

ALASKA: PRECARIOUS RICHES AND STUBBORN POVERTY

By Arlon R. Tussing

I. ALASKA'S OIL INCOME

Alaska's famous natural-resource wealth is concentrated in one oil field. The Prudhoe Bay field on Alaska's Arctic coast is the biggest ever found in the United States: During 1981 it accounted for 17 percent of U.S. crude-oil production, and at the beginning of 1982, it contained 25 percent of the nation's proved oil reserves. Because the Prudhoe Bay field is on state-owned land, the government of Alaska has, for a few short years at least, emerged as the richest political entity in North America, measured by income per resident.

While other states were having to make painful cuts in public, income from Prudhoe Bay oil was allowing Alaska to abolish its income tax, appropriate more money per capita for public services and capital improvements than any other state, and even give each resident a check for \$1000. Alaska, where a booming economy seems to be driven by the record fuel prices paid by out-of-state consumers, is thus a natural scapegoat, especially in hard times. Nevertheless ---

The perception of Alaska and Alaskans as fabulously wealthy is a myth.

II. THE PEOPLE OF ALASKA ARE NOT RICH

Instead of a bloated cigar-chomping capitalist, the best metaphor for Alaska today is probably the slum kid who wins the Irish Sweepstakes or the heavyweight championship, and thereby gets one brief chance to overcome his handicaps before age, taxes, bad luck, and bad companions catch up with him.

Alaskans, on the average, still have lower real incomes and less real wealth than residents of the East and Midwest.

The U.S. government's personal-income statistics seem to show Alaskans as having higher average incomes than the residents of any other state. This comparison ignores the big difference in prices and living costs. According to the U.S. Bureau of Labor Statistics, the cost of a moderate-income standard of living in Anchorage is 40 percent higher than the national average. Moreover ---

Many Alaskans --- a far higher proportion than in any other state --- live in a truly primitive Third-World kind of poverty.

Anchorage living costs are the lowest in Alaska. In the "bush" communities where the poorest Alaskans live, prices average another 30 to 60 percent higher. Adjusting Alaska **statewide** personal income figures by the **Anchorage** living-cost differential therefore substantially **overstates** the average real income of Alaska residents. Even with this overstatement, however, Alaska (the US Commerce Department's "Anchorage Economic Area") ranked only 46th highest among the nation's Economic Areas in 1980 real per-capita personal income.

In 1980, the average real income of Alaskans was lower than the average real income of people living in the following Eastern and Midwestern Economic Areas

Chicago (#5) and 4 other Illinois economic areas,
Detroit (#7) and Lansing-Kalamazoo (#37),
Washington, DC (#13).
Milwaukee (#18),
Cleveland (#25) and Toledo (#36),
Wheeling-Steubenville (#28),
St. Louis (#27) and Kansas City (#20),
Indianapolis (#32) and Fort Wayne (#31),
Baltimore (#34),
New York City (#39),
Philadelphia (#41) and Pittsburgh (#33),

III. SUDDEN INCOME IS NOT INSTANT WEALTH

Horrible climatic conditions, huge distances from the Lower 48 and among Alaska communities, the high costs that flow from climate and remoteness, and the newness of modern economic life in Alaska have combined to leave Alaska far behind other states in both private and public fixed capital.

It takes a community or a region decades of steady prosperity to build up a stock of private and public capital to the point that it is truly wealthy.

The most important indicator of **private** wealth is housing. In 1980, Alaska homes had, on the average, fewer rooms and fewer rooms per person than those in any other state except Hawaii. In 7 of Alaska's 23 census districts (comparable to counties in other states), the average home had **less than one room per person**. In one Alaska census district (Wade-Hampton), there were only three rooms for every five persons.

There was not a single county in any state except Alaska, where the number of persons exceeded the number of rooms of living space.

On the average, Alaskans had 41 percent less living space (in square feet per person) than the U.S. average. And, more than 12 percent of the occupied dwelling units in Alaska lacked modern plumbing; in the next lowest state (Kentucky) only 7 percent of the homes were without plumbing.

