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INDEX

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The following existing loan funds, authorities, and development corporations are effectively repealed by the current version of SB 1.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Existing funds and corporations which are not repealed by SB 1 are: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. <u>Purposes</u>

- 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.

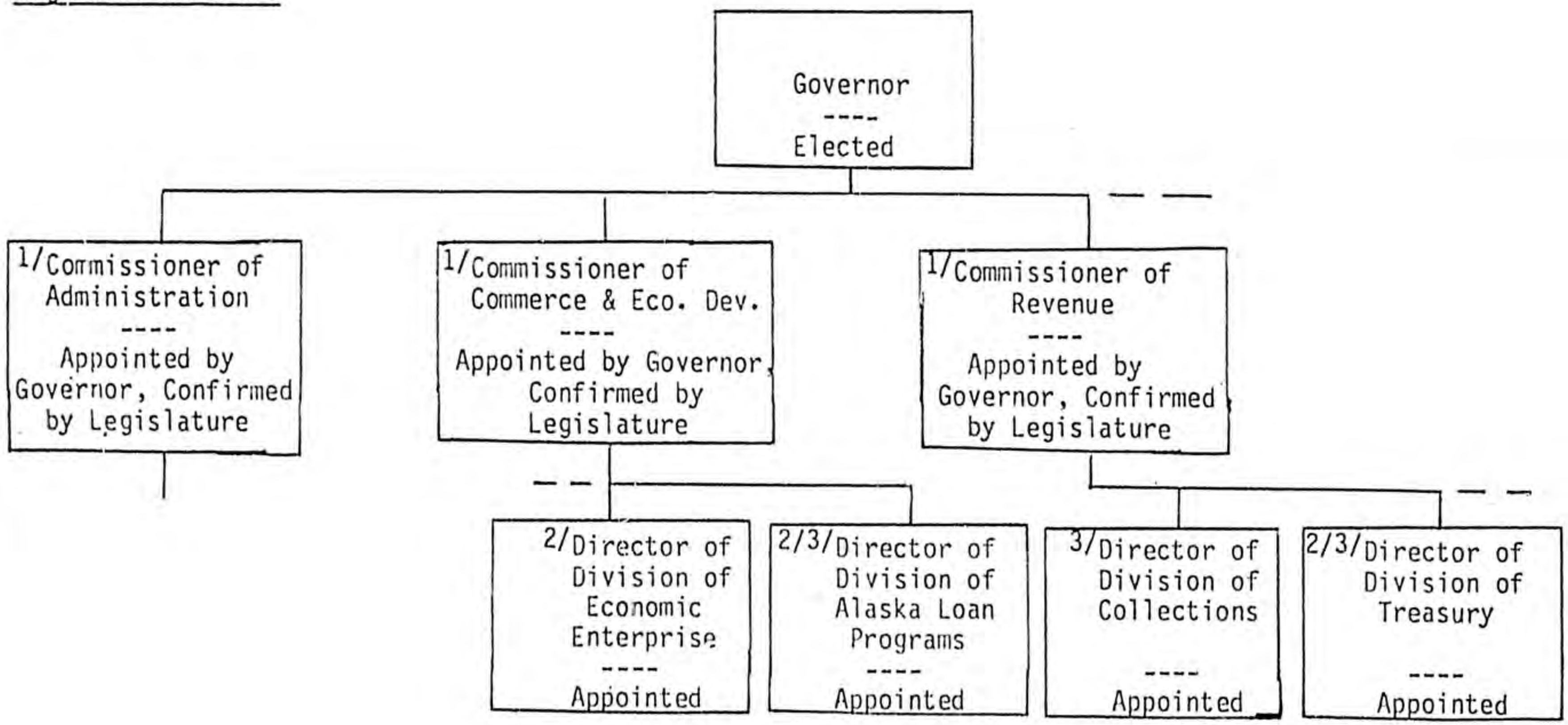
- Refund any or all existing state or municipal general obligation and revenue bonds.

- 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.

P. B. McDowell
February 1, 1980

Bill 35

Supplied by Queen's Printer Edmonton — Price 45¢

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 (e) and by adding the following clauses after clause (e):*

(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.

Printed by the Queen's Printer for the Province of Alberta, EDMONTON

STATE OF ALASKA

JAY S. HAMMOND, Governor

OFFICE OF THE GOVERNOR

DIVISION OF POLICY DEVELOPMENT AND PLANNING

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.

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 Urion

Special Committee on
The Alaska Permanent Fund
Pouch V, Juneau, AK 99811

Contents

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 meduim 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 forseeable 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.

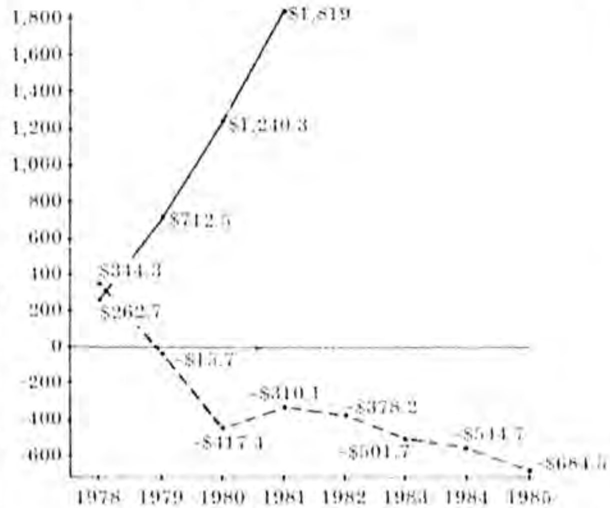
It is important to note that, in addition to whatever money is put into the permanent fund, there are previous constraints on state revenue. These include a 5 per cent dedication to the Renewable Resources Development Fund, payments to the Alaska Native Fund and fixed assets in various state loan funds.

