

ALASKA LEGISLATURE SPECIAL COMMITTEE / SUBJECT FILES 8672

105 SCOMM 9: HOUSE SPEC. COMM. ON PERMANENT FUND 1977-78

ALASKA
DEPARTMENT OF NATURAL RESOURCES
OFFICE OF THE COMMISSIONER

10. [Av Cross, Attorney General
Department of Law

100-11077

RECEIVED

February 24, 1977

FROM: Guy R. Martin
Commissioner

Guy Martin

SUBJECT:

Trust Lands

The permanent fund established by Constitutional amendment consists of "25% of all mineral lease rentals, royalties, royalty sale proceeds, federal mineral revenue sharing payments and bonuses received by the State" (emphasis added). Some of these revenues may be generated from lands received in trust for specific purposes in school lands, university lands and mental health lands. Can you advise us as to whether 25% of the proceeds in the categories listed for the permanent fund and derived from trust lands should be credited to the permananet fund or whether such proceeds are exempt by terms of the trust?

22 2-7-77

SCOMM

#9:13

August 11, 1977

Robert J. Dupere
Consultant
Senate Permanent Fund Committee
Pouch V
Juneau, AK 99811

Dear Mr. Dupere:

As you requested, I am passing along the mailing lists being used for distribution of the House Committee's background report/questionnaire. The material is being mailed to:

Anchorage Municipal Bodies
Members of the Legislature
Administration Officials
Officials of Oil and Gas Companies
Bankers
Fairbanks Community Leaders
Members of the State Chamber of Commerce
Members of the State Investment Advisory Committee
Native Corporation Officials
State Labor Leaders
Members of Conservation Organizations
Members of the News Media
Members of the Land Use Planning Commission

There are more lists being solicited, but this brings you up-to-date as to which are being used right now. I'll send you copies of the material Monday, when it's due from the printer.

The bibliography you requested does not exist. I believe what you want is an index to the Committee's files, which is being updated at the moment. It should be ready the end of next week, so I'll send you a copy then.

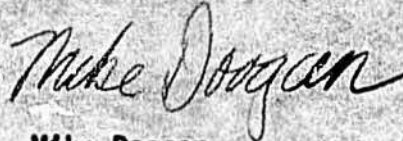
Robert Dupere

-2-

August 11, 1977

Enclosed please find a final copy of the Committee's contract with Belden Daniels.

Sincerely,

A handwritten signature in cursive script that reads "Mike Doogan".

Mike Doogan
Administrative Assistant

Enclosure

August 22, 1977

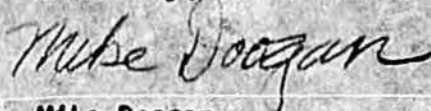
Robert Dupere
Consultant
Senate Permanent Fund Committee
Pouch V
Juneau, AK 99811

Dear Mr. Dupere:

Enclosed is a copy of the Committee's file index which I am forwarding to you as per your request during our meeting in Juneau. By now you should have received, the postal service willing, a copy of Beiden Daniels' contract and a copy of the Committee's brochure, mailed last week. According to my notes, the index rounds out the material you requested.

I will forward to you, as soon as it is completed, a copy of the Committee's revised meeting schedule. If there is anything else I can provide, please don't hesitate to call on me.

Sincerely,



Mike Doogan
Administrative Assistant

Enclosure

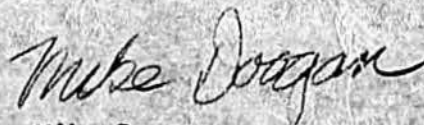
August 24, 1977

Robert J. Dupere
Consultant
Senate Permanent Fund Committee
Pouch V
Juneau, AK 99811

Dear Mr. Dupere:

As promised in my last letter, enclosed is a copy of the
Committee's revised schedule.

Sincerely,



Mike Doogan
Administrative Assistant

Enclosure

September 13, 1977

Rob Koscius
Bupere & Associates
Consultants
Senate Permanent Fund Committee
Pouch V
Juneau, AK 99811

Dear Rob:

Enclosed is a copy of the sign-up sheet from the symposium
Saturday.

Sincerely

Mike

Mike Doogan
Administrative Assistant

Enclosure

August 11, 1977

Robert J. Dupere
Consultant
Senate Permanent Fund Committee
Pouch V
Juneau, AK 99811

Dear Mr. Dupere:

As you requested, I am passing along the mailing lists being used for distribution of the House Committee's background report/questionnaire. The material is being mailed to:

Anchorage Municipal Bodies
Members of the Legislature
Administration Officials
Officials of Oil and Gas Companies
Bankers
Fairbanks Community Leaders
Members of the State Chamber of Commerce
Members of the State Investment Advisory Committee
Native Corporation Officials
State Labor Leaders
Members of Conservation Organizations
Members of the News Media
Members of the Land Use Planning Commission

There are more lists being solicited, but this brings you up-to-date as to which are being used right now. I'll send you copies of the material Monday, when it's due from the printer.

The bibliography you requested does not exist. I believe what you want is an index to the Committee's files, which is being updated at the moment. It should be ready the end of next week, so I'll send you a copy then.

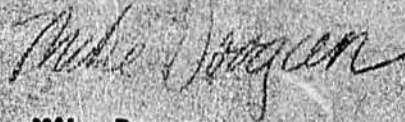
Robert Dupere

-2-

August 11, 1977

Enclosed please find a final copy of the Committee's contract with Belden Daniels.

Sincerely,



Mike Doogan
Administrative Assistant

Enclosure

August 22, 1977


Robert Dupere
Consultant
Senate Permanent Fund Committee
Pouch V
Juneau, AK 99811

Dear Mr. Dupere:

Enclosed is a copy of the Committee's file index which I am forwarding to you as per your request during our meeting in Juneau. By now you should have received, the postal service willing, a copy of Beiden Daniels' contract and a copy of the Committee's brochure, mailed last week. According to my notes, the index rounds out the material you requested.

I will forward to you, as soon as it is completed, a copy of the Committee's revised meeting schedule. If there is anything else I can provide, please don't hesitate to call on me.

Sincerely,



Mike Doogan
Administrative Assistant

Enclosure

Contract Between
STATE OF ALASKA
LEGISLATIVE AFFAIRS AGENCY
AND
DUPERE & ASSOCIATES, INC.

The parties to this agreement are the LEGISLATIVE AFFAIRS AGENCY, on behalf of the Legislative Council's Senate Interim Committee on the Alaska Permanent Fund, hereinafter referred to as the "Agency," and DUPERE & ASSOCIATES, INC., hereinafter referred to as the "Contractor."

THE PURPOSE OF THIS AGREEMENT is to provide the Senate Interim Committee on the Alaska Permanent Fund assistance in the development of the policies for the utilization and management of the Permanent Fund which will be recommended for adoption by the Senate.

IT IS THEREFORE MUTUALLY AGREED THAT:

CLAUSE I. - STATEMENT OF WORK

(a) The Contractor shall, on the request of the Chairman of the Senate Interim Committee on the Alaska Permanent Fund (hereinafter referred to as "the Chairman"), provide the Committee with the basic research and policy recommendations to be presented to the Senate.

(b) The approach to accomplish (a) above is essentially as follows:

(1) Compare present statutory procedures in regards to the various State loan programs in all categories.

Determine if program meeting all needs.

Compare investment results and yield on portfolios.

Document the various criteria for loans in all programs.

Document extent and categories of loans and related programs utilized by others.

(2) Outline indicated area which could be served.

(3) Outline alternate approaches in regards to bank participation.

(4) Streamline financial management programs to deliver loans at lowest possible interest rates.

(5) Streamline the State of Alaska and its created agencies' tax-exempt borrowing for industrial aid bonds; housing; municipal financing to lower interest cost.

- (6) Expand the legislative branch's role in overview of debt financing.
- (7) Structure alternate treasury management procedures to provide checks and balances for those funds not utilized in specific legislative-directed programs.
- (8) Provide innovative approaches to extend funds on a relative risk-free basis for Alaskans.
- (9) Streamline executive organization to fix responsibilities for effective and efficient delivery of services and management of the Permanent Fund and other investments.
- (10) Streamline service to potential Alaskan borrowers.
- (11) Input to Legal Affairs' indicated bills to accomplish Committee's goal.
- (12) Prepare situation papers for Committee meetings.

CLAUSE II. - PERIOD OF PERFORMANCE

- (a) This contract covers the period beginning July 2, 1977 and ending January 9, 1978.
- (b) This contract may be terminated by either party upon written notice to the other.
- (c) Upon termination, the final fee shall be for that portion of the fee schedule outlined in Clause III (b) upon given notice of termination.

CLAUSE III. - PROJECT DIRECTOR

The Project Director shall be the Chairman of the Senate Interim Committee on the Alaska Permanent Fund.

CLAUSE IV. - COMPENSATION AND METHOD OF PAYMENT

(a) The Contractor shall be paid a fixed fee of ^{115,000.00} ~~\$138,000~~ for the work to be performed under this contract.

(b) The fee shall be paid as follows:

- | | |
|---|------------------|
| (1) Upon approval of contract | \$11,000 |
| (2) On the first of each month August, September, October, November, December 1977 and January 1978 | 15,500 |
| (3) Within 20 days of completion of the contract (January 9, 1978) the balance of | 11,000 |
| | <u>\$115,000</u> |

- (c) The fixed fee shall defray the following expenses:
- (1) Additional staff engaged by Dupere & Associates, Inc. to perform the work.
 - (2) Present staff of Dupere & Associates, Inc.
 - (3) Travel of the employees of Dupere & Associates, Inc. as directed by the Contractor.
 - (4) Travel of others as directed by the Contractor.
 - (5) Long distance telephone calls as directed by the Contractor.
 - (6) Office services and supplies generated by the project.
 - (7) Postage and related cost generated by the contract.
 - (8) Fees of Consultants utilized by the Contractor at his discretion; these being: Wainwright & Ramsey Inc. and Lombard/Wall Inc. -- but not limited to these.
 - (9) All related payroll expenses, employee benefits, workmen's compensation and unemployment insurance.

CLAUSE V. - PERSONNEL

- (a) The Contractor will hire the following additional personnel:

Three Consultant-Researchers

These will be subject to direction and supervision by the Contractor.

- (b) The Contractor will establish the standards of performance, pay schedule, retention and scope of work for each.
- (c) The Contractor will subcontract with other Consultant firms for advisory to the Contractor to the extent deemed feasible. The firm of Wainwright & Ramsey Inc. will be utilized on questions involving State and agency credit and rating bureaus. Lombard/Wall Inc. will be utilized for advice concerning management of investment portfolios.

CLAUSE VI. - REPORTS

The Consultant shall keep the Project Director informed as to the progress of the work performed under this agreement and shall be prepared to make presentations to the Committee as scheduled by the Project Director.

CLAUSE VII. - OFFICE SPACE, EQUIPMENT, AND SERVICES

- (a) Office space, telephone, and necessary equipment shall be made available for the Contractor's staff in the general proximity of Room 345 of the Court and Office Building, Juneau, Alaska.

(b) Specific drafting of legislation shall be provided on a timely basis from the Legal Affairs personnel of the Legislative Affairs Agency; such drafting to meet the scheduled meetings of the Committee.

CLAUSE VIII - ALL WRITINGS CONTAINED HEREIN

This agreement contains all the terms and conditions agreed upon by the parties. No other understandings, oral or otherwise, regarding the subject matter of this agreement shall be deemed to exist or to bind either of the parties to this agreement.

IN WITNESS WHEREOF, the parties have executed this agreement on the dates noted next to their signatures.

CONTRACTOR

LEGISLATIVE AFFAIRS AGENCY
(By direction of the Executive Director)

DUPERE & ASSOCIATES, INC.
Robert J. Dupere, President

GREGG K. ERICKSON

Accepted

Approved as to form

GEORGE HOHMAN, Chairman

AGENCY LEGAL COUNSEL

SCOMM

#9:14

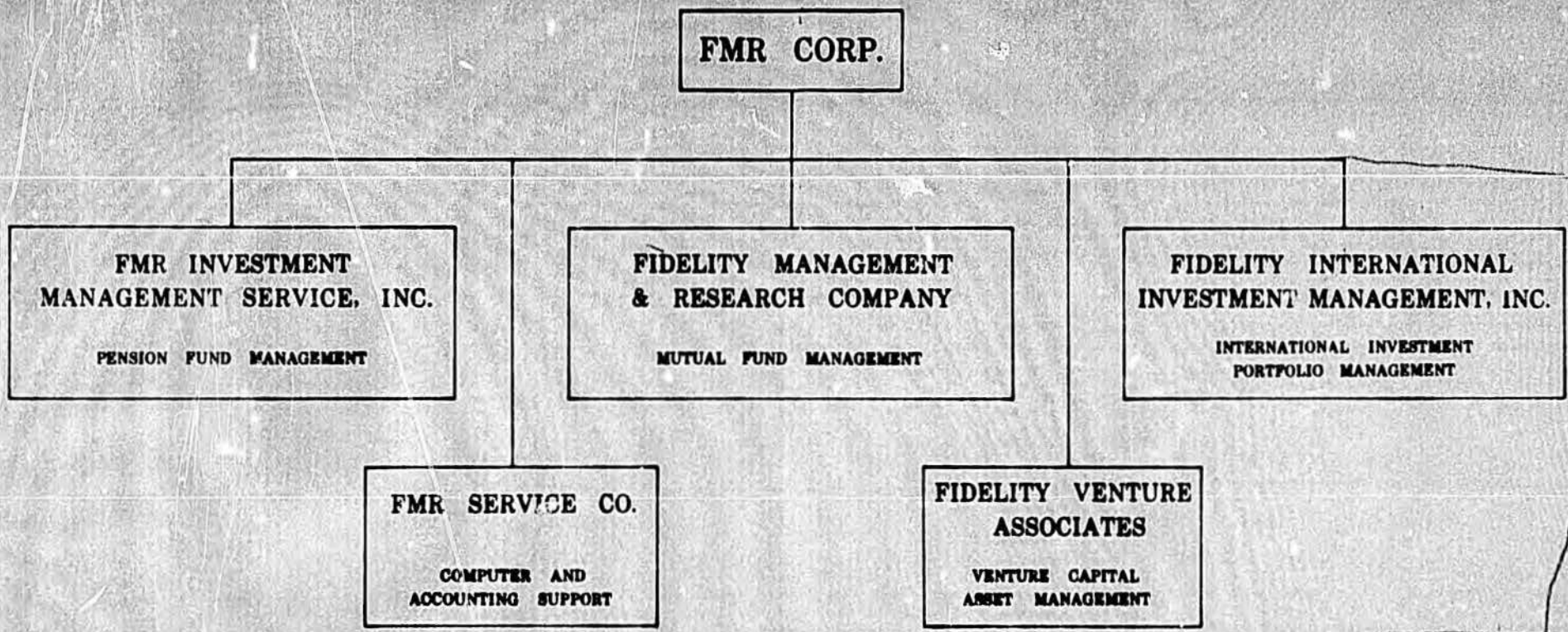
617/722-0555

ROGER L. CLIFTON
PRESIDENT

FMR INVESTMENT MANAGEMENT SERVICE, INC.
NUMBER ONE BOSTON PLACE • BOSTON

File

MAJOR OPERATING UNITS OF THE FIDELITY ORGANIZATION



Handwritten notes in a box, possibly including a date like 1/15.

1. Mr. Gary L. Bergstrom
Acadian Financial Research
303 Marsh Street
Belmont, Massachusetts 02178

\$ 2.5 billion

c/o Ford Foundation
(212) 573-5050

2. Professor James Lorie
University of Chicago
5836 Greenwood Avenue
Chicago, Illinois 60637
(312) 753-4261

Modern Portfolio Theory

3. Mr. Clay Myers
State Treasurer of Oregon
State Treasury Department
Room 158
State Capital Building
Salem, Oregon 97310
(503) 378-4329

4. Mr. James C. George
Investment Manager
State Treasury Department
Room 167
State Capital Building
Salem, Oregon 97310
(503) 378-4111

5. Mr. Roger Meier
Chairman, Oregon Investment Council
Suite 904
Oregon National Building
Portland, Oregon 97205

- Wednesday - Oct 19

276-3433

6- (503) 228-1333

617

726-0330

6. Mr. Jon L. Hagler
Vice President for Investments and Treasurer
Ford Foundation
320 East 43rd Street
New York, New York 10017
(212) 573-5050

7. Mr. George Russell
Frank Russell Company
One Washington Plaza
Tacoma, Washington 98402
(206) 572-9500

*consultant on selection of
money managers*

8. ^{*Pete*} Mr. Graham O. Harrison
President
U. S. Steel & Carnegie Pension Fund
767 5th Avenue
New York, New York 10022
(212) 826-8420

internal

October 7, 1977

STATE OF ALASKA

Mr. Clark Gruening
Mr. Belden Daniels - Harvard University

THE FIDELITY ORGANIZATION

Mr. Roger Clifton, President - FMR Investment Management Service, Inc.
Mr. Terrence B. Magrath, Vice President - Fidelity International Investment Management, Inc.

TOPIC OUTLINE

I. Evolution of Pension Fund Asset Management in the United States

- a. history
- b. current state of the art
- c. trends in force — *specialized managers*

II. Elements of Asset Management Function

- a. administration →
- b. planning *way of planning* — *Policy-flexibility*
- c. investment management

III. Perceived Nature of Alaska's Problem

- a. organizational issues
 - 1. control/responsibility
 - 2. establishment of policy
 - 3. interfacing with management unit
- b. investment policy issues
 - 1. inflows - expectations/deviations
 - 2. pattern after inflows
 - 3. risk tolerances
- c. operating issues
 - 1. selecting asset management structure
 - 2. special problems of running large pool of assets *\$ billions*

IV. Major Structure Options

vs eg US-Steel

a. multi-manager approach

Requirements

1. central administrative staff
2. purchased services
 - policy setting consultation *Hank Russell - Tacoma*
 - performance measurement service *Wash*
 - manager selection service
 - money management

Advantages

1. low overhead
2. flexibility to change structure
3. competition between managers

Disadvantages

1. very high service cost
2. complex administration
3. central staff critical

b. internal management

Requirements

1. total investment management company staff (sans marketing)

Advantages

1. relatively low cost (economies of scale)
2. under control of Alaska board
3. most responsive to State's needs

Disadvantages

1. little flexibility
2. difficult to match capability to asset base
3. remoteness from capital markets if based in Alaska

c. contract organization

Requirements

1. one time search
2. designation of liaison responsibilities in State

Advantages

1. responsive to Alaska - integrated
2. capability growth matched to needs
3. flexible to change structure
4. no committed overhead

Disadvantages

1. cost higher than internal option
2. no direct competition (competition through comparison with objective measures)

**Fidelity
International**
BOSTON LONDON TOKYO

December 1, 1977

Mr. Billy Berrier
Director of Division of Legal Services
Legislative Affairs Agency
Pouch Y - State Capital
Juneau, Alaska 99801

Dear Bill:

I telephoned my comments to Ken Vasser on the Powers and Duties section of the Work Draft Paper dated November 14, 1977 which you gave me at our meetings in Anchorage. This letter is to confirm these recommended changes to you. A marked-up copy is attached.

I believe that we had agreed in Alaska that the "prudent person" rule given in 37.13.130 (a) would be altered to assure that the standard of measurement would be the "prudent expert", i. e. how large pools of similarly oriented capital are managed, rather than how the individual investor manages his/her money. Given that change is made, I offer the following specific suggested changes to subsequent sections.

1. Page 8, Section (b), Line 14. Delete "type and maturity of investments in" and add to the end of the sentence the following: "by type of security, within type of security and with respect to geographic distribution. The board shall ~~from time to time~~ establish overall ^{and review regularly} ~~guidelines~~ ^{written} for the diversification of the assets of the Permanent Fund".

Comment: the way that line had been written could be construed to restricting you to just investing in debt securities, since equity securities do not have a maturity of investment. The change clarifies this and assures that diversification will be more complete. Furthermore, it explicitly requires the board to assume the very important "policy-making" function, i. e. setting the overall mix of assets. This, coupled with the total return objective set forth in 37.13.020 and coupled with the "prudent expert" constraint, should provide a mechanism to match the asset mix to the fund's needs as conditions evolve.

