

ALASKA LEGISLATURE SPECIAL COMMITTEE / SUBJECT FILES 8672

135 S COMM 9: HOUSE SPEC. COMM. ON PERMANENT FUND 1977-78

1 MR. MOTLEY: I tried to read through the purposes and
2 I didn't see any that just said that.

3 MR. FUHRMANN: Don't look in the purposes, look in
4 the section called portfolio.

5 MR. MOTLEY: It appears that one needs a road map,
6 if you'd now give it to me.

7 MR. BUTLER: Some of the foreign funds, sadly enough,
8 don't have a detailed written description on them, some of
9 those subjects, to give them this flexibility I think that
10 Charles mentioned, and sadly on short notice or just by
11 reading what's available in writing it doesn't always point
12 that up clearly.

13 MR. MOTLEY: Thank you, Mr. Chairman.

14 MR. WOHLFORTH: Representative Urion.

15 MR. URION: Well, if I haven't had a chance to read
16 this I don't know if I'm ready to ask any intelligent questions.
17 One thing I can't see here, did you make any judgment on how
18 these funds have fared? I can read the portfolio, but I
19 don't know in the monies they put in, the type of loans they
20 made, and good and bad loans, or what.

21 MR. FUHRMANN: Most of them have done very well.

22 MR. URION: I can't read that in there.

23 MR. MOTLEY: Obviously the one you managed did better
24 than most.

25 MR. FUHRMANN: No, we don't manage any of them, nor

1 desire to. Most of them that are dealt with in the inter-
2 national section are involved in loans and have government
3 guarantees. Some of them specifically state they will not
4 participate in restructuring bad loans, which is to say they
5 won't call upon the guarantee of the government behind the loan.

6 Others, National Financiera, the Mexican Development
7 Bank, has as a policy that they will participate in restruc-
8 turing bad loans, and they have had hundreds of them. What
9 they do is, they restructure the debt service, give interest
10 moritoriums -- there are all variety of things being used.

11 There are some Canadian funds now that are involved
12 in having made some investments which we are investigating
13 now exactly what they are doing with respect to them, and
14 they're somewhat sensitive about talking about what they're
15 doing. But we are in the process of discovering what they do.
16 But most of those funds have very good success, mainly because
17 they have the guarantees behind their investments. You know,
18 it depends.

19 You can survive on a performance basis forever as
20 long as you're willing to restructure the loan.

21 MR. MOTLEY: In other words, you have no delinquencies,
22 you just rewrite the deeds.

23 MR. FUHRMANN: Right.

24 MR. URION: Do we have in amongst the papers here
25 something that would tell us that?

1 MR. FUHRMANN: The annual reports of some of these
2 will have information.

3 MR. URION: The annual reports?

4 MR. FUHRMANN: Yes.

5 MR. URION: And what will be the statutes that sets
6 up the management structure and how the funds will be used?
7 Do we have any of those available?

8 MR. BUTLER: Yes, we have it specifically for the
9 Alberta Heritage Trust Fund and others.

10 MR. FUHRMANN: The Kuwait Bank.

11 MR. ODEN: And domestically we have them available
12 but there's numerous cross references, etc., etc. We've
13 endeavored to underwrite the pertinent sections. But we do
14 have those.

15 MR. URION: Do we have those?

16 MR. EDENSO: Mr. Chairman, if I might. Mr. Urion,
17 your Price Waterhouse report also describes the structure and
18 organization, and management control features of nine funds
19 that are involved in this, and some of the very ones that
20 they've talked about.

21 MR. URION: That's all.

22 MR. WOHLFORTH: Thank you. Mr. Thorstenson.

23 MR. THORSTENSON: Chuck, I'm missing page three of
24 your introduction to this as well -- I got page two mixed in.
25 My question, I guess, would be to Chuck. I felt when I heard

1 you say that politics becomes a problem in management of
2 these funds, particularly on a national level, more or less;
3 you mentioned some were very political and some were less
4 political. Would you recommend a way that this could become
5 less of a problem, particularly in our case?

6 MR. FUHRMANN: Right now I would rather not. I'd
7 rather not. I don't know whether you want to have it be part
8 of your political process or whether you want it to be separate.

9 MS. FLEISCHER: We haven't decided.

10 MR. FUHRMANN: No, you haven't decided.

11 MR. EDENSO: I'm getting out of line. Maybe you
12 could explain some of the political processes that have
13 occurred which have resulted in a structuring of some kind
14 of management entities.

15 MR. BUTLER: We can speak to that both domestically
16 and internationally, in that there is some parallel between
17 the United States and others.

18 MR. ODEN: With finite natural resources, a lot of
19 states had a severance tax or some other sort of royalty
20 that was coming in that up until 1973 was not that significant.
21 All of a sudden they find themselves with a tremendous source
22 of revenue. So states such as Montana, Wyoming and New
23 Mexico have created new programs, primarily under the auspices
24 of the Governor and the State Treasurer, and the management
25 of the funds in these are usually left to a certain degree on

1 a discretionary basis with broad guidelines produced by the
2 finance arm of the executive branch of these states. That is
3 the typical structure.

4 MR. BUTLER: For example, in New Mexico, and correct
5 me if I'm wrong, Pat, the fund is managed by the Governor, the
6 State Treasurer and four or five members appointed by the
7 Governor but approved by the State Legislature, but within
8 the very broad guidelines of the charter. Then they're
9 free within that to invest in any manner, and obviously that
10 could be quite political because the Governor is on the board
11 as is his appointee, the Treasurer, as are his other appointees,
12 and that's where the sole decisions lie. Monetarily it's
13 been a successful program to date as far as they have had
14 no losses.

15 MR. ODEN: It might be noteworthy that insofar as
16 the investments of the funds, the Texas Permanent Fund and the
17 New Mexico Permanent Fund are really the only two I came up
18 with a definite policy to invest in common stocks. The
19 others have sort of not learned their lesson, but have become
20 much more wary about investment in common stocks and have
21 by internal regulation limited themselves to income producing,
22 fixed income securities, primarily federal government securities.

23 MR. FUHRMANN: Most of them attempt or express that
24 they are above politics. They express that they are.

25 MR. WOHLFORTH: I would suggest that when we use the

1 term "political" or "politics", you know we run into a big
2 semantics problem. Do we mean politics - invidious, or
3 politics - of the political process? So why don't we try
4 and say which way we are using it? It might help save a
5 little time.

6 MR. FUHRMANN: Let's talk about where the people come
7 from that manage these things. Are they coming from the
8 political arena, are they politicians, are they involved in
9 representing the people either by election or by dictatorial
10 power, or wherever they got there, or are they out of the
11 business community or the investment community, are they
12 financial people, or are they agricultural types or engineers?
13 And to answer that question is to say that you will find funds
14 that had any or all of those or a combination of the above.

15 But the majority of them do reflect people from the
16 political community. They have either been there or they
17 are still there. But they will argue that their decisions
18 are taken irrespective of their political inclinations, whether
19 it's partisan or whether it's political philosophy, what we've
20 so quickly come to call liberal or conservative, or whatever,
21 but their decisions are taken objectively, and that they run
22 these things all on a businesslike basis.

23 What is most important, we feel, is that whoever
24 runs it must be answerable and responsible to the public and
25 easily identifiable and accountable. Otherwise the opportunities

1 for graft, mismanagement, etc. are enormous. I keep thinking
2 in my mind about the Venezuelan situation, where the manage-
3 ment changes about every three months. At first the reason
4 was because they were making decisions that were not
5 necessarily agreeable to the powers that be in the political
6 process, and later it was because the people themselves that
7 were put in those positions couldn't live with the bureaucratic
8 environment in which they were placed. Now it's because the
9 image of working there is considered so unattractive that
10 nobody wants to be involved. But they are working hard to
11 straighten themselves out.

12 I think we have very strong feelings that the group
13 or individuals involved should be people that are able to
14 judge and evaluate situations that structure, and must either
15 be in a position to monitor and evaluate their investments
16 or get people that can do it for them. We think that
17 this is a long run situation. That, I believe, is definitely
18 established here, that we're not talking about a temporary
19 fund, you're talking about a permanent fund and, therefore,
20 it is important that the people be "above" politics, Mr.
21 Chairman, because politics or political parties in power
22 would ever change and the fund is meant to be permanent and
23 to go over time. So we think the people should be people
24 of stature and run for all and on a businesslike basis.

25 But again, the most important thing, we think, is

1 accountability, and being able to answer to the people.
2 I think this is really what Price Waterhouse and we discussed
3 at length right after this.

4 MR. GRUENING: Mr. Chairman.

5 MR. WOHLFORTH: Yes.

6 MR. GRUENING: While we're on the subject, I'm curious
7 How do you reconcile being above politics as a goal and then
8 trying to be accountable? I don't think they're mutually
9 exclusive.

10 MR. FUHRMANN: Well, performance must be able to
11 be judged, and the person responsible for the performance
12 must be able to be evaluated. That's what I'm talking about.

13 MR. GRUENING: Politics doesn't -- decided by whom
14 though?

15 MR. FUHRMANN: What I mean is they shouldn't be
16 necessarily -- well, I don't know what I mean.

17 MR. LOVE: Sort of like what Eric was saying.

18 MR. FUHRMANN: Shouldn't be used as a favor to get
19 votes. The guidelines and objectives should be clearly
20 established so the person has an operating map from which
21 to work, and then the person identified, and then let alone,
22 subject to evaluation of performance. I don't know -- you're
23 asking us for recommendations which we're prepared to do at
24 some point in the future if we're asked to. But we haven't
25 been so far and really prefer not to. I think that there is

1 a responsibility here on the part of the Committee members
2 to give us some guidelines of where you want us to go.

3 MR. WOHLFORTH: We have time (probably in order not to
4 short-cut the next presentation) for one or two more questions,
5 and then we'll resume after the next presentation.

6 MS. FLEISCHER: I just can't resist pointing out that
7 it sort of bears out my point, the discussion we've had.
8 Mr. LeResche asked a question of applicability, and you don't
9 know which funds are going to be applicable, if any of them
10 are going to be applicable or if all of them are going to be
11 applicable, or which ones we look at until we know what the
12 purpose of our own fund is going to be. That's still, I think,
13 our number one task, we have to decide that before we know
14 how to evaluate anything. I think it is useful to look at
15 what other people are doing ahead of time to give us some idea
16 of the alternatives that are available, but ---

17 MR. FUHRMANN: Well, that is the purpose of this.

18 MS. FLEISCHER: Right, but we still can't really
19 discuss things until we know which direction we want to go,
20 and I do hope that management and structure would reflect the
21 goals and objectives and that is that we still have to know
22 that so we know how we want it structured.

23 MR. WOHLFORTH: Yes.

24 MR. LOVE: I'd like to know, based upon your experience
25 of studying all these different funds, foreign and domestic --

1 I'd like to know, when these funds were created in the first
2 place, the same task that we're going through right now, if
3 you could tell us a little bit about the processes by which
4 the different communities went through in developing the
5 funds, the amount of time it took them to come up with their
6 plans, the public processes they went through. I think that
7 might be very helpful to us in seeing some of the steps maybe
8 we have to go through here.

9 MR. BUTLER: In general, we haven't done that at
10 this point in that, as has been mentioned a couple times, we
11 don't have a lot of very specific guidelines to go on. This
12 was an overview and, Jamie, we frankly just have not gone to
13 that depth, especially as far as time and the exact discussions.
14 In some cases we do have in the source data here, for example,
15 some of the actual Congressional testimony or Legislative
16 testimony that went into creating some of these, in Alberta
17 and places like that. Some of this may be difficult, if not
18 impossible, to get from, say, the Middle Eastern countries
19 and things, as an example.

20 MR. FUHRMANN: Where they obviously grew out of sinful ban
21 types of arrangements, some of the different structures. But
22 we do have it in some cases, yes.

23 MR. LOVE: I would be interested at some point though
24 in some observations or information on that.

25 MR. WOHLFORTH: Proceed.

1 MS. FLEISCHER: Eric, could I? I forgot one of the
2 questions I wanted to ask. When we read the data from these
3 various funds are we to read purpose here as both objectives
4 or do some of these funds have other sets of goals and
5 objectives from which they've extracted the purpose, and I
6 do notice under "Portfolio", for instance, there is a lot
7 of talk and most of these are about objectives. It doesn't
8 say exactly what the objectives are.

