

ALASKA LEGISLATURE SPECIAL COMMITTEE / SUBJECT FILES 8672

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

IV Objectives for Permanent Fund Investment

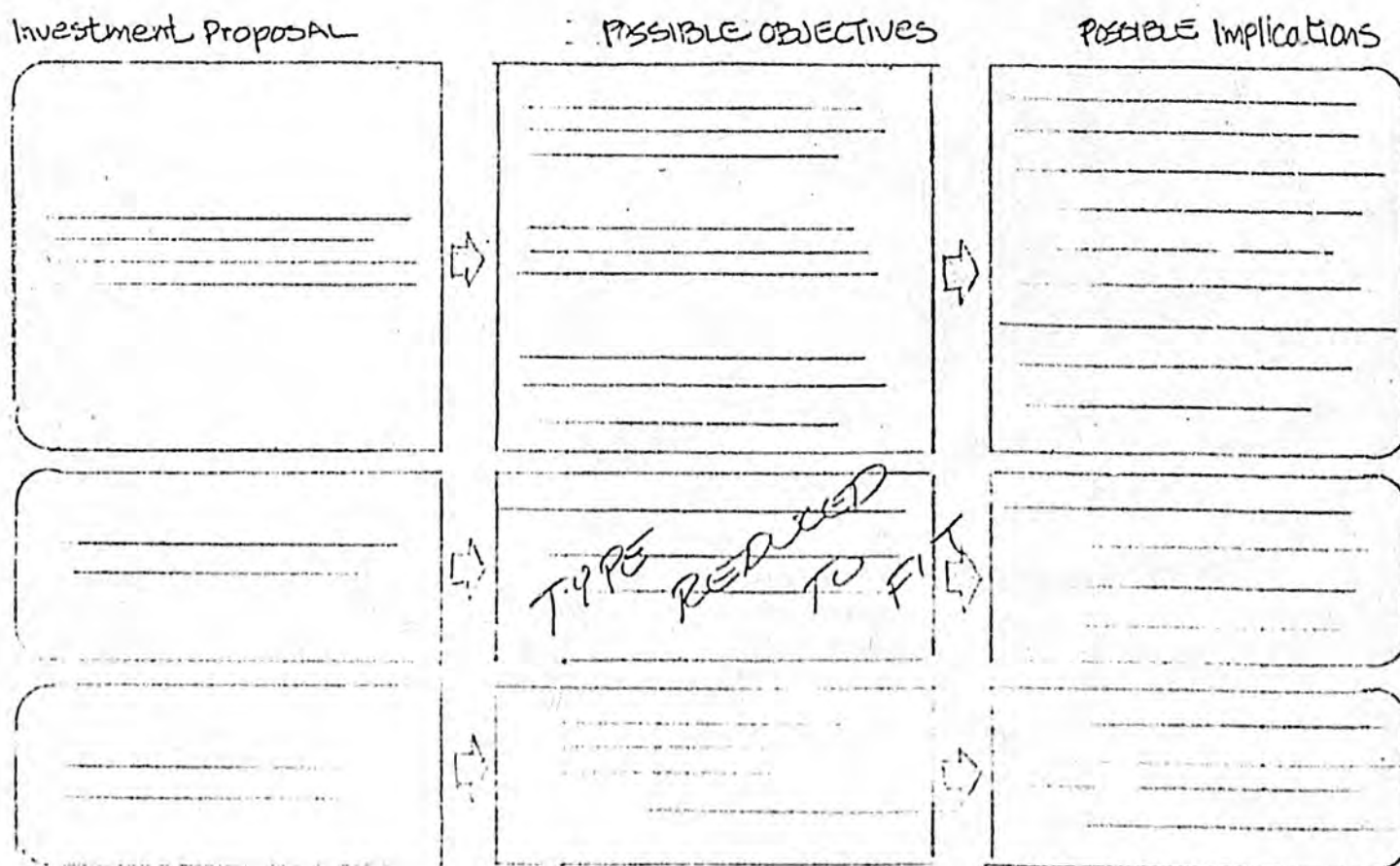
The people of Alaska should establish the overall objectives for their permanent fund. The committee hopes to achieve this through public meetings and other public participation information and participation programs to be held throughout the state in the coming months and through direct solicitation, such as the attached questionnaire. We need to know your priorities to write permanent fund enabling legislation.

The proposals listed below have emerged from the Alaska Public Forum, the State Investment Advisory Committee, survey research, and

concerned individuals. The list is not exhaustive, nor are the proposals or objectives mutually exclusive. Remember that the types of investments made will determine the amount of income the fund earns.

Before you evaluate these proposals, consider the following: Many of the proposals for in-state investment may involve an interest or risk subsidy; that is, the money is loaned at lower interest or in greater quantities than borrowers can obtain from private lenders. The fund would earn a lower return than the market rate, unless the

Figure 3 Possible Objectives and Implications for Investment Proposals



General Fund makes up the difference (which has been proposed).

Subsidies may only make sense if the loan or guarantee launches an in-state enterprise that not only repays the loan but also creates new individual tax sources to cover the original subsidy as well as the cost of additional state and local government services and environmental and social costs generated. If no in-state opportunities exist, the Permanent Fund cannot create them. All investments must be thoroughly evaluated to separate the winners from the losers.

Another point to ponder is that objectives may often conflict. Although different strategies may be used to pursue the same objectives, each

proposal lends itself to the achievement of some objectives more than others and even some to the exclusion of others. For example, a strategy which seeks to distribute fund benefits directly to individuals, such as consumer loans, will provide public facilities, such as through loans to municipalities. Likewise, strategies which seek to guide the State's economy through economic diversification, for example, probably will not maximize investment income.

Trade-offs are inevitable. As you identify the proposals that might best achieve your objectives, think about the likely trade-offs involved. Figure 3 shows sample investment proposals, their objectives, and a brief outline of the implications.

Investment Proposal	Possible Objectives	Possible Implications
	TYPE REDUCED TO FIT	

▽ USE of Fund Income

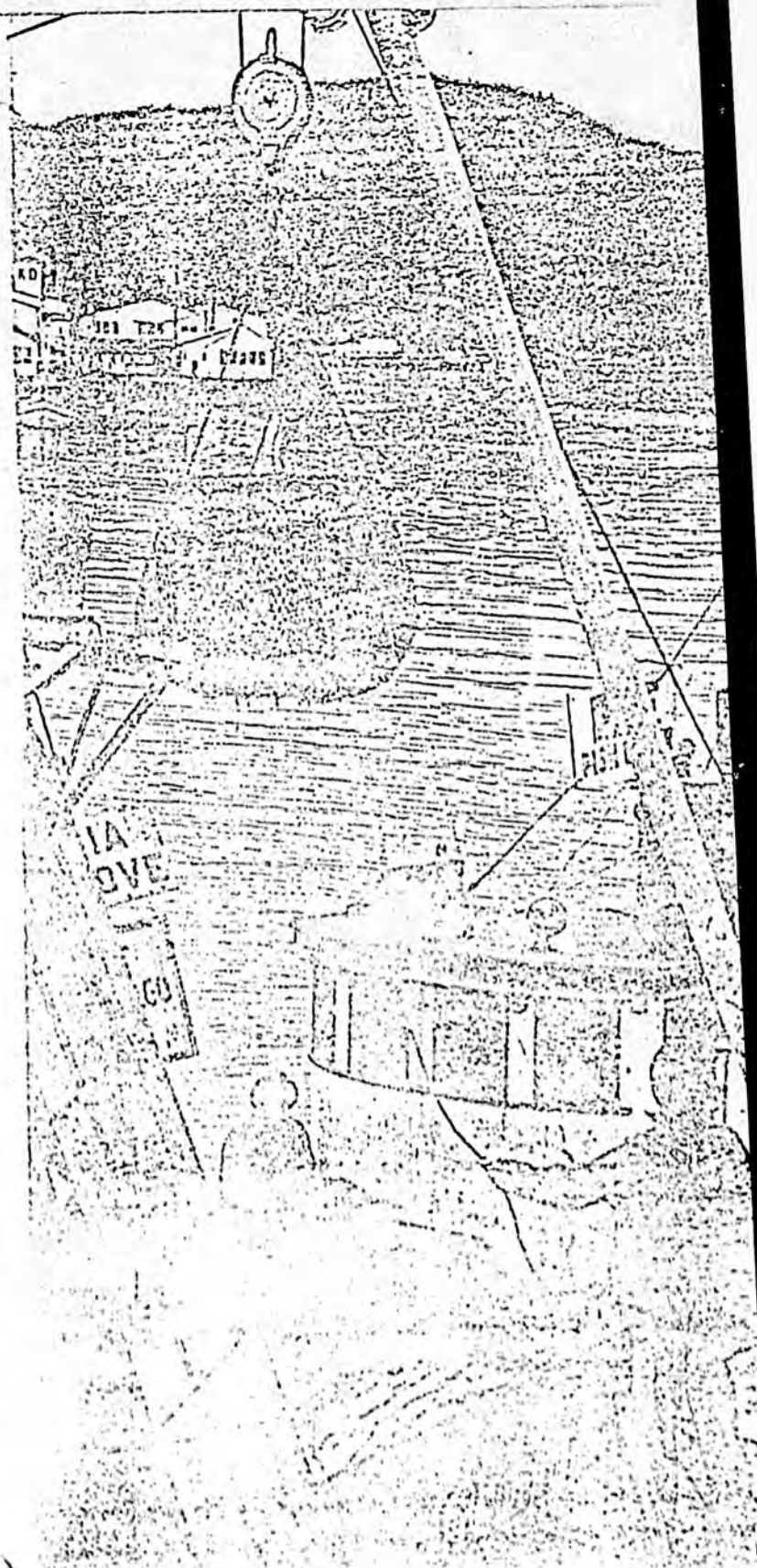
The income derived from investment of the Permanent Fund can be used for any purpose designated by the legislature. Before we present some of the most-often discussed proposals for use of the earnings from the Permanent Fund, we invite you to invent your own and include it as part of your response to this booklet.

The people who attended Alaska Public Forum meetings throughout the state last year and those who mailed in forum questionnaires expressed three main preferences for use of permanent fund income:

- (1) Reduce taxes for Alaska residents.
- (2) Loan it to Alaskans for renewable resource development.
- (3) Return it to the Permanent Fund for reinvestment.

The governor has proposed that a portion of the income be distributed directly to Alaska residents. This plan, which he calls "Alaska, Inc.," would issue "shares" to each Alaskan based on residency. Each shareholder would receive a percentage of the fund income as a dividend, a process which the governor feels would draw public attention to the operation and effectiveness of permanent fund investments.

Each of these options for use of the fund income involves trade-offs, as discussed in the previous section on objectives for investment of the principal, and you should consider them as you decide how you would like the income used. Since the investment policy of the fund will determine the amount of earnings and the potential impact permanent fund investment will have on the Alaska economy, the committee feels that the use-of-income question should not overshadow thorough analysis of permanent fund investment goals.



VI Objectives for the Control and Management of the Permanent Fund

A common concern of many Alaskans after realizing the potential dollar magnitude of their Permanent Fund is who will control this wealth. The only other fund of similar or larger size in state government is the General Fund. As discussed earlier, the constitution requires that all appropriations from the General Fund be made by the legislature and be subject to gubernatorial veto. After appropriation by the legislature, some agency of the executive branch usually administers general fund money.

The state constitution requires that the legislature determine what kind of investments are eligible for permanent fund money. However, the day-to-day management of the money may be delegated to an agency in the executive branch (as it is presently) or to an organization or organizations outside the legislative and executive branches.

The two critical management questions are: How much control over policy should be delegated by the legislature to another agency or agencies? To what extent will the managers in those agencies be accountable to the people of Alaska, either directly or through their elected officials?

If the legislature simply directs the managing agency to diversify the Alaska economy by making sound investments in Alaska's renewable and nonrenewable resources (one of the investment guidelines in H.B. 298), a great deal of discretion is left to the managing agency as to what is a sound investment, what resources to invest in, and which individuals or corporations will receive financing. For example, fund managers may decide to invest in a multimillion-dollar hydroelectric project, or they could use the same money for home loans to individual Alaskans.

