

Minutes of

Joint

Committee

JOINT COMMITTEE ON ECONOMIC RECOVERY
January 29, 1988
3:30 P.M.

MEMBERS PRESENT

Senator Arliss Sturgulewski, Co-Chair
Senator Lloyd Jones, Co-Chair
Senator Jack Coghill
Senator Jan Faiks
Senator Rick Halford
Representative Max Gruenberg, Jr., Chairman
Representative Kay Brown
Representative Red Boucher
Representative Steve Rieger
Representative Frank Ulmer

MEMBERS ABSENT

Senator Dick Eliason
Senator Joe Josephson
Senator Fred Zharoff
Representative Al Adams
Representative Niilo Koponen
Representative Mike Miller
Representative Mike Navarre

WITNESS REGISTER

J. Anthony Smith, Commissioner
Department of Commerce and Economic Development
P. O. Box D
Juneau, Alaska 99811

Lee Gorsuch, Director
Institute of Social and Economic Research
University of Alaska, Anchorage
3211 Providence Drive
Anchorage, Alaska 99508

David A. Rose, Executive Director
Alaska Permanent Fund Corporation
Department of Revenue
P. O. Box 4-1000
Juneau, Alaska 99811

ACTION NARRATIVE

**Tape One, Side One
Number 002**

Representative Gruenberg, Chairman, called the meeting to order at 3:38 p.m. He noted that Representatives Fritz Pettyjohn and Mike Davis were also in attendance.

Senator Sturgulewski advised the committee that the Senate members had an organizational meeting and will be in communication with the House regarding its work. Senator Jones commented on the statewide need for economic recovery and stressed the importance of appropriate management of the state's natural resources.

Representative Gruenberg provided opening remarks on the existing economic recession. He stated that Alaskan wage and salary employment over the last year has decreased 4.7% from this time last year. It represents a loss of approximately 10,000 jobs and that decline has effected nearly every employment sector of our economy without exception. The drop-off in housing starts to virtually zero in the urban regions of the state; the 3.5% decline of number of persons in the government workforce which is a loss of about 2,500 jobs, and the weak and erratic price of oil in the preceding year have all combined to bring us face-to-face with a severe economic recession. The annual income generated by the Alaskan non-agricultural wage and salary workforce between 1985-86 declined by almost 4.5% from \$6.48 billion to \$6.15 billion. By all indications, the figures for 1987 will be worse and this reduction of cash to our economy has had a significant impact.

He continued that our banking institutions have also felt the impact as we witnessed last year with the closure of the Bank of the North and the necessary merger of Alaska Mutual Bank and United Bank of Alaska into Alliance Bank. Our local economies have felt the impact as 1,300 businesses filed for bankruptcy this past year which was the highest rate ever recorded in this state. Many others have begun the new year teetering on the edge of financial insolvency. And our home owners have also felt the impact as defaults on home mortgages rose to the highest point in our state's history. By June of last year (the latest figures available in 1987) over 11,900 residential loans were delinquent or in default. Most Alaskans have seen a decrease in property values, in some cases up to 50%, a terrible personal tragedy for those who have invested their futures in this state.

In reference to the state's resources, he added that the picture is not entirely bleak as we have seen gradual increases in stabilization of our natural resource

industries. According to recent state and private research studies, both mining and southeast timber have recovered somewhat. According to Alaska's Department of Labor, our bottomfish industry was the premier growth industry of 1987. This industry posted a 41% gain in employment over last year's level. This was an increase of 1,700 jobs. Further efforts to diversify our economy where feasible can only continue these trends. These must be accomplished in concert with effective research management policies.

Representative Gruenberg then introduced the guest speakers for the meeting. The first to come before the committee was Commissioner J. Anthony (Tony) Smith, Department of Commerce and Economic Development.

Number 172

Commissioner Smith addressed the committee not only in the capacity of Commissioner, but also as Chairman, Alaska Housing Finance Corporation, Chairman of State Bond Committee, and Chairman of the Alaska Industrial Development and Export Authority. He felt that the future is bright and the ultimate solution to our problem is industrial development and creation of real jobs. He provided the following statistics.

Hardrock mining is up 30% this year. We were, in 1986, 42nd in the nation and are on our way to a billion dollar industry. Timber is up -- the low point was \$213 million gross state product. We're at \$300 million this year and heading towards a historical high and have a tremendous opportunity for expansion in southcentral and the interior. Oil and gas -- we have surpassed Texas as the number one U.S. producer and, by the time that ANWR is finally brought on stream, we will have 45% of the domestic oil reserves. We have much room for expansion in the fishing industry. Tourism has much potential over the next five years. The federal government is expanding in Alaska and has growth potential.

Number 263

Commissioner Smith continued that he has been advised by the oil industry that they have squeezed 40% out of their cost system. They do not expect that 40% to return to the system, since they have been able to reduce the cost of oil production. He met with Juneau Mayor Polley and discussed the increase in mining activity in southeast -- we are looking at \$10-15/hour for labor. We are now looking at a different economic structure. Whatever economic remedies we employ must be sustainable through the year 2000 in terms of state revenues and state options. He then discussed the difficulties the financial industry has incurred. The FDIC now holds \$250 million in assets as a

result of the closure and merger of the four banks and it is working with him on options of dealing with the assets. MGIC and Fannie Mae are also deeply involved in solving the financial problems.

Number 355

Commissioner Smith commented that we "went off the precipice last December" and his view of the economy differs somewhat from others. He looks at the problem more in terms of cash flow than in negative or loss in equity. By 1990-92, he feels that owners of Class A buildings will be back in the \$2.00 range where most banks made their loans in the early 1980's; the problem is getting there from here. The other problem he sees is that the professionals are draining the equity from the business in an effort to keep the real estate on the positive side of the ledger. The write-down itself is not necessarily negative if the businesses can continue to work out their loans. One option is to work the assets back into the economy but it is not easy. He sees little hope for commercial owners of Class B buildings, that are not well situated or, if built after 1980 and financed under the normal debt structure, to make a comeback -- and no future for owners of Class C buildings unless owner-occupied in some fashion.

Number 480

The FDIC holds about 3700 separate assets that need to be evaluated, and many of them do not impact the market. His goal has been to facilitate a private sector response. In discussing the situation with John Williams, Deputy Commissioner, Mr. Williams described it as creating a situation where the management of these assets is a market-taker not a market-maker, and distinguished the motives of outside versus in-state interests. As an example, Sealaska has hired Peter McDowell and is putting together a project team to work with the FDIC and looking at creating a private sector response to the problem. In conclusion, he stated that he felt we need a number of small initiatives rather than finding one solution to the problem.

Number 544

Senator Faiks asked for clarification of his statement on recovery of commercial Class A structures. The Commissioner explained the significance of good location as well as quality of structure (elevators, steel frame, etc.) in evaluating the marketability of a building. Senator Faiks pointed out that the hardest-hit group is the small business and that efforts should be aimed at assisting them, as well as the large investors.

Number 630

Senator Coghill asked if the marketing groups were coordinating the effort. The Commissioner answered that all the groups are working together. The AIDA policy is work-outs, and the banks are working at managing the problem. Further, there are some statutory changes that will be necessary and a bill will be coming in on the 2% rule of AIDA and other recommended changes. The AIDA bill is with the Department of law and should be out shortly. Senator Sturgulewski added that the Senate side has identified some areas that they will pursue and requested that information be provided to them as soon as possible so that independent analyses can be made.

Number 677

Representative Boucher asked if the Department is doing everything it can to get everyone involved sitting at the table to work things out, and referred to the aggressive action taken by the Minnesota legislature in dealing with the farm crisis. Commissioner Smith said that the problems have consumed all of their time and explained the wholistic approach to the problem as well as the separate work done with MGIC and Fannie Mae.

Number 743

Senator Jones inquired what the Department is doing to create new wealth: value-added products, new industries, etc. Commissioner Smith answered that Governor Cowper directed the department to stop using regulations against mining and timber industries; and that the administration has taken a pro-active role moving these industries, as well as tourism, ahead; and hopes to get the marketing program moving which met with funding problems last year.

Number 789

Lee Gorsuch, Director, Institute of Social and Economic Research, University of Alaska, Anchorage, and currently serving as Interim Dean of the School of Economics and Public Policy, was next to testify. Dr Gorsuch referenced the following report that was distributed to the members: "Alaska Review of Social and Economic Conditions", December 1987, published by the Institute. He urged the committee to support additional funding to the Department and the Governor's Office in support of economic information; specifically, state government has less economic capability and produces less economic information today than it did in the mid-late 1970's and the department is sorely lacking in its ability to respond to requests from individuals and businesses looking for investment opportunities in Alaska.

He commented that prospects for the 1990's are optimistic and stated that the recession is part of the economic recovery. The consequences of the reduced state spending were population loss, employment and income loss, and less demand for housing and building. He felt that the employment rate will continue to decelerate to the end of 1988, and then start on a modest recovery. The President of ARCO indicated that the oil and gas industry are optimistic about the future of oil and gas development in the state; they are increasing their exploration activities, and estimated reserves of recoverable oil have increased substantially and now the peak production years will be 1990-91. Also, the Alaska Permanent Fund created a new industry in the state. Although wages and prices have declined, Alaska businesses are now more competitive.

