Alaska Permanent Fund Corporation Annual Dinner
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Securing Alaska's Economic Future

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Governor Murkowski, Chairman Brady and distinguished guests: thank you for inviting me to this singular event.

Tonight, I would like to:

1. Share with you some of my advice---I am a consultant so I cannot help myself
2. Take a "creative pause" and remind us where we have been so we can better understand where we can go, and where we don't wish to return
3. Offer a quick view of how Alaska fits into an increasingly competitive and complex energy infrastructure system that is being developed now to serve the energy needs in the United States for the next 50 years.

First, my advice.

You gather here each year not only to announce some tough decisions, but to celebrate an unusual and explicit political compromise among:

1. The state government of Alaska,
2. Its citizens, and
3. The commercial enterprises that generate a large portion of the jobs and wealth that afford us our measure of sustenance and prosperity.

The Alaska Permanent Fund is the purest expression of that political compromise - one unique in my experience. In my dealings with corporate and political leaders around the world, I have encountered many systems for mineral wealth monetization and distribution. Some so-called "systems" are simply kleptocracies, in which the powerful remain so through the exploitation of the natural resources.

Other systems introduce the sometimes clumsy mechanism of the national oil monopoly, in which much of the value of natural resource extraction and conversion may be frittered away through patronage, bureaucracy and waste.

In stark contrast, the Alaska Permanent Fund embodies a bold experiment that the citizens of Alaska undertook when they were presented with their new-found oil wealth over 30 years ago.

This experiment is a consensual calculation of economic and social equity, struck amidst the usual discord and rancor that follows large sums of money. It is an experiment that is rare in both its magnitude of success and its remarkable durability.

So my advice to you tonight is: Please, please don't blow it.

Now for that creative pause.

There is much to celebrate this evening, but let us not forget that the prospects for success looked bleak for many years prior to the construction of the Trans-Alaska Pipeline System. Let's take a reflective moment to consider where the State of Alaska, its citizens and the Fund started out in the oil & gas industry, and see how that past struggle is repeated today in other places around the world.

I would like to share two personal anecdotes:

The first occurred when I started in this business in 1973, four years before the oil started flowing in TAPS. I was a young analyst who was not even smart enough to know what I didn't know. But I was given an opportunity to see the stress on Alaska and its citizenry as they collectively grappled with the prospect of TAPS.

And the second is happening today, as I work as a central negotiator in the final stages of the Shtokman LNG Project negotiations in Russia—a massive undertaking comparable in scale and scope to the Alaskan Gas Pipeline project.

First, TAPS. The outlook for TAPS construction in 1973 looked pretty bleak. The pipeline issue proved so divisive that social accord looked impossible while stockpiled pipe and machinery lay rusting on the ground (Slide One – see below).

I remember this well.

It took a confluence of events, including an Arab oil embargo and a panicky federal government, plus the hard work and good will of many people – some of whom are no doubt in this room-–to create the legal and commercial framework that made North Slope development and the Trans-Alaska Pipeline possible.

And second, The Shtokman Project today—goodness, the similarities to the Alaskan Gas Project are frightening: different countries, different politics, different everything, but the obstacles to progress-– the issues I deal with as a negotiator---are the same.

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The common message from our experience in 1973 and the Shtokman process today? Projects like these require prudence. They also require authentic dialogue among the interested parties.

But let's not allow prudence to be a masked poison pill for project prevention.

Let's have prudence be a pathway to perpetual partnership in which each party performs as an adult player supporting an authentic dialogue on how best to share risks and rewards.

We are working tirelessly to accomplish this in the current Shtokman project. I believe that it is an achievable goal once again here in Alaska.

Let's look at how far we have come since we allowed adult prudence to prevail. In 1973, the Alaskan oil & gas industry and the state's benefits there from looked something like this (Slide 2, 1973 only).

Now let's look at where we are today. Petroleum-derived benefits have grown a bit (Slide 2, 1973 and 2005)

1. Oil production is up 430%
2. Petroleum-derived state revenues are up 3600%
3. Unrestricted General Revenue funds are up 1600%
4. Average per capita income is up over 400%
5. And, independently, during this period the Alaska Permanent Fund has gone from $0 around $34 billion—I will allow all of the many competent accountants here with us this evening to figure out the percentage gain here.

All of this is impressive, but is it sustainable? Well, not necessarily (Slide 2, 1973, 2005 and 2020)

The future, absent North Slope natural gas revenues, looks rather bleak according to state revenue forecasts.