277-4581
333-1775 home

FSH Florida

Repon F. Committee

TERRANCE D. MACRATH
Vice President

5-7 Hancock

2. Page 8, Section (e), Line 21. Between the words "persons" and "to", insert "to recommend or".

Comment: there may be a time which the board would prefer to contract with a party to provide advice on the management of the funds rather than to assume full discretionary management. This wording allows them that flexibility and it also differentiates between the advisory and discretionary management functions, thereby assuring that the latter is permitted.

3. Page 8, Section (f), Line 27. Delete "listed on a recognized stock exchange".

Comment: leaving the requirement to restrict investments to those issues listed on exchanges could preclude the fund from investing in substantial organizations, such as banks, which do not list. Since the board is constrained under the prudent expert rule, there should be no further need to restrict them to listed securities.

4. Page 8, Section (f), Line 29. Delete "or in which default is imminent to principal or interest at the time of investment".

Comment: this is non-operational since the prudent expert would obviously try not to invest in securities about to go into default. The wording as it is could allow hindsight litigation in the event some holding does go into default.

5. Page 9, Section (b), Line 2. Change word "stocks" to "securities" if your intent is to preclude all participation in a particular industry or alternatively change word "stocks" to "stocks and convertible issues" if your intent is to preclude equity participation in a particular industry.

Comment: my understanding is that you wish to assure diversification of the investments of the fund from the revenue source of the fund. Choosing from the above alternatives will exclude either a whole industry or just the equity component, however you desire. Keep in mind, however, that debt issues respond to maturity, quality and other factors germane to the issue, rather than to the industry. My recommendation is to just exclude the equity participation.

6. Page 9, Section (f), Line 2. Change "mining company" to "company whose primary business is the exploration or development of oil or gas", or "company whose primary business is the extraction of gold", or whatever combination of industries you desire.

Comment: restricting investments from such a broad category as mining companies could preclude investments in many securities which may have small mining operations. For instance, virtually every steel company does some mining. While you may want to add or delete certain industries to the above recommendation, the general principle is to be as narrow and specific as possible in your exclusions.

7. Page 9, Section (f), Line 3. Delete the word "private".

Comment: the word "private" could be misleading in the sense that companies like the one I work for, for instance, is a privately held corporation, with no stock sold to the public. U.S. Steel, on the other hand, would be considered to be a publicly held corporation. Further, there may come a day in which the fund may want to buy stock in quasi-government corporations such as Comsat, which could not be considered private in any case. Deleting the word "private" takes away this ambiguity.

8. Page 9, Section (f), Line 3. Delete all after the word "which" through to the semicolon on line 7 and substitute "is not paying dividends on that stock in cash at the time of purchase".

Comment: my understanding is that the only real requirement you have is that each security must be income producing. The way the sentence now reads the corporation could be paying dividends on another security, but not on the one being purchased in the fund. Also, by deleting the time and yield requirement, you are providing the board the flexibility to structure the portfolio as they see fit to achieve the objectives, again within the prudent expert rule.

9. Page 9, Section (f), Line 7. Delete all after the semicolon through to line 11.

Comment: this provision could be considered ambiguous in the sense that an interest payment could have been defaulted, but then made up at a later date. It seems to me that the prudent expert rule should be sufficient for the board to act in deciding whether or not a particular bond is qualified for purchase.

10. Page 9, Section (f), Line 11. Delete the last sentence.

Comment: this constraint could be very restrictive as capital markets and/or fund requirements change. Substituting the policy function in section (b) should preclude the necessity of establishing specific constraints.

Bill, I think you have drafted a fine piece of legislation, and one which should serve the people of the State of Alaska well. You may recall in my testimony that I emphasized the following points:

1. Investment management is a profession. Whether you develop investment capability internally or hire outside firms to do your investing, it is important that the actual investment operations be carried out by investment professionals.
2. The investment professionals should be able to act as independently as possible from spurious political considerations, their only allegiance being to the effective management of the assets. They especially should not be subject to turnover with changing political administrations.
3. The board should be high level and should consider themselves liable, in every sense of the word, for the prudent management of the assets to achieve the stated objective. They should delegate the actual operations but retain the policy function. They should be able to hire or contract separate staff or services to independently evaluate the professionals' investment and operational performance.

Given the above, and the changes recommended for the Powers and Duties section, you should have an effective mechanism to invest the assets in an optimum way as the fund and capital markets evolve.

Fidelity
International

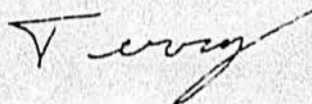
Mr. Billy Berrier

- 5 -

December 1, 1977

I hope this has been of help, and it certainly has been a pleasure to work with you and your colleagues in Alaska. Please let me know if there is anything else we can do for you.

Yours very truly,



TBM:del
Enclosure

cc: Mr. Clark Gruening
Special Committee on the Alaska
Permanent Fund
528 W. 5th, Suite 270
Anchorage, Alaska 99501

1 owned, controlled, or invested in by the permanent fund. If a member of
2 employee owns or controls an interest, he shall immediately disclose the
3 interest in writing to the board and refrain from participating in any
4 manner in any board activity relating to that interest.

5 Sec. 37.13.130. POWERS AND DUTIES. (a) The prudent-person rule
6 is applicable to the board in its management and investment of permanent
7 fund assets. In making investments, the board shall exercise the judgment
8 and care under the circumstances then prevailing which a person of
9 ordinary prudence, discretion, and intelligence exercises in the management
10 of his own affairs not in regard to speculation but in regard to
11 the permanent disposition of funds, considering the probable income from
12 them as well as probable safety of capital.

13 (b) The board shall seek to maintain a reasonable diversification
14 ~~of type and maturity of investments in its investments.~~
15 ~~BY TYPE OF SECURITY, WITHIN TYPE OF SECURITY AND WITH RESPECT TO GEOGRAPHIC~~
16 ~~DIVERSIFICATION. THE BOARD SHALL FROM TIME TO TIME ESTABLISH GENERAL GUIDELINES FOR~~
17 ~~THE DIVERSIFICATION OF THE ASSETS OF THE PERMANENT FUND.~~

18 (c) The board shall submit long-range and quarterly investment
19 reports to the State Investment Oversight Committee.

20 (d) The board may not borrow funds or guarantee loans made by any
21 other program or association.

22 (e) The permanent fund shall be used only for income-producing
23 investments. The board may contract with the Department of Revenue or
24 ~~other persons~~ ~~to select investments for the permanent fund.~~
25 ~~TO ASSISTANCE OR~~ Investments shall be selected in accordance with (f) of this section.

26 (f) Subject to (a) of this section the board may invest its assets
27 in obligations of the United States or obligations for which the faith
28 and credit of the United States are pledged for payment of principal and
29 interest; loans secured by first liens on unencumbered realty or lease-
30 hold; and corporate stock and corporate obligations ~~listed on a recog-~~
31 ~~nized stock exchange.~~ No investment may be made in a security which is
32 in default ~~or in which default is imminent to principal or interest at~~

* (COMPANYS WHOSE PRIMARY BUSINESS IS THE EXPLORATION OR DEVELOPMENT OF OIL OR GAS) OR (COMPANYS WHOSE PRIMARY BUSINESS IS THE EXTRACTION OF GOLD) OR AS DESIRED.

1 ~~the time of investment. No portion of the assets of the fund may be~~
 2 ~~used in the purchase of (SECURITIES) OR (STOCKS OR CERTAIN SECURITIES) ~~stocks of any mining company;~~ → * nor in the purcha
 3 of stock of any ~~private~~ corporation which ~~during the preceding five~~
 4 ~~is NOT PAYING DIVIDENDS ON THAT STOCK IN CASH AT THE TIME OF PURCHASE~~ ~~is not paying dividends in each of at least three and one-~~
 5 ~~fourth per cent per year upon the par or stated value of the class of~~
 6 ~~stock purchased or upon the par or stated value of a class of stock~~
 7 ~~junior to the stock purchased; nor in the purchase of bonds of any~~
 8 ~~private corporation, upon which any regular interest payment has been~~
 9 ~~defaulted at any time within five years before purchase, except bonds~~
 10 ~~never in default but which have been outstanding for less than five~~
 11 ~~years. No more than 15 per cent of the assets of the fund may be in-~~
 12 ~~vested in common stock.~~~~

13 Sec. 37.13.140. BOARD BUDGET. The board's budget is subject to
 14 the Executive Budget Act (AS 37.07).

15 Sec. 37.13.150. AUDITS. The Legislative Budget and Audit Commit-
 16 tee shall conduct annual operational and performance evaluations (post-
 17 audits) of the board's investments and investment programs and report
 18 the results to the State Investment Oversight Committee.

19 Sec. 37.13.160. REPORTS AND PUBLICATIONS. No later than the 20th
 0 day of the legislative session, the board shall publish a report to the
 1 governor, legislature, and the public in easily understandable language.
 2 Each report must include financial statements audited by the Legislative
 3 Budget and Audit Committee, a statement of the amount of money received
 4 by the permanent fund from each investment during the period covered, a
 5 statement of permanent fund investments, a description of permanent fund
 6 investment activity during the period covered by the report, and any
 7 other information the board believes would be of interest to the govern
 8 the legislature, and the public. The annual income statement and balance
 9 sheet of the permanent fund shall be published in at least one newspaper

October 7, 1977

STATE OF ALASKA

Mr. Clark Gruening
Mr. Belden Daniels - Harvard University

THE FIDELITY ORGANIZATION

Mr. Roger Clifton, President - FMR Investment Management Service, Inc.
Mr. Terrence B. Magrath, Vice President - Fidelity International Investment Management, Inc.

TOPIC OUTLINE

- I. Evolution of Pension Fund Asset Management in the United States
 - a. history
 - b. current state of the art
 - c. trends in force

- II. Elements of Asset Management Function
 - a. administration
 - b. planning
 - c. investment management

- III. Perceived Nature of Alaska's Problem
 - a. organizational issues
 1. control/responsibility
 2. establishment of policy
 3. interfacing with management unit

 - b. investment policy issues
 1. inflows - expectations/deviations
 2. pattern after inflows
 3. risk tolerances

 - c. operating issues
 1. selecting asset management structure
 2. special problems of running large pool of assets

IV. Major Structure Options

a. multi-manager approach

Requirements

1. central administrative staff
2. purchased services
 - policy setting consultation
 - performance measurement service
 - manager selection service
 - money management

Advantages

1. low overhead
2. flexibility to change structure
3. competition between managers

Disadvantages

1. very high service cost
2. complex administration
3. central staff critical

b. internal management

Requirements

1. total investment management company staff (sans marketing)

Advantages

1. relatively low cost (economies of scale)
2. under control of Alaska board
3. most responsive to State's needs

Disadvantages

1. little flexibility
2. difficult to match capability to asset base
3. remoteness from capital markets if based in Alaska

c. contract organization

Requirements

1. one time search
2. designation of liaison responsibilities in State

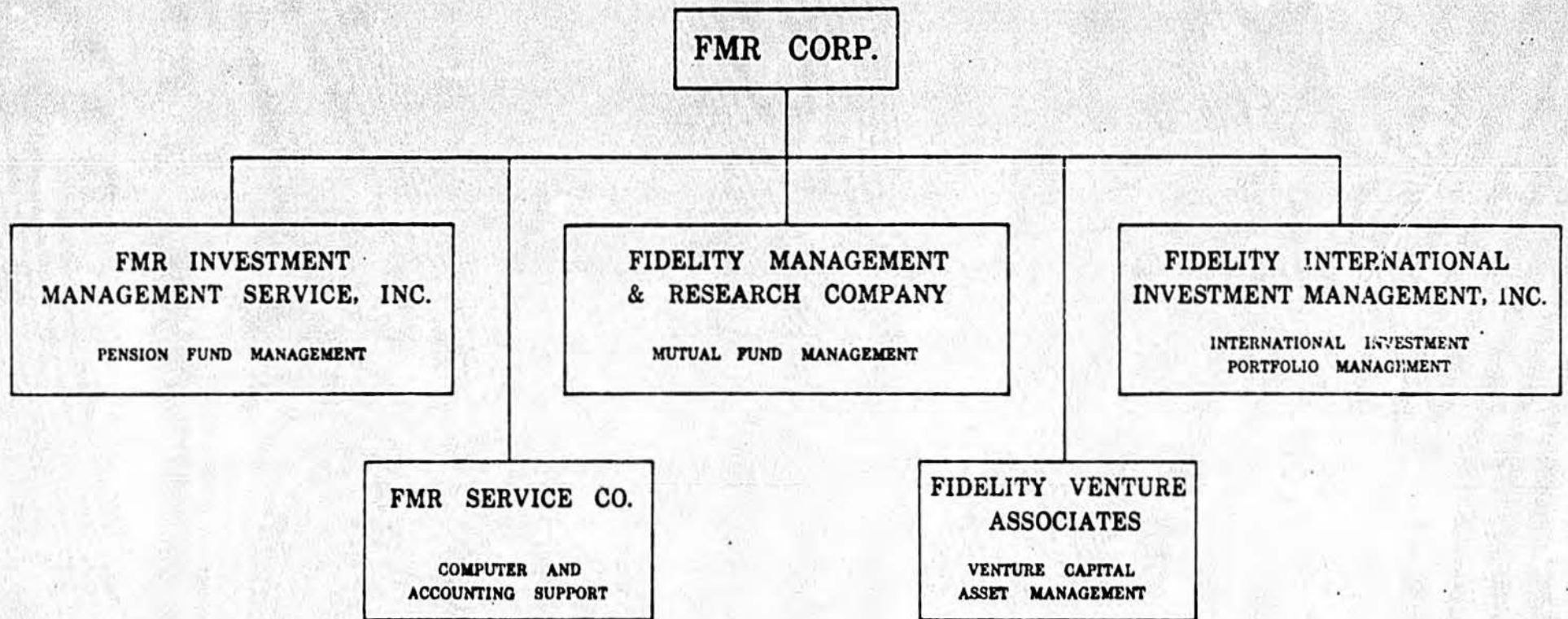
Advantages

1. responsive to Alaska - integrated
2. capability growth matched to needs
3. flexible to change structure
4. no committed overhead

Disadvantages

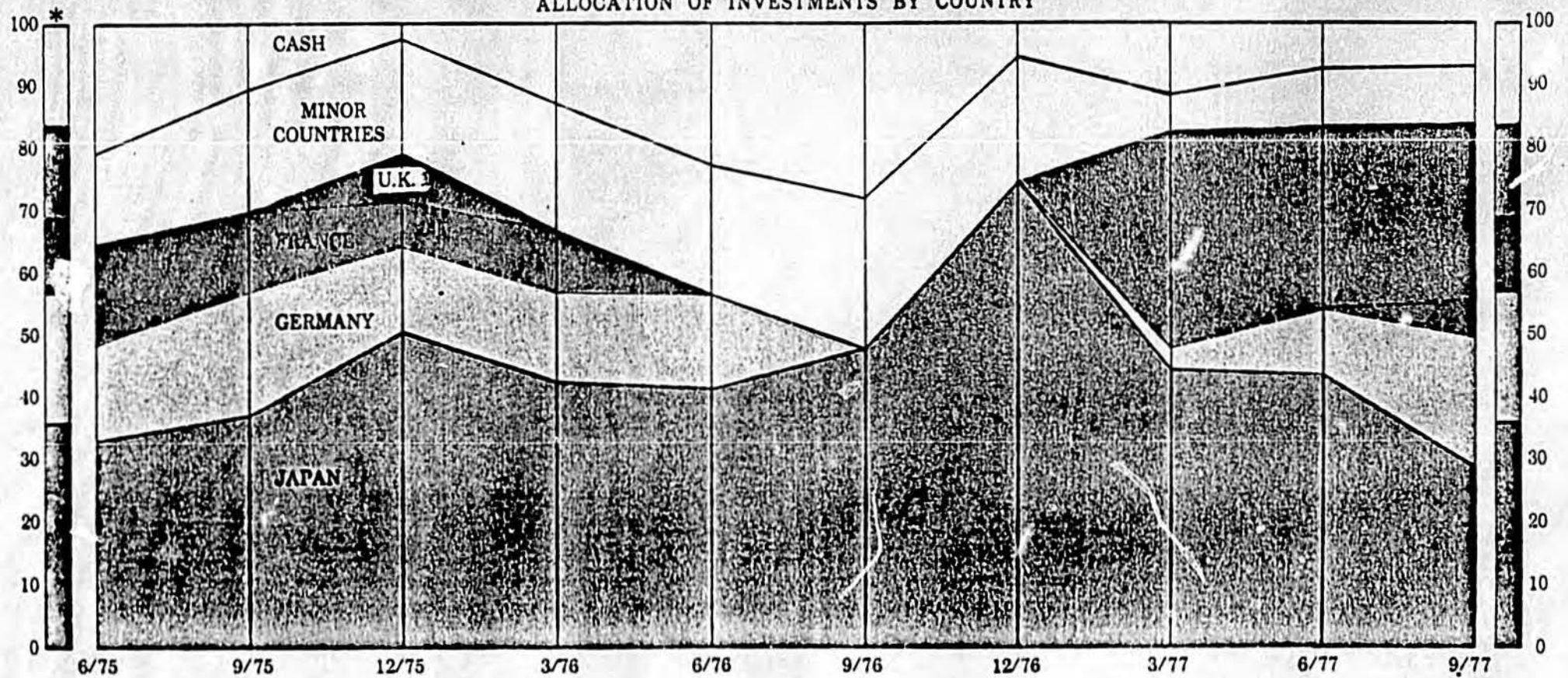
1. cost higher than internal option
2. no direct competition (competition through comparison with objective measures)

