

COMMONWEALTH NORTH

**At A Crossroad: The Permanent Fund, Alaskans,
and Alaska's Future**

A Commonwealth North Study Report

November 2007

Study Co-Chairs: Cheryl Frasca and Eric Wohlforth

COMMONWEALTH NORTH

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About Commonwealth North

The mission of Commonwealth north is to educate its members and others on significant public policy issues and to assist in their resolution. This mission is accomplished through forums and member briefings on relevant public policies, and through study groups that analyze various public policy issues and prepare written reports.

At A Crossroad: The Permanent Fund, Alaskans, and Alaska's Future

A Commonwealth North Study Group Report

Executive Summary

The Alaska Permanent Fund offers our state financial opportunities exceeding those of any other state and most nations. With a balance of nearly \$40 billion, the Fund and the size of its Dividend continue to grow rapidly. It promises soon to become an even more important element of Alaska's future economy. However, there is little public awareness of the potential size of the Fund and the Dividend and, for example, little understanding that the Dividend amounts to only approximately one-half of annual Fund income. Because of this the board of directors of Commonwealth North decided that a study was timely and asked our study group to examine the following questions:

- What funds should be deposited in the Fund?
- How should funds be managed?
- How should earnings be used?

As we moved along our normal study group process of listening to relevant speakers, and discussing the issues presented, it became evident that the issues demanded a new state-wide collaborative process involving the general public, civic and professional groups, native corporations, businesses, and very importantly, the legislature and governor. Therefore, this report is intended to be a resource or reference document for a public dialogue about the future of the Fund and its earnings.

The study group concluded that any discussion of the Permanent Fund and its earnings must take into consideration two key elements:

- The Permanent Fund Dividend (PFD) is an important part of the State economy and expectations of Alaskans.
- The State's economy and annual budget have suffered from an unstable revenue stream and the Permanent Fund earnings can help mitigate this situation.

Our work benefited from thorough briefings by state officials, Permanent Fund management, and others.

We conclude that the effects of the Dividend program on our economy and Alaskans generally should be carefully studied while we move forward. The report contains suggestions on management and governance of the Fund, urging that the Alaska Permanent Fund Corporation:

- adopt more endowment-like investment policies;
- benchmark its performance against endowment funds;

- better compensate its board of trustees and staff;
- enhance the board selection and evaluation processes;
- operate full-scale branch in Anchorage and outside offices so as to maintain better contact with the investment world.

This report reviews and critiques past efforts to achieve a statewide consensus for use of non-dividend Fund income, including the Principles and Interest Conference in 1998 and the Conference of Alaskans in 2004, as well as legislative efforts in 2002 and 2004. The report explores various suggested uses of non-dividend income including the community dividend and education.

Finally, this report calls for two action items related to payouts from the Permanent Fund:

- adoption of a percent of market value payout formula, suitable for an endowment fund, and adoption of a statutory version of this formula as a first step;
- initiation of a statewide public dialogue in connection with other civic groups, the Legislature and the Administration to arrive at a consensus as to future use of non-dividend Fund income.

These final action steps need to include involvement in the process by the Administration and the Legislature, if any meaningful action is to take place.

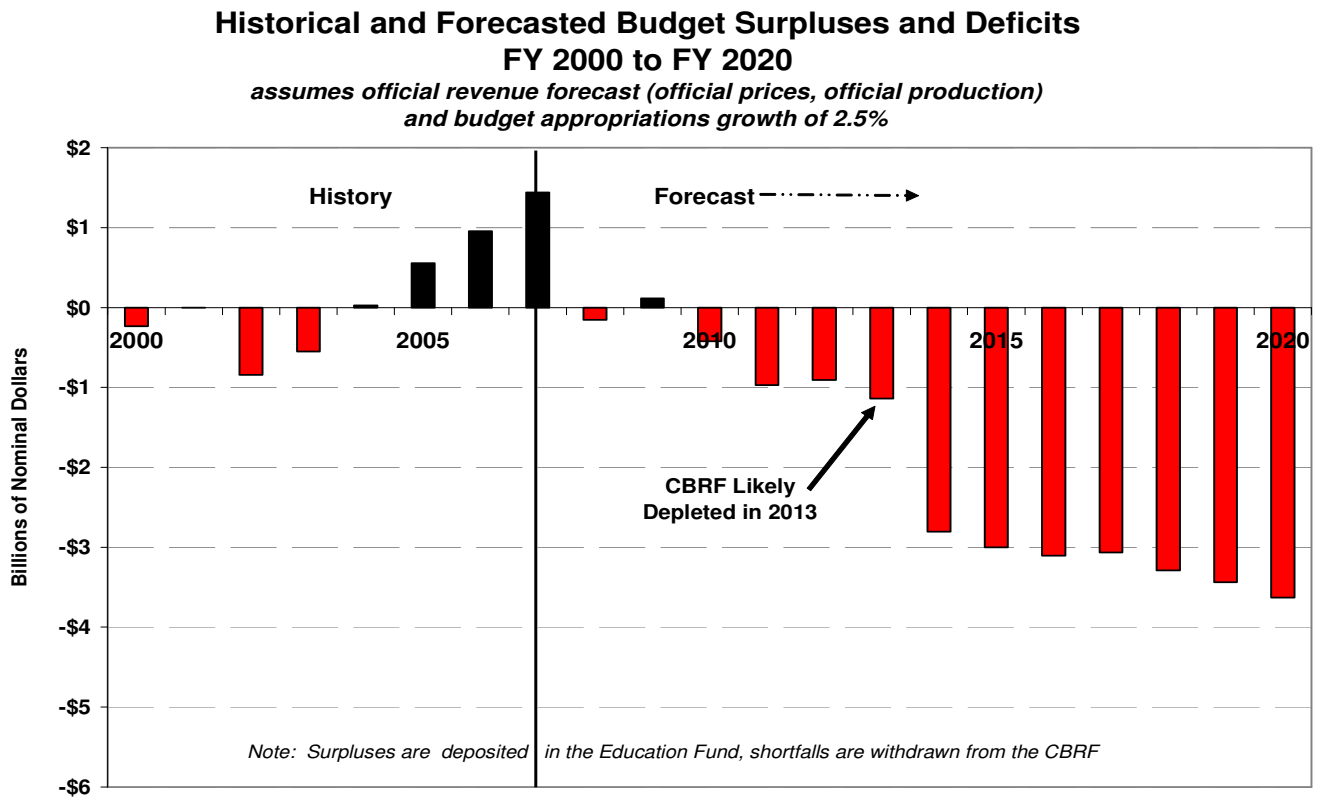
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A. Why This Report, Why Now?