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

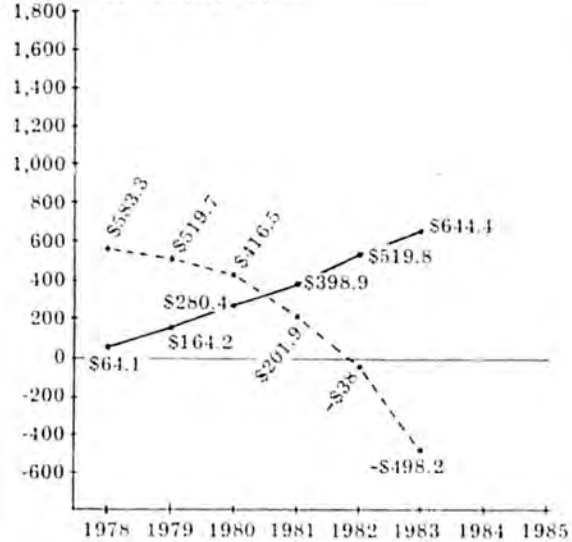


—— Permanent Fund (1985 Balance = $4,806.7 million)
- - - General Fund (1985 Balance = -$684.5 million)

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.

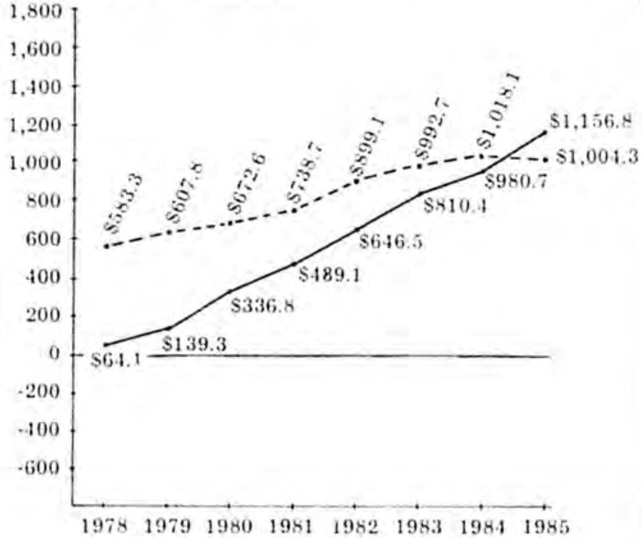
Source: Division of Legislative Finance

Chart 2
30% Contribution



—— Permanent Fund (1985 Balance = $903.3 million)
- - - General Fund (1985 Balance = −$2,202.7 million)

Chart 3
30% Contribution



—— Permanent Fund (1985 Balance = $1,156.8 million)
- - - General Fund (1985 Balance = $1,004.3 million)

Note:

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

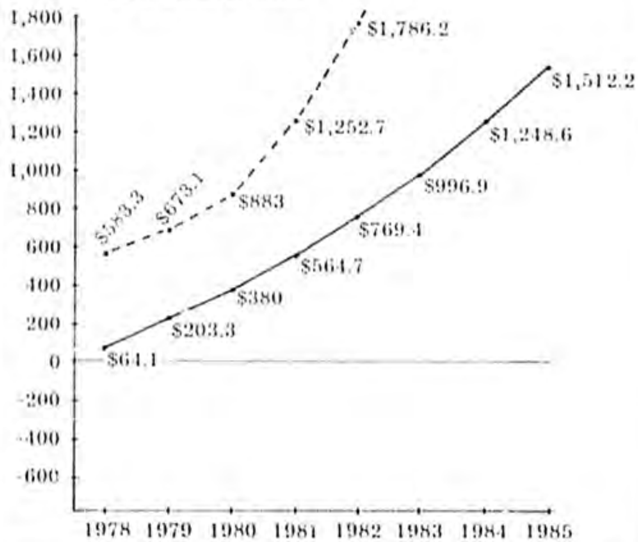
In Chart 2, wellhead values increase 2.5% annually; expenditures increase 15% annually; tariffs are about $6.25 per barrel; the State loses the dispute over deduction of treatment costs for royalty calculations; the state severance tax "floor" remains at 80¢ per barrel (equivalent to a wellhead value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



—— Permanent Fund (1985 Balance = $1,512.2 million)
- - - General Fund (1985 Balance = $4,185.9 million)

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 Corportation (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 statuatory 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.

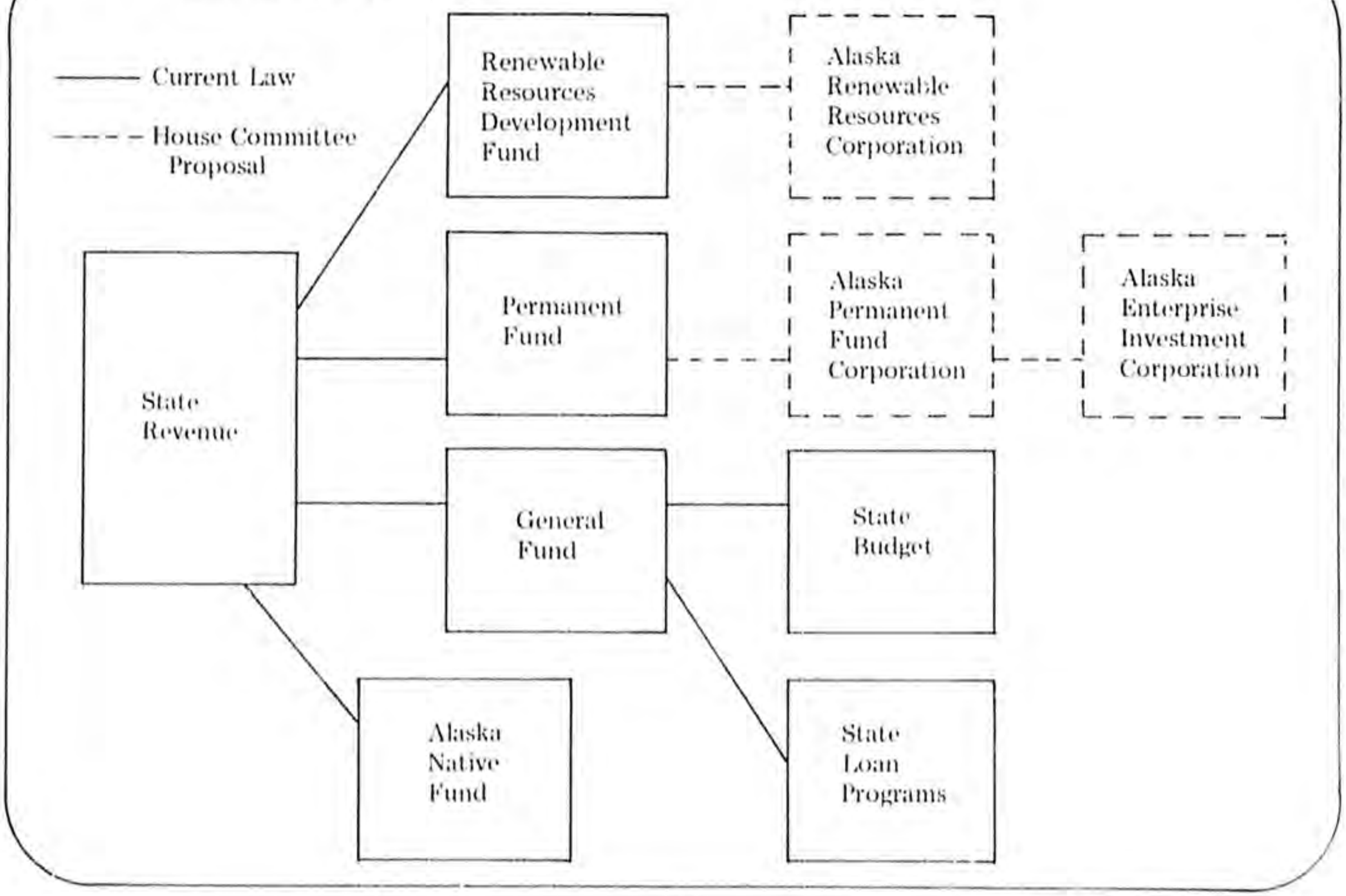
Medium risk would include portions of those listed above and part of the Alaska Enterprise Investment Fund.

