

ALASKA LEGISLATURE SPECIAL COMMITTEE / SUBJECT FILE 8672

599 SCOM 118: HOUSE SPECIAL COMM. ON PERMANENT FUND 1978-80

c) Many local development organizations were involved in initiating and managing projects such as rental housing and community service facilities, which improved the living conditions of their constituents. Most of these projects required property development, which in turn required equity to leverage construction loans and mortgages. The organizations themselves were seldom able to generate such equity, and the major institutional sources of equity--the Federal Government and private foundations--were cutting back such funding.

Thus, categories of enterprises which could operate, or, in the case of housing and services, should operate in depressed areas were identified. All three types needed financing which did not impose an inflexible repayment schedule, and all observers of the financial scene agreed that this kind of financing was unavailable through conventional private channels.

The use of State funds to provide such financing was further justified on the basis that the Commonwealth would capture pecuniary benefits in addition to conventional return on investment. These would consist of increased income sales and business tax collections and decreased welfare and unemployment insurance payments amounting to about \$3000/year per job created or retained.

II. SOURCES OF FUNDS/CAPITALIZATION

CDFC's source of investment funds is the proceeds of a \$10 million state general obligation bond issue. These funds will be transferred to CDFC in a lump sum. Increments to this capital would require further legislative bond authorization. The interest and principal on the bonds will be paid out of general state tax revenues as opposed to operating revenues of CDFC.

This form of capitalization is justified by the following argument:

1) According to the analysis of the economic conditions in depressed areas presented above, equity financing of enterprises is the most potentially productive form of capital assistance to businesses in these areas. So far, CDFC is the only state financial intermediary designed to provide equity financing.

2) CDFC cannot count on a regular stream of returns from these investments. Therefore, it could not meet its own financial responsibilities if it were forced to pay off its investment capital on an inflexible schedule demanded by debt financing. The experience of SBIC's and MESBIC's demonstrate that intermediaries charged with making equity investments cannot fulfill their mandate if they themselves rely on loans for their

investment funds. One response of these institutions to their capitalization has been to invest conservatively, usually through debentures, in order to assure a regular income stream. The other has been to make equity investments and run the risk of going broke, which several SBIC's have. In neither case is the statutory function, for which these institutions have been granted special borrowing rights, been carried out.

3) The use of general tax revenues to pay off the bonds issued in behalf of CDFC is justified on two counts:

- a) It matches the sources of costs and prospective benefits. In the long run, it is hoped that the increased employment provided by CDFC-financed enterprises will generate benefits to the general fund in terms of increased tax collections and decreased welfare payments.
- b) It matches costs and benefits on the time dimension. Debt service costs will be paid over a period of 20-30 years, and the benefits described above should accrue over a similarly long period.

III. USES OF FUNDS/OPERATIONS

A. General Powers

In order to tailor its services to the specific financial

needs of each project, the CDFC Board has been granted a panoply of financial powers and broad discretion over their use. CDFC may finance all costs of a project which the directors deem recoverable and necessary to the carrying out of the act's purpose. Thus, money to finance market surveys, product planning, early staffing and working capital could be advanced as well as more traditional finance secured by physical assets. CDFC may also provide directly or pay for technical advisory services to the venture. CDFC may advance such finance in the form of purchase of equity, convertible debt instruments or straight loans. It may formulate and readjust the terms for loan repayment or payment of dividends to accommodate the venture's cash flow as it evolves. CDFC may also acquire, hold and transfer real property where necessary to further the establishment or expansion of an enterprise.

Although CDFC has the statutory flexibility to advance money on longer and less onerous terms than private financial institutions of any type, it is constrained to seek some return on its investments if it is to continue operations. The way in which financial returns must be realized and the constraints thus imposed on CDFC financing operations are discussed in section D.

B. Targeting

There are two sets of targeting requirements involved in the statutory directions to CDFC investment activity: one defines eligible sponsoring agencies as Community Development Corporations (CDCs) not dissimilar to regional and local development corporations in Alaska; another defines eligible geographic areas.

Targeting to CDCs - All CDFC financing is advanced to CDCs, which then transfer the funds to the ventures. The statutory requirements for eligible CDCs have been formulated to assure that they are accountable to their constituents.

In the legislation, a CDC is defined as, "a quasi-public, non-profit corporation organized under the General Laws to carry out certain public purposes and with by-laws providing that:

- 1) it is organized to operate within a specific geographic area coincident with existing political boundaries;
- 2) that membership in the corporation shall be open to all residents of said area who are eighteen years or older;
- 3) that at least a majority of its board of directors shall be elected by the full membership with each member having an equal vote;

- 4) that the by-laws of the Community Development Corporation shall provide that any other directors be either appointees of elected state or local government officials or appointees of other non-profit organizations having as a purpose the promotion of development in the designated geographic area;
- 5) that said elections shall be held annually for at least one-third of the members of the Board of Directors so that each elected director shall serve for a term of at least three years;
- 6) that the designated geographic area shall be consistent with some existing, or combination of existing, political district, provided that the aggregate population of such geographic area shall not exceed one hundred and fifteen thousand people based on the most recent appropriate census."

In addition to these formal requirements, observers and supporters of the bill have suggested that several further criteria be incorporated into CDFC's operating guidelines. These include:

- 1) The organization should be active in the community prior to CDFC funding, although not necessarily in economic development. Involvement in social service

provision or political organizing provides a community group with the opportunity to develop stable leadership, strategy and visibility that may contribute to its ability to manage a subsidiary or ensure community support of a sponsored venture. Evidence of prior activity also indicates that the CDC is not a "front" set up by private interests merely to take advantage of CDFC financing. Finally, prior experience provides the CDFC Board with some basis for judging the competence of the CDC's management to oversee the use of state funds.

- 2) There should be paid management and/or professional staff responsible to the CDC board. This might insure continuity and stability of venture oversight or management.
- 3) The leadership of the CDC should have demonstrated initiative in soliciting the participation of its constituents. Evidence of this activity might include frequency of public meetings, the publication of newsletters and other publicity efforts.

Targeting to Depressed Areas - The CDFC legislation requires that CDFC operate exclusively in depressed areas. The legislation defines a target area as "any area in which, according to the

most recent government census, the household income is reported to be at least 15% lower than the reported income for the Boston standard metropolitan statistical area" or "any contiguous area in which the board of directors of the particular CDC finds and publishes in accordance with statistical criteria previously established by the CDFC that substantial conditions of blight, economic depression, and widespread reliance on public assistance exist in said area."

CDFC is perhaps the only government financial intermediary that places restrictions on the location of the projects it will finance on the basis of descriptive statistical criteria. On the other hand, these criteria are not unambiguous. There is no specific measure of "average household income" in the 1970 census. The two closest approximations are "mean family income" and "median family income." (The median is a preferred descriptor of income distributions since it is not subject to bias stemming from concentrations in the low or high ends of the distribution.) The lists of eligible towns differ depending on which measure is used, and the preferred "median" excludes some of Massachusetts's most visibly depressed towns.

However, an area does not have to be a city or a town in order to qualify for CDFC financing. The legislation states that a CDC must be located in a target area that is consistent with

political boundaries." This might be a state representative district, a ward or even a precinct. Many cities that do not qualify do have sections within them that do.

C. Balancing the Interests of the Parties in Individual Projects

Any CDFC-financed project involves three organizations with different, and in some cases conflicting, aims.

Management of the venture wishes to obtain financing on the favorable terms CDFC can offer. It can be assumed that they wish to give up as few of the operating prerogatives and financial returns of conventional management as possible.

Members of the CDC want to be able to exert sufficient control over the venture to assure that the jobs it offers CDC constituents are as well-paying, secure and satisfying as possible. If the CDC itself is able to take an equity position in the venture, it will want to realize a return on its investment in order to finance its own operations or further investments.

CDFC wants to assure that the purposes of the bill are met by its investments and that it can recover its investment plus sufficient surplus to finance further operations.

All of these claims are on the same pool of funds; revenues generated by the venture.

The key to balancing these claims is the form of participation the CDC takes in the project. The six possible forms allowed by the legislation are as follows:

- a) The project is conducted by a wholly owned subsidiary of the CDC.
- b) The CDC owns a majority of the voting stock of the corporation or other organization conducting the project.
- c) The CDC owns a majority of the capital stock of the corporation or other organization conducting the project.
- d) The project is conducted by a limited-dividend corporation or other association organized under the laws of the Commonwealth to provide public benefit and which exists for a public purpose.
- e) The project is conducted by a non-profit corporation including local development corporations organized under the Small Business Act.
- f) In all other cases, adequate provision is made for reporting to the CDC, and that the CDC must approve all major transactions including but not limited to any sale, merger, dissolution, the sale or issue of substantial amounts of stock and corporate reorganization.

No one form of participation will be suitable or preferable in all cases. Particular circumstances will differ from venture to venture and CDFC will have the flexibility to consider each deal separately. In projects conducted under clauses d and e below, the forms of participation are determined by the statutes which govern federal and state programs. We focus on two types

of participation: the wholly owned subsidiary (form a) and the joint venture between a CDC and a private entrepreneur (forms b, c and f). The national CDC experience indicates that both joint ventures and wholly owned subsidiaries can be viable vehicles for economic development. There are different costs and benefits to the various parties from both.

Wholly Owned Subsidiaries: A wholly owned subsidiary requires that the CDC provide or hire its own management. This could limit the resources available to other activities in the community. However, by undertaking the entire financial and managerial responsibility for a venture, the CDC could develop considerable management skills, produce a product useful to its constituents, control the labor practices of the venture and retain all earnings for other CDC activities. The fact that a venture is a wholly owned subsidiary is no guarantee that the company will contribute to community goals. There have been CDC subsidiaries which have provided few benefits to local residents. Therefore, CDCFC will need to be certain that adequate safeguards of community interests are written into any investment agreements it underwrites.

Joint Ventures with Majority CDC Ownership: A joint venture requires much less CDC staff time and in-house expertise than a subsidiary. However, it also generates less earnings for the CDC and allows the CDC less control of the venture's activities. On the other hand, the prerogatives and returns given up by the CDC are generally appropriated by the venture's management, a situation which should leverage more watchful and energetic private control of the enterprise.

Forms b and c in the legislation provide for joint ventures in which the CDC owns a majority of either the voting or the capital stock. This strong CDC ownership position and the influence implied by that ownership may be sufficient to represent and protect the community's interests. The CDC would be able to share in the benefits--both earnings and employment--if the venture succeeds. Similarly, the CDC can protect the interests of the community if the venture does poorly. For instance, the CDC could determine the distribution of labor cut-backs and the proceeds from the liquidation of assets.

Joint Ventures with Minority CDC Ownership: There may be cases in which the CDC is willing to assume a minority ownership position in the venture (form f) in return for substantial employment or other benefits. In those cases, the CDC's interest can

be protected by including specific legally binding requirements in the agreement between the CDC and the entrepreneur. Examples of these requirements are as follows:

- 1) The venture must obtain the express written approval of the CDC before undertaking any expansion of operations outside the local area and before altering any of the Articles of Incorporation or By-laws.
- 2) The management agree to make reasonable efforts to hire and promote local unemployed people as long as the quality of work was not sacrificed.

It is clear that any agreement between a CDC and the venture it sponsors will require compromise by both parties, especially in regard to managerial prerogatives. It is important that CDCFC ensure that the extent of each party's prerogatives is stated as explicitly as possible in the documents of the transaction.