MAJOR OPERATING UNITS OF THE FIDELITY ORGANIZATION



FIDELITY WORLD PENSION TRUST

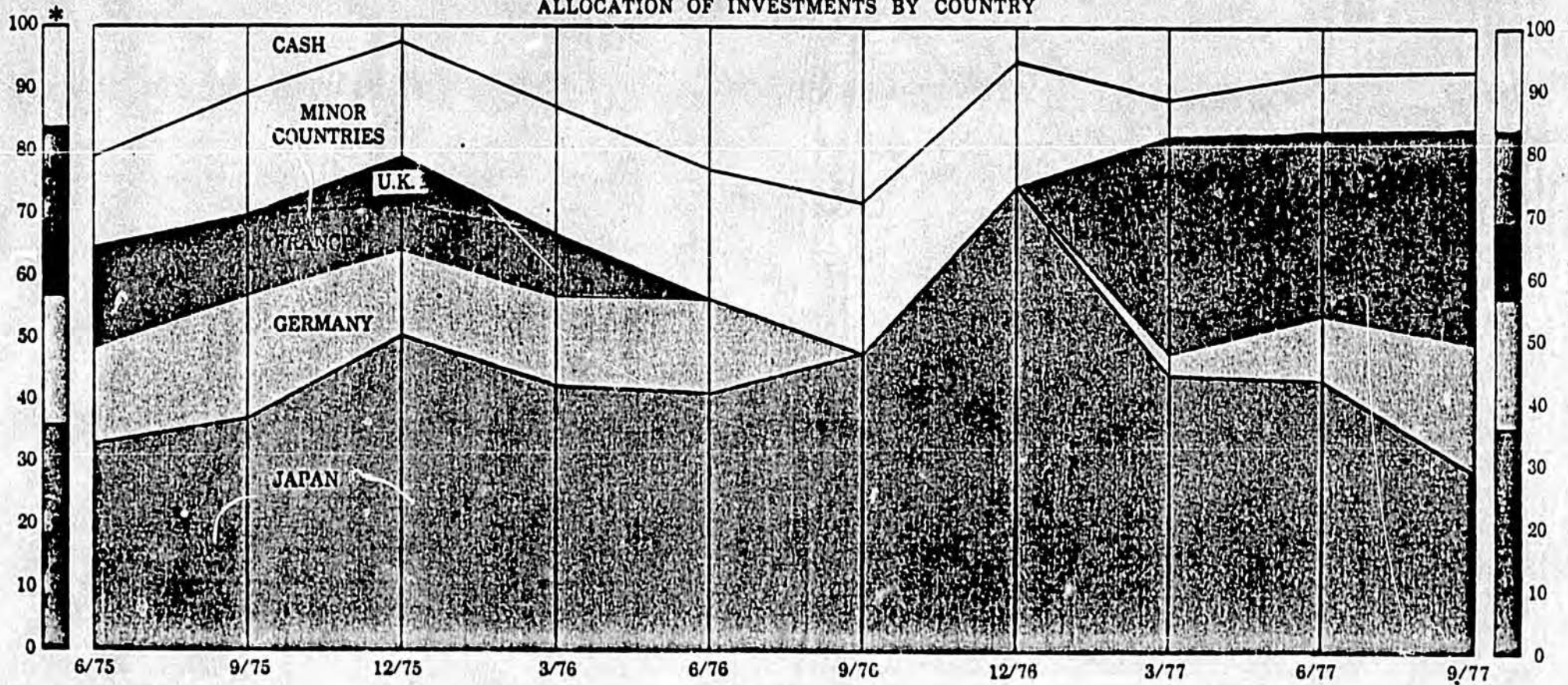
ALLOCATION OF INVESTMENTS BY COUNTRY



• NEUTRAL POSITION

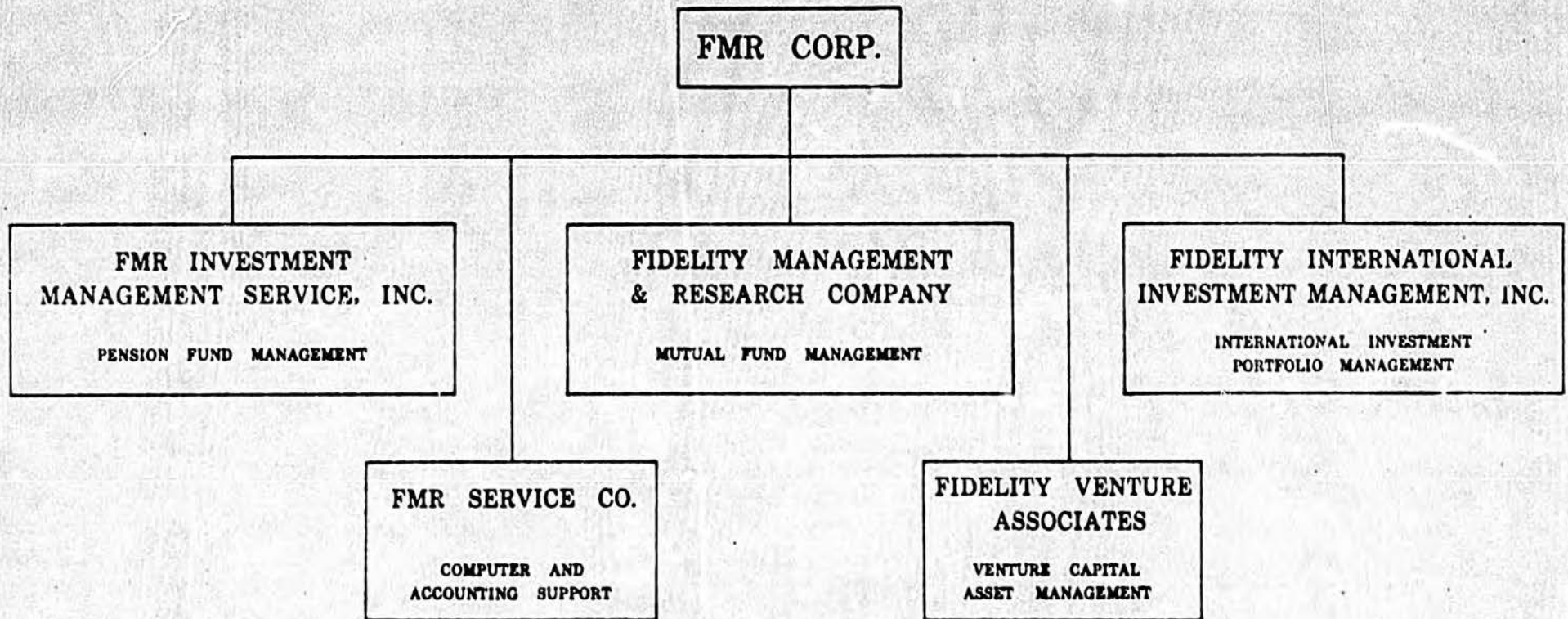
FIDELITY WORLD PENSION TRUST

ALLOCATION OF INVESTMENTS BY COUNTRY



• NEUTRAL POSITION

MAJOR OPERATING UNITS OF THE FIDELITY ORGANIZATION



SCOMM

#9:15

Israel's Other War



After my first visit to Israel fifteen years ago, I summarized my impressions by saying that two Jewish traditions were at war in Israel: a 100-year-old tradition of belief in paternalistic socialist government and of rejection of capitalism and free markets; and a 2,000-year-old tradition, developed out of the necessities of the Diaspora, of self-reliance and voluntary cooperation, of getting around government controls, of using every device of Jewish ingenuity to take advantage of such opportunities as escaped the clumsy grasp of government officials. I concluded that, fortunately for Israel, the older tradition was proving the stronger.

On a recent visit to Israel, shortly after the elections that, to everyone's astonishment, voted in the Likud bloc, I found that the war between these two traditions had moved into a new phase. Though the socialist doctrine had been winning the war in practice, it had been losing the war in public opinion.

SPREAD OF SOCIALIST PRACTICE

Government controls over the Israeli economy have mushroomed apace. Roughly one-third of the Israeli working force is employed by the government directly, and another third by the Histadrut—a quasi-governmental industrial-labor complex. Total government spending (adjusted for funds from abroad) amounts to some 60 to 70 per cent of national income. Subsidies are a way of life: to labor and industry; to farmers and consumers of food; to homeowners and renters. And so are taxes and inflation.

A large government sector is not a recent phenomenon. But it has changed its character, as the selfless idealists who were initially in control were replaced, or themselves turned into the very different types who were tempted by opportunities for privilege and profit to seek and gain positions of power. In addition, the mere passage of time produces increasingly rigid and harmful controls and regulations, an accumulation of costly and wasteful projects, a canceling of benefits by burdens, entrenched privilege, and corruption. It is easier to pass laws than to repeal them; to enact regulations than to correct them. Government bureaucrats may do as good a job as profit-seeking entrepreneurs in selecting projects to undertake. But while losses forcibly end strictly private failures, the tax collector is always there to provide artificial respiration to governmental failures.

Until the Yom Kippur war of 1973, Israel nonetheless was able to grow rapidly. The influx of people and capital from abroad, plus the strength of the earlier tradition, were, in Adam Smith's words from his 1776 masterpiece, "powerful enough to maintain the natural progress of things toward improvement, in spite both of the extravagance of government, and of the greatest errors of administration." But then growth came to a screeching halt. In the past three years, output has been roughly constant, while inflation has averaged nearly 40 per cent a year.

The Labor government naturally cited the needs of defense as an excuse for both economic difficulties and the mammoth government budget. True, the defense burden is heavy, particularly in ways that do not show up in the budget—such as the drain of manpower for reserve military duty. However, if military aid from abroad is subtracted from total military cost, the remainder which is financed from domestic sources amounts to only about one-quarter of total government spending (similarly adjusted for funds from abroad).

DECLINE OF SOCIALIST OPINION

The use of socialist rhetoric to justify and protect positions of privilege and power plus socialism's failure to deliver the goods have generated growing public cynicism. In addition, there has been a reaction in Israel, especially among the young, against widening government controls—matching the reaction in most of the Western world, including the U.S.

In Israel, these tendencies have been reinforced by the division between the Ashkenazim, the Jews of European extraction, and the Sephardim, the more recent flood of immigrants from the Arab and Islamic countries. The socialist doctrine was an Ashkenazic import and has been implemented primarily by Ashkenazim. The Sephardim had no similar tradition. As Bernard Avishai put it in a recent article in *The New York Review of Books* (June 23, 1977), "The citizens of the 'second Israel' are fiercely resentful of the Labor movement for having turned the whole country into what they perceive as a European closed shop. . . . Labor has been seen as the party of privilege and cultural snobbery, especially among residents of and escapees from the poorer Sephardic neighborhoods."

This change in public opinion, and the associated domestic economic difficulties, had far more to do with the defeat

of the Labor Party and the victory of the Likud alliance than the differences over foreign policy that have been so much discussed in the American press.

There is a wide consensus in Israel, that ranges over all parties except for fringe extremists, on the substance of foreign policy. The much-discussed differences are almost entirely about the rhetoric in which it is thought tactically expedient to clothe that policy.

The modern miracle of Israel was achieved by free men and women fighting against incredible odds. The true hope of Israel—and of freedom everywhere—is the enterprise, initiative, ingenuity, drive, and courage of the individual citizens, cooperating voluntarily with one another, producing the incredible progress in every sphere that comes only from the activities of the individual. The threat from its neighbors unfortunately mandates a large military effort on Israel. That effort must be coordinated and administered by government. Hence, Israel cannot escape having a sizable socialist sector. But that sector can remain as it has been, relatively efficient only so long as it is supported by a free people and a strong, productive, private economy.

PROSPECTS FOR CHANGE

Prime Minister Begin and his government have proclaimed their intention to cut government down to size and to give greater scope to the free market. Much as I approve of these objectives, their attainment will not be easy. Too many groups have a vested interest in government subsidies, including many of the strongest supporters of the Likud. In a discussion that I had in Israel with a group of private businessmen, private farmers and private bankers, the business leaders expressed support for eliminating government subsidies—provided the process started with agriculture. The leaders of agriculture expressed support for eliminating government subsidies—provided the process started with business. Ditto the bankers.

It will be a triumph of leadership and idealism if Prime Minister Begin and his government can untangle the snarl they inherited from the 29-year rule of their socialist opponents. Their success is vital both for Israel and for free men everywhere. I wish them well.

WHERE CARTER IS GOING WRONG

Interview With Nobel Prize Winner Milton Friedman

The President's plan to spur the economy with tax cuts and more federal spending will simply bring on more inflation, warns economist Friedman, who gives his prescription for lower unemployment with stable prices.

Q Professor Friedman, will President Carter's program of tax cuts and spending stimulate the economy?

A There is nothing in the package which will stimulate anything. How can the Government stimulate the economy by taking money out of one pocket of the public and putting it into another pocket? The rebate plan, for example, would distribute \$50 apiece to most consumers. As a result, those consumers will tend to spend more. But where will the Government get the money to send out the rebates?

Q But almost everyone looks on the rebate as a good way to stimulate the economy—

A It appears to be a stimulant because people are looking at the visible effects and paying no attention to the invisible effects. The \$50 rebate checks and the extra expenditures by consumers that will result are very visible. The people who will not have employment because the Government will borrow the money or cause more inflation are not very visible. Nobody notices them.

Q How about the proposals for increasing federal outlays on public works and public-service jobs, which are also part of the Carter program?

A The same thing applies. If the Government spends money on a public-works program or hires people, where does it get the money to spend?

Q So you believe the Carter program will do more harm than good—

A On the whole, I think that's the case. I'm in favor of tax reduction under any and all circumstances as the only effective way to put a lid on total Government spending. But the particular form of tax reduction that is proposed in this program is undesirable. It proposes to give rebates on a basis that has no relation to current activity.

If we're going to reduce taxes, we should at least reduce them in a way that will give people an incentive to save more or work harder, not simply drop checks out of airplanes. We ought to make it a permanent reduction in taxes.

Q There is some permanent reduction included in the Carter plan, apart from the rebates—

A Yes, but even that is somewhat misleading. President Carter really is not proposing to reduce taxes; he is proposing to increase them.

Q How so?

A The real tax burden on the American people is the amount the Government spends, not the amount that is labeled "taxes." If the Federal Government spends 460 billion dollars in fiscal year 1978, which is roughly what the President proposes, and takes in something like 400 billion in taxes, who do you suppose pays the other 60 billion? The tooth fairy? Or the Arab sheiks?

The American people pay it. It's paid in the form of the hidden tax of inflation or, if it's financed by borrowing from the



Professor Friedman, 64, profoundly influenced the thinking of world officials with his studies on the role of money, done largely at the University of Chicago. Now on leave, he is a visiting scholar at San Francisco's Federal Reserve Bank.

public, then in the form of higher taxes that will be needed in the future to pay the interest and the principal. That means that it lowers the value of all property today to the extent that property will be subject to higher future tax burdens.

Q How much inflation do you think the Carter economic package will cause?

A That depends on how the Federal Reserve behaves. It has been expanding the money supply too rapidly, and that implies that inflation was going to speed up anyhow, regardless of this program.

I should also point out that Carter's program is very small in magnitude. It is obviously an attempt to offer the smallest program possible while throwing bones to as many groups of supporters as possible. From that point of view, it makes a lot of sense. The economy is growing at a healthy pace, and it would be unwise politically for the President to speed things up even if he could.

Q In the final analysis, will the Federal Reserve simply create the money to pay for the Carter tax cuts and spending increases and lend it to the U.S. Treasury?

A If the funds are supplied by the Federal Reserve, that will produce more inflation and thus destroy private jobs to the same extent that it creates Government-financed jobs.

Q But isn't it true that the additional borrowing and spending will add to inflation only if the Federal Reserve increases the supply of money faster than the supply of goods and services increases? Federal Reserve Chairman Arthur Burns has indicated he thinks he can avoid doing that—

A The plain fact is that the quantity of money has already been increasing faster than output. Chairman Burns indicated in his recent testimony that the narrow money supply— M_1 —would have to increase at only about zero to 2 per cent per year to avoid inflation, and the broad money supply— M_2 —at about 3 to 5 per cent. Yet his announced targets are far higher than that— $4\frac{1}{2}$ to $6\frac{1}{2}$ per cent for M_1 , 7 to 10 per cent for M_2 —and actual monetary growth has recently been even faster.

Q What if the Treasury sells bonds to the public to cover the Carter deficit?

A If the Treasury borrows from the public, there will be less money left in the hands of private investors to be loaned out and spent for building houses and creating new factories and machines. The result is to reduce private employment and increase publicly financed employment.

Q What would you do about high unemployment?

A The long-range solution is to increase the incentive for ordinary people to save, invest, work and employ others. We make it costly for employers to employ people, and we subsidize people not to go to work. We have a system that increasingly taxes work and subsidizes nonwork.

Q How could that be changed?

A First, I propose that the Federal Reserve reduce the rate of monetary growth gradually over the next three years by about 2 percentage points a year until they get to a rate that is in keeping with the long-run increase in economic output. That would eliminate the inflationary bias in the economy.

I would simultaneously index personal and corporate income taxes—that is, automatically adjust personal exemptions, tax brackets and so on for inflation. That would keep inflation from automatically driving taxes up and be far more effective than the measures Mr. Carter and others have proposed. Congress has been very prompt in protecting its own salaries against inflation. It has done nothing to protect the public.

Finally, I would cut the real taxes borne by the American people by cutting all Government spending 10 per cent across the board.

Q Do you also favor increasing the tax credit for investments in new plant and equipment?

A No. Those credits do not stimulate capital investment; it only looks as if they do.

Suppose a company invests more money to take advantage of the credit. Where does it get the money? From profits or from loans. So the real question is whether the credit increases the total pool of funds available for investment.

If it reduces taxes, it may seem to increase the pool, but then we have to ask: Who pays the taxes instead of the companies that take the credit? All it does is to divert investment into directions which qualify for the credit and away from investments that don't. It has a negligible effect on increasing the total pool.

The most effective way to stimulate capital is to put investment on equal terms with everything else, and that means moving toward a tax that you pay on what you spend instead of on your income. But if we are going to retain the income tax, then we ought to abolish the tax on corporate profits and require the companies to attribute their income to their stockholders, whether they pay it out in dividends or not. The stockholders would bear the tax burden directly and openly instead of, as now, indirectly.

Q Are there steps that could be taken to reform the tax system short of switching over entirely to a tax on spending?

A If we simply replaced all tax rates above 25 per cent with a flat 25 per cent rate, taxpayers would lose interest in tax shelters, and the amount of revenue the Government takes in would almost surely increase at the same time as the taxpayers benefited. But there is not one chance in a million of Congress enacting such a simple measure.

Q What would your plan for tax-and-spending cuts do for employment?

A It would mean a healthy increase. It would reduce Government jobs and increase private jobs. People would have more incentive to work.

You see, the problem today isn't lack of purchasing power, which the rebates are supposed to remedy. We've had too much purchasing power. That's why we've had so much inflation. How can the problem be purchasing power when prices are rising 5 per cent a year now and, in my opinion, will be going up at a rate of 7 to 9 per cent over the next two years?

Q Can that inflation be reduced through Government guidelines—or jawboning, as it's called?

A Such measures have temporary effect, but over any long period they are harmful.

There's only one place where inflation is made: That's in Washington. I don't mean that people in Washington impose inflation on the rest of the community for no good reason. Inflation is made in Washington in response to pressures from the people at large.

The people who are really making inflation are the voting public—because they ask their Congressmen to enact goodies in the form of spending, but they are unhappy about having taxes raised to pay for those goodies. The only way Congress can spend more without appearing to raise taxes is through inflation.

Q The President's economic advisers say that a great deal of our inflation has been caused by special circumstances that raised the cost of oil, other fuels, foods and so on—

A That's wrong, and the proof of it is very simple:

Those special circumstances affected all countries. So why is it that they were followed by inflation at a rate of 2 per cent in Switzerland, 6 per cent in Germany, 12 per cent in the United States, 25 per cent in Britain and 30 per cent in Japan?

It cannot be that the same factors had such widely different results. This is simply a case of trying to find excuses.

Q Some economists say the U.S. is in for a period of relatively slow economic growth. Do you agree?

A We're not doomed to any such period, but we may have one if the heavy hand of Government regulation continues to interfere with the effective use of our resources.

There is nothing of a technical or necessary character that will slow economic growth. On the contrary, if we could cut the Government back to size, reduce some of its regulatory activity—for example, eliminate the price controls on oil and natural gas—we could have a period of very rapid economic growth.

Q Wouldn't we still face shortages of oil and gas?

A There is no physical shortage of fuel and energy—only an artificial shortage created by bad Government policies.

The Organization of Petroleum Exporting Countries has produced a serious artificial shortage of oil, and the United States has greatly exacerbated the economic effects of the OPEC strategy by its own policy. Our Government is providing a subsidy of roughly \$3 a barrel on oil imported from the OPEC countries through its scheme to equalize the cost of refining imported oil and artificially cheaper domestic oil.

Q Isn't it true that the United States



King Carl XVI Gustaf awarding Nobel Prize in economics to Friedman in Stockholm last year.



Jobless-pay lines: Toll is highest among young blacks. "We have a system that increasingly taxes work and subsidizes nonwork."

INTERVIEW WITH MILTON FRIEDMAN

[continued from preceding page]

is running out of large deposits of oil and gas that can be exploited at relatively low cost?

A There is a physical limit to our reserves.

But remember that there was also a big scare in the 1920s, when it was said that reserves of oil would only last 20 years. Since that time, consumption has increased dramatically, and so have reserves.

If we allowed the price system to operate, we would reverse the trend toward reduced domestic production of oil and gas for the immediate future and enable the adjustment to dwindling reserves to be met over a considerable period of time.

Q Turning back to the problem of creating more jobs, what do you think of proposals to give employers tax credits or bonuses if they hire the unemployed?

A The Carter plan for giving a credit equal to 4 per cent of the employer's Social Security payroll tax is ludicrous. It is simply a proposal to reduce the payroll tax from 11.7 per cent of wages to 11.66 per cent.

That's all it is when you take away the Madison Avenue packaging. Who would give it a second thought if it were explained in that straightforward manner?

Q But there are proposals in Congress for more-generous bonuses for hiring, aren't there?

A The bonus schemes will encourage employers to fire some people in order to employ others who will qualify for the subsidy. The Government will then try to close that loophole, and the complexity of the program will grow and grow. It will create employment all right—for more federal bureaucrats to administer the program.

Q Should government do anything to help black teenagers, who have the highest rate of unemployment?

A These young people are disadvantaged in part because of government policies—for example, the kind of schooling they get, which is provided by government.

The effective way to reduce black teen-age unemployment over the long run would be to introduce a voucher system for education. That would introduce competition into the schools, particularly in the slum areas of our big cities, and that would tend to upgrade the kind of schooling the young blacks can get.

As it is, the government first provides very poor schooling, and then the harm is multiplied by the minimum-wage law, which makes it difficult for them to get on-the-job training. Without the minimum-wage law, the least skilled could offer to work for low wages, which would provide an incentive for employers to hire and train them. It has always been a mystery to me why a teen-ager is better off unemployed at \$2.30 an hour rather than employed at, say, \$2.

