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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.

STATE INVESTMENT ADVISORY COMMITTEE
MINUTES
August 26, 1976
Anchorage, Alaska

Chairman Robert McFarland called the meeting to order at approximately 9:30 a.m. on August 26, 1976, in the Court Building at Anchorage, Alaska.

Original Members present were:

Mr. Robert McFarland, First Federal SAvings & Loan, Anchorage
Mr. Dennis Waldock, Foster & Marshall, Anchorage
Mr. Eric Wohlforth, Attorney at Law, Anchorage

Absent Members:

Andrew Warwick, Commissioner, Department of Administration
Langhorne Motley, Commissioner, Department of Commerce
Senator John Butrovich, Fairbanks
Senator Jalmar Kerttula, Palmer
Representative Hugh Malone
Representative Richard Urion

New Members present:

Dr. Logsdon, Associate Director, Agricultural Experiment Station, University of Alaska, Palmer
Jim Edenso, Deputy Commissioner, Department of Revenue
Robert Barnes, President, Alaska State Bank, Anchorage
Mr. Martin Pihl, Vice President and Comptroller, Ketchikan Pulp Company, Ketchikan
Mr. Robert Thorstensen, Petersburg Fisheries, Inc., Petersbu--
Representative Clark Gruening, Anchorage
Representative Joe McKinnon representing Jamie Love, Anchorage
Mrs. Lanie Fleischer, Anchorage
Dr. ~~Ms.~~ Dona Lehr representing Bob LeResche, Director, Policy Development & Planning

New Members appointed but absent at the meeting:

Mr. Jamie Love
Mr. Emil Notti, President Alaska Native Foundation, Anchorage
Senator John Sackett

Others present were:

Mr. Vince Wright, Research Section, Department of Revenue
Bob Richards, Alaska Pacific Bank, Anchorage
Kenneth Butler, White Weld & Co., Inc.
Peter McDowell, Price Waterhouse, Inc.
Dan Regis, Price Waterhouse, Inc.
Jim Rhodes

Advisee:

Sterling Gallagher, Commissioner, Department of Revenue

MINUTES:

Mr. Gallagher: The Governor has given me a letter outlining the things he would would like the State Investment Advisory Committee to do in developing a Permanent Fund. We have copies of that letter here and I will pass them out to you. Briefly, the Governor stated five items for consideration: One, preliminary work necessary to establish a permanent fund; two, the estimated size of the permanent fund; three, policy concerning the investment goals of the permanent fund; four, management and organization of the permanent fund; five, State and public interest in the permanent fund.

"The permanent fund will be a very visible entity to the Alaskan public. The purpose of the permanent fund is to preserve a legacy for future generations of Alaskans and still provide immediate benefits to the present Alaskans. I ask that the Division of Policy Development and Planning be placed specifically in charge of proposing means of developing such a concept. I envision this entity to be similar to a corporation owned by all Alaskans which would receive a dividend paid out of the earnings of the permanent fund. While I realize that there are potentially many problems with this idea I would like the SIAC to consider not only the developmental aspects of the permanent fund but to also consider how to best and most directly provide tangible benefits to Alaskans."

Mr. Edenso: I will pass this letter out to each of you. It is an important statement by the Governor and gives an outline of ideas and concerns, and a basis from which to start.

Mr. McFarland: Mr. Rhodes, do you want to introduce the consultants?

Mr. Rhodes: We expect as much as $2 billion to be in the permanent fund within a decade, and we could be talking money on the order of $20 billion. This is a vast sum of money and could be used in new ways, apart from the regular budget of the State. That is why I believe the permanent fund will be the most important change in Alaska since Statehood. With so much at stake we have given extra thought and pains in sellecting consultants.

For the basic data on the Alaska economy, and the events and limits of changing it, our unanimous choice was Bob Richards, economist and senior officer of Alaska Pacific Bank.

Secondly, you will need information on the financial techniques that could be used by the fund. Here, our joint choice was White Weld and Company, Inc. of New York. White Weld is the sixth largest investment banking house in the United States. Internationally they rank first among the American firms in this field. They have sent four men to be with us today.

Mr. Ted Swick, senior vice president in the public tax exempt portion of the firm; Mr. Ken Butler, first vice president of the San Francisco office; Mr. Paul Downey, senior vice president for corporate finance, national and multi-national, based in New York; and Mr.Charles Furmin, specializing in Overseas business finance. Mr. Furmin has been involved with the special oil revenue fund of the Republic of Venezuela.

For the question of how to organize the fund we are considering the firm of Price Waterhouse of New York. Mr. Peter McDowell is a full partner of the firm which is based in New York. For the past two years he has been dealing with the organizational problems of the World Bank and Development Banks in a number of countries. I think Mr. McDowell has to be unique among New York consultants because he grew up in Alaska, has a vacation home in the state, and returns every year. With him is Mr. Dan Reiches who heads the Price Waterhouse office in Anchorage.

A fourth need for the Committee is to identify the best prospects for development bonds in the State. No final decision has been reached on whether or not these firms would be able to come to grips with the problems or whether more specialized help is going to be necessary.

Mr. Edenso: Vince Wright is from the research area of the Department of Revenue and has prepared some numbers for the Committee. He will also talk from a chart, a forecast of the amounts in dollars to be received or put into the permanent fund.

Mr. Wright: First, let me stress these numbers are preliminary, there are many variables to consider. I am projecting numbers such as prices, the oil market for oil, tariff rates, etc. As many of you know, the State is currently discussing with FEA what the future might be with respect to the price of oil. I believe in April of 1977 the President will make a decision relative to the price of Alaskan crude.

These particular figures are based on our March 3 computer run. On the first page, first column you will see that each figure represents the revenue that is subject to the permanent fund contribution. The amendment itself says, royalties, bonuses, mineral leases, and federal royalties, so the first column represents the total with respect to those items.

The second column is 25% of the first column. The amendment also states that at least 25% of these items will be devoted to the permanen fund. The third column is simply the accumulative balance. So, when we look at this permanent fund stream, we are talking roughly $2 billion.

I would like to direct your attention to the second page. Each one of these items, State oil royalties, State gas royalties, mineral lease royalties, bonus sales, are items that are subject to the permanent fund. The State oil royalty picture is the most significant at this point in time. The first column represents the total State royalties we expect to get up to the year 1985. We've simply added all those columns to derive our total revenue column. That total revenue is $41.6 million. It is 25% of this amount that is subject to the permanent fund. It is a minimum figure--just income. It is also assuming the gas line by 1985.

Mr. Gallagher: Also, Vince, 1976 is over so you can't fit any money into it. 1977 will be three quarters over before the permanent fund is really established. On the federal royalty item you can expect it to be much larger in the future, or at least the announcement a few days ago by the Interior Department said that when they develop the PET #4 that would be included on some sort of sharing basis.

Mr. Wright: On the third page of the handout, or the assumption that these figures are based on, the tariff rates, that includes the pipeline tariff itself, the tanker tariff and a tariff that represents the transfer of oil from Pad #5 to Pad #3, or from the West Coast to Texas. We subtract out the tariff rate from the refinery price and derive our wellhead value. Based on the wellhead value is how we compute our royalties. The third item is the throughput forecast as of March 3, and the fourth item is the cost factor.

We've also assumed an inflationary rate here, which is very conservative in nature. These figures are what we call current dollar terms, not constant dollar terms. We will be updating these figures periodically.

Mr. Gallagher: These runs depend on surplus we have on the west coast which is a fluctuating number, between 300,000 barrels and 800,000 barrels. The current Federal law stands that oil will have to stand a shipping charge of approximately $2.20 to the midwest, so that is a significant factor. It is just how large that surplus will be.

Mr. Wright: Are there any questions at this point?

Mr. Wohlforth: Are these new figures from the last run? When do we get to the 1.2 million? Is this tariff to Los Angeles?

Mr. Gallagher: That is the last run. We will get to the 1.2 million barrels per day in November 1977. The tariff is to the West Coast. The FEA says they're going to freeze the index until November and start releasing it upwards after that. So our current price is frozen until then. The best estimates I have, in talking with the FEA last week, is that we will get a replacement price for oil. Currently it is $12.80 for Saudi crude in the west coast.

Mr. McKinnon: Is that 7.8 billion figure based on the current Alyeska estimates?

Mr. Wright: Yes, it is. We realize, of course, that it might be revised upward very shortly.

Mr. Gallagher: There is a formula I've worked out -- adjusted by another 800 million, I think it is somewhere around $0.20.

Mr. McKinnon: But every 800 million increase in the cost of lime will raise the tariff $0.20?

Mr. Gallagher: No, I said 800 million. What you're seeing is almost a $10 billion; a $7.8 billion pipeline, that is capitalized interest of $1.5 billion, and that is $9.3 billion, and it will probably be $10 billion before it's over.

Mr. McKinnon: That is assuming all costs are allowed as a part of the tariff?

Mr. Gallagher: Yes, we're pretty sure that they will allow capitalized interest, that is pretty standard. So the valuation will probably be around $10 billion. You will notice that the wellhead value drops in 1979, that is because of the surplus on the west coast. As the oil starts up, the first 69,000 barrels a day could all be used on the west coast under the Department of Revenue's estimate; in November they go to 1.2 million barrels. Even at that the west coast could use it until about May of 1978. At that point we will have to start putting it through the Panama Canal in 55,000 ton tankers.

Once they do that the cost to the west coast will go from $0.75 to $2.20 over to Pad #3, where we are estimating 500,000 barrels right now. We are replacing three crudes off the west coast. Saudi, Iran and Equador, 500,000 barrels is the total of those three crudes. That is why the number is averaged down in the following year. We don't think the Sohio Pipeline will be ready by that time, but we're hoping it will be.

Mr. Rhodes: Have you made any estimates of what would happen if that part of Alaskan crude that was surplus on the west coast ......

Mr. Gallagher: The tariff wouldn't be any greater than $0.75, so we would save $1.40 on 500,000 barrels a day. It is very much in our interest to get it.

Mr. Gruening: What is the possibility of the presidential and conventional regulation of this price?

Mr. Gallagher: Like I said, we met with FEA. With President Ford, I'm sure we could get a replacement cost. I hear rumblings from Congress that it could slip over to the Democratic president, if Mr. Carter is elected.

I'm not too hopeful that the other fields up there will be produced until we get a higher price. We're estimating 1,000 barrels a day to be the breakeven point on a well in the Prudhoe area. Lisburne doesn't make it into that criteria because it is a pack formation, a limestone formation, and it's very hard to draw out. We are expecting Kaparik to produce at that price, so that is probably 170 barrels a day. We also think we could get a price break on two or three of the fields in the Cook Inlet area.

We're sending the data on all the fields in Cook Inlet and may, by regulation, accept two or three of the fields because of the economic limit. There is one, I forget which one it is, that is within two years of shutdown. To give an estimate, Cook Inlet is 190 barrels a day right now, and by getting a higher price, that would drop it down to 50 barrels a day. That would give that field probably another six or seven years.

Mr. Pihl: Is the thought to accept the cost -- the actual cost of the line, whatever it is?

Mr. Gallagher: No. The idea is to go back in and throw out some. Let's put it this way, we use some of the cost if there are things that were due to mismanagement, things they could have foreseen, that sort of thing. The ICC formula has never been reviewed since the late 1930's. We are interpleader in a case before the ICC to review the whole.

Mr. Edenso: I'm not sure if all of you people really understand how tariff rates are established, or how you arrive at a wellhead value, and the different variables that go into it. We need some explanation on it.

Mr. Gallagher: Perhaps I could explain it -- how we get through to 1979. Replacement cost is the price of our barrel of oil, that when it comes on to the west coast, replaces someone else's oil. We're talking now about the different types of oil.

There is Indonesia coming on to the west coast and our oil is not substitutable for Indonesian oil because of the sulfer content. The sulfer content in Indonesian oil is very mucy like Cook Inlet, .04 to .08 sulfer. It is the same weight and value as Alberta crude -- very high value crude. Prudhoe oil is a higher sulfer crude, 1.08% sulfer. That is very much like Saudi Arabia, which is almost exactly the same weight as Prudhoe oil.

There is a price differential on the west coast for Saudi crude and Indonesian crude, because the sulfer difference is about $0.40 a barrel for replacement barrel. So let's say the Saudi crude for Prudhoe, which is a replacement barrel is $12.80. We think this price will raise -- lower the world rate of inflation by 1/2 of 1%.

Let's define what we think the world rate of inflation is, Germany, Japan, and the United States combined, rate of inflation, and we think OPAC will try to move that to their price of oil and keep it at that price.

Presently Saudi crude delivered to the west coast, comes to $12.80; Indonesia is about $3.20, there is a weight differential.

Tanker rates are between $0.49 and $0.75. We have that price range presently, and we're talking about 600,000 barrels a day. The price at Valdez is $12.05. But our taxes and royalties are not based on that price but a value back at the wellhead.

The tariff has fixed and variable costs. Fixed cost is depreciation and interest, and things like that and never changes, but some of the operating costs vary considerably because of additional pump station. The first year, at 600,000 barrels a day, the tariff is going to be about $5.25; that is the first barrels that roll down the pipeline about next July. The first barrel out of the tap next year, we'll probably get $6.70 for it. That is July 1977. The next year when it starts pumping at 1.2 million, this figure will inflate by about 6%. I think the tariff at that point will be probably around $4.00. The wellhead at that time will be $9.35.

There is one caveat though. At this point only 500,000 to 700,000 barrels a day to be taken to the west coast, there is a difference of $2.20; so you subtract another $0.70 you get an average wellhead price of about $8.65 in the following year.

So that is how we spin off the taxes and royalties. That gives a pretty good idea of the tariffs we're looking at in the next two immediate years. It is very important to get an additional refining capacity on the west coast.

Mr. Pihl: I take it you are basing this upon the assumption that the pipeline is going to be finished on schedule?

Mr. Gallagher: Yes. I work with Alyeska all the time and they give me their data. I always want to believe them, and then they change the numbers.

Mr. Pihl: Do you have any credence in the New York analysists estimating the pipeline is going to be delayed about a year to a year and a half?

Mr. Gallagher: No, not at this point. I have nothing to indicate it. Yesterday I got a delay in shutting down some of the camps. They're going to shut them down a month later. They have some parts of the line hydrosonically tested which they're doing this summer. I will know by January.

Mr. McFarland: At this time we could ask Mr. Butler to report on the work they have been doing.

Mr. Edenso: Mr. Butler and White Weld have been working on investigating other permanent funds. There is a Texas permanent fund, an Alberta permanent fund, and others and they've been investigating and looking at these funds to see what kind of organization they have, what kind of structure, how they are put together, what size they are, and those types of questions. I think they can give us a report on what they've found, and possibly answer some questions any of you might have.

Mr. Butler: We are more or less feeling our way into this because we don't know just which way the Committee sees fit to go. But one of the first funds we've had verbal communications with and extreme data, has been the Alberta Savings Trust Fund, recently instigated by the Province of Alberta. This particular fund looked more similar to the Alaska Permanent Fund idea than most of the other. That Fund is financed essentially, exclusively from oil rentals, royalties, lease payments. So since that fund was established with essentially, monies from non-renewable natural resources, namely oil, that they do want to create a permanent fund to diversify and strengthen the economy, and they have what sounds like some of the same types of goals that you do, we have looked into that one to a certain extent.

As of this month they transferred from the general fund, $1.5 billion in assets. That is not currency or government securities. I believe some of it is land and other assets, but the total value was $1.5 billion and the fund is now operational. It only became effective last May as far as legislation goes, so they have not yet made any loans or done any development work, but they have their enabling legislation and have the funds transferred.

Generally, they are transferring 30% of the funds that flow from the non-renewable resources into this fund. They have restrictions as to how much could be used for non-income producing loans, how much can be used for capital development and capital resources.

We could go into more detail but I think it might be a little premature. Just to give you an idea, it is 30% of the funds coming from non-renewable resource revenues. The total transferred to date from previous income of those sources is $1.5 billion. We have copies of the exact legislation that we could provide you with, given a little time. We have access to some of the discourse that went on at the legislative level which might be applicable as it is based on a lot of the same assumptions.

We also looked at the Texas University System Permanent Fund. That fund was originally established in the 1800's when Texas was still a republic and came through into statehood.

Basically, that is the income received from approximately one million acres of land where there is cattle grazing rights leased out and oil extracted from under the ground. That fund is strictly for capital buildings for the University of Texas -- expansion of the physical plant. I don't believe it can be used for anything other than that. It is extremely restrictive. The principal cannot be committed or touched in any way. If they sell any securities they have to have income from the earnings of the funds 1.5 times the interest cost on the securities. Let's say they borrowed money at 7% -- $20 million or so, they have to have that covered by earnings from the fund 1.5 times before they can do it.

We have access to their legislation also, if that would be of interest to the committee. Those bonds, whenever they borrow in the debt market, they are rated AAA, and are considered one of the highest credits in the market.

Another area we have looked at to a certain extent is the Government Development Bank in Puerto Rico. They have raised funds for a great variety of things in the Commonwealth of Puerto Rico. Telephones, highway construction, developments of business, etc. Their source of funds, though, are strictly going to the capital markets. It is not funded in any way from resources, non-renewable or otherwise, revenue, royalties, taxes, so to that extent it is not at all similar to what might be developing in Alaska. They just go out and borrow and to a certain extent they guarantee or partially guarantee the securities, depending on the exact details of it.

They have raised, over the years, well into billions of dollars of funds for these various purposes and are secured by the revenues of some of these -- they build a tow road, a sewer system, or expand the telephone capabilities. In other cases, the general obligation of the Commonwealth itself.

The State of Pennsylvania is another area we've looked at to date. Pennsylvania has an authority called the Industrial Development Authority for the State of Pennsylvania, which has over the years helped business to expand in Pennsylvania, disbursing some $900 billion, helping to create an additional 166,000 jobs in the state over the same period.

That was started by the State general fund making an initial appropriation a few years ago in chunks of $30 million at one time, and some more later. This was all through loans -- developmental loans to business firms. They have income from the repayment of those loans from which they make new loans. The loans are intelligently made to businesses that have a chance of making profits, and it is rather self-supporting. They haven't had to appropriate additional monies from the general fund to expand the program.

So, properly done, this might be a consideration, where at some point, the permanent fund would set aside a chunk of money and make loans to business -- of the type that would diversify and strengthen the economy.

We have also talked with British Columbia. They have done similar in the developmental area, but they have not created a development fund or a permanent fund. They have helped ride out the general revenues of the Province, businesses that are not able to pay for themselves. This has been largely in ferries, railroad, transportation areas, and is just a political decision that they make at the time. They are helping them to develop further in some cases and just carry on normal operations, but it is not a separate fund, just an appropriation made each year.

There are other areas out of the country -- in other parts of the world -- Venezuela -- taken from the World Bank. It is my initial feeling that you would want to explore everything that has happened in this area throughout the world, but we should make mutual decisions as to which of these would make sense.

I would be happy to try to answer any questions.

Mrs. Fleischer: Did you look at Norway?

Mr. Butler: The government of Norway has set up a Crown Oil Corporation and they have a number of development programs that have been managed by the state, but they are a part of the regular budget, however, I'm not aware of any permanent fund or special account being set aside.

Mr. Gallagher: They sound like they are going to get into the business of a permanent fund.

Mr. Wohlforth: Has your work been involved in any of the other Canadian provinces who has an industrial development corporation?

Mr. Gallagher: Are you talking about the hydroelectric?

Mr. Wohlforth; No. The Quebec Industrial Development Assistance Act. Mr. Rhodes and I have worked to some extent on the legislative effort this session which is patterned on that to some degree.

Mr. Butler: We are aware, partly through Jim, of the existance of that one. We have not investigated it as yet, but we will be happy to do so.

Member: There is nothing comparable in any of the provinces to what Alberta has done, even by way of contemplation. Saskatchewan has given some consideration of this. Their source is more potash than oil, but a lot of the provinces and a lot of the other countries have set up industrial development banks at one time or another, using sources such as this.

Mr. Wohlforth: I think we are talking about two things. One is a fund which is a little bit atypical, there are not that many of them. The other is the concept of what kind of structure. Is it a development loan bank structure, is it something more typically Lower 48 development authority development that you mentioned, is it international finance corporation? At some point I hope the committee would get a clear outline on paper of at least the basic nature of what's happened throughout the world in these areas. I'm sure we will hear more on it today in relation to the World Bank and the IFC. It's easy to get mixed up talking in this area.

Mr. Butler: Very much so. There are probably some good and bad points in each of these types of endeavors. One thing, we were talking very briefly with Moody's Investor Services the other day and they wanted to know if this was a "true permanent fund" or a "development fund". In their eyes a permanent fund is like the Texas permanent fund where principal is to be there permanently and never risked, pledged, or guaranteed, and the income used in a very restrictive way. They don't need to know this immediately, but it will make a lot of difference in those kinds of decisions, how to proceed, etc. Obviously these are some of the very things the Committee is going to be involved in and concerned with.

Mr. Gallagher: That question really goes to quality of the earnings and not quality of the assets. The quality of the earnings and not so much where you invest it.

Mr. Butler: No, that's true. But what they were alluding to is the principal might vary, or parts of it might be committed at some point in time. That would not be a "permanent fund" by a strict definition, it is more of a development fund. They were critical at that point, but it is one which should be considered.

Mr. Edenso: I think Mr. McDowell of Price Waterhouse would like to talk a bit about some of their ideas.

Mr. McDowell: The potential participation of our firm arose rather informally. My own responsibilities have included the base and residence in Washington to work very closely with the World Bank, the Inter-American Development Bank, and virtually all of the other development institutions throughout the world. There is, in most, if not all, developing countries today, at least one development institution.

They are all generally sponsored by the World Bank or one of the other major regional banks. They are structured in a certain way, and tend to meet some of the needs that the Governor's letter and other background I've had, exists here. There seems to be a commercial banking structure strong enough in Alaska to provide for most or all of the short term credit needs. The State itself, through its capacity for debt, or for revenue, probably has reasonable resource to take care of very, very long term finance of intrastructure, hydroelectric projections or highways, those which we would normally define as a government responsibility, but which are necessary ingredients for development.

There is not, however, probably any great provision for medium term capital. If you wish to see the State develop business and industrial strength and yet meet other objectives, that is probably a necessity. There is probably a requirement for quite a few businesses that need 15 year loans, where maybe they could get five over here, and maybe a project could be handled at fifty over there, but what do we do with the fellow that needs 15 or ten, seven, or even twenty. This is the questions I raised to Jim. I asked him what kind of structure is this and he thought there probably was a gap, and it sounds from the Governor's letter, that there probably is.

Then, if we draw parallels with the international scene, of what is occurring in developing countries. Most of them have a commercial banking network, it may be First National City Bank or Chase or Bank of America, or maybe a local bank, but they have adequate networks in almost every country. The government itself could borrow the long term capital. They could go to World Bank and get a fifty year loan with twenty years grace, a very poor country, perhaps at no interest, to build a hydroelectric dam. It is the secondary investment where they have a gap. In that instance they have developed finance companies at the urging of many of the international banks. It fills a need in those countries which may reflect a similar need here.

I feel we have a great deal of experience in the general area of development banking, among other fields. I happen to personally possess some of the experience in the firm and I would like to be regarded as a resource to the group and to make our skills available as necessary.

Mr. Gruening: Where do we get that long term money at no interest?

Mr. McDowell: I think your per capita income might be a little high.

Mr. Gruening: What is a medium term loan? Would that include home loans?

Mr. McDowell: Not in the normal context. It might include housing loans, but it might be for housing as a project, not as a normal single family owned home that we think of. It depends on the country. There really is a substantial variation. Most countries do not have a well developed savings and loan industry, but several do; whether the government runs the savings banks or commercial. Quite often they meet that need as we define it for homes through a part of the commercial banking system.

Mr. Gallagher: How do the countries go about trying to insulate the long term funds from political influence?

Mr. McDowell: There are several characteristics in the development bank model that helps prevent this. None of them are insulated completely, obviously, from the politics of the country. First is the establishment of a separate institution. The government owns the stock in most cases but it is set up as a separate corporation.

Second, there is a semi-independent board appointed by a variety of means. Often they will have a double board structure. First there will be a Board of Governors which is the policy making group that represents the members, in the case of an international bank that is owned by various countries, or it represents the constituencies within a particular country or region. Then there is a Board of Executive Directors, who actually carry out the day-to-day operations of the institutions.

The model, again, is the World Bank. The executive directors represent each of the countries and meet once or twice a week. They pass the final proof on all loans and spend the rest of the week studying the documents concerning those loans that have been submitted to them by the staff.

The third procedure is that there are very well defined project selection and evaluation, criteria rules, procedures, and systems in the development banks. Again, they have been refined over the last 25 years or so by the World Bank, but the trend of techniques they use are quite well documented and quite well known and implies that a project goes through several levels of screening. It also implies that it goes through a significant amount of analysis as to all of its effects, as well as the potential return on investment before it ever gets to the Board.

Mr. Wohlforth: There was a massive study three or four years ago on the World Bank and it is really instructive reading. One of the impressive things about the World Bank is that they are a very tough lender. A lot of the under-developed countries went through a lot of agony before they got their loans, and some didn't. If it wasn't a successful act it originates from the fact that they were a tough lender, and still are.

Mr. McDowell: The projects are extremely well analyzed and documented. There is no default of any kind in their repayment records, after twenty some years. They have a lot of leverage with the countries because they could cut off any country that doesn't repay, but still, they do a good job. They are a beaurocracy. They have 6,000 people in Washington running this, their administrative costs are not unreasonable relative to their lending program, which was $6 billion this year. They have also served as a model for 200 to 300 other institutions around the world.

Mr. Gallagher: Pete, will you go into how they use a soft loan program versus a hard program. There are different qualifications for each, I think.

Mr. McDowell: Within the World Bank there are four lending programs. One is at zero rate of interest, one at 4.5%, one at 9%, and the fourth program is equity investments and loans to strictly private enterprise in developing countries. That is called the Internat' nal Finance Corporation. The other three are all part of the World Bank itself, with different technical names, but they use the same staff.

In sectors where the payoff on a loan is softer, such as a rural development, or agriculture development, the best objective is to raise the per capita income of the farmers. If it is in a country which has a very low ability to pay, they are normally on a low per capita distribution of income, which means there aren't that many wealthy people either. There just isn't any type of money, therefore, they can't afford to pay 4% or 8%, then they will give out these soft loan programs. I wouldn't say sternly that the standards for evaluation of the project are any different, I think they are just as tough as they carry it through, it is just that they don't expect a rural development loan to earn the same rate of return or forecast the same rate of return as you would for a hydroelectric project, wherein you're going to generate electricity which you are going to sell to users, and which has a very definitive financial picture. It is quite easy to project what is going to happen with one of those projects but it is quite difficult to project what is going to happen to 300,000 small farmers with less than an acre of land.

So the same institution, the same people, can get into a variety of soft to hard lending programs. Again, I don't think their standards of evaluation vary, but their standards of expected return are certainly varied. You might differentiate Alaska, for example, among fisheries, forest products, petroleum, manufacturing -- perhaps six different sectors for the development institution to consider. You may well expect six different returns and consider a subsidy of interest on certain of these things.

Mrs. Lehr: In the literature on the World Bank, there was some discussion of the policies of the toughness of the World Bank and the potential real and imagined problems of this toughness and the policies of influencing the internal work, or the policy that the government of any particular country might have. Do you see any relevance of that experience for Alaska?

Mr. McDowell: They are an international institution and they hold this sacred. They try not to be influenced more than proportionally by any one country. But they do meddle in the internal affairs of all of their member countries; they do it deliberately and they do it on the basis of their hope in believing they are doing right in helping the countries. They go in and insist upon taxation programs, subsidization programs, price control programs. They will put in as a condition of the loan that the government or country change the way it does something, which could be viewed as a purely internal matter.

They are fairly unique in that way. They are like the United Nations, although are a little more subtle about it, but they still interfere with internal country affairs. Depending on who your borrowers were, a development institution in Alaska could have the same power. In trying to help a particular organization, your people will want to go in and make a few suggestions that are conditional -- the granting of the loan is conditional upon certain things. However, I don't see that being too much different from the regular commercial bank. It acts as advisor in certain capacities.

Mr. Gruening: That raises an interesting question -- the political control of the permanent fund. I think we've been talking about the areas and types of loans but as far as a political structure I think the World Bank has made that a good example. I hope ultimately we have more political control, not in how the loans are administered, but ultimately the strategy. There has to be some fixation of political control. In other words, at some point we have to look at what the governing body would be. I assume it is an executive function but it could be set up as an independent corporation.

Mr. McDowell: Which the second tier of the institutions are, independent corporations, stock owned by the government, but it is incorporated under the laws of the country, or in this case, the State. Clearly, it has officers, directors who are elected by the shareholder while they are appointed by the State government. But I think you might want to look at several alternatives with the board structures; one tier, two tier representative of various groups. All the World Bank has is a board that represents its members, its owners. Each owner has the right to elect a certain portion of a director.

Mr. Gruening: According to the money invested?

Mr. McDowell; Essentially. Their voting power on the loans is also a proportion of the investment. Again, you're talking about beneficial owners, at this time would be all the people of the state but perhaps there is some political way to come up with the proportionality of voting or directors that would be represented.

Ms. Lehr: Represented?

Mr. Edenso: I think Dona was referring to the terms of the loan. For example, the small business loan program of the Department of Commerce, conditions are sometimes written into the commitment to make a loan which the borrower must meet or the loan won't be made.

Mr. McDowell; Right

Mr. Edenso: Some conditions are additional security, or security of a certain nature to secure the protection of the loan, adequate collateral, terms of the loan and length of time and dollar amounts.

Mr. McDowell: The parallels of that kind, requiring specific improvement to a particular institution as receiving the loan are also exact.

Ms. Lehr: I was thinking of a slightly different thing, I think the Committee should be concerned with the implications of the type of cntrol and who makes the decisions, the necessity for public input, coordination with legislative and administrative policy, rather than having an isolated decision making process isolated from changes in loans.

Mr. Wohlforth: It could be an advisory structure of all kinds of interest groups, but it seems to me it clearly has to be a bank in concept and operation.

Mr. McDowell: Your Board of Governors concept could work. If there is a belief on the part of the Governors that agriculture is, for example, its priority is too low, then they will change it at that meeting.

Mr. Wohlforth: A few years ago we had a conference with an IFC man, the Bank of America and the Bank of Tokyo. Mr. Gustafson talked with us for several days. At that time there was no permanent fund in contemplation. But his very strong and positive advice at the end was, don't create your structure first, don't legislate a bank, don't adopt regulations. He said to first identify investment opportunities, whether or not, if a development loan bank were created and funded, is there existing investment opportunity simply waiting for investment capital or interim capital for it to function.

I had no way of really evaluating it because I was talking to an expert. He had been through this several times, and said typically, that is the way these things have been generated in other places in the world. It seems to be a very important part of the work of the committee particularly since we are developing an expertise in the State in the last several years with Native Corporations. We have to evaluate their experience and certainly they are providing us with a catelog of things of do's and don't's.

Mr. McDowell: That statement is very well put and probably an interesting model for later deliberations.

Mr. Rhodes: Pete, are there any countries that have development banks that are right inside the government itself?

Mr. McDowell: Yes -- and No. Development banks are very much under the political control of the government. The government owns the stock; under the country's laws they can vote out the officers.

Mr. Rhodes: One thing that disturbs me about having something right under the Governor or inside the State, is not perhaps so much influence meddling, as the lack of continuity.

Mr. McDowell: In many cases, the banks are set out as relatively independent institutions. The President's representative in the Ivory Coast, for example, serves on a board of the National Development Bank. Several people on that board are appointed by the President. When a new government takes over I'm sure those members will be changed. The the president of the bank doesn't report directly to the president of the country, administratively, or in an executive state, he reports to the board, some of which represent administration.

So if you want to make a State department, then I don't think you're talking about one of these kinds of models. I don't think you're speaking of a development bank. You're talking about something that is much more like a normal function of state government. If you're talking about making it semi-independent or quasi-independent, then you're talking about choosing from one of these other options.

Mr. Rhodes: The management structure is decided by the legislature, subject to the Governor's veto.

Mr. Butler: In Alberta, the Investment Advisory Committee of the Fund is the executive counsel of the province, which is the Governor's cabinet level appointees; yet if they suggest an investment the standing committee of the legislature has to approve it and the legislature must then specifically approve the funds going from the fund for that recommended investment, so the legislature keeps the purse strings even though the administration may propose the building of a railroad or something. If the legislature doesn't go along with it no money will come out of the fund for that purpose. That is one way of a checking balance for the legislature and the administration kind of work.

Mr. Gallagher: The legislature in Alberta is the administration or the dominant part, is it not?

Mr. McFarland: Because of the parliamentary form of government.

Mr. Gruening: Just mentioning, the Heritage Trust Fund. I think they divided it into three categories, but at least a third of the funds dedicated to non-revenue producing, or non-income producing investment goes into capital improvement. In other words, it isn't strictly analagous because in Alaska, all income, direct appropriations are in the capital fund.

Mr. Butler: Such as a road. Investments in projects which will provide long term economic or social benefits to the people of Alberta which will not, by their nature, yield a return to the trust fund. Those are limited in total to 20% of the investment in the fund by legislation, but they do fully expect to do some that won't give a return.

Mr. Gruening: You could take the same language and apply it, but it would not return the highest rate of return to the permanent fund. In other words, there may be investments that have a social value but still meeting the definition of income producing. A 1% interest is income producing.

Mr. Wohlforth: I think that phrase is the most intriguing one. What does income producing mean?

Mr. McFarland: I think it is pretty important that this committee come up with a recommendation. This is a political question at this stage of the game of passing the constitutional amendment, and I think you're going to have to have some direction how we intend to invest it and where. I think we should give them an outline of how we're going to proceed.

Mr. Gruening: Of course, it has to pass. I assume the voters are going to pass it but you might give some thought to when we have some outlines, to make contact with the public. Right now, of course, it is a very vague concept, and everyone has a different idea for what it could do.

Mr. Rhodes: I've been in touch with the Growth Policy Council. They have a whole series of items being planned. By the 15th of January, 90% of these items would have met and addressed five major issues as defined by administration, and five major issues as decided by various regional groups. It would be very critical of the State's immediate future. I asked them about having an early hearing held on the permanent fund but they had a rather rigid schedule in mind.

So perhaps you want to do something more, but so far as I know there is no other effort from the administration.

Mr. McFarland: I think there are a couple of dangers. I don't think this will pass without a lot of work. That is why I think the statements at this stage are very critical. If the people think there is going to be another layer of government involved to pursue this and take over the banker prerogative. In other words, they're seeing or thinking that, rather than getting reduction in taxes from this, the money is bypassed into a permanent fund. So I think it will have to be pretty well defined, hopefully, and the people will understand.

Mr. Rhodes: Is it seriously difficult?

Mr. McFarland: There has been no publicity on it yet, what the legislature has done. You know, "permanent fund", that sound great, but when the people start digging into what it is and what it entails, etc., then they will be thinking about it.

Mr. Wohlforth: I agree with you, it could very easily be put into difficulty if approached from a negative point of view. Here is 25% of the largest resource, then you are being permanently segregated away from the possibility of reducing your taxes. I would like very much to see this committee be supplied with some memoranda, not in great depth or detail on some of the subjects that the consultants have talked about, but have in mind some of the distinction of what has happened elsewhere, with maybe a little bibliography so at least we could be up to snuff before the vote in November. At present I would find that valuable.