Tape One, Side Two
Number 881

The bad news is that the economic recovery has taken its toll. Those who enjoyed the prosperity of the rapid growth of the early 1980's are now experiencing the pain, agony and loss associated with the decline. The industry that has been hardest hit is construction -- it grew to about 22,000 workers at the peak in 1984-85 and now stands around 9,000 workers. They have absorbed over half of the employment loss since the peak. The regions of the state that have experienced the greatest population and employment growth are the same regions that now experience the greatest loss -- Anchorage, Mat-su and Kenai. Correspondingly, investors who were most active during this period, a majority being in real estate, are now experiencing the most serious dislocation. Those, who before the boom were already disadvantaged (mainly the bush) also felt the greatest impact. Rural parts of the state were unable to convert the windfall of state spending into any sustainable source of economic growth in general.

Number 952

Dr. Gorsuch indicated that all the signs for Alaskan industries are now positive. Mining activity has increased; tourism is showing opportunities for growth; fisheries continue to be a robust industry; military has increased its activities, federal government's presence continues to be stable and timber prices have rebounded. If we can stabilize state government spending, the basic industries will drive the moderate growth of the economy and will provide opportunities for economic development.

Number 987

In summary, Dr. Gorsuch reiterated that the economic recovery is in place and working. There is economic

hardship and the need for relief; and opportunities for growth and economic development. He recommended that the committee, during its deliberations, distinguish its efforts directed at: (1) overall design of the economic recovery plan, strategic in nature; (2) economic relief, not necessarily related to recovery, and (3) economic development and growth of the state. With regard to the recovery plan, the implication is that state spending has to achieve some level of sustainability -- to pump up state spending only to have it decline in the future years will simply destabilize the private economy again. Referencing economic relief, he commented specific targeted initiatives that minimize the adverse economic consequences but maximize the economic relief are in order. With economic development, he felt that there are several instances where these basic industries afford the state opportunities for additional capital investment incentives, promotion, and development of information to support capital investment expansion.

Number 010

Dr. Gorsuch commented on his previous discussion with Governor Cowper. He thought that state spending, per se, would not aid in the recovery. If their projections are correct, the recession will end this year and recovery will start in 1989. In 1989, we could see an additional 2,000-3,000 jobs added to the labor force, an infusion of about \$100 million added to the economy. Question: If \$100 million in personal income were to be picked up in 1989, and if you could find \$100 million for 1988, couldn't you offset the pain associated with dislocation by having accelerated spending. Answer: Yes.

He offered some general criteria that he thought would maximize the net economic benefit such as, target individuals that are unemployed as they are more inclined to spend incomes in the local economy (i.e., youth or chronically unemployed, extending unemployment benefits to those who continue to be unemployed); capital projects that have the effect of lowering future operation-maintenance expenses, and in the process also create employment opportunities for resident Alaskans; sources of refinancing for small businesses; challenge funds available for the university or non-profit organizations that aggressively pursue federal and out-of-state money that augments their financial base. He felt the major policy issue are the problems associated with residential housing market. There is concern that AHFC continues to operate at the same level of staff support and capability they had when they were building and financing houses, and now we are looking at managing a large surplus inventory of homes. They could use additional technical expertise to help them manage these problems.

Number 127

Senator Sturgulewski requested specific information prepared by the Institute on value-added or areas that might be utilized in stimulating basic industries be provided to the committee for review.

Number 150

Senator Halford asked what percentage of the total employment occurs in oil, gas, mineral, military, fisheries and tourism; and how will the recovery affect various areas. Dr. Gorsuch estimated 20%-25%. Of that remaining, the largest element is in the support industry -- more than twice the size of the basic industries. Dr. Gorsuch identified a couple of projects that individually will add 200-300 jobs, but cumulatively (10-15 projects) there will be a positive impact. When he refers to positive outlook for the 1990's, he means moderate growth of 1%-2%, which equates to 2,000-3,000 jobs a year. Responding to another question from Senator Halford who questioned the validity of the market indicators, Dr. Gorsuch clarified that, in taking the real estate market as an example, the large surplus supply of residential housing has had the effect of depreciating the value of everyone's home -- not just those who made large transactions. We need to get the financial industries to actively cooperate with the state to bring some stability to the market so that prices don't erode further and result in a collapse. In short, everyone who had anything to do with real estate has been hurt, whether you were a land owner, builder, furnisher of building supplies, interior design, mortgage insurance companies, etc. He said that the ISER studies are based on specific oil price and state revenue assumptions and if those assumptions change, the results would have to be modified accordingly. The most reliable recovery is in employment and total personal income which represents aggregate consumer demand, the best signals of what is happening in the Alaskan economy.

Number 348

Representative Boucher asked for more details on the psychological impact on consumer spending and savings; and asked if the press' overall attitude has had a significant effect on consumer spending. In response to the first question, Dr. Gorsuch said that this information is not readily available since the state does not have uniform sales taxes, personal income tax, etc. The information could be obtained in a survey. In reference to the actions of the press, Dr. Gorsuch guessed it did, and cautioned the legislature to avoid increasing the level of spending or assistance if it cannot be sustained.

Number 409

David Rose, Executive Director, Alaska Permanent Fund Corporation, came before the committee. He has been in contact with many people in the past weeks: bankers, real estate people, investors, financiers, etc. He talked with Mayor Fink, who advanced his proposal with respect to the Permanent Fund investing in some of the surplus property in terms of buying and holding it. It is his feeling that because there were some bad investments, they wouldn't suddenly become good ones if the permanent fund invested in them. There are standards: legislated through statutes, constitutional, or standards imposed by the trustees which all property and investment would have to meet. It was not the trustees' intent to lessen or weaken the standards nor had they communicated to him any desire for legislative change.

Number 457

Mr. Rose continued that a white paper was issued which detailed some options. He referred to the Analysis Sheet that was prepared on the banks and distributed to the committee. The Permanent Fund has \$218 million invested in the Alaskan economy and, of this money, \$165 million are in Alaskan banks. The Fund's policy with respect to deposits in the Alaskan banks are to create stability. Despite the bank failures, the Fund has not lost any money, nor do they add to a failure by removal of the deposits. Concerning the FDIC, he indicated that it will not dump on the economy a tremendous amount of property and cheapen the collateral of other banks. That action would devalue collateral held by existing banks, much of that collateral is against the \$165 million that the Fund holds as collateral against its loans. The FDIC would not negatively effect their member banks.

Number 520

He questioned whether action should be taken to move the supply and demand curves of the market economy -- that is a fundamental question as you will have to carefully evaluate who will be served. He noted that the current market has benefited some individuals such as people being able to go into business as the rent for office space is more affordable; and the huge migration from low cost housing to better housing.

Assuming you make an affirmative decision on the above. Any action will have to be well planned. For example, you cannot stabilize housing by taking some of it and keeping it off the market if you aren't going to have the control that prevents the addition of new supply -- you will have to shut down new construction, with few exceptions. It

will need the cooperation from state, local, and in some instances federal, governments so that all actions are in concert.

Number 593

Representative Boucher commented on a previous point regarding the shift in housing, from low to moderate, and noted the increase in population in Anchorage south of Tudor Road.

Number 600

Commissioner Smith returned to the table to expand on Mr. Rose's comments. Referring to the condominium problem, he stated that 34,694 (73.6%) of the active loans are single family housing which all the commentators contend is firming up and moving forward. Only 6,400 were condominiums, and 5,900 duplexes, triplexes and fourplexes.

Representative Gruenberg announced the next meeting of the Joint Committee to be February 1, 3:30 p.m., House Finance Committee Room. There being no further business to come before the committee, the meeting was adjourned at 5:04 p.m.

JOINT COMMITTEE ON ECONOMIC RECOVERY

February 1, 1988

3:30 P.M.

MEMBERS PRESENT

Senator Arliss Sturgulewski, Co-Chair
Senator Joe Josephson
Representative Max Gruenberg, Jr., Chair
Representative Red Boucher
Representative Kay Brown
Representative Niilo Koponen
Representative Mike Miller
Representative Mike Navarre
Representative Steve Rieger
Representative Fran Ulmer

MEMBERS ABSENT

Senator Lloyd Jones, Co-Chair
Senator Jack Coghill
Senator Dick Eliason
Senator Jan Faiks
Senator Rick Halford
Senator Fred Zharoff
Representative Al Adams

WITNESS REGISTER

J. Anthony Smith, Commissioner
Department of Commerce and Economic Development
P. O. Box D
Juneau, Alaska 99811

ACTION NARRATIVE

Tape One, Side One
Number 001

Senator Sturgulewski, Senate Co-Chair, called the meeting to order at 3:35 p.m. Also present were Representatives Virginia Collins, Adelheid Herrmann and Henry Springer.

Representative Gruenberg noted the receipt of advanced copies of the Directory of Projects and Proposals with Direct Economic Impact from the Division of Policy, Office of the Governor.

Number 050

Commissioner Smith was the only witness to testify before the Joint Committee. He started his overview by commenting on the residential market and Alaska Housing Finance Corporation (AHFC). The major opportunity of AHFC is to manage the portfolio including the properties that has been foreclosed or returned to the corporation.