Q Should the United States do more to help the underdeveloped countries?

A Who says we've been helping them? We have been granting subsidies to underdeveloped countries, and the evidence is overwhelming that this has been hurting them, not helping them. What we have done is to strengthen the small clique which is in charge of the governments in these countries at the expense of the populace at large.

Q What should be done?

A The most effective thing we could do to help would be to drop our tariffs and thus encourage the underdeveloped countries to compete on fair and open terms and sell us whatever they can. That would do far more good than shoveling out bushels of money to maintain governments that do not effectively represent the public at large.

Q Should the U.S. cut tariffs unilaterally?

A We have little control over what Britain or Germany or Japan does. I would like to see the United States act like the great nation it is and unilaterally reduce trade barriers across the board.

Q What if other countries dump goods into our market at less than cost and ruin industries employing our workers?

A People who say free trade does that are not looking at what happens to exchange rates.

Suppose Japan is so foolish as to subsidize every export to the United States, so that there is nothing we can sell them and everything they have to sell is cheaper than what we produce here. How would we pay for their exports? We would send them dollars. What would they do with the dollars? The Japanese who told them would say: "There's nothing we can buy with these dollars. Everything in the U.S. is too expensive at the present exchange rate."

So instead of valuing a dollar at 300 yen, the Japanese would say: "The dollar isn't worth anything to me. I'll give it to you for 200 yen." If that doesn't work, the rate will go to 100. And the result will be that the price of Japanese goods will go up in terms of dollars while U.S. goods will become cheaper in Japan.

That swing will continue until the amount the U.S. is selling to Japan is roughly equal to what Japan is selling to the United States. In the process, we will have less employment in those industries in which we are inefficient compared with the Japanese, and more employment in those in which we are most efficient.

This is difficult for most people to see because we overemphasize the visible effects and neglect the invisible. If Japan exports more steel to us, the people in the steel industry who lose their jobs are very visible. The fact that Japan earns more dollars and buys many other goods, so that we have more people employed in export industries, is not nearly as visible.

Q Do you suggest that tariffs be wiped out overnight?

A I would favor doing it over a five-year period in order to make the adjustment easier.

Q Looking ahead, what do you see as the greatest economic problem facing this country?

A The growth of government. We are going down the same road as Great Britain. We are 10 or 20 years behind Great Britain, but if we keep on the way we are going, we will be in the same state that Britain is in now.

Forty per cent of our national income is being spent by the federal, State and local governments. Fifty years ago the proportion was 10 per cent. Are we getting our money's worth?

I would like to see a constitutional amendment that would say that spending for all purposes by the Federal Government could not exceed 25 per cent of the income of the people. That is roughly what it is now. So the amendment would not reverse the trend, but at least it would stop it and give time for a change in attitudes and a growth in understanding to develop that would make a reversal politically feasible.

U.S. News & WORLD REPORT

**The Only News Magazine
Devoted Entirely to National
and International Affairs**

Copyright © 1977, by U.S. News & World Report, Inc., 2300 N Street, N.W., Washington, D.C. 20037, for entire contents of this publication. All rights reserved.

VOL. LXXXII NO. 9 MARCH 7, 1977



The Associated Press is exclusively entitled to the use for publication of the local, telegraphic and cable news published herein, originated by U.S. News & World Report or obtained from the Associated Press.

U.S. NEWS & WORLD REPORT is published weekly, except two issues combined in one at year-end, at \$18 per year, by U.S. News & World Report, Inc., at 2300 N Street, N.W., Washington, D.C. 20037. Second Class postage paid at Washington, D.C., and at additional mailing offices.

POSTMASTERS: Send Form 3579 to U.S. News & World Report, P.O. Box 2860, Greenwich, Conn. 06830.

CONTENTS OF THIS ISSUE

Memo to Readers	4	The Spreading Impact of Worst Drought in Decades	55
Letters to Editor	6	Burger vs. Warren— Whose Court Is Better?	58
Washington Whispers	8	A Report Card on Supreme Court	60
Tomorrow	11	Trend of American Business	69
Carter Sets New Priorities	15	Why It Won't Be Easy to Strike a U.S.-Cuba Deal	71
Ask Americans About Their President: "So Far, So Good"	18	Should U.S. Do Business With Cuba?— <i>Opposing Views</i> ..	73
Where Carter Is Going Wrong— <i>Size-Up by Milton Friedman</i>	20	Citizen's-Band Radio: Danger of Air Pollution?	76
Discontent With First "Billion-Dollar Congress"	23	How to Avoid the Pitfalls in This Year's Tax Return	80
Cabinet Members Tell What They Own, What They Owe	28	Banking by Computer	81
Tough Talk on Human Rights— Will It Scuttle Détente?	30	Tax Rulings	83
Uganda: A Helpless World Wrings Its Hands	36	News You Can Use	85
Worldgram	37	Storm Brews Over Union Demands on Congress	88
Slowdown for "Strip Cities"	39	News-Lines	90
Arthur Fiedler Discusses the Future of American Music	44	Editorial	92
Business Around the World	49		
"My Son, the President"— <i>Interview With Lillian Carter</i> ...	52		

Cover: Official White House Photo



U.S. NEWS & WORLD REPORT

2300 N Street, N.W., Washington, D. C. 20037

By Milton Friedman

Fair Versus Free

In presenting his energy program, President Carter stressed "fairness" as an essential ingredient of an acceptable program. The Federal Communications Commission seeks to enforce a "fairness doctrine" on radio and TV stations. We suffered numerous "fair trade" laws, until they were declared unenforceable. One businessman vies with another in proclaiming his faith in competition—provided that it is "fair."

Yet, scrutinize word for word the Declaration of Independence, the Constitution and the Bill of Rights, and you will not find the word "fair." The First Amendment does not protect the "fair" exercise of religion, but the "free" exercise thereof; it does not restrain Congress from abridging the "fairness" of speech or of the press, but the "freedom" of speech, or of the press.

FROM UMPIRE TO BIG BROTHER

The modern tendency to substitute "fair" for "free" reveals how far we have moved from the initial conception of the Founding Fathers. They viewed government as policeman and umpire. They sought to establish a framework within which individuals could pursue their own objectives in their own way, separately or through voluntary cooperation, provided only that they did not interfere with the freedom of others to do likewise.

The modern conception is very different. Government has become Big Brother. Its function has become to protect the citizen, not merely from his fellows, but from himself, whether he wants to be protected or not. Government is not simply an umpire but an active participant, entering into every nook and cranny of social and economic activity. All this, in order to promote the high-minded goals of "fairness," "justice," "equality."

Does this not constitute progress? A move toward a more humane society? Quite the contrary. When "fairness" replaces "freedom," all our liberties are in danger. In "Walden," Thoreau says: "If I knew for a certainty that a man was coming to my house with the conscious design of doing me good, I should run for my life." That is the way I feel when I hear my "servants" in Washington assuring me of the "fairness" of their edicts.

There is no objective standard of "fairness." "Fairness" is strictly in

the eye of the beholder. If speech must be fair, then it cannot also be free; someone must decide what is fair. A radio station is not free to transmit unfair speech—as judged by the bureaucrats at the Federal Communications Commission. If the printed press were subject to a comparable "fairness doctrine," it too would have to be controlled by a government bureau and our vaunted free press would soon become a historical curiosity.

What is true for speech—where the conflict is perhaps clearest—is equally true for every other area. To a producer or seller, a "fair" price is a high price. To the buyer or consumer, a "fair" price is a low price. How is the conflict to be adjudicated? By competition in a free market? Or by government bureaucrats in a "fair" market?

Businessmen who sing the glories of free enterprise and then demand "fair" competition are enemies, not friends, of free markets. To them, "fair" competition is a euphemism for a price-fixing agreement. They are exemplifying Adam Smith's remark that "People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices." For consumers, the more "unfair" the competition the better. That assures lowest prices and highest quality.

RULES OR ACTIONS

Is then the search for "fairness" all a mistake? Not at all. There is a real role for fairness, but that role is in constructing general rules and adjudicating disputes about the rules, not in determining the outcome of our separate activities. That is the sense in which we speak of a "fair" game and a "fair" umpire. If we applied the present doctrine of "fairness" to a football game, the referee would be required after each play to move the ball backward or forward enough to make sure that the game ended in a draw!

Our Founding Fathers designed a fair Constitution to protect human freedom. In Thomas Jefferson's ringing phrases from the Declaration of Independence, "Governments are instituted among Men" "to secure" "certain unalienable Rights, that among these are Life, Liberty, and the Pursuit of Happiness."



administration energy official. His prognosis: the companies will get their guarantees, the coal-gasification plants will be built—and the U.S. will have a new source of energy.

—ALLAN J. MAYER with WILLIAM J. COOK in Washington and bureau reports

Secrets of the Nazis

One of the first spoils of the Nazi defeat in World War II was a treasure trove of documents: more than a million pages detailing the industrial miracle by which Hitler's scientists kept his war machine rolling on synthetic fuels. But to the Allied victors, who had all the cheap petroleum they could use, the secrets were of only academic interest; the documents were shipped off to storage in such places as Washington's National Archives, the British Imperial War Museum and even the dusty garages of a few European scientists.

A generation later, the world energy crunch has provided a new perspective—and the German papers have taken on a sudden new urgency. It's widely known, for instance, that the Nazi scientists worked out much of the technology behind today's most sophisticated coal-gasification projects, but there was clearly much more to their work. To find it, three big U.S. energy-using companies are helping to fund a research project at Texas A&M University, where Dr. Richard Wainerdi, a chemical engineer, and a ten-man team are gathering documents from stashes around the world—many of them still in the cartons and leather straps of 1945.

High Hopes: "It's just a matter of time until the price of synthetics will be competitive with products coming out of the ground," says one of Wainerdi's team, Dr. Kurt J. Irgolic. Officials of Union Carbide, Dow Chemical and Diamond Shamrock Corp. are betting he's right; they have agreed to pick up most of the project's \$150,000 cost so far.

To date, Wainerdi's team has uncovered a 6,000-page energy plan far more elaborate than the one that President Carter put together this year. It has found detailed analyses of production costs and descriptions of at least twenty processes for converting German coal to oil, gas and feedstocks to make petrochemicals. One technique turns high-sulfur coal into low-sulfur oil, an obvious environmental advantage. "The Germans were superb," Irgolic said. "In the '30s, any American who was ambitious in organic chemistry was finding some way to spend at least a year studying in Germany."

Industry's final evaluation of Wainerdi's efforts will have to wait several years, but patience could pay. Among those Nazi papers could lurk ideas leading to major new processes and sources of energy. What intrigues the researchers is that there might be some leads that the Germans, for lack of technology or resources, couldn't pursue—but that might be fully practical today.

PF: Friedman

MEETING WITH MILTON FRIEDMAN

6/9/77

Attendees:

- Hugh Malone
- Clark Gruening
- Pat Rhodey
- Brian Rogers
- Jim Rhode
- Judy Brogan
- Jim Edenso
- Norman Bailey
- Joan Bailey

Malone: Constitutional amendment to set up alternate way for State to use oil money. Better ways for State to use money than expanding government.

- 1) Alaska Inc.
- 2) Diversify state economy
- 3) Opportunities for private enterprise
- 4) Long-run generation of earnings on fund itself to lower taxes

Friedman: Distribute rights to capital sums. Let individuals decide how to spend. Second-best approach, don't allow money to go for current government spending. Limit total state spending as a fraction of income. Legislators would be under less pressure from individual lobbies. This would give an excuse for them to turn down those who want money for their pet project.

Gruening: How do you set the percentage?

Friedman: No natural percentage. Set something going and stick to it. Expending during fiscal year, state spending percentage of personal income of citizens in three prior calendar years equals 20 percent. That would be the ceiling for the next year. Creates a ceiling automatically adjusted for inflation. If public wants to, they can raise it. Let people vote on the budget as a whole in this way.

Rogers: The three-year boom would affect spending.

Friedman: Personal income would adjust this. Don't use state gross product. Other device: Limit equals per capita spending for prior year adjusted for inflation. It is more stringent than the 20 percent. Most government spending doesn't get you what you spend. Percentage limit easier to sell. Using the permanent fund to diversify the economy will dissipate the fund. World Bank approach hasn't helped participating countries.

Malone: What is the approach and structure that would allow the greatest benefits to the people?

Friedman: Write individual checks to the people. You may borrow from the fund; percentage of your original entitlement. Each individual (co-owner of the fund) to invest as he wants. Interest rate would have to correspond to the interest rate of the rest of the fund. Need collateral. In outlying areas, there may be no investment opportunities. Find one or move out. For example, the amount of money spent to put TV into bush communities, if the people had had the money to spend in any way they wanted, they probably wouldn't use it for TV. There may be someone who does have an idea. Collateralize with the physical facility to be built. The only criteria should be that the applicant has to indicate what the physical facility would be and that would be the collateral, that is, beyond his eligibility. The project would have to provide some kind of collateral. Practical difficulty is with people leaving the state. Dividends, absentee owners could withdraw with collateral itself. Pay back or lose dividend. Investing in income-producing entity. If these monies flow into the general fund, they are absorbed into general expenditures. If you said this money had to be returned to the people, it should be.

Gruening: Should Alaska Inc. be tied to the permanent fund?

Friedman: Segregate temporary source so it will provide permanent income. Create permanent income stream.

Gruening: State owns mineral wealth, so money flows into the State. State has a problem diverting this back into state economy.

Friedman: Pro rata shares to citizens. Stay away from ethical question. Search for justice is going to destroy the world. How to handle this for greatest development of resources of the people of Alaska?

Rhodey: Insure private enterprise in the future. Sock the money away.

Friedman: How does that assure private enterprise in the future? Base entitlement in residency length in the state. Anything but giving it to current residents is going to subsidize growth. The ownership of resources is a form of socialism. Oil and mineral resources probably not finite. Real issue is drastic decline in the price of oil. If an individual would rather work here than somewhere else, businesses will be attracted here. If not, why should some be taxed and some subsidized? Value judgments not the issue--it is not wanting to face result of policies. Value judgments will dissipate the fund. Pressure to invest in Alaska is enormous. Meet the political pressure by allowing the people to have their amount of money. Who would choose which businesses to subsidize? Element of loss distinguishes private from public. How cheap to produce at the margin? How expensive not to sell it now? Arabs justify high prices by saying that

oil is finite. Not so, it is because they cannot hold the price of oil up indefinitely. Require the state university to charge full tuition, exactly what it costs the State to educate each student. Subsidy should be through voucher system. Higher income group is being subsidized to the tune of \$100,000,000. Analogous to underdeveloped countries spending for foreign aid. Meet political pressure with alternative scheme to preserve value of the fund. Fund could be used as leverage. Can't guarantee stability during change. Minimize by making it easy to establish other enterprises, money to get through the transition. The most wasteful expenditure is to guarantee jobs in the failing industry. Self-interest is first, but people try to be rational. Closer self-interest is to them directly--the better they do.

SCOMM

#9:16

August 12, 1977

John K. Galbraith
Professor
Harvard University
207 Littauer
Cambridge, MA 02138

Dear Professor Galbraith:

The House Special Committee on the Permanent Fund is in the process of drafting enabling legislation for the Alaska's Permanent Fund, approved through a constitutional amendment in November, 1976. I am enclosing material on the Permanent Fund, that, I hope, will give you an idea of what sort of creation we're talking about.

As part of our work, we are attempting to stimulate public debate on the goals of the Fund. In addition to public hearings and other methods of soliciting what has unfortunately come to be known as public input, we are planning to stage a symposium on goals in Anchorage in September, our target date being September 10.

It is fair to say that the economic terms of the debate over the Fund have heretofore been set by institutional, not to say conservative, economists, most notably Milton Friedman, who was brought to the state by the banking community in June.

Without in any way attempting to question the quality of Mr. Friedman's ideas, we are speaking of a fund which has the potential of being the largest dedicated revenue fund in the English-speaking world, so we would be remiss in our duties if we did not attempt to expose the public to a broad spectrum of economic thought.

In short, we are asking for your assistance.

If you have any interest in appearing here, please send us the dates on which you might be available and your fee schedule for such appearances. Or call us at the number shown above.

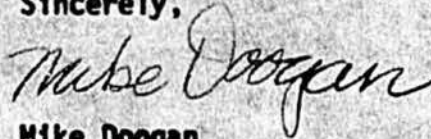
Professor Galbraith

-2-

August 12, 1977

If you wish a more independent opinion of the Committee and the Permanent Fund issue, you might get in touch with Belden Daniels of Harvard's Department of City and Regional Planning, who is under contract to the Committee as a consultant.

Sincerely,



Mike Doogan
Administrative Assistant

Enclosure

SCOMM

9:17



707 A Street, Suite 206
Anchorage, AK 99501

UNIVERSITY OF ALASKA

FAIRBANKS, ALASKA 99701

INSTITUTE OF SOCIAL AND ECONOMIC RESEARCH

Representative Clark Gruening, Chairman
Subcommittee on the Alaska Permanent Fund
Alaska House of Representatives
528 West 5th Avenue, Suite 270
Anchorage, Alaska 99501

Mr. James Edenso, Deputy Commissioner
Alaska Department of Revenue
Pouch SB
Juneau, AK 99811

December 15, 1977

Dear Sirs:

The Institute of Social and Economic Research hereby submits the enclosed report entitled The Permanent Fund and the Growth of the Alaskan Economy: Selected Studies. The report, prepared under contract to the State Department of Commerce on behalf of the House Subcommittee on the Alaska Permanent Fund, analyzes the economic and fiscal effects of a) alternative contribution levels to the Fund; b) alternative uses of the Fund's earnings; c) selected in-state investments of the Fund; and, d) in-state placement of the 1969 Prudhoe Bay bonus money.

The compressed contract period for performing the work precluded the preparation of a preliminary draft and the solicitation of comments. ISER could compensate for this shortcoming by preparing a condensed supplemental report designed to reach a broad audience. This supplemental report would benefit from any legislative or departmental comments the final report elicited.

Because the basic analytic tool designed and used in the conduct of the study is a computer program, additional analytical work can be performed efficiently and at low cost. For example, both the timing and the level of revenues, expenditures and/or contributions to the fund could be easily modified within the structure of the existing program and the corresponding outputs re-analyzed.

page 2

ISER would be pleased to have the opportunity to prepare the supplemental report and/or conduct additional analyses. We have enjoyed working with the Committee and its staff and trust our work will be of use to the Committee as it fulfills its charge to recommend how the Permanent Fund should be structured and implemented.

As you read the report, I call to your attention one unavoidable conclusion derived from the study. It dramatically underscores the danger of making incremental investment or expenditure decisions without regard for their long-term economic or fiscal effects and poignantly highlights the need for the legislature to engage in long-term fiscal planning.

If we can provide any further information or elaboration of the study's findings, we will be pleased to do so at your request.

With best regards.

Sincerely,

A handwritten signature in cursive script, appearing to read "Lee Gorsuch".

Lee Gorsuch
Director

LG/m
encl.

M E M O R A N D U M

TO: Clark Gruening, Chairman, House Permanent Fund Committee

FROM: Lee Gorsuch, Director, Institute of Social and Economic Research, University of Alaska

SUBJECT: Alaska Native Regional Corporations and the Permanent Fund

February 1, 1978

In late July, we agreed to include several questions related to the Permanent Fund in the study of regional corporations we are conducting in collaboration with the Alaska Native Foundation. The questions included were designed to (1) ascertain Native regional corporation views of potential Permanent Fund investment needs and of possible opportunities in rural areas, and (2) explore potential areas of cooperation between the Permanent Fund and Native corporation investments.

We have made no material changes in the responses we received, nor have we analyzed them. The responses constitute the views of selected executives of six of the twelve Native regional corporations. This memorandum summarizes the responses we obtained which included specific ideas and examples of investment opportunities and perceptions of the broader Permanent Fund policy issues.

While our overall study covers all Native regional corporations, we were only able to address the Permanent Fund related questions to six of them. This is due primarily to our survey having already been completed in a number of regions prior to the add on of the Permanent Fund related questions in late July.

General Investment Policies and Goals

Respondents were asked for their opinions as to what Permanent Fund investment policies and goals should be in general and how they should apply to rural areas in particular.

All respondents supported the concept of the Permanent Fund and generally regarded it to be of great potential value in meeting rural area needs.

