

ALASKA LEGISLATURE SPECIAL COMMITTEE / SUBJECT FILES 86/2

586 SCOM 118: HOUSE SPECIAL COMM. ON PERMANENT FUND 1978-80

1. PERMANENT FUND COMMITTEE MEETINGS 1979: MEMBERSHIP, MEETING MINUTES, TAPE LOGS, TRANSCRIPTS.
2. THE ALASKA PERMANENT FUND AND OTHER SIGNIFICANT WORLD FUNDS
3. PUBLIC CONTROL OF PUBLIC MONEY, BY SHEARER
4. DEVELOPMENT AND PLANNING IN ALASKA, BY CUMBERLAND AND FISHER.
5. MINUTES AND NOTES: PERMANENT FUND FREE CONFERENCE COMMITTEES, 1980
6. PERMANENT FUND COMMITTEE 1979: JOINT COMMITTEE REPORT
7. HB 281 (1979) - NON RENEWABLE RESOURCE REVENUES; LEGISLATIVE OVERSIGHT
8. OFFICE OF THE GOVERNOR MATERIAL
9. HB 277 (1979) MANAGEMENT OF THE ALASKA PERMANENT FUND
10. PERMANENT FUND: LEGISLATION AND STATUTES
11. PERMANENT FUND--1979--CONTRACTS
12. PERMANENT FUND CONSULTANTS 1980
13. PERMANENT FUND: CONSULTANTS & REPORTS
14. APPENDIX TO FINAL REPORT OF HOUSE SPECIAL COMMITTEE ON THE PERMANENT FUND. VOL. I: TRANSCRIPTS, MINUTES
15. HB 282 (1979)
16. HB 400 (1979)
17. HJR 23 (1979)
18. HB 414 (1979)
19. HB 162 (1979)
20. HB 280 (1979)
21. HOHMAN BILL, 1978 AND 79 BACKGROUND, SB 1, 1979

SCOMM 18: HOUSE SPECIAL COMMITTEE ON THE PERMANENT FUND, 1979-80

LIST OF FILES (PAGE 2)

MICROFICHE #

22. APPROPRIATIONS FROM FUNDS THAT ARE DEDICATED
(LEGALLY OR MORALLY) FROM ROYALTIES.

22A. PERMANENT FUND LEGAL OPINIONS, 1979

23. PERMANENT FUND REVENUE ESTIMATES, 1979

24. PERMANENT FUND FIRST FREE CONFERENCE
COMMITTEE 1980 (INCLUDES SB 161)

25. PERMANENT FUND SECOND FREE CONFERENCE
COMMITTEE 1980 (INDLUCEES SB 161)

26. PERMANENT FUND CORRESPONDENCE 1980

27. HB 279 (1979)

28. PERMANENT FUND PRESS CLIPPINGS

29. PERMANENT FUND CLIPPINGS

30. REP. HUGH MALONE--HOUSE SPECIAL PERMANENT
FUND COMMITTEE--PACKET

SCOMM

#18:1

ELEVENTH LEGISLATURE - First Session

SPECIAL COMMITTEES

--House of Representatives--

AGRICULTURE COMMITTEE, SPECIAL

HJ 2-9-79 pg. 182

Membership:

Rep. Patrick J. Carney, CHAIRMAN
Rep. Robert H. Bettisworth
Rep. H. Puppy Moss

Ex officio members:

Rep. Alvin Osterback
Rep. Bill Miles

ELECTIONS, "STATE AFFAIRS" SUB-COMMITTEE ON

HJ 2-1-79 pg. 117/118

Membership:

Rep. Bill Parker, CHAIRMAN
Rep. Mike Miller
Rep. Richard I. Eliason

PERMANENT FUND COMMITTEE, SPECIAL

HJ 2-12-79 pg. 212

Membership:

Rep. Hugh Malone, CHAIRMAN
Rep. Samuel R. Cotten, VICE-CHAIRMAN
Rep. Phillip Guy
Rep. C. V. Chatterton
Rep. Joe L. Hayes
Rep. E. J. Haugen
Rep. Oral Freeman
Rep. Leo P. Schaeffer, Jr.
Rep. Brian Rogers

ROADS AND HIGHWAYS, SPECIAL COMMITTEE ON

HJ 3-1-79 pg. 421

Membership:

Rep. Joyce Munson, CHAIRMAN
Rep. Charles H. Parr
Rep. Oral Freeman
Rep. Ramona L. Barnes
Rep. Richard W. Halford

HOUSE SPECIAL PERMANENT FUND COMMITTEE

TESTIMONY BY WALTER FILKIN

ON MARKETING ASPECTS OF BONDS

29 MARCH 1979

Filkin: A key consideration in a program of this type is the fact that there would be two sources of security for bonds, and it almost by definition says that one is not sufficient. Judging from the permitted acts or the permitted loan activities that can be engaged in, I think it is reasonably clear that some might require additional security. The broad categories of municipal, housing, residential, and commercial do lend themselves to all grades of lending activities. Certainly in the municipal category alone, which I'm most familiar with, there are borrowing activities that are equal to that of the Federal government which would be AAA rated down to activities that are of very highly questionable ability to repay such as start-up ventures by very small water or sewer systems, or other sorts of bond issues in areas where there are declining populations or reducing tax bases, or in the case of New York City, some of the problems in borrowing are well documented and we need not go into them. But in any event, there is a vast range of quality. So when you come to an activity of borrowing in the long-term market, the question of can the issue repay and pay not only the debt but also the interest on a timely basis, is the critical question in terms of what additional will be needed if there is some question about its marketability. So we get into the area of a loan program covering a vast array of possibilities, having as an ultimate or a backup security the earning power of the Permanent Fund. I think that's what we're really dealing with today.

To the extent that the security of the loans that are being made are sufficient in the market place, the Permanent Fund pledge itself isn't necessary. And so what we are dealing with is something where I presume the drafters of the bill would say the pledge of the Permanent Fund would be a vital necessity here and the question is, first of all, how does it impact the ability of the State to conduct its more typical or more normal borrowing programs and, secondly, what is the prospect of being able to conduct a continuing program like this in the general market.

Let's consider the make-up of the Permanent Fund itself. I think it is important if it is viewed as a true source of security for this loan program and the financing of this loan program, that sufficient boundaries be put on the investment uses of the Permanent Fund so that the benefit that is hoped for doesn't get dissipated. I mention that because part of the uses of the Permanent Fund might certainly be valid but their impact on security for bonds might be very limited... For instance, the Permanent Fund, at an extreme, if it were used for loans that had little or no chance of being repaid, the pledge of that fund as security for another loan would not be viewed as a good security in the market place. The other extreme, if the Permanent Fund were restricted to its investment only in U.S. Government Treasury bills and bonds as the Texas Permanent Fund is for example, the security of that Fund on another borrowing would make that other borrowing AAA rated. And that's exactly what the U. of Texas, whose Permanent Fund secures much of its borrowing, has right now... Somewhere in the middle is probably where the Alaska Permanent Fund would fall, but keep in mind that two independent pledges are important for the market to view the combination of the two as adequate in the long term. If, for instance, you had a \$100 million Permanent

Fund that was currently 50% in U.S. Government and 50% in commercial loans such as fisheries and other small business type loans, that in itself probably wouldn't be sufficient without some other parameters around that Permanent Fund and some other limitations on the amount of debt that could be incurred that would be secured by a pledge of that fund. Even though at the outset you could say our first borrowing is going to be \$25 million and we have the income from that \$100 million fund as a backstop pledge. So I would suggest that it is important that the limitations on the investment opportunities in that fund be considered carefully in order to gain what is hoped to be gained by a pledge of the fund for borrowing to secure these various loan programs.

The impact of the loan programs on the State borrowing program itself - which today is in the neighborhood of about 250-300 million dollars every two years; it could have some impact. If in the transition of the General Fund surplus there is a view of the market place that it can be funneled into the loan program to the extent that they are not credit worthy programs could somehow draw down on the balance in the State's bank account, the market place could view the State far differently than it currently does. In the last ten years, the State excess of revenue over expenditures has been about four years out of ten. The other six years, there's been a slight to large excess of expenditure over revenue. The market place has not disregarded this but has accepted it, because ten years ago there was roughly a billion dollar surplus in the General Fund and has accepted the fact that there could be an excess of expenditures from time to time but overall has not looked at it as an alarming trend. It might have if there had been no surplus... If in the future there is a program which in some way could draw down, in the view of the market place, an unlimited amount of that surplus through the operation of the program

such as the Permanent Fund pledge and State loan programs, then I think the impact on the State for its own borrowings would be negative.

Rogers: If we're going to use this money to guarantee one form of loan, or one issue, then we'd have to pledge that we wouldn't use it to guarantee something else?

Filkin: That would go without saying. What I'm suggesting, though, is that, in addition to that, if you contemplate selling a block of bonds, and you've got an adequate revenue flow from the Permanent Fund to support the debt service on that issue, the only real way that the market would accept that sort of an arrangement would be if they could be assured that a year from now or ten years from now you wouldn't issue ten times the amount of debt with the same revenue projections that you now have. In other words, you'd be relying more on the loans themselves to provide the cash flow rather than the Permanent Fund. And to the extent that they thought that might happen, you'd probably feel it today when you issue that first issue of bonds.

Rogers: Are you saying that that would effectively put a lid on our other issuances that are completely unrelated; revenue bonds or G.O. bonds that were not secured by...?

Filkin: No, not necessarily. What I'm saying is that the way you would get your Permanent Fund bond program off the ground would be to show two things: first of all, that the debt service on that first issue can be well secured by the cash flow from the Permanent Fund; and secondly, that if you're going to incur more debt in the future, that the cash flow from the Permanent Fund will have to have increased sufficiently to support that debt as well.

Rogers: You're only referring to debt which is guaranteed by Permanent Fund income? You're not referring to other debt...?

Filkin: I was in an earlier comment and I'll get back to that, but on this question

here that is all I'm referring to. If your principal and interest requirements are \$5 million per year... and suppose you have \$4 million of Permanent Fund income pledged to the payment of those bonds, then another bond issue is proposed a year or two years out that's going to have an additional \$5 million of debt service; if it can't be shown that Permanent Fund income is going to increase at least proportionately to support that additional debt, then you've got problems not only doing it then but selling this first issue....

If there are ways in which the unappropriated General Fund balance, which I guess now becomes an unallocated reserve, can be utilized; in other words, if there are deficiencies in various accounts that have to be filled, and the Commissioner of Revenue or whoever is going to administer it is required or even has permission to fill those reserves because they've been drawn down to pay bonds or something due to the fact that the loan program itself hasn't been self-supporting, then that would have an impact on State borrowing for general obligation purposes.

Rogers: Because the market would realize that even though we've been keeping a fairly steady even revenue vs. expenditure you'd have in effect a possible sudden large expenditure drawing out all of our surplus...?

Filkin: The market would view that as a possible leak even though every year there is that possibility... this sort of a program, it might focus as a new program and focus on that....

Rogers: The market sort of weighs these as probabilities and this would increase just a new opportunity for leak as a higher probability...?

Filkin: That's a good way to put it, yes.

Rhode: Unless I'm ahead of your remarks, we spoke a moment ago about the possibility

of issuing up to a billion in revenue bonds on behalf of the Northwest proposal, assuming we got an IRS exemption, and others are talking about the Susitna project, the current estimate of the Corps of Engineers brings the final cost of that up to $3\frac{1}{2}$ billion. How interrelated are these things? Is the market going to judge Susitna or Northwest proposal strictly on its own without regard to a large revenue bond program of the kind in this bill or?

Filkin: That really depends on where the possible relationship between the State and these particular projects... what that relationship is. If it is truly a revenue bond project, payable only out of the revenues that flow from the gas pipeline or from the Susitna and the contracted sale of power, they should have little impact on the State's finances. The fact that they are so large and the fact that today the State is so committed to petroleum (means that) something that happens in the petroleum area does have an impact on how the market views the State of Alaska general obligation bonds. If that weren't the case, the State of Alaska probably would still be rated BAA1, but instead it's rated A1 and so that was a positive thing, but at the same time if negative things do happen in areas so vast as petroleum or in the future so vast as natural gas or hydro power, those each could have some impact on the State's loan financing arrangements.

Rhode: Maybe another way to put the question, when New York City got in trouble, did other agencies, say of the State of New York or revenue bonding authorities, ... (get in trouble)?

Filkin: For a time there was sort of a ripple effect or a neighborhood effect on municipals and it was felt the greatest on the East Coast. It was felt in greatest in New York City. To some extent it had little or no impact

and in fact there were a number of municipalities in New York State that really suffered a close out from the market place for several months. As a result of New York City's problems, people didn't want to associate with anything close to New York. It was a little bit irrational but nevertheless that's what some of the investors as a group decided to do. They had enough of an alternative in the Midwest and the West and Alaska that they said, wait this one out. That's more temporary -- even though for somebody else it's minor, when it happens to you it's major -- but it was a temporary thing that ultimately corrected itself and the problem was zeroed in on and sort of isolated. Just to give you some idea, seven or eight years ago when the State of Alaska went to the market place to borrow money, the comparison was sort of three-way: should this be a slightly higher rate or slightly lower rate than New York City and Puerto Rico? Well, today the conversation is: how much more should it be than the State of California, which is AAA rated, or Virginia, or Minnesota or Illinois, and there's no discussion at all about how Alaska rates with New York State or Puerto Rico, because they have declined at a time when Alaska has improved. The one area, though, where there was some valid concern was if this is happening in New York, is it also happening in Boston and Baltimore and Detroit and Cleveland. And the fact is, it was, and people weren't focusing on it quite as much. So it did highlight the problem and probably bring it to light in other areas a little more clearly....

