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WEALTH MANAGEMENT: A COMPARISON OF THE ALASKA PERMANENT FUND AND OTHER OIL-GENERATED SAVINGS ACCOUNTS AROUND THE WORLD

Two Presentations Made to the Board of Trustees of the
Alaska Permanent Fund Corporation
at the Annual Meeting September 24-25, 1987
Anchorage, Alaska

Oil Rich: Spend or Save?
How Oil Countries Have Handled the Windfall

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The Alberta Heritage Savings Trust Fund and the Alaska Permanent Fund: A Ten-Year Retrospective

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Dear Readers:

It is with great pleasure that I present to you this first in a new series of **The Trustee Papers**.

The original collection of **The Trustee Papers** was presented to the Alaskan public in 1982, and had its genesis in a series of seminars held by the Trustees of the Alaska Permanent Fund Corporation in the Spring and Fall of 1981. Now, six years later, the Trustees have decided to renew this particular educational effort as part of the Corporation's on-going Public Information and Accountability Program.

The Alaska Permanent Fund is a public trust which belongs, collectively, to all Alaskans. Since everyone in Alaska is a beneficiary, the Trustees intend to make every effort to ensure that the Alaskan public understands the history of the Fund, how it works, how it's doing, and its role in the future. It is hoped that publication of **The Trustee Papers** will further the accomplishment of this goal.

The papers presented herein compare the performance of the Permanent Fund after one decade with that of other public savings accounts around the world, and attempt to provide some perspective on the relative merits of the approach we in Alaska have taken to the management of our oil wealth.

Persons interested in additional information regarding Permanent Fund issues are encouraged to contact the Corporation's office at the address above. Thank you.

Sincerely,

Byron I. Mallott
Chairman, Board of Trustees

OIL RICH: SPEND OR SAVE? HOW OIL COUNTRIES HAVE HANDLED THE WINDFALL

by
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There was a cartoon by Bill Mauldin some years ago - unfortunately some student pinched my copy - but let me describe it. It shows two bedouins on their camels looking down at a sand dune. Peeking out of the sand dune is the end of what is a rusted barrel of oil and the caption is, "You know, they said that we were really rich once."

This concern is one which has been surprisingly real in the Persian Gulf, particularly among the Arab states, and especially among the Saudis. This probably is attributable to the fact that most of the Saudi ministers studied in this country and every young Saudi minister I know has, at one time or another, visited cities like Virginia City; they've seen what happens when the lode runs out. So, for them, the question of what to do with the oil revenues was particularly real. Now, it's bizarre, in one sense, because Saudi Arabia has known oil reserves equivalent to 160 years of present production and it has at least 150 billion barrels sitting around unbooked, that I know of. So, the depletion is a long way off, but nonetheless, they worry about it.

As you know, the oil surpluses have been common to a lot of countries; to Norway, to Alaska, to Alberta, to the OPEC countries, the more familiar oil exporters, but their responses have been rather different, reflecting, in some cases, their resource endowments, in some cases their politics, in some cases the quality of their ministers of finance.

I think it's useful to divide the major exporting areas into three subcategories:

1. The negative savers; that's a euphemism for spendthrifts.
2. The passive savers who have saved in spite of themselves.
3. Those countries which institutionalized their savings.

The third is perhaps more relevant here, but it's important to look at the others because they implicitly adapted a strategy which I gather is occasionally being proposed here as an alternative to saving through portfolio investment, to save through local expenditure to develop a local economy. So that all three of these options, in fact, represent different ways of looking at the use of oil funds and somehow investing for the future.

Let's turn first to the grasshopper, the Disney analogy, "Mr. Cricket Goes to Town" or "The Grasshopper and the Ant." There were four important oil exporting countries which were negative savers. Not merely did they spend all of their current oil revenues, they spent all the windfalls that came in 1973 and 1974 and all of those that came again after 1979. Not merely did they spend everything, they also went out and put themselves in hock. There are four: **Algeria, Mexico, Venezuela and Nigeria.** And their argument, insofar as it was intellectualized at all, was that they should spend the money to build their economies. By building their economies they could transform those economies into a reduced dependence on oil. All four failed. They spent their oil revenues. They spent the borrowed money. They now must service the debt and there is no discernible increase in domestic production capacity, outside of the oil sector, to show for all of the billions that they spent and borrowed. The bottom line there is pretty grim.

It represents, though, one theoretical option, namely the spending of oil revenue. I should mention that what happened there is that the dynamics of spending oil revenues in those countries at such a rapid rate actually reduced the efficiency of investment and actually reduced the ability of the country to diversify - far from increasing it. There's a sobering lesson there, I suggest.

The second category of countries are countries which actually saved some of their oil revenues, but they did it ad hoc. There was no institution set up to do it. The money came in and accumulated. The two important cases here are **Libya** and **Saudi Arabia.** In both cases the savings were non-trivial. Saudi Arabia accumulated through about 1983 somewhere between $90 and $130 billion in its temporary permanent fund. Libya put away what looks to be on the order of $30 odd billion. Now, these numbers are not public record, but they can be inferred, and the figure for Saudi Arabia was at least $90 billion.

What they did, in the case of both Libya and Saudi Arabia, was simply bank the oil revenues as they came in, and as the budgetary process could not expand rapidly enough to spend. Therefore, the funds accumulated in current amounts. In the case of Saudi Arabia there is a rather unusual division between the way in which oil revenues are collected and spent. Oil revenues are collected by the Monetary Authority and they are disbursed by the Ministry of Finance. The Monetary Authority simply maintained current amounts in a number of banks around the world into which the oil revenues had to be deposited quarterly, monthly or weekly. As these accounts grew, they suddenly grew beyond the ability of the handful of banks to hold them, so the Saudis were forced, ad hoc again, to find more bank accounts, to find more banks in which they could bank. They were very cautious about the banks in which they were willing to put their money.

They started going out in maturity. First of all, the Saudis put the money in overnight accounts. Then they went out to a week's deposit. Then they started going to negotiated (certificates of deposit) for 30 days; then 60 days; stretching out, after a couple of years, to as much as 90 days. They created an extremely conservative, extremely liquid portfolio. They have now expanded somewhat into real estate and cautiously into the equities market. But basically, the Saudi fund was held, ad hoc, as an increasing working balance by the government, yielding, at its peak, on the order of $9 billion a year in revenue. That was never shown in the budget. The assets are off the balance sheet. The income, with one minor exception today, is not shown as part of the budget. Any deficit that the Saudi government reports is made without allowing for the income from the portfolio. This is done for obvious psychological reasons; it reduces the claim on cash.

Now, when the oil revenues turned down, both because of production cutback and because of declining prices, the Saudis then simply began, as did the Libyans, to reverse this process. When they had a budget deficit, they simply drew on the cash balances, which were a mix of the accumulated deposits plus the interest on those deposits, and they've drawn down $30 to $40 billion out of these balances over the last few years as part of their anti-recessionary or counter-cyclical policy. This was one device that ended up, ad hoc, being an anti-recessionary, counter-cyclical fund, but totally non-institutionalized, non-structured.

The third set of countries are those seven cases - six oil cases and a surprise - which one way or another, tried to institutionalize the capture of the oil income and its rechanneling into some longer-term contribution to the economy. The six countries are **Iran**, **Abu Dhabi**, **Oman**, **Kuwait**, **Venezuela**, and then very briefly, **Alberta**, and then I'm going to end with our surprise case.

One is reminded here of a collection of cartoons by Gary Trudeau from the Doonesbury volumes which dealt with Duke running a football team, if I remember correctly. But it was the cover that was marvelous. The cover was, "But the pension fund was just sitting there." In some of these instances the pension fund was "just sitting there" and somebody like Duke got it.

I want to first compare and contrast Iran and Kuwait, because they are so extreme in what happened.

In the case of **Iran** there is a very early precedent for a resource savings fund. In 1957, prodded by the U.S. for political reasons, the Iranians set up what was called the Plan Organization. Seventy percent of all oil revenues were to go into the Plan Organization to be spent for national development - which sounded like a good idea. This was a criterion for us supplying them certain military aid. This fund was set up, it was disbursed, revenues were diverted to special accounts each year, and they were spent for national development.

