RENEWING
THE
WEALTH
OF
NATIONS

by

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Abstract

RENEWING THE WEALTH OF NATIONS

This thesis explores how capital flows are linked to economic development and proposes an alternative pathway to enhancing livelihoods in the marginal spaces of the global economy, drawing on examples from North America and the Pacific. Mainstream theories of development are largely based on European and North American examples, and argue for a progression of developmental stages from agriculture to industry to services, based on a flow of capital from core to periphery. Such theories are not place-specific, and do not reflect the particular conditions of remote and marginal places.

In the peripheral spaces of the global economy, investment opportunities may be limited. An alternative practice is to invest outside the region of capital generation, through the mechanism of a trust fund. I argue that local development can be achieved through investing in global financial markets, in core countries, rather than at the site of capital generation. In this way, local development is not limited to the marginal place where the benefits are to be felt; peripheral capital instead flows into the core to seek out the best investment opportunities. The local development process becomes differently spatialized by engaging global financial markets.

Capital generated in the periphery often comes in temporary streams, or windfalls, and benefits decline when the resource is depleted. Such non-renewable resources can be transformed into renewable fiscal ones when capital generated
from resource extraction is invested in financial markets through a trust fund. To make non-renewable resources renewable, they can be converted from a physical form into a financial form, thus extending the benefits of capital into perpetuity.

This thesis suggests that trust funds may serve as an alternative development mechanism in certain peripheral spaces of the global economy. Trust funds receive a share of resource revenues and increase them through investment. States can establish trust funds as an instrument of government policy, with all citizens as beneficiaries. Trust funds allow for re-spatializing the nature of investment as well as for sustaining it over time.

My analysis is based on the examination of six case studies. Two of these are peripheral economies in North America: the state of Alaska in the United States, and the province of Alberta in Canada. Both Alaska and Alberta established trust funds to manage their petroleum revenues. The four remaining cases are independent Pacific island nations: Kiribati, Nauru, Tonga, and Tuvalu. Each of these island nations established a trust fund to manage windfall resource revenues. The performance of these six trust funds has varied, largely reflecting policy choices. I develop a set of six criteria for the management of a successful fund.

In this thesis, I ask development practitioners to reimagine the economic spaces of marginal economies and the relationship between core and periphery. I argue for a separation of the sites of capital generation and capital investment, and for transforming non-renewable windfall resources into renewable fiscal ones.
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1. INTRODUCTION

In 1776, Adam Smith suggested that economic growth, and the betterment of society, depended on capital accumulation. Individuals accumulate capital, leading to both an augmentation of personal fortunes and to the improvement of society as a whole. Capital was the key: capital could be invested to finance new industries and expand the economy. Capital derived from what individuals put aside, ‘either regularly or annually, or upon some extraordinary occasion’ (Smith, 1999 [1776], I, 441). Thus economic development was at its foundation the work of individuals and small collectives.

The capitalist economic system had already expanded beyond Europe when Smith published *The Wealth of Nations*, and European capital had already reached the capitalist periphery. Europe ‘developed’ due to its ability to import raw materials from overseas, add value to them through manufacturing, and market those manufactures in the core and the periphery.¹ This process led to the emergence of thriving financial markets in the core states, in which capital could be invested, loaned out, and circulated through the economy.

¹ The core/periphery model is widely used in all branches of science, including the economics of development (Borgatti and Everett, 1999; Krugman, 1996). Borgatti and Everett (1999) formalise the core/periphery model based on networks and links.
that have not accumulated sufficient capital, and have therefore insufficiently
enjoyed the fruits of economic growth. How are these regions to be ‘developed’?
Since at least the end of World War II, a veritable army of development analysts
has considered this question. The answers generated tend to point in a single
direction: capital must flow from the wealthy core to the impoverished periphery,
so that new industries may flourish and peripheral economies expand. This
outbound capital would be generated by the financial markets of the core
economies.

Core states invest the bulk of their wealth in their own economies, or in
other core economies. Most global capital flows are within developed countries
(Gibson-Graham, 1996, 127). This is because peripheral economies, especially the
most peripheral, offer relatively few opportunities for profitable investment. Yet
peripheral states are continually advised, by global financial institutions such as the
World Bank, to create the conditions necessary to attract core capital and to invest
their own capital locally: they are advised to create local infrastructure and
industries and to replicate the development histories and trajectories of the core.
But what if peripheral states could invest their national wealth, not locally, but in
the financial markets of the core states? Would this generate greater wealth than
local investment? Would it lead to a betterment of society as suggested by Adam
Smith? This thesis considers these questions and suggests a way in which
peripheral states could invest in core economies and renew and expand the wealth
of marginal places.
1.1 The nature of development

Development is a word with many meanings. In the context of places on the margins of the global capitalist economy, it is often seen as a process by which these places will arrive at the same standards of living as the ‘developed’ societies of Europe, America, and Japan. Fifty years of development studies scholarship has explored the processes by which societies change their living standards and improve the wellbeing of their populations. The mainstream of this scholarship has concluded that the world’s capital distribution is uneven, and that a redistribution of the world’s wealth, through investment and trade, will benefit all societies (Henderson et al., 2001). The mainstream sees the solution to the ‘problem’ of ‘development’ as capital flow from richer to poorer societies, evening out the distribution of wealth and opportunity, and bringing the living standards of developing societies into line with developed ones. As geographer Carl O. Sauer critically noted, we have ‘universalize[d] our culture’, and that today we define ‘underdeveloped’ parts of the world as ‘those that have not yet been fitted into our pattern, which is one of “growth” or “progress” in measurable satisfactions, a mystique of numbers’ (1967, 61-62).

A minority of development analysts has taken a different approach. One
group, the dependency theorists (and their close relations), reject the notion of capital flows from richer to poorer as a foundation of development. Dependency theorists, such as André Gunder Frank and Fernando Henrique Cardoso, argue that flows of investment and trade between core and peripheral states always benefit the core. Investment and trade are therefore merely a form of exploitation, in which capital is actually extracted from developing countries. Initial capital, from the developed world, finances resource extraction activities that ultimately leave the poor countries poorer. These theorists argue that engagement with global capital is therefore no solution to development, and that developing states are better off cutting their ties to global capital, and relying on their own resources and traditional livelihoods. The ‘anti-development’ school is even more radical. These theorists, such as Gustavo Esteva and (in some respects) Arturo Escobar, problematise the entire concept of development, arguing instead for avoiding engagement with global capital. The anti-development theorists’ epistemological position also leads to a focus on local alternative economies and ignores state-led development.

Mainstream development models argue for capital flows from developed to developing societies as the path to development, assuming that the basic institutions of society—such as secure property rights and impartial enforcement of contracts—are in place. Mainstream theorists suggest that their models are universal, and they ignore the specifics of different places. Dependency theorists and anti-development theorists argue for a withdrawal from engagement with global capital. In this thesis I suggest a third path. I argue that, paradoxically, capital flows from developing to developed countries may be a development strategy that could benefit certain kinds of states. This reverse flow, in which
capital generated from the developing countries’ own resources is invested in
global financial markets through the mechanism of a trust fund, allows small and
resource dependent states to engage with globalization to their own advantage.

2. GLOabal DEVELOPMENT

Development theories and models since the emergence of ‘development studies’ in
the 1940s have tended to take a global or universalist approach to development,
conceiving of development as a process with equal applicability in all places and at
all times. Development is imagined as a constant, global process that plays out in
the same way every time. Theories and models developed in and for one location
may be applied, *mutatis mutandis*, to all other locations. Thus has modernity
annihilated space.4

2.1 Modernist and neoliberal theories

Mainstream development theory, in its modernist and neoliberal forms, is premised
on the flow of capital from developed to developing countries. Mainstream models
are founded on an ideological position that requires the developed countries to
assist developing ones, offering themselves as potential models of success. The
reasons for this are largely based on economic advantage, though they are often
couched in terms of altruism. Mainstream models assume a single linear path to
development, from Rostow’s (1960) ‘stages of growth’ conception to the more
recent trend towards promoting the service sector in developing societies. The
direct flow of capital into the periphery is promoted by a loose coalition of

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4 There is an extremely extensive critical literature on both mainstream and alternative forms of
economic development. For thorough reviews of this literature see Arndt, 1987; Brohman, 1996;
development agencies, multinational corporations, and international banks as the solution to economic growth in developing countries.

As Brohman notes, ‘the neoliberal development model is based on a neoclassical reading of the economic history of the industrialized capitalist world’ (1996, 31). This includes such elements as private market-led growth, private investment based on profit motives, relatively low wages, gradual industrialisation, and technological advancement based on innovation diffusion and increased globalisation (Brohman, 1996, 31). Once certain conditions are set in place in peripheral regions, investment will be attracted to them and initiate the process described above. The whole model is based on the trickling down of ‘benefits’ from developed, industrialised states to those in some earlier ‘stage’ of development. External capital is necessary to offset perceived local capital shortages, so the core invests in the periphery and thereby transforms it; the core enlarges and the periphery diminishes. Within the mainstream model, regional incomes will converge over time and regional economic disparities will disappear (Martin and Sunley, 1998). The extinction of the periphery is the telos of mainstream development models.

Mainstream development models suggest that certain conditions are necessary to attract external capital and—and retain domestic savings—to initiate the process of development diffusion. These include policy actions sometimes bundled under the rubric of ‘good governance’, including fiscal discipline (reducing budget deficits), tax reform, financial liberalization (market-based interest rates), competitive exchange rates, elimination of barriers to direct foreign investment, privatization, deregulation, legally secure property rights, and openness and transparency of government practice (Globerman and Shapiro, 2002;
Peet with Hartwick, 1999, 52). Within a global economy, geographical location becomes less important and a place’s regulatory environment becomes paramount (Hudson, 1998).

Though the trickling down of development benefits may have social aspects, in that benefits trickle from the individual rich to the individual poor, development is nevertheless imagined as a spatial concept: development spreads geographically from the richer countries of North America, Europe, and East Asia to the poorer countries of the developing world; development is thus something that diffuses (Berry, 1972). The experiences of North America, Europe, and East Asia are both the hearth regions of development and models of what development can and should be. According to these models, the periphery will only develop when it embraces the historical economic imaginings and practices of the developed world.

2.2 Alternative and critical theories

Alternative and critical theories of development may be loosely lumped into three broad categories: dependency and neomarxist models, anti-development critiques, and post-development critiques. The first two of these suggest that mainstream models of development are ultimately harmful and bring few benefits to peripheral regions. Post-development theorists instead argue for new ways of imagining the development process.

Dependency

Dependency theory, like the Marxist and neomarxist models of development from which it springs, denies the possibilities of development. Dependency theory
developed out of and as a reaction to modernization models. Rejecting the ‘stages of growth’ progression and the necessity of external capital, dependency theorists suggested that the flow of capital from core to periphery was at best an exploitative colonial process, increasing the dependency of the periphery on the core. The core provided both raw materials and markets for manufactured goods, but the real valued-added took place in the core, with its industrialized manufacturing sector. Peripheral states become locked in this position, unable to break free and ‘develop’ on their own. Peripheral states are then unable to directly manage their own economies, and they are forced to adopt policies that benefit the core (Orlove, 1977). The inability of the periphery to truly develop with external capital led some dependency theorists, such as André Gunder Frank, to propose socialist revolution as the only alternative to exploitation by the core (Frank, 1969).

Anti-development

The critical movement commonly known as anti-development is premised on the idea that ‘development’ is at root a discourse of power. In this critique, global development institutions (such as the World Bank) exercise power not because they are a source of capital but because they define development discourse and how development is imagined. This position leads anti-development theorists to reject the entire development enterprise as tainted by core-based financial institutions. Gustavo Esteva famously stated that the entire development project ‘stinks’ (Esteva, 1987), pointing out, among other things, the corruption, environmental degradation, and the damage to individual and collective livelihoods that (some) development projects engendered. A more moderate, but still critical, position is that of Arturo Escobar (1995), who sees the core-based development
project as a ‘global hegemonic imagination’ (Peet with Hartwick, 1999, 145) that runs roughshod over traditional societies and their ways of life. As Escobar notes:

> Development was—and continues to be for the most part—a top-down, ethnocentric, and technocratic approach, which treated people and cultures as abstract concepts, statistical figures to be moved up and down the charts of ‘progress’ (1995, 44).

Yet Escobar’s work, like others in the anti-development camp, and while making some good points, tends to lump all development theories together, does not recognize difference within development approaches, and confuses rampant capitalism with modernity. The anti-development school makes almost no reference to place, and calls for a retreat from the global and an embrace of alternative economies that ignores the possibilities of state-led development (Corbridge, 1998; Curry, 2003; Hart, 2001). Finally, anti-development cannot itself escape from the discourse of development, and is forced to analyse it using the same terms as other theories.

**Post-development**

Somewhat allied with the anti-development perspective is that of post-development. But while anti-development theorists have little faith in the possibilities of development, those in the post-development school see light at the end of the tunnel. Post-development theorists agree with many of the critiques of development levelled by scholars such as Escobar (and in some respects Escobar himself holds a post-development position), but they differ in viewing
development as a lost cause. Instead, post-development scholars attempt to reimagine development and unhinge it from the mainstream. This position is perhaps best expressed by J.K. Gibson-Graham in a recent paper:

The challenge of post-development is not to give up on development, not to see all development practice—past, present and future, in wealthy and poor countries—as tainted, failed, retrograde, as though there were something necessarily problematic and destructive about deliberate attempts to increase social well-being through economic intervention; as though there were a space of purity beyond or outside development that we could access through renunciation (Gibson-Graham, 2004).

Thus post-development theorists imagine a potential development that is divorced from both its mainstream capitalist underpinnings and its dependence on replicating ‘First World’ development history through industrialization based on direct foreign investment. This imagining of development recognizes that alternative, non-capitalist economic practices also form part of the conceptual space of development (Gibson-Graham, 1996).

In sum, mainstream models of development have been challenged in a variety of ways. Dependency and neomarxist theories have stood mainstream models on their heads, arguing that capital flowing from developed to developing countries solidifies a position of dependence and exploitation. Anti-development theorists reject the entire development project (but provide few practical alternatives), whereas post-development theorists point in new directions. In its analysis of development based on capital flows from periphery to core, this thesis fits partially within the post-development school.
2.3 The geography of finance

Geographers have increasingly focused on the spatial circumstances of finance. Geographer Andrew Leyshon (1995; 1997; 1998) has identified three general theoretical approaches to the geography of finance. The first is a political economy approach to understanding the spatiality of finance, the second is an anthropological approach to the concept of money, while the third approach suggests alternatives to the hegemonic imagination of the global economy.

The centrepiece of the political economy approach is explaining how globalization further separates the wealthy from the impoverished in both intranational and international contexts. In his 1995 article, Leyshon divides the political economy approach into three subcategories. One of these is the geopolitical economy of money, which explores financial hegemony, the financial bases of state and elite group power, shifts in power away from state interests and towards transnational interests of social elites, the ‘transnational business class’, and the blurring of state-economy boundaries. Geographers identified with this subcategory include Stuart Corbridge and John Agnew. Another subcategory is the geoeconomics of finance, identified with geographers such as Gordon L. Clark. This subcategory is concerned with such issues as globalization and the ‘end of geography’, the denationalization of currencies (such as the Euro), and the rise of ‘pension fund capitalism’ and the privatization of welfare, in which private funds begin to replace public programs. A third subcategory is the geography of financial exclusion, associated with such geographers as Andrew Leyshon and Nigel Thrift, which examines housing markets and ‘negative equity’, the growth of indebtedness, and national landscapes of exclusion. The political economy approach to the geography of finance appears to be the dominant one at present.
In his 1997 and 1998 articles, Leyshon continues his explication of the geography of finance and considers two other approaches. The anthropological approach to money is concerned with such questions as why global financial centres like New York, London, and Tokyo have persisted in the face of globalization, and with exploring the role of information in the spatial movement of capital. Some of Nigel Thrift’s work fits into this approach. The last approach, which is concerned with exploring alternatives to hegemonic imaginings of the global economy and global capitalism, is associated with J.K Gibson-Graham. This approach seeks to destabilize understandings of capitalism as a dominant and all-encompassing system by examining such metaphors as the ‘economic body’ and the ways in which it may be penetrated and by identifying non-capitalist alternatives, both extant and potential.

The work of the geographers analysed in Leyshon’s series of articles is largely (though not entirely) concerned with the developed world—and especially with North America, Europe, East Asia, and Australia—or with creating new theoretical positions in the face of globalization. The work of geographers of finance has focused its attention on flows of capital within and between advanced, industrial, developed states. In this sense the geography of finance is a field largely separate from the geography of development. How places on the periphery of the global system might engage with that system to their own advantage is a question significantly absent from most of the concerns of the geography of finance.\footnote{Although some geographers, such as Gordon Clark, have noted that the lack of financial integration between rich and poor countries is a threat to development (Clark, 2004a).}
Offshore banking

One aspect of the geography of finance that is concerned with development in peripheral places is its analysis of offshore banking (see, e.g., Hampton and Christensen, 2002; Hudson, 1998). Offshore banks offer tax advantages to individuals and corporations by allowing wealth to be deposited or nominally carried on the books of banks, trusts, and shell corporations domiciled in the ‘offshore’ country, typically a small state and usually an island (e.g., Bahamas, Cayman Islands, Tonga, Marshall Islands). The sovereignty of these small states allows them to develop their own tax policies and regulations. Typically there are no taxes in these places. Instead, there is a small fee for setting up and maintaining an offshore bank, trust, or corporation. These fees may be significant enough to account for an important share of national income, and a panoply of small states worldwide has thus adopted offshore banking as a development device.

Offshore banking is an example of a direct flow of capital from developed to developing countries. The capital remains the property of the foreign investor, and the earnings from this capital, as well as the capital itself, do not trickle into the offshore banking state. The capital is fictitious in the sense that it is not invested in local development projects; the capital is only nominally within the offshore banking state. The only economic effects on offshore banking states are fees assessed by the offshore state, as well as a relatively low level of multiplier effects. A further disadvantage of this development strategy for small states is that tax haven status often incurs the disapproval, and even the wrath, of the developed countries, who feel that they are being cheated of rightful tax revenues. Sanctions may even be taken against offshore banking states, and external regulation is tightening (Read, 2004). Offshore banking is therefore a precarious and risky
development strategy, especially as to remain competitive in the industry (and even more so for new entrants) the offshore state must make even greater concessions in order to attract capital.

An important aspect of offshore banking is that its sites are not spatially differentiated: Samoa, the Cayman Islands, Panama, Liechtenstein, and Bahrain are all virtually equivalent. Space no longer matters, because core capital does not care where it goes as long as the destination meets the twin conditions of secrecy (the ability to hide capital) and limited or no tax liability. Regulatory environment is more important than location (Hudson, 1998).

The geographic analysis of offshore banking and capital flight focuses on capital that has its source in core countries, not marginal ones. The primary analytical concern is with capital flight from core to periphery, the loss of tax bases in core countries, and the impacts on the development of the offshore banking countries. In a sense, offshore banking is the opposite of the cases considered in this thesis. In offshore banking, core capital flows to the periphery, takes advantage of those marginal spaces (or outlaw spaces) in the global economy, then returns with profit to the core.

Money as mercury

Geographer Gordon Clark, in a very interesting recent paper on the geography of global finance, proposes a new metaphor for monetary flows: ‘money flows like mercury’ (Clark, 2004a). This insight supports my reimagining of the ways that capital flows can contribute to economic development. The characteristics of money/mercury are that it: 1) runs together at speed; 2) forms in pools; 3) re-forms in pools if disturbed; 4) follows the channels in an apparently smooth surface; and
5) is toxic if poorly managed (Clark, 2004a, 12). Within neoliberal development ideology, capital flows from core to periphery are the solution to regional economic inequality. In this thesis I contend that reversing the flow of capital, from periphery to core, is an alternative economic development strategy. Clark’s metaphor of money as mercury is helpful here, as it suggests that capital pools in peripheral locations may be harmful, especially in small economies. A development perspective arguing, as I do, for the removal or relocation of capital from peripheral places, is consistent with Clark’s mercury metaphor. Peripheral places can remove this harmful substance (money/mercury) from the local environment by sending it abroad to do its work of separating gold from ore.6

2.4 The uncertainty of global development

Geographers, economists, and other analysts have struggled to understand the nature of development and the causes of the unequal distribution of wealth. They have also sought policies designed to sustain wealth and to distribute it more evenly. The concepts of core (or centre) and periphery (or margins) are useful in the analysis of development and have been accepted by scholars and practitioners of all theoretical stripes (Borgatti and Everett, 1999; Krugman, 1996; Potter, 2001). They have been used both in analysing economic unevenness between and within countries (Henderson et al., 2001).

Core regions are those highly industrial or post-industrial regions that are economically advantaged: their citizens are on average better fed, better housed, and better educated than the world as a whole. These regions are closely linked

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6 It is also interesting to note that the most important mercury mines, such as Almadén, New Almadén, and Huancavélica, were located in the periphery and the mercury itself was removed and often transported to core regions.
both to each other and to the periphery. The core region might be defined as including (when viewed on a polar map projection) the geographically proximate and ‘central’ regions of North America, Europe, and East Asia (with a few outliers such as Australia and New Zealand). Industrial activity continues to concentrate in this core, despite higher wages than in the periphery, because of agglomeration benefits (Krugman and Venables, 1995).

This thesis is concerned with the development of ‘remote’ regions, which have been simply defined as those with ‘few opportunities for profitable investment’ (Leven, 1986). Their continued existence, despite transformations in technology and economic globalization, poses significant questions for the future. As Henderson et al. (2001, 100) note, ‘one of the most difficult questions is: what to do with lagging regions, often remote and perhaps sparsely populated?’ Unfortunately they do not answer this question. They do, however, note that ‘development must … take the form either of mitigating the disadvantages of being outside existing centres, or of the creation of new centres of activity’ (Henderson et al., 2001, 85). In this thesis I focus on a way in which the disadvantages of remoteness can be mitigated.

3. LOCAL DEVELOPMENT

If, as Ray Hudson argues, ‘successful’ local development is in large part dependent on local economic and social conditions, then it is important to understand how these local conditions are linked to the process of development (Hudson, 1999). By ‘local development’ I mean analytical attempts to construct a place-specific model, 7 They also observe that ‘… new centres of activity can develop, but the process is not one of steady convergence of all locations. Instead, it is rapid development of a few locations, leaving others essentially unaffected’ (Henderson et al., 2001, 86). Thus, there will always be remote regions.
theory, or explanation of development processes, distinguished from global development by the focus on the local rather than the global. Local development analysts argue that no explanation or theory of development can hold true at all times and in all places. What is needed instead are theories of development that have purchase only in particular contexts, but which more accurately reflect the conditions of place. I consider here three such theoretical attempts: the analysis of small states as constituting a distinct development ‘region’, the MIRAB model developed for Oceania, and a northern model of development applied to Arctic and Subarctic regions.

3.1 Development in small states

Is ‘smallness’ a factor in development? Are small states an analytical category, and do they share enough in common to make comparisons among them? Are processes of development in small states different from those in larger ones? While there is a substantial body of literature on small states, not all scholars agree about the answers to these basic questions, and small states are imagined in a variety of ways.

A basic point of disagreement in the small states literature is the definition of smallness. Some scholars do not define smallness or provide an ambiguous definition of it (e.g., Armstrong, et al., 1998; Bertram, 2004; Briguglio, 1995; Laplagne, et al., 2001; Milner and Westaway, 1993; Read, 2004). Several of these authors also make no distinction between ‘small’ states and ‘micro’ states. In some cases these authors assume that the reader will understand that most island countries are small.

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8 Though these authors do consider states with a population under 3 million as ‘microstates’.
Other authors use different variables in defining smallness. These may include territorial size of the state, its population, and the size of its economy or national income as measured by GDP or GNP (Streeten, 1993). Of these variables, population is used by most scholars as the key point in defining smallness. The question then is: what size population is defined as small? Definitions vary: Streeten (1993) defines ‘small’ as below 10 million people, Armstrong and Read (2004) use 5 million, Crowards (2002) uses 2.7 million, and Baldacchino (1993) and Easterly and Kraay (2000) use 1 million. Several authors also perceive different kinds of smallness; for example, Streeten (1993), who, as noted above, considers a state with fewer than 10 million people ‘small’, considers those with fewer than 5 million as ‘very small’, while Crowards, who considers populations below 2.7 million as ‘small’, considers those below 0.5 million as ‘micro’. Finally, some authors, such as Liou and Ding (2002), point out that all definitions of smallness are arbitrary and have no theoretical basis. Although definitions vary, and theoretical significance is questionable, a large number of scholars use the analytical category of ‘small state’, and most recognize that definitions of smallness may be fluid and changing: using a population figure is merely an entry point. Smallness is something that one knows when one sees it.

If one accepts ‘small state’ as an analytical category, the next question is: what significance does smallness have on a national economy? Most scholars of smallness suggest that small states differ from larger ones, and that economic development could well be a different process. Baldacchino (1993), for example, goes so far as to say that mainstream development theories don’t apply to small

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Footnote: This unusual number derives from a cluster in a regression analysis. Crowards is also the only author to construct an index of smallness, combining population, land area, and income.
states, but because of colonial histories these states nevertheless cling to universalist models of development. Overton (1993), in a review article focusing on Oceania, notes that universalist models (modernization, dependency, and gender studies) are often applied to the Pacific, but that these models do not necessarily work in that context.

How, then, do small states differ from larger ones? Or, rather, how does their smallness make them different? Small states, by definition, have smaller populations, and this gives them a relatively limited labour and skilled management pool. Small size may also prevent economic diversification and economies of scale, limit the presence of natural resources and capital, and increase the likelihood of poverty (Liou and Ding, 2002). The remoteness of many small states adds to transportation costs, and small states are more vulnerable to natural disasters as well as economic ones (Barker, 2000; Briguglio, 1995). Small states are typically more open, with much more external movement of both capital and people. Out-migration is often common and encouraged (James, 1993; Overton, 1993). Small states are often dependent on outside capital, in the form of remittances, foreign aid, and overseas jobs in order to sustain and develop their economies (Cook and Kirkpatrick, 1998). Yet clearly there are important differences in the development trajectories of, for example, Singapore and Fiji.

The smallness of a state may affect its development potential. James (1993) notes that development of the formal economic sector is something that most small states have not yet achieved, and that development will be attained through investment, improved production, and trade. Milner and Westaway (1993) and Read (2004) find that smallness is not an obstacle to growth and prosperity, and that growth and smallness are not correlated. Baldacchino (1993) suggests that
small states tend to outperform large ones, as they depend on trade and are outward or globally oriented. And Bertram (2004) suggests that the GDP of small states reflects that of their patrons. While Paul Streeten (1993), founder of the journal *World Development*, notes that small states are different from large ones, Easterly and Kraay, of the World Bank, argue that small states are no different from larger ones, and that they therefore should receive the same policy advice. For them, development may be universalist and globalized: ‘the lessons of growth experience from all countries seem to be applicable to small states’ (2000, 2024).

Though there is an increasingly large body of work on the development nature of small states, there is no clear consensus on what constitutes a small state and on what significance smallness may have on development potential and prospects. Most work on small states, with a few exceptions, has been concerned with explaining the performance of small states or on establishing smallness as an analytical category, and there has been little on specific policy advice for small states. One notable exception is Baldacchino (1993, 43), who observes that ‘the central economic concern for microstates with respect to the outside world is the active preservation or, better still, the enhancement of their status and desirability as rentier states’. This statement is important in the consideration of the trust funds discussed in this thesis, economic instruments that are themselves enhanced by a smaller, rather than larger, number of beneficiaries.10

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10 The literature on smallness referred to here is mainly global in focus, with some exceptions, such as Overton (1993), who looks only at Oceania. Three of the four Oceanic states considered in this thesis, namely Kiribati, Nauru, and Tuvalu, are so small as to have dropped out of the analysis of many small-state scholars, mainly due to lack of comparable data.
3.2 The ‘MIRAB model’ in Oceania

Scholars of Oceania have identified distinctive features of the region that limit the applicability of globalist models in understanding development in Pacific islands (Hau’ofa, 1993, 1998; Overton, 1993, 1999; Ward, 1995). The ‘MIRAB model’\(^{11}\) of development was an attempt to bring greater place specificity to development theory, in this case to the microstates of Oceania, to which models developed for continental countries did not seem to apply. The MIRAB model was developed in the 1980s by two New Zealanders, economist Geoffrey Bertram and geographer Ray Watters (Bertram, 1986; Bertram and Watters, 1985, 1986; see also Bertram, 1999; and Poirine, 1998). The model was an attempt to explain the relatively successful economic performance of small Pacific states, based on their higher than expected rates of economic growth and their GNP per capita. Bertram and Watters argued that, given their extreme isolation, poor soils and agricultural base, limited natural resources, and other factors, Pacific island countries should be among the poorest in the world. Statistically, however, these countries outperformed much of Africa and Asia (in terms of levels of GNP and growth), and their standards of living are higher than what classical, modernization, and dependency models predict (Bertram, 1999, 106). Why was this so? Bertram and Watters suggested that the cause lay in the Pacific countries’ ability to exploit globalisation, through migration (MI), remittances (R), foreign aid (A), and bureaucracy (B)—hence the term MIRAB. Pacific islanders would migrate to other countries (notably Australia, New Zealand, and the United States) and would remit a share of their earnings to families back home in the islands. Pacific island states

\(^{11}\) The ‘MIRAB model’ is really a description of Pacific island economies, rather than a true model or analytical framework. I use the term ‘model’ here, however, as that is how it is used in much of the literature.
were also able to use their geographic position to derive aid from Australia, New Zealand, the United States, and the United Kingdom, among others. Finally, island governments (bureaucracies) were the main source of formal employment. These factors together gave the Pacific island states a relatively high and sustainable standard of living.

The viability of MIRAB economies is based on reimagining the economic spaces of Pacific island states. Bertram (1993) suggests that Pacific islanders resident overseas constitute part of the economic space of island economies. As Bertram notes, mainstream imaginings of development argue that to be sustainable development must be ‘underpinned by productive activity within the territorial boundaries of the island economy itself’ (Bertram 1993, 248). His alternative interpretation of development is that it can be sustainable:

so long as the indigenous people, wherever they reside, retain a set of entitlements sufficient to support material welfare standards over the foreseeable future, while preserving or enhancing their collective identity and the natural environment of their home territory (Bertram, 1993, 248).

The majority of island-born Cook Islanders, Tokelauans, and Niueans (all New Zealand-affiliated territories) now live in New Zealand, with about 90% of Niueans resident in New Zealand. Thus, as Bertram (1993, 254) notes, ‘the modern sector of the Niuean economy … lies in New Zealand’ and that ‘Samoa’s modern sector lies in Auckland and Los Angeles’. Flows between the island territories and islanders resident overseas are continual, with remittances flowing to the islands (often in exchange for island produce or symbolic goods, representations of island
identity) and continual short-term population movements between the islands and Australia, New Zealand, and the United States.

The MIRAB model has been criticised by some scholars, largely because it assumes that the remittances and donor aid components are constant and sustainable.\textsuperscript{12} Some analysts claim that a ‘remittance decay’ function reduces the rate of remittances as migrants remain longer in their destination countries (Connell, 1980, 1987; James, 1991; Campbell, 1992). Supporters of the decay hypothesis suggest that migrants become less connected to their home countries and that the transfer of capital also declines; remittances are therefore an unsustainable source of national income. More recent research, however, has largely refuted the remittance decay hypothesis. For example, Brown (1997, 1998), in his study of Tongan and Samoan migrants and remittances to their home countries, found that the remittance decay hypothesis has no validity. Poirine (1997) and Simati and Gibson (2001) have also refuted the remittance decay hypothesis. These scholars argue that, contrary to earlier theories, remittances are largely motivated by economic incentives such as investment and asset accumulation in the home country, under ‘implicit loan’ arrangements, rather than by largely altruistic motives. Nevertheless, many mainstream analysts still see remittances and donor aid\textsuperscript{13} as unsustainable and as creating dependent relationships with outside sources of national income.

What becomes clear from Bertram and Watters’s MIRAB analysis is that

\textsuperscript{12} Poirine (1998) provides the best overview of the arguments against MIRAB; he then goes on to critique and ultimately reject these arguments.

\textsuperscript{13} Decay in donor aid is more difficult to assess, as aid levels fluctuate with particular projects. Between 1985-89 and 1990-95 donor aid as a percentage of GNP declined in some Pacific countries (Tonga, Samoa, and Vanuatu) but increased in others (Kiribati, Marshall Islands, and Solomon Islands) (Duncan et al., 1999, 9).
conventional notions of what constitutes economic development cannot be applied mechanistically to the very small island economies of the Pacific’ (Bertram 1993, 257). Island states currently depend on the export of their population, and the return of economic gains from the employment of those islanders resident overseas. Bertram and Watters liken this process to the transnational corporation, which has a nominal home (a head office in a major financial centre) but operates worldwide and whose operations support the home office but are distributed globally. These ‘transnational corporations of kin’ (Bertram and Watters, 1985, 511; Bertram, 1993, 254-57) allocate financial and labour resources worldwide, and, as Bertram (1993) notes, the goal is not to maximise incomes in the island territory alone, but to maximise the overall welfare of the islander population (which he equates with ‘shareholder equity’). Thus ‘development’ is imagined as ‘enhancement of the international collective net worth of islander groups’ (Bertram, 1993, 254), rather than as increased productivity or growth in the island state itself.

Bertram further notes that capitalism has only a small role in island society (Bertram, 1986, 809-10). Therefore, promotion of capitalist forms of economy is not necessarily a solution to problems of development. Instead, Bertram argues (1986, 1993) that the key is to make rent incomes secure: ‘what matters is whether the entitlement of island communities to rent incomes remains sustainable’ (Bertram, 1993, 257). He notes that, given prevailing circumstances, continued rent flows are more critical to island survival than the formation of productive forms of industry:

It is continued rent entitlements that are required to render current living standards
sustainable. The promotion of productive activity within the territory of these micro states finds its rationale not in its direct contribution to real income, so much as in its role in defining and reinforcing the roles of individuals within indigenous society and culture (Bertram, 1993, 253).

Mainstream development models fall down in the context of microstates, in which productive industry is important mainly for sustaining culture: Bertram argues that ‘there are viable paths to modernity and welfare that do not rely upon a repetition of the European large-country model of industrialisation and primitive accumulation’ (1993, 248). Economic sustainability will depend on the ability of microstates to sustain rents over the long term. For many microstates this means continued reliance on remittances and aid. But investing rents in financial markets can also provide a means of sustaining the flow of rents over time.

The MIRAB model is important as a place-specific conception of development. It was designed to describe development conditions in Oceania, particularly in atoll microstates. In many ways it does account for the performance of Pacific island economies (Poirine, 1998). However, it still remains very much within the notion of capital flows from developed to developing countries as the way to engage globalisation, and even MIRAB advocates cannot assume that donor aid will continue at present levels. The ‘model’ thus only partially serves as a set of policy guidelines for development in small Pacific states. It does, however, recognize that sustaining rents is the key to the long-term viability of small island states, and that engaging with globalisation is perhaps one way to do this. As Bertram (1999, 107) notes, ‘Pacific islander populations became globalised long before most of the rest of the non-OECD world’.
3.3 Northern theories of development

While there is no equivalent to the MIRAB model in the context of North America, some scholars have attempted to analyse regional development in the remote regions of the continent, with particular reference to Alaska. The objective of these scholars is to assess whether Arctic regions might require a distinctive theory of development, or whether they are better treated and understood within a broader category of ‘remote regions’ that also includes non-Northern regions.14 In doing so they continue within a North American tradition of analysis of frontier regions, which began in a general sense with Frederick Jackson Turner (1893) and developed into theories of frontier development with the work of Harold Innis (1930, 1940), Walter Prescott Webb (1952), Mel Watkins (1963), and Douglass North (1966), among others. The ‘staples theory’ developed by these scholars explored the role of natural resource exports as engines of economic growth.

Geographer David Sugden of the University of Edinburgh was one of the first scholars to analyse frontier formation in the polar regions (Sugden, 1982). Basing his analysis on the concepts of core and periphery, he examined how intrusive waves of economic development were superimposed on traditional indigenous economic systems. This process is in general similar to the history of the frontier in temperate North America, but, unlike in temperate regions, polar frontiers never permanently advanced and never really ‘closed’. The pattern of frontier history in temperate North America was gradual settlement from East to

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14 In the analysis of North American regional development, ‘North’ and ‘Northern regions’ refer to Arctic and Sub-Arctic regions, typically defined as Alaska in the United States, and the territories of Yukon, Northwest Territories, and Nunavut in Canada, plus the northern or Sub-Arctic parts of seven of the ten Canadian provinces (British Columbia, Alberta, Saskatchewan, Manitoba, Ontario, Québec, and Newfoundland).
West, pushing the frontier of settlement further west until all the intervening space was filled and the frontier ceased to exist. In the Arctic, however, non-indigenous settlement was never permanent, at least in large numbers. Rather, waves of settlement accompanying resource extractive projects were of short duration, and retreated when the resource was exhausted or no longer exploited. So, for example, when furs were an important industry, settlers moved in and established communities, but these often were abandoned when the fur market declined. The same was true of gold in the Klondike and Yukon river regions of Canada and Alaska: large numbers of settlers arrived in these areas to mine gold, but retreated when the resource was exhausted, leaving no large permanent settlements in the former goldfields. Thus each natural resource had its own, temporary frontier and settlement zone, but these shifted due to market factors, solidifying the polar regions’ status as remote regions.

The most original work on the North American ‘North’ as a remote region is that of University of Alaska economist Matthew Berman (1992). Berman suggests that the North can be defined as that portion of the continent that will never be developed, in the sense that long-term economic growth will never be achieved. Four northern attributes—an export-oriented transportation system, a resource-dependent market economy, the low biological productivity of land and the consequent limitations on agriculture, and the extreme variability of the market economy—limit the potential for development in this region, and Berman argues that this is what distinguishes it from other, non-Northern, remote regions. These attributes in combination inhibit the development of both agricultural and industrial sectors, meaning that the North will never have a diversified economy in which primary, secondary, tertiary, and quaternary sectors are all present. Berman
notes that these attributes can be mitigated by public investment (in infrastructure, for example) but that both agriculture and industrial activities will have to be subsidised during the economic downturns that characterise the Northern economy.

Berman illustrates his argument by comparing 22 remote regions from all over the globe in terms of their road-rail networks, distance from a major urban centre, population density, road and rail density, exports as a percentage of gross product, agricultural productivity per unit area, and measures of variability of real GDP. These seven factors are combined to create an index of remoteness. Berman’s findings suggest that the seven regions geographically located in the Far North (such as Alaska, the Canadian Territories, Greenland, and the Finnmark province of Norway) also comprise the regions that show the highest levels of remoteness. Some of the other places considered, including Alberta and Fiji\(^\text{15}\) indicate moderate levels of remoteness, but are still classified as remote regions.

Berman’s work suggests that there are varying degrees of remoteness, with those considered as ‘most remote’ having the least probability of developing (in terms of economic growth). But, like the MIRAB theorists, Berman does not necessarily see this as a disadvantage. He suggests that, rather than attempting to recreate non-Northern economic conditions and practices in the North, policy should be directed towards adapting to the North’s distinctive and extreme remoteness and helping residents lead meaningful and productive lives given these constraints. Berman’s conclusions point out that subsidizing agriculture, infrastructure, and import substitution are a ‘waste of money’; that diversifying

\(^{15}\) Fiji was the only Pacific island country included in Berman’s study. Though Fiji is geographically remote from large urban centres, it has the highest population density of all the included regions as well as a developed road-rail network and high agricultural productivity. Had Berman included smaller Pacific island countries, such as Tuvalu or Nauru, among his cases, these countries would have indicated high levels of remoteness, closer to those of Northern regions.
opportunities for households is more productive than diversifying the industrial base; and that, as resource rents are ‘unstable and transitory’, Northern residents should avoid becoming dependent on them (Berman, 1992). His overall conclusions suggest that recreating industrial society in the North will not succeed, and that traditional, localized, and alternative approaches to development are a more appropriate response to Northern conditions. In a sense, Berman’s work does for the North what the MIRAB advocates have done for Oceania: it has proposed place-specific development responses to conditions of extreme remoteness.

4. REVERSING THE FLOW AND RENEWING THE WEALTH

In this thesis I argue for a reassessment of how capital flows are linked to economic development in marginal places. I suggest that the use of trust funds can reverse the flow of capital for the benefit of developing states. Typically, domestic resources are invested locally. But what if investment opportunities in the country are all high risk and low return? An alternative is to invest outside the country.\textsuperscript{16} This policy is taken for granted in developed countries, in which capital is always seeking out the highest returns. American, European, and East Asian capital has flowed into the rest of the world, seeking new investment opportunities. Yet developing countries are told that they should invest locally.

Two sub-themes emerge within this analysis. The first is that of the spatiality of investment and how marginal places can pursue a global investment policy. ‘Local’ development suggests that capital generation and development

\textsuperscript{16} Investing outside the country of capital origin is not new, of course. For example, Queen Elizabeth I of England invested a substantial portion of the booty obtained from Sir Francis Drake’s privateering voyages in the Ottoman Empire through the Levant Company, rather than in England itself. And individuals—in what is known as ‘capital flight’—invest outside the source region of capital. These points are discussed in Chapter 8.
investment take place at the same site. My analysis suggests that ‘local’
development—in the periphery—can take place when investment is made in global
financial markets, themselves based in core countries, rather than at the site of
capital generation. In this way, local development is not limited to the remote or
marginal place where the benefits are to be felt. Instead, peripheral capital flows
into the core to seek out the best investment opportunities. The local development
process becomes differently spatialised by engaging global financial markets.

The second sub-theme is that of sustainability. Resource benefits often
come in temporary streams, and decline or are removed when the resource is
depleted. How is a sustainable economy built on non-renewable resources, which
are inherently finite? Non-renewable resources can be transformed into renewable
fiscal ones when the capital generated from resource extraction is invested in
financial markets. This is consistent with Adam Smith’s contention that
development springs from savings and the accumulation of capital. To make non-
renewable resources renewable, they can be converted from a physical form into a
financial form, thus extending the benefits of capital into perpetuity. A trust fund is
one mechanism to do this.

This thesis examines how reversing the flow of capital can benefit
developing countries and regions. I look at six cases where trust funds have been
established as a mechanism to reverse the flow of capital. These trust funds invest
capital generated in developing countries or marginal regions within developed
states in global financial markets, generating new capital for the originating state.
Trust funds are an example of state-led development that invests in the non-local
private sector through global financial markets. Assuming the continuation of
global financial markets, trust fund investments provide a sustainable and self-
reliant source of income for places on the margins. They engage the global to
develop the local. I explore the paradoxes of state-led development in the periphery
through investment in the private sector of the core and suggest that trust funds
reduce the risk, and enhance the profits, of peripheral states’ investment by
respatialising the field of investment to include the entire world, and that this
process leads to a sustainable stream of economic benefits that return to source and
enhance the livelihoods of peripheral residents. Through the mechanism of a trust
fund, peripheral states can cast their bread upon the global financial waters, and
watch it return to them after many days with interest.

Four of the six cases considered here are Pacific island countries: Nauru,
Kiribati, Tuvalu, and Tonga. These are among the most marginalized independent
states on earth, in terms of their distance from larger neighbours and markets, and
in terms of their own resource base and potential. The two other cases, Alaska and
Alberta, are marginal spaces within developed countries and within the global
economy, as they are largely producers of raw materials with limited input into
global capital movements. Each of these six places has set up a trust fund to
manage and invest non-renewable resource revenues.17

Mainstream and alternative development models imagine the core as either
the source of beneficial capital or as an exploitative and neo-colonialist force. In
my analysis, I view the core rather as a fertile field for investment, through a kind
of reverse colonialism in which Albertans, Alaskans, and Pacific islanders profit
from their investments in London, New York, and Sydney, rather than the other

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17 The establishment of trust funds does not guarantee development. The funds must be properly
managed and fund policy is important. Some funds have performed well, and some have not. The
cases selected here illustrate both successful and unsuccessful funds. The conditions for success are
described in Chapter 7.
way around. If the periphery will never become core, then the periphery must adapt to remaining the periphery and take advantage of its position within a global economy. Trust funds provide a means by which these marginal spaces in the global economy can both ‘jump stages’ and ‘jump scale’. By jumping stages, developing states can avoid the usual path of movement from agriculture, to manufacturing, to services, and then to information-based economies. By jumping scale, developing states can move from the local economy to direct engagement with the global economy.

5. OUTLINE OF THE THESIS

The next chapter, Chapter 2, examines resource management policies, focusing on trust funds and discussing their legal basis, the obligations that fund trustees have when investing trust assets, the different kinds of funds and the ways that fund capital is invested, and the different ways in which fund earnings may be distributed. Chapter 3 presents a brief methodological basis for the analysis of the six case studies, and also comments on issues concerned with gathering data. Chapter 4 looks at the Alberta Heritage Savings Trust Fund in Canada. The Alberta government used this fund in an attempt to transform the province from a peripheral to a core region, and the fund’s investment policies and investment geographies reflected this. Chapter 5 looks at the example of the Alaska Permanent Fund in the United States. Unlike in Alberta, Alaska’s fund was used by the state to counteract Alaska’s peripheral position in the global economy by saving revenues and channelling fund earnings directly to fund beneficiaries in the form of dividends. Alaska’s investment policies thus differed substantially from those pursued in Alberta. Chapter 6 turns to the four Pacific island cases (Kiribati,
Nauru, Tonga, and Tuvalu) and describes their patterns of success and failure, and how these small isolated states have made global financial markets work for them (or not) through offshore investing. *Chapter 7* explores the factors that account for the relative success of a trust fund and compares and contrasts the policies and actions of the six funds. The last chapter, *Chapter 8*, looks at the applicability of the trust fund model in other places, noting its effectiveness as a development tool.
1. INTRODUCTION

Non-renewable resource revenues form the economic basis of many economies. These resource dependent economies often occupy the marginal spaces of the global economy, and their prospects for development depend on the ability of the state to capture, retain, and invest the revenues derived from resource extraction, sale, and export. Likewise, small island states may depend on a (potentially non-renewable) flow of capital from foreign aid donors and on remittances from non-resident nationals, or on ‘sovereignty resources’, such as sale of passports or tax haven status, that often earn the disapprobation of core countries. Non-renewable natural resources, sovereignty resources, and flows of aid and remittances are all forms of windfall resources, for which sustainability is inherently uncertain. A windfall ‘is something that comes free and unexpected and of good import’ (Webb, 1951, 180). Such revenue streams are unstable and potentially unreliable foundations on which to build a self-reliant and sustainable economy that provides a high level of benefits to residents.

The paradoxical failure of states highly endowed with valuable mineral and petroleum resources to develop at the same rate as poorly endowed states is known

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1 The term originates in the wood that fell from trees after storms, and which could be freely collected and used by tenant farmers (Webb, 1951).
as the ‘resource curse’. Proponents of this argument suggest that the large revenue flows from natural resources leads to lower growth rates because the conflict over the distribution of the revenues leads to poor policies and investment decisions (Auty, 1993; Auty and Mikesell, 1998, Karl, 1997, Ascher, 1999). Rapid growth in the non-renewable resource sector encourages rent-seeking, misallocation of resource rents, and even corruption. The resource curse thesis is invoked to explain the poor performance of such richly endowed countries as Zambia, Bolivia, and Papua New Guinea when compared to the rapid economic growth of poorly endowed countries such as Switzerland, Singapore, and Japan. Though the resource curse thesis has been challenged, it is important in highlighting policy choices as the critical dimension in economic growth. Resources themselves are not necessarily a ‘curse’: development depends on the kinds of policy choices made about how to exploit the resources and about how to invest and distribute the revenues that they generate. Resource curse theorists argue that natural resources as the foundation of an economy predispose and prejudice policy makers to make decisions that ultimately work against long-range economic development (Karl, 1997).

Can the resource curse be lifted? Can natural resources help stimulate development? What policy choices are optimal? Windfall resource revenues typically flow into a state’s consolidated revenues fund, the same ‘account’ into which all revenues (such as taxes) are deposited. Once in consolidated revenues, resource revenues become indistinguishable from other revenue sources. As such, their inherent unsustainability is often overlooked or forgotten. The finite and volatile nature of these resources is frequently only acknowledged when resource revenues start to decline and policy makers scramble to find funds to cover their
budget deficits.

An alternative to the practice of depositing revenues into consolidated funds is to pursue a financial investment policy in which revenues are instead invested in global financial markets through the use of trust funds. Trust funds are a mechanism by which revenue streams from non-renewable natural resources are diverted into consolidated revenue and transformed into renewable fiscal resources. A trust fund can save a portion of natural resource revenues and invest these to generate earnings while preserving the original fund capital. If earnings (or some portion of them) are reinvested into the trust fund, then the fund will continue to grow, even after resource revenues have stopped flowing in. The trust fund becomes a renewable resource, similar, for example, to a fishery, in which fund capital is analogous to the fishery’s breeding stock and the fund earnings analogous to the harvestable part of the resource. If sustainably managed, trust funds, like fisheries, will continue to generate a sustainable harvestable yield in perpetuity.

This chapter examines trust funds as a resource revenue management policy, looking in particular at the relationship between trust funds and the more general legal institution of the trust, at the benefits of trust funds compared to direct deposit policies, at the different kinds of trust funds that can be created, and at different policies for distributing fund earnings. Each of these issues re-emerges in the case study chapters that follow. In those chapters, different trust funds are used to illustrate different trust fund features. Later, Chapter 7 compares the case studies and elaborates on the close relationship between the failure to adhere to the obligations of trustees and failure in fund performance.
2. DIRECT USE OF WINDFALL REVENUES

2.1 Rentier policies

A rentier approach to resource revenue management is a non-interventionist policy in which resource revenues are directly deposited into consolidated revenues (the state’s ‘general fund’). The resource revenues become one of many revenue sources used by the state to finance its activities, along with taxes, levies, duties, and so on. But resource revenues, unlike taxation, are non-recurring. Substantial, non-recurring revenues are a catalyst for development during a limited period of time, but simultaneously have the potential to increase resource dependence, cause inflation, and distort the economy.

Direct use of resource revenues through the general fund allows the state to reduce taxation, to increase spending, or both. Reduced taxation may stimulate consumer spending, but it can also lead to the state’s dependence on resource revenues and unwillingness to reintroduce taxation when resource revenues decline. Many national states (e.g., Saudi Arabia, Venezuela) have used resource revenues to finance infrastructure development in order to diversify the economy and reduce dependence on non-renewable resources. Many of these states emphasised short-term goals, such as employment generated through infrastructure construction, rather than focusing on the long-term effects of changes in the structure of non-renewable resource revenues. Short-term goals such as these are often driven by political considerations and the desire of political leaders to remain in power, and have failed to achieve expected development outcomes (Amuzegar, 1999; Karl, 1997).
2.2 Problems of direct use

Direct use of resource revenues is often problematic, especially if the use of resource revenues has the effect of fiscal expansion at a time when the economy is in full (or nearly full) employment. Windfall wealth enables the state to expand and increase its activities. As the state expands and penetrates further into society, demand for products and services grows, leading to inflation. The demands for increased wages and social services spiral upwards until the capacity of the state and economy to meet them is exhausted. The economy is then liable to collapse, or revert to a ‘bust’ period. One need only look at the example of Norway or other petroleum exporting states which, seen in retrospect, heavily overextended themselves through increased spending, often also financed to a significant degree by external capital (and credit) (Hannesson, 2001). Small, dependent economies such as the Pacific island states or resource-dependent regions of North America are even more likely to feel the effects of collapse if economic capacity is exhausted (in the case of resource-dependent economies).

