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STATEMENT OF
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ENERGY AND MINERALS DIVISION
BEFORE THE
HOUSE SUBCOMMITTEE ON
OVERSIGHT AND INVESTIGATIONS
COMMITTEE ON INTERIOR AND INSULAR AFFAIRS

Mr. Chairman:

We appreciate your invitation to discuss costs for the Alaska Highway Gas Pipeline Project. But first, some background information on the Project itself may be helpful.

As you know, the Alaskan Natural Gas Transportation Act of 1976 was passed to expedite Federal actions, making possible a pipeline system to deliver North Slope Alaskan natural gas to U.S. markets. The President, in September 1977, recommended the Alaska Highway Gas Pipeline Project--a 4,800-mile overland pipeline system--over two alternative proposals with a start-up date anticipated by January 1983. The President's decision was heavily influenced by the Project sponsors' assurance that the pipeline could be privately financed. Federal financial assistance was "explicitly rejected" by the President.

The Congress approved this decision in November 1977 and--as part of its consideration of the President's National Energy Plan--later passed favorable gas pricing legislation

through the Natural Gas Policy Act of 1978. This Act, which allows the cost of Alaskan gas to be averaged with cheaper gas supplies, was viewed as a key factor in assuring the Project's viability.

The Project is currently scheduled to come on line about 2 years later than anticipated in 1977--late 1984 instead of early 1983. In our opinion, further delays are possible as complex issues--such as the securing of right-of-way agreements and deciding how to treat gas conditioning costs--still need to be worked out. Such delays of course affect costs. I think it might be appropriate in this regard to remember what happened with the costs of the Trans-Alaska Oil Pipeline Project.

In our June 1978 report, "Lessons Learned From Constructing the Trans-Alaska Oil Pipeline" (EMD-78-52, dated June 15, 1978), we noted how cost estimates rose as system design and engineering became better defined. The lesson to be learned is that realistic cost estimates are usually available only after detailed engineering design. For example, in 1968, using a feasibility study as the basis, the oil line's estimated cost was about $1 billion. By May 1974, at the start of preconstruction, the cost was about $4 billion. As of April 1977, shortly after permanent pipeline construction started, the cost was over $6 billion. After 6 months of operation, the estimated cost was about $8 billion.

Similarly, the gas line's estimated cost seems to be increasing as more is known. In March 1977, the sponsors estimated that the line would cost about $6.6 billion in 1975 dollars--which means that is how much it would have cost if started and completed in 1975. That same estimate in escalated dollars--i.e., basing the estimate on costs anticipated in the year construction was actually to take place and thus the expenditure incurred--amounted to $9.6 billion. In September 1977, the President used a $10 to $13 billion estimated cost figure. Currently, the sponsors are talking about a $15 billion cost for the Project, although no official revised cost estimate has been made public--nor is one expected before next Spring.

In preparing for this hearing, you requested our Office to provide a "ballpark estimate" of the Project's cost adjusted to 1979 dollars, applying appropriate indices to the sponsors' original cost estimates and assuming no change in the Project's scope or other factors. We have done this and now have found that the $6.6 billion estimate in 1975 dollars is equivalent to about $10.2 billion in 1979 dollars as of January 1, 1979. That is the date of the latest indices. The cost as of October 1979 would be higher, particularly in view of the recent inflationary spiral. It should also be noted that the $10.2 billion estimate in 1979 dollars already exceeds the sponsors'

March 1977 $9.6 billion estimate in escalated dollars for a project anticipated, at that time, to be completed by January 1983.

Let me explain the methodology we used in arriving at the $10.2 billion figure. We adjusted the sponsors' earlier figures by applying an index of construction costs to each of the four main segments of the pipeline. In addition, because the Alaskan sponsors notified the Federal Energy Regulatory Commission that their costs will already be at least 30 percent higher than originally estimated, for other than inflationary reasons, we increased the cost of the Alaskan segment by 30 percent before adjusting it. The results came out as follows:

	1979 dollars	1975 dollars
Alaska	$ 4.4 billion	$ 2.4 billion
Canada	3.6 billion	2.6 billion
Western Leg	.7 billion	.5 billion
Eastern Leg	1.5 billion	1.1 billion
	$10.2 billion	$ 6.6 billion

You may wonder about the seemingly large disparity between our $10.2 billion figure and the sponsors' $15 billion figure. Remember, ours is based on 1979 dollars--not escalated dollars--and is comparable to the $6.6 billion in 1975 dollars.