One of the last inquiries that I made just before the (1979) revolution was in a discussion I had with the Ministry of Finance about the classification of "development expenditures." I had tried to read the list of the largest single items in the development budget for the preceding year. What we were curious about was why the following items showed up as "development expenditures" by their fund. They were: 5,000 new officers' quarters for the Frontier Force, 96 subregional headquarters for the Secret Police, two military airfields, and so it went. This was their fund for the future. Now, some of it was spent on agricultural development, on projects which were very much like the barley project in Alaska that I heard about a couple of days ago, or worse. The money was spent and there was surprisingly little to be seen for it. That was a function of the efficiency of the local economy. But structurally what was going on was this fund was not a fund at all, it was an alternative way of describing the capital budget of the government.

Now, the contrast was what was done in **Kuwait**.

Kuwait set up its fund ad hoc in 1962 as part of a secret account maintained by the minister of finance, not to steal money, which is so often the case in the undeveloped world, but to keep it away from the National Assembly whom he was afraid would spend it and squander it. So, he set up some accrual accounts which accumulated billions of dollars until they were institutionalized in 1976 into what was called the Fund for Future Generations. They took all the money that the then minister had squirreled away, which was about $8 billion - he found some of the most extraordinary investments I've ever seen. He found a niche in the overnight sterling franc market in which he could keep about $100 million at any point in time yielding year-in, year-out 18 to 20 percent. It was small, but it was very, very lucrative. It was an extremely well-managed fund run by one full-time employee and a half-time secretary - who was semi-literate. That got out of hand after a while and they did expand.

They institutionalized this and now 10 percent of all revenues from all sources must go into the fund. The fund income is capitalized automatically and is reported nowhere. The government's oil revenues are reported publicly, net the contribution to the fund. All of this is intended to reduce the degree of salivation by Kuwaitis, by the National Assembly, or by their neighbors. There is no public figure on the size of the fund at the present time, but a published calculation about a year ago in the Financial Times alleged that it is around $35 billion and that's a number I would be willing to use. Half of that represents the accumulation of the initial contribution from the squirrel fund, pre-1976 money, and the other half roughly is what has been paid in accumulated interest after that. The fund is run by an autonomous office attached to the ruler's personal court, the dewan. It maintains most of its headquarters' staff in London, and it's extremely diversified. They have equity positions from anywhere between 25 percent and 100 percent of the firms. They own 25 percent of Hercs, 25 percent of a German steel company, 100 percent of a couple of American firms like Santa Fe. They also maintain equity positions under 5 percent in many companies. They also have large holdings in back-to-back trustee accounts in Switzerland, which provide an even greater anonymity. They have been increasing their investments in real estate around the world, everywhere from resorts on the U.S. East Coast to sugar plantations in Sudan. It's an extraordinarily diversified portfolio.

Its income until 18 months ago was greater than the country's oil revenues. So, Kuwait had reached the point, except for certain military commitments, where it could have shut off oil production completely and continued on at the same level of public strategy. So, they did it; they emancipated themselves from oil.

It's ironic, in the case of Kuwait, that they can do this because Kuwait also has vast oil reserves. They have about 70 billion barrels that are booked and another 50 billion or so that they haven't bothered to book. So, they have between 150 to 250 years worth of reserves at present production, at an average production cost of about 35 cents to 40 cents per barrel; so, it's a rather unusual case. They have emancipated themselves.

The third instance, not quite so successful, was **Oman**.

The government of Oman in 1980 set up the state General Reserve Fund, which was to be their resource fund. It was to receive 15 percent of all oil revenues. The income was, by decree, to be capitalized. It was not to be touched. And, moreover, any budgetary surplus in any year was to be put back into the fund as capital. What they did is they endowed the fund when it was established with the accrued surpluses of about $1 billion. This has not proved to be very durable. If one reads the press, they still deduct the contribution every year of 15 percent. In fact, what they do is they contribute to the fund above the line and then withdraw the contribution, or more each year since 1982 when their budgetary expenditures outpaced revenues. Oman's expenditures have been rising every year, and the last two years they've had to draw into the fund, and it will be depleted by the end of this coming fiscal year. So, it has permitted them a counter-cyclical policy, but they have nothing left in the bank. So, the moment of truth for them is going to come in somewhere between 12 and 18 months.

The **Venezuelans** also failed the durability test. They established the fund in the late 1970s and it was to receive 13 percent of all income above the pre-windfall period. They indexed it to their level of oil income in 1973 or 1974.

There were three objectives to their fund. It was to provide savings for the future; it was to provide foreign aid to Latin America and the Caribbean, not exactly consistent with the first; and thirdly, it was to develop the local economy, focusing on what were called the "strategic options," which meant very large-scale industrial development in the Orinoco region of the jungle. The fund has ceased receiving money. Venezuela, as I mentioned, has become a major net debtor to the order of at least $30 billion, known, and there may well be more as they're trying to consolidate what the independent authorities have borrowed. The projects in the Orinoco, which took up most of the investments of the fund, are all requiring net subsidies from the state - a bit like the Alaska barley project - and are producing no income whatsoever to the fund. So, this is an example of the fund which invested almost entirely domestically, contributing significantly to the inflation of the country in the period between 1978 and 1984, and for which there is no obvious tangible result and certainly no income. There is a certain amount of value added out in the jungle, but the ventures at this point still require massive operating subsidies so that I think, on balance, one has to say that fund failed, too.

The fifth was set up by **Abu Dhabi**, again, in the late 1970s. This fund is extremely secretive. There have been several public scandals, however, related to its management, including one currency trader who got away unextraditably with at least $70 million. It was, again, to manage the ad hoc surpluses, but unlike Saudi Arabia which simply managed the ad hoc surpluses through the ad hoc bank accounts and the existing Monetary Authority, Abu Dhabi set up a separate organization to do it. It had accumulated, at one point, about $30 billion net of whatever had disappeared. But much of this, I believe, was spent back into Abu Dhabi into supporting the banks when they started to fail and that took an infusion on the order of $5 billion U.S. Secondly, the state oil company ate money at a phenomenal rate. It was run by Algerians who operated in a Soviet capital-intensive model and spent money as if it were really going out of style. That took somewhere between $5 and $10 billion out of the fund. So, it's not entirely clear to me that there's much left outside Abu Dhabi.

Theoretically, though, according to the very rare public statement by the governor of Abu Dhabi, the fund is there and is whole. I don't believe it. This is not documentable.

The sixth case was **Alberta**. The Alberta Heritage Fund survives a durability test, if you will, even though it's not growing, but it fails a critical test of true diversification. Much of the money that was accumulated by Alberta in the Heritage Fund was reinvested in Alberta, some of it in the Capital Projects Division, some of it in the Alberta Projects Division, or I mean most of it. It's arguable whether or not this added to the economic development of Alberta. It may or it may not have. It may simply have substituted for borrowing. What is absolutely, unequivocably clear is that the income from this fund, insofar as they get any out of those projects, in no way is a counter-cyclical stimulus to the Albertan economy. Any value to the Alberta economy from the domestic investments in the Heritage Fund can arise only from whatever productivity can be attributed to the initial outlay. Income has no net impact on the economy. This is where the Kuwait strategy and the Alaskan strategy would appear to offer much more potential in the face of a downturn because the funds are invested outside and therefore their expenditure has a net positive multiplier impact upon the local economy when spent.

Now, the last case is the extreme case in the world, to my knowledge. It has nothing to do with oil, it is called the Long-Term Investment Fund for the government of **Nauru**, which is a little island in the Central Pacific. It has a population of 4,000 people, which makes it slightly larger than Barrow. The island is a coral outcropping capped with phosphate rock. They are mining the phosphate. It's the only significant source of employment for the local population. The mine runs out in about 20 to 25 years. When the mine runs out, they will have virtually dug up the island to the water line. Not only will there be no resources, there will be no place left to live. Nauru recognized somewhat early on that it had a problem. So, they have been investing, purportedly, and I say this because the Crown agents don't like to discuss it, they purportedly invest about 25 percent of their gross revenues abroad. One known investment of theirs is a very tall office building in either Melbourne or Sidney, the Nauru House, which brings in significant rental income to them now. They, however, also spent some of their money on a local shipping company and a local airline, if you can imagine it, which has not proven to be terribly lucrative. But a good bit of it did go into portfolio investment, largely in Australia. It is believed that there will be enough income 10 to 15 years down the pike to provide an annuity for all Nauruians and their heirs forever. Theirs is the extreme case because not only is the resource depleted, the country is depleted along with the resource.