Rent-seeking

Different kinds of resources determine different social structures and production arrangements and thus have an effect on the political system (Cardoso and Faletto, 1979). In some cases, uncontrolled entry of resource rents into the economy could lead to rent-seeking and the emergence of a resource elite that would seek to advance its own interests against those of other social groups. Rent-seeking is defined as any activity that attempts to improve a person or group’s well-being by escaping the forces of competition in the market place (Colander, 1984). Disparate interest groups compete for a share of economic rents, usually through the political
system. When the magnitude of economic rents is large, the incentives for rent-ceeking behaviour increase. Any group will engage in rent-seeking behaviour if the perceived gains exceed the costs of rent-seeking.

The disadvantage of rent-seeking is that it does not create new wealth, but only redistributes existing wealth within the economy (to the group that seeks it). This redistribution may lead to negative sum transfers such as inflation, inefficiency, wasted resources, and higher taxes. Gary Anders (1988) has argued that the policies followed by the state of Alaska following petroleum discoveries encouraged rent-seeking, exacerbating the cyclical behaviour of the economy and limiting the potential for economic growth. Similar situations could develop elsewhere. For example, an emergent resource elite could hold a large share of the economy’s wealth, and the political system would become biased towards its interests at the expense of other groups. This problem would be especially acute in small and relatively new states such as those in the Pacific, which are still undergoing the process of state-building. Because of their colonial histories, the governments of new states often have little impact on state development and resource extraction, factors that now lead to difficulty for the state in penetrating society. Many former colonies have jurisdiction, but weak authority over their territory, a characteristic that reinforces the development of a resource elite. A weak state is much more open to penetration and exploitation by foreign firms.

Dutch Disease

Development of a single resource sector can lead to a phenomenon known as Dutch Disease (Corden and Neary, 1982). This concept was originally applied to the effects of petroleum development on the economy of the Netherlands, but has
also been applied to other mineral and petroleum based economies. Under such a situation, one sector of a state’s economy undergoes a rapid development or boom, while other sectors fall into (relative) decline. The main effects of the boom are resource movement and spending effects. Through resource movement, resources (such as labour) are drawn from other industries to the booming sector by the higher prices paid in this sector, leading to a series of adjustments in the economy, including through the real exchange rate. Labour becomes divided into a high wage group connected to the booming sector, and an increasingly marginalised unskilled sector facing unemployment. Moreover, resources such as minerals and petroleum produce few forward and backward linkages, and often fail to encourage the development of other economic sectors. The spending effect occurs when higher real income leads to higher spending and higher prices (Corden and Neary, 1982). The relative importance of these two effects depends on the extent to which the booming sector uses factors of production from elsewhere in the economy.

The arguments presented above suggest that direct use of resource rents from resource booms could lead to economic problems. In sum, large amounts of unprecedented economic rents entering a small economy in a weak state lead to damaging effects in the economy and an increase in social expectations that ultimately cannot be met. Thus the resource boom quickly turns to bust. The way to avoid this problem is by controlling the entry of rents into the economy. The following section discusses some ways of doing this.

3. INDIRECT USE OF WINDFALL REVENUES

3.1 Financial investment policy

An alternative to the direct use of resource revenues is a financial investment
policy by which resource rents are isolated, and their entry into the economy strictly controlled. By slowing the entry of economic rents, the distorting effects of windfall revenues are avoided. One vehicle for the achievement of this is a trust fund, which acts as a filter to slow down the rate of entry of economic rents.

Global engagement

The advantages of a financial investment policy are numerous. First, it is likely to be beneficial for small states to further open up to international capital markets in order to better diversify risk. Easterly and Kraay (2000) argue that, controlling for location, small states have higher per capita GDP than other states, statistically similar per capita GDP growth rates to other states, but greater volatility of annual growth rates. They explain the last finding to be due in part to small states’ greater volatility of terms of trade shocks. In turn, the greater terms of trade shocks are due to the greater openness, which has a positive net payoff for growth. Further opening up to international capital markets may decrease the volatility of terms of trade shocks through diversification while also increasing growth. The need for such diversification will probably intensify with the seemingly inevitable reduction in the availability of concessionary flows in the coming years.

Intergenerational equity

A second advantage of a financial investment policy is the intergenerational distribution of natural resource entitlements. Gerlagh and Keyzer (2001) consider exhaustible natural resources (allowing for irreversible degradation of renewable resources) with amenity value, where amenity value stands for the various services that the resource can supply indefinitely (e.g., sustainable supply of the gene pool).
Gerlagh and Keyzer compare a ‘zero extraction’ policy (enforced conservation that avoids environmental degradation) and a ‘grand-fathering’ policy (endowment of the present generation with all resources) with a trust fund policy (where future generations receive claims from the natural resources). Of the three policies, only the trust fund policy ensured efficiency and protection of welfare for all generations.

**Protection of capital**

A third advantage of a financial investment policy is the increase in transparency of the resource revenue investment and the protection of capital from direct expenditure by the government. Resource revenues represent a public good, which stimulates interest group competition for access to those revenues. As state revenues increase, interest groups seek to use those revenues for their own projects. Politically dominant groups can often manipulate the political system to their advantage, leading to their further dominance. By directing resource revenues into financial investment, interest group competition can be reduced, as available revenues to compete over are reduced. A further advantage is that financial investment provides a means of increasing public savings, and such an increase has been linked with an increase in economic growth (Krieckhaus, 2002, 1698).

### 3.2 Trust funds

Trust funds provide an effective means of intervening in an economy in order to achieve certain objectives and benefits. In a general sense, a trust fund is a pool of investment capital that is kept separate and distinct from a state’s consolidated revenues account (also known as the general fund). The trust funds considered here
have a special purpose and their capital, or corpus, often derives from natural resource revenues, particularly from windfall revenues. Trust funds as examined in this thesis are national and sub-national state institutions. They are similar in a very general way to pension funds and other capital pools that are also termed trust funds (e.g., the environmental ‘superfund’ in the United States).

Natural resource trust funds have not been well explored. Pension funds and other trust funds, however, have been the subject of recent studies. Gordon L. Clark, of the University of Oxford, has written a series of articles, culminating in a book, on the pension fund industry in Europe and the Anglo-American world (Clark, 1997, 1998a, 1998b, 1998c, 2000a, 2000b). Clark’s work examines the private pension fund industry and is primarily concerned with two factors. The first is how the private pension fund industry has come to replace, in many respects, the government’s role in providing the retirement benefits of citizens, as the state has retreated from the provision of public goods. Clark notes how private pension funds have grown enormously during the past five decades and are now among the largest pools of capital anywhere, with a great influence on national economies. Clark’s second concern is with the nature of fund trustees’ decision-making. Here he is interested in demonstrating why convention dominates investment choice, and why fund trustees and managers are so reluctant to explore alternative investment products. Clark’s work does not directly relate to natural resource trust funds, but his arguments do help to explain the factors underlying trust fund investment allocation, a topic that is explored in this thesis in Chapter 7.

A recent work by Eric M. Patashnik (2000) examines trust funds administered by the United States government. He focuses in particular on trust funds for social security, Medicare, highways, airports, and the environmental
superfund. Despite their large size, these funds have been little examined. The funds examined by Patashnik are similar to the natural resource trust funds considered here in that they are government funds and are restricted to a special purpose. But Patashnik’s work is more concerned with, as he calls it, the ‘politics of commitment’, and why politicians have created trust funds for some programs, such as medical care and state highways, but not for others. Like Clark, his principal focus is on the micropolitics of decision-making among the politicians who created the funds and the trustees and managers who run them.

Trust funds are explored in greater detail later in this chapter. Before proceeding to an examination of the nature and structure of natural resource trust funds and their objectives and benefits, it is first necessary to examine the legal basis of the ‘trust’, the principle upon which the trust fund is based.

4. TRUSTS

Trust funds as an economic instrument are based on the legal institution of the ‘trust’. The rules governing trust funds are essentially the same as those governing trusts, especially with respect to the obligations of trustees and their duty to act in the interest of the beneficiaries. This section gives some background to the legal institution of the trust with particular emphasis on the obligations of trustees.

4.1 Historical origins of trusts

Although trust-like concepts, in which property is held by one person on behalf of another, were known in Roman law, the modern institution of the trust has its origins in English mediaeval legal practice. The modern trust derives most directly
Chapter 2: Trust funds and windfall revenues 45

from the mediaeval concept of the ‘feoffor’.\(^2\) This institution conveyed a legal estate in land to a ‘feoffee to uses’ (equivalent to the modern ‘trustee’), who held the title on behalf of a ‘cestui que use’ (equivalent to the modern ‘beneficiary’).

The feoffor developed as an institution that allowed a knight to depart for the crusades while retaining title to his estates as well as provision for the welfare of his family in his absence. The feoffee to uses acted as a guardian to the estates, but held a kind of legal title to it, allowing him (the feoffee to uses) to administer the property and make necessary decisions and changes regarding its use.

The feoffor also had other uses. For example, it was used to avoid the payment of feudal taxes on the death of an estate owner by conveying title to subsequent feoffees, a practice still current with modern estates under living trusts and other mechanisms. Estates could thus avoid payment of taxes when the owner died, as the property could be held in trust for the heirs. Feoffors could also be used in devising property to someone other than the eldest son of the estate owner, as required under mediaeval law. The estate could be put in trust and held by the feoffee to uses and then devised to a designated third party, to someone other than the heir apparent (Hepburn 2001, 261). A further function of the mediaeval feoffor was the practice of holding property on behalf of religious institutions. The *Statutes of Mortmain* (AD 1279 and 1290) prohibited the transfer of property to the

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\(^2\) This term, and related ones, has a complex etymology, but derives from the Latin *pecus* (cattle) through Old German *Vieh*, which was Latinised as *feodum* and became *fief* among the Gallo-Romans and in English. In Provençal the word became *feu*, from which derives our word *feudal*. These words were therefore associated with moveable property, and later with real property. The word *trust* probably derives from the Old High German *gitriuwi* (faithful), from which itself probably derives from the Sanskrit *dāru* (tree), from which also comes the English word *true*. It is interesting to note that words like *fee*, *fief*, and *feudal* derive from words meaning *cattle*, while *trust* and *true* derive from the root *tree*. Our ancestors considered cattle as their main source of property, and trees as something true and faithful. See Bloch (1961 [1939], Vol I, Chap 12) for a discussion of some of this etymology.
‘dead hand’ of religious institutions, because, unlike living persons, they were not taxed. Transferring property to a feoffor to uses on behalf of the religious institution was a way of getting around these statutes.

The Statute of Uses (AD 1535) revoked some, but not all, of these practices. Specifically, the statute allowed for tax liability in the relationship of ‘first use’, i.e., the relationship between the settlor (the one who donated the property and set up the feoffor) but allowed the continuance of ‘second uses’, the relationship between the feoffee to uses and the beneficiary. It is this ‘second use’ relationship that is the basis of the modern concept of trust that emerged around the seventeenth century and continues in modified form to the present (Hayton, 2001; Hepburn, 2001; Sheridan, 1993).

4.2 The nature of the trust

The trust is, along with the corporation (limited liability company), one of the most important institutions in modern English common law (Sheridan 1993, 1). The trust is a diverse and flexible institution, and ‘the key attributes of trusts can be employed in whatever ways the ingenious mind of man can devise’ (Hayton, 1993, 18). The essential characteristic of a trust is the separation between legal and equitable interest (Hepburn, 2001, 259). Unlike a corporation, the trust is not a legal person, and cannot be sued. Trusts are typically used for managing investments, while corporations are typically used for trade. The trust had become an important modern institution because it is a convenient method for a small number of persons to hold property on behalf of many others (Sheridan, 1993, 1).

The modern trust is a standard institution in all Commonwealth countries, the United States, and much of Europe. Given its multiple forms, the trust is
difficult to define. All trusts, however, share certain features and reflect certain relationships. L.A. Sheridan defines a trust as:

…a relationship which arises wherever a person (called the trustee) is compelled in equity to hold property, whether real or personal, and whether by legal or equitable title, for the benefit of some persons (of whom he may be one and who are termed beneficiaries) or for some object permitted by law, in such a way that the real benefit of the property accrues, not to the trustees, but to the beneficiaries or other objects of the trust (Sheridan 1993, 3).

The trust is therefore a relationship in which one person holds property on behalf of another. Typically the law of trusts ‘is concerned with the utilisation and preservation of wealth’ (Hayton, 2001, 1). Much of trust law is concerned with preserving family wealth, but there are many other purposes.

4.3 Obligations of trustees

Modern legal practice in Commonwealth countries and the United States, as well as in other places, clearly spells out the obligations of trustees with respect to the property that they hold in trust for others. A.R. Mellows, in The trustees handbook (3rd edition, 1975, 60) summarises these obligations in two points:

- The trustee(s) must do the best he or she reasonably can for the beneficiary, within the limits of the law;
- The trustee(s) must treat all beneficiaries equally and fairly, and not place one beneficiary in a better position at the expense of the others.
Mellows points out that these are only the most general obligations of trustees and that they are especially important when applied to investments. The trustees must balance the twin goals of high return and low risk and also take into account the interests of all beneficiaries. This has important considerations with respect to permanent and long-term trust funds, in which many of the beneficiaries are yet unborn. Investments that generate high returns in the present, but sacrifice long-term stability or income generation, would contravene this principle.

Samantha Hepburn (2001, 335-352) provides a more elaborate discussion of the obligations of trustees. She specifies ten obligations for trustees, each of which has a bearing on the trust funds considered in the following chapters. These ten obligations, or duties, are:

- To avoid conflict of interest and to account for any profits;
- To act with reasonable prudence;
- To act in the interests of the beneficiaries;
- To act impartially;
- To keep funds separate (from the trustees’ own funds);
- To act gratuitously;
- To invest in authorised securities;
- To not purchase trust property;
- To keep accounts;
- To allow beneficiaries access to trust documents.

Several of these obligations may need explaining. The first five, the obligations to
avoid conflict of interest, to act prudently, to act in the interests of beneficiaries, to act impartially, and to keep funds separate, are all fairly straightforward. These first five obligations are also closely related to Mellows’s two more general obligations. Trustees are required to avoid any conflict of interest between their own business or financial affairs and those incumbent upon them as trustees, and to keep the beneficiaries’ funds separate from their own. They are further required to act in the best interests of the beneficiaries and to do so without favouring some beneficiaries over others. The property or funds held in trust must be managed prudently and thus avoid speculative investments. The first five obligations suggest a clear distinction between an individual trustee and his or her property, and the beneficiary and his or her property, emphasizing the concept of individually-held property. The obligations also assume a consensus surrounding the concept of prudence—a concept continuing the individualist notion, as the trustee is obligated to display the same prudence in investment for others as he or she would for his or her own property.

The remaining five obligations are perhaps more subtle. The duty to act gratuitously refers to the rule that trustees cannot receive any profit from the funds held in trust (Hepburn, 2001, 343). The exception to this is where the trust specifically allows for remuneration or where there is an agreement between the beneficiaries and the trustees. The obligation to invest in authorised securities requires the trustees to follow the instructions provided by the trust instrument, statute, or the courts (Hepburn, 2001, 344). For example, the Alaska Permanent Fund was originally prohibited from investing in non-United States equity securities. This provision was later removed by a referendum in which Alaskan residents, as the beneficiaries, authorised trust fund investments in overseas
equities. Trustees are obligated to not purchase trust property. This would give
them an unfair advantage, as trustees could use their position to influence the
transaction. Trustees must also keep proper accounts and make these available to
the beneficiaries. They must also make other, non-financial, documents available if
these relate to the trust.

Most of the ten obligations of trustees reflect a Eurocentric bias;
unsurprisingly so, as the trust is a European institution. Ideas of private property,
which remains private even in the absence of the owner, are embedded in the trust.
So too are notions of profit (in the sense that trusts can generate profits, but that
trustees themselves cannot profit from the trust), concepts of prudence (European
understandings of what a ‘prudent’ person would invest in), and impartiality (no
favouritism towards family or one’s kin or peer groups). Moreover, securities
(bonds and shares) are European ways of creating and holding value, and they are
implicit in the ways in which trusts invest. Investments of this type also require the
keeping of accounts, to reflect changes in the value of securities within a market
for them. The Eurocentric nature of the trust should be borne in mind when
contemplating the use of this institution in non-European settings, especially those
in Oceania where European economic culture only lightly overlays traditional
Oceanic economic imaginings and practices.

As will be seen in the following chapters, the performance of trust funds, in
terms of their ability to provide for the welfare of the beneficiaries, is directly
related to the trustees’ ability to adhere to these ten obligations. The trustees’
adherence to their obligations under the law of trusts is the greatest factor in
accounting for the performance of the six trust funds considered here. Chapter 7
explores the relationship between the obligations of trustees and the practices of
each of the six trust funds, and develops six criteria, closely related to trustees’
obligations, that are responsible for the fiscal and spatial effects of each fund.

5. TRUST FUNDS

5.1 Legal principles

A trust fund is essentially the entity that holds the assets of a trust. In a trust
relationship, title to trust assets is held by the trustees, who must act on the behalf
of the beneficiaries. As noted previously, trustees are obliged to follow not only the
basic legal principles governing trusts but also any stipulations in the trust
instrument. The trust typically has three functions: administration, benefit
adjudication, and asset management (Clark, 2004b, 6).

The trust fund consists ‘not only of the original assets and those
subsequently added, but also of those assets from time to time representing the
original or added assets’ (D Hayton, et al., Principles of European Trust Law,
are redeposited into the trust fund are governed by the same principles as the
original capital. The principles are applied across the board no matter the asset
type.

Trust fund beneficiaries are of course different and will have different
opinions as to what constitutes safe and secure investments. Trustees must attempt
to balance these perspectives and to take into account the views of different classes
of beneficiaries. As Hayton notes:

The interests of the beneficiaries are paramount and the trustees must do their best
to hold the balance fairly between those beneficiaries … interested in income and
those beneficiaries … interested in capital. Indeed, the trustees have a paternalistic function of protecting each beneficiary against himself (Hayton, 2001, 6).

While at the same time taking differing perspectives into account, the trustees must also uphold the fiduciary principles of prudent management. In order to play it safe, trustees have most commonly adopted a conservative investment approach (Clark 1997, 1998b). Hayton describes the situation in the United Kingdom, where the Trustee Act authorises certain investment classes as ‘safe’, thus controlling the behaviour of trustees:

Since the beneficiaries’ interests are paramount the trustees cannot (in the absence of authorisation in the trust instrument) invest trust moneys as they might invest their own: they have to play ‘safe’ and invest only in investments authorised under the Trustee Act 2000 [UK]. (Hayton, 2001, 6).

While important in maintaining prudence in investment management and restricting speculation, such policies may limit the ability of trust funds to invest in alternative sectors such as venture capital. This is a controversial area, as it is difficult to balance prudence with more exploratory and innovative investments.

5.2 Definitions

In a general sense, a trust fund refers to a sum of money held by one person or entity (the ‘trustee’) on behalf of others (the ‘beneficiaries’), based on the principles discussed in the previous sections. In this discussion, I will use the term ‘trust fund’ to designate moneys held in trust by a government (trustee) on behalf of the nation’s legal residents (beneficiaries) (Duncan et al., 1995). Trust funds are
distinct state managed accounts and typically have a distinct source of income, a
distinct management policy, and a distinct use for fund capital and earnings. The
following features are common:

- Distinct capital source, not deriving from consolidated revenue;
- The capital is protected from direct expenditure by the government;
- The capital is held in trust for beneficiaries, with the state acting as trustee;
- The fund is designated with some special purpose, or serves some function apart from general state expenditures;
- The earnings derived from fund investments may also have some special purpose, in line with the purpose of the fund (Poole et al., 1992, 199).

Trust funds are generally permanent and self-sustaining. Fund capital is invested and may increase through the reinvestment of fund earnings, which also protects the real value of the fund against inflation, and through additional deposits. Fund capital is typically preserved while earnings are redeposited, transferred to consolidated revenue, or used for some other purpose (or a combination of these). The fund functions as a renewable resource, providing a steady stream of financial revenues without depleting fund capital. If fund capital is invested offshore, the earnings may provide a new source of foreign exchange and investment capital for the investing country.

In many cases, fund capital, or principal, is derived through the export sale of the state’s natural resources. A portion of the state’s natural resource revenues are deposited into the fund, while the remainder enter the general fund and can be
spent directly. The capital increases through both deposits and investment income. The original capital can be preserved while the earnings can be used to finance the state’s budget or to finance extraordinary development initiatives. In this way the fund capital is never depleted, but instead acts as a renewable resource. Fund earnings can eventually replace income generated through resource extraction if the resource is depleted, as shown in Figure 2.1.

![Figure 2.1 Relationship between resource and trust fund income](image)

The solid line represents income from resource extraction, while the dotted line represents income from trust fund earnings. At some point income from trust fund earnings will surpass that from resource extraction.

5.3 Trust fund types

Trust funds can be divided into two basic types based on their objectives and investment of capital (as opposed to the distribution of earnings).

Savings funds

The first type of fund emphasises savings, and may be considered a pure trust fund.
The objectives of a savings fund are security of principal, avoidance of risk, and continuous generation of income. Modern Portfolio Theory (MPT) is the fundamental guide for such investments. Fund trustees and managers will operate under the Prudent Investor Rule, and will attempt to maximise income and minimise risk, given the degree of risk adversity. The Prudent Investor Rule, a basic tenet of fiduciary law, decrees that investments be made with the degree of judgement and caution exercised by prudent persons in managing their own affairs, i.e., not for speculation but for investment. Investments will be selected based on financial criteria only. The geographic locality of the investment is irrelevant: the fund will invest where potential returns are the greatest and the risk lowest. Usually this means investing outside the local economy, in order to diversify risk or if less risky investments are available elsewhere. Local employment and other direct benefits must be sacrificed for stability, diversification, and guaranteed return.

**Development funds**

A second type of fund emphasizes development. Fund managers will consider social criteria when investing, and investments will be made within the region to provide employment and direct local benefits. Risks will be higher, and potential returns lower, but the possibility of achieving direct local impacts is much greater. Building infrastructure and diversifying the economy are often objectives of development oriented funds. These funds emphasize direct development, employment generation, local investments, and economic diversification.
5.4 Benefits of trust funds

The advantages of trust funds over a direct use policy are the following:

- **Savings**: Save resource revenues that would otherwise be spent and misallocated into immediate direct consumption;
- **Equity**: Extend benefits of resource revenues over many generations or in perpetuity;
- **Income**: Provide an additional source of budgetary income for the state;
- **Investment capital**: Provide an additional or alternative source of investment capital;
- **Intervention**: Be used to intervene in the economy to achieve state objectives, such as diversification or stabilisation;
- **Macro management**: Externalise windfall effects and prevent distortions arising in the economy.

**Savings**

Windfall revenues, such as those that accrue from non-renewable natural resources during a short period of time, are notorious for being misallocated into wasteful and consumptive projects (Barro, 2002). State behaviour in this instance is remarkably like that of lottery winners, who have likewise received a windfall either in a single lump sum or in a series of payments over a limited period of time. Studies of lottery winners have indicated that they tend to misallocate their winnings by investing in immediate consumption, often investing in assets that depreciate rapidly and require ongoing maintenance costs, such as automobiles (Imbens et al., 1999). Though winners of large amounts increase their short-term
savings, they tend not to increase their long-term, retirement savings.

Another aspect of lottery winnings is that of how states themselves have managed their proceeds from state-run lotteries. As state lottery revenues are not generally perceived as a natural resource, and as they involve social and moral issues that most natural resources do not, they tend to be invested in special projects. Revenues from lotteries administered by the government of New Zealand (‘Lotto’ and ‘Instant Kiwi’) have been largely used to finance cultural activities and the arts, and remain largely at the discretion of the Minister of Internal Affairs. Recent surveys have indicated that New Zealanders would prefer that more lotteries revenues be directed towards general welfare and that the discretionary powers of the Minister be reduced (Christoffel, 1990; New Zealand Lottery Grants Board, 1990). This suggests that the beneficiaries of the distribution would prefer tighter control over the spending of lottery proceeds, and more restraint on the part of those who act as trustees for the revenues.

Equity
That future generations are entitled to a share of non-renewable resource revenues is the basic principle underlying a trust fund. Funds isolate revenues from immediate government spending and, depending on their structure, can help to avoid interest group competition. The trust fund capital can be constitutionally protected to prevent its misappropriation by governments or interest groups. The state of Alaska, for example, requires a public referendum to amend the state’s constitution before Permanent Fund moneys can be spent. The legislature has discretion over investment earnings, but the constitution requires that an amount sufficient to offset inflation be redeposited into fund capital. The constitutional
amendment creating the Permanent Fund also governs how the capital should be invested, requiring low risk, long-term appreciation, and a guaranteed return. The handling of investment responsibility by major investment firms, limits on foreign investments, a thorough audit, and extensive public relations and awareness have helped the Alaska fund avoid the problems of rent-seeking. On the other hand, the province of Alberta has no such constitutional protection: the fund is managed directly by the provincial cabinet and has occasionally succumbed to interest group pressure, especially during election campaigns.

Income

Trust funds can also provide an additional source of income for the state. When resource revenues are deposited into a state’s general fund, they vanish into a larger pool of capital which is then expended through the state’s budget. If resource revenues are separated into a trust fund, the fund can be invested so as to produce earnings of its own. These earnings are distinguished in that they are directly attributable to the resource revenues themselves (an important consideration in demonstrating to the state’s residents that revenues have been used wisely). Fund earnings are generated through the investments of the fund capital, or corpus. Typical investments include equities, fixed-income investments such as bonds, and real property.

Trust fund income might usefully be compared to the practices of the individual investor. Typically, an individual will maintain a cheque account, in which the individual’s income is deposited and from which payments for expenses are made. An individual will also typically maintain a separate account, either a savings account or a unit trust (or a combination of the two), the purpose of which
is partially to save and partially to generate new income. A state’s trust fund will also generate new income, which can then either be deposited into the state’s consolidated revenue fund or maintained for some separate purpose. The trust funds considered in later chapters have all generated a significant share of the state’s total revenues. In the case of Alaska, trust fund earnings are greater than income received from petroleum revenues themselves. Alaska’s trust fund has become the principal source of income for the state.

Investment capital

Trust funds may also provide new sources of investment capital. As noted above, funds will invest their capital to generate new earnings. Capital is typically invested in income-generating assets, such as equities, fixed-income assets, and real property, but may also be invested in capital projects and infrastructure and in alternative investment products. Clark (1997) has noted the reluctance of fund trustees to allocate assets to alternative investment products, based largely on conservative investment views as well as on incomplete information. Clark identifies four types of alternative investment products. The first is a modified mutual fund, in which assets are bundled into a single investment, often with some special purpose. For example, Clark notes how one Massachusetts mutual fund was made appealing to fund trustees because its investments are concentrated in assets that are deemed to be sensitive to the interests of organised labour (Clark 1997, 1304-05). A second alternative investment product is the secured investment trust. Secured investment trusts are similar to mutual funds, but invest largely in urban infrastructure, construction, and development securities (Clark, 1997, 1305). They may often invest in low and middle-income housing. A third type of alternative
investments through pension fund investment innovations, which do not draw as heavily on existing investment firms. Instead, these innovations might allow a number of pension funds to join forces and create a largely internal investment bank to handle investments, thus minimising costs and increasing financial returns.

A fourth form of alternative investment is venture capital, in which trust funds take equity positions in new and emerging companies, usually those associated with high risk but potentially high returns (such as in the biotechnology sector). Clark notes how each of these four alternative investments can not only lead to higher returns for fund managers, but can also achieve social good through investing in such things as low income housing and in newly emerging technology firms, areas that traditional funds and other financial vehicles typically shy away from.

**Intervention**

A trust fund may constitute a significantly large pool of investment capital, and may thus have a great deal of influence in a small economy. A fund may, for example, receive a higher proportion of windfall revenues during economic ‘boom’ periods, and reduce the inflow during ‘busts’, instead allocating fund income to social expenditures, such as health and education, during recessionary periods when revenue flows into consolidated revenues are lower than budgeted. Such a practice helps stabilise the budgetary process and increases the reliability of budgetary information. Some trust funds, for example, allow drawdowns of fund principal under certain limited conditions, when other state revenues are lower than expected. The trust fund can thus make up for shortfalls in state income, either through the distribution of fund earnings or through fund capital. Funds can also help to stabilise commodity prices, as the fund could subsidise producers when
world prices are low, and tax producers at a higher rate (through a windfall tax) when prices are high. Figure 2.2 illustrates in a general conceptual sense how a fund may transfer revenues from boom to bust periods.

![Figure 2.2 Stabilizing revenues during boom and bust periods](image)

The curve reflects boom and bust income periods, while the arrowed lines indicate potential transfers of income from boom to bust periods.

As noted earlier, trust funds can invest in more than just portfolio investments. In doing so, they can encourage (or discourage) economic diversification. Through venture capital and infrastructural investments, trust funds can help stimulate new industries. Alberta’s fund invested its assets so as to diversify the province’s economy away from the oil sector, by encouraging, and financing, such activities as petrochemicals production and oil tar sands recovery, and in financing medical research and the medical industry, including major research hospitals.
Macro management

The use of a fund can also moderate economic cycles, as the fund can save at a higher rate during periods of prosperity and inject these saved rents into the economy during periods of recession. Natural resource prices are subject to large price fluctuations based on world demand. Therefore, a peripheral economy can experience a massive amount of resource revenue windfalls during periods of high demand and high prices. In most cases the economy is unable to absorb these rents (without distortionary effects) and the surplus is wasted. By depositing a portion of these windfall revenues into a trust fund, the problems of absorption can be avoided: the economic rents become sterilised and, if the fund invests outside the local economy, become externalised. These externalised rents can be slowly reintroduced into the economy at a controlled pace during periods of stagnation and recession.

A sample trust fund is shown in Figure 2.3. The model illustrates the flow of money through the trust fund and shows three alternatives for the use of fund earnings. The fund trustees can of course combine these alternatives.
6. DISTRIBUTING BENEFITS

Trust fund earnings can be distributed in various ways (Figure 2.3). One possible distribution policy is to transfer them to consolidated revenue. Trust fund earnings then become another source of government revenue, possibly replacing revenues from the resource itself over time, or lowering the tax burden for residents. A second possible use for trust fund earnings is the provision of collective goods, generally in the form of infrastructure. Under this form, benefits may not accrue to each beneficiary equally. Alberta’s fund is an example of the use of trust fund earnings to finance infrastructure and capital projects. A third form of distribution is through the transfer of fund earnings directly to the beneficiaries in the form of dividends. Individual disbursement, used in Alaska in the United States, creates multiplier effects in the economy, as most individual dividend payments recirculate
and stimulate local demand for goods and services. Individual disbursement also ensures greater equity, in that each beneficiary receives an equal share of the disbursement. A combination of these distributional policies is also possible, depending on the amount of earnings to be distributed.

6.1 Transfers to consolidated revenue

A trust fund that transfers its earnings to consolidated revenue is a stabilisation fund. If earnings are deposited automatically or annually, the fund serves as an additional, but recurring, source of state income. The fund can also be managed so that deposits only take place during periods of recession, when state income falls below a certain level, or when the state budget is in deficit. The exact terms will be worked out by the state and by fund managers.

6.2 Collective goods

A second distributional possibility is the provision of collective goods, typically in the form of infrastructural projects. Through this form of distribution, trust fund earnings can finance special projects for which capital might otherwise be lacking. Collective goods might include the construction or retrofitting of transportation systems such as roads, rail lines, and port facilities, or could include the provision of collective services such as education and health care.

Another method of providing collective goods is an arrangement by which earnings are allocated to community associations, which then spend the money based on community needs. The community acts as an entity midway between the state and the individual. Small communities can use this income to provide new community infrastructure and other items that would not normally be covered by
the state. The James Bay Cree in Canada have used this approach in the
management of their land claim compensation fund. Each community has a seat on
the fund board, and the board reviews all community requests to avoid project
duplication. Similarly, fund earnings could be used to support grants and loans to
entrepreneurs in the form of venture capital.

6.3 Dividends

Trust fund earnings may also be channelled into the economy via individuals. Fund
earnings are divided and paid out as dividends to each beneficiary (usually to each
local resident). This system allows each resident to make his or her own
investment decisions, removing state control over earnings investment. Proponents
argue that dividends have a positive multiplier effect, encourage spending in small
economies, and are the most equitable form of earnings distribution. Moreover,
dividends override interest group conflicts and provide a means for residents to
check on the fiscal management of the fund. But dividends have the disadvantage
of removing fiscal resources from the state’s hands and reduce state assets, and can
also lead to dependence on the annual payment.

Alaska has incorporated a dividend program in its state trust fund since
payments reduce fiscal illusion and enhance fiscal responsibility. Furthermore,
dividends may be considered as a form of Universal Basic Income (UBI), in which
the state guarantees a minimal income to each resident. Such a policy is designed
to maximize each resident’s freedom within the otherwise constraining bonds of
capitalism (van Parijs, 1995, 2000, 2001). The effects of dividend payments as a
means of earnings dispersal are explored in greater depth in Chapter 5.
Chapter 2: Trust funds and windfall revenues

7. CONCLUSION

The direct use of resource revenues can be problematic. This is especially true in small, underdeveloped economies that form the marginal spaces of global capital, such as Pacific island states or the resource hinterlands of North America. Resource revenues tend to arrive in uneven streams, based on production levels and world prices. Rentier and interventionist policies address this issue differently. Rentier, or non-interventionist, policy regimes must ride out the often substantial swings in resource prices and production levels. States pursuing such policies must find alternative means of finance (such as taxation) during periods of low resource prices or production. Political leaders are often unwilling to raise taxes or to reimpose abolished taxes, leading to increased budget shortfalls. States pursuing more interventionist policies can manage resource revenue flows and distribute resource benefits over time. Such a policy assumes that policy administrators are acting prudently and in the best interests of the state and its citizen-beneficiaries.

What is the fiscal instrument most suited to managing resource revenues in small, peripheral economies? Trust funds may be the answer. A fund has the advantages of extending resource benefits (across time and space), providing a sustainable source of income, and externalising resource rents through investment. A fund also removes resource rents from direct political control. Depending on the use of fund earnings, the fund can pay annual dividends to residents and provide a Universal Basic Income; provide collective benefits, often in the form of infrastructure and social services, in the region; or save all earnings to finance or stabilise state activity in future, when the resources are depleted. Trust funds can transform a non-renewable windfall resource into a renewable fiscal resource.
While trust funds can provide the development benefits noted above, it is their application within specific geographies and histories that influences whether these potential capacities are realised. The following chapters consider six trust funds in six states, exploring their origins, management and investment policies, and the impacts they have had on trust beneficiaries. These chapters track the specificities of the six trust funds and situate them in their geographical place to see how and why some or none of these capacities have been exercised. These six cases illustrate the varying capabilities of trust funds to extend benefits both spatially and temporally. The nature and direction of capital flows plays a major role in the ability of these funds to achieve development goals within the context of each place.
Comparing six cases

A note on method

1. INTRODUCTION

This thesis considers six cases where trust funds have been established. Two of the cases, Alberta and Alaska, represent sub-national states, or resource hinterlands, within developed countries. The other four cases, the Pacific island countries of Kiribati, Nauru, Tonga, and Tuvalu, represent small island developing countries. While at first it may seem unusual to compare North American resource hinterlands with Oceanic states, each of these places is a marginal space within the global economy and a part of the capitalist periphery. This marginal position with respect to global capital has prompted each place to set up a trust fund as a response to its peripheral position. By comparing such places, we will find that trust funds are one possible mechanism for stimulating local development by investing locally-generated capital in the core. These six cases illustrate the diverse places in which trust funds might be useful.

1.1 Trust funds in other places

Trust funds have also been used as a response to perceived marginality in other places. Other national states, including Kuwait, Oman, Botswana, and Norway,
have also set up state-managed trust funds, as have sub-national states such as Montana, Wyoming, and New Mexico in the United States. Moreover, indigenous groups such as the James Bay Cree and the Inuit of Northern Québec (both in Canada) have used trust funds as a mechanism for managing their land claims settlement compensation payments, again as a response to a marginal position within global capitalism. In each of these cases trust funds were a response to an increase in revenues from a windfall resource: in the national states mentioned above this was oil (or diamonds in the case of Botswana), in the sub-national states coal, and in the indigenous cases cash compensation payments from a national government as part of a treaty settlement.

The establishment of a trust fund is a singular, but not exceptional, response to the conditions of a relatively small economy, a relatively small population, the introduction of a stream of windfall resource revenues, a perceived position of global economic marginality, and (in most cases) a visionary individual with the political will to set up a fund. In some cases, such as Kuwait and Oman, windfall revenues arrived so rapidly and in such large amounts that governments could simply not spend the money fast enough, and it accumulated in a fund.\(^1\)

1.2 Selection of cases

As discussed in Chapter 1, mainstream development scholars have analysed processes of development as applying to all places at all times, without any place specificity. The work on MIRAB economies and northern development scholars, discussed in the first chapter, has pointed the way towards more place-specific

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\(^1\) See Stauffer (1988) and Davis et al. (2001). Kuwait’s fund is thought to have been largely exhausted in paying its obligations to the United States as a result of the first Gulf War.
analyses. These two regions, Oceania and the Arctic/Subarctic, have been identified by scholars as extremely marginal places with an exceptionally limited development potential, deserving both special analytical concern and the need for alternative development models. Berman (1992), in particular, considers Oceania and Northern regions to be the most ‘remote’ on earth. Trust funds have been established in these regions as a means of compensating for this limited development potential. I have therefore drawn my cases from these two regions.2

Selection of these cases was also based on several more specific factors. Trusts and trust funds, as historically British legal institutions, are likely to flourish in areas where English Common Law has been established. The six cases selected are all in locations of former British colonial legal influence. Alberta and Alaska have the largest sub-national trust funds in North America, and represent two different investment and managerial philosophies. Each was formed as a common reaction to an increase in oil revenues in the 1970s. The four Pacific trust funds were established at different times and in response to different resource booms, yet each is both a reaction to a position of perceived marginality and an attempt to manage a small, open economy with limited investment options. Given the limitations of a thesis, it was impossible to include all existing trust funds in this analysis. My selection of cases was in part guided by the need to include the most appropriate cases and by access to available information. My previous tenure as a Research Associate of the Arctic Institute of North America in Calgary, Alberta, prompted my early interest in North American trust funds, and I was able to carry

2 Regions which, interestingly enough, have received relatively little attention from development scholars (and geographers in particular), who have tended to focus on Africa, Latin America, and Asia.
out much field research in Alberta and Alaska at this time. The carrying out of thesis research under the Research School of Pacific and Asian Studies at the Australian National University guided me towards an examination of Pacific island funds, especially so as these funds were under-researched.

1.3 Comparing cases

Compared to other branches of social science, geographers have been less exercised with the application of methodological concerns and constraints on their analyses. Political scientists and sociologists, on the other hand, have entire methodological subfields within their disciplines. This situation perhaps reflects political and sociological concerns with causal inference, and the need to demonstrate causal relationships (e.g., the causes of revolution, or the causes of alcoholism). Geographers, on the other hand, have been less centrally concerned with causal relationships and more concerned with examining historical contingency. As such, our discipline lacks a strong governing paradigm.  

Geographers have, however, recently developed an extensive interest in qualitative methodology, especially ethnographic methods such as interviewing and discourse analysis (Baxter and Eyles, 1999; Clark, 1998d; Crang, 2003; Lees, 2004).

Within social science there are three general methods of analysis: case study analysis, comparative analysis, and statistical analysis (Lijphart, 1971). Case study analysis tends to focus on the detailed examination of a single case, while statistical analysis focuses on the universe of cases, or at least on a very large

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3 As reflected in the continual debate over what geography is, what its goals and methods are, and how it relates to other science and social science disciplines. The rejection of environmental determinism and regional analysis have not been replaced by any central paradigm (see Johnston, 1987).
number of cases. Comparative analysis lies somewhere between these extremes, exploring a small number (‘small N’) of carefully selected cases (Ragin, 1987). According to Skocpol and Somers (1980), the comparative method has three general goals. One of these is the explanation of covariation among cases for the purpose of causal analysis. Another is the parallel demonstration of theory, or demonstrating that a particular concept or model sheds light on the cases. Yet another purpose (and the one employed here) is the contrast of contexts, pointing out the differences between cases and establishing how a similar process plays out differently in each context.

As Collier notes:

> Comparison is a fundamental tool of analysis. It sharpens our power of description, and plays a central role in concept-formation by bringing into focus suggestive similarities and contrasts among cases. Comparison … can contribute to the inductive discovery of new hypotheses and to theory-building (1993, 105).

The decision to analyse only a few cases is influenced by the phenomena to be studied, and often the researcher must focus on small number of cases because few instances of the analysed phenomena exist (Collier, 1993). The selected cases become analytically equivalent and the researcher explores the parallel processes of change operating in different settings.

Each method of analysis has its strengths and weaknesses. Case studies, for

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4 Within the field of development studies, economists have tended to use statistical methods, whereas anthropologists have tended to use case studies. The discipline of geography seems well positioned to use the comparative method given its links to both economics and anthropology, and its position somewhere ‘between’ them.
example, allow for an extensive and ‘deep’ analysis of a single case, but the theoretical insights generated are often limited in their applicability to other cases. Case studies may usefully confirm a theory, or marginally weaken it, or assess deviance from accepted theories, but they may have difficulty in building new models or explanations (Lijphart, 1971). Statistical methods, on the other hand, can compare the universe of cases and assess different explanations through statistical control, but such methods tend to ignore historical contingency and the particular features of each case. This search for universal models often ignores the details of place.

Comparative research can combine the benefits of the case study and statistical methods and eliminate many of their weaknesses (Ragin, 1987). Small-N research allows for a greater capacity to build explanations that may apply to other cases, yet it can incorporate historical contingency. Selecting extreme cases (those that widely differ in their effects or outcomes) can be especially valuable and insightful (Collier and Mahoney, 1996). Yet problems can occur. One of the most slippery issues in comparative analysis is selection bias, in which the researcher selects cases with similar outcomes (no variance in the dependent variable) and ignores cases with divergent ones. This bias often truncates the number of cases, ignoring either extreme cases or those in the middle. But a careful selection of cases, including both middle and extreme cases (in terms of the outcome to be explained) can compensate for the inherent bias in selecting cases. Moreover, some comparative studies have produced important findings despite selection bias (Rogowski, 1995).

Sociologist Michael Burawoy (1989) notes that the comparative method can manifest itself in both the traditional method of *induction*, in which the
researcher seeks a common pattern among diverse cases, and in scientific research programmes, in which the researcher explores the unique features that lead each case to its outcome. Burawoy notes that the advantage of the latter is its incorporation of historical contingency. The method of induction, on the other hand, assumes that facts are uncontroversial and ‘that they converge toward one unique theory’ (Burawoy, 1989, 763). The method of induction also tends to assume that the researcher is situated outside the conceptual space that is being researched.

In general, an expansion of the ‘contrast space’ (Garfinkel, 1981) can improve the reliability of comparative findings. This ‘most different’ systems design allows the researcher to trace common elements from a diversity of cases (Przeworski and Teune, 1970). For example, in this thesis I include unsuccessful trust funds (negative cases) to explain why some funds succeed in providing benefits and some do not (varying outcomes). Finally, ‘the most fruitful approach is eclectic’ (Collier, 1993, 105) and ‘too much methodological self-consciousness is an obstacle to good science’ (Burawoy, 1989, 761).

This thesis is less concerned with explaining causality than in demonstrating an alternative means of achieving economic development in marginal places.5 The preceding two chapters have outlined the general models of development holding currency today and have pointed out their limitations when applied to Oceania, the Arctic/Subarctic, and to marginal places in general. Two place-specific models were also discussed, each attempting to analyse development.

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5 I do, however, explore how trust funds can provide benefits to their beneficiaries, and I analyze six criteria for success, demonstrating the factors that lead to a fund that can assist the process of development.
potential from within a single region. In this thesis I hope to illuminate how trust 
funds, by reversing the flow of capital, can provide an alternative development 
strategy.

2. RESEARCH TECHNIQUES AND CONSTRAINTS

Michael Burawoy (1998) distinguishes between research methods (such as case 
studies or the comparative method), research techniques (such as interviewing or 
discourse analysis), and models or theories that guide research. In general I am 
guided by Burawoy’s conception of ‘reflexive science’, in which the researcher is 
not considered as being situated outside of the conceptual space being researched. 
The construction of models is less important in reflexive science, because models 
are separate from the thing modelled (Burawoy, 1998, 10). Instead of insulating the 
research subject from its object, reflexive science ‘elevate[s] dialogue as its 
defining principle and intersubjectivity between participant and observer as its 
premise’ (Burawoy, 1998, 14). Burawoy’s call for intersubjectivity is paralleled in 
geographical research by Clark’s (1998d) call for ‘close dialogue’ rather than 
‘theory-enslaved’ stylised facts. Clark notes that one advantage that economic 
geographers have over economists is their ‘fine-grained, substantive appreciation 
of diversity, combined with empirical methods of analysis like case studies’ (1998, 
75).

In what Burawoy (1998) calls the ‘extended case method’, the researcher 
Attempts to trace the source of small differences to external forces, and the cases 
are not viewed as instances of some general law (as in the method of induction). 
Rather than trying to establish the universal laws of which the selected cases are 
mere illustrations, the extended case method researcher is more interested in
reading each case in the context of what was going on at and in a particular place and time. The trust funds that I analyse in the following chapters are therefore not the manifestation of some general law of trust funds, but rather individualized responses to contextual factors in each of the six places examined. Each fund is a unique response to certain spatial and temporal conditions. An economic geography study reflects more on practice and instance, rather than on determinative claims (Lee, 2002).

My research is based on the analysis of textual documents, including archival sources and contemporary financial reports, on semi-structured and unstructured interviews with a variety of individuals, and on the application of the hypothesis of reversing capital flows as a strategy for economic development. I triangulate these sources of knowledge to produce an overall understanding of how trust funds may contribute to development. This process rejects an objectivist textual strategy, in which economic processes are ascribed to one underlying logic (Hughes, 1999).

Several researchers have commented on the interview process as a way to incorporate a diversity of voices in analysis (Hughes, 1999). Ward and Jones (1999) note how accessibility and positionality are shaped by the politically time-specific entry of the researcher into the field (they give examples of interviews conducted before and after important elections). Timing was also important in my own work. My North American interviews were largely conducted in the late 1980s, when the Alaska and Alberta funds were a little over a decade old. Key individuals (some now deceased) were able to comment on the origins of these funds as something relatively fresh in their minds. I was able to follow up on more recent information through a number of later interviews with other individuals.
In the Pacific island cases, my visits to Kiribati and Tuvalu coincided with the desire of these countries to get on the world stage, whereas visits to Nauru and Tonga coincided with their desire to get off it.\textsuperscript{6} Positionality as a particular kind of ‘outsider’ doing research can also have advantages, especially in the interviewing of foreign elites (Herod, 1999). Herod’s study describes the advantages he gained as a British researcher at an American university conducting research in the Caribbean. In my own Pacific research, I found that hailing from the Australian National University as a postgraduate student had distinct advantages, as the university is well regarded in the Pacific (and many government officials in Pacific island states have done postgraduate work there). Although I am an American, I was treated as an Australian: as someone familiar with the Pacific and sharing a [British] Commonwealth background.\textsuperscript{7} Furthermore, as a geographer, I may have been perceived as less ‘threatening’ to elites, compared to economists, who may be associated with international organisations such as the World Bank. These positional factors can help the researcher gain the confidence and trust of interviewees.\textsuperscript{8}

The following subsections highlight some of the particular issues pertaining to the investigation of each case.

\textsuperscript{6} Kiribati and Tuvalu are particularly interested in drawing attention to their campaign regarding the importance of global climate change on the viability of atoll states (Connell and Lea, 1992). Likewise Nauru and Tonga wish to divert attention away from recent financial scandals. I also found, as Ward and Jones (1999) observe, that the openness of interviewees may be due to the lack of previous researchers investigating the same topic.

\textsuperscript{7} For example, my knowledge of and interest in rugby and Australian Rules football were assumed, and I was consequently invited to several social gatherings based on these sports.

\textsuperscript{8} As an example, after several days of interviewing government officials in Tuvalu, I was later left entirely alone for several hours in the Prime Minister’s office building while all office staff, from the Prime Minister down to the typists, attended a meeting in a building some distance away. I was told to look at whatever documents held my interest during this time.
2.1 Alberta

Alberta, one of the prairie provinces of Canada, established the Alberta Heritage Savings Trust Fund in 1976. The fund is administered through the Alberta Treasury, located in Edmonton, the provincial capital. I resided in Calgary, Alberta, from 1986 to 1989, and during this time I began to conduct research on Alberta’s fund. I was able to make many visits to Edmonton as well as gather information on the public record in Calgary. I was able to access treasury records in Edmonton and also relied on the fund’s own published reports (mainly financial). This primary material was supplemented by secondary published sources such as newspaper reports and academic studies (see references). Albertan financial data, like that of Alaska, is reliable. Annual reports are presented in two parts, with one part aimed towards a public readership and a second part at auditors.

As a provincial resident, I was exposed to public perceptions of the fund, which I supplemented by unstructured interviews with key individuals. These included a series of interviews with Peter Lougheed, the former Premier of Alberta and the fund’s conceptual father; Dick Johnston, the then Alberta Treasurer and the direct manager of the fund; Roger Gibbins, a professor of political science specialising in Alberta politics; and Alan Warrack, former Vice-President of the University of Alberta and a former minister in the Alberta provincial cabinet (the interviews with Alan Warrack took place at later dates, in 1994 and 2000). As in Alaska, the Alberta government was open and forthright in allowing access to the fund’s records, which, however, were not as extensive because the fund’s origin was not a substantial topic of public debate (see Chapter 4).
2.2 Alaska

Alaska, the northernmost state of the United States, established the Alaska Permanent Fund in 1976. Fund offices are located in Juneau, the state capital. As noted earlier, I conducted much fieldwork relating to Alaska’s fund in the late 1980s, when I resided in Canada and was researching northern development issues. During this period I made several visits to Juneau (as well as to other parts of Alaska) to access Alaska Permanent Fund archives as well as the state legislature’s archives. These files contained a wealth of documents concerning Alaska political economy and the origins and development of the trust fund, especially in the form of legislative memoranda and letters. This material was supplemented by published sources, both primary sources such as the fund’s financial and analytical reports, and the secondary sources mentioned in Chapter 5, including newspaper records and academic studies.

