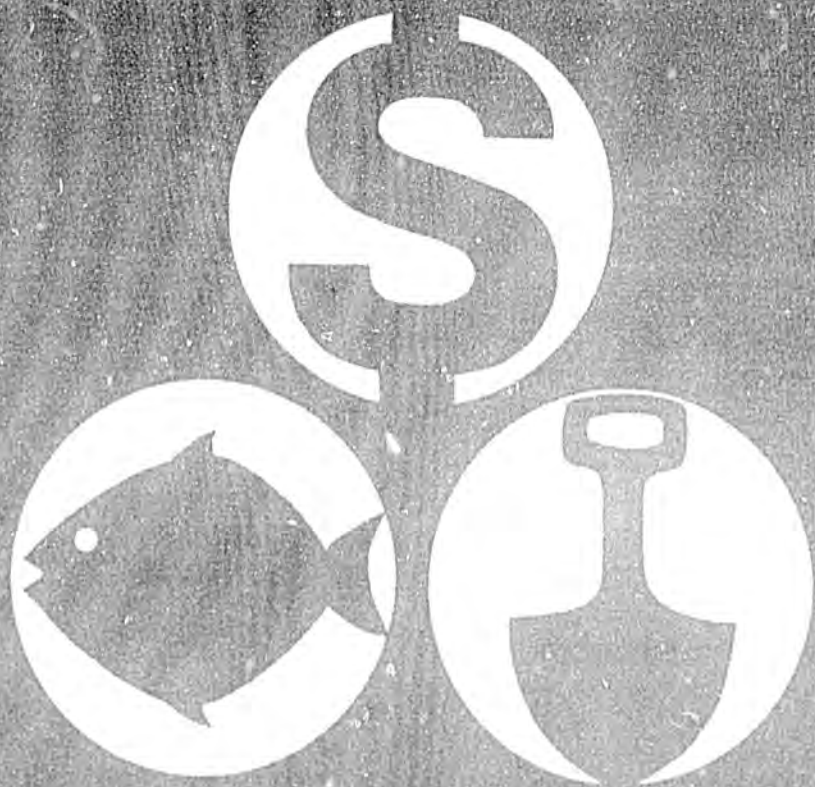


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The Role of the Permanent Fund in Alaska's Future



A Preliminary Report by
the House Special Committee
on the Alaska Permanent Fund

Special Committee on
The Alaska Permanent Fund
(907) 276-3433
528 W. 5th, Suite 270
Anchorage, AK 99501
[Pouch V, Juneau, AK 99811]
(907) 465-3873

Members
Rep. Clark Gruening, Chmn.
Rep. Terry Gardiner, V. Chmn.
Rep. E. J. Haugen
Rep. Russ Meekins
Rep. Bill Miles
Rep. Leo Schaeffer
Rep. Rick Urion

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I Introduction

An overwhelming majority of Alaska voters approved an amendment to the state constitution in November 1976 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 1977 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 questionnaire on the back cover. 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 Alaska 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, to explore some of the major emerging policy issues, and to set forth a 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."

The principal represents Alaska's mineral wealth transformed into dollars through the sale of natural resources to private developers. The legislature 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 House Committee on the Permanent Fund, 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 directed the advisory committee 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 draft legislation 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 measures propose a two-board 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 permanent fund corporation strong executive power and sole responsibility for presenting investment proposals to the investment committee. Both proposals require that at least 40 percent of the fund must be placed in high-grade securities, but allow up to 30 percent of the assets to be invested in Alaska development loans and another 30 percent in community projects and private dwellings. Except for the appointment of the policy board members (who are subject to legislative confirmation under only one of the bills), both proposals would allow the fund to operate rather independently from the executive and legislative branches.

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. As of July 15, 1977 four million dollars had accrued to the Permanent Fund and had all been invested in a savings account in the Bank of America and in U. S. Treasury notes. Almost \$45,000 in interest has been earned in the first five months of its existence.

The House Special Committee on the Alaska Permanent Fund met on July 15 and 16, 1977 and heard testimony from a number of expert witnesses; two of whom presented papers on the establishment of the fund ("Economic Considerations in Establishment of Alaska's Permanent Fund" by Arlon Tussing, Institute of Social and Economic Research, University of Alaska and "Thinking About the Alaska Permanent Fund: A Cautious Approach for Alaskan Policymakers" by Belden Daniels, Department of City and Regional Planning, Harvard University). Copies of both papers are available from the Committee on request.

One of the major thrusts of Dr. Tussing's testimony was that there is no need or useful function for permanent fund investment in major industrial or commercial enterprise in Alaska, unless special reasons existed to subsidize them. Dr. Tussing's report infers that, at least initially, it makes more sense to invest the major portion of the fund outside the state.

Dr. Daniels emphasized that no development bank can create economic activity not already in existence; if there is no market or if costs are too high, "artificial" investment from the Permanent Fund will not help. Dr. Daniels suggested that the fund could provide needed commercial credit and financing of small- and medium-scale enterprises in Alaska but that fund managers should, in most cases, insist on market return for fund investments. A possible exception is economically feasible joint ventures with regional development corporations outside the major population centers. Daniels emphasized the importance of coordinated planning between the Permanent Fund and the General Fund.

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.



Robert Lewellen

III The Fund in Relation 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. Dedication of that wealth to the Permanent Fund should provide an opportunity to make this wealth a renewable resource for many generations.

Although the form of the wealth is changing, 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 on oil revenues. 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