While no official revised cost estimate is available, such an estimate is very important in lining up financial backing and also since it will be used as the starting point in determining the approved rate of return on investment for the sponsors. As you may know, the Federal Energy Regulatory Commission, on September 6, approved an incentive rate of return based on how well the Project meets its estimated cost. The Commission's order makes clear that the sponsors may elect to revise their cost estimate for the Alaskan segment as a basis for determining their rate of return. We understand that the sponsors do plan to use a revised estimate on the basis that design conditions have changed significantly since 1977.

Thus it is difficult to speculate on what the revised cost estimate will be.

The slippage in bringing the Project on line, the already announced cost growth, and the potential for higher costs as engineering estimates are completed highlight the difficulty of putting together a complete financial package for this Project and thus the possibility of renewed discussions about Federal financial assistance. Therefore, I want to briefly discuss our report, "Issues Relating to the Proposed Alaska Highway Gas Pipeline Project," that we are issuing to the Congress and request that the full report be made part of the record.

As I stated earlier, when the President and the Congress approved construction of the Alaska Highway Gas Pipeline Project in 1977, they specified that the Project should be privately financed and Federal financing assistance was "explicitly rejected."

However, in January of this year, in response to a question from the Joint Economic Committee, the Secretary of Energy discussed the possibility of $2 to $3 billion in Federal loan guarantees for the Alaskan segment of the Project. Loan guarantees to support energy and other costly projects have become popular because their supporters argue that the program is costless in the absence of a default. If the borrower repays the loan, the budgetary impact would be limited to administrative expenses. In case of default, however, the liability to the Government becomes substantial.

There are other potential avenues for financial backing--short of Federal financial involvement--that are still under consideration. These include participation by various beneficiaries of the Project such as the State of Alaska, the gas producers, and purchasers of the gas. In any event, this Project offers a potentially significant future domestic gas supply. Thus, if Federal financing assistance is requested, Project proponents undoubtedly will urge the Congress to quickly provide the needed assistance.

Currently it is premature to consider Federal financial involvement since (a) it is not known that help will be needed and (b) some important issues have not been resolved. In addition, without specific legislation, the Department of Energy lacks authority to make loan guarantees to the Project.

Although Federal financial assistance has not been requested, we believe that getting prepared for a prompt, informed decision--should such assistance be requested--is essential.

If the sponsors should demonstrate the need for Federal financial assistance after all regulatory procedures are completed, the Congress should evaluate alternatives to Project gas before it considers granting financial aid to the Project. Possible alternatives to be evaluated include

--conservation steps,

--unconventional domestic resources,

--intensified drilling in the lower 48-States,

--liquefied natural gas, and

--Mexican and Canadian gas.

However, if the Congress decides to grant financial aid it should (1) evaluate all feasible alternatives to Federal financial involvement (not just loan guarantees) and (2) ensure that the public interest is served and that the

Government has an appropriate control over and return on its investment.

In our view, the Secretary of Energy is the appropriate person to provide information and analyses to the Congress should a decision be needed on Federal financial assistance for the Alaskan gas pipeline. In that light, we make two recommendations to the Secretary of Energy in our report.

First, the Secretary of Energy should, within 60 days, provide the Congress an analysis showing how this Project now fits in with the overall national energy plan and strategy to satisfy the Nation's future energy needs.

In addition, if the sponsors officially state that the Project cannot be privately financed or Federal financing assistance is requested, the Secretary of Energy should provide the Congress, within 90 days of that occurrence, his recommendation on the matter of Federal financial involvement.

The Secretary, in support of his recommendation, should provide a detailed analysis of the Project and alternatives which could secure or conserve a similar or greater amount of gas or equivalent amount of energy. The analysis should

--demonstrate why his recommendation is the best course of action, and

--compare the benefits that each source could provide if it received the same amount and

type of Federal financial assistance or an amount approximating that requested for the pipeline.

Using this information, Congress would be in a better position to make an informed decision on how best to invest Government funds to meet national energy needs.

In closing, I emphasize that our comments should not be construed as taking a GAO position either for or against the Project or on what the congressional decision should be on the issue of Federal financial involvement if it occurs. Our prime concern is that the Government should be in a position to make an informed decision on what to do if Federal assistance is proposed.

This concludes my statement, Mr. Chairman. I will be happy to answer any questions.