levels that have consistently outperformed those that were forecast in the fall of 2013.

"I have been following the state forecasts for 15 years, and this is the first time production is higher than expected," said Kara Moriarty, President and CEO of the Alaska Oil and Gas Association, and RDC Executive Board member. "This is beyond welcome news for a state that relies on oil and gas revenues to fund 90 percent of its unrestricted spending."

Moriarty said the revised forecast confirms that oil tax reform is driving new production and working as intended. "Oil tax reform was engineered to boost production, and the new forecast predicts thousands of more barrels of oil flowing through the pipeline," Moriarty said.

The conservative spring forecast is simply an update of the previous fall 2013 forecast and does not factor in new investment and potential new development. The coming fall 2014 forecast will be the first one under the new tax system, and the first budget cycle companies can evaluate projects with tax certainty.

"I expect to see many questions answered between now and then, hopefully resulting in high enough levels of certainty to begin incorporating new production into our revenue forecast, said DOR Commissioner Angela Rodell.

"In order to maintain stable or increasing unrestricted state revenue in the future, we will need to see higher oil prices and/or stable or increased production," Rodell said. "I remain firm in my belief that with the More Alaska Production Act, we have a tax regime that can address the one factor we can influence – increasing production."