

SCOMM

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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 introduced 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 prerogatives 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 Heritage 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% required 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 Alaskans. 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) borrow 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 possible 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 an 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.