

COMPASS NORTH

LEASE RETURN TO COMMONWEALTH NORTH

Five Challenges For Alaska

COMPASS NORTH Five Challenges For Alaska

AN ACTION REPORT
BY
COMMONWEALTH NORTH

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COMPASS NORTH: What next for Alaska?

COMPASS NORTH was started in Alaska's Silver Anniversary year, its 25th year of Statehood. It was initiated by Commonwealth North's Board of Directors as a means of bringing together knowledgeable Alaskans to review the past and to set a direction for the future.

The starting point, the "Compass", is Alaska's Constitution - a Constitution designed under the leadership of Commonwealth North's founding co-chairman, Governor William A. Egan. Governor Bill didn't live to see the conclusion of COMPASS NORTH, but he did set the criteria for selecting participants: "people who know about Alaska and care about it".

This describes the 77 Commonwealth North participated in this year-long study: men and women representing a wide spectrum of constituencies and philosophies, whose vision, hard work, and risk taking have contributed to They include two today. of Alaska's Alaska of governors; members of the Constitutional Convention; leaders of the Statehood movement; past and present legislators; activists in the Alaska Native Claims Settlement Act and the Alaska National Interest Conservation Act; builders organizations, hospitals, businesses, civic schools.

The charge to each of the five Challenge committees was to strive for consensus on issues of such importance to Alaska that they will be resolved, by decision or default, within the next few years - and the resolution will affect the future direction of the state.

As these Alaskans worked together, a sense of urgency began to develop, a sense of the enormous opportunities in the coming years and a sense of the enormous dangers to our system if wrong decisions are made.

COMPASS NORTH sets out a new direction for the future, a new way of thinking based on the hope that Alaska will continue to be a frontier of opportunity for every individual.

COMPASS NORTH: Setting a direction for the future

Alaska is "unique" in so many ways that Alaskans take the word for granted. In this state "unique" is a cliche; unique in size, unique in beauty, unique in resources.

What is only beginning to be understood is that Alaska is also unique in its economic structure. It is this uniqueness that will decide its future.

Alaska is an "owner state". It owns 28% of its land base, which includes the largest discovered oil field in North America. The revenues from this field give the state government control over the largest pool of capital in the economy.

Land and capital are ingredients of ownership. They are the basis of power. The State of Alaska, as the owner of more than 100 million acres of land and billions of dollars in resource wealth, has power.

In a democratic society, all governments have obligations to the people. In Alaska the government has an obligation of ownership that is above and beyond that of a traditional state government. It has an obligation as an owner to help sustain the economy - to use its land and capital to preserve and enhance the private enterprise system.

This is a new frontier in public obligation. Never before has a state government been so wealthy in relation to its citizens. Never before has a state government controlled so much of its land and capital assets.

This new frontier means Alaskans must pioneer a new concept of state government, a government that uses its power in partnership with the private sector to create new opportunity and new wealth.

Alaska's obligation of ownership is more than an interesting hypothesis: the state is on a time line. Every available public and private forecast depicts a rapid decline in Prudhoe Bay oil revenues in the 1990's. The state's economy is almost totally dependent on these revenues.

If Alaska is not a responsible owner, if the state government does not stop dissipating its capital base on current operations, the result may be similar to that of a failed company: unemployment, bankruptcy, and social hardship.

There will be many Alaskans who do not believe the state has any obligations as an owner. They will believe that all state revenues should be treated alike and "spent" on public services. They will believe that all state land should be preserved from further development.

The irony and tragedy for Alaska, should this thinking prevail, is that without a strong, growing economy, the government will not be able to provide public services or protect the environment. The private sector will not be able to generate jobs and income.

What must be done to meet the obligations of ownership?

Alaskans and our leaders must begin to think like owners - to make our ownership work for us.

Alaskans must begin to think about revenue as owners:

Traditional government leaders ask: How much do we have to spend?

Leaders of Alaska as an owner state must ask: What is our income? What are our assets? Can we sustain the current level of spending into the future? Where should we invest to get the greatest return on our money?

• THE STATE'S OWNERSHIP REVENUES ARE CAPITAL ASSETS THAT MUST BE MANAGED TO CREATE NEW WEALTH.

As an owner the state receives revenues that are separate from taxes. These are royalties, rentals, and bonuses from the lease and sale of its resources. This capital should be treated as a powerful renewable resource, a means of creating new wealth.

EXECUTIVE SUMMARY

But right now only 25% of these ownership revenues must be invested in the Permanent Fund. The rest are being spent on the current operation of government. The state must stop dissipating this capital base.

 ALASKA'S OWNERSHIP REVENUES SHOULD BE DIVIDED EQUALLY BETWEEN THE PERMANENT FUND AND A NEW CAPITAL INVESTMENT FUND.

It is likely that the Permanent Fund will be a "safety net", a means of sustaining government service as Prudhoe Bay revenues decline. The Capital Investment Fund would be the means of encouraging new development. It could finance revenue producing, regionally important projects that add to the long term economic health of the state.

- THE FUTURE OF THE PERMANENT FUND IS TOO IMPORTANT AN ASSET TO BE LEFT TO "DECISION BY DEFAULT". THE LEGISLATURE SHOULD ENACT LEGISLATION WHICH ESTABLISHES LONG TERM GOALS FOR THE FUND.
- TO ENSURE A "SOFT LANDING" FROM THE DECLINE OF PRUDHOE BAY REVENUES, CURRENT SPENDING MUST BE REDUCED TO LEVELS THAT CAN BE SUSTAINED IN THE FUTURE.
- MISUSE OF WEALTH IS A GREAT DANGER IN AN OWNER STATE.

 THE STATE GOVERNMENT MUST REFRAIN FROM USING ITS WEALTH
 TO USURP LOCAL DECISIONS OR DISPLACE LOCAL RESPONSIBILITY.

The legislature has taken over the role of local government by direct appropriation and other political distribution practices that bypass or dictate to local communities.

Revenue sharing must follow the Constitutional mandate of "maximum local self government".

State revenue sharing should be accomplished through a single formula based on equitable distribution. Except for emergencies, no funds should be allocated outside such formula. The emphasis must be on local decision making and local responsibility.

Alaskans must begin to think about land as owners:

Traditional government leaders ask: Are we doing a balanced job regulating between private land owners?

Leaders of an owner state must ask: What are our resource assets worth? Is there enough development underway to maintain our economy and continue growth? Are we helping the private sector promote responsible development?

• ALASKA'S STATEHOOD LANDS AND RESOURCES SHOULD BE MANAGED AS CAPITAL ASSETS. PUBLIC POLICY MUST BE REFOCUSED, AS A MATTER OF HIGHEST PRIORITY, TO REFLECT THE STATE'S DEPENDENCE ON NATURAL RESOURCE DEVELOPMENT.

Resource development is Alaska's only option for a continued economic base.

The plain fact is, if there is no further natural resource development, the state will be bankrupt.

Public leadership must distinguish between ritualistic environmentalism and areas of true ecological concern. After years of government decisions weighted in favor of "no development" today's leadership must redirect public policy toward action consistent with the mandate of Alaska's Constitution: "to encourage the settlement of its land and the development of its resources by making them available for maximum use consistent with the public interest."

- THE LEGISLATURE, AS CUSTODIAN FOR STATE LANDS, SHOULD DEVELOP A COMPREHENSIVE POLICY THAT RECOGNIZES THE STATE'S RELIANCE ON RESOURCE DEVELOPMENT AND DIRECTS MANAGEMENT OF THESE RESOURCES AS CAPITAL ASSETS.
- THE GOVERNOR SHOULD FORGE THE RESOURCE DEVELOPMENT STRATEGY NECESSARY TO ENACT LEGISLATIVE POLICY.

The leadership must work together to meld Alaska's need for development with concern for the environment by formulating an overall state resource development strategy. The

EXECUTIVE SUMMARY

emphasis should be on technically sound, efficient permitting; stable tax policies; and balanced multiple use management by state agencies.

• THE OBLIGATION OF OWNERSHIP INCLUDES ENCOURAGING NEW REVENUE SOURCES. THE STATE SHOULD DETERMINE ITS ROLE AS AN INVESTOR IN THE DEVELOPMENT OF ALASKA'S RESOURCES.

It can be good public policy to invest state funds in resource development projects, but the state must decide the limits and goals of its investment role. At a minimum, project investment should be economically feasible and be able to return to the state a cash flow having a present value greater than the state's investment.

To meet these obligations of ownership Alaska's elected leaders must use the full power of their Constitutional authority and responsibility.

Public policy will decide the future of the owner state, and it is Alaska's elected leaders who decide public policy. Alaska needs decisive leadership now, leadership that understands the obligations of ownership and has the courage to make the politically hard decisions necessary to meet that obligation.

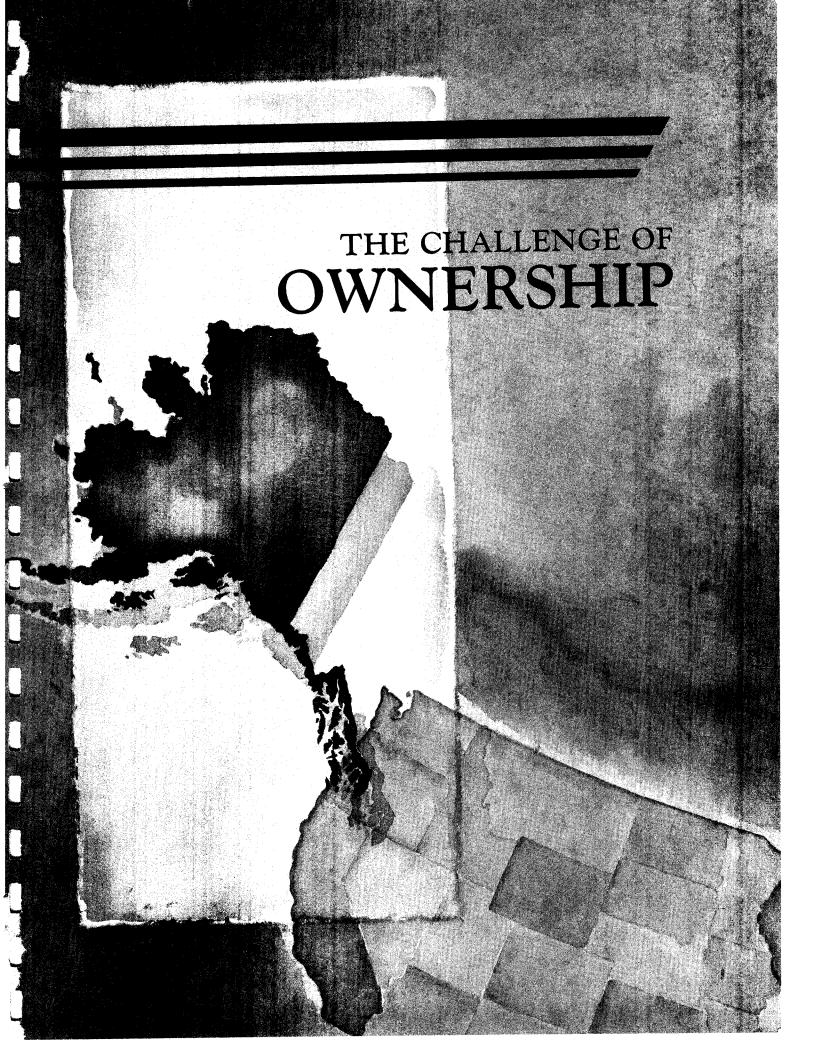
No other state constitution grants more authority to the governor than does Alaska's. No other state constitution implies more public trust in its legislative representatives than does Alaska's.

It is these elected leaders who must meet the obligation of ownership by preserving Alaska's capital assets.

It is these elected leaders who must meet the obligation of ownership by advocating responsible resource development.

If our leadership fails in this pioneering effort we could well end up with socialism - a government that uses its land and capital to feed its own growth.

The challenge for Alaskans is to develop economic and social strategies that use public ownership as a catalyst to develop a strong free enterprise system.



COMPASS NORTH

THE CHALLENGE OF OWNERSHIP COMMITTEE

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FRED CHIEI U.S. Department of Energy Alaska Regional Director

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THE CHALLENGE OF OWNERSHIP

A new perspective on Alaska's unique role as an "owner" of resources and capital from those resources.

Congress broke tradition when it granted Alaska the right to select 103 million acres of land at statehood: Alaska became one-of-a-kind - an "owner state".

Are we making it work for us? Or are we getting buried in government? What are the opportunities for the future? What are the dangers?

What are the obligations of ownership?

CONCLUSIONS & RECOMMENDATIONS

The following are the principal conclusions and recommendations of the Challenge of Ownership Committee.

- 1. Alaska is an "owner state" a state that holds title to 28% of its land base, and the largest pool of capital in the economy. The combination gives the government tremendous power "to decide". The decision can be for a vital free enterprise economy or for an economy totally dominated by centralized govvernment.
- 2. As an owner, the state receives ownership revenues which are separate from taxes. These are royalties, rentals, and bonuses from the sale of its resources. These ownership revenues should be managed as capital assets, as a means of promoting a strong, private economy and creating new wealth, not as a means to build bigger government.
- 3. The state is now spending most of its ownership revenues as if it were tax income. It must discontinue dissipating these revenues and manage them as true capital assets.

RECOMMENDATION: The best means of creating new wealth and promoting a strong, private economy is to invest Alaska's ownership revenues equally in a Capital Investment Fund and the Permanent Fund. The Constitution must be amended to establish a Capital Investment Fund for projects that can generate new economic activity.

4. Alaska's basic assets are its statehood land and resources. The government is not managing these legacies as capital assets. While the economy depends on development, management practices oppose it. The state is in the schizophrenic position of regulating against itself.

RECOMMENDATION: The governor must be the principal advocate for development, since his leadership sets the agenda for the state.

RECOMMENDATION: The legislature, as custodian for state lands, must develop a comprehensive policy that recognizes the state's reliance on resource development and directs the management of these resources as capital assets.

5. Alaskans need to know how the state is managing its statehood legacy of land and resources. What are Alaska's resource assets worth? What kinds of development are taking place?