9 MR. FUHRMANN: I think that you can remember that
10 these are summaries.

11 MS. FLEISCHER: Right.

12 MR. FUHRMANN: And there is more extensive information.

13 But I think you're going to find that those summaries
14 are pretty all inclusive with respect to objectives. So you
15 will see the flexibility that is built into the language of
16 the law or charter, but not necessarily in the operating
17 policies that actually govern. Most of them are subject to
18 policies that have been set on a continual basis by a board
19 that meets regularly, which board is either made up of people
20 from the political process or representatives of the various
21 nations that are involved as investors, or a group of some
22 from people within the fund themselves who are managing it
23 and people from outside who may be citizens and/or part of
24 the political community or the business environment.

25 MR. WOHLFORTH: Commissioner.

1 MR. GALLAGHER: One of the things you said was that
2 you didn't see the relevancy, in answering a question over
3 here, the relevancy of some of the international boards, and
4 maybe you should rethink the question and ask what is the
5 constituency of the board. I think that a lot of them are
6 very relevant in that if you examine what their constituency
7 of the management is, it was a very broadly based constituency.

8 MR. FUHRMANN: Maybe one man from Switzerland, one
9 man from England, one man from France, because England, France
10 and Switzerland were contributors of the equity of the fund.

11 MR. GALLAGHER: Right and, in fact, we in this case
12 have got a broad political support, and the support comes
13 from all sectors of the state. Now, if you go back and
14 examine that, your management structure ---

15 MR. FUHRMANN: I see your point, but I think that
16 you will find that there are funds that are more similar that
17 have done what you're saying, where they have pulled people
18 from representative groups, be it knocking it down from the
19 level of nation, to the level of state and the level of county.
20 Your point is the broad base representation.

21 MR. BUTLER: We'll be happy to pursue that in more
22 depth, and at this point are looking for this kind of sug-
23 gestions and guidance to home in from here.

24 MR. FUHRMANN: But it's obviously a natural board
25 that is created when you have twelve countries participating.

1 It's obvious who the twelve board members are going to be,
2 one from each nation.

3 MR. GALLAGHER: It's obvious but, you know, that comes
4 back from their constituency, namely, those countries that
5 are involved.

6 MR. WOHLFORTH: Jim.

7 MR. EDENSO: I think I would like to defer asking
8 any questions until after other members of the board have had
9 an opportunity to explore with you what you've explained to
10 them concerning the other funds, and also in the interest of
11 moving on until we get to the point of the next report.
12 So, Mr. Chairman, with your permission ---

13 MR. WOHLFORTH: I think it might be well, unless the
14 other people here would object seriously, that we go on to
15 hear the Price Waterhouse and then resume questioning on the
16 other side of the table. You'll have the benefit then of two
17 things to respond to. We will recess you gentlemen subject
18 to call.

19 MR. BUTLER: Thank you. Could I ask a question?
20 There could be a problem of how do we gain access to some of
21 the background material?

22 MR. WOHLFORTH: I presume it will be in your office,
23 Jim.

24 MR. RHODE: Yes, it will. Sir, I was going to suggest
25 that if we could have one set here in Anchorage then people

1 could reach me and I'll be glad to supply copies.

2 UNIDENTIFIED: Where can we reach you?

3 MR. RHODE: Our office is in the Dawson Building at
4 Sixth and K, number 30, and the phone number is 277-2423.

5 MR. WOHLFORTH: This is the point in the agenda where
6 we're going to hear from Mr. Peter McDowell of Price Waterhouse
7 and Company accompanied by Mr. Dan Regis, who is the resident
8 Anchorage partner, to report on the organization, management
9 and control of development banks and you have, I think, in
10 hand his report. Go ahead, Mr. McDowell.

11 MR. McDOWELL: Thank you, Mr. Chairman. It has been
12 brought to my attention that there may be a few of our guests
13 in the audience who don't have the full background on our firm.
14 If I could just take 30 seconds I'll explain it.

15 Briefly, Price Waterhouse is an international C.P.A.
16 firm with departments for taxation and management consulting
17 as well as our normal auditing functions. Our background
18 for this particular study is that we are the auditors of
19 all of the development institutions that we've discussed in
20 our report, plus a number of others around the world, and
21 in addition I have been personally involved with the manage-
22 ment and the lending programs of the development institutions
23 for the last two and a half years. So we were asked, in effect,
24 to transfer some of this knowledge, based on these two sets
25 of client activities, to the Committee and to the state.

1 If I may, I'll report on what is in the hands of all
2 members of the Committee.

3 MR. LOVE: Not everyone is familiar with it but we've
4 all got it in hand.

5 MR. McDOWELL: Fine. If it would be all right, I'd
6 like to go through it from two directions, one the report
7 itself, the other I'd like to after that address some of
8 the questions which I've extracted from the minutes of the
9 last meeting.

10 The report is a report of five case studies, four of
11 which are specific institutions based in Washington, D.C.
12 We selected these four, the International Finance Corporation,
13 the World Bank, the Inter-American Development Bank and the
14 finance program of the U. S. Government's Overseas Private
15 Investment Corporation for detailed review, partially because
16 we know a great deal about the institutions and have a long-
17 standing client relationship with each of them and partly
18 because they are prominent, well managed and diverse and
19 generally are representative of the types of institutions
20 active in the development banking field.

21 The fifth case study concerns a class of institutions
22 which are normally organized in each developing country and
23 go by the term commonly of development finance corporations.

24 I have summarized our findings, particularly the
25 similarities among the five case studies. First, however, I

1 might define a development bank. Simply, it's a bank which is
2 like other banks that we're familiar with, with two or three
3 exceptions: (1) it does not accept deposits, (2) it is very
4 aggressive in the promotion of the projects to which it makes
5 loans or provides equity financing, it is active as opposed
6 to being relatively passive. The development banks then form
7 sort of a community in the financial area or markets of the
8 world with these differences, two differences, to normal banks
9 that we consider. But other than that the bulk of them are
10 managed and operated and established as commercial institutions,
11 as Mr. Fuhrmann and his associates explained earlier.

12 The report, and again I won't try to go through every
13 page, but I would like to highlight some of these points
14 and certain of these case studies -- if we could, start at the
15 last. This is attachment "V" titled "World Bank/IFC - Spon-
16 sored Development Finance Companies". I won't go through the
17 general statements of purpose and the philosophy sections,
18 but I would like in this case study to turn to the section on
19 relationships with governmental units. These DFC's are
20 normally national institutions, they are concerned with only
21 nation/state now rather than a group. Some of the problems
22 normally encountered by DFC's are those which I've indicated
23 on page four and five.

24 The relationships with their governments, which
25 normally are their owners, are (1) they cooperate closely

1 in order to represent private sectors during the development
2 of economic policies and plans by the government. They,
3 however, have an initial objective that they are expected to
4 maintain adequate profits and sustain their credit worthiness,
5 or in other words to sustain their integrity as financial
6 institutions, and make an important contribution to develop-
7 ment. That's the public policy goal that often causes them
8 to engage in compromises that an ordinary businessman wouldn't
9 countenance.

10 The governments apply pressures because they normally
11 own all or most of the stock and, therefore, are the stock-
12 holders. As with any corporation, they can dilute the
13 independence of these institutions in many ways, and I've
14 listed three of these; pressure to hold interest rates below
15 market and, again, most of these institutions survive on some
16 capital and from funds borrowed from other sources; pressure
17 to consider projects which are too small for economic invest-
18 ment and, perhaps, are too risky; and pressure to fund
19 projects in least developed regions.

20 Now, I think as our discussions took place this
21 morning all or some of these items, you can see, could be
22 situations faced within the State of Alaska.

23 The influence, which is political influence, govern-
24 mental influence, can easily become interference with manage-
25 ment decisions, and this is where you have a problem. Most

1 of the DFC's organize to be independent as far as management
2 decisions on investments, staffing and internal administration
3 are concerned. These are the three keys to having a well
4 managed institution.

5 So, pointing out in terms of relationships with
6 governmental agencies, the DFC's probably have the most
7 direct of these five case studies. Even OPIC doesn't have
8 such direct influence, although it is a creature of the United
9 States Government, as far as the chance or the probability
10 of interferring with its day-to-day operating decisions.

11 The fourth case study, which is the Overseas Private
12 Investment Corporation Finance Program, is also interesting
13 in terms of some of the exceptions that it encompasses to the
14 normal structure and control of a development bank. Its
15 sources of funds are U. S. Congressional appropriations and
16 proceeds from its own operations. In addition, it has
17 authority to guarantee loans to a far greater amount than it
18 has authority to make direct loans. So it's a guarantor of
19 other people's loans in many more instances than it actually
20 makes loans itself. That's a difference. The others tend
21 to strictly make their own loans; although most have their
22 guarnatee power, they don't care to exercise it.

23 The relationships with government are, I think,
24 interesting as well. OPIC is a corporation of the United
25 States Government. It's subject to review about every four

1 years through the Congressional authorization processes.
2 Congressional oversight is, in effect, directed toward it.
3 It has its own Sunset Law. Every four years it comes up and
4 the question is asked, "Should OPIC continue," by the Congress
5 and so far it's been answered positively the one time they've
6 been through the cycle. It comes up again in 1978.

7 Selection of its board, senior management and staff
8 is a very closely related governmental function. There are
9 six members of the board of directors from the private sector
10 and OPIC's president, directly appointed by the President
11 of the United States and confirmed by the U. S. Senate.
12 The four other government directors hold specific posts in
13 the current administration. The private sector director can
14 serve a three-year term, and they have rules about expiration
15 so that the appointments and expirations of directors' terms
16 occur on a staggered basis.

17 The first three case studies, I think, will probably
18 reflect similarities than exceptions. The World Bank, the
19 International Bank for Reconstruction and Development, is
20 really the first of the species. It was founded for two
21 purposes (1) to assist in reconstruction after World War II,
22 which that job has been over quite some time, and (2) to assist
23 in the development of economic development of under-developed
24 countries, which is the role it's been carrying on for most
25 of its life. The Inter-American Development Bank was formed

1 at a later date to, in effect, in response to the need felt
2 by countries in Latin American that the World Bank was fine
3 and they liked the loans and they liked the projects but
4 they weren't getting enough and, therefore, they preferred
5 to have in addition to the World Bank their own bank. We
6 in the United States agreed and provided a substantial portion
7 of the initial capital for that.

8 The International Finance Corporation is again a
9 later development. If was found that the World Bank could
10 not and did not wish to deal in the private sector directly
11 and its member countries, and the International Finance Cor-
12 poration was established as a related institution, in some
13 ways a subsidiary, but a related institution to deal solely
14 in that sector. It's quite small, it's a very small institu-
15 tion compared to the main bank itself.

16 The summary of our findings, if I may, I would like
17 to go through and just point out a few things. Of the five
18 case studies, some of the similarities include (1) they all
19 have a common purpose to provide loan financing for high
20 priority economic development projects in developing countries.
21 The IFC and OPIC -- IFC also provides equity and OPIC also
22 provides loan guarantees. None of them make small loans.
23 All of them make loans that are relatively large and, as
24 stated earlier, they pass on funds to specialized intermediaries,
25 generally the DFC's in individual countries and they, in turn,

1 because they're a smaller scale operations, are able to make
2 loans to small businesses and small government projects, and
3 do it on a reasonably economic manner. The problem with it
4 is that the operating costs of an institution like one of
5 the larger development banks is relatively high because they
6 have extremely competent people who are well paid in order
7 to retain them, and it could very well be that you could spend
8 a minimum of a Hundred Thousand Dollars in staff time putting
9 a loan together. If the loan is a Hundred Thousand Dollars
10 the cost benefit ratio just doesn't work out to make any
11 sense.

12 The operating philosophies are similar, they're all
13 aggressive in project promotion, preparation and design
14 activities to far greater extent than normal commercial
15 banking institutions. They are also all run on a prudent
16 and businesslike basis, and most frequently the word "prudent"
17 is that which is included in their charters to indicate that
18 they should be run on a commercial businesslike basis. The
19 charters are relatively general, but "prudence" has been
20 interpreted by the institutions to mean just that. They're
21 expected to generate revenues adequate to fund their operating
22 expenses, including the costs of borrowed money, and to
23 provide some profits to insure security and growth as con-
24 tinuing institutions.

25 The institutions tend to be independent from their

1 governments, with the exception of some of the development
2 finance companies. But the general range is that they are
3 independent to a fairly great extent as far as day-to-day
4 management and operations are concerned. Each institution
5 is organized with boards, boards of governors and/or boards
6 of directors, and a strong chief executive officer. Again,
7 this is a crucial factor in the success of these institutions.
8 They universally have strong chief executive officers who are
9 delegated substantial powers to manage the institutions.