Permanent fund managers must be account-

able to elected officials and the public, but at the same time, they should not be vulnerable to political and special interest pressures in the loan-making process. "Politics" will not necessarily be kept out of loan decisions by placing experts on a board which is not accountable to the executive or the legislature. Clear, widespread notice to the public about the types of loans that qualify, how loans are applied for and granted, disclosure requirements for decision makers, publishing list of loans or guarantees made, and regular auditing by the executive and legislative branches of government might provide at least a partial remedy to the control and accountability problems.

Current proposals call for appointment of managers by the governor (one adds confirmation by the legislature) with removal only for cause. The State Investment Advisory Committee discussed the possibility of elected members, but a brief look at Alaska's highly centralized government (with only the governor, legislators, and lieutenant governor being elected) indicates why this probably would not have been consistent with the state constitution.

An alternative to the highly centralized and rather independent management structure proposed in H.B. 298 would be for the legislature to provide for the administration of the Permanent Fund under the existing constitutional power of appropriation. The legislature, with approval of the governor, would designate eligible investments by law. The legislature annually would pass an investment bill for the Permanent Fund, much like the budget bill for the General Fund. The permanent fund investment bill would apportion available permanent fund money among the eligible investments.

Funds deposited in the Permanent Fund would temporarily be invested in liquid and secure money-market instruments pending each year's investment bill, as is now being done with permanent fund receipts. The legislature might choose to create new types of financial intermediaries and designate them as eligible for loans or loan guarantees in order to meet Alaska's changing capital needs. For example, the development bank corporation proposed in H.B. 298 could be one of the new financial intermediaries designated as an appropriate recipient of fund money. At the very least, legislative authorization could be required before loans exceeded a specific dollar amount.

The organization of the fund may profoundly affect how the fund performs, but the organization should reflect—not determine—the goals of the fund. Goals established today may not be those held by tomorrow's Alaskans. There must be built into any permanent fund structure both ability to protect the principal of the fund and responsiveness to meet changing goals.

VII The Permanent Fund Questionnaire

The Permanent Fund belongs to you. What are your suggestions for use of the money? Would you please take the time to share your ideas with us by indicating your preferences for permanent fund investment proposals. For each proposal, please answer the following questions. Feel free to suggest as many proposals as you think we should consider.

1. What investment proposal do you suggest and how is it income-producing for the Permanent Fund?
[Example — invest in blue chip, preferred stocks]

2. What objectives are achieved by your proposal? [Example — high return, flexible, no growth impact on Alaska, investment as secure as stock market]

3. What objectives are avoided by this proposal? [Example — no diversification of Alaska economy, does not affect unemployment, does not affect consumer loans]

4. What may limit the effectiveness of this proposal? [Example -- government can't move quickly in the stock market, investment is high and tied up for the duration of the investment, possible large losses]

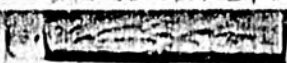
5. Which groups would benefit from this proposal? [Example — financiers, brokers]

6. What groups are likely to oppose this proposal? [Example — developers, people looking for a government dole through a subsidized loan, people who don't trust the stock market]

7. What are your suggestions for management of the Permanent Fund? Use reverse side for additional comments.

Note: If you would like to receive further information on the progress of this committee, please include your name and address|

cut this questionnaire along dotted line, fold so that our address is on the outside, and mail your comments.



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file publication

Alaska State Legislature

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House of Representatives

August 3, 1977

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OBJECTIVES FOR THE CONTROL AND MANAGEMENT
OF THE PERMANENT FUND

A common concern of many Alaskans after realizing the potential dollar magnitude of their Permanent Fund is who will control this wealth. The only other fund of similar or larger size in state government will be the general fund. As discussed earlier, all appropriations from the general fund are required by the constitution to be made subject to veto by the legislature. After appropriation by the legislature general fund money is, with a few exceptions, administered by some agency of the executive branch*

In regard to the Permanent Fund, the state constitution requires that the legislature determine what kind of investments are eligible for permanent fund money. The day to day management of the money may be, however, delegated to an agency in the executive branch (as it is presently) or to an organization or organizations located outside the legislative or executive branches.

There are two critical questions; First, how much control over policy should be delegated from the legislature to another agency or agencies. Secondly, to what extent will the managers in those agencies be accountable to the people of Alaska, either directly or through their elected officials, the governor and the legislators.

* The court system, the university of Alaska and Alaska Housing Finance Corporation are examples of these exceptions.

The permanent fund managers may make decisions, for example, as to whether to invest in a multi-million dollar hydroelectric project or to make a home loan to a particular individual. If the legislature were to simply direct the managing agency to deversifiy the Alaska economy by making sound investments in Alaska's renewable and non-renewable resources (this is one of the investment guidelines in HB 298) a great deal of discretion is left to the managing agency to decide not only what is a sound investment but what resources as well as individuals or corporations will receive financing.

Permanent Fund managers must be accountable to elected public officials and the public, but at the same time, an expressed desire to insulate the managers from political and special interest pressures. Current proposals call for appointment of managers by the governor (one adds confirmation by the legislature), with removal only for cause. The S.I.A.C. discusses the possibility of elected members, but a brief look at Alaska's highly centralized structure (with only the governor, legislature and lieutenant governor being elected) indicates why this probably would not be consistent with this policy in the state constitution.

It in order to shield the loan making process from "political INfluences" the fund is too insulated from policy directives of elective public officials, a large degree of both responsiveness and accountability to the public will be lost. "Politic" is not necessarily kept out of loan decisions by placing experts on a board which is not accountable to the executive or the legislature.

• The remedy may be, at least in part, to require understandable public notification of what type of loans qualify and how loans are applied for and granted, disclosure requirements for decision makers, public notice of loans or guarantees made, and regular auditing by reporting to the executive and legislative branches of government.

In contrast to the highly centralized and rather independent management structure proposed in HB 298, an alternative for consideration would be to allow the fund to continue to be invested by the State Department of Revenue in liquid and secure money market instruments in order to provide a capital pool which can be allocated by the legislature for loans or loan guarantees to a number of financial intermediaries under this approach, for example, the development bank corporation proposed in HB 298 would not be the Permanent Fund but only one of the types of financial intermediaries which could be designated as eligible for permanent fund money.

The organization of the fund may profoundly affect how the fund performs but the organization should reflect and not determine the goals of the fund. Goals established today may not be that held by tomorrow's Alaskans. There must be built into any permanent fund structure the ability to protect the principal of the fund and the responsiveness to meet changing goals.

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The State of Alaska may hold an estimated \$8.6-billion in surplus revenues by 1985. Required shares of oil and other resource revenue accumulating in the state's new Permanent Fund is expected to reach as high as \$7-million by 1985, while an additional \$2.6-billion balance is projected to accumulate in the state's general fund.

The \$8.6-billion assumes no new dramatic oil discoveries, or the leasing of potentially rich state owned offshore areas, such as the Beaufort Sea (adjacent to Prudhoe Bay).

Alaska faces difficult tasks in handling the growing excess revenues of the general fund in relationship to the state budget, and the growth of government, and also in setting up and managing the Alaska Permanent Fund.

However, it has now become obvious that the Permanent Fund is in itself one of Alaska's richest resources, and one which could have a strong relationship to future development in the state. It is further likely the Alaska Permanent Fund will accumulate so much capital that a significant portion of its investments must go outside the state for investment at "high but safe" returns, while the remainder will be made available through a variety of investment and consumer-loan programs within Alaska. However, serious philosophical issues will be generated around how the fund is developed, who controls the fund, how remote management should be from direct control of elected officials, and fund infringement into domains of banking.

THE ALASKA PERMANENT FUND IN PERSPECTIVE

Unlike many of his counterparts in other states, the Alaska policy maker has a distinct distaste for special funds in government. In 1955 the people of Alaska drafted a modern and highly streamlined state constitution, and one of its hallmarks was a prohibition against dedicated revenues. The new constitution created a highly centralized general fund concept, into which all revenues would flow, and out of which all expenditures would be budgeted. However, the prohibition excluded not only troublesome dedicated funds --funds where the revenue was tied to some particular spending function-- but also broadbased funds for the purpose of investing excess revenues.

The writers of the constitution did not anticipate the rose-colored world of excess revenues, and even after the entry into that charming world in 1969 Alaska policymakers were hesitant to tamper with the old prohibition for fear of creating a hazy and undisciplined line, one which would keep on moving, leading them back into the world of dedicated funds.

In 1976 a constitutional amendment modified the constitutional prohibition to allow a broadbased fund to accumulate (a minimum) of 25% of all incoming oil and other resource revenue from royalties, fees, land rents, and other bonus payments.

The only restriction on the permanent fund was that monies not be spent on the general operations of government. The funds only dedication was to maintain its principal and produce some income. The broadness of the amendment was also linked to another Alaskan "quality" --one of being double cautious not to "practice general law in the constitution."

In enacting the amendment it appears lawmakers did not see the fund as simply a savings account, nor did they see it as a super-development bank. At the point of initiation many lawmakers viewed the constitutional amendment, and the fund, as first simply a means of excluding a certain percentage of excess revenue from the province of normal operational state spending. The alternative structure created was left to the future as to apportionment of concept of the fund between trust fund, development bank, and source of small consumer loans for individual Alaskans.

BEGINNING WORK ON THE PERMANENT FUND

The legislature and executive are now just beginning the task of filling-in where the constitutional amendment left off. The amendment is intentionally broad, including almost anything that preserves the principal and earns some return.

The refined concepts of the permanent fund were left to "general law," and also intentionally subject to the revisions of future legislatures.

The 1977 legislative session will see a number of permanent fund bills introduced, and these bills will frame some of the permanent fund issues. However, action on the permanent fund will be delayed until the 1978 session, with the permanent fund becoming the subject of a complex hearing and public seminar program during the legislative interim. Portions of the interim effort may be on a cooperative effort between the legislative and executive branches (the seminars ??), despite partisan differences. It is also likely that hearings will use complex TV-coverage via-satellite, with two-way communication for citizen participation from even remote locations.

Additionally, the legislature may approve a number of television public affairs productions, along the lines of "60-minutes" in order to project some of the conceptual issues to the public prior to hearings.

LEGISLATION GOES INTO THE HOPPER

Some of the emerging issues surrounding the permanent fund might best be discussed by discussing one of the legislative proposals. On March 3rd, Governor Jay Hammond intorduced HB-298 " . . . relating to management of the Alaska Permanent Fund" On the same day the House Special Committee introduced HB-300 providing for the same, and being very close to the concepts of HB-298 except for asserting legislative perogatives in fund management.

The governor's bill was the work of the State Investment Advisory Committee, and consulting work of Price Waterhouse & Company (Washington D.C.), and White, Weld & Company, of New York. A great deal of the consulting work appeared to revolve around the "development bank" concept, and the method of operation of other principal funds in the world --ranging from the World Bank to the Alberta Cultural Hertitage Fund.

A "SUPER BANK" IN OVERALL FORM

The governor's HB-298 casts the permanent fund in the form of a "super bank" with a great deal of autonomy from the operations of the governor and the legislature.

The legislation creates an ALASKA PERMANENT FUND CORPORATION, a public corporation of the state, and while the corporation would be

be lodged within the State Department of Revenue, it would have an independent legal existence of its own. The serpateness tends to follow the World Bank pattern, providing an insulation from the political structure insuring loans will be based on sound economic criteria, even though social and many geographic-political factors will be weighed. In contrast the Alberta Fund is operated in a conventional government manner by their equivilant of our Department of Revenue.

The new legislation provides for 50% of all mineral lease rental income, royalty income, and bonus payments go into the permanent fund, an increase of 25% over the base 25% ired by the constitutional amendment. It should be noted HB-300, the legislative version of the permanent fund, would provide that 100% of all bonus payments go into the fund. Additionally, it should be noted that oil and gas (and mineral) severance taxes "do-not" go to the permanent fund, but rather to the general fund. Further, due to the wording of the constitutional amendment, and the legislative history of the resolution, it is doubtful if severance taxes can constitutionally ever be put into the fund.

The constitutional resolution was specifically amended in the senate to exclude severance taxes, creating a definitive negative history that the legislature meant to exclude severance taxes, and other taxes, leaving the legislation only the future option of putting non-tax income in the fund. The action was an example of Alaska's caution in dedicating funds, with the lawmakers wishing to be sure a future legislature could not get "carried away" and catch the state in the mire of dedication of revenue.