Number 075

Senator Sturgulewski asked the Commissioner to explain briefly how the insurer fits into the picture of residential loans. Commissioner Smith stated that AHFC is a secondary market, it buys loans from banks, and for the period 1980-86, it had 80+ percent of the market. AHFC has other markets such as federal programs like Fannie Mae and Freddie Mac that take AHFC's loans. MGIC, a primary mortgage insurer, protects the financial institutions, not the home owner, by protecting the buyers of bonds which finance the transactions. He then detailed other actions taken by AHFC to determine the amount of exposure of the groups. Basically, AHFC has been insured for the losses and insures that the bondholders are paid. The overall approach of dealing with the housing situation is wholistic in nature, to soften the impact and not drive people out of their homes.

In June, 1987, AHFC had approximately 52,000 out of 84,000 total loans in the state. 34,694 (73.6%) of those loans were single-family detached residences and that market, generally speaking, has firmed up. Condominiums made up 6,480 (13.7%) of AHFC's portfolio. 5,966 (12.7%) were duplexes, triplexes or fourplexes; and roughly 3,000 mobile homes which were basically a direct appropriation.

Number 294

Representative Gruenberg asked if these figures are relative percentages to that of a few years ago. Commissioner Smith answered they are relatively the same. Although the condominiums make up a small percentage of the overall market, they make up a large percentage of the problem. AHFC has taken back 3,700 properties and 1,000 of those are mobile homes. It may have as many as 5,000 units come back as they work through the HOPE program.

Number 357

Representative Rieger requested clarification on the 5,000 figure being additional or total units. Commissioner Smith responded "total", an increase of 1,300 properties. He then provided the inventory as follows: In 1987, 1,100 mobile homes and 2,500 other. He will provide a more detailed breakdown to the committee.

Number 378

Senator Josephson asked how the 5,000 figure was derived. Commissioner Smith said that figures he uses are vacant units and he will have more information available in March as they are awaiting responses from the mailout. In responding to Senator Josephson's question as to whether we have seen the worst, the Commissioner feels that we have reached a point where the situation has stabilized.

Number 437

Representatives Boucher, Navarre and Ulmer requested specific information be provided on the breakdown as referenced, the HOPE program, and a geographic breakdown.

Number 484

Commissioner Smith continued that the Board has recently requested AHFC to provide financial statements at monthly meetings. This is a \$5.8 billion corporation that does not have the capabilities, at present, to provide financial statements. It's because they are shorthanded and overwhelmed by the magnitude of what hit, and they don't have a workout specialist. He urged support for additional staff to handle the new and difficult responsibilities.

Number 517

Representative Gruenberg asked that the Commissioner provide in writing a summary of the various programs, the department's recommendations, and requests for additional staff.

Representative Collins stressed the problems associated with negative equity which prohibits movement in the market, and asked that the situation be addressed. The Commissioner discussed the possibility of positive red-lining, identifying projects that can be traded into, to help get the market moving.

Number 561

Representative Koponen inquired about proposed long-term changes. Commissioner Smith commented that there have been discussions of taking trades in certain areas -- a form or urban renewal -- where you can trade out of housing that is no longer economically justified and then take the property down because it cost too much to maintain an empty unit. Representative Koponen asked about changing the construction standards. Senator Sturgulewski said that the Community and Regional Affairs Committee is carrying out the legislative directive and have developed thermal standards. One difficulty is that we only have building codes in a few

areas and many of the problems are in the areas that do not have building codes. There has been a nine month postponement of regulations but it will create a problem with AHFC, which is not a regulatory agency.

Number 606

Representative Boucher said that Marriott has proposed building a hotel in Anchorage for \$28 million, resulting in 170 construction jobs and it would employ 150 full-time employees. What has happened to the project. Commissioner Smith responded that he has been in touch with the people, almost every 30 days, and there is a proposal that the administration is introducing on AIDA which will increase the limit to \$25 million and this project would roughly fit the perimeters of AIDA as proposed.

Number 630

Senator Sturgulewski said that there are suggestions to limit AHFC from making additional loans; and limit AIDA with regard to the 2% rule and asked that he provide an update. The Commissioner said that AIDA's portfolio is no better than that of banks, it is doing workouts, and the department is not concerned about the solvency of AIDA. Estimated costs for new construction is \$2.30-2.50/square foot; and Class A space is now available for \$.80-1.20/square foot so it will be a long time before there is a rush to AIDA to construct office buildings in today's market. The problem with moratoriums in statutes is that you have a problem of reacting to the other side of it -- 2% rule is case in point. He then detailed the 2% rule: if a financial institution has more than 2% of its portfolio with AIDA delinquent over 90 days, it is not allowed to generate any more AIDA loans, including refinancing and workouts. Basically, there is not a secondary market for commercial loans in Alaska as we had a situation where none of the banks in the state qualified to originate an AIDA loan. The administration will be introducing a bill that allows you to deal with the rule by regulation.

Tape One, Side Two
Number 001

Commissioner Smith continued his discussion of AIDA. There was discussion, with the number of bank failures and mergers, about changing the regulations so that a non-resident bank could originate a loan if the project was in Alaska, and that change has been made. He then discussed some other regulatory changes.

Number 123

Representative Koponen asked for current statistics on the vacancy rate in Anchorage. The Commissioner did not have that data but rather the department focussed on the square footage rate, etc. Senator Josephson asked if any assistance might be available to the University to acquire surplus property for its housing needs. Commissioner Smith responded that it is one of the areas that needs exploration and dealt with on an identifiable project basis.

Number 170

The Commissioner referred to the state loan guarantee program similar to the SBA program. The problem with that type of program is that the state cannot print money and the federal government can. They will continue to work on it but there are many problems. To have such a program would be a major step forward for the economy of the state.

Number 235

Senator Sturgulewski requested that a paper be prepared on it, and asked who should be contacted for expertise in this area. Commissioner Smith provided the following list of individuals: Frank Cox, SBA; John Shackelford, Key Bank; Jan Sieberts, NBA; Ron Bosi and Jerry Weaver, Rainier Bank; Bert Wagnon, AIDA; and Jack Jessee, ComRim Systems, Inc., who is also a member of the AIDA Board.

With regard to the guarantee program, the Commissioner said that SBA has a \$500,000 program which isn't enough and it also has areas that they cannot participate in; so if we did this type of program AIDA would pick up above \$500,000 in areas where SBA did not serve to make the credit possible. The problem in creating the program is that you are looking at a liability in the future that you can't quantify now.

Number 297

In discussing the banking situation with Senator Josephson, the Commissioner said that the biggest problem the banks are having is finding earning assets -- they are looking for loans, and there isn't much velocity in the market now. Senator Josephson asked that in this economic climate, is it possible to require credit reporting agencies to note that in a situation where a person has a good credit history until 1985-87 that there may be systemic circumstances that led to the problem. The Commissioner responded that he would have problems with it and detailed his concerns.

Further, if we are going to do pro-active economic development, we need AIDA. If we take AIDA's assets to take care of the problems, we will have bigger problems. The

ultimate solution is more people and more economic activity; and how you manage your way to that day.

Number 406

Representative Gruenberg asked if AIDA has the necessary statutory flexibility to meet the crisis. If it doesn't, the Commissioner said, he will advise the committee. Representative Gruenberg stated that there might be a better overall approach to the slow process of project-by-project and loan-by-loan review by AIDA, as solutions need to be found quickly.

Number 432

Senator Josephson said that people in Anchorage have commented that AIDA created part of the problem as it contributed to the over-supply of office space. The Commissioner responded that you could not lay blame on AIDA or AHFC -- they were just merely part of the problem. Some banks were using broker deposits to excess. By that, you pay more than the market by making loans at higher rates of interest than the more conservative lender; and people that couldn't get loans at the more conservative lower rates ended in higher delinquencies. He generally discussed the different factors that led to our situation.

Number 490

Commissioner Smith then discussed the FDIC. There are 3,700 assets, 602 parcels of real estate out of the four banks. 1,275 assets with a book value of \$170,165,000; 602 parcels with a book value of \$28,077,000. There are 15 charge-off's with a book value of \$36 million; and bank premises of \$22,400,000. It is anticipated that 1,000 loans will be put back under the deal with NBA, with an estimated value of \$90 million. They would like for management of the assets to remain in-state versus FDIC setting up a liquidation office in Anchorage. The problem is that not all of the assets impact the market and it is difficult to determine how the state can step in and decide what should be done and how it should be managed.

One idea that has been discussed is: the private real estate investment trust which Sealaska, with some other native corporations and private investors, is reviewing with the FDIC.

Number 535

Senator Sturgulewski asked about the bridge bank. The Commissioner responded that creation of the bridge bank will necessitate amendment to Title 06.01 to give the Director of the Division of Banking and Securities the

authority to regulate an entity that would be a non-depository financial institution with powers of receiving and managing banking assets. She asked if it is different than what is required for a REIT (real estate investment trust), and what is the difference between the REIT and a bridge bank. He said that REIT's are already provided for in the administrative code, and regulated in the sense of its offering; a bridge bank is regulated more like a banking institution. The flexibility depends on the creativity of the people that put it together. The difficulties associated with managing the assets is why he advocates a private sector response.

Number 608

Senator Josephson commented on the approach of exemption from local property taxation that if the acquirer of the distressed parcel kept it vacant and participated in this pooling concept, there would be immunity or exemption from local tax. The state could be involved in it either by changing the municipal code to authorize it, or by conceivably payment to the municipality in lieu of those taxes. The Commissioner said that he has discussed this with Mayor Fink and others and it will be a very complex decision, if made. His direction has been to facilitate a private sector response in-state.