For thirty years the State has been saving a portion of its oil revenues in the Permanent Fund (Fund). For nearly the same amount of time, the nearly exclusive use of the Fund's earnings has been to make dividend distributions to individual Alaska citizens. As the Fund approaches \$40 billion, with projections of annual earnings of \$4 to \$5 billion and individual annual Dividends possibly reaching \$3,000 to \$4,000 in the near future, it is time to re-evaluate what, if any, role the Fund should take in the State of Alaska's financial future. The 30-year maturing of the Fund affords the State a tremendous opportunity to address not only future Dividends, but also an examination of the Fund's governance and investment policies, as well as other potential uses of the earnings that remain after paying individual Dividends. The Fund's potential importance is clear in any projection of the State's future finances, as illustrated in Chart 1, which was presented at a Commonwealth North forum on July 25, 2007 by Commissioner of Revenue Pat Galvin and Office of Management and Budget Director Karen Rehfeld.

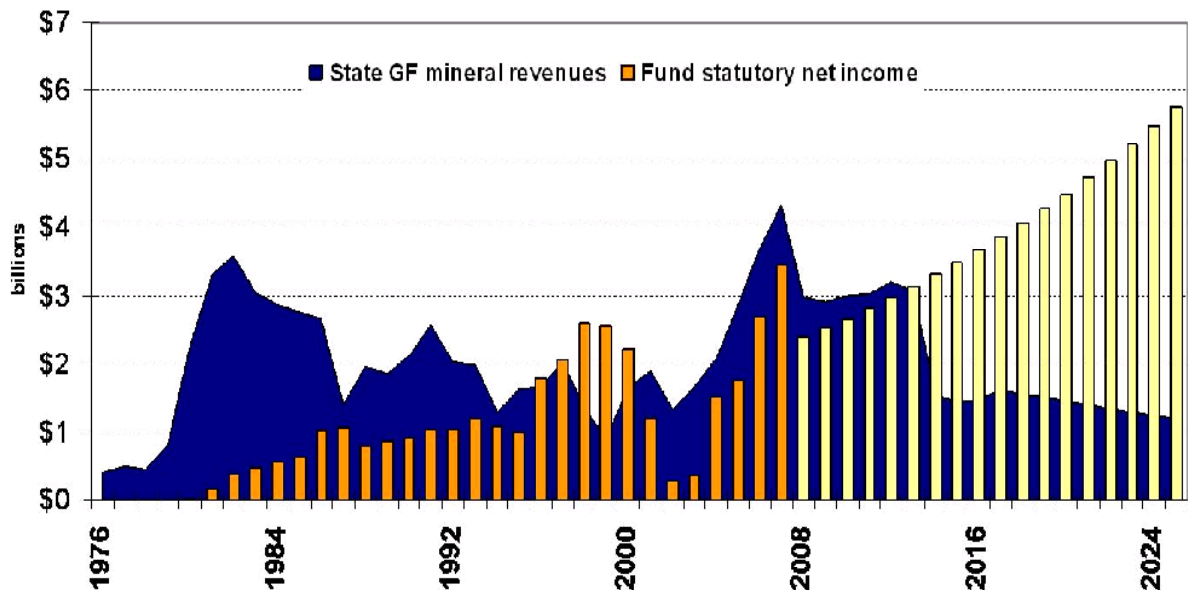
Chart 1.



Source: Alaska Department of Revenue, "Revenue Sources Book," and presentation by Revenue Commissioner Pat Galvin and office of Management and Budget Director Karen Rehfeld at CWN meeting, July 25, 2007. "CBRF" is the Constitutional Budget Reserve Fund.

This chart illustrates one possible scenario of the State’s fiscal future. Revenues projected in this chart include only the currently utilized general fund sources, and do not reflect any reliance on Permanent Fund earnings or other new potential sources (such as a gas line) to help pay for state services. The State’s revenue/expense projections show potential budget shortfalls ranging in the billions of dollars in the next five to ten years, based on currently identified revenue sources. This projected shortfall is due to declining revenue resulting from declining oil production, and projected increases in state budgets. While Commonwealth North is not taking a position at this time on the preferred uses of the earnings of the Fund, the chart does suggest that these earnings will eventually need to become a factor in the State’s fiscal picture. This is illustrated in Chart 2 that depicts over time income from the Permanent Fund versus the level of the State’s general revenue from oil and gas development.¹

Chart 2.



When the CWN Study Group got underway in early 2007, it was originally initiated to review and make recommendations about the Permanent Fund. But something interesting happened. The Study Group had consistent participation from community members, some of which were not CWN members and do not typically participate in its activities. This expanded our learning horizon. The discussion evolved from the Permanent Fund to the broader issue of the stability of Alaska’s future economy given our strongly held conviction that the State’s revenue system is structurally unstable.