Alaskan financial data is highly reliable, as financial matters are part of an open process and are audited by external private firms. It is important, however, to read such data within the social setting in which they were prepared and also to appreciate the rhetorical organisation of the discourse (Lees, 2004). For example, the Permanent Fund’s annual reports contain two sections, one of which is directed at the general public and another at accountants (the latter required under U.S. law). The first part contains summaries and colourful graphs, and highlights key issues. The 2003 annual report emblazoned the word ‘accountability’ on its cover and used such keywords as ‘leadership’, ‘responsibility’, and ‘honesty’ as rubrics in the report’s first section. These terms were undoubtedly selected to reassure Alaskans that their fund was well managed, despite recent accounting scandals at several prominent American corporations. The financial section, on the other hand,
consists entirely of material needed by auditors and is presented in the language of accountancy.

Printed material was further supplemented by unstructured interviews with key informants, including, among others, Steve Cowper, the then Governor of Alaska and fund trustee; David Rose, the fund’s executive director; Byron Mallott, fund trustee and later executive director of the fund; the late Hugh Malone, Commissioner of Revenue and fund trustee; and the late James Rhode, assistant to the governor and the fund’s earliest historian (see a full list of interviewees in the references). Moreover, during my visits to Alaska I spoke with a variety of Alaskans to gain a general assessment of the public’s views on the fund and I have been in contact with many Alaska residents since that time. The Alaska Permanent Fund is open and transparent both to the public and to researchers, and I was given full access to archives and to key informants.9

2.3 Oceania

I consider four separate states within Oceania: Kiribati, Nauru, Tonga, and Tuvalu. Kiribati and Nauru are both Micronesian states, while Tonga and Tuvalu are part of Polynesia. Each fund was set up at a different time and under difference circumstances, as discussed in detail in Chapter 6.

Kiribati

The Revenue Equalisation Reserve Fund was set up in 1956 when Kiribati was part of the Gilbert and Ellice Islands Colony. The fund is currently administered

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9 I was also invited to give a presentation on trust funds to the Governor of Alaska and to the Board of Trustees of the Alaska Permanent Fund at their 1990 annual meeting in Juneau.
through the Ministry of Finance at its offices in Bairiki on the atoll of Tarawa. I made a field visit to Tarawa in 2002, where I was able to access the trust fund records held at the Ministry of Finance offices. I was given full access to all records and to all individuals involved in managing the fund. Records consisted of detailed financial statements prepared by both fund trustees and investment advisors and commentaries on them. Unlike in Alaska and Alberta, these reports were intended largely for consumption by persons knowledgeable in accountancy and financial matters. Detailed financial information was not secret, yet it was not made available to the public except upon request. I also conducted unstructured interviews with, among others, Tebwe Ietaake, the Permanent Secretary of Finance; Atanteora Beiatau, the government’s Chief Economist; Colin Hill, the then Australian High Commissioner to Kiribati; and Ueantabo Neemia-Mackenzie, Director of the University of the South Pacific campus in Kiribati. I spoke also to number of I-Kiribati in order to ascertain their awareness and knowledge of the fund. I also consulted the limited amount of secondary publications on Kiribati’s economy and on the trust fund.

Nauru

The Nauru Phosphate Royalties Trust Fund, an umbrella fund comprising five subsidiary funds, was set up in 1922 during the colonial mandate administration of Nauru under joint British, Australian, and New Zealander trusteeship. Until very recently the fund was managed through the Nauru government’s financial office in Melbourne, Australia, although the Nauruan ministers and government officials with ultimate responsibility for the fund resided in Nauru. Nauru presents some difficulties to the researcher, as the Nauruan government is highly secretive and
refuses to release anything other than the most basic financial information (and even that is not easy to get: the Nauruan national budget is considered a state secret!). I visited the Nauruan Consulate in Melbourne but was not able to gather much information there. I also made a trip to Nauru in 2002 but again was unable to meet officially with any government officials.\textsuperscript{10} However, I was able to speak to a number of Nauruans (and some expatriates) and also was able to communicate with several members of Naoero Amo, a Nauruan opposition political party. These members, Kieren Keke and David Abeang, provided me with some Nauruan financial statements pertaining to the trust fund that had been submitted in the Nauruan parliament as well as copies of several Nauruan newspapers and newsletters. These materials were only available in Nauru and they were not intended for general distribution.

There is virtually no secondary literature on Nauru’s economy and its trust fund. However, there is rich historical material from the mandate era, when the country was essentially under the administration of the British Phosphate Commissioners (BPC). I was able to visit the BPC archives in Melbourne and was allowed access to the entire collection, some of which was declassified at my request. This material contained valuable documents relating to the origins of Nauru’s trust fund in the form of memoranda, letters, and financial statements.

\textit{Tonga}

The Tonga Trust Fund was formed by the Kingdom of Tonga government in 1989 and is administered directly by agents of the Royal Family and the Ministry of

\textsuperscript{10} I was, however, able to meet ‘ unofficially’ with one Nauruan cabinet minister involved in economic development issues.
Finance in Nuku’alofa, the capital of Tonga on the island of Tongatapu. As in Nauru, Tonga keeps information about its trust fund under wraps (though it is more open about general economic and budgetary data). I visited Tonga in 2002 but was unable to gain access to any government officials specifically involved with the trust fund. However, I did speak to Angus Macdonald, the then Australian High Commissioner in Tonga. I also consulted Tongan newspapers and the secondary literature on Tongan political economy, only a small portion of which contained information about the trust fund. I was able to obtain some information about the fund from journalistic sources and informal interviews with Tongan citizens as well.

**Tuvalu**

The Tuvalu Trust Fund was established in 1987 by the joint action of the Tuvalu government with those of the United Kingdom, Australia, and New Zealand. The fund is administered by the Tuvalu government at offices located in the village of Vaiaku on the atoll of Funafuti in Tuvalu. The three other founding countries also have seats on the fund’s board of trustees but most fund meetings are held in Tuvalu. I visited Tuvalu in 2002 and was able to access archival information both in the Tuvalu National Library and at the Prime Minister’s Office (where most records pertaining to the Tuvalu Trust Fund are held). I was given full access to all records.

This information was supplemented by interviews with a number of key individuals involved with the trust fund, including Saufatu Sopoanga, the Prime Minister of Tuvalu; Bikenibeu Paeniu, Minister of Finance and former Prime Minister; Solofa Uota, Permanent Secretary of Finance; Panapasi Nelesone,
Secretary to Government; James Conway, Advisor to the Tuvalu Trust Fund; and Lt Cmdr Steve Cleary, of the Royal Australian Navy. All of these people were very forthcoming with information about Tuvalu and its trust fund.¹¹

In each case, it was necessary to triangulate the textual, interview, and theoretical components of the data. Interviews with a variety of individuals, including government officials and ‘persons on the street’, helped to ensure that a diversity of voices was presented. Financial data was read in the understanding that some countries produce more reliable data than others, and data was checked with alternative sources when available.

3. EVALUATING THE CASES

The intent of this thesis is to explore the use of trust funds as a means of development by reversing the flow of capital. Trust funds may help marginal or remote developing places invest their capital in more stable and profitable markets in core countries. In assessing the ability of trust funds to do this, I am less concerned with their impacts on economic growth than with a more qualitative understanding of how to sustain marginal economies and provide for the livelihoods of their present and future generations. I am also interested in understanding trust funds as a tool for augmenting economic equity, both between individuals and between generations. A further concern is with the management of trust funds themselves, and the factors that enable a trust fund to provide sustainable benefits.

¹¹ It is interesting to compare the openness with which my requests for information were received in Kiribati and Tuvalu with that of Nauru and Tonga. As I discuss in Chapter 7, openness and transparency are important criteria in measuring the success of a trust fund.
In the previous chapters I have outlined various means of sustaining resource revenues and distributing the benefits derived from common property resources. In assessing the performance of trust funds, I could draw upon three means of comparison. The first is comparing the objectives of the six trust funds with their outcomes. Did the funds achieve the objectives that their founders and managers intended? Second, the funds can be compared to standard industry benchmarks. Did the funds produce a rate of return on investment consistent with such benchmarks? Third, the funds can be assessed as to their sustainability. Were the funds managed so as to ensure their long-term existence, and have they maintained the ability to provide benefits? Are the funds still viable entities?

In my analysis, I am primarily concerned with the first and third of these means of comparison, and my methods reflect this concern. In the following three chapters I explore the origins and intentions of the six trust funds, identifying their objectives both when the funds were established and how these intentions may have changed over time. Each fund is examined within its own political and historical context. I then turn to a more direct comparison of the funds in Chapter 7, in which I identify six criteria that appear to have accounted for the ‘success’, as measured against the funds’ own intentions, of several of the cases, and the apparent ‘failure’ of several others. These six criteria—investment policy, investment location, benefit distribution, governance and management, protection of capital, and permanence of the fund capital—closely parallel the obligations of fund trustees as described in Chapter 2.

Geographers are increasingly foregrounding the importance of the financial. Economic geographers are, in a sense, making up for lost time in their analysis of financial markets, pension funds, and flows of capital, areas that they
had hitherto largely neglected (Martin, 1999). Some economic geographers have even suggested that finance should be the core subject of economic geography (Clark, 2004a, 2). In this thesis I hope to further this inquiry by exploring the directional links between capital flows and economic development, the trust fund as an institution for achieving this development, and the place-specific context in which trust funds have and could emerge.
The Canadian province of Alberta established the Alberta Heritage Savings Trust Fund (AHSTF) in 1976 as a response to rapidly increasing provincial oil revenues. The trust fund received a portion of provincial oil royalties and invested these revenues in ways that were intended both to boost the overall economic performance of Alberta and to provide quality-of-life improvements for provincial residents. Alberta’s long history of grievance against the economic paramountcy of Eastern Canada prompted it to use its windfall revenues as a means of emerging from the perceived economic dominance of the eastern provinces of Ontario and Québec. The AHSTF, as a pool of capital, would be used by Alberta to diversify and expand its economy completely independent of Eastern Canadian finance.

Alberta’s establishment of a provincial trust fund was part of a larger strategy of ‘province-building’, through which Alberta attempted to transform itself from a peripheral into a core region. The strategy was based principally on economic diversification, which in Alberta meant reducing its dependence on petroleum and other primary resources, and developing secondary, tertiary, and quaternary economic sectors. With the rise in oil prices in the mid 1970s, Alberta tried to use its windfall gains to follow the development trajectory of Eastern Canada: using staple resources as the basis for the creation and expansion of
manufacturing and service sectors. The AHSTF was to act as a kind of
development bank that would help finance provincial diversification projects that
commercial investors themselves refused to undertake. The fund’s spending on
social services and infrastructural improvements also benefited many Albertans
directly and helped solidify their support for the political party in power. Alberta’s
use of its trust fund as an instrument to negate its perceived colonial position
within the Canadian confederation and to transform itself into an economic core is
reflected in the particular nature of the AHSTF’s investments and especially in
their geographic location. In this thesis, the AHSTF serves as an example of a
particular kind of trust fund and as an illustration of the particular geographies
associated with such a fund.

1.1 Western alienation and economic grievance

Alberta is the westernmost of Canada’s three prairie provinces. Historically, the
prairie region, which together with British Columbia is known as Western Canada,
has perceived itself as a resource hinterland. This self-perception of hinterland
status, in which control of resources has been historically dominated by interests
based in the eastern part of the country, is a political phenomenon known as
‘western alienation’ (Gibbins, 1980, 167 ff.). Today, each of the western provinces
has its own distinct resource base. In Saskatchewan this has been agriculture along
with potash and uranium mining, while in Manitoba, the third of the prairie
provinces, it has been agriculture along with some hard-rock mining in the north.
In British Columbia, the resource sector has been dominated by hard-rock mining
and forestry. Alberta is distinctive in that, along with agriculture (wheat and beef
cattle), the province is dominated by the oil industry.
Characteristics of Alberta’s hinterland position include a large territory (661,848 km²), relatively small population (3.1 million), large distance from principal Canadian and American markets, dependence on external capital, and an economy dominated by the primary sector, with only a small secondary sector and a small but growing tertiary sector. Though historically rural, Alberta has two large cities, Edmonton and Calgary, which now contain nearly two-thirds of the provincial population. Not only is there a tension between rural and urban interests, but also a North/South divide within the province that is noticeable in the rivalry between Edmonton and Calgary. Rural/urban and North/South cleavages are reflected in the policy debates surrounding resource management in the province.

Alberta, together with Saskatchewan, was created as a province in 1905, well behind the establishment of the provinces of British Columbia (1871) and Manitoba (1870). Both Alberta and Saskatchewan were carved out of the Northwest Territories, a political entity under direct federal government control. The Northwest Territories’ government had originally proposed the formation of a single province, but the Canadian federal cabinet was able to block this proposal using the argument that a large western province would challenge the political interests of the two largest eastern provinces, Ontario and Québec (Richards and Pratt, 1979, 16).

The creation of two provinces instead of one was not the only effort of the federal government to limit the resource hegemony of the West. On the grounds that federal control was needed in order to implement western settlement, public lands were not transferred to provincial control until 1930. During the period 1905-1930, no direct resource revenues accrued to the Alberta government: this 25-year period of federal resource dominance, coupled with other factors, solidified
Alberta’s hostility to and alienation from the federal government and Eastern Canada, an alienation that continues into the twenty-first century.

Western alienation is a political ideology of regional discontent (Gibbins, 1980, 169), which is reflected in Alberta’s continuing campaign to reduce its perceived dependency on Eastern Canada.¹ Western alienation also incorporates arguments against the colonial position of Alberta within the Canadian confederation (Gibbins, 1980, 173).² Given this alienation, the Alberta government has been consistently aware of the need to develop provincial sources of capital, free from federal and eastern control, and to use natural resources for the development of the province. As Canada’s only sub-national petro-state, Alberta’s political economy differs from all other provinces. The provincial decision to establish a natural resource trust fund was the most significant step in freeing Alberta from reliance on eastern and foreign capital, as well as providing financing for provincial development interests. The province’s trust fund would be used to sustain the flow of economic wealth into the province and to invest that wealth in Alberta industries, helping the province to make the transition from a peripheral to a core economic space. In order to understand the distinctive nature of Alberta’s trust fund it is necessary to examine the province’s political-economic history and especially its strategy of province-building. The following sections provide a brief background to Alberta’s political economy. The discussion of the fund’s origins and analysis of its operations follows the sections on political economy and

¹ Western alienation is in many respects the Canadian equivalent of a general sense of alienation from the dominance of eastern capital in North America. In the United States, this alienation has been expressed in a number of agrarian movements, including the Granger Movement (1867-76), the Populist Party (1892-96), and the ‘Sagebrush Rebellion’ (1970s-80s), among others.
² Also interviews with Professor Roger Gibbins, Head of the Department of Political Science, University of Calgary, and Director, Canada West Foundation, Calgary, 1987 and 1988.
2. ALBERTA POLITICAL ECONOMY

Alberta is heavily dependent on the oil industry, and the province’s economy is consequently highly unstable, more unstable than other oil-producing economies such as Texas, Oklahoma, and Colorado, which are more economically diversified (Mansell and Percy, 1990, 5, 14). Alberta directly relies on oil and gas for at least one-quarter of its provincial Gross Domestic Product, and, including direct and indirect linkages, about 70 percent of Alberta’s economy is linked to the oil and gas sector (Mansell and Percy, 1990, 17-19; Pembina Institute, 2001).

As in other petro-states, oil was understood to provide the means for rapid provincial development. Alberta’s first oil discovery was in the Turner Valley, south of Calgary, in 1914, during the era of federal government control of resources and resource revenues. Though important as a Western Canadian source of petroleum, Turner Valley was not an especially significant oil field: production had peaked by 1942, and the resource was nearing depletion by the late 1940s (Richards and Pratt, 1979, 44). But as good fortune would have it, a major oil deposit was discovered in Leduc, near Edmonton, in 1947. This was the Leduc No. 1 well, drilled by the Imperial Oil Company, an oilfield ten times larger than that at Turner Valley (Palmer and Palmer, 1990, 300-301). The size of this discovery, as well as several nearby ones in the following years, established Alberta’s position as a major oil-producing region. The oil boom was on.

2.1 The politics of oil

The increasing provincial demands for resource control are reflected in the political
parties that have governed Alberta since its creation as a province. From 1905 to 1921 the province was governed by the Liberal Party, one of Canada’s two major political parties of the period and the party that dominated the national government at the time of Alberta’s creation. The provincial government changed hands in 1921, when the United Farmers of Alberta (UFA), a populist group drawing support from Alberta farmers, and reflecting provincial alienation from federal government policy, governed the province (see Macpherson, 1969, 62 ff.; Gibbins, 1980, 133-35).

In 1935, in the middle of the depression years, the provincial government changed hands yet again, when the Social Credit Party, a rightist-populist party under the leadership of William ‘Bible Bill’ Aberhart, was elected. The Social Credit Party, with its eponymous ideology, also relied on an agrarian base of support and much of the party’s public policy was geared towards addressing agricultural interests; this explains in part the Social Credit Party’s passive rentier policy for managing oil resource wealth. Moreover, the ideology of the Social Credit Party ‘assumed that the most efficient way of developing resources was through the private sector’ and that the government lacked the expertise to intervene in petroleum development (Palmer and Palmer, 1990, 314).

Social Credit was a social philosophy developed by Major C.H. Douglas, a British economic theorist of the early to mid twentieth century. Douglas’s social credit theories began with his analysis of the role of commercial banks in creating money through credit. Douglas observed that the increase in the money supply derived from bank credit did not also create the funds needed to pay interest on that credit. Those funds would have to come from increased consumer debt or from economic growth. Douglas’s famous ‘A+B Theorem’ suggested that ‘A’ was
equivalent to wages, salaries, and dividends, while ‘B’ was equivalent to interest on debt, the cost of services, and intermediate goods. Workers received the ‘A’ component, but not the ‘B’ one, meaning that they could not afford to purchase the goods that they themselves laboured to produce (Douglas, 1934). The strategy favoured by Douglas was to provide the ‘B’ component to workers either in the form of dividends (essentially a universal basic income) or as subsidies to producers (Douglas, 1934; Richards and Pratt, 1979, 32-33; Macpherson, 1969, 108).

This consumerist, anti-business, philosophy appealed to Canadian farmers, and inspired the formation of the Social Credit political party in Alberta. An important component of the economic philosophy of the Social Credit party was the payment of dividends to Alberta residents. These dividends would be designed to ensure a ‘just price’ for consumer goods, making them affordable to farmers. Dividends were never paid in Alberta for several reasons. First, the Douglasite wing of Alberta’s Social Credit party, which advocated a strict adherence to Douglas’s economic policies, began to lose ground in the late 1930s to more mainstream views within the party, especially as Douglas’s views became increasingly cranky (Richards and Pratt, 1979, 34-35). Second, the provincial government had few sources of funds from which to pay dividends, and used World War II as an excuse not to pay them (Macpherson, 1969, 209). Third, the federal government disallowed most of the Social Credit programmes in 1945, including the dividend programme (Macpherson, 1969, 209-210).

By the late 1960s—as a result of increased in-migration stemming from oil

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3 Information about Major Douglas and his Social Credit theories, including their application in Alberta, can be found in Douglas 1934, 1937; Richards and Pratt, 1979; and Macpherson, 1969.
development, as well as increased urbanization in the province—support for the Social Credit Party was waning and the Progressive Conservative Party, led by Peter Lougheed, was able to win the election in 1971 and the party governs Alberta to this day. The Progressive Conservative party dispensed with much of the social and economic philosophy of its Social Credit predecessors, including the payment of dividends to provincial residents. Dividends became associated with discredited economic theories, and this association has prevented the Alberta government from entertaining the possibility of paying dividends from the province’s trust fund earnings.

C.B. Macpherson, one of Canada’s leading political theorists, described the pattern of political control in Alberta as:

> two waves of revolt … each followed by a longer period in which the government … became increasingly conservative. Each revolt expressed a cumulative feeling that … the economic subordination from which they were suffering was an inherent part of eastern financial domination and of the party system (1969, 215).

The electoral victory of the Progressive Conservative Party in 1971 fits this pattern of revolt against the existing structure followed by conservatism. The Progressive Conservatives were initially concerned with enhancing Alberta’s economic autonomy through a strategy of province-building. Province-building was abandoned about 20 years after the party’s coming to power, when the party

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4 This same pattern, of a newly-elected party’s ‘radical’ phase, characterized by a charismatic leader, a clear political vision, and an aggressive policy program, which is later followed by a more conservative, less visionary program, may also be found in other Anglo-American political systems. Compare Ronald Reagan’s visionary program with his successor George H.W. Bush’s, or Margaret Thatcher’s with John Major’s.
Chapter 4: Alberta

entered the conservative phase predicted by Macpherson. The Progressive Conservative plans for the Alberta Heritage Savings Trust Fund (AHSTF) and much other resource policy were developed during the early, ‘radical’ stage of the party’s tenure. Once this radical stage ended, the fund became much less important in provincial economic policy. The AHSTF was an event in the early stage of Progressive Conservative Party power.

2.2 Oil and western alienation

The Alberta provincial government has historically been the voice of western alienation (rather than, say, the Alberta delegation in the federal parliament). Even during the Social Credit administration, the province used its oil wealth to defy the federal government: Palmer and Palmer (1990, 302) describe how the government of Ernest Manning at first refused to supply natural gas to Eastern Canada, because they considered this resource as exclusively for Albertan use and as the province’s ‘God-given legacy.’ And as Richards and Pratt (1979, 17) note:

Westerners of all classes came to perceive Ottawa as an imperial government, a complex of institutions organized by central Canadian elites for the purpose of dominating and plundering the hinterlands. The provincial administration, whatever its political colouration, became the indispensable agent for attacking political colonialism and bargaining with external economic interests.

The provincial government continues to lead the protest behind western alienation. Each provincial government must demonstrate to its public that it is addressing the issues leading to alienation and must further demonstrate that it is taking steps at
the national stage to alleviate provincial dependency. The strategy undertaken by the Provincial Conservative government made use of the province’s oil wealth, which would be used to diversify the economy and thereby offset reliance on eastern manufactured goods and services. As the provincial government noted in an early budget speech:

> The future growth of our Province will depend on our ability to guide our economy through the transition from a resource and agricultural orientation to a balanced economy of both primary industry and secondary manufacturing.... In this Budget we are outlining programs directed towards diversification and decentralization of the Alberta economy (Alberta Budget Speech, March 1972).

As this budget speech reflects, the new Alberta policy was aimed at *diversification*, meaning essentially that the province would transform itself from a resource hinterland and quasi-colony into a diversified manufacturing centre, or from a peripheral region into a core. Such was the vision of the province.6

The AHSTF was a policy initiative of the Progressive Conservative Party and its leader Peter Lougheed. It was in part a reaction against the passive rentier policy pursued by the Social Credit government, and a statement that henceforth the province would become more active in resource management and economic

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5 The Alberta public’s viewpoint with respect to provincial control of oil is reflected in a popular bumper sticker appearing on private vehicles in the early 1980s, which read: ‘Let the Eastern Bastards Freeze in the Dark’.

6 As Gibbins (1980, 91) notes, if diversification should be successful in Alberta, the result would most likely be increased differentiation and political conflict within Alberta and among the prairie provinces in general. The converse of Gibbins’s argument would be that if diversification is not successful (as indeed it has not been), Alberta would continue to evidence a pattern of single-party dominance (as indeed it has).
development. The next section examines the various resource management strategies pursued in Alberta, showing how the trust fund concept came about.

3. PROVINCE-BUILDING AS A DEVELOPMENT STRATEGY

The origins of the AHSTF are best understood in the context of the historical development of the provincial state in Alberta and its province-building strategy. Province-building was Alberta’s strategy for augmenting its own provincial autonomy against that of perceived encroachments by other governments (national and sub-national) within Canada7. It was a kind of anti-colonial struggle against the perceived internal colonialism of both eastern Canadian provinces and the federal government of Canada.

3.1 Province-building and resource management

Province-building is one of three strategies by which a province can utilize the resource rents available to it (McMillan and Norrie, 1980, 213).8 Province-building is a strategy employed by the state, emphasizing the enhancement of provincial autonomy vis-à-vis the federal government, the expansion of the political and economic strength of the province, and diversification of the economy. Province-building state activity, according to Stevenson, includes:

the management of natural resources, the construction of public works, the

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7 Province-building thus differs from national development strategies, as province-building is an attempt by a sub-national government to enhance its own powers against those of other sub-national governments as well as the national government. Province-building therefore does not necessarily lead to higher national levels of development.

8 The other two strategies are non-interventionist rentier policies that involve distribution of provincial rents through either collective goods or individual dividends.
operation of utilities and transportation enterprises, the building of highways, the encouragement of industrial development and diversification, the regulation of industrial relations, and the defence of provincial economic interests in negotiations with other governments (1980, 266).

In Canada, notes Stevenson, these activities usually lie within the domain of the provincial governments, and as such can contribute to province-building.

As McMillan and Norrie noted in 1980, ‘the Lougheed government is openly and avowedly province-building,’ and ‘a series of “Alberta First” interventionist policies have been spawned’ (1980, 213-14). The principal features of the province-building strategy were the diversification of the Alberta economy and the enhancement of provincial power against that of other governments in Canada.

3.2 Economic diversification

Diversification necessitated intervention in the provincial economy on the part of the Alberta state, through some state-controlled instrument. The AHSTF was this instrument, and it is controlled by the Alberta cabinet, where it is insulated from governmental opposition and societal group pressures.

The Alberta government had embarked, in the 1970s, on a path that led towards an increase in state intervention with the purpose of achieving the diversification of the Alberta economy. However, this objective was not in the best interests of many groups within Alberta, and in fact was a policy objective of the Alberta state, and not necessarily that of all societal groups. The province-building objective of diversification entailed several costs that could detrimentally affect
The Alberta state was able to proceed with this policy of industrialisation beyond what the market could sustain because it was equipped with a vast and increasing flow of resource revenues. And because these revenues were controlled and administered directly by the state, the actual costs of the diversification program were not clearly presented to the Alberta public, and remained hidden.

In sum, province-building was a kind of sub-national ‘nationalism,’ in which the cornerstone of economic policy was diversification. The economic situation of a resource hinterland limits diversification beyond certain limits resulting from the market. Alberta’s policy of province-building was an effort to transcend the limits of the market by diversifying beyond what the market could sustain. As such, the Alberta government attempted to enact by fiat policies that would abolish the constraints of a resource hinterland. But this trans-market philosophy required statist instruments to achieve its corresponding policies: the AHSTF was this instrument, viewed not as an end, but as a tool of diversification. By defying market constraints, the Alberta government opened itself up to a series of problems that have plagued its development policies, and the AHSTF, ever since. The following section explores some of the conflicts that arose from the
Chapter 4: Alberta

4. THE CONSEQUENCES OF PROVINCE-BUILDING

To a certain extent the development of Alberta during the 1970s originated in events external to the province. The political crisis in the Middle East, culminating in the oil embargo of 1973, resulted in world oil prices doubling by the mid 1970s. As the principal oil-producing region in Canada, Alberta was the beneficiary of a massive increase in petroleum revenues. To some extent the amount of this increase was blunted by existing contractual arrangements with private oil firms as to the maximum royalty that the province could extract. However, these arrangements were soon altered to suit the province, and these changes stemmed to some degree from the actions of the federal government. The strategy of province-building brought the Alberta government into conflict with both the oil industry and the federal government.

4.1 Confronting the oil industry

In an effort to increase provincial revenues, the government of Alberta raised the royalty received from provincially-owned oil resources. The federal oil export tax initiated in 1973, which limited provincial revenues, provided some justification for the Alberta government to adjust the royalty rates upward.

There was no consultation with private industry before the royalty rates were increased. As Richards and Pratt observe: ‘in a striking departure from the long-established practice of prior consultation, this decision was taken by cabinet with no advance discussion with representatives of the oil industry: in effect, the industry was handed a fait accompli’ (1979, 225). Alberta was acting to assert its province-building agenda.
own inchoate policies of province-building. The close alliance with the oil industry, which had existed under the previous rentier arrangement, was being discarded in favour of a more independent and aggressive state pursuit of its own interests. This break ‘put the province on a collision course with the international oil industry’ (Richards and Pratt 1979, 226). Alberta's new policies and actions did not sit well with many Albertans, including the constituents of the governing Progressive Conservative party. As Pratt and Tupper noted in 1980, ‘many Alberta businessmen (notably oil executives in the Calgary industry) [did] not, to put it mildly, share Lougheed's belief in the necessity of an interventionist state’ (1980, 254). Industry pressure eventually forced Alberta to reduce royalty rates somewhat, although not to their original level. The oil companies made use of their traditional threats with some success, claiming that excessive taxes would curtail exploration and drilling activity. Some oil companies told tales of woe to their shareholders, which culminated in several stories in the *Financial Post* predicting a downturn in the Alberta oil industry (Laxer, 1983, 113-15).

The Alberta government had difficulty in overcoming these assertions for two reasons. First, the government was ideologically committed to free enterprise, and one possible strategy to control oil revenues, state intervention in the form of a state-owned oil company (such as Saskoil in Saskatchewan), would go against the grain of government ideology and would alienate many constituents. Second, the province was now so dependent on oil revenues that it needed the oil companies to keep drilling at no less than current levels. Hence the Alberta government had to back down, in light of industry, media, and federal government pressure, and lower the royalty rates and provide additional incentives. The province had nevertheless achieved an increase in revenue, and had demonstrated its willingness to confront
the international oil firms over control of the resource rents, an action which had
great symbolic importance. Where private and public interests diverged, Alberta
was able to make use of its own political and economic resources, including
ownership of the oil leases, to advance its strategy of province-building.

### 4.2 Confronting the federal government

In addition to its conflict with the oil industry over the royalty rate structure and
the division of resource rents, the province also faced a greater challenge from the
federal government. The government of Canada had its own set of policy
preferences apropos resource rent control—in general the government of Canada
was concerned with the effects of rapid economic growth in Alberta, and with the
costs associated with this growth. The responses of the federal government were
designed to mitigate both the costs of the Alberta increase and the political and
economic influence of the province. The concentration of Canadian petroleum
deposits in the province of Alberta allowed only a single province to benefit from
the doubling of world oil prices. Unlike the United States, where Alaska, Texas,
Louisiana, California, Oklahoma, and others enjoyed an increase in oil revenues,
Alberta, and to a much smaller extent Saskatchewan, were the only Canadian
provinces where rents from oil resources increased. As these oil resources were
located on provincially-owned land, the federal government was unable to benefit
from the oil boom, as it could not tax the provincial governments.

*The equalization system*

Perhaps the most serious problem that the federal government faced was the
impact of the resource revenue increase on Canada’s equalization system. The
equalization system in Canada is a national program which attempts to reallocate income within Canada in an effort to achieve similar levels of public goods throughout all provinces. The rapid growth of a single province—Alberta—distorted the equalization system and necessitated some basic changes in the manner by which equalization payments were calculated. The equalization system is based on a national average of potential provincial income. Provinces falling below the average receive a federal payment to bring them up to the national average. Alberta's rapid increase in resource revenues caused the national average of all provinces to rise. The gap to be filled by the federal government was now larger, and, moreover, some provinces which formerly were above the national average now fell below it. The federal government was forced into a position in which its payments to the ‘have not’ provinces were increasing, yet it was unable to tap the increased resource revenues accruing to Alberta. This problem led the federal government to institute changes in the equalization system, as well as to advance a number of new federal programs that significantly undercut the privileged position of Alberta.9

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9 Alberta’s economic expansion precipitated three basic changes in the equalization system. First, only one half of the revenues from non-renewable natural resources were to be counted in computing the national average of provincial income. This immediately lessened the impact of the oil boom in Alberta, and the resultant strain that it placed on the equalization system. Second, only provinces with a per capita income falling below the national average—whether or not they fell above or below the national average used for equalization purposes—would be eligible to receive equalization payments. Thus Ontario would not become a ‘have not’ province, even though its potential tax base might fall below the national average. Third, moneys deposited into provincial trust funds—such as the AHSTF—would not be counted in determining the national average. As Brooks (1987, 321) notes, ‘part of the lore of intergovernmental relations in Canada is that the AHSTF was suggested to Alberta’s premier, Peter Lougheed, by prime minister Pierre Trudeau, as a means of “sterilizing” this oil-based income’. While the story is apocryphal, it does indicate that in some sense the federal government encouraged the establishment of the AHSTF, as well as its continued expansion.
The National Energy Program

The federal program that had perhaps the greatest impact on the Alberta oil industry, and the province itself, was the National Energy Program (NEP), which was instituted in 1980. This program was designed in part to ‘Canadianize’ the oil industry and reduce the level of foreign ownership, and to provide for eventual energy self-sufficiency for Canada. The NEP also provided incentives to encourage exploration and drilling on the federally-owned lands of the Northwest Territories and offshore. These incentives threatened to reduce the level of oil industry activity in Alberta, while increasing the ability of the federal government to extract the royalties from oil drilled on its own lands.

These provisions of the NEP were met with hostility in Alberta and the other western provinces, but perhaps the greatest threat to Alberta’s struggle for greater control of its oil resources came in the revenue-sharing provisions of the NEP. Under the arrangement that existed just prior to the promulgation of the NEP in 1979, the distribution was as follows: Alberta received 49% of the oil and gas revenues, the oil industry received 39%, and the federal government received the remaining 12% (Conway, 1983). After the NEP was implemented, the distribution of the resource revenues changed to 41% for Alberta, 31.6% to the oil industry, and 27.5% to the federal government (Conway, 1983). All of these provisions were attacked by the Alberta government:

Two days after the launching of the program, [Peter Lougheed] appeared on province-wide television to challenge the NEP. He lashed out at the federal government's imposition of a Natural Gas Export Tax and at the Petroleum and Gas Revenue Tax. He flatly rejected Ottawa's schedule for increasing the price of
domestic oil and natural gas. He announced that in retaliation against the federal measures, the Alberta government, in three phased ninety-day intervals, would cut back on oil production, eventually to the tune of 180,000 barrels a day, about 15 percent of the province's total. In addition, he announced that Alberta would hold back on its decisions with respect to further oil sands and heavy oil developments (Laxer, 1983, 81).

These actions on the part of the federal government created a three-way battle for control of Alberta's oil resource wealth. The oil industry, the federal government and the province of Alberta all competed for a larger share of the resource rents.

Other issues
In addition to the problems in intergovernmental relations generated by rising oil prices, the boom led to serious social problems in the province. Crime, drug use, alcoholism, and prostitution all increased, and Alberta had the highest rates of suicide, divorce, abortion, and teenage pregnancy in Canada (Palmer and Palmer, 1990, 336). In addition, the rapid rate of urban growth led to problems with transportation, education, and other social services. These problems stemmed from the massive in-migration sustained and encouraged by oil money. In the absence of any wealth-sterilizing or neutralizing mechanism, resource rents entered the economy at rates much higher than normal, inflating the fragile economic bubble that was now close to bursting.10

10 As indeed it did in the mid 1980s, when oil prices dropped considerably and the Alberta economy entered a recession. A popular bumper sticker appearing at this time read: ‘Please God, Give Us Another Oil Boom: We Promise Not to Piss it Away This Time’.
5. ORIGINS AND OBJECTIVES OF THE ALBERTA HERITAGE SAVINGS TRUST FUND

The above discussion has noted how the province-building strategy pursued by Alberta since 1971 has been a manifestation of continued western alienation within the Canadian federal system. Like other remote resource-dependent regions, Alberta was locked in a quasi-colonial status with respect to the industrialized centres of Eastern Canada. Provincial strategy evidenced two factors that are typically found in the decolonization process: devolution of political authority from federal to provincial levels, and diversification of the economy. The second factor is a counterpart of the first. And, as in other resource hinterlands, natural resources are seen as the key to solving the problems of quasi-colonialism and endogenous, sustainable development. Alberta responded to these problems in part by establishing a natural resource trust fund (Smith, 1991). By doing so it provided a foundation for the province-building strategy as well as providing a basis—which would depend on the exact policies pursued—for achieving a sustainable flow of revenue.

5.1 Peter Lougheed and the idea of a trust fund

The AHSTF owes its origins to ideas circulated among the Alberta cabinet in the early 1970s. The provincial government was receiving revenues at a faster rate than it could spend them, and this fact, coupled with the trust fund principles discussed earlier, convinced Peter Lougheed, the Premier of Alberta, that a fund should be established. Specifically, the idea of a fund was raised following the rise
in oil prices in 1973 (Collins, 1980, 159). The Alberta Cabinet proposed a natural resource trust fund in late 1974 (Warrack, 1994, 4); in the Alberta Budget Speech of February 1975 a fund was specifically mentioned; and later that month an election was called. Part of the reason for calling an election was to assess the public’s support for the trust fund concept. As Lougheed surely predicted, he and the Progressive Conservative government won by an impressive landslide in that election held later in 1975. Lougheed interpreted this success as a sign of public support for the fund concept (Smith, 1987). In autumn 1975, Bill 74 was introduced in the Alberta legislature calling for the creation of a fund, but this bill was intentionally allowed to die (Smith, 1987). The bill had been introduced to alert Albertans to the concept of a fund; by allowing the bill to die the government hoped to stimulate public input regarding the fund. The bill, now renamed Bill 35, was reintroduced into the legislature in April 1976, where it was approved and became the *Alberta Heritage Savings Trust Fund Act*.

### 5.2 The trust fund and provincial resource policy

Natural resources were central to the Progressive Conservative Party’s vision for Alberta. Noting that in the early 1970s the province was deficit-financing its budgets, Allan Warrack (1994, 4) lists four aspects of the new resource policy:

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11 Also interviews with The Hon. Peter Lougheed, QC, Former Premier of Alberta, Calgary, 1987 and 1988, and with The Hon. Dick Johnston, Treasurer of Alberta, Edmonton, 1988. Lougheed told me in these interviews that he viewed the province through the metaphor of a house, with the concomitant need to provide for its future economic security through savings. It is clear both from the series of interviews with Lougheed himself, and from other sources, that Lougheed was the originator of the trust fund idea.

1) To increase the share of public ownership of natural resources;

2) To increase prices of oil and gas to market levels;

3) To upgrade resources, which would increase employment; and

4) To gain greater investment opportunities as public resources are developed.

These policy dimensions reflect several factors. First, the province would rely on the market economy, but it would attempt to increase provincial ownership of resources. Second, increased resource prices and increased public resource ownership would lead to an increase in provincial revenue. Other aspects of Alberta policy suggest that this new flow of resource revenues could be used to achieve the provincial goal of economic diversification. These policy objectives, together with a dramatic increase in oil prices by the mid 1970s, did in fact provide the province with substantial new revenues.

The fund was developed as a means to counteract the problems of a resource hinterland and its peripheral economy. Specifically, developing a large pool of endogenous capital would extend the benefits of resources over time (and allow future generations to share in them); it would provide a source of capital in addition to that provided by Eastern Canadian banks and by foreign financiers (and would, ultimately, replace these sources); and it would provide a pool of capital that could be used to achieve the Alberta government’s diversification objectives, which were so central to the Progressive Conservative Party’s general program and necessary to secure the support of the party’s urban constituents. Thus, while the fund did have long-range objectives and was founded on a long-range resource management philosophy, it nevertheless provided immediate economic support for the governing party. That the provincial cabinet had direct responsibility for the
fund strengthened this latter tendency.

The *Alberta Heritage Savings Trust Fund Act* passed the provincial legislature on 19 May 1976, and the AHSTF received its first allocation of $1.5 billion (from general revenues). The fund was given three objectives:

1) To save for the future;

2) To strengthen and [later ‘or’] diversify the economy of Alberta; and

3) To improve the quality of life for Albertans (Alberta Statutes, 1976).

These stated objectives indicate that the fund would be used to benefit Alberta alone. Moreover, the fund could also be used to provide a source of capital for Alberta government-sponsored projects. The stated objectives, especially the latter two, provided the authority for the province to use the AHSTF as a developmental instrument. In addition to specifying the objectives of the fund, the *Alberta Heritage Savings Trust Fund Act* specified the fund’s organization, management, and investment policies. The *Act* created the AHSTF through legislation, meaning that such legislation could be amended by a motion of the provincial legislature. The *Act* did not provide any constitutional protection for the fund.

6. FUND OPERATIONS, MANAGEMENT, AND INVESTMENT

For the first 21 years of the AHSTF’s existence, during the period of province-building under the Lougheed and later the Getty governments, the fund’s investments were concentrated in Alberta and consisted overwhelmingly of fixed income assets. In 1997 the fund began a major restructure, as it transformed itself

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13 All dollar figures expressed in this chapter are in Canadian dollars.
from a primarily development-oriented fund into a primarily savings-oriented one. The fund served its initial purpose of province-building, and now serves the different purpose of providing a sustainable revenue stream for the province, which, among other things, allows Alberta to extract no provincial sales tax from its residents.

Between 1976 and 1987, when the fund was capped, the province deposited over $12 billion into the AHSTF. From 1976 until 1982, AHSTF earnings were redeposited into the fund. Thus the fund grew rapidly in its early years, from an initial balance of just over $2 billion at the end of the first fiscal year in 1977, to over $12 billion by the end of the fiscal year in 1985. The fund then stabilized with a balance of about $11 or $12 billion, as no new revenues are being deposited into it and its earnings are transferred to the general fund. The fluctuations in the fund’s balance reflect the changing valuation of its assets as financial markets fluctuate. The fund’s shifting investment geographies in the context of different provincial development strategies are discussed below.

6.1 Fund governance

Management

The AHSTF is managed at the highest level by the provincial government, which in Canada means that the provincial cabinet, and especially the provincial treasurer and premier, constitute the fund’s trustees. The fund is directly managed by the Alberta Treasury and thus the provincial treasurer has great control over fund investment decisions. Both the provincial Auditor-General and an AHSTF Oversight Committee, composed of nine members of the provincial legislature (MLAs), of which three are not members of the governing party, provide some
level of oversight of fund management. An Operations Committee, consisting of private-sector financial advisors, also provides investment advice to the Alberta Treasury.

**Accountability and governance**

Despite these various monitoring bodies, the AHSTF remains a creature of the provincial cabinet, and thus of the governing political party. The fund has no constitutional protection, and the enabling legislation for the fund can be changed by amendments enacted by the provincial legislature. In a sense, Albertans thus directly elect their fund’s trustees, though in practice the provincial treasurer, elected only by his own riding’s (parliamentary district) constituents, is the only trustee with direct influence on fund investment practices.

AHSTF financial statements are available to the public. The fund issues an annual report each financial year (ending 31 March) and this report is also available through the internet, as are the fund’s quarterly reports. All financial statements are audited by the provincial Auditor-General. MLAs can also answer their constituents’ questions about the fund, and the AHSTF office in the provincial treasury is also happy to answer questions or to refer one to the location of information. The AHSTF has its own logo, which appears on the capital projects financed by the fund, making it clear to Albertans where financing for these projects came from. The AHSTF has an open and transparent policy with respect to its investments, and most financial information is made available to anyone.

### 6.2 Generation of fund capital

Prior to the creation of the AHSTF in 1976, 100% of the province’s resource
revenues were deposited into the provincial general fund, meaning that they became part of the general provincial budget. After the AHSTF was established, 30% of revenues went into the AHSTF, while the remaining 70% went into the general fund. During this period the fund’s investment revenues were redeposited into the fund. These provisions were later changed, in 1982, to only 15% to the AHSTF and the remaining 85% into the general fund, with fund earnings being transferred to the general fund. This change was based on declining revenues and the need for funds to balance the province’s budget. Then, in 1987, the AHSTF was capped, with the result that, once again, 100% of resource revenues went to the general fund. The period of new resource revenues being deposited into the AHSTF lasted from 1976 to 1987. Transfers to and from the fund between 1976 and 2003 are shown in Table 4.1.

The limited, eleven-year period of resource revenues flowing into the trust fund again suggests that the policy underlying the AHSTF was a moment in the Progressive Conservative government’s overall policy for Alberta, a moment taking place during the earlier, ‘radical’ phase of Progressive Conservative policy. The trust fund thus served a particular purpose at a particular time, and was not intended to serve the same function in perpetuity.
### Fiscal Year | Net Income (Loss) | Transfers from GRF | Transfers to GRF | Capital Expenditures | Fund Equity\(^a\)
--- | --- | --- | --- | --- | ---
1976/77 | $88 | $2120 | - | ($36) | $2172
1977/78 | 194 | 931 | - | (87) | 3210
1978/79 | 294 | 1059 | - | (132) | 4431
1979/80 | 343 | 1332 | - | (478) | 5628
1980/81 | 734 | 1445 | - | (227) | 7570
1981/82 | 1007 | 1433 | - | (349) | 9661
1982/83 | 1482 | 1370 | (866) | (296) | 11,351
1983/84 | 1467 | 720 | (1469) | (330) | 11,739
1984/85 | 1575 | 736 | (1575) | (228) | 12,247
1985/86 | 1667 | 685 | (1667) | (240) | 12,692
1986/87 | 1445 | 216 | (1445) | (227) | 12,681
1987/88 | 1353 | - | (1353) | (129) | 12,552
1988/89 | 1252 | - | (1252) | (155) | 12,397
1989/90 | 1244 | - | (1244) | (134) | 12,263
1990/91 | 1337 | - | (1337) | (150) | 12,113
1991/92 | 1382 | - | (1382) | (84) | 12,029
1992/93 | 785 | - | (785) | (84) | 11,945
1993/94 | 1103 | - | (1103) | (71) | 11,874
1994/95 | 914 | - | (914) | (49) | 11,825
1995/96 | 1046 | - | (1046) | - | 11,825
1996/97 | 932 | - | (756) | - | 12,001
1997/98 | 947 | - | (922) | - | 12,026
1998/99 | 932 | - | (932) | - | 12,026
1999/2000 | 1169 | - | (939) | - | 12,256
2000/01 | 706 | - | (706) | - | 12,256
2001/02 | 206 | - | (206) | - | 12,256
2002/03 | (894) | - | - | - | 11,362
Total $24,700 $12,047 ($21,899) ($3486) $11,362

* at cost

Source: AHSTF Annual reports, various years

### 6.3 Geographies of fund asset distribution

When the fund was set up in 1976 it consisted of three divisions, each focused on a particular type of asset and with a particular political purpose. In 1980, the province added two additional divisions, but these never amounted to much and were insignificant in the AHSTF’s overall structure. The five divisions were the Alberta Investment Division (AID), the Canada Investments Division (CID), the
Capital Projects Division (CPD), with the two later additions being the Commercial Investment Division (CMID) and the Energy Investment Division (EID). Figure 4.1 illustrates the original structure of the fund, outlining its source of capital, investment divisions, and distribution of earnings. The fund’s investment divisions, and their asset types and geographies of investment, are discussed below.

![Figure 4.1 Alberta Heritage Savings Trust Fund, original structure](image)

**Figure 4.1 Alberta Heritage Savings Trust Fund, original structure**

Solid lines indicate legally-mandated transfers.

**Alberta Investment Division**

The function of the Alberta Investment Division (AID) was to ‘strengthen or diversify the economy of Alberta’ and to ‘yield a reasonable return or profit’ (AHSTF, *Annual reports*, various years). The division was expected to make a ‘reasonable return’, but not necessarily a ‘commercial return’ on its investments (Warrack, 1994). Investments could be either in fixed income assets (debt investments, such as bonds, debentures, and so forth) or in equities. In practice most of the assets held by this division were fixed income assets and especially
debentures issued by various agencies of the Alberta government. Most of this division’s assets consisted of loans to provincial crown corporations, such as the Alberta Mortgage and Housing Corporation, Alberta Agricultural Development Corporation, Alberta Municipal Financing Corporation, and Alberta Government Telephones (later semi-privatised and called TELUS).

Investments in these particular crown corporations reflect the province’s desire to initiate the transition from a peripheral into a core economy as well as the need to placate various voter groups and factions. The Alberta Mortgage and Housing Corporation (AMHC), the largest investment of the AID, had several purposes designed to appeal to a large segment of the population. The AMHC both provided funds to construct and maintain affordable rental housing for low wage earners and pensioners and financed (at subsidised rates of interest) mortgages for middle-income Albertans. The Alberta Agricultural Development Corporation attempted to encourage sustainable agricultural production by providing loans and loan guarantees (and financial counselling) to farmers and small agribusinesses and by providing disaster relief services. The Alberta Municipal Financing Corporation provided subsidised loans to the province’s municipalities, school districts, and hospital districts, and made loans to both large and small communities. These three crown corporations, by providing subsidised financing for renters and home owners (mainly urban), farmers (rural), and municipalities, permitted borrowers to avoid depending on commercial, Eastern Canada-based banks for their financial needs; the lower-than-market rates of interest also encouraged community expansion. The crown corporations, by providing cheaper finance, channelled provincial oil wealth to residents in the form of means-tested goods.

Other investments of the AID took the form of equity shares in various
infrastructural projects designed to offset the province’s reliance on eastern finance. Investments in the Syncrude Oil Sands Project, in NOVA Corporation of Alberta Ltd, in Alberta Energy Company Ltd, in Millar Western Pulp Ltd, and in Prince Rupert Grain Terminal – Ridley Grain Ltd, replaced eastern finance with the province’s own capital. Syncrude, Alberta Energy, and NOVA are all petroleum-related exploration, development, and production companies; Millar Western Pulp operates a pulp mill using Alberta timber; and the Prince Rupert Grain Terminal (controlled by Ridley Grain) operates a grain terminal and elevator facilities in Prince Rupert, British Columbia, allowing Alberta farmers to export their grain while bypassing the more expensive port facilities in Vancouver and other Lower Mainland British Columbian port cities. In each of these ventures the AHSTF is part of a consortium of investors (including the private sector), and some are publicly traded companies. The fund’s investment in these corporations allows Alberta to directly influence development in the province by holding seats on the boards of directors of each of these entities as well as to ensure continued investment in the province’s resource industries.

The investments of the AID provided benefits to a wide variety of Alberta residents, allowing them to bypass commercial lenders and market rates of interest for provincial sources of subsidised credit. Investments in energy companies helped to augment and expand the province’s resource sectors (but were not directed at creating economic diversification). It is interesting to consider that these rather socialistic investment practices were the policy of a professed conservative and free market-oriented government. On the other hand, such investments ensured voter loyalty and allowed the Alberta government to pursue its development policies through other divisions of the AHSTF. It should also be borne in mind that
both subsidised credit and energy investments could have been administered
directly by the province, and did not require a trust fund as the financial
mechanism to carry out development policies. Including such investments within
the fund both helped to secure support for its existence and consolidated provincial
lending under a single entity that was directly controlled by the provincial cabinet
and treasury.

