The Early History of the Alaska Permanent Fund

Perspectives on the Origins of Alaska's Oil Savings Account

The Trustees' Papers Volume No. 5

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Table of Contents

Dear Fellow Alaskans,

The Board of Trustees is pleased to present the fifth in a series of Trustee Papers that trace and examine the major issues surrounding the establishment and development of the Alaska Permanent Fund. This latest edition is entitled: The Early History of the Alaska Permanent Fund: Perspectives on the Origins of Alaska's Oil Savings Account. It examines the initial debate that defined the Fund's mission and its early policy decisions.

This paper consists of four separate documents. The first, a speech by Elmer Rasmuson, the Trustees' first president, examines the establishment of the Alaska Permanent Fund Corporation and the Fund's early investment philosophy.

Joan Kasson's The Creation of the Alaska Permanent Fund Corporation follows the debate about the shape and powers of the corporation and the many purposes it could fulfill.

The third section, The Permanent Fund Dividend Program, looks at Alaska's unique decision to distribute dividends directly to its residents instead of following the more conventional program of using revenues to fund traditional governmental programs.

The final document is an in-depth analysis of the Legislative History, Intent and Operations of the Fund, and examines such policy decisions as the Fund's intent, its corporate structure, the dividend program and the prudent investor rule.

We hope you will find this paper as informative as the others that have preceded it. If you have ideas or suggestions about future Trustee Papers, please don't hesitate to contact me.

Sincerely,

Grace Berg Schaible
Chair, Board of Trustees

Trustee Papers Volume V

Elmer Rasmuson, a respected long-time Anchorage banker, was the first Chairman of the Board of Trustees of the Alaska Permanent Fund Corporation, and served on the board until 1986. The following paper is a transcription of his address to the 1993 annual meeting of the Corporation's Board of Trustees in Ketchikan on September 28, 1993.

Mr. Chairman, Trustees, Ladies and Gentlemen:

First, I wish to express my deep appreciation of the honor and privilege of addressing you on the occasion of the 1993 Annual Meeting of the Alaska Permanent Fund Corporation. The Fund will always be an institution in which I have a close and abiding interest.

Concerns about the Permanent Fund usually cluster around three aspects:

- First, investment operations and results.
- Second, purpose and use of the Fund principal and income.
- Third, social and political consequences and influence.

In my remarks tonight, I will touch on all three. I am going to start with some review of the history of the Fund and the basis for some of the early decision-making in which I was involved.

Fund History

Ordinarily, I do not spend much time in looking backward. I rather follow the philosophy of that pitching great Satchel Paige. Don't look back; the bastards may be gaining on you!

However, it has been well said also that, Those who do not learn from history are condemned to relive it. Another reason I feel it desirable to describe the basis of some of the early decisions, is that it is not disclosed in the official history of the Permanent Fund. When I was appointed to the Board of Trustees, I was the only member who was not a resident of Juneau. The Board elected me chairman. Much of the agenda of the early meetings was contained in memoranda that I entitled Thoughts of the Chairman. Nevertheless, when the Legislative History of the Fund was written in 1986, I was never contacted, nor is the whole story written of why certain decisions were made both positive and negative.

In evaluating historical events, time is the greatest instrument of perspective. What is not supported by the test of time can be dropped out. But recommendations, not supported originally, yet still pertinent, deserve to be re-surfaced and hopefully followed.

I shall identify in these remarks certain recommendations which I continue to feel would be beneficial for the long-run management of the Fund. In this connection, I might mention that all of us who have had the responsibility of advocating courses for public action, are afflicted at times by what I call Cassandraism. That is a word I have coined to describe the fate of Cassandra, daughter of the king of Troy. She was granted the spirit of prophecy but got crosswise with the god Apollo. The latter could not take away her gift but ordained that her prophecies would never be believed.

Constitutional Amendment Necessary

The dissipation, through state spending, of the bonus payments received from both the Cook Inlet and North Slope leases prompted many concerned Alaskans to vow to do better with the royalty income. This resolution was led by Gov. Hammond.

However, because the Alaska Constitution prohibited any dedicated funds, it was necessary to have an amendment thereto. This was accomplished in the fall of 1976 when the people of Alaska voted to set aside in a Permanent Fund at least 25 percent of the state's oil royalties and related income. It is important to note that, under the terms of the amendment, while the principal of the Fund is permanently stashed away, the disposition of the income is completely up to the discretion of the Legislature.

In truth the Permanent Fund began, chiefly, with a negative goal, to place a part of the one-time oil wealth beyond the reach of day-to-day government spending. That this savings approach has been accomplished is evidenced by the handling of the $41.8 billion of state oil revenues received during the fiscal years 1977-1993. Eighty percent, or $33.5 billion, has been spent in the General Fund. Eighteen percent, or $7.6 billion, has been saved in the Permanent Fund. Two percent, or $691 million, has been saved in the Constitutional Budget Reserve Fund.

It took four years after the Constitutional authorization before the Legislature passed a bill in 1980 creating the Alaska Permanent Fund Corporation, providing for independent management by a Board of Trustees, a cautious list of authorized investments principally government bonds and a dividend program for the public from the Fund's earnings. In this interim period, there was much debate in the Legislature and press about the use of the Fund, with emphasis on economic development and social benefits.

Fortunately, the Legislature limited the charge to the Fund trustees to investment responsibilities. The soft dollar allocations of oil money and economic stimuli were left to other corporations or specific appropriations. This was a crucial and wise decision by the Legislature. By restricting the duties of the Trustees to investment management, their task was simplified, their performance could be objectively measured in the marketplace and they were freed in large measure from social and political pressures. In truth, much of the success and prestige of the Permanent Fund is due to their singleness of financial stewardship. The contrast with the early performance of the Alberta Heritage Fund is eloquent proof of the superiority of the Alaska course of action.

Board's First Meeting

The first meeting of the Fund's Board of Trustees was in September 1980. There were two obvious tasks confronting the Board. The first was to set up the organization that could independently manage the investments belonging to the Fund but currently in the custody of the Department of Revenue. The second was to establish criteria for developing a portfolio and the mechanism for managing it.

Because these and other considerations would probably merit public input and certainly legislative action, it was agreed by the Board to use the first year to study the problem and then submit our recommendations for legislative authority. This was acceptable to the governor and we established close working relations with the Legislative Budget and Audit Committee so there would be no surprises when we submitted our legislative proposals.

I think it is probably safe to say that none of the original Board of Trustees had had any real investment experience in Fund management. Certainly, I did not. I was a commercial banker, not an investment analyst. However, being thrust into a situation wherein I had no previous experience seems to be the story of my life. I have found the best procedure is to read what I can and learn from those who have good track records.

Consequently, I made arrangements to meet with available fund managers or policy makers on the East Coast. These were around 10 of the largest business concerns, one state manager and two university fund experts Harvard and Yale. Subsequent to this trip I visited a smaller but representative group on the West Coast.

Researching Existing Funds

In the initial trip, I could not get any of the other Trustees to travel with me. The commissioners were busy with their departmental duties. The two other public members apparently had other commitments of higher priority. This difficulty of enlisting Trustee support for travel and management duties, outside of meeting attendance, has colored my perception of what the Trustee responsibilities should embrace.

In each interview I asked questions seeking to identify a common thread of superior investment performance and the preferred organization. Three principles came through loud and clear. First is an emphasis on a common stock portfolio anywhere between 50 percent and 80 percent of assets. Second is a continuous monitoring of performance and selection, using a combination of in-house and outside management. Third is a long-term adherence to the policy of reinvesting up to half of the annual earnings as an addition to principal to cover inflation and to increase earnings.

The pension funds were very helpful in determining best investment performance. However, their objective is quite different from that of the Permanent Fund. Pension funds have only one concern to fund defined retirement benefits. Superior investment performance does not increase benefits; it merely reduces the corporate contribution.

Most analogous to the Permanent Fund are the university endowment funds. The objective of the latter is to maximize income within the bounds of safety, provide a dependable amount of annual income to the academic departments and to preserve and enlarge the investment pool. The outside source of additional capital to the Permanent Fund is the 25 percent oil royalty income. The similar infusion for university endowments comes from annual giving by alumni and friends. Most helpful in developing my learning curve were the words of advice from George Bennett, chairman then of State Street Investment Company. George had previously been treasurer of Harvard University and a key founder in the Harvard Management Company. I will relate an anecdote from our conversations.

On entering his office I noticed an abundance of yachting pictures on the walls. In the course of our visit I asked him what was the best single guide in choosing an investment manager and evaluating his performance. His reply was that in yacht racing he did not try to be the first in a race. His goal was to come in second or third, and if he could do this consistently, he would win the regatta.

His point is that the top performer in a particular year is due largely to that investment style coming into favor. Top performance carries more risk in volatility and the number one in any year is likely to be a dud in the next. Diversification in style as well as security is essential.

Seeking Public Comment

During the course of this initial year of study, the Trustees sponsored a series of seminars in different locations in Alaska. There was a twofold purpose in these seminars. The first was to develop a more informed constituency among the Alaska public. We invited lecturers of various views but with impressive credentials from studying and advising other governments with large oil revenues. Most of these lectures are preserved in the publication of The Trustee Papers. The second objective was to obtain directly and informally views of the Alaska public.

With the benefit of ideas from these various sources, discussions with the legislative oversight committee and input from each member of the Board of Trustees, the task was begun of developing a consensus within the Board for official recommendations for legislative action. My own ideas are set forth in some detail in a memorandum to the Board in November 1981 on "Considerations for Permanent Fund Legislation".

There was unanimous support within the Board for broadening the investment base to include equities, such as common stocks and selected real estate. This followed the advice and experience of outside funds and meant the Permanent Fund could benefit from the general economic growth of the nation as well as receive an annual income.

The Legislature accepted this recommendation with respect to domestic stocks. The Board also wanted to include foreign stocks. There are many reasons for this but one statistic is illustrative. Twenty-five years ago, 75 percent of the listed securities of the world were on U.S. exchanges. Today this percentage has dropped to around 25 percent. The foreign stock issue failed largely because of parochialism of certain legislators. The merits of this issue finally prevailed and the necessary authority was given in 1989. The cost of this delay has undoubtedly been multi-million dollars in lost income.

Inflation-proofing was another issue which was accepted rather easily. Although this concept was not in prominent discussion prior to the Enabling Act of 1980 and was not mentioned in that act, the importance of reinvesting some portion of Fund earnings to offset the ravages of inflation and thus preserve permanently the purchasing power of the Fund as well as its nominal value, was persuasive. Influential in this consideration were the horror stories of what happened to the real earnings' value of the Ford and Rockefeller foundations. Also the Legislative Budget and Audit Committee had independently received a legal opinion from a prestigious New York law firm that the legislative requirement of the Prudent Investor rule mandated selection of investments and procedures which would maintain the purchasing power of the Fund dollar. Currently, the public has overwhelmingly supported this concept by an 83 percent to 13 percent vote in a 1989 poll.

Corporation is Insulated from Politics

The independence and composition of the Board of Trustees became a controversial issue. At first blush, it would seem simple to comply with the legislative intent in the 1980 Act. This declares that the Permanent Fund Corporation is to be ... managed by the board of trustees. The purpose of the board is to manage and invest the assets of the corporation in accordance with this chapter. (AS.37.13.040)

However, there is a double-ended elusiveness about the meaning of the term manage. On the one hand, how much is the Board independent of the governor and the legislators? On the other hand, how much direction and supervision does the Board give to the staff and vice-versa?

To appreciate the intricacy of the situation, a little background is helpful. There is no doubt from the public and legislative debate that the majority view was to insulate the management of the Fund from political pressures. This was ostensibly achieved through the creation of a separate managerial corporation, providing for transfer of the funds from the Department of Revenue and the appointment of three public members.

However, there is much subtlety in the political process, whether this be state or federal. The Permanent Fund Corporation was created at a time when the Legislature had followed a practice in the creation of boards and commissions to name either legislative members or executive commissioners over which they had confirmation or budget review. Else why select three commissioners? The Legislature retains oversight authority through its Legislative Budget and Audit Committee, maintains budget control over the Corporation's expenditures and has final decision over the eligible investment list.

Board Membership Issues

Being aware of this and having observed the participation of the Board members during the year of study, I recommended in my memorandum to the Board that: The movement towards beneficial independence can be facilitated by a change in the composition of the Board of Trustees to limit the cabinet representation to the Commissioner of Revenue and have four public members with staggered terms of office of four years each.