We also decided to include a discussion of the study’s recommendations regarding implementation early in this report, so that as you review our report you can reflect on them, and seriously think about the current “state of the State” and what kind of state we want to leave to Alaska’s future generations. What is the State’s role—and what are our

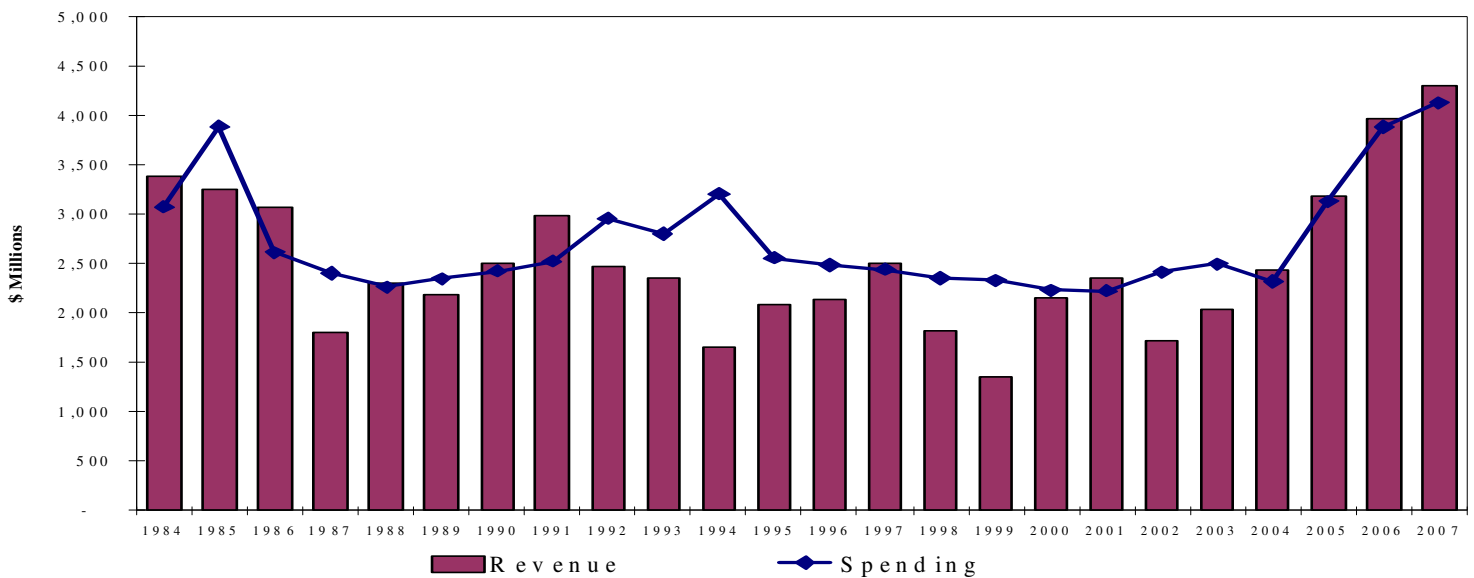
¹ Alaska Permanent Fund Corporation “Fund Works”, 2007.

responsibilities as citizens—in meeting our state and community needs? How should the cost of state services in the future be paid? Should earnings of the Permanent Fund—after paying individual Dividends—help pay for state services? Should individual Alaskans, visitors, and non-oil businesses be taxed on their wages, purchases, and income? What’s fair—and even more important—how will Alaskans come together to achieve agreement in answering these questions?

Alaskans, governors, and legislatures have been grappling with trying to answer these questions ever since Alaska became a state. Revenue that pays for state services continues a roller coaster ride. As a result, the State has used the Constitutional Budget Reserve Fund (CBR) to prop up state spending 12 times since created by voters in 1990. This is illustrated in Chart 3 below. For any year that spending exceeded revenue, the CBR was used so as to have a “balanced” budget. This demonstrates that the State has a *systemic* problem with how it finances services and to ensure a stable economy—both public and private sectors—Alaska needs a *systemic* solution.

Chart 3.²

**General Fund Unrestricted Revenue vs. Expenditures
FY 1984 - FY 2007**



FY 2007 Revenue based on \$53.60/bbl ANS West Coast and 624,000/bbl day production.
PPT revenue is included as is \$565 million in surplus FY 06 revenue.

Note regarding Chart 3: The gap between Spending and Revenue was filled by draws from the Constitutional Budget Reserve in order to “balance” the budget.

² Source: Office of Management and Budget, State of Alaska.

The key question is how does Alaska stop—or at least moderate—the dips in this revenue roller coaster? Greater stability is important not just for delivery of state services, but also for the small and large businesses that drive Alaska’s private sector and employ over 220,000 Alaskans throughout the state. Extreme uncertainty over the State’s finances causes businesses to seriously evaluate the risk of future investment in Alaska. As a result, CWN believes it is extremely timely that on the verge of Alaska’s 50th anniversary of statehood, we come together as Alaskans to share with each other what we want for the State’s and the Permanent Fund’s next 50 years—and then decide together how we get there.

Current high oil prices—and corresponding high state revenue—have provided elected officials with a temporary reprieve from grappling with these questions. But even though oil prices are at record levels, all but \$5.6 million of the over \$4 billion in oil revenue was spent in this current fiscal year³ to pay for state services and programs. The CBR has successfully promoted stability in state services because it enabled essential state services to continue without regard to that year’s revenue. While that’s the good news, it also has meant that elected officials have not had to take meaningful action that will promote Alaska’s long-term fiscal and economic health. Some suggest elected officials will wait until the State falls over the cliff into the “fiscal gap” because only then will enough elected officials believe they have constituent support to access previously unused revenue sources such as the Permanent Fund earnings or to reinstate a personal income tax.

CWN does not believe it is prudent for our leaders to put off these important decisions. We believe Alaskans can come together, and through thoughtful and informed discussions throughout the state, urge elected and appointed officials to take prudent action—before the economy is in peril.

For all these reasons, CWN concluded that these very important and complex issues deserve a thorough and thoughtful process that engages Alaskans in assessing and making decisions about the State’s financial choices.

³ “Fiscal 2008 Conference Committee Less Vetoes Fiscal Summary”, Office of Management and Budget, Revised 7/3/2007.

