

ALASKA LEGISLATURE SPECIAL COMMITTEE / SUBJECT FILE 86 / 2601

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and with---in specific projects, one in the Aleutians, one in the Kotzebue area. You can't begin to talk about a significant fisheries project that is going to be sound unless you get the concrete in there for the pier first. And so, obviously, the infrastructure decision made through general fund investments has got to be made side-by-side with the Permanent Fund.

Point Number Four. The private market needs to be used first in terms of solving both market and capital issues within the state, and all of your planning and development in terms of any financial intermediary specifically that might be set up within it have got to be planned in collaboration with the private market and implemented in collaboration with them. This is essential if you are to husband your resources properly, both in terms of lowering the risk in which state funds are invested, and also lowering the cost. And I would suggest that ---and I will cite some specifics before we finish---that there are lots of opportunities for that kind of collaboration which are mutually attractive to the market sites, to the population of Alaska, and to the state government. And therefore, specifically, in the case of regional development banking subsidiaries of the Permanent Fund to deal with some of the problems of capital availability in the regions, I strongly support Arlon's position that they should be a collaboration between the native corporations, between the private market

place, and between the Permanent Fund. I will give a few specific cases in a moment. Without knowing in great detail the operations of the present revolving loan funds, what little I know confirms the experience in many other states and many other places that those funds which are in collaboration with the marketplace have a portfolio which is not only financially of better quality but in terms of the economic impact has a greater impact within the state.

Point Number Five. What are the potential areas for use of the Permanent Fund and how might the Permanent Fund be organized in order to deal with them? I think there are four that deserve very careful consideration by you and I will try to highlight those points which are either extending on a point that Arlon has made or in addition to them. First of all, in terms of large scale economic activity in the state, the very efficiency and consolidation which is taking place in money and capital markets on a worldwide basis means that there is capital available for those large enterprises and I think you should ask very carefully what the market imperfection is, either in terms of the private market or financial market, which would lead you to be asked to undertake either an equity investment in or a debt loan to or specifically a debt guarantee of a large activity which you should presume can be handled by the marketplace. Now, I would like to introduce another issue with regard to large scale enterprise. At the present

time large scale enterprises in Alaska are primarily being developed by resources from outside Alaska and you may want to ask yourself the question whether or not there is a reason to intervene in order not to change the underlying economic viability of the project, which is presumed to be sound, but to change the ownership, both in terms of who is bearing the risk and who is bearing the reward for that particular large scale undertaking. I am going to suggest a number of points a couple of models around the world which your---which the previous consultants of the state were not asked to look at because they were asked to look primarily at international development banking experience. There is very close to you a model that deserves your careful consideration in terms of this issue of shifting ownership for very large scale enterprises and it is the Canada Development Corporation.

Canada Development Corporation was created in 1971, I might note after a 10 year debate. I don't mean to suggest that this process may go on for a while, but I am fascinated that it did take 10 years to do it in Canada. It was created with an initial public investment by the federal government of Canada of a quarter of a billion dollars. Three years later it was able to have the largest public offering in the history of Canada, \$150 million public offering, primarily by small individuals in Canada, primarily because of the soundness of the investments which it had made. It now has total assets in

less than a 6 year period of over a billion dollars and is producing a significant return on investments and has repurchased a number of rather large corporations which were originally under foreign ownership, primarily American ownership. Now, it is a mixed success, depending on the standards that one uses. But it is one alternative form of use of the Permanent Fund in which you would be operating on a market basis but with a somewhat different public purpose.

Second, in terms of uses. There are on a world-wide basis--- there are problems of the availability of intermediate long term capital for small and medium size businesses generally and particularly in remote areas. Now it is very important to note that this is not an Alaskan problem. This is a world-wide problem. And the question then that you have to ask yourself is whether or not you have an economy that is in some way particularly dependent on those kinds of enterprises for economic growth and therefore there is warranted on the part of you and the Permanent Fund some intervention. In Massachusetts, for instance, we are a particularly dependent economy on small and medium size businesses. We are also particularly dependent on the creation of new high value added and high technology companies, which, as I mentioned earlier, have difficulty of access to the capital market. Therefore, we have created a series of new development banks in Massachusetts, two wholly privately owned and several that have a mixed and private capital in order to deal

with that problem. Very critical point. That activity must be undertaken, planned and implemented in collaboration with your existing commercial banks and thrift institutions both federally and state chartered in order to create a mode of investment that is sound, from a risk standpoint, spreads the cost and builds those institutions more deeply into the economy on a sounder basis.

There are a number of models that warrant your careful consideration. One, again, is the Connecticut Development Authority, which in my judgment is the soundest of the intermediate and longer term joint ventures between public capital and private capital. Every European nation, every Canadian province, almost every state in the lower 48, has this kind of intermediary. This one just happens to be the best of them. OK. Third. There is a particular problem that deserves your attention in terms of support for regional and small community economic development and I would say on the basis of my experience in Appalachia, my experience in New England, and my experience with regional economic development efforts in Europe, that without knowing precisely the nature of your own economic situation in the---outside of the major cities, that this is a very serious problem, as Arlon has already noted, and that---but I think the extraordinary thing is you have a resource that does not exist in any other state, and that is the existence of the native corporations.

What I think is worth your serious consideration is the regionalization of parts of the Permanent Fund to deal on a joint venture basis with the native corporations. And I would like to note that this is the one case in which I think, underlined many, many times, that there may well be a sound economic and financial reason for the Permanent Fund to take a significantly lower rate of return, and that is this: The native corporations have a very high need to produce at the highest rate of return at the lowest risk on a worldwide basis as they can in order to husband their own resources and protect their stockholders. They are therefore naturally looking to investment opportunities in the Anchorage area, Fairbanks area and outside the state, as they should, I think--because of their opportunity costs. I think that they are essential to the sound investment in their region. It is not sound for them to have all of their economic eggs in their local basket, or even in the basket of Alaska as a whole, but that development will only take place if in fact the Permanent Fund is willing to compensate for their opportunity costs. This will require much more careful consideration and analysis, but I think in principle the idea is sound. I just, in fact, had the opportunity to sit down and talk in more specific terms about a specific project in Kotzebue where I think this is true. The project will be financed but it may well not be financed as soundly as is good for the project in order to have the shopping mall to get started in Kotzebue.

Once again, there are very good models for your consideration, some new and some old, in terms of this kind of collaboration. One set that deserves your further attention is the British Columbia Central Credit Union, which has had an enormous impact on regional and small scale community development in an economy which I would presume is not radically different from the Alaskan economy in terms of its overall construction, political dimension and demographic dimension and underlying economy. Related to that is an extraordinary institution in Germany called the DG Bank, known as the largest bank in the world, starting from small scale community development, now investment opportunities on a worldwide basis. A new institution in Massachusetts not yet operational but I think conceptionally very sound, the Community Development Finance Corporation is an institution that I think deserves consideration by you in the planning. I might note a small kind of example of refinement I would suggest for consideration in HB300, and I know this---I think it is a mistake in the community development of units of the Permanent Fund to limit the form of investment to only debt and debt guarantee. I think equity is essential for community and regional economic development and the Permanent Fund should have the opportunity of making those kinds of equity investments on a joint venture basis in a minority position with the native corporations in the kind of case that Leo and I just had an opportunity to talk about.

Fourth and finally, in terms of uses of infrastructure investments. Be wary, be cautious. There is an enormous body of experience on a worldwide basis of public investments made in anticipation of private market investments following and those public investments are lying in the fields. Now, where there is the opportunity for a market investment like a fishery, like a fish processing plant and in the Aleutians, but an infrastructure investment needs to be made first, then we have---in order to realize the private investment---then there is a very great need for collaboration between general fund infrastructure investments and Permanent Fund income producing investments.

Point Six. Without having access to either private market projections for the economy or the university's projection, or the government's projection, under no circumstances in my judgment will there be the capabilities for absorbing substantial amounts of Permanent Fund resources in any of the above four categories over the foreseeable future. And it is interesting that I arrived at the need to make private market investments, not from the standpoint of security, not from the standpoint of evening out the long term ups and downs in the cycle of state government revenue, but from the standpoint of development banking. And I very much support the language of 298 and 300, which say no less than 40% in terms of investment grade security and---but no more than 30% in community development, or no more than 30% in productive private enterprise

Now, Point Seven I have already covered and that is good. There are other models in addition to the ones which you asked the original consultants to look at that are worthy of your consideration. There is no need for any kind of activity that you might undertake with the Permanent Fund to reinvent the wheel. Somebody has been there first and made plenty of mistakes and finally of all there were times creative models ---models are available for your use and should be used.

Eight. Looking at the structure of the development bank and is proposed in 298 and 300. A general proposition first, very important. Some members of the committee, I think, will be a little sick of hearing me stress this. There is one great strength in a development bank and one great weakness. The great art in design is to maximize that strength and minimize the weakness. The strength is that it is the most efficient mechanism for making a public capital investment that is sensitive to market conditions in order to contribute to economic development. It beats setting up a bureaucratically administered fund in terms of both equity and efficiency by a very long distance, and it beats tax expenditures and tax incentive by a very long distance, which are the two other principal forms of public investment. But the price that is paid is the price of accountability to a public purpose, both to the executive and to the legislature. There is a history of development banks

being lost from public control. Now, I want to re-emphasize that I think the basic plan of 298 and 300 is very sound. I think that in terms of both counsel and the decisions of the investment advisory committee and the drafts that have come from the executive and legislature are essentially sound in detail, as well as concept. There are 30 or 40 pages in my paper that literally go through the draft line by line, comment on them, the meanings of the phrases and any more detailed technical issues that I think deserve some consideration.

What I think deserves your consideration is how to insure that the resources of the Permanent Fund are planned and implemented in conjunction with the general fund for purposes of economic development, not for purposes of market security investments, investments for purposes of economic development, that insure that the planning is consistent, but that the investment decision-making of the Permanent Fund is in no way compromised. The whole idea of creating the Permanent Fund is in fact to remove---one of the major ideas as I understand it---is to remove revenue from the expenditures of state government. And if you think it is done in Alaska, you should see it in Massachusetts. The expenditures always rise to meet revenue whether you need them or not.