SUPERBANK PURPOSE --FUDGING TOWARD FLEXIBILITY

While the current legislative forms of proposed management for the permanent fund are cast in the overall mold of "superbank," the goals and purposes fudge considerably towards and mix of "trust for the future" and current consumer benefits.

The purposes clauses of the legislation tends to shy away from any one concept, such as trust, development bank, or consumer bank. The bill's preamble reads: "The purpose . . . is to provide a means of conserving revenues from mineral resources . . . to the benefit of present and future generations of Alaskans. The revenues . . . shall be invested in income earning investments which will provide further benefits to the present and future generations of Alaskans.

The preamble further speaks to the diversification of the Alaskan economy by investments in renewable and non-renewable resources, smoothing cyclical patterns of growth in the Alaskan economy, encouraging participation of private capital, promoting . . . capital for community purposes, and supplementing private investment.

It appears that the State Investment Advisory Committee considered the more definitive possibilities of trust or development bank, and specifically opted to soften the declared purpose of the fund. Alaska is unique in relationship to its proposed permanent fund, because while Alaskans perhaps want a measure of control over their economic destiny --want a measure of development-- they are aware that the great asset of Alaska may be its small population divided into a high margin of excess wealth.

COMPROMISE TRUST/DEVELOPMENT BANK/CONSUMER BANK

The administration and legislative bills both option for a split concept in the permanent fund, probably representative of the multi-faceted view which most originating lawmakers and the public have of the permanent fund.

The legislation provides the fund "must" invest 40-per cent of the permanent fund in investment grade securities, a bone for the trust fund or savings account principle, and insuring a maintenance of income for future generations of ns. Since the interest from the fund goes into the general fund, or at least can or cannot go into the permanent fund at legislative option, the earnings of a steadily growing 40 per cent could stand to back-stop general Alaska government operations at some future point should the government find itself in revenue jeopardy from exhaustion of tax-paying natural resources.

Second, the proposed legislation provides that not more than 30 per cent of the fund should go to provide a reasonable proportion of longer-term investment capital for financing expansion of productive enterprises, for which capital on reasonable terms is not available --hence, 30% development bank.

Third, the fund may go not more than 30 per cent for investment capital needs of community investment projects of municipalities (utilities) and private dwellings --hence, 30% consumer bank. It should be noted that Alaska is already deep into other consumer loan programs, such as the nation's number one student loan program, an extremely broad vets loan program, a number of fisheries loan programs, and others.

TOWARDS A BANK --THE POWER TO "BARROW"

The apportionment of money perhaps allocated a disappointing 30 per cent to development bank operations of the fund, but the pending legislation also confers the power to raise capital and barrow against the assets of the permanent fund --the power to expand the capital base of the development bank portion of the fund. Hence, the fund twists back from pro-trust in the larger 40% allocation of money to pro-superbank, with the legislation likewise conferring the power to grant debt guarantees, in addition to debt, in the case of the 30 per cent development bank portion of the fund.

THE STRUCTURE OF FUND MANAGEMENT

The overall policy board of the fund, called the PERMANENT FUND POLICY BOARD, would consist of the Commissioner's of Revenue and Commerce, and seven other members appointed by the governor. The seven gubernatorial appointments must be Alaska residents and not state employees. Terms would be four years and the issue of legislative confirmation remains a "difference" between the legislature and the executive. Further, members would only be removable for "cause," a familiar feature in boards and commissions of other states, but one foreign to the Alaska system where virtually all appointees serve at the pleasure of the governor. It is possible the policy board may end up serving "at the pleasure," based on the logic that lawmakers want responsibility firmly fixed on the governor, and that any "removal" from the policy board of a multi-billion dollar fund would be bound to attract thorough press scrutiny. The chairman of the policy board would be the President (actual manager) of the corporation (although he would not be a voting member).

The policy board would be charged with the broad policies of investment, with selecting the INVESTMENT COMMITTEE (the next layer of management), relations with the legislature and public, reviewing investments and performance, and providing for reports and audits of the fund. The policy board would adopt a five year plan, revised annually, and do the sectorial analysis of the Alaskan economy in order to guide investments into areas of economic need.

Beneath the policy board would be the PERMANENT FUND INVESTMENT COMMITTEE, consisting of the President (also Chairman of the Policy Board), who is appointed by the policy board and would serve at its pleasure, and four other members serving at the pleasure of the policy board.

The investment committee has sole responsibility for all investments, with the concept being one of "seperation and balance" of powers, with the investment committee not interfering in the overall policy decisions, and leaving that body to handle external political and special interest pressures. In the same vein the policy committee may not interfere in the individual decisions of the investment committee on individual loans, with the principle being insulating that investment committee from the pressures fielded by the policy committee.

Under the two board system the President --the executive manager of the fund-- is the link between the policy board and the investment committee, with the President being non-voting chairman of the policy board and a voting chairman of the investment committee. The concept is also one of fixing responsibility on the executive president.

The two board system points towards a procedure where the investment Committee would receive detailed proposals, and the staff produce a detailed analysis and recommendation free from external pressure.

The superbank management operation would have a great deal of discretion beneath the broad guidelines of the policy board. The staff could probably exercise a great deal of judgement in terms of providing all of the debt on a project, participating together with private capital, obtaining an equity share, or perhaps working with equity in such a way as to support offerings of local securities, in providing guarantees of private capital, and with other authorizing legislation, perhaps participate in an arrangement where interest rates are subsidized (the interest subsidy coming from a legislative appropriation in order to maintain the integrity of the permanent fund).

It should be remembered that the fund probably will be able to: 1) barrow to expand its development bank capital, 2) sell its securities and debt to other mortgage markets to recoup base capital, and 3) make investments in financial intermediaries who may be better able to manage small investments deemed to be too small to be under direct supervision of the permanent fund investment corporation.

The legislation as presently written follows normal development bank philosophy in declaring that the state corporation would never seek to control or manage a venture, regardless of financial condition. However, it is likely through its position the state would probably be aware of trouble on an early basis, and be able to 1) insist on various kinds of audits, 2) offer technical assistance, and 3) insist on timely consulting assistance and consulting management.

CONFLICTS OF INTEREST AND BOARD MAKEUP

The sophisticated superbank structure makes interesting drawing on organizational charts, but poses some serious issues in a state as small as Alaska.

Obviously the control of a multi-billion dollar corporation offers a source of great power, and likewise attracts greed from a multitude of special interests. One has only to look and see who sought to influence the State Investment Committee in their deliberations of the fund --the bankers.

The question will be posed in legislative scrutiny: "Where do we find people with knowledge and expertise to put on the policy board and investment committee who do not already have 'built-in' conflicts?" In larger states we might well find an abundance of people who have garnered excellent financial management experience, but long since departed those "special interest" institutions for academic life, or work in some large and more distant industry, where one might have reason to think the individual did not one day expect to return to their old occupation.

For example, one can expect the Alaska banker to have immediate conflicts over what are "reasonable terms" in the market, or a banker might not have an immediate interest in a project, but his rival is a participant in the package, or perhaps it might be the bankers "friendly rival." The potential for subtle bias on both the policy board and the investment committee is very high. Compounding the problem is the fact in the small Alaska structure it will be difficult to find knowledgeable board members without conflicts, and that same smallness may dictate that bank-employees may have to be prohibited from serving.

Playing with the structure of the superbank is a fascinating mental exercise until the more human issue of "who serves and where do they come from" is considered. Its sort of like a government finding a good director of banking or an insurance commissioner, if they have expertise it is likely they came from banking or insurance, who they are supposed to turn around and regulate. On the flip side of that coin, with political appointments being a precarious occupation, those so chosen likely expect to one day go back to their respective profession. The conflict is one of general institutional bias of both past association and expected future association, all of which stands completely separate from the problems of actual "hard" conflicts within the investment community.

It is possible that legislative interest could at first run strongly towards the superbank double-board structure, but at the end of the game the legislature throw-in the towel and simply opt for a permanent fund as a sub-unit of the Department of Revenue, or as a separate agency.

We must remember that Alaska in general has a love affair with a tight and highly centralized executive, and a phobia generally running against independent boards, commissions, and executive officials. The concept is one of fixing all responsibility with the governor and providing no place for that executive to pass-the-buck. In Alaska the governor is not only the sole elected executive official, but with only a few rare exceptions he has "no" officials, boards, and commissions which do not serve at his "sole pleasure." The centralized system with maximum accountability on the governor has worked well in Alaska and breeches in the system are not easily made.

A PROBLEM OF PUBLIC ACCOUNTABILITY

Another problem in structuring the fund is the accountability of permanent fund managers and policy makers to public officials, and therefore the public. The inter-relation of insulation from political and special interest meddling versus the need for accountability to the Alaska public stockholder is a difficult one.

The governor's proposed HB-298 puts the board on a staggered term appointment by the governor, but with removal only for cause, while the legislative bill requires "legislative confirmation," with removal also only for cause. There is a special set of constitutional problems in Alaska surrounding confirmation, which will be discussed later. However, it appears the governor's bill probably does not satisfy the issue of public accountability, since the policy makers and managers once appointed would not be accountable to the legislature, and only to a limited extent to the executive.

Consultants to the State Investment Advisory Committee recommended an elected Permanent Fund Policy Board as their way of solving accountability, but providing insulation from the legislature and executive (directly accountable to the public). However, a brief look back at Alaska's highly centralized structure (with no other elected administration officials except Lt. Governor), gives indication why this recommendation was not considered and simply would not "fly" in Alaska.

The next step is therefore confirmation of the policy board, providing involvement in the appointive process of both legislature and executive, but again Alaska's tightly-wound constitution presents some unique problems.

The Alaska Constitution grants confirmation power to the legislature for Department heads and certain other enumerated instances, but for years it was felt the legislature could provide by statute further offices to be required for confirmation. A 1975 Alaska Supreme Court decision has given the narrower view, again in line with Alaska's highly centralized executive concept, and there is some doubt as to whether confirmation of policy board members could be required if the corporation is a sub-unit of the Department of Revenue.

It is possible the legislature could set the Alaska Permanent Fund up as an entity in itself, virtually a department with corporate status, and therefore require confirmation of the President, and possibly the policy board. If the unit was set up under Section 26 of the constitution, which provides potential for exception from the straight-line executive accountability of the Alaska system (an appointive board with power of hire-and-fire over the departmental manager), then clearly the board would be available for legislative confirmation.

A third option which may be considered is to leave all policy board members serving at the pleasure of the governor, with or without the element of legislative confirmation. Such an option would make the governor publically accountable for their action in the Alaska tradition, with the protection of public questioning guarding against arbitrary removal of board members. In fact, in this day and age of public investigations, special prosecutors, public interest advocacy groups providing a special kind of public watchfulness, plus the scrutiny of the press, it is highly likely no other special protection and insulation for the fund policy board is needed.

THE WORLD OF THE PERMANENT FUND

All manners of potential can be dreamed up for the permanent fund, especially those portions assigned to a development bank concept or the so-called consumer bank.

First, a word about the consumer bank which will be discussed further in a forthcoming Alaska Series report on the history and evolution of the permanent fund (as a guide to understanding the fund in Alaska). The consumer bank is that portion of the fund which the individual Alaskan, the lone citizen, has some reason to think he might call on one day. Second, it is that portion of the fund which might participate in funding a community enterprise, perhaps some recreation function, or a unique utility, or some such entity with which the public might identify as a substantial permanent fund benefit reaching them "as a group."

The Alaska consumer bank has a history in the \$900-million bonus money and a variety of legislation which followed setting up loan programs ranging from a extremely liberalized veterans home loan program, a student loan program among the most liberal in the United States, a number of fisheries vessel and enhancement loan programs, to a state Municipal Bond Bank, and others. Many of these programs utilized what was called "mandatory purchase," a feature whereby the loaning program qualified and approved the loan, and the Department of Revenue was required to buy the loan with state excess revenues (revenues from the \$900-million).

It is likely for practical and political reasons that the permanent fund will have to allow for a portion assigned to public community loans, and other consumer loans.

It is possible that the so-called consumer loans might be loaned to an intermediary better able to administer the smaller loans, or that an automatic purchase system be set-up with a certain percentage of the fund assigned for legislated loan programs.