B. About the Alaska Permanent Fund

In 1969 Alaska received \$900 million in bonus bids for leases for tracts along Prudhoe Bay for oil exploration. By the mid 1970s that money had been spent on programs and infrastructure to meet the needs of the young state. After extensive debate about how to save some of Alaska's windfall the State would be receiving due to oil development, in 1976 voters approved a Constitutional amendment that created the Permanent Fund, which passed by a 2 to 1 margin. This Constitutional amendment required⁴ that the State deposit at least 25% of state mineral royalties and lease rentals into the Fund. The amendment states:

Article IX, 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 [Effective February 21, 1977].

Until 1980 there was no clear purpose for the earnings of the Permanent Fund. The two most popular suggestions were to use the Fund as a development bank or as a trust fund for Alaskans. After extensive debate, in 1980 the Legislature decided to use the Fund as a trust, approved a program of individual Dividends to be paid from the income of the Fund, and created an independent corporation to invest the Fund within legislatively specified parameters.

In 1980 the Legislature also identified three goals for the Fund in state law.⁵ It said the Fund will:

- Provide a means of conserving a portion of revenue from mineral resources to benefit all generations of Alaskans;
- Maintain safety of principal while maximizing total return; and
- Be used as a savings device managed to allow the maximum use of disposable income from the Fund for uses designated by law.

The first deposit into the Permanent Fund of \$734,000 was made on February 28, 1977, which came from the first oil production. Cumulatively, \$27.5 billion has been deposited into the principal of the Permanent Fund:

⁴ A constitutional amendment was required because Section 7 of Alaska's Constitution prohibits dedication of revenues.

⁵ AS 37.13.020 (see appendix for statute).

Table A.
Deposits to Permanent Fund Principal

Constitutionally dedicated revenue from oil	\$9.7 billion
Additional appropriations by Legislature	\$7.04 billion
Inflation-proofing	\$10.8 billion

The \$27.5 billion was the total contribution to the “reserved fund balance”⁶ at the end of Fiscal Year 2007 (June 30, 2007). In addition to the contributions, the Fund also had \$6.2 billion in unrealized earnings.⁷ The total of these amounts is considered “principal” and as such is constitutionally protected from being spent. State law requires the Fund be “inflation-proofed” as a tool to preserve its purchasing power over time. The amount required to inflation-proof the Fund is calculated by using the inflation rate for the previous two years. At the end of that fiscal year that amount is placed into the principal of the Fund, thus counteracting the inflationary increase in prices.

As of June 30, 2007 the Fund also had an additional \$4.1 billion in the Earnings Reserve, which is not part of the Fund’s principal and can be spent by the Legislature. Together, these pushed the total value of the Fund to \$37.8 billion on June 30, 2007.

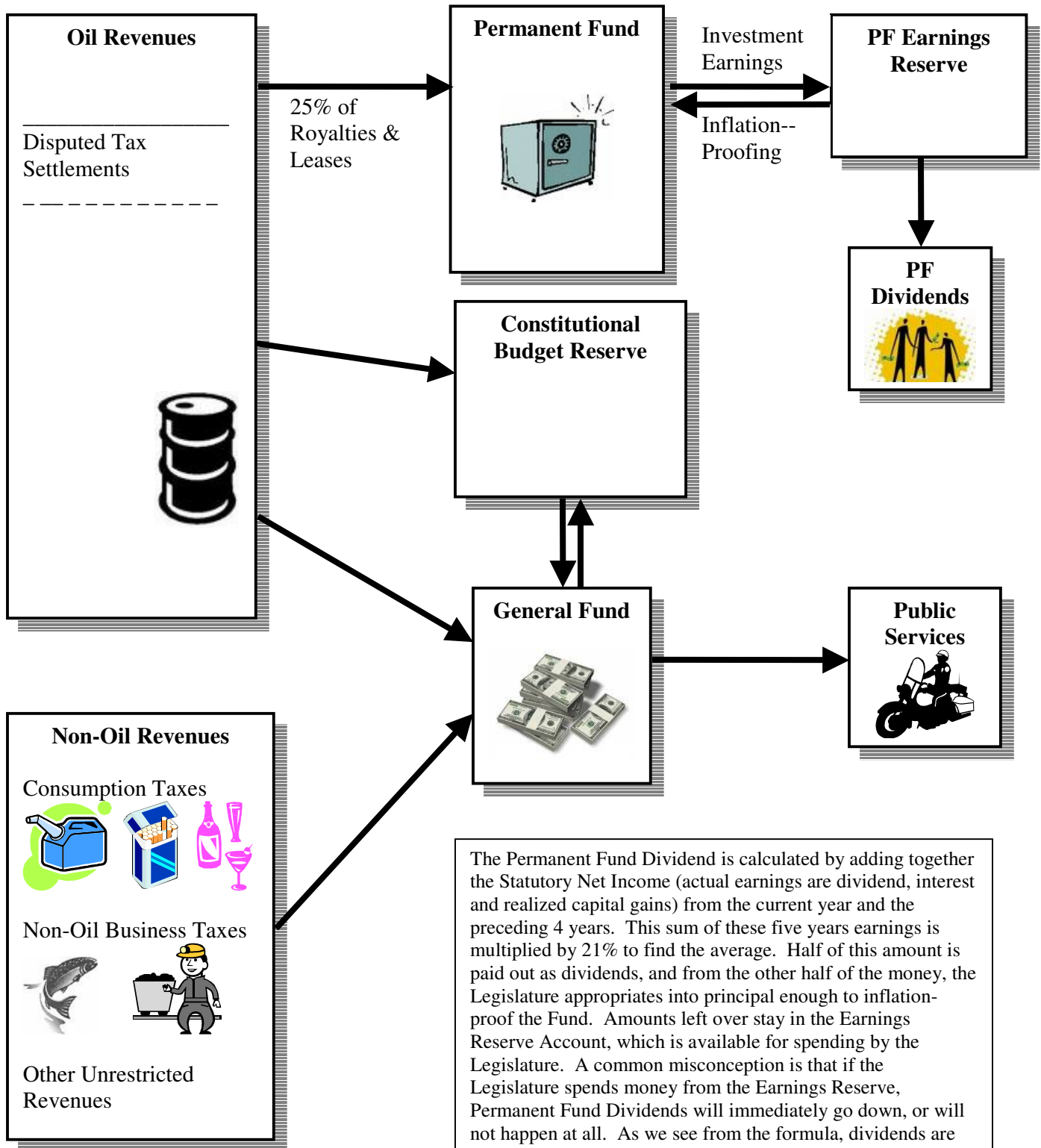
In Fiscal Year 2007 the State deposited \$532 million of constitutionally dedicated mineral revenues into the Fund principal, along with \$860 million for inflation-proofing. The Fund earned \$3.4 billion in statutory net income,⁷ which is realized earnings (dividends and interest income received and realized capital gains), and \$5.4 billion in GAAP income or market value increase.