Conclusions

If I can try to draw some conclusions from these rather diverse cases. First of all, the one factor which differentiates these different funds is the degree to which they use or deploy the funds domestically. The full spectrum is there: Alberta and Iran where the funds were, effectively, totally expended domestically; and Kuwait and Alaska, where the funds were virtually entirely invested abroad. The consequences of the domestic spending are pretty well understood and they're subsumed in the economics literature and the journalistic articles under the term "the Dutch disease"; the fact that too rapid expenditure of external resources - be it debt, be it foreign aid, be it natural resource income - contributes to inflation, it screws wage rates, makes domestic industry uncompetitive, and it also distorts expectations and expectations are hard to reverse. It's much easier to raise people's incomes than it is to force them down again. There have been a number of rather messy revolutions in the Middle East which came as a result of such reversals.

The second consideration here is that one has to distinguish form from fact in looking at these funds. On the face of it the Saudis had no such fund, but they had over $100 billion put away. Venezuela had a highly institutionalized fund which yields nothing at the present time. So, the contrast between structure and impact is remarkable.

Thirdly, touching back in a different way on the first point, one really has to distinguish the objectives of funds. Are they development funds or are they trust funds? There is a fundamental difference, a very, very basic difference.

The trust funds were Alaska, Kuwait and Oman.

The funds that were development funds, in effect, were Venezuela, Abu Dhabi, Alberta and Iran. They did not prove successful.

What comes out of this, I guess, is very difficult to generalize except that domestic expenditure carries a high opportunity cost.

Alaska is probably the first case of a major oil exploring area where depletion is imminent or is potentially imminent. Part of this is due to geology, part of it is due to world oil prices, and part of it is probably due to Alaska's rigid tax policy that discourages development. So, here the question of the use of funds or the availability of funds as an alternative to oil revenues is, of course, much more real than it is in most places where it is academic. In Saudi Arabia, for example, it is truly academic.

The other effect that I think makes the Alaskan example so interesting is that the Alaska Permanent Fund has been set up in such a way that it does provide some kind of future cushion, unlike a number of the examples that I gave, because of the fact that it was invested outside. So that what you have is a rather stellar example for some of the others, and, indeed, much of the work that I did on this was done, in the latest go-round, for the government of Norway, which was concerned about setting up a fund. We looked particularly closely to your example because it's one that most clearly worked. The Kuwaiti example worked, but it is so special that it is very hard to reproduce those kinds of circumstances anywhere. The Norwegian case was believed to be much closer to your circumstances, and it was to your fund that we looked.

QUESTIONS

Q: I just was wondering, one, if any of those funds paid out dividends along the Alaskan model? And, two, I just wondered, there are a lot of OPEC nations that you didn't mention, Indonesia and such, and I wondered if they never got to the point where they really had any excess?

A: Indonesia has a population of 100 million, and a rapacious bureaucracy spends everything. There was no institutionalization for redistribution. In the case of the countries who spent all their revenues, they were redistributing, and often it was in the form of grants, so, in a sense, you could review certain kinds of grants as specialized dividends - that's stretching the point. There was nothing structurally comparable to the dividend program except Nauru will have it at some point when they get around to determining how they pay off annuities, but that has not been settled at least as of a year ago.

Q: So, in Kuwait and even Saudi Arabia there's no annual check that just comes?

A: Oh, gosh, no. There's no annual accounting.

Q: Doctor, in these other countries have you ever done a per capita analysis of how much it equates to savings per person?

A: Yes. One thing that's interesting in the case of Alaska is that Alaska's revenues, per barrel, are much less than found elsewhere in the world because Alaska has to, in effect, split with the Feds and its costs are high. So, the net revenues that Alaska has to dispose of per barrel are significantly less. At the peak they ran about what, $5.00 per barrel or $4.50, in that range; at the same time, the Saudis were netting about $28.00 per barrel in disposable government revenues. So that if you try to compare Alaska with other oil producing areas it's a little misleading to do it on the basis of comparable production levels.

Q: Doctor, my question is, how much does it equate to per capita?

A: I'm saying one has to be a little careful there because the flow of funds, if you look at barrels, are totally different. Now, Kuwait's portfolio at, probably $35 billion, divided by 500,000 Kuwaitis, that's $75,000. Yes, right. But, let's see, Abu Dhabi's native population is about 80,000 and there are another 40,000 carpetbaggers. So that you have 80,000 with a portfolio of $20 billion round numbers. Saudi Arabia, in its heyday, had $100 billion with a native population, according to official figures, of six million. That's the range.

Q: During the debate in Alaska over whether or nor the Permanent Fund should be a trust or some kind of development bank, we heard an awful lot about capital gaps and, on looking into it, we found that most areas that produced oil thought that the capital markets passed over their part of the prairie, tundra, or desert. I came to call it the "Theory of Wicked and Ignorant Bankers" who deliberately turned away every chance there was to get into profitable ventures in these areas. What do you say about this capital gap?

A: Politically it's usually associated with xenophobia. In Canada it's the resentment against the Bay Street boys, against the Toronto banks. Basically, it's very, very hard to find real examples anywhere in the world where bankers or investors weren't willing to put money into good projects in a hospitable environment. Usually, it's either there are no decent projects and, if there are no good projects, then this argument becomes a wonderful pretext for trying to get some kind of local subsidy. You hear it all the time in the Third World, yet I've done a lot of oil concession negotiations in the Third World. When we've walked away, we've walked away because we weren't being offered a reasonable deal. I think that's probably the most important single reason. The structural argument about capital gap is probably not very convincing. There will be cases, bankers do have some memory, at least three or four years to remember, to forget a bad debt or a default. Then along comes another half generation later and they'll do it again. I just don't find that one convincing. I recognize that there's a broad literature on it, usually coming out of the Third World, though.

Q: Doctor, I was really fascinated by your remarks because there were five things that I generally attribute to Alaska's success. I kept looking for those five things in some of these other successes, particularly Kuwait. The five things are, first, the structure and the origin of the Fund is cumbersome for change; i.e., it is constitutionally created. Secondly, the form of government is a very republican form of government which has separation of powers, checks and balances, and I think to some degree strengthens the Fund so someone doesn't dominate it. In this Fund we have a great deal of public accountability - everybody knows what this Fund is doing because it's so open. We have a dividend program which seems to buy some protection and guarantees a constituency for the Fund. And again openness, not in terms of public accountability, but openness in the sense of how decisions are made. This is a little bit different from accountability - accountability is the result but openness is how you conduct yourself.

I look at these five things and I say, "This is why the Alaska Fund is successful," and yet I find it very interesting when I listen, unless I've missed something, I look at the Kuwaitian fund and it seems to have none of these attributes. I find that tremendously intriguing.

A: And conversely we found this Fund intriguing. Kuwait worked because there were three ministers of finance during this entire period, all of whom were extremely capable. They just carried it off by themselves. Now, in the Alaskan case, one of the things that I found so interesting was this combination of two things, the structure of the Fund which requires the number of political interventions to get at the capital - in a democracy that is important because it slows things down. The fact that, your second point is true, this is a democratic government, means that the Fund is a target; a relatively tempting and easy target, except for that first set of protections and the dividend which provides another kind of psychological protection. So, in one sense, the nature of the government is a weakness rather than an advantage in terms of the vulnerability of the Fund in a downturn. It's much easier to salt away money when income is rising faster than it can spend.

Q: Would you conclude then that it compels the other attributes? The governmental form compels the other attributes such as dividends?

A: Right. But it works. One has politicians voting money away from themselves. I'm from Massachusetts and that's just breathtaking.

Q: I was fascinated by your discussion as well as the number of cases that you went into. What I'm looking for is a common denominator, a set of factors that help explain why one group chose the trust and one group chose development. Was it just serendipity or was there a pattern?

A: I don't know. I've been looking, but I haven't found it. And, as has been pointed out, there was this extraordinary contrast between Kuwait and Alaska, both of which worked, but in settings which were so totally different it's very hard to find any common denominator except oil. No. From the point of view of political science or political theory it would be really nice to understand why and it may be purely serendipitous. Or, if there is a logic, I'll be damned if I see it.