Malone: Are there other points you think you should touch on in the legislation?

Filkin: I hesitate to go through point by point in the legislation. I guess my concern is that it appears to be so all-inclusive that I would urge a little concern on that point alone. If I could cite just one example, the permitted investments have a long list, starting with U.S. Government and going all the

way down through prime corporate bonds and then any other sorts of securities as a separate category.

Malone: This is the Permanent Fund you're referring to?

Filkin: Yes. Again, given the objective of the Permanent Fund as a source of security for another group of loans which needs that source of security, the opportunity to invest in such a broad range loses the impact that was designed for that fund. I'm not suggesting how the investments ought to be made, but the restrictions on the investments ought to be made with the objective of what the pledge of that fund is designed to do.

In the area of the municipal loan program, there is a section dealing with the fund's purchase of municipal bonds on a set formula.

Malone: It requires the loan fund to submit a bid for certain types of municipal bonds according to the formula.

Filkin: Where we've observed formulas like this in the past and there haven't been many but the experience has been roughly the same, the fund either buys all the bonds in a given market or none of them simply because there hasn't yet been devised a formula that is simple enough to administer and yet sensitive enough to react to the changes in the market place on a day-to-day basis. And I would say that even though there has been some care taken in drafting that section, I think the experience would prove to be true in Alaska, too, that the fund would wind up the purchaser of a lot of bonds or no bonds depending on the market; and I guess a corollary to that is that the marketable bonds which might go to the rest of the bond market and the poor security or those that are not deemed credit worthy would line up in the portfolio of the Permanent Fund because there isn't any limitation other than A rated and better or BAA rated or worse, as I recall.

Rhode: Another witness from New York the other day gave his judgment that revenue bonds of the kind in this bill which are a mixture of everything from student loans to commercial lending would not, at least initially, be marketable without this guarantee of earnings coming off the Permanent Fund.

Filkin: I think that's a good generalization. You could always find a situation where the source of security for an unusual commercial loan or a student loan was so strong that it wouldn't need any additional security, but I think, by and large, a combination such as this with its broad ability to lend under just about any circumstances, is dependent on the fund. I think the pledge of a very strict source of pretty much unrelated security is a requirement.

181

APPROVED

HOUSE SPECIAL PERMANENT FUND COMMITTEE

TRANSCRIPT OF TESTIMONY BY SAMUEL PLAIA ON SS SB 1

27 MARCH 1979

Plaia: Senator Hohman's bill is a very extensive one, but rather than make a detailed analysis of it, due to time constraints I'd prefer to make some general comments on the intent of the bill and what problems I feel may arise from the bill as it's presently constituted.

Your comments earlier about the use of the income of the Permanent Fund to support debt to provide the capital funds quickly to bring massive investment into the State to help the State develop a series of industries and help the State's citizens receive money under favorable terms and conditions is certainly the essence of Sen. Hohman's bill. The theory of it is that the income from the Permanent Fund could be used as the security for the sale of so-called revenue bonds (being revenue in the sense that they would be paid back not by the general obligation resources of the State, but from the income produced from the investments that such a loan program would make... i.e., the loans themselves when repaid or paid down on a schedule would presumably amortize the revenue bonds). But recognizing that such programs would require a substantial amount of time to put into action, as well as several of the purposes for such loans being ones which would require extensive time for their repayment, the attempt is made to provide the specific income from the Permanent Fund's investments as the security or collateral which would make an investor willing to buy the bonds. Because the investor does not have the specifics of what the particular loans would be made in and, therefore, could not make a judgment as to the value of that particular program and the likelihood as to whether the investment is going to be repaid through the earnings of that particular loan, he would need such additional collateral. In addition, it would provide the investor an opportunity to examine perhaps more closely the projected income of the P.F. over a period of years and give the investor a certain sense of security that without regard to whether the loan programs succeed or fail, in effect the money is going to be segregated and kept there so that principal and interest can be paid when due. It is also true that that kind of a collateral would allow bonds to be sold at a somewhat lesser interest rate and, as a matter of fact, without it, I don't think bonds for such programs as proposed here in this bill could be sold at least for some of the purposes which have been outlined in the bill.

Given that introduction, I'd prefer to address some of the loan purposes. There are certain areas I feel require comment.... (page # referred to are from original version of SB 1, and same as HB 279)

Starting on page 25, we have the loan purposes: residential housing, commercial purposes, public purposes, and education. In the case of residential housing, I see no general problems since that is a well-established public purpose and is being used in the State presently and throughout the lower 48.

The area that I have the prime concern with is commercial purposes... (here reads what bill says about commercial loans). It seems to me that the intent here is somewhat similar to that of the Federal government Small Business Administration, which is to provide loans for smaller industries which do not have ready access to capital from other sources, either because there's an inefficient market mechanism by which they can raise such funds or there are not appropriate investors prepared to make such funds available.

The record of the SBA has not been particularly good. The intent has been sound and despite the very elaborate documentation that is required before such loans are granted, there have been a significant and outstanding number of defaults. When I read this bill, I tried to imagine a situation which could arise, and that is let's assume we have an idea which we believe is commercial and can create cash flow and, presumably profit. And what I'm concerned about is what can happen as a result of the State making an investment in such a commercial venture. And that is that a group of people would get together as provided in the bill and form a corporation and put in a certain amount of capital and then go to this particular program and outline a plan for the expenditure of let's say one million. And they make projections and show that if they are successful they will be able to produce a profit and a cash flow and after administrative costs and expenses will then produce a source of funds which can be used to repay the loan. There will be an enormous temptation, if this program is put into effect, for somebody who's always wanted to be a successful entrepreneur to come up with some pretty good ideas which seem to be sound, and form a corporation and get let's say the million dollars, which will provide for salaries and the rent and overhead and travel expenses of the corporation, and set aside a certain amount as a reserve for the repayment program and successfully repay their obligation. Unfortunately, what they can also do.... (Here tape was changed; scenario of corporation that might default on loan payments was continued).

And the ^{only} recourse is that the State or the program can now go to the individual who has personally guaranteed the particular obligation and say now I want to collect from you or the group of shareholders the \$750,000 that's not been paid back. And at that point any individual who does not have the money has available the appropriate mechanism through bankruptcy court to be relieved of that obligation.

As a result, the funds which made this investment have now lost this principal and the Permanent Fund income will now have to be used to make up that deficit. So that you have here a State going into the business of loaning funds to corporations in ways in which that corporation can very, very easily bleed off the assets leaving you with nothing at some particular time, either by intent or unintended, because of poor business judgment.

Malone: In the commercial loan section of the bill, it provides for collateralization... such safeguards... can they be built into the law so the loan fund or the Permanent Fund, I don't know, would have recourse against the collateral...?

Plaia: Yes, that can certainly be done, however if collateral is a building, it's pretty hard to move a building; and if collateral is inventory and expended money, then the collateral is not existent. A ship, for example, yes you could probably re-capture a ship... and we have records of the attempt to collect such collateral... but it's not so easy to collect....

Malone: ...To what extent would the legislation concept encourage defaults... Is the fact that the buyer of the revenue bond is not looking to the operation of the loan fund (unclear)....?

Plaia: It's the only security he has, and that's the only reason he would buy the bond. For example, several years ago the Small Business Administration encouraged the formation of private small businesses and corporations to get the private sector into particular businesses and it provided certain incentives and tax advantages to encourage them to develop these small business investment corporations (SBIC). And there was a great flurry of raising capital for these SBICs, publicly held but non-governmental corporations, to provide such funds because the assumption was that you could put together a sophisticated group of investment decision-makers and that they could provide the funds for let's say a small company that needed \$350,000 for expansion of existing facilities or that had a new idea or a new patent which seemed to have a strong possibility of success. And the SBICs would provide the capital for this in return for a share in the equity of the corporation. The record of this as it stands today is pretty dismal despite the presumed sophistication... there were banks, for example, that had SBICs formed as subsidiaries and the record of investments is extremely poor, and these were investments that were made with the same intent and purposes as here by people who presumably had a great deal of sophistication and the record is that it was not successful. Not only was it not successful, but in most cases it failed. Now the value of these SBICs has (unclear) because the portfolios have not produced the income which would allow them to pay the dividends to the equity shareholders in a way which would make good market price on the security. In addition, ...over the last five years the SBA itself, in guaranteeing or making some of these loans, has found that the primary purpose of the loans seems to have been to feather the nest of the officers of the corporations who borrowed the money.

Malone: Why did the SBICs encounter these problems?

Plaia: The problem is the pressure for investment. If you have the funds sitting around, you want to put them to work. Now if the purpose in putting them to work is not just to invest the principal and get a prudent income out of it, you're going to have to find investment opportunities, and you become far more willing to look at investment opportunities when the job that you have is to make investment in such opportunities. So while you may not seek them out, you certainly become far more receptive to them when they come in because who knows when the next opportunity is going to come along for you to make such an investment and fulfill your duties and responsibilities. Pressure -- the funds are there and they are supposed to be put to work.

Malone: What sort of standards do the officers of the SBIC have to meet...?

Plaia: Judgment, mature judgment, in terms of the people involved, what their record is in making a company go. They look at officers, they look at the product, they look at the product's share of the market or they make a judgment of how valuable the product is....

Malone: I understand that they do that... But what I'm getting at is what is the essential difference... I mean if we talk about a loan fund secured by a separate fund with its own earnings... maybe there's no incentive for the loan fund to turn in a good record as opposed to a bad one... What is the parallel with the SBICs?

Plaia: In the case of the SBICs, number one they would require far less equity than a bank because they are depending much more on their judgment.

Kocsis: Re. value limitations section of the bill, isn't that a fairly conservative way of approaching it and that would protect it about as much as a private bank or anyone could be protected?

Plaia: If banks are doing that, it's not for some of the kinds of purposes as these commercial loans. No bank would make a commercial loan on these standards, at least in my opinion. They might make it for housing... 90% is pretty standard but that's based on the theory and feeling that real estate is a continual and constantly increasing asset because of its diminishing availability... But this is not the case in commercial ventures. Take fishing for example, which depends solely on nature... Re. 95% of the appraised real property... I'm not sure the bank would go along with that. 80% of tangible personal property... what might constitute tangible personal property as security for the loan... car, furniture, paintings, jewelry... you can't get 80%....

(Comments from Haugen and Bushre unclear).

Rhode: Mr. Chairman, I just have a comment. Surely it must make a difference if I have some kind of plant and equipment worth a half million, but it's located in Barrow. If the State has to go in on a default and sell off the property, it's true the replacement cost of that project is as I stated in my appraisal, but can you get that kind of money? You are asking someone to come in to take over a failed business.

Plaia: You will sell it at so-called distress prices, so that even 75% would be good if this is in an area that is remote or has been chosen simply because that is the place where the incorporated individual has chosen to live and reside. If you want to encourage somebody else to come in there, you are going to have to give them a big carrot. The big carrot is that they are going to be able to buy something really cheap. The market place is pretty vicious when it comes to things like that.

Malone: To summarize the points you've raised so far... In at least the initial years, the operational loan fund may not be held to reasonable standards because at least in the issuance of bonds the buyer is going to be looking at the Permanent Fund for security, not the operation of a new loan fund. Secondly, you have said that the operators of the loan fund may be under considerable pressure to get the money out and that may lead to problems in getting money back again. (Plaia confirms these).

One of the things that came up in the last session of the last legislature... a very complicated area... The public purposes section here, particularly the section where the loan program or fund would purchase municipal bonds....

Plaia: (Referring to series of formulas on pp.32-3). First of all, let me give you a little background. Municipal securities for the most part are sold in what's called serial maturities, in other words the total loan will mature over let's say a 20-year period and in the first year x amount of principal will be paid and whatever the interest is and in the second year another amount of principal will be paid etc. so that in each year you have part of the debt maturing. So it's called a serial loan, as opposed to a so-called term loan... Serial maturities sell at generally increasing rates of yield. In other words, the shorter the maturity, the less the yield; the longer the maturity the higher the yield. For example, a bank would be willing to accept a much lesser rate of interest for a bond due in one year than it would for one due in several years. So we have then what is called a yield curve... that is a curve whereby the shorter maturities generally sell at a lower price, the longer maturities sell at a higher price... Now the yield curve itself is subject to constant changes and distortions in the market place, depending upon the amount of investment money available for certain maturity ranges. Therefore, you go into periods where you will have a so-called normal yield curve whereby the one year maturity will be much lower than the longest maturity... But in cases of fluctuations in interest rate patterns and the availability of money, there may be less money available for shorter term investments than are available for longer term investments. Therefore, to create an interest in the shorter term investments, the yield has to be raised so there you get what is called flattened yield curve... i.e. the differential between these two is much closer... we are currently going through what is called a flat yield curve... Now this formula fixes the rate at which the State must buy securities, and it fixes it in such a way that it does not take into account the distortions that may occur from time to time in the yield curve. So consequently, the State would be forced to buy securities whether it wanted to or not, because the investor would not under this formula be able to find a way in which he could develop a security and a yield curve that he could sell in the market place....

Malone: Then you're saying the formula set out in the bill may result in the director of the loan program buying bonds for more than they can be sold for. (Plaia confirms). Is that because the formula is defective?