10 Related to one of the questions that came up earlier,
11 the stockholders -- each of the institutions is effectively
12 a corporation. As with any of our corporations in this
13 country, the stockholders have the ultimate power. Now, in
14 their case you often see two boards, the first board being
15 the board of governors. Well, the board of governors, in
16 effect, votes on those same issues that our stockholders of
17 a normal U. S. financial or commercial corporation would vote
18 on. They are the stockholders, as persons. They represent
19 the governments which own the shares, but they are in effect
20 the stockholders. If you send out a prospectus to the
21 shareholders of the corporation that you're involved in and
22 ask them to vote on something, the boards of governors would
23 in fact vote on those matters. They delegate their powers,
24 with a few exceptions, to operating management which begins
25 with another board, a board of executive directors. That

1 board is part of a line management and they are approximately
2 the equivalent of our normal corporate board of directors
3 as we might have in this country, plus some of the functions
4 that are normally ascribed only to our individual management
5 executives. They're kind of a quasi-combination. They look
6 much more like a British board of directors than a United
7 States board of directors.

8 The British have a system where their boards are
9 made up mostly of the internal management with a few outside
10 directors. But that board is an executive board that meets
11 daily, weekly, whatever is necessary to run the organization.
12 That's in effect what the board of executive directors does
13 in a development bank.

14 The chief executive officer is chosen by one or the
15 other of the boards; there's no consistency; he's chosen by
16 one of the boards, normally the board of executive directors
17 or the equivalent; in one case by the board of governors.
18 In all cases key senior management, starting with the chief
19 executive officer and the professional staff personnel, are
20 selected by the board or chief executive officer or his
21 delegated executives. The only exception is that in OPIC
22 the portion of the staff below the professional level is hired
23 and paid, and remunerated, and dismissed and so forth under
24 U. S. Government Civil Service Regulations. The key posts
25 are exempt; in other words, there are no exceptions to that

1 rule.

2 The institutions share common control structure.
3 I think this is a crucial area, and as I go through another
4 set of rhetorical questions that I hope to be able to answer,
5 I'll go through the controls in more detail. But each of
6 the institutions is organized to provide an adequate separation
7 of duties and numerous levels of loan and investment review
8 and approval, and I'll go back to why in a moment.

9 Final responsibility and accountability clearly rests
10 with the board and the senior management in every case, and
11 their accountability extends to public accountability in all
12 instances in the specified institutions and in many instances
13 in the DFC's. To a minimum, audited annual reports are issued
14 to their stockholders and to the public. In addition, all
15 major institutions carry on very comprehensive voluntary
16 public information programs.

17 The World Bank and the World Bank group, I think,
18 publishes a thousand, two thousand documents a year concerning
19 themselves, and there's very little that you can't find out
20 about these institutions in terms of their goals, objectives, and
21 their lending programs that isn't published by them in one
22 form or another.

23 Now, if I may go back, I reviewed the minutes and
24 I said, "Now, what directly, what were some of the concerns
25 that the Committee appeared to express at its August meeting?"

1 If I can be so presumptuous as to outline some questions and
2 the answers as defined for this kind of institution, I will.

3 The first question is, how do you insure political
4 influence is minimized in the loan or investment operating
5 process. I'm not stating and I don't think you're stating
6 that political influence should not exist. This is a state
7 corporation, or a state creation; but how do you keep it out
8 of the loan and investment operating process. Well, all of
9 them have done this partly by creating an independent corporate
10 entity with all of its operating functions, with the exception
11 of the International Finance Corporation which, as I said,
12 is a subsidiary of the World Bank to some extent. The others
13 have all their functions, they have all the functions of a
14 bank. They have their lending operations, they have their cash
15 management operations, they in effect control their own liquid
16 assets, they make their own borrowings as independent insti-
17 tutions. But the crucial thing is that they have all of
18 their operating functions self-contained as to the day-to-day
19 management decision making. That's the key. In other words,
20 if you put into a charter that a certain item that's crucial
21 in the management of one of these institutions and it's not
22 granted to that institution, you probably are going to create --
23 you would create problems, or at least these institutions tend
24 to be successful, I believe, partly because they are independent
25 corporate entities.

1 Another thing is to delegate all operating respon-
2 sibilities from the stockholders to a board of directors
3 which represents enough diverse interests so that no single
4 outside agency or group can control decisions of the board.
5 I think OPIC is probably the best example of board selection
6 to do this. The majority on the board of sic is from the
7 private sector. There are four Presidential appointees
8 who are also on the board, there's the president of the
9 institution itself, and then there are the five (shall we
10 call them) outside directors. Half the board is outside
11 directors.

12 The U. S. Government cannot make a board decision.
13 Essentially they do not have a majority on the board. They
14 have a strong input, they've got 40 percent plus the president,
15 but they cannot make a final loan decision or investment
16 decision without the concurrence of at least one member
17 from the private sector. So there is a situation where your
18 board is diverse enough that no one has the controlling interest
19 in the vote, controlling power over the vote.

20 The international banks, as we've pointed out in each
21 of these case studies where we have the information, the
22 largest single stockholder, in other words the largest amount
23 of voting power, is about a quarter. It happens to be the
24 U. S. in each case or the World Bank and IFC and Inter-American
25 Development Bank. The United States government cannot

1 control the lending decisions, the operating decisions of
2 any of those institutions, unless it gets another 25 percent,
3 26 percent of the vote to go along with it, and that's quite
4 a number of countries.

5 Now, there are many other factors involved in insuring
6 this kind of thing to insure any political influence is kept
7 out of the operating process. Then the alternate side of
8 the question is, how do you insure that adequate political
9 influence is exerted in the policy making process; because
10 again we come back to the fact that these are all government
11 created institutions.

12 The first thing they tend to do is lay out objectives
13 in the charter for the institution, objectives and an operating
14 philosophy. Simply said, the bank will make loans for
15 development projects in less developed countries and it will
16 do so on a prudent basis. That's a simple statement of the way
17 most of their charters are written, just about that general.

18 But second, only ultimate powers are reserved to
19 stockholders, but the fact is ultimate powers are reserved
20 to the stockholders. The stockholders have the power to change
21 the articles of incorporation, they have the power to liquidate
22 the institution, and they have the power to elect the directors,
23 select and elect the directors, two in effect staggered and
24 partially insulated terms but yet they still have all of
25 these ultimate powers.

1 In accordance with the way the Constitutional
2 Amendment is written regarding the Permanent Fund, the
3 Legislature of the State of Alaska appears to have the first
4 of these two powers, the power to change the articles of
5 incorporation (because this thing is established by legislation)
6 and to liquidate the institution. The third power, the
7 election and selection of the directors can certainly be
8 shared among -- well, in the first two powers subject to veto
9 by the Governor. The third power, that of appointment of
10 the directors, can certainly be shared subject to guidelines
11 provided by the articles of incorporation and, in fact, in
12 all these cases it is.

13 You have, obviously, in these very general but final
14 powers, you've got a lot of opportunity for insuring that
15 adequate political influence is exerted. But you also have
16 the opportunity by structuring an independent corporation
17 with certain other features to make sure that that political
18 influence stops at the policy making level and is not exerted
19 at the operations level.

20 Another question which I extracted is, what can be done
21 to insure that high standards of credit worthiness of borrowers
22 and project viability are maintained. The first requirement
23 along this line, again a general one, is all of these insti-
24 tutions are required to be prudent, and that's interpreted
25 as making enough income in total, not necessarily from any one

1 project, to pay their operating expenses to provide for
2 reserves against bad debts and losses, and normally to put
3 the rest of it (if there is any left over) into capital so
4 that their borrowing and lending power can be increased.

5 The second major area that they observed is that they
6 have competent management and staff, and they insure that
7 they have competent management and staff. How is it done?
8 Primarily they structure a strong chief executive officer,
9 as I've stated before, and give him, subject to the approval
10 by the directors, the power to hire, dismiss, organize, and
11 pay the staff of the institution. That's a crucial factor,
12 that you have the people of high quality.

13 Now, what will these people of high quality do? Well,
14 I think, if I may, I'd like to direct your attention to
15 Attachment II, which deals with the World Bank and move to
16 page eight. This is probably the ultimate in what a develop-
17 ment bank can and does do to insure credit worthiness and
18 project viability. This is an institution, incidentally,
19 which has a requirement that all of its loans are guaranteed
20 by the government of the country in which the loan is made.
21 So they don't need to do any of this. Yet they feel that
22 to do their job, to be active, development of an active
23 development force, that they must go through this standard
24 of activity which, again, is the highest standard that you
25 will find.

1 Page eight, we discuss the control that the board
2 of executive directors provides. They must approve all pro-
3 posals for loans, borrowings, budgets, reports and policy
4 issues before they are implemented. They also have standing
5 committees and, again, we mention the audit committee, and
6 three different audit agencies report to that audit committee
7 of the board of directors rather than to the management of
8 the bank. So the board of executive directors is final
9 approval. It also has reporting to it several of the outside
10 checks on the activities of the management and staff.

11 Let me go on to operating controls, starting on page
12 eleven. What are the operating controls built into this
13 bank? Again we've described these on the basis of our interest
14 as auditors and our information as auditors, as well as our
15 review of documents and discussions with key executives.
16 They use budgets and they use long range plans. Three dif-
17 ferent departments review credit worthiness of borrowers.
18 Project loan preparation follow-up is extensive. I go through
19 some of the phases that they're involved with. Again this
20 is the activism in development that is characteristic of a
21 development bank. They separate again duties of all sorts.

22 Another question, and this really falls into the
23 last one; how do you determine priorities. How are priorities
24 established for industries and among projects? This is a
25 crucial thing. They have limited resources, and I assume that

1 eventually the Alaska Permanent Fund will find that its
2 resources are probably limited relative to the total needs
3 it could be serving. The institutions go through extensive
4 economic analysis themselves. They are a key force in
5 economic analysis for the economies of their countries in
6 which they are investing or loaning money.

7 The DFC's, the case study five, are closely involved
8 with government economic planning in most of the countries.
9 Most have planned economies to a significant extent and they
10 have then priorities established by the government for which
11 sectors are to be emphasized and then later on which projects.
12 The other means of establishing project priorities, particu-
13 larly among projects, if you only have one project it's
14 obviously the highest priority. You must have a variety
15 of projects to look at to be able to rank them in order of
16 priority. The aggressive, the active promotion of projects
17 with extensive participation in their design and implementation
18 is the other source of priorities.

19 How are projects identified? This is a related
20 question. Well, two ways. They're brought to the attention
21 of the institution by the prospective borrowers and they
22 are also brought to the attention of prospective borrowers
23 by the institution itself. So there is a two-way communications
24 flow.

25 Again, these are just three questions that appeared

1 out of the minutes and, if I may, I'd like to stop at this
2 point and entertain any questions that the group may have,
3 and I'd be glad to refer to any section of the report or
4 try to answer any questions related to it.

5 MR. WOHLFORTH: Do you want to lead off, Jim, or
6 do you want to wind up afterward?

7 MR. EDENSO: I'd like to defer to other members of
8 the Committee.

9 MR. WOHLFORTH: Martin.

10 MR. PIHL: I made a note of a couple of question
11 areas. I'm not sure whether you want to answer one of these
12 or whether Ken Butler might, or his group might. One has
13 to do with foreign investment and whether these funds are
14 used to, you might say, control your own destiny, touching
15 on a matter that Bob Thorstenson brought up about foreign
16 investment coming into the country and whether you see in
17 these cases whether there is any play or role in the control
18 of investment, in capital, that is made.

19 MR. McDOWELL: I think if I can respond in two ways --
20 if you look at the flow of capital to developing countries
21 on a world-wide scale, I don't believe that the development
22 banks themselves create new capital. I think they divert
23 capital. The World Bank again being the best example, the
24 World Bank goes to the U. S. capital market or to the URAL
25 currency market, or to the Japanese Financial Market, and it

1 borrows money. I don't think it creates any new capital
2 because it doesn't have the functions of a regular bank in
3 that sense. It takes capital which probably would have gone
4 to an alternative use in the U. S. or Europe or Japan and
5 diverts it through development projects to the developing
6 countries. So they are, in effect, quite instrumental in,
7 as you say, controlling the destiny of what happens in any
8 one of those individual constituent countries.

9 MR. PIHL: In this case we're starting with the
10 capital.

11 MR. McDOWELL: Then you're not even removed. They're
12 removed by one institution from the capital itself. The
13 big institution marshals the capital and then spreads it out
14 through the governments in essence. In the case here you
15 don't need anyone else to marshal the capital for you. You
16 have the resources and you have the credit as a state to do
17 that, and given that, again I don't believe in a world-wide
18 scale they actually create new capital, I think they just
19 divert capital. Perhaps there's an analogy in the Alaska
20 situation. Perhaps you have the opportunity to divert capital
21 into Alaska that may not come here otherwise.

