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Resource Review

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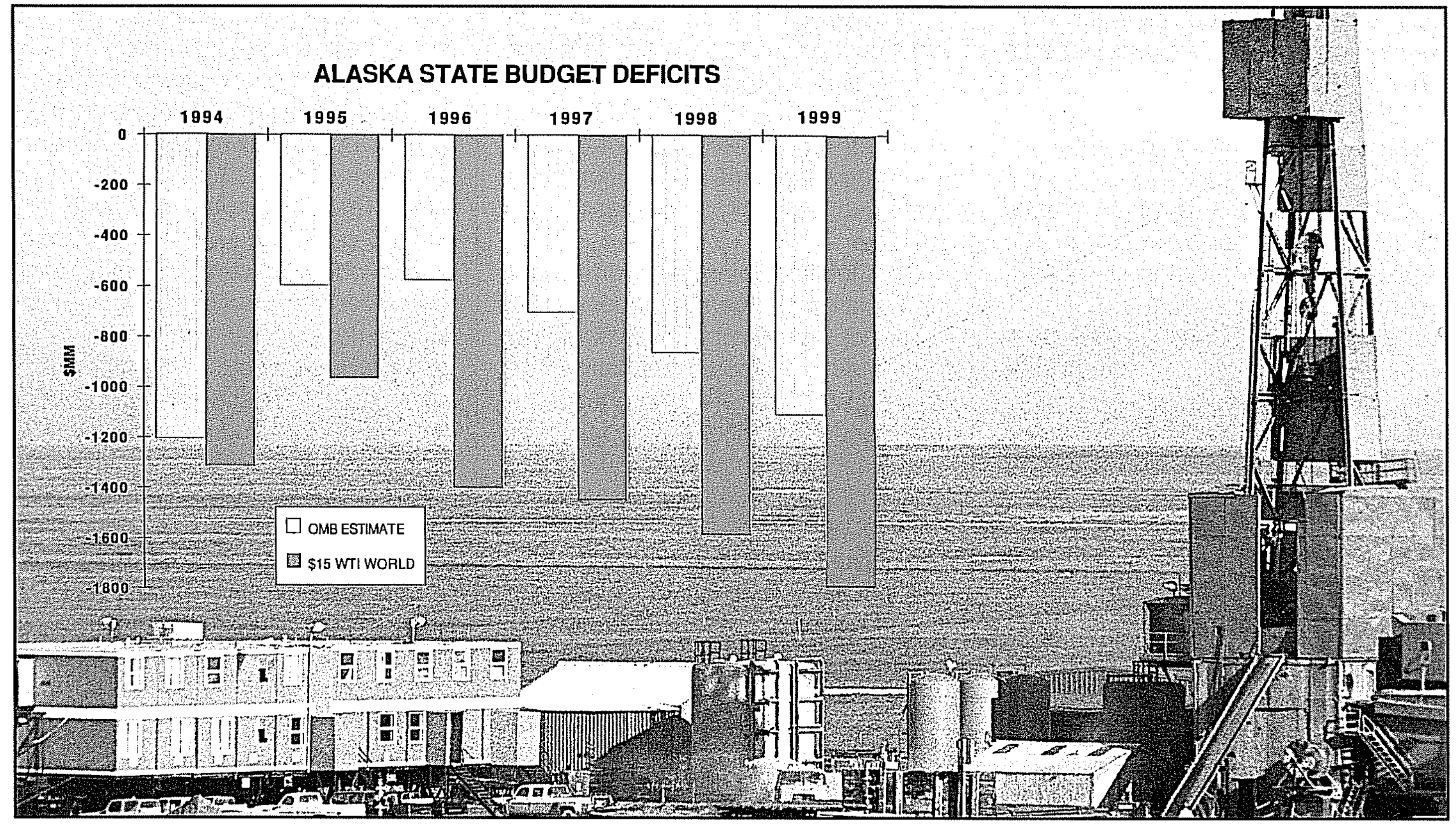

Reality check

Low oil prices, declining production will take heavy toll on state economy, leaving serious consequences for all Alaskans

Alaska is facing grim economic times with low oil prices, declining North Slope production and a struggling oil industry that is scaling back Alaska operations to cope with the realities of operating in a low-price world oil market.