The then-incumbent Commissioner of Revenue argued against reducing cabinet representation to only one commissioner and in the interest of getting the full bill passed, I dropped the issue. I submit to you, if there are valid arguments to reduce cabinet representation (and possible gubernatorial influence) from three to two, why not to one? The question of compensation to the public members proved an even thornier issue and one that I believe is of continuous and substantive importance to the management and preservation of the Fund.

The 1980 Act provided for compensation to the public Board members to be an honorarium of $400 for attendance at meetings. Believing strongly that in this practical world you get what you pay for, I recommended that there be substituted an annual fee for all personal services of each public member. I stated my reasoning as follows:
"The attendance honorarium is illogical in that it assumes that the Trustees' services are performed only at a stated meeting. It ignores the fact that the Board is a working body involving continuous services in committees, traveling, consultation with staff, investment managers, other Fund Trustees, participation in work shops with legislators, interested public groups, etc."

I suggested the annual fee be on a par with that of the legislators. My rationale was that it be

"... set midway between the value of the Trustee's services in the marketplace and a pure donation of time which is not within the ability of many fine, potential Trustees. It is not so large as to be a sought-after prize for political appointment but it is enough to demand the commitment and time of qualified Trustees."
I got little support for this recommendation. The commissioners had no personal interest. The public members apparently did not want an expanded role. The Legislature was suspicious of paying the Board members a salary.

When Gov. Hammond called me a year later to ask as to my availability to continue on the Board of Trustees, I responded in the negative, followed up by a letter from which I quote in part:

I feel that my own contribution was possibly most significant in the organizational stage. I have personal obligations that can take all my time available. I am also persuaded that the Board should be heavily involved in operational decisions. Unfortunately, the Legislature, by failing to provide for adequate compensation to the public members, does not recognize the necessity of Trustee participation. I would not feel comfortable with the prospects of relegating the future operations and destiny of the Fund to the staff.

Governor May Replace Board Members

When the 1982 bill was developed, the Board and the Legislature gave great attention to structuring the terms of the Trustees with the idea that appointments were permanent and stability of the Board are essential. The Enabling Act states that, The governor may remove a member of the board from office. A removal by the governor must be in writing and must state the reason for the removal. (Sec.37.13.070 AS) I was shocked when our present governor (Gov. Hickel) removed two of the public members and I can find no written submission of cause. I was disappointed that there was no outcry from the press, the Legislature or the public.

Review in Conclusion

I will conclude my remarks with an overall review of the Fund. First, I would say that in the primary objective of the Permanent Fund, it has been a resounding success. It has saved billions which would otherwise have been dissipated.

Secondly, it has had a superior return on investments. And through inflation-proofing, it has maintained the real value of the Fund. Performance evaluation is a very complex and even more difficult task than developing an investment strategy. Consequently, I will say no more on this subject except to comment that if I had been on the Board of Trustees during its operational stage, I would probably have urged a higher allocation in common stocks.

Thirdly, I am impressed with the clarity and completeness of the disclosures in the annual reports. They are excellent in stating what has been done; they could be improved in telling why. Some examples: reasons for deciding and changing investment allocations in fixed income and equity instruments; why the Alaska residential mortgage portfolio was sold; the criteria for real estate investments; the choice of passive vs. managed portfolios; the basis for in-house vs. outside managers; the strategy for Alaska vs. outside investments.

Explaining why an action is taken is always good discipline for the decision-maker. More important, sharing with the public the reasoning for taking various actions makes the public more informed and hopefully a more determined champion of the Fund.

Corporation Board as State Fiscal Leaders?

I feel very strongly that the greatest expanded service that the Board of Trustees could render all Alaskans would be to take on the conceptual leadership for the financial policies of the state. We certainly need this leadership, and who else is going to do it? Any governor or legislator, regardless of party, is focused on spending, operations and the writing of law.

Actually, this enlarged role for the Trustees involves more a concept of responsibility rather than any additional duties. I offer as a model the various boards of the Federal Reserve Banking System. When that system was created, there was no thought that the Reserve Board would have any responsibility for price levels or interest rates. They moved into that role to fill a vacuum. The studies by the various Reserve Boards are eagerly sought after today and serve as examples of thoughtful and substantive reasoning.

Comparably, the Trustees of the Permanent Fund have the best access to all the economic and financial data of the state, nation and world. The Trustees have the benefit of top economists and analysts. Sharing the Board's reasoning and conclusions with the general public will not only enlighten the thinking of all of us but add to the Board's stature and influence.

I compliment the Board and staff on the initiation of the educational program for ele mentary students called Learning is Permanent which helps young Alaskans learn about economics and about the Permanent Fund. I strongly urge the Board to reinstitute the process of holding public seminars throughout Alaska with qualified experts to stimulate thought and enlarge our horizons. This has an additional practical benefit in permitting the Trustees to float trial balloons without attribution.

Views on Permanent Fund Dividends

Finally, I will make some comments on the sensitive subject of the dividend program.

Technically, the dividend program is not a responsibility of the Trustees, even though it uses half of the Fund's earnings. However, the Trustees are Alaskans and, if the Trustees accept the enlarged stature which I hope they will, they cannot escape being drawn into the crucial debates which I envision will develop in the near future.

Again, I believe that an inquiry into the history of the dividend program is illuminating. In the intense discussion of the uses of the Fund principal or income prior to the Enabling Act of 1980, there is little indication that a dividend program was of much public interest. It appears to have been primarily a concept of Gov. Hammond. An original dividend program based on longevity of residency was included in the 1980 Act but struck down by the U.S. Supreme Court as discriminatory.

While the litigation was in progress, the Trustees were carrying out their program of public seminars. At each meeting, I made a specific point of asking whether the attendees, either in their individual capacity or as representatives of an organization, wanted a dividend or rather an appropriation of income that would benefit all the people of Alaska through block grants or public works. I remember only one person who testified in favor of the dividend program. In an address to the Anchorage Chamber of Commerce in October 1981, where the use of the Fund income was discussed, I pointed out that if the residency feature of the dividend program be stricken down, the problem of in-migration could be serious.

The significance of this historical reference is that there is little indication that the public was greatly interested originally in the dividend program. However, there is no doubt whatsoever that, like a chemical dependency, the public is now strongly supportive of receiving the annual dividends.

Dividend Support is Broad, Fragile

Let us examine the consequences of the dividend program and particularly the impact on the Permanent Fund.

The benefits of the dividend program are obvious in increasing individual disposable income and at the same time expanding merchant sales, to the extent the money is spent in Alaska. Another argument of popular repetition is that the dividend gives a supportive constituency to maintenance of the integrity of the Fund.

But like all single issues of popular support, there is a fragility in this protection. Up to now, the governor and the Legislature have pretty much left the Fund and the Trustees alone because they have asked one thing only earn enough money to maintain the dividend program. What will happen when oil revenue drops to a point where the spending appetites of the Legislature are not satisfied? Then I predict there will be strong attacks on the Permanent Fund.

The Legislature based its fiscal year 1994 budget on $18.38 per barrel of oil. We are not averaging this and the current year deficit is estimated as upwards of $500 million. Short of another windfall, the easiest additional source of money is the Constitutional Budget Reserve of $691 million and the Permanent Fund's earnings' reserve which is almost $1 billion.

After this is exhausted, the next target will be the inflation-proofing procedure. Don't automatically assume the Legislature will protect you there. Ever since the Fund was created, the Legislature has placed the dividend fund as number-one priority ahead of inflation-proofing. There are self-dubbed economists who actually argue that inflation-proofing is socially undesirable. I call this the Wimpy philosophy: Gladly would I pay next Tuesday for a hamburger today!

Dividend Recipients Increasing

In the meantime, the eligible population, which is the denominator in calculating the per person dividend, is steadily increasing. This results from births and in-migration of oldsters. The developer of a senior housing co-op in Anchorage is quoted:

"But seniors are the fastest-growing group in Alaska. Although they make up about 4 percent of the population, as compared to an average of 12 percent in the lower 48, more and more seniors are wanting to stay here after they retire. In fact, there are seniors moving up here to retire now."

At the same time more and more grumbling is heard from Alaskans who feel disenfranchised from eligibility because of traveling restrictions and yet observe violations from those who are not qualified within the intent of the law.

In evaluating the future consequences of the dividend program bear in mind that with the dividend program taking one-half of the Fund earnings and inflation-proofing needing close to the other half, the Fund can never grow in the future except through infusion of mineral receipts.

I mention these sobering realities because the decisions are a responsibility of all Alaskans and fiscal soundness, like liberty, must ever be vigilantly defended and guarded.

I will sum up by saying that money may not be everything, but I tell you, having the Permanent Fund gives us all a lot of confidence and determination for the future.

Trustee Papers Volume V

The Creation of the Alaska Permanent Fund: A Short History

By Joan Kasson

Writer Joan Kasson researched and wrote this paper for the Alaska Permanent Fund Corporation in November 1983, as part of an early effort to record the history of the Fund. Publication in the Trustee Papers Volume No. 5 marks the first time this paper has been widely available to the public.

Introduction: An Overview

In 1976, the voters of Alaska passed a Constitutional amendment establishing the Alaska Permanent Fund. The amendment required the dedication of 25 percent of mineral bonuses, royalties and related income to a special fund to be put into income-producing investments. On June 30, 1983, the assets of the Fund stood at about $4.3 billion, a hefty sum by any standard.

The Fund is operated as a public trust, much like trust funds established for pension funds. This means Fund managers must balance the idea of income producing against ordinary prudence about risk. In its simplest terms, the Permanent Fund is a savings account geared to make money for Alaskans.

How the Fund came to exist, and how it came to be operated in this manner, is the subject of this history. The Fund exists as a result of evolution of thought regarding state ownership of wealth, and how that money should be managed to best benefit all Alaskans, present and future.

This evolution occurred in three stages: first, the decision on what was wanted; next, the decision on how it was to be accomplished; and finally, the beginning of a process to decide what it is to do.

Many people were part of this evolutionary process. The executive and legislative branches of state government played major roles. The public, through voting and participating in the legislative hearing process, contributed their views. What are called special interests also played a large part. The business community, banks, fishing and agriculture advocates all registered their views on the Permanent Fund.

The evolution of the Permanent Fund took several years. During this time, many things happened in Alaska to affect it. Large oil and gas deposits were discovered on state-owned lands. The state chose to raise taxes on the petroleum industry to increase state revenues. These revenues increased even more as the Organization of Petroleum Exporting Countries' (OPEC) price hikes took effect. Finally, state expenditures increased along with revenues.

The Alaska Permanent Fund is a trust. Early proposals and discussions considered the use of the Fund as a vehicle to diversify the Alaska economy. However, the trust concept for the principal of the Fund prevailed at every turn. The later issues debated during the evolution of the Fund were, instead, questions regarding management and use of the Permanent Fund earnings.

Background: Resources Belong to Alaskans

In 1955, Alaska was still a territory of the United States. Late that year, fifty-five people met in Fairbanks to write a constitution in preparation for statehood. The resulting document was viewed by many as a model constitution. Two themes present in the Constitution bear directly on the Permanent Fund.

The constitutional convention delegates saw the importance of resource development. Alaska has long been dependent on its natural resources. All the economic booms that Alaska had experienced, except the World War II military boom, had been caused by resource development. Furs, gold, then fish, were harvested and in the eyes of the delegates, the benefits from these harvests primarily went outside Alaska.

The constitutional convention delegates were not opposed to resource development, but they wanted Alaskans to get the maximum benefit. Thus, Article VIII of the Alaska Constitution, stressed just that:
Article VIII, Section 2, General Authority. The legislature shall provide for the utilization, development, and conservation of all natural resources belonging to the State, including land and waters, for the maximum benefit of its people.
The second theme was opposition to the dedication of revenues. Dedication of revenues means that certain revenues are assigned to special funds for special purposes, bypassing the appropriations process. At the time of the convention, many states had such dedications. The delegates believed that dedicated revenues constrained the government from pursuing the maximum welfare for its citizens, so they forbade dedication except in certain, limited cases.

The delegates realized the importance of Alaska's resources. They wanted Alaskans to realize the maximum benefit from them. They did not, however, foresee that the state would later become financially dependent on one source of revenue.

$900 Million Oil Lease Sale

On September 10, 1969, the state received $900,041,605.34 in bonuses from the Prudhoe Bay oil lease sale. Earlier discoveries, in particular the Swanson River Oil Field on the Kenai Peninsula, had increased state revenues, and therefore expenditures, but nothing on the order of Prudhoe Bay had ever happened before. The $900 million, as it came to be commonly called, was nearly as much as all previous state budgets combined. The fiscal year (FY) 1970 budget had totaled only $172.8 million.