Chart 4 illustrates how money received by the State flows into the Permanent Fund, the State’s General Fund (which can be used to fund public services), and the Constitutional Budget Reserve.

⁶Reserved Fund Balance is the total of all mineral revenues, special appropriations, and inflation-proofing contributions to the fund, plus the balance of unrealized gains.

⁷ See Glossary for definition.

Chart 4: Alaska's Income and Outgo*



The Permanent Fund Dividend is calculated by adding together the Statutory Net Income (actual earnings are dividend, interest and realized capital gains) from the current year and the preceding 4 years. This sum of these five years earnings is multiplied by 21% to find the average. Half of this amount is paid out as dividends, and from the other half of the money, the Legislature appropriates into principal enough to inflation-proof the Fund. Amounts left over stay in the Earnings Reserve Account, which is available for spending by the Legislature. A common misconception is that if the Legislature spends money from the Earnings Reserve, Permanent Fund Dividends will immediately go down, or will not happen at all. As we see from the formula, dividends are the first priority of the Permanent Fund, and if the Legislature decides to spend money from the Earnings Reserve, that has no direct immediate impact on the size of the dividend. However, expenditures from the Earnings Reserve will reduce future earnings of the Fund and reduce future dividends.

* Based on a graphic conceived by Cliff Groh, II, called "the Groh Flow."

Other governments around the world have created Sovereign Wealth Accounts, which are variations on the Permanent Fund theme. The Economist estimates Sovereign Wealth Accounts have some \$1.5-2.5 trillion to invest. Alaska was one of the first to set up a Sovereign Wealth Account. Funds from oil-producing countries account for roughly two-thirds of assets in all Sovereign Wealth Accounts. This ranking⁸ provides some perspective on the size of the Permanent Fund in relation to funds run by other countries. A June 25, 2007 Washington Post Op-ed by Sebastian Mallaby and Paul Volcker points out that the government of Sao Tome, an oil producing country, consults with Alaskan officials on sound and transparent wealth management.

Sovereign Wealth Funds - Estimated Assets

Gold sovereigns			
Sovereign—wealth funds, estimated assets March 2007, \$bn			
Country	Fund	Assets, \$bn	Inception Year
UAE	ADIA	875	1976
Singapore	GIC	330	1981
Saudi Arabia	Saudi Arabian funds of various types	300	Na
Norway	Government Pension Fund—Global	300	1996
China	State Foreign Exchange Investment Corp. + Central Huijin*	300	2007
Singapore	Temasek Holdings	100	1974
Kuwait	Kuwait Investment Authority	70	1953
Australia	Australian Future Fund	40	2004
US (Alaska)	Permanent Fund Corporation	35	1976
Russia	Stabilisation Fund	32	2003
Brunei	Brunei Investment Agency	30	1983
South Korea	Korea Investment Corporation	20	2006
Source: Morgan Stanley		*Not yet finalized	

Though the Permanent Fund began as a receptor for oil revenues, investment earnings are now its own largest contributor to fund balance:

- Since Fiscal Year 1999, contributions to principal for inflation-proofing were higher than dedicated oil revenues every year except 2003.
- During the period 1977-1998, the Legislature made special appropriations to Fund principal of \$6.7 billion, versus \$6.3 billion in dedicated oil revenue deposits.
- The largest deposit of dedicated mineral revenues occurred in FY 2006 in the amount of \$601 million. In that same year, the Fund earned \$975 million in interest, dividends and other income, and the market value increased by nearly \$3 billion.

⁸ The Economist, “The World’s Most Expensive Club,” May 24, 2007. www.economist.com.

Social and Economic Impact of the Dividend

There can be no doubt that the Permanent Fund, and in particular the Permanent Fund Dividend (PFD), has exerted a great impact on Alaska over the last 31 years. Since 1982 a family of four has received \$103,530 in dividends. With annual distribution of approximately \$1,500 to each Alaskan, the PFD may affect poverty rates, migration rates, consumption patterns, and possibly even subsistence patterns among Alaska's diverse peoples. The problem is that we can only infer these effects. There have been no studies that stand up to peer review to assess the Permanent Fund Dividend's socio-economic impact, nor has there been intelligent debate on whether the size of the Fund or Dividend will negatively impact Alaska's stream of Federal appropriations.

What we do know about the effect of the Permanent Fund is in relation to other measurable statistics. Based on 1990 and 2000 census figures, the Permanent Fund Dividend has a clear effect on income. Predictably, in both 1990 and 2000 the Dividends made up a much larger proportion of income in remote rural areas than in urban areas. For example, the PFD distributed in 2000 was almost 16% of per capita income for the Wade-Hampton census area in western Alaska, whereas in Anchorage the Dividend was less than 8% of per capita income.

It is clear that the Dividend is an important component of income for low-income peoples. Professor Scott Goldsmith of the Institute for Social and Economic Research (ISER) at the University of Alaska Anchorage, has theorized that Dividends provide an alternative to credit for the poor, so that when "Dividend time" comes around, poor families are able to make big-ticket purchases such as home appliances. Considering the high unemployment rates, for example 20% in the Wade-Hampton Census Area, there can be no doubt that the Dividend provides a vital influx of cash for poor families and communities. To gain a better understanding of the economic and social impact of the Dividend and to assist policy makers in making more informed decisions for the future of the Dividend, we recommend that the State initiate a study to address issues surrounding the social and economic impact of the Dividend raised in this section.

