

'An Act establishing the Alaska mineral lease bonus permanent fund and providing for an effective date.'

COMMITTEE REPORT

3/21/75

HOUSE

Mr. Speaker:

Date Mar 27, 1975

The Committee on FINANCE has had HR 324

under consideration. A Majority of the members of the Committee

() recommends it DO PASS

() recommends it DO NOT PASS

() recommends it DO PASS WITH ATTACHED AMENDMENT(S)

(X) recommends it BE REPLACED WITH CS FOR HR 324 AND THAT

CS FOR HR 324 DO PASS

() "and" recommends it BE REFERRED TO THE _____
COMMITTEE

() reports it back WITHOUT RECOMMENDATION

() "other"

Members signing the Majority report:

<u>[Signature]</u>	<u>[Signature]</u>	_____
<u>[Signature]</u>	<u>[Signature]</u>	_____
_____	<u>[Signature]</u>	_____
_____	_____	_____

Members NOT concurring in the Majority report:

_____ recommends:

_____ recommends:

_____ recommends:

_____ recommends:

_____ recommends:

[Signature] Chairman

BY MALONE, ANDERSON, BEIRNE, BOWMAN,
BRADLEY, BRADNER, BROWN, BUCHHOLDT,
COTTEN, COOPER, DAVIS, DUNN, ELIASON,
FISCHER, FREDMAN, GARDNER, GRUENING,
HACKNEY, HANSEN, HERSHBERGER, ITTA,
KELLEY, MCKINNON, MILLER, NAUGHTON, OSE,
OSTERBACK, OSTROSKY, PARKER, PAPE,
RHODE, SMITH, SPOCKING, SULLIVAN,
SWANSON AND URLON

IN THE HOUSE

HOUSE BILL NO. 324

IN THE LEGISLATURE OF THE STATE OF ALASKA

NINTH LEGISLATURE - FIRST SESSION

A BILL

For an Act entitled: "An Act establishing the Alaska mineral lease bonus permanent fund; and providing for an effective date."

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

* Section 1. AS 37.11 is amended by adding new sections to read:

CHAPTER 11. PERMANENT [RENEWABLE RESOURCES] FUNDS.

ARTICLE 2. ALASKA MINERAL LEASE BONUS PERMANENT FUND.

Sec. 37.11.100. PURPOSE. The legislature finds and declares that it is essential to preserve the revenue derived from mineral lease bonus sales, a non-renewable resource, for future generations of Alaskans, and further, that this purpose best can be served by preserving this income in a permanent fund to be used for investment capital by Alaska residents.

Sec. 37.11.110. ALASKA MINERAL LEASE BONUS PERMANENT FUND. There is established as a separate fund the Alaska mineral lease bonus permanent fund. Receipts designated under sec. 120 of this chapter for deposit in the permanent fund are to be held perpetually in trust for the benefit of both present and future generations of Alaskans.

Sec. 37.11.120. FUND PRINCIPAL. Ninety-five per cent of the receipts paid the state from mineral lease bonuses shall be deposited in the permanent fund. These deposits shall be considered fund principal and shall be invested in perpetuity in accordance with AS 37.10.070 (investment of surplus state funds). However, the types of investments that may be made are limited to:

(1) obligations of, or obligations insured or guaranteed by,

1 the United States or agencies or instrumentalities of the United States;

2 (2) obligations secured by reserves paid in by the United
3 States or agencies or instrumentalities of the United States or obliga-
4 tions of corporations in which the United States is a shareholder or
5 member;

6 (3) notes issued by Farmer's Home Administration;

7 (4) bank certificates of deposit which are secured as to the
8 payment of principal and interest in accordance with Alaska law; or

9 (5) state loan programs that are designed by law as eligible
10 for permanent fund investment.