Plaia: It's not that the formula itself is defective. It's not possible to accept such a formula. Any formula of this type would be defective. It might be effective at one particular time, but a year later that formula is still fixed, you haven't changed it, and the conditions in the market has changed so that distortions occur which would then force the State to buy not at so-called market rates.

(Discussion among members re. subsidies unclear).

(Comment from Bushre re. State loan programs unclear).

In this particular instance, I'm saying this formula simply will not work. It will encourage investment bankers to not bid on the bonds at times in certain maturities and under other conditions it will not only discourage them but it will make it impossible for them to submit bids for the bonds. So that in effect, the State would have to purchase those bonds... at rates which are not so-called market rates and therefore, the State would also lose the benefit of the additional income it could get by investing in non tax-exempt securities. (Discussion re. interest rates, guarantees, and more about yield curve unclear).

...If the yield curve proposed here is different from the yield curve in the market place, people are going to buy which is the more effective and in this instance they are not even going to be able to buy it because the State....

Kocsis: Do you think mixing the bonds together would still have that effect of lowering it?

Plaia: No, the market is the market. It makes its own curve and what makes the curve is the amount of money that's available for investment in a particular security range. For example, now we have a flattened yield curve where the differential between one year securities and thirty year securities is very narrow, the reason being that the banks do not have that much money available to put into tax-exempt securities. (Example of insurance companies having money to invest recently, compared to several years ago when natural disasters left them with less money but at that time banks had plenty of dough).

(Question from Malone re. municipal bonds and discussion unclear).

Malone: Re. commercial loans, to what extent are we likely to run into any problems for issuing tax-exempt bonds for that? How is this treated in other jurisdictions?

Plaia: One can under certain conditions issue tax exempt bonds for so-called industrial purposes, e.g. in the area of pollution control that's being done frequently. I believe the limit has recently been raised to \$10 million from 5 million. Most of the bonds that I do see issued, however, for pollution control run from 1-3 million. That has been defined as a genuine public purpose. I think that what would happen in this particular program would be that the very people who would come to you to receive the benefits from this kind of a program would not qualify... therefore, there is serious question here as to whether the bonds that would be sold would be tax exempt. In other words, the bonds would be sold using the income of the Permanent Fund to provide the... to make these loans and there might be very serious questions and it would have to be examined, yes.

Kocsis: It was examined by E.F. Hutton and they felt it would be tax exempt.

Plaia: But in all due respect to E.F. Hutton, they are investment bankers as I am and they are not tax counsel....

To continue with my concerns about the loan purposes as drafted here, re. the student loans as it's drafted here I would think that it would be an encouragement to default on the loans... It's not so much an invitation but it's certainly a suggestion that if you do default you won't be punished very severely. And in effect that's a subsidy and that's all right, too, except that it's a little unfair because in effect the person who does pay the loan off is subsidizing the person who doesn't pay it off.

I believe those were the major concerns I had about the bill....

HOUSE SPECIAL PERMANENT FUND COMMITTEE
PARTIAL TRANSCRIPT OF TESTIMONY BY THEODORE SWICK

10 APRIL 1979

Swick: ...From my experience and from examination of the procedures that are outlined in this proposed legislation (HB 279), this method of aid to local government, in my judgment, will not work at all unless the intent of this provision is to have the State, in fact, buy all of the bonds put up for sale by these various cities. If that's the goal, then I think this will work. If it's a provision that's trying to help the weaker cities, why that's fine, too, and I think it will happen. But the fact that the State will be making a bid that is presumably competitive with the marketplace; I think this thing is all out of shape and all out of reality. In fact, I don't believe it even could be restructured to work. It'd really almost be re-inventing the wheel....

First of all, it's based on the Bond Buyer average. The Bond Buyer is a newspaper that services the municipal bond industry... That average is made up of a determination of the market every Thursday morning in New York by a series of phone calls and is established by the market price for a 20-year a-rated or aa-rated bonds....

The municipal market is a over-the-counter market in the purest sense... On any particular list of bonds,... if you ask ten traders what they're worth, you're going to get a disparity in the price. That's the way the Bond Buyer average is made up....

For example, Matanuska-Susitna recently sold \$20 million in the public marketplace, a-rated bonds... If we took this formula in the bill and took

the Bond Buyer average as it was that day, that issue would've been bought by the State. And it would've been bought at prices which were probably 50/100s off the marketplace... The State would've paid on the average about \$7 per 1,000 more than competitive marketplace said the bonds were worth. I don't think the motive here was to provide a financing mechanism with State funds for a-rated (unclear) in Alaska. Now if it was, you've got it.

Again, based on ratings and on the index, the thing is I think unworkable because in the marketplace there are very subtle variations within a rating category... So when you apply a pricing mechanism based on credit rating as this does, there's no way that that formula is going to come up with a price that has any reality to the real market for those bonds.

Another flaw in it is we have what we call a yield curve and that deals with the fact that most municipal issues are issued in serial form... In so-called normal times, each year you go out in the life of the loan, and each principal installment attached to each year, has a yield on it higher than the one proceeding it. So as the bonds get longer in life the yield goes up, and as a result the interest rate goes up.

Now when you take an artificial arrangement, where you have every five years a set... where your yield curve is absolutely flat for five years... again, no reality to the marketplace at all.

...If the intent were to buy all the bonds put up for public sale by issuers in Alaska, then this thing would work like a charm. But you will not get any competition from Wall Street people.

Now the act goes on to say that the award will be made to a combination of bidders... that they will combine pieces of the best bids of several parties and come up with an award... From our point of view, on the

underwriting side in Wall Street, if that is the prospect we would not even bid on the bonds... The reason for that being that the way your procedure is structured, the chances are that if we were going to make a split award, the State would buy the shorter years and we on Wall Street would end up with the longer years.

Again, the award of the securities is made on the best cost of money to the issuer. (Describes calculation of arrival at "net interest cost")... What happens is we have our profit built into the short bonds and we make no money or sell at a loss for long bonds... So again, in the marketplace, this is all out of reality... I don't think this thing will work and that's an attempt to explain why. If the State, through this formula, takes off the bonds where we have some profit in it and leaves us the ones where we have some loss in it, we're only going to do that once, and probably never....

(Re. proposal in HB 414 for use of Permanent Fund income to guarantee debt for power projects, Swick gives some history of how he and other consultants to prior committee came up with idea)... The opportunity appeared to be there to take advantage of this very high quality cash flow to contribute to other needs in the State of Alaska and at the same time not invade or violate the spirit or intent of this trusted part of the income. So what we came up with led to this 595. Here's the way we envisioned it. That money comes out of very high grade investments and we took this towards another developing major problem in Alaska which was the demand for energy....

So this seemed a positive place to go to make an important contribution with this very high grade cash flow. The idea then would be that under the Power Authority Act... they are only permitted to fund "feasible"

projects... so first of all we want our projects to pass all those tests... and they'd be revenue projects which would be funded... in the bond market... the people who lend money to tax-exempt borrowers are used to that sort of thing....

So you have a project that already passed all those tests and seems feasible, but the lenders are still depending on estimates of experts that 10, 20, 30 years from now certain events are going to take place so that lender is going to get his money back. We can lend that guy alot of comfort in his examination of an Alaska revenue project as to whether he wants to lend them any money or not by saying we will take and pledge the income from this very high grade investment account and we will have that available in the event that the predicted results of the revenue producing project did in fact not occur in any given year, you would have access to the cash flow from the Permanent Fund to make you whole and pay the interest and principal.

Now, one thing that would accomplish would be to drive down the cost of borrowing for that particular project... And I think you could come up with aa bonds... I could envision that guarantee providing a aa-rating for project security.

Secondly,... I could see the cost of borrowing for a project getting down to within about 50/100s of the cost of your general obligation borrowing. In other words, if it cost the State of Alaska $5\frac{1}{2}$ to borrow towards general obligation debt, I could envision these bonds selling for something like $5\frac{3}{4}$ or 6%, I think no more that 50/100s. I would go further to say that if that income flow guarantee was not there, the cost of borrowing could be anywhere from $6\frac{1}{2}$ to 7, $7\frac{1}{2}$, depending wholly on the

belief of the figures in the feasibility study and the convictions of the consulting engineer. Now, the important thing in this is the expectation that the project will be self-supporting and that the money will never be used. If it's needed it is there and it will be used, of course. But the expectation is that the project will be self-supporting and feasible.

Now what happens -- every year that those bonds are outstanding, you have an obligation to either pay interest or interest and principal on the project debt. If that year goes by, and the project in fact does cover its debt service obligations, then that flow of money from the Permanent Fund income is freed up and can be used for anything else. If you didn't do anything with it, it would go to the General Fund. The legislature could provide a second use for it.

In very simple terms, you're getting a double dip on that money. And if you want to go on to a development program and use the money for that, or if you wanted to subsidize some other lesser feasible project after the guarantee has been removed, you have it. And the delay is only a year, one year's income. Once it isn't needed, you can do anything you want to with it. It is not committed to the debt issue for 30-year bonds.

I think it's a valuable thing to do with that flow. I think it can perform a great service for you. You're not tying up any money in a long term way. It would be possible because in the way we handle cash flow in a revenue project is (technical description)....

So it serves a purpose, it drives down the cost of borrowing, but it's a one-shot deal on that dollar income. And once you don't need it, you can do whatever you want to with it. I wouldn't want any grant program... As I see it, I want to hold that trusted part of this Permanent Fund so

it can't be attacked at all. You could eat into the income as one of these projects goes by of course, but you could put into the agreements that... it can be recovered. You never violate the principal at all, and you never give anything away.

Malone: So the basic argument is this be done for projects that were, first of all, adjudged by standard criteria to be financially and economically feasible to begin with and that, secondly,... it'd be for those projects for which bonds could be sold but they'd be sold at higher rates than this would bring?

Swick: That's correct.

Freeman: What you're talking about here, isn't that what's normally referred to as double barrel bonds, guaranteed not only by the revenues but also backed up by funds...?

Swick: Yes,... it is... In a double barrel bond you have a revenue flow which is dedicated and you have a general obligation pledge which is there and they're both there all the time. But I guess that's right, once that revenue flow in any one year goes by then it's no longer an obligation... I hadn't thought of it that way. There are double barrel bonds that have a very enviable position in the market.

Haugen: Is it advisable to get yourself into a double barrel bond... heavy front end costs in the development of hydro projects... if you pledged revenue and other income so you have the ability to say to the borrower here's what I can offer you...?

Swick: If it's a revenue producing project, you have the income flow which is pledged to the bonds... but you also, in a classic double barrel situation, you also pledge to the lender or the bond holder that you will use the full taxing power of your community if necessary. And the result of that is to drive down the cost of borrowing because the lender sees

additional security for his protection.

Haugen: ...You're pledging the income of (unclear)?

Swick: No, I was talking about the double barrel bond itself. The suggestion here that this bill embraces is that you're not pledging anything but the revenues of the project. And the Permanent Fund income is there in the event that everybody who guessed what those revenues were going to be on a projected basis is totally wrong and the... revenue will not meet the obligations for bonds, then you have the Permanent Fund. But as I say... the project would have to pass the tests... in regards to what the Power Authority can do and what the legislature will in fact authorize them to do.

Hayes: I've heard the concern expressed about power projects that initially there is a lot of front end costs and possibility of negative cash flow, but as any power project proceeds on into time it becomes more and more viable in terms of cash flow to retire bonds. To the extent that guarantees from the Permanent Fund would lower the interest rate on the bonds, it would accommodate the negative cash flow, the problem in the earlier years which is part of the problem that Ernie's concerned about....

Swick: ...You would be saving somewhere in the neighborhood of 100 (unclear)... it's the difference between a 5% and a 6% bond.

Hayes: It's enough to possibly make a very tight situation a viable project.

Swick: The point of the feasibility test that any of these engineers make is what is the cost of money.

(Discussion of effect of difference of one percentage point).

Rhode: I want to clarify one point. The use of the earnings of the Permanent Fund as a guarantee was described as a double barrel and in a large sense I see that's true. But... with a G.O. pledge you are at least initially

cutting down your bond capacity....

Swick: Absolutely. That is a commitment which lasts for the whole length of the debt.

Malone: We have a number of proposals to use income from the Permanent Fund to guarantee debt... As I understand the difference here is that, number one, that this would be done on a project basis and the particular project would meet standard criteria for practicality and feasibility. And that the debt or bonds would be issued pretty much on a project basis... so we wouldn't be aggregating apples and oranges....

Swick: That's my view. Again,... the point being is you can get something of value out of this income flow, you're putting it in very mild jeopardy if any, hopefully none, and it doesn't stop you from using it for whatever else at a very nearby later date. Two shots with the same dollar.

Malone: ...The reason this is probably possible in this case, does it rest on those points I raised or does it rest on other things? Because an argument made previously to the committee was that in the case of debt issued on the strength of a Permanent Fund income guarantee, that the creditor was going to look solely to the Permanent Fund income as his source of guarantee and was not going to pay any attention to the possibility of the project or the use of the proceeds paying back his loan that he's made. This is in cases where the Permanent Fund is guaranteeing revenue bonds that were issued to buy home mortgages or small business loans or fisherman's loans, etc. If there's a difference in this case, I want to isolate what it is....

