

ALASKA LEGISLATURE SPECIAL COMMITTEE / SUBJECT FILES 8672

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

The second investment purpose is in the non-oil producing Arab world in loans and guarantees. Thirdly, in the undeveloped world outside their world, where they have done very little and probably will do very little in the future.

Fourth, is the investment in government bonds, buying treasury bills or bonds of the U. S. Government or the French Government or any number of other governments in the developed world, and lastly investment in non-government, buying bonds of corporations and at some future time investing in common stock of corporations. That is not contemplated at present.

Dr. Logsdon: I would like to comment on the public's understanding of the permanent fund. We were discussing that maybe we should invest in a stocking factory or mattress factory so we would have something to stick all developers into. That would be one form of permanent fund. People may not think in terms of development bank, but they do think in terms of putting their savings in a bank. Maybe development bank is the wrong terminology. The World Bank does not . . .

Member: The real name is International Bank for Reconstruction Development. The short term is World Bank.

Dr. Logsdon: Then maybe we should have an Alaskan Development Bank, but give it some other name by which it could become known. Another thought I had was that since wealth only is created by change in resources, not resources themselves, but the change in either form or place, in order to avoid a boom and bust there is only one way, that is to broaden the economy based on resources, based on change of resources.

Mr. Pihl: I think we have a lot to work with. I view the whole program as one of managing assets. My own preference would be fishing. Another would be emphasis on increasing the standard of living, helping communities with projects of development.

Mr. Rhodes: If the State of Alaska were to set up a wine industry in Nome, made greenhouses, import the grapes, that would diversify the economy.

Mr. Richards: You engage in those enterprises, which in the long run, Alaska has a comparative advantage. However, that is really not answering the question. Taking the case of a petrochemical plant, nevertheless, Alaska has no comparative advantage at the present time or even in the foreseeable future in the petrochemical industry. However, the construction could be subsidized by low interest rate loans, gifts of property, to make a petrochemical plant viable. If the existence of that plant then generated ancillary activity, that may in fact bring about a continuing viability.

Mr. McDowell: The dollars spent for those products remain in the State a bit longer, then perhaps a secondary tertiary benefit will provide enough to accomplish something.

Mr. Wohlforth: Any development loan bank that is created would be able to invest either on an equity or a net basis, only a percentage of a given project, the discipline afforded by the necessary other private source would be a break in safeguard on the efficiency of its investment.

Mr. Richards: There would be practical limitations on the amount of debt that could be invested and those would be governed by the market. If you looked for

external sources as well, the amount a development bank would invest in an equity is what you would be concerned with. You certainly don't want to own it all, even though the public might own the development bank.

Mr. McFarland: I think we better set up some priorities. This fund we're talking about, basically, is going to go in income producing -- the income produced will go to the State, the principal will remain with the fund. In investing this fund, we have long range goals that will develop a broad range economy, also some short ones, such as mortgages. There are others available, but you have to make the decision if you want to shut off any outside capital. I think you have to do something that the people see that there is a need. That could be mortgages, and the second might be promoting the bonds, etc.

Mr. Gallagher: We talked about the role of the permanent fund, we should now talk about the structure -- how people view the structure of the permanent fund; some of the drive lines that might go into making sure that all the processes, all bases have been touched in making loans. What sort of structure is best to keep out unwarranted political influence. Not that political influence is bad, but the proper political influence in a policy direction.

Mr. Wohlforth: It seems to me the problem in Alaska is quite different from the problems in South America have been. We are a highly democratically oriented state with a maximum personal access to our legislators. I am speaking very frankly of my own point of view, with people having expectation and in many cases the realization that they can get to a legislator and talk to him and achieve a result.

I think where there is a problem or an opportunity, we will have to recognize the structure of a development loan bank. If you will contend with this issue in a democratically oriented society you would have to face the very realistic fact that in Alaska a borrower for business would feel that he has an entitlement to a particular loan and would want access to that. Within that context, you could build an efficient development loan bank. Please don't take what I say as making a value judgment.

Mr. McKinnon: North Dakota has a state bank. British Columbia has a state savings and loan and I imagine they have gone through the same problems. It would be interesting to look at their experience, see what safeguards they have built into their systems.

Mr. Wohlforth: The North Dakota bank is still pretty small. It's not a big operation - more a crop loan operation.

Mr. Gallagher: That bank has invested in things that make sense in North Dakota. I think it has mostly invested in guaranteed loans by the Federal government, SBA sort of loans.

Mr. Wohlforth: I think the representatives and politicians can have real input because each one of these develops in a different social political context. The South American countries have real dictatorships. It's got to be difficult to run an efficient loan program there. In Canada you've got government respect.

Mr. Gruening: You were talking about areas where the permanent fund could invest. I have trouble thinking about the management aspect without thinking about some of the areas that might go into it. I think Mr. Barnes mentioned the savings portion of it. I think, at least in the initial decade, the permanent fund shouldn't devise methods to put this all into long term investments. There ought to be something to take care of that cyclical problem or the problem that is unforeseen.

One of the criticisms of the permanent fund is the dedicated fund. If there is a portion of the fund which is made and just held as other state investment, there already is a statutory theme for devising it, so it is liquid. Then the other is probably a substantial area. I immediately think of the traditional resource development, fishing and timber, but maybe there are other areas that there is a comparative advantage because of some other source of power or something.

Mr. Gallagher: If you wait and only talk about management until you've got what you invest in -- even before you decide what you are investing in, you have to decide what the goals are. I think some of the management structure is tied in, and the process you go through to insure you deliver that product out the other end in some sort of coherent fashion that would have an adequate structure to meet a variety of things that may come to the future. If you predispose that we are going to have a veterans loan program then you don't need a management structure any more than you have right now. If you want some flexibility for the future, you are going to have to design it at this point.

Mr. Gruening: If you find that Alaska has no comparative advantage over anything, that solves your problem about economic investment. They are all social in nature. Like the Alberta Heritage fund. They divided it percentagewise into area. I think before you could establish the percentage you have to look at what is available to invest. The economic aspect of large projects are not something that are feasible and in the near future you're looking at the social area. I'm not making any conclusions yet, just wrestling with an approach.

Mr. Wohlforth: I agree. I think, just for purposes of talking out load, it might be that a structure was created, a board appointed, and a positive dictate, not to invest in anything for a year's time, until these questions are answered. I think you have to approach this without presuppositions as to what types of investments are necessary. Certainly, a giant hydro project, as large as this fund might be, would literally eat it all up in four, five, or ten years.

Mr. Pihl: The resolution says at least 25%. How is that percentage going to be set?

Mr. Gallagher: The legislature has the authority to go with a number less or greater than 25%. Maybe we should talk about how this investment advisory committee should work. In the Governor's letter he asks the Department of Policy Development Planning to bring to this committee some of the Governor's ideas on Alaska, Inc. Where would the committee like to go from here in the way of consultants? We have consultants here. What are the questions you want to know that will help us define their mission here.

Mr. Wohlforth: Whether they see it a tough priority study issue, the question of potential investments in Alaska and what the nature, size, composition, etc. I would also like to see a little more definition on different types of structures, and what they might feel -- at least suggested range of structures in Alaska -- I guess I'm saying I want them to do our work for us.

Member: In that regard, we intend to provide this committee with a detailed analysis of each of these funds, and comparisons can readily be made.

Mr. Wohlforth: I would be interested in what the northern countries such as Norway, Sweden, etc. have done. Is there any case studies on nations in geographic areas that are more analagous to ours than Puerto Rico?

Member: Absolutely.

Mr. Edenso: Apparently the public does not know what HR-39 says. HR-39 says the permanent fund's principal may be invested or will be invested in income earning projects, opportunities, or investments. That pretty well states what the permanent fund will do. I can't see any person voting for or against a permanent fund without understanding what they are voting for. We understand there will be 25% oil revenues and royalties -- oil revenues set aside for a permanent fund which will be used to invest into different income earning opportunities. Something should be done about educating the public.

Mr. McFarland: What are the present sources? Did I hear about \$120 million a year?

Mr. Edenso: The veterans' portfolio is \$110 million and it would run about \$50 million annually. That money is coming from the general fund. It is mandated. Any loan that the veterans make the Department of Revenue has to purchase the paper.

Mr. Gallagher: The pension funds are \$290 million in size; we have \$80 million in loan mortgages, about \$20 million of that is in commercial property and \$60 million is in dwellings. The pension funds will go from \$290 to \$350 million in size by the end of the year. In the general fund there is \$450 million, \$110 million in veterans loans. We have another \$20 million in ASHA loans and purchases of AHFC. We have \$27 million long term deposits with banks in Alaska and they will start running in 1981 through 1985. That was part of that 14 year program. We have \$9 million in fishing loans; \$5 million in agricultural loans; \$200,000 in Native Corporations, and \$8 million in municipal loans.

Mr. McFarland: We really don't have any problem of where we're going to put our money until fiscal 1978, is that correct? I think this committee should take a position for or against a permanent fund. That might be a place to start.

Mr. Wohlforth: I move that the committee support the amendment establishing the permanent fund.

Mr. Gruening : I'll second that.

Mr. McFarland: Moved and seconded. Any discussion? Any objection?

Mr. Gruening: What do we tell the public, aside from the fact that we support the fund. I get the feeling, even though a lot of legislators will want to act on it right away, you're looking at least two or three years before you have enough to get into any of these areas, the social or just purely economic.

Maybe one of the recommendations, aside from just a broad general area that the fund could have multipurposes is that the legislature may take more than one session to look at it. I think it would be a political mistake to devise a lot of things that may not agree with what the people have in mind. There is also another area that is interesting. What do you do with the income that it says will go into the general fund, that was how it came down from the Governor, unless otherwise provided by law, which would enable the legislature to either dedicate those revenues for the specific purpose or to require them to go back into the permanent fund, or to have a dividend check to every Alaskan.

Mr. Gallagher: When you actually look at Alaska, Inc. and look at what is meant by Alaska, Inc., you are really talking about not the investments that go into the bank itself, but about the income that comes off the fund and how you could use it. Jim, do you have any comments?

Mr. Rhodes: I would say, with the staff work that I see ahead, it is going to run some four to six weeks. I can't see any further than that.

Mr. Edenso: I find the Governor is anticipating some sort of legislation.

Mr. Rhodes: That was on the other side of seeing how large the job is.

Mr. Gallagher: Administration has two jobs. The consultants having to do the industry study question will probably be worked out in the next four to six weeks with legislators as to just how we go about developing those industry studies. We will come back to this committee with some sense of direction on that question.

Dr. Logsdon: Is the Growth Policy Council looking at these figures on the permanent fund, or state royalty income, or anything like this?

Mr. Gallagher: No, I don't know what their exact topics are.

Mr. Rhodes: No, I was told the permanent fund will be one of them.

Ms. Lehr: It is certainly considering the permanent fund as one of the issues.

Mr. Edenso: My other job was investment opportunity, the potential for a bond fishery in Alaska. That seemed like a natural for something like the permanent fund. You couldn't ask for better timing. Passage of the 200 mile economic zone bill in Congress, and becoming effective in March 1977 changes the posture of all the people fishing out in the ocean.

Alaska has the opportunity to begin harvest operations of a total potential production volume of between 400 and 600 million pounds of fish. For example, Japan imports are catching 80% of its consumption of fish within a 200 mile economic zone off the State of Alaska. That is a substantial catch. Alaska could benefit from that. You would also have management capability over the resource; it is labor intensive, but it is also capital intensive.

Mr. McFarland: I think we need to get into the swim of things in Kodiak. All the big fishermen in Kodiak send their money outside.

Ms. Lehr: I think you might have a good investment idea, but I think instead of talking about specific investment we should wait until the committee has the information on which to evaluate.

Mr. Wohlforth: We can't help but speak of specific investments. My pitch is that we indeed address the specific problems first.

Mr. Edenso: The question is put to you, then. Where are Alaska's major industries?

Mr. Richards: I think when you look at potentials you have to give that a lot of thought. For example, there is crude within the State -- very seriously considering a steel mill, because of the availability of natural gas and raw material.

Mr. Edenso: If you can't approach it from that direction how about approaching it from the kind of vehicle or organizational structure that you might contemplate. What kinds are available, what kinds have been used? As you picture it, how will funds flow through the State to finally arrive at something called "permanent fund."

Dr. Logsdon: How many more people would it take in Revenue to handle the permanent fund as a separate entity?

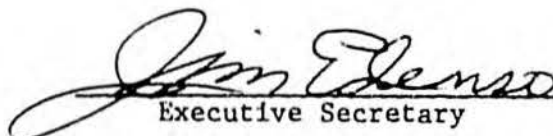
Mr. Gallagher: I don't know. If you made vacation loans it would take about 500, it depends on what sort of investment you are investing in, whether it is short term or a small ticket item. I think the Small Business Loan has five loan officers and five loan secretaries, the veterans loan has 27 people.

I think that will pretty well wrap things up. We will not set a meeting until we get some sense of readiness by the consultants. Jim will develop a paper and circulate it to the committee. Maybe it could be something that could be put out to the public before election time. I don't know if we will hold the final approval on that until after we meet the next time or we circulate it and get everyone's comments and then move.

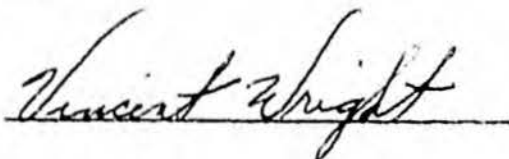
I assume there is a need to get it to the public twenty or some days before the election.

Mr. McFarland: Any other business? If not, we'll adjourn.

Meeting adjourned at approximately 4:00 p.m.

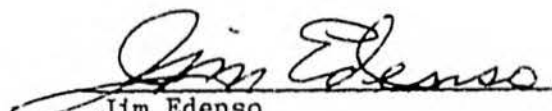

Executive Secretary

ATTEST:



CERTIFICATION

I, JIM EDENSO, Executive Secretary of the Alaska State Investment Advisory Committee, hereby certify that the foregoing Minutes of the August 26, 1976 meeting of said Committee duly called and held at Anchorage, Alaska, on said date, are a substantial verbatim extract of the recording of the proceedings of said meeting with deletion of insubstantial matter and changed only to clarify the statement.


Jim Edenso
Executive Secretary

ADDRESS TO THE STATE INVESTMENT ADVISORY COMMITTEE
BY STERLING GALLAGHER, COMMISSIONER OF REVENUE
OCTOBER 13, 1976

I. I would like to welcome you to the second meeting of the State Investment Advisory Committee concerning the establishment of the proposed Permanent Fund. The last meeting served to introduce the new members of the Committee and to initiate the process of establishing the Permanent Fund. This meeting will allow the Committee the opportunity to begin evaluating the work currently being undertaken by the Consultants for the Permanent Fund.

Bob Richards will further describe the State's economy by providing a sectional analysis of each segment. His input will allow the Committee to begin focusing on the potential investment opportunities available in Alaska. Information of this nature will be useful for considering investment policy.

Price Waterhouse will present their report on the organizational structure, management and control of existing funds which currently undertake the administration, management, and investment of large development programs. Their report compares the characteristics of funds which are similar in nature to the proposed Permanent Fund, e.g., the limitation which permits only income earning investments.

White Weld & Co. will present their report on existing permanent funds. Characteristics of these funds will be reviewed and outlined for the committee.

II. The Governor has asked the S.I.A.C. to actively pursue the establishment of the Permanent Fund. This committee was expanded to include a broader base of Alaskans to provide a greater breadth of ideas and input for establishing the Permanent Fund.

There has been some concern expressed in the new media that the SIAC has become a "powerful board." This is a basic misunderstanding of the SIAC. The SIAC is mandated by statute to advise the Commissioner of Revenue on investment policy for the State's funds. The use of the SIAC for the Permanent Fund is an exception and the expansion is intended to be temporary. Upon the event that the Permanent Fund is established it is anticipated that the SIAC will return to its previous status.

III. There has been much concern expressed concerning the goals of the Permanent Fund. Let me share with you at this time my view on the potential goals of the Permanent Fund. Briefly, I see three major goals of the Permanent Fund:

1. The Permanent Fund could have as one of its goals the strengthening of the State's economic base. This could be accomplished by adopting policies for the investments which tend to stabilize the economy - a flattening out of the so-called peaks and troughs in the economy. Investments into renewable resources using non-renewable resource funds will help future economic conditions. Policies which tend to reduce the seasonality of employment would provide greater employment opportunities for more Alaskans. The benefits of the Permanent Fund should reach a broad population base of the State.

annual?

how many?