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.

Chart 5
State Financial Distribution



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 issue 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

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 a members.

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 legislative intent; ~~and~~ this has raised questions concerning the wisdom of entrusting the Permanent Fund to such an independent board.

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 catagories 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.

agree.

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 arguement 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 occuring 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 satified 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 ~~ADA~~ AIDA 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 catagories 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. <u>Why does Alaska need a development bank?</u>

<u>Proposals</u>:

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, ~~of~~ 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 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 or want

private capital to fail to flow and present these factors to the Governor and the Legislature, who may then shoose 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.) ~~and~~ 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 gasline.

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

M E M O R A N D U M

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

31-01LH

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
- 78
19%

10%

16%
5%

Prepared by:
Legislative Finance
February 7,1979

STATE OF ALASKA
LEGISLATIVE FINANCE WORKING DOCUMENT
BUDGET FORCASTING MODEL

1

26-JAN-79

COMMENTS

NO GAS PRODUCTION
NO EXPORTS
6.5% INLFATION
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 G.F. CASH BAL = 20.00%
% OF ROYALTIES LEASES AND BONUSES DEPOSITED IN PERMANENT FUND = 30.00%
ANNUAL % INCREASE IN BUDGET APPROPRIATION = 10.00%

YEAR END	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										120.9	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	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	988.8	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	2788.6	382.2	3170.8	2671.6	0.0	0.0	306.7	2978.2	192.6	2331.7	2843.8	0.0

STATE OF ALASKA
LEGISLATIVE FINANCE WORKING DOCUMENT
BUDGET FORCASTING MODEL

26-JAN-79

COMMENTS
- NO GAS PRODUCTION
- NO EXPORTS
- 6.5% INLFATION
- 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 G.F. CASH BAL = 20.00%
% OF ROYALTIES LEASES AND BONUSES DEPOSITED IN PERMANENT FUND = 30.00%
ANNUAL % INCREASE IN BUDGET APPROPRIATION = 15.00%

YEAR END	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	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 FORCASTING MODEL

3

26-JAN-79

COMMENTS
NO GAS PRODUCTION
NO EXPORTS
6.5% INLFATION
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 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 END	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

Ernie #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 <u>now</u> 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 d 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.

#18:30

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.

(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 develope 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 Enviable 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 provinical treasurer, 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.

United Press International

Peter Lougheed

"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 Broadbent, 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?"

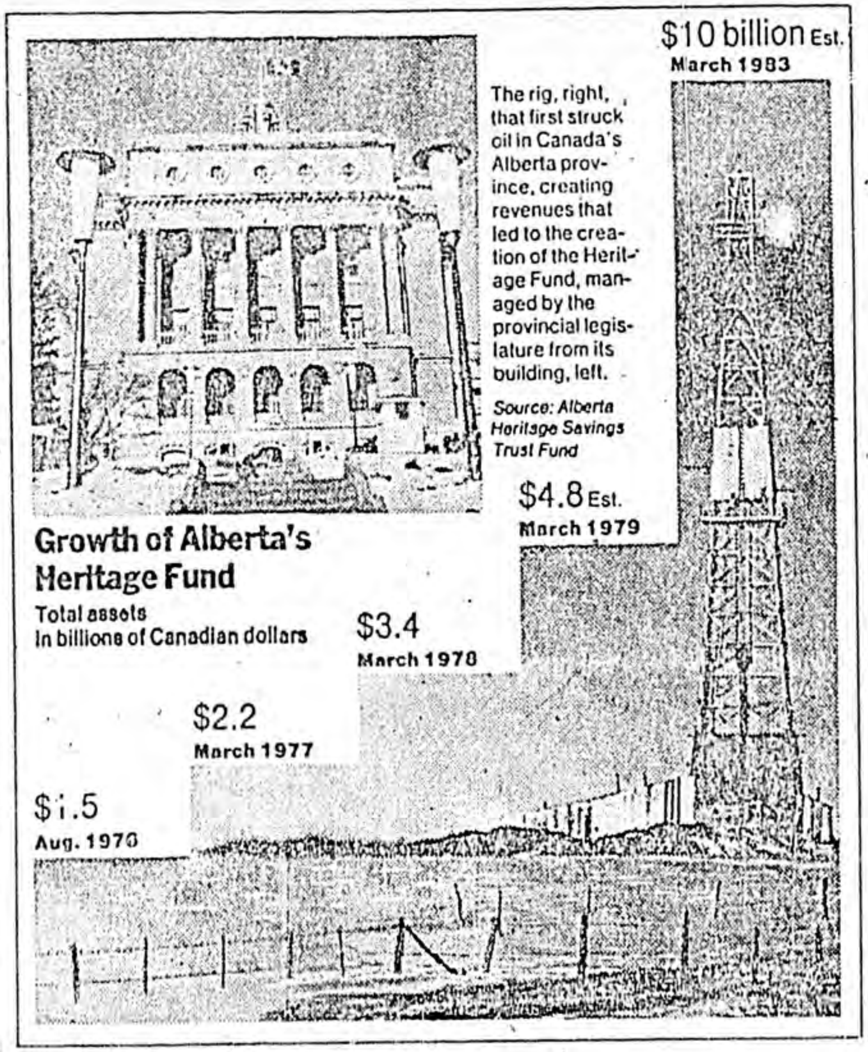
The government has done little with the fund to shape Alberta's economic diversification, one of the reasonsfor the fund's founding. But there are signs of change here. Mr. Lougheed has proposed a $100 million investment to expand terminal facilities in British Columbia to improve maritime export of 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 Enviable Oil Nest Egg



The rig, right, that first struck oil in Canada's Alberta province, creating revenues that led to the creation of the Heritage Fund, managed by the provincial legislature from its building, left.

