

ALASKA LEGISLATURE SPECIAL COMMITTEE / SUBJECTS 86 / 2

593 SCOMM18: HOUSE SPECIAL COMM. ON PERMANENT FUND 1978-80

Testimony on Permanent Fund
Offered by Frances Ulmer
March 17, 1979

Mr. Chairman, members of the Committee,

Thank you for this opportunity for the Administration to testify on HJR 23 and HB 277. HJR 23 is a proposed constitutional amendment to increase the permanent fund contribution rate from 25% to 75% and from 25% to 100% for bonuses. It would also provide for 100% of the revenues received from the sale of land not otherwise pledged to be placed in the permanent fund. While the increase would not become effective until July 1, 1981, we seek timely action by the legislature to insure that the amendment can appear as a ballot proposition at the next general election. HB 277 is the Governor's proposed enabling legislation for the permanent fund. It also incorporates the proposed increased contribution levels.

During the election, the Governor repeatedly expressed his long-standing concern for the state's dangerous dependence on non-recurring revenues to finance ongoing state government. After the election, he announced that correcting this situation would be his top legislative priority for the 1979 legislative session. To initiate this task, the Governor asked the Division of Policy Development and Planning to review the various spending limitation proposals which have appeared across the nation and assess their appropriateness for Alaska. While the Governor recognizes the many real needs for government services in Alaska and understands the problems associated with limiting state spending per se, he is committed to holding down the rate of budget growth to give our recurring revenue sources a chance to catch up to our spending requirements. The Governor is committed to avoiding what, as you have heard in testimony before this committee and elsewhere, is a very real potential for fiscal disaster in this state. Simply stated, we are far too dependent on a single, rapidly depleting revenue source - oil.

Our analysis revealed that spending limitations are generally complex, inflexible, and difficult and expensive to implement. Our recommendation, which was adopted by the Governor, was that Alaska already has a superior mechanism for achieving the same goal - increased contributions to the permanent fund. Increased contributions to 75% would allow a moderate increase in spending level, but at the same time, make a larger portion of our non-recurring revenues unavailable for financing ongoing state spending and thereby reduce the unacceptable rate of budget growth made possible, in the past, by such revenues. Such increased contributions would also improve our ratio of recurring to non-recurring revenues by tripling the earnings potential of the fund.

Let me speak briefly at this point about our proposals for permanent fund earnings. Under HB 27, one-half of the earnings would be returned to the general fund to supplant non-recurring revenues with a recurring revenue source for ongoing state government. The other half would be returned to the public in the form of tax credits. The tax credit proposal is contained in HB 99 which was referred to the House Judiciary Committee. The Governor is convinced that such a mechanism which would link Alaska's citizens directly to the fund, by distribution of earnings, is the best way to guarantee successful fund performance.

Can we afford a 75% contribution rate? The increase would not go into effect until FY 1982, at which time additional revenues will begin flowing into the treasury due to termination of the reserves tax pay-back. Analysis of the state's fiscal picture for the next several years indicates that a 75% contribution rate leaves room for budget levels to move upward with inflation and population, yet would remove surplus funds from the temptation to spend and create unacceptably high budget growth. I do not have specific numbers with me today on revenue projections or budget projections, but I would refer you to Ron Lehr of Budget and Management, and Vince Wright of the Department of Revenue for additional information.

In this year of increased fiscal awareness and responsibility, I urge you to look favorably on this method to hold down the growth in state spending. This is essential if we are to allow our recurring revenue sources to begin to pick up a larger percent of the tab. We must begin now to put state spending on a sounder financial footing.

HB 277 is the Governor's proposal for the use and management of the permanent fund. In his transmittal letter the Governor stated:

I am convinced that the 25 percent dedication must be considered to be a trust fund and be invested accordingly. That means that the existing law providing for its safe investment in the money market is quite adequate for the management of those funds. A repeal of the subsection transferring funds is all that is required. No other change is contemplated. This is a straight, money-market program of investment, an investment trust, pure and simple...

The bill I propose is essentially conservative. It is based on the premise that the permanent fund is first and foremost a trust fund and that in its management we

must learn to walk before we can run... the mechanism to expand its use, [and here the Governor refers to contributions in excess of 25%] to use it as a development bank for economic diversification is included, and when the need for such a use is demonstrated, and such a use would be prudent, it will be available for that purpose.

Before continuing with a discussion of the development investment mechanism for the additional 50%, I would like to ask Peter Bushre of the Department of Revenue to share with you some testimony about the meaning of the trust concept, and the rationale used in selecting management by Treasury instead of a special corporation.

I would like to speak briefly about the Governor's belief that contributions to the Fund in excess of the first 25% should be used to meet legitimate capital demand in Alaska which is not otherwise being satisfied by the private market. By "legitimate" we mean capital gaps which may exist in Alaska due to market imperfections or inefficiencies in the private capital markets.

The Governor feels that the permanent fund, due to its special status as repository of the state's non-recurring mineral wealth, should be managed most carefully and prudently. Therefore, he feels that any economic intervention to be achieved using the fund should flow through a highly visible development bank structure predicated on using this capital resource to correct documented inefficiencies in the state's capital markets.

To date, there have been only two state sponsored studies on the question of the existence of capital gaps in the Alaskan economy, one by Dr. Tussing and one by Arthur D. Little. As Dr. Tussing testified, his study found evidence of a capital gap only in rural Alaska, and even there the lack of economic activity was due to more factors than simply a lack of credit. He concluded, and I quote:

...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.

The other report was ADL's "Economic Development in Alaska: A Sectoral Analysis." In it's section on the role of the permanent fund, the report included that:

The permanent fund clearly has the potential to play a major role in Alaska's economic development. Although there are many outside forces which will shape the direction of Alaska's economy, the state will be able to foster industrial development by decision on such matters as provision of transportation infrastructure, and taxes, and will be able to mitigate the adverse impacts of growth by providing public services, housing, and the like: the Fund can stimulate development by providing equity capital, long-term loans, or debt guarantees for new business.

However, based on the economic research reported here, we believe that the majority of the funds available for economic development should be held while long-term opportunities are studied in detail. More immediate capital needs can be identified and met, such as mortgage financing of additions to the fishing fleet. Equity investments and loans for larger projects will more prudently follow detailed study of specific proposals or possible developments, including financial plans, markets available, and non-financial impacts...

As discussed above, market forces and overall economic development trends beyond the state's control will to some extent perpetuate cyclicalities and other negative economic fluctuations in Alaska. Further, the availability of capital will not, of itself, be a significant attractor of new industry, particularly large national or international firms. It is more likely that Permanent Fund financing for new business will go to smaller, local firms or entrepreneurs who are unable to raise money from out-of-state institutions and whose requirements exceed the lending ability of local banks (in amount or term).

Neither of these studies were conclusive - they did not include detailed analyses to identify capital gaps or document actual situations where creditworthy projects could not obtain financing. Therefore, the Governor's proposal structures a development banking mechanism which requires the identification of such capital gaps in advance of the

commitment of any funds, and provides for amendment of the bank's enabling legislation by temporary act to allow investment when such situations have been discovered and documented to the Governor and the legislature.

The mechanism we are proposing is the establishment of an Alaska Permanent Fund Corporation to do an annual capital market assessment and to report to the Governor and the legislature where the permanent fund can provide capital to creditworthy projects which would not otherwise receive financing. If no capital gaps are uncovered, the corporation is limited to a list of secure investments for the additional contributions until such time as capital gaps are identified. If capital gaps are identified, the legislature can expand the list of eligible investments to permit investment in the identified areas (not on a per project basis, but by economic sector). We feel that these features properly place responsibility on elected officials to make the policy decisions, while leaving the analytical tasks and actual investment decisions to the corporation's management, where they properly belong. Some have proposed the Alberta Heritage Trust as an example of how elected officials could participate in the policy development process. However, the Alaskan situation is different from Alberta's parliamentary system. Because of the separation of powers provisions of the Alaska Constitution, the legislature would be unable to set the policies and priorities of a development bank except through statutory enactment. Therefore, the process we are proposing represents the only way for the legislature to maintain an active policy making role for the permanent fund while ensuring the corporation's ability to implement that policy in an independent, businesslike manner.

The bill includes several operating principles, the most important of which is that the corporation must earn a market rate of interest on all of its investments. As with the Alberta Heritage Trust, any subsidies must be appropriated by the legislature from the general fund to make up the difference between the subsidized rate and the market rate. The Governor believes that, ultimately, maximization of income and its distribution to citizens in the form of tax credits is the most equitable way of benefiting Alaskans while preserving permanent fund principal to accrue such benefits in perpetuity. Other key features of the bill are outlined in the information package enclosed with this testimony (including "The Alaska Permanent Fund: A Decision Guide", a section by section summary of SB 226/HB 277, and a memo dated 2/23/79 describing in some detail the policy guidelines which formed the basis of the bill).

An important provision in the bill which I would like to draw to your attention is a mechanism for guaranteeing power development projects. Section .060 enables the corporation to guarantee the debt of power projects recommended by the Alaska Power Authority. This provision recognizes Alaska's need for power development and is intended to assist and stimulate that development. However, because such a guarantee is dependent on the income stream of the Fund which would otherwise be distributed as tax credits or public services, the bill requires the corporation to obtain Alaskans' approval of the guarantee in a statewide election.

In rethinking the permanent fund issue this fall, the Division assisted the Governor in a policy formulation process to identify those goals and policies which are most important to him. Through this process, Governor Hammond identified eight major policy concerns which he hopes will be incorporated into any permanent fund bill that reaches his desk. These policies are:

OVERALL POLICY OBJECTIVE

The permanent fund is the vehicle through which a portion of the state's oil wealth is transformed from mineral to financial form. It is not to be depleted, but rather maintained and invested in such a way as to provide a continuing stream of benefits to Alaskans.

1. Policy Guideline on Eligible Investments

The investment of the permanent fund principal should be based upon a list of eligible investments identified as appropriate with respect to risk level and return to the fund. All other things being equal, priority would be given to in-state investments.

2. Policy Guideline on Allocation Among Types of Investments

The Governor and the legislature should address, in general terms, the allocation of permanent fund investments among the uses designated in a list of eligible investments.

3. Policy Guideline on Interest Rates

The rates of interest charged to borrowers by the permanent fund should conform to the rates which would be obtained in the private sector for similar financing under similar conditions. The legislature and the Governor should specifically identify investment categories which they may wish to subsidize. Such

subsidies must be appropriated from the general fund, such that the rate of return to the permanent fund remains at the market rate and the security of the fund is maintained.

4. Policy Guideline on Permanent Fund Earnings

The permanent fund earnings are to provide an ongoing stream of benefits to Alaskans through a direct distribution or tax rebates and the provision of public goods and services.

5. Policy Guideline on Management Control

Permanent fund enabling legislation should include thorough reporting and audit requirements, to assure responsible, visible management practices.

6. Policy Guideline on Management Prerogatives

Fund managers should be limited to operating within the guidelines specified in enabling legislation and annual directives. They are not to be responsible for designing or implementing social or economic policy outside of their specific mandate.

7. Policy Guideline on Contribution Rate

As much as possible of the state's mineral resource wealth should be preserved in a form which will yield continuing benefits to Alaskans. Such a policy seeks to avoid increasing dependence on non-sustainable revenue sources for the operating expenses of state government.

These policies have been incorporate in HB 277. We hope that any vehicle which is selected as permanent fund enabling legislation will also include them.

In closing, let me make a few comments about public expectations.

As many of you know, the Alaska Public Forum took the issue of the Permanent Fund to the people. The Year End Reports of 1977 and 1978 detail the results of those Forum meetings and the responses from the participants.

There are a number of conclusions which one could make from those results. I would urge you to look at that material for your own analysis. But I feel very assured that you will agree with me on one inescapable conclusion, and that is that there are many more ways to use the money wisely than there is money to use. There are competing goals which are difficult if not impossible to reconcile. Although we have heard a multitude of desires for the fund, it cannot be all things to all people. You must decide what its principal purpose should be and what policies should guide its management and use. That decision can be made somewhat easier by recognizing that there are other sources of funds to accomplish some of these other purposes.

The state already has a variety of mechanisms to inject money into the economy and to enhance the economy, from bond-financed expenditures on capital facilities such as ports and highways, to loan programs such as the Alaska Renewable Resources Corporation, the Fish and Agriculture Bank, the twelve state loan programs, and the General Fund itself. Governor Hammond has decided on what he feels is the most prudent and most important policy objective of the Permanent Fund, and recommends it to you, for your consideration, in this package of legislation:

"The permanent fund is the vehicle through which a portion of the state's oil wealth is transformed from mineral to financial form. It is not to be depleted, but rather maintained and invested in such a way as to provide a continuing stream of benefits to Alaskans."

Thank you for this opportunity to share these ideas with you.

MEMORANDUM
DIVISION OF POLICY DEVELOPMENT AND PLANNING
OFFICE OF THE GOVERNOR

TO: [

DATE: February 23, 1979

Distribution

FILE NO:

TELEPHONE NO:

FROM: Frances A. Ulmer
Director

SUBJECT: Permanent Fund Policy

The following discussion summarizes the major policy concerns which the Governor has identified for incorporation in a Permanent Fund legislative package. Also presented are the sections of SB 226/HB 277, which encompass these policy guidelines. The outline is followed by a narrative description of the bill.

OVERALL POLICY OBJECTIVE

THE PERMANENT FUND IS THE VEHICLE THROUGH WHICH A PORTION OF THE STATE'S OIL WEALTH IS TRANSFORMED FROM MINERAL TO FINANCIAL FORM. IT IS NOT TO BE DEPLETED, BUT RATHER MAINTAINED AND INVESTED IN SUCH A WAY AS TO PROVIDE A CONTINUING STREAM OF BENEFITS TO ALASKANS.

Explanation: The Permanent Fund implementing legislation should provide the establishment of a permanent and thus prudently managed investment portfolio, which maintains the value of the principal and maximizes earnings given risk constraints. The stream of financial benefits to Alaskans from the Permanent Fund is not to be eroded by use of Fund principal for investments at less than market rates.

Section 020 of the bill establishes the purpose of the Permanent Fund: It is to provide a means of conserving a portion of the state's revenues from mineral resources for the benefit of Alaskans. The Permanent Fund is not to be depleted but rather maintained in income-producing investments to provide a continuing stream of benefits to Alaskans.

The key provisions for implementing this policy are outlined below.

1. Policy Guideline on Eligible Investments

THE INVESTMENT OF THE PERMANENT FUND PRINCIPAL SHOULD BE BASED UPON A LIST OF ELIGIBLE INVESTMENTS IDENTIFIED AS APPROPRIATE WITH RESPECT TO RISK LEVEL AND RETURN TO THE FUND. ALL OTHER THINGS BEING EQUAL, PRIORITY WOULD BE GIVEN TO IN-STATE INVESTMENTS.

Explanation: Considerable debate has raged regarding the amount of in-state investment and the appropriate risk level which would be allowed by alternative management structures for

the Permanent Fund. The exact meaning and implications of such terms as "trust fund," "prudent-man rule," and "loan program" are unclear as regards in-state investment and the security of the fund.

A specific list of clearly drafted categories eligible for investment will maximize policy control by elected officials with respect to the risk level and uses of the fund. The list presented in the Governor's proposal contains those types of investments which are generally regarded by money managers as relatively low risk investments. As the Permanent Fund Corporation gains operating experience and identifies capital gaps, the list can be expanded by temporary Acts or permanent amendments to permit additional uses of the fund.