Number 637

Representative Gruenberg talked about the constitutional problems associated with out-of-state versus in-state "vulture funds". He asked that the department review property takeovers. The Commissioner agreed. The committee discussed the opportunities created for others when the economy falls.

He spoke about extending the right of redemption to three years, which Minnesota did. It means when someone is going to go through judicial foreclosure, they have got to look to three years instead of one year. Representative Boucher said that he had a copy of the Minnesota proposal for review. The Commissioner indicated that it will impact outside financial institutions. It isn't going to make it easier at a point when we are having trouble attracting capital in the state.

Tape Two, Side One
Number 001

Senator Josephson asked about what FDIC is planning. The Commissioner stated that FDIC will aggressively market the properties, which may deflate values, and it has the flexibility to sell and finance. We see an opportunity of

a big discount such as a person buying at \$.25 on the dollar and get it back into the market.

Number 009

Representative Rieger questioned that in the state's position as facilitator, is it going to attach strings to market placement. The Commissioner answered that if you require a period of "hold" in Alaska, it will mean substantial dollars.

There being no further business to come before the Committee, the meeting was adjourned at 5:10 p.m.

JOINT COMMITTEE ON ECONOMIC RECOVERY

February 9, 1988

12:00 NOON

MEMBERS PRESENT

Senator Arliss Sturgulewski, Co-Chair
Senator Lloyd Jones, Co-Chair
Senator Jack Coghill
Senator Jan Faiks
Senator Rick Halford
Senator Joe Josephson
Senator Fred Zharoff
Representative Max Gruenberg, Jr., Chairman
Representative Kay Brown
Representative Red Boucher
Representative Steve Rieger
Representative Niilo Koponen
Representative Mike Miller
Representative Mike Navarre

MEMBERS ABSENT

Senator Dick Eliason
Representative Al Adams
Representative Fran Ulmer

WITNESS REGISTER

Larry Schannault, Deputy Regional Director
Division of Liquidation
Jay Hone, Asset Marketing Specialist
Martha Hicks, Attorney, Legal Division
Federal Deposit Insurance Corporation
25 Ecker Street, Suite 1900
San Francisco, California 94105

ACTION NARRATIVE

Tape One, Side One
Number 002

Representative Gruenberg, Chairman, called the meeting to order at 12:07 p.m. He noted the following legislators were also in attendance: Senator Rick Uehling, Representatives Pat Pourchot, Dave Donley, Virginia Collins, Fritz Pettyjohn, Ramona Barnes, Steve Frank and Drue Pearce.

Number 053

Larry Schannault, FDIC, provided opening comments on the FDIC's role in its handling of assets received from three bank closures in the state. They are currently in the process of determining the value of its assets through analysis by conducting appraisals of real property and reviewing financial and other data. He estimated that the FDIC has acquired a total of \$250 million in various types of assets secured by real estate mortgages (REM), commercial property, automobiles and property owned individually as owned real estate.

Number 105

Concerning owned real estate (ORE) which is property foreclosed on, or the person(s) accepted a deed in lieu of foreclosure prior to the bank failure, which was owned property by the bank. FDIC has approximately 650 such individual properties representing \$30 million in various types of property (commercial and single-family homes) and \$20 million in bank premises that are in the process of being appraised by certified independent appraisers. They have payment notes that are secured by various types of collateral i.e., car, REM, commercial-type properties, and they are reviewing financial data to determine the recovery and length of time it will take for FDIC to collect the loans.

He discussed the responsibilities the receiver has versus the insurer. FDIC is the insurer of bank deposits up to \$100,000 per account. When a bank fails, the FDIC has several mechanisms to assure that depositors get reimbursed: (1) payoff of the funds back to the depositors; or (2) insured portion of the deposit was transferred to an assuming bank and the uninsured portion is retained by the receiver and becomes a creditor of the estate of the receiver; or (3) all deposits were transferred to an assuming bank. FDIC has completed its responsibility as insurer; now it has to maximize recovery of the loans and assure a timely liquidation so there is a maximum return to the estate of the receivership. He did not know how long it would take to complete the receiver responsibilities. Once they complete the rewrite of the instruments and modify the terms, it is in a payout status, the FDIC then has a performing obligation which it can sell to another institution or investor. The goal of liquidation is to turn the assets into cash as rapidly as possible.

Number 242

Representative Boucher questioned whether the FDIC has contacted the debtors for workouts and the timeframe involved in the process. Mr. Schannault responded that

there has been limited contact unless the debtor has voluntarily come in for assistance. Approximately 90 days have transpired since FDIC took over the loans. He would estimate another 90 days following the initial contact before workouts begin.

Number 276

Senator Faiks asked Mr. Schannault to explain the various departments and their inter-relationships. He clarified the insurance and receivership operations and said that the bank examination is part of the insurance function which does not relate to activities of the Division of Liquidation. The information is not shared information concerning what action the liquidator may take with regard to the receivership estate; or how it would impact operating banks that may be under examination.

She asked if they allowed real estate speculation to determine their decision-making on liquidation. Mr. Schannault responded that the Division has never held property for speculative purposes.

Number 323

In responding to a question from Senator Josephson, Mr. Schannault said that the average (2-10 years) is the amount of time it would hold the assets if it cannot complete a sale. If there is a market to buy at a fair price, it would not take as long.

Senator Josephson asked if the FDIC Board has the authority to say that certain action by the FDIC in an area might impact the remaining members of the FDIC. Mr. Schannault said he was not aware of any such directive in the past. The FDIC does not have a mandate that they have to be in and out of a liquidation in a specific amount of time. The first effort goes toward selling the performing loans; then correct the delinquencies on the non-performing loans and put them in a paying status, then sell those. If successful, they don't have any remaining assets.

Senator Josephson commented that if they cannot sell an asset, it would reflect either a substandard asset or, in context, difficult to market.

Number 400

Representative Brown asked about the FDIC's policy on liquidating via auction. Mr. Schannault answered that it would not make sense to have an auction at this point in time, as it would not bring back the highest returns. She asked if the FDIC could make a commitment to hold action until the state makes a proposal. He was advised by the

legal department that the FDIC cannot put themselves in that position -- the door is open -- and they can't exclude any person or group from buying if it is a fair offer.

Number 437

Representative Rieger asked for clarification of their role in restructuring the debt. Mr. Schannault indicated that packages of loans have already been prepared on loans from the Alaska Bank of the North, and they hope to complete work on First Interstate's loans within 90 days. He said that Representative Rieger was correct in that some work-outs are included in these packages.

Number 472

Senator Sturgulewski asked if the FDIC is required to consider the impact that dumping property on the market would have on healthy banks. Mr. Schannault said not in the receivership actions, and it has been his experience that this action has not had an impact on other banks in a community, but could not guarantee the same result in the Alaska situation.

Senator Sturgulewski continued that should the Legislature create a stabilization entity which pooled the assets of various institutions and held them for stabilization and eventual liquidation, could the FDIC enter into agreements with it or other agencies. Mr. Schannault said that he has never been approached on this proposal, nor to his knowledge has the Board of Directors, so he did not know the answer. Further, the statutory guidelines may allow for such action.

Number 554

Senator Uehling referred to the Uniform Appraisal Instruction to Appraisers for FDIC Real Estate Properties (not required for residential single family properties) which stated that "The FDIC believes in an intensive marketing program and normally expects to sell a property within 6 - 12 months of acquisition", and expressed concern that large purchases will be made by outside interests. Mr. Schannault said that they have not been approached by any entity to purchase owned real estate in Alaska. They do have a mailing list of investors which are interested in buying individual properties such as shopping centers, apartment complexes, office buildings, etc., which would be contacted. Properties will be turned over to real estate brokers in the area.

Number 595

Representative Koponen inquired how long the FDIC would hold property until it determines to sell at a much reduced price, due to the depressed market. Mr. Schannault responded that the properties are being appraised at today's market and they do not hold property to speculate in hope that the market will improve at some later date. If they get offers that are consistently lower than the appraised values, they will go back to the appraiser and request a re-evaluation.

Number 626

Senator Halford provided a scenario whereby the FDIC's action will have an negative impact on existing commercial property owners. Mr. Schannault described how they would proceed in working with persons in modifying terms of a workout. In the case of ORE, just because they have taken possession of the property does not mean that the debt was alleviated. The person could have worked out in a debt in lieu of foreclosure, or if the FDIC has the property, it would still be working with the debtor for any deficiencies remaining. He agreed with Senator Halford that if the FDIC can show that the person can repay the deficiency on the loan, it would go through a judicial process to foreclose. If the FDIC determines that the person does not have the ability to repay a deficiency, it would not be practical for them to go through a judicial foreclosure.

Number 678

Senator Jones asked for clarification of what offers would be accepted. Mr. Schannault said that they would not take any offer, but would take offers in line with the appraisals. He felt that the state, like other individuals and investors, may want to appraise the property separately for comparison purposes.

Number 738

Representative Boucher asked if they were aware of any measures taken in other states, such as Texas, that encountered similar problems; and should the legislature be involved in the situation. Mr. Schannault was not aware of any similar program as that discussed in any other state. Further, the FDIC would not recommend any action by the state. He was not aware of any outside "vulture funds" waiting to take action.

