STATE of ALASKA

MEMORANDUM

OFFICE OF THE GOVERNOR

TO: The Honorable Sterling Gallagher
Commissioner
Department of Revenue

DATE: July 25, 1977

Ron Lind
Division of Budget and Management
Office of the Governor

SUBJECT:

FROM: Jay S. Hammond
Governor

JSH

As we have discussed, a high priority issue of this Administration is the need to switch the financing of State operations from a non-recurring (particularly, oil dependent) basis to recurring revenue sources. There are several possible strategies for accomplishing this objective. I would appreciate your participation proposing and evaluating the pros, cons, and probabilities for success of various methods.

As an early step in this analytical process, my Division of Policy Development and Planning, after discussions with your agencies, commissioned a short report by the Institute of Social and Economic Research. This report outlines possible approaches to "fiscal planning" for the state.

I am forwarding copies of this paper for your information. Please comment. I would also like to receive recommendations you wish to offer regarding possible solutions to the long-term fiscal problem, as well as a delineation of specific steps which will be necessary to begin the shift in financing base.

JSH/dp

Q: Are not all revenues nonrecurring?

Q: what are recurring revenues — even the personal income tax takes a percentage from oil production, transportation etc activities roughly equivalent to that oil provides for the whole state budget

PRACTICAL ISSUES IN LONG TERM FISCAL PLANNING FOR ALASKA

by

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Division of Policy Development and Planning

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PRACTICAL ISSUES IN LONG TERM FISCAL PLANNING FOR ALASKA

1. Introduction

There are several practical issues which can be raised with respect to long term fiscal planning for the state of Alaska. These problems are related to the level of analysis, the time frame over which one is doing the planning, and certain constraints which data availability may impose upon the process. Of course, these problems are not unique to Alaska, but the pace of economic and population growth, lack of social and economic data and infrastructure, and the amount of funds the state expects to receive from oil and gas activities will mean that the traditional problems in planning will be exacerbated.

The level of analysis will determine the choice of planning tools to a greater extent than might be imagined. For economic impact issues of the most general kind, it may be sufficient to forecast independently the total level of State expenditures planned for each year, introduce this planned series into a few simple equations describing population, income, and employment growth, and have a fairly accurate overview of the impact. For questions of much greater complexity, such as the different impacts of specific percentages of the Permanent Fund to be spent for specific types of projects, a detailed econometric model might be needed. The complexity of the question will have definite implications for the level of complexity of the analysis, and the effort which might be needed to produce the answer.

The time frame of the analysis will also affect the type and detail of analysis done on a specific question. Suppose, for example, that one wished to know the effect on the rate of growth of education expenditures of an increase in the rate at which migration to Alaska included children of school age. If the time frame of analysis were one to five years, the major effects could probably be modeled by adding students into the base of the current school finance laws. However, since in a longer run period of ten to twenty years, a more general relationship between numbers of students and the expenditures per student could tend to dominate and even cause changes in specific funding formulas, general funding assumptions might be more accurate than the current formulas.

Finally, the rate of growth of the Alaskan economy and the scarcity of certain social and economic elements, such as multiple transport modes between points and local availability of some goods and services normal for the

United States, makes it extremely difficult to project past economic and government relationships into the future. This is compounded by lack of reliable data and indicators of business and government activity in many areas; and by the fact that Alaska is facing a situation in which its economy is maturing at the same time that the traditional spending constraints imposed on the state government for most of the historical period by lack of an adequate tax base will soon be removed. The lack of a traditional industrial and transportation base, along with weather and cost problems in Alaskan business, makes data from other states of limited use. Yet, data compromises may have to be made, especially to answer the more complex and difficult modeling questions regarding future Alaskan growth in response to government fiscal policy. Ultimately, the choice of the form of analysis will depend both on the objectives of the analysis and the quality of the supporting data.

There are a series of long term fiscal policy questions or options which will affect Alaskan state government fiscal planning over the foreseeable future. Among these are: whether the State wishes to increase or decrease its dependence on oil revenues, or its dependence on revenues resulting from taxes on recurrent economic activity; whether to provide the equivalent of the most modern health, communication, transportation, and education services to all Alaskans; whether to increase the size, stability, and complexity of the State's economy; and whether to minimize the tax burden on the average Alaskan. To reach any of these fiscal goals or any other fiscal goal, however, it will be desirable for the planners to restate the goal in increasingly precise terms, as is done with one goal in the following section. Following this, it will be desirable to deal with a large range of specific issues related to both revenues and expenditures of state government in Alaska. The purpose of this paper will be to identify several of these specific issues as they relate to the budget process and to the specific goal of releasing the State from dependence on oil revenues as the largest source of funding for the operating budget.

I have chosen to organize the issues in Alaskan fiscal planning around a number of specific subject areas, for analytical convenience. In actually attempting to complete any long term fiscal plan, the planner will have to deal with several of these specific issues simultaneously. However, by classifying them according to subject areas, I hope to encourage a more organized approach to the bewildering number of factors which have to be taken into account. In each case, I will attempt to identify the issues, suggest some methodologies for dealing with them, tell where I feel the data gaps lie, and discuss some strategies for dealing with these gaps. Where necessary, further studies are outlined. In each case, I will try to use examples which deal with the specific objective of long term State fiscal independence from oil and gas.

2. Objectives and Goals of the Fiscal Plan

In any fiscal planning process, the State administration should define its general fiscal objectives as operational goals so that the planning staff can tell whether the objective is being met. While this may seem an obvious point, it is not necessarily easy to come up with a specific set of goals, both of which will fulfill the long term objective, and which will permit the fiscal planning staff to empirically determine whether or not the goal is being met. For example, if the objective of "fiscal independence from oil" is not stated as a more precise goal, such as "no funds from oil property taxes, bonuses, severance taxes, or royalties are to be used to finance current general fund expenditures," the staff is left to conclude that maybe these funds could be used for ten percent of current expenditures and that this would constitute "independence." Obviously, the path to such a goal could be much different than the goal actually intended, if literally no dependence is desired. In any case, it is desirable to define the goal operationally, as is demonstrated in the following example.

a. Example of Defining a Fiscal Objective

The State of Alaska currently depends on oil and gas taxes, bonuses, and royalties to fund 60 to 70 percent of the general fund budget of FY 1978.[1] Since oil and gas deposits are finite, this source of money is limited, and the State is faced with the problem of how to move from a dependence on this single unreplenishable source of funding to sources based exclusively on continuing State economic activity, without substantially reducing services, disrupting the growth of the Alaskan economy, or saddling the populace with a large tax burden in the short run. Besides the term "exclusively," this statement of the fiscal goal has four basic elements which raise specific questions of definition:

1. How soon is the State to be independent of oil revenue?

2. What exactly are the prohibitions on reduction of government services? What constitutes "substantial" reduction?

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[1]Alaska Office of the Governor, Division of Budget and Management, Executive Budget Fiscal Year 1977-1978, p. 9.

3. What sort of disruption of the Alaskan economy is not tolerable?

4. What defines an onerous tax burden?

The answer to the first question is critical to the overall strategy, since if the State were to save all its oil revenues next year rather than spend any on its operating budget, either large increases would be required in effective tax rates on personal and business income, or there would have to be large cuts in government services, or both. At the other extreme, since it can be reasonably supposed that not all the oil and gas in place on State lands has been found, it is not necessarily true that the State will have no more oil revenues after current sources run out. While other choices are available, I recommend that experiments be done with at least two arbitrary dates of "independence"--for example, one 10 years hence and one 25 years hence. Substantial oil revenue seems assured for at least 10 years, so Alaska would probably not have to worry about draconian measures over a much shorter period. Conversely, 25 years is probably past the outer plausibility limit on projections of such crucial factors as population growth, so a 25-year projection is useful if we want to discuss independence from oil revenues only in the "long run."

The second operational term whose meaning the State must examine is "substantial reduction in services." While it is possible that the citizens of Alaska would never accept a reduction in the overall level of government service each receives, it is not clear that this translates into a prohibition against reductions in real expenditures per capita for at least some programs. Neither does it translate into any particular rule on the rate of increase in total real expenditures in either total or per capita terms. However, three useful and plausible assumptions concerning expenditures are: constant per capita real expenditures on each expenditure category, a low fixed growth rate in total real expenditures, and the historic experience in growth of expenditures per capita by category. The first case essentially "freezes" spending at current levels, the second case would show the effect of a relatively conservative government expenditure guidelines policy like that being currently attempted, and the third suggests a "no controls" situation.

The third aspect of the policy of becoming independent of oil and gas as a source of current revenues is that of impacts of the policy on Alaska's economy. A state administration would probably not wish to pursue policies leading to actual massive and persistent reductions in total employment, for example, because of the high political and human costs of doing so. However, the policies which the State may pursue to get to the goal of independence from oil revenue in the long run might, theoretically, reduce the rate of growth of the economy to such an extent as to frustrate the achievement of the goal of independence. This could occur either because of an attempt to reach the goal too fast by confiscatory tax rates on the current tax base and by holding down State spending in Alaska to too great an extent; or failure could occur because the government spent too much and taxed too little. Without trying to prejudge the issue, I can recommend that the State adopt some basic guidelines for "intolerable" results, such as: no decreases in total employment lasting more than one year, no decreases in per capita real disposable income persisting beyond one year, or some critical growth rate which is considered too low to support the long term increase in population.

Finally, it is necessary to define an "onerous tax burden." This could be done by reason of its economic effects, or by some (necessarily arbitrary) standard of fairness, such as the average or highest effective tax rates for certain taxes in other states. Since any policies undertaken to reach the goal of independence from oil revenues have implications for the feasible tax rates on non-petroleum sources, some standards must appear against which tax effects are to be measured. As an example, one can specify that the average effective tax rates for any tax on personal income and on the activities of the nonpetroleum sectors of the economy not exceed the highest average effective tax rate for a similar tax in any other state.

As can be seen from the example, even if no other sources of variation existed, definition of the goal itself could lead to many equally interesting cases which would have to be evaluated. There are, however, many other issues to examine in the context of a fiscal plan. Discussion of these follows.

3. Issues Related to the Size of Budget and Growth in Expenditures

It is useful to think of the State government as taking one of two approaches to fiscal management. It can either take what I shall call an "expenditure-oriented" approach--that is, try to determine what expenditures will be demanded by the people of the State over the forecast period and devote most of its effort to looking for sources of funds for those expenditures--or, it can take a "revenue-oriented approach," in which forecasts are made of state revenues and the State's budgeted expenditures are made to fit to the revenues available. In neither case can the State pick its path of future expenditures with impunity, since level of available revenues will always potentially constrain the choice of the level of expenditures. Secondly, some expenditures are not within the discretion of the budget staff. This is important, since the economic effects of the budget (and, therefore, some future revenues) depend not only on discretionary expenditures but on other expenditures which are not part of those sections of the budget over which any single administration and legislature have control. Alaska has relatively few state expenditures which do not go through the appropriations process, but overall flexibility in spending is somewhat limited in many cases. A strictly "expenditure-oriented" approach may get into trouble because of unanticipated economic effects of those expenditures which affect revenues, and a "revenue-oriented" approach may get into trouble because some expenditures cannot be tailored to the available revenues. Therefore, fiscal planning needs to include elements of both strategies.

a. Size of the Budget Generally

For Alaska to carry out either strategy or a mixture of them, a series of distinctions have to be made with respect to the size of budgets and the growth in expenditures. In the first place, the capital budget in any year contains within it implicit obligations for future operating budgets. Highways, for example, must be maintained once built, if they are to continue to provide service (and debt service will continue in any case). This relationship between capital and operating budgets is likely to increase in importance in the future as the capital stock ages, especially if the State embarks on a large capital construction program, using oil and gas revenues to supply either part or all of the necessary funds.

However, I am aware of no studies in existence or planned which investigate the relationship between capital and operating expenditures. If the State elects to pay cash on a large capital construction program, it may be left without a source of earned interest income. In such a case, the construction program may itself have to generate enough long run funds to pay for maintenance. If the State elects to guarantee construction bonds with its oil money, then the public projects built and interest on the invested oil money backing the bonds may have to supply enough funds to pay for maintenance and coverage of debt, plus repayment of principal. Either way, the future demand for operating budget expenditures will increase as a result of current State capital budget expenditures, and this relationship needs to be examined.

One possible strategy to determine the relationship would be to use State Public Works and Highways financial records to determine 1) capital cost and 2) subsequent levels of maintenance expenditures of a large group of capital projects. If a standard time profile of operating expenditures can be established by comparison of projects (with maintenance expenditures as a proportion of capital expenditures explained by one or two parameters), then the overall capital budget can be related to subsequent operating expenditures.

Whether or not the relationship between the capital and operating budget can be established, it is still important to make a distinction between the two, since they influence the Alaskan economy (hence, future revenues and expenditures) somewhat differently. For one thing, the operating budget is quite labor intensive. The many services ordinarily supplied in the budget are usually personal services of some sort. Furthermore, a fairly high many state employees were also not state residents immediately prior to their employment w/ the state.

percentage of the government operating expenses represents salaries paid to Alaska residents. The capital budget on the other hand sometimes represents construction expenditures which end up either as purchases from materials suppliers outside of Alaska or as wages and salaries of construction workers who are not state residents. As such, they represent a leakage of spending power from the Alaskan economy. Since the resultant effects of a dollar of these two kinds of expenditures are much different, it is important to distinguish between them in planning total expenditures and examining effects.

b. Expenditures Not Under Staff Control

Some expenditures are obligated by formulas written into the statutes (such as the Teachers' Retirement System or the Public School Foundation Program), or by the acceptance of Federal programs requiring state matching funds. These expenditures usually grow right along with the size of the client population, or with the increases and decreases in Federal funding. In long run fiscal planning, it appears worthwhile to compile a time series on each formula expenditure, and to attempt to forecast the demand these functions will place on state revenues over the forecast period. These obligated expenditures represent a minimum amount of revenues which must be available in each year, and

4. The Budget Through 1985

    a. Overview by category
    b. Overview by object
    c. Detail by groups of programs

5. Policy Experiments with the Budget

6. Appendices

    a. Definitions of variables and constants
    b. Estimated equations and results
    c. Annotated data listing

7. References

V. Budget

Total estimated cost of the project is approximately $35,000. It is anticipated that Man-in-the-Arctic Program work on fiscal modeling in closely related areas will have significant impact on reducing the total cost of the project to the figure cited here.

restrict the ability of the State to influence the Alaskan economy by switching expenditures from one expenditure category to another. Similar projections ought to be made for State expenditures which lie entirely outside the State budget, such as the Trust and Agency Funds, the Enterprise Funds, and the State corporate entities like the Alaska State Housing Authority. As was stated at the outset, however, the exact form of this projection would depend on whether it is relatively short range, where present formula factors might be important, or whether the projection is long range, and depends upon more general relationships.