Sections .030(c) and .050 address investment of the Permanent Fund and contain lists which define the range of investments available to Permanent Fund managers for both the 25% trust and any additional contributions for the development bank.

Section .190 contains the operational principles for the fund. The first principle states that the Fund shall give preference to investments within Alaska having a risk level no higher than and an expected yield equivalent to, alternative investment opportunities.

2. Policy Guideline on Allocation Among Types of Investments

THE GOVERNOR AND THE LEGISLATURE SHOULD ADDRESS, IN GENERAL TERMS, THE ALLOCATION OF PERMANENT FUND INVESTMENTS AMONG THE USES DESIGNATED IN A LIST OF ELIGIBLE INVESTMENTS.

Explanation: The list of eligible investments may include a range of uses of Permanent Fund principal such as mortgages, corporate securities, bank certificates of deposit, government securities, etc. Some policy guidance to the fund managers regarding the allocation of investments among categories should be exercised by elected officials. This guidance should be provided for in Permanent Fund enabling legislation through both executive and legislative approval of investment programs and through annual directives to the fund managers by the legislature. Such guidance must be sufficiently flexible to allow for balanced and effective portfolio management.

Section .110 establishes an Executive Oversight Committee consisting of the Governor and four cabinet members, and charges them with review and approval of the Permanent Fund Corporation investment program as developed by the policy board.

Section .100 provides for a Legislative directive through which the Legislature can express preferences for emphasis among the categories on the Corporation's investment list.

3. Policy Guideline on Interest Rates

THE RATES OF INTEREST CHARGED TO BORROWERS BY THE PERMANENT FUND SHOULD CONFORM TO THE RATES WHICH WOULD BE OBTAINED IN THE PRIVATE SECTOR FOR SIMILAR FINANCING UNDER SIMILAR CONDITIONS. THE LEGISLATURE AND THE GOVERNOR SHOULD SPECIFICALLY IDENTIFY INVESTMENT CATEGORIES WHICH THEY MAY WISH TO SUBSIDIZE. SUCH SUBSIDIES MUST BE APPROPRIATED FROM THE GENERAL FUND, SUCH THAT THE RATE OF RETURN TO THE PERMANENT FUND REMAINS AT THE MARKET RATE AND THE SECURITY OF THE FUND IS MAINTAINED.

Explanation: There is no fixed or certain definition of the "market interest rate." The concept of a market rate is fluid, meaning that rate of return on an investment opportunity which is required to attract the necessary capital from the private capital markets. This is a function of several factors including the lender's opportunity cost of capital, the length, risk level, liquidity, and other terms of the loan. Because the Permanent Fund will be a public sector lender, and will be making different types of investments under a variety of conditions, no fixed definition of market interest rates in statute may be possible.

While investment of the Permanent Fund should remain accountable to elected officials, the fund must be insulated from undue political influence. The up-front subsidization of certain types of projects through general fund appropriations would allow for the implementation of social policy by those who should be making such decisions, i.e., elected officials. However, decisions to subsidize should be structured to insure a rational dialogue between elected officials (and their goals in using subsidies) and the fund managers (and their goal of maintaining the integrity of the Fund).

Section .190, the operating principles, contains subsection (4) which instructs the corporation to undertake financing on terms and conditions which take into account the participation of other investors, the risks being undertaken by the fund and the terms and conditions normally obtained by private investors from similar financing. Sec. 070 also requires market interest rates.

Section .190 also contains provision for the Legislature to appropriate funds for subsidizing categories of investment which are determined to be of such high priority that special terms and conditions are appropriate. The amount and timing of subsidies must be such that the rate of return to the fund remains the market rate.

4. Policy Guideline on Permanent Fund Earnings

THE PERMANENT FUND EARNINGS ARE TO PROVIDE AN ONGOING STREAM OF BENEFITS TO ALASKANS THROUGH A DIRECT DISTRIBUTION OR TAX REBATES AND THE PROVISION OF PUBLIC GOODS AND SERVICES.

Explanation: Unless otherwise directed by law, the earnings of the Permanent Fund are deposited in the general fund. The Governor has proposed to return some portion of the earnings to the public in the form of either tax rebates or cash dividends. Such a program will link the performance of the Fund directly to every Alaskan by providing tangible benefits from the fund. Permanent Fund earnings further appear to be the fastest growing source of recurring revenues needed to offset operating budget dependence on oil wealth. Thus these earnings can help allow for the continued provision of public goods and services without drastic increases in tax burden to the state's citizenry.

A companion bill (HB 99) has been drafted to implement this policy. The Governor's Permanent Fund enabling legislation, in Section .030(b), provides only that income be returned to the General Fund.

5. Policy Guideline on Management Control

PERMANENT FUND ENABLING LEGISLATION SHOULD INCLUDE THOROUGH REPORTING AND AUDIT REQUIREMENTS, TO ASSURE RESPONSIBLE, VISIBLE MANAGEMENT PRACTICES.

Explanation: The form of management control is critical to the accountability of the fund to the Governor, legislature, and the public. A list of eligible investments will provide the basis for this control by restricting the uses of the fund to legislatively established purposes. Beyond this constraint, the annual reporting requirements can serve to inform elected officials and the public as to the performance of the fund. Such reporting could include, for example, the following elements: specific investments-- amounts and rates of return; subsidized investments; impact of investment constraints on fund performance; investment plans; performance measures; and results of independent audit. Further control could be exercised through the formation of an Executive/Legislative review committee charged with overseeing fund management.

Section .090 instructs the Permanent Fund Corporation Policy Board to provide for annual independent outside audits.

Section .140 instructs the corporation director to establish appropriate organizational, operating, and financial controls.

Section .160 instructs the Corporation Investment Committee to set standards for the organization, and administration, and collection of loans.

Section .200 establishes the general reporting requirements including:

- a. comprehensive financial statements and audit reports,
- b. income statements and balance sheet to be published in at least one newspaper in each judicial district, and
- c. income statement and balance sheet to be published in the election pamphlet.

6. Policy Guideline on Management Prerogatives

FUND MANAGERS SHOULD BE LIMITED TO OPERATING WITHIN THE GUIDELINES SPECIFIED IN ENABLING LEGISLATION AND ANNUAL DIRECTIVES. THEY ARE NOT TO BE RESPONSIBLE FOR DESIGNING OR IMPLEMENTING SOCIAL OR ECONOMIC POLICY OUTSIDE OF THEIR SPECIFIC MANDATE.

Explanation: Under this policy the fund managers would be money managers charged with maximizing return to the Permanent Fund under the established constraints. They could be located either within state government (e.g., Treasury Division) or as a separate corporation but their duties would be limited to financial management. Decisions about social or economic policy and programs to implement that policy should be made by elected officials.

Sections .110 and .100, creating the Executive Oversight Committee and the Legislative directive respectively, provide elected officials an opportunity to formulate general policies on an ongoing basis for implementation by corporation managers. Addition to the investment list by statute give elected officials further control over the uses allowed for the fund.

7. Policy Guideline on Contribution Rate

AS MUCH AS POSSIBLE OF THE STATE'S MINERAL RESOURCE WEALTH SHOULD BE PRESERVED IN A FORM WHICH WILL YIELD CONTINUING BENEFITS TO ALASKANS. SUCH A POLICY SEEKS TO AVOID INCREASING DEPENDENCE ON NON-SUSTAINABLE REVENUE SOURCES FOR THE OPERATING EXPENSES OF STATE GOVERNMENT.

Explanation: The Governor has chosen increased contributions to the permanent fund as the best mechanism for both holding down state spending and providing a source of recurring revenues. Increasing the contribution rate yields two major benefits: (1) it would make a large amount of

nonrecurring revenue unavailable for ongoing state spending and would reduce the unacceptable rate of budget growth, and (2) it would triple the earnings potential of the fund to provide certain, recurring revenues for financing tax credits and future state government activities.

Section .030(a) sets the contribution rate at 25% until FY 1982, at which time it increases to 75% except for bonuses which increase to 100%. SJR 26/HJR 23 is a proposed constitutional amendment to increase the contribution rates to the permanent fund as described above.

Narrative

The composition of the Permanent Fund is 25% of all mineral lease rentals, royalties, royalty sale proceeds, federal mineral revenue sharing payments, and bonuses received through FY 1981, after which it increases to 75% except for bonuses, which increase to 100% (as also proposed in SJR 26). Income is returned to the general fund, except for amounts retained for corporation operations (subject to the Executive Budget Act) and the funding of necessary reserve accounts. A companion bill (HB 99) addresses use of an amount equal to one-half of the earnings as tax credits.

The bill establishes the constitutionally mandated minimum 25% as a trust fund to be managed by the Department of Revenue. Provisions for managing this portion of the fund, including a list of eligible investments, already exists in statute as AS 37.10.065. Such management is in keeping with the purpose established in Sec. 020 of the bill.

The bill further establishes any additional contributions over 25% as a "cautious" development bank within the Department of Revenue, structured as an independent corporation. Policy making for the corporation is vested with a policy board subject to review and approval of an Executive Oversight Committee and the Legislature. Legislative policy input is provided for through legislative directives and expansion of the investment list by temporary Act or permanent amendment.

Permanent Fund Corporation policy is specified through an investment list, the categories of which reflect in general terms the uses of the corporation principal desired by elected officials. The list, as now conceived, is fairly conservative, allowing for money market and mortgage investments. The director of the corporation is instructed to prepare both an initial determination and an annual assessment of the capital markets serving Alaska and recommend to the Governor and the Legislature possible expansion of the investment list based on these assessments.

The Corporation director is empowered to manage the daily operations of the corporation. Investment decisions are to be made by an Investment Committee chaired by the director with four public members appointed by the policy committee.

Because it may well be the only feasible means of financing large electric power projects, the bill authorizes guarantees based on the corporation's income for electric generation and transmission facilities. This provision contains safeguards so that it can only be used for feasible projects of the lowest cost to the consumer after approval of the guarantee by a majority of the state's voters.

Operating principles are established for investment of the Fund including:

- a) preference for investments within Alaska which have risk levels and expected yields comparable to alternative investment opportunities;
- b) a version of the prudent man rule;
- c) preparation of an investment program, based on an annual credit assessment of the state by the director. The assessment may also include recommendations to the Governor and the Legislature to expand the investment list if appropriate;
- d) the requirement that all Permanent Fund investments earn a market rate of interest;
- e) the requirement that if the Legislature wishes to subsidize investments it must specifically appropriate general fund money to do so (which will maintain a market return to the fund); and,
- f) several additional operating principles.

The bill also contains extensive reporting requirements, and conflict of interest and confidentiality of information sections.

FAU:ms

Section-by-Section Summary of SB 226

- Sec. 010: Establishes the Alaska Permanent Fund in the Department of Revenue according to Article IX, Section 15 of the Alaska Constitution.
- Sec. 020: Sets out the purpose of the fund - to conserve a portion of the state's revenues from mineral resources and to maintain the fund's principal through income-producing investments.
- Sec. 030: (a) Sets the contribution rate at the constitutional minimum of 25% until FY 1982, at which time the contribution rate increases to 75% except for bonuses which are set at 100%.
- (b) Provides that income from the permanent fund shall be deposited in the general fund except for amounts appropriated for the corporation's expenses and amounts required for reserve accounts.
- (c) Provides that all of the permanent fund principal dedicated under the 1976 amendment (the first 25%) be managed as a trust fund by the Department of Revenue as prescribed by the Interim Management Act (AS 37.10.065). Any contributions dedicated by statute or additional constitutional amendments above the 25% level must be allocated to the Permanent Fund Corporation.
- Sec. 040: Establishes the Alaska Permanent Fund Corporation in the Department of Revenue to invest and manage permanent fund contributions in excess of the 25% level, and provides it with the necessary corporate powers.
- Sec. 050: (a) Establishes a list of investments eligible for corporation investment. This list represents the policy set by the legislature and the Governor for the use of permanent fund principal above the 25% level.
- (b) Allows the corporation to make additional investments only as authorized by law.
- (c) Provides for contracts for the investment, custody, safe-keeping, and management of securities and execution of transactions.
- Sec. 060: Provides for guarantees of indebtedness of electric generating and transmission facilities recommended by the Alaska Power Authority from corporation income. Such guarantee must be approved by the investment committee, the Executive Oversight Committee, and by the voters via proposition at a statewide election.

Sec. 070: Mandates that the corporation receive a market rate of interest on all investments.

Sec. 080: Establishes a policy board consisting of the Commissioners of Commerce and Economic Development and Revenue and five public members appointed by the Governor, serving at his pleasure for a four-year term.

Sec. 090: Establishes the duties of the policy board:

- 1) appoint the director and investment committee,
- 2) select an independent outside auditor and receive audit reports,
- 3) review and publish financial statements,
- 4) review and approve an annual investments program, the corporation's operating budget, and a financial plan for the following three years,
- 5) present the material in (4) to the Executive Oversight Committee,
- 6) determine whether investments are consistent with the statute,
- 7) set remuneration and other terms of employment for employees, and
- 8) hold public hearings on the investment program.

Sec. 100: Provides for a legislative directive establishing legislative preference among investment categories.

Sec. 110: Establishes an Executive Oversight Committee consisting of the Governor, the Commissioners of Commerce and Economic Development and Revenue, and the Directors of Policy Development and Planning and Budget and Management.

Sec. 120: Establishes the duties of the Executive Oversight Committee - to review and either approve or revise the corporation's annual investment program and present it to the legislature.

Sec. 130: Provides for the corporation's operating budget to come from corporation earnings subject to the Executive Budget Act.

Sec. 140: Establishes a corporation director and duties:

- 1) responsibility for the day-to-day business of the corporation and management of staff,
- 2) establishment of organizational, operating, and financial controls,
- 3) investment activity, and
- 4) preparation of reports.

Sec. 150: Establishes an Investment Committee consisting of the director and four public members appointed by the policy board for four year terms.

Sec. 160: Establishes the duties of the Investment Committee:

- 1) approval of all investment proposals, and
- 2) setting of standards for the origination, administration, and collection of loans.

Sec. 170: Provides for an initial determination by the director which:

- 1) evaluates the capital market serving Alaska,
- 2) specifies resources and methods other than the permanent fund available to mitigate any inefficiencies (capital gaps) which are found, and
- 3) recommends additional investment categories to be added to the investment list by law to enable the corporation to invest in such categories.

Sec. 180: Provides for the Executive Oversight Committee to establish reserves out of income consistent with sound financial practices.

Sec. 190: Establishes eight operating principles:

- 1) in-state investment preference for equivalent investment opportunities,
- 2) a version of the prudent man rule,
- 3) annual analysis of the state's capital markets to serve as the basis of the investment program, and of recommendations for expansion of the investment list,
- 4) market interest rates, except that the legislature may appropriate monies to subsidize permanent fund investments,
- 5) diversification in investments,
- 6) requirement for investment proposals and staff review,
- 7) powers of corporation to take legal actions to protect its investments, and
- 8) discontinuation of loan purchase from financial institutions with delinquent loans.

Sec. 200: Provide for reports and publications by both the Commissioner of Revenue and the corporation including:

- 1) financial statement audited by independent outside auditors,
- 2) a statement of the amount of money received from each revenue source,
- 3) a statement of investments appraised at market value,
- 4) a description of investment activities, and
- 5) any other information.

The annual income statements and balance sheets must be published in at least one newspaper in each judicial district annually. The income statement and balance sheets for the two years preceding the publication of the election pamphlet must be included in that pamphlet.