The question before Alaskans was what to do with all that money. Should it be saved, or should it be spent to meet Alaska's many needs, such as rural schools, safe water, transportation and communication links? The Legislature appropriated money to look into the question. The Brookings Institute held four seminars in late 1969 to decide what should be done. Discussion covered issues as diverse as Alaskans themselves.
There are plenty of details, but the basic point is, we're going to invest in Alaska its people, through education, health and well-being opportunities, and in the physical through esthetics and their preservation and natural resources, using the non-renewable in the best interests of the state, both economically and environmentally.[1]

Spending, then, was to be the course to take.

The Idea: Saving Mineral Wealth

Although the Brookings seminars may have called for spending, the idea of investing some of the state's wealth was being mentioned here and there. Before the 10th Annual Convention of the Alaska State Chamber of Commerce in October 1969, Robert Krantz, of the investment firm Kidder, Peabody & Company, called for the establishment of a perpetual and permanent capital fund for the continuing development of Alaska.2 Krantz envisioned a fund where the principal would remain intact but the income would be available for appropriation by the Legislature. His reasoning:

In the investment banking world, we are constantly exposed on an almost day-to-day basis to situations which demonstrate the insatiability of the demand for funds once they become available and the ease with which capital can be dissipated. This is found at all levels unfortunately in our own homes as well as within business and philanthropic organizations. It is at the government level, however, that we find this intense pressure for current expenditure in its most extreme degree.[3]

Krantz's speech did not receive much notice nor was his idea new. Other states had similar funds. However, it is the first written record of the idea of a permanent fund for Alaska.

At the same time, Gov. Keith Miller was outlining his idea for a resources permanent fund. He introduced legislation to create the fund in 1970. It passed the Senate, but died in the House. It was, however, a taste of things to come. It was the first formal legislation on the subject, and it brought out issues that were to be major points of contention later.

Miller's resources permanent fund was not a dedicated fund. Instead, the Legislature was to appropriate money to it. In addition to this dedication question, the legislation showed that management would be a major issue. Who would control all that money? Should it be the legislature or the executive, Republicans or Democrats?

Not until 1975 was the idea looked at again. In the meantime, state budgets increased annually, and the state began to bond itself into debt based upon expectations of future income from the oil fields. In 1972, $124.5 million worth of general obligation bonds were approved, and in 1974, $189.5 million more.

Legislature Feels Pressure to Invest, not Spend

By 1975, the idea of a permanent fund had gained a following in the Alaska Legislature. The primary reason was negative reaction to the spending of the $900 million received from the Prudhoe Bay lease sale. People asked, What happened to the $900 million? Ð implying it had been wasted.

Committee Substitute for House Bill 324 amended Senate, (CSHB 324 am S),4 An Act establishing the Alaska mineral lease bonus permanent fund; and providing for an effective date, passed the Legislature during the 1975 session. Its purpose:
The Legislature finds and declares that it is essential to preserve a portion of the revenue derived from mineral lease bonus sales, a nonrenewable resource, for future generations of Alaskans, and further, that this purpose best can be served by preserving this income in a permanent fund to be used for investment capital by Alaska residents.
CSHB 324 am S was the first bill passed by the Legislature that specifically created a permanent fund for the benefit of future generations.

It is important to note the uses to which the money could be put. This bill dedicated 50 percent of mineral lease bonuses (money received for the sale of leases) to the fund. This principal was to be invested as other state surplus funds and in approved loan programs. The income resulting from this investment either could be reinvested in the fund, or appropriated for the administration of the fund or for other operating and capital expenses of state government as provided by law.

This first successful attempt was promptly vetoed by Gov. Jay Hammond. Hammond said that allocating 50 percent of mineral lease bonuses to the permanent fund was an unconstitutional dedication of revenues. The state Constitution specifically prohibited such dedications. Therefore, Hammond called for a Constitutional amendment, rather than a statute. He was, however, fully in favor of a permanent fund.

Gov. Hammond Offers Plan

In 1976, Hammond introduced Sponsor Substitute for House Joint Resolution 39 (SSHJR 39) to the Alaska Legislature. The important section:
Sec. 2. Article IX, Constitution of the State of Alaska, is amended by adding a new section to read: Section 15. ALASKA PERMANENT FUND. Ten percent of all mineral lease rentals, royalties, royalty sale proceeds, revenue sharing payments, bonuses, and mineral production taxes received by the State shall be placed in a permanent fund, the principal of which shall be used only for income investments. The legislature may appropriate additional amounts to the permanent fund which shall become part of the principal of the fund. All income from the permanent fund shall be deposited in the General Fund.
A committee substitute for SSHJR 9 passed the Legislature overwhelmingly and was successfully put before the voters of Alaska at the November 1976 general election. The important section now read:
Sect. 2. Article IX, Constitution of the State of Alaska, is amended by addition a new section to read: Section 15. ALASKA PERMANENT FUND. At least twenty-five

percent of all mineral lease rentals, royalties, royalty sale proceeds, federal mineral revenue sharing payments and bonuses received by the state shall be placed in a permanent fund, the principal of which shall be used only for those income producing investments specifically designated by law as eligible for permanent fund investments. All income from the permanent fund shall be deposited in the General Fund unless otherwise provided by law.

The state had its Permanent Fund. Now, the question was how to run it.

An Analogy: What to Do With a Windfall

Let us suppose for a moment that you come from a large family and someone leaves you a large sum of money unexpectedly; in short, a windfall. Your first inclination might be to buy that house you needed and get the operation for one of the kids you haven't been able to afford. Then, perhaps you buy a van to help out Aunt Millie's catering business. Now that home for wayward children down the street could sure use some money.

At some point you may realize that this money will not last forever. So, you decide to save some for later. Do you put it into a straight savings account and earn 5 1/4 percent? Not if you can earn 11 percent through one of those money market accounts. But wait, if you invest it in the stock market you might even make more money. Then again, you might lose some, too. Maybe you could make loans to all those relatives for what they want and need. Will they pay you back?

The connection may seem a bit thin, but it illustrates the kinds of choices that were available in 1977 on how to structure the Alaska Permanent Fund. In a 1976 working paper, Robert Richards of Alaska Pacific Bank outlined a series of investment options. He identified the options as falling into three areas: social orientation, economic orientation, and fiscal management orientation. Some examples:

- Social orientation income redistribution from high-income to low- income earners, subsidies to low-income families, geographic redistribu- tion, i.e., from urban to rural environments, subsidies to any Alaskan to improve the quality of life.
- Economic orientation subsidizing small businesses, or traditional industries such as fishing and timber, or providing subsidies to create a more broad-based economy.
- Fiscal management orientation to save and invest the Fund conservatively to hold for when revenues fell, or use the Fund to reduce state debt and/or taxes.

In a paper prepared for distribution prior to the 1976 election, the Department of Revenue outlined its view of the objectives of the Permanent Fund. These included economic diversification for the state, controlling expenditures by government, saving the money for the future, revenue sharing with local governments, or perhaps community development through capital construction, increased social services, direct aid to community businesses.&sup5;

It was up to the Legislature to decide which one or combination of the above the Permanent Fund should be managed to achieve.

First Efforts: Seeking a Direction for the Fund

Anticipating the passage by the voters of HJR 39, Gov. Hammond expanded the size of the State Investment Advisory Committee (SIAC), and directed it to look into organizational structures and investment options for the Permanent Fund. The committee was composed of representatives from the business community, consumer groups, the executive branch, the Legislature and members of the general public.

It became clear through the SIAC hearing process that the Permanent Fund was being viewed as all things to all people. At a hearing held in November 1976, testimony called for investment in fish hatcheries, loans for utilities, housing loans and creation of a trust to save for the future.&sup6;

The SIAC, through the governor, introduced two bills to the 1977 legislative session. The first, HB 210, passed quickly. It was an interim measure outlining management of the Permanent Fund while the Legislature debated the long-term structure. HB 210 required the Commissioner of Revenue to invest the Permanent Fund in conservative investments. It was a holding pattern.

The second SIAC bill contained its plan for the long-term management structure. Although it did not pass, the bill showed the direction the Permanent Fund was headed at that time. The bill, HB 298, called for a 50-percent contribution rate, up from the 25 percent required by the Constitution. The money would be invested by percentages in different types of investments; 40 percent in investment-grade securities; 30 percent in Alaska private industry where other capital from private entities was not available; and 30 percent in community development through municipalities, public corporations and construction. The management would be by a policy board appointed by the governor, and an investment committee, separate from the policy board, would make the specific investments. All income would go to the General Fund. Investments would be limited by application of the Prudent Investor Rule. No investment would be allowed where other private capital was available, and the Fund would not be allowed to manage any entity in which it had invested.

In his letter of introduction, Gov. Hammond stressed that HB 298 was not necessarily the final product, but only a vehicle for discussion.

The House of Representatives, meanwhile, had appointed a special committee to look into Permanent Fund management. Chaired by Rep. Clark Gruening, the committee received all bills introduced on the Permanent Fund. They also introduced one of their own, very similar to the SIAC bill, but with a higher contribution rate.

Also of interest in the 1977 session was the introduction of Hammond's HB 525. This bill, which went nowhere, was the first to call for a cash distribution of Permanent Fund income to individual Alaskans. Called Alaska, Inc., the plan called for payments to registered voters of one share for every five years of residency. This would be paid for by 50 percent of the Fund's annual income.

Although none of the Permanent Fund bills introduced in 1977 passed, the discussion was well under way. That discussion was focusing on a combination of development and saving.

Public Hearings Guide Fund Design

During the interim between the 1977 and 1978 legislative sessions, the House Special Committee on the Permanent Fund took its hearings on the road around the state. The results of all those hearings were outlined in the committee's final report, "A Proposal for the Alaska Permanent Fund."

The final report gathered up all the testimony presented to the committee and divided it up by what the public, the consultants, and the committee proposed. It gives a good idea of where the Permanent Fund was headed in late 1977.

In summary, the public response to the hearings was worked into a general list of points for the committee to follow:

- The money in excess of current needs should be put into the Fund.
- This money should not be used for current expenditures.
- The investments should not be in areas where existing private financing was available.
- The income of the Permanent Fund should be used for the benefit of current and future Alaskans.
- The structure of the Permanent Fund should allow public accountability.
- However, political decision-making should take place where necessary. Appointed officials of the Permanent Fund should not make those types of decisions.

The consultants' positions were also collated into general points. Their positions became much more important later when serious legislative maneuvering took place. Essentially, the consultants agreed:

- Subsidizing, through cheap loans or bonds, industries or commercial enterprises was not a good idea for the Permanent Fund.

- If the project proposed was a viable one, then private financing entities would fund them.
- If private banks refused, then perhaps the project was not a good one.
- In that case, why should the state take the risk?

The most aggressive (and in conventional terms, imprudent) lending policy cannot, however, create an industry where resources, markets, skilled labor and other requisites are missing, and the Fund's managers should never become so soft as to finance enterprises whose promoters are not taking a substantial risk themselves, or which do not have convincing prospects of long-term viability.&sup7;

The consultants, however, did feel that medium and small industries might benefit from Permanent Fund assistance where institutional barriers may exist. In this case, the barriers were defined as lack of knowledge, and distance. Lending in small towns or the Bush is exceptionally expensive; however, the cost of investigating and servicing small commercial, real estate and installment loans and lease purchase contracts and the like, and the costs of collection, foreclosure, repossession and resale can easily exceed the potential earnings from loan fees and interest. These excess cost burdens, together with unfamiliarity with local conditions, understandably make the statewide (Anchorage and Fairbanks) banks and other financial institutions reluctant to provide capital even for larger locally-owned development, such as resorts, hotels, apartment houses, fish processing plants, etc., and where they do make loans they are willing to finance a smaller portion of total investment.&sup8;

Fund Goals Become Clear

Based upon its hearings, the committee determined that the first two goals of the Permanent Fund were to be permanence and income production. These are in conflict in that investments that may earn a very high return are likely to be more risky than ones with a lower expected return. The goals must be balanced against each other. The additional goal was that part of the Permanent Fund be used for the short-term benefit of Alaskans. In effect, these required a trust concept for the principal of the Fund.