2. A second goal could be to provide assistance in the area of community development. This idea falls within the broad population based concept. Assistance in communication development, housing assistance and other socially related programs could be goals for the permanent fund.

3. Finally, a third goal could be to support the "savings account" concept. This would affect the economic growth of the State and allow for greater selectivity and participation in future development. Additional benefits would be derived from direct earnings received on the funds. Finally, this could provide a "cookie jar" for the occasional rainy day.

IV. Many people have expressed concern for safeguarding the funds. There are many ways of developing safeguards and some of these have been traditionally used by other organizations with similar responsibilities. Safeguards are generally provided procedurally through the management and control of the organization.

Management provides safeguards by building checks and balances into the decision making process, e.g., a loan committee in a bank; limited lending authority; banking and cash handling procedures, etc. A further control is the use of generally accepted accounting reporting and auditing procedures. Annual audits are very effective check on management activities which enhance greater control procedures. Further, public reporting requirements on a regular basis greatly inhibit the misuse of funds.

V. A brief review of our activity will establish that there is a major effort by the State to establish the Permanent Fund:

1. The cooperation between the administration and the legislature to establish the Permanent Fund.
2. The use and expansion of the SIAC as a human resource pool to develop the Permanent Fund.
3. The hiring of consultants to provide research and data relevant to the development of the Permanent Fund.
4. The use of the public forum, the Alaska Growth Policy Board, to carry the dialogue of the Permanent Fund to the general public.

EEW:jr
11/18/76

STATE INVESTMENT ADVISORY COMMITTEE
WORKSHOP MEETING NOVEMBER 16, 1976

Minutes of Workshop of State Investment Advisory Committee,
held on November 16, 1976, in the conference room, Department of
Revenue, 509 West 3rd Avenue.

In attendance were:

Eric Wohlforth
Dennis Waldock
Jamie Love
Dr. Charles Logsdon
Jim Edenso
Commissioner Sterling Gallagher
Mr. Jim Rhode
and others

The meeting was specifically called to consider the structure
of the entity to be developed by legislative enactment for
administration of the Permanent Fund.

1. Dr. Logsdon read a paper which outlined certain
issues to be considered in developing a suggested structure.
He noted that there should be accountability of the board
or boards, but that the boards should be free from political
pressure groups. He suggested initially a board structure
with the Legislature sitting as the primary board to consider
policy. In addition, he mentioned the desirability of a "secondary
board" also to determine policy matters and a executive board to
administer the specific investment programs. The issue whether
the structure should be within or outside of state government was
discussed, and it was noted that a structure developed outside of
the existing state government would insulate the administration
of the fund from political change through elections. The
question of management of the fund and where operating money
is to come from was discussed. Under this heading the question
of either direct appropriation by the Legislature or permitted
use of fund income for operating expenses was noted.

2. The suggestion of a policy board along the lines
of the Price Waterhouse suggestion of a citizens board was
rejected since such a policy board, it was felt, would have
too little power and oversight function. It was noted that
there should be a separation of policy and line functions
in that the Legislature was a policy making board in fact.

Mr. Gallagher noted the World Bank policy of sector analysis in making loan determinations. Mr. Love noted the desirability of two boards below the Legislature which would provide in his view both double accountability and a proper check and balance.

3. It was determined that there should be a closer examination of the existing state loan programs, such as the Veteran's Loan Program, the Tourism Loan Program, the Small Business Loan Program and an evaluation of the effectiveness of these programs. There were queries as to the existing management structure of state loan programs.

4. After considerable discussion, it was determined that there should be a policy committee, composed of two legislative members, two cabinet officers and seven members of the public. The policy committee would be Alaska residents, appointed by the Governor, subject to legislative confirmation, if this is constitutional. All the members would serve four-year terms (initially staggered), and would be removable for cause. The functions of the policy committee were outlined as follows:

(a) to perform sectoral analyses in areas of the Alaska economy.

(b) to provide financial audit and operational analysis as well as program evaluation.

(c) to provide an annual report to the Legislature and to the public.

(d) to provide for an annual budget of the operations of the fund.

(e) it was not decided, but suggested, that the policy committee have loan approval authority over loans of certain amounts.

(f) the policy committee should develop a program for its subsidiary management board.

5. The policy committee should hire and fire the chief operating officer. It was suggested that the chairman of the board who would be elected by the board itself, possibly have a specific staff to perform sectoral analyses.

6. It was further determined that there should be an in-house staff developed with minimal reliance on outside staff.

7. The management board and its composition were next discussed and it was determined after much discussion that the management board should number five including the chief operating officer, and the four other members should be appointed by the policy board. The management board would meet perhaps as infrequently as every two weeks. It was determined that a policy board member should not sit on the management board and the two entities would be distinct and separate. The function of the management board would be approval of loans or investments. It would further exercise loan evaluation and supervision.

8. It was determined that the term "investments" meant marketable money market instruments and that loans constituted everything else.

9. The chief operating officer who would sit on the management board would have complete control of the hiring of staff and the setting of salaries. The staff would have at least four separate functions which would include a) internal audit, b) post audit, c) disbursement and, d) loan supervision.

It was recognized at the meeting that the tentative structure suggestions were made in the context of a development bank type proposal. At the end of the meeting Mr. Love suggested that the next meeting should concentrate on the necessity or desirability of regionalization of the fund, that is whether regional institutions should be established by legislation to promote or veto loans within the particular area of the region. Mr. Wohlforth mentioned that in his view, the activity of the permanent fund board should be directed through existing political institutions in Alaska as far as possible. He noted distinction between public loan programs where there perhaps should be complete control and approval at the local level, and private development loan programs where such local control might or might not be desirable.

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MEMO

DATE: January 27, 1977

TO: Hugh Malone
Sterling Gallagher

From: James Love

SUBJECT: SIAC Permanent Fund Proposed Legislation

NOTES ON THE PERMANENT FUND BILL

page 2. Section 37.13.017 (5) limits the permanent fund from making investments in areas where private capital is available. Naturally, those areas which attract private capital are the best, offering the highest rates of returns at the lowest risks. The effect of this limitation is to force the fund into soft loan areas. The fund should be able to compete in these areas.

page 3. In Sec. 37.13.030 (b), the president of the fund, who is really its executive director, is made the chairman of the policy board. In my opinion, this makes the staff person too powerful, and diminishes the power of the board itself. I feel very strongly that the chairman of the policy board should be chosen by members of the board, from their own ranks, if they are meant to be a strong group.

page 5. Sec. 37.13.070 states that the president shall have the sole responsibility for bringing investment proposals to the investment committee for a vote. I feel strongly that any individual or business should have the right to demand that their proposal is taken before the committee. The president should not totally control the flow of proposals to the committee, although she should have the ability to recommend against proposals sent to the committee against her recommendation.

page 5. Sec. 37.13.080. There is no reason to exempt the permanent fund from the Executive Budget Act, except to remove it from normal review of government programs. If there is a concern that the Budget Act does not allow for sensible budgeting of reserves, then it should be amended.

page 5. Sec. 37.13.080. Only top officers should be in the exempt service. One of the problems with ASHA was that it was exempt from normal civil service guidelines. It became a haven for patronage jobs. On a federal level, agencies such as the SEC give employees civil service protections. Yet, they are fully able to attract qualified and motivated staff. The permanent fund needs this protection to keep from being subject to political manipulations.

page 6. Sec. 37.13.090. This should read: "The Permanent Fund shall..."

page 6. Sec. 37.13.100. (2). This is another example of language to keep the fund from making loans attractive to the private sector. It should be stricken.

page 6. Sec 37.13.100. (3) I don't feel that this paragraph should be in the bill. Perhaps there could be a statement that the fund should not manage projects, but I feel that it should reserve the right to exercise its stock voting rights.

page 7. 37.13.100. (8). The last sentence in this paragraph. "The permanent Fund shall be sensitive to the views of affected local communities and shall include an analysis of those views in proposals for large investments.", is a step in the right direction, but it should be worked on more. First of all, consideration should be given to giving local government units actual veto power over proposals of a certain size, which primarily affected their community. This was an area of much dispute in the SIAC, since many of the committee members felt the fund should be able to finance projects in communities regardless of the local feelings toward the project. These committee members felt that development projects would be hamstrung if local communities were given a chance to approve or disapprove projects. Frankly, this line of thinking bothers me, and I am sure that it does not fit in with the thinking of the Governor. You could easily have another Kachemak Bay on your hands. A section should be written which requires that local communities be deeply involved in large development proposals which significantly affect their areas. At a minimum, such projects should require the endorsement of local government units. If the projects have any merit at all, this should present no problem.

Also, the bill should require the managers of the permanent fund to work with the local governments to evaluate the permanent fund programs, and to set priorities. Perhaps wording like: "The Permanent Fund shall consult on a regular basis with local government units to determine the funds' goals and priorities." I believe that provisions like this should be built into the bill. It really lacks accountability to the public. Nine people are just given the entire responsibility to make too many important decisions.

page 7. 37.13.100. (9). It seems that there should be a limit on this paragraph. What is a financial intermediary, and how large of loans can they manage without the approval by the permanent fund loan committee.

page 7. 37.13.110. There has been much talk about using the permanent fund as security for loan guarantees and other type of leveraging. The legislation might consider some initial limits on this. Say, to only a portion of the fund or its earnings. Also, the legislation might consider some limitations on the risk of projects that it extends guarantees on.

page 8. 37.13.150. We are working on other, more detailed conflict of interest and bribery measures, which I will forward later. One small point, during the ASHA investigation, Attorney General Gross, determined that the State's bribery statutes did not extend to anyone but Executive Officials of state government. Obviously, key people working with the Permanent Fund should be covered.

page 9. 37.13.170. This section is much too vague. In the process of protecting confidential financial information, public access to records involving loans of public funds, are limited to: "Publication of statistics presented in a manner that prevents the identification of particular reports, items, persons or enterprises...", Much broader disclosure of loan records should be available. For example, recommendations by the staff to approve or disapprove loans. Interest rates, security for loans, repayment schedules, and other terms. Delinquency should also probably be subject to disclosure. Confidentiality should be limited as much as possible, and maximum public scrutiny should be the policy. The language in this paragraph definitely needs work.


The bill does not state whether or not it is bound to adopt its operating policies by regulation, via the administrative procedures act. The SIAC rejected this. Surely this should be required by the bill. It requires the agency to go through a public process when adopting its regulations. The regulations then have the force of law. The entire experience with ASHA should teach us something. There, the agency was totally unaccountable because it had no regulations which had legal standing. Also, under the administrative procedures act, citizens may propose regulations for the agency. This will help, by preserving the public's right to formally petition the Permanent Fund to adopt certain policies or procedures. Again, it builds more accountability into the system.

These suggestions are addressed at the bill in its present form. I will have more comments later. Specifically, a code of ethics, and some work to require sophisticated economic planning, including a proposal that the fund adhere to state policies for growth of the Alaskan Economy. I will be studying alternative structures, and point out areas which I feel have not yet received enough study and which need to be addressed before the state decides on the funds' structure and goals.

JAMES LOVE:nj

TO: State Investment Advisory
Committee
House Special Committee on
Permanent Fund

DATE : March 3, 1977

FROM: Robert E. LeResche 
Director
Policy Development and
Planning
Office of the Governor

SUBJECT: Attached "Thought
Paper" on Permanent
Fund Investments

There has been much discussion regarding the relationships between goals for the Permanent Fund and the types of investments the Fund eventually makes. I asked Tom Singer, a talented temporary employee of this Division, to consider these relationships conceptually and practically during his tenure here and as a special project during this past semester at the Stanford Graduate School of Business.

I think you will find the attached draft result, "Structuring Decisions for the Alaska Permanent Fund: A Conceptual approach to the Allocation of a Public Capital Resource" of interest. In it, Mr. Singer explores practical ways in which individual investment proposals can be measured against stated fund objectives, considering non-market, or "social", benefits and costs as well as market factors.

Upon final publication of the report, I will be sure to make "clean copies" available to you.

REL/bll

Attachment

STRUCTURING DECISIONS FOR
THE ALASKA PERMANENT FUND:
A CONCEPTUAL APPROACH TO THE
ALLOCATION OF A PUBLIC
CAPITAL RESOURCE

THE ALASKA PERMANENT FUND

1. Background

The idea of a permanent fund is based on two related concepts:

- 1) that natural resources (primarily oil and gas) are a non-renewable resource and that a portion of the wealth they represent to the people of Alaska should be saved for future generations, and
- 2) that, given the likelihood of rapid development of these resources and the accumulation of dollars by the State, this money should be kept out of the State's operating budget,* retained as an asset, and put to some long-term beneficial use.

These concepts, and the creation of a permanent fund, create a profound public policy problem: How can a public capital asset, estimated to reach \$2.5 billion by 1985, be allocated to achieve the competing and sometimes conflicting goals which are valued by Alaskans?

A partial answer to this question is presently unfolding through the activities of the State Investment Advisory Committee, ~~which~~ charged ~~by~~ ~~the~~ to explore alternative uses and management structures for the permanent fund. This group has focused attention on development banks as the most promising type of organization to manage a capital asset to achieve both economic and social goals. Two major questions raised by a development bank are: 1) how public policies concerning the uses of the

* This sentiment is the result of the shock felt by many Alaskans over how quickly the \$900 million from the Prudhoe Bay oil lease sales was spent by government. Little rational discussion has occurred concerning what this money was spent on, i.e., the extent to which it has financed government services desired by the voters.

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permanent fund will be formulated, and 2) how these policies can be implemented by the managers of a development bank. Concern has been expressed by many interested Alaskans about the need to combine public control over the fund with sound business-like management practices. The first part of this report is a brief discussion of the public choice process necessary for the rational, systematic allocation of a public capital resource. The second part borrows from the theories of public sector economics, and focuses on the conceptual difficulties faced by the fund's managers in choosing among competing projects according to their non-financial as well as their financial returns (that is, how their economic, social, environmental, and distribution impacts can be considered in addition to the financial yield). The final part of the ~~report offers some guidelines concerning how elected officials can retain control over the actual allocation decisions.~~

2. A Word on Objectives

The establishment of the permanent fund creates a difficult problem concerning the allocation of public resources. In the United States, public funds are usually allocated through the budgetary process, a political process theoretically designed as a mechanism for the expression of voter preferences through their elected representatives (public sector "market" demand). Removing from the budgetary process some of the money the State receives through the sale of public natural resources creates a vacuum for allocation. Who is to decide how and where the money should be spent? At some point, objectives must be established and weighted to guide the allocation of the fund. This will occur either through the political process, or by fiat by those who finally control the fund.

indeed, because we are allocating public wealth, the traditional private criterion of profitability (and the means for measuring it) should be just one input to the loan proposal evaluation calculus. An argument can be made that projects which pass the market test should be turned out into the market, and the permanent fund should be used only for those projects whose spillovers are valued by society but not by the market.

One of the justifications offered for a development bank is the existence of a medium and long term "capital shortage" in Alaska. What does capital shortage really mean? The capital markets respond to investment opportunities according to both financial yield and risk class. Thus many borrowers willing to pay the going rate or even a premium may still find capital unavailable because lenders can find less risky investments elsewhere. This appears to be the case in Alaska. If the private market found investment opportunities acceptable in Alaska, the money would be there (for example, the Trans-Alaska pipeline).

What does this mean for the permanent fund? By making capital available to projects which cannot find financing in the private market, the State will in essence be assuming risks unacceptable to the private market. This is clearly a justifiable use for public money; since the fund is a public capital resource, it can respond to a "social" market demand rather than private market demand. Thus spillovers from investments to Alaska may be worth the higher risk levels assumed. This brings us back to the problem of public sector capital allocation and the need for the active participation of the legislature.

Thus, if the Bank operates like a strict private market bank, it will be subsidizing private market developments by whatever risk premium would ultimately be required to attract

private capital. On the other hand, if the bank operates to implement various State policies determined by the legislature, it will be seeking to offset that subsidy by gaining market and non-market, social returns on fund investments. Thus there is a need for legislative objectives, measures for objective achievement, and project analysis to identify both positive and negative spillovers.