RECOMMENDATION: The state must account for its management of Alaska's statehood land and resources in an annual "stockholders" report that is sent to each voter. This report should include critiques of state management by private groups.

OWNERSHIP: CORNERSTONE OF PUBLIC POLICY ISSUES

Alaska is an "owner state."

A state that owns 28% of its land base.

A state that owns the largest discovered oil field in North America and, from the revenues, both supports itself and "drives" the economy.

It is this ownership status with its contradictions, dangers, and opportunities, that is the cornerstone of the major public policy issues facing the state today.

Congress established Alaska as an owner when it authorized the state to select 103 million acres of land under the Statehood Act. The purpose: to provide the new state with a solid economic foundation.

Today, after 25 years of statehood, state-owned resources and state-owned revenues dominate the economy:

- over half of personal income can be traced to state government spending;
- over 85% of state revenues are from the development of stateowned resources;
- local governments depend on state revenues for up to 75% of their funding;
- state loans and state investments dominate the commercial market;



An adage cautions: "He who owns decides".

In Alaska, to a significant degree, it is the state government that decides:

- decides which of its millions of acres of state land will be developed, which sold, when, and at what price;
- decides how to spend its billions of dollars of state resource revenues, for what purpose, and on what terms.

It is this potential to decide that makes many Alaskans wary: they don't believe it is appropriate for a state to "own" land. They are concerned that the people will lose control of a state government that can support itself without public taxes.

The concerns are valid. But Alaska's ownership of land and the revenues from the development of that land will not "go away" just because it doesn't sound right for a government to own or to be wealthy.

The question is whether Alaska, its leaders and its people, can come to grips with the fact of ownership and what it could mean for the state.

Can we make it work for us?

"He who owns, decides."

Ownership won't "go away" just because it doesn't sound right.

WHAT CAN OWNERSHIP MEAN FOR THE STATE?

In 1979, when oil prices soared and full implications of what it meant for a state to own a supergiant oil field began to hit home, economists from around the country were invited to advise Alaskans on how best to manage this new wealth.

"Burn it, before it destroys your system," was one famous comment.

Others pointed out that as long as the state was bound to land ownership, it would always run the risk of centralized government.

Most Alaskans are well aware of the dangers: Alaska could become "welfare" state. The leadership could make the easy decision, time that government can after time, do/be/solve/pay for everything. All economic planning and control could, by default, become vested in government. All "roads" could end up leading to Juneau.

But the benefits are equally obvious: a frontier state with great needs and great potential with the "gift" of enough capital to make things happen.

It is an unprecedented opportunity to build a new tradition, a new type of careful, "limited partnership" between the public and private sectors - a partnership directed toward a strong, free

Can we make it work for us?

enterprise economy.

It comes down to understanding that there is an essential difference between using the benefits of ownership to build bigger

All "roads" could end up leading to Juneau.

government and using the benefits of ownership to shape a vital private economy.

It comes down to deciding whether Alaska will be a government of the people - or a people who live off the government.

This is the compelling challenge of ownership: to develop economic and social strategies that use public ownership as a catalyst to develop a strong, free enterprise society.

To meet this challenge will require an extra edge of public vigilance; a public monitoring to ensure that all the individual "right" decisions-of-the-moment, don't add up to a level of control that will overburden a free society.

To meet this challenge will require some new ways of thinking about public land and public revenue.

The challenge means new ways of thinking about public land and public revenue.

I. MANAGING OWNERSHIP REVENUES AS CAPITAL

Right now, we are liquidating the assets of the state.

Ownership will work for Alaska if the state leadership combines good business sense with good government.

It is good business sense to preserve your capital base - to put capital to work generating new sources of revenue and new opportunity.

Alaska's statehood lands and resources are its basic assets.

While, as a government the state collects taxes from the developers of these resources, as an owner it collects a separate source of revenue - royalties, rentals, and bonuses.

These "ownership revenues" are the state's capital base.

Right now, only 25% of Alaska's ownership revenues must be invested, (in the Permanent Fund) the rest are being consumed by the state's operating and capital budget.

Right now, Alaskans are not thinking like owners. We are dissipating our capital base to buy more government.

We are liquidating the assets of the state.

If ownership is to work for Alaska, the state must manage both its statehood lands and its ownership revenues as capital assets - assets to be developed and reinvested to sustain the economy into the future.

The state has a \$6 billion savings portfolio today because in 1976 Alaskans did think like owners.

They said "no" to spending all of the state's assets on government, and the Permanent Fund was formed.

If the state's economy is to survive the projected decline of Prudhoe Bay production and revenues, Alaskans must think like owners again.

The Permanent Fund amendment protects 25% of the state's ownership revenues. Twenty-five percent is not enough.

The principle must be that, for as long as it is possible, the state will invest its ownership revenues to create the new wealth that will be so necessary to the future and it will operate government from its tax revenues.

Alaska's ownership policy must be a commitment to manage all of the state's ownership revenues as assets. An additional 25% of these revenues should be directed to the Permanent Fund, and the remaining 50% dedicated, by Constitutional amendment, to a Capital Investment Fund.

The Permanent Fund establishes the savings side of Alaska's portfolio. The Capital Investment Fund, first proposed by Commonwealth North three years ago, would establish the investment side.

If the economy is to survive, Alaskans must think like owners again.

It is good business, as well as good government, to look ahead - and in looking ahead, Alaska is going to need both a Permanent Fund and a Capital Investment Fund.

While the purpose of the Permanent Fund is still to be decided (see The Challenge of Wealth Manage-ment), it is most often referred to as a "rainy day account". It is considered likely that this fund will help sustain government spending as Prudhoe Bay revenues decline.

The Capital Investment Fund concept has a very specific purpose. It is intended to promote the new development the state will depend upon for future new revenue.

The Fund is to be invested in projects that are necessary for development: ports, energy, transportation systems. It would invest in projects that are both self-amortizing and self-sustaining.

The commitment to direct all of Alaska's ownership revenues to the Permanent Fund and a Capital Investment Fund is central to the question of whether state ownership will be a catalyst for a strong private economy, or a dead end.

The governor and the legislative leadership must work together to propose amending Alaska's Constitution to dedicate 50% of the states ownership revenues to a Capital Investment Fund.

The governor and the legislature must support a Capital Investment Fund.

THE CAPITAL INVESTMENT FUND

The Capital Investment Fund would use part of Alaska's ownership revenues to invest in projects that are necessary for development: ports, energy, transportation systems; projects that add to the long-term economic health of the state.

WHAT KIND OF PROJECTS WILL BE ELIGIBLE?

The larger, regionally important projects that generate economic development and meet basic investment criteria:

- the capability of returning the principal to the Fund;
- the capability of generating sufficient revenue to cover operations and maintenance.

HOW WILL THE FUND BE ESTABLISHED?

By Constitutional amendment. This amendment will require a two-thirds vote of the House and the Senate before it is placed on the ballot for a public vote in 1986.

WHO WILL DECIDE WHETHER OR NOT A PROJECT IS FUNDED?

The Fund will be managed by a Board of Trustees charged with determining which projects meet market criteria, and with making recommendations to the legislature. The legislature makes the final decision.

WHY DOES ALASKA NEED A CAPITAL INVESTMENT FUND?

To provide a source of seed capital to finance Alaska's economic infrastructure; and, as importantly, to provide a mechanism for addressing basic major project needs in a controlled, coordinated fashion.

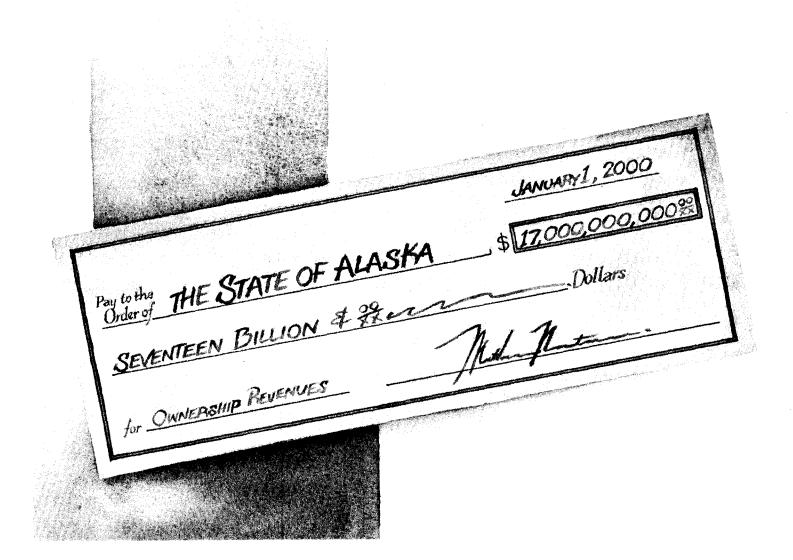
ALASKA CAN AFFORD A CAPITAL INVESTMENT FUND

Can Alaska afford to invest all its capital assets in the Capital Investment Fund and the Permanent Fund?

It can't afford not to.

The state's economy is based almost entirely on oil revenues and taxes from Prudhoe Bay. Every production forecast shows this field will begin a rapid decline in the 1990's. The state must prepare for the projected drastic drop in revenues.

Alaska doesn't have a crisis yet; it has an opportunity.



It has the time and capital to give itself the means for a new start. Capital is a tremendous renewable resource.

Between 1986 and 2000, Alaska's projected ownership revenues will total over \$17 billion dollars. Nearly \$5 billion will go to the Permanent Fund, the rest will go, year by year, to expand the state budget.

When Prudhoe Bay oil is gone, what will Alaska have?

- a level of government spending the state cannot sustain;
- new entitlements the state cannot continue to support;
- debt and operating costs from capital improvements the state cannot maintain.

If this \$17 billion is invested equally between the Permanent Fund and the Capital Investment Fund, the results will be dramatically different. Table I shows the value to the state if both are fully funded.

By the year 2000, the projected balance in the Permanent Fund, at a conservative 4% real rate of return, will be \$23 billion!

What about the Capital Investment Fund?

By the year 2000, the projected balance for the Capital Investment Fund, at a conservative 3% real rate of return, will be \$11 billion!

Alaska can invest \$17 billion, or spend it on government.

The Capital Investment Fund is the best means to create new wealth. When the Prudhoe Bay oil is gone, what will Alaska have?

- two tremendous long-term revenue pools that can be used to maintain quality public services and programs;
- capital investment projects constructed or underway that will provide the opportunity for new wealth generation;
- sustainable operating and capital spending levels because the state had adapted its budget to tax revenues years before.

Alaska can't afford not to manage all of its ownership revenues as capital assets.

The Capital Investment Fund is the best means Alaska has to take its wealth from the non-renewable oil resource of Prudhoe Bay and create new wealth. It is the best way to trade one asset for another at better than equal value.

TABLE I
Value to the State if Resource Revenues Are Divided Between
the Permanent Fund and the Capital Investment Fund

			PERMANENT FUND		CAPITA	L INVESTMENT	FUND
FISCAL YEAR	GEN. FUND REVENUE	50% CONTR. OWNERSHIP REVENUE	FUND BALANCE	EARNINGS @ 4%	50% CONTR. OWNERSHIP REVENUE	FUND BALANCE	EARNINGS @ 3%
	(millions)	(millions)	(millions)	(millions)	(millions)	(millions)	(millions)
1986	2307	695	6350	254	695	0	0
1987	2388	725	7299	292	725	695	21
1988	2218	740	8316	333	740	1441	43
1989	2199	770	9389	376	770	2224	67
1990	2080	725	10534	421	725	3061	92
1991	1937	690	11681	467	690	3878	116
1992	1885	655	12838	514	655	4684	141
1993	1811	620	14006	560	620	5479	164
1994	1643	560	15186	607	560	6264	188
1995	1538	520	16354	654	520	7012	210
1996	1429	490	17528	701	490	7742	232
1997	1322	435	18719	749	435	8464	254
1998	1239	400	19903	796	400	9153	275
1999	1112	355	21099	844	355	9829	295
2000	1039	320	22298	892	320	10478	314
2001			23510			11112	

Table assumes that 100% of Ownership Revenues (i.e. royalities, bonuses, lease fees) will be divided equally between the Permanent Fund and the Capital Investment Fund. (1985 millions of dollars.)

Left hand column reflects all other expected revenues that would flow to the General Fund.

There is a conservative assumption of a 4% real rate of return from the Permanent Fund and 3% from the Capital Investment Fund; both show the earnings reinvested in the respective funds.

These projections are taken from State Government Forecast and are predicated primarily on proven and probable reserves of oil in the vicinity of Prudhoe Bay.

There is no assumption of new discoveries; and no value allocated to the production and marketing of North Slope gas, or for positive impacts in the economy from the Capital Fund investments.

PREPARING FOR THE FUTURE IS A 'CRITICAL NEED'

By streamlining the budget, Alaska can have quality services and investments. The idea of a Capital Investment Fund, of using capital as a renewable resource, has had strong public support.

However, some legislators have taken the position that the state must spend its capital assets on current budgets "to meet critical basic needs".

The implication is that there is no "fat" in the current state budgets; that all the budget revenues, including the state's capital assets, are being spent only on essential projects and programs.

This argument has little credibility. Between FY 1979 and FY 1981, the state's budget grew from \$1.4 billion to about \$4 billion. At least two of these budgets were passed in the midst of public objection to the political chaos of the spending process.

The state does have critical basic needs, many of which are not being met because of the lack of prioritization in the budget process now.

By concentrating on true programs and facility needs, by returning to the pre-Prudhoe Bay budgeting practices of public debate and public determination of statewide needs, the state can maintain a high quality of public service and invest its ownership revenues in the Permanent Fund and Capital Investment Fund.

Alaska's most critical, basic need right now is to prepare for its future.

II. MANAGING STATEHOOD LANDS AS CAPITAL ASSETS

Alaska's statehood lands and resources are its basic assets.

The economic health of both the public and private sectors rests almost entirely upon the development of these resources by the private sector.