Swick: Your points are right. That the project will be evaluated to the best of the professional peoples' ability that it will never in fact touch any of the Permanent Fund income money. That's the first series of tests but that's what it comes to. Now, if you had a loan program to which this revenue flow was pledged, particularly if it had multiple purposes, there is

no way that anyone could make a prediction that you were never going to touch that Permanent Fund money, because you're going to have a default ratio... You are right that the investor will forget about the ingredients of an issue unless in the marketing of the securities and the solicitation of lenders' money it is carefully pointed out that that's the intent of this thing and that's what the legislation says and that's the way it's going to be because it would be a very bad thing, in my judgment, if the cost of money as a result of this guarantee caused an unfeasible project to be made feasible. I don't think they should be in there.

Malone: Could you comment on the energy reserve account?

Swick: I don't believe that that fund, as it's presently legislated and constituted, is the basis for security for any borrowing. I just don't think it will work... Secondly, I think it could be a source of a grant program, whether it's an out-and-out contribution of, say, a couple of million dollars here and there... It could be used for early investigation of a project, for some of these front end costs we're talking about. The pot, if you will, as I understand it, renews itself at a fairly modest but regular rate each year... probably generating about, roughly, \$20 million a year. I think you can use that in conjunction with all these other things we've been talking about as a source of money for, in effect, a subsidy type item where you put a little equity into a project to help a small thing get off the ground. It could be used for these small hydro developments that I think are going to be developed all over the lower 48... I don't think it can be an ingredient of security for borrowing in its present state.

Malone: Because it's subject to appropriation?

Swick: That's correct.

Swick testimony
April 10, 1979
Page ten

Haugen: Way I understood, that fund would be used to leverage money for energy development projects.

Swick: In my judgment, I'm putting a squash on that. I'm saying that the way that money is generated and the way it's handled, it will not support debt, it will not support leverage, because the lender has no assurances that it's going to be there next year.

(End of testimony).

HOUSE SPECIAL PERMANENT FUND COMMITTEE 1979
reel-to-reel tapes

<u>Tape No.</u>	<u>Date</u>	<u>Significant Information, etc.</u>
1	3/6 3/8	Revenue estimates (Milt Barker), Alberta Heritage (Jime Rhode) "Capital Gap". (Arlon Tussing)
2	3/17 3/20 3/23	HB277, HJR23; Fran Ulmer, Pete Bushre, Bob Greeley HB400, HB162, HB414 Sen. Summer on SB122; Ken Vassar on Residency Requirement Legality
3	3/23-3/27 3/29	Ken Vassar (con't), Pete Bushre, Sam Plaia on SB122 and SSSB1 George Wolf on SSSB1; Walter Filkir on "Marketing aspects of Bonds"
4	3/29 4/8	Filkin (con't), Martin Moore Preparation for mark-up
5	3/30 4/26	Clark Greuning Mark-up on HB281 - final draft review
6	4/10	Conference call--Robert Greeley; Theodore Swick

cassettes:

7	4/11, 4/12	Mark-up, conference call with Clark Greuning
8	4/12, 4/18	Mark-up
9	4/18, 4/21	"
10 and 11: Library did not receive any tapes for these numbers		
12	4/23, 4/24	Mark-up
13	4/24	"
14	4/24	"

Note: see tape #5 for 4/26, final draft review

SEE COMMITTEE FILES FOR MINUTES AND NOTES FROM THESE MEETINGS

MEETING OF THE HOUSE SPECIAL PERMANENT FUND COMMITTEE

March 6, 1979

This was the first meeting of the committee, aside from a previous brief organizational one. All members were present except for Representatives Schaeffer and Freeman.

Copies of a tentative schedule (attached) were distributed, and the schedule was discussed. Rep. Rogers said that he would like the AGSOC bills to also be considered by the committee.

Milt Barker, from Legislative Finance, passed out some hand-outs concerning revenue estimates and reviewed for the committee the permanent fund income prospects. Pete Bushre, from the Department of Revenue, was also present and commented on the estimates. The fund currently has about \$100 million and is growing at a rate of \$63 million per year; this is roughly half the rate estimated earlier. The committee questioned Barker and Bushre concerning the accuracy of the present estimates and the factors which might result in unpredicted decreases or increases.

Jim Rhode, committee aide, reviewed for the committee what he knew about the Alberta Heritage Fund, including the structure of it in three separate funds which correspond to trust and development bank elements. He pointed out in particular the provision that openly identifies any subsidies as such instead of concealing them. He read from a transcript of the Permanent

March 6, cont.

Fund Symposium in 1977, in which the Canadian economist Dr. Gordon identified some of the negative effects the Alberta Heritage Fund has had on Albertans (attached).

House Special Committee on the Permanent Fund

Proposed Schedule as of 6 March 1979

<u>Agenda</u>	<u>Meetings</u>		
Discussion of Schedule Review of Revenue Estimates Review of Alberta Heritage Fund Analysis of "Capital Gap" Issue	Tuesday 6 March 4:30 p.m.	Thursday 8 March 4:30 p.m.	Saturday (as needed)

Administration Testimony Analysis of Administration and 1978 House Proposals	Tuesday 13 March 4:30 p.m.	Thursday 15 March 4:30 p.m.	Saturday (as needed)

Testimony on HB 162 (Haugen); Other Proposals from the Committee Testimony on HB 280 (Sumner) Analysis of Sumner Proposal	Tuesday 20 March 4:30 p.m.	Thursday 22 March 4:30 p.m.	Saturday (as needed)

Testimony on HB 279 (Hohman) Analysis of Hohman Proposal	Tuesday 27 March 4:30 p.m.	Thursday 29 March 4:30 p.m.	Saturday (as needed)

Further Testimony as Required Committee Mark-up	Tuesday 3 April 4:30 p.m.	Thursday 5 April 4:30 p.m.	Saturday (as needed)
	Tuesday 10 April 4:30 p.m.	Thursday 12 April 4:30 p.m.	Saturday (as needed)

NOTE: This schedule is subject to change as the result of schedule conflicts by consultants, and by direction of the Committee. This schedule may also be altered by additional referrals.

GRUENING: Thank you, Chat. I didn't ask for that plug.

CHATTERTON: (inaudible) ...I really have two questions for the panel, that developed this morning, but I can't help feel a little bit facetious. There was a person who testified here a little earlier this afternoon and made a suggestion as to how to use some of the Permanent Fund funds. I felt I should provide you also with a corollary suggestion for their use. Instead of buying all of the federal lands that are put up for oil and gas leases or along with that, I suggest that we buy the national interest land and thereby immediately solving the D2 question.

Mr. Chairman, through you I would like to ask the panelists or anyone that would care to comment--we did hear earlier comments about: 1. loaning money; 2. investing money. It was even suggested earlier--there was some comment about investing in a pipeline or a petrochemical plant--state funds. My question to the panel and to the Economists--if they have any background on this, would they care to comment--does the potential for a conflict of interests develop when a taxing entity becomes a participant in the profitability of a taxable entity?

My next question is--is there a degree of parallelism, at least in some facets between what is before you, Mr. Chairman, with this Permanent Fund and what had to be before the U.S. Congress some years ago when they were faced with seeing that each and every native Alaskan got a fair share out of the Alaska Native Settlement Act? Is there a parallelism? That's my second question. Thank you, Mr. Chairman.

GRUENING: I'll leave that up to the panelists, the Economists, anyone who wants to speak up.

GORDON: I am really no expert on the problems of taxable entities. The notion that some of the investment proposals put forth recently here remind me very much of where I now live. I happen to have moved to Canada in the last few months. In Canada, there are truly an astounding number, they talk about free enterprise like everybody, there's just an astounding number of what they call their Crown Corporation, Federal Crown Corporations, and Provincial Corporations. Now when you say is there a conflict of interests, they attempt, at least, by this device called a Crown Corporation, to make the Crown Corporation totally operate like an individual enterprise, despite the fact that the state or the province or the nation owns all the shares--sometimes not all the shares, most of the shares. I think if you survey the record of those Crown Corporations, that it is dismal. They have a Crown Corporation selling what Westinghouse sells--atomic reactors. They got involved in a little bribery, but the most significant think is they managed to sell two of their atomic reactors to Argentina at a loss of \$130 million. The Province of Alberta has something called Alberta Heritage Fund. They're visably in the business of setting up businesses that otherwise wouldn't be there--irrigation facilities, food packing plants, huge petrochemical operations. The other thing they're doing is providing more services than otherwise would be the case and lower taxes. They're the lowest tax province in Canada by some piece. The result is that an enormous number of people

are leaving the rest of the country and going there. The wages are lower there than they are where I happen to live in British Columbia, but people are moving there--that's where the jobs are. It is not benefitting, as far as I can see, the average Albertan at all. Rents are going up. Land is getting scarce. I see very little merit, what apart from the conflict of interest problem.

GRUENING: Is there any comment on the second half of the question, which was--was there any parallel between the Native Land Claims and what we might be trying to do with the Permanent Fund? Mr. Love.

LOVE: I don't have a comment on that but on Dr. Gordon's comment. Dr. Gordon, do you operate out of British Columbia right now?

GORDON: Right now, yes.

LOVE: Well, it is my understanding that in British Columbia, under the new democratic party, there's a lot of acquisitions in terms of the Crown Corporation. As a result, partially because of their policy for rapid acquisitions, there's a problem with the insurance industry that the new democratic party was defeated and replaced by the conservative government of Mr. Bennett. It's also my understanding that Mr. Bennett's conservative government has not divested themselves of any of the acquisitions made by the NDP and that most of them, in fact, are now on the whole profitable. Is that in an accurate summation? Just as a parallel to the experience the Federal Crown Corporation as looking to British Columbia where you teach.

GORDON: No, not entirely. You see, to describe the present government as conservative is, I think, quite incorrect. We have two kinds of parties in British Columbia. One is socialist and the other is more socialist. It is not true that those have become profitable. It's not true--they've all been losers. In fact, if you investigate in the theories of finance they teach in business schools, it is extremely difficult to lose money consistently by investing. The NDP did not succeed in doing so. But more serious, some of their acquisitions, a distressing number of their acquisitions, have lost money. They perhaps could have been defended on the grounds that they had some social purpose. There's a great dispute about what the social purpose was and whether it helped anybody significantly. I'd say in Canada, there's all kinds of conservative government of another province in far east. New Brunswick. They bought all kinds of things, setting up another conservative government. They got into an endless stream of business--nearly all of which went bankrupt. The one advantage, incidentally, of the Crown Corporation is it isn't like many of the Corporations into which the British government bails people out. When they set up a Corporation, it is like a private corporation. When it goes bankrupt, it's bankrupt. So it doesn't continue forever. It's just draining off the public purse. That is a legal device which, I think, is of some usefulness. I think there's a great parallel; it's a little hard to classify political opinion. It seems to be so simple

MEETING OF THE HOUSE SPECIAL PERMANENT FUND COMMITTEE -- TAPE LOG

March 23, 1979

Agenda: SB 122

Members Cotten, Freeman and Hayes were absent.

Tape #2, Side 2
800 Sen. Sumner addressing concepts behind SB 122, why he supports it philosophically, questions concerning gains/losses on an individual's share.

943 Discussion of leveraging.

1059 Questions concerning management, eligibility.

1099 Sumner testimony ends.

1103 Ken Vassar, Legis. Affrs. Attorney, addressing legality of residency requirements for qualifying for shares of P.F. Committee concerned about creating two classes of people - one who are qualifying residents and other non-qualifying residents. Questions about implications if there is not a second distribution.

Tape #3, Side 1
0150 Vassar testimony ends.

0166 Pete Bushre, Deputy Comm. of Treasury, raising questions about language of bill and mechanics of administering it. Discussion re. how earnings and losses accrue to individuals and to Fund, losses generated by re-direction and mechanics of re-direction, panic selling, and advisability of direct involvement of body politic in P.F. investment.

0595 Bushre testimony ends.

0610 Adjournment.

MEETING OF THE HOUSE SPECIAL PERMANENT FUND COMMITTEE -- TAPE LOG

March 27, 1979

Agenda: Sam Plaia on SB 122 and SS SB 1

Members Freeman and Schaeffer were absent.

Tape 3, Side 1 Call to order.
0611

0645 Sam Plaia, Financial Consultant, making general comments concerning intent of SB 122 and comments paragraph by paragraph: re. distribution of income, transfer of shares, directed investments (burden on shareholder and "prudent person" rule), eligibility requirements.

0947 Discussion re. capital gains/losses.

0997 Discussion re. leveraging, including borrowing at tax exempt rates. Also questions concerning minor's rights, residency requirements, implications from banker's point of view of shareholder's freedom to re-direct investments.

1140 End of Plaia's comments and discussion on SB 122.

1144 Sam Plaia making general comments on Hohman bill SS SB 1.

1186 and Analysis of specific elements of Hohman bill. Discussion
onto Side 2 re. loan purposes, with focus on concerns about loans for commercial purposes. Analogy of SBA and SBIC.

Tape 3, Side 2 Discussion re. loans for public purposes, municipal
0310 bonding, fluctuations in yield curve.

0574 More discussion on commercial loans, concerning tax exempt bonds.

0612 Concern re. student loans.

0630 Plaia testimony ends.

0637 Adjournment.

MEETING OF THE HOUSE SPECIAL PERMANENT FUND COMMITTEE -- TAPE LOG

March 29, 1979

Agenda: Hohman bill w/ testimony from George Wolf and Walter Filkin

Member Schaeffer absent; members Chatterton, Haugen and Hayes left early to attend another meeting.