Forcing an investment pace which is not there is another problem. I have lived through disastrous efforts of the federal government in the '50s to try and jam money into ghettos at a rate that could not be absorbed. If you want to see economy in people's lives

destroyed, that is a good way to do it. So the issue here is to make sure that not only is this avoided but that the investment pace---that the legislature and executive do not insist on an investment pace which will create unwise investments that will only come back to be of much greater problems in the end. Now, I am going to take advantage of the fact that I am an outsider, unfamiliar with the custom and history of executive and legislative arrangement in Alaska and not propose a specific solution to that problem. I think my function in that case is better served by reacting as counsel to ones that fit the genius of the Alaskan situation, based on the experience in many other settings outside of Alaska. But I guess my summary feeling is that there is a---that a very fine start has been made through the drafting of 298 and 300, through the kinds of sensitivities I have been hearing from private market people, people in the executive and legislature, people in native corporations over the last couple of days. And the issue is to build on that excellent start in a process which continues to collaboratively involve the private market, the executive, the legislature and the users of---services in the further refinement and in the implementation of the plan.

GRUENING: Thank you, Dr. Daniels. Are there any questions from the committee? I have one, if no one else does, to

start with. Earlier, Arlon testified he saw the range of possible investments in the magnitude of \$40 or \$50 million range and you are aware, Dr. Daniels, of course, that the two bills that you mentioned---298 and 300---set aside 40% of the incoming Permanent Fund revenue to kind of savings, which wouldn't be used for that kind of investment in the state development banking and investment in the state. Given the fact that its magnitude is somewhat smaller than you might have guessed earlier, would you suggest that that percentage in investments---let's say not a development banking type in the state---be larger. In other words, that 40% ought to be raised?

DANIELS: Well, I would have several observations. One, if I understand Arlon correctly and understand the paper where he talks about this in somewhat detail, that's a hunch on his part subject to more careful econometric modeling on the part of the university, further grants that might be made by administration for consultant assistance in that regard. I think that one of the tasks that is before the committee is to take a very careful look at kinds of projects like the ones that Representative Schaeffer and I were talking about earlier, in order to see totally what is out there. You also do need to do some very careful modeling and you need some computing models so you get some different judgments because, as you know, you are still very much in the dark as to how to use some of

these econometric models. So that needs to be done before anybody can start making some more rigorous hunches.

Two. Having been through this for 18 years, and having just been through it in Massachusetts with six new development banks, in the end no way to know until you get out there. Because you are operating on the supply side, you take your best anecdotal information and you take the best econometric information, and on the basis of that you make a judgment. Then you create a mechanism which will grow according to real demand being out there. I want to give you an example. Massachusetts has probably the best housing development agency in the country---probably the world---in terms of the state housing finance agent. When that institution was first created in 1968---that is a very short time ago---that institution was created with an initial \$50 million. That institution less than ten years later is a \$2 billion institution because the demand was out there and it grew to meet the demand. The initial ceiling was set and the demand appeared to be greater than initially anticipated. The control was a ceiling of indebtedness which it could incur and the legislature consistently raised the ceiling as the demand was demonstrated.

GRUENING: Do you see a possible parallel in initially setting the ceiling for the development corporation that we

may establish in either 298 or 300 below that that would come into the Permanent Fund from the 25% mandatory contribution?

DANIELS: Well, I would make one other observation. You already have a ceiling.

GRUENING: Well, no. You have one in the constitution. You have another one from a draft standpoint. You already have a ceiling in 298 and 300.

DANIELS: That's right. A ceiling on two categories of presumably higher risk investments in which all of the balance must go into investment securities. I think I want to be cautious at this point in suggesting that it is possible that the legislature could set lower ceilings and then subject to proven demand to raise them. I think I would want to suggest that this is a possibility which others have tried worthy of your consideration. I don't think I want to make a judgment at this early stage in the game if that is precisely the rule that they follow. I would like to note, however though, that with regard to investment grade security, it is my understanding in reading the legislative history and reading the minutes of the committee, in reading the work that has been done today, that the intention is to invest in the full range of marketable securities that are available in order to maximize return at a prudent level of risk, and that what is at issue here is a

form of investment that is considerably beyond characteristic short term secured placement of debt on the part of the state with idle cash flow. I also think it is important to realize that the Permanent Fund is not only potentially one of the largest development banks in the world, it will be a very large investment bank by world-wide standards operating on a world-wide basis in terms of this portfolio investment and has got to have the most able management that money can buy. One of the reasons again, from an efficiency standpoint, that independence for investment decisions has got to be protected.

GRUENING: Questions?

MEEKINS: You have down in your paper and re-emphasized today it isn't enough for the Permanent Fund to plan what we would like to do with the Permanent Fund, but it must be coordinated with the expenditures of the general fund for a number of reasons and that brings up a question related to that, that the planning course in order to do any kind of planning or thinking needs to have information and judgment about what's going to happen in the future or what is happening. You have to take inventory of the current situation. It seems to me that---I have been thinking about that after reading your paper and others that one of the benefits of the Permanent

Fund, even though the major impact is going to be what we do with the general fund, one of the real benefits of the Permanent Fund provides a kind of catalyst or reason to get organized and that is what we are doing now. I am wondering how you feel---what kind of--- if you thought about what kind of things we need to do in order to start gathering information. I know that is necessary, but I can't really perceive what steps we take in order to have information that we can make decisions upon.

DANIELS: I really appreciate that question because it gives me an opportunity to say that we have this unfortunate tendency in the United States to think that planning somehow is useless in America---and yet what I would like you to do, and I think you precisely hit the nail on the head. The Permanene Fund creates an opportunity to begin to think about Alaska as a public enterprise, and what I am suggesting for you is simply that you begin to adopt as a state the same standards of planning that any multi-national corporation takes for granted as a mechanism for marshalling and husbanding your assets in order to produce larger return on those assets.

I do think that there is a way of thinking about the general fund and the Permanent Fund, in which the Permanent Fund is really the retained earnings of the people of Alaska. There is the difference on an annual basis between your revenue and your expenditures. Now, most states live by the hand-to-mouth business where they spend

every penny of today's expenditures to meet whatever revenue they have in hand without any thought toward investing those resources in order to create a sounder longer term public enterprise. I never thought about that idea before until I had put before me the kind of awesomeness of the Permanent Fund itself.

The issue every year is to expend and invest on a current and long term basis the expenditure of the state as a whole in order to, number one, produce a higher annual net earning which will go into the Permanent Fund, and in order to produce an increasing growing revenue base. Now, without going into all the details of it, I think we do need five year planning, or if that is too dangerous a phrase, pick three or seven, and that you need to begin to project both for the general fund and for the Permanent Fund expected revenue, levels and qualities of expenditures.

I do want to make one disagreement which I will illustrate in a moment. In order to be sure that you are husbanding all of those resources and maximizing them, you are going to make mistakes. You know, we do create Edsels in this world. And--- but you aren't going to make as many as you will if you just go willy-nilly. Now, I do want to make one, I think, distinction---and I don't know whether Arlon is still here to respond. Well, I want him to. I will get him in a bar or something afterwards, but we are unfortunately still living in the

never-never land of dear Keynes who told us that every public expenditure was a good as every other public expenditure and it ain't true and all you have to do is look at England and Massachusetts as two terrible cases in point if you want to see that it is not true. The Permanent Fund must also require that you increase the quality and productivity of your general fund expenditures so that they are made only in terms of the increase of return that they are going to produce. I further suggest in the paper that you must begin to project, not only the financial soundness of Permanent Fund investments, but the economic impact of them, and then as part of this planning process you must measure---you must audit the economic impact as well as the financial impact to determine whether or not those investors did in fact live up to their economic projections, as well as their financial projections. That is part of the planning process, too. In that regard I think 300 is better than 298 in one specific where 300 requires that annually the executive and the Permanent Fund management account to the legislature for what has been invested and report in terms of what future plans are.

RODEY: Let me shorten Russ's question down a bit. What is the best measure of the amount of additional capital that our economy can absorb and where do we go in the parameters of the desirable amount of capital?

DANIELS: That question is a little different than I thought. I can't give you the answer you want. The measures that you want are the specific fiscal measures of return to the state. If you make an investment of state capital, if the state takes some of its revenue and invests them in the Permanent Fund, then the returns for the state is not only the return to the Permanent Fund itself of the soundness of that investment, but the returns in tax dollars to the state itself. We are now putting on the new development banks in Massachusetts a two track accounting. One that accounts for the financial soundness of the enterprise and one that accounts for the reduction in social overhead costs and the increase in tax revenues created.

Now, we are very much at an early stage, all of us in the world, in being sharp in that kind of analysis and projection, and even the cost benefit analysis of the World Bank, the InterAmerican Development Bank, don't apply because for better or worse the State of Alaska does not have its own currency and does not---and so you cannot be as rigorous in the attribution of the economic benefits based on your investments. We have to factor that down. The process is two points. One, I can't say what the quantitative answer is, but I can say that it is the use of some of these techniques of measurement that are crude at this point, but I think over the next

ten years are going to become much more refined and you should be a part of that refining process.

Obviously, as public trustees, what we would like to do and must do is to draw a curve and we want to know the point at which the capital going into market can't be absorbed in an acceptable manner, whatever the acceptable manner is.

That starts by not subsidizing. That starts by the fact that those investments that are going to be made are going to be made in terms of a market return and that it's only in terms of infrastructure investments where the subsidy already, according to 298 and 300, is borne by the general fund and not by the Permanent Fund. It's really a capital subsidy and a proper one because the external benefits again returns to the state. And possibly with the one exception---the one that I introduced---the possibility of differential costs for joint ventures with the native corporations for essentially sound projects in order to correct for their opportunity costs, which rightly encourages them to invest outside of the region, not inside. Are we together or not?

RODEY: One last point. Are there a number of models we can look to for the limited purpose of development banking in determining what capital or proper capital absorption is in a market?