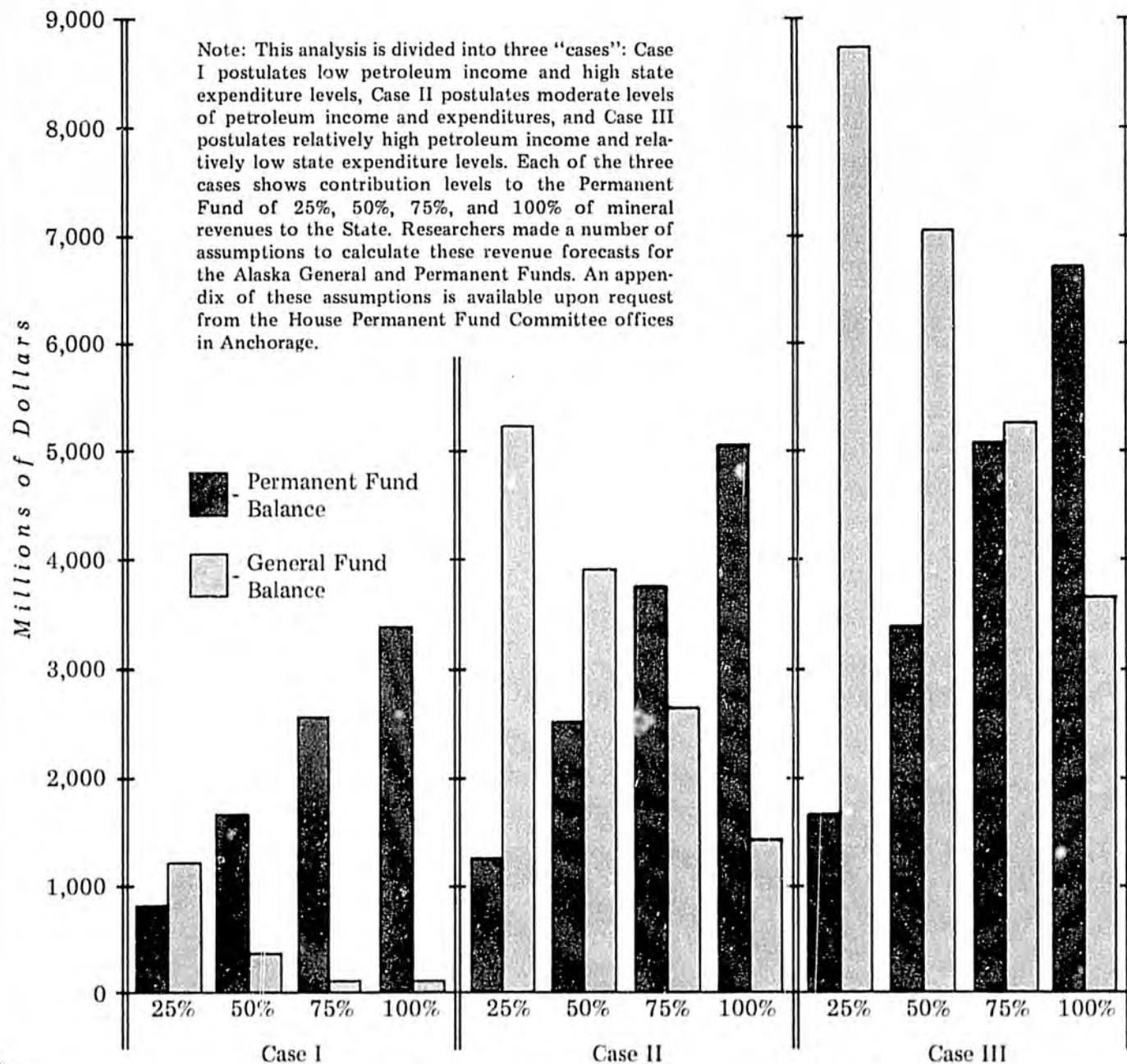
the General Fund to finance state activities. As required by the constitution, the General Fund is the sole repository (with the exceptions of the Alaska Permanent Fund and the Renewable Resources Development Fund) of all state revenues from all sources. The legislature is the only body empowered by the constitution to appropriate money from the General Fund.

The objectives of some of the general fund expenditures may be similar to those of certain investments of the Permanent Fund. For example, the State currently maintains loan programs to promote a variety of interests, ranging from business to home loans and senior citizen housing. Careful coordination with existing 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.

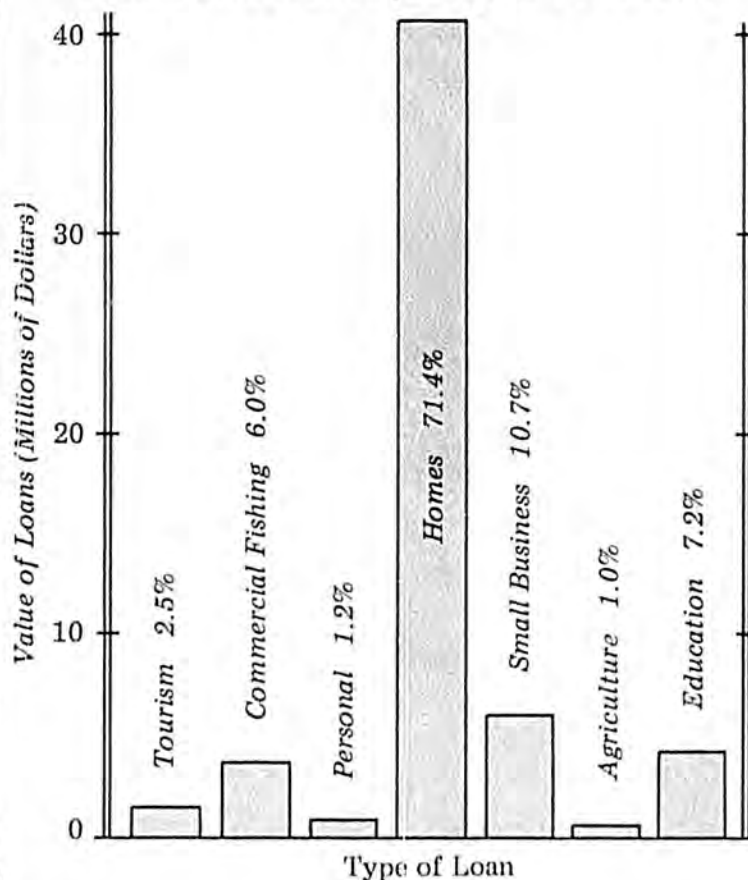
These various tools should be considered as we ponder alternative fund uses so that we can best match tools with objectives. Further, provisions for coordinating permanent fund and other government activities will be a crucial element in developing the enabling legislation.

Figure 1
Revenue Projections through 1985



Source: State of Alaska, Legislative Affairs Agency, Research Division, July 14, 1977.

Figure 2
Loan Fund Activity: Fiscal Year 1976



Source: State of Alaska, Office of the Governor,
 Division of Budget and Management, October 11, 1976.

