A Permanent Plan for the Alaska Permanent Fund

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In 1977, Alaskans had the undeniable good sense and extraordinary foresight to establish the Alaska Permanent Fund. We realized the importance of putting away a portion of the state's one-time oil wealth, acknowledged that one day the stream of income from the oil would be gone and wanted to ensure that future generations of Alaskans would benefit from our prudence. Since it's inception, with an initial deposit of $734,000, we have been steadfast in building the Fund, and over the years, we have created one the hundred largest savings accounts in the world, today valued at nearly $25 billion, exceeding such prominent financial establishments as the Rockefeller Foundation, the Ford Foundation, and the J. Paul Getty Trust (APFC, 1997, chap. 1). The growth of the Fund is not only a result of saving, but also of protecting what is already in the bank - the principal - from it's worst enemy: inflation. Historically, lawmakers have been scrupulous in not only inflation proofing the Fund, but in loading it with extra deposits to speed it's growth (APFC, 2002, p.43). But in actuality, the principal of the Fund is subject to only statutory inflation proofing, leaving the door open for the legislature, current or future, to eliminate the statute and spend all Fund earnings, including those required for dividends, *without* voter approval. The best solution for preserving the capital wealth for current and future generations of Alaskans is to constitutionally establish the Fund as an endowment for the state, limiting the annual payout from the Fund to a five percent of market value (POMV) averaged over a five-year period. With such an endowment and payout principle, we will be providing constitutional protection against inflation, we will be maximizing the total amount of Fund income which can be paid out in the future, we will be creating the availability of $175-300 million per year for purposes other than inflation proofing and dividends, and we will be letting lawmakers know in advance how much Fund income will be available for appropriation each year.

First and foremost, by establishing the Fund as an endowment, we will be protecting the Fund from inflation. Without inflation protection, the true value, or the purchasing power of the Fund, will diminish over time. To illustrate this, consider the value of the dollar. Twenty-five years ago, a single dollar bought a lot more than it does today. The decrease in the value of the dollar is due to inflation. The same illustration can be applied to the principal of the Fund. Today, the Fund is valued at nearly $25 billion. In the same way that the purchasing power of a dollar 25 years ago was much more than it is today, the purchasing power of the $25 billion today is much higher than it will be 25 years from now. In order to protect the fund from diminishing in value, additional funds must be added to the principal, or income retained in Fund each year to make up for the inflation. To accomplish complete inflation protection, it is only necessary for the Fund to retain sufficient income to offset the rate of inflation. Currently, the Fund is earning an average long-term rate of return of eight percent and the rate of inflation is averaged at three percent. Eight percent return, minus 3 percent inflation, equals five percent "real" return, or five percent sustainable payout (APFC, 2002, p. 2). In other words, each year, the Fund can payout up to five percent of its value, averaged over a five-year period, and still have complete protection from inflation. In addition, the POMV endowment principle will inflation proof the entire fund, both the corpus and the earnings reserve, whereas under the current method, only the principal is protected. This is an important factor when you consider that approximately 15% of the Fund consists of the earnings reserve account (APFC, 2002, p. 29). Furthermore, by applying the POMV limit, the inflation proofing is done automatically, with no calculation or funds transfers' necessary, lessening the possibility for human error.

Not only will the Fund be automatically and completely protected from inflation, by establishing the Fund as an endowment we will be maximizing the total amount of income that can be paid out in the future. In essence, what this means is that over time, by limiting the maximum yearly payout to five percent, the principal of the Fund should continue to grow. Five percent of an ever-larger fund becomes an ever-larger amount of money. For example, a five percent payout of a $40 billion fund is much greater than a five percent payout of a $25 billion dollar fund, a five percent of a $50 billion fund is greater than a $40 billion fund, and so on. So for all intents and purposes, it is more likely that the Fund's principal and its income will continue to grow in perpetuity (APFC, 2002, p. 7).

In addition to maximizing income for future payouts, by establishing the Fund as an endowment, we will be making $175-300 million available per year for purposes other than inflation proofing and dividends. In other words, the legislature will have $175-$300 million more a year to help balance the budget. For example, lets assume that in any given year, the Fund's market value, averaged over the last five years, is $25 billion and the current dividend formula is maintained. The five percent maximum payout for the year will amount to $1.25 billion. And since the Fund has been automatically inflation proofed by the POMV principle, no additional funds are needed for inflation protection, resulting in a net amount available for the legislature to use to help fill the fiscal gap close to the projected $300 million (APFC, 2002, p. 3). Moreover, in the same way as the maximum payout will increase over time, so will the amount available to the legislature. Whether or not the legislature would use the left over earnings to fund government is debatable, but none-the-less, the money would be available to them for such purposes, without affecting the dividend or inflation protection.

In establishing an endowment and employing the POMV principle, not only will we be able to offer excess earnings to the legislature to help fill the fiscal gap, we will be able to let lawmakers know in advance how much income will be available for appropriation. To illustrate the importance of this point, think about your family budget. Would it be difficult to balance your budget if you were unsure how much you were earning at your job? Without a doubt, it would be very difficult. But that is precisely the dilemma that the legislature is faced with each year in creating a budget for the state. Currently, they are only provided estimates by the Fund managers of what will be available for appropriation, but this estimate can vary by $100s of millions, making last minute cuts necessary, which can be devastating to programs already facing budget shortfalls. And just as we are able to more easily balance our budgets at home because we know fairly close to how much we will be bringing home in our paycheck, if lawmakers are provided with a final number in advance, the legislature will more easily be able to balance the state budget, easing tension across the board.

While much of the public is in support of the endowment proposal, there are many skeptics who believe that the Fund is better off the way it is. Opponents to the endowment proposal argue that the five percent payout is too high, and will eventually drain the fund. On the contrary, five percent is not just a number the APFC Board pulled out of the air. The Board has done extensive studies on other large endowments across the country and found that five percent is what 85% of all public endowment funds payout, and that a smaller percentage will result in less income from the Fund over the long term, limiting the benefits to current and future Alaskans. Another argument often brought up is the idea of using the Fund for government. Yes this use of earnings breaks the long-honored tradition that the fund is untouchable, but the fact of the matter is, the Fund was established more or less as a "rainy day" account. And if we all look at our state, it is raining today. Moreover, as former Commissioner of Revenue Wilson Condon points out, "we must recognize the need to spend money as a community to protect our freedom as individuals" (APFC, 2002, p. 44).

An endowment, as defined by Merriam-Webster's Unabridged Dictionary, is "revenue permanently appropriated to any object" (Dictionary.com). A constitutionally established endowment is the best way to provide *permanence* for the Permanent Fund. The time has arrived for all Alaskans to come forward, once again, with the same extraordinary foresight and undeniable good sense displayed more than a quarter of a century ago, and commit to constitutional protection the Permanent Fund. It is up to us to ensure that the value of the fund is sustained in the long-term; the future of our children and our children's children depend upon our actions today.

References

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