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COMMITTEE REPORT HOUSE

FURTHER: FINANCE

March 6, 1979

Date: 3-7-80

Mr. Speaker:

The Committee on STATE AFFAIRS has had SSHB 240

"An Act creating the Alaska General Stock Ownership Corporation;
eff. date."

under consideration and (a majority of the committee) (the committee)
reports it back with the following recommendations:

- do pass do not pass
- do pass with attached amendments(s)
- replace with CS for SSHB 240 same title
 new title
- and recommends ~~same as above~~ [handwritten note]
- AND attaches a "Letter of Intent" New Fiscal Note
- reports it back without recommendation
- referred to the _____ Committee

**MEMBERS SIGNING
DO PASS**

Tony Gardner - Not Pass

[Handwritten Signature]

Ray M. [Handwritten] - Do NOT PASS

**MEMBERS HAVING
OTHER RECOMMENDATIONS:**

[Handwritten Signature] - No Rec

[Handwritten Signature] - No Rec

Tony Gardner - No Rec

[Handwritten Signature] " "

[Handwritten Signature]
CHAIRMAN

Kelsoism, GSOC, and AGSOC

**Prepared for
The House Finance Committee
ALASKA STATE LEGISLATURE**

by

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Table of Contents

| | Page |
|---|------|
| I. Executive Summary..... | i-v |
| II. Introduction..... | 1 |
| III. The Kelso Framework..... | 1 |
| A. Mixed Capitalism and its Fatal Flaw..... | 3 |
| 1. Maldistribution of Wealth..... | 3 |
| 2. Maldistribution of Income..... | 4 |
| B. The Kelso Program of Reform..... | 7 |
| C. Is the Kelso Program Workable?..... | 11 |
| D. Is There Really a Basic Maldistribution of Income?..... | 13 |
| E. Does Capital Diffusion Make Sense Outside the Kelso Framework?..... | 16 |
| IV. The General Stock Ownership Corporation..... | 17 |
| V. AGSOC: Some Administrative and Organizational Features..... | 21 |
| A. The Guarantee Issue..... | 21 |
| 1. Borrowing Without Creditor Protection..... | 22 |
| 2. Borrowing With a Guaranteed Loan..... | 22 |
| 3. Borrowing With a Loan Guarantee Fund..... | 23 |
| B. The Investment Decision-making Process..... | 25 |
| 1. Role of the Seller of the Asset..... | 25 |
| 2. Role of Creditors..... | 26 |
| 3. Role of AGSOC's Management..... | 26 |
| 4. Role of the Board of Directors..... | 26 |
| 5. Role of the Legislature..... | 27 |
| 6. Is an AGSOC-type Investment Possible?..... | 28 |
| a. Asset with a Finite Life..... | 29 |
| b. Asset with a Perpetual Life..... | 30 |
| C. The Holding v. Operating Company Issue..... | 31 |
| VI. Appendix..... | 34 |

Executive Summary

This report is divided into three parts: the Kelso framework; the GSOC; and the AGSOC.

The Kelso Framework. Central to the analysis of capitalism by Kelso and his associates is the alleged existence of a massive maldistribution of income: capital accounts for 90 percent of the economy's output but gets only 30 percent of that as income while labor produces only 10 percent and gets 70 percent. There is also said to be a maldistribution of wealth; 10 percent of the households own all of the capital assets. They argue that these two maldistributions are inherently contradictory and, unless corrected, Mixed Capitalism (i.e., the type of capitalism that exists in the U.S. today) will collapse into State Capitalism (i.e., the type of capitalism that exists in Russia today).

To prevent these developments, Kelso and his associates advocate a capitalist revolution--the creation of Universal Capitalism by the adoption of a gigantic capital diffusion program that would make new capitalists of the 90 percent of households that now own no capital. This revolution would require that corporations no longer retain earnings for purposes of internal financing, thereby compelling them to pass profits through to stockholders as dividends; would eliminate collective bargaining by unions; and would abandon the full employment and welfare transfer policies of the federal government. The magnitude of these changes would be huge; these changes, designed

to reduce the alleged maldistribution of income, would require that wages decrease by 85 percent and that the returns to capital increase by 600 percent. Similarly, the rate at which the economy would have to grow in order to effect this transfer would also be very large, given historic comparisons; they would have to be "several" times four percent.

We suggest that, even if this analysis by Kelso and his associates were correct, it is doubtful that such a program of action is feasible. If the economy were to expand to the extent and as rapidly as projected, we would expect inflation to be a major problem and that the levels of concentration and centralization in the economy would increase significantly from their present levels. More important, however, is the high probability that present economic/physical constraints on resources, especially energy, would not allow the necessary rapid rates of growth. The scope and speed of the proposed reform are beyond current economic/physical resource capabilities.

More determinative of the relevance of the Kelso framework, however, is the fact that the alleged massive distribution of income does not exist. Kelso and his associates provide no quantitative support for the existence of the 90-10/30-70 breakdown. It appears to be the result primarily of casual observation. Their version of such an income maldistribution has no known support among professional economists. It is argued below that, in alleging the existence of such a maldistribution, Kelso and his associates made a basic theoretical error. They overlooked the fact that entry and the competitive market dis-

tribute the results of particular productivity improvements, whether made by capital or labor, primarily to consumers in the form of lower prices rather than to capitalists and labor in the form of persistently higher profits or wages. Given this historic process, there is no justification for allocating exclusively to capital a persistent and high rate of return for having initiated a productivity improvement.

Although a capital diffusion plan is central to the analysis of capitalism made by Kelso and his associates, the invalidity of that analysis does not necessarily make capital diffusion also invalid. Such programs should be considered on their own terms and rated up or down on the basis of their own merits. This is true of both GSOC and AGSOC.

GSOC. The most important feature of the federal law that created the opportunity for states to create GSOCs was the refusal by Congress to grant two very significant tax exemptions that were initially sought. The failure to obtain these exemptions had three effects. First, the probability of a negative cash flow during the first years of a GSOC was increased. Second, this adverse effect on cash flow will increase the probable need and duration to finance losses during the early years of a GSOC. And, third, the possibility is increased that during these initial years a GSOC will not be able to pay dividends to its stockholders but will pass through to them a tax liability. During these years, the stockholders would be net losers.

AGSOC. We analyzed three administrative and organizational

features of AGSOC, as currently proposed: the guarantee issue, the issue of the investment decision-making process, and the holding v. operating company issue.

In connection with the guarantee issue, we concluded that a loan guarantee fund would undoubtedly be required by private creditors of an AGSOC. The key to long term legislative control over an AGSOC lies in the enabling and appropriation acts with respect to successive loan guarantee funds. But the significance of the fund goes further: it can affect the nature of the investment decision-making process.

Five parties will be involved in the investment decision-making process: the seller of the asset, creditors, AGSOC management, AGSOC's Board of Directors, and the Legislature. Given the elective nature of both the Board and the Legislature, it is hard to escape the conclusion that the investment decision-making process will be subject to appreciable political influence. This means that Alaska will have to rely heavily on creditors to sift the good risks from the bad risks. In projects of the magnitude presently contemplated, it is doubtful wisdom for debtors to depend so heavily on creditors. Such dependence will, at best, come at a price.

The general principle with respect to investment is that, if markets work efficiently and if the buyer functions only as a non-speculative and non-operating investor, the price paid (i.e., the amount borrowed) plus interest paid on the debt will just equal the income generated by the asset over its life. This principle applies to assets with either a finite or perpetual life.

Given the above principle, how can a buyer borrow, invest, pay back the loan, and still make money? A buyer can, for example, make money if he has better information than the seller, is a better negotiator than the seller, is both more risk prone and lucky, or is able to increase the annual income generated by the asset. Income can be increased (1) if the buyer were to become an operator as well as an investor and if he is more efficient as an operator than the seller or (2) if the buyer got a tax break not previously available to the seller. This analysis suggests that, failing to get their desired tax breaks, AGSOC proponents will begin to promote AGSOC as an operating company rather than as a holding company. AGSOC as an operating company, however, would break the Kelso conception as to the nature of investment in capital diffusion programs. The expected result of such a change in function would be to increase significantly both the risk characteristics and the degree of uncertainty associated with the AGSOC. There would undoubtedly be an adverse effect both on the ability to secure 100 percent debt financing and on the probability of a reasonable pay-out period.

Kelsoism, GSOC, and AGSOC

Introduction

The proposed Alaska General Stock Ownership Corporation (hereafter AGSOC) came to Alaska in three steps. The first step was the writings of Louis D. Kelso and his associates¹ in which they set forth a program of capital diffusion. The second step was the inclusion by Congress in the Revenue Act of 1978 of the General Stock Ownership Corporation (hereafter GSOC) provisions in which Senator Gravel played a major role. The final step was the introduction in the Alaskan Legislature of a bill proposing to create an AGSCC.

The present report follows this development. The first section is an economic analysis of the writings of Kelso and his associates. The second section discusses major characteristics of a GSOC with special reference to tax considerations. The third section analyzes important issues raised by the AGSOC proposal itself. The preceding executive summary will function as a conclusion.

The Kelso Framework

Kelso and his associates identified four types of capitalism. Primitive Capitalism was the "form of capitalism which existed in Great Britain during the nineteenth century and which persisted

¹These abbreviations will be used to identify the following three books. CM will identify The Capitalist Manifesto by Louis O. Kelso and Mortimer J. Adler (Random House, New York) 1958; TFT for Two Factor Theory: The Economic of Reality by Louis O. Kelso and Patricia Hetter (Vintage Books, New York) 1967; and PA for A Piece of the Action by Stuart M. Speiser (Van Nostrand Reinhold Company, New York) 1977.

in a waning state until the end of the First World War" (CM, p. 104). State Capitalism is the "form of capitalism that exists in Soviet Russia today" (CM, p. 105). Mixed Capitalism is the "form of capitalism which exists in the United States and Great Britain today and which has been developing since the end of the First World War and the rise of labor unions to power with the help of the countervailing power of government" (CM, p. 105). Finally, Universal Capitalism or Capitalism "with a capital 'C'" is the "form of capitalism which will exist, probably in the United States first, after the capitalist revolution has brought into being the first justly organized capitalist economy" (CM, p. 107). Universal Capitalism is advocated by Kelso and his associates.

In brief, Kelso argues that Mixed Capitalism is doomed because of internal contradictions and will be replaced by State Capitalism unless the transition is made to Universal Capitalism. Universal Capitalism will be the product of installing capital diffusion policies--accompanied by other key changes in corporate conduct, labor unions, and government economic policies--on a sufficiently grand scale to give all citizens a second income that is derived from their ownership of capital and not from their labor. This section will briefly sketch out his argument with emphasis on the key role of his capital diffusion program. The General Stock Ownership Corporation (hereafter GSOC) and the Alaska General Stock Ownership Corporation (hereafter AGSOC) are directly derived from this capital diffusion program although, as will be duly noted, they differ importantly from the diffusion

institutions described in the writings of Kelso and his associates. As they see it, the game is big and the stakes are obviously high.

Mixed Capitalism and its Fatal Flaw. It is the position of Kelso and his associates that Mixed Capitalism contains a fatal flaw or internal inconsistency that, unless eliminated, will cause the collapse of Mixed Capitalism into State Capitalism. This fatal flaw consists of a massive maldistribution of wealth and of income.²

Maldistribution of wealth. According to Kelso and his associates "2.3% of America's households own about 80% of the economy's productive capital, and an additional 5 to 8% own the rest" (TFT, p. 40). In short, 7 to 10% of U.S. households own all productive assets. This massive maldistribution is said to be the result of the two conventional methods by which new productive capital is financed (TFT, p. 40, p. 79). The first method is the internal corporate financing of new investments by the use of retained corporate earnings. The second method is the insistence by creditors that debtors provide collateral that consists of existing capital owned by the debtors. The use of these two conventional financial processes assure that those who get more will be those who already have. In short, the rich get richer. Increasing centralization of capital is the result.

² To this reader, Kelso and his associates use the concepts of wealth and income in an ambiguous manner. In that which follows, wealth is used as a stock concept and income as a flow concept. For an example of the ambiguity, see CM, p. 129.

This maldistribution is said to cause a shortage of purchasing power; "a few families have purchasing power in excess of their consumption needs, and the great majority have needs in excess of their purchasing power" (TFT, p. 40). According to Kelso and his associates, it is this excessive concentration in the ownership of capital and the resulting shortage of purchasing power "that is the basic cause of the economic dislocations or periodic 'depressions' in an industrial economy based on private property in capital and labor" (CM, p. 151). This condition is aggravated by the maldistribution of income.