Q: But what I was trying to get defined in my own mind in trying to explain the differences between the two is, you mentioned the word xenophobia, and Albertans might bristle at that, but I think it's more honest if I agreed with you on that case, a fear of the Bay Street boys. But that fear was also present in Iran, wasn't it? A fear of outside powers, of nationalism that came to a head. And the case of Iraq. Is there a commonality in that regard? The common factor of economic colonization that seems to have peaked more in some of these countries?

A: It would be tempting in the case of Iran, but looking back at the people who actually made the decision, no. If it had been left to the lower middle classes, to the mobs, potential mobs in south Tehran, they might have reacted that way, but it wasn't. This was taken under pressure from the U.S. Embassy. The decision was made by a handful of American-educated, all accountants, all Ph.D's, all from American universities, all on the Shah's staff. Maybe that tells us something.

Q: Doctor, based on what has happened with the Permanent Fund today, and looking at the economic conditions of the state today, what would be your advice in managing the Permanent Fund into the future?

A: It's remarkable what Alaska did in terms of funding the Fund. I think, with hindsight, the state probably would have been better off if it had sterilized more of the money earlier, inflated the economy less so that there was less of a crunch. That would have meant also that the sustainable level would have been higher today because more would have been saved. But hindsight is always cheap.

Q: I guess that ultimate question is emancipation. How would you weigh the prospects of Alaska achieving emancipation and, if you were in a policy-making position in Alaska, what steps would you urge, if indeed you felt that goal could be achieved?

A: I have to cop out on that because I really don't know Alaska, but let's look at what happened elsewhere. Let's take Norway because Norway was an industrial state, even though it had a broad agricultural fishing base, before oil. And the impact of oil upon Norway was to virtually drive out traditional, tradable goods sections because wage rates were bid up, expectations were such that the government found it easy to concede to the unions so that hours worked continued to fall, benefits rose, direct wage payments rose and the upshot is that the real cost of doing business in Norway, vis-a-vis its trading partners, is about 50% higher. And that happened in the space of six years. They spent ahead of their oil revenues by borrowing in the early 1970s and then continued increasing net government expenditure through the 1970s on into the early 1980s while paying off some of the debt. But nonetheless, the structural damage to the Norwegian economy had been done.

Now, if that happens to Norway, that's a sign that one wants to be careful. It has proved very hard everywhere else to establish competitive industries whether they're export industries or import substitution industries, if wage rates are out of line. We found that in the U.S. when the dollar was so high. And this applies with equal force to the local economy. So, the first question that I would ask is, what is the structure of wages in Alaska in relation to productivity? I gather it's high.

Q: At the moment.

A: And that may be helping. That may mean there's a possibility for restructuring with not too much pain.

THE ALBERTA HERITAGE SAVINGS TRUST FUND AND THE ALASKA PERMANENT FUND: A TEN-YEAR RETROSPECTIVE

by
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I would like to thank you for giving me the opportunity today to meet with you to discuss a matter of mutual concern - the record of your state and my province in the disposition of non-renewable resource revenues. In 1976 when the Alaska Permanent Fund and the Alberta Heritage Savings Trust Fund were created they were hailed as two far-sighted instruments of public policy. Underlying the creation of both funds in this period of optimism was the assumption that they would help Alaskans and Albertans weather the storm of bad economic times - "saving for a rainy day" was a common expression. The collapse of world prices in 1986 put this optimism to the test and provides an opportunity to look back and reflect upon these two experiments in public policy. To what extent did they live up to their initial promise of countering the downward cycle of their resource-based economies?

In the time I have with you I want to compare not only the origins, objectives, organization and management of these two funds but also the performance of each between 1976 and 1987. This comparison, by necessity, must be brief but it will reveal that, although these two funds came into existence at the same time, and with similar motivations, they have evolved along very different lines, the consequences of which are very significant. These differences in the development of the two funds are, in turn, reflective of political, ideological and economic differences between Alberta and Alaska. In my comparison of the funds I will be placing greater emphasis on the Alberta Heritage Savings Trust Fund, the assumption being that the audience here today has more than a passing acquaintance with the Permanent Fund.

The Origins of the Alberta Heritage and Savings Trust Fund and the Alaska Permanent Fund

Underlying the origins of the Heritage Fund and the Permanent Fund is a common desire to transcend the limitations of small, resource-rich, regional economies. Historically, both Alaska and Alberta have exhibited all the characteristics of a staples economy - one dominated by the sales of renewable and non-renewable resources. According to Harold Innis, Canada's most noted political economist and exponent of the staples thesis, the predominance of a staples economy locked Canada into a subordinate position to the more developed centers of the world economy - first France, later Great

Britain, and finally, the United States - the consequence of which was the extreme vulnerability of Canada's resource export economy to sudden fluctuations in world commodity prices. Booms were inevitably followed by busts.[1]

Indeed, such has been the history of both Alberta and Alaska. In Alberta, the first staple of importance was wheat. During the depression of the 1930's falling commodity prices devastated thousands of primary producers. While the new West of the post-war era enjoyed a somewhat broader economic base - in Alberta oil and natural gas eventually joined and superceded wheat as the province's chief staple - it was still primarily dependent on the extraction of natural resources and fluctuating world markets for these commodities. Alaska's history, too, represents a continuing pattern of resource exploitation as a basis of economic prosperity - first, furs by the Russians, but later, under American hands, gold, then salmon, copper and timber production, and finally, like Alberta, oil. Throughout its history Alaska's development process "has been subject to booms and busts associated with on-again, off-again resource exploitation."[2]

In the 1970's and early 1980's Alberta and Alaska experienced a boom in the oil and natural gas sectors like no other boom before it - producing large budgetary surpluses for both governments. While optimistic about their future Albertans and Alaskans shared a common concern about their fate once oil revenues began to decline. As the Fairbanks Daily News-Miner put it,

> What could be more exciting than the prospect of true economic stability for Alaska? What Alaskan wouldn't like to see the boom and bust economic cycle that has transformed the state and territory since the turn of the century be transformed into a relatively smooth line on the economic chart?[3]

Two years previously the Premier of Alberta, Peter Lougheed, had expressed similar sentiments in a speech to the Calgary Chamber of Commerce:

> Since entering public life over nine years ago, my theme has been that this province's economy is too vulnerable, it is too dependent on the sale of depleting resources, particularly oil and natural gas, for its continued prosperity. We have perhaps another decade left to diversify our economy to become less dependent. If we fail to do so, in my opinion, we will leave the next generation in Alberta a sad legacy indeed - a lack of economic muscle to sustain our quality of life over the long term.[4]

It was within this context of boom and bust and the anticipation of budgetary surpluses that the idea of the Heritage Fund was first raised in the Alberta cabinet in the early 1970's. Not until February, 1975, however, did the government announce that the Heritage Fund would be created setting aside surplus funds for economic diversification and the "benefit of future generations of Albertans."[5] The promise of a heritage fund became part of the Progressive Conservative government's election platform that spring. Yet, while Premier Lougheed asked for the electorate's support for the concept throughout the campaign the proposed uses and shape of the fund were ill-defined.

In the fall of 1975, after their overwhelming victory at the polls, the Lougheed government introduced Bill 74, a preliminary version of the Alberta Heritage Savings Trust Fund (AHSTF) Act, to the provincial legislature, but allowed it to die on the order paper so that the public could respond to the proposal over the winter. Indications are that the debate was low key if it existed at all. Public hearings, for example, which were demanded by the opposition were not held. People were expected to make their concerns known to their individual Members of the Legislative Assembly. In April, 1976 the bill was reintroduced as Bill 35 - the only major change being that 30 percent of Alberta's non-renewable resource revenues would not be automatically transferred to the fund as originally planned, but rather the transfers would have to be authorized annually in advance thus ensuring, asserted Lougheed, that the Legislature "controls the tap."[6] On April 26, 1976 the Legislative Assembly overwhelmingly approved Bill 35. Unlike the constitutional amendment that was necessary to create the Alaska Permanent Fund, the Heritage Fund, it should be stressed, was created by ordinary legislative action of Alberta's parliamentary system. Furthermore, the AHSTF Act specified the objectives, organization, management and investment policies of the Heritage Fund.