Number 788

Senator Faiks discussed the proposal of the Legislature requesting appraisals on various properties. Mr. Schannault said that when FDIC acquires the assets, it is at the book value at the time the bank failed and have not

been adjusted to value in today's market. FDIC looks at the properties, has them appraised, and reviews the contracts to determine the actual value in today's market. They have contracts for REM's, commercial buildings and operations, fishing contractors, resorts, condominiums, cars and personal loans. With regard to appraisals, they recommend appraisals by others to assure similar value ratings.

Tape One, Side Two
Number 856

Senator Josephson asked what percentage of the appraisal has been accepted for subsequent sale. Mr. Schannault said that they have taken as low as 80-90% of appraised value on individual properties, not aggregate sales. Senator Josephson then inquired about a proposed buyer taking points instead. The FDIC would also consider such a proposal. Senator Josephson commented on the social and economic involvement of outside versus in-state interests.

Number 941

Representative Rieger discussed the state's focus on the situation whereby the state should be more concerned with the next purchaser of property versus FDIC's actions.

Number 998

Senator Jones asked who did the appraisals, and Mr. Schannault responded they were prepared in-house and described their procedures which he said are similar to normal business formulas in calculating the values. Mr. Hone clarified that there are two types of appraisals: real estate is done by outside appraisers; and loans which they are qualified to do.

Number 028

Senator Sturgulewski wanted to know how the FDIC is handling the small business loans. Mr. Schannault said that an analysis is prepared and approximately 95% of them are referred to another lending institution. With regard to a construction loan that is at the end of its term, they would make an advance as the loan would then be ready for take-out by another institution. The other institution would take over the line and have the secured interests in the property used as collateral.

Number 095

Representative Navarre inquired about FDIC procedures once the portfolio has been taken over. Mr. Schannault said that they evaluate it, offer the loans to other banks,

businesses or investors that are interested. If they are not interested, the FDIC works out the past-due and problem loans to get them in current status and market them. The process includes inventorying the assets, analyzing individual files, appraising if necessary, then establishing a reasonable value and offering them for sale. If they have a buyer, the loans are gone.

Number 124

Senator Halford asked, absent any consideration of state action, when would the FDIC establish a liquidation office in the state. Mr. Schannault responded that it is not just the state action that they would predicate that decision on -- it would be the fact that they could not dispose of the assets in any other manner, and if they make the determination that there is no market or the market will not pay what they think it is worth, the FDIC would establish an office in a short period of time, no more than a week or 30 days. Senator Halford then asked when outside investors normally buy property. In our case, is it possible that we have not heard from them as their perception may be that the market has not yet bottomed-out. Mr. Schannault said that could well be the situation.

Senator Halford then commented on the observation that FDIC may have facilitated the continued downturn of the market in Oklahoma's situation which is similar to ours. Mr. Schannault said he had no knowledge of that occurrence.

Number 224

In reference to property being dumped in the market, Representative Gruenberg questioned whether there is any national policy, or whether the FDIC's regional office has autonomous authority. Mr. Schannault said that they have national policy with regard to liquidation of assets and the holding of properties for fair market value. Representative Gruenberg asked about the appeal process. Mr. Schannault said that while there is not a formal appeal process, there is an informal process which they could contact the Board and outline the concerns and direct it to the Chairman of the FDIC. Further, if you take this action -- appeal to the Board -- the party is excluded from any decision process with regard to the complaint as the Board would then have heard the issues from your view. He would recommend that they go through the normal process of contacting his office which, in turn, is forwarded to the national office. He did not think that the appeal would stay their action in the interim.

Number 353

Senator Zharoff asked how best to slow FDIC's action in liquidating the assets. Mr. Schannault did not think that property would be sold immediately in that the "snowball has not started".

Number 375

In response to the line of questioning, Ms. Hicks stated that it appeared that everyone is referring to the separation of powers problem. The FDIC, as a receiver, is appointed by a state administered agency; and the receivership is supervised by the courts, either national or state depending on the charter of the bank. In order to effect the mandate of the receiver, she did not think you could do it by legislation, but rather you would through the court, if you have standing to do so. The legal question is whether the legislature would have standing to effect the rights of the creditors and shareholders of the failed bank by way of intercession. She felt that unless there was a policy decision made by the national office to comply with whatever pace was established by the legislature, the only alternative would be to go through the receivership court.

Number 415

Senator Zharoff asked for clarification of the appraisal process in regard to low offers; and how long will they continue to solicit investors to take over the properties. Mr. Schannault said that if a number of low bids come in for properties which leads them to believe that there may be something wrong with the appraisals, they may ask for another appraisal. The offers remain available on a continuous basis.

Number 460

The fire alarm sounded, so the meeting was adjourned at 1:25 p.m.

JOINT COMMITTEE ON ECONOMIC RECOVERY

March 7, 1988

5:00 P.M.

MEMBERS PRESENT

Senator Lloyd Jones, Co-Chair
Senator Arliss Sturgulewski, Co-Chair
Senator Jan Faiks
Senator Rick Halford
Senator Joe Josephson
Senator Pat Rodey
Representative Max Gruenberg, Jr., Chairman
Representative Kay Brown
Representative Steve Rieger
Representative Niilo Koponen
Representative Mike Miller

MEMBERS ABSENT

Senator Dick Eliason
Senator Jack Coghill
Senator Fred Zharoff
Representative Al Adams
Representative Fran Ulmer
Representative Red Boucher
Representative Mike Navarre

WITNESS REGISTER

Dr. Ryan Amacher, Economist
Clemson University
Clemson, South Carolina 29631

ACTION NARRATIVE

Tape One, Side One
Number 002

Senator Jones, Senate Co-Chair, called the meeting to order at 5:15 p.m., and introduced Dr. Ryan Amacher as the guest speaker. He noted that Senator Fanning was also in attendance.

Number 017

Dr. Amacher said, in terms of his personal biases, he followed theories advanced by economists George Stiegler and Milton Friedman. In discussion the housing situation in Anchorage, there is less demand than in the past and an oversupply has resulted. There is only an oversupply if

the price is held up at artificial levels. What will happen is the price will fall, the market will adjust, and at some price it will be sold. The price has to fall as long as those needs exist unless they are taken off the market in some way. The situation is analogous to farm policy. The well-meaning legislation will have unintended consequences.

In all the legislation, the most attractive is the interest rate buydown proposal. Any proposal that benefits some people is welfare but no one likes to label it as such, and he recommended adding a sunset provision. What he felt would be most efficient, and would do the least harm, is the interest buydown so people and businesses would not have their houses or businesses foreclosed on, in the time estimated for the economic recovery to take place. The bottom line is that it will not happen unless one of two things occur: supply diminishes or demand increases.

Dr. Amacher then addressed the positive effects on the market: it's good for people that are renting, buying, or want to start a business. The worst possible action is to have the state stockpile the houses, because at some point you will have to unload it. The state would then be the evil person as it would be the drag in increasing property values. The legislature needs to design something that allows the market forces to work to the greatest extent possible, and be based on need.

Although the problems exist in other states, as well, it is a bigger problem here due to the overbuilding created by state government. However, even if the state created the problem, it does not mean it can solve the problem.

Number 273

Representative Gruenberg asked Dr. Amacher to define the interest buydown proposal. Dr. Amacher described the situation whereby people bought property during the peak, now their income has fallen or they are unemployed, and a straight subsidy to them or the banks would alleviate the cash-flow problem -- something to lower their payments.

Number 299

Senator Josephson asked if Dr. Amacher felt we have reached bottom or whether there are factors that will perpetuate a downward spiral. Dr. Amacher did not believe in upward/downward spirals but that economies reach equilibrium; and could not say if the state is at the bottom of the equilibrium. In discussing the economic analysis of Lester Thurow as it relates to government spending, he said that the analysis works to a certain point and stops. While government actions are well-intended, government solutions

don't work and further, the private sector can forecast better than government. Senator Josephson commented that some reports indicated we can expect more crises in the banking industry. Dr. Amacher felt there was nothing wrong with banks going bankrupt and we cannot compare our situation with the Great Depression. The state can't do fiscal policy, public work projects, etc., since the economy is now internationalized. The only way the spending contributes to the multiplier effect is to the extent that it is spent on products made here. As few products are made here, the money dissipates into the U.S./world economy in the first round of spending.

Number 415

Senator Faiks addressed the comparison of our situation to the Great Depression. She asked "when an enormous amount of money was pumped into the economy in a variety of programs, did it stimulate the recovery?" Dr. Amacher responded it was the Keynesian argument as it relates to government spending; the Great Depression happened at a time when only 3% of our GNP (gross national product) was exported or imported, and explained the multiplier effect of the Keynesian theory. She asked if the state could control spending within its borders, would the analogy apply. Dr. Amacher said "yes" if you could do that; however, you can't do it and commented on overriding laws pertaining to interstate commerce. In responding to another question from Senator Faiks about increasing consumer spending by issuing another permanent fund check, Dr. Amacher reiterated the comments about the lack of products being made here, so the money would be gone immediately.

Number 487

Senator Sturgulewski asked him to respond to the bridge bank concept whereby properties would be pooled and managed by AIDEA or an outside entity. Dr. Amacher said the concept would pool the risks of the owners but did not think it would stabilize the prices. What concerns him about the trust or bridge bank concepts is "if it makes sense, why isn't it being done?" The reason it isn't being done is because it needs the state's \$15 million. He compared the situations in Houston and Dallas' markets and said foreign investors are keeping those markets alive.