The following state loan programs and activities are potentially eligible for permanent fund investment (i.e., they are "income producing," although the rate of return will vary):

(1) The Scholarship Loan Program provides loans to Alaska residents for postsecondary vocational and academic training with a forgiveness incentive for remaining 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 to help Alaska communities 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-interest loans to promote rapid development of agriculture as an industry 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 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 hydroelectric 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

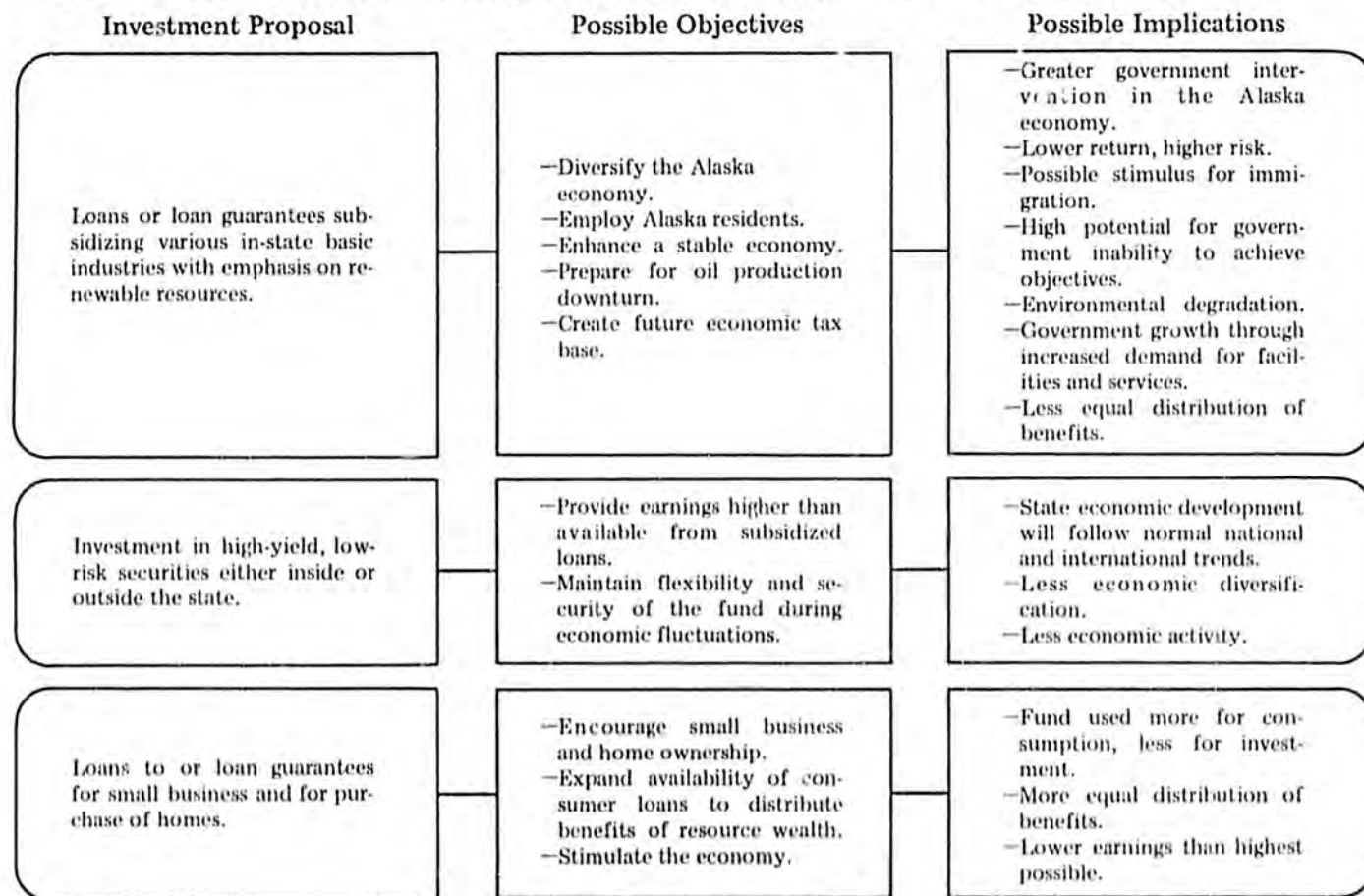
The people of Alaska should establish the overall objectives for their permanent fund. The committee hopes to achieve this through public meetings and other public participation and information programs to be held throughout the state in the coming months and through direct solicitation, such as the 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 Invest-

ment 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

Figure 3
Possible Objectives and Implications for Investment Proposals



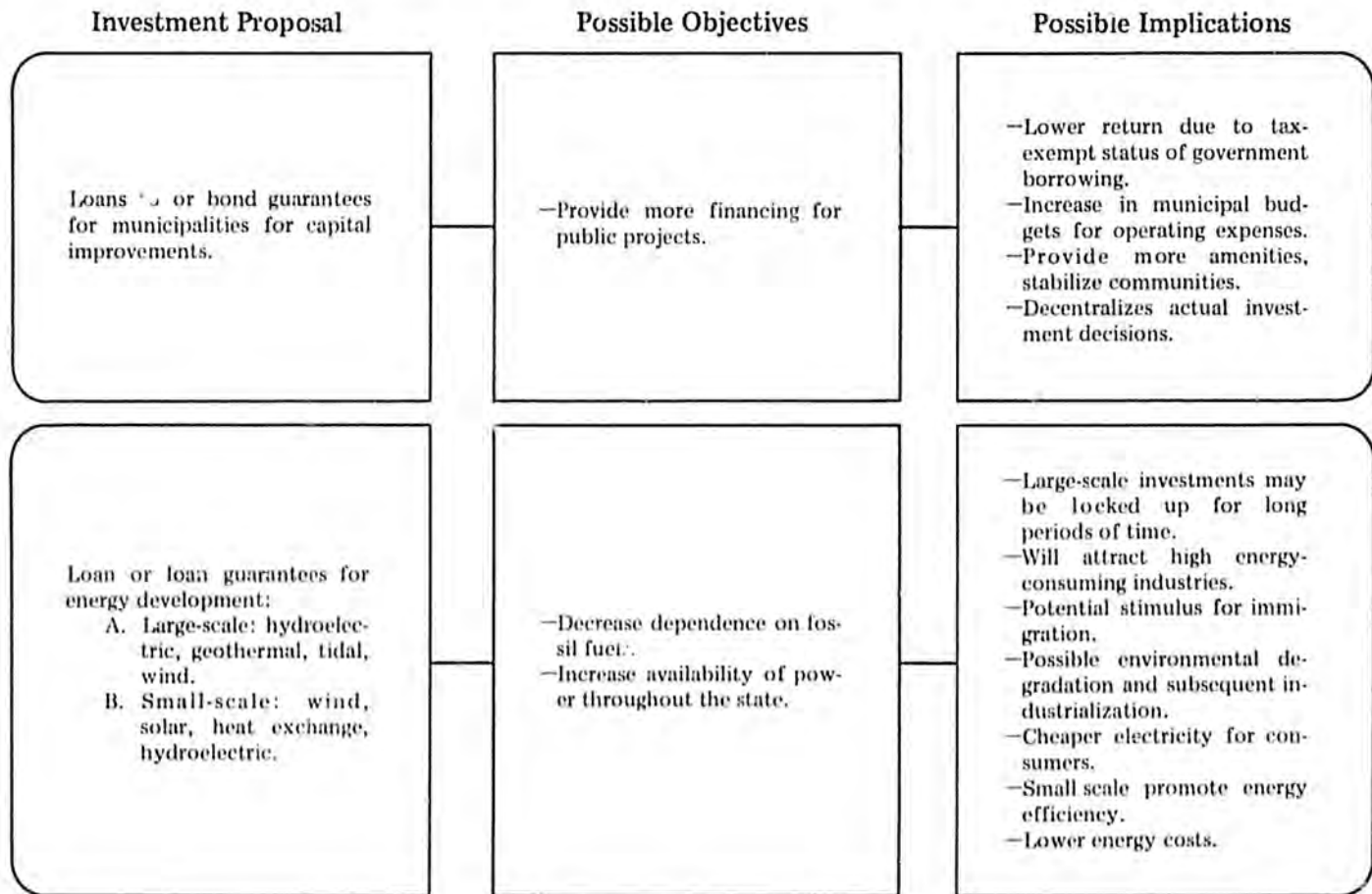
obtain from private lenders. The fund would earn a lower return than the market rate unless the General Fund makes up the difference (which has been proposed).