There are a number of ways in which the values and desires of the citizens of Alaska can be translated into objectives and criteria for the use of the fund. Although this is a difficult, even painful, process of conflict to consensus, we are, after all, speaking about a major determinant of the future of Alaska. A unique public hearings program, the Alaska Public Forum, is currently under way and will hopefully produce information useful to elected officials about how Alaskans feel toward the rate and kind of growth they desire for Alaska. The legislature has considerable control over the allocation of the fund through its power to specify the types of income producing investments which are eligible for loans. After the determination of objectives has been accomplished (an on-going process), the legislature will be able to specify the types of investments it feels will serve best to achieve these objectives. Oversight of the Fund management to insure implementation of the Legislature's goals might best be achieved through the creation of a new legislative committee on the Permanent Fund. The Governor will presumably exercise some control and balance if he is given power over the appointment of the Board of Directors or the management.

Thus we have reason to hope that our elected officials will be able to formulate and implement specific policies concerning the objectives they, as representatives of the public, hope to achieve with the permanent fund.

Indeed, a statement of objectives must be forthcoming before the management of the fund begins operation to serve as a guide for those operations. Otherwise, the legislature may be faced with a powerful entrepreneurial institution deluging them with investment schemes, without any objective-based criteria for choosing among them. The problem of establishing uniform evaluation criteria based on multiple objectives is the focus of the remainder of this report. It is up to elected officials and the public to provide goals and objectives. The analyst can merely point the way to translating these objectives into criteria designed to identify and implement an optimal investment policy for the permanent fund.

3. Analysis

Some sort of analysis will be required to judge the degree to which loan proposals contribute to the achievement of the goals for the permanent fund. In this sense, analysis denotes a systematic evaluation of the attributes of proposed uses of the fund to facilitate comparison and selection among them. As we have seen above, there are a wide variety of factors which the development bank should be required to identify and consider beyond private financial considerations.

A common and widespread technique for evaluating project proposals in the public sector is cost/benefit analysis. This is a simple analytic technique in concept: the analyst (or loan officer) adds up all of the benefits a project is expected to produce, and adds up all of the costs required to produce the benefits. He then discounts these costs and benefits to their present value, and those projects with the greatest net benefit are chosen until resources are exhausted (see Analysis for Public Decisions

by E.S. Quade; Cost Benefit Analysis by E.J. Mishan; and "Benefit-Cost Analysis: A Criterion for Social Investment" by R.C. Lind, in Water Resources Management and Public Policy, ed. by T.H. Campbell).

However, cost/benefit analysis is not so simple in practice. The choice of the discount rate and the measurement of non-market costs and benefits are well known problems. Also, the choice of which spillovers are analyzed can create controversy. In Alaska, spillovers such as environmental impacts, immigration, long-term boom-bust cycles, the distribution of in-state vs. out-of-state ownership, and the distribution of project costs and benefits are extremely important. Returning to the problem of measurement, how are these spillovers to be valued to permit the comparison of alternatives? These problems are explored below.

a. The Discount Rate

The problem of choosing the proper discount rate has received a great deal of attention among economists and can only be outlined here. It is a problem because different discount rates can result in very different present values, and thus discount rates have been widely used to manipulate the results of analysis. In essence, the social discount rate should reflect two components, the social opportunity cost of capital and the social rate of time preference. The former is determined by what the same resources could earn in their next best investment, while the latter is determined by how much today's generation values tomorrow's consumption. The former is usually higher than the latter. The discount rate can have a major impact on project evaluation depending on the expected life of a project and the timing of the costs and benefits. The higher the discount rate, the less value is placed on future costs or benefits. The choice of a discount rate

is a fairly technical question and guidance is readily available in the economics and public policy literature. Let it suffice to say that: 1) the legislature may want to consider the implications of using a low discount rate to reflect concern for future generations; and 2) the development bank should be monitored for consistency in its application of the chosen rate or rates.

b. Uncertainty

In attempting to assess the impacts of future activities, analysis is necessarily fraught with uncertainty. Much of the data produced by analysts will simply be estimates or reasoned guesses as to the likelihood of future events. It is crucial that uncertainty in the analysis performed by the bank be made as explicit as possible so as not to misrepresent the information. One way to convey uncertainty is to provide a range of estimates rather than a single value. Single values often possess an aura of accuracy and precision even when it is clear that they are estimates. Thus it has become common practice to provide ranges of estimates such as high/medium/low or optimistic/status quo/pessimistic. Although more numbers or words are often more confusing, this practice flags the uncertainty surrounding estimation and reminds decision-makers that they are considering expert opinion and not hard facts. Explicit treatment of assumptions and uncertainty help the decision maker to utilize analysis as a decision tool and not as a source of easy answers.

Another way of uncovering uncertainty is through sensitivity analysis. This is the process of repeating an analysis with slight modifications in one or more of the factors under analysis. If the results vary significantly with only minor changes in a factor, the analysis is said to be

highly sensitive with respect to that factor. The decision maker should be aware of all uncertainty, but particularly in important factors which might warrant further study to achieve a reduction in uncertainty.

c. Measurement

Measurement and valuation is an enormous and continuing problem which has received ample attention in the economics and public policy literature. How does one measure or value the desire for solitude, the pleasure of catching a salmon, life styles, etc.? Yet aren't many people Alaskans simply because they could not "purchase" such things elsewhere? Measurement and valuation of non-market factors and spillovers may indeed be the greatest challenge in the allocation of the permanent fund, because without the means for measurement and comparison, it is all too easy to rely solely on dollars in analysis. If the permanent fund will be used to satisfy non-market (public goods) demand as well as market demand, systematic measurement and comparison of spillovers will be required to identify the real social return from fund investments. This will also be needed if project selection criteria are to be based on both financial and non-financial costs and benefits. Particularly in Alaska, where non-market goods and services are so important, the difficulty of this task should not deter those responsible from attacking it.

By measurement, economists mean the estimation of values for costs and benefits, and, in the ideal, with those values expressed in a single unit of measurement (dollars). The problem of measurement arises because many factors of interest to public sector analysts, such as the four listed above, are non-market factors; they have not received dollar values in the marketplace. Even dollars are sometimes criticized as units of measure

because in imperfect markets they do not represent true social costs and benefits.

The development of measures of value for non-market factors cannot be addressed in the abstract because of the lack of any theoretical framework to structure our thoughts about values. Markets and prices are so central to our economic system that non-market, non-price valuations are usually passed over as individual value-judgments with no overall societal validity. Thus, the usual approach has been to attack this problem on a situational basis and rely on creative innovation to solve the measurement problem (such as the various techniques for demand estimation).

The first step must be a statement of goals and objectives to provide some direction, or value, to measurement itself. Measurement is a relative concept, and here we seek to measure project impacts in terms of their contribution to or detracting from goals and objectives. Thus analysis is geared to the measurement and evaluation of both direct and indirect factors expected to result from projects as they relate to goals and objectives.

A well known example of the measurement problem involves a nail factory in the Soviet Union. Because profitability (i.e., markets and prices) is not the measure of achievement in that society, other measures had to be devised. First, the total weight of output was selected, but had to be abandoned when only huge railroad spikes were produced. Then the total number of nails was tried, but this resulted in the over-production of tacks and staples. Many such examples exist, and demonstrate that measures must be rationally tied to clearly stated goals.

An often mentioned goal for the Permanent Fund is the "Alaskanization" and diversification of the Alaskan economy. A possible measure is the dollars of assets owned by Alaska residents in a specified set

of enterprises. But such a measure does only a partial job, for it ignores the distribution both of ownership among Alaskans and of assets among the enterprises, and does not place a value on degrees of achievement. A more complex measure is required which 1) specifies a minimum acceptable distribution of assets and owners among enterprises, and 2) assigns greater weight to both different asset levels and to assets in more highly valued enterprises. Thus more complex and specific goals will require more complex and specific measures (as opposed to a lower unemployment rate as a measure of the goal reduced unemployment). Other goals, such as freedom to choose from a variety of lifestyles, present considerable difficulties for the design of adequate measures of achievement. What are the parameters (social indicators) which constitute a lifestyle, and how can we measure or estimate the impact of projects on them?

That task is difficult, but by no means hopeless. Indeed, the frontiers of many academic disciplines such as economics, anthropology, sociology, and ecology are in this very area. In economics, several techniques have evolved for estimating the value of spillovers. One method relies on the analyst's judgment based on expertise and experience. Another is called contingency calculations and identifies relative values by comparison with the opportunity costs of foregone alternatives (is this worth as much as ...?). A third technique is to ask people through surveys and questionnaires how much non-market factors are worth to them, and many pitfalls with this method have been overcome through ingenuity. A final technique, called "throwing up our hands," relies on physical description and explanation and leaves valuation to the decision-maker.

In policy analysis, a revolutionary contribution has been the rejection of the need to reduce everything to dollars (measurement without

valuation). The scorecard technique (discussed below) has been hailed as a method which permits decision makers to confront their values directly rather than have the analyst hide value judgments behind tortuous economic estimation techniques and a veil of dollars. Thus impact assessment can proceed through the measurement of physical impacts or through qualitative descriptions of impacts without forcing the analyst to place dollar values on them. This, in turn, does force the final decision makers to place values on them, for the approval or disapproval of his electorate or constituency.

The managers of the fund will undoubtedly explore these frontiers and identify useful measurement techniques to meet their analytic needs. They may even have to invent some of their own. It is premature to explore these techniques in great detail until we know what needs to be measured, and that depends on the objectives for the fund. Let it suffice that measures, if not comparative values, have been and can be devised for almost any public policy objective. The measures may never be as precise an indication of relative value as the dollar, but, as Robert Dorfman says, "At the very least, such a process enables attention to be focused on the question of whether the unmeasurable benefits are deemed impressive enough to justify sustaining the measurable costs that they entail."

4. The Search for Relevant Information

According to Governor Hammond:

What most Alaskans ask for is: Freedom to choose a life-style designed to one's own blueprint: a natural environment that facilitates this life-style and inspires rather than immerses one's sense of life and spirit. Yet also, most want an economic environment which is rewarding but under the control of the people it most affects ...

This balancing of environmental, social, and economic goals can only be achieved through careful, thorough analysis in which all relevant questions are asked. The purpose of analysis is to develop information, not just data. In order to be relevant, analytic techniques must focus on the important direct and indirect effects of each project as they relate to the objectives of the fund.

It would be premature at this point to present in great detail the specific analytic techniques available for evaluating competing uses of the Permanent Fund.* Appropriate techniques depend on the management structure, the uses contemplated, and the resources available for analysis. They also are conditioned on the goals specified by the legislature, i.e., what to look at depends on what your goals are. This section introduces a number of issues and analytic techniques which the managers of the fund may want to consider when they eventually address this task. The following list can also serve as a preliminary outline of questions to which Alaskans should demand answers regarding the impact of the uses of the Permanent Fund on the future of Alaska. The list is not exhaustive, and overlap will be evident.

Financial Analysis

- Internal Rate of Return¹
- Net Present Value¹
- Total Dollars Required for Investment
- Credit Worthiness of Applicant
- Time Frame and Cash Flow of Project

Business Analysis

- Risk: Financial Strength of Applicant
- Market Situation of Project Output

*A number of useful techniques are cited in the bibliography.

type photos on same page as number. (see following pages)

Business Analysis (continued)

Marketing²

Management Capability

Management Motivation³

Accounting System

Availability of Infrastructure and Human Resources

Economic Analysis

Long-Term Commitments of Resources / Long-Term Flexibility

Contribution to Gross State Product

Balance of Payments⁴

Employment Effects: Total Number of Jobs

Number of Jobs Filled by Alaskan Labor Force

Duration of Jobs

Labor Mix⁵

Alaskan Ownership⁶

Diversification⁷

Inflation Effects⁸

Income Distribution Effects

Project Benefit Distribution⁹

Direct Contribution of Project (Wages, Taxes)

Impact of Competition in In-State Markets

Impact on Savings

Recreation and Leisure: Supply

Demand

Environmental Analysis

Effluents and Residuals Modeling¹⁰

Environmental Analysis (continued)

Impact on Endangered or Indicator Species

Impact on Areas of Critical Concern

Impact on Species Populations

Compliance with State and Local Regulations

Socio-Cultural Analysis

Impact on Lifestyles¹¹

Subsistence¹¹

Pressures Toward Urbanization

Cross-Cultural Effects¹²

Population Distribution Changes

Immigration¹³

Impact on Local Self-Determination

Infrastructure Analysis (Schools, Hospitals, Police, Fire, etc.)

Impact on Demand for Public Services

Cost (and Burden of Cost) of Incremental Public Services Required

Demands on Existing Communications System

Demands on Existing Transportation System

Demands on Existing Energy Distribution System

Technical Analysis

Technological Risks

Engineering Analysis

Technological Development Geared to Alaska

FOOTNOTES

¹These are measures of the return on investment after discounting, and provide an estimate of the ultimate profitability of a project.

²Marketing includes analysis of the demand for the loan project output (both in-state and export markets), the timing of that output, and the way in which the output is offered to the public.

³The intentions of the loan applicant regarding both Alaska and the goals specified for the Permanent Fund should be a matter of concern to the Fund's managers.

⁴Balance of payments refers to the impact of projects on the types and amounts of goods and services imported and exported by Alaskans. This trade framework extends into impacts on ownership, competition, and employment and has implications for Alaskan control and self-sufficiency in its economy. Project analysis should look at both comparative advantage and import substitution depending on the goals specified for the Fund. Analysts should also pay careful attention to the extent to which benefits from export industries (employment income, profits, multiplier effects) remain in Alaska, and to the impact of these industries on the non-export sectors of the economy.

⁵Labor mix refers to both the number of white and blue collar jobs created and to the various types of skills required for the project.

⁶Increased Alaskan ownership and control of business operating in the State has been frequently mentioned by elected officials as an important goal for State economic policy.

⁷Diversification addresses the problem of both boom and bust and seasonal cycles which have plagued the Alaskan economy. Analysis is required to determine the extent to which proposed projects will broaden the economic base of the State and therefore stabilize the economy by insulating it from seasonal and external market fluctuations.

⁸Analysis of the timing, coordination, and design of projects can help prevent unwanted inflationary effects caused by tight labor markets, bottle-necks in supply, or other factors. Indexing is useful here.

⁹A critical and often overlooked area in project analysis is the distribution of project costs and benefits. The target group for benefits should be analyzed and specified, as well as groups who will pay any external costs. This must be done for both direct costs and benefits and for spillovers. In specifying objectives, the legislature may want to address the question of distribution (between demographic groups, sectors of the economy, geographical regions) and place more weight on some groups than others. This would enable the loan officer to take the distributional implications of alternative proposals into account and weight those projects with a more highly valued distribution of costs and benefits. The legislature may also want to address equity questions and investigate schemes whereby those who gain from funded projects are forced to compensate those who lose.

¹⁰Modeling techniques have been developed to estimate the quantities of both air and water pollutants produced by various industrial processes. Estimates of these "pollution loadings" can then be translated into actual impacts on the ambient environment.

¹¹ Recognizing that the Permanent Fund will be a major tool of State economic policy, the central question of growth and lifestyles may well become critical to the managers of the Fund. Analytic techniques utilizing "social indicators" will need to be identified or developed to measure the impact of proposed projects on life-styles and communities. The difficulty of this task should not be allowed to undermine its importance.

¹² Cross-cultural effects refers to the impacts from sudden contact between different cultures which could result from a project located in the bush.

¹³ Accelerated immigration is often perceived as one of the greatest negative benefits of development in Alaska. Estimates of the impact of projects on immigration, linked to employment and labor mix, may prove to be a major decision factor for loan requests.

¹⁴ Impact on local self-determination refers to the extent to which proposed projects conform to the local land use and development plans and community goals in the project area.

5. Project Screening

Analysis is not free. A thorough project analysis in each of the areas discussed above could cost millions of dollars. Therefore it may be wise for the legislature or the bank management to develop some sort of screening process, similar to the maximization, constraint technique discussed below. This could involve a two stage project analysis system.

As a first step, each loan applicant would be required to evaluate his project against a preliminary checklist of minimum or maximum standards. This checklist could be developed by the Bank or the legislature to incorporate maximum or minimum acceptable impacts or levels of contribution toward goals. This process assumes that there ~~does~~ exist limits to certain tradeoffs or impacts of concern to the legislature. Such a screening process would ease the analytic burden of the Bank, and force loan applicants to bear the cost of project impact assessment. Loans or grants for feasibility and impact studies could be made available to needy applicants. If a loan proposal passes this screening process, it could then be subjected to the more rigorous types of analysis discussed above. Such in-depth analysis would focus on the dominant attributes of the proposal, defined by comparing the attributes of the proposal against the objectives of the fund. This system would remove all clearly unacceptable proposals from further consideration, and would free the Bank's staff to pursue the more promising proposals in detail.