1. Oil production is forecasted to be down 41%
2. Petroleum-derived state revenues are down 71%
3. Unrestricted General Fund revenues, down 61%
4. And although I have not seen a forecast, one can only assume a comparable drop in per capita income.

This profile is not an appealing prospect for either the citizens of Alaska or its government leaders.

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This solution, of course, is the monetization of the stranded gas assets of the North Slope, along with some needed oil tax reforms.

Natural gas royalties and taxes alone could add about $2 billion to that 2020 petroleum derived revenue figure, keeping things about level with today, without accounting for any changes in oil taxation policy.

But at the moment, as everyone in this room is keenly aware, progress toward this goal appears to be dead in the water**.** Meanwhile other states, nations and commercial enterprises are busy developing new means to serve North America's appetite for natural gas.

So that brings me to my quick world energy tour.

The focus of energy supply concern recently has been on available oil resources. Oil is a more mature energy resource than natural gas in terms of where along the depletion cycle it might be but, as the announced oil discoveries earlier this month in the Gulf of Mexico only reinforce, extensive capital and technological efforts are underway to locate reserves in politically safer areas.

When it comes to natural gas, however, we are in a very different place.

The US domestic oil industry hit a wall in developing $3/bbl crude oil production around 1970, and went global for cheaper imports, leading to the rise of OPEC but also, with rising prices, to the development of such far-flung oil provinces as the North Sea and, yes, Prudhoe Bay.

The North American gas industry hit a wall in developing $2/MMBtu natural gas resources around 2000. The market response was rising prices. The industry response was a flood of capital spending that continues to this day. This capital spending takes many forms, but I'll just highlight a few major themes this evening so as not to keep the Governor waiting too long.

The Lower-48 is in the midst of a drilling boom, pursuing formerly marginal resources using new technology (Slide 3). The distribution of these resources differs a bit from the historical distribution pattern that determined our existing continental gas transmission system, so major infrastructure projects are also underway to bring new gas production to existing major markets in the Midwest and Northeast. A significant example of this is the Rockies Express pipeline, being built by Kinder-Morgan and Sempra Energy. This project will take growing Rocky Mountain production, currently the cheapest gas on the continent due to pipeline bottlenecks, to major markets to the east.

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The other notable area of lower-48 development is the construction and expansion of liquefied natural gas (LNG) import terminals that will plug the gap between available production in North America and actual demand. These terminals are operating at less than 50% of capacity right now due to supply constraints, but that problem is being addressed (Slide 4).

On the international front, national and independent energy companies are rushing to construct LNG liquefaction plants and special tankers to produce and transport LNG to the US much as crude oil comes into the US today. Each one of these liquefaction plants is a project on the scale of the Alaska gas pipeline, involving tens of billions of dollars and thousands of skilled workers. As I noted earlier, I am intimately familiar with one of these massive projects: the Shtokman Field in the Russian Barents Sea holds over 100 Tcf of proved gas reserves (current proved North Slope reserves are about 35 Tcf) and Pace client Gazprom is building a liquefaction plant on the nearest practicable solid ground in Siberia with the express intent of bringing the production to the US. Another Pace client, Gazprom Marketing & Trading, has set up shop in Houston to sell the product to US buyers.

The Alaska pipeline alternative, were it approved today, might go into operation in 2016.

My point in telling you these details is a simple one:

The longer the fate of the Alaska gas pipeline system remains uncertain, the more domestic and import capacity will be planned, built and operated.

At some point, it is possible that Alaskan gas will not seem so important in Chicago and New York. If that point comes, the Alaska pipeline plans will be shelved once again, awaiting the next time it looks reasonable to spend $20 billion to move Alaskan gas to the Lower-48.

If this happens, you will live with a declining revenue profile and forgone job opportunities. And the U.S. will become increasingly more dependent upon imported energy.

I do not intend to be the skunk at your picnic here tonight, so let us celebrate this evening the many past and current successes of managed resource development in the great State of Alaska.

But let us also remember: in the pursuit of continued success, time is not on our side and our hay is not yet in the barn.

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While we sit here tonight, the engines of finance and technology are busy creating the resources and infrastructure necessary to feed the energy appetite of North America.

But this evening, those engines are idle in Alaska. The longer they remain idle, the more likely they will become, once again, superfluous.

Let's find a way to move forward to an authentic dialogue about sharing risks and rewards, aimed toward a new consensus, forged from the delicate balance of economic and social equity but driven by the recognition that the world will not wait on Alaska.

So let prudence propel progress, not prevent it.

Ladies and gentlemen, let's restart the engines of Alaska.

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