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.



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. The 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.



Yvonne Mozée

VI Objectives for 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 lists 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.

National Park Service



VII Permanent Fund Questionnaire

The Permanent Fund belongs to you. What are your suggestions for use of the money? Would you please

Place
Stamp
Here

Special Committee on the Alaska Permanent Fund
528 West Fifth Avenue, Suite 270
Anchorage, Alaska, 99501

VII 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?

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?

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

6. What groups are likely to oppose this proposal?

7. What are your suggestions for management of the Permanent Fund?

Note: If you would like to receive further information on the progress of this committee, please check here and correct the address if necessary.

Cut this questionnaire along dotted line, fold so that our address is on the outside, and mail it to us.

THE ROLE OF THE PERMANENT FUND IN ALASKA'S FUTURE

A Preliminary Report

Alaskan voters last November 2, 1976 by a substantial majority vote amended the Alaska State Constitution to provide for a Permanent Fund. The constitutional amendment required that twenty-five percent of all the State's non-renewable resource revenues be placed in the "Alaska Permanent Fund" where this revenue would be maintained (the concept of permanent^{ce}) through those "income-producing investments" the legislature designates as eligible for permanent fund money. The constitution also provides that income from the investments will go into the State's general fund (where all other non-permanent fund revenues and taxes are deposited) unless the legislature decides to dedicate that income for other purposes.

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Committee members wished to state early in the committee's
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direction required by the constitution. It is the hope of the
committee that you, ~~the reader of this report~~, will take the time
to ^{read} ~~respond~~ to the committee's statement of the issues and give
us your views or comments in the self-addressed and postage paid
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If you desire further information or wish to discuss any aspect
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Above all, please take the time to read this report and watch for
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1977.

CLERK

THE ROLE OF THE PERMANENT FUND IN ALASKA'S FUTURE
A PRELIMINARY ANALYSIS

Purpose:

- I. A report on the issues to be resolved by the legislature and a solicitation of comments on the issues from the committee members and a list of interested Alaskans.
- II. A preliminary statement of background and questions to be used in the committee's presentation at the Alaska Public Forum and in the media.

[Draft to committee on July 15, 1977. Publication finished and printed by August 1, 1977.]

I. Introduction by committee chairman [Statement of committee task]
[Clark will draft by June 25]

II. Historical perspective - constitutional and legislative

- 1969 - Brookings Seminar
- 1970 - Early Permanent Fund proposals
- 1974 - Permanent Fund bill passed by legislature (acted by Hammond)
- 1976 - Permanent Fund constitutional amendment passed by legislature and public
- 1977 - Permanent Fund temporary implementation bill passed by legislature; State Investment Advisory Committee proposal; Permanent Fund Committees set up

III. Summary of Work to date

- State Investment Advisory Committee proposal - Price, Waterhouse; White, Weld; etc.
- House & Senate Permanent Fund Committee session work
- Alaska, Inc. proposal

IV. Statement of issues to be resolved

Ferry A. Alternative objectives for the Permanent Fund

Dick B. Level of funding

- 1. relation to objectives and other funds
- 2. revenue projections

Doug C. Investment guidelines

- 1. constitutional and legal limitations
- 2. possible statutory requirements

Bruce D. Use of Permanent Fund income

- 1. return to permanent fund
- 2. Alaska, Inc.
- 3. deposit in general fund

E. Management structure

- 1. Accountability to legislature, governor and public
- 2. Evaluation and audit of permanent fund performance
- 3. Executive and legislative involvement

V. Solicitation of responses

- A. What other issues should be considered
- B. What alternative uses are there
- C. How should the permanent fund relate to other state funds
- D. Tie in to Public Forum

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Handwritten notes on the right margin, including a large bracket and some illegible text.

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C. INVESTMENT GUIDELINES

The Alaska Constitution is the fundamental limitation of power of the State legislature. Article V.II (Natural Resources) of our Constitution ^{allows for} envisioned evolving principles of management of all resources of Alaska under State jurisdiction. For example, it directs that fish, wildlife, ^{and} ~~air and~~ water, in their natural state, are reserved to the people for their common use. ^{(The} "Common use" ~~is a~~ principle ~~that~~ ^{is} has evolved ^{over} for 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 the limitations and obligations of the State in managing our resources to evolve through legislative policy-making and judicial interpretation.