It also realized, however, that the Permanent Fund is only one of several financing vehicles available to the state and that it was unnecessary, as well as unwise, to try to design a Permanent Fund to do all things.&sup9;

The compromise the committee worked out was introduced in the 1978 session as HB 596. The legislation created two entities: The Alaska Permanent Fund Corporation and the Alaska Enterprise Investment Corporation. The former, receiving the bulk of the revenues, was to be severely restricted on the type of investments it could make. The ultimate goal of the Permanent Fund Corporation was to maintain safety of principal. The second entity, the Enterprise Corporation, was the answer to providing short-term benefit to Alaskans. It was to provide funds to "financially sound small- and medium-scale productive private enterprises and community development projects."

Two points must be made here. First, people began to realize that the Permanent Fund really wasn't that large of a part of state revenue. In FY 1978, contributions to the Alaska Permanent Fund totaled $50.4 million, while total unrestricted revenue to the state was $787.4 million. There was other money available to fund the miscellaneous projects people envisioned.

Second, in 1978, other entities began to be created to handle these assorted wants. The first real effort to do just this was a result of the House Special Committee's efforts. Many of the people testifying before the SIAC and the House Committee wanted to further renewable resource industries and break Alaska's dependency upon one nonrenewable source of revenue oil. As a result, the House committee introduced legislation, which later passed, to create the Alaska Renewable Resources Corporation. The purpose of this corporation was to give grants and other financial assistance to "projects and programs that identify and demonstrate new products, markets and technologies in renewable resources."

During the interim, the Senate also had a Special Committee on the Permanent Fund working. In addition, the executive branch was still involved through the Division of Policy Development and Planning. The result of all this studying of the question was the introduction of several bills in the second session of the Tenth Alaska Legislature in 1978.

1978-1980: Subsidized Loans vs. Free Trade

In a memo to two consultants dated September 2, 1977, a staff assistant to the House Finance Committee outlined the prevailing state of affairs:
Where to invest the Permanent Fund seems to be the question of whether a developing economy (isolated, with leakage of an estimated 64 cents on the dollar, but mostly literate and skilled), based largely on a depleting resource (transfer payments from the oil and gas industry), and having few apparent options for some time should have a policy of government intervention. In short, a policy of loans at the going market or subsidized loans, or even subsidized infrastructure loans (which may be possible in some cases) versus a policy of free trade.[10];
The question of how the Permanent Fund should be invested had from the beginning centered on the development bank versus the trust. There were different approaches with each bill, but all of them took some form of one tack or the other. From 1978 to 1980, the development issue remained but instead, focused on the Permanent Fund earnings.

The major Permanent Fund management bills introduced in 1978 were to be the basis for three years of discussion. The main bills in 1978 were HB 596 and SB 429. In 1979 and 1980, SB 1 traveled through the legislative process, first encompassing the Senate's ideas and then the House's. It finally became a compromise bill in free conference[11] committee and was adopted by the Legislature.

Prudent Investor Rule to Guide Investments

All of the versions reflected the recognition on the part of legislators that the principal of the Permanent Fund should remain inviolate. It should be invested with an eye toward safety of principal first. The Prudent Investor Rule, well established in common law, was to guide the investments. The greatest danger of substantial erosion of the Permanent Fund principal is not (as suggested in a February 23, 1979 Permanent Fund policy memorandum of the Division of Policy Development and Planning) from a practice of making investments at less than market rates but rather from making investments entailing more than a reasonable risk. Generally, in the investment world the higher the risk, the higher the expected return.[12]

Agreement on the safety of principal was only the tip of the iceberg, however. The main differences between the House and Senate bills were the management structure and the use of the income.

Dividends or Loans? House, Senate Differ

The first difference was that the Senate wanted the state Department of Revenue to manage the Permanent Fund and its investments. In a report of the Senate Special Committee on the Permanent Fund issued in 1978, the main reasons cited for this stand were that the expertise was there and that there would be no conflict of interest since all the money in all the funds administered by Revenue belonged to the people of the state.

The House, however, saw a need for management independent from state government. The point: to insulate the Fund from politics, but keep it accountable to the public. Such a task was to be accomplished by the creation of a public corporation separated from established government agencies. The corporation would be under legislative oversight to assure that it would not become too independent.

The second difference, and the most hotly debated, was over the use of Permanent Fund income. Ideas for its use abounded, but three major ideas surfaced in the 1978 to 1980 debate.

The House Permanent Fund bill did nothing with the income stream, leaving it for later Legislatures. The income was to continue to flow into the state's General Fund, available for whatever uses the Legislature chose.

The governor supported wholeheartedly a proposal to give the money to Alaskans in the form of dividends. Some of his reasons were outlined in a February 14, 1980 memo to Hugh Malone:

Benefits from oil wealth which belong to all Alaskans can be distributed in many ways: low-interest loans, tax relief, expanded government services. While these all may have merit, not all Alaskans are beneficiaries. This is why I have proposed a Permanent Fund dividend program which, compared to drastic income tax reduction or repeal, would:

1. Provide benefits to all Alaskans from the earnings of their resource wealth ...
4. Confine benefits to Alaskans ...
8. Equitably impact both rich and poor.
9. Retain the taxpayers' one remaining tie with, and consequent concern for, government growth: How much it costs them.
10. Far less likely reduce federal revenue sharing to the state.
11. By contrast, maximize favorable impact upon the state's economy by keeping a far larger portion of the money to fund the programs here in Alaska.

The Senate had its own proposal for Permanent Fund income. The legislation was introduced by the Senate Special Committee, chaired by George Hohman of Bethel. It provided a vehicle to thoroughly revamp the state loan programs. Many programs would have been abolished and then restored in a centralized Alaska Loan Programs Fund. The purpose, in part to:

"... create moneys for small businesses at low interest affordable rates which could be used not only to help out existing small businesses, but to generate new businesses particularly in the area of renewable resources."

The same memo also noted: The Alaska economy is currently in a state of crisis, particularly in the area of small business.[13];

The idea of loans for Alaskans went back to the original permanent-fund-as-a-development-bank idea of 1975. In a 1978 memo, an aide to the House Finance Committee chairman outlined what the Enterprise Fund, mentioned earlier as part of HB 596, and a variant of the development bank idea, was to accomplish:

The Enterprise Fund is to close the capital gap in Alaska, private and public. This gap is measured by economists as the amount of capital that would normally be provided by private markets but is not because of institutional barriers in the financial community as a whole. Such barriers include lack of information, lack of experience with particular kinds of investment, and racial and other bias. Local regulatory practice can be a barrier, but the effects are probably not great due to the relatively free flow of capital within and even between countries.

A capital gap is not a sheer absence of funds. Money can usually be obtained at some price. Rather, the usual reason that funds are not forthcoming is that other areas, offering better returns and lesser risks, can pay more for capital and enjoy more investor confidence.

The full scale of this gap in Alaska is not documented. However, the evidence is that the shortfall is in the millions, not billions, of dollars and is focused in rural Alaska, mainly in small and medium ventures. Elsewhere, there is no proof that large, attractive loans are being missed or rejected by the private capital markets (banks and their lines of credit, bond and money markets, and insurance companies).[14] The House moved away from this stance in later Permanent Fund bills, but the Senate continued to feel that the Permanent Fund was the vehicle to cure the rural capital gap.

Criticism of Senate's Loan Plan

Opposition to the Senate bill is shown by the following excerpts:

The Governor: In any program increasing the dispersal of our oil wealth all Alaskans, not simply taxpayers, should be beneficiaries. We already have numerous programs selectively dispersing portions of our oil wealth in the form of expanded subsidized government programs and low interest loans. These go only to select Alaskans, not to all. The size of these selective hidden dividends can be substantial.

For example, take the case of someone who gets a $100,000 state loan of oil wealth at 9 1/2 percent interest. Yet, all other Alaskans who own just as much of that wealth as he could get about 15 1/2 percent return if their money were loaned at market rate. Therefore, the loan recipient is receiving a dividend, or subsidy, of $6,000 in the first year alone. That subsidy or dividend would amount to an incredible $94,000 on a 30-year loan.

That dividend or subsidy is being paid from oil wealth owned by all Alaskans. We don't confine payment of such loan dividends to taxpayers only or demand that before we provide Alaskans with low-interest loans, we first eliminate the income tax. Why should a system which provides far more equitable benefits to all Alaskans, such as the Permanent Fund dividend concept, be subordinate to that consideration? It seems high time that any new means of dispersing oil wealth should provide that all Alaskans, even the non-taxpaying, housewife, student, unemployed or retired couple get a share.[15]

The House: What are the House objections to the Hohman bill? The primary objection is that it is concerned much more with the state's loan programs than the Permanent Fund, and that a free conference committee on the Permanent Fund is not the place to so drastically restructure the loan programs. SB 1 is extremely complex and, if implemented, would have far-reaching consequences for the state's economy and credit rating. Specific problems with the concept include: 1) the earnings of the Permanent Fund are put at risk; 2) consolidation of the loan programs does not solve the existing problem of access to them; 3) the programs would receive automatic funding without legislative review; 4) there is no method of prioritization and the different loan programs could not be judged separately on their merits; and 5) municipalities would be encouraged to issue unrestricted debt.[16];

As can be seen, the problems with the loan fund approach basically were of three types: specific problems with the technical aspects of SB 1; general problems with the idea of subsidies to generate development; and questions whether the Permanent Fund was an appropriate place to fund such a program. While legislative votes on General Fund appropriations were held in the public eye, as envisioned by SB 1, decisions directing the use of the Permanent Fund income could have been made without public scrutiny.

It took three years, massive amounts of paperwork, numerous versions of various bills, and for the first time extensive use of professional financial and investment experts and economists. But the Legislature ultimately adopted the House version without the Enterprise Fund that had been proposed in 1978. The final version required independent management through the Alaska Permanent Fund Corporation, secure investment of the principal in government and other high-grade securities, and left the income-use question unanswered.

Appropriations to the Fund and Dividends

At the same time the fight over management was going on, another important piece of legislation was introduced. This one proposed appropriating $900 million to the Alaska Permanent Fund, a symbolic amount recalling the $900 million received from the 1969 Prudhoe Bay lease sale. It passed, as did a later appropriation for $1.8 billion. The justification:

The oil revenues currently being received by the state are in excess of what should be immediately spent, and depositing a portion of them in the Permanent Fund would be a wise and responsible move.[17];

There was another bill firmly supported by Hammond winding its path to passage in 1980. Earlier paragraphs have noted his emphasis on dividends for all Alaskans. The dividend distribution plan finally gained enough support to pass. In an article written for The Alaska Journal in 1983, two participants in the dividend battle outlined the major reasons for passage:

... As explained by Elmer Rasmuson, the Alaska Permanent Fund Corporation's first chairman, The Permanent Fund began, chiefly, with a negative goal, to place part of the one-time oil wealth beyond the reach of day-to-day government spending.

Some Alaskans, including then-Gov. Jay Hammond, came to favor direct distribution of a portion of the oil revenues as a check on government growth. Without such a check, asserted Hammond, government spending and lending would create a dependence which would bring a wrenching dislocation when the oil money ran out.

Direct distribution, on the other hand, would give each citizen a personal stake in oil revenue and thus give Alaskans an incentive to oppose pork barrel spending and budgetary hyper-growth in general. Further, argued Hammond, if the distribution was paid in the form of annual dividends from the Permanent Fund's earnings, Alaskans would be more likely to fight raids on their savings account.[18]; Erickson and Groh further credited the economic concerns of equity and efficiency for the passage of the dividend program. The dividends would provide for equal distribution of the oil wealth. Loans, for example, did not, as only some could receive the benefits, and then at the expense of others. Efficiency involved the normative judgment that the people themselves should be able to choose how to spend the money, rather than have government do it.

Zobel Challenge Modifies Dividend Plan The arguments in favor of the dividend distribution program prevailed. The legislation established a program giving every Alaska resident $50 for every year of residency since statehood in 1959. This graduated Permanent Fund dividend concept was to prevent migration to Alaska solely to collect the dividend check.

This law was promptly challenged on constitutional equal protection grounds by two Anchorage attorneys, Ron and Patricia Zobel. The case ended up before the United States Supreme Court. The dividend payments were held in limbo pending the Court's decision. The Court agreed with the challenge to the program and declared the program invalid.

Looking ahead to that possibility, in 1982 the Legislature passed another dividend plan to go into effect should the Court rule against the 1980 version. It called for equal payments to all six-month residents of the state. The first payment was to be $1,000, and all future annual payments were to be based on earnings of the Permanent Fund. That income was to be averaged on a five-year basis, and fifty percent of the average was to be divided among all eligible Alaskans.