Mr. Gallagher: There was a voting poll in Fairbanks a month ago on the permanent fund - it passed 90%.

Mr. Rhodes: You raised an interesting point, I never heard that before. We run some dangers supposing it passes overwhelmingly, as I expect. It is possible that if the public were unhappy with this initial effort, there might be a turning against the fund.

Mr. McFarland: As I see it, the cost of government is going to increase. The money is going to have to come from somewhere. There is going to have to be new taxes levied, etc. On the other hand, until this gets to working and we get some dollars in it.......

Mr. Rhodes: If the Committee decides they want to bring some of the issues of the permanent fund to the public I'm sure there would be no problem in using the proper quorum as a means of doing that.

Mr. Edenso: This is just an assignment. You need to realize that the numbers you saw today are really estimates, when in addition to that your attention is focused on 25% of the revenues to be received by the State from oil and gas royalties as well as potential taxes. There is another 75% that will go into the State general funds. So keep in mind that in focusing only on a portion or a percentage of the total number of dollars that will come into the State are revenues and taxes.

Mr. McFarland: Well, I'm a political animal, you know. If no one questions it and it passes, well fine. But if somebody raises an objection, then eight or ten different people will have eight or ten different opinions. What I'm saying is, let's try to develop some policy that we can come out of this investment committee with that answers some of the questions that might be brought up, so we're speaking with some voice, that's all. I don't know that there is going to be any opposition to it, but I see a lot of loopholes.

I don't think it's enough for this committee to say we're all for the permanent fund. We need to say we're for the permanent fund because -- we'll be able to get some money and develop the state, what it will grow to and how much it will contribute to the general fund, maybe ten years or so from now.

Mr. Gruening: I would like to add to what Jim said in pointing out the 25% of these revenues to be set aside. In a sense they are non-recurring revenues, they're not taxes -- they're what we would call "wasting assets." In other words, to use it. I know that people raise the concept of using it to reduce taxes, but in a sense, the only way you do that is to have a tax base that is other than the average guy working, and the permanent fund could get into that kind of idea. Another response is, you're taking a wasting asset and using a portion to continue an even economy. Perhaps when we're talking about the kind of investments we will have to relate that to the philosphy that we're setting aside a portion of a wasting asset, not a tax revenue. We are selling a part of Alaska. Are we going to try to keep it here to develop a viable tax base.

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Mr. McFarland: We will reconvene and at this time we will have a report by Bob Richards.

Mr. Richards: As I understand it, the basic reason for our being invited to be on this committe was to provide data on the Alaska economy and to analyze some of the macro-economic implications of various contemplated activity. But our first assignment was to brainstorm the full array of investment objective options. It is the result of that brainstorming that I am prepared to report on now.

I must say that our orientation was toward achieving a comprehensiveness and completeness, rather than a rationality and sensibility. I sense, frankly, eleven different philosophical foundations and backgrounds at this table, and I think that is obviously one of the strengths of the group. But, depending on what one's philosophical bent may be some of these options may appear a bit peculiar, but I think it is imperitive that the committee not fall into the trap of implicitly pursuing a particular objective.

These options seemed to fall into three general categories. Those options that had predominantly a social orientation, those options that had predominantly an economic orientation -- economic from the standpoint of economic development, and those options that appeared to have a fiscal management orientation.

Option or objective number one would be income redistribution. The principal objective of the fund would be to serve as a vehicle for redistributing income from high income earners to low income earners. This would imply a strategy of placing investments in the safest securities with the income from these investments going to lower income families on the basis of some sort of formula that may resemble the federal negative income tax formula. Obviously, a considerable amount of actuarial work would be required to insure the program were operated so that some day it would not have to be supplemented by general operating budget.

Objective number two is subsidization of lower income families. Here the fund would be utilized to guarantee or purchase loans up to certain amounts and for certain purposes. The program would be structured to achieve this objective so as to provide financing to families who otherwise would have a difficult time obtaining funds. An example of this would be an expansion of the State's existing home mortgage program.

A third objective would be geographic redistribution of wealth. Under this objective the fund would invest principally in rural development programs. (We don't mean to imply that all these objectives are mutually exclusive. Indeed, you may structure the operation of the fund to pursue one or more of these objectives.) Under this objective the fund would make capital available for both public and private projects in areas that otherwise would not be able to attract such capital.

This objective tends to fly in the face of a very important concept that I think we should always keep in mind. Just because the financing is available for a particular project does not make the project sensible from a long run operational viability standpoint. I think, particularly looking to rural enterprises in Alaska, we have to keep this important distinction in mind, that we don't go financing projects that otherwise would have no long term operational viability.

The fourth objective would be the support of a specific designated social objective. For example, the endowment to finance the University of Alaska -- like the Texas Permanent University Fund.

As we've all acknowledged, directly or indirectly, this strategy represents a rather dramatic commitment of State funds and it would seem that such a commitment would have to have some degree of flexibility as it runs the risk of not coinciding with future social objectives, which some have expressed is the case in Texas.

The fifth objective or alternative would be to directly increase or improve the quality of life of all Alaskans through various subsidies. Basically, this would be the same as alternative number two, except that lower interest rate loans and other State loan programs would be available to all Alaskans, regardless of income or financial criteria. There wouldn't be a wealth criteria, there would be other sets of criteria. Naturally, such a program would run the risk of some rather dramatic disparity, such as an extremely wealthy individual receiving a State subsidized loan.

The sixth objective or alternative would be the providing of a vehicle to allow all Alaskans to participate more directly in the economic development of the State through an ownership position, such as the Alaska, Inc. as proposed by the Governor. The creation of a private corporation, the stock of which would go to Alaskans on the basis of some sort of criteria. The corporation receiving these revenues and investing these revenues and having the power to declare dividends on the basis of its earnings. Again, the legality of such a vehicle certainly opened the question in establishing such a program, and it is an extremely complex matter.

However, I have had a number of discussions with the Governor on this, also with Commissioner Motley. There is an intriguing thought here, that some sort of "general stock ownership plan" similar to the employees stock ownership plan recently authorized by Congress, be developed to achieve this end. Of course, in addition to the legal questionability and the mechanical complexity, it seems to me there are so many philosophical questions with such a program.

The next series of objective alternatives seem to have primarily an economic orientation. One would be to subsidize small business through the expansion of an existing loan program. A small business revolving loan fund, the commercial fisheries loan fund, the tourism revolving loan fund, but in the creation of similar programs, recognizing that this is a subsidy.

Again, this program would likely take the form of loan guarantees or purchases to bring about lower interest rates and more favorable return. I think there is another important point that the committee must keep in mind throughout its deliberations, and that is subsidies only make economic sense if the activity directly or indirectly induced by the subsidey, generates in the long run revenue to the State government which exceeds the cost of the subsidy, thereby bringing about a net benefit to the State. Otherwise, the dramatic logical extension of this is sitting around with a lot of subsidy programs that really didn't create enterprises that in the long run could return back more than they took in the way of subsidies and all of a sudden you are absent a tax base to support the subsidy.

The eighth objective alternative would be to service a vehicle to bolster, make viable Alaska's traditonal industry, particularly fisheries and forest products.

Such a strategy would imply a variety of programs, including loan guarantees and purchases, bond purchases, some sort of industrial bond bank. A direct ownership of major projects which effects substantially the viability of these industries.

These programs should be pursued only if they sufficiently alter the very structure of the industries so as to create truly viable enterprises, which generate taxes and other revenues which more than offset the cost of the programs to the state.

As an economist, I think we ought to rid ourselves completely of, what in my mind is the term, "renewable" and "nonrenewable resources". To me those are meaningless terms and lead to some rather nonsensical policy decision.

What I'm suggesting is that we invest in Alaska's traditional industry, that we make a subjective value judgment that we're going to keep those going (the fishing, forest products) because of the traditional relationship with communities etc. But not because of the renewable and nonrenewable. You could put all the fishermen in Katchemak Bay out of work as a result of the oil development that could occur there. Place that in an endowment fund and pay them and their offspring a very attractive income for perpetuity. Here is a tradition we're looking at, not the notion of renewable resource.

The ninth objective alternative is to serve as a vehicle to create a more stable and a more broadly based economy. This is almost identical to number eight, except that under such an objective the fund could invest in a whole array of projects, not just those related to our traditional industry. Under such an objective the highest priority would be placed on the financing, either debt or equity of major projects that really substantially alters the very structure of Alaska's economy, thereby the objective bringing about a more stable economy. Examples might include hydroelectric facilities, petro chemical plant agricultural projects, hard rock mining ventures, again the major notion here ... ng the magnitude of the project.

The last two objective alternatives fall under the area of a fiscal management orientation.

The tenth objective is to serve as a vehicle to provide a cushion for possible future revenue. The money would be invested relatively conservatively, the earnings would be reinvested separately so as not to be mingled with the fund because of the statutory problems, in the safest security and the accumulation of such earnings would be available to fill any gap resulting from a momentary short run decrease in revenues to the state as a result of cyclical or other factors.

Finally, the eleventh objective would be a reduction in the State debt and/or the tax burden on Alaska's taxpayers. Under this objective the fund would be utilized to buy back State of Alaska bonds, reducing the State's outstanding debt, thereby lowering the interest payments of the State, and improving the State's bond rating, which in turn, would lower the interest rate on future bond issues. Further, such a strategy earnings of the fund would be utilized to help pay for the State's operating expenses or for distribution for local governments for their support of current operations.

That represents the development of a full array of alternatives. At least now you are placed in the position of having to deal with these matters explicitly. I think another important distinction must be kept in mind, and is really alluded to quite clearly in the Governor's letter, that is the very name of this instrument which the Alaska voters are being asked to approve or disapprove, implies the notion of sustainability and perpetuity permanent fund. Therefore, it seems to us that the management of the fund should be in accordance with the intent of the legislature and the Alaska voters. This would imply a long range rather than short range orientation.

In this regard, I think it is important to acknowledge that relatively often the pursuit of short run social objectives, such as redistribution of wealth, for example, can be counter productive to the extent that it could undermine the very factors that are necessary for their long run continuation. Further, I think it should be acknowledged that pursuit of economic objectives to the extent that they expand the tax base, for instance, to the extent that the pursuit of economic objectives expands public revenue -- the pursuit of economic objectives, then, often more effectively contribute to the long run maximization of social objectives.

We feel that the pursuit of investment objectives options eight and nine would seem to most effectively satisfy the apparent intent of the Alaska voters, if they approve the creation of a permanent fund. That is the end of my recitation of array of options.

Mr. Gallagher: You used the word "subsidization" -- loans to lower income families -- are you meaning that you are subsidizing if the private sector could provide the loan at a higher rate of interest? I'm not sure how that term applies when you're talking about loans -- the social goals. You applied it to business as well, saying that perhaps businesses couldn't get loans from the private sector. Are you applying that as well to the home loan situation?

Mr. Richards: The notion of subsidy arises out of the assumption that wherein a person who could get a loan from a private sector under a certain set of terms, but now has this available to him under another set of terms which are more attractive than the State, then this gap is referred to as the subsidization.

Mr. Gallagher. My idea of subsidization is tied up around ideas of whether there are any positive returns on long term rate of inflation of you're getting a negative return in terms of long term rate of inflation.

Mr. Richards: I could understand that.

Mr. Gallagher: Maybe we're saying something implicit when we say "subsidy". For example, the veterans loans turned out to be the State's best investment of the $900 million. Some of the other investments unnecessarily were busts, but it wasn't a subsidy in the sense that it produced income on the State's money, so maybe that term doesn't apply just because the loans might be available at a higher rate of interest in a private sector.

Mr. Richards: That's because the earnings of the State were met with their market. There was no opportunity cost to the state for that program.

Mr. Wohlforth: You can't pick out this investment because the State had a negative rate of return on $15 million in their portfolio, therefore there is $100 million positive if you compare it to what the State could have received on market FHA/VA loans. There would have been a gap of from 2-1/2% to 3% over that period of time. There is a demonstratively loss of income. The social benefit of assisting the veteran to get in a home cheaper is another question to me.

Mr. Gallagher: I don't know that it is as much a subsidy as a combination of social and economics.

Mr. Richards: I purposely used the term "subsidy" because I think we have to recognize what we're doing even though the social benefit may exceed the cost of the subsidy. I think we have to really recognize what is going on.

Mr. Edenso: I missed your discussion on the subsidy, but it seems to be one of the key words and "opportunity cost". The immediate visibility of a loan program which the State has called the veteran's loan only returns 7% immediately, but those funds turn over within the State. They go into the banking system, into labor and wages and material. So if you assume that the turnover to be 1-1/2 times or twice, there is a greater economic benefit than meets the eye.

Mr. Richards: That's what I'm suggesting. I'm saying that if you enter into a subsidy program it should be done in such a way that the net social benefit exceeds the net social cost.

Mr. Gallagher: I would also like to point out that if we had to sell those veterans's loans in the last two years it would have been at $.75 to a dollar or more.

Mr. Gruening: The point is, the inclusion of all the subsidies, including the beefing up Alaska traditional industry, everything except maybe financing data or equity, all major projects, what you're giving them is a lower rate of interest because it makes the initial cost lower.

Mr. Richards: You are right. The public sector subsidizes the private sector all the time. Highways, the post office, etc. The issue at hand is that the effect of the subsidy generates a return that exceeds the cost.

Mr. Wohlforth: I think there are modes of efficiency, a subsidy context, the Housing Finance Corporation being an example, where there is leveraged financing, over $100 million of mortgages purchased at below market rates, financed on a leveraged basis on the tax exempt market throughout the country. The State subsidy has been a purchase of mortgages to the tune of 20% of the financing, which a 100% bond financing, external to the State of Alaska. So there is a subsidy, but a subsidy which is quantifiably less and achieved on a leverage basis.

Mr. Rhodes: One of the problems in Alaska in calculating this cost benefit on a subsidy is the tremendous leakage from our economy, high amount of import, if we had been a separate country. A lot of people are a little too quick to assume that the cost of the subsidies are offset by benefits. Not that many local dollars finally stay in the Alaskan economy.

Mr. Richards: But it would seem that under some of these objectives, projects could be invested in that would help reduce the leakage.

Ms. Lehr: I would like to make a related point. We're talking about subsidies, one a year -- your first possible objective was income redistribution. I think we would have to be aware of one thing, is that all of these have income distribution effects.

Mr. McKinnon: Did I get the impression that you've got investment in sustainable and nonsustainable resources? Did I get the impression that you thought investment in sustainable resources was not necessarily the optimum use of the permanent fund?

Mr. Richards: No, I think you could invest in forest products and fishing industry. I think the maximum long range social benefit would be achieved by investing in dams, power distribution centers, transporation systems, ports, aluminum plants, because those are the things that generate continuing sources of revenue for the pursuit of social objectives.

Mr. Gruiening: You could reuse iron, but once oil is consumed it is gone. Why would you build a hydroelectric plant unless ultimately you had to find some source of power other than burning oil? In other words, because it is a limited resource, eventually you're going to have to have a total substitution of oil as a major source of energy. So I agree that hydroelectric may be a viable project, but on different grounds -- a good project for the permanent fund to least look at, because we're going to have to look at some different energy sources.

Mr. Richards: I don't propose that because we have to be fearful of an energy supply, I propose it more as a cost element. Further, it may be an alternative to let the oil flow. Sell hydroelectric power to Western Canada and the United States.

Mr. Gruening: If oil were truly a renewable sustainable resource, it would be the chief source of power. It's going up in price because of the shortage, isn't that a correct analysis?

Mr. Richards: In terms of its current market situation, yes, but I don't like to get into these discussions.

Dr. Logsdon: I think the things we call renewable resources are not renewable resources at all, but are industries that use renewable features. This is very confusing.

Mr. Gallagher: Timber is only a renewable resource in Alaska every 90 years; mining, if there is enough mining acitivity, it may be a renewable resource for a good 300 years.

Mr. Waldock: I think Bob has some very valid points for the application of this permanent fund. Where this money should go, I'm not in a position yet to make a valid judgment. If you wanted to pin me down to any areas, I think I would have to go back to Puerto Rico's thought, or the World Bank's thought, which is basically the same premise that Bob Richard's idea is. I think what we have to do is try to find out what the majority of this committee wants, and hopefully we will prepare ourselves well enough so we could inform the public of some of the ideas so that it will pass the voter's approval in November.

Mr. Gallagher: One of the things Bob missed is that we have $200 million of a permanent fund already located in the treausry, and by transferring that asset out of the treasury you could get the general fund back into its more traditional role.

Mr. Wohnlforth: Option number eleven refers to reduction of the tax burden. I suggest there is an alternative tactic within that strategy, the possibility of focusing their attention on enhancing financing vehicles such as State general obligation debt through a pledge of enforcement of funds, this is possible. A leverage concept rather than the purchase back of that, attempting to see if our debt can't be strengthened and command lower interest rates.

We are in the configuration of issuing $120 million of State debt a year, local government, and other state agencies are pushing us up to probably somewhere in the $250 to $300 million range. Otherwise, I'm very much intrigued by the suggestions about major intra-structure investment. The whole question of actual investment possibilities and sources is one where a real intensive study has to go forward. We look at the Native Corporation. In the last two or three years with access to large amounts of money (I'm not involved with a Native corporatin) is that they are mostly investing in existing enterprises. Is this the matter of choice by them or is this the assessment that venture capital enterprises in Alaska are relatively few. I think this is something we have to direct our attention to.

Ms. Lehr: I think it is a little early for us to say what we think would be fine investments, although there are some knowledgeable people here. I think there needs to be some investigation on how much capital, how much investment the Alaska economy can usefully absorb on a short run. Whatever type of investment we undertake has a myriad of policy and traditional implications and we get some general ideas of what is possible to make reasonable decisions.

Mr. Rhodes: A good number of people agrees with the permanent fund concept because it keeps money from reaching the State budget. A number of legislators told me they actively supported the veterans loan program, not because they thought housing was a crucial problem in the State but it was all money that was beyond the reach of the beaurocrats. In Alberta they accommodated that sentiment by requiring some 20% to be held in government money markets.

Member: The Venezuela fund was principally organized to keep some 25% or 30%

of their oil revenues out of the money supply initially in order to control and avoid the enormous inflation and that led to policies toward investing their money externally. Meanwhile they built up an enormous series of objectives which clearly include all the other eleven that Mr. Richards dealt with, all of which are objectives of the fund. Some additional ones that reflect its sovereignty is that part of the fund will be invested in Latin American banks, development banks. Part of it will help support the prestige of Venezuela and the world economic ventures. But development issues are that they literally are going to attempt to redistribute the wealth, they're going to try to subsidize the poor people, they're going to try to get parts of their country that are ignored by enterprise, to suddenly have enterprise developed. They have parts set aside for education and parts to develop technology. Just about all of these elements, and one major one, is keeping the money out of the money supply until the economy could hardly stand it, by investing it externally.

Venezuela is an interesting situation. We probably intend to spend a great deal of time in the future discussing what they have done right and they've done wrong, where their pitfalls have been, because I think there is a lot to be learned there. It is a situation closely related to us in the sense of the source of revenue--oil. Theirs is an ownership, ours is an ability to tax, and it's not completely dissimilar.

Audience Member: There are two ways to create money. One is to earn it as Venezuela is doing and one is to print it, as Brazil is doing. Even though Brazil seems to be managing in a different way, it is certainly not what Venezuela wants.

Member: Partially, that is because of some administrative way to hang up some people changes and politics that might be avoided in a non-Latin American situation. Unlike what is proposed here they are talking in dollar amounts and are determined to go in there as opposed to percentages.

Mr. Gallagher: Is it keeping down the rate of inflation in the country?

Member: It has to. If there were $3 billion more in a single year flowing into that economy, the government accounts for something or 80% of the gross national products in Venezuela, so you could see the impact of an additional $3 billion.

Member: Saudi Arabia has done pretty much the same thing. White Weld is a technical advisor and this is an assignment we took on in November 1974, and have renewed annually since. They admit there are tremendous flows of dollars in their scant experience and they need all the outside help they can possibly get. They hired us and we have three representatives there on a permanent basis. They also hired Bering Brothers Bank in London.

Our job for them is simply to advise them on the enormous investment opportunities -- most of the income in Saudi Arabia unlike some of the other countries -- is the central bank, the loan producing properties. We're talking about the excess cash flow of approximately $2 billion a month in Saudi Arabia. Prior to the tripling of the price of oil it was still an enormous $7 - $8 billion a year, most of which has been deposited in banks around the world, with some exception.

Saudi Arabia is set up so they have five objectives with their dollars. Number one is internal development. Taking whatever dollars are necessary to improve the quality of life in Saudi Arabia, and to improve it in perpetuity so the investment is made, and whether we accept the terms or not, resources which are sustainable and those that are not.

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 comtemplated 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 ancelary 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.

Alasks 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.

Jim Elenso
Executive Secretary

ATTEST:

Vincent Wright

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

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. how many? The benefits of the Permanent Fund should reach a broad population base of the State.

annual?

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.

#60

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 sensable 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 dissapprove loans. Interest rates, security for loans, repayment scheduals, 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 enought study and which need to be addressed before the state decides on the funds' structure and goals.

JAMES LOVE:nj

STATE of ALASKA

MEMORANDUM

#60

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

DATE: March 8, 1977

FROM: Robert E. LeResche RL
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 <u>allocated</u> 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, ~~[illegible]~~ charged ~~[illegible]~~ 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

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*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.

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, becuase 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. [redacted] 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 concensus, 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 detraction 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

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

Internal Rate of Return[1]

Net Present Value[1]

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

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

Business Analysis (continued)

Marketing[2]

Management Capability

Management Motivation[3]

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 Payments[4]

Employment Effects: Total Number of Jobs

Number of Jobs Filled by Alaskan Labor Force

Duration of Jobs

Labor Mix[5]

Alaskan Ownership[6]

Diversification[7]

Inflation Effects[8]

Income Distribution Effects

Project Benefit Distribution[9]

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 Modeling[10]

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 Lifestyles[11]

Subsistence[11]

Pressures Toward Urbanization

Cross-Cultural Effects[12]

Population Distribution Changes

Immigration[13]

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

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

[2]Marketing 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.

[3]The 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.

[4]Balance 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.

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

[6]Increased 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.

[7] Diversification 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.

[8] Analysis 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.

[9] A 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.

[10] Modeling 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 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

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*An example is provided in Appendix 1.

		ject A	ject B	ject C	Projects vest in Best ure Financial trument Such Treasury ls)
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 Population Location				
	Immigration				
	Cross-Cultural Effects				
	Other				
Infrastructure Analysis	Demand for Public Services				
	Cost of Public Services Demanded				
	Impact on Communication System				
	Impact on Transportation 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.

PROJECT A	PROJECT B
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	PROJECT B
$10,000 Revenue to Construction Workers	$12,000 Revenue to Construction Workers
Capacity for 51 Additional Salmon Boats	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 clarif[illegible], 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, ppm	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					
LDMV 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†	73.4†	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

[a]Coding: * = best; † = next best; ‡ = worst; and § = next worst.
[b]See Appendix D for detailed composition.
[c]Strategy currently mandated by CARB.
[d]As percent of total county population.
[e]Surcharge income used to offset bus subsidy to whatever extent possible.
[f]Percent of average annual income for income group, retrofit procurement expenditure made in a single year.

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SIAC

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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 nd 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 aprove 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 doesn'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. Southeastern 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 capsulize 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 indutries 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 intensity. 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 enourage 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 inome 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 intra-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 constraints, 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. Furhmann 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 foregiveness 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 Fuhrmann headed the firm's effort in that area.

Mr. Fuhrmann: 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 extent n 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 activites 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 mar[illegible] Substantially all of their activities consist of direct lending for specific pr[illegible]s in the various countries and lending policies appear to be determined on social benefits as well as economic grounds.

The most significant amount these international and regional development institutions is the Inernational 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 analagous 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 policement 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 varius 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 Unversity 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 concered, 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 becuase 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 there 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 objectives 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 businesslike 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 a rojects identifed? 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 afrord.

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 uneconomc 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 becuase 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 size without calling for a new vote to subscribe more capital. The stockholders of the World Bank can increase the size of their institution by changing the leverage ratio, but it's quite difficult to change the articles of incorporation even though it can be done.

Mr. LeResche: The Alberta Fund sets proportions of loans that can be made for various purposes. A strong executive officer working under the Alberta rules would feel accountable.

Mr. Fuhrmann: He doesn't feel accountable with respect to the loans that are in the soft category because it's been removed from the fund by being put on the Legislature. He is accountable with respect to those things he has authority over. They have maintained the autonomy within the normal business environment with respect to soft loans but the responsibility really rests with the Legislature.

Mr. Love: Alaska seems to be a country that might have too much capital and would have a problem of how much capital we can absorb. Should we have a Development Bank approach? Is that the best vehicle for us in the investment of the Permanent Fund?

Mr. McDowell: That is true, but there are other issues that are addressed by the development banks--investment decisions that aren't made on economics alone, they're made on income distribution effects, employment effects, environmental considerations, health and social considerations, plus the economics of the project situation.

Mr. Love: What are the mechanisms for evaluating whether or not the loan programs that the state enters into are actually achieving the specific objectives being outlined?

Mr. McDowell: The reporting of the accomplishment toward this sort of objective is in the annual reports of the institutions.

Mr. Waldock: I have a few questions I'd like to put to the Committee. One is, exactly what criteria was used for the selection of all of these different financial consultants?

Mr. Gallagher: At the present time we've only got two under contract. Arthur D. Little is not under contract. We went in search of several firms who were knowledgeable in certain areas and called and talked to the ones we thought appeared to have the most to bear on the subject.

Mr. Motley: The Investment Advisory Committee, as an entity of the State, is subject to the procurement and purchasing rules and laws of the State. We have to keep that in mind.

Mr. Waldock: The second question is, "What exactly are the fees paid to these various consultants and what is the length of their contract?"

Mr. Edenso: The terms of the contract are general, they are intended to expire at the presentation or the completion of our task and then have the Committee itself return to its original condition after we have prepared some output for the 1977 Legislature. We anticipate completing the closed contracts sometime in January of 1977.

Mr. Rhode: I believe all the contracts are identical in that they expire with the convening of the Tenth Alaska Legislature and generally the compensation is based at their customary fees with a ceiling not to exceed.

Mr. Waldock: Which is?

Mr. Rhode: It depends on the contract. For White, Weld it is set at the amount of $20,000 ceiling, with allowances for actual expenses.

Mr. Edenso: The Lesiglature passed an appropriation of $185,000 and the Governor slashed that to $135,000. Getting down to the actual contracts; Bob Richards from Alaska Pacific Bank - his contractual services are at a ceiling of $15,000 and $2,000 for travel and expense purposes, in other words he is limited to a total of $17,000.

White, Weld and Company, Inc. of New York has a ceiling of $20,000 with $10,000 for travel and expenses, or a total of $30,000. Price Waterhouse has the same limitation on their contract.

We have on contract but not utilized, Professor Edward Solomon from Stanford University - contractual services of $5,000, travel and expenses of $2,500 or a total of $7,500. There is also an unsigned contract, but an agreement if we need it, with Dr. Richard Neve from the University of Alaska in Seward, to prvide us specific information on fisheries and fisheries related subjects. His contract is budgeted for at $5,000 and travel and expenses at $1.000, or a total of $6,000.

We have budgeted for the Legislators involved with the Permanent Fund and for their discretionary use a total of $30,000. We have budgeted for legal research purposes $5,000; we have also budgeted for travel contractual services for the State Investment Advisory Committee $3,000 in services and an additional travel and expenses of $5,000, for a total of $8,000.

There is also a contingency fund of $16,500. We had programmed, prior to our full realization of what the costs would be for the information we were asking from Arthur D. Little, we had programmed $10,000 and for their travel and expenses not to exceed $5,000. The information we are asking from Arthur D. Little is very complex and very difficult to gather. It requires some very talented people in the area of the national economy, interpretation of that with the State economy, and some econometric modeling, not techniques but the results of a developed econometric model. We have not signed this contract yet but we're contemplating asking for a supplemental appropriation to allow us to proceed with this.

I think that generally gives us a total of $135,000, contractual services of $109,500 and travel and expenses of $25,500. We have one other contract -- Mr. Bill Batko. He would come under the budget item of State Investment Advisory Committee. He was recommended to us by Mr. Love. His total contractual services is $500 and travel and expenses of $1,500.

Mr. Waldock: Since it is one of the responsibilities of the Investment Advisory Committee to advise the Commissioner of Revenue and the State of Alaska on their selections of financial consultants and since these financial consultants primarily for the help on the Permanent Fund have already been selected, can it be assumed that the Investment Advisory Committee is not going to be held responsible for any incorrect advice given by these consultants?

Mr. Wohlforth: I would say yes, that can be assumed.

Mr. Gallagher: It was an executive prerogative.

Mr. Edenso: For the information of the Committee -- Alaska Statutes, Chapter 37.10.070(f) states, "The investment policy shall be formulated by the

Commissioner of Revenue, who shall be advised by a committee appointed by the Governor but shall contain representation from the Legislature. In formulating investment policy they shall consider maximum income and safety as governed by the prudent man rule and the benefit to the private and public sectors of the economy in terms of increased housing and commercial credit, stimulated business activity, increased employment, support of the market for state and local bonds, increased public revenue, together with the possible inflationary effect of the investment and (h) and (i) of this section. The Commissioner of Revenue, with the consent of the Committee, may enter into contracts for services providing investment advice, custody of securities and execution of transactions in or out of Alaska." That pretty much spells out what the previous role of the Investment Advisory Committee was. However, in the expansion of the Committee to undertake the task of establishing the Permanent Fund, the Governor asked that the Committee address itself only to the Permanent Fund at this point in its expanded state. Now, were you to begin to provide advice to the Commissioner as an expanded Committee, I would suggest that with the new members of the Committee, that may be inappropriate at this time.

Mr. Motley: Mr. Waldock and I have not discussed this subject before, but I think I understand the thrust of his questions. I think, as a long-time member of this Committee he would like to continue to participate in some of the decision making processes with regard to the selection of criteria, consultants, et al. As a fellow member of his Committee, I think I understand what he's saying. I don't have any problems with the selections made, but I've taken note of his scrutiny of the process.

Mr. Waldock: I'd like to say the same thing and not just for myself. I think everybody on this Committee should have that opportunity to have that choice and we might as well get the course of the Committee aimed in the right direction.

Mr. Waldock: The final question is the conflict of interest law. The law came into effect in 1972 that anybody working in an advisory or consultant capacity may not act in a contra-capacity as an investment banker, dealer, or accountant due to the possibility of conflict of interest. My question is, will this also hold true for the Permanent Fund?

Mr. Motley: What is the statutory reference?

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

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

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

Mr. Rhode: This matter was specifically addressed. Every consultant was given a copy of the relevant statute. I'm not aware that Price Waterhouse is dealing in securities. In the case of White Weld, they're in virtually every type of investment that is possible, all the way from tax exempts to taxable debt. So any way the Fund turned out there would some kind of business that they might have a part in at some later point. But that would be true of any other highly reputed national investment banking house that we might bring before this Committee.

Mr. Waldock: That's the exact point. I think if they are used as consultants they should not be involved in the actual use of the Funds, once it's in operation.

Mr. Motley: I move that I would be happy to work with Mr. Waldock and anybody else to draft the question and ask the Attorney General for his advice. There may be ramifications later on and perhaps White, Weld and others would like to know what their ramifications are.

Mrs. Fleischer: I'll second it.

Mr. Wohlforth: Any discussion? All those in favor say, "Aye." Opposed. So ordered. Mr. Motley, will you and Mr. Waldock work on this question.

Mr. Urion: Before we get completely off of this subject matter, I'd like someone to explain what this $30,000 is for? You said it was budgeted for the legislators to use as they see fit. I happen to be a legislator. How is it being used?

Mr. Edenso: To the best of my knowledge, it's being used for expenses incurred by the legislators for matters relating to the Permanent Fund, for telephone calls; for some travel, etc.

Mr. Malone: The appropriation was made in the Executive Branch, so what they've done is actually set aside $30,000 for the Legislature to basically make proposals against. It's the budget for that $30,000 that Senator Kerttula and I have worked up. The primary expenses are staff and office expenses.

Mr. Love: It is my hope that one of our very next meetings will be a meeting where the public has an opportunity to appear before us and give us their ideas on what they want the permanent fund to do. There are probably many other different approaches to the investment purposes for the development, many different ideas and proposals that we should at least hear before we make our minds up about what the proper direction is. We should not be committed in any direction before we have an opportunity to hear from the public.

Mr. Motley: I don't think anybody is committed. We can't commit anything until after the election. What we did today was mostly for enlightenment. It's probably the initial intellectual exercise to figure out what may happen if certain things do occur. The one thing that changes the Constitution is it says income producing investment, and that's where you have to start from. There isn't any mention on the ballot about social benefits versus social costs; there's nothing about subsidies, soft loans, or anything like that. We have to keep that in mind.

Mrs. Fleischer: I'm reluctant to leave the room without some decision on establishing the goals and objectives of the Committee. I would like for us to decide to do that, and I so move. I move that we make the next order of business a discussion of and decision upon the goals and objectives for the permanent fund.

Mr. Love: I'll second

Mr. Wohlforth: It's open for discussion.

Mr. Motley: I think it's a little premature at this stage of the game. I really think it would be presumptuous for us to come down with all kinds of goals and objectives when there's just a one liner that's going to be on the ballot.

Mrs. Fleischer: By the next time we meet we'll know whether we have a task or not.

Mr. Malone: I have to agree with Commissioner Motley. The very creation of this fund in the first place is on the ballot to be decided November 2 by the people of the State, and while I'm quite hopeful the outcome of the election will be positive, I feel it is presumptuous right now to start laying out goals.

Mr. Love: I think this Committee is going to have to look at the question of developing some pretty important goals and objectives relative to investment policies regardless of what happens to the permanent fund. The reason the permanent fund is being created is to have some mechanism to deal with anticipated surpluses of revenue; we're going to have more revenue than the State is going to spend.

Dr. Logsdon: Am I correct that the purpose of the standing committee is to address itself only to the permanent fund?

Mr. Wohlforth: I think that's correct, yes.

Dr. Logsdon: So if there's a "no" vote on the ballaot, this Committee automatically goes back to its original status?

Mr. Wohlforth: I hadn't understood that until today, but I guess that's right.

Dr. Logsdon: May I offer an amendment to the motion, that if the voters approve the permanent fund before the next meeting that this issue be considered, the issue of objectives of the permanent fund be considered at the next meeting?

Mr. Wohlforth: Do you consent to the amendment?

Mrs. Fleischer: Is that the sole purpose of the expanded committee? If the voters disapprove what will the Committee do then?

Dr. Logsdon: Then the Committee is not going to look to the objectives of the permanent fund because there won't be one.

Mrs. Fleischer: I accept the amendment.

Mr. Gallagher: There's a broad base public support. There are those who believe in the savings account concept, there's those who believe in community development, and there's those who believe in economic diversification.

Mrs. Fleischer: You mean you're saying that's what the goals are?

Mr. Gallagher: That's among the wide range. There are at least those goals in front of the public. The choice hasn't been narrowed down to all three.

Mr. Wohlforth: The motion is to consider goals and objectives at the next meeting if the permanent fund passes. Do we have any further discussion? All those in favor signify by saying, "Aye." Opposed? It passes.

Mr. Gruening: It isn't very long before the election and the convening of the legislature in January. I feel we should have specific questions or goals to put before the legislature -- narrow it down a bit. We do have some real deep issues.