While the province claimed that because crown corporations borrow from
the AHSTF at market rates the fund therefore earns market returns, and that ‘crown
corporations are safe, secure investments … they always make their payments on
time’ (AHSTF Annual report, 1991), some analysts have suggested that the returns
generated by this division were not the same as those from commercial
investments, and that in fact the fund exposed itself to the default risk of struggling
government agencies (Warrack and Keddie, 2002).14 The one exception to this was
the division’s investment in the Syncrude oil sands project in northern Alberta,
which did generate significant annual revenues.

That the province would invest in assets that did not generate the highest
potential returns (‘commercial returns’) is telling, and reflects this division’s focus
on investments that would strengthen or diversify Alberta. The assets of this
division were located entirely within Alberta. The province needed debt funding
for many of its crown corporations, such as those providing mortgage, agricultural,
municipal, and telecommunications financing, and used the AHSTF, rather than
the open market, as a source of funds, thus bypassing the need for external capital

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14 Also interviews with Allan Warrack, former Member of Alberta Provincial Legislature and
former Vice-President and Emeritus Professor of Business Administration, University of Alberta, in
Tucson, 1994, and in Kauai, 2000. Warrack considers (with the exception of Syncrude) the
financial performance of the AID to have been ‘poor’.
and its colonialist associations. The AID’s investments also had a popular appeal, as they were visible signs of fund investment. The crown corporations that received AID investment provided mortgage subsidies to Alberta homeowners, subsidized the transportation of agricultural commodities (making them more competitive internationally), and subsidised local and long-distance telephone services, making them less expensive for provincial residents, among other things. AID investments benefited a wide segment of the Alberta population, but especially low-income renters, middle-income home owners, farmers, and those employed in energy and other natural resources sectors. The AID was a clear reflection of the province’s avoidance of external capital and its increasing reliance on Alberta capital sources. It was also an example of the province’s attempts to circumvent market forces by providing credit in places that commercial lending failed to penetrate, by lending at below market rates. The Alberta government sacrificed a commercial rate of return in order to stimulate provincial development in projects that seemed beyond the ability of a peripheral economy to finance and to avoid relying on core region sources of credit.

Canada Investments Division

The other major financial investment division of the AHSTF was the Canada Investments Division (CID). Whereas the AID focused on investments entirely within the province of Alberta, the CID focused on investments outside the province but within Canada. One factor behind this division was the desire of the province to mitigate external hostility towards the AHSTF by demonstrating the fund’s willingness to use Alberta wealth to help other provinces (Pretes, 1988). The division made loans to other provinces between 1977 and 1982 (all of them
now repaid) at an average interest rate of 12.5%, which reflects the high interest rates prevailing during that period, due in part to the election of a separatist government in Québec and the subsequent nervousness in external financial markets about investing in Canada (Warrack, 1994).

The CID made 33 loans totalling $1.9 billion. These went to five provincial governments (Newfoundland, New Brunswick, Nova Scotia, Prince Edward Island, and Manitoba) and to provincial crown corporations (usually power companies) in these provinces and to Hydro-Québec in Québec (AHSTF Annual reports, various years). Like the AID, the CID’s goal was to produce a ‘reasonable return or profit’. Though limited by the enabling legislation to no more than 20% of total AHSTF assets, the CID was perhaps the most successful of the fund’s divisions and certainly the most profitable overall. It is worth bearing in mind that the greatest returns came from investments external to Alberta, rather than from those within the province. The investment geographies of this division focused on maximizing economic returns and not on investing within Alberta.

Capital Projects Division

The most controversial of the AHSTF’s five divisions was the Capital Projects Division (CPD). The reason for the controversy was the nature of the division’s investments: the CPD financed capital projects rather than invested in financial assets. As such the assets produced little or no financial return (and often entailed costs, such as maintenance costs), but were designed to provide social benefits to Alberta residents. The goal of the CPD was to ‘provide long-term economic or social benefits to the people of Alberta’; but fund managers noted that ‘projects may not necessarily by their nature yield a return’ (AHSTF Annual reports, various
years). Despite their infrastructural and non-return producing nature (to say nothing of the province’s inability to sell these assets), the ‘amounts expended on projects are deemed to be assets of the fund’ (AHSTF Annual reports, various years). CPD investments were listed in the fund’s annual reports and other financial statements as ‘deemed assets’, provoking a statement each year by the provincial Auditor-General to the effect that listing capital projects as ‘deemed assets’ violated standard accounting practices. In 1987 the Auditor-General finally disallowed the inclusion of ‘deemed assets’ in the fund’s financial statements, although the AHSTF continued to list them as assets until the fund was restructured.¹⁵

Though ‘deemed assets’ raised the hackles of the accounting profession, these infrastructural investments were popular with the public as they were visible manifestations of the fund’s commitment to benefit Albertans. Each of the division’s projects, where possible, prominently displayed the AHSTF logo, helping to publicise the fund’s socially-beneficial investments. The deemed assets of the Capital Projects Division were divided into a number of subcategories: agriculture and rural development, research and technology, economic diversification, environment, and quality of life, reflecting the diverse goals of the division.

The agricultural and rural development component of the CPD was committed to developing the province’s agrarian infrastructure. These included:

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¹⁵ For example, in the fund’s 1991 Annual report, Alberta Auditor-General David D. Salmon observes that ‘the practice of including deemed assets … on the balance sheet is not appropriate nor is the presentation in accordance with generally accepted accounting principles. Deemed assets represent amounts expended which are not recoverable by the Fund and where assets do exist, they belong to other organizations … the financial position of the Fund would be better understood if the deemed assets … were not included’.
private irrigation water supply, irrigation rehabilitation and expansion, agrifood research, grazing reserves development and enhancement, renewable energy research, rail hopper cars, and individual telephone line service for rural customers. Irrigation projects consisted of grants to assist in the development of 40 projects irrigating about 1800 hectares of marginal provincial lands as well as financial assistance to the province’s 13 main irrigation districts in order to enable them to rehabilitate canals and pipelines. Agrifood grants supported research designed to sustain and expand Alberta’s agrifood sector. The division’s funds were also used to rehabilitate about 55,000 hectares of marginal grazing lands in order to increase pasture productivity. The fund also purchased 1000 rail hopper cars to increase the grain carrying capacity of the province’s rail system (beyond that of the private sector) and converted about 25,000 rural telephone customers from party to individual phone lines. All of these projects assisted rural residents and especially those directly dependent on agriculture.

The research and technology aspect of the CPD supported cancer, heart disease, and occupational health and safety research through research grants and scholarships as part of Alberta’s commitment to become a centre of medical research. The CPD also provided scholarships to undergraduate and postgraduate university students. The principal beneficiaries of these programs were the residents of the cities of Calgary and Edmonton.

The economic diversification component of the CPD helped finance the Alberta Microelectronic Centre and the Electronics Test Centre in an effort to boost the province’s fledgling high technology sector. These facilities provided consultation and testing services. Other aspects of economic diversification as funded through the CPD included support for a Food Processing Development
Centre (to conduct research on food processing and packaging technologies) and financial support for the construction of 18 airport terminals in Alberta. Though economic diversification was a principal goal of Alberta’s province-building strategy, the financial commitment to these projects (some of which, such as airport terminals and food processing, were of dubious diversification potential) was less than 10% of total division investments (AHSTF Annual reports, various years).

Investments falling under the subcategory of environment included programs to fund reforestation nurseries; various water reclamation projects designed to sustain the province’s water needs through the construction of irrigation canals, dykes, flood-free road systems, and reservoirs; and land reclamation projects such as restoring abandoned garbage dumps, sewage lagoons, gravel pits, and mine sites.

The subcategory of quality of life was oriented towards enhancing Alberta’s recreational opportunities through the development of municipal and provincial parks and tourism areas. These included the Kananaskis Country provincial recreation area in the Rocky Mountains near Calgary; the fund supported the construction of 3000 automobile campsites in 30 campgrounds, 17 backcountry campsites, 13 group camps, 75 picnic areas, and 6 amphitheatres as well as 1500 km of hiking, cross-country skiing, and off-road vehicles trails, a golf course, and a lodge (AHSTF Annual reports, various years). Other projects funded urban parks in Calgary and Edmonton as well as in smaller cities.

The investments of the CPD were entirely within Alberta, produced no direct financial returns, and often entailed maintenance costs borne outside the fund, but the ‘deemed assets’ were politically popular and helped develop public
support for the idea of a trust fund. Yet the rhetoric of economic diversification enunciated in the province-building strategy was not matched in practice, with only a small component of deemed assets consisting of projects with a clear economic diversification goal. Most of the CPD’s assets were directed at supporting the agricultural sector (rural residents) and providing recreational amenities for mainly urban residents. The fund’s deemed assets enhanced the quality of life of Albertans but did little in the way of diversifying GDP and employment away from the primary sector.

Other fund divisions

The two additional divisions of the AHSTF added in 1980 were the Energy Investment Division (EID) and the Commercial Investment Division (CMID). These two divisions remained quite small and had little impact on overall fund investments. They were important, however, in setting the stage for revisions to AHSTF investment policy in the late 1990s.

The EID was a division designated to ‘facilitate the development, processing or transportation of energy resources within Canada’ and, like other divisions, was supposed to ‘yield a reasonable return or profit’ (AHSTF, Annual reports, various years). In the early 1980s it included a limited investment of about $25 million in debentures of Luscar, an energy company. These assets were eventually sold or transferred to other fund divisions, and the EID ceased to exist in practice in by 1985. The CMID, on the other hand, remained in use for the fund’s duration, and has become the basis of the new financial structure of the AHSTF (discussed later). The CMID was intended to ‘yield a commercial return or profit’, rather than just a ‘reasonable’ one (AHSTF, Annual reports, various years).
The division invested in both Canadian equity and fixed income securities, but until the late 1990s the division was never large relative to the AID and CID. The division constituted well under 1% of AHSTF assets, reflecting the lack of importance attached to savings and commercial returns by the provincial cabinet.

The AHSTF, from its inception in 1976 until a major overhaul of fund policy twenty years later, was designed to finance government operations in Alberta through purchasing the debentures of its crown corporations, and to provide social benefits for Alberta residents through investment in physical and social infrastructure within the province. Loans to other provinces, while profitable, were below market rates of interest at the time and the loans arguably were made to stave off hostility and negative publicity in Eastern Canada stemming from Alberta’s rapid enrichment. While some Albertans benefited from increased funding for selected social services (which could have been financed without a trust fund), the diversification aspect of the fund’s existence was unsuccessful, prompting Alberta’s leaders to change tack and restructure the AHSTF.

6.4 Distribution of fund earnings

Trust funds generate annual returns from their investments. In general, fund trustees, based on fund policies and objectives, can designate various purposes for fund earnings. In Alberta, all fund earnings between 1983 and 1997 were transferred to the province’s General Revenue Fund (consolidated revenues). Since 1983 a total of almost $21.0 billion has been transferred from the AHSTF to the General Revenue Fund, with another $3.4 billion being spent on capital projects (see Table 4.1). Since 1997 a portion of fund earnings has been retained in the fund.
to offset the loss of the fund’s real value against inflation, so the transfers to general revenue have been slightly less than total fund earnings. Fund earnings have ranged widely, due to Canadian and global investment conditions. The fund generated a net income in every year since its inception with the single exception of 2003, the most recent fiscal year.\textsuperscript{16} In that year the fund sustained a loss of $894 million, and therefore nothing was transferred to general revenue.\textsuperscript{17}

Dividends to provincial residents were never seriously considered as a possibility for the distribution of fund earnings (as they are in Alaska) because the idea of dividends is tainted by its association with the Social Credit policies of the mid twentieth century. As noted earlier, the Social Credit dividend programme was never implemented, largely because it was blocked the Supreme Court of Canada on the grounds that Alberta did not have the constitutional authority to engage in monetary policy. As support for Social Credit as a political party waned in the 1960s, so too did support for the dividend policy. Moreover, as Alberta’s economy prospered during the oil boom years, the perceived need for dividend payments to individuals came to be seen as increasingly irrelevant.

\textsuperscript{16} 2004 financial statements have not yet been released, but a net income is expected, based on the data in the first three quarterly reports.
\textsuperscript{17} It is worth noting here that the only other provincial natural resource based fund in Canada was the Saskatchewan Heritage Fund, which was an investment fund set up and administered by the Saskatchewan government between 1978 and 1992. The fund received and invested the province’s natural resource revenues (primarily oil, potash, and uranium) and attempted to save revenues for future generations. The fund was established under the *Heritage Fund (Saskatchewan) Act* in 1978. The initial capital was $465 million, but this grew over the years so that the balance of the fund was frequently over $1 billion. The fund received all non-renewable resource revenues, invested these, and paid a dividend of not more than 80% of the fund’s balance each year to Saskatchewan’s general revenue fund. The fund provided investment capital, usually in the form of loans, to provincial crown corporations. Capital projects such as hospitals, airports, restoration of historic sites, and universities were also financed. The act enabling the fund was repealed in 1992 on the grounds that the fund was no longer necessary. In effect, the Saskatchewan fund was closely modeled on Alberta’s, except for its practice of maintaining a constant balance and transferring the bulk of its earnings to the provincial government as a dividend (see Saskatchewan Finance, 1978).
By the mid-1990s the AHSTF had become less important to Alberta’s overall policy objectives. The premier, Ralph Klein, although of the same political party, was not associated with the province-building agenda of the earlier era. Alberta had lived through both an oil boom and the subsequent oil bust, and was now on a more stable track. The wild fluctuations in the province’s economy in the 1970s and 1980s were in the forefront of Albertans’ minds (as indicated by issues discussed in the media) and experiments in diversification and other province-building objectives did not stir the public as they once did. Safety and stability were now the key economic issues, hence the abandonment of province-building by the Alberta leadership.

The failure of the economic diversification aspect of province-building was another critical factor in the restructuring of the fund. The Pembina Institute for Appropriate Development has monitored the province’s economic diversification policies and has constructed an Economic Diversification Index (EDI) that assesses the diversification of Alberta’s economy relative to the Canadian economy as a whole. In their 2001 report, the Pembina Institute (2001) found that, although Alberta’s Gross Provincial Product (GPP) has grown steadily since 1971, when the Progressive Conservatives were elected, the relative diversification of the province was lower in 1999 than it was in 1971. Using 100 as the EDI benchmark for 1971, the Institute found that the corresponding level for 1999 was below 40. They note that ‘Alberta’s economy in 1971 was one of the most diverse in the past 30 years’

18 Ralph Klein is from Calgary, where he has been mayor, and is not associated with the Edmonton-based, football-playing ‘good old boys’ network of Lougheed and Getty.
Furthermore, Alberta’s dependence on natural resource industries hardly changed between 1971 and 1999, from 28.0% of GPP in the former to 25.9% of GPP in the latter (Pembina Institute, 2001). The service sector’s position in the provincial economy was constant as well. The realisation that the diversification program of province-building was not working, coupled with the emergence of new leadership within the party, propelled the provincial government down a very different path.

In 1995 the provincial government conducted a province-wide survey on the future of the AHSTF. The survey was called ‘Can we interest you in an $11 billion decision?’ and it received over 50,000 responses. The survey results indicated that, while Albertans approved of maintaining the fund, they wanted to see it invest in more typical trust fund investments that would generate financial revenues (something more along the lines of the Alaska fund, knowledge of which was becoming more common in Alberta). With these survey results, the provincial legislature amended the Alberta Heritage Savings Fund Act to restructure the investment practices of the fund. The fund would no longer be used for direct economic or social development agendas, but would instead focus on long-term financial investments. A follow-up survey conducted in 1998 indicated that a large majority of Albertans approved of these changes in fund policy.
The province thus began the process of converting Alberta-based debenture assets into a broader portfolio of equity and fixed income assets that would generate long-term income and growth. The five original investment divisions were collapsed into two new ones, called the Endowment Portfolio and the Transition Portfolio, the latter consisting of the old divisions’ assets that were gradually being sold off or exchanged for the basket of investments in the new Endowment Portfolio (see Figure 4.2). A minimum of $1.2 billion in old assets (or 10% of the total) would be transferred each year into the Endowment Fund until such time as all old assets were disposed of (Warrack, 1994). A further innovation was that the fund would retain a portion of its earnings to offset the real loss of value due to inflation. Previously the AHSTF had no inflation-proofing, so that the real value of the fund declined each year. In essence, the ‘new’ AHTSF was modelled very closely on the Alaska Permanent Fund. This is not surprising, as the AHSTF had (at least partially) fulfilled its original intention of supporting the provincial economy and providing economic and social benefits to Albertans, and
because economists and other investment analysts had continually pointed to the
success of the Alaska fund’s investment strategy.

<table>
<thead>
<tr>
<th>Actual Asset Mix (book values)</th>
<th>Year</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2003</td>
</tr>
<tr>
<td>Fixed Income</td>
<td>35.8%</td>
</tr>
<tr>
<td>Public Equities</td>
<td></td>
</tr>
<tr>
<td>(Canadian)</td>
<td>21.4%</td>
</tr>
<tr>
<td>(United States)</td>
<td>17.5%</td>
</tr>
<tr>
<td>(Other)</td>
<td>15.7%</td>
</tr>
<tr>
<td>Total</td>
<td>52.9%</td>
</tr>
<tr>
<td>Private Equities</td>
<td>0.8%</td>
</tr>
<tr>
<td>ARS(^b)</td>
<td>2.6%</td>
</tr>
<tr>
<td>Real Estate</td>
<td>7.9%</td>
</tr>
<tr>
<td>Total</td>
<td>100.0%</td>
</tr>
</tbody>
</table>

\(^a\) does not include capital projects assets
\(^b\) Absolute Return Strategies, including arbitrage, short selling, etc.
Source: calculated from AHSTF Annual reports, various years

Table 4.2 AHSTF asset distribution by type of asset, selected years (percent)

Fund Asset Mix

Tables 4.2 and 4.3 illustrate the changes both in the composition of assets and in
the location of investment. Table 4.2 shows the most recent year, 2003, and compares it with 1993 and 1983, or 10 and 20 years prior. In 1983, or seven years after the fund’s inception, 95.0% of assets were in fixed income securities, while only 5.0% were in equities. The pattern is the same for 1993, with a slightly larger proportion of fund assets (98.2%) in fixed income securities and a mere 1.8% in equities. In 2003, however, or five years after the restructuring, the proportion of fixed income assets has declined substantially to 35.8%. Equities (public and private) now represent 53.7% of AHSTF assets. Real estate accounts for 7.9% of assets, and the remaining 2.6% is accounted for by Absolute Return Strategies (ARS), which include such things as arbitrage, short selling, and other more
aggressive and speculative investments. Thus, within a ten-year period, the AHSTF has gone from a fund investing almost entirely in fixed income assets (mainly debentures and receivables) to one with a diversity of investments with about half in equities, a third in fixed income securities, and the remainder in real estate and Absolute Return Strategies. The fund portfolio has been transformed from a highly stilted one into a portfolio more in accordance with modern investment theories. Fund assets are now selected in order to achieve long-term growth and annual financial return, rather than to achieve vague ‘economic and social benefits’, which are difficult to quantify and measure.

**Fund Asset Location**

The geographies of asset distribution have likewise changed. Table 4.3, using the same three years as in Table 4.2, shows the location of AHSTF investments as belonging to one of three classes: Alberta, Canada (not including Alberta), or Other (including the United States and locations outside North America). In 1983, 75.4% of fund investments were in the province of Alberta, with the remaining 24.6% in other regions of Canada (mainly accounted for by the Canada Investments Division’s loans to other provinces and provincial entities). In 1993, the percentage of Alberta-based investments had declined to 42.4%, and that for Canada increased to 57.6%. There were still no international investments at this time. By 2003, the portfolio had radically changed, now showing only 4.0% of investments as being located within the province of Alberta, 64.5% in Canada, and 31.5%, or almost one-third, in international securities.
The shifting of both investment type and investment location of AHSTF assets reflects changes in the philosophy and significance of the fund to the provincial government. During the years of province-building, Alberta-based investments were paramount, because the province-building strategy required direct intervention into the provincial economy by financing Alberta crown corporations and capital projects. Diversification of the Alberta economy, and not its investment portfolio, was the issue of primary concern. By 1993 the fund was investing in Canadian fixed asset securities, and by 2003, when province-building was no longer an issue, the AHSTF had transformed itself into a typical investment portfolio, with equities, fixed income securities, and real estate all adequately represented. The restructuring of the fund focused on generating the best financial return and letting private market forces determine the composition of the province’s economic sectors. Finally, as discussed above, the Progressive Conservative Party must have realized that the diversification strategy of the province-building years was not in its own best interests.19 The change in the

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19 This was also reflected in yet another survey conducted by the Alberta government, called ‘Looking forward: Planning for the future with the Alberta Heritage Savings Trust Fund’. This survey, conducted in 2003, generated 77,000 responses. Sixty-one percent of responses noted that the fund should be used for savings and long-term investment (Alberta Government, 2003).

### Table 4.3 AHSTF asset distribution by location of asset, selected years (percent)

<table>
<thead>
<tr>
<th>Asset Location</th>
<th>2003</th>
<th>1993</th>
<th>1983</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alberta</td>
<td>4.0%</td>
<td>42.4%</td>
<td>75.4%</td>
</tr>
<tr>
<td>Canada</td>
<td>64.5%</td>
<td>57.6%</td>
<td>24.6%</td>
</tr>
<tr>
<td>Other(^a)</td>
<td>31.5%</td>
<td>0.0%</td>
<td>0.0%</td>
</tr>
<tr>
<td>Total</td>
<td>100.0%</td>
<td>100.0%</td>
<td>100.0%</td>
</tr>
</tbody>
</table>

\(^a\) including United States and outside North America

Source: calculated from AHSTF *Annual reports*, various years
AHSTF’s structure reflects this awareness.

7. CONCLUSION

The AHSTF served, and continues to serve, two basic functions within the Alberta economy. At its foundation, and for the first twenty years of its existence, the fund was intended to be primarily a source of investment capital for provincial projects, significant within the context of a province-building strategy and within the political imaginary of western alienation. In the late 1990s, as the fund was transformed, the source-of-capital *raison d’être* diminished and was replaced by a savings and income-generation function. Income generation was less important during the early years, because the province had sources of income external to the fund; it became more important later when provincial resource revenues declined.

The AHSTF is distinctive among the cases considered in this thesis for several reasons. Its original purpose as an alternative source of investment capital, and as a vehicle for the transformation of the province from a periphery into a core, distinguishes it from the other funds considered here (see Chapter 7). This, in turn, prompted its particular economic geographies and investment practices, such as a concentration of investments within the province itself, with only a minor share of fund assets in global, or even Canadian, financial markets. The preponderance of fixed income assets, rather than a balanced portfolio, is another factor stemming from the fund as a provincial capital source.

I have argued in Chapter 1 that capital flows from periphery to core, in terms of the investment of local resource revenues in global financial markets through the mechanism of a trust fund, is an alternative development strategy worthy of consideration. The AHSTF at first did not pursue such a strategy; rather,
it invested its assets within the province (and not globally) and invested in assets that did not hold out the promise of long-term, market rates of return (rather than in a balanced financial portfolio). The fund included capital projects as ‘deemed assets’ though they generated no income, entailed maintenance costs, and could not be exchanged on any financial market. These investment strategies were guided by a political decision to diversify the provincial economy beyond what the market could sustain as part of a larger province-building ambition. These strategies were geared towards transforming Alberta from a peripheral economy into one closer to the centre of the capitalist core. Yet despite the rhetoric of economic diversification, the AHSTF invested in few projects that significantly altered the sectoral structure of the economy. Most of the fund’s Alberta investments provided various social benefits but did little to transform the economy into one approximating that of a core region. The province’s rhetoric of economic diversification turned out to be largely empty in practice.

The AHSTF never increased its real value beyond the first ten years of its existence, and its investment returns are smaller now than they were ten to twenty years ago. The fund did not achieve the diversification goals of its founders, and the province of Alberta is in most respects no more diversified today than it was thirty years ago (Pembina Institute, 2001). Given the failure of the diversification policy, the development aspect of the Alberta Heritage Savings Trust Fund is limited when compared with the funds of other regions. Alberta did not initially take advantage of the development strategy I have proposed here, in which peripheral capital is invested in the core. Alberta instead chose to invest its capital largely within its own borders, especially in the building of infrastructure and the provision of cheap credit to various consumer groups. In doing so, the province
invested in projects deemed either too risky or too unprofitable by commercial sources of capital: Alberta failed to follow the market.

These policies of the AHSTF were later recognized, by the provincial government (the fund’s trustees), by investment analysts (the fund’s advisors), and by the Alberta public (the fund’s beneficiaries), as inadequate and inappropriate to an income generation role. Fund policy was modified in 1997 to transform the AHSTF into a more savings-oriented investment fund, with a balanced portfolio aimed at generating a reliable and sustainable income in the long-term. Fund trustees and beneficiaries retired the original purpose of the AHSTF as a province-building tool, and turned instead to a fund more appropriate to a savings strategy, which involved the investment of provincial capital in the financial markets of the core.
Alaska

1. INTRODUCTION

Alaska, in the United States, established the Alaska Permanent Fund (APF) in 1976 to save a portion of its oil revenues stemming from the 1968 discoveries at Prudhoe Bay. After some debate over the form that the fund should take, fund trustees chose a savings model that was designed to maximize fund income over time, rather than to provide immediate social benefits for residents. Unlike the fund in Alberta, Alaska’s trust fund invested primarily outside the state and in a variety of asset classes. Though the origins of Alaska’s fund stem from a perceived marginal position within the American economy, the goal of Alaska leaders was not to transform the state into a core region (as in Alberta), but rather to adapt to the state’s peripheral economic geography and to solidify its fiscal future by creating sustainable sources of state income in addition to petroleum revenues (which would eventually be depleted). The APF therefore chose to seek better investment returns outside the state.

The APF’s investment strategy was part of a long range assessment of the nature of the Alaskan economy. State leaders and investment advisors were especially concerned with Alaska’s growing dependence on oil revenues. These windfall revenues could not be sustained, and in order for Alaska’s economy to prosper, alternate sources of revenue needed to be found. Given the state’s
Peripheral location relative to economic cores, Alaska possesses few non-resource based investment opportunities. This realization prompted the state’s financial advisors to recommend an offshore investment policy for part of the state’s oil wealth. The APF’s investment geographies thus differed from those of the fund’s counterpart in Alberta. The state also chose to pay out a portion of the fund’s earnings annually to each Alaskan resident. The result of this direct payment of state revenues to individuals has had interesting spatial and temporal effects on the Alaska economy and has supported the state’s development objectives by providing a sustainable stream of benefits to all Alaskans equally.

1.1 Alaska’s resource economy

Alaska is the largest state, in terms of its landmass, in the United States, with an area of 1,527,464 km$^2$. It is the only American territory lying in the Arctic and Subarctic. The population of the state is very small—only about 630,000 people—making it one of the smallest states, by population, in the nation. Alaska’s large territory, small population, distance from the conterminous United States, and Arctic and Subarctic location distinguish it from the rest of the country.

European settlement of Alaska began with a series of Russian expeditions in the Bering Sea region led by the Danish commander Vitus Bering. On his second expedition in 1741, he landed in Alaska and found the sea otters that would become the basis for Russian colonization. New Archangel (later called Sitka) became the Alaskan colonial capital in 1806 when the Russian-American Company, which was founded in 1799 to exploit the resources of the colony, moved its headquarters there. Colonization, especially under the leadership of the
autocratic Aleksandr Baranov, the Chief Manager or Governor of the colony, brought the Russians into conflicts with the indigenous population. The Russian settler population was never more than about 550 people, but by the end of the Russian colonial era the Native Alaskan population had declined to around 33,000 from the original 75,000, largely due to introduced diseases (Naske and Slotnick, 1987).¹

By the middle of the nineteenth century Russia had lost interest in its North American territories, and the Russians sold their Alaska colony to the United States in 1867 for $7.2 million² (or 2 cents per acre). The Russians were as eager to sell the colony as the Americans were reluctant to buy it. Russian Alaska was a drain on the Russian treasury as the colony was not self-supporting, it was extremely distant from the capital at St Petersburg, and the sea otter population had substantially declined. The Russians wanted to sell the colony specifically to the United States to block British expansion in northwest North America. The United States Congress, influenced largely by Secretary of State William H. Seward, finally agreed to purchase Alaska. The purchase was not widely popular and Alaska was often depicted in the media as a worthless Arctic wasteland and called by such names as ‘Seward’s Folly’, ‘Seward’s Icebox’, and ‘Walrussia.’

Despite early doubts, Alaska proved to be resource rich. American settlers discovered and exploited valuable stocks of fish, timber, gold, and other minerals. Many of the non-indigenous in-migrants were attracted to the state by its natural resources, especially mineral resources (McBeath and Morehouse, 1994, 12).

¹ In Alaska, the terms ‘Native Alaskan’, ‘Alaska Native’, and ‘Native’ always refer to the indigenous peoples of the state (Eskimo [Inuit], Aleut, and ‘Indian’).
² All dollar figures expressed in this chapter are in United States dollars.
Economically and politically, Alaska was a colony (Morehouse, 1984; Naske and Slotnick, 1987). During the period 1867-84 there was no real government in Alaska, apart from a customs office under the jurisdiction of courts in California and Oregon. Civil, judicial, and land districts were established in Alaska in 1884, under the terms of the *Alaska Organic Act*. A governor was appointed by the president of the United States, and had the power to oversee the administration of the Act. By 1906, Alaska had the right to send a delegation of observers to the national capital, and in 1912, a second *Organic Act* was passed, formally making Alaska a territory of the United States, and permitting it to maintain its own legislature. Despite these decentralizing actions, Alaska was still subject to direct control by the federal government: its governor was appointed, and the actions of the legislature could be overturned by the United States Congress and courts. Over 99 percent of the land was owned by the federal government (Morehouse, 1984).

American perceptions of Alaska changed in the late nineteenth century with a series of gold rushes beginning in 1880 in Juneau and followed by similar discoveries in other parts of the territory. The largest and most influential of these rushes took place on the Yukon River in and after 1896, concurrent with the Klondike discoveries further upstream in Canada. This gold rush increased the state’s population, and Alaska now came to be portrayed as a land of wealth and opportunity (Sundborg, 1946). Gold production declined after 1914 and the territory’s population declined with it. Another major event in Alaska’s history was World War II and its impact on the American government’s recognition of Alaska’s strategic global position. The Japanese invasion and occupation of some of the Aleutian Islands during the war prompted increased militarization of the territory in the post-war years, along with increased federal spending on
infrastructure such as port facilities, highways, and airstrips. The Alaska Highway was built, connecting the territory with the 48 conterminous states (through Canada) and the United States government gave greater attention to Alaska’s position just across the Bering Sea from the Soviet Union.

Independence and decolonisation have been major themes in Alaska history (McBeath and Morehouse, 1994, 2). During the early twentieth century, Alaska Territory made increasing demands for greater decentralization, and even statehood. After several failed attempts, Alaska became the 49th state of the United States in 1959. Under the statehood act, Alaska was allowed to select about 27% of federal lands that would be conveyed to the new state and become state lands. The state government selected lands based largely on their location and economic importance and chose mainly parcels near urban areas, along roads and railways, and areas, such as the North Slope, that had resource potential.

At the time of statehood, Alaska’s secondary and tertiary economic sectors were limited or nonexistent; resources were exploited for the benefit of outside regions, and there was little local input into decision making. In both the political sense (absence of local authority and control) and the economic sense (an unbalanced resource economy exploited for the benefit of outside interests), Alaska maintained a colonial relationship with the rest of the United States. Statehood permitted the independent development of Alaska, and the oil discoveries of 1968 provided potential local capital for development.

2. ALASKA POLITICAL ECONOMY

In many respects, Alaska still has a frontier economy, little changed from colonial and territorial days. The non-Native Alaska economy has historically been
characterized by a series of resource booms: Russian exploitation of the sea otter was followed by gold rushes, then by military investment and basing, and then by petroleum extraction.3

### 2.1 The politics of oil

Oil was first discovered in Alaska on the Kenai Peninsula, south of Anchorage, in 1957. As this discovery was during the period of territorial administration, the resource was on federal land. Nevertheless, the United States government negotiated a revenue-sharing provision under which Alaska receives 90 percent of royalties, with the federal government receiving only 10 percent. This revenue-sharing provision differs from that of the other 49 states. The *Mineral Lands Leasing Act of 1920*4 provided for revenue sharing from mineral resource extraction on federal lands, with the states receiving 37.5 percent of revenues and the federal government receiving 62.5 percent. The *Act* also specified the uses to which the states could put these revenues. In 1976 the revenue-sharing formula was revised by the *Federal Land Policy Management Act of 1976*5 and the *Federal Coal Leasing Amendments Act of 1975*.6 Despite the earlier legislation, Alaska was granted a special concession, and the later acts did not alter the situation, nor did they bring the other states up to parity with Alaska. Congress argued that such a provision, which differs from the revenue-sharing provisions of other states, was

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3 Interview with George Rogers, Professor of Economics, University of Alaska Southeast, Juneau, 1990.
5 U.S. Congress, *Public Law* 94-579. The act is more commonly known as the *Bureau of Land Management Organic Act*.
necessary as Alaska was a remote, developing hinterland and in need of resource revenue: ‘this federal mineral revenue-sharing was to be the crutch with which the state could financially walk’ (Bradner, 1987, 5).

Alaska’s major oil discovery came eleven years later, in 1968, when a supergiant oil field was discovered at Prudhoe Bay, in the far northern part of the state known as the North Slope. This discovery was on state land, meaning that the state alone would receive the resource royalties. The Prudhoe Bay field is the largest in the United States, and Alaska is now among the largest oil-producing states in the country.

Alaska has much in common with many oil-producing nations. Indeed, in many respects Alaska is more similar to oil-producing nations than it is to other oil-producing states in the United States:

Oil and gas production had had a radically different place in Alaska’s economy from the one it occupied in other major oil-producing states of the United States, and is having a more crucial influence on its development. Alaska resembles Kuwait or Libya more than it does Texas, Louisiana, or Oklahoma, both in the prominence of petroleum in the total economy and in the way in which its economic influence is exercised -- through government royalties and taxes on the oil industry, rather than through private-sector wages and salaries, profits, or the royalties of private landowners. Oil revenues made up almost all the State of Alaska’s general revenues in the early 1980s (Tussing, 1984, 53).

Petroleum-based economies or petro-states, like Alaska, are, as a whole, subject to a greater degree of boom and bust than hard-rock mineral economies (Karl, 1997). Alaska has grown increasingly reliant on petroleum exports. Even before the bust
years of the 1980s, Alaska experts warned about petroleum dependence:

Many Americans think that [Alaska] is already rich, when in fact it is less fiscally sound than before oil was discovered at Prudhoe Bay. In 1960, 98 percent of the state’s current operating budget (unrestricted General Fund) of $28 million was coming from recurring sources, mainly income taxes. By fiscal year 1978 the total General Fund budget had risen to just under $800 million ... spending much more per capita on government services than was coming in from taxes. Sixty-one percent of the unrestricted General Fund budget was coming from non-recurring sources (Weeden, 1978, 146).

In Fiscal Year 1969, just prior to the year in which Prudhoe Bay revenues would enter the budget, Alaska had a budget of $245 million. As former state legislator Mike Bradner noted:

There was a meager capital budget, and a meager loans budget that annually received appropriations and which annually ran out of money. The state had 7,756 employees, a monthly payroll cost of $5.9 million, and the average monthly state salary was $760. In 1968 state debt service was only $7.8 million on a debt of $90 million, for a state debt of $357 per person (Bradner, 1987, 5).

Capital spending prior to the Prudhoe Bay windfall was almost entirely through state general obligation bonds, and occasionally from revenue bond ‘lease-back’ financing through Alaska State Housing Authority. In 1968 the general bond issue was $62.7 million, of which $55 million was for education (Bradner, 1987, 5). Sources of funding for state non-capital expenditures included state income tax,
state gross business taxes, and state corporate taxes, while the source of funding for local communities was from sales and property taxes. Before the oil boom years the state relied almost totally on taxation as a source of revenue.

Petroleum revenues also affected the role of the state in Alaska society. As Alaska grew flush with petro-dollars, the state decided to forego more reliable sources of income, such as taxes. Hence the state has grown larger, but has become increasingly dependent on a single source of income—a source that will ultimately be depleted. The state lowers taxes, yet it funds more programs. These actions generate a certain set of expectations in the population, such as expectations concerning the state’s role in funding and subsidizing development and social programs (Young, 1992, 142-158). When resource revenues begin to decline, it will be difficult for the state government to convince the population that it can no longer afford such programs, and that taxes must be increased or reintroduced.

2.2 Oil and the colonial complaint

Political economy in Alaska has always been characterized by struggles over natural resources and their development. The state has an economic history resembling that of the western states such as Montana or Wyoming (Brown and Thomas, 1994). Many western states perceive themselves to exist within a colonial relationship with the federal government, a perception that historian Gene Gressley called the ‘colonial complaint’ (Gressley, 1963). Western states protest the still substantial federal ownership of lands within the West and the ability of the federal government to restrict access to the resources on them and prevent state governments from using or taxing these lands. As Gressley (1963) noted, western states have ‘a long tradition of protest against economic and cultural exploitation
Western protest often assumes the form of challenges against what is perceived as federal efforts to restrict access to natural resources within state boundaries, such as the ‘Sagebrush Rebellion’ of the 1970s and 1980s (Cawley, 1993).

Resource control struggles in Alaska intensified after the discovery of the Prudhoe Bay oilfield in 1968. State-owned petroleum had the potential to distort the existing political economy by introducing substantial new economic rents into the state (into both state and private hands). Moreover, the presence and eventual domination by an oil elite—which itself was well integrated with the outside oil community—shifted the balance of power within the state and also posed new questions about the pace of development and the future of Alaska. The state would now have its own revenues and would become less dependent on federal financing, and the need for access to federal lands would diminish with new wealth flowing into state coffers.

Alaska's Prudhoe Bay petroleum discoveries in 1968 forced the state to confront the issue of oil wealth management. The first proceeds from this oil field were received on 10 September 1969 by the state from the sale of exploration leases on the North Slope. The total sum was $900,041,605.34, and Governor Keith Miller urged that it be saved and invested in treasury bills and other quality securities (Kasson, 1983). The amount received from lease sales was nothing short of overwhelming, as the state budget for 1969, when the lease money was received, was less than $200 million (Brown and Thomas, 1994). The state legislature accepted the separate management of the funds, but proceeded

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7 This sum soon became part of Alaskan economic folklore as the ‘fabled $900 million’ that began the oil boom years (Interview with James B. Rhode, Assistant to the Governor, Juneau, 1988).
immediately to spend $36.4 million on capital improvements, such as roads, ferries, docks, and airports (Rhode, n.d.). The remainder of the lease money was spent on recurring expenditures and on various projects within the next few years. What was impressed upon the general public was the rapidity with which the state could spend such a large sum.8

3. ORIGINS AND OBJECTIVES OF THE ALASKA PERMANENT FUND

The Alaska Permanent Fund began as a response to the windfall oil wealth flowing into state coffers. Shortly after the receipt of the oil lease funds, various groups in the state—including the business community, members of the general public, and the state legislature—began to advocate some mechanism to administer at least part of the state's oil revenues (Helgath and Bibb, 1986, Goldsmith, 1980). In 1969 the state government sponsored a series of seminars held at the Brookings Institute to assess management options. These seminars recommended that the revenues be spent on worthwhile projects that would contribute to the welfare of all Alaskans (Kasson, 1983; Alaska Information Service, 1980).

Alternative proposals to spending state revenues were being bandied about at around the same time. In 1969 Robert Krantz, of the investment firm Kidder, Peabody, gave a speech to the Alaska Chamber of Commerce in which he recommended a trust fund in which the principal would remain untouched but the earnings could be spent by the state legislature (Kasson, 1983; Goldsmith, 1981). At about the same time, Governor Keith Miller (Republican) proposed a savings trust fund, which he called the Alaska Permanent Resources Fund, but this

8 Interview with James B. Rhode, Juneau, 1988; and Rhode (n.d.).
proposal did not receive legislative support (Alaska Department of Revenue, 1984, 5). Various further bills were introduced into the legislature calling for different kinds of funds, but it was the 1975 bill\(^9\) creating a permanent fund that was passed by the legislature and formed the legal basis for a state trust fund. Though the 1975 bill passed both houses of the state legislature, it was vetoed by Republican Governor Jay Hammond (himself an advocate of the fund, see Hammond, 1994) on the grounds that the Alaska State Constitution prohibited dedicated funds:

Constitution of Alaska, Title IX, Section 7. Dedicated Funds. The proceeds of any state tax or license shall not be dedicated to any special purpose, except as provided in section 15 of this article or when required by the federal government for state participation in federal programs. This provision shall not prohibit the continuance of any dedication for special purposes existing upon the date of ratification of this section by the people of Alaska.

A constitutional amendment was required to establish a dedicated fund. Hammond wanted a fund with dedicated revenues, rather than one with appropriations from the general fund from time to time, in order to guarantee permanence to the fund and to ensure that it would receive deposits in all years (the fund proposed by Governor Miller was not a dedicated fund, but required periodic appropriations from the general fund). If resource revenues were deposited into the fund by the state legislature whenever it felt it could do so, then politicians could divert those funds to other ends and the permanent fund would not grow. Hammond therefore suggested amending the constitution in order to permit dedicated funds

\(^9\) CSHB 324 am S.
Chapter 5: Alaska

The constitutional amendment proposed by Hammond was approved by the voters in 1976, and in that year (on 2 November) the Alaska Permanent Fund (APF) was established:

Constitution of Alaska, Title IX, Section 15. Alaska Permanent Fund. At least twenty-five percent of all mineral lease rentals, royalties, royalty sale proceeds, federal mineral revenue sharing payments and bonuses received by the State shall be placed in a permanent fund, the principal of which shall be used only for those income-producing investments specifically designated by law as eligible for permanent fund investments. All income from the permanent fund shall be deposited in the general fund unless otherwise provided by law.

The establishment of the APF appeared to represent a general consensus on the need to save part of Alaska's petroleum wealth (Helgath and Bibb, 1986). As commentators noted, the establishment of the fund was based on three arguments: saving resource revenues for the future, acting as a restraint on government spending, and the generation of earnings to supplement resource revenues (Brown and Thomas, 1994). These arguments received public support, furthered by the notion that the other 75% of revenues not dedicated to the trust fund could be used in other ways.

That a savings fund (as opposed to both direct distribution of resource revenues or depositing their entirety into the general fund) was proposed and accepted by a majority of Alaskan politicians is itself worthy of comment. Brown and Thomas note that a dedicated fund was ‘inconsistent with the kind of market-oriented, laissez-faire economics often espoused by Hammond and his advisors’
because the market solution would be to distribute all revenues to residents directly (1994, 42). These authors suggest that the high geographic mobility of Alaskans diminishes their time horizons (as many current residents would eventually leave the state) therefore making direct distribution inappropriate. Residents would cash in during boom years and then depart during busts. Forced savings through a trust fund would avoid this problem.10

Once constitutional restrictions were removed and the fund was in place, Alaskans began to address the issue of what type of fund would be established (Alaska Information Service, 1980). Consultants from both within and outside the state, in addition to state politicians and business and citizen groups, proposed a number of different forms that the APF could take. Proposals for the fund began almost immediately. In 1976, Robert Richards of Alaska Pacific Bank authored a working paper that suggested three possible uses for permanent fund capital: social, economic, and fiscal (Kasson, 1983). The social use would augment the welfare of society by assisting low-income Alaskans through subsidies, and would also assist poorer communities, usually those in rural areas, through direct transfers. An economic use would support Alaskan businesses through subsidies to encourage expansion and diversification of the state’s economy. The fiscal use would save resource revenues and invest these to generate income for future use.

Richards’s working paper outlined three strategies for the use of fund capital. Each of these strategies had its own advocates and different advisors,

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10 Brown and Thomas also observe that while a savings fund makes economic sense, it does not make political sense, because ‘forced savings are being allocated to future generations who cannot vote for current politicians’ (1994, 42). This leads them to add that ‘either the politicians who supported the Permanent Fund were unaware of this point, or they exhibited a measure of altruism not often seen in American politics’ (1994, 42).
legislators, and members of the business community and general public supported each of them to some extent. In order to resolve these competing strategies, Governor Hammond expanded the State Investment Advisory Committee (SIAC) and asked it to explore possible uses for fund capital (Kasson, 1983). The SIAC at first recommended an economic development orientation for the fund. Yet after independent consultants were called in to give fresh perspectives this support began to shift. The House Special Committee on the Permanent Fund also held hearings in many Alaska communities to assess public views on the fund. The results were included in testimony before the state legislature (see Gruening, n.d.).

The economic development proposal

Proponents of the economic development function viewed the fund as a development bank that would finance economic expansion in Alaska. Proponents included the SIAC, the Alaska State Senate, the Alaska Department of Revenue, and the Alaska Department of Commerce and Economic Development, as well as much of the private financial and resource extractive sector and many rural residents. Rural residents in particular wanted support for housing, for rural infrastructural projects such as power generation, and for assistance with renewable resource development such as fisheries and agriculture. These groups supported an economic development objective because they expected the fund to make subsidised loans and other support available to private enterprises that would promote economic growth. Some projects envisioned by this faction included permanent fund financing of public utilities, political subdivisions of the state, and private investment projects (Helgath and Bibb, 1986; Goldsmith, 1981, 1984).

Support for an economic development objective for the fund was based on
the perception that there was a capital shortage in Alaska, which prevented capital from reaching private industry and rural residents. This perspective was essentially based on the mainstream conception of development, which argues that capital flows from core to periphery will alleviate local capital shortages and stimulate economic development. It is therefore unsurprising that it was supported by the private sector and government departments responsible for the state’s economic growth. Support for this perspective diminished, however, after a number of internal and external consultants argued that structural issues, rather than capital shortages, were the cause of insufficient investment in the private sector and rural areas. These consultants included Nobel prize-winning economists Milton Friedman and Kenneth Arrow, Alaskan economists Arlon Tussing and George Rogers, Harvard planner Beldon Daniels, and heavyweight financial advisory firms such as Kidder Peabody and Price Waterhouse, among many others. Tussing (1977), for example, noted that capital markets were working in Alaska and that revisions to the state’s regulatory and taxation policies would be far more effective in promoting development than would government financing of development projects. Other consultants agreed with these views. They also pointed out that the revenues flowing into the state’s general fund could be used to support development objectives, and that the trust fund was not the best mechanism for this purpose.

Although initially well supported, this vision of the APF was not successful because, after consultant recommendations, a general consensus\textsuperscript{11} agreed that the

\textsuperscript{11} The two main early histories of the Permanent Fund, Kasson (1983) and Helgath and Bibb (1986), both speak of a ‘general consensus’ in very broad terms. I draw upon these two well-researched histories for much of this section.
lack of capital was not responsible for the slow rate of development, and that such investments would only benefit an elite, and not the public at large (Helgath and Bibb, 1986). Furthermore, development funds were available from state sources external to the permanent fund. In essence, the consultants had convinced supporters of the economic development objective that state-directed and -financed development, including economic diversification, would not be in the best interests of the state and that private financial markets were adequate to the task.12

**The social welfare proposal**

Another proposal for permanent fund management might be termed the ‘social welfare’ proposal. This proposal, which counted Governor Hammond among its supporters, concerned itself with the disposition of fund earnings rather than with the details of how fund principal was invested. Hammond’s proposal for a program that he called ‘Alaska, Inc.’ viewed the state as something like a corporation, with each resident as a shareholder. The principal of the fund was to be held in common, with the earnings distributed to each shareholder/resident. Such a program was both individualistic, in that it allowed residents to spend their share as they wished, and also egalitarian, in that it distributed fund earnings to all Alaskans equally and not just to certain special groups (like rural residents or private resource firms). The overarching idea was that public wealth should be directly distributed to the public. Rather than the state paternally making decisions for the collective use of this wealth, each individual Alaskan would make his or her own investment decision. As in Adam Smith’s vision of the ‘invisible hand’, the

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12 Alberta’s fund, discussed in the previous chapter, is an example of a fund with a primarily economic development purpose.
investment decisions of individuals working in their own interest would ultimately lead to improvements in collective welfare.

Despite the backing of both Governor Hammond and economist Milton Friedman, this notion of the APF as a social reform mechanism was ultimately rejected by the legislature based on arguments that social reform was best handled through open government and not the APF, and that social objectives and performance could not be easily measured, compared to financial ones. Some analysts also expressed concerns that individuals would misallocate their share into non-productive and wasteful activities, that capital would leave the state, and that more people would settle in Alaska and dilute the effect of individual payments (Rhode, 1978; Groh, 1997). Nevertheless, the ‘Alaska, Inc.’ idea did not fully die and it re-emerged several years later in the form of the APF dividend program (discussed later).

The savings proposal

The ultimately successful proposal for the APF envisioned the fund as a savings instrument and a true ‘trust’ fund (Helgath and Bibb, 1986). Such a proposal reached a wide consensus because it removed fund principal and earnings from the influence of special interests, and because it guaranteed a source of finance for many years into the future, when Alaska's petroleum revenues would decline. In some respects, the victory of the savings approach represents a protest on the part of the public against the perceived extravagant spending habits of state politicians (Rhode, 1978).  

13 Also interview with James B. Rhode, Juneau, 1988.
equally, and no special interest group could feel that they were being denied access to state revenues while others had access to them. Thus the savings perspective, unlike the economic development one, was perceived as highly egalitarian.

The principal economic merit of the savings perspective is that it would use resource revenues to generate earnings through portfolio investment, and that these trust fund earnings would eventually become substantial enough to augment, and later to exceed, revenues from resource extraction. An additional economic argument in favour of a savings approach is that saving at least a portion of resource revenues prevents these from entering the state’s economy with potential distortionary effects such as Dutch Disease. Savings would ‘sterilise’ a portion of resource revenues, limiting the adverse effects of a massive injection of new capital into the Alaska economy (see Chapter 2). Finally, saving a portion of resource revenues would extend resource benefits to future generations. While politicians and current residents would not themselves benefit from these saved revenues, their children and grandchildren would.

As Helgath and Bibb note, ‘at the conclusion of two years of debate and public hearings the legislature chose very clearly the “fiscal objective” as appropriate for the Permanent Fund’ (1986, 23). A clinching argument for the victory of this perspective was that funds for economic development purposes were nonetheless available from the bulk of oil revenues that continued to flow into the state’s general fund.\textsuperscript{14} Thus, in a sense, the state could have a savings-oriented trust fund and money for economic development at the same time (and with the introduction of the dividend program in 1982 it would have all three proposals).

\textsuperscript{14} Interview with Hugh Malone, former Speaker of the Alaska State Legislature, Commissioner of the Alaska Department of Revenue, and Permanent Fund Trustee, Juneau, 1988.
Alaska now had a trust fund backed by widespread legislative, industry, and public support. This perspective on the fund was codified by the 1980 *Permanent Fund Act* and by amendments to it in 1982.

