

ALASKA LEGISLATIVE COUNCIL / HOUSE SPECIAL COMM. ON PERMANENT FUND 1978-80

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

Q. Why has it been so difficult for the House and Senate to agree on the management and investment of the Permanent Fund?

A. Probably, because of differences in political philosophy and a composite of misunderstandings in regard to the differences between the two Bills. It is the goal of every legislator whether he be a Representative or Senator to do the utmost to benefit Alaska. With this goal in mind, it would seem inescapable that SB 1 would be the most advantageous to Alaskans for the reasons outlined in this questionnaire. However, differing views and ideas are certainly encouraged and all thoughts in regard to the Permanent Fund and its investment should be analyzed before laying the foundations which will ultimately affect the future of Alaska. It would be beneficial to the legislature for persons to become informed and provide information in regard to the management and investment of the Permanent Fund. Positive feedback in the form of letters, telegrams, and participation in the upcoming video conferences is encouraged in order to get as much public input as possible. It is in this manner that the legislature can fulfill its mandate to act in the best interest of all Alaskans.

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dry

J. Tobin

Alaska's Legislature routinely the millions — or is it billions? sn't make much of an impres- hundred grand, and a little bit d it's no easy task to come by, takes home a weekly paycheck or an honest hour's work. And to be a small businessman try- al investment, to manufacture service to customers — and e a few jobs for working men

if you happen to be a high school buck manufacturing and selling ights. Or ice scrapers. Or Christ- ons. Or T-shirts. Or desk-top book- coupage for sale. Or making pen- erating the concession stands for

RED out by now that this It is. It represents next year's ent program, which this year ers involved in doing precisely n companies which manufac- ices, all backed by shares of relatives, all hoping to end the to be paid to themselves and hareholders.

nd one worth devoting some time s participants always call it) has he money it needs to finance next ates on May 15, which also coin- banquet. At that gala dinner af- ers and members of the various uther to salute this year's work — r success, and to pay tribute to rd way that the world of private is bathed in red ink, as well as

The Anchorage Times

City/State

Section

B

Businessmen plead for loans

Associated Press

Juneau — Wearing badges pro- claiming they are the "indignant sur- vivors," 18 men and women in busi- ness pleaded with — and sometimes threatened — legislators to appropri- ate more money for low-cost loans.

The group traveled to Juneau at their own expense to counter a week- long parade of consultants that a House-Senate free conference com- mittee on the permanent fund heard this week. Most of the consultants, hired by the administration or the House, told conferees that the per- manent fund earnings should proba- bly not be used to finance state loan programs.

The citizens' delegation here Fri- day included some persons who had

been among an angry crowd that challenged Gov. Jay Hammond to get more loan money out last week in Anchorage.

Hammond on Friday announced the state will pump an additional \$75 million into low-interest business loans, and declared a three-month moratorium on foreclosures on state business loans.

(Related Story, A-1)

Angie Kruckenberg, owner of OK Lumber in Fairbanks, led off the tes- timony with an emotional plea for 8 percent interest loans, and con- cluded to a round of applause.

"Let this money be used for the small businesses in Alaska at low in- terest," she said. "Turn it over and make money for us and make us one

of the wealthiest countries in the world. We have the best people in the country here in Alaska, and they are ambitious. It makes me cry to see the billions of dollars going stateside to feather somebody else's nest."

Like many of the witnesss, she told the committee of her own finan- cial problems, saying she and her husband came to Alaska in 1973, bought "nine acres of swamp" which they have filled in and created "probably one of the most updated lumber yards in Fairbanks."

She said they got into the lumber business to supply construction re- sulting from the trans-Alaska pipe- line, but now are unable to purchase the necessary \$1.5 million to \$2 mil- lion inventory needed to survive. She

said a \$300,000 ceiling on personal loans is "peanuts."

"We want to put in a truss fac- tory, but we had to spend everything we had to build a warehouse. What can you do with \$300,000 (which she has borrowed from the state) except build a warehouse that might sit empty?"

"We have people like myself who have ambitions, but we can't get the dollars to coincide with our equity," she complained, adding that her business is worth \$7 million but she can't borrow against it.

Pat Stephan of Anchorage said that instead of allowing the free en- terprise system to work, the govern- ment is running people out of busi-

(See LOANS, Page B-2)

Official enters plea of innocent

Associated Press

Juneau — Former state Depart- ment of Education transportation of- ficer Greg Thies pleaded not guilty in Juneau Superior Court Friday to charges of embezzling public money.

Thies, 33, was arraigned on two charges of embezzling a total of \$40,571.24 in money that was to have gone to the Anchorage and Lower Yukon school districts.

Thies was secretly indicted by a Juneau grand jury on March 6.

He was fired from the Depart- ment of Education last July for un-



The night was a
success. The
entertainment
was a
great success.
The night was
a success.

"Hey, friend, we've had it. If there's violence, if there's an eruption of the population to do some-

"As a psychologist, I'm scared. Those meetings were rowdy. Unless people get a realistic feeling that they're in control of their lives again, their anger is going to be increasing," added Dr. Robert Colman of

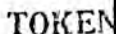
Officials from the Metropolitan Edison Co., operator and part owner of the plant, spoke briefly at the end of the ing. They said they would support the NRC's efforts to better inform residents around the plant of the cleanup operation.

Philadelphia's
reputed leader
the Philadelphia
area since 1966.
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say.

(Continued from Page B-1)

"I want to earn," Seibel said. "I want to make my own way. This money should be loaned to the people."

Johnson also said that there is strong support to recall Hammond and warned that legislators, too, might find themselves "recalled" after this fall's election.



Kenneth Taylor, left, formerly Canada's ambassador to Iran, holds up a key to New York City Friday after it was presented to him by New York Mayor Ed Koch. Taylor's wife, Dr.

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Sen. Hohman's revenue plan

SEN. GEORGE HOHMAN, the influential Democratic legislator from Bethel, merits some kind of special award. He's come forward — through the unveiling of his long-nourished plan of how the state should use revenue from the permanent fund — with what may be the biggest spending bill ever introduced by a single legislator in Juneau.

Under terms of Mr. Hohman's bill, just about anybody could get a big state loan for any purpose whatever — assuming, of course, there is any money left to lend after the state met other provi-

sions of the senator's legislation.

The loans to individuals and businesses presumably are optional under Mr. Hohman's bill. But he would make it mandatory that the state make loans of up to \$5 million whenever asked to do so by towns under 5,000 population or by non-profit corporations. It also would be mandatory for the state to buy bonds at 6 percent interest from any community with less than 5,000 population if there were no other purchasers standing in line.

So much for the permanent fund.

Power of community councils

A NEW CIVIC awareness of the power and influence that a... attending a meeting of the Turn-again Community Council rene-

March 5, 1980

The Alaska Permanent Fund and Management of Alaska's Wealth

This information is provided by Representative Hugh Malone, chairman of the House Special Committee on the Permanent Fund and a member of the free conference committee on the Permanent Fund.

The Alaska Permanent Fund was established by the voters in 1976 to receive at least 25% of all mineral royalties and bonuses. What this means in real terms is that approximately one out of every eight dollars which the state receives in oil revenues is deposited in the Permanent Fund. The fund currently contains about \$350 million and is earning interest of over 11%. It is being invested by the Department of Revenue under an interim management plan, and the earnings flow into the general fund. The legislature has yet to decide just how the Permanent Fund shall be invested and managed over the long-run. A free conference committee, of three House and three Senate members, is presently meeting in an attempt to reach agreement on Permanent Fund legislation.

Alaska today is in the unique position of having enough money to adequately provide governmental services; to construct needed capital projects; to eliminate the personal income tax, expand loan opportunities, and return a share of the oil wealth to Alaskans as dividends; and to save a portion of the wealth for the future. Although earnings of the Permanent Fund will never completely replace today's oil revenues, they can go a long way towards helping stabilize the Alaskan economy and reducing the need for personal income tax payments in the

future.

Q. What are the basic components of the House Permanent Fund bill (HCS for SB 161)?

A. The House bill focuses on the management of the Permanent Fund and addresses three major concerns-- safety of principal, accountability, and legislative oversight. The fund would be invested as a trust consisting of a wide variety of quality, high-grade investments. These investments have been described as "squeaky conservative." The House also decided that the fund, because of its fundamentally different goals, should not be invested by the same people who manage money for day-to-day use by the state-- the Department of Revenue-- but should be managed by a public corporation distinct from state government. The proposed Permanent Fund Corporation, with its own board of trustees, would be made accountable in several ways. The House bill also expands the powers and duties of the Legislative Budget and Audit Committee to oversee all lending and investment functions of the state, including those of the Permanent Fund Corporation.

Q. How much money would the House bill deposit into the Permanent Fund?

A. The House bill would raise the contribution level to the Permanent Fund from the current 25% to 50% of all bonuses, 25% of royalties from existing leases, and 50% of royalties from new leases. It's important to remember that 50% of bonuses and royalties actually means about 25% of all oil revenues, so that three-quarters of state revenues would still be going to the general fund for general governmental purposes.

Q. What would be the advantages of investing the Permanent Fund according to the House plan?

A. The Permanent Fund, if invested as an "inviolable trust," would be just as secure as possible and would return substantial earnings to Alaskans. Because the investments would be diversified and would not rise and fall with Alaska's economy, the earnings would be stable. In addition, the establishment of a secure trust would be a sign to the national financial community that Alaska is following a responsible fiscal policy. The passage of the House bill would not preclude aiding the state's economy in other ways as well. Loan programs, capital projects, tax repeals or refunds-- all these can be taken care of through the general fund.

Q. Under the House plan, what would happen to the fund's earnings?

A. The earnings would flow into the general fund, just as they do today. Future legislatures would still have the option of redirecting the earnings. Paying them as dividends to today's Alaskans is one idea.

Q. How does the Hohman bill (SB 1) differ from the House bill?

A. Senator Hohman's bill is an extremely long and complex one which deals only peripherally with the Permanent Fund. SB 1 provides for the elimination of existing loan programs and development authorities and the substitution of a new program combining all loan purposes. The loan program would be tied to the Permanent Fund by using the Permanent Fund earnings to guarantee revenue bonds to fund the loans. The Hohman bill also differs from the House bill in that its Permanent Fund investment list is much broader (and less secure), its contribu-

tion rate is set at 100% of bonuses and 25% of royalties, and the fund is managed by the Department of Revenue.

Q. What are the House objections to the Hohman bill?

A. The primary objection is that it is concerned much more with the state's loan programs than with the Permanent Fund, and that a free conference committee on the Permanent Fund is not the place to so drastically restructure the loan programs. SB 1 is extremely complex and, if implemented, would have far-reaching consequences for the state's economy and credit rating. Specific problems with the concept include 1) the earnings of the Permanent Fund are put at risk, 2) consolidation of the loan programs does not solve the existing problem of access to them, 3) the programs would receive automatic funding without legislative review, 4) there is no method of prioritization and the different loan programs could not be judged separately on their merits, and 4) municipalities would be encouraged to issue unrestricted debt.

Q. What does the House offer as an alternative to the loan program portion of SB 1?

A. The House Finance Committee is currently developing a package of loan bills which will address the needs of Alaskans for easily accessible and low-cost loans. Although the details are yet to be worked out, some consolidation will occur and loans will be made available for financing housing and businesses. Emphasis will be placed on ensuring that those people who most needs loans receive them. Interest rates will be reasonable. I feel confident that the House will pass comprehensive and responsible loan legislation within the

next several weeks. I might add that \$35 million a month in state funds is right now available for Alaskan mortgages through HCR 33, sponsored by the House Finance Committee this session.

Q. What does the state's financial picture look like for the next few years?

A. The latest financial projections are very impressive. With the Permanent Fund receiving just 25% of royalties and bonuses and with the earnings being distributed to the public, at the end of 1982 we should have about \$1.2 billion in the Permanent Fund and \$6.7 billion in the general fund. Since, at current growth and inflation rates, \$1.6 billion will be needed to meet the state budget, there will be over \$5 billion extra in the general fund to be appropriated for whatever purposes the legislature desires. While the opportunities for spending money within the state are vast, the legislature also bears an unprecedented responsibility to manage Alaska's new wealth wisely. Setting a portion of it aside in a secure Permanent Fund should be one step in responding to that responsibility.

SCOMM

#18:30

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REPEALERS -- SB 1 (1980)

The following existing loan funds, authorities, and development corporations are effectively repealed by the current version of SB 1.

- 03.10 Agricultural Revolving Loan Fund
- 16.10 Commercial Fishing Revolving Loan Fund
- 16.10 Fisheries Enhancement Revolving Loan Fund
- 18.26 Alaska Medical Facility Authority
- 18.56 Alaska Housing Finance Corporation
- 18.100 Housing Development Revolving Loan Fund (allows grants only)
- 18.100 Senior Citizens Housing Development Fund (allows grants only)
- 26.15 Veterans Revolving Loan Fund
- 41.22 Outdoor Recreational, Open Space, and Historical Properties Development Fund
- 41.30 Area Redevelopment Revolving Loan Fund
- 44.33 Child Care Facility Revolving Loan Fund
- 44.33 Residential Care Facility Revolving Loan Fund
- 44.55 Alaska Gas Pipeline Financing Authority
- 44.56 Alaska Power Authority
- 44.58 Alaska Municipal Bond Bank Authority
- 44.59 Alaska State Development Corporation
- 44.60 Alaska Small Business Development Corporation
- 44.61 Alaska Industrial Development Corporation
- 45.86 Water Resources Revolving Loan Fund
- 45.88 Alternative Technology and Power Resources Revolving Loan Fund
- 45.90 Tourism Revolving Loan Fund
- 45.95 Small Business Revolving Loan Fund
- 45.98 Historical District Revolving Loan Fund

Existing funds and corporations which are not repealed by SB 1 are:

- 14.40 Scholarship Revolving Loan Fund (apparently an oversight)
- 14.40 Memorial Scholarship Revolving Loan Fund (apparent oversight)
- 44.47 Temperate Social Activities Revolving Loan Fund
- 44.56 Power Project Revolving Fund (an oversight?)
- 44.19 Disaster Relief Fund
- 37.11 Alaska Economic Disaster Impact Fund
- 37.12 Alaska Renewable Resources Corporation
- 44.54 Commercial Fishing and Agriculture Bank

NOTES ON PURPOSES, ORGANIZATION,
MANAGEMENT AND REPORTING
PROPOSALS IN SB 1

I. The Alaska Permanent Fund

A. Purposes

- A separate fund consisting of certain state mineral revenues.
- Used for income-producing investments which may include in-state investments that have a risk level and expected yield comparable to specified alternative investment opportunities and consistent with the prudent-man rule.
- Permanent: "1. Fixed and changeless; lasting or meant to last indefinitely" (Source: The American Heritage Dictionary of the English Language, 1970).
"1. Lasting or intended to last indefinitely without change; continuing in the same state or in the same place, stable, durable, abiding." (Source: Webster's New Universal Dictionary of the English Language, 1976)
- Accumulate sufficient income in the Fund to allow diversification of Alaska's economy and to insure that future generations receive benefits from development of the State's nonrenewable resources (Source: Joint Chairman's Report on CS SSHJR 39, March 24, 1976).
- Purpose of the income is to secure obligations of the proposed Alaska Loan Programs Fund.

B. Organization, Management and Reporting for the Principal (assets) of the Alaska Permanent Fund

- Policy decisions about permissible types and proportions of investments would be made by the legislature and contained in the statute.
- Operational decisions about specific investments would be taken by the Commissioner of Revenue and his staff.
- Commissioner of Revenue is appointed by the Governor, confirmed by the Legislature, and serves at the pleasure of the Governor.
- Annual operating budget subject to the Executive Budget Act.
- Quarterly and annual investment reports to the Legislative Budget and Audit Committee, Investment Oversight Division (proposed).
- Annual report to Governor, Legislature, and public.