Mr. Wohlforth: How about November 5 for the next meeting and advertise it in plenty of time to also have public input on that date. Also have Mr. Edenso make up specific questions for the consultants to answer. I would entertain a motion that the meeting date be November 5, that there be time for public discussion, and that there be a sub-committee appointed to meet with the Commissioner or his Deputy to pinpoint specific questions we want answered at that meeting from the consultants.

Mr. Gruening: Let's take that suggestion in three motions. The meeting date sounds fine, how about the 6th also? I'll second the motion. The other one - public participation. I so move that we advertise ahead of time, perhaps starting now before the election.

Mr. Edenso: What do we do if it doesn't pass?

Mr. Love: I would say that the purpose of the meeting would be for people to come and address the Committee on the issue of investment policy because that issue is still before us regardless of whether we have a permanent fund or not.

Mr. Wohlforth: All right then, is that satisfactory, that the meeting day the morning be devoted to public input? Then finally, a sub-committee to work with the Commissioner of Revenue on pinpointing questions, specific questions, for the consultants to answer at that meeting.

Mr. Malone: If a general discussion is planned at the next meeting as well as participation by the public, I would think that the concept of sub-committees might be more valuable after some of those things are hammered out, the sub-committees after the charge.

Mr. Wohlforth: Scratch the idea of the sub-committee for now. I'll entertain a motion for adjournment.

Mr. Love: I would like to introduce Mr. Bill Batko. He's been doing some work which we submitted to the board in short papers having to do with different types of not such gigantic, but smaller development corporations. For personal services he'll be submitting some papers after he gets back to Vermont and thinks about all the discussions that went on here.

Mr. Edenso: I would also like to introduce Mr. Ken Jensen from Arthur D. Little at San Francisco. We have a tentative contract with them to provide us with some national economy questions, given the potential size of the permanent fund and the nature of Alaska's economy and what Alaska's economy might look like in the future. This will provide the Committee information which relates directly to potential investment policy.

Mr. Motley: With that in mind then, you're asking for the Committee's approval. I'd like to review that contract to make sure that we avoid any kind of duplication on the other efforts that are involved in establishing that for the State. I would withhold that until I've had a chance to review that contract.

Mr. Wohlforth: Is there any further business? Do I hear a motion to adjourn?

Mr. Motley: Yes, so move.

Meeting adjourned at 5:15 p.m.

CERTIFICATION

I, JIM EDENSO, Executive Secretary of the Alaska State Investment Advisory Committee, hereby certify that the foregoing Minutes of the October 13, 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

Jim Edenso
Executive Secretary

STATE INVESTMENT ADVISORY COMMITTEE
MINUTES
November 5 and 6, 1976
Anchorage, Alaska

Chairman Eric Wohlforth called the meeting to order at approximately 9:00 a.m. on Friday, November 1976 in Room 406, State Courthouse Building, Anchorage, Alaska.

Members present were:

Dr. Logsdon, Association Director, Agricultural Experiment Station, Palmer
Mr. Eric Wohlforth, Attorney at Law, Anchorage
Mr. Robert Barnes, President, Alaska State Bank, Anchorage
Mr. Dennis Waldock, Foster & Marshall, Anchorage
Mr. Jamie Love, Alaska Public Interest Research Group, Anchorage
Mrs. Lanie Fleischer, Anchorage
Mr. James Crawford, Coordinator Alaska Offices, Anchorage
Mr. Langhorne A. Motley, Commissioner, Department of Commerce and Economic Development, Juneau
Mr. James Rhode, Anchorage
Mr. Robert LeResche, Director, Development Planning & Research, Juneau
Mr. Firchard Freer, Deputy Commissioner, Department of Administration (For Bill Allen, Commissioner)
Senator Jalmar Kerttula, Palmer
Senator Frank Ferguson, Kotzebue
Representative Clark Gruening, Anchorage

Absent Members:

Mr. Emil Notti, President, Alaska Native Foundation, Anchorage
Mr. Martin Pihl, Comptroller, Ketchikan Pulp Company, Ketchikan
Mr. Robert Thorstenson, Petersburg Fisheries, Inc., Petersburg
Mr. Robert McFarland, First Federal Savings & Loan, Anchorage
Senator John Butrovich, Fairbanks
Representative Hugh Malone, Kenai
Representative Richard Urion, Anchorage

Advisee:

Mr. Sterling Gallagher, Commissioner, Department of Revenue, Juneau

Others present were:

Mr. Bob Richards, Alaska Pacific Bank
Mr. Frank Murkowski, Alaska Bankers Association
Mr. Don Dickey, Alaska State Chamber of Commerce
Mr. Bill Scott, Chamber of Commerce
Mr. Phil Daniel, United Fishermen of Alaska
Mr. Robert Smith, Central Alaska Utilities
Mr. Dwight Bowden, Home Federal Savings & Loan
Mr. Paul Kapansky, Home Federal Savings & Loan
Mr. Dan Regis, Price Waterhouse & Co.
Mr. Al Fleetwood, Alaska Bankers Association
Mr. Charles Fuhrmann, White Weld & Co.
Mr. Ted Swick, White Weld & Co.

MINUTES:

Mr. Wohlforth: In Bob McFarland's absence I will now open the meeting. As you know, the Permanent Fund amendment passed last Tuesday. This has been the subject of study by this Committee for the last two meetings where the structure of the Permanent Fund and testimony has been taken at prior meetings from consultants.

This morning we've set aside some time for public hearings now the the Permanent Fund idea has passed. What kind of structure of operation, what kind of organization, what sort of use of monies for income producing investments is appropriate to recommend to the Legislature and legislative committees when they start their work in January. We'll briefly go through the agenda. This morning is set aside for a public hearing. This afternoon, Mr. Bob Butler will give a report on possible uses of the Permanent Fund to leverage investment. Mr. Richards will speak on the Alaska banking system and various kinds of investments that might be contemplated for the Permanent Fund. Tomorrow, Price Waterhouse will have someone report on management governing boards and problems encountered in both the operation of other permanent funds and in the operation of development loan situations elsewhere in the world In other words, how can we avoid some of the mistakes that have been made elsewhere. Then we will have a work session under the general topic of structural and organizational considerations.

Mr. Phil Daniel: I'm with United Fishermen of Alaska. I would like to speak in rather general terms about the present situation in the fisheries as it might relate to the Permanent Fund. The Alaska fisheries at this point is rather archaic in structure and scope. We are presently harvesting about four stocks; gourmet items, and neglecting things that could be done. There is no doubt but that in the future we will have to rely on renewable resources, such as tourism, fisheries, timber, and things of this type. So it might be worth considering what the Permanent Fund could do to stimulate the fisheries industry by way of investment, and certainly the movement into the bottom fish.

Our salmon fisheries are in great difficulties. We have only about a third of our salmon stock remaining. I don't want to go into detail on gravel incubators except to say they produce a very healthy smolt and at a much lesser cost than the so-called conventional hatcheries that have been employed for years in the northwestern part of the United States. I could see the Permanent Fund acting as a stimulant to the industry moving into the bottom fishery; acting as a stimulant to the hatchery production situation. I can certainly see a very significant role that could be played by the Permanent Fund to stimulate the industry and hopefully provide an economic base that we can turn to when other avenues have exhausted themselves.

Mr. Motley: What you are really saying is there is no domestic market for the 5.1 billion pounds of fish. Wouldn't you think it is a logical assumption that given a 200 mile limit that the people who have been used to eating fish aren't going to stop eating them. So what we're really talking about is a change in the relationship of the process in which they're caught and processed within the 200 mile limit, i.e., the exclusion of foreign fishing rather than necessarily disrupting the total market? You would envision the Permanent Fund to be a vehicle to possibly replace the Japanese mother ships with American mother ships or on-shore processing facilities?

Mr. Daniel: I think that, but I would like to go beyond that. We've done so little in the Lower 48 to convince people that fish is a good product. We should broaden the market in the Lower 48 by convincing people that good fish is really a desirable produce.

Mr. Motley: With regard to the fish hatcheries program under the Constitutional change, that they would be a more apt vehicle for this investment as opposed to a State-operated hatchery program?

Mr. Daniel: I really think they can do it more cheaply as far as the capital investment, the initial investment. They are going to have to have good biologists and they've got to have a good business manager.

Mr. Gallagher: Those mother ships or a like vehicle, how much would they run in American dollars? A million and a half?

Mr. Daniel: I think it would be very much more than that. Large crabbers, 80 - 100 feet, now run better than a million dollars. A floating factory ship is what we're talking about and that would probably run millions of dollars.

Mr. Love: What effect would all this off-shore operation have?

Mr. Daniel: There is real nervousness among the fishermen. There have been reports by the National Fishery Service that indicate vulnerability of crab and shrimp loss one part per million of oil actually dissolved into the water. They don't really know what that means but it doesn't sound good. So there is real apprehension about OCS. I've suggested to the oil companies that they take a group of fishermen to the Gulf of Mexico and allow those fishermen to talk to their counterparts. That way they would realize they could live with OCS development and I think it would go further to solve the problem than anything else.

Mr. Love: How much investment capital do [illegible] k would be advisable?

Mr. Daniel: I really can't answer that [illegible] fully. I believe if we got private industry into it we could do it somew[illegible] ch[illegible]er than the State. As far as developing markets and stimulating the harve[illegible] f bottom fish, I really don't have figures on that.

Mr. Love: I just wanted to point out in the interest of future deliberations that it would be useful to have some figures. Also if you see the need for an investment in the area of hatcheries and in building boats or in processing facilities.

Mr. Daniel: Well, I can see it in the boat building if you're moving into different fisheries. If you're using a boat for other purposes besides salmon it is justifiable. If you're looking at moving into these bottom fisheries, very definitely we could use State money. The burden right now for the fisherman who wants to develop a new technique or move into something is entirely upon that fisherman. I don't know of any experimental monies that are available except perhaps a very small amount. I see it certainly in the hatchery situation, but I want to emphasize that what we are really interested in is the loan program where the State gets its money back. Simply a loan that is repaid out of the sale of surplus fish at the hatchery racks and repaying these assessments on the fishermen.

Mr. Love: You think the big part of it is hatcheries.

Mr. Daniel: The bottom fish could be tremendously valuable.

Mrs. Fleischer: How renewable are bottom fish? You are not talking about hatcheries when you mention bottom fish.

Mr. Daniel: No. Hatcheries only apply to the salmon. Bottom fish is a more frustrating situation. Our halibut stocks are in big trouble. Bottom fish can be renewed but only by not fishing them for awhile. We need a better and more careful regulatory regime. Under the new bill we have the ability to tell the foreign fisheries where and when they can fish. We can insist upon it, but there is always the question whether our State Department is going to show any courage.

Dr. Logsdon: What is the existing capability of Alaska fishermen to take bottom fish?

Mr. Daniel: I would say that some of the crab fishing boats could be substantial in size and could be converted fairly easily but it would cost in the neighborhood of $45,000. The gear capability is another thing and I don't think we're very close to that and the cost for conversion in that case would be in excess of $50,000.

Mr. Waldock: If we funded the Fishery Department, we would want to know if it would be a profitable operation because part of the criteria of the Permanent Fund money is it has to have a return for the investors.

Mr. Daniel: No, I would say there isn't probably much being done there. It should be carefully looked into--whether you let the money go in the direction of private industry or whether you let it go into any department as to whether or not you get an attractive cost benefit ratio.

Mr. Wohlforth: This subject is one that would take weeks of testimony before we get finished with it. Hopefully, people like Mr. Daniel will work closely with us and the legislature on this problem.

Mr. Dickey: I want to commend the Legislature for their efforts and this Committee for their work on the Permanent Fund in presenting this package to the voters. Our purpose today, basically, is not so much to offer specific suggestions as to where the funds might be invested but more to speak to the point of the goals, the objectives and the structure that we see might be helpful.

I think the permanent Fund is an exciting concept, properly used can bring untold benefits to the wide cross-section of Alaskans. I think it has also the possibilities of abuse and, if abused, will create a boondoggle second to none that we've had and of unprecedented consequence. I am going to ask Bill Scott to speak first. He is past president of the Alaska State Chamber of Commerce and is Alaska managing partner of the accounting firm of Peat, Marwick & Mitchell.

Mr. Scott: It seems to me that the structure of the Fund itself needs strong management and leadership. The Fund needs to be in a separate State-created corporation or entity that would be answerable to the Legislature. Because the Legislature will set many of the guidelines. I believe the Fund should have constant and on-going review, not only from the financial transaction standpoint but also from an operational analysis standpoint, so that programs can be continually evaluated. Frank Murkowski will have comments on more specific investment areas.

Mr. Murkowski: The statement that the Fund is to be used for income producing investment is one of the things I wish to talk about. I don't feel the State can realistically involve itself in very broad loan programs for the benefit of the public as a whole in a general way because of the politics that enters into these programs once they are established and the lack of independence that a State agency has in loaning funds. The political pressures result in bad loans and severe losses, sometimes. I would suggest that the area to look into initially are some of the broad guarantee concepts. There is on the books at the present time the Alaska State Industrial Corporation which allows the State to use its tax exempt status. The concept has never been used because there has been a reluctancy in the administration to allow the State's credit to be on the line in the concept of a guarantee. It has an application from the standpoint of providing the development of industries that are of high potential but yet high risk from the standpoint of other adequate markets in the State. As an example, the cement business in Alaska today. We certainly have all the resources to develop a cement manufacturing process but it is questionable whether the markets are here. But a guarantee program where the Permanent Fund could guarantee the bonds has an application. That type of program would result in substantial new industry. It would not be a tax incentive per se, but it could have a very substantial assistance to the development of the industry.

If you get into participation in loans that you require 25% participation from the lending institution, then the policing is done by the lending institution that is directly involved in the credit. Agriculture is another area that the Permanent Fund could be involved in by developing and clearing the land.

I'll leave you with the warning, if the program does get into an area where it is a broad loaning function, then politics is going to enter into it. No administrator can hold up under that kind of pressure.

Mr. Gruening: Did you say the Veterans loan program was an example of a bad program?

Mr. Murkowski: No, I specifically stated that the Veterans program was an excellent program. It is not a broad loan program where somebody can come in with anything. It is secured by real estate, the safest kind of program there is.

Mr. Gruening: Is that because it's a housing loan?

Mr. Murkowski: That is one of the reasons. It has specific guidelines and collateral value. It takes reasonable discretion out because you've got specifics. But you get into areas where you're projecting what the cash flow of a new business is going to be and you've got to be realistic with it; if it's marginal, that means it is marginal and you've got to look at it that way.

Mr. Gruening: The fact that it is a home loan as opposed to, say, participating by the bank. Which factor is important?

Mr. Murkowski: There is no relationship. The real estate loan stands on its own. You've got guidelines and you loan a percentage to the value, you know what the value is and you look to the credit worthiness of the borrower. If he's got the income to pay for the loan, he gets the loan.

Mr. Gruening: Why couldn't the same kind of criteria apply to any business loan?

Mr. Murkowski: First of all, any kind of business loan doesn't fall into value. Usually the individual wants to start a business. He's an unknown entity and has no operating experience. He wants to borrow for the collateral, he has no equity. But he might have a great idea.

Mr. Gallagher: When I was in the banking system, we reviewed our reserve for bad debts and 89% of our charge-offs were commercial loans, 2% in real estate, and 9% in installment loans. We took all of our losses in commercial loans.

Mr. Murkowski: There is no politics in the Veterans program.

Mr. Gruening: I'm interested in why you can't insulate some of the politics from the business loan situation? Why can't we make the people that are administering it responsible?

Mr. Murkowski: It's a different type of politics. The banker is going to go broke or he's going to eat his bad loans, but with the government it doesn't work that way. I think the people are responsible, it's the pressures they get. And I don't have any suggestions.

Mr. Waldock: Rather than have a new vehicle for handling the Permanent Fund could the Alaska State Development Corporation handle it? Realizing there are a few pitfalls with it, could any safeguards be put in?

Mr. Motley: I think if you had the banks in then everybody has something at stake and you have two underwriting criteria.

Mr. Murkowski: If you keep the banks in enough and don't let them off with 5% or 10%.

Mr. Wohforth: I am aware of the Alaska State Development Corporation experience. I think the point of a higher degree of private participation is absolutely the key to any reinstitution of that kind of vehicle.

Mr. Scott: It is almost certain, if not extremely probable, that any loan that is made within the State will have social impact. To the extent that it creates a better economy and new jobs, that social impact will be good under all the guidelines we go by. I don't believe the social impact should be the prime consideration on a loan made from the Permanent Fund, or anybody else.

Mr. Love: Do you think the social impact should be the principal goal of the Permanent Fund or do you think that we should look to standards of the quality of life and whether or not certain types of development are necessarily good. Which direction should we work for:

Mr. Scott: Why can't we have both? Every goal I ever had in my life was toward the bettering of the quality of my life and in the process of everybody else's that I dealt with.

Mr. Love: There are going to be times when these can be best achieved through increased economic growth and times when it would adversely affect these.

Mr. Scott: That has to be the Legislature's decision and not the administrators of a loan program. The two should be separate and don't directly affect one another except incidentally.

Mr. Edenso: What do you think might be reasonable terms for a small loan program, whether it should have 10 years, 20, or 5, or whether or not it should have a fixed interest rate or should the interest rate be tied to some kind of market rate of interest?

Mr. Murkowski: I can't come up with a blanket suggestion. I would comment that the borrower needs 10 years instead of five. The longer you put it out the more risk you have in subsidizing interest rates. Is that in the best interest of the State? From the private sector, I don't like the word "subsidy" because of what it implies. I don't think the State loan programs should be subsidy programs from the standpoint of the application of the word subsidy. You have to establish the priority that the Permanent Fund is going to apply itself to. How broad you want to get, if and when or, if you get into a loan program on an expanded basis. Should you only come into those areas that the private sector can't serve adequatly. Who makes the decision whether the private sector is serving the public adequately.

Mr. Edenso: Do you see any problem with the State loaning, say, $1 million for 15 or 20 years?

Mr. Murkowski: Yes, very definitely. If the State gets into loans of that nature they are just one step away from a welfare state. State loan programs change with administration and you'd never be able to control the politics in it.

Mr. Edenso: We have a very rapidly growing influence or segment in the business community in Alaska with the Native regional corporations who have potentially a very high need or desire for capital. Suppose they express a strong desire to participate in a Permanent Fund, would you see the banks as well participing in this kind of a development or lending activity?

Mr. Murkowski: The experience that most banks have had with the Native regional corporations in their effort to acquire whatever their particular interest is, they are in a position to put in an equity contribution that makes the long-term financing available for whatever they have in mind.

Mr. Wohlforth: Part of the work session this afternoon deals with the structure of the Board or whatever it is that will administer the Fund. How would you like to see such a Board structured? Would you want appointments subject to the approval of the governor?

Mr.Dickey: We would like to come back later and talk specifically on that. We will have some suggestions that I hope will be useful.

Mr. Wohlforth: How many more would like to testify this morning?

Mrs. Fleischer: I don't understand the dividing line on subsidy. Isn't guaranteeing loans for a high risk cement industry with public money a form of subsidy? Or, if we use public money or bonds to build roads or hydroelectric plants, to help the mining, manufacturing industry, isn't that a form of subsidy? Or is that a different kind of subsidy?

Mr. Murkowski: It's inpterpretation, obviously. If the mine can't be developed without it and then the road is built theoretically to open the mine, it provides jobs, it provides a tax base for the State, etc. So it is returned.

Mrs. Fleischer: Theoretically, wouldn't there also be a return on other forms of subsidies?

Mr. Scott: You can build a return into any program. A guaranteed program could provide a percentage rate in exchange for the guarantee. It doesn't have to be a loan of money to justify a rate of return.

Mr. Wohlforth: Mr. Smith, Central Alaska Utilities, would like to speak now.

Mr. Smith: I represent two entities. I am president and general manager of Central Alaska Utilities, a water utility supplying the suburban area of Anchorage. I am also president of the Alaska Utilities Association, an association of regulated utilities throughout Alaska consisting of water, gas, telephone, electric, refuse and various other utilities that are regulated by the Alaska Public Utilities Commission.

One primary difficulty that we've all faced, not just in the State of Alaska, but nationally as well, is in obtaining long range financing for the development of these facilities. Apparently facilities such as reservoirs, transmission lines, extensions to serve new areas and source facilities such as wells and treatment plants are not attractive as an investment to the banking or financing community. However, these utilities are one of the most stable operations anywhere in the country. Our product is absolutely essential to the maintenance of life and health.

We feel the money is a good risk and would be spent in Alaska for Alaskans. We are asking for a program in which monies would be repaid with interest. We need a vehicle whereby funding is made available to utilities which are vital to the existence of the economy, health and happiness to the people of the State of Alaska and which are essentially not now available.

Mr. Gallagher: Is it not true that with the existence of the public utility any subsidy both for the private and the public utility, I'm thinking in terms of interest rate, does get passed onto the consumer through the rate making process?

Mr. Smith: That is correct. The cost of doing business is paid for by the customer whether it is in a department store or a utility company.

Mr. Love: You want long term loans?

Mr. Smith: Long term loans with a reasonable rate of interest is what we're suggesting.

Mr. Love: What is a reasonable rate of interest?

Mr. Smith: 3%; 9% I believe is the ceiling on the existing funds now. However, the problem is the term, not the interest rate.

Dr. Logsdon: Are you suggesting that the Permanent Fund should be subdivided into categories?

Mr. Smith: I think that would be helpful. Then the utilities or whatever would know what they had to work with and keep within that goal.

Mr. Gallagher: What is your own capital need?

Mr. Smith: Roughly a million dollars a year. It goes out very easily and fast. The water comes free, the reservoirs are roughly on the order of $750,000 each. One parting word -- the money is to be spent entirely within Alaskan industry and the service that we provide is entirely to Alaskans.

Mr. Crawford: What is the breakdown as far as water utilities and electrical utilities as compared to REA?

Mr. Smith: I believe we only have one REA in the group. All of the regulated utilities are not members of the Association.

Mr. Edenso: What is the average or normal turnover rate for long term debt in Alaska utilities? How long is the average long term debt kept on the books?

Mr. Smith: Except in extreme or unusual cases, long term debt has not been available for the utilities.

Mr. Edenso: Would $10 million be adequate if you have an average life of long term debt of 30 years?

Mr. Smith: There are a number of factors that will govern then. One, the rate of expansion given for a particular area. The Public Utilities Commissioner would have specific figures on all of this. Every utility is required to file an annual report to the Commissioner.

Mr. Wohlforth: Two gentlemen from the Home Federal Savings & Loan have been waiting patiently.

Mr. Bowden: I am Dwight Bowden, Chairman of the Board of the Home Federal Savings & Loan Association. I'm also a real estate broker and primarily interested in residential housing. Mr. Paul Kapansky is here as president of Home Federal Savings & Loan.

We feel one of the excellent uses of the Permanent Fund would be as a secondary market for residential home loans or multi-family housing loans in the State of Alaska. We feel this is an area the Permanent Fund could get into at fairly low risk and provide much needed housing for Alaskans who can't afford it.

Mr. Kapansky: We also feel that not only to compete with some of the existing secondary markets but perhaps create a secondary market where there is none, primarily residential lending. When we get involved in commercial projects, it is an extremely capital-short state. When we put a package together we can't sell it here and have to pay a higher rate for it. If we had something within the State of Alaska which we would not have to charge the buyer or the builder as much, it would be much better.

Mr. Love: Do you think we look more towards being involved in the housing market whether it is multi or single family homes because of the increasing cost of the single family home. How realistic do you think it is over the long run to really think in terms of providing single family homes?

Mr. Bowden: I would say multi family housing is going to be priced in the range that more people can afford than a single family home on its own lot because of the high cost of land and the high cost of developing that land.

Mr. Love: There is going to be a big move to have the Permanent Fund get involved in housing. Housing is a real tough item here and it is important that we get comments from the banks and savings and loan industry. Just exactly what areas are in need in terms of financing.

Mr. Kapansky: One of the restrictions is that we cannot collateralize deposits. So that in most instances we can only bid on $100,000 in increments.

Mr. Gallagher: The Department of Revenue put out of the pension fund large quantities of money into housing. Is that a successful program? Has it satisfied that market, or is the market quite a bit bigger?

Mr. Kapansky: We have utilized every nickel and the market is quite a bit bigger than you have funds to utilize. The money is essentially for low income people.

Mr. Wohlforth: Are there any other questions? If not, Mr. Fleetwood would like to say a few words.

Mr. Fleetwood: I'm Al Fleetwood, Secretary-Treasurer of the Alaska Bankers Association. In particular, we are pleased to support the creation of a Permanent Fund. We feel the Fund can be used as an economic stabilizer. It should be structured and maintained as a Trust for the lasting benefit of the citizens of the State of Alaska. As such, all objectives, investment policies and guidelines should be established within the context of the "reasonable or prudent-man" investment principle. We feel the Fund can be a tremendous asset for the State in terms of both a capital source for future development and a cushion for a possible period of inadequate State revenues.

Mr. Love: Will the Association try to have some specific suggestions on how to deal with some of the problems that have been brought up?

Mr. Fleetwood: It is difficult to get all of the banks together, but they are committed to come up with some composite position and I think it will be very meaningful to your Committee.

Mr. Wohlforth: Thank you. Any further questions? If not, we will recess until after lunch.

Mr. Fuhrmann: I am Charles Fuhrmann and with me is Ted Swick. We are from White Weld Incorporated, the New York office. We've been asked to speak on the use of leverage in the Permanent Fund. It is our feeling that it is premature for a detailed discussion of leverage because the goals and objectives of the fund have not been established. Nor has there been a decision taken as to whether or not leverage is appropriate for the Fund. It is appropriate, however, for the Committee members to be aware of the possibilities of leverage so they can focus on those decisions.

The Fund itself is going to have a pool of funds and a future cash flow. Leverage should be a means of magnifying the influence and maximizing the economic impact of the Fund. There are various ways of doing that; one is by direct borrowing of the Fund, either tax exempt borrowings or straight debt issues in either the public or private capital markets where the Fund was the borrower.

Among the various development banks and other funds in the world, many have used borrowings on their own assets either from their governments or from the public or private market. Another means of leverage is the use of guarantees, which allow you to have a multiple effect in the use of assets rather than being limited to the assets themselves, you could extend guarantees of other people's securities to an extent much greater than the assets you have. The value of the guarantee would be based on the amount of leverage you created and the form of the collateral behind the guarantee. A third means of leveraging the Fund or at least maximizing the economic impact, is the form of the participation or financial participation you take in a project's financial structure. Encourage and facilitate the participation of private capital because they come from behind that capital and create a sense of security and minimize the risk to that capital. In this way you have the means of expanding the size of the projects you can participate in without having to be the total lender.

Mr. Swick: Let's talk about tax exemption for a bit. It isn't always clear just what tax exemption means. The assets of the Fund itself and the source from which they come has no bearing on whether or not your activities can be tax exempt. The only restriction that I see based on Federal statutes, is that if you were using the proceeds of a bond issue issued by the Fund or an appropriate underlying entity that might be created, that those bond proceeds from that specific tax exempt issue could not be used for the benefit of a private person. That would include either individuals or corporations.

I don't whether there has been any decision on the tax exempt subject. The financing possibilities and the use of the Fund can be found when you decide what you want to do. I think the economic impact can be very pleasing as to what you are trying to accomplish.

Mr. Gallagher: Could you elaborate on public purpose in tax exempt financing, just what are the limits of public purpose?

Mr. Swick: The definition has been stretched beyond reason, particularly when you talk about industrial aid and lending credit to private persons. One recent development is where the IRS took a view of a public purpose is when they declared the handling of garbage or refuse as a public purpose. I think it is possible for this Fund and the source of its assets to be not restricted in the activities you can engage in with that money. If you do go into the borrowing market and expand the capital base in that manner, there should be legal documents to have that money segregated and just trace it through so it doesn't end up in an industrial private person's hands.

Mr. Love: Would you say that housing and public utilities, even investor-owned utilities are the more traditional areas?

Mr. Swick: Investor-owned utilities, the answer is no. They have entered into the tax exempt field in the area of pollution control in very significant amounts. It has been a more reasonable source of raising capital for non-productive expenses than they have to to comply with the environmental protection laws. Traditionally, the services you expect from your town, country, borough, or State such as schools, roads, sewers, water, and housing.

Mr. Waldock: I wonder if you would address the possibility of using an insurance program on some of our loans. The Alaska State Housing Development just put out some bonds within the last month and it is a fully insured program. Would there be any possibility of using this type of an insurance on various types of loans that we might be able to utilize through the Permanent Fund -- bond issues of local communities?

Mr. Swick: Yes, I think those techniques can be applied to this corporation mo...

Mr. Fuhrmann: There isn't much difference between a guarantee and an insurance program. With a guarantee program the Fund could get a fee for providing the guarantee. To the extent that they are putting assets aside to collateralize the guarantee, those assets will not be idle but will be invested. The combination of the guarantee fee and the earnings on the put-aside assets may be considered an attractive investment alternative.

Mr. Crawford: What is the point spread between tax exempt and non-tax exempt bonds?

Mr. Swick: It fluctuates and changes with maturity.

Mr. Wohlforth: We will need some expert advice perhaps from the Attorney General's office on some of these questions like what is income-producing investments and what can they invest it in. The concept of leveraging. It may be that the Legislature will consider that we will continue to borrow for public improvements and have the Fund provide a substantial reserve against the amount that is borrowed.

I think we ought to consider early whether or not, if we use a reserve fund concept for public borrowing, if we can do other than borrowing for so-called income producing investments, which a school obviously doesn't qualify for. Does the fact that ultimately the monies may be paid back to the reserve fund as a loan, does that qualify it as an income producing investment?

Mr. Fuhrmann: At noon today I was asked, "What happens if the Fund wants to get into research and development or front-end money or something that would lean to an income producing situation". My answer was that if the Fund is income producing that another form of leverage -- a sense of multiplying your economic impact and the ability to pledge future funds that will be coming into the Fund as opposed to current funds, you can provide a long term takeout to a bank so the bank is actually putting up the start-out money and is assured of a takeout from you when the project becomes operational. So you have the ability right away to encourage projects that are not initially income producing. The other alternative is having interest holidays until the project gets going, but that may not be consistent with the income producing concept.

Mr. Wohlforth: Mr. Richards, Alaska Pacific Bank.

Mr. Richards: My discussion today will really have two parts. The first part will be institutional in nature, comments on describing the Alaska Banking System. The other part is the initial observations on the relationship between the Permanent Fund and the Alaska Banking System. On a per capita basis there are more separate banking institutions -- not number of offices -- in Alaska than in all of the other weste states. That, of course, includes commercial banks, savings banks, and savings and loan associations.

I think the most important element of the Alaska banking system in terms of the Permanent Fund is the role which Alaska banks have played as a conduit for channeling funds from large, long-term investors to Alaska's families and businesses. They also serve as conduits through loan participation with Outside banks. The relevance of all this, is that the Alaska banking system is structured and has operating procedures established for serving as an effective conduit for the flow of funds from large investing agencies to Alaska's families and businesses. In conclusion, if a portion of the Permanent Fund is allocated toward loans to consumers, families and Alaska businesses and organizations, then it would make sense to do this through an efficient system of financial institutions already set up to perform this function.

Mr. Gallagher: I see a need for an institutional change. The tendency of the commercial banks in the State to send out relatively young and inexperienced managers to the small rural branches. Since they are young and inexperienced they seem to be unwilling to take risks or do any new sort of program. What sort of institutional change or emphasis could be accomplished in order to make them more responsive to that problem?

Mr. Richards: I don't necessarily concur with your thesis. It would be helpful to know what tack we're headed for. Are we discussing the Alaska Banking System, the Permanent Fund, or the relationship between the two?

Mr. Gallagher: The rural areas are not getting the loans that the Anchorage and Fairbanks communities are. The bank managers are usually not aware of the loans that can be made.

Mr. Love: I think it would be helpful to the Committee to have some indication from the banks where the Permanent Fund might fill gaps that are not otherwise met and I would like information on how we can better interface with Savings and Loans and credit unions. Also, before we start making a lot of plans for the Permanent Fund we need to know what the needs are in the State and what we're looking at in terms of this money. How do the banks fit in with the Permanent Fund?

Mr. Waldock: What is the length of a short term loan and what is the length of your long term loans? In other words, what the commercial banks are doing versus what you think the Permanent Fund should be doing in regards to length of time.

Mr. Richards: I think the Alaska banking system is set up to take care of credits generated by local Alaska businesses and families. They make consumer loans for as long as ten years. The Permanent Fund should be oriented more toward economic development type of loan.

Mr. Wohlforth: Is there a real demand for long term credit? What does real mean? Does that mean there are projects which should be financed now and which are not because of the lack of long term capital? We don't want to set up a credit mechanism which is inappropriate to the economic scene and climate of Alaska. Everyone has perceived the capital needs for Alaska but nobody has a real grasp on what they are, are they being unmet now for lack of capital?

Mr. Barnes: The Alaska banking system is a mortgage banking system plus we are filling a gap and that gap is real estate monies. That's where the real need is. We have to now write our mortgages to the underwriting standards of Outside lenders. Those, in many cases, are not realistic Alaska criteria. If the State had a program in which these criteria were eliminated, that I think would serve a real purpose.

Mr. Crawford: I notice on the agenda tomorrow we get into the structure. We still haven't decided what our goals are. I think we continue to put the cart before the horse. We should decide what the objectives of the Fund are and what direction we want to go.

Mr. Wohlforth: Do the members feel we are making any progress in our thinking? In the discussions we've had are the areas sharpened in your minds, the issues that the legislature has to face in determining the goals and the areas where the Fund can be effective?

Mr. Love: I think some of the most important things we can do now, we can't commit the State towards goals in different directions.

Mr. Wohlforth: It is frustrating for any group to be thrust with the job of finding the goals. It is only through a process of discussion of the segments of lending activities or capital needs in the State. At least we can be aware of some of the positive things that have happened elsewhere and that is what we want to avoid and we can transmit that to the legislature.

Mr. Edenso: Our task before us right now is to address what kind of structure and organization we may have. If we take it in the context that we do want to provide some kind of social service or social good, or if you do want to provide some economic development activity or if you do want to provide some connumity development activity then you can begin to talk about structure, organization and management. We can't go along between now and January and not come up with a product. I fully intend to see that this Committee has some kind of product before the legislative body in January.

We have three major categories, one is what are the goals and objectives. I don't believe we have either the time or the money available to us between now and January to answer that. The second is, what kind of organization, what kind of structure, how does that relate to the general public, how does it relate to the legislative body and to the adminlistration. I think we can address that. And finally, you have a problem of what do you do with the income of the Permanent Fund. How do you distribute that to directly benefit Alaska. So tomorrow, I think we should address that problem first, do we want a dual board system or don't we?

Mr. Wohlforth: We will recess this meeting and resume at 9:00 tomorrow.

MINUTES of NOVEMBER 6, 1976

Mr. Wohlforth called the meeting to order at 9:00 a.m., November 6, 1976.