However, while the economy of the state is dependent upon resource development, the management practices of the state are designed to inhibit development. The state is in the schizophrenic position of regulating against itself.

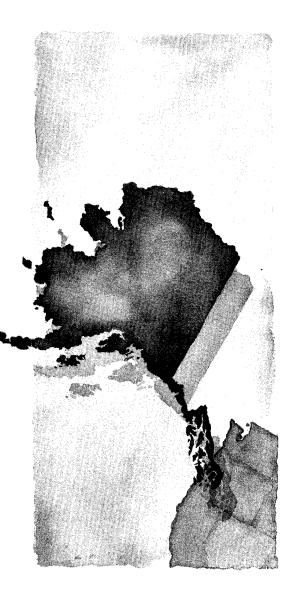
What business are we really in?

Congress granted Alaska the unprecedented right to select the largest grant of federal land ever made for the purpose of providing the new state with the resources to be self-supporting.

Alaska is in the business of resource development.

The purpose is spelled out in Alaska's Constitution: the state's "owner's manual".

What business are we really in?



What happened between statehood and today?

The State of Alaska must re-read its "owner's manual".

"It is the policy of the State to encourage the settlement of its land and the development of its resources by making them available for maximum use consistent with the public interest."

Article VIII, Section 1

What happened between statehood and today?

Why is it that resource developers say it is as difficult, if not more so, to "do business" on state lands as it is on federal lands?

Why do so many state resource managers adopt practices that plainly imply that the choice is between development and the environment, rather than adopting practices that maximize both?

Why is the entire state process of resource development geared to confrontation rather than cooperation?

Slowly, over the years statehood, Alaska has stopped viewing its lands and resources as capital to be assets - assets managed the for continuing prosperity of its citizens.

If the state is to continue to prosper, if it is to encourage the development of new sources of wealth in the lead time before Prudhoe Bay oil production declines, it must re-think its management policies.

The State of Alaska must re-read its "owners manual".

THE STATE'S OBLIGATION: RESPONSIBLE DEVELOPMENT

The writers' of Alaska's Constitution did not believe development and conservation to be mutually exclusive; to the contrary, they believed them to be compatible.

The mandate is for responsible development. This is the obligation of ownership.

There is a distinct difference in obligation when a state's economy is dependent upon resource development and the state owns a large percentage of the land.

In all other states the land ownership patterns between public and private are relatively balanced so that development of public land is not the main option for economic stability. This is not true for Alaska. For the foreseeable future, public resources are the "sole source".

In Alaska it is the responsibility of the state, as an owner, to adopt an active role in encouraging the development of its resources by the private sector in order to sustain its own economy.

Alaska's land base: 28% state ownership, 60% federal, 12% native corporations, 1% other private individuals and municipalities.

NEEDED: A NEW START FOR RESOURCE DEVELOPMENT

establish the policies directing the utilization and development of the state's resources.

It is the legislature that must

It is the governor who must be the principal advocate for development, for under Alaska's Constitution, he is responsible for meeting the obligations of ownership.

The advocacy of the leadership decides the questions of development in Alaska, for the management structure is weighted more toward regulation than to ownership.

While, in theory, there should not be a fundamental difference in objective between the developer of resources and the regulator of resources, in practice, there has been an attitude of confrontation rather than cooperation.

The Department of Natural Resources is a "balancer" of interests, which often places it in a confrontation role. The Department of Environmental Conservation and the Department of Fish and Game take positions of confrontation.

There is no department with land management authority responsible for articulating the state's role as owner.

The result is that the private lessee, in effect, represents the interests of the state when "doing battle" with state agencies over the right to develop state resources.

The governor must be the principal advocate of development.

The mediation route is political, either "lobbying" through the many agencies for permits or lobbying the legislature or the governor's office to support a development objective.

This is not a satisfactory way to manage capital assets.

Since the state does not seem to be able to achieve organizational balance, it must meet its obligations through public policy, policy that sets priorities for the management of Alaska's resources as capital assets.

The state has so many policies directed to the management of Alaska's resources that they are cancelling each other out.

The state is in the need of a new start.

The legislature must develop a comprehensive resource development policy that recognizes the state's reliance on resources as its economic base and directs management of the state's resources as capital assets.

The goal must be to encourage and facilitate responsible private development of the state's lands.

The goal must be to facilitate responsible development.

ALASKAN NEED TO KNOW HOW THEIR LAND IS MANAGED

The connection must be made between land as an asset and the state's economy. Alaskans need to know how the state is managing its statehood legacy.

- What are Alaska's resource assets worth?
- How is the state using them?
- What lands are set aside for wilderness and habitat values, for settlement, resource development?
- Are there enough new development projects to support the economy?
- What is the return from the statehood land and resources?

The State of Alaska does not have a comprehensive resource plan, nor does it assign value to much of its physical assets.

Prudhoe Bay, with an estimated present value in excess of \$30 billion, is neither accounted for, nor treated as the state's single most valuable asset.

The entire budget process is predicated on revenues projected from future resource development, yet there is no overall sense of what the real development possibilities are.

Many Alaskans never have the opportunity to understand the connection between land as a capital asset and the state's financial condition.

The state should account for the management of its statehood lands and resources, its capital assets, in an annual "stockholders" report that is sent to each voter.

This report would provide an overview of the statehood lands as assets.

The report would include three categories:

- lands of proven resource value
- lands of probable resource value where the resource has been identified but there is not yet accurate information on quantity;
- lands of undiscovered resource value where there is still the chance of a discovery, but the lowest probability of being resource rich.

In all three categories, the report would show land classification and ownership (leased or unleased) along with exploration and permitting status. In the first category more complete information would be expected, along with possible production schedules.

The report would deal in two quantities: natural unit (how many tons of fish, bd. ft. of timber, barrels of oil, etc.) and magnitude of resource (in terms of proved and probable, depletable or renewable yields).

The report would show land status and use by developers. The report would show projected dollar values only in those instances where it was near accurate to do so. It would show yield/production/harvest from the year previous with actual dollar value.

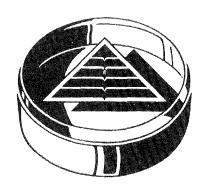
Other categories would include maps showing classification of lands and lands currently under study for classification.

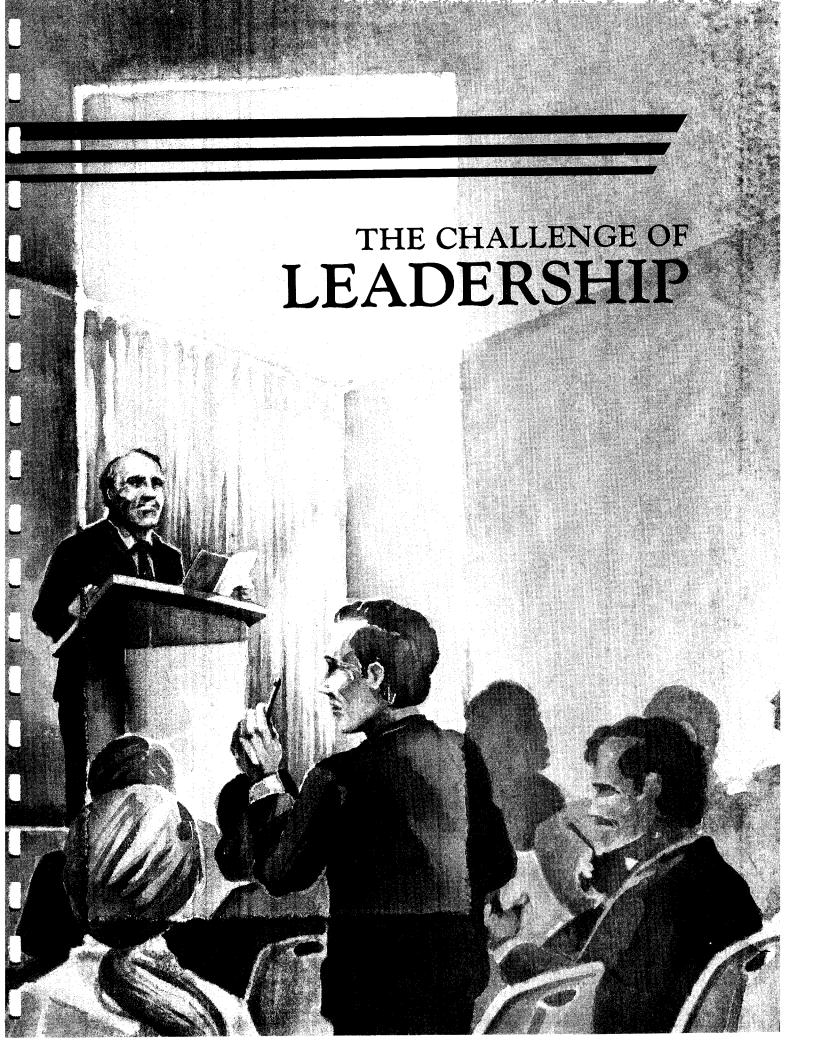
Since the development of state resources depends on production by the private sector, the report should include critiques of state management by private groups, including fishing, mining, petroleum, timber, and agricultural interests.

These critiques would assist in clarifying and resolving public policy issues affecting state management of its resource assets.

This report would begin to help Alaskans understand the economic base of the state, the role of resource development, and the seriousness of the choices that be made. It would provide a better forecast of future revenue potential into the economy.

It would begin to help Alaskans understand the role of resource development.





COMPASS NORTH

THE CHALLENGE OF LEADERSHIP COMMITTEE

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THE CHALLENGE OF LEADERSHIP

An examination of the critical decision-making roles of Alaska's executive and legislative branches.

Alaska has a tremendous need for decisive leadership right now. The Constitution sets out the authority of the governor and the legislature; why then is there continual disagreement over who has the right to decide?

The struggle over budget responsibility goes beyond a healthy check and balance. It has resulted in decision-by-default with each side blaming the other for overspending and indeciveness. What can be done? Do we need to change the Constitution - the leaders - or the practices?

CONCLUSIONS & RECOMMENDATIONS

The following are the principal conclusions and recommendations of the Challenge of Leadership Committee:

1. Alaska's Constitution sets out strong roles for both the governor and the legislature, but these roles have become blurred and weakened in practice. The result has been decision-by-default, over-spending, and indecisiveness. For the sake of the state's future, Alaska's elected leaders must return to the mandates of the Constitution.

RECOMMENDATION: Alaska's Constitution clearly makes the preparation of a total state budget the duty of the governor. He must take whatever action is required to carry out this responsibility.

2. The legislature is the arbitrator of the public interest, but this decision-making role is seriously impaired because the state cannot accurately determine where its dollars are being spent.

RECOMMENDATION: The House and Senate Finance Committee should hold joint meetings with the legislative leadership and the governor to adopt procedures reforming the oversight process of the state budget.

3. The elected leadership is responsible for considering both the present and the future needs of the state in determining public policy.

RECOMMENDATION: The proposed Capital Investment Fund is the best way to strike a balance between current and future needs. The governor and the legislature should support the proposal to amend the Constitution to establish such a fund.

4. The legislature is the testing ground for spending priorities but there has been no serious review of the operating budget since it began its upward spiral in 1979. Without such review the state will become buried in "political entitlements" that will severely limit its spending choices in the future.

RECOMMENDATION: The governor and the legislature should open public debate on program review to determine responsible ways to cut the operating budget to sustainable levels and encourage improved program delivery through priority and goal setting.

5. The writers of the Constitution designed a positive role for the legislature, a legislature intended to be a part-time group of citizens working in all walks of life.

RECOMMENDATION: In conjunction with the recent passage of the Constitutional amendment to limit sessions, two other steps should be taken to encourage a citizens legislature:

- The Conflict of Interest statute should be amended so it no longer infringes on an individual's right of privacy to such a degree that it discourages able and principled people from running for office.
- The number of consecutive terms should be limited to two four year terms in the Senate, and four two year terms in the House.

THE CHALLENGE: A CALL FOR COURAGE IN LEADERSHIP

The State of Alaska has some hard decisions to make during the coming years: survival decisions.

- How much of its oil wealth should be saved?
- How much should be invested in projects to generate new wealth?
- Should the state reinstitute taxes?
- Which programs should be strengthened, which elimi-nated?

These are "choosing between" rather than "handing out" decisions - the most difficult for elected leaders to make, especially in Alaska.

Small as it is in population, the state abounds in contradictions. It is shaped by differences both of geography and philosophy: the rural subsistence communities and the urban service centers; the "growthers" and the "no-growthers"; the public sector and the private sector; the savers, the investors, and the spenders of public revenues.

The danger is that elected leaders sometimes become paralyzed by the conflicting demands and opt for the easy way out - no decision at all.

Right now Alaska doesn't have time for the easy way out. The state is midway through what may be the single most wealthy period in its history. If no decisions are made, or if the wrong decisions are made,

Right now, Alaska doesn't have time for the easy way out.

the opportunities this wealth presents will be lost. Because of the expected decline of Prudhoe Bay revenues in the 1990s, wrong decisions now could cost the state its future.

This is what the challenge of leadership is all about: a test of vision to use this opportunity of wealth to set a direction for the future and a test of courage to make the politically hard decisions necessary to get there.

Yet, over the past five years there have been few examples of elected leaders attempting to respond to this magnificent challenge.

Instead of public debate as to what choices would be in the interest of the state, too often there has been public squabbling over who gets to decide. Instead an assessment οf statewide priorities, there has been statewide handout.

This has begun to change, for the public hasn't been bought off that easily. Elected leaders who were most insistent that their constituents wanted "all they could get" are being defeated. Elected leaders who have been attempting to make the hard decisions are starting to make headway.

Alaskans expect courage in leadership: they expect the hard decisions to be made. Alaskans expect courage in leadership.

THE GOVERNOR: ADVOCATE & INITIATOR



No other state constitution grants more authority to the governor than does Alaska's.

Any discussion of public policy usually comes down to: "If it is going to happen, the governor has to support it."

This doesn't mean the will of the governor always prevails—far from it. It does mean that the governor's agenda establishes the central issues for public debate.

