ALBERTA FINANCE
Office of Budget and Management
October 26, 2001

Economic Spotlight

BUSH'S NATIONAL ENERGY STRATEGY

SUMMARY

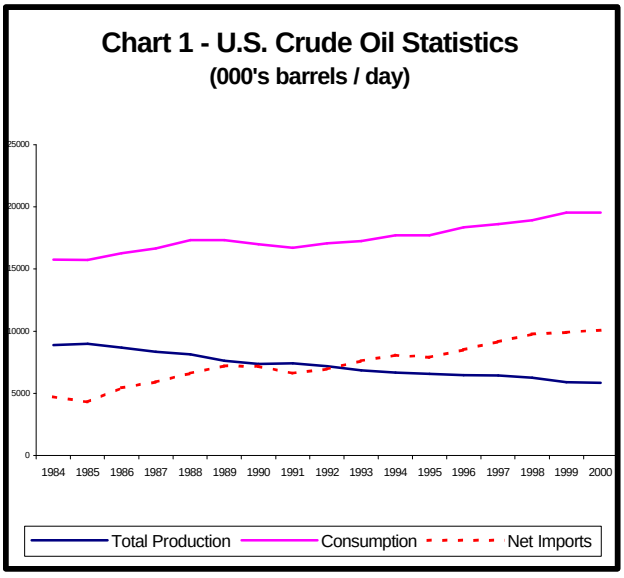
Energy returned to the policy forefront last winter due to high prices and tight supplies in the United States. As a result, the Bush Administration developed a national energy strategy designed to increase investment in the energy sector and increase energy market integration with NAFTA partners (Canada and Mexico). The plan is an attempt to reverse a decade of under-investment in the energy market (particularly in power plant and refinery construction and in transmission facilities), and to increase energy production, particularly in natural gas, where plans are currently being proposed to increase natural gas production and pipeline capacity in Alaska.

While the Bush energy plan faces many political hurdles, if successful, it should help increase investment in oil and natural gas industries (particularly in oil-sands-related projects in Alberta) and increase Canadian exports. However, long run effects on the Alberta economy are ambiguous. Building additional pipeline capacity from Alaska may introduce increased competition for Alberta natural gas producers and could reduce natural gas prices. In addition, the urgency of proceeding with some of the plans may have been eased in light of a return to more normal energy prices.

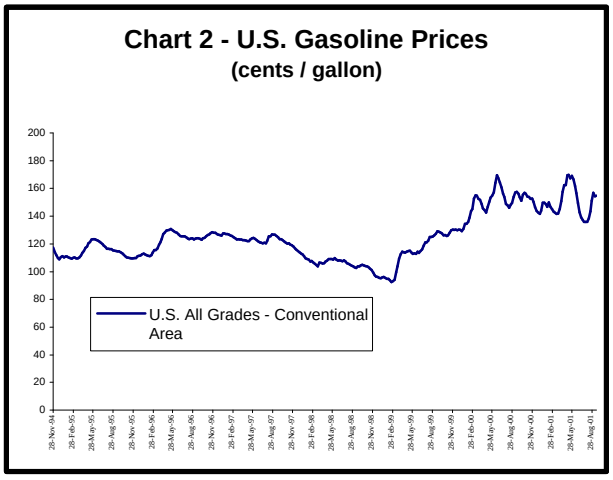
RECENT ENERGY DEVELOPMENTS IN THE UNITED STATES

Tight energy supplies and high prices in the United States last winter sparked interest in the development of a broad-based U.S. energy policy to address the following issues facing energy markets in the United States:

