

SCOMM

101:3

6/16-17/95

Gail

- public hearings important
 ~~re: public~~ to public
 constantly questioned re: public
 hearings
 telecom OK
 critical ^{that} public be involved
- very much paying attention to
 work of commission
 edge for report
- grateful for effort

Perm Fund

Mallor, Kelley
Video

Scenarios:

- mid case revenue projections DOR
- rate of return 9.7% US stocks
 assumption:
 real rate 4.79% dividends
 interest realized &
 unrealized

\$246b / 95b+1 / inf
earn div available to use

Discussion re: mgmt of PF, inflation
mobility, earnings reserve, dividend
calculation

inflation cost vs. value inflation model?
- Cost

how define "realized gain"
discussion

currently 400 million in unrealized gain
^{maybe looking at} new policy to take 1/3rd in
portfolio (BSM this yr). People be
\$100 million a yr.

Needale scenario (graph 4)
discussion re: "bulking up" corpus

PF keep w CDROM modules.

Revised Base Case

Federal cost shifting
rate of growth, formula programs
recc:

MN

Establish "Grace Commission"
to analyze programs

ALL

Need to calculate reserve cushion
into meeting gaps.

disc: what drives budget
incl. pop growth & inflation

★

CALL JIM KELLY RE CDROM/GRAPHICS ★

79-96 compare
median CPI & pop = 116% inc.
gains to indiv -
groups -

5 6 7
 Goesuch Ludwig Presmer Nordate
 O O □ O

- 4 O Motley O McConnell 8
- 3 O Lincoln O Navane 9
- 2 O ~~Loeschel~~ O Riensell 10
- 1 O Oconnee O Brady 11

O 13 O 12
 Fouse Kogea Richee

- 14 Westfall
- 15 Pouchot

	<u>COST 1</u>	<u>COST 2</u>	<u>TIME</u>	<u>NUMBER</u>	<u>DIS</u>
<u>Tabloid</u>	ADN 9350	AP 7200	19 July		

11x17 (1pg) LEGPRINT = NC Admin 1400

Insertion
Cost

Information to public has to be
by consensus

POSSIBLE
ASSUMPTION

if limit to half pop & int. ^{cur} ~~then~~ \$200m

Why

AM

Report should be paid out
as problem explained in

A?

real vs. nominal dollars?

A?

mean out base of

183 current gap
359 ^{pop} inc pop ~~gap~~ = 10% real
415 revenue reduction ^{budget}

return
1:30
pm

Subcommittee Reports

Style & Drafting - will meet next week

Revenue Sources

- letter from State Assessor re
Statewide property tax
- 30 million ea 1 mill
- much property is vacant &
exempted
- sales tax est 1987 \$49 million
per ea cent (incl food) update
in revenue will show scenarios
generated at pt. of sale
- audit of PT earnings
- utilities, state health, excise,
Federal revenues (Pouchot)

Income Tax (Groesbeck)

- unusual relationship w local govt
- ec. eff argument; investment impacts
- equity: who pays
- elasticity
- political feasibility
- interstate capture
- inflation

If Alaska taxed at comparable level
to other states would yield about
500 million \$

Keep current local govt tax structure
in mind when considering taxes

[* Check Pat Pouchot tomorrow *]

could do shifting of responsibilities
along w " of taxes

Allison Elgee AE
 Mike Greaney MG
 Cheryl Frasca CF
 Shelby Stasny SS

AE

Couper Admin different environment
 after Sheffield red 200
 projected

cut add plan \$150m
 not merit favorable reaction, march
 red forecast up

- So budget ended up status quo
- then deep recession
- maintain level spending, but forced agencies to absorb inflation
- made effort to equalize
- police note in Hillside
- transfer Class 3 road maint to munis
- make prisoners local resp, more to arrangement

- didn't give agencies target cuts
- then Edon Valdez changed picture & end of term

UEP:

- legislative/observer
- expenditure side of budget
- look at form & non-form
- half go bud form, half non-form
- handout
- compare 85 to 95 budget
- inflated it
- formula / non-formula / then prove out education & social services
- form Medicaid / AIDE
- nonf below 85 level
- not blended

AE:

comparisons / depts shift & change /

marine highway fund

CF also doesn't reflect shift from GF to NonGF
i.e. student loan - bonds
PCE - endowment^{to}

Mike Naw also increase program receipts not reflected

MG • almost a billion dollars out of ^{anyones} pocket
can't really cut too much

• expenditure level about where it should be,

SS • Hickey promised 5% budget reduction
each yr of administration
• goal + charge to depts
• 1st budget presented to Leg not accepted
• people + leg really need to look at needs-
based programs Need to revisit ^{needs} tests
put into formulas
• 2nd budget not as aggressive. Had
looked around to see if reductions
really necessary
• Have systems that need fixing
• accounting
• personnel
• building maint
need to be looked at as part of
an overall plan
• budget stayed level during Hickey
admin. which

CF • target active over 3 yrs
• let each dept do strategic
thinking about how to get there
and the statutory + regulatory changes

needed

- attachment in considerations
how would they change the
mix & level of Sves. Why done
this way? How could service
be delivered differently?
Revenue \$ other than State GF

- 94 budget - decided to shift
focus, require incremental information
and then talk about in words the
goals & Sves of the dept.
also describe outcomes
- not a successful experiment

- budget has about 80 different fund
sources, GF is only about four. Type
non-GF = 705. HB 1000

(• Von GF - how much still out there)

- agency
people pushed to find non-GF sources

- Budgets go up, down, or sideways
throws cold water on notion that
chg in budget process results in great
change
- mechanisms, CBE, Sweep. Constitution
only allows a few dedicated \$, case
can be made that all other \$ are
GF and are available.

- Oregon / dedicated \$ /

List of funds represent political
transfers

Brian
Rogers
SS

HG

GE

• number of \$ tied to exp.
i.e. div of insurance paid for by
industry

AE

~~str~~
enterprise receipts should be
separated out.

MN:

AM

Need to talk about investments for
efficiency i.e. state accounting system
also need to build incentives into
budget process

DE:

Long term impacts ^{of cuts} are starting to
show:

i.e. very little planning
deferred maint

MG:

also courts involved in budget process
now

JB

Q- Formula programs drive. How would
begin to change:

DE

currently spending less per student

Twain

Contract w Local Govt, services
provided, underused tax capacity
uniform policy, mandatory
brought
& present clear picture

35 Mandatory thorough - legislature
 should sit as assembly
 Formula prog
 {medicaid} need to look
 {medicare} at kind of safety net

SR Idea needs to be broadened, maybe
 state is not right one to deliver
 a particular service, but.
 maybe muni not best vehicle i.e.
 non-profits, service areas.

AE Currently not equity statewide in service
 delivery

CF MK-drop out of medicaid..?

BR Political regional considerations?

AE most ^{centralization} cutbacks done already

SS probably continue to happen @ cutbacks

CF Some depts make decisions based on
 legislators position.