Sec. 210: Establishes conflict-of-interest policies requiring the director and staff of the corporation, and the members of the policy board and investment committee to comply with the Conflict of Interest Act and to disqualify themselves from decisions in which they have a financial interest.

Sec. 220: Establishes confidentiality of information policies protecting information which discloses the particulars of a business which is not a matter of public record.

AS 37.10.065(c) is repealed.

Immediate effective date in accordance with AS 01.10.070(c).

THE ALASKA PERMANENT FUND

A Decision Guide

*The Division of Policy Development
and Planning*

October 1978

The Decision - What is the Administration's Position on the Permanent Fund

As you know, the Tenth Alaska Legislature failed to agree on a plan for the use and management of the Permanent Fund. As a result, you now have the opportunity to provide leadership to the Eleventh Alaska Legislature on this tremendously important issue. We are entering our third year of deliberation on the Permanent Fund, and an enormous amount of information, as well as three legislative proposals, are already before us. The following decision guide lays out the generally accepted conceptualization of the choices involved. Starting with a set of policy goals, the guide presents the major alternatives which have been developed for achieving those goals, and presents some key considerations for choosing among them. Once you have identified your goals and chosen your preferred alternatives, we can begin to develop your recommendations or legislative proposals for the coming legislative session.

For the sake of clarity and a manageable discussion, this decision guide will consider only use of Permanent Fund principal. Use of Permanent Fund income will be ignored. In reality, however, many combinations are possible using the principal to achieve one goal and the income for another. Once your policy direction is clear, the appropriate disposition of the principal and the income can be determined.

Our Nest Egg - Separating Fact from Fantasy

Great claims have been made about our "billion dollar" nest egg. But how much money are we really talking about, and over what time frame? To a degree, what the Fund can do depends on how large it is. Before beginning our exploration of the decision you face, consider these startling facts about the growth of the Fund.

In February, 1976, the Department of Revenue predicted that the contribution to the Permanent Fund for F.Y. 1978 would be \$113.9 million. A year later the Division of Legislative Finance predicted it would be \$85 million, and the Division of Research Services predicted \$80-\$90 million. In September of 1976, the Department of Revenue reported a "preliminary actual" figure of \$80.5 million. The following figures show a more complete history:

Department of Revenue
Permanent Fund Contribution Projections (in millions)

FY.	2/76	2/76	2/77	11/77	2/78
1976	113.9	85.4	82.3	82.8	85.5
1978	131.2	130.9	130.0	88.7	89.3
1981	164.5	163.8	165.3	117.0	77.4

Clearly our nest egg will be much smaller and will grow more slowly than was thought originally. These prediction errors resulted from unforeseeable circumstances such as the pipeline and tanker tariffs and the Pump Station 8 explosion. Much thinking about the Permanent Fund is based on the concept that the Fund is a "pot of billions" just waiting to be used. A more cautious appraisal of our riches is clearly in order as you consider existing proposals and develop new ones.

New Considerations

Most of the following alternatives for use and management of the Permanent Fund were incorporated into legislation before the 10th Legislature. Each was based on extensive research, public hearings, and hard thinking. The major issues surrounding the alternatives are outlined below.

After this initial review, ample background material and detail is available to help refine your thinking.

Savings

Alternatives:

Interim Management

Trust in Independent Corporation

Trust in Treasury

45% of principal in development bank

- As a group, the savings alternatives represent the least risky use of the Permanent Fund. The lower risk level results in a lower earnings potential than some other investment opportunities; however, the earnings are relatively certain and the risk of loss is minimized.

- Strict trust standards may mean fewer Permanent Fund dollars will be invested in Alaska.

- Savings would provide the least stimulus for immigration.

- The question of who should manage the savings trust created a major difference between the House and Senate. The House favored an independent corporation, while the Senate felt the Division of Treasury was appropriate. The major arguments were:

Independent Corporations

for

insulated from politics

flexible and therefore
acceptable to the
public

able to attract
better personnel

against

too insulated from
elected officials

created another
bureaucracy

Treasury

for

economy of
scale in
investing

organization
already in
place

against

harder to attract
top people

history of political
lending

What is the Goal of the Permanent Fund?

The State Investment Advisory Committee, the Public Forum, and the House and Senate Permanent Fund Committees have heard many, many answers to this question. Presented below is a distillation of the answers, and the organizational ideas which have been developed to implement them.

<u>Goal</u>	<u>Policy</u>	<u>Alternative</u>
Savings	"...to preserve the state's oil wealth and insure a safe income stream"	-retain interim management law, no new bill. -trust fund managed by an independent corporation (House) -trust fund managed by Treasury (Senate) -large scale development bank minimum of 40% of principal in savings (Administration)
Economic Development	"...to provide for the diversification and stabilization of the Alaskan economy."	-large scale development bank maximum of 30% of principal in economic development (Administration) -small scale rural development bank (House) -expanded state loan program (Senate) -financing for major one-to-state projects (Gasline, Sustina) -financing for GSOP
Community Development	"...to provide for the health, education, social and public facility needs of Alaskan communities."	-large scale development bank maximum of 30% of principal in community development (Administration) -expanded state loan program (Senate) -municipal bond purchases Treasury

Economic Development

Alternatives:

80% of principal in development bank (Administration)
Small scale development bank (House)
Expanded state loan program (Senate)
Financing for major projects
Financing for GSOP

- These alternatives represent more risky uses of the Permanent Fund than savings. They also promise higher monetary returns and social returns such as employment. Any losses on investments would result in erosion of the principal of the Fund.

- One of the goals of economic development is to generate a tax base to replace non-recurring oil revenues in the future. Economic analysis has shown that such growth rates need to be astronomically high to generate a tax base sufficiently large to replace oil revenues.

- Under existing conditions, economic development actually worsens the state's fiscal deficit by stimulating immigration. As long as non-renewable resources revenues constitute 70% of government expenditures, "nest egg" will only be further diluted by immigration. Thus either our tax structure must be changed to increase recurring revenues or per capita spending must be decreased to mitigate the negative fiscal impacts of economic growth.

- Most experts agree that all of the economic development alternatives would involve a subsidy by definition - by making public capital available at interest rates which were unable to attract private capital. If rates are charged that would attract private capital (by definition a market rate), such public capital would merely be displacing private capital with no net economic gain for the state.

- Under certain circumstances, subsidies can be sound public policy. The above simply points out the dangers of hidden or unintended subsidies. Decisions to subsidize certain economic sectors or population groups through loans at below market interest rates should reflect deliberate policy goals and be limited to the target sector or group. The amount of the subsidy should also be identified.

- As you know, the state is rapidly approaching a crisis with our loan programs. Since the opening of the Anchorage and Fairbanks offices of the Division of Business Loans, application volume has doubled and is still growing. Loan demand exceeds \$15 million per month, and is threatening the liquidity of the General Fund surplus. Various solutions to this problem are being developed. Here it is important to recognize that attention next session may focus on the Permanent Fund to solve this problem (as with the Senate proposal). However, at \$15 million per month, state loans would absorb the entire annual contribution to Permanent Fund principal in two months. Clearly, solutions may have to be found elsewhere.

- There is a tension between the goal of equity and the goal of rational economic intervention. Some of the proposals, such as expanded "first come, first served" loan programs or financing a GSOP, are based on equal access by the benefit for all Alaskans with a minimum of bureaucratic discretion. Other proposals, such as the development banks and financing major projects, are based on optimal economic intervention by economic experts under the policy guidance of elected officials.

- The size and rate of the Permanent Fund may be inadequate for economic development proposals with large capital requirements.

- Administration, House, and Senate participants found that, while hard to document or quantify, people feel that some real capital shortages do exist in Alaska, especially rural Alaska.

Community Development

Alternatives:

80% of principal in development bank (Administration)

Expanded state loan program (Senate)

Municipal bond purchases by Treasury

- Using Permanent Fund money to construct public facilities for community development would match nonrecurring revenues with nonrecurring expenditures. However, this ignores operating expenses.

- The return on public, tax exempt borrowing is considerably lower than alternative investments for the Permanent Fund.

- Economic development strategies will be ineffective if real bottlenecks from a lack of public facilities are not removed.

- There are many real community development needs in Alaska and a large variety of existing mechanisms to finance such projects:

- Investment in community development should improve the quality of life for all resident Alaskans.

- Use of Permanent Fund principal to meet community development needs may duplicate the purposes of the Municipal Bond Bank or other capital improvement programs.

- Some legal question raised about some types of these investments fulfilling constitutional mandate to be "income producing."

PLEASE NOTE: THE PRECEDING PAGES WERE TREATED
AS A UNIT IN THE ORIGINAL DOCUMENT.

ERIC E. WOHLFORTH
ROBERT B. FLINT
TIMOTHY G. MIDDLETON

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M E M O R A N D U M

TO: Hon. Sterling J. Gallagher
Commissioner of Revenue

Hon. Clark Gruening, Chairman
Special Committee on the Alaska
Permanent Fund

FROM: Eric E. Wohlforth *Eric E. Wohlforth*

DATE: February 1, 1978

SUBJECT: Brief Comments on House Bill 595 Relating to
Income of the Alaska Permanent Fund, House Bill
596 Relating to Non-renewable Resources, and
House Bill 682 Relating to Non-renewable Resources.

Section 1 of HB 596 provides for an investment oversight committee apparently with the purpose of overseeing the activities of all agencies of the State performing lending, borrowing or investment functions, including the corporations established by the bill itself.

Section 3 of the bill establishes, by adding a new chapter to AS 37, the Alaska Permanent Fund from which is allocated 5/6 of mineral rents and royalties to the Alaska Permanent Fund Corporation. AS 37.13.020 contains legislative findings with respect to the Alaska Permanent Fund Corporation and its primary goal which is to maximize total return while maintaining safety of principal and states that it is a savings device to allow the maximum use of disposable income as needed for the purposes as provided by law. Under 37.13.130 the prudent man rule is established to govern the investment activities of the corporation with the provision that assets may be used only for income producing investments and that the board maintain reasonable diversification. Subsection (g) of Section 130 limits investments to direct obligations of the United States, mortgage loans and stock and "corporate obligations freely marketable under the Securities Act of 1933". It is submitted that the limitation to direct obligations to the United States may be too limiting now and that investment permission should be extended to government agencies and instrumentalities currently the subject of investment of monies in the State general fund.

Hon. Sterling J. Gallagher
Hon. Clark Gruening
February 1, 1978
Page Two

The Alaska Enterprise Investment Corporation is created by Section 4 and is funded with an allocation from the Permanent Fund of one-sixth of all of the receipts thereof up to \$100,000,000. The corporation is permitted to invest its capital in loans or stock of projects, with stock investment limited to 25% of the capital stock of a project and loans up to 90% of cost except where additional amounts are necessary to protect the interest of the fund.

AS 44.55.125 imposes a prudent man rule on the investment policy of the corporation requiring at least 150% of all guarantees by the corporation to be invested in investment grade securities with not more than 50% invested in "financing the establishment, improvement, and expansion of productive private enterprise which will benefit Alaskans, and for which sufficient capital is not available from other sources or unreasonable terms" in the form of equity, debt or guarantees and 50% "for financing the longer-term investment capital needs for financially sound small and medium scale community development projects of municipalities and public corporate entities and private dwellings for which sufficient financing is not available from other sources or unreasonable terms". The right to guarantee obligations in addition to the right to invest in the stock or purchase the debt of a corporation is referred to in AS 44.55.080 and AS 44.55.120 and provides that the corporation has power to guarantee obligations of another corporation or legal entity to facilitate their sale. In general, guarantees are made in connection with corporate financings by a parent of a subsidiary in which there is already an investment. There would be some question as to whether a guarantee of debt not incident to an investment of monies would qualify under the constitutional limitation that money to the Permanent Fund may only be invested in an income producing securities.

AS 44.55.130 establishes a capital reserve account to secure obligations of the corporation. Monies in the capital reserve account are to be used to pay principal, interest and redemption premium on obligations of the corporation. The capital reserve account is funded with the income of the corporation until that is equal to 25% of its

Hon. Sterling J. Gallagher
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February 1, 1978
Page Three

outstanding obligations. Under AS 44.55.120(4) the corporation is permitted to borrow amounts up to its paid-in capital. If the corporation is conceived as a borrowing vehicle to provide money for investments or loans and there should be additional provisions establishing its rights to enter into covenants and agreements with bondholders, provisions providing that the indebtedness of the corporation is not a debt of the State and otherwise as necessary for a public bond financing. The above is not in the nature of a policy observation since it is readily perceived that the primary thrust of the fund is an investment or lending vehicle rather than a borrowing vehicle.

HB 595 provides that income from investment of the Permanent Fund, becomes part of the Permanent Fund and may be used to provide for guarantees of indebtedness issued by governmental agencies of the State for power projects. This is a worthy and sensible goal for the use of Permanent Fund income in my opinion. However, I feel that the efficacy of a guarantee of debt of public authorities, municipalities or agencies issued for power projects may well be subject to the legislature's appropriating income to the fund for this purpose on an annual basis. Further, the requirement that the fund itself be invested in income producing investments may not be satisfied by a guarantee or indebtedness of another body. When AS 37.13.200 provides for the guarantee of indebtedness issued for power projects of monies transferred to the Permanent Fund from its income, the actual obligation which is entered into by the board of trustees of the Alaska Permanent Fund Corporation may amount only to an annual direction to use income for the purpose stated rather than a long term obligation requiring the corporation to devote the income to that purpose without further act. As I have stated before, I may well be wrong in my reading of the power and permission to devote Permanent Fund income on a long term basis without further appropriation of the legislature, but I think there is at least a substantial question whether an effective guarantee can be entered into under HB 595 of such income to secure indebtedness of another party.

As to HB 682 creating an Alaska Renewable Resources Corporation, the primary purposes appear to be research and development in renewable resource industries and investment

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February 1, 1978
Page Four

in projects related to research and development. The investment permission in AS 37.12.170 is limited in size (\$1,500,000) and in percentage of a project (25%) unless a greater amount or percentage is fixed by concurrent legislative resolution. Under AS 37.12.050, the corporation is allocated 5% of mineral lease bonuses and rentals, half of which are to be placed in the fund. Under AS 37.12.150(11) the corporation "may make financial assistance available in the form of grants, loans, loan guarantees or other appropriate forms to public research and development groups in the state in order to facilitate investment" and in (13) may further make grants. The power to make grants seems to run counter to the constitutional requirement that the Permanent Fund may only be invested in income producing investments. As to guarantees, please see my comments above.

EEW:jr

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April 18, 1977

Hon. Clark Gruening, Chairman

Commissioner of Revenue, Sterling Gallagher

Members of the Joint Legislature
Committee on the Permanent Fund

Sirs:

I am very sorry that I cannot attend your hearings scheduled for April 20 and 21, on the Permanent Fund. I would like, nevertheless, to set down for your consideration a precis of my views.

The special State Investment Advisory Committee Hearings held last year were an immensely valuable start of consideration of uses of the permanent fund. Advisors were used intelligently and were made to work hard to educate the Committee on development loan and permanent fund systems in place elsewhere. Not the least important lesson of the hearings was the fact that public education as to the parameters of the issues is at least as important as pure public input. In light of this, I feel that you should consider compiling a readable digest of this expert testimony, and that otherwise available to you, as to what has happened elsewhere both with permanent funds created with non-renewable resource revenues and with public development banking. I further suggest that the digest be made broadly available in Alaska before embarking on broad scale public hearings. Hearings conducted in this context would seem to me to be very much more valuable than those conducted in a public vacuum of knowledge of what has happened elsewhere. Ideally the digest would contain a readable summary of the history of state loan programs to date.