A final issue is the financing of the CDC's equity position if it does not have internally generated funds to purchase it outright. The functions and appropriate rewards to CDCFC and the venture management are those of the conventional financier and entrepreneur. The CDC's presence can appear to be a legal formality (to assure the publicness of the expenditure) and a political necessity (to assure that constituents and local

political leaders feel they are being involved in the expenditure of community resources). What economic justification is there for CDFC subsidizing the CDC's equity participation?

First, the CDC may offer services in packaging the deal and mobilizing community support for the venture which will accrue to the venture as pecuniary benefits. Second, the possibility of monetary returns may induce the CDC to monitor the venture's financial and social performance vigorously, helping to assure CDFC that its objectives are being accomplished. One proposal for providing this equity position is to award the CDC a "finder's fee" of 5-10% of the venture's returns, depending on the CDC's role in assembling the deal.

D. Constraints on Uses of Funds Caused by Sources

The Board's investment decisions are constrained primarily by CDFC's capital structure. For all intents and purposes, CDFC's original \$10 million bond authorization is its entire, non-renewable capitalization. The institution may seek to borrow or issue bonds to finance further operations, but here they would be constrained by market perception of the quality of the assets--the ventures--which would generate the repayment stream.

The only reliable way in which CDFC could prolong its operations is to recover its equity investment. It may sell the securities of the ventures it holds. The CDC, by statute, holds the right to first refusal for any sale of securities of the venture it sponsors. If, as is most likely, the rate of return on the ventures is below the conventionally marketable level--say 14-16%--CDC's will be the major secondary market for these securities.

Even if CDFC realizes no capital gain or some loss on these sales, in selling its interests to CDC's it will be fulfilling one of its secondary objectives, "to enhance capital ownership in depressed areas."

CDFC may try to make part of its stream of investment returns more predictable by providing financing in the form of debt or warrants. These are cash flow problems which can only be worked out as the program's operations evolve.

IV. MANAGEMENT

The nine-member CDFC Board of Directors is responsible for all investment decisions. Three of these members are state cabinet secretaries. The other six are gubernatorial appointees serving staggered terms of five years. Two are to be individuals experienced in investment finance, three are to be representatives

of CDCs from eligible target areas and the final member is to represent organized labor. It is important to notice that all interests involved in any individual CDFC deal are represented on the Board.

The staff, whose number will be determined by the volume of business CDFC receives or generates is headed by a President. This designation for the chief staff officer was chosen over "Executive Director" in order to reinforce the fact that CDFC has been designed as a business enterprise, not a social service organization. The staff will enjoy a great deal of discretion in undertaking the promotional activities necessary to generate financial opportunities and in structuring the terms of individual deals.

V. ACCOUNTABILITY

Financial - CDFC will keep standard financial accounts and will report annually to the state legislature. These reports and the books on which they are based will be audited periodically by state officials. From an operational point of view, CDFC will be held accountable for its financial performance by the constraints imposed by its capitalization. These constraints are described in Section IIID.

Social - The CDFC Board has engaged an accounting firm experienced in the operations of public authorities to design reporting and measurement systems to be used in evaluating the Corporation's progress in achieving its non-financial objectives. The consultants have been charged with designing methods to project employment, both by number and types of jobs to be created by a proposed investment. They are also developing methods by which to estimate a project's impact on tax collections and state expenditures.

Before CDFC money can be advanced to a project, the Board must find that all jobs in the enterprise will be full-time and non-seasonal, pay 150% of the minimum wage and provide medical benefits. Further statutory guidelines may be enacted after CDFC begins operations.

VI. EVALUATION

CDFC's proposed operations raise complex financial and political issues. While those issues concerning the nature of its services and targeting have been largely worked out in the CDFC statute, critical problems remain. Despite the pages of required findings and precautions in the bill, CDFC could fail to carry out its mission due to any number of managerial decisions. By investing too conservatively in too few enterprises,

CDFC would merely be displacing private market activity. If investment decisions are overly determined by political considerations and subsequently fail, CDFC will not only shorten its own life but discredit an important and controversial approach to depressed area development.

The program's success is dependent on the ability of individual CDC's to use the availability of CDFC funding to leverage the cooperation of private business ventures. The history of such attempts is predominantly one of failure with a few encouraging exceptions. One of the lessons of this experience has been that new community-based enterprises often require technical assistance if they are to succeed. The Massachusetts state government has so far made no explicit provisions for providing such services to CDFC-financed ventures. Criticism of the program from community groups has focused on this point.

Equally important for success will be the CDFC's ability to manage its limited financial resources. Choices in this matter, however, will largely be determined by the success of the ventures in which CDFC invests.

VII. RELEVANCE TO THE ALASKA PERMANENT FUND

Purposes - CDFC is offered as an example of a program designed to provide community development finance to depressed areas. In this regard, the two most important points of the CDFC experience are 1) that the program design was based on an analysis of the economic problems of depressed areas in Massachusetts and 2) that provisions for targeting investment, based on this analysis and the experience of similar efforts, were built into the CDFC statute.

Capitalization - CDFC's lump sum financing by general obligation bonds of the state allows it the flexibility to provide financing in a timely manner on terms suited to the individual enterprise. This form of financing also imposes the discipline of a finite pool of funds. The corporations' investments must generate a return if it is to continue operations.

Uses - The current draft of the Alaska Permanent Fund statute is seriously flawed in that it does not permit equity investments in community development projects. The long experience of CDCs in the United States demonstrates that this type of finance is necessary if community-based enterprises are to succeed.

Management - The need to balance the political interests involved in CDFC's operations is reflected in the composition

of the Board, which includes representatives of the state, the financial community and CDCs.

Accountability - Accountability for operations such as CDFC's requires, first, a set of reporting and measurement procedures to evaluate performance along financial and social criteria. Reporting conventions and criteria exist by which to judge financial performance, and CDFC has begun to develop similar procedures for judging performance on social criteria. Accountability also requires effective sanctions to unsatisfactory operations. In the case of financial performance, unwise or wasteful performance is kept in check by CDFC's finite (and rather small) capitalization. Effective sanctions in response to unacceptable performance on social criteria have not yet been developed beyond the required findings necessary for investment disbursal.

D. REGIONAL ECONOMIC DEVELOPMENT

EUROPEAN INVESTMENT BANK
Discussion Draft

September 14, 1977
Page 92

INTRODUCTION

The European Investment Bank (EIB) was established in 1958 by the Treaty of Rome, the charter of the European Economic Community. It is an autonomous, publicly-owned financial institution whose primary function is to lend long-term to projects promoting the balanced development of the member economies and of the Community as a whole. The Bank also guarantees a small number of loans each year.

I. PURPOSES

Statutory Goals

According to its statute, the EIB's purpose is to contribute to the "balanced and steady development of the common market" by lending to:

- a) projects for developing less developed regions;
- b) projects for rationalizing industries or for developing new activities called for by conditions arising from the establishment of the Common Market, where these projects are of such a size or nature that they cannot be entirely financed by the various means available in the individual Member States; and/or
- c) projects of common interest to several Member States which are of such a size or nature that they cannot be entirely financed by the various means available in the individual Member States.

Evolved Management Goals

These were the goals of the bank at its inception. For all practical purposes, the bank now allocates its funds among:

- projects in less developed regions of the Community (e.g., southern Italy, Ireland, northern Denmark, western France);
- projects in industrial regions where redevelopment and investment in fresh activities is called for by the decline of established industries;
- projects of special interest for the development of the Community as a whole (e.g., advanced technology, and especially energy supply and distribution systems);
- infrastructure projects of common interest to several Member States such as railways, motor ways and telecommunications; and/or
- projects involving technological and economic cooperation between enterprises in the different member States.

EIB has been directed by the European Commission, its parent organization, to assist regional development efforts, but the Bank may exercise its discretion in how to do so. In examining EIB's lending policies, capitalization and operations, we will focus on the mechanisms which facilitate the regional reallocations and employment of capital the bank is able to effect.

Lending Criteria

EIB sets lending criteria which follow from its position as a multinational, publicly-owned bank which can facilitate specific development projects through the provision of capital. These criteria are:

a) The project must further development of the Common Market. The Bank will finance capital investments which relate to well-defined, economically homogeneous projects, geared to a specific objective which can be obtained in a set period of time.

b) The project must either be implemented within the territory of the EEC or, if outside the territory, be of common benefit to all the members of the Community (e.g., an oil supply facility).

c) The project must, in the case of infrastructure, contribute to increased economic productivity or, in the case of a private enterprise, must offer prospects of a reasonable return on investment.

d) EIB financing should not replace financing available from other, particularly national, sources.

Eligible Borrowers

a) Public and private enterprises may borrow directly from the Bank provided their project meets the criteria discussed

above. EIB will finance investments by foreign corporations as long as their project is located within the EEC's territory.

b) Banks and other financial institutions may also borrow directly from the EIB to finance loans to enterprises which meet EIB's criteria. In fact, this is the method the EIB uses to make its funds available to small- or medium-sized ventures.

c) Finally, the EIB will lend to autonomous state or regional authorities, such as the German Lander, which retain certain powers under federal systems of national government.

Restrictions on Use of Funds

EIB loans may not be used

- a) to finance cash requirements of firms or working capital;
- b) to finance speculative real estate development; and/or
- c) in the case of governmental authorities, to finance state social overhead capital such as health and welfare services.

EIB will not negotiate loans below 1 million UA directly. Its funds are channeled to enterprises with such small capital needs through intermediate institutions under the "global loan program." Direct loans to projects run from 20 to 30 million UA.

Lending Terms

EIB will not lend funds equalling more than 40 percent of the value of the asset to be financed. This policy requires local promoters and financial institutions to share the risks of the enterprise and, hopefully, forces them to bring their detailed knowledge of local conditions to the careful evaluation of the project.

The terms of most EIB loans fall into the seven to twelve year range. In the case of particularly desirable infrastructure projects, it may be stretched to 20 years.

IB requires appropriate security for all its loans. Usually this takes the form of a guarantee of repayment by the state in which the project is located. Other forms of security acceptable to the Bank are:

- a guarantee from a public authority with a good credit rating;
- a guarantee from a major bank, industrial or financial group; and/or
- a claim on specific assets which are liquid enough to cover the outstanding balance at any time.

Interest rates are uniform to all borrowers across several classes of loans, defined by the currency in which they are disbursed and their repayment period.

II. SOURCE OF FUNDS/CAPITALIZATION

EIB's share (equity) capital is provided by the treasuries of the nine states comprising the EEC. The total amount of subscribed capital and the amount to be contributed by each member is determined by the Bank's Board of Governors. Capital is subscribed in the form of a pledge, a portion of which the members deposit with the Bank. These deposits plus reserves funded by EIB operating surpluses must, under statute, equal 20 percent of pledged capital; this is more than sufficient to meet EIB's debt service should its borrowers be unable to repay loans in the short term.

This "paid-in" portion has ranged from 25 percent to its current level of 15.7 percent of subscribed capital during the 19 years of EIB operations. The balance of the pledge may be called in by the Board of Directors should these funds be needed to meet Bank obligations. Thus, members are permitted free use of the greater portion of their pledge. In 1976, pledged capital amounted to 3.54 billion UA of which 557 million was paid in.