Alaska's lags behind the nation in **public** wealth, too. There is no road between Juneau, the state's capital and Anchorage, its largest city. Anchorage, a city of 200 thousand, still lack pavement, sidewalks, and street lights. Juneau still lacks anything people outside would recognize as a supermarket, a department store, or an auditorium suitable for the performing arts. Large areas of And a majority of the incorporated cities in Alaska have **none** of these, nor do they have municipal water or sewer systems, or telephone utilities.

IV. ALASKA'S ECONOMIC-DEVELOPMENT HANDICAPS

Alaska is remote and cold and, because it is remote and cold, it is still sparsely populated and sparsely developed. As a result ---

Almost everything costs more to do in Alaska than it does in the Lower 48,

Almost everything Alaska buys costs more than it does in the Lower 48, and

Almost Everything Alaska sells returns less than it does in the Lower 48.

Alaska's pervasive cost disadvantages have meant that it has been a competitive location in national or world markets only those for products that could be extracted from some exceptionally rich or exceptionally large resource like the Prudhoe Bay oil field. Previous Alaska resource booms were all based on one or another of the world's biggest or richest resources --- furs in the 18th Century, salmon in the late 19th, gold at the beginning of the 20th, and copper between World War I and World War II. But all of them together failed to create much that was permanent, or anything at all which could reasonably be considered an Alaska regional economy. Each surge of resource development came and (except for salmon fishing) went, leaving little more than a few ghost towns or isolated, struggling villages, and disrupted Native lifestyles. With this background ---

Alaska entered its present oil-driven economic boom very poor, and with few solid economic-development prospects.

Apart from Arctic oil revenues and the state-government activity which those revenues support, Alaska's present economic base and its industrial-growth prospects still range from the marginal to the speculative.

All of Alaska's existing basic industries except Arctic oil are severely limited in one way or another.

Alaska's fisheries, for example, are not only seasonal but have huge annual ups and downs, while the fish-processing industry is dominated by low-wage transient employment. The forest-products industries have been stagnant for years and are now in the same depression as in the Pacific Northwest. Oil reserves and production in the Cook Inlet basin are declining rapidly; except near Prudhoe Bay, no commercial oil discovery has been made in Alaska for more than 15 years. The few existing commercial-scale farms could not exist without government subsidies. And the future of Alaska mining is still highly speculative, despite the frequent announcement that some major development is imminent.

The only Alaska industry that is reasonably sure to grow is tourism which, because of the climate, is very seasonal. Tourism, moreover, is dominated by low-wage employment. Alaska's only "basic industry" that is both permanent and stable is the U. S. Defense Department, which became the state's largest employer during World War II, a position it still holds.

It is only the oil revenue of state government which now gives Alaska a fighting chance to join the American Union as a viable economic entity.

The legacy of the Prudhoe Bay oil resource could be different from that of earlier resource booms: Alaska is now a State, with the authority to tax the extractive industries. The oil reserves are on State land, moreover, and the government of Alaska, through its leasing arrangements with the oil companies, retains a one-eighth ownership interest in all the oil and gas that is extracted. Most critically, the Prudhoe Bay field was discovered at the ideal historical moment --- just before world oil prices ascended to their highest levels in modern times. What this means is that ---

This time at least some of the benefits will stay behind: Anchorage will not vanish when the Prudhoe Bay field is exhausted, as Chitina and McCarthy did in 1938 when what was once the world's richest copper mine closed.

How much will, in fact, remain is still an open question.

V. ALASKA'S PRECARIOUS OIL INCOME

The Alaska oil-revenue flows denominated in billions of dollars appeared suddenly and unexpectedly only in 1979, and by mid-1981 they were already in steep decline. Today, nobody knows where the bottom is or when it will be reached.

Like the fortune of the proverbial Sweepstakes winner or ex-Champion, Alaska's sudden luck at Prudhoe Bay could disappear as quickly as it appeared, and leave the state broke and broken within a decade.