Source: Alberta Heritage Savings Trust Fund

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 nonrenewable 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.

"Them 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 [illegible]

New York Times 1/15/75

Opinion 1977-27

STATE OF ALASKA
THE LEGISLATURE
LEGISLATIVE AFFAIRS AGENCY

POUCH Y . STATE CAPITOL
JUNEAU, ALASKA 99811
907-465-3800

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 permissable investments. It would presumably designate specific investment catagories 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 catagories 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 catagories 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 permissable 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 Consitution 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))

While it is my opinion the courts will be liberal in sustaining the reasonable expectations of the legislature and the fund managers, they are unlikely to allow investments which cannot reasonably be anticipated to produce maximum current income consistent with safety of principal modified by application of other permissable public policy considerations. It appears certain that investments which cannot reasonably be anticipated to produce direct income would not be allowed.

BGB:jpd

LONG RANGE GENERAL FUND REVENUE FORECAST
(In Millions of Current Dollars)

	FY 79	FY 80	FY 81	FY 82	FY 83	FY 84	FY 85
GENERAL FUND PETROLEUM REVENUE							
Oil & Gas Severance Tax (Net of EDIC)	165.5	172.1	270.1	537.6	616.2	689.2	752.5
Petroleum Property Tax	161.0	166.0	171.0	176.0	181.0	186.0	191.0
Petroleum Corporation Income Tax	166.0	160.0	160.0	160.0	160.0	160.0	160.0
Oil & Gas Royalties (Gross)	297.5	360.2	467.3	647.9	747.9	849.7	943.0
Bonus Sales	0	0	0	0	0	0	0
Mineral - Petroleum Lease Rentals (Gross)	2.7	2.3	2.3	2.3	2.3	2.3	2.3
Federal Shared Mineral - Petroleum Rents & Royalties (Gross)	1.1	1.1	1.5	1.5	1.5	1.5	1.5
TOTAL GENERAL FUND PETROLEUM REVENUE (GROSS)	793.8	861.7	1,072.2	1,525.3	1,708.9	1,888.7	2,050.3
GENERAL FUND NON-PETROLEUM REVENUE							
Taxes							
Individual Income Tax	130.0	145.0	168.0	208.9	257.6	310.3	368.8
Corporation Income Tax	37.0	39.0	36.5	41.9	47.4	53.0	58.7
Business License Tax	22.0	3.8	3.1	3.3	3.4	3.6	3.8
Alcoholic Beverage & Cigarette Excise Tax	9.2	9.3	9.4	9.6	9.8	9.9	10.0
Fuel Taxes	27.8	29.3	30.0	30.8	31.4	32.0	32.4
School Tax	2.4	2.5	2.6	2.6	2.6	2.7	2.7
Other Taxes	24.6	26.2	32.2	30.5	35.0	36.7	41.8
TOTAL TAXES	253.0	255.1	281.8	327.6	387.2	448.2	518.2
LICENSES & PERMITS	20.2	20.1	21.2	22.1	23.2	24.2	25.3
FEDERAL SHARED NON-PETROLEUM REVENUE	3.4	3.5	3.5	3.5	3.5	3.5	3.5
INTEREST REVENUE (FROM GF & PF)	62.0	45.0	60.4	68.1	78.7	91.0	104.9
OTHER SALES & USE REVENUE	3.1	5.5	5.7	5.9	6.1	6.3	6.5
FACILITIES RELATED CHARGES	23.6	27.6	30.8	32.6	34.3	36.1	37.8
SERVICE RELATED CHARGES	4.5	3.4	3.6	3.8	4.0	4.1	4.2
MISCELLANEOUS REVENUE	3.9	3.9	3.9	3.9	3.9	3.9	3.9
TOTAL GENERAL FUND NON-PETROLEUM REVENUE	353.7	364.1	410.9	467.5	540.9	617.3	704.3
TOTAL GENERAL FUND REVENUE (GROSS)	1,147.5	1,225.8	1,483.1	1,992.8	2,249.8	2,506.0	2,754.6
Less State Native Land Claim Payment	41.6	50.8	68.5	96.8	112.8	104.3	0
Less Permanent Fund Contribution	75.2	90.7	117.8	162.9	187.9	213.4	236.7
TOTAL GENERAL FUND REVENUE (NET)	1,030.7	1,084.3	1,296.8	1,733.1	1,949.1	2,188.3	2,517.9

Prepared by the Department of Revenue, Research
February 1979

PROJECTED PERMANENT FUND BALANCES AND EARNINGS [1]

Fiscal Year	Permanent Fund Balance	Earnings @7% on Average Permanent Fund Balance	Permanent Fund Balance if Earnings @7% Retained in Fund
1978	54.5		
1979	128.9	6.4	135.3
1980	219.0	12.2	238.0
1981	325.4	19.0	364.8
1982	444.5	26.9	513.6
1983	576.9	35.7	686.6
1984	723.7	45.5	886.6
1985	885.8	56.3	1117.4
1986	1064.2	68.2	1380.2
1987	1260.1	81.3	1679.5
1988	1474.6	95.7	2019.9
1990	1964.6	128.6	2835.5

FOOTNOTE: (1) Assumes no gas line, no lease bonuses, no new fields produced. Sadlerochit produced at 1.16 mm BPD thru 1990, 6.5% annual increase in oil prices.