It is unclear at this time what the relevant explanatory variables would be in all cases. However, Foundation program expenditures are well explained by the size of school age population, and similar variables might be found for other formula programs. In projecting budget expenditures, it will be useful to forecast formula State expenditures separately.

c. Strategies for an Expenditures Approach to the Budget

More generally, if the State primarily takes an "expenditures approach" to budget projection, it may be necessary to forecast either explicitly or implicitly the demand for government services. In general, it will not be sufficient to extrapolate past trends in total expenditures, since, for example, the mix of total expenditures has been changing rapidly from transportation toward expenditures on health, social services, and education. While expenditures for both transportation and social services have been increasing, the two categories are controlled by different demand relationships, so the change in mix alters the rate of growth of the total. At the very least, it will be necessary to extrapolate each major expenditure category separately. However, it will probably be more useful in the long run to search for explanatory variables for each major expenditure category. Both Department of Revenue and ISER have initiated work in this area (see the attached working paper by Scott on education), but much more remains to be done.

There appear to be three obvious alternatives for using the expenditure projection information. One method is to project the series some distance into the future based on extrapolation of each category or on exogenous assumptions concerning the underlying demand relationships, and to compare the expenditures for each year with revenue projections made independently. This method would be the easiest to do, but would ignore the expenditures' effects on the rate of growth, and on revenues. It could only be used for rough comparisons. A second method would be to project a series of expenditures based on extrapolation of each category or on assumptions concerning the underlying demand relationships, and enter these exogenously into an econometric model such as the ISER statewide model, or Department of Revenue's adaptation of the model. This method would imply that the State has some plan of expenditures which is invariant with the effects of the expenditures. However, it would show the effect of such expenditures on total revenue. A third method would be to make expenditures truly endogenous in an econometric model, "determined" by specified relationships inside the model as is currently done in the Department of Revenue adaptation of the ISER econometric model, and feeding back into the model (through wages and salaries, for example), as in the ISER version. It is not necessary that State government expenditures be completely endogenous, by the way. ISER is currently experimenting with including both an endogenous and an exogenous component to expenditures, and there is no mechanical reason why it could not be done.

The principal practical difficulty, as I see it, is the scarcity of instrument or explanatory variables available to project "demand" for government expenditures. While one would ideally like to take into account changes in program offerings, shadow prices for services, and changes in the tastes and structure of the community client populations, only population by age and sex, employment, payrolls, gross product, and personal income are available as general instrument variables and proxies. As a result, it is usually only possible to estimate reduced form "expenditure" equations rather than true "demand" relationships.

For some expenditures such as those of the State Ferry System, it may be necessary to estimate future expenditures using both State and national data--the relationship between State population and system data on ridership, and the (exogenous to the model) relationship of the U.S. economy to ridership, for example. Whether studies of this detail are attempted will obviously depend on the presumed importance of the endogenous part of the expenditure projection.

d. Appropriations as a Proxy for Expenditures

Another issue which is related to the general size of the budget and the rate of expenditure growth is a data problem. The fact is that budget expenditures from a given year's appropriations in a given fiscal year do not correspond to actual expenditures during that fiscal year, spending which may be funds from the previous, current, or coming fiscal year budget, or any of several successive capital budgets. It is not surprising, therefore, that total operations budget expenditures for any given fiscal year are usually smaller than the corresponding total operating expenditures in that year (as defined by The Annual Financial Report from the Department of Administration, Division of Finance), or that operating budget plus capital budget appropriations generally exceed total cash expenditures. Ideally, one would like to have actual expenditures functionally related to planned appropriations, and economic impacts related to actual expenditures. With a few exceptions, the eventual operating expenditures in any one year in the past have been within ten percent of original budget total appropriations. It seems reasonable, therefore, since there appear to be no particular instrument variables which explain the difference between actual expenditures and prior appropriations, to use operating budget appropriations directly to explain economic impacts of this portion of State spending.

Capital expenditures are more difficult. The basic components of capital expenditures are General Fund highway construction expenditures, non-highway "general fund"[2]

[2] As this term is used by the Division of Finance, not as the Division of Budget and Management uses the term.

capital expenditures, and Capital Project Funds (general obligation bond) capital expenditures. Highways expenditures are not obviously predictable from appropriations, since highways expenditures are dependent on highways expenditures timing as well as the total size and timing of appropriations. Since Capital Project Fund capital expenditures depend upon biennial general election approval of general obligation bonds, rate of bond sales, and expenditures out of the bond sales (which depend in turn on the desired finish date of each project and the required construction time), capital projects expenditures funded by general obligation bonds are not predictable from appropriations, either. In general, causation seems to run the other way: expenditures are directly related to the demand for capital goods services, and appropriations are fitted to the requirements for the expenditures program and the economics of the bond markets. A way to econometrically model State capital expenditures is to develop demand indicators for services, capital depreciation, and carrying capacity of the capital stock, and try a few capital replacement rules from outside the model. For example, in hospital construction there are acceptable hospital use to hospital bed ratios. A possible rule is that hospital capacity be provided at such a rate that the acceptable bed use ratios not be violated at any time over a specified time period, and that if they are, that hospital capacity be augmented by some specified number at prevailing construction costs. In addition, any hospital would be replaced at specified intervals, and real facilities upgrading expenditures per capita could follow historical trends, so that total hospital construction expenditure in any year would be (exogenous) new construction costs, plus (endogenous) capital replacement costs, plus (endogenous) facilities upgrading costs. School construction, university construction, airports, and highways all lend themselves to similar treatment, although demand and capacity measures are different in each case. Ferry construction is done out of state, so it should not be a part of capital expenditures for economic impact purposes, although it is part of total expenditures for budget purposes.

To summarize, it is necessary to project as closely as possible actual expenditures in any one fiscal year to find the impact on the State economy. It is probably a satisfactory substitute to use appropriations as a proxy for expenditures in demand relationships for operating expenditures. However, it is unsatisfactory to use appropriations or appropriations plus bond sales to do this for capital expenditures, and another method is suggested.

If, however, this is considered too complex a methodology, the obvious alternative is to simply prepare a limited number of capital budgets outside the econometric model, and introduce the bond sales, expenditures, and general fund capital appropriations into the model as exogenous series.

4. Issues Related to Revenue Estimation

The State could take a primarily revenue-oriented approach to fiscal modeling. One way to do this would be to make a "first pass" estimate of revenues from recurrent (non-petroleum) sources for a series of future years; establish a schedule of recurrent expenditures (initially larger than non-petroleum revenues) which would permit, for example, some target annual growth rate for the unexpended balance of oil and gas revenues, including both the Permanent Fund and General Fund; and then introduce the exogenous expenditures series into an econometric model to see the projected revenue results of the policy, given the expenditures. By successive adjustments of the expenditures, a target growth rate of unexpended petroleum revenues could be achieved without ever making expenditures a function of revenue, under a wide variety of assumptions concerning the rate of development in the petroleum sector.

While the technique does not inherently provide "guidelines" for expenditures, in the same sense that modeling the demand for government expenditures does, the "supply" of government expenditures exogenously introduced into the model in each year can be compared to a model-generated "demand" values in the same year, and adjustments made to successive exogenous expenditures series to reduce the disparity between "supply" and "demand" values. As alternative strategies, the gaps between desired and demanded expenditures could simply be left as they come out of the experiment and analyzed for differences in government services delivered, or changes introduced on the revenue side to reduce differences between "demand" and "supply."

It is not recommended that an extensive search be conducted with models for "the best" solution, given the constraints on use of oil revenues imposed from outside the model. Probably a wide variety of explicit policies will result in approximately the same long run average growth rate in the unexpended balance of oil and gas revenues, while yielding much different results as to timing of expenditures and their distribution among the major functions of government. Instead, the best use of the econometric model would be to help define some rough limits of expenditure policy, beyond which a proposed expenditure pattern would result in the violation of one or more target revenue rules.

If the State wishes to take a revenues approach without explicitly accounting for the feedback effect of State expenditures upon the growth rate of the economy as a whole and upon recurrent revenues, it risks facing in the future a circumstance where induced growth brought about by State expenditures policies has so increased the size and altered structure of the Alaskan economy that both revenue and expenditures estimates are gross underestimates. In such a circumstance, hindsight probably would reveal that the State could have achieved independence from non-recurring oil and gas revenues as a source of funds for current expenditures at an earlier date with lower population and economic growth rates. Failing to account for the feedback loop is equivalent to saying either that total government expenditures are totally unrelated to government expenditures on wages and salaries in Alaska (which must then be forecast exogenously), since total government expenditures do not affect the determination of how much is spent for wages and salaries; or it says that government spending has an impact multiplier of zero, since neither larger nor smaller government expenditures alters the rate of growth.

There are three separate issues which relate to the State fiscal planners' ability to project recurrent revenues using econometric models. These are the problem of aggregate data, the problem of sensitivity of revenues to changes in the type of revenue base, and the problem of changes in the structure of the Alaskan economy.

a. Use of Aggregate Data

The issue of aggregate data is essentially the same one as came up earlier in the paper with respect to the scarcity of explanatory variables which determine demand for government services. We know that total tax collections are a function of both the taxable base, be it income or property or gross sales, and the effective rate structure. In order to predict increases in total personal income tax collections, for example, it is not sufficient to know how much aggregate income in the State increased; it is also necessary, given the progressive rate structure, to predict total incomes of persons in each rate class, or equivalently, the average effective rate on total income.[3] The detailed information is not

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[3]ISER is currently working on a model which projects the "distribution of income" on the basis of an average wage rate in each of 11 major occupational categories, with changes in the distribution being caused by changes in the occupational mix. However, even this model will prove of only limited use for estimating income tax collections when the distribution of income for each occupation shifts along with average income for that occupation. We still would have to use aggregate estimated effective rates for each occupation.

currently available to model this kind of change in the tax structure, however, so this tax must be modeled on an aggregate basis, using alternative assumptions concerning the average effective rate, if necessary. Similar problems apply to all taxes with anything but a proportional rate structure with respect to its tax base. This is a problem that can only be solved by improved data, and can only be partially avoided by clever use of modeling techniques.

b. Sensitivity to the Revenue Base

The second issue is that the calculation of total State revenues will probably be sensitive to different variables during different parts of the forecast period. Recurrent revenue estimates are currently very sensitive to the average effective tax rates on personal and corporate income, since these constitute the bulk of non-petroleum revenues. However, estimates for future years are likely to be increasingly sensitive to the rate of return on unexpended oil revenues in the General Fund and the Permanent Fund. The higher the target rate of growth of these funds, and the higher the early rate of return, the more important it will be to account for the expenditures and revenues sides of fiscal policy simultaneously, because the greater will be the interaction of expenditures and revenues policy. Also, because in this case fewer petroleum dollars are available to fund current expenditures in the early years, fiscal planners may have to worry about ways to change the effective personal and corporate tax rates to generate enough revenue, which may throw all the projections off the true value. Perhaps the only creative way to deal with this issue is to run sensitivity tests on the model or other method of projection, to see if it has any important effects on policy.

c. Effect of Structural Changes

The third issue is that changes in the structure of the Alaskan economy, particularly changes which result in unanticipated changes in the tax base, will reduce the usefulness of any formal modeling technique which depends upon past history of economic growth to forecast future economic growth and State revenues. For example, large expansion of Alaskan manufacturing of finished goods for export has not been a past feature of growth. However, if such growth were to occur as a result of radically changed economics of energy in industry, or if the State's fiscal policy were successful in inducing large growth of manufacturing in the future, there might well be increases in gross receipts, property, and corporate income taxes that no model or simple projection could anticipate.

(Econometric models do satisfactorily handle "evolutionary" changes in the level of secondary business activity related to local increases in population and major industrial demand.)

Any change of this type in the entire structure of the economy can be handled best by introducing outside the model a side analysis, where effects of State policy on the attracting of industry are analyzed. If, based on this analysis, it appears the structure of Alaska's economy will change drastically, the fiscal planner will probably want to take explicit account of the change in his revenue projections, either by adding blocks of corporate, property, and sales taxes explicitly; or by exogenously introducing primary manufacturing production and employment series into his econometric model in the way petroleum mining and transportation is currently done in ISER's MAP models.

It may have occurred to the reader that at sufficiently high level of complex intermediate economic activity in manufacturing, the technique of input-output analysis may prove useful for analysis of the ultimate revenue impacts. This is probably true, except that I-O is not well adapted to even evolutionary changes in the structural coefficients of the I-O matrix, and it is not well adapted to time series policy analysis, a separate run being required for each year over which the fiscal planner wants to simulate policy. Finally, the same type of assumptions are necessary to introduce non-existent industries into I-O matrices as into econometric models, even though the specific data requirements are somewhat different. Little seems to be gained by using I-O at this time.

5. Issues Related to the Permanent Fund and Its Use

There are four general issues related to the management of the Permanent Fund, as it affects long range fiscal planning for the State. These four management issues must either actually be resolved or assumptions made with respect to them in order to do anything about expenditure policy. Since management of this fund is not part of the regular revenue and budgeting process of the State, fiscal planners may have to accept some aspects of its management as exogenous to their planning process. Stated as questions, the issues are as follows: What rate or rates of return will be earned on the Permanent Fund balance? At what rate and by what criteria will payments into the Fund take place? What will be the actual permitted uses of Permanent Fund principal? What will be the actual permitted uses of Permanent Fund interest?

a. Rate of Return

The rate or rates of return which the Permanent Fund earns are obviously crucial to any planning process, whether the Permanent Fund interest is transferred to the General Fund and used to pay for goods and services purchased by the State, or whether it is permitted to accumulate, increasing the size of either the General Fund balance or Permanent Fund balance. Yet, the rate is not easily predicted since rates of return vary across classes of securities according to their riskiness, taxability, and maturity date, since the rates of return on each type of security vary over time, and since there is some pressure to invest in Alaskan lending institutions and investment projects quite apart from liquidity and rate of return considerations. Some effort must be made to project a plausible rate of return, but the greater the extent to which criteria other than liquidity and risk come into plan, the more difficult this task will be. In view of the many uncertainties involved, a variety of rates should probably be assumed, to test the sensitivity of revenues to the rate of return.

b. Rate of Fund Accumulation

Quite apart from rate of return issues, there is the question of how fast money will be paid into the Permanent

Fund, with its resultant effects on the rate at which the Fund grows. This would be particularly important if the State chooses a target rate of growth for the Fund. Whether or not fiscal planners have some say in the rate of mineral leasing, amounts received for lease bonuses, royalties, property taxes, and production taxes will depend at least partly on markets for mineral products outside of Alaska. Since it is not possible for the State to force the workings of these markets to accommodate State fiscal plans, the plans will have to accommodate currently unforeseen events in these markets.