6. Information Transfer

Sometimes too much information can be as unproductive for decision makers as not enough information. At higher levels of management and

government, top decision makers deliberating many issues need only information critical to their decisions. For decisions concerning alternative project proposals, such information includes only data revealing the significant differences among projects. Presented below is a matrix of the various analyses discussed above. This type of matrix is well adapted to the scorecard technique and can be used to convey only the critical information required by final decision makers.

All of the information presented in the matrix will not be in the same units of measurement. Indeed, much of the information may be qualitative and verbal. Thus one of the analysts' tasks will be to translate the various units of impact measurement into terms understandable to decision makers (such as the deposition of so many tons of suspended solids results in so much reduction in salmon spawning sites or the construction of a project may result in so much secondary economic activity). This will enable the decision makers to compare impacts directly against the various objectives for the fund, and to make the necessary tradeoffs according to the legislative guidelines or his own values (more on this below).

It is unlikely that this sort of project analysis will result in projects which are clearly objectively (i.e., net present dollar value) superior to competing projects. Although this may be a cause of concern for some, in the author's opinion herein lies the value of this decision-making process. Project selection will ultimately reflect a value judgment, for neither preference revelation nor information will ever be perfect or objective. The process outlined in this report recognizes that there is great latitude in the public sector for considering values, both market and non-market. It thus seeks to:

- (1) recognize the strengths and weaknesses of analysis and the need for ~~public~~ ^{public} participation;
- (2) identify the sorts of information which will be relevant in the allocation of the permanent fund; and
- (3) insure that the information is presented to decision makers with a minimum of distortion so that decisions (tradeoffs among goals) can be held accountable to the owners of the fund, the Alaskan people.

7. Tradeoffs Among Objectives

Even after direct and indirect project costs and benefits have been identified, a problem still remains for the project (loan) analyst who must choose among projects with different degrees of contribution towards the various goals. Indeed, all of the goals of the fund may not be equally desirable. Should the legislature or the executive leave the decision concerning tradeoffs to the analyst? Or is there a means by which elected officials can transmit their preferences among goals to the analyst along with goals themselves? Presented below are three promising theoretical approaches to the problem.

a. Scorecard Technique

This technique can be just part of the following methods, or it can stand alone. Essentially, the scorecard technique involves the presentation of all data by the analyst in their natural units instead of converting them into one measure (such as dollars).* The value of this method lies in the

*An example is provided in Appendix 1.

Projects Invest in Best Future Financial Instrument Such Treasury (15)	Project C	Project B	Project A	Financial Analysis		
				Internal ROR or Net Present Value	Total Dollars Invested	Other
				Business Analysis		
				Risk		
				Marketing		
				Timing		
				Management Capability		
				Accounting and Credit Worth		
				Other		
				Economic Analysis		
				Contrib. to Gross State Product		
				Jobs Created		
				Alaskan Ownership		
				Diversification		
				Inflation		
				Labor Mix, New Skills		
				Direct Contrib.= Wages, Taxes		
				Savings		
				Recreation and Leisure		
				Other		
				Environmental Analysis		
				Effluents and Residuals		
				Endangered or Indicator Species		
				Areas of Critical Concern		
				Change in Species Populations		
				Compliance with State and Federal Regulations		
				Other		
				Socio-Cultural Analysis		
				Impacts on Life Styles		
				Impact on Subsistence		
				Urbanization Pressures		
				Changes in Popu- lation Location		
				Immigration		
				Cross-Cultural Effects		
				Other		
				Infrastructure Analysis		
				Demand for Public Services		
				Cost of Public Services Demanded		
				Impact on Commu- nication System		
				Impact on Trans- portation System		
				Other		
				Technical Analysis		
				Technological Risks		
				Soundness of Engineering		
				Other		

transmission of the maximum amount of information to participants in decision making. By leaving the data in natural units (such as numbers of jobs, numbers of eagles, dollars of income, or pounds of sulfur dioxide); the tradeoffs made by the decision-maker can be readily perceived by all. For example, if two potential projects produce the following hypothetical benefits, it will be clear from the analyst's choice what his values are.

<u>PROJECT A</u>	<u>PROJECT B</u>
100,000 Acres of Wilderness	\$20,000,000 Income to Individuals
50 Brown Bear Dens	200 Permanent Jobs
1,000,000 Visitor Days/Year	700,000 KW/hrs. electricity/year

If the benefit figures simply appeared in aggregate dollar figures, the true tradeoffs would be much more difficult to uncover (and the estimates a great deal more tenuous). Regardless of which, if any, of the other techniques are adopted, the scorecard technique for data collection and presentation should be used. Although the analyst initially makes the tradeoff, subsequent decision makers will be able to understand exactly what the tradeoff was.

b. Maximize One Goal, Set the Rest as Constraints

This technique arises from the structure of many programming techniques, such as linear and goal programming. Instead of trying to make difficult tradeoffs, the decision maker with this method simply chooses one goal (the over-riding one if one exists) to maximize and sets minimum acceptable levels for all the others to serve as constraints. These minimum levels could be designed as minimum annual goal achievement levels required of the Bank's project mix.

For example, assume the legislature chooses economic diversification and "Alaskanization" as the over-riding goal, and a measure of achievement, dollars of assets owned by Alaska residents in a specified set of enterprises, is designed. Assume the legislature also chooses job creation, recreation and tourism enhancement, wildlife rehabilitation, and industrial expansion as the other goals. Measures for each of these other goals must be designed, and then minimum acceptable levels of each must be established for achievement by the management for a given period of time. By setting these constraints, the legislature will have insured at least minimum acceptable tradeoffs or levels of achievement among goals and given the managers a more structured, constrained, and operational task. Unlike the pure scorecard technique, with this method the decision about tradeoffs among goals is not left entirely to the analyst.

c. Explicit Weighting or Ranking of Goals

The final technique offers the greatest control, and the greatest challenge to elected officials. It is based on the desire for values to determine choice, rather than for choice to determine values. If one agrees that the legislature can best represent the values of Alaskans, then perhaps the legislature should specify not only the types of investments which will contribute towards goals, but also the allocation of the fund among investments. Indeed, it would be far better for the legislature to identify explicitly the values which determine tradeoffs among goals, than to leave such value judgments to the managers of the fund. Consider the following simple hypothetical example:

An analyst is faced with choosing between two competing loan requests producing the following benefits:

PROJECT A

\$10,000 Revenue to Construction
Workers
Capacity for 51 Additional
Salmon Boats

PROJECT B

\$12,000 Revenue to Construction
Workers
Capacity for 50 Additional
Salmon Boats*

If the analyst chooses Project B, he is implicitly determining that one additional salmon boat is worth less than \$2,000. Thus the choice has determined value. On the other hand, if the legislature had stated that the survival and stability of the salmon industry is an important goal for the fund (and said nothing about income to construction workers), the analyst would have been constrained to choose Project A (assuming that one additional boat contributed to that goal). However, weighting is not quite that simple. Is a small increment in stability of the salmon industry worth a large foregone amount of income to the construction workers? Some limits and perhaps actual weights must be specified, to guide with the relative magnitude of the tradeoffs. Thus the legislature must consider all of their goals in relation to each other, and determine how much gains in each one are worth in losses to all of the others. This task could be accomplished by a task force or committee which could develop a goal weighting scheme for consideration by the legislature.

One way to establish the preferences or weighting by decision makers among competing goals or investments is to review past allocation decisions as a guide to future allocation. This method is usually rejected because preferences change and because the range of past decisions is usually inconsistent or contradictory. Another method involves the use of gaming or

*This example assumes that the social value of an additional salmon boat is not merely the present value of the dollar value of the expected catch over the boat's useful life.

simulation techniques, whereby the legislature engages in a "trial run" allocation. The spectrum of choices (and a range of quality and quantity for each choice) within eligible investment categories are enumerated, and each legislator is given a fixed number of points or dollars to allocate among them. This technique is valuable because it forces each legislator to consider the whole range of choices within a fixed resource constraint, and to reveal his preferences among the choices. More of some means less of others although with \$3 billion to allocate there should be more than less! This is indeed the very process that unfolds through the budgetary process. The creation of such a "trial run" in a gaming situation would permit a systematic consideration of tradeoffs by each decision maker, and could result in an overall identification of tradeoff weights for the entire legislature.

A detailed plan for the implementation of goal ranking or weighting must await the identification of objectives by the legislature. This section is merely intended to point out that such procedure is possible and perhaps desirable. If goals are specified and measures for them designed, the legislature can rank or weight them to guide the tradeoffs required in making choices among competing project proposals. Tradeoffs will thus reflect the values of the legislature, not the project analyst.

These three approaches to tradeoffs require varying commitments of resources. Unfortunately, greater control can only be obtained through greater effort. The scorecard approach is the easiest to implement, but its usefulness depends upon the active oversight of loan decisions by legislators to insure that the Bank is making acceptable tradeoffs. The

maximization, constraint method is useful if one overriding goal is determined, and if minimum acceptable levels of other goals can be established. If this is possible, more automatic legislative control of tradeoffs is possible. The most difficult and time-consuming technique is the weighting of goals, yet this technique also offers the greatest flexibility and control. Weights provide the fund's managers with specific legislative guidelines to tradeoffs among all of the goals for the fund and they can be adjusted over time. Unfortunately, for legislators, safety often lies in ambiguity. To "fight it out" to identify tradeoffs acceptable to the entire legislature is much more difficult and revealing than the preparation of a simple list of eligible investments.

Regardless of which method is actually implemented, it is important to recognize that someone is going to have to make tradeoffs among goals. Each project which is chosen will contribute toward different goals, and to different degrees, than the rejected alternatives. It is up to the legislature and the Governor as to what extent they want to leave these choices to the managers of the fund. The above techniques offer ways to help elected officials either make the choices themselves, or constrain those to whom authority has been delegated.

8. Conclusion

It is useful, and often essential, to place public policy problems in some sort of theoretical framework to provide a structure for thinking about them. This report has attempted to utilize theories from public sector economics in order to formulate an approach to what to do with the permanent fund.

As we have seen, the first necessary step is the revelation of voter preferences through a variety of mechanisms such as the legislature, the governor, and the Public Forum. The need for this should be clear: the citizens of Alaska own the permanent fund, and in the United States we rely on the political process as the surest way for citizens to exercise control and accountability over the allocation of government resources. Once voter preferences have been clarified, the legislature and the Governor can refine them into goals and objectives to serve as investment policy for the fund. In turn, measures of effectiveness in achieving the goals and objectives must be identified or invented to serve as criteria for selection among alternative uses of the fund.

Once the goals and objectives for the fund have been identified, the role of the analyst begins. Competing uses of the fund will contribute to different degrees to the different goals, and will result in various indirect costs and benefits which in the public sector not only can be but must be considered. Thus, the task of the analyst is to identify both the market and non-market attributes (costs and benefits) of the alternatives and present this information in a manner useful to both decision makers and the interested public. Finally, the report introduced three techniques for insuring that elected officials retain control over the tradeoffs among goals, and recommended that some effort be expended towards the most powerful technique, the systematic weighting of goals.

In sum, the report has sought to clarify and partially illustrate the opportunity presented to the state of Alaska to identify, and then seek, a publically defined social return on its investment of the permanent fund.

APPENDIX 1

EXAMPLE OF SCORECARD

TABLE 6.1.
Impact Summary for the 1977 Reference Cases^a

Item	Case					
	Nominal	A	B	C	D	E
Strategy components						
Fixed source	Nominal	Nominal	Maximal	Medium	Maximal	Medium
Retrofit ^b	D ^c	R	L	M	L	M
Mileage surcharge, ¢/mi	0	0	0	0	0	0
Bus-eligible population, % ^d	70	70	70	70	80	80
Bus headways, peak/off-peak, min	40/40	40/40	20/40	20/40	20/40	20/40
Bus fare, ¢/trip	25	Free	Free	Free	Free	Free
Environmental Impacts						
Worst-day oxidant concentration, ppb	0.13‡	0.08*	0.08*	0.08*	0.08*	0.08*
Number of days oxidant above standard	15‡	1*	1*	1*	1*	1*
Lead standard achieved?	No‡	Yes	Yes	Yes	Yes	Yes
Annual gasoline consumption, million gal	615	618	609	607	604	603
Annual diesel-fuel consumption, million gal	2.4	2.4	3.4	3.4	4.8	4.3
Transportation-Service Impacts						
LDV mileage reduction, % of uncontrolled	0.0	2.9	4.3	4.3	5.0	5.0
Trips forgone, % of uncontrolled	0.1*	1.0‡	0.9§	0.9§	0.9§	0.9§
Trips by bus, % of all trips	1.1	1.4	2.6	2.6	3.1	3.1
Carpooling, % of home-work trips	5	5	5	5	5	5
Economic Impacts						
Annual strategy expenditures, \$ millions						
Fixed-source control	2.8	2.8	5.1	3.2	5.1	3.2
Retrofit	7.7	67.6	51.5	55.2	51.3	55.0
Mileage surcharge	0	0	0	0	0	0
Bus	10.0	10.0	15.0	15.0	23.0	23.0
Net expenditures after transfers, \$ millions ^e	20.5*	80.4§	71.6‡	73.3‡	79.4§	81.2‡
Unallocated income from surcharge, \$ millions	0	0	0	0	0	0
Incremental recurring employment	77‡	815§	1041‡	1048‡	1536*	1543*
Incremental nonrecurring employment	212*	2071‡	1144*	1483§	1144*	1483§
Number of buses	175*	175*	348*	348§	490‡	490‡
Distributional Impacts						
General aviation annual cost, \$/aircraft	0*	0*	500‡	0*	500*	0*
Retrofit procurement cost per household, % of income ^f						
Under \$5000						
User-pays financing	0.8*	8.9‡	5.4‡	6.5§	5.4‡	6.5§
Income-proportional financing	0.2	2.6	1.6	1.9	1.6	1.9
Over \$15,000						
User-pays financing	0.1	1.2	0.8	0.9	0.8	0.9
Income-proportional financing	0.2	2.6	1.6	1.9	1.2	1.9

^aCode: * = best; ‡ = next best; † = worst; and § = next worst.^bSee Appendix D for detailed composition.^cStrategy currently mandated by CARB.^dAs percent of total county population.^eSurcharge income used to offset bus subsidy to whatever extent possible.^fPercent of average annual income for income group; retrofit procurement expenditure made in a single year.

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August 26, 1976

File
SIAC

#60

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SIAC

#60

In November, Alaskan voters are expected to approve an amendment to the Alaska Constitution establishing a Permanent Fund for the receipt of certain proceeds from non-renewable resources. According to the estimates by the Department of Revenue, the Fund balance will approach \$2 billion by 1985. Assuming passage of the amendment, there are at least three major issues relating to the Permanent Fund which must be addressed:

1. Definition and selection of eligible "income producing investments" for use of the Fund principal.
2. Determination of the uses for income (earnings) from Fund investments.
3. Development of the organizational and managerial structure for the Permanent Fund necessary to implement (1) and (2).

Clearly, these issues are interrelated - appropriate organization and management structures will vary with the selected use of the principal and interest. Further, the investment strategy selected for the principal will determine the amount of Fund earnings available for any purpose.

The range of choices regarding the Permanent Fund is wide. For instance, listed below are several possibilities which readily come to mind. They are meant to be suggestive rather than exhaustive or mutually exclusive.

A. Use of Permanent Fund - Principal

1. Financial investment (possibly outside the State) yielding the highest rate of return (given some risk factor).
2. Bonding security to improve State infrastructure or to finance capital relocation.
3. Development Bank - Loan Funds:
 - a. housing or other construction;
 - b. industrial development;
 - c. small business;
 - d. fish hatcheries;
 - e. employee equity participation in business or cooperative enterprises;
 - f. agricultural development.
4. Equity capital for State participation in joint ventures.
5. Direct investment in renewable resource sector.

B. Use of Permanent Fund - Earnings

1. Reinvestment in Permanent Fund (accumulate and compound earnings).
2. Distribution of earnings in cash payments to Alaskan residents (some form of "Alaska, Inc.").