C. Fund's Management and Governance

The Permanent Fund has matured over the past thirty years, growing much faster and becoming larger than expected. It is now a world-class fund, with investment opportunities that were not available during its formative years. We believe now is an appropriate time to take a fresh look at the Fund and management issues related to it.

Before we continue further, we want to commend the Alaska Permanent Fund Corporation (APFC) management for their openness and transparent reporting processes. The APFC provides significant information on their website⁹ that is easily understood. It also does an excellent job educating Alaskans on the how the Fund works. We benefited greatly from three meetings with APFC's executive director, staff, and consultants.

The observations on the Fund's management made in our report are just that, observations, rather than recommendations. They are offered in a spirit of seeking further dialogue with Fund staff, consultants, and the public, rather than as dogmatic assertions. Some of the observations and analysis may not be correct. It is in the spirit of discovery and dialogue that we hope to move forward. The issues relating to the Permanent Fund are complex and important. We hope that any errors in our presentation of these issues will be corrected in the course of this dialogue.

Investment Strategy and Performance

The Fund's performance can be measured two ways: how does it do versus benchmarks¹⁰ and how does it do vis á vis its peers. The first measure gives a snapshot of whether the overall performance has exceeded that of a passive indexed fund. The peer ranking shows how it has performed in a universe of similar sized funds. Both analyses are compiled and reported each quarter by Callan & Associates, the Fund's primary financial advisor. Relative performance compared with the database has been on a constant and upward trend over the past five years and for June 30, 2006 was in the top 25 percent of the database.¹¹

The Alaska Permanent Fund is larger than the Gates Foundation (\$33 billion) and the Harvard endowment (\$34.9 billion),¹² yet smaller than large state retirement Funds like Washington, CalPERS or NYSTRS. New Mexico and Texas are the only other states that run substantial endowment funds. The New Mexico and Texas funds are described in the appendix.

Though the Permanent Fund is most like an endowment fund, such as those at universities and foundations, its investment strategy has been much less aggressive. This is partly due to the Fund's origins. The early Fund operated under a list of investments specified in state law. It was not until 2005 that the statutory list was finally replaced

⁹ www.apfc.org.

¹⁰ See Glossary for definition.

¹¹ www.apfc.org.

¹² Gates Foundation value as of March 31, 2007, and Harvard Endowment value as of June 30, 2007.

with the “Prudent Investor” rule, allowing more flexibility to pursue higher return alternative investments. The lateness of this entry is evident in the Fund’s long-term returns, which have been competitive with internal benchmarks and public pension funds, according to its consultant, Callan & Associates, but have lagged returns of foundations and endowments, as shown by the National Association of College and University Business Offices (NACUBO) data in the chart on the next page. For example, Yale’s 10-year returns to the end of FY 2006 were 17.2% versus 8.5% for the Permanent Fund in the same period. In FY 2007, the Permanent Fund earned 17.1% returns on its investments.

It is clear from examining other large funds that higher returns follow greater allocations to the alternative investment category and smaller allocations to fixed income securities. Table B¹³ provides a one-year snapshot of performance for several large funds. By far the stellar performer is the Yale endowment. The Yale investment team produced returns double that of the Permanent Fund with half the assets. The funds that achieved higher returns invariably had higher allocations to private equity and hedge funds. New Mexico has roughly 14% of its assets allocated to alternatives. The Washington retirement fund presents an interesting mix of aggressive and conservative investing.

Table B.
Comparison of Permanent Fund to Other Large Funds and Endowments

Comparison of Perm Fund to Other Large Retirement and Endowment Funds								
	Alaska Permanent Fund	Alaska PERS/TRS	Yale Endowment	CalPERS	NYSTRS	Washington	NACUBO \$1 billion +	Pennsylvania
Value as of 6/30/06	\$33 billion	\$13.7 billion	\$18 billion	\$244 billion	\$90 billion	\$53.8 billion		\$32 billion
Return for FY '06	11.0%	11.7%	22.9%	11.8%	11.8%	16.7%	15.2%	16.4%
Allocation								
Public Equities	53.0%	51.0%	26.2%	61.2%	70.4%	47.8%	44.9%	56.3%
Fixed Income	29.0%	28.0%	3.8%	24.5%	12.7%	24.1%	12.5%	15.3%
Private Equity	4.0%	6.0%	16.4%	5.7%	3.5%	16.8%	5.9%	9.8%
Hedge Funds	4.0%	3.0%	23.3%				22.4%	
Real Assets	10.0%	9.0%	27.8%	7.2%	5.6%	10.5%	4.4%	7.9%
Short-term/Cash			2.5%	1.4%	2.6%	0.9%	1.7%	1.2%
Venture Capital							3.5%	3.4%
Other		3.0%			5.1%		4.2%	6.1%

The higher returns experienced by these other funds may result from a more aggressive investment style employed by those funds, as evidenced by the higher allocations to private equity and hedge funds. Investments are often evaluated in terms of their expected long-term return rate and their expected short-term volatility. The volatility, or risk, is measured in terms the potential loss in a bad year. Typically, the riskier investments provide a higher long-term return, but are subject to the potential for greater losses in the short-term. Thus, an evaluation of a portfolio’s performance should take into account the level of risk inherent in the portfolio. The Yale endowment, for example, has been invested more aggressively than the Permanent Fund, and appears to have benefited with a higher return.

¹³ These figures are based on the 2006 Annual Reports, sometimes called Comprehensive Annual Financial Reports, found on their respective websites.

NACUBO annually reports on college and university endowment funds. The composite of endowments with over \$1 billion in assets are heavily invested in alternatives, namely private equity and hedge funds. The 2006 returns were lower than Yale, Washington and Pennsylvania, but were 4.2% higher than the Permanent Fund. At \$40 billion, 4% represents over \$1.6 billion. Comparisons with university endowments should be made and followed because the form and function of the Permanent Fund is most like an endowment. The below table shows NACUBO returns, which are net of expenses, while the Permanent Fund is gross. This makes the comparison a little skewed, but nonetheless illustrative. Since the NACUBO \$1 billion + is net of fees, their performance is all the more impressive.