Tape #3, Side 2

0639	Call to order.
0680	George Wolf, Attorney, discussing Industrial Development Bonds, non-commercial loans.
0722	Exceptions.
0749	Tracing.
0805	Tax exemptions, arbitrage aspects.
0918	Discussion of consequences of not getting advance ruling from IRS.
1005	Future trends.
1083	Summary by Malone and Wolf.
1114	Wolf testimony ends.
1117	Walter Filkin introduced.
1127	Filkin testimony begins, re. marketing aspects of bonds, and impact of loan programs on State borrowing program.

Tape #4, Side 1

0212	Concern about permitted investments of P.F. being too all-inclusive.
0284	Reaction to Plaia's assessment of need for guarantee of earnings from P.F.
0304	Filkin testimony ends.
0306	Chairman introduces new documents.
0361	Other comments - Martin Moore.
0406	Adjournment.

MEETING OF THE HOUSE SPECIAL PERMANENT FUND COMMITTEE -- TAPE LOG

March 30, 1979

Agenda: General policy considerations, w/ testimony from Clark Gruening.

Member Hayes absent.

Tape #5, Side 1

0000-0035

Technical difficulty, not recording.

0036

Clark Gruening testimony in progress.

0100

Critical elements not now in law.

0179

Re. accountability.

0255

Re. trust concept and development banking.

0330

Goals P.F. can accomplish.

0385

Summary.

0397

Formal Gruening testimony ends.

0398

Questions and discussion with members.

0717

Adjournment.

MEETING OF THE HOUSE SPECIAL PERMANENT FUND COMMITTEE -- TAPE LOG

April 8, 1979

Agenda: Mark-up

Members Cotten, Guy, and Schaeffer absent.

Tape #4, Side 1
0407

Call to order.

0410

Issues to consider in mark-up; Malone suggests handling ea. issue separately.

0837

Motion adopted with no objections to use HB 281 as mark-up vehicle re. management system.

0922

Bushre re. 4-7 memo from Revenue, with discussion from members.

Tape #4, Side 2
0000-0322

Discussion with Bushre continues.

0337

Tom Singer re. 4-7 memo from DPDP, with discussion from members.

0572

What next.

0664

Adjournment.

MEETING OF THE HOUSE SPECIAL PERMANENT FUND COMMITTEE -- TAPE LOG

April 11, 1979

Agenda: Mark-up, conference call with Clark Gruening.

Members Guy and Schaeffer absent.

Tape # 7, Side 1

000

Call to order.

Introduce memo from DPDP and list prepared by staff of issues for consideration in HB 281.

212

Pete Bushre with summary of comments in his letter re. gains/losses, and questions from members.

367

Conference call with Clark Gruening, re. Investment Oversight Committee (IOC).

616

Gruening call ends.

621

Bushre continues.

633

Questions and discussion with members re. IOC.

Tape # 7, Side 2

000

Discussion re. IOC continues.

510

Motion to assign purposes and duties of IOC to Budget & Audit Committee, and to include letter from the P.F. Committee requesting that B & A report to the legislature as to the workability of this and consideration of assigning responsibilities of IOC to a new or existing committee after one year. Also include Findings, p. 1, l. 18-27.

531

Motion adopted with no objections.

549

What next?

587

Adjournment.

MEETING OF THE HOUSE SPECIAL PERMANENT FUND COMMITTEE -- TAPE LOG

April 12, 1979

Agenda: Mark-up.

Members Cotten, Hayes and Schaeffer absent; member Haugen left early.

Tape # 7, Side 2

589

Call to order.

Review of motion adopted 4/11.

635

Sec. 2.

No suggestions.

645

Sec. 3.

Discussion of what percentage of mineral lease bonuses after deductions should go into P.F.

Tape # 8, Side 1

000

Discussion of percentage of mineral lease bonuses continues.

361

Motion by Freeman to change 100% to 50%,
p. 6, l. 5, *and add word "remaining" after "bonuses."*
Discussion.

461

Motion adopted with no objections.

467

Motion by Rogers to change 30% to 50%,
p. 6, l. 11.
Discussion.

674

Vote on motion.

Guy, Malone, Rogers in favor.

Freeman, Chatterton opposed.

Chair does not rule on motion. Not enough members present.

735

What next?

Tape # 8, Side 2

000

Suggestion re. p. 6, l. 29.

Chair wants full committee present.

120

Adjournment.

MEETING OF THE HOUSE SPECIAL PERMANENT FUND COMMITTEE -- TAPE LOG

April 18, 1979

Agenda: Mark-up.

Members Cotten and Schaeffer absent.

Tape #8, Side 2

122

Call to order.

Review of motion adopted 4/12 and
motion chair did not rule on on 4/12.

171

Brian Rogers presents information prepared
by Milt Barker re. how different leasing
scenarios would affect Permanent Fund
contributions.

343

Motion by Rogers to renew motion of 4/12
to change 30% to 50%, p. 6, l. 11.
Discussion.

542

Vote on motion.

Guy, Haugen, Malone and Rogers in favor.
Chatterton, Freeman, Hayes opposed.
Rogers withdraws motion.
Amends motion to read p.6, l. 5 40%.
p. 6, l. 11 40%.

557

Vote on motion.

Rogers in favor.
Other members present opposed.
Discussion of effect of not changing % in HB 281.

607

Malone introduces new topic, list of eligible
investments.

650

Larry Eppenbach, of Legislative Affairs Research,
comparing investments in House bill and in
Administration bill.

Tape #9, Side 1

000

Larry Eppenbach continues, with questions
from members.

350

Pete Bushre responds to question re. long-term
investments of P.F. in Alaska banks.

369

Eppenbach continues, with some suggestions.
Additional comments from Bushre.

496

Adjournment.

MEETING OF THE HOUSE SPECIAL PERMANENT FUND COMMITTEE -- TAPE LOG

April 21, 1979

Agenda: Mark-up

Member Schaeffer absent. Member Haugen arrived mid-way into meeting.

Tape #9, Side 1

498

Call to order.
Review.

592

Discussion of contribution rates continues.
Chair suggests committee take another look at motion passed on 4/12 now that more members are present and also because two questions (p. 6, l. 5, 11) are closely related.

Tape #9, Side 2

000

Discussion of contribution rates continues.

336

Motion by Freeman to change 100% to 50% and after "bonuses" add "remaining", p. 6, l. 5.
Discussion.
Amendment to motion by Rogers to change 30% to 50%, p. 6, l. 11.
Discussion.

489

Vote on amendment to motion.
Cotten, Guy, Rogers in favor.
Chatterton, Freeman, Hayes, Malone opposed.
Amendment to motion fails.

545

Vote on main motion.
Freeman, Guy, Hayes, Malone in favor.
Chatterton, Cotten, Rogers opposed.
Main motion carries.

553

Motion by Rogers to change 30% to 25%, p. 6, l. 11, and add "as of effective date of this act, and 50% of all... received from leases issued after effective date..." p. 6, l. 13.
Discussion.

590

Motion by Chatterton to divide question.
Discussion.

627

Rogers withdraws motion. New motion by Rogers to add "50% of all... from leases issued after effective date of this act", p. 6, l. 13.

636

Vote on motion.
Cotten, Guy, Malone, Rogers in favor.
Chatterton, Freeman, Hayes opposed.
Motion carries.

MEETING OF THE HOUSE SPECIAL PERMANENT FUND COMMITTEE -- TAPE LOG
April 21, 1979
Page Two

658 Motion by Freeman to change 30% to 25%,
p. 6, l. 11.

678 Motion adopted with no objections.

684 Discussion of language p. 6, l. 29 and p. 7, l. 1.

Tape #10, Side 1
000 Discussion continues.

183 Motion by Rogers to change p. 6, l. 29
and p. 7, l. 1 to read "The corporation's goal
should be to maintain safety of principal while
maximizing total return."

266 Motion adopted with no objections.

267 Motion by Rogers to change p. 6, l. 27-8
to read "...to benefit future generations
of Alaskans."

370 Amendment to motion by Guy to delete "future."
Vote on amendment to motion.
Chatterton, Guy in favor.
Other members opposed.
Amendment to motion fails.

436 Amendment to motion by Freeman to substitute
"all" for "future."

443 Amended motion adopted with no objections.

461 Sec. 030
Malone suggests deleting "a mechanism", p. 7, l. 6.
Sec. 040
Discussion, no changes.
Sec. 050 and 060
Discussion.

642 Motion by Guy to have Board of Trustees consist
of five members, for better geographic
representation.
Discussion.

684 Vote on motion.
Cotten, Guy, Haugen, Malone, Rogers in favor.
Chatterton, Freeman, Hayes opposed.
Motion carries.

691 Motion by Rogers that Board members be appointed
for five-year terms.
Discussion.

Tape #10, Side 2
000

Vote on motion.
Hayes, Rogers in favor.
Other members opposed.
Motion fails.

012

Motion by Cotten to change 4 to 3, and after "reappointed" add "and must be reconfirmed", p. 7, l. 23. Also, change terms to read "two members for one year, two members for two years, one member for three years", p. 7, l. 24-26.

058

Vote on motion.
Chatterton, Cotten, Freeman, Guy and Haugen in favor.
Hayes, Malone, Rogers opposed.
Motion carries.

081

Motion by Malone that members can't be appointed for more than two consecutive three-year terms.
Discussion.
Malone withdraws motion.

127

Sec. 070
Motion by Guy that if vacancy occurs, replacement must be from that geographic area.
Discussion.

309

Vote on motion.
Guy, Haugen in favor.
Other members opposed.
Motion fails.

319

Sec. 080
Motion by Cotten to delete p. 9, l. 2-4.
Discussion.

392

Motion adopted with no objections.

401

Discussion of language p. 8, l. 29 and p. 9, l. 1-2.

514

Motion by Rogers to change p. 8, l. 29 to read "At least three members of the board...."
Motion adopted with no objections.

542

Sec. 090
Suggestion by Freeman to change quorum from two to three members, p. 9, l. 5.
Adopted with no objections.

552

Sec. 100
Discussion of language and fee. No changes adopted.

MEETING OF THE HOUSE SPECIAL PERMANENT FUND COMMITTEE -- TAPE LOG
April 21, 1979
Page Four

- 571 Sec. 110
Discussion of who determines salary. No changes adopted.
- 603 Sec. 120
Motion by Rogers to add after "board" the words "and Executive Director of the Board", p. 9, l. 18.
Motion adopted with no objections.
- 636 Sec. 130
Discussion of language in (a) of this section.
- 708 Motion by Guy to change "means that" to "is when"
p. 9, l. 29.
- Tape #11, Side 1
000 Discussion of language continues.
- 093 Guy withdraws motion.
Motion by Chatterton to change p. 9, l. 26-28 to read "The prudent-man rule shall be applied by the board in the management...."
Motion adopted with no objections.
- 109 Sec. 130 (b)
Discussion of language.
Motion by Rogers to change "may" to "shall"
p. 10, l. 7.
Motion adopted with no objections.
- 148 Motion by Freeman to delete "seek to"
p. 10, l. 9.
Motion adopted with no objections.
- 195 Motion by Rogers to substitute "Budget and Audit Committee" for "Investment Oversight Committee"
p. 10, l. 13.
Motion adopted with no objections.
- 205 Discussion of language in (e) and (f), p. 10.
- 376 Discussion of desirability of prohibiting contracts with agencies or departments of the state.
Motion by Rogers to add after "investments" the words "without approval of the legislature"
p. 10, l. 19.
Discussion continues.
- 549 Chair asks for adjournment with Rogers' motion pending, if no objection.
- 559 Adjournment, with Rogers' motion pending.

MEETING OF THE HOUSE SPECIAL PERMANENT FUND COMMITTEE -- TAPE LOG

April 10, 1979

Agenda: Mark-up, conference call with Greeley, testimony from Swick.

Member Cotten absent; member Schaeffer left early.

Tape #6, Side 1

000

Conference call with Robert Greeley,
re. treatment of capital gains/losses.

155

Malone re. summary of basic theory on
gains/losses. Questions and discussion
with members.

263

Theodore Swick, discussing marketplace for
state and local government securities.

369

Swick re. use of Permanent Fund income,
with questions and discussion with
members.

440

Malone with summary, and questions and
discussion with members re. double barrel
bonds.

490

Discussion of use of income from Permanent
Fund to guarantee debt continues.

524

Swick on energy reserve account and leveraging.

554

Swick testimony ends.

555

Other business, what next.

572

Adjournment.

MEETING OF THE HOUSE SPECIAL PERMANENT FUND COMMITTEE -- TAPE LOG

April 23, 1979

Agenda: Mark-up

Members Cotten and Haugen absent. Members Chatterton and Hayes arrived mid-way into meeting.

Tape # 11, Side 1
560

Call to order.
Review by Chair of previous actions taken related to mark-up.
Motion by Rogers from 4/21 pending, re. contracts with state agencies.

621

Discussion by Rogers of pending motion.
Withdraws motion.

641

Motion by Rogers to delete p. 10, l. 17-19 beginning with "except...."
Discussion.

685

Motion adopted with no objections.

687

Sec. 130 (g), Eligible Investments.
Discussion.

Tape # 11, Side 2
000

Discussion continues, comments from Doogan re. prior committee's rationale re. this section.

064

Discussion continues, with members, committee staff, and Sen. Rodey making comments.

403

Discussion continues, with comments from Bushre.

Tape # 12, Side 1
000

Discussion of investment possibilities continues.

015

Motion by Chatterton to delete p. 10, l. 23.
Discussion.

253

Vote on motion.
Chatterton, Freeman, Hayes, Malone, Rogers, Schaeffer in favor.
Guy opposed.
Motion passes.
Discussion continues.