Fortunately, there are some tools available to aid in these projections. The State Division of Minerals and Energy Management has conducted studies of oil leasing policy using computer programs which demonstrate expected impact of future fields on State revenues. ISER has a program called SCENARIO which will aggregate year by year oil and gas income from several fields in different stages of development, given a specific leasing policy, prices of oil and gas, and assumed successes in exploration. The State Legislative Affairs Agency can project the effect on State revenues of any change in taxation policy on total tax collections from existing State fields. Alternatively, fiscal planners could simply assume some illustrative time paths of the various oil and gas revenues to see how the fiscal plan is affected.

c. Uses of Fund Principal

The third issue with respect to the Permanent Fund is the permitted uses of Fund principal. It was shown above that this may affect the earned rate of return on the Fund. However, if the principal of the Fund is invested inside the State of Alaska or on projects to encourage Alaskan exports (such as a pipeline or LNG tanker fleet) by accepting rates of return on these projects that, while profitable for the State, are below private market rates, then unpredictable economic growth would occur in Alaska which may not be conveniently analyzed by any existing impact or forecasting model. To the extent that the State does not invest Permanent Fund principal in Alaskan projects, or to the extent that it accepts only market rates of return and merely substitutes for private capital, the rate of Alaskan economic growth will not be substantially affected, although the rate of return on the Fund might be.

The temptation to assume that Permanent Fund principal is not invested in Alaska at subsidized rates is overwhelming, considering all the modeling complexities raised by the alternative. However, in the event that subsidized Alaskan investment must be taken into account, assumptions will have to be made or analysis done concerning the amount, timing, type of business growth that will occur as a result of subsidized lending rates, since future tax revenues and endogenous state expenditures may be affected. Default and repayment rates on the type of loans involved will also have to be considered, since this will affect the rate of return on the Fund.

d. Uses of Fund Interest

The final issue to be considered here is the uses which are assumed to be made of the interest on the Permanent Fund. Several possibilities emerge, including: transferring all of the interest to the General Fund, with no further restrictions on its use; transferring only part of interest to the General Fund for a specified period of years, in order to save the rest in the Permanent Fund to augment the rate of increase and move up the day of fiscal independence; paying part or all of the interest earned as "dividends" to Alaskans, perhaps on the model of stock dividends, or on the model of a negative income tax; or some combination of the above. Currently, there are so many proposals for use of Permanent Fund interest that no single assumption regarding its use seems justifiable.

Two approaches to the problem appear useful. One would be to proceed, as has been recommended in several other cases, with several alternative assumptions which span the range of possible uses of the Fund interest, to check the sensitivity of resulting revenues and expenditure paths.

The other approach is to statistically "search" for a "best" policy. For example, set up some hypothetical fiscal series, such as an expenditure-determined rate of withdrawals from the General Fund, and an endogenous rate of non-petroleum revenues additions to the General Fund, the remainder of revenues to be provided by Permanent Fund interest. Then, employing a social welfare criterion such as "maximize present value of per capita payments from the Permanent Fund to Alaska, Inc., over time," an optimal control model could be used to yield the time path of permitted withdrawals for direct payments to individuals which maximized this social welfare measure, subject to the cited fiscal constraints. The series of Alaska, Inc., payments thus introduced into the economy as incomes of persons could be added to the economic model as a series of exogenous payments to personal income, and the parent econometric model resimulated to note the effects. Several runs of the optimal control model subject to the same social welfare criteria, but with different preferred paths of expenditures, would yield a family of "best" Alaska, Inc., expenditures, subject to the given constraints. By changing the constraints and the criteria, one could check the economic effects of different "optimal" paths, and different "optimality" criteria. The preferred strategies for use of Permanent Fund interest could be found by comparing simulated economic effects of the path of expenditures which maximized each criterion, or by combining these strategies in various ways. The essential difference from the simpler expedient of using intuition to generate the assumed levels and uses of interest payments is that each program of payments in the case where the optimal control model is used maximizes some social welfare criterion and, therefore, has some claim of "optimality."

In summary of this section, whether fiscal planning involves choosing a series of expenditure paths, and adapting Permanent Fund policies to those expenditures, or whether fiscal planning involves picking certain Permanent Fund criteria and adapting expenditure policies to these criteria, it will still be necessary to make certain assumptions about the policy parameters applying to the Permanent Fund, and there are a few tools available to make consistent use of these assumptions, and which will aid the fiscal planning process.

6. Issues Related to Economic Impact

Throughout this paper to this point, I have discussed fiscal planning policy in terms of its economic impacts. Although some of what is said here has been anticipated in what has been written in previous sections, it is worthwhile to briefly discuss two important issues that will have to be faced in any fiscal planning done for the State of Alaska. One of these is that the aims of a given fiscal policy can probably not be restricted to a single criterion of success, such as the level of disposable personal income per capita, or the number of jobs created, or the rate of spending of oil revenues. The State's goals are inherently multidimensional. The other is that it is not sufficient to look at only the aggregate measures, such as total spending or employment or personal incomes earned. Fiscal planners must be concerned with the distribution of benefits and costs of policy between groups and over time.

a. Multiple Dimensions of Impact

The existence of the first issue, that fiscal planners must examine at once several dimensions of policy, implies that there ought to be consistent treatment of the assumptions the planner wishes to make with respect to the State economy and fiscal structure in a single, unified, general equilibrium framework. While it is theoretically possible to do fiscal analysis in a partial equilibrium framework, holding a proposed path of expenditures and the structure of the economy constant and successively computing its effect on revenues, employment, output, etc., in each year, it is much more convenient and sensible to link an expenditure model with specified structural impacts to a model whose structure evolves naturally and which structure accounts for hard-to-trace general equilibrium effects of one variable on another through time. A dynamic expenditures model linked to an econometric model seems the best way to accomplish both the goals of simultaneous accounting for multiple effects of policy and of allowing for a natural growth path in the Alaskan economy.

b. Aspects of Impact Not Handled by Models

The second issue is not conveniently handled by even a relatively sophisticated econometric model such as the ISER MAP models. The problem is that while these models can, given appropriate assumptions, trace out in some detail the aggregate effects of a given fiscal policy over time, the most important effects may occur at an individual and small group level beyond the analytical ability of the model. For example, suppose that a run of an augmented MAP model showed that by spending only half of Permanent Fund interest and allowing it to accumulate, state income and other recurring taxes and interest on the Permanent Fund could take over all recurring expenditures reasonably anticipated by 1995, and that this policy would result in a 50 percent increase in employment. The criteria should be expanded to include the distribution of benefits and costs. If, for example, this achievement of fiscal independence from oil by 1995 can only be had by reducing real expenditures per capita by 50 percent between 1978 and 1985, the desirability of the goal might be called into question. Beyond that, even if total expenditures for government functions were not reduced, reductions for some functions and offsetting expansions of others might have distributional consequences about which the models are silent, but which would lead to rejection of the policy if they were known.

Aware of this problem, and similar general problems with distributional issues, ISER staff have begun the modeling of demand and supply of occupation classes, and of distribution of income based on average compensation of occupational classes in Alaska. However, completion of this effort is about one year away, and does not include distribution of government expenditures in any case. Precise knowledge of benefits and costs will depend on individual program analysis. At the more general decision level, the fiscal planner will have to depend on a combination aggregate measure of economic and fiscal impact, and on informed judgment guided by model outputs.

7. Summary

This paper has organized a series of issues with respect to long term fiscal planning in Alaska into four areas: issues related to forecasting the size of state budgets and effect of state spending policy on the economy and on revenues; issues relating to the forecasting growth of revenues, whether used to meet a given series of state expenditures or adopted as criteria to regulate expenditures policy; issues related to the role the Permanent Fund plays in the future financing of Alaskan government services; and finally, a short section on two issues relating to generating and interpretation of forecast results. Where I have been aware of convenient methods of handling these issues in some useful and creative way, I have briefly described how the method might be applied to resolve the issue. Where I have felt that several alternatives existed, I tried to suggest what these are. Obviously, however, the solutions or methodologies selected will depend upon what the State administration determines its goals are with respect to fiscal planning, where goals are really more precise and defined ways of stating more general objectives.

While I have applied the methodologies in a general way to one possible goal of fiscal policy, stated in rather limited terms, I do not mean to suggest that this is anything more than an example of "how it might be done." Definition of the goals leading to the general fiscal objectives will undoubtedly be a shared executive-planner responsibility where the author has no special expertise. I hope, however, that I have demonstrated that one of the benefits of the planning exercise outlined in this paper is that the questions to be answered by the plan become much clearer, no matter by what process they are finally resolved.

APPENDIX A

Model of Education Expenditures

The MAP State Education

Expenditures Model

Progress Report

Institute of Social and Economic Research
Anchorage Fairbanks Juneau

October 4, 1976

Introduction

This model is the first in a series designed to improve MAP program capabilities to project the consequences of state government expenditures policies in Alaska. This model (EDMOD) is not an attempt to forecast the future, both because it requires the input of several exogenous data series which themselves cannot be forecast precisely, and because the structure of the model depends upon historic relationships which may not hold true in the future. Moreover, the model projects education expenditures for a period in which state revenues are expected to be abundant, while the historical data come from a period when the state's funds were relatively scarce.

Because of these problems, the model was built with two primary considerations in mind concerning the level of state education expenditures in the future. First, the model should provide some distinction between expenditures which are primarily discretionary in nature, and those which may be mandated by increases in population and past trends in expenditures per pupil. (Ideally, one would like to explain the trend in expenditures per pupil, but it has not proved possible with the data available to separate past movements in expenditures per pupil into demand and supply components.) This projection of past relationships into the future has value in the budget planning process, and can be used to demonstrate the importance of differences in assumptions concerning the exogenous variables and parameters of the model in the forecasting of future expenditures. Second, since the state may be the future recipient of large amounts of discretionary income, it is also important for the model to allow departures from past trends in expenditures at the discretion of the researcher, and to offer some basic measures of the effectiveness of the discretionary spending decision in altering the level of government services in education.

A decision was made early in the development of this model to temporarily set aside the problem of capital spending for education, both because the relevant determinants of demand for capital spending would be less easy to isolate than those for operations spending, and because the measures of capital services are a profound conceptual and data problem. (In contrast, the ratio of professionals or teachers per student is a recognized, though admittedly crude measure of educational "services".) Also, because of the importance of state operations expenditures for wages and salaries in inducing state economic growth, it was felt that the initial payoff would be highest in modelling operations expenditures.

To generate business-as-usual expenditures, the model estimates the levels of enrollment in the various state school systems and in the Native BIA schools based on predicted population from the MAP population model. (A model listing is shown in Appendix A.) These enrollments are combined with the historical spending-to-enrollment relationships to estimate state operations spending on primary and secondary education, excluding debt service and capital outlays. A provision has been made in the model to accommodate consolidation of the BIA attendees into the state schools by the use of a variable constant. Primary and secondary education expenditures are combined with state expenditures for the University of Alaska and for a "miscellaneous" category (the state library system and public television are major components) to estimate total state government operating expenditures for education.

Local school district operating expenditures are estimated in much the same fashion as total state operating expenditures, with state funds transferred to district schools being estimated based on enrollment, local funds being estimated from personal income, and federal funds being supplied exogenously. These three components are added together as an estimate of local potential operations spending, actually being an estimate of revenues available for operations spending on education, and the sum is used to estimate actual spending, to which it bears a strong historical relationship. (Local districts have historically been limited in their spending capacity by the level of transfers from the state and federal governments, and by the tax effort which has been made locally.) The moving proportion of available revenues spent by school districts on wages and salaries of professionals is computed, and this district schools proportion is multiplied times total operations expenditures in the state for all primary and secondary education to estimate the number of education professionals and professional/student ratios for the forecast period.

The basic model has been modified for this report to permit the state to make additional discretionary transfers to local school districts, signified by the variable EXEDS. Theoretically, it is possible to alter the model in several ways with exogenous variables--e.g, to permit a higher local tax effort, an exogenous component could be added to EDFINL, the local funds variable. In addition, it is possible to test the sensitivity of state expenditures and services delivered to changes in the basic assumptions underlying the model, such as enrollment/population ratios. Finally, the model is designed to either operate as an independent model using exogenous data supplied by the MAP model, or to be integrated into the structure of the MAP econometric and population models, and to interact with them.

The Data

The data used to develop EDMOD came from four major sources in Alaska state government, and from one federal source. As a result, there are data incompatibility problems which have to some extent determined the possible structures the model could take. The enrollment data (actually, Average Daily Membership, which is the average enrollment figure used to determine state aid) are reported by the schools to the State Department of Education, and appear in their Annual Report. A consistent series is available from FY 1963 through FY 1975. Also appearing in the Annual Report are the sources of funds used by local district schools, a broken series which is not reported in FY 1971 or before FY 1966. Actual expenditures of local districts come from this source, also, as does the proxy variable for reported expenditures by local districts on professionals (instruction plus administration expense), and the number of full-time equivalent professionals working for the districts. More detail is available in some years on how this number of professionals breaks down into teachers, administrators, and others, but the series is so severely broken that, for example, there is only one year in which both instructional services expenditures and the number of teachers are both reported. Therefore, all professional employment was used as a measure of service. The reporting system has now been changed, so no consistent series on expenditures is available after FY 1974.

The historical series in the state Budget Document (Supplement, in later years) are the main source for state government expenditures for the University of Alaska, state expenditures for district and state-operated rural and military base schools, and state expenditures for miscellaneous educational purposes. The numbers reported in this source form an unbroken series from FY 1963 to FY 1975 (with the exception of miscellaneous, which is unbroken only since FY 1964), but corresponding figures reported by the Department of Education (e.g., the amount transferred from the state to its district schools under the Foundation Program, which dominates such transfers) do not equal each other. Nor does the total expenditure figure for education reported in the Budget Document equal that reported in the state's official Annual Financial Report from the Department of Administration Division of Finance. Part of the discrepancy comes from differences in reporting dates and accounting conventions, especially concerning the treatment of encumbrances at the end of the fiscal year, but may not account for all the difference.

The source of personal income (PI) was a combination of the wages and salaries data reported by the State Department of Labor, and of other sources of personal income as reported by the U. S. Department of Commerce, Bureau of Economic Analysis. The wages and salaries data reported for corresponding categories by the state and federal sources do not match, and since state employment figures were used, the federal payroll figures were adjusted to the state totals.

There is no good count of population by ethnic group prior to the 1970 Census of Population which can be used as a guideline to build a detailed population model. Consequently, the detailed breakdown of population by ethnic group and age group generated by the MAP population model and used by this model is only available for a five-year period, 1970 to 1975. This causes some problems. The ratios on school enrollments to population 1970-75 indicate that variance in the equation is high, but it was left to stand for this report. Total expenditures by the University (EUA) was forecast exogenously.