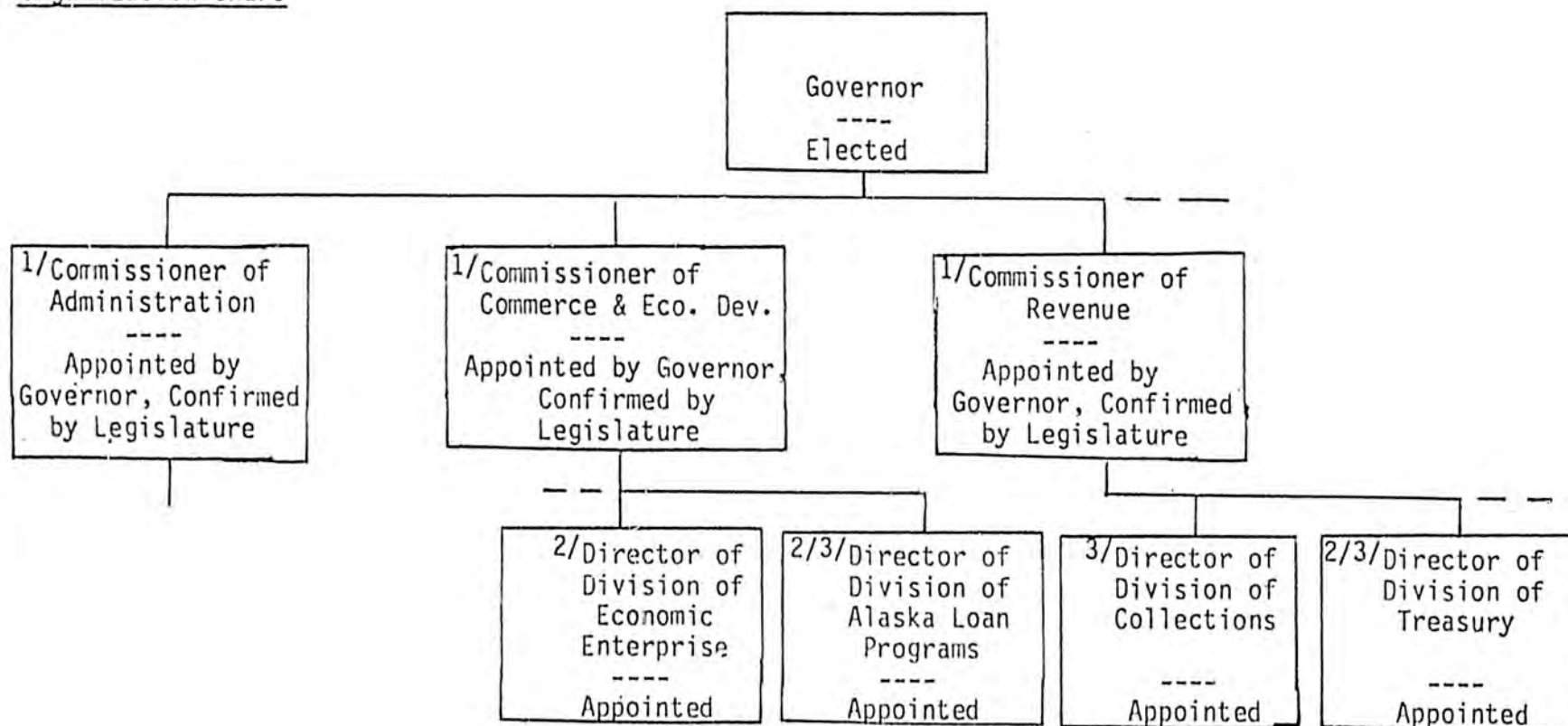
II. The Alaska Loan Programs Fund

A. Purposes

- Use virtually all the State's financial resources, other than those required for normal operations of State government.
- Provide the lowest possible interest costs to Alaska borrowers, consistent with sound financial practices.
- Make available to all sectors of the Alaska economy loans including long-term financing.
- Establish a strong, single loan source.
- Make a significant contribution to lowering costs of living for Alaska residents and costs of operations in the private and public sector(s).
- Import capital to fund loans to the veterans, housing, commercial, public, non-profit, and education sectors in Alaska.
- Refund any or all existing state or municipal general obligation and revenue bonds.
- Provide fire and liability insurance for projects financed by the Alaska Loan Programs Fund.
- Provide a market for all future general obligation bonds issued by Alaska municipalities.

B. Management of the "Alaska Loan Programs Fund."

Organization Chart



Notes: 1/These three Commissioners function as the "State Bond Committee"

2/These three Directors would function as the "Alaska Loan Programs Evaluation Committee"

3/These three Directors could be classified as partially exempt

C. Decisions

- Policy decisions about general loan program sectors; i.e., municipalities with populations less than 5,000, non-profit corporations, all other municipalities, veterans, industrial development, education, tourism, child care facilities, fishermen and other business; individual loan amount upper limits and recipient categories would be made by the Legislature and included in the statute.
- Policy decisions about the amount of revenue bonds to be sold to provide funding of the Alaska Loan Programs Fund would be made by the State Bond Committee.
- Policy decisions about the investment of fund cash balances and reserve accounts would be made by the Director of the Division of Treasury, subject to the approval of the Commissioner of Revenue, unless disapproved by the Legislature within a period of 60 days.
- Policy decisions about the total amount of loans to be made to various sectors of the economy would be made by the Director of the Division of Loan Programs, apparently without reference to a Commissioner.
- Policy decisions about interest rates to be charged would be made by the Commissioner of Revenue.
- Policy decisions about further subsidies of interest rates to be charged would be made by other loan agencies such as the ARRC.
- Operating decisions about rescheduling and foreclosing on delinquent loans would be made by the Alaska Loan Programs Evaluation Committee apparently without reference to a Commissioner.
- Annual operating budget subject to the Executive Budget Act.

D. Reporting

- Monthly reports on investments by Director of the Division of Treasury to the Legislative Budget and Audit Committee.
- Monthly reports on loan defaults by the Department of Administration to the Departments of Revenue and Commerce and Economic Development, and to the Legislative Budget and Audit Committee.

- Monthly reports on loan collections by the Division of Collections to the Legislative Budget and Audit Committee.
- Quarterly reports on investments, defaults and collections by the Legislative Budget and Audit Committee to the Legislature.

P. B. McDowell
February 29, 1980

NOTES ON LOAN PROGRAMS/REVENUE BONDING AUTHORITIES

A. General Notes

What are the possible goals of the Legislature (House)?

1. Primary Goals

- (a) Import capital to fund housing, business/industry and state/municipal capital projects in Alaska.
- (b) Expand the Alaska economy in terms of GDP and personal disposable income of present residents, (not in terms of revenue to state government).
- (c) Plan the economic development of Alaska, where
 - State government is the planning agency
 - Private and municipal sectors are encouraged (but not coerced) to fit into State plans with financial incentives provided by State bonding, loan and equity investment programs
- (d) Provide loans at below market interest rates to Alaskan residents, municipalities, and non-profit corporations for limited and/or unlimited purposes.
- (e) Make loan program/revenue bonding policy explicitly (on purpose) rather than implicitly (accidentally) as at present.
- (f) Unify various state loan programs into a single program to enhance planning for priorities and increase organizational visibility and legislative control.

2. Secondary Goals Re Management

- (i) Criterion: The distance from the Legislature with regard to policy and operating decisions.
- (ii) Definitions: Policy decisions are those which define the size, classes of expenditure and general criteria for differentiating among individual recipients of program funds or services.

Operating Decisions are those which differentiate among individual recipients and determine the amounts allocated to individual recipients.

Possibilities

- (a) Policy and operating management by the Legislature itself, or a subdivision thereof
- (b) Policy and operating management by independent state corporation separate from the Commissioner-headed departments
- (c) Policy and operating management by a single commissioner level department of the executive
- (d) Policy management by multiple commissioners (a committee) and operating management by state civil servants not subject to confirmation
- (e) Operating management by private sector commercial banking institutions
- (f) Policy and operating management by municipalities
- (g) Policy and operating management by non-profit and/or quasi-municipal government corporations
- (h) Policy and operating management by state civil servants below the levels subject to Legislative confirmation.

N.B. For all the alternatives above, policy and operating management could be separately assigned to any two alternatives.



1976

CHAPTER 2

THE ALBERTA HERITAGE SAVINGS TRUST FUND ACT

(Assented to May 19, 1976)

Preamble

WHEREAS substantial revenues are being received by the Province from the sale of non-renewable resources owned by the people of Alberta; and

WHEREAS there is a limited supply of non-renewable resources and therefore revenues from the sale of those resources will ultimately be reduced; and

WHEREAS it would be improvident to spend all such revenues as they are received; and

WHEREAS the Legislature of Alberta considers it appropriate that a substantial portion of those revenues be set aside and invested for the benefit of the people of Alberta in future years:

THEREFORE HER MAJESTY, by and with the advice and consent of the Legislative Assembly of Alberta, enacts as follows:

Definitions

1. In this Act,

- (a) "Investment Committee" means the Heritage Savings Trust Fund Investment Committee established under section 3;
- (b) "non-renewable resource revenue" means
 - (i) moneys received by the Crown pursuant to agreements as defined in *The Mines and Minerals Act*,
 - (ii) moneys received by the Crown as bonuses to acquire agreements as defined in *The Mines and Minerals Act*, and
 - (iii) moneys received under an agreement between the Crown in right of Alberta and the holder of a bituminous sands lease under which the Crown agrees to accept money payments in lieu of royalty under the lease;

- (c) "Special Act" with reference to any fiscal year after the 1976-77 fiscal year means an Act of the Legislature authorizing the transfer from the General Revenue Fund to the Trust Fund of 30 per cent of the non-renewable resource revenue received in that fiscal year;
- (d) "Trust Fund" means the Alberta Heritage Savings Trust Fund established under section 2.

Alberta
Heritage
Savings Trust
Fund

2. (1) There is hereby established a fund to be known as the "Alberta Heritage Savings Trust Fund".

(2) The Provincial Treasurer shall hold and administer the Trust Fund in accordance with this Act.

(3) The Provincial Treasurer shall establish and maintain a separate accounting record of the Trust Fund.

Heritage
Savings
Trust Fund
Investment
Committee

3. (1) There is hereby established a committee called the "Heritage Savings Trust Fund Investment Committee" consisting of all members of the Executive Council.

(2) The Investment Committee shall designate one of its members as chairman and another as vice-chairman.

(3) The Lieutenant Governor in Council may make rules governing the calling of meetings of the Investment Committee, the quorum required at its meetings and, generally, the conduct of the Committee's business and affairs.

Transfer of
assets

4. (1) As soon as practicable after the commencement of this Act, there shall be transferred from the General Revenue Fund to the Trust Fund \$1,500,000,000.

(2) The amount transferred pursuant to subsection (1) may be transferred in cash or other assets, but where assets other than cash are to be transferred, the Investment Committee shall, before any transfer is made, approve

- (a) the assets to be transferred,
- (b) the manner in which and the time or times at which the transfer is to be made, and
- (c) the valuation of the assets or the method by which the assets are to be valued,

and may impose such conditions relating to the transfer as the Investment Committee considers necessary.

(3) Where the Investment Committee is of the opinion that any asset to be transferred under subsection (1)

- (a) will yield a reasonable return or profit to the Trust Fund, and
- (b) will tend to strengthen and diversify the economy of Alberta,

the Investment Committee may direct that the asset upon its transfer shall form part of the Alberta Investment Division of the Trust Fund as if the asset were the subject of an investment made pursuant to section 6, subsection (1), clause (c).

(4) Assets other than cash that are transferred pursuant to subsection (1) and that do not form part of the Alberta Investment Division of the Trust Fund by virtue of a direction under subsection (3) shall consist only of assets within the classes enumerated in section 9, subsection (1) and upon being transferred shall be deemed to be investments made under that section.

(5) The income of the Trust Fund accrues to and forms part of the Trust Fund.

Transfer of
non-renewable
resource
revenue

5. (1) After the commencement of this Act,

- (a) 30 per cent of the non-renewable resource revenue received in the 1976-77 fiscal year shall be transferred from the General Revenue Fund to the Trust Fund in accordance with this Act;
- (b) 30 per cent of the non-renewable resource revenue received in the 1977-78 fiscal year shall be transferred from the General Revenue Fund to the Trust Fund in accordance with this Act but only if the transfer is authorized by a Special Act enacted in that fiscal year;
- (c) 30 per cent of the non-renewable resource revenue received in the 1978-79 fiscal year and in each fiscal year thereafter shall be transferred from the General Revenue Fund to the Trust Fund in accordance with this Act but only if, in the case of each fiscal year, the transfer is authorized by a Special Act enacted in the preceding fiscal year.

(2) The title of a Special Act shall be "The Alberta Heritage Savings Trust Fund Special Appropriation Act" followed by a reference to the fiscal year to which it relates.

(3) The President of the Executive Council or a member of the Executive Council designated by him for the purpose shall, with leave of the Assembly,

- (a) introduce during the 1977-78 fiscal year a Bill for a Special Act relating to the 1977-78 fiscal year, and
- (b) introduce during the 1977-78 fiscal year and during each fiscal year thereafter a Bill for a Special Act relating to the next succeeding fiscal year.

(4) The Provincial Treasurer shall, with respect to each month in

- (a) the 1976-77 fiscal year, and

(b) each succeeding fiscal year in respect of which a Special Act is enacted, transfer 30 per cent of the non-renewable resource revenue received in the month from the General Revenue Fund to the Trust Fund as soon as practicable after the end of the month in which it is received.

(5) Notwithstanding subsection (4), the Provincial Treasurer may, with respect to any month to which that subsection applies, estimate 30 per cent of the non-renewable resource revenue to be received in that month and transfer that sum from the General Revenue Fund to the Trust Fund during that month or as soon as practicable after the end of the month in respect of which the estimate is made.

(6) With respect to the 1976-77 fiscal year and each succeeding fiscal year in respect of which a Special Act is enacted, the Provincial Treasurer, depending upon whether the total of the sums transferred pursuant to subsections (4) and (5) is greater or less than 30 per cent of the non-renewable resource revenue received in that fiscal year as shown in the public accounts for that fiscal year, shall

- (a) transfer moneys from the General Revenue Fund to the Trust Fund, or
- (b) transfer moneys from the Trust Fund to the General Revenue Fund,

so that the amount of the non-renewable resource revenue in the Trust Fund for that fiscal year is equal to 30 per cent of the non-renewable resource revenue received in that fiscal year.

(7) No interest is payable with respect to any money transferred pursuant to this section to or from the General Revenue Fund or to or from the Trust Fund.

Divisions of
the Trust
Fund

6. (1) The assets of the Trust Fund shall be used for the following purposes:

- (a) the making of investments in projects which will provide long term economic or social benefits to the people of Alberta but which will not by their nature yield a return to the Trust Fund;
- (b) the making of investments by way of loans to
 - (i) the Crown in right of Canada, or
 - (ii) the Crown in right of any other province of Canada, or
 - (iii) any other person if the repayment of the loan and the payment of interest thereon by that person is guaranteed by the Crown in right of Canada or the Crown in right of any other province of Canada;
- (c) the making of investments which, in the opinion of the Investment Committee or in the opinion of

the Legislative Assembly as expressed in a resolution of the Assembly,

- (i) will yield a reasonable return or profit to the Trust Fund, and
- (ii) will tend to strengthen and diversify the economy of Alberta.

- (2) Investments referred to in subsection (1), clause (a)
 - (a) shall only be made if moneys are first appropriated from the Trust Fund by an Act of the Legislature specifically for a purpose described in subsection (1), clause (a),
 - (b) shall not exceed 20 per cent of the assets of the Trust Fund, and
 - (c) shall form the Capital Projects Division of the Trust Fund.
- (3) Investments referred to in subsection (1), clause (b)
 - (a) shall be made or approved by the Investment Committee in accordance with the directions contained in any resolution of the Legislative Assembly,
 - (b) in the absence of any such directions, shall be made only with the approval of the Investment Committee,
 - (c) shall not exceed 15 per cent of the assets of the Trust Fund, and
 - (d) shall form the Canada Investment Division of the Trust Fund.
- (4) Investments referred to in subsection (1), clause (c)
 - (a) shall be made or approved by the Investment Committee in accordance with the directions contained in any resolution of the Legislative Assembly,
 - (b) in the absence of any such directions, shall be made with the approval of the Investment Committee, and
 - (c) shall form the Alberta Investment Division of the Fund.
- (5) For the purposes of this section,
 - (a) investments in the Capital Projects Division shall be deemed to be assets of the Trust Fund with a value equal to the amounts expended pursuant to Acts of the Legislature referred to in subsection (2), clause (a);
 - (b) investments in the Canada Investment Division and the Alberta Investment Division and all other assets of the Trust Fund shall be valued at book value;
 - (c) the percentage limitations referred to in subsection (2), clause (b) and subsection (3), clause (b) shall be determined at the end of each fiscal year.