In the category of development bank there appear to exist many potentials, and also many potentials for conflict. The fund can provide a valuable source of total capital, cooperating capital, equity capital, guarantees, and etc. However, how the fund operates will draw both the bouquets and brickbats of both business and banker.

How will the banker feel about equity and participating capital in projects by-passing their banks? How about potential competitors in a field in relationship to a project in which the fund is a participant. For example, Alaska was brewing no beer of its own, all was exported, but when Alaska tried to grant a tax exemption to a potential brewery, the state and the brewery were mired in litigation with competitors selling beer in Alaska for several years.

Obviously the banker and the managers of the permanent fund may differ greatly as to when private capital is, or is not, available, and whether terms are "reasonable."

The fund may provide a valuable source of participating capital for the Native Land Claims Corporations, especially the more viable Village Corporations who might find that the fund is a key source for expanding their capital to the point where the smaller village corporation is viable.

It would appear that the permanent fund will prove an invaluable tool in providing frontier capital in Alaska's sprawling rural areas, where there is an underdeveloped economy in the extreme. However, such zones also represent a risky area of investment, and poses a difficult conceptual point for fund policy concerning acceptable risk (and the rules of investment).

The native corporation became a source of capital for these same underdeveloped areas, but those corporations also have found: 1) they must balance their portfolio with viable urban investments, and 2) that regardless of available capital frontier enterprise in an almost economyless zone is extremely difficult. Simply adding an associated investor in the form of the fund will not change the fact that any business emerging in the high-cost rural zones of Alaska is going to be a high risk operation.

The fund policymakers will have to wrestle with difficult rules of investment, balancing such aspects as broad social, economic, and political profits, against higher risk and loss of profits and capital (on occasion), and perhaps to what degree the higher profit and more secure portion of the fund portfolio --in the trust sector or more profitable urban bank structure-- should be gaged to offset expected loss from the frontier areas.

Both bills as introduced into the legislature currently declare for applicability of prudent-person rule, which could pose difficulties as the fund is applied to frontier loans.

Nevertheless, despite problems of investment in Alaska sprawling rural areas, it is obvious that Alaska now possesses, in native corporation capital and the fund, two extremely valuable economic tools.

Ten years ago in Alaska there essentially were no economic tools, or real hope of development capital, for the underdeveloped rural areas of Alaska and the peoples who live there.

The permanent fund and native corporation also have interesting parallels. The native corporation is a private firm with a unique social base of stockholders. It is not only motivated for profits but also social profits (jobs, business, etc. in rural areas). The fund is government with a probable twist in management and structure towards the private. Government's usual goal is social, but in the case of the fund it takes on the usual private purpose of "profits." The two unique structures may make good partners and understand each other better than many observers think.

FUTURE PERMANENT FUND REPORTS

The permanent fund will become the subject of a regular and ongoing series of Alaska Series Reports. The Series will follow the fund during the legislative interim as special committee actions begin to mold the policy and philosophy of the permanent fund, and in the near future will issue two brief reports. One of those reports will simply provide historical background of the fund, such things as why Alaska avoided a fund in 1969 when it received the \$900-million, and the gradual evolution to the present broadbased fund. The purpose of a report is simply to provide a source for observers to perhaps understand why Alaskans will shape the permanent fund in certain ways. The second report will simply make some comparisons of the Alaska Permanent Fund with other world monetary funds, and also deal with some financial projections dealing with the monetary potentials of the fund.

PERMANENT FUND QUESTIONNAIRE

INVESTMENT

The Permanent Fund belongs to you. What are your suggestions for the investment of the money? Would you please take the time to share your ideas with us by indicating your preferences for Permanent Fund investment proposals. For each proposal please answer the following questions. Feel free to suggest as many proposals as you think viable.

1. What investment proposal do you suggest for the Permanent Fund?
example - Invest in blue chip, preferred stocks.

2. What objectives are achieved by this proposal?

1-High return on investment 2-Flexible: funds can be shifted easily
with the flow of the market 3-No growth impact on Alaska 4-Investment
is secure

3. What objectives are avoided by this proposal?

1-Does not diversify Alaskan economy 2-Does not effect unemployment in
Alaska 3-Does not effect consumer loans

4. What are external constraints of this proposal?

1-Government must be able to move quickly in the stock exchange
2-Initial investment is high and tied up for the duration of the investment

5. Which groups would benefit from this proposal?

1-Financeers - brokers 2-All Alaskans because of guaranteed earnings.

6. What groups would be likely to oppose this proposal?

1-People who want to develop Alaska fast 2-People who don't understand
basic economics 3-People who are looking for a government dole through
a subsidized loan.

PERMANENT FUND QUESTIONNAIRE

CONTROL

In addition to the investment of Permanent Fund monies a policy on the control of the Fund must also be established.

What are your suggestions for who should manage the Fund?

Would you please take the time to share your proposals with the committee and answer the following questions about your suggestion?

1. Proposal for control of the Permanent Fund.

example - Two-tiered board. Policy board appointed by Governor, confirmed by legislature for 3 year, rotating terms. Management board composed of financial consultants hired by policy board. They are monitored in relation to the achievement of goals established by the Policy Board. A five year investment plan must be presented to and adopted by the legislature. This plan is reviewed and updated annually.

2. What objectives are achieved by this proposal?

1-Maintains accountability through the annual adoption of the investment plan
2-Removes political tinkering through the use of professional financial staff.

3. What objectives are avoided by this proposal?

1-Does not directly involve the citizenry in investment decisions.
2-Does not give either the Governor or the legislature direct control over the investment decision.
3-Does not allow great flexibility in investment except annual updates of the plan.

4. What are the constraints of your proposal?

1-Policy Board could become too powerful if the legislature does not take the time to thoroughly review the investment plan.
2-The integrity of both Policy Board members and management board members must be unquestionable.

PERMANENT FUND

Tom Singer's question

General

1. Do you believe that the government should use the permanent fund to actively intervene in the State's economy to pursue public policies?

a. If yes, how:

- market interest rate loans to any enterprise which can pay back the loan plus interest
- market interest rate loans to only a certain set of enterprises chosen by state policy - makers
- subsidized loans to chosen sectors to achieve clearly stated goals
- state organizations to assist certain sectors, such as state marketing, organizing, or information efforts, or technical aid or research efforts, etc.
- state owned and operated enterprises in chosen sectors

b. If no, what should the state do with the permanent Fund?

- put it in a savings account
- invest it in securities
- other

2. The permanent fund consists of two basic parts - principle^{al} and income. The principle is that sum which goes into the fund from oil revenues and is put to work (invested) to earn a return and perpetuate itself - i.e. it is permanent. The income is the return on those investments. Presently, the principle is expected to be _____ in 1977 and grow to _____ by 1985. Income from these funds, if invested at 8%, would be _____ in 1977 and _____ in 1985.

Consideration of the uses of the fund should be broken down into uses appropriate for the principle and for the income.

a. Regarding the principle, which alternative uses do you favor:

- Investments which maximize income, yet are secure and relatively riskless
- Investments which sacrifice some income in the pursuit of social objectives (e.g. subsidies to renewable resource industries, heavy industry, or consumers), yet are still relatively safe

b. Regarding the income, which alternative uses do you favor:

- Return it to the fund to earn money
- Return it to the General Fund for the legislature to use to pursue social objectives as it sees fit.
- Have the legislature earmark it for existing and new state loan programs
- Distribute it to Alaskans through an Alaska, Inc. type program
- Some combination of the above

- c. Regardless of whether the fund maximizes its return or is used to subsidize, are there areas of the state's economy you wish to see supported or discouraged through the permanent fund?

Heavy industry (coal development, aluminum refining, oil refining, petrochemicals, uranium refining, dams)

Light Industry (electronics,

Retail Trade (cooperatives,

Fishing

Timber

Hard - rock mining

Tourism

Agriculture

- d. In the previous question, you expressed your preferences about various sectors of the Alaskan economy. For the sectors which you prefer, why do you prefer them? For the sectors you disfavor, why do you disfavor them?

(write sector in column)
Prefer Disfavor

Employment potential

Personal income potential

Growth-inducement potential

Personal stakes

Lifestyle implications

Impact on recreation values

Impact of environmental quality

Impact on immigration

Other

- e. In the previous Public Forum, renewable resources received considerable public support as an area for state intervention.

Alaska State Legislature

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REP. LEO SCHAEFFER
REP. RICK URION

House of Representatives

July 15, 1977

THE ROLE OF THE PERMANENT FUND

IN ALASKA'S FUTURE:

A PRELIMINARY REPORT

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I. Introduction

An overwhelming majority of Alaska voters approved an amendment to the state constitution last November which provides that at least 25 percent of certain state nonrenewable resource revenues be placed in a permanent fund. The amendment requires that the fund's "principal shall be used only for those income-producing investments" the legislature designates as eligible for permanent fund money. The amendment also provides that income from the investments will go into the State's General Fund (where all other revenues and taxes are deposited) unless the legislature designates that income for other purposes.

In 1978 the Tenth Alaska Legislature will consider several different proposals for management and organization of the fund and use of the fund's earnings. Three bills introduced in the last session were referred to the House Special Committee on the Alaska Permanent Fund. Our task is to find out what Alaskans want the fund to achieve and to recommend legislation for a permanent fund that can best attain those goals.

The intent of this report is to inform Alaskans about the Alaska Permanent Fund--how it evolved, present management, possible future roles, and investment and management options for its principal and earnings. This report also allows committee members to state what they feel are the main issues to be resolved in the permanent fund enabling legislation.

We hope that you will take the time to study this booklet, jot down your comments and questions as you read, and send us your views by filling out and mailing the postage-paid questionnaire on the last page. You may obtain further information about the Alaska Permanent Fund by calling or writing:

House Special Committee on the Alaska Permanent Fund
528 West 5th Avenue, Suite 270
Anchorage, Alaska 99501 Phone: (907) 276-3433

Above all, please watch for and participate in the public meetings and

forums on the Permanent Fund to be held throughout the state beginning in September. If we have your comments by then, we can incorporate your ideas in the Public Forum program. Legislators will attend each forum to discuss the Permanent Fund, answer your questions, and find out what you want your Permanent Fund to be.

II. Evolution of the Permanent Fund

The permanent fund idea in Alaska gained popularity only after the \$900 million North Slope lease sale in 1969. Following this sale, the Brookings Institute conducted a series of seminars concerning "The Future of Alaska." More than 100 Alaskans were invited to attend, explore some of the major emerging policy issues, and set future goals and a practical policy plan for Alaska's future. The participants agreed that the "Alaska way of life" should be preserved. They defined this life-style as one which combines the conveniences of technological innovation with the opportunity and values of living as close to nature as possible.

After the Brookings seminars, several bills were introduced in the 1970 legislative session to establish some sort of "permanent fund" with the \$900 million. However, other more immediate uses for the money were judged to be more important, and no permanent fund was established.

The 1974 legislature passed a bill creating the Alaska Renewable Resources Development Fund. This legislation provides that not less than five percent of nonrenewable resources income will be deposited in a separate fund beginning July 1, 1978. Monies can be appropriated from the fund only for capital and operating expenditures for the rehabilitation, enhancement, and development of renewable resources programs.

Another bill, which would have created a permanent fund by statute, passed the legislature in 1975. However, because of a disagreement with the legislature over constitutionality, the governor vetoed it. The 1976 legislature passed House Joint Resolution 39, calling for a constitutional amendment to establish the Alaska Permanent Fund. The voters approved that amendment in November 1976 by a margin of nearly nine to one.

The amendment lifted the prohibition against special dedicated funds to

allow a minimum of 25 percent of all mineral lease rentals, royalties, royalty sale proceeds, federal mineral revenue-sharing payments, and bonuses to accumulate in a special fund separate from the General Fund. The only restriction on the use of the principal of the fund is that it must be for "income-producing investments" and, therefore, not for the general operating costs of government. The income from these investments will be deposited in the State's General Fund unless otherwise provided for by law.

The Joint House Finance and Judiciary Committee Chairmen's Report, detailing legislative intent for HJR 39, stated that sufficient revenue would be accumulated in the Alaska Permanent Fund to allow diversification of Alaska's economy and to insure that future generations receive benefits from development of the State's nonrenewable resources. The report noted that the fund would be restricted to income-producing investments "which the legislature would establish and change from time to time to meet the needs of the state." Use of the fund's earnings was left open to the legislature "to give future legislatures the maximum flexibility in using fund earnings--ranging from adding to fund principal to paying out a dividend to resident Alaskans."