Clark Gruening
February 1, 1978
page 2

Some Specific Comments

- o The Fund should be used primarily to ensure that there is sound and steady growth in the economy of the state. Don't want rapid growth booms and busts... Use the Fund to help stabilize the economy... Help knock out the valleys and knock off the peaks on the economic growth of the state.
- o The Permanent Fund should not be used to any great extent to subsidize something that cannot naturally occur or at least stand on its own after a brief period of time... Don't like the idea of subsidized business, but could use the Fund to help get things going and then get out; that sort of thing.
- o Remove from political spectrum.
- o Can't differentiate between urban and rural areas and projects. Need to look at each individual investment... The availability of other funding in urban areas and lack of it in rural areas, will soon take the Permanent Fund to rural areas and small communities.
- o Rates of profit are not commensurate with the risks that exist in rural areas... If the Permanent Fund has a goal of doing something for rural Alaska, it is going to have to accept something other than the maximum return. But this may be justified by reducing other costs or enhancing other returns to the public than directly in terms of Permanent Fund growth... Rates of return can take into account broader values through shadow pricing.

Relationship Between Permanent Fund and Regional Corporations

All respondents expressed an interest in having Permanent Fund monies available to regional corporations in support of their in-state investments.

There was consensus that the Permanent Fund should be a source of funding and perform a role comparable to that of a bank. It should provide funding on the basis of proposals and appropriate collateral, similar to EDA, FHA, state loan programs, etc.

While emphasis was on loan programs, the possibility of joint ventures was also envisaged. Under such circumstances, according to our respondents, the Permanent Fund should provide money only, not

Clark Gruening
February 1, 1978
page 3

management. It would, in effect, become a limited partner, with the applicant corporation functioning as the general partner. The respondents fully accepted the accountability associated with the partnership arrangement but were insistent that the state should not be directly involved in management of particular enterprises.

Interest was also expressed in intermediateterm financing. Commercial banks generally finance projects on a 5-7 year term, maximum, and insurance companies lend for a period of 20-30 years. The respondents felt a void exists in the availability of 8-20 year money.

Respondents also emphasized the need to make money available expeditiously, without too much red tape and delay. (It was suggested that sometimes the real cost of "cheap" money (e.g., 5%) turned out to be about 20%.)

One respondent saw no reason to support Native corporations by virtue of their being Native corporations or just to put money into the bush. This respondent suggested that the Permanent Fund participate only when a beneficial investment can be shown. At the same time, this respondent felt that there were many opportunities for "beneficial" investments in rural areas and with Native corporations.

Financing Corporation Investments

An attempt was made to elicit specific examples of situations where the Permanent Fund could today assist, or could in the past have assisted, with the financing of regional corporation projects:

- o The Harbor View apartment complex in Kodiak is at this time financed by a credit union (50%) and by Koniag Corporation (50%). The project meets local needs, creates jobs - and is carrying itself. No commercial institution would touch the project initially, and public funds would have helped. Even today, Permanent Fund participation in the project's financing could free Koniag equity and enable Koniag to initiate other projects. As Mortgagor, the Permanent Fund's investment would be secured by a profitable real estate project.
- o Similarly, Ahtna Lodge at G'enallen has a very high regional corporation equity. Additional financing was provided under the State Tourism Loan Program, by a private bank, and by CEDC. Refinancing of Ahtna's equity would free its capital for further investments. If the interest rates of the new capital provided by the Permanent Fund were lower than current ones, profitability could be achieved earlier even with a higher debt level.

Clark Gruening
February 1, 1978
page 4

- o Cook Inlet has several high yield projects, including office buildings and hotels, where conversion of equity into a loan, consolidation of existing debt, and refinancing of existing medium-term notes could all have a very favorable economic impact on the corporation.
- o Most of respondents regarded fisheries to be one economic activity in which Permanent Fund loans or guarantees could have made investments possible in the past and could still facilitate projects presently and in the future. In each case, capital requirements were viewed as having been or being too large to be borne solely by the regional corporations. Among the investment possibilities cited were major high seas processing ships; boats and on-shore plants; and a large enterprise involved in harvesting, processing, and sales of sea foods.

Areas of Prospective Investment

Fisheries and mineral resources development and processing were mentioned over and over as prime candidates for future Permanent Fund support in the various regions.

As might be expected, the principal emphasis in fisheries was on high seas and on-shore facilities related to taking full advantage of the extended (200 mile) fisheries jurisdiction in the waters adjacent to Alaska. Great opportunities are seen for large-scale protein development, but concern exists about obtaining initial financing for what, in effect, will constitute a new approach to fisheries in the United States. Financing is seen as being required for large fleets, on-shore installations, transportation and marketing, research -- in other words, everything to initiate broad utilization of off-shore fisheries.

A number of regions currently have mineral contracts with options to participate in production if exploration indicates existence of economically feasible resource deposits. Exercising such options will mean that regional corporations will have to pay a share of future costs. While under such circumstances private financing of what would likely be large capital requirements could probably be arranged, respondents felt the Permanent Fund could earn a high yield by financing such ventures... Specific opportunities suggested for Permanent Fund involvement in the minerals area were the development and industrialization of the Beluga coal fields and the establishment of a cement manufacturing plant. Aside from these specific areas, others were mentioned only in general terms. These included geothermal energy development, housing and investment guarantees, and OCS-related projects.

Clark Gruening
February 1, 1978
page 5

Other Comments and Suggestions

Human resources development was stressed by a number of respondents. While several pointed to job creation as a major goal for rural areas, another respondent saw this factor pertinent only as a consideration if judging between two projects of equal merit, believing that most investments in Alaska would assist with local employment.

One respondent saw the lack of people with interest, attitudes, and skills appropriate to business and financial management as the greatest obstacle to development in rural Alaska.

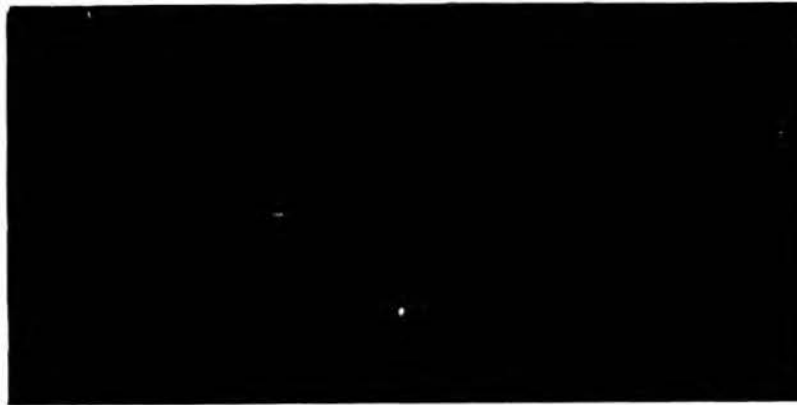
A suggestion was made that the Permanent Fund could facilitate some sort of one-stop-financing service. The idea came up in connection with a discussion of constraints facing small business, where money may be available but not getting to where it should or could be. Many existing financial institutions simply do not service rural areas. A servicing facility or process sponsored in connection with the Permanent Fund could actually facilitate the availability of commercial financing and of other funding sources, such as EDA, SBA, BIA, and others.

The hope was also expressed that the Permanent Fund would encourage a greater understanding of rural investment opportunities and investment environment. It was pointed out that most of the demand studies and many feasibility studies done for rural areas are based upon urban notions of yield and, therefore, often greatly understate risks and misinterpret the return opportunities. Even the most skilled appraisers are not sufficiently qualified to deal with rural areas and make appropriate judgements. If the Permanent Fund is to obtain good feasibility studies, our respondents felt it will need to develop its own capability to analyze economic and business opportunities or to sponsor somebody else in development of the appropriate analytic capability, as does the World Bank and other international lending institutions.

In conclusion, I want to emphasize that ISER has not analyzed or endorsed the suggestions offered above nor should they be interpreted to be an official position of the Alaska Native regional corporations. Rather, these are the views of several executive officers of the corporations.

LG/m

#17



INSTITUTE OF SOCIAL AND ECONOMIC RESEARCH
UNIVERSITY OF ALASKA

Anchorage • Fairbanks • Juneau

THE PERMANENT FUND AND THE GROWTH
OF THE ALASKAN ECONOMY: SELECTED STUDIES

A Report for the
House Special Committee
on the Alaska Permanent Fund

by

Scott Goldsmith

with

Lee Gorsuch
Lee Huskey
Mike Scott
and
Arlon Tussing

December 15, 1977

Institute of Social and Economic Research
University of Alaska

Anchorage - Fairbanks - Juneau



707 A Street, Suite 206
Anchorage, AK 99501

UNIVERSITY OF ALASKA

FAIRBANKS, ALASKA 99701

INSTITUTE OF SOCIAL AND ECONOMIC RESEARCH

Representative Clark Gruening, Chairman
Subcommittee on the Alaska Permanent Fund
Alaska House of Representatives
528 West 5th Avenue, Suite 270
Anchorage, Alaska 99501

Mr. James Edenso, Deputy Commissioner
Alaska Department of Revenue
Pouch SB
Juneau, AK 99811

December 15, 1977

Dear Sirs:

The Institute of Social and Economic Research hereby submits the enclosed report entitled The Permanent Fund and the Growth of the Alaskan Economy: Selected Studies. The report, prepared under contract to the State Department of Commerce on behalf of the House Subcommittee on the Alaska Permanent Fund, analyzes the economic and fiscal effects of a) alternative contribution levels to the Fund; b) alternative uses of the Fund's earnings; c) selected in-state investments of the Fund; and, d) in-state placement of the 1969 Prudhoe Bay bonus money.

The compressed contract period for performing the work precluded the preparation of a preliminary draft and the solicitation of comments. ISER could compensate for this shortcoming by preparing a condensed supplemental report designed to reach a broad audience. This supplemental report would benefit from any legislative or departmental comments the final report elicited.

Because the basic analytic tool designed and used in the conduct of the study is a computer program, additional analytical work can be performed efficiently and at low cost. For example, both the timing and the level of revenues, expenditures and/or contributions to the fund could be easily modified within the structure of the existing program and the corresponding outputs re-analyzed.

page 2

ISER would be pleased to have the opportunity to prepare the supplemental report and/or conduct additional analyses. We have enjoyed working with the Committee and its staff and trust our work will be of use to the Committee as it fulfills its charge to recommend how the Permanent Fund should be structured and implemented.

As you read the report, I call to your attention one unavoidable conclusion derived from the study. It dramatically underscores the danger of making incremental investment or expenditure decisions without regard for their long-term economic or fiscal effects and poignantly highlights the need for the legislature to engage in long-term fiscal planning.

If we can provide any further information or elaboration of the study's findings, we will be pleased to do so at your request.

With best regards.

Sincerely,



Lee Gorsuch
Director

LG/m
encl.

THE PERMANENT FUND AND THE GROWTH OF
THE ALASKAN ECONOMY: SELECTED STUDIES

TABLE OF CONTENTS

I.	THE PERMANENT FUND AND THE PATTERNS OF STATE EXPENDITURES	
A.	Introduction	I-1
B.	Structure of the Permanent Fund	I-5
C.	The Permanent Fund in the Context of the Alaskan Economy	I-13
C.1	Introduction	I-13
C.2	Assumptions	I-14
C.3	A Simulation of the Alaskan Economy	I-33
C.4	Sensitivity of the Basic Case to Increase in Petroleum Revenues	I-48
C.5	Sensitivity of Base Case to Increased Contribution Rate to the Permanent Fund	I-52
C.6	Conclusion	I-59
D.	Target Expenditure Growth Rates	I-60
E.	Targets Which Take the Supply of Revenues into Account	I-74
II.	IMPACT OF ALTERNATIVE USES OF PERMANENT FUND EARNINGS	
A.	Introduction	II-1
B.	Base Case	II-5
C.	The Economic Impact of Alaska Inc. Payments	II-14
D.	The Impact of Alternative Proposals for the Disposition of Permanent Fund Earnings	II-29
E.	Conclusion	II-55
III.	ANALYSIS OF ECONOMIC IMPACT OF PETROCHEMICAL FACILITIES AND FISH HATCHERIES ON THE ALASKAN ECONOMY	
A.	Introduction	III-1
B.	Base Case	III-6
C.	Aggregate Economic Impacts	III-13
D.	Regional Economic Impacts	III-19
E.	State Fiscal Impacts	III-30
F.	Local Fiscal Impact	III-37
G.	Per Capita Impacts	III-40
H.	Conclusion	III-43

TABLE OF CONTENTS (Continued)

IV. ALASKA CAPITAL MARKETS AND STATE FUNDS

A.	Introduction	IV-1
B.	The Setting: The Alaskan Financial Sector	IV-4
C.	Policy Goals	IV-8
D.	Placement of the Funds	IV-11
E.	Other Programs	IV-14
F.	The Impact of the Bank Placement Program	IV-17
	F.1 Growth Impact	IV-18
	F.2 Equity Impact	IV-26
	F.3 Efficiency Impact	IV-32
G.	Conclusions	IV-34

APPENDICES

A. GROWTH IN STATE AND LOCAL GOVERNMENT EXPENDITURES IN ALASKA

A.I.	Theory of Public Expenditure Growth	A-1
A.II.	Historical Public Expenditures Patterns in the U.S.	A-10
A.III.	Alaska Historical Public Expenditure Patterns	A-15

B. MODIFICATIONS TO MAP ECONOMETRIC MODEL FOR ANALYSIS OF PERMANENT FUND

B.I.	Accommodations to Simulate to 1999	B-1
B.II.	Treatment of Permanent Fund	B-2
B.III.	Treatment of State Expenditures	B-6
B.IV.	Renewable Resources Development Fund	B-9
B.V.	Guide to Variables Used in Analysis	B-10

C. PETROLEUM REVENUE ASSUMPTIONS

C.I.	Prudhoe Bay Oil	C-1
C.II.	Prudhoe Bay Gas	C-3
C.III.	Cook Inlet Revenues	C-5
C.IV.	Miscellaneous Variables	C-7

TABLE OF CONTENTS (Continued)

D. METHODOLOGY EMPLOYED IN ALASKA INC. ANALYSIS

D.I. Eligibility	D-1
D.II. Total Shares	D-4
D.III. Migratory Response Pattern	D-10
D.IV. Consumption Response Patterns	D-18

E. ASSUMPTIONS TO RUN REGIONAL IMPACT CASES

REFERENCES

THE PERMANENT FUND AND THE GROWTH OF
THE ALASKAN ECONOMY: SELECTED STUDIES

EXECUTIVE SUMMARY

The contract under which this project was done outlined four general study areas. Each centered upon a distinct question related to permanent fund policy.

I. What are the long run fiscal and economic prospects for Alaska and what are the impacts on these prospects of the Permanent fund?

Figure 1 shows the basic pattern of future state revenues (R99S) to be one in which the growth of total revenues reflects the cyclical nature of petroleum related revenues (RP9S). A significant decline in petroleum revenues leads to a corresponding decline in total revenues and adjustment to a lower long term growth path.

Figure 1 - PROJECTED STATE REVENUES

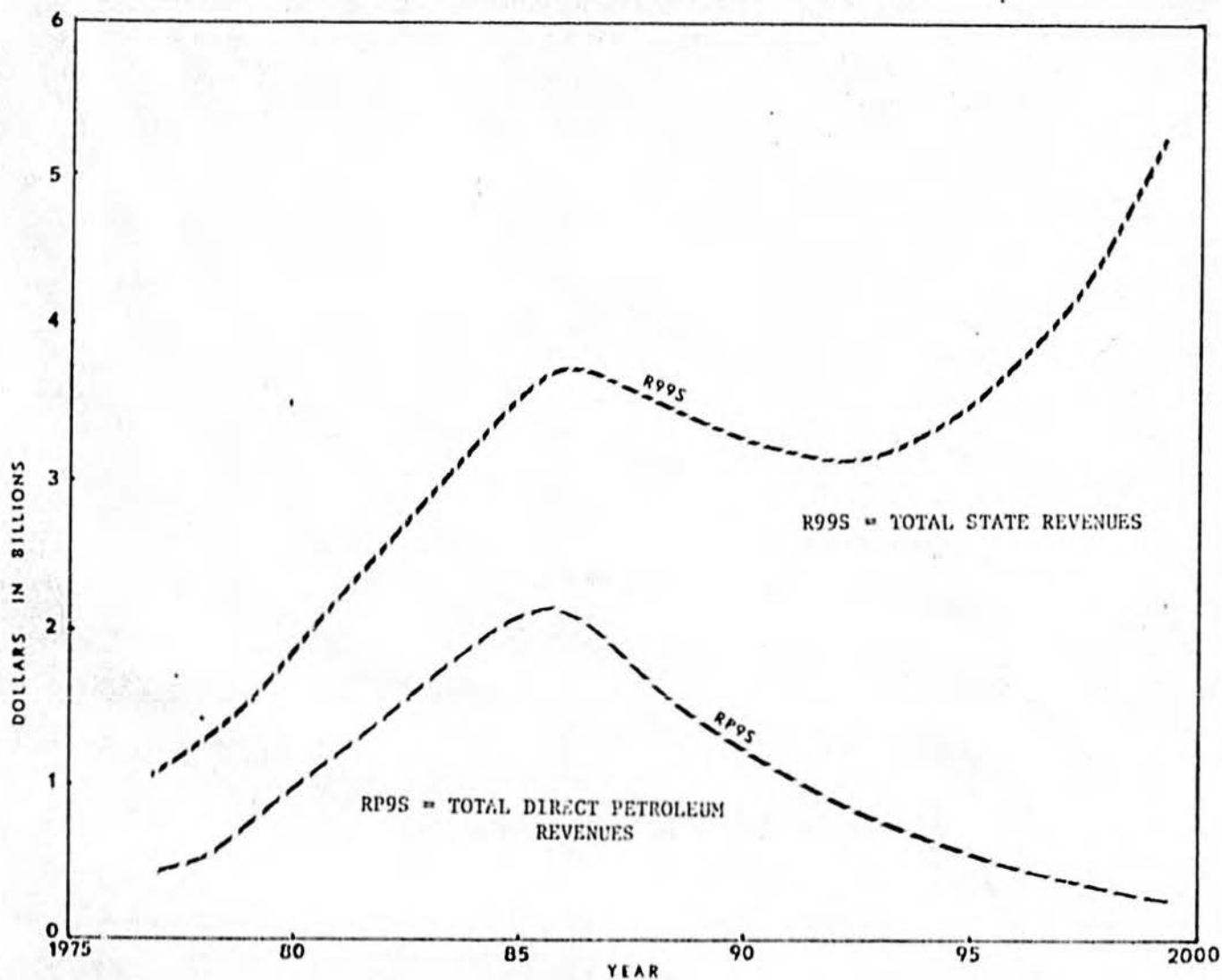
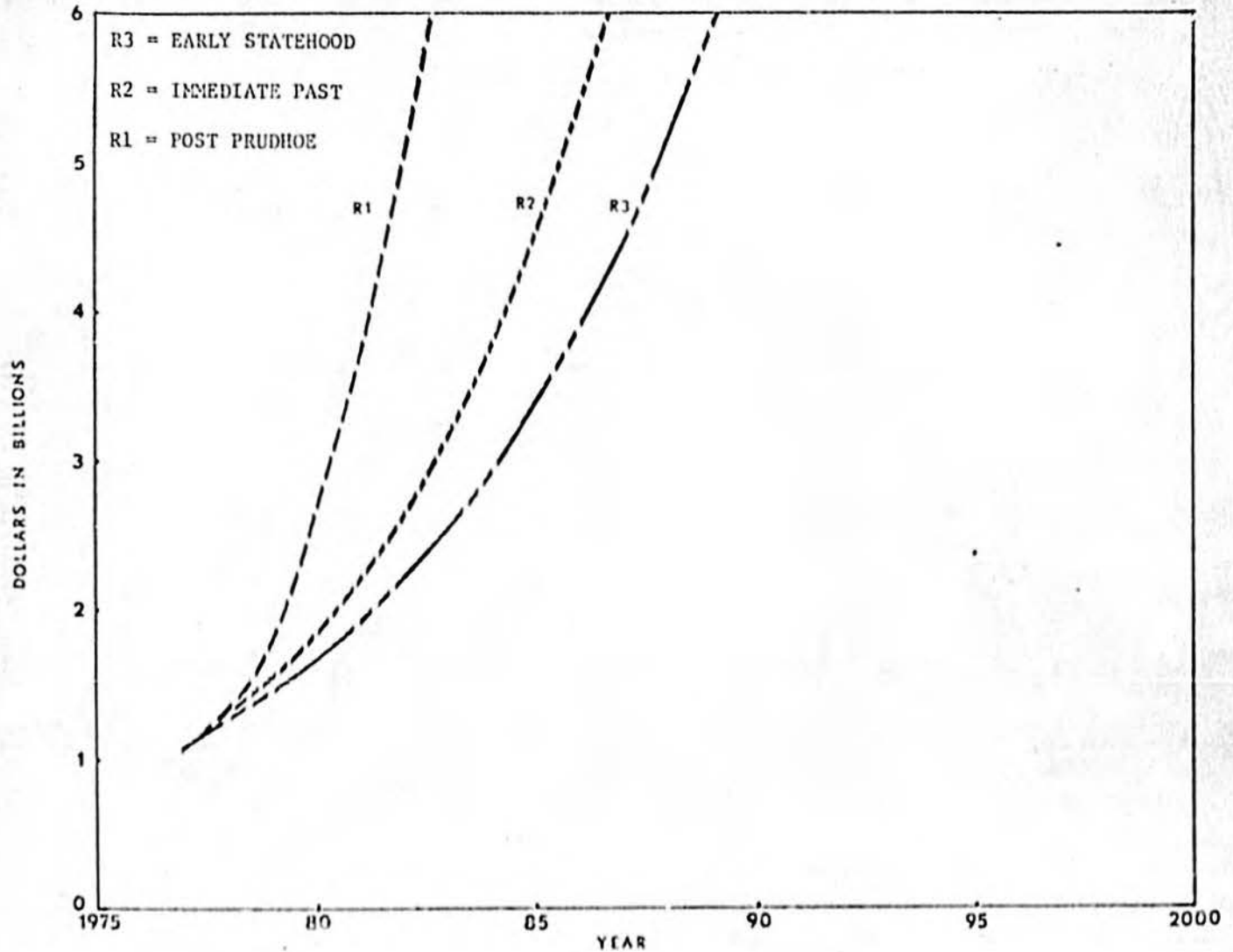


Figure 2 on the same scale presents projected state expenditure growth at rates comparable to three periods of post-statehood growth. Comparison of Figures 1 and 2 shows that even expenditure growth rates such as experienced by the state immediately after statehood cannot be sustained beyond the late 1980s.