DANIELS: Well, analysis as I understand it right now is being proposed to be done with the executive---with consultant

help, using models which they already have available to them. I think that is absolutely essential to your purpose. I think that should then be corroborated by anecdotal evidence that you gather and I think it further then should be tested by putting a series of assumptions into the several models that are available to you. I was out of the room when Arlon was referring to the man in the arctic model, but I am aware of it and it seems to me that it is a tool, that is---you want to take the analysis that is done by the treasury and perhaps there is some other data that is now available and I am not yet aware of, and then you want to begin to make some assumptions in terms of investment modes through your econometric models and begin to see.

GRUENING: Representative Miles had a question.

MILES: Thank you, Mr. Chairman. Dr. Daniels, I missed a point that you made early in your presentation when you were speaking of the potential areas of use of the Permanent Fund in the regional small community development entities. We have been hearing quite a bit this afternoon about no subsidization and if it is an economically advisable program private capital will generally come in and take care of the project. But you indicated, and I didn't follow from Point A

to Point B that in the small community or regional development area we could take a lower rate of return. Can you tie those back in?

DANIELS: Yeah, the issue is somethin~ we call opportunity. First of all, I want to make one thing very clear, that any premenance that we have in the money and capital markets today on a world-wide basis are precisely because of the increase in efficiency of that market and its consolidation of resources and the problem that is developing is that there are left behind lots of relatively small undertakings. Now some of these you have got to realize can get very big. We literally do have companies in the \$100 to \$150 million range in Massachusetts that cannot at the present time, because of the structure of the marketplace, get adequate equity and long term debts. Those are pretty good sized.

What happens is---is that the opportunity for substantial return at a lower risk are available to these increasingly large financial intermediaries on a world-wide basis that do not make it worth their while to take the lower return through increased cost and possibly through increased risk. The issue here---and I don't want to get too technical---the issue is to create mechanism in collaboration with the private financial intermediaries which reduce information costs and which reduce transaction costs. I give you specific case in point. John Hancock Life Insurance Company

today invests \$1 billion a year. Twenty-two people do that. It is not worth John Hancock's while to consider any investment smaller than about \$20 million in a firm that is smaller than about \$100 million. The cost of an office and the attendant risk, even though these are otherwise sound investments, just don't warrant giving the opportunity for placing their funds.

MILES: So they wipe out everything...

DANIELS: That's right.

MILES: ...under \$100 million...

DANIELS: Absolutely.

MILES: They don't even...

DANIELS: Won't look at it. John Hancock last year made one investment in one company below \$100 million. Now, the same is true of the native corporations. Their task is to maximize their return and their opportunity for doing that are greater outside of the region than inside the region. Now because of the enormous public benefit to reducing welfare

costs and reducing unemployment insurance costs---public benefits, forget it, state benefits --- right to the treasury of the state to lower these annual expenditures and to increase tax returns. I am saying, I feel on a hunch, that there are lots of opportunities for collaboration with the native corporations in which the return to the state, a fiscal return to the state, in specific dollar benefits warrant a reduction in return through the Permanent Fund and in collaboration with the native corporations. Now further with your own commercial banks and savings banks there are also mechanisms for making---for dealing with their opportunity costs in terms of extending the terms of financing, in terms of reducing their costs.

I will give you a case in point. We had an analysis in Massachusetts of our fishing fleet in light of the 200 mile limit. In fact, we just considered what are all the issues that we need to undertake in terms of a comprehensive approach on the---with regard to the state to try and see that Massachusetts which has a situation very similar to yours is able to really take advantage of the 200 mile limit. We found that the average life of fishing vessels in Massachusetts is 29 years and 7 months. We further found---you can imagine that there is some real dillies out there. On the other hand, we found that the commercial banks and even the thrift institutions were not making loans beyond ten years. They were doing that for sound reasons. The issue is for us to come up with an

insurance program operated through a development bank so that it is operated on a sound basis which will make it attractive for those banks to extend their term and also make it possible for them to lower their equity requirements from 25% to 10% in order to make it more possible for fishermen to be able to buy their boats and not, you know, be so totally depending on piling stuff up on the---until they could actually go out and get one. Now the point I want to make is that in every instance John Hancock is acting reasonably, your local commercial and savings banks in Anchorage or Fairbanks are acting reasonably, the native corporation is acting reasonably. You also can act reasonably in terms of your return on investment to the state by working in collaboration with them to create a joint venture situation that benefits you both.

GRUENING: Further questions of Dr. Daniels?

MEEKINS: Thank you, Mr. Chairman. In regard to infrastructure investment, it seems to me that some of those--- it goes back to the idea in my mind of fighting with the general fund. It seems to me that a lot or at least some infrastructure investments, the ones that come to my mind, would likely be good candidates for direct appropriation from the general fund, those that have anything to do with

transportation costs being lowered or dock facilities or something like that. And it would seem then that you would---in some cases it would be better to take money out of the Permanent Fund and invest it in those things and then take the general fund money for the return or just a direct appropriation of the general fund, or would it make any difference?

DANIELS: OK, well, we Americans do some other funny things, and one of the things that we do is we finance long term physical assets---50% of all long term physical assets are financed on a current account basis by government. You don't know, if one were a business one would never think of doing something like that. The point of using the Permanent Fund with regard to infrastructure financing is to take an actuarial view of long term physical assets and say that it is not necessary to pay for 100% of the cost of a dock facility or an airport or a road in year one, if in fact the useful life of that investment is going to be spread out over a period of time, the economic benefit, the tax benefit coming from it, etc. Not only is the cost going to be emphasized over a life, but the returns on the investment are going to appreciate to the state over the term of life. Now what I am suggesting is that I intuitively trust a development bank to make a sound assessment of the cost of that physical asset, you know to control the cost of building the airport and to police the maintenance of it. It is just a different way of thinking, different way of operating,

and you will create a more efficient asset that will be better maintained if the management of that financing--- and it will be financed on a more sound basis if the management of that has gone through the Permanent Fund.

Now what I am saying is that if there is any cost difference between the realistic return on the investment, if in fact it is something that is totally external like a road, and you don't want to put toll bridges up, or for instance you do want to assess part of the cost of that---maybe you do want to assess to the fishing venture part of the cost of that user charge for making the public investment to the extent that there is a return on the investment that is insurance, then that comes back to the Permanent Fund to the extent that it costs \$2 million and you are only going to get an internal return over 15 years of \$1.3, then the general fund has to pick up the difference of \$700,000, but I suggest that is more efficient than the general fund automatically going out and appropriating a million dollars in a rich year for a project which, because you are not paying attention to it, ends up costing \$3 million, which then is not going to be adequately maintained because nobody is minding the store.

MEEKINS: What about a case of an infrastructure investment that has completely external rate of return? For instance,

a road where you have one particular group of people, but you don't want to charge a toll because it limits the amount of use and therefore theoretically the total benefit to the public is reduced because some people won't use it if it has that cost. If that is the case you won't have any revenue produced from it. Or very, very little. When you think of efficiency in doing the Permanent Fund, would you think that the total return should be taken up by the general fund or...

DANIELS: Yeah, but you might finance it on a---I mean the Permanent Fund must---I was about to say, you know, hopefully---the Permanent Fund must be managed and will be managed, or else we are all gone, according to the high standards of a world-wide financial intermediary.

On that basis the Permanent Fund---this gives me an opportunity to make another critical point---don't think about the annual paid-in net retained earning as being the Permanent Fund. That is only the equity capital base of the Permanent Fund. Permanent Fund, if it is soundly managed, like any good development bank, will have the capability of accessing world-wide money and capital market in terms of its paper and the British Columbia Development Authority involved in New York, London, Paris; the British Columbia Central Credit Union that I referred to borrowed in world-wide capital market to support a dock that are in little villages in British

Columbia that no financier in London has any confidence in. But they had confidence in the British Columbia Federal Credit Union or in the British Columbia Development Authority. One good thing, it may well be much more effective for you to finance that airport by accessing international capital market and spreading the cost over a number of years. So you have to look at the expenditure side separate from the revenue side.

MEEKINS: Are you suggesting that that kind of borrowing by the Permanent Fund would be at a lower rate than, say, we can get general obligations bonds for?

DANIELS: It may well be. That depends at various times on the state of the municipal bond market. The municipal bond market is cheaper but it is a very inefficient market and it may not always be the most---it may be at certain times that it is cheaper to borrow on a world bond basis.

MEEKINS: It must be the state's general obligation bonds were more expensive so to speak---why would you bother to borrow through the infrastructure investments? Why would you want to borrow through the Permanent...?

DANIELS: Well, there are other considerations, and that is that the---to the extent that that is an obligation of the Permanent Fund---it is not a part of the indebtedness of the state and frees the indebtedness for other purposes. I don't know the specific structure of your state bonded indebtedness. To my understanding, it is relatively high on per captia.

MEEKINS: Yeah. Usually like these corporations have been set up are viewed anyway by the bond market as being part of the indebtedness, even though you say this is not a...

DANIELS: But the Permanent Fund is a somewhat different creature. It has got, eventually, \$1-\$2 billion worth of equity standing behind that bond just in and of itself. Why look to the state when you got that kind of a resource standing behind it? The point is that we want to separate out the decision as to whether or not to use the Permanent Fund. We want to look at the expenditure side with one set of eyes and the revenue side with the other set of eyes. It may be efficient to have it managed by the Permanent Fund on the expenditure side but financed through the general obligation bond market. It may be efficient to have it managed and financed by the Permanent Fund. It may be efficient on the revenue side to account for user charges which would come back to the Permanent Fund and make up the difference through the general fund, or it

may be efficient to finance it all through the general fund. I mean I can even envision, and this gets a little speculative for this type of discussion, but you know these facts between the Permanent Fund and the state, where financing constructed by Permanent Fund and the payment from the state is on annual revenues as a user charge by the state as a whole.

GRUENING: Further questions from the committee? He raises a thousand very important, very interesting questions.

GARDINER: I have got so many notes here that I can start with Point Number One.

GRUENING: I hope Dr. Daniels might be available tomorrow and in the future for that matter---that is something we need to discuss. Feel free to put your question in writing.