Disposition of
investments

7. (1) Where any investment is made under section 6 with the approval of the Investment Committee, no disposition shall be made of that investment except with the approval of the Investment Committee.

(2) Where a resolution of the Legislative Assembly directs the making of any investment pursuant to section 6, no disposition shall be made of that investment except pursuant to a resolution of the Legislative Assembly.

(3) Where a resolution of the Legislative Assembly directs the disposition of any investment then, notwithstanding subsection (1), the investment shall be disposed of in accordance with the directions contained in any resolution of the Legislative Assembly.

Terms and
conditions
on approvals

8. Any approval given by the Investment Committee under section 6 or 7 may be made subject to such terms and conditions as the Committee considers necessary.

Residual
investment
powers

9. (1) Notwithstanding section 6, where any moneys in the Trust Fund have not been or are not being invested pursuant to that section, the Provincial Treasurer may invest and may re-invest those moneys in any or all of the following:

- (a) the bonds, debentures or other evidences of indebtedness of, or guaranteed as to the repayment of principal and interest by, the Government of Canada, the government of any province of Canada or any municipal corporation in Canada;
- (b) the bonds, debentures or other evidences of indebtedness of or guaranteed as to the repayment of principal and interest by the government of a country other than Canada;
- (c) the bonds, debentures or other evidences of indebtedness of any agent of the Crown in right of Alberta;
- (d) certificates of deposit, deposit receipts or other evidences of indebtedness given by a chartered bank or treasury branch in consideration of a deposit or deposits made with the bank or treasury branch;
- (e) certificates of deposit, deposit receipts or other evidences of indebtedness which are unconditionally guaranteed by a chartered bank;
- (f) the bonds, debentures or other evidences of indebtedness of or guaranteed by any corporation, if those bonds, debentures or other evidences of indebtedness are authorized investments under section 63, subsection (1) of the *Canadian and British Insurance Companies Act*;
- (g) mortgages or hypothecs of real estate or leaseholds in Canada if the amount paid for the mortgage or

hypothec together with the amount of indebtedness under any mortgage or hypothec on the real estate or leasehold ranking equally with or superior to the mortgage or hypothec in which the investment is made does not exceed three-quarters of the value of the real estate or leasehold covered thereby;

- (h) mortgages or hypothecs of real estate or leaseholds in Canada notwithstanding that the mortgage or hypothec exceeds the amount authorized under clause (g) if the excess is guaranteed or insured by, or through an agency of, the Government of Canada or a province of Canada, or by an insurance company approved by the Treasury Board.

(2) The Provincial Treasurer may dispose of any investments made or deemed to be made under this section.

(3) Notwithstanding section 28.4, subsection (1) of *The Financial Administration Act*, the Provincial Treasurer shall transfer moneys from the Trust Fund to the Consolidated Cash Investment Trust Fund only where the moneys have not been invested or re-invested under subsection (1) or where the moneys have not been invested pursuant to section 6.

Administration
fees

10. (1) Where any costs, expenses or other payments are directly attributable to the administration of the Trust Fund, the Provincial Treasurer may charge the cost, expense or payment to the Trust Fund.

(2) After the end of each fiscal year the Investment Committee shall

- (a) estimate an amount consisting of the fees, wages, salaries, costs, expenses or other payments incurred in connection with the administration of the Trust Fund and paid out of the General Revenue Fund in the preceding fiscal year, and
- (b) authorize the Provincial Treasurer to transfer the amount estimated under clause (a) from the Trust Fund to the General Revenue Fund.

Quarterly
reports

11. (1) The Provincial Treasurer shall, as soon as practicable after the end of each quarter of the 1977-78 and succeeding fiscal years, prepare a report summarizing the investments made under section 9 and listing the investments made under section 6 during the preceding quarter.

(2) When a quarterly report is prepared under subsection (1), the Provincial Treasurer shall forthwith furnish copies of the report to all members of the Legislative Assembly and to the Clerk of the Legislative Assembly and upon doing so shall make the report public.

Annual
reports

12. (1) The Provincial Auditor shall from time to time and at least once each year audit the accounts and financial transactions of the Trust Fund.

(2) The Provincial Treasurer shall, as soon as practicable after the end of each fiscal year, prepare a report summarizing the operation of the Trust Fund during the preceding fiscal year and containing a financial statement, audited by the Provincial Auditor, showing

- (a) transfers of cash and other assets to the Trust Fund during the preceding fiscal year,
- (b) payments made from and income accrued to the Trust Fund for the preceding fiscal year, and
- (c) the total moneys expended under Acts of the Legislature referred to in section 6, subsection (2), clause (a) in respect of investments in the Capital Projects Division of the Trust Fund.

(3) When an annual report is prepared under subsection (2), the Provincial Treasurer shall forthwith furnish copies of it to all members of the Legislative Assembly and to the Clerk of the Legislative Assembly and upon doing so shall make the report public.

Review of
operations

13. (1) There is hereby established a select standing committee of the Legislative Assembly called the "Select Standing Committee on The Alberta Heritage Savings Trust Fund Act" consisting of 15 members.

(2) The members of the Select Standing Committee shall be appointed at the commencement of each session in the same way that members are appointed to other select standing committees of the Legislative Assembly.

(3) When a copy of an annual report is furnished to the Clerk of the Legislative Assembly pursuant to section 12, subsection (3) the annual report shall be deemed to be referred to the Select Standing Committee for review and a report concerning the investments of the Trust Fund which may contain any recommendations of the Committee concerning those investments.

(4) Where a motion is made in the Legislative Assembly for second reading of a Bill for a Special Act relating to the 1978-79 or any succeeding fiscal year, then, unless the Assembly by resolution otherwise directs, the debate on the motion shall be proceeded with only if the report of the Select Standing Committee relating to the preceding fiscal year has been tabled in the Assembly.

(5) The Select Standing Committee may, without leave of the Assembly, sit during any period when the Assembly is adjourned or after prorogation of a session of the Legislature.

R.S.A. 1970,
c. 142

14. *The Financial Administration Act is amended*

- (a) *as to section 16.1 by adding the word "or" at the end of clause (c) and by adding the following clauses after clause (c):*
 - (f) *between accounts in the General Revenue Fund and the Alberta Heritage Savings Trust Fund, or*
 - (g) *between accounts in the Consolidated Cash Investment Trust Fund and the Alberta Heritage Savings Trust Fund, or*
 - (h) *for the purpose of making investments under section 9 of The Alberta Heritage Savings Trust Fund Act,*
- (b) *by adding the following section after section 40.1:*

Advances

40.2 The Provincial Treasurer shall, upon the direction of the Treasury Board, advance from the General Revenue Fund to the Alberta Heritage Savings Trust Fund such sums as may be required upon such terms and conditions as the Treasury Board may impose.

- (c) *as to item 1 of the Schedule, by adding to the list of designated funds of the Provincial Treasurer the following:*
 - (a.1) Alberta Heritage Savings Trust Fund.

Coming
into force

15. This Act comes into force on the day upon which it is assented to.

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,

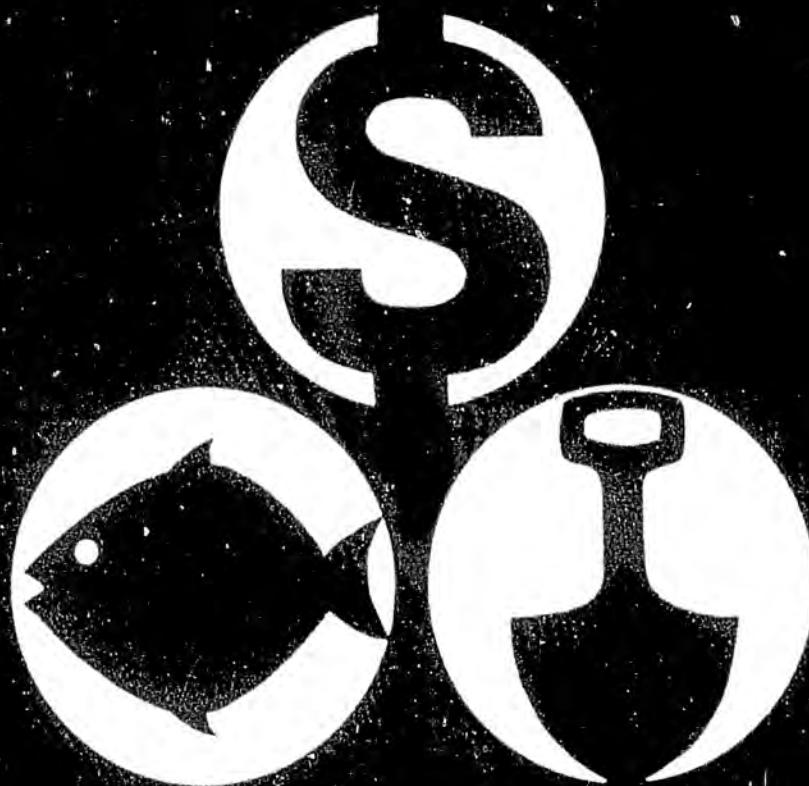


Frances A. Ulmer
Director

Attachments
FAU:ms

A Proposal for the Alaska Permanent Fund

Final Report by the House Special Committee on the Alaska Permanent Fund



Rep. Clark Gruening, Chairman
Rep. Terry Gardner, Vice Chairman
Rep. Ernie Haugen
Rep. Russ Meekins

Rep. Bill Miles
Rep. Leo Schaeffer
Rep. Rick Urlon

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I Introduction

In November 1976 Alaskan voters overwhelmingly approved an amendment to Section 15, Article IX of the state constitution creating the Alaska Permanent Fund.

The amendment reads:

"At least twenty-five per cent of all mineral lease rentals, royalties, royalty sale proceeds federal mineral revenue sharing payments and bonuses received by the State of Alaska shall be placed in a permanent fund, the principal of which shall be used only for those income-producing investments specifically designated by law as eligible for permanent fund investments. All income from the permanent fund shall be deposited in the general fund unless otherwise provided by law."

The amendment defines the permanent fund in broad terms. It leaves to the legislature and the governor the task of refining the fund: what it is, what it does and how it works.

These refinements will be contained in the permanent fund enabling legislation passed by the House and Senate and approved by the governor.

The House Special Committee on the Permanent Fund was created during the past legislative session to consider proposed permanent fund enabling legislation and to propose its own enabling legislation. The committee has been working during the interim to determine what Alaskans see as the permanent fund's goals and how to best achieve those goals.

(For a more complete history of the Alaska Permanent Fund, see the committee's preliminary report, *The Role of the Permanent Fund in Alaska's Future*.)

When the second session of the Tenth Legislature convenes (in January 1978), the committee intends to hold public hearings on its proposed permanent fund enabling legislation.

This report is intended to review what the committee has done and what its proposed enabling legislation will do about the Alaska Permanent Fund.

II What the public said

In an attempt to determine what Alaskans thought about the permanent fund, the committee engaged in a wide-ranging program of public participation. This program included the mailing of the committee's preliminary report, which contained a questionnaire to be filled out and returned; a symposium on goals of the permanent fund in Anchorage, cosponsored by the National Endowment for the Humanities and the Alaska Humanities Forum; public hearings in Anchorage, Fairbanks, Kotzebue and Juneau; and participation with the Alaska Public Forum in its questions on the permanent fund.

The committee received various proposals for use of permanent fund money. Everything from preserving artifacts to tracking whales was suggested. But several general points emerged from the public participation process.

First, the permanent fund was created as a depository for mineral revenues in excess of current state needs.

Second, the mineral revenues put into the permanent fund (the principal) should stay there and not be dissipated by using it to pay for the operations of state government or by investing it unwisely.

Third, where there are sound investments in Alaska the permanent fund should make them

without duplicating financial services already available.

Fourth, money earned by permanent fund investments (the earnings) should be used for the identifiable benefit of current and future Alaskans.

Fifth, the management of the permanent fund should be insulated from politics but should be accountable to the public.

Sixth, the management of the permanent fund should not make decisions properly made through the political process.

These general points guided the committee as it worked on its proposal for permanent fund enabling legislation.

In addition, the public made two main points on how it wanted state government to assist it in shaping the future Alaska.

First, state government should provide sufficient funds and programs for the proper development of renewable resources.

Second, state government should provide sufficient funds and programs for the development of alternate energy.

Again, these two main points guided the committee as it worked on its proposal for permanent fund enabling legislation.

III What the consultants said

In conjunction with its public participation program, the committee hired consultants and lured advisors to assist it.

The consultants were Dr. Belden Daniels of Harvard University's Department of City and Regional Planning; Dr. Arlon Tussing, Dr. Scott Goldsmith and Lee Gorsuch of the University of Alaska's Institute for Social and Economic Research; the financial consulting firm of White, Weld and Company; the financial management consulting firm of Price Waterhouse and Company.

The advisors were Dr. Donald Gordon of Simon Fraser University; Dr. Barbara Bergman of the University of Maryland; Robert Blixt, executive secretary of the Minnesota State Board of Investment; Terry Magrath of Fidelity Management; and representatives of Manufacturers Hanover Trust.

Additional assistance and advice were gathered from state offices and agencies, particularly the Legislative Affairs Agency. The committee also drew heavily upon previous work done by the State Investment Advisory Committee.

In order to keep this report as concise as possible, no detailed explanation of the advice of every consultant and advisor is offered here.

Rather, a brief summary of the main points of consensus illustrates the principles that guided the committee.

First, the permanent fund is not necessarily a vehicle for financing major commercial or industrial enterprises in Alaska. Such enterprises, if sound, will receive financing from existing sources. If they are not sound then they are not proper investments for the permanent fund. In some cases it may benefit the state to offer guarantees for the financing of projects, but such policy decisions properly are made through the political process.

Second, the permanent fund cannot create sound enterprises. If other factors are adverse (lack of market, product cost) permanent fund investment will not help.

Third, financially sound small and medium scale enterprises, particularly in rural areas of Alaska, might be proper permanent fund investments because they may not be receiving money from existing sources due to institutional barriers (lack of knowledge, distance).

Fourth, permanent fund managers ought to be allowed maximum latitude for making specific investments consistent with policy direction.

Fifth, permanent fund managers ought to be accountable to the public through the legislature and governor and through public reporting requirements.

IV What the committee did

While gathering public opinion and professional advice, the committee began working on its proposal for permanent fund enabling legislation. This work focused on five main questions.

First, how much money should be put into the permanent fund?

Second, what should be the fund's financial goals?

Third, how should the fund be managed?

Fourth, how should fund managers be made accountable to the public?

Fifth, what should be done with the earnings of the fund?

V How much money should be put into the permanent fund?

The constitutional amendment requires that at least 25 per cent of the specified revenues be put into the permanent fund. This means, obviously, that more money could be put into the fund. But, in all probability, at least a portion of the specified will be needed to finance state government.

In the foreseeable future the vast majority of permanent fund dollars will come from the fund's share of the state's 12½ per cent royalty share of Prudhoe Bay oil. While the committee was working, projections of revenue from this source turned downward.

This downturn was caused primarily by two events.

First, the explosion at Pump Station 8 limited the amount of oil flowing through the trans-Alaska pipeline. This, in turn, limited the amount of oil the state received as its royalty share. It is estimated that Pump Station 8 will be repaired by March 1978. But until it is repaired the state's royalty share will be roughly half of what had been anticipated.

Second, the rejection of the Interstate Commerce Commission's interim pipeline tariff put into effect substantially higher tariffs requested by the trans-Alaska pipeline's owners.

The tariff is the fee charged by pipeline owners to transport oil through the pipeline. The higher the tariff, the lower the profit per barrel of oil for the owner of the oil. With the exception of the State of Alaska, the owners of Prudhoe Bay oil also are the owners of the trans-Alaska pipeline. So, the interim tariff rejection means that the state must pay an additional \$1.35 per barrel, on the average, to transport its oil through the pipeline. The result: the state loses an average of \$1.35 per barrel profit on its royalty share of Prudhoe Bay oil.