Number 535

Senator Josephson referred to the banking situation, and the impact on shareholders and customers. He asked if we should be concerned about the assets becoming concentrated in a couple of banks, or FDIC's involvement. Dr. Amacher said it would trouble him more if the state did welfare for

banks than to have a monopoly bank. We need to help the people that need it the most.

Number 591

Representative Koponen asked if he recommended the state use state income to fund the traditional functions of government such as education, police, etc., as a first priority before going into other programs. Dr. Amacher responded in the affirmative.

Number 598

Representative Rieger generally discussed the supply/demand forces and the rationality/irrationality of the market, and asked that he address the erratic market actions. Dr. Amacher answered that when markets don't act rationally, it's usually because there is some government impediment, and related the story of the price of trailers being more expensive in-state from a state agency than purchasing outside. Markets that have problems usually have information problems. He felt it might be productive for the state to pursue involvement of foreign investors.

Number 684

Representative Gruenberg commented that the discussion has focussed on macro economics, and thought we should address the impact on the individuals. Also, he asked for his reaction to the state's economy being based mainly on service industries (excluding resources), and the Jobs Bill that passed was intended to benefit small service companies to keep the money in the state. Dr. Amacher thought we might get another round of spending but states cannot control fiscal policy because the economy is open.

Number 722

Senator Halford asked about the effect of reduced government spending and public employment on the overall economy. Dr. Amacher said its difficult in a political setting as people forget that every dollar spent to create public jobs, the state is taking the dollar away from someone -- the dilemma of the political arena. Senator Halford asked what if a majority of the tax base is foreign to the state. Dr. Amacher said if the state gets all its money from outside and spends it inside, there would be a positive effect. The alternative to spending money on public works programs would be to give it to the people and let them direct the spending.

Senator Halford commented on the statement that economic activity has to come down to match the existing level; that no one is sure how to create a thrust in the short-term,

but there is interest in helping people survive the fall. Dr. Amacher reflected on the state economy 14 months ago compared to now. There's less public concern now than then; adjustments are taking place. No matter how hard the state tries, the equilibrium is going to occur.

Number 787

Senator Rodey asked if a market analysis was appropriate to Alaska -- federal, state and local government employees represent the majority of employment; and oil companies and banks are highly regulated. Dr. Amacher said "not entirely"; a market analogy is appropriate when looking at a planned economy such as the Soviet Union or PRC (Peoples Republic of China). The best way to look at what needs to be done in that situation is to use market analysis. The reforms that take place in terms of promoting economic growth are reforms, whether they are planned reforms or introduction of the market that move it in that direction. Maybe what we need is "perestroika" (Russian for restructuring). Using the market mechanism to analyze things is valid in all economies. Of the three markets that impact the state: federal and state governments and the oil industry, oil companies are driven by a different market and indications are the federal government will decrease spending.

Number 825

Senator Faiks reviewed the proposal which would do the least damage -- reduce interest rates for a set period of time on a needs basis for residential/commercial mortgages. Dr. Amacher said this would help relieve the cash-flow problems and could be handled through the buydown or direct payment. Senator Faiks asked his views on guaranteed business loans where the line of credit would be extended and guaranteed by a state agency. Dr. Amacher did not like the proposal but understands it. If a viable business is looking for help, the banks should be glad to help.

Tape One, Side Two
Number 864

Senator Jones asked if Dr. Amacher agreed with including a sunset provision in legislation. Dr. Amacher said "yes", especially a bill concerning a subsidy program.

There being no further business to come before the Joint Committee, Senator Jones adjourned the meeting at 6:03 p.m.

JOINT COMMITTEE ON ECONOMIC RECOVERY

April 28, 1988

12:00 P.M.

MEMBERS PRESENT

Senator Lloyd Jones, Co-Chair
Senator Arliss Sturgulewski, Co-Chair
Senator Jan Faiks
Senator Rick Halford
Senator Joe Josephson
Senator Fred Zharoff

MEMBERS ABSENT

Senator Dick Eliason
Senator Pat Rodey
Senator Jack Coghill
Representative Max Gruenberg, Jr., Chairman
Representative Kay Brown
Representative Steve Rieger
Representative Niilo Koponen
Representative Mike Miller
Representative Al Adams
Representative Fran Ulmer
Representative Red Boucher
Representative Mike Navarre

WITNESS REGISTER

Presentation by: Dr. Lester Thurow, Dean
(teleconference) School of Business
Massachusetts Institute of Technology
Boston, Massachusetts

ACTION NARRATIVE

Tape One, Side One
Number 002

Senator Jones, Senate Co-Chair, called the meeting to order at 12:11 p.m. He noted the House members were absent due to the House being in session; and Senator John Binkley was also in attendance.

He turned the meeting over to the Senator Josephson, who was instrumental in contacting Dr. Lester Thurow for his comments. Senator Josephson introduced Dr. Thurow and said identified some of the issues being considered by the committee. Specifically, the state has real estate problems; and has experienced a loss in the property tax base

in the Railbelt area, particularly Anchorage. Various proposals have been advanced for the state to assist small state chartered banks, either directly or through a public corporation of the state. Another concern is the overriding problem of a declining oil price; the source of 85% of state revenues.

Number 072

Dr. Thurow indicated he had received the materials. The material argued the problem began because the state started out with an oil accelerator boom which was compounded by a government spending accelerator boom, and he felt this was the right analysis. The desirable thing would have been, if the state had an oil accelerator boom, the government spending boom be held back and used in a counter-cyclical way. Even though this was probably known ahead of time; it is human nature that nobody does it. It didn't happen in Wyoming, with the oil and coal boom; and it didn't happen in Houston. When reviewing the Alaska problem, it should be remembered that everybody in the oil belt -- Calgary, Houston, Denver, Casper -- has the same problem.

He felt the state should consider how it can make sure the cutback in property tax revenue does not devastate local government services. Local government services end up being critical on two dimensions: If there is a deficiency in local government services, in terms of the basics of education, sanitation, etc., new industries will not be attracted to an area. The number one aim should be maintaining a viable infrastructure; part of it being the education of the citizens.

Another important thing Alaska does is export people. He then discussed his personal situation of leaving his state, Montana, which does not make him a Montana failure but rather a Montana success. One of the jobs of a state is to make a person a good export product. He claimed the state should not let the school system deteriorate because it would not only hurt the direct Alaskan economy, but also effect people who pass through the state. Again, this should be the state's prime goal.

Number 156

Dr. Thurow continued if you look at the more narrow effects that are occurring in the state; he agreed with the basic diagnosis of the problem being a combination of an oil and accelerator boom. However, he disagrees with some of the papers which implied if we move our wealth in Alaska, the rebound in the economy would automatically follow, because wages and things like that will fall and that will lead businesses to come in. The fall in wealth and the consequent fall in housing values and wages puts a floor on how

far the economy can go; it doesn't cause an automatic recovery. Prices and wages falling, etc., may ease the fall, but it does not cause a rebound in the economy.

He felt it was important to understand what has happened in Alaska and Houston, etc., is not the equivalent to the stock market crash on October 19th, which had very little effect on the American economy. The reason is the stock market crash wasn't really a crash. On January 1, 1988, stock market prices were higher than they were on January 1, 1987. If you look at what happened to the stock market prices from the first to the end of October; then there was a loss of wealth. But from the beginning to the end of the year, wealth was made.

He stated if you have a real wealth decline, as Alaska has had, it has very different effects from the national situation. There is nothing in the situation that causes an automatic rebound. The result of falling prices and wages keep the economy from falling even farther than it would, and slows the rate of decline.

Number 212

In discussing an economic recovery, he said the basic thing, from the point of view of a private investor, is to determine the level of uncertainty and the expected change in price. He has reviewed the articles about the state considering schemes about supporting housing prices by shipping trailers out of the state, or buying certain types of houses and keeping them off the market. He informed the committee if the state really has substandard housing that needs to be torn down -- if they are really that substandard -- they should be torn down and taken out of the supply. But if you think about housing that is reasonable housing, the basic problem is: suppose you take it off the market; it will create a tremendous uncertainty as to when it will be placed back on the market and whether the future price economy will be down or up. The desirable end is to have everybody understand that the prices are as low as they can possibly go and, therefore, the expectation is a capital gain. Not being here, he did not know where current prices are in terms of the equilibrium.

Number 239

There were two arguments that were made in the paper about supporting housing prices. One argument was if the prices fall below 80% of the purchase price, there would be a significant number of defaults. It is true, but simply buying houses and holding them off the market does not solve the problem. People would then know you are holding a big supply of houses and they could not resell their houses at a value that's above 80% of what they paid for it. Also,

there would be reason to believe that some future capital losses are ahead of them. That idea is much more negative when it comes to economic development than knowing the prices have already hit bottom. People would prefer to think that they can look forward to capital gains, not losses. While buying and holding houses might help certain individuals in Alaska, it would hurt others. In general, this is not something that would make the state economy more prosperous.