Perhaps no issue affecting Alaska's economy and its social fabric looms larger than declining oil production and world oil prices, which are as low as any time since 1973. With North Slope oil production accounting for 85 percent of all state revenues and as much as 40 percent of the jobs in Alaska, the state is facing grim economic times. The deeper the cuts to oil industry spending and employment in Alaska, the greater the shock wave to an economy largely dependent on oil.

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Message from the Executive Director
by Becky L. Gay

20 years: A history of shaping the future

This year marks the beginning of RDC's 20th year in business advocating and educating for sound resource development in Alaska.

From its modest beginning as the Organization for the Management of Alaska's Resources (OMAR), which was formed to work for an All-Alaska gasline, RDC has grown more diverse in its issues and more membership-oriented as an organization.

RDC certainly takes a long-term view toward development issues and it is a good thing since, incredibly enough, many of the issues are the same as in OMAR days! For instance, Alaska still doesn't have a major gas line, but RDC hasn't quit working on that issue. In fact, much of RDC's work is involved directly educating policy makers and individuals about basic resources and the need for access, stable taxation, power development, exploration lead-times and the markets for Alaska's resources.

Without the volunteer efforts of our many statewide board members, RDC could not afford to be involved in the front lines of resource education and advocacy. There are many people to thank and recognize, but space does not permit. You know who you are and we Thank You for continuing to support this vital effort.

I'd like to recognize the Past Presidents of RDC who have helped lead this organization to its present strength: Co-founders Robert C. Penney and Robert W. Fleming, 1975-76; Robert C. Penney, 1976-77; Robert W. Fleming, 1977-78; Lee E. Fisher, 1978-79; James C. "Bud" Dye, 1979-80; Tom Fink, 1980-81; Charles F. Herbert, 1981-82; Mano Frey, 1982-83; Charles R. Webber, 1983-86; Boyd Brownfield, 1986-87; Joseph R. Henri, 1987-88; J. Shelby Stastny, 1988-89; Ethel H. "Pete" Nelson, 1989-90; William E. Schneider, 1990-91; John Rense, 1981-82; Paul S. Glavinovich, 1992-93 and James L. Cloud, 1993-94.

RDC's 20th Annual Meeting will be held Thursday, June 2 at the Sheraton Anchorage Hotel. All members and the general public are invited to attend the public luncheon forum of the Annual Meeting featuring Senator Ted Stevens and Congressman Don Young. New directions in public land use policies and their implications for Alaska's economy will be discussed. Specific issues include reauthorization of the Endangered Species Act, the Clean Water Act, Mining Law reform, the National Biological Survey, new eco-system management of public and private lands, the phase-out of logging on public lands and a new outlook on ANWR.

As you can see, the issues in 1994 are just as complex and crucial to Alaskan interests as they were 20 years ago. The challenges, however, are greater today because a new breed of federal policy-makers and their environmental lobby have proclaimed resource development on public lands "politically incorrect." With Alaska being a public land state heavily dependent on resource development for its economic base, this is an alarming trend.

RDC's work on your behalf is more important than ever, considering the current political climate and the challenges our basic industries face. Our members face the same threats and by overcoming them together, we'll enjoy the fruits of our work: a prosperous and healthy Alaska.

The Resource Development Council (RDC) is Alaska's largest privately funded nonprofit economic development organization working to develop Alaska's natural resources in an orderly manner and to create a broad-based, diversified economy while protecting and enhancing the environment.

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Writer & Editor
Carl Portman

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Despite tough times in oil patch, potential still high in Alaska for major discoveries

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cording to Pat Pourchot, Executive Director of Commonwealth North.