The Maldistribution of Income. According to Kelso and associates, over "70 percent of the wealth produced (read "income") is distributed to labor, but over 90 percent of that wealth (again read "income") is produced, not by labor, but by capital instruments" (CM, p. 129). In other words it is alleged that, while capital accounts for 90 percent of output, the owners get only 30 percent of that income. Labor, on the other hand, produces only 10 percent but gets 70 percent of the output. In Mixed Capitalism, labor exploits capital! The massive maldistribution of income claimed by Kelso and his associates is advantageous to labor and disadvantageous to capital. No wonder that Milton Friedman, Nobel Laureate in Economics, said of this theory: "It's Marx stood on its head" (PA, p. 124).³

³ More generally, Professor Friedman characterized the "two factor theory" of Kelso and his associates as "a crackpot theory" (PA, p. 124).

This alleged maldistribution of income (we shall assume for the time being that such a maldistribution of income exists. I personally do not believe that this type of a maldistribution of income exists.) is said to be the result of a conflict between a capitalistic mode of production and a laboristic mode of distribution (CM, p. 129). The capitalistic mode of production refers to the increasing use of capital and associated labor-saving improvements in technology to produce an ever increasing supply of goods while decreasing the demand for labor. The laboristic mode of distribution distributes the national income through wages paid in the process of employment. "The laboristic distribution which organized labor, with the help of government, has managed to effect has been achieved by the exercise of political and economic power, not by bargaining" (CM, p. 125). This laboristic mode has been supplemented by a "needistic" distribution based on welfare programs that transfer income from one group to another

The simultaneous use of capitalistic and laboristic modes increases the supply of goods to be distributed, thereby increasing the pressure on the distribution system, while decreasing the demand for labor, thereby decreasing employment and further eroding the basis of distribution. A gap is said to develop between society's ability to produce goods and its ability to distribute goods. As a consequence the government comes under increasing pressure to increase employment or to develop welfare-like transfer systems in order to generate sufficient purchasing power to move all that can be produced. The result has been

the expeditious adoption of a full employment policy and the development of a welfare system based on income transfers from the rich to the needy. These "laboristic" and "needistic" programs are at the heart of the policies of Mixed Capitalism.

The full employment policy, drafted as a partial solution to the conflict between the capitalistic mode of production and the laboristic mode of distribution, requires that the economy be continually stimulated. This stimulation leads to persistent inflation which, according to Kelso, is Mixed Capitalism's "insoluble problem" (CM, p. 129). "Inflation is a natural and necessary process in an economy that is capitalist in its mode of production and laboristic in its form of distribution" (CM, p. 129).

In addition, Kelso sees a potential conflict between the maldistribution of wealth and income: the "effective and highly concentrated ownership of capital in about 5 percent of the households of our economy is incompatible with the production of some 90 percent of the wealth (read income) by capital instruments" (CM, p. 136). As capital continues to produce more, the increasing concentration of capital decreases the ability of capital ownership to serve as a basis for distributing income, thereby creating increasing pressures to use labor and employment as the basis for distribution. Kelso and Adler reached this pessimistic conclusion:

If mixed capitalism cannot check the inflationary process of the last thirty years, if it cannot resolve the conflict between its policy of full employment and the technological advances that lie ahead, if by the very nature of the elements in the mixture the laboristic

aspect of the distribution tends to expand and the capitalistic aspect to contract..., then, perhaps, mixed capitalism...contains the seeds of its own destruction. (CM, p. 129)

The Kelso Program of Reform. The principal goal of the reform program of Kelso and his associates is to create Universal Capitalism whose essential characteristic is to make effective capitalists of those 90 percent of the households who own no capital. This transformation will provide the basis for a distribution system that is based predominately on capital ownership rather than on labor. This capitalistic mode of distribution will be able to absorb the output of the capitalistic mode of production. The gap that breeds inflation will allegedly be closed. And, according to the theory, this capitalist revolution will correct the fatal maldistribution both of wealth and of income.

More particularly, the capitalist revolution consists of four steps. First, corporations will no longer be able to finance expansion internally from retained earnings; profits are to be paid to stockholders as dividends. This change will prevent further concentration of wealth and facilitate the creation of the New Capitalists by accelerating the repayment of funds borrowed to finance the purchase of their equity positions. Second, markets must be freed from the collective or "coercive" (TFT, p. 76) bargaining imposed by unions that has distorted the distribution of income to the advantage of labor. Collective bargaining

introduces into the economy a governmental enfranchisement of unions to levy taxes upon employers, stockholders, and upon the economy as a whole. It sanctions a form of monopoly

and conspiracy made effective by organized force which dwarfs any industrial monopoly ever contrived. It eliminates from the major area of the economy the use of objective, impartial, and free competition as a just determinant of economic values. (CM, p. 187)

A measure of the extent of the distortion Kelso and Adler attribute to labor unions is indicated by this passage.

If a competitive evaluation of the contribution of labor were then to set wages at a level which labor could justly claim as a return for its services, labor's standard of living might dwindle to bare subsistence or even fall below it. (CM, p. 61)

Under Kelso's program unions would indeed be transformed; they would cease being an organization that exploited capitalists and become an institution whose function would be to protect the small and medium sized capitalists from all challenges. Under Universal Capitalism,

...the labor union will obviously not be needed as an instrument of power to effect a laboristic distribution of wealth (read income)...But to say that the union will not be needed to perform this function in a justly organized economy, with diffused ownership of capital and a capitalistic distribution of wealth (read income), is not to say that there will be no socially useful service for it to undertake. Voluntary associations of capitalist workers, operating through democratic processes of self-government, may serve their own members and the whole society by functioning as agencies for the economic education of the newly made capitalists, and as instruments for the protection of their property rights. (CM, p. 157)

Kelso recognizes that the reform of corporations and unions would be both necessary and difficult.

The giant corporations which exist and the giant labor union which has just come into existence represent enormous concentrations of power which have not as yet been made fully responsible for the use they make of their power. The most difficult task that government faces, in effecting the transition from our present mixed capitalism, is to tame and harness

the power of these creatures of capitalism and, by making them responsible in the discharge of the limited functions they should perform, make them serve (Universal) Capitalism, or at least prevent them from despoiling either. (CM, pp. 156-157)

The third step is to create the class of New Capitalists who presently own no capital. This will be a massive undertaking because sufficient new capital must be created to give those 90 percent of households that own no capital a grubstake that will provide with them an important second income based on capital ownership. Some idea as to the magnitude of the change required can be obtained from the following considerations. Under Mixed Capitalism labor is the source of 70 percent of household income. Under Universal Capitalism and after correction of the maldistribution of income, labor would be the source of only 10 percent of that income--as determined by labor's 10 percent productivity. Capital ownership would have to become the source of that 60 percent difference. In short, during the transition from Mixed Capitalism to Universal Capitalism, wages would have to decrease 85 percent (6/7s) and the return to capital would have to increase 600 percent, assuming no increase in the standard of living.

This mammoth restructuring of both the production and distribution systems would apparently be accomplished by allowing these households to borrow from banks and to purchase stock in a limited set of well established, blue chip corporations; the investments of the New Capitalists are not to be in venture capital. The purchased securities would be held in escrow until they had been paid for by dividends received. The New Capitalists

would then receive their stock. Three programs would expedite this process. First, the corporations could retain no earnings; this would maximize the dividends to accelerate paying off the loan. Second, tax exemptions would further maximize the flow of earnings to repay the loan. Third, a Capital Diffusion Insurance Corporation would be created in order to encourage banks and other institutional creditors to engage in 100 percent financing by protecting them against losses. This last proposal would, in effect, base creditor protection on the collective credit worthiness of non-capitalist households rather than on assets owned by established capitalists.

Finally, the U.S. economy would have to grow at a much more rapid rate than it has in the past if the New Capitalists are to acquire a capital base sufficient to make a difference; the New Capitalists are not to be created at any significant expense to existing capitalists. The New Capitalists and their "Second Income" are to be created out of growth. For example, in the United States and Canada a growth rate will be required that is "several times the three and a half to four percent that is currently achieved in the U.S. and in most Western economies." (TFT, p. 9) The situation would be even more striking in less industrialized economies; their productive capacity "may have to be expanded fifteen, twenty or more times in order to build second economies capable of producing general affluence." (TFT, p. 47) It is evident that the arrival of Universal Capitalism will be heavily dependent upon realizing sustained rates of growth significantly greater than the world has as yet experienced in a sustained and general fashion.

Is the Kelso Program Workable? Let us assume for the sake of argument that the diagnosis of Kelso and his associates is correct and that their proposed remedies could solve the problems. Is the plan workable?

To answer this question, two economic features of the plan should be recalled. First, the plan envisions a huge increase in capital formation in order to create the capital base for an adequate second income for 90 percent of U.S. households. Second, in order to realize this great expansion within a reasonable period of time, the economy must grow at an unprecedentedly rapid, sustained rate of growth.

If we assume for the moment that such rates of growth are within our physical capabilities, we must examine the effects of such large and rapid rates of growth on the national economy. At least two consequences can be predicted with reasonable assurance: the program would be inflationary and would lead to an increase in both industrial centralization and concentration.

Kelso and Hetter have argued that his capital diffusion plan would be "deflationary" (TFT, p. 97) on the grounds that the new capital formation would lead to a larger supply of goods. They acknowledge, however, that the debt financing aspect of the program would increase significantly the supply of money. This would, of course, be inflationary unless the supply of goods could be increased simultaneously and commensurately. The increase in the money supply and hence demand would begin immediately with the start of the plan. The increase in the supply of goods would come more slowly and later. Because of

this lag, inflationary pressures would develop. History does not support Kelso's implicit assumption as to the almost spontaneous responses of supply to a sharp and sustained increase in demand. We could expect significant lead times, lags, and bottlenecks. The inflationary potential of the Kelso plan was recognized by a 1976 staff report of the Joint Economic Committee of the U.S. Congress.⁴

The Kelso program would funnel much of this new capital expansion into established, well-managed firms (TFT, p. 97). This would increase their size relative not only to the economy as a whole but also to other less favored firms with which they compete in relevant markets. The first type of increase we customarily call centralization and the second type concentration. Because of this preference for blue chip firms, we can expect the capital diffusion plan of Kelso to increase both centralization and concentration.

A more important difficulty, however, than the likely inflationary and centralization tendencies of the Kelso program, is the great likelihood that the projected rates of growth are beyond our present economic/physical capabilities. It is increasingly apparent that we are entering a mandatory slow growth period, constrained by energy and raw material supplies. Growth targets have been reduced by both developed and developing countries. What might have been a potentially viable policy in the

⁴ See PA, p. 254-6 for a discussion of that report. The report did support, in general, efforts to diffuse capital ownership.

60's appears no longer to be viable, given the magnitude of the proposed change.

Implementation of the plan would also undoubtedly pose political problems. Two major economic institutions, both with political clout, would have to undergo basic changes. Management would lose the flexibility associated with internal financing. The impact on labor unions would be even more far-reaching. Not only are unions accused of exploiting capitalists (albeit apparently of willing capitalists) but the plan would dismantle collective bargaining as we know it. The new unions would function as the protectors of the interests of small capitalists.

Political problems could also be associated with the need for wages to fall some 85 percent during the transition to Universal Capitalism as the income to households from capital ownership rose 600 percent. Upheavals of this magnitude boggle the mind and challenge credibility, especially when the whole conception is based on an alleged massive maldistribution of income that does not exist.

Is There Really a Basic Maldistribution of Income? From the standpoint of a professional economist the most suspect aspect of the analysis by Kelso and his associates is their contention that, although labor gets about 70 percent of the economy's income and capital gets 30 percent, capital should get 90 percent and labor only 10 percent based on their comparative productivities. This contention was rather summarily dismissed by Professor Paul Samuelson, a Nobel Laureate in Economics, in a brief

report that he prepared on Kelso's ideas for the Puerto Rican government.

Kelsoism is not accepted by modern scientific economics as a valid and fruitful analysis of the distribution of income, but rather it is regarded as an amateurish and cranky fad....Its central tenet (the 90-10/30-70 gap) is contradicted by the findings of economic empirical science: according to statistical study of macro-economic trends, by such distinguished scholars as Professor Simon Kuznets of Harvard (Nobel Laureate in 1971), Senator and Professor Paul H. Douglas (award winner for his Cobb-Douglas statistical measurement of the aggregate production function), MIT Professor Robert M. Solow, and numerous researchers at the National Bureau of Economic Research under the direction of Arthur M. Burns, chairman of the Board of Governors of the Federal Reserve System, economic adviser to Presidents Eisenhower and Nixon, the contribution of labor to the totality of GNP is in the neighborhood of 75 percent, with only 25 percent attributable to land, machinery and other property.