11 Sec. 37.11.130. USE OF FUND INCOME. (a) Income received from
12 investment fund principal may be:

13 (1) reinvested in investments authorized under sec. 120 of
14 this chapter;

15 (2) appropriated for the administration of the fund; or

16 (3) appropriated to provide funding for operating or capital
17 expenditures for loan or grant programs that are expressly established
18 by law for financing from this fund and are designed to assist:

19 (A) individuals who have been residents of the state for
20 at least five years;

21 (B) corporations for which Alaska is the principal place
22 of business that have been operating continuously in the state for
23 at least three years; or

24 (C) public corporations or political subdivisions of the
25 state.

26 (b) Plans for expenditures of fund income under (a) of this section
27 shall be prepared in detail by the appropriate state department or agency
28 and shall be submitted by the governor in accordance with the Executive
29 Budget Act (AS 37.07) as part of his annual budget presentation to the

legislature.


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Sec. 37.11.140. PROTECTION OF PRINCIPAL. An investment transaction involving fund principal which results in an actual dollar loss of principal shall be reimbursed in full from fund income before additional income is expended.

* Sec. 2. This Act takes effect immediately in accordance with AS 01.10.-070(c).

Sterling Gallagher
Commissioner
Department of Revenue

March 27, 1975

Lawrence C. Eppenbach 
Deputy Commissioner
Department of Revenue

Treasury Comments on
HB 324 and SB 297

This memorandum summarizes preliminary Treasury comments on HB 324 and SB 297, Acts establishing an Alaska mineral lease bonus permanent fund. In general the Treasury Division supports measures which set aside a portion of revenue from petroleum discovery to better plan for the day when Alaska's nonrenewable wealth will be gone. We are also deeply involved in the financial planning required for the state to meet the crunch coming in Fiscal Years 1976-1978 which both bills may directly effect. Our comments, will be limited to those of a technical nature and will not include an assessment of the revenue effect of setting aside bonus payments.

General

HB 324 and SB 297 proposes to create a permanent fund by an act of legislation morally obligating future legislatures to leave it intact. Once begun, such a fund may acquire a long term character.

Contributions

The deposit of 95% of mineral lease bonus into a permanent fund would cause a total of 102% to be dedicated (5% Renewable Resource, 2% Claims Act). In addition, the sharing of cash bonus as distinct from royalty payments, rentals, etc. would add a new dimension to the question of whether the state should adopt royalty bid lease contracts.

The most critical aspect of a 95% bonus sharing is the previously mentioned impact on planning the state's financial response to our temporary crunch. A smaller percentage, or a staggered increasing percentage over time, or a delayed effective date would all improve the chances for a bonus sale this year to help the State meet its pending financial obligations.

Investment

A long term fund should have broad investment authority exercised at the discretion of professional investment managers held responsible for their actions under a prudent man rule. Such investment authority would allow the fund to take maximum advantage of imperfect markets (made so because of constraints placed on other funds) to achieve a high return.

Ideally a permanent fund has its portfolio balanced between instruments achieving a high "economic" total return; such as certain Alaskan investments, and those achieving a high cash return to provide a hedge against inflation.

AS 37.10.070 provides a comprehensive list of desirable investment instruments including a full range of short and long term fixed income investments, Alaskan residential and commercial mortgages and common stock. The Treasury division recommends that this list be adopted intact. Should there be an absolute need to eliminate a particular form of investment, such as common stock, then it should be specifically deleted. The approach taken by HB 324 imposes unnecessary and undesirable limitations on the range of legal investments.

Use of Fund Income

There is some concern expressed in Treasury as to the legality of (a) (3) regarding the limitations on appropriations of fund income. The approach taken in SB 297 (otherwise identical) of deleting this portion obviously removes this issue. However, we are not attorneys and suggest a review of this provision by the Department of Law.

Additional Points

The proceeds of cash bonus bids add to the state's total stock of wealth. It would be desirable to continue to have claim to this total wealth to secure State GO bonds. Rating agencies have expressed concern that any division of our resource development proceeds may injure our ability to secure debt. Of course, any legislature could appropriate these funds to meet the debt service requirements of state bonds. However, a bond buyer would be more assured and hence require less interest if such a pledge was made specifically.