22 MR. PIHL: The second question or area, you mentioned
23 security and growth of the fund. Do the funds try to maintain
24 a growth that's equivalent to a long-term inflation rate,
25 for example, or when you speak of maintaining the integrity

1 of your fund, Two Billion Dollars by 1985, it's got to grow
2 by a certain percentage to remain permanent. Do the funds
3 try to do this?

4 MR. McDOWELL: They try to. They're not all successful.
5 They all make enough money to pay their operating expenses,
6 including the costs of borrowings, and to set aside, in the
7 cases of those that don't have the government guarantees, to
8 set aside reserves for bad debts so that you don't shrink
9 your capital by losing it. They haven't been necessarily
10 completely successful in countering inflation. They do make
11 some contribution toward the erosion of capital by inflation,
12 but in most cases they don't necessarily overcome that com-
13 pletely, and it isn't considered to be one of their over-
14 riding objectives.

15 So they maintain their integrity as best they can.
16 You look at them over a 40 or 50 year period, their capital
17 has been eroded by inflation, you know, there's no two ways
18 about it. But their social purpose -- in other words, the
19 definition of "prudence" only goes to a point and then it
20 becomes more important -- that you're prudent up to a stage,
21 that stage being not to let the capital deteriorate very fast,
22 although it's probably going to a little bit. Then beyond
23 that their objective is to get the money out there, to get
24 as much money out there as they can, at rates that the
25 countries can afford.

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MR. PIHL: Thank you.

MR. WOHLFORTH: Bob Barnes.

MR. BARNES: A brief question on the organization and controls. You went through quite a description of that, and it seems that they're very elaborate, which creates a large bureaucracy, which creates a lot of overhead and makes it uneconomic for the small loans. That's the natural progression?

MR. McDOWELL: Well, it's not necessarily the size of the staffs that makes it uneconomic to do small loans. It's a combination of the operating philosophies, that is to be active in all stages of the project, definition, development and implementation, which runs your operating costs up. The other is the fact that their staffs are very highly qualified and, by virtue of that, to retain them they're well paid. They don't have that many employees per dollar, but they do have high paid employees, and they do spend a lot of man hours on any given project.

MR. REGIS: Peter, is it not also a fact that they're after this role in order to search and ferret out the market opportunities that this becomes a more costly endeavor, if it's to be anything except a passive role?

MR. McDOWELL: It's always a two-way -- projects come both ways, from them out and from others to them, and they prefer to have them coming from both directions. If you look

1 back at the way they operate, if you go back far enough into
2 the origins of the lending program for any particular country,
3 it's probably the majority of the projects probably have come
4 out of their institution rather than the other way around.

5 MR. BARNES: Has there been a problem in any of these
6 organizations with the so-called strong executive concept
7 such as McNamara at this point is too strong to be accountable
8 to anybody?

9 MR. McDOWELL: No, he's accountable because the
10 ultimate power in these institutions is -- because there is
11 some erosion of capital, unavoidably, in the way they
12 operate and the way they're set up, and because a strong
13 chief executive would normally like to see his institution
14 expand profitably, but to see it expand. The member govern-
15 ments can put the check on him, which they've just done, as
16 a matter of fact, by saying, "We won't increase the capital.
17 Your leverage ratio is set, we won't raise that either. We
18 don't think it would be prudent, and you'll be held to your
19 proper size," and this just occurred in the last three months.
20 It was primarily, interestingly enough, the United States
21 Government that took the lead. But again, even we don't have
22 the power by ourselves. We had to persuade a number of
23 other countries to join us on that issue.

24 MR. BARNES: I have one last question but I think
25 it's really on New Mexico and I think maybe the White, Weld
group could answer that. I notice that there are two funds

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1 that are handled within the state treasury operation. Do you
2 know if they have a large staff or if they have a relatively
3 small staff?

4 MR. FURHMANN: They have a very large staff.

5 MR. GALLAGHER: The State Treasurer there is a doddering
6 old man.

7 MR. FUHRMANN: I believe by a very large -- it's
8 like about thirteen hundred people or something, in round
9 numbers, if I'm not mistaken.

10 MR. McDOWELL: This is interesting, I think. Back
11 in Attachment V on DFC's I gave the upper limits of size of
12 the DFC's as a group, and I said they go up to three thousand
13 employees and they go up to Three Billion Dollars in lending.
14 Well, the one with three thousand employees is not the one
15 that lends Three Billion Dollars. So they vary all over
16 the map, but then there are totally different employment
17 objectives in the developing countries than we would even
18 consider reasonable here.

19 MR. FUHRMANN: The Mexican one actually acts in many
20 cases as the finance department for the corporations they're
21 involved with, so they have enormous responsibility to the
22 companies that ultimately get the funds. At the same time,
23 the National Financiera, itself, cannot do anything without
24 going to the Minister of Finance for approval in a sense of
25 its raising its own monies, etc., because they don't want

1 to be competing with the government's financing in the market-
2 place. So they have a cue all the time as to who is going
3 to be raising the money.

4 MR. McDOWELL: Just one more point, Bob. The crucial
5 control is that these institutions are expected to earn a
6 profit. Again, it may not be adequate to offset all infla-
7 tionary impacts, but that chief executive has got to make
8 money, and normally there's a lid on the interest rate they
9 can charge. So his only flexibility is in his operating
10 costs. He's got to manage his organization so that there is
11 a spread adequate to at least pay expenses and to provide
12 a return that is prudent, shall we say; so you do have a
13 control.

14 MR. BUTLER: I'd just like to point out I brought an
15 article on this recently from the Wall Street Journal called
16 "Man with a Mission" and it's about Mr. McNamara and the
17 World Bank, about a week ago, and the recent meeting of the
18 INF in Manila and all. In one little paragraph here, apparently
19 there's some question about whether they are earning a profit
20 or how this is measured. This is a little bit out of context,
21 but it says, "The U. S., Britain, West Germany, Japan and
22 France, the bank's largest shareholders, there's a question
23 of whether or not the McNamara management, preoccupied with
24 pumping out ever larger loans, has paid sufficient attention
25 to the bank's financial soundness. It was this concern that

1 prompted the U. S. to lead a quiet but successful campaign
2 this year for internal changes to slow the pace of lending
3 and insure that the interest rate the bank charges on its
4 loans is higher than its cost of borrowing." I think that's
5 what Peter was alluding to earlier. But obviously some
6 people in the some of the nations with money at stake here
7 are somewhat concerned about the recent trends.

8 MR. McDOWELL: Yes, the shareholders have just made
9 Mr. McNamara accountable in a very direct way. That's
10 probably the best description of it.

11 MR. WOHLFORTH: Representative Gruening.

12 MR. GRUENING: The last time I saw McNamara he was
13 pointing at a map of Vietnam. I have a question on what
14 Bob LeResche raised earlier about whether the source of the
15 funds really was relevant, and I've been thinking on that
16 for the last hour. In the Alaska situation the funds will
17 be the natural resources, and as I understand the World Bank
18 it's borrowed money by and large, and it seems to me that
19 responsibility to the shareholders in the Permanent Fund case
20 is somewhat different in that the shareholders in Alaska would
21 be all of the citizens who have a right to that resource.
22 So I'm wondering whether the political control aspect, does
23 that change your thoughts on the management, how far down
24 policy decisions should go in terms of political control?
25 I mean, if the Legislature is, in fact, and the Governor,

1 ultimate policy makers, would that change your thoughts at
2 all as to how far down in terms of policy? To me it's a
3 fine line, where policy and management breaks off. Would it
4 influence your thinking any as to where that line would be,
5 given the fact -- and I think that the source of income is
6 important.

7 MR. McDOWELL: I think ownership is important.

8 MR. GRUENING: Okay, maybe that's better.

9 MR. McDOWELL: I think that in each of these cases,
10 with the exception of the DFC's -- the DFC's has stockholders
11 more like any corporation does. Unless they're a hundred
12 percent government owned they've got 5, 10, 20 stockholders.
13 They might have the IFC, they might have First National City
14 Bank, each, say, with a seat on the board or the right to a
15 seat on the board. At least they've got some votes as far as
16 their shares are concerned. In the other cases there's not
17 quite the direct analogy. Not only do we have the direct
18 analogy here. The stockholders of the Alaska Permanent
19 Fund, I agree with you, are the citizens of the State of
20 Alaska.

21 Now, just as the World Bank has a board of governors
22 appointed by the stockholders, I would suspect that some device
23 of this kind is going to be necessary because you can't have
24 all 450,000 people on the board of directors. You've got to
25 narrow it down. Now, who do you choose? You, the Legislators

1 and the Governor and some of the other executive officers are
2 elected by the people to represent them in most matters,
3 perhaps including this one. If you do, then you've got a
4 logical structure you can just grab right away at this top
5 policy level. Or perhaps you'd like to spread it out through
6 some other channel and say, "Well, if we get 12 or 15 people
7 who are representative of the population of the state, then
8 they can represent the stockholders, they can be our board
9 of governors," in the analogous situation.

10 MR. GRUENING: Do we need a second board of directors?
11 In other words, the Legislature in itself is a board of
12 directors. But just thinking out loud here, do we need that
13 second peer board? In other words, if I understand you,
14 the Legislature would be involved but through a board, they
15 would have some kind of control over a board.

16 MR. McDOWELL: Through the appointment and perhaps
17 process, but I think that the line stops at who decides
18 whether or not to grant a loan. That process should not be
19 directly impacted by -- I don't believe it should be directly
20 impacted by the stockholders. Again, let me use the general
21 phrase, because I'm not sure which body you will eventually
22 decide to pick to be called the stockholders, or represent
23 the stockholders. You've got to go one more step down, and
24 then that next group should have that power.

25 MR. GRUENING: Just one more question. I was thinking

1 that it appears in the Alberta Fund that the Assembly there
2 has some kind of committee that has something to do with
3 the loans. I don't know whether they actually approve the
4 loans or not, but would it be going too far down to have a
5 system where the Legislature approved loans over a certain
6 amount or certain special loans? For example, we could
7 set goals here, but then you have the problem of which goals
8 over a period of time take priority. I see that five years
9 from now one goal would be more important than another, and
10 the Legislature may disagree with that certain policy and,
11 being elected by the people, may decide, "We want to emphasize
12 this goal." Could you see a situation where the Legislature
13 would say, "Okay, we don't want to see a loan of this amount
14 in this policy area"?

15 MR. McDOWELL: I think you'd be into operations at that
16 point, but if you -- perhaps if you -- you have left the
17 power with the Legislature, in effect, to create and then
18 to change the articles of incorporation. Now, taking just
19 a look at the general statement of purpose for the International
20 Finance Corporation, for example -- no, that's not sufficiently
21 restrictive. Let me pick one that is.

22 The purpose of the Overseas Private Investment
23 Corporation is to encourage economic and social development
24 in approximately 80 lesser developed countries considered
25 friendly to the United States. That's a major restriction on

1 their lending because there are 120 developing countries, and
2 only two-thirds of them are eligible for OPIC financing.
3 Now, that statement was created by the United States Govern-
4 ment, and they can change it tomorrow, and they can change
5 it during the next session if they wish, to include the other
6 40 who aren't friendly or to cut it down to 40 who are the
7 most friendly. Just this one example, that's a tight
8 restriction compared to what most of these institutions have.
9 But, again, it's a direct creature of the United States Govern-
10 ment, and the U. S. Government has the power and the right
11 to set that kind of restriction any time it wants, as the
12 Legislature of the State of Alaska has with the Alaska
13 Permanent Fund.

14 The other problem is because, if you take an opera-
15 tional decision and transfer it up too far, then you cannot
16 hold the management of that institution accountable; you've
17 just destroyed their accountability by assuming it at another
18 level. You know, you can't hold them accountable. I mean,
19 I would assume that if you did create a fairly strong chief
20 executive officer type organization, and he and the board of
21 directors, which is the operating board of directors,
22 which is representative of the various groups, should be
23 representative of the various groups in the state, decide to
24 make a loan and then that's called back at some later date,
25 he would probably resign because you can't hold him accountable

1 for his results anymore.

