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How the Permanent Fund came to be

Political vision in 1976, but voices of caution, too

Editor's note: Given the importance of the Permanent Fund in making an annual payment to support the state budget and the Permanent Fund Dividend, we present this historical perspective, part one of a series, on the Permanent Fund and the dividend. We first published this in 2017. Mike Bradner was a participant in the Fund creation as Speaker of the House in 1976.

By Mike Bradner

Alaskans are perceived today as being extraordinarily wise for setting up the Permanent Fund. That legislators and Gov. Jay Hammond established the Fund in 1976, before the start of North Slope oil production and a time when Alaska was still poor, made it all the more remarkable.

There were, in fact, doubts. Rural legislators, like former Sen. John Sackett, worried about poverty in the state's remote rural villages. Sackett was wary of big portions of future oil revenues being locked away. Others, remembering the 1964 Alaskan earthquake, worried about another disaster and the wisdom of putting so much money in an inaccessible Fund. The late Sen. Terry Miller, a Fairbanks Republican (later a Lieutenant Governor) played a key role in brokering differences be-tween older, more conservative Legislators and a band of young liberals who were the primary advocates of the Permanent Fund.

Miller is responsible to deleting dedication of tax revenue to the Fund, leaving only state "land-owner" revenues like royalties, lease sale bonuses and lease rentals to be dedicated. Many now applaud the decision, because it drew a critical distinction between taxes, which are normally used to finance public services, and the unusual land and resource wealth Alaska received when Congress gave it a generous land endowment at statehood in 1959.

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In 1976, legislators resisted "defining" the Fund (Cont.)

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Perhaps one of the unique aspects of the 1976 action in creating the Fund was that its creators avoided the impulse to try and define the it in detail. Their restraint was the legacy of good political genetics. The authors of the Permanent Fund were the generation that followed the political elders who had written the state constitution in 1956. The legacy handed down to lawmakers of the mid-1970s was not to meddle in the constitution, but if you must, keep it simple and do not legislate general law in the constitution.

The most commendable element, however, was the courage of lawmakers then to keep the 1976 amendment simple, to keep the language appropriately "constitutional," and to trust future Legislatures to be the best judges of their own times. This makes the Permanent Fund a "living policy," with each generation of Alaskans having the right to rethink and debate the fundamental idea within the context of a changing world.

Idea of savings fund surfaced first in 1960s

The notion of a savings fund is as old as Alaska statehood itself and the vision that mineral wealth would be at the center of the new state's development. It was recognized in 1959, when Congress approved Alaska's statehood, that the young state would someday not only be able to tax its re-source development, like other states, but also be a major resource owner itself. The idea of a special fund began receiving attention in the early 1960s, when oil discoveries in state-owned waters of Cook Inlet brought a rapid series of lease sales, generating about $65 million between 1959 and 1965. It was a lot of money in those years. There was a fear that the new state would become dependent on such "wind-fall" lease sale money and be unable to sustain its budget when these sales became less frequent. Thus, the idea of a "permanent" savings fund was born.

But the 1960s were simply too lean to seriously consider a public savings account. There were also deep philosophical concerns. Alaskans were freshly graduated from the school of constitutional and organic state-creation. The handbook of public policy, in those times, taught that governments should not save money beyond immediate needs and respectable cash balances. Government had no right to extract taxes from citizens beyond what was needed for their current services, the thinking went. The new Alaska Constitution also prohibited dedicated funds, where a tax is tied to a specified defined spending purpose.

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"Landowner revenues" not conventional revenues (Cont.)

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This was a fundamental philosophical centerpiece in the new constitution, to avoid the entanglements of dedications to different purposes prevalent in other states, and which has caused problems. Alaska was to have a system where all revenues went to the state General Fund, the writers of the state Constitution decided. The Legislature was given the authority to sort out the priorities for spending. However, as Alaska began to mature as an oil producer, the notion also developed that "landowner" revenue, such as royalties, lease bonus payments and lease rents, were not revenues in the conventional sense, like taxes. These represented the public owners' fee for the taking of a resource at a particular point in time. Unlike most other states, Alaska came to substantial re-sources in its subsurface estate. Thus, an "owner-state" reasoning (Alaska Gov. Walter Hickel later articulated the term) began to evolve. At this same time, in the late 1960s and early 1970s, the notion developed that one generation shouldn't be permitted to consume the bulk of commonly-owned resource assets at the expense of future Alaskans.