^{because members recognized} Recognizing that changing needs in developing non-renewable resources of the State since the 1957 Convention dictated a more specific mandate of trust obligations, ^A the legislature presented the Permanent Fund to the voters. In essence, the legislature asked the voters, "pursuant to our broad obligation to manage the resources in the capacity of trustee, do you want us to create a permanent trust fund of part of the non-recurring

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* ~~"Income producing"~~ will undoubtedly evolve as other fundamental constitutional concepts, but this much is fairly clear: when possible, the Permanent Fund must be used to foster diversification of the Alaska economy and ensure that future generations receive benefits from non-renewable resource development today. House Journal, March 24, 1976.

Beyond those fundamental objects of the trust fund, investment parameters are unclear. The most troublesome question presently on the surface is whether the Fund must be managed to keep abreast with inflation. If protection of the Fund principal was foremost in the minds of the amendment's creators, as is suggested by the dominance of the word "permanent" in the amendment, then the obligation of the State might well include keeping abreast of inflation. The legislature may adopt that as a policy in the enabling act. Whichever direction the policy evolves, we know this much: If the Fund keeps abreast with inflation, investment policies will likely be different than if it doesn't. It may be necessary for the Fund to secure its money in a balance of high return - low risk investments in order to keep up with inflation, and such investments might preclude many Alaskans from participation. This policy consideration needs much input from all sectors of Alaska life.

Beyond the specific constitutional obligations, the legislature is left with broad enabling powers of the Natural Resources article to mandate other obligations of the Fund. Trust law places many obligations on fund

managers that are not specifically referred to in our Constitution. The legislature may adopt certain policies as obligations of the Fund. They may range as widely as guaranteeing that a certain percentage of investments in commercial projects in Alaska will flow to "small businesses," to mandating a cost-benefit analysis in renewable resource projects.

Another issue of public policy that will affect investments is whether the Fund should be effectively decentralized through the use of regional funding mechanisms. To do so would necessitate the creation of those funding mechanisms. Development banks, community development corporations, land and water conservation funds, the Renewable Resource Development Fund, cooperatives banks and credit unions have all been mentioned. No doubt decentralization into any such mechanisms will have to be viewed on an ad hoc basis.

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I Introduction

An overwhelming majority of Alaska voters approved an amendment to the state constitution in November 1976 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 1977 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 will best attain those goals.

The intent of this report is to inform Alaskans about the Alaska Permanent Fund—how it will be presently managed, 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 ← 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.

The 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, to explore some of the major emerging policy issues, and to set forth a 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."

The principal represents Alaska's mineral wealth transformed into dollars through the sale of natural resources to private developers. The legislature 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.

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 directed the advisory committee to study and report on the estimated size, investment goals, management, organization, and public interest in the Permanent Fund.

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

The State Investment Advisory Committee conducted its deliberations with energy and diligence. Members conferred with consultants to produce draft legislation 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 developed 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 measures propose a two-board 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 Permanent Fund corporation strong executive power and sole responsibility for presenting investment proposals to the investment committee. Both proposals require that at least 40 percent of the fund must be placed in high-grade securities, but allow up to 30 percent of the assets to be invested in Alaska development loans and another 30 percent in community projects and private dwellings. Except for the appointment of the policy board members (who are subject to legislative confirmation under only one of two bills), both proposals would allow the fund to operate rather independently from the executive and legislative branches.

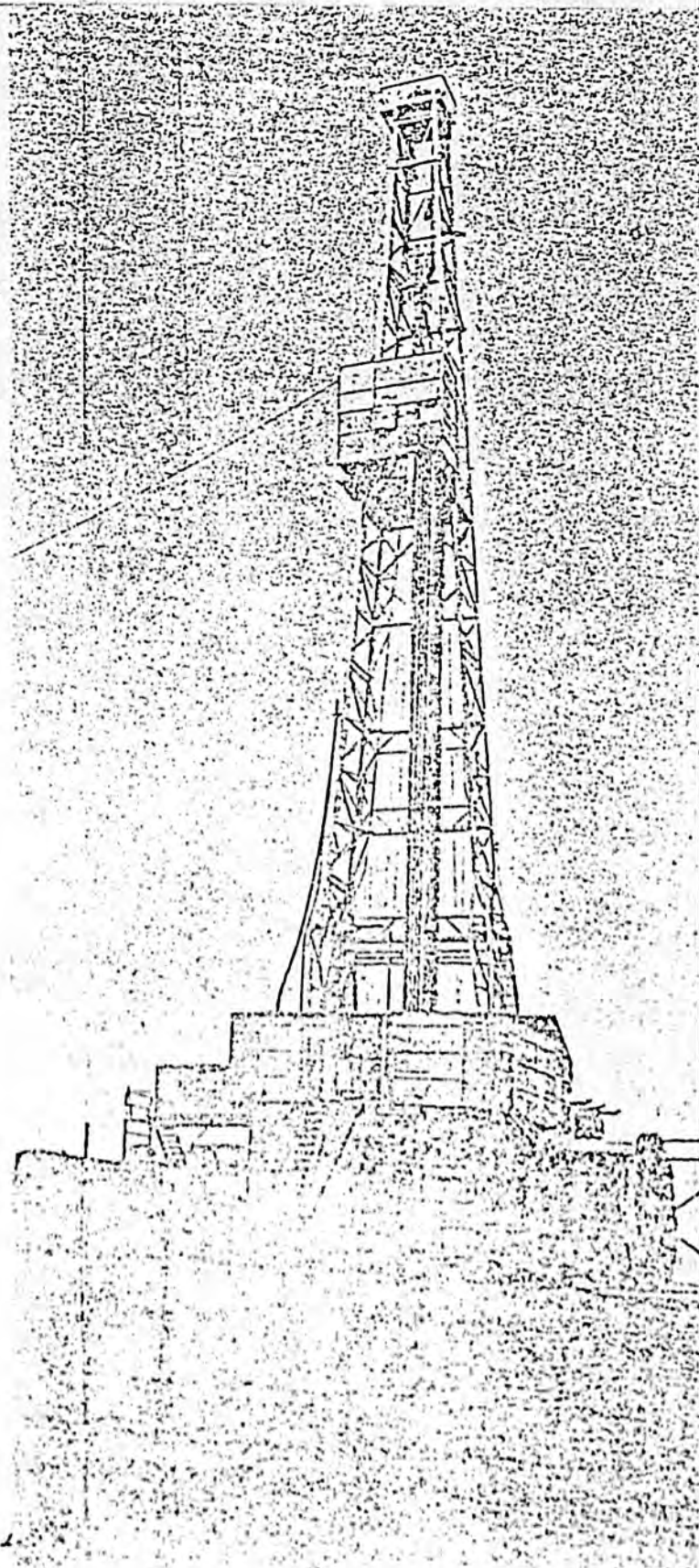
In 1977 the legislature passed an interim permanent fund management bill that will stay in effect until specific investment objectives and management structure have been thoroughly examined and agreed upon. It directs the commissioner of revenue to invest permanent fund money into various "money-market instruments," such as U. S. Treasury notes, certificates of deposit, and high-grade securities (not stock), all of which are relatively liquid and secure. As of July 15, 1977 four million dollars had accrued to the Permanent Fund and had all been invested in a savings account in the Bank of America and in U. S. Treasury notes. Almost \$45,000 in interest has been ^{earned} in the first five months of its existence.