Higher tanker charges and unanticipated field treatment charges also may reduce the state's profit on its royalty oil.

This downturn of revenue from Prudhoe Bay has had a similar effect on the state's general fund, creating a deficit in anticipated revenue for the current fiscal year of between \$50 million and \$100 million as of this writing.

Adjustments in the state's oil taxation policy could help offset this general fund revenue deficit. But such adjustments would not make more money available to the permanent fund since tax revenues cannot go into the permanent fund.

The other factor affecting the amount of money available for the permanent fund is the level of state spending. Money spent on state government projects and programs cannot go into the permanent fund.

This has led some to suggest that 100 per cent of the specified revenues be put into the permanent fund so that none of the specified revenues can be used to finance state government. But such an approach, revenue/expenditure projections show, would soon leave insufficient revenue to finance state government even if there was no real growth (that is, more dollars spent per person after inflation effects are subtracted) in the state budget. (See chart 1)

Such a situation, called deficit spending, is prohibited by the state constitution.

Projections, it is important to remember, carry no guarantee. Changes may occur (tariffs may be lowered once again, new sources of revenue may be found) that the projections do not take into account. They are planning tools and are not intended as outright projections of the future.

The committee took these projections into account as it worked on its proposed permanent fund enabling legislation.

It is important to note that, in addition to whatever money is put into the permanent fund, there are previous constraints on state revenue. These include a 5 per cent dedication to the Renewable Resources Development Fund, payments to the Alaska Native Fund and fixed assets in various state loan funds.

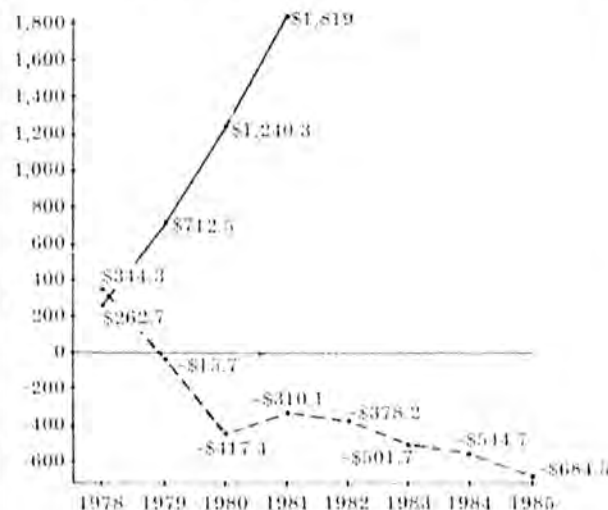
The committee's proposal puts 30 per cent of the specified revenues, with the exception of bonuses, into the permanent fund. The latest revenue/expenditure projections show that this would put the permanent fund's value by 1985 between a low of \$903.3 million and a high of \$1.5 billion. These figures do not include any earnings from the permanent fund that might be returned to the permanent fund. (See charts 2, 3 and 4)

The committee's proposal puts 100 per cent of bonuses (minus 5 per cent for the Renewable Resources Development Fund and 2 per cent, until it is paid off, for the Alaska Native Fund) into the

permanent fund. The committee decided that no bonus money should go into the general fund because such a policy could lead to the premature sale of leases simply to balance the state budget.

The committee is continuing to study its formula budgeting concept, although it is not contained in the committee's proposal. Generally, this concept requires the establishment of a formula, based on the previous year's budget, for setting budget growth. Once the revenue required by the formula was provided, all other revenue would flow to the permanent fund. The formula, of course, could not allow the permanent fund contribution rate to fall below the 25 per cent required by the amendment.

Chart 1
100% Contribution



— Permanent Fund (1985 Balance = \$4,806.7 million)
 --- General Fund (1985 Balance = -\$684.5 million)

Note:

The underlying assumptions are: the rate of interest on permanent and general fund investments is 7%; the percentage of current year expenditures in the general fund cash balance is 20%; 100% of royalties, leases, and bonuses are deposited in the permanent fund; the annual increase in the budget is 15%; 50% of the permanent fund earnings go to Alaska, Inc. payments or for other uses outside permanent or general funds.

Source: Division of Legislative Finance.

Chart 2
30% Contribution

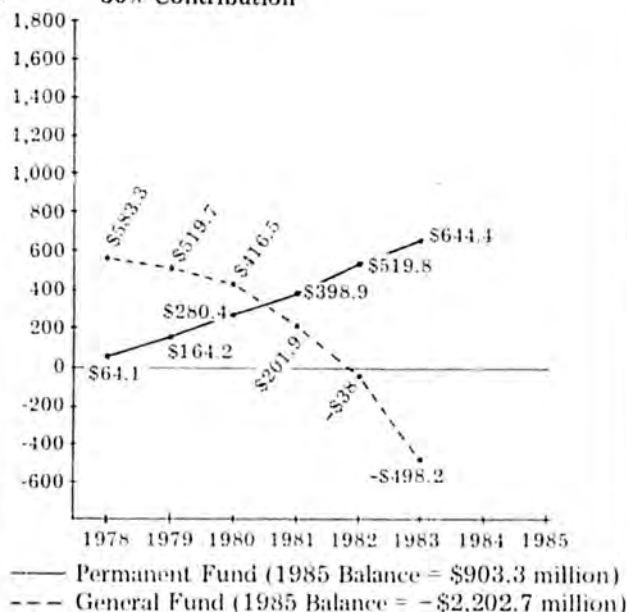
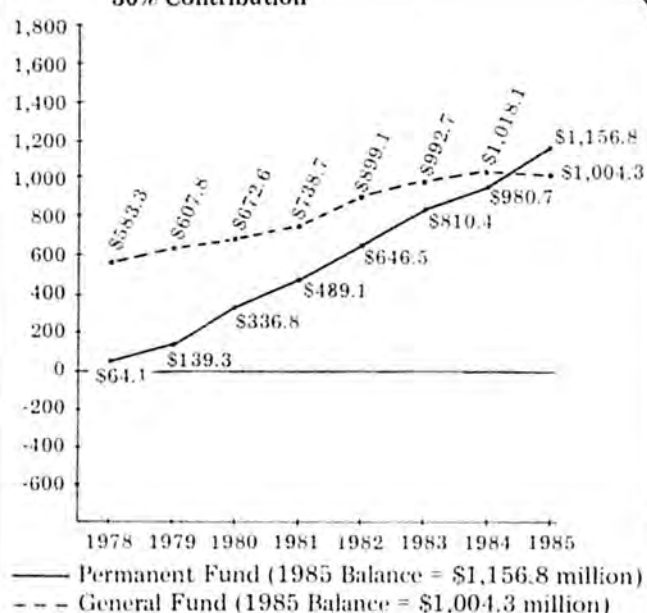


Chart 3
30% Contribution



Note:

In all cases permanent fund earnings are assumed to return to the general fund. Other underlying assumptions are:

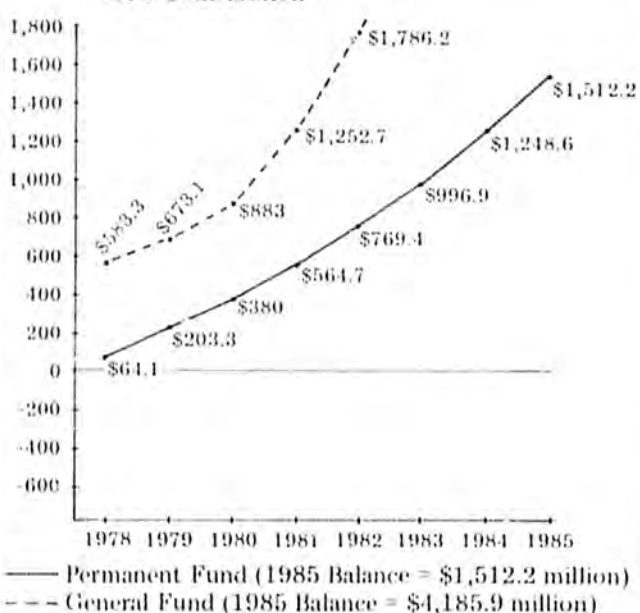
In Chart 2, wellhead values increase 2.5% annually; expenditures increase 15% annually; tariffs are about \$6.25 per barrel; the State loses the dispute over deduction of treatment costs for royalty calculations; the state severance tax "floor" remains at 80¢ per barrel (equivalent to a wellhead value of about \$6.53 per barrel).

In Chart 3, the State is successful in its suit to halt deduction of field treatment costs for royalty calculations and that the tariff dispute is resolved by "splitting the difference" between the interim tariff of \$4.90 per barrel and the company tariff of \$6.25 per barrel. With those additions to wellhead value, 1979 and subsequent years' oil prices increase 3.75% annually; the state severance tax "floor" remains at 80¢ per barrel; and state expenditures increase 10% annually.

In Chart 4, the State prevails in both the treatment cost and tariff dispute, adding about \$1.97 per barrel over current value; oil prices rise 5% annually; expenditures increase 7.5% annually; the severance tax "floor" remains at 80¢ per barrel.

Source: Division of Legislative Research.

Chart 4
30% Contribution



VI What should be the financial goals of the fund?

The financial goals, generally, are dictated by the constitutional amendment. On questions where the amendment is mute, the committee looked to expressed public opinion and professional advice for its answers. Based on this, the committee made three basic decisions on the fund's financial goals and embodied them in its proposal.

First, the main goal of the permanent fund is permanence; that is, the fund's primary purpose is to preserve the money put into it. This dictates that investment risk be minimized, that permanent fund investments be as secure as possible.

Second, fund investments must produce income. This rules out investments in projects and programs that will not return income directly to

the fund. Without dictating a specific level of return, the committee decided that permanent fund investments must meet market rates and terms to insure, insofar as possible, their security and ability to produce income.

Third, a portion of the permanent fund should be used for the benefit of current Alaskans, as long as that use is secure and income producing.

In making these decisions the committee realized that it was ruling out many types of investments, including highly speculative and subsidized investments. It also realized, however, that the permanent fund is only one of several financing vehicles available to the state and that it was unnecessary, as well as unwise, to try to design a permanent fund to do all things.

VII How should the fund be managed?

Based on its decision on the fund's financial goals the committee, with the assistance of its consultants and advisors, created two corporations.

The first, called the Alaska Permanent Fund Corporation (APFC), is essentially a trust fund. It receives five-sixths of the permanent fund revenue until the second corporation is paid its \$100 million; then it receives all the permanent fund revenue.

The Alaska Permanent Fund Corporation is an independent, non-taxable public corporation managed by a three-member board of trustees.

The APFC board's members are appointed by the governor and confirmed by the legislature for four-year terms. They receive no salary and serve on a part-time basis. The trustees are empowered to manage and invest the corporation's assets within the constraints of the committee's proposal.

These powers include hiring an executive director and approving staff, as well as contracting with private firms.

The constraints on the trustee are as follows: They must manage the corporation's assets prudently and maintain a reasonable diversification of investments. They may not borrow money or provide loan guarantees. Their investments must be income producing and are limited to U.S. government guaranteed bonds, first mortgages and corporate stocks and bonds. No more than 30 per cent of the corporation's assets may be invested in stocks. The trustees are subject to public reporting requirements and external audit.

The second corporation, called the Alaska Enterprise Investment Corporation (AEIC), is essentially a development bank. It receives one-sixth of the revenue dedicated to the permanent fund up to \$100 million. When that amount has been paid into the AEIC that one sixth reverts to the Alaska Permanent Fund Corporation.

The Alaska Enterprise Investment Corporation is an independent, non-taxable public corporation managed by a seven member policy board. One member of the policy board is appointed by the governor from the executive branch. The other six are appointed by the governor and confirmed by the legislature from the general public. The public members are unsalaried, part-time and serve four-year terms.

The policy board members are empowered to appoint an executive director and members of the investment committee, set policy for the AEIC within statutory constraints and monitor the corporation's plans and performance.

The executive director is empowered to hire and fire staff and serve as a member of the investment committee. He is responsible to the policy board for the corporation's performance.

The other four members of the investment committee also are appointed by the policy board. They are full-time, salaried and serve four-year terms. The investment committee is solely responsible for approving all investment proposals.

The corporation is designed to provide financial assistance to financially sound small and medium scale productive private enterprises and community development projects. In doing so it may borrow up to \$100 million, provide financial guarantees and loans, and purchase up to a 25 per cent ownership in an enterprise or project. Up to 50 per cent of its financial resources may be used to finance private enterprises; the other 50 per cent may be used for community development projects.

All corporation investments must be made according to market rates and terms. The corporation may not give financial assistance of more than \$2.5 million to any enterprise or project without legislative approval. The corporation may not use its money to replace private capital.

The corporation is subject to public reporting requirements and external audit.

Thus the House committee's proposal sets aside most of the permanent fund as a trust to preserve its principal and produce earnings from secure investments. The balance of permanent fund revenues, up to \$100 million, are designated for a development bank designed to find and fill capital gaps in Alaska on an income-producing basis. Both corporations are insulated from politics in their day-to-day operations but subject to policy decisions made by the public through the political process.

The committee's proposal, in short, is designed to provide both financial security and reasonable financial assistance to current and future Alaskans.

VIII How should the fund managers be made accountable to the public?

Since the permanent fund is public money, the committee realized the need for those who managed it to be accountable to the public for their actions. So the committee's proposed permanent fund enabling legislation includes several provisions designed to insure that accountability.

First, members of the APEC board of trustees and the AEIC policy board are appointed by the governor and confirmed by the legislature. This insures that the public's elected representatives must be sure that members of the boards are qualified.

Second, the proposal requires that both corporations report directly to the public in plain English what they have done and why during each year.

Third, all board members and employees of both corporations are subject to the state's conflict of interest law.

Fourth, both corporations are constrained in several ways by the provisions of the committee's proposal.

Fifth, the committee's proposal creates an Investment Oversight Committee (IOC) of the legislature, designed to monitor the activities of both corporations and all other agencies of the state which perform lending, borrowing or investment functions (this would include the Renewable Resources Development Fund, the existing state loan programs and the Department of Revenue).

The IOC is composed of eight members: the President of the Senate, the Speaker of the House and three members appointed from each house. At least one member from each house shall be a minority member.

In addition to its monitoring responsibilities, the IOC must report to the legislature its recommendations regarding the confirmation of suggested appointees.

IX What should be done with the earnings of the fund?

The permanent fund will produce earnings from both corporations. The committee found during its public participation process that demands on these earnings are infinite. Revenue/expenditure projections indicate that the permanent fund will not produce sufficient earnings to provide money for all the suggested projects and programs. (Under the most optimistic projections, at a highly optimistic rate of return of 10 per cent, the permanent fund will return \$150 million in 1985. This is between one-fifth and one-sixth of the current fiscal year's budget.)

The committee has chosen to introduce a separate piece of legislation providing for the use of the permanent fund's earnings. Based on the public's demand for funds for energy, the committee's proposal is to use permanent fund earnings as a guarantee for bonds issued by governmental agencies for power projects.

Guarantees are a commitment to pay any default on interest or principal payments on

bonds. Once the government agency issuing the bonds makes these payments, the portion of permanent fund earnings used as the guarantee would be freed and flow to the permanent fund or general fund.

The committee's recommendation is that the earnings be returned to the permanent fund. Unless this or some other recommendation is approved, the earnings, under the constitutional amendment, will go to the general fund.

This proposal, according to financial advisors, would draw more private money at lower rates to Alaska for power projects. It would not expose the fund's earnings to excessive risk of loss due to default.

The committee's use of earnings proposal is an attempt to assist Alaskans in the creation of power projects. It also is a discussion proposal, designed to spark further debate in the legislature and throughout the state on what Alaskans want permanent fund earnings to accomplish.

X The Renewable Resources Development Fund

In addition to its duty to review and propose permanent fund enabling legislation, the committee is responsible for providing for enactment of the Renewable Resources Development Fund (RRDF).

The RRDF, passed by the legislature in 1974, receives not less than 5 per cent of the receipts from bonuses, rentals and royalties for the rehabilitation, enhancement and development of renewable resource programs.