Under its statute, EIB may not have loans or guarantees outstanding in amounts greater than 250 percent of its subscribed capital. In practice, EIB has been considerably more liquid. In 1976, loans outstanding of 5.49 billion UA were held against capital and reserves of 3.96 billion. Total EIB borrowings were

4.72 UA backed by 3.54 billion in equity, for a debt/equity ratio of only 1.33.

EIB maintains this high degree of backing to ensure access, on favorable terms, to European debt markets; its low paid-in/subscribed capital ratio to minimize the burdens of participation to its members. This arrangement seems viable so long as there is no sustained period (several consecutive years) of loan defaults. In that case, EIB would have to rely on its members' ability and willingness to contribute further portions of their subscriptions in order to meet obligations.

Given EIB's financial performance, such a crisis is not likely to arise. During the past seven years, operating revenues have exceeded annual operating expenses by at least 15 percent. Instead of paying out the surplus to the member states as dividends, the EIB internalizes them to supplement its various reserve funds. The growth of these funds is traced in Table 1.

The EIB's ability to transfer its profits into these reserve funds without paying taxes has allowed the funds to grow at an impressive rate. These reserves may replace paid-in capital in accounting deposit requirements. So, even though the Bank is non-profit, it does act to the direct pecuniary benefit of the member nations by using its "profits" as reserves which decrease the need for paid-in capital. Should the reserves get large

Table 1

GROWTH IN RESERVE ACCOUNTS
1970-1976

<u>Reserves:</u>	<u>1970</u>	<u>1971</u>	<u>1972</u>	<u>1973</u>	<u>1974</u>	<u>1975</u>	<u>1976</u>
Statutory	57.3	63.7	68.5	97.7	110.0	130.0	150.0
Loan Risk	56.0	64.0	71.0	105.0	118.0	143.9	174.7
Equalization	9.0	9.0	9.0	13.0	13.0	13.0	13.0
Monetary Risk	5.0	5.0	12.5	23.0	29.0	33.5	38.4
Building	2.0	4.0	6.5	11.0	16.0	25.0	45.0
TOTAL RESERVES	129.3	145.7	167.5	249.7	286.0	345.4	421.1

enough, the Bank may be able to order increased subscriptions without calling in any capital.

The European Investment Bank acquires virtually all its loan funds on the European bond market. Although the Bank resorts mainly to the European market, it has been able to sell its debt internationally, particularly in the United States and Japan.

The issues range from a low of 6.3 million UA to a high of 239.1 million, averaging from 20 to 40 million. About 40 percent of these issues are placed privately. Since 1974, the Bank has raised more than 800 million UA per year through the sale of bonds. Virtually all the public issues are underwritten by syndicates composed of European commercial and savings banks.

The interest rates the EIB must pay are in line with its strong backing. Rates rose from about 7.0 percent in 1972 to nearly 10.0 percent in 1974, and has since declined. In fact, the Bank has just adjusted its uniform lending rates downward to reflect this movement.

The most noteworthy aspect of the EIB bonds is that they are all long-term. There are a few occasions where the Bank borrowed for less than seven years. Most issues are for at least 10 years, with some going for as long as 15 to 20. The lengths of these liabilities match that of the productive capacity of the assets EIB finances--capital intensive plant and infrastructure.

Table 2
FUNDS RAISED UP TO AND INCLUDING 1976

Year	Number	Issues			Participations by third parties in EIB loans (mil. UA)	Funds raised (mil. UA)
		Amounts (mil. UA)				
		Private issues	Public issues	Total		
1961	3	7.6	13.8	21.4	-	21.4
1962	2	-	32.3	32.3	-	32.3
1963	3	8.0	27.2	35.2	-	35.2
1964	5	13.5	53.3	66.8	-	66.8
1965	4	-	65.0	65.0	-	65.0
1966	6	24.0	114.5	138.5	-	138.5
1967	8	40.0	154.5	194.5	-	194.5
1968	13	112.5	100.0	212.5	-	212.5
1969	9	63.7	82.3	146.0	-	146.0
1970	7	66.6	102.3	168.9	-	168.9
1971	20	208.0	204.9	412.9	-	412.9
1972	19	133.4	328.6	462.0	17.5	479.5
1973	22	207.0	401.0	608.0	4.3	612.3
1974	16	704.2	121.3	825.5	-	825.5
1975	26	318.6	495.1	813.7	17.0	830.7
1976	17	221.0	510.9	731.9	17.0	748.9
1961-1976	180	2128.1	2807.0	4935.1	55.8	4990.9

The EIB has enviable access to the European bond market and is beginning to offer its issues in the American and Japanese markets. The burgeoning growth of its demand for funds, shown in Table 2, has not compromised this access. The benefits of timely access to funds, long repayment terms and favorable interest rates derived from EIB's strong backing are transferred to its borrowers.

III. USES OF FUNDS/LENDING OPERATIONS

By Sector

Over EIB's operating history, its loans, in terms of money volume, have been concentrated in infrastructure projects, predominately in energy, transportation and telecommunications. EIB has made about four times as many loans to industrial sectors as to infrastructure projects. However, total money volume of these loans was only about half of that devoted to infrastructure. Manufacturing projects have received the preponderant number of industrial loans. Table 3 summarizes this allocation pattern and Tables 4 and 5 give more complete breakdowns of historical and current activity.

By Objective

In reporting its loan activities by statutory objectives, EIB

Table 3
EIB FINANCING, 1976 AND TOTALS 1958-1976

Sector	1976			1958-1976		
	#	Amt. (mil. UA)	% of Total	#	Amt. (mil. UA)	% of Total
<u>Infrastructure</u>						
Agriculture	1	30.1	2.8	8	123.9	2.0
Water Supply	6	74.3	6.8	19	220.9	3.7
Transport	6	107.2	9.9	60	1001.2	16.7
Telecommunication	8	200.1	18.4	38	853.7	14.2
Other	-	-	-	2	16.3	0.3
Energy	18	376.5	34.7	109	1764.2	29.4
Total	39	788.2	72.6	236	3980.2	66.3
<u>Agriculture, Industry and Services</u>						
Agriculture	-	-	-	5	7.5	0.1
Industry	120	297.8	27.4	874	2004.0	33.4
Services	-	-	-	7	13.7	0.2
Total	120	297.8	27.4	886	2025.2	33.7
<u>Grand Total</u>	159	1,086	100	1122	6005.4	100.0

All figures in millions UA.

Table 4

SECTORAL BREAKDOWN OF FINANCING PROVIDED WITHIN THE COMMUNITY, 1958-1976

Sector	Number		Amount (million u.s.)		% of total
	Total	of which global loan allocations	Total	of which global loan allocations	
Infrastructure	236		3 980.2		66.3
Agricultural development	8		123.9		2.0
Water supply and distribution	19		220.9		3.7
Transport	60		1 001.2		16.7
Railways	14		221.8		3.7
Roads, bridges and tunnels	34		587.9		9.8
Shipping and inland waterways	8		144.9		2.4
Airlines	3		41.7		0.7
Other	1		4.9		0.1
Telecommunications	38		853.7		14.2
Other	2		16.3		0.1
Energy	109		1 764.2		29.4
(Production)	(77)		(1 243.7)		20.7
Nuclear	29		620.2		10.3
Thermal power stations	13		133.2		2.3
hydroelectric and pumped storage plant					
Development of oil and natural gas deposits	17		245.5		4.1
Solid fuel extraction	16		223.1		3.7
(Transport)	2		16.7		0.3
Transmission lines	(32)		(520.5)		8.7
Gaslines and oil pipelines	6		65.8		1.1
	26		454.6		7.6
Agriculture, industry and services	886	553	2 025.2	262.4	33.7
Agriculture, forestry, fishing	5	4	7.5	2.0	0.1
Industry ⁽²⁾	874	546	2 004.0	255.9	33.4
Mining and quarrying*	18	15	12.8	6.4	0.2
Metal production and semi-processing*	77	31	553.4	22.5	9.3
Construction materials*	63	39	167.2	20.1	1.8
Woodworking	39	37	19.2	13.2	0.3
Glass and ceramics	25	13	33.2	6.9	0.6
Chemicals*	97	25	457.2	12.1	7.6
Metalworking and mechanical engineering	153	119	166.9	52.9	2.8
Motor vehicles, transport equipment	32	19	139.5	8.3	2.3
Electrical engineering, electronics	47	32	74.4	18.4	1.2
Foodstuffs	132	95	159.4	46.3	2.7
Textiles and leather	65	53	37.2	23.2	0.6
Paper and pulp*	28	23	29.6	10.3	0.5
Rubber and plastics processing	41	30	58.7	12.7	1.0
Other	14	11	6.9	3.9	0.1
Building - civil engineering	4	4	1.7	1.7	—
Global loans	39	—	141.6 ⁽³⁾	—	2.4
Services	7	3	13.7	1.4	0.2
Tourism	5	3	9.3	1.4	0.1
Research and Development	2	—	4.4	—	0.1
Grand Total	1 122	553	6 005.4	262.4	100.0

(1) See note 4 to Table 2, page 23.

(2) Of which basic industries (marked with an asterisk): 1 165.2 million u.s.

(3) This amount represents the unallocated portion of the global loans.

Table 5
SECTORAL BREAKDOWN OF FINANCING PROVIDED WITHIN THE COMMUNITY, 1976

Sector	Number		Amount (in million ECU)	
	Total	of which global loan allocations	Total	of which global loan allocations
Infrastructure	39		788.2	72.6
Agricultural development	1		30.1	2.8
Water supply and distribution	6		74.3	6.8
Transport	6		107.2	9.9
Railways	1		19.7	
Shipping and inland waterways	5		87.5	
Telecommunications	8		200.1	18.4
Energy	18		376.5	34.1
(Production)	(11)		(247.6)	
Nuclear	3		111.3	
Thermal power stations	2		33.4	
Hydroelectric and pumped storage plant	2		12.1	
Development of oil and natural gas deposits	3		60.5	
Solid fuel extraction	1		3.3	
(Transport)	(7)		(128.9)	
Gaslines and oil pipelines	7		128.9	
Agriculture, industry and services	120	86	297.8	47.5
Industry (1)	120	86	297.8	47.5
Mining and quarrying*	3	3	2.2	2.2
Metal production and some processing*	21	11	115.3	8.3
Construction materials*	8	7	7.2	3.6
Woodworking	4	3	3.8	1.4
Glass and ceramics	2	1	4.7	6.6
Chemicals*	15	8	83.7	4.2
Metalworking and mechanical engineering	14	13	2.7	6.1
Motor vehicles, transport equipment	4	3	17.1	2.0
Electrical engineering, electronics	9	8	5.3	4.6
Foodstuffs	16	15	7.7	6.0
Textiles and leather	5	5	4.4	4.4
Paper and pulp*	3	3	1.3	1.3
Rubber and plastics processing	7	4	11.9	2.1
Other	1	1	0.1	0.1
Building - civil engineering	1	1	0.6	0.6
Global Loans	7		13.7 (2)	
Grand Total	159	86	1 086	100.0

(1) Of which 11 industries marked with an asterisk: 218.7 million ECU.