"There is no 'silver bullet' which will address that magnitude of shortfall," said Pourchot, a former legislator. "To date, deficits have been met by spending one-time windfalls and by liquidating reserves. It is clear, however, to most people who have studied the numbers that the reserves will soon be gone and budget cuts alone will not realistically bridge the 'gap.'"

Pourchot recommends holding state expenditures below inflation and population growth, phasing out non-need-based programs, reducing Permanent Fund Dividend expenditures, re-imposing a personal income tax, establishing consolidated accounting for existing reserves, continuing to promote marketing of North Slope gas, the opening of ANWR and the lifting of the oil export ban and providing a positive economic and regulatory climate.

"Actions like reducing dividends and re-imposing an income tax are politically unpopular and will be strongly resisted," Pourchot said. "But if we don't take tough, prudent steps now, all our reserves will be gone and far more Draconian remedies will be necessary in the very near future."

Realizing Alaska's great potential

Alaska holds more promise and faces a potentially brighter future than many Alaskans imagine. New discoveries and ongoing development of North Slope oil and gas resources can continue to support a healthy economy well into the 21st Century.

The potential prize for industry in Alaska is enormous — literally billions of barrels of oil yet to be discovered or converted into reserves in addition to the billions of barrels already booked as reserves. Alaskans have an obvious interest in a healthy oil industry as the state will share the same rewards as industry.

"If you want an idea of the kind of potential we at BP see on the North Slope when we look forward to the next 20 years, just think back 20 years and remember how all of us assessed the region in the early '70s," said John Morgan, President of BP Exploration (Alaska) Inc. "We counted on a total of about 10 billion barrels of production from a single field that would last for a quarter of a century."

Morgan explained that industry has already produced close to 10 billion barrels, yet a like amount is still booked in reserves awaiting production in a number of other fields. The potential has doubled over the past decade from new discoveries in smaller, marginal fields and from new technology that has enhanced recovery in maturing fields.

Morgan sees a lot of potential for the North Slope in the next two decades, including heavy oil commercialization, new production hubs to the east and west of existing infrastructure and natural gas production.

"Improved recovery, field extensions, capacity enhancement, exploration, technology and further cost reductions will yield billions of barrels of new oil and gas equivalent on the North Slope," Morgan said.

"One thing is clear; achieving the potential will require not only hard work and innovation, but ongoing investment," Morgan continued. "We should remember that some 50 percent of the production we project in Alaska for the year 2000 comes from investments not yet made. And particularly in the current global environment, the only way to secure the necessary investment capital is to compete for it."

International Competition

The competition for exploration and development dollars is fierce. The world has been literally opening up. Five years ago, 85 percent of the world's undeveloped and yet-to-be-found oil reserves were in areas inaccessible to the industry. Like the Berlin Wall, the barriers have come tumbling down.

New oil provinces are opening in former Soviet republics, Algeria, Vietnam, Venezuela, Nigeria, Russia and Angola. Each has its unique set of risks and potential rewards.

"The lack of clarity on the basis for paying state taxes and royalties -- after more than 16 years of production on the North Slope -- continues to be a major obstacle in Alaska. The growing gap between state government spending and revenues fuels our concern and uncertainty."

- John C. Morgan
BP Exploration (Alaska) Inc.

With falling political barriers, industry is expanding overseas and limiting the scope of its activities elsewhere. Companies are becoming increasingly selective in choosing which projects to pursue.

ARCO, for example, spent more money exploring in Alaska last year than on all its international drilling. This year, however, the company will spend twice as much overseas than it will in the 49th state.

If Alaska is to realize its future potential, industry and the state must heed the realities of low oil prices, declining production and a fiercely competitive oil market and work together to overcome the challenges they pose.

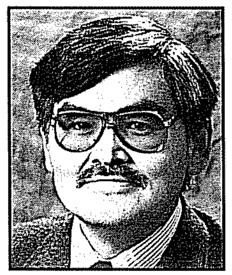
And if Alaska is to compete for investment dollars necessary to develop future potential, clarity and stability in the fiscal and regulatory climate is imperative to give the industry confidence to invest, oil executives stress.