BL Why medicaid exceed MI
 MG Fed govt calling shots.

MG MORE THE SAME THAN DIFFERENT
 THAN OTHER STATES

AM Health care costs rising
 pool of eligibles greater

do analyses of areas of fastest growing

AE Variety of ways we do better than other states do.

SS After a fixed days change pool of eligibles.
% of poverty level

LG Should commission get into specific budget #s or target?

Need to empower change
No clear guide as to what is public resp vs private resp

MG: details only if time left over I'm looking at policy

AE: Don't set target for reduction w/o guidance to do.
Need to pay attention to consequences
Also need to look at whether state pays for university here is state pays for VS. counties in other states local govt.

JB Did press help ^{at} public understanding?

SS No

AE Mixed Bag

MG No, mixed bag

CF No

Return to SC Reports:

Expenditure exercise:

AM:

RANGE of Scenarios

- categories within budget
- arranged by subject area
- helpful to make notes

EXP. WORKSHEET

Byron - Would you please
introduce the Delegation?
Or ask Alex

MEMORANDUM

To: Whom it may concern
From: Alex Ponomarev, visit coordinator for the Northern Forum
Subject: Visit of an official delegation from Khanty-Mansiysk Autonomous Region (June 6 -June 17)

Purpose of the visit:

Meet representatives of Alaska State Government, Anchorage Municipality, Alaska Permanent Fund, Alaska Legislature, Native corporations and Alaska business community to study the system of government and administration of Alaska, regulation of private business, involvement of Native people. The delegation was invited to Alaska by the Northern Forum.

Khanty-Mansiysk Autonomous Region:

- The oldest oil and gas producing region in Russia
- Population: more than 650 thousand people
- Capital: city of Khanty-Mansiysk

Members of the Delegation:

~~1. Gennady Dmitrievich Oleynik~~

~~Head of International Economical Relations for
Khanty-Mansiysk Region~~

2. Sergey Semenovich Sobyenin

Chairman Of Duma (similar to President of State Senate)

3. Alexander Leonidovich Sidorov

Mayor of the city of Surgut

4. Alexander Mikhailovich Konstantinov

Deputy Head of Administration Native People Affairs

5. Valentin Igorevich Nazarov

Director of the Programs Fund for Future Generations

6. Alexnader Ivanovich Kondyrev

Executive Director of the Fund for Future Generations

★ Richard ★
Fireberg
controlling

Cheryl Trasca 40.50.30

See material

LG Need to make determination re
how handle inflation + inflation proofing.

AM Goals need to be decided upon.

Noedale Review of Revenue Committee.

Tom Williams.

see material for summary of
proposal - pg ii.

→ entire principal of PF SB int. proposed

★ review of merit + step increased
double stepping

"Contract w/ local govt"
 plan would bring stabilization to local govt as well.

MN If comm set out list of resp. mandated to local govt, what reaction AMU/local govt?

WITHDRAWN

BR * (KEVIN RITCHIE) AMU - prepare format/draft allow comm to look at responsibility allocation ^{MATRIX} ~~SHOWN~~ some

AM address disparity among communities

SR Should address private non profits who is paying, rather than who is delivering

Controversy about resp, or tradition done OTHER STATES

TAKTOLOB RE: PRES SBASSO
 * ✓ School Bd Asso. * DOE

* LOESCHER plans to work w/ AMU to frame questions & issues. Working w/ Comm. CEA wants liaison w/ schools, Dofed, etc.

MN * CEA Model Borough Act, analysis of prop tax bases, LABOR gross income, retail sales

LG: How respond to 25% loss over next 5 yrs.

The Superintendent has been sent out.

Rieger:

(See outline) -

Shottson Report - Study Commissioned by LBA.

Risk Tolerance: Should be willing to address

IBB - looked at target

Rh *

inc in Rieger material

Revenue & analysis of proposed standard deviation of risk 3. compare current 2 Shottson pg 8. Graphs *

B³⁰ - 1/15

1st Budget

LG Goals
Assumptions
Principles

BR & Options

Report vs Press Release

★ Call ADN Editor? ★

Bob & Bruce - Sunan

Lee & Judy - ADN

Mary & Brian - Newstime

Mica Navane

Town Meetings

Am. Television

★ Pub OUTREACH COMM ★

★ LOOK FOR TELECONF times/SITES ★

EXP SP Brady

will be calling around to
see what exp. principles comm. wants

★ Then ask Brad to run budget against
principles

January

★ Principles for revenue raising as well

LG: Performance report
O&M in op bud.

BR see sheet 10

LG ^{Budget} Appropriation reform }
SR

▶ Intecim Report

DRAFT

STATE OF ALASKA
LONG RANGE FINANCIAL PLANNING COMMISSION

716 West Fourth Avenue, Anchorage, Alaska 99501

Phone: (907)258-8165, Fax (907)258-9869

Internet: LRFPC%legis@state.ak.us

Staff: Melissa Aber Fouse

Bob Walsh

Brad
Pierce
465-3008
Judy Brady
279-8114

Friday, 16 June 1995

9:30 am to 5:00 pm

Regular Commission Meeting-Anchorage

Legislative Information Office

716 West Fourth Avenue, Room 220

DISCUSSION OF NEW IMPROVED BASE CASE

BRAD PIERCE & HIS DANCING OVERHEAD PROJECTOR

SUBCOMMITTEE REPORTS

1. PUBLIC OUTREACH (LUDWIG)
3. STYLE AND DRAFTING (ROGERS)
4. REVENUE SOURCES (NORDALE)
5. BUDGET PROCESS AND RESERVES (MCCONNELL)
6. INTERGOVERNMENTAL SUBCOMMITTEE (LOESCHER)
2. EXPENDITURES (BRADY)

LUNCH

Brad the Impaler skewers the budget

FINANCE PANEL

discussion of historical budgeting assumptions

greany-left msg on vacation til tuesday

stasney-left msg OK

frasca-ok

elgee-ok (right, brad?)

DRAFT

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AGENDA

Saturday, 17 June 1995

8:00 am - 4:30 pm

Regular Commission Meeting-Anchorage

Legislative Information Office

716 West Fourth Avenue, Room 220

1. Commission Business

General Discussion

Discussion of Interim Report

Set Subcommittee Schedule

2. public testimony

LUNCH

3. Presentation of Plans:

Rieger

Williams

Forward Funding/Biennel Budgeting - Brad, any suggestions as to a
presenter. Can you do?