When the Court struck down the 1980 plan, the 1982 version went into effect. On June 14, 1982, ... the big computer in the State Office Building down the street from the capitol started up, and the first oversized blue-and-gold $1,000 checks rolled off the high-speed printer and into the mailbox.[19]; What is not so clear is the extent to which government investment can create self-sustaining non-government economic development. Nevertheless, the notion that government efforts can and should bring long-term prosperity still exerts a powerful grip on many Alaskans, particularly in the case of energy development.

Dividend distribution is of course also a way to inject money into the economy but it flies in the face of these traditional Alaska notions of development as well as the practices of other governments. All governments distribute benefits in a host of forms, but never before in the industrial world has a government mailed checks to all its residents simply because they lived there. Indeed, the only historical parallel to the Permanent Fund dividend distribution appears to be a recent program of the remote Malaysian state of Sabah, which, like Alaska, used windfall revenues collected from natural resource development to fund its per capita payments.[20];

Post-1980: Fund Grows, Management Evolves

After passage of the 1980 management legislation, the Permanent Fund continued to accrue mineral revenues as before, but now under the management of the Alaska Permanent Fund Corporation. Oversight was and is provided by the Legislative Budget and Audit Committee, but the Legislature as a whole has generally stayed away from the Fund. The exception was passage in 1982 of some non-controversial amendments to the 1980 Act. The legislation broadened the investments the Corporation was allowed to make, and more importantly, called for a certain percentage of the income to return to the Fund's principal to prevent inflation from eating it away over time.

The Corporation itself has separated from the Department of Revenue, inhabiting offices in another building, hiring staff to manage and invest the Fund independently from other state funds, and managing its own operational budget. In its 1983 annual report the Corporation reported net earnings of $471,125,000. The total Fund balance on June 30, 1983, was reported to be $4,375,036,000.

With over four billion dollars in the Permanent Fund, it was inevitable that the next question should arise: What exactly was this money for? By virtue of the thirty bills introduced during the 1983 legislative session having something to do with the Permanent Fund, it was clear that several members of the Legislature had some ideas as well.

Why is there a Permanent Fund? It was created for myriad reasons, not least of which was to keep it out of the immediate government spending stream. How to manage it was another question settled after lengthy debate.

What the Fund is and how it is being managed give some clues about what the Fund is for. But pressure continues to use the Fund in short-term ways now, or to save it to use in short-term ways in the future. It is up to the same people who decided to create the Fund and how to manage it, to decide its ultimate fate.

Footnotes

1. Alaska, Legislative Council and the Brookings Institution, Statement of the Gamma Group: Seminar One, A Conference on the Future of Alaska (no place of publication, no date).
2. Robert A. Krantz, Jr., Investment Management for Alaska's Second Decade, (October 4, 1969), p. 2.
3. Ibid., p. 3.
4. Throughout this text, the words House Bill are abbreviated as HB, and the words Senate Bill as SB.
5. Alaska, Department of Revenue, Permanent Fund, Alaska Revenue Journal, vol. 1, no. 2 (October 1976): pp. 6-7.
6. Alaska, State Investment Advisory Committee, Hearing Minutes of November 5 and 6, 1976, (Anchorage, Alaska), pp. 2-9.
7. Arlon Tussing, Economic Considerations in Establishment of Alaska's Permanent Fund, (Anchorage, Alaska: Institute for Social and Economic Research, July 7, 1977), p. 21.
8. Ibid., p. 17.
9. Alaska, House Special Committee on the Alaska Permanent Fund, A Proposal ..., p. 7.
10. James B. Rhode, Aide to House Finance Chairman, to Barbara Bergman and Donald Gordon, Professors, Legislative Affairs Library files, September 2, 1977, p. 2.
11. Free conference is a type of committee composed of members from both the House and Senate. Its purpose is to resolve differences in House- and Senate-passed versions of a particular bill.
12. Alaska, House Special Permanent Fund Committee, Testimony of Clark Gruening, (March 30, 1979), pp. 10.
13. Questions and Answers Concerning Alaska's Permanent Fund, 1979 or 1980, p. 6.
14. James B. Rhode, Aide, to Steve Cowper, Chairman of the House Finance Committee, Legislative Affairs Library files, March 8, 1978, p. 1.
15. Jay Hammond, Governor, to Hugh Malone, Representative, Legislative Affairs Library files, February 14, 1980, p. 3.
16. Hugh Malone, The Alaska Permanent Fund and Management of the Alaska's Wealth, House Special Committee on the Permanent fund, Legislative Affairs Library files, March 5, 1980, p. 4.
17. Hugh Malone to Homer News, et. al., Press Release, Legislative Affairs Library files, January 31, 1980, p. 3.
18. Clifford John Groh and Gregg Erickson, The Permanent Fund Dividend Program: A Noble Experiment, The Alaska Journal, vol. 13, no. 13 (Summer 1983), p. 142.
19. Ibid., p. 145.
20. Ibid., pp. 141-142.

The Permanent Fund Dividend Program:
Alaska's Noble Experiment
By Clifford John Groh and Gregg Erickson
Clifford John Groh was a law student at the University of California at Berkeley, and Gregg Erickson an economic consultant in Juneau when they collaborated on this report, which first appeared in the Summer 1983 edition of Alaska Journal. Longtime Alaskans, both Groh and Erickson were active in the effort to adopt the Permanent Fund dividend legislation.

Last fall and winter virtually every Alaskan received their own spendable, savable, investable $1,000 share of Alaskas oil wealth their Permanent Fund dividend. The more than 400,000 people who received these checks became part of one of the most remarkable social experiments in modern American history, testing whether a small slice of public resource revenues might benefit Alaska more in the hands of individual Alaskans than in the hands of their state government.

The dividends and the Permanent Fund which generates them stand apart from traditional American notions of governments role in society. The concept of the government distributing resource revenues in equal amounts, directly to all individuals, makes an astonishing end-run around usual debates about taxes and public spending.

Alaskas Tradition of Government Investment

Both the dividends and the Permanent Fund stand in particularly sharp contrast to the dominant Alaska ideology which holds that government investment is essential to build a stable, diversified and self-sustaining private economy. The vision of Alaska as a rich storehouse of resources waiting to be unlocked through government investment has a long history. In 1915, Anchorages first newspaper saw the Alaska Railroad and the proven and potential possibilities of the country that road will traverse and open up as the key to a sparkling future for the newly established tent city.1 The railroad did indeed assure Anchorage a future, but over the next two decades that future sparkled only dimly.

For Ernest Gruening, writing in 1954, the economic stagnation which characterized all of Alaska during that and several earlier periods was the direct result of government neglect, just as the upturn in the mid-1930s, the growth during World War II, and Alaskas cold war boom of the early fifties were the consequence of government attention.2 In each case Gruening cites, political neglect meant less government spending while attention meant more.

The critical economic impact of government spending in Alaska is clear. With the single exception of the 1974-77 pipeline construction period, economic good times in modern Alaska have also coincided with periods when government was pumping money into the state disaster relief in 1964-65, state spending of oil lease bonus receipts in 1970-73, and state spending of Prudhoe Bay royalty and tax revenue in 1979-83. (3)

What is not so clear is the extent to which government investment can create self-sustaining non-government economic development.4 Nonetheless, the notion that government efforts can and should bring long-term prosperity still exerts a powerful grip on many Alaskans, particularly in the case of energy development. Many Alaska political leaders point to the building of dams in the Tennessee Valley and the Columbia River Basin as examples of how hydroelectric development can lower power costs, provide construction jobs, and attract industry. Just as plans for Rampart dam captured the imagination of Alaskans in the 1950s and 1960s, the proposed Susitna hydroelectric project has been hailed by many in the 1970s and 1980s as a major boom for the Railbelt region between Anchorage and Fairbanks.(5)

Government Dividends Almost Unique

Dividend distribution is of course also a way to inject money into the economy, but it flies in the face of these traditional Alaska notions of development as well as the practices of other governments. All governments distribute benefits in a host of forms, but indeed, the only historical parallel to the Permanent Fund dividend distribution appears to be a recent program of the remote Malaysian state of Sabah, which like Alaska used windfall revenues collected from natural resource development to fund its per capita payments.(6)

How it Happened

Both the Permanent Fund and the Permanent Fund dividends originated in the harvest of Alaskas tremendous oil wealth. The development of the vast Prudhoe Bay oil field on state-owned land allowed the state government to collect more than $12 billion in petroleum taxes and royalties in the decade from 1972 to 1982, with the expectation of an additional $140 billion or more by the year 2000.(7)

Exploding revenues produced exploding budgets. By 1982, Alaska was number one among the states in per capita expenditures ($88,500 per person), and was spending almost three times as much per Alaskan as the U.S. government was spending per American. (8)

The first waves of the rising sea of oil money prompted Alaskans to create the Permanent Fund by a 1976 Constitutional amendment. By law, this public savings account receives at least 25 percent of all oil royalties which works out to approximately 10 percent of the states oil revenue in an average year.9 As explained by Elmer Rasmuson, the Funds first board chairman, The Permanent Fund began, chiefly, with a 'negative goal, to place part of the one-time oil wealth beyond the reach of day-to-day government spending. (10)

Hammond Supports Direct Dividends

Some Alaskans, including then-Gov. Jay Hammond, came to favor direct distribution of a portion of the oil revenues as a check on government growth. Without such a check, asserted Hammond, government spending and lending would create a dependence which would bring a wrenching dislocation when the oil money ran out. Direct distribution, on the other hand, would give each citizen a personal stake in oil revenue and thus give Alaskans an incentive to oppose pork barrel spending and budgetary hyper-growth in general. Further, argued Hammond, if the distribution was paid in the form of annual dividends from the Permanent Funds earnings, Alaskans would be more likely to fight raids on their savings account. (11)

Some Alaskans supported direct distribution on the grounds of equity, contending that "the powerful and connected are already benefiting from the states wealth through special-interest appropriations, often arranged behind closed doors." (12) Many pointed to the states heavily subsidized loan programs as the biggest example of inequitable benefit distribution. By 1981, some upper-income borrowers under the home loan program were receiving monthly subsidies larger than the payments made under the best-known federal welfare program, Aid for Families with Dependent Children. (13)

Others backed direct distribution primarily on economic grounds, arguing that individuals use of a portion of the oil money would result in more efficiency and utility than the governments use.14 Additionally, some favored the concept out of a libertarian fear that unrestrained government would eventually threaten individual freedom. (13)

After several years of advocacy, Hammond was able to engineer legislative passage of a Permanent Fund dividend distribution bill during the high revenue year of 1980. The legislation provided that the annual dividends would vary, increasing commensurate with length of residency. (16) Hammond contended this cumulative residency feature would avoid the 'rip-off and run syndrome which has so plagued Alaska. (17)

Zobels Challenge Residency Test

Many supported this the longer youre here, the more you get plan as a way to reward the contribution of longtime residents; this idea has a long lineage in Alaska history going back to the establishment of the Pioneers Homes in 1913. Eligibility for the homes was restricted in recent years to Alaskans over 65 who had resided in the State for at least 10 years.18 A related program, the Alaska longevity bonus, provides direct payments (currently $250 per month) to Alaskans over 65 who have resided in the State since 1959, the year Alaska became a state. Both programs reflected the notion that those who had pioneered Alaska should be given special benefits in their old age, and both enjoyed wide popularity in the State. However, Ronald and Patricia Zobel, two Anchorage lawyers, believed that all of the residency tests embodied in these programs were unconstitutional, and they filed suit against the dividend program. (19) In mid-1980, all payments were blocked pending resolution of the litigation, which ended up in the U.S. Supreme Court.

Concern about the outcome of the Zobel litigation led the Hammond administration to introduce, in early 1982, another dividend bill, designed to take effect if the original legislation was struck down by the Court. In essence, this backstop bill provided that every six-month resident would get a dividend. (20) The equal distribution scheme embodied in the backstop bill met with almost no enthusiasm in the Legislature. In February of 1982 it was estimated that there were less than 10 votes (out of 60 in the entire Legislature) for the proposal. (21) Some legislators feared that the equal direct distribution scheme proposed in the backstop bill would encourage in-migration to Alaska, plus touch off a negative reaction outside the State which would add fuel to a Congressional campaign to limit Alaskas oil revenues. (22)

Hammond Forces Vote on Dividend Plan

Neither did this proposal draw much attention from the public at large. The dividend legislations universal impact gave no individual or group any special incentive to seek its passage. It proved difficult for the bills supporters to motivate citizens to work for a bill whose benefits while substantial to the average person were distributed so widely. If the legislation passed, everyone would get a check; if it did not, no one would.