...this 75-25 percent breakdown is diametrically opposite to the Kelso presuppositions, which are purely speculative and not based on econometric analysis of the observed statistics of nations at different stages of development. (PA, p. 112)

According to Samuelson, the principal determinants of the distribution of income between capital and labor are changes in the relative supplies of labor and capital, changes in technology, trade union pressure, antitrust policies, and welfare transfers.⁵ The process, however, is dominated by the first two determinants. The two have combined to stabilize the 75-25 (similar to Kelso's 70-30) distribution of income.

Professor Samuelson's comments do not quite get to Kelso's concern. I do not believe that Kelso's problem is that the 70-30 (or 75-25) breakdown fails to measure what capital and labor get.

⁵ Paul Samuelson, Economics (McGraw-Hill, New York) 1973, 9th edition, pp. 741-748).

His concern is that the distribution should reflect the relative contributions of capital and labor to national output. If capital produces 90 percent, it should get 90 percent. If labor produces only 10 percent, it should get only 10 percent. It is for these reasons that he contends "there is no longer any basis for believing that the available statistics give us an accurate picture of the relative economic productivity of capital and labor" (CM, pp. 260-261).

The real issue is the relative productivities of capital and labor. Kelso and his associates offer no empirical support for this important quantitative aspect of their analysis. It seems to be based on nothing more than casual observation. I believe that Kelso and his associates have made a fundamental theoretical error. The central question is simply stated: How is the productivity dividend to be distributed? Kelso's answer is straightforward: Capital, not labor, is responsible for the increased productivity; therefore, it is only just that capital should get it all. But, in a market system (and recall that Kelso is a strong believer in a market system) there are three claimants to a productivity increase: capital, labor, and the consumer. Kelso overlooks the critical role of the consumer. In a market economy, the initial, high return to capital for innovation is eventually eroded and prices fall a entry of new capacity, attracted by the profits, increases industry supply. New products have such a life cycle. The price experience of small hand-held calculators over the last five years is a good example. In short, the principal beneficiary of increases

in productivity in a market economy is the consumer and not the capitalist. The consumer benefits from the lower prices made possible by technological gains and enforced by a competitive market. It is the consumer, not capital or labor as factors, who is the principal beneficiary of productivity improvements. If the above analysis is accepted, there is no reason to accept Kelso's 90-10 breakdown or, more importantly, his claim of a massive maldistribution of income that is alleged to be a fatal flaw of Mixed Capitalism.

Does Capital Diffusion Make Sense Outside the Kelso Framework?

According to Kelso and his associates, the two fatal flaws of Mixed Capitalism were the maldistributions of wealth and income. Of these two, the maldistribution of income was both the more controversial and the more important. In my opinion, the maldistribution of income as described by Kelso, does not exist. It is not a fact. Is there, however, a maldistribution of wealth? In this instance, the facts are less controversial and reasonable people can disagree as to the desirability of the existing distribution of wealth. For those who would prefer a more even distribution of wealth, a capital diffusion program is one way to achieve it.

In 1976, for example, the Joint Economic Committee of the U.S. Congress stated in its Joint Economic Report:

To begin to diffuse the ownership of capital and to provide an opportunity for citizens of moderate incomes to become owners of capital rather than relying solely on their labor as a source of income and security, the Committee recommends the adoption of a national policy to foster the goal of broadened ownership. (PA, p. 25")

In sum, a policy of capital diffusion should be evaluated outside the Kelso framework and its dire predictions of the collapse of Mixed Capitalism. Such a policy should be allowed to stand on its own feet and be voted up or down on its own merits. In this conclusion, I agree with Stuart Speiser, an admirer of Kelso, when he wrote concerning Kelso's two factor theory--the theory that is based on the existence of the massive maldistribution of income--that it is "an irrelevant issue that would be ruled out of the case if Kelso were trying it in court" (PA, p. 95) and "a millstone around Kelso's neck" (PA, p. 122). In addition, Speiser believes that this theory "has absolutely nothing to do with capital diffusion or universal capitalism" (PA, p. 95). I would, however, go one step further and argue that capital diffusion policies should be evaluated on their own terms and not even as a part of that broader program, Universal Capitalism. It is in this limited context that we proceed to an analysis of GSOC and AGSOC.

The General Stock Ownership Corporation

The General Stock Ownership Corporation (hereafter GSOC) plan, as initially conceived, had at its heart two elements: finance by borrowing and significant tax exemptions to facilitate that debt financing. Debt financing was at the ideological core of the Kelso program: individuals were to utilize their collective credit worthiness to finance their increased participation in the capitalist system. This was to be a "boot strap" operation--a painless way for all to become capitalists and ac-

quire a significant second income. Although we shall concentrate in this section on the tax exemptions, it is important to stress that their importance derives from the key role of debt financing.

The GSOC plan, as initially proposed in the U.S. Senate, sought two major tax exemptions. First, the corporation in which a GSOC acquired stock was to be allowed to deduct as an expense dividends paid to GSOC. This would approximately double the revenue to GSOC relative to other stockholders. Second, the bill proposed that GSOC be given tax-exempt debt financing. Not only would GSOC have been able to deduct the interest payments on its debt but it would also be able to deduct its payments against the principle. In other words, the principle debt was not to be paid out of taxable income as it normally is, for example, in a home mortgage; the mortgage payment would itself be tax deductible. This was a critical exemption and would have significantly facilitated debt financing.

In the final bill, Congress gave GSOC neither of these important exemptions. Instead GSOC was allowed to integrate its tax liability with its stockholders; the corporation was allowed to escape double or triple taxation by passing its income tax liability through to the stockholders. This is the same type of tax advantage that is routinely exercised by small business.

The refusal of Congress to grant the previous two major tax exemptions has three consequences with respect to the operation of a GSOC. First, by reducing the after tax income of the GSOC

Congress's refusal increased the probability and duration of a negative cash flow during the first years of the GSOC. Second, this adverse effect on the cash flow will increase the probable need and duration to finance losses during the initial period of a GSOC. In particular, it complicates attempts by a state legislature to guarantee the debt of the GSOC to its creditors either by a guaranteed loan or a loan guarantee fund.

The third consequence of Congress's refusal to grant the tax exemptions initially sought by the GSOC proponents is the taxable income issue. It will be recalled that under the only tax exemption granted--the tax integration exemption--GSOC's taxable income flows through to its stockholders. This tax liability flows through whether the stockholders receive any dividends or not. The source of the problem is twofold. First, although it is not inevitable, it is probable that a GSOC will initially generate a negative cash flow. It, therefore, will be unable to pay dividends because its expenses, including interest and payments against principle, will exceed its revenues. Second, despite the negative cash flow and consequent inability to pay dividends, the GSOC can generate a taxable income which passes through to the stockholders as a tax liability. This is a result of the fact that a payment against principle is included in taxable income because it is not deductible, thereby increasing taxable income, but is excluded from cash flow because it is paid to the creditors, thereby decreasing the cash flow. In sum, in the first years of a GSOC it is very probable that its stockholders will get no dividends but will receive an ad-

ditional tax liability. The cost to particular stockholders will depend on their tax status. In passing, we might note that at a hearing of the Alaskan House Finance Committee on November 2, 1979, Senator Gravel acknowledged the probability that the plan "can wind up having to saddle the people with a tax liability."

In conclusion, the proponents of the original GSOC went to Congress and asked for a silk purse. Instead, Congress gave them a sow's ear. And it is well understood that you cannot make a silk purse out of a sow's ear. Congress, however, could be asked once again for the silk purse--i.e., for the two major tax exemptions--in order to minimize the taxable income problem and to increase the financial viability of the GSOCs. Such action by Congress would create a new set of problems--equity problems associated with transfers from one set of taxpayers to another set.

It is convenient to distinguish between two types of tax subsidies: direct subsidies and indirect subsidies or tax expenditures. A direct subsidy involves taxing A to pay B; it is a direct transfer from A to B. A tax expenditure involves a more complex subsidy. One set of citizens (A) gets a tax break. Government revenue is reduced by this amount; consequently, in order to compensate for the revenue loss, B's taxes must be increased or C's benefits must be reduced. A transfer is involved: A benefits at the expense of B or C. Peter is robbed to pay Paul.

It is correct to note that these "silk purse" exemptions would not make a GSOC a Robin Hood. Robin Hood took from the rich to give to the poor. Such a GSOC would instead take from all (rich and poor) to give to some (rich and poor). Congress recognized that these "silk purse" exemptions were a potential threat to the corporate tax base at the national level. This erosion would increase as the use of GSOCs expanded. This is why Congress rejected these exemptions and will undoubtedly continue to reject them. Consequently, the future viability of GSOCs in general and of AGSOC in particular must be assessed on the basis of the very limited tax exemption given in the 1978 law.

AGSOC: Some Administrative and
Organizational Features

We shall consider three important issues raised by the administrative and organizational features of the proposed Alaska GSOC (hereafter AGSOC): the guarantee issue; the issue of the investment decision-making process; and the holding v. operating company issue.⁶

The Guarantee Issue. An AGSOC will be limited to financing its investments by borrowing. There will be no initial payments for stock. There can be no relatively significant retained earnings by which an AGSOC could finance its own expansion. An AGSOC could borrow directly from the State of Alaska or from

⁶ Other important issues include the constitutional issue and the issue of stockholder control. These will not be discussed in this report; they have been the subject of other reports.

the private sector. I shall limit this discussion to efforts to borrow from the private sector.

In borrowing from the private sector (e.g., banks and insurance companies), an AGSOC would have three possible options: borrowing with no guarantee or collateral to protect the creditor; borrowing with creditor protection provided by a guaranteed loan; and borrowing with protection provided by a loan guarantee fund.

1. **Borrowing Without Creditor Protection.** It is very doubtful that this is a realistic option for at least four reasons. First, there is the need for 100 percent debt financing. As a result, there would be no margin for error; the creditor would be fully exposed. The creditors would not even have the minimal protection provided by an equity contribution to the original investment.

Second, the very large sums of money that are involved in proposed investments can be expected to assume that creditors will seek some type of protection. It is one thing to lend \$1,000,000. It is quite a different order of magnitude to lend \$500,000,000 or \$1,000,000,000. Third, the probability of an initial negative cash flow which must be covered by borrowing raises further difficulties when financing must be 100 percent by debt. Losses are not assets that could conceivably protect the creditors.

Finally, Mr. Kelso and his associates have recognized the historical need for creditor protection. In conventional finance, based on the assets of individual debtors, "existing financial

or tangible capital is put at risk to insure against the possibility that newly formed capital either may not pay for itself within a reasonable time, or that if it does so, the wealth it produces may not be used to make that disbursement" (TFT, p. 93). They would substitute for that individual credit worthiness either the collective credit worthiness of all within a given jurisdiction or some insurance scheme. For example, a Capital Diffusion Insurance Corporation (CDIC), modelled after the Federal Housing Authority Insurance Plan, was suggested (CM, p. 241) in order to insure institutional creditors against losses in the realization of any capital diffusion plans. In brief, AGSOC will almost certainly have to offer its creditors some type of a guarantee against losses.

2. Borrowing With a Guaranteed Loan. It is quite certain that the Alaskan Legislature cannot constitutionally guarantee a loan to an AGSOC. Such a guarantee does not involve a capital improvement. The Alaskan Legislature can, however, protect AGSOC's creditors, if it so desires, by the creation of a guarantee loan fund.

3. Borrowing with a Loan Guarantee Fund. The creation of a loan guarantee fund would involve two legislative acts: an enabling act and an appropriation act. The enabling act is necessary to create the loan guarantee fund. Conditions that determine the reach and functions of the fund are in control of the Legislature. This would be an important statute. The appropriation act would provide the money required by the fund. The amount of the appropriation would depend on negotiations between AGSOC and the seller of the assets being acquired (this

determines the amount of money AGSOC would have to borrow and between AGSOC and its creditors. The Legislature would be asked to appropriate the amount of money that AGSOC and its creditors negotiated as sufficient to protect the creditors, given the size of the loan. This could be 50 percent or more. The appropriate money would, in effect, sit there; it could be put to no other use. This use of state money would be at the expense of other uses. There would be no free lunch.

Neither the enabling act nor the appropriation act appear to present any constitutional issue. An adequate "public purpose" can almost certainly be found.

The proposed AGSOC bill includes a start-up loan guarantee fund for which it appropriates \$5,000,000. This fund is for the limited purpose of enabling the AGSOC, when created, to be able to borrow enough to cover its organizational, start-up costs. The bill, however, makes no provision for a loan guarantee fund designed to cover investments made by the AGSOC.

It has been stated that the bill does not provide for an investment loan guarantee fund in order to maximize the flexibility and discretion of AGSOC's board of directors. Others have suggested that it might well be a political maneuver--a two stage strategy. Initial silence with respect to the loan guarantee fund should increase the probability of passing the AGSOC bill because the issue of financial consequences would be minimized. Then, once the AGSOC bill is passed, it would be easier to pass the necessary enabling and appropriation acts on the grounds that, without them, there can be no AGSOC.