Mr. Regis: This is the second report of Price Waterhouse & Co. We will address three specific questions today. First, we'll take a look at the problems associated with development banks. The only notorious and widely-known case of a development bank failure occurred with the development bank of Ethiopia. The problems probably began as a result of a split between the agricultural and industrial sections of their charter. Originally it was a multi-faceted institution. Subsequently the agriculture was retained and the industrial section was put in a separate development bank. There was too much concentration in the agricultural sector of the economy. There was not adequate diversification to protect the portfolio as a whole when crop failure or whatever, hit. Also the loans were much too small to be adequately supervised and too small to be processed efficiently. Also the loans were to unsophisticated borrowers who did not properly use the proceeds to expand production and as a result were unable to repay them. Management was simply not adequate to the task. Finally, the control system which was devised for a multi-faceted bank and which were set up to handle a larger volume, were not revised when it went to a small operation. These problems were recognized with the Ethiopian bank and it was remerged into the industrial bank and it appears now to be operating successfully.

The main reasons for failure of a development bank or finance development company is: incompetent management, unusual or undue political influence, and lack of a clear operating mandate, and also too ambitious a program. A summary of lessons which could be learned from these experiences would be first of all that the operating management must be very capable as must the Board. The appointment power must be removed generally from the political influence so that operating management can exercise prudent decisions. The charter of the institution must clearly define the objectives. Impossible objectives should not be set. Finally, government influence must be reasonably controlled so as not to dilute the independence of the institution.

The second issue had to deal with measurement techniques. The World Bank has a section essentially for evaluating the results of particular programs which are undertaken. At the completion of every project there is a detailed project completion report submitted by the various sections involved in making the loan. Evaluation is really a three-fold process. The primary thrust is a comparison of actual to plan as it was originally proposed when the project was brought to the World Bank.

There are a whole series of specific things which are compared in this actual plan which include implementation, just how quickly it was done, if it was done in the same time as proposed, has a serious impact of a host of the benefits intended. Compliance, did the borrower and the government associated meet the loan covenants, etc. Did the consumer perform as expected. What is the financial performance of the borrower. What is the economic impact to the extent that it can be measured. Efficiency on the part of the lending institution. Could or should other projects of this like be offered and can it be done in a more expeditious manner?

The second thrust is a macro view of the impact on the economy of the country or area, whatever was intended and this would be cumulative as opposed to individual. The macro view is designed to see whether you help employment, income redistribution, whatever else was intended in that particular country, has the standard of living increased, etc.

And, finally, can we do a better job? Was the performance of the bank actually appropriate to the circumstances presented to it? Was the diagnosis of the borrower's needs appropriate? Was the definition of the objectives of the project correct at the outset, understood, whatever. Were there unintended effects, good or bad? Poor or good environmental impacts? Was the bank participation effective or was it detrimental? The purpose of all this is to restructure activities in future efforts.

The next one is Organization. The question essentially is, what is the appropriate organizational structure at the policy level for the Permanent Fund institution assuming that development financing is a significant part of the activities? Our conclusion is essentially it should be a dual board structure. The objectives of the dual board structure are, first, you want to avoid undue political influence while being responsive to the political system. You want to provide for public input. You want to make sure that the organization allows the selection of the most capable people. And, finally, you want to make sure that the organization preserves the operating management's prerogatives ordinarily associated with management exercise.

The dual board structure should be composed of a board of citizens and secondly a board of directors. The purpose of the board of citizens would be to review and suggest changes in the charter and to represent the citizens of the State of Alaska and voice their views with respect to the operation of the Fund. The board of citizens would meet annually only unless there were some other special purpose. They would not be compensated except to the extent of expenses and essentially they would be representatives in what might be termed Alaska, Inc. We feel that a popular election of some portion of the board would be appropriate because it allows the public input in the sense that the wishes of the majority of the State can be expressed, the views and concerns of minorities in geographic areas, and it would give life to the concept of Alaska, Inc. There is a very close analogy with the representatives elected here being very comparable to the board of directors or the board of governors being elected by shareholders.

Our view of the board of directors is that initially it be composed of a group of seven, or it could be as high as eleven, who would be appointed by the governor in staggered terms so that no one gubernatorial candidate or elected official can control it. These seven would be confirmed by the legislature so the legislature has its input. The board of directors would essentially be a policy making board. It receives and acts on the issues presented to it by management but does not intervene in management in the sense that it does not present specific loans, it does not suggest geographic redistribution emphasis. Its purpose is to set policy and to react to input provided by the staff.

The president of the Alaska Permanent Fund should be appointed by the board of directors. He should have the power to conduct all the ordinary business of the corporation, hire, fire, be responsible only to the board in the sense of what is normal prerogatives of management. He would serve also as ex-officio as chairman of the board of directors but would have no vote.

Mr. Gallagher: How could that large board and the board of citizens be more responsive than a body that is already elected every two years called the legislature? Why would that be more responsive to the Permanent Fund?

Mr. Regis: It would be more responsive because it would have only one issue to deal with.

Mr. Wohlforth: How far down in policy does the board of citizens go and where is the split between that board and the board of directors?

Mr. Regis: The split would be very narrow in the sense that it would be the issues that would affect it, for example, an ordinary corporation under the Articles of Incorporation or the bylaws associated therewith.

Mr. Wohlforth: You also state that the board of directors would be explicitly prohibited from suggesting or recommending any particular financing operation to be considered or made by the board. But it would have the power to decide on loans or equity investments proposed to it by the staff. What do you mean by particular fiancing operaton? Are you talking of the actual industry to which a loan would be made or the borrower?

Mr. Regis: The board would decide on issues presented to it and would query very closely the staff on all of the factors either for or against a particular loan. But it should not enter into the question of seeking out particular areas of loans other than by policy.

Mr. Crawford: If the board of citizens is a group that is only going to meet once a year why do we need it?

Mr. Regis: The purpose of the meeting once a year is to receive the report and the accountability of the operating personnel and board of directors. You make the Permanent Fund accountable to the board of citizens or the electorate itself. Also you want to be able to change the direction of the Permanent Fund if circumstances themselves change. There is no proviso without some kind of public input for the citizens to do that.

Mr. Love: One of the fears I have would be the whole issue of how much money they could spend to get elected, who they could get contributions from. I can see basically the recipients of a potential loan being very heavy contributors to the people who are running for office to decide where these loans are allocated.

Mr. Regis: You must make sure there is not undue influence from any one sector. To make unusual contributions to a member of the board of citizens, your prospects of achieving a loan under the protection built into this organization is not great.

Mr. Freer: Why couldn't the legislature sit once a year as a citizens board? They are duly elected by the citizens of Alaska.

Dr. Logsdon: One observation might be that the citizens board might be an awfully expensive group to bribe. We're trying to achieve insulation from political processes as it related to other things other than the Permanent Fund, which might be an argument against the legislature sitting as a citizens group.

Mr. Regis: That is right. We are suggesting this as entirely separate from the legislature.

Mr. Barnes: The function of a citizens board is like stockholders. They have an annual meeting and would certainly not pass on day-to-day operations. Couldn't the legislature do that just as easily?

Mr. Regis: They could. I would prefer to see something removed from the legislature so the legislature has its input through the board of directors instead of as controlling, as it would be under that method.

Mr. Edenso: A good many of the residents of Alaska perceived the Permanent Fund as a means of insulating government from the legislative body.

Mr. Gallagher: The purpose was to insulate it from undue political influence, not necessarily from the legislators. You need the proper political input.

Mr. Edenso: The Permanent Fund is viewed as a savings account or separate fund which the legislative body can in no way influence for budgetary purposes or government spending.

Mr. Crawford: They can't defeat the purpose if they can't spend the money.

Mr. Regis: But if they were to function as both a board of citizens and to pass on the board of directors that would give them a chief proportion of the influence. This insulates the Fund from any influence by the legislature but still allows very positive influence.

Mr. Wohlforth: I think we must distinguish between policy and influence.

Mr. LeResche: I'm still unclear as to where the line between policy and operation is.

Mr. Regis: The board of directors will overall decide the policy of the Fund subject to review by the citizens board. The citizens board votes on the Articles of Incorporation and the Bylaws and passes on the annual report made to it by the board of directors. If the citizens board disagrees with the direction of the Fund they can change that through the Bylaws if they wish.

Mr. LeResche: So the actual policy sits with the board of directors and the oversight policy is with the board of citizens.

Mr. Regis: That is correct.

Dr. Logsdon: What you are talking about is essentially establishing a separate corporation to handle the Permanent Fund. The stockholders of that corporation are all the citizens of the State of Alaska. In order to have a stockholders meeting and you can't find a room that is large enough to put everybody into, so you select a certain number of citizens to represent the stockholders and they perform the same function as stockholders of any corporation. The reason this is separated in this sense from the Legislature is because you've got a separate corporation. It's really two separate functions.

Mr. Regis: That is right. It is a State instrumentality so consequently you do have to put State input in it.

Mr. Motley: Who are the president and this board of directors directly answerable to? Who could fire the president and the board of directors?

Mr. Regis: The President can be fired by the board. The board -- either their term expires or they can be fired by the legislature and the governor.

Mrs. Fleischer: How is the fund to be structured if this is a development bank? I don't really see a use for the board of citizens. It would be a useless board if they met but once a year and had no real power. They might be cynical about the board of citizens if you told them they did have power and they didn't have power. I don't think it is realistic to think they can change the bylaws, especially if it has to go through the legislature, and if they did it would take them a long time. If the Fund were a savings account, if a decision were made to invest money and then put the income into a general fund, it would be set up entirely different. Then the legislature would make the decisions about how the money would be spent because they would be spending out of the General Fund.

Mr. Regis: I don't think this particular organization would fit those circumstances. If you're going to have a savings fund concept the relative risk becomes measurably less. Just a comment, if you go to solely a savings account concept, if that were the primary function, then a lot less complicated organization would be drawn up.

Mrs Fleischer: Maybe we should be laying out the alternatives. It could be a pure savings account,it could be a pure economic development fund, or it could be a broader economic development fund, or a combination of all three. How would you set it up if it were purely one of those or a combination? Each one would be different. What we need is the structure of at least those four alternatives. Then we could give that to the legislature and say if you make this decision it will then be structured this way. We could lay out the choices so it would be really clear to all concerned.

Mr. Gallagher: I agree. If your goals and objectives are savings account, then you're going to have a different structure. If we only have a savings account, then you don't need that large a board.

Dr. Logsdon: I'm not so sure a citizens board could function on the basis of the amendment; they may only be able to advise in a general sense. It may be a legal question.

Mr. Gruening: I think your point is that ultimately the goals will have to be established by the legislature only. That would clarify some of the problems we had initially -- in which people were alarmed that this group was going to decide the goals. I also think the savings account concept is a good one for a number of years.

Mr. Wohlforth: We can approac this from the point of view, does there have to be an economic study of just where we re, and a long term economic study of how effective our capital markets are, and what sort of projects are ready to be financed. What has been the effectiveness of our existing loan programs and how large is the State budget going to be in relation to the Permanent Fund in ten years. This has implications for the savings account concept. These are things really worthy of consideration.

Mr. Edenso: It is really nice to raise those questions and to seek answers to them, however, we are really faced with the question, do we or don't we want to address something called the structure of the Permanent Fund. We could spend the next years studying the nature of the capital market in Alaska and we would find on an actual basis as the price of oil fluctuates the capital market, Alaska so fluctuates. We would be a little remiss in waiting for some period of time to try to establish the structure of a Permanent Fund. In ten years we could have a $1.5 billion and we have to know what to do with it. We've got to address structural organization.

Mr. LeResche: The legislature certainly will have to deal with this, but our expert witnesses and consultants say the structure will vary according to the objectives we set forth. We haven't set any specific objectives for the Permanent Fund yet, therefore, it is premature to discuss specifics about the structure.

Mr. Rhode: It is quite clear that the legislature is not going to recommend that the Fund be turned over entirely to construct buildings at the University of Alaska.

There are three major areas of activity for the Fund. Given those broad goals, we expect this Committee to state its recommendations and preferences, but also to offer alternatives to the legislature.

Mr. LeResche: I'm talking at the level of savings account, direct social objectives, maximum return on investment, industrial diversification. Any one or all of them will have a different management structure.

Mr. Edenso: The problem is that without a goal or objective, we can't look at some reasonable approaches to management and structure. We are faced with a very critical time factor. In approximately 120 days we are going to start receiving funds into the Permanent Fund. We need to have something before the legislative body for their consideration. I don't believe it is possible, given the current level of resources,both monetary and human, to establish the goals and objectives of the Permanent Fund. Another major question is what do we do with the income?

Mr. Love: Without getting into too much controversy, let me just say that I feel we should put the money in conventional money markets for a period of time until a lot of the planning and work with the public and the legislature is done. I don't want to get into a big argument about goals and objectives because I think there is confusion about what those words mean. I think we should take the total amount of money in the Permanent Fund, the first half year is not going to be all that significant, in comparison with all the other State's revenue, and put it in conventional money markets for the time being.

Mr. Gruening: I don't think we need to come up with a permanent structure that is going to last for the next ten years in the first part of the legislative session. They might wish to just buy current investments for a time until they have a chance to really think about it more.

Mr. Edenso: This meeting wasn't intended to come out with something that would be our recommendation to the legislature for a structure and organization. It is a first effort at considering various structures that are available and getting some meaningful dialogue in trying to put it all together.

Mr. Gruening: Let's take the savings account aspect and if there are any differences that should exist in the structure to administer that kind of policy. What structure might you consider as an interim structure.

Mr. Ferguson: I'd go along withe the board of trustees -- 7 members appointed by the governor and confirmed by the legislature to take care of the administration of the investments in the Permanent Fund for x amount of years. The first thing we have to do is at least recommend that we have a structure set up to administer the investments of the funds as they come in until we actually see how much money we have.

Mr. Gallagher: I would like to accomplish at th. point a management structure. If we agree that the three goals are savings account, community development, and economic diversification, come up with a management structure at the next session. That we spend the interim between that session and the following thinking about the strategies as to how to accomplish those things. In those areas we need a lot of analysis In housing, what are some of the institutional things that we have to go through, where are the housing needs in the State? The same way with fisheries, or any other sector. In the following session, when we have $200 million probably in the Permanent Fund, then we have those policies established. The legislature has then had two years to work on the problem and at that point you can start accomplishing something.

Mr. Rhode: Representative Malone has always expected that a temporary statute would be necessary to provide for the routine investment of whatever revenues are reaching the Fund. What he is hoping for from this committee are recommendations and alternatives on structuring the fund given a set of goals. That does not have to be done under a crisis footing, it may well be a process that involves the 1978 session or beyond. This committee ought to be able by session time or in the early months to assess or make some recommendations along the lines of any development activity whether you ought or ought not to have a governing board insulated from those who make loan appraisals, etc. The legislature may well be able to resolve a lot of these organizational matters by the first session, but hold it until the goals have been settled and combined with the enabling act.

Mr. Love: If what we are really talking about in the first year would be a conservative approach on how to invest these funds, I am looking for you to think in terms of making a recommendation to us. One of the alternative structures would be to simply perform a function of very conservative investment the first year. Secondly, maybe provide some information and advice on the administration during that first period of time, planning for the second year. I would like to know how that structure would differ from the structure that is before us now.

Mr. Regis: My reaction is that probably the citizens board would not be required at all although you might want to have it provided for at a future point, at least in concept.

Mr. Love: One of the major recommendations we can make is the initial management structure for the Permanent Fund toward doing certain types of planning jobs, certain types of economic planning jobs. The types of analysis that we think are very important. Maybe that is more important a job in the first year than making loans.

Mr. Barnes: I think we should decide and make a motion that the legislature should make temporary legislation and then if they want to give us their goals and objectives, we can certainly work out the alternatives for them.

Mr. Gruening: I think that is a good suggestion, but let's go further. We might suggest to the legislature something they could consider in terms of structure on a more permanent basis -- on a structure and organizational basis.

Mr. Gallagher: One of the things I would like to accomplish now is, if we want to talk about savings account objectives, what sort of management structure the Committee would see. To me, there are two obvious things. One, you can either leave it in the Department of Revenue -- if your goal is only savings account, and have them manage it just like any other fund. That's the most inexpensive. Or, the other alternative is to have some sort of small board overview that activity but still have it accountable to one manager. If that is your goal, the savings account, what does the Committee think of those two alternatives?

Mr. Wohlforth: I don't think it makes any sense to have an operational board. You need one manager who should be the State Treasurer, or in this case, the Department of Revenue. I hope there will be an investment statute on the books by the time there is money in the Fund.

Mr. Gruening: I move that the Committee direct Commissioner Gallagher to draft for consideration at the next scheduled meeting of this Committee a temporary statute which authorizes management of the Permanent Fund monies in a manner similar to the Department of Revenue's present administration of surplus funds.

Mr. Love: I'll second it.

Dr. Logsdon; May I make an amendment that it be a statute and not a temporary statute?

Mr. Gruening: I concur.

Mr. Gallagher: Does that mean some sort of sunset provision like this one will self-destruct after one year?

Mr. Gruening: Make this discussion on the motion. Presently there exists a set of statutes which deal with the Commissioner' authority to invest surplus funds. Now, the Permanent Fund will have to have that kind of statutory authorization from it established forever. Because there always are funds that are not immediately invested in one of the goals; they are funds that are coming in; they are funds that haven't been administered for purposes of the goal. So you always have to have that kind of statutory authority. So, maybe this could be a statute that exists for the life of the Permanent Fund. On the other hand, I like the suggestion of a sunset provision. It may be in the structure. But right now we are concerned with strictly how are we going to administer this fund until we really get the structure for the goals more firmly established.

Mr. Gallagher: Do you mean that the Department of Revenue will invest the money during next fall and meanwhile the legislature will pass a statute creating the structure.

Mr. Gruening: What I'm saying in this particular recommendation is, the draft would not create any instruction that doesn't exist now. It's just authorizing the administration of funds that come in under some kind of arrangement.

Dr. Logsdon: I might suggest that there be a clause in the statute permitting the Commissioner of Revenue to invest these funds with a structure that was established in the future; to provide funds to this as established by the legislature.

Mr. Gallagher: I think when you revise in the following session under a strategy bill, the Commissioner of Revenue should phase out of it.

Mr. Gruening: The constitutional amendment itself establishes the Fund. There is nothing we have to do further to establish the Fund. Money is going to accumulate as of an effective date of 120 days after the certification of the last election. What we are talking about is a recommendation from this committee which would authorize somebody to handle those funds in some manner, a very conservative manner.

Mr. Motley: What do you visualize as far as the objectives of the Commissioner of Revenue? Can he invest in equities, invest just in savings accounts, or to deposits to banks?

Mr. Wohlforth: The questions has been called. The motion is that it is the direction of the Commissioner of Revenue to draw up a statute for presentation to the next meeting, which would authorize him to invest the Permanent Fund in a manner similar to other State funds. Included in the motion was some provision, some time limitation on that authority. Is that correct or not?

Mr. Gruening: I would use the language, "authorizes management" although it means investment. I think the public needs to know the distinction between the kind of investments the Fund will get into in the future and the need to manage the Fund as a surplus fund.

Mr. Gallagher: I want it very obvious that it is very temporary.

Mr. Gruening: Every statute is temporary in the sense that it can be repealed. You could put a self-destruct date on it which would make the legislature consider whether it wants to continue it.

Mr. Gallagher: The other assumption that underlies the whole thing is we are going to work on having a structure next year.

Mrs. Fleischer: Could we have a reading on the motion?

Mr. Gruening: The motion is the Committee direct Sterling Gallagher to draft for consideration at the next scheduled meeting of this Committee the statute which authorizes management of Permanent Fund monies in a manner similar to the Department of Revenue's present administration of surplus funds.

Mr. Wohlforth: All in favor say "aye." Opposed? Motion carries.

Mr. Wohlforth: We have accomplished only a small portion of the task.

Mr. Gallagher: I have to have a report to the governor on Monday having to do with a totally unrelated subject and that is going to take me about three hours to write I need some time, that report has to be typed all day Sunday. My time limits are getting short. I would like to talk now about maybe a savings account or maybe the four objectives and ask about just management structures overall and see how the committee reacts to them.

Mr. Love: I would like to hear if there are alternative ideas on the ways to do management. Maybe we should look at different models -- like the Regional Corporations are taking a much different direction in terms of funds and maybe splitting it up may be an alternative as opposed to a centralized fund.

Mr. Gallagher: Why don't we put the four different things we've been talking about in front of us: Savings account. Economic diversification. Community Development. Smorgasbord.

First, the savings account area. The Commissioner of Revenue can invest it under some sort of surplus, or you could have a separate institution do it. With the savings account you could just have a small board and that's the extent of it. Does anyone see any difference in the management structure? You can either do it through the Treasury and have an Advisory Board or have a full board with a director and two or three people to do accounting.

Mr. Love: You can really decide the purpose of the Fund is a savings account purpose but you can still get involved in quite a bit of social loans in the State that are income producing. You may make a decision that the money markets, which are not perfect or not adequate, are serving some very profitable and sound investments within the State of Alaska. Mortgage loans and areas outside of conventional neighborhoods.

Mr. Gallagher: Are you suggesting something like they do in the retirement fund, invest in the highest and best return. I do invest in mortgages.

Dr. Logsdon: What do you consider a savings account?

Mr. Gallagher: In my mind we mean government corporates and fixed income. You can also buy private placements and CD;s.

Mr. Edenso: Are we considering the different ways you earn income in the savings account approach, or are we considering some kind of a structure and organization for managing the savings account approach? Regardless, you have a pool of money there and you've agreed to manage it, you've got to have some kind of management decision making process which tells you which is a better investment. If it's going to be into some developmental activity or social goal, then you're going to have a board or management structure that somewhat varies from a pure investment banking function where you're making decisions on money market instruments, whether fixed income, equity or mortgage loans. It's a different kind of activity, a different decision making process. To try to get a board to agree on one instrument over a specific period of time when you know the money market is changing daily you might never gain any income opportunities. Under savings account we're talking about a straight money market activity.

Mr. Gallagher: When we're talking about savings account, we're mainly talking about investment decisions that arise outside -- it's a trust account and you look for the highest rate of return which quite likely may not be in Alaska.

Mrs. Fleischer: Would that include mortgage investments, secondary markets? If it is then could you also tie that to some decision to invest in home mortgages in the villages?

Mr. Gallagher: No, then that would become developmental.

Mrs. Fleischer: If a decision is made that it does not produce income, but experience shows that it is sometimes income producing. So, who is making the decisions as to whether ...?

Mr. Gallagher: That is an importan' structural question. The retirement funds try to fill the unfilled need in the Stat .

Mr. LeResche: Could we establish the , inciple that the savings account objective would require the simplest of all the manage. ent structures? Is the board agreed on that?

Mr. Wohlforth: Yes.

Mr. Crawford: Possibly under options there, we should list the trust concept of managing for the highest return.

Mr. Gallagher: That is one of the goals you have to write up, Jim.

Mr. Love: I would like to look at the structure of the Regional Native Corporations as an alternative to that of a centralized system. There are separate corporations representing geographic areas of the State. Maybe the same thing could be done with the Permanent Fund.

Mr. Edenso: I don't see the similarities between the Permanent Fund and the Native Land Claims Settlement Act at all. I don't think there is any degree of comparison. The one has a completely different objective than the other.

Mr. Love: What's the difference?

Mr. Edenso: The difference is the Native Land Claims Settlement Act is mandated by law to provide in fee simple title, mainly land distribution to the 12 Regional Corporations and to provide monetary distribution to the 12 corporations. It also identifies specifically who the beneficiaries are under the Act.

Mr. Gruening: Decentralization of management is maybe a better term. I think that is a basic question, whether we're going to have a one management structure for development or whether you decentralize.

Mr. Edenso: Decentralization decision making.

Mr. Love: These are all various alternatives. It could be central management with regional decision making, development for a particular area. It could be a combination of the two. It could be completely autonomous Statewide that just did everything at a State level. Maybe that's the most efficient way to do everything.

Mr. Wohlforth: There is a Permanent Fund, not 12 or 14 permanent funds established by the voters. Almost certainly, there has to be a central governing body.

Mr. LeResche: I think we're talking about different objectives for different areas rather than about different management structures.

Mr. Love: I think we should be openminded about all possibilities. It may be that you would want 6 or 12 different management structures competing against each other.

Mr. Gruening: I think there has to be some central administration to determine which region gets it. But the idea would originate and be administered by a regional authority which may or may not be part of the Permanent Fund. But the concept would be that the Permanent Fund wouldn't take outside investors who want to move into a region for development.

Mr. Edenso: I think one of the things that was addressed by centralization, decentralization concepts was the idea submitted by Price Waterhouse and the recommendation for a board that would be composed from all the various election districts in the State. That would very definitely give you input on a regionalized basis as to how you would structure and possibly make decisions concerning either savings, development or community development types of activity. So far we haven't had anythig to do with structural organization.

Mr. Wohlforth: We could divide the decision making by regions and this raises the issue would there be some sort of subsidiary governing board by regions or does representation on the citizens board meet that problem? Central and regional boards might be better than funds.

Mr. Motley: If you decentralized this and went into various regions, let's assume, for example, a genuine need for electricity and a particular individual in that particular region where the dam is going to be constructed says I like to fish in that stream, therefore, I think this is really a disastrous thing, so henceforth let's say no to this particular area. Wouldn't this cause a lot of problems in some of these larger development programs that may be necessary for Alaska?

Mrs. Fleischer: Maybe the need is for energy, maybe thermal energy is a better answer than a hydroelectric dam.

Mr. Edenso: I think, central boards is descriptive of possibly more than one board.

Mr. Love: We have the Price Waterhouse model which is one model for development. Another approach might be to just turn the development completely over to the Department of Economic Development and make it a cabinet position.

Mr. Motley: Wouldn't that come under a great deal of political pressure? It means that the present governor or whoever designs that Cabinet can pretty much select in which direction the Permanent Fund's monies are going to go.

Mr. Love: It may not be all the money that is in the Permanent Fund. A certain percentage will be in savings account and a certain percentage in development. Mr. Meekins approached me about the legislature making up the board of the Permanent Fund.

Mr. Gallagher: They don't have the power under the constitution to be able to do it though.

Mr. Love: Maybe they were given that power by the constitutional amendment.

Mr. Gallagher: They weren't given any executive power, only policy making power.

Mr. Edenso: The question then comes, can a legislator also be on the board. Then you've got a board that is 60 members strong, not 40.

Mr. Rhode: I have had discussions with legislators on that point. It awaits legal advice by the Legislative Council or the Attorney General as to whether the legislature could be able to approve each and every loan over a certain size. I have been advised that possibly because the amendment was a separate part of the Constitution the normal doctrine of separation of powers might not apply.

Mr. Gallagher: we have a pretty clear case on the Royalty Board on which the people just voiced their opinion.

Mr. Wohlforth: There are some real legal questions here that I hope are being addressed at the outset. How much latitude is there in the legislature to divide the Fund up into regions? How much delegation is permissible by the legislature to aid the board? What does income producing mean? Can the legislature appoint members of the board directly, or sit as members of the board?

Mr. Gallagher: That's a question whether the legislature considers it executive.

Mr. Wohlforth: They are all interrelated. They are major questions that have to to be addressed very early.

Mr. Crawford: Is the Attorney General addressing those questions?

Mr. Gallagher: We have to know what the questions are before we can answer them.

Mr. Crawford: I would like to amend the motion to read either the Attorney General or a private attorney, whichever has the time prior to the next meeting.

Mr. Gallagher: The Attorney General has a staff of 35 attorneys.

Mr. Wohlforth: Let's move on to community loans.

Mr. Gallagher: There are a whole range of possibilities in community loans.

Mr. Love: We should call it community development.

Mr. Edenso: Bob, do you have any ideas on structural organization?

Mr. Barnes: I think the model that Price Waterhouse came out with is basically the model that everyone seems to be happy with, but we haven't addressed the citizens board yet. We've been philosophizing on how you do these things but not the structure of the entity that does it. That is what we should concentrate on.

Mr. Love: I think it should be decentralized as much as possible.

Mr. Edenso: Do you have ideas pertaining to the structure itself or the organization of the structure, possibly a board or not a board?

Mr. Barnes: I think the citizen board approach for the political sensitivity is important. That could be a small board appointed by the governor who actually operates the entity and let them choose the management. The legislature will tell us the goals that the board is supposed to meet. Basically that structure is going to serve if you have a developmental type approach. If you have the savings approach, you have a small board and a small staff. Those two alternatives are the only things we've been talking about.

Mr. Love: We're still going to have to deal with whether or not you want to have decentralized decision making about what the priorities are in different communities as far as development in those communities. You will still be able to have centralized management of the actual development but you may want the decisions made about what they want developed decentralized.

Mr. Barnes: I would say the citizen board concept answers that question. You have the input, that's what they are there for. If you put this decision out all over the State you're going to get nothing done.

Mr. Motley: What I would like to see basically, is a structure to manage the Permanent Fund. It does not have any objective goals or anything else, but at least establishes a centralized managerial group. The objectives will have to be settled by what the legislature says. I'll wait for my comments until we get to talking about the combination of these things.

Mrs. Fleischer: I don't understand how you'll get regional decisions reflected under community development. I think the people will have some priorities in their own communities that have to be reflected.

Mr. Rhode: They would approach the existing State agency to put a loan together and offer it to the Permanent Fund.

Mr. Crawford: Do you feel this recommendation is applicable to the four alternatives that we've had? Is it a management system that can be accepted?

Mr. Waldock: We tried to approach as a businessman's decision. You could have them decentralized to the point where you'd never get anything done. So starting here we've used the Department of Revenue, because the Department of Revenue has already got short term vehicles in charge of handling money for the State of Alaska. Then there's a totally separate group of people, starting from the top Chairman of the Board, president, vice president, etc., the same structure as the banks. Over here and totally separate from any other entity, we have a staff of people, for example, you decide to go just into a savings account, you might have one person investing the money, and they should have a board of directors. We selected, and this is open for discussion, 12 people. The 12 people are broken down into groups of three. The top group would be in power for four years, the next group is 3 years, 2 years, and 1 year.

The board of directors will be responsible to the people. The people can hire or fire them depending on the performance of what they are doing with the Fund.

We suggest that these 12 people be selected, 6 from the administrative group or the governor's group, and 6 from the legislative group. If you decide to go into general development of the State, needless to say this particular board is going to be much larger in size. If you elect just to put it in savings, probably one person would handle it.

As far as the structure is concerned, this will have to wait for a later date because the people of the State of Alaska or the legislature will have to decide what kind of vehicle they are going to want. If they want a combination of savings account, general development or community development. That is something the legislature itself is going to have to decide and that will be the proportionate or amount of money for each area that will go into it. At least by keeping this concept or working management, they can immediately take over the responsibility.

Mr. Barnes: I think you will need a tie-breaker on your board, say 11 or 13.

Mr. Waldock: We'll say 13, an odd number.

Mr. Freer: The six from the administrative side, do you contemple they would be existing employees of the State or would they be from the public sector.

Mr. Waldock: From the public sector.

Mr. Freer: Would they be full time paid employees?

Mr. Waldock: Our suggestion is that the governor would select six people, one from each section of the state. The same with the legislative people, they would choose one person from each section of the state so that the whole state would be represented.

Mr. Freer: Are they voluntary or are they paid?

Mr. Waldock: We believe they should be on a voluntary basis. The working board of directors are going to be paid very handsome amounts of money. The people would be supervising to make sure that your policies are carried out. If it isn't carried out you remove the board of directors and put in a new board of directors.

Mr. Gallagher: The third week in December is the next meeting.

Mr. Waldock: Is there a possibility to move it forward one week?

Mr. Edenso: Jim Rhodes and I have talked at some length about the next meeting. Due to travel schedules and time of the year, it looks as though the third week of December is probably the best -- and probably have another two day meeting.

Mr. Waldock: Would it conflict with the Department of Revenue if we had it sometime between the 6th and the 10th, which is the second week in December?

Mr. Edenso: If we're going to hold a meeting that soon I would like an idea of what we're going to discuss.

Mr. Love: I would like to talk about the two things mentioned previously. Distribution of earnings from the Fund and the effect of the investment policies.

Mr. Rhode: I will take each separate goal and start looking at how an organization under that would be structured.

Mr. Wohlforth: The idea of subcommittees makes sense.

Mr. Love: Let's have a couple of work session on community development and development and just those who are interested in those particular areas make up the the subcommittees.

Mr. Crawford: It is going to be very difficult for us to come up with any kind of consensus on a structural entity until we get the answers from the Attorney General so far as the constitutional questions.

Mr. Waldock: How about the 3rd and 4th of December for a full meeting?

Mr. Wohlforth: If no objection, so ordered.

Mr. Wohlforth: The 19th and 20th of November for a workshop, December 3rd and 4th for a regular meeting. May I have a motion to adjourn?

Mrs. Fleischer: I move we adjourn.

MEETING ADJOURNED AT 1:50 p.m. November 6.

CERTIFICATION

I JIM EDENSO, Executive Secretary of the Alaska State Investment Advisory Committee, hereby certify that the foregoing Minutes of the November 5 and 6, 1976 meeting of said Committee duly called and held at Anchorage, Alaska, on said dates, 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

Jim Edenso
Executive Secretary

STATE INVESTMENT ADVISORY COMMITTEE
MINUTES
December 16 and 17, 1976
Anchorage, Alaska

Chairman Eric Wohlforth called the meeting to order at approximately 9:00 a.m. on Thursday, December 16, 1976 in Room 402, Superior Court Building, 303 K Street, Anchorage, Alaska.

Members present were:

Mr. Eric Wohlforth, Attorney at Law, Anchorage
Mr. Jamie Love, Alaska Public Interest Research Group, Anchorage
Mr. James Crawford, Coordinator, Alaska Offices, Anchorage
Mr. Jim Edenso, Deputy Commissioner of Revenue, Juneau
Mrs. Lanie Fleischer, Anchorage
Dr. Dona Lehr, Policy Development and Planning, Juneau
Mr. Clark Gruening, Alaska State Representative
Mr. Robert Thorstenson, Petersburg Fisheries, Inc.
Mr. Langhorne A. Motley, Commissioner of Commerce and Economic Development, Juneau
Mr. Bill Allen, Commissioner of Administration, Juneau
Mr. Martin Pihl, Comptroller, Ketchikan Pulp Company
Mr. Robert Barnes, President Alaska Statebank, Anchorage
Mr. Robert McFarland, Anchorage
Dr. Charles Logsdon, Associate Director, Agricultural Experiment Station, Palmer

Absent Members:

Mr. Dennis Waldock, Foster and Marshall, Anchorage
Mr. Emil Notti, President, Alaska Native Foundation
Mr. Robert LeResche, Director, Development Planning & Research, Juneu
Mr. James Rhode, Anchorage
Mr. John Butrovich, Alaska State Senator, Fairbanks
Mr. Jalmar Kerttula, Alaska State Senator, Palmer
Mr. Frank Ferguson, Alaska State Senator, Kotzebue
Mr. Hugh Malone, Alaska State Representative, Anchorage
Mr. Richard Urion, Alaska State Representative, Anchorage

Advisee:

Mr. Sterling Gallagher, Commissioner, Department of Revenue, Juneau

Others present were:

Mr. Rodney Burgh, Alaska Bankers Association, Anchorage
Mr. Richard Alexander, State Investment Officer, Juneau
Mr. Charles Fuhrman, White Weld, Inc.
Mr. Art Peterson, Assistant Attorney General

MINUTES

Mr. Wohlforth: I will call the meeting to order. I want to introduce the new Commissioner of Administration, Mr. Bill Allen. If no opposition we will approve the minutes of the last State Investment Advisory Committee meeting. The next item is a report on existing State loan programs given by Mr. Motley.

