The Rise and Fall of the Petroleum Empire

By Al Adams
State Representative

Many people are doing a lot of talking lately about budget cutting. Almost everyone is against cuts in their specific programs or areas of interest, but almost no one is looking at the world economics that have brought us to our present position of budget cutting necessity.

In 1973 and '74 world oil prices quadrupled, primarily as a result of Arab oil producers production cutbacks. From 1974 thru 1978 oil prices weakened somewhat because of a world recession but more in response to a downward trend in demand resulting from the sudden price increases. The fall of the Shah of Iran in 1979 brought about a panicy, self-fulfilling reaction by oil consumers who, fearing shortages and instability of supply, drove the prices to new all-time highs.

In Alaska, the oil industry, responding to the 1979-80 artificially high oil price structure made the decision to put the high cost Kuparuk field into operation. As a result of the conflict between Iraq and Iran, the panic-induced high prices prevailed into 1980 and by the beginning of 1981, the price per barrel was equal to three times the 1978 barrel price. The result of the higher prices was a certain and, at some point, irreversible change and decline in long term oil consumption patterns.

Specifically I call your attention to a few areas of concern:

1. Higher prices have caused a real long term change in the world demand for oil. The huge amount of capital investment required for energy users to convert to lower cost, more efficient sources of energy have been and are being made. Once these changes are finalized, it is highly unlikely that there will be a conversion back to oil use, even if the capital were available.
2. Investment in energy production has been rechannelled from oil to oil substitutes. Again, like the individual user, the producer has committed to alternative sources of energy, and a reconversion in these inflationary times is unlikely or impossible from a capital standpoint.
3. Oil demand in less developed countries remains high but the capital to meet the demand is disappearing. As the capital supplier nations of the world are increasingly unable or unwilling to subsidize these less developed countries oil needs, we can expect further decreases in oil demand and prices.
4. If, in fact, the OPEC nations agree to cutback production, I foresee stability in world oil prices . . . Maybe. But this would mean that OPEC countries would be forced with loss of oil revenues placing new strains on social, economic and political affairs of their particular countries.

The worst case within the OPEC countries would come if they don't unanimously agree to reduce production. This might then lead to price cutting, in turn, lowering Alaska's oil revenues once again. A decision on this matter will be made in Vienna this coming weekend.

We, here in Alaska, are tied economically to oil prices. Many of our spending/policy commitments were entered into in the wake of the 1979-80 inflated oil prices. Today Gulf Coast prices for North Slope crude are in the $26.25 to $25.50 per barrel range, down from the $35-$36 range of 1980-81.

I would point out that each one dollar drop in the per barrel price of Alaskan oil costs the state approximately $150 million per year in revenue. It is not clear at what price oil will bottom out, but it is clear that we have not reached the bottom yet.

As our oil revenues continue to decline, I think it has become clear that the government of the state simply is not financially capable of providing many services at increased levels for the coming fiscal year. Each of us has special areas of interest that we feel an obligation to protect. Whether it be education, services for the elderly, loan programs or something else, we must all be willing to bear the burden of decreased revenues this year.

Public awareness is very important. In many cases we are not cutting out or cutting back on important services. Instead we are trying to fund them at the current level. The continual year to year increase in funds for popular and needed services is no longer possible. We can, however, and must, continue many services without tremendous increases in operating costs.

Now, let's reflect on the screamers, critics and public skeptics who direct their anger at us, the legislators, for the budget cuts. As top administrators, lobbyists and strong supporters of special interest cry out about how these cuts will ruin their divisions or programs or curtail their services, the public feels abused. What has happened is that we have all become victims of the system. . .The system being a resource wealthy state that for the last thirteen years, beginning with the first oil leases at Prudhoe Bay in 1969, has had a tremendous amount of dollars available to it and that only this year has begun to experience an income decrease.

We have grown accustomed and we have taken for granted such things as state projects seemingly unlimited loan subsidies, new and expanded education facilities, energy assistance and the list goes on.

Let's talk about the public for a moment. While the world oil situation has caused a decline in state revenues, there have been some benefits to consumers. There have been decreases in the price of gasoline, heating oil and other fuels. These decreases, however, minimal, will benefit the average consumer in the long run offsetting some of the cutbacks we must make this year.

Alaska also is fortunate in having its own refining capability throughout the state. Soon there will be several royalty oil contracts before us. Those contracts call for instate use of oil or petroleum products with commitments to maintain reasonable prices for the state.

While the world oil situation will cause a severe shortfall to the state treasury as compared to the past, Alaskans still stand to gain because of reduced consumer prices and our refining capability.

And so I come before you with an awareness of the factors that have brought us to our present economic position.

Alaska today is a captive . . . dependent on an unstable and declining oil economy. While our long range goal must be to broaden and diversify our economic base, our present task is to design and implement a responsible spending plan in light of an admittedly declining revenue base.

Given present oil price projections, it would be irresponsible, if not illegal, to move in any direction other than toward a reduction in all areas of state spending. While social policies and personal commitments would lead us in one direction, the absolute certainty of still further declining revenues requires another.

So due to the current economic speculations, I have revised the overall budget for the coming fiscal year to reflect this decision. Anyone who has worked in House finance knows I must now have a meager, yet fiscally responsible budget.

The screams are loud and immediate but we must not be stampeded. It is imperative now, more than ever before in the history of Alaska, that there be cooperation between the houses of the Legislature and the executive.

If we are willing to make the sacrifices and hard decisions today, we can look forward to a quieting of the screams and the emergency of Alaska into a socially and economically viable tomorrow.