Hammond broke through this inertia by threatening to call a special session and veto funding for lawmakers pet projects should the Legislature not pass the legislation. The governor underscored his commitment by personally testifying before a legislative subcommittee although he strongly favored the original plan and hoped it would be upheld. (23) The political chaos produced by years of rapid budgetary growth helped the bills passage in two ways. Some legislators came to agree with Hammond that the Legislatures track record showed that a portion of the oil money was better off in the hands of the people. The pressure of dealing with the cascade of petrodollars also fragmented the Legislatures attention span, and gave the governor extra room to maneuver and make deals to gain passage of his top priority. (24) Finally, the bills passage was aided by the support of a tiny but committed core of diverse legislators and activists led by two former Speakers of the House. (25) The backstop bill passed the Legislature with only two major changes from the governors bill. Several provisions were inserted to ensure that no Alaskans would lose federal public assistance payments because of the receipt of dividends. After behind-the-scenes philosophical arguments about the trustworthiness of parents, the provisions instructing the State to hold on to minors dividends until they turned 18 were replaced by a requirement that parents and guardians be allowed to collect dividends on behalf of minors.

Once on the floor, the legislation benefited from the governors pressure, as well as from a perception that voting against distributing cash to residents could be politically dangerous particularly in an election year. The bill passed easily in the waning hours of the session.

The Supreme Court ruled 8-1 against the original plan on June 14, 1982, less than two weeks after the session ended. (26) Hammond then signed the bill, although deeply disappointed that his original residency-based plan had been struck down. (27) Hours later, the big computer in the State Office Building down the street from the capitol started up, and the first oversized blue-and-gold $1,000 checks rolled off the high-speed printer and into the mailbox.

Conclusion

Despite the novelty of Permanent Fund dividends and the publicity surrounding the $1,000 first-year distribution, Alaska still spends most of its oil revenue in traditional ways. Adding the $120 million earmarked for 1983 dividends which will be about $300 per Alaskan to the approximately $3 billion state budget would increase state expenditures by less than 5 percent.

The verdict is still out on Permanent Fund dividends. The program may be seen as an equitable and efficient strategy which both challenges the decision-making capacities of all citizens and encourages responsibility in unusual conditions of collective wealth. Or history may record the distribution as a wasteful and immoral giveaway of public assets to private greed. What is clear is that Americas federalist system has again allowed a state to serve as a laboratory for decidedly different ideas.

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3. George W. Rogers, The Alaska Economy in the 1960s, in Gordon S. Harrison (ed.), Alaska Public Policy: Current Problems and Issues (Fairbanks: University of Alaska, 1971). Linda Leask (ed.), Prices and Incomes Alaska and the U.S. 1967-1980, in Alaska Review of Social and Economic Conditions, June 1981, Gregg Erickson and Thomas O. Singer, State Spending and the Alaska Economy, paper presented at the Conference on Alaskas Budget Process: The Agenda for Change, Anchorage, Alaska, December 4, 1982.
4. Alaska Permanent Fund Corporation, The Trustee Papers (Anchorage: 1982). (Hereafter this is cited as The Trustee Papers.)
5. Anchorage Daily News, January 12, 1983, p. 1.
6. Malcolm Gillis, The Effects of in-State Investment: Lessons From Oil-Fired Development in Other Parts of the World. in The Trustee Papers, p. 41. Endowed with timber and oil resources, Sabah has made annual cash payments of almost $50 per capita, which is about 5 percent of Sabahs annual per capita income. Alaskas $1,000 payment was just over 6 percent of the States 1982 estimated per capita personal income.
7. Alaska Department of Revenue. Revenue Sources. Quarterly Update, September, 1982, pp. 7, 10; Alaska Department of Revenue, Petroleum Production Revenue Forecast, December 1980, p. 10.
8. Between FY 1977 and FY 1982 the States general fund expenditures increased by 235 percent; per capita expenditures adjusted for inflation increased by 159 percent. Milt Barker, Memorandum to the Hon. Al Adams, August 6, 1982, table 1. Adjustments for inflation and population were calculated from data in Barker, supra., and The Hammond Almanac 1983 (Maplewood. N.J.: Hammond Almanac, Inc., 1982), pp. 186. 244.
9. Alaska Constitution. Article IX. Section 15; and Ch. 18 SLA 1980.
10. Anchorage Daily News, June 26, 1982, p. A-13.
11. Gov. Jay Hammond, Farewell Address, November 29, 1982 (photocopied), pp. 8-18; Anchorage Daily News, February 7, 1982, p. A-13.
12. Anchorage Daily News, July 10, 1982. p. G-3.
13. Richard B. Coffman, Capital Shortage, Public vs. Private Allocation of Capital, and Alternative Ownership Systems for Alaskas Oil Wealth, in The Trustee Papers, pp. 23-26; and Donald Gordon, The Problems of Wealth, ibid., pp. 4-6.
14. Dick Randolph, the Libertarian candidate for governor in the 1982 election, frequently touched on this theme.
15. Adults who had resided in Alaska for 21 years or more would receive $1,050 in the programs first year, others would get $50 for each year of residency (Ch. 21 SLA 1980).
16. Statement by Governor Jay S. Hammond on Supreme Court Decision (no date), (photocopied), pp. 2-3.
17. Ch. 25 SLA 1913; and Ch. 44 SLA 1915.

18. Zobel vs. Williams, U.S., 102 S.Ct. 2309.72 L.Ed.2d 672 (1982). The Zobels also filed and won a similar suit in the State courts against a related program which rebated State income taxes on the basis of residency.
19. Under this backstop plan, the per capita payments in the programs first year would be $1,000, a figure chosen because it would consume almost all of the money appropriated up to then to fund the old plan; after the first year, the amount of the annual dividend was to be calculated by dividing the number of eligible applicants into half of the Permanent Funds interest earnings. (The other half of the income would be retained by the Fund so as to keep up its earning power in the face of inflation.)
20. Brian Rogers to Gregg Erickson, February 13, 1983.
21. Ibid.
22. Statement by Governor Jay S. Hammond on Supreme Court Decision, note 17, supra.
23. See Richard A. Fineberg, Chaos in the Capital: The Budget System in Crisis (Anchorage: Alaska Public Interest Research Group, 1982).
24. The uniqueness of the direct distribution issue made nonsense of traditional political alignments, as shown by the coalition of the Republican Hammond with moderate to liberal Democrats Malone and Gardiner, as well as the nations first Libertarian legislator, Rep. Dick Randolph of Fairbanks.
25. Zobel vs. Williams, note 19, supra.
26. Hammond, note 17. supra.

Trustee Papers Volume V

Alaska's Permanent Fund
Legislative History, Intent and Operations

The Rural Research Agency, an agency of the Alaska State Legislature, was directed to examine the legislative history, intent, and subsequent implementation of the legislation which created the Alaska Permanent Fund Corporation (APFC). The Agency produced this report, which was first published in January 1986, then abridged and edited for the Trustee Papers Vol. 5.

Executive Summary

Introduction

The 1976 Constitutional Amendment (Article IX, Section 15) created the Permanent Fund and provides the fundamental directives for contributions and earnings of the Fund. The Constitution:

1. allows the creation of a dedicated fund;

2. directs a minimum level of mineral resource revenue contributions to the princi-pal of the Fund; and

3. directs that all earnings be deposited to the General Fund unless otherwise pro-vided by law.

Issues in The Development of the Permanent Fund

Three major issues arose in the development of legislation to manage the Permanent Fund:

1. the objectives of the Fund;

2. fiscal issues; and

3. organization and management of the Fund.

Legislation enacted in 1980 stated the final choice of objectives as:

1. the Corporation should provide a means of conserving a portion of the States revenues from mineral resources to benefit all generations of Alaskans;

2. the Corporations goal should be to maintain safety of principal while maximizing total return; and

3. the Corporation should be used as a savings device managed to allow the maximum use of disposable income from the Corporation for purposes designated by law.

A trust was created to be managed by the Alaska Permanent Fund Corporation with a Board of Trustees to provide policy guidance. The management direction was conservative and placed paramount importance on safety of principal. The objective of the Fund was to

earn the highest possible return with low risk to the principal. Other objectives considered and rejected were social and economic. The social objective had few advocates, other than Gov. Jay Hammond, who proposed Alaska, Inc., the precursor to the Permanent Fund Dividend program. The economic development objective was not chosen because the consensus was reached
that:

1. lack of available capital was not the reason for limited economic development in Alaska;

2. that soft loans were very risky; and

3. loans were a subsidy to a select few people.

Members of the Senate had proposed bills utilizing the Permanent Fund principal for an economic development bank. Those bills were defeated for the above reasons and because they would have caused fundamental and major changes in responsibility among various state departments.

The state Constitution requires a minimum of 25 percent of selected mineral resource revenues be placed in the Permanent Fund. Subsequent legislation increased this to 50 percent. Analysis by administrative and legislative legal counsel concluded that once money was placed in the body of the Permanent Fund principal it could not be withdrawn without a Constitutional amendment. Inflation-proofing was considered but not included in the 1980 legislation. Legal opinions suggested that the Trustees must consider inflation in making investment decisions. However, the Legislature was under no obligation to consider additional inflation-proofing such as is now done.

The Trustees were directed by the Legislature to use the institutional prudent investor rule in guiding their investment decisions. Therefore the criteria by which the Permanent Fund Corporation management should be evaluated is based upon the concepts of diversity, total portfolio strategy, and assessment of risk. The Corporation should not be judged on individual investment decisions.

The major focus of the 1980 legislation was the management and organization of the Permanent Fund Corporation. The public clearly wanted a politically neutral Fund and the opportunity to participate in policy development. The Legislature and the executive were concerned about oversight and mechanisms for control of the Fund. The Trustees are gubernatorial appointees who submit the budget of the Corporation to the Legislature through the executive budget proposal. Legislative oversight is accomplished through the Legislative Budget and Audit Committee (LBA). Initially the LBA Committee was to have this responsibility for three years; then an assessment as to the need for a separate standing committee was to be made. This assessment never occurred.

Fiscal Structure of the Permanent Fund

In the Funds first decade, management of the Permanent Fund was directed by three pieces of legislation:

1. Chapter 6 SLA 1977 effective March 23, 1977.

2. Chapter 18 SLA 1980 all but one section became effective April 9, 1980.

3. Chapter 81 SLA 1982 effective July 1, 1982.

4. Chapter 23 SLA 1986.

5. Chapter 83 SLA 1986.

Initial legislation permitted an investment list that included only fixed-income securities such as notes, bonds or bills guaranteed by the Federal Government, debt of federally insured financial institutions and corporate investment-grade securities. Under interim management, all earnings from the investment of the Permanent Fund were deposited in the General Fund per the Constitution.

The 1980 Permanent Fund Act is the basis for current management of the Fund. The Joint Committee Report stated that SB 161 was concerned with the single most important question at this time the management of the Funds principal and that the legislation addressed three areas: safety of principal, accountability and legislative oversight.

It placed management of the Permanent Fund under the Alaska Permanent Fund Corporation (APFC) and its Board of Trustees. Future nonrenewable mineral resource revenues would be subject to a 50 percent contribution rate rather than the past rate of 25 percent. Fixed-income securities remained the only type of investments permitted. Legislation passed in 1980 made a number of changes to the Permanent Fund earnings distribution scheme. From FY 1980 through FY 1982, annual income was divided between:

1. Dividend Fund received one-half of the amount of income available for distribu-tion (the five-year moving average of net income).

2. General Fund received the remaining half of the amount of income available for disbursement (based on the Constitutional provision for income not otherwise spent by the Legislature).

3. Undistributed Income Account since annual income was (and always has been) larger than income available for disbursement, a retained earnings type of account was created containing the difference between earnings and distributions each year.

(Note: In 1986, this account was renamed the Earnings Reserve Account.)

The 1980 Permanent Fund Act created the undistributed income account, but it failed to define the account or mandate any management or investment guidelines. A letter of intent that accompanied the legislation also did not discuss the creation or objective of this account.

The 1982 Amendments addressed three major issues:

1. Composition of the Board of Trustees changed to

four public members with four-year terms, and two members of the administration.

2. Permissible Investments the list of allowable investments types was expanded to include domestic stock (common and preferred) and selected types of real estate. Asset allocation was also changed to accommodate these new investment types.

3. Inflation-Proofing a portion of annual earnings was henceforth to be reinvested in the principal to offset the effects of inflation.