Another article asked, where do you store trailers -- in the trailer park or design a special lot? He felt this was a perfect illustration of the problem. As far as the people who own the trailer park, obviously they want the trailers next to them as it adds rent to them. Other people were saying they should be stored elsewhere at a slightly lower cost. He thought the state was actually getting arguments on how you distribute the income among Alaskans versus how you make Alaska richer. Although the state is suffering enormous losses, he did not think state government should get into the business of cushioning the losses for one group while making the losses for another group bigger. In this situation, everything the state does to hold the prices in one area will push the prices down in another. What that does is distribute income in the state without making it a wealthier place.

Number 291

Dr. Thurow stated it is possible for the market to have overshoots, where a market goes right through equilibrium and housing prices go below the norm, in terms of economic analysis. He did not see much evidence of this happening, judging by the papers he received. It should be remembered that when you think of an economy based on oil, you are essentially working in a world where the price of oil is not an economic choice, but a political price.

It is expected that by the mid-1990's, the price of oil should pick up because little exploration is being done at current prices, and existing fields will be pumped out. If there is a reasonable rate of growth to that period, there would be supply and demand factors that push oil prices up. The state's problem could be a 7-8 year problem, at the most; so the question is what is the sensible thing to do to get people through that time. However, it should be recognized there is some uncertainty because of situations in the Mideast. The key thing should be how to maintain the state doing a good job, based on the things the state is supposed to do.

Number 336

He commented the state should keep in mind it is a capitalist economy, and some small capitalists will take economic losses. If the state tries to get in and change the economic losses, it will not change the total losses, it moves the losses around to different citizens. Maybe citizens of the state know to whom some of the losses should be allocated, but allowing interest groups to make those choices should be avoided.

Number 354

Senator Josephson said several banks have failed, and several small banks advise them that their hold is very tenuous, unless the state helps them with some capitalization problems that the regulators require of them. There are various schemes involving the state buying debentures or the state taking some type of preferred position by injecting capital. The banks argue they are very active in lending to real estate and small business; the large banks are more conservative, and a trend is developing in concentrating banking power in 2-3 institutions. He asked what Dr. Thurow thought about the concentration of banking activity in a state like this.

Dr. Thurow said, first, there is a factual question: Have these banks in the past made more local loans than the bigger banks?" Usually when you get into it, you find they haven't done so. Secondly; even if they have, if the bank is under that kind of financial constraint, what the state is doing is giving them money to tide them over the old loans and they will not have any money -- even if you give them money -- to make new loans in the state or anywhere else. He felt it was a perfect example where people who own the banks are taking a loss; and using the tax revenue of the state to bail the shareholders out takes away from some other Alaskans. The state would be shifting losses from one Alaskan to another.

He added that even small banks are not owned by local people, and the state would need to ask who owns them. The U.S. is alone, among major industrial countries, in having many small banks. That is a world which is disappearing very rapidly, and would disappear rapidly even if you didn't have a financial collapse. If you look at Massachusetts which is booming economy, their small banks are probably disappearing faster than those in Alaska because big banks buy them up. If the small banks were profitable in Alaska and therefore, had value, the owners of the small banks would be voluntarily selling their banks to big banks just like small banks are selling out all over America.

He stated even if you gave a subsidy to the banks, and in turn made them profitable banks, they would still become big banks because that is the trend. It's happening in

America because it has already happened in the rest of the industrial world. Even a bank like Citibank, by worldwide standards, is a small bank. The entire banking industry, worldwide, is going to become much more concentrated. For every state, the era of small banks is simply over. What the state would be doing, if they succeeded, is turning a small bank into a profitable bank so the owners of the bank could sell it to a bigger bank. He did not think that is what the legislation wanted to do.

Number 433

Senator Josephson said a lot of the portfolios of the failed banks ended with the FDIC. One of the anxieties felt by the committee has been the FDIC might begin a policy of dumping the collateral at distressed prices, which would further depress the real estate market. He asked if that is likely; and if so, what would be the effect.

Dr. Thurow responded it was highly unlikely because the FDIC, and the savings bank equivalent of it, has got a very severe cash flow problem of its own. If it were to actually sell those properties at distressed prices, then paper losses become real losses. They don't have enough funds to take real losses without going to Congress and getting multi-billion dollar appropriations to pay for real losses. From their point of view, as long as they can keep those losses as paper losses, as opposed to real losses, they are better off in terms of their own bookkeeping and finance.

If you look at what those institutions are doing in Texas, where over half the banks are going broke, they have in-house incentives and are not dumping property. If they did dump property, it becomes a question of how much do they own and how far will they force the price down. It partly depends on the liquidity in the world, because if you think somebody is throwing property on the market at a point where it is below equilibrium, people should have an incentive to buy from the FDIC, hold them for a brief period of time until the dumping is over, and resell the property for a profit. He felt there were plenty of people in the world who specialize in this business; and if the FDIC, in any systematic way, were to start that kind of policy, there would be many very wealthy people who would be glad to play that game and buy them up. Once somebody convinces their forces to crash below equilibrium, there's real money to be made by buying, waiting and reselling. He felt the likelihood of this happening is precisely zero.

Number 483

Senator Sturgulewski commented on his statement on the need for the public to become convinced that the economy has

reached the floor, and residential housing. She said the committee has a proposal for a bridge bank which would allow organizations (i.e., FDIC, banks, Hallwood group) to come together and manage commercial properties that have already gone through the foreclosure process and now are with an agency. The properties would be put on the market in some orderly fashion. She asked if he distinguished between the residential and commercial concerns.

Dr. Thurow answered "not really" because it is something where there are companies in that business, and it should not need a subsidy to be done. If you take a company that specializes in this, the question to ask is "why do they need a state subsidy?" If the answer to that question is they are having a cash flow problem, he said the moral of the story, that the Japanese and all of American history teaches, is anytime a state or federal government gets into an enterprise like this, it should get equity participation in return. It should get a certain percentage of the profits, and the percentage of the profits and losses is the same. Such as, if it agrees to take potentially 30% of the losses, then it gets 30% of the profits, etc.

The key thing is not to set up a world where it is profitable for the private company to make the money, and if it loses money, the state government takes the loss. Often, when you look at these deals as they are structured, all the risks are on the side of the government and all the gains are on the topside of the private entrepreneur. If it is a real sharing, where the private entrepreneur is saying he doesn't have enough cash to manage it, but s/he would put up 70% of the money and take 70% of the risks, and 70% of the loss; and the state puts up 30% of the money, and take 30% of the losses, if any; then it would be a sensible thing to review. If the private company wants to parameterize it so they get all the gains, if it is profitable; the state takes all the losses, if any, the answer is the state is being "conned".

Number 534

Senator Sturgulewski referred to Lenin socialism and said Alaska is similar in the sense it is an "owner" state -- an owner of royalty oil and land -- so there has been a great deal of intervention by the state in terms of development. She referred to Dr. Thorow's comments on the public's attitude of the economy, and said there was a great amount of expectation by the public that the state will make things right. She asked if he had any suggestions for the committee to pursue specific actions which might be appropriate to gain the positive public perception.

Dr. Thurow answered one of the problems is certainty or uncertainty whether the state government will do anything.

Clean decisions made quickly, in many ways, is more important than whether you make a decision "yes" or "no". It is important not to take an oil downturn and turn it into a huge government downturn. The place where state government should focus, if it has money to do anything, should be the category of making sure that local government services do not collapse. After reading the papers, he was not sure how much of a risk of that was real. Some of the articles sounded like with the decline in property values, the normal sources of funding for those local government activities would completely cease.

He had no objection to a state government playing "entrepreneur" and relayed the story of the building of the Eerie Canal, and the benefits that resulted from its construction in terms of providing cheaper transportation from New York to the Midwest than from Boston or Philadelphia. If the state gets involved in this type of thing, it needs to have a good project and not be the entity that buys all the bad projects. He felt the idea of the state buying all the trailers and shipping them back to the Lower 48 was a loser.

Number 591

Senator Halford referred to the concern about maintaining services in local governments. He said the state has an amazing capacity for Lenin socialism because our Constitution gives the state the biggest winner in the state -- owner of the oil. Dr. Thurow added if it owns the biggest winner, it doesn't mean it should buy all the losers. Senator Halford referred, again, to the support for basic governmental services; and asked if that would be a positive step in dealing with the attitude of people on the economy.

Dr. Thurow said "absolutely", and what people have learned from all economic development in the last 20 years, is there is one key thing: the skills and educational qualifications of your workforce. That's all the Japanese and Israelis have got. In some ways, the same applies to Massachusetts as it does not have oil or any natural resources, but it has a good workforce. If you think of what a lot of local government does, it provides the infrastructure without which you can't do business. If you let it collapse, it's difficult to recover. The best thing local and state governments can do is provide the basics in terms of producing a high quality workforce. With the fundamentals of a high quality workforce, you go into two dimensions: attract outsiders interested in doing economic activity in Alaska; and a workforce that is good.

To the extent that economic activity does not happen in Alaska, it provides Alaskan citizens the opportunity, if

they need to, of going somewhere else and earning a good living. He reiterated the idea that having someone leave Alaska should not be considered an Alaska failure, but it represents an exportable product. However, if you have people who are unskilled and cannot get jobs elsewhere, that is the ultimate Alaskan failure; because not only has it failed in terms of the local economy, but it has also failed in terms of its export market. The purpose of state government in the long run is to benefit the citizens of Alaska; some of those citizens will live here and some will not. One of the papers said the state government, itself, was partly responsible for this problem because it also had a big construction boom at about the same time as the oil industry was having a big construction boom. The state does not control the oil industry, but it should do things that help it and the citizens who live here.