The House Special Committee on the Alaska Permanent Fund met on July 15 and 16, 1977 and heard testimony from a number of expert witnesses; two of whom presented papers on the establishment of the fund ("Economic Considerations in Establishment of Alaska's Permanent Fund" by Arlon Tussing, Institute of Social and Economic Research, University of Alaska and "Thinking About the Alaska Permanent Fund: A Cautious Approach for Alaskan Policymakers" by Beldon Daniels, Department of City and Regional Planning, Harvard University). Copies of both papers are available upon request from the Committee.

One of the major thrusts of Dr. Tussing's testimony was that there is no need or useful function for permanent fund investment in major industrial or commercial enterprise in Alaska, unless special reasons existed to subsidize them. Mr. Tussing's report infers that, at least initially, it makes more sense to invest the major portion of the fund outside the state.

Dr. Daniels emphasized that no development bank can create economic activity not already in existence; if there is no market or if costs are too high, "artificial" investment from the Permanent Fund will not help. Dr. Daniels suggested that the fund could provide needed commercial credit and financing of small- and medium-scale enterprises in Alaska but that fund managers should, in most cases, insist on market return for fund investments. A possible exception is economically feasible joint ventures with regional development corporations outside the major population centers. Daniels emphasized the importance of planning fund activity generally as well as coordination between the Permanent Fund and the General Fund.

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. Dedication of that wealth to the Permanent Fund should provide an opportunity to make this wealth a renewable resource for many generations.

Although the form of the wealth is changing, 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 on 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 all state revenues from all sources. The legislature is the or' body empowered by the constitution to appropriate money from the General Fund.

The objectives of some of the general fund expenditures may be similar to those of certain investments of the Permanent Fund. For example, the State currently maintains loan programs to promote a variety of interests, ranging from business to home loans and senior citizen housing. Careful coordination with existing 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 to 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.

Figure 1

Revenue Projections through 1985

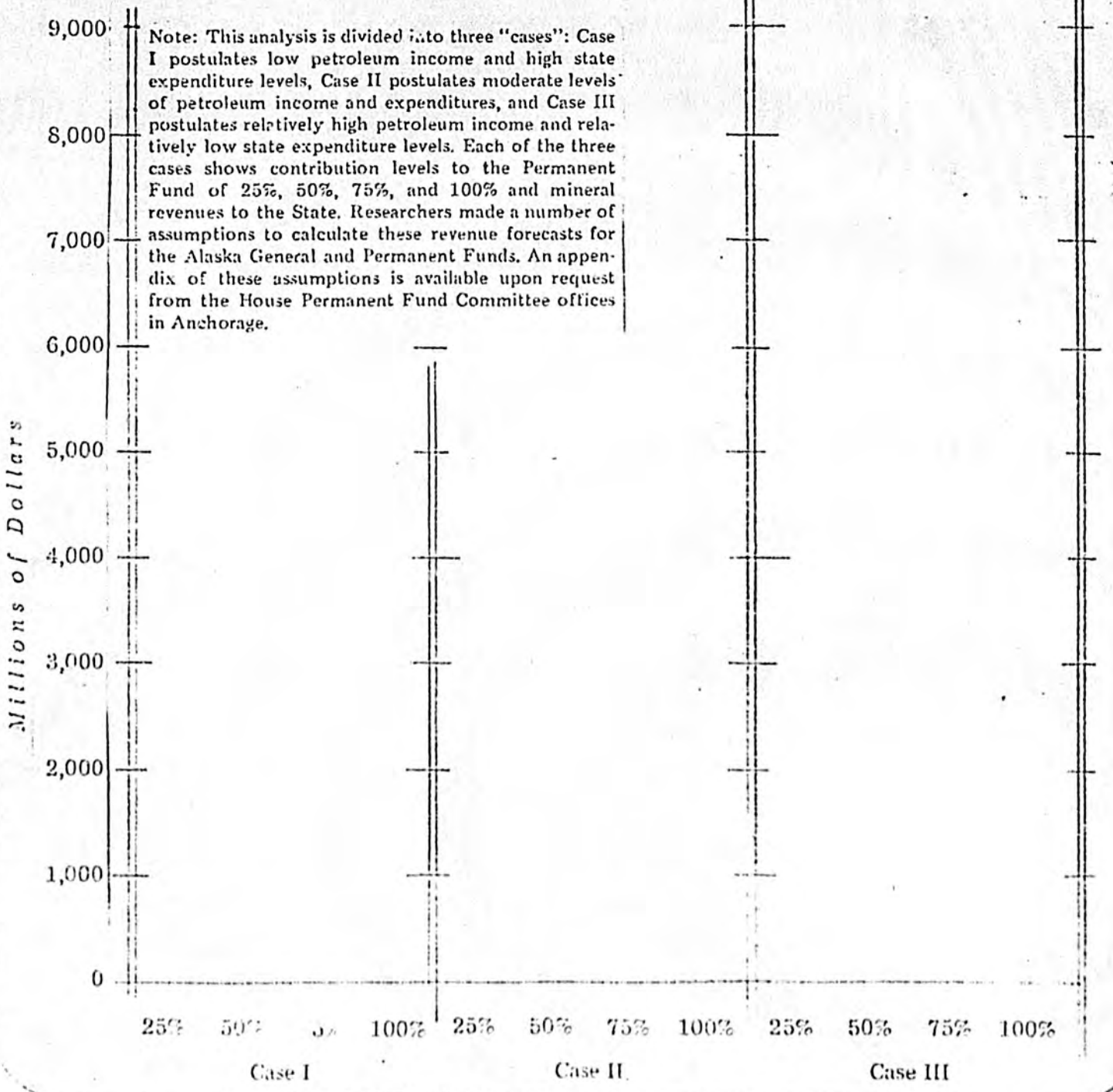


Figure 2
Loan Fund Activity, F.Y. 1976

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The following programs and activities are potentially eligible for permanent fund investment (i.e., they are "income producing," although the rate of return will vary):