The committee formed a subcommittee to examine the RRDF. The subcommittee's work over the interim culminated in a work draft which will be taken up once again by the committee when the Tenth Alaska Legislature convenes.

The work draft sets up a corporation, called the Alaska Renewable Resources Corporation (ARRC). The corporation is an independent, non-taxable public corporation managed by a three-member board of trustees. Trustees are appointed by the governor and confirmed by the legislature for four-year terms. They are full-time and

salaried. Trustees are empowered to employ an executive director and staff. They also are empowered to render financial assistance within the constraints set in the work draft.

The corporation is designed to give grants, loans, loan guarantees and other financial assistance to projects and programs that identify and demonstrate new products, markets and technologies in renewable resources.

The corporation is subject to the same conflict of interest and reporting requirements as the permanent fund corporations.

The corporation's purpose is to provide financial and technical assistance to projects and programs that are of higher risk than is acceptable to private financial markets. It is the "leading edge" of the state's efforts to develop viable, stable renewable resource businesses and to provide financing for commercial, traditional and common uses of the state's renewable resources.

XI Summary

The House Special Committee on the Permanent Fund's efforts will result in three bills as described previously. One will establish the Alaska Permanent Fund Corporation, the Alaska Enterprise Investment Corporation and the Investment Oversight Committee. The second will provide for the use of the permanent fund's earnings. The third will establish the Alaska Renewable Resources Corporation. As yet undecided is a fourth bill on formula budgeting.

The committee's package aims at four goals:

First, to be consistent with the constitutional amendment and statute creating the RRDF.

Second, to be responsive to public desires and consultant advice.

Third, to insure that the public will remain informed about the activities of its permanent fund and RRDF managers.

Fourth, to fit the permanent fund and RRDF into the existing public financing structure.

In accomplishing this last goal, the committee's proposals seek to avoid both unnecessary risk to the permanent fund and duplication of existing financial services.

In looking at the structure of public finance with the committee's proposals included (Chart 5), it is convenient to divide it into three risk categories; high risk, medium risk and low risk.

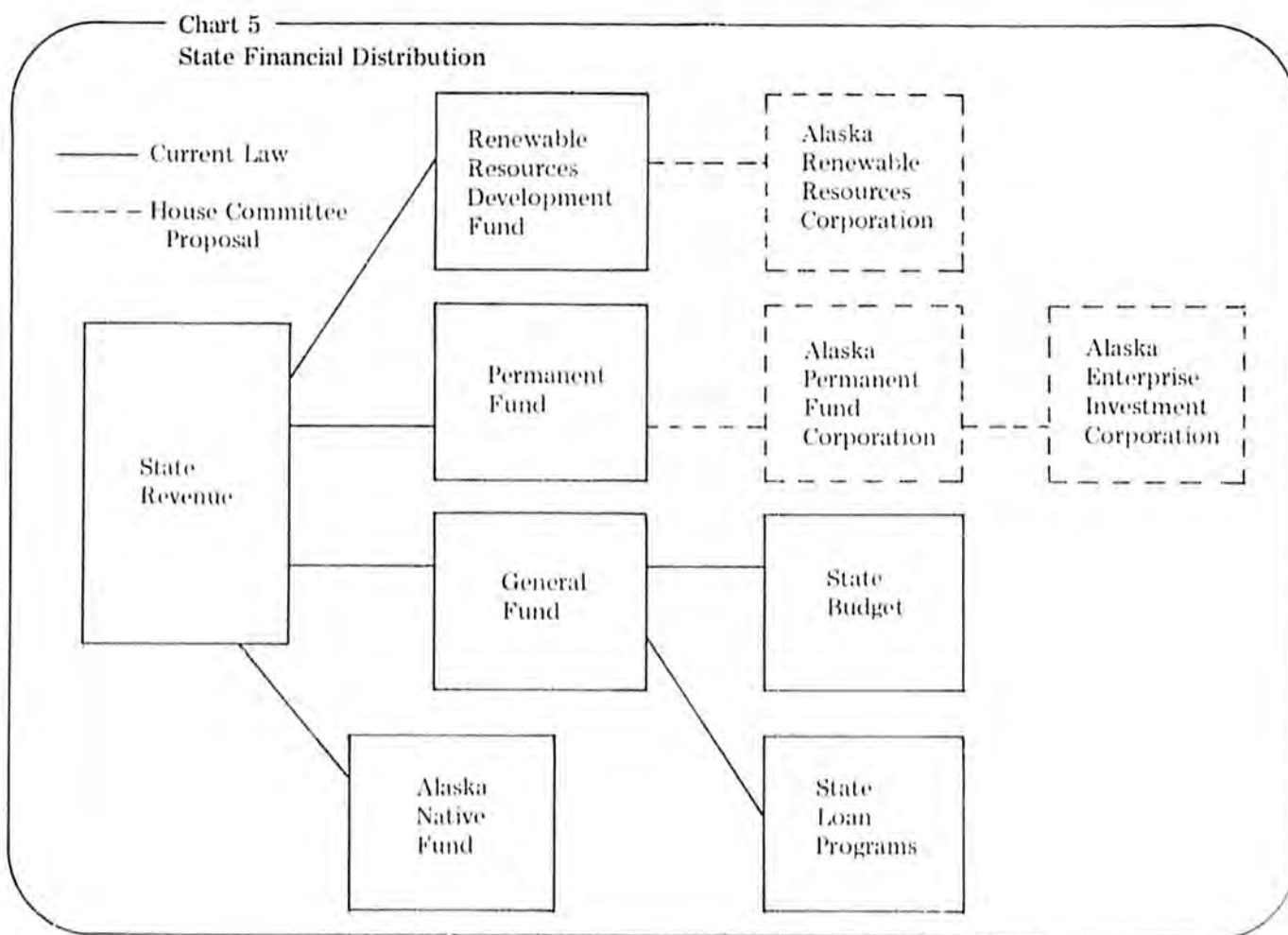
High risk would include portions of the general fund's budget and loan programs and part of the Alaska Renewable Resources Corporation.

Medium risk would include portions of those listed above and part of the Alaska Enterprise Investment Fund.

Low risk would include the Alaska Permanent Fund Corporation, part of the AEIC, and some state loan programs.

This then, is the House committee's proposal, to provide for public purposes with public funds from high risk to low.

The committee welcomes any comments you might have on its proposals or any proposals of your own. You can write to the House Special Committee on the Permanent Fund, Pouch V, Juneau, 99811.



Appendix

The following may be found in the appendix to this report:

Reports

"Thinking About the Alaska Permanent Fund: A Cautious Approach for Alaskan Policymakers," by Belden Daniels.

"Models and Options for the Alaska Permanent Fund: Functions, Regionalization and Accountability," by Belden Daniels.

"Economic Considerations in the Establishment of Alaska's Permanent Fund," by Arlon Tussing.

"Report on Trust Funds," by White, Weld and Company.

"The Role of the Permanent Fund in Alaska's Future," by the House Special Committee on the Permanent Fund.

Transcripts

Committee Meeting, July 13, Anchorage.
Symposium, September 10, Anchorage.
Public Hearing, September 14, Fairbanks.
Public Hearing, September 15, Anchorage.
Committee Meeting, November 18, Anchorage.

Minutes

Committee Meeting, July 14, Anchorage
Public Hearing/Committee Meeting
September 17, Kotzebue.
Public Hearing/Committee Meeting,
October 20-21, Juneau.
Committee Meeting, November 19, Anchorage.
Committee Meeting, December 12-13, Anchorage.

Memoranda

Revenue Projections, Legislature Affairs
Research.
Revenue Projections, Division of
Legislative Finance.
Questionnaire Returns.
Index to Committee Files (Documents
listed in the index are available upon
request).

Written Testimony

Various

Proposed Legislation

On the Alaska Permanent Fund
On the use of Alaska Permanent Fund
earnings
On the Renewable Resources
Development Fund (work draft)

MEMORANDUM TO
GOVERNOR HAMMOND

DRAFT

FROM: Fran Ulmer

SUBJECT: Principal Difference
Between Espe Proposal and
Administration Permanent Fund
Legislation

The following memo outlines the principal differences between the Espe Permanent Fund management proposal and the management proposal as embodied in SB226, your Permanent Fund bill. While most of these issues are hopelessly inter-related, we have done our best to separate them into coherent, separate but connected discussions.

1. Structure: Independent Board vs. Treasury Proposals

Principle
The Espe proposal recommends that both the savings (endowment) part of the Fund and the development banking part be managed by an independent corporation with a board modeled after the Federal Reserve Board. The example given is a nine member board with the President of the Senate, Speaker of the House, Commissioners of Revenue, Commerce, and five gubernatorial appointees as members.

Detail
Your proposal recommends that the savings portion, the first twenty-five percent, be managed by the Department of Revenue, Division of Treasury. Your proposal also recommends that the development banking portion, any contributions above twenty-five per cent, be managed by an independent corporation, with a board consisting of the Commissioners of Commerce and Economic Development and Revenue and five public members appointed by the Governor and serving at his pleasure.

Discussion: The two basic purposes served by an independent board are insulation from politics and provision of expertise. As the Division of Treasury already manages several trust funds which have not been subject to political influence, and as there are significant economies of scale to be gained from Treasury management, your bill recommends management of the savings portion of the Fund in Treasury. Because the development banking section provides for more active

investments in the Alaskan economy, your bill recognizes the greater need for insulation and outside expertise and calls for independent corporation status for this portion.

In addition, the Legislature is giving considerable attention this session to the question of control of independent entities in the context of the debate on both the Permanent Fund and the loan programs. Many legislators have expressed concern over the tendency for independent boards to substitute their policies for those of the Legislature as expressed in statutes, ^{and other statements of} ~~and this~~ has raised questions concerning the wisdom of entrusting the Permanent Fund to such an independent board. ^{legislative intent.}

2. Methods of insulation from political pressure: How effective?

Proposals:

The Espe proposal recommends that insulation be achieved through management by an independent board. The members of this board could be given fairly long terms (nine years) which would provide insulation from shorter-term political pressures. (The House proposal, which envisions only a savings function for Permanent Fund principal, also proposes independent corporate structure to increase Fund visibility resulting in insulation from political pressure.)

Your proposal recommends insulation from political pressure via two basic mechanisms. For the savings portion, insulation is achieved through a statutory investment list which defines the range of eligible investments. Within the constraints of this list and the rules of prudent investment (i.e. diversification), any investments would be acceptable. Further, there are several trust funds (pension funds) presently managed by Treasury about which there have been no complaints of influence peddling with respect to investments.

For the development banking portion, insulation is sought via independent corporation status with a board whose majority would be public members. Legislative and executive policy control would be

achieved through statutory control over the categories for eligible investments. Insulation from political pressure would be achieved by control of actual investment decisions by an independent investment committee appointed by the board. This provides a second tier of insulation from political pressures.

Discussion: There are basic tradeoffs inherent in structural attempts to provide proper policy control of public funds by elected officials yet prevent improper influence peddling by those officials. Structural attempts to fortify this attempt can help defend against human frailty, but ultimate responsibility must lie with individual politicians and managers. As there has been no research into the effectiveness of various structural alternatives for preventing political interference, it comes down to a matter of judgement. Insulation from politics can be seen as a continuum with direct legislative and/or cabinet decision-making on the least insulated end and totally independent management on the other. The former end allows elected representatives to make policy but provides the opportunity for political, rather than strictly economic, decisions. The latter end allows freedom to make investment decisions on strictly economic and financial grounds, but relinquishes any connection between elected officials and the public's money. Your proposal is balanced more towards the former, while the Espe proposal leans toward the latter.

Which?
This model ignores the small size of Alaska and the frequent existence of personal and financial relationships among its residents.
Perhaps the key lies with visibility and self-interest. . Whichever approach is selected, it should be required to conduct as much of its business as possible in the public eye. And the institution itself, whether in Treasury or separate and independent, should be required to maintain a high public profile. Concurrently, mechanisms to connect the Fund with the public in terms of direct financial benefit (i.e. Permanent Fund dividends) should contribute greatly to the goal of prudent and profitable management. The public will be watching.
Agreed?

3. Mixing Purposes under the Permanent Fund

Proposals:

The Espe proposal combines two purposes under the Permanent Fund-savings and economic development. Both purposes would be administered by the independent corporation. The Espe proposal also recommends community development type investments in infrastructure to facilitate economic development.

Your proposal also has the two purposes of savings and economic development, but places them under separate management structures, Treasury and an independent corporation respectively.

Discussion: The major argument here is that the distinction between purposes may blur over time, leading to an erosion of politically less popular purposes in favor of more popular ones. The risk of this occurring is greatest when the least division between purposes exists (Espe proposal), and this risk is reduced as more barriers are in place (your proposal). The House Permanent Fund has been arguing a different position that deserves your consideration. They maintain the general fund exists (and, because of surplus revenues, has the capability) to meet all economic and community development purposes. They further maintain that these programs can be designed as independent corporations or lending programs from the surplus to avoid growth in operating or capital budgets. They conclude that the Permanent Fund should have one clear purpose~~s~~ and one purpose alone-savings. This would lead them to resist proposals which give the Permanent Fund multiple missions or create the impression of there being multiple Permanent Funds. Part of their fear stems from the Alberta experience, where their Heritage Fund was "sold" as a savings device, but in reality it has four "windows," each with a different purpose but only one of which is savings, which receives the residual after the other purposes have been met.

4. Public Institutions vs. Private Institutions - Going Through

The Banks

Proposals:

The Espe proposal states "Further, through utilizing existing financial institutions both for deposits (Certificates of Deposit investments) and as a conduit for the purchasing of loans, these objectives can be satisfied with virtually no increase in state bureaucracy or operating expenses." The objectives referred to are:

- 1) "It is imperative that Alaska's current fiscal surplus be managed to ensure long-run sustainable growth of revenues...
{ the primary objective for the endowment fund should be capital preservation in the form of risk-free and low-risk investments."
- 2) "Clearly certificates of deposits with Alaska banks qualify as appropriate low-risk investments...Such an investment in Alaska bank CD's will enable Alaska banks to make more funds available for longer term loans...purchasing Alaska loans also qualifies as an appropriate investment for the endowment fund, at rates commensurate with current money market conditions."

It concludes "In summary, the attractive aspect of the endowment fund concept....is that it can be invested in a manner that simultaneously achieves the two important objectives of capital preservation and the allocation of funds to Alaska families and businesses."

Your proposal for the Permanent Fund savings portion allows for purchase of CD's of Alaska banks but not for purchasing Alaska loans. The development bank portion could invest in CD's with funds available after filling "capital gaps," i.e. purchasing Alaska loans.

Discussion: Clearly both proposals allow for investment in Alaska CD's and loans. They differ in that your savings portion would be excluded from purchasing Alaska loans. However, the development bank portion and more importantly your ^{AFPA} ~~ADA~~ loan program proposal would be able to purchase Alaska loans to increase bank liquidity. The House proposal presently excludes Alaska CD's as eligible investments for the savings function. The rationale for this exclusion



and for excluding loans from savings investments, lies with political considerations discussed in the first three sections. First, CD's are presently purchased from the general fund, as are Alaska loans (about \$450 million worth, although these are direct or participation loans, not purchase of private bank loans). Thus the general fund has been meeting these purposes, and it is not clear that the demand is so great as to compel Permanent Fund investment in addition. Secondly, as HCR 33 and, the entire history of state investment in Alaska loans demonstrates, the demand of the Alaskan economy for investment funds, as expressed by the legislature, is a demand for below-market interest rates. Can we expect the Permanent Fund (the people's money) to be immune from these pressures? Can the Permanent Fund savings portion really be managed to ensure long-run sustainable growth of revenues, i.e. to preserve capital, and to allocate funds to Alaskan families and businesses? Is there really a need for investment capital beyond that presently being provided through the general fund?

5. Public Sector Development Banking - We Already Have It.

Proposals:

The Espe proposal states "Development bank loans should be made to qualifying projects in both the public and private sectors. Public projects include those typically engaged in by the public sector - loans and other power projects, ports, transportation facilities, etc. which expand the infrastructure and which, thereby, make it easier and more feasible for the private sector to pursue its own objectives."