4. FUND OPERATIONS, MANAGEMENT, AND INVESTMENT

The Alaska Permanent Fund’s governance, investment, and earnings distribution policies differ substantially from those of the Alberta Heritage Savings Trust Fund discussed in the previous chapter (and are much more like the funds of Oceania, discussed in the next chapter). Alaska’s fund is separated from direct control by the state’s governor and legislature and it is subject to constitutional protections and restrictions. The fund’s investments are located mainly outside of the state in both other American states and internationally, and the asset mix is much more diverse. Finally, the APF distributes part of its earnings directly to its beneficiaries in the form of dividends. In pursuing such policies, Alaska’s fund more closely approximates the alternative model of economic development through a trust fund that I set out in Chapter 1. Alaska’s fund offsets the state’s peripheral geography by investing its capital in the financial centres of the core; the state’s resource-generated capital flows from the periphery into core economies, where investment returns are potentially greater (and with reduced risk). Each of these issues is discussed in greater detail below.

4.1 Fund governance

The Alaska Permanent Fund Corporation, to give it its full name, is a ‘separate and

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independent instrumentality of the state’ (Alaska Permanent Fund, *An Alaskan’s guide to the Permanent Fund*, various years) and an incorporated body that is part trust and part corporation. As Warrack and Keddie (2002) observe, this means that the state’s saving and investment function is separated from its spending function. While the state legislature makes decisions about spending state funds, the bulk of the state’s investment decisions are made outside the legislature and through the APF. Once placed in the APF, fund capital becomes inviolable and cannot be removed or expended by the state (except by constitutional amendment). Only the earnings generated by the fund can be spent and there are restrictions on this as well (see below).

**Management**

The fund is managed by a board of six trustees, who are responsible for broad investment policy decisions. These six trustees are appointed by the governor and serve four-year terms. Of the six, one trustee is the Alaska Commissioner of Revenue, and another is a member of the state executive cabinet. These two members serve as liaisons between the state’s executive branch and the fund. The remaining four trustees are drawn from the public at large (usually meaning the private sector), and must have demonstrated experience in financial management. They are often executives from state businesses (including small businesses), bankers or financial consultants, or directors of Alaska Native regional corporations.\(^{16}\) Trustees are not salaried, but do receive a small honorarium for

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\(^{16}\) Interviews with Byron I. Mallot, President, Sealaska Corporation, and later Executive Director, Alaska Permanent Fund Corporation, Juneau, 1988; and with Charlie Parr, Permanent Fund Trustee, Fairbanks, 1987.
The fund also employs an executive director, who is a full-time, salaried employee and is hired based on financial management experience at a salary comparable to a corporate executive in the private sector. A full-time, salaried staff of 30 assists the executive director in carrying out the day-to-day operations of the fund. More specific investment decisions are outsourced to a number of private investment firms, based out of state, who directly manage the APF’s portfolio. The fund thus has three levels of governance: trustees, who make broad policy decisions; the executive director and APF staff, who manage operations; and investment consultants, who carry out investment transactions in accordance with the APF’s guidelines.

Accountability and transparency

The APF is managed in a very transparent fashion. The fund holds an annual meeting that is open to the public, at which any Alaska resident may ask questions of the trustees, fund staff, and representatives from investment advisory firms. These annual meetings rotate in location to various parts of the state. Other meetings of the Board of Trustees are held throughout the year, and most portions of these are likewise open to the public. Often these meetings take place in smaller and more remote communities. This open style of management allows for a great deal of citizen participation.
The fund publishes an annual report and quarterly reports that are available on request. These reports provide full disclosure of fund income and assets in two parts. The first part of each report summarises fund performance in language that can be understood by the general public, and includes a number of simple charts and diagrams illustrating fund performance and transactions. The second part of the reports consists of audited (by a private accounting firm) financial statements including statements of income and loss and balance sheets with fund management commentary appended. These reports are in accordance with the Government Accounting Standards Board Statement No. 34 (GASB 34).

In addition to the public availability of financial reports and public participation in Board of Trustees meetings, the APF has embarked on an extensive public relations campaign that helps to explain the fund and its purpose to the public.20 For example, summaries of the fund’s operations are included with the dividend cheque that each beneficiary receives. The fund also publishes annually a short guide entitled *An Alaskan’s guide to the Permanent Fund* that further explains fund purposes and activities and situates the fund’s work in the context of the Alaska economy. Video programs about the fund are shown in secondary schools so that children are aware of the fund’s goals and performance.

Accountability for fund performance is addressed in several ways. Trustees, staff, and investment advisors are all held accountable for the fund’s performance. The public meetings and publicly-available financial statements noted above ensure that the fund’s beneficiaries are aware of what is going on. Auditing of the fund’s financial statements by an impartial, independent accounting firm also

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serves to hold fund trustees and staff accountable. The dividend program is yet another means of ensuring accountability. As the part of the APF that each beneficiary is most aware of, the amount of the annual dividend acts as a kind of bellwether of the fund’s performance. Beneficiaries will certainly wonder why their dividend is lower than in the preceding year, or if it is not as large as expected. If the amount of the dividend is not to their liking, fund beneficiaries will demand explanations from all those involved in the fund’s operations.21

### 4.2 Generation of fund capital

As in the other trust funds discussed in this thesis, the Alaska Permanent Fund derives the bulk of its capital from revenues flowing from windfall resources. Alaska’s massive oil discoveries, discussed above, provided a new source of income for the state. As noted in the earlier discussion, Alaskans debated the possibilities for the use of these revenues, and determined to save a portion of them in a trust fund to be managed for long-term income generation. The general structure of fund management is shown in Figure 5.1.

The constitutional amendment (to the state constitution) that allowed the Alaska Permanent Fund to be created (Title IX, Section 15) specified that at least 25% of all mineral revenues (lease rentals, royalties, federal revenue sharing payments, and bonuses) be placed in the Permanent Fund. Remaining revenues would go into the state’s general fund. In 1980, with oil money flowing in and oil prices high, the state elected to deposit 50% of mineral-based revenues (mainly from petroleum) into the APF. This alteration to the percentage of revenue flowing

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into the fund was by legislative directive, but it has remained in force and since 1980 the APF has received half of the state’s mineral-derived revenues. These recurring, constitutionally-required deposits are known as ‘dedicated revenues’.

Table 5.1 shows the amount of dedicated revenues flowing into the fund since its inception. The table shows that since 1977, when the first dedicated revenues entered the fund, a total of approximately $7,707,000,000 has been deposited into the fund as dedicated revenues, representing (since 1980) half of the state’s oil revenues.

Dedicated revenues are the principal, but not only, source of fund capital. Periodically the state legislature has voted to deposit additional sums into the fund (these are known as legislative appropriations). In doing so, they remove these funds from their control, as once deposited into the APF they cannot be removed or expended by the legislature (it is a remarkable case of politicians removing money

![Figure 5.1. Alaska Permanent Fund structure](image)

The solid lines indicate legally-mandated transfers and dotted lines indicate transfers made at the discretion of the state legislature.
from their own hands). These appropriations have taken place mainly in years of budget surpluses, which typically occur when global oil prices are high. Some appropriations have also been made when particular or special sums have been received, such as from the sale of new oil drilling leases. Since the fund’s inception a total of about $7,390,000,000 has been deposited into the fund by legislative appropriations (see Table 5.1).

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Transfers from GRF</th>
<th>Dedicated Revenues</th>
<th>Inflation Proofing</th>
<th>Fund Equity</th>
</tr>
</thead>
<tbody>
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<td>$54</td>
<td>$54</td>
<td></td>
<td></td>
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<tr>
<td>1978/79</td>
<td>84</td>
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<td>1979/80</td>
<td>344</td>
<td>483</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1980/81</td>
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<td>385</td>
<td>1769</td>
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</tr>
<tr>
<td>1981/82</td>
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<td>400</td>
<td>2969</td>
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</tr>
<tr>
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<td><strong>$7883</strong></td>
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</tr>
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</table>

Table 5.1. APF sources of capital and fund equity, 1977-2003, in US$ millions

Source: calculated from APF *Annual reports*, various years.
A third major source of fund capital is ‘inflation-proofing’. The fund is required by law to maintain the real (as opposed to the nominal) value of its assets. Each year, the fund transfers a portion of its earnings back into the fund corpus, where it becomes inviolable. This amount is calculated based on a formula, and generally averages the past five years of the United States inflation rate (based on a federally calculated cost of living index). Throughout the history of the fund, an average of about two-thirds of the fund’s earnings have been redeposited as inflation-proofing. The total amount since 1982 (when the provisions entered into force) has been about $7,883,000,000. Inflation-proofing has been the largest of the three main sources of fund capital (although not by a significant margin), accounting for a little over one-third of fund capital (dedicated revenues and legislative appropriations each also account for about one-third of fund capital, see Table 5.1). The amount of inflation-proofing relative to total income and to dividends is shown in Table 5.2.

A final source of fund capital is private contributions. As these are insignificant when compared to other sources, they do not appear in the table. Yet it is important to note that some beneficiaries chose to forgo their dividend and elect to have it deposited back into the fund. Though not significant in numbers, it is interesting to note that some beneficiaries refuse the dividend and decide to have it revert to public purposes.

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22 In 2002 the Board of Trustees proposed that the constitution be amended to limit the fund’s payout to no more than 5%, limiting the dividend to the fund’s real (as opposed to nominal) earnings. The Board projected average annual earnings of 8% and average annual inflation of 3%, resulting in the 5% figure, which the Board deems sustainable. (Their arguments are presented in Alaska Permanent Fund Corporation, 2002). The proposal was backed by former Governor Jay Hammond and by many Alaskan citizens, as represented in the editorial pages of the Anchorage Daily News.
<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Net Income (Loss)</th>
<th>Dividends</th>
<th>Inflation Proofing</th>
<th>General Fund</th>
<th>Reserves Balance</th>
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<td>1136</td>
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<td>100</td>
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<td><strong>Total</strong></td>
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<td><strong>$12,540</strong></td>
<td><strong>$7883</strong></td>
<td><strong>$287</strong></td>
<td><strong>N/A</strong></td>
</tr>
</tbody>
</table>

Table 5.2. APF income and expenditure, 1977-2003, in $ millions

Source: calculated from APF Annual reports, various years.

The APF has three primary sources of capital: recurring dedicated revenues deriving directly from the state’s oil wealth, legislative appropriations that are periodic transfers from the state’s general fund into the APF, and inflation-proofing from fund earnings in order to protect the real value of the fund. Each of these has accounted for approximately one-third of total fund capital since the fund’s inception. The first of these is required under the state constitution, the last
under state legislation. Only legislative appropriations are not legally required and represent a legislative consensus to transfer additional sums from the general fund into the Permanent Fund.

4.3 Geographies of fund asset distribution

The Alaska Permanent Fund’s investments are distinguished by being held almost entirely outside the state. I explore two aspects of fund investment policy: the fund’s asset mix, and the geographies of asset location. Before exploring each of these it is necessary to say something about the fund’s organisational structure.

The Alaska Permanent Fund Corporation consists of two separate accounts. The primary one of these is the Alaska Permanent Fund, and the secondary one is the Realized Earnings Account (REA) (formerly known as the Earnings Reserve Account). The former is the corpus of the fund and its principal is inviolable, meaning that it cannot be expended by the legislature. The latter is a much smaller account that holds realised but unexpended earnings (See Figure 5.1). Earnings generated by the APF’s investments are placed into the REA to await their distribution, whether by constitutional mandate or by legislative decision. There are three potential destinations for fund earnings. One of these is inflation-proofing, required by law. The second is the payment of dividends to fund beneficiaries (discussed later). The third is the transfer of fund earnings into the state’s general fund, usually in small amounts to cover administrative costs. The APF and the REA remain as separate accounts, but their investments are commingled, and there is really no separation of these assets for accounting purposes. In the following discussion it should be understood that I am referring to the assets of the two accounts together. Table 5.2 shows the two account balances,
about $24,615,000,000 for the APF, and about $100,000,000 for the REA. The latter is tiny when compared to the former.

Fund asset mix

The APF’s assets are divided into three general classes: fixed income investments (such as bonds and treasury bills), equities (mainly shares in private corporations), and real estate (both Real Estate Investment Trusts and direct holdings). Table 5.3 illustrates the percentage of holdings in each class for the years 2003, 1993, and 1983.

<table>
<thead>
<tr>
<th>Actual Asset Mix (book values)</th>
<th>2003</th>
<th>1993</th>
<th>1983</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fixed Income</td>
<td>41%</td>
<td>69%</td>
<td>87%</td>
</tr>
<tr>
<td>Equities (United States)</td>
<td>68%</td>
<td>77%</td>
<td>100%</td>
</tr>
<tr>
<td></td>
<td>(Other)</td>
<td>32%</td>
<td>23%</td>
</tr>
<tr>
<td>Total</td>
<td>51%</td>
<td>24%</td>
<td>11%</td>
</tr>
<tr>
<td>Real Estate</td>
<td>8%</td>
<td>7%</td>
<td>2%</td>
</tr>
<tr>
<td>Total</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
</tr>
</tbody>
</table>

Table 5.3 APF assets by actual asset mix, in percent
Source: calculated from APF Annual reports, various years.

In 1983, less than ten years after the establishment of the fund and only three years after the 1980 legislation that stipulated investment policy, the fund carried the bulk of its investments, 87%, in fixed income securities, with 11% in (entirely United States) equities and only 2% in real estate. This division reflected a conservative investment philosophy in which safety was associated with fixed income securities and not with the more widely fluctuating prices of shares.

The fund has gradually shifted its investment mix towards a more balanced
portfolio and its exposure in equities has increased. In 1993 only 69% of
investments were in fixed income securities, with equities rising to 24% and real
estate to 7%. In the most recent year, 2003, fixed income securities represented
only 41% of total fund assets while equities had increased to 51%, reflecting a
more aggressive investment strategy and also faith in the rising American and
global stock markets. In 2003 the share of real estate in the portfolio had risen to
8%. The portfolio is diversified to take advantage of the best investment
opportunities available, and to diversify the assets sufficiently as to reduce risk.
Thus APF investments are not targeted toward assets with any particular
connection to Alaska; they are merely those that are deemed the best available in
global markets (in terms of balancing returns and risks).

Investments are equally diversified and balanced within each asset class.
Within the fixed income portfolio, about 25% is invested in corporate bonds, about
38% invested in United States treasury bills (considered to be among the most
secure and conservative assets possible, as they are backed by the United States
government), about 22% in mortgage-backed bonds, 12% in non-U.S. dollar
denominated bonds, and 3% other.23 About 80% of investment decisions in this
asset class are internally managed, with the remaining 20% externally managed
(through four investment companies). The APF thus handles directly the majority
of its fixed income asset transactions. The fund achieved a return of about 15.3%
on these investments in 2003 (APF Annual report, 2003).

With respect to equities, the portfolio is diversified and balanced in a
number of ways. The fund invests in both domestic and non-U.S. shares (discussed

23 Figures in this and subsequent sections are drawn from the Fund’s Annual reports and Quarterly
reports, various years, unless otherwise indicated.
About 80% of the fund’s equities are in companies with a relatively large capitalisation (in other words, large corporations) with the remaining 20% in smaller firms. Equity assets are equally split between growth and value shares (between those whose income potential derives from appreciation in the price of the shares and those whose income derives substantially from earnings paid out as dividends). Portfolio management is about 58% active (trading to generate profit) and about 42% passive (holding for longer term appreciation in value). The sector allocation of the fund’s equity investments is as follows, in descending order of asset percentage: financials, information technology, health care, consumer discretionary, industrials, consumer staples, energy, materials, telecommunications, and utilities. Financials and information technology have been the stock market darlings of recent years, thus the fund’s heavy tilt towards them (about one-third of total share holdings). It should be noted that these sector allocations parallel very closely the benchmark allocations of both Standard and Poor’s 1500 Index and the Callan Associates CAI Large Cap Style Index.

The fund employs 24 investment companies to handle equities trading and the assets are held by custodian banks. The equity portfolio is extremely diversified in just about every way and is geared towards maximising returns while minimising risk in the overall portfolio (in accordance with Modern Portfolio Theory) (Alaska Permanent Fund, 1996). In 2003, equity investments returned only 0.25% on investment, reflecting poor stock market performances in that fiscal year. Long term averages have been much higher.

The final component of the fund’s assets is real estate. Real estate investments are held both through Real Estate Investment Trusts (REITs) and through direct investments. In the APF, about 35% of real estate investments are in
the form of REITs and the remaining 65% in direct investments. Real estate investments are further diversified by being divided into industrial, office, residential, and retail properties. The fund has shares in 58 properties in 17 states and the District of Columbia, and these states are distributed throughout the Western, Midwestern, Southern, and Northeastern regions of the country. Only two investments are in the State of Alaska (in Juneau and Ketchikan). This asset class produced a return on investment of 9.1% in 2003.

Overall, fund assets have performed well. The ten-year rolling return on investment averages between 1985-1994 and 1994-2003 have varied between a high of 11.7% and a low of 7.8% for total returns, and between a high of 8.4% and a low of 5.3% for real returns adjusted for inflation. These returns compare favourably with standard industry benchmarks.

Fund asset location
The previous discussion has described the diverse and balanced portfolio of the Alaska Permanent Fund in terms of its distribution of asset classes. APF assets are also distributed geographically, and the fact that they are held largely outside the State of Alaska is a critical issue in assessing their role in the Permanent Fund’s strategy of pursuing the best investments regardless of location. I have noted in Chapter 1 that the flow of investment capital from periphery to core in order to seek the best investment returns is a development strategy worthy of consideration, and that the investment geographies of fund assets are of critical importance. The Alaska Permanent Fund follows that strategy by carrying almost the entirety of its assets outside the state. Table 5.4 shows the location of fund assets for 2003, 1993, and 1983.
In 1983 the fund carried only 3% of its assets within the state, with the remaining 97% being held elsewhere in the United States. The distribution was not much different for 1993, with 4% of assets held in Alaska, 90% elsewhere in the United States, and 6% overseas. In 2003, a mere 1% of fund assets were held in Alaska, with 80% being held in the rest of the United States and 19% globally.

Why has the Alaska Permanent Fund chosen to invest 99% of its assets outside the State of Alaska? In the discussion of the fund’s origins, I noted that Alaskans were in agreement about the fund’s need to avoid being dominated by local special interests. Any investment within the state could be perceived as favouring particular factions. In-state investment could also lead to rent-seeking, in which special interest groups compete for a share of the state’s assets and distribute them to themselves without increasing Alaska’s overall wealth or economic productivity (Anders, 1988). The Board of Trustees’ decision to invest offshore derives in part from the desire to avoid rent seeking in the state (see also Chapter 2 for a discussion of rent-seeking).

The more important reason for the fund’s external investment is the fact that better investment returns, with lower risks, are available outside Alaska. As a peripheral economy highly dependent on the oil industry, Alaska has few

<table>
<thead>
<tr>
<th>Asset Location</th>
<th>2003</th>
<th>1993</th>
<th>1983</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alaska</td>
<td>1%</td>
<td>4%</td>
<td>3%</td>
</tr>
<tr>
<td>United States</td>
<td>80%</td>
<td>90%</td>
<td>97%</td>
</tr>
<tr>
<td>Other</td>
<td>19%</td>
<td>6%</td>
<td>0%</td>
</tr>
<tr>
<td>Total</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
</tr>
</tbody>
</table>

**Table 5.4 APF assets by asset location, in percent**

Source: calculated from APF Annual reports, various years.
opportunities for profitable investment beyond the natural resources sector. As the Alaska Permanent Fund’s goal was to save and invest for the future, a future in which oil revenues would decline and in which the trust fund would become the primary revenue-generating entity in the state, it needed to pursue a policy of secure but profitable investment. Thus the state looked outside for such investments, especially to global financial and real estate markets.

The geography of the fund’s investment distribution is determined by the need to balance the portfolio to offset risk and to generate sustainable returns. The only assets held in-state are a small number of certificates of deposit held in several Alaskan banks, and two real estate properties. One of these is the building in Juneau in which the APF’s offices are located (the fund owns 100% of this building and thus avoids having to pay rent). The fund also holds a 13% investment in a retail centre in Ketchikan, an investment that was based entirely on its return potential and not on any need to direct investment towards that city.

The fund invests both in the United States (outside Alaska) and internationally. International investments consist of both fixed income and equity assets denominated in a number of currencies. Real estate is concentrated entirely within the United States.

Alaska residents have indicated little support for Alaska Permanent Fund investment in infrastructure or industrialisation. A 1998 town meeting survey found that only 31% of respondents agreed with the statement that the state ‘should invest Permanent Fund public wealth in commercial and industrial development to provide more jobs for Alaskans’, while 69% disagreed (Alaska Permanent Fund, 1999; Doogan, 1998). Other analyses also support the maintenance of the current structure of the Permanent Fund (e.g., Piper, 1987; Rose, 1988; Smith, 1991).
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4.4 Distribution of Earnings

The Alaska Permanent Fund is characterised by a number of features that distinguish it from several of the other trust funds discussed in this thesis. One of its distinguishing characteristics is the fund’s substantial offshore investment portfolio geared towards generating commercial rates of return rather than providing collective social goods to beneficiaries. The other, even more distinctive, feature is the use and distribution of Permanent Fund earnings. The APF pays out a portion of its earnings each year in the form of dividends to beneficiaries. Each Alaskan resident receives an annual cheque representing his or her share of fund earnings.

History of the dividend program

The dividend program was introduced in 1982 and represents the legacy of Governor Jay Hammond’s ‘Alaska, Inc.’ program. That program was part of the social welfare proposal debated at the inception of the fund. Though the APF emerged as a savings fund, the social welfare proposal was later grafted on to it and helped to ensure public support for the continued maintenance and expansion of the fund. The dividend gave each Alaskan a personal stake in the success of the APF. If the fund grew, so too would the dividend. As Alaska has no state income tax and no state sales tax (only municipal sales taxes), the dividend reflected allocation of state money directly to citizens, rather than the other way around.

Before elaborating on the dividend program, I should first point out other uses of fund earnings. As noted above, Permanent Fund earnings generated from protected capital are held separately in the Realized Earnings Account, which may
be appropriated by the legislature. As Table 5.2 shows, a portion of fund earnings has been transferred to the state’s general fund, while a much larger portion has been redeposited into the fund to offset the effects of inflation. But, since the fund’s inception, a little over one-third of its total earnings have been paid directly to beneficiaries as dividends. Table 5.5 shows the amount of the individual dividend for each year since the program started in 1982.

<table>
<thead>
<tr>
<th>Year</th>
<th>Dividend</th>
</tr>
</thead>
<tbody>
<tr>
<td>1982</td>
<td>$1000.00&lt;sup&gt;a&lt;/sup&gt;</td>
</tr>
<tr>
<td>1983</td>
<td>386.15&lt;sup&gt;b&lt;/sup&gt;</td>
</tr>
<tr>
<td>1984</td>
<td>331.29</td>
</tr>
<tr>
<td>1985</td>
<td>404.00</td>
</tr>
<tr>
<td>1986</td>
<td>556.26</td>
</tr>
<tr>
<td>1987</td>
<td>708.19</td>
</tr>
<tr>
<td>1988</td>
<td>826.93</td>
</tr>
<tr>
<td>1989</td>
<td>873.16</td>
</tr>
<tr>
<td>1990</td>
<td>952.63</td>
</tr>
<tr>
<td>1991</td>
<td>931.34</td>
</tr>
<tr>
<td>1992</td>
<td>915.84</td>
</tr>
<tr>
<td>1993</td>
<td>949.46</td>
</tr>
<tr>
<td>1994</td>
<td>983.90</td>
</tr>
<tr>
<td>1995</td>
<td>990.30</td>
</tr>
<tr>
<td>1996</td>
<td>1130.68</td>
</tr>
<tr>
<td>1997</td>
<td>1296.54</td>
</tr>
<tr>
<td>1998</td>
<td>1540.88</td>
</tr>
<tr>
<td>1999</td>
<td>1769.84</td>
</tr>
<tr>
<td>2000</td>
<td>1963.86</td>
</tr>
<tr>
<td>2001</td>
<td>1850.28</td>
</tr>
<tr>
<td>2002</td>
<td>1540.76</td>
</tr>
<tr>
<td>2003</td>
<td>$1107.56</td>
</tr>
</tbody>
</table>

Table 5.5 APF dividend, 1982-2003, in US$ per capita

<sup>a</sup> source of funds was legislative appropriation

<sup>b</sup> source of funds was a combination of legislative appropriation and permanent fund earnings

Source: calculated from APF Annual reports, various years; and Alaska Permanent Fund Dividend Division, Annual report, 2000.

Jay Hammond’s initial dividend proposal, as part of his ‘Alaska, Inc.’ plan, was to base the amount of the dividend on the number of years’ residency for each
recipient, so that, for example, each resident received $50 for each year of residency (Hammond, 1994; Groh, 1997). He was supported by a ‘tiny but committed group of public officials, political activists, and academics’ (Groh, 1997). The 1980 legislation that incorporated the Permanent Fund likewise established a program giving each adult citizen $50 for each year of residency since statehood in 1959. The idea behind the graduated program was to reward long-term residents, called ‘sourdoughs’ (who were thought to have pioneered Alaskan development), to limit newcomers’ (called ‘cheechakos’) share of the state’s wealth, and to prevent migration to Alaska to claim dividends (Hammond, 1994; Kasson, 1983).

This program was immediately challenged by Ron and Patricia ‘Penny’ Zobel, two Anchorage attorneys who had resided in the state for less than three years. Their suit24 eventually reached the United States Supreme Court, which struck down the Alaska legislation as unconstitutional, by an 8-1 margin, in that it created classes of citizens based on residency. Hammond then considered using Permanent Fund earnings to support municipalities, but was convinced by his staff that ‘municipalities had used the state oil money they had received to buy sports arenas and convention centres—the kind of items that Hammond considered frills’ (Groh, 1997). He changed tack once again, and came out in support of a program making annual dividend payments in the same amount to all Alaskans, regardless

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24 Zobel v Williams, U.S. S. Ct. 2309.72 L.Ed.2d 672, 1982. The Alaska Supreme Court originally upheld the residency-based program by a 3-2 margin, but the Zobels appealed and the United States Supreme Court heard the case the following year. Dividend payments were suspended while the case was being adjudicated. At the time of the case, the Zobels were publicly vilified in the media. Today their role in shaping the dividend program is now all but forgotten, and virtually all Alaskans have received more money through the equal distribution program than they would have under Hammond’s original residency-based plan.
of their length of residency in the state. His backstop bill, prepared while the United States Supreme Court was hearing the Zobels’ case, was rushed through the Alaska legislature after the court’s decision.25 The backstop bill provided for an immediate payment of $1000 to all Alaskan residents and was funded through a direct legislative appropriation from the state’s general fund.26 The period of residency in Alaska to qualify for a dividend was initially six months, because legislators believed that a one-year residency period would get them in more hot water with the courts.27

The process of implementing the dividend program relied on generating legislative and public support. Arguments in favour of the dividend were that it:

- Was the most equitable way to distribute earnings;
- Creates a constituency in support of the Permanent Fund;
- Compensates Alaskans for the high cost of living in the state;
- Produces a large economic impact through multiplier effects;
- Allows each individual to make his or her own investment decision;28
- Was based on the idea that state ownership of the oil fields means that the people own it and should benefit directly from it (Goldsmith, 2001; Groh, 1983).

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25 The House bill, which passed by a 28-11 margin, approved a single 1982 dividend payment. The Senate version, passed the next day by a 14-4 margin, provided for continuing the dividend program on a per capita basis.

26 The Governor signed the bill on 14 June 1982, and literally ‘hours later’ the state’s computer started printing dividend cheques (Groh and Erickson, 1983). Technically speaking, the dividend payments are not ‘cheques’ (which are drawn on banks) but ‘warrants’ (which are drawn on the treasury).

27 The length of residency to be eligible for a dividend was amended to 24 months in 1989. The Superior Court in Alaska then ruled this residency period unconstitutional, at which point the residency period was again amended to 12 months. In 1989 felons were debarred from receiving dividends, and in 1996 misdemeanants with two prior crimes were likewise debarred.

28 In a 1998 town meeting survey, 71% of respondents agreed that ‘individual Alaskans can decide how to spend their wealth better than the government’ (Alaska Permanent Fund, 1999).
Goldsmith further notes that the dividend also ‘provides a base income level to each citizen regardless of means’ and that it ‘contributes to equality in the distribution of income’ (2001). The legislature considered all of these arguments and by 1982 there was tripartisan (Democrat, Republican, and Libertarian) support for the program (Groh, 1997).

**Impacts of the dividend**

The first dividend, in the amount of $1000, was paid in 1982 and was based entirely on funds from a legislative appropriation, rather than on Permanent Fund earnings. The second dividend, paid the following year, was for $386.15 and was based partially on a legislative appropriation and partially on funds derived from APF revenues. In all subsequent years the dividend was based entirely on APF earnings. The amount of the dividend rises and falls based on fund earnings. Between 1999 and 2001, with enormous stock market rises, the fund was able to pay out dividends approaching $2000 per capita, but in 2003, reflecting poorer stock market performances, the dividend had fallen to $1107.56 (see Table 5.5).

Nevertheless, the dividend is paid to each resident, regardless of age, so that a family of five would have received in excess of $5500 in 2003. This amount can form a substantial component of family income for poorer Alaskans and especially those in rural areas (including many indigenous Alaskans), who have few other employment prospects. The dividend already accounts for about 6.2% of Alaska personal income overall (Knapp et al., 1984; Goldsmith, 2001). The dividend may also help stabilise migration patterns in the state. For example, many
rural Alaskans might be less inclined to move to urban areas because they have the
security of dividend income wherever they may live. Thus the dividend may
reduce rural to urban migration and the concomitant strain it places on urban
resources (Huskey et al., 2004). Huskey et al. suggest that their results are
consistent with other studies on the effects of transfer payments and migration
(e.g., Cebula and Belton, 1994; Knapp and Huskey, 1988; and Shaw, 1986).

Details about the contemporary impacts of the Permanent Fund dividend
are unfortunately lacking. The only substantial study of the dividend’s impact was
conducted in 1984, based on only two years of data (Knapp et al., 1984). These are
some of their findings:

- The 1982 dividend ($1000 per capita) directly increased personal income by
  6.3%, or about the same amount as the state’s oil industry payroll;
- The ‘average’ recipient saved $200 of the dividend, used $200 to pay federal
taxes, paid off $50 in debt, and spent $550;
- Of that $550, $450 went towards recurring expenses (food, fuel, clothing) and
  $100 was used for ‘special’ items (travel, electronic goods);
- Use of the dividend varied with an individual’s income level: lower income
  Alaskans applied more of their dividend towards reducing debt and paying for
  recurring expenses, whereas higher income Alaskans directed more of their
  dividends towards savings;
- The dividend increased family income by 20% for half of rural Alaska
  Natives, and 6% of all rural Alaskans (Native and non-Native) had their
  income increased by more than 50%;
- The dividend increased the personal incomes of 39% of all Alaskans (rural
  and urban) by more than 10% (Knapp et al., 1984).
These results suggest that the dividend has had substantial effects on the ability of the state to provide benefits to its residents and to achieve broad ‘social equity’ development goals.

No equivalent study of the dividend’s impacts and effects has been conducted since 1984.²⁹ However, the Knapp et al. report, combined with other, less substantial but more recent studies (Goldsmith, 2001; Groh, 1997) and anecdotal and interview data suggests some general patterns. First, the economists who authored these reports are in agreement about the general multiplier effects of the dividend: dividend income largely recirculates within the state and supports local businesses. Second, the dividend did not lead to any apparent migration from other states (few people moved to Alaska just to get a dividend). Third, the dividend may reduce the wage differential with other states (Alaska’s wages are among the highest in the nation to offset its high cost of living), because the dividend, as income, has the effect of reducing wages without reducing people’s well-being. Fourth, the dividend represents a cash flow to rural Alaska, where it is

²⁹ Although there has been no dividend audit or study of the dividend’s impacts since 1984, the Alaska Permanent Fund Dividend Division (APFDD) does keep extensive records of applications and payments. Alaskan residents must apply for their dividend each year by a 31 March deadline, and must answer a questionnaire that is used to determine eligibility. In 2000, the APFDD received 607,596 applications, of which 420,583 were from adults and 187,013 were from children (including 8879 newborns). Of these, 585,878 were determined to qualify for dividends. The median age of the applicants was 31.5 years old. About 40% of applicants listed Alaska as their place of birth, with California at 7%, Washington at 6%, and Oregon at 3% following in rank order. The most common first names for male applicants were, in rank order, Michael, John, James, Robert, and David, and for female applicants Mary, Jennifer, Linda, Patricia, and Susan. The most common surnames were Johnson, Smith, Williams, Jones, and Brown. 79,010 dividends were garnished, including 10,846 by the state’s Child Support Enforcement Division for delinquent child support payments, 7177 by postsecondary institutions for delinquent student loan payments, and 23,470 by the Municipality of Anchorage for fines, delinquent taxes, and attorney fees (Alaska Permanent Fund Dividend Division, 2000). While this data provides interesting information about dividend applicants and recipients, it does not deal with the micro- and macro-economic effects of the dividend program.
more substantial compared to other sources of income, and in areas of very low income (especially rural indigenous communities) it may account for more than 20% of income (and for some residents the dividend increases their income by more than 50%). Fifth, it may reduce rural to urban migration. And sixth, the dividend appeared to have little effect on inflation and people’s desire to work.

Dividends are also a form of Universal Basic Income (UBI) such as has been proposed by the Belgian political theorist Phillipe van Parijs (1995, 2000, 2001). Van Parijs proposes that governments should make annual transfer payments to residents, regardless of their other incomes, in order to provide a UBI sufficient for subsistence. He argues for a UBI based on principles of justice, jobs, and growth. By justice he means providing the freedom that a basic income would allow, giving some individuals the free choice not to work or to limit their working hours (individuals who wanted to work would of course continue to do so, and would have higher incomes and therefore much greater purchasing power). Van Parijs also suggests that the multiplier effects of UBI payment income circulating in the economy would promote increased employment and economic growth. He notes that Alaska, through its Permanent Fund dividend, is the only place in the world that has actually instituted a UBI program.

Though van Parijs’s proposal is, at least at this stage, largely a speculation given out as a means of forcing societies to consider issues of economic justice, the similarities between his general proposal and Alaska’s dividend program are striking. As noted in this chapter, dividends have provided a raft of benefits for Alaskan residents. Yet the philosophical underpinning for dividend payments in Alaska is not so much general principles of economic justice as it is a more libertarian tenet of channelling the public’s own wealth directly into the public’s
own hands: Alaskans are simply claiming their own. Nevertheless, the net result of the dividend is providing a UBI for all state residents regardless of their other sources of income.

**Subsistence**

Subsistence use of Alaska’s renewable resources forms part of the diverse economic livelihoods of both Alaska Native and non-Native populations. The Alaska Federation of Natives has estimated that rural Alaskans harvest about 44 million pounds of fish and game for food each year, with an annual value of $220 million. These wild foods supply one-third of the caloric requirements of rural residents (Alaska Federation of Natives, 2004). About 60% of rural households (half Native and half non-Native) statewide harvest game and about 80% harvest fish (Goldsmith, *et al.*, 2004). Many households could not survive without subsistence. As Berardi (1998) notes, ‘subsistence is an important element of family economies and a central part of personal and cultural identity’ for rural residents.

Transfer payments make subsistence possible: they allow individuals and families to receive a cash income that supplements subsistence foods and can be used to purchase necessary goods such as fuels and clothing. As Dubbs (1992) noted, ‘if the transfer economy is eroded, residents throughout village Alaska will have to depend on private sector and commercial activities in order to obtain the cash necessary if they wish to continue subsistence pursuits’. As private sector

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30 During my first visit to Alaska in 1987, I stayed with a family who lived in a log house outside Fairbanks. They depended for much of their food on subsistence harvesting. A moose would feed the family for almost half a year. During my stay with this family, we ate moose for breakfast, lunch, and dinner, and I was impressed by the number of ways that one can prepare this food.
employment opportunities are not widespread in rural Alaska, in the absence of transfer payments residents would have to consider migrating to urban areas.\textsuperscript{31}

The Permanent Fund dividend, as a UBI payment distributed to all Alaskans, along with special rural subsidies and Alaska Native regional corporations payments, provides the cash that allows rural residents to maintain their subsistence lifestyles. About $93 million in dividend payments went to rural areas in 2002 (Goldsmith, \textit{et al.}, 2004). As one Alaska Native noted, the Permanent Fund dividend ‘is really important for our people out here, especially those that are subsistence hunters and gatherers. They rely on that money’ (Pemberton, 2003). Berardi (1998, 87) notes that transfer payments ‘have been instrumental’ in supporting residents in ‘economically nonviable locations’, often the homelands of Alaska’s indigenous peoples.

\textit{Public support for the dividend}

In 1999, with state oil revenues declining due to falling world prices, and with the state’s budget running into deficit, Alaskan legislators proposed reducing the dividend payment in order to balance the budget. By this time the dividend had come to be viewed as an entitlement, and Alaskans reacted angrily to the proposal. Figure 5.2 shows two popular cartoons from 1999 reflecting citizen views on the continuance of dividend payments. The cartoons represent the state government as the tool of special interests, denying each Alaskan his or her right to a share of state oil revenues.

\textsuperscript{31} Transfer payments (such as the dividend) to rural areas also have a delayed multiplier effect that benefits urban areas as well, as rural residents often use their transfer income to purchase goods and services from urban areas (Bradner, 1992).
Figure 5.2. Two Dale Luther cartoons reflecting Alaskan attitudes in the referendum on the use of the Permanent Fund Dividend (PFD), 1999

Alaska held a non-binding referendum on this issue on 14 September 1999. Voters were asked whether they would approve a reduction in the amount of the dividend in order to reduce budget deficits and help finance state government (a ‘yes’ vote). Alaskans voted overwhelmingly, by a margin of 83% to 17%, to retain
full dividend payments. This result effectively negated further proposals to reduce or tamper with the dividend.

Other surveys also indicate citizen agreement with the status quo. In 1998 the Permanent Fund sponsored over 100 community meetings in various parts of the state. Participants in these town meetings could express their views to delegates from the APF, and were also asked their opinions about the investment of Permanent Fund capital and the use of its earnings. In data compiled from those meetings, 85% of respondents agreed with the statement that ‘every Alaskan, young or old, new comer or old timer, has a right to an equal share in the public wealth of the Permanent Fund’. Only 15% disagreed. 74% of respondents also agreed that ‘giving equal Permanent Fund benefits to future Alaskans (unborn children and people who move here later) is as important as giving benefits to Alaskans here today’. When asked if the Permanent Fund should be abolished and a lump sum of $38,000 be given to each resident, only 13% of respondents agreed while 87% disagreed. These responses suggest strong support for the continuance of the fund and its egalitarian provisions (Alaska Permanent Fund, 1999; Doogan, 1998).

In sum, the dividend program is a distinctive means of distributing fund earnings. Wedding societal with individual interests, the dividend allocates public funds to individuals equally as beneficiaries of the Alaska Permanent Fund.

Dividends are based only on Alaskan residence, and they are not means-tested or

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32 These figures can be compared to the results in the Knapp et al. (1984) study, which found that 60% of Alaskans thought that the dividend program was a good idea (and that 10% thought it was a bad idea, with 30% having mixed feelings). That study also found that 71% of Alaskans would be willing to give up the dividend rather than have state income taxes reintroduced.

33 It should be borne in mind that citizens attending the town meetings were self selected, and may not represent the Alaskan population as a whole (Doogan, 1998).
based on the number of years of residence. Dividends recirculate within the Alaska economy and help to support local businesses. Though they are equally distributed, they benefit (relatively speaking) lower-income individuals and families and persons residing in rural areas. They thus serve a rural development function without appearing to be targeted at specific ‘special interest’ groups. They further remove investment decisions regarding the use of fund earnings from the state and place them in the hands of individuals. Thus, what appears initially to be a curious socialistic practice of a government giving away money in fact turns out to have very Smithian results in renewing the wealth of individuals. The ability of the dividend to achieve these ends is based in part on its size (it is in the thousands of dollars, not the tens or hundreds) and that in turn is based on the ability of the APF to invest at commercial rates of return in national and international financial markets rather than being compelled to invest in the poorer returns with higher risks found within Alaska itself.

5. CONCLUSION

The Alaska Permanent Fund nicely illustrates the model of development proposed in this thesis, in which capital generated in a peripheral region is invested in the financial markets of the core. Through the mechanism of the APF, Alaskans separate the site of capital generation from the site of capital investment. Shunning the potentially more risky and limited investments within the state, Alaskans, through their representatives and trustees, chose to invest their windfall revenues offshore, in national and global financial markets. These markets provided opportunities for greater investment returns with lower investment risks.

As discussed early in this chapter, Alaskans debated three proposals for the
use of their windfall revenues. They considered using them, as Alberta did, to
directly stimulate economic growth in the state through investment in local
infrastructure. This proposal was ultimately rejected, based on neo-liberal
economic arguments that the government should not invest where the market
refused to do so, and that the market knows best where to invest. This neo-liberal
argument led paradoxically to an investment strategy by which the state
government retained billions of dollars of state oil wealth and invested them
outside the state. The neo-liberal argument for investment was melded with the
earlier social welfare proposal by allocating over half of fund earnings to
individual Alaskan beneficiaries. Thus collective goods provided by the
government were forsaken for individual decision making as to the investment of
public wealth. Rather than choosing to follow the Rostovian development path of
industrialisation, Alaska turned instead to mitigating the effects of its peripheral
economic position by engaging with the global economy on its own terms as an
investor.

The results of this experiment seem to indicate success. Alaska now
controls a trust fund valued at over $24 billion on behalf of fewer than 600,000
eligible beneficiaries. The fund generated an income of nearly $1 billion in 2003
(during a year of poor market performance) and in earlier years it generated annual
incomes in excess of $3 billion. The fund transformed non-renewable oil revenues
into a renewable fiscal resource. The real value of the fund is maintained by
redepositing a share of earnings to offset inflation, and the remainder of earnings is
paid out as dividends to each beneficiary. Alaskans continue to vote in support of
the fund, even allowing the state to run budget deficits rather than dip into fund
earnings. From the limited research available, the dividend appears to provide a
number of social benefits, including support for small-scale and community economies and especially those in rural areas.
Oceania

Kiribati, Nauru, Tonga, and Tuvalu

1. INTRODUCTION

The following sections consider the trust funds of four Pacific microstates, exploring their origins, management and investment policies, and the impacts they have had on trust beneficiaries. The Pacific islands region, which many islanders prefer to call Oceania (Hau'ofa, 1993, 1998), shares a common colonial experience and a common geographical remoteness from the core centres of capital. In many respects the Oceanic countries are among the most peripheral places on earth. Limited investment opportunities in the region have prompted several Oceanic states to establish trust funds to reduce their position of marginality by engaging with global capital.

This chapter considers the experiences of Kiribati, Nauru, Tonga, and Tuvalu and the economic geographies and development aspects of their trust funds. It will focus in particular on the application of trust funds within specific national economic geographies. It is these specific geographies that influence whether or not the potential capacities of trust funds are realized. The four cases considered here reflect varying capabilities of the state to extend the benefits of resource revenues to Pacific island residents.
2. **KIRIBATI**

The independent Republic of Kiribati possesses a trust fund that derives from colonial times. The fund was set up during the British colonial period as a means of saving a portion of the phosphate mining revenues that accrued to the colonial government and its entities and with the intent of using these saved revenues to benefit the people of the islands. The fund is now under the control of the Kiribati government, and it invests in offshore assets with the goal of producing a sufficient return to help finance government activity. In doing so, Kiribati funds government services without having to tax heavily its largely subsistence-based populace. The fund invests offshore in order to provide social benefits within the country.

2.1 *Kiribati and the political economy of an atoll state*

The Republic of Kiribati is a Micronesian island state in the Central Pacific (see Map 1). The country comprises the Gilbert Islands (Kiribati proper), the Phoenix Islands, and the Line Islands, including Kiritimati (Christmas Island). Prior to independence in 1979, Kiribati was part of the British Gilbert and Ellice Islands Colony (GEIC). Kiribati contains 34 islands, all but one of them coral atolls, with a combined area of 811 km². The total population is about 92,000 and consists primarily of Gilbertese, known as I-Kiribati. Nearly half the population lives on the capital island of South Tarawa. Kiribati’s exclusive economic zone totals 3,550,000 km² (the second largest in the region), giving a sea to land ratio of 4377 to 1. Kiribati’s small land area and generally unproductive coral soils (Mason, 1960) means that today most of the nation’s wealth is derived from offshore fishing licences granted to overseas fleets. Copra and seaweed are the most important domestic exports and their production provides cash income for
Kiribati is a low-income country with an estimated 2001 GDP (PPP) of about US$79 million, or about US$800 on a per capita basis. Only about 20% of the working-age adult population is formally employed, and most of those hold jobs in the public sector (Throsby, 2001, 2). The remaining 80% depend on a combination of subsistence (fishing and agriculture) and family support (from both resident and non-resident family members) for their livelihood. The generation of new wealth depends heavily on offshore income from fishing access fees, remittances, and development aid, in addition to revenues from the country’s trust fund. Kiribati uses the Australian dollar, and thus avoids the need for setting its own monetary policies and managing the currency. The country does not have a reserve bank or monetary authority and the use of the Australian dollar limits the ability of Kiribati to exercise its own monetary policies (Kiribati, 2000a).

2.2 The Revenue Equalisation Reserve Fund

The Revenue Equalisation Reserve Fund (RERF) was established when Kiribati was part of the GEIC. The source of fund capital was royalty revenue from the extensive phosphate deposits on the island of Banaba (Ocean Island), which was part of the GEIC. These deposits were discovered by Albert F. Ellis, a New Zealand geologist employed at the Sydney office of the Pacific Phosphate Company (then John T. Arundel and Co). In 1899 Ellis took an interest in a stone doorstop at the company’s office and suspected that it might contain phosphate. Ellis tested the stone, and the results suggested an incredible phosphate content of 78 percent (Ellis, 1935; Williams and Macdonald, 1985). Ellis established the provenance of the doorstop as coming from Nauru; he also realized that the
neighbouring island of Banaba, which was known to be geologically similar, was likely to contain phosphate. He revealed his discoveries to the company, which arranged for field visits to gather more samples.

Ellis made field visits to both islands in 1900. On Banaba, he immediately negotiated a 999-year agreement with Temati, the alleged ‘king’ of the island, giving the company exclusive rights to mine phosphate on Banaban lands in exchange for an annual payment of £50 in cash or trade goods (Ellis, 1935; Macdonald, 1982, 95-96). Phosphate mining began on Banaba in 1900 and continued until 1979. In 1945, largely because of the extensive environmental damage done to the island (which was never very agriculturally productive), the Banabans were relocated to a new home on the island of Rabi, in Fiji, a plan that had been under discussion since 1928 (Schutz and Tenten, 1979). Mining continued on Banaba until 1979, when Banaban agitation, falling world phosphate prices, and depleting reserves convinced the newly-independent Kiribati government to close the mines (K. Teaiwa, pers. comm., 2002).

The post World War II period was a time of rebuilding after the disaster of war, when the main island of Tarawa was heavily damaged. Michael Bernacchi, Resident Commissioner of the GEIC for much of the 1950s, advocated order, reconstruction, and the colonial administration’s demonstration of concern for locals’ welfare and lack of exploitation (Macdonald, 1982, 173). He proposed establishing a trust fund, to be administered by the GEIC on behalf of the islanders,

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1 The terms of the agreement were periodically revised, under British government pressure, and rental payments, compensation for damage, and royalties were later paid to the Banabans. During the period 1900-13 the Pacific Phosphate Company made a total profit of more than £1,750,000, of which less than £10,000 was paid to Banabans. See Macdonald (1982, Chap 6) for details.
based on the revenues from Banaban phosphate.\textsuperscript{2} In the continuing debate over whether phosphate revenues should be saved or spent, Bernacchi clearly supported saving part of the phosphate revenues. His proposed fund would accumulate reserves to generate income when phosphate revenues ceased flowing.

Bernacchi pushed for the fund in 1956 because in the following year the agreement that the colony had with the United Kingdom regarding copra exports was due to expire and would put the colony in a weaker financial position (Macdonald, 1971, 140). The Revenue Equalisation Fund (later Revenue Equalisation Reserve Fund) was accordingly created in 1956 with $555,580\textsuperscript{3} provided by the colonial administration, of which $155,580 came from the sale of Japanese assets from their wartime occupation and $400,000 from the GEIC’s general fund (Toatu, 1993). As Macdonald notes, the trust fund ‘represented the first positive step that had been taken to safeguard the Colony’s financial future’ (1982, 173).

Thereafter, varying amounts of phosphate revenues from the Banaba mines were deposited into the fund. In 1963, the new Resident Commissioner, V.J. Andersen, reversed this policy, arguing that phosphate revenues were more urgently needed for infrastructural projects. From 1963 to 1967 no revenues were

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\textsuperscript{2} The Banabans at this time had their own trust fund, which was set up in 1913 and based on the earlier recommendations of the then Resident Commissioner, Captain John Quayle Dickson RN. From 1908 onwards, the fee that the Pacific Phosphate Company paid for phosphate rights was paid to the GEIC, rather than into the British treasury. After the Banaban fund was established, the Pacific Phosphate Company paid 6d per ton to the government and another 6d per ton to the Banaban fund. Albert Ellis was retained as the company’s representative on Banaba until his later appointment to the British Phosphate Commissioners (see the Nauru section of this chapter). The Banaban fund was later used to finance the relocation of the islanders to Fiji and was a model for the RERF.

\textsuperscript{3} Currency figures in this chapter are expressed in the local currency for each country, unless otherwise indicated. For Kiribati, Nauru, and Tuvalu this is the Australian dollar, while for Tonga it is the Tongan Pa’anga.
deposited into the fund. In 1967, concerned with the financial position of the colony, the British government ordered a socio-economic survey be carried out under the direction of Sir George Mooring. The Mooring Report of 1968 called for depositing 25% of phosphate revenues into the trust fund, and this policy was kept in place until the closing of the Banaban mines in 1979.

Prior to independence, all income generated by the fund was reinvested, and drawdowns began only after 1979. When Kiribati became independent in 1979, the Ellice Islands formed a separate country called Tuvalu. The Tuvaluans asked for a share of the trust fund, but Kiribati was successful in arguing that the fund belonged to it alone. Kiribati was also successful in convincing aid donors that fund capital not be considered in aid decisions (Macdonald, 1982, 273).

Fund governance

When the RERF was first set up it was managed by the colonial authorities. After Kiribati’s independence, the fund was transferred to the independent government and its structure was elaborated within the new National Economic Planning Office, part of the Ministry of Finance. The RERF is managed by a unit within this office, called the Investment Unit, along with the Policy Analysis Unit, the Budget Unit, and the Line Ministries (which handles the economic affairs of the remoter islands). Each of these units is under the direction of a Senior Economist, and within the Investment Unit there are two other economists assisting the Senior Economist. All of the units are under the direction of the Chief Economist. The Investment Unit is responsible for the nation’s investments, including those of the

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RERF. This unit is responsible for the day-to-day operations of the fund and for supervising the independent private investment firms that handle trading, investment advice, and custodianship of the assets.