Under Alaska's Constitution it is the governor who is the initiator, the advocate of a direction for the future.

Alaska's Constitutional Convention delegates had lived with the frustrations of shared powers. To replace this system, the delegates created a centralized structure directly accountable to a governor with the powers necessary for strong leadership.

Unlike most states, Alaska's Constitution gives the governor the power to veto line item appropriations along with the duty to submit a state budget to the legislature.

The Constitutional duty to submit a state budget is the major source of friction with those legislators who would like to reduce the governor's role to merely that of administrator.

Alaska's Constitution clearly imposes on the governor the duty to submit a total proposed budget for all of the public funds to be spent in the coming year - a budget that reflects his balancing of the state's priorities.

While the legislature is given exclusive power to appropriate funds, Article IX, Section 12, intends that the governor act as the initiator of public policy in submitting a complete budget. He is to propose spending priorities in the best interest of the state as a whole.

The practice of the past six years has resulted in a partial budget, with the governor submitting an operating budget while the capital funds are divided into thirds among the governor the two branches of the legislature.

This is an abdication of authority and responsibility by the governor and an unconstitutional assumption of power by the legislature.

The Constitution intends that public debate among legislators, as to where funds will be spent and to what purpose, will result in state spending that reflects public consensus.

The practical result of the onethird, one-third, one-third division is the loss of opportunity to ever reach consensus. "The governor shall submit to the legislature . . . a budget for the next fiscal year."

Article IX, Section 12 The rule has been: no questions asked.

If necessary, the hammer of the veto must be used again and again.

Members of the House and Senate, as well as the governor, have millions of public dollars to spend that are never subject to the open debate process of determining the highest and best use of public funds. Instead, the rule has been: "I will not question how you spend your millions if you do not question how I spend mine."

For the most part, no questions have been asked and the cost in lost opportunities, for money that could have been better spent, is immense.

The governor, as well as individual members of the legislature, have been attempting to change this practice.

The executive branch must take whatever action is necessary to bring the budget process back in line with the Constitution.

Each governor must prepare a total budget in advance of the legislative session, soliciting input of local governments, regional legislative caucuses, and the people as he or she designs statewide priorities.

Finally, if necessary, each governor must use the Constitutional hammer of the line item veto again and again.

LEGISLATURE: ARBITRATOR FOR THE PUBLIC

To balance its strong executive, Alaska's Constitution establishes an equally strong legislature. The tone of Article II is that of public confidence in elected representatives.

With the confidence is given the authority: to appropriate funds; to write the laws of the state; to set management policy for Alaska's public resources.

The legislature is to act as reconciler of the many contradictory interests that make up Alaska. It is to be the public arena for arguments to be aired and choices made.

The legislature is the arbitrator of what is in the public's "best interest."

The problem over the past five years is that the legislature has neglected its role of arbitrator - of choosing among opposing interests to decide the public interest.

Questions of leadership are whether individual legislators will be willing to make the hard choices with oil revenues still available; and, whether the budgeting process can be streamlined to make such choices more possible.

The legislature is the arena in which choices are to be made.

REMOVING OBSTACLES TO LEADERSHIP

While the governor has the duty to initiate the budget, the legislature has the responsibility to evaluate, decide, and appropriate. If the governor doesn't veto - the legislature has the final word.

Right now it is evident that no one is quite sure what that word is. Other recent studies have reached the same conclusion:

The state has lost track of where its dollars are being spent.

It is the opinion of many policymakers that few officials are certain as to what agencies are spending their money on, or to what purpose, and that the capital budget review process is flatly out of control.

Elected leaders cannot test the validity of proposed spending priorities when essential information is not available or is confused.

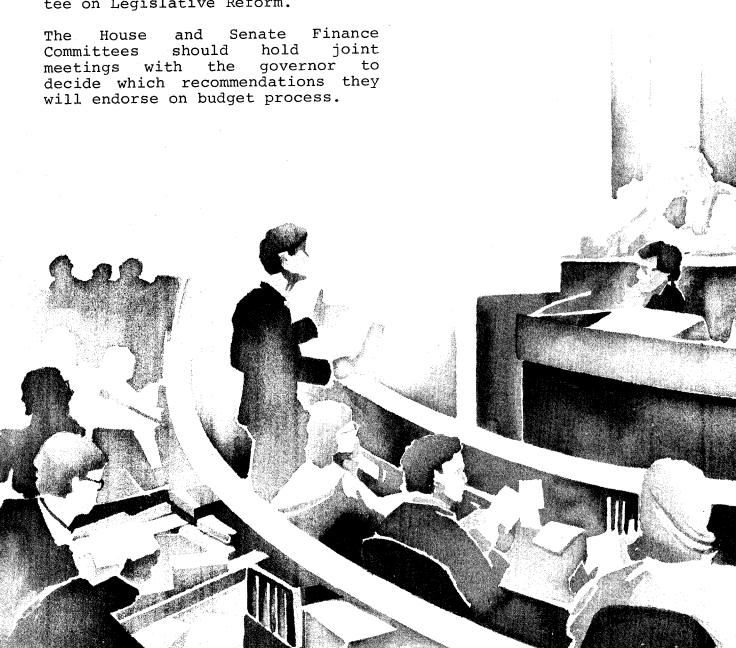
There <u>must</u> be a clearing away of obstacles to informed decision-making:

 Regaining oversight of budget expenditures must be a major priority for the legislature.

It is not possible for elected leaders to make credible statements about whether or not the budget can or cannot be curtailed when it is general knowledge that specific information is lacking to back up these judgements.

This "gap" in need-to-know information has been of concern to many legislators and several studies have been done on legislative reform.

These studies should be used as a starting place for action. In particular, the 1983 recommendations of the National Conference of State Legislatures should be reviewed for implementation. This report was authorized by the Alaska Legislature's Joint Special Committee on Legislative Reform.



The legislature must distinguish between capital improvements and capital investments.

One former legislator describes the situation in the following manner: When you visit farm country, you can quickly tell which are the consuming farms and which are the producing farms. Those farms with large houses and small barns are the consuming farms. Those with large barns and small houses are the producing farms. "Alaska's oil wealth", he said, "is being spent on the house, not the barn."

A Captial Investment Fund is the best way to meet investment needs.

A longer term compromise of current and future capital investment needs must be struck or Alaska's opportunities will be missed.

The dedication of a portion of current income for future large investment projects is an essential security in achieving a proper balance.

The Capital Investment Fund concept is the best means of doing this. The legislature must begin the process of amending Alaska's Constitution to dedicate a portion of Alaska's resource revenues for investments in large scale, revenue-producing projects.

• The legislature must reaffirm its role as a testing ground for priorities in the operating budget and open public debate on responsible ways to cut back this budget to a sustainable level.

Between 1979 and 1982, Alaska's budget skyrocketed, going from \$1.4 billion to over \$4 billion.

Most lawmakers agree that there has been no serious test of priorities of the operating budget since 1979.

The proposed FY 1986 budget calls for "holding the line" - but it's a line that is too high to be sustained in the future. The latest budget maintains operating expenses that erupted into being with the dramatic increase of oil prices.

The state is literally burying itself in "political entitlements". Program budgets that doubled or quadrupled only in the past four years are now being treated as if they represented true entitlement obligations.

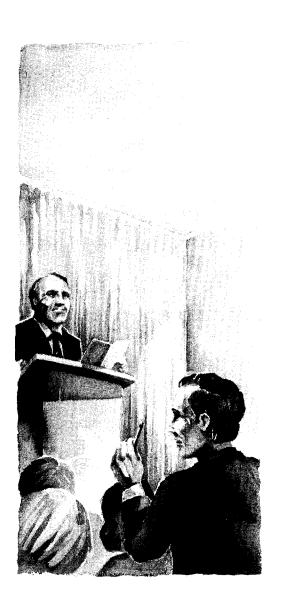
Instead of priority assessment, some lawmakers are making "voter" assessments and taking the position that so many budget dollars represents so many votes. It suddenly becomes irresponsible to attempt to cut back the operating budget to where it can be sustained in the years to come.

Did the state permanently quadruple its entitlements in a four year period? Is this the operating budget the state wants to or intends to maintain (with inflation increases) into the future?

If there is no test for priorities now, the answers to all these questions will, by default, become "yes".

The state is literally burying itself in "political entitlements".

TO ENCOURAGE A 'CITIZEN' LEGISLATURE



The writers of Alaska's Constitution designed a strong, positive role for the legislature - which they envisioned as a citizen legislature.

It is obvious from the record of the Constitutional Convention that the delegates wanted a legislator who says "we" and means: "we members of the public" They did not want a legislator who says "we" and means: "we members of the legislature".

Too often members of the public hear legislators say: "Well, it may be a good idea, but you don't understand politics." or "Of course, I don't think it's right, but you have to go along with the majority."

When legislators become condescending toward the public, there is no citizen legislature; there is a self-serving bureaucracy responsible first to itself.

The passage of the Constitutional amendment to limit sessions will help broaden access. In addition, two other actions should be taken:

• The Conflict of Interest statute should be strengthened and amended so that it no longer infringes on an individual's right to privacy to such a degree that it discourages able and principled people from running for office.

It is entirely appropriate to prohibit certain personal conduct and business relationships on the part of public officials. It is not appropriate to require candidates to file detailed lists of personal or family clients, customers, business associates, and property information, as if this public exposure will insure the person's honesty.

The solution is to change the focus. Now intrusive disclosure is required with a "rap on the knuckles" when there is a violation. The procedure should be reversed, with emphasis on basic up-front disclosure and extremely tough penalties when an official fails to "self-disclose" and votes or rules on issues that could result in personal financial gain.

 Consecutive terms should be limited in the legislature so the focus is on the public good rather than on individual reelection.

The Constitution should be amended limiting state senators to two consecutive four year terms and House members to four consecutive two year terms.

A break in consecutive terms gives policy-makers an opportunity to be a "citizen" again and breaks the "tyranny of power" that can stifle creative approaches to governing.

Shorter terms break the "tyranny of power" that can stifle government.

FORGING NEW LINKS WITH THE PEOPLE

Most governments have a very direct link with the people - personal income taxes. This link does not exist in Alaska.

Alaska needs to forge new links between the people and their government.

One method to help provide that linkage and to assist the Alaskan people to evaluate their elected leaders would be an Alaska Annual Report prepared by the governor's office.

This report should be an accounting from the leadership to the public. should answer the public's questions: What have you done with these public assets? What have you done for us? The report should be after the informational modeled style of the annual reports of the Regional Corporations.

addition to presenting traditional "corporate bottom line" that has resulted from the state's actions, the Alaska Annual Report should illustrate how operations budget was spent for education, health and services, the judicial system, and so on, and relate the funds appropriated to program goals achievements.

If issues are related to numbers, the Alaska Annual Report will enable citizens to take a more informed interest in the management of their assets and provide a means to monitor and measure the performance of state government.

"What have you done with our public assets?"

TOWARD A NEW POLITICAL PHILOSOPHY

One of the many contradictions of Alaska is that it is a state where many came to get away from government, yet bureaucracy is a major occupation.

The mix of independence of thought and interdependence on government shows up in the small percentage of the state's voters who indicate a political party preference. Nearly 60% register as unaffiliated.

While independent voter registration makes it easier for individuals from both the private sector and the public sector to work with various administrations, there has been a price.

In the legislature, it has made it easier for free floating coalitions to take control.

These coalitions are controlled by regional interests. Instead of a "marriage of philosophy" these coalitions are marriages strictly of convenience. The only issues are who is going to have the positions of power and biggest piece of the revenue pie.

The other weakness is that the public knows neither whom to praise nor whom to blame. If a Democratic majority achieves major accomplish-

The public doesn't know whom to prais or whom to blame.

ments for the state, the voters could react at the polls in support of that party's candidates. If a Republican majority opens an era of prosperity, that party would get the credit. But how does a voter support a coalition at the polls?

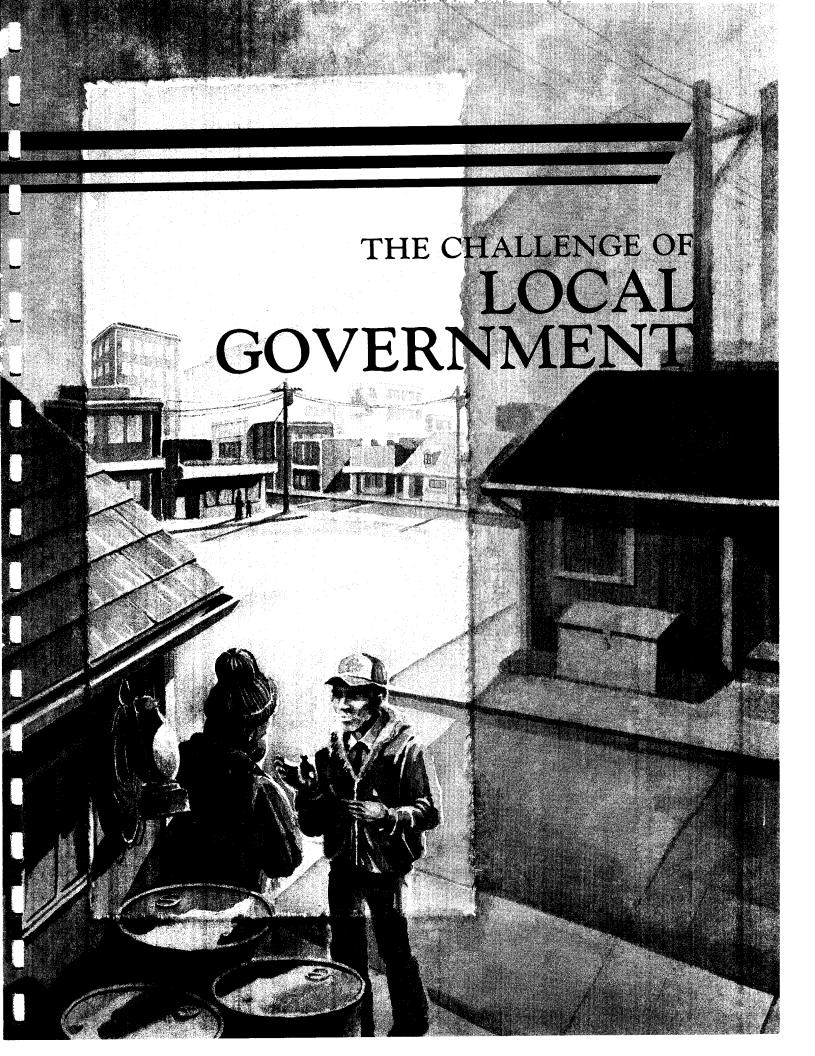
A positive step to help the parties gain strength in Alaska is to reinstitute the preferential primary that was used in this state prior to 1968. This system, unlike a "closed primary", does not exclude "uncommitted voters" from the primaries.