The key to long term legislative control over an AGSOC, whether created by a legislative act or by referendum, lies in the enabling and appropriation acts in connection with successive loan guarantee funds. But the significance of the fund goes further: it can affect the nature of the investment decision-making process.

The Investment Decision-making Process. The declared goals of AGSOC's investment decision-making process are that it be professional and free of political considerations. The nature of AGSOC's investment decision-making process raises important issues that might well have an adverse effect upon the realization of these goals. It is apparent that five parties will be involved in this process: the seller of the asset, the creditors, AGSOC's management team, AGSOC's Board of Directors, and the Legislature. The anticipated role of each will be briefly discussed.

1. The Seller of the Asset. The purchase price of the asset will be negotiated by the seller of the asset and AGSOC's management. Because of the nature of the decision-making process, however, participation in one form or another along the way can be expected from the creditors, AGSOC's Board of Directors, and the Legislature. The result of the negotiation between the seller and management will reflect their relative positions with respect to information, risk preferences, and negotiating skills and power. As pointed out in the last part of this section, these differences are key to determining the price and resulting profitability of the transaction.

2. Role of Creditors. Creditors hold a veto power.

With 100 percent debt financing, nothing happens without their approval. Their interest in the extent of a loan guarantee fund will depend upon the degree of risk involved in the investment. It is clear that Mr. Kelso and his associates prefer relatively low risk, blue chip type of investments. Speiser, for example, says that "Kelso thinks that venture capital (capital for starting new enterprises) is a game to be played by the very wealthy" (PA, p. 80). The proponents of AGSOC appear to be somewhat ambiguous as to whether AGSOC should be used to promote development and new ventures or should be limited to taking over a part of a major, successful enterprise. Whichever is the case, it is certain that the creditor will relate the risk to the amount of money demanded in the loan guarantee fund.

3. Role of AGSOC's Management. Management is to make the initial investment decision for AGSOC. This will be presumably a professional decision, i.e., based on the intrinsic merits of the case. But their decision must be approved by the Board of Directors. Given the probable political nature of the Board as described in the following section, it is quite certain that management will have to exist and survive in a political environment.

4. Role of the Board of Directors. The role of the Board is critical in the investment decision-making process. The Board's approval is necessary before any project can begin. At this point we can expect political considerations to be injected directly into the process because the Board is quite

explicitly designed to be a political institution. Directors run in a statewide election; the usual proxy system is prohibited. The electorate is broader than the usual electorate because stockholders (and, therefore, voters) will include those younger than the normal voter. In addition, after a phase-in period each Director will serve a limited term of two years. There will be an election every year at which one half of the Board must stand. Given such short terms and annual elections, a Director will always be running for office. In addition, the candidate nominated by the Board can be challenged by nominees put forward by groups of stockholders. Under these circumstances it is hard to escape the conclusion that the Board will be a political institution and that the investment decision-making process will be significantly influenced by political considerations.

It is legitimate to ask what, in this context, is meant by the term "political." Without impugning the motives of anyone, in this context political means that the decision-making process is subject to a perverse incentive system; Directors will be unable to make decisions that are unpopular with this diversely structured electorate whose decisions will almost certainly not be professional in nature.

5. Role of the Legislature. The Legislature becomes involved in the investment decision-making process because of the almost inevitable need for a loan guarantee fund and the consequent need for passage of the enabling and appropriation acts. It is here that the Legislature takes over the investment decision-

making process; its political decision-making process will be able to dominate the investment decision-making process at this point. The Legislature is the final hurdle.

While one enabling act may be able to serve more than one project, it is more than likely that each project will require its own appropriation act. This is likely because each project can be expected to differ as to risks and the identity of creditors and, therefore, as to the magnitude of the loan guarantee fund. By the very nature of the AGSOC arrangements, the Legislature will be involved in the investment decision-making process and will be held accountable at the polls.

In sum, Alaskan participation in the investment decision-making process will be influenced by two political institutions (the Legislature and the Board of Directors) which may or may not be able to work together in harmony with one another⁷ and a third group (AGSOC management) which, through ostensibly professional, must function and survive in a political environment. These considerations mean that Alaska would probably have to depend heavily on creditors to sift the good risks from the bad risks. In projects of the magnitude presently contemplated, it is doubtful wisdom for debtors to depend so heavily upon creditors. Such dependence will, at best, come at a price.

6. Is an AGSOC-type Investment Possible? The non-speculative and non-operating investment in an income-producing asset creates

⁷ For example, they differ (1) as to the nature and extent of their electorates, (2) as to the roles of the traditional political parties, and (3) as to the range of issues that they must consider and the consequent focus of their energies.

some interesting questions as to the nature of the profitability of the investment. Two examples will be used to illustrate the nature of the problems involved. The first example involves the purchase of an asset with a limited life; the second is a perpetual asset.

Asset with a Finite Life. Assume an asset with a five year life that produces an annual after-tax income of \$100. Further assume that the buyer and seller have the same information, the same risk preference, and are subject to the same discount rate of five percent. Under these conditions, what is the maximum price that the buyer should pay and what is the minimum price that the seller should accept? Both prices should depend upon the calculations by the buyer and seller of the discounted present value of that future flow of income. Based on calculations given in an Appendix to this report, the maximum price of the buyer and the minimum price of the seller are both \$432 (rounded off). A deal is possible.

If the buyer bought the asset for \$432, how would he fare after five years? The buyer would have received an income of \$500 over the life of the asset. Over the five years, however, he would have paid back \$432 to his creditor, returning the principle borrowed plus a total interest payment of .68 (rounded off). In short, the buyer would have paid out \$500 for the \$500 that he received. His cash outflow equals his cash inflow. He started with nothing and wound up with nothing. The general rule is that, if markets work efficiently and if the buyer functions only as a non-speculative investor, the price paid

(i.e., the amount borrowed) plus the interest paid on the debt will just equal the income generated by the asset over its life. This principle also holds in the case of an asset with perpetual life.

Asset with Perpetual Life. Assume an asset with a perpetual life that generates an annual after-tax income of \$100. Further assume that the buyer and seller have the same information, the same risk preference, and are subject to the same discount rate of five percent. Under these conditions, the maximum price that the buyer will pay and the minimum price that the seller will accept is \$2,000 ($\$100 \div .05$). Assume that the buyer borrows \$2,000 for ten years to buy the perpetual asset. At the end of the ten years, the buyer will own the asset and its future stream of income. He will, however, have received only \$1,000 in income while he will have repaid the \$2,000 that he borrowed plus ten years of interest. In short, after ten years he will own the perpetual asset but he will have paid out much more than he received during that time. After ten years the asset should begin to pay back his arrears. Theoretically, however, over time, this transaction should also wash, i.e., the cash inflow should equal cash outflow.

If the general principle holds that repayment of principle plus the interest paid equals the income generated by the asset over its life, how can a buyer borrow, invest, pay back, and still make money? It can be done but under a different set of circumstances than those that govern the general principle. A buyer, for example, can make money if he has better information

than the seller, is a better negotiator than the seller, is both more risk prone and lucky, or is able by one way or another to increase the annual income generated by the asset. Income can be increased in the following two ways. If the buyer is an operator as well as an investor and if he is more efficient than the seller, income will increase because of the more efficient operation. Second, income will increase if the buyer gets an income tax break that was not available to the seller. It should also be noted, however, that the buyer can lose if it turns out that the seller had better information, that the buyer encountered bad luck, or that income fell because, for example, the buyer was a less efficient operator.

The above analysis is relevant to the proposed AGSOC program in at least two ways. First, it demonstrates the critical role in the viability of an AGSOC of the two "silk purse" tax exemptions that were initially sought and finally refused. And, second, it suggests that AGSOC proponents will begin to promote AGSOC as an operating company rather than as a holding company. As an operating company, an AGSOC would apparently gain a tax advantage through its tax integration feature and might be able to increase income if it proved to be more efficient as an operator than the seller. But AGSOC as an operating company would break with the Kelso tradition as to the nature of investment in his capital diffusion program.

The Holding v. Operating Company Issue. The federal enabling statute simply empowers a GSOC "to invest in properties." It is assumed that this empowers the GSOC not only to purchase

and hold securities in other corporations (the holding company issue) but also to purchase assets and operate a business in its own name (the operating company issue). As a holding company, the federal law limits a GSOC's holding to 20 percent of the stock of any corporation. As an operating company, however, a GSOC can apparently own 100 percent of the assets of a business operated under its own corporate name.

In the Kelso scheme of things, the 90 percent of households were to be allowed to invest only in a limited group of corporations. This group was more broadly conceived in CM than in the later TFT and PA. In CM individual households were to purchase directly the stock in existing corporations so as to realize a "balance between securities of well-seasoned corporations and those of still somewhat speculative businesses;" investment in the securities of "brand new and completely unseasoned enterprises" as well as those of "unseasoned and speculative" (CM, p. 241) firms was to be denied. Concern over the need to reduce the level of concentration, however, induced Kelso and Adler to suggest that the program "should direct a predominant share of new capital formation into new enterprises owned by new capitalists" (CM, p. 215). In later writings investment recommendations became more cautious.

In TFT Kelso and Hetter wrote of investment only in terms of "well-managed" firms (TFT, p. 61 and P. 97). Speiser in his PA is more descriptive. According to him, Kelso advocated investment only in the "big winners," the "profitable giants" (PA, p. 56), the "major successful businesses" (PA, p. 54), and

and the "largest and most successful" corporations (PA, p. 80). Investment was to be discouraged in "new start-up ventures" (PA, p. 56) and in "venture capital (because that) is a game to be played by the very wealthy" (PA, p. 80).

In sum, investment by households was to be done either directly or through a special mutual fund arrangement in major, well-managed corporations. Investment in speculative or start-up ventures was to be discouraged. In no event and at no place did Kelso and his associates in the three books covered in this report recommend a comprehensive capital diffusion program that would involve creation of and investment by non-capitalists in a special corporation that would both acquire productive assets and manage the operation.

As we noted in the previous section, AGSOC proponents may well come under increasing pressure to transform an AGSOC from a holding company into an operating company. Such a development would certainly break with Kelso's previous reasoned conceptions of the nature of investment by non-capitalist households in the corporate economy. The expected result of this development would be significantly to increase both the risk characteristics and the degree of uncertainty associated with the AGSOC. There would probably be adverse effects on the ability to secure 100 percent debt financing and on the probability of a reasonable pay-out period.

Appendix

The discounted present value of a future income stream is calculated by this formula:

$$\frac{Y_1}{2+i} + \frac{Y_2}{(2+i)^2} + \frac{Y_3}{(2+i)^3} + \dots + \frac{Y_n}{(2+i)^n} \quad \text{where}$$

Y is the annual income for that year, i is the discount rate, and n is number of the years in the asset's life. If we assume Y to be \$100, i to be 5 percent, and the life of the asset to be five years, the result of the calculations would be:

$$\frac{\$100}{1.05} + \frac{\$100}{1.1} + \frac{\$100}{1.16} + \frac{\$100}{1.22} + \frac{\$100}{1.28} =$$

$$\$95.24 + \$90.90 + \$86.21 + \$81.97 + \$78.13 = \$432.45$$

The buyer should, therefore, be willing to pay \$432 for the asset or less. Using the same calculations, the similarly situated seller would accept no less than \$432.

If the buyer borrowed \$432 for five years at five percent to buy the asset, his situation at the end of five years would be:

1. He would have received \$500 in income over the five year period.
2. He would have paid back the \$432 he borrowed plus \$68 in interest payments on the declining balance to the creditor--a total of \$500.

In short, his cash inflow would equal his cash outflow for the five year period.

STATE OF ALASKA
THE LEGISLATURE

POUCH V - STATE CAPITOL
JUNEAU ALASKA 99811
907 465 3800

LEGISLATIVE AFFAIRS AGENCY

MEMORANDUM

March 10, 1980

SUBJECT: Final draft of CS for House Bill 240
TO: Representative Mike Miller
FROM: Tamara Brandt Cook
Legislative Counsel

Enclosed please find the final draft you requested of CSHB 240. I noted that sec. 10.50.295(b) relating to shareholder removal of directors is ambiguous and would suggest that this section be redrafted for the sake of clarity. It now reads:

"An individual director may be removed if the majority of votes cast for his removal exceeds the number of votes he received at the last preceding election . . ."
(Emphasis added)

This is capable of being interpreted to mean that a director may not be removed unless the number of votes over 50 percent of the votes cast (a majority) is greater than the number of votes he received when elected. On the other hand, it could simply mean that only a majority of votes is required if the number exceeds the number of votes which the director initially received.