Conclusions

1. The Permanent Fund was established with a set of principles which have been significant in its success. These principles, such as the Prudent Investor Rule, flexibility of Trustees in investment decisions, insulation (but not isolation) from political activity, and accountability to the Legislature, have been followed and should continue to be adhered to. Deviation from these principals, such as disinvestment, may harm the future financial success of the Fund.

2. Flexibility of investments should be expanded to include foreign stocks. (Note: This authority was provided by the Legislature in 1989.)

3. A major portion of the earnings of the Permanent Fund are designated for inflation-proofing. How adequately the principal is protected from the impact of inflation is influenced by the methods used to determine the amount reinvested. Inflation-proofing will soon become the major source of new revenues for the Permanent Fund.

4. The other program funded from Permanent Fund earnings is the Dividend Program. This program has disproportionately raised the incomes of low-income Alaska families many of

whom live in rural Alaska. In addition economists have com-pared the effect of the Permanent Fund Dividend to expenditures in the capital and operating budgets and have concluded that it is the most effective way to encourage economic activity in Alaska.

5. Since it is unlikely that the Permanent Fund will continue to earn real rates of return at the current level (because the current situation is historically unusual and allows higher than normal returns on fixed income investments) and since the possi-bility of increasing inflation exists, the Legislature eventually may have to choose between the Dividend program and inflation-proofing. It is unlikely under the exist-ing distribution scheme that large amounts of money will ever be available to the General Fund for appropriation.

6. The Undistributed Income Accounts original purpose and legislative history is vague. However, this account, since renamed the Earnings Reserve Account, is comprised of the earnings of the Permanent Fund, and the Constitution is very clear that these earnings are to be deposited to the General Fund and subject to appropriation unless otherwise designated by the Legislature. Under the current law, appropriating the Earnings Reserve Account is clearly within the legal options of the Legislature and is consistent with the intent of the Permanent Fund.

Chapter One: Introduction

The Alaska Permanent Fund was approved by the citizens of Alaska nearly two decades ago when they overwhelmingly passed a Constitutional amendment allowing a dedicated fund to be created. The principal of the Permanent Fund now exceeds funds such as the Rockefeller Foundation, the Ford Foundation, and the J. Paul Getty Trust. This report examines whether the

Permanent Fund has fulfilled the public and legislative objectives for which it was created in 1976. It describes the historical legislation that guided the development of the Funds investment strategy and discusses the Funds fiscal structure. Finally, the report examines the future of the Permanent Fund and the options Alaskans now have as a result of the Permanent Fund.

The history of the Permanent Fund is complex with many different groups involved in the development of the legislation and an equal number of ideas about the objectives and management of the Permanent Fund. At various times, two to thirty-five bills have been before the Legislature regarding the Alaska Permanent Fund Corporation (APFC). This paper has been designed to focus on the major historical themes related to current legislative issues regarding the Permanent Fund:

1. the objectives or purpose of the Permanent Fund;

2. the management of the fund; and

3. the disposition of the earnings of the fund.

The discussion emphasizes those objectives considered during the development of the Permanent Fund which are likely to be reconsidered with a declining revenue base for the State of Alaska: the Permanent Fund as an economic development tool, as a fiscal savings account, or as a social mediator. Arguments for and against each objective are presented and an explanation of why the fiscal objective was chosen. Issues such as inflation-proofing and disposition of earnings are discussed. Comparisons are made between legislative intent and existing operations on topics such as accountability, investment strategy, legislative oversight and the Earnings Reserve Account. Alternative scenarios for the future Permanent Fund earnings are presented.

History of Concept

In 1976 the public was very optimistic about the financial future of Alaska. Total revenues anticipated to accrue by 1985 to the States Treasury from oil royalties and taxes were as high as $8.6 billion without any additional discoveries of new oil fields. At the same time, there was concern about the growth in government spending and the economic future of Alaska once the oil revenues declined. The states population had just experienced the effects of a construction boom as a result of the $900 million bonus payment for Prudhoe Bay and the construction of the trans-Alaska oil pipeline. A mechanism to slow or to dampen the boom and bust cycle the Alaska economy was experiencing was desired by the citizens. Among Alaskans, the general consensus was that the operation of the fund would have the effect of reducing the immediate fiscal impact of oil and gas income and a stretching out and smoothing of its long-term impact (Tussing 1977). The public embraced the concept by a margin of two to one when they approved the Constitutional amendment. The vote represented broad support of liberal and conservative factions in Alaska society.

The idea of saving a part of the windfall oil revenues appeared to arise simultaneously in the early 1970s among the financial community, the general public, and the Legislature. In a speech before the Alaska Chamber of Commerce in 1969 the concept was presented by a member of the financial community, Robert Krantz, as a perpetual fund from which the Legislature would appropriate and use the earnings. The Legislature heard similar proposals from a seminar they had sponsored on the Future of Alaska conducted under the auspices of the Brookings Institute. During the 1970 legislative session, Gov. Keith Miller introduced legislation which would have set up an appropriated reserve of money for a resources permanent fund. The legislation passed the Senate but not the House. In 1975 legislation (CSHB 324 am S) was introduced and passed by the Legislature creating a Permanent Fund but this time Gov. Hammond vetoed the legislation, citing the Alaska Constitution which prohibited dedicated funds and proposing the Constitutional amendment (SSHJR 39) which the voters approved in

1976.

The Constitutional Amendment

The Constitutional amendment permitted the existence of a dedicated fund which had been forbidden previously. It also set the minimum amount and sources of the revenues from which the Permanent Fund was to be created. The amendment is reproduced below:

Section 15. ALASKA PERMANENT FUND. At least twenty-five per cent of all mineral lease rentals, royalties, royalty sale proceeds, federal mineral revenue sharing payments and bonuses received by the State shall be placed in a permanent fund, the principal of which shall be used only for those income producing investments specifically designated by law as eligible for permanent fund investments. All income from the permanent fund shall be deposited in the general fund unless otherwise provided by law.

The Constitutional amendment represented a compromise between the Senate and the House in the types of revenues and amount of revenues allocated. The revenues dedicated to the Permanent Fund were those revenues which the State received as a result of its status as a landowner or because of its relationship to the Federal Government. The House had wanted to include severance taxes but the Senate argued that taxes were assessed for the operations of government, not to create, in essence, a profit. The compromise between the governor, House, and Senate was designed to exclude the severance tax, but to raise the minimum contribution from 10 percent to 25 percent of the allowable revenues. In effect, either bill allocated 10 percent to 11 percent of the States mineral revenues to the Permanent Fund.

Although the Constitutional amendment did give a conservative direction to the Fund, it did not set up the management structure, the allowable income-producing investments for the Fund, or designate how the earnings would be used when deposited in the General Fund. These issues were to be decided with subsequent legislation. Table 1 summarizes the steps creating the Alaska Permanent Fund.

Table 1. Chronological Sequence of Permanent Fund Events

1969	Concept of a savings account first proposed by Krantz before the Alaska State Chamber of Commerce.
1970	Gov. Miller introduces first bill, which is defeated in House of Representatives.
1975	Permanent Fund bill passes Legislature and is vetoed by Governor Hammond for Constitutional reasons.
1976	Voters approve Constitutional amendment.
1977	HB 210 provides for interim management of the Permanent Fund, and passes in March. September Anchorage Symposium by House Permanent Fund Committee on Objectives of Permanent Fund.
1980	SB 161 creates the Alaska Permanent Fund Corporation.
1982	SB 684 amendments to the 1980 Permanent Fund Act.

Chapter Two: Issues in the Development of the Permanent Fund Concept

Three major issues or questions arose during the development of the Permanent Fund which were either addressed in the Constitutional amendment and or clarified in subsequent legislation. The issues are:

1. What are the objectives of creating a Permanent Fund?

2. What are the financial concerns related to creating a Permanent Fund?

3. How was the Permanent Fund going to be managed?

To determine the answers to these issues the House and Senate established special Permanent Fund Committees, contracted with many financial consultants, and commissioned polls and surveys to determine public opinion. The Hammond Administration, through the Alaska Growth Policy Council and the State Investment Advisory Council, solicited public input.

Objectives of the Fund

The objectives proposed for the Permanent Fund were many; some were very broad while others were very specific. The possibilities were described categorically as social, economic and fiscal. Examples of social objectives would be to use the Fund to promote programs with an emphasis on changing social conditions such as the redistribution of wealth through the negative income tax, to subsidize low-income families, to correct regional economic differences, or to support educational programs. Economic objectives were described as those which would promote economic diversification and development. Proposals for subsidized loan programs, large infrastructure programs to build hydroelectric dams, railroads, and ports, or the development of industrial parks can be categorized under the economic objectives. The fiscal objective centered upon the idea of the Fund as a savings account which would be managed very conservatively, primarily investments in high-grade low-risk securities, or would be used to reduce state debt. Each objective had advocates who advanced specific legislation for Fund objectives and management. The various groups involved in the development of the Permanent Fund are summarized in Table 2.

Table 2. Groups Involved in the Development of the Permanent Fund Legislation

State Investment Advisory Council (SIAC). Membership was expanded and directed by Gov. Hammond to develop a Permanent Fund proposal. Membership included academic specialists, private enterprise representatives, the Departments of Commerce and Economic Development, Revenue, and the Division of Policy Planning and Development.	Initially stressed the idea of Permanent Fund as an Economic Development Bank.
Alaska Growth Policy Council and the Public Forum were established by Gov. Hammond to determine opinions on future development of the State.	Had no position on Permanent Fund, but provided mechanism for public input regarding the Permanent Fund.
Division of Policy Development and Planning (DPDP). Directed by Gov. Hammond to provide policy coordination and	Coordinated and developed analysis of various positions. Appeared to be pro fiscal objective.

guidance between the various departments.	
Alaska State Senate.	Sen. Hohman developed loan program revisions to be funded by the Permanent Fund.
Alaska State House of Representatives Permanent Fund Committee. Seven members specifically working on Permanent Fund Legislation from 1976 until passage of management bill in 1980.	Developed the fiscal concepts which were eventually included in the management sections of the bill. Conducted many of the public seminars and provided information booklets.
Commonwealth North. Business lobby group.	Advocated use for infrastructure development.
Alaska Chamber of Commerce.	Advocated loan programs for businesses.

Economic Development Objective

Proponents of the economic development or diversification objective included numerous and powerful special interest lobbies. Special interest groups saw the Permanent Fund as a development bank which could finance projects. For example, the power utility organizations promoted the concept of using the fund for hydroelectric development. Suggestions were made that the Permanent Fund finance the Alaska Natural Gas Transportation System, and Alaska Railroad extension into the interior of Alaska, community development banks and so forth. The Permanent Fund became the wishing well for all of these interests and more.

The main proponents in the State Government for the economic solutions were the State Investment Advisory

Council (SIAC), the Department of Revenue, the Department of Commerce and Economic Development, and the Senate. Gov. Hammond had requested that SIAC take the lead role in developing legislation concerning the management of the Permanent Fund. Membership in SIAC was expanded and included representatives from the Departments of Commerce and Economic Development, Revenue, and Administration, agricultural representatives, members of the financial or banking communities, resource development interests, and representatives from the Native community. SIAC considered the following objectives for the Permanent Fund; the development of a loan program, loan subsidies, securing or guaranteeing State industrial development bonds, and a development bank. The Council hired White, Weld & Co. as consultants to examine the possibilities. Kenneth Butler, vice-president for White Weld, summarized the possibilities SIAC examined:

"... the assets of the Permanent Fund can be used in a great variety of ways and combination of ways within the structure of the tax-exempt market to maximize its effectiveness and impact on solving the needs of Alaska and achieving its economic goals. Briefly stated, some of the opportunities are: 1) direct guarantee of debt, 2) make-up of revenue shortfall, 3) loans to projects or political subdivisions, 4) combination financing with public utilities or private industry, 5) industrial development financing, 6) pledge of specific assets and/or income of the Fund for certain projects, and 7) others. It is important to understand that these initial efforts focused on using the entire body or principal of the Permanent Fund for loans and development activities, however, as discussion continued the focus shifted to the earnings. For example, in 1981 after the Permanent Fund had been established, business groups such as the Business Round Table advocated the use of the earnings for infrastructure development as opposed to the Permanent Fund Dividend Program."

The Department of Revenue had conceived a similar breakdown of the possible Permanent Fund objectives.

Commissioner of Revenue Sterling Gallagher stated the possible objectives for the Permanent Fund as economic diversification, community development or a savings account. Two additional possibilities were considered in October, 1977, using the Permanent Fund as a mechanism for revenue-sharing with municipal governments, or as a control on state spending.