The opportunity for coalitions of philosophy will be improved.

No one has to declare a party affiliation to vote; each voter is handed one secret ballot with all the candidates from each party listed. The difference is that each voter may only vote for candidates from one party. No mixed-party voting is accepted on this ballot. The general election process would be enacted as usual.

In this way, allegiance to the party closest to individual philosophies will be strengthened and the opportunity for coalitions of philosophy improved.





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THE CHALLENGE OF LOCAL GOVERNMENT COMMITTEE

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THE CHALLENGE OF LOCAL GOVERNMENT

A look at the price Alaskan communities are paying for the years of "plenty" in state revenues and what reforms are necessary to return local decisions to the local people.

Is there a way for all of the state's diverse and widespread communities to share in public revenues in a manner that reflects the tradition of Alaskans helping Alaskans?

Will the elected state leadership agree on a revenue distribution formula that guarantees local decision-making and local responsibility? Finally, are communities willing to search for alternate ways to meet their own local obligations as state revenues decline?

CONCLUSIONS & RECOMMENDATIONS

The following are the principal conclusions and recommendations of the Challenge of Local Government Committee:

- 1. The concept of sharing Alaska's Prudhoe Bay revenues with the people through their local governments was well intentioned, but the process is defeating the purpose; the legislature has taken control from the local people. To correct this situation the state must:
 - bring revenue sharing back into line with the "maximum self-government" language of Alaska's Constitution;
 - reinforce the traditional Alaskan approach of equitable sharing;
 - encourage local responsibility, accountability, and incentive.
- 2. Spending decisions for local services and capital improvements should be made by the citizens in each community, not by individual legislators acting for special interest constituents outside the legitimate local budgeting process.

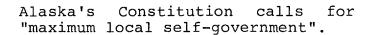
RECOMMENDATION: All present state programs for support of local governments should be combined into a single program by which all funds to local governments would be allocated by formula rather than political distribution. This Local Government/Equitable Share (LOGES) Fund would include BOTH capital and operating allocations. Under the LOGES Fund concept:

- State revenues would be allocated on a formula that emphasizes the meeting of essential basic needs (equitable) rather than strictly on a per capita (equal) basis.
- No state funds could be allocated to local communities outside the formula, except for emergency need.

- Funds could only be allocated to communities that are willing to establish a government entity under state laws (the unorganized borough should be divided into common service areas), thereby having the ability to perform required service functions and to levy taxes.
- Some local contribution would be required, whether it be tax, in-kind service, or private sector match. (One approach would be to restructure the Permanent Fund dividend program to meet the matching requirement.)
 - 3. With Prudhoe Bay revenues expected to decline, it is not sound planning for local communities to continue to rely on state funds for up to 75% of their total spending.

RECOMMENDATION: Beginning now, while there is still lead time, every local community should develop revenue "weaning" plans that include the goal of cutting dependence on state revenues. Communities should set up mechanisms to recommend ways of bringing new sources of revenue into local areas and/or to develop local taxing plans.

THE PRICE OF STATE FUNDING: LOCAL CONTROL



Over the last five years, in an effort to fulfill the perceived needs of the Alaskan people, the legislature has, in effect, "bought out" this basic philosophy. Local people have lost control.

The question of equity, of how the state should distribute public wealth to its widespread communities, is one-half of the challenge of local government.

The question of how local governments can regain control over these funds is the other half.

How much and who controls? These questions have a unique Alaskan flavor because of the number of dollars available and because of the level of dependence they have generated.

In 1967, Alaska municipalities received only 33% of their total funds from the state, compared to 41% nationwide.

By 1980, with the surge of oil revenues from Prudhoe Bay, Alaskan municipalities received up to 75% of their total funds from the state - compared to only 44% nationwide.

There has been a price:

 "Fair share" battles between small community/large community legislators.

LOCAL GOVERNMENT

 Legislators usurping the role of local citizens by "bringing home" millions of dollars to communities often unrelated to local budgeting processes.

The "fair share" battle is devisive. At risk is Alaska's common denominator of neighbor caring for neighbor - the tradition of Native and pioneer cultures.

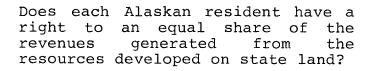
The intrusion of the legislature into the budgeting processes of local communities undermines the "needs assessment approach" to public spending. The result of this overdose of ad hoc spending will be a legacy of debt; local governments saddled with unnecessary services and facilities that will be a heavy burden on future generations.

The legislature should rethink the state's approach to revenue sharing and return to a process that will:

- bring revenue sharing back into line with the "maximum self-government" language of Alaska's Constitution;
- reinforce the traditional Alaskan approach of equitable sharing;
- encourage local responsibility, accountability, and incentive.

The legislature should "rethink" its approach to revenue sharing.

THE YARDSTICK MUST BE EQUITABLE SHARE



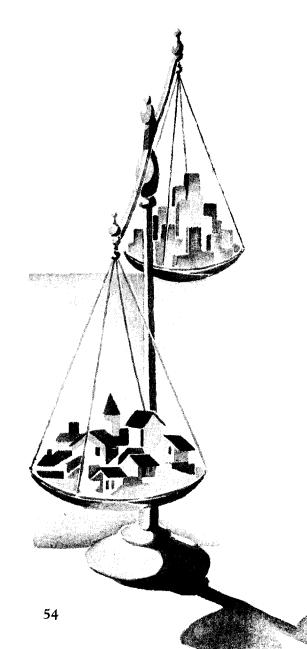
This question is one of the most sensitive and misunderstood in Alaska.

Urban residents often believe the state entirely subsidizes the smaller communities. Many rural residents perceive that urban Alaskans obtain a disproportionately large share of the state's oil revenues.

The truth is that many smaller communities are levying sales and property taxes on themselves to provide local services; urban communities rarely receive as much state funding per capita as their rural counterparts.

The needs and relative sizes of the nearly 300 communities in the state are so diverse that a strictly equal distribution would not be appropriate. There are 220 villages with populations between 25 and 600; some are without the basic services taken for granted larger urban communities. A single village phone provides the entire telephone communications system in 98 villages. No protected water exists in at least 30 communities, and in another 50 to 60, residents haul water from a single village well.

Alaska's larger municipalities are faced with very different but equally difficult challenges. Urban populations are growing at a



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rapid rate. Anchorage, for example, is proportionately the fastest growing city in the nation, becoming home to 50,000 additional residents in the last three years. There is a great demand for basic needs such as schools, roads, and utilities.

Each legislator fights for funding for his or her district; and yet the Alaskan tradition has always been to allocate a somewhat larger per capita share to those communities that lack basic essential services. This tradition is appropriate.

In Alaska the yardstick must be equitable distribution not equal (per capita only) distribution. Any approach other than equitable when lives, education, and health are at stake, will increase regionalism and antagonism.

To meet "basic needs" is the first priority in public revenue sharing.

FORMULA AND **POLITICS**

NOW: A MIX OF The public will support "equitable" distribution of public funds long as the process of determining legitimate needs is also equitable.

> One community may be willing to raise its own taxes, or give up a service to make funds available to another community in need, but only if the need is genuine.

> is the problem with present system: Funds are going to local communities both by formula and by political distribution. is the political distribution that generates the rivalry and bitterness.

The major ways state funds distributed to local governments through revenue municipal assistance, the education foundation formula*, and legislative appropriations.

STATE REVENUE SHARING was established in 1970 following the celebrated \$900 million Prudhoe Bay lease sale.

The formula rewards those communities that are willing to themselves and build roads medical facilities. Beginning in 1980 the formula was changed so that each community, including those that are not incorporated,

One community will help another, if the need is genuine.

The School Foundation program faces major overhaul this year, with both the legislature and the Department of Education wrestling with some of the same equity problems.

LOCAL GOVERNMENT

are given a minimum of \$25,000 per year plus a regional cost of living adjustment.

THE MUNICIPAL ASSISTANCE program was begun in 1980 as a replacement for the repealed Gross Business Tax. The first \$10.6 million is distributed according to the allocations established by the previous tax and the remainder is divided strictly on a per capita basis.

Although both revenue sharing and municipal assistance are "formula" programs - neither is spared from "dividing the pie" politics.

The legislature is not obligated to fully fund either program. The level of appropriation becomes part of the bargaining between both the governor and the legislature as to "who gets what" every session.

This political gamesmanship has undercut the object of the two programs, which was to take the guesswork and the politics out of revenue sharing.

DIRECT LEGISLATIVE APPROPRIATION for capital items is the "worm in the apple" for local governments sharing state revenues.

As oil revenues quadrupled state revenues, the legislature stopped reviewing statewide capital projects on a need basis. Individual legislators are allocated several million dollars to spend at his or her discretion.

New projects and services are "brought home" to local districts whether or not they are planned

Formula programs are still treated as part of the "political pie".

Questions of necessity are never aired in the local public arena.

for, or whether the money could be better used elsewhere.

Just as intrusive is the practice (and it has become a practice) of legislators commonly inserting line item appropriations into municipal budgets - earmarking specific funds for a specific program or non-profit group.

Is it necessary? Does it duplicate? Does it meet community goals? Is the individual or group qualified to perform the service? These questions are never examined in the public arena because these "identified recipient" appropriations bypass the public arena.

Since the millions of dollars appropriated outside of the two formula programs are not broken out of the budget, the true picture of what unrestricted funds are allocated to municipal government is not readily available.

These practices must come to an end:

- They make a mockery of "equitable" arguments because there is no determination of "legitimate needs".
- They undermine the role of the local public officials and their responsibility to budget "in the best interest" of their own electorate.
- They undermine the role of the legislators who now campaign on local road and school bus turn-out "issues" rather than statewide public policy issues.

LOCAL GOVERNMENT

THE SOLUTION: A 'ONE-STOP' FORMULA PLAN

The two formula programs, revenue sharing and municipal assistance, should be combined into a single program that cannot be manipulated; one state fund for all local government capital and operational funding sources.

A single formula should be adopted that both combines a per capita share and is weighted to the cost of living differences.

An "emergency need" caveat could be included that would give any community the opportunity to petition the state for additional funds on the basis of "need".

The governor has appointed a task force to review the advantages of unifying existing local government programs. This task force must factor into their deliberations the need for local governments to take the initiative and be held accountable in order to receive state funds.

These conditions of such a program, titled in this Report as The Local

An "emergency need" caveat would give needed flexability.

Government/Equitable Share (LOGES) Fund, should be mandatory.

1. The LOGES Fund should only be given to a community that is willing to establish a government entity under state laws thereby having the legal ability to perform the required service functions and to levy taxes.

The principle must be that any community receiving state funding must share the responsibility for operating those facilities and services.

This principle should apply to all of Alaska, including the communities in the unorganized borough.

The delivery of state services to the unorganized borough has no uniform system, with nearly all state agencies having conflicting boundaries and jurisdictions.

Right now the legislature sits as a sort of regional assembly to the communities in the area outside the jurisdiction of any organized local government. In practice, it does not work very well for legislators from outside the area to decide what is right at the local level.

The unorganized borough should be divided into common service areas. Each area could then determine which services and facilities are important enough to support.

2. Some local contribution should be required in order to receive LOGES Funds, whether it be a tax, in-kind service, or private sector match.

All communities must share responsibility of operating their services.

LOCAL GOVERNMENT

One option in the future could be to restructure the Permanent Fund dividend program as a group benefit distribution to be used by local communities to meet the matching state requirement.

3. A wise and yet revolutionary concept would be the expansion of the LOGES Fund to include legitimate local capital projects.

Each year the legislature should determine the dollar amount available for local capital improvements and instead of cutting it up based on who has the political horsepower, add it to the direct grants to municipalities.

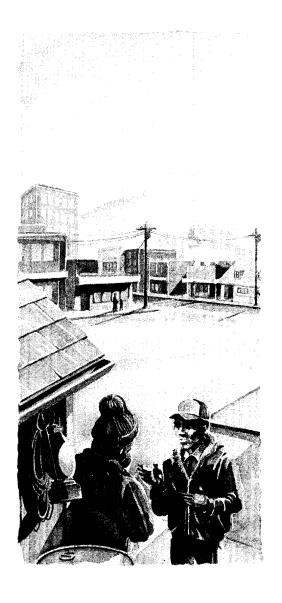
The local people, or the people elected they have to municipal assemblies and councils, would then decide what capital improvements and government services are the top priorities for their communities. This process would realize the intent of the opening phrase of Article X in Alaska's Constitution which calls for "maximum local self government."

The key to a LOGES Fund that includes capital and operating funds is the willingness of the legislature to discipline itself; to return to minding the business of the state instead of the business of local government.

The legislature must agree, either in practice or by law, that no state funds will be allocated to local communities outside the LOGES Fund.

The intent: maximum local self-government.

LOOKING AHEAD TO SELF. SUFFICIENCY



Hard decisions are ahead for local governments.

In the past seven years new groups received public funds and became new constituencies. These new constituencies will expect continued public support.

New projects have been built, requiring operation and maintenance.

New services have been initiated, requiring staffing and support facilities.

As the revenues from Prudhoe Bay drop, will the public agree to increase the percentage of the total budget to local government? Or will local governments have to do with less state support?

It is likely they will have to do with less state support.

There are many thoughtful Alaskans, rural and urban, who believe that in this case, less is in the best interest of local governments. They believe that the high level of dependence on state funds is neither wise nor healthy, that it invites the kind of interference it has generated.