Overall policy decisions for the RERF are set by the RERF Committee, comprised of six members. These include the Minister of Finance, who serves as the chair and is an elected Member of Parliament; the Permanent Secretary of Finance, the Secretary to the Cabinet, the Attorney-General, the Chief Economist, and the Director of Planning. The RERF Committee appoints investment fund managers, makes auditing decisions, and sets operational guidelines including fund asset composition. It meets quarterly. The Committee also helps to integrate the activities of the fund into the overall mission of the Ministry of Finance and into overall government policy.

The third component of investment management is the independent investment firms that directly trade and hold the fund’s assets. At the present time, two firms have this responsibility, both based in London: Nikko Global Asset Management (UK) Ltd and HSBC Asset Management (Europe) Ltd. A third private firm is the custodian that holds the fund’s assets: State Street Australia Ltd, based in Sydney. Together there are three levels of administration: at the top is the RERF Committee, which sets overall policy objectives; the Investment Unit of the Ministry of Finance, which handles investment operations, coordination of investment policy with the national budget, and supervision of investment

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5 Interviews with Tebwe Ietaake, Permanent Secretary, Kiribati Ministry of Finance, Tarawa, 2002; with Atanteora Beiatau, Tarawa, 2002; and with Teuea Toatu, Consultant, Canberra, 2003.
6 Atanteora Beiatau also told me that various ministers and other government branches often ignore the advice of the Ministry of Finance, making implementation of overall financial strategies difficult.
7 Interview with Atanteora Beiatau, Tarawa, 2002.
managers; and the independent private firms that directly manage the fund’s investments by holding and trading assets.

Accountability does not appear to be a major issue with respect to the RERF. I-Kiribati in general are aware of the fund, and many of them express pride in the financial independence that it gives their country. Most are not familiar with the specific operations of the fund, yet they do know that it produces an income that finances government operations (when needed) and indirectly supports projects on the outer (i.e., not South Tarawa) islands. Fund reports are audited by the national Auditor-General and tabled in Parliament. According to the Asian Development Bank, the RERF has been well managed, and the fund has not been subject to charges of favouritism or corruption (ADB, 1998).

**Generation of fund capital**

The RERF has grown considerably since its inception in 1956 and reported a balance of $658.0 million in 2000. Table 6.1 gives details about the growth of the fund capital as well as its earnings and per capita values. The table shows data for the years 1989-2000 as well as for 1956, 1968, and 1979. Data from these three earlier years allows for some comparisons between fund operations during Kiribati’s independence and several sample years during the colonial administration.

The RERF redeposits the entirety of its earnings back into the fund corpus. Parliament, in consultation with the Ministry of Finance, may make additional

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8 I draw this conclusion from random informal interviews and conversations with a variety of I-Kiribati on South Tarawa and on the ‘outer island’ of North Tarawa during my visit to the country in 2002.
deposits into the fund (for example, during times of budget surplus) and may also make drawdowns from fund capital. For example, Table 6.1 shows that in 1999 the fund recorded earnings of $54.5 million, of which $5 million was withdrawn with the balance remaining in the RERF. In 2000, the fund generated earnings of $58.9 million, all of which remained as part of the fund’s corpus. It is in this manner, rather than through new resource revenue deposits, that the fund grows.

Geographies of fund asset distribution

The RERF aims for an equal balance of equity and fixed income investments, with about 46% of the portfolio invested in equity investments and 54% in fixed interest investments (State Street, 2002). Fixed income investments include mainly bonds (corporate and government) and cash assets. Equities include corporate common and preferred shares. Assets are held in various currencies, though Australian dollar-denominated investments account for about 31% of the total, mainly because Kiribati does not have its own currency and instead uses the Australian dollar. RERF assets held in other currencies helped increase the value of the fund during the 1990s as the Australian dollar depreciated against many currencies (ADB, 1998, 52). These other currencies included the US dollar (26% of investments), euro (22%), yen (10%) and sterling (7%), with the remaining 4% in other currencies (e.g., Singapore dollar, Malaysian ringgit, Swiss franc) (State Street, 2002; NICAM, 2002; HSBC, 2002). None of the fund’s investments (other than very small cash holdings) are in Kiribati itself.

Distribution of fund earnings

The function of the RERF at this time is to stabilise government revenues,
especially at times when copra and fishing revenues are low. At these times the
government is authorized to make drawdowns against RERF income. The
government did this annually between 1989 and 1997, when a total of $44.5
million was withdrawn (the fund generated earnings of about $345 million during
this period, so only about 13% of earnings were removed). Between 1998 and 2000
no withdrawals were made from the RERF (see Table 6.1 for details of deposits
and withdrawals). RERF income thus provides the Kiribati government with a
cushion against downturns in its resource (copra and fishing) industries. Redeposit
of fund earnings ensures that the fund continues to grow and that its real value is
maintained. RERF annual earnings are equivalent (2000) to about one-third of the
budget’s estimated current expenditures, and to about one-fifth of the country’s
total annual expenditure (including development expenditure) (Kiribati, 2000b;
ADB, 2002).

The Kiribati Statistics Office conducted three household surveys in 1996 in
order to determine income and expenditure patterns in the country, using the
islands of South Tarawa, Onotoa, and Butaritari as case studies (ADB, 1998;
Kiribati Statistics Office, 1996a, 1996b, 1996c). These surveys found that
expenditures on food on the three islands were similar, but that the two outer
islands of Onotoa and Butaritari had much lower percentages of income spent on
fish and meat (about 18% of total food expenditure on Tarawa, but less than 8% on
Onotoa and Butaritari). Household income on South Tarawa was $268 per
fortnight, on Butaritari $93 per fortnight, and on Onotoa $10 per fortnight. Both of
these figures indicate the much higher dependence on subsistence on the outer
islands. About 80% of I-Kiribati are engaged in subsistence (AusAID, 2001).
Kiribati’s economy still depends heavily on subsistence. But, as the Asian Development Bank notes, ‘while household production can continue to sustain a basic livelihood, it cannot produce the funds needed to purchase imports of fuel, machinery, and the other items that are now essential components of the I-Kiribati lifestyle’ (ADB, 1998, 187). I-Kiribati have been increasingly integrated into a cash economy since the 1920s, when missionary and colonial influence led to a rising demand for imported clothing, foods, and other goods such as pots and pans, knives and axes, and soap (Schutz and Tenten, 1979). The cash economy has altered I-Kiribati society in substantial ways. As Talu and Tekonnang note:
Parents are eager for their children to be educated, not for what it will do to them, but because it will enable them to obtain jobs which bring home money. It is also changing their attitude to marriage. Formerly, parents wished to see their children married so they could have grandchildren; today some people are opposing marriages because this cuts off a source of income for them. In quite a few cases money has taken precedence even over land values. Many cases are known of people who have sold their land to buy a motorcycle or other assets (1979, 163).

I-Kiribati of today are well connected to the modern world and thus have need of cash and imported goods to supplement their subsistence-based household economies.

The mainstream development response to the country’s need for cash income is recommending an expansion of the private sector (ADB, 1998; Duncan et al., 1999). The Bank further notes, however, that past efforts to develop productive industries ‘have been disappointing’ (ADB, 1998, 187). The Bank sees the encouragement of the private sector as the solution (because of the perceived need for formal employment); the trust fund, however, may at some point provide an alternative source of revenues that could provide a basic income to I-Kiribati if distributed as dividends. Dividends could provide a supplement to subsistence livelihoods. ⁹ As the Asian Development Bank notes, ‘the people of Onotoa and Butaritari seem to be able to maintain an acceptable standard of living with

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⁹ Most I-Kiribati also depend on the production of copra for part of their cash income. The Kiribati government’s policy guarantees the same copra price to all producers, on whatever island they may be located. The price paid is not means-tested. This has the effect of reducing differences in incomes between producers on outer islands and those on South Tarawa, equitably distributing that income to all (ADB, 1998, 190).
minimal cash incomes’ (ADB, 1998, 65). The Bank also notes, however, that the need for cash to finance children’s education and other goods has prompted many people to relocate to South Tarawa in order to enter wage labour.

Transfer payments through the trust fund may help encourage people to remain on outer islands and reduce overpopulation and consequent urbanisation problems in South Tarawa. At the moment the RERF generates about $640 per capita. A redeposit of at least a portion of this revenue is needed to maintain the fund’s real value and offset inflation. In future, if fund earnings continue to rise, a portion may be available for dividend payments. The amount available would be enhanced by an increase in Kiribati’s fishing licensing fees.

2.3 Conclusion

Kiribati’s Revenue Equalisation Reserve Fund has been considered a success by a variety of analysts (ADB, 1998; Toatu, 1993; IMF, 1995; Throsby, 2001). The Asian Development Bank further notes, for example, that the health of the average I-Kiribati has improved during the past two decades, and that the Kiribati government has been able to maintain a high level of health expenditure (ADB, 1998, 192). With a window of phosphate revenues lasting only from 1900 to 1979, preceding Kiribati’s independence, the fund has grown to hold assets of $658 million, or about $7152 per capita, increasing by a factor of ten during the independence period. Fund assets are invested entirely offshore, in Australian, North American, European, and Asian financial markets. This practice follows the

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10 Also interviews with Tebwe Ietaake; Atanteora Beiatau; Ueantabo Neemia-Mackenzie, Director, University of the South Pacific Kiribati Campus; and Colin Hill, Australian High Commissioner, Tarawa, 2002; and Teuea Toatu, Canberra, 2003.
model described in Chapter 1 of this thesis, in which capital generated in the periphery is invested in the core.

Kiribati did not attempt to transform itself into a core economy. It did not directly invest any of its trust fund assets within its own sovereign boundaries. Instead, the fund’s trustees chose to mitigate the disadvantages of the country’s peripheral position by engaging directly with global financial markets. Using fund managers based in London and Sydney, Kiribati built up a portfolio of offshore investments that provides an annual income. This income assists the country when it experiences budget deficits. In doing so, Kiribati avoids having to impose or increase taxes on its subsistence-dependent population, and avoids the need to request aid from international donor agencies, placing it in debt and in a position of dependence.\footnote{As Teiwaki notes, foreign aid is a ‘strategy by the metropolitan countries to exert their influence in national politics’ and that the conditions of foreign aid ‘tend to undermine national sovereignty’ (1988, 153).} Capital generated years ago on the remote Pacific island of Banaba is now being invested throughout the world. Kiribati has transformed a local, non-renewable resource into a renewable one that stimulates local development.

3. NAURU

The trust fund of Nauru, the Nauru Phosphate Royalties Trust, is the oldest considered in this thesis, having been established in 1922. The trust fund was set up under the peculiar colonial administration of the island, which was a League of Nations mandate territory and later a United Nations trusteeship, with the British Empire as the trustee and Australia as the de facto administrator. During the entire colonial period, Nauru was effectively ruled by a quasi-private institution known
as the British Phosphate Commissioners, who were responsible for mining and 
exporting the phosphate rock that was, and still is, the sole basis of the Nauru 
economy.

The fund was established in order to provide Nauruans with a resource that 
would support them after phosphate was depleted. Like the other funds considered 
in this thesis, the idea was to save and invest a share of resource revenues in order 
to generate an income that could be used to finance government activity in the 
absence of resource revenues. During the colonial administration all of Nauru’s 
finances were managed in great secrecy, a policy that continues to the present. 
Nauru’s fund was poorly administered after Nauruan independence, and as a 
consequence its value has declined considerably, to the point where the fund as a 
viable entity is questionable. Given its limited resource base, Nauru in essence had 
only one opportunity to invest the proceeds of that resource, an opportunity which 
it squandered. Nauru chose to invest the bulk of its assets internally, and to weight 
them heavily towards on-lending to other government entities. These poor policy 
choices resulted in a very different outcome from the case of Kiribati, which faced 
similar constraints but made different policy choices.

3.1 Nauru and the political economy of phosphate

The Republic of Nauru, like its neighbour Kiribati, is a small Micronesian state in 
the Central Pacific, located almost on the equator (see Map 1). Unlike Kiribati, 
Nauru consists of a single island only 21 km² in size, making it one of the world’s 
smallest countries. Nauru is distinctive for its historical mix of Micronesian, 
Polynesian, and Melanesian features, including its unique language. Nauru was 
one part of Germany’s Pacific empire but was mandated to the British Empire as
a whole after Germany’s defeat in the First World War, although it was in practice administered by Australia. The population today is about 12,000, about three-quarters of which are Nauruans, the others being mainly guest workers of Oceanian, Filipino, and Chinese descent. Nauru’s GDP (PPP) was estimated at US$5000 per capita in 2001, though estimates vary and data on any aspect of the Nauruan economy are difficult to obtain.\textsuperscript{12} Nauru’s economy has been entirely based on phosphate extraction during the twentieth century, though internet banking is an emerging industry. Both phosphate mining and internet banking have been problematic in recent years, as will be seen below.

3.2 The Nauru Phosphate Royalties Trust

Nauru became a German colony in 1888, part of the German Micronesian territories governed from Jaluit in the Marshall Islands. As a small and relatively remote island, Nauru was insignificant in terms of German colonial ambitions, but it was useful as a place of trade and for the production of a few products such as copra. Its phosphate deposits remained unrecognized and unmined.\textsuperscript{13}

As noted in the section on Kiribati, phosphate deposits on Nauru were discovered by the New Zealand geologist Albert F. Ellis, who was employed at the Sydney office of the Pacific Phosphate Company (then called John T. Arundel and Co.). Ellis’s discovery that the office doorstop was a piece of phosphate rock from Nauru led him to the conclusion that that island contained phosphate in

\textsuperscript{12} Indeed, at times the national budget, and even the population census, have been given the status of state secrets as far as visiting researchers have been concerned (R.G. Ward, pers.comm., 2002).

\textsuperscript{13} Nauru’s trust fund emerged under somewhat murkier circumstances than those of Kiribati, Tonga, or Tuvalu, and involved a great deal of secrecy and colonial machinations. This section therefore elaborates on Nauruan colonial history and is more detailed than the corresponding sections for the other three Oceanic states. Much of the information on the British Phosphate Commissioners is drawn from Williams and Macdonald’s excellent study \textit{The phosphateers} (1985).
commercially exploitable quantities (Ellis, 1935; Williams and Macdonald, 1985). The company arranged for field visits to gather more samples, on both Nauru and Banaba.

The site visits, conducted in early 1900 under somewhat secretive terms in order to avoid alerting the Germans of the discovery (in Nauru), confirmed the earlier tests. Both Nauru and Banaba had enormous phosphate deposits that could be mined relatively easily and cheaply, and would provide an important source of fertilizer for the emerging Australian and New Zealand agricultural sectors. As Ellis noted, the sample drawn from a shaft about eight feet deep was ‘phosphate all the way down and no bottom reached’. John T. Arundel and Company, now reconstituted as the Pacific Phosphate Company, reached an agreement with the German government to lease the phosphate deposits and mine them, and exploitation began in 1907. Less than a decade later war broke out between Great Britain and Germany, and Nauru was seized by Australian forces in 1915.

After World War I, former German territories were removed from German administration and parcellled out, under various terms, to the victorious Allied powers. Australia, under the vociferous Prime Minister W.M. ‘Billy’ Hughes, argued for the outright annexation of Nauru as Australian territory (Weeramantry, 1992, 9, 44-45; Horne, 2000, 163; Hiery, 1995, 120). This position brought Australia into conflict with Woodrow Wilson of the United States, who argued that former German territories should not be annexed, but rather should be ‘mandated’, with the ultimate goal of independence, by the Allied colonial powers. The fledgling League of Nations created three classes of mandates. ‘A’ mandates

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14 British Phosphate Commissioners Archives, Melbourne, BPC R178/0, WOB 3/0, Item 17.
consisted of formerly Turkish territories, such as Syria and Lebanon, which were thought to be very close to independence. ‘B’ mandates consisted of the bulk of German African territories, which were thought to require a much longer preparatory time before independence would be reached. The adamant Australian position, backed by a few other states such as New Zealand and South Africa, led to the third category of ‘C’ mandates, which gave far greater powers to the colonial metropolitan power, provided that the ‘sacred trust of civilization’ be upheld, and that the territory eventually be prepared for independence. Nauru, along with other former German Pacific territories such as New Guinea and Samoa, was given a ‘C’ mandate. In 1920, at the conclusion of the peace treaty, the Nauru mandate was awarded to the British Empire, or literally to ‘His Britannic Majesty’, and not to a single country. This was unique among the mandates (Viviani, 1970, 9-10).

A year prior to the official League of Nations award of the Nauru mandate to the British Empire, Great Britain, Australia, and New Zealand had met in secret to divide the island’s phosphate among themselves (Hiery, 1995). The Nauru Island Agreement, signed in 1919 between the three countries, gave 42 percent of the phosphate to Great Britain, 42 percent to Australia, and 16 percent to New Zealand. The agreement also created the British Phosphate Commissioners (BPC), a tri-partite body that held all title to the phosphate and the physical plant for its extraction, and was responsible for mining and shipping phosphate to the partner countries. The rights were purchased from the Pacific Phosphate Company for £3.5 million. Though the administration of the island itself was also the responsibility of the three countries, Australia gradually took the lead and essentially conducted all administrative matters itself, with the BPC acting as a quasi-private company handling phosphate extraction, loading, and transport. During both the League of
Nations mandate period and the subsequent United Nations trusteeship Australia treated Nauru as its own colonial territory (e.g., Clarke, 1962).

Though Great Britain tended to see the BPC as an investment, Australia and New Zealand saw the institution as a vehicle for providing their own farmers with subsidized fertilizer. Nauruan phosphate was sold at cost to fertilizer companies in the latter two countries, helping to boost agricultural output while encouraging farming on marginal lands—which required heavy inputs of fertilizer to make them productive. Australia, with its poor soils, especially benefited from this scheme. Any profits derived from phosphate operations, such as from the occasional sale of phosphate to other countries such as Japan, were divided among the three member states according to the same formula.

The BPC did not operate in a vacuum on Nauru, because the island was inhabited. The Nauruans had their own system of land tenure, and even the phosphate lands, located in the centre of the island, were privately held by individuals (Weeramantry, 1992, 163-65). Albert Ellis, during his 1900 reconnaissance of Banaba, had signed an agreement with the purported ‘king’ of that island, which, so the company argued, gave them the right to extract phosphate (see the Kiribati section of this chapter). A similar agreement was concluded with the Nauruans, giving them a small royalty, which they could use in trade, in return for the rights to mine phosphate on their lands. At first, the Nauruans, like the Banabans, were amazed that men would actually pay for rocks that seemed so abundant and generally useless (except for making fishing lures) (Williams and Macdonald, 1985; Viviani, 1970).

The BPC generally claimed that they had no legal obligation to pay royalties to the Nauruans, other than perhaps some compensation for damage to
land, structures, and fruit trees. However, the BPC did decide to pay a small royalty ‘voluntarily’ (Williams and Macdonald, 1985; Weeramantry, 1992, 108). This royalty was generally returned to Australian interests in the form of trade. Indeed, this was one of the reasons that royalties were given.

The origins of Nauru’s trust funds can be traced back to events on Banaba. Captain John Quayle Dickson RN, the Resident Commissioner on Banaba in 1910, suggested setting up a trust fund, from company resources, which would allow the Banabans to purchase another island at the time when theirs became uninhabitable from extensive mining (Williams and Macdonald, 1985, 89). His successor as Resident Commissioner, Edward Carlyon Eliot, actually set up a trust fund in 1913, with an initial allocation of £4734 plus a regular royalty payment of 6d per ton (Williams and Macdonald, 1985, 100). The income from the fund would be used on the behalf of the Banabans or paid directly to them, in addition to the other royalties that they received. Though the Nauruans were probably unaware of the Banaba situation, they did begin to agitate for higher royalties and additional payments from the BPC in 1925 (Williams and Macdonald, 1985, 205). The response from the Commissioners was to suggest that the Nauruans did not really understand money, and that they needed very little of it anyway, as their tropical island provided them with their every need (Williams and Macdonald, 1985, 282). The BPC further suggested that the small royalty currently paid to the Nauruans was sufficient, and that it allowed them to purchase trade goods. The Nauruans, however, were already beginning to show a concern for their economic future; they

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15 See also letter from Alwin R. Dickinson, BPC UK Commissioner, to Under Secretary of State, Colonial Office, 25/7/1921. BPC Archives, Melbourne, MP1174/1/0, Item 807. According to this letter, 6d per ton was paid to the Banaban trust fund, and the payment to Nauruans was only ½d per ton.
knew that the phosphate would not last forever and they wanted some provision for their future (Williams and Macdonald, 1985, 213-14). In response, the BPC set up a small trust fund in 1922, the seed of what would eventually become the Nauru Phosphate Royalties Trust.

The Nauru fund owes its origins to the actions of the BPC’s UK Commissioner, Alwin R. Dickinson. In 1921, Dickinson proposed a Nauru fund similar in purpose to that in Banaba. He thought that the fund would not need to be as large as the Banaban fund, because agricultural land would not be destroyed in Nauru, as it was in Banaba. Nevertheless, Dickinson proposed a royalty of 6d per ton, of which 3d per ton would be paid into the trust fund. He noted that ‘in my view it is at least desirable to accumulate a substantial sum for the welfare of the natives in Nauru’. The other two commissioners as well as the administrator did not agree, and instead proposed a total royalty of 3d per ton, with 1d per ton of this going to the trust fund (only one-third of what Dickinson had proposed). This alternative proposal was accepted by the Colonial Office on 5 August 1921, effectively settling the matter. Dickinson continued to pursue the matter but dropped it after correspondence from Harold Gaze, the BPC’s Administrator, stated that ‘correspondence with Nauru shows that the natives are satisfied with settlement’. The Nauru trust fund can thus be considered as the creation of the UK’s Commissioner, Alwin R. Dickinson, even though his original proposal was

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16 BPC Archives, Melbourne, MP 1174/1/0, Item 807.
17 BPC Archives, Melbourne, MP 1174/1/0, Item 807. This file contains correspondence between Dickinson and the Australian Commissioner H.B. Pope, the New Zealand Commissioner Albert Ellis, and the BPC’s Administrator, Harold Gaze, dating from 1921.
18 The increase in the total royalty from ½d to 3d per ton did not sit well with Australian Prime Minister Billy Hughes; Winston Churchill, as Colonial Secretary, wrote to him on 20 June 1921 outlining the new terms and asking for his cooperation. BPC Archives, Melbourne, K178/0, Item 21.
19 BPC Archives, Melbourne, MP 1174/1/0, Item 807. Note initialled by H. Gaze, 22/12/1921.
This fund received less than 0.1 percent of the total value of the phosphate. Conceived in secret prior to the League of Nations mandate in 1919, the BPC continued to be a highly secretive body. Financial information was kept under wraps, and not often released—and usually under external pressure—to either the League of Nations or even to the partner governments (Williams and Macdonald, 1985, 279). The Commissioners felt that financial information, which included the value of the phosphate, was best kept within the BPC and not revealed to the Nauruans or to the foreign public (Weeramantry, 1992, 105, 232). This legacy of secrecy was to last even to the present, and strongly affects, the manner in which the Nauru Phosphate Royalties Trust is operated. The arguments used by the BPC, that the Nauruan public did not understand the arcane world of international finance, are still used today (Ellis, 1935, 259; Weeramantry, 1992; The Visionary, 2001).

Nauruan concerns for their future continued to grow. Their island home was gradually being destroyed by the mining operations, reducing the amount of land suitable for agriculture or living. At one point the Nauruans considered relocating to another island; this proposal never came into fruition because of the...

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20 ‘Promises, tricks, and deceit’ were used in dealing with the Nauruans, according to Hiery (1995, 241).
21 For details on the BPC’s secrecy, see Williams and Macdonald, 1985, 359, 364, 472-73. Connell (2004) notes the extreme secrecy of Nauru’s first independent government under President Hammer DeRoburt, quoting a 1987 Australian government cable stating that ‘DeRoburt himself has a secretive and arrogant approach to government’. DeRoburt’s successors continued the same style of governance.
22 My informal interviews with a number of Nauruans and Nauruan residents in 2002 revealed a general popular pattern of mistrust in government, a lack of knowledge and feeling of involvement with the trust fund, and a perception of government corruption and waste. Moreover, all of the Nauruans interviewed said they had no idea of what would happen when the phosphate runs out.
23 Hiery notes that ‘the mandatories used all means at their disposal to break Nauruan resistance to the exploitation of their environment and the destruction of their fields and gardens’ (1995, 241).
lack of a suitable island on which the Nauruans could have complete sovereignty. Instead, Nauruan leaders proposed independence for the island, with complete Nauruan control of the phosphate industry and its revenues (Weeramantry, 1992, 265-306).

Nauru’s independence was granted in 1968, and the newly-independent republic assumed control of the phosphate industry and the trust funds, now known as the Nauru Phosphate Royalty Trust, with four component parts. Each of these components had its special function, but it is the Nauruan Long Term Investment Fund, which was supposed to provide for Nauru’s economic needs in the post-phosphate era, that is of particular interest.

Fund governance

At Nauru’s independence in 1968, the assets held by the Commonwealth trusteeship and the British Phosphate Commissioners were transferred to the Nauruan government. These included both the Nauru Phosphate Corporation and the Nauru Phosphate Royalties Trust.

The Nauru Phosphate Royalties Trust (NPRT) is administered directly by the Nauru Ministry of Finance. Its operations are highly secretive, and little is known about the exact administrative structure. A Trust Board does exist, but its composition is uncertain. The Nauruan parliament is empowered to examine the reports of the NPRT, but in practice it does not always do so. The tight circle of control of Nauru politics by a small clique of politicians effectively seals off details of the fund’s structure from the general public.24

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24 Interview with John Raige, Nauru, 2002, and information from Kieren Keke and David Abeang, Naoero Amo political party, Nauru, 2002.
The Nauruan government operates with a great degree of secrecy, especially with respect to financial matters. Charges of corruption have been rife. For example, the Nauruan newspaper *The Visionary* has noted that ‘government accountability to the people has been lacking in Nauru for decades (*The Visionary* 12-01, 2001, 7). The same source describes the Nauruan government as a secret organisation and notes that the media has had very little access to Nauruan politicians. Another Nauruan newspaper, *The Nauruan*, found that former Nauruan president Kennan R. Adeang was paid a $600,000 ‘consulting fee’ in order to investigate the possibilities of establishing an offshore banking centre in the country; Adeang was also paid a monthly $50,000 ‘consulting fee’, which was listed in the national budget without explanation (*The Nauruan* 2(1) and 2(2), 1998). The NPRT operates within this context of secrecy and corruption.

The NPRT is divided into four parts, each of them separate trust funds, though they are administered as a single unit and their investments are commingled. Fund 1 is the Nauruan Long Term Investment Fund, which is supposed to invest for the future in order to provide the Nauruan government with an income when phosphate supplies are depleted. Fund 2 is the Nauruan Land Owners Royalty Trust Fund (RONWAN), which is designed to provide a continuing stream of earnings to Nauruan landowners whose land has been affected by phosphate mining. Fund 3 is the Nauru Housing Fund, established in order to provide affordable and heavily-subsidised housing to Nauruans. This fund is insignificant in size when compared to the other three. Fund 4 is the Nauru Rehabilitation Fund, designed to save phosphate revenues and use them to rehabilitate Nauru’s environment, which has suffered considerably from mining.
Figure 6.1. Nauru trust funds and their links to revenue sources and expenditures.

Source: Government of Nauru

The NPRT has been implicated in several schemes to generate additional
revenues through the sale of Nauruan passports to foreigners. Figure 6.1 illustrates one of these schemes, depicting a complicated and perhaps fanciful outline of how passport revenue would enter the trust fund. More important for this analysis is some indication of how the trust fund, labelled here as NPRT, is linked to other government operations.

**Generation of fund capital**

The NPRT receives a share of the revenues generated by the Nauru Phosphate Corporation (NPC), whose sole business activity is the mining and export of Nauruan phosphate. The exact amount of the royalty payment is unknown, but it has probably varied over time, depending on the financial position of the NPC. As of 1998, about $17 million of back royalties were owed to the NPRT and listed by the fund as receivables (see Table 6.3). As NPC operations gradually wind down due to depletion of the phosphate, the payment to the NPRT, if any, will decline as well and may even cease to exist.

**Geographies of fund asset distribution**

As many scholars have deplored, Nauruan financial information is difficult to obtain (Connell, 2004). I was, however, fortunate in acquiring copies of some financial materials submitted to the Nauruan parliament, consisting of NPRT

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25 Nauruan passports have been sold to overseas buyers (*The Nauruan* 1(5), 1997). Changes made to the *Nauruan Community Ordinance (Amendment) Act* of 1997 and the *Passports Act* of 1997 created a new class of Nauruan citizens, which gave the right of Nauruan residence and the right to own property, but required investment in the country (*The Nauruan* 1(4), 1997). The desire to use passports as a sovereignty resource continues in Nauru. During my visit to the island in 2002, I met a rather shifty Australian ‘consultant’ who was attempting to convince the Nauruan government to invest in his passport sales scheme.

26 Connell’s paper notes that ‘little information has ever been available on the finances of the NPRT’. Connell himself does not include any financial data on the NPRT in his paper.
financial reports for 1998.  

The data presented here reveal a great deal about the financial position of the NPRT. Table 6.2 shows the total assets of the trust fund, disaggregated into the four component funds, for 1998, as stated in the fund’s financial reports. Total assets are listed as $2.1 billion, of which nearly $1.4 billion is in the form of receivables. This table also shows that Fund 2 has the largest balance, followed by Fund 4 and Fund 1, with Fund 3 being very much smaller than the others.

<table>
<thead>
<tr>
<th>Fund</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fund 1</td>
<td>$163,041,000</td>
</tr>
<tr>
<td>Fund 2</td>
<td>$349,038,000</td>
</tr>
<tr>
<td>Fund 3</td>
<td>$1,954,000</td>
</tr>
<tr>
<td>Fund 4</td>
<td>$226,985,000</td>
</tr>
<tr>
<td>Subtotal</td>
<td>$741,017,000</td>
</tr>
<tr>
<td>Receivables</td>
<td>$1,375,783,500</td>
</tr>
<tr>
<td>Total</td>
<td>$2,116,800,500</td>
</tr>
</tbody>
</table>

Table 6.2. Nauru Phosphate Royalties Trust reported assets (1998) (A$)

- Includes $239,486,000 in loans collateralized against the trust fund.
- See Table N-2 for details.

Source: Calculated from *Nauru Phosphate Royalties Trust Financial Statements* (1998)

The total amount of payments receivable, nearly $1.4 billion, is disaggregated in Table 6.3. This table reveals that the bulk of these receivables are from the Republic of Nauru Finance Corporation (RONFIN), a kind of on-lending agency that made loans to other agencies, using NPRT assets as collateral. RONFIN

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27 Information provided through John Raige during my visit to Nauru in 2002, with information also from Kieren Keke and David Abeang, Nauru, 2002. Nauruan financial data is not highly reliable, and even the trust’s independent auditor, Pannell Kerr Forster of Melbourne, has not approved the reports. The auditor refused to state that whether Nauru’s financial statements accurately reflected the financial position of the NPRT because of the trust’s failure to disclose information (even to its own auditors!) and because properties are listed at values disclosed by trustees, and not by independent external sources (*The Visionary* 2-01, 2001). However, the information provided here is the best available, and I believe that this is the first time it has been made available to an academic researcher.
receivables accounted for $930 million of the total NPRT receivables. The second largest share of receivables was from the Republic of Nauru itself, and this figure is not disaggregated further. Other Nauruan entities, including the Bank of Nauru, the Nauru Superannuation Board, the Nauru Phosphate Corporation, and others, also owed money to the NPRT.\footnote{The Nauruan Phosphate Corporation has missed most of its payments to the NPRT since 1995 (\textit{The Visionary} 2-01, 2001).}

<table>
<thead>
<tr>
<th>Entity</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>RONFIN</td>
<td>$930,000,000</td>
</tr>
<tr>
<td>Republic of Nauru</td>
<td>$391,391,000</td>
</tr>
<tr>
<td>Bank of Nauru</td>
<td>$220,500</td>
</tr>
<tr>
<td>Nauru Superannuation Board</td>
<td>$2,286,000</td>
</tr>
<tr>
<td>NPC</td>
<td>$1,321,000</td>
</tr>
<tr>
<td>Other controlled entities</td>
<td>$33,346,000</td>
</tr>
<tr>
<td>Phosphate royalties owed by government</td>
<td>$17,219,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$1,375,783,500</strong></td>
</tr>
</tbody>
</table>

Table 6.3. NPRT reported payments receivable (1998) (SA)
Source: Calculated from \textit{Nauru Phosphate Royalties Trust Financial Statements} (1998)

Table 6.4 shows NPRT reported income for 1998, broken down by the four component funds. The total income reported was $71.9 million.

<table>
<thead>
<tr>
<th>Fund</th>
<th>Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fund 1</td>
<td>$33.6 million</td>
</tr>
<tr>
<td>Fund 2</td>
<td>$18 million</td>
</tr>
<tr>
<td>Fund 3</td>
<td>$1.7 million</td>
</tr>
<tr>
<td>Fund 4</td>
<td>$18.6 million</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$71.9 million</strong></td>
</tr>
</tbody>
</table>

Table 6.4. NPRT reported income (30 June 1998) (AS)
Source: Calculated from \textit{Nauru Phosphate Royalties Trust Financial Statements} (1998)

Nauruan budget estimates for 2000-2001 gave an estimated total revenue of $36.4 million, of which $11 million was accounted for by the Department of Finance and $11.5 million by the Island Development and Industry Secretariat. The breakdown
of the latter is shown in Table 6.5, with roughly equal parts of this revenue source derived from the activities of the NPC, the Bank of Nauru, fishing licences to foreign vessels, and international leases. The budget does not indicate the source of the Department of Finance’s contribution, but it is likely that this represents part of the earnings of the NPRT.

<table>
<thead>
<tr>
<th>Source</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>NPC</td>
<td>$3 million</td>
</tr>
<tr>
<td>Bank of Nauru</td>
<td>$3 million</td>
</tr>
<tr>
<td>Fisheries</td>
<td>$3 million</td>
</tr>
<tr>
<td>International Leases</td>
<td>$2.5 million</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$11.5 million</strong></td>
</tr>
</tbody>
</table>

Table 6.5. Breakdown of Island Development and Industry (IDI) revenue contribution (Budget Head 02) estimates for 2000-2001 (A$)

Source: Calculated from Nauru Phosphate Royalties Trust Financial Statements (1998)

What, then, is the real financial position of the NPRT? Table 6.6 illustrates my calculations as to the real value of the trust fund. The fund’s recorded balance is about $2.1 billion, of which $1.3 billion is in the form of payments receivable that are highly unlikely to be paid. Many of these entities owning money to the trust fund are now insolvent or very nearly so. Thus we can assume that the trust fund will never receive these payments. This leaves a subtotal of $766 million in fund assets.

This $766 million consists of receivables listed as fund assets in the amount of $457 million. These receivables are also unlikely to be paid, and should be written off as well, leaving a subtotal of $309 million in fund assets. Of these assets, $239 million are collateralized loans, in which NPRT assets have been used as collateral by other Nauruan government entities, such as RONFIN. As the debts of RONFIN and other agencies will not be paid, the NPRT assets will be forfeited
and cannot be considered as trust fund assets. If we deduct these collateralized assets, we are left with a figure of $70 million. Of these remaining assets, $26 million are still receivable. As they are also not likely to be collected, we can deduct them as well, leaving a final figure of $44 million. This gives a much more accurate depiction of the real value of the NPRT. Though on paper it may appear to have a balance over $2 billion, in reality the balance is $44 million at best, and even these assets may be over-valued or non-liquid. Table 6.6 thus illustrates the rather poor financial position of the NPRT.

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Recorded fund balance</td>
<td>$2,116 million</td>
</tr>
<tr>
<td>Less: Receivables written off</td>
<td>($1,350 million)</td>
</tr>
<tr>
<td>Subtotal</td>
<td>$766 million</td>
</tr>
<tr>
<td>Less: Receivables listed as fund assets</td>
<td>($457 million)</td>
</tr>
<tr>
<td>Subtotal</td>
<td>$309 million</td>
</tr>
<tr>
<td>Less: Collateralized loans</td>
<td>($239 million)</td>
</tr>
<tr>
<td>Subtotal</td>
<td>$70 million</td>
</tr>
<tr>
<td>Less: Assets still receivable</td>
<td>($26 million)</td>
</tr>
<tr>
<td><strong>Total estimated fund assets</strong></td>
<td><strong>$44 million</strong></td>
</tr>
</tbody>
</table>

Table 6.6. NPRT estimated real assets (1998) (A$)
Source: Calculated from *Nauru Phosphate Royalties Trust Financial Statements* (1998)

Turning now to the kinds of assets in which the NPRT invests, we can see in Table 6.7 the fund’s asset breakdown by asset class. Five main classes are shown. The first, real property, accounted for 11% of fund assets in 1998 (a breakdown of properties held is shown in Table 6.9 and discussed below). The NPRT, unlike its counterparts in Kiribati, Alaska, and Alberta, held no fixed income securities. An insignificant amount was held in equities and cash. By far the bulk of the fund’s assets, 86.6%, were in the form of accounts receivable. As noted above, these receivables will never be received, given the Nauruan government’s insolvent financial position, and thus cannot be considered true
assets, as discussed above.

<table>
<thead>
<tr>
<th>Asset Class</th>
<th>In A$</th>
<th>As % of total assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real property³</td>
<td>$234,000,000</td>
<td>11.00%</td>
</tr>
<tr>
<td>Fixed income securities</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Equities</td>
<td>$38,000</td>
<td>0.002%</td>
</tr>
<tr>
<td>Cash</td>
<td>$3,800,000</td>
<td>0.18%</td>
</tr>
<tr>
<td>Accounts receivableb</td>
<td>$1,832,783,500</td>
<td>86.60%</td>
</tr>
<tr>
<td>Other and unknown</td>
<td>$46,179,000</td>
<td>2.18%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$2,116,800,500</strong></td>
<td><strong>100%</strong></td>
</tr>
</tbody>
</table>

Table 6.7. NPRT assets by asset class (1998)

Source: Calculated from *Nauru Phosphate Royalties Trust Financial Statements* (1998)

³ Does not include loans made to property controlling entities (which are listed under receivables); valuations in Table 6.6 include these loans.
b Includes both accounts receivable owed to NPRT (see Table 6.3) and fund assets listed as receivables

The nature of the NPRT’s assets is peculiar. The fund has eschewed the most typical classes of trust fund investments, fixed income securities and equities, and instead has loaned the bulk of its assets to other Nauruan government entities. How these government entities have invested these loans is unclear, but my sources in Nauru suggested that at least part of these funds was used to prop up the national airline, Air Nauru, and the national shipping company, both of which are thought to be unprofitable. These kinds of investments are very questionable for fund assets held in trust for beneficiaries.

The bulk of the NPRT’s assets appear on the balance sheet as receivables from the Republic of Nauru Finance Corporation (RONFIN). This is a state-controlled on-lending agency, empowered to carry on the Nauruan government’s business of finance and investment, including the issuance of securities (such as government bonds). The *RONFIN Act* of 1972 allows RONFIN to use NPRT assets as collateral, meaning that the investment practices of RONFIN can substantially
affect the financial position of the NPRT. I was unable to obtain financial statements for RONFIN, so the details of its investment practices cannot be included here.

Table 6.8 presents the same data as in Table 6.7, but with payments receivable removed. A similar picture emerges. If these payments are removed from the balance sheet, then receivables listed as assets account for almost 62% of total assets, with real property now accounting for over 31%. Again, fixed income is nonexistent while equities, cash, and other assets are negligible.

Table 6.9 illustrates the geography of the NPRT’s real property investments, showing the name of the property, to which of the four component funds it is attached, the value of the property in 1998, the amount collateralized, and the lender who holds the mortgage, lien, or other claim on the property.

<table>
<thead>
<tr>
<th>Asset Class</th>
<th>In A$</th>
<th>As % of total assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real property</td>
<td>$234,000,000</td>
<td>31.58</td>
</tr>
<tr>
<td>Fixed income securities</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Equities</td>
<td>$38,000</td>
<td>0.005%</td>
</tr>
<tr>
<td>Cash</td>
<td>$3,800,000</td>
<td>0.51%</td>
</tr>
<tr>
<td>Accounts receivable</td>
<td>$457,000,000</td>
<td>61.67%</td>
</tr>
<tr>
<td>Other and unknown</td>
<td>$46,179,000</td>
<td>6.23%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$741,017,000</strong></td>
<td><strong>100%</strong></td>
</tr>
</tbody>
</table>

Table 6.8. NPRT recorded assets by asset class (1998)

Source: Calculated from *Nauru Phosphate Royalties Trust Financial Statements* (1998)

*Does not include loans made to property controlling entities (which are listed under receivables); valuations in Table 6.6 include these loans.*

The majority of the fund’s real property assets are located in Australia and the United States. Australian properties are concentrated in Melbourne, and include most famously Nauru House (as of 2005 no longer owned by the NPRT or any Nauruan entity), the Southern Cross Hotel (partial share), and the Savoy Park...
Plaza. Nauruan real estate investments have been largely in commercial office and hotel properties.

<table>
<thead>
<tr>
<th>Property</th>
<th>Fund</th>
<th>Value (1998)</th>
<th>Amount Collateralized</th>
<th>Loan</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Australia</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Nauru House, Melbourne</td>
<td>Fund 2 – 100%</td>
<td>$112.8 million</td>
<td>$47.5 million</td>
<td>National Mutual – RONFIN</td>
</tr>
<tr>
<td>Savoy Park Plaza, Melbourne</td>
<td>Fund 2 – 100%</td>
<td>$30 million</td>
<td>$31.25 million</td>
<td>Citibank – RONFIN</td>
</tr>
<tr>
<td>Savoy Tavern, Melbourne</td>
<td>Fund 2 – 100%</td>
<td>$3.5 million</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Islanders Place, Melbourne</td>
<td>Fund 1 – 100%</td>
<td>$500,000</td>
<td>$1.2 million</td>
<td>Gourlay Nominees – loan to RONFIN</td>
</tr>
<tr>
<td>Willis St, Kow, Vic</td>
<td>Fund 1 – 100%</td>
<td>$600,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Southern Cross Hotel, Melbourne</td>
<td>Fund 1 – 76.95% Fund 2 – 8.53% Fund 4 – 14.52%</td>
<td>NPRT’s share $53.9 million</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Railway Square, Sydney</td>
<td>Fund 2 – 100%</td>
<td>$43.1 million $7.8 million</td>
<td></td>
<td>Bankers Trust Multiplex</td>
</tr>
<tr>
<td><strong>USA</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Hawaiki Tower, Honolulu</td>
<td>Fund 1 – 48.26% Fund 4 – 51.74%</td>
<td>$113.2 million</td>
<td>$69.8 million</td>
<td>Fincapital &amp; various other loans – loan to NPRT</td>
</tr>
<tr>
<td>Forest Heights, Portland</td>
<td>Fund 1 – 72.72% Fund 4 – 27.28%</td>
<td>50.1 million</td>
<td>$2.9 million</td>
<td>Centennial Bank – NPRT</td>
</tr>
<tr>
<td>Pacific House, Washington</td>
<td>Fund 1 – 74.76% Fund 4 – 25.24%</td>
<td>$7.5 million</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bentwood, Texas</td>
<td>Fund 1 – 100%</td>
<td>$54.8 million</td>
<td>$13 million</td>
<td>Drago Doic – NPRT</td>
</tr>
<tr>
<td>Raytheon Building, Houston</td>
<td>Fund 1 – 75% Fund 4 – 25%</td>
<td>$15 million</td>
<td>$10 million</td>
<td>Coastal Bank – NPRT</td>
</tr>
<tr>
<td>Pacific Star Hotel, Guam</td>
<td>Fund 1 – 24.05% Fund 2 – 67.67% Fund 4 – 8.28%</td>
<td>$139.4 million</td>
<td>$13.5 million</td>
<td>Fincapital &amp; Bank of Guam – loans to RON Guam</td>
</tr>
<tr>
<td>Yigo Home, Guam</td>
<td>Fund 1 – 100%</td>
<td>$330,191</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Guam Consulate</td>
<td>Fund 1 – 100%</td>
<td>$467,402</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>16 Kimberley St, Suva, FIJI</td>
<td>Fund 1 – 100%</td>
<td></td>
<td>$288,583</td>
<td></td>
</tr>
<tr>
<td>Sukuna Rd, Suva, FIJI</td>
<td>Fund 1 – 100%</td>
<td></td>
<td>$173,000</td>
<td></td>
</tr>
<tr>
<td>Grand Pacific Hotel, Suva, FIJI</td>
<td>Fund 1 – 70% Fund 4 – 30%</td>
<td></td>
<td>$6.7 million</td>
<td></td>
</tr>
<tr>
<td>Taiwan Consulate</td>
<td>Fund 1 – 100%</td>
<td></td>
<td>$490,000</td>
<td></td>
</tr>
<tr>
<td>Western Samoa Land</td>
<td>Fund – 100%</td>
<td></td>
<td>$1.4 million</td>
<td></td>
</tr>
<tr>
<td>Denig School, NAURU</td>
<td>Fund 4 – 100%</td>
<td>NPRT’s share $480,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>$591,629,196</td>
<td>$240,050,000</td>
<td></td>
</tr>
</tbody>
</table>

Table 6.9. NPRT real estate assets, 1998.
Hawai‘i, Oregon, Texas, and Guam, among others. Smaller holdings are in various
Oceanic countries including Fiji, Samoa, and a small investment in Nauru itself.
Most of the more valuable properties have been collateralized and as of 2005 many
have been lost through foreclosure. In the context of real property, at least, Nauru
attempted to diversify risk by investing outside the country.

**Distribution of fund earnings**

The distribution of the NPRT’s income is unclear, but some facts may be
ascertained. Of the NPRT’s four separate trust funds, one of them, the Nauruan
Land Owners Royalty Trust Fund (RONWAN), is supposed to make payments to
individual Nauruan landowners. In 2001, a Nauruan newspaper noted that
RONWAN was experiencing a shortage of cash and could not meet its payout
requirements to beneficiaries (*The Visionary* 14-01, 2001). At about the same time
the Bank of Nauru was declared insolvent, and depositors are restricted in the
amount of cash that they may withdraw from the bank each week. In 2002 this was
limited to only a few hundred dollars per week. The disposition of earnings from
the other three NPRT trust funds may either be redeposited into the fund, or
transferred to Nauru’s general fund. The exact distribution cannot be determined at
this point.

### 3.3 Conclusion

Data from 1998 suggest that the Nauru Phosphate Royalties Trust has a real value
of only around $44 million, not the $2 billion claimed in the fund’s financial
reports. Even this amount may overstate the value of the fund, as, over the past
several years, the fund has been forced to sell off many of its real property assets in
order to meet its debt obligations. The NPRT may in fact have assets considerably less than $44 million.

Nauru’s fund was established in 1922 during the League of Nations mandate era, when the island was administered by Australia and the British Phosphate Commissioners, who wrapped their financial activities in a veil of secrecy. This secrecy continued into the independence era. This lack of openness and transparency contributed to the poor performance of the fund, as assets were used for collateral for other Nauru entities in the absence of any real oversight.

Contrary to the model described in this thesis, Nauru chose to invest the bulk of its assets within Nauru itself, in the form of loans to other Nauruan agencies; the country did not separate the site of wealth generation from the site of investment. Nauru thus put its fund into a difficult position on two counts: by investing locally, rather than in global financial markets, and by choosing high risk, low return investments, rather than a more balanced portfolio that would be available in global markets.

The financial situation for Nauru is now especially critical, as, unlike most other Pacific islands, Nauru has virtually no subsistence food production, and even fresh water must be imported. Most Nauruans do not work, but are supported by royalty payments received from their own phosphate lands. Health and education benefits, as well as island infrastructure, have been funded by the Nauruan government. Now that phosphate stocks are running out, both individual royalties and state resource revenues will be severely restricted.29

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29 Many recent journalistic sources have commented on Nauru’s financial problems. See, for example, Easdown, 1988; North, 1993; The Australian, 2001; Skehan, 2003, Steward and Chulov, 2003; and Callick, 2004. Nauru has recently experimented with alternative sources of revenue, but these have also resulted in disaster. For example, the United States government recently charged
Nauru’s historic lack of transparency and openness with respect to fiscal policy and activity, and its apparent unwillingness to use qualified investment advisors in other countries, precipitated a dramatic decline in the value of the trust fund such that it can no longer provide the benefits that it was supposed to provide. Nauru thus illustrates the perils associated with secrecy, with local investment, and with the failure to diversify the investment portfolio.

4. TONGA

The Kingdom of Tonga set up a small trust fund in 1989 with the professed intention of using the fund to stimulate economic development. Under the country’s traditional and nearly absolutist monarchy, the fund quickly became implicated in the Royal Family’s penchant for esoteric investments and schemes. The fund itself derived its capital from the dubious sale of Tongan passports to non-Tongans, and the controversy that this policy generated both within the Kingdom and outside continued in the management of the fund’s assets. Tonga provides an example of a trust fund that was mismanaged due to limitations on its accountability and transparency of governance. I include it in this thesis as an example of a failed trust fund and of the problems potentially inherent in funds derived from sovereignty resources.

4.1 Tonga and the politics of sovereignty resources

The Kingdom of Tonga, the only remaining independent kingdom in Oceania, with allowing the Russian mafia to launder US$70 billion through Nauruan banks in 1998, and threatened to restrict the island’s ability to conduct transactions in US dollars (Hilzenrath, 1999).
consists of several small archipelagos and several outlying islands in the South Pacific (see Map 1). The capital is Nukuʻalofa on the main island of Tongatapu. Of the 169 Tongan islands, 36 are inhabited. Tonga is distinctive among Oceanic countries in that it was never colonized by any foreign power, though it was a British protectorate from 1900 to its formal independence in 1970. Tonga is 748 km$^2$ in size and has a population of about 108,000, nearly all of whom are Tongan. GDP (PPP) per capita was about US$2200 in 2001. Tonga uses its own currency, the Paʻanga.

Tonga’s political system, as a kingdom, is different from its Pacific neighbours. The King—Taufaʻahau Tupou IV—has nearly absolute power. The Tongan Legislative Assembly has 30 seats, 10 of which consist of cabinet ministers appointed directly by the King, 2 are governors of the northern archipelagos of Vavaʻu and Haʻapai and are also directly appointed by the King, 9 are elected by the country’s 33 nobles, and 9 are People’s Representatives and are popularly elected. The King therefore appoints 12 of the 33 seats directly and exerts an influence over the election of the seats reserved for the nobility. Tonga’s Constitution can easily be amended by the Legislative Assembly. Members of the Royal Family own or control the majority of Tonga’s major businesses including its communication, internet, and brewing sectors.