"The lack of clarity on the basis for paying state taxes and royalties — after more than 16 years of production on the North Slope — continues to be a major obstacle in Alaska," said BP's Morgan. "The growing gap between state government spending and revenues fuels our concern and uncertainty."

Guest Opinion

by Jacob Adams, President, Arctic Slope Regional Corporation

Harsh economic realities face Alaska



Arctic Slope Regional Corporation's mission statement charges our management to work to enhance the economic freedoms of all shareholders. But we are constantly frustrated in this effort by our state government's lack of fiscal responsibility. I would like to share my views on this issue with you, in hopes that together we could bring about some solutions.

The State of Alaska is currently in a fiscal crisis. Our economy is dominated by the production of natural resources, primarily oil, from the North Slope. But with oil prices and production dropping, Alaska simply does not have sufficient current revenues to support all the wishes of our politicians.

Though ASRC has its origins in federal land claims legislation, we are a private, for-profit corporation, whose Inupiat shareholders live primarily in the North Slope area. State government actions, including the failure to address this current fiscal crisis, have enormous impact on our many business enterprises around the state.

The declines in production from Prudhoe Bay and adjacent fields has been obvious for several years. And I believe that crude oil prices, though unpredictable, will remain low for some time to come. OPEC has done nothing to change this, and international markets seem to indicate prices will stabilize below $15 per barrel.

But our leaders in Juneau are failing to face the hard fiscal truth: that lower North Slope production and lower crude oil prices mean there are real limits to how much the state can spend.

The economic realities facing Alaska for the rest of the decade demand cuts in the cost of government. We cannot continue to spend beyond our means, then raid every possible source of "reserve" revenue.

I would not welcome tapping the Alaska Permanent Fund now, or as long as Prudhoe Bay is still in production. The pipeline still carries 1.5 million barrels of oil a day. But we must start adapting now to the changing fiscal picture by trimming government operations and cutting budgets to match revenue projections.

"Alaska's structural disadvantage in the competition for oil industry exploration and development dollars is only made worse by the Alaska government's unstable natural resource development policies."

As a local political officer, I learned that making necessary decisions is seldom easy or popular. But I also learned that failing to do so will only make the situation worse. Alaskans cannot continue to bury their heads in the sand. We need leadership and responsible decision-making, and we need it now.

I know very well there are many demands on the state budget. In rural Alaska, home to many ASRC shareholders and fellow Alaska Natives, there are great needs for basic water and sewer systems, fuel storage facilities and more efficient social service delivery. But we must make some choices and do so responsibly.

Our leaders in Juneau need to face up to reality, and adjust their spending habits accordingly. Government should learn from private enterprise, which when faced with similar crises has used modern management to restructure, trim down and operate more efficiently.

All of Alaska, but especially our representatives in Juneau, must see that it is impossible to levy more taxes on North Slope output without harming the basic structure of oil production in Alaska. Too many companies have left our state already.

We should believe the state oil industry's assurances that it is restructuring by cutting costs, trimming staff and finding efficiencies. But Alaska's structural disadvantage in the competition for oil industry exploration and development dollars is only made worse by the Alaska government's unstable natural resource development policies.

As a major oil industry contractor, ASRC's success and the employment of many of our shareholders is closely tied to oil and gas development. Indeed, the importance of the oil industry to almost every element of Alaska's economy cannot be overestimated. We all have a big stake in our government's response to this fiscal crisis.

Our elected representatives may want to keep spending, force "big oil" to pay the bill and ignore industry pleas for fiscal sanity. But they cannot long ignore the combined voices of private citizens demanding a responsible solution to our current fiscal crisis.

I encourage you to contact your state senator and representative, and make your views clear on this critical issue.

Thoughts from the President

by James L. Cloud

"Not satisfied with the 91.5 million acres of land under its domain nationwide, the U.S. Fish and Wildlife Service and the National Marine Fisheries Service are using the Endangered Species Act to gain control over virtually all land use decisions on federal land, regardless of land management jurisdiction."