Honorable Clark Gruening, Chairman
Commissioner of Revenue, Sterling Gallagher
Members of the Joint Legislature
Committee on the Permanent Fund
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If I may presume to advise you further on procedure, I commend to your consideration the hearing-seminar procedure of the type conducted by the Brookings Institute in 1970 after the North Slope lease sale. The considerations of possible use of the permanent fund have major implications for Alaska's governmental structure as well as its economic future. I cannot emphasize too strongly the importance of the selection of the correct method of securing public input.

As to substantive matters, I have two observations. First, the preliminary pass at the development loan banking issue which I chaired in Juneau in 1971 elicited the firm recommendation of the representative of the World Bank that structuring of a development loan program be preceded first by intensive investigation of development banking opportunities. We were told then, and I have heard since, that a one year initial effort to ascertain the scope and magnitude of investment opportunities be first undertaken before a developmental banking structure is legislated. The initial committee should be comprised of Alaska businessmen, entrepreneurs and investors in various sectors of our economy and should have adequate support help.

Our situation in this regard is better advanced than in 1971 for now we have developing case histories of successes and failures in Native Corporate investment in the State. We should take advantage of this body of knowledge in configuring any Development Loan structure.

Secondly, I feel that Permanent Fund monies devoted to the public sector should be used on a "leveraged" basis. I feel that establishment of reserve funds to support local government borrowing or State agency

Honorable Clark Gruening, Chairman
Commissioner of Revenue, Sterling Gallagher
Members of the Joint Legislature
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borrowing for this purpose is preferable to direct loans to municipalities. The reason for this view is the fact that local government bonds are tax exempt. Loans between tax exempt entities are not economically efficient if the debtor entity can borrow publically at tax exempt rates. Satisfactory precedent for this procedure now exists with both the Alaska Municipal Bond Bank Authority and the Alaska Housing Finance Corporation.

Thank you for the opportunity to comment. I wish again I could attend the meeting and hearings. Extra copies are enclosed for the Committee's use.

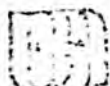
Very truly yours,

WOHLFORTH & FLINT

By Eric E. Wohlforth
Eric E. Wohlforth

EEW:vf

Enclosures: as stated.



BANK OF AMERICA

October 19, 1971

BANK INVESTMENT SECURITIES DIVISION

Mr. Eric E. Wohlforth, Commissioner
Department of Revenue
State of Alaska
Pouch S
Alaska Office Building
Juneau, Alaska 99801

Dear Commissioner Wohlforth,

The objective of forming an Alaska Industrial Development Corporation is certainly commendable, from a theoretical standpoint. Yet given the variety of structural and operational alternatives relative to such formation, the small step from concept-in-theory to implementation-in-practice imposes on the executive several large and hard questions which demand resolution. It was obvious, from our conversation last Friday, that you and your staff are well aware of the organizational problems and pitfalls. What you might be less familiar with - insofar as research materials are concerned, is: 1) the latest literature on industrial-aid financing and the IRS; 2) prospectively, the increased ease and attractiveness of using tax-exempt bonds issued by the state or a state agency, as the primary financing vehicle for raising seed capital to lure new industry to Alaska.

Recent efforts by the Investment Bankers Association and other interested groups have concentrated upon:

the desired exclusion from present IRS industrial-aid bond limits of all state and local general obligation bond issues, regardless of purpose

expansion of the straight industrial-aid limit to \$15 million per issue, as proposed by Chairman Wilbur Mills of the House Ways and Means Committee.

Favorable action in either of these areas should promote renewed consideration by Alaska of tax-free industrial-aid bonds as a financing alternative to subsidize or support statewide industrial development. The cheapest method of financing would clearly be to issue voted bonds backed by the state's guarantee or its full faith and credit. Reasonable rates could also be obtained by using a state agency as issuer, provided that: 1) a debt-service reserve fund were established from bond proceeds equal per issue to maximum annual principal and interest; 2) annual access to the state's general fund were statutorily permitted, to compensate for any drawdown of the reserve fund to meet debt-service payments. In the case of

Mr. Eric E. Wohlforth
Commissioner

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October 19, 1971

either direct state or state agency financing, support for industrial-aid issues would presumably be derived not from state-tax moneys, but rather from loan repayments by the benefited industries. As such, from a municipal analyst's viewpoint, the bonds in due course would be treated as self-liquidating obligations deductible from the state's gross debt - thus reducing, to small or no measure, potential impairment of the state's general credit.

The success of an industrial development corporation in Alaska is keyed as much to its structure and planning as to the method selected for financing its operations. It would be an error, in my view, to staff and administer the corporation as a unique, state-level entity responsible only to the executive and a governing board, and responsive by its nature largely to the corporate stature, potential profitability, and market prospects of applicant industries on a case-by-case basis. In order to ensure a better, more even-handed result, I would strongly recommend - before the corporation is formed, that a joint study be undertaken: by the state and selected local governments or chambers of commerce, to determine the number, type, size, and optimum location of the industries that such a corporation would seek to draw to Alaska. By inviting local participation in the planning process, the corporation would additionally benefit from a broader political base of support, as well as a greater prospective commitment from the private local sector in financing a share of the corporation's activities. Then, too, while there is an evident need for an executive director and professional staff on the state-corporation level, there would seem to be an equally pressing need for local representation on the governing board - which would presumably include leading spokesmen from the public, business, financial, and academic communities.

Much stress in this analysis has been given to the necessity for intergovernmental cooperation in planning, organizing, and administering an Alaska Industrial Development Corporation. This relationship could additionally be extended, on the public level, to the financing aspect as well. Where the siting of a corporation-assisted enterprise could reasonably be expected to stimulate ancillary developments, the local government in the area may strongly be induced to underwrite certain infrastructural costs associated with servicing an industrial complex. To the extent that such participation could be courted, the capital costs of a corporation-assisted enterprise would be reduced, and the free-resource funds of the corporation enlarged accordingly.

I welcome this opportunity to share these views with you, Mr. Wohlforth, and hope that the enclosed materials on industrial-aid

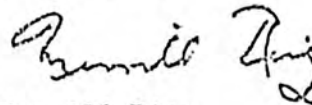
Mr. Eric E. Wohlforth
Commissioner

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October 19, 1971

financing will prove of value. If I can be of any further assistance,
please be in touch.

Sincerely,



Merrill Ring
Senior Research Officer

Enclosures

MR/vs
622-2530(415)

cc: Mr. Leland S. Prussia, Jr.
Mr. William D. Shaw, Jr.

Introduced: 2/22/79
Referred: Special Permanent
Fund Committee and Finance

1 IN THE HOUSE

BY THE RULES COMMITTEE BY
REQUEST OF THE GOVERNOR

2 HOUSE BILL NO. 277

3 IN THE LEGISLATURE OF THE STATE OF ALASKA

4 ELEVENTH LEGISLATURE - FIRST SESSION

5 A BILL

6 For an Act entitled: "An Act relating to management of the Alaska Permanent
7 Fund; and providing for an effective date."

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

9 * Section 1. AS 37 is amended by adding a new chapter to read:

10 CHAPTER 13. ALASKA PERMANENT FUND.

11 Sec. 37.13.010. ALASKA PERMANENT FUND. (a) Under art. IX, sec.
12 15, of the Alaska Constitution, there is established, as a separate
13 fund in the Department of Revenue, the Alaska Permanent Fund.

14 Sec. 37.13.020. PURPOSE OF THE PERMANENT FUND. The permanent
15 fund is to provide a means of conserving a portion of the state's
16 revenues from mineral resources for the benefit of Alaskans. The
17 permanent fund is not to be depleted but rather maintained in income-
18 producing investments to provide a continuing stream of benefits to
19 Alaskans.

20 Sec. 37.13.030. COMPOSITION OF THE PERMANENT FUND. (a) The
21 permanent fund consists of at least 25 per cent of all mineral lease
22 rentals, royalties, royalty sale proceeds, federal mineral revenue
23 sharing payments, and bonuses received through FY 1981, and will at
24 the beginning of FY 1982 increase to at least 75 per cent of all
25 mineral lease rentals, royalties, royalty sale proceeds, and federal
26 mineral revenue sharing payments, and 100 per cent of the bonuses
27 received by the state. The commissioner of revenue shall deposit
28 money from these sources in the permanent fund at least once each
29 month.

1 (b) Income from investment of the permanent fund does not become
2 a part of the permanent fund and must be deposited in the general
3 fund, except that income in the following amounts may be retained in
4 the fund and used as indicated:

5 (1) the amount appropriated to pay the corporation's operat-
6 ing and administrative expenses, under AS 37.13.100;

7 (2) any amount allocated to a reserve account established
8 under AS 37.13.180.

9 (c) All of the revenues dedicated to the Alaska Permanent Fund
10 by the 1976 amendment to article IX of the Alaska Constitution shall
11 be administered as a trust fund and invested by the commissioner of
12 revenue as prescribed by AS 37.10.065. Any money deposited in the
13 Alaska Permanent Fund in addition to that revenue must be allocated to
14 the Alaska Permanent Fund Corporation and invested as prescribed by
15 this chapter.

16 Sec. 37.13.040. ALASKA PERMANENT FUND CORPORATION. (a) There
17 is established the Alaska Permanent Fund Corporation. The corporation
18 is a public corporation and government instrumentality in the Depart-
19 ment of Revenue but has a legal existence independent of and separate
20 from the state. The purpose of the corporation is to manage and
21 invest the money from the Alaska Permanent Fund allocated to it in
22 accordance with this chapter.

23 (b) The corporation has all powers necessary to carry out the
24 purposes of this chapter including but not limited to the following:

- 25 (1) sue and be sued;
26 (2) adopt a seal;
27 (3) have perpetual succession;
28 (4) adopt and amend policies and operational procedures
29 which are not inconsistent with this chapter;

- 1 (5) make and execute contracts and other instruments;
2 (6) in its own name, own, exchange, transfer, lease, rent,
3 convey, acquire, or dispose of by other means real and personal pro-
4 perty.

5 Sec. 37.13.050. INVESTMENT OF THE PERMANENT FUND. (a) The
6 corporation's allocation from the Alaska Permanent Fund must be invested
7 in income-producing investments of the following types, which invest-
8 ments must conform to the purposes set out in AS 37.13.020:

9 (1) obligations of, or obligations insured or guaranteed
10 by, the United States or an agency or instrumentality of the United
11 States;

12 (2) obligations secured by reserves paid in by the United
13 States or an agency or instrumentality of the United States or obli-
14 gations of corporations in which the United States is a shareholder or
15 member;

16 (3) certificates of deposit or their equivalent issued by
17 United States domestic banks, savings and loan institutions or credit
18 unions which are insured by the United States or an agency or instru-
19 mentality of the United States and secured as to the payment of princi-
20 pal and interest in accordance with Alaska law;

21 (4) corporate investment-grade securities;

22 (5) banker's acceptances drawn on and accepted by United
23 States banks which each have a combined capital and surplus aggregating
24 at least \$100,000,000;

25 (6) repurchase agreements, the securities underlying the
26 agreements being any of the items in (1) - (5) of this subsection;

27 (7) real estate mortgage securities insured by or guaranteed
28 by the United States or an agency or instrumentality of the United
29 States;

1 (8) conventional real estate mortgages secured by real,
2 estate in the state or other collateral allowed under this chapter;

3 (9) deposits of federally insured savings and loan associa-
4 tions not to exceed 10 per cent of each savings and loan association's
5 deposits exclusive of federal, state, and municipal deposits;

6 (10) fixed-term certificates of debenture of federally
7 insured credit unions not to exceed 10 per cent of each credit union's
8 shares.

9 (b) The corporation may make other types of investments which
10 are not freely traded on a recognized market only as expressly autho-
11 rized by law.

12 (c) The director may enter into contracts providing for invest-
13 ment, custody, safekeeping, and management of securities and execution
14 of transactions.

15 Sec. 37.13.060. GUARANTEES OF INDEBTEDNESS. The corporation
16 may, from its income from the fund and for a reasonable fee, guarantee
17 construction of electric generating and related transmission facilities
18 which have been recommended by the Alaska Power Authority as to reli-
19 ability and technical feasibility, which have the lowest cost to the
20 consumer of available alternatives, which have been approved by the
21 investment committee as to the financial condition of the borrower,
22 and which have the final approval of the executive oversight committee,
23 and the guarantee for which has been submitted as a proposition at a
24 statewide election and been approved by a majority of those voting on
25 the question. The aggregate of all guarantees may not exceed 100 per
26 cent of the total assets of the corporation.

27 Sec. 37.13.070. RATE OF INTEREST. The rate of interest charged
28 by the corporation on investments made under AS 37.13.040 must at all
29 times be at least equal to the market rate of interest applicable to

1 the kind of investment, less an appropriate servicing fee.

2 Sec. 37.13.080. POLICY BOARD. (a) There is established the
3 Alaska Permanent Fund Policy Board, consisting of the commissioner of
4 commerce and economic development, the commissioner of revenue, and
5 five members to be appointed by the governor who serve at his pleasure.
6 The five appointed members must be Alaska residents and may not be
7 employees of the state. Their term of office is four years, and they
8 may be reappointed. Terms must be staggered. Initial terms are one
9 year for one member, two years for two members, three years for one
10 member, and four years for one member.

11 (b) The commissioner of revenue shall serve as the chairman of
12 the policy board.

13 (c) A quorum for the transaction of policy board business con-
14 sists of at least four members. Decisions of the board must be made
15 by a majority of the appointed members. The provisions of AS 44.62.310
16 and 44.62.312 apply to meetings of the board.

17 (d) Appointed members of the policy board are not entitled to
18 compensation as such but are entitled to per diem and travel allowances
19 as provided by law for members of state boards and commissions.

20 Sec. 37.13.090. DUTIES OF THE POLICY BOARD. The policy board
21 shall:

22 (1) appoint the director and other members of the investment
23 committee;

24 (2) select an independent outside auditor and receive and
25 publish all audit reports;

26 (3) review and publish financial statements audited by
27 independent outside auditors;

28 (4) review and approve the annual investment program based
29 on the credit assessment of the State of Alaska as established in AS

1 37.13.190(3), the budget for the forthcoming year, and the financial
2 plan for the following three years;

3 (5) present a report on the annual investment program, the
4 financial plan for the following three years and any other information
5 considered to be of interest to the executive oversight committee by
6 December 1 annually;

7 (6) determine, without approving or disapproving the
8 investment itself, whether a specific investment or kind of investment
9 is consistent with the provisions of this chapter;

10 (7) set the remuneration and other terms of employment of
11 the director and the remuneration of the investment committee on a
12 daily basis;

13 (8) hold public hearings on the investment program and
14 submit its findings to the executive oversight committee and the
15 legislature at the beginning of each regular session.

16 Sec. 37.13.100. LEGISLATIVE DIRECTIVE. The legislature may
17 express any preference or emphasis it desires to be placed among
18 investment categories designated in AS 37.13.050(a) by concurrent
19 resolution, consistent with the purposes and principles prescribed by
20 AS 37.13.020 and 37.13.190.