PREPARED BY: LEGISLATIVE FINANC
March 8, 1979

ALLOCATIONS OF PROJECTED OIL & GAS ROYALTIES
($ millions)

Fiscal Year	Oil & Gas Royalty 1/	Permanent Fund 25%	Renewable Resources 2/ Development Fund 2-1/2%	Renewable Resources 2/ Investment Fund 2-1/2%	Reserve for Energy Facilities 5%	Reserve for Capital Outlay 25%	Native 3/ Claims 16%	Mental Health Trust 1-1/2%	University Trust 1-1/2%	Public School Fund 1/2%	Unallocated Balance
79	297.6	74.4	7.4	7.4	14.9	74.4	47.6	4.5	1.5	1.5	63.9
80	360.3	90.1	9.0	9.0	18.0	90.1	57.6	5.4	1.8	1.8	77.5
81	425.7	106.4	10.6	10.6	21.3	106.4	68.1	6.4	2.1	2.1	91.6
82	476.4	119.1	11.9	11.9	23.8	119.1	76.2	7.1	2.4	2.4	102.4
83	529.7	132.4	13.2	13.2	26.5	132.4	84.7	7.9	2.6	2.6	113.9
84	587.3	146.8	14.7	14.7	29.4	146.8	94.0	8.8	2.9	2.9	126.3
85	648.1	162.0	16.2	16.2	32.4	162.0	46.6	9.7	3.2	3.2	196.6
86	713.6	178.4	17.8	17.8	35.7	178.4		10.7	3.6	3.6	267.5
87	783.4	195.8	19.6	19.6	39.2	195.8		11.7	3.9	3.9	293.7
88	858.1	214.5	21.4	21.4	42.9	214.5		12.9	4.3	4.3	321.7
89	937.6	234.4	23.4	23.4	46.8	234.4		14.0	4.7	4.7	351.5
90	1022.3	255.5	25.5	25.5	51.1	255.5		15.3	5.1	5.1	383.3
TOTAL CONTRIBUTIONS:		1909.8	190.7	190.7	382.0	1909.8	474.8	114.4	38.1	38.1	2389.9
FY 78 BALANCE:		54.5					25.2				
FY 90 BALANCE:		1964.3					500.0				

FOOTNOTES:

1. Based on assumptions of no gas line, Sadlerochit production at 1.16 million barrels per day, 6.5% annual increase in oil prices, and no new fields produced, and no lease bonuses.

2. Allocations to both Renewable Resources Funds cease when the Investment Fund reaches $250,000,000.

3. Payments cease when $500,000,000 has been paid.

PREPARED BY:

LEGISLATIVE FINANCE
March 8, 1979

House Special Committee on the Permanent Fund

Proposed Schedule as of 6 March 1979

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

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

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

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

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

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

ECONOMIC CONSIDERATIONS
IN ESTABLISHMENT OF
ALASKA'S PERMANENT FUND

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

for
Legislative Affairs Agency
State of Alaska

July 7, 1977

I. INTRODUCTION

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

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

Uses of the Permanent Fund

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

There is little doubt that the operation of the fund would have the effect of reducing the immediate fiscal impact of oil and gas income and a stretching out and smoothing of its long-term impact, however the fund is organized and whatever its investment strategy. But the size of these impacts will depend on how much of the permanent fund's capital is invested or lent in Alaska and on what terms. Given certain assumptions about the size and structure of the state's economy, the revenues committed to the fund, the yields of the fund's investments and the disposition of income from those investments, we can forecast its effect on the shape of long-term growth of state product, personal income, employment and per capita income. Some elementary projections of this sort have already been made by ISER under the Man in the Arctic Program.

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

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

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

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

II. CAPITAL MARKET EFFICIENCY

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

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

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

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

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

This issue has important implications for the permanent fund's investment strategy. If capital markets serving Alaska business are workably efficient, permanent fund moneys dedicated to Alaska investment will have no impact on the aggregate level of investment (and thereby the rate of economic growth), the industrial structure, or on the profitability of investment in Alaska, unless these moneys are offered on subsidized terms. Loans from the permanent fund at market rates would simply displace private capital that would otherwise be available at the same rates. The only material result might be a reduction in the diversity--and thereby safety--of the permanent fund's own investment portfolio because it would be imprudently concentrated on Alaska issues and unduly sensitive to business fluctuations special to the state.

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

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

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

Alaskan Capital Markets

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

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

Many small businessmen including, it appears, most prospectors, inventors, independent merchants, and operators of hotel, restaurant and other tourist-related businesses outside of Anchorage, and some contractors do not, however, believe in the efficient markets paradigm. I heard many complaints about treatment by banks and finance companies and a feeling that "the system" is biased against small businessmen and against Alaskan enterprise. I heard anecdotes purporting to show that even Alaska banks favor outside-owned businesses. Many persons in this group expressed a hope that the permanent fund could correct this bias and make more funds available for ventures like their own. It was especially noteworthy to me that most state and federal civil servants in the economic development or business assistance field expressed views more consistent with the capital shortage paradigm than with that of efficient markets and believed that government should provide more financial assistance to private industrial development in Alaska. Whether or not these sentiments express an accurate view of the way in which the economy and financial markets operate, it seems likely that it is a more representative view than the more sophisticated textbook, "big business" view of capital markets, and constitutes a substantial political constituency for an activist policy by the permanent fund's managers.

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

A common situation among small and medium Alaska business enterprises seems to be a rate of growth (with sales increasing at 20 to 100 percent per year) that leads to a need for additional fixed and working capital far outstripping internally generated cash flow. It is "obvious" to the owners and operators of these businesses that money borrowed to sustain this growth would earn a very good rate of return, but that there is never enough credit available. Businessmen in this situation seem to express two strikingly different attitudes toward their own "capital shortages." Those who operate by the efficient markets paradigm (and these seemed generally to be the most successful) expressed their problems objectively in terms of necessary cash flow and debt-equity ratios acceptable to lenders, while there were others who attributed their cash crunch to the institutional incapacity of financial institutions to serve their kind or business, or to the laziness, ignorance or malice of particular lenders.

It is clear that there are widely contrasting perceptions among Alaska businessmen and others about the adequacy of financial institutions and the supply of capital to Alaska ventures. Curiously, the distribution of these perceptions seems to be bimodal; that is, they cluster at one extreme or the other with only a scattering of individuals in the middle. Perceptions also seem to be highly correlated by industry and by size of enterprise. In general the bigger the firm, or the faster it is growing, the more satisfied its spokesmen are with existing capital markets. Without exception, representatives of large financial enterprises doing business in Alaska and of large national and multinational corporations spoke as if they believed in efficient markets and, without exception, they rejected the notion that lack of information, high transactions costs or institutional barriers created a capital shortage in Alaska or in the industries with which they are connected or whose financial needs they serve.