Prudhoe Bay changed things – normal fiscal rules would not apply

The discovery of Prudhoe Bay changed things. The discovery of this huge oil field, the largest in North America, promised future taxes and royalties well beyond normal current annual needs. Its size alone meant that normal public fiscal rules would not apply in Alaska, and that the state would become a fiscal anomaly. Fiscal decisions are usually policed by the scarcity of taxpayer dollars. Suddenly, because of the Prudhoe Bay discovery, this would not be true in Alaska.

Things didn't change right away, however. Alaska still had a lean state government in the late 1970s, with the effective reach of state services largely confined to more populated urban areas. Rural Alaska had few services. The state's populated enclaves, many separated by wide distances, also struggled under high taxes. There were local property taxes over 20 mils in some communities, high local sales taxes, a state income tax along with other state taxes. Alaskans had learned statehood was expensive.

1969 oil lease windfall prompted thinking about future

The September, 1969 oil lease sale on the North Slope, which brought $900 million to the state treasury, was a watershed event for Alaska. In the months following the lease sale the state Legislature sponsored a series of citizen meetings hosted by the Brookings Institute. Week-long discussion sessions in October, November, and December involving a cross-section of Alaskans from across the state. What did Alaskans want to do with the $900 million windfall, and their future oil wealth?

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In 1969, $900 million bonus energized the discussion

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Surprisingly, a broad consensus emerged. The group generally affirmed spending from the $900 million surplus until North Slope oil began to flow. (At that time, Alaskans believed that would be in about 1973). Until then, the state had a lot of "catching up" to do in basic public services, so it seemed reasonable to spend some of the 1969 bonus money before oil started slowing. The consensus was also that the state income and other taxes should stay in place, but that Alaska also needed a method of building schools (education is a state responsibility under the Alaska Constitution), that urban areas needed a share of the oil wealth to expand their services and that some basic services should be extended to remote and costly rural Alaska.

As for the notion of capturing surplus revenue in a special fund, the general idea was aired at the Brookings Institute conferences but the conclusion was that Alaska should first build some infra-structure. However, the idea of an investment fund for surplus oil income was mentioned that year to the Alaska State Chamber of Commerce annual meeting. Robert Krantz, with Kidder, Peabody & Co., proposed a "perpetual and permanent capital fund for the continuing development of Alaska." The idea began to take root. Later that year, Gov. Keith Miller commissioned Stanford Research Institute to do a study of Alaska's options for using its oil revenue, and a savings fund was again mentioned in SRl's report.

Gov. Keith Miller introduced first proposal, for a "development" fund

Based on that, the governor introduced a bill to establish a development fund, and although it didn't pass the resulting discussion established a broad consensus that a fund would be established, at some point. There was still a fear in 1970, in the heady atmosphere created by the $900 million bonus windfall, that creation of a development fund might open the Pandora's box of dedicated spending initiatives. The Actual creation of the Permanent Fund was still seven years away, and in 1970 any concept of it was hazy and undefined. What did result from discussion of Gov. Miller's proposal, however, was a broad, bipartisan consensus that some sort of fund was needed in the future, perhaps tied to a future lease sale or the beginning of the flow of oil through the pipeline.

Serious conceptual questions, however, started to emerge. Did the accident of a resource discovery at a certain time give that generation sole ownership of such assets? Or, should these assets be treated as a multi-generational trust, its benefits to be spread forward and perhaps even backward, to senior citizens, in time? Lawmakers clearly saw that oil wealth would benefit future Alaskans. This was a value question. Legislators pondered whether the wealth shouldn't also benefit long-tenured Alaskans, who might not be around to taste future fruits of oil development.