GARDINER: I appreciate that.

GRUENING: I just have one question. You mentioned something that you may want to follow up later. You mentioned regionalization of the Permanent Fund. What do you mean by that? In what way would it be regionalized?

DANIELS: OK, let me again---and I am kind of looking at Jim Edenso when I say this. In my view, the essential structure of 298 or 300 is very sound for a development bank, subject to specific comments and criticisms that are made in this paper, in which I simply raised further questions. I would suggest that both functionally and geographically consideration be given to some differentiation in terms of task. And if I may take the opportunity to speak for a minute on the functional side before the geographic, because I think they are related. The private market is very wise in separating out its sources and uses of funds, its risks, its management, according to different kinds of tasks. You know, we don't ask thrift institutions to be short term inventory and working capital commercial banks. We don't ask either of them to be venture capitalists because the risks are very different, the sources and uses of funds are very different and the kinds of people who are good at it are very different. My own experience, particularly in the United States in terms of development banking, is that it is wiser to separate out those functional operations as subsidiaries of an umbrella development bank, and I would suggest for consideration the possibility of the Permanent Fund as proposed in 298 or 300 actually having some operational subsidiaries who deal in venture capital in intermediate and longer term debt financing, infrastructure financing, etc., something we just recently did in Massachusetts.

Geographically, we have a world-wide experience. This is true in terms of international development banking, it is true in England, France, India, you name it, that if you are talking about a huge geographic area where the problems are different, the people are different, and the ability to access risk is different, it is wise to have your capital gathering capability and your kind of centralized technical support capability at the center, but to decentralize risk assessment--- I don't know Alaska. I mean, as I said earlier today when I was kind of out in the suburb, the furthest end of the Bush that I have been. I want to be careful. I don't know enough about Alaska to say that your distance is so large, your differences are so great, that it is necessarily important to do that. But my hunch is, it is, and that you would be wiser to have a series of regional subsidiaries of the Permanent Fund as designed in 300 that would operate in different parts of the country under very strong direction from central management in terms of their goal, you know, in terms of their direction and what they do, but not on a day-to-day basis.

GRUENING: OK, it is getting late, but we have other people. I would like to get the feeling of all the members here as to what they want to do. I want to wrap this thing up by early tomorrow and we could go later tonight or we could quit now. What is the general consensus of the committee?

Anyone want to go an additional half an hour? I think we could pick up a report. The next item would be a report from Jim Edenso on where the Permanent Funds are invested presently. Does anyone have any druthers on that?

RODEY: I have to leave personally, but what was your plan for tomorrow?

GRUENING: Start at 9:00 and wrap up about 11:00 or 11:30. I want to ask Mr. Edenso, Jim is it possible---you will be here tomorrow for that?

EDENSO: Yes.

GRUENING: OK.

GARDINER: What are your other witnesses for tomorrow?

GRUENING: We have Mr. Edenso from the treasury and Dick Haggart will be giving us some revenue projections, both short term and long term, and then we will get into asking what the committee members want to do on following up some of the big questions that have been raised today. We did an issue paper

that we want to send out to the people who are interested in the issue and would read the issue paper, and solicit responses and discuss the rest of the program. We may want to work out some sort of joint effort on following up some of these questions. I want to thank Dr. Daniels for a very enlightening presentation. Anything further? We will stand in adjournment until 9:00 tomorrow.

Proceedings
of
The House Special Committee on the Permanent Fund

SYMPOSIUM
September 10, 1977
Anchorage

Rep. Clark Gruening, Chairman
Rep. Terry Gardiner, Vice Chairman
Rep. Ernie Haugen
Rep. Russ Meekins
Rep. Bill Miles
Rep. Leo Schaeffer
Rep. Rick Urion

PRESENT: Dr. Barbara Bergman, University of Maryland; Dr., Donald Gordon, Simon Fraser University. Citizens' Panel: Dr. George Rogers, John Havelock, Dr. John Lindauer, Jamie Love, Tim Bradner. Members of House Special Committee on the Permanent Fund: Clark Gruening, Chairman; Russ Meekins, Bill Miles, Mike Doogan, Administrative Assistant. Senate Special Committee on the Permanent Fund: Pat Rodey, Vice Chairman.

Introductions made by Chairman Gruening--continues:

GRUENING: I had a long statement on the Permanent Fund and my views on it, but due to a self-inflicted wound playing racquet ball yesterday, I'm going to have to cut it short. I would like, before I turn it over to the economists, to state briefly, we do have a very challenging task before us. I know when I originally favored the concept establishing a Permanent Fund, I saw many goals and many objectives that the fund could accomplish. As I get into the subject and see the complexity of it, I see that maybe our goals can be achieved by finding that which is best achieved by a special fund such as the Permanent Fund.

Today, I want to explore that. I want to explore the possibility on a philosophical basis as opposed to what your pet investment may be. I know that people discuss various things the fund can do and we, as committee members, have received suggestions from people for investments--everything from artifacts to wheat.

What we want to explore today are the reasons why that particular investment is consistent with your philosophy or your goal that you wish the Permanent Fund to seek. With that I'd like to turn it over to Dr. Bergman.

BERGMAN: Thank you. In trying to think over what kind of a contribution I could make, what occurred to me was to try to say some things that would sort out the issues, which would try to separate one issue from another and show how they're related. What economists have to offer, I think, is rules of thumb and wisdoms of various types. I think our major expertise is trying to sort out the issues. So let me try to do that. I don't think I'm going to tell you anything you don't know.

A good way to start out would be to discuss three kinds of scenarios for the state. Let me call the three scenarios: the spend as you get scenario--dole it out as fast as you get it--that's one. The development fund approach, which is to try to take some of the oil revenues and use it to develop the state. And the third scenario, let's call the gilt edge approach, which is to take the Permanent Fund and essentially invest it, for the most part, in the Lower 48, in the capital markets and use only the income.

Now, very kindly provided here was a thing which without which no professor travels--that is a blackboard. Let me try to contrast these and then show what they entail in some respects.

We have three panels here and measure time on the horizontal axis and dollars on the vertical axis.

This is the spend as you get approach. Let's assume, without inquiring for the moment where the numbers come from, that at more or less a current level of services there are certain financial needs which the state has. Let me for the moment put those down as more or less horizontal, perhaps with a very slight, a moderate growth trend; but certainly not a big growth trend. Let's call that need for spending. At the moment, there are some non-oil taxes, and let us assume that those also, tax breaks remaining the same, have a more or less horizontal trend. So these are non-oil related taxes. They depend on the economic state. They would presumably grow unless the tax breaks change as the days go. And then, of course, what we've got is this hump of the oil revenues which are going to exceed by some very considerable amount for some considerable time the needs for outlay of services at current levels. The spend as you get approach very simply is just to do this sort of thing: use them all up, and then when they run out, go back to that situation. Of course that is the approach the Permanent Fund presumably designed to avoid. I just put that in as a base line.

The next one represents the gilt-edge approach: g-i-l-t. I suppose some of those who want to see the development of the fund might spell gilt in another way. There again, people assume that the fund revenues will not be used for development purposes. All of it, and this is an extreme case, will again be devoted to gilt-edge investment. So the non-oil revenues will not be any different than they would have been, but the spending will look more like this. There will be perhaps some spending out of the oil revenues for current purposes--again I'm putting needs, the same in the second panel as in the first panel. But, after a while there will be considerable income from the Permanent Fund assets and the Permanent Fund income will take over as the oil revenues come out. So there might be some excess of the Permanent Fund income over needs; but in general, possibly that might be devoted to raising levels of services or sending some of the funds back, possibly lowering taxes or a variety of things.

The third approach is the development fund approach, and then the scenario is something like this.

I might say, the scenario from the developmental fund approach is somewhat controversial; that is, the first two I put down naturally you can't foresee even how gilt-edge investments will do. We all know that. Nevertheless, you might say, this is a conservative approach from the point of

a risk. The one we're about to talk about perhaps is, at least from the standpoint of a risk per se, somewhat more risky.

But the more optimistic scenario, from some points of view anyway, goes something like this. The use of the fund for development purposes will broaden the tax base, and instead of having the non-oil revenues flat, as we do in the other two cases, they sort of take off. Here again, we have the oil revenues helping us and they peter out. It may be that some capital has also been lost because there is going to be a greater risk--the kind of loans we make--so the income from the fund will probably not be as big as it would in case 2. But nevertheless, there'll be some and the non-oil base in the state will have done well enough to cover the needs. Those are the three scenarios.

Now, say the third one is not as sure-fire in the sense of being able to tell what will happen as the others. For example, Dr. Tussing's view is, in general, with certain rather limited exceptions, the use of the fund as a development fund would not have this take-off effect on the economy. In general, the economy is going where it's going. It's got a dynamic of its own. It depends largely on such

an opportunity, the investment opportunities there are will be financed through private channels, which will be adequate to finance in the deserving ones, the ones that will pan out. That kind of adjustment has what the private sector does well; if there is a shortage of some type in Alaska which can be remedied through capital flow ect. This is one view. That view is that, in fact, the development fund scenario that I've drawn here wouldn't really work out. That is the non-oil revenues will not be materially affected by whether it is used this way or that way. What will mainly be affected is the amount of the capital which is left and return on it. If you ask me what I think, I would say that you need to decide whether you do believe in the efficacy of the development fund approach. I'm sure a lot of people do. I may say, that since I knew I was coming here, I did some work in Washington trying to find out what some people in Washington who are in capital markets think about closed funds to places like Alaska. Ther general views that I got were that the market mechanism for getting funds into places like Alaska has much improved in the last 10 years: federal infra-structure, federal homeowned bank boards.

So if you believe that, then one might be rather doubtful that the development fund should have been. On the other hand, I tend to be skeptical of doctrinaire pronouncements

of that sort. I think there is some merit to that scenario, although I would certainly argue caution. I would say that, in general, the idea of the Permanent Fund--the thing that makes it different from the spend as you get case-- is a desire to preserve some of the resources for future generations. I think, in a way, the best way you could put this is comparing the people who have to manage the fund to the trustees for a family.