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

The time and resources available for preparing this report did not make it possible to separate perceptions and ideology from reality. Each group's perceptions were supported with convincing anecdotes. Nevertheless, most of the correlations between attitude and situation were predictable, and the perceptions surely contain a measure of self-interest and self-justification. Officers of financial institutions who have the job of searching out and appraising investment opportunities are likely to believe that their jobs are useful and effective, and they are unlikely to emphasize the problems of those kinds of enterprise that they do not serve (and which may not, in fact, be served well by any sector of the capital market). And it is not surprising that public officials feel that government financial and technical assistance (like economic regulation) is essential to a healthy business economy. But among businessmen, are the first group satisfied with the status quo because it served them well, or are those who accept, understand, and work easily within the status quo the people who are for that reason most likely to succeed as corporate managers and entrepreneurs?

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

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

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

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

Some businessmen will always have grievances against their bankers (and many Alaskan businessmen have some gruesome yet convincing tales to tell) or against the financial system generally. But Anchorage and Fairbanks banks do compete aggressively for business customers, and some of the "atrocity" stories can be attributed to understandable disagreements over the credit-worthiness of a particular borrower or venture rather than a systematic failing of the system. Again, apart from any argument that a particular line of business or kind of investment ought to be subsidized, there seems to be no case for the permanent fund or one of its subsidiaries to enter the commercial capital markets in these communities. I am not certain at this point how well these needs are being served in other urban places in Alaska.

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

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

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

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

III. SUBSIDIES AND SOFT LOANS

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

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MARGINAL VALUE

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

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

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

In this situation, subsidized loans by the permanent fund can without question have an influence on the shape and direction of economic growth in Alaska, and that influence will be greater the greater the proportion of permanent fund moneys devoted to the favored types of enterprise. The form the subsidy is likely to take to make it effective, however, will not be (and should not be) lower interest rates, but rather a relaxation of lending standards to enhance the availability of funds. One danger here, even if the legislature deliberately authorizes the fund's managers to make such loans, is that the nature and the degree of actual subsidy may not begin to appear for many years, until it begins to show up as defaults on principal and interest payments. This danger will be aggravated if, as is often the case with governmental loan programs, there is not a rigorous policy of classifying problem loans and of promptly writing off those which are uncollectable. Banks and thrift institutions are required by law and regulation to do this, but even there the requirement is only very loosely implemented or enforced, because lending officers are reluctant to expose their own imprudence in making bad loans or to write down the capital position of their institutions.

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

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

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

IV. COUNTER-CYCLICAL INVESTMENT

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

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

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

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

Even if there were significant capital market deficiencies which gave permanent fund outlays a real effect on aggregate investment in Alaska, or even if the fund had a policy of subsidizing Alaska business (thereby expanding the level of investment beyond what it otherwise would be), it is still not obvious whether a policy of varying state expenditures or permanent fund investment in response to economic conditions would in fact reduce business fluctuations in the state, increase them or be on balance neutral. The crucial question here is the relationship between our ability to forecast economic conditions or recognize cyclical turning points, and the time it takes for a change in appropriations or in lending policy to show up in unemployment rates or rates of economic growth.

Some very gross economic changes, such as the buildup and decline of pipeline construction activity, obviously could be anticipated and their fiscal effects projected with some degree of confidence. But the Alyeska pipeline is likely to be historically unique in size and specific gravity in the state's economy. Future ups and downs are more likely to be the resultant of a number of smaller influences, many of which (general business confidence, for example) cannot be mapped out in advance and are difficult to quantify even retrospectively. If booms and recessions often cannot be recognized clearly until after they have been with us awhile, and their turning points recognized only after they have passed, it is also true that significant delays are inevitable between the recognition of a new trend, the fiscal action that is appropriate and the actual movement of new dollars into (or out of) the private economy. Depending upon the relative lengths of the various lags, attempts to stabilize Alaska's economy or smooth its growth rate might be successful, but it seems equally likely that state fiscal policy would zig when it should be zagging, that the amplitude of the business cycle would thereby be increased, or even that the permanent fund's intervention could create oscillations in the state's economy where otherwise there would be none.

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

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

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

V. PUBLIC ENTERPRISE

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

The crucial characteristics of some public works, such as hatcheries and habitat improvement, is that they cannot be financed conventionally. Benefit-cost analysis may well show that the new benefits to society exceed the capital and operating outlays, but the burdens and the benefits may not fall on the same people, and it may be impractical (or impolitic) to collect a user charge from the beneficiaries. In the case of these fishery-related investments, however, costs could be allocated at least roughly among the beneficiaries through a surcharge on fishing licenses, entry permits or raw fish taxes. If such capital improvements are not to be funded this way, however, they seem more appropriate subjects for general fund appropriations than as "investments" by the permanent fund.

VI. ISSUES FOR FURTHER INVESTIGATIONS

This report has identified a number of questions whose answers are crucial if the Legislature is to develop appropriate policies for operation of the permanent fund. At most, however, the author has been able to give only tentative answers to these questions. The following is a list of issues that warrant further investigation, together with some discussion of methods and sources.

1. Capital market structure, costs and efficiency. A survey is necessary of the number, size and aggregate Alaska activity (e.g., loans made, loans outstanding, loans being serviced) for various institutions in the financial market, with offices both inside and outside of Alaska. Questionnaires and interviews would be used to determine the relative weight of each of these institutions in financing different industries in Alaska and their policies regarding various types of Alaska business.

A survey is necessary to determine just what is the price of money in Alaska and how does this price (together with other credit conditions) differ from those elsewhere in the United States. A large body of aggregate data comparing Alaska conditions with those in other states is available in the commercial bank call reports; some information is available by major loan categories (real estate, commercial and installment). The absolute level of these rates is less indicative than their relation to rates in other Western states and particularly the trend of any Alaska rate differential. Any differences in other loan terms (for example, requirements for compensating balances) would have to be based upon questionnaires or systematic interviews with lending officers.