In contrast to the Heritage Fund the process of creation of the Alaska Permanent Fund was much more drawn out. While Alaskans, too, were aware that forthcoming revenues from the giant Prudhoe Bay field were surplus to their needs the only agreement that could be reached in 1976 was that "twenty-five percent of all mineral lease rentals, royalties, royalty sale proceeds, federal mineral revenue-sharing payments and bonuses received by the state [should] be placed in a permanent fund." Beyond this no consensus was reached at this time on the objectives, organization, and management of the Permanent Fund. At this point it could be safely said that the Heritage Fund and the Permanent Fund represented little more than a good idea in the minds of the electorate. It was the ensuing debate in the years that followed that gave the Permanent Fund a clarity of purpose and structure never achieved by the Heritage Fund.

Objectives of the Permanent Fund and the Heritage Fund

The absence of definition for the Heritage Fund is evident in its choice of objectives. From the very beginning the government thought the fund could somehow pursue a number of competing objectives. Introducing the AHSTF bill to the legislature on April 23, 1976 Premier Lougheed outlined four objectives of the proposed fund: 1) to serve as a savings account to provide a future source of revenue to offset resource revenue declines; 2) to lessen the need for the province to borrow and thus reduce the province's future debt load; 3) to improve the quality of life and 4) to strengthen and diversify the economy.

Each of these objectives exist, to some degree, in tension with the others. For example, the decision to concentrate on the social quality of life objective, in essence, represents a decision to spend which is in clear conflict with the savings account/fiscal objective. Similarly can one invest in economic diversification and still meet the savings objective? At the time however, Lougheed stressed that both the economic and savings objectives were of primary importance. The fund, he said:

> Must offset the probability of declining revenue in the future by its appreciation and by its income. At the same time, it must be a vehicle for diversification and for strengthening our economy. . . . It must do both; not just one, but both.[7]

Less emphasis was given to the second and third objectives. In time, however, the second objective came to dominate the fund. The quality of life objective was a grab bag of odds and ends including everything from parks to housing loans. In 1980 the government, less enchanted by the prospects of economic diversification, made a significant amendment to the fund's objectives no longer requiring it to strengthen **and** diversify the economy, but only to strengthen **or** diversify the economy.

In Alaska the process of selecting the objectives of the Permanent Fund was much more arduous than the Heritage Fund taking over three and a half years involving numerous participants and widespread public debate.[8] Different constituencies saw the Fund in a different light and, in turn, proposed a variety of economic, social and savings/fiscal objectives. Similar, perhaps, to Albertans, Alaskans initially appeared to emphasize both the economic and savings objectives of the Fund with somewhat greater support for the economic development objective. Unlike Alberta, however, the protracted nature of the Alaska debate forced Alaskans to choose between the two objectives with the fiscal/savings objective eventually emerging triumphant. In the end this was a healthy process for the managers of the Fund could focus on doing one thing well. Again, however, the process was not complete for while the April, 1980 legislation set the Fund's principle objective, provided for investment management and accountability, it was silent on the disposition of the Fund's earnings, a question not resolved until 1982.

Organization and Management of the Permanent Fund and the Heritage Fund

The contrast in the objectives of the two funds is representative of other significant differences in their organization, management and accountability. Of fundamental importance is their relationship to other organs of government. In this regard the Heritage Fund differs significantly from the Permanent Fund. Unlike the Permanent Fund which is run as a public corporation with an arm's length distance from the executive and legislative branches of government the Heritage Fund is controlled by the provincial cabinet. With the exception of capital spending which must be approved by the legislature, the Investment Committee of the Alberta Cabinet possesses discretionary power to manage and invest all assets of the fund (80%) without informing or obtaining prior approval of the legislature. In Premier Lougheed's opinion only the cabinet was capable of taking a long-term perspective and insulating the fund from the hubbub of the political process - a mistaken view in the end. According to Lougheed:

> These revenues do not belong entirely to the present generation. They belong at least on a 30-70 split to future generations. They can't become a huge slush fund for this Assembly to satisfy unrealistic expectations.[9]

Day-to-day administration of the fund is the responsibility of the Provincial Treasurer and members of his staff. The Investment Committee and Treasury receive additional investment advice from two investment firms, Morgan Grenfell and Company and Montreal Investment Management, Inc.

In Alaska, too, there was a fear of leaving the Fund in the control of the legislative branch but there was an additional reluctance to leave it within the hands of the executive branch. Yet, at the same time, it still had to be accountable to elected officials. According to the Free Conference Committee report "the aim was insulation without isolation" best achieved by creating "a public corporation distinct from state government."[10] The management framework of the Permanent Fund needs little elaboration to this audience. What is distinctive about it from an Alberta viewpoint is that management of the Fund lies in the hands of trustees and staff with recognized competence in business and finance who have a vested interest in ensuring the success of the Fund and not in the hands of politicians who must keep an eye on the election calendar.

Accountability

In addition to the significant differences in management of the two funds there is a very important difference in their accountability, in particular their public accountability. In terms of legislative accountability both funds are, it appears, deficient. In Alaska the Legislative Budget & Audit Committee was given responsibility for oversight of the Permanent Fund. Yet indications are that the Committee has not developed the financial expertise necessary to assess large-scale state investments leading one consultant to observe that "without oversight the. . . potential for mismanagement of public funds persists."[11]

In Alberta it must also be said that the legislature has not been able to provide thorough, knowledgeable and effective oversight to the Heritage Fund. Legally, the Standing Committee of the Alberta Heritage Savings Trust Fund Act is charged with the responsibility of providing legislative oversight. Various government officials, including cabinet members, appear before the Committee in its fall meetings to answer questions. While the Committee has, on occasion, challenged the government, particularly in its reporting of the fund's assets, the cabinet is under no obligation to heed its recommendations. This has led to frustration on the part of both government and opposition members of the Committee. In 1986 Stan Nelson, an exasperated Progressive Conservative MLA from Calgary, stated:

> Quite frankly I get a little sick and tired of seeing these notes from the various provincial treasurers indicating that they'll have a look at this and really nothing is ever done. I get the impression that some members of the cabinet occasionally feel that the members of committees are just there as a tool for a public purpose.[12]

Ray Martin, leader of the Official Opposition, has described the annual review as "next to useless."[13]

Ineffective legislative accountability in the Alberta case is compounded by weak public accountability. Beyond the publication of quarterly reports and an annual report audited by the Provincial Auditor General, the government is not required to make any other information public nor is it required to publish a market value appraisal of the fund's investments or have a performance evaluation conducted. Even the information the government is required to make public may be sporadic. For example, in the preparation of this presentation I attempted to obtain a recent 1987 quarterly report. I found out the latest report was December, 1986. Some rounded figures were available from the March, 1987 Budget Address but more precise figures remain confidential until the release of the annual report (year end is March 31) sometime this month or next just prior to the fall meeting of the Standing Committee. In the parliamentary game of politics one of the rules of the game is don't provide, if possible, the opposition with the means to criticize your performance. In addition, the Provincial Auditor-General is limited to strict adherence to accepted auditing standards and is not permitted to make a value for money audit, such as that conducted by the federal Auditor-General of Canada which has resulted in harsh criticism at times of the federal government's spending habits.

By 1986 the provincial government was admitting that the public was confused about the fund. In his appearance before the Committee in 1986 Premier Don Getty, Peter Lougheed's successor, observed:

> I find very few people, in public or private life, who express. . . any real knowledge of the fund. . . . They continue to think that we have this huge pile of money sitting under the Legislature. . . . The awareness of our citizens is a problem with the fund.[14]

In contrast one of the strong points of the Permanent Fund is its record of public accountability. For example, the public is encouraged to attend and participate in meetings of the board of trustees. My appearance before you today simply could not take place in Alberta. Public accountability in the Alaskan case is also enhanced by such measures as independently audited statements, market-value appraisals of investments, your recently instituted public information and accountability program, and finally the distribution of dividends. One can only hope that, after all this, Alaskans are aware of the Fund and what it is trying to do.

Fiscal Structure of the Funds

A brief comparison of the two funds reveals that the Heritage Fund is considerably more complicated than the Permanent Fund. Unlike the Permanent Fund the Heritage Fund is divided into five investment divisions of varying size and purpose: the Alberta Investment Division; the Capital Projects Division; the Canada Investment Division; the Energy Investment Division and the Commercial Investment Division. Funds not invested in any of the five divisions must be invested in deposits and marketable securities. Approximately 93% of the Heritage Fund is invested in various types of bonds and 1.6% in stocks, with equity in Syncrude and the Alberta Energy Company accounting for another 4.2%.