462

Motion by Rogers to add "investment grade" to beginning of p. 10, l. 24.
Discussion.

532

Motion adopted with no objections.

MEETING OF THE HOUSE SPECIAL PERMANENT FUND COMMITTEE -- TAPE LOG
April 23, 1979
Page Two

536 Motion by Rogers to delete p. 11, l. 6-8 after "stock."

542 Motion adopted with no objections.
Discussion continues.

595 Motion by Chatterton to insert "common" before
"stock" p. 10, l. 29, and before "stock"
p. 11, l. 6.
Amendment to motion by Chatterton to include
only p. 11, l. 6 in motion.
Discussion.

675 Motion by Freeman that after the word "used",
the words "in the purchase ...at the time of
the purchase; nor" be deleted, p. 10, l. 28.

688 Chatterton's motion still pending.
Motion to insert "common" before "stock"
p. 11, l. 6.
Motion adopted with no objections.

695 Freeman's motion considered.
Motion adopted with no objections.
Discussion continues.

Tape # 12, Side 2
000 Discussion continues, between members and Bushre.

104 Motion by Chatterton to delete amended p. 10,
l. 24-25 to "marketable;".
Discussion.

471 Chatterton withdraws motion, if no objection,
so can start fresh at next meeting.

510 Adjournment.

MEETING OF THE HOUSE SPECIAL PERMANENT FUND COMMITTEE -- TAPE LOG

April 24, 1979

Agenda: Mark-up

Members Cotten, Guy, Haugen and Rogers absent.

Tape #12, Side 2

511

Call to order.

530

Introduction of list prepared by Dept. of Revenue and committee staff on suggested alternatives for investments for Sec. 130 (g). Chair outlines two possible approaches - list broad categories or list specific types of investments that are eligible.

628

Questions from members to Pete Bushre re. suggested alternatives and current investment practices for pension fund.

Tape #13, Side 1

000

Discussion with Bushre continues.

088

Motion by Chatterton that committee takes suggested alternatives approach. Adopted with no objections.

099

Discussion of rating of corporate debt securities; Bushre provides definition of a-rated and aa-rated securities.

205

Motion by Chatterton to change "rated A" to "rated AA" in (4) of suggested alternatives list. Motion adopted with no objections.

216

Motion by Chatterton to limit investment in corporate debt securities to 30% of Fund. Discussion.

448

Motion by Freeman to amend to 25%. Amendment to motion adopted with no objections. Motion adopted with no objections.

463

Discussion on other alternatives.

505

Motion by Freeman to accept (1), (2), (3), and (4) as amended, and (5), (6), (7) from suggested alternatives list. Motion adopted with no objections.

- 516 Motion by Hayes to adopt (11), (12), (13), and (14) from suggested alternatives list.
Discussion with Bushre about whether (12) refers to only guaranteed portion of mortgages.
- Motion by Chatterton to amend motion to delete (12).
Vote on amendment to motion.
Freeman, Chatterton in favor.
Hayes, Malone, Schaeffer opposed.
Amendment fails.
- Vote on main motion, with (12) changed to make it clear that it refers only to guaranteed portion.
Freeman, Hayes, Malone, Schaeffer in favor.
Chatterton opposed.
Main motion carries.
- 575 Motion by Hayes to adopt (8) from suggested alternatives list.
Discussion.
- 644 Vote on motion.
Hayes in favor.
Chatterton, Freeman, Malone, Schaeffer opposed.
Motion fails.
- 653 Discussion of remaining sections. Rep. Hayes leaves temporarily to attend another meeting.
No quorum, for the moment no official action.
- Tape #13, Side 2
000 Unofficial discussion continues.
- 458 Hayes returns, quorum present.
Chair reviews prior discussion.
Consensus is that committee is not inclined to add more investments to list.
- 469 Motion by Chatterton that aggregate summation of (11), (12), (13), and (14) not exceed 25% of Fund.
Motion adopted with no objections.
- 492 Sec. 130 (h)
Technical change "IOC" to "B&A", p. 11, l. 12.
- 528 Sec. 130 (i)
Motion by Chatterton to keep as is.
Motion adopted with no objections.

572 Sec. 140 and 150.
 Malone proposes to adopt both sections with
 conforming language needed re. list of investments
 and deletions needed re. stocks and dividends.
 No objections.

595 Sec. 155
 Discussion re. how mortgage loss reserve account
 is no longer needed.

601 Motion by Freeman to delete Sec. 155.
 Motion adopted with no objections.

604 Sec. 160
 Motion by Chatterton to retain as is.
 Motion adopted with no objections.

610 Sec. 170
 Retained as is except for technical change of
 "B&A" instead of "IOC", p. 12, l. 16.

Tape #14, Side 1
000 Sec. 180
 Motion by Hayes to retain as is.
 Motion adopted with no objections.

010 Sec. 190
 No changes.

071 Sec. 200
 Motion by Malone to delete first sentence,
 p. 13, l. 14-16.
 Motion by Chatterton to add "or influence"
 after "finance", p. 13, l. 16.
 Discussion of definition of "partisan."
 Motion by Freeman to retain only second sentence
 and delete word "partisan."
 Combined motion adopted with no objections.

193 Discussion of disclosure.

254 Sec. 210
 Motion by Hayes to retain as is.
 Motion adopted with no objections.

295 Sec. 220
 No objections to language as written.

358 What # should be used on bill?

386 Adjournment.

MEETING OF THE HOUSE SPECIAL PERMANENT FUND COMMITTEE -- TAPE LOG

April 26, 1979

Agenda: Final draft review.

Members Freeman, Guy and Schaeffer absent.

Tape #5, Side 1
0718

Call to order.
Review final draft of HB 281.
Technical error - p. 9, l. 19. "5" should be "4".

Motion by Chatterton to add "in the aggregate"
after "not to exceed", p. 9, l. 21.
Motion adopted with no objections.

Lorde raises question of whether "or influence"
should be inserted after "finance", p. 12, l. 1.
Chair thinks this was included in motion adopted 4/24.
Discussion - Chatterton explains his intention.
That language to be incorporated if no objections.
No objection.

Hayes raises question of whether p. 8, l. 9
would read better as "prudent not to do so" or
"prudent to not do so."
Discussion. Retained as is.

0809 Distribute draft letter of intent to accompany bill.
Consensus that it reflects intent of committee.
Discussion of fiscal note - will ask Leg. Fin. Div.
to prepare it.

0837 Discussion of meeting with Governor and staff
yesterday. Chair has asked that Governor
consider only the issue of management of the
principal of the Fund as the Governor determines
whether or not to support bill.

0883 Discussion of what number to put on bill.
Motion by Chatterton to use 281.
Motion adopted with no objections.

0898 Motion by Cotten to report bill out of committee,
with technical changes made.
Motion adopted with no objections.

Motion by Cotten to incorporate letter of intent
with bill.
Motion adopted with no objections.

0909 Adjournment.

MEETING OF THE HOUSE SPECIAL PERMANENT FUND COMMITTEE

March 8, 1979

All members were present except for Rep. Schaeffer.

The meeting's topic was "the capital gap," with Arlon Tussing as the guest speaker. In 1977 Tussing was asked by the House Permanent Fund Committee to do a study about the adequacy of capital, to determine if there was a gap and, if so, where it was. His report on that, "Economic Considerations in Establishment of Alaska's Permanent Fund," was handed out to committee members, and Tussing explained that, since he has not been working on the question recently, he doesn't have any new conclusions.

Some of the main points which Tussing made are summarized here:

If we invest the permanent fund entirely in Alaska at market rates and terms, the effect is neutral. We merely displace what the banks normally do.

If we invest all of the permanent fund in Alaska, we put all our eggs in one basket and leave them vulnerable to the ups and downs of the Alaskan economy. It makes much better economic sense to diversify by investing outside of the state.

Tussing's "survey" found that the existing capital markets are adequate for large-scale projects. For medium-size projects, he saw no need to intervene unless it's decided that a particular

March 8, cont.

sector needed an advantage. For small projects, there are widely contrasting, polarized, perceptions concerning the adequacy of existing capital markets. Although the lending institutions and successful businesspeople feel that the supply of capital is adequate, many other Alaskans believe that money is unavailable.

There is a problem in rural Alaska, where banks are not anxious to lend. It is simply not good business to lend in the bush, for various reasons.

Normal financing might not be available for certain projects, such as fish enhancement projects. Others, like the barley project and the bottomfishery, can use subsidies to build infrastructures so that the critical mass can be reached.

If you give soft loans to everyone indiscriminately, you give a windfall to the person who doesn't need it as well as helping the one with the marginal operation. If you help only the one who really needs it, you support and favor the poor businessman at the expense of the good one.

There are two ways to subsidize through soft loans-- to loan at an interest rate lower than market rates or to relax the conditions of the loan. Since the interest rate is not the main factor in determining a project's viability, the latter method is preferable.

ECONOMIC CONSIDERATIONS
IN ESTABLISHMENT OF
ALASKA'S PERMANENT FUND

by
Arlon R. Tussing
Institute of Social and Economic Research
University of Alaska

for
Legislative Affairs Agency
State of Alaska

July 7, 1977

I. INTRODUCTION

The following report was prepared under a contract between the State of Alaska Legislative Affairs Agency and the University of Alaska Institute of Social and Economic Research. Its object was to explore some of the fundamental economic questions involved in establishing the structure and policies for the permanent fund authorized by a 1976 amendment to the Alaska Constitution. Research for this report was devoted mainly to an initial exploration of the question to what extent capital markets serving Alaska are reasonably efficient, and consisted largely of unstructured and unsystematic interviews with businessmen on both sides of those markets --- officers of financial institutions and other investors and lenders, and corporate officers and entrepreneurs in Alaska industries or with Alaska interests.

In line with the contract between the Legislative Affairs Agency and ISER, the study and report were to be "...in the nature of a general reconnaissance, and need not involve the collection or processing of original quantitative data." Among the tasks of the study, however, was to prescribe "the analytical and policy issues" which deserve further investigation in depth. A number of the issues raised in this report do warrant collection and processing of original data. In line with the report's terms of reference, I have not proposed final conclusions on any of the six interrelated questions set out in the contract, but have only attempted to explore and define them sufficiently to propose how the Legislature might proceed with such investi-

gations, particularly some quantitative testing of the hypotheses offered here.

Uses of the Permanent Fund

Public officials, "experts" of various kinds and voters generally have envisioned several different purposes for an Alaska permanent fund. The constitutional amendment which authorized the fund reflects a consensus that at least one-fourth of Alaska's non-recurring mineral leasing revenue should be excluded from the regular stream of state spending. A corollary of this consensus is that the fund should be profitably invested to give state government a permanent stream of revenue independent of current mineral leasing income and independent of economic conditions in the state generally. Because state government spending is a large part of Alaska's economic base (and will grow proportionately larger as tax and royalty income from North Slope oil begins to flow), the spending of income from permanent fund investments and their responding in Alaska's private economy could have a stabilizing effect on employment and income in the state.

There is little doubt that the operation of the fund would have the effect of reducing the immediate fiscal impact of oil and gas income and a stretching out and smoothing of its long-term impact, however the fund is organized and whatever its investment strategy. But the size of these impacts will depend on how much of the permanent fund's capital is invested or lent in Alaska and on what terms. Given certain assumptions about

the size and structure of the state's economy, the revenues committed to the fund, the yields of the fund's investments and the disposition of income from those investments, we can forecast its effect on the shape of long-term growth of state product, personal income, employment and per capita income. Some elementary projections of this sort have already been made by ISER under the Man in the Arctic Program.

Beyond this, there is little agreement on the proper purposes or the long-term effects of permanent fund investment strategies, and there has been little examination of the economic fundamentals which determine whether these purposes can actually be achieved by an instrument by the fund, or what its actual effects (intended and unintended) are likely to be. Apart from the purpose of delaying and smoothing the fiscal impact of non-recurring mineral leasing revenue, other goals that have been suggested for the permanent fund are to accelerate the growth of the state's non-oil economy and at the same time to expand state government's non-oil tax base.

In pursuit of this end it is usually assumed, and there seems to be a near-consensus in the unofficial statement of legislators, that permanent fund moneys invested or lent in Alaska be confined to creditworthy projects and enterprises, and at market rates and terms. If capital markets in Alaska (and in the United States) are workably efficient, however --- and my investigation so far suggests that they are --- investment of permanent fund moneys in Alaska will have exactly the same effect on the state's economy as investing them outside Alaska.

(The quality of the fund's investment portfolio may, however, be affected by the choice.) That is, permanent fund money would tend to replace the same amount of money that otherwise would have been provided from private financial sources.

Unless it provides capital subsidies, permanent fund activity will not accelerate growth of non-oil industry and thereby diversify the state's economy. If capital markets are generally efficient, moreover, non-subsidized permanent fund outlays would not tend to smooth out Alaska's business cycle or the growth rate of employment and population, even if there were no other fundamental difficulties (treated in part IV of this report) in using state investment policy as a counter-cyclical tool. In the absence of capital subsidies, any attempt to disperse economic activity or to foster rural industries will also tend to be futile if the absence of growth in rural Alaska or in particular small communities is a result of factors other than the failure of financial institutions to bring enterprise and investors together on mutually acceptable terms. If poverty or stagnation is caused by deficiencies in natural resources, the skills or attitudes of the labor force, transportation, communications and energy costs, or an unsatisfactory institutional environment, the permanent fund cannot cure these ills, nor even mitigate them unless it is treated as a source of capital available for investments which will not meet market tests.