Suppose the trustees have been given the instruction to make sure the grandchildren are taken care of. That kind of instruction would argue to the gilt-edge route. Suppose the current adults in the family come and say, "we have a family business which is in terrible need of funds, and if we can get these funds, the grandchildren will be better off, not through the silly gilt-edge securities you're going to buy but rather through the business that we are going to develop. Come on, trustee, give us the money." Now should the trustee do that?

I don't think in a doctrinaire way the answer is yes or no. I think you can say the trustee ought to watch out. I think the question the trustee has to ask is why can't the present adults in the family get commercial funding? Does the trustee know something about the family that perhaps commercial markets don't know about that

family? Also, this leads to a rather different point, that you've got more than one grandchild, you have to worry about intra-personal equity; you have to worry about different groups in the constituent population.

Let me turn to that for a minute. I'm used to a much bigger blackboard. This is the only deprivation I've suffered since coming to Alaska. You can think of the cast of characters we have that the people planning for this fund have to take into account. Most planning models involve summary statements of this much income and that much expenditure; but the real guts of the thing are the benefits and costs to individuals or group. Not everybody in Alaska has the same interests and there are some opposing interests, I'm sure. For example, what interests the kinds of people we have here to consider. First of all, the people who are in business; there are people who work in those businesses; there are professional people; and there are native Americans. You can divide those into people who are here now and people who might come if you get this development fund scenario, if it goes the way this diagram says it will go. Even those people you can then branch off into twice as many groups by talking about different values. For example, some business people are here regardless of the special characteristics

of the Alaskan community and environment. They're here to make a buck. Others make a lot of bucks. There's nothing wrong with that; it's the good old American way. Then there are the people who are here because of the special nature of the Alaskan economy: the special nature of the Alaskan environment; the special nature of the people here. And they have an interest in keeping it that way. So you classify people in three different ways:

- 1) by their role in the economy
- 2) by their value system
- 3) by whether they're here or whether they're not here yet.

It seems to me, that it's very hard to do any planning for the state, should you in some formal way, try to weigh costs and benefits. For example, I would weigh costs to the native American community as very high, in my calculations. I wouldn't just subtract the native American communities costs from the benefits, say to a hotel owner. Usual calculations, you subtract the cost from the benefits; or you take a ratio of the cost and the benefits. If the ratio looks good, say let's go ahead. I think there's a waiting process that has to be put in here. I would discourage any planning process due to the fact that there are the different groups and they do have different interests and different values to be taken into consideration.

GRUENING: Doctor, I just wanted to mention that this hotel is owned by native Americans.

BERGMAN: Why don't I stop here.

GRUENING: That wasn't intended to cut you off. Incidentally, although we're elevated on this stage, it wasn't intentional. I think the audience here is just as elevated, and we want to make this informal. After the panel makes their statements and questions, I hope that people will feel free to come up here and make a statement and ask questions of either the economists, the panelists, or even us, for that matter. Go ahead, Dr. Gordon.

GORDON: Well, to some extent, I think I'll be overlapping with Professor Bergman, so I'll eliminate that kind of consideration.

I am struck, as the Chairman said, with what I consider the awesome responsibility of those people who are to decide what is going to happen to the Permanent Fund in particular, and other oil revenues. I am struck by that because while I find the numbers tossed around a bit confusing, they are all pretty big. If we take the kinds of figures that are in the little green pamphlet, we talk about numbers like \$8 billion, whether in the Permanent

Fund, as in some assumptions it is, or whether it's in the Permanent Fund or not, it's a transitory income from these oil revenues.

Now, it's very hard to get people to take numbers like \$8 billion and have it mean something. I find it useful to use this as a person in a family. So I got out my World Almanac, I find that there are about 400,000 Alaskans. Suppose this fund has by 1985 about \$8 billion, and suppose you can define an Alaskan, and as Professor Bergman pointed out, that may be the trickiest part of the problem, suppose we define Alaskan as people who were here when the oil was discovered, we say it legally belongs to the entity, the state of Alaska, it morally belongs to those people. It's their money. Those people who are going to make the decision have to spend that money for them. If we divide the \$8 billion by 400,000 people, we get \$20,000 apiece. If we estimate the average family is four persons; that's \$80,000 per family.

It's just as Professor Bergman suggested, It's like being in the role of a trustee. If you dress up the story, the father dies, he leaves a young wife and three children, but she happens to have \$80,000. You are a brother or a friend or something, you are appointed trustee. It's assumed in trustee agreements, as I've had the misfortune to read some of them, that people who are the beneficiaries of the trust

really can't be charged with spending their own money. So, somebody else has to spend it, and a guess is, the implication of the way the fund is set up. Now \$80,000 will set up their whole way of life different than it otherwise would be. The most important thing is to think of this as making a decision for about 100,000 four-person families out there, each of which has \$80,000 which you have been entrusted with spending.

Now, the tricky thing is going to be defining an Alaskan. For that purpose, I assume you can define an Alaskan in some limited way as consisting of a certain number of people and it's those people who, in effect, own the \$20,000 apiece or the \$80,000 per family.

There is another thing that struck me in looking around the world in the last few years. There are countries like Kuwait, Saudi Arabia and the press almost universally, and a lot of people who should know better, go to these countries and say, "You know, these countries have a real problem; they can't spend that money." These countries aren't democracies. So what they must mean is that the king and his bureaucracy can't spend the money, because we all know that if you passed this money around among the average Bedouin in Saudi Arabia, that with the help of Sears Roebuck, a thousand other firms from the

rest of the world, they'd have no trouble spending the money at all. In those countries the money isn't the people's money. It's the king's money. But, again, the notion that you have a problem spending the money is only appropriate for a very different kind of society than we think we have.

A third question that I think is very important, apart from what is currently in the Permanent Fund or what is in the Permanent Fund in the future according to different assumptions, there was a very significant question about what should be treated as income from a depleting resource and permanent income. In economics, there is a very common distinction between what you might call regular income and windfall income. Sometimes these are called permanent income and transitory income. In principal, it's just as every prudent household would treat those two things quite separately. If you have an income of \$15,000 a year and you expect it to continue forever, you treat it one way. If in one particular year an aunt dies, totally unbeknownst to you, she has some money and she left you \$15,000. Now it's hard to find one person, I think, who would say they'd treat that once and for all \$15,000 in the same way as their regular \$15,000. They wouldn't just double their spending that year because their income happened to double.

The most important thing is to think of transitory income as different from permanent income. When some oil

money is going to last some 25 years, especially at the beginning, that money is partly transitory and partly permanent. For simplification, I want to think of it as transitory.

One way to compare any other ways of treating this money would be to imagine a world in which we don't live and imagine just giving that \$80,000 to each family--what it would do for them and what they could do with it. With that as a benchmark, consider alternative problems. In considering these other alternative policies, we have to make some critical assumptions. Perhaps we should investigate the facts.

We have to make some presumption about a very critical thing and that is the flow of labor and capital into and out of Alaska. That's part of the problem defining an Alaskan. That has been already alluded to by Professor Bergman and she referred to the paper by Dr. Tussing in which he argued that, subject to further research, capital flow is very easily into and out of Alaska, and therefore, the rate of return to capital in Alaska is primarily set in the United States, or even better in the world market. Capital flow is pretty easily around quite a few countries.

I would like to extend that and just for the sake of argument, subject to a lot of further research on the problem, that the same is true of labor. The labor flows

pretty freely from one part of the United States to another. If that's true, then there's nothing that can be done with this fund that can change the wage of labor. Now, of course, it isn't the wage of labor, there's a whole structure of wages--from high priced brain surgeons down to busboys. But those wages will be set, not in Alaska, they'll be set in the United States because there's free migration back and forth. I want to make those assumptions for the moment anyway. Assume that there is competitive capital market and competitive labor market. I will modify that later on.

Now consider two or three alternative ways of using this money. One of them I asked my conservative friends. They have the assumption that giving money to the government is pouring it down the rathole to some degree--they have different rathole co-efficients, but it's significantly bigger than zero.

So, they say cut taxes. If we cut taxes, then we won't keep the level of government expenditures at what it would be otherwise. Cut taxes, then the money would be used by the people for sensible purposes--cut sales taxes, cut income taxes, so forth. Now, if you ask yourself what that means, subject to the assumption that the flows of labor and capital between the United States and Alaska

are perfectly free; the initial effect of that would be that real wages after taxes would rise in Alaska relative to what they were in the United States. As soon as they did, more people would come from the United States to Alaska. The final result of that would be that the real wage would be precisely the same as it was before. The real return on capital would be the same. Nothing would happen.

Who would gain? Well, there would be more people. If you would own a local monopoly, with economy of scale, such as the local newspaper, you would probably gain, as opposed to being a barber or even a hotel owner. If more people came, more people would set up hotels. You wouldn't rake off big gain. On the other hand, if more people came, it is unlikely more newspapers would be set up. So that's one small way in which local people would gain. Secondly, local people would gain to the extent they own scarce resources, that can't be reproduced. Not a hotel because you can build another, but not the land on which the hotel is built. If you own scarce, high-priced land in downtown Anchorage, you would gain.

Finally, it could very well be that you have a labor union. I guess economists like to call that a labor monopoly. Unions don't like that word. They don't mind talking about market power, but these are all words. Let's suppose there is a labor group

here which has the power to raise the wage or lower the wage to some degree. Subject to, of course, to the constraint that when they raise the wage, not so many people will be hired as when they lower the wage. Now, if we imagine a cut in taxes, we abolish the competitive market for labor which we assumed. If we imagine cutting taxes, people will come here. The labor union can keep the wage. The people coming here won't depress the wage to make up for the taxes. The labor union can keep the wage the same way because the demand for labor will be the same as before. In the case of a local monopoly in labor, and in the small bits of income that are earned by land rents in scarce areas, there might be some gain. The overwhelming bulk of income, which is the competitive wage plus capital, won't be affected in the long run.

What will happen, of course, is that the \$8 billion will be spread over the rest of the United States, because by some small amount, as labor leaves the rest of the United States wages will rise--higher than they otherwise would be.