40/30/30 - Frasca

Harbour

Cremo

COST 1

COST 2

INSERTION COST ^{10#} FREIGHT TIMING

Additional
Assumptions

Ch 13, Title 37

1pg
TAB:

ADN
9350

AP

3105
51.75 @ 1000
(60,000)
Circ

IF PRINTED
THERE

^{circ}
39,000
\$4290
(110 @ 1000)

1pg
11x17:

LEGPRINT
0

ADMIN
PRINT
2000+

3105 ±

4290 120
Cases
paper
= 1/2 standard

Ad: ADN Full
pg 1000

AP (4pgs)
3615

0

1+3
51.75

60
3105.00

Dave Theberge

- will have hand out
- draft letter ▶ phase I philosophical approach
II detail
- adopt code of ethics
 - outside of formal meeting, won't talk about this to anyone
- Family analogy

Roger Crum

- Funds - some appropriable
- How LARGE is PF?
- " " is actual budget?
- Forward funding only moves the burs.
- 2 kinds of income: taxation such as other states, revenue from resources & land, endowment grant.

by using appropriation authority,
legislature moves unsustainable dollars
from endowment.

- Should not spend unsustainable revenue.
- Need to define sustainable level of spending.

~~I don't know up
a sharp letter
to pay Harvard.~~

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SATURDAY, 17 JUNE, 8:30 AM TO 4:30 PM

1. FINANCE PANEL

discussion of historical budgeting assumptions

- ✓greany - 465.3795 mag - vacation
- stasney - NANA - 265.4159 - mag
- ✓frasca - 258.1226, left mag 30 May OK
- ✓elgee - 258.1226, left mag 30 May OK

Discuss w/
Brian June

2. public testimony

3. Presentation of Alternate Plans:

Rieger, Left mag 30 May, Anch, STAFF VING

Williams 564.5955 - OK Eyes/10yrs

Forward Funding - ?? Joe Hayes

40/30/30 - Frasca - mag

Cremo 333.9888, left mag

Direct funding -

Do Nothing + 1/3 EL

OMB
Storage

Kerenhede
FARGOLI

number
assumptions

Gorsuch
- Cremo
- etc.

What is it
supposed to do?
How best
How implement?
How look 5-10 yr
How don't
I'm doing
nothing
What downside?

Judy
Prady

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Staff: Melissa Aber Fouse

BRAD
PIERCE
465.3008
CALL 10AM

DRAFT AGENDA
REGULAR MEETING
FRIDAY, 16 JUNE, 9:30 AM TO 5:00 PM

SUBCOMMITTEE REPORTS

1. PUBLIC OUTREACH (LUDWIG)
2. EXPENDITURES (BRADY)
3. STYLE AND DRAFTING (ROGERS)
4. REVENUE SOURCES (NORDALE)
5. BUDGET PROCESS AND RESERVES (MCCONNELL)
6. INTERGOVERNMENTAL SUBCOMMITTEE (LOESCHER)

LUNCH - HAVE BROUGHT IN??

Must be Brian

ASSETS

DISCUSSION OF NEW IMPROVED BASE CASE

BRAD PIERCE & HIS DANCING OVERHEAD PROJECTOR

STATE ASSETS

1. ALLISON ELGEE - ANNUAL FINANCIAL REPORT

should there be a discussion here about cash flow or is that muddying the waters?

2. MARTY RUTHERFORD - NON BOOK ASSETS
listing and valuation of state physical assets that are not buildings or structures, ie., timber, minerals, etc.

3. ?? MCCONNELL - SUMMARY OF PHYSICAL ASSETS BRAD, DONT YOU THINK WE SHOULD AT LEAST HIT THE HIGH SPOTS ON THIS ONE?
ie we have a billion \$\$ in assets or whatever.

MAF
LEFT 1159
762.2403



**Economic Sustainability in
Theory and Practice:
The Sad Case of Alaska**

Stephen L. Jackstadt and Dwight R. Lee

*Contemporary
Issues Series 66*

July 1994



Center for the
Study of
American Business
Washington University • St. Louis

Economic Sustainability in Theory and Practice: The Sad Case of Alaska

Stephen L. Jackstadt and Dwight R. Lee

For many, sustainability has become the overriding concern when evaluating economic performance. While seldom defined with operational precision, the general principle behind economic sustainability seems to be avoiding any decision that benefits the current generation at the expense of future generations. According to the World Commission on Environment and Development, "The most commonly-cited definition of 'sustainable development' is: Development that meets the needs of the present without compromising the ability of future generations to meet their own needs."¹

Most people would agree with the sentiment that economic sustainability appears to embrace. And if the advocates of sustainability contented themselves with broad statements of their concern for the future, few would object. But those most vocally in favor of economic sustainability insist on being specific about what they see as the major threat to sustainability and the appropriate means for overcoming that threat. With few exceptions, they see the threat as the greed and short-sightedness of the market economy, with political action required to promote the far-sighted concern that is the hallmark of economic sustainability. For ex-

Stephen L. Jackstadt is Professor of Economics at the University of Alaska, Anchorage. Dwight R. Lee is Ramsey Professor of Economics at the University of Georgia and an adjunct fellow of the Center for the Study of American Business at Washington University in St. Louis.

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ample, in criticizing the market's discounting of the future, Vice President Al Gore approvingly quotes Herman Daly's statement, "There is something fundamentally wrong in treating the earth as if it were a business in liquidation."² Or consider the statement by Lester Milbrath, Emeritus Professor of Political Science at the State University of New York at Buffalo:

Markets are very poor in providing foresight to deal with future problems. . . . Markets typically fail to recognize [the finiteness] of supply if the current supply is plentiful and cheap. Markets . . . have perpetually undervalued the earth. This failure imposes on future generations the costs we blindly refuse to pay. Only collective political decisions can provide focus and direction for the myopic vision of markets.³

There are many such statements attesting to the widespread belief that economic sustainability demands that political decisions be substituted for market decisions. The popularity and persistence of this belief is surprising given the undeniable record of market economies in achieving not just economic sustainability, but economic growth. In market economies, the well-being of successive generations has been persistently improved, with well-being broadly defined to include longevity, leisure time, and environmental quality.

The success of market economies when measured against the objectives of sustainability is not only easily observed, it is readily explained. Private property rights and voluntary exchange, the two hallmarks of any market economy, have been increasingly recognized by economists as essential for creating the information and motivation for people to appropriately take into consideration the future conse-

quences of their actions.⁴ And because political decisions are not guided by the incentives provided by private property and voluntary exchange, there is little basis for believing that political action outperforms market action in highlighting the importance of the future. Indeed, both the insights of economic analysis and the evidence, strongly suggest that the goal of economic sustainability is poorly served by substituting political decisions for market decisions.

*Economic sustainability is poorly served
by substituting political decisions for
market decisions.*

This study considers an example of a state government that could have realized fiscal sustainability with a far-sighted approach to its natural resource endowment. The fiscal windfall that the state of Alaska received from North Slope petroleum presented the state government with a unique opportunity to realize a sustainable benefit from a nonrenewable natural resource. This opportunity has been squandered despite the dire and easily foreseeable consequences. Some efforts were made in Alaska to preserve the temporary oil wealth, but these efforts were more than offset by myopic incentives that exist in all political settings. Alaska's response to its oil revenue windfall should serve as a warning to those who see government action as the appropriate way of achieving sustainability in the use of our natural resources.