By the time Permanent Fund legislation was enacted in 1980, several concepts concerning economic development had emerged from the process. Important among these were that economic intervention activities had little chance of succeeding, that the likelihood of loss of the body of the Permanent Fund was high, the size of the Permanent Fund would be inadequate for large infrastructure projects, and that economic development would encourage immigration and worsen the states taxable base.

PUBLIC PERCEPTIONS

Two perceptions influenced public opinion among Alaskans in the mid 1970s:

1. Alaska economic development was being hindered by a lack of capital; and

2. Alaska lifestyles based on renewable resources such as fish and timber should be promoted.

Members of the public initially perceived the Permanent Fund as an economic development tool by a margin of 4-1 (Dittman 1976). The Dittman Poll conducted for the Alaska State Senate in October of 1977 concluded that the top five of twenty-two options for the use of Permanent Fund earnings had an economic orientation. They were:

1. loans for renewable resource development (fisheries and timber);

2. loans for farming and agricultural development;

3. loans for senior-citizen housing programs;

4. loans for large-scale electrical power

development (hydro-electric/geothermal); and

5. loans for small business development.

Similarly, an Alaska Chamber of Commerce questionnaire showed that Chamber members wanted the Permanent Fund to be invested in high-grade stocks (43 percent) and be used for loan programs or development projects. The public wanted to apply the same criteria used by private institutions such as banks for loans in any development lending program. Overall small-business owners and the public conceived of the Permanent Fund as a tool for economic diversification.

Rural Perspectives

Rural residents, in polls and at public hearings, supported the economic development uses of the Permanent Fund. They were more inclined to use the Permanent Fund principal as well as the earnings immediately than urban residents (29 percent vs 22 percent) and were less supportive of loan programs (38 percent vs 62 percent). In the Dittman Survey, rural residents said they were capital-short and would participate in and benefit from loan programs. They wanted these programs to be administered by the state as opposed to private banks. During a Symposium on Permanent Fund objectives, housing loan program needs were presented as an example of the type of programs rural residents envisioned for Permanent fund dollars. Jamie Love of the Alaska Public Research Group said, Its very difficult for people living in rural Alaska to provide housing through conventional or their own resources. He advocated rural loan programs funded by the Permanent Fund.

With more information, village and Native corporate leaders support of the economic objective modified somewhat between 1976 and 1977. For example, the savings account approach was recommended by Alaska Public Forum participants in Dillingham in the fall of 1977. However, money for renewable resources was a close second. In Wainwright that fall, participants in the Alaska Public Forum recommended the money be used for immediate infrastructure needs such as an airport terminal, with investment in renewable resources a close second. Opinion among Native Corporation leaders was that the Permanent Fund had great potential value in meeting rural area needs. Native Corporate representatives envisioned the Permanent Fund as a bank similar to the Economic Development Administration, the Federal Housing Administration, and State loan programs. Specifically these leaders saw a need for loans for projects involving fisheries and minerals development. Overall, the rural people still envisioned the Permanent Fund as an economic development bank.

Consultant Recommendations

Consultants were very influential and numerous during the development of the Permanent Fund. Table 3 lists the main consultants who were involved.

Table 3. Consultants Used in Developing the Permanent Fund Legislation

Alaska Pacific Bank	Robert Richards worked with SIAC, produced Permanent Fund position paper in the Alaska Series.
Arthur D. Little	Financial consultants contracted by SIAC to examine State loan programs and recommend changes.
Baily, Donahue, and Kasson, Inc.	Political consultants who were contracted by SIAC to study attitudes about goals of Permanent Fund and level of awareness in 1977.
Debevoise & Plimpton	Legal firm contracted by Legislative Budget and Audit to determine the implications of the Prudent Investor Rule.
Dittman	Market and public opinion research

Research Associates	firm contracted by Senate Permanent Fund Committee to do Results of Personal Hearing-in-the-Home Program concerning the Alaska Permanent Fund.
Beldon Daniels	Regional planner, from Department of City and Regional Planning, Harvard University and Counsel for Community Development contracted by House Permanent Fund Committee to write two issue papers on the development of the Permanent Fund.
Robert J. Dupere	Questionnaire research firm contracted by Senate Permanent Fund Committee to do business opinion poll about Permanent Fund.
Fidelity International, Inc.	Financial consultants on bill drafts to Legislative Affairs Agency Legal Division.
Milton Friedman	Nobel Prize winning conservative economist from the University of Chicago. Met with both SIAC and House Permanent Fund Committee members.
Institute of Social and Economic Research	University of Alaska research group contracted by the House Permanent Fund Committee to analyze different contributions, needs, and economic scenarios regarding the Permanent Fund.
Kidder, Peabody and Co.	Financial consultants contracted by House Permanent Fund Committee to provide advice on Permanent Fund structure, recommend other advisors such as Robert Blixt of Minnesota Board of Investments.

Price Waterhouse & Co.	Financial advisors contracted by House Permanent Fund Committee to examine the organizational structure of the Permanent Fund as a development bank, criteria for integrity, oversight, and boards.

The economic objective was examined thoroughly by consultants and their recommendations demonstrated some consensus in the ability of the Permanent Fund to promote economic diversification, alleviate the rural capital shortage, and about participation in soft loan programs.

Rural people believed a capital shortage existed because of the difficulties they were having in obtaining loans. Coffman and Fry studied the problem and concluded that structural problems, rather than a lack of dollars, were causing the shortage (Coffman and Fry N.D. and Coffman 1982). The structural problems cited were a lack of investment opportunity, land title problems, insurance difficulties, lack of supporting infrastructure, lack of information and expertise, seasonal nature of business opportunities, the high costs of goods and services, and the low personal incomes of rural Alaskans. Alaska economist Arlon Tussing had come to a similar conclusion and noted that the private market appeared to be fulfilling the capital needs of Alaskans (Tussing 1977). In his opinion, the costs of borrowing money in rural Alaska reflected the actual higher cost of lending in those areas. He did qualify his findings by suggesting that a state program in one area, loans to small- and medium-scale enterprises in small and rural communities, might fill a specific capital shortage. The overall conclusion by these consultants was that private lending institutions were providing adequate money and that an infusion of Permanent Fund dollars would replace rather than supplement the available lending pool.

The ability of the Permanent Fund to create new industries and/or to promote existing industries was seriously questioned by consultants. Beldon Daniels repeatedly stressed the need to develop realistic expectations concerning the Permanent Funds ability to foster economic diversity. He noted that a coherent statewide policy on expenditures, taxes, and administrative regulation was needed to encourage private capital investments. Tussing agreed with Daniels, as have subsequent consultants. Tussing said, It appears that a reduction of existing barriers to capital mobility and improving information flows would not necessarily accelerate the rate of development in Alaska fisheries, agriculture, or tourist industries, for example or in rural Alaska generally. In the Trustee Papers #1, Peden argues that investments in education, identifying specific industries that suit the region, and providing a cooperative government business atmosphere were more important than massive infusion of public capital to encourage economic diversification.

Concern for the potential inflationary results of Permanent Fund investments in Alaska was expressed by several consultants. International development specialist Malcolm Gillis argues in the Trustee Papers #1 that large infusions of money into small economies have caused inflation and socio-economic dislocation rather than economic diversification. This type of dislocation had been labeled in 1977 as The Dutch Disease when Holland experienced rising unemployment and lowered industrial productivity as a result of petrochemical revenues. The anticipated magnitude of the Permanent Fund in comparison to other pools of money in the State caused Daniels to comment:

"Alaskas economy with its $4.5 billion in personal income is simply not large enough to be able to absorb significant in-state investments by the $4 billion Permanent Fund. Further, opportunities for making sound investments are relatively narrow. There are real limits on the ability of public fund investments to force feed sound, new economic activity in Alaska ... Alaskas second unique problem arises from its relatively small capital market. The Permanent Fund currently towers over all other financial sources in Alaska. If even 25 percent of the Permanent Fund were invested within the state, that portion of the Fund would be the fifth largest financial source in Alaska."

The potential use of the Permanent Fund for loan programs raised the issues of subsidies and market rates of return on Permanent Fund dollars. The Permanent Fund had been conceived by proponents such as Gov. Jay Hammond as a way to benefit all Alaskans. Arrow summarizes the consensus in the Trustee Papers #1, noting that low-interest loans or below-market-rate loan subsidies are similar to any other public good and that subsidies benefit small groups, doing nothing for future generations, and possibly doing nothing for present-day Alaskans. The conservative economists, Gordon and Friedman, recommended that direct payments rather than social-welfare programs or loan programs would provide the greatest benefit for individual Alaskans. Finally, nearly all of the consultants agreed that if the Permanent Fund provided loans at below-market rates or at higher risk than the commercial banks, an erosion of the principal of the Fund would occur. The consultants agreed with White Welds conclusion that soft-loan programs do not belong in a legacy public or private.

In summary, the consultants were useful to the public and the Legislature. Consultants emphasized the relative small size of the Permanent Fund to the overall state budget and economy. They introduced caution in expectations of what the Fund could achieve in terms of economic diversification and pointed out that other economic problems besides capital shortages were the factors hindering Alaskas economic development. Finally, they discussed the two major ways in which the principal of the Fund could be lost:

1) if investments were too cautious resulting in real rates of return below inflation; and
2) if investments were too risky resulting in loss of the capital.

Social and Community Welfare Objectives

Proponents of the social welfare objective concentrated on the disposition of the earnings of the Permanent Fund as opposed to the principal. Proponents of the social welfare objective also advocated an investment strategy to eliminate or balance specific inequities in economic, social, physical, or political parameters of the state. Alaska Pacific Bank analyst Richards gave examples of programs which promoted income redistribution or tax relief as possibilities for social objectives for the Permanent Fund. Proponents of the community welfare objective advocated investment in municipalities and community development to provide for the health, education, social, and public facility needs of Alaska communities.

Gov. Hammonds Recommendation: Alaska, Inc.

The most serious advocate of social welfare goals was Gov. Jay Hammond. His proposal concentrated on the earnings of the Fund and was developed as a piece of legislation separate from legislation mandating management of the fund. Hammond wanted to develop a Fund which would benefit all Alaskans and to develop a public constituency which would protect the fund. Although the governor suggested and considered many options such as low-interest loans, tax relief, and increasing government services, he settled upon Alaska, Inc., which became the Permanent Fund Dividend program. His reasoning was that:

"In any program increasing the dispersal of our oil wealth all Alaskans, not simply taxpayers, should be beneficiaries. We already have numerous programs selectively dispersing portions of our oil wealth in the form of expanded subsidized government programs and low-interest loans."

Hammond did not give up social welfare objectives once the Permanent Fund legislation passed in 1980. For example, in 1981 he was proposing that earnings be allocated between the dividend program and a municipal dividend program.

Consultant Recommendations

Consultants were very influential in the formulation of objectives for the Permanent Fund. It appeared that Hammond was taking the advice of consultants such as Friedman. Friedman, in a meeting with members of the Administration and representatives from the Legislature, recommended to the State that the general public would receive the greatest benefits through some kind of direct ownership shares or distribution. Consideration of the Permanent Fund as a vehicle for social reform centered on the concept of the Fund as an economic bank and was most actively pursued during the first stages of the debate. Beldon Daniels, when considering the Permanent Fund as an economic bank, recommended a strategy which attempted to minimize the rates of increase in economic disparity among regions and demographic groups within Alaska. Daniels did not believe that the Permanent Fund could do much in changing the social situation in Alaska.

The other major recommendation was to advise against any kind of social objectives for the Permanent Fund. The reason for this recommendation was the inability to account for or measure the social performance of the Fund as succinctly as through financial criteria. The idea was to keep the Fund relatively pure in objectives and to allow the earnings to go back to the General Fund where the legislative process could respond to social needs and allocate funds more effectively. The Trustees (the governing board of the Permanent Fund) have taken these recommendations very seriously, as noted in former Trustee Dr. George Rogers testimony before the Alaska State Legislature. Despite the diverse background and philosophies of the participants, the consensus that emerged was that the fundamental goal of the Fund was providing high quality savings and stability of income. The conclusion was that the Fund performance was most readily measured by financial standards, and that economic, social and political goals were best carried out and best judged in the open forum of regular government, that is, the ongoing democratic political process.

Public Perceptions

The public supported inclusion of many of the social welfare objectives for the Permanent Fund in proposed Fund loan programs. Housing loan programs and weatherization loans are two examples of loans with social objectives. There was also a quality-of-life component to some of the letters and testimony before the House Permanent Fund Committee with suggestions that the Permanent Fund be used for cultural events.