Estimation of the Equations

The complete results of the estimation of the stochastic structural equations of EDMOD appear in Appendix B. This section will briefly describe the results of the regression analysis to date.

Initially, the decision was made to run the equations with ordinary least squares (OLS), treating each equation independently. As in other MAP research, the researcher is faced with the problem of extremely short data series, combined with a relatively large number of explanatory variables and a scarcity of variables which permit identification of individual equations. These considerations combine to exclude as impractical the use of two-stage least squares (2SLS) or indirect least squares techniques. In any case, the test of the model is not the structural elegance of the single equations comprising it, but the model's ability to give intuitively satisfactory projections which meet consistency tests. The OLS results were of high quality, though not consistently so. A major internal test was passed in every case--the explanatory variable was highly significant in every case, and the explanatory power of the equations was generally high. In the two cases where corrected multiple correlation coefficient

(CRSQ) was less than 0.80, additional effort will be made to improve the fit of the equation to the historical data. However, it should be pointed out that reestimation of the local expenditures equation 16 has thus far produced worse results.

An additional comment seems worthwhile on two other issues--the apparent arbitrary choice of the range of the regression equations, and the low values of the Durbin-Watson statistic in three of the equations. The overall MAP approach has been consistently to use as much data as is available and possible to use in estimating structural equations. In this case, the choice of range was not affected by data outliers; rather, it was dictated by missing data. The Durbin-Watson statistic seems to indicate first-order serial correlation in three of the equations, which could affect the efficiency of the equation estimated. However, this is probably not a problem in these cases even if serial correlation exists, since the null hypothesis (coefficient CiB=0) is so overwhelmingly rejected. In any case, the coefficient is not biased by the serial correlation problem if it exists, so the estimates in the forecast period will not be changed, even though the degree of confidence which can safely be placed in them may be reduced. However, since the simulation model of which these equations are a part will likely be affected even more by other larger sources of bias and loss of efficiency, worry over this source seems an inefficient use of research time.

Simulations and Results

The model described above was used for two simulation experiments over the period 1976 to 1990. In the first experiment, the past relationships between variables were projected into the future in a "growth as usual" case based on non-Native civilian population data from an earlier run of the MAP econometric model A7 (accelerated growth at a wellhead oil price of $7 per barrel), with Native population growth proceeding at the rate which prevailed between 1970 and 1975, and with military population constant at the 1975 level. In the second experiment, the variables remained the same, except that the state was assumed to spend an extra $100 million per year in the form of operating subsidies to the district schools. The results are summarized in Tables 1, 2, 3, and 4 and are described briefly below.

Table 1 shows the base case simulation enrollments. Since enrollment figures for district schools and state-operated rural schools are fixed proportions of civilian non-Native population growth, the increase in ADMD (district school membership) and ADMS (state rural school membership) reflects the population growth associated with petroleum development in the A7 case. Military population is assumed constant, so membership in base schools (ADMB) also remains constant. Enrollment in district schools doubles between 1976 and 1990, while rural school districts slightly more than double their enrollment.

Table 1

GROWTH-AS-USUAL CASE, A7 SCENARIO
SCHOOL ENROLLMENT VARIABLES

(Thousands of Students)

	ADMD	ADMB	ADMS	ENRN	ENRU
1976	75.817	6.91	7.8976	4.68867	22.1688
1977	78.8054	6.91	8.2089	4.71681	23.8313
1978	78.7363	6.91	8.2017	4.74516	25.6187
1979	80.879	6.91	8.4249	4.77351	27.5402
1980	86.759	6.91	9.0374	4.80228	29.6055
1981	92.9568	6.91	9.683	4.83105	31.826
1982	98.8531	6.91	10.2972	4.86003	34.213
1983	105.846	6.91	11.0256	4.88922	36.779
1984	112.537	6.91	11.7226	4.91862	39.5374
1985	119.132	6.91	12.4096	4.94802	42.5077
1986	126.164	6.91	13.1421	4.97763	45.6905
1987	133.488	6.91	13.905-	5.00766	49.1171
1988	141.352	6.90994	14.7242	5.03749	52.801
1989	149.727	6.91	15.5966	5.06793	56.761
1990	158.346	6.91	16.4944	5.09838	61.0182

Key: ADMD = District Schools, Average Daily Membership
ADMB = Base Schools, Average Daily Membership
ADMS = State Rural Schools, Average Daily Membership
ENRN = Native BIA Schools, Potential Enrollment
ENRU = University of Alaska, Potential Enrollment

Native potential enrollment increases, but a combination of low net population growth and the fact that many Natives attend district or state-operated rural schools keep enrollment increases to only about 10 percent of the 1976 base. This may even actually overstate the case, since with recent increases in local statutory control in the state-operated rural schools, and probable increased levels of funding to all state schools, the BIA alternative will likely appear less attractive than in the past. The attendance at the University of Alaska (all campuses: ENRU) more than triples, from a 1975 base of about 18,500 to a 1990 enrollment of just over 61,000. The decision to attend school is probably much more an economic one for the potential college student than for the potential primary or secondary student, since the college student directly bears part of the cost as tuition and fees, and this latter enrollment could be markedly affected by changes in the cost and value of education to the student. However, if past trends prevail, the potential for enrollment growth is very large. Even so, the expenditures "required" by trends in past relationships may be less than would be predicted by extrapolating the past proportion of the state budget to the new era.

Table 2 reports the expenditure data for the base case. As can be seen from the table, all categories of state spending for education grow substantially between 1976 and 1990. While spending on primary and secondary education grows some twelve times over the 1976 level between 1976 and 1990, and miscellaneous spending grows 3.4 times

Table 2

EXPENDITURES BY CATEGORY, GROWTH-AS-USUAL

(Millions of Dollars)

	EEDS96A	EEDS98A	EEDMSCS	EEDUAS
1976	105.205	143.348	53.3155	36.8301
1977	117.665	162.545	60.0638	39.2354
1978	117.366	162.082	62.3724	41.7982
1979	126.854	176.9	66.6725	44.5284
1980	155.432	222.53	75.4293	47.4365
1981	189.802	279.149	84.7299	50.535
1982	226.791	341.937	93.8396	53.8357
1983	276.416	428.787	104.481	57.3522
1984	330.093	525.681	114.725	61.0981
1985	389.264	635.604	124.708	65.0888
1986	459.571	769.943	135.005	69.3403
1987	541.13	930.289	145.404	73.8691
1988	638.672	1127.65	156.274	78.6941
1989	754.484	1369.	167.638	83.834
1990	887.2	1653.8	179.203	89.3097

	EEDGFS	EEDL99
1976	233.493	131.41
1977	261.844	144.763
1978	266.252	145.739
1979	288.101	156.981
1980	345.395	187.412
1981	414.414	222.629
1982	489.612	260.131
1983	590.619	310.745
1984	701.504	365.325
1985	825.401	425.093
1986	974.288	495.607
1987	1149.56	576.904
1988	1362.62	673.602
1989	1620.47	787.833
1990	1922.31	918.215

Key:

EEDS96A = Total State Transfers to Local School Districts

EEDS98A = Total State Operating Expenditures for Primary and Secondary Education

EEDMSCS = Total State Miscellaneous Education Operating Expenditures

EEDUAS = Total State Transfers to the University of Alaska

EEDGFS = Total State General Fund Operating Expenditures for Education

EEDL99 = Total Local School Distric Operating Expenditures over the period, transfers to the University of Alaska grow only about 2.4 times, less than the projected rate of increase in student population. This suggests that higher education may be a future area within education where the state may wish to increase funding, relative to past trends. For example, if state transfers to the University of Alaska bore the same proportion of total education operations spending in 1990 as in 1976, the University would receive $303.2 million in 1990, not $89.3 million. If real spending per University student were constant (allowing for an average annual inflation rate of 5 percent), then 1990 transfers to the University in this case would be $200.7 million.

Table 3 shows the difference between estimated total spending on education projected by using past proportions of total state spending by function and spending on education projected with the same exogenous data, using past enrollment trends. As the table shows, the difference is quite large in most years. Initially, the difference is a little over $200 million, peaks at nearly $600 million, and then declines rapidly.

Table 4 reports the result of the second experiment, which took the same exogenous data as in the growth-as-usual case, but added $100 million per year to the operating revenues which the state provides to the local school districts, and which, it is assumed, are spent in the same manner as other operating subsidies.

Table 3

TOTAL EDUCATION EXPENDITURES

PROJECTED PAST BUDGET PROPORTION VS.
"REQUIRED" BY ENROLLMENT TRENDS

(Millions of Dollars)

	Past Budget Proportions	"Required" Total Expenditures*	"Required" Operating Expenditures	Projected, Less "Required"
1976	485.8	276.6	233.5	209.2
77	521.7	310.1	261.8	211.6
78	472.2	315.5	266.3	156.7
79	595.2	341.3	288.1	253.9
80	757.2	409.2	345.4	348.0
81	841.1	490.9	414.4	350.2
82	1051.5	580.0	489.6	471.5
83	1242.6	699.6	590.6	543.0
84	1413.6	831.0	701.5	582.6
85	1574.5	977.8	825.4	596.7
86	1738.5	1154.2	974.3	584.3
87	1882.7	1361.8	1149.6	520.9
88	2026.1	1614.1	1362.6	412.0
89	2181.0	1919.6	1620.5	261.4
90	2332.3	2277.2	1922.3	55.1

*Based on the ratio of state general fund operations expenditures for education to all state expenditures for education, as reported in the State of Alaska Annual Financial Report. Ratio = 1.1846.

Table 4

PROFESSIONAL EMPLOYMENT IN EDUCATION, NUMBER OF PROFESSIONAL EMPLOYEES PER STUDENT, AND DEPARTMENT OF EDUCATION DIRECT PLUS INDIRECT EXPENDITURES PER STUDENT

Case 1: Growth as Usual

	PROF	PROFPS	EEDPSS
1976	5.36903	0.059245	2.17009
1977	5.71125	0.060807	2.37009
1978	5.71704	0.060918	2.39167
1979	5.98123	0.062166	2.53157
1980	6.71111	0.065343	2.90107
1981	7.5297	0.068733	3.32158
1982	8.36341	0.072061	3.75474
1983	9.42601	0.07615	4.30814
1984	10.5142	0.080158	4.88228
1985	11.6539	0.084173	5.49153
1986	12.942	0.088512	6.18911
1987	14.3643	0.093092	6.9713
1988	15.9836	0.098067	7.87751
1989	17.8132	0.103425	8.92178
1990	19.8097	0.108994	10.0852

Case 2: State to Local Exogenous Transfer = $100 million per year

	PROF	PROFPS	EEDPSS
1976	6.39216	0.070534	3.27354
1977	6.67535	0.071072	3.43477
1978	6.68116	0.071191	3.45723
1979	6.90402	0.071757	3.57092
1980	7.53046	0.07332	3.87472
1981	8.25086	0.075316	4.23441
1982	9.00032	0.077549	4.61636
1983	9.97393	0.080577	5.11601
1984	10.9871	0.083763	5.64465
1985	12.0613	0.087116	6.2138
1986	13.2879	0.090878	6.87303
1987	14.654	0.094969	7.61938
1988	16.2205	0.099521	8.49106
1989	18.0015	0.104518	9.50239
1990	19.9547	0.109792	10.6355

Key: PROF = Professionals Employed in Primary and Secondary Education, in Thousands

PROFPS = Professionals Per Student

EEDPSS = State Expenditures for Primary, Secondary, and General Education, Per Student, in Thousands of Dollars Per Student.

How much of a difference would this additional discretionary spending make? Table 4 shows that since the number of pupils is assumed to be independent of the level of the subsidy (i.e., good schools do not in themselves attract large numbers of additional primary and secondary students to Alaska), the difference in spending per student declines from over $1,100 per student in 1976 to $550 per student in 1990. The additional $100 million initially translates into about 1,000 additional professionals if schools spend these funds in the normal manner, i.e. not concentrating it only on teacher salaries. It also reduces the student-to-professional ratio from 16.9 to 14.2, a difference of not quite 16 percent. However, by the end of the period, $100 million per year makes virtually no difference in this ratio. Enrollment growth, increasing labor costs, and inflation combine to reduce the effect of the $100 million to almost no difference in "service".

Conclusion

The education expenditures model in this report is for demonstration and is not the final version. Additional work may remain to be done on several of the equations which, while they give intuitively satisfactory results for the projection period, have not been subjected to the full range of tests, and could be improved. The problems of integrating this model with the MAP econometric and population models remain, as does that of satisfactorily projecting capital spending in education. Some district education data is reported on a regional basis, and this awaits coordination with regional population models, if regional local expenditures for education are to be projected. The model should be taken for what it is: an initial attempt, not a completed effort.

Appendix A

Symbol Declarations and Equations

The model whose results are given in this progress report is reported below. The definitions of variables and parameters appear at the end of this Appendix, in alphabetical order. The values of the parameters and coefficients appear in Appendix B.