(2) Difference between the sum of the 7 global loans granted in 1976 (13.7 million ECU) and the sum of the global loan allocations (13.7 million ECU).

consolidates its three mandates (see page 1) into two classifications: projects for "regional development" and projects of common interest to several member countries. Some projects cannot be unambiguously classified and are counted in both categories. About 18 percent of all projects undertaken by EIB since it began operations have been so counted. Keeping that in mind, some 76 percent of EIB's 6 billion UA in loans have been justified on the basis of furthering the development of less developed regions. Projects of interest to several countries have been mostly in the fields of energy and transportation. Table 6 shows a more complete breakdown of loans by objective.

Global Loans

The management of EIB recognizes that small enterprises are the dominant type of industrial organization in labor-intensive sectors. These firms seldom have capital needs which match EIB's 1 million UA direct lending minimum. However, they are an important source of employment and, in certain sectors and areas, an efficient form of organization.

In order to meet these firms' needs, EIB lends to intermediate institutions, usually regional development authorities who in turn lend to small firms. The authorities are allocated a given amount and are given a finite period in which to use the funds.

Table 6

FINANCING PROVIDED WITHIN THE COMMUNITY IN 1976 AND FROM 1958 TO 1976
Breakdown by Economic Policy Objective

Objective	1976		1958-1976	
	million ECU	%	million ECU	%
Regional development (1)	820.0	100.0	4 558.6	100.0
Belgium	17.9	2.2	75.1	1.6
Denmark	9.1	1.1	35.7	0.8
Germany	9.2	1.1	356.4	8.0
France	60.1	7.4	846.0	18.6
Ireland	57.4	7.0	164.1	3.6
Italy	347.1	42.3	2 200.6	48.3
Luxembourg	—	—	4.0	0.1
Netherlands	30.4	3.7	70.5	1.5
United Kingdom	238.8	29.2	786.2	17.4
Common interest to several Member Countries (2)	438.6	100.0	2 470.1	100.0
Energy	376.5	85.9	1 490.3	60.3
Thermal power stations	30.4	8.1	30.4	1.2
Hydroelectric and pumped storage power stations	42.1	11.0	141.4	5.7
Nuclear	111.1	29.4	598.6	24.2
Development of oil and natural gas deposits	60.5	16.8	258.6	10.5
Solid fuel extraction	3.3	0.9	27.9	1.1
Gaslines and oil pipelines	128.9	34.4	153.4	6.2
Transport	16.4	4.4	589.6	23.9
Railways	—	—	103.9	4.2
Roads and bridges	—	—	423.9	17.2
Shipping	16.4	4.4	40.4	1.6
Airlines	—	—	5.5	0.2
Other	—	—	4.9	0.2
Telecommunications	—	—	30.5	1.2
Other infrastructure	—	—	16.3	0.7
Protection of the environment	—	—	18.0	0.7
Industrial cooperation	25.9	6.9	213.6	8.7
Research	—	—	2.7	0.1
New technology	19.7	5.5	19.7	0.8
Modernisation and conversion of undertakings (3)	—	—	89.4	3.6
DEDUCT to allow for duplication in the case of financing justified on the basis of both objectives			- 172.6	
Total	1 086.0		6 005.4	

(1) Article 130 (a) and (L) of the Treaty of Rome.

(2) Article 130 (c) of the Treaty of Rome.

(3) Article 130 (b) of the Treaty of Rome: these projects, classified in 1976 under the heading 'Industrial cooperation', have now been included under 'Common interest to several Member Countries' by way of simplification and in view of the modest amount involved. In the 1976 Annual Report, the total amount of financing provided for projects included in the heading 'Industrial cooperation' was 213.6 million ECU, of which 99.5 million, relating to projects included in the heading 'Industrial cooperation', had now been deducted to avoid duplication: 113.1 = 213.6 - 99.5.

Projects so financed must meet EIB criteria and be located in a specified area, usually one of the less-industrialized regions. If suitable projects cannot be found within the specified time, the loan money is restored to EIB.

In the nine years of this program's operations, 404 million UA have been allocated to various regional authorities, of which 262.4 million has actually been disbursed. EIB has withdrawn from participating national and regional financial intermediaries 11 of the 38 global loans it has made in the last eight years. Apparently these institutions were unable to find suitable investments, and EIB was intent on enforcing its lending criteria. The average size of the loan has been 474,000 UA, and most have been concentrated in depressed areas of Italy, France and Germany. Although the global loan program represents a sound concept, allowing small firms access to an expanded capital market, it comprises a very small part of EIB's total lending activity--about six percent in 1976.

The overriding impression left by this review of EIB's operations is that the Bank takes a regional approach to its lending--acknowledging the interaction of public investment and private productivity. It then cooperates with national and regional level public and private financial institutions to provide capital to directly productive enterprises.

This pattern has been particularly evident in EIB's operations in the Mezzogiorno (southern Italy), one of the most depressed regions in Europe. Over the years 1961-1972, the Bank provided 7.5 percent of all investment capital coming into the region, concentrating its investments in roads, telecommunications, energy distribution systems and capital intensive industry. I cooperated with the World Bank and Italian public and private financial institutions in encouraging coordination and planning, providing capital to finance these plans where Italian sources were insufficient.

IV. MANAGEMENT

There are three basic levels of administration at EIB. The Board of Governors is responsible for strategic decisions; ensuring that statutory directives are carried out, designating levels of subscribed capital, authorizing changes in policies conditioned on movements in exchange rates, etc. Each member state appoints one Governor. A majority of the Board, representing at least 40 percent of subscribed capital, is necessary to carry motions.

The Board of Directors is responsible for all lending and borrowing decisions. They are appointed by the Board of Governors and have renewable terms. The number of directors from each

member state is set by statute, and the larger states, France, Germany, the United Kingdom and Italy are most heavily represented.

The Management Council, headed by a President, is responsible for seeing that the professional staff carries out the Director's decisions. The EIB retains agents and industry specialists in all member states to evaluate and monitor loans. Loan agreements are executed under the national laws of the state in which the project is located.

V. ACCOUNTABILITY

There is a minimal formal structure of reporting and sanctions by which the Board of Directors, EIB's operating decision-makers, are held responsible for their work. The Board of Governors, acting on behalf of the executive of their respective states, must approve the Directors' Annual Report. If performance is not satisfactory, Directors may be dismissed. States may further effectively censure Bank decisions by refusing to subscribe more capital. But all these measures would operate only in extreme cases of mismanagement or violation of statutory directives. In the important daily work of lending and borrowing, the Directors seem to have a free hand.

VI. EVALUATION

EIB is an operating arm of the European Commission, the central planning and policy-making body of the European Community. We have seen that EIB's major operations have been concentrated in aiding efforts to develop regions characterized by lack of industrialization (the Italian Mezzogiorno) or inefficient industries declining under the force of increased competition stemming from the lowering of trade barriers (Belgian coal regions).

The European Commission has not yet developed a Community-wide policy for coordinating the planning and finance of economic development in subnational regions. In such efforts, national authorities must take the initiative and be responsible for overseeing or executing the planning, financing and administering activities involved. Where the financing of costly industrial plant or infrastructure is involved these authorities may not be able to raise sufficient capital in a timely manner. The private or quasi-public financial systems of the several member states are set up primarily to service national needs. As yet there exists no institutional mechanism to coordinate these systems to provide the massive amounts of capital necessary to finance large-scale development projects.

EIB is designed to do just this. With its solid equity backing, it can raise large amounts of capital quickly in the inter-

national bond market on the terms necessary to finance long-lived assets such as capital intensive physical plant and infrastructure. Because EIB borrows and lends in stable currencies, some promoters in countries with weaker currencies have been unwilling to take EIB loans. They would suffer a loss if their national currency, in which they would receive the revenues generated by the asset financed, were devalued in relation to the currency in which they would have to pay off the loan. This risk is offset in many cases by the favorable interest and repayment period terms on which EIB can offer its funds. For example, Italian firms and authorities have been EIB's largest borrowers.

Real economic factors affecting a borrower's potential performance are not susceptible to EIB influence. Long and concerted effort is needed, for instance, to improve infrastructure, labor productivity and the stability of the regional population in the Mezzogiorno before it becomes a suitable location for the capital intensive facilities the EIB prefers to finance.

The Bank appears to take these considerations into account in pursuing its policies. First, it lends to infrastructure projects, where the ability to mobilize large amounts of capital is critical. Second, it will not lend more than 40 percent of the value of an asset. In a fact, its participation has been substantially less in most cases. EIB seeks to provide the incremental

amount of financing needed to implement a project which already enjoys sound national managerial and financial backing. Financial responsibility is thus not transferred from local government and business organizations whose political and economic fortunes are closely tied to the success of the projects. Unfortunately, EIB's performance, in terms of allocating capital to efficient uses, cannot be inferred from its financial success. Most of its loans are secured by guarantees from national governments. The performance of its borrowers is not reported in central documents. Due to the guarantees, poor performance does not show up as a default rate. The pattern of financial responsibility and ultimate accountability therefore corresponds to the European Commission's as yet decentralized regional development policy.

VII. RELEVANCE TO THE ALASKA PERMANENT FUND

Purposes: The primary way in which the European Investment Bank is relevant and important to the Alaska Permanent Fund is in the strong regional orientation of the European Investment Bank, where 63 percent of its portfolio has been invested in the development of lesser developed regions of Europe. It is important to note that although the vast percentage of its resources has been employed in regional development, only six percent of those resources have been employed through the "global loan program." The importance of that point to the Alaska Permanent Fund is that the global loan program would be most analogous to a regionalized effort in which the regional projects of the Alaska Permanent Fund were implemented through the regional and local community development corporations. This matter bears further consideration.

It is also worth noting that the European Investment Bank rarely takes more than 40 percent positions in its loans, to ensure that the risk and responsibility are borne by both local financial institutions and the private marketplace. Analogously, in Alaska, this is the intent of the present language of the Alaska Permanent Fund and in the case of regional development suggests the wise course of joint venturing with the

regional corporations and with the private marketplace in all regional loans.

Sources and Uses of Funds: There are three principal matters concerning the European Investment Bank's capitalization which are worth noting for the design of the Alaska Permanent Fund:

First, all of the earnings of the European Investment Bank have been retained for reinvestment in strengthening the capital structure of the European Investment Bank. This is a different use of retained earnings than those of either the Alaska, Inc. proposal or a proposal to use the earnings for General Fund purposes at some future date.

Second, with a strong equity base the European Investment Bank has been very successful in borrowing the substantial amount of its capital needs in European and worldwide private capital markets. This is a very important model for the Alaska Permanent Fund. In designing the Alaska Permanent Fund the \$2 to \$4 billion of oil revenues should be viewed as a paid-in equity capital base for the Alaska Permanent Fund against which it can then borrow for its lending purposes on world markets.

Third, the European Investment Bank has a nice balance of its sources and uses of funds. The majority

of the European Investment Bank's borrowings in world capital markets are for seven to ten years, to support expansion capital lending running seven to ten years. The longer infrastructure loans of 15 to 20 years are then in turn supported by borrowings in the international capital market of from 15 to 20 years.

Fourth, all of the infrastructure investing is backed by a government guarantee. In my judgment, it would be much more efficient for Alaska to do the majority of its infrastructure financing through the Permanent Fund, but backed by general revenues.

Management and Accountability: The management and accountability issues of the European Investment Bank are less relevant to the Alaska Permanent Fund.