Cost of Administration

The Treasury Division does not anticipate any cost of administration requiring a fiscal note at this time with acceptance of Treasury's proposed 1976 budget. Future expenses, not expected to be large, would be displayed in future annual budgets.

Mr. Chairman:

I appreciate deeply your courtesy in allowing me to submit my views concerning House Bill 324. I am precluded from returning to Juneau this evening because of a conference in Anchorage and a public hearing of the Anchorage Charter Commission, of which I am a member.

Mr. Chairman, I am confident that Alaskans welcome your leadership in seeking to provide approaches for State budgeting that are more rational, and better planned, than approaches followed in the past. Leadership in that direction is long overdue. Too often, the appropriation process has been viewed as an area in which special interests contend for advantage--"Log rolling" that has tended to swell State operating budgets.

At the same time, the Legislature's use of bonus moneys received in 1969 has been generally wise. It has almost always been humane. As one Alaskan, I would prefer that my representatives err--if err they must--on the side of efforts to improve the quality of life in Alaska, rather than to err on the side of indifference to human need. The Legislature can take pride in the strides we have made in communications, social services, education, and other fields which have benefited from the use of the 1969 bonus money.

House Bill 324's assumptions about State expenditures are so important to Alaska's future that I respectfully suggest that the measure needs full-scale public involvement before the Legislature. For if--as the Administration urges--Alaskans are to be engaged directly in the kind of basic decision-making that helps plot our course for future generations, then these assumptions need

Handwritten notes:
Huff -
here is the
testimony I
prepared on
the original
HB 324 which
I promised
Lant report to
delivered.
Regards -
Joe
Josephson

that involvement, and if--as the Administration wishes--we are to assess even-handedly all alternative revenue and expenditure policies, the House Bill 324 should not be viewed in the abstract, in a vacuum, or as a disembodied proposition, but should rather be considered for its effects on other options of revenue-raising and expenditure.

And finally, if--as the Administration says we must--we are to weigh State actions carefully for their effects on State growth rates, then House Bill 324 should be studied in that light.

As I understand it, a basic concept of House Bill 324 is that non-renewable resource receipts should not be employed to meet ongoing expenses of State government. Speaking as a former legislator, and as a citizen, I must be frank in admitting my doubts about that concept, even though my view may not square with the common wisdom of the time. But of this I am sure: conceptually, royalty income and production taxes are just as much receipts from non-renewable resources as are bonuses. It is unclear why one type of petroleum revenue is to be barred from use in the operating budget, while other types would not be barred. Perhaps it is recognized that some use of non-renewable resource revenue has to be included in the operating budget as a practical matter. Perhaps it is argued that the State constitution prohibits a dedication of royalty income and severance taxes, but allows a dedication of bonus receipts. But if legal arguments are the reason for the distinction implicit in House Bill 324, then I suggest that

at least royalty income and bonus bids are on the same constitutional footing.

Mr. Chairman, members of your committee have also shown leadership in attempting to get better information for the Legislature's budgetary planning. I have personal knowledge of the efforts made by Representative Cowper, for example, to increase the flow of knowledge about pipeline costs to the Committee. Few would argue that these efforts are inappropriate; most Alaskans would agree that they emanate from a high sense of public responsibility.

In that light, the consideration of House Bill 324, at this time, is striking. All of us know that some estimates have been made of some matters that these estimates may not be proved accurate. Indeed, it has been the very uncertainty about some issues--the cost of the pipeline, the amount of bonuses to be received from a Beaufort sale--that has led to the introduction of measures to tax oil and gas in place. These uncertainties should be cautions against the passage at this session of a bill that treats the unknown as known. House Bill 324 assumes that the best use of 95 per cent of income from bonuses is in revenue sharing and in particular, but unspecified, "loan or grant programs.. designed to assist individuals and corporations". Social programs-- in education, in improvement of state institutions for corrections, health care, the elderly, etc.--take a back seat. Although a premise of the bill is the desire to avoid a swelling State bureaucracy, the measure may increase the size of bureaucracies at local government levels by compelling a movement of programs from one level of

government--the State--to local governments because of the prohibition against using bonus receipts directly by the State except for limited purposes. I doubt that such an artificially induced movement of programs will prove to be cost effective or in the public interest. I believe such a movement of progress would be especially detrimental to the interests of residence of the unorganized borough.