SYMBOL DECLARATIONS:

ENDOGENOUS:

ADMB ADMD ADMS EDFINL EEDL99 EEDMSCS EEDS96 EEDS98
EEDUAS ENRN ENRU ESCHPROF FOUNPROF

DEFINITION:

ADMN ADM97 ADM98 EEDGFS EEDL EEDL98 EEDPSS EEDS96A
EEDS98A EED99S PROF PROFEX PROFPS

EXOGENOUS:

EDFINF EUA EXEDS NPOP519 PI POPC519 POPM519 TPOP
TPOP1524 TPOP519 DUM1 DUM2

COEFFICIENT:

C10A C10B C12A C12B C13A C13B C14A C14B C6A
C6B C7A C7B C8A C8B C8C C8D C9A C9B

PARAMETER:

CADM1 CADM2 CADM3 CADM4 CADM5 K

EQUATIONS:

```
 1:   ADMD == CADM1*POPC519
 2:   ADMS == CADM2*POPC519
 3:   ADMB == CADM3*(TPOP519-NPOP519-POPC519-POPM519)
 4:   ADM97 == ADMD+ADMS
 5:   ENRN == CADM4*NPOP519
 6:   ADMN == K*ENRN
 7:   ADM98 == ADM97+ADMB+(1-K)*ENRN
 8:   ENRU == CADM5*TPOP1524
 9:   LOG(EEDS96) = C6A+C6B*LOG(ADMD)
10:   EEDS96A == EEDS96+EXEDS
11:   LOG(EEDS98) = C7A+C7B*LOG(ADM98)
12:   EEDS98A == EEDS98+EXEDS
13:   EEDMSCS = C8A+C8B*TPOP+C8C*DUM1+C8D*DUM2
14:   LOG(EEDUAS) = C9A+C9B*LOG(ENRU)
15:   EEDGFS == EEDS98A+EEDMSCS+EEDUAS
16:   LOG(EDFINL) = C10A+C10B*LOG(PI)
17:   EEDPSS == (EEDS98A+EEDMSCS)/ADM98
18:   EED99S == EEDS98A+EEDMSCS+EUA
19:   EEDL == EEDS98A+EDFINL+EDFINF
20:   EEDL98 == EEDS96A+EDFINL+EDFINF
21:   EEDL99 = C12A+C12B*EEDL98
22:   ESCHPROF = C13A+C13B*EEDL99
23:   LOG(FOUNPROF) = C14A+C14B*LOG(ESCHPROF)
24:   PROFEX == FOUNPROF/EEDL98
25:   PROF == PROFEX*EEDL
26:   PROFPS == PROF/ADM98
```

Definitions of Variables:

ADMB = Average Daily Membership in Base Schools (Thousands)

ADMD = Average Daily Membership in District Schools (Thousands)

ADMN = Average Daily Membership in Native (BIA) Schools (Thousands)

ADMS = Average Daily Membership in State-Operated Rural Schools (Thousands)

CADM1 = Ratio of ADMD to POPC519, for School Year 1974-75

CADM2 = Ratio of ADMS to POPC519, for School Year 1974-75

CADM3 = Ratio of ADMB to Military Dependent Population, for School Year 1974-75

CADM4 = Ratio of ENRN to NPOP519, for School Year 1974-75

CADM5 = Ratio of ENRU to TPOP1524, for School Year 1974-75

EDFINF = Federally Supplied Operating Funds of Local School Districts (Millions)

EDFINL = Locally Supplied Operating Funds of Local School Districts (Millions)

EEDL = Estimated Total Operating Expenditures for Primary and Secondary Education (Millions)

EEDL98 = Estimated Total Operating Expenditures for Primary and Secondary Education by Local Districts (Millions)

EEDL99 = Actual Total Operating Expenditures for Primary and Secondary Education by Local Districts (Millions)

EEDGFS = Total State General Fund Operating Expenditures for Education (Millions)

EEDMSCS = Total State Miscellaneous Operating Expenditures for Education (Millions)

EEDPSS = Total State Operating Expenditures for Primary and Secondary Education, Per Student (Thousands)

EEDS96 = Total Demand-Induced Operating Expenditures for Primary and Secondary Education by Local Districts (Millions)

Definitions of Variables (Continued):

EEDS98 = Total State Demand-Induced Operating Expenditures for Primary and Secondary Education (Millions)

EEDUAS = Total State Operating Funds Transferred to the University of Alaska (Millions)

EED99S = Total Operating Expenditures for Education by the State and University (Millions)

ENRN = Potential Enrollment in Native (BIA) Schools (Thousands)

ENRU = Potential University of Alaska Enrollment, All Campuses (Thousands)

ESCHPROF = Expenditures for Instruction and Administration, by District Schools (Millions)

EUA = Total Operating Expenditures of the University of Alaska (Millions)

EXEDS = Exogenous State Transfer of Funds to Local Districts (Millions)

FOUNPROF = Total Professional Personnel Hired by Local Districts (Thousands)

K = Proportion of Potential Native School Enrollment Attending BIA Schools

PI = Personal Income (Millions)

NPOP519 = Native Population 5-19 Years of Age (Thousands)

POPC519 = Civilian Population 5-19 Years of Age (Thousands)

POPM519 = Military Population 5-19 Years of Age (All 15-19) (Thousands)

PROF = Total Primary and Secondary Education Professionals (Thousands)

PROFEX = Ratio of Professionals Hired per $1000 of Operating Expense, District Schools

PROFPS = Ratio of Professional Personnel per Student, All Schools

TPOP = Total State Population

TPOP1524 = Total State Population, 15-24 Years of Age

EDMOD

Appendix B

Estimated Values and Regression Statistics

for Stochastic Equations

Key:

NOB = Number of Observations

NOVAR = Number of Explanatory Variables (Including the Constant)

RANGE = Time Series of Observations (Includes End Dates)

RSQ = Multiple Correlation Coefficient

CRSQ = RSQ, Corrected for Degrees of Freedom

SER = Standard Error of the Residuals

SSR = Sum of Squared Residuals

F = Snedecor "F" Statistic of Significance

DW = Durbin-Watson Statistic of First-Order Serial Correlation of Errors

COEF = Regression Coefficient (The A-coefficient is always the constant)

STER = Standard Error of the Coefficient

T-STAT = Student "t" Statistic of Significance

9: LOG(EEDS96) = C6A+C6B*LOG(ADMD)

NOB = 13   NOVAR = 2
RANGE = 1963 TO 1975
RSQ = 0.91428   CRSQ = 0.90649   F(1/11) = 117.332
SER = 0.2224   SSR = 0.544   DW(0) = 0.64

COEF	VALUE	ST ER	T-STAT
C6A	-7.87517	1.06519	-7.39323
C6B	2.89514	0.26728	10.83200

11: LOG(EEDS98) = C7A+C7B*LOG(ADM98)

NOB = 13   NOVAR = 2
RANGE = 1963 TO 1975
RSQ = 0.9259   CRSQ = 0.91916   F(1/11) = 137.438
SER = 0.1948   SSR = 0.417   DW(0) = 0.58

COEF	VALUE	ST ER	T-STAT
C7A	-10.87220	1.27174	-8.54907
C7B	3.51419	0.29976	11.72330

13: EEDMSCS = C8A+C8B*TPOP+C8C*DUM1+C8D*DUM2

NOB = 12   NOVAR = 4
RANGE = 1964 TO 1975
RSQ = 0.92175   CRSQ = 0.8924   F(3/8) = 31.410
SER = 5.3373   SSR = 227.898   DW(0) = 1.00

COEF	VALUE	ST ER	T-STAT
C8A	-85.07490	24.60170	-3.45809
C8B	0.32589	0.09048	3.60164
C8C	8.55669	6.27211	1.36424
C8D	-22.24140	6.19347	-3.59111

14: LOG(EEDUAS) = C9A+C9B*LOG(ENRU)

NOB = 13 NOVAR = 2
RANGE = 1963 TO 1975
RSQ = 0.92607 CRSQ = 0.91935 F(1/11) = 137.787
SER = 0.1812 SSR = 0.361 DW(0) = 1.59

COEF	VALUE	ST ER	T-STAT
C9A	0.89536	0.14213	6.29977
C9B	0.87487	0.07453	11.73820

16: LOG(EDFINL) = C10A+C10B*LOG(PI)

NOB = 9 NOVAR = 2
RANGE = 1966 TO 1970, 1972 TO 1975
RSQ = 0.67839 CRSQ = 0.63245 F(1/7) = 14.766
SER = 0.1927 SSR = 0.260 DW(1) = 1.86

COEF	VALUE	ST ER	T-STAT
C10A	-1.93336	1.27576	-1.51545
C10B	0.67178	0.17483	3.84254

21: EEDL99 = C12A+C12B*EEDL98

NOB = 8 NOVAR = 2
RANGE = 1966 TO 1969, 1972 TO 1975
RSQ = 0.99055 CRSQ = 0.98897 F(1/6) = 628.858
SER = 4.1371 SSR = 102.692 DW(1) = 2.65

COEF	VALUE	ST ER	T-STAT
C12A	-4.11577	3.50147	-1.17544
C12B	0.94426	0.03765	25.07700

22: ESCHPROF = C13A+C13B*EEDL99

NOB = 7 NOVAR = 2
RANGE = 1966 TO 1969, 1972 TO 1974
RSQ = 0.9557 CRSQ = 0.98233 F(1/5) = 344.547
SER = 2.9571 SSR = 43.723 DW(1) = 1.51

COEF	VALUE	ST ER	T-STAT
C13A	3.23779	2.59664	1.24692
C13B	0.64289	0.03463	18.56190

23: LOG(FOU.PROF) = C14A+C14B*LOG(ESCHPROF)

NOB = 10 NOVAR = 2
RANGE = 1963 TO 1969, 1972 TO 1974
RSQ = 0.97604 CRSQ = 0.97305 F(1/8) = 325.957
SER = 0.0490 SSR = 1.920E-02 DW(1) = 0.52

COEF	VALUE	ST ER	T-STAT
C14A	-0.80588	0.09820	-8.20667
C14B	0.50308	0.02786	18.05430

Constant Values:

K = 1.0 CADM1 = 0.96 CADM2 = 0.10 CADM3 = 0.50 CADM4 = 0.21
CADM5 = 0.18

Exogenous Data Supplied on Endogenous Series:

ESCHPROF: 1975 = 100.0

APPENDIX B

Proposal for Expenditures Modeling

Revised Draft
April 12, 1977

PROPOSAL FOR EXPENDITURES MODELING PROGRAM

I. Introduction

The accompanying paper on practical issues in long term fiscal planning for Alaska provides a general rationale for an expenditure modeling effort linked to an econometric model of Alaska's economy, in that there is currently no sophisticated budget planning model in Alaska's state government which projects future demand for current government expenditure programs, and which has an expenditures "feedback" loop that takes into account the effect of altered expenditures paths on subsequent revenues and demand for expenditures.

The feature of demand for expenditures modeling is valuable, since it may point out discrepancies between planned or projected expenditures and those expenditures which would have resulted from extending current levels and trends in government services. Second, the feedback loop may be particularly important for certain expenditures policies which could result in high levels of immigration. Preliminary MAP studies with a cruder model indicate, for example, that use of oil revenues to roll back the state personal income tax is counterproductive, in that half of the initial gains in disposable real personal income are eroded by population increases.

Similar effects could exist in many other fiscal areas, and it is important that these be examined in planning fiscal policy. Third, detailed expenditures modeling lends itself to estimation of measurable effects of those expenditures in terms of services delivered. This would enhance the value of the effort, since regardless of eventual expenditures policies decided, at least some of the resulting effects on services can be projected.

II. Proposed Project

I.S.E.R. proposes to do a comprehensive, detailed five-year state expenditures planning study for the use of the Division of Policy Development and Planning, Division of Budget and Management, and other state agencies which the governor or his representative may direct. The study in its finished form will be compatible with (and will draw from) I.S.E.R.'s statewide long run econometric model, and with long run modeling efforts currently proposed by I.S.E.R. for contract with the state's Legislative Affairs Agency. At a minimum, the detailed expenditures study will provide the following:

a. Detailed projection of demand for budget expenditures by subcategories of the nine major functional categories of expenditure in the state operating budget through 1985. This will be a more detailed modeling effort than that contemplated in the Legislative Affairs proposal, and is aimed at systematically projecting the current programs into the future to test their implications for state budgets.

b. Study of a number of alternatives for budget expenditures through 1985 to demonstrate the sensitivity of the budget to various assumptions concerning individual programs.

c. Projections of state expenditures by object by year by budget category.

d. The impact of transferring variable proportions of interest to the General Fund and to other projects, including direct distribution to persons.

e. Projections of some limited measures of government service availability.

f. Relationships between budget expenditures and total economic impacts.

g. Separate treatment of special funds, state enterprises, and formula spending programs.

In addition, I.S.E.R. will attempt to model two other capabilities which are valuable, though far less tractible to produce:

h. The projected demand for capital expenditures.

i. The relationship between capital expenditures and subsequent continuing expenditures.

The proposed project will involve model development and a series of applications to study the future of the state budget in detail. The State will have an additional option either to purchase the use of Institute resources for additional use of the model, or to pay for the subsequent conversion of the model from TROLL software environment in which the model will be developed, to a form compatible with the State's computer in Juneau. The final product will consist of a copy of the model listing, regression results, annotated data listing, and the applied budget study, to be delivered to the Division of Policy Development and Planning 120 days after the contract is signed.

III. Data

Though additional clarification of data definitions and additional limited aid in data compilation may be requested from Division of Budget and Management, Department of Revenue, and Division of Employment Security, I.S.E.R. staff currently has in hand nearly all the data anticipated as usable for the modeling effort. Little extra collection effort is anticipated. The primary sources will be the state's Executive Budgets (title varies), Revenue Sources, Annual Financial Reports, and miscellaneous sources such as the U.S. Department of Commerce, State Division of Employment Security, and State Departments of Labor and Public Works. The data is of uneven quality, particularly before 1965, but is usable for the present project.

IV. Outline of the Study

1. Introduction and Executive Overview of the Budget Through 1985

2. Data Problems and Solutions

3. Estimation of the Equations, to Include:

    a. Choice of variables
    b. Choice of functional form
    c. Results of estimation and adjustments

SCOMM

#18:9

02-001B (Rev. 10/78)

STATE
of ALASKA

MEMORANDUM

TO: Senator Clem Tillion

DATE: April 17, 1979

FILE NO:

TELEPHONE NO:

FROM: Governor Hammond

SUBJECT: Permanent Fund Legislation; Loan Programs

The following are my bottom line concerns regarding permanent fund enabling legislation and reorganization of the loan programs. I will be flexible regarding details and other aspects of the legislation, but I hope to see the following principles incorporated into any permanent fund legislation which arrives on my desk.

Permanent Fund

1. The permanent fund should be managed as an inviolable trust fund. This means that these funds should be invested in a safe, secure manner to provide a relatively certain flow of income. The principle of the permanent fund may not be used as a guarantee for any debt nor may the fund be used to guarantee debt of its own.

2. 50% of income return to general fund and 50% of income for specific programs as designated by the legislature, such as guarantees for hydro projects, guarantees for state loans, dividends to Alaskans (Ak., Inc.), provided that at a minimum of 25% of earnings would be returned to Alaskans.

3. Investment of permanent fund principal should be based on a list of eligible investments identified as appropriate with respect to risk level and return to the fund.

4. All permanent fund investments should yield a market rate of return.

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

6. No reorganization of state government for loan programs.

7. Increase contribution rate of 50% of bonuses and royalties, at a minimum.

8.

STATE OF ALASKA

JAY S. HAMMOND, GOVERNOR

DEPARTMENT OF LAW

OFFICE OF THE ATTORNEY GENERAL

POUCH K-STATE CAPITOL
JUNEAU, ALASKA 99811

March 21, 1979

The Honorable Brian Rogers
Alaska House of Representatives
Pouch V
Juneau, Alaska 99811

Re: HJR 23, proposing a constitutional amendment re permanent fund

Dear Representative Rogers:

You have asked whether it is necessary for the effective date clause of a constitutional amendment to be made a part of the proposition to be voted on by the electorate.

The short answer is no.

The pertinent provision of the constitution reads as follows:

> Amendments to this constitution may be proposed by a two-thirds vote of each house of the legislature . . . . Unless otherwise provided in the amendment, it becomes effective thirty days after certification of the election returns by the lieutenant governor.

Alaska Const., art. XIII, § 1.