Future luck will surely make a difference: **Perhaps** another field the size of Prudhoe Bay will be found on state land and **perhaps** world oil prices will firm or climb once more. Neither event is very likely, and prudent Alaskans aren't counting on either of them, because at bottom ---

Alaska's oil billions are a fluke.

The Prudhoe Bay field, large as it is, might easily have turned out to be an economic disaster. The Atlantic Richfield company discovered the field in 1968, but oil did not begin flowing until 1977, four years after Congress resolved a bitter nationwide controversy over construction of the \$9 billion Trans-Alaska pipeline (TAPS). Though the oil companies didn't realize it in 1970 when they decided to build the pipeline ---

Without the OPEC oil-price revolution of 1973-74, Prudhoe Bay oil would have been nearly worthless.

The unanticipated high cost of building TAPS has combined with tanker charges beyond Alaska to make the average cost of shipping crude oil from Prudhoe Bay to the major refining centers of the U.S. Gulf and West Coasts about \$10 per barrel. On an inflation-adjusted basis, \$10 is actually **more** than the 1972 market value of crude oil delivered to Lower-48 refineries. It took OPEC's post-1974 prices, therefore, to justify the oil companies' investment in TAPS and production facilities at Prudhoe Bay. Even after the oil-price upheaval of 1973-74, the

pipeline seemed so risky that the nation's biggest institutional lender refused to buy Sohio's pipeline bonds.

In barrels of oil, the field was a bonanza from the start, and beginning with the first crude oil shipments in 1977, Prudhoe Bay made a significant dent in America's need to import OPEC oil. But Arctic oil still wasn't an immediate **money** bonanza for either the companies or the State. In 1977, the federal government classified Prudhoe Bay oil as "new oil" in the price-control scheme, with a ceiling price of less than \$11. Until mid-1979, however, this ceiling didn't matter, because shipping costs absorbed the bulk of the oil's market value, leaving only \$2 to \$6 per barrel at the wellhead (depending on the destination of the oil) to be divided between the oil companies, the State of Alaska, and the federal treasury.

It was only in 1979 that Prudhoe Bay became a truly exceptional source of income for the State of Alaska.

After the Iranian Revolution, the OPEC nations once more tripled their export prices. The price of Prudhoe Bay oil leapt upward too, and for a while bumped against the federal ceiling until, in February 1981, President Reagan completed the decontrol of oil prices begun by President Carter 13 months before. The average wellhead price of Prudhoe Bay oil --- the basis of State royalties and taxes --- rose from \$4.82 per barrel in December 1978 to \$25.90 in March 1981.

That price increase was also the incentive North Slope producers needed to boost Prudhoe Bay production and TAPS transportation capacity from 1.2 million barrels per day to 1.6 million, and to begin developing the smaller Kuparuk field nearby. Higher output and higher prices combined to increase the total wellhead value of Prudhoe Bay oil more than sevenfold between late 1978 and early 1981.

However, few of those who make an issue about Alaska's great windfall seem to be aware that ---

The federal government, through its 70-percent windfall profits tax and the corporate income tax, has captured almost 60 percent of the OPEC-induced price increase since 1978.

The take at Prudhoe Bay is now split into three nearly equal shares: (1) The companies (who have to recover their field-development and operating costs out of their third); (2) State royalties, production taxes, and income taxes on the companies' oil-production income, and (3) federal taxes.

VI. THE WAY DOWN

Alaska's oil revenues are now on their way down, as oil prices began falling early in 1981 and are likely to fall further.

Wellhead prices at Prudhoe Bay peaked at about \$26 per barrel in early 1981, when the landed prices of foreign oil averaged about \$38; they have now (November, 1982) fallen into the \$19-\$20 range, corresponding to Gulf Coast refinery prices of about \$32.

Between June 1981 and June 1982, the Alaska Department of Revenue reduced its base-case petroleum-revenue forecasts for Fiscal Years 1983 through

1997 from \$99 billion to \$35 billion (in 1982 constant dollars), a figure that is probably still too optimistic. Most likely ---

World oil prices will ultimately fall to \$10 or \$15 per barrel, and they might drop much further before rebounding into that range.