II. CAPITAL MARKET EFFICIENCY

Every proposed strategy for Alaska's permanent fund depends

upon stated or unstated assumptions about the "efficiency" of national or international capital markets. The proposition that Alaska as a whole, certain regions of Alaska, or certain Alaska industries suffer a chronic capital shortage which can be remedied by permanent fund investment strategy amounts to saying that existing capital markets do not, in fact, function efficiently.

By "efficiency" in the capital market, we mean the ability of loanable or investible funds to move readily in and out of Alaska, among industries and among different kinds of capital instruments of different term and risk (common stocks, bonds, loans, etc.) in response to the differences in anticipated yields.

The most important elements of capital market efficiency are mobility, cost and information. Legal limitations on the flow of loanable funds can clearly reduce capital market efficiency as defined here (though there may be good social reasons for the restrictions). An example of a legal restriction on the mobility of capital for social reasons, the federal government limits the rate of interest payable by banks and thrift institutions on savings deposits, in order to channel funds to, and reduce interest costs for, the residential mortgage market (but it also restricts the funds available to savings institutions). The fees of brokers, underwriters, lenders, and "finders" of venture capital, and taxes such as capital gains and stock transfer taxes also increase the cost of moving funds from one investment to another. A lack of competition can both erect barriers to capital mobility and increase transactions costs.

The element of capital market efficiency most often held to be deficient in Alaska is information. If funds are to move easily and at competitive rates of return from areas or industries with cash flow surpluses to those with excess demand for capital, entrepreneurs must know where equity and debt money is available and on what terms, and potential investors or lenders must have the means to appraise the earning capacity and risk of the ventures they are asked to underwrite.

Capital mobility, transactions costs and the adequacy of information are all a function of market size and diversity (which is in turn a function of market size). A region with large and diversified capital demands will attract a large number of financial institutions of different kinds, who will serve as intermediaries between entrepreneurs and investors or lenders. They will compete among one another for business, thereby lowering capital transactions costs to ultimate borrowers and lenders. And most critically, they will make it their business to understand the industries and kinds of enterprises they serve and their local and regional economies, thereby increasing market information necessary to evaluate individual ventures.

This issue has important implications for the permanent fund's investment strategy. If capital markets serving Alaska business are workably efficient, permanent fund moneys dedicated to Alaska investment will have no impact on the aggregate level of investment (and thereby the rate of economic growth), the industrial structure, or on the profitability of investment in Alaska, unless

these moneys are offered on subsidized terms. Loans from the permanent fund at market rates would simply displace private capital that would otherwise be available at the same rates.

The only material result might be a reduction in the diversity--and thereby safety--of the permanent fund's own investment portfolio because it would be imprudently concentrated on Alaska issues and unduly sensitive to business fluctuations special to the state.

If, on the other hand, institutional barriers to capital movements, excessive fees or taxes on capital transactions, or inadequate information result in a shortage of capital for Alaska ventures at normal market terms, then it will indeed make a significant difference to Alaska's economy how much of the permanent fund is allocated to investment within the state. The conclusion that investment strategy would, in fact, make a difference need not necessarily carry with it the implication, however, that the difference would be great, or cost-effective or even in the right direction. To the extent there are demonstrated inefficiencies--barriers, costs or ignorance--in Alaska's capital markets, it may well be cheaper and more effective to remedy those problems directly rather than to offset them with permanent fund investments.

The paradigm (pattern of concepts and theories) of capitalistic finance presented in business school textbooks is one of efficient capital markets. Within the terms of this paradigm, it is very unlikely that Alaska could suffer a chronic capital shortage. Outside investors and lenders, in their search for

the highest rates of return consistent with a given degree of security, would make an effort to discover investment opportunities in the state, while entrepreneurs with Alaska interests would shop the world's capital markets for venturers or lenders of funds on appropriate terms. Whatever lack of information existed about capital sources, the particular industry, Alaska's institutions or business conditions, or regarding the particular firm could be remedied at a price, and at least for large ventures, that price would be relatively small compared to the funds involved. A variety of financial intermediaries and investment services would compete with one another to bring together borrower and lender or entrepreneur and investor, and to furnish either side with needed information. This competition would increase capital mobility and lower both transactions costs (the spread between the yield to lenders and the cost to borrowers, for example) and the cost of information.

Capital market efficiency is obviously a relative matter. The mobility of funds is seldom totally unfettered; there are almost always fees and taxes or other transactions costs; and information itself comes only at a price and is never perfect. The relevant questions here are to what extent and for what regions and industries in Alaska are capital markets significantly less efficient than elsewhere in the national economy and to what extent, if at all, can the investment strategy of the permanent fund remedy or offset these inefficiencies.

Alaskan Capital Markets

In my conversations with businessmen inside and outside of Alaska, it appeared that bankers and officers of financial institutions generally, officers of large corporations, successful real estate developers and the most successful entrepreneurs in contracting, tourism and fishing tended to "believe in" the efficient markets paradigm and conduct their businesses as if it were an accurate view of the world. It is true that several of them spoke of a national "capital shortage"; the reference is to the aggregate effect of high taxes and inflation, and few of the businessmen in these categories seem to believe that there is a shortage of investment or debt capital peculiar to Alaska or to their own industries. The officers of banks, finance companies and other money market institutions believe that their companies actively seek out investment opportunities in Alaska and consistently denied that they insisted on higher rates of return or greater security for Alaska issues. Two West Coast bankers active in Alaska stated a belief that it was probably easier to place large issues generated by their Alaska correspondents than comparable issues from California or Washington State because of the widespread confidence in Alaska's wealth and continued industrial growth. Two corporate officials made a similar observation, one of them alluding to the "glamor" of Alaska investment.

Officers of national or multinational corporations in petroleum, mining and fish processing indicated that for them, the procedures, problems and costs involved in the financing of Alaska

ventures were for all practical purposes identical with those for financing comparable ventures in the Lower 48 or in other politically stable advanced capitalist states. Their own sources were national and international, and their ability to raise funds rested in part on the overall strength and reputation of the company, and in part on their ability to communicate to potential investors and lenders the reasons (resource base, engineering cost estimates, market factors, etc.) why they themselves believed that the proposed Alaska investment was sound. One successful developer scoffed at the notion of an Alaska information gap: "Information, salesmanship--that's what business leadership, what you call entrepreneurship is all about. It's your job as a developer to get all the information your banker needs into his hands. Make him as confident about your project as you are yourself."

Many small businessmen including, it appears, most prospectors, inventors, independent merchants, and operators of hotel, restaurant and other tourist-related businesses outside of Anchorage, and some contractors do not, however, believe in the efficient markets paradigm. I heard many complaints about treatment by banks and finance companies and a feeling that "the system" is biased against small businessmen and against Alaskan enterprise. I heard anecdotes purporting to show that even Alaska banks favor outside-owned businesses. Many persons in this group expressed a hope that the permanent fund could correct this bias and make more funds available for ventures like their own. It was especially noteworthy to me

that most state and federal civil servants in the economic development or business assistance field expressed views more consistent with the capital shortage paradigm than with that of efficient markets and believed that government should provide more financial assistance to private industrial development in Alaska. Whether or not these sentiments express an accurate view of the way in which the economy and financial markets operate, it seems likely that it is a more representative view than the more sophisticated textbook, "big business" view of capital markets, and constitutes a substantial political constituency for an activist policy by the permanent fund's managers.

In preparing this report, I encountered several instances where entrepreneurs or corporate managers were working on financing a fisheries, mining or tourist venture, a shopping center or a residential subdivision. Those in this group who seem to accept the efficient markets paradigm regarded it as the essence of their own job as a developer or manager to assemble and integrate the necessary information on resources, markets, costs, economic and environmental regulation and to draft credible profit and loss projections and pro forma financial statements acceptable to their corporate boards or to outside investors or lenders.

A common situation among small and medium Alaska business enterprises seems to be a rate of growth (with sales increasing at 20 to 100 percent per year) that leads to a need for additional fixed and working capital far outstripping internally generated

cash flow. It is "obvious" to the owners and operators of these businesses that money borrowed to sustain this growth would earn a very good rate of return, but that there is never enough credit available. Businessmen in this situation seem to express two strikingly different attitudes toward their own "capital shortages." Those who operate by the efficient markets paradigm (and these seemed generally to be the most successful) expressed their problems objectively in terms of necessary cash flow and debt-equity ratios acceptable to lenders, while there were others who attributed their cash crunch to the institutional incapacity of financial institutions to serve their kind or business, or to the laziness, ignorance or malice of particular lenders.

It is clear that there are widely contrasting perceptions among Alaska businessmen and others about the adequacy of financial institutions and the supply of capital to Alaska ventures. Curiously, the distribution of these perceptions seems to be bimodal; that is, they cluster at one extreme or the other with only a scattering of individuals in the middle. Perceptions also seem to be highly correlated by industry and by size of enterprise.

In general the bigger the firm, or the faster it is growing, the more satisfied its spokesmen are with existing capital markets. Without exception, representatives of large financial enterprises doing business in Alaska and of large national and multinational corporations spoke as if they believed in efficient markets and, without exception, they rejected the notion that lack of informa-

tion, high transactions costs or institutional barriers created a capital shortage in Alaska or in the industries with which they are connected or whose financial needs they serve.

On the other hand, hardly any local merchants, service industry operators or tourist business operators outside of Anchorage and Fairbanks, and hardly any entrepreneur or developer who was still trying to put together his first "big deal" (capitalized at \$1 million or more), believed that financial institutions operated efficiently or fairly, and most of them felt that Alaskan enterprise was at a substantial disadvantage compared with firms in the same business elsewhere. As I mentioned before, almost every public official interviewed believed that there was an Alaska capital shortage that could, and should, be treated by application of government money. Anchorage and Fairbanks merchants, contractors and real estate developers seem to fall into both groups, as do operators of independent businesses connected with forestry, fisheries and mining.

The time and resources available for preparing this report did not make it possible to separate perceptions and ideology from reality. Each group's perceptions were supported with convincing anecdotes. Nevertheless, most of the correlations between attitude and situation were predictable, and the perceptions surely contain a measure of self-interest and self-justification. Officers of financial institutions who have the job of searching out and appraising investment opportunities are likely to believe

that their jobs are useful and effective, and they are unlikely to emphasize the problems of those kinds of enterprise that they do not serve (and which may not, in fact, be served well by any sector of the capital market). And it is not surprising that public officials feel that government financial and technical assistance (like economic regulation) is essential to a healthy business economy. But among businessmen, are the first group satisfied with the status quo because it served them well, or are those who accept, understand, and work easily within the status quo the people who are for that reason most likely to succeed as corporate managers and entrepreneurs?

My own provisional conclusions on the issue of capital market efficiency are as follows, but they are subject to modification on the basis of a quantitative study of attitudes and actual workings of the financial system in Alaska:

1. Investors and entrepreneurs, would-be lenders and would-be borrowers alike believe that the existing capital market institutions are adequate to finance large industrial or commercial developments in oil and gas, mining, petrochemicals, fisheries, timber, trade, and tourism anywhere in Alaska. I have found utterly no reason to doubt this consensus, and see no way in which the permanent fund could improve on the mobility of capital, transactions costs, or the information made available to investors by the sponsors themselves and through existing financial institutions.

It follows, therefore, that the permanent fund's investment activity in these areas will not significantly influence the profitability or growth of basic industry in Alaska unless loans are made at less than current market rates or under less secured terms (e.g., more highly leveraged, lower coverage rates, less collateral) than is customary. If the permanent fund invests in Alaska industrial ventures at market rates and terms, therefore, it will divert private capital elsewhere that would otherwise be attracted to the venture. In short, there is no need and no useful function for permanent fund investment in major industrial or commercial enterprise in Alaska, unless there are grounds to subsidize that enterprise.

2. Despite the disagreement of those who do not believe in the efficient markets paradigm, the working and fixed capital requirements of residential and commercial real estate developers, contractors, retail and wholesale merchants and purveyors of services in Fairbanks and Anchorage are being served by existing banks, thrift institutions, finance companies, mortgage brokers and the like, in exactly the same way and at approximately the same rates and under the same conditions as in other communities throughout the nation.

Some businessmen will always have grievances against their bankers (and many Alaskan businessmen have some gruesome yet convincing tales to tell) or against the financial system gen-

erally. But Anchorage and Fairbanks banks do compete aggressively for business customers, and some of the "atrocious" stories can be attributed to understandable disagreements over the creditworthiness of a particular borrower or venture rather than a systematic failing of the system. Again, apart from any argument that a particular line of business or kind of investment ought to be subsidized, there seems to be no case for the permanent fund or one of its subsidiaries to enter the commercial capital markets in these communities. I am not certain at this point how well these needs are being served in other urban places in Alaska.

3. Several alternatives exist for financing the purchase or lease of standardized machinery used in business, including motor vehicles, construction equipment, aircraft, boats, electrical generators, compressors, machine tools and the like. Commercial banks, finance companies, credit unions, manufacturers and vendors all offer some kind of financing for this kind of chattel, and one or more of these forms of financing seems to be available to creditworthy borrowers in any Alaska industry or location. Higher servicing and collection costs do tend to limit borrowers in the more remote areas of Alaska to higher interest rate alternatives, but on balance this reflects not a failure of the market to reflect true costs but the opposite, it does not constitute a case for permanent fund involvement in the install-

ment credit business, unless there is also a case for a capital subsidy to rural enterprise generally.