E. : AN ALASKA CENTRAL BANK OWNED BY LOCAL COOPERATIVE
DEVELOPMENT BANKS

1. BRITISH COLUMBIA CENTRAL CREDIT UNION
Discussion Draft

September 14, 1977
Page 117

I. PURPOSES

The British Columbia Central Credit Union is a private, federally-chartered financial institution owned by the credit unions of British Columbia. Established in 1944, its major function is that of a reserve bank for British Columbia's 178 credit unions. In 1970, it merged with the B.C. Credit Union League, a promotional and educational institution and has since provided a wide range of financial and administrative services to its members. Credit unions require most of these services in order to compete with other types of financial institutions for the deposits and loan business of British Columbia savers. In general, credit unions are too small to undertake the capital expenditure and staff requirements necessary to provide these customer services efficiently.

Credit Unions in British Columbia - Credit unions are deposit institutions offering a full range of customer services. Their investments tend to be concentrated in home mortgages, consumer credit and property development. They are distinguished from banks in that they are cooperatively owned by their depositors, each of whom is entitled to one vote in electing the board of directors and who may participate in membership-management meetings.

All members are required to have a "common bond," a legally construed economic association. These bonds may be of three types: community (those who live or work in a given political jurisdiction serviced by the credit union), associational (e.g., ethnic or church groups) or occupational. About one half of the credit unions in B.C. have community common bonds.

In 1975, there were 178 credit unions with 261 branch offices in B.C. These serviced some 600,000 members, about 23% of the population and composed some 23% of all deposit institution offices in the province. About one half of these offices are located in the greater Vancouver area.

The industry has grown remarkably and become more concentrated in recent years. Since 1971, membership has been growing at a compound annual rate of 11%, assets at 35%. In 1971, there were 217 credit unions holding slightly less than \$500 million in assets. In 1975, the 178 credit unions held over \$1.5 billion in assets, with half of these held by the 15 larger units. (The remaining units are extremely small, median asset size being less than \$70 million.) Credit union assets account for 10% of those held by all financial institutions in the province (20% if corporate business is excluded). Individual units are usually located within communities serviced by commercial banks and are in competition with them for deposits.

Distribution of assets - There has been a sharp rise in the demand for housing in B.C. due to the migration of large numbers of young families. Consequently, the credit unions' assets have become concentrated in home mortgages. In 1971, they composed 62% of the \$400 million in loans outstanding. In 1975, they composed 76% of the \$1,280 million in loans outstanding. Other credit union assets include municipal, provincial and federal government securities and consumer loans.

Liabilities - The main source of funds to credit unions is the deposits of members. Credit unions offer term and demand accounts as well as retirement and home owner savings plans. The latter two types of deposits have grown at a remarkable compound annual rate of over 100% in the past four years. Of the \$1,409 million on deposit in 1975, 36% were in demand and 64% were in term accounts.

Liquidity - Credit unions are required by law to maintain liquidity reserves with a bank, a central credit union or in qualifying federal government securities equal to 10% of deposits shares and borrowings. Virtually all British Columbian credit unions maintain their reserves and surplus in B.C. Central. In recent years, aggregate Loan/Deposit ratios for the industry have exceeded 90%. The credit unions as a whole, then, have

demanded funds from other sectors of the capital market. This borrowing and the cash management involved have been handled by B.C. Central. B.C. Central's functions within the credit union system and its mediating role between the system and the outside capital market is the subject of the following sections.

B.C. Central Operations

Financial - B.C. Central's main financial function is to provide individual credit unions with funds sufficient to meet local loan demand when local deposits prove inadequate. These funds are provided in the following forms:

- non-restricted reserve credit lines equal to 10% of the credit union shares and deposits for use only in meeting any net reduction in shares and deposits due to increased loan demand;
- restricted and non-restricted credit lines to credit unions equal to four to six times a credit union's monthly cash flow for operational purposes. Approved lines of credit under these first two provisions equaled \$262 million in 1975;
- term loans to credit unions to finance office buildings and credit union mortgage loans;

- emergency loans through the Canada Deposit Insurance Corporation.

Actual borrowings by credit unions from B.C. Central have grown rapidly in recent years from \$26.1 million in 1971 to \$91.8 million in 1975, reaching a high of \$108 million in the tight money market of 1974. Credit union credit line and loan requirements are worked out annually in consultation with B.C. Central's financial staff on the basis of financial statements, loan records and cash flow projections.

Credit union deposits are not covered by the Canadian Deposit Insurance Corporation. Insurance of deposits is handled by another central institution, the Credit Union Share and Deposit Guarantee Fund. The Fund is administered by a five member Board of Directors, three of whom serve on the B.C. Central Board. The Fund, which stood at \$13 million in 1975, is capitalized by annual assessment of member credit unions. The Board of the Fund may intercede directly in the operations of individual credit unions experiencing financial difficulties and may grant financial assistance where deemed necessary.

B.C. Central provides other important financial services to its members. These include centralized check clearing, bad debt collection, investment management for retirement and home ownership saving plans and secondary marketing of credit union

mortgages. The last service is another form of increasing member liquidity.

Non-financial services - B.C. Central's most important non-financial service is the provision of on-line teller terminal data processing to handle deposit and loan transactions in local offices. In 1975, this system covered one-half of all credit union offices. The savings in time and cost effected by this system increase credit union ability to compete with other deposit institutions. Other nonfinancial services provided for the most part on a fee basis are economic forecasting, personnel recruitment, printing and supply purchase, collection assistance, data processing and systems development, market research, facilities design and planning, education, advertising and public relations, legal counsel, housing development and travel services. B.C. Central also provides financial services to British Columbia's 108 cooperatives.

II. SOURCES OF FUNDS/CAPITALIZATION

Equity - B.C. Central's major source of equity is the sale of shares to member credit unions. In 1975, members held 6.26 million shares with a par value of \$31.3 million, all of which was paid in to B.C. Central. B.C. Central is required by law to maintain a 10/1 debt/equity ratio. Their debt consists

of deposits and borrowings; equity of membership shares, retained earnings and provisions for dividends. Despite rapid recent growth of deposits in the credit union system and consequently in B.C. Central's deposits, its debt/equity ratio was a fairly conservative 5.7 in 1975.

Deposits - B.C. Central's deposits are comprised of the liquidity reserves and surplus funds of its members. As credit union deposits have grown, so has B.C. Central's; from \$49.7 million in 1971 to \$195.8 million in 1975. These developments are illustrated in Table I. B.C. Central also receives one-half the total in the Credit Union Share and Guarantee fund as deposits. In 1975, this amounted to \$6.2 million. Central pays interest on all deposits, which composes its largest capital expense. See Table 3.

Borrowings - Because credit unions' lending activity has outstripped their deposit base in recent years, they have been demanders of funds from sources outside their system. These demands are mediated by B.C. Central. To finance loans to credit unions, B.C. Central borrows from Canadian, US and foreign banks and has established non-restrictable credit lines with three of the largest Canadian commercial banks. Borrowings vary greatly from year to year depending on the level of deposits

FIGURE I
Credit Union Financial System in British Columbia

December 31, 1975

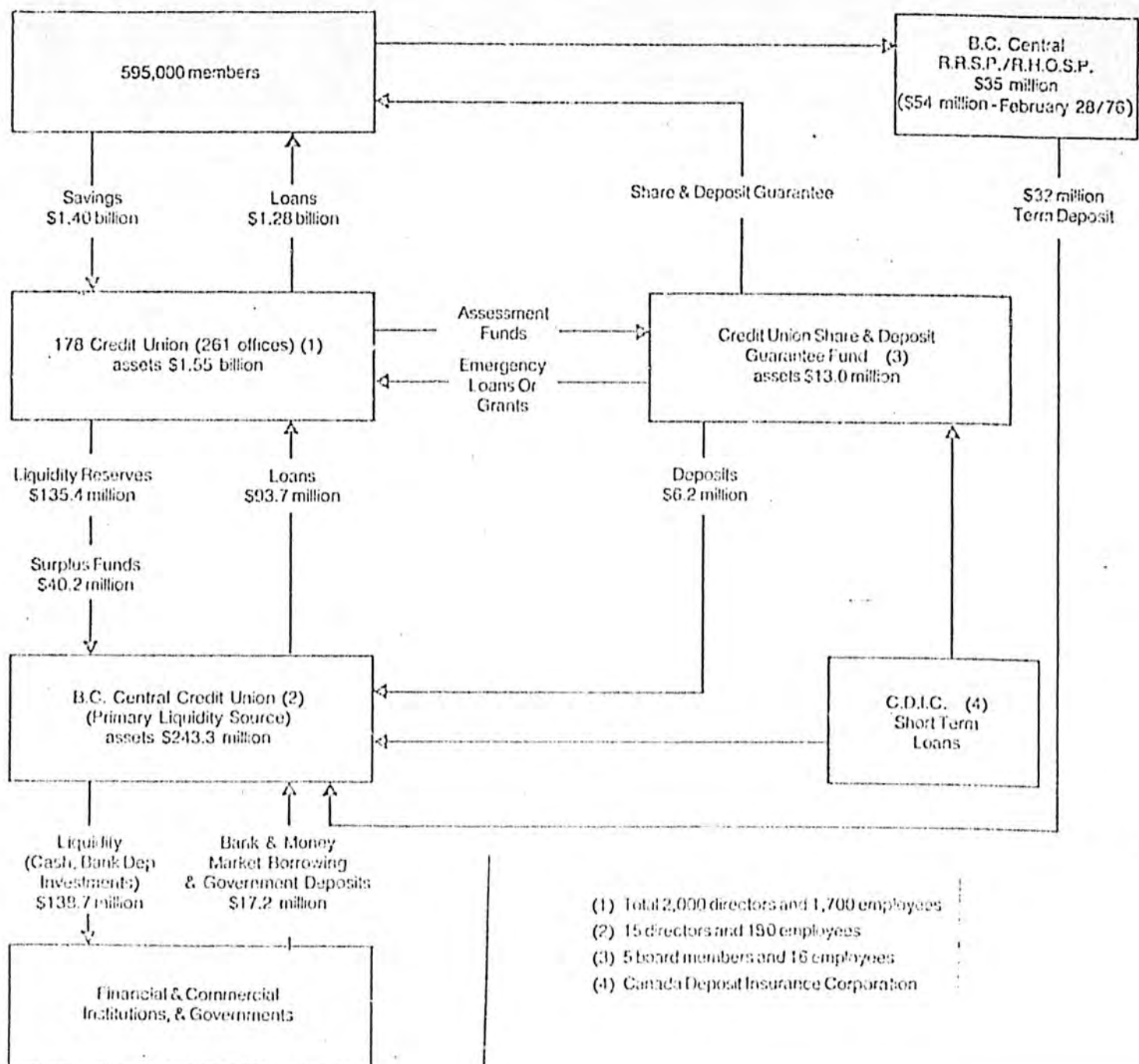


TABLE I

Summary Statistics for B.C. Central Since 1971

(000's except where indicated)

	1975	1974	1973	1972	1971
ASSETS					
Liquid Assets	\$127,885	\$ 61,824	\$ 64,408	\$ 50,541	\$35,626
Loans to members	91,823	108,973	56,705	45,371	26,177
Total assets	243,290	193,225	141,721	109,027	67,807
LIABILITIES					
Notes payable	4,500	12,490	13,150	23,519	5,643
Members' Deposits	195,817	145,048	101,685	66,389	49,679
Members' Shares	31,300	24,815	18,317	12,746	9,153
INCOME AND EXPENDITURES					
Income	27,175	19,938	12,768	7,296	4,916
Expenses (financial)	18,941	13,906	8,032	3,962	2,706
Net Income	2,299	1,621	1,103	1,343	1,008
Dividends per share	35¢	35¢	35¢	30¢	30¢
Percent Growth in Assets	25.9%	36.3%	30.0%	60.8%	29.7%

and loan demand at the local level. See Table I, "Notes Payable," for the level of debt outstanding in recent years.