Your proposal does not specify development^{type} investments for the development bank portion of the Permanent Fund. Rather, it specifies a list of ten fairly conservative, low-risk and liquid investment categories for temporary investment of the ~~bank's~~^{their} allocation of Permanent Fund monies. It further instructs the^{development} bank to make initial determinations and annual assessments of the state's capital markets to identify investment opportunities for which private capital is not available, and to assess the reasons for such "capital

gaps." The bank may then recommend to the Governor and the Legislature additions to their investment capabilities to meet those gaps.

Discussion: Your bill does not address the concept of "public" versus "private" investments and therefore all of the types of investments recommended by the Espe proposal would be possible if the bank found such investments to be sound yet capital deficient and the Governor and the Legislature concurred in that finding. However, again the issue of alternative sources of available funding comes up. For infrastructure generally we have the capital budget funded by the general fund and general obligation bonds, which require a vote of the people. For dams and other power projects, we have as well the Alaska Power Authority and the Alaska Industrial Development Authority which can finance sound projects on the revenue bond market. For ports, transportation facilities, etc., we have in addition to the capital budget and G.O. Bonds, the Alaska Industrial Development Authority, the Municipal Bond Bank, municipal bonding powers, regional authorities, and probably other institutions as well. What can the Permanent Fund provide to projects with "reasonable economic viability" that all of these other options cannot? Your proposal requires the bank to ask and answer this question. Is there any compelling reason to go farther than that at the time?

6. Why does Alaska need a development bank?

Proposals:

The Espe proposal recommends development banking for large projects with "reasonable economic viability over the long term" which are "designed to expand the industrial base of Alaska..." The proposal recommends against development bank participation in projects which can obtain total financing from the private sector. Instead, the proposal states "Private projects suitable for development bank participation are those such a nature and size that public assistance is substantial, oil and gas pipelines, petrochemical facilities, fish processing plants, mineral refineries, sawmills, etc. "It also recommends "that another function of the development bank be to guarantee the bonds, capital notes, ^{or} ~~or~~ other types of debt utilized to finance large private projects, and that the development bank serve as a conduit for the issuance of revenue bonds which have the effect of reducing the debt service burden of private projects." The proposal concludes "It is not the intent of the development bank to subsidize industry, but rather to take more than normal risk in causing projects to happen which have demonstrated feasibility."

Your development bank proposal is based on the premise, expanded in the discussion section below, that we don't really know ~~if~~ we need ^{or want} a development bank or not. You have proposed establishment of a "blue ribbon" board and staff to analyze economic sectors or projects which are capital deficient (cannot attract private capital) and identify the reasons for such capital shortages. Specifically, the bank is to assess what market or other risk factors are causing private capital to fail to flow and present these factors to the Governor and the Legislature, who may then choose to extend state financing through the development bank if the benefits from extending such financing warrant acceptance of the risks involved.

Discussion: ~~This section will begin with an examination of the recommendations in the Espe proposal.~~ It is a reasonable assumption that the difference between development banking and normal private banking is that the former can accept projects with "reasonable economic viability over the long run" while private investment would require almost certain economic viability in a certain period of time, with all risks well understood and of an acceptable level. The Espe proposal speaks of projects for development banking which are "of such a nature and size that public assistance is substantial..." While the meaning of this is unclear, let us assume that public assistance means either (or both) government decisions (leasing, permits, taxes, etc.) ^{or} government financial assistance. If the former decisions create project risk unacceptable to private investors, the most efficient correction is to address those factors, not to provide public ~~funds~~ ^{investment}. If "public assistance" just means public financing, under what circumstances is such financing justified? The proposal states "It is not the intent of the development bank to subsidize industry, but rather to take more than normal risk in causing projects to happen which have demonstrated feasibility." If the risks are due to government - caused uncertainty, we have already seen that government action to reduce those uncertainties and not government financing is the appropriate action. If the risks are market risks, such as prices, cost of production, availability of markets, etc., the real question is should the state accept these risks which the private sector chooses not to accept. Your proposal is designed to have those risks as well as project benefits identified and presented to the Governor and the Legislature. If these policy-makers decide that the benefits justify the risks, then the bank can proceed with the financing and assume "more than normal risk." Such a tight decision-making process makes public investment rational and explicit, and is preferable to a blanket mandate for the bank to finance projects rejected by the private sector (which is essentially "Lemon Socialism" as described by Beldon Daniels).

The Espe proposal recommends use of guarantees, which, given the previous discussion, may be the best financial mechanism for use by a development bank. Rather than simply supplying debt capital and bearing all of the risks of a venture, the bank could simply agree to guarantee specific risk factors identified by their staff and accepted by the Governor and the Legislature. Having had these risks assumed by a third party (which stands to benefit in more ways than simply strict return on investment, i.e. the State of Alaska, the private sector should then be willing to proceed with an otherwise feasible project. Such use of limited and targeted intervention, as conceived in your proposal, will leave most aspects of industrial expansion, such as project development, feasibility analysis, project selection, and financing, to the private sector where it properly belongs.

This is the situation with the gasoline F

With respect to revenue bonding, we have already shown below that there are a host of state and local revenue bonding entities. Without compelling evidence of further unsatisfied needs, the development should leave revenue bonding to existing agencies.

One final point. The Espe proposal recommends financing large projects. Virtually all economic analysis to date points to small and rural business as suffering capital shortages, not large projects. We have contracted for a study of the capital shortage question, a kind of first broad cut at the development bank's task, with two economists experienced in the capital markets field. Their results should be available next month. Hopefully, their findings on the existence of and reasons for capital shortages in Alaska will help refine the debate on this subject.

STATE OF ALASKA

THE LEGISLATURE

BUDGET AND AUDIT COMMITTEE

FINANCE DIVISION
POUCH WF-STATE CAPITOL
JUNEAU, ALASKA 99811
PHONE: (907) 465-3795

February 7, 1979

MEMORANDUM

TO: Representative Bill Miles
Co-Chairman
House Resources Committee

FROM: Milt Barker *MB*
Fiscal Analyst

SUBJECT: General & Permanent Fund Balance Projections

The attached projections are based on the following assumptions:

1. No gas line construction or gas production.
2. Sadlerochit production remains at approximately 1.2 million BPD through 1990.
3. No production other than Sadlerochit and currently producing Cook Inlet fields.
4. Oil price increases at the refinery as scheduled by OPEC with annual increases of 6.5% beginning in January 1980 thereafter.
5. 6.5% annual inflation in non-petroleum revenues and petroleum corporate income tax.
6. No lease bonus revenue.
7. Interest earned on permanent and general fund investments at 7%.
8. ~~No increase in illiquid general fund investments (Alaska loans) beyond \$500 million.~~

MBB:pw
Attachments

GENERAL FUND AND PERMANENT FUND PROJECTED BALANCES

FISCAL YEAR	TOTAL REVENUE	1	BUDGET APPROPRIATION	2	TOTAL EXPENDITURE	3	SURPLUS OR DEFICIT	END OF YEAR PERMANENT FUND BALANCE	END OF YEAR GENERAL FUND BALANCE	BUDGET CUTS OR ADDITIONAL REVENUE REQUIRED TO MAINTAIN GF BALANCE AT \$500 MILLION
1979								128.9	578.5	
1980	1249.1		1030.0		1195.7		53.4	219.0	631.9	0.0
1981	1480.2		1184.5		1380.3		99.8	325.4	731.7	0.0
1982	1663.6		1362.2		1581.3		82.3	444.5	814.0	0.0
1983	1801.4		1566.5		1810.2		- 8.8	576.9	805.2	0.0
1984	1940.1		1801.5		2071.6		-131.5	723.7	673.7	0.0
1985	2080.6		2071.7		2312.6		-232.0	885.8	500.0	58.4
1986	2238.2		2382.5		2596.5		-358.3	1064.2	500.0	358.3
1987	2412.4		2739.8		2974.8		-562.5	1260.1	500.0	562.5
1988	2600.0		3150.8		3408.2		-808.3	1474.6	500.0	808.3
1989	2810.8		3623.4		3904.7		-1093.9	1709.0	500.0	1093.9
1990	3034.4		4166.9		4473.6		-1439.2	1964.6	500.0	1439.2

1. Unrestricted revenues, including 100% of royalties.
2. FY 80 figure is the Governor's general fund request; subsequent years reflect 15% annual compound increase.
3. Total expenditure is budget appropriation plus permanent fund, renewable resources fund, and native claims fund contributions.

1960 \$ 16%
 - 78 \$ 5%
 19%
 10%

Prepared by:
 Legislative Finance
 February 7, 1979

1

COMMENTS

ASSUMPTIONS

ANNUAL RATE OF INTEREST ON GENERAL + PERMANENT FUNDS = 7.00%
 % OF CURRENT YEAR EXPEND. IN G.F. CASH BAL = 20.00%
 % OF ROYALTIES LEASES AND BONUSES DEPOSITED IN PERMANENT FUND = 30.00%
 ANNUAL % INCREASE IN BUDGET APPROPRIATION = 10.00%

NON							PAYMENTS		SURPLUS	PERM-	GENERAL	REVENUE REQ
YEAR	INVESTMENT	INVESTMENT	TOTAL	BUDGET	SUPPLE-	DEBT	TO	TOTAL	OR	ANENT	FUND	FOR GF
END	REVENUE	INTEREST	REVENUE	APPROPRIATION	MENTALS	SERVICE	FUNDS	EXPENDITURE	DEFICIT	FUND	END OF YEAR	OF \$500 MIL
1979										128.9	578.5	
1980	1179.5	49.6	1249.1	1030.0	0.0	0.0	165.7	1195.7	53.4	237.0	631.9	0.0
1981	1394.8	86.5	1481.3	1133.0	0.0	0.0	195.8	1328.8	152.5	364.7	784.3	0.0
1982	1559.9	110.0	1669.9	1246.3	0.0	0.0	219.1	1465.4	204.5	507.6	999.8	0.0
1983	1681.7	136.6	1818.3	1370.9	0.0	0.0	243.7	1614.6	203.7	666.5	1192.6	0.0
1984	1810.3	164.3	1974.6	1508.0	0.0	0.0	270.2	1778.2	196.4	842.7	1389.0	0.0
1985	1944.7	194.6	2139.3	1658.8	0.0	0.0	240.9	1899.8	239.6	1037.2	1628.5	0.0
1986	2089.8	229.5	2319.3	1824.7	0.0	0.0	214.1	2038.8	280.5	1251.2	1909.0	0.0
1987	2243.2	266.9	2510.1	2007.2	0.0	0.0	235.0	2242.2	267.9	1486.3	2176.9	0.0
1988	2407.8	305.0	2712.8	2207.9	0.0	0.0	257.4	2465.3	247.5	1743.7	2424.4	0.0
1989	2593.2	343.6	2936.8	2428.7	0.0	0.0	281.3	2710.0	226.8	2025.0	2651.2	0.0
1990	2780.6	382.2	3170.8	2571.6	0.0	0.0	306.7	2978.2	192.6	2331.7	2843.8	0.0

STATE OF ALASKA
LEGISLATIVE FINANCE WORKING DOCUMENT
BUDGET FORECASTING MODEL

2

26-JAN-79

COMMENTS

NO GAS PRODUCTION
NO EXPORTS
6.5% INFLATION
NATIVE CLAIMS INCLUDED
EDIC INCLUDED
\$500 MIL ILLIQUID LOAN PORTFOLIO
NO LEASE BONUS
SADLEROCHIT & COOK INLET PRODUCTION ONLY

ASSUMPTIONS

ANNUAL RATE OF INTEREST ON GENERAL + PERMANENT FUNDS = 7.00%
% OF CURRENT YEAR EXPEND. IN C.F. CASH BAL = 20.00%
% OF ROYALTIES LEASES AND BONUSES DEPOSITED IN PERMANENT FUND = 30.00%
ANNUAL % INCREASE IN BUDGET APPROPRIATION = 15.00%

YEAR	NON INVESTMENT REVENUE	INVESTMENT INTEREST	TOTAL REVENUE	BUDGET APPROPRIATION	SUPPLE- MENTALS	DEBT SERVICE	PAYMENTS TO FUNDS	TOTAL EXPENDITURE	SURPLUS OR DEFICIT	PERM- ANENT FUND	GENERAL FUND END OF YEAR	REVENUE REQ FOR GF BAL OF \$500 MIL
1979										128.9	578.5	
1980	1179.5	69.6	1249.1	1030.0	0.0	0.0	145.7	1195.7	53.4	237.0	631.9	0.0
1981	1394.8	85.4	1480.2	1184.5	0.0	0.0	195.8	1380.3	99.8	364.7	731.7	0.0
1982	1559.9	103.7	1663.6	1362.2	0.0	0.0	219.1	1581.3	82.3	507.6	814.0	0.0
1983	1681.7	119.7	1801.4	1566.5	0.0	0.0	243.7	1810.2	-8.8	666.5	805.2	0.0
1984	1810.3	129.8	1940.1	1801.5	0.0	0.0	270.2	2071.6	-131.5	842.7	673.7	0.0
1985	1944.7	135.9	2080.6	2071.7	0.0	0.0	240.9	2312.6	-232.0	1037.2	500.0	58.4
1986	2089.8	148.4	2238.2	2362.5	0.0	0.0	214.1	2596.5	-358.3	1251.2	500.0	358.3
1987	2243.2	169.2	2412.4	2739.8	0.0	0.0	235.0	2974.8	-562.5	1486.3	500.0	562.5
1988	2407.8	192.2	2600.0	3150.8	0.0	0.0	257.4	3408.2	-808.3	1743.7	500.0	808.3
1989	2593.2	217.6	2810.8	3623.4	0.0	0.0	281.3	3904.7	-1093.9	2025.0	500.0	1093.9
1990	2788.6	245.8	3034.4	4166.9	0.0	0.0	306.7	4473.6	-1439.2	2331.7	500.0	1439.2

STATE OF ALASKA
LEGISLATIVE FINANCE WORKING DOCUMENT
BUDGET FORECASTING MODEL

3

26-JAN-79

COMMENTS

NO GAS PRODUCTION
NO EXPORTS
6.5% INFLATION
NATIVE CLAIMS INCLUDED
EDIC INCLUDED
\$500 MIL ILLIQUID LOAN PORTFOLIO
NO LEASE BONUS
SADLERCHIT & COOK INLET PRODUCTION ONLY

ASSUMPTIONS

ANNUAL RATE OF INTEREST ON GENERAL + PERMANENT FUNDS = 7.00%
% OF CURRENT YEAR EXPEND. IN G.F. CASH BAL = 20.00%
% OF ROYALTIES LEASES AND BONUSES DEPOSITED IN PERMANENT FUND = 30.00%
ANNUAL % INCREASE IN BUDGET APPROPRIATION = 20.00%

YEAR	NON INVESTMENT REVENUE	INVESTMENT INTEREST	TOTAL REVENUE	BUDGET APPROPRIATION	SUPPLE- MENTALS	DEBT SERVICE	PAYMENTS TO FUNDS	TOTAL EXPENDITURE	SURPLUS OR DEFICIT	PERM- ANENT FUND	GENERAL FUND END OF YEAR	REVENUE REQ FOR GF BAL OF \$500 MIL
1979										128.9	578.5	
1980	1179.5	69.6	1249.1	1030.0	0.0	0.0	165.7	1195.7	53.4	237.0	631.9	0.0
1981	1394.8	84.2	1479.0	1236.0	0.0	0.0	195.8	1431.8	47.2	364.7	679.1	0.0
1982	1559.9	97.2	1657.1	1483.2	0.0	0.0	219.1	1702.3	-45.2	507.6	633.9	0.0
1983	1681.7	105.7	1787.4	1779.8	0.0	0.0	243.7	2023.5	-236.1	666.5	500.0	102.2
1984	1810.3	117.7	1928.0	2135.8	0.0	0.0	270.2	2406.0	-477.9	842.7	500.0	477.9
1985	1944.7	136.7	2081.4	2563.0	0.0	0.0	240.9	2803.9	-722.5	1037.2	500.0	722.5
1986	2089.8	158.2	2248.0	3075.6	0.0	0.0	214.1	3289.6	-1041.7	1251.2	500.0	1041.7
1987	2243.2	182.5	2425.7	3690.7	0.0	0.0	235.0	3925.7	-1500.0	1486.3	500.0	1500.0
1988	2407.8	210.1	2617.9	4428.8	0.0	0.0	257.4	4686.2	-2068.4	1743.7	500.0	2068.4
1989	2593.2	241.3	2834.5	5314.6	0.0	0.0	281.3	5595.9	-2761.3	2025.0	500.0	2761.3
1990	2788.6	276.8	3065.4	6377.5	0.0	0.0	306.7	6684.2	-3618.8	2331.7	500.0	3618.8

Emile #18:30

TESTIMONY BEFORE THE HOUSE
SPECIAL PERMANENT FUND COMMITTEE

By Clark Gruening

March 30, 1979

Mr. Chairman, committee members, friends, and former colleagues, I understand that you're about to go into what's known as "mark-up" on the various Permanent Fund proposals before you. As I recall, mark-up takes place when you've heard every conceivable bit of advice as to what you ought to do, and now it's your turn to do what you think should be done. Having been through this exercise myself once or twice, I hope I can share with you some basic references I found helpful in sorting out all the information and issues.