TBC:jdn

Enclosure

WORKING PAPER ON
DIVIDEND DISPERSAL PROGRAMS

By Governor Jay S. Hammond

There is increasing interest in providing Alaskans with a "piece of the action" through some method of distributing "dividends."

I am encouraged by this for I believe it appropriate that all Alaskans receive some direct benefits from their resource wealth rather than simply receiving whatever more government we politicians think they should have.

-- ALASKA INC.

Some few years ago, I proposed a means by which a portion of income earned from investments of the public's resource wealth would be distributed in direct dividends to all "shareholders". This proposal became known as Alaska, Inc. I introduced a modified form of Alaska, Inc. again this year, as has Senator Sumner.

-- AGSOC

Another means of granting Alaskans a "piece of the action" has been proposed by Senator Gravel. This is known as "Alaskan General Stock Ownership Corporation" or AGSOC. Unlike Alaska, Inc. which disperses a portion of earnings from investments of citizen-owned resource wealth, an AGSOC would permit citizens to own shares of development programs which might relate - but not necessarily exclusively - to the manner in which that resource wealth was transported, refined or manufactured. The necessary capital to acquire ownership in such endeavor could come either from the sale of tax free revenue bonds, private financing or State guaranteed funds.

-- MUTUALLY EXCLUSIVE OR COMPATIBLE?

While the intent of both programs is similar, there are important distinctions. Moreover, while they are by no means mutually exclusive, I am increasingly convinced that insofar as the State's long term best interest is concerned, an AGSOC can best work only if an Alaska, Inc. program is first put into place and, as well, certain amendments are made to both bills now before us.

In order to discuss my reasons for so concluding, it is necessary first to explain how, ideally, I believe an Alaska, Inc. program should work.

-- MECHANICS OF ALASKA, INC

Each Alaskan would receive, annually, one share of 1/2 the earnings of Permanent Fund investments for every year they have resided in "an area where cost of living was recognized by the Federal government as warranting a 25 percent cost of living pay differential for its employees." While nothing is said about residency versus nonresidency, all Alaskans, of course, would qualify. Those with longer tenure would accrue more shares. Shares would not be transferable. However, new Alaskans, upon qualification, would as well receive shares.

Application for annual dividends could be made upon filing an income tax form attesting to ones having resided during most of the previous year in such a high C.O.L. area. Thus, persons who leave the state would no longer qualify after one year.

In a bill I presented to the Legislature this year, House Bill 99, such "dividends" would come only in the form of tax credits. Moreover, no one would qualify for more than one share for each year during which the applicant had paid State income taxes up to a total of five shares. This five-year limitation was proposed since Department of Revenue tax records are held for only five or six years.

While this approach was taken to curry support from those who wanted tax relief as well as for administrative convenience in checking an applicant's eligibility, it raises serious questions.

For example, all citizens, whether they're taxpayers or not, are impacted by Alaska's high cost of living. Moreover, if you truly believe, as I do, that Alaskans collectively own such resource wealth as their royalty oil, how can we justify dispersing income investments of collectively owned Alaskan wealth selectively to only those who make enough money to have to pay taxes? Accordingly, I would prefer that dividends go to all otherwise qualified citizens either in the form of tax credits or as a negative income tax return.

Additionally, since the rationale for dispersing dividends is based on the belief that with all their energy wealth Alaskans should receive at least some direct relief from the exceptionally high price they've had to pay for energy, then there is little rationale to compensate them for but 5 years of such impact. Compensation should be for each year so impacted.

Though determining the number of years for which each applicant is qualified may seem difficult, it is less difficult than obtaining similar data required for proof of eligibility for receipt of the longevity bonus, guide licenses, limited entry permits, or entry into a pioneer home.

To minimize administrative costs and the likelihood of perjury, we could require an affidavit from the applicant with two other "shareholders" as witnesses. If all parties were to lose eligibility should they perjure themselves, it is unlikely many would falsify claims. In those cases where no witnesses will come forward, shares could be confined to the number of years the applicant can provide documentation to prove his case, i.e., tax records, etc.

The conclusion that an Alaska, Inc. type program should be established before an AGSOC proposal was reached primarily because of the potentials of an AGSOC to place the shareholders' interests precisely at odds with State interests. For example, one AGSOC proposal involves partial purchase of the trans-Alaska oil pipeline. Should all shareholders then get dividends based on the profitability of that purchase, it is to the shareholders' benefit to get the highest possible price - i.e. tariff - for transporting oil. However, the State treasury, including the Permanent Fund, gets more money the lower the tariff. Thus, the AGSOC's interest would be precisely opposite those of the State in regard to the level of tariff. On the other hand, in the case of an Alaska, Inc. type distribution of Permanent Fund earnings, the interests of the State and the shareholders would be precisely the same.

Similarly, if an AGSOC were to invest in a petrochemical plant, its shareholders would benefit if we sold that plant our royalty oil at a cut rate. This too would be a loss to the State's Permanent Fund and to those who did not hold shares of that AGSOC.

Only by passing an Alaska, Inc. type program first could we likely establish conditions where the State and all Alaskans' interests were compatible insofar as maximizing the return from the citizens' resource wealth. Once in place, such programs reduce the likelihood of conflicting AGSOC proposals being undertaken.

In its present form, proposed AGSOC legislation has other problems:

1. Since only one share of stock goes to each person here in Alaska at the time each AGSOC is formed, ultimately there would be two types of Alaskans: those who were shareholders, and those who were not.

Remedy:

One way to remedy this is to amend the bill to provide one share of stock for each year the shareholder has resided in a locale where the government recognizes cost of living impact sufficient to warrant their payment of a 25 percent cost of living differential to government workers. Then all Alaskans would be shareholders.

2. AGSOC shares would be transferable, permitting money to leave Alaska. This should be amended since the prime objective and rationale is to insure that Alaskans get a "piece of the action" to compensate them, in part, for the exceptionally high cost of living impact here in Alaska. Accordingly, persons who have moved to Hawaii or California have no justification for receiving such cost of living offset.

Remedy:

A remedy would be to require that persons make application for their annual dividends on an Alaskan income tax filing form attesting to their having resided during most of the previous year in an area of qualifying high cost of living differential.

3. Another problem is, what if the AGSOC loses money? Who then pays off the bonds or other debt obligations? I am opposed to State guarantees. Would the AGSOC shareholders then become liable?

Remedy:

To offset this concern, were the Alaska, Inc. concept in place first, guarantees or collateral could be an AGSOC shareholder's prospective Alaska, Inc. dividend's. Far better to use the AGSOC shareholder's prospective Alaska, Inc. dividends as such than use, as guarantees, Permanent Fund principle or general fund monies which belong to all Alaskans, not just AGSOC shareholders.

4. Under an AGSOC proposal some shareholders may be unwilling participants in programs to which they are philosophically or otherwise ill disposed.

Remedy:

If one is already a shareholder in an Alaska, Inc. program, they should be able to elect whether or not they wish to become an AGSOC shareholder. By so doing, they would not be compelled to participate in some development program they may not favor in order to get any "piece of the action" whatsoever.

Another reason why the Alaska, Inc. program should go in place first is because it would motivate placement of more oil wealth behind the Permanent Fund "rope" where it could not be used for more government or as guarantees for some shakey AGSOC proposal. Since Alaska, Inc. shareholder "dividends" are directly dependent upon the amounts of money placed in the Permanent Fund, there would be a countering pressure to those political pressures which create bigger government.

Because the Alaska, Inc. approach would provide "dividends" from an "enterprise" already returning revenues which belong to all Alaskans, the charge of "improper involvement of government in to private sector affairs" is absent. Of course, since AGSOC's are not truly government functions the traditional "undue involvement" charge does not really wash. However, because of the potential impact on government funds to bail out ailing AGSOCs, a reverse concern may be valid: "undue involvement by the private sector in the affairs of government."

Other advantages recommending prior implementation of Alaska, Inc. are its comparative simplicity and the fact that unlike the speculative nature of any AGSOC, we would be betting on a "sure thing." For example, we know that we have a fully capitalized, debt free enterprise in the Permanent Fund which can immediately start paying "dividends". No loans must be made; bonds sold; speculation engaged in. We are already functioning "in the black." Surely if we're going to condition the public to feel comfortable with any "dividend distribution" system at all, we should start with a simplistic "sure" winner.

A major benefit of increasing contributions to the Permanent Fund is that the other half of the resultant increased recurring income from Permanent Fund investments would flow into the General Fund where it could supplant these non-recurring oil wealth dollars now improperly funding our day to day government operations. Such reduction of our dangerous dependence upon principle dollars for funding operations - which should be funded with income dollars - is imperative.

If the AGSOC program goes on the line first, the chances of finding surplus State dollars to place into the Permanent Fund would likely diminish.

Thus, while I favor both the Alaska, Inc. and AGSOC concepts for insuring all citizens a "piece of the action," I believe it imperative that the Alaska, Inc. program be placed on line before an AGSOC be established. Meanwhile, I would like the enabling AGSOC legislation amended to deal with those problems I've previously outlined.

United States Senate

April 26, 1979

Dear Friends:

Governor Hammond in his "Working Paper on Dividend Dispersal Programs" criticises the House State Affairs Committee AGSOC bill. He assures me that his comments were not intended to give the impression that he would veto the AGSOC bill, but were offered as an aid in moving the bill forward. However, the Governor has made some assertions which are wrong and need to be corrected.

The Governor implies that AGSOC, like Alaska Inc., is merely a means of distributing "dividends" to Alaskans. AGSOC is not a scheme for distributing state assets to Alaskans, but a vehicle through which Alaskans can acquire new wealth independently of government. AGSOC is a vehicle for new capital ownership by the citizens of Alaska, not a scheme to distribute something they already own.

The Governor maintains that AGSOC would place the interests of the shareholders at odds with the interests of the state. The interests of the state are not independent of the interests of its people. The shareholders of AGSOC will be the people of Alaska. It is my conviction that people will be better citizens if they have a real economic interest in private enterprise and that they will act in their own best interests as economic shareholders and political citizens.

The Governor criticises AGSOC because it will create two types of citizens, shareholders and non-shareholders, and proposes as a remedy a scheme which creates many classes of citizens shareholders based on length of residency in Alaska. The Governor misses the point of AGSOC. The rationale for AGSOC is not to "compensate" anyone for living in Alaska, but to provide a means other than the taxing power of the state for Alaskans to participate in the economic development of their state.

The House State Affairs Committee AGSOC bill prohibits ownership of AGSOC shares by outsiders. When a shareholder leaves the state he is required to sell his stock either to the corporation or another Alaskan.

The House Committee carefully considered the question of state financial assistance to AGSOC and made it clear that AGSOC was to be treated no differently than any other private corporation seeking state financial assistance. If, after full legislative action, the state decides to assist in AGSOC financing it will be doing no more than what it has already done for those Alaskans holding more than \$150 million in state low interest business loans.

The corporate doctrine of limited liability protects the shareholders of AGSOC from any liability for the debts of the corporation.

There is no requirement that an Alaskan become a shareholder of AGSOC. He may reject the stock offered to him at any time within one year of its issue. If he becomes a shareholder and does not want the corporation involved in a particular investment he may put the question to a vote of the shareholders.

Best regards,


Mike Gravel

February 23, 1979

Honorable James Duncan
State Representative
Pouch V
Juneau, Alaska 99811

Dear Jim:

I would like to take this opportunity to express my opposition to your General Stock Ownership Plan (G.S.O.P.) bill.

I feel the State's royalty and/or permanent fund income would be more equitably used as a vehicle to reduce income taxes and increase revenue sharing. This would result in a distribution which relates in some manner to the widely varying burdens carried by different people by present income and property tax schedules.

I likewise find the \$100/200/300 tax credit bill passed last year distasteful. The person who pays, say, \$10,000 a year in State income tax realizes no more benefit than the person who previously paid only \$300 and only an insignificant benefit in comparison to the person who draws welfare and pays no taxes.

A program for an across the board percentage temporary tax credit or permanent tax reduction would be more equitable. A scaled credit with a smaller percentage applying to higher tax brackets would be less preferable than a flat credit but would still be preferable to last year's credit or the proposed G.S.O.P., which are both nothing more than thinly-veiled welfare programs.

Sincerely,

Roger R. Shattuck

RRS/cc
cc: Honorable Mike Miller
Honorable Bill Ray

*Shattuck + Grummett done
Erasmus Camp
301 Seward St
Juneau 99801*

ALASKA
GENERAL STOCK OWNERSHIP CORPORATION

BILL SUMMARY

Federal law requires state authorization of general stock ownership corporations receiving special tax treatment under Subchapter "U" of the Internal Revenue Code. The bill creates the Alaska General Stock Ownership Corporation (AGSOC). This corporation is a completely private for profit corporation which will operate under the Alaska Business Corporations Act to the extent consistent with the AGSOC act. The shares of the AGSOC will be owned and voted by the citizens of Alaska with each resident holding a share of stock.