(1) The Scholarship Loan Program provides loans to Alaska residents for postsecondary vocational and academic training with a forgiveness incentive for remaining 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 to help Alaska communities 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 corpora-

tions—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-interest loans to promote rapid development of agriculture as an industry 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 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 hydroelectric 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

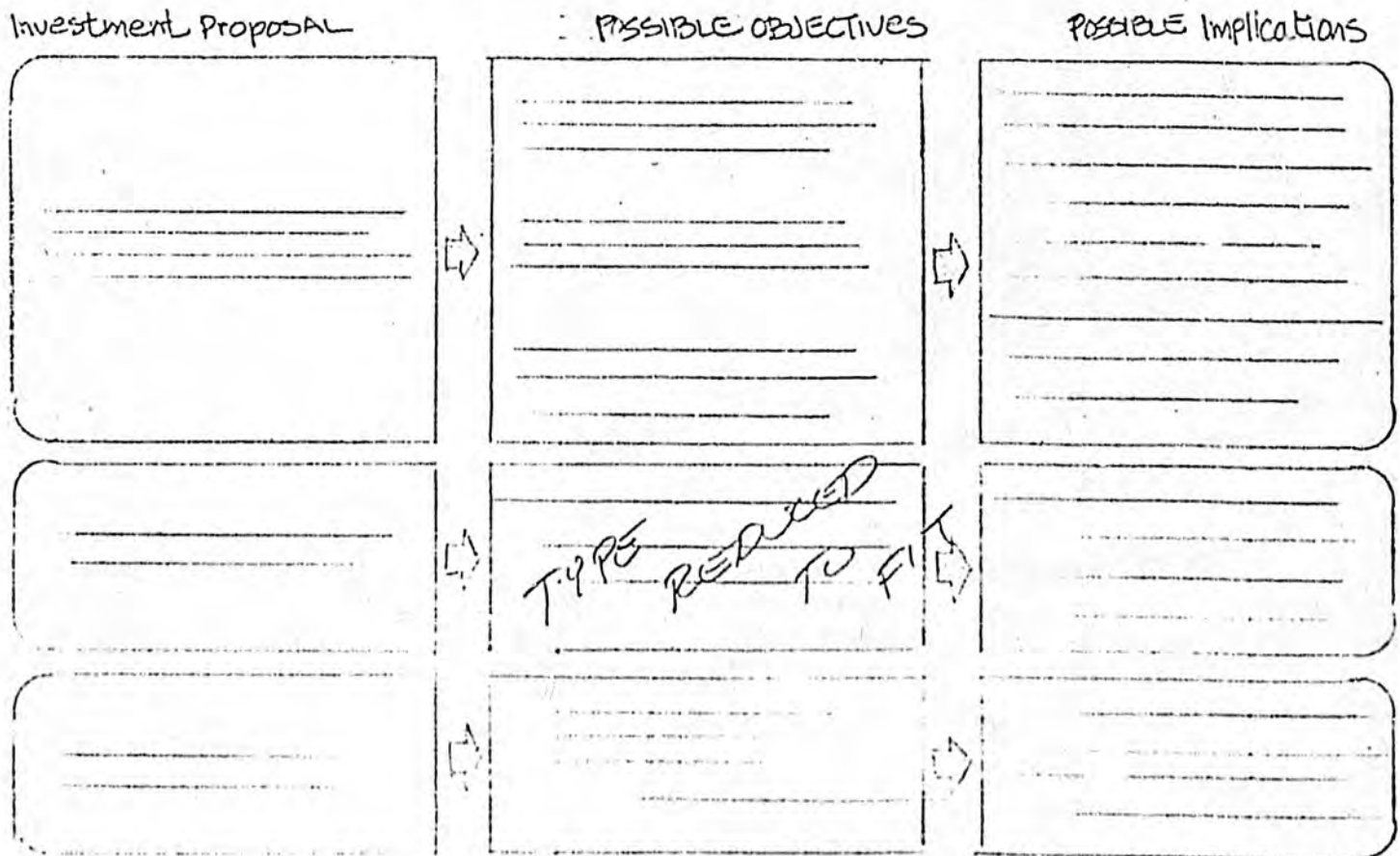
The people of Alaska should establish the overall objectives for their permanent fund. The committee hopes to achieve this through public meetings and other public participation information and participation programs to be held throughout the state in the coming months and through direct solicitation, 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