Beginning now, while there is still lead time, every local community should develop revenue "weaning" plans that include a five year goal of cutting dependence on state revenues.

LOCAL GOVERNMENT

Alaskan communities must examine their options for a higher level of self-support, including payment in-kind, property and sales tax, service reduction, and facility closure.

No one likes property taxes, sales taxes, or user fees, but they are all available instruments to Alaska's local governments.

If state revenues drop as dramatically as anticipated, it will be the local people who must bear the on-going costs of debt service, operations, and maintenance of community facilities. Therefore, the local people should have the largest say regarding what obligations are incurred.

When major local government funding decisions are made, the local people should be consulted, either through the ballot box or by means of a public opinion poll. Voters should be told simply and clearly the on-going (life-cycle) costs for each proposed new facility as well as the expense of adding new services and government employees.

An alternative way for the public to participate in determining priorities would be to institute a "chit" or "debit card" system whereby each local resident is given a chit that represents an equal share of the available monies designated for his or her community.

When state revenues drop, the local people will pay on-going costs.

For their own best interest, communities need to diversify their revenue base.

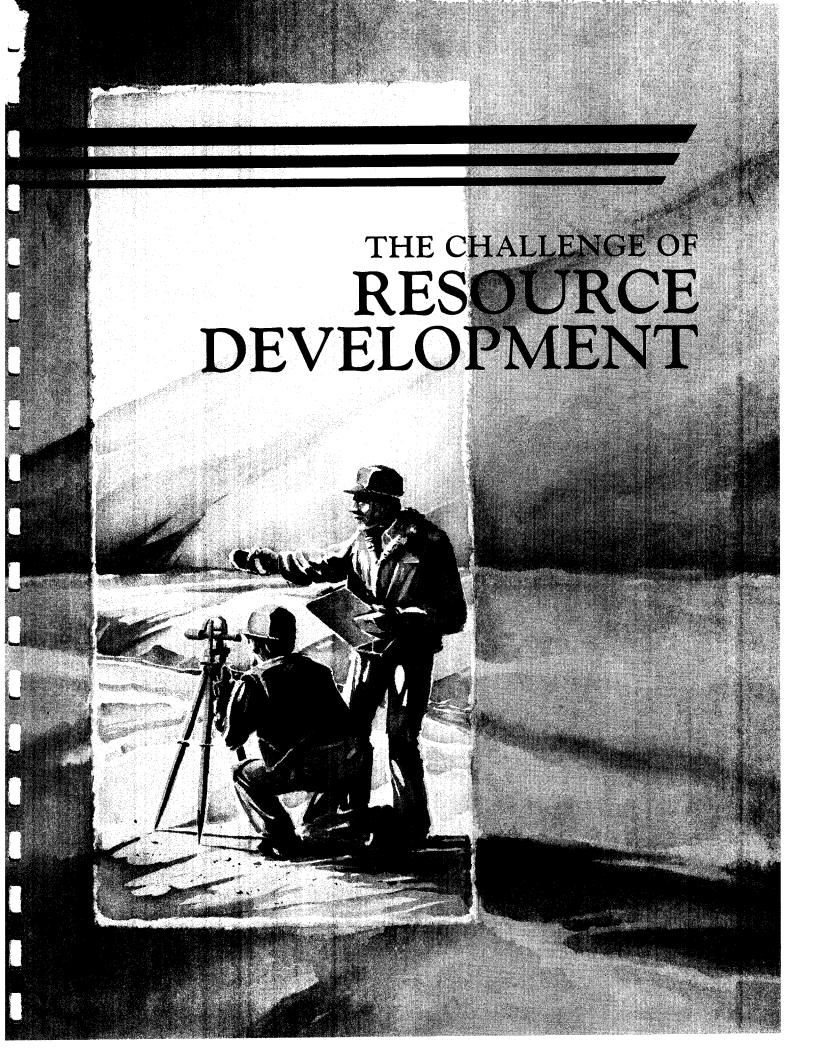
The citizen would then be asked to "spend" or "vote" that chit for the community projects or services he or she felt were the most important. This device would make the point to every citizen that he or she is a shareholder of the state's "common wealth" and is responsible for its wise use.

In the final analysis, local communities need to set their own priorities, and, while there is still lead time, to grapple with specific community economic plans.

For their own best interest, communities need to diversify their revenue base, to encourage healthy and stable economic growth.

The most successful communities will be those that can attract development that is compatible both with local natural resources and community values. Areas for cooperation between the local public and private sectors need to be found and nurtured, areas that will ultimately bring new revenue communities, into sources the thereby providing "for the good of the people as a whole."





COMPASS NORTH

THE CHALLENGE OF RESOURCE DEVELOPMENT COMMITTEE

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THE CHALLENGE OF RESOURCE DEVELOPEMENT

An assessment of the role of public policy in the development of Alaska's resources.

Alaska is resource-dependent. With the decline of Prudhoe Bay oil production less than ten years away, the need for new development is critical.

What can be done now to assure a continuing economic base for Alaska? Can public policy make a difference? What is the role of the state in encouraging development? Should public money ever be invested in private development?

CONCLUSIONS & RECOMMENDATIONS

Following are the principal conclusions and recommendations of the Challenge of Resource Development Committee:

- 1. Resource development is Alaska's only option for a continued strong economic base in the foreseeable future.
- 2. If Alaskans are to maintain their present level of economic well-being, the governor and the legislature must make new resource development a matter of highest priority. The approach must meet the need for development while satisfying concern for the environment.

RECOMMENDATION: The governor should appoint a cabinetlevel working team to forge consensus on a resource development strategy - an Alaskan Action Plan that encourages responsible development. It should include:

- A return to emphasis on the early conservation values of "wise use" of resources mandated in Alaska's Constitution;
- Strong emphasis on technically sound, efficient processing of permits through one "lead" agency;
- A stable tax policy that includes incentives for new development projects;
- A commitment to a statewide public education effort to build a knowledgeable constituency that understands the need for responsible development.
- 3. Alaska's implementation of coastal zone management is subverting both the purpose of the Federal Coastal Zone Management Act and Alaska's Constitution in giving coastal districts veto power over resource development projects of statewide interest.

RECOMMENDATION: The legislature must review the state's coastal zone management practices to make sure that it has not, by default, given away its own Constitutional authority to manage Alaska's lands.

4. If Alaska is to succeed as a resource state, all of its management and regulatory agencies must be required to balance the needs of multiple interests.

RECOMMENDATION: The policies and practices of the Department of Fish and Game must be broadened to reflect the balanced use so strongly implied in Alaska's Constitution.

5. It can be sound public policy to invest state funds in resource development projects - but the state must decide the limits and goals of its investment role.

RECOMMENDATION: The state should consider incentives or financial participation in resource development projects when the following minimum criteria are met:

- The project is, overall, economically feasible.
- The project is able to return to the state economy a cash flow that has a present value greater than the expenditure or cost paid by the state government.
- State participation is necessary for the venture to start up in the near future.
- The developers of the project and the state must agree, in advance of any state funding, to mutually acceptable terms for users' fees and repayment.
- The project is necessary to sustain or improve the economy and is able to generate new resident employment.

WHAT NEXT FOR ALASKA: DECLINE OR DEVELOPMENT?

Alaska is at a crossroad.

Perhaps for the first time in the state's history it is possible to forecast a major economic cycle.

Today 86% of Alaska's revenues come from a single resource - oil - from a single field - Prudhoe Bay. The resource is non-renewable; the field will be largely depleted within the coming 20 years.

What next for Alaska?

By the year 2000 Alaska could have a reasonably strong resource development base. A base that would support a healthy state economy;

Or,

By the year 2000 Alaska could remain as it is now, almost totally dependent on oil revenues from Prudhoe Bay and watch its economy decline and stagnate as production from Prudhoe Bay ends.

The critical challenge is to focus the state's public policy toward encouraging responsible resource development - development essential to sustaining Alaska's economy.

There is a perception by some Alaskans that resource development doesn't impact them directly, that the resource businesses are doing well enough, and that Alaska might be better off without further development.

Does Alaska need further resource development?



When Alaska became a state 25 years ago it had two economic options:

- develop its resources; or
- remain a long-term economic dependent of the federal government.

Today Alaska does not have the second option.

The level of federal spending here can no longer keep Alaskans in any-where near the style to which they have become accustomed.

What else does the state have to "drive" its economy - to provide the jobs, the money for schools, roads, health care, environmental protection?

Alaska has little manufacturing, processing, or agricultural base.

Tourism is a steadily increasing bright spot, but is not strong enough to support the state's economy.

The fact is that resource development is only option for a continued economic base.

Alaskans who believe that the state already has diversified resource development to depend on are wrong.

Right now Alaska is living off the development of Prudhoe Bay oil. State spending - state loans - state government - state construction - all are financed by this one field. All the economic eggs are in one basket.

All the economic eggs are in one basket.

PUBLIC POLICY: A TOOL FOR DEVELOPMENT

Alaska has resources.

Coal, oil, natural gas, timber, fish, gold, lead, zinc, molybdenum - all in world class quantities.

It also has the highest costs in the nation to produce those resources; stiff competition in an international market; no inland-to-tidewater transportation over most of the state; and in some instances, no direct access to tidewater because of checkerboard ownership patterns.

Finally, Alaska has public ownership - 88% public ownership: 28% in the state; 60% in the federal government. (The remaining 12% is held by native corporations, with less than 1% held by other private individuals and corporations.)

Public ownership is a notoriously poor system under which to achieve successful resource development.

Elected leaders and public bureauracies are usually not motivated to make the necessary decisions for successful development.

Alaska should have been different. Both its Statehood Act and its Constitution reflect the understanding that the state would be resource-dependent.

After statehood, Alaska's leaders did look to the development of resources and articulated clear guidelines in the Alaska Land Policy Act and in legislation for "wise use".

RESOURCE DEVELOPMENT

But in more recent years, many government leaders ignored these guidelines and adopted a philosophy of "no use". Warnings about the future cost were ignored. Revenues from Prudhoe Bay were pouring in; the need for new development was believed to be years away.

Now Alaska is less than ten years away from paying the cost and as the end of Prudhoe comes in sight, this short-sighted opposition-in-principle has started to change. But the growth of a new, balanced advocacy is occuring too slowly. The state is losing the time and opportunities it needs to secure its future.

Can public policy make a difference?

Every step taken to increase efficiency, to streamline permitting, adds to the competiveness of these resources. As one administrator pointed out: "A company trying to develop a \$1 million project can't afford to spend \$5 million fighting the bureaucracy."

While public policy cannot create markets, it can and does influence the level and pace of resource development by setting priorities, by removing obstacles, by providing incentives.

The state must commit to a new approach, an approach that recognizes its dependence on resources and takes actions necessary to make diversified resource development possible.

The Statehood Act reflects Alaska's dependence on resource development.

Can public policy make a difference?

A RESOURCE DEVELOPMENT STRATEGY FOR ALASKA

Since Alaska's economy is dependent on resource development, why not be the best?

Why not have resource development policies and practices that set a standard for the entire nation?

The State of Alaska should establish a comprehensive resource development strategy - a total action plan that encourages and rewards responsible development.

Such an action plan will only be possible with the full support of the governor and the legislature. The governor should appoint a cabinet-level working team to force dialogue and forge consensus on the state's commitment to resource development.

Key legislative leaders should be included in building this strategy, since under Alaska's Constitution, it is the legislature that is charged with providing "for the utilization, development, and conservation of all natural resources belonging to the state."

Alaska's resource development strategy should include:

1. A return to the early conservation values of "wise use" of resources.

The early conservation movement in the United States did not propose to close down resource development, but rather to make development compatible with environmental values.

RESOURCE DEVELOPMENT

"Wise use" conservation "marries" economic values with environmental values.

Alaska's Constitution reflects this philosophy in its directive to develop the state's resources on sustained yield principles.

A development strategy must be based on the philosophy of "wise use" with strict adherence to the mandates of the Constitution.

Emphasis on technically sound, efficient processing of permits through one "lead" agency.

In a sense, the state has put the cart before the horse. Alaska has been concentrating on the marketing of its resources, but the best marketing plan in the world will be useless until the state cleans up its act as a regulator.

One state agency can't market resources that another state agency is holding hostage.

Both resource development and environmental protection are enormously complicated, expensive, technical processes.

The decision as to whether a project meets permitting standards should also be a technical process.

Right now there are too many complaints of "permitting-by-politics"; of state agencies staffed by personnel who oppose development; inexperienced decision-makers; of review authority and veto power

The governor should appoint a cabinetlevel working team to forge consensus on development.

There are too many complaints of "permitting-by-politics".

handed out through inter-agency "Memorandums of Understanding".

This must be resolved. Alaska's resources can't be competitive when state agencies are adding to production costs and vetoing permits in long inter-agency power struggles.

There have been continuing attempts to "fix" the state's permitting system but it is now obvious that the best single answer is the "lead" agency concept.

Regulatory decisions should be coordinated by a single agency - the agency that has the expertise and the statutory jurisdiction.

3. A stable tax policy that includes incentives for new projects.

The goal should be to play fair with project owners while getting a fair share for the state.

Essentially it means having coherent state policies in place for taxing various resources and not changing these policies in mid-stream, i.e., when the project begins to show a profit.

The legislature should continue its efforts of providing tax incentives to companies that start new development projects.

While tax incentives immediately raise cries of "corporate socialism," thoughtful analysis will show that they can provide long-term benefits to a state. The petroleum based secondary industries on the

Tax incentives can have long-term benefits for the state.

RESOURCE DEVELOPMENT

Kenai Peninsula are in place, in part, because of tax incentives.

• The legislature should review its unitary tax policy.

The tax, which 12 states including Alaska still have, taxes a portion of the worldwide income of companies, not just income earned in the state.

The federal government has called for a repeal of this tax, which many experts believe inhibits development. Japan, for instance, has refused to make new investments in states that have the tax.

4. A statewide public education program to build a knowledge-able constituency that understands the necessity for responsible development.