21 Sec. 37.13.110. EXECUTIVE OVERSIGHT COMMITTEE. There is estab-
22 lished the Permanent Fund Executive Oversight Committee, consisting of
23 the governor, the commissioner of commerce and economic development,
24 the commissioner of revenue, the director of the division of policy
25 development and planning, and the director of the division of budget
26 and management. The governor, or, in his absence, the commissioner of
27 revenue, is the chairman.

28 Sec. 37.13.120. DUTIES OF THE EXECUTIVE OVERSIGHT COMMITTEE.
29 The executive oversight committee shall review and either approve or

1 revise and approve the corporation's annual investment program and
2 present it to the legislature no later than the 20th day of each
3 regular session.

4 Sec. 37.13.130. OPERATIONAL BUDGET. The annual operating budget
5 for the corporation must be prepared and administered in accordance
6 with the Executive Budget Act (AS 37.07). Appropriations must be made
7 for the budget from income earned by the corporation from investment
8 of the money allocated to it from the Alaska Permanent Fund.

9 Sec. 37.13.140. CORPORATION DIRECTOR. The director of the
10 corporation is to be appointed by the policy board and serve at its
11 pleasure. The director

12 (1) is responsible for the day-to-day business of the
13 corporation and the organization, appointment, promotion, and discharge
14 of the staff which is in the exempt service under AS 39.25;

15 (2) shall establish and maintain adequate and appropriate
16 organizational, operating, and financial controls;

17 (3) is responsible for making investments except that the
18 director may delegate this authority under the provisions of AS 37.13.-
19 050(b);

20 (4) prepare reports as specified in AS 37.13.170, 37.13.-
21 190(3), and 37.13.200.

22 Sec. 37.13.150. INVESTMENT COMMITTEE. (a) There is established
23 the Alaska Permanent Fund Corporation investment committee consisting
24 of the permanent fund corporation director, who shall serve as chairman,
25 and four public members appointed by the policy board. All public
26 members must be Alaska residents for at least three years, may not be
27 state employees, and must be persons of recognized competence and wide
28 experience in investment, finance, or other business management related
29 fields. Their term of office is four years and they may be reappointed.

1 Terms must be staggered. Initial terms are one year for one member,
2 two years for two members and three years for one member. Members of
3 the investment committee serve at the pleasure of the policy board.

4 (b) A quorum for the transaction of investment committee business
5 consists of at least three members. Decisions of the committee must
6 be made by a majority of the members. The provisions of AS 44.62.310
7 and 44.62.312 do not apply to meetings of the committee.

8 (c) Members of the committee are entitled to per diem and travel
9 allowances as provided by law for members of state boards and com-
10 missions.

11 Sec. 37.13.160. DUTIES OF THE INVESTMENT COMMITTEE. The invest-
12 ment committee:

13 (1) has sole responsibility to approve all investment pro-
14 posals, except that the committee may establish criteria for invest-
15 ments that may be approved by the director;

16 (2) shall set standards for the origination, administration,
17 and collection of loans.

18 Sec. 37.13.170. INITIAL DETERMINATIONS. Within 30 days after
19 the beginning of the legislative session following enactment of this
20 chapter, the governor shall submit a report compiled by the director
21 and approved by the policy board and the oversight committee to the
22 legislature. This report must:

23 (1) evaluate the capital markets serving Alaska;

24 (2) specify and discuss resources and methods other than
25 the permanent fund available to mitigate inefficiencies, if any are
26 found, in Alaskan capital markets; and

27 (3) recommend additional investment categories to be included
28 in the list of eligible investments established in AS 37.13.040, if it
29 is found that the permanent fund corporation is the best mechanism for

1 correcting these inefficiencies; those recommendations must conform to
2 the purposes established in AS 37.13.020 and the operating principles
3 established in AS 37.13.190.

4 Sec. 37.13.180. RESERVES. The executive oversight committee
5 shall establish reserve accounts from income earned by the corporation
6 to preserve the principal of the permanent fund allocated to the
7 corporation, consistent with sound financial practices.

8 Sec. 37.13.190. OPERATIONAL PRINCIPLES. The operations of the
9 corporation must be conducted in accordance with the following princi-
10 ples:

11 (1) the corporation shall give preference to investments
12 within the state to the extent that they have a risk level no higher
13 than, and an expected yield equivalent to, alternative investment
14 opportunities;

15 (2) the prudent-man rule of investments is applicable; in
16 making investments, the staff and the investment committee shall
17 exercise the judgment and care under the circumstances then prevailing
18 which an institutional investor of ordinary prudence, discretion, and
19 intelligence exercises in the management of investments entrusted to
20 it not in regard to speculation but in regard to the permanent disposi-
21 tion of funds, considering the probable income from them as well as
22 probable safety of capital;

23 (3) the corporation shall prepare an annual analysis of the
24 state's capital markets, and may recommend additional investment cate-
25 gories to be included in the list of eligible investments established
26 in AS 37.13.050 if it is found that the permanent fund corporation is
27 the best mechanism for correcting market inefficiencies; those recom-
28 mendations shall conform to the purposes established in AS 37.13.020;
29 and its investment program shall be based, to the extent consistent

1 with the fund's purposes and operational principles, on correcting
2 shortages and inefficiencies in those capital markets;

3 (4) The corporation shall only undertake its financing on
4 terms and conditions which take into account the participation of
5 other investors, the risks being undertaken by the corporation, and
6 the terms and conditions normally obtained by private investors from
7 similar financing; the legislature may appropriate funds for subsidizing
8 categories of investments which it determines to be of such high
priority that special terms and conditions are appropriate; the amount
and timing of subsidies must be such that the rate of return to the
11 corporation remains the market rate;

12 (5) the corporation shall seek to maintain a reasonable
13 diversification in its investments;

14 (6) for those investments which are not freely traded on a
15 recognized market, the corporation may not consider investment proposals
16 unless the applicant or originating financial institution has submitted
17 a detailed proposal to the corporation staff, and the staff has pre-
18 pared a written report recommending the investment after a study of
19 its merits;

20 (7) nothing in this section prevents the corporation, in
21 the event of actual or threatened default on any of the permanent fund
22 investments, actual or threatened insolvency of the enterprise in
23 which the investment has been made, or other situations which, in the
24 opinion of the corporation threaten to jeopardize the investment, from
25 taking the action and exercising the rights it considers necessary for
26 the protection of its interest;

27 (8) when more than two per cent of the aggregate of all
28 loans purchased from a financial institution becomes delinquent for 90
29 days, the corporation shall discontinue purchasing loans from that

1 financial institution until the delinquency is reduced to less than
2 two per cent.

3 Sec. 37.13.200. REPORTS AND PUBLICATIONS. (a) The commissioner
4 of revenue and the corporation shall each publish in easily understood
5 language a separate annual report to the governor, legislature, and
6 the public. Each report must include financial statements audited by
7 independent outside auditors, a statement of the amount of money
8 received by the commissioner and by the corporation from each source
9 during the period covered, a statement of the commissioner's and the
10 corporation's investments including an appraisal at market value, a
11 description of their respective investment activities during the
12 period covered by the report, and any other information the commissioner
13 or corporation believes would be of interest to the governor, the
14 legislature, and the public. The annual income statement and balance
15 sheet for the entire fund must be published in at least one newspaper
16 in each judicial district. The income statement and balance sheet for
17 the two fiscal years preceding the publication of the election pamphlet
18 under AS 15.57 must be included in that pamphlet. The corporation may
19 also publish other reports it considers desirable to carry out its
20 purpose.

21 Sec. 37.13.210. CONFLICT-OF-INTERESTS POLICIES. The director
22 and staff of the corporation, and the members of the policy board and
23 the investment committee shall comply with the requirements of the
24 Conflict of Interest Act (AS 39.50) and the director, staff, and
25 members of the investment committee shall disqualify themselves from
26 voting on any investment in which they have a financial interest.

27 Sec. 37.13.220. CONFIDENTIALITY OF INFORMATION. (a) Information
28 furnished the corporation by an applicant for a loan or investment
29 which discloses the particulars of the applicant's business or affairs

1 is not a matter of public record. The information must be kept confi-
2 dential except when its production is required for a criminal investi-
3 gation or court proceeding. These restrictions do not prohibit the
4 release or publication of the information in a manner that prevents
5 the identification of a particular applicant.

6 (b) Nothing in this section prevents the corporation from dis-
7 closing the terms and conditions of individual investments as public
8 information.

9 * Sec. 2. AS 37.10.065(c) is repealed.

10 * Sec. 3. This Act takes effect immediately in accordance with AS 01.-
11 10.070(c).

STATE OF ALASKA

OFFICE OF THE GOVERNOR

DIVISION OF POLICY DEVELOPMENT AND PLANNING

JAY S. HAMMOND
GOVERNOR

POUCH AD-JUNEAU 99811
PHONE 465-3577

March 29, 1979

The Honorable Hugh Malone
Chairman, House Special Committee
on the Alaska Permanent Fund
Court Bldg, Room 647
Juneau, AK 99801

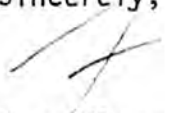
Dear Representative Malone:

Enclosed are the responses to the via questions which your committee addressed to the Administration during our testimony. The six questions were:

- (1) What are the Governor's intentions regarding the reserve accounts established by last year's legislature?
- (2) Is HJR 23 in proper legal form?
- (3) Does the existing permanent fund constitutional amendments mandate to trust responsibilities?
- (4) What other uses is the Governor considering for permanent fund income?
- (5) What revenue projections were used to justify a proposed contribution level of 75%?, and
- (6) Can the gas pipeline be financed with the permanent fund under the proposed investment lists?

We hope these answers are satisfactory. We will be happy to respond further if you should require more information.

Sincerely,


Fran Ulmer
Director
Policy Development and Planning

cc: Committee members

MEMORANDUM
DIVISION OF POLICY DEVELOPMENT AND PLANNING
OFFICE OF THE GOVERNOR

TO: ☐

DATE: February 23, 1979

Distribution

FILE NO:

TELEPHONE NO:

FROM:

Frances A. Ulmer
Director

SUBJECT: Permanent Fund Policy.

The following discussion summarizes the major policy concerns which the Governor has identified for incorporation in a Permanent Fund legislative package. Also presented are the sections of SB 226/HB 277, which encompass these policy guidelines. The outline is followed by a narrative description of the bill.

OVERALL POLICY OBJECTIVE

THE PERMANENT FUND IS THE VEHICLE THROUGH WHICH A PORTION OF THE STATE'S OIL WEALTH IS TRANSFORMED FROM MINERAL TO FINANCIAL FORM. IT IS NOT TO BE DEPLETED, BUT RATHER MAINTAINED AND INVESTED IN SUCH A WAY AS TO PROVIDE A CONTINUING STREAM OF BENEFITS TO ALASKANS.

Explanation: The Permanent Fund implementing legislation should provide the establishment of a permanent and thus prudently managed investment portfolio, which maintains the value of the principal and maximizes earnings given risk constraints. The stream of financial benefits to Alaskans from the Permanent Fund is not to be eroded by use of Fund principal for investments at less than market rates.

Section 020 of the bill establishes the purpose of the Permanent Fund: It is to provide a means of conserving a portion of the state's revenues from mineral resources for the benefit of Alaskans. The Permanent Fund is not to be depleted but rather maintained in income-producing investments to provide a continuing stream of benefits to Alaskans.

The key provisions for implementing this policy are outlined below.

1. Policy Guideline on Eligible Investments

THE INVESTMENT OF THE PERMANENT FUND PRINCIPAL SHOULD BE BASED UPON A LIST OF ELIGIBLE INVESTMENTS IDENTIFIED AS APPROPRIATE WITH RESPECT TO RISK LEVEL AND RETURN TO THE FUND. ALL OTHER THINGS BEING EQUAL, PRIORITY WOULD BE GIVEN TO IN-STATE INVESTMENTS.

Explanation: Considerable debate has raged regarding the amount of in-state investment and the appropriate risk level which would be allowed by alternative management structures for

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Explanation: Considerable debate has raged regarding the amount of in-state investment and the appropriate risk level which would be allowed by alternative management structures for

the Permanent Fund. The exact meaning and implications of such terms as "trust fund," "prudent-man rule," and "loan program" are unclear as regards in-state investment and the security of the fund.

A specific list of clearly drafted categories eligible for investment will maximize policy control by elected officials with respect to the risk level and uses of the fund. The list presented in the Governor's proposal contains those types of investments which are generally regarded by money managers as relatively low risk investments. As the Permanent Fund Corporation gains operating experience and identifies capital gaps, the list can be expanded by temporary Acts or permanent amendments to permit additional uses of the fund.

Sections .030(c) and .050 address investment of the Permanent Fund and contain lists which define the range of investments available to Permanent Fund managers for both the 25% trust and any additional contributions for the development bank.

Section .190 contains the operational principles for the fund. The first principle states that the Fund shall give preference to investments within Alaska having a risk level no higher than and an expected yield equivalent to, alternative investment opportunities.

2. Policy Guideline on Allocation Among Types of Investments

THE GOVERNOR AND THE LEGISLATURE SHOULD ADDRESS, IN GENERAL TERMS, THE ALLOCATION OF PERMANENT FUND INVESTMENTS AMONG THE USES DESIGNATED IN A LIST OF ELIGIBLE INVESTMENTS.

Explanation: The list of eligible investments may include a range of uses of Permanent Fund principal such as mortgages, corporate securities, bank certificates of deposit, government securities, etc. Some policy guidance to the fund managers regarding the allocation of investments among categories should be exercised by elected officials. This guidance should be provided for in Permanent Fund enabling legislation through both executive and legislative approval of investment programs and through annual directives to the fund managers by the legislature. Such guidance must be sufficiently flexible to allow for balanced and effective portfolio management.

Section .110 establishes an Executive Oversight Committee consisting of the Governor and four cabinet members, and charges them with review and approval of the Permanent Fund Corporation investment program as developed by the policy board.

Section .100 provides for a Legislative directive through which the Legislature can express preferences for emphasis among the categories on the Corporation's investment list.

3. Policy Guideline on Interest Rates

THE RATES OF INTEREST CHARGED TO BORROWERS BY THE PERMANENT FUND SHOULD CONFORM TO THE RATES WHICH WOULD BE OBTAINED IN THE PRIVATE SECTOR FOR SIMILAR FINANCING UNDER SIMILAR CONDITIONS. THE LEGISLATURE AND THE GOVERNOR SHOULD SPECIFICALLY IDENTIFY INVESTMENT CATEGORIES WHICH THEY MAY WISH TO SUBSIDIZE. SUCH SUBSIDIES MUST BE APPROPRIATED FROM THE GENERAL FUND, SUCH THAT THE RATE OF RETURN TO THE PERMANENT FUND REMAINS AT THE MARKET RATE AND THE SECURITY OF THE FUND IS MAINTAINED.

Explanation: There is no fixed or certain definition of the "market interest rate." The concept of a market rate is fluid, meaning that rate of return on an investment opportunity which is required to attract the necessary capital from the private capital markets. This is a function of several factors including the lender's opportunity cost of capital, the length, risk level, liquidity, and other terms of the loan. Because the Permanent Fund will be a public sector lender, and will be making different types of investments under a variety of conditions, no fixed definition of market interest rates in statute may be possible.

While investment of the Permanent Fund should remain accountable to elected officials, the fund must be insulated from undue political influence. The up-front subsidization of certain types of projects through general fund appropriations would allow for the implementation of social policy by those who should be making such decisions, i.e., elected officials. However, decisions to subsidize should be structured to insure a rational dialogue between elected officials (and their goals in using subsidies) and the fund managers (and their goal of maintaining the integrity of the Fund).