2 MR. FUHRMANN: Can I comment on Clark's question
3 with respect to Alberta? The Alberta has, if you remember,
4 percentages of their fund that limits the amount that can go
5 into what we have been terming here in the last two meetings
6 as soft loans or loans that don't really have a strong
7 economic return, and that's 20 percent of their fund. That
8 is standing, that rule sticks. That does not mean that 20
9 percent of the funds can be invested in soft loans by the
10 executive committee. The Legislature has to appropriate those
11 funds that go into soft loans. The Legislature can also
12 recommend loans of a more general nature and then the fund
13 will put monies into those loans, so the Legislature does
14 participate as a recommender and a recommender with full
15 authority. Once they recommend, that loan will be made,
16 but it will be structured by the executive committee and the
17 operating people. So they do in Alberta, the Legislature
18 does maintain some participation in how loans get paid.

19 MR. McDOWELL: Which is really -- it's completely
20 similar to the normal governmental budget making and approval
21 process. It's really no different than having in the state
22 the Executive propose a budget to the Legislature, which
23 reviews it, modifies it and eventually approves it. So you
24 haven't really done anything different probably in a like
25 situation.

1 MR. WOHLFORTH: Doctor Logsdon, do you have a question?

2 DR. LOGSDON: Yes, I would like to get something
3 clear here now. Do these development banks borrow private
4 money?

5 MR. McDOWELL: Some do, yes.

6 DR. LOGSDON: Do they participate in equity?

7 MR. McDOWELL: In the case studies here, the Inter-
8 National Finance Corporation does, and normally, depending
9 on what they're supposed to do with the developing finance
10 companies, some of them will participate in equity. There's
11 no universal rule.

12 DR. LOGSDON: I wondered about this term, Development
13 Banking. I see an ad for a commercial bank that says, "We
14 are a Development Bank."

15 MR. McDOWELL: That's interesting.

16 DR. LOGSDON: What do you think they're saying? Are
17 they trying to identify those features of the Development
18 Bank?

19 MR. McDOWELL: I suspect not. I suspect they have
20 another concept of the term "development". I don't know;
21 is that your bank?

22 MR. BARNS: Yes. I don't suppose it's illegal, is it?

23 DR. LOGSDON: Well, I have an ad that I copied out
24 of a magazine that talks about, "We are Development Bankers,"
25 and they do participate in equity and take a very active part,

1 apparently, in the companies in which they invest.

2 MR. BARNES: This is not a United States Commercial
3 Bank?

4 DR. LOGSDON: It's a United States Bank.

5 MR. BARNES: It would have to be a private bank then.

6 DR. LOGSDON: And apparently a private bank.

7 MR. REGIS: Peter, the one bank in which equity
8 participates, that is as a vehicle for loans primarily is
9 it not?

10 MR. McDOWELL: Yes, the IFC's -- well, let me just
11 give you the numbers. Last fiscal year they made 225 Million
12 Dollars in loan commitments and equity financing of 20 Million
13 Dollars. So the one that does equity, it's still ten to one
14 on loans over equity.

15 DR. LOGSDON: We haven't heard anything about the North
16 Dakota Bank. Is there any relationship here between the North
17 Dakota Bank and this Permanent Fund?

18 MR. MOTLEY: North Dakota is no state bank.

19 DR. LOGSDON: Yeah, it's a state bank.

20 MR. GALLAGHER: It's the general fund of the state
21 treasury. It's a liquidity portion of the general fund and,
22 you know, they operate on liquidity purposes.

23 MR. LOVE: They make regular commercial loans though.

24 MR. GALLAGHER: Yes, but they're all federally
25 guaranteed and they're sellable, and that's a big difference.

1 MR. LOVE: It has a high rate of return, it's higher
2 than the top one hundred banks -- a higher rate of equity
3 last year, I think, than the one hundred largest banks in
4 the country.

5 MR. McDOWELL: There's no provision for loan processes.

6 MR. GALLAGHER: It's all demand deposits, that's one
7 of the reasons, and the demand deposit is the State General
8 Fund.

9 MR. LOVE: It's also very -- you know, we talked about
10 the employee thing, and I think it employs less than 90 people.
11 It's small in employees. It's a relatively popular proposal
12 in the bank, even among their really conservative Republican
13 dominants, who control the state.

14 MR. ODEN: Excuse me. I might add that we've been
15 in touch with the bank and they're sending a whole packet
16 of information, and you should have a summary sheet similar to
17 those you have within two weeks.

18 MR. WOHLFORTH: Dennis, you're next.

19 MR. WALDOCK: Yes, Mr. Chairman. First off I would
20 like to state that as soon as we all have finished asking the
21 questions of these various financial consultants that we
22 have here today, I have four questions that I would like to
23 direct to the Investment Advisory Committee itself. But
24 in regard to my question to whatever group would like to
25 respond to it, since you both have been involved with the

1 structure of a lot of the development corporations that you
2 have in your pamphlets that you gave us, and given Alaska
3 with its small population and great infusion of money,
4 projected possibly to be Two and a Half Billion Dollars by
5 1985 -- in other countries which had that large influx of
6 money with a small populace like we have, has there been any
7 cases where you've thrown into disarray the banking systems,
8 the regular, ordinary banking systems of those countries?
9 Let me go a little bit further. What I'm trying to say is,
10 let's assume, for example, the Permanent Fund Executive Branch
11 elected to get into mortgage loans -- well, this would throw
12 the rest of the banking systems into total chaos.

13 MR. LOVE: That's not necessarily true.

14 MR. GALLAGHER: We're already in the mortgage loan
15 business.

16 MR. WALDOCK: You are to a certain extent.

17 MR. LOVE: We already own forty percent of the market.

18 MR. WALDOCK: But you're trying to tell me that you
19 can take Two and a Half Billion Dollars and put it into
20 mortgage loans in Alaska?

21 MR. WOHLFORTH: The question is really, is there an
22 example throughout the world where a huge infusion of money
23 (maybe it's the Saudi countries) has disrupted the banking
24 system, and do any of the advisors have anything they would
25 like to put to that.

1 MR. FUHRMANN: The answer with respect to both Middle
2 East and Venezuela, which are really the areas that are most
3 similar to what you're talking about, is that they had among
4 their objectives and purposes initially getting the money out,
5 and they have invested in external investments, money market
6 instruments, government borrowings, they've put money into
7 the World Bank, or into subsidiary banks of the World Bank,
8 things like this. They've taken the money out of their
9 own economy to avoid that conflict, as well as the resulting
10 inflationary impact if they had allowed that money to go
11 into their own economy.

12 MR. MOTLEY: So they upset somebody else's apple cart?

13 MR. FUHRMANN: Yeah, right, or made it available in
14 places where the apple cart -- there's nobody there.

15 MR. ODEN: In addition, in New Mexico there is a
16 severance and a Severance Tax Permanent Fund. Investments
17 of that fund are in CD's of state banks. So rather than harm
18 the state banks, it's really been a great advantage to the
19 state banks to have a ready market for their CD's, and as the
20 CD market can approve of a loan at the going rate for CD's
21 now anyway.

22 MR. WALDOCK: What is the length to share those CD's?

23 MR. ODEN: They vary from one to five years. With
24 those monies the banks turn around and make loans on capital
25 projects. They do all the research and they do all the

1 evaluation on the validity of the loans rather than being
2 done by the state.

3 MR. WALDOCK: Well, with a five-year limit there, it
4 really isn't restricted to short term loans.

5 MR. ODEN: Yes, it is to a large extent. Those can't
6 be rolled over.

7 MR. FUHRMANN: The purpose of almost all these funds,
8 in one way or another, is to help build capital formation
9 internally and make private financing available. This often
10 is the reason why they get into equity, is to provide the
11 credit upon which the entity can finance itself, leverage
12 itself off the equity or anything, in the case of encouraging
13 other institutional investment through participation loans
14 only, or buying the CD's of the banks, of the private -- you
15 know, you can make the funding available -- all these concepts.

16 MR. GALLAGHER: Mr. Waldock.

17 MR. WALDOCK: Yes.

18 MR. GALLAGHER: I believe at the last meeting I spoke
19 to that very question, and I said if you go back and look
20 at the deposit structure of the State of Alaska in comparison
21 with other states in the Union, you would find that we resemble
22 the deposit structure of more rural states in that we have
23 high demand deposits and low in savings deposits. If you
24 orient the Permanent Fund toward long-term investments, i.e.,
25 those longer than five years, then you're not competing with

1 the commercial banking system. The commercial banking system
2 here in the state doesn't put all those mortgage loans on the
3 books. In fact, they sell them to Fannie Mae and several of
4 the state agencies. We would not, in fact -- even if you go
5 into the mortgage loan business you're not competing with the
6 commercial banking system, especially if they're the ones
7 that make the loans.

8 MR. MOTLEY: Providing an outlet for them.

9 MR. GALLAGHER: Yes.

10 MR. WALDOCK: Sterling and Tony, mortgages was a quick
11 example and it was a poor example, but the point I'm concerned
12 about is that the terrific influx in money could, if not con-
13 trolled properly, throw the whole banking society off kilter,
14 and I was curious to see if that had taken place any other
15 place with this large infusion of money with the low amount of
16 populace that we have. That was basically the question.

17 MR. GALLAGHER: There's probably adequate funds for
18 the short term lending. Commercial banks are oriented
19 toward short term lending with the shortness of money. And
20 this state is not in the short term market, but it's in
21 the long term market. So if we orient ourselves in that
22 manner we're not going to be disruptive at all. We'll be,
23 in fact, supplementing.

24 MR. WOHLFORTH: Do you have another questions?

25 MR. WALDOCK: No. Well, I have four other questions,

1 but I would like to wait until after the rest of the Committee
2 members have finished speaking to the consultants.

3 MR. WOHLFORTH: Representative Malone.

4 MR. MALONE: Thank you, Mr. Chairman. Mr. McDowell,
5 one thing you mentioned in discussion of the World Bank, I
6 believe, was that you didn't really believe it was in the
7 process of diverting capital. Will you describe that process
8 to the Committee and whether that might hold any implications
9 for the Permanent Fund?

10 MR. McDOWELL: We were saying from a world-wide
11 standpoint such institutions, I think, do divert capital
12 because they take capital out of developed country capital
13 markets which again probably would have been loaned to some-
14 one else if it hadn't been loaned to the World Bank, and
15 channel it into specific projects in specific developing
16 countries. Maybe there's an analogy here. Back to your
17 question, the one country that I am familiar with that's got
18 a similar situation was Kuwait. What happened in Kuwait was
19 that they filled up their commercial banking coffers with
20 kind of a wash in cash, everything else just flowed right
21 out into the international financial markets in other countries.
22 In effect, it was just passed out of their banks into other
23 banks and invested in securities elsewhere in the world.

24 Let's say that could happen here and probably will
25 happen here in the early stages at least. The revenues to the

1 Permanent Fund will probably flow through the treasury out
2 into the capital markets of the United States initially, I
3 would guess, although some of it would stop over in banks
4 in the states and create mendable assets, but most of it will
5 probably flow right on out there. So you won't see a terrific
6 disruption of your banking system before it's had a chance
7 to grow a little bit more and to absorb some more of this.

8 Then, if that's all you do with it, then that capital
9 will be out there, it will be earning a certain return for the
10 State of Alaska, but it probably will be loaned then to some
11 other project. It may be loaned to U. S. Steel for expansion
12 in Pennsylvania, it may be loaned in the European market for
13 expansion in Europe, or Africa or somewhere else. If you
14 create an institution that can call those funds then back
15 to you at a later time, channel them into the Alaskan economy,
16 then you in effect have gained a measure of control over your
17 own destiny, and you've been able to divert a capital flow
18 that may have gone somewhere else instead. But I think
19 without an institution for diversion or without some rules
20 for diversion, in effect, goals for diversion let's say, it
21 probably won't occur.

22 MR. GALLAGHER: Mr. McDowell, maybe you're not familiar
23 with the assets in the State Treasury. There is what you
24 might almost call a Permanent Fund already in the State
25 Treasury, and it's Two Hundred Million Dollars and growing.

1 You know, it could be a goal of the Permanent Fund to return
2 the General Fund, which is the State's operating column,
3 back to its original purpose and not leave that Permanent
4 Fund in there.

5 MR. WOHLFORTH: Mr. LeReche.

6 MR. LERECHE: You've been really helpful to me in
7 kind of helping us, helping me at least, think about where
8 the line between policy control and operational control is,
9 but I'm still not clear and, obviously, you can't be clear
10 today. But let me ask you a couple more questions that,
11 hopefully, will illuminate this a little bit more. The
12 institutions you described have two measures of success (this
13 I gathered implicitly in what you said) credit worthiness and
14 project viability. Does that pretty much summarize the
15 measures that you're using to tell us those are successful
16 institutions?