Figure 2 PROJECTED STATE EXPENDITURES



A basic simulation of Alaskan economic growth shown in Figure 3 indicates the magnitude of the adjustment in state expenditures (E99S) necessary to attempt to maintain state financial solvency. Total expenditure growth has a ten year hiatus. At the same time, the permanent fund (PFBAL) grows to a level of \$3 billion.

Figure 3 - SIMULATED STATE FISCAL POSITION
Including Permanent Fund Part I

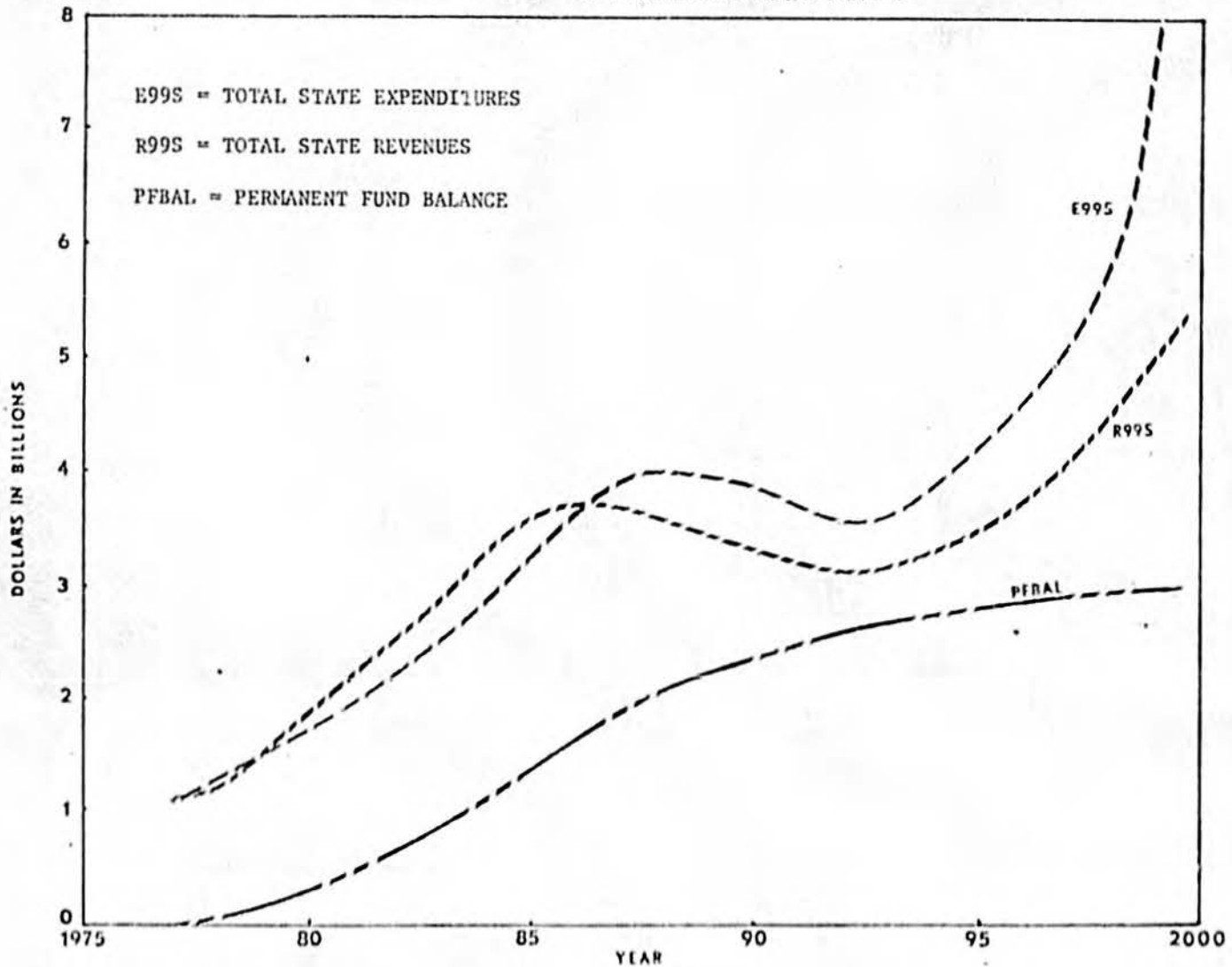
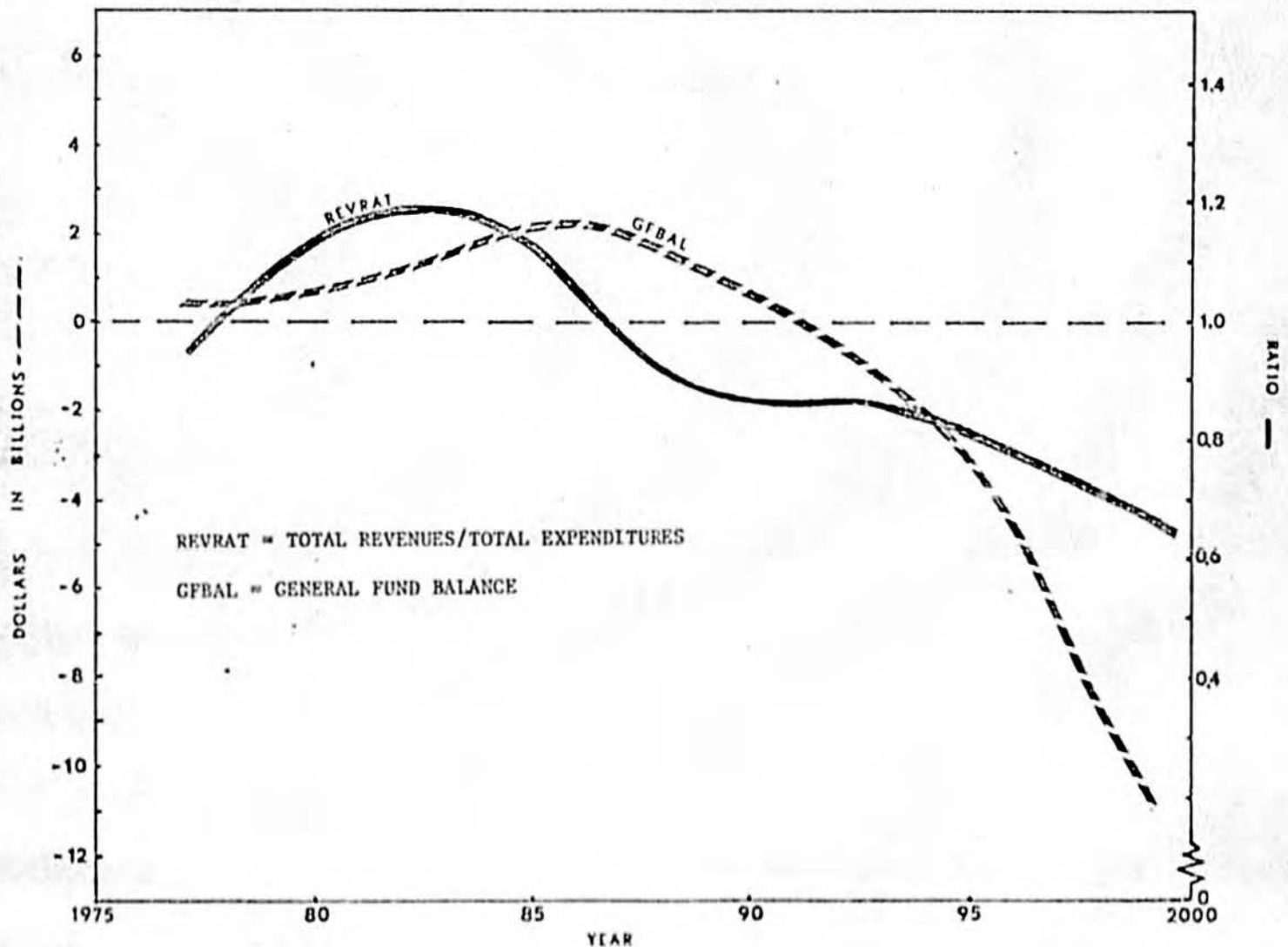


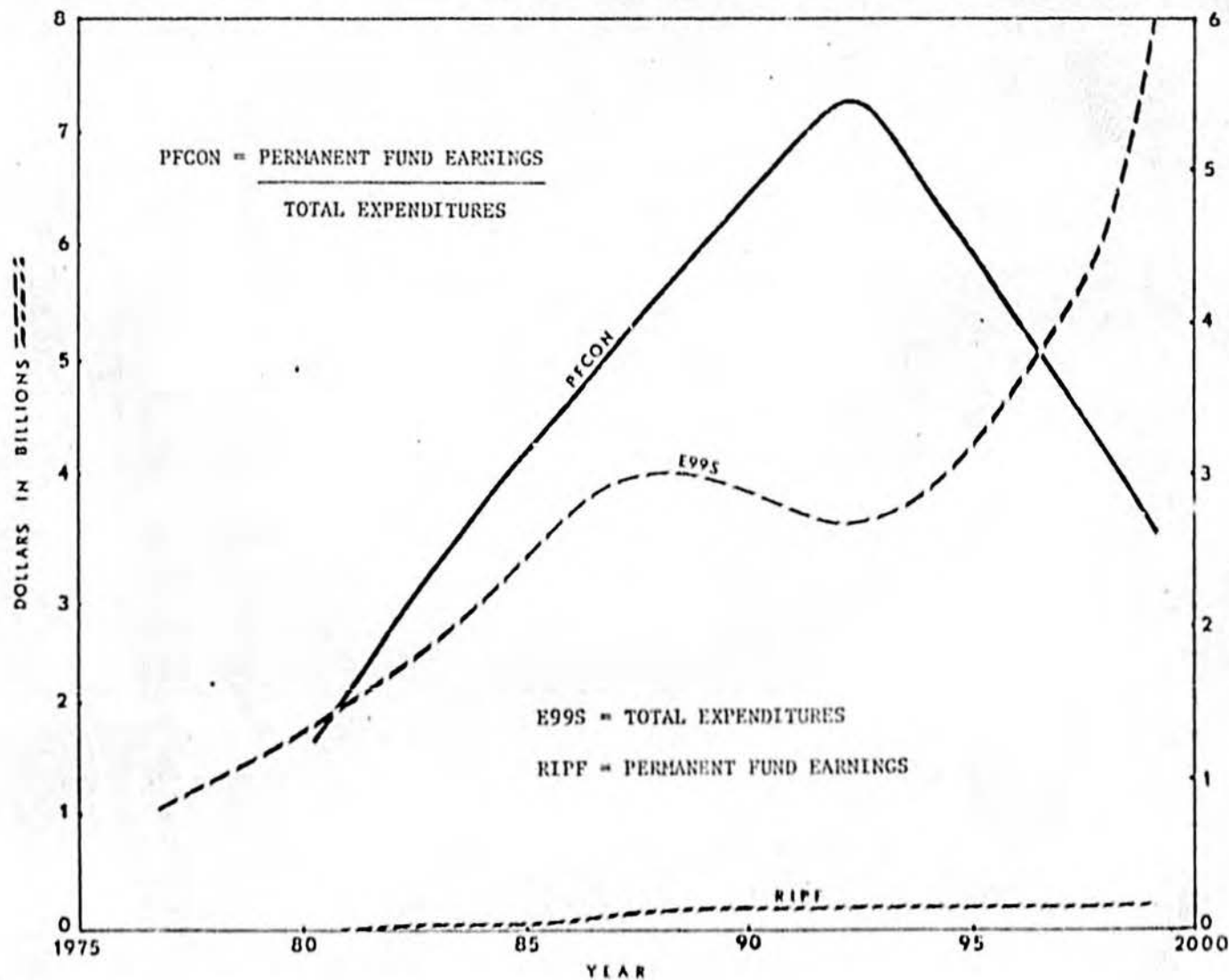
Figure 4 reflects the fact that in spite of this expenditure reduction and the permanent fund the general fund balance (GFBAL) falls below zero in the early 1990s and reaches -\$10 billion in less than ten years. This represents the amount of alternative revenues which must be generated within that period to get the state back on a "pay as you go" basis represented by the ratio of total current revenues to current expenditures (REVRAT) not including permanent fund contributions.

Figure 4 - SIMULATED STATE FISCAL POSITION
Including Permanent Fund Part II



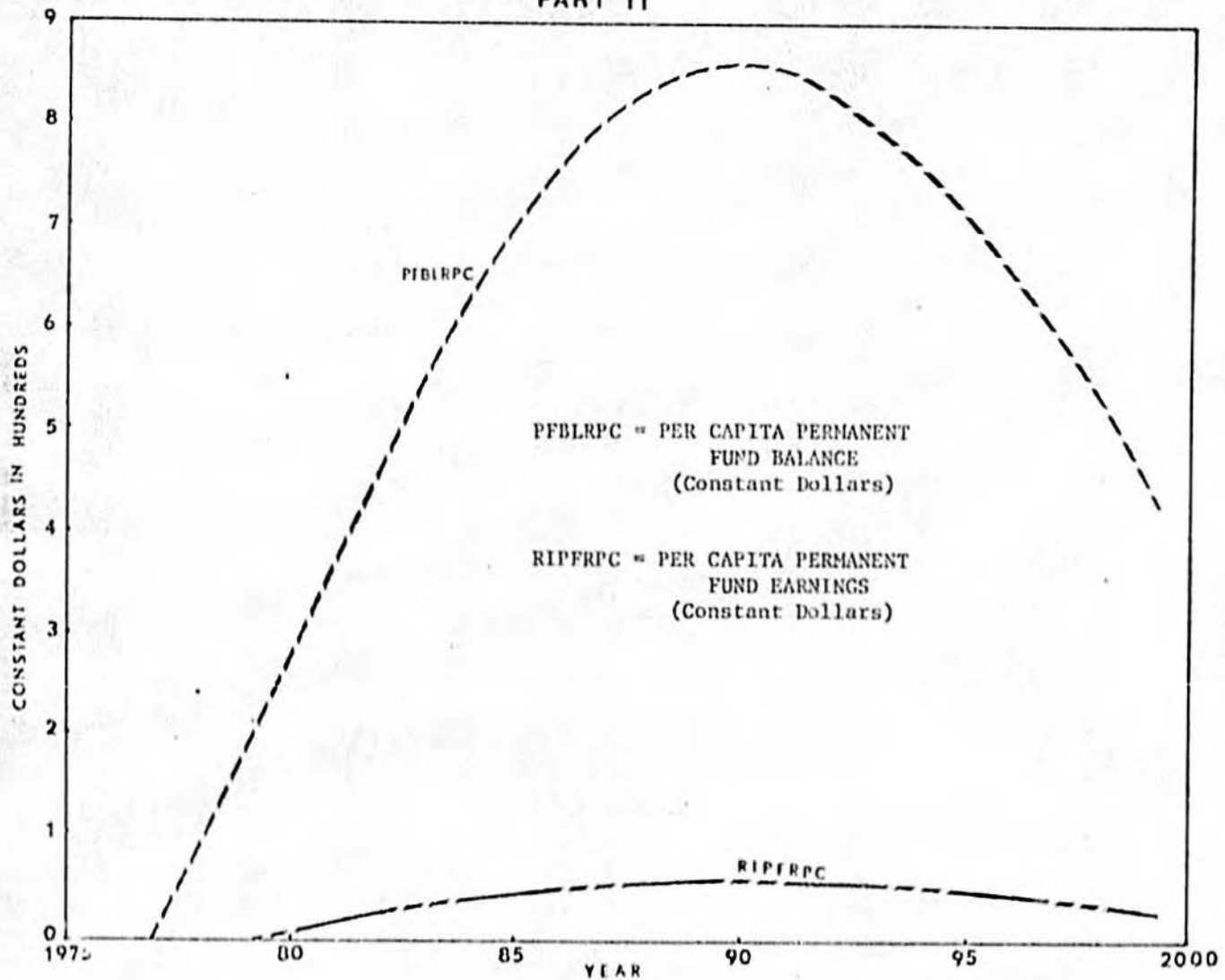
At a 25 percent contribution rate and 7 percent return, the permanent fund generates a substantial amount of annual income (RIPF). As a percentage of total expenditures (PFCON), Figure 5 indicates that its contribution can temporarily exceed 5 percent but will rapidly decline because of a slowdown in the growth of the fund itself.