Table C.		
Comparison of Long Run Returns		
	Alaska Permanent Fund	NACUBO \$1 billion +
Ending FY 06		
1-year	11.0%	15.2%
3-year	11.9%	15.3%
5-year	7.0%	8.8%
10-year	8.5%	11.4%

A major reason for the disparity between NACUBO \$1 billion + and the Permanent Fund is the amount invested in the alternative asset category. Until 2005, the Permanent Fund was tied to a legal list of investments containing little alternative classes. Since 2005 and the adoption of the “Prudent Investor Rule,” the Fund has increased its alternative asset holdings, but slowly. A major reason for the very late development of the private equity asset category is the slow investment cycle, sometimes called the "J" curve, for this type of investment. Money is given to an investment manager who is only able to slowly disburse it to partnerships for investment. Early on, the investment yields negative returns, then increases, making a J-shaped graph. In 2006 and 2007, the Fund made some progress toward an alternative investment allocation. Two High Yield Bond funds totaling \$113.7 million were funded in December 2006. Another fund has \$53.5 High Yield Bond exposure. In addition, two so-called Enhanced Alpha funds totaling \$813.9 million were funded in July 2006. Enhanced Alpha means these funds have a limited ability to “short” securities (selling securities you do not own).

The Fund’s alternative Investment Profile looks like this:

Table D.			
Permanent Fund Alternative Investment Profile			
(As of December 31, 2006)			
	Percent Committed	Percent Invested	Amount Invested (000’s)
Absolute Return	4	3.90	1,556
Private Equity	4	.75	321
Infrastructure	2	-	-
Enhanced Alpha	2	2	814
High Yield Bonds	.25	.25	114
Other SHLP*	1.50	1.50	610
Total	13.75	8.40	\$3,415

*This investment, carried under Real Estate in the Fund's Performance Report, represents 50 percent ownership in a real estate operating company.

All but Absolute Return and Private Equity can be termed Quasi-Alternative Investments. Alternative Investments, in the strict sense, therefore amount to 4.65 percent of the Portfolio, 3.9 percent of which are hedge funds of a conservative category.

Current Distributions of Fund Income

The constitutional amendment that established the Permanent Fund specified that the earnings of the Permanent Fund be deposited into the State’s General Fund (which makes the money available for spending by the Legislature) “unless otherwise provided by law.” The Legislature later passed a law¹⁴ that approximately half of the annual income was to be distributed on a per capita basis (the Dividend program) and as much of the balance as necessary was to be deposited to the Fund’s principal to account for losses in the value of the Fund due to inflation.

The amount available for annual dividends is based on the realized earnings of the Fund over the current and four preceding years. That amount is multiplied by 21% to find the average. One-half of that amount is transferred to the Permanent Fund Dividend Division of the Department of Revenue for payment of dividends and the other half is available for inflation-proofing the Fund. Funds remaining after these two obligations have been met remain in the Fund’s Earnings Reserve Account and are available for spending by the Legislature. In nearly all years there have been significant remaining funds placed in the Earnings Reserve Account. There is currently a balance exceeding \$4 billion in the Earnings Reserve Account.

Modernizing Permanent Fund’s Payout Calculation

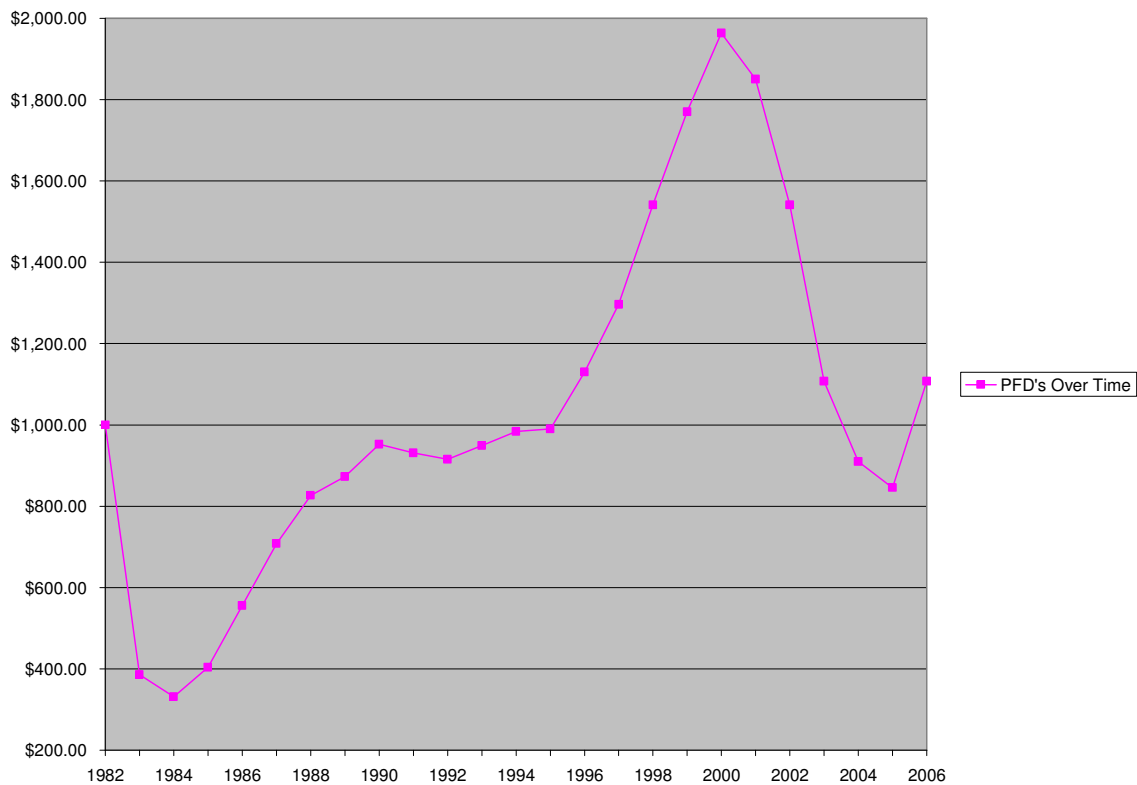
Endowment funds are trust funds that are maintained in perpetuity. Even if no additional funds are added to an endowment, withdrawals from an endowment are calculated in a way to preserve the capital in the Fund and not deplete it. Nearly all endowment funds