Similar questions can appropriately be asked about differences in the rates and conditions for various categories of credit as between the urban centers of Alaska, and small communities and rural areas. The quickest approximation to an estimate of geographic differentials could be obtained by comparing loan statistics for the outlying branches of statewide banks with those of their urban offices. A hypothesis that deserves investigation is the proposition that retail credit markets are more competitive and more efficient than "wholesale" markets in Alaska. If this is the case, channelling the permanent fund's Alaska lending through existing financial institutions could result in large, unearned windfalls to the banking system without significantly benefitting Alaska borrowers. It would be instructive to see what happened to the "spread" between the interest cost of public deposits to Alaska banks and their interest earnings on real estate loans, for example, as a result of the Alaska preference provision in management of the state's North Slope bonus money. A similar question can be asked about the actual effect of the state's purchases of residential mortgages, after loan fees are taken into account.

2. Demand for investment and for loanable funds. A sample survey and detailed case studies should be undertaken of the financial structure and the procedure of financing fish processing plants, hotels and other relevant investment projects in Alaska. The contrasts, if any, in structure, procedures, costs of capital for individual components of financing (interim construction, working capital, etc.) should be noted and the appropriate implications drawn. The importance of capital financing costs to overall project costs is an important element in judging the potential sensitivity of investment demand to interest rates.

The investment demand schedule for individual industries ought to be investigated. The question here is to what extent will a reduction in the interest rate to a particular group or for a particular purpose result in an increase in the level of investment. The question is difficult to answer generally because the shape of the curve relating investment outlays to interest rates will differ for each subcategory of investment and will be affected by a large number of other factors. Builders of national econometric models have spent much time trying to specify investment demand functions with only limited success, however. The data base modeling Alaska investment demand is very limited because there are almost no satisfactory statistics that can be used as indicators of investment activity, with the partial exception of residential construction. The more productive approach would be to model individual projects--even fictional projects--in the way the Delta barley project was analyzed.

3. Aggregate impacts of different policies toward permanent fund appropriations and investments. The percentage of eligible funds that should be channelled into the permanent fund is of central importance. Not only will the future growth of the state's economy be determined to some extent by the choice of eligible permanent fund investments, but perhaps more importantly, it will be determined by the amount of money remaining in the general fund for unrestricted use. Specifically, Department of Revenue analysis of state revenues presented in February, 1977, projected a permanent fund balance of $1.8 billion in 1985 based upon a 25 percent contribution rate. The same source projected a general fund balance in excess of $6 billion in the same year. Increases in spending above the historical pattern of state government expenditures would have a downward effect on the total remaining in the general fund, but the balance can be expected to remain substantial.

The possibility of such a large general fund balance requires that the choice of the percentage of oil revenue dedicated to the permanent fund reflect the expected impacts of the uses of the general fund balance as compared with the impacts of administration of that money through the permanent fund.

For example, one way to make use of the general fund balance would be to reduce the personal income tax. The ISER MAP analysis shows that this would indeed cause a significant reduction in the general fund balance. At the same time, it would have a highly stimulative effect on the private sector as the increase in disposable income stimulated private sector demands. Employment and population would increase. Additional revenues would be generated, but these would not be sufficient to maintain constant per capita government expenditures. Either the level of services would have to decline or the general fund balance would be depleted more rapidly than initial calculations indicated, or both. If the permanent fund is to be a buffer against the depletion of the general fund, or is interpreted as a fund to benefit Alaskans, the expansion generated by the income tax could be the worst possible use of general fund money.

The growth implications of any constant percentage permanent fund contribution needs examination. Lumpy additions into the genera[l] fund caused by lease sales on state lands may be accompanied by bursts in general fund spending activity by the state. This erratic behavior could result in uneven growth and its problems. A formula for permanent fund contributions, which minimizes fluctuations in the general fund, might be a more appropriate rule than a fixed percentage.

Projections of the state fiscal position are important in the formulation of permanent fund policy in another way. Knowledge of what is happening to the general fund can determine permanent fund objectives. A large general fund balance, for example, tends to reduce the force of the argument that certain industry should be stimulated because of the tax base it provides.

The MAP model can be of assistance in the formulation of permanent fund policy in this regard because it can be used to project "futures" under varying assumptions of general fund policy given a "neutral" permanent fund. The state model can be used for this purpose.

A related issue is what policy should be established with regard to disposition of interest from the permanent fund. It is important not only what uses should be made of permanent fund interest but to a certain extent, what should be the target interest rate considering the uses of the interest. That is, if the interest is not put to good use, there should be relatively little concern with a high interest rate.

The basic issue, however, is whether the interest should be returned to the general fund without strings, should remain in the permanent fund for some period, or should be distributed to Alaska individuals who, in a sense, become the owners of the permanent fund.

The implications of each alternative on the growth of the economy and its fiscal condition will be considerably different. Reinvestment in the fund would have minimum impact in the short run. Transfer to the general fund would result in increased expenditures on state and local government which would have a stimulating effect on the economy with the impetus on increase in public sector activity. A transfer payment directly to individuals under some form of Alaska, Inc., project would provide an economic increase with a private sector impetus.

All of these kinds of expenditure programs can be analyzed with the MAP model framework. For this kind of analysis, which attempts to provide a picture of the relative impact of alternatives, specific program details are not necessary. The qualitative impacts would be the same regardless of whether a specific dividend amount were paid out as Alaska, Inc., payments or the available interest on the fund were distributed in that fashion. Here also, the state economic model can be used.

On the assumption that permanent fund investment will somehow be directed to the growth of certain industries, there is also a need for econometric simulations of the effects of expanding various Alaska industries on the state's economy as a whole, particularly on its employment and tax base.

4. Performance of soft loan programs. There are a number of existing state loan programs directed to social and economic development objectives. In general, they have loaned money at lower than prevailing commercial interest rates (but not necessarily at less than the state's "opportunity cost" of money). The actual quality of these funds' portfolios is unknown, however, and the actual rate of subsidy taking into account prospective future loan losses cannot, therefore, be determined. A systematic study should be made of this issue and its implications explored for administration of any soft loan program under the permanent fund.

Similar studies would be useful with respect to federal loan programs such as EDA and SBA, particularly concerning their Alaska activities. The experience and performance of International Development Agency programs and subsidized loan programs of other nations and states would also suggest problems which might be expected from any Alaska soft loan program established under the permanent fund.