It is now obvious that the OPEC nations have unwittingly been pricing oil out of the "bulk-fuel" markets which account for two-thirds of world energy consumption --- the markets for electrical-generation, industrial-boiler, and stationary heating fuels --- and the market for petrochemical feedstocks. High prices have also persuaded motor-vehicle owners and other consumers of refined petroleum products to conserve more oil than either industry or governments thought possible. Until oil prices fall sufficiently that they are again competitive with long-term coal and natural-gas costs in bulk-fuel markets, the world's crude-oil producing capacity will continue to exceed its oil-consuming capacity by a wide margin, OPEC will remain impotent, and the downward pressure on prices will be relentless.

The tendency of oil prices to exaggerate any short-term supply-demand imbalance, which helped OPEC push oil prices up to unsupportably high levels over the last decade, are also capable of working in reverse. Once an out-of-control oil surplus caused a sharp price break, the subsequent market collapse could continue until prices had gone considerably **below** the long-term costs of other bulk fuels, just as the spot-market panics of 1974 and 1979 for a while permitted OPEC to set prices well **above** the long-term cost of competing fuels.

Prices of \$10 to \$15 at "Outside" refineries would reduce Alaska wellhead prices and the State's oil revenues to a tiny fraction of their 1981 peak values.

The prospect of a further fall in oil prices is not the only threat to Alaska's petroleum revenues. In the late 1980s, oil production from the Prudhoe Bay field will begin to fall off rapidly. Today, there does not seem to be enough commercially recoverable oil in nearby fields to offset this decline, and Alaska probably faces both a reduction in its revenue per barrel and a shrinking number of barrels in which it has a royalty share or on which it may legally levy a severance tax.

Many of the most promising Alaska oil-exploration targets, including the "Diapir Field" leases in the Beaufort Sea that the federal government sold for more than \$2 billion in October 1982, are on the Outer Continental Shelf (OCS), where the state owns no royalty rights and has no taxing power.

By 1990, therefore, Alaska's petroleum revenues may no longer be anything remarkable, but the State may still suffer most of the economic handicaps it had before the discovery of oil at Prudhoe Bay.

VII. CATCHING UP

Every Alaska politician, journalist, and planner probably has a list of pressing "needs" that can be met only by an appropriation of State money. Politicians, journalists, and planners in the Midwest and East doubtless have similar lists of pressing "needs" which, in their minds, call for a redistribution of government

revenues from energy-exporting states like Alaska to energy-importing states like their own. "Needs" are both subjective and boundless, however, and there is no universal principle of justice that decrees who really **ought to** benefit from windfall riches that are due to some accident of geology. But **one** public purpose that reducing Alaska's current or expected petroleum revenues would **not** serve is the cause of greater equality in income and wealth among the regions of the United States.

Legislation that would shift some of Alaska's present oil-revenue sources from the State to the federal government would be a regressive redistribution of income --- a transfer from a poor area to richer ones.

It would take 180 million square feet of new residential construction, for example, just to provide 400 thousand Alaskans with the same number of square feet of living space that the average American enjoyed in 1980. At an Anchorage construction cost of \$70 per square foot, and an average cost of \$100 per square foot outside of Anchorage, this construction program alone would cost \$24 billion 1982 dollars.

This cost estimate is about the same as the present value **all** of Alaska's expected petroleum revenues between now and 1997. At a 5-percent real ("inflation-adjusted) discount rate, the \$35 billion of expected State petroleum revenues cited earlier have a present value of about \$25 billion. Thus ---

It would take nearly all of Alaska's expected petroleum revenues for the next 15 years just to bring its 1980 housing stock up to national levels.

Alaska's deficiency in public facilities is even greater by national standards. The replacement cost of State and local government-owned fixed capital in the whole United States --- schools, hospitals, and other public buildings, paved streets and sidewalks, street lights, and water, sewage, electrical, and telephone systems --- is on the order of \$40 trillion, or about \$150,000 per capita. The 60 percent of today's Alaskans who live in Anchorage and Fairbanks enjoy **at most 75 percent** of the public amenities enjoyed by the average citizen of the Lower 48. The smaller urban places where about one-fourth of Alaska's people live surely enjoy **no more than one-half** the value per person of the public facilities that are typical of the other states. And about 15 percent of Alaska's population lives in places that have **no public fixed capital at all** other than schools which, nationally, account for about 15 percent of local public wealth.