Mr. Motley: There are some thirteen loan programs now existing in the State; ten of them in the Department of Commerce and Economic Development including public corporations, Alaska State Development Corporations, Small Business Development Corporations, Alaska Housing Finance Corporation, and Veterans Affairs. Generally, the loan programs were conceived to fill a void in private money markets, as determined by the legislature. They generally charge lower interest rates than banks and are considered to be higher risks. Some of them have social benefits as opposed to economic development, such as the Student Aid program and the Senior Citizens Housing programs. The rest are mainly economic development.

In speaking about the Permanent Fund and these loan programs -- the most important words are "income producing" and "permanent." We need to define those words. I think a proper legislative definition of permanent fund and income producing is paramount. That will guide the rest of it, setting up the mechanism, whether you have elected members or appointed members, whether you have two boards, it ought to be in layman's terms and and it should have a periodic accountability to the public, in simple terms. I'm not talking about balance sheets prepared by Price Waterhouse or anybody else. The average citizen should be able to know what was income producing and did it remain permanent. We should do something with the definition of income producing and permanent because that will set the groundwork for a lot of the rest.

Mr. Gallagher: What investments do you know of that keep up with the rate of inflation? The only thing I know of is commodities, and maybe oil.

Mr. Motley: Probably mortgages.

Dr. Logsdon: I think there's two points of issue here. One is the legal requirements of the Constitution which says the permanent funds will have the same dollar figure, at least at the end. You can meet the criteria even though the purchasing power is eroded to where it doesn't amount to very much. What we are talking about is what considerations we should do to try to protect it. As far as the legislature is concerned I'm not sure they will build in this kind of protection unless it's specifically stated that they should account for an inflation figure.

Mr. Pihl: I think the two points that Tony has identified are the two real key issues. Permanence of the fund and what is income producing.

Dr. Lehr: If one of the goals of the loan programs, say the business loan programs, is to encourage economic development, do you have any information on the effectiveness?

Mr. Motley: That's one of the gaps in the program. In some of them we do. When we deal with Small Business Adminstration, they have to show for every loan they make, how many jobs are created, primary, secondary; each loan fund states that it will do this, that, and the other, but we've never done an analysis on them.

Mrs. Lehr: I think if there are eventually specific objectives set up for the permanent fund, the measurement of the fund's success in achieving those objectives is an important part of the process.

Mr. Motley: I'm not pushing for any of the programs we now have. I think each one of them should be scrutinized individually for the permanent fund performance.

Mr. Gruening: One of the reasons that the term "income producing" appears is not so much to define investments and keep up with inflation but to define where the permanent fund can be spent; the idea was that it wouldn't be used for the operating expenses of State government.

Mr. Motley: All I'm saying is that I think in law some kind of accommodation ought to be made for inflation so that you establish a test for the managers.

Mr. Love: There are four things that I would like to know about the loan programs. They can be answered at some future time. I would like to know the dollar amount of each loan program, the gross and net yield of each program, the goals and criteria for each program, and the management structure of each program. I think we should do a better job in setting out specifically what we think these loan programs should be accomplishing so we can later evaluate.

Mr. Barnes: I agree that the issue of needing a legislative definition is critical, but I don't think this committee can do anything about it. That's up to the legislature. We have agreed that it is a trust fund, the principal should be protected and therefore the prudent man theory comes into effect, therefore the structure is relatively simple. If they envision it as something more than that, then the income producing is defined as social benefits, then I think you are into a development bank and a very complex structure with all kinds of sector analysis and staff.

Mr. Wohlforth: It's got to be something of a new ball game for investment advisors, and certainly the dramatic rate of inflation over the past three or four years has put that science or art into a whole new configuration.

Mr. Rhodes: The legislature's phrase "income producing" meant at the least that loans must bear some interest, there would be no transfer to communities or industries, nor used by the State budget. Nothing was said about how much income. The words "permanent fund" would seem to preclude undue risks of the principal no matter how much a particular investment might hold out. It's not just simply the yields but also the indirect benefits in terms of new income, new jobs, etc. Those are real dollar effects that don't show up on the plus sheet of the permanent fund, but they do benefit the economy of Alaska.

Mr. Motley: Nobody is talking about an ironclad rule. What we're talking about is inflation.

Mr. Burgh: I'm Rodney Burgh, Director of the Alaska Bankers Association. This is a preliminary presentation on behalf of the Alaska Bankers Association, representing our present position; it is anticipated we will desire to meet with you as future developments occur.

A trust type fiduciary responsibility of the fund's managers to the people of Alaska is inherent in the decision of the populace to set aside a portion of non-tax resource revenues. The tenor of the times indicates that the decision was motivated by a desire to control the spending of revenues which derive from exhaustible resources. If Alaskans had favored large capital spending programs by the State there would have been no reason to create the fund. Thus the fund has been created to accumulate revenues which can be conserved for use in the future.

A typical trust function is the preservation of capital, it undertakes to protect the real value of capital from inflation, and to increase the real value through prudent investments. This assignment requires careful analysis of risk for each investment considered and eliminates the consideration of high risk ventures. Generally speaking, the larger the dollar volume involved, the more complex is the risk analysis required and the more costly. The income earned from investments wihin Alaska large enough to be meaningful to a fund the size of the permanent fund would be eroded by the costs of investment analysis and other administrative expenses. More importantly, such investments are not likely to be within a risk category which is complimentary to the trust relationship mentioned earlier. Therefore, the best course of action seems to be for the permanent fund to place its funds in national money markets where risk analysis is performed in the most efficient manner by professionals and where a multitude of investment options is available.

Inasmuch as there is a trust relationship between the fund's management and the people of Alaska, it is critical that Alaskans be given a timely reporting of investment results. The most effective method of reporting would be through a direct economic return to the people. Such a return provides the most efficient incentive for Alaskans to gauge the performance of those persons who are tasked with fund management. An economic incentive can take many forms, for example, direct cash dividend, reduction in taxes, profit sharing plan with a vesting schedule, or other forms of pension plans. Our position calls for the creation of a trust relationship of legal standing which will incorporate the goals of preservation of capital, maintenance of real value, and reasonable and prudent capital appreciation. We feel it is against the interests of the people as represented in such a relationship to incur administrative costs associated with in-house investment risk analysis.

Mr. Allen: You addressed the situation of disbursing current dividends. It's my thinking that the makeup of the permanent fund is for future use, not current use.

Mr. Burgh: There's nothing in it that says the income is also supposed to become permanent; it's only the principal. You would preserve the principal but the income could be used for other purposes.

Mr. Wohlforth: I take it the general position is, let's invest in high quality instruments, either short term or corporate bonds of corporations which are in Alaska. First, is participation in any sort of development loan concept -- in participation with private borrowers. Is that the banks' correct position?

Mr. Burgh: Yes, we don't feel that the permanent fund is intended to be a risk fund.

Mr. Wohlforth: Admittedly every investment has a risk quotient, but you're saying the risk quotient should be absolutely minimum. Do you have any thoughts on the legislative structure, of who's responsible for handling investments?

Mr. Burgh: I would presume that someone with the State is going to have some area of responsibility for it.

Mr. Wohlforth: Are you recommending that investment advisors or fund managers be appointed for this function?

Mr. Burgh: Yes. People with investment expertise.

Mr. Edenso: Has your group considered any kinds of programs that would provide long term capital for economic development purposes?

Mr. Burgh: Most of the long term capital provision that we get is from outside investors that work in the long term investment field.

Mr. Edenso: Would you think that without the ready long term capital there would be adequate amounts for development within the State?

Mr. Burgh: Any social problem or any other economic benefits that you want to get from fund investment should be from the income rather than from the permanent fund itself. You should try to get the best protection and best yield from the permanent fund. The yield we get from that can then be invested in other programs. Utilizing the principal of the permanent fund for providing long term capital investments in the State is not a prime objective of the permanent fund. Possibly some diversification would include some.

Mr. McFarland: I think we should ask the Bankers Association to bring in what statistics they can on overlying. This is an area that the State could very well get good interest from. The banks are regulated and are only allowed certain limits, so really the Outside banking institutions are taking the cream off the interest. We should have some idea what the potential is if instead of using a corresponding bank, use the State.

Mr. Burgh: I think most of the banks, when reporting, do show the amount of servicing they are doing, which indicates funds have flowed through the bank from other institutions. It's quite sizeable in relationship to our own portfolio.

Mr. Allen: Your request for participation is because of your legal limit or because of the term?

Mr. Burgh: Both. If it's a working loan it's because of the legal limit. If you're talking about long term loans it's because of the term. Housing for example, the bank cannot afford to keep a lot of thirty year loans in its portfolio or it would soon not have money for other purposes.

Mr. Allen: As the years go by the capital starts increasing -- the availability to meet their demands as far as dollars are concerned, is increased. I would like to know if your committee has suggested us making loans on the income, a higher risk loan from the income, what gaps can we fill?

Mr. Burgh: We don't have any particular recommendations. I can say that we have some loans out that are many times our lending limit and we've not had any problems like corresponding banks to participate with us.

Mr. Allen: The corresponding relationships are getting the interest when the earnings should be here within our State.

Mr. Wohlforth: Thank you, Mr. Burgh. Next on the agenda is Richard Alexander, Investment Officer, Division of Treasury.

Mr. Alexander: I've been asked to describe the State's loan programs and their relationships to the general fund, and also other loan programs within the Department of Revenue. Our general fund has been decreasing for the past several years and at the same time the State's mortgage portfolio has been increasing rapidly. It has become one of the largest investments in the fund. Also, our mortgage activity within the two retirement funds has increased substantially in the last few years.

There are loans that are required to be purchased by the general fund; Veterans, Small Business, Fishing, and Tourism loans. The Veterans loans are by far the largest holding within the fund. The rate of return on these loans is 7-1/2%. The Small Business loans are presently earning 8%; Commercial Fishing loans earn 7%; and

Tourism loans earn 8%. All of these loans we are required to purchase. The rest of the loans, the Commissioner has the option to buy.

The optional loans are the Bank Incentive Loans which presently are inactive. Alaska Housing Finance Corporation is another type of loan within which we have various type notes for a total of $9.2 million. We also have Alaska State Housing Authority notes for a total of $4.5 million receiving 7-1/2% interest. Then we have a $1 million note loaned to the Medical Malpractice Revolving Loan Fund for an interest rate of 9-1/2%. The next category is Native corporations -- we're almost through with that as they will all be paid off by June. The last is entitled Municipal loans in which we have $3.4 million 5% note for the University of Alaska Activity Center. The remainder is made up of Alaska State Development Corporation Bonds, City of Nera a School Bonds, City of Palmer Industrial Park Revenue Bonds, all totaling around [illegible] million. We also have $.5 million in Agricultural loans.

The Retirement Funds are authorized to purchase FHA, VA, Federal Small Business guarantee loans, conventional residential and commercial mortgages. At the present time we have over $9 million invested at an average rate of return of about 9%. Approximately 32% of these funds are invested in mortgages at the present time. We are committed to purchase another $50 million by the end of March at rates from 9-1/2 to 10-1/2%.

We buy mortgages for the funds mainly because of the high rate available but also to help Alaskans obtain loans that might not be made if we were not in the market. We concentrate in areas that are not readily marketable Outside. For example, Fanny Mae will not purchase a mortgage over $87,500; we try to pick up that slack. The cost of housing in Alaska is pretty high and there are many mortgages over that dollar mark. Another example are commercial loans under $.5 million. Buyers Outside seem to want the loans over that amount. We've bought mortgages from all banks and savings institutions within the State. We look for special situations such as the Community Hospital in Fairbanks. On that loan we receive 10-1/2%.

Mr. Gallagher: We've got loans from Dillingham, Glennallen and Kodiak.

Mr. Wohlforth: I have added up the State Loan program including housing financing and I find a figure of $417,694, which is a pretty healthy figure. Next on the agenda are representatives of White, Weld on structural alternatives for the permanent fund, leveraging, etc.

Mr. Fuhrmann: My talk today will be mostly on what the group did and talked about in their trip to Alberta, New York and Washington a short time ago. So I'll pass out a booklet about the trip and let you read it rather than spend a lot of time on it today. At the work session tomorrow I'll spend time on the organizational structure and various alternatives. Did everyone get a copy of the book? If not there are more available.

Mr. Wohlforth: I'm interested in the leveraging section. Have you considered the fund being a lender to establish reserve funds of local government or agencies of the State? I'm thinking of reserve funds of 20 or 30 percent of whatever is really needed to enhance the credit worthiness of such an agency. So on a loan basis the debt of the agency would be retired before the fund would receive the principal back.

Mr. Fuhrman: Ostensibly making it appear as though it were equity in there to improve the credit rating?

Mr. Wohlforth: Right.

Mr. Fuhrman: Definitely. It was also discussed with the credit agencies. They wanted to focus more on what the definition of permanent fund was in income-producing and distribution of income.

Jim Rhode: At our discussion with Standard and Poors and Moody's, they wanted to know what would be the status of any further amounts that were put in the Permanent Fund, would it be placed there irrevocably or would it be treated again differently from income from taxation?

Mr. Fuhrmann: The amendment states that at least 25% of a combined pool of oil, or resource related revenue will go to the permanent fund, which has an implication that the legislature from time to time may wish to raise that to say, 40%. Their first question was if it was raised to 40% would it be 40% forever. The answer is clearly no, the legislature had a chance to take it back down again, but not below the 25%.

Mr. Love: What is the relevance of this material to the rest of the material? Does White, Weld make any recommendations in terms of structure?

Mr. Fuhrmann: All of this was material being used by various people in our firm for the purposes of their presentations to this delegation and has to do with the tentative organizational structure. We have been asked to propose alternatives, but we have not recommended anything.

Mrs. Fleischer: What exactly was the purpose of the whole trip?

Mr. Edenso: That's a good question. We intended to go to the various cities, first to meet with the Alberta Heritage Fund people and discuss with them the characteristics of the Heritage Fund as to its legal structure and the legislation that established it, its funding and management characteristics, some of the goals and objectives that they have established. We found a number of interesting points and comments concerning that. I'll try to cover some of them.

First, in Alberta we met with the counterparts to our Department of Revenue to discuss the structure, the organization, and the management of the Alberta Heritage Fund. It's interesting that their Heritage Fund is managed by the equivalent of our Department of Revenue. The decisions of the day to day activities are carried out by the equivalent of Commissioner Gallagher, myself, or investment officers. They also have a committee which determines and passes decisions on whether or not to make a particular investment. There are limitations or constraints in the areas of investment but I don't believe there is a limitation on the size of investments. Secondly, they have a program which calls for providing capital for social programs or social types of investments which do not necessarily tie into income-producing as our constitutional amendment calls for. We also discussed some of the concerns we had about subsidy financing.

It was interesting to note that where they are subsidizing an interest rate they actually go to their parliamentary body to obtain the subsidy from their general fund which states publicly and exposes publicly, the fact that there is a subsidy program going on and how many dollars are involved with it and for what it's to be used. That is something that we in the Permanent Fund State Advisory Investment Committee have not really considered.

Mrs. Fleischer: You haven't considered making it public?

Mr. Edenso: We haven't considered public exposure of any subsidy that we undertake.

Mrs. Fleischer: How do they do it?

Mr. Edenso: You go with an appropriation bill and say, "Well here's how many dollars we want and here's why we want it, and here's what we are going to use it for."

Mr. Rhodes: What I learned in Alberta was, the final purpose of the Heritage Fund so far as there is a defined purpose, is to insure that Albertans pay the lowest taxes in Canada. They admitted their fund wasn't really large enough to diversify the economy of Alberta enough to replace oil revenues with taxation on new private business, but they saw the fund as a way of closing or reducing future deficits of the profits.

I thought I might quickly tell you what the fund is doing. Up to 20% of the money can be capital outlays, and they are concentrating on irrigation for agriculture, and in medical research. Thirdly, a project with three oil companies to develop technology for recovering oil from oil sands. About 85% of the money they are loaning out in three ways. Home loan subsidies for middle income and lower, also in loans to their municipal authorities. The subsidies for the home loans and the subsidies for the local government are laid out plainly as a matter of public record -- who is getting it, when they are getting it, how much. The subsidies have to be voted on by Parliament. There are no concealed or under the table subsidies at special preferred interest rates to this group of homeowners or that group of towns. The reason they make loans to their local governments directly is they don't have the tax exempt privilege for their local governments. They borrow from taxable rates, which of course would be considerably higher than our local governments.

The third use is that it makes loans to its utilities, and there you have to know that the profits of the phone system and most of the electrical generation is passed through the Parliament. That's pretty much how the fund is laid out.

The government of the day runs the fund. It doesn't have its own staff. The Treasury people take care of the Heritage Fund in their spare time.

The high point from New York was exploring the different ways the fund could be leveraged. It seems that using the fund to guarantee this or that private corporation, or any other number of choices would be superior to having the fund make loans directly from its assets. Among the arguments advanced for using guarantees are that they are contingent liabilities, not direct liabilities. All things being equal, the fund would be able to do more guaranteeing than it would borrowing and lending. The credit rating can be better for any given amount of guaranteeing than it can for a like amount of borrowing. The point being that you get to keep your money while you are making guarantees in investment grade securities which are the very lowest risk.

In Washington it was pointed out that if you leave even a crack in the door open to the fund to lend financial assistance to the public sector, the fund will have an inevitable bias because it's also a public entity and it will favor public sector proposals that come to it. The experience of most development funds is that the private sector is very rapidly crowded out.

Mr. McDowell: There's two ways this can happen. The International Development Bank has full authority to lend to private enterprise and the public sector. The

World Bank has has in its charter full authority to lend to private enterprise. About 15 years after it was started it finally formed the International Finance Corporation, a subsidiary set up to do nothing but private enterprise. It has no Authority to lend to the public sector. The Sudan Development Corporation charter was set up without too much in it, it's probably the most general charter there is. But it did specify how that development corporation was supposed to relate to the Government of the Sudan. In its first two years of existence the Government of the Sudan borrowed back half of its capital. At this point in time it is not paying any interest and has no intention of giving it back. The company was set up to operate in the private sector. By not defining it carefully in the charter how it relates to its government, now half the money is gone from its original purpose.

Mr. Rhodes: A number of the people we saw in Washington alluded to this in one way or another and pointed out that this problem could be minimized by using intermediaries.

Mr. McDowell: This report has been prepared in response to four specific questions submitted several weeks ago. The first relates to what goes into a charter of a development institution, the second relates to loan standards and interest rate, the third, election of directors, and the fourth, the structures or alternate structures or modifications to the present proposed organization.

The first section of the report really deals with what broad statements of priority should be set in the charter and what policies should be set at the board level. I've selected 29 different things which I consider to be generally the substantive matters that are normally covered in a charter, at least in a general way. There are many other items covered in charters, but most of them are technical, legal matters. These are pretty much all of the substantive matters that you might find in a charter.

The terminology "development institution" as I've used it is an institution which provides longer term investment capital as opposed to operating or working capital, through intermediaries in the form of equity or debt to enterprises or projects, or directly. Enterprise being, say a business; a project being, perhaps, a dam. The permanent fund may or may not become an institution of that sort, but this material is based on the assumption that it will.

The 29 items I've broken up into general items. Every one has a general statement of purpose and function. Sometimes they'r mixed, sometimes they're separated. The operating philosophy is usually given. Legal personalities and capacities have to be there. Sectoral covers, if any, if any distinctions are made in terms of both economic sectors and size sectors. Geographic coverage. General criteria to be applied to the selection of capital investments is normally given. The kinds of capital to be provided; equity, direct loans, loan guarantees, convertible debentures. There's usually something about the general relationship of interest rates to market rates. Relationships with the private sector; relationships with governments; relationships with other sources of capital, with recipients of investment capital, particularly with regard to identifying investment opportunities and providing technical assistance. Relationship to capital markets; many of these are set up in order to encourage local capital markets. Organizational matters; the general powers and parliamentary rules of the board or boards are always included in the charter. The general powers of management are laid out. The composition, qualifications, methods of selection, and terms of the board's management and staff are referenced. There is some designation of the organizational levels with responsibility for relations with governments, the general public, the financial community, prospective recipients of investment capital. There are also conflict of interest policies for board members and the staff.

Under financial, there will be general financial goals of the institution, level of profits to be attained, protection of capital, prudent management of assets. Source and amount of capital. Borrowing powers and limits, if any. Sources of funds to pay for operating expenses, including general long-range economic and investment research. The disposition of net income from operations. Accountability. General requirements for independent audit and public reporting. Occasionally the general requirements for operational evaluations. This technique is relatively new and most charters don't have it, but I would recommend that you do. Finally, the general requirements for maintaining the confidentiality of information obtained from prospective and actual recipients of investment capital. This is a problem with public institutions. When you deal in the private sector you've got to have rules that the confidential data you obtain from your clients will remain confidential. You've got to say something about it in the charter because you may not get any private borrowers if they realize that what they consider their competitive information is going to be divulged.

For specific examples. In a charter there is a general absence of absolute quantities and percentages. What do you do with a fishing loan if it is only a hundred thouand and a boat costs a million? Why put yourself in a position of going out of business in a particular sector, two , three, or five years from now by putting a number in the charter. Because the charter of that loan program has a ceiling built in which appears to be getting unrealistic, the charter will have to be changed.

Mr. Gruening: Are you referring to the total loan amounts or the total category?

Mr. McDowell: Generally, the specific absolute quantities are not specified for any fund. A charter, usually, is a document that will withstand the test of time. What is important today may be totally unimportant in the future.

Mr. Gruening: But our charter here is the constitution. Goals would be the types of loans. I was thinking maybe the legislature might want to write a safeguard in it assuming one of the major motives of the fund was a savings aspect. You wouldn't want to allow the entity to make loans in an area that's committed for a long term basis at a certain amount of risk as opposed to having it in liquid form where if you decided you wanted to change the emphasis from community development to diversification, you could do so if there was a portion of it set aside as savings. Otherwise, I think the legislature might be worried that the managers might commit the fund within a short period of time.

Mr. McDowell: Once you appoint a board, the board will establish the policies. A policy can be changed by the board the next year or five years from now. As long as the policy remains in accordance with the charter, then the charter doesn't need any legislation to change it.

The purposes of these institutions nearly all are stated: to support and stimulate the establishment of new private enterprise and the expansion and modernization of existing private enterprises. The second purpose is to encourage and assist. The third purpose is to encourage, promote, and assist the securities market. The Industrial Finance Corporation of India is to make medium and long term credits more readily available to industrial concerns, particularly where they can't get it from a bank and there is no capital market to take a stock issue. The next one, carry on the business of assisting industrial enterprises within the private sector. That says it's got to be in the private sector, it's going to be industrial. It's going to assist in the creation, expansion and modernization, encouraging and promoting private ownership of industrial investments and the expansion of investment markets. How? By providing long and medium term loans or equity. To sponsor and underwrite new issues of shares and securities; guarantee loans from other private investment sources; make funds available; revolve their funds as rapidly as prudent, and furnish managerial, technical, and administrative advice and technical assistance.

Another example is the Inter-American Development Bank. This is a fairly recent institution, so it could have incorporated some of the lessons learned by World Bank and others who were in business before this. But they're going to contribute to the process of economic and social development, individually and collectively. What does this mean? It means they can provide finance for projects in one country; they can provide finance for projects in more than one country. This general wording has been expressed in their charter. They can also promote the investment of public and private capital for development purposes. It's going to utilize its own capital, funds raised by it in financial markets, for financing the development of the member countries, giving priority to those loans which will contribute most effectively to their economic growth. That's a constraint on them. It tells them they have to deal with priority matters. They're supposed to encourage private investment and supplement private investment when private capital is not available on reasonable terms and conditions.

They will have three categories of operation - their term for loan. They will make loans from ordinary funds into regional resource funds and the funds for special operations, that is the fund to subsidize interest rates. The basic principle of separation is that these three sources of money will be kept separate at all times. Under no circumstances will they be used to pay off the obligations of the other.

Under Organization and Management. The charter states they shall have a board of governors, a board of executive directors, a president, an executive vice president, a vice president in charge of the fund. That is the fund for special operations, for subsidies of interest rates, and such other officers and staff as may be considered necessary. They deal with the board of governors, how they get appointed or elected, how long they serve, who chairs the meeting, what powers they must retain unto themselves, or specify the other powers that they delegated a general statement of what they have delegated, how often they should meet, what a quorum for a meeting is.

The board of governors and other boards are in effect held accountable for doing things that are necessary or appropriate. There are two boards, two different sets of people. The board of directors shall elect a president who shall not be a governor or an executive director or alternate for either. He has a tie breaking vote on the board of executive directors. The Conflict of Interest statements, "the President, officers, and staff of the Bank, in the discharge of their offices, owe their duty entirely to the Bank and shall recognize no other authority. Each member r. the Bank shall respect the international character of their duty." This is saying no matter what country you are from you work for the bank independently of the politics of your own background.

Finally, there is a control saying, "the Corporation shall seek to maintain a reasonable diversification in its investments." I think that is something you could say in your charter. I view it as a financial control that any organization should have.

The interpretation of the charter should be a dynamic process that keeps recurring, and that function is normally delegated to the board.

Mr. Gruening: When they want to change these charters, what does it take?

Mr. McDowell: It takes a vote of the stockholders as represented by the board of governors - a two thirds vote.

Mr. Motley: Do they get involved in equity financing?

Mr. McDowell: Yes. They have to have reserves; it's left to the management to determine the absolute size of those reserves. I've listed some questions which are asked by the policy board: Is the proposed project in a sector in which additional investment is needed? Does the project fit in with a logical sectoral program? Does the project fit in with the most urgent needs of that sector? Does it contribute to diversification and/or better income distribution among regions or groups? What are the environmental and health impacts of the project including benefits or hazards to the environment and human well-being? In addition, the bank policy requires, and carries out, specific economic tests, including cost/benefit analysis measured by the internal economic return and/or the benefit cost ratio. I used the World Bank example because their charter is simpler than the rest. It really just says that loans should be made prudently for highest priority development projects on the basis of economic considerations.

As you can see, all these questions aren't just economic situations. The board itself over a period of time has had the flexibility to adopt new techniques such as cost/benefit analysis which wasn't there when the bank was set up. New criteria, such as health and environmental considerations which weren't important when it was established. They've done this by board policy because they had input from their staff, input from their borrowers to stockholders, and other people working in the area of development finance. They have to listen to their stockholders and be responsive to it. If the president and his staff are not responsive to what the board of executive directors wants, they fire him and get a new one. But they don't put the responsibility for any particular function at any higher level than it's supposed to be, the accountability goes up a step at a time. The fact is, the management is accountable to the board. If the board says you are not following our policies, then they get a new manager.

Mr. Gruening: The World Bank provides for two boards?

Mr. McDowell: Yes.

Mr. Gruening: The executive directors, what are their qualifications, are they financial types or do they try to get somebody with broad backgrounds?

Mr. McDowell: They tend to be out of the Ministries of Finance.

Mr. Gruening: So they have politicl and all sorts of background, not strictly financial?

Mr. McDowell: They are not strictly bankers. Should interest rates be set in the charter or by the board? In most cases, interest rates are required by charter to be appropriate or to approximate prevailing market rates. If they're just to be appropriate, then they pick and choose out of their funds whether they should make a subsidy or not, or to charge a higher rate. But they do charge rates which overall will come up with the profit for the institution every financial reporting period. They demonstrate that they have protected their capital by not dipping into it and also paid their operating expenses and perhaps even made a contribution against inflation, against the erosion of capital. So any project that can't pay back at market rates doesn't meet a market test. In practice the are usually set by board policies. The World Bank sets it by formula which is passed by the board. Any subsidies are normally, separately appropriated.

Getting into the proposed structure of the permanent fund. Essentially what you get from an election is direct representation of the interests and views of the constituents of the person that you elect. That is the pros of it. The cons, well, if you elect part of the board I think you create too many classes of directors, which is an intense degree of evil in itself. If you elect all members of a relatively small board, you would have equal directors, but you probably wouldn't include all representatives of all the significant minorities within the State. There just aren't enough positions to go around. Finally, election support is campaign financing, which could result in elected members being subject to undue influence by special interest groups.

Suggestions on alternate structures of modifications. The proposal as it currently stands does tend to strike a reasonable balance among the three groups, citizen, legislative, and executive influence and involvement. The operation of the fund is going to be under the supervision of a board, which will be made up mostly of private citizens, and proposed and confirmed by the executive and legislature. The board will be accountable to three parties and eventually also will be the power to amend the charter.

The important thing about the two board proposal is that they provide an important separation of responsibilities for policy and operation. This is an essential prerequisite for accountability for freedom from undue and improper political and special interest pressures. If you establish a policy board that does not have responsibility for operational decisions on specific loans and investments, you've got an organizational level that you can dedicate to being responsive to political, economic and social considerations as well as the views of individuals or groups. If you delegate the responsibility for specific investments to the investment committe, it provides the policy board with insulation from dealing with a specific project. Also, if you specify that the policy board is the only appropriate forum for all this input, then you insulate the investment committee from undue pressures as well.

Some suggestions for the powers and responsibilities for the policy board, the management board, or investment committee, and the chief executive officer. The function of the policy board should be an annual review and approval of long-range operating plans which include an investment program based on sectoral analysis of the Alaska economy, which include the budget for the forthcoming year and the financial plan for the following number of years. I would not suggest that the policy board just review the budget for a year, that's too short term function for a board member's level to be dealing with. I would also suggest that the management board have sole power to approve all investments rather than allocating part of that power to another body. The chief executive officer should be responsible or accountable for everything that's done so that in the minds of the legislature, the executive, and the public, that one individual will carry more accountability than anyone else in the institution.

Mr. Gruening: Who selects the chief executive officer, the management or policy board?

Mr. McDowell: It was proposed that the policy board would select all five members of the management board, including the chief executive officer. I think you must have the policy board select all of those people to get that step by step accountability. I would recommend that he be non-voting and to chair the policy board.

Mr. Gruening: We might be tending a little bit on the bureaucracy side by having two boards which would check and balance each other, but they might compete in terms of policy. We all know that staff can get involved in policy. I don't know if these people are going to be full time or not; the policy board probably isn't and they may be unpaid. On the other hand, the management board is making the loan decisions, so I think you pretty much have to pay them full time.

Mr. McDowell. I don't think so. You're getting to incorporate a few more outsiders to work with the present ones in making the final decisions, who have some of the technical skills but they may not necessarily be any good at holding a public forum and abosrbing the input from private citizens ana reflecting it in policies, but are pretty good at investment programs. All of the loans would go to the board. You provide that management of the board will establish proper organizational operating financial controls in having that kind of process through the staff.

Mr. Wohlforth: Basically, aren't we talking about management or investment committee which is a pretty hard working committee, perhaps meeting as frequently as every two weeks; the policy board, on the other hand, meets much less frequently.

Mr. McDowell: I would estimate that you envision it quarterly, the policy committee, to review reports provided to them and make decisions they are empowered to do.

Mr. Allen: Wouldn't the chief executive officer have an authorized loan limit? Anything in excess of that be approved or passed on by the investment committe, and all loans or investments be reviewed by the investment committee?

The meeting was adjourned at 4:00 p.m., December 16, 1976.

Mr. Wohlforth called the meeting to order at 9:30 a.m., December 17, 1976.

Mr. Gallagher: Art Peterson is with us today. He is the Attorney General responsible for drafting the legislation. He is here to hear what people say directly so he can interpolate it and put it in the statute.

Mrs. Fleischer: Before we go to the actual legislation. Will there be a provision saying that if the particular community objects to a particular development, it would not be done?

Mr. McDowell: One of the mechanisms that exist is the zoning.

Mrs. Fleischer: A large part of Alaska is not zoned.

Mr. Wohlforth: I think it's a major issue. It appears in order to proceed on this in this way, by listing major questions, and I put it, "Consent of communities to enterprise location? Another question would be whether or not the enabling legislation should specify a dollar or other type of division between so called public sector activities, support of local government bonds and local borrowing, and private sector activities. Should there be a definition in the charter as to the amount of funds to go into each area?

Mr. Allen: Specified by a dollar amount or by percentages?

Mr. Wohforth: Dollar amount or other formula. Should the charter attempt to devise a formula to divide the fund's activities into public and private sector?

Mr. McDowell: I believe the question is very important. Just on the basis of the experience of the various institutions has indicated that if you do want to invest in the private sector then you must put a ceiling on what it can do in the public sector. Otherwise there won't be any investments in the private sector. In other words, if you want to invest in productive private enterprise then you must put a lid on the public sector portion, and the housing portion if it's separate. Those are the two needs which generally tend to become insatiable in terms of having a higher political priority than the productive private enterprise.

Mr. Gallagher: We have to go through two bills. Could we complete the one easy bill first. Is this the time to list questions?

Mr. Peterson: I suggest, if we keep it to major questions and then use the bill as a catalyst for traditional questions and then get into the specific questions. Not every question is going to be major policy type questions. Maybe list those and then go over the bill.

Mr. Wohlforth: Alright, we'll start with the questions.

Mr. Crawford: I think it should be addressed as to whether or not inflation is going to be part of the charter, part of the bill, or some provision for inflation.

Mr. Barnes: Is that setting a minimum return on any investment?

Mr. Crawford: Charter recognition of inflation, terms of minimum fund return.

Mr. Gallagher: How do you distinguish between the soft and hard loan programs? Maybe the charter has a preference for guarantees over direct lending. Also the ability of the fund to borrow.

Mr. Wohlforth: Should the charter encourage leverage?

Mr. Pihl: The point of leverage is where I had a question. Would the Fund be able to issue its bonds to finance the pipeline, finance the tankers, or finance the gas pipeline. I'm not advocating State ownership but using the fund as a vehicle for financing. Using this leverage and having a much lower interest rate chargeable to the wellhead value.

Mr. Gallagher: The wellhead on the gas situation is influenced by transportation costs.

Mr. Wohlforth: I can see the legislature, with this fund in existence, all of a sudden recognizing that there are different projects, gas pipeline, petrochemical, etc., it should be given a preference. So the question would be whether the charter should get into detail, preference detail of specific projects of finances. In other words, how much would the legislature be willing to delegate a board in terms of specific preference?

Mr. McFarland: It should include the right for legislation whether it's ever exercised or not.

Mr. Barnes: Another question should be about the direction of the income. Should the income go to the general fund or should it be directed to other projects or should it be returned to the fund itself?

Mr. Wohlforth: In the private sector should participation be mandated by charter?

Mr. Fuhrman: It seems to me that the two draft bills we were reading last night bring up a couple of potential questions, one being what the compensation of the members of the various boards or committees or staff people might be, or how determined, and also whether there should be any language dealing with the qualifications of those board members. Geographic or professional expertise or education or race, party affiliation?

Mrs. Lehr: I think there should be specification of membership. We talked before about two members of the Governor's cabinet and those have been specified in the bill. Another area that I think should be discussed is the budget procedures. It doesn't indicate whether it will be subject to the Executive Budget Act.

Mr. Peterson: My assumption when drafting the bill was that it would be under the Department of Revenue budget, but that may not be a committee assumption.

Mr. Gallagher: I thought it was the best idea, but then what about the accounting problem. How do you forecast the budget and reserve for bad debts? That's really a professional judgment. I would like the board people to make that decision and not have to go for a supplemental.

Mr. Wohlforth: The question here is whether the fund is going to be permitted to live off its income to a certain extent or not.

Mr. Rhode: I have discussed this formerly with a number of legislators, and one problem in bringing the operating budget of the fund before the legislature is that at the very least it will affect the independence of the fund to set its own rates to pay compensation. The legislature will be able to reach in and rip out $10 thousand on a salary they don't like. In the extreme case, it could very well jeopardize the action of the fund.