A Brief History

The discovery of oil at Prudhoe Bay on Alaska's North Slope in 1968 dramatically altered the state government's revenue picture. The first large infusion of Prudhoe Bay revenues to the state came from \$900 million in North Slope oil lease sales in 1969. The \$900 million bonanza (equivalent to \$2.9 billion in 1993 dollars) was five times the total state budget the year before.⁵

State spending nearly doubled between 1969 and 1971 and increased by 46 percent again in 1972 as the legislature began gearing expenditures to expectations of huge oil revenues once the Trans-Alaska Oil Pipeline was completed. Construction delays pushed the pipeline's completion date back several years, but rapid growth in government spending continued. To bridge the gap between current government spending and expected oil revenues, the state raised severance taxes on oil again and enacted a "reserves tax" in 1976 on holders of North Slope oil and gas leases which due to a rebate provision was really a forced loan from the oil companies.⁶

The Trans-Alaska Oil Pipeline was finally completed in 1977 and oil began flowing to the Valdez tanker terminal in July of that year. State revenues from royalties and yet higher severance taxes began to rise slowly at first, but when the Iranian Revolution pushed oil prices to over \$30 per barrel in 1980 (\$58 per barrel in 1994 dollars), state revenues increased dramatically. General fund revenue skyrocketed from \$1.5 billion in 1979 to \$4.5 billion in 1982. State spending out of the general fund also spiraled upward, growing from \$1.4 billion in 1980 to \$3.6 billion the following year. From 1981 through 1988 Alaska's state spending increased nearly 20-fold, with total state spending over this period amounting to \$34

billion, or about \$70,000 for each Alaskan resident.⁷

As oil revenues soared, the taxes paid by Alaskan residents plummeted. The individual income tax and several other state taxes were repealed in 1979-80. As a result, real taxes paid to the state by individual Alaskans after 1980 were only 14 to 16 percent of the real taxes they paid during FY 1976.⁸

In 1990, Alaska per capita state spending was almost four times the national average.

Alaskans also eased their tax burdens at the local level as state dollars flowed to schools and municipalities. By 1982, tax rates in boroughs throughout the state were 30 to 40 percent lower than they had been before the opening of the pipeline. The only exception was the newly-formed North Slope Borough, where property tax rates were increased by more than 50 percent since nearly all property taxes were paid by oil companies operating at Prudhoe Bay.⁹ Alaska's tax burden is ranked fifty-first, behind all other states and the District of Columbia.¹⁰

Since Alaskans pay only a small percentage of the taxes needed to finance government spending, there is little public opposition to government spending. It is easier for Alaskan politicians to increase taxes on the oil industry than to resist constituent demands for more spending. Taxes on the oil industry have increased eleven times since 1955. Currently Alaska's tax rates on oil producers are the highest in the United States.¹¹

With Alaska able to export almost all of its tax burden, it is not surprising that the state dominates the competition in per-capita state spending. In 1990, Alaska per capita state spending was almost four times the national average and nearly two-and-a-half times higher than that of Wyoming, its closest competitor. The additional per-capita spending in Alaska is far in excess of the amount that can be explained by the higher cost of living in Alaska.

The Path Not Taken

The magnitude of the fiscal windfall to Alaska provided the state with a unique opportunity to realize sustainable benefits from its natural resource endowment. The state could have increased total spending in response to the population growth motivated by the development of its petroleum resources and also guaranteed that the revenue from those resources continued to provide indefinitely for future generations of Alaskans. If the state government of Alaska had behaved in the far-sighted way that the most vocal advocates of sustainable growth believe government will, it would have saved enough of the temporary oil revenues to generate the interest income necessary to sustain state spending at generous levels.

The state did try to preserve some of its oil wealth, which everyone recognized as a temporary windfall. In response to a voter-approved amendment to the Alaskan constitution, in 1976 the state began depositing a portion of all mineral lease rents and royalties into what is known as the Permanent Fund. Special legislative appropriations helped fatten the fund, and by the end of 1993 the value of the Fund's investments totaled \$15.6 billion — roughly \$26,000 for each Alaskan citizen. Each year some of the Fund's earnings go to "inflation

proof" the principal and by formula most of the remainder is paid out to Alaska citizens as a "dividend." In 1993, each man, woman, and child who qualified as an Alaska resident (anyone who has lived in the state for at least one year) received a dividend check in the amount of \$949.46.¹²

However, a state government motivated by the concern of sustainability would have done much more to assure a secure fiscal future for Alaska. In 1967, the year before oil was discovered at Prudhoe Bay, per capita state spending in Alaska was 2.47 times the U.S. average. Adjusting for Alaska's higher cost of living, real spending per capita was still 1.6 times the national average.¹³ Consider a policy where, starting from this already high base, the state had allowed real per-capita spending to grow at a rate equal to the U.S. average through 1993 (adjusting for the year-to-year differences in the cost of living increases between Alaska and the rest of the United States), with the excess revenue having been deposited in Alaska's Permanent Fund. Assuming that this augmented hypothetical fund generated a rate of return equal to that of the actual Permanent Fund, the Fund would have contained \$66.7 billion by the end of 1993.¹⁴

Assuming that the hypothetical fund continues to earn an average real rate of return of 5.15 percent (as it has since it started earning interest in 1978),¹⁵ the real value of the hypothetical Permanent Fund of \$66.7 billion could be maintained indefinitely, with no net additions, with \$3.4 billion being spent each year to finance state spending. This amount is \$500 million (or 17 percent) more than the total state spending in 1993. If the state had not distributed the \$4.47 billion in annual dividend checks to Alaskan residents (which began in 1982), and put it in the Permanent Fund and allowed it to accumulate interest, the hypothetical fund

would have contained \$75.03 billion at the end of 1993.¹⁶ At an interest rate of 5.15 percent, this fund would be producing an annual revenue stream of \$3.9 billion.

In other words, in our completely possible hypothetical world, Alaskans could now be benefiting on a sustainable basis from lavish state expenditures without paying a single cent of state taxes! And our hypothetical exercise understates on two counts the opportunity the Alaska state government had to benefit from a policy of fiscal sustainability. First, the population figures used to determine the hypothetical spending levels are based on the actual population which surely increased in response to the larger actual state spending. Second, if state spending were financed entirely out of interest payments from the hypothetical Permanent Fund, all future revenues from the oil industry could be used to further augment that fund.¹⁷

Surely the program of fiscal sustainability just discussed would have done more to promote the long-run well-being of Alaskans than the program of fiscal depletion that has been the hallmark of Alaskan spending policy since the availability of the North Slope oil revenues.

Wasting Resources and Disregarding the Future

There is little evidence from Alaska's recent fiscal history that politicians are motivated by the ideals of sustainability. The Alaskan state legislature has spent most of the huge, but temporary, influx of state oil revenue catering to the short-run interests of organized interest groups. This political process has allowed the current generation of Alaskans to capture benefits at the expense of future generations by plundering much of the wealth of a nonrenew-

able natural resource. The almost total disregard that political decision-makers show for sustainability can be seen in just a few of the spending programs that have been funded in Alaska with the windfall from the oil tax.