Figure 3 Possible Objectives and Implications for Investment Proposals



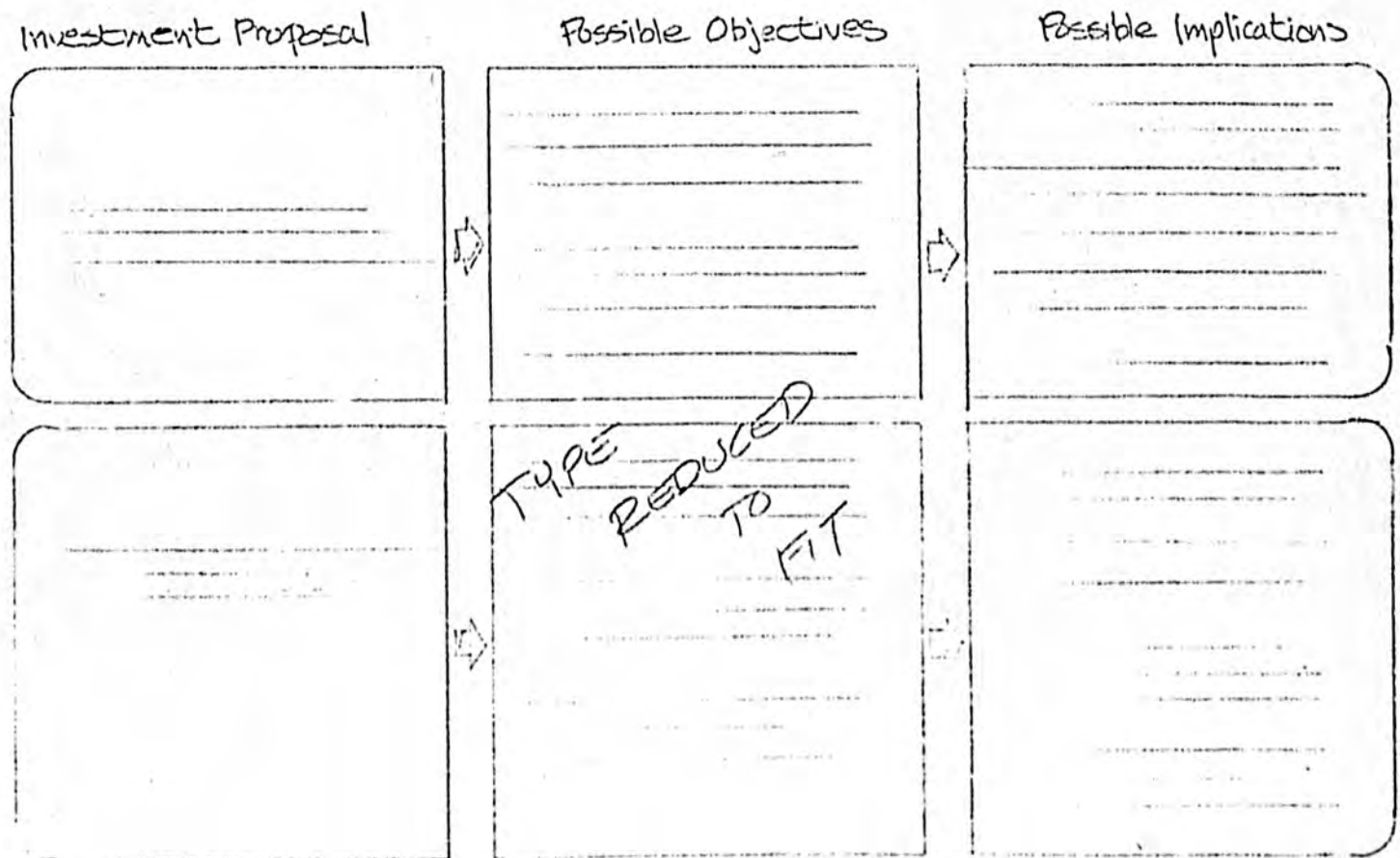
General Fund makes up the difference (which has been proposed).

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.



USE of Fund Income

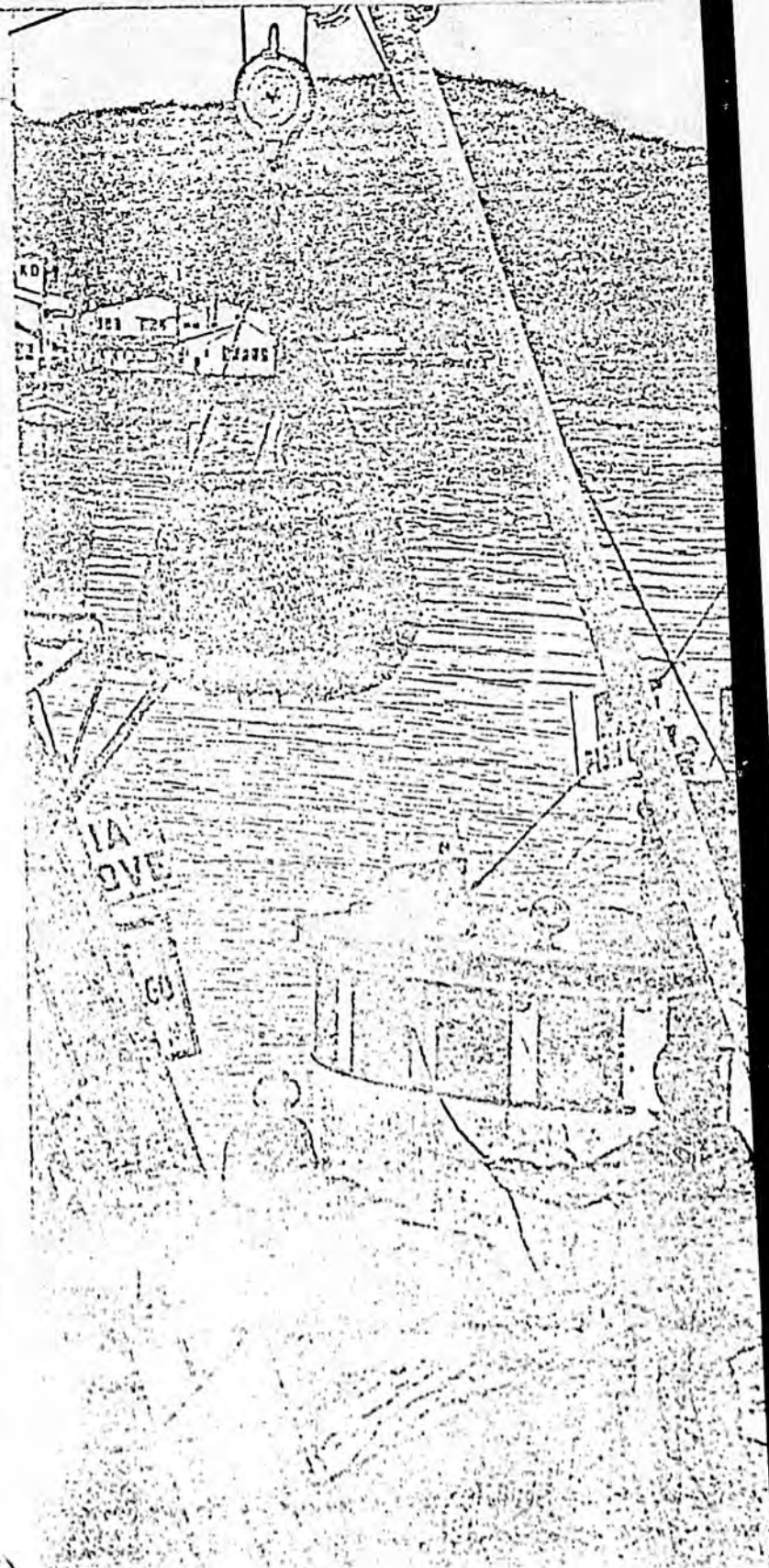
The income derived from investment of the Permanent Fund can be used for any purpose designated by the legislature. Before we present some of the most-often discussed proposals for use of the earnings from the Permanent Fund, we invite you to invent your own and include it as part of your response to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