17 MR. McDOWELL: No, those are really for the projects
18 and the countries that they lend money to. For the institution
19 itself their measures of success are continuation; in other
20 words, just survival. Do they survive intact as financial
21 entities? In other words, are they permanent or continuing?
22 That's partly measured by whether they make a profit every
23 year. So they're very much like any other commercial insti-
24 tution, you know, there's a bottom line. It's a number, and
25 that's one of the measures of their success. The other measure

1 of their success is the changes in the countries that they
2 deal with. Does per capita income go up? Does income
3 distribution improve? In other words, within a given country
4 is the quality of life for the people of that country better?

5 MR. LeRESCHÉ: It's measured on achieving their other
6 objectives also.

7 MR. McDOWELL: Essentially, and those are the more
8 important objectives. The bottom line, you know, on the
9 income statement is just the one that measures whether or not
10 they're achieving prudence. That's just one of their objec-
11 tives; they have to be prudent.

12 MR. LeRESCHÉ: It was hard for me to hear in your
13 statement.

14 MR. McDOWELL: Yes. The other is, again, in these
15 general statements of purpose you read these more qualitative
16 goals. But they do their best to measure whether they're
17 achieving these qualitative goals, and those are some of
18 the measures which they use.

19 MR. LeRESCHÉ: I think your strong message was that
20 these have been successful institutions because of their
21 executive autonomy of the operation or operations. Tell us
22 a little bit more about why you assume that? Did you take some
23 examples that didn't have autonomous operation or was this,
24 in effect, because of that?

25 MR. McDOWELL: Some of the banks in the countries

1 themselves, the DFC's, the National Development Banks, have
2 failed, gone out of existence, and they haven't done even
3 the basic thing, that that is to survive. In most instances
4 when you read reports of why it happened or what happened,
5 they were susceptible to the pressures from the fact that
6 their major or only stockholders was the government of the
7 country, and the government of the country imposed restric-
8 tions on them or pushed them in different directions that
9 they just couldn't survive economically on. So, generally
10 speaking, that's what happens.

11 Some go down because of poor management, no question
12 about it. Some are poorly managed and they just collapse
13 because they made bad loans and the government didn't do a
14 thing, they were left completely alone. But in many of the
15 instances the fact was that this inevitable pressure became
16 interference in the day-to-day operating procedures.

17 MR. LeRESCHÉ: So the line of policy interference
18 was drawn a little too high or too low?

19 MR. McDOWELL: Too low, yes.

20 MR. LeRESCHÉ: I'm just trying to understand exactly
21 where you would want it drawn. You said that it's proper to
22 lay out the objectives of the Fund or the institution in
23 the charter. Then you said the charters of most of these
24 are very general, one or two sentences.

25 MR. McDOWELL: Well, or maybe several paragraphs,

1 but they're still general wording. The wording is still
2 general.

3 MR. LeRESCHÉ: But also in the case, I think, of
4 the World Bank you said the leverage ratio was set by
5 limitation on interest or ---

6 MR. McDOWELL: It's right in the articles.

7 MR. LeRESCHÉ: That seems fairly specific as opposed
8 to general. Isn't that an operational control?

9 MR. McDOWELL: Not really. It's a description of the
10 size of the institution. The stockholders in effect stated
11 that they did not want the institution to exceed a certain
12 size without calling for a new vote to subscribe more capital.
13 I should point out that the stockholders of the World Bank
14 and the other institutions can increase the size of their
15 institution not by -- well, they can do it by changing the
16 leverage ratio, but it's quite difficult to change the
17 articles of incorporation even though it can be done.
18 In these cases it requires a significant vote, which is not
19 the situation here. But they can accept or reject management's
20 requests for an increase in capital. The World Bank can
21 leverage it at, is it nine to one, whatever capital they've
22 got.

23 MR. REGIS: It's not interference in the management
24 prerogative.

25 MR. McDOWELL: It just says you have so many funds to

1 work with.

2 MR. LeRESCHÉ: Okay, one step further then. The
3 Alberta Fund goes one step further. It sets proportions of
4 loans that can be made for various purposes. In this con-
5 text, if we were proposing to you the Alberta setup and asking
6 you, as our consultant, if that was a good one or a bad one
7 because of executive autonomy, what would your evaluation be?
8 Would you recommend our getting into something that specific?

9 MR. McDOWELL: Let me just answer -- I'm not trying
10 to avoid the question -- if you decide that the objectives
11 of the Development Fund shall be several: that is, it would be
12 perhaps a "Development Bank" similar to these, and it will
13 also, let's say, get involved in very small loan programs,
14 which you can do this, you know. I'm saying that the other
15 institutions don't because they've found it's not really
16 economic, but you can certainly possibly do it -- and it
17 shall be involved in "social programs" where the interest
18 rate can be zero or slightly over, then sure, you might
19 as well strike the percentages because you've got three quite
20 different programs. If you make the thing just one program,
21 then I would say no, you're hamstringing management and the
22 board's ability out in the future to adapt to the changing
23 conditions of the state.

24 MR. LeRESCHÉ: Okay, but a strong executive officer
25 working under the Alberta rules would still feel accountable.

1 MR. FUHRMANN: He doesn't feel accountable with respect
2 to the loans that are in the soft category because it's been
3 removed from the fund by being put on the Legislature. He is
4 accountable with respect to those things he does have
5 authority over. So they have maintained the autonomy within
6 the normal business environment with respect to soft loans
7 but the responsibility really rests back with the Legislature.

8 MR. McDOWELL: Where it normally is in a government
9 program anyway. So you're almost saying perhaps that in the
10 State of Alaska we have a variety of governmental institutions
11 and programs doing a lot of things in the social intra-structure
12 areas. I'm not sure that I would say -- I mean, I wouldn't
13 say that it was necessarily advisable to create another
14 institution to do the same thing. I think what you have is
15 an opportunity to create an institution that's going to do
16 something else that you're not doing already. I think Alberta
17 has, in effect, taken (I don't know what the percentage is
18 but) 20 percent of their "Permanent Fund" and it's not part
19 of their Permanent Fund. It's just part of their regular
20 government programs. It's subject to the same processes as
21 their normal budget requires. So I don't think they've done
22 anything different with that section, that soft loan section.

23 MR. LeRESCHÉ: Just a final comment. I guess what's
24 concerning me is who controls the secondary effects, the
25 good income producing it has? Will the executive officer

1 have to choose between two or three of these things, all
2 things being equal, but this will have different effects on
3 different parts of our state's economy. Who controls that
4 and I assume you're arguing that the executive officer
5 controls it himself.

6 MR. McDOWELL: Well, the board does.

7 MR. LERESCHE: The second board?

8 MR. McDOWELL: The operating board.

9 MR. LERESCHE: Thank you.

10 MR. WOHLFORTH: I wonder if we might take about a
11 two-minute at ease. We've been sitting here for two hours
12 and twenty minutes, and then resume. Let's keep it short.

13 (Whereupon the meeting recessed at 3:50 p.m.
14 and reconvened at 4:05 p.m.)

15 MR. WOHLFORTH: Please take your seats and we'll
16 resume. Unless there is a serious objection I propose another
17 fifteen minutes of questions for the consultants and then,
18 since we are running out of time on the agenda, try and wind
19 up by between a quarter of 5:00 and 5:00 o'clock in terms of
20 general discussion of where we do we go from here. I realize
21 that cuts short. Who was the questioner? Were you through,
22 Bob? Okay.

23 MR. MOTLEY: Mr. Chairman. I would like to address
24 the remarks you made with regard to guarantees. Have you seen
25 any quality of the investment of the loans, a difference in

1 programs that had guarantees as opposed to programs that had
2 direct loans?

3 MR. McDOWELL: Guarantees depending on the sense that
4 the agency or the institution is acting as the guarantor for
5 them, not that it gets somebody else to guarantee them?

6 MR. MOTLEY: No, that it acts as a guarantor.

7 MR. McDOWELL: Yeah, the one case of that -- well,
8 where they actually do it is OPIC, and their loan guarantees
9 far exceed their actual loans. Their experience on the pro-
10 jects is that they tend to be slightly less involved with the
11 development of the project when they're doing a guarantee
12 operation than they do when they're making a direct loan.

13 MR. MOTLEY: What about the profit between the two
14 as far as the of the quality of investments go?

15 MR. McDOWELL: Well, their losses don't seem to be --
16 from what I understand their losses don't seem to vary that
17 much between the two. They do have losses. They do lose
18 money on the loans, they've got work-out projects, and they're
19 doing work-outs all the time on losers because they do get
20 into very, very high risk areas by design. But nothing was
21 indicated to me that they found the experience to be sub-
22 stantially different. This is more the nature of the businesses
23 they're investing in that causes the losses, whether they're
24 guaranteeing the loans or not because they do almost the same
25 amount of preliminary work prior to giving a guarantee as

1 they do if they give a direct loan. It's just a difference
2 in scale. Their guarantees they use for projects that are
3 for the larger amount involved. They save their limited
4 amount of loan capital for small loans. But again, they're
5 heavily involved in each kind.

6 MR. MOTLEY: Thank you, Mr. Chairman.

7 MR. WOHLFORTH: Representative Urion.

8 MR. URION: I'll pass, Mr. Chairman.

9 MR. THORSTENSON: Bob Thorstenson. Pete, do you
10 anticipate a DFC type of an institution involved with the
11 Permanent Fund in Alaska?

12 MR. McDOWELL: Well, I've been asking some questions
13 about whether there -- at the last meeting there was quite
14 a bit of discussion about what do we do when we need small
15 loans. Does an institution created by the Permanent Fund
16 make them or does someone else make them? It looked to me
17 like the Permanent Fund will have a lot of money, it will be
18 relatively large and, therefore, it will probably not be
19 too well equipped to deal in the very small areas. I was
20 trying to draw the analogy to the development banks we've
21 discussed in here, most of which finance intermediaries.
22 It appears that there are two sets of intermediaries already
23 in existence in this state, i.e., the Native Regional Corpora-
24 tions as a potential level of intermediary, and the Local
25 Development Corporations as another level of this organization.

1 and the commercial banks, not to exclude them, which are
2 already set up, perhaps to deal in smaller loans using funds
3 that they may be loaned in turn from this institution.
4 So I can see the parallels, and you may very well want a two
5 tier system in the state in the future.

6 MR. WOHLFORTH: Thank you. Any questions?

7 MS. FLEISCHER: I don't have any questions.

8 MR. WOHLFORTH: Mr. Love.

9 MR. LOVE: Peter, as I understand a lot of these
10 development banks we're talking about, one of the reasons
11 for them is to help under developed capital formations,
12 divert monies from markets where capital is more readily
13 available to areas where it's not easily obtainable, from
14 the various industrial nations, etc. I'm wondering, you know,
15 just how applicable that is to the State of Alaska which seems
16 to have a radically different situation. Instead of a country
17 that has to divert capital from other markets because we're a
18 capital poor area, we seem to be an area where there is not
19 really a shortage of capital and, in fact, we have dangers
20 (like Mr. Richards talked about), a problem of how much capital
21 we can absorb. Do you see that as something that should make
22 us think very carefully about whether or not a development
23 bank approach, as you've described it and used the World Bank
24 and these other things for that, per se, is that the best
25 vehicle for us in the investment of the Permanent Fund?

1 MR. McDOWELL: I think I would like to ask the people
2 from White, Weld to come in also, but I'll just lead off. I
3 think, yes, there are a number of differences between the
4 situation in Alaska and the situation in most developing
5 countries. The opportunity probably exists in Alaska to use
6 "development money" not to try to have to raise the level of
7 literacy and the level of the income of the individual citizens
8 of the state from zero or almost zero up to some acceptable
9 level where you avoid starvation, etc. Those problems really
10 don't exist, at least in the same magnitude, as they do in
11 the developing countries.

12 But the other issues that are addressed by the develop-
13 ment banks include such things as the -- investment decisions
14 aren't made on economics alone, they're made on income distri-
15 bution effects, they're made on employment effects, they're
16 made on environmental considerations, health considerations
17 and social considerations, plus the economics of the situation,
18 the project situation. So, perhaps even though those are
19 relatively less important when what you're really trying to
20 do is create a way for people to get enough to eat.

21 I don't think the models -- you know, they vary
22 wildly -- I think you could adapt it to the Alaska situation
23 with some significant structural emphasis differences.