Income - B.C. Central derives between 80 and 85% of its income from interest payments on loans and returns on investments in securities. The split between loan interest and investment income varies from year to year, depending on loan demand from members. Other sources of income are service charges, fees for services to members and membership dues. Gross income has grown from \$4.9 million in 1971 to \$27.2 million in 1975.

III. USES OF FUNDS/INVESTMENTS

Reserve Requirements - B.C. Central is required to maintain liquidity reserves in cash or short term assets equal to 20% of its deposits and commercial paper liabilities. In 1975, it held \$48.3 million in such assets; 23.5% of its deposits and market liabilities. See Table II.

Loans and Investments - B.C. Central's longer term uses of funds are concentrated in loans to members and investments in securities. The flow of loans to members varies from year to year, depending on demand. Interest rates are adjusted to B.C. Central's borrowing terms, and a spread of 1/2% is permitted by law.

B.C. Central invests primarily in high yield, short term notes of Canadian corporations. Other securities held include Canadian Governments, Canadian corporate bonds, bonds of co-operatives and shares in other credit unions and cooperatives.

Operating Expenses - All expenses involved in providing B.C. Central's many services--salaries, materials and rents--are paid out of B.C. Central's operating income. After-tax earnings, having subtracted financial and administrative expenses, came to \$2.29 million in 1975. Of this, \$1.87 million was distributed as dividends to members. (The current dividend on membership shares is 7%.) Retained earnings at the end of 1975 totaled slightly over \$3 million. See Table III for a complete breakdown of income and expenses. See Figure I for a schematic representation of the relationships described above.

IV. MANAGEMENT

The strategic management policies of B.C. Central are set by a 14-member Board of Directors elected by the member credit unions. Day-to-day management of the institution is handled by a managerial staff of 80 (total staff - 180) in three divisions: Administration and Finance, Services and Development.

Each division is headed by a manager and is further subdivided along functional lines.

V. ACCOUNTABILITY

B.C. Central is a privately owned institution and is subject to no special forms of government oversight or control. Its operations are inspected annually by the federal Superintendent of Insurance office. On the provincial level, Central's operations are monitored by the Department of Consumer Affairs to ensure that consumer and mortgage credit practices accord with department guidelines and provincial usury laws.

VI. EVALUATION

B.C. Central has performed its function of helping a system of small depository units operate effectively and grow in highly competitive and quickly changing local markets. The most remarkable feature of B.C. Central is that it invests primarily within the system from which it draws its funds. Of its \$173 million in loans and investments outstanding in 1975, 50% were directly in cooperatives and credit unions. Another 36% were held in very short term corporate notes for cash management purposes and could presumably be converted to cash should there be a sudden increase in membership loan demands. Thus,

virtually all credit union deposits remain within the system.

B.C. Central's importance as a promotional institution should also be noted. Competition for deposits demands timely and cost-efficient customer service as well as professional promotional activity and well-trained personnel. These are functions which all but the largest credit unions could not afford to undertake on their own.

VII. RELEVANCE TO THE ALASKA PERMANENT FUND

Purposes: B.C. Central, as noted in the July 11, 1977 report, is the best model of a cooperatively owned state central bank capable of providing deposit and lending services to those rural areas too small for full commercial banking services. It has the twin advantages of insuring local, cooperative ownerships sensitive to local needs on the one hand. On the other hand, it provides aggressive centralized capital and management services to ensure that each village receives the most sophisticated economic development assistance possible.

It is also important to note that British Columbia's economy, geography and demography is not unlike Alaska's.

Sources of Funds: B.C. Central's equity comes from the local member cooperative banks or credit unions. It is owned

and governed by local users. As noted in the July 11, 1977 report, the Permanent Fund could initially capitalize the state central bank, and then arrange to transfer ownership to the local cooperative banks. This could be along lines used to devolve ownership of the Farm Credit System from the Federal Government to local users. For a description of that procedure, see II.

Regionalization Models and Options in this Report

B.C. Central's debt is raised in international capital markets, based on its strong equity base and sound management. The Alaska Permanent Fund and its affiliated Alaska State Central Bank could do the same.

Uses of Funds: B.C. Central is a model of a strong central organization capable of raising international capital to support effective local economic development under effective local control.

Management: B.C. Central is governed by its local user institutions and attracts extremely able and aggressive central management.

Accountability: B.C. Central is fully accountable to its local member cooperative banks. The Alaska Permanent Fund could ensure that it is equally accountable to public purposes.

TABLE II
Consolidated Balance Sheet
1975

ASSETS

Cash and Demand Deposits	\$35,296,728
Short Term Deposits, due 1976-1979 (callable notice 1 - 15 days)	13,000,000
Investments	81,680,246
Loans	91,823,385
Mortgages Receivable	15,165,509
Accounts Receivable and Accrued Interest	4,099,861
Land, Buildings and Equipment	2,224,522
	<u>\$243,290,251</u>

LIABILITIES

Notes Payable and Deposit Balances	\$200,317,269
Accounts Payable, Accruals, and Outstanding Acceptances	6,495,372
Deferred Income Taxes	215,400
Provision for Dividends	1,875,595
Retained Earnings	3,086,610
Members' Shares	31,300,005
	<u>\$243,290,251</u>

TABLE III

Income and Expense Statement - 1975

INCOME

Loan interest	\$ 7,745,411
Investment income	15,096,769
Service charges and sundry	1,340,040
Fees for services to members	2,643,521
Members dues	349,007
	<u>27,174,748</u>

DIRECT EXPENSES

Interest on deposits	14,393,292
Interest on borrowings	4,123,399
Service charges and sundry	423,963
	<u>18,940,654</u>

INCOME LESS DIRECT EXPENSES

8,234,094

ADMINISTRATIVE AND GENERAL EXPENSES

5,803,650

EARNINGS BEFORE TAXES

2,430,444

Income taxes - deferred

131,609

NET EARNINGS FOR THE YEAR

2,298,835

Retained earnings - beginning of year

2,659,631

Dividends

4,958,466

1,871,856

RETAINED EARNINGS - END OF YEAR

\$ 3,086,610

I. PURPOSES

The Deutsche Genossenschaftsbank (German Cooperative's Bank or DG Bank) is the central reserve bank of the vast West German cooperative system. Founded as the Deutsche Genossenschaftskasse, a cooperatively-owned financial institution, shortly after World War II, it was reorganized as a corporation and renamed the Deutsche Genossenschaftsbank in 1972.

DG Bank is the apex institution of a three-tiered system which holds 13% of all deposits in German financial institutions. The base of the system is composed of some 6,400 small banks and building societies which service the members of agricultural, industrial and trade cooperatives, as well as unaffiliated depositors. Ten regional cooperative banks provide liquidity management, auditing, check clearing and investment services to the base. DG Bank provides similar services to the regional banks. This system and DG Bank's place in it are described below.

Cooperatives in Germany

Structure of the Movement - After World War II, the German cooperative movement was organized into four sectors, each with its own credit system and network of regional and national unions.

The four sectors are agriculture, industry, consumers coops and non-profit housing finance societies.

By far the largest of these sectors is agriculture. In 1971, more than 1.8 million farmers were members of one or more of the 12,590 local societies. 1,650 marketing and supply co-operatives, 4,300 trade cooperatives and 12 centralized cooperatives with 1,500 branches or depots were engaged in the buying and selling of goods and achieved a total turnover of \$6.4 billion.* In addition, there were in 1971, 4,780 specialized cooperatives with 29 affiliated regional federations. The agricultural credit coops take deposits from and finance the fixed and working capital requirements of their members.

The industrial and trade cooperatives perform similar functions, and are active primarily as central material purchasers for their members. They were serviced by 624 coop banks in 1971.

Consumer and non-profit housing coops (central purchasing agents for the residential construction industry) comprise a relatively small part of the system.

The breakdown of local financial institutions servicing these sectors in 1971 was as follows:

*All monetary figures in the text are given in dollars, converted from DM at the exchange rate prevailing at the time the figure was reported. This is done for ease of comprehension. Figures in Tables I and II are presented in DM, where a sense of proportion is more important than absolute totals.

Agriculture	5,680
Industry	668
Housing and Consumer	45
Total	6,393

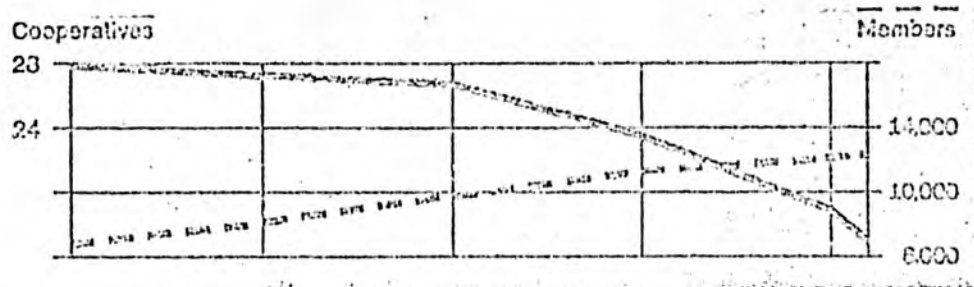
The system also includes 10 mortgage banks unaffiliated with cooperative societies.

Recent trends in total units and membership are illustrated in Figure I. Overall, the graphs show increasing membership and concentration, especially in the two most important sectors, agriculture and credit. Concentration has mostly been achieved through the merger of two units.

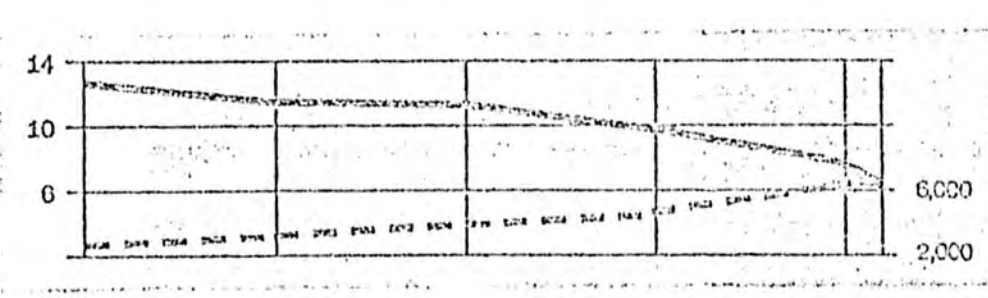
Despite these mergers at the local level, the cooperative system maintains the most extensive branching system of any sector of the German financial market, and its units are incredibly small. In 1971, there were 18,665 coop bank branches, compared to 14,506 for savings and 5,428 for commercial banks. In terms of aggregate balance sheet totals, the cooperatives are behind both the other sectors. The average balance sheet total for the banks serving industrial coops was \$23.3 million; for those servicing agricultural customers, only \$3.7 million.