3. Reduction of a personal tax burden through the use of earnings to finance current expenditures.
4. Financing of increases in current expenditures with earnings. (e.g. health, education, and transportation)
5. Distribution of earnings to local governmental units for local financing of public goods and services, or for local tax relief.
6. Use of earnings for any of the purposes suggested above (Part A) for use of principal.

The sheer size of the Fund coupled with its range of alternative applications has vast policy implications. Are the expenditure decisions to be made in the public or private sector (government expenditures or investments versus cash grants or reduced taxes)? Are expenditures and investment decisions to be made favoring present or future generations? Emphasizing industrial development or renewable resources? Maintaining or replacing particular lifestyles? Speeding, slowing, or smoothing population and economic growth?

It is inevitable that specific objectives will differ substantially among individuals - varying with political philosophy as to the role of government as well as with normative judgements regarding what constitutes a "desirable" future for Alaska. A goal of particular importance to this Administration is the enhancement of renewable resource-based industries such as fisheries, forestry, and possibly agriculture. Another prime concern of this Administration is the participation of all Alaskans in the benefits from the utilization of nonrenewable resource wealth. Whatever the particular goals pursued, disposition of both the principal and earnings of the Permanent Fund have long- and short-run policy effects. The Fund and its uses should be viewed as a policy tool, and its potential uses and implications carefully examined.

Since the Permanent Fund is a critical policy tool, it is the proper role of the Division of Policy Development and Planning to insure the consideration of the following concerns:

1. Investigation of a wide range of alternative strategies, eschewing a narrow view of economic diversification or investment possibilities.
2. A clear statement and understanding of benefits to be obtained from Fund activities, i.e. - careful project evaluation in terms of net social benefit rather than vague assertions of the public good or private profitability.

3. A determination of the distributive implications of each plan, i.e. - who benefits from the activities directly and indirectly? (Are plans couched in terms of the general good really for the specific good or benefit of a particular group or segment of society?)
4. An interpretation and integration of various alternatives in terms of short- and long-run policy goals.

There is an immense amount of power implicit in control of the Permanent Fund, given its size and potential. Those who control the use of the Fund will shortly be presiding over resources greater than the current State operating budget. It is safe to assume that individuals from within and outside the public sector will be attracted by these resources, and the power and influence their control represents. This point is stressed to emphasize the critical need for a thorough and balanced evaluative process on this issue.

The State Investment Advisory Committee will play a key role in this process - weighing various types of Fund organization and management as well as alternative Fund uses. This Committee has a major responsibility in contributing to these vital choices. The resolution of the issues raised above has strong implications for the kind of Alaska we will see in the future.

ALASKA STATE INVESTMENT ADVISORY COMMITTEE

PERMANENT FUND MEETING

509 West Third
Anchorage, Alaska 99501

October 13, 1976

AGENDA

- 9:30 a.m. Opening Comments - Commissioner Gallagher
- 10:00 a.m. Adoption of Minutes of the August 26 meeting -
Bob McFarland, Chairman
- 10:30 a.m. Status report on Alaska Economy - Bob Richards,
Alaska Pacific Bank
- 11:00 a.m. Update on Revenue Projections - Vince Wright
- 11:30 a.m. Open Discussion
- 12:00 Break for Lunch
- 1:30 p.m. Report on current Permanent Funds, Characteristics of Management,
Legal Structure, etc. - Ken Butler, White Weld & Co.
- 2:30 p.m. Report on the Organization, Management and Control of Development
Banks - Peter McDowell, Price Waterhouse Co.
- 3:30 p.m. New Business
- 4:00 p.m. Set Date of Next Meeting
- 4:10 p.m. Adjourn

MEMORANDUM

State of Alaska

TO: Jim Rhodes
943 W. 6th Avenue, Suite 30
Anchorage, Alaska 99501

DATE: September 20, 1976

FILE NO:

TELEPHONE NO:

FROM: Jim Edenso
Deputy Commissioner, Treasury
Department of Revenue

SUBJECT: SIAC - Minutes

The last meeting of the Alaska State Investment Advisory Committee was very informative and served to indicate the magnitude of the task we have before us. After a considerable wait we have finally received a copy of the transcript of that meeting. Please find enclosed a copy of the minutes. This should serve as a reference document for your use in reviewing the meeting and consideration for future discussions.

Since August 26, we have undertaken the following activity:

1. A contract with Price Waterhouse & Co. has been signed. This firm will provide an analysis of potential organizational structures and management for the administration of the permanent fund.
2. A contract has been negotiated with Ezra Solomon. This contract will provide a reference source for questions concerning either the national or the Alaskan economies. Mr. Solomon will also provide his knowledge and expertise concerning financial investments and social benefits.
3. Negotiations with the firm of Arthur D. Little, Inc. are currently underway. The purpose of this contract is to provide macro econometric modeling as it relates to the national and the Alaskan economies. This firm will work in close cooperation and coordination with Alaska Pacific Bank.

In conversation with Commissioner Gallagher and other SIAC members it has been determined that October 13 would be a good date for the next meeting. Please put this date on your calendar and plan to attend. Anchorage is the most central and consequently the most logical place to hold the SIAC meetings. I will be forwarding to you any reports and information received from the consultants prior to the October 13 meeting.

If you have any questions concerning the last meeting or relating to the permanent fund please feel free to contact me directly. It would make planning this meeting easier if you can inform me of any conflicting dates concerning the October 13 meeting date.

JE:ge
Enclosure

STATE INVESTMENT ADVISORY COMMITTEE

MINUTES

October 13, 1976
Anchorage, Alaska

Chairman Eric Wohlforth called the meeting to order at approximately 9:45 a.m. on October 13, 1976 in the Department of Revenue Conference Room, 509 West Third, Anchorage, Alaska.

Members present were:

Dr. Logsdon, Associate Director, Agricultural Experiment Station,
University of Alaska, Palmer
Mr. Eric Wohlforth, Attorney at Law, Anchorage
Mr. Robert Barnes, President, Alaska State Bank, Anchorage
Mr. Dennis Waldock, Foster & Marshall, Anchorage
Mr. Martin Pihl, Vice President & Comptroller, Ketchikan Pulp Company,
Ketchikan
Mr. Robert Thorstensen, Petersburg Fisheries, Inc., Petersburg
Mr. Jamie Love, Alaska Public Interest Research Group, Anchorage
Mrs. Lanie Fleischer, Anchorage
Representative Hugh Malone, Kenai
Representative Richard Urion, Anchorage
Representative Clark Gruening, Anchorage
Mr. Langhorne A. Motley, Commissioner, Department of Commerce and
Economic Development, Juneau
Mr. Jim Edenso, Deputy Commissioner, Department of Revenue, Juneau
Mr. Robert LeResche, Office of the Governor, Juneau

Absent Members:

Mr. Emil Notti, President, Alaska Native Foundation, Anchorage
Mr. Robert McFarland, First Federal Savings & Loan, Anchorage
Senator John Butrovich, Fairbanks
Senator Jalmar Kerttula, Palmer
Andrew S. Warwick, Commissioner, Department of Administration, Juneau
Mr. James Crawford, Anchorage
Senator Frank Ferguson, Kotzebue

Advisee:

Sterling Gallagher, Commissioner, Department of Revenue, Juneau

Others present were:

Peter B. McDowell, Price Waterhouse & Co., Inc.
Kenneth Jensen, Arthur D. Little, Inc., San Francisco
Kenneth Butler, White, Weld & Co., San Francisco
Bob Richards, Alaska National Bank, Anchorage
Charles J. Fuhrmann, White, Weld & Co.

Others present - continued:

Gary Larson, Price Waterhouse & Co.
L. Patrick Oden, White, Weld & Co.
Dan Regis, Price Waterhouse & Co.
Susan Andrews, Anchorage Times
Paul Engelman, Federal/State Land Use Planning Commission
Bradford Tuck, Federal/State Land Use Planning Commission
Thomas R. Packer, Alaska National Bank
David Rose, Bond Bank Authority
Jim Weber, Bureau of Land Management, Anchorage
Jim Rhode, Staff, House Finance Committee
Frank Reed, Jr., Dean Witter & Co.
Jack O'Quinn, Alaska Oil & Gas Association
Dona K. Lehr, Policy Development & Planning
Carol A. Greil, Area Realtors, Inc.
Vincent Wright, Department of Revenue, Juneau
Paul Dodson, Department of Revenue, Juneau
Lisa Jorgenson, AKPIRG, Anchorage

MINUTES:

Mr. Wohlforth: In Bob McFarland's absence I will now open the meeting. The first item of business is opening comments by Commissioner Gallagher.

Mr. Gallagher: I would like to welcome you all to the second meeting of the State Investment Advisory Committee concerning the establishment of the proposed Permanent Fund. The last meeting served to introduce new members of the Committee and to initiate the process of establishing the Permanent Fund. This meeting will allow the Committee the opportunity to begin evaluating the work currently being undertaken by the Consultants for the Permanent Fund.

Bob Richards will further describe the State's economy by providing a sectional analysis of each segment. His input will allow the Committee to begin focusing on the potential investment opportunities available in Alaska. This information will be useful in considering investment policy.

Price Waterhouse will present their report on the organizational structure, management and control of existing funds which currently undertake the administration, management, and investment of large development projects. Their report compares the characteristics of funds which are similar in nature to the proposed Permanent Fund, e.g., the limitation which permits only income earnings investments.

White, Weld & Company will present their report on existing permanent funds. Characteristics of these funds will be reviewed and outlined for the Committee.

The Governor has asked the State Investment Advisory Committee to actively pursue the establishment of the Permanent Fund. This Committee was expanded to include a broader base of Alaskans to provide a greater breadth of ideas and input for establishing the Permanent Fund.

There has been some concern expressed in the news media that this committee has become a "powerful board." This is a basic misunderstanding of the State Investment Advisory Committee. The Committee is mandated by statute to advise the Commissioner of Revenue on investment policy for the State's funds. The use of the State Investment Advisory Committee for the Permanent Fund is an exception and its expansion is intended to be temporary. In the event that the Permanent Fund is established, it is anticipated that the Committee will return to its previous status.

There has been much concern expressed concerning the goals of the Permanent Fund. Briefly, I see three major goals of the Permanent Fund.

The Permanent Fund could have as one of its goals the strengthening of the State's economic base. This could be accomplished by adopting policies for the investments which tend to stabilize the economy, a flattening out of the so-called peaks and troughs. Investments into renewable resources using non-renewable resource funds will help future economic conditions. Policies which tend to reduce the seasonality of employment would provide greater employment opportunities for more Alaskans. The benefits of the Permanent Fund should reach a broad population base of the State.

A second goal could be to provide assistance in the area of community development. Assistance in communication development, housing assistance, and other socially related programs could be goals for the fund.

Finally, a third goal could be to support the "savings account" concept. This would affect the economic growth of the State and allow for greater selectivity and participation in future development. Additional benefits could be derived from direct earnings received on the funds.

Many people have expressed concern for safeguarding the funds. There are many ways of developing safeguards and they are generally provided procedurally through the management and control of the organization.

Management provides safeguards by building checks and balances into the decision-making process. A further control is the use of generally accepted accounting reporting and auditing procedures. Annual audits are a very effective check on management activities. Public reporting requirements on a regular basis greatly inhibit the misuse of funds.

A brief review of our activity will establish that there is a major effort by the State to establish the Permanent Fund; the cooperation between the administration and the legislature in establishing the Permanent Fund; the use and expansion of the State Investment Advisory Committee as a human resource pool to develop the Permanent Fund; the hiring of consultants to provide research and data relevant to the development of the Permanent Fund, and the use of the public forum, the Alaska Growth Policy Board to carry the dialogue of the Permanent Fund to the general public.

Mr. Wohlforth: Thank you, Commissioner. The next item is the adoption of the minutes of the August 26 meeting. Is there a motion?

Dr. Logsdon: I so move.

Mr. Waldock: I'll second it.

Mr. Wohlforth: Any discussion? If not, all in favor of adoption signify by saying "aye." Contrary? They are adopted. We will now go to Vince Wright, Director of Research for the Department of Revenue, to give an update on revenue projections.

Mr. Wright: Each quarter, the Department of Revenue publishes a "Revenue Journal." We feature what we consider to be the results of vital research efforts and this particular one is devoted to permanent funds. We are not advocating any ideas whatsoever. We're simply presenting a series of thoughts, concepts and ideas that council members, administration and the legislature have developed over a period of time in relation to the permanent fund concept.

We have listed those items that Joint Resolution No. 39 has specified as being qualifiable for the permanent fund monies. Right now the amendment reads at least 25% of State oil royalties, State gas royalties, Federal royalties, mineral lease rentals and bonus sales will be set aside for permanent fund purposes. We have listed these items in numerical amounts that are attributable to each of these categories by year commencing in FY 77 and going out through fiscal year 1985. We have also calculated what the actual contribution rate would be on a per year basis. Then we have simply accumulated those figures so that by fiscal year 1985 based on the 25% contribution rate, we're roughly calculating \$1.8 million.

In arriving at these projections there are many assumptions such as price of the oil, throughput assumptions, tariff rates, etc. and we constantly have to update these figures due to changing conditions.

It's on the basis of wellhead value that we determine our royalties; at 12-1/2%. First, we start out with refinery products. We're adopting Saudi Arabian crude

and from that we subtract what we call a series of tariff rates. There are various tariffs. For example, you have the tax tariff which represents the line itself; you have the tanker tariffs which in this case coincides with shipment from Valdez to Long Beach. The third set of tariffs assumes that for a six-month period we're going to ship oil through the Panama Canal. Another set of tariffs we've identified with what we call the SOHIO line project. In other words, assuming that everything is approved there will be a line running from Long Beach to Midland, Texas. That line consists of an El Paso gas line which El Paso has agreed to convert to an oil line should the FPC approve it, and it also consists of 200 miles of new lines that would have to be built across Southern California.

All of those items make refinery prices from which we derive the wellhead value. From that wellhead value you take your royalties, which amount to 12-1/2%.

Are there any questions so far?

Mr. Motley: What was the allocation for going around the Panama Canal?

Mr. Gallagher: It's 75¢ to Long Beach, probably about another dollar to the East Coast, about \$1.60-\$1.75. Other tariff is \$2.20, so that adds about 45¢ to 50¢ by taking it through the Panama Canal past Long Beach and going by water.

Mr. Love: What would happen if the tax rate was changed drastically? Is there an area where taxes will go into this?

Mr. Wright: Taxes do not go into this, only percentages of royalties.

Mr. Love: Would that affect the royalties or anything?

Mr. Wright: Depending on which route the oil goes the tariff rates can be affected, therefore, wellhead value can be affected, therefore, royalties.

Mr. Love: I'm talking just about the Alaska State taxes.

Mr. Wright: The tax does 't.

Mr. Waldock: Have you considered shipping any of this excess oil to Japan? What would be the savings in exchanging oil with the Middle East coming to the East Coast?

Mr. Gallagher: There is a considerable savings to the State. The advantage to the United States is minimal because you just displace the Saudi crude. Just different people get the income. In one case shippers seem to get the money, or pipeline companies, in the other case it would go to the owner of the property. We, being an owner, would receive quite an income differential, but the nation as a whole would not get that much difference.

Mr. Waldock: Do you have any statistics on how much it would save the Alaskan people?

Mr. Gallagher: There is about 9¢ per barrel differential. I'm saying the advantage to the Japanese is somewhere around 9¢.

Mr. Wohlforth: If there are no further specific questions we will ask Mr. Bob Richards to give us a status report on the Alaska economy.

Mr. Richards: Thank you. My discussion today will be in four parts: What the Alaska economy looks like today; where the Alaska economy seems to be headed; a brief examination of what sort of policy implications seem to naturally flow from the first two; and a little bit of regional observations.

There's really not too many surprises in the structure of the Alaska economy today. We have charted the cyclical behavior of Alaska's economy, particularly the civilian employment. The first chart is the historical development employment; the second is the historical development of population. Other charts show the diversification in industry and the geographic diversification.

Mr. Edenso: What are the industries most affected by seasonality?

Mr. Richards: Tourism and fishing; forest products and construction; trade and services.

Mr. Gruening: What is the average month of employment? How many people unemployed and how many people employed of the total work force?

Mr. Richards: I don't have the absolute numbers here with me. But there are 14% more people employed in August than there are in November and about 12% less employed in January than there are in March.