24 MR. LOVE: I'm not saying that I think that's a bad
25 idea. I'm just -- I think that was an obvious thing to talk

1 about since the ones you described seemed to be, from a
2 logical situation, pertinent. Do you think if we identify
3 goals as addressing the issues like employment problems,
4 distribution of wealth, and other social considerations,
5 the one vehicle we can do that is through the development
6 bank? Do you think in Alaska, with our present situation,
7 this might be a real good way to address those?

8 MR. McDOWELL: Yes, they could certainly be required
9 as conditions for consideration of a project, to at least
10 say these things should and will be considered.

11 MR. LOVE: And these are common objectives in those
12 areas where they do this development bank, is that right?

13 MR. McDOWELL: You've got different layers of developing
14 countries, some are quite developed and still get this money
15 and develop these projects. You'll see, for example, that
16 in the analysis of a project in Singapore, which still gets
17 a couple of these loans, one or two of these loans a year,
18 environmental considerations are very important compared to,
19 for example, a very poor country in Africa.

20 MR. LOVE: I think it's good to hear this because I
21 think there are so many misconceptions of just why people
22 got this, what the term "development bank" means. I think
23 that the things you described are the exact opposite of
24 objectives that some people might attach to it, but they might
25 seem frequently at odds with those; the idea that those two

1 can work together is something that the public probably needs
2 to think about more.

3 The other is the -- well, first of all, you said that
4 these types of -- you mentioned before that in some of these
5 countries that these are the real important objectives of
6 capital that have to be measured not just in terms of whether
7 the loans are being paid back at a good rate of return or
8 not, or whether or not in addition to being paid back that
9 they positively affect things like the standard of living,
10 quality of life, literacy and things like this. I wondered
11 if your firm can provide us, or I guess it's staff members,
12 can provide us with some of the mechanisms by which these
13 objectives are evaluated, whether they succeed or not, because
14 I think that's something that very soon we're going to have
15 to start developing is, what are the mechanisms for evaluating
16 whether or not the loan programs that the state enters into
17 are actually achieving the specific objectives being outlined.
18 Now, the other thing is -- well, first, do you think that's
19 something that your firm will be able to provide us with?

20 MR. McDOWELL: There's examples of the reporting of
21 the accomplishment toward this sort of objective in the
22 annual reports of the institutions. Sure, they have their
23 income statements, but mainly what they're doing is addressing
24 what effect they've had on the countries and these other
25 areas of concern. So those are examples of the public

1 reporting of it. In other words, they know that they must
2 report to their public, not only that they made, you know,
3 Ten Cents a share or whatever it was, but they also have to
4 report what was the measurable progress (if you can measure
5 it) toward the other more social type objectives.

6 MR. LOVE: You see, I'm just saying that when we talk
7 about this it's going to be, I think, better for us as we
8 can start to develop if we can see conceptional models
9 (cookbooks maybe) as to how we can actually compute these,
0 you know, easier ways of evaluating loans prior to when they're
11 made as to what the objectives might be, or evaluate them after
12 a period of time. I know that we're starting from ground zero
13 right now, or from scratch, and I haven't been able to get
14 a handle on how that process can be taking place. So if you
15 have any more information about that, I think it would be
16 very helpful.

17 MR. REGIS: I think we can. I don't see any reason
18 why we can't develop more detailed information in that area.

19 MR. McDOWELL: No, that's no problem.

20 MR. LOVE: That concludes my questions.

21 MR. WOHLFORTH: Thank you. I just have one comment.
22 There is quite an abundance of literature on the subject
23 matter. The Brookings Institute did about three or four
24 years ago an exhaustive study on the World Bank, and I would
25 hope that we might have at least a beginning bibliography

1 available. It seems to me it's going to be necessary for the
2 Legislative Committee that considers what we're doing here,
3 hopefully, to acquaint themselves with the published material,
4 and I would hope that one of the consultant groups would take
5 that task in hand and give us a bibliography early so that
6 we can begin to see to what extent the sources are available
7 here in Alaska where we have (I'm embarrassed to say) an
8 extremely poor library system for anything in the nature of
9 business materials or stuff of this kind. It seems to me
10 while there are a few months left before the Legislature
11 attacks this, it would be well to start getting material here
12 in some supply. Anything else on this side of the table,
13 any questions?

14 MR. LOVE: I'd just like to suggest that maybe in
15 some of these larger studies that they could be made available
16 in Jim Rhodes' office, who has an office here in Anchorage
17 and does work with this Investment Advisory Committee, then
18 maybe members of the Committee could make use of the material
19 that way instead of having to distribute a lot of stuff to
20 everyone.

21 MR. WOHLFORTH: We're more or less through with the
22 direct questions of the consultants and we'll simply open
23 it up for general comments and discussion, as the agenda
24 indicates it's time for new business, and we'll go around
25 the table starting on this side again. I think you're up.

1 Any observations on the meeting today or any insights that
2 you would like to share with us?

3 MR. MALONE: Insights? No. Thank you, Mr. Chairman,
4 I don't have any general comments right now. I am concerned
5 about what the future course of the Committee would be, but
6 would be glad to listen to the insights others may have.

7 MR. WOHLFORTH: Dennis.

8 MR. WALDOCK: Mr. Chairman, I indicated earlier I have
9 four particular questions I'd like to direct to the Committee,
10 and that is in regards to the course of where we're going,
11 and I'd like to start off with the first question. It's
12 mainly because of myself and a few of the other Committee
13 members who have noticed, for example, all these new financial
14 consultants that we've got here for the Permanent Fund, i.e.,
15 the Arthur D. Little, Price Waterhouse, White, Weld., etc.,
16 I've been wondering exactly what kind of criteria was used
17 for the selection of these financial consultants.

18 MR. WOHLFORTH: I guess that would be a question of
19 the Commissioner's Deputy in terms of the process that they
20 went through in the selection, if they care to respond.

21 MR. GALLAGHER: I point out that only two are under
22 contract at the present time, Arthur D. Little being the one
23 that isn't under contract. The process that we went through
24 was to search out with the Legislative branch who were some
25 of the people who were knowledgeable in the areas, and several

1 names were brought forward. We called from that list and
2 talked to several different groups, ones that we thought
3 appeared to have the most to bear on the subject.

4 MR. WALDOCK: The second question I'd like to address
5 to the Committee ---

6 MR. MOTLEY: Dennis, could I just amplify? I think
7 he's brought up a very good point, Sterling, and I think it's
8 something, maybe for the edification of some of the newer
9 members. This Investment Advisory Committee, as an entity
10 of the state, is subject to the procurement and purchasing
11 rules and laws of the state, and I think we have to keep that
12 in mind as we go down the pike because it could conceivably
13 put Mr. Malone in a rather interesting position of Legislative
14 Budget and Audit hat on one hand and a Member of the Committee
15 on the other hand, and I say that with tongue in cheek but
16 you know what I'm talking about. We are subject to certain
17 procurement purchasing requirements.

18 MR. WALDOCK: The second question that I'd like to
19 bring up is, what are exactly the fees paid to these various
20 consultants and what is the length of their contract.

21 MR. EDENSO: I think I can respond to that. The terms
22 of the contract are general, they are intended to expire at
23 the presentation or the completion of our task, which one of
24 them, and I think Mr. Rhode and I both agree on, is to have
25 the Committee itself return to its original condition after

1 we have responded or prepared some product or some output for
2 the 1977 Legislature. Whether that be in the form of recom-
3 mendations for content of a statute or whether that be a
4 statute I'm not sure, but we anticipate completing the closed
5 contracts sometime in January of 1977.

6 MR. WOHLFORTH: Jim.

7 MR. RHODE: Mr. Waldock, in fact, I believe all the
8 contracts are identical in that they expire with the convening
9 of the Tenth Alaska Legislature, and generally the compensation
10 is based at their customary fees with a ceiling not to exceed.

11 MR. WALDOCK: Which is?

12 MR. RHODE: Well, it depends on the contract. For
13 example, White, Weld's is set at the amount of Twenty Thousand
14 Dollars ceiling for their professional time, and allowances
15 have been put aside for expenses. It's customary in all
16 consulting work of the State of Alaska to pay actual expenses
17 in addition to professional time, and we've estimated those
18 as best we can.

19 In part, I prepared some estimates based on the con-
20 sulting work that was done in connection with the Alaska
21 Power Study, which was my own experience, but Mr. Edenso had
22 other studies from which to make further estimates.

23 MR. EDENSO: In answer to how much they're costing,
24 the Legislature passed an appropriation of \$185,000 during
25 the last session, and in a fit of conservatism and desiring

1 to save some money for the state, the Governor slashed that to
2 \$135,000. I would commend the Governor for his philosophy.
3 The Governor really had no idea what the magnitude of this
4 project was and what the related costs were, especially in
5 developing the kind of data base that is necessary to proceed
6 with developing the establishment of a Permanent Fund or the
7 effort it would take to gather all this data.

8 However, getting down to the actual costs, we have on
9 contract Mr. Bob Richards from the Alaska Pacific Bank.
10 His contractual services are a ceiling of \$15,000, not to
11 exceed that. We have budgeted for him for travel and expense
12 purposes \$2,000. His total then is \$17,000 that he is limited
13 to.

14 The other contractors are White, Weld and Company,
15 Incorporated of New York. Their contractual service fee is
16 \$20,000 (that's the ceiling), travel and expenses, since
17 they are from New York, since they have been visiting with
18 other funds and are anticipated to continue those visitations,
19 it's \$10,000, for a total of contractual services plus expenses
20 of \$30,000.

21 We have on contract, but we have not utilized, Pro-
22 fessor Edward Solomon from Stanford University, contractual
23 services of \$5,000, travel and expenses of \$2,500, for a total
24 of \$7,500.

25 We have an unsigned contract, but an agreement should

1 we wish the information, of Dr. Richard Neve from the
2 University of Alaska in Seward, to provide us specific informa-
3 tion on fisheries and fisheries related subjects. We have
4 budgeted for this contract \$5,000 and travel and expenses
5 \$1,000, for a total of \$6,000.

6 We have budgeted for the Legislators involved with
7 the Permanent Fund and for their discretionary use a total
8 of \$30,000. We have budgeted for legal research purposes
9 \$5,000. We have budgeted for travel contractual services
10 for the State Investment Advisory Committee \$3,000 in
11 contractual services, an additional travel and expenses of
12 \$5,000, for a total of \$8,000.

13 MR. WALDOCK: I didn't get the figures on Price
14 Waterhouse.

15 MR. EDENSO: Price Waterhouse, excuse me, they were
16 not on my list. Price Waterhouse has the identical features
17 to the consultants White, Weld and Company, Incorporated.
18 They are contractual services not to exceed \$20,000, travel
19 and expenses not to exceed \$10,000.

20 We have a contingency fund of \$16,500. We had pro-
21 grammed, prior to our full realization of what the costs
22 would be for the information we were asking from Arthur D.
23 Little, we had programed \$10,000, for the travel and expenses
24 budget not to exceed \$5,000. However, I should point out
25 to you that the information we are asking from Arthur D. Little

1 is very complex and very difficult to gather. It requires some
2 very talented people in the area of the national economy,
3 interpretation of that with the state economy, and some
4 econometric modeling, not techniques but the results of a
5 developed econometric model. We have not signed this contract
6 yet. We're currently contemplating asking for a supplemental
7 appropriation to allow us to proceed with this.

8 I think that generally gives us a total of \$135,000.
9 Contractual services total amount, \$109,500, travel and
10 expenses is \$25,500.

11 I left out one other contractor. He has not signed
12 but I've got his contract here, and that's Mr. Bill Batko.
13 He would come under the budget item of State Investment
14 Advisory Committee. Mr. Batko was recommended to us by Mr.
15 Love. His contract -- I am not familiar with the exact
16 dollar number, but his total contractual services is \$500 and
17 his travel and expenses we have budgeted for \$1,500.

18 MR. WALDOCK: My next question is something that's
19 concerned me here. After taking the time to consult with
20 attorneys on the exact responsibilities of the Investment
21 Advisory Committee, my question stems as such. Since it is
22 one of the responsibilities of the Investment Advisory
23 Committee to advise the Commissioner of Revenue and the State
24 of Alaska on their selections of financial consultants, and
25 since these financial consultants primarily for the help

1 on the Permanent Fund have already been selected, can it be
2 assumed that the Investment Advisory Committee is not going
3 to be held responsible for any incorrect advice given by
4 these consultants.