Section .190, the operating principles, contains subsection (4) which instructs the corporation to undertake financing on terms and conditions which take into account the participation of other investors, the risks being undertaken by the fund and the terms and conditions normally obtained by private investors from similar financing. Sec. 070 also requires market interest rates.

Section .190 also contains provision for the Legislature to appropriate funds for subsidizing categories of investment which are determined to be of such high priority that special terms and conditions are appropriate. The amount and timing of subsidies must be such that the rate of return to the fund remains the market rate.

4. Policy Guideline on Permanent Fund Earnings

THE PERMANENT FUND EARNINGS ARE TO PROVIDE AN ONGOING STREAM OF BENEFITS TO ALASKANS THROUGH A DIRECT DISTRIBUTION OR TAX REBATES AND THE PROVISION OF PUBLIC GOODS AND SERVICES.

Explanation: Unless otherwise directed by law, the earnings of the Permanent Fund are deposited in the general fund. The Governor has proposed to return some portion of the earnings to the public in the form of either tax rebates or cash dividends. Such a program will link the performance of the Fund directly to every Alaskan by providing tangible benefits from the fund. Permanent Fund earnings further appear to be the fastest growing source of recurring revenues needed to offset operating budget dependence on oil wealth. Thus these earnings can help allow for the continued provision of public goods and services without drastic increases in tax burden to the state's citizenry.

A companion bill (HB 99) has been drafted to implement this policy. The Governor's Permanent Fund enabling legislation, in Section .030(b), provides only that income be returned to the General Fund.

5. Policy Guideline on Management Control

PERMANENT FUND ENABLING LEGISLATION SHOULD INCLUDE THOROUGH REPORTING AND AUDIT REQUIREMENTS, TO ASSURE RESPONSIBLE, VISIBLE MANAGEMENT PRACTICES.

Explanation: The form of management control is critical to the accountability of the fund to the Governor, legislature, and the public. A list of eligible investments will provide the basis for this control by restricting the uses of the fund to legislatively established purposes. Beyond this constraint, the annual reporting requirements can serve to inform elected officials and the public as to the performance of the fund. Such reporting could include, for example, the following elements: specific investments-- amounts and rates of return; subsidized investments; impact of investment constraints on fund performance; investment plans; performance measures; and results of independent audit. Further control could be exercised through the formation of an Executive/Legislative review committee charged with overseeing fund management.

Section .090 instructs the Permanent Fund Corporation Policy Board to provide for annual independent outside audits.

Section .140 instructs the corporation director to establish appropriate organizational, operating, and financial controls.

Section .160 instructs the Corporation Investment Committee to set standards for the organization, and administration, and collection of loans.

Section .200 establishes the general reporting requirements including:

- a. comprehensive financial statements and audit reports,
- b. income statements and balance sheet to be published in at least one newspaper in each judicial district, and
- c. income statement and balance sheet to be published in the election pamphlet.

6. Policy Guideline on Management Prerogatives

FUND MANAGERS SHOULD BE LIMITED TO OPERATING WITHIN THE GUIDELINES SPECIFIED IN ENABLING LEGISLATION AND ANNUAL DIRECTIVES. THEY ARE NOT TO BE RESPONSIBLE FOR DESIGNING OR IMPLEMENTING SOCIAL OR ECONOMIC POLICY OUTSIDE OF THEIR SPECIFIC MANDATE.

Explanation: Under this policy the fund managers would be money managers charged with maximizing return to the Permanent Fund under the established constraints. They could be located either within state government (e.g., Treasury Division) or as a separate corporation but their duties would be limited to financial management. Decisions about social or economic policy and programs to implement that policy should be made by elected officials.

Sections .110 and .100, creating the Executive Oversight Committee and the Legislative directive respectively, provide elected officials an opportunity to formulate general policies on an ongoing basis for implementation by corporation managers. Addition to the investment list by statute give elected officials further control over the uses allowed for the fund.

7. Policy Guideline on Contribution Rate

AS MUCH AS POSSIBLE OF THE STATE'S MINERAL RESOURCE WEALTH SHOULD BE PRESERVED IN A FORM WHICH WILL YIELD CONTINUING BENEFITS TO ALASKANS. SUCH A POLICY SEEKS TO AVOID INCREASING DEPENDENCE ON NON-SUSTAINABLE REVENUE SOURCES FOR THE OPERATING EXPENSES OF STATE GOVERNMENT.

Explanation: The Governor has chosen increased contributions to the permanent fund as the best mechanism for both holding down state spending and providing a source of recurring revenues. Increasing the contribution rate yields two major benefits: (1) it would make a large amount of

nonrecurring revenue unavailable for ongoing state spending and would reduce the unacceptable rate of budget growth, and (2) it would triple the earnings potential of the fund to provide certain, recurring revenues for financing tax credits and future state government activities.

Section .030(a) sets the contribution rate at 25% until FY 1982, at which time it increases to 75% except for bonuses which increase to 100%. SJR 26/HJR 23 is a proposed constitutional amendment to increase the contribution rates to the permanent fund as described above.

Narrative

The composition of the Permanent Fund is 25% of all mineral lease rentals, royalties, royalty sale proceeds, federal mineral revenue sharing payments, and bonuses received through FY 1981, after which it increases to 75% except for bonuses, which increase to 100% (as also proposed in SJR 26). Income is returned to the general fund, except for amounts retained for corporation operations (subject to the Executive Budget Act) and the funding of necessary reserve accounts. A companion bill (HB 99) addresses use of an amount equal to one-half of the earnings as tax credits.

The bill establishes the constitutionally mandated minimum 25% as a trust fund to be managed by the Department of Revenue. Provisions for managing this portion of the fund, including a list of eligible investments, already exists in statute as AS 37.10.065. Such management is in keeping with the purpose established in Sec. 020 of the bill.

The bill further establishes any additional contributions over 25% as a "cautious" development bank within the Department of Revenue, structured as an independent corporation. Policy making for the corporation is vested with a policy board subject to review and approval of an Executive Oversight Committee and the Legislature. Legislative policy input is provided for through legislative directives and expansion of the investment list by temporary Act or permanent amendment.

Permanent Fund Corporation policy is specified through an investment list, the categories of which reflect in general terms the uses of the corporation principal desired by elected officials. The list, as now conceived, is fairly conservative, allowing for money market and mortgage investments. The director of the corporation is instructed to prepare both an initial determination and an annual assessment of the capital markets serving Alaska and recommend to the Governor and the Legislature possible expansion of the investment list based on these assessments.

The Corporation director is empowered to manage the daily operations of the corporation. Investment decisions are to be made by an Investment Committee chaired by the director with four public members appointed by the policy committee.

Because it may well be the only feasible means of financing large electric power projects, the bill authorizes guarantees based on the corporation's income for electric generation and transmission facilities. This provision contains safeguards so that it can only be used for feasible projects of the lowest cost to the consumer after approval of the guarantee by a majority of the state's voters.

Operating principles are established for investment of the Fund including:

- a) preference for investments within Alaska which have risk levels and expected yields comparable to alternative investment opportunities;
- b) a version of the prudent man rule;
- c) preparation of an investment program, based on an annual credit assessment of the state by the director. The assessment may also include recommendations to the Governor and the Legislature to expand the investment list if appropriate;
- d) the requirement that all Permanent Fund investments earn a market rate of interest;
- e) the requirement that if the Legislature wishes to subsidize investments it must specifically appropriate general fund money to do so (which will maintain a market return to the fund); and,
- f) several additional operating principles.

The bill also contains extensive reporting requirements, and conflict of interest and confidentiality of information sections.

FAU:ms

Section-by-Section Summary of SB 226

- Sec. 010: Establishes the Alaska Permanent Fund in the Department of Revenue according to Article IX, Section 15 of the Alaska Constitution.
- Sec. 020: Sets out the purpose of the fund - to conserve a portion of the state's revenues from mineral resources and to maintain the fund's principal through income-producing investments.
- Sec. 030: (a) Sets the contribution rate at the constitutional minimum of 25% until FY 1982, at which time the contribution rate increases to 75% except for bonuses which are set at 100%.
- (b) Provides that income from the permanent fund shall be deposited in the general fund except for amounts appropriated for the corporation's expenses and amounts required for reserve accounts.
- (c) Provides that all of the permanent fund principal dedicated under the 1976 amendment (the first 25%) be managed as a trust fund by the Department of Revenue as prescribed by the Interim Management Act (AS 37.10.065). Any contributions dedicated by statute or additional constitutional amendments above the 25% level must be allocated to the Permanent Fund Corporation.
- Sec. 040: Establishes the Alaska Permanent Fund Corporation in the Department of Revenue to invest and manage permanent fund contributions in excess of the 25% level, and provides it with the necessary corporate powers.
- Sec. 050: (a) Establishes a list of investments eligible for corporation investment. This list represents the policy set by the legislature and the Governor for the use of permanent fund principal above the 25% level.
- (b) Allows the corporation to make additional investments only as authorized by law.
- (c) Provides for contracts for the investment, custody, safekeeping, and management of securities and execution of transactions.
- Sec. 060: Provides for guarantees of indebtedness of electric generating and transmission facilities recommended by the Alaska Power Authority from corporation income. Such guarantee must be approved by the investment committee, the Executive Oversight Committee, and by the voters via proposition at a statewide election.

Sec. 070: Mandates that the corporation receive a market rate of interest on all investments.

Sec. 080: Establishes a policy board consisting of the Commissioners of Commerce and Economic Development and Revenue and five public members appointed by the Governor, serving at his pleasure for a four-year term.

Sec. 090: Establishes the duties of the policy board:

- 1) appoint the director and investment committee,
- 2) select an independent outside auditor and receive audit reports,
- 3) review and publish financial statements,
- 4) review and approve an annual investments program, the corporation's operating budget, and a financial plan for the following three years,
- 5) present the material in (4) to the Executive Oversight Committee,
- 6) determine whether investments are consistent with the statute,
- 7) set remuneration and other terms of employment for employees, and
- 8) hold public hearings on the investment program.

Sec. 100: Provides for a legislative directive establishing legislative preference among investment categories.

Sec. 110: Establishes an Executive Oversight Committee consisting of the Governor, the Commissioners of Commerce and Economic Development and Revenue, and the Directors of Policy Development and Planning and Budget and Management.

Sec. 120: Establishes the duties of the Executive Oversight Committee - to review and either approve or revise the corporation's annual investment program and present it to the legislature.

Sec. 130: Provides for the corporation's operating budget to come from corporation earnings subject to the Executive Budget Act.

Sec. 140: Establishes a corporation director and duties:

- 1) responsibility for the day-to-day business of the corporation and management of staff,
- 2) establishment of organizational, operating, and financial controls,
- 3) investment activity, and
- 4) preparation of reports.

Sec. 150: Establishes an Investment Committee consisting of the director and four public members appointed by the policy board for four year terms.

Sec. 160: Establishes the duties of the Investment Committee:

- 1) approval of all investment proposals, and
- 2) setting of standards for the origination, administration, and collection of loans.

Sec. 170: Provides for an initial determination by the director which:

- 1) evaluates the capital market serving Alaska,
- 2) specifies resources and methods other than the permanent fund available to mitigate any inefficiencies (capital gaps) which are found, and
- 3) recommends additional investment categories to be added to the investment list by law to enable the corporation to invest in such categories.

Sec. 180: Provides for the Executive Oversight Committee to establish reserves out of income consistent with sound financial practices.

Sec. 190: Establishes eight operating principles:

- 1) in-state investment preference for equivalent investment opportunities,
- 2) a version of the prudent man rule,
- 3) annual analysis of the state's capital markets to serve as the basis of the investment program, and of recommendations for expansion of the investment list,
- 4) market interest rates, except that the legislature may appropriate monies to subsidize permanent fund investments,
- 5) diversification in investments,
- 6) requirement for investment proposals and staff review,
- 7) powers of corporation to take legal actions to protect its investments, and
- 8) discontinuation of loan purchase from financial institutions with delinquent loans.

Sec. 200: Provide for reports and publications by both the Commissioner of Revenue and the corporation including:

- 1) financial statement audited by independent outside auditors,
- 2) a statement of the amount of money received from each revenue source,
- 3) a statement of investments appraised at market value,
- 4) a description of investment activities, and
- 5) any other information.

The annual income statements and balance sheets must be published in at least one newspaper in each judicial district annually. The income statement and balance sheets for the two years preceding the publication of the election pamphlet must be included in that pamphlet.

Sec. 210: Establishes conflict-of-interest policies requiring the director and staff of the corporation, and the members of the policy board and investment committee to comply with the Conflict of Interest Act and to disqualify themselves from decisions in which they have a financial interest.

Sec. 220: Establishes confidentiality of information policies protecting information which discloses the particulars of a business which is not a matter of public record.

AS 37.10.065(c) is repealed.

Immediate effective date in accordance with AS 01.10.070(c).

THE ALASKA PERMANENT FUND

A Decision Guide

*The Division of Policy Development
and Planning*

October 1978

The Decision - What is the Administration's Position on the Permanent Fund

As you know, the Tenth Alaska Legislature failed to agree on a plan for the use and management of the Permanent Fund. As a result, you now have the opportunity to provide leadership to the Eleventh Alaska Legislature on this tremendously important issue. We are entering our third year of deliberation on the Permanent Fund, and an enormous amount of information, as well as three legislative proposals, are already before us. The following decision guide lays out the generally accepted conceptualization of the choices involved. Starting with a set of policy goals, the guide presents the major alternatives which have been developed for achieving those goals, and presents some key considerations for choosing among them. Once you have identified your goals and chosen your preferred alternatives, we can begin to develop your recommendations or legislative proposals for the coming legislative session.

For the sake of clarity and a manageable discussion, this decision guide will consider only use of Permanent Fund principal. Use of Permanent Fund income will be ignored. In reality, however, many combinations are possible using the principal to achieve one goal and the income for another. Once your policy direction is clear, the appropriate disposition of the principal and the income can be determined.

Our Nest Egg - Separating Fact from Fantasy

Great claims have been made about our "billion dollar" nest egg. But how much money are we really talking about, and over what time frame? To a degree, what the Fund can do depends on how large it is. Before beginning our exploration of the decision you face, consider these startling facts about the growth of the Fund.

In February, 1976, the Department of Revenue predicted that the contribution to the Permanent Fund for F.Y. 1978 would be \$113.9 million. A year later the Division of Legislative Finance predicted it would be \$65 million, and the Division of Research Services predicted \$80-\$90 million. In September of 1978, the Department of Revenue reported a "preliminary actual" figure of \$50.5 million. The following figures show a more complete history:

Department of Revenue
Permanent Fund Contribution Projections (in millions)

FY	2/76	9/76	2/77	11/77	9/78
1978	113.9	89.4	62.3	52.6	50.5
1979	131.2	130.9	130.0	88.7	69.3
1980	164.5	183.6	165.3	117.0	77.4

Clearly our nest egg will be much smaller and will grow more slowly than was thought originally. These prediction errors resulted from unforeseeable circumstances such as the pipeline and tanker tariffs and the Pimp Station 8 explosion. Much thinking about the Permanent Fund is based on the concept that the Fund is a "pot of billions" just waiting to be used. A more cautious appraisal of our riches is clearly in order as you consider existing proposals and develop new ones.

Key Considerations

Most of the following alternatives for use and management of the Permanent Fund were incorporated into legislation before the 10th Legislature. Each was based on extensive research, public hearings, and hard thinking. The major issues surrounding the alternatives are outlined below.