As originally introduced, the provisions on amendment and revision of the constitution did not include any language on the effective date of an amendment. 6 MINUTES, Alaska Constitutional Convention, App. V, p. 25 (1956) (hereinafter, MINUTES). It was added by way of amendment, with the following explanation:

> [O]n line 8, we added the words, 'Unless otherwise provided in the amendment, it becomes effective . . . .' We want to make it [a constitutional amendment] effective 30 days later,

> but we have not changed the intent, because the legislature, if it so desires, can designate the effective date . . . . We just wanted to put in a cautionary note there if the legislature should happen to forget when it became effective.

5 MINUTES 3425.

The constitution has a related provision in the article on the legislative branch. It reads as follows:

> Laws passed by the legislature become effective ninety days after enactment. The legislature may, by two-thirds of the membership of each house, provide for another effective date.

Alaska Const., art. II, § 18.

The spokesman quoted above probably had it in mind when he said that the provision on amendments "now conforms" to other provisions of the constitution. 5 MINUTES 3425.

While it can be argued that the phrase "in the amendment" means that the effective date must be a literal part of the actual amendment to the constitution, we think that goes too far and that it serves no useful purpose. We think the better view is that the convention used the word "amendment" in the sentence at hand to mean the bill or resolution on which the legislature would act in proposing to amend the constitution.

The convention routinely referred to the papers before it which contained proposals to alter the language of the proposed articles it was considering as amendments. Thus, HJR 23 can itself be thought of as a proposed constitutional amendment -- which it is -- and the effective date is provided in it just as was contemplated by the convention. This particular use of language is common, particularly where, as here, there was no established procedure or mechanism for proposing amendments at the time the constitution was drafted. Not having an established mechanism to which they could refer, the framers simply used the word "amendment" in an inclusive sense.

Moreover, a convention which prided itself on its lean and spare language and which avoided the excessive verbiage of its nineteenth century counterparts with a passion, could hardly have intended to clutter up its own document with effective date clauses of only transitory significance. The only possible purpose of making an effective date clause a part of the actual amendment itself would be to have a popular vote on it. That purpose is negated, however, by the testimony of the spokesman quoted above, in which he says, "the legislature, if it so desires, can designate the effective date of the amendment . . . ." 5 MINUTES 3425.

Accordingly, we can see no constitutional intent to require that the effective date be incorporated into the actual language of an amendment and conclude that it suffices that the clause is included in the resolution.

You have also asked whether a section should be added which contains directions for placing the proposed amendment on the ballot. This is the format used in the Legislative Drafting Manual, Appendix XIII. Because the standard section has no legal effect and merely restates a directive contained in article XIII, section 1, of the Alaska Constitution, we have considered recommending its deletion from the format to the Revisor of Statutes. However, we have not yet done so, and the omission of the standard section was simply an oversight. We would in no way object to its insertion as a section 3.

Your inquiry has caused us to review the resolution in its entirety. In doing so, we have discovered that the title -- which stems from an original working draft of a somewhat different proposal -- is overbroad. We recommend that the word "finance" be deleted and that the words "the permanent fund" be inserted in its place.

Sincerely yours,

AVRUM M. GROSS
ATTORNEY GENERAL

By: Rodger W. Pegues
Rodger W. Pegues
Assistant Attorney General

RWP/pjg

JAY S. HAMMOND
GOVERNOR

STATE OF ALASKA
OFFICE OF THE GOVERNOR
JUNEAU

February 14, 1980

The Honorable Hugh Malone
Alaska State House of Representatives
Alaska State Legislature
Pouch V
Juneau, Alaska 99811

Dear Representative Malone:

Benefits from oil wealth which belong to all Alaskans can be distributed in many ways: low interest loans, tax relief, expanded government services. While these all may have merit, not all Alaskans are beneficiaries. This is why I have proposed a Permanent Fund Dividend program which, compared to drastic income tax reduction or repeal, would:

1. Provide benefits to all Alaskans from the earnings of their resource wealth.

2. Encourage greater contributions to the Permanent Fund.

3. Set in place a dividend dispersal system which most economists believe better meets the objectives of an A.G.S.O.C.

4. Not serve to narrow our already too narrow tax base.

5. Confine benefits to Alaskans.

6. Be less vulnerable to federal "tax bites".

7. Serve as less a magnet to attract persons to come up here.

8. Equitably impact both rich and poor.

9. Retain the taxpayer's one remaining tie with, and consequent concern for, government growth: How much it costs them.

10. Far less likely reduce federal revenue sharing to the State.

11. By contrast maximize favorable impact upon the State's economy by keeping a far larger portion of the money to fund the program here in Alaska.

12. Likely satisfy <u>both</u> the tax reduction and A.G.S.O.C. initiatives.

If it were not for these twelve considerations, I would prefer income tax reduction or repeal. It's simpler and far easier to sell politically, so long as the public can be kept unaware of what we could achieve with a comparable expenditure of their oil wealth through the Permanent Fund Dividend concept. Once they in turn become aware, various interest groups, many initially favoring instead drastic tax reduction or repeal, have similarly concluded that the Permanent Fund Dividend concept better meets the above objectives. To date, that concept has been endorsed as preferable to income tax repeal by ANS, ANB, AKPIRG, the Municipal League, the Council of Mayors, and RurAL CAP.

All of the above twelve points are, in my view, important. However, some are less so than others. To aid you in your deliberations, here are the ones which I deem most important.

1. First and most important, the aggregate cost of the benefits provided must be ultimately offset by some source of sustainable revenue. The logical source is the income stream of the Permanent Fund. By relating the size of their benefit to one-half the earnings of the Permanent Fund contributions, the public will not only be supportive of larger fund contributions but as well will likely be far more demanding that at least this portion of their oil wealth be invested prudently, rather than used for hidden subsidies or bigger government.

Initially, of course, one-half the earnings of the Permanent Fund would be inadequate to fund "benefits" equal in cost to the State of either income tax repeal or the minimal $50 per share Permanent Fund Dividend I propose. However, once three billion dollars were in the fund, one-half the income stream would be sufficient to offset the costs of income tax repeal -- about $160 million for 1979.

Ultimately, were no "lid" placed upon the total benefit (aside from limiting it to one-half Permanent Fund earnings) each share would become worth several hundred dollars. Then the aggregate costs would far exceed that incurred through repeal of the income tax. Accordingly, I propose that the aggregate costs in any given year not exceed what the total income tax obligation was for the prior year.

2. In any program increasing the dispersal of our oil wealth all Alaskans, not simply taxpayers, should be beneficiaries. We already have numerous programs selectively dispersing portions of our oil wealth in the form of expanded subsidized government programs and low interest loans. These go only to select Alaskans, not to all. The size of these selective "hidden dividends" can be substantial. For example, take the case of someone who gets a $100,000 State loan of oil wealth at 9 1/2 percent interest. Yet, all other Alaskans who own just as much of that wealth as he could get about 15 1/2 percent return if their money was loaned at market rate. Therefore, the loan recipient is receiving a "dividend", or subsidy, of $6,000 in the first year alone. That subsidy or "dividend" would amount to an incredible $94,000 on a 30-year loan. That "dividend" or subsidy is being paid from oil wealth owned by all Alaskans. We don't confine payment of such loan "dividends" to taxpayers only or demand that before we provide Alaskans with low interest loans, we first eliminate the income tax. Why should a system which provides far more equitable benefits to all Alaskans, such as the Permanent Fund Dividend concept, be subordinate to that consideration? It seems high time that any new means of dispersing oil wealth should provide that all Alaskans, even the non-taxpaying, housewife, student, unemployed or retired couple get a share.

3. If benefits are confined to taxpayers only, as benefits grow in size with increased Permanent Fund earnings the income tax obligation would ultimately be eliminated. We would then have no continuing system for distributing benefits. This is yet another reason for setting up a system which disperses some of their oil wealth to all Alaskans -- even after income tax obligations have been eliminated.

Please use the above twelve criteria as a yardstick to measure whatever proposals may come before you. If you can better meet them through a system other than the Permanent Fund Dividend concept, I will happily support it.

Sincerely,

Jay S. Hammond
Governor

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

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

Mr. Chairman, members of the Committee,

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

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

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

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

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

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

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

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

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

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

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

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

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

> ...it appears that most attempts of the permanent fund to serve as a development bank for Alaska would duplicate functions that private financial institutions (backed up in many cases by other governmental assistance programs, e.g. FHA, Farmer's Home, VA, etc.) perform or are capable of performing adequately. At this stage in my investigation, I have been able to identify only one function in which a new public financing source might

> function better than the current machinery of the private capital market, and that is in provision of commercial credit and financing of small and medium scale industrial and commercial enterprises in small communities and rural areas.

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

> The permanent fund clearly has the potential to play a major role in Alaska's economic development. Although there are many outside forces which will shape the direction of Alaska's economy, the state will be able to foster industrial development by decision on such matters as provision of transportation infrastructure, and taxes, and will be able to mitigate the adverse impacts of growth by providing public services, housing, and the like: the Fund can stimulate development by providing equity capital, long-term loans, or debt guarantees for new business.
>
> However, based on the economic research reported here, we believe that the majority of the funds available for economic development should be held while long-term opportunities are studied in detail. More immediate capital needs can be identified and met, such as mortgage financing of additions to the fishing fleet. Equity investments and loans for larger projects will more prudently follow detailed study of specific proposals or possible developments, including financial plans, markets available, and non-financial impacts...
>
> As discussed above, market forces and overall economic development trends beyond the state's control will to some extent perpetuate cyclicality and other negative economic fluctuations in Alaska. Further, the availability of capital will not, of itself, be a significant attractor of new industry, particularly large national or international firms. It is more likely that Permanent Fund financing for new business will go to smaller, local firms or entrepreneurs who are unable to raise money from out-of-state institutions and whose requirements exceed the lending ability of local banks (in amount or term).

Neither of these studies were conclusive - they did not include detailed analyses to identify capital gaps or document actual situations where creditworthy projects could not obtain financing. Therefore, the Governor's proposal structures a development banking mechanism which requires the identification of such capital gaps in advance of the commitment of any funds, and provides for amendment of the bank's enabling legislation by temporary act to allow investment when such situations have been discovered and documented to the Governor and the legislature.

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

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

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

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

OVERALL POLICY OBJECTIVE

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

1. Policy Guideline on Eligible Investments

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

2. Policy Guideline on Allocation Among Types of Investments

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

3. Policy Guideline on Interest Rates

   The rates of interest charged to borrowers by the permanent fund should conform to the rates which would be obtained in the private sector for similar financing under similar conditions. The legislature and the Governor should specifically identify investment categories which they may wish to subsidize. Such subsidies must be appropriated from the general fund, such that the rate of return to the permanent fund remains at the market rate and the security of the fund is maintained.

4. Policy Guideline on Permanent Fund Earnings

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

5. Policy Guideline on Management Control

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

6. Policy Guideline on Management Prerogatives

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

7. Policy Guideline on Contribution Rate

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

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

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

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

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

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

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

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

STATE
of ALASKA

MEMORANDUM

DIVISION OF POLICY DEVELOPMENT AND PLANNING
OFFICE OF THE GOVERNOR

TO: Distribution

DATE: February 23, 1979

FILE NO:

TELEPHONE NO:

FROM: Frances A. Ulmer
Director

SUBJECT: Permanent Fund Policy

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

OVERALL POLICY OBJECTIVE

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

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

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

The key provisions for implementing this policy are outlined below.

1. Policy Guideline on Eligible Investments

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

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

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

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

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

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

2. Policy Guideline on Allocation Among Types of Investments

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

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

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

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

3. Policy Guideline on Interest Rates

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

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

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

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

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

4. Policy Guideline on Permanent Fund Earnings

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

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

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

5. Policy Guideline on Management Control

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

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

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

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

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

Section .200 establishes the general reporting requirements including:

a. comprehensive financial statements and audit reports,

b. income statements and balance sheet to be published in at least one newspaper in each judicial district, and

c. income statement and balance sneet to be published in the election pamphlet.

6. Policy Guideline on Management Prerogatives

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

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

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

7. Policy Guideline on Contribution Rate

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

Explanation: The Governor has chosen increased contributions to the permanent fund as the best mechanism for both holding down state spending and providing a source of recurring revenues. Increasing the contribution rate yields two major benefits: (1) it would make a large amount of nonrecurring revenue unavailable for ongoing state spending and would reduce the unacceptable rate of budget growth, and (2) it would triple the earnings potential of the fund to provide certain, recurring revenues for financing tax credits and future state government activities.

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

Narrative

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

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

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

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

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

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

Operating principles are established for investment of the Fund including:

a) preference for investments within Alaska which have risk levels and expected yields comparable to alternative investment opportunities;

b) a version of the prudent man rule;

c) preparation of an investment program, based on an annual credit assessment of the state by the director. The assessment may also include recommendations to the Governor and the Legislature to expand the investment list if appropriate;

d) the requirement that all Permanent Fund investments earn a market rate of interest;

e) the requirement that if the Legislature wishes to subsidize investments it must specifically appropriate general fund money to do so (which will maintain a market return to the fund); and,

f) several additional operating principles.

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

FAU:ms

Section-by-Section Summary of SB 226

Sec. 010: Establishes the Alaska Permanent Fund in the Department of Revenue according to Article IX, Section 15 of the Alaska Constitution.

Sec. 020: Sets out the purpose of the fund - to conserve a portion of the state's revenues from mineral resources and to maintain the fund's principal through income-producing investments.

Sec. 030: (a) Sets the contribution rate at the constitutional minimum of 25% until FY 1982, at which time the contribution rate increases to 75% except for bonuses which are set at 100%.

(b) Provides that income from the permanent fund shall be deposited in the general fund except for amounts appropriated for the corporation's expenses and amounts required for reserve accounts.

(c) Provides that all of the permanent fund principal dedicated under the 1976 amendment (the first 25%) be managed as a trust fund by the Department of Revenue as prescribed by the Interim Management Act (AS 37.10.065). Any contributions dedicated by statute or additional constitutional amendments above the 25% level must be allocated to the Permanent Fund Corporation.

Sec. 040: Establishes the Alaska Permanent Fund Corporation in the Department of Revenue to invest and manage permanent fund contributions in excess of the 25% level, and provides it with the necesaary corporate powers.

Sec. 050: (a) Establishes a list of investments eligible for corporation investment. This list represents the policy set by the legislature and the Governor for the use of permanent fund principal above the 25% level.

(b) Allows the corporation to make additional investments only as authorized by law.

(c) Provides for contracts for the investment, custody, safekeeping, and management of securities and execution of transactions.

Sec. 060: Provides for guarantees of indebtedness of electric generating and transmission facilities recommended by the Alaska Power Authority from corporation income. Such guarantee must be approved by the investment committee, the Executive Oversight Committee, and by the voters via proposition at a statewide election.