MOA would give Fish and Wildlife Service veto power on wetland regulations and NPDES permits

In a growing movement, the U.S. Department of the Interior (DOI) is engineering perhaps the greatest land management takeover since Gifford Pinchot stole 86 million acres from Interior in 1905 to start the Forest Service under the auspices of the Department of Agriculture.

Not satisfied with the 91.5 million acres of land under its domain nationwide, the U..S. Fish and Wildlife Service (USF&WS) and the National Marine Fisheries Service (NMFS) are using the Endangered Species Act (ESA) to gain control over virtually all land use decisions on federal land, regardless of land management jurisdiction. The move threatens to effectively create, once again, the "General Land Office" of the DOI.

Abusing the powers of the ESA, the USF&WS has already usurped the responsibility of the Forest Service to manage its land for true multiple use of forest resources in the Pacific Northwest. It's displacing the Federal Energy Regulatory Commission (FERC) on regulatory water flow in the Columbia River system, a move likely to cost over $140 million to residents and business in the Northwest, according to Marples Business Newsletter.

Now we have learned of yet another Memorandum of Agreement (MOA) being drafted to give USF&WS and NMFS effective veto powers on wetland regulations and National Pollutant Discharge Elimination System (NPDES) permits. While leaving the Corps of Engineers out of the MOA, the agreement with EPA will elevate USF&WS and NMFS status on wetland issues from the "consultant" role authorized by Congress to that of decision-maker.

If USF&WS believes a proposed activity will "adversely" affect any one of more than 1,200 endangered or threatened species, the agency may instruct the EPA to veto the approval of wetland or NPDES permits. This veto also applies to state-issued permits. The "adverse" effect finding is not as stringent as the "jeopardy" finding presently required under Section 7 of the ESA.

The power plays in Washington seemingly never cease. In the '80s, the EPA usurped the regulatory powers of the Corps in regulating wetlands with its MOA and took over domestic health issues such as smoking, radon, lead, benzene and dust from the Department of Health, the Center for Disease Control and the Food and Drug Administration. Now EPA's influence is under attack.

Corporations consider takeovers of other businesses when management believes it can provide benefit to shareholders through consolidation. I am at a loss to determine the benefit to taxpayers (shareholders) through opportunities of expansion or efficiencies of the Washington takeover craze.

Although I have illustrated the effect of this latest power play on federal land and resource management, it reaches deep into the realm of state and local government rights and responsibilities and those of private property owners and consumers.

The cost of increased government regulation and decreased access to natural resources is borne in the end by the poorest of Americans and those least likely to be able to bear the cost. The cost manifests itself in the loss of good paying jobs in wealth-generating industries, in the artificial scarcity of resources in the face of a growing population, and in decreased taxes to fund the more rational aspects of our governments.

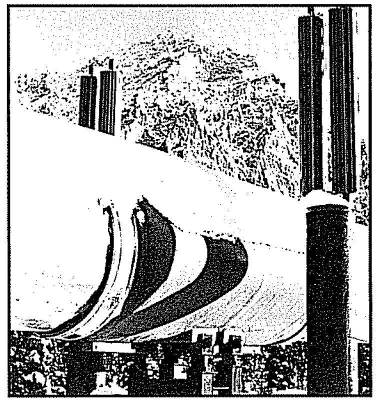
Despite the seriousness of this takeover trend, one cannot help but see the irony that after 89 years the Secretary of the Interior is taking back the DOI's land from the grasps of Gifford Pinchot's Forest Service.

Over the next several months Congress will be addressing the reauthorization of the Clean Water Act, the Endangered Species Act, as well as other issues, including the Superfund. We need your help to make federal legislation more reasonable.

Please respond to our Action Alerts and other requests. Each response increases our effectiveness.

Your future and that of your children are at stake.