Let's consider another thing, another scenario. I think this is something like developing the economy. The word development is a bit tricky. It is generally used, always used, in economics to apply to so-called underdeveloped areas, developing economies in places like Bangladesh and

and Peru and Zaire, etc. But that's not true in Alaska, because clearly, even without making the rigorous assumption, those countries think of trying to take an economy where the real wage rises very significantly. Nothing is going to make the real wage rise very significantly in Alaska because that's set in the United States. Just as the real wage in Seattle is set in the United States. It's not development in the same sense.

I'm always a little confused about development. Sometimes people say, we want to create jobs. I see in Alaska, people talk about diversifying the economy and developing renewable as opposed to non-renewable resources. But all these things, seem to me, subsidizing local industry in some way so that there will be industries here that otherwise wouldn't exist.

Dr. Tussing, in his paper, was talking about situations where you don't subsidize. He said, as Professor Bergman indicated, that he generally believed that if you don't subsidize, then you're not going to create any more industry. But, he did not say, and I don't think Professor Bergman intended to imply that he did, that you couldn't subsidize industries and create industries that wouldn't otherwise exist.

If you did that, there would be more people. There'd also be a bigger tax base. There'd be more services to supply those same people, presumably required.

Basically, when you got all through that, just as in the, what I call, conservative case, this is the interventionist case. The people who trust government more than the rathole theory. The interesting thing is that they both come out with roughly the same conclusion. You have more people, you have more capital, the real wage is the same, the rate of return on capital is the same, and in the case of a few local monopolies, they have gained but nothing else has happened. The reason it happens, of course, is that the benefits are flowing to Alaskans, but an Alaskan is really defined as anybody who can benefit by moving here. Or by not moving here, for that matter.

Now, let's consider a third thing--amenities. You create amenities. The trouble is if you build a big opera house in Anchorage, I'd be much happier to come for a lower wage than I otherwise would. An amenity is a real part of the real wage. People would then have their real wage and amenities rather than lower taxes. Incidentally, when you talk about amenities and providing government expenditures, there is no difference in principal between whether the income is a renewable resource or a non-renewable resource. If income flows to the state, one question that should always be asked is, if this in-

come is flown directly to the people, it's their income, would they then be willing to be taxed some of that income to create the thing which they would consider building? A better university, a big opera house, play fields, golf courses--all those things. Before you build a golf course, which I'd be much in favor of, you've got to think about the fact, would the people be willing to be taxable on the course, if, instead of going first to the state, it had gone to them? That's of course true whether the funds are transitory funds or permanent funds.

Now, another thing mentioned is stabilizing the economy. I thought Dr. Tussing's paper had an adequate analysis of that question. It is very easy, when one has looked back on a time series, what happened to the economy. To say, if we had only put a little more money into the economy there, and then taxed a little more there, the economy would be much more stable. In fact, it is sort of inevitable to think it sensible to pour money in there and take it out there. The problem is, as anyone who tries to make money in the stock market will know, that's not nearly as simple. If you look back at the stock market over the last four years and you would say, "gee, it was easy to make money in the stock market--all you had to do was buy here and sell here." It may seem that the problem of sta-

bilizing the economy is not that different. It is a problem of prediction. It is the problem of getting the spending going very rapidly relative to when you need it. As Dr. Tussing says, those problems are not easy to solve.

I might add something. If you can predict the economy, then you can stabilize without any Permanent Fund. You borrow the money when you need and you pay it back other times. It's not hard to stabilize if you can predict, without having any special Permanent Fund.

When I think more about this problem, here's this money, which it is said, belongs to Alaskans; but what are you going to do with it so it will make some difference in Alaska, with some real difference to the average Alaskan? I come back to what I call the benchmark. The best thing would be to take it, the \$80,000, and spread it around to each family.

Suppose you can't do that. Is there some way you could spread the income from that? Not by cutting taxes. The income from that goes to certain people who, as it is interpreted, own the resources.

Incidentally, I think the idea of just giving the money to the people is somehow associated with conservative views, whatever conservative means. My understanding is that Milton Friedman has suggested that view. Everyone knows he's conservative enough. It must have occurred to a

lot of people since the beginning of time--it certainly occurred to people in Alberta at the time oil revenues were discovered there. Whether it's conservative or not, it's profoundly egalitarian because it would take \$80,000 and give it to each family. No depending on whether they're rich or poor. Exactly the same amount. It's not egalitarian because you're soaking the rich to help the poor. That money didn't belong to the rich any more on a one-for-one basis to begin with. So it would have a profoundly egalitarian effect on the distribution of wealth and the distribution of income, if you can't distribute the wealth.

I was intrigued by the suggestion in the green pamphlet of the Governor that you might pass out the income. I understand there's some legal problems in all this. The legal problem is again defining an Alaskan. I understand perhaps the legal problems will be solved if you think of pension for when a person's 55. There's nothing in nature that says a pension has to be distributed at 55--maybe at 45, maybe 25. Anyway, I think if you regard these resources as being morally belonging to Alaskans, you should think of some way to give it to those people you define as Alaskans. Otherwise, you might as well write a check for \$8 billion and send it to Jimmy Carter, because that's where it's going, for all practical purposes.

If you took \$20,000 per person and put it in the stock market, would he own it--\$20,000 per person; \$80,000 per family. You notice that the average Alaskan, who let's suppose, is like the average American now, wouldn't have \$4,000, rounding out the \$3,900 to \$4,000, but he'd have \$24,000.

Of course, there's other wealth besides the stock market. Houses, some wealth that isn't counted like future pension plans. But, I come back to a number like that to impress, because I'm impressed, to try to impress you with the awesome nature of this responsibility. There are a lot of poor people in Alaska. I can't imagine one way that would do better for those poor people and for some people who are not so poor than to contrive some scheme whereby you can benefit them, if you believe they morally own those resources. Now you may say they shouldn't own those resources, they belong to the United States. You might even say they shouldn't own those resources, they belong to Alaskans, it seems to me, that the thing is to contrive some scheme where, in fact, the Alaskans will do the benefiting. Some defined body of Alaskans.

To make one final note. If you talk about future Alaskans--that's pretty confusing. You see, there's where

the analogy with the family breaks down. If you think of a trustee and a family, you want to take care of the children and the grandchildren; and if Alaskans were defined that way, it would be simple. It would be the children and the grandchildren of the original 400,000. If you talk about who might live in Alaska who now lives in Alabama or New York City or Seattle, then it becomes very hard to do anything with it.

Of course, if you gave the money out as a grant, which you couldn't, chances are the parents would take care of the children; and they would take care of their grandchildren, as is the normal way we treat wealth. The normal way we treat wealth in the United States, we assume people are responsible and are capable of handling their own money better than the government. If we say that's not possible, then we should probably try to devise a method by Alaska, Inc. or a pension at some age, so that the people who morally own the resources get some access to the, really do the benefiting. You might ask them if they'd rather have the income from \$80,000 or some vague thing called diversifying the economy. There isn't such a thing as economy or state, there are just people there.

Anyway, I think it's a very tricky problem. It appears to be in a large respect a legal problem. The only economic aspect of it, I think, is to recognize that nothing you do

with this money can change, for all practical purposes, the real wage and the rate of return of the capital, and that's the bulk of normal income. Whether resources invested in Alaska or Toyko, for that matter, or the New York Stock Exchange, it doesn't so much matter. I think it depends more on whether you use it to deliberately subsidize income or not. Presumably, as a prudent trustee, you invest it with considerations of real earnings after allowing for inflation, which makes it more complicated, and some safety. Thank you.

GRUENING: Thank you, doctor. Thank you, Dr. Bergman and Dr. Gordon. I think you've specifically trampled on a lot of people's assumptions. I think they ought to have the opportunity to trample on yours. We have a panel that will hopefully do that. I would like to make just one remark on the figures that are being tossed around today. \$80,000 is, of course, very hypothetical. The revenue projection includes both the Permanent Fund and the general fund, based on the pipeline, presuming a full design capacity, based upon a reasonable tariff, based upon a lot of things. We are dealing with a lot of if's. I think the point is well taken.

The panel can proceed in the order in which they were introduced.

HAVELOCK: We must make a determination of how it's to be managed in the future. Both of our panelists have referred to the analogy of the family. We are trustees for a family. You can reduce this to the position of a person in a family.

There are profoundly different ways in which a regional economy operates and in which a family operates. The differences, I think, need to be addressed. I think we need to get the Alaska public out of the situation of thinking about it in purely family terms--the kind of terms, which say, for instance, on the national level, that because the national debt went up last year we're worse off. Those kind of economics are very dangerous.

As far as the scenarios that Barbara pointed out, they're not real--any of them. That is, the scenarios of reality are sort of a merged concept of all three. There is a tendency to confuse oil revenue with Permanent Fund revenue, in fact, so far as you know, the Permanent Fund is only a committed percentage of oil revenue. I don't like little bumps like that, that sort of look like here today, gone tomorrow. We are not talking about a bump. We are talking about a very long curve. It may start high, but oil revenue isn't going to suddenly shut down. The economics of scarcity, we're the last major producer of oil on the American continent, so as the amount of oil available goes down, the value per unit will go up. The whole business of

Alaska running out of money strikes me as a basic error in viewing the situation which could get tangled up in managing the fund.

The discussion of what constitutes an Alaskan has been a troublesome one in this state. I'm not sure it's very fruitful, other than it provides entertainment in setting one group of Alaskans against another, based upon their longevity in the state. But, I think you do need in any scheme that's being set up to look at the winners and the losers under various schemes of investment.

One of the basic problems of the family analogy, of course, is that it assumes that when you put something away we aren't spending it. Particularly if you are involved in investment in Alaska. What the Permanent Fund is really doing is simply shifting the expenditure of funds from more of a tilt to the public sector, which is the effect of having a legislature the dominant controlling factor in the expenditure of funds, to having a predominantly private sector investment to the extent that Permanent Fund money is committed to profit-making enterprises automatically.