The Alaskan state legislature has spent most of the temporary influx of state oil revenue catering to the short-term interests of organized interest groups.

Barley Boondoggle

The state of Alaska has spent more than \$50 million in an attempt to promote Alaskan barley farming. This money has gone for loans which were never repaid, and the construction of access roads, rail lines, hopper cars, and grain elevators, all designed to facilitate the transportation and storage of large quantities of barley which were never grown. And many of the Alaskan farmers who were taking money from the state to grow barley were double-dipping — simultaneously taking money from the federal government *not* to grow barley.¹⁸

First-Class Trip

Many public-school students in Alaska are treated to field trips that make the typical visit to the zoo as exciting as extra homework. The Bering Strait School District, for example, received a \$300,000 grant from the Alaska Department of Education in 1980 as part of an "adventure based" education program. This grant was used to finance a tour of Europe for high-school students. The \$88,414 cost of travel was expensive, but the largest expense was the \$106,034 paid to "specialists" in ad-

venture-based education who arranged the trip and accompanied the students to Europe.¹⁹

Sour Milk

In a failed attempt to start a local dairy industry, the state gave away over 14,000 acres of land and made \$20 million in loans to would-be dairy farmers. Virtually none of the money has been repaid.²⁰ To provide an outlet for Alaska milk the state bought a creamery and promised to pay above-market prices to Alaska dairies. Since Alaskans could buy milk cheaper from Seattle, the price support scheme collapsed within a few years. The creamery, still owned by the state, continues to limp along by purchasing most of its milk from Washington State.²¹

A Dog's Life

The Alaska Renewable Resources Corporation (ARRC) was established in 1978 to provide venture capital for developing businesses based on Alaska's renewable resources. Some rather bizarre projects have received ARRC loans. Probably the strangest project funded, out of a field of strong contenders, was one for dog-powered washing machines.²² By 1987, three years after the legislature voted to terminate the program, ARRC had written off \$28 million in bad loans.²³ The success of Alaska's overall state loan program (of which ARRC is but a small part) has also been dismal. As of the end of 1987, over \$233 million in loans made by the Alaska state government were in default and another \$1 billion were delinquent.²⁴

Pay Per View

LearnAlaska, an instruction telecommunications system operated by the University of Alaska, was established by the state in 1981 to bring instructional programs to every Alaska village with a population of twenty-five or

more. Six years and \$23 million later, LearnAlaska was finally dropped as a bad idea. Barry Willis, Alaska's Director of Instructional Development during those years, called LearnAlaska "a technological solution in search of an educational problem which it never found." LearnAlaska did little more than duplicate RATNET, the state entertainment network that brings programs like Monday Night Football, General Hospital, The Simpsons, and Beverly Hills 90210 to rural areas at state expense.²⁵

Plenty of Pork

If one looked only at state spending it would be reasonable to conclude that Alaskans have prodigious appetites for the cultural, artistic, and athletic. Enormous sums have been spent building performing arts centers, convention centers, and sports arenas in towns and cities throughout the state. Even in the most populated cities these structures stand as monuments to government profligacy. The \$70 million Performing Arts Center constructed with state money in Anchorage loses over \$1 million annually even when all of the capital cost of the center is ignored.²⁶

This special-interest waste has insured that the long-run prospect for the Alaskan economy is one of painful adjustment and dislocations. The lack of accountability that has made the political decisions so responsive to the short-run demands for wasteful government spending has made them entirely unresponsive to long-run economic realities.²⁷

A bumper sticker commonly seen in Alaska after oil prices plummeted in the mid-1980s read "Please God, Just One More Boom. Next Time We Won't Piss It Away." Since then Alaska has had not one, but two "booms" and in each case Alaskans failed to keep the bumper sticker's promise. In August 1990 when Iraq

invaded Kuwait, oil prices soared temporarily on the fear that Mideast supplies would be interrupted. The result was a \$700 million windfall to state coffers. Instead of treating the revenue as transitory income and saving it, Alaska's politicians used it to maintain spending.

The long-run economic reality for Alaska is that the North Slope oilfields are being depleted.

An even bigger windfall followed in 1992 and 1993 when oil companies, including ARCO, Unocal, BP Exploration, and Chevron agreed to pay the state \$1.7 billion to settle long-running disputes over payments of back taxes and royalties. Again the promise of the bumper sticker was ignored and the governor and legislature appropriated over half the amount, ignoring a law passed by voters in 1990 which specified that such windfalls be placed in a Constitutional Budget Reserve Fund for future use. By spending rather than saving this latest windfall, the state was able to maintain overall spending and more than double capital spending from \$300 million to \$616 million.²⁸

Future Prospects

The long-run economic reality for Alaska is that the North Slope oilfields are being depleted. Since 1989, production at Prudhoe Bay (where virtually all of Alaska's oil is produced) has declined by over 15 percent. Most experts on petroleum recovery predict that even if new oilfields on the North Slope are brought on

line, petroleum production in Alaska will decline to half of what it is today by the year 2004. As oil production declines so will state tax revenues. If state spending from general fund revenues remains at the current (1993) level of \$2.9 billion per year, it will exceed projected revenues by as much as \$1 billion per year by the turn of the century. A recent study by the Institute for Social and Economic Research (ISER) at the University of Alaska in Anchorage concludes that the state is currently spending at an annual rate of \$1.2 billion more than can be sustained in the long run.²⁹ Indeed, Alaska already faces a fiscal crisis. Due to its lack of spending restraint and a drop in world oil prices, projected revenues for the current fiscal year (FY94) fall over \$1 billion short of appropriations. The projection for next year, even if oil prices rebound, is for a budget shortfall of \$600 million.

Even with the most optimistic projection of state oil revenues, there can be no doubt that Alaska faces wrenching economic adjustments. State spending, which accounts for over 33 percent of the jobs and three of every ten dollars of personal income in Alaska, will have to be decreased significantly and taxes on Alaskan citizens will have to be increased significantly. Regardless of the relative mix in spending cuts and tax increases, the effect will be the exodus of a large number of Alaskan residents with a further reduction in the tax base and significant declines in property values. Alaskan natives who have grown dependent on government programs will be harmed the most. According to the ISER, 41 percent of all economic activity in the rural interior is attributable to state spending.³⁰

A preview in miniature of what is likely in store for Alaska may be found in what happened during the 1986-88 recession when falling oil prices reduced tax revenues and forced

state budget cuts of \$1.4 billion over three years. During this period, Alaska lost 22,000 jobs (10 percent of the total) and \$1.07 billion in wage income (13 percent of the total); banks foreclosed on 10,429 residential properties (7 percent of the total). In Anchorage, Alaska's largest city, assessed property values fell by 46 percent and 29,000 people (9 percent of the total population) left the state.³¹

*The looming fiscal crisis in Alaska
cannot be blamed on any difficulty in
seeing it coming.*

The looming fiscal crisis in Alaska cannot be blamed on any difficulty in seeing it coming. It has long been recognized that the levels of state spending, and the oil revenues that supported them, could be sustained only temporarily. Neither can the coming crisis be blamed on the inability to respond adequately to it. As we have already seen, the magnitude of the temporary oil revenues is so large, relative to the population of Alaska, that they could have been converted into a generous and sustainable level of per-capita state spending. What explains the lack of fiscal foresight that, on balance, has characterized Alaska's political decisions during its oil boom? The best explanation is not found in some unique aspect of Alaska's situation, but in the myopic tendency intrinsic to all political decision making.