The division of the fund managed most comparably to the Permanent Fund is the Commercial Investment Division (CID) with $241 million (Cdn) in equity investments. These investments are small in size compared to the overall fund ($15.363 billion Cdn). However, combined with $1.86 billion (Cdn) in cash and marketable securities, they represent the most liquid portion of the fund.

By far the most significant division of the fund is the Alberta Investment Division (AID) which consists of $7.86 billion (Cdn) in loans to Alberta crown corporations. While ostensibly the investments of AID must strengthen or diversify the economy, it is my contention that they should be assessed both in terms of a fiscal objective (as a substitute for borrowing) and a quality of life objective. Recent adverse economic conditions have meant that crown corporations such as Alberta Mortgage and Housing Corporation ($3.4 billion Cdn in loans) that make interest payments to the

Heritage Fund are losing money and will require direct subsidies of $309.9 million (Cdn) from general revenues in fiscal year 1987/88 to operate.[15] The result, claim the opposition parties, is a misrepresentation of the fund's actual worth.

No doubt the most controversial division of the fund is the Capital Projects Division (CPD) which has spent $2.625 billion (Cdn) for such projects as parks, hospitals and irrigation ditches. Despite the fact that the money is non-recoverable they are listed as "deemed assets" in the annual report of the fund thus inflating the Heritage Fund's assets to $15.363 billion (Cdn) instead of $12.738 billion. Both the Provincial Auditor-General and the Standing Committee on the AHSTF Act have consistently recommended that deemed assets be removed from the balance sheet of the fund but to no avail.

The only other significant division is the Canada Investment Division which consists of $1.857 billion (Cdn) in loans to other provincial governments and crown corporations. It was established in part to diversify the fund's portfolio and to reduce the inflationary pressures in Alberta in the 1970's, but an unstated motive was to mollify public opinion in the rest of Canada, particularly the most populous province of Ontario, which was growing increasingly concerned about Alberta's growing wealth and power. Lending activity was suspended in March, 1982. Many of these loans were made in times of high interest rates with repayment not due until 2005 and represent sound investments.

The Energy Division of the fund was established in 1980 to facilitate the development of energy resources within Canada but it has never had investments of any consequence. Its only investment at present is $11.0 million in corporate debentures to Luscar Ltd., a coal mining company.

Most investments of the Heritage Fund, with the exception of those in the Canada Investment Division, have been made in Alberta. No long-term goal of an annual real rate of return for the fund has been publicly announced. The annual report indicates nominal rates of return only. By using the Consumer Price Index the real rate of return can be calculated but two notes of caution are in order. First, nominal rates of return for the Heritage Fund do not include the Capital Projects Division. Second, the annual reports do not take into account that cumulatively the crown corporations of AID are subsidized from general revenues. The table on the following page indicates the real rates of return between 1978 and 1987.

Contributions to the fund have altered significantly over the years. Prior to 1983 the Heritage Fund received 30 percent of all resource revenues but the recession of 1982 prompted the government to reduce that figure to 15 percent. Collapsing oil prices in 1986 forced the provincial government to "cap" the fund as of the 1987/88 fiscal year with no indication when, or if, contributions would be resumed.[16] In addition, no longer is the Heritage Fund protected from the effects of inflation as it was prior to 1983. Since then income from the fund has been diverted to general revenues. Moreover, the fund principal itself is now eroding because the province has reallocated monies to support ongoing projects initiated by the fund.

The complexity of purpose and fiscal structure of the Heritage Fund contrasts sharply with the Permanent Fund where simplicity of purpose translates into simplicity of fiscal structure. The Permanent Fund is composed, as you are aware, of two parts:

A Comparison of the Real Rates of Return of the AHSTF and the Permanent Fund, 1978-87

Year	AHSTF	Permanent Fund
1978	-0.1%	1.08%
1979	0.2	0.58
1980	0.8	0.03
1981	-1.6	2.48
1982	1.0	4.73
1983	6.7	6.66
1984	8.7	7.67
1985	10.0	7.35
1986	10.2	10.79
1987	10.1*	12.22
Average rate of return 1978-87	4.6%	5.36%

Source: Alaska Permanent Fund Corporation, 1986 Annual Report, Alberta Heritage Savings Trust Fund, Annual Report, 1985-86

**At the time of writing, the 1986/87 annual report of the Alberta Heritage Savings Trust Fund had not been released. This figure represents an estimate based on the 1985/86 figures. Given that many of the loans in the AID were renewed in 1986/87 at a lower rate the estimated real rate of return for 1986/87 is somewhat high.*

principal and earnings reserve. The principal of the Permanent Fund as of June 30, 1987 stood at $7.86 billion (US) and the Earnings Reserve Account at $529 million (US) for a total of $8.8 billion (approximately $11.6 billion Cdn) in Fund equity.[17] The principal of the Fund includes: 1) oil royalties deposited by constitutional dedication ($2.91 billion), 2) extra money deposited by legislative appropriation ($3.96 billion), and 3) income of the Fund which has been transferred to principal in order to "inflation-proof" the Fund $981 million). The Earnings Reserve Account (ERA) consists of all other net income which has not been distributed as dividends or transferred to principal for inflation-proofing. The ERA is managed as part of the Fund but can be appropriated to general revenues by ordinary act of the legislature. Expenditure of the principal (but not the ERA) is prohibited by the state's Constitution. In Alberta, on the other hand, expenditure of the principal has been a common occurrence in the Capital Projects Division. Furthermore, in a parliamentary system there is no overriding constitutional system preventing the Province of Alberta from spending any part of the Heritage Fund. In 1982 inflation-proofing was added to the Permanent Fund, the same year in which it was dropped from the Heritage Fund.

As the table in this section indicates the average real rate of return for the Permanent Fund not only exceeds the Heritage Fund but also the long-term goal of the trustees to realize an annual earnings rate of 3 percent above inflation. Currently the investment policy of the Fund is as follows: 1) Up to 84 percent can be invested in fixed-income securities, chiefly US government bonds; 2) Up to 15 percent can be invested in common stock in US companies, and 3) Up to 6.5 percent can be invested in real estate.

Only 5 percent of the Permanent Fund is committed to investments in Alaska, another striking difference with the Alberta Fund.[18]

Performance Analysis

Assessing the performance of funds the size of the Permanent Fund and the Heritage Fund is a very complex and difficult task usually conducted by national investment firms with experienced staff and the latest data analysis capabilities at their disposal.[19] A performance analysis can be conducted at three levels. These are:

1. Comparison of the funds against previously set objectives.
2. Comparison of the funds against like funds of portfolios.
3. Comparison against the market as a whole as measured by national market indices.

While comparison of both funds against previously set objectives is possible only the Permanent Fund has had an independent performance analysis conducted that considers levels two and three above. The government of Alberta has steadfastly maintained that the Heritage Fund is unique and cannot be compared against any other fund. As former Provincial Treasurer Lou Hyndman expressed it to the Standing Committee on the AHSTF Act in 1982:

> It hasn't been demonstrated that valid performance comparisons can be made for the Heritage Fund with any other similar fund. There simply isn't any other fund that has the objectives, the same restraints, the same performance measurement situation or the same portfolio of holdings.[20]

Although no comprehensive performance analysis has yet been conducted which allows one to assess the Heritage Fund against other funds or national market indices, a comparison with the Permanent Fund indicates that the latter has, over time, yielded a higher real rate of return than the Heritage Fund, 5.36 percent versus 4.60 percent.

In the case of the Heritage Fund, therefore, that leaves one only with the option of comparing the fund against previously set objectives. Originally the government put a primary emphasis on using the fund for diversifying the economy. There is, however, little evidence that Alberta's economy, with the exception of a growing petrochemical industry, has become more diversified or that government policies have contributed to diversification.[21] In particular, there is little evidence to suggest that the Heritage Fund has ever been used, except in a limited way, as a tool for economic diversification. No doubt some of its activities such as Vencap, a small venture capital company (investment $200 million Cdn), and capital expenditure on irrigation, medical research, forestry and food processing have contributed to economic diversification. Furthermore, no analysis of the fund's impact upon diversification has yet been conducted.[22] Neither is there any evidence that the fund has strengthened the economy. Most of the $6.1 billion the government claims is devoted to strengthening the economy is tied up in loans to crown corporations. The point is made all too frequently that, with backing from the province, these corporations could have easily raised capital on the open market. In sum, the Heritage Fund hasn't caused anything to happen that would not otherwise have occurred.