The bill directs the Governor to appoint incorporators to form the AGSOC and sets forth the following:

- 1) Board membership limitations assuring Alaskan control;
- 2) Federal requirements for corporate articles;
- 3) Stock distribution to all Alaska residents;
- 4) Penalties for fraudulent acquisition of AGSOC stock;
- 5) One year statute of limitations on AGSOC challenges;
- 6) Financing for AGSOC startup costs; and,
- 7) Technical amendments required to Alaska statutes.

The corporation is designed to have as its shareholders existing Alaskan residents. Stock will be distributed to eligible individuals without cost. Investments by the AGSOC will be made through the use of borrowed funds and the earnings from those investments used to retire the loan and distribute dividends to the shareholders. Except for minor exemptions the AGSOC will be subject to the same rules as all other Alaska corporations.

SC.

DETAILED EXPLANATION

The bill creates a new Chapter 50, entitled "Alaska General Stock Ownership Corporation", within Title 10, the Corporations and Associations title, of Alaska Statutes. The act contains nine sections which may be summarized as follows:

Section 1 sets forth those areas where the AGSOC differs from a typical Alaska business corporation organized under Chapter 5 of Title 10. To the extent that these provisions do not conflict with the provisions of Chapter 5, the Alaska Business Corporations Act, Chapter 5 will apply;

Section 2 includes the corporation among those organizations eligible to receive secured loans from the Permanent Fund;

Section 3 allows the investment of surplus state funds in bonds of the AGSOC;

Section 4 exempts the AGSOC from registration under the Alaska securities laws while providing protection from fraud;

Section 5 creates a one year statute of limitations on suits brought to challenge legality of the AGSOC;

Section 6 makes the provisions regarding eligibility for stock ownership "nonseverable" in order to assure that if this fundamental section is found unconstitutional the entire law will be voided;

Section 7 makes fraud or misrepresentation in obtaining or selling shares of the AGSOC a Class C felony; and,

Sections 8 and 9 provide effective dates immediately following the Governor's signature for most of the legislation.

ANALYSIS: SECTION 1

Section 1 of the bill constitutes the primary legislative section. It creates a new chapter, Chapter 50, of the Alaska Statutes, Title 10, setting forth technical requirements for the Alaska General Stock Ownership Corporation. The Chapter is divided into nine sections dealing with creation of the AGSOC, federally required charter limitations, board of directors, notification of shareholders' eligibility, limitations on corporate liability, restrictions on application for shares, fraud penalties, corporate dividends and definitions. A section by section analysis of Chapter 50 follows.

50.010. ALASKA GENERAL STOCK OWNERSHIP CORPORATION CREATED.

This section directs the Governor to appoint nine people as the incorporators and initial board members of the Alaska General Stock Ownership Corporation. These nine people, a majority of whom must be Alaskans, will adopt corporate articles and by-laws and file with the state to create the corporation as required under the Alaska Business Corporations Act. The bill allows the appointment of some non-Alaskan directors to provide flexibility in obtaining special expertise.

The status of the general stock ownership corporation is made clear by this section. AGSOC is not and may not be considered to be an agency, instrumentality or political subdivision of the State of Alaska. This parallels the federal statute which provides that a GSOC shall be treated as a private corporation and not as a governmental unit. The section also clarifies AGSOC status in relation to other statutes by requiring that it comply with the provisions of Subchapter U of the Internal Revenue Code and the Alaska Business Corporations Act. To the extent that the AGSOC authorizing legislation is not inconsistent with Chapter 5 of Alaska Statutes Title 10, AGSOC will be subject to all the rules applicable to any other Alaska business corporation.

50.020. ARTICLES OF INCORPORATION.

Federal law requires certain charter provisions for general stock ownership corporations and these are set out as requirements for the articles of incorporation of the Alaska General Stock Ownership Corporation. Each of the subsections in .020 set forth a different requirement which must be included in the AGSOC articles.

Subsection 1 provides that the AGSOC may issue only one class of stock which impliedly must be voting common stock.

Subsection 2 provides that stock may be issued only to a certain class of individuals. The group to whom stock may be issued, a closed class of original issue shareholders, are those people who fulfill two tests:

- a) They were residents of Alaska, as defined by the definition Section .900, as of the effective date of the legislation which, under Section 8 of the bill, will be the day following the Governor's signing; and,
- b) They remain residents of Alaska until the shares are issued.

50.900 defines resident as a person who lives in Alaska and intends to remain here permanently. The definition allows for temporary travel or employment outside without loss of residency. In a dispute arises over residency all of the facts and circumstances indicative of permanent residency must be considered.

Subsection 3 provides that at least one share of stock must be issued to each eligible resident unless that person elects within one year not to receive the stock. The legislation contemplates issuance of shares to eligible individuals free of charge with corporate investments financed entirely with borrowed funds. The one year period allows shareholders who do not wish to receive stock for whatever reason to reject their share, but this election not to receive stock is irrevocable and once made may not be changed.

Subsection 4 provides for limitations on the transferrability of the stock so that shares may not be sold or used as security for a loan during the first five years unless the shareholder dies or moves out of the state. Shares may only be transferred to another Alaska resident and then only if that person would not own more than ten shares of AGSOC stock after the transfer. Corporations and other artificial persons may not be shareholders. Finally, in order to protect minors, shares may not be transferred until the shareholder reaches 18.

Subsection 5 provides that the corporation shall qualify as a general stock ownership corporation subject to the special tax provisions of Subchapter U of the Internal Revenue Code.

Subsection 6 provides for a limitation on investments which the corporation may purchase. The corporation may not invest in assets acquired by it or for its benefit through the power of eminent domain. This is not to imply that the AGSOC has the power of condemnation since that power may be exercised only by the government. The limitation is designed to prevent the AGSOC from acting in collusion with an agency or local government to acquire a going business from an unwilling seller. It is not intended to prevent the purchase at arm's length of a business where a portion of the seller's assets may have been acquired by condemnation. The AGSOC would not be prevented from investing in a project where some minor portion of the assets must be acquired through eminent domain if the State or local government determines that the exercise of its condemnation power is appropriate. Such a situation might occur should the AGSOC become involved in the construction of a major pipeline.

Subsection 7 provides the AGSOC with a right of first option to purchase, at a price not less than book value, any stock offered for sale during the first five years of the corporation. The terms and conditions for exercise of this right will be set forth in detail in the corporate bylaws and a notice of the restriction will appear on the stock certificates or receipts.

The five year period for the right of first option parallels the time during which shareholders are prohibited from selling their stock. Only a limited number of shares will become available for sale during this period of time and it is unlikely that an organized market for AGSOC stock will develop during this period. Discretion is left with the corporation to pay prices higher than book value for the stock, but it is likely that the directors will determine that book value is the appropriate price.

Since shareholders who become non-residents during the five year period of transfer restrictions may be able to sell their stock at a high price in an uncontrolled market emigration might be encouraged. The option by the corporation provides a controlled market during the transfer restriction period and allows time to structure the full public market which will develop after the transfer restrictions lapse.

50.030. BOARD OF DIRECTORS.

This section sets out the provisions for AGSOC directors which differ from those applicable under Alaska Statutes Title 10, Chapter 5. The nine incorporators serve as the original board of directors and are divided into three groups in accordance with AS 10.05.186, except that only one-third of the directors will stand for election at the first annual meeting, one-third at the second annual meeting and one-third at the third annual meeting. Thereafter each director will serve for a term of three years as provided in AS 10.05.186. None of the other provisions of the Alaska Business Corporations Act regarding directors are changed and the normal rules of Chapter 5 apply to the AGSOC.

This section provides a civil right of action against individuals who obtain stock through fraud or misrepresentation and who sell stock on the same basis. It allows the stock to be voided, dividends to be recovered with interest and costs of the suit to be paid by the defendant.

50.080. DIVIDENDS OF THE CORPORATION.

Under the rules of the Alaska Business Corporations Act a corporation may pay dividends only out of earned surplus, the retained earnings of the corporation. Since the AGSOC is required by federal law to distribute 90% of its taxable income to its shareholders on an annual basis it may be necessary to distribute a dividend in excess of earned surplus. Such a situation can arise because accounting for tax purposes and for purposes of the corporation's books may not and are not required to be the same. For this reason an exception to the general rule of Chapter 5, Title 10, is required allowing the AGSOC to distribute dividends as required to meet the terms of Internal Revenue Code Subchapter U except where such distribution would cause the corporation to become bankrupt or when the corporation is already bankrupt. Bankruptcy in this situation means when the corporation is unable to meet its current obligations.

50.090. EXEMPTION FROM AS 10.05

This section exempts the AGSOC from the provisions of the Alaska Business Corporations Act which requires \$1,000 of paid in capital before operation of the corporation commences.

50.100. LOAN GUARANTEE FUND.

This section establishes a fund within the Department of Revenue which is to be used to guarantee loans to the AGSOC by private lenders. This fund is intended to provide security for private credit to be used by the AGSOC for its startup expenses such as the costs of stock issue and the investigation of potential investments.

50.900. DEFINITIONS.

This section defines the terms used in Chapter 50. Especially important is the definition of resident since that definition will determine who is eligible to receive AGSOC stock without charge.

50.040. NOTIFICATION OF ELIGIBLE SHAREHOLDERS.

Since stock is to be distributed free of charge all Alaska residents must be notified of its availability. This section sets out the minimum notice requirements of weekly broadcast and publication for at least three months before stock distribution and monthly broadcast and publication for eleven months after distribution. These are minimum requirements only and the board of directors may determine that the corporation should take other steps to identify and notify potential shareholders. The AGSOC might want to compile mailing lists from various sources to develop a list of potential shareholders while in the bush it might be appropriate for it to hire census personnel to locate and identify eligible Alaskans.

50.050. CORPORATION NOT LIABLE TO SHAREHOLDERS.

This section makes it clear that although the AGSOC is required to take reasonable steps to notify potential shareholders of their right to stock the burden of applying for stock lies with the resident and the corporation is not liable for failure to notify or issue stock to a potential shareholder. If a resident makes application for stock after the distribution of one or more dividends he loses his right to those dividends and is entitled to receive only those dividends declared and paid after the date upon which his stock was issued to him.

50.060. LATE APPLICATION FOR SHARES.

The legislation provides that stock is to be issued to all qualifying residents and the corporation directed to use reasonable efforts to identify potential shareholders. The burden of application is upon the resident. Those residents who are identified or who identify themselves will have one year in which to elect not to receive stock. To protect against those eligible residents who are not identified and fail to identify themselves hoping to see how the corporation fares before applying for their stock, a final cutoff date is provided after which distributions of stock will be made only upon payment to the corporation of book value.



STATE OF ALASKA
OFFICE OF THE GOVERNOR
JUNEAU

March 12, 1979

The Honorable Mike Miller
Chairman
House State Affairs Committee

The Honorable Brad Bradley
Chairman, Senate Commerce Committee
Alaska State Legislature
Juneau, Alaska 99811

Dear Sirs:

Thank you for this opportunity to offer my views on SB 170/HB 240, the enabling legislation for an Alaska General Stock Ownership Corporation (AGSOC). As you know, I have been an advocate of a similar idea, Alaska, Inc., which was designed to distribute a portion of the income produced from Permanent Fund to Alaskans. This idea has been incorporated into my proposal for the Permanent Fund through the distribution of one-half of the earnings of the Permanent Fund to Alaskan residents in the form of tax credits.

As I understand it, the AGSOC concept proposes a completely private corporation, the shareholders of which would be Alaska residents who elect to receive a share. Like Alaska, Inc., the earnings of the AGSOC would also be distributed to residents as dividends on their shares. I would like to express my support of the AGSOC idea in concept. AGSOC would represent a unique experiment to provide an opportunity for the broad participation of Alaska residents in the financing of resource development projects in the state. I would encourage you to undertake as much investigation and public discussion as possible in order to familiarize all Alaskans with this idea and to insure that a wise and informed decision will be made. While I wish to reserve judgement on the specific details of this idea pending additional review, I do hope to work closely with your committee and other committees as the bills proceed through the legislative process.

To facilitate this cooperation, I have requested the Division of Policy Development and Planning to coordinate the Administration's review of this legislation, and to work closely with the Departments of Law, Revenue, Commerce and Economic Development, and with Sterling Gallagher, who is on contract with my office on this issue.