Political Privilege vs. Political Patience

As economists Rodney Fort and John Baden have pointed out, when government takes con-

trol of resources they become common property.³² This is most apparent when government assumes control of the revenue generated by resources. Unfortunately, government revenues are not systematically allocated to their highest valued public use by well-informed and public-spirited political decision makers. The allocation of tax revenues occurs primarily in response to political pressures brought to bear by organized groups, each with a dominant interest in a particular government program.

Predictably, the advantage to each interest group is in grabbing as much tax revenue for itself as possible, as soon as possible. Taking into account the long-run cost of expanding current government commitments would, for an interest group, be an exercise in folly and futility. The special-interest lobbyists who converge in the corridors of government power, including those in the Alaskan capital of Juneau, are surely aware that the long-run interest of all would be best served if each moderates his or her current demands on the public treasury. Yet each special interest also knows, as does every exploiter of a common property resource, that the wealth it fails to capture today will not be invested for its future benefit, but will be captured tomorrow by another special interest. Patience may be a virtue, but it doesn't pay in politics.

The benefits from a government program are typically concentrated on a small organized group (with the benefit to each member of the group being quite large). The tax burden necessary to finance such a program is spread over the entire group of unorganized taxpayers (with the cost to each being very low). So organized political activity is sure to be mobilized in support of any government spending proposal and little if any organized political activity will be

mobilized in opposition. When people organize politically it is almost always to obtain special-interest benefits for themselves, not to oppose the special-interest benefits of others. The result is a bias in the political process that favors transferring wealth into the public sector where it is dissipated as a common property resource with little regard for the long-run consequences.

Organized political activity is sure to be mobilized in support of any government spending proposal and little if any will be mobilized in opposition.

The political bias toward depletion rather than sustainability is amplified in Alaska because of the per-capita magnitude of the oil revenue windfall and because the taxpayers providing this windfall (the consumers of petroleum products) are more remote and dispersed relative to the recipients (those living in Alaska) than is typically the case. But organized special interests tend to dominate the unorganized general interest in all political jurisdictions, elevating immediate concerns over long-run concerns.³³ The most effective way of controlling the adverse effects of political myopia is by imposing strict limits on the ability of government to gain control over resources. Unfortunately, this lesson is being ignored by those who constantly call for more government control to promote their noble objective of protecting the interests of future generations.

Conclusion

Alaska's recent fiscal history is a cautionary tale for those who believe that economic sustainability is best achieved by political means. If ever a government had the opportunity to implement a policy of economic sustainability, it was the state government of Alaska. With the oil tax revenues that began flowing into the state treasury in 1969, Alaska could have maintained per-capita spending at its existing (and generous) rate relative to per-capita spending by the other states, while saving enough to maintain current per-capita spending indefinitely with the interest on the accumulated capital. Such a policy of sustainability has not been the case in Alaska. Most of the oil money that flowed into Alaska's treasury flowed right back out to fund a bewildering array of special-interest programs that have done much to foster dependency on continuing government spending and little to develop an economy that can sustain itself after the oil revenues dry up. Those oil revenues are drying up, and as they do Alaska is going to pay a high price for its political myopia. But even as the fiscal abyss draws near, the occasional oil revenue surges into Alaska's treasury (such as the one that occurred during the 1990-91 Gulf War) are spent rather than saved.

The irresponsible and short-sighted government spending that has been Alaska's response to its oil boom is sad, but not surprising. It is a completely predictable result of the disproportionate influence special-interest groups can exercise through the political process. While such groups would be collectively better off in the long run if all exercised restraint in their demands on government resources, each recognizes that its interest is best served by capturing as much as possible now with little concern for the future.

While disregard for the future may be more apparent in Alaska than in other political jurisdictions, the problem of political myopia is general. The Alaskan case illustrates vividly the perversity of relying on government to promote the ideals of economic sustainability.

Notes

1. World Commission on Environment and Development, *Our Common Future* (New York: Oxford University Press, 1987), p. 43.
2. Al Gore, *Earth in the Balance* (New York: Plum, 1993), pp. 190-191.
3. Lester W. Milbrath, *Envisioning a Sustainable Society: Learning Our Way Out* (New York: State University of New York Press, 1989), pp. 144-45.
4. For an insightful discussion of how private property and free exchange motivate the maintenance of natural resources and environmental quality, see Terry L. Anderson and Donald R. Leal, *Free Market Environmentalism* (San Francisco: Pacific Research Institute for Public Policy, 1991), especially chapters 2 and 4, and pp. 65-74.
5. Scott Goldsmith, Teresa Hull, and Steve Colt, *Monitoring the Performance of the Alaska Economy: The 1986 ISER MAP Economic Database* (ISER Working Paper 86.5, Institute for Social and Economic Research, University of Alaska, Anchorage, June 1986), p. 24.
6. Robert B. Weeden, *Alaska: Promises to Keep* (Boston: Houghton Mifflin Co., 1978), p. 147.
7. Oliver S. Goldsmith, Lee Gorsuch, and Linda Leask, *Facts and Fables of State Spending* (ISER Fiscal Policy Paper No. 2, Institute for Social and Economic Research, University of Alaska, Anchorage, October 1989), p. 3.
8. Oliver S. Goldsmith and Teresa Hull, *Tracking the Structure of the Alaska Economy: The 1994 ISER Map Economic Database* (ISER Working Paper 94.1, Institute for Social and Economic Research, University of Alaska, Anchorage, March 1994), pp. 18-19.
9. Thomas A. Morehouse, Gerald A. McBeth, and Linda Leask, *Alaska's Urban and Rural Governments* (New York: University Press of America, 1984), p. 93.