If there is an objective of the fund that has become more important in recent years it is use as a savings account, providing an income stream to maintain ongoing government services and minimize, until its latest budget, taxes. Since 1983 an average of $1.5 billion (Cdn) a year has been diverted from the fund to general revenues. However, with the fund capped the income stream from the fund will steadily decline in real dollars. In addition, the inflexibility of many of the fund's investments, i.e. long term loans to crown corporations and other provinces, limits the ability of the province to dip easily into the fund to cushion dramatic drops of general revenue. Public perception, however, is that the fund can be easily tapped thus creating an unwillingness to accept increasing taxes or government cutbacks. With the dramatic drop in oil prices in 1986 this perception, also widely shared outside Alberta, hampered the province's ability to get widespread support in the rest of Canada for special assistance for the ailing oil and gas industry.

The intangible nature of the third objective, improving the quality of life, makes it very hard to evaluate. The fund has made extensive investments in recreation and parks, health, housing and education. These investments, particularly those in home mortgages, must be viewed as a concession to political realities. In the booming 1970's housing, admits Dick Johnston, was a problem: "People were crying for mortgages and we had this huge fund here; how can you say no?"[23]

In 1976, the fourth objective, that of using the fund for government borrowing needs was given little attention but within a few years it became the central objective of the fund. Today, most of the fund has been lent to provincial crown corporations that went into a recession along with the rest of the province in 1982 and 1986. Unfortunately, the Alberta government did not see any necessity in investing in other areas that would remain healthy when the provincial economy took sick. Most ironically, the government, faced with large deficits, had to go to New York to do what it said it did not want to do - borrow outside the province.

On the other hand, there is no doubt that the Permanent Fund has fulfilled its primary objective of being a savings account for future generations. It has done so in an admirable manner. But while acting as savings account the Fund was intended to provide an income stream to be decided by law. It is here that the decisions of the state are debatable, or, better to say, for an outsider inexplicable. In 1986 and early 1987, for example, the State of Alaska found itself in a position where, due to declining oil prices, it was forced to cut millions from its capital and operating budgets. The state was also considering laying off or reducing the salaries of its employees. This, at a time when citizens were sent dividend checks totalling $295 million and the legislature had authorized the transfer of $1.26 billion of the ERA to Fund principal on July 1, 1986. Given that the anticipated shortfall for Fiscal 1987 was $1 billion (from a budget of $2.4 billion) and could have been alleviated by reducing the portion of ERA transferred to principal or by reducing or eliminating the amount paid in dividends, one has to question whether such tough restraint measures were necessary? Few legislators, it appears, demonstrate a willingness to alter the popular dividend program transforming the dividends from a means, that is, making citizens more aware of the Fund, into an end in itself. No doubt in the years ahead as Prudhoe Bay revenues dry up the question of whether to continue with the dividends will loom even larger.

In addition to evaluating the objectives of the Permanent Fund one can compare it against other funds and the market as a whole. According to SEI Funds Evaluation Services "the Fund has earned a rate of return that is comparable to that of its peers, but with a much lower level of risk."[24] One can only hope that external evaluations will become as permanent as the Fund itself.

Summary

In sum, despite similar origins the Heritage Fund and the Permanent Fund took very different directions. Whereas the Heritage Fund was intended to pursue competing objectives the Permanent Fund struck out in a singular direction. Its primary objective, to be a savings account, gave it a clarity of purpose that the Heritage Fund never achieved. The Permanent Fund's openness and clarity of purpose also facilitated public accountability and support. Both funds demonstrate the limitations of legislative oversight thus making public accountability imperative. It is here that the Permanent Fund clearly demonstrates that there is no contradiction between openness and public knowledge and a well-run fund. In fact the latter is predicated on the former.

Public support of the Permanent Fund was facilitated by the decision to create a public corporation distinct from government. Management of the Fund by experts in finance and business has reinforced public perception of its competence and political neutrality permitting the trustees to invest increasingly in common stocks, which over time, yield a higher rate of return. In Alberta, the Heritage Fund, from the very beginning, has been politicized - from its announcement on the eve of the 1975 election to the creation of the Canada Investment Division, to its provision of mortgage loan assistance to clamoring homeowners suffering from high interest rates in 1982 prior to a provincial election. The critical difference between political management of the Fund in the late 1970s and the mid-1980s is that what was a political asset is now a political liability as more questions are asked about the Fund. The politicization of the Fund also helps us to understand its conservative investment strategy. If the Provincial Cabinet had invested in the stock market and lost, not gained as the Permanent Fund did, the political price may have been very high indeed.

Finally, in terms of assessing the performance of the funds, it is much easier to evaluate the Permanent Fund. The decision of Alaskans to accept Fund dividends when that money could have been used to prevent budget cuts is certainly debatable, but the fact remains that the Fund has fulfilled its purposes of being a savings account and providing an income stream. The disposition of that income is a legislative responsibility. Assessing the Heritage Fund when its objectives are in conflict is much more difficult.

To understand how the two funds could take such different directions when they had similar motivations necessitates examining some of the more salient political and economic differences between Alberta and Alaska. For example, there are the very significant constitutional differences between the United States and Canada. The Alaskan legislature, for example, simply did not have the authority to establish a dedicated fund - your constitution prohibited it from doing so. Once the necessary amendment was approved by the voters it gave the Fund a degree of protection that it might not otherwise have had in a parliamentary system where the acts of the legislature are supreme.

In addition, in Canada the parliamentary system with its strict party discipline tend to be dominated by the political executive, that is, the cabinet. That the Alberta cabinet should desire to exercise control over the fund should come as no surprise. In Alaska, however, the fragmented nature of the political system with its separation of powers and weak party system makes it difficult to easily resolve political differences as evidenced in the drawn-out contest to determine the Fund's objectives. This division makes compromise necessary and ultimately the politically most contested objective was abandoned and the Fund made a public corporation.

The place of Alaska and Alberta in their respective federal systems played a role in shaping their funds. In particular the position of Alberta within its federal system is much more pronounced than Alaska within the American federal system. Alaska represents no more than one-fourth of one percent of the American population and its wealth, while substantial, was not perceived as serious challenge to the distribution of power within the American political system. This was not the case in Alberta which represents ten percent of the Canadian population and the wealth of which was seen as threat to the distribution of power centralized in eastern Canada, particularly Ontario and Quebec. During the 1970s and early 1980s the Alberta government spent much of its time warding off what it saw as federal encroachments on its surplus. The establishment of the Canadian Investment Division must be seen as one attempt to satisfy the appetite of the eastern Canadian wolf.

Coupled with the fear of the political power of eastern Canada is fear of its economic power. There is a perception amongst people of very differing political persuasions in the Canadian West that the commercial banks, concentrated in eastern Canada, have prospered at the West's expense. In 1973 the Western Premiers asserted that "by mobilizing Western Canada savings and transferring them to Central Canada, the banks, in effect, have reduced the development potential of the West."[25] It was this perception that contributed to the Heritage Fund being used for borrowing purposes.

In Alaska, on the other hand, bankers and economic consultants were able to persuade the legislature that the assertions that banks were not serving Alaska's capital needs were ill-founded. Economists have made a similar point about the Canadian West but to a much more skeptical audience.

It was also this fear of the economic power of eastern Canada and a desire to break out of the cycle of boom and bust economies that led to economic diversification being posed as one of the objectives of the Heritage Fund. Albertans also appeared to believe that economic diversification was a viable option. While the economic base of Alberta is narrow, in the early 1980s it did have both a strong energy sector and a strong agricultural sector to build upon. With these as a starting point it was hoped that the economy could expand into the growing information and medical research industries along with tourism, forestry and coal production. That the province was never able to produce a coherent strategy showing how this was to be done is unfortunate.

The result is that today Alberta faces an uncertain future. The best hope for the Alberta economy lies in the recovery of oil prices. But isn't this where it all started ten years ago? Alaskans, too, are faced with the prospect of hoping for the best. While your Fund will provide a valuable income stream in the years to come Alaskans are still left in the disturbing position of building their economy on the very shaky foundation of resource exports. "Plus ca change, plus c'est meme chose."