Understanding the difference between permanent fund principal and the income the investment of principal earns is important. The principal represents Alaska's mineral wealth transformed into dollars through the sale of natural resources to private developers. The House Committee on the Permanent Fund must decide what forms of wealth-preserving and income-producing assets this money should take. Our mineral sale revenues have recently been financing about 60 percent of state expenditures. When revenue from mineral sources begins to decline, part of the future role of the Permanent Fund may be to supplement the General Fund with earnings from fund investments or to help create a tax base to provide new state revenue sources.

Presently, the income earned by permanent fund investments can be channeled into any use the legislature designates. The committee, therefore, must also recommend where and how to use the fund's earnings which, unlike use of the principal, need not produce income.

The governor anticipated voter approval of the permanent fund amendment. In August 1976 he temporarily expanded the membership and duties of the State Investment Advisory Committee, which is charged by statute to advise the commissioner of revenue on investment policy for the State. He appointed additional members from the general public and the legislative and executive branches and directed the entire body to study and report on the estimated size, investment goals, management, organization, and public interest in the Permanent Fund.

The State Investment Advisory Committee conducted its deliberations with energy and diligence. Members conferred with consultants to produce a draft proposal for a permanent fund structure. To arrive at its findings, the State Investment Advisory Committee examined consultants' reports on many of the resource-based monetary funds and development banks throughout the world.

In March 1977, two bills were introduced in the State House to begin debate on the structure of the Permanent Fund. Both bills would structure the Permanent Fund essentially as a development bank; both propose a two-tiered management system, a policy board with overall policy-making power, and a committee under the policy board to approve investment proposals. Both bills also give the president of the fund's corporation strong executive power and sole responsibility for presenting investment proposals of at least 40 percent of the Permanent Fund in high-grade securities, up to 30 percent in Alaska development loans, and up to 30 percent in community projects and private dwellings.

The two bills differ in level of funding and provision for confirmation of policy board members. House Bill 298 calls for deposits of 50 percent of proceeds from bonuses, mineral lease rentals, royalties, and federal mineral revenue-sharing payments, while House Bill 300 includes 100 percent of bonus payments and the same percentage from other sources. Except for the policy board appointment power of the governor (which is subject to legislative confirmation only under the provisions of H.B. 300), either proposal would operate the fund rather independently from the executive and legislative branches of state government.

In 1977 the legislature passed an interim permanent fund management bill that will stay in effect until specific investment objectives and management structure have been thoroughly examined and agreed upon. It directs the commissioner of revenue to invest permanent fund money into various "money-market instruments," such as U.S. treasury notes, certificates of deposit, and high-grade securities (not stock), all of which are relatively liquid and secure. By July 1, 1977 more than \$3.9 million had accrued to the Permanent Fund and been invested.

During the 1977 legislative session, the Speaker of the House and the President of the Senate appointed special committees to consider alternative proposals for the Permanent Fund during the legislative interim. The committees will gather and distribute information, listen to public opinion, seek expert advice, consider how the fund should be administered, establish major goals for the fund, and present their recommendations to the full legislature in January 1978. The committees will make major efforts in the areas of public education and participation to learn what Alaskans want their permanent fund to be. This booklet marks the beginning of this phase.

III. The Fund's Relationship to the Constitution and Other State Funds

Oil and minerals are a removable portion of Alaska's statehood entitlement to its citizens--past, present, and future. This nonrenewable wealth is now being extracted and transformed into another form of wealth--money. The decision to keep a portion of that wealth in a renewable status through dedication to the Permanent Fund provides an opportunity to protect that wealth from being spent and lost to future generations.

The form of the wealth is changing, yet the State still stands in the role of trustee, holding this resource wealth in trust for the benefit of the people of Alaska. Any objectives established for the Permanent Fund must be consistent with the same legislative obligations required for resource management. The legislature must decide into what income-producing assets permanent fund money should be placed. It is important to clearly define the obligations of the State before setting fund objectives.

The income earned from fund investments provides another source of wealth. Presently, a significant portion of state expenditures relies upon oil wealth. The legislature has already stated that one objective of the fund is to diversify the state economy. As oil wealth declines, the Permanent Fund may bear the responsibility of supplementing the General Fund through income from fund investment, creation of an expanded tax base, or some combination of the two.

The Permanent Fund is one of several tools policy makers can use to achieve public objectives. Each year the legislature appropriates money from the General Fund to finance state activities. As required by the constitution, the General Fund is the sole repository (with the exceptions of

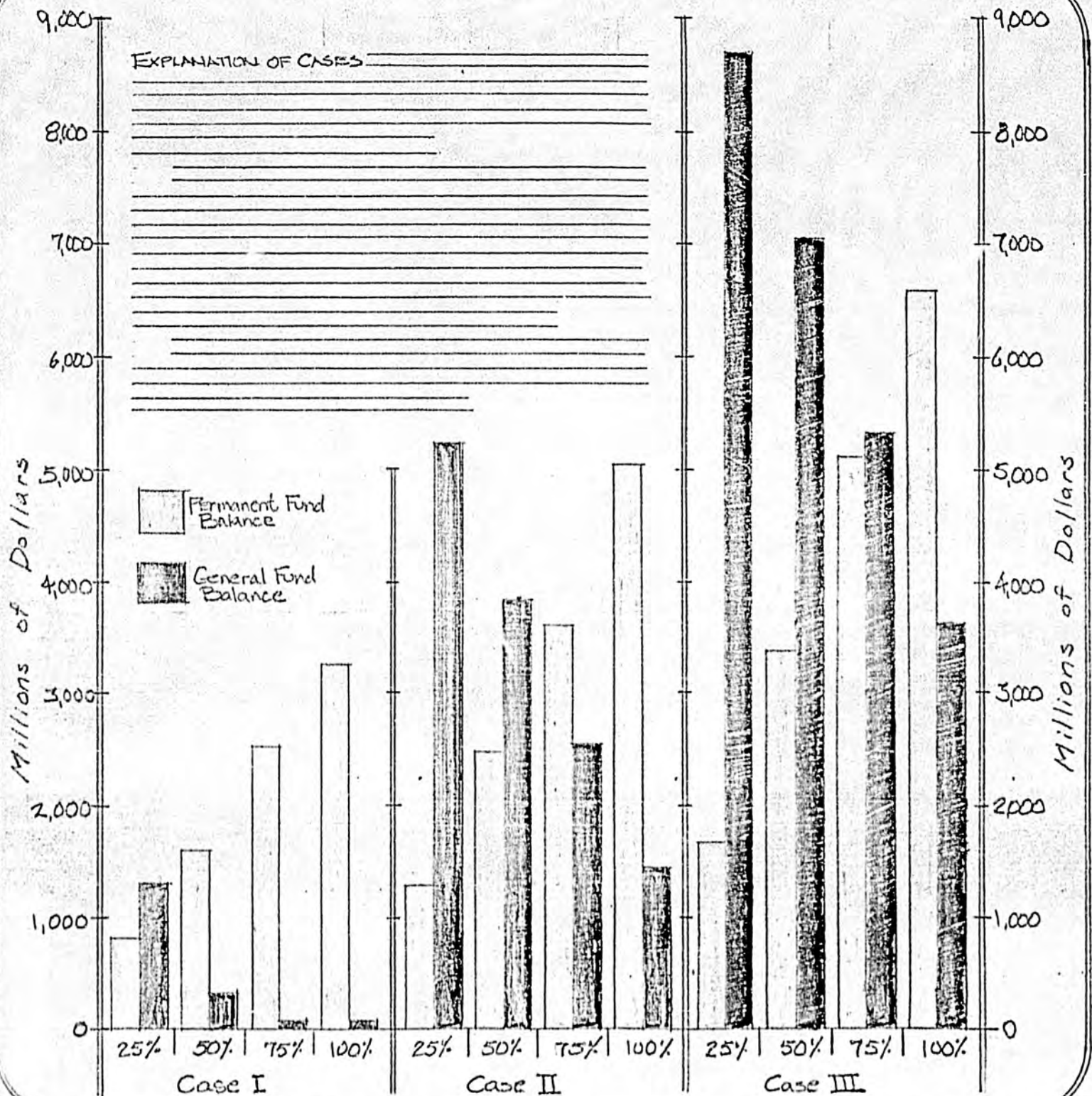
the Alaska Permanent Fund and the Renewable Resources Development Fund) of the Alaska P
all state revenues from all sources. The legislature is the only body em-
powered by the constitution to make appropriations (subject to veto by the
governor) from the General Fund for whatever purposes the Tegislature deems
proper.

The objectives of some of these activities may be similar to certain
proposed uses of the Permanent Fund. For example, the State currently main-
tains loan programs to promote a variety of interests, ranging from businesses
to senior citizens housing and home loans. Careful coordination with exist-
ing loan activities will help avoid duplication and conflict of programs.

The State also possesses extensive bonding powers and can pursue major
projects by issuing general obligation or revenue bonds. Special purpose
agencies, such as the Alaska Power Authority, can (with legislative approval)
provide for the financing of specific facilities. The State additionally
has mechanisms, such as the Municipal Bond Bank, to assist local governments
borrowing money to achieve their objectives.

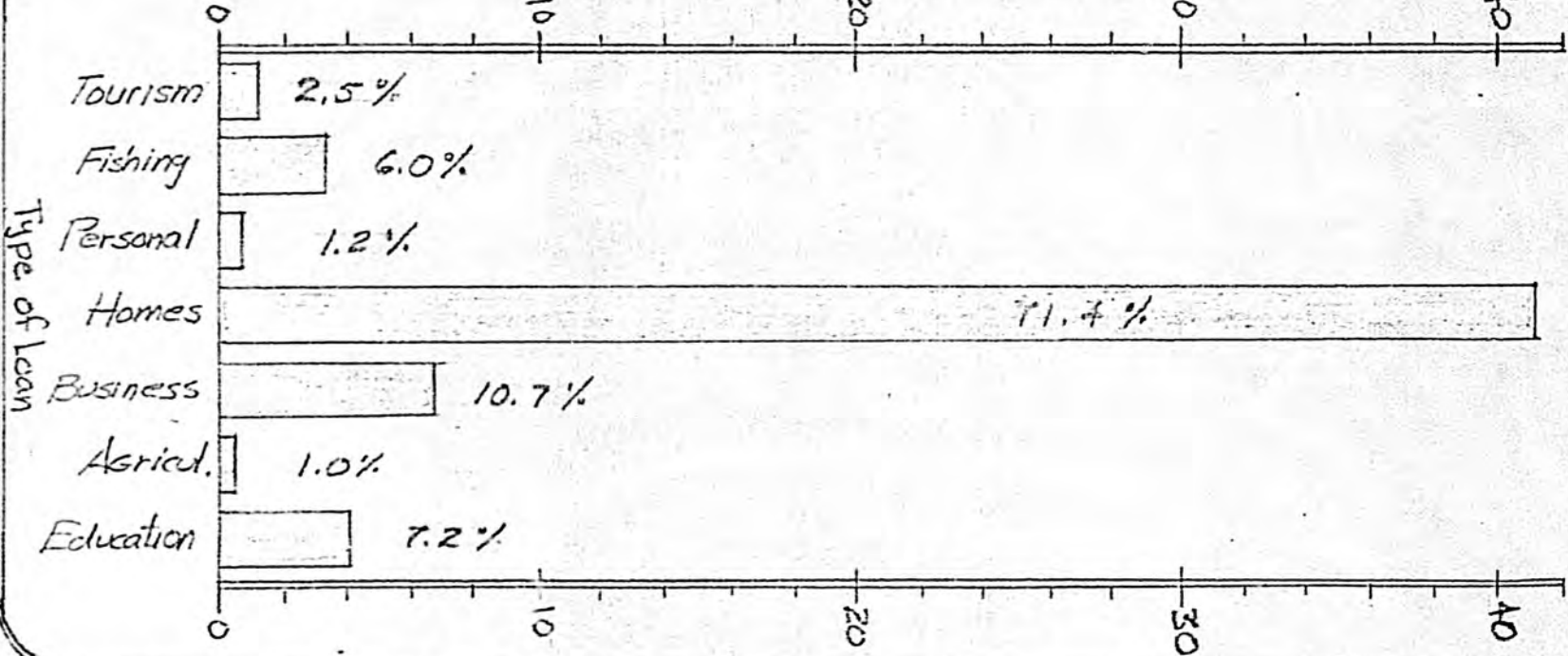
These various tools should be considered as we ponder alternative fund
uses so that we can best match tools with objectives. Further, provisions
for coordinating permanent fund and other government activities will be a
crucial element in developing the enabling legislation.