If State functions should be delegated to local governments, then that is a process that should be considered on its own merits; it should not occur as a by-product of legislation restricting the State's use of its own revenues.

House Bill 324 assumes that "pressure" from Alaska citizens for expenditures are essentially wrong, and that the people's representatives need greater insulation from these pressures--to protect the public from itself. I believe this assumption needs public involvement and scrutiny.

The State's investment in human programs--retarded children, aid for dependent children, establishment of pre-school child care centers, treatment for alcoholics and addicts--may be far more appropriate use of the bonus moneys than loans to Alaska's businessmen. Perhaps I am wrong. Perhaps the "trickle down" theory can be vindicated. But the essential point is that on March 26, 1975, we as Alaskans need to address that proposition directly, not obliquely, and with public involvement. How much revenue will the State stand to collect from prospective sales of leaseable tracts? How much money from these sales, or the income from them, can be absorbed effectively into the Alaska

economy? To what extent would beneficiaries from the loans and grants be using public money for purposes that private money is-- or will become--available to fund? What will such expenditures do to the State's rate of growth? If the growth rate is stimulated, what will happen then to the State's budget, and how will growth-induced pressures on the budget be met?

Because of this Committee's commitment to sound budgetary planning, and the acquisition of helpful information in the planning process, I would hope that some modeling, based upon alternative assumptions, could be studied before action on House Bill 324.

Mr. Chairman, in my service as a legislator, I opposed the creation of so-called permanent funds. My bias--if that is what it is--should be well known, and if it is not, I want to be sure that the Committee understands that my point of view has been of long standing. I simply don't believe that any legislature is necessarily wiser than its successors, and I don't believe that business loans to individuals and corporations are more worthy use of public funds than educational, health, and social services, and other programs that benefit directly those who must rely most on government for "an equal start in the race of life".

But philosophy aside, House Bill 324 presents another question. If it be in the public interest to create a permanent fund, then consideration should be given to the creation of the fund through the constitutional amendment process. The amendment process has in its favor the direct involvement of Alaskans in a matter of

fundamental importance, and true permanency. Other possibilities exist and should be explored: for example, perhaps legislation, or constitutional amendment, should limit the amount by which one year's budget may exceed the budget for the prior year, leaving the Legislature in complete control in setting priorities for using the available sum. This course has the merit of avoiding any predetermination about the wisest and most cost-effective spending priorities.

Mr. Chairman, Mr. Eppenbach offered some technical comments this week which I will not repeat here. In my role as legislative counsel for BP-Alaska, I would only add that House Bill 324 makes more likely the imposition of a tax on oil and gas in place. That is a tax which many members of the House say should be adopted only as "a last resort". House members understand the detrimental consequences to the public of such a tax; many of these consequences were outlined in February by Dr. Milton Lipton, consultant to the Legislature on petroleum policy.

For example, Dr. Lipton advised committees that a tax on oil and gas in place--more likely to occur if Beaufort lease revenues can not be used for State operating expenses--would have what Dr. Lipton called a "depressant effect" upon the size of competitive bonuses received by the State. Such considerations are germane to the question of House Bill 324.

For that reason, and others, the Legislature should encourage the Governor to conduct a Beaufort lease sale late this year. Then the Legislature can assess the results and consider more aptly whether a regressive tax, giving a "depressant" effect on overall revenues,

is necessary. We can test again the effectiveness of the competitive lease system. If a permanent fund is established, we can reach a judgement - with public involvement - as to:

- whether 95 percent of bonuses or some other percentages should be committed to a permanent fund, and if so for what purposes,
- whether the establishment of such a fund should occur by constitutional amendment;

Mr. Chairman, time has not permitted me to address House Bill 324 from every aspect, but I hope that the foregoing comments are of assistance to the Committee. I am grateful for the opportunity given me to submit them.

Joe P. Josephson