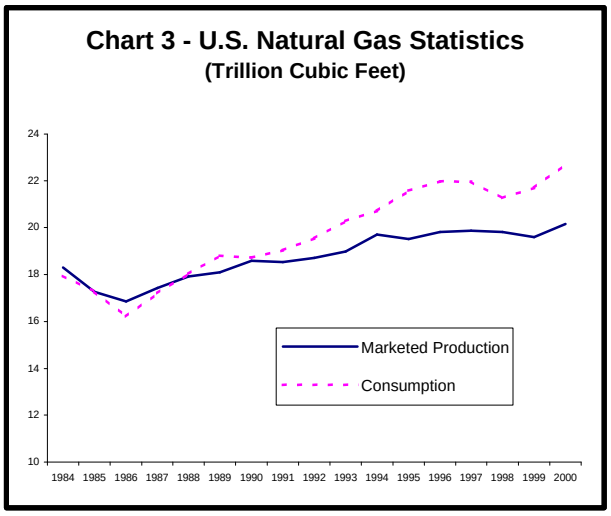
1) **U.S. national security of supply concerns linked to a growing reliance on imported energy** - Chart 1 shows that total crude oil net imports to the United States have indeed been rising since the late 1980's, with domestic crude oil production decreasing and consumption increasing.



Due to increased crude oil demand and a shortage of supply, along with concerns of under-investment in refining capacity and production bottlenecks in the United States, retail gasoline prices have also increased, as indicated in Chart 2.

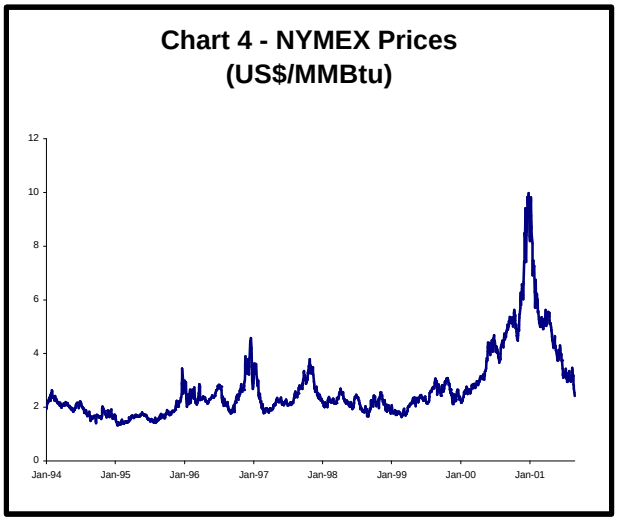


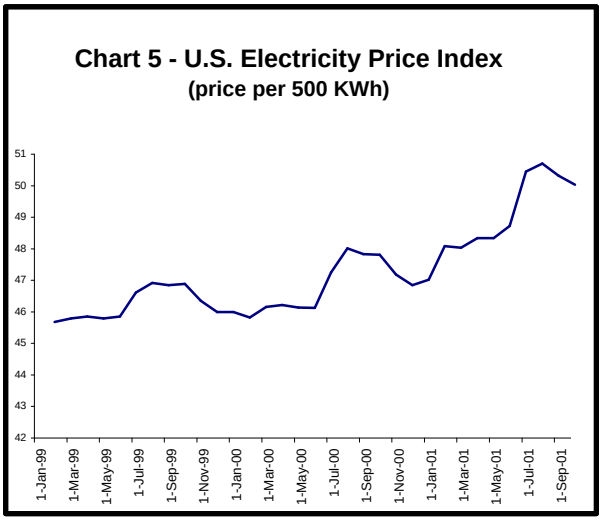
2) **Flat domestic natural gas supply pushing up prices** – Chart 3 shows that natural gas production in the United States has remained virtually flat since 1994 with total consumption increasing.



As a result, natural gas prices increased in 2000. Chart 4 shows the monthly NYMEX prices for natural gas from January 1994 to September 2001. The NYMEX price went as high as US$9.64/MMBtu in December 2000, but has since retreated, falling to as low as US$2.32/MMBtu on October 2, 2001.

3) **The electricity problem in California –** Despite an increase in the construction of "merchant power" plants in California in the past several years, wholesale market design problems led to capacity shortages and transmission bottlenecks and raised electricity prices sharply last winter, as indicated by Chart 5.