Revenue Projections through 1985



Value of loans (\$1000,000)

Loan Fund Activity
Fiscal Year 1976



The following state loan programs and activities are potentially eligible for permanent fund investment (i.e., they are "income-producing"):

(1) The Scholarship Loan Program provides loans to Alaska residents for post-secondary vocational and academic training with a forgiveness incentive to remain in Alaska after completing school.

(2) The Fisheries Enhancement Revolving Loan Fund supports loans to nonprofit organizations or individuals for the development of hatcheries.

(3) The Municipal Bond Bank Authority is an independent public corporation established to assist communities in Alaska to develop needed public facilities by marketing general obligation bonds. The bond bank will purchase these bonds, offering its own revenue bonds to the public bond market.

(4) The Division of Business Loans administers five revolving loan funds and two public corporations--the Small Business Revolving Loan Fund, the Tourism Revolving Loan Fund, the Commercial Fishing Revolving Loan Fund, the Child Care Facilities Revolving Loan Fund, the Water Resources Revolving Loan Fund, the Alaska State Development Corporation, and the Small Business Development Corporation. These five loan funds enable qualified businesses and public utilities to obtain long-term financing for developing, expanding, or modernizing their operations.

(5) The Veterans Affairs Revolving Loan Fund makes loans to qualified Alaska national guardsmen and veterans in Alaska. These loans may be used to purchase, refinance, build and remodel homes, farms, businesses, and multiple dwellings. In addition, a qualified veteran may receive a loan for education, fishing, mining, or personal use.

(6) The Agricultural Revolving Loan Fund provides long-term, low in-

throughout the state.

(7) The Senior Citizen Housing Development Program provides loans and grants to municipalities, housing authorities, and other nonprofit local sponsors to stimulate new housing construction and for rehabilitation of existing units for senior citizens.

(8) The Alaska State Housing Authority (ASHA) and the Alaska Housing Finance Corporation (AHFC) are operated by the state for public and low-cost housing programs and state-supported financing for low- and moderate-cost private sector housing development. Currently, ASHA receives almost all of its funding from the U.S. Department of Housing and Urban Development, and currently manages housing units throughout the state. AHFC makes or buys mortgages on low- or moderate-income housing, insures mortgages, and makes home improvement loans and loans for other associated costs of home ownership, including down payments, to qualified persons or developers. In addition, the State has established 13 regional native housing authorities with powers essentially similar to those of ASHA. The federal government provides virtually all of the funds for these activities, so state participation is minimal and limited to insured short-term loans.

(9) The Alaska Power Authority is designed to promote the development of hydro-electric and fossil fuel power sources for domestic Alaska usage. The authority is generally empowered to issue bonds and notes to finance power development activities in the state, with the debt being secured by the projects themselves or by the earnings of these projects. This program is still in the formative stages and has yet to issue bonds.

IV. Objectives for Permanent Fund Investment

The people of Alaska should establish the overall objectives for their permanent fund. The committee hopes to achieve this through public meetings and other public participation information and participation programs to be held throughout the state in the coming months and through direct solicitation, such as the attached questionnaire. We need to know your priorities to write permanent fund enabling legislation.

The proposals listed below have emerged from the Alaska Public Forum, the State Investment Advisory Committee, survey research, and concerned individuals. The list is not exhaustive, nor are the proposals or objectives mutually exclusive. Remember that the types of investments made will determine the amount of income the fund earns.

Before you evaluate these proposals, consider the following: Many of the proposals for in-state investment may involve an interest or risk subsidy; that is, the money is loaned at lower interest or in greater quantities than borrowers can obtain from private lenders. The fund would earn a lower return than the market rate, unless the General Fund made up the difference (which has been proposed).

Subsidies may only make sense if the loan or guarantee launches an in-state enterprise that not only repays the loan, but also creates new individual tax sources to cover the original subsidy as well as the cost of additional state and local government services and environmental and social costs generated. If no such in-state opportunities exist, the Permanent Fund can't create them. In-state investments must be

to be thoroughly evaluated to separate the winners from the losers. The proposals should be

Another point to ponder is that objectives often conflict. Although different strategies may pursue the same objectives, each proposal lends itself to the achievement of some more than others and even some to the exclusion of others. For example, a strategy which seeks to distribute fund benefits directly to individuals, such as consumer loans, will provide public facilities, such as through loans to municipalities. Likewise, strategies which seek to guide the state's economy through economic diversification, for example, will not maximize the income from fund investment.

Some other possible "tradeoffs" are:

employment	vs.	immigration
economic diversification	vs.	environmental degradation
size of state government	vs.	quantity and quality of public service

Tradeoffs are inevitable. As you identify the proposals that might best achieve your objectives, think about the tradeoffs involved. Figure 3 shows sample investment proposals, their objectives, and a brief outline of the implications.

Figure 3

Possible Objectives and Implications for Investment ProposalsInvestment ProposalPossible ObjectivesPossible Implications

1. Loans or loan guarantees subsidizing various in-state basic industries with emphasis on renewable resources.

- Diversify the Alaska economy
- Employ Alaska residents
- Enhance a stable economy
- Prepare for oil production downturn
- Create future economic tax base for state

- Lower return, higher risk
- Possible stimulus for immigration
- High potential for government inability to achieve objectives
- Environmental degradation
- Government growth through increased demand for facilities and services
- Less equal distribution of benefits

2. Investment in high-yield, low-risk securities either inside or outside the state.

- Provide earnings higher than available from subsidized loans
- Maintain flexibility of the fund for investment in Alaska during economic downturns

- State economic development will proceed according to national and international considerations
- Less economic diversification

3. Loans to or loan guarantees for small business and for purchase of homes.

- Encourage small business and home ownership
- Expand availability of consumer loans to distribute benefits of resource wealth
- Stimulate the economy

- Fund used more for consumption, less for investment
- More equal distribution of benefits

4. Loans to or bond guarantees for municipalities for capital improvements.

- Provide more financing for public projects

- Lower return due to tax exempt status of government borrowing
- Increase in municipal budgets for operating expenses
- Provide more amenities, stabilize communities
- Decentralizes actual investment decisions

5. Loan or loan guarantees for energy development

- A. Large-scale: hydroelectric, geothermal, tidal, wind
- B. Small-scale: wind, solar, heat exchange, hydroelectric

- Decrease dependence on fossil fuels
- Increase availability of power throughout the state

- Large scale investments may be locked up for long periods of time; will attract high energy-consuming industries
- Potential stimulus for immigration
- Possible environmental degradation and subsequent industrialization
- Cheaper electricity for consumers
- Small-scale promote energy efficiency
- Lower cost of energy for state use

Figure 3

Diversification of Alaska's economy.

Diversification of Alaska's economy.

Loans or loan guarantees to various basic industries with emphasis on renewable resources industry.

Employment of Alaska residents.

Enhancement of a stable economy compatible with environmental concerns.

Investment in savings such as high yield-low risk securities which involve investments mostly outside the state.

Maintain liquidity of Fund and a capital pool for investment in Alaska during an economic downturn while preventing over investment during times of high economic activity.

Provide higher earnings than available from in-state subsidized loans for operating expenses of government.

Same as a) except to pay out indirect dividends to Alaskans or return to the Fund to keep it abreast of inflation.

Loans to or loan guarantees for small business and for purchase of homes.

Encourage small business and home ownership.

Expend availability of consumer loans to distribute benefits of oil wealth.

Stimulate the economy.

Loans to or loan or bond guarantees for municipalities for capital improvements.

Provide more financing for improvements and amenities which the quality of life in Alaska communities.

Loan or loan guarantees energy development such as hydroelectric, wind, geothermal, tidal and heat exchange.

Decrease dependence of fossil fuels.

Provide power for a growing population.

Raise standard of living in rural areas.

V. Use of Fund Income

The income derived from investment of the Permanent Fund can be used for any purpose designated by the legislature. Before we present some of the most-often discussed proposals for use of the earnings from the Permanent Fund, we invite you to invent your own and include it as part of your response to this booklet.

The people who attended Alaska Public Forum meetings throughout the state last year and those who mailed in forum questionnaires expressed three main preferences for use of permanent fund income:

1. Reduce taxes for Alaska residents.
2. Loan it to Alaskans for renewable resource development.
3. Return it to the Permanent Fund for reinvestment.

The governor has proposed that a portion of the income be distributed directly to Alaska residents. This plan, which he calls "Alaska, Inc.," would issue "shares" to each Alaskan based on residency. Each shareholder would receive a percentage of the fund income as a dividend, a process which the governor feels would draw public attention to the operation and effectiveness of permanent fund investments.

Each of these options for use of the fund income involves trade-offs, as discussed in the previous section on objectives for investment of the principal, and you should consider them as you decide how you would like the income used. However, since the investment policy and structure of the fund itself will determine the amount of earnings and since the fund involves much more money, its potential impact on

and society, the Alaska economy and society may be far greater.

Therefore, the committee feels that the basic use-of-income

question should not overshadow thorough analysis of permanent fund

investment goals.

Objectives for the Control and Management of the Permanent Fund

A common concern of many Alaskans after realizing the potential dollar magnitude of their Permanent Fund is who will control this wealth. The only other fund of similar or larger size in state government is the General Fund. As discussed earlier, the constitution requires that all appropriations from the General Fund be made by the legislature and be subject to gubernatorial veto. After appropriation by the legislature, some agency of the executive branch usually administers general fund money. (The court system, University of Alaska, and Alaska Housing Finance Corporation are examples of some of the exceptions.)

The state constitution requires that the legislature determine what kind of investments are eligible for permanent fund money. However, the day-to-day management of the money may be delegated to an agency in the executive branch (as it is presently) or to an organization or organizations outside the legislative and executive branches.

The two critical management questions are: How much control over policy should be delegated by the legislature to another agency or agencies? To what extent will the managers in those agencies be accountable to the people of Alaska, either directly or through their elected officials?

If the legislature simply directs the managing agency to diversify the Alaska economy by making sound investments in Alaska's renewable and nonrenewable resources (one of the investment guidelines in H.B. 298), a great deal of discretion is left to the managing agency as to what is a sound investment, what resources to invest in, and which individuals or corporations will receive financing. For example, fund managers may decide to invest in

million-dollar hydroelectric project, or they could use the same money for home loans to individual Alaskans.

Permanent fund managers must be accountable to elected officials and the public, but at the same time, they shouldn't be vulnerable to political and special interest pressures. If the loan-making process is to be shielded from political influences by insulating fund managers from policy directives of elected officials, a large degree of both responsiveness and accountability to the public will be lost.

Current proposals call for appointment of managers by the governor (one adds confirmation by the legislature) with removal only for cause. The State Investment Advisory Committee discussed the possibility of elected members, but a brief look at Alaska's highly centralized government (with only the governor, legislators, and lieutenant governor being elected) indicates why this probably would not have been consistent with the state constitution.

"Politics" will not necessarily be kept out of loan decisions by placing experts on a board which is not accountable to the executive or the legislature. Clear, widespread notice to the public about the types of loans that qualify, how loans are applied for and granted, disclosure requirements for decision makers, publishing list of loans or guarantees made, and regular auditing by the executive and legislative branches of government might provide at least a partial remedy to the control and accountability problems.

An alternative to the highly centralized and rather independent management structure proposed in H.B. 298 would be for the legislature to provide for the administration of the Permanent Fund under the existing constitutional power of appropriation. The legislature, with approval of the governor, would designate eligible investments by law. The legislature annually would pass an investment bill for the Permanent Fund, much like the budget

perpetual fund. The bill for the General Fund. The permanent fund investment bill would apportion the available permanent fund money among the eligible investments.

Funds deposited in the Permanent Fund would temporarily be invested in liquid and secure money-market instruments pending each year's investment bill, as is now being done with permanent fund receipts. The legislature might choose to create new types of financial intermediaries and designate them as eligible for loans or loan guarantees in order to meet Alaska's changing capital needs. For example, the development bank corporation proposed in H.B. 298 could be one of the new financial intermediaries designated as an appropriate recipient of fund money.