Mr. Edenso: What you're saying is that there is more stability and seasonality in employment in trades, services and finances, government, possibly transportation, communications, and utilities than there is in construction, manufacturing and mining. In other words, productive industries plus limited service industry of tourism is largely seasonality affected. The mainstay for employment in the State is not affected by seasonality.

Mr. Richards: That's right. Government is and is not the mainstay of employment. Government and basics are the only things that result from autonomous investment decisions. Distributive is an induced investment decision. Distributives are a function of what's going on in Alaska economy, and government partially is, and the basic is not at all, and government is partially not.

Mr. Edenso: I'm not sure I really understand what is basic and what is distributive.

Mr. Richards: Basic is mining, manufacturing, tourism, forest products, fishing, petroleum, hardrock mining, and some construction.

Mr. Edenso: Those aren't really affected by seasonality, then?

Mr. Richards: No. Some of them are seasonal and some are not. I'm not suggesting that all basics are seasonal. Basics are basic. They're autonomously induced. Distributive is internally induced. To the extent of whether or not some basics are seasonal and some are non-seasonal, that's another dimension.

Mr. Edenso: That's what I'm trying to get at. What are those basics that are in fact seasonal, and what percentage or proportion of the economy, what is the importance of their role in the economy?

Mr. Gallagher: We want a breakdown for each industry.

Mr. Richards: All right, we'll do it for each industry.

Mr. Pihl: Do you have any data on resident and non-resident employment? I would judge that the peak is greatly increased by non-resident employment?

Mr. Richards: Yes, we do have data on that and I will develop it for you next time.

Mr. Love: Are we to assume that all of the data is for 1975 unless otherwise indicated?

Mr. Richards: Yes. Graphs 7, 8, and 9 are 1975 data. The next graph is from 1973 data. This graph definitely has some investment implications in terms of a permanent fund. Almost 2/3 of our gross state product comes from the South Central region. The South Central region has 54.5% of the population, so the gross state product per capita is considerably higher in South Central than elsewhere. South-eastern also has a higher than proportionate share of gross state product relative to population. Alaska is a highly labor intensive state. Labor costs have been of concern to all of us. Alaska heads the per capita personal income by states for 1974 by 30%. The major source, 90% of personal income in Alaska, is from wages and salaries as distinguished from other sources of personal income, Social Security payments, retirement benefits, etc. In other words, over 90% comes from wages and salaries.

Mr. Gallagher: Has there ever been a chart done correlating it back to inflation or real dollars?

Mr. Richards: The change in real over time?

Mr. Gallagher: No; inflation. This state in comparison to the national economy.

Mr. Richards: Yes.

Mr. Gallagher: I would like to see this chart reposed over the real, discounted, for instance.

Mr. Richards: Okay, what do you want to use as the base period? 1960?

Mr. Gallagher: Can you get the cost of living index for each state and then repose it here?

Mr. Richards: Yes, but as I indicated, that is a function of time. The cost of living is a function of changes over time.

Mr. Love: He's saying that if the cost of living in Alaska is 50% higher than the cost of living in the District of Columbia it wouldn't make sense to say in real dollars that our income is higher than that of a person living in the District of Columbia. Our standard may be lower in some instances.

Mr. Richards: It's not inflation you want; but the cost of living differential at a moment in time.

Mr. Reed: Have you ever done a study of the disposable income? I think that is a critical factor which integrates in the cost of living and how much of a percentage of our income we spend for housing, etc. Has our disposable income percentage-wise increased?

Mr. Richards: I can give you some general reflection of the situation now, in terms of the 1974 data the cost of living differential between Anchorage and the rest of the United States was close to 25%. The next chart arrays the sectors of our economy on the basis of the extent of their labor intensity, and as you can see, we're a highly labor intensive economy.

Mr. Gallagher: If you want to raise that basis, take out the seasonality, you invest more in government?

Mr. Malone: Looking at the breakdown on per capita income across the United States and relating Alaska to Washington, D.C., it looks like government might be the best investment, if we just made a simple assumption.

Mr. Richards: The last two charts reflect the disproportionate role played by the petroleum industry in terms of the public sector.

Mr. Love: One of the advantages of a large percentage of our revenue coming from petroleum related industries is that you have to raise less revenue through things like personal income taxes and state application of sales taxes, etc. What you may perceive as a problem because it's a centralization of our revenue source in a single industry, may be interpreted by others as an overall benefit because it allows us a tax relief off other groups that otherwise would be carrying the burden.

Mr. Urion: It doesn't work out that way.

Mr. Richards: I think the point you made is a valid one, but nevertheless I still hold the notion that severe lack of diversification in any regard is in fact a problem. The final discussion is a further elaboration of the role of the public sector in Alaska. It's been by far the major cause of population growth in the State of Alaska and this does not include the military.

Mr. Edenso: You show an increase in state and local government employees as nearly 15,000. For a specific period of time within that time frame have you had a larger increase than at some other time?

Mr. Richards: Yes, the latter years the increase was greater than the former years.

Mr. Edenso: We don't know where we see a tremendous amount of growth taking place. I assume it occurred after 1971 or 1972. Maybe that's an erroneous assumption.

Mr. Richards: I'll get you the specific pattern on that.

Mr. Malone: The increase in employment, particularly in the government sector in Alaska is very large. Are there any statistics available or information available that might indicate to us where these people came from who went to work for state government; whether they came from the state itself or came from outside the state?

Mr. Rhode: I checked with Kent Dawson of the Governor's office on that. They did a quick survey and found about 55% of those hired as state employees had been physically resident in the state less than one year at the time of their hire.

Mrs. Fleischer: Does that include students who had been living outside in college for four years and then were coming back?

Mr. Rhode: No, those would count as full bona fide residents. This was done for

the year 1975.

Mr. Richards: No, I don't have any answer to that. To capsule where the economy seems to be headed. The next two or three years will be periods of rather severe slowdown in growth, then we'll have a period of acceleration. The reasons for this are threefold: (1) the decrease of employment on the pipeline project; (2) more modest state spending increases and, (3) a holding back in the private section.

The slowdown is not going to be a bust for three reasons: (1) this huge stable underlayment of government providing 40% of total jobs, 30% of civilian jobs, (2) the fact that the pipeline is not contributing as much of the boom as is normally believed, therefore the absence of it is not going to contribute as much to the bust as normally believed. My study showed that 40% of those workers send their payroll checks directly outside. The third factor is that the businessmen are not going to squelch their expansion plans and investment plans completely because they're too much aware of what is coming in the 1980's. So investment in the private sector will continue but at a slower rate than it has in the past two or three years. That's the short run outlook.

In the long run, the three most rapidly growing sectors of Alaska's economy over the next ten years will be petroleum, construction, and the visitor industry. I think by the end of the next decade these three industries will surpass fishing in their importance as sources of employment. The hardrock mining and forest products industries are impossible to predict, hopefully, they'll experience some growth, but probably at slightly more erratic patterns and uncertain rates. Finally, I think agriculture continues to remain a long shot, though a tremendous potential.

In the public sector, state and local government in ten years will replace the federal government as the dominant employer in the State of Alaska. Anchorage, I think, will continue to serve as the State's commercial and financial center.

The relative thing is not so much the type of investments that the Permanent Fund would be making but the timing of the investments, and perhaps the geographic location as well.

Obviously we need more jobs in the wintertime and we need more diversification. As I've pointed out, our economy is highly labor intensive. The petroleum industry is extremely capital intensive. The bank tellers and hotel clerks are paid considerably less than roustabouts on drilling rigs and bookkeepers for petroleum firms. The one thing that explains that is the differing degree of labor intensity and capital intensity. However, in terms of the policy implications of the outlook, I don't think there's any reason for the State to panic about going into a bust and, therefore, to go into some major explicit counter-cyclical spending spree. The normal increases that simply flow from social concerns will be enough to keep a sufficient amount of spending injected into the economy, and the implication of the long range outlook is that because of the type of growth we're going to have, the fund will be principally capital intensive, and it's likely that public revenues will increase to a considerably greater degree than the demand for public services. Therefore, the managers of the fund are going to have more latitude for investment decisions.

Mr Wohlforth: Thank you. Any questions?

Mr. Malone: The concept of using the fund balance or fund investment as a counter-cyclical device poses a very difficult political question in that when you have a

great amount of activity in the economy, something like the trans-Alaska pipeline, there's considerable demand for capital; when the business community perceives things may be slacking off, they're not going to go on the hook for the debt. So then probably these types of investments or expenditures may more normally come from the State budget in terms of a public works project rather than an investment in the private sector as a construction of a new plant or service industry.

Mr. Wohlforth: I think it's the public sector's experience in the last six years. After the oil lease sale in 1969, we expanded state spending for current expenses and capital improvements. Then with the pipeline finally on the horizon we again expanded state spending in the capital improvement sector which, of course, means anywhere from \$80 to \$90 million in bonds per year.

Why did that happen? I feel because there was a perceived requirement in construction of necessities in the State. We wanted schools, roads, and all the things that were necessary and continued to be necessary, notwithstanding there was a tremendous burst in economic growth related to the pipeline.

I come to no conclusion on the subject except to say that it is a very difficult mix of public and private perception of what is needed in the State and at the same time observe what's happening to the economy and the possible inflationary effect. I would like to see some studies done on this subject.

Mr. Waldock: Bob, have you begun to develop charts on what ratio of monies should be applied towards the economic investments rather than social investments? At our last meeting I was left with the feeling that you strongly felt the majority of the money should be directed towards economic investments rather than social investments and I was wondering if you had come up with a ratio that you might suggest.

Mr. Richards: No, I haven't yet but I will give some thought to this matter and see how we might come up with some numbers on it.

Dr. Logsdon: In relation to spendable income, Alaska with over 90% income from wages and salaries, how does this compare with the U. S. average? Do you have that figure?

Mr. Richards: I don't have it but I think it's in the high 70's.

Dr. Logsdon: You can't hide the wage and salaries from taxes. I think this could be a significant figure, about 70%?

Mr. Gruening: You're talking about population growth related to State spending. The money was generated by the bonus lease sale, the money was there. What would be the alternative? Could it be that the Permanent Fund was an alternative as a savings to prevent the spending that generated the population growth? What is the policy implication?

Mr. Richards: As an economist, I don't think it's my role to make any political observation or recommendation.

Mr. Gruening: If the government had decided not to hire any new State employees but injected into the private sector, it seems to me you would encourage the same population growth. It's the function of spending to generate that, not the fact that it was spent in government, isn't that right?

Mr. Richards: It depends on whether you invest in a highly labor intensive

sector, which government is, or a highly capital intensive sector.

Mr. Gruening: Would you say that one of the goals of the Permanent Fund should be to even out the economic distribution to the State; to bolster regional economies so that you don't have an uneven high cut?

Mr. Richards: I think it should, but we have to be careful to distinguish between what is form and what is substance. It should be invested regionally on the basis of something that will be sustainable in that industry, in what region, and what will in fact contribute to a long run sustainable change in these proportions, as distinguished from the injection of funds to the present people who happen to reside there. There is a very real distinction.

Mr. Gruening: I would like to know where State loans have generally gone geographically.

Mr. Motley: I can provide that as we keep the loans on file by election districts. It's in the public domain.

Mr. Barnes: Everyone in Alaska is really enamored at the cost of living today and use it as a juncture for higher salaries. In showing the cost of living index do you think it would show Alaska at the top and Mississippi at the bottom of all the states?

Mr. Richards: Yes, it will.

Mr. Motley: Where will it put Georgia?

Mr. Richards: The Bureau of Labor Statistics measurement of cost of living gives as much misinformation as information. It does not sufficiently take into consideration life style differentials. We all know that a gallon of gasoline costs more in Anchorage than it does in Seattle and we all know that people in Anchorage spend less on gasoline than people in Seattle. But it's really nothing more than a good rough estimate.

Mr. Barnes: Do you think our situation is similar to Venezuela in that if we take these funds that have been projected, put them into the economy (the money was there) what alternative was there to spending it? I would think the alternative is what Venezuela did, put it in a fund that is not used in the economy on a short term basis but only brought back into the economy diversified over a much longer period of time. In other words, can we absorb these funds into our economy? Can we build dams and other projects?

Mr. Richards: That's a fascinating question, the whole question of absorption and one to which I've not addressed any attention, but it is a key question.

Mr. McNeil: I think Mr. Richard's report is very helpful and has identified a number of things that the investment policy should be directed at, such as seasonality. I think the aspect of resident versus non-resident employment is an important one to the State. I notice the projection of growth and other income of the State is 285 million for fiscal year 1977 growing to 800 million in 1985. That's a pretty substantial rate of growth; I think around a 20% rate of growth per year.

Mr. Edenso: Bob, could you elaborate on that a little, 285 million going up to 800 million?

Mr. Richards: Almost all of that is induced by the growth of the petroleum

industry and the growth of State government, almost all of it is personal income-- the majority of it is personal and corporate income taxes.

Mr. Gallagher: Government spending made a huge climb in 1970, since then all we've bought with government is inflation, the bigger population base. All those big leaps in numbers are just inflation and population base. This is boiling government spending down to a real per capita dollar. The times when we were going through 20% population gains we were also going through 10% inflation. So when the budget went up by 30% it shouldn't have been that much of a surprise.

Mr. Edenso: Bob, you give us "Gross State Produce by Region." I can speculate on why you made your comments concerning the disproportionate distribution of that product by the South Central and Southeastern, but will you elaborate a little more on why we have a concentration of gross State product in the South Central region and the Southeastern region disproportionately on population versus the Interior and other areas?

Mr. Richards: In terms of Southeastern that's where the resource has been, the fishing and the forest products; that's where our industry has been. The primary factor underlying South Central has been that this is the hub of the largest sector, the distributive sector, the public section and also it 's the financial sector which is included in the distributive sector.

Mr. Edenso: So where there are different types of development or potential investment opportunities, a very prime consideration will be the ability of that particular region to support an industry of any kind. So you're talking on large capital outlays for construction development.

Mr. Richards: Yes, I concur with that.

Mr. Love: I share some of the concerns in terms of wanting more objectives in terms of evaluating your basic orientation of where you think the direction of the Permanent Fund is. You gave a very short and subjective paper on what you considered to be the different investment possibilities in terms of how we would maximize benefits to the Alaskan public. There's very strong indications for a development banking type approach. I agree with a lot of your assumptions but I'm reluctant to see this Committee submit itself to that course unless some more objective data comes out that we can have other people look at and have them say that Bob Richards authoritatively said that this is the route to go. I want to be able to quantify this as much as possible in the future. I think there's a lot of support for that position and I would suggest that we try to develop something more objective.

Mr. Richards: I concur with everything you've just stated and I will endeavor to do that task. We face a practical problem of simply data.

Mr. Love: It was brought up earlier that there are times when there is a relationship between government spending and providing infra-structures to development industries. You made some bold and sweeping assertions that government spending is the main fuel to inflation. I would like to know more about the cause and effect relationship between the development of a capital against other industry and the needs that creates in terms of more intra-structure. Would you agree that there are situations where development creates needs for government spending, government services?

Mr. Richards: Absolutely. We share the same concern. You want to conduct this enterprise known as implementation of the permanent fund so as to maximize social benefits in the long run. We've got to have facts before we can have investment.

Mrs. Fleischer: A lot of my questions have been answered. But I'm wondering if we really want to provide jobs in the wintertime. A lot of the jobs are seasonal by choice. Do we want to sustain a high population or to continue doing things that attract people from outside. Obviously we want to employ people who live here and probably on a continuing, steady rate, but do we want to attract large numbers of people from the outside and do we necessarily want to sustain them?

Mr. Richards: I believe we're going to get a certain amount of economic growth in Alaska whether we want it or not, it's beyond our control.

Mr. Gallagher: Minimize the population growth, change the pattern.

Mrs. Fleischer: There is a lot of movement in the State. People tend to live live in two places, a lot of them.

Mr. Thorstenson: Being from Southeast, I was interested in your long term opinion or outlook on minerals, forest and fisheries. The first two were almost pessimistic, a rather slower growth. Fisheries you seemed to have a little more optimism on. We in the industry have had a recent bit of optimism with the extended jurisdiction, higher prices for fish, and world consumption of protein and higher standard of living. Do you see any immediate injection of capital that will change this term of growth, either domestic or foreign?

Mr. Richards: I would like to know what your opinion on the matter is.