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Longevity bonus was precursor to PDF

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This question energized the Longevity Bonus, which paid a monthly stipend to senior citizens until it was changed to a needs-based payment. However, the discussions among citizens and Legislators in 1969 and 1970 sharpened issues that would later mature to help lawmakers navigate philosophical concerns, particularly about the dedication of funds.

But completion of the trans-Alaska oil pipeline was delayed, and the day Alaska would enjoy its oil wealth was put off. Efforts to speed the pipeline, such as settlement of Native land claims, the environmental lawsuits and finally the necessity of congressional action to clear the pipeline, made it clear its completion would be substantially delayed. This meant that oil flow would be delayed, and that the draw-down on the $900 million surplus would not last until new oil revenues began to flow.

This sobered the atmosphere in the early 1970s as lawmakers worked with financial projections of a dwindling $900 million. It also prompted the discussion of what might happen when oil was gone from Prudhoe Bay. In 1975 a new Legislature and newly-elected Gov. Jay Hammond came to office. Hammond had talked often about the distinction between "renewable" and "nonrenewable" resources and those terms shaped must of the debate about natural resources policies at the time.

Immediately, however, the Legislature and Hammond faced the prospect of the $900 million lease sale money from 1968 being depleted prior to the expected flow of oil in late 1977, or by 1975. Lawmakers were embarrassed at having to enact an oil "reserves" tax, a property tax on the oil in the yet-to-produce reservoir at Prudhoe Bay, to bridge the gap until the oil flowed. This also raised legal questions and the last thing the Legislature wanted was for a critical revenue source to be bogged down in lawsuits. However, negotiation between legislators, Hammond and the North Slope oil companies resulted in agreement that the reserves tax would be credited against state production taxes once oil flowed, so it became in effect a loan from the industry to the state, which was almost broke.

New legislators in 1975 willing to tackle new idea –saving oil wealth

1975 also brought a rush of young new lawmakers to the State House, and these were freshmen (and women) who lacked the philosophical anguish around the dedicated fund issue felt by older legislators. Among others, there was Hugh Malone of Kenai; Clark Gruening of Juneau; Terry Gardiner of Ketchikan; and Steve Cowper of Fairbanks (later to be governor.) These young legislators formed the nucleus of people tinkering with the idea of a Permanent Fund.

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In 1976, some felt Fund was premature before oil flow (Cont.)

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Jim Rhode, an able staffer to Malone and Cowper, was deeply involved in defining the philosophy of a savings fund. Some of the motivation, to be sure, was political. These new, post-Vietnam Democrats were sensitive to charges of being "too liberal" and were looking for an issue to establish their conservative fiscal credentials. They found an issue in the Permanent Fund. In the debates that followed, generational as well as partisan elements were at work. More experienced, older Legislators, mainly in the Senate, were accustomed to working out broad bipartisan consensus on major issues, and some resented these brash young newcomers. Many senators simply felt the dedication of oil revenues to a fund before the pipeline was completed was premature. There was still the lurking fear that proposals for a savings account would encourage discussion of other dedicated funds.

In 1975, the prospect for a two-thirds vote needed to secure a constitutional amendment in the Senate was very dim. In the state House, Malone, Gruening and others decided to pursue the idea of a fund in statute, mainly to avoid the constitutionally dedicated fund issue, since what one Legislature did by law could be changed by another. The statutory exercise was a good practice run because it allowed lawmakers in both the House and Senate to work out their philosophical concerns. Legislators also gained confidence that a dedicated savings was sufficiently unique that the political resolve against spending dedications could be maintained.

The statutory Permanent Fund passed in 1975. But while Governor Hammond supported the idea, he and Avrum Gross, then Attorney General, felt the only truly effective Permanent Fund would be one authorized in the state Constitution, and to be the sole exception to the ban on dedicated funds. Hammond vetoed the law passed in 1975 and announced he would introduce a constitutional amendment to create a Permanent Fund in the 1976 Legislature, which could be voted in the state general election later that year. What happened next cemented the political consensus that would ensure the amendment's passage, and not delay the issue to the next Legislature and a 1978 general election. Instead of introducing their own constitutional resolution to gain political credit, the House proponents of the Fund closed ranks behind Governor Hammond's proposal.