These changes at the primary level have affected the structure and operations of the regional cooperative banks. Each merger of two local units tends to reduce deposits with the regional banks, because the compensatory movements of

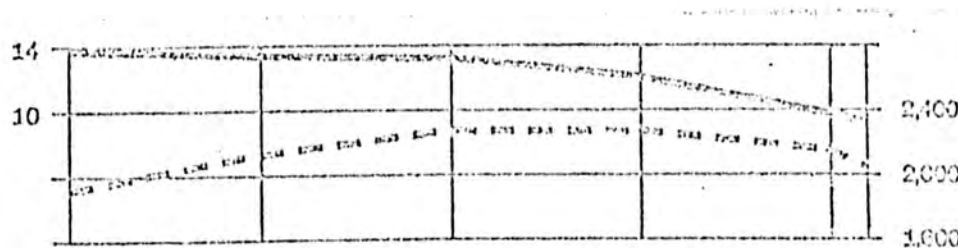
FIGURE I
Cooperatives and Their Membership in the
Federal Republic of Germany



Primary Cooperatives - Total



Cooperative Banks

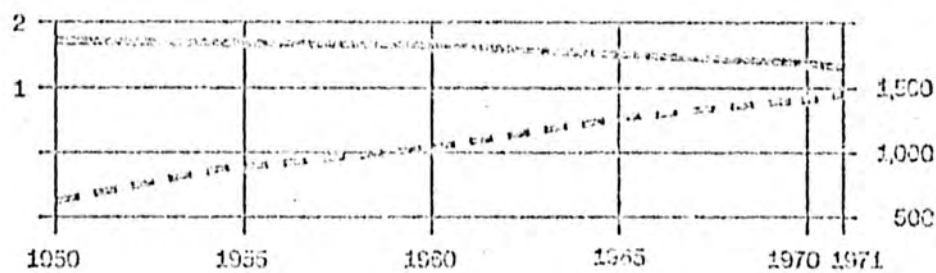


Trade and Service Cooperatives

FIGURE I (continued)



Consumer Cooperatives

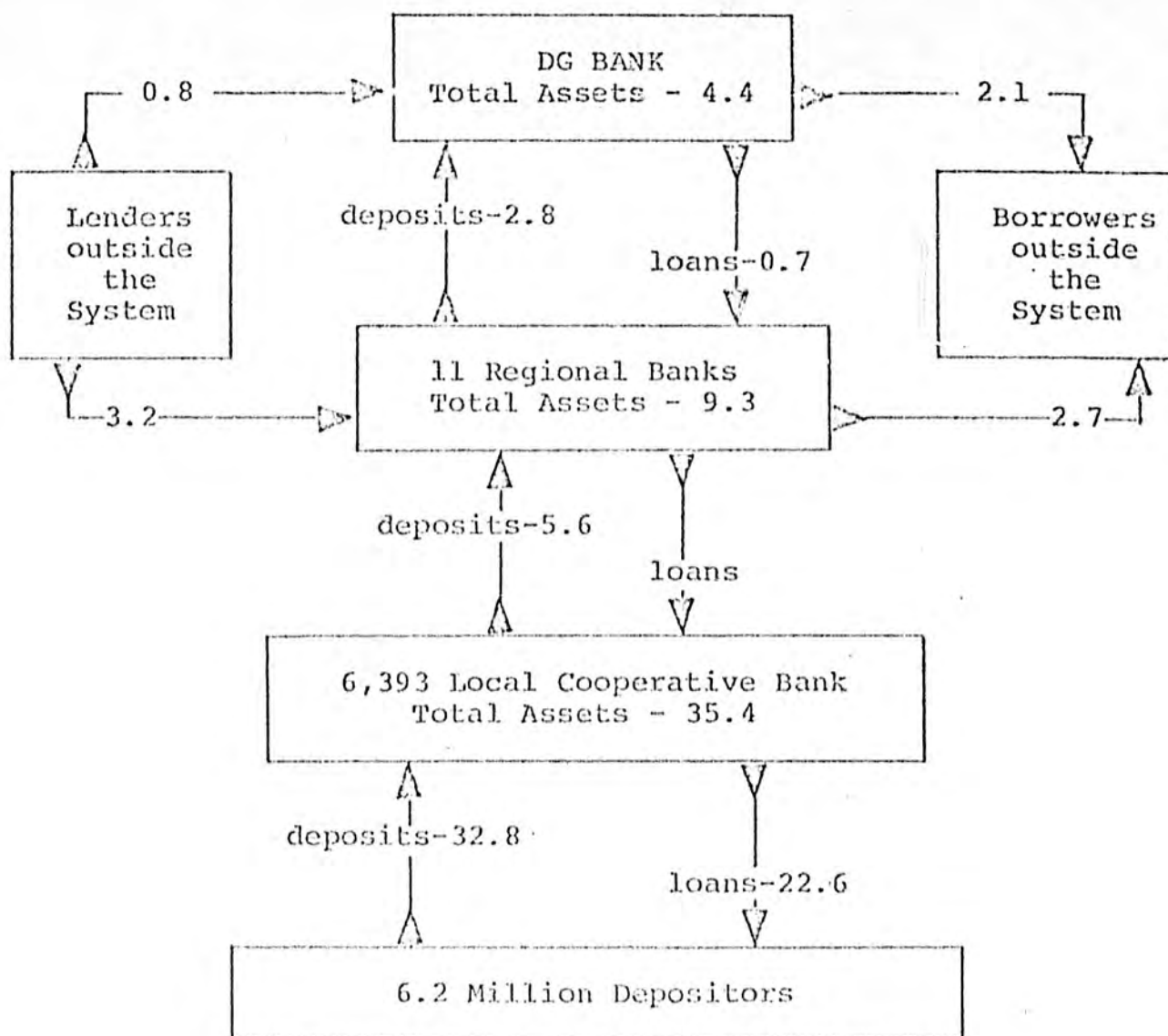


Cooperative Building Societies

FIGURE II

The German Cooperative Financial System (1971)

Figures in billions of dollars (US) at the
then-prevailing exchange rate



liquid funds increasingly take place within the new unit, instead of passing through the central institution. The percentage of customers' deposits held by the local cooperative banks at their affiliated regional bank has therefore been declining. Also, larger local cooperative banks usually make heavier demands on their regional banks, on which they depend for long-term funds to finance expansion in the volume of lending.

This situation has led to the need for larger units at the regional level, capable of maintaining larger balances of loanable funds and providing services such as check clearing where economies of scale can be realized. Since 1968, the parallel regional systems of the various primary cooperative sectors have been in the process of consolidation, and the number of regional cooperative banks has fallen from 18 to 10. Of these, seven have reorganized as corporations able to sell shares to the general public. These regional banks, in turn, rely on DG Bank for depository, liquidity management and other essential services. The financial interrelationships of this system, from local depositors to DG Bank are shown schematically in Figure II.

Sources of Funds - The source of funds to the local system is the deposits of members. The local coops offer a full range of deposit accounts and instruments: checking and savings

accounts, negotiable and non-negotiable savings certificates. These last instruments are issued for terms of 7 years and their proceeds are earmarked for term lending to medium-sized firms.

Uses of Funds - Besides consumer, home mortgage and business loans to members, coop banks undertake a number of lending and investment activities. These include construction financing, term loans to other credit cooperatives and industrial customers and leasing.

DG Bank Operations - DG Bank provides financial and non-financial services to the regionals in order to help them facilitate these local activities. Such tasks performed jointly by DG Bank and the regionals include check clearing, centralized electronic transaction procession, property broking, secondary mortgage marketing, advertising, personnel training, and the placement of reserve and surplus funds in investments outside the cooperative system. This last function is reserved primarily to DG Bank. They underwrite and market domestic and foreign corporate equities and securities of various governments and public authorities.

II. SOURCES OF FUNDS/CAPITALIZATION

Equity - DG Bank is capitalized by the purchase of shares. Of the \$134.5 million in paid-in equity in 1975, some 75% was

held by the regional banks. The rest was held by corporate and institutional investors outside the cooperative system. The current dividend on shares is 8%.

Deposits - DG Bank's main source of deposits is the regional banks' reserve and surplus. Of the \$7.92 billion on deposit in 1975, \$5.36 billion was attributable to the regionals. Other banks and corporations provided the balance of the deposits. DG Bank pays interest on these deposits at prevailing rates, and these interest payments compose their largest financial expense. The volume of deposits in the entire system has risen rapidly in recent years.

Borrowings - When necessary to increase its base of loanable funds, DG Bank will raise money on the European bond market through issue of its own bonds. In 1975, it had \$832 million outstanding--down from recent years due to the simultaneous increase of deposits and decrease of loan demand within the coop system.

Income - Net interest payments on loans compose by far the largest portion of DG Bank's income, some 86% of the \$606.5 million in 1975 gross earnings. Other sources of income include that from investments and securities, commissions and fees and miscellaneous sources amounting to \$11.8 million.

III. USES OF FUNDS/INVESTMENTS

Because loan demand in the sectors from which the cooperative system draws its deposits--agriculture, small business and middle-income individuals--has fallen in recent years, DG Bank has had to find uses for its investible funds outside the cooperative system. Some 57% of its \$7.5 billion in loans outstanding in 1975 were to banks outside the cooperative system. Another 26% were to non-bank, corporate customers, leaving 17% to be channeled back to the regional banks. Over 70% of these loans were for terms of less than four years.

Unlike American banks, German banks are not restricted from engaging in equity and underwriting transactions involving corporate securities, and they may own subsidiaries directly instead of through a holding company. All these activities figure prominently on DG Bank's balance sheet. Of the \$1.24 billion in investments held by the bank, 46% are in corporate bonds, many of which DG Bank underwrote. Three percent was held in other securities, mostly corporate equities, 12% in shares of subsidiaries and 39% in Treasury notes.

DG Bank's underwriting business is substantial. In 1975, it underwrote 17 large issues, mostly for German public authorities and political units. The Bank also participated

in 47 other issues as guarantors for various private and public entities.

DG Bank held equity interest in over 50 other financial institutions, including the seven regional banks reorganized as corporations. Among the Bank's wholly-owned subsidiaries is the Deutsche Genossenschafts-Hypothekenbank, one of Germany's largest mortgage banks, several closed-ended mutual funds and several foreign subsidiaries engaged in placing DG funds in investments abroad. DG Bank also owns 19 and 50%, respectively, of the shares of the two leasing firms whose services they broker to the regional banks.

Thus, using the very sparse information provided in DG Bank's annual reports and including accounts which may register holdings outside as well as within the cooperative system, it appears that only 18.6% of DG Bank's investments are in the cooperative system.

IV. MANAGEMENT

The top level of management is the Managing Board, composed of five members elected by representatives of the regional banks and cooperative unions. DG Bank does not report the breakdown of managerial responsibility between its various divisions. Nor do they present any overriding management policies besides

a commitment to helping local credit cooperatives achieve a greater market share.

V. ACCOUNTABILITY

DG Bank is a privately-owned corporation and thus enjoys almost total freedom in its investment and liability-generating policies. It is restricted only insofar as it must obey laws designed to protect depositors.

VI. EVALUATION

DG Bank's major purpose is to help the thousands of tiny financial units which compose the cooperative credit system remain competitive with other sectors of the German financial system characterized by larger units. Banks in these other sectors tend to deal in larger blocks of money and thus have lower unit transactions costs. DG Bank and its regional affiliates seem to do this job well. From 1973 to 1975, the share of deposits in all German banks held by cooperatives increased from 11 to slightly more than 13%.