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

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

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

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

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

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

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

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

Sec. 140: Establishes a corporation director and duties:

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

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

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

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

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

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

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

Sec. 190: Establishes eight operating principles:

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

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

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

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

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

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

AS 37.10.065(c) is repealed.

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

THE ALASKA PERMANENT FUND

A Decision Guide

The Division of Policy Development
and Planning

October 1978

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

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

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

Our Nest Egg - Separating Fact from Fantasy

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

In February, 1976, the Department of Revenue predicted that the contribution to the Permanent Fund for F.Y. 1978 would be $113.9 million. A year later the Division of Legislative Finance predicted it would be $86 million, and the Division of Research Services predicted $80-$90 million. In September of 1978, the Department of Revenue reported a "preliminary actual" figure of $80.6 million. The following figures show a more complete history:

Department of Revenue
Permanent Fund Contribution Projections (in millions)

F.Y.	2/76	8/76	2/77	11/77	8/78
1978	113.9	88.4	82.3	82.6	80.6
1979	131.2	130.9	130.0	88.7	89.3
1981	164.5	183.6	188.3	117.0	77.4

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

Key Considerations

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

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

Savings

Alternatives:
Interim Management
Trust in Independent Corporation
Trust in Treasury
40% of principal in development bank

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

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

- *Savings would provide the least stimulus for immigration.*

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

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

What is the Goal of the Permanent Fund?

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

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

Economic Development

Alternatives:

30% of principal in development bank (Administration)
Small scale development bank (House)
Expanded state loan program (Senate)
Financing for major projects
Financing for GSOP

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

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

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

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

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

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

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

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

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

Community Development

Alternatives:

30% of principal in development bank (Administration)
Expanded state loan program (Senate)
Municipal bond purchases by Treasury

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

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

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

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

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

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

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

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

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M E M O R A N D U M

TO: Hon. Sterling J. Gallagher
Commissioner of Revenue

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

FROM: Eric E. Wohlforth; Eric E. Wohlforth

DATE: February 1, 1978

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

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

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

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

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

AS 44.55.130 establishes a capital reserve account to secure obligations of the corporation. Monies in the capital reserve account are to be used to pay principal, interest and redemption premium on obligations of the corporation. The capital reserve account is funded with the income of the corporation until that is equal to 25% of its outstanding obligations. Under AS 44.55.120(4) the corporation is permitted to borrow amounts up to its paid-in capital. If the corporation is conceived as a borrowing vehicle to provide money for investments or loans and there should be additional provisions establishing its rights to enter into covenants and agreements with bondholders, provisions providing that the indebtedness of the corporation is not a debt of the State and otherwise as necessary for a public bond financing. The above is not in the nature of a policy observation since it is readily perceived that the primary thrust of the fund is an investment or lending vehicle rather than a borrowing vehicle.

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

As to HB 682 creating an Alaska Renewable Resources Corporation, the primary purposes appear to be research and development in renewable resource industries and investment in projects related to research and development. The investment permission in AS 37.12.170 is limited in size ($1,500,000) and in percentage of a project (25%) unless a greater amount or percentage is fixed by concurrent legislative resolution. Under AS 37.12.050, the corporation is allocated 5% of mineral lease bonuses and rentals, half of which are to be placed in the fund. Under AS 37.12.150(11) the corporation "may make financial assistance available in the form of grants, loans, loan guarantees or other appropriate forms to public research and development groups in the state in order to facilitate investment" and in (13) may further make grants. The power to make grants seems to run counter to the constitutional requirement that the Permanent Fund may only be invested in income producing investments. As to guarantees, please see my comments above.

EEW:jr

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April 18, 1977

Hon. Clark Gruening, Chairman

Commissioner of Revenue, Sterling Gallagher

Members of the Joint Legislature
Committee on the Permanent Fund

Sirs:

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

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

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

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

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

Secondly, I feel that Permanent Fund monies devoted to the public sector should be used on a "leveraged" basis. I feel that establishment of reserve funds to support local government borrowing or State agency borrowing for this purpose is preferable to direct loans to municipalities. The reason for this view is the fact that local government bonds are tax exempt. Loans between tax exempt entities are not economically efficient if the debtor entity can borrow publically at tax exempt rates. Satisfactory precedent for this procedure now exists with both the Alaska Municipal Bond Bank Authority and the Alaska Housing Finance Corporation.

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

Very truly yours,

WOHLFORTH & FLINT

By Eric E. Wohlforth
Eric E. Wohlforth

EEW:vf

Enclosures: as stated.

BANK OF AMERICA

October 19, 1971

BANK INVESTMENT SECURITIES DIVISION

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

Dear Commissioner Wohlforth,

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

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

> the desired exclusion from present IRS industrial-aid bond limits of all state and local general obligation bond issues, regardless of purpose
>
> expansion of the straight industrial-aid limit to \$15 million per issue, as proposed by Chairman Wilbur Mills of the House Ways and Means Committee.

Favorable action in either of these areas should promote renewed consideration by Alaska of tax-free industrial-aid bonds as a financing alternative to subsidize or support statewide industrial development. The cheapest method of financing would clearly be to issue voted bonds backed by the state's guarantee or its full faith and credit. Reasonable rates could also be obtained by using a state agency as issuer, provided that: 1) a debt-service reserve fund were established from bond proceeds equal per issue to maximum annual principal and interest; 2) annual access to the state's general fund were statutorily permitted, to compensate for any drawdown of the reserve fund to meet debt-service payments. In the case of either direct state or state agency financing, support for industrial-aid issues would presumably be derived not from state-tax moneys, but rather from loan repayments by the benefited industries. As such, from a municipal analyst's viewpoint, the bonds in due course would be treated as self-liquidating obligations deductible from the state's gross debt - thus reducing, to small or no measure, potential impairement of the state's general credit.

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

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

I welcome this opportunity to share these views with you, Mr. Wohlforth, and hope that the enclosed materials on industrial-aid financing will prove of value. If I can be of any further assistance, please be in touch.

Sincerely,

Merrill Ring

Merrill Ring
Senior Research Officer

Enclosures

MR/vs
622-2530(415)

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

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

BY THE RULES COMMITTEE BY REQUEST OF THE GOVERNOR

IN THE HOUSE

HOUSE BILL NO. 277

IN THE LEGISLATURE OF THE STATE OF ALASKA

ELEVENTH LEGISLATURE - FIRST SESSION

A BILL

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

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

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

CHAPTER 13. ALASKA PERMANENT FUND.

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

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

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

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

(1) the amount appropriated to pay the corporation's operating and administrative expenses, under AS 37.13.100;

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

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

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

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

(1) sue and be sued;

(2) adopt a seal;

(3) have perpetual succession;

(4) adopt and amend policies and operational procedures which are not inconsistent with this chapter;

(5) make and execute contracts and other instruments;

(6) in its own name, own, exchange, transfer, lease, rent, convey, acquire, or dispose of by other means real and personal property.

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

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

(2) obligations secured by reserves paid in by the United States or an agency or instrumentality of the United States or obligations of corporations in which the United States is a shareholder or member;

(3) certificates of deposit or their equivalent issued by United States domestic banks, savings and loan institutions or credit unions which are insured by the United States or an agency or instrumentality of the United States and secured as to the payment of principal and interest in accordance with Alaska law;

(4) corporate investment-grade securities;

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

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

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

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

(9) deposits of federally insured savings and loan associations not to exceed 10 per cent of each savings and loan association's deposits exclusive of federal, state, and municipal deposits;

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

(b) The corporation may make other types of investments which are not freely traded on a recognized market only as expressly authorized by law.

(c) The director may enter into contracts providing for investment, custody, safekeeping, and management of securities and execution of transactions.

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

Sec. 37.13.070. RATE OF INTEREST. The rate of interest charged by the corporation on investments made under AS 37.13.040 must at all times be at least equal to the market rate of interest applicable to the kind of investment, less an appropriate servicing fee.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Sec. 37.13.110. EXECUTIVE OVERSIGHT COMMITTEE. There is established the Permanent Fund Executive Oversight Committee, consisting of the governor, the commissioner of commerce and economic development, the commissioner of revenue, the director of the division of policy development and planning, and the director of the division of budget and management. The governor, or, in his absence, the commissioner of revenue, is the chairman.

Sec. 37.13.120. DUTIES OF THE EXECUTIVE OVERSIGHT COMMITTEE. The executive oversight committee shall review and either approve or revise and approve the corporation's annual investment program and present it to the legislature no later than the 20th day of each regular session.

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

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

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

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

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

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

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

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

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

(c) Members of the committee are entitled to per diem and travel allowances as provided by law for members of state boards and commissions.

Sec. 37.13.160. DUTIES OF THE INVESTMENT COMMITTEE. The investment committee:

(1) has sole responsibility to approve all investment proposals, except that the committee may establish criteria for investments that may be approved by the director;

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

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

(1) evaluate the capital markets serving Alaska;

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

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

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

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

Sec. 37.13.190. OPERATIONAL PRINCIPLES. The operations of the corporation must be conducted in accordance with the following principles:

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

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

(3) the corporation shall prepare an annual analysis of the state's capital markets, and may recommend additional investment categories to be included in the list of eligible investments established in AS 37.13.050 if it is found that the permanent fund corporation is the best mechanism for correcting market inefficiencies; those recommendations shall conform to the purposes established in AS 37.13.020; and its investment program shall be based, to the extent consistent

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

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

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

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

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

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

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

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

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

Sec. 37.13.220. CONFIDENTIALITY OF INFORMATION. (a) Information furnished the corporation by an applicant for a loan or investment which discloses the particulars of the applicant's business or affairs is not a matter of public record. The information must be kept confidential except when its production is required for a criminal investigation or court proceeding. These restrictions do not prohibit the release or publication of the information in a manner that prevents the identification of a particular applicant.

(b) Nothing in this section prevents the corporation from disclosing the terms and conditions of individual investments as public information.

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

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

STATE OF ALASKA

JAY S. HAMMOND
GOVERNOR

OFFICE OF THE GOVERNOR

DIVISION OF POLICY DEVELOPMENT AND PLANNING

POUCH AD-JUNEAU 99811
PHONE 465-3577

March 29, 1979

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

Dear Representative Malone:

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

(1) What are the Governor's intentions regarding the reserve accounts established by last year's legislature?

(2) Is HJR 23 in proper legal form?

(3) Does the existing permanent fund constitutional amendments mandate to trust responsibilities?

(4) What other uses is the Governor considering for permanent fund income?

(5) What revenue projections were used to justify a proposed contribution level of 75%?, and

(6) Can the gas pipeline be financed with the permanent fund under the proposed investment lists?

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

Sincerely,

Fran Ulmer
Director
Policy Development and Planning

cc: Committee members

STATE
of ALASKA

MEMORANDUM

DIVISION OF POLICY DEVELOPMENT AND PLANNING
OFFICE OF THE GOVERNOR

TO: Distribution

DATE: February 23, 1979

FILE NO:

TELEPHONE NO:

FROM: Frances A. Ulmer
Director

SUBJECT: Permanent Fund Policy

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

OVERALL POLICY OBJECTIVE

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

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

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

The key provisions for implementing this policy are outlined below.

1. Policy Guideline on Eligible Investments

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

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

STATE of ALASKA

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

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

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

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

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

2. Policy Guideline on Allocation Among Types of Investments

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

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

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

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

3. Policy Guideline on Interest Rates

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

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

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

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

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

4. Policy Guideline on Permanent Fund Earnings

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

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

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

5. Policy Guideline on Management Control

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

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

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

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

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

Section .200 establishes the general reporting requirements including:

a. comprehensive financial statements and audit reports,

b. income statements and balance sheet to be published in at least one newspaper in each judicial district, and

c. income statement and balance sheet to be published in the election pamphlet.

6. Policy Guideline on Management Prerogatives

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

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

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

7. Policy Guideline on Contribution Rate

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

Explanation: The Governor has chosen increased contributions to the permanent fund as the best mechanism for both holding down state spending and providing a source of recurring revenues. Increasing the contribution rate yields two major benefits: (1) it would make a large amount of nonrecurring revenue unavailable for ongoing state spending and would reduce the unacceptable rate of budget growth, and (2) it would triple the earnings potential of the fund to provide certain, recurring revenues for financing tax credits and future state government activities.

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

Narrative

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

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

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

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

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

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

Operating principles are established for investment of the Fund including:

a) preference for investments within Alaska which have risk levels and expected yields comparable to alternative investment opportunities;

b) a version of the prudent man rule;

c) preparation of an investment program, based on an annual credit assessment of the state by the director. The assessment may also include recommendations to the Governor and the Legislature to expand the investment list if appropriate;

d) the requirement that all Permanent Fund investments earn a market rate of interest;

e) the requirement that if the Legislature wishes to subsidize investments it must specifically appropriate general fund money to do so (which will maintain a market return to the fund); and,

f) several additional operating principles.

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

FAU:ms

Section-by-Section Summary of SB 226

Sec. 010: Establishes the Alaska Permanent Fund in the Department of Revenue according to Article IX, Section 15 of the Alaska Constitution.

Sec. 020: Sets out the purpose of the fund - to conserve a portion of the state's revenues from mineral resources and to maintain the fund's principal through income-producing investments.

Sec. 030: (a) Sets the contribution rate at the constitutional minimum of 25% until FY 1982, at which time the contribution rate increases to 75% except for bonuses which are set at 100%.

(b) Provides that income from the permanent fund shall be deposited in the general fund except for amounts appropriated for the corporation's expenses and amounts required for reserve accounts.

(c) Provides that all of the permanent fund principal dedicated under the 1976 amendment (the first 25%) be managed as a trust fund by the Department of Revenue as prescribed by the Interim Management Act (AS 37.10.065). Any contributions dedicated by statute or additional constitutional amendments above the 25% level must be allocated to the Permanent Fund Corporation.

Sec. 040: Establishes the Alaska Permanent Fund Corporation in the Department of Revenue to invest and manage permanent fund contributions in excess of the 25% level, and provides it with the necesaary corporate powers.

Sec. 050: (a) Establishes a list of investments eligible for corporation investment. This list represents the policy set by the legislature and the Governor for the use of permanent fund principal above the 25% level.

(b) Allows the corporation to make additional investments only as authorized by law.

(c) Provides for contracts for the investment, custody, safekeeping, and management of securities and execution of transactions.

Sec. 060: Provides for guarantees of indebtedness of electric generating and transmission facilities recommended by the Alaska Power Authority from corporation income. Such guarantee must be approved by the investment committee, the Executive Oversight Committee, and by the voters via proposition at a statewide election.

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

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

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

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

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

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

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

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

Sec. 140: Establishes a corporation director and duties:

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

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

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

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

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

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

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

Sec. 190: Establishes eight operating principles:

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

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

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

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

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

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

AS 37.10.065(c) is repealed.