Mr. McDowell: You transfer accountability to the legislature if you do that. If you want the legislature to be accountable, fine. If you don't then you can't give them any control of the budget.

Mr. Wohlforth: Should the charter prohibit or permit equity -- private sector participation or should there be debt only? Should the Act be specific in terms of outlining the feasibility work that the banks should undertake before financing a private sector project?

Mrs. Fleischer: Should the charter specify that the productive enterprise should be financed at market rates so that we are not in the business of subsidizing?

Mr. Wohlforth: Let me run through these questions. (1) the consent of the community to enterprise location, should that be in the charter? (2) division of fund, whether the charter should specify the division of fund activity between public and private sector. (3) should the charter recognize the effect of inflation in terms of minimum fund return? (4) should the charter deal with the question of soft and hard loans and the subsidy recognition? (5) should the charter encourage leverage financing or be neutral? (6) should the charter specify specific projects to be financed? (7) direction of the fund income to the general fund for its other uses. (8) should the charter recognize any mechanics for division of activity between regions of the State? (9) where the fund should be located; (10) should the charter mandate participation in the private sector? (11) what is the compensation of the boards and staff and how would that be determined and what are the qualifications of the chief executive officer? (12) what would be the qualifications of the board members? (13) should the board of the fund be subject to the Executive Budget Act or be autonomous and be permitted to live off its earnings? (14) should the charter permit equity investments? (15) should the charter require market rate of return on investments?

Dr. Logsdon: How about segregation by industry?

Mr. Wohlforth: That is a good question. Last year there was actually enacted a bill that mandated that these investments be put into renewable industries which would provide this, fishing, timber, agriculture, forestry, outdoor recreation. Should the charter show an emphasis or mandate for renewable resources.

Mrs. Fleischer: That is a good idea. It may not be very important at the moment, but how would you classify wilderness, as a renewable resource or non-renewable resource?

Mr. McDowell: What's a wilderness? You can't consume it.

Mr. Wohlforth: I mean by renewable resource a reusable commodity, like timber.

Mr. Allen: There should also be audit procedures and powers and authority of the chief executive officer.

Mr. Gallagher: We should have a strong definition of what post audit is too.

Mr. Love: There should be some way of evaluating the fund's effectiveness in achieving the particular goal.

Mr. Wohlforth: All right. Establishment of audit procedures and performance evaluation.

Mr. Love: The charter should also state whether the fund is going to have to achieve some kind of income distribution.

Mr. Gallagher: That involves the subsidy question.

Mr. Love: Not entirely a question of subsidy.

Mr. McFarland: I understood when talking about the Heritage Fund that the Parliament could direct the subsidy. Do they have to come out of the general fund with the money to pick up the gap?

Mr. Gallagher: Yes.

Mr. Rhodes: Don't they touch on what's going to happen to the real per capita income?

Mr. McDowell: An example of a case we mentioned yesterday. The charter says the decisions should be based on economic considerations. It also says it should not be based on political considerations. The board of directors can make policy statements that economic considerations have to include distribution of income, and then the staff proceeds to implement it. So the project area is a statement not a project in itself. A statement of what the project will do. It would address the issues of health and environment.

Mrs. Fleischer: The charter should address the issue of goals and purpose of the fund.

Mr. Fuhrman: The real issue would seem to be how far do you go into those areas in the legislation and what portions of it are the responsibility of the policy board and what portions are the responsibility of staff and management of the fund.

Mrs. Fleischer: I think it would help the staff and policy board if they had some clear idea of what the purpose of the fund was, what the people in the State thought it was for, and how we are going to accomplish everything.

Mr. Fuhrman: It seems like the appropriate thing is that more detailed statements fall out as you go farther down the line, so very general statements would be at the top.

Mrs. Fleischer: Economic considerations should be defined to include employment, income distribution, environment, health and social issues.

Mr. Rhodes: That is really a question of degree.

Mr. Edenso: We're talking about criteria for making investments. You could specify that criteria in the charter or you could allow the policy board to specify it, or you could allow the legislative body to specify it in legislation. Some of the criteria are the creditability of any particular investment, whether or not the proposed investment falls within some kind of acceptable environmental impact statement, whether or not an investment falls within some kind of socially stated criteria, and finally whether or not it falls within some kind of acceptable income terms. Those are really the broad categories we've been trying to address.

Mr. McDowell: I would strongly suggest that you put that langugage in the with the addition of, "and other considerations." A very real potential future consideration would be how does this project or this investment program fit in with the United States National Economic Plan?

Mr. Gallagher: We're not accomplishing much this way. What I would like is for us to get the 29 points covered now so that at the next meeting we can have a complete bill to look at - which we can change then if desired. We could add to it or take it out at that time, but we would a complete bill to look at.

Mr. Peterson: What terminology do we use? Either the charter and mean legislature, or call it the bill and then clarify it.

Mr. Wohlforth: The charter is the bill.

Mr. Peterson: I've heard it used alternatively, let's put it in the charter or let's let the legislature handle it.

Mr. Gallagher: We've talked about it in very broad general outlines where small community development do some economic diversification and create a savings account to be used in the future. That's just the general language we will use for number one item.

Mr. McDowell: Are you assisting community development? Stimulating economic diversification?

Mr. Gallagher: And providing a savings account for the future.

Mr. Love: I think the savings account should be the first one, everything else to come afterwards. Just say, the single purpose of the fund would be to provide a permanent source of revenue for the citizens of the State of Alaska.

Mr. Edenso: What are we really attempting to do? We have a procedure and the procedure is a philosophical statement of what the permanent fund should accomplish. We have a charter which is a guideline for how it should accomplish it. I think the overall charter specifies in broad terms, the guidelines the permanent fund should function under. A preamble or a philosophical statement specifies in general terms what you want to accomplish with that permanent fund.

Mr. Rhodes: Why don't we steal the phrase from the Alberta Heritage Fund -- future generations, etc.?

Mr. Fuhrman: They say, "Whereas substantial revenues are being received by the Province in the sale of non-renewable resources; whereas there is a limited supply of non-renewable resources, and therefore revenues will ultimately be reduced; whereas it would be improvident to spend all such revenues as they are received; whereas the Legislature considers it appropriate that a substantial portion of those revenues be set aside and invested for the benefit of the people of Alberta in future years; therefore, Her Majesty, by and with the advice and consent of the Legislative assembly enacts as follows:"

Mr. Gallagher: Sounds great.

Mr. Peterson: We can embody that substance in the purpose clause without all the "whereas".

Mr. Gallagher: We've pretty well covered number one. As a general operating function, I see the permanent fund as a wholesale institution. Soft loan programs should be done through the Department of Commerce. Otherwise you are dealing with financial intermediaries, or the project is such a size you have resident experts in-house to handle it, or you are in the money market. I really see it as a wholesale institution.

Mr. Wohlforth: You might explain what you mean by that term.

Mr. Gallagher: Wholesale versus retail. Retail is making direct loans under a certain limit and working with the individual borrower. Wholesale banking gets into larger loans either direct or in combination with other financial institutions. They would be loans sold to the fund, not necessarily initiated.

Mr. Thorstenson: I don't think we should preclude ourselves in the charter from being involved in some of the business that the banks consider their own. It could well be a policy when there comes a time we don't feel that the banks are fulfilling their role and we may want some of that business.

Mr. Wohlforth: The question is then, the Legislature should pick up the subsidy - the subsidy interest rate -- what sort of operating philosophy do we have then?

Mr. Gallagher: You can break it down two ways. First the loan evaluation -- you never evaluate a loan in terms of subsidy. When you make a loan evaluation you require in the charter that it is done at economic interest rates, not at subsidized interest rates. And two, you should only subsidize in areas where the consumer will get the direct benefit. Also you should never subsidize below long term rate of inflation.

Mr. Fuhrman: Who's going to determine that?

Mr. Gallagher: The policy board can make that determination.

Mr. Edenso: If we subsidize we have to go to the legislature to appropriate the difference from the general fund.

Mr. Fuhrman: Is the word "subsidy" a correct word to use? Your capital is still at risk in that loan. Are you suggesting that the staff and the investment committee would determine that the project is financially viable on a capital basis? That the project can afford to pay the interest rate they're prepared to pay as long as the legislature is making up the difference?

Mr. Gallagher: Subsidy is a good word. And yes to the other questions.

Mr. Fuhrman: My reason for asking is I'm trying to think how the credit institutions will perceive the fund if they feel that you've taken on a capital risk despite the fact that you have been able to insulate yourself from the income risk. The income can go anywhere out of the fund. They only look at the assets as the source of the credit. It matters that you've been able to make a judgment that the capital is not at risk.

Mr. McFarland: I think the crux of this is who initiates the subsidy programs.

Mr. Love: I've got a suggested language to cover this whole section number two. Six points which I've written down are: (1) promote market returns; (2) promote renewable resource industries; (3) diversify the economy; (4) promote equitable distribution of the State's wealth; (5) protect the environment; (6) provide community development.

Mr. Wohlforth: What you stated are already within our goals. We were talking about structural treatment of subsidy loans and we've completed the methodology of structural treatment of these loans. I see a real constitutional problem with the legislature committing to pay a portion of a rate of interest on a private loan.

Mr. Edenso: Some phrases I took from one of the charters while we were in Washington, D.C. Loans should be made on terms and conditions and only obtained by private investors for similar financing. Here we would have the language, "And in the event that any loan is to be made below market rates of interest, the difference shall be subject to legislative appropriations." I think the word "subsidy" is a red herring.

Mr. McDowell: It would be a policy decision to provide an incentive for a loan in a particular sector. The legislature would make that policy decision.

Mr. McFarland: It seems to me the greatest contribution we can make here is to get the highest yield we can on the money and give it to the general fund and let the legislature take care of the subsidy programs, whatever they want to do in the social area. The social area is political, believe it or not.

Mr. Wohlforth: I like the idea, it has a lot of political advantages. We have faced the subsidy issue and when the bill is drafted it will be seen by the Legislature right off. Next, how can the legislature take the position that the fund itself should be the subsidy lender in fact of what we believe the people voted for. Third, they can't argue their prerogatives are being defeated because we've said if there are subsidies it is their prerogrative to make and appropriate funds for them.

Mr. McDowell: It's probably the only way that you can be responsive to a need by the public and that the fund retain its integrity and credit value.

Mr. Wohlforth: All right, do you want to get to the question of division between the private and private sector?

Mr. Gallagher: I would like to do them through the Alaska Municipal Bond Bank as guarantees so the permanent fund doesn't get into making loans to political entities for day to day operations, they may have to get into the business of municipal utilities, but you would have to differentiate between the business and social areas of municipalities.

Mr. McDowell: The choices are: the fund will use its capital to make direct loans which will not have guarantee authority, that it can make no more than 20% of its loans to one sector. Another choice is to give guarantee authority -- capital will be used for direct loans to productive private enterprise.

Mr. Fuhrman: It is a way of maximizing the income on a secure investment by using that investment as collateral or pledge behind the guarantee. It has the effect of reducing the cost of capital for the person you are guaranteeing, and you get a guarantee fee which is added to the income you are making on your underlying investment, which may be a government security, a federal government security of some kind. I think that you have to determine that a guarantee or any kind of commitment has the same dollar value in terms of determining what your percentage of participation is in a sector.

Mr. Love: I'm afraid there's going to be a tendency of the permanent fund to make all public investments unless there is some requirement that they make a certain percentage to private enterprise.

Mr. Edenso: Why would you want to limit your guaranteeing just to political subdivisions or to such as the municipal bond. Why not make it to private enterprise as well?

Mr. Crawford: I think we've got to define those terms. What is "public sector" and "private sector?"

Mr. Wohlforth: For a working definition, can you say that a municipality or public agency of the State is public sector and the rest is private sector? The IRS has no trouble defining it. They know exactly what is public and what is private. We've talked about the question of percentages, now let's get back to whether there should be a mandated percentage for either one or not.

Mr. Fuhrman: I have the impression there will be investments in money market instruments or short term instruments; that may be a permanent event or just a place where you put funds while they wait to be put somewhere else, but that will be going on. I would assume the charter would allow for that to go on and there shouldn't be any maximum on that kind of involvement. There would also be a statement about investment grade securities which I define as being money market instruments, and some longer term corporate securities, government securities, or utilities securities. That would probably be the only category that you would consider putting a minimum on, i.e., at least a blank percent of the fund will be in these securities.

With respect to public sector finance, and by that I'm eliminating federal government paper which would be in the category of investment grade securities I just discussed. The private sector you would never want to consider at any point having a minimum percentage or minimum dollar amount because it will force you to look at your audit to see where you were against your ratios. It may cause you or your staff to actually have to seek out a loan to meet the requirement that would be a loan that no practical man would ever consider. There may not be an opportunity to invest in a good loan at that particular time. That is why we would say "up to" rather than "at least", in those categories.

Remember that you're not going to be investing in tax exempt securities which some of the public sector securities would be. It doesn't make any sense for a tax free institution to be investing in tax free securities.

Mrs. Fleischer: If we are in the business of making the division, I like what Mr. Fuhrman suggested, that we say "at least" when we're talking about money market securities and investments and use the words "up to" or "at most" when we're talking about the other.

Mr. Wohlforth: Fine, we're making progress. "At least" in a certain amount of money market instruments, and "up to" or "not exceeding" in the other two categories.

Mr. McDowell: The "at least" provides a savings account. Could I raise the issue of this, just briefly. You're talking about carving up a pot which has three elements in it. You've got the 25% that is your capital. If you allow the fund to borrow, you've got the borrow interest, and if you allow the fund to guarantee you've got the guarantee authority. This is the money that you would or could make direct loans with. That implies an operating philosophy and organization structure. That's not a direct loan; somebody else made the loan, somebody else appraised it, somebody else decided it was a loan worth making, and somebody else administered it. So there's two different organizations -- the guarantee authority which doesn't require much of an organization, someone else does all the work.

Mr. Fuhrman: The question is if you have to call on your capitalization, how do you determine what percentage of what is what?

Mr. McDowell: The guarantee authority cannot be part of your capitalization. It's a part of your financing ability.

Mr. Edenso: The guarantee authority only inhibits the amount of capital you have on hand, it restricts it. It states that you will hold aside so many dollars to guarantee somebody else's debt.

Mr. Fuhrman: What we're really trying to determine, if you deal with percentages, what the definition of the makeup of that percentage is. Percentage of the total capitalization. Is it the percentage of the total capitalization plus the guarantee authority, or what is it?

Mr. McFarland: Suppose you set a 30% figure. I think if you have set up reserves that has to fall within that 30% figure. I don't think you can commit your reserves for more than one thing.

Mr. Edenso: I would say if you're going to have a guarantee, it would be best to talk to your raters, Moody's or Standard and Poors, and find out what they think, because they are the ones who are really going to be the most interested in how you set up a contingent liability and the effect it might have on your rating.

Mr. McDowell: That's the issue. If you set aside a third and invest in investment grade securities and that's where it stays, how much guarantee authority do you think we ought to have?

Mr. McFarland; I think if we set a figure I would recommend that the figure not exceed 30% in the public sector.

Mr. Gallagher: I move for zero in the public sector except through guarantees.

Mrs. Fleischer: Let's define public and private sector.

Mr. Wohlforth: We've suggested that the public sector be confined to the municipalities, everything else be considered private including co-op, utilities, etc.

Mr. Love: How about things like housing projects for the elderly?

Mr. Gallagher: I agree with you, but there are certain things I would like to weed out at the start, like school loans.

Mr. Wohlforth: Your feeling is not so much against fund assistance to municipalities but through vehicles other than direct loans, is that it?

Mr. Gallagher: Right. I would like a market test on municipalities -- market test on a municipal investment.

Mr. Fuhrman: Why not put a low percentage figure in and let the policy board decide what to do with it.

Mr. Thorstenson: We're getting too specific for the charter. We've got a policy committee that will be sitting that will determine policies.

Mr. Crawford: If we're talking in the savings account concept of investing in mortgages for the State, then what are we talking about as far as the private sector?

Mrs. Fleischer: What's wrong with saying at least 40% or 50% of the money to go into investment grade securities.

Mr. Fuhrman: The definitions can be built into the language.

Mr. Gallagher: Why don't we just leave that whole question until the next meeting?

Mr. Fuhrman: Why not leave the percentage blank until the actual writing of the bill when you could expand on it?

Mr. Gallagher: There is one other operating philosophy that has been brought up, how much can you loan to any one borrower.

Mr. Rhodes: That's addressed in the questions.

Mr. McDowell: Most of the charters don't do this but there should be at least a general statement for adding appropriate controls of various kinds. Diversification is the thing to control in an institution like this.

Mr. Wohlforth: Is there a percentage limitation?

Mr. McDowell: No, it's a prudent man test.

Mr. Gallagher: The only other general operating philosophy is maybe the prudent man rule.

Mr. McDowell: You don't really know the exact amount of lending power at this point. You don't really know what the total amount of capital is ever going to be. It's just 25% of certain levies.

Mr. Wohlforth: Shouldn't there be a maximum percentage?

Mr. Barnes: I think a limitation is really a policy board decision.

Mr. Fuhrman: If you leave it there, it's easier to change it and it can be more responsive to the levels of the fund's earnings.

Mr. Crawford: I've got a suggestion on the percentage. The one concern is limiting the public percentage, not the private or the money market. I don't think it's appropriate at this time to set those, but the public could be set.

Mr. Wohlforth: We had a suggestion of 30% previously.

Mr. McDowell: The issue is, the permanent fund, only being a minor portion of the State's resources in the future, should any of it go to the public sector? I've heard that only 17% of the total revenue is really going to wind up in this fund. Shouldn't all public sector projects that have to be financed be financed out of the 83% left?

Mr. Wohlforth: Again, what do you mean by public sector? What kind of involvement is there going to be? Involved in a leveraging capacity, with loans to establish reserve funds for borrowing, or would it be a direct loan?

Mr. McDowell: No matter how you provide financing, it is a public sector need that is being financed. I just want to raise the question of total magnitude, is whatever is going to wind up in this fund so significant that it has to go to public sector needs?

Mr. Wohlforth: Should we move on to legal personality? The board needs to be given a judicial identity.

Mr. Edenso: It's got to have a corporate identity to protect the managers of the fund.

Mr. Peterson: There are some basic ones like ASHA and development corporations that like to sue and be sued in their own name. Is it clear that the committee wants to take that approach, and not simply treat this as a State agency like the loan programs that Tony Motley always handles. Most of them are not of this separate corporate identity type.

Mr. Gallagher: We want separate corporate identity.

Mr. Peterson: Is that the general feeling?

Mr. Gallagher: Yes.

Mr. Wohlforth: The list goes next to sectoral coverage in terms of both economic and size factor. We have dealt with that somewhat already, particularly with what charters say on the subject, if anything.

Mr. McDowell: You don't see much more than the split between public and private, or the exclusion of one or the other as far as economic sectors are concerned. Some institutions are set up as an agricultural development bank. It just says you will invest in agriculture. At the present time here, no one seems quite ready to say one sector within the productive private enterprise is more significant than another. That will probably be the first job of the management of the fund, to have those studies done and submit it to the policy board as an investment planning policy statement.

Mr. Peterson: Would you want any sort of bill statement to the effect that the policy board could give consideration to the various other economic sectors, or just some general statement like that or just leave it blank?

Mr. Wohlforth: You've got to be a little realistic there. I think that a number of legislators feel that the renewable resource field is the one that should be promoted.

Mr. McFuhrman: It's in the self interest of the fund to consider investments in the non-renewable's that are currently not being exploited as well because it will have the benefit of producing additional revenues to which the fund may draw -- from which the fund may draw.

Mr. McDowell: The policy board would not approve an investment program unless in their view it agreed with what they are hearing from executive, legislative, public, special interest groups, regional groups, etc. That's why they should be the recipient in a forum of these views. The structure provides the authority for them to come up with a program that is acceptable to the people in Alaska.

Mr. Wohlforth: What do you mean by geographic coverage?

Mr. McDowell: Do these investments have to be physically located in Alaska? That's one question of geographical coverage. Another question is, should the institutions seek to promote investment or employment in certain kinds of areas within the State? Those are the two issues. Do you limit it to the State and do you seek to emphasize certain parts of the State?

Mr. Gallagher: I think you should do it by economic sector rather than geographical sector. Fishing is pretty well coastal and mining is pretty much interior.

Mr. McDowell: Utilities could be anywhere.

Mr. Gallagher: Yes, and the economic sector goes into that.

Mr. McDowell: you might want to confine, at least some of the expenditures, to take place just within the State of Alaska.

Mr. Gallagher: All of the loan programs should only go to the State of Alaska.

Mr. Edenso: You might want to reconsider that, depending on what your economics tell you. We might want to lend to somebody who is going to construct something out of State that is going to help an industry in the State.

Mr. Wohlforth: General criteria to be applied to the selection of capital investments.

Mr. Pihl: Isn't that a policy board matter?

Mr. Gallagher: What is considered capital investments?

Mr. Wohlforth: Appreciable assets, that's a capital investment.

Mr. Fuhrman: I think you have it with income-producing. The specific criteria are policy and even down at the staff level.

Mr. Fuhrman: At one of these meetings I read a list of all the criteria that had been used. Some of the language used were: "not readily available from other sources - commercial liability - impact on economy - satisfactory return - terms consistent with risk - fixed rates no greater than private - only to government or government guarantee - only for productive purposes - prudent - diversification of equity ..." Those are all the kinds of criteria for judging loans by various parties. When you have a structure that is being proposed here, a charter, a policy board, an invstment committee, and a professional staff, that needs to be particularly specific at the first level, are not as great.

Mr. Wohlforth: Don't we need some broad statements?

Mr. Edenso: Wouldn't that be more in the area of guidelines that a management of investment committee would be utilizing to determine decisions on investments?

Mr. Wohlforth: Yes, but the question is do we put some general language like that in the charter?

Mr. Edenso: What I'm trying to determine is are we getting down to the staff level or are we going to stay at some upper management level?

Mrs. Fleischer: I accept the question as: Is this the area where the general criteria is defined?

Mr. McDowell: The charter says that loans should be made on the basis of priority considerations -- priority and economic considerations.

Mr. Pihl: I think we should go down the list of 29 items and key the items as either charter items or policy board items, and then concentrate on the charter items. I would like to move that we appoint a drafting committee composed of Eric Wohlforth, Sterling Gallagher, Jim Edenso, Peter McDowell and Art Peterson. For the rest of the day let's limit our discussion to the charter items first and then if we have more time go on. But let's talk about the charter items and leave the drafting committee to come back with a product.

Mr. Edenso: That makes a lot of sense. I would suggest that Mr. McDowell be asked to be available to work with the committee to draft the proposed bill and get it ready for a meeting sometime in early January.

Mr. Wohlforth: I'm taking a two week vacation from the 27th to the 12th of January. I'll ask that Jim Rhodes be a member of that committee in my place.

Mr. Love: When this subcommittee meets there should be some way of recording the actions they are taking and that those meetings also be for the public for anyone who wants to attend. These are very important deliberations.

Mrs. Fleischer: Does it matter that there's no non-staff person on the drafting committee?

Mr. Wohlforth: Are you ready for the question?

Mr. McDowell: I can't be on the subcommittee as a member, if you want to rephrase the motion to consultant to the subcommittee, that's fine.

Mr. Wohlforth: Any more discussion? Any objections?

Mr. Love: I would register an objection.

Mrs. Fleischer: I'd like to see Jamie on there just so there is someone on who's not staff.

Mr. Wohlforth: Motion carries. Objections noted. I assume the time and place will be ...

Mr. Gallagher: To me the best day to work on it is Monday.

Mr. McDowell: This coming Monday?

Mr. Love: The next working day.

Mr. Edenso: I would suppose it would take more than one day.

Mr. Gallagher: Well, Monday and as many other days as it takes until it's done.

Mr. Wohlforth: Are we through with number six? I'm not sure whether we decided on general language in terms of investment criteria or not.

Mr. Love: What about the requirement - the criteria that says, "And that economic considerations should be defined to include employment, income distribution, environment, health and social considerations." We were going to add "and others."

Mr. McDowell: You might add another phrase in the beginning of it, use investments where it says "loans". It's not defined yet what an investment will be, but could read, "that investments be made in a prudent manner for high priority projects on the basis of economic considerations which are defined as . . ."

Mr. Gallagher: I'm not sure I want to include employment. I'd rather have capital in intensive industries that require very little employment.

Mrs. Fleischer: I'd rather have employment than labor.

Mr. Edenso: This sentence completely ignores anything to do with income and the earning of income, which is the primary charge of the constitutional amendment.

Mrs. Lehr: It is defined to include; it doesn't exclude anything with the "and others."

Mr. Crawford: In the clause "environment, health and social cosiderations" does that mean we have to have an EIS for every loan that is being considered? Why in a loan program do we put the management for this entity under that type of analysis? They should deal with the financial end and not the environment issue.

Mr. Edenso: We are considering item number six, the general criteria to be applied to the selection of capital investments and then we say, "economic considerations and ..." This completely ignores anything to do with earning income of any kind.

Mr. Peterson: Then add "income."

Mr. Edenso: The primary consideration should be some kind of emphasis on income, maximizing income.

Mrs. Lehr: That's stated in the purpose.

Mrs. Fleischer: I believe that the people in the State would like to know that whatever investment decisions are made to use the money are not counter-productive to the other goals of the State. That means you don't make decisions that do not take into consideration the environment and health and social considerations. You might want an aluminum plant but if it discharges mercury poisoning in the water then perhaps we might not want it but we might also decide it is economically viable to build it.

Mr. Crawford: The Department of Environmental Quality has veto power of water discharges and will not issue the permit for that plant if it is going to be harmful.

Mrs. Fleischer: Then it should be in here.

Mr. Crawford: Why duplicate it?

Mrs. Fleischer: Why duplicate anything then. Many of our departments should be involved. I think they should all be considered.

Mr. Wohlforth: Where it says "economic considerations should be defined to include", then you list three things that are not economic considerations. List, maybe, proper conditions on financing, something that you're sure has no adverse environmental impact, but don't say economic considerations to include social considerations, because in the plain fact of the English language, they don't.

Mrs. Fleischer: Even though they are negative impacts?

Mr. Wohlforth: I'm just talking about grammar and English.

Mr. Love: It costs a lot of money to finance health and social considerations; it costs money to repair the environment that's damaged. I'm not so sure I would go along with such a strict definition.

Mr. Rhodes: You could talk about the economic costs of environmental problems and social problems but the point is a social problem isn't an economic problem as such.

Mrs. Fleischer: But if it costs money, then it turns out costing more money in the long run.

Mr. McDowell: What you're really trying to define in the charter is what considerations should be included. You might say the group now is looking at the considerations that should be included in evaluating an investment are economics, and the other list, perhaps the policy board may decide. Putting it in the charter just puts the policy board on notice that their policy should recognize this kind of a statement.

Mr. Wohlforth: This kind of statement should recognize that they can't ignore, there are conditions to consider, but the prime thrust is economic in the traditional sense. I'm saying that those costs, which are social costs, have to be weighed.

Mr. Love: Part of the problem is these things are not appropriate to any of the items we've discussed so far, so just where do they fit into the charter?

Mr. Wohlforth: You can give all six equal weight, employment, income, environment, health, social, you may have a project that is 20% justified by traditional economics, and 40% social and environment. I happen to disagree with it.

Mr. McDowell: However, they must be income producing to the standards set elsewhere in the charter.

Mr. Pihl: This paragraph says that the board of executive directors is going to give attention to this kind of item. It's not in the charter. I thought we were going to identify the charter and the policy board items.

Mrs. Fleischer: I think we should want to say in the charter here is the general criteria that they should look at.

Mr. Wohlforth: Are you saying that although it is primarily economic, consideration should be given to these other factors or are you saying all these factors have equal weight? Which way are we going to say it?

Mrs. Lehr: The policy board can decide what the weights are.

Mr. Wohlforth: Do we feel we've beaten this enough to leave it to the committee to decide?

Mrs. Fleischer: Yes, let's do.

Mr. Crawford: Could we go down these and decide which is charter and which is policy board?

Mr. Pihl: Items one, two, and three are charter items, and four, five, six, and seven are policy board items.

Mr. Love: All of these things be included in the charter as general statements.

Mr. Pihl: What should be charter acts and what should be policy board acts?

Mr. McDowell: This is a list of general statements which provide the framework for the establishment of policies by the board in the following areas of concern. The charter will address at least these 29 points plus other matters which are very substantive, like where the headquarters are. It might be politically important but not substantive in terms of what it is going to do. I would suggest that the charter include a reference to each of these items, in general terms.

Mr. Pihl: I thought a general statement on prudence would cover all that.

Mrs. Fleischer: I assume you meant to the extent that geographic coverage shall be left open.

Mr. McDowell: Or remain silent. One of the options of all these is to remain silent. The charter can and should be silent in certain areas where you don't think it is appropriate to Alaska situations.

Mr. Gallagher: Something should be mentioned of financial prudence, adequate controls.

Mr. Wohlforth: Numbers 10 to 14 categorize relationships with other persons and institutions.

Mrs. Fleischer: Should we make provision here for relationship to community needs? I've not seen anything that says the permanent fund is going to respond to the felt needs of communities. Like housing.

Mr. Wohlforth: One of the problems we've had is poor communications. Perhaps we should put it that the board will get together with local governments and find out what they want.

Mr. Edenso: The whole purpose of getting a broad base policy board is to include that, I would assume.

Mr. Love: While they're doing sectoral analysis they can do this too. There's hundreds of communities around the State.

Mr. Edenso: Would you rather have a board with a member from every community?

Mr. Love: No.

Mr. Fuhrman: You could have a 65 member policy board,

Mr. Edenso: One of the unique characteristics about Alaska's population and the political figures involved with that population is that they are first of all, visible, and secondly, accessible. If you do something that is earth shattering or government shaking in this State everyone is going to hear about it.

Mr. Love: There's many cases where entire regions of the State have been totally angry because they don't feel there is any method of formally saying what the Alaska Housing Authority ought to be doing in their communities, what they think the priorities are. There isn't any type of consulting or formal dialogue.

Mr. Edenso: There's about 250 villages. I would estimate the cost of doing that with a ten member board would largely inhibit accomplishing any kind of program.

Mr. Love: You wouldn't have to send the board to every village, just write a letter asking them every year to submit a statement or proposal on a project.

Mr. McDowell: By assigning responsibility for receiving information from the public to government units, legislature, etc., to the policy board to take care of because later on you designate the policy board as the appropriate recipient for the views of every community. Does that take care of the relationship?

Mr. Crawford: Could we vote on it?

Mr. Wohlforth: We should have some statement in the charter that the policy board will consult with local governments.

Mr. McFarland: So move.

Mrs. Fleischer: Second it.

Mr. Love: You might want to say that a project over a certain dollar amount in a specific community could be turned down by the local government in that area.

Mr. Edenso: That doesn't make any economic sense. If somebody wants to put a project in, a private citizen can get a petition signed by a few of the people in the community and kill the project. You've already done that when you say "shall consult with local governments.

Mr. Love: On priorities. We didn't say on loans. There is a difference in consulting with them on priorities and consulting with them on specific loan projects.

Mr. Fuhrman: You're only attacking the financial impact.

Mr. Love: Let's just say the project impacts that specific area.

Mr. Wohlforth: Shall we have that in a motion, whether there should be a restriction based on consent of local government to a project financed by the permanent fund?

Mr. Love: Primarily in it's own community over a hundred million dollars.

Mr. Wohlforth: Is there a second to the motion.

Mr. Barnes: I second it.

Mr. Wohlforth: All those in favor of the motion say "aye".

Motion defeated.

Mr. Wohlforth: Do we want to require participation financing in a particular project?

Mr. Love: Would you say either that they have some private mortgages or that they require 25% participation by another lender?

Mr. Gallagher: I think we might tell the policy board that they should consider those things.

Mr. McFarland: Are you talking about mortgages now?

Mr. Gallagher: Anything. Wherever it's deemed desirable.

Mr. McFarland: Let's suppose you buy an $80 thousand mortgage from a bank and insist that the bank participates in that mortgage to the extent of 25%. That type of deal will wipe out all the small banks. They can't tie their money up like that.

Mr. Gallagher: What we're saying is that they should consider it in the charter where it is deemed desirable.

Mr. Wohlforth: I'm thinking about $50 million project loans, I've long felt it was a real break or imprudence to have participation.

Mr. Gallagher: Any project that size should be mandatory.

Mr. Wohlforth: Shouldn't we think about something like that in the legislation just to guard the public against the unhappy eventuality of poor management or whatever.

Mr. Edenso: To require a percentage like 75%, 25% participation where it is deemed desirable.

Mr. Crawford: On larger projects -- a $100 million projects -- long term money you've just cut all the Alaska banks out.

Mr. Edenso: It's not exactly undesirable to have outside banks make a capital investment in the State. I think that's really a help to the economy; we're importing money for a change instead of exporting it.

Mr. Wohlforth: The question is, if we're talking participation, should we have a dollar floor on the participation requirement, should there be a percentage?

Mr. Edenso: The big concern is with residential housing -- let's exempt residential housing.

Mr. Gallagher: How about a percentage of the fund?

Mr. Edenso: I think it's pretty unreasonable to tie down a percentage of the fund without knowing the potential size of any kind of investment market we're going to have.

Mr. Wohlforth: I'm talking about a percentage of financing the project. Should we establish a percentage on that? Do we simply say we're going to do it in participation with other sources?

Mr. Barnes: And let the policy board from time to time set the limit.

Mr. Edenso: I think we ought to define what reasonable is; we ought to say 25%.

Mr. McDowell: It might be totally unreasonable in specific cases.

Mr. Gallagher: I think the words, "where it's reasonable".

Mr. Allen: Say we have a loan for $100 million for 25 years. You know the banking industry will not participate in that and their success in attracting outside investors to feed money into the State of Alaska is very limited.

Mr. Edenso: The banking system shouldn't be in the position of making long term capitalization loans to begin with. You can probably find 25 year long term funds if you require participation with a responsible financing company such as life insurance, that's the proper place for long term investing capital, not the commercial banking system.

Mr. Gallagher: How about projects where there are guarantees from insurance companies and guarantees from the Federal government?

Mr. Love: When you've got insurance or guarantees you don't need participation, do you?

Mr. Gallagher: That is participation.

Mr. McFarland: If you're talking about participation of a bank that is trying to sell a package, that's one thing. If you're talking about going into a $100 million project and you want insurance to put in $25 million, do you consider that participation?

Mr. Gallagher: Financial participation means someone else making a credit check, either guaranteeing or taking 25% of the project. If you guarantee you also make the same credit check as you do in making an investment.

Mr. Edenso: When you require participation you are not buying as large a piece of the action and you're insuring that someone else is going to be involved. You'll get the involvement when you guarantee only if you go to the point where you have to call that guarantee. The exposure is there regardless of whether it is direct or indirect.

Mr. Wohlforth: Should there be a percentage or should we use just general language encouraging participation guaranteeing our returns?

Mr. Crawford: General language.

Mr. Gallagher: There should be a general statement that we encourage Alaskan ownership.

Mr. McDowell: To encourage an Alaskan market for Alaskan equities.

Mr. Love: I would certainly endorse that because they recycle the money back into the economy at a better rate than an outsider will.

Mr. Wohlforth: So fourteen is finished; we'll pass to fifteen - general powers and parliamentary rules. We talked about the fact that we're going to have general corporate powers -- parliamentary rules, the board will set up its own rules of procedure. General powers of management - sixteen.