Perhaps the most striking aspect of DG Bank's operations is the extent to which it invests outside the cooperative system, especially when compared to the British Columbia Central Credit Union. Such a comparison is misleading, however, in that the

real economic conditions in the two institutions' deposit markets may be entirely different. Young families are heavily represented among the British Columbian cooperatives' members. Their demand for large mortgage loans is high, and they tend to keep little in savings. Thus, their central bank must channel funds from outside the system to its member units if they are to continue to compete for loan business.

DG Bank is the lead institution of a complex system financing many types of economic activity. Its managers claim and behave as if loan demand is declining in these sectors. An analysis of these sectors and a critique of DG Bank's lending policy is impossible given the paucity of information on these activities available in secondary sources and the Bank's own tight-lipped reporting policies. Management may be doing its members a service by investing outside the system if that is where their funds can earn the greatest return.

However, one of the Bank's financial policies does seem to be a disservice to the member cooperatives. This is the selling of shares by both the regional banks and DG Bank to investors outside the cooperative system when liquidity appears to exist among the individual cooperatives to buy these shares. Thus, earnings on the deposits contributed by the units at the base of the system (and ultimately their members) are siphoned off

to outside investors through the payment of dividends. According to our own calculations based on information given in DG Bank's annual reports, these payments outside the system amounted to 18.9% of the Bank's net earnings in 1975.

VII. RELEVANCE TO THE ALASKA PERMANENT FUND

Purposes: DG Bank provides an important counterpoint to BC Central. It shows what happens to a similarly constituted cooperative development bank when it matures in a mature industrial economy.

Sources and Uses of Funds: DG Bank is no longer wholly owned by its users. It now is a net exporter of funds---not only out of local cooperatives, but out of Germany.

Management and Accountability: DG Bank is increasingly less accountable to its local cooperatives. It manages its funds similar to a large multi-national bank.

TABLE I

Balance Sheet - 1975

	DM Million
ASSETS	
Cash and Bills Receivable	627.4
Due from Regional Cooperative Banks	3,198.3
Due from Other Banks	
Less Than Four Years	9,852.9
Four Years and Over	909.5
Treasury Bonds	1,313.1
Bonds and Notes	1,625.5
Other Securities	117.8
Loans and Advances to Non-Bank Customers	
Less Than Four Years	3,324.9
Four Years and Over	1,459.6
Due from Public Authorities - Equalization	
Claims	86.9
Own Bonds Held for Trading Account	38.0
Fiduciary Transactions	165.2
Investments in Subsidiaries and Affiliates	413.0
Premises and Equipment	45.1
Other Assets	107.6
Total Assets	<u>23,284.8</u>
LIABILITIES	
Deposits of Regional Cooperative Banks	13,381.9
Deposits of Other Banks	
Less Than Four Years	3,528.4
Four Years and Over	1,683.9
Deposits of Non-Bank Customers	1,192.5
Bonds and Notes Issued	2,302.1
Fiduciary Transactions	165.2
Other Liabilities	283.5
Capital Stock	366.6
Reserves	355.0
Profit After Transfer to Reserves	25.7
Total Liabilities	<u>23,284.8</u>
Endorsement Liabilities	417.8
Guarantees	1,694.7

TABLE II
Income and Expenses - 1975

	DM '000
INCOME	
Interest Earned	1,305,936.6
Income from Securities and Investments	159,911.1
Commissions and Fees	18,741.5
Other Income Including Adjustment of Special Reserves	29,471.3
Total Income	<u>1,514,060.5</u>
EXPENSES	
Interest Expense	1,272,019.7
Commissions	1,813.7
Depreciation, Provisions, Transfer to Special Reserves	32,048.8
Staff Expenses	34,542.4
Other Operating Expenses	23,918.2
Taxes	19,192.4
Other Expenses	4,852.5
Total Expenses	<u>1,388,387.7</u>
NET INCOME	125,672.8
Transfer to Reserves	100,000.0
PROFIT AFTER TRANSFER TO RESERVES	<u>25,672.8</u>

II. REGIONAL MODELS AND OPTIONS

REGIONAL MODELS
Discussion Draft

September 14, 1977
Page 149

International and Domestic Patterns

International development banking provides a pattern for regionalizing the Alaska Permanent Fund which is strikingly paralleled in a number of publicly-sponsored American development finance systems. In each instance a three-tiered arrangement has evolved with these common elements:

First, a government-sponsored development bank or fund which oversees the whole system.

In the middle, regional development banks or corporations which are more sensitive to local differences and act as a bridge between local needs and national or state resources.

At the bottom, local development corporations or banks with a great deal of autonomy and flexibility to respond to local needs and differences.

This essential three-tiered pattern is found in the international development banking system headed by the World Bank, in sophisticated national development banking systems in Third World countries such as those of Brazil, Mexico and India, and in regional development banking systems of developed countries of Europe such as France or Italy. The same pattern is followed in publicly-sponsored American credit systems such as the Farm Credit system and the Federal Home Loan bank system.

It is no coincidence that this pattern repeats itself in such a range of settings. The advantages of this pattern are elementary, sensible, and obvious.

In each instance, the system is publicly-sponsored and accountable but independently operated by an experienced, career-minded professional staff. Both capital and management are organized on a long-term basis and initial public investment is used to generate larger amounts of private capital from the private capital market.

Just as international and domestic experience provides us with important parallels, each gives us a better understanding of different aspects of the overall structure and organization which could help define the Alaska Permanent Fund as a development bank capable of supporting the quite different regional economic needs of different areas of Alaska.

For instance, international development banking systems are superior to American development finance systems in the provision of infrastructure financing and venture capital. By definition two major American credit systems, the Farm Credit system and the Federal Home Loan bank system, do not provide either long-term infrastructure finance or essential venture capital to new enterprise. Venture capital is essential to the development of rural regions of Alaska and lower-income

communities in those regions, as it is in Africa, Asia or Latin America.

Just as the international development banking systems help us understand the basic capital formation instruments for development banking systems, particular American experience in structuring financial institutions gives us a set of basic guidelines for constructing the regional units of the Alaska Permanent Fund. After looking at the evolution of international experience, it is worth taking a close look at the specific legal, financial and organizational mechanisms used by successful American development finance systems.

International Models

One of the most appropriate transferable lessons from international development banking experience is that a network is necessary in order to support regional economic development--not a single, monolithic institution. This is especially true where regional and ethnic distances are great, where infrastructure is inadequate, and where sensitivity to local needs must be particularly acute.

The evolution of the international development banking system into a geographically decentralized and functionally differentiated worldwide system was neither wholly planned nor

conscious. It simply evolved to fit the rising needs of various developing countries and regions of the globe.

For instance, early on, the World Bank began to recognize the value of working through local intermediary development banks, since they were much more sensitive to local practices and, in many cases, more likely to make sound financial judgments about loans and investments. The World Bank group began to work with existing national development banks and to sponsor the creation of a worldwide network of national private development finance corporations in a host of Third World countries.

Second, in large and complex countries with large geographic areas and significant regional differences, we can observe a tendency to complement this international decentralization with an intranational regional decentralization to subnational institutions. In one study of 209 development banks, nearly 40 percent were located in 10 countries--Argentina, Brazil, Colombia, India, Malaysia, Nigeria, Pakistan, the Philippines, Spain, and Venezuela--each of which has developed extensive, decentralized and regionalized development banking systems.

Third, this pattern repeats itself once again in the sophisticated and elaborate regional development banking systems which have been organized in France, Italy, and the United Kingdom.

At the base of each system is the fundamental unit--the local development bank or corporation which serves to broker the risk between the local entrepreneur and the outside sources of capital. Between the local development corporation and the apex of the system there is often a regional development bank or corporation which mobilizes its own capital for local use and may be required to broker-finance between the local and the top institutions. At the higher levels in any event there is also a careful elaboration of different infrastructure and equity "windows" to provide more discrete forms of capital for specialized purposes. Figure 1 provides a highly abstract and stylized version of the institutional relationships among the World Bank, multinational regional development banks, and local national institutions on the one hand, and national development banking institutions, regional and local development corporations on the other hand.

An American Parallel: The Farm Credit System

The Farm Credit system has evolved as a highly sophisticated, publicly-sponsored but user-owned development finance system like the international development banking network. It has unfolded gradually since its establishment in 1916, assuming new functions and becoming more decentralized in response to

the credit needs of farmers. Today the federal Farm Credit Board and the Farm Credit administration operate at the financial level, while twelve district Farm Credit Boards at the regional level serve hundreds of constituent associations and cooperatives at the local level. The functional diversity of this system is reflected in twelve federal Land Banks serving 594 constituent Federal Land Bank Associations, twelve Federal Intermediate Credit Banks working with 442 local production credit associations, and twelve banks for cooperatives serving constituent farmers in cooperatives. This arrangement provides three different functional "windows" of credit to member farmers and ranchers in each of the twelve regional Farm Credit Boards.

The Farm Credit grid system, then, parallels the international development banking patterns both in its geographic decentralization of decision making and its separation of different functions. The pattern of geographic decentralization is repeated again in other American financial networks such as the Federal Home Loan bank system and, of course, the Federal Reserve system. These important domestic parallels not only confirm international experience; they also provide us with proven, workable, legal, financial and organizational precedents for a regionalized Alaska Permanent Fund.

The Farm Credit system has, for example, developed two structural attributes worth noting and using in constructing a regionalized Alaska Permanent Fund. In a characteristically American fashion, on December 31, 1968, the Farm Credit system became 100 percent user-owned with retirement of the original federal government capital investment in the system. Part of each farmer's loan purchases stock ownership in the capital structure of the banks and associations. Member farmers elect the Board of Directors of the Federal Land Bank Association, production credit associations, and cooperatives; the Boards of the associations and cooperatives in turn elect the District Farm Credit Board and make nominations to the President for the federal Farm Credit Board (see attached Figure 2).

The local users govern the system by electing or nominating each governing board in the system. The local users eventually repurchase the ownership of the system from the federal government with a small percentage of the proceeds received from the system. This user governance and eventual user ownership is a critical precedent for establishing local cooperative banking institutions in communities in the state too small to properly support a full-service bank.

Second, the private capital market finances the \$8 billion debt of the Farm Credit system through the sale in the bond

market of consolidated federal Farm Loan bonds. "Consolidated" is primarily what they are: thousands of individual farm mortgages, crop loans and farm equipment loans which have been put together by the Farm Credit system for resale in the private capital market. The private capital market supplies the bulk of the funds used, not the Treasury. On the other hand, the Treasury's standby credit is assurance to the market that the government stands behind the obligation, even though there is no direct government guarantee. I similarly feel that with the huge paid-in capital base of the Alaska Permanent Fund it will similarly be possible to sell many such packaged private obligations in consolidated bonds in the marketplace with the standby backing of the Alaska Permanent Fund itself.

Unlike virtually all international development banking systems, the Farm Credit system has not developed an affiliated venture capital corporation. As a result, the Farm Credit system is precisely that--a 100 percent debt financing system which is no longer able to respond adequately to the needs of those low-income farmers and lesser-developed regions of the country which it was originally set up in the 1920's to serve. Nor has it been able to be effective in its original purpose of seeking to end farm tenancy by making landowners out of sharecroppers. Credit does not make owners, only debtors. The