The two basic references I find helpful are: first, Section 15, Article IX of the State Constitution creating the Alaska Permanent Fund and those major principles Alaskans have told us they wanted written into any permanent fund legislation.

Before reflecting further on those basic references, one preliminary question needs to be addressed. This question will undoubtedly arise among that group known as "the body at the other end of the hall." That is, does there need to be any action this session to establish in law more definite

management and investment guidelines. This question is sometimes phrased as, what's wrong with letting the Department of Revenue go on doing as it has been doing with the Permanent Fund money.

Why is it better that a comprehensive Permanent Fund management bill pass sooner than later? In the first place, the passage of time is not going to make the legislature's decision any easier. As the size of the Permanent Fund grows, so will the number of lobbying groups which seek special uses of the money. The pressure will grow in proportion to the size of the Permanent Fund.

We would do well to take a leaf from our own State Constitutional Convention, which in 1955 and 1956 worked under the advantage of writing the Constitution in the relatively uncharged political atmosphere. That is not to say that the Constitutional debates were not spirited, heated, and arduous. But in the main, those debates focused on matters of long-term policy and not short-term political expediency. The hard work of the many eminent Alaskans who were delegates to the Convention was viewed by some as an academic exercise since, at the time of their deliberations, statehood for Alaska was still a major uphill battle to be won in Congress. Yet the delegates took their jobs seriously and were able to produce, in a relatively unpressured atmosphere, a document that is widely admired as a model Constitution.

In regard to the Permanent Fund, I have heard the comment more than once that the legislature really doesn't need ^{to make} a more definite and clear statutory statement of Permanent Fund management structure and investment guidelines until the fund grows to a size in which it can "really do something."

I firmly believe we need better guidelines than those stated presently in A.S. 37.10.065--otherwise known as the interim management statute. I disagree with the statement in the Governor's letter of transmittal for the administration's Permanent Fund proposal that this statute is adequate for the management of the basic 25 percent. If you also believe that the interim management statute can be improved, the time to do it is now before the pressure is really upon the administration and the legislature for bills to meet competing demands for immediate disbursement of Permanent Fund money for this or that project.

What are, then, the critical elements, not now in law, that a Permanent Fund management bill should contain? This brings us back to those basic references I referred to. After the passage to the constitutional amendment in November of 1976, public hearings were held, questionnaires were sent out, and both the House and Senate committees working on Permanent Fund legislation received testimony of statements both on how the fund should be specifically invested, what

should be the basic management concept. Even if there appeared to be no consensus on what the specific Permanent Fund investments ought to be, there appear to me to be a clear view by Alaskans on those general principles under which the fund should be managed.

In my view the five main principles emerging from the Alaska public can be simply stated as follows:

First, the Permanent Fund should serve as a safe depository for mineral revenues and not used for current expenditures;

Second, the mineral revenues placed in the Permanent Fund (the principal of the fund) should stay there and not be dissipated by using it to pay for operations of state government or by investing it unwisely;

Third, where there are sound investments in Alaska the Permanent Fund should make them without duplicating financial services already available;

Fourth, money earned by the Permanent Fund investments (the earnings or income) should be used for the benefit of current and future Alaskans; and

Fifth, the day-to-day management of the Permanent Fund should be insulated from politics but the management should be accountable to the public in matters of policy and performance.

Some of these principles are in a large degree mandated by a plain reading of the constitutional amendment. In reviewing A.S. 37.10.065, it's obvious that no attempt was made to write these principles into the law. It should

be noted, however, that this statute was only intended as an interim measure passed on the heels of the amendment in order to authorize somebody to invest the first Permanent Fund money.

What is critically important now is that a definite statement of investment management goals be stated in law.

The present list of investments is limited to mostly so-called "money market instruments" which, by their nature, preclude a larger portion of Permanent Fund money from being invested in Alaska even though undoubtedly many investments can be safely made in Alaska.

Another major problem with the interim management statute is that it authorizes management by the Department of Revenue. A primary function of that Department is to ensure that sufficient revenue is available from the General Fund to meet on-going state expenditures. In other words, of necessity, the General Fund is of primary concern to the Commissioner of Revenue. This is as it should be since it is the General Fund which will continue to be the largest repository of public money and the sole source of revenue for operation of state government.

Without being critical of any person or policy of the Department of Revenue, I have no doubt that had the interim statute permitted the Commissioner of Revenue to

purchase state loans with Permanent Fund money that past and current General Fund cash crunches would have sorely tempted the Commissioner to sell the least liquid loans to the Permanent Fund in order to achieve liquidity for the on-going expense of government operations. The same conflict exists between General Fund and Permanent Fund management policies even within the limited list of investments currently allowed for the Permanent Fund. Even money market instruments, because they can grow relatively less liquid or less attractive with fluctuating interest rates, are subject to being traded off at a loss to the Permanent Fund.

It may be argued that there is an economy to be achieved by having all the funds managed under one roof. This proposition is yet to be persuasively demonstrated, but should this be viewed as a critical factor, it might be wiser to place all investments functions under a board such as Wisconsin's Investment Board for which investment functions have been clearly separated from revenue and taxation problems. Even though there is a split within the Department of Revenue by division between investments and revenue collection, I would submit that a headstrong Commissioner (and Alaska has seen a few of these) can easily overlook any separation^{of} function so as to solve whatever political or financial problems may confront him.

Moreover, there's something to be said because of the special constitutional stature of the Permanent Fund for establishing a separate corporate identity for the Permanent Fund management. ^{(as} Under the House proposal of the last session of the Tenth Legislature and House Bill 281 now before you) The establishment of a separate corporate existence removed from the Department of Revenue should not mean any less accountability. Accountability is assured by continued oversight by the legislature through an appropriate committee or committees. The administration would continue to have oversight ~~power~~ through the appointment and removal power and budget review under the Executive Budget Act. It is interesting to note that the administration has no problem with management of 75 percent of the Permanent Fund by a separate corporation.

This brings us back to a very basic question. What are you going to ask this management structure to do? What guidelines are you going to give them for the investment of this public money? After considerable deliberation, the predecessor to this committee, the House Special Permanent Fund Committee in the Tenth Legislature determined that the guidelines should approximate those of a savings trust and that regardless of whatever long-term investment commitments

the fund may be called on to make in the future, that a large portion of permanent fund money should be in very liquid form of investment--that is to say that a large portion of the fund would be flexible and available for a totally new kind of investment in which savings may or may not be the primary emphasis.

By flexibility or liquidity, we meant the ability to change the form or thrust of the investment without discounting or taking a substantial loss on the investment you are "cashing in." Implicit in this statement is the possibility that the legislature may reasonably or unreasonably decide at some time in the future that the fund should be committed directly or indirectly (by equity investment or by guaranteeing or pledging) to some major project or series of projects within the Alaskan economy or to address an "economic emergency" by certain investments the legislature may designate by statute.

The necessity and wisdom, however, of stating in law a clear statutory charter for the savings trust is that when that time comes to change the major thrust of the Permanent Fund, it can only be done by amending the law by a bill requiring hearings and majority approval of each House as well as the approval of the Governor. There is, in my view, a far less likelihood of ill-advised or secret deals being cut for the disposal of permanent fund money under

the requirement of a passage of a bill rather than simply the decision of a compliant bureaucrat.

The statutory charter you are called upon to address would also provide for a flexibility which may or may not be the case under the "temporary" statutory provisions. Without further inquiry it is difficult to ascertain the true position of Permanent Fund from the Department of Revenue's monthly investment reports.

One extreme would have been to completely remove the policy decisions of the Permanent Fund managers from reach of any elected officials. This would have had the unfortunate result, however, of completely insulating the managers of the Permanent Fund from the general public or the need to respond to changes of public policy. This was the essence of the major criticism against the establishing a Permanent Fund in the first place. Nevertheless, I believe the provisions of House Bill 281 will prevent the Permanent Fund from becoming a headless monster. House Bill 281 appropriately balances the need for insulation from day-to-day politics with the need for responsiveness to changes in basic public policy.

There is, among all the legislative proposals now before you, a consensus that the trust concept should be the dominant theme of any final bill. In order to make this

theme more plain to the principal fund managers, there needs to be both a general statement as to investment standards (such as the prudent man rule) and list of eligible investments specified as appropriate in regard to risk level and return to the fund. The greatest danger of substantial erosion of the Permanent Fund principal is not (as suggested in a February 23, 1979 Permanent Fund policy memorandum of the Division of Policy Development and Planning) from a practice of making investments at less than market rates but rather from making investments entailing more than a reasonable risk. Generally, in the investment world the higher the risk, the higher the expected return. In a number of instances, however, we have seen the investment of public assets in investments which are highly risky and yet offer in the outset a very low return. Sometimes, these investments are justified on policy grounds as being necessary to diversify the economy or create jobs. Often, neither goal is achieved.

Both before and after the passage of the constitutional amendment establishing the Permanent Fund, elected officials, consultants, members of the general public all offered differing views to what the Permanent Fund could and should accomplish. I recall writing an article in which I enumerated various worthy things the Permanent Fund could do. Principal

among these was the opportunity to use Permanent Fund money to diversify the economy and to replace absentee ownership of certain industries, particularly renewable resource industries, with Alaskan ownership. Now that I'm older and wiser, or at least older, I see the Permanent Fund cannot reasonably be expected to accomplish all our goals at once.

One reason for a modification in my view is that the fund didn't turn out to be as big a pot of gold as anticipated. Another factor was the realization that many of the "development banking" investments would be at risk levels generally incompatible with the concept of a savings trust. A solution we proposed was to commit the basic 25 percent mandated by the Constitution to a savings trust and to provide for an additional contribution over and above the 25 percent to an "Alaska Enterprise Investment Corporation." The purpose of this corporation, as in your House Bill 282, is to assist financially sound, small and medium scale productive private enterprises and community development projects in the State.

I urge you to act on bills which provide for clear and accountable management of the Permanent Fund and the Alaska Enterprise Investment Corporation. Whether or not capitalization for the enterprise function actually comes from an additional dedication from the Permanent Fund

or from the General Fund, I believe there needs to be an active entity in the area of development banking, designed to assist the economies of the varied communities and regions of the State in an original way which does more than merely replace sources of capital that otherwise would have been available. After the separate managements of the Permanent Fund and the enterprise function have had the opportunity to establish a track record, some joint participation by the two entities in "development banking" may be justified.

In the meantime, Permanent Fund management ought to be required by law to place a premium on safety and liquidity of investment so that when we see more clearly where the greatest potential of the fund for new investment opportunities lies, we can act.

Even though it now appears we cannot accomplish all our goals at once, over a period of time it is, in my view, possible to do most of those things originally envisioned for the Permanent Fund. Within the realm of a savings trust a number of current benefits still accrue to Alaskans:

1. Mineral wealth, otherwise destined for expenditure in the operating budget of state government is held available for future capital investment and improvement in the State;

2. Active capital investment in the State can be properly made under the savings trust concept;

3. The credit worthiness of the State for both general obligation bonds and revenue bonds is enhanced, thereby increasing the ability of the State to acquire new capital sources at lower cost;

4. The opportunity to participate in the diversification of the Alaska economy at a future time remains open; and

5. The Permanent Fund will continue to serve as a meaningful focus for the public to discuss State fiscal and economic policy.

There is a common awareness now that the income from the earnings of the Permanent Fund will never be sufficient to replace, in any significant amount, the revenue now required for state government. I'm still partial to the use of income proposal contained in House Bill 595 of the Tenth Legislature. That use of income proposal was designed to assist the development of low cost energy projects throughout the State.

If, however, this committee does not reach this conclusion as to the use of the income from the Permanent Fund, returning the income to the principal of the fund so that the impact of inflation on the corpus of the fund will be lessened is preferable to its present deposit in the General Fund.

To sum up, three points bear repetition. Whatever bill you finally agree on, provision ought to be made in the investment guidelines for liquidity of investment of the larger portion of the fund. Second, the statutes must provide for public accountability for the performance and policy of the fund's management. This, I believe, entails placing the management out from under the potential conflict situation within the Department of Revenue. Accountability also should include at a minimum, a meaningful reporting procedure and an active oversight function by the legislature. My last point is that the legislature has sufficient information to make a decision this session and I don't think there is any good reason for delaying a permanent fund bill.

#18:20

TO: Rep. Malone, Chairman
House Special Committee on the Permanent Fund

FROM: James B. Rhode, AA

SUBJECT: Major Proposals for the Permanent Fund

DATE: 22 February 1979

At your request, we have prepared a brief description of the major proposals for the use of the Permanent Fund, whether or not a bill was actually introduced.

(1) Administration, 1977 - An independent fund with no less than 40% held in a trust of investment grade securities, 30% for business development loans, and no more than 30% for community facilities.

(2) Administration, 1977 - Alaska, Inc. pays all earnings of the fund to our citizens on the basis of residency.

(3) Administration, 1979 - An independent fund with no less than 25% of royalty and related proceeds devoted to a trust, with additional contributions to the fund available for business development loans upon a showing that such loans are needed to fill a "capital gap" in the state.

(4) Administration, 1979 - One-half of fund earnings are to be paid to our citizens as tax credits and one-half are to go to the general fund. Before these distributions, the annual earnings are pledged to guarantee power debt.

(5) Administration, 1979 - A constitutional amendment increasing to 75% the contributions to the fund of royalty and related proceeds, plus 100% of mineral bonus bids, and all net income from lands, unless committed under Federal programs or for debt.

(6) House, 1978 - The bulk of the fund is held in a separate trust, but \$100 million may be used by an Enterprise Fund for rural, small business loans. Fund earnings are returned to the fund if not called as guarantees of power debt.

(7) Hohman, 1978 - Creates a trust whose earnings are pledged to secure a multi-million dollar issue of debt for the use of the state's existing loan programs; these programs are to be consolidated and delinquencies to be collected by Revenue.

(8) Sumner, 1979 - Once the fund has reached \$2 billion, every citizen as of July 1, 1981 may choose the investment of his pro-rata share from an eligible list prepared by the Commissioner of Revenue, to include a state managed trust, with all earnings to be retained by the citizen.

Permanent Fund Proposals, Con't

(9) Colletta, 1979 - Permits the fund to make secured loans to a General Stock Ownership Corporation (GSOC).

(10) Haugen, 1979 - Devotes the principal of the fund to power projects.

(11) Swanson, 1977 - Creates a trust whose earnings are to be used to develop renewable resource industries; any losses of principal are to be made up from earnings.

(12) Ray, 1977 - Devotes the principal of the fund to community capital projects.

(13) Northwest, 1978 - Commits the first \$500 million of fund principal for the state's equity position in the gasline project.

(14) Hickel, 1978 - Devotes the fund to moving the capital and building the Susitna dam.

(15) Earth Resources, Co., 1979 - Pledges the earnings of the fund to secure debt for the construction of gas conditioning plants in Fairbanks.

Alberta's Enviably Oil and Gas Net Egg

Continued From Page D1
tion and growth here, not to mention the careers of the fund's political overseers.

Fund Designed in 1976

The Heritage Fund was designed in 1976 by the conservative government of Premier Peter Lougheed with three goals and four divisions. The goals were to improve the quality of life for Alberta's 1.9 million citizens, to invest for expansion and diversification of a provincial economy once based largely on agriculture and to provide a source of income and possibly capital in the more distant future when the area's fossil fuel reserves, and thus government royalties, decline.