The Tongan economy depends heavily on tourism, fishing, and agriculture, the latter including exports of squash, coconuts, bananas, and vanilla. Remittances from overseas nationals are also important and supplement the subsistence livelihoods of many Tongans. Given this dependence on agriculture and remittances, the Tongan government, and the Royal Family in particular, have attempted to diversify the economy and increase the Kingdom’s revenues by
developing Tonga’s sovereignty resources. These include offshore banking, marine vessel registration, and the sale of passports to non-nationals. Most of these ventures were unsuccessful and brought censure on the government, but continued nevertheless. Nearly all of these projects have been approved or sponsored by the Royal Family, and their activities remain highly secretive.

Tonga’s efforts to establish itself as a offshore banking centre have met with failure. As Van Fossen notes, ‘new offshore banking legislation introduced in 1984 led to the licensing of a number of banks that defrauded depositors. Almost all were deregistered’ (2002, 48). Tonga was unable to enter successfully into a highly competitive industry, largely due to the fraudulent practices of these banks and the consequent stigma attached to the country’s banking sector.

Tonga has also been equally unfortunate in its ventures into flag of convenience vessel registry. In January 2002, the Israeli navy and air force seized the Tongan-registered ship Karine A in the Red Sea. The ship was carrying 50 tons of arms destined for the Palestinian Authority. The weaponry included 122 mm and 107 mm Katyusha rockets with 20 km and 8 km ranges, respectively, 120 mm and 80 mm mortar shells, anti-tank missiles, anti-tank mines, sniper rifles, Kalashnikov rifles, and assorted ammunition (Israeli Ministry of Foreign Affairs, 2002). The capture of this ship provided yet another embarrassment for the government, especially as the country could be perceived as supportive of terrorism. Tonga banned further ship registration in 2002, but 170 vessels still sail under the Tongan flag (Fiji Times, 2002).

Other Tongan ventures, such as the Tongasat satellite company, which controls six orbital slots, and the licensing of Tonga’s top level internet domain, ‘.to’, are thought to be more profitable, but these ventures are controlled by the
Royal Family (Tongasat in particular by Princess Pilolevu Tuita) and do not make public their financial data.

4.2 The Tonga Trust Fund

The Tonga Trust Fund is embroiled in this world of speculative investment and possible corruption. The Legislative Assembly passed the *Tonga Trust Fund Act* in 1989, which, according to Kenneth Bain,\(^\text{30}\) ‘provided for the management of moneys segregated from the ordinary revenues of Government to be used to fund development projects approved by the Legislative Assembly’ (Bain, 1993, 165). The fund quickly became a creature of the Royal Family and reflected its interests.

Fund governance

The TTF is controlled by the King and is managed by three trustees: the prime minister (the King’s son), the minister of finance, and the minister of justice (Van Fossen, 2002, 48-49). These trustees establish investment policy in consultation with the Privy Council (ADB, 2001). Despite the fact that audits were supposed to take place and the results made available to the Legislative Assembly, ‘the objective of the trust fund was clear: to keep the money away from the ordinary budgetary and foreign exchange processes and rules of government (Bain, 1993, 165). As a result, the fund does not release financial information. Table 6.10 presents some limited information about the TTF’s accounts as gleaned by Van Fossen (2002) from Tongan budgetary documents.

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30 Kenneth Bain served as Secretary to the Tongan Government in the 1950s and has published several books about Tonga, including *The New Friendly Islanders* (1993), which received the king’s imprimatur and even included a foreword by the monarch himself.
Generation of fund capital

The Tonga Trust Fund has its origins in the exploitation of a sovereignty resource: the sale of Tongan passports to non-nationals. In 1984 the Tongan government began to sell passports, under an Act of the Legislative Assembly and under the King’s authority, to Chinese nationals through an office in Hong Kong (Moala, 2002). These passports were of two types: Tonga protected persons passports, which were essentially travel documents and did not confer citizenship or the right of residence in Tonga, and special citizenship passports, which granted ‘citizenship’ but did not confer the right of residence or other rights belonging to Tongan citizens. Protected persons passports sold for US$17,000 to individuals and US$25,000 to families, while citizenship passports sold for US$35,000 plus a US$2000 handling fee (Moala, 2002, 78). The government also sold passports to citizens of other countries, including nationals of South Africa, Libya, Thailand, and the Philippines, Ferdinand and Imelda Marcos included (Lawson, 1996, 102-103). Both categories of passports were in a different class from the normal Tongan passports, and did not confer right of residence in Tonga. In total 426 passports were sold under this act and possibly more during other time periods (Moala, 2002; Goodwin, 2003).31

The sale of passports to non-Tongans was challenged by several of the People’s Representatives in the Legislative Assembly, notably including ‘Akilisi Pohiva, the leader of Tonga’s small but influential Pro-Democracy Movement. Pohiva and others challenged the sale on the grounds that passport recipients were

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31 218 of which were sold after the repeal of the 1984 Act in 1988.
not entitled to Tongan citizenship under Clause 29 of the Constitution, which requires five year’s residence in Tonga in order to qualify. At about the same time, purchasers of these passports began to discover that their new Tongan passports, acquired in good faith, were not being accepted as valid travel documents by many countries, including the United States, Canada, and Australia. Purchasers began to demand that the Tongan government take action to normalise their passports.

Faced with challenges from both the local Pro-Democracy Movement and dissatisfied passport recipients, the Tongan government moved to normalise the passports. The challenges had embarrassed the Tongan government and resulted in the Nationality Act of 1988, which repealed the 1984 Act, and the Constitution was amended in 1991 to further clarify the situation. Passport recipients were granted full Tongan citizenship and right of residence. Essentially, as Kalafi Moala, the editor of the Taimi o Tonga newspaper, noted, the government tried to retrospectively pass laws to make legal what they had done illegally (Moala, 2002, 81). The Tonga Trust Fund (TTF) was formed with money from these passport sales.

**Geographies of fund asset distribution**

The majority of TTF assets were deposited into a Bank of America account in San Francisco, though the TTF did invest in other projects as well, though what these were remains uncertain (Moala, 2002, 106, 119; ADB, 2001).

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32 Lawson (1996, 102-103) notes that one of the implications of the passport scandal was the decline in respect for the Tongan nobility; and that women, rather than nobles, were increasingly seen as the real forces behind maintaining Tongan traditions.

33 Kalafi Moala, editor of the country’s ‘opposition’ newspaper Taimi o Tonga [Times of Tonga], is a long-time critic of the Tongan government’s absolutism. He has been arrested and imprisoned in Tonga on several occasions and is currently living in New Zealand, as he is banned from entering the Kingdom.
The chequered history of the TTF did not end with the scandalous source of its assets. The Bank of America cheque account, estimated to contain between US$21 and US$35 million (Moala, 2002; Goodwin, 2003), was discovered in 1994 by a Bank of America employee, Jesse Dean Bogdanoff,\(^{34}\) who, during a routine audit, was surprised to discover so large a sum in a non-interest-bearing account. According to his own story (Goodwin, 2003; Moala, 2002), Bogdanoff made several attempts to contact the Tongan government to suggest other investment options. Not getting any response, he departed for Tonga himself and managed to gain an audience with the King. As his Bank of America contract prohibited Bogdanoff from stealing a client from the Bank, he apparently convinced the King

\(^{34}\) In addition to his employment with Bank of America, Bogdanoff also ran his own company, Wellness Technologies, which specialized in the sale of magnets to cure back pain. He is also an active member of the Buddhist sect Soka Gokkai.
in 1999 to appoint him as a financial advisor to Tonga and was granted the additional title of Court Jester. He was given an annual salary of US$250,000 (Goodwin, 2003).

After several years of providing investment advice and seeing the value of the TTF increase (due in large part to rising global financial markets in the mid 1990s) Bogdanoff persuaded the King to invest a large portion of the fund’s assets (actual amount unknown, but thought to be around US$26 million according to the Tonga Star newspaper) in a Nevada [USA]-based company called Millennium Asset Management Services (MAMS). MAMS invested in viatical settlements, in which the company bought life insurance policies from people with terminal illnesses (often AIDS), was named beneficiary, and then collected a large return on the death of the insured. Bogdanoff claimed that the investment would produce a 30% return in 18-24 months (Goodwin, 2003). TTF assets were invested in MAMS, but failed to produce the desired returns and the invested capital was never seen again. The mysterious vanishing of the trust fund assets (the location or dispersal of the assets is still unknown) provided a second embarrassment for the Tongan government.

In 2002, after several Tongan ministers visited the United States and were unsuccessful in locating the missing millions, the Tongan government filed suit against Bogdanoff in a San Francisco court, charging him with fraud, negligence,

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35 His official title was ‘King of Jesters and Jester to the King’. He was photographed in motley wearing a green, gold, and purple jester’s cap. The basis of Bogdanoff’s claim to this title, as he told the King, was his birthday on 1 April.

36 Other investments of TTF assets, under the direction of Bogdanoff, were in various fly-by-night dot com companies and in a company whose business was the generation of electricity from flywheel devices. Only a small portion of TTF assets went into anything resembling development projects in Tonga and most of these were in the form of loans (Van Fossen, 2002). Some of these loans were listed on the books as TTF assets but had no likelihood of being recovered.
and breach of fiduciary duty. The suit claims that he skimmed about US$5 million off the top and that he received commissions from MAMS itself of up to US$1 million (Goodwin, 2003; Tonga Star, 2002). Bogdanoff claimed that he was misled by MAMS and therefore he is as innocent as the Tongan government. He also claimed that, in any case, the Royal Family merit this financial loss: ‘karmically they deserve it because they have been ripping off the Tongan people for 1000 years’ (quoted in Goodwin, 2003, 19). The response of the King to this scandal (and the loss of the bulk of the TTF’s assets) was to ignore it. The King has made no mention of the trust fund’s losses in any of his public statements.37

4.3 Conclusion

The Tonga Trust Fund differs in part from the other trust funds considered here as it was never intended (except perhaps rhetorically) as a trust in which a government acts as trustee for citizen beneficiaries; the TTF was clearly a creature of the Royal Family. The development aspect of the TTF was not entirely fictitious, in that some loans were made to other government agencies for potentially developmental purposes. Van Fossen (2002, 48) notes that US$10.7 million of TTF assets were listed as accounts receivable from the Tongan government, a sum, however, that is unlikely to be repaid. The TTF invested in overseas assets in an attempt to increase its revenues through high-risk investments rather than to diversify or globalise its portfolio.

37 My requests to the Tongan government for information on the TTF naturally went unanswered, but corroboration for most of the events related here and compiled from journalistic sources was given by Angus Macdonald, Australian High Commissioner in Tonga, in an interview in Nuku’alofa in 2002. The many Tongans I spoke to while on Tongatapu typically expressed great respect for the Royal Family, but were rather more cynical about the government’s investments and those of the TTF in particular.
Tonga’s political climate, as the last bastion of monarchy in the Pacific, may have some considerable bearing on the management of the fund. Anthropologists Patrick Kirch and Marshall Sahlins (1992), in their work on the Hawaiian Kingdom, describe what they call the ‘political economy of grandeur’, in which the status of Polynesian royalty and nobles is linked to personal possessions and the flaunting of wealth. Speaking of royal and noble chiefs in Hawai‘i, Kirch and Sahlins observe that ‘each one felt compelled to demonstrate in the new medium of commercial prowess that he or she was equal to and better than, and same and different from, the others’ (1992, 77). These authors go on to describe the thirst for novelty, the desire to hoard treasure, and the status-enhancing obligation to feed the commoners of the Hawaiian chiefs. They further note that ‘European commodities had a special value as signifying the capacity of the ali‘i [nobles] to incorporate the traditional generative powers of Kahiki, the lands of the sky beyond the horizon’ (Kirch and Sahlins, 1992, 80). I suggest that the Tongan Royal Family is engaged in similar stratagems. The TTF provides a direct source of finance, separate from the national budget, allowing the monarch to pursue traditional Polynesian forms of display. Kirch and Sahlins note that the Hawaiian chiefs’ enterprises ‘came to very little, if not dead losses’ (1992, 81). By following in the same path, the Tongans have brought about the same outcome.

The Tonga Trust Fund, based on the sale of passports to non-Tongans, attempted to convert the sovereignty resource of citizenship into liquid assets through the mechanism of a trust fund. Unfortunately for Tongans, the disastrous investments of the fund did not abide by prudent fiduciary practices and resulted in great losses. The concept of extending sovereignty resource benefits over time failed due to the actions of fund trustees and the lack of transparency in fund
management, which might have prevented such investments from going forward.

5. **TUVALU**

When Tuvalu separated from the Gilbert and Ellice Island Colony, and what became the Republic of Kiribati, it was one of the most marginalised states on Earth. The country had no resource base—unlike Kiribati and Nauru it had no mineral resources—and did not possess a trust fund dating from the colonial era. When Tuvalu separated from Kiribati in 1978 it was unable to claim a share of the trust fund established in the Gilbert and Ellice Islands Colony. Yet Tuvalu was aware of the importance of this fund, and how it helped stabilise the economy of a marginal atoll state. Tuvalu had no resources upon which to build a trust fund—even its sovereignty resources, such as the sale of postage stamps, were insufficient—but it was able to convince a consortium of donor countries to help it establish a trust fund with donor aid money. This fund, the Tuvalu Trust Fund, was modelled after that of Kiribati and has performed equally well. Tuvalu’s trust fund is distinctive in that it is based on a novel use of foreign aid that has benefited both Tuvalu itself as well as the donor countries. As in the case of Kiribati, Tuvalu’s fund invests offshore in primarily fixed income and equity investments. Tuvalu is now able to finance its recurrent expenditures without foreign assistance.

5.1 **Tuvalu and the problems of remoteness**

Tuvalu is a small Polynesian state in the South Pacific and is one of the world’s smallest countries (see Map 1). The country was formerly part of the British Gilbert and Ellice Islands Colony but was reluctantly granted independence by the British in 1978, after insisting on separating from the remainder of the colony,
which went on to become the Republic of Kiribati in 1979. Tuvalu consists of nine small islands comprising 26 km\(^2\). The capital is Vaiaku on the atoll of Funafuti and the population numbers about 11,000, nearly all of Tuvaluan ethnicity. Tuvalu is one of the world’s most isolated states, and can only be reached by air twice per week on 21-seat propeller aircraft flying from Suva, Fiji. There is no air service between the nine islands of Tuvalu and a single ship makes deliveries and carries passengers between islands. GDP (PPP) per capita is about US$1100 and most Tuvaluans participate at least partially in subsistence livelihoods, though some revenue is gained from copra exports and fishing licences granted to overseas fishing fleets. Like Kiribati and Nauru, Tuvalu uses the Australian dollar as its currency. Tuvalu is isolated and resource poor, and it was for this reason that the British were hesitant about granting independence to Tuvalu. The islands of Tuvalu have infertile soils, and the country is prone to natural disasters including cyclones and tsunamis (Mellor, 2003). The country has, nevertheless, made good use of its sovereignty resources.

5.2 The Tuvalu Trust Fund

When Tuvalu become independent in 1978, it was ‘almost penniless’, and the conditions of independence were harsh on the country.\(^38\) For example, the new nation had no moveable property except for one ship. Financial reserves were negligible (Tuvalu, 1988). The country lacked such basic amenities as paved roads and street lighting, had few motor vehicles, no overseas representation, and depended on foreign air carriers to connect it with the outside world. The country

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\(^{38}\) Interview with Panapasi Nelesone, Secretary to Government, Funafuti, 2002.
depended on continued foreign assistance—reluctantly given, as the British had opposed Tuvaluan independence—to finance all government activity. Budget deficits were penalized with threats of a reduction in the amount of foreign aid.\footnote{Interview with Panapasi Nelesone, Funafuti, 2002.}

In the late 1970s, in the early years of Tuvalu’s independence, the only resource income was the sale of postage stamps to foreign collectors. This sovereignty resource provided a small amount of independent income to the state. Tuvalu issued a variety of stamps, often reflecting foreign, non-Tuvaluan themes, as these appealed to collectors. Even today the country continues to sell postage stamps to foreign collectors.\footnote{It is interesting to note that these stamps are printed almost entirely for overseas sales. Even the Tuvalu post office does not carry most of the stamps, which must be purchased from the Philatelic Bureau. Among collectors, Tuvaluan stamps are much rarer when they have been posted, rather than when they are unused.} The investments made through philatelic sales were disappointing, however, and this was due to the inadequacies of the public accounting system, which obscured the vulnerability of the economy, resulting the in the accumulation of foreign debt (Tuvalu, 1988). Given the limited financial income derived from the philatelic business, Tuvalu was continually seeking long-term aid commitments from donor countries, and especially from the UK (Tuvalu, 1984).

Henry Faati Naisali, the Tuvaluan Minister of Finance, was aware of the Kiribati trust fund and wanted to replicate it in Tuvalu; he realized that the fund was working well for the newly-independent nation of Kiribati and was disappointed that the terms of Tuvaluan independence did not include a share of that fund. Naisali proposed to the British government that it grant Tuvalu a larger sum of international aid money in advance, which could be used as the basis for a
trust fund, instead of responding to annual requests for aid from Tuvalu (Bell, 2001).

This initial request was turned down by the British. Naisali then went to Australia and New Zealand in an attempt to convince these donors to contribute to a potential Tuvaluan trust fund; he further asked Australia and New Zealand to help him convince the British to contribute as well. As Naisali noted years later, ‘my objective in seeking to establish the Trust Fund was to give Tuvalu political independence through the achievement of a greater level of financial independence. Future generations of Tuvaluans will have greater freedom to set their own destiny’ (Tuvalu Trust Fund, 1997).

Naisali also used the terms of the Philatelic Agreement signed between the British and Tuvalu governments in 1983 as a further argument in support of a trust fund. This agreement specified that the sum received from the sale of a ‘leaders of the world’ series of postage stamps would be placed into a separate fund called the Special Philatelic Fund, which would be invested and fund earnings used to finance recurrent expenditures of the Tuvalu government (Tuvalu, 1984). This meant that the idea of a trust fund began appearing in formal agreements within five years of Tuvalu independence.42

Naisali continued his campaign to solicit aid donations to a potential Tuvalu trust fund, and he hired several Australian consultants to advise on the matter. In 1983, the UK government announced that budgetary support for Tuvalu would decrease substantially (by about $100,000 per year) beginning in 1987, 41 Interview with Panapasi Nelesone, Funafuti, 2002.
42 The Tuvalu Provident Fund, a pension fund for retirees, was established in 1984, to which the employee would contribute 5% of earnings matched by the employer, with the benefit payable as a lump sum upon retirement (Tuvalu, 1984).
forcing Tuvalu to consider alternatives for generating revenues (Tuvalu, 1988). The country considered three possible strategies: increasing direct and indirect tax rates, balancing the budget by cutting fiscal expenditure, and seeking alternative sources of revenue. The first two strategies ‘were politically unacceptable and were therefore not pursued’ (Saitala, 1995, 46).

The break for Naisali came in 1984, when during a personal meeting with UK Prime Minister Margaret Thatcher, he was able to convince Thatcher to support his idea for a Tuvalu trust fund, based on arguments that Tuvalu was badly treated after its independence, when all of the GEIC trust fund went to Kiribati (B. Macdonald, pers. comm., 2002). In 1985 the potential donors—the UK, Australia, and New Zealand—each commissioned independent studies on the merits of establishing a trust fund in Tuvalu. These reports supported the fund in concept, noting that it would help stabilise the economy of Tuvalu and reduce its annual requests for donor aid. The Australian report also advanced a further argument in favour of the trust fund, namely that:

The fund appears best suited to countering unwanted advances by the USSR. Without the security of government revenue provided by the fund, Tuvalu would appear more prone to difficulties in dealing with the Soviets (Fisk and Mellor, 1986, 112).

The consultants also noted that previous investment revenues from the National Bank of Tuvalu and the Philatelic Fund were held overseas, and this practice was consistent with the aims of the proposed Tuvalu trust fund (Fisk and Mellor, 1986). Now that the green light was given by the three potential donors, who had
committed to providing funds, the Tuvalu Trust Fund (TTF) was established in 1987, and codified in an international agreement signed by the governments of Australia, New Zealand, the UK, and Tuvalu (Tuvalu Echoes 93, 1987; Australia, 1988). Each of the three donor countries reserved the right to withdraw its initial capital from the fund (though not the earnings), and maintain a seat on the trust fund board. The donors were thus granted substantial involvement in and oversight of the affairs of the TTF.

Fund governance

The TTF differs from the other trust funds considered in this thesis in that it has substantial participation from outside countries, and the fund’s management is partially in the hands of these initial donors. The TTF is administered by a Board, chaired by the Minister of Finance of Tuvalu, with representatives from each of the three major initial donor states (UK, Australia, and New Zealand) and with the Tuvalu Permanent Secretary of Finance as the secretary of the Board. The Board sets general investment guidelines and supervises investment transactions, which are conducted by independent private investment firms based in Australia. At present these are INVESCO and Citigroup. Another investment firm, Watson-Wyatt, also based in Australia, is the fund’s monitor.43

An oversight role of the Board’s activities is given to the trust fund’s Advisory Committee. Initially the UK pushed for a kind of policing committee that would audit ‘just about everything’ concerned with the TTF.44 However, a compromise was reached when Australia and Tuvalu ‘came to [Tuvalu’s] rescue’,

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43 Interview with Solofa Uota, Permanent Secretary of Finance, Funafuti, 2002.
44 Interview with Panapasi Nelesone, Funafuti, 2002.
arguing that such an invasive policing committee was unnecessary and that an Advisory Committee, together with an independent fund monitor, could handle the work of oversight and monitoring. The Advisory Committee contains representatives from the three donor states plus Tuvalu itself. The Advisory Committee meets twice per year and its role is limited to advising on investment policy. Altogether, about 19 people have some management role in the TTF.

The structure of the TTF is similar in outline to that of the Alaska Permanent Fund, in that it consists of two component parts. In Tuvalu these are known as the ‘A’ Account and the ‘B’ Account. The A Account is the corpus of the fund, and includes the sums donated by the three donors, plus occasional additional donations (some of them from other countries, such as Japan), as well as contributions from the Tuvalu government. This fund generates earnings, a portion of which is redeposited into the fund in order to offset inflation and maintain the real value of the fund. The Australian inflation rate is used as the basis for determining the amount of inflation-proofing redeposited into the A Account. The remaining income, as well as other windfall revenues, is deposited into the B Account, which also generates an income that is redeposited. The B Account may also make transfers to Tuvalu’s consolidated revenues, which must be approved by parliament and included in the Tuvalu budget. The capital in the A Account can be withdrawn only as a last resort, whereas the B Account acts as a cushion for use

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46 Interview with Solofa Uota, Funafuti, 2002.
48 Recently the B Account has been renamed the Consolidated Investment Fund (CIF). I use the term B Account in this thesis, however, as the CIF still commonly goes by that name in Tuvalu.
49 Interview with Solofa Uota, Funafuti, 2002.
50 Interview with Panapasi Nelesone, Funafuti, 2002.
during economic downturns. In general, the A Account is the responsibility of the Board, in which the donors still have a stake. The B Account is the responsibility of the Tuvalu government. Whenever the Tuvalu budget is in surplus, the surplus funds are placed in the B Account.

**Generation of capital**

As noted in the above section, the original source for the TTF’s capital was foreign aid donations, which were advanced to Tuvalu as a lump sum rather than being annually requested and budgeted. The idea was to allow the Tuvalu government to assume control and responsibility for its finances, rather than having to depend on annual aid solicitations (Tuvalu, 1984). Several other donors, such as Japan and South Korea, have also made small contributions to the TTF. Tuvalu budget surpluses and extraordinary earnings are also deposited into the fund, including those from the sale of the internet ‘.tv’ rights (discussed below).

Table 6.11 illustrates the growth of the TTF from its inception in 1986, with an opening balance of $26.4 million, of which Tuvalu’s contribution, or share, was $1.6 million. At that time the Tuvalu share of the fund was very small. Over the past two decades both the overall fund balance and Tuvalu’s share have increased substantially. Tuvalu’s share is now approaching half of the total balance of the fund. The fund balance in 2002 was $76.7 million, of which just under 10% was held in the B Account, where it is available to the Tuvalu government for drawdowns. Stock market performance in the late 1990s contributed to the rapid growth in fund assets during this period.

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51 The B Account functions in a manner similar to that of the Earnings Reserve Account of the Alaska Permanent Fund. See Chapter 5.
Table 6.11. Tuvalu Trust Fund Balance, A$ millions

<table>
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<tr>
<th>Date</th>
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<tr>
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</tr>
<tr>
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</tr>
<tr>
<td>2002b</td>
<td>32.2</td>
<td>76.7c</td>
</tr>
</tbody>
</table>

Table 6.11. Tuvalu Trust Fund Balance, A$ millions

a Balances as of 30 September for each year, except for opening balance
b Estimate
c $7.2 million of which is in the B Account in liquid assets

Geographies of fund asset distribution

At present, the TTF invests about 70% of its principal in aggressive assets (mainly equities) and about 30% in defensive assets (mainly fixed income securities), with the majority (about two-thirds) of assets in Australian dollar-denominated investments. A recent Board decision, reflecting downturns in international stock markets, has determined that the fund should invest equally in aggressive and defensive assets.52 All equity and fixed income assets are located outside Tuvalu,

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52 Interview with Solofa Uota, Funafuti, 2002. Today the benchmarks for investment are: Growth Assets: Australian shares 25%, international shares 20%, real estate 5%; Non-growth assets: Australian fixed interest 15%, international fixed interest 15%, liquid assets 20% (INVESCO Australia, 2002; Citigroup Asset Management, 2002).
largely in Australia, the USA, Asia, and Europe. The fund’s sole real estate
investment is in Fiji, and consists of the building housing the Tuvalu diplomatic
mission and employee residences in Suva. Thus the entirety of the TTF’s assets is
invested outside the country, separating the site of capital generation from capital
investment.

A further interesting aspect of the spatiality of Tuvalu’s resources and
investments lies with its revenues from the internet ‘.tv’ top-level domain. In the
early 1980s the Internet Assigned Numbers Authority (IANA) assigned each
country a two-letter internet domain, which for Tuvalu was ‘.tv’ (AusAID, 2002;
Hanley, 2004). This, by sheer accident, was a desirable ending, of very little use to
Tuvalu itself (the country does not maintain many internet sites and it does not
even have television) but of interest to foreign corporations, especially those in the
television and telecommunications industry. The ‘.tv’ ending could also be
licensed to individuals who may want to set up their own website at rates lower
than those for ‘.com’ and other such top-level domains.

Several investors were interested in acquiring rights to the ‘.tv’ domain,
which they could then on-license to other users. In 1997 Tuvalu negotiated with a
Canadian company, which submitted the winning tender, to licence the domain,
but this company defaulted. In 1999 Tuvalu signed an agreement with DotTV
Corporation, based in the USA, giving them the rights to market and manage the
‘.tv’ domain, and paying Tuvalu a royalty of $1 million per quarter plus 20%
equity in the company. Several payments were made, and Tuvalu received $5
million in royalties before DotTV Corporation also ran into financial trouble and
was bought out by Verisign, the same company that licenses the ‘.com’ domain,
among others. The new royalty agreement provided about $500,000 per quarter
plus 5% of quarterly revenues over $5 million. Some of this income was deposited into the Tuvalu Trust Fund but much was used for infrastructural development, including paving the Funafuti’s roads, installing street lighting, and paying the admission fee of $50,000 to join the United Nations (Hanley, 2004). Tuvalu thus benefited from a cyber-resource that is spatially abstract.

Distribution of fund earnings

A portion of the Tuvalu Trust Fund’s earnings are redeposited into the fund, in order to offset against loss in real value due to inflation. The amount redeposited is determined by the rate of inflation in Australia (Tuvalu, 1995). Any sum remaining after this redeposit is transferred to the B Account. B Account capital can then be drawn upon to make up shortfalls in the Tuvalu national budget, helping to finance government services for Tuvaluans.

5.3 Conclusion

The Tuvalu Trust Fund is highly regarded both in Tuvalu and by external assessors (AudAID, 2002; Mellor, 2003; Saitala, 1995; Tuvalu, 1995). The trust fund has allowed Tuvalu to transform its sovereignty resources—donor aid and internet domains—into state-administered financial assets that generate earnings used to finance government activity. As a consequence, Tuvalu has no national debt and can independently finance its own budget, without depending on continual aid

53 Also interview with James Conway, Funafuti, 2002.
54 Also interviews with Saufatu Sopoanga, Prime Minister of Tuvalu; Bikenibeu Paeniu, Minister of Finance of Tuvalu and former Prime Minister; Solofa Uota; Panapasi Nelesone; and James Conway; Funafuti, 2002. The trust fund is also highly regarded by other Tuvaluans, who are aware of the fund and have positive feelings towards it.
from foreign donors (foreign aid is still used to finance specific and non-recurring projects, such as hospitals and airstrips). Tuvalu has effectively deployed the model outlined in this thesis, of investing externally in order to generate a stream of sustainable revenues that can finance development needs. This is especially important in a country in which only about 25% of the population is engaged in the formal economy (Fairbairn, 1993).

At present, Tuvalu is satisfied with the progress of its trust fund, though there is some discontent over the continuing involvement, after almost two decades, of the three main donor states. Bikenibeu Paeniu, the Minister of Finance and former Prime Minister of Tuvalu, noted in an interview that the TTF is still too much controlled by the donors, and that this inhibits the ability of Tuvalu to solicit additional contributions from other countries because the fund is seen as a ‘creature of the donors’. The Minister also noted that any changes to the international agreement that governs the TTF had to be tabled in the parliaments of four countries, making it difficult to amend. Though the TTF has performed well and has been well managed, the Minister hinted that the presence of the donors continues a kind of neo-colonial tradition that limits the sovereignty of Tuvalu. He also noted that Tuvalu’s financial position is ‘naked’ to the donor countries: too visible, and that this open position reduces Tuvalu’s bargaining position in negotiations. Yet the donors are reluctant to remove themselves.

Despite these gripes, the fund remains popular with the vast majority of Tuvaluans. The success of the TTF has prompted the Tuvalu government to develop an Outer Island Fund (known as the Falekaupule Fund), which targets

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55 Interview with Bikenibeu Paeniu, Funafuti, 2002.
56 Interviews with Bikenibeu Paeniu and James Conway, Funafuti, 2002.
development in the outer islands (i.e., not Funafuti). This fund was established with $2 million, the principal coming from an Asian Development Bank loan as well as a community contribution. Earnings from the investment of this fund are returned to the island communities, which can submit proposals for local projects, although the exact financial mechanisms have not yet been determined. The general aim of this fund is to reduce migration from the outer islands to Funafuti.

Tuvalu, by following the model outlined in this thesis, has been able to transform itself from a penniless newly-independent state into one that can independently provide for the welfare of its citizens, reducing and even eliminating the need for foreign aid and private remittances. By separating the sites of capital generation and capital investment, Tuvalu can sustainably finance its recurring expenditures.

6. CONCLUSION

This overview of four Oceanic funds has revealed interesting similarities and differences. Though located in a common region, with a broadly similar cultural background, the four Oceanic states have pursued differing fiscal and investment policies, and have thus achieved differing performance outcomes. In some respects, two of the Oceanic countries, Kiribati and Tuvalu, have more in common with the investment practices of Alaska than they do with their neighbours in Nauru and Tonga.57

Kiribati, like Alaska, drew on a mineral resource (now depleted) to

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57 And, in some respects, the overall investment philosophy of Nauru had much in common with the earlier investment policy of Alberta, in terms of investing primarily in loans to other government agencies and within the state.
establish a trust fund, saving a portion of resource revenues and investing them outside Kiribati. Kiribati invested offshore, where investment returns are potentially greater and whereby risks can be reduced through diversification. Tuvalu, though lacking a mineral resource base, was able to use sovereignty resources—donor aid and its internet domain—to generate revenues that could be invested in government and development activities even though the site of investment was external. Nauru and Tonga had problems with their trust funds, partially based on the philosophy of investing internally (as did Alberta) and partially based on poor management practice, and especially the lack of openness and transparency in fund governance. These issues are explored in comparative perspective in the next chapter.
1. INTRODUCTION

The six trust fund cases examined in depth in the preceding three chapters illustrate various degrees of success in achieving the development goals of each state. This chapter identifies six key criteria that determine the relative performance of each fund, assessing their ability to sustain and equitably distribute natural resource revenues. These six criteria are:

1. **Investment Policy**: whether to invest in capital (infrastructure) assets or in financial (portfolio) ones.

2. **Investment Location**: whether to invest onshore (locally) or offshore (globally).

3. **Benefits Distribution**: whether to distribute fund benefits (usually fund earnings) directly to individuals (through dividends) or through the provision of collective goods (by the government).

4. **Governance and Management**: whether the fund and its management are open and transparent to the beneficiaries, or whether this information is kept secret, and the nature and degree of public input into fund decision making.

5. **Protection**: whether the fund’s assets are protected from misallocation by the trustees, and whether legal structures exist to prevent fund asset depletion without permission of the beneficiaries.

6. **Permanence**: whether the fund is intended to last in the long term or permanently,
These six criteria help determine the ability of each trust fund to provide a sustained and equitable distribution of fund benefits to the beneficiaries. The preceding chapters have identified certain special or unique features of each fund. These include such features as the Alaska fund’s payment of dividends to individuals, Alberta’s heavy investment in non-income producing capital assets and its largely onshore investment policy, Nauru and Tonga’s tradition of fund secrecy and limited public involvement, and the legal protection given to the trust funds in Alaska and Tuvalu, the former by constitutional amendment, and the latter by an international treaty. In this chapter, these six criteria are examined in greater depth and the various policies of the six funds are compared.

2. INVESTMENT POLICY: CAPITAL ASSETS OR FINANCIAL ASSETS

Investment policy is a key issue in determining why some trust funds contributed to greater levels of social welfare and equity. In general terms, fund assets can be directed towards either financial or capital investments. Financial investments include shares, bonds and other forms of fixed income securities, and real estate (where investment in real estate is a form of speculation or for income production), whereas capital investments consist of physical plant and infrastructure. In the former case, the principal goal is to produce a high and stable income with a low level of risk over the long term, while in the latter case social welfare goals (in a broad sense), such as the provision of employment or the diversification of the economy, may be paramount.

The investment policy pursued by a trust fund shapes the overall character
of the fund. Some funds, such as that of Alaska, have a strict ‘trust’ function; others, such as Alberta, are ‘developmental’ funds. As described in Chapter 5, the Alaska Permanent Fund resulted from a compromise among various interest groups, each with its own conception of what the Alaska fund should be. This compromise resulted in a fund with a clear ‘trust’ function; that is, it was to capture a share of the revenues derived from petroleum exploitation and invest these for the long-term financial benefit of all Alaskans, including future generations. To do so, the fund could not favour particular projects, which also meant that it tended to invest nearly all of its assets outside the state. Alberta, on the other hand, established its Alberta Heritage Savings Trust Fund with ‘developmental’ goals. The fund was to provide an alternate source of investment capital replacing that of Eastern Canadian banks, and was to intervene in the Alberta economy to diversify it (beyond what the market was doing). The ‘trust’ and ‘developmental’ goals of these two funds dictated different investment policies.

The distinction between financial and capital investment is perhaps the most fundamental decision facing fund trustees. The factors dictating a particular choice are complex and case-specific. Nevertheless, some common issues face all trust funds:

1. Fund trustees need to determine the basic purpose of the fund: is it to provide investment capital for development projects, or is it to provide income for government use or individual use?

2. How is conflict between interest groups avoided? Windfall revenues create the potential for rent-seeking, in which interest groups (non-productively) compete for a limited pool of fiscal resources, each wanting their own special project financed.
3. Windfall rents, entering a small economy, may lead to an inability to decide how to spend this new income. Saving resource rents in a trust fund may be a default procedure, rather than part of an overall fiscal strategy.

4. Political issues emerge when resource rents accrue to marginal regions, which often harbour feelings of resentment against political and economic centres. New income may provide support for articulating an ‘anti-colonialist’ discourse.

5. Fund trustees must decide if the fund’s primary function is to stabilise the economy. If so, then fund assets must be liquid (not capital assets) in order to draw them down quickly.

The choice of whether to invest in financial or capital assets is thus both politically and economically driven.¹ Each of the five points noted above depends on political circumstances within the state. If fund trustees seek to enhance state revenue, they must avoid doling out fund capital to special interests. They must also design an overall fiscal strategy that allows the trust fund to expand while staving off public pressures for reduction of taxes and an increase in state services. If, on the other hand, fund trustees are more interested in intervening in the structure of economy, then they may decide to use the trust fund as the vehicle for intervention. This means that the trust fund could be viewed as a kind of development bank, financing capital projects and negotiating with key interest groups to buy their support (by financing their projects).

The desire for government intervention in the economy often stems from dissatisfaction with the way the capital market is working in the state. In the case of sub-national states, this dissatisfaction might be directed against either the

¹ The decision to invest locally is largely a political choice, whereas the decision to invest in global financial markets is a rational economic choice.
national government or other sub-national states, or both. In the case of developing independent states, dissatisfaction might be directed against international finance agencies (such as foreign commercial banks or the World Bank) or against developed nations in general. In each case a trust fund provides an alternative source of investment capital that responds to perceptions of marginality.

The selection of an investment policy entails consequences. For example, the distribution of risk can differ greatly between forms of investment. Risk can be reduced through a diversified portfolio of financial investments, which are invested in a basket of international currencies and markets. Capital or developmental investments, however, are all made in local currency, and within the same state. Thus an economic downturn within the country or region can seriously affect the performance of capital assets.

Financial investment reduces the potential for interest group conflict, because no group can claim that others have profited from investment decisions (because most financial investment is external—this is discussed in a later section). Conversely, capital investment is often highly visible—a tangible asset. It is usually local and non-mobile. Beneficiaries of the fund see their assets ‘at work’—such as in the recreation areas, rolling stock, grain terminals, rural telephone service, and other infrastructure financed by the Alberta Heritage Savings Trust Fund. In Alaska, where the Alaska Permanent Fund’s investments are almost entirely financial, citizens have only their annual dividend cheque as a tangible proof of their fund’s existence. In the Pacific cases of Nauru, Kiribati, and Tuvalu, the financial investment policies of the trust funds or the use of the fund revenues are aimed at funding government services, and thus the funds and their assets remain invisible to beneficiaries. It is not difficult to imagine a case where this
visibility of assets leads residents to call for abolishment of the fund in times of fiscal crisis.

Economic stability is also a consequence of investment policy. Some trust funds—such as those of Kiribati and Tuvalu—serve a specific stabilization function, and others may have the same purpose in a more occluded way. A stabilization fund is interventionist, but does not aim for economic diversification. Rather, stabilization funds attempt to even out economic activity over periods of boom and bust. The fund will collect revenue at a higher rate during boom periods, when rents are high, and disburse them during bust periods, when the economy is sluggish and there is a shortage of capital. In order to slow down the entry of rents into a small economy during a boom period, the government may decide to sterilize rents—externalise them and prevent them from entering the local economy—by investing abroad. Investing locally in nongovernmental financial assets ‘would transmit resource revenue volatility to the economy’ (Davis et al., 2001, 17). This issue is more fully discussed in the section on investment location.

A key element of a capital investment policy is diversification of the economy. Diversification, as a conscious government policy, goes counter to the ideology of the ‘laws of the market’, which argues that if an economic opportunity existed (such as a new industry or sector) then private capital would move in and exploit it. Both Alaska and Alberta are historically marginal economies (in a national sense) based on primary sectors. Alberta harboured an historic grudge against the perceived centres of Canadian economic power in Ontario and Québec, as described in Chapter 4. The windfall revenues deriving from oil price increases, captured and invested in a trust fund, allowed Alberta to claim its place under the Canadian economic sun. The Alberta Heritage Savings Trust Fund had an
 enormous symbolic importance, as a sign of Western Canadian economic ascent, in addition to its more practical purpose as an alternative source of development capital in Alberta (Pretes, 1988).

Financial vs capital investment is perhaps the most basic policy choice facing fund trustees. Reasons for choosing among these alternatives are both political and economic, and include questions of whether the fund is to serve as a source of income (for individuals or the state) or as a source of capital (which is expected to generate future income), whether the state is interventionist or not, and the relationship between the state and powerful interest groups that clamour for a share of the wealth. Consequences of these policy choices include issues of the distribution of risk, of liquidity of assets, on whether income is generated, and on the ability of the state to intervene beyond the market.

3. INVESTMENT LOCATION: ONSHORE OR OFFSHORE

A second issue for fund trustees is the choice of where to invest. In some respects the choice of investment location is the paramount factor in the fund’s pursuit of economic development. As noted in Chapter 1, trust funds may serve as part of a development strategy that deviates from the mainstream concept of structural economic transformation in stages. Investing outside the local region separates the sites of capital generation from the sites of investment. The flow of capital from a peripheral to a core region might be advisable when the periphery contains limited investment opportunities.

The distinction here is between investing within the boundaries of the state (within the region covered by the trust fund), or investing beyond these, for example in national or international financial markets. The choice of investment
location is often closely related to the overall goals of the fund (fiscal or social) and the type of investment (financial or capital), and there is also the issue of visibility—whether fund beneficiaries see their investments in action.

The most basic determinant of investment location is the relative marginal position of most trust fund economies. As discussed in Chapter 2, trust funds are in part a response to a (perceived) peripheral position in a national or international economy, and reflect a desire on the part of the state to use natural resources to diminish economic and political marginality. Marginal economies are typically defined by their dependence on the primary economic sector (especially mining or agriculture) and on their remoteness from markets. Marginal economies—such as Alaska, Alberta, and the four Pacific islands discussed in this thesis—usually desire some greater contact and involvement with global markets. Setting up a trust fund is one way of decreasing marginality, by providing a new and independent source of investment capital as well as additional state revenue.

Paradoxically, the marginal position of resource-dependent economies (such as the five cases included here) stimulates the desire for local development but provides limited opportunities for local investment. Under the assumptions of free market economies, it is assumed that worthwhile investment opportunities will not go unexploited: non-local capital will move in whenever an attractive investment project presents itself. If non-local capital fails to move in, it suggests that the risk-adjusted returns are too low for private investors. This is the perilous investment situation into which some fund trustees have chosen to plunge, and, as we shall see, often to their detriment.

Internal investment means investing within the state or region covered by the trust fund. These investments are typically in capital projects, as financial
investments are normally not constrained by state boundaries (unless, however, they are partly government-owned). Internal investments are typically a policy choice of interventionist governments that are dissatisfied with the hand they have been dealt, so to speak, by the market. Interventionist governments may choose to invest internally in order to achieve economic diversification, to subsidise domestic tradeables sectors, to provide employment and other social benefits, to reduce the tax burden, and to visibly demonstrate fund operations.

Economic diversification was a clear goal of the Alberta government in the 1970s and 1980s. Hitherto, the province had been largely dependent on two industries, agriculture and petroleum. With the price rises in petroleum in the 1970s, Alberta received windfall rents from provincial oil lands. These unusual revenues allowed the province to finance its diversification policy. For example, money was invested in petrochemical industries and in the recovery of oil tar sands. The province was also determined to become a leading Canadian centre of medical research, and invested trust fund moneys in research facilities in both Edmonton and Calgary (mainly at the two universities and their allied hospitals). Alberta also subsidised several industries, notably agriculture (the traditional economic base and the source of many votes), by financing their infrastructure. The provincial government used Alberta Heritage Savings Trust Fund capital to construct a grain terminal in Prince Rupert, British Columbia, allowing Alberta farmers to export their grain to Asia at a lower cost and also by bypassing the overused facilities in Vancouver. The government purchased additional rolling stock, increasing the capacity for grain export by rail.

Employment generated by Alberta Heritage Savings Trust Fund investments is more difficult to quantify, but certainly the construction of
infrastructure, such as that noted above, created new jobs, as did Heritage Fund
subsidies on home mortgages (which increased housing construction). That is but
one example of the multiplier effects of provincial spending on employment.
Alberta is unique in Canada in not having a provincial sales tax. This tax, which is
as high as 12% in some provinces (e.g., Newfoundland), is considered by many
Albertans as almost an affront to their petroleum-rich economy. Even in times of
fiscal crisis, such as the ‘bust’ period with low oil prices in the late 1980s, the
provincial government refused to impose a provincial sales tax. In every case the
argument made was that consumers should not be taxed when the province is
simultaneously depositing ‘excess’ revenue into a trust fund. Finally, internal
investment, in capital assets, demonstrates tangibly the province’s commitment to
providing amenities for residents. Fund investments such as provincial recreation
areas and rolling stock are emblazoned with the Heritage Fund logo, leaving no
doubt about where the money supporting these projects comes from.

Internal investment, in a marginal region, faces limited opportunities. In
Alberta, the provincial government, despite its diversification ambitions, found
relatively few opportunities for investment. Many of these were related to the
petroleum sector (such as petrochemicals and oil sand extraction) or to
agriculture—hardly real sectoral diversity. Development opportunities—despite
available capital—were lacking in most manufacturing and service industries,
often due to the distance from markets. Internal investment in capital projects also
meant that the provincial government had to negotiate among competing interest
groups about whom to fund, and, not surprisingly, tended to fund projects of those
groups supporting the party in power. Mortgage subsidies were clearly designed to
buy support for the Progressive Conservative party, especially when they were
announced just prior to an election. This favouritism alienated other interest groups that felt less well served, especially urban voters. Finally, conspicuous internal investment antagonised other provinces that were less well endowed, very nearly precipitating a crisis in the Canadian federal system. Many provinces, especially those in Eastern Canada, complained that Alberta was exporting high oil prices, and reaping the benefits financed by Eastern Canadian consumers.

A further consideration is the performance of internal assets, especially when they take the form of capital projects. Many of the Heritage Fund’s capital investments produce no income, especially when these investments take the form of government subsidies. Capital projects often generate no revenue themselves but they can have high maintenance costs—costs that continue beyond construction. For example, trust fund money financed the Kananaskis Country provincial recreation area in the Rocky Mountains near Calgary, but the province pays maintenance costs for the park out of general revenue. It should also be borne in mind that investing internally is really a case of putting all of one’s eggs into one basket. If Alberta is in recession, most or all of its investments will be in recession as well. Thus internal investment may provide social benefits, but it is a risky strategy financially.

External investment has been the policy choice of trust funds in Alaska, Kiribati, and Tonga, and Tuvalu (and to some extent in Nauru). These funds are oriented towards savings in a strict ‘trust’ sense. Their purpose is to save resource revenues and invest these to generate income, income that is geared towards replacing the direct revenues from depleting natural resources. These funds thus give financial criteria—high return and low risk—a much greater importance than providing local social benefits, as in Alberta. Given that all four of these places are
marginal regions with small, open, marginal economies (perhaps less so in the case of Alaska), fund trustees have chosen to eschew local investment in favour of better returns and lower risk elsewhere. Engaging globalisation through offshore investment has been a conscious strategy of these places.

To invest externally is also to accept that capital markets generally work, and that if local projects were potentially profitable outside capital would move in and exploit them. External investment allows for a diversified portfolio, incorporating a mix of equity and fixed income securities as well as (non-local) real estate. The Alaska Permanent Fund invests largely within the United States (in US dollar denominated investments) but has increasingly shown a tendency to invest overseas as well. Thus the Alaska fund’s investment portfolio is diversified both in type of investment (shares, bonds, real estate) and in location of investment (e.g., California, New York, Japan, Korea). Fund capital is relatively liquid and can be moved around easily, with an ability to exploit the best investment opportunities. As investments are in different currencies, fluctuating exchange rates provide both additional income (through arbitrage) and by hedging against devaluations.

The trust funds in Nauru, Kiribati, Tonga, and Tuvalu have pursued a similar strategy. Nauru’s investments, mostly in the form of real estate, were largely outside the country (though recent revelations, discussed in Chapter 6, suggest that a substantial amount of investment was in the form of internal loans to other Nauruan government agencies), scattered throughout the Pacific. The Nauru Phosphate Royalties Trust’s most famous investment, and its most visible, was Nauru House in Melbourne. This large office building provided not only rental income but also made a statement about Nauru’s economic success, especially to
an Australian audience. Other Nauruan real estate investments were in other parts of Australia as well as in the US mainland, Hawaii and Fiji. Nauruan financial investments were largely in Australian securities, which made sense as Nauru uses the Australian dollar and has historical connections to the country.

Kiribati and Tuvalu also invest heavily in Australia, for similar reasons. Furthermore, the legislation governing their trust funds requires that a high proportion of fund investments must be in Australian dollar denominated securities. Kiribati and Tuvalu both use the Australian dollar and their funds make use of Australian investment advisers and custodians.

In three of these cases, fund managers have chosen to make what they consider to be the best investment (high return, low risk), wherever it may be. Financial returns have therefore been quite high. Alaska’s fund, for example, has consistently been one of the best performing investment trusts in the United States, outperforming many market indices by a wide margin in most years. Kiribati and Tuvalu’s funds have also increased in value since their inception, again due to secure but high-performance assets (the cases of Tonga and Nauru are more difficult to assess, see Chapter 6). Thus external investment is the ideal choice for fund managers who want to generate earnings with relatively low risk.

A final consideration with respect to external investment is that it tends to be accepted by most if not all interest groups. No group can claim that someone else is benefiting, because the investments are beyond the reach of all. As discussed in Chapter 5, when the Alaska Permanent Fund was proposed and debated, different groups had different ideas about what shape the fund could take. Developers, not surprisingly, hoped that the fund would finance capital projects—projects from which they would directly benefit. Many consumers hoped for tax
relief, or more funding for education, or for more state highways. But, once again, such investments would only benefit select user groups. Investing outside the state, while satisfying no one in the sense of direct benefit, had the advantage of equity, while providing a communal benefit for the entire state by generating more state assets. The later idea of a dividend distribution, discussed in Chapter 5 as well as below, was an egalitarian move to distribute fund revenues to every Alaskan and not to particular groups or interests. The dividend distribution was only made possible by a fund policy of external investment, which generated significant enough revenues on an annual basis to both protect the fund’s real value against inflation and provide an excess for distribution. An internal investment policy would not have produced enough revenue to make any individual disbursement significant.

Investing trust fund assets internally or externally is a fundamental investment decision, and most funds (with the partial exception of Alberta and Nauru) have chosen one or the other. Internal investments have the advantage of providing benefits such as new jobs or subsidies for new industries, but they often fail to generate any substantial financial return, and, furthermore, entail maintenance costs over the long term. External investment, while not as visible to beneficiaries, provides a greater financial return at a lower risk, and more equitably distributes fund benefits across groups. As will be seen in the following sections, internal investment is closely tied to the provision of collective goods and to a trust fund whose duration is less than permanent.

4. BENEFIT DISTRIBUTION: INDIVIDUAL DISBURSEMENT OR COLLECTIVE GOODS

In addition to the allocation of fund capital, fund trustees must also consider the
issue of income distribution. Trust funds—especially if they pursue a financial investment strategy, as discussed above—generate earnings. Even in cases where trust fund capital cannot be touched by government authorities, the generated income is often available for disbursement. Part of this revenue may be redeposited into the fund, to increase its capital as well as to protect the real value of the fund from decline due to inflation. Earnings may also be available for distribution to the fund’s beneficiaries.