Mr. Thorstenson: I know there's a lot more investment coming into the industry, because of the recent crisis created in the foreign countries by our extended jurisdiction. I think this group will have to weigh that situation, whether that's something we want to see or we should see it or attempt to encourage the capital from domestic sources such as this one.

Mr. Richards: I certainly concur with your line of reasoning.

Mr. LeResche: You said our growth will be discreet rather than continuous, that we'll go through periods of unemployment and inflation, that we should perhaps use the permanent fund at least passively as a counter-cyclical device. How do you define this bust that we're not going to have?

Mr. Richards: To a certain extent there's a semantic issue here, and maybe I've reacted too much to the term "bust". The way outsiders coming to Alaska and inquiring about the post pipeline bust, the way they bring up the question and then talk about it, using the term "bust" implies that when the oil pipeline is over that's all there is, there's going to be an economic collapse, something that approaches the depression, this is what I'm asserting we're not going to have. I apologize if I've over-reacted to the term "bust". We are going to have cyclical fluctuations and probably rather severe from time to time, but only a matter of degree.

Mr. LeResche: You have said that the petroleum industry and related industries hold a disproportionate number of our eggs right now. They're certainly highly capital intensive, they're destined to grow probably fastest of all the industries in the next ten years. This implies that because of these reasons we shouldn't use the permanent fund to invest in petroleum related industries because it's going to take care of itself anyway. Is that a fair conclusion to draw from what you said?

Mr. Richards: Unless you invested it in such a way that the cyclical behavior of that industry is mitigated through diversification.

Mr. LeResche: It's interesting to me that the relationship between the fact that we have so much of our income coming from that industry it would seem to argue against getting any more of our income tied into that industry, but I see why there is another reason we might want to do it.

Finally, just as an economist, what are the virtues of having our economy balanced regionally?

Mr. Richards: I'm glad you raised that. I don't know of any state in the union that is regionally balanced, certainly not California, Washington, Oregon, Utah, Colorado. So I don't mean to imply that if all those sectors were equal it would be better than it is now. It is just an intuitive feeling, that in the Interior, the Western region, and the North, there are not sufficiently sustainable economy to enable the people residing there to do some of the things they apparently want to do in terms of their standard of living.

Mr. Edenso: Bob, in the first part of your presentation this morning, you've talked about distribution of labor between the various sectors of the economy. You didn't describe the labor as skilled or unskilled, how that was distributed, or how that was affected generally by the fact of seasonality which influences Alaska's employment. Do we have any numbers which do reflect that?

Mr. Richards: The State Department of Labor does and we can get them.

Mr. Edenso: We know there is a distribution of skilled and unskilled labor and that also has a major effect within the economy.

Mr. Motley: I have just one comment. It appears that the quest of the search for data is in evidence here and I think it's a valid one. Probably, by its nature, it determines our first investment and that appears to be the Full Employment Act for Consultants.

Mr. Wohlforth: We will go into that subject this afternoon. At 1:30 there will be a report by Mr. Ken Butler of White Weld and a report by Peter McDowell of Price, Waterhouse.

LUNCH BREAK

Mrs. Fleischer: I'll try to keep my comments brief, but I do have a lot to say. I find myself sitting here thinking we're putting too many carts before the horse and that all of the information being presented here may or may not be relevant to what we really need to do. What I would like us to do, after the reports have been finished, is to focus on the thing we have to do first and that is establish the goals and objectives for this Committee or for this Permanent Fund. We need to have an open discussion on what we see as the purpose of the Fund and what we think it should be for before we really know what questions to ask our consultants. I know they can give us some useful information, but we don't know what information we want until we've established our goals.

I think we need to include the people in the State in the decision making process in regard to the goals and objectives. I know that's probably an unpopular thought because of our time constraint, but it is a necessary thing. I believe if the voters of the State are shown that this is the way it's devised they won't oppose it. I don't think they will defeat the amendment on the permanent fund because I believe that whatever the permanent fund means to the people, it does mean something positive. I think it's up to the Committee to see that the goals and objectives set do reflect

what the people of the State want to do with the Permanent Fund, that they are established, and I think we have to do that.

I'm a little concerned that maybe some goals have already been established, but as a Committee we haven't done that and that is one of our first jobs and I want to see us do that. I would suggest that we do that job before we do anything else, as it is something we can't ask our consultants to do, we have to do that ourselves.

Mr. Wohlforth: Thank you. I think the forthcoming information from our consultants will fit in with what you suggest and I think it may be enlightening.

Mr. Kenneth Butler of the investment banking firm of White, Weld and Company, New York City will make the first presentation.

Mr. Butler: Thank you. In accordance with the request of the Committee, we have provided you with a survey of domestic, foreign and international development banks, funds and development programs for your use in determining the future structure and objectives of the Alaska Permanent Fund. We have selected those banks, funds or development programs which are of major importance, as well as those which are particularly relevant to Alaska's situation in that they are either based upon natural resource revenues or confined to a limited geographic area.

Mr. Fuhmann and Mr. Oden are here as representatives of a larger group of White, Weld people who are involved in advising you on the permanent fund within the State. Our analysis of domestic permanent and development type funds was headed by Mr. Pat Oden.

Mr. Oden: In analyzing the domestic permanent funds we looked at two categories of funds. One of them is focused on those states which receive income from a finite natural resource and the manner that they use that income. The majority of the states receiving income from finite natural resources spend the income on a current basis.

The second one consists of two states-- a commonwealth and a state, which have formal economic development programs. We've requested from each state its particular assistance programs and aid programs to industry and they vary from property tax forgiveness to income tax forgiveness to outright guarantees. We're also in the process of accumulating a substantial file on complete information from each state on its economic development program.

Mr. Butler: With respect to the international and foreign development banks, funds, and development programs, Charles Fuhmann headed the firm's effort in that area.

Mr. Fuhmann: Substantially all of the less developed nations of the world, and a certain number of the more developed nations, have government owned or controlled entities whose purpose is to participate in the financing of local economic development projects. In most of the small nations these entities function principally as the vehicle through which the major world-wide institutions provide funds. These are also the vehicles through which the nations' development funds are disbursed into the economy by the government and they are very heavily involved with political process. These entities also act as the conduit for World Bank funds and other development funds provided by the larger international institutions and are invested in smaller projects in the country concerned through these development banks, the World Bank considered not being interested in smaller projects.

One of the advantages of the latter process is that the use of a local bank as a vehicle permits the larger institution's loan to receive a government guarantee, which

is a common prerequisite for the extension of credit to that country.

Our report covers the Swedish Investment Bank, Japanese Development Bank and National Financiera, the Mexican Development Bank. In each case these institutions are responsible for carrying out the national economic policy through their activities and they enjoy various degrees of autonomy from the national political process. The Swedish Investment Bank is the most independent.

The international institutions with memberships consisting of several countries whose purpose is to foster the economic growth and development of a particular region represent potent world-scale economic forces and tend to be both non-political and commercial in their operations. The financial strength of these entities is typically based on the uncalled capital subscriptions of their members. Virtually all of them borrow heavily, both locally and in the international capital market. Substantially all of their activities consist of direct lending for specific projects in the various countries and lending policies appear to be determined on social benefits as well as economic grounds.

The most significant among these international and regional development institutions is the International Bank for Reconstruction and Development, the World Bank, both in terms of its world-wide membership and the international scope and significance of its lending activities. Importantly, all of the other international institutions, whether the Inter-American Development Bank, Asian Development Bank, the African Development Bank, have been created with the assistance of and modeled after the World Bank, both operationally and in financial structure.

Of these three, only the African Development Bank is not a significant international borrower and depends heavily on loans from other institutions, such as the World Bank.

The other type of institutions is one which functions in limited geographic areas within a particular industry to promote economic growth and development, or to achieve a social objective and is based on local or regional resources. Of the three basic groups of international development institutions, this group contains the smallest number of entities and is the most analogous to the situation in Alaska. These development institutions or funds are new and based on natural resource revenues. Significantly, only two are international in scope; others are modeled after the World Bank but limited in their activities to a defined geographic region, ethnic grouping or social purpose. The remainder are national investment funds.

The majority of these funds are based in the Middle East and dependent upon oil related revenues. Importantly, most of these funds have yet to become fully operational and it is too early to judge their potential significance. The two national investment funds, the two which you may find are the most directly related to the proposed Alaska Permanent Fund, are the Fondo de Inversiones de Venezuela and the Alberta Heritage Savings Trust Fund. The similarities here extend both to the source and the purposes.

The purposes in these studies cover a pretty wide range. Some are developed to encourage economic nationalization and structural adaptation and development, some are to create employment, improve personal income, expand regional development, centralize industry, promote exports, stimulate capital formation, foster economic independence, urban redevelopment programs, supplement private investment, not be the sole investor, improve land use and settlement, subsidize low income housing; some deal only with the intra-structure projects, roads, utilities, water, sanitation. Education is the main emphasis of many of the programs. Some are to develop conversion

areas, replacing judicial activities with new industries; some are geared strictly toward better living and working standards; many of the funds are involved not only in providing monies but also in providing technical and financial services. Some of them are policemen and police the operations in which they invest, others take a back seat position. There are those that are a reservoir only at the present time for public funds to keep them out of the current economy and avoid inflation, waiting for the time when the monies are needed. Some are geared for redistributing income, encouraging technical independence, and some are meant to assure rational and diversified internal investment which may not be taken care of in the normal course of general programs.

With respect to income policy, many of them have the income of the fund retained by the fund. Others have it put into a statutory reserve, representing a percentage of their investments or as a reserve against bad investments; some of them have limited it to a percentage of their equity investments to protect against those going sour, or a percentage of soft loans, or of their total portfolio. Various kinds of reserve have been established by some, by others none at all. In almost every case the fund is involved in covering its own operating costs; some are taxed by their national authorities, others are untaxed. Some, the income goes direct to the state or national treasury general funds, but the capital is left untouched. Others have access to the capital. Some divide their income to the stockholders. Some have structures with common and preferred stockholders which brings in additional capital; some have the income transferred to related funds.

Criteria that are used in making investment decisions range all over as well. A large number of these funds have, among their criteria, that the funds not be generally available from other sources so that the fund is not competing with local sources. Some demand that the projects that are invested in are commercially viable, that they have an impact on the economy, that the terms reflect a satisfactory return on investment, that the terms are consistent with the risk and actually apply traditional credit standard to the project they are considering investing in. Some demand that they only participate in loans as a participant, not be the sole lender. Many have floating rates, some have fixed rates.

Some say they can only lend to government agencies or other governments. Some say they can only be for productive purposes, they must be prudent investments, that they can only be used to supplement private capital or to make private capital available by putting in subordinated monies. Some only support projects that are for their local use; others invest both in their own geographical environment, others invest all over the world and their purpose is to make money, build credit behind something. Employment is a big issue in many of these funds: to stimulate employment or develop skills, talents or technical expertise that they don't have. Many of them are only interested in larger projects--they do not want to have a widespread dispersal of their funds and limit themselves only to major, huge projects.

Some insist on security on all loans and others take the social good and social benefit route and don't really care whether they're going to lose all their money in terms of investments, but whether the social benefit is determined to outweigh the social cost. So, there are a wide variety of criteria.

We are continuing to collect information on additional funds, both domestic and international. We are also compiling a file of source materials which are essentially background materials on each of these funds. This work is not complete. This file will include annual reports, prospectuses for those that leverage themselves, copies of their charters, and the legislation that was necessary to implement

them originally, and just about anything else we can get our hands on. At this point we feel that it would be most helpful to have certain representatives of the Fund meet with the Alberta Heritage Fund people and the State of New Mexico people to assess their programs and to better understand the philosophy of their decisions.

We would also suggest that it could be helpful to visit with us in New York to discuss first-hand with various members of our firm their experiences with the various international foreign and domestic funds and development programs.

Mr. Butler: That's a brief overview of the domestic and international techniques on ground we've covered. Are there any questions before we go on?

Mr. LeResche: You alleged that certain funds are more relevant to Alaska than others for two reasons, first because the source of funds is natural resources and secondly, because they're confined to a limited geographic area. I don't understand that. Why is the source a matter at all and how is our fund limited to a geographic area? We're not obliged to invest it only in the state.

Mr. Butler: That wasn't the implication. We were more or less concentrating on certain types of funds - non-renewable natural resources as the main source of funds, and it isn't as applicable where, like the Development Bank of Puerto Rico or the World Bank, where their sole source of funds is borrowing in the international capital markets.

Mr. Fuhrmann: To the objectives it doesn't really make much difference, but in the structure it makes some difference because the member states are not going to be represented here. They're not a series of nations who are involved in this environment or in this fund as contributors, with respect to what they do with their income and what their objectives are and the kinds of projects they necessarily invest in. I don't think it's fair to say they're irrelevant.

Mr. LeResche: Do the management structures follow logically from the objectives in all cases here?

Mr. Oden: In the states that we've reviewed with respect to permanent funds, they fall into a couple of broad categories. In Texas, the monies are all applied by the University of Texas system; they are on state owned lands; New Mexico is the same situation. The funds were set up in the previous decade and the rationale on where those should fit within the governmental structure would certainly not be relevant today. The objectives of the newly developed permanent funds are set up, as far as their populace is concerned, to serve those objectives.

Mr. Fuhrmann: On the international ones, obviously the ones that involve member nations are going to be structured on an organization, management and policy level to reflect the membership of international bodies. The national ones, or the ones that relate to a particular area often reflect either the political environment from which they've come, whether it's more democratic or less democratic. Some of them have recognized for their own purposes the advantages of independence, others have felt the advantages were having it be less independent.

Mr. Motley: In going through this, I've been looking for a restriction according to the big income producing investments and I haven't found it. Is that true or not?

Mr. Fuhrmann: No, you missed some, because there are a lot of them that insist upon the commercial viability of the project; upon a satisfactory return on

their investment, coupling that with the ability of the project to meet those terms. The majority of the ones that are dependent upon the taxing authority of the nations involved are not worried. Almost all of them are involved in income producing and less socially good loans than the opposite.

Mr. Motley: Are they as restrictive as just the one liner that the people decide on? that's my question.

Mr. Fuhrmann: I think that one liner has got a lot of flexibility.

Mr. Wohlforth: Has anyone used that terminology in the charter?

Mr. Fuhrmann: I think both charters of the Islamic Bank and the Kuwait Fund insist that they be income producing, and the words themselves are used.

Mr. Motley: The reason I raised that question is because it appears to me that the Permanent Fund is attractive to some people because in essence it will be a negation of use for public building, etc. In other words, if there are no restrictions there would be a lot of latitude and that may not be what the people want. My question really is, How many specifically restricts to income producing?

Mr. Fuhrmann: I don't know how many, but I think you will find that it is specific about that.

Mr. Thorstenson: You said that politics becomes a problem in management of these funds particularly on a national level. You said some were very political and some were less political. Would you recommend a way that this could become less of a problem particularly in our case?

Mr. Fuhrmann: Since I don't know whether you want to have it a part of your political process or whether you want it to be separate, I'd rather not answer that question.

Mr. Edenso: Maybe you could explain some of the political processes that have occurred which have resulted in a structuring of some kind of management entities.

Mr. Oden: With finite natural resources, a lot of states had a severance tax or some other sort of royalty that was coming in that up until 1973 was not that significant. All of a sudden they now find themselves with a tremendous source of revenue. So states such as Montana, Wyoming and New Mexico have created new programs, primarily under the auspices of the Governor and the State Treasurer, and the management of the funds in these are usually left to a certain degree on a discretionary basis with broad guidelines produced by the finance arm of the executive branch of these states.

Mr. Butler: In New Mexico the fund is managed by the Governor, the State Treasurer and four or five members appointed by the Governor but approved by the State Legislature within the very broad guidelines of the charter. Then they're free within that to invest in any manner. Obviously, that could be quite political because the Governor is on the board as is his appointee, the Treasurer, as are his other appointees, and that's where the sole decisions lie. Monetarily, it's been a successful program to date as far as they've had no losses.

Mr. Oden: The Texas Permanent Fund and the New Mexico Permanent Fund are really the only two with a definite policy to invest in common stocks. The others have

become more wary about investment in common stocks and have by internal regulation limited themselves to income producing, fixed income securities, primarily federal government securities.