It is a long panel. I think one analogy I'd like to throw out for you to think about--it's a long panel so I'm just going to throw a few pot shots and then back out. There are a lot of analogies to what's happened in Alaska. One of them

is presumably supposing you'd had an Appalachian regional commission when they started getting into coal, would you have set up a Permanent Fund and devoted part of Appalachian money into that? What about the grandchildren today in Appalachia? How would they have benefitted from that fund?

BERGMAN: Stock in Gerneral Motors.

HAVELOCK: Well, if the function was to keep people in Appalachia, it worked because there was such a fund in a sense insofar as the United Mine Workers took money and put it into various pension funds, and so on. If we did that, and helped to pin people down to going on and living in an economy which was not self-sustaining, I don't think we've done anybody's grandchildren any great favors.

I think it's great to be an Alaskan, but if there are no jobs here, why the hell not move out--for those who have no employment? I don't see the public purpose served in subsidizing people who are two generations beyond me, who are only marginally going to be related to me, who, if you look at the general trends of the economy of the United States, are going to be far richer than I am anyway. Those are some of the reasons why I think you have to look at the management very carefully.

GRUENING: I have one question. If you want to discourage future generations, what about present generations?

HAVELOCK: The assumption of statehood incidentally, one of the assumptions on that chart, is that we have the income to sustain a moderate level of public need. The assumption of statehood was that we would use resource money in order to meet public need. All over the record of statehood hearings, the basic opposition of making Alaska a state was that there was not the income from regular tax revenues to sustain the public need level. I think you can invest. I would say that we've got to meet a schedule of unmet public sector needs before we start going on with a heavy dose of private expenditure, the worst risk of which is going to subsidize premature development of natural resources that we should be developing at the end of that curve.

GRUENING: Any questions here of John Havelock?

MEEKINS: Mr. Havelock, we hear a lot on this Committee about needs, you know it's very difficult to define needs, pressing needs expand to meet the amount of revenue that's available. I think that the concept is somehow inherent

In other words, saying that we should meet our needs first, we should spend all the money that we have to some people. This argument has been made to me, that we should spend all the money that we have simply because needs will expand infinitely.

HAVELOCK: Well, I think that the legislature can sort of define a minimum sustainable standard of living in Alaska, the kind of picture of Alaska you want and hold to. There is some truth in what you say, that needs will go expanding indefinitely.

The tendency of heavy private sector investments is going to be to spread the benefits to much more extremes. That is, losers in our society are going to go on being losers, even though you're putting all this in. Losers benefit out of public sector expenditure, some kinds of it. I'm not sure I'm ready for the opera house; there are a lot of things before that. I think that is a legislative problem and it involves taking a management approach to public sector needs in terms of establishing your baseline.

MEEKINS: One more question. You were talking about what you consider to be fallacy in the analogy of the family. I'm just wondering if I have it correctly. As I understood what you said, you seemed to be implying that investments are going

to be made with this money because people are going to deposit it in their bank accounts. If we did have an Alaska Inc., this money would then be deposited in the private financial institutions, they would make the relevant decisions about investments. Is that not as preferable in your view as the legislature making those decisions about how that money is invested?

HAVELOCK: Generally speaking, no. My basic point is simply you should know that's what's going on. That you are transferring the decision making process over the use of funds. I think that's obviously very healthy for a pure investment policy, for instance. I don't think you guys know what you're doing if you're giving the legislature the authority to run around money markets and decide what kind of instruments to buy and sell. Obviously, it's the kind of things you want to give to the private sector. Prejudice is the same in any form of development banking. I've seen too much development banking with heavy political control that amounted to shenanigans. I would rather see, if you are going to go into development banking, the use of banking standards of risk evaluation. I'd rather not have that muddled by politics.

GRUENING: Thank you, John. We have now next to him Dr. George Rogers. Incidentally, the two economists, if our panel isn't going to ask questions, you can ask them questions.

ROGERS: Clark, one of the things I'm going to do after this meeting is inquire into the nature of your racquet ball inflicted injury. I think as a public-spirited citizen I might suggest the state invest in racquet ball courts as a means of cutting down on public discussion somewhat.

I, like John, will make a statement and then be available for questions. I am an economist, but find it difficult to act as an economist when I get into a political setting for obvious reasons.

I, unlike John, was not opposed to the Permanent Fund but I was in favor of it for different reasons than the stated reasons. I know how the legislature acts when it gets a pot of money. I know it's going to spend every penny that comes in. I looked upon it as a curb upon legislative spending. I'm not too concerned about the intricacies of whether we call it a development bank or not. I agree with Dr. Tussing, that the development bank has very limited, or will have very limited, impact upon the Alaska economy, which gets me very quickly to my statement.

I would like to put the statements made by Professors Bergman and Gordon into the Alaska economic context. I think this is very important. In Jim Rhode's covering letter, inviting them to attend here, he made one passing remark that, I think the statement was that of every dollar gross state product \$.64 leaks out. I think this gives you an idea of the nature of our economy. It's a colonial economy in which the state product is largely exported, the value is largely exported.

BERGMAN: What do you think that statistic is for the state of Maryland?

ROGERS: It's probably something like that, but the point I want to get to quickly on that...

BERGMAN: Alaska's not that very much different from the rest of the country in that respect.

ROGERS: Okay. That's right, because we do--as states we are part of a national entity. There are these traits, etc.

First of all, the value is not an Alaskan value. It is something that goes into the national economy very definitely. Looking at the regional economy, however, you find that we generally define in the terms of such measures as per capita

real income earned by residents and other measures. You find that the Alaska economy is dominantly a government economy.

Very quickly, if you were to look at the basic part of our economy--the part that generates the whole thing--looking at the resource we find that before oil came along, it was very, very minimal. A fading fishing industry, a stagnant forest products industry, and then this great military establishment, construction industry that was generated by that. From 1940 on, whatever measure you use of the regional economy, you find that half or more of the employment, income, etc. generated by it is in terms of state and federal government income directly.

Then the support industry in the private sector is primarily in support. These people, these programs are living off them in some way. If we were to eliminate or reduce the rat hole co-efficient in the Alaska economy back to a level that would be a more reasonable one in terms of Professor Gordon's philosophies, we would have something like the 1939 economy.

At that time, we had a thriving fisheries industry; we had mining industry, which, in terms of labor employed, was probably larger than the oil industry's going to be here. So in terms of a natural resource economy, we would be reducing

ourselves to something like 75,000 people operating primarily a few natural resource extractive industries with a minimum of federal and state government services required to maintain that work force in operation.

The thing is that the state government has become the driving force in our economy. This is the reason that the scenarios by Professor Bergman are relevant. I don't agree with John that they are irrelevant because she concentrated on state revenue. Each one of these is a hypothetical projection of what the state revenues might be, given three different scenarios or three different ways of managing the oil revenues: spend as you go; putting it into a development bank type operation; or working out the investment---I think the investment was the second and the development bank was the last one---because the reason we have a community like Anchorage is because of government spending.

The government spending has almost assumed a life of its own. When we are talking about stabilizing the economy, we are really, in essence, talking about stabilizing the level of government spending; because if it drops off, our economy drops off. If the private sector, for example, the oil revenue drops off, if there isn't anything else to take its place, then one way of doing it is to increase

government employment. If you are talking about distributing the money to the average Alaskan, you would, in many cases, be distributing to a government bureaucrat and his family. So that the Kuwait model is a relevant one in Alaska, except that the bureaucracy is much larger and represents a much larger segment of the population.

BERGMAN: What about the privates on the base?

ROGERS: The privates on the base. Yes. That's a whole sector of the economy that is generally there, they generate income in Alaska but they are only here for a couple of years on an average, depending on what their turnaround is. But we consider them part of the bureaucracy too, because they are paid by the government. They perform governmental functions of safety and protection.

But what I am saying is we've got to get our talk about investment, management, talk about the use of the fund into a realistic Alaskan economic setting. When we talk about diversification, we are talking desperately about trying to get something else besides government in the picture. Not simply to proliferate a lot of little business around, which is probably what we will end up doing. But it is a tough job to find something, an alternative, to continued government spending, government employment.

Another thing, I notice the Alaska Humanities Forum is one of the sponsors of this. When I saw this, I wondered, what a nice organization like that was doing in a place like this. I decided that we should make some comments on that too.

Professor Gordon talked about amenities. I think this is what the Alaska Humanities Forum is interested in: making Alaska a better place to live. Now this is something that economists can't give you advice on, except we can give you some analogies, cost-benefit type of analogies, help you in that way.

This is another thing we should consider. The Permanent Fund, we have two functions: one is to manage the investment policy of it. In other words, maintain the integrity of the fund, so that, in fact, the fund is a Permanent Fund; and that we do get the maximum income generated which we can then use for current spending. The current spending could be used for a number of purposes. We could use it for the creation of new development, or we could use it for amenities--a whole range of things we might consider. I don't want us to get caught in the development bank syndrome and just stick there. I think there are other things that we should consider as citizens when we talk about the use of the Permanent Fund.

I don't have any questions at this time. I made quite a few notes. As the discussion goes on, I think we can come back to that Clark, I think I'll stop now.

GRUENING: Thank you very much, Dr. Rogers.

Incidentally, thanks for mentioning the Humanities Forum. It is on the agenda the fact that they helped sponsor this. I should say again, we're very grateful to the Alaska Humanities Forum for sharing half the cost of the room and other incidental costs we have in setting this up.

Are there any questions for the economists or this panel? As soon as we get through the panel, we're going to open this up to the audience to inquire of anybody here. Rep. Meekins.

MEEKINS: Dr. Rogers, I have a question that really arose when Dr. Gordon was speaking. I'll direct it to you, and see if you have any thoughts on it.

He was indicating he felt very strongly, it seemed that the individuals in Alaska could make better decisions regarding the spending of what is morally their money than the legislature. We've coined a phrase here talking about the rat hole co-efficient. That's the implication of that phrase that the legislature isn't as wise and can't spend the money as wisely as individuals can or least not as efficiently.