Figure 5 - SELECTED MEASURES OF THE PERMANENT FUND



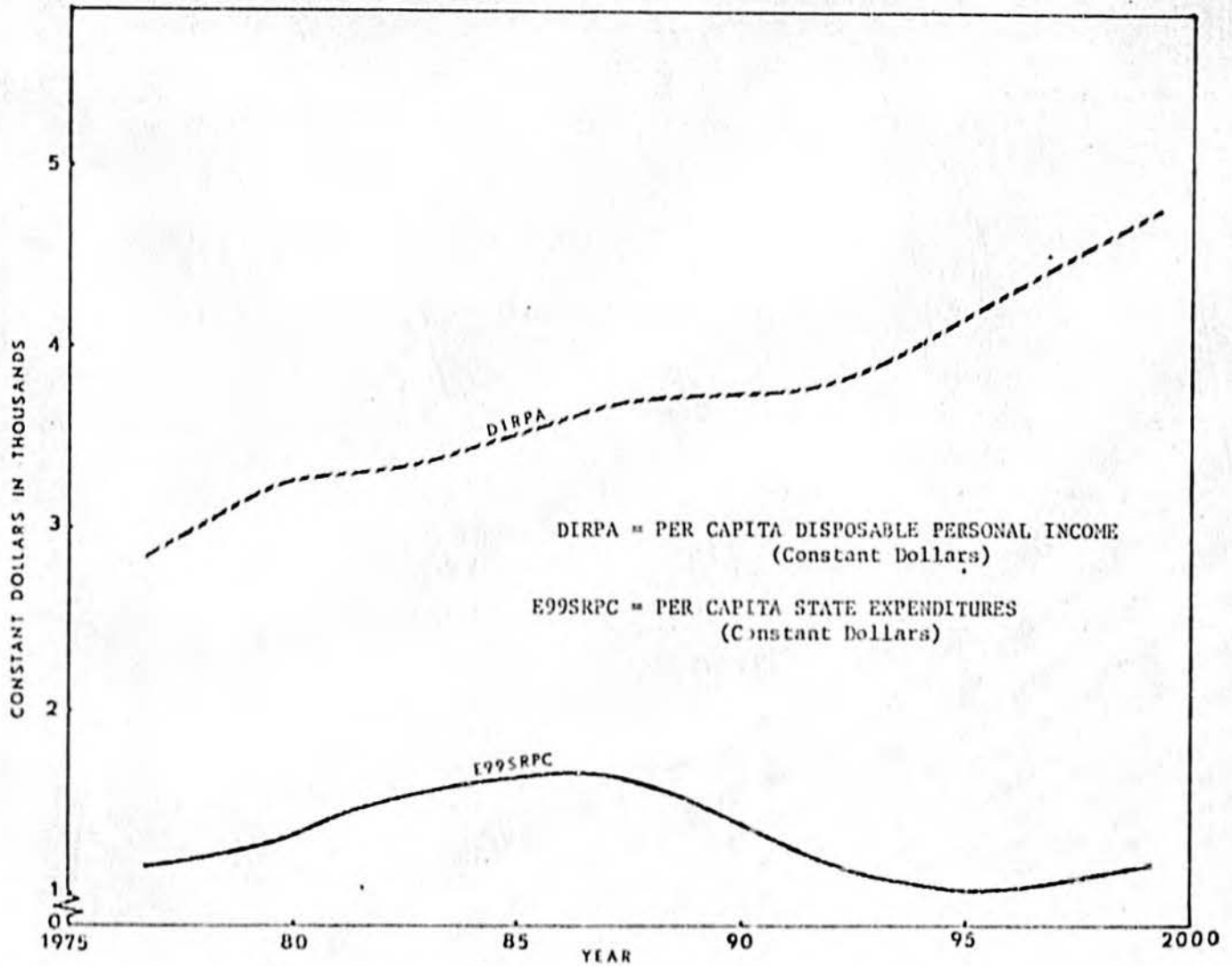
From the perspective of the average citizen of Alaska, the constant dollar (1967 U.S.) value of the permanent fund and the permanent fund earnings (PFBLRPC and RIPFRPC) exhibit long run cyclical behavior. Figure 6 shows they rise rapidly until the early 1990s and then fall off rapidly.

Figure 6 - SELECTED MEASURES OF THE PERMANENT FUND
PART II



The total state expenditure pattern which indicates a decline in the late 1980s is reflected in Figure 7 in a significant real decline in per capita state expenditures (E99SRPC) which puts the level of services about 1995 substantially below present levels.

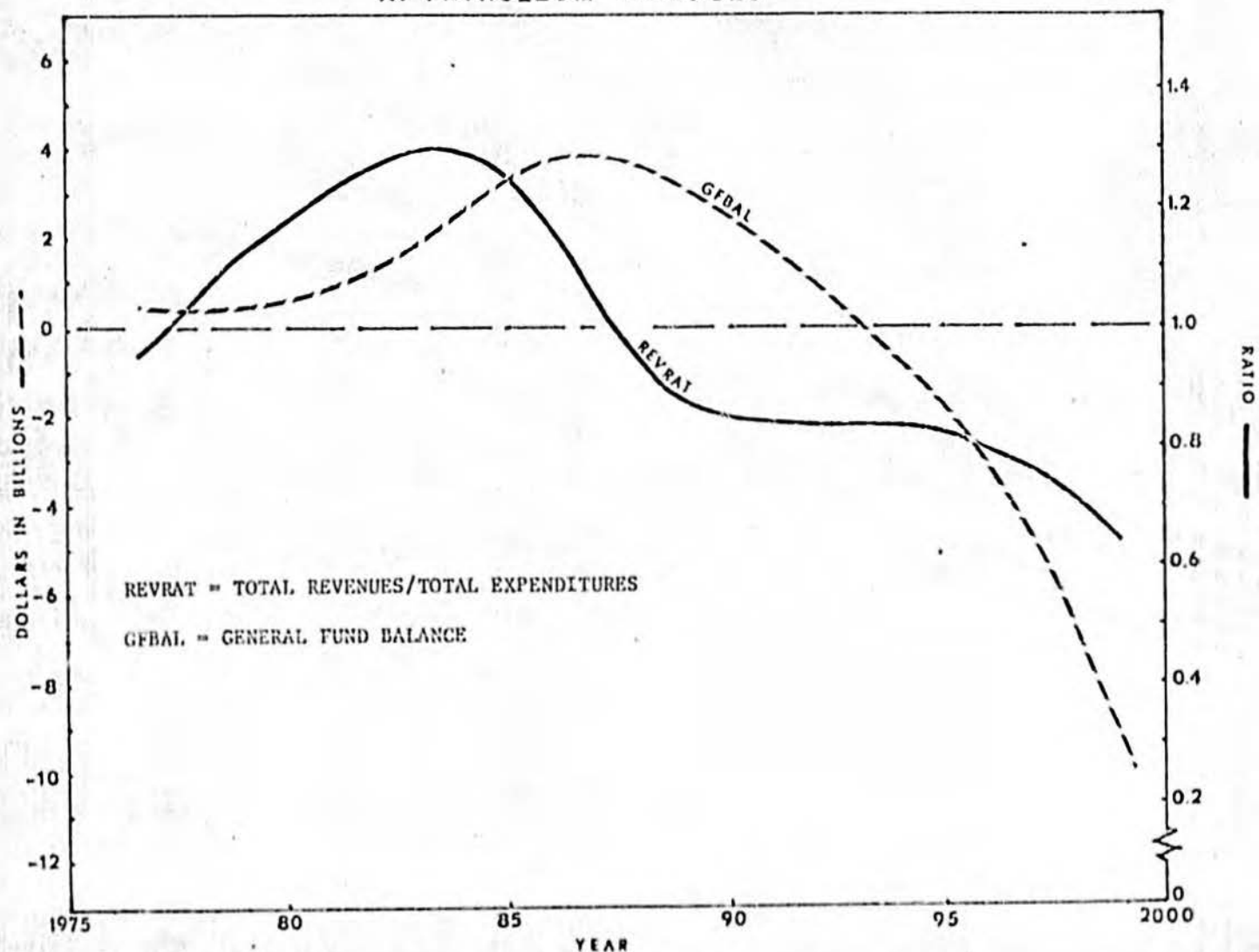
Figure 7 - SELECTED MEASURES OF THE PERMANENT FUND
PART III



The assumption of a 25 percent increase in petroleum revenues beginning in 1983 above the level which can presently be reasonably projected changes the timing of future events but not their pattern. In Figure 8, the indicators of state financial viability from Figure 4 are repeated with values taken from a simulation with higher assumed levels of petroleum revenues. The general fund balance remains positive an additional year but there is very small change in the time when there is a deficit on current account.

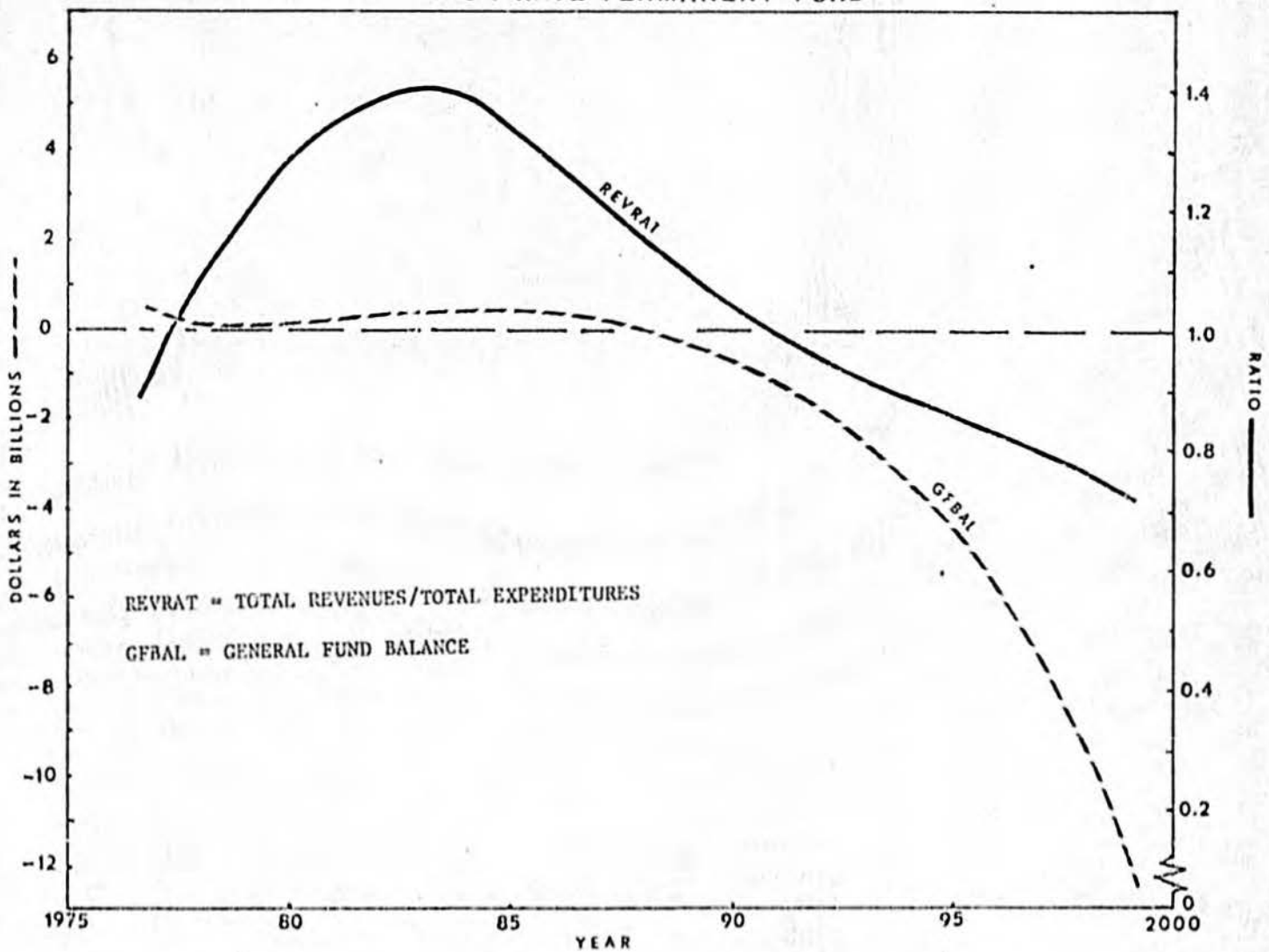
This results because the availability of increased general fund revenues has led to an increase in state spending. This has, in turn, generated economic growth and with it some "feedback" on the demand for state expenditures.

Figure 8 - POSITION OF STATE ASSUMING 25% INCREASE
IN PETROLEUM REVENUES



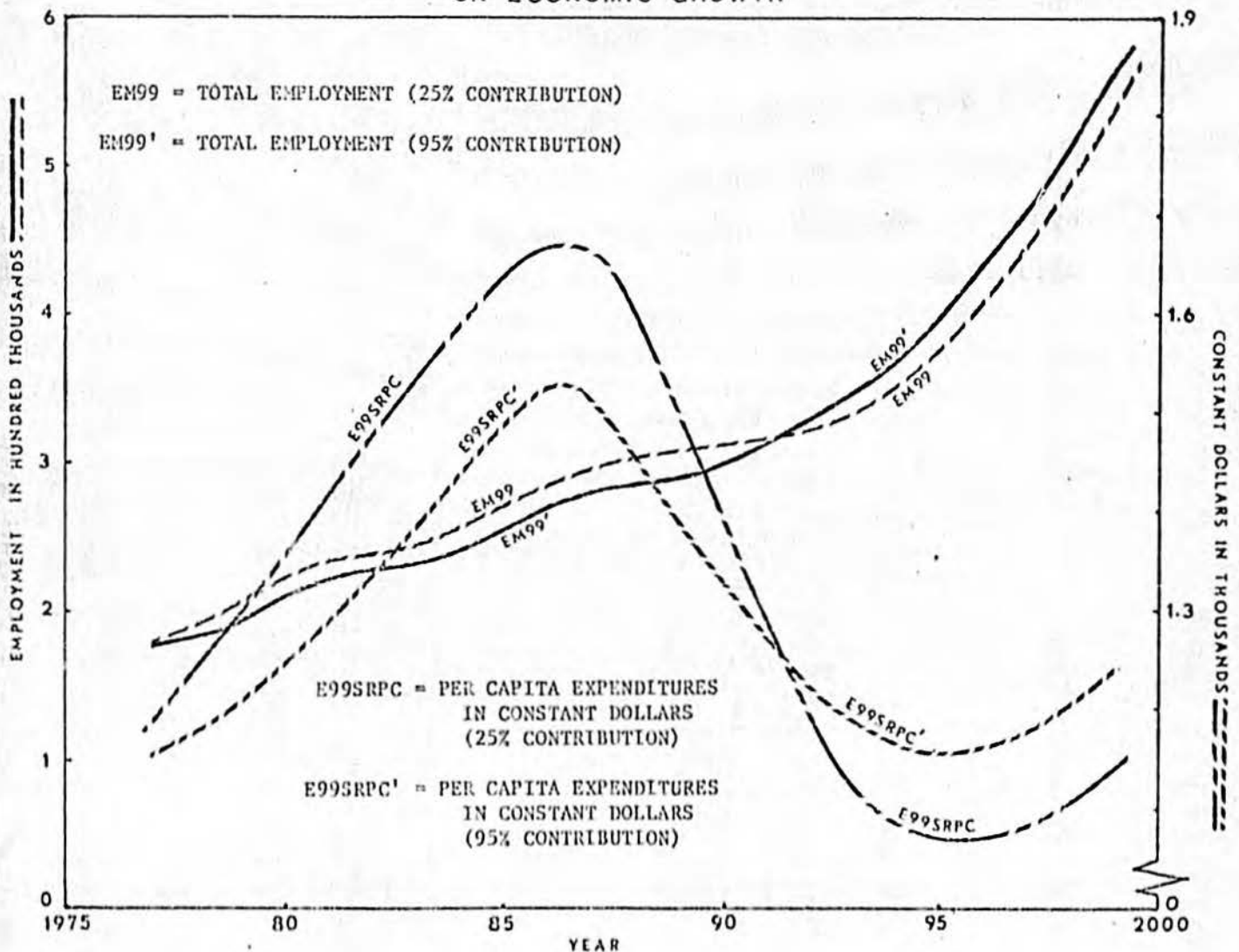
A substantial increase in the contribution rate to the permanent fund has the opposite impact on the financial position of the state. Figure 9 shows that in the case of a 95 percent contribution rate expenditure growth slows such that revenues exceed expenditures for a longer time than otherwise. However, such a large amount of money becomes "locked in" to the permanent fund that the general fund balance becomes negative before 1990.

Figure 9 - FISCAL POSITION OF STATE ASSUMING 100% CONTRIBUTION RATE PERMANENT FUND



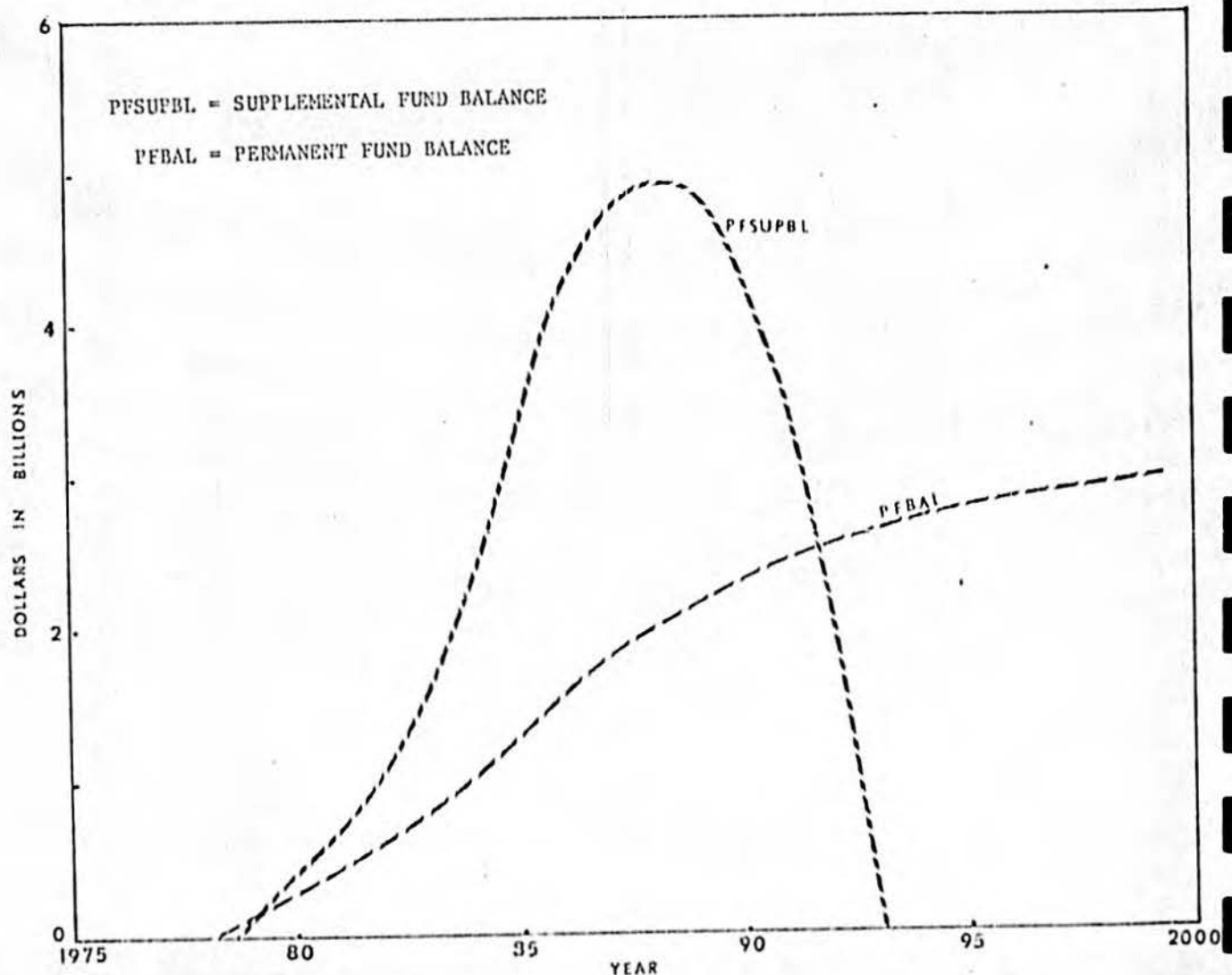
Larger permanent fund contribution rates remove money from the general fund and thus eliminate the possibility of it being spent on current budget appropriations. The resultant slowdown in economic activity is shown in Figure 10 where total employment (EM99) is plotted in the two cases of 25 percent and maximum (95 percent) contribution rates. With higher contributions growth is slower in early years but is later more rapid because the larger balance is able to temporarily provide for about 20 percent of state expenditure needs from earnings.

Figure 10 - IMPACT OF PERMANENT FUND WITHDRAWALS ON ECONOMIC GROWTH



These simulations and others indicate that in the 1980s a very substantial general fund balance will accrue to the state. A relationship between the general fund balance over and above immediate operating needs (PFSUPBL) and the permanent fund (PFBAL) as pictured in Figure 10.A is typical. During the next fifteen years this supplemental fund is likely to be substantially larger than the general fund. To concentrate on the permanent fund as a mechanism for controlling the patterns of Alaskan development overlooks this even larger fund source. This supplemental fund should be managed explicitly to allow state expenditure growth to adjust to the realities of state finances after petroleum revenues begin their decline.