Mr. Fuhrmann: Let's talk about where the people come from that manage these funds. Are they coming from the political arena, are they politicians, are they involved in representing the people either by election or by dictatorial power, are they from the business community or the investment community, are they financial people or are they agricultural types or engineers? To answer that question is to say that you will find funds that had any or all of those or a combination of the above. However, the majority of them do reflect people from the political community. But they will argue that their decisions are taken irrespective of their political inclinations, whether it's partisan, political philosophy, liberal or conservative, or whatever, but their decisions are taken objectively and that they run these things all on a businesslike basis.

What is most important is that whoever runs it must be answerable and responsible to the public and easily identifiable and accountable. Otherwise the opportunities for graft, mismanagement, etc. are enormous.

Mrs. Fleischer: I think we have to know where we're going before we know how to evaluate any of this information. In other words, what are our goals and objectives?

Mr. Wohlforth: We will defer more questions until we've heard from Peter McDowell of Price Waterhouse. Then we'll have the benefit of two things to respond to.

Mr. McDowell: Thank you. Our report is of five case studies, four of which are specific institutions based in Washington, D.C. We selected these four, the International Finance Corporation, the World Bank, the Inter-American Development Bank, and the finance program of the U. S. Government's Overseas Private Investment Corporation partially because we know a great deal about the institutions and have a long-standing client relationship with each of them and partly because they are prominent, well managed and diverse and generally are representative of the types of institutions active in the development banking field.

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

A development bank is like other banks we're familiar with except for two or three differences: (1) it does not accept deposits, (2) it is very aggressive in the promotion of the projects to which it makes loans or provides equity financing and, (3) it is active as opposed to being relatively passive. The bulk of them are managed and operated and established as commercial institutions. I would like to highlight some of the points of the sponsored Development Finance Companies. They are normally national institutions concerned with only nation/state now rather than a group. They cooperate closely with their government in order to represent private sectors during the development of economic policies and plans by the government. The initial objective is that they are expected to maintain adequate profits and sustain their credit worthiness, in other words, to sustain their integrity as financial institutions and make an important contribution to development. That's the public policy goal that often causes them to engage in compromises that an ordinary businessman wouldn't countenance.

The governments apply pressures because they normally own all or most of the stock. As with any corporation they can dilute the independence of these institutions in many ways; (1) pressure to hold interest rates below market, (2) pressure to consider projects which are too small for economic investment and perhaps too risky, and, (3) pressure to fund projects in least developed regions.

Most of these situations could be faced within the State of Alaska. The influence, which is political influence, can easily become interference with management decisions, and this is where you have a problem. Most of the development banks organize to be independent as far as management decisions on investments, staffing and internal administration are concerned. These are the three keys to having a well managed institution.

The Overseas Private Investment Corporation Finance Program (OPICFP) is also interesting in terms of some of the exceptions that it encompasses to the normal structure and control of development banks. Its sources of funds are U. S. Congressional appropriations and proceeds from its own operations. In addition, it has authority to guarantee loans to a far greater amount than it has authority to make direct loans. So it's a guarantor of other people's loans in many more instances than it actually makes loans itself. That's the difference. The others tend to strictly make their own loans; although most have their guarantee power they don't care to exercise it.

The relationships with government are interesting as well. OPIC is a corporation of the United State government. It's subject to review about every four years through the Congressional authorization processes. Selection of its board, senior management and staff is a very closely related governmental function. There are six members of the board of directors from the private sector and OPIC's president, directly appointed by the President of the United States and confirmed by the U.S. Senate. The four other government directors hold specific posts in the current administration. The private sector director can serve a three year term. They have rules about expiration so that the appointments and expirations of director's terms occur on a staggered basis.

The World Bank was founded for two purposes; (1) to assist in reconstruction after World War II, and (2) to assist in the development of economic development of under-developed countries. The Inter-American Development Bank was formed at a later date in response to the need felt by countries in Latin America that the World Bank was fine and they liked the loans and the projects but they weren't getting enough, therefore they preferred to have their own bank. The International Finance Corporation is again a later development. It was found the World Bank did not want to deal in the private sector directly so the International Finance Corporation was established to deal solely in that sector.

In summary, some of the similarities include: they all have a common purpose to provide loan financing for high priority economic development projects; none of them make small loans; the operating philosophies are similar, they're all aggressive in project promotion, preparation and design activities to far greater extent than normal commercial banking institutions. They are all run on a prudent and business-like basis and most frequently the word "prudent" is included in their charters to indicate that they should be run on a commercial businesslike basis. They're expected to generate revenues adequate to fund their operating expenses, including the costs of borrowed money and to provide some profits to insure security and growth as continuing institutions.

Each institution is organized with boards, boards of governors and/or boards of directors, and a strong chief executive officer. This is a crucial factor in the success of these institutions. They share common control structure. They are each organized to provide an adequate separation of duties and numerous levels of loan and investment review and approval. Final responsibility and accountability clearly rests with the board and the senior management. Their accountability in all instances extends to public accountability.

Some questions that I think you want answered I will try to answer. One of them is, how do you insure political influence is minimized in the loan or investment operating process? They've done this partly by creating an independent corporate entity with all of its operating functions. They have their lending operations, cash management operations, they can control their own liquid assets, and they make their own borrowings as independent institutions. But the crucial thing is that they have all of their operating functions self-contained as to the day-to-day management decision making. That's the key. In other words, if you put into a charter that a certain item that's crucial in the management of one of these institutions and it's not granted, you would create problems. Part of the success of these institutions is because they are independent corporate entities.

Another thing is to delegate all operating responsibilities from the stockholders to a board of directors which represents enough diverse interest so that no single outside agency or group can control decisions of the board. There are many other factors involved in insuring political influence is kept out of the operating process.

Then the alternate side of the question is how do you insure that adequate political influence is exerted in the policy making process. The first thing they do is lay out objectives in the charter for the institution, objectives and an operating philosophy. Simply said, the bank will make loans for development projects in less developed countries and it will do so on a prudent basis. The ultimate powers are reserved to stockholders; they have the power to change the articles of incorporation, the power to liquidate the institution, and they have the power to elect the directors.

In accordance with the way the Constitutional Amendment is written regarding the Permanent Fund, the Legislature of the State of Alaska appears to have the power to change the articles of incorporation and to liquidate the institution. The appointment of the directors can certainly be shared subject to guidelines provided by the articles of incorporation. In these very general but final powers you've got a lot of opportunity for insuring that adequate political influence is exerted. But you've the opportunity by structuring an independent corporation with certain other features to make sure that political influence stops at the policy making level and is not exerted at the operations level.

Another question which I found is, what can be done to insure that high standards of credit worthiness of borrowers and project viability are maintained? The first requirement is to be prudent, make enough income in total to pay their operating expenses to provide for reserves against bad debts and losses. Another major area is that they make sure they have competent management and staff. They have a strong executive officer.

Another question is how do they determine priorities? They have limited resources. The institutions go through extensive economic analysis themselves. They are a key force in economic analysis for the economies of their countries in which they are investing or loaning money.

In all cases studied, all are closely involved with government economic planning. Most have planned economies to a significant extent and then have priorities established by the government for which sectors are to be emphasized. Then later you have project priorities. You must have a variety of projects to look at to be able to rank them in order of priority.

How are projects identified? They're brought to the attention of the institution by the prospective borrowers and they are also brought to the attention of the prospective borrowers by the institution itself. So it is a two-way communication.

I'd like to stop at this point and see if there are any questions.

Mr. Pihl: I have a question concerning foreign investment and whether these funds are used to control their own destiny. Is there any role in the control of investment, in capital, that is made?

Mr. McDowell: I don't believe the development banks themselves create new capital; they divert it. In Alaska's case, you are starting with the capital, you don't need anyone to marshal the capital for you.

Mr. Pihl: You mentioned security and growth of the fund. Do the funds try to maintain a growth that's equivalent to a long-term inflation rate, for example, or when you speak of maintaining the integrity of the fund, \$2 billion by 1985, it's got to grow by a certain percentage to remain permanent. Do the funds try to do this?

Mr. McDowell: They try to; they're not all successful. They all make enough money to pay their operating expenses, including the costs of borrowings, and to set aside reserves for bad debts so that you don't shrink the capital by losing it. They aren't necessarily successful in countering inflation. They try to maintain their integrity as best they can. But their social purpose--in other words, the definition of "prudence" only goes to a point and then it becomes more important--that you're prudent up to a stage, that stage being not to let the capital deteriorate very fast, although it's probably going to a little bit. Beyond that their objective is to get the money out at rates the countries can afford.

Mr. Barnes: A brief question on organization and controls. It seems they're very elaborate which would create a large bureaucracy and a lot of overhead making it uneconomic for the small loans. Is that the natural progression?

Mr. McDowell: 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 that runs the costs up. The other fact is their staffs are very highly qualified and to retain them they are well paid. They don't have many employees per dollar, but they do have highly paid employees and they spend a lot of man hours on any given project.

Mr. Barnes: Has there been a problem in any of these organizations with the so-called strong executive concept--being too strong to be accountable to anybody?

Mr. McDowell: No, he's accountable cause the ultimate power is the member government putting a check on him by saying, "We won't increase the capital. Your leverage ratio is set so we won't raise that either. We don't think it would be prudent and you'll be held to your proper size."

Mr. Barnes: I notice there are two funds that are handled within the state treasury operation. Do you know if they have a large staff or if they have a

relatively small staff?

Mr. Fuhrmann: They have a very large staff - about thirteen hundred people.

Mr. McDowell: I gave the upper limits of size of the DFC's as a group, and I said they go up to 3,000 employees and \$3 billion in lending. The one with 3,000 employees is not the one that lends \$3 billion. They vary all over the map, but then there are totally different employment objectives in the developing countries than we would even consider reasonable here.

Mr. Fuhrmann: The Mexican one actually acts as the finance department for the corporations they're involved with, so they have enormous responsibility to the companies that ultimately get the funds. At the same time, the National Financiera cannot do anything without going the Minister of Finance for approval in a sense of its raising its own monies because they don't want to be competing with the government's financing in the marketplace.

Mr. McDowell: The crucial control is that these institutions are expected to earn a profit. The chief executive has got to make money and normally there's a lid on the interest rate they can charge. So his only flexibility is in his operating costs. He's got to manage his organization so that there is a spread adequate to at least pay expenses and to provide a return that is prudent.

Mr. Gruening: I've been thinking about the source of the fund really being relevant. In the Alaska situation the funds will be the natural resources, and it seems to me that the responsibility to the shareholders in the Permanent Fund case is somewhat different in that the shareholders in Alaska would be all of the citizens who have a right to that resource. I'm wondering how far down policy decisions should go in terms of political control?

Mr. McDowell: I think ownership is important. The stockholders of the Alaska Permanent Fund would be the citizens of the State of Alaska. Just as the World Bank has a board of governors appointed by the stockholders, I would suspect that some device is going to be necessary because you can't have all 450,000 people on the board of directors. You've got to narrow it down. Who do you choose? You've got the legislature and the governor and some other executive officers elected by the people to represent them in most matters, perhaps including this one. If you do, then you've got a logical structure at this top policy level. Or you might like to spread it out and have 12 or 15 people representative of the population of the state, then they can represent the stockholders, they can be the board of governors.

Mr. Gruening: Do we need a second board of directors?

Mr. McDowell: Through the appointment and perhaps process, but I think the line stops at who decides whether or not to grant a loan. That process should not be directly impacted by the stockholders. I'm not sure which body you will eventually pick to be called stockholders, or represent the stockholders. You've got to go one more step down and that next group should have that power.

Mr. Gruening: In the Alberta Fund that Assembly appears to have some kind of committee that has something to do with the loans. Would it be going too far down to have the Legislature approve loans over a certain amount or certain special loans? For example, we could set goals here, but then you have the problem of which goals over a period of time take priority. Say, in five year from now one goal would be more important than another, could the legislature say they wanted to emphasize a certain goal or not?

Mr. McDowell: You'd be into operations at that point, unless you left the power with the legislature to create and then to change the articles of incorporation. The purpose of the Overseas Private Investment Corporation is to encourage economic and social development in approximately 80 lesser developed countries considered friendly to the United States. That's a major restriction on their lending because there are 120 developing countries and only 2/3 of them are eligible for OPIC financing. However, the United States Government can change it at any time because they have created it.

Another problem is that if you take an operational decision and transfer it up too far then you can't hold the management of that institution accountable; you've just destroyed their accountability by assuming it at another level.

Dr. Logsdon: Do these development banks borrow private money? Do they participate in equity?

Mr. McDowell: Some do borrow private money, also some of them will participate in equity. There's no universal rule.

Mr. Waldock: Is there an example throughout the world where a huge infusion of money has disrupted the banking system?

Mr. Fuhrmann: Both the Middle East and Venezuela had among their objectives and purposes initially getting the money out; they have invested in external investments, money market instruments, government borrowings, they've put money into the World Bank or subsidiary banks of the World Bank. They've taken the money out of their own economy to avoid that conflict as well as the resulting inflationary impact if they had allowed that money to go into their own economy.

Mr. Oden: In addition, in New Mexico there is a severance and a Severance Tax Permanent Fund. Investments of that fund are in CD's of state banks.

Mr. Waldock: What is the length to share those CD's?

Mr. Oden: They vary from one to five years. With those monies the banks turn around and make loans on capital projects. They do all the research and all the evaluation on the validity of the loans.

Mr. Waldock: With a five year limit it really isn't restricted to short term loans.

Mr. Oden: Yes, it is to a large extent. They can't be rolled over.

Mr. Fuhrmann: The purpose of almost all these funds, one way or another, is to help build capital formation internally and make private financing available.

Mr. Gallagher: The deposit structure of the State of Alaska in comparison with other states resemble the deposit structure of more rural states in that we have high demand deposits and low in savings deposits. If you orient the Permanent Fund toward long-term investments (longer than five years) then you're not competing with the commercial banking system.

Mr. Malone: Mr. McDowell, you mentioned that you didn't really believe the World Bank was in the process of diverting capital. Will you describe that process and whether that might hold any implications for the Permanent Fund?

Mr. McDowell: These institutions do divert capital because they take capital

out of developed country capital markets and channel it into specific projects in specific developing countries. Kuwait had a similar situation. They filled up their commercial banking coffers with kind of a wash in cash, everything else just flowed right out into the international financial markets in other countries. In effect, it was just passed out of their banks into other banks and invested in securities elsewhere in the world.

That could and probably will happen here in the early stages at least. The revenues to the Permanent Fund will probably flow through the treasury out into the capital markets of the U. S. initially, although some of it would stop over in banks in the states and create mendable assets. So you won't see a terrific disruption of your banking system before its had a chance to grow and absorb some of this.

Then, if that's all you do with it, that capital will be out there and earning a certain return for the State of Alaska, but it probably will be loaned to some other project. It may be loaned to U.S. Steel for expansion in Pennsylvania, it may be loaned in the European market for expansion in Europe, Africa, or somewhere else. If you create an institution that can call those funds back to you at a later time, channel them into the Alaskan economy, then you've gained a measure of control over your own destiny been able to divert a capital flow.

Mr. LeResche: The institutions you've described have two measures of success, credit worthiness and project viability. Does that pretty much summarize the measures that you're using to tell us those are successful institutions?

Mr. McDowell: No, those are really for the projects and the countries they lend money to. For the institution itself their measures of success are continuation, in other words, just survival. Do they survive intact as financial entities? The other measure of their success is the changes in the countries they deal with. Does per capita income go up? Does income distribution improve? In other words, within a given country is the quality of life for the people of that country better?

Mr. LeResche: I think your strong message was that these have been successful institutions because of their executive autonomy of the operations.

Mr. McDowell: Some of the banks in the countries themselves failed, went out of existence, they didn't survive. In most instances they were susceptible to the pressures from the fact that their major or only stockholders was the government of the country and the government of the country imposed restrictions on them or pushed them in different directions that they just couldn't survive economically. Some do go down because of poor management and just collapse because they made bad loans. But in many of the instances the fact was that this inevitable pressure became interference in the day-to-day operating procedures.

Mr. LeResche: So the line of policy interference was drawn a little too high or too low?

Mr. McDowell: Too low, yes.

Mr. LeResche: You said it's proper to lay out the objectives of the Fund or the institution in the charter--very general, one or two sentences. But, in the case of the World Bank you said the leverage ratio was set by limitation on interest, which seems fairly specific as opposed to general. Isn't that an operational control?

Mr. McDowell: Not really. It's a description of the size of the institution. The stockholders stated that they did not want the institution to exceed a certain