After this initial review, ample background material and detail is available to help refine your thinking.

Savings

Alternatives:

Interim Management

Trust in Independent Corporation

Trust in Treasury

40% of principal in development bank

- As a group, the savings alternatives represent the least risky use of the Permanent Fund. The lower risk level results in a lower earnings potential than some other investment opportunities; however, the earnings are relatively certain and the risk of loss is minimized.

- Strict trust standards may mean fewer Permanent Fund dollars will be invested in Alaska.

- Savings would provide the least stimulus for immigration.

- The question of who should manage the savings trust created a major difference between the House and Senate. The House favored an independent corporation, while the Senate felt the Division of Treasury was appropriate. The major arguments were:

<u>Independent Corporations</u>		<u>Treasury</u>	
<u>for</u>	<u>against</u>	<u>for</u>	<u>against</u>
insulated from politics	too insulated from elected officials	economy of scale in investing	harder to attract top people
visible and therefore accountable to the public	created another bureaucracy	organization already in place	history of political lending
able to attract better personnel			

What is the Goal of the Permanent Fund?

The State Investment Advisory Committee, the Public Forum, and the House and Senate Permanent Fund Committees have heard many, many answers to this question. Presented below is a distillation of the answers, and the organizational ideas which have been developed to implement them.

<u>Goal</u>	<u>Policy</u>	<u>Alternative</u>
Savings	"...to preserve the state's oil wealth and insure a safe income stream"	-retain interim management law, no new bill. -trust fund managed by an independent corporation (House) -trust fund managed by Treasury (Senate) -large scale development bank minimum of 40% of principal in savings (Administration)
Economic Development	"...to provide for the diversification and stabilization of the Alaskan economy."	-large scale development bank maximum of 30% of principal in economic development (Administration) -small scale rural development bank (House) -expanded state loan program (Senate) -financing for major one-time state projects (Gasline, Susitna) -financing for GSOP
Community Development	"...to provide for the health, education, social and public facility needs of Alaskan communities."	-large scale development bank maximum of 30% of principal in community development (Administration) -expanded state loan program (Senate) -municipal bond purchases Treasury

Economic Development

Alternatives:

30% of principal in development bank (Administration)

Small scale development bank (House)

Expanded state loan program (Senate)

Financing for major projects

Financing for GSOP

- These alternatives represent more risky uses of the Permanent Fund than savings. They also promise higher monetary returns and social returns such as employment. Any losses on investments would result in erosion of the principal of the Fund.

- One of the goals of economic development is to generate a tax base to replace non-recurring oil revenues in the future. Economic analysis has shown that such growth rates need to be astronomically high to generate a tax base sufficiently large to replace oil revenues.

- Under existing conditions, economic development actually worsens the state's fiscal deficit by stimulating immigration. As long as non-renewable resources revenues constitute 70% of government expenditures, "nest egg" will only be further diluted by immigration. Thus either our tax structure must be changed to increase recurring revenues or per capita spending must be decreased to mitigate the negative fiscal impacts of economic growth.

- Most experts agree that all of the economic development alternatives would involve a subsidy by definition - by making public capital available at interest rates which were unable to attract private capital. If rates are charged that would attract private capital (by definition a market rate), such public capital would merely be displacing private capital with no net economic gain for the state.

- Under certain circumstances, subsidies can be sound public policy. The above simply points out the dangers of hidden or unintended subsidies. Decisions to subsidize certain economic sectors or population groups through loans at below market interest rates should reflect deliberate policy goals and be limited to the target sector or group. The amount of the subsidy should also be identified.

- As you know, the state is rapidly approaching a crisis with our loan programs. Since the opening of the Anchorage and Fairbanks offices of the Division of Business Loans, application volume has doubled and is still growing. Loan demand exceeds \$25 million per month, and is threatening the liquidity of the General Fund surplus. Various solutions to this problem are being developed. Here it is important to recognize that attention next session may focus on the Permanent Fund to solve this problem (as with the Senate proposal). However, at \$25 million per month, state loans would absorb the entire annual contribution to Permanent Fund principal in two months. Clearly, solutions may have to be found elsewhere.

- There is a tension between the goal of equity and the goal of rational economic intervention. Some of the proposals, such as expanded "first come, first served" loan programs or financing a GSOP, are based on equal access by the benefit for all Alaskans with a minimum of bureaucratic discretion. Other proposals, such as the development banks and financing major projects, are based on optimal economic intervention by economic experts under the policy guidance of elected officials.

- The size and rate of the Permanent Fund may be inadequate for economic development proposals with large capital requirements.

- Administration, House, and Senate participants found that, while hard to document or quantify, people feel that some real capital shortages do exist in Alaska, especially rural Alaska.

Community Development

Alternatives:

30% of principal in development bank (Administration)

Expanded state loan program (Senate)

Municipal bond purchases by Treasury

- Using Permanent Fund money to construct public facilities for community development would match nonrecurring revenues with nonrecurring expenditures. However, this ignores operating expenses.

- The return on public, tax exempt borrowing is considerably lower than alternative investments for the Permanent Fund.

- Economic development strategies will be ineffective if real bottlenecks from a lack of public facilities are not removed.

- There are many real community development needs in Alaska and a large variety of existing mechanisms to finance such projects.

- Investment in community development should improve the quality of life for all resident Alaskans.

- Use of Permanent Fund principal to meet community development needs may duplicate the purposes of the Municipal Bond Bank or other capital improvement programs.

- Some legal question raised about some types of these investments fulfilling constitutional mandate to be "income producing."

Article 3. Investment and Deposit of State Funds.

Section

- 65. Investment of the Alaska Permanent Fund
- 66. Investment of surplus funds
- 67. Deposit of state funds
- 68. Purchase of bonds
- 69. Sale of bonds held as investments

Section

- 85. Financial aid to corporations by state or political subdivision
- 87. Loans to bond construction funds
- 88. Department of Administration authorized to make advances to the University

Sec. 37.10.065. Investment of the Alaska Permanent Fund. (a) The Alaska Permanent Fund consists of 25 per cent of all mineral lease rentals, royalties, royalty sale proceeds, federal mineral revenue sharing payments and bonuses received by the state. The commissioner of revenue shall deposit in the Alaska Permanent Fund 25 per cent of the receipts from these sources at least once each month. The commissioner of revenue shall invest the money in the Alaska Permanent Fund in income-producing investments of the following types:

- (1) obligations of, or obligations insured or guaranteed by, the United States or agencies or instrumentalities of the United States;
- (2) obligations secured by reserves paid in by the United States or agencies or instrumentalities of the United States or obligations of corporations in which the United States is a shareholder or member;
- (3) certificates of deposits issued by United States domestic banks which are members of the Federal Deposit Insurance Corporation and secured as to the payment of principal and interest in accordance with Alaska law;
- (4) corporate investment-grade securities;
- (5) bankers' acceptance drawn on and accepted by United States banks which each have a combined capital and surplus aggregating at least \$100,000,000;
- (6) repurchase agreements, the securities underlying the agreements being any of the items (1) — (5) of this subsection;
- (7) deposits of federally insured savings and loan associations not to exceed 10 per cent of each savings and loan association's deposits exclusive of federal, state, and municipal deposits;
- (b) fixed-term certificates of debentures of federally insured credit unions not to exceed 1 per cent of each credit union's shares.
- (b) The commissioner of revenue may enter into contracts providing for custody of securities and execution of transactions.
- (c) The commissioner of revenue shall transfer to whatever agency established for the express purpose of managing and investing the Alaska Permanent Fund all or part of the securities and money in the Alaska Permanent Fund in accordance with Alaska law no later than two weeks after receipt of written notice from that agency. (§ 1 ch 6 SLA 1977)

Legislative committee report — For Senate Journal, p. 575; 1977 House Journal, report on ch. 6, SLA 1977 (H110), see 1977 p. 279.

SENATE BILL NO. 225 by the Commerce Committee by request, entitled:

"An Act providing for state chartered credit unions."

was read the first time and referred to the Commerce Committee and the Judiciary Committee.

SENATE BILL NO. 226 by the Rules Committee by request of the Governor, entitled:

"An Act relating to management of the Alaska Permanent Fund; and providing for an effective date."

was read the first time and referred to the State Affairs Committee and the Finance Committee.

The above bill will not be available in the Documents Room until further notice.

Fiscal note appears in Senate Supplement No. 7 to today's journal.

Governor's transmittal letter on SENATE BILL NO. 226 follows:

February 13, 1979

The Honorable Clem Tillion
President of the Senate
Alaska State Legislature
Juneau, Alaska 99011

Dear Mr. President:

Under art. III, sec. 18, of the Alaska Constitution, I am pleased to transmit a bill for the management of the permanent fund. It is a companion measure to my proposal to amend the constitution to increase the dedication of revenues to the permanent fund, and the two should be read together.

I am convinced that the 25 per cent dedication must be considered to be a trust fund and be invested accordingly. That means that the existing law providing for its safe investment in the money market is quite

adequate for the management of those funds. A repeal of the subsection transferring funds is all that is required. No other change is contemplated. This is a straight, money-market program of investment, an investment trust, pure and simple.

The bill establishes the Alaska Permanent Fund Corporation for the purpose of managing all monies deposited in the permanent fund which are in excess of the original 25 per cent dedication. The corporation is governed by a policy board consisting of the commissioners of revenue and commerce and five members from the public at large. An executive oversight committee composed of the governor, the commissioners of revenue and of commerce and economic development, and the directors of budget and management and of policy development and planning reviews and approves the board's policy determinations with respect to its investment program but has no control over individual loans. That control lies with an investment committee.

The corporation has general authority to make investments which are freely traded on recognized money markets and certain mortgage transactions. Beyond that, it must request and receive express authority by law to enter into so-called development banking. Again, only money deposited in the fund which is in addition to the 25 per cent dedication is allocated to the corporation for its investment. And even this must be invested in the same manner as a prudent trustee would invest the money placed in his care.

The corporation's policy board is required to make an initial analysis -- and, after that, an annual analysis -- of the state's capital markets and to ascertain what inefficiencies exist there. It then recommends how the permanent fund can and should (and should not) be used to correct these inefficiencies. If additional types of investments are considered to be desirable, it will recommend their authorization. If permanent authorization is preferable, a permanent amendment to section 50 would be proposed. Otherwise, a temporary Act will be proposed.

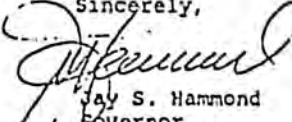
Because it may well be the only feasible means of financing large power projects, the bill authorizes guarantees based on the corporation's income for electric generation and transmission facilities. This provision is hedged in with safeguards so that it can only be used for feasible projects of the lowest cost to the consumer and after approval of the guarantee by a majority of the state's voters.

The bill I propose is essentially conservative. It is based on the premise that the permanent fund is first and foremost a

trust fund and that in its management we must learn to walk before we can run. Nevertheless, the mechanism to expand its use, to use it as a development bank for economic diversification is included, and when the need for such a use is demonstrated, and such a use would be prudent, it will be available for that purpose.

The widespread interest in the permanent fund and statewide concern for it mandate prudence and caution. I know that you agree and hope that the proposed measure is favorably considered.

Sincerely,


Jay S. Hammond
Governor

SENATE BILL NO. 227 by Senators Colletta and Stimson, entitled:

"An Act relating to insurance for alcoholism and drug dependency."

was read the first time and referred to the Health, Education and Social Services Committee and the Judiciary Committee.

The above bill will not be available in the Documents Room until further notice.

SENATE BILL NO. 228 by the Rules Committee by request of the Governor, entitled:

"An Act relating to the excise tax on and license fees for sale of intoxicating liquors; and providing for an effective date."

was read the first time and referred to the Commerce Committee and the Finance Committee.

Fiscal note and Governor's transmittal letter will be printed in a future journal.

SENATE BILL NO. 228 will not be available in the Documents Room until further notice.

SPECIAL ORDERS

Senator Sackett moved and asked unanimous consent that he be excused from a call of the Senate, February 15 and 16. Without objection, Senator Sackett was excused.



STATE OF ALASKA
OFFICE OF THE GOVERNOR
JUNEAU

March 29, 1979

The Honorable Hugh Malone
Chairman
Special Committee for the
Permanent Fund
House of Representatives
Alaska State Legislature
Juneau, Alaska 99811

Dear Mr. Chairman:

I understand that you have requested a statement of my position on the special funds and accounts which have been created by the legislature. According to the Attorney General, the constitutionally mandated Permanent Fund, which was adopted by a constitutional amendment in 1976, is exempted from the constitutional prohibition against dedicated funds. I am aware that legislative counsel has concluded that the Renewable Resources Fund is also constitutionally protected, allegedly having been grandfathered into existence by the same constitutional amendment which created the Permanent Fund. But at this point in time, the only ruling from the Attorney General's Office which I have received, raises some doubt about the requirement to treat anything other than the Permanent Fund as inviolate. Apparently, the other funds and accounts are subject to legislative appropriation and are not dedicated or automatically allocated.

I recognize that the legislature has the legal authority to fund all of these special accounts, if it wishes and if it has the money to do so. The budget which I submit to the legislature is my recommendation on expenditures and allocations which I feel are the best use of the financial resources available to the State. I make those recommendations on the basis of needs, as I understand them to be; they may or may not reflect the percentages expressed in prior legislatures' special accounts and funds, which I consider to be recommendations and not constitutional requirements. These comments apply not only to the funds which the legislature adopted last year, i.e., capital outlay reserve, energy facility reserve, etc., but also to the formula allocations, i.e., school foundation, revenue sharing, community schools, etc. The legislature itself has frequently "underfunded" or ignored such formulas and accounts. Both branches should, and I believe, do consider these as recommendations, not requirements.

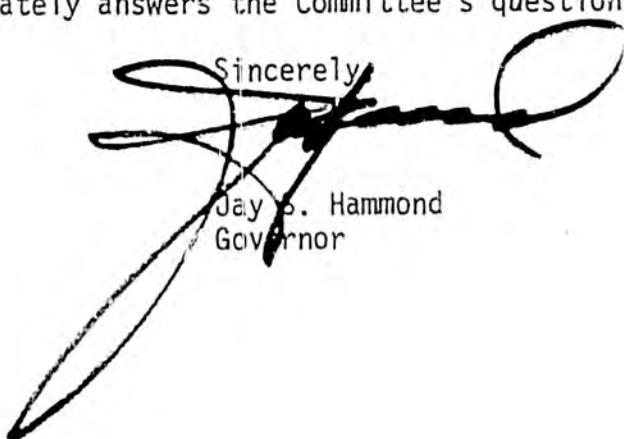
What then is the purpose of those special formulas, accounts, funds, reserves? The first purpose is as a policy statement: to the extent that monies are available, these purposes should be considered and be weighed against other alternatives for funding. The second purpose is for planning. To the extent that other groups (school boards, municipal governments, etc.) are dependent upon State funding for their programs, they should have some guidance on the level of funding which may be available for those programs.

March 29, 1979

As indicated above, the Permanent Fund is an exception to these generalizations, because of its constitutional status. Similarly, I consider the Public School Fund an exception because it was created to replace the constitutionally mandated school trust lands. I feel that to fulfill our constitutional obligation to provide for school funding in the future and to implement the exchange of trust lands for a trust fund (as passed in the 1978 legislative session), we should fund that account for both FY 79 and FY 80.

I hope that this adequately answers the Committee's question.