As the constitutional amendment worked its way through the Legislature in 1976 it was the veteran "old timers" in the Senate who refined the issue. They were, at Terry Miller's instigation, careful to remove taxes from the measure, which defined the conceptual difference between taxes and re-source ownership assets. There were back-room discussions over some means of emergency access to the fund, since the 1964 Alaska earthquake was only a decade in the past.

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Debate on whether some of Fund should be available for emergency

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The earthquake was still fresh in peoples' memories, and all lawmakers were acutely aware that the earthquake had centered in Prince William Sound. A future quake there could damage the pipeline and its terminal and interrupt the flow of oil and state revenue for a substantial time.

Should some of the Fund be available for an emergency?

There was discussion of some form of access to the principal of the Fund in an emergency, something like the three-quarters vote in the House and Senate now required to tap the Constitutional Budget Reserve. In the end, however, it was reasoned that the income from the Fund, which was undesignated for any use (until the dividends were created in 1981) could be the source of emergency revenues. The Senate was also concerned about over-committing to the Fund. Legislators were still embarrassed at having depleted the $900 million lease sale surplus and having to pass a temporary reserves tax to bridge the gap until oil flowed. It would be better for the fund to receive a bit less rather than too much, it was reasoned. There was also concern that unpredictable political events, like the federal oil price controls on oil that existed at the time, could unexpectedly depress state oil revenues just as unpredictable actions of OPEC could increase them.

As a result, the Permanent Fund was given a conservative touch in the end. It was to receive 25 percent of royalties, bonus payments, and rents, and taxes were excluded. (The Legislature later, by statute, provided that 50 percent of oil revenue from new leases would go to the Fund). Most important, lawmakers left it to future Legislatures to decide, in law, the important questions of how the Fund was to be invested and what its revenues were to be used for. *In 1976, Legislators never dreamed that within five years the Permanent Fund would be paying the state's citizens direct cash dividends*.

What Norway did that Alaska didn't do

Norway's oil and gas savings fund, the world's largest sovereign wealth fund, has topped $1 trillion in assets. Norway's fund was started in 1996 and reached $1.001 trillion in market value Sept. 19. In a country of just 5.2 million people, it has been an extraordinary success, growing faster than the country's ministers ever thought possible. It is one of the world's largest investors, owning on average 1.3 percent of every listed company in the world.

Like Alaska's Permanent Fund, on which it was modeled, Norway's fund was set up to help manage the nation's oil and gas wealth for future generations by taking the revenues from petroleum and investing it in financial assets abroad.

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What did Norway do that Alaska didn't?

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At the same time, in a crucial difference with Alaska, Norway did not reduce its heavy personal and business taxes, allowing it to save 100 percent of its oil and gas revenues. The fund has grown at a fast pace, with its assets rising 13-fold since 2002. At the end of 2016, about half of the fund's assets were due to the returns on its investments, approximately 45 percent due to inflows from oil and gas revenues, and the rest due to currency movements. Like Alaska's fund, it started by investing purely in bonds but now has close to 65 percent of its assets in equities, roughly similar to Alaska. It made its first equity investment in property in 2011 and has now built up a $30 billion portfolio, mostly in the U.S. and Europe.

Norway's fund has also become an increasingly active shareholder in its investments, voting against management and other shareholders in investments such as Apple and Facebook on corporate governance issues. But it faces big questions about its future, just as in Alaska. There are growing concerns about how much of the Fund the government should use to support its budget. An unofficial rule to use up to 4 percent of the fund's value each year has been revised down to 3 percent, but many argue that this still could prove too much. Alaska, meanwhile, settled on an annual draw of 5.25 percent until 2021, and then 5 percent thereafter.

PFD tussle in 2019 could push withdrawal rate over 6 percent – dangerous move

It is possible that if Alaska provides for a large Permanent Fund dividend in 2019, and keep its budget approximately status quo, the draw from Permanent Fund earnings may exceed 6 percent. If it happens again – and 2020 is an election year – almost all financial advisors agree the rate is too high to sustain the Permanent Fund for the long term,