Number 654

Senator Jones said he hoped Dr. Thurow was not advancing the concept that "the last one to leave turns out the lights." Dr. Thurow did not think it was the case. He reiterated the idea that he, personally, should not be considered a Montana failure. Senator Jones added there had to be a job for him to go to. Dr. Thurow responded there were two ways to get jobs: (1) Having a natural resource based economy. By 1995, that resource base of the Alaskan economy will be picking up because of the fundamentals of supply and demand on oil. Companies will be making investments and explorations again. (2) If you can offer companies a higher quality workforce.

He stated Massachusetts is successful not due to the efforts of Governor Dukakis, but because it is a relatively cheap place to buy high skilled workers, not low skilled workers. Having a high quality workforce is one of the few things that can guarantee that you don't shut out the lights. One way to shut out the lights is to run out of natural resources -- such was the case of the old mining communities which have died out all across America. If you have an environment where you have a high quality workforce and people like to live there, that's one of the ways to general economic activity.

The only other way to generate economic activity, is if the area is fortunate enough to be a transportation hub for movement of goods around the world. He then discussed the geographic advantage of Singapore. He did not think the situation applied to Alaska due to its location.

Number 701

Senator Faiks referred to Dr. Thorow's comments on the small bank bail out situation. She stated the state has

three small state chartered banks which are capital poor, whom have said if they get \$3 million each minimum, the money will be loaned out to qualified businesses and the money will roll over throughout the state. It would allow them and the businesses to last longer, and everyone would be happy because a recovery will occur. She asked that he address how the money will not necessarily get into the economy in that method.

Dr. Thurow said, if the state were to do that, the only way the state should do it is to calculate the net worth of the bank today, as an example: \$10 million. And, if the state gives that bank \$3 million, the state should get a 30% of its shares. It's the only way something like that makes sense, because the state would be taking a risk of losing its money; and it shouldn't take risks in this environment unless, if it works, it gets the gains. The problem is if the state gets banks in very weak circumstances, what the banks are probably doing is not asking for money to make loans in Alaska, but asking for money which allows them to survive and service their own interest payments to other people where they have borrowed money. Giving the banks money will not lead them to make more loans in the local economy; it will allow them to pay their bills to others. Another consideration is the national trend of small banks being bought out.

If the state bailed out the small banks, and succeeded, the state would create a small bank which would invariably sell to the big bank, so any benefit would quickly disappear. If a small or big bank has the money, it would put it in the most profitable investments it can find. If the most profitable investment is in Alaska, the bank will put it there; however, if it is not in Alaska, the investment would not be made there, regardless of it being a small bank.

Number 748

If the state were to take a bank's proposal seriously, he would recommend the following. He would calculate the net worth; if it is negative, he wouldn't touch it; if it is positive, and he gives them a certain amount of money, he gets that fraction of the shares. If they leave the room, he would know that they really wanted him to take some of the losses as opposed to helping them.

Senator Halford asked if the net worth is zero, he would get 100% of the shares. Dr. Thurow said "absolutely" because they don't have anything to offer. If a bank has a negative net worth, it is worthless. If the state wants to help the state economy, the state could set up its own bank. It does not make sense to buy into a bank with negative net worth. To him, that really would be Lenin

socialism. He added lots of states have had state banks by setting up a bank without buying a bank. If the state is worried about out of state banks, they could consider this approach.

Number 764

Senator Faiks asked if the test would be, if the bank wanted \$3 million, their net worth was \$10 million and they were willing to give the state 30% of the shares or 30% of the potential profit, the state could say the bank legitimately wanted to make the loans in the state and help the small businessmen and their offer was legitimate. If the bank says "no", the state needs to question the whole scheme. Dr. Thurow said it still would not guarantee the bank would make a lot of local loans, but it would indicate they believe it could be turned around without the state taking some of their losses. If you don't do that, the state is a loser. He suggested if the state wants to practice socialism, it should practice real socialism. Real socialists believe in making money, they don't believe in taking losses, and he provided an example of the Japanese government.

Senator Faiks said the banks indicate it's the state's social conscience to help support them over this rough area. They are state chartered, etc. Dr. Thurow said one way is to take an ownership position only on an equity basis.

Number 789

Senator Josephson added, if the state did that, the state or state investment corporation could elect 30% of the directors of the bank and make sure the public policy was being implemented. Dr. Thurow referred to the situation whereby everybody who is a taxpayer of the U.S., owns one of the eleventh largest banks in the country, Continental Illinois. It got into a negative net equity position and we, the taxpayers, ended up having to take over the bank. We, the taxpayers, threw out the board of directors, fired the executives, and elected a new board of directors and manager. The federal government did not just give Continental Illinois money; it took the equity, which was zero, but it didn't leave the shareholders with anything either.

Number 802

Senator Sturgulewski referred to the three methods of developing economic activity: establishment of a transportation hub, development of resources, and the highly educated workforce. She submitted, with regard to the transportation hub, the state has one of the finest examples in the world at Dutch Harbor. Referring to the state

being an "owner" of its resources, she asked how the state could do something in a counter-cyclical way so it is not adding to the problem.

Dr. Thurow responded there are a lot of things the state could do; however, the question is how it can discipline itself to do them. When the state hits the oil boom, and the oil companies are doing a lot of construction, etc., the state should import money. When the oil boom stops, the state should hit its infrastructure boom, and state spending should be used for the economy's fall in a counter-cyclical way. It would generate revenue when the private economy is booming, and spend revenue when the private economy is sagging. The time to plan it is now. Supposing there is another boom in the late 1990's, would the state do the same thing as before. He thought it was probable. He asked if there was any way the state could box itself in so that if another oil boom came, it would not, once again, have the public spending boom followed by a sagging oil business and at the same time, a sagging public spending.

Senator Sturgulewski said if the permanent fund had not been inspired from that situation, the state would have had another \$8-9 billion problem.

Number 842

Dr. Thurow said the fishing harbor is natural resource development, and to the extent that Alaska has fish, the resource should be developed. The transportation hub, which he talked about, is not just a geographical facility for ships but has to be in a location where they want to pass. If Rotterdam (Holland) harbor, the transportation hub for Europe, were located in southern Argentina, it would not be worth much because there aren't many ships that want to go to southern Argentina. Senator Sturgulewski said Dutch Harbor is located on the trade route to Japan and the continental U.S.

Number 862

Senator Josephson stated that most of the home mortgages are financed through a state created corporation which was developed at the peak of the oil boom. There are proposals to decrease interest rates on these loans as a way of helping them through the troubled economy and reduce default rates. He asked Dr. Thurow if had a chance to review the proposal.

Tape One, Side Two
Number 870

Dr. Thurow said it was similar to Third World debt problems. He provided the following scenario as an option in cases where people have a temporary cash flow problem, assuming the person has \$100,000 owing on principal, the interest rate was 10%, making the interest payment for that year \$10,000. The person would only pay \$5,000 on interest but the other \$5,000 would be capitalized into the principal so at the end of the year s/he owes \$105,000. This situation defers the income for the state but it would not lose income. The problem with the proposal is that those taxpayers in Alaska which don't have the subsidized loans would have to give up some of their money to subsidize the people who do have the subsidized loans. All the state would be doing is moving the losses from one Alaskan to another; it is not reducing the full amount of losses of all Alaskans. It would be a political decision whether moving losses around from one group to another is sensible.

In general, the people that have these loans are probably as wealthy, or wealthier, than the people who would be subsidizing them, so there is no argument that it is a subsidy from the rich to the poor. If anything, it may be a subsidy the other way around. It would depend on the income of the average taxpayer versus the income of the average person who has one of these mortgages.

Number 930

Senator Josephson commented that being a rich natural resource state creates a trap, in a sense, because it can make the leaders lazy about developing the human resource. Dr. Thurow said, in international literature, it is referred to as the "Dutch Disease" because Holland, shortly after World War II, discovered fabulous fields of natural gas owned by the state. Because of it, they could afford a lot of things, in some sense, without having to work for them. It led to a certain number of problems in Holland that are similar to those in Alaska.

Number 953

Senator Sturgulewski said there was a request, from the economic development agency from the area hardest hit, to change the state statute dealing with property taxes so local communities could allow property tax reductions to attract industry to the area. The major revenue source to that area is property taxes. She asked if he had any comment on this type of tax incentive.

Dr. Thurow responded it could not be judged in the abstract, such as, if you give a tax incentive, what do you get back as a quid pro quo. Sometimes the deals make sense from the point of view of the local government, but they have to be dealt with on a case-by-case basis. He has seen

places where this type of action did get enough economic development that it clearly paid for itself. There are other cases where the local government got "skinned"; it gave tax advantages away which didn't buy them anything in terms of economic development.

Number 999

Senator Josephson again thanked Dr. Thurow, on behalf of the Legislature, for his participation and said Dr. Lee Gorsuch, University of Alaska, wanted to convey a standing invitation for him to visit Anchorage and appear before interested groups.

Dr. Thurow added he was one of the growing number of people from the Lower 48 that have been on top of Alaska's highest mountain.

There being no further business to come before the committee, Senator Jones, Senate Co-Chair, adjourned the meeting at 1:04 p.m.