These conservative estimates of Alaska's lag in fixed public assets, together with an estimated state population of 400 thousand and construction costs at 140 percent of the national average in Anchorage and Fairbanks, 180 percent in the smaller cities, and 240 percent in the "bush" imply that ---

It would cost about \$36 billion just to bring Alaska's per-capita stock of public capital into line with that of its sister states.

Thus, Alaska's deficiencies in housing and local public works alone "require" at least \$60 billion. But these categories of fixed investment together do not exhaust the list of outlays that would be "needed" to make Alaska equal in per-capita wealth to the rest of the nation. The \$60-billion total omits, for example, the obvious shortfall in the fixed assets of Alaska profit-making and non-profit

institutions such as retail businesses, clubs and lodges, churches, and private schools and hospitals.

Alaskans therefore could spend well over \$60 billion to equalize the state's per-capita stock of physical wealth with that of the other states, without yet providing **any** money for fixed investments or continuing outlays intended to offset the impact of Alaska's climate and remoteness on living costs or on the cost of doing business, or for bringing the educational and health standards of rural Alaska up to the national mean. Moreover ---

Even after spending \$60 billion or more, Alaska would still be relatively poor, even because these expenditures would not be sufficient to guarantee the state a diversified or permanent economic base.

Arctic oil revenues are, therefore, more crucial to Alaska's economic future than automobile sales are to Michigan, rubber sales to Ohio, or microprocessors and computer software to Massachusetts or the San Francisco Peninsula. The older settled regions each have a mix of basic industries, big internal markets, and sophisticated transportation, trade and communications links with other states. They frequently suffer cyclical depressions, and some of them are unavoidably declining relative to the nation as a whole, but nowhere in the population centers of the East or Midwest is the demise of a single industry or revenue source likely to dictate the collapse of a whole regional economy.

The revival of parts of New England that seemingly had no future after textiles, shoe-manufacturing, and other traditional industries had departed testifies to the resilience of established industrial areas if they have a quality labor force and a developed economic infrastructure. All that Alaska now has with which to overcome its pervasive economic disadvantages is its sudden and precarious bubble of oil income. If this help is insufficient, no other help is now in sight. Even so ---

Alaska's expected oil revenues are still small relative to their legitimate public uses --- narrowing the wealth gap between Alaskans and other Americans, and building a permanent economic base that would allow present Alaskans to remain and enjoy them.

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I. ALASKANS ARE NOT RICH

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Alaskans, on the average, still have lower real incomes and less real wealth than residents of the East and Midwest.

The U.S. government's personal-income statistics seem to show Alaskans as having higher average incomes than the residents of any other state. This comparison ignores the big difference in prices and living costs. According to the U.S. Bureau of Labor Statistics, the cost of a moderate-income standard of living in Anchorage is 40 percent higher than the national average. Moreover ---

Many Alaskans --- a far higher proportion than in any other state --- live in a truly primitive Third-World kind of poverty.

Adjusting Alaska statewide personal income figures by the Anchorage living-cost differential (which ignores the fact that prices in most of Alaska are much higher than in Anchorage) shows Alaska as having only the 46th highest real per-capita personal income among the Commerce Department's Economic Areas of the United States.

In 1980, the average real income of Alaskans was lower than the average real income in the following Eastern and Midwestern Economic Areas: Chicago (#5) and 4 other Illinois economic areas, Detroit (#7) and Lansing-Kalamazoo (#37), Washington DC (#13), Milwaukee (#18), Cleveland (#25) and Toledo (#36), Wheeling-Steubenville (#28), St. Louis (#27) and Kansas City (#20), Indianapolis (#32) and Fort Wayne (#31), Baltimore (#34), New York City (#39), Philadelphia (#41) and Pittsburgh (#33).