The Honorable Mike Miller
The Honorable Brad Bradley

March 12, 1979

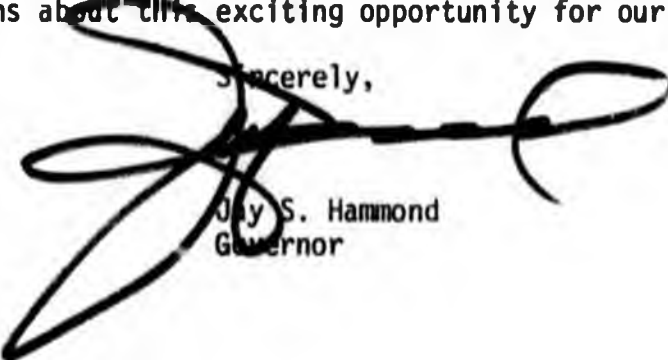
Page 2

Specific comment and recommendations on the bill must await additional analysis. However, there appears to be a number of philosophical and technical difficulties with the sponsor substitute which we wish to take up with your committees at subsequent hearings.

One fundamental issue which I would like to raise at this point is the question concerning the applicability of the normal procedures for corporate governance (annual shareholder meetings, voting by proxy, etc.) to this unique corporate creature which will make shareholders voice their concerns and influence or veto management decisions. I hope that this experiment in economic democracy might be linked to an experiment in corporate democracy which might involve the creation of mechanisms specifically tailored to insure adequate shareholder representation and participation in major management decisions.

There are many details about the bill which require closer scrutiny, such as the amount of state assistance which will be required and the investment opportunities available. My Administration intends to work closely with you on this issue to analyze these and other questions. We look forward to an open dialogue to resolve any uncertainties and to talk with Alaskans about this exciting opportunity for our future.

Sincerely,



Jay S. Hammond
Governor

ALASKA STATE LEGISLATURE

Legislative Affairs Agency

Pouch Y - State Capitol
Juneau, Alaska 99811

REGIONAL INFORMATION OFFICE

1024 West 6th Avenue
Anchorage, Alaska
99501
(907) 278-3668

Enclosed for your information and files are materials relating to the teleconference on HB 240, Alaska General Stock Ownership Corporation held March 12, 1979, including a copy of the witness and observer list.

Judy Hopkins
Anchorage Moderator

Alaska State Legislature

TELECONFERENCE HEARINGS



SUBJECT: HB 240 - Alaska General Stock Ownership Corporation (Duncan et al)

COMMITTEE: House State Affairs (MILLER, Fuller, Gardiner, Parker, Eliason, Martin, Metcalfe)

DATE: Monday, March 12, 1979

TIME: 5:30 p.m. A.S.T.

SITES PARTICIPATING: Gravel, Anchorage, Fairbanks and other interested sites

CONFERENCE MODE: audio

LOCATION: LIO

MODERATOR: *Hopkins*

UAA ADVISED, CONFIRMED na

Extra bills ordered _____

Register prepared 3/5/79

NOTES:

Summary coming

PUBLICITY:

INVITATIONAL

| | Date | Quantity |
|----------------|----------------|-----------|
| PSAs | <u>3/4/79</u> | <u>26</u> |
| Audio PSAs | | |
| Video PSAs | | |
| News releases | <u>3/8/79</u> | <u>30</u> |
| Direct mail | | |
| Phone contacts | <u>3/12/79</u> | <u>34</u> |
| Other: | | |
| Posted at LIO | <u>3/5/79</u> | |

| | |
|----------------------|------------|
| Copies to LTN Juneau | <u>3/3</u> |
| Copies to committee | <u>3/3</u> |
| Copies to sponsor | _____ |

| | |
|----------------------|----------|
| NUMBER IN ATTENDANCE | <u>4</u> |
| NUMBER TESTIFYING | <u>0</u> |

- ✓ UAA 263-1756
- ACC 263-1536
- ✓ CPA 276-8181
- ✓ ISEK 278-4621

*Briefing teleconference -
Hearings later on.*

*start - 5:30
end - 8 pm*

62-00

Today in Anchorage

Public input on House Bill 240, creating the Alaska General Stock Ownership Corp., is invited by the House State Affairs Committee in an audio teleconference beginning at 5:15 p.m. at the Legislative Information Office, 1024 W. Sixth Ave. Area residents interested in testifying should register in advance by calling 279-3668. Observers are welcome.

← Anchorage Daily News, Monday, March 12, 1979

Alaska State Legislature

TELECONFERENCE HEARINGS



March 8, 1979

Contact: Representative Mike Miller
465-4964 Juneau or Judy Hopkins
278-3668

FOR IMMEDIATE RELEASE

ALASKA GENERAL STOCK OWNERSHIP PLAN AIRED

Legislation creating the Alaska General Stock Ownership Corporation will be considered in an audio teleconference hearing beginning at 5:30 p.m. Monday, March 12 at the Legislative Information Office, 1024 West Sixth Avenue. Participants will include Senator Mike Gravel and residents of Anchorage and Fairbanks interested in commenting on the proposal before the House State Affairs Committee, chaired by Representative Mike Miller of Juneau.

House Bill 240, sponsored by Representative Jim Duncan and eight of his House colleagues, creates the Alaska General Stock Ownership Corporation as a completely private for profit corporation which will operate under the Alaska Business Corporations Act to the extent consistent with the AGSOC act. The shares of the AGSOC will be owned and voted by the citizens of Alaska with each resident holding a share of stock.

The bill directs the Governor to appoint incorporators to form the AGSOC and provides ^{for} board membership limitations assuring Alaskan control,

(MORE)

Legislative Affairs Agency
Legislative Teleconferencing Network
State Capitol . Pouch Y . Juneau . 99811

Phone: 465-4980

MORE ON STOCK OWNERSHIP PLAN

stock distribution to all Alaska residents, penalties for fraudulent acquisition of AGSOC stock, and financing for AGSOC startup costs.

The corporation is designed to have as its shareholders existing Alaska residents. Stock will be distributed to eligible individuals without cost. Investments by the AGSOC will be made through the use of borrowed funds and the earnings from those investments used to retire the loan and distribute dividends to the shareholders. Except for minor exemptions, the AGSOC will be subject to the same rules as all other Alaska corporations.

Federal law requires state authorization of general stock ownership corporations receiving special tax treatment under Subchapter "U" of the Internal Revenue Code.

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Alaska State Legislature

TELECONFERENCE HEARINGS



March 6, 1979

Contact: Judy Hopkins 278-3668

PUBLIC SERVICE ANNOUNCEMENT

(Run through 3 p.m. 3/12/79)

PUBLIC INPUT ON HOUSE BILL 240, CREATING THE ALASKA GENERAL STOCK OWNERSHIP CORPORATION, IS INVITED BY THE HOUSE STATE AFFAIRS COMMITTEE IN AN AUDIO TELECONFERENCE STARTING AT 5:15 p.m. MONDAY, MARCH 12, AT THE LEGISLATIVE INFORMATION OFFICE, 1024 WEST SIXTH AVENUE.

AREA RESIDENTS INTERESTED IN TESTIFYING SHOULD REGISTER IN ADVANCE BY CALLING 278-3668. OBSERVERS ARE WELCOME.

///

PLEASE PRINT

Name DOUGLAS B. TERHUNE Here to TESTIFY _____
Representing SELF
Mailing Address 2711 W. 84TH AVE Zip 99502 Here to OBSERVE
Phone 243-7189

BROADCAST CONSENT: This proceeding may be broadcast live or recorded for later broadcast by radio or television stations. Please indicate your consent by signing below:

Douglas B. Terhune
(signature)

Have you participated in other legislative teleconferences? YES How many? 6-8 Would you have participated in this hearing if the network were not available? _____

PLEASE PRINT

Name Amy E. Prestegard Here to TESTIFY _____
Representing Senator Grant
Mailing Address P.O. Box 2283 Anchorage Zip 99510 Here to OBSERVE
Phone 277-4591

BROADCAST CONSENT: This proceeding may be broadcast live or recorded for later broadcast by radio or television stations. Please indicate your consent by signing below:

Amy E. Prestegard
(signature)

Have you participated in other legislative teleconferences? _____ How many? _____ Would you have participated in this hearing if the network were not available? _____
How did you learn about this hearing? _____ If yes, did you use the network:
_____ instead of travel
_____ instead of phone conversations
_____ instead of mailed testimony

PLEASE PRINT

Name Fred B. Morgan Here to TESTIFY (Fred)
Representing Self
Mailing Address Box 2328; Anchorage, Alaska Zip 99510 Here to OBSERVE _____
Phone _____

BROADCAST CONSENT: This proceeding may be broadcast live or recorded for later broadcast by radio, or television stations. Please indicate your consent by signing below:

Fred B. Morgan
(signature)

Have you participated in other legislative teleconferences? V How many? 3 or 4 Would you have participated in this hearing if the network were not available? No
How did you learn about this hearing? Anch. Daily News (2-day in Anch. ed.) If yes, did you use the network:
_____ instead of travel
_____ instead of phone conversations
_____ instead of mailed testimony

PLEASE PRINT

Name Terry McCutcheon Here to TESTIFY _____
Representing _____
Mailing Address _____ Zip _____ Here to OBSERVE _____
Phone _____

BROADCAST CONSENT: This proceeding may be broadcast live or recorded for later broadcast by radio or television stations. Please indicate your consent by signing below:

(signature)

| | |
|---|--|
| Have you participated in other legislative teleconferences? _____ How many? _____ | Would you have participated in this hearing if the network were not available? _____ |
| How did you learn about this hearing? _____ | If yes, did you use the network: _____ instead of travel _____ instead of phone conversations _____ instead of mailed testimony |

Date: 3/12/79 Subject: HB 240 - GSOC Location: Anchorage

EOM

LA21 1930 15.24 JA01 0043 15.24 03/16/79

FROM: FAIRBANKS LEGISLATIVE INFORMATION OFFICE

TO: REP. MILLER, HOUSE STATE AFFAIRS CHAIRMAN
CC: CLAUDIA COYNER, TELECONFERENCE NETWORK REP.

FOLLOWING IS LIST OF OBSERVERS ON MARCH 12 AT HOUSE STATE AFFAIRS
COMMITTEE TELECONFERENCE ON HB 240 FOR INCORPORATION IN YOUR
COMMITTEE'S RECORDS.

1. JENNIFER JOHNSTON, BETTYE FAHRENKAMPE, 221 KODY DR., FBKS 99701
452-8097
2. ROBERT DEMPSEY, ECON, DEVELOPMENT COMM., CHAMBER OF COMMERCE,
11 WOLF RUN, FBKS 99701 479-5154
3. ROSE C. HOUGH, SEN. MIKE GRAVEL AND DEMOCRATIC CENTRAL DIST.
COMMITTEE, 4050 EVERGREEN AVE, FBKS 99701 452-6227
4. EDITH RISSELL, SENATR MIKE GRAVEL, BOX 7, 101 12TH AVE., FBKS 99707
452-6227
5. ALLAN R. JOHNSTON, SELF, 221 KODY DR., FB S 77701 452-8094
6. MONTE SHADE, SELF, P.O. BOX 1271, FBKS 99707 452-8352
7. TERRY PALCZER, SELF, SR BOX 10671, FBKS 99701 479-6344
8. SHERRY MODROW, SELF, BOX 2847, FBKS 99707 456-2037

/NS/ EOM

ALASKA STATE LEGISLATURE

Legislative Affairs Agency

Pouch Y - State Capitol
Juneau, Alaska 99811

REGIONAL INFORMATION OFFICE

1024 West 6th Avenue
Anchorage, Alaska
99501
(907) 278-3668

Enclosed for your information and files are materials relating to the
teleconference on HR 240 - AGSOC
held March 14, 1979, including a copy of the witness and
observer list.


Judy Hopkins
Anchorage Moderator

TELECONFERENCE HEARINGS



SUBJECT: HB 240 - Alaska General Stock Ownership Corporation (Duncan et al)

COMMITTEE: House State Affairs (Miller)

DATE: Wednesday, March 14, 1979

TIME: 5:30 - 7 p.m. A.S.T.