The organization of the fund may profoundly affect how the fund performs, but the organization should reflect--not determine--the goals of the fund. Goals established today may not be those held by tomorrow's Alaskans. There must be built into any permanent fund structure both ability to protect the principal of the fund and responsiveness to meet changing goals.

nal VII. Permanent Fund Questionnaire VII. Permanent Fund Questionnaire VII. Permanent Fund Questionnaire

A. Investment

The Permanent Fund belongs to you. What are your suggestions for use of the money? Would you please take the time to share your ideas with us by indicating your preferences for permanent fund investment proposals? For each proposal, please answer the following questions. Feel free to suggest as many proposals as you think we should consider.

1. What investment proposal do you suggest and how is income-producing for the Permanent Fund? [Example - invest in blue chip, preferred stocks]
2. What objectives are achieved by your proposal? [Example - high return, flexible, no growth impact on Alaska, investment as secure as stock market]
3. What objectives are avoided by this proposal? [Example - no diversification of Alaska economy, does not affect unemployment, does not effect consumer loans]
4. What may limit the effectiveness of this proposal? [Example - government can't move quickly in the stock market, investment is high and tied up for the duration of the investment, possible large losses]
5. Which groups would benefit from this proposal? [Example - financiers, brokers]
6. What groups are likely to oppose this proposal? [Example - developers, people looking for a government dole through a subsidized loan, people who don't trust the stock market]
7. What other comments do you have on this proposal?

Permanent Fund Questionnaire

B. Management

In addition to the investment of permanent fund monies a policy on the management and control of the Fund must also be established. What are your suggestions for who should manage the Fund? Would you please take the time to share your proposals with the committee and answer the following questions about your suggestion?

1. Proposal for management of the Permanent Fund. [Example - two-tiered board, with policy board appointed by governor, confirmed by legislature; management board of financial consultants hired by policy board. Board monitored in relation to their achievements. A five-year investment plan presented to and adopted by the legislature, reviewed and updated annually]

2. What objectives are achieved by this proposal? [Example - maintains accountability through annual adoption of investment plan, removes political tinkering through use of professional financial staff]

3. What objectives are avoided by this proposal? [Example - doesn't directly involve citizens in investment decisions, no direct control by the governor or the legislature, doesn't allow great flexibility in investment except for annual updates of five-year plan]

4. What are the constraints of your proposal? [Example - policy board could become too powerful if the legislature doesn't thoroughly review the investment plan, the integrity of both policy board members and management board members must be unquestionable]

5. What other comments do you have on this proposal?

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

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INTRODUCTION

An overwhelming majority of Alaska voters approved an amendment to the state constitution last November which provides that at least 25 percent of certain of the State's nonrenewable resource revenues be placed in a permanent fund. It further states that the fund's "principal shall be used only for those income-producing investments" the legislature designates as eligible for permanent fund money. The amendment also provides that income from the investments will go into the State's General Fund (where all other revenues and taxes are deposited) unless the legislature designates that income for other purposes.

In January 1978 the Tenth Alaska Legislature will consider several different proposals for management and organization of the fund and use of the fund's earnings. Three bills were introduced in the last session and were referred to the House Special Committee on the Alaska Permanent Fund. Our task is to find out what Alaskans want the fund to achieve and to recommend legislation for a permanent fund that can best attain those goals.

The committee produced this report to inform Alaskans about the Alaska Permanent Fund--how it evolved, present management, possible future roles, and investment and management options for its principal and earnings. This report also allows committee members to state what they feel are the main issues to be resolved in the permanent fund enabling legislation.

We hope that you will take the time to study this booklet, jot down your comments and questions as you read, and send us your views by filling out and mailing the postage-paid questionnaire on the last page. You may obtain further information about the Alaska Permanent Fund by calling or writing:

House Special Committee on the Alaska Permanent Fund
528 West 5th Avenue, Suite 270 (276-3433)
Anchorage, Alaska 99501

Above all, please watch for and participate in the public meetings and forums on the Permanent Fund to be held throughout the state beginning in September.

THE BIRTH AND EVOLUTION OF THE PERMANENT FUND

Following the 1969 Prudhoe Bay lease sale, the Brookings Institute conducted a series of seminars concerning "The Future of Alaska." More than 100 Alaskans were invited to participate, to explore some of the major emerging policy issues, and to set future goals and a practical policy plan for Alaska's future. The participants agreed that the "Alaska way of life" should be preserved. They defined the Alaska life-style as one which combines the conveniences of technological innovation with the opportunity and values of living as close to nature as possible.

Following the Brookings seminars, several bills were introduced in the 1970 legislative session to set up some sort of "permanent fund" with the \$900 million generated by the Prudhoe lease sale. However, other more immediate uses for the money were judged to be more important, and no permanent fund was established.

The 1974 legislature passed a bill creating the Alaska Renewable Resources Development Fund. This legislation provides that not less than five percent of renewable resources income will be deposited in a separate fund beginning July 1, 1978. Monies can be appropriated from the fund only to provide for capital and operating expenditures for the rehabilitation, enhancement, and development of renewable resources programs. Funds not expended within the fiscal year will be invested in the same manner as general fund balances, but use of the income is restricted to funding

capital and operating appropriations for renewable resources programs. When the unappropriated balance reaches \$250 million, the development fund ceases and this balance is invested as other surplus funds are, with the interest dedicated to renewable resource programs.

49 A bill which would have statutorily created a Permanent fund passed the legislature in 1975, but Governor Hammond vetoed it and reintroduced the concept in 1976. The 1976 legislature passed House Joint Resolution 39, calling for a constitutional amendment to establish the Alaska Permanent Fund. The voters approved that amendment in November 1976 by a margin of nearly nine to one. While it is not possible to specifically state the intentions of the voters in approving the Permanent Fund amendment, it has been widely and probably fairly assumed that most voters hoped that by establishing the fund, a portion of Alaska's nonrenewable resource wealth would be saved from the day-to-day spending for operations of state government.

The amendment modified the constitutional prohibition against special dedicated funds to allow a minimum of 25 percent of all mineral lease rentals, royalties, royalty sale proceeds, federal mineral revenue-sharing payments, and bonuses to accumulate in a permanent fund.

The only restriction on the use of the principal of the fund is that it must be for "income-producing investments" and therefore not for the general operating costs of government. The income will be deposited in the State General Fund unless otherwise provided for by law.

The joint House Finance and Judiciary Committee chairmen's report on HJR 39 stated that "sufficient income would be accumulated in the Alaska Permanent Fund to allow diversification of Alaska's economy and to insure that future generations receive benefits from development of the State's nonrenewable resources." The report noted that the fund would be restricted to income-producing investments "which the legislature would establish and change from time to time to meet the needs of the state." Use of the fund's earnings was left open to the legislature "to give future legislatures the maximum flexibility in using fund earnings--ranging from adding to fund principal to paying out a dividend to resident Alaskans."

In August of 1976, prior to voter approval of the Permanent Fund amendment, the governor, in anticipation of the establishment of the fund, temporarily expanded the membership of the State Investment Advisory Committee (S.I.A.C.) to include additional members from the public at large and the legislative and executive branches. The S.I.A.C., which is charged by statute to advise the commissioner of revenue on investment policy for the state, was then directed by the governor to study and report on the following questions:

1. The estimated size of the Permanent Fund.
2. Investment goals of the fund.
3. Fund management and organization.
4. Public interest in the fund.

The S.I.A.C. quickly began its deliberations with energy and diligence, and over the next seven months worked with consultants from Price-Waterhouse and Co., White, Weld and Co., and the Alaska Pacific Bank to produce a draft proposal for a permanent fund structure. That proposal was introduced on March 3, 1977 as House Bill 298. On the same day, this committee introduced H.B. 300, which is very similar to H.B. 298, except for a higher level of funding and provision for legislative confirmation of the governor's appointments to the permanent fund policy board.

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Both H.B. 298 and 300, now under consideration by the legislature and this committee, would structure the Permanent Fund essentially as a development bank, which except for the appointment authority of the governor would operate rather independently from the executive and legislative branches of government. In arriving at its findings, the S.I.A.C. through its consultants examined a great number of resource-based monetary funds and development banks throughout the world.

Deposits to the fund were raised in HB 298 to include 50 per cent of all mineral lease rentals, royalty income, and bonus payments. (H.B. 300 includes 100 percent of bonus payments.) Both bills propose a two-tiered management structure, a policy board with overall decision-making power, and a committee under the policy board to approve investment proposals. Forty percent of the Permanent Fund would be invested in high-grade securities, 30 percent in Alaska development loans, and 30 percent in community projects and private dwellings.

In 1977 the legislature passed an interim management bill for the permanent fund until specific investment objectives and management structure have been thoroughly examined and agreed upon. The interim management bill directs the commissioner of revenue to invest permanent fund money into various "money-market instruments," such as U.S. treasury notes, certificates of deposit, and high-grade securities (not stock), all of which are relatively liquid and secure. By July 1, 1977, the more than \$3.9 million accruing to the Permanent Fund to that date had been invested in these liquid money-market instruments.

In the 1977 legislative session, the House and Senate appointed special committees to consider alternative proposals for the Permanent Fund during the legislative interim. The committees will gather and distribute information, listen to public opinion, seek expert advice, consider how the fund should be administered, major goals for the fund, and present their recommendations to the full legislature in January 1978. The committees will spend a major effort on public education and participation to learn what Alaskans want our permanent fund to be. This booklet marks the beginning of this phase of the House committee's work.

ALTERNATIVE OBJECTIVES FOR THE PERMANENT FUND

Before the legislature establishes a management structure for the Alaska Permanent Fund, the objectives of the Fund should be considered in widely held public discussions and clearly delineated in the enabling legislation. If a consensus on various broad visions for Alaska can be reached, legislation to enable the Permanent Fund to achieve these visions can be more easily drafted.

The Permanent Fund can be viewed as a fiscal tool - one of many possible tools available for management of the state's short term surplus wealth. Before decisions are reached on the objective or objectives to be assigned the Permanent Fund it should be recognized there are, in addition to the all-purpose general fund, over a dozen active state loan funds through which millions of state dollars are funnelled to achieve objectives similar to those which may be considered for the Permanent Fund.

The Committee believes that the legislature, by defining a limited number of objectives for the Permanent Fund and by devising an effective method for coordinating and reviewing the objectives and performance of all the various loan programs, better management of Alaskan short term wealth could result.

General proposals for use of the Permanent Fund money have already emerged through the Alaska Public Forum, the State

Investment Advisory Committee and survey research. These proposals broadly stated together, intended objectives are as follows:

Major Proposals

Major Objectives Sought
to be Achieved

- | | |
|---|---|
| 1. Loans or loan guarantees to various basic industries with emphasis on renewable resources industry. | a) Diversification of Alaska's economy.
b) Employment of Alaska residents.
c) Enhancement of a stable economy compatible with environmental concerns. |
| 2. Investment in savings such as high yeild - low risk securities which involve investments mostly outside the state. | a) Maintain liquidity of Fund and a capital pool for investment in Alaska during an economic downturn while preventing over investment during times of high economic activity.
b) Provide higher earnings than available from in-state subsidized loans for operating expenses of government.
c) Same as a) except to pay out indirect dividends to Alaskans or |

return to the Fund to keep it
abreast of inflation.

3. Loans to or loan guarantees for small business and for purchase of homes.

- a) Encourage small business and home ownership.
- b) Expand availability of consumer loans to distribute benefits of oil wealth.

c) Stimulate the economy.

4. Loans to or loan or bond guarantees for municipalities for capital improvements.

- a) Provide more financing for improvements and amenities which the quality of life in Alaska communities.

5. Loan or loan guarantees energy development such as hydroelectric, wind, geothermal, tidal and heat exchange.

- a) Decrease dependence on fossil fuels.
- b) Raise standard of living in rural areas.

c) Provide power for a growing population.

d) ^{Attract} ~~Attract~~ high energy consuming industries.

The above list of proposals is certainly not exhaustive nor are the proposals or objectives mutually exclusive. Various uses of the income earned from any of the investments are possible but it should be recognized that many of the in-state proposals for investment would involve an interest subsidy and therefore lower earnings for the Permanent Fund or shareholders in "Alaska, Inc."