The state has spent millions of dollars on public relations efforts to explain Alaska to other states. Now the state needs to spend part of these revenues explaining Alaska to its own citizens.

In public ownership, all the people have a right to be heard. In a state dependent on resources, it should be the role of the government to increase the quality of the dialogue.

Alaskans, urban and rural, need to understand what development in this state is all about - the need for it - the obstacles - the environmental concerns - the sheer magnitude of effort that is required to move a project into actual production.

The state needs to explain Alaska to its own citizens.

REMOVING OBSTACLES TO RESOURCE DEVELOPMENT

Of all the many obstacles to resource development today, three come up repeatedly:

- The fact that Alaska's dependence on oil is not reflected in public policy;
- The belief that one state agency has gained excessive control over development control far beyond its statutory authority.
- The danger that small, special interest groups in coastal communities will decide statewide issues through coastal zone management.

Each of these obstacles add to the overall cost of resource development without contributing to overall environmental values.

1. The legislature should formulate a coordinated state policy for oil and gas exploration and development on state lands.

Alaska has immense resources, but in magnitude of revenue and production, it is, above all, an oil state. No other state economy, including Texas, Louisiana, or Oklahoma comes close to being as dependent on oil as Alaska's.

Incredibly, more than three-fourths of the revenues to state government come from oil, yet there is no coordinated state policy on exploration and development of oil and gas.

RESOURCE DEVELOPMENT

Policy isn't just pro forma anymore - policy often decides. As regulations become more complex it is policy that overrides the contradictions.

The policies and practices of the Department of Fish and Game should be broadened to reflect the need for balanced management.

If Alaska is to succeed as a resource state, all of its regulatory agencies must be required to balance the needs of multiple interests.

The concept of multiple use is not just an after thought in Alaska's Constitution; it is a center thought, an essential tool to balance the needs of the state to develop its resources, manage its wildlife, and provide land to build and farm on.

There is agreement among resource developers that while both Department of Natural Resources and the Department of Environmental Conservation at least attempt to balance the needs of concurrent or competing users, the habitat division of the Department of Fish and Game consistently acts as a purpose, single single interest agency.

As a matter of practice, most development projects, lease sales, timber sales, exploration, and development permits face what is perceived as "opposition-in-principle" from the Division of Habitat.

Multiple use is a "center thought" in Alaska's Constitution.

There is agreement that habitat acts as a single interest agency.

If one department in practice holds from itself exempt balanced management principles, then department should be changed or the entire regulatory structure changed: one department wildlife; one department for mining; one department for timber; one department for fisheries - and let each department "fight" for its single purpose.

If balanced use is to be the basis for public land management in Alaska, then the Department of Fish and Game should be given the flexibility to maximize habitat values in conjunction with resource development.

3. The legislature must review the state's coastal zone management practices to make sure that it has not, by default, given away its own Constitutional authority to manage Alaska's lands.

Alaska's implementation of coastal zone management has created a new species of local government, complete with a sovereign's authority to veto resource development that subverts both the purpose of the Federal Coastal Zone Management Act and Alaska's Constitution.

Coastal zone management has become a tool of power, rather than a tool of environmental management.

The purpose of the Coastal Zone Management Act of 1972 was to move coastal land use decisions away from local, parochial decision-making authorities so that the broader public interests would be considered.

Alaska's coastal zone management has become a tool of power.

RESOURCE DEVELOPMENT

Ironically, Alaska's implementation threatens to do precisely the opposite: it takes land use decisions which should be made by the state based on broad statewide considerations, and turns the authority for these decisions back to local or regional powers.

Through the mechanism of coastal districts, it delegates the power which should be exercised by the state government.

Alaska's Constitution provides for two forms of local government: cities and boroughs. The coastal zone districts are effectively a third form of government existing outside the intent of the Constitution.

Alaska's Constitution also gives the legislature the responsibility to set policy for management of state lands. There is a likelihood that local coastal zone plans will, in effect, set policy for large areas of the state.

There has always been a serious question whether Alaska needs its own coastal zone management program. The legislature should take a second look at this question, and should consider whether the federal grants to establish a state coastal zone program may not, in the longrun, be the most expensive federal monies Alaska has ever received.

State land decisions are turned over to local powers.

Alaska should consider the cost of federal coastal zone grants.

WHEN SHOULD THE STATE INVEST IN DEVELOPMENT?

When, if ever, should the state participate in private for-profit development?

The simple answer is that the state should consider participation when it is going to get out of it more than it put into it.

The simple answer is also the best answer.

This is not a question of subsidy, but of incentive. There is a difference. Subsidy implies an on-going demand for public funds, rationalized primarily on the basis of public good (e.g. subsidizing a marginal business because a specific constutuency depends on it for jobs).

Incentive strongly implies an investment principle, in addition to a "public good" advantage that makes it attractive to forego short-term financial return for longer-run returns.

The advantage to the state is the infusion of new wealth, new jobs, new vitality into local and regional areas. But the risk is there as well and some criteria should be established as the basis of evaluating state participation.

The state must determine its investment role in the development of Alaska's resources so that public funds are neither lost in a confusion of subsidies nor denied when the state's interest would truly be served.



RESOURCE DEVELOPMENT

As a guide, the state should consider financial participation in, or concessions for, a development project when substantially all the following minimum criteria are met:

 The project is, overall, economically feasible.

The project can reasonably be expected to succeed, in the long term, on its own merits and will not require continuing financial assistance from the state.

• The project is able to return to the state economy a stream of cash that has a present value greater than the expenditure or cost paid by the state government.

An economic impact study should be completed assessing the cash flows that will occur as a result of the proposed project. Such cash flows would include the impact of local employment and secondary service growth in local communities. At a minimum, the discounted cash flows into the state's economy and the state's treasury, must exceed the costs to the state government.

Some economists insist that unless a project directly feeds the state government economy, it should be rejected. This is wrong thinking. There is more to Alaska than the "government treasury"; the best dollar is not necessarily the one redistributed by the state government. A job in a mine is better than a welfare check from the state.

The "best" dollar is not necessarily the one redistributed by the state government. State participation is necessary for the venture to start up in the near term.

The state has limited capital and should only participate when a sound project requires assistance to begin production in the immediate future.

 The project is necessary to sustain or improve the economy and is able to generate new employment for residents.

If the state is to participate financially, and forego short-term investment gains, there must be benefits to the economy or there may be no public purpose served. The creation of new jobs for residents, especially in remote areas, has a significant effect on local economies and is the key to both the social and economic maturity of the state.

The developers of the project must agree, in advance of any state funding, to mutually acceptable terms for users' fees and repayment.

If the investment principle is to guide state participation in development projects, the terms must be agreed upon, by contract, before public funds are used. In the past, some projects have been funded before all necessary terms were agreed to, with the state becoming the loser.

The creation of new jobs is important to local communities.

RESOURCE DEVELOPMENT

THE STRATEGY OF OPPORTUNITY

Can Alaska "make it" as a resource state? Can its high-cost, hard-toreach resources be competitive in world markets?

Maybe.

Resource development is a high risk business.

The risk is the developer will guess wrong. Guess wrong about costs. Guess wrong about markets holding steady or going up.

The other side of risk is guessing right.

This is the opportunity the state must hold open in its public policy strategies: the opportunity to quess right.

Economists say today that no combination of anticipated development projects can match the revenues to the state from Prudhoe Bay. That is, if everything stays the way it is today.

In the early 1960s it was known that the North Slope had oil potential. It was also known it

The other side of risk is "guessing right".

would be expensive to move the oil to market. Then the magnitude of Prudhoe was discovered. Then world oil prices soared.

Because the state had held open the opportunity to risk, had opened state lands on the North Slope to leasing, exploration, and development, the producers moved ahead and guessed right. The whole state benefited.

This is what resource development is all about - being ready for the "window," the market break, when it comes.

Alaska may not have other resources to match Prudhoe Bay, but the state will never know unless it keeps the opportunities open, and encourages active pursuit by those who are willing to try.



THE CHALLENGE OF WEALTH MANAGEMENT

COMPASS NORTH

THE CHALLENGE OF WEALTH MANAGEMENT COMMITTEE

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THE CHALLENGE OF WEALTH MANAGEMENT

A review of the policy choices open to Alaska in the face of declining production and revenue from Prudhoe Bay.

What can Alaska do to "get the most" out of its oil revenues? How can Alaska's petroleum wealth be used today and what can the state do to insure a "soft landing" in the 1990s, when Prudhoe Bay revenues begin a rapid decline?

CONCLUSIONS & RECOMMENDATIONS

The following are the principal conclusions and recommendations of the Challenge of Wealth Management Committee.

1. The critical need is to realistically prepare for the rapid decline in Prudhoe Bay revenues projected for the 1990s. The best alternatives are to reduce state spending now and to encourage new revenue sources through private investment.

RECOMMENDATION: The 1982 Constitutional spending limit amendment automatically goes on the ballot for reconfirmation by the voters in 1986. It must be strengthened to reduce spending to levels that can be sustained in coming years.

RECOMMENDATION: Of all projected new revenue sources, the North Slope natural gas pipeline shows the potential for best return. The state should move the gas pipeline to the top of its agenda.

2. The big gap in the state's investment portfolio is the lack of capital investments within Alaska that can help generate revenue when the Prudhoe Bay reservoir is depleted.

RECOMMENDATION: The legislature should make the Capital Investment Fund a top priority for the 1986 general election.

3. As long as the state's revenues are affected by world oil prices, neither the governor nor the legislature can determine in advance the size of each year's income.

RECOMMENDATION: The Constitution should be amended to establish a cash based budgeting system. Earnings from General Fund investments (\$240 million in 1984) should be set aside annually until a full year's requirement is met.

4. The state lacks the basic management tools of an annual audited financial statement and a five year plan for revenue, spending, and capital improvements.

RECOMMENDATION: The legislature should institute an annual financial statement and require the governor to prepare and update annually a five year revenue, spending, and capital improvement plan.

5. The state must protect its future by insuring that its moral obligation pledge to repay bonded indebtedness is not being misused by local governments.

RECOMMENDATION: The state bond committee should provide debt guidelines and the state should set ceilings on local government debt, beyond which it will not pledge its moral obligation to pay if the municipalities default.

6. The future of the Permanent Fund is clouded because there has been no formal decision as to its goals.

RECOMMENDATION: The legislature should enact legislation which establishes the long-term goals for the Permanent Fund so the public and the leadership can make rational decisions as to how large the Fund should be, when earnings should be used, and for what purpose.

GETTING THE MOST FOR OUR OIL MONEY?

Is Alaska getting the most for its money?

Since Prudhoe Bay oil began flowing through the Trans Alaska Pipeline in 1977, over \$17 billion of unrestricted revenues have flowed through the state treasury.

What did Alaska get for \$17 billion? If we had it to do over again, would different decisions be made?

The answers could be prophetic because, in a sense, Alaska does get to "do it over again".

State revenues from Prudhoe Bay between today and the year 2000, when production will be in rapid decline, are expected to be double what has already been received.

In the final accounting, when the oil from Prudhoe is gone, will Alaska have gotten the most for its money?

This is the central issue of public wealth management: getting the most out of public assets to serve the long-term best interests of the people.

It has been said that there is no agreement among Alaskans as to what constitutes "best interest". In



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fact, there has been consensus on basic principles of wealth management:

- Alaskans strongly supported a Constitutional amendment to invest part of these oil revenues in a Permanent Fund savings account;
- They strongly supported a Constitutional amendment to set a spending limit;

Polls have indicated strong support for the concept of a Capital Investment Fund that would invest in revenue producing regional infrastructure projects.

Discipline in current spending and emphasis on investing for the future, both in savings and in capital projects - these themes represent the challenge of wealth management Alaskans have made to their elected leadership.

Not an easy task, for the challenge will clearly require rolling back current spending to levels that can be sustained as Prudhoe Bay revenues decline.

This is a double-bind for elected leaders. The public says, "Spend less now, invest in the future". The special interests say, "You have more than enough surplus revenues to fund my project".

To meet the challenge will require a strong sense of commitment to Alaska's future, the management tools to make strategic choices, and the policies to enforce decision-making.

The double-bind: a need to cut spending now, with "surplus" funds still available.

WHAT WILL ALASKA BE LIKE AFTER PRUDHOE BAY?

Predictions for the year 2000 range from that of a state facing bank-ruptcy to that of a state rescued by a combination of new petroleum/resource developments and rising

What will Alaska be like after Prudhoe Bay? This is the pivotal

wealth

management

question for

decisions today.

market prices.

Should the state manage for doom or miracles? Or is there a more rational approach?

For as the supergiant Prudhoe Bay field made Alaska an instant billionaire state, subsequent spending policies made Alaska an instant dependent.

Eighty-five percent of total state revenues come from this single field, a single field that every forecast agrees will be in rapid decline by 1990.

Fear of a future with no Prudhoe Bay revenues has generated a wide selection of public policy choices from "save it all now" to "get what we can now".

There are policy-makers who say the government has been crying "wolf" about declining revenues since 1977 - and that "gloom and doom" predictions about the 1990s are just that.

Others are convinced state revenues really are going to fall dramatically and that no combination of actions will save the economy from a hard fall.

Should the state manage for doom or miracles?

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Ironically, the policy solution offered by both these viewpoints is the same: business as usual.

The approach is to continue spending - to "get what we can while the money lasts" and pass legislation that will give favored constituencies first cut of the dwindling revenues in the future.

In contrast, there are those who are also convinced that revenues are going to decline, perhaps permanently, from the incredible highs of the past four years. But they believe that the state can, by prudent choice, avoid economic disaster and pursue opportunities for continued economic vitality.

These leaders may differ as to method, but all support the following concepts:

spending conservation;

investment rather than consumption of "surplus revenues";

encouraging private investment
in new projects;

This rational approach combines the strengths of sound fiscal planning; includes the principles of wealth management endorsed by the Alaskan public; and must be the basis for public policy choices if Alaska is to have a sound future.

There are those who believe Alaska has a more rational choice.