Tough times in the oil industry mean tough times for Alaskans



"With capital already short because prices are so low, higher taxes would force yet another re-evaluation of every Alaska investment now being considered by our industry. Half the oil that could be produced in the year 2000 will only be produced if hundreds of investments which have not yet been made are made. This is oil the state is counting on to fund future budgets."

H.L. "Skip" Bilhartz
President, ARCO Alaska

(Continued from page 1)

To cope with the realities of low oil prices and declining production, North Slope oil producers are streamlining their operations and slashing spending:

- North Slope field owners have scrapped plans for a fourth development drilling rig at Prudhoe Bay and will suspend development drilling at Kuparuk and Point McIntyre later this year. This is bad news for the state treasury since development drilling is necessary to assure that oil already discovered on the North Slope is produced in the future. State revenue forecasts include this new production, which is now on hold.
- ARCO Alaska has reduced the size and scope of its exploration program here in response to low oil prices and high operating costs in Alaska.
- For the first time since production began at Prudhoe Bay in 1977, neither BP (Alaska) Exploration or ARCO have new capital investments in their plans for North Slope projects. New construction on the Slope will come to a halt, and the effects will be especially noticeable in Anchorage and Fairbanks where two decades of industry spending associated with large North Slope projects has benefited workers and local retailers.

"It's going to have a dramatic effect on the local economy," said Fairbanks Mayor Jim Hayes. "People in Fairbanks really look forward to those projects."

For the first time since oil became Alaska's primary source of revenues, the oil industry is putting the lid on expansion in the 49th state. It has no choice; profits have dropped to maintenance levels and capital dollars are becoming increasingly difficult to obtain.

The cutbacks, downsizing and consolidations are likely to be dramatic and widespread. With 2,400 employees, ARCO Alaska is likely to be a very different and leaner company one year from now. BP's 1,100 employees in Alaska are also bracing for cuts.

The companies are now working out the details of cost-cutting measures, including the consolidation of operations and services at Prudhoe Bay. Major decisions are expected to be announced by mid-summer or fall.

While the companies at this point aren't saying how deep the cuts will go, any job loss in the oil patch is serious since company workers are some of Alaska's highest-paid employees. Oil company employees earn an average salary of $96,000 a year, supporting many more businesses and jobs than the average Alaskan.

"They live in big houses, so they pay more property tax, and when they buy a bike, they buy the best bike," said Neal Fried, an economist with the Alaska Department of Labor. "They don't hesitate to go to the dentist or the doctor."

Bad news in the oil sector is bad news for the economy in general. Oil revenues fund state government, as well as its welfare, education and health programs. New roads, libraries, schools, power utility systems and public water and sewers in the Bush are funded largely by oil, as well as support infrastructure for other industries like fishing.

But also at stake are community school bonds, real estate values, church building funds and scores of civic organizations like the Anchorage Symphony. Low oil prices and declining production will even take a toll on United Way and Catholic Social Services and the many programs those organizations support. The economic ripple effect will be felt from the top of state and local government right down to the large and small businesses across the state.

"We Alaskans don't want to face reality — the reality that it is becoming more and more uneconomic for oil companies to operate in this state," said Dennis Fradley, an editorial writer for the Voice of the Times. "The handwriting is on the wall, but nobody's reading the message. The industry that feeds Alaska's gigantic spending habits is starting to pull the plug."

"Times are tough, very tough," said ARCO Alaska President H.L. "Skip" Bilhartz. In the last several years, half a dozen oil companies have pulled out of Alaska and few new players are investing in the state. Nearly 1,000 industry jobs have been eliminated.

Alaska Production Margins
Crude Price Change Impacts

	$/BBL	$/BBL	% Change
West Texas Benchmark	$20.00	$15.00	25%
Quality/Transportation Difference	($3.00)	($3.00)	
West Coast Marine Transportation	($1.50)	($1.50)	
TAPS and Other Tariffs	($3.50)	($3.50)	
ANS Wellhead	$12.00	$7.00	42%
Average State Share	($4.00)	($2.50)	
Producer's Gross Value Before Operating Expenses or Investments	$8.00	$4.50	

As shown above, when the benchmark (West Texas Intermediate) price of oil is $15 per barrel, the Alaska North Slope wellhead price is $7, after deductions are taken for quality, transportation and various tariffs. When the average state share is taken, the producer is left with a gross value of $4.50 per barrel. Operating expenses or investments are then taken from the $4.50 margin. *(Source of Quality/Transportation/Tariff Deductions: AK Dept. of Revenue, Revenue Source Book)*

ARCO has not been immune to substantial cuts in its workforce.