DO YOU

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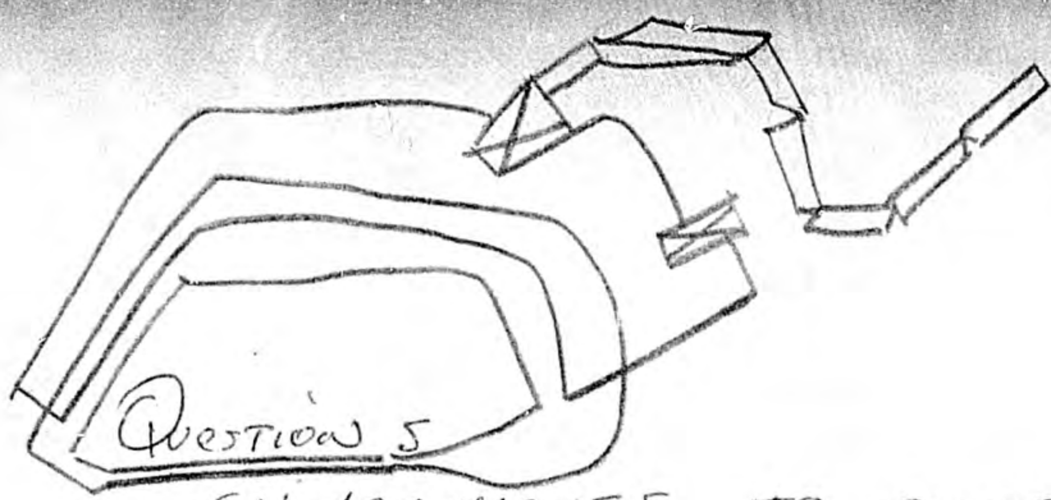
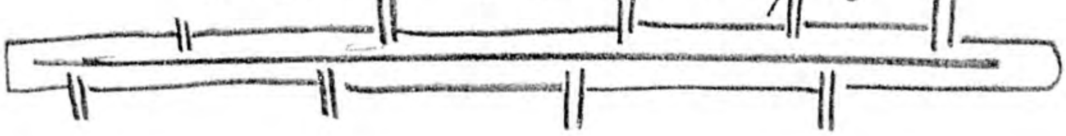
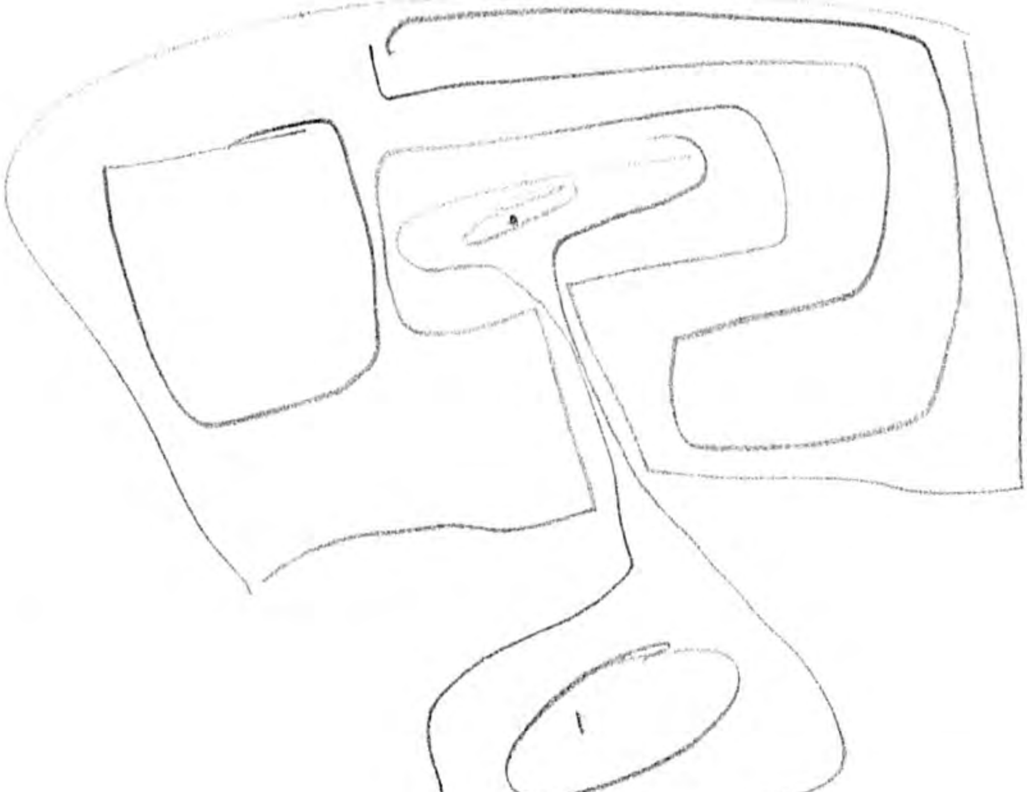


Question 5

(1) ARGUMENTS TO CONTRARY
WHAT ARE THEY?





HISTORY OF
PROJECTED PERMANENT FUND BALANCES
25% Contribution Rate

Fiscal Year Projected	11-76 Dept. of Revenue "Revenue Journal"	7-6-77 Legislative Affairs Haggart Memo	9-22-77 Legislative Finance Barker Memo	11-17-77 Legislative Affairs Haggart Memo	2-6-78 Legislative Affairs Haggart Memo	12-19-78 Dept. of Revenue "Petroleum Production Revenue Forecast"	2-7-79 Legislative Finance Barker Memo	Actual
77	2.8	----	4.0	----	----	----	----	4.0
78	93.6	88.7	68.0	53.8	----	----	----	54.5
79	225.9	208.6	180.5	158.1	138.4	126.9	128.9	
80	411.0	349.1	312.4	281.0	235.2	217.1	219.0	
81	622.1	502.3	457.0	408.0	334.0	333.9	325.4	
82	868.2	668.7	615.0	539.2	434.7	495.9	444.5	
83	1167.1	855.5	795.3	675.7	542.4	682.8	576.9	
84	1509.5	1052.6	991.5	817.6	663.1	895.3	723.7	
85	1883.8	1265.3	1204.0	964.4	786.8	1131.0	885.8	
86			1432.7			1400.1	1064.2	
87			1678.6			1695.9	1260.1	
88			1942.5			2017.7	1474.6	
89			2225.3			2365.8	1709.0	
90			2528.0			2733.5	1964.6	

Prepared by:
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