Sincerely,



Jay S. Hammond
Governor

STATE OF ALASKA

OFFICE OF THE GOVERNOR

DIVISION OF POLICY DEVELOPMENT AND PLANNING

JAY S. HAMMOND, Governor

POUCH AD
JUNEAU, ALASKA 99811
PHONE: 465-3512

February 22, 1979

The Honorable Hugh Malone, Chairman
House Special Committee on the Alaska
Permanent Fund
Alaska State Legislature
Juneau, Alaska 99811

Dear Mr. Malone:

You have requested background information about SB 226/HB 277, Governor Hammond's enabling legislation for the Alaska Permanent Fund. When considering SB 226/HB 277, I believe it would be helpful to also consider at the same time two other measures which the Governor has introduced. The first is SJR 26/HJR 23, which would amend the Alaska Constitution to increase contributions to the permanent fund from 25% to 75%. The second is HB 99, which would distribute one-half of the earnings of the fund to Alaskans in the form of tax credits. These three bills represent a package which, when read together, accomplish the objectives set forth in the attached material.

I would like to share with you several documents which were instrumental in the formulation of policies embodied in the Governor's permanent fund package. The first document is a memo which describes the Governor's policy decisions regarding the purpose and use of the fund. The policy principles which the Governor has identified as those which should control the management of the fund are:

1. Investments should be based upon a list of eligible investments.
2. All other things being equal, preference should be given to in-state investments.
3. The Governor and the Legislature should select in general terms their preferences among types of eligible investments.
4. Market rates of interest should be earned on all Permanent Fund investments.
5. If the Legislature and the Governor wish to have certain categories of investment subsidized, such subsidies should be appropriated from the General Fund.
6. One half of Permanent Fund earnings should be returned to the public in the form of tax credits.

Honorable Hugh Malone
February 22, 1979
Page 2

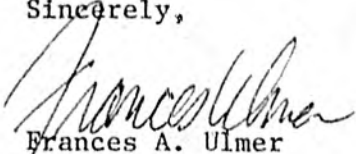
7. The other half of Permanent Fund earnings should be returned to the General Fund for use in the provision of public goods and services via the operating budget.
8. Thorough reporting and audit requirements should be included in the legislation.
9. Fund managers should not be responsible for designing or deciding upon economic or social policy.

The first document offered provides a more detailed explanation of these principles and explains how the Governor's permanent fund bill incorporates these policies.

The second document is a section-by-section outline of SB 226/HB 227. The third document is "The Alaska Permanent Fund - A Decision Guide" which summarizes our view of the permanent fund issues at the close of the last legislative session.

I hope these documents will assist your understanding of the Governor's proposal. We will be happy to provide any additional information to your committee as needed.

Sincerely,


Frances A. Ulmer
Director

Attachments
FAU:ms

TO: [Rep. Hugh Malone

DATE: March 28, 1979

FILE NO:

TELEPHONE NO:

FROM:  Fran Ulmer

SUBJECT: Re: Permanent Fund Income

The following is in response to your question concerning the Governor's preference for use of permanent fund income. As you know, the Governor proposed the Alaska, Inc. idea several years ago. This idea was introduced into the 10th Alaska legislature as HB525/SB384. It provided for cash distribution of at least 50% of permanent fund earnings via shares (based on residency) in Alaska, Inc.

The Governor has introduced a similar plan this session as HB99. This plan would distribute at least one-half of permanent fund earnings in the form of tax credits.

Generally speaking, the Governor desires that all Alaskans share directly and equitably in at least some portion of the earnings of the permanent fund. The Governor also seeks to give individuals a stake in the budget process by providing a direct link to that process; i.e., contributions to the permanent fund and higher earnings vs. budgetary expenditures and higher level of government services, and permanent fund earnings be designed so as to not stimulate immigration. Attached to this memo you will find two speeches by Gov. Hammond which elaborate on these themes. Basically, the Governor is not wedded to any particular proposal, and welcomes any ideas which will implement these goals.

Attachments

"... If Alaska, Inc. would do what many believe it might ... isn't it worth gambling one-sixteenth of the income from our non-renewable resource wealth?"

~~financial practice.~~

~~In my two years as governor, it has become increasingly apparent that unless we are able to make that shift, we have commenced a countdown to chaos which will make New York's financial plight seem trivial by contrast. One means of possibly helping us make that shift is a proposal I've put forth which would make each Alaskan a shareholder in our resource stocks. It's my hope that, by giving John Q. Alaskan a "piece of the action", we'll also be giving him an increased awareness of the improper uses those resource dollars are often put to. I call this grass roots revenue sharing proposal "ALASKA, INC.". I'll begin outlining it in the next article in this series.~~

FACING UP TO THE FUTURE

Part Four of a Five-Part Series

by

Governor Jay S. Hammond

"Alaska, Inc." - One Possible Solution

The "Alaska, Inc." proposal is not something which the public can or should accept without examination. It will only come about if the public concludes it provides the best, perhaps the only, means by which we can possibly shift now to an appropriate "pay as you go system" before it is too late. It will come about not because we politicians have told the public it should, but because the public concludes, as have I, that it may be the only way to assure that at least a portion of our non-renewable resource wealth is returned in some discernible benefit form to Alaskans both here now and in the future.

However, the only way it's likely to happen is if the people demand it. Otherwise, expect business as usual. Save for that small percentage of non-recurring resource wealth which must by constitutional mandate go into the permanent fund, inevitably ever greater amounts of our non-recurring wealth will be used to fund state government spending before most politicians would dream of offending the electorate by suggesting new taxes.

Therein lies the most compelling arguments in behalf of dispersing dividends to citizen shareholders in "Alaska, Inc.". We are blessed as no other state has been; we can afford to try something different. In fact, it may be we cannot afford not to.

The basic question as to how we use our income from investment of our resource inheritance wealth is this: Do you believe as I that all Alaskans should share equally in at least a portion of that income? If you do, "Alaska, Inc." may be the only means by which this can be done.

The "Alaska, Inc." bill we are introducing will be a blueprint for discussion. It should not be acted on this year. I submit it to provide merely something to build upon or be torn asunder. It incorporates features and procedures designed to ease administrative costs; reduce fraud; provides no inducement for persons to come to Alaska; permits options which reduce the federal tax bite; permits us to shift to appropriate tax schedules without undue cost to most Alaskans now here.

It obligates but a minor portion of the income earned from permanent fund investments. The great bulk of such income can still be used for expanding government. Hopefully, however, once the public is conditioned to the "Alaska, Inc." concept, there would be ever greater restraints placed upon those who would spend monies from depleting non-renewable resources. I would hope that ultimately 100 percent of such revenues were placed into the permanent fund. However, we cannot do that in one jump.

It will take a long time to wean ourselves away from siphoning "nest egg" inheritance oil dollars into state salaries and services. However, even the modest amounts of money committed under present law to the permanent fund should at least start to turn down the tap.

The blueprint bill which we will introduce provides that a person who has been physically present in Alaska during the majority of each of five years would be eligible to receive a dividend check for a share of earnings derived from investments of permanent fund oil money. Shareholders would make application by signing an affidavit attached to state income tax forms. That affidavit would attest, under penalty of losing all future benefits for perjury, that one had met the qualifications which, along with physical presence, required that one be registered to vote. There will be an option to defer receiver dividends for those who find that under such deferral they could reduce the federal tax bite. Persons 65 years of age who qualified would initially receive two shares. Subject to the effective date of the legislation, for each subsequent five years during which an individual met the qualifications, an additional share would be conveyed. Children, upon achieving the age of 18 and otherwise meeting eligibility requirements, would receive one share for each accumulative five year period subsequent to the date of the act.

Possibly we should provide that those imposing costs on the state should have the dividends used to defray those costs. For example, we might

charge room and board of those housed in our correctional facilities.

There are some of course who's earned income is such that state dividends could be largely offset by federal income taxes. An option to defer receipt of dividends until retirement age or some such time could go a long way to offset the federal tax bite. A tax audit option also should be considered.

Since oil royalties and lease bonuses make up but a portion of revenues derived from oil, there will still be a significant amount of oil revenues from severance taxes available for spending through general fund appropriations, just as now. Under a constitutional amendment establishing the permanent fund, only 25 percent of just lease bonuses and royalties would have to go into the permanent fund. If leases bonuses and royalties made up 50 percent of the annual income to the state from oil, that means that only one-eighth of our annual income from oil would be placed into the permanent fund. In turn, under our "Alaska, Inc." proposal, but one-half the earnings from permanent fund investments, or one-sixteenth of the potential earnings from our oil wealth, would be dispersed in dividends to qualified Alaskans. If "Alaska, Inc." would do what many believe it might insofar as suppressing government growth to the level people would permit themselves to be taxed; creating public pressures to place additional depleting non-renewable resource wealth into the permanent fund; assuring that all Alaskans received some discernible benefit from their share of our resource wealth and that those flocking to Alaska in the

future really paid their way rather than requiring the state to subsidize their presence; if it even possibly could do these, isn't it worth gambling one-sixteenth of the income from our non-renewable resource wealth? or, should we permit it to go the way of the \$900 million instead?

While the initial dividends to be paid Alaskan shareholders might be modest, by increasing the amount of oil wealth within the permanent fund or the percentage allocated to dividends. Those dividends could be significant. They could more than offset the additional costs to most Alaskans now here of appropriate taxes to which we must begin to shift if we ever hope to start "paying as we go" for government—or not going!

"... The more I have considered the objections raised and explored possible alternatives, the more I have become convinced it may be the only means by which we can possibly once more begin to 'pay our way'."

FACING UP TO THE FUTURE

Part Five of a Five-Part Series

by

Governor Jay S. Hammond

In Defense of "Alaska, Inc."

Of course, there have been objections raised to the "Alaska, Inc." concept. I was reluctant to float it out because I knew it would be vulnerable politically. Yet, the more I have considered the objections raised and explored possible alternatives, the more I have become convinced it may be the only means by which we can possibly once more begin to "pay our way".

Among the main objections I have heard raised is the suggestion that to pay dividends directly to Alaskan shareholders would pander to the public's "greed". But even if such would be the case, would it not be refreshing to have the public's so-called "greed" working to suppress the growth of government and state budgets to counter special interest "greed"? Of course, one man's presumed "need" becomes the other fellow's "greed". Regardless of the terminology, it would be interesting to have the modifying influence of the public's "greed" or "need" countering that of special interests or the pork barrel process. Another objection has been that such a program would create pressure from the public to exploit our resources at a less than prudent pace. But those pressures could not be worse than the pressures we are faced with now. It would be much easier to

resist public pressures to lease out all our oil lands as quickly as possible simply to achieve a larger dividend than it is under the present circumstances to resist putting up new oil leases each time the growth of government demands an increase in revenues. Such was the case when I took over this administration. Faced with a \$200 million shortfall, I had little choice but to cast around for some immediate revenues. Obviously, I could not double the income tax. The only thing I could assuredly do was to find another oil province to lease and hope we could raise enough money. Thus, I was almost compelled to put up the Beaufort Sea leases simply to meet the state's payroll, despite the fact the time was not the most auspicious nor the price potentially top dollar. That's a lousy way to be forced to do business. However, unless we shift to funding government from appropriate tax dollars it's only a matter of time before this governor or the next will be forced to start selling lands to pay off the help.

Some have suggested that if you believe that all Alaskans should share equally in our non-renewable resource wealth, perhaps we should simply sell it all and disperse shares directly to Alaskans rather than placing that wealth into a permanent fund. I disagree most emphatically. That wealth does not belong to simply those of this generation. It belongs to Alaskans now and in the future.

Some have said the program would be difficult to administer and would lead to fraud and litigation. By using an affidavit attached to one's income

tax return, we not only will increase the number of income tax filings but simplify the process of application. Moreover, it is unlikely that many will be inclined to cheat if they are made aware that if by so doing they would foreclose the opportunity to ever again participate in the program. Since initially all who qualified would receive but one modest share, it is unlikely there'd be much inducement for an individual to jeopardize his potential long-term earnings by perjuring himself. An additional safeguard could be structured into the act by simply requiring that applicants must submit, upon demand, evidence supporting their contended qualifications. Such evidence might consist of affidavits from two prospective shareholders who, if found to have perjured themselves, would also lose forevermore prospective benefits. Procedures such as these would certainly cut down on the potential for abuse.

While dispensing dividend checks to Alaskans may seem unusual, if one thinks about it, no matter how we use State monies, they are dispersed in "dividends" from a gigantic people's owned business corporation we could call "Alaska, Inc." If we use the money to cut taxes, a "dividend" is granted taxpayers. Use it to expand services; recipients of these services receive a "dividend". If we use it for municipal revenue sharing, "dividends" are conveyed to municipal dwellers.

While some investment earnings from "nest egg" wealth in the Permanent Fund could and will no doubt be used for the above purposes, all such "dividends" are selectively dispersed. What about the individual who

lives outside a municipality? Or who makes too little income to pay taxes? Or who receives no welfare benefits and few, if any, State services? Does not he also deserve a "dividend" from that wealth which belongs to all Alaskans? Perhaps the only way he can ever expect to see a share of ... that wealth is if he actually receives a dividend check. Perhaps we should take a page from the Native Land Claims Act. The Natives foresaw that the only way some of their corporate shareholders might see any part of their wealth was to distribute a portion in the form of a direct dividend check. However, they are distributing a portion of their capital nest egg wealth. I propose something far more modest: a distribution not of the "nest egg" wealth itself but a part of its earnings.

It seems to me that no matter how we use the income from our "nest egg" wealth, a major objective should be to see that at least a portion of it is distributed equitably. Should someone come forth with a more equitable means of assuring that all Alaskans can have a "piece of the action" than direct dividend checks, I welcome that information. To date nobody has.

Some say municipal revenue sharing's the way we should go. I don't think most Alaskans agree. However, there's an easy way to find out. Let people exercise local option. Should they elect to have all dividends go to the municipality rather than to themselves, so be it. However, I suspect most would like to have a chance to decide for themselves how

they would spend at least a small part of their wealth rather than leave all of such decisions up to elected officials.

Polls have shown that confidence in the way public monies are spent is inversely proportionate to the distance you remove those monies from the public's control. Thus, the public has least confidence that the federal government spends their money wisely. Somewhat more confidence in state government; and far more in local government since they at least have those who will spend it within their arms length. "However, if you really want my dollars spent wisely," says the average citizen, "let me say where they are spent." I think it's high time we listened.

STATE OF ALASKA

JAY S. HAMMOND, GOVERNOR

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September 16, 1977

Hon. Clark Gruening
Chairman
House Special Committee on
the Permanent Fund
528 West Fifth, Suite 270
Anchorage, Alaska 99501

Re: Permanent fund, accounting
for inflation; our file J-66-107-78

Dear Representative Gruening:

You have asked whether there is any legal requirement that the statutory guidelines for administering the permanent fund take inflation into consideration.

We believe that the answer is no.

The answer to your question requires an inquiry into the legal nature of the permanent fund and, there being no law on the precise subject, involves some speculation.

First, we believe that, despite the absence of an actual transfer of legal and equitable interests to a trustee and beneficiary respectively, the Alaska Supreme Court will treat the permanent fund as a trust or quasi-trust, and as a general rule, apply trust concepts in determining its administrators' duties. We make this assumption (1) because of the tendency of the court, exemplified by such cases as Moore v. State, 553 P.2d 8 (Alaska 1976), to impose trust-like duties upon the State's management of its patrimony, and (2) because the constitutional amendment which created the permanent