Mr. McDowell: The defined powers and responsibilities of management -- in this case the chief executive officer -- are normally stated vey simply. His sole power is to present investment proposals to the management board. This clearly puts accountability and responsibility together. It says, "no one except the management and staff can present the proposal to the investment committee."

Mr. Gallagher: When you present it, do you have to come in with a positive recommendation?

Mr. McDowell: There are going to be certain cases where the staff may want to go to the board for a final clear decision.

Mr. McFarland: I think we should get a recommendation one way or the other even if it goes to the board. Either we favor this or we don't. It could save a lot of time.

Mr. Edenso: I have a question on number 14. We said limit these geographically to Alaska, or can we participate or help to finance an investment in Alaska that's owned by or initiated by somebody in the lower 48?

Mr. Wohlforth: As far as we got was giving Alaskans preference everything else being equal.

Mr. Pihl: That's as far as a project is concerned?

Mr. Edenso: Is the limitation geographically to Alaska or is it a limitation to Alaskan-owned industries?

Mr. Crawford: How do you define Alaskan? The election rule is 30 days before election.

Mr. Gallagher: That's for the policy board to decide.

Mr. Wohlforth: We're down to the chief executive officer and the suggestion that he be required to recommend or not recommend a particular financing.

Mr. McFarland: It's a waste of time if he doesn't make a recommendation.

Mr. Love: If the staff makes a recommendation and the board approves a lot of the loans that the staff disapproves, that makes them more accountable. They've got to answer as to why they made that loan.

Mr. McDowell: I think you have to hold back on that until you decide exactly what the fund's going to do. It's just too far down the organization to clearly define all of its functions.

Mr. Fuhrman: While we're talking about organization, doesn't it make sense to either start at the top down or the bottom up in our conversation now?

Mr. Wohlforth: The policy board, the management board, etc.

Mr. Fuhrman: And the staff. It's easier to talk from the bottom up than down. What I'm suggesting is that the staff, including the president, be responsible for accounting and control on a daily basis and prepare reports along the way. They would be responsible for employing and compensating people on the staff and external or internal advisory assistance in their functions which would include evaluating loan investment proposals, preparing and packaging loans and investment proposals for presentation to the investment committee for approval.

Mr. McDowell: All those matters are covered in the phrase, "responsible for ordinary operations." The charter should say just about that.

Mr. Fuhrman: Right, and "invest or reinvest monies not subject to investment committee or policy board approval", which is a general statement and avoids the issue.

Mr. McDowell: Without clearly saying exactly all the things it's going to do you can't define the operating organization yet.

Mr. Wohlforth: Do we agree with the general statements as it concerns the chief executive officer?

Mr. Fuhrman: I don't envision the chief executive officer is going to arrive alone at the investment committee to present the proposal. He would bring that member of his staff who has worked on the packaging to make the presentation with him.

Mr. McDowell: You must make him responsible and accountable for it, even though he is completely supported by his staff.

Mr. Fuhrman: He's not responsible for it at all if the investment committee decides to make that investment. Then it is the investment committee as a whole that is responsible.

Mr. McDowell: He has recommended it and he is reponsible for presenting it.

Mr. Fuhrman: He has presented it on a financial basis and the investment committee is going to look at it on a financial basis and in conjunction with the policies which they have interpreted as coming down from the policy board.

Mr. McFarland: Then he will either recommend it or not recommend it. He has to be able to tell a person that his loan is not so good and not to expect to get it. But if he insists on it going to the board it should go to the board.

Mr. McDowell: There are a lot of ways that could be handled in a positive manner but are not techniques that could be defined in a charter. You just have to make someone responsible.

Mr. Wohlforth: We all seem to be agreed on this. If the draft workshop plus the Price Waterhouse comments are acceptable, then we are at nineteen -- conflict of interest.

Mr. Gallagher: This should only go down to the chief executive officer level. Below that you can handle it as internal policy.

Mr. Crawford: The chief executive officer is going to have to disclose? How far does it go in State government?

Mr. Gallagher: It goes to directors level.

Mr. Love: All of the staff below the chief executive officer you want an internal policy. Do banks have internal policies for loan committees?

Mr. Allen: You file a public financial statement.

Mr. Love: When you talk about the board, there are two boards, a policy board and a loan committee which included four outside directors. Would those four outside directors file a public conflict of interest report?

Mr. Gallagher: Yes.

Mr. Love: That seems like an adequate procedure to me. If all those people are filing conflict of interest statements it seems perfectly appropriate for the other staff to conform to whatever internal policy you have.

Mr. Wohlforth: All right. General financial goals, level of profits to be attained, protection of capital, prudent management of assets are next on the list.

Mr. Gallagher: It's pretty well covered. The only thing is level of profit, make sure that we have a reserve for bad debts.

Mr. Pihl: We were going to have something on seeking to compensate for inflation -- I mean building your principal by leaving that amount of your income to compensate for inflation.

Mr. Gallagher: I'd be against that because there would be nothing left over. No income if you added to the principal every year from the income to compensate for the inflationary loss of the dollar value to the principal.

Mr. McFarland: But for a certain period of years your income would be inflated. If you sold oil ten years ago at a certain price, ten years from now it will have escalated considerably.

Mr. Gallagher: That would be returns off the fund.

Mr. Edenso: That assumes the only capital in the fund is going to be contributed capital mandated by the constitution. It doesn't take into consideration the possibilities of issuing debt to obtain debt capital.

Mr. McFarland: If we put the inflationary factor in and retain that, I don't think we'll get past the legislature with it.

Mr. Wohlforth: We seem to have some general agreement about not having a retained earnings requirement equal to inflation rates, unless someone feels strongly otherwise, we'll go on. Borrowing powers and limits, if any, of the corporation.

Mr. Gallagher: I think it should be able to borrow, but that's a policy matter.

Mr. Pihl: But the charter has to say that you want the power to borrow.

Mr. Rhodes: Can we at this point, not knowing the size of the fund really in five years, can we establish some overall ration of the leveraging total on loan guarantees, treat it as direct liabilities?

Mr. Fuhrman: We've discussed this and indicated that we wouldn't anticipate much leveraging in the early years, but that perhaps the legislation should at least allow for it and then let the policy board make a decision later on management's recommendations as to needs or what they would do with it, whether to take advantage of it. The concept we're recommending is that you at least have the ability to leverage and then let time determine whether you do or not. Then we discussed whether or not you wanted to have built into the legislation capital ratios beyond which you wouldn't go if you were to leverage or that you would always at all times maintain at least so much equity per debt or various units. Whether or not guarantees should be counted as a liability on a dollar for dollar basis. Our thought there was that if you chose to have those kinds of limitations at this point they would be in the charter, much broader than what the market place will ultimately let you have anyway. That whenever you enter the market place to borrow, or whenever you place your first guarantee on something that someone else is borrowing there will be built into the purchase agreement restrictions on what the permanent fund can do from then on with respect to its capital ratios, which will be more restrictive than anything you put into the charter. Therefore it's not very important one way or the other whether you have it in the charter.

Mr. Wohlforth: So the borrowing powers should be in the charter but limits should not be. Is that the consensus? All right, twenty three.

Mr. Gallagher: I think the expenses should all be paid by the fund.

Mrs. Lehr: What would be the determination of the budget? Is there any limit to having fancy offices?

Mr. Gallagher: The policy board would have to approve the budget.

Mr. Love: Let's say that the budget go to the legislature.

Mr. Wohlforth: Should the budget be subject to the Executive Budget Act?

Mr. Gallagher: I used to be for it until I saw the accounting implications if you have a reserve for bad debt -- the political implications of going to the legislature for supplemental for reserve for bad debts.

Mr. Crawford: It should be exempted from the Budget Act for a couple of reasons. The primary purpose is insulating this from political influence.

Mr. Wohlforth: Would you make a motion to that effect?

Mr. Crawford: I so move.

Mr. McFarland: I second.

Mr. Love: I want to speak against it. I don't think we can give a blank check in the face of the amount of income that the fund has to spend. I don't think that's responsible fiscally and it's not a good public policy. I feel we would be making a major mistake by exempting the permanent fund from some type of legislative review as to it's level of expenditures for managing the fund.

Mr. Wohlforth: How does the World Bank do it? Is the operating budget taken out of income without regard to national government's direct line item appropriation?

Mr. McDowell: They are completely independent of the governments on that matter. The board of executive directors has the final word. In this case it would be the policy board. The policy board is charged in the charter by the legislature with behaving in general in a responsible, reasonable and prudent way. It is accountable to the public, the executive, and the legislature for behaving in that manner. You appoint those policy board members to represent the interests of the people of the State of Alaska and expect them to do it.

Mr. Edenso: I'm in favor of the motion. The quality of the people you're going to hire, the process that is going to require them to be placed in that position, the public visibility of them before they get to that position, are all going to work to insure that we have people of integrity who are not going to do damage to the State. They've got a responsibility to execute to the best of their ability the income earning side of the permanent fund which also means holding down expenditures. Finally, I think a major reason for not having the permanent fund chief executive officer go through the legislative process is that it would force him to acknowledge that first he has the policy board to answer to and secondly he has to go to the legislative body annually to obtain what he thinks is a reasonable amount of dollars to carry out his job. That means he has not nine but 69 bosses. He will spend most of his time lobbying the legislature just to get what he wants.

Mr. McDowell: The budget in this kind of an institution, also includes its operating revenues, which in effect includes its loan and investment program. The budget is the complete financial plan.

Mr. Love: What we're really debating here are issues like staff, salaries, travel, office space, consultants, etc.

Mrs. Lehr: What control does the legislature have? It can only remove the members of the policy board for cause. I don't see where the control comes in from that highest level.

Mr. Rhodes: Their reach is the charter. They can lay more specific priorities down. They have the final remedy of taking the budget process in hand if it turned out that lowest staff members was being paid an exorbitant amount.

Mr. McDowell: Their first option would be to fire the policy board. Their second option would be to change the charter. The policy board is not being paid. They do not share in the benefits of any of the operating expenses of the fund other than probably the conference room and per diem to attend the meetings. They are going to decide on what all the rest of the people get, but they themselves will not benefit from their decisions. You've got a very good separation of power.

Mr. Peterson: This policy board is appointed by the Governor. There's no confirmation by the legislature, there's no direct appointment by the legislature.

Mr. Phil: It is confirmed by the legislature.

important thing is for the public to know there will be checks and balances on the fund.

Mr. Rhodes: I'm not sure in the case of the permanent fund if described as independent, that the public would necessarily be reassured, that the legislature had auditors looking after it. Peter, where would operational evaluations, post audits, be done?

Mr. McDowell: That depends. There are very few people outside the institutions qualified to do operational evaluations of capital investmen development investments. It's a specialized internal audit function of a development institution and it's the normal pattern that they report to the audit committee rather than to the management.

Mrs. Lehr: It is not the same staff making the loan decisions and doing the post evaluation.

Mr. McDowell: No, they are separate.

Mr. Love: My question is in what instance is the public given the right to examine the conclusions of the evaluations so they can react and have their input into the way the permanent fund is being managed?

Mr. McDowell: The only thing you have to watch out for is that you reserve the confidentiality of information given to you.

Mr. Wohlforth: that takes us right through number twenty nine. This meeting is adjourned.

Meeting adjourned at 4:00 p.m.

Mr. Peterson: I'm tal g about the draft we submitted yesterday. Then there are a couple of Alaska Constitutional provisions plus a recent Supreme Court Decision that deals with the separation of powers and the confirmation ability of the legislature. What is the accountability to the legislature? They have the continuing legislative authority to change the legislation or charter, but beyond that I think they would probably have little authority.

Mr. Wohlforth: We did say that we would have a policy committee appointed by the Governor, subject to legislative confirmation, if this is constitutional. So we just have to determine if we can make it subject to the legislature.

Mr. Gallagher: There is a possibility that legislators may be on the board without voting power - in an advisory capacity only.

Mr. Wohlforth: Could we get to the question of w : or not we are subject to the Executive Budget Act? All those in favor that the . .d not be subject to the Executive Budget Act signify by saying "aye". Opposed?

Mr. Love: Nay.

Mr. Wohlforth: Number twenty four. Source of funds to pay for any subsidy of loan interest, etc. That we've already discussed. Twenty five, disposition of net income from operations. Twenty six, proportion of the total capital of an enterprise or project which the institution may provide. We've been over that. Twenty seven, general requirements for independent audit and public reporting.

Mr. Gallagher: On public reporting - at least as the Treasurer I'm required to report either annually or semi-annually, including a list of my investments, and I don't find that objectionable.

Mr. Wohlforth: Is it agreed that we need independent audit and public reporting including performance evaluations? All right. Twenty eight, general requirements for operational evaluations, post audits of capital investments. Do we agree on that?

Mr. Crawford: In the draft bill there was a provision that the executive directors were the ones who did the audit. I think the audit should go to the policy board rather than the executive directors. The executive directors and the investment committee are making the investments and you can't have anybody who is making investments doing the audit.

Mr. McDowell: I think the policy board should be the audit committee and should be the only recipient of reports from the outside auditors.

Mr. Wohlforth: There is a legislative audit which could be their control.

Mr. Love: I think we should recommend that they have an audit. It would serve the public interest better to have an audit.

Mr. Rhodes: I think the most recent precedent would be the Alaska Power Authority where they chose an independent audit rather than a legislative.

Mr. Love: That audit would be satisfactory, but I think it would be good to say that an independent audit would be done annually, but the legislature would have the authority to do its own independent audit if it deems necessary. I think the

CERTIFICATION

I, JIM EDENSO, Executive Secretary of the Alaska State Investment Advisory Committee, hereby certify that the foregoing Minutes of the December 16 and 17, 1976 meeting of said Committee duly called and held at Anchorage, Alaska, on said dates, 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

Jim Edenso
Executive Secretary

STATE INVESTMENT ADVISORY COMMITTEE
MINUTES
January 6, 1977
Anchorage, Alaska

A special meeting of the State Investment Advisory Committee was convened at 9:00 a.m., January 6, 1977 with Mr. Robert McFarland presiding. The meeting was held in Room 19, 509 West Third Avenue, Anchorage, Alaska.

Members present were:

Dr. Charles Logsdon, Director, Agricultural Experiment Station, Palmer
Mr. Robert McFarland, Anchorage
Mr. Martin Pihl, Comptroller, Ketchikan Pulp Company, Ketchikan
Mr. Jamie Love, Alaska Public Interest Research Group, Anchorage
Mr. Bill Allen, Commissioner, Department of Administration, Juneau
Mr. Langhorne A. Motley, Commissioner, Department of Commerce and Economic Development, Juneau
Mrs. Lanie Fleischer, Anchorage
Dr. Dona Lehr, Development Planning & Research, Office of the Governor, Juneau
Mr. Sterling Gallagher, Commissioner, Department of Revenue, Juneau
Mr. Jim Edenso, Deputy Commissioner, Department of Revenue, Juneau

Absent Members:

Mr. Eric Wohlforth, Anchorage
Mr. Robert Barnes, President, Alaska State Bank, Anchorage
Mr. Dennis Waldock, Anchorage
Mr. Emil Notti, Alaska Native Foundation, Anchorage
Mr. Robert Thorstenson, Petersburg Fisheries, Inc.
Mr. James Crawford, Coordinator, Alaska Offices of Ted Stevens/United States Senator
Mr. Robert LeResche, Development Planning & Research, Juneau
Mr. James Rhodes, Anchorage
Senator John Butrovich, Fairbanks
Senator Jalmar Kerttula, Palmer
Senator Frank Ferguson, Kotzebue
Representative Hugh Malone, Kenai
Representative Richard Urion, Anchorage
Representative Clark Gruening, Anchorage

Others Present:

Mr. Peter McDowell, Price Waterhouse, Inc.
Mr. Ted Swick, White Weld, Inc.
Mr. Bob Richards, Anchorage
Mr. Frank Reed, Dean Witter and Company

MINUTES

Mr. McFarland: We will open our meeting by everyone introducing themselves.

Mr. Gallagher: I would like to review the more current bill, then I would like to discuss with the committee as to what direction they want to go -- look at some of the sectoral analysis and lending functions or activities we should be doing. Also at what point do we do it, who is going to do what, and how to develop the data on these various sectors.

Mr. Edenso: Perhaps we'd better look this bill over to see the differences since there have been a number of changes.

Mr. McFarland: Has the constitutionality of the proposed bill been checked? Do we have the right under the Constitution to do the things asked for in the bill?

Mr. Gallagher: Yes.

Mr. McFarland: Why don't we go over it point by point? Does anybody have any changes for the first page?

Mr. Gallagher: Several people of the financial community wanted a better definition of "encourage and assist the participation of private capital . . . in private enterprises of benefit to Alaskans." They didn't understand what that meant.

Mr. Motley: I think their problem was they thought that was getting to be a specific guideline. Once it was explained that it was a broad-brush type of approach they understood it better.

Mr. Love: I don't remember us really taking a position on number one and two, smoothing out cyclical pattern of growth.

Mrs. Fleischer: What does that mean?

Mr. Gallagher: I'm not sure number two should be in.

Mr. Edenso: If you look at the characteristic of the fishing industry in Alaska today, you have several species at several different times of the year. I think it should apply to fisheries as well and tourism.

Dr. Logsdon: Perhaps you do not want to invest the Permanent Fund money in Alaska at certain times, you may want to move it out of Alaska to avoid the impact of investing in extra billion dollars.

Mr. McDowell: The issue of timing investments could become important because of the cyclical pattern. There should be discretion in timing investments and this should be one of the criteria.

Dr. Logsdon: My reasoning was that the big push in Alaska has been to increase government activities and 25% of the royalties monies will go into the Permanent Fund, leaving 75% in government which is going to increase the government even faster. During this period I think it may be well to back off on the Permanent Fund, or withhold it until you are ready to see which direction things move. If you pump the whole bit in at once you could have a big explosion.

Mrs. Fleischer: You're not saying this would mandate smoothing out the cyclical cycle?

Dr. Logdson: I'm not talking about a seasonality employment, not on an annual basis but on a longer term basis.

Mrs. Lehr: This list is fairly generalized and I don't think it could be interpreted to mean that every investment has to meet every one of these criteria. They are just general guidelines.

Mr. McDowell: The crucial sentence in paragraph 17 is the last one. It says, "The Permanent Fund shall be guided in all its decisions by the purpose set forth above." There's only one purpose set forth above and that is to provide a means of conserving a portion of the State's revenues from mineral resources. That is the purpose, the rest is elaborating on it. The Permanent Fund's management is put on notice that decisions should always be considered in light of paragraph 17.

Mr. McFarland: Anything else? Can we go on to page two?

Mr. Love: Can we insert before the word "seek" at the top of the page, the words, "primary purpose"?

Mr. Pihl: The overriding or controlling principle shall be to seek to maintain the principal.

Mr. McDowell: There are six or more ways of going about that.

Mrs. Lehr: The purpose is the ultimate benefit of present and future generations of Alaskans.

Mr. Love: I think it should be to conserve.

Dr. Logsdon: I tend to scratch the last half of that sentence because that's the only way in which you are supposed to seek to preserve the capital of the Fund. You do these other things for some other purpose, but this is the one that you use to preserve the capital.

Mr. Love: Should we put a period after sound investments or after future generations?

Dr. Logsdon: Either one -- probably through sound investments. Sounds like the only way you can preserve it is through investment grade securities. We are actually talking about preserving it through other means as well.

Mr. Love: Maybe after generations. Maybe you want to make some sort of investments which in themselves would be risky but if you maintain a system of reserves, overall it would be a sound investment policy.

Mr. Allen: That's prudent management but has no effect on risks.

Mr. Gallagher: You could set up a reserve when you make the high risk investment at the start. The idea of reserve is for bad debts -- I guess the definition could be made to cover prior and active reserve, but the usual definition of reserve for bad debts is after the fact, after you've made sound investments.

Mr. Love: I move that we reword number six to say, "seek sound investments in investment grade securities."

Mrs. Fleischer: I second it.

Mr. Gallagher: I think the way you are describing it "further benefit to Alaskans" it's a benefit to Alaskans to seek to preserve it for future generations. Something that you're not going to be presently investing in the State to do it outside the State. And that's the way to preserve it.

Mrs. Fleischer: I thought that was the main idea of preserving the Fund.

Mr. Gallagher: It is, but you're describing further benefits to Alaskans. When you describe further benefits to Alaskans you're deciding that you want to preserve some of this money so that it could be invested later maybe inside the State. The Fund may not be growing as fast at that point in time, so you are preserving this money at this point in time to conserve it later to be used in the above five purposes.

Mr. McFarland: It's window dressing. Why don't you say, "seek also to preserve the Permanent Fund for future generations."

Mr. Love: That sounds good.

Mr. Motley: There's a motion on the floor.

Mr. Love: I will amend the motion to incorporate the language that Mr. McFarland just used.

Mr. Motley: Would you like to restate your amendment?

Mr. McDowell: "Seek also to preserve the Permanent Fund capital . . ."

Mr. McFarland: All those in favor signify by saying "aye".

Mr. Gallagher: No.

Mr. McFarland: Adopted. Can we go on to composition of the Permanent Fund?

Dr. Logsdon: One thing that keeps bothering me and that's the Corporation as something separate from the Fund. The Fund I think of as money and in the last sentence of the first paragraph it says" except that income in the following amounts may be retained by the Corporation." Because if you say, "by the Permanent Fund" it goes back into the Fund and can this be used?

Mr. Edenso: Throughout the bill we've used the Alaska Permanent Fund interchangeably to refer to the Fund, the capital of the Fund, and the Corporation.

Mr. McDowell: We talked about this quite a bit and tried to use a different name but we kept running into all kinds of problems because the fund of money and the organizational entity just are inseparable. There has to be legal entity in addition to the Fund. The Fund is a governmental accounting classification; there has to be an organizational entity as well, so we put in 015 to define that there would be a corporation and would be called the Alaska Permanent Fund; 010 says there is a fund called the Alaska Permanent Fund. Both things exist and both are used exactly the same way all through. Whether you're talking about the account or whether you're talking about the corporation, it didn't seem to matter once we said there were two and they are essentially the same.

Dr. Logsdon: I guess I have to accept it because everybody seems to agree to it.

Mr. Motley: We're using interchangeably the principal of the Permanent Fund and the entity of the permanent Fund, that's what you're concerned with?

Mr. McDowell: Let's put it aside for now. Finish the bill and then see if there are any problems with this part.

Mr. Love: Is there going to be someone from the Attorney General's office here if we should need any legal help?

Mr. Gallagher: When the Governor's Office saw the bill they said it was a very professional looking bill and was it drafted by the Department of Law.

Mr. McFarland: I think in the normal process of this bill it will pass through these types of hands.

Mr. Pihl: A question on paragraph 020 - whether it should not read "at least twenty five percent" and also provide for the legislature to establish a percentage at something higher than that annually if they so choose.

Mr. Love: You could say 25% plus money appropriated annually.

Mr. Allen: That isn't how the Constitution reads.

Mr. McFarland: The money has to come from mineral resources.

Mr. Allen: Where does it have to do with the budget?

Mr. Gallagher: This bill will last from year to year. If you set a good number it will last without getting another bill introduced. Let's go through section by section, 020.

Mr. Edenso: I would like to ask the committee to announce their feelings on 020, paragraph 1, the amount needed to pay the operating and administrative expenses of the Permanent Fund. I think that's a very important item.

Mr. Gallagher: I thought we would take that up under the budget section.

Mr. McFarland: Under allocating a reserve account. Do you contemplate holding out reserves at national schedule -- 3%, 5%, or whatever the national norm is?

Mr. Gallagher: No, this reserve is a financial reserve, and under 090 it says, "consistent with sound financial practices." In other words, an audit or CPA firm looks at the quality of the assets, they will pick a number that is appropriate and reserve for bad debts.

Mr. McFarland: Are you going to rely on them to pick the number that you reserve?

Mr. McDowell: They will evaluate management's estimates and comment accordingly.

Mr. McFarland: Bad debts come out of dividends and not out of the general fund -- not out of the expense fund.

Mr. Motley: It will come out of reserves.

Mr. Swick: Are the provisions of one and two of 020 the law that is allowing you to keep earnings from going to the general fund?

Mr. Gallagher: Yes.

Mr. Swick: Does the words "reserve account" address itself only to the reserve for bad debts concept or does it go beyond into a credit reserve for some other entities?

Mr. Motley: It's not just reserve for bad debts. I think it's broad enough in its language.

Mr. Richards: We are limited to 25%.

Mr. Love: Should we be recommending 35% the first year? Is 25% too low or is it about right according to the revenue needs of the State?

_ Gallagher: I'll be discussing that with the Governor on Friday. There is a possibility that it will be a figure other than 25%.

Mr. McFarland: How about 025 (b)?

Mr. Love: I got a little lost with "reasonable proportion of longer-term . . . " What do you mean by "reasonable?"

Mr. Motley: It's a limit factor.

Mr. Gallagher: We had a hard time with definitions in (c), so we finally defined it as to municipalities and state agencies, things like that. In (b) the words "private enterprises" does not include things that are not enterprises. A person in a single family dwelling is not an enterprise.

Mr. Motley: But you've covered it under (c). Public corporate entities.

Mr. Gallagher: How about private businesses? How about changing the word "enterprises" to "entities"?

Mr. Allen: How do you define "entity"?

Mr. Gallagher: A home is a productive asset of an individual. Where does it fall under these three definitions?

Mr. Richards: Housing loans?

Mr. Motley: Why don't you add that. Say productive private enterprises and home loans.

Mr. Edenso: I would suggest that when you are financing a home that it is an investment grade security -- mortgage of some kind.

Mrs. Fleischer: Is that true of every home you finance or just some homes?

Mr. Love: How about the center for old people in Fairbanks?

Mr. Gallagher: I move that we amend section (b) -- strike the word "enterprises" and put in the word "entities".

Mrs. Fleischer: I think it should be clear that home loans be in here, and if changing the words to "entities" doesn't do it, then we should add a (d) and do it that way, but we should do it explicitly.

Mr. Edenso: Why don't we take the last sentence and say, "These investments may take the form of equity, loans, mortgages, home loans, housing financing, or loan guarantees," or something of that nature.

Mrs. Fleischer: That would satisfy it, I think.

Mr. McDowell: I'll explain this best by example. The way (a), (b), and (c) are written, the mortgage on a specific home of somebody in the State or anywhere else, would be financed under (a) or (c). An investment in a home building company, privately owned, would be financed under (b). But if you squeeze (b) and allow it to do what (a) and (c) should be doing on home mortgages, then I don't think you will ever make an investment in the home building.

Mr. Gallagher: Then I would move it into a (d) category. I'll withdraw my previous motion.

Mrs. Fleischer: I'll second the withdrawal.

Mr. Gallagher: I move that we add an additional section called (d) that the Permanent Fund may invest not more than blank percent of its resources to provide a reasonable portion of long term investment capital for financing the establishment, improvement, and expansion of, - - I want to use a word that describes housing but that is productive. I want it to specifically include the Alaska Housing Finance Corporation but I don't want to preclude it.

Mr. McFarland: Is a house considered an investment grade security?

Mr. Gallagher: Your mortgage is.

Mr. McFarland: Do you want to write another section to cover housing and let someone else write it out for us?

Mr. Gallagher: Yes.

Mr. McFarland: Is that agreeable to everybody? Will you have somebody do that?

Mr. Edenso: Draft a (d) on dwellings.

Mr. Love: I would move on section (b) on the second line, the word "longer term" is removed, and ask for unanimous consent.

Mr. Motley: What's your motion?

Mr. Love: To deduct the word "longer-term" on (b), second sentence down.

Mr. McFarland: In other words it would read, "The Permanent Fund may not invest more than "x" percent of its resources to provide a reasonable proportion of investment capital for financing the establishment, improvement, ... " etc.

Mr. Love: I don't think we should limit ourselves in terms of long or short term. I'll make a motion to remove the word, "longer-term" from (b).

Mrs. Fleischer: I'll second it.

Mr. McFarland: All those in favor signify by saying "aye". Opposed? Motion lost.

Mr. Edenso: Is it the direction of the committee that we do want a section (d)?

Mr. McFarland: Yes.

Dr. Logsdon: Could I have an explanation of the term "equity" in the last sentence?

Mr. Motley: You could buy stock in a company, for instance.

Mr. Richards: This would imply equity as distinguished from debt or ownership.

Mr. Love: Or ownership? Isn't equity ownership?

Mr. Motley: You could buy stock. Isn't that equity position?

Mr. Love: Are we going to move on any of the specific percentages of any category?

Mr. Gallagher: Yes.

Mr. McFarland: I hate to see us lock in the percentages because this is not easy to change should it become law. The requirements of Alaska shift all the time.

Mr. Pihl: I think the words "at least" in (a) provide us with that flexibility, and that we really ought to recommend percentages.

Mr. Motley: In some place you put a floor and in another place you put a ceiling.

Mr. McFarland: Jim, do you have any recommendation on percentages? Do you want to get into that right now?

Mr. Love: Maybe 40% for (a) and 30% for (b).

Mr. McFarland: Let's do them separately. Forty percent for (a).

Mr. Edenso: I'm still not convinced that we need to add a (d) section.

Mr. McFarland: All those in favor of adding a (d) section say "aye". Motion carried.

Mr. Edenso: We're talking about three sectors of the overall economy. The public area, the private area, and the concept of the savings account. I believe you're going to lock in the investment committee to making a certain number of loans in the housing area regardless of the credibility or desirability.

Mr. Allen: We don't want to do that and I hope it doesn't come about.

Mr. Motley: There is only one floor and that is in investment grade securities.

Mr. Allen: I think you did a good job and I understand the language and the intent, but if someone else doesn't understand you can tell him it is right there in (d).

Mr. Gallagher: There is nothing in my area of investment grade securities that includes the word "mortgages".

Mr. Edenso: In (b) we might be able to say, "These investments may take the form of equity, loans, housing loans, or loan guarantees."

Mr. Gallagher: The reason I want to put a lock on housing was to make sure it didn't swamp private enterprise, so that's why I want a section (d).

Mr. Edenso: At no other place in the bill are you referring to any particular section of the economy. You don't refer to fishing per se, or forest products per se, so you're going to get the question raised "why not so many percent to something else?"

Mr. Gallagher: How about productive private enterprises and housing?

Mr. McDowell: Put it sepearately if you're going to put it in, otherwise one could crowd the other out.

Mr. Gallagher: We don't want to use the word "housing".

Mr. Love: We could change it to expansion of productive private enterprise and facilities which will benefit Alaskans. That could include utilities, houses, etc.

Mr. Richards: I don't think you would find any economist who would go along with the notion that housing is included in the intent of a bill that used the word "productive".

Mr. Love: Well just eliminate "productive" and have private enterprise by itself.

Mr. Richards: Why don't you just explicitly deal with the matter of putting shelters over people's heads as a separate item.

Mr. Gallagher: Alright, I move that we have a (d).

Mrs. Fleischer: I second it.

Mr. McFarland: Any further discussion? All those in favor signify by saying "aye". Opposed? Motion carried. Let's go to percentages now.

Mr. Love: 40% -- 20% -- 20% -- 20%.

Dr. Logsdon: 40% -- 25% -- 25% -- 10%.

Mr. Gallagher: I move 40% -- 25% -- 25% -- 10%.

Mr. Pihl: I'll second it.

Mr. McFarland: Moved and seconded. Any discussion?

Mrs. Fleischer: Is there a ceiling or a floor on housing?

Mr. Allen: There is a ceiling.

Mrs. Fleischer: In other words you're saying no more than ten percent in housing.

Mr. Gallagher: Ten percent would be $180 million in direct loans. That doesn't mean you can't assist it through loans of Alaska Housing Finance under (c).

Mrs. Fleischer: I would speak against the motion because I want to see 50% in (a). If the purpose of the Permanent Fund is to conserve a portion of the State's revenues for the ultimate benefit of present and future Alaskans I think we should put 50% in (a).

Dr. Logsdon: All of it is towards conservation of the principal.

Mr. Love: At this point we shouldn't lock outselves out of investment opportunities in Alaska.

Mr. Allen: You've got to consider your yield is going to be less.

Mr. Love: I think 50% is too high.

Mr. Reed: I like the idea of "at least" 40%. It does allow you the flexibility if the market warrants it to go up higher in securities.

Mr. McFarland: Any more discussion? Motion is 40% -- 25% -- 25% -- 10%. All this in favor signify by saying "aye". Opposed? Motion carried.

Mr. Richards: At the very last page, the very last line of page 520, just scratch loan or loan guarantees and substitute the words "and debt".

Mr. Gallagher: The words "and debt guarantees".

Mr. McFarland: Do we have a motion?

Mr. Gallagher: I move that the last sentence read, "These investments may take the form of equity, debt, or debt guarantees."

Mr. Edenso: Why don't we just say, " ... equity, debt, debt guarantees, loans, or loan guarantees."

Mr. Gallagher: On (c) to include that same language. Instead of loans, debt guarantees. I have amended (b) and (c) to "take the form of equity, debt, or debt guarantees."

Mr. McFarland: Is there any objection? Hearing none, motion is approved. We'll go on to Policy Board.

Dr. Logsdon: On (c), may I ask a question? I presume that on community development projects of municipalities, that taxes are the security?

Mr. Gallagher: No, it could includ revenues.

Dr. Logsdon: Or revenues. It's hard to foreclose on a municipality.

Mr. Gallagher: It isn't that hard.

Dr. Logsdon: So it is taxes that are the security.

Mr. Gallagher: All the revenue.

Mr. McFarland: All right. We'll go to the Permanent Fund Policy Board now.

Mr. McDowell: Could I suggest a wording for (d)? (d) Permanent Fund may invest not more than ten percent of its resources in private housing in the form of debt or debt guarantees. Private housing in public sector (c) could include all public sector housing.

Mr. Gallagher: Does (d) limit you to single family dwellings, because private enterprise includes whole type families, then it's rental situations.

Mr. Love: Does this limit (a) from investing in profitable mortgages as investment securities -- really highly rated mortgages?

Mr. Gallagher: In the Federal nomenclature an investment grade security isn't mortgages.

Mr. Love: It isn't?

Mr. Richards: It depends on what you are mortgaging. I think the intent of what Jamie is raising is a valid concern.

Mr. Reed: Housing mortgage loans are not normally considered to be an investment grade security.

Mr. Edenso: If you include this you're going to get in direct competition with the savings and loan institutions. There is one political hazard there.

Mr. McFarland: I don't know that you are competing with the banks. You can do this through the banks if its possible.

Mr.Edenso: If you'ge to buy from savings and loans and commercial banks, then why do you need (d)?

Mr. Gallagher: You are buying individual loans, you're not buying the banks.

Mrs. Fleischer: You might also want to buy individual loans because there may not be any other way for people to get loans for private dwellings in the bush areas.

Mr. Love: I think by limiting to 10% you could be making it so you couldn't participate to the maximum extent you might want in the secondary money market.

Mr. McFarland: There is a lot of other State money available for this type of loan.

Mr. Gallagher: You can also make the loans from (c). You've got three areas from which you can do housing loans, (b), (c), and (d). The only thing (d) does it makes it for a single family dwelling.

Mr. Love: Maybe it should be in addition to any housing under (b) and (c) the Fund can enter into mortgages up to ten percent.

Mr. Reed: That clarifies it.

Mr. McDowell: Mortgages for private dwellings in Alaska.

Mrs. Fleischer: So it would read, "In addition to any housing loans under (b) or (c), the Permanent Fund may invest not more than ten percent of its resources in private dwellings in Alaska in the form of debt or debt guarantees."