FOOTNOTES

1. For more on Innis and the staples thesis see Mel Watkins and Easterbrook (eds.) Approaches to Canadian Economic History (Toronto: McClelland and Stewart, 1967)

2. Thomas Morehouse (ed.) Alaskan Resource Development: Issues of the 1980s (Boulder, Colo.: Westview Press, 1984), 3

3. Fairbanks, Daily News-Miner April 26, 1976, 4

4. Premier Peter Lougheed, Speech to the Calgary Chamber of Commerce, 1974, as quoted in the Edmonton Journal Feb. 16, 1983

5. Budget Address, Feb. 7, 1975, 9

6. Premier Lougheed, Alberta Hansard, April 23, 1976, 832

7. Premier Lougheed, Alberta Hansard, op cit., 829

8. For a list of those who participated see Sheila Helgath and Sarah A. Bibb, Alaska's Permanent Fund: Legislative History, Intent and Operations (Juneau: Rural Research Agency, Alaska State Senate, 1986) and "A Proposal for the Permanent Fund," Final Report by the House Special Committee on the Alaska Permanent Fund, 1977

9. Premier Lougheed, Alberta Hansard, op cit., 832

10. See Final Report of the House Special Committee on the Alaska Permanent Fund, 1977

11. Helgath and Bibb, op cit., 57

12. Legislative Assembly of Alberta, Standing Committee of the Alberta Heritage Savings Trust Fund Act, October 28, 1986, 339

13. As quoted in Andrew Nikiforuk, "Alberta's Rainy Day," Report on Business Magazine, December, 1986, 92

14. Standing Committee, op cit., 35

15. Budget Address, March 20, 1987

16. Budget Address, March 20, 1987. All figures for the various divisions of the fund along with the total fund assets are taken from the Budget Address

17. Alaska Permanent Fund Corporation, Statement of Assets, Liabilities and Fund Equity, June 30, 1987

18. Alaska Permanent Fund, Annual Report, 1985

19. For an overview of the complexities see Helgath and Bibb, from whom the following classification was adapted, op cit., 90-91

20. Legislative Assembly of Alberta, Standing Committee of the Heritage Savings Trust Fund Act, 1982

21. See K. H. Norrie and M. B. Percy, Economic Council of Canada, Discussion Paper No. 201. Norrie reconfirms his conclusion in Kenneth Norrie, "A Regional Economic Overview of the West Since 1945," in A. W. Rasporich, (ed.). The Making of the Modern West: Western Canada Since 1945 (Calgary: University of Calgary Press, 1984), 97-105. Norrie and Percy's conclusions are supported by Brenton M. Barr, "The Economic Geography of Prairie Canada in Regional Perspective," in Rasporich, ibid., 78-89 and by Ed Shaffer, "The Political Economy of Oil in Alberta," in David Leadbeater (ed.), Essays on the Political Economy of Alberta (Toronto: New Hogtown Press, 1984), 174-91

22. On this point see the exchange between the New Democratic MLA Leo Piquette and the Provincial Treasurer Dick Johnston, Standing Committee, October, 1986

23. Toronto Star, February 9, 1987

24. Alaska Permanent Fund Corporation, Press Release, April 14, 1986

25. Western Premiers, "Capital Financing and Regional Financial Institutions," Joint Submission of the Western Premiers to the Western Economic Opportunities Conference, July 24-26, 1973 as quoted in Kenneth Norrie, "Some Comments on Prairie Economic Alienation," in Canadian Public Policy, 1976

QUESTIONS

Q: Dr. Smith, one of the things, of course, that's been debated before and after the Permanent Fund structure was set up, is the wisdom of concentrating the investments of the Fund in a narrow geographic area or one industrial sector, etc. Too much concentration of the investments would lead to a lot of volatility in, not only the income stream, but you could lose the principal that way, too. Isn't that topic debated in Alberta?

A: Well, it's being debated now. To be honest, it was not debated to that great an extent in the 1970s. Again, you have to understand somewhat the Canadian political system where there has been so much antagonism to the federal government that you had, more or less, a circling of wagons and the main opposition came from the east, from Ottawa, and that the interests of the province had to be protected. This argument was bought by the Alberta populous. The Lougheed government, with each election, had increased majorities. The last majority he had was 75 in the government and four in the opposition, so that most Albertans accepted what the government was saying in this regard. It's only been within the last year or two that this is changing, and particularly this summer with the collapse of Alberta's major financial institution and the loss of $2 billion. This financial institution had invested largely in Alberta in real estate and in some other areas that were quite vulnerable.

This is teaching Albertans, I think, a very tough lesson that the strategy of investing solely in your province in one or two sectors is not a wise one, that you have to have a diversity of investments to protect the province over the long term. But this argument was simply not accepted in the 1970s. Albertans accepted almost unanimously that the money had to be invested in Alberta which is very narrowly based, that the money couldn't go elsewhere, and it should also be used as a savings account and there was very little question about that. So, it's only been in the last two or three years that Albertans have taken a very cold shower in that regard.

Q: You mentioned early in your presentation that you thought both the Alberta Heritage Fund and the Alaska Permanent Fund were weak in the area of accountability to the legislative branch. The trustees are quite concerned about that here as well, about the communications, understanding, and accountability to the legislative branch. Do you have any specific observations or recommendations for the Permanent Fund in that regard?

A: The difference in Alberta and Alaska in this is stark because the process by which the legislature reviews the fund in Alberta means that the governing party controls that process, so that the questions that are asked by the opposition for further information can be overridden by either the Committee, controlled by the government, or the cabinet. I think the primary difficulty here in Alaska, as an outsider and observing both processes, is how do you build up this independent expertise by which the legislature can criticize the Permanent Fund? I simply don't think that can be done by the legislature. I think the best thing to do is to encourage the process of what you're doing right now, and that is to provide as much information as possible to the public that is clear and direct and then the legislators, who we presume are intelligent, can make their own deductions from this information and ask their own tough questions. Indirectly, the legislative responsibility will come via the public information and, I would imagine, to the legislators. But to build up a body of expertise for the legislature, I would think, would be superfluous to providing good open public accountability. To me, that's the key, if you want good legislative accountability.

Q: Sir, I've been to Alberta a number of times and what struck me was that people from all walks of life very readily accepted that the fund was in the charge of politicians. In fact, they're into it up to their eyebrows. I remember meeting waitresses and all sorts of people saying, "Oh, I wish that we could have a dividend, but we'll never have anything from the fund except what the government tells us we can have." In sharp contrast, in Alaska there's a growing sense, deeply felt I think, that the Fund belongs to the public, not to the politicians, and politicians tread warily. Some of them who have not treaded warily are not treading. You express bafflement, but to me it's not mysterious. There's one single striking difference between the two funds and that's the dividend. Everybody, man, woman and child, has a direct personal stake in the survival and the success of that Fund, which wasn't or isn't true in Alberta.

A: That is a disagreement of perception. I think Albertans would raise the question - and you might say your perception is that of the more mature political populous - that perhaps the dividends would be better used for: (a) economic diversification; or (b) for keeping up the standards of social services and not to cut education or health. These are very strong feelings. I think there's that trade-off between the two. Albertans would take increased government control over the fund, and not have its income used for dividends.

So, you are correct that Albertans see that the fund is, in fact, controlled by the politicians, not so much controlled by the public. I've been asked by a number of reporters in Alberta about the differences in the funds and one of them is this control by the politicians. I asked the people in a general way, "Would you take your savings, take them all out of the bank today, and go down to the legislature and give them to the Provincial Cabinet to let them manage your savings?" And there's kind of a look of horror on people's faces. This is the last thing they would do is take their personal savings and give it to politicians. They don't look upon the Heritage Fund directly as it being their fund in terms of the way Alaskans look on the Permanent Fund as their Fund. That comes from very different traditions in the two countries where government plays a much larger role in the society and there's a much greater deference to authority in Canada than there ever was in Alaska.

Q: You recognize that in Alaska the dividends are adding not only to personal income, but to the tax base. There's nothing to prevent the legislature or local governments from instituting personal income tax or property taxes.

A: I can recognize those arguments, but they would just fall on deaf ears in Alberta; they would not accept it that way. Dividends were tried in the late 1950s by the social credit government; people got $20 every year around Christmas-time to help buy a pair of shoes. Those dividends now are seen by Albertans as a quaint little measure of a responsible, progressive time that has passed by.