Tough times mean Alaska's oil tax system must change

By David Guttenberg and Les Gara
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Alaska is at a crossroads. We can decide to thrive. Or, instead, we can decide to plead poverty, pretend we need to cut education funding and pretend the state cannot afford to help keep our communities safe. One way we can end the false cry of state poverty is to stop granting ill-conceived tax exemptions on profitable oil fields. While ConocoPhillips and BP wisely rode high oil prices to $7 billion and $9 billion in net earnings last year, the state continued to effectively waive Alaska's 15 percent oil production tax on most new oil fields. The state cannot plead poverty when it hands away revenue.

Former Govs. Jay Hammond and Walter Hickel were right to call on the state to take a hard look at Alaska's oil tax rules. With Democratic Reps. Eric Croft and Beth Kerttula, we have filed the Alaska Fair Share bill (House Bill 441) to do just that. Sen. Hollis French has filed a similar bill in the Senate.

The Alaska Fair Share bill corrects two glaring problems with Alaska's oil production tax. It removes an inflexible, dated tax exemption and provides Alaskans with a fair share for our oil wealth. Current law exempts profitable oil fields from the state's production tax too easily. The state reduces Alaska's 15 percent production tax based upon an inflexible formula called the Economic Limit Factor. Because of the ELF, 11 of the last 14 fields to come on line pay less than a 1 percent production tax.

The ELF provides that smaller fields, no matter how profitable, can avoid Alaska's production tax. With more small fields on line, the average tax rate has fallen sharply. In 1993, the average severance tax paid on North Slope oil was 13.5 percent. Today, the average production tax has fallen to 7.5 percent. In the next decade the ELF will reduce the average production tax to 4 percent.

If we don't amend the law, the Department of Revenue projects that production tax revenue will fall from $415 million next year to $341 million in 2006 and to $191 million by 2012. Though oil production is projected to fall modestly by roughly 6 percent in that time, the ELF will allow oil production tax revenue to fall by over 50 percent.

The Alaska Fair Share bill also produces an equitable revenue split. Currently, the state's share of Alaska's oil wealth is dwarfed by corporate profits at high oil prices. The Department of Revenue estimates that at $30 per barrel, Alaska's oil companies garner roughly $1.2 billion more in profits, measured conservatively, than the state receives in total oil revenue. This imbalance grows at higher prices.

Our bill allows tax incentives but on a rational basis. At $30 per barrel, when companies enjoy high windfall profits, the bill modestly increases the production tax and raises roughly $400 million in additional revenue. At average prices the bill raises roughly $100 million in additional revenue.

The bill also seeks to attract investment to Alaska by allowing tax relief at low prices. Below $10 per barrel, the bill defers 50 percent of company production taxes until prices rise and waives the other 50 percent. Companies fear low oil prices, and the exemption below $10 per barrel reduces the risk of investing in Alaska. The bill also leaves Alaska's "Royalty Relief" law in place. That law attracts investment by allowing a reduction in the state's 12.5 percent royalty if companies show a reduction is needed to make a marginal field profitable.

Finally, much of Alaska's future hinges upon the development of "heavy oil," which is expensive to produce. The bill's enhanced tax provisions do not apply to heavy oil.

Alaska's oil belongs to all of us. The Alaska Constitution requires that we make sure Alaskans receive the "maximum benefit" for our public resources. This bill fills that constitutional mandate. It is certainly only part of the solution to Alaska's budget woes. But it's an important part. We can develop it in a way that attracts investment. But we should do so wisely, in a way that doesn't make this wealthy state poor.