Each year, 30 percent of the royalties are transferred into the fund. The other 70 percent go to the General Government Revenue Fund where, among other things, the money has eliminated the need for any provincial sales, gasoline or estate taxes.

Unlike most other North American governments, Alberta's thus was able to plan a budget surplus of \$768.5 million for this year with expenditures of \$3.79 billion (Canadian).

An additional \$1.5 billion will go into the Heritage Fund's four divisions. These are Capital Projects, Canada Investments, Alberta Investments and the surplus. With a ceiling of 20 percent of the fund, Capital Projects involves building facilities for recreation, education and irrigation as well as health care and medical research installations, which the government hopes to make into a major "industry" here.

15% of Fund Is on Loan

Canada Investments lends a maximum 15 percent of the fund to Canada's federal and provincial governments.

The Alberta Investments provision, probably the most important, is tied up

largely in the debentures of the Alberta Housing Corporation and the Alberta Home Mortgage Corporation. It also holds a 10 percent share of the vast Syncrude oil sands recovery project plus more than \$200 million of convertible debentures in Gulf Canada Ltd. and Canada-Cities Service, which it acquired when the government stepped in to rescue the Syncrude project.

The surplus portion of Heritage Fund, a little more than \$2 billion, is invested in short-term securities, ranging from overnight to 12-month maturities. This money is put into a variety of bank, commercial finance and grain company paper as well as treasury bills.

Mervin Leitch, the provincial treasurer,



Peter Lougheed

has said the rule is to seek highly liquid marketable securities with the best interest and least-risk possible, pending longer-term investment decisions for the money.

"We go for the short-term, conservative stuff," said Brent Harding, a treasury aide. "There are no investments in gold mines or moose pastures."

Legislature Exercises Control

The Capital Projects division is controlled by the Legislature, which currently has 75 seats, 69 of them controlled by Premier Lougheed's Progressive-Conservative Party. The other divisions are overseen by the 24-member provincial cabinet. The mechanics are carried out in Mr. Leitch's Treasury Department by an eight-member staff of traders, who also handle the short-term investment of the province's general revenues.

Treasury officials said their investments were returning 9 to 10 percent. The Heritage Fund's latest annual report, released last July, reported a weighted average yield of 8.6 percent.

But for this and a number of other reasons, the Heritage Fund has come under mounting criticism in recent weeks and months.

"They are way too conservative, almost timid," said one financial analyst, who like many others sees the need for an expanded professional staff to manage the rapidly growing fund.

But given Premier Lougheed's penchant for firm control of all things political and his anticipated call for elections in March, few expect any dramatic changes.

There have also been criticisms from other less-endowed provinces, such as Ontario, which maintain that Alberta has no need or right to siphon off further vast sums and potential investments from them for itself.

"As a Canadian," said Ed Broad-

bent, leader of the opposition New Democratic Party in Ottawa, "I find it disturbing that one part of the land is a miniature Saudi Arabia and in a position to simply compound its gains."

Loan to Nova Scotia

The loans to other provinces are a partial response to these charges; financially pressed Nova Scotia, for instance, saved a considerable underwriting cost and potential currency exchange losses on its direct \$100 million loan from Alberta, but is paying standard commercial rates.

But the greatest difficulty, the Premier acknowledges, probably lies in the future. There are already divisions over how and when the money should be spent, not least from civil servants clamoring for wage increases. "Why are we saving it all?" one community leader asked. "let's spend it now on education. What better investment is there?"

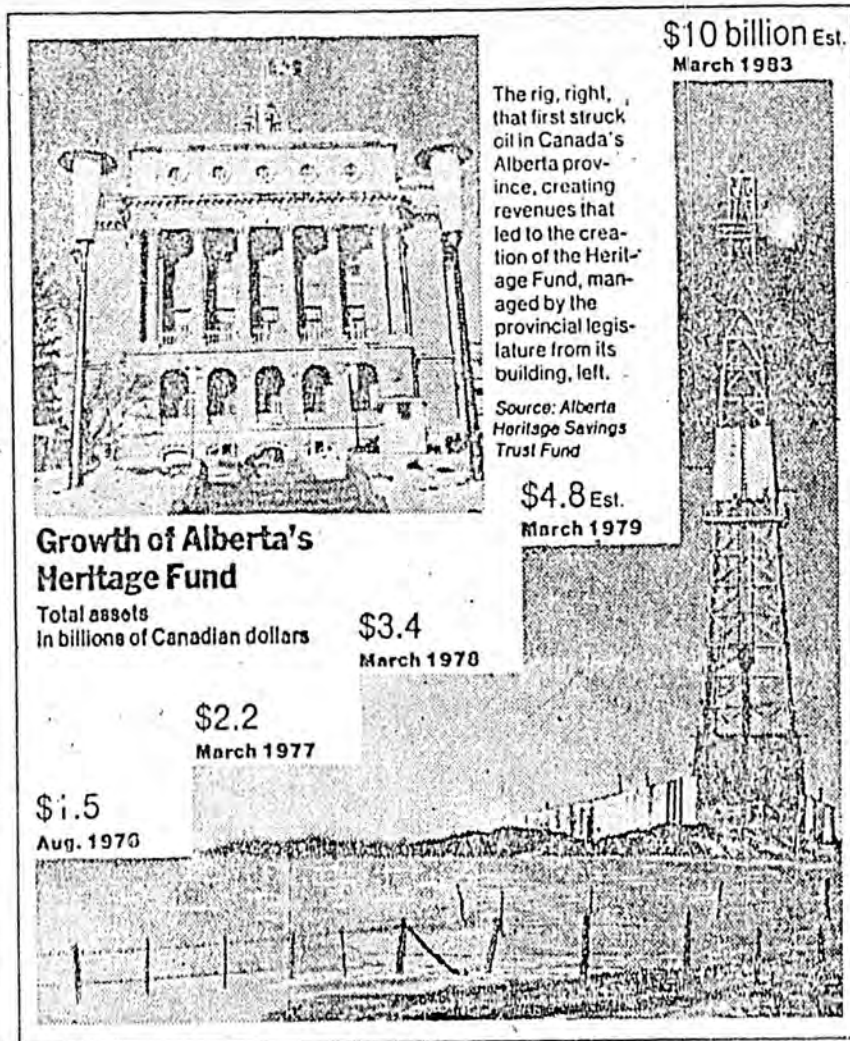
The government has done little with the fund to shape Alberta's economic diversification, one of the reasons for the fund's founding. But there are signs of change here. Mr. Lougheed has proposed a \$100 million investment to expand terminal facilities in British Columbia to improve maritime export of Alberta's vital grains. And there appears to be less reluctance now to expand loans to corporations, boding some competition for banks, or to taking more equity positions. The province already owns Pacific Western Airlines, a regional carrier that it bought on the stock market in 1973.

This trend is fast raising fears of future injudicious spending and possible political favoritism — if not by the present administration, then perhaps by its successors.

"It is a fiscal rule," said a bank analyst, "that governments with money tend to create programs that stick around and haunt them later when the money is gone. Then all they can do is cut growth, not actual expenses."

Or as one Calgary oilman put it: "I'm worried about some yahoo candidate promising to repave everybody's street with that money if they'd just elect him. A lot of people would vote for that. I would."

Alberta's Enviably Oil Nest Egg



By ANDREW H. MALCOLM

Special to The New York Times

EDMONTON, Alberta — The rainbow ends here. And the pot of gold is the Alberta Heritage Savings Trust Fund.

Thanks to the oil and gas that lurk beneath these prairies and to the Arabs who raised their world value, the Province of Alberta now has about \$4.5 billion it isn't quite sure what to do with. To handle this delightful problem, it has created a trust fund for the future, and into it goes 30 percent of the province's receipts in royalties from non-renewable resources.

In the time it took to read this far, \$1,400 more has poured into the fund. That is \$166,666 an hour, or \$4 million a day, or \$1.5 billion a year, give or take \$100 million or so.

"They are big bucks," said one of the growing number of bankers, such as Citicorp and First Boston, who have opened or expanded their offices in Alberta.

To be sure, there are many other financial attractions in Alberta, a Texas-sized province that has Canada's most prosperous economy, smallest taxes and lowest unemployment. But the 30-month-old Heritage Fund has already created the largest money market west of Toronto and ignited regional jealousies and denunciations of Alberta's "blue-eyed Arabs."

How the fund is handled, or mishandled, in the coming years will significantly shape the future economic direc-

Continued on Page D5

To - Lag
Jay Kuthub

New York Times
1/15/79

STATE OF ALASKA THE LEGISLATURE

POUCH Y - STATE CAPITOL
JUNEAU, ALASKA 99811
907-465-3900

LEGISLATIVE AFFAIRS AGENCY

MEMORANDUM

SUBJECT: Permanent fund

TO:

FROM: Billy G. Berrier, Director
Division of Legal Services

You have requested my comments on the legal implications of the words "permanent" and "income producing" as used in the constitutional amendment authorizing the permanent fund on the legal standards and guides the legislature may wish to establish in legislation.

The relevant provision is Section 15, of Article IX which reads:

"Section 15 ALASKA PERMANENT FUND. At least twenty-five percent of all mineral lease rentals, royalties, royalty sale proceeds, federal mineral revenue sharing payments and bonuses received by the State of Alaska shall be placed in a permanent fund, the principal of which shall be used only for those income-producing investments specifically designated by law as eligible for permanent fund investments. All income from the permanent fund shall be deposited in the general fund unless otherwise provided by law".

It is clear from the wording of the amendment itself and from the surrounding context that the concept is that a fund be created in which a portion of the mineral revenues of the state would be set aside in order to insure preservation for the future of that portion of the revenue. There can be no legitimate question that the objective is preservation of that portion as capital for the long term use of the state and its people and prevention of uses which are expedient in the short term but which would dissipate the capital of the fund. The paramount consideration must be the probable safety of the capital of the fund to be invested.

The term "permanent" as used three times in the body of the amendment and in the title of the fund would be read in the normal sense of that word since that reading is consistent with the context of the amendment, with the legislative and public discussion of the amendment, and with the understanding that the voters would be presumed to have in approving the amendment.

While the permanent fund is not a trust in the technical legal meaning of the term, the protection of capital required has substantial similarities to the requirements binding upon a trustee. This requirement is commonly referred to as the prudent-man rule. There have been numerous cases on this rule and many commentators have set out reasonable similar statements of the rule. A good statement is found in Scott on Trusts 3rd Ed in Sec. 227 (pages 1805 - 1806) which reads:

"The only general rule which can be laid down as to investments is that the trustee is under a duty to make such investments as a prudent man would make of his own property having primarily in view the preservation of the estate and the amount and regularity of the income to be derived. In various forms this rule has been stated in innumerable cases. It involves three elements, namely care and skill and caution. The trustee must exercise a reasonable degree of care in selecting investments. He must exercise a reasonable degree of skill in making the selection. He must, in addition, exercise the caution which a prudent man would exercise where a primary consideration is the preservation of the funds invested."

This rule would seem to adequately set out the general parameters constitutionally required for permanent fund investments of principal. It would apply at two stages of the process. The legislature would be bound to apply it in exercising the duty to circumscribe and delineate investments required under the limitation in the constitution reading:

"...the principal of which shall be used only for those income-producing investments specifically designated by law as eligible for permanent fund investment. (emphasis added)

The managers of the fund are given no constitutional discretion under this clause. The discretion is lodged exclusively in the legislature; and, if the objectives of the permanent fund are to be attained, investments specifically designated by law as eligible for permanent fund investment must also meet the criteria of having as a primary consideration the preservation of the funds invested.

The legislation, however, would not be expected to detail the permissible investments. It would presumably designate specific investment categories and create a management structure for the fund which would make the specific decisions as to which investments are to be made. Here again, the prudent-man rule would be applicable. In addition to designating specific categories of investment, any legislation should also establish guidelines for the fund management which are consistent with the objective of the fund. The need for this arises because within a class which as a class meets the objectives of preservation of the funds invested, some specific investments would still not be made by a prudent man. Possibly this could be largely avoided by using an ultra restrictive approach to allowable categories of investment but this approach would create or exacerbate other problems.

The primary difficulty with an ultra restrictive approach to allowable investments is that, as a matter of law, the problem of inflation would not be a factor in investment decisions. It can be reasonable assumed that inflation to some degree may be anticipated.

The argument has been made that inflation can realistically be anticipated to occur, that if principal is not increased in an amount to compensate for inflation the real value of the principal will decline even though the nominal value is maintained and that the duty of a prudent investor is to maintain the real value of the principal. Therefore, failure to account for inflation in investment policy violates the prudent-man rule of investment. I have found no authority to support this argument as a legal requirement. Factually, the argument would fall here. The constitutional amendment makes a clear distinction between principal which is permanent and income which is subject to expenditure by the normal appropriation process unless the legislature directs otherwise. At the time the amendment was adopted, inflation had occurred at an extremely high rate in the immediate past so it must be assumed that both the legislature and the public were conscious of inflationary effect. It would therefore, to support this argument, require assuming that investments which would have a capital appreciation, entirely apart from income earned, which is at least equal to inflation are the only permissible investments. This does not seem reasonable.

The argument that inflation must be taken into account does not seem valid here but that does not mean that inflation may not, or even that it should not, be taken into account. There is no reason that legislation establishing the management of the permanent fund and the disposition of fund income should not address this problem directly. I have suggested earlier that the legislation needs to establish standards for investments to avoid having to specify only ultra restrictive investments. The legislation could also require that the possible effects of inflation be a consideration in investment decisions made by the fund managers.

The term "income-producing" as used in the amendment presents serious conceptual difficulties. In context, this could simply be a restatement of the normal duty to make productive investments. In relation to trusts this has been stated:

"It is the duty of a trustee to preserve the trust property and make it productive. It is ordinarily his duty to invest trust funds in such a way as to receive an income without improperly risking the loss of principal." (Scott on Trusts 227 p. 1805)

However, as stated earlier, the permanent fund is not a trust in the technical legal sense. Simply carrying over the trustee's duty could be misleading.

The term "income-producing" is not a term of art and has no fixed legal meaning differing from the conventional meaning of the term. It is possible that a court would hold that the term implies that maximum income consistent with safety of principal must be the exclusive criteria for investment. This would be consistent with trust law but it appears that the amendment contemplates broader considerations as well. It would appear more likely that other considerations, such as the effect particular investments would have on furthering public purposes other than maximization of income, could also be given weight. Some examples of other public purposes are providing jobs, improvement of the Alaskan economy and economic diversification.

It is clear that production of income is a necessary goal of each investment; it is probably that maximization of income consistent with safety of principal must be a major goal, ; but it appears unlikely that a court would hold that this must be the exclusive goal of permanent fund investment policy.

While the investment of the permanent fund differs from investment of state treasury surplus funds in several respects including the specific requirement of income producing investment of permanent fund principal, both have as major goals protection of principal and production of income. It is interesting to note that state treasury surplus fund investment specifies policy goals additional to the primary goals. On this point AS 37.10.075(f) provides:

(f) Investment policy shall be formulated by the commissioner of revenue who shall be advised by a committee appointed by the governor which shall contain representation from the legislature. In formulating investment policy they shall consider maximum income and safety as governed by the prudent-man rule and the benefit to the private and public sectors of the economy in terms of increased housing and commercial credit, stimulated business activity, increased employment, support of the market for state and local bonds, increased public revenue together with the possible inflationary effect of the investment, and (h) and (i) of this section.

The question of what the term means as a matter of law will almost certainly be decided by the courts on a case by case basis. The questions involved are complex and change over time. In reasonably similar instances, the courts have refused to provide a general definition. For example the Alaska court in dealing with the term "capital improvements" as used in the Alaska Constitution said:

"We believe it would be unwise for this court to attempt to provide an abstract definition of "capital improvements." We have concluded that it is beyond human ability to permanently circumscribe with mere words at a given point in time a concept which though limiting in aspect, is otherwise intended to provide a broad, permanent and continuing authority for municipalities to finance present as well as unforeseeable future needs." (Juneau v. Hixon 373 P2d 743 (Alaska 1962))