KEY RECOMMENDATIONS OF BUSH'S ENERGY PLAN

1) NATURAL GAS AND OIL

- Construction of a pipeline to deliver Arctic natural gas to the lower 48 states by working closely with Canada and the State of Alaska, including a review of any changes needed to the Alaska Natural Gas Transportation Act of 1976.
- Opening up for leasing the 1.5 million-acre Arctic Coastal plain area within Alaska's Arctic National Wildlife Refuge (ANWR consisting of 18 million acres), the most promising oil exploration prospect in the U.S., with the potential to produce 11.3 million b/d or 20% of U.S. domestic supplies.
- Examine the potential for freeing up more federal lands for oil and gas exploration in northern Alaska, such as the National Petroleum Reserve.
- Tax incentives to encourage exploration and development.
- Encourage the development of fuel cell technology for motor vehicles through possible tax incentives associated with the purchase of vehicles using the technology.

2) PIPELINES AND REFINERIES

- Improving regulatory processes governing approval of interstate natural gas pipelines to allow for the creation new developments in pipeline projects.
- Improve refining capacity and flexibility of the fuel distribution infrastructure in the United States.

3) ELECTRICITY

- To eliminate transmission bottlenecks by establishing a "national grid" for electricity, rather than keeping the existing three grids that only provide limited power.
- Revitalize nuclear and coal burning power in the United States.
- Encourage research in clean coal technology.

REACTION TO THE BUSH PLAN

The overall reaction to the Bush initiative to increase domestic energy supplies has been favourable:

- On August 2, 2001, the U.S. House of Representatives passed an energy bill that would make way for increased development and drilling in the Arctic National Wildlife Refuge while maintaining a balance with conservation objectives.
- The legislation introduced a package of tax breaks and incentives totalling US $33.5 billion over 10 years, mostly earmarked to help stimulate investment in energy development.
- It is also hoped that increasing natural gas supplies and thereby lower natural gas prices, electricity prices will be reduced, particularly for natural-gas-fired cogeneration.

Unlike the initiative to increase energy supplies, the Alaska pipeline initiative has met a mixed reaction from governments, producers and stakeholders. There are two main issues to be resolved:

1. **Pipeline route:** The Yukon and Northwest Territories have been lobbying for a route that would see the gas move from Alaska under the Beaufort Sea to Canada's Mackenzie Delta. However, the government of Alaska has recently passed a law that would force any pipeline taking natural gas from Prudhoe Bay reserves to run through the state following the Alaska Highway. In addition, demands by key aboriginal groups, such as the Deh Cho first Nations, may also hinder development of the pipeline through the Mackenzie Delta.

2. **Development costs:** Preliminary estimates for the pipeline show an estimated cost of US$15 to $20 billion. Regardless of the route chosen, this is uneconomical in the eyes of oil and natural gas producers under current natural gas prices, which have plummeted to US$2 per thousand cubic feet in recent weeks from a high of US$10 last winter, and regardless of the route chosen.

POTENTIAL IMPLICATIONS OF BUSH'S ENERGY PLAN FOR ALBERTA

Most of the initiatives outlined in the Bush energy plan are long run in nature, designed to alleviate the rate at which energy supplies are diminishing in the United States. However, recent declines in energy prices may have reduced the urgency in proceeding with some of the plans outlined within the plan, such as the construction of the Alaska pipeline. On the other hand, the September 11 terrorist attacks in the United States may have redirected the focus of the Bush plan to security of supply issue, and as a result, could focus on projects to increase energy supplies, such as drilling projects in Alaska.

While the Bush energy plan still faces many political hurdles – both from Congress and state governments – it would have the following effects for Alberta:

Short Run:

- Given the declining projections of crude oil supplies in the United States, Alberta's share of the United States petroleum markets should continue to grow over the next 5 to 10 years. This entails increased investment opportunity in oil-sands-related projects in Alberta.
- The construction and manufacturing sectors of the economy would also benefit from increased activity as accompanies should have the opportunity to bid for new contracts across North America, particularly Canadian steel pipe and power transmission equipment manufacturers.

Long Run:

- The long-run effect of adding pipeline capacity from Alaska on natural gas producers in Alberta is ambiguous. Introducing increased pipeline capacity from Alaska could increase competition for natural gas producers in Alberta, thereby reducing prices.
- Increased use of nuclear power and coal may reduce the demand for natural gas in the long run.