Before picking the proposal or proposals and objectives you feel may most properly be assigned to the Permanent Fund, a brief discussion of the implications of the above investment proposals or strategies is in order.

LOANS TO BASIC INDUSTRIES FOR DIVERSIFICATION OF THE ECONOMY

If diversification of the Alaska economy is a main objective of making loans or loan guarantees to basic industries involving either renewable or non-renewable resource development, it is reasonable to assume that the particular enterprises needing venture or development capital would seek help from the Permanent Fund only because it provided cheaper capital (lower interest charges) or capital that otherwise was not available from private sources. The Fund in comparison with other possible investments would be most likely getting a lower return for taking relatively high risks in making these loans or loan guarantees to encourage new or more diversified basic industries.

Under what circumstances, then, would it be wise to forego

higher income from earnings on our state investments where no subsidy in terms of low interest loans was involved? The objective of diversification only makes sense when the loan or guarantee is reasonably expected to launch an in-state enterprise which at some time in the near future will not only pay back the loan but will produce corporate or individually taxable incomes which can cover the original subsidy and the cost of state and local governmental services required by the enterprise. If there are no such enterprises there is nothing the Permanent Fund or any development banking scheme can do to create them. Obviously, a method of analysis which separates most of the winners from the losers is required.

CONSTITUTIONAL, LEGAL, AND MANAGEMENT ISSUES

Once objectives for the permanent fund have been established, there are still a number of issues to be resolved, within certain constitutional and legal limitations, such as the permanent fund's relationship to other state funds, its management structure, investment guidelines, and the use of the permanent fund income.

The Alaska Constitution is the fundamental limitation of the power of the state legislature. Article VIII (Natural Resources) of our constitution allows for evolving principles of management of all resources of Alaska under State jurisdiction. For example, it directs that fish, wildlife and water, in their natural state, be reserved for the common use of the people. The "common use" principle has evolved over thousands of years since it was first introduced into script in Roman law.

The Alaska Constitution declares that lands, and resource interests in them, wherever under state jurisdiction, are "public lands." The framers originally intended to add that those public lands would be held in trust. However, they finally withdrew that specific language and provided for certain fundamental constitutional limitations and obligations in natural resource management and gave broad powers to the legislature to "provide for the utilization, development and conservation of the public domain." The framers intended that the limitations and obligations of the State in managing our resources evolve through legislative

policy making and judicial interpretation.

The legislature presented the Permanent Fund to the voters because members recognized that changing needs in developing non-renewable resources of the State since Alaska's constitutional convention dictated a more specific mandate of trust obligations. In essence, the legislature asked the voters, "Pursuant to our broad obligation to manage your resources in the capacity of trustee, do you want us to create a permanent trust fund with part of the nonrecurring resource wealth?" The imperative language of the amendment created the trust fund.

This is an important perspective while analyzing the constitutional limitations of Permanent Fund investments. The one obligation the Permanent Fund amendment burdened the State with was that investments be "income-producing." The definition of this obligation will undoubtedly evolve as the other fundamental constitutional concepts have, but it is fairly clear that the intent was that the Permanent Fund be used to help diversify Alaska's economy and ensure that future generations benefit from nonrenewable resource development today.

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Investment guidelines have not been defined beyond those fundamental objectives of the trust fund. One crucial investment question is whether the fund must be managed to keep abreast with inflation. If protection of the fund's principal was foremost in the minds of the amendment's creators, as the dominance of the word "permanent" in the amendment suggests, then the State may well be obligated to

ture may adopt certain of these for Fund management, ranging as widely as guaranteeing that a certain percentage of investment in commercial projects in Alaska will flow to "small businesses" to mandating a cost-benefit analysis in renewable resource projects.

Relationship to other State Funds

The Permanent Fund is not an isolated part of state financial workings; it does not exist in a void. The legislation enabling operation of the Permanent Fund must recognize its relationship to the State General Fund, existing (and proposed) loan programs, and to capital projects.

While the Permanent Fund will be structured in an attempt to achieve state goals, the effort to shape the growth of the State's economy through the permanent fund will only succeed if the expenditure or investment of these other state funds must also be tied to state goals. In fact, the impact of general fund surpluses may prove even more critical in terms of state policy since fewer constraints exist on how such money may be used.

The State's General Fund is a relatively inefficient mechanism for dealing with short-term revenue surpluses because (1) the political process tends to allocate total available revenues without systematic consideration of longer term economic and social consequences or actual effectiveness of spending; (2) Existing fiscal mechanisms were virtually all enacted during periods of revenue scarcity and have an innate bias towards maximizing their share of fiscal

keep the Fund's earnings in pace with the rate of inflation. The legislature could adopt that as a policy in the enabling act. Nevertheless, we know that if Fund earnings must at least match the inflation rate, investment policies will probably differ from policies if they need not match inflation. It could mean that the Fund would have to secure its money in high return-minimum risk investments in order to keep up with inflation, which could preclude most Alaskans from participation.

Another issue for resolution involves the constitutional provision which states that "at least 25 percent" of mineral-derived income shall be put in the Permanent Fund. Are amounts in excess of this 25 percent that might be designated by any legislature for deposit to the Fund a permanent part of the Fund or subject to removal under certain circumstances?

One other possible constitutional problem is legislative confirmation of the appointment of managers for the Permanent Fund. The Alaska Constitution grants confirmation powers to the legislature for department heads and certain other officials, but the Alaska Supreme Court recently held that the confirmation powers are restricted to those specific officials. A resolution was introduced this year to remedy this problem by proposing an amendment to the constitution subjecting the managers to legislative confirmation.

Beyond specific constitutional obligations, the legislature is left with broad enabling powers of the natural resources article to mandate other Fund obligations. Trust law places many obligations on fund managers that are not specifically referred to in our constitution. The legisla-

resources; and (3) political pressures on future legislatures will be virtually insurmountable to distribute available revenues if surplus general fund revenues exist. Thus, the General Fund should only receive those funds which will not be detrimental to long-run growth objectives set for the state.

The State maintains loan programs to promote a variety of interests, ranging from businesses to senior citizen housing and home loans. Before considering the potential effectiveness of these programs, several points are important to consider:

(1) Since loans are interest-bearing investments, they are potentially eligible for backing by the Permanent Fund.

(2) Under current law, however, there is no requirement that the Permanent Fund purchase such securities, nor is there any provision allowing permanent fund monies to be used for funding such programs directly.

72. (3) There is no current provision requiring coordination between ongoing state objectives (as exemplified by the loan programs and their statutory objectives) and the investment objectives of the Permanent Fund. Also, though it is generally argued that the State operated these loan programs to enhance development by providing goods and services which otherwise would not be available in the private sector, there is no concrete evidence that they have.

While investments of permanent fund money in state loan programs may be attractive, several problems exist which should be considered. State loan programs intentionally sub-

sidize specific sectors of the economy and society, so the Permanent Fund would earn a lower return on invested capital than it could if invested elsewhere.

The State Investment Advisory Committee suggested one answer to the problem of differential rates of return. The General Fund could reimburse the Permanent Fund for the difference between the subsidized rate and the market rate. However, the growth impacts of such a program are not easily predictable or controllable. Presently, there do not appear to be any legislative or administrative checks on the quality or volume of loans. Unless controlled by permanent fund legislation, this could result in a ballooning of state loans with only marginal increases in carrying costs (since the only appropriated cost to the State would be the interest differential subsidy).

Accordingly, if existing loan programs are to be used as investment vehicles for the Permanent Fund, a policy that would make such investment levels contingent on annual appropriations or an absolute or percentage limit on permanent fund participation in state loan programs would be appropriate.

If the legislature chooses to allow use of some permanent fund money to support state loan programs, the existing and prospective investment and development activities of the fund must be coordinated. Otherwise, prospective borrowers in Alaska could have access to three or more major state funding sources, only one of which would be directly accountable to the legislature for appropriations.

It would be possible to use the Permanent Fund as a purchasing agent of state bonds, thus financing at least portions of the State's capital improvements. This has the advantage of internalizing the State's bonding activity and turning long-term obligations into long-term revenue sources (as repayments are made to the Permanent Fund). However, the differential in rate of return to the Fund (since State bonds are tax-exempt, their rate of return is lower than high-grade corporate securities) and possible distorting effects on the state's growth rate argue against such a use of the fund. In addition, the bond market currently acts as a brake on the temptation for the state to issue excessive amounts of debts, preventing problems when revenue sources dry up.

Another important public policy question is whether the Fund should be decentralized through the use of regional funding mechanisms or financial intermediaries. Development banks, cooperative banks, credit unions, community development corporations, technology development corporations, and use of land and water conservation funds and the Renewable Resource Development Fund have all been suggested as ways to decentralize the Fund's economic power.

Management Structure

The organization of the Fund's management may profoundly affect how the fund performs, but it should reflect, and not determine, the goals of the fund. Who will invest the money and how the investment process will work are as important as the choice of investments.

Permanent Fund legislation must address the following management issues:

(1) Structure - The Permanent Fund could organizationally resemble a corporation, a credit union, a development bank, or some other financial entity, or could be managed through our current legislative and executive system. Presently, the Fund (under the interim management bill) is being administered by the Department of Revenue and could continue to be so administered. The structure will largely determine whether the economic power of the Permanent Fund is centralized or decentralized. For example, the development bank model centralizes the fund's economic clout, but leaves questions about responsiveness to community and regional needs.

(2) Evaluation of Fund Performance - The legislature must delineate methods for evaluation and audit of Permanent Fund performance. How are the benefits and costs of investments to be evaluated? How can the benefits of job stimulation be balanced against the costs of environmental degradation? This is a complex area that is closely tied to the fund's goals as well as its structure.

(3) Flexibility - The legislature intended that the Permanent Fund would be flexible enough to meet changing

state needs. The structure must allow a shifting of the flow of capital investment as rapidly as conditions demand.

(4) Accountability and Control of Fund Managers - Permanent Fund managers must be accountable to elected public officials and the public, but at the same time insulated from political and special interest pressures. Current proposals call for appointment of managers by the governor (one adds confirmation by the legislature), with removal only for cause. The S.I.A.C. discusses the possibility of elected members, but a brief look at Alaska's highly centralized structure (with only the governor and lieutenant governor being elected) indicates why this probably wouldn't be consistent with the rest of state government policy.

If in order to shield the loan making process from "political influences" the fund is too insulated from policy directives of elective public officials, a large degree of both responsiveness and accountability to the public will be lost. "Politics" is not necessarily kept out of loan decisions by placing experts on a board which is not accountable to the executive or the legislature.

The remedy may be, at least in part, to require plain understandable public notification of what type of loans qualify and how loans are applied for and granted, disclosure requirements for decision makers, public notice of loans or guarantees made, and regular reporting of activities to the executive and legislative branches of government. It might also be wise to require legislative approval of large loans (e.g. all loans over \$25 million).

Use of Permanent Fund Income

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Income derived from Permanent Fund investments (interest) will be deposited in the general fund unless otherwise provided for by law. The interim management bill now governing the fund specifies no other use of the income; however, several alternatives have been suggested for enactment in the final management bill.

Participants at Alaska Public Forum meetings throughout the state last year expressed three main preferences for the use of Permanent Fund income. Many suggested that the income simply be returned to the Permanent Fund for reinvestment.

Others suggested that the income be loaned to Alaskans for renewable resource development. This could be accomplished through the Permanent Fund, the Renewable Resources Development Fund, or other state loan programs for resource development. A third major choice voiced at the Public Forum was to use the income for tax cuts for Alaska residents.

The governor has proposed that a portion of the income be distributed directly to Alaska residents. This plan, which he calls "Alaska, Inc.," would issue "shares" to each Alaskan based on residency. Each shareholder would receive a percentage of the fund income as a dividend, a process which the governor feels would draw public attention to the operation and effectiveness of Permanent Fund investments.

Obviously, the income the fund earns will vary from year to year, but because no restrictions have yet been made

on its disposal, more innovative and creative choices can be considered. In terms of potential impact on the Alaska economy, the investment policy of the fund itself is more significant than the use of the income. Accordingly, it would not be wise to allow the question of possible use of the income to overshadow thorough analysis of investment goals to be established by the legislature.