SITES PARTICIPATING:

CONFERENCE MODE: audio

LOCATION: LIO

MODERATOR: *Hopkins*

| | |
|------------------------|-----------|
| UAA ADVISED, CONFIRMED | <u>na</u> |
| Extra bills ordered | <u>v</u> |
| Register prepared | <u>v</u> |

NOTES:

Gravel will be on hand in Washington

PUBLICITY:

INVITATIONAL

| | Date | Quantity |
|----------------|-------------|----------|
| PSAs | _____ | _____ |
| Audio PSAs | _____ | _____ |
| Video PSAs | _____ | _____ |
| News releases | _____ | _____ |
| Direct mail | _____ | _____ |
| Phone contacts | _____ | _____ |
| Other: | | |
| Posted at LIO | <u>3/13</u> | |

Bob Richards
(Miss Lou Couch) 276-3110

✓ suspension 276-7133 out of town

✓ Link 279-2522

✓ Hancock - 263-1810 out of town

✓ Cryst - 272-3508

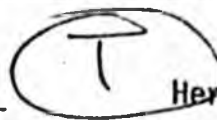
| | |
|----------------------|------------|
| Copies to LTH Juneau | <u>3/5</u> |
| Copies to committee | <u>3/5</u> |
| Copies to sponsor | _____ |

| | |
|----------------------|----------|
| NUMBER IN ATTENDANCE | <u>1</u> |
| NUMBER TESTIFYING | <u>1</u> |

67-03-1

Name

Terry McCutcheon



Here to TESTIFY

Representing _____

Mailing
Address _____

Zip _____

Here to OBSERVE _____

Phone _____

BROADCAST CONSENT: This proceeding may be broadcast live or recorded for later broadcast by radio or television stations. Please indicate your consent by signing below:

(signature)

Have you participated in other legislative teleconferences? _____ How many? _____

How did you learn about this hearing?

Would you have participated in this hearing if the network were not available? _____

If yes, did you use the network:

_____ instead of travel

_____ instead of phone conversations

_____ instead of mailed testimony

Date: 3/14/79

Subject: HB 240 - AGSOC

Location: Anchorage

LA21 2527 18.17 (3/16/79 JA01 0013 08.36 03/17/79

FROM: FAIRBANKS LEGISLATIVE INFORMATION OFFICE

TO: SEN. MULCAHY, SENATE STATE AFFAIRS COMMITTEE CHAIRMAN
REP. MILLER, HOUSE STATE AFFAIRS CHAIRMAN

CC: CLAUDIA COYNER, TELECONFERENCE NETWORK REP.

FOLLOWING IS LIST OF WITNESSES ON MARCH 14 AT SENATE & HOUSE STATE AFFAIRS
COMMITTEE TELECONFERENCE ON SB 170 & HB 240 FOR INCORPORATION IN YOUR
COMMITTEES' RECORDS.

1. DONALD D. THOMAS, SELF, 3070 TOTEM DR., FBKS 99701 479-2004
2. BOB DEMPSEY, SELF, 11 WOLF RUN, FBKS 99701 479-5154
3. FRANK P. LEE, SELF, P.O. BOX 80565, FBKS 99701 456-8671
4. ALLAN R. JOHNSTON, SELF, 221 KODY DRIVE, FBKS 452-8094
5. MONTE S. SHADE, SELF, P.O. BOX 1271, FBKS 99707 452-8352
(OBSERVE ONLY)

/NS/ EOM

PERSONAL MESSAGE FORM

DATE March 13, 1979

NAME Vander Pearson

REPRESENTING The Greater Fairbanks Black Caucus

ADDRESS 1028 1/2 23rd Ave.

Fairbanks, Alaska 99701

PHONE NUMBER 479-6514

TO House State Affairs Committee

RE House Bill 240

MESSAGE I support House Bill 240 and would like to see this bill
become law. As I understand H.B. 240, it would create a
General Stock Ownership Corporation that would finance the
Alaska Gasline. With this approach, every Alaskan will have
a opportunity to participate in the growth and development
of Alaska.

Vander Pearson
Signature

CAN BE CONTACTED AT FOLLOWING TIMES 4:30 - 8:00 P.M. Week days

ADDRESS AND PHONE NUMBER (if different from the above) _____

4705 Palo Verde, Univ. West

Fairbanks, Alaska 99701 479-6514

Senator Gravel finally got his Government Stock Ownership scheme into law, but who, all things considered, wants it?

A bad idea whose time, alas, came



Senator Gravel of Alaska
A curious way to build a constituency for capitalism.

By Fern Schuber

IN THE WANING HOURS of the 95th Congress a new economic animal was born—the Government Stock Ownership Corp. The GSOC (pronounce it “Gee, Sock”) owes its life to Senator Mike Gravel of Alaska, who, in the rush toward adjournment, tacked the idea into the big tax-cut bill. It is an odd beast, a sort of state-chartered mutual fund. A state could use its credit to borrow right and left for the GSOC so that the corporation could invest in stock. It would distribute each year at least 90% of the profits to its shareholders, who, in turn, would be credited with the income for federal tax purposes. (Shareholders would not be able to use GSOCs as tax shelters, however, because they would not be allowed to flow through any losses.)

In theory, any state can now set up a GSOC. One can almost hear the bond salesman and underwriters of the world bracing to handle a flood of new state-guaranteed issues. But, in fact, few are likely to, and only Alaska, with its huge

Not the least peculiar thing about the GSOC is that it all but totally separates risk from reward. If the Alaska legislature runs with the idea, each of Alaska's 405,000 residents would receive a free share of stock and its dividends. But the corporation's only real asset in the beginning would be the state's ability to guarantee huge loans, the proceeds of which would be invested by the corporation. As in any state, however, a lot of Alaskans don't pay taxes. Furthermore, Alaska is unique in that it has a native group of people who live off the land and have no cash income. Is it fair that only taxpayers absorb the risk of GSOC, while an initial group of Alaska residents reaps the benefits?

After the stock has been distributed, of course, there will also be an ever-growing divergence between the stockholders, on the one hand, and taxpayers and citizens on the other. As people move to the state, they may not be eligible for a share of stock. At the same time, citizens who lived in Alaska and have since moved may still own stock.

other stockholders. For instance, GSOC proponents are talking about investments on the scale of \$1.5 billion. With that money the corporation might buy BP's 16% share of the oil pipeline. (BP is rumored to be eager to get its money out to help cover mounting exploration costs in the North Sea and elsewhere.) In that case, the state would be guaranteeing a \$1.5 billion loan—its total indebtedness now is only \$694 million, with guarantees in various forms for about another \$400 million. The state's credit rating would clearly be affected. If it needs to borrow more money, say, for a public works project, interest rates would be higher. Who would pay these higher rates? The taxpayer, of course. The stockholders who are taxpayers would have a direct, obvious stake in the corporation's profits and a less obvious inter-

“Not the least peculiar thing about GSOC is that it all but totally separates risk from reward. Is it fair that only taxpayers absorb the risk while an initial group of Alaska residents reaps the benefits?”

est in holding down taxes.

Gravel, nevertheless, is pushing GSOC as a way “to build a constituency for capitalism.” He got the idea from the theories of economist Louis Kelso, godfather of the employee stock ownership plans in effect at a good many U.S. companies. Alaska shows at least tentative interest in pushing the idea. The state has given Kelso a \$180,000 contract to draw up a GSOC blueprint and is spending an additional \$60,000 on other related consulting work. Kelso's blueprint is due next February, and the legislature is expected to tackle it shortly after that.

Gravel's staff has looked with particular longing at BP's 16% share of the Alaska oil pipeline. That would produce revenues of \$406 million a year, they reckon. After operating costs and annual debt payments, about \$158 million would be left to distribute to shareholders. Thus each of Alaska's citizen-shareholders would get a dividend check for \$390 a year. BP projects its revenues will be \$372 million this year and \$437 million next year if the pipeline runs at capacity.

GSOC, in a way, is another offspring of Proposition 13. “People recognize that once the money flows into the state treasury, it's harder to get it back into the hands of the people,” says Milt Barker, a fiscal expert for the state legislature. GSOC may be perceived as one way to filter the money into the people's hands. But the Alaska legislature had better take a hard look at Kelso's blueprint and add

Rule 23.1 Derivative Actions by Shareholders.

In a derivative action brought by one or more shareholders or members to enforce a right of a corporation or of an unincorporated association, the corporation or association having failed to enforce a right which may properly be asserted by it, the complaint shall be verified and shall allege that the plaintiff was a shareholder or member at the time of the transaction of which he complains or that his share or membership thereafter devolved on him by operation of law. The complaint shall also allege with particularity the efforts, if any, made by the plaintiff to obtain the action he desires from the directors or comparable authority and, if necessary, from the shareholders or members, and the reasons for his failure to obtain the action or for not making the effort. The derivative action may not be maintained if it appears that the plaintiff does not fairly and adequately represent the interests of the shareholders or members similarly situated in enforcing the right of the corporation or association. The action shall not be dismissed or compromised without the approval of the court, and notice of the proposed dismissal or compromise shall be given to shareholders or members in such manner as the court directs. (Added by Supreme Court Order 258 effective November 15, 1976)

MEMORANDUM

TO: Representative Jim Duncan, Chairman
Budget and Audit Committee
Alaska State Legislature

FROM: Arlon R. Tussing

RE: Questions about an Alaska General Stock
Ownership Corporation (GSOC)

I am submitting these preliminary comments at the request of Mr. Milt Barker of the Division of Legislative Finance. They are based upon my review of the following materials:

1. Louis O. Kelso, et al, Design of an Alaskan General Stock Ownership Plan, Volume I. (February 15, 1979);
2. Kelso & Co., (untitled) documents on British Petroleum's interest in TAPS (December 7, 1978);
3. Alaska House of Representatives, Sponsor Substitute for House Bill No. 240 (March 6, 1979);
4. Wilmer, Cutler & Pickering, Federal Constitutional Issues Presented by Alaska's GSOC (December 15, 1978);
5. Senator Mike Gravel, various speeches, Congressional Record citations on GSOCs (1978 & 1979).

MEMORANDUM

Page Two

I regret that I was not able to present these comments in person to the House State Affairs Committee on March 20, 1979, but I hope that they will be of use to you. Please let me know if you have any further questions.

QUESTIONS ABOUT AN ALASKA GENERAL STOCK
OWNERSHIP CORPORATION

1. GSOCs in General. Louis Kelso's concept of the General Stock Ownership Corporation (GSOC) has much in common with socialist and welfare state programs for redistributing wealth.* Instead of directly expropriating or taxing away property for redistribution, however, Kelso's approach would use the government's credit to finance specially created corporations, whose shares would be dealt out to eligible citizens. The individual shareholder in GSOC thus could regard any dividends he received as earnings from his ownership of private capital rather than as a government handout.

Like confiscation or condemnation, GSOCs would create no new wealth for society. The money used to create the GSOC would have to be bid away from private investors who did not have the same access to the government's power to tax (or, in the case of a federally-sponsored GSOC, to print money) in order to make good on their obligations. Because

* Kelso's accusations against present-day capitalism could well have come from a handbook of revolutionary Marxism. His program, it appears, is a remedy for "endemic poverty . . . misuse of technology, resource waste, despoliation of the environment, declining personal freedom, increasing lawlessness and civil disorder, the waning of liberal education, the civil rights impasse, the youth revolt, urban concentration, rising public and private debt, public loss of confidence in leadership and the seemingly irreversible advance toward a totalitarian society." (Kelso, et al, p. 16).

the "losers" would be widely scattered and impossible to identify individually, however, we could expect this kind of property redistribution to be less painful and less socially disruptive than more traditional socialist schemes.

There is nothing novel or radical in this aspect of the GSOC. Private individuals and corporations already benefit from a wide variety of federal and state loan and guarantee programs: each of them reallocates resources and redistributes wealth as surely (if not as visibly) as would taxation or government ownership of industry. GSOCs would no more revolutionize or redeem the capitalist system than do the existing programs of government credit for housing, agriculture, shipbuilding, rural electrification or education. The value of the GSOC concept to Alaska must be judged not by the sweeping claims of its inventors, but rather by whether specific proposals are properly tailored to the state's specific problems.

2. GSOCs in Alaska. The GSOC concept (like that of "Alaska, Inc.") appeals to legislators and other Alaskans because it may be a Constitutional way to use the state's petroleum revenue to increase the wealth of present resident Alaskans without permanently swelling the size of state government or attracting a host of immigrants to share in the windfall. In my opinion, something like a GSOC as contemplated in H.B. 2'0 may indeed be the best way to give

Alaskans a personal stake in the state's natural resource income. But the GSOC concept is still a very rough one, and there are a number of reservations and cautions even apart from technical legal issues, that I would like to raise here. As the Legislature deliberates further on the GSOC concept, I would expect to raise other problems and perhaps to offer some suggestions for improving the pending legislation.

3. Widely distributed ownership vs. broad-based control. GSOCs may very well be a means of widening ownership in Alaska industry, but widely distributed ownership is not the same thing as broadly-based control. It is a truism that corporations with widely dispersed share ownership are the easiest for small groups of insiders to control. They are practically immune both to stockholder revolts and to hostile takeover attempts (which are often the only way in which an ineffective management can be replaced).

Small shareholders normally do not take an interest in corporate affairs, and it is usually not worth their time to do so. Most shareholders express any dissatisfaction with management by selling their stock, not by becoming active in corporate politics. Otherwise, they routinely give their proxies to management, or simply decline to vote at the annual meeting. This experience in ordinary business corporations is duplicated in "non-profit" economic enterprises