5 MR. WOHLFORTH: I would say yes, it can be assumed.
6 That's my answer, for what it's worth.

7 MR. GALLAGHER: It was an executive prerogative.

8 MR. EDENSO: For the information of the Committee,
9 I'd like to attempt to respond to that. Alaska Statutes
10 Chapter 37.10.070 Paragraph F, "The investment policy shall be
11 formulated by the Commissioner of Revenue, who shall be
12 advised by a committee appointed by the Governor but shall
13 contain representation from the Legislature. In formulating
14 investment policy they shall consider maximum income and
15 safety as governed by the prudent man rule and the benefit
16 to the private and public sectors of the economy in terms of
17 increased housing and commercial credit, stimulated business
18 activity, increased employment, support of the market for
19 state and local bonds, increased public revenue, together
20 with the possible inflationary effect of the investment and
21 (h) and (i) of this section. The Commissioner of Revenue,
22 with the consent of the Committee, may enter into contracts
23 for services providing investment advice, custody of securities
24 and execution of transactions in or out of Alaska."

25 MR. WOHLFORTH: Is there any more?

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MR. EDENSO: That pretty much spells out what the previous role of the Investment Advisory Committee was. However, in the expansion of the Committee to undertake the task of establishing the Permanent Fund, the Governor asked that the Committee address itself only to the Permanent Fund at this point in time in its expanded state. Now, were you to begin to provide advice to the Commissioner as an expanded Committee, and I would suggest that with the new members of the Committee, that may be inappropriate at this time.

MR. MOTLEY: Mr. Chairman.

MR. WOHLFORTH: Yes, Commissioner.

MR. MOTLEY: Mr. Waldock and I have not discussed this subject before, but I think I can understand the thrust of his questions. I think, as a long-time member of this Committee, he would like to continue to participate in some of the decision making processes with regard to the selection of criteria, of consultants, et al., and I, as a fellow member of his Committee, I think I can understand what he's saying.

I don't have any problem with the selections that were made, and I may be reading something into it, Dennis, that you haven't said, but I have no problems with the selections made. But I have taken note of his scrutiny of the process.

MR. WALDOCK: I'd like to say the same thing, and it's

1 not just myself; I think that everybody on this Committee
2 should have that opportunity to have that choice, and we
3 might as well get the course of this Investment Advisory
4 Committee aimed in the right direction. I saw this as a
5 particular area of conflict and problems and decided to
6 address myself to the Committee in regards to it.

7 MR. MOTLEY: I think one of the things, Dennis, you
8 have to keep in mind is, as we meet on them -- and I've
9 fallen into this spot under other circumstances so I think
10 I can address it -- and that is, in the interest of getting
11 on and trying to get things done, sometimes we find ourselves
12 way out in the front end of the Board, and maybe that may or
13 may not have been the case in this case. But I've certainly
14 heard what you said and I've taken note of it.

15 MR. WALFORTH: The final question here is, I think,
16 the real crux of what I was trying to drive at here. There
17 is a law in effect that came in effect after the Investment
18 Advisory Committee had actually been in operation, and I
19 believe that law came in effect in 1972, (I wasn't able to
20 get the exact date) and that is that anybody working in an
21 advisory or a consultant capacity may not act as a contra-
22 capacity as an investment banker, or dealer, or accountant
23 capacity due to the possibility of conflict of interest.
24 This generally held in the Permanent Fund. My question is,
25 will this also hold true for the Permanent Fund?

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MR. MOTLEY: What is the statutory reference?

MR. WALDOCK: 1972, Tony.

MR. WOHLFORTH: Yes, but what chapter?

MR. WALDOCK: Unfortunately I Xeroxed enough copies to bring along for the members and left it in my office, and I'll have to get it back

MR. WOHLFORTH: The only one I'm aware of is that prohibition which applies to the state and local governments of having a financial advisor bid on bonds. Is there another one that I'm not aware of?

MR. RHODE: No. That's what you're talking about, isn't it?

MR. WALFORTH: Yes.

MR. RHODE: It doesn't apply in this situation because they're giving advice on general public issues. They're not structuring debt, preparing a prospectus, advising us on any specific type of investment, nor are there any investments for them to deal in.

MR. WALFORTH: Mr. Rhode, couldn't you possibly see a conflict of interest in investment advice or a consultant in this particular case because it takes in a broader area? Couldn't there be a little bit of conflict of interest if that individual was to structure the way the Permanent Fund is to be run and then, in fact, turned around and be in the other end of the operation?

1 MR. RHODE: This matter was specifically addressed.
2 Every consultant, at least on my motion, was given a copy
3 of the relevant statute, and so in our informal opinion
4 (we could get a written one from Legislative Counsel), the
5 situation didn't cover them. But my immediate reply is this:
6 I'm not aware that Price Waterhouse is even dealing in
7 securities, and in the case of White, Weld, they're in
8 virtually every type of investment that is possible, all the
9 way from tax exempts to taxable debt. So I don't understand
10 how--any way the Fund turned out there would be some kind of
11 business that they might have a part in at some later point.
12 But that would be true of any highly reputed national invest-
13 ment banking house that we might bring before this Committee.

14 MR. WALDOCK: That's the exact point. I think that
15 if they are used as consultants they, in fact, should not
16 be involved in the other end of the operation.

17 MR. RHODE: What other end?

18 MR. WALDOCK: The actual use of the Funds, once
19 it's in operation.

20 MR. WOHLFORTH: In other words, you're proposing that
21 their actions here up to the Legislative Session would bar
22 them from any advisory role in terms of the Permanent Fund
23 later; is that what you're saying?

24 MR. WALDOCK: Not in an advisory role, in actual
25 active role.

1 MR. WOHLFORTH: Well, what do you mean by active role?

2 MR. WALDOCK: I guess I'd have to read the law again,
3 but even probably on an advisory role.

4 MR. RHODE: No, it doesn't say advisory. It says if
5 you're actually dealing in some kind of debt instrument for
6 the state at the same time you're advising them, that's
7 unlawful. But if you're rendering advice and there's no
8 involvement with any kind of financial transaction, then
9 you are not under the conflict of interest laws.

10 MR. GALLAGHER: I'm not aware that White, Weld is
11 involved in any issuance of any debt of any agency of the
12 state government.

13 MR. RHODE: It's not.

14 MR. WALDOCK: Well, that wasn't the point I was striving
15 for. I'm striving for the point of, they are a consultant
16 at this period of time, and I'm not directing it towards
17 White, Weld or any of the other consultants; I am just making
18 a statement and asking for a question here. For example,
19 an investment advisory firm cannot act as a consultant, a
20 financial consultant and then turn around and be an under-
21 writer of an issue, i.e., the bond bank that just was formed
22 here in the last year. Now, that role or law went into
23 effect in 1972.

24 My question here is, now that we've utilized the
25 talents of these consultants that we have selected or have been

1 selected, are they going to be barred with the Permanent Fund
2 monies to participate in the operational end once those funds
3 are in operation.

4 MR. GALLAGHER: If we sell debts out of the Permanent
5 Fund, is that your question?

6 MR. WOHLFORTH: I think it's to some extent hypotheti-
7 cal. Shouldn't it await the event, if we get a Permanent
8 Fund, if the Legislature passes the ---

9 MR. LOVE: Mr. Chairman, I would suggest that what we
10 do in this case is to ask for an Opinion by the Attorney
11 General on this specific question that Dennis has just asked.
12 He's asked a very specific question, I think a legal question,
13 and he's asking about a specific statute, and I can't see any
14 problem with going to the Attorney General and asking him
15 to provide us with an authoritative Opinion.

16 MR. GALLAGHER: I'm not even sure I understand the
17 question.

18 MR. EDENSO: Mr. Chairman.

19 MR. WOHLFORTH: Mr. Edenso.

20 MR. EDENSO: Mr. Chairman, I think that what Mr.
21 Waldock is doing is putting the cart way in front of the horse
22 at this point in time. The structure, the nature of the
23 organization, in fact the control of the Permanent Fund has
24 not been established. We don't know whether or not it's going
25 to be an agency which is directly related to the state, falls

1 under the state regulatory statutes, falls within the statutes
2 which he's referring to, falls within those confin... The
3 Permanent Fund, or the management entity which has direct
4 responsibility for investing or not investing these funds,
5 the decision making process has not been identified or
6 defined. So I think his question might be very pertinent,
7 but at this point in time it is impossible to say, or even
8 to ask a legal Opinion on it.

9 MR. WOHLFORTH: I'll have to rule, as the Chair, that
10 we've exhausted the subject. If someone wants to make a
11 motion we can deal with, otherwise we'll go on to another
12 question. We've got a lot of things to say in here. I don't
13 want to cut anybody off, but just idle conversation on the
14 thing will keep us here until 6:00 o'clock without getting
15 into some of the really important items. If there is a motion
16 it will be recognized.

17 MR. MOTLEY: I would move that I would be happy to
18 work with Mr. Waldock and anybody else whom you appoint to draft
19 the question and ask the Attorney General. There may be
20 ramifications down the stream; maybe White, Weld and the
21 rest of the world would like to know what their ramifications
22 are downstream.

23 MS. FLEISCHER: Second.

24 MR. WOHLFORTH: Second to the motion. Any discussion?
25 All those in favor say, "Aye."

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(Whereupon Committee members said, "Aye.")

MR. WOHLFORTH: Opposed. So ordered.

MR. MOTLEY: Do you want to appoint anybody else, Mr. Chairman, to draft that question?

MR. WOHLFORTH: Well, you and Mr. Waldock work on it.

MR. MOTLEY: Anybody else that would like to work on it ---

MR. URION: Mr. Chairman.

MR. WOHLFORTH: Yes.

MR. URION: Mr. Chairman, before we get completely off of this subject matter here, I'd like someone to explain to me this \$30,000 you had in your budget there for Legislators to use how they see fit. I happen to be a Legislator.

MR. EDENSO: Mr. Chairman, I didn't say they could use it as they saw fit. I merely pointed out that they could use it as they determined they wanted to use it in their efforts in participating in the Permanent Fund.

MR. URION: How is it being used?

MR. EDENSO: To the best of my knowledge, it's being used for expenses incurred by the Legislators for matters relating to the Permanent Fund, for telephone, for some travel, etc., and I think the people who are directly responsible for that, I would ask that they add to what I have said.

MR. MALONE: Mr. Chairman.

MR. WOHLFORTH: Yes, Mr. Malone.

1 MR. MALONE: The appropriation was made in the Execu-
2 tive Branch, so what they have done is actually set aside
3 \$30,000 for the Legislature to basically make proposals
4 against. Now, it's the budget for that \$30,000 which, for
5 the most part, myself and Senator Kerttula have worked up.
6 Jim doesn't have that budget here, but if you ask him he can
7 get you a copy of it. The primary expenses are staff and
8 office expenses.

9 MR. URION: It's kind of unusual to give money for
10 Legislators to the Executive Branch. What are we trying to
11 do, hide it from the taxpayers, that the Legislators spent
12 about another \$30,000?

13 MR. GALLAGHER: The intent behind that was that the
14 Administration and the Legislature are cooperating in this
15 effort. We put the money in one place just like in a tax
16 study. Most of my funds for my study is put in the Legis-
17 lature. I go with proposals to the Legislature; they find
18 them worthy or they don't find them worthy.

19 MR. MALONE: Mr. Chairman.

20 MR. WOHLFORTH: Yes.

21 MR. MALONE: One further comment on that, Rick.
22 Probably, normally those funds would have been transferred
23 and accounted for separately, but because of some legal
24 confusion on the transfer of funds, elected not to ask for
25 transfer right now.

1 MR. RHODE: At one time it was prepared to go to the
2 Budget and Audit Committee to make the formal transfer of
3 the \$30,000, but you're familiar with the legal posture of
4 that Committee in regard to transfers of appropriations.

5 MR. GALLAGHER: Let's say they're prepared to receive
6 the money.

7 MR. URION: I understand I'm the sixth vote too.

8 MR. WOHLFORTH: Mr. Love.

9 MR. LOVE: I don't know if the entire Committee can
10 resolve the dispute between Rick and his colleagues, but there
11 is something that involves the issue of consultants that I
12 wanted to ask Dennis. I have a concern that as we're going
13 along a lot of the presentations today seemed to all point
14 in the direction that we're going to develop this development
15 bank, and that most of the advice in this meeting today I
16 felt was provided and (I hope I'm not of the wrong impression)
17 that we've already committed ourselves to a direction like
18 that without other alternatives and without hearing from the
19 public before we commit ourselves to that choice or any other
20 choice.

21 What I wanted to express, at least, before this meeting
22 is over that it's my hope that one of our very next meetings
23 will be a meeting where the public has an opportunity to
24 appear before us and tell us what their thinking, what their
25 ideas are for the Permanent Fund, and to have some input there,

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