10. Beth Kobliner, "Cut These State and Local Taxes," *Money*, January 1994, pp. 82-87.
11. From material provided by the Alaska Department of Revenue, Oil and Gas Audit Division, May 1994.
12. *An Alaskan's Guide to the Permanent Fund*, Alaska Permanent Fund Corporation, Juneau, September 1993.
13. Goldsmith, Gorsuch, and Leask.
14. The authors arrived at the \$66.7 billion figure by starting with 1967 real per-capita spending in Alaska and increasing it each year by the average national real rate of growth in per-capita state spending. The Anchorage, Alaska Consumer Price Index (CPI) was used to compute the hypothetical nominal rate of Alaska per-capita spending that would have kept pace with the U.S. states' average. By using Anchorage, rather than U.S. prices, the authors compensate for the year-to-year difference in cost of living increases between Alaska and the rest of the U.S. These hypothetical per-capita amounts are multiplied by each year's population to compute the hypothetical total nominal state expenditure. This amount is subtracted from actual nominal spending (which does not include contributions to the Permanent Fund). The difference is assumed to be deposited in a savings account. Interest is then imputed to the account at a rate equal to the change in the CPI plus 3 percent prior to 1978 when interest first began accumulating on the Permanent Fund. From 1978 onward, interest is calculated at the actual nominal rate of return earned by the Permanent Fund. The total amount in the hypothetical savings account is added to the equity in the actual Permanent Fund to arrive at the \$66.7 billion dollar figure. A table outlining these calculations is available from the Center for the Study of American Business.
15. *Alaska Permanent Fund 1993 Annual Report*, Alaska Permanent Fund Corporation, Juneau, 1993, p. 25.

16. Author's calculations.
17. Even though oil production is declining, projections by the Alaskan Department of Revenue predict that the state will receive at least \$22 billion in additional oil revenues between 1994 and 2010. See Alaska Department of Revenue, *Revenues Source Book: Forecast and Historical Data* (Juneau, Alaska: Fall 1993), pp. 1-2.
18. John Strohmeier, *Extreme Conditions: Big Oil and the Transformation of Alaska* (New York: Simon and Schuster, 1993), pp. 102-103, 107-108.
19. *A Special Review of the Department of Education, Bering Strait REAA Adventure Based Education Program*, State of Alaska, Division of Legislative Audit, October 1, 1981.
20. Strohmeier, 1993, p. 103.
21. *Ibid.*, pp. 103-107. Also see Timothy Egan, "Alaska Farm Plan Yields Bitter Harvest," *New York Times* (March 4, 1992), p. A-12.
22. Interview with Senator Rick Halford, a long-time member of the Alaska Legislature and the current Senate President, (Juneau, March 1988).
23. Memorandum to Garrey Peska, Chief of Staff, Office of the Governor of Alaska, from Jack Kreinheder, Senior Analyst, Division of Policy, November 30, 1987, p. 2.
24. Alaska Office of Management and Budget Division of Budget Review. Also see Strohmeier, p. 121.
25. Quote from Barry Willis is from an interview by Efie Caldarola, a student of Steve Jackstadt.
26. *1994 Approved General Government Operating Budget Book*, Municipality of Anchorage, December 7, 1993, pp. 20-24.
27. For a discussion of other extravagant state expenditures in Alaska, see Strohmeier (1993).
28. *Executive Budget Book*, Office of Management and Budget, State of Alaska, Juneau, January 1994; p. 270.

29. Oliver S. Goldsmith, *The Alaska Fiscal Gap* (ISER Fiscal Policy Paper No. 1, Institute for Social and Economic Research, University of Alaska, Anchorage, August 1989), p. 11.
30. Oliver S. Goldsmith, L. Gorsuch, A. Hill, L. Leask, and M. Dalsfoist, *Alaska's Dependence on State Spending* (ISER Fiscal Policy Paper No. 5, Institute for Social and Economic Research, University of Alaska, Anchorage, October 1990), p. 7.
31. Ibid.
32. Rodney D. Fort and John Baden, "The Federal Treasury as a Common Pool Resource and the Development of a Predatory Bureaucracy," *Policy Review* (Winter 1980), pp. 69-81.
33. For a somewhat different explanation for political myopia, see James M. Buchanan and Dwight R. Lee, "Tax Rates and Tax Revenues in Political Equilibrium: Some Simple Analytics," *Economic Inquiry* (July 1982a), pp. 344-54 and Buchanan and Lee, "Politics, Time, and the Laffer Curve," *Journal of Political Economy* (August 1982b), pp. 816-19.

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STATE OF ALASKA
LONG RANGE FINANCIAL PLANNING COMMISSION

716 West Fourth Avenue, Anchorage, Alaska 99501

Phone: (907)258-8165, Fax (907)258-9869

Internet: LRFPC%legis@state.ak.us

Staff: Melissa Aber Fouse

Bob Walsh

SCHEDULE

As of 16 June 1995

Regular Meeting-Anchorage
Friday, 16 June, 9:30 am to 5:00 pm
Saturday, 17 June, 8:30 am to 4:30 pm

Video Meeting
30 June 1995

check audio

Friday, 9:00 am to 4:00 pm

UAF-212 B Butrovich, UAA-University Lake Bldg, UAF Library

Budget Stabilization

Discussion of Budget Cuts Scenarios (HCR 1, (4))

Impacts Briefing

*Dept
Lanok
Pancast*

*Karen
Perdue*

*10
S/C Rpt
Data Report
Principles
Base Case*

Regular Meeting-Anchorage
Friday, 14 July, 9:30 am to 5:00 pm
Saturday, 15 July, 8:30 am to 4:30 pm

Complete Drafting of Interim Report
Discuss Public Participation

Video Meeting

Thursday, 27 July

Afternoon & Evening

UAF-212 B Butrovich, UAA-University Lake Bldg, UAF Library

*not
call
re up*

Review Final Document Mark-up
Impacts of Alternatives, Responsibilities of State &
Local Governments: Municipal Debt [HCR 1, (9)]

Regular Meeting 10

Friday, 11 August, 9:30 am to 5:00 pm
Saturday, 12 August, 8:30 am to 4:30 pm

~~Regular Meeting~~
~~Friday & Saturday 25 & 26 August~~
~~9:30 am to 5:00 pm~~

12-14
05-08 September
Possible Public Hearings

Final Report Preparation

Approve Final Report

Mon thru
WK 12 Telecont.
7-10
11, 12, 13, 14
STATEWIDE?
REGIONAL

MEMORANDUM

18

State of Alaska
Office of the Governor
Office of Management and Budget

DRAFT

June 13, 1995

TO: LRFPC Budget Process Subcommittee

FROM: Brad Pierce
Senior Policy Analyst

SUBJECT: Ideas from Initial Teleconference

Listed below are the subjects members have come up with for discussion at future meetings. We have tentatively divided them into two groups, those that the commission needs to address directly and those the commission might point to as areas for further attention.

Budget Process Issues for the Commission to Address

- Treatment of program receipts and other designated fund sources vs. general funds and restricted revenues.
- Incorporating performance measures into the budget process.
- Constitutional Budget Reserve (CBR) requirements and issues in the context of an overall reserves policy. *incl other assets*
- Forward funding all or part of the budget (required by LRFPC resolution).
- *BE* Bring Permanent Fund real earnings "on budget."
*all expenditures to PFE, AMIC, etc.
reappropriations, allocations*

Other Issues that the Commission Might Want to Identify for Further Study

- Making the budget more understandable to the general public.
- Portraying the state budget in relation to federal and local spending.
- Out year O and M costs of capital projects in a 5 year spending plan.
- Incentives for savings.
- Unbudgeted reimbursable services agreements (RSAs).
- The proliferation of special funds.