The two most basic means of distributing fund earnings to beneficiaries are individual disbursement and the provision of collective goods (there are also intermediate possibilities, such as distribution to communities or groups). Individual disbursement refers to paying out an equal share of the fund’s earnings to each beneficiary, usually through the form of a dividend. The Alaska Permanent Fund is the only one of the five cases under consideration that pays annual dividends to its beneficiaries, and has done so every year since 1982. The other four funds direct fund earnings to collective goods, which may take the form of physical infrastructure, as in Alberta (as discussed previously) or by funding government operations, as in the Oceanic countries (at least in Kiribati and Tuvalu).

The choice of distributing dividends in Alaska was based on several factors. These included the desire to avoid interest group conflict, because groups could not compete for benefits when they were distributed equally to all. Spending on capital goods benefits only a portion of the population, whereas individual disbursement reaches everyone. Alaska fund trustees argued that individuals should be able to make their own investment decisions, rather than letting the state make them. In Alaska, the source of Permanent Fund capital was petroleum.
resources on state land. Trustees also argued that, as each Alaskan owns a share of
the resource itself, each individual should benefit directly from that share in
ownership. Finally, trustees suggested that the high cost of living in Alaska, and
the relatively small population, should be offset by individual disbursement of oil
revenues.

Individual disbursement of Alaska Permanent Fund revenues has numerous
discal, spatial, and temporal effects. The dividends put new money into consumers’
hands, and increased purchasing power. In 2003 dividend payments totalled about
US$1.2 billion, or about US$1100 to each person (597,000 people). As Goldsmith
(2001) notes, this accounted for 6.2% of Alaskan personal income, an amount
larger than the oil industry payroll. In this sense, the Alaska Permanent Fund
dividend constitutes one of the largest ‘industries’ in the state, but one in which
each resident shares equally as an ‘owner-resident’.

A study of the first dividend payment, made in 1982, of US$1,000 (Knapp
et al., 1984) notes that dividend distribution did indeed have positive effects in the
Alaskan economy. The authors of this study note that about 5000 new jobs were
created as a result of the dividend, that US$360 million of new consumer
purchasing power was generated, and that the 1982 and 1983 dividends ‘have been
significant factors in the rapid economic growth of the early 1980s’ (Knapp et al.,
1984, 2). These authors further suggest that individual disbursement of the 1982
and 1983 dividends resulted in higher growth in employment and purchasing
power than other means of distribution—such as capital projects or tax
reductions—would have had. An additional finding of this study was that the
dividend appeared to have no effect on inflation. This study was conducted 18
years ago, and unfortunately has never been updated or replicated. However, as
Goldsmith (2001) observes, other economic data as well as anecdotal evidence gives cause to believe that ‘a large share of the dividend recirculates in the regional economy’ and that ‘a significant share goes to fund big-ticket purchases, producing jobs and income in trade and services’.

Dividend payments have spatial effects as well. The dividend is paid to each individual regardless of means, and an equal amount is paid to each person. For wealthier families, annual dividends account for only a small percentage of total income. But for poorer families, many of which are concentrated in rural areas, the dividend accounts for a relatively high percentage of total annual income. In some parts of rural Alaska, this percentage has reached 10% of annual income. The dividend has hovered under US$2000 for the past several years, and there is every reason to believe that the size of the dividend will be about the same over the next five years. Rural families can therefore plan for and budget this income. Many rural families depend on subsistence activities (hunting, trapping, and fishing) for part of their food and income. The annual dividend gives these families additional cash income that allows them to purchase, for example, fuels and imported foods. Dividends, as a reliable source of cash income, may lower rates of urbanisation in Alaska, as rural families have less reason to migrate to urban areas in search of wage employment (Huskey et al., 2004; Knapp and Huskey, 1988). The fact that dividends are paid to all state residents equally means that urban voters, who constitute the majority of the state’s population, do not view the relatively larger effect that dividends have in rural areas as any concession to rural interests.

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2 See also Cebula and Belton, 1994; Nelson and Wyzan, 1989; and Shaw, 1986, for comparable analysis of the effects of transfer payments in other regions (United States, Canada, and Sweden).
Dividends may also have other spatial effects. For example, as Goldsmith (2001) notes, the dividend ‘should reduce the wage differential between Alaska and lower cost regions of the US since employers can offer workers a lower wage without reducing their economic well being’. Wages are higher in Alaska to offset the high costs of importing most materials: dividends in effect subsidise wages. No study has been conducted on this issue, but it is theoretically plausible (Goldsmith, 2001). Likewise, no study has been done on the effect that dividend payments have on in-migration to Alaska (except for the Knapp et al. study in 1984). Some economists have noted that a larger dividend than that paid presently could result in population movement from other states, especially larger families (as each child would receive a dividend). However, at the present time, and with dividends under US$2000, there has not been much in-migration generated primarily by the desire to collect dividends.

The Permanent Fund dividend also has temporal effects. The idea behind the dividend is that it be paid annually and in perpetuity (unless it is repealed, which is unlikely under present political circumstances). The most notable temporal effect is on population movement in and out of the state (also a spatial effect, but temporally governed), as individuals assess their dividend income when timing their move. Thus individuals would be most likely to leave the state after receiving their dividend (which is usually paid in October) rather than before receiving it. Also, individuals may delay their departure from Alaska by several years in order to collect more dividends; in this sense the dividend provides a disincentive against out-migration.

A final consequence of the dividend program is that it creates a constituency for the Permanent Fund. Every Alaskan resident has a personal stake
in maintaining and protecting the fund capital, and ensuring that it grows (at least enough to offset inflation) every year. Very few Alaskans have called for the fund’s abolition, or have suggested that fund capital be invested in other, non-income generating, ways. The dividend literally buys support for the fund. On the other hand, Alberta’s trust fund has come under repeated criticism, with many residents suggesting that fund capital be used to fund government services rather than having taxes raised. In Alaska, it is more likely that a state income tax would be introduced rather than that the dividend should be abolished. The dividend is now seen as an entitlement.

Financially, dividend disbursement reduces the accumulation of state assets, as Alaska literally gives its money away. Some economists (e.g., Olson and O’Brien, 1990) have noted that as oil revenues decline, the state will need to husband its assets more carefully. Olson and O’Brien, along with others such as Brown and Thomas (1994), warn that the state will have to impose a state income tax if it continues to give dividends away. An income tax would presumably be progressive, in that lower incomes would be taxed at a lower rate, so higher income individuals would benefit least from an income tax.

The Alberta Heritage Savings Trust Fund has chosen a very different course of action with respect to distributing the revenues it generates from investments. First, it should be borne in mind that the investment revenues accruing to Alberta’s fund are lower, because, as discussed in a previous section, much of the Alberta fund’s investments are non- or low-income producing. However, the fund does earn an annual income, and the entirety of this is transferred to the province’s General Fund. Thus, in this sense, the Alberta Heritage Savings Trust Fund is merely another source of provincial income, such
as oil royalties and taxes of various kinds. Distribution of fund income goes to a single recipient, the Alberta Treasury. Nevertheless, the fund has a distributive effect primarily through its investments. Previous sections have described how Alberta’s fund invests largely in capital assets. By not paying dividends, the province keeps assets in its own hands and does not privatise them. In doing so, it opens itself up to rent-seeking, in which interest groups compete for project funding.

Nauru, Kiribati, and Tuvalu, like Alberta, transfer their fund earnings (with some provisions for redeposit to offset inflation) to their General Funds. Fund income is used largely to finance government operations. The argument behind this is that, at some prior time, government operations (such things as education, health, social services, security, etc.) were financed directly by natural resource revenues (in Nauru and Kiribati) or overseas development aid (in Tuvalu). With the cessation of that source of income, some other means of financing government had to be found. Each of these Pacific countries set up a trust fund as a renewable resource, using its investment income to finance government operations. The funds are therefore vital as the primary source of government revenues. Any individual distribution of fund earnings would reduce government revenue to a point where basic services could not be financed. This situation may not be permanent, however. For example, both the per capita value and the per capita income of Kiribati’s Revenue Equalisation Reserve Fund (RERF) have been increasing. In 2000, the per capita value of the RERF stood at A$7152, while the per capita income for the same year was A$640. If the Kiribati fund continues to grow at a rate that reflects past performance, the RERF may be able to pay out dividends in the way that Alaska does. This could have beneficial implications for development
policy in Kiribati.

Most trust funds were set up as a way of transforming a non-renewable natural resource into a renewable fiscal resource, as a way of financing government operations when direct resource payments (royalties or taxes) decline with the depletion of the resource. Alaska’s fund differed in that it also has the function of transferring state resource revenues into private hands. In doing so, Alaska reduces the accumulation of its own assets but stimulates a consumption-driven economy, while simultaneously addressing issues of spatial and temporal equity.

5. GOVERNANCE AND MANAGEMENT: TRANSPARENCY AND SECRECY

Governance issues also affect the performance of a trust fund, its ability to achieve social equity, and its popular perception. A key issue of governance is the openness or transparency of fund operations. Some trust funds have gone to great lengths to make their activities and investment policies visible to fund beneficiaries, while others have only released limited information, and, in the cases of Nauru and Tonga, have kept most fund investments under wraps.

Alaska conceived of its trust fund as a ‘people’s fund’, in which each state resident was a kind of shareholder in the fund. The fund was therefore subject to great public scrutiny. Political circumstances also dictated this openness. Prior to 1976, Alaska’s State Constitution prohibited dedicated funds. As described in Chapter 5, Governor Jay Hammond, the leading proponent of the Alaska Permanent Fund, was able to secure a public referendum among Alaskan voters, which repealed the prohibition against dedicated funds and established the basis for the Permanent Fund. Alaskan voters thus had a crucial role in the formation of Alaska’s fund, and naturally could be expected to take an interest in a state entity
that would be receiving up to half of the state’s oil revenues.

As described in more detail in Chapter 5, the Permanent Fund is administered by an Executive Director (a position selected on merit), but governed by a Board of Trustees with six members. Two of these are ex officio, and are members of the state cabinet. The other four are public figures, often from the private sector, who are selected on the basis of their financial or business expertise. The Permanent Fund holds an annual meeting, which rotates to different locations around the state (usually in Juneau, Anchorage, or Fairbanks) as well as regular meetings throughout the year in smaller communities. All of these meetings are open to the public, and every member of the public may ask questions of the trustees during these meetings. The fund’s financial information is released in annual and quarterly reports (which are independently audited) and also through other publications directed at a more general audience, as well as on videos directed at schoolchildren. The Permanent Fund spends substantial effort on educating the public (including within schools) about the purposes and operations of the fund.

Fund managers are also called to account at annual meetings. The Permanent Fund leaves its day-to-day investment operations in the hands of several investment banks and stock brokerages. Each year, at the annual meetings, representatives from these banks and brokerages present their accounts. Again, the public may directly question these investment advisers, who will have a lot of explaining to do if, for example, the share of investments under their supervision has underperformed market indices. An additional indicator of fund performance, most visible in the eyes of the public, is the size of the annual dividend. Over the past several years, fund dividends have hovered near US$2000. Many Alaskans
expect their dividend to increase every year. Fund dividends did decline slightly within the past several years, because of the performance of American and international stock and bond markets. The public understands this, but nevertheless uses the dividend as a gauge by which to assess fund performance. If the divided decreases, or does not increase by much, people want to know why.

Alberta’s fund, though originally couched in a ‘house’ metaphor, was usually seen by the Albertan public as a ‘rainy day’ fund, the idea being that at some future point the fund capital would be expended. This factor perhaps accounts for a diminished public interest in the investment activities of the Alberta Heritage Savings Trust Fund. The public assumed that, when the time came, the fund would be there.

Perhaps the greatest factor in the relative secrecy under which the Heritage Fund operates is the nature of the Canadian political system. Canadian provinces do not have their own constitutions, in which basic political goals and values are lodged and displayed. The Alberta fund, unlike its Alaskan counterpart, was not constitutionally protected. Its principal, unlike that of Alaska, could be allocated by the political party in power by a majority vote of the provincial Legislative Assembly. In effect this meant that the Alberta cabinet, or in practice the Provincial Treasurer, had almost complete control of the fund—of its broad policy goals as well as of its day-to-day operations. The fund could be dipped into, and this generally took place prior to elections, when special projects were announced.

The Alberta Heritage Savings Trust Fund also publishes annual and quarterly reports, but does not hold public meetings. The public is expected to express concerns or questions about the fund to members of the Legislative Assembly. In practice this means that the public passively receives fund financial
reports, but has little influence on fund policy, and is not able to access information beyond what is available in annual and quarterly reports. An Oversight Committee of the Legislative Assembly exists, but it has done very little to monitor the activities of the fund.

The trust funds of Kiribati and Tuvalu publish their accounts annually, though in limited copies which are not widely disseminated. Tuvalu’s fund, because it was set up by aid donors, is under the supervision of Australia as well as New Zealand and Great Britain. Nauru’s fund, on the other hand, is notorious for its secrecy. The last financial reports tabled in the Nauruan Parliament date from 1998, and do not reveal the details of many fund assets. In particular, they give very little information about the internal loans made by the Nauru Phosphate Royalties Trust to Nauruan government corporations and agencies. Lack of disclosure has prompted a new political party, Naoero Amo, to call for the release of fund statistics, a request denied by the government on the grounds that this is not public data. As noted in Chapter 6, the secrecy of the Nauru fund is a partial legacy of the secrecy under which the British Phosphate Commissioners (BPC), with their Australian, New Zealand, and British members, operated during the mandate era (1920-1968). During that time, the BPC filed only minimal information, and much of that only under pressure, with the League of Nations and later the United Nations, despite the filing requirements of the mandate. The reason for this secrecy was that the BPC and its member countries were profiting handsomely from cheap Nauruan phosphate and returning very little of the economic rent to the Nauruans. This tradition of secrecy and the lack of financial reporting lingers even to today, and Nauru’s fund has been subject to numerous allegations of corruption and misuse of resources (and of the concept of ‘trust’),
both by Nauruan opposition parties, individual Nauruans, and international
commentators. Even the details of what was one of its most visible assets, Nauru
House in Melbourne, are not clearly known. In fact, no academic analysis of Nauru
in recent times has provided even the most rudimentary discussion and disclosure
of Nauruan fund assets and investments.

The lack of transparency and the presence of secrecy can allow corruption
and mismanagement to flourish. As Adam Smith noted,

> The agents of a prince regard the wealth of their master as inexhaustible; are
careless at what price they buy; are careless at what price they sell; are careless at
what expense they transport his goods from one place to another. Those agents
frequently live with the profusion of princes (Smith, 1999 [1776], Vol 2, 408-09).

With a lack of transparency, fund managers and others with control over
fund assets can misappropriate fund capital to their own ends. Some of the
eamples of the kinds of investments of trust fund capital made by the
governments of Nauru and Tonga illustrate Smith’s remarks, as the agents of the
fund invested in frivolous and self-serving assets.

When fund performance (in both a financial and social equity sense) is
compared with the degree of transparency and openness there is a strong
correlation between openness and success. Nauru’s fund, which is extremely
secretive, is generally thought of by internal and external analysts as absolutely a
failure, whereas Alaska, with its transparent investments and full disclosure, has
been economically highly successful.
6. PROTECTION: SECURITY AND APPROPRIATION

A trust fund’s assets consist of both the investment capital and the earnings that this capital generates through investment. Fund trustees must consider how these assets are protected from misallocation or misuse, and who retains the legal right to expend fund assets. Recall that trust funds are entities held by trustees on behalf of beneficiaries, to whom the assets belong. Do trustees have the right to expend fund capital if they feel it is in the best interests of the beneficiaries, or must the beneficiaries themselves decide? The six funds analysed illustrate two diverging approaches to this issue.

In three of the cases examined—Alberta, Nauru, and Tonga—no legal mechanism exists by which to prevent the expenditure of fund principal by fund trustees. In each of these cases, the fund trustees are identical with the legislature. Though committees exist to set investment and management guidelines, ultimate trusteeship and responsibility lies with the provincial legislature in Alberta, in the national parliament of Nauru, and with the king in Tonga. These legislative bodies, which represent the voter-beneficiaries, may expend fund capital without direct consultation with the beneficiaries.

The problems of such a lack of fund protection are clear enough: the fund capital is not protected against legislative raids on the capital. No legal condition exists to prevent such raids, and the only barrier is public pressure. The example of Alberta is instructive. Political commentators have alleged on several occasions that the principal of the Alberta Heritage Savings Trust Fund has been ‘dipped into’ by the provincial legislature, which really means by the political party in power. Some Heritage Fund capital was used to support an electoral promise to provide mortgage relief and rebates for Alberta residents. As in the case of
Kiribati, no legal obstacles exist to prevent such expenditure (which, some would argue, achieves a social benefit). The actions of the Alberta legislature on this occasion were not only perfectly legal but also in keeping with the spirit of the trust fund to provide benefits to Albertans. Nevertheless, such lack of protection opens the fund to short-sighted considerations that may detract from long term goals such as sustainability.

Alaska, Kiribati, and Tuvalu stand in stark contrast to the three other cases, as the trust funds in these two states have instituted legal protections against the expenditure of fund principal. In Alaska, the fund beneficiaries must be directly consulted before capital may be spent. In Tuvalu, an international board of trustees, consisting of the representatives of those donor states that provided the original capital of the Tuvalu Trust Fund, must give permission for fund capital to be expended. In this sense Alaska and Tuvalu illustrate two different methods for restraining a fund’s trustees, but which result in broadly similar outcomes.

The legal protection of the Alaska Permanent Fund’s capital stems from the nature of the American federal system. In the United States, each state has its own constitution, often mirroring the national one. Though different states may have differing methods for amending their constitutions, in general they require the consent of the voters as expressed through a referendum. This is the case in Alaska. A majority of the state’s voters – who also constitute the fund’s beneficiaries (at least the ones of voting age, 18 and over) – must approve, through referendum, any constitutional changes. Because the Alaska Permanent Fund is embedded in the constitution, any changes to fund policy, including the expenditure of fund capital, must be approved by a majority of the voting beneficiaries. As noted in Chapter 5, the Alaska Constitution, prior to 1976,
prohibited dedicated funds. In order to create the Permanent Fund, Alaskans voted in a referendum to amend the constitution and legally (and constitutionally) establish the Permanent Fund. The conditions by which the fund was to be governed, including the provision that fund capital was to be left untouched, are part of the state’s constitution.

Alaska’s embedding of its fund in the state constitution has proven highly effective, both in preventing legislative raids on fund capital and in creating a sense of stakeholdership among Alaskans. Fund capital has remained intact, the constitutionally-mandated provisions to protect the value of the fund against inflation by redepositing a portion of fund income have been adhered to, and any changes to the most overarching fund policies have been settled by state-wide referendum. The constitutional protection given to Alaska’s fund has proven successful, though it may not be directly replicable in places, such as Alberta, where (in the case of Canadian provinces), provincial constitutions do not exist.

Tuvalu exemplifies a different way of protecting fund capital. Tuvalu’s fund was set up by foreign aid donors in 1987. The largest donors were Australia, New Zealand, and the United Kingdom, with smaller contributions from Tuvalu itself as well as from Japan and South Korea. The fund was inscribed in an international treaty, the *Agreement Concerning an International Trust Fund for Tuvalu* (1987) signed by Tuvalu and the three major donors (Australia, 1988). This treaty established the fund and spells out its legal status, conditions of management, provisions for change, and so forth. It also established a Board of Directors, consisting of a delegate from each of the four parties, and vests ‘all the powers of the fund’ in this board. This international treaty has protected Tuvalu’s fund capital, while maintaining Tuvalu sovereignty yet allowing the fund’s donors
to monitor fund activities.

The existence of a protective legal framework is often supplemented by cultural values oriented towards saving. For example, Kiribati has not witnessed any politically motivated attempts to expend fund capital. This may be partly accounted for by the generally homogenous I-Kiribati population, by a cultural predisposition towards savings, and by the shared perception that the fund is necessary for Kiribati’s well-being.

Legal protection of fund principal is an important consideration for any trust fund. Though social and cultural practices may prevent fund trustees from expending fund capital, they are no guarantee of capital preservation. Ideally, a trust fund will take advantage of the nature of the political and constitutional system under which it operates to enshrine the protection of fund capital and to limit its expenditure to circumstances in which a majority of beneficiaries approve.

7. SUSTAINABILITY: SHORT TERM AND LONG TERM FUNDS

A final consideration for trust fund managers is the projected duration of the fund. Is it to be a permanent fund, operating in perpetuity, or does it have a limited time frame? The five funds analysed here were all set up as permanent funds, yet their investment policies and use of capital have, in some cases, limited the funds’ expected lifespan.

Both permanent and temporary funds fulfil a purpose. Permanent funds, as in the five cases discussed in this thesis, are generally seen as a kind of renewable resource. Indeed, one of the great benefits of trust funds is that they can effectively transform a finite and depletable natural resource into a renewable fiscal resource. This new fiscal resource can be managed according to the principles of renewable
resources, under which the ‘breeding stock’, in this case the fund capital, is not ‘over harvested’, and continues to produce an annual return in perpetuity. In this sense management of a trust fund is analogous to managing a fishery or a forest. If fund capital is ‘over harvested’, or diminishes, it reduces the ability of the fund to generate future income, in the same way that over harvesting fish reduces the number of fish caught in future years. If trust funds are to be permanent, they must be managed as renewable resources.

Trust funds may also be temporary, with a set duration and fulfilling a specific function. In this sense they are analogous to non-renewable resources, and can be managed accordingly. A temporary fund, managed as an annuity, might be used to help in economic transition, to diversify an economy (lasting until that diversification is reached), or to stabilise the inflow of new wealth into an economy during a ‘boom’ period. For example, Papua New Guinea set up a Mineral Resources Stabilisation Fund, now disbanded, but which functioned during the 1980s and 1990s as a way of stabilising state revenue that was subject to wild price fluctuations. Mineral economies are subject to rapid change and high volatility, depending on world prices and demand for minerals. During some years substantial windfall revenues may flow into an economy, but during other years the inflow might be very small. How to manage this volatility? A stabilisation fund accrues excess revenue in boom years, and then releases this savings into the economy (typically into the state’s General Fund) during bust years. A fund of this type is only needed when the economy is dependent on a resource with a widely fluctuating price.

The trust funds of Alaska, Alberta, Nauru, Kiribati, Tonga, and Tuvalu were all set up as permanent funds, and their names often reflect this. Alaska
specifically calls its fund the Alaska Permanent Fund, while Alberta’s fund name stresses the idea of heritage and savings: the Alberta Heritage Savings Trust Fund. Though the names of the Pacific funds are more generic, an examination of their founding legislation suggests that these funds were intended to be permanent.

Despite the goal of permanence, some funds may deplete themselves because of poor investment policy. The Alberta Heritage Savings Trust Fund, for example, has invested heavily in capital assets, which do not produce a financial return. Furthermore, no new money is deposited into the fund. This means that the fund’s size is effectively shrinking: though its nominal value remains constant, its real value is decreasing due to inflation. Though the Alberta fund may be permanent in theory, its diminishing size limits its ability to function in the Alberta economy in the same way as it did in the past. Alberta’s neighbouring province of Saskatchewan also set up a trust fund, the Saskatchewan Heritage Fund, but this fund (which was set up in 1978) was wound down by a repeal of its enabling legislation in 1992. Thus the ‘heritage’ of Saskatchewan resource assets was preserved for less than two decades. Alberta has decided to restructure its Heritage Fund so that it is now increasingly invested in financial and non-local assets—following a policy similar to that of Alaska. This recent switch in investment policy may prevent the Alberta Heritage Savings Trust Fund from going the way of its sister fund in Saskatchewan. Nauru and Tonga’s funds have performed so poorly that their future existence is in question.

One of the key reasons for setting up a trust fund is intergenerational equity. The idea is that natural resources and their direct financial benefits belong to future generations as well as to present ones. The legislation governing all six funds considered here suggests that each had intergenerational equity as one of its
major goals. If ‘future generations’ are left unspecified, it suggests that all future generations are to be considered beneficiaries of current resource extraction, and the fund must therefore exist in perpetuity in order to transfer a share of resource income to them. None of the funds under consideration limits its definition of ‘future generations’ to one or two following generations.

Permanence is the desired goal of the six funds considered here, but the ability of the funds to reach this goal has varied, largely dependent on their investment policies. Funds pursuing a strict financial investment policy, husbanding fund capital in high return and low risk investments, have fared best with respect to the ability to perpetually support the fund. Given that a major goal of each of these funds is to provide a source of government revenue after a non-renewable resource revenue source is depleted, it would seem necessary that financial investment, together with an externally-directed investment practice, and openness and transparency of public participation, are necessary conditions for fund permanence.

8. CONCLUSION
The six states considered here—Alaska, Alberta, Kiribati, Nauru, Tonga, and Tuvalu—have attempted to deal with resource dependence, remoteness, and economic ‘underdevelopment’ by saving and investing a portion of the state’s share of resource revenues. Each of these six states has created a trust fund with this share of resource revenues, in which the revenues are held in trust by the state on behalf of the resident beneficiaries. The goals of each of the six funds are broadly similar: to save a share of resource revenues, to invest these both to maintain the real value of the fund and to provide an additional source of income
for the state, to achieve intergenerational equity by transferring a share of the value of resources extracted in the present to future generations, and, in some cases, to intervene in the economy. In a more general sense, the goal of each fund is to increase the welfare and well-being of state residents, and to maintain sustainably this increased welfare. This constellation of economic and social goals has been termed ‘social equity’. Each of the trust funds under consideration here has attempted to increase the social equity of its region.

The ability of the funds to meet these goals has varied considerably. The reason for this variation lies in the different policies pursued by each of the funds. These policies may be subsumed under six general rubrics: investment policy, investment location, benefits distribution, governance and management, protection of fund capital, and fund permanence, which are summarized in Table 7.1. Table 7.2 illustrates, in the most general sense, the factors that help maximize the ability of a fund to achieve its social equity goals. Only one fund, that of Alaska, meets all six of the ‘more successful’ criteria. None of the funds meets all six of the ‘less successful’ criteria, though Alberta comes close. These assessments do not indicate sufficient criteria for a fund’s success. Rather, they suggest some general pathways that fund trustees (and beneficiaries) may want to consider when setting up a new fund or re-envisioning an existing one.
Table 7.1. Summary of Sustainability and Distribution Policies.

<table>
<thead>
<tr>
<th>Case</th>
<th>Investment Policy</th>
<th>Investment Location</th>
<th>Distribution of Benefits</th>
<th>Governance and Management</th>
<th>Protection</th>
<th>Sustainability</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alaska (USA)</td>
<td>Financial (shares, bonds, real estate)</td>
<td>External (USA and global)</td>
<td>Dividends (and inflation-proofing redeposit)</td>
<td>Open (public meetings and accounts)</td>
<td>Protected (by constitutional amendment)</td>
<td>Permanent (real value maintained)</td>
</tr>
<tr>
<td>Alberta (Canada)</td>
<td>Capital (infrastructure, internal loans, some financial)</td>
<td>Internal (Alberta, other Canada)</td>
<td>General Fund (no redeposit)</td>
<td>Open (public accounts)</td>
<td>Not Protected (legislature may appropriate)</td>
<td>Short Term (real value not maintained)</td>
</tr>
<tr>
<td>Nauru</td>
<td>Financial (real estate, internal loans, other (?))</td>
<td>Internal (Nauru, Australia, other Pacific)</td>
<td>General Fund (some inflation protection)</td>
<td>Secret (limited release of information)</td>
<td>Not Protected (legislature may appropriate)</td>
<td>??? (permanent intention, short term in practice)</td>
</tr>
<tr>
<td>Kiribati</td>
<td>Financial (shares, bonds)</td>
<td>External (global)</td>
<td>General Fund (some inflation protection)</td>
<td>Open (public accounts)</td>
<td>Protected (legislature may not appropriate)</td>
<td>Permanent (real value maintained)</td>
</tr>
<tr>
<td>Tonga</td>
<td>Financial (bank deposits, insurance)</td>
<td>External (USA)</td>
<td>General Fund (no redeposit, unknown)</td>
<td>Secret (limited release of information)</td>
<td>Not Protected (King may appropriate)</td>
<td>Short Term (real value not maintained)</td>
</tr>
<tr>
<td>Tuvalu</td>
<td>Financial (shares, bonds)</td>
<td>External (global)</td>
<td>General Fund (some inflation protection)</td>
<td>Open (public accounts, external oversight)</td>
<td>Protected (by treaty)</td>
<td>Permanent (real value maintained)</td>
</tr>
</tbody>
</table>

Note: italics indicate a distinctive feature.
Table 7.2. Summary of Fund Criteria and Performance Outcomes.

<table>
<thead>
<tr>
<th>More Successful</th>
<th>Investment Policy</th>
<th>Investment Location</th>
<th>Benefits Distribution</th>
<th>Governance and Management</th>
<th>Protection</th>
<th>Sustainability</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial Investment</td>
<td>Offshore Investment</td>
<td>Individual Distribution</td>
<td>Open and Transparent</td>
<td>Legal Protection</td>
<td>Long-Term Goals</td>
<td></td>
</tr>
<tr>
<td>Less Successful</td>
<td>Capital Projects Investment</td>
<td>Onshore Investment</td>
<td>Collective Distribution</td>
<td>Secret</td>
<td>No Legal Protection</td>
<td>Short-Term Goals</td>
</tr>
</tbody>
</table>
Conclusion

1. REVERSING THE FLOW

This thesis has explored how capital flows are linked to economic development. Adam Smith suggested that capital accumulation was the basis of economic development, and that savings were prompted by a desire to better the human condition. In Smith’s vision, individual savings leads to societal benefits. In the trust fund model proposed here, societal savings leads to individual benefits. Reversing the flow of capital also ‘reverses’ the flow of benefits.

The process of capital accumulation, and the expansion of the capitalist economic system, was taking place when Smith was writing, and continues to the present. Smith’s early economic insights led to a conception of development that was based on capital accumulation followed by investment in new industries. This conception was further refined by development scholars into the twentieth century. The mainstream of this scholarship created a model in which economic development is achieved by a process of economic transformation through progressive stages, from agriculture to industry to services. This model has been successfully deployed to explain the development trajectories of Europe, North America, and East Asia.

But what about the development process outside these core regions? How is development to be achieved in the peripheral spaces of the global economy? Most
development analysts have continued to apply the mainstream model, with its European and North American biases, to peripheral regions. A consequence of this direct transposition is the limited applicability of the mainstream models to stimulate economic development in peripheral regions, as evidenced through the failure of many development projects.

How, then, can capital accumulation, and economic development, be achieved in the marginal and remote spaces of the global economy? I have argued in this thesis for reconsidering the directional flow of capital within the global economy. In mainstream conceptions of development, capital flows from core to periphery, from the more-developed to the less-developed spaces, investing in new industries and thus providing economic benefits to the region. In this thesis I have suggested that in certain peripheral spaces, capital flow from periphery to core may be a more appropriate strategy for economic development. In this conception, the core becomes a site for investment, rather than a source of capital. Capital is instead generated in the periphery, either through natural resources or through sovereignty resources. The non-renewable nature of these resources, as windfalls, means that only a limited window of opportunity exists for their investment. I have suggested here that a trust fund may be the most appropriate mechanism for capturing these windfalls, investing them in core regions, and achieving this reversed flow of capital. In doing so, the sites of capital generation and capital investment are spatially separated.

1 Interestingly, this is analogous to what individuals have been doing with their own savings in developing countries where the opportunities for investment are not favourable. In this practice of capital flight, the returns on capital may be repatriated to the capital source country, or not. Typically, societal benefits are not a result of this capital flight, though some individuals may benefit.
This thesis also argues for a more place-based conception of development, in which different development models may be appropriate to different regions, and that no model can capture and explain the nature of development everywhere. Earlier attempts to create place-specific development models include the MIRAB model in Oceania and the model of Northern development used by some scholars in the Arctic and Subarctic regions of North America. Likewise, the conceptions of Small States scholars have indicated how different models of development may have greater or lesser applicability depending on the size of the state. My own approach suggests that a state’s position within the global economy is an important factor in determining how capital flows can best be used to achieve development objectives. Other factors, such as the size of the state’s population relative to its resource endowment, are also important.

2. TRUST FUNDS AND CAPITAL ACCUMULATION

How is this reversal of the flow of investment capital, from periphery to core, to be achieved? I argue in this thesis that a trust fund is the most effective mode of development finance. Trust funds save a portion of natural or sovereignty resource capital and invest this capital to generate earnings while preserving the original fund principal. If the trust fund’s earnings (or some portion of them) are reinvested into the trust fund, then the fund will continue to grow, even after resource revenues have stopped flowing into the fund. The trust fund becomes a renewable resource that, if sustainably managed, will continue to generate earnings in perpetuity. In this way, non-renewable natural resources are transformed into renewable fiscal resources.

Trust funds, as an interventionist policy, provide a number of advantages
and benefits that passive policies do not provide. Passive investment policies, in which resource revenues are deposited into a state’s general fund, can lead to such problems as rent-seeking and Dutch Disease. This is especially the case in small, undeveloped economies that form the marginal spaces of global capital, such as the island states of Oceania and the resource hinterlands of North America. Trust funds, on the other hand, can produce the following benefits:

- **Savings**: Save resource revenues that would otherwise be spent and misallocated into immediate direct consumption;
- **Equity**: Extend benefits of resource revenues over many generations or in perpetuity;
- **Income**: Provide an additional source of budgetary income for the state;
- **Investment capital**: Provide an additional or alternative source of investment capital;
- **Intervention**: Be used to intervene in the economy to achieve state objectives, such as diversification or stabilisation;
- **Macro management**: Externalise windfall effects and prevent distortions arising in the economy.

The six cases I considered in this thesis were able to achieve these benefits to a greater or lesser extent, depending upon how closely they followed the six criteria for success discussed in depth in the previous chapter. These are:

- **Investment Policy**: whether to invest in capital (infrastructure) assets or in financial (portfolio) ones;
- **Investment Location**: whether to invest onshore (locally) or offshore (globally);
• *Benefits Distribution*: whether to distribute fund benefits (usually fund earnings) directly to individuals (through dividends) or through the provision of collective goods (by the government);

• *Governance and Management*: whether the fund and its management are open and transparent to the beneficiaries, or whether this information is kept secret, and the nature and degree of public input into fund decision making;

• *Protection*: whether the fund’s assets are protected from misallocation by the trustees, and whether legal structures exist to prevent fund asset depletion without permission of the beneficiaries;

• *Permanence*: whether the fund is intended to last in the long term or permanently, or whether it is viewed as a short term device.

Assessed on the basis of these criteria, the performance of the six trust funds varied significantly. Alaska, Kiribati, and Tuvalu are examples of trust funds that have successfully achieved their objectives. Nauru and Tonga are examples of trusts funds that failed to achieve their objectives, while Alberta is a middle case (Alberta has shifted its fund policies and is now becoming more like the Alaska, Kiribati, and Tuvalu funds).

Alberta, a province of Canada, established its Alberta Heritage Savings Trust Fund in 1976, as a response to increasing provincial oil revenues. Alberta historically perceived itself as a hinterland region of Canada, dependent for capital and manufactures on the larger and more industrialised provinces of Ontario and Québec. The rise in oil revenues gave Alberta a window of opportunity to use these revenues to offset this perceived marginal position. Alberta’s trust fund, which received a share of the province’s oil revenues, was used by the Alberta government in an effort to make the province more core-like. This was done by
investing primarily within Alberta and not externally, by making subsidised loans to provincial crown corporations, and by attempting to diversify the economy away from petroleum dependence. The fund also distributed its benefits in the form of collective goods in an attempt to propitiate important local economic sectors and class fractions. Alberta’s internally-directed investment policy did not take advantage of the benefits of investing globally, and did not re-spatialise Alberta’s investment field to include many regions beyond the province’s borders. As such, the fund declined, failing to hold its real value and becoming prey to partisan politics. Recently Alberta abandoned its attempts to establish itself as a core, and has shifted the focus of its trust fund towards globalised investments.

The state of Alaska, in the United States, instead chose an investment programme more consistent with the conception of peripheral development outlined in this thesis. The state’s trust fund was also established in 1976 and received its initial capital from state oil royalties. Alaska, through its Alaska Permanent Fund, chose to invest externally, in the United States and beyond. This investment practice allowed the state to take advantage of the diversity offered by global financial markets, so that when Alaska itself was in recession, its offshore investments were performing well and generating needed revenues. Alaska is also distinctive in choosing to distribute a large portion of the trust fund’s earnings individually to each beneficiary, in the form of annual dividends. These dividends provide a universal basic income for all Alaskans, and have slowed down the rate of migration from rural to urban regions. Dividends also have stimulated new businesses and employment in Alaska, including in rural regions. As dividends are distributed to all Alaskans equally and are not means-tested, they are not perceived as targeted towards special interests. Alaskans have responded favourably to their
trust fund and have repeatedly voted to keep it going, despite growing state budget
deficits. Alaska provides the clearest example of the development strategy
suggested in this thesis.

The four Oceanic states considered in this thesis—Kiribati, Nauru, Tonga,
and Tuvalu—have experienced varying levels of success with their trust funds.
Kiribati’s trust fund was established in 1956, when the country was part of the
British Gilbert and Ellice Islands Colony. The fund was based on phosphate
revenues, and was designed to support the islands’ economy after the resource was
depleted. Nauru’s trust fund was established in 1922 for similar reasons, and
likewise received its capital from phosphate revenues. The two countries began on
parallel tracks but substantially diverged, based on differing investment
philosophies and practices. Kiribati, independent since 1979, chose to invest its
fund externally, and largely in secure fixed income and equity investments. Nauru,
on the contrary, invested largely within the national territory, in the form of
subsidised loans to Nauruan government agencies, investments that, given Nauru’s
profligate spending, are unlikely to be repaid. Thus Nauru has lost the bulk of its
investments and the fund may possibly be insolvent. Nauru’s practice of extreme
secrecy prevented external analysts as well as concerned Nauruans from altering
the fund’s investment trajectory.

Tonga and Tuvalu are largely resource-poor Polynesian states. Unlike
Kiribati and Nauru, they lacked a substantial mineral resource upon which a trust
fund could be established. Both countries were able to take advantage of
sovereignty resources, including the sale of passports and postage stamps, as a way
of building up investment capital. Tonga’s sale of passports was criticised early on
by members of the Tongan parliament, and the rather shady deals that began with
passport sales continued in the investment of trust fund capital, which was conducted secretively and in defiance of most standard investment practices. The consequence of these actions was the loss of the bulk of the fund’s capital in speculative investments. Tuvalu, an even more marginalised state, initially sold postage stamps to collectors to raise capital, but was successful in persuading three large donor states to contribute capital to its trust fund, thereby avoiding the need for annual requests for aid. The involvement of these international donors as well as Tuvalu’s own policy of fiscal openness and transparency and conservative investment practices allowed the fund to grow. The earnings of Tuvalu’s trust fund now finance government activity, and the country no longer needs to ask donors to fund its recurrent expenditures. Thus sovereignty resources, another form of windfall with a limited window of opportunity, were parlayed into a sustainable fiscal resource.

The six trust funds examined in this thesis resulted from the visions of six individuals. Peter Lougheed, Jay Hammond, Michael Bernacchi, Alwin Dickinson, King Taufa’ahau Tupou IV, and Henry Faati Naisali each understood that natural and sovereignty resources do not last forever, and that only a short window of opportunity exists in which to capture resource revenues and invest them for the future. Each of these six individuals independently proposed a trust fund as a mechanism to invest windfall revenues in order to obtain long-range benefits for the community. Each trust fund resulted from the persistence of a visionary sponsor.2

\[2\] It is also worth noting that both Peter Lougheed, as premier of Alberta, and Jay Hammond, as governor of Alaska, were members of conservative political parties that advocated free-market approaches to economic development. Both Lougheed and Hammond had sufficient popular and party support, as well as a great deal of foresight and economic understanding, to make their visions
The six trust funds considered in this thesis demonstrate differing outcomes, which varied according to how well they followed the conception of development as a reversal of the flow of capital from periphery to core. Alaska, Kiribati, and Tuvalu were successfully able to take advantage of global financial markets and used them as fertile fields of investment.

3. ASSESSMENT OF METHODS AND FUTURE RESEARCH

In conducting research for this thesis I have used the comparative method, based on the analysis of six case studies. Four of these cases are small Pacific island states, each of which has established a national trust fund in order to achieve both sustainability and self-reliance in the support of economic livelihoods. The two other cases are sub-national entities—one a state of the United States and the other a province of Canada—that have set up more regionally-based trust funds with the same intentions as in the Pacific cases. The comparative method has allowed me to explore the origins and trajectories of trust funds in a variety of contexts, and to explore the factors that have distinguished successful funds from unsuccessful ones.

In analysing these cases, I have been guided by sociologist Michael Burawoy’s concepts of ‘scientific research programmes’ and ‘extended case method’, in which the researcher explores the unique features that lead each case to its outcome, rather than searching for a common pattern among all cases, as in the method of induction. Using a scientific research programmes and extended case method approach has allowed me to explore the particular features of each of the
six cases and to incorporate historical contingency. Each of the six places examined here set up a trust fund at different points in time and under different circumstances and conditions, yet each trust fund was a response to a similar perceived position of economic marginality. Each trust fund was an attempt to interact with a larger global economy.

My research on each of these six cases involved the analysis of textual documents, including historical archival materials and contemporary financial statements. These textual sources were supplemented by semi-structured and unstructured interviews with key officials in each of the six places. I also interviewed a variety of other individuals in order to glean a sense of awareness and knowledge of each trust fund, and to place the funds within the context of beneficiaries’ understandings of how their livelihoods were linked to state fiscal policies. This helped me understand how each trust fund is perceived by its beneficiaries.

My research was also guided by my own hypothesis concerning the links between capital flows and economic development. Contrary to mainstream perspectives, I have argued here that capital flows from peripheral economic spaces to the core of the global economy can, under certain conditions, be beneficial to places on the margins. Textual data sources, interviews, and a guiding hypothesis were all triangulated to arrive at an overall understanding of how trust funds can contribute to economic development. In doing so, I have explored how multiple economic logics underpin the origins and functioning of each of the six trust funds examined here.

This thesis has demonstrated the value of trust funds as an economic development tool for places on the margins of global capital. It also points the way
to future studies that might explore particular trust funds in greater depth. In particular, a community-based study of a single fund would allow a researcher to explore the effects of an individual distribution of fund earnings through dividends versus the provision of collective goods by the state. A more detailed study of a single fund would also shed light on the intricacies of day-to-day fund management and the complex set of issues that fund trustees must balance when making investment choices. Other issues, such as the nature and type of fund investments, would also bear further examination.

4. RENEWING THE WEALTH OF NATIONS

This thesis has considered how a different—from the mainstream—development practice has been able to enhance the economic performance of the marginal spaces of the global economy. The model proposed here may be applicable in many other cases, and some other states have already established trust funds with similar purposes. Botswana, for example, was one of the world’s poorest countries when it received independence in 1966. Its Pula Fund, based largely on revenues from diamond sales, cushions the Botswana economy from volatile shifts in mineral prices by providing the government with a source of capital to finance operations during periods of weak growth. FSM’s Compact Trust Fund and the Marshall Islands’ Intergenerational Trust Fund have allowed these two Pacific island countries to assume gradual control over their own economic affairs, at a time when the United States government is withdrawing its financial support for these former trust territories. A portion of the annual American aid grant is saved each year in the FSM and Marshall Island trust funds, allowing them to generate a source of capital that will eventually replace that derived from American aid. The
trust funds can be used as exit strategies, as donors, usually former colonial powers, gradually reduce their financial support for newly-independent states. Trust funds can provide an economic base for a sustainable and self-reliant state as it undergoes the transition from dependent to independent territory.

The model described in this thesis may also be applicable in other places, for example, in Niue, São Tomé, and Brunei (Anderson, 2002; Tisdell, 1998) and in various Native American communities. Each of these are places remote from the cores of the global economy, yet possess natural or sovereignty resources that could be used as the source of investment capital. The small populations of these places also insure that the per capita benefits of any trust fund would be relatively large. Niue, in the Pacific, could follow the Tuvalu (and FSM and Marshall Islands) model, in which part of New Zealand’s financial assistance to the island is saved in a trust fund, eventually making Niue far less reliant on continued New Zealand assistance. In the cases of São Tomé off the coast of Africa, and Brunei in Southeast Asia, both of which are oil rich states, a portion of oil revenues could be invested globally through a trust fund, providing a future capital source after petroleum reserves are depleted.

The world’s newest country, Timor-Leste (East Timor) in Southeast Asia, has already implemented a trust fund strategy to manage its revenues from offshore petroleum reserves. The Timor-Leste Petroleum Fund, established at the suggestion of Prime Minister Mari Alkatiri, will save a portion of current oil revenues for the use of future beneficiaries. Alkatiri noted that ‘equity between this generation and those in the future is the central principle underpinning the creation of the Fund’ (laohamutuk.org, 2005). Timor-Leste’s fund, modelled on that of
Norway, will save a portion of the nation’s oil revenues and invest them in global financial markets, while fund earnings will be held in a separate account held at the Federal Reserve Bank in New York. Protections on the use of fund earnings and capital have been embedded in the country’s new constitution. Timor-Leste has thus provided for its future at the very inception of the country’s independence, guaranteeing that current windfall benefits will be extended into perpetuity.

Two sub-themes have emerged through this thesis. The first of these is the spatiality of investment. Within the alternative model proposed here, the sites of capital generation and capital investment are separated, but local development takes place when investments are made globally. This practice is of course not new. For example, John Maynard Keynes (1958; 1960) relates the story of the windfall revenues acquired on Sir Francis Drake’s first three voyages (1573-1580), during which Drake raided Spanish ships and returned with a substantial booty. Keynes notes that the value of the gold that Drake brought back to England has been estimated as being between £300,000 and £1,500,000. Much of this revenue was used to pay off England’s national debt, but the remaining sum of £42,000 was invested overseas by Queen Elizabeth I in the Ottoman Empire, through the Levant Company. Keynes notes how the profits derived from this investment were used to finance the East India Company, and then how that company’s profits were used to finance further English economic expansion. According to Keynes, this offshore investment of a windfall resource was the basis of English economic expansion and prosperity. It was not the treasure itself that was beneficial, but the way of investing it in other enterprises that stimulated England’s development (Keynes,
1960, 156-158; Webb, 1952, 196-198).³

The wise Elizabeth I realized that investing in one of the leading empires of the day was a better course of action than investing in England itself, which was in the sixteenth century a rather remote and marginal corner of the world. England’s Ottoman investments followed the investment policy that I have advocated in this thesis, in which windfall capital is invested, not locally, but in the global financial markets of the day. The investments of the Alaska, Kiribati, and Tuvalu trust funds parallel the strategy that enabled England to achieve a high level of economic development.

The second sub-theme that has emerged in my analysis is that of sustainability. Non-renewable resources, whether natural or sovereignty-based, are finite. Their exploitation cannot provide a stream of benefits in perpetuity. But non-renewable resources can be transformed, through the mechanism of a trust fund, into a renewable fiscal resource. If the trust fund is well managed, it can produce a continuing stream of earnings far beyond the time frame of revenues from the windfall resource. The key to sustainability is the policy choices made during the window of opportunity, when the non-renewable resource is being extracted. Will these revenues be directed to current consumption, or will a portion of them be saved and accumulated as investment capital? And will this investment capital be invested in such a way as to generate annual earnings? If wisely managed, a trust fund can transform non-renewable windfall resources into renewable fiscal ones.

This thesis is a response to Gibson-Graham’s (2004) call ‘to think about

³ Conversely, the Spanish state spent the bulk of its colonial windfalls on the military and on public display, precipitating a decline in Spain’s economy (Karl, 1997, 34).
and practice development differently’. In this thesis, I ask development practitioners to reimagine the economic spaces of marginal economies and the relationship between core and periphery. I call for a separation of the sites of capital generation and capital investment, and for transforming non-renewable windfall resources into renewable fiscal ones. By avoiding the European tradition of industrial development, a new pathway is opened that can assist marginal spaces in renewing the wealth of nations.
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O. Scott Goldsmith, Professor of Economics, University of Alaska Anchorage; in Anchorage, 1988.

Gunnar Knapp, Professor of Economics, University of Alaska Anchorage; in Anchorage, 1988, and in Lake Tahoe, 1992.

Byron I. Mallott, President, Sealaska Corporation, and later Executive Director, Alaska Permanent Fund Corporation, in Juneau; 1988, 1990.


Thomas A. Morehouse, Professor of Political Science, University of Alaska Anchorage; in Anchorage, 1988, 1989.


James B. Rhode, Assistant to the Governor and Permanent Fund historian; in Juneau, 1988.

George Rogers, Emeritus Professor of Economics, University of Alaska Southeast; in Juneau, 1990.


Kiribati

Atanteora Beiatau, Chief Economist of Kiribati and RERF Board Member; in Tarawa, 2002.

Tim Davies, Third Secretary, Australian High Commission, Kiribati; in Tarawa, 2002.


Tebwe Ietaake, Permanent Secretary of Finance and RERF Board Member; in Tarawa, 2002.
Colin Hill, Australian High Commissioner, Kiribati; in Tarawa, 2002.

Rob Leach, Government Procurement Advisor; in Tarawa, 2002.

Ueantabo Neemia-Mackenzie, Director of the University of the South Pacific-Kiribati Extension; in Tarawa, 2002.


Nauru

Greg Castle, Australian plumber employed at refugee camp; in Nauru, 2002.

Russell Comelio, Australian labourer employed at refugee camp; in Nauru, 2002.

Melchior Mataki, Environmental scientist; in Nauru, 2002.

John O’Grady, Environmental scientist; in Nauru, 2002.

John Raige, Nauruan activist; in Nauru, 2002.

Guy Stafford, Australian electrician employed at refugee camp; in Nauru, 2002.

Tonga

Angus Macdonald, Australian High Commissioner, Tonga; in Nuku'alofa, 2002.

Tuvalu

Lt Commander Steve Cleary, RAN, Advisor to Tuvalu; in Funafuti, 2002.

James Conway, Advisor to the Tuvalu Government; in Funafuti, 2002.


Emily Koepke, Executive Director, Tuvalu Family Health Association; in Funafuti,
Panapasi Nelesone, Secretary to Government; in Funafuti, 2002.

Dr Tekaai Nelesone, Director of Health; in Funafuti, 2002.

The Right Hon. Bikenibeu Paeniu, Minister of Finance, former Prime Minister, and TTF Board Member; in Funafuti, 2002.

The Right Hon. Saufatu Sopoanga, Prime Minister of Tuvalu; in Funafuti, 2002.

Capt Tito Tapungao, Chief Executive Officer, Tuvalu Maritime Training Institute; in Funafuti, 2002.

Hellani Tumua, President of Tuvalu Overseas Seafarers’ Wives Association and AusAID Representative; in Funafuti, 2002.

Solofa Uota, Permanent Secretary of Finance and TTF Board Member; in Funafuti, 2002.