4. The general feeling of local businessmen in small communities and rural areas of Alaska is that they face a genuine capital shortage and that they are at the mercy of one or two financial institutions that are indifferent to their aspirations or the facts of their business situation. There seems to be some merit to these complaints. Lending in small towns or the bush is exceptionally expensive, however; the cost of investigating and servicing small commercial, real estate and installment loans and lease purchase contracts and the like, and the costs of collection, foreclosure, repossession and resale can easily exceed the potential earnings from loan fees and interest. These excess cost burdens, together with unfamiliarity with local conditions, understandably make the statewide (Anchorage and Fairbanks) banks and other financial institutions reluctant to provide capital even for the larger locally-owned development, such as resorts, hotels, apartment houses, fish processing plants, etc., and where they do make loans they are willing to finance a smaller portion of total investment. In these cases, governmental participation or guarantees (EDA, SBA, Farmer's Home, Alaska Veterans loans, etc.) have often been essential to obtaining conventional private financing. This portion of the demand for capital in Alaska may then be a legitimate area for permanent fund activity.

In summary, it appears that most attempts of the permanent fund to serve as a development bank for Alaska would duplicate

functions that private financial institutions (backed up in many cases by other governmental assistance programs, e.g., FHA, Farmer's Home, VA, etc.) perform or are capable of performing adequately. At this stage in my investigation, I have been able to identify only one function in which a new public financing source might function better than the current machinery of the private capital market, and that is in provision of commercial credit and financing of small and medium scale industrial and commercial enterprises in small communities and rural areas.

III. SUBSIDIES AND SOFT LOANS

Diversification of Alaska's economy is widely regarded as a desirable goal for state policy and as a proper purpose of permanent fund strategy. The benefits argued for such a policy are reduction of economic fluctuations and creation of a permanent employment, income and revenue base not dependent upon oil and gas or other exhaustible resources. The line of reasoning in the previous section of this report suggests that the existing concentration of Alaska economic activity by region tends to reflect real resource location and cost factors (such as transportation expense and small market scale) rather than capital market failures. It appears that a reduction of existing barriers to capital mobility and improving information flows would not necessarily accelerate the rate of development in Alaska fisheries, agriculture or tourist industries, for example, or in rural Alaska generally.

Making capital more readily available at lower rates to Alaska enterprise generally could be expected to increase investment in all sectors of the state's economy, but there is no reason to believe that it would influence the concentration of investment in the desired direction, that is, in favor of economic diversification or geographical dispersion (if the latter is indeed a desirable objective). Lower capital costs would likely have their biggest impact precisely where development would proceed most rapidly in any event. If investment activity is already concentrated in oil and gas-related activity, fish processing and in Anchorage residential and commercial real estate development, that is probably where more abundant, cheaper capital would go. There is a strong confirmation of this proposition in the investment behavior of the rural-based regional and village corporations.

Making capital cheaper and easier to obtain will undoubtedly have one effect which may be regarded as counterproductive; business will be given an added incentive to substitute capital for labor and the state's economy will tend to become more capital intensive than it otherwise would be. If investment policy is to be in any way directed toward "job creation," it must be highly selective and not simply a matter of lowering capital costs across the board.

If the legislature deems it desirable to influence private investment in Alaska in the direction of greater economic diversification by means of permanent fund investments, it will have to authorize the fund's managers to make loans to the favored

types of venture on terms other than those of the private market. There is a serious question, however, how many new ventures will be made feasible simply by a reduction of interest rates on borrowed capital below customary rates. There is in fact good reason to believe that investment demand in new speculative industrial, agricultural or tourist-related development are relatively insensitive to interest cost. This is because private investors are not likely to commit their own equity to such ventures unless they have a prospect of recovering their total investment in five years or less. Such an outcome requires an annual cash flow equal to 30 to 50 percent on total investment, a situation in which two or three percentage points interest expense is seldom crucial. More important parameters are the standards for the creditworthiness of the venture and requirements for equity and collateral. In other words, it is likely to be more critical for a new venture in fish processing or tourism whether it can borrow three-fourths rather than two-thirds of its total requirements, than it is whether the interest rate on that loan is 9 or 12 percent.

In this situation, subsidized loans by the permanent fund can without question have an influence on the shape and direction of economic growth in Alaska, and that influence will be greater the greater the proportion of permanent fund moneys devoted to the favored types of enterprise. The form the subsidy is likely to take to make it effective, however, will not be (and should not be) lower interest rates, but rather a

relaxation of lending standards to enhance the availability of funds. One danger here, even if the legislature deliberately authorizes the fund's managers to make such loans, is that the nature and the degree of actual subsidy may not begin to appear for many years, until it begins to show up as defaults on principal and interest payments. This danger will be aggravated if, as is often the case with governmental loan programs, there is not a rigorous policy of classifying problem loans and of promptly writing off those which are uncollectable. Banks and thrift institutions are required by law and regulation to do this, but even there the requirement is only very loosely implemented or enforced, because lending officers are reluctant to expose their own imprudence in making bad loans or to write down the capital position of their institutions.

In any event, there is sure to be some opportunity for the permanent fund to influence the sectoral and geographic direction of economic development in Alaska by manipulation of credit terms. The most aggressive (and in conventional terms, imprudent) lending policy cannot, however, create an industry where resources, markets, skilled labor and other requisites are missing, and the fund's managers should never become so "soft" as to finance enterprises whose promoters are not taking a substantial risk themselves, or which do not have convincing prospects of long-term viability.

The most relevant model of a development bank for Alaska is not the IBRD (the World Bank) or the regional development banks, but the International Development Agency, the World Bank's "soft

loan" subsidiary. If the permanent fund is to direct the shape of economic growth in Alaska, it will not be through normal commercial investments on normal commercial terms, but through a postponed or hidden subsidy in the form of higher loss rates in future years. This is not the appropriate place to judge the desirability or assess the ultimate beneficiaries of capital subsidies directed at changing the structure of Alaska's economy, but the Legislature may well wish to assure that those implicit subsidies are not totally hidden, by setting out (or requiring the fund's managers to set out) explicit and rigorous standards for the granting, servicing, classification and writeoff of soft loans, and by requiring a rigorous annual audit of the fund's loan quality.

There is another dimension to the capital subsidy issue which the Legislature should keep in mind as it authorizes any soft or subsidized loan program under the permanent fund. Granting credit at terms more liberal than the market will almost certainly make some enterprises viable that would not otherwise be so, but it is difficult to draw lending standards in such a way that other ventures which would be viable anyway do not receive a windfall that serves no social purpose. This consideration suggests a policy that might be adopted toward the soft loan program --- that loans under this program be made at rates perceptibly above market rates (as is appropriate to the greater risk). If my earlier observation is correct that speculative investment in Alaska is more sensitive to the degree of leveraging permitted than to interest rates as such, higher interest rates would

screen out some of those enterprises which did not need assistance from the fund and would at the same time help build up a reserve for loan losses to offset the subsidy aspect of the program.

IV. COUNTER-CYCLICAL INVESTMENT

There are several possible concepts of the permanent fund as an economic stabilization device for Alaska. The one basic concept of the fund on which there is a near-consensus is that it is to be regarded as a savings account for a "rainy day." That is, Alaska's government is about to experience an extraordinary surge of income from oil and gas royalties that is not likely to be sustained. Since petroleum revenues will not only be the main source of general government income but will for some time be a principal support for the private economy and the main engine of economic growth, the permanent fund would be used to reduce the injection of income into the state's economy during the boom phase, and then the income from investing these revenues would be used to sustain state expenditures and their fiscal impacts after the boom has ended.

It has also been suggested that the permanent fund could help even out short-term business fluctuations in Alaska, or maintain long-term economic growth (as measured by the growth of state product, real personal income or employment) at some optimum rate. Such stabilization policies could in principle operate through varying appropriations to the permanent fund, working through the fiscal impacts of general fund expenditures;

through varying the permanent fund's rate of new lending in Alaska, working through the fiscal impact of investments supported by these loans; or with both appropriation and investment policy. The basic principle is simple: when the state's economy was booming, larger appropriations would be made to the permanent fund (thereby reducing revenue available to the Legislature for general fund outlays) and/or a smaller proportion of permanent fund assets would be invested within Alaska. When the state was in a recession, the flows would be reversed: less revenue would be appropriated to the permanent fund and more to the regular capital and operating expenses of state government, and/or the permanent fund would inject more investment money into the Alaska economy (presumably by selling off non-Alaska investments in its portfolio).

There are, however, both conceptual and practical problems with using the permanent fund as a stabilizing device on any more sophisticated basis than is implied by the "savings account" notion. One of them has been identified previously --- to the extent that existing financial institutions make up a reasonably efficient capital market, the volume of unsubsidized loans or investment the fund makes in Alaska may not have a significant effect on economic activity in the state.

Even if there were significant capital market deficiencies which gave permanent fund outlays a real effect on aggregate investment in Alaska, or even if the fund had a policy of subsidizing Alaska business (thereby expanding the level of investment

beyond what it otherwise would be), it is still not obvious whether a policy of varying state expenditures or permanent fund investment in response to economic conditions would in fact reduce business fluctuations in the state, increase them or be on balance neutral. The crucial question here is the relationship between our ability to forecast economic conditions or recognize cyclical turning points, and the time it takes for a change in appropriations or in lending policy to show up in unemployment rates or rates of economic growth.

Some very gross economic changes, such as the buildup and decline of pipeline construction activity, obviously could be anticipated and their fiscal effects projected with some degree of confidence. But the Alyeska pipeline is likely to be historically unique in size and specific gravity in the state's economy. Future ups and downs are more likely to be the resultant of a number of smaller influences, many of which (general business confidence, for example) cannot be mapped out in advance and are difficult to quantify even retrospectively. If booms and recessions often cannot be recognized clearly until after they have been with us awhile, and their turning points recognized only after they have passed, it is also true that significant delays are inevitable between the recognition of a new trend, the fiscal action that is appropriate and the actual movement of new dollars into (or out of) the private economy. Depending upon the relative lengths of the various lags, attempts to stabilize Alaska's economy or smooth its growth rate might be successful, but it seems equally likely that state fiscal policy would zig when it

should be zagging, that the amplitude of the business cycle would thereby be increased, or even that the permanent fund's intervention could create oscillations in the state's economy where otherwise there would be none.

It is not obvious which of these outcomes would in fact result from an attempt to use the permanent fund as a stabilizing influence. The effect would depend in part on whether it was appropriations, lending or both which were being varied, and what economic indicators were being used to trigger policy changes. A business cycle model could be developed which would simulate the behavior of Alaska's economy under the influence of various decision rules.

Intuitively, I expect that such a model would show that the various lags in recognizing trends and implementing policy, and in the actual economic impact of that policy, would preclude using the permanent fund to offset economic fluctuations with a term of less than about three years. If the fund is to be useful as a stabilizing device, it will probably be only as an instrument to regulate growth rates in very gross terms and only in the very long run. If, for example, the social impacts of a continuing growth rate in employment below 2 percent per year or above 8 percent were determined to be unacceptable, the legislature might conceivably key permanent fund appropriations or investment policy to the average growth of employment in Alaska over the previous five years, with the understanding that no individual year's growth is ever likely to be on track because of the fund's policies, and that excessive growth in one year might be offset by

stagnation in another, or vice versa. It is likely, in other words, that long-term stability in growth rates might be achieved at the expense of greater instability in the short run.

The practical problems in establishing a stabilization policy for the permanent fund are political and administrative. If permanent fund appropriations (and their complement, operating expenditures from the general fund) are to be varied, it is the Legislature which would have to vary them. While there would be little difficulty persuading the executive branch to propose and the Legislature to authorize increases in capital and operating expenses during a recession if money is readily available to be committed, it may be too much to expect a sharp reduction in outlays to offset an economic boom in the state, particularly when revenues and "needs" have both been increasing at exceptional rates precisely because of the boom. The fate of the state government's announced interest to "stockpile" public works projects until the end of the Alyeska construction boom should be instructive on this point. It is not clear, moreover, that the managers of the permanent fund would be immune from similar pressure with respect to their lending and investment policies, if they were granted the discretion to alter those policies according to economic conditions in the state.

V. PUBLIC ENTERPRISE

Another suggested use for permanent fund moneys is to finance public works projects. The works most often proposed are hydro-electric plants and fisheries improvements such as hatcheries and

habitat enhancement. These two examples are of course quite different; electrical generating facilities can be and usually are self-supporting from the sale of power. The principal reason for governmental investment in such facilities, ideology aside, is the exemption from federal taxes of the income of a public utility and of the interest it pays on its debt. This very consideration suggests that revenue bonds of the Alaska Power Authority or other governmentally owned utilities would not be an appropriate permanent fund investment, because the permanent fund (whose own income is tax exempt) could be expected to earn a higher rate of return from investments in taxable federal or corporate bonds than the Power Authority would have to pay in interest on its own tax-exempt bonds, assuming that the securities were equally rated. This consideration does not, however, necessarily foreclose the permanent fund from providing all or a part of the equity component of Power Authority capital (and in earning a rate of return appropriate to the risk taken by an equity investor), or from providing a guarantee of Power Authority bonds, or from subsidizing electric power development.

The crucial characteristics of some public works, such as hatcheries and habitat improvement, is that they cannot be financed conventionally. Benefit-cost analysis may well show that the new benefits to society exceed the capital and operating outlays, but the burdens and the benefits may not fall on the same people, and it may be impractical (or impolitic) to collect a user charge from the beneficiaries. In the case of these fishery-related investments, however, costs could be allocated at