Mr. McDowell: " ... the Permanent Fund may invest not more than ten percent of its resources in private dwellings in the State of Alaska in the form of debt or debt guarantees."

Mr. McFarland: You heard the motion. Is there any objection? Hearing none, the motion is adopted. There is a new section (d). All right, the Policy Board now.

Mrs. Lehr: We had no discussion previously about who should be the cabinet members on the policy board. When we voted on the issue it was two cabinet members and in section (a) they are specified. I would like to suggest the possibility of changing this to "consisting of the Commissioner of Revenue and the Director of the Division of Policy Development Planning." I think it would be prudent to have someone from the Governor's Office who has dealings with all State agencies and policies, on the policy board in order to facilitate that coordination between general State policy and the Permanent Fund activities.

Dr. Lehr: I'll make a motion to that.

Mrs. Fleischer: I'll second it.

Mr. McFarland: Motion seconded. Discussion.

Mr. Love: I'm opposed to the motion because the Governor already has a lot of influence with the two commissioners on the policy board. I think instead of having someone from the Office of Planning Development it should be someone more like the Commissioner of Community and Regional Affairs and the Attorney General.

Mr. Gallagher: I'm opposed to the motion as proposed too because a lot of the programs that we may be investing in or the policy committee are investigating, have a very close coordination with the activities of the Department of Commerce. Currently there are programs in the Department of Commerce -- renewable and non-renewable resources -- that have to be coordinated with the Permanent Fund, therefore, I think it necessary for the Commissioner of Commerce to be on the board for the close coordination of these other programs. The reason for the Commissioner of Revenue is that he is chief financial officer of the State. I feel that it has the correct commissioners.

Mrs. Fleischer: I want to support the intent of the motion. I would like to see it broadened and was thinking of the Commissioner of Environmental Quality. Would it be totally out of line to have the policy board approved by the legislature?

Mr. Gallagher: Only State boards are confirmed where they are of a regulatory nature and not an executive function.

Mrs. Fleischer: So you would have to broaden the membership of the policy board to include commissioners who are confirmed.

Mr. Gallagher: I think the present membership is adequate.

Mr. McFarland: I think these two cabinet officers should be appointed by the Governor and these are the two people he would appoint -- the Commissioner of Revenue and the Commissioner of Commerce.

Mr. Love: I think the Commissioners of Revenue and Commerce should be on it but I also think the Commissioner of Community and Regional Affairs should also be there because of their work on community development and municipalities, then of course the Attorney General should be there so he could work closely with the Governor.

Mr. Pihl: I would like to speak in favor of leaving it as it is. I assume there is interchange between the people we're talking about at the cabinet level, and I think the whole bill provides for input from the various elements.

Mr. Edenso: I would speak also in favor of leaving the board makeup as it is currently recommended in the proposed bill. Primarily I disagree with having the Attorney General included on the policy board. Certainly the Commissioner of Commerce and Economic Development has two major areas of concern in the State. One is the regulation of business throughout the State, licensing, etc., securities, corporations, and at the same time he has responsibility for stimulating the economy, direct loans to businesses, economic planning, etc. He does work with other cabinet members, so I think he is a very important person to the ongoing activities of the policy board. Although the Commissioner of Community and Regional Affairs does have responsibility for revenue sharing this is not revenue sharing type programs. This is an investment type program.

Mr. McFarland: Could we have the motion stated again?

Mrs. Lehr: I'm willing to withdraw the motion. I think it's fairly clear that the majority of the committee are in favor of retaining the commissioners.

Mrs. Fleischer: I'll withdraw the second if the motion is withdrawn. But the overall problem as far as I can see, is how we assure that the policy board is going to actually be acting in accordance with the desires of the people of the State. In other words, how are you going to assure that they're going to be responsive?

Mr. Reed: I have one suggestion that I've done a lot of thinking on and have discussed with a number of legislators as a potential. I would like to see consideration being the public's direct input into the policy board on policy. It looks like the Governor has way too much power to put his philosophy in. He's appointed his commissioners and apparently he then appoints all seven other members. In effect, he has appointed nine people to the nine member board. I would like to see the public have a direct input through the election of three members run on a state-wide basis for election to the policy board. It could be a compensated position but one who would have direct input from the people.

Mr. McFarland: What kind of qualifications would you set for a member of this board?

Mr. Reed: I think the public and the electorate would set the qualifications for the members of the board. On the elected people the population will determine them. I think that the people who would run for this would be some of the more renowned people in the community.

Mr. Edenso: Your suggestion virtually insures that three people from Anchorage will be on that board.

Mr. McFarland: Anyone want to make a motion.

Mr. Love: I'll make a motion that we have an additional member from the public and the Commissioner of Community and Regional Affairs -- an eleven member board.

Mrs. Fleischer: I'll second it.

Mr. McFarland: Any discussion?

Mr. Gallagher: I would object. The Governor always has a very loud voice on this. By adding a commissioner who has an unusually loud voice it gives the Governor more predominance, and I would object.

Mr. Allen: I object on the same grounds.

Mrs. Fleischer: My concern is that there be a little bit broader input on the part of the cabinet members than just economic development and commerce. I think there are other factors to consider besides commerce.

Mr. Gallagher: They have the chief financial officer of the State.

Mrs. Fleischer: Are you saying that generally they would provide a check and balance because of their departments?

Mr. Gallagher: Yes.

Mr. Love: I would still like to have the Commissioner of Community and Regional Affairs on as he is the one who does more with the individual communities.

Mr. McFarland: You say that Commerce is strictly a business deal. What departments do you have under the Department of Commerce?

Mr. Gallagher: Economic Enterprise, Veterans' Loans, Small Business Loan Department, Banking Securities, Tourism and ATC, APUC, ASHA, HFC, Occupational Licensing.

Mr. McFarland: That sounds pretty heavily consumer oriented to me.

Mr. Rose: I would speak for Community and Regional Affairs. Of all the State agencies it was created as a result of municipalities' desire to have representation somewhere in State government, it is probably the one agency that has the firmest grasp and they are certainly in the best position to know what the pulse is in the various communities, what they're trying to put together, their goals and aspirations.

Mr. McFarland: Any further discussion? All those in favor of the motion say "aye." Opposed? Motion's defeated.

Mrs. Fleischer: I move that we add a word in the first sentence of (a). "There is established the .... the Commissioner of Revenue, and seven members to be appointed by the Governor, with geographic distribution to be a factor."

Mr. Love: I second it.

Mr. McFarland: Any discussion?

Mr. Gallagher: I object because I think the Governor will naturally do that. I don't think we would have to tell the Governor his business.

Mr. McFarland: All those in favor of the motion say "aye". Opposed? Motion defeated.

Dr. Logsdon: This says may not be employees of the State. I wonder if it should include municipalities as well as State?

Mr. Gallagher: I have a motion. I would like to strike the word "by lot" in (a) and as determined by the Governor.

Mr. Love: I'll second that.

Mr. McFarland: Is there any objection to that?

Dr. Logsdon: Yes.

Mr. McFarland: Objection to the motion made and seconded. Discussion.

Mr. Gallagher: On other boards I've been on, when we had controversial members we always put it on a short term basis to see how it would work out.

Dr. Logsdon: That's the same objection I have. If you want to constitute the board as you want it, you appoint them for the entire length of term you want. If you do it by lot that removes this possibility of that much control.

Mr. Edenso: The first appointment will be like that; after that they will be for a full four-year term.

Mr. McFarland: All those in favor of the motion signify by saying "aye". Opposed? Motion carried. We'll go on to (b). The president of the Alaska Permanent Fund shall serve as the chairman of the policy board but shall not be a voting member. Is there any objection to that?

Mr. Love: Yes. I've always beenopposed to the president being the chairman of the board. I think if the board can have an independence of its own I think it is best to elect its own chairman. I would move to change that to say, "The president of the Alaska Pemanent Fund shall serve as a member pro tem without a vote on the board, and the board will elect its own chairman."

Mrs. Fleischer: I'll second it. I'd like to hear the thinking on it though.

Mr. Edenso: I would like to speak against that motion. The reason we've selected the president to be the chairman of the board and a nonvoting member of the board is because he would become a natural tie between the investment advisory committee and the policy board, and not direct the policy of the policy board. The members of the policy board make their own decisions concerning those policies based on the performance of the investment advisory committee and based on the relationships they developed both with the legislative body and with the public at large.

Mr. Pihl: I would speak in favor of leaving it just as it is. I've had access to several boards of corporate entities and I find in practice that this is the way it works effectively. You might consider changing the word "serve" to "act as". The president shall act as president of the board.

Mr. Love: This is about the craziest relationship I think we can come up with. The president is really the hired staff to run the Permanent Fund and as chairman of the committee, he expects the committee to have a lot of independence. The chairman is traditionally going to be running the meetings and have a lot of influence.

Mr. McFarland: The chairman generally has less to do with it than anybody else, and I think putting him as chairman disarms him completely.

Mr. Love: How can they discuss the firing of the chief executive officer with the chairman of the board sitting there?

Mr. Edenso: Any time the board wishes to discuss performance of anybody they are perfectly capable of doing so. They can ask that individual to leave. They set their own rules as to how the board itself operates.

Dr. Logsdon: How do other funds handle this?

Mr. McDowell: Most of them combine the investment committee and the policy decision board in one board, then there is another board of governors. Dealing with the one that makes policy, the president usually chairs it. Also usually, he has a tie-breaking vote when they have an even number of members. He has a tie-breaking vote only but he does chair. It's done for administrative convenience. This is when they are in their sessions on policies, forgetting about when they reconstitute themselves into the investment committee. It;s done to insure that the full communication between the link -- the one person who is the link from policy to implementation is the president or chief executive officer. It insures that he understands completely because he sat right there during all this discussion the policy board committee had on what they want him to do and see that it gets done. Another thing it is usually a recognition of the fact that in any of these institutions one individual is most accountable to everybody, including the public, and the most visible to the public is that chief executive officer. They are also the ones who hire the president.

Mrs. Fleischer: So instead of electing a chairman they hire him.

Dr. Logsdon: Yes.

Mr. McFarland: Any further discussion? The motion is, "the president of the Alaska Permanent Fund shall not serve as chairman of the policy board." All in favor signify by saying "aye". Opposed? Motion defeated. Any objection to (c) as it is written? No objection. (c) is adopted. (d) Members shall receive no compensation, is there any objection to that? Hearing none, it is adopted. Duties of the Policy Board. (1) Select and appoint the president and other members of the investment committee. Any objection? Hearing none it is adopted. (2) Annual review and approve long range operating plans, to include an investment program based on sectoral analysis of the Alaska economy, the budget for the forthcoming year, and the financial plan for the following years.

Mr. Gallagher: Is the sectoral analysis required before you make any investment in any area?

Mr. Edenso: It doesn't seem like you would want to make the investment before you do it.

Mr. Love: I think it's satisfactory the way it's written because the intent is there.

Dr. Logsdon: Who does the sectoral analysis?

Mr. McDowell: That's part of the ordinary business of the Fund. The Permanent Fund arranges for it.

Dr. Logsdon: Then it's administrative costs?

Mr. Gallagher: Yes.

Mr. McFarland: Is there any objection to (2)? Hearing none, it is approved. No. (3).

Mr. Gallagher: I move that on (3) we expand the idea of relationship.

Mr. Edenso: I would like to point out that you say you are going to have a relationship, and I assume that the board would undertake to establish some kind of formal process for doing that.

Mr. Gallagher: I'm trying to address the problem of local communities -- making sure they contact them.

Mrs. Fleischer: We should do it under operating principles.

Mr. McFarland: Why don't we, under (3) say "have sole responsibility for establishing relations with the general public, legislature, etc."

Mr. Love: I think (3) is satisfactory. Maybe we need to add another section (10) which deals with relationships between muncipalities.

Mr. McFarland: (4) review quarterly reports from the investment committee concerning decisions and supervision. Any objection to that? Hearing none, it is approved. (5) review, consider, and approve policies. Any objection? Hearing none, it's approved. Review and publish an annual report including financial statements audited by independent outside auditors.

Mrs. Fleischer: Such publishment being required in at least one state-wide newspaper.

Mr. Edenso: Normally you publish only the financial statement but you don't publish the complete annual report. You could request that the financial statements of the Permanent Fund be published. You don't have to specify whether it goes into a state-wide newspaper or not.

Mr. Fleischer: I think it should be in a newspaper. I don't want to see it in its own little booklet that will sit in an office of various departments. It should be in the newspapers.

Mr. Edenso: The report will be formally made to the legislature. That is very wide public exposure.

Mrs. Fleischer: I would like for the person on the street to pick up a newspaper and see what is happening to the Permanent Fund.

Mr. Edenso: One of the greatest impacts you will get is the distribution of income. If the Permanent Fund is not performing, the first people who are going to pick it up are the legislators and the Governor's office. And finally, when the thing is not distributing or earning any income that's going to be obvious to everybody.

Mrs. Fleischer: If it is published in the newspaper it will help make sure that decisions that are made all year long will be as prudent as possible.

Mr. McDowell: You could have that down in 120, Reports and Publications.

Mr. Gallagher: An annual report should be sent out, but publishing it in a newspaper would be awkward.

Mr. Edenso: Normally all stockholders in a corporation get a copy of the annual report.

Mr. Gallagher: I agree that it should receive wide distribution and leave the question open as to what media it takes.

Dr. Logsdon: I don't think you will have to require it, I think if you issue it it would be published.

Mr. Pihl: I think that requiring it to be published in a newspaper is awkward and costly. We've got in here that it would be published and I'm sure it would be available throughout the State.

Mrs. Fleischer: I understand it will be made available. But there is a big difference between making something available and people getting it -- all records are available to anyone who wants to go to Juneau or some office and look up the file. I think it should be mandated that it be published in the newspaper, as the fore-closure lists are published. I think it would be a very good preventative in terms of making sure the decisions are above-board and as wise and prudent as possible. There's nothing like public exposure; that's the whole principle of democracy.

Mr. Gallagher: I would go for it as saying wide distribution, leave the media and the form it takes to the board - a management decision what they determine as wide distribution.

Mrs. Fleischer: I still say it should be published. How do they determine the foreclosure lists?

Mr. Gallagher: I publish an annual listing of my assets in every newspaper once a year and the State Treasury twice, and it says in the four judicial districts in one newspaper.

Mrs. Fleischer: All right. Say that.

Mr. Gallagher: Listing the assets is fine, but all the 17 pages of footnotes?

Mrs. Fleischer: Does the financial statement say who has gotten what loans for what purpose?

Mr. Gallagher: They are set up in a category. You will have U. S. Treasury bonds, corporate bonds, you'll have housing loans "x" dollars, fishery loans "x" amount, and you will have that sort of a breakout. You won't have everyone's name listed.

Mrs. Fleischer: It won't say which fisheries group or which corporation?

Mr. Gallagher: It depends on whether it is a significant amount. In an annual report you don't really report its segment, nor really describe it too much unless it's greater than five per cent of the assets.

Mr. McDowell: CPA firms put out a financial report that breaks down the amount of business we're talking about. List individually the things are are large and group together small things. So you have 40% of the fund minimum going into investment grade securities -- not a listing -- just probably eight categories and the dollar amount in each one and the income from the whole group . On the development project side you would probably list all the big ones.

Mr. Gallagher: It's not really of that much interest to anyone.

Mr. Edenso: The greatest amount of interest you're going to get is how much the Fund makes.

Mr. Gallagher: That's right. I don't think the people have a real high interest in who got what loan.

Mr. Fleischer: There shouldn't be any cause for that, but there could be.

Mr. Gallagher: Because of public information rules, under confidentiality, that is available if the newspaper wants to go and report it, the Fund has to disclose it. But it's only when its noteworthy that they come and look for those things.

Mr. Edenso: The annual report merely states the condition of the company at a point in time and its performance over a period of time. It doesn't break down a specific loan or investments. It's an aggregate report as to condition and time.

Mrs. Fleischer: I really think the people would be interested in knowing where the money is going in the State in terms of development loans. Why can't we have the audited financial statement put in at least once each year in one newspaper in each of the four judicial districts.

Mr. McDowell: I think the two statements that are the most important are the income statement and the balance sheet. Those are recognized terms and it will limit it to two pages. Then in the ad you could state if they want the full report to write to a certain place and it will be sent to them.

Mrs. Fleischer: All right. The income statement and balance sheet shall be published in at least one newspaper in each of the judicial districts.

Mr. McFarland: Any objection to that? Hearing none, it's dopted. Let's go back to number 7, page 4. Any objection to that one? Hearing none, it's adopted. Number 8.

Mr. McDowell: This makes them the court of last resort for a person who wanted an investment and was turned down on the basis that the investment was not in accordance with the policy of the Permanent Fund in accordance with this law.

Mr. Edenso: It gives the policy board the opportunity to deal with disgruntled people.

Mr. McFarland: Any objection to eight? Hearing none, it's approved. Number 9. Any objections? Hearing none, it's approved.

Mr. Swick: Is there anything in there anywhere th-' tells about performance.

Mr. McDowell: The reviewing end of it would be done by the policy board. The doing of it is someone else's responsibility.

Mr. Edenso: The Permanent Fund shall carry out operational evaluations (post-audits) of its investments and investment programs and report the results to the policy board audit committee.

Mr. Swick: That's a report of what has happened. Is it an evaluation?

Mr. McDowell: Well, what is a performance evaluation?

Mr. Swick: Has what the investment committee done as good as it might have done?

Mr. Edenso: We've got a measure of performance by some criteria, and one of the criteria is in accordance with the policies that have been formally adopted by the policy board.

Mr. McDowell: The use of evaluations implies a standard.

Mrs. Fleischer: Why can't we use the word "performance" evaluation rather than "operational" evaluation?

Mr. Pihl: Could you say "operational and performance evaluations"?

Mr. McDowell: Yes.

Mr. McFarland: Any objections to that? That's inserted in number 10, page 7.

Mrs. Fleischer: So that would read, "the Permanent Fund shall provide for operational and performance evaluations (post-audits) of its investments and investment programs and report the results to the policy board audit committee."

Mr. McDowell: Which is the recipient of all audit reports.

Mr. McFarland: Let's go back to page 4, section 050, Permanent Fund Investment Committee.

Mr. McDowell: The policy board determines the remuneration and the terms of of service, including how long their terms are for the investment committee. They have complete control over the investment committee except on investments.

Mr. McFarland: Any objection to section 050 - section (a)? Hearing none, it's approved. (b) A quorum shall consist of four members of the investment committee. All decisions will be taken by majority vote. Any objection to that? Hearing none, it's approved. Section 060, Duties of the Investment Committee. Sole responsibility to approve all investment proposals and review all investments in investment grade securities.

Mr. Gallagher: We mean by this last little part that the money market changes from day to day and they should review those immediately after they are made. If they don't like it to tell the investment officer to get rid of it, but we don't want them to make prior approv . On all other investments, prior approval is necessary.

Mr. McFarland: Any objections? Hearing none, it's approved. 070, Permanent Fund President. Shall be appointed by the policy board for a term of five years, may be reappointed and shall serve at the pleasure of the policy board. Any objection to that? Hearing none, it's approved. The president shall (1) have sole responsibility for presenting investment proposals to the investment committee. Any objections to that?

Mr. Pihl: The word "sole". Suppose you have an outstanding president and he is ill for a period of time, does that preclude us from doing anything?

Mr. McFarland: You would have an acting president then.

Mr. McDowell: You would set up the internal rules and would have to make provision for that.

Mr. Edenso: He can delegate it.

Mr. McFarland: Okay. Number (2) be responsible for the ordinary business of of the Permanent Fund and the organization, appointment, dismissal, and remuneration of the officers and staff. Is there any objection to that? Hearing none, it's approved. (3) be responsible for making investments in investment grade securities, subject to review by the investment committee. Any objection? Hearing none, it's approved. (4) establish and maintain adequate and appropriate organizational, operating, and financial controls. Any objection? Hearing none, it's approved. Section 080, Status of the Permanent Fund. The Permanent Fund shall be excluded from the provisions of the Executive Budget Act. The president, officers, and staff of the Permanent Fund are in the exempt service.

Mrs. Lehr: Our concern here is for a means of legislative input to the Permanent Fund short of changing the charter. The way the bill is set up now the legislators are not members of the policy board nor do they confirm the private members of that board. Their only input is the confirmation of the two commissioners that are on the board. We're looking for a vehicle by which they will have input and a view of what the Permanent Fund is doing through the regularly established procedures. Under the Executive Budget Act the operating expenditures would go through the regular budget process. They would be reviewed by analysts in the Executive Branch and the Legislative Branch, and the performance would be reviewed. This would give the legislature a time and context in which to look at the performance reports on what the Permanent Fund is doing. It would also give the management of the Permanent Fund a good forum for interchange of ideas with the State on what other programs are going on, to assure some coordination.

It would be unfortunate if a great deal of State expenditures were going out through the budget into programs which the Permanent Fund is also spending amounts on. It would be an opportunity for coordination -- for understanding between what the Permanent Fund is doing and what the State government as a whole is doing.

As an alternative, if the legislators have nothing short of changing the law that you may end up with much more restrictive legislation, more detailed, and more closely defined on exact investments which could be detrimental to the operation of the Permanent Fund. I don't think they will cut out any operating expenditures but it is a non-disruptive and non-damaging way of assuring some checks and balances and some legislative input.

Mr. Gallagher: Within the first month of any session the Permanent Fund shall make presentation before the joint finance committees of the legislature, give a briefing as to what they've done in the way of policies, their financial operations, what their budget is, what they've accomplished the year before, and where they are going.

Mrs. Lehr: That would be valuable, but still the legislature has no recourse if they don't like what you're doing except to change the law.

Mr. Gallagher: That's when you should review the budget with them.

Dr. Logsdon: What was the objection to the confirmation of the policy board by the legislature?

Mrs. Fleischer: It was unconstitutional.

Mr. Gallagher: The Attorney General says "the Legislature shall confirm commissioners and regulatory boards" it doesn't mean executive boards.

Dr. Logsdon: As we conceived this, the legislature was the primary board. They should have the power to confirm.

Mr. Gallagher: I will convey to the Governor that it is the firm feeling of the board that all members should be confirmed by the legislature.

Mr. McDowell: Could you put that in the form of a motion; that that's a recommendation and that it's not going in here because it's presently unconstitutional.

Mr. Gallagher: I'll make the motion.

Mr. Love: I'll second it.

Mr. McDowell: I strongly recommend that it be done, too.

Mr. McFarland: We have a motion, is there any objection?

Mr. Gallagher: Let me make the case for why it shouldn't be. If we have Alaska, Inc. or some sort of dividends flowing back into certain programs, you're making the Permanent Fund responsible for getting out and doing a good job and getting a market return. If the legislature has power over the budget, they can always point their finger to the legislature and say, "we couldn't get a return because we couldn't hire the highest qualified people to get the job done."

Mr. McDowell: If it is included in the Executive Budget Act then the legislature is accountable for the achievement of the purpose. If it is not included the policy board is completely accountable for achieving the purpose.

Mrs. Lehr: Do you think the legislature is held accountable for the operation of various State departments?

Mr. Gallagher: Yes.

Mr. McFarland: What are we doing with 080, approving it the way it reads? Any objections? Hearing none, it's approved.

Mr. Gallagher: I move that we approve the reserve section.

Mrs. Fleischer: That's fine with me. Under operating principles. The prudent person rule is fine, but I'd like to put something in front of it. Insert as (1) moving the rest down, "the policy board shall consult with local communities on any project that is impacted?"

Mrs. Lehr: How about the wording, "The Fund shall be sensitive to the views of the impacted community and shall include an analysis of those views and impact in the investment or loan proposal."

Mr. Edenso: I object to the use of the term "impacted". I think it's very bad analogy.

Mr. McDowell: How about as part of item 8 - operational principle. You could add "community views" to the list of other considerations.

Mr. Edenso: I wouldn't object to that if you struck "social".

Mrs. Fleischer: I don't think we should strike "social". I think people should be able to look at this legislation and feel the Permanent Fund would pay attention to the needs of the smaller communities. I feel it should be separately listed.

Dr. Logsdon: It says, "the Permanent Fund shall make investment decisions with regard to economic and other considerations" including this list.

Mrs. Fleischer: What language do you use to differentiate between -- I'm talking about cement plants?

Mr. Edenso: If a community really objects to an investment project proposed, they can always zone it out of existence.

Mrs. Fleischer: I just think it will make people feel better if they read this and they see those words in there.

Mr. McFarland: What are the words again?

Dr. Logsdon: "The Permanent Fund will make no investments in a community if the community objects to that investment."

Mrs. Fleischer: That's what I would like to see.

Mr. McDowell: Under the philosophy of general wording, those things in most cases have been left to be pointed out in this document as items where the

Permanent Fund is being put on notice about a certain area without being too detailed because we don't want to exclude other good things that could and should be done in the future which we don't know about now. It's cited that the policy board shall have relationship with local communites.

Mrs. Fleischer: That is not the same thing at all.

Mr. McDowell: But that's dealing with the general policy and investment program level At a specific investment level you're talking about economic, employment, income distribution, environment, and health and social. Now you'r just talking about adding one more.

Mr. Gallagher: "The Permanent Fund shall be sensitive to the views of the affected community and shall include an analysis of those views and effects in the determination of making large investments."

Mrs. Fleischer: I like that. I'll move for that.

Mrs. Lehr: I'll second.

Mr. McFarland: Moved and seconded. Any further discussion? Any objection? Hearing none, it's adopted.

Mr. Gallagher: Under duties of the policy board, number 10, "shall hold a hearing", or whatever other words are appropriate.

Mr. McFarland: "Within the first thirty days of the start of the session the Policy Board shall report to the Legislature." That will be item 10 under policy board. Any objection to that? Hearing none, that's approved.

Mr. Pihl: Under 080, I wondered if it would be wise to have an item 7 specifying the power to borrow and guarantee.

Mr. McFarland: It's covered under contracts. We're on page 5, down to Reserves. Any objections to 090, Reserves? Hearing none, it's adopted. Operational Principles, 100. The operations of the Permanent Fund shall be conducted in accordance with the following principles. Item (1), any objections? Hearing none, item (1) is approved. Item (2). Any objection? Hearing none, that's adopted. Number (3) shall not assume responsibility for managing. Any objection to that? Hearing none, it's adopted. Number (4). Any objection?

Mr. Gallagher: The word "subsidy" is buried deep in the paragraph. Perhaps it should be redrafted to enlighten what market rates are. They aren't the highest rate, they are like instruments.

Mr. McDowell: Terms and conditions normally obtained by private investors for similar financing.

Mr. Edenso: Why don't you just add it as a separate paragraph?

Mr. Gallagher: That might be fine.

Mr. McFarland: I like it the way it is. If there is a question they're going to ask for answers.

Mr. Edenso: I didn't have any problems with the way it was written.

Mr. Swick: I think the english would allow you to take the second phrase of the single sentence that starts, "unless the legislature...", just make that the first sentence.

Mr. Edenso: Then you're putting too much emphasis on the subsidy and not emphasizing the normal operations of the Permanent Fund

Mr. McFarland: Is there any objection to number (4) as it's written? Hearing none, it's approved. Number (5).

Mr. Swick: The word "seek" gives me some comfort, but shouldn't the word "shall" be "may"?

Mr. Gallagher: Yes. I move we adopt the word "may".

Mr. Pihl: I'll second it.

Mr. McFarland: "The Permanent Fund may seek to revolve its funds by selling its investments ..." Any objection to that wording? Hearing none, it's adopted. Number (6)"the Permanent Fund shall seek to maintain a reasonable diversification in its investments." Any disagreement with that? That's approved. Number (7). Any objection to number (7)? Hearing none, it's adopted. Number (8). We added something to that, didn't we?

Mr. McDowell: Second sentence -- "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".

Mr. McFarland: Any objection to that wording? Hearing none, it's approved. Number (9). Any objection to number 9? Approved. Number (10) we already agreed on -- The Permanent Fund shall provide for operational and performance evaluations. Number (11) Any objection to that? Hearing none, it's approved. Section 110, Borrowing Powers. Any objection to that paragraph? Hearing none, it's approved. Section 120, Reports and Publications.

Mr. McDowell: This is where we will add another sentence that says, "The annual income statement and balance sheet of the Permanent Fund shall be published in at least one newspaper in each judicial district."

Mr. McFarland: Any objection to that? Hearing none, it's approved. Section 140, Technical Assistance.

Mr. Gallagher: One thing I'd like to point out here is that technical assistance is an operating expense and therefore it's deductible under operating expenses.

Dr. Logsdon: So if there is no investment made this is an administrative cost?

Mr. Gallagher: Right.

Mr. McFarland: Any objections? Hearing none, 140 is approved. Section 150, Conflict of Interest Policies. Any objection to that?

Dr. Logsdon: Isn't legally "shall" a term that is used to be very positive rather than "will"? Such as "shall" disqualify themselves.

Mr. Gallagher: We've got a quorum requiring four people to be on the investment committee, three people are required if you need a majority and if one or two disqu lify themselves you'd never have a majority.

Mr. McDowell: They should be in the inevestment committee meeting because they have the most information to contribute to the discussion.

Mr. Gallagher: I'm just pointing out that when you say "shall" disqualify you're really cinching the requirements.

Mr. McFarland: You do, but I think you have to have it.

Mr. McDowell: It's a public fund.

Mr. Swick: Does the structure allow something like that to be elevated to the policy board?

Mr. McDowell: No. The policy board could consider interpretation of 150, but they can't consider the investment committee.

Mr. Edenso: Then they just consider their own investments at convenient times where they have a conflict of interest. You're not going to have all three of them walk in at the same time with some kind of problem.

Mr. Gallagher: But when you disqualify one, are you no longer in a quorum?

Mr. McDowell: The quorum applies to whether you can hold the meeting, and officially, it also applies to the vote. The majority vote must take place within the quorum; therefore, he can't disqualify himself after the meeting is started.

Mr. Edenso: That's only if they are addressing themselves to a particular investment. The meeting itself is not disqualified if they have a quorum because some may or may not have an interest in a particular investment.

Mr. Gallagher: But you've got to have four people there for every vote? If one person disqualifies himself.

Mr. Edenso: Then they can't vote on that investment. I think "shall" is probably proper, although I'm not dissatisfied with "will".

Mr. Pihl: I don't see anything in here that requires a member to make known any interest in something that is being considered.

Mr. McDowell: There is a disclosure law that is covered at the very end.

Mr. Pihl: What if he just doesn't come to the meeting? I think he should be required to make a disclosure of any interest.

Mr. Edenso: I think that's required under section three at the end.

Mr. McDowell: All right, let's see, "Members of the investment committee shall disclose their interest in any investment proposal and disqualify themselves from voting on it." How's that? That gets it during the interim before you have to report it.

Mr. McFarland: I doubt that anybody will be appointed to the board who will have to worry about financial disclosure.

Mr. Gallagher: I was just pointing out the problem. As an officer of a corporation do you have a financial interest?

Mr. McFarland: Only to the stock.

Mr. Motley: Why don't we leave it at any kind of financial interest.

Mr. Gallagher: Maybe it is something the policy board should handle itself.

Dr. Logsdon: You could require disclosure without disqualification. Let somebody else decide it for you.

Mr. Pihl: I really think the requirement for disclosure should be in.

Mr. Gallagher: I feel that it should be defined by the policy board, but I was trying to make sure that we don't put anything in the statute that prevents the policy board from making a reasonable judgment.

Mr. Edenso: Is our wording now, "shall disclose their interest in any investment proposal and disqualify themselves?"

Mr. Gallagher: I so move.

Mr. Motley: I second.

Mr. McFarland: Any further discussion? Any objection? Hearing none, it's adopted. Location of the Fund.

Mr. Gallagher: I move to strike that.

Mr. Motley: I second. Strike that whole section.

Mr. McFarland: Any objection? Hearing none, it's approved. Sec. 170, Confidentiality of information. Any objection to that? Hearing none, it's approved. Sec. 180, Tax Exemption.

Dr. Logsdon: I assume they are exempt from federal taxes?

Mr. Motley: Yes.

Mr. McFarland: Any objections to 180? Definitions - any objections to the definitions?

Mr. McDowell: I suggest you modify (3) to change loans and loan guarantees to debt and debt guarantees.

Mr. McFarland: Anything else under definitions? Hearing none, it's approved. Sec. 110, Policy Board Investment Committee. I don't know what that is.

Mr. McDowell: It's exempt service.

Mr. McFarland: Any objection? Hearing none, it's approved. Sec. 200?

Mr. McDowell: It adds the Permanent Fund, boards and commissions, members of which must disclose their financial interest.

Mr. McFarland: Section (4), Investments Outstanding. Any objections to that? Hearing none, it's approved. Five is an emergency clause. Any objection to that?

Mr. Gallagher: It takes effect immediately. I didn't want to wait 90 days.

Mr. McFarland: What was the other document we had?

Mr. Gallagher: That was the interim investment.

Dr. Logsdon: There was one section that we didn't approve. We approved everything except the one on the constitution of the Permanent Fund policy board.

Mr. McDowell: There was only one change and we approved it. The change was one sentence, "the initial term shall be one member serving" we just took out "by lot".

Mr. Pihl: That was "determined by the Governor" wasn't it?

Mr. Gallagher: The Governor sends down a letter saying you have a one year or five year appointment.

Mr. Edenso: It leaves it up to the Governor to do it.

Mr. Gallagher: There were a few minority opinions on a few subjects. When we send this to the legislature, how shall we include the minority views?

Mr. McFarland: Nobody asked to be recorded that way.

Mr. Gallagher: When it goes down to the legislature, do you want a report of why we did each section this way?

Mr. Motley: I think it's going to go through so much anyway that we'll never recognize it afterwards.

Mr. McDowell: It already exists as a matter of public record in the consultant's reports and the transcripts of all the meetings.

Mr. McFarland: Do you want action on the interim bill?

Mr. Gallagher: Yes.

Mr. Pihl: Does the interim legislation provide for getting the policy board and the investment committee in motion?

Mr. Motley: You can't do it without law.

Mr. Gallagher: I think we're going to do that right here.

Mr. Motley: It's cleaner just to leave it the way it is. The money is coming in and we've got to start putting it in investments.

Mr. Pihl: I just wondered about forming investment committees.

Mr. Motley: I think you're better off not doing it.

Mr. Gallagher: Does everyone understand number one is U. S. Government securities? Number two is things like the World Bank and Inter-American Development Bank. Number three is CD's - Corporate investment grade securities must be double A or above. Bankers acceptances; repurchase agreements one through five; deposits of S&L's not to exceed 10% of each S & L's deposits exclusive of federal, state, and municipal deposits, and that also goes for credit unions.

Mr. McFarland: Any objections? Hearing none, it's approved.

Mr. Edenso: Is that the whole bill?

Mr. McFarland: Yes.

Mr. Edenso: No changes to it?

Mr. Motley: Mr. Chairman, I want to compliment you on your ability to shepherd these two deals and you've done a good job of keeping it going.

Mr. McFarland: It was a well thought-out document, really.

Mr. Swick: I think the whole Investment Advisory Committee ought to be commended. You came up with a fine job.

Mr. McFarland: Meeting adjourned.

Meeting adjourned at 4:00 p.m.

CERTIFICATION

I, JIM EDENSO, Executive Secretary of the Alaska State Investment Advisory Committee, hereby certify that the foregoing Minutes of the January 6, 1977 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

Jim Edenso
Executive Secretary