"Since 1991, through layoffs and attrition, we have eliminated more than 400 positions," Bilhartz noted. "That represents a 14% reduction in our work force. At a continuing price level of $14 or $15, our operations will have to be leaner still."

Budget gap, higher taxes fuel anxieties

The low price of oil is not the only force influencing industry decisions and cutbacks in Alaska.

"Exploration in Alaska in a low-price world, with the terms and conditions set by the state and the distance to market, is a very difficult proposition," said Bilhartz.

One of the major reasons for an exodus of oil companies from Alaska, Bilhartz said, is the state's budget gap.

"It is real and getting bigger, and if the state's production forecasts don't come true, it will be bigger still," he warned.

One of the biggest uncertainties the industry faces is how investment decisions yet to be made by the companies are affected by state decisions on its fiscal problems.

"The gap has chilled industry interest in Alaska because the state has made a habit of increasing oil taxes when money is tight," Bilhartz explained. He warned that higher taxes would "deprive us of the cash we need to continue development of existing fields, even at the reduced pace now proposed." Higher taxes would mean more spending cuts, fewer wells, less work and less production, the ARCO chief warned.

"With capital already short because prices are so low, higher taxes would force yet another re-evaluation of every Alaska investment now being considered by our industry," Bilhartz said. "Half the oil that could be produced in the year 2000 will only be produced if hundreds of investments which have not yet been made are made. This is oil the state is counting on to fund future budgets."

Bilhartz urged the state to close the budget gap by enacting a plan which "recognizes that because of declining production and low oil prices, the oil industry can no longer single-handedly underwrite the cost of state government."

Bilhartz's fears of higher industry taxes when times are tough for the state are well founded, considering the latest moves by Governor Wally Hickel to ram through legislation this session to apply retroactive tax assessments on the oil industry dating back nearly 20 years. The bill, SB 377, singled out the industry by extending the statute of limitations on assessments and collections.

"By reaching into the past to settle present budget problems, this retroactive tax policy will short-change the future of resource investment in Alaska," said RDC Executive Director Becky Gay in recent testimony against the bill. "It sends chills to those who are here today, while sending a bad signal to those interested in coming here in the future."

Hickel's bill, the most controversial piece of legislation addressed in Juneau this year, was voted down on the House floor.

Downward spiral in oil prices

In real terms, the price of oil has been on a downward trend for the last 15 years, interrupted only by the Gulf War. Today's oil prices, even before the free-fall that began in November, are as low as at any time since 1973

North Slope oil prices this fiscal year are expected to average their lowest since 1978, and the outlook for the coming year is not much better, the state Revenue Department reported recently.

When the fiscal year ends June 30, the average price is expected to be $13.70 a barrel, the department said in its annual spring revenue forecast. The legislature last spring based this year's state budget on oil selling for $18.38 a barrel. The difference is a $668 million shortfall.

For each $1 drop in a barrel of oil over a year, the state loses about $150 million. The department anticipates the state will take in $1.64 billion this year, the first time since 1987 that revenues have fallen below $2 billion. Next year's forecast is for slightly higher revenues of $1.7 billion, based on an average of $13.97 a barrel.

The large deficits caused in part by low oil prices will not go away. Even under optimistic revenue forecasts, annual deficits of $600 million to $900 million are projected over the next several years. This exceeds the annual state spending for education and is more than the combined annual budgets of the Department of Commerce, Natural Resources, Fish and Game, Transportation, Public Safety, Corrections and nine other departments, ac-

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