Figure 10.A - RELATIONSHIP OF PERMANENT FUND AND SUPPLEMENTAL FUND



A first step in this direction involves adjusting expenditure growth to hit a target determined by real demand for public services rather than allowing it to fluctuate with the vagaries of short term revenues. Figure 11 illustrates one set of state expenditure patterns based upon growth of state expenditures at the same rate as real per capita personal income. Even in these cases representing conservative (about 12 percent) state expenditure growth, cutbacks are essential in the 1990s. Without foresight, a massive cutback is indicated in 1994 in case A while with the larger petroleum revenues of case B it is not necessary until 1997, but then much larger. Anticipation of the revenue shortfall leads to the smoother case C which allows highest expenditures in the long run. Case D involves more rapid growth of the target and thus earlier and more substantial reduction of expenditures.

Figure 11 - POSSIBLE TARGET EXPENDITURE GROWTH RATE

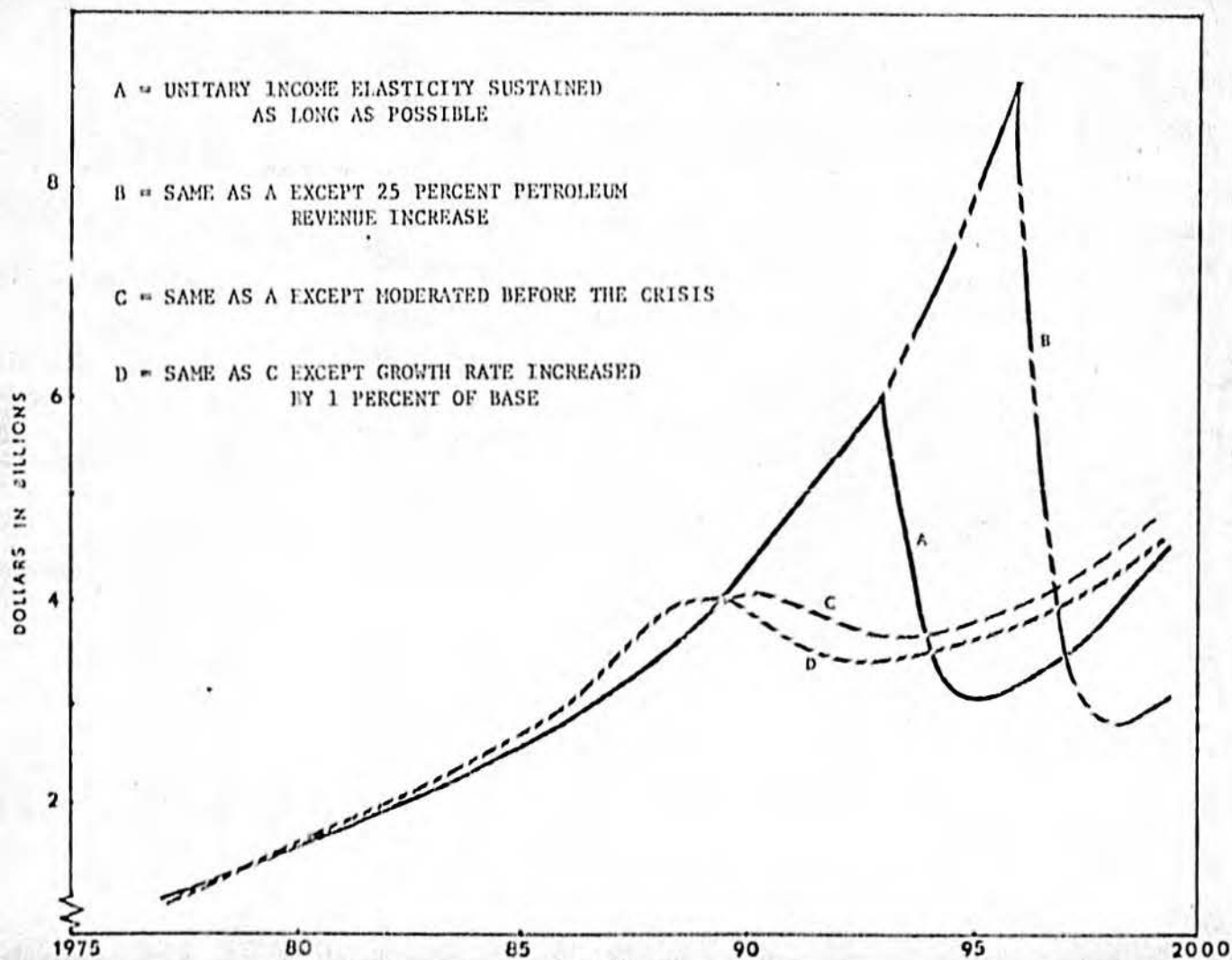
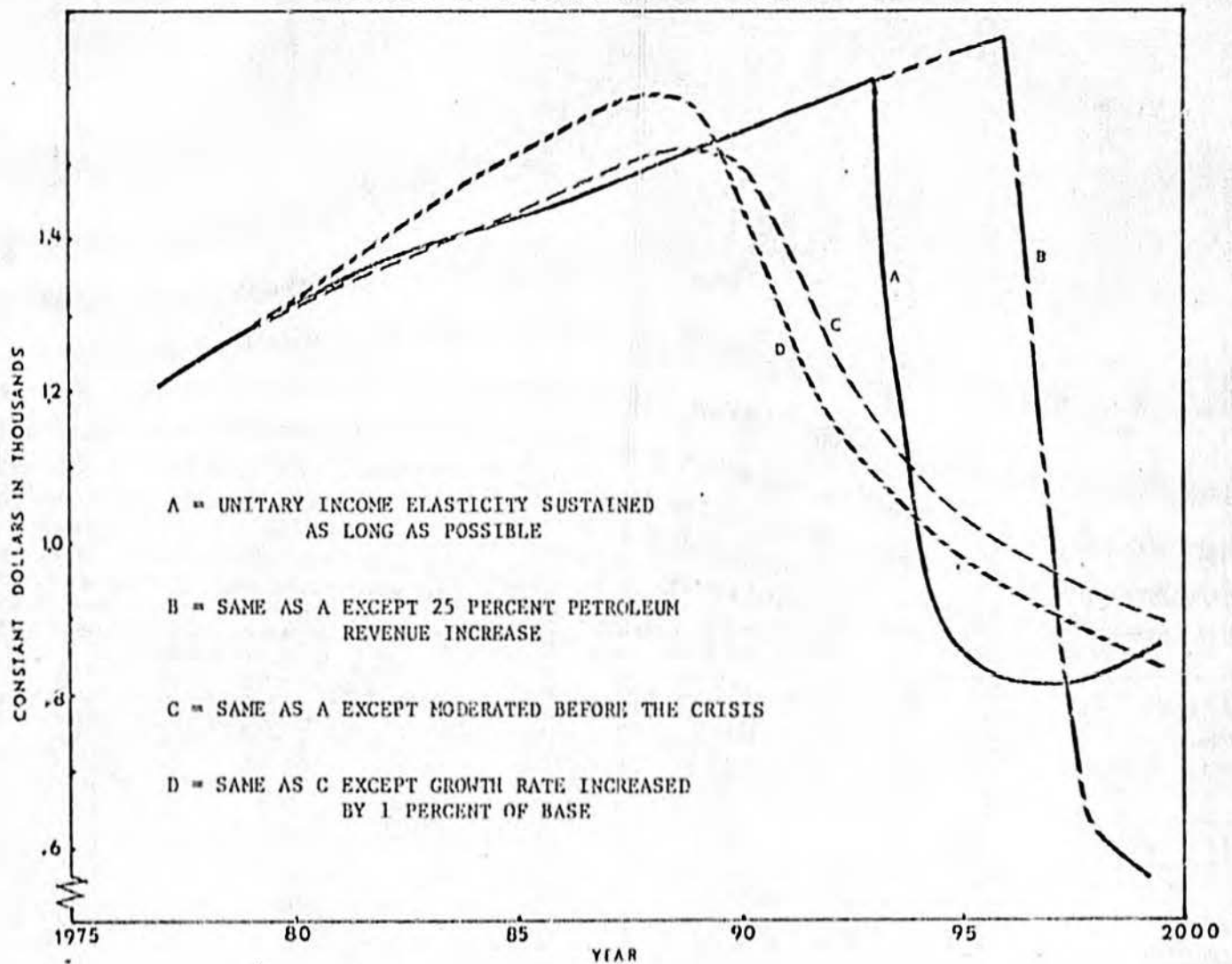


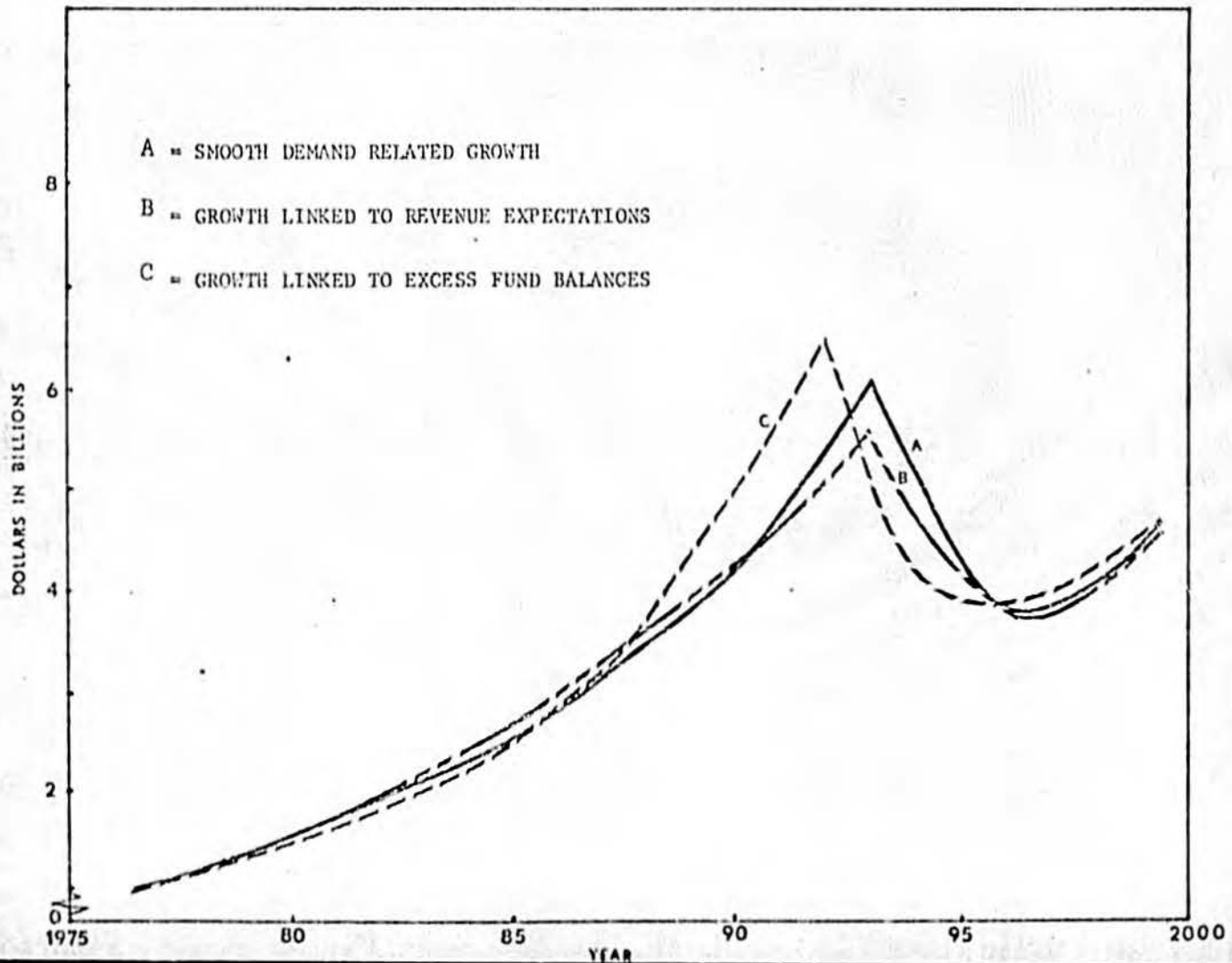
Figure 12 shows for these state expenditure patterns the implications for the level and growth of per capita real state expenditures. Significantly, even in the case where the revenue shortfall is anticipated (C) there is a substantial fall in the level of services provided by the state. In the 1990s it is substantially below present levels.

Figure 12 - LEVELS OF PER CAPITA STATE EXPENDITURES IMPLIED BY TARGET GROWTH PATHS



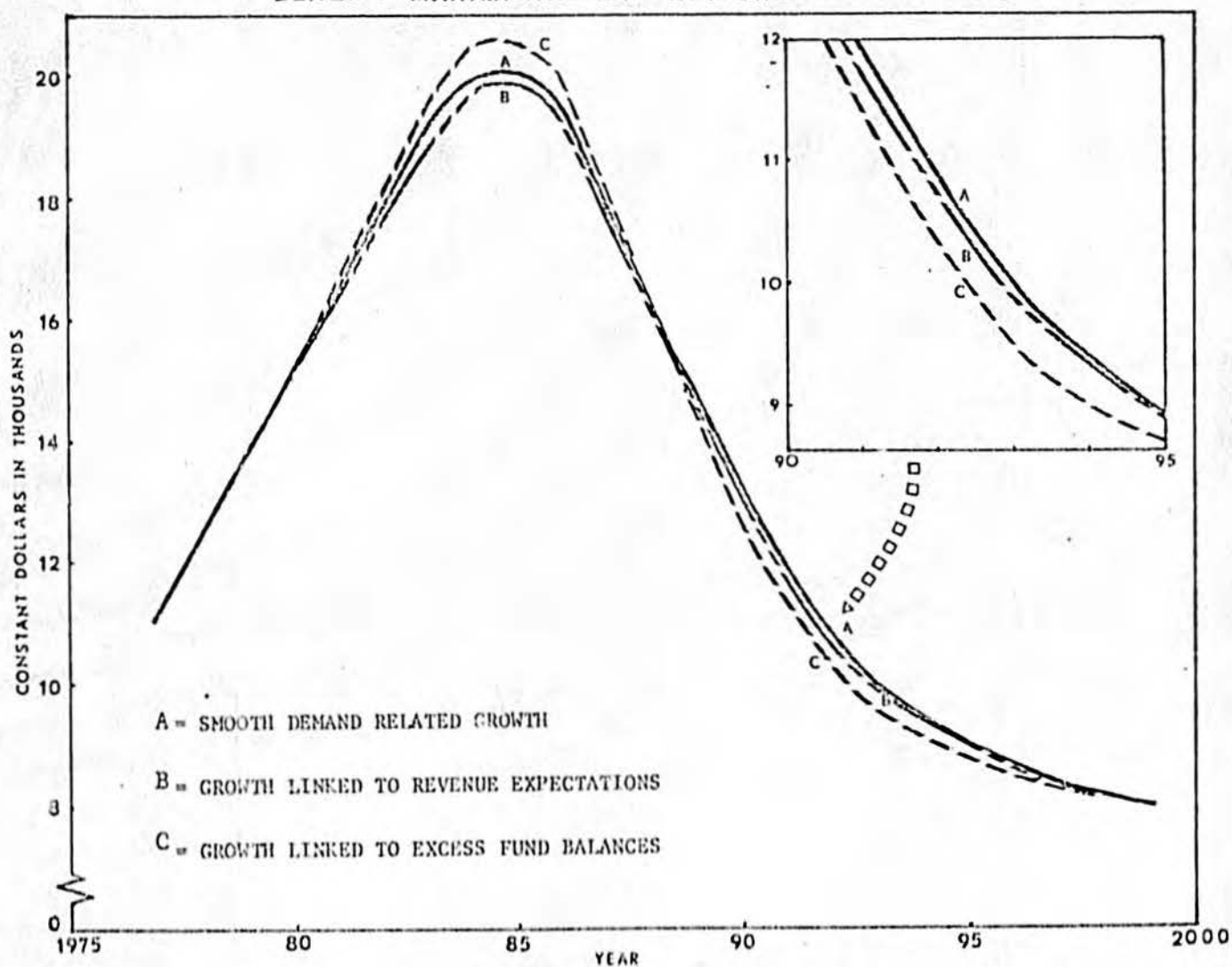
More sophisticated targets can be developed for state expenditure growth which take into account explicitly the unique long term revenue situation in Alaska. Figure 13 shows the state expenditure patterns derived from two such targets in contrast to the previous case A. Linking expenditures to expectations of future petroleum receipts (B) increases expenditures in the present relative to the future. Linking expenditures to the buildup of the balance in the permanent fund (C) delays expenditure growth until a future date. This allows larger expenditures supported by higher fund earnings, but ultimately all cases return to essentially the same growth path. This illustrates that the choice of expenditure patterns in the short run has implications for longer run growth but ultimately the underlying relationship between non-petroleum revenues and state expenditures will re-emerge to constrain state spending.

Figure 13 - POTENTIAL BENEFIT MAXIMIZING EXPENDITURE GROWTH PATHS



Finally, in Figure 14 another dimension of the tradeoff involved in the choice of expenditure growth patterns is shown. The state revenues received in the case C where growth is linked to revenues received results in higher earnings from fund balances but eventually, because state expenditures are stimulated, the per capita real revenues decline below the other cases.

Figure 14 - CONSTANT DOLLAR REVENUES PER CAPITA WITH BENEFIT MAXIMIZING EXPENDITURE GROWTH PATHS



The present state expenditure decisions from this perspective involve three tradeoffs which have implications for

1. the size of the economy,
2. the total amount of state revenues, and
3. the long run timing of state expenditures.

II. What are the economic implications of varying the assumptions regarding use of the earnings from the permanent fund? In particular, what is the effect of Alaska Inc. on the economy and state finances.

The economic impact of changes in the use of the earnings of the permanent fund is significant because of the large size of the fund itself. However, since the fund grows more slowly as time passes the importance of any policy change regarding earnings disposition declines.

The most important impact of any use is upon the level of the fund balance itself. Reinvestment of earnings increases the balance significantly while using the earnings to increase state expenditures leads to rapid depletion of the general fund and any money which can be withdrawn from the permanent fund. Alaska Inc. and a personal income tax rebate occupy essentially middle ground in their impact on the fund since they prevent a faster balance buildup but do not increase demand on the fund as does an increase in state expenditures under the conditions of the "ratchet effect" of state spending assumed in the analysis.

In terms of aggregate economic impact, all alternatives were significant. Reinvestment of earnings shifts the pattern of growth toward more

rapid future growth while the opposite is true in the other. They all reflect the fact that an increase in the level of disposable personal income resulting from spending fund earnings results in overall growth of the economy much larger than the original change.

The cases in which growth of the economy is accelerated in early years also illustrate the fact that in these cases the slowdown necessitated by the financial difficulties projected for the state would also be larger.

Finally, the Alaska Inc. program seems to be more effective in getting additional income into the hands of individuals than a tax rebate. Because of the provision of multiple shares after every five year increment in a person's length of residence, the value of an individual share begins to erode in real dollars less than ten years after the program is instituted.

III. What are the economic impacts of the types of projects which might be financially assisted by the permanent fund? In particular, what would be the impact of a large refinery or fisheries enhancement program?

The petrochemical and fisheries enhancement projects cannot be directly compared to one another because of the large differences in size of the proposals and also because no explicit assumptions can be made regarding the method or size of permanent fund financial participation in either project. It is more valid therefore to concentrate on the comparison of each to a base case simulation. The petrochemical facility

represents a very capital intensive project while the fisheries enhancement program is labor intensive.

Construction of the petrochemical plant leads to a "mini-boom" which results in an apparent long run increase in the level of aggregate economic activity. The capital intensive nature of the refining process notwithstanding, the employment impact is substantial because the construction phase is relatively labor intensive. Both the "boom" and the long run economic growth are regionally concentrated in the Anchorage and Southcentral areas.

Fisheries enhancement results in growth of the economy which is not accentuated but it is steady and leads to substantial long run increases. Because of the regional dispersion of the hatcheries the impact is not concentrated in any region. Interestingly, however, nearly 50 percent of the growth occurs in Anchorage where there is no primary employment increase.

The refinery provides state tax revenues through the taxation of both business and personal income while the impact of the fisheries enhancement program is primarily in the form of personal tax increases. Revenues generated are significant but less than 1 percent of total state revenues by 1990 in either case. State expenditure growth exceeds revenue growth in each case by a considerable margin because of the target level set for state expenditures on a per capita basis.