One of the things that, I think, legislators are always confronted with is our system of government is representative in the sense that we are expected to know a little bit more than the general public. They are expected to vote for us, and then we are supposed to get more involved in the individual decisions. Sometimes we find that when we study something, at second thought, it's a little more complicated than it seems to the public. Even though we represent our constituents, we find ourselves voting in opposition to say, a majority view. We don't have a strict case of radical democracy in the sense that the majority view does not always prevail in the legislature. This sometimes is extremely good.

So, if you apply that thinking to decisions about how best to provide for the benefit of the people of the state, you sometimes maybe would have a contradiction between what the majority of the people would vote for, even allocate their own money for, and what might indeed be best for them.

It's a difficult question, but as an example, in some states, the public votes upon appropriations to education. In some of the states lately, they've had a very difficult time getting any appropriations at all. They've gone for weeks and sometimes even months without any appropriation

for their school system. It seems to me to be an example, at least it's quite obvious to me--I'm very supportive of education, I think there's a benefit distributed throughout the entire society, whether or not people have children, when we spend money on education. Using that as an example, I just wondered if you have any thoughts on that.

ROGERS: I don't have any profound thoughts on this. I think this is an extreme example of what might be done with the money. The assumption is that all spending is done by individuals. If that were so, I think this would certainly be a valid model to use. You mention education. Education is a group or a social decision. The individual may not have any children, therefore, that individual would not spend any money in education. However, society as a whole has some responsibility, whether you have children or not, so that there are a number of social decisions. We still have to have taxations.

I think what Professor Gordon is talking about, I think we had better get you into the discussion, is the distribution of windfall income, incomes that are transitory. We need the distinction between permanent income and transitory income.

This would be, for example, the \$900 million bonus we

received, which is all gone now. Would it have been better if we had handed it to Alaskans because it's going to go in three or four years anyhow, let them have a spree or invest it wisely, or set it aside in a permanent fund? We did neither. We let it dribble out into our general revenues and it was spent. The effect of that was difficult to trace. They are assigned to--how much the expansion of expenditures reflected need and how much merely reflected the availability of money to the legislature? I'm getting off the point. As I say, I think it was intended as a poll.

GRUENING: Dr. Gordon, would you like to comment?

GORDON: Well, some questions it matters a lot whether the money coming in is transitory or permanent; some questions, it doesn't matter much at all. Obviously, there are some things that we choose to provide collectively. There's some argument as to how many of those things we should choose to provide collectively. There's no question of some things with the exception of very few people. Everybody agrees that some things should be provided collectively, so that when the income of the community goes up, there should be, presumably, more private good and more public goods.

I think it's important, however, to distinguish between something abstract called the economy. The economy doing this and the economy doing that. What's happening to the individuals? Fundamentally, our whole system of government is set up on the idea that the people vote for these things. If the money happens to go to the state first, whether it's permanent or whether it's transitory, one always wants to keep in mind, suppose it had gone to the people first, then you could go to them and say, "Let's have a better school." They could allocate the money that way. If, in fact, it goes to the state first, I think really the people get a little unconscious of what's involved.

In a way, I'm amazed at some of the answers that have come, because I think, if you want to use this number \$20,000, if you said, "Would you want to dole out \$80,000? Maybe you can't spend a lot of money but you want to get the income on \$80,000. We'll take care of the principal. We'll give you the income." Or do you want to diversify the economy? You put that up to them. I find that incredible that people would say "No, we don't want the income; we want to diversify the economy. "

I'd like to ask Dr. Rogers another question. So the economy has expanded from 75,000 to 400,000 people, the economy has--and that's mostly from state spending. The question

is who's better off than they otherwise would be? The economy isn't somebody better off or worse off. It's individuals.

I don't think for a moment, and I don't think Dr. Rogers thinks otherwise, it would really go back to 75,000 people. If you took this money, invested most of it outside of Alaska, invest it as a prudent trustee would invest it, and then pay the income to the population-- I'd be wanting to know, not what happened to what some people call the economy, what happened to the individuals, who, morally own that money. Would it have any harmful effect on any other individuals? It's a little hard to see who would be hurt by it.

BERGMAN: I'd like to say one thing. The \$80,000 is not coming in an instant. It wouldn't be a check. I think that would be pretty hard to resist. I think realistically, that if the state of Alaska did propose to send every family a check for \$80,000, the people of the United States would re-think the ownership of those resources. The fact that it does come over a period and it is not being handed out in cash to the residents of the state, to some degree maps the fact that is in part what is going to happen regardless of the scenario you adopt.

I think when you talk about taking either the capital sum and doling it out as it comes in, or doling out the income in cash--particularly when you talk about the capital sum--doling out the capital sum, which I think is beyond the question anyway.

I think there is a difference in what individuals might do and what they might compact as a body politic to do. The government properly does have a longer vision, a longer horizon than individuals, certainly than many individuals. That is right and proper.

I am not as devoted to consumer sovereignty as many economists are, that is, I am not as devoted to the proposition that every citizen ought to have the right to handle, to make every decision himself, and that the government should not constrain any economic decisions. A lot of people would do things they would be sorry for if this money were handled that way. I don't think that's the question anyway.

I think the major practical question is the filling of public need, which governs how much goes into the Permanent Fund. Once you've got the Permanent Fund, the use of it or the investment of it, when I gave my list of different kinds of Alaskans what I was intending to do was, Professor Gordon was also calling attention to, and that is to try to get it from a gross concept called the economy down to people. I don't happen to think that the provision of amenities within reason

by the public sector is a bad thing. I don't think building a very good university here, building very good sports facilities, reducing some of the problems that are inherent in the geography of Alaska is really going to spread this benefit around to the entire United States. By the way, if it did, that wouldn't be so bad either-- if some of it went that way.

GRUENING: Senator Rodey.

RODEY: I had a question for Dr. Rogers regarding the rate of contribution. The proposal has been made that we put into the Permanent Fund 100% of the royalties plus all monies coming in from the severance taxes and allow the state budget to reflect only a base year figure, population increase, inflation, and perhaps an adjustment factor.

As a veteran legislative observer, this would deal with the question you mentioned previously and that was one of a budget constraint. How do you feel about proposals for this sort of input to the Permanent Fund that would essentially take all of the royalty and a good portion of the severance tax leaving only what is necessary for state expenditures on a predetermined level?

ROGERS: This would be, I don't have the figures-- I don't know what size figures we're talking--and the fact is I've been trying to avoid getting involved in the Permanent Fund controversies entirely. I certainly feel that this would serve the purpose of putting a damper or rather constraining by putting some limits on state spending in the future which would be a good thing.

The income, however, from that fund is still available for use. As I recall, some of the calculations made on that was that it began to become quite sizable, quite a monster in its own right. Even using a relatively low interest rate, you come up with annual income. This, then in a few years, becomes the critical thing. Not so much the principal as what is done with the income--if this is re-invested in the Permanent Fund, it then compounds the problem at a future date. I'm calling it a problem now rather than a solution. If it is then added into the general fund, then again it accelerates the level of state spending.

I can't really give you an answer until I've seen the actual solid figures on that. Certainly, the very crude projections we made using our Man in the Arctic model and using 25 to 50%, 100%, we found that the greater the contribution made to the Permanent Fund had a general dampening effect on the level of the economic attainment in terms of employment income; and this is simply because the assumption was that

the government spending would continue at that rate.
It's a dog chasing its tail proposition. It does provide
a great slowing down of the runaway process.

GRUENING: Thank you, Dr. Rogers. Next in order is
Jamie Love of the Alaska Public Interest Research Group.
Go at it Jamie.

LOVE: I don't want to repeat or go over a lot of the
things that have been said by some of the other participants
here, although there are a lot of important things that
have been brought out. I know that most of us can agree
that the money in oil wealth and Permanent Fund basically
is to improve our qualities of life and standard of living.
I know that there's one sort of philosophical difference
that's emerging right now and that is on this issue of
whether or not people should just be given the money so
they can benefit themselves, or whether the government
should spend it for them, and whether or not the main focus
of the Permanent Fund ought to be some type of vehicle to
get money in the people's hands--get the oil revenue
in their hands. I know that's been the primary focus
of the public debate that I've heard on the Permanent Fund,
more than any other issue, is how you're going to disburse
the earnings from the Fund. Realistically there's going

to be sort of a lot of ways the oil wealth is going to be managed to help us.

There's some areas, I think everyone's going to agree, that consumer sovereignty, or whatever you want to call it, makes a lot of sense. I don't want the government to do my grocery shopping for me or a lot of other things. But I think there are areas where some type of public actionary or adventurist is the only way that certain projects are going to get accomplished. I think it's going to be, in fact as we go along, probably a mixture of those two.

I would like to make one observation relative to things like the difference between a rathole and a pressing need for a lot of people. I don't always think it's just the project per se. There are examples, there are times when the same project can turn out to be either one.

Most of us are familiar with a lot of efforts to develop housing in rural parts of Alaska. It's difficult for people living in rural Alaska to provide housing through conventional, their own resources--people living not in a cash economy. Types of impact that we felt here in urban areas, I'm sure are even more dramatic in rural areas. In that area, if housing is going to be provided for people in rural Alaska, the government's going to have to provide certain types of subsidies for financing to accomplish that. Some people

look at rural housing projects as more in the rat-hole area than in the pressing needs type area--it's because they're poorly managed. There is a tremendous recognition by a lot of people. There's a lot of waste in mismanagement. There's some other reasons why the housing wasn't done properly in some areas. This is one of the problems the state's going to be facing as we go along and we come into a lot of wealth and we try and take a very activist role in terms of improving qualities, people's qualities of life.

We've taken a big quantitative jump into a new area of running the government and providing services. We've been very interested, at least, in our organization, at looking at the ways and vehicles the state can best put together a lot of planning mechanisms and management functions to have more quality control or better evaluation system as we try to accomplish, whether it's a loan program or a cash subsidy or a number of different other things.

One thing I want to note briefly before I get into some other comments is when we talk about the Permanent Fund and we talk about investments, I'm sure that everyone in his mind is thinking that we're also talking about capital spending by the government in terms of just cash, just building projects that aren't really an income producing venture like infrastructure development--roads, highways,