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

THE ALASKA PERMANENT FUND

A Decision Guide

The Division of Policy Development
and Planning

October 1978

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

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

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

Our Nest Egg - Separating Fact from Fantasy

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

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

Department of Revenue
Permanent Fund Contribution Projections (in millions)

FY	2/76	9/76	2/77	11/77	9/78
1978	113.9	89.4	82.3	52.6	50.5
1979	131.2	130.9	130.0	88.7	69.3
1980	164.5	183.6	185.3	117.0	77.4

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

Key Considerations

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

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

Savings

Alternatives:
Interim Management
Trust in Independent Corporation
Trust in Treasury
40% of principal in development bank

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

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

- Savings would provide the least stimulus for immigration.

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

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

What is the Goal of the Permanent Fund?

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

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

Economic Development

Alternatives:

30% of principal in development bank (Administration)
Small scale development bank (House)
Expanded state loan program (Senate)
Financing for major projects
Financing for GSOP

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

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

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

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

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

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

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

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

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

<u>Community Development</u>

Alternatives:

30% of principal in development bank (Administration)
Expanded state loan program (Senate)
Municipal bond purchases by Treasury

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

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

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

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

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

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

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

Article 3. Investment and Deposit of State Funds.

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

(1) obligations of, or obligations insured or guaranteed by, the United States or agencies or instrumentalities of the United States;

(2) obligations secured by reserves paid in by the United States or agencies or instrumentalities of the United States or obligations of corporations in which the United States is a shareholder or member;

(3) certificates of deposits issued by United States domestic banks which are members of the Federal Deposit Insurance Corporation and secured as to the payment of principal and interest in accordance with Alaska law;

(4) corporate investment-grade securities;

(5) bankers' acceptance drawn on and accepted by United States banks which each have a combined capital and surplus aggregating at least $100,000,000;

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

(7) deposits of federally insured savings and loan associations not to exceed 10 per cent of each savings and loan association's deposits exclusive of federal, state, and municipal deposits;

(8) fixed-term certificates of debentures of federally insured credit unions not to exceed 1 per cent of each credit union's shares.

(b) The commissioner of revenue may enter into contracts providing for custody of securities and execution of transactions.

(c) The commissioner of revenue shall transfer to whatever agency is established for the express purpose of managing and investing the Alaska Permanent Fund all or part of the securities and money in the Alaska Permanent Fund in accordance with Alaska law no later than two weeks after receipt of written notice from that agency. (§ 1 ch 6 SLA 1977)

Legislative committee report. — For report on ch. 6, SLA 1977 (HB 10), see 1977 Senate Journal, p. 575; 1977 House Journal, p. 279.

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

"An Act providing for state chartered credit unions."

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

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

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

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

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

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

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

February 13, 1979

The Honorable Clem Tillion
President of the Senate
Alaska State Legislature
Juneau, Alaska 99811

Dear Mr. President:

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

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

SB 226 adequate for the management of those funds. A repeal of the subsection transferring funds is all that is required. No other change is contemplated. This is a straight, money-market program of investment, an investment trust, pure and simple.

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

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

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

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

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

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

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

Sincerely,

Jay S. Hammond
Governor

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

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

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

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

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

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

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

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

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

SPECIAL ORDERS

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

JAY S. HAMMOND
GOVERNOR

STATE OF ALASKA
OFFICE OF THE GOVERNOR
JUNEAU

March 29, 1979

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

Dear Mr. Chairman:

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

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

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

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

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

Sincerely,

Jay S. Hammond
Governor

STATE OF ALASKA

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

STATE
of ALASKA

MEMORANDUM

#18:09

TO: Rep. Hugh Malone

DATE: March 28, 1979

FILE NO:

TELEPHONE NO:

FROM: Fran Ulmer

SUBJECT: Re: Permanent Fund Income

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

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

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

Attachments

~~financial practice.~~

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

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

FACING UP TO THE FUTURE

Part Four of a Five-Part Series

by

Governor Jay S. Hammond

"Alaska, Inc." - One Possible Solution

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

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

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

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

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

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

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

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

Possibly we should provide that those imposing costs on the state should have the dividends used to defray those costs. For example, we might charge room and board of those housed in our correctional facilities.

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

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

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

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

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

FACING UP TO THE FUTURE

Part Five of a Five-Part Series

by

Governor Jay S. Hammond

In Defense of "Alaska, Inc."

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

Among the main objections I have heard raised is the suggestion that to pay dividends directly to Alaskan shareholders would pander to the public's "greed". But even if such would be the case, would it not be refreshing to have the public's so-called "greed" working to suppress the growth of government and state budgets to counter special interest "greed"? Of course, one man's presumed "need" becomes the other fellow's "greed". Regardless of the terminology, it would be interesting to have the modifying influence of the public's "greed" or "need" countering that of special interests or the pork barrel process. Another objection has been that such a program would create pressure from the public to exploit our resources at a less than prudent pace. But those pressures could not be worse than the pressures we are faced with now. It would be much easier to resist public pressures to lease out all our oil lands as quickly as possible simply to achieve a larger dividend than it is under the present circumstances to resist putting up new oil leases each time the growth of government demands an increase in revenues. Such was the case when I took over this administration. Faced with a $200 million shortfall, I had little choice but to cast around for some immediate revenues. Obviously, I could not double the income tax. The only thing I could assuredly do was to find another oil province to lease and hope we could raise enough money. Thus, I was almost compelled to put up the Beaufort Sea leases simply to meet the state's payroll, despite the fact the time was not the most auspicious nor the price potentially top dollar. That's a lousy way to be forced to do business. However, unless we shift to funding government from appropriate tax dollars it's only a matter of time before this governor or the next will be forced to start selling lands to pay off the help.

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

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

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

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

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

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

Some say municipal revenue sharing's the way we should go. I don't think most Alaskans agree. However, there's an easy way to find out. Let people exercise local option. Should they elect to have all dividends go to the municipality rather than to themselves, so be it. However, I suspect most would like to have a chance to decide for themselves how they would spend at least a small part of their wealth rather than leave all of such decisions up to elected officials.

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

STATE OF ALASKA

JAY S. HAMMOND, GOVERNOR

DEPARTMENT OF LAW

OFFICE OF THE ATTORNEY GENERAL

POUCH K – STATE CAPITOL
JUNEAU 99811

September 16, 1977

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

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

Dear Representative Gruening:

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

We believe that the answer is no.

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

First, we believe that, despite the absence of an actual transfer of legal and equitable interests to a trustee and beneficiary respectively, the Alaska Supreme Court will treat the permanent fund as a trust or quasi-trust, and as a general rule, apply trust concepts in determining its administrators' duties. We make this assumption (1) because of the tendency of the court, exemplified by such cases as Moore v. State, 553 P.2d 8 (Alaska 1976), to impose trust-like duties upon the State's management of its patrimony, and (2) because the constitutional amendment which created the permanent fund is extremely similar to the classic spendthrift trust both in its roots or causes and in its establishment, i.e., the owner of the State's capital, the people, dissatisfied with the state government's spending of the royalty bonus from the Prudhoe Bay leases, has resolved to remove a portion of that capital from the spending power of the government and to place it in trust, with only the income from its investment available to the government for expenditure.

Because the people established the trust, we believe that the state government will be deemed to be the trustee, not the trustor. This means that, despite the power vested in it by the constitutional amendment to designate by law the kinds of investments to be made, the legislature--as the appropriating arm of the government--will not be deemed to be the trustor or settlor, and that therefore, its power to designate eligible investments is not plenary but rather is limited by the express terms of the amendment on the one hand and by implied trust concepts on the other. In other words, the legislature may designate only income-producing investments and may not designate imprudent, income-producing investments or provide for imprudent administration of the fund principal. To the extent, if any, that it did, the managers of the fund would nevertheless remain under a duty to make only prudent income-producing investments and to provide a prudent administration.

Finally, we believe that the Alaska Supreme Court will rule that--absent exceptional circumstances involving the very existence of the State or its citizens--the preservation of the fund principal is of primary import, i.e., that investment policies cannot endanger the principal. This belief rests on what we perceive to be the essential character of this trust or quasi-trust, i.e., a conservative, cautionary nest egg. */

Of course, the Alaska Supreme Court could rule that no trust or quasi-trust exists and that the law of trusts does not, therefore, govern the fund's administration. That would remove the administration of the fund from the operation of the prudent-man rule. There would then be no duty to limit investments to those which are prudent. That would pretty much give the legislature the power to authorize the expenditure of the fund's principal on any income-producing investment even though it would not be a prudent, i.e., an investment which a trustee could not properly make. This result would allow the fund principal to be frittered away and thereby frustrate the basic purpose of the constitutional amendment. Principally for that reason, we believe the Alaska Supreme Court will impose trust concepts to avoid that result and to give the amendment its full effect.

*/ While the permanent fund is essentially a conservative device, the constitutional amendment was not overly conservative. It did not apply to taxes on minerals at all and it still leaves 75 percent of other mineral revenues available for expenditure.

There can be no question that a trustee must take into consideration the trend of prices and the cost of living, the prospect of inflation or deflation. RESTATEMENT (SECOND) OF TRUSTS 2d § 227, Comment e (1959). To do otherwise would hardly be the conduct of a man of prudence. Accordingly, the fund managers will have to take inflation (or deflation) into account in making and changing investments, if--as we believe--the fund constitutes a trust.

It does not follow, however, that the legislature has a duty to provide specific guidelines on the matter. If the court rules that there is a trust, the prudent-man rule applies. If it rules otherwise, the rule does not apply. Unless the legislature itself resolves the question by making the fund a trust, the matter is entirely up to the court. Whichever way it rules, the court would not, and could not, order the legislature to adopt any particular guidelines. It would merely order the fund managers to follow the prudent-man rule.

Nor does the legislature have any duty to increase the amount of the fund principal because of inflation. The constitutional amendment, which sets forth the principal terms of the trust, makes it mandatory to deposit 25 percent of the designated mineral revenues in the fund. That is the trust property which must be administered, we believe, under the prudent-man rule. While the legislature _qua_ legislature clearly has the power to increase that amount, nothing in trust law places a duty on it to do so. It could also provide for all or a portion of the income from the principal to be deposited in the fund, i.e., added to the principal. But under the terms of the trust, i.e., the constitutional amendment, it has no duty to do so.

We hope that this answers your question. We remind you that we are making an educated guess as to the trust or quasi-trust nature of the permanent fund. We believe it is a trust or quasi-trust and that trust law applies. We are constrained to add that we could be wrong. The legislature may wish to treat the fund as a trust. That would resolve the issue. It should feel free, however, to experiment and treat it otherwise insofar as it determines the public interest warrants doing so, and let the court resolve the issue.

Sincerely yours,

AVRUM M. GROSS
ATTORNEY GENERAL

By: Rodger W. Pegues
Rodger W. Pegues
Assistant Attorney General

RWP:chp

March 21, 1979

The Honorable Brian Rogers
Alaska House of Representatives
Pouch V
Juneau, Alaska 99811

Re: HJR 23, proposing a constitutional amendment re permanent fund

Dear Representative Rogers:

You have asked whether it is necessary for the effective date clause of a constitutional amendment to be made a part of the proposition to be voted on by the electorate.

The short answer is no.

The pertinent provision of the constitution reads as follows:

> Amendments to this constitution may be proposed by a two-thirds vote of each house of the legislature . . . . Unless otherwise provided in the amendment, it becomes effective thirty days after certification of the election returns by the lieutenant governor.

Alaska Const., art. XIII, § 1.

As originally introduced, the provisions on amendment and revision of the constitution did not include any language on the effective date of an amendment. 6 MINUTES, Alaska Constitutional Convention, App. V, p. 25 (1956) (hereinafter, MINUTES). It was added by way of amendment, with the following explanation:

> [O]n line 8, we added the words, 'Unless otherwise provided in the amendment, it becomes effective . . . .' We want to make it [a constitutional amendment] effective 30 days later,

> but we have not changed the intent, because the legislature, if it so desires, can designate the effective date . . . . We just wanted to put in a cautionary note there if the legislature should happen to forget when it became effective.

5 MINUTES 3425.

The constitution has a related provision in the article on the legislative branch. It reads as follows:

> Laws passed by the legislature become effective ninety days after enactment. The legislature may, by two-thirds of the membership of each house, provide for another effective date.

Alaska Const., art. II, § 18.

The spokesman quoted above probably had it in mind when he said that the provision on amendments "now conforms" to other provisions of the constitution. 5 MINUTES 3425.

While it can be argued that the phrase "in the amendment" means that the effective date must be a literal part of the actual amendment to the constitution, we think that goes too far and that it serves no useful purpose. We think the better view is that the convention used the word "amendment" in the sentence at hand to mean the bill or resolution on which the legislature would act in proposing to amend the constitution.

The convention routinely referred to the papers before it which contained proposals to alter the language of the proposed articles it was considering as amendments. Thus, HJR 23 can itself be thought of as a proposed constitutional amendment -- which it is -- and the effective date is provided in it just as was contemplated by the convention. This particular use of language is common, particularly where, as here, there was no established procedure or mechanism for proposing amendments at the time the constitution was drafted. Not having an established mechanism to which they could refer, the framers simply used the word "amendment" in an inclusive sense.

Moreover, a convention which prided itself on its lean and spare language and which avoided the excessive verbiage of its nineteenth century counterparts with a passion, could hardly have intended to clutter up its own document with effective date clauses of only transitory significance. The only possible purpose of making an effective date clause a part of the actual amendment itself would be to have a popular vote on it. That purpose is negated, however, by the testimony of the spokesman quoted above, in which he says, "the legislature, if it so desires, can designate the effective date of the amendment . . . ." 5 MINUTES 3425.

Accordingly, we can see no constitutional intent to require that the effective date be incorporated into the actual language of an amendment and conclude that it suffices that the clause is included in the resolution.

You have also asked whether a section should be added which contains directions for placing the proposed amendment on the ballot. This is the format used in the Legislative Drafting Manual, Appendix XIII. Because the standard section has no legal effect and merely restates a directive contained in article XIII, section 1, of the Alaska Constitution, we have considered recommending its deletion from the format to the Revisor of Statutes. However, we have not yet done so, and the omission of the standard section was simply an oversight. We would in no way object to its insertion as a section 3.

Your inquiry has caused us to review the resolution in its entirety. In doing so, we have discovered that the title -- which stems from an original working draft of a somewhat different proposal -- is overbroad. We recommend that the word "finance" be deleted and that the words "the permanent fund" be inserted in its place.

Sincerely yours,

AVRUM M. GROSS
ATTORNEY GENERAL

By:
Rodger W. Pegues
Assistant Attorney General

RWP/pjg

bcc: Tom Singer, DPDP