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There was not a single county in any state except Alaska, where the number of persons exceeded the number of rooms of living space.

On the average, Alaskans had 41 percent less living space (in square feet per person) than the U.S. average. And, more than 12 percent of the occupied dwelling units in Alaska lacked modern plumbing; in the next lowest state (Kentucky) only 7 percent of the homes were without plumbing.

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III. ALASKA'S COMPARATIVE DISADVANTAGES

All of Alaska's existing basic industries except Arctic oil are severely limited in one way or another.

Alaska's fisheries, for example, are not only seasonal but have huge annual ups and downs, while the fish-processing industry is dominated by low-wage transient employment. The forest-products industries have been stagnant for years and are now in the same depression as in the Pacific Northwest. Oil reserves and production in the Cook Inlet basin are declining rapidly; except near Prudhoe Bay, no commercial oil discovery has been made in Alaska for more than 15 years. The few existing commercial-scale farms could not exist without government subsidies. And, the future of Alaska mining is still highly speculative, despite the frequent announcement that some major development is imminent.

Alaska's only "basic industry" that is both permanent and stable is the U. S. Defense Department, which became the state's largest employer during World War II, a position it still holds.

It is only the oil revenue of state government which now gives Alaska a fighting chance to join the American Union as a viable economic entity.

IV. ALASKA'S PRECARIOUS OIL INCOME

The Alaska oil-revenue flows denominated in billions of dollars appeared suddenly and unexpectedly only in 1979, and by mid-1981 they were already in steep decline. It took the 1973-74 OPEC price upheaval to justify the oil companies' investment in the Trans-Alaska pipeline (TAPS) and production facilities at Prudhoe Bay. Even then, the pipeline seemed so risky that the nation's biggest institutional lender refused to buy Sohio's pipeline bonds.

It was only in 1979 that Prudhoe Bay became a truly exceptional source of income for the State of Alaska.

The second OPEC oil-price upheaval in 1979 plus decontrol of U.S. oil prices in 1980-81 pulled the average wellhead price of Prudhoe Bay oil --- the basis of State royalties and taxes --- up from \$4.82 per barrel in December 1978 to a peak of \$25.90 in March 1981. Higher output and higher prices combined to increase the total wellhead value of Prudhoe Bay oil more than sevenfold between late 1978 and early 1981. However ---

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World oil prices will ultimately fall to \$10 or \$15 per barrel, and they might drop much further before rebounding into that range.

Until oil prices fall sufficiently that they are competitive with long-term coal and natural-gas costs in bulk-fuel markets, the world's crude-oil producing capacity will continue to exceed its oil-consuming capacity by a wide margin, OPEC will remain impotent, and the downward pressure on prices will be relentless.

Prices of \$10 to \$15 at "Outside" refineries would reduce Alaska wellhead prices and the State's oil revenues to a tiny fraction of their 1981 peak values.

Regardless of oil-price trends, production from the Prudhoe Bay field will begin to fall off rapidly in the late 1980s. Alaska probably faces both a reduction in its revenue per barrel and a shrinking number of barrels in which it has a royalty share or on which it may legally levy a severance tax.

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It would take about \$36 billion just to bring Alaska's per-capita stock of public capital into line with that of its sister states.

This \$60 billion would not begin to deal with shortfall in the fixed assets of Alaska profit-making and non-profit institutions such as retail businesses, churches or private schools and hospitals. Nor does this sum include any money for fixed investments or continuing outlays "needed" to offset the impact of Alaska's climate and remoteness on living costs or on the cost of doing business, or for bringing the educational and health standards of rural Alaska up to the national mean.

Moreover, even if Alaska had enough petroleum revenue to cover these "needs", the state would still be relatively poor, because even these outlays would not be sufficient to guarantee it a diversified or permanent economic base.

Alaska's expected oil revenues are thus quite small relative to their legitimate public uses --- narrowing the wealth gap between Alaskans and other Americans, and building a permanent economic base that would allow the present residents to remain in Alaska and enjoy these amenities.