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LONG RANGE FINANCIAL PLANNING COMMISSION

716 West Fourth Avenue, Anchorage, Alaska 99501

Phone: (907)258-8165, Fax (907)258-9869

Internet: LRFPC%legis@state.ak.us

Staff: Melissa Aber Fouse

Bob Walsh

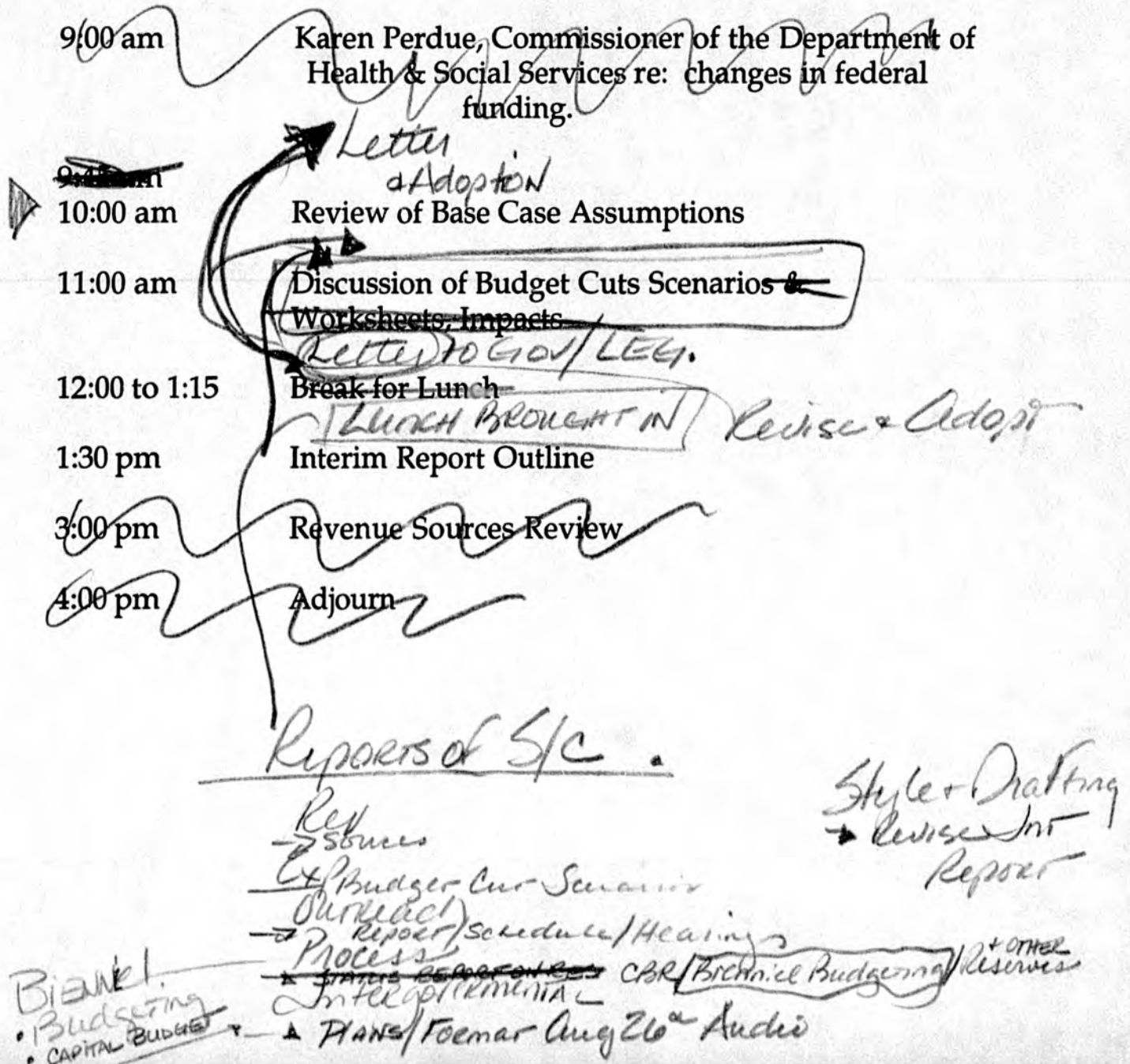
9:00? 10"

Regular Meeting-Anchorage

Friday, 14 July, 10:00 am to 5:00 pm

Anchorage LIO, 716 West Fourth Avenue, Suite 220

Complete Drafting of Interim Report
Discuss Public Participation



Regular Meeting-Anchorage
Saturday, 15 July, 8:30 am to 4:30 pm
Anchorage LIO, 716 West Fourth Avenue, Suite 220

\$11⁰⁰ public testimony.

12⁰⁰ Break for Lunch

July 29th VIDEO, conf

**STATE OF ALASKA
LONG RANGE FINANCIAL PLANNING COMMISSION**

716 West Fourth Avenue, Anchorage, Alaska 99501

Phone: (907)258-8165, Fax (907)258-9869

Internet: LRFPC%legis@state.ak.us

Staff: Melissa Aber Fouse
Bob Walsh

SCHEDULE

As of 01 July 1995

Regular Meeting-Anchorage

Friday, 14 July, 9:30 am to 5:00 pm

Saturday, 15 July, 8:30 am to 4:30 pm

Complete Drafting of Interim Report
Discuss Public Participation

Video Meeting

Thursday, 27 July

1:30 pm to 7:30 pm

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~~Review Final Document Mark-up~~ *APPROVE COMPLETED INTERIM REPORT*

Impacts of Alternatives, Responsibilities of State &
Local Governments: Municipal Debt [HCR 1, (9)]

Target Date

05 August, Saturday

Distribution of Interim Report & Survey
Use Month of August for Public Outreach/ie Radio Talk
Shows, Newspaper Interviews, Municipal Meetings,

Regular Meeting

Friday, 11 August, 9:30 am to 5:00 pm

Saturday, 12 August, 8:30am to 4:30 pm

Stabilization of Revenues [HCR 1, (3)]

Budget Process [HCR 1, (5)]

Regular Meeting
Friday & Saturday 25 & 26 August
9:30 am to 5:00 pm

Identify New Revenues
Will Condon
Municipal League
British Petroleum
Prepare for Public Hearings

05-08 September
Possible Public Hearings

Regular Meeting- Anchorage LIO
Friday, 15 September, 9:30 am to 5:00 pm
Saturday, 16 September, 8:30 am to 4:30 pm

Final Report Preparation

Regular Meeting-Anchorage LIO
Friday, 29 September 9:30 am to 5:00 pm
Saturday, 30 September, 8:30 am to 4:30 pm

Approve Final Report