SPENDING FOR A 'SOFT LANDING'

Spending conservation is the most readily available policy alterna-CONSERVATION: tive that could lead to a "soft landing" and improve the outlook for the state's economy in the next decade.

> Since 1979, state spending Prudhoe Bay oil revenues has been the major driving force in the state economy. Ιf leadership ignores its own forecasts continues to spend beyond future sustainable levels, the end result will be very much like that of a company: unemployment, failed economic and social hardships - the classic negative multiplier.

> Spending conservation policies must be enacted that encourage sound, long-term wealth management decisions. These policies include:

- Strengthening of the Constitutional spending limit.
- Adopting a cash-based budgeting system (utilizing earnings from General Fund investments as the funding source).
- Reducing current state spending to levels that can sustained in the future as Prudhoe Bay revenues fall.
- STRENGTHENING OF THE CONSTITU-1. TIONAL SPENDING LIMIT: job of leadership is more rational when the public sets the boundaries - when the public agrees that the government cannot, and in should not, be everything to everybody. This is the effect of a Constitutional spending limit.

If spending continues, the result could be like that of a failed company.

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Alaskans supported the 1982 Constitutional spending limit amendment, but that amendment is not effective now because it is based on spending expectations that existed prior to the decline in world oil prices in 1982 and 1983.

Although it hasn't received much attention, the 1982 amendment contains a provision requiring that it automatically be placed on the ballot in 1986 for reconfirmation by the voters.

The legislature should prepare a second, companion amendment for the 1986 ballot that rolls back the \$2.5 billion spending base to a reduced level and makes other changes as necessary.

2. SHIFTING TO CASH BASED BUDGET-ING: This policy is a natural for Alaska's petroleum based economy because it requires that spending not exceed the previous year's actual revenue. In contrast, the current system bases spending on forecasted revenue.

This policy proposal has been popular in concept and difficult to execute because it would require redirecting of revenues into a special fund. The state would have to accumulate a nest egg equal to one year's total income.

A workable approach is to set aside the earnings from General Fund investments (last year's annual earnings were \$240 million) until the necessary amount is accumulated. This process could not be guaranteed without a Constitutional amendment.

The spending limit amendment goes on the ballot in 1986.

General Fund earnings should be used for cash based budgeting. 3. REDUCING CURRENT STATE SPEND-TO LEVELS THAT CAN INTO THE 1990s: SUSTAINED Forecasts show that if the state persists in maintaining current spending levels, within 10 years it will face a revenue gap of over \$1 billion even if personal income taxes are reinstated and the Permanent Fund dividends are plowed back into the General Fund.

Spending decisions faced by the state are serious: to begin planned reductions now, or continue spending and face forced reductions in the near future. Forced reductions always cost more in social and economic hardship.

Spending for capital improvement projects by the State of Alaska increased from \$191 million in 1973 to \$1.2 billion in 1984 - an increase of 628.2%.

Spending for day-to-day government operations increased from \$383 million in 1973 to \$2.2 billion in 1984 - an increase of 574%.

Neither inflation nor population explain these increases. The money began pouring in; the state spent it - sometimes in very reasonable and considered ways. Now there has to be a review to determine what spending was not reasonable and to reduce the budget in those areas.

Loan programs, education programs, energy development, community

Forced reductions always cost more in social and economic hardship.

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development - all the "sacred cows", new and old, must be re-evaluated in terms of program goals and effectiveness.

The intent must be to provide all necessary public service at the best possible cost. This will put the government in the position of being able to sustain a continuing high quality level of service as revenues decline.

If there is no weeding out of the inappropriate or ineffective programs now, deep across-board cuts will be required as revenues decline. The result will be that the best will suffer with the worst.

A re-evaluation of capital spending is also essential because the operating and maintenance of capital improvements is a continuing and ever-increasing "call" on state revenues. This fact must be taken into account if the state is not, by default, to build past its future ability to maintain and operate its facilities.

The entire capital budgeting process needs review. (See The Challenge of Local Government, and The Challenge of Leadership.) The proposal to drastically reduce this budget is appropriate until the state has a long-range capital spending plan and processes in place to set priorities and assess on-going costs.

The state's capital spending must be re-evaluated.

SURPLUS FUNDS: TWO INVESTMENT STRATEGIES

Alaska's Permanent Fund is the only one of its type in the United States - a dedicated fund that does not specify the purpose for which the money is to be used.

As the Fund grows (it now totals \$6.1 billion) the level of public interest in its ultimate use increases. In the last legislature there were over 40 bills dealing with Fund questions such as:

Should there be a requirement that a percentage of Permanent Fund monies be invested in Alaska?

Should there be a requirement for investments in revenue-producing public capital projects?

Should the majority of the earnings be plowed back into the Fund or should they be spent now for other purposes?

These are the management policy questions. There is a more basic issue:

What is the purpose of the Fund?

The only certainty is that the Permanent Fund is a true state savings account. A portion of Alaska's ownership revenues from oil production are set aside by a Constitutional amendment with the provision that the principal "shall be used only for income-producing investments" while the income is subject to legislative control.

The Permanent Fund is a true state savings account.

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The public thesis when the amendment passed in 1976 was that one day the Prudhoe Bay oil would run out and Alaskans would need a cushion.

It is still considered likely that the Fund will eventually be used as an endowment to "fill in" revenue gaps and sustain a certain level of government spending at some time in the future when Prudhoe Bay revenues decline.

There are two public policy pitfalls involving the Permanent Fund:

The mistaken belief that the Fund alone can "save" the future economy without spending conservation measures or further development of new revenue-producing projects.

This would be an extremely serious error for wealth managers to make because it would delay corrective measures that must be taken within the next two to three years.

The use of the Fund earnings to sustain current operating budget spending levels into the future.

No other state has ever had an "endowment" to sustain its budget. The possibility makes it even more important that the state streamline its current budget and Constitutional spending limit. Earnings from the Fund should never be used to supplement future budgets without the safeguard of a strong spending limit. It would be ironic

No other state has had an "endowment" to sustain its budget.

It is time to decide the purpose of the Permanent Fund. indeed if this well conceived account was ultimately used to continue a level of government spending that many citizens judge to be irresponsible.

Now there are questions as to whether all "surplus" revenues should be placed in the Fund, in addition to the 25% mandated by the Constitution - the "front loading" proposal. The question is difficult because until Alaskans know what they want the Fund to do, they cannot know how large is "large enough".

It is time to decide the purpose and goals of the Permanent Fund. The longer these basic decisions are put off, the more likely it is that the ultimate use will be decided by default - by a series of interim, small decisions that eventually foreclose other choices.

The legislature should enact legislation which establishes the long-term goals for the Permanent Fund so the public and the leadership can make rational decisions as to how large the Fund should be, when earnings should be used, and for what purpose.

Management of the Permanent Fund should continue to be directed toward keeping options for future use open, while at the same time, maximizing the return on investment:

• Earnings from the Fund should continue to be used first to inflation-proof the Fund.

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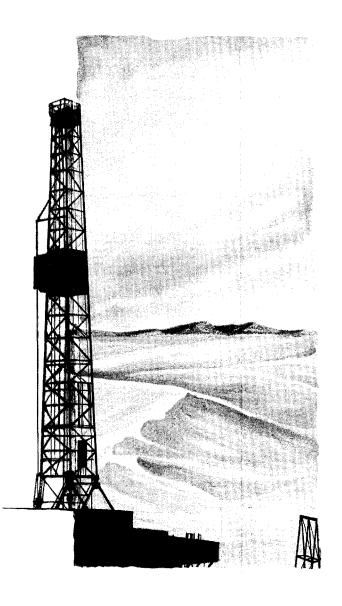
- Investment strategy should continue to employ the prudent investor rule.
- In-state investment should be encouraged but should be made carefully so as not to disrupt the market economy or compete with Alaska's private sector investors.
- A separate fund should be established for revenueproducing capital investments; the Permanent Fund should not attempt to be a "dual strategy" fund.

Alaskans already have a savings investment account. What is needed is a second fund that takes the now available surplus cash from the spending stream and invests it into in-state projects that will themselves generate additional revenue.

A Capital Investment Fund concept continuing has received support, but would require Constitutional amendment to quarantee that sufficient revenues would be set aside. The Fund would only invest in those regional capital projects that meet strict criteria and that can be proven to have a positive impact future state economy. (See the Challenge of Ownership the and Challenge of Leadership.)

A Capital Investment Fund is the "gap" in the state's portfolio.

A VITAL STEP: NEW SOURCES OF REVENUE



No matter how well Alaska manages its money, the state economy will not remain vital without new sources of revenue.

All of the "doom" estimates based on current spending are also based on current sources of revenue. As Prudhoe production declines, it is obvious that new production must be encouraged.

At the same time the state cuts back in spending and invests present surplus revenues, it must look to future production.

Any wealth management scenerio fails without this crucial step.

Of the various opportunities for new revenue sources, the most likely are new oil production and the marketing of North Slope natural gas.

THE NORTH SLOPE NATURAL GAS PIPE-LINE MUST BE MOVED TO THE TOP OF THE STATE AGENDA.

In addition to bringing nearly \$14 billion of private investment into the state, Alaska could receive as much as \$800 million a year in royalties and severance, property, and income taxes from this one resource. All other potential revenue sources combined, including mining, timber, fish, and even personal income tax, would yield far less.

The State of Alaska must push for an economic way to move gas from the North Slope.

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The state can encourage a gas transportation system by:

- Continuing to examine the ways its tax and regulatory system affect the cost structure of Alaska construction. The 1984 passage of Senate Bill 402, relating to exemptions from tax, or credit against tax for gas processing projects and new petroleum development, is a step in the right direction.
- Working to secure better ties with Asian nations, one of the state's most likely markets for gas. The greater our mutual familiarity, the better the chances of "joining together" down the road.
- Pushing hard for free trade in Alaskan oil. While prohibitions do not exist on gas, the refusal of the United States to sell oil makes Alaska look like an unreliable supplier in all forms of energy.

Free trade in Alaska's oil is important for the future.

NEEDED: TOOLS FOR FINANCIAL MANAGEMENT

When world oil prices soared in 1979, so did Alaska's General Fund revenues. State revenues doubled between FY 1979 and FY 1980, and almost doubled again in FY 1981: \$1.4 billion to \$2.8 billion to \$4 billion.

State government spending is almost entirely based on oil revenue expectations - expectations that can change overnight following world oil prices.

The impact on Alaska's revenue picture is substantial. State analysts estimate that every \$1 decrease in the price of oil means a loss of \$150 million a year to Alaska in royalties and taxes.

This unpredictable rise and fall cycle is central to the state's need for an efficient wealth management system, a system that will give lawmakers the ability to make strategic choices.

The State Department of Revenue does a scholarly job of forecasting expected revenue trends in its Petroleum Production Revenue Forecast and Revenue Sources publications. But spending based on expectations of future revenues requires two additional management tools:

A long-range financial plan to serve with revenue forecasts as a guide in determining whether current proposed budget levels can be sustained.



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- An annual audited financial report that presents the actual balance sheet and income statement for the state government.
- The governor's office should prepare a five-year financial plan that includes revenue, expense, and capital improvements.

Currently, the annual state budget process is a twelve month forecast of spending that is routinely subject to amendment through supplemental budget appropriations. As a result, the current process does not even produce a reliable one year spending plan.

A long-range financial plan, while not binding subsequent legislatures, would serve as a continuing guideline for reconciling current spending with future expectations.

The plan should address proposed capital spending, including construction schedules, source of funds, and estimates of on-going operations and maintenance costs.

2. The legislature should mandate an annual audited financial statement conforming to generally accepted accounting principles.

The State of Alaska does not have an annual audited financial statement. This fundamental tool of management in both the private and the public sectors must become an annual obligation of state government.

The state needs these fundamental tools for rational planning.

CONSIDERATIONS age FOR DEBT MANAGEMENT At age be BAN

At a time when credit rating agencies are downgrading the credit ratings of many states, Alaska can be proud of its rating upgrade from BAA to AA over the past decade.

It is in the state's interest to offer a well-structured, high-quality security in order to obtain funds and to obtain them at acceptable interest rates.

Public policy considerations for debt management include the following:

CAPITAL FINANCING

If a capital project is expected to generate revenues sufficient to service bonds, it is fiscally responsible to finance construction through project revenue bonds even if current general revenues are available to cover project costs.

Revenue supported debt does not increase the direct debt burden of the state and may encourage sound financial management. Each capital project should be evaluated on its merits, not on the availability of current revenues. These are the underlying principles of the Capital Investment Fund.

MORAL OBLIGATION PLEDGE

The state has a direct, and may have an indirect, obligation to repay bonded indebtedness, with the revenues from Prudhoe Bay and the Permanent Fund considered as the "deep pockets" in case of default.

Each capital project must be evaluated on its merits.

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Careful scrutiny must take place, so that this moral obligation of the state is not abused by state and local governments.

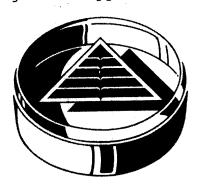
State Bond Committee should The provide debt guidelines. This approach is superior to imposing a the ceiling on local government. Ceilings on government debt, however, should be established beyond which the state pledge its will not obligation.

LEASING AS DEBT

The state has used another device to incur debt that does not require a public vote (as does a general obligation bond sale).

By entering into long-term lease agreements the state can acquire additional public facilities. The lease agreement, in many ways, is just as binding as debt; \$27 million was spent in 1984 on leases of this kind.

The public should be informed of the amount of money being spent on leases annually, and limits should be placed on the amount of lease obligations that the state can incur in this manner without obtaining voter approval.



Ceilings should be placed on local debt.

The public should be informed of how much is spent on leases.

COMMONWEALTH NORTH

Commonwealth North is a non-profit corporation, organized and existing under the laws of the State of Alaska.

As well as providing a forum for national and internationally-known speakers, working committees study critical issues facing the state and prepare action papers, such as this one.

Commonwealth North was founded in 1979 and co-chaired by two former Alaska Governors, Governor Walter J. Hickel and Governor William A. Egan. The two sat as co-chairmen until Governor Egan's death in 1984.

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