¹⁴ AS 37.13.145 (see appendix for full statute).

utilize an annual payout calculation based on the market value¹⁵ of the fund, rather than earned income, which is what the Permanent Fund currently uses. If the Permanent Fund functioned as an endowment, the annual payout (i.e. dividend payments) would be based on its market value. This is the basis for proposals to restructure the Fund under a Percent of Market Value, or POMV. The primary difference between these two payout methods is the consistency of annual withdrawals. Under a POMV method, the amount available for distribution would be more consistent, while an annual distribution (such as for dividends) based on earned income fluctuates as illustrated in Chart 5.

Chart 5.

Historical Amount of Individual Permanent Fund Dividends



Another interesting anomaly is that the realized earnings of the Fund—and therefore the payout for dividends—are disconnected from the value of the Fund. As the market is going up, the amount of the Dividend often goes down, and vice versa. In 2000 the Fund value was approximately \$26 billion and in 2005 the value was approximately \$29 billion. Dividends for those two years were \$1,963.00 and \$845.00 respectively. As the value of the Fund grew, the payout from the Fund declined. This is not to say that an endowment payout would not be without fluctuations, but when the value of the Fund is higher, the payout will be greater, and it will fluctuate less. Another benefit of an endowment payout approach is that the Fund would be automatically inflation-protected. As long as the Permanent Fund earns 5 percent in annual real earnings after inflation

¹⁵ See Glossary for definition.

(which means the Fund enjoys an 8 percent annual earnings and inflation does not exceed 3 percent), an endowment payout would not decrease the purchasing power of the Fund over time.

Michael Burns, Executive Director of the Alaska Permanent Fund Corporation, talked about three changes that were important to modernize the Fund's management. The first change was to require that a governor must have cause to remove a Trustee; the second was adoption of the "Prudent Investor Rule,"¹⁶ both of which were accomplished in recent years.

The third change is a percent of market value (POMV) payout mechanism. When the Fund began operations it was heavily invested in bonds, which paid out a predictable stream of realized income in the form of interest. Currently the Fund is 75% invested in assets that do not pay a set return over time. Investments are typically valued at market. The realized income formula for distribution of income does not take into account appreciation in value and potential depreciation. In short, the current method for calculating income is outdated.

For many years the APFC has advocated the use of a typical endowment type distribution of earnings. It believes that POMV is purely a mechanism that better protects and clarifies the operation of the Fund. The other question—the purpose for which the earnings are used—is not in the purview of the APFC.

Most efforts to update the Fund to POMV have relied on a constitutional amendment, which requires a two-thirds vote of the Legislature to place it on the ballot for a vote by Alaskans. A two-thirds vote is a high threshold to achieve in most legislatures. An alternative in Alaska would be to create an endowment payout mechanism in state law, which can be adopted by a simple majority in both houses of the Legislature. For example, a statutory five percent market value annual payout could be established as long as the principal of the Fund remains untouched. The constitution limits payouts from the Fund to its earnings, which excludes spending the constitutionally mandated deposits. As long as the payout using the POMV payout mechanism did not exceed the earnings of the Fund, this payout mechanism would meet the constitutional provisions. A statutory POMV would allow a trial phase from which Alaskans could decide at a later date whether to adopt the new payout formula by amending the constitution.

Trustee Compensation, Qualification and Selection

Six members comprise the Board of Trustees of the Permanent Fund Corporation: the Commissioner of Revenue, one principal head of a department (commissioner) and four private citizens appointed by the Governor. Trustees are appointed for four-year terms, can be reappointed, and can only be removed for cause.

Trustees receive an honorarium of \$400 per day for each board meeting and public meeting they attend as a representative of the APFC. The honorarium does not adequately compensate for the time outside of meetings that we would expect Trustees to undertake

¹⁶ See Glossary for definition.

in their management of the Fund. Elmer Rasmuson, first Chair of the Permanent Fund, said in 1993 ...

“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 workshops with legislators, interested public groups ...”¹⁷

On the other end of the scale, the Canada Pension Plan (CPP) Investment Board pays its members more liberally than any public fund we have found. Each member of the Board receives \$20,000 per year plus \$1,000 per meeting. Committee chairs receive additional salaries of \$7,500 and the board chair receives \$95,000 remuneration plus the meeting stipend. In addition, the CPP directors engage in self and peer evaluation, the results of which are used to encourage directors' education and are considered in deciding whether to reappoint members. As a side note, the CPP Fund has performed relatively on par with the Permanent Fund. In years 2005 and 2007 the Permanent Fund outperformed the CPP Fund, but in 2006 it showed stronger returns.

In addition to compensation, the qualifications of various fund management boards across the country vary widely. APFC Trustees “. . . must have recognized competence and wide experience in finance, investments, or *other business-management fields*”¹⁸ (emphasis added). This “other business-management” qualification does not necessarily prescribe adequate preparation for the strategic direction of a fund the size of the Permanent Fund. For the Yale endowment fund, nine of the eleven management committee members are active or retired investment managers, venture capitalists or bankers. In Alaska, an example of a fund with more stringent qualifications is the Alaska Retirement Management Board. Seven of the nine members of this board must be “. . . professionally credentialed, or have recognized competence in investment management, finance, banking, economics, accounting, pension administration, or actuarial analysis . . .”¹⁹

As a counterpoint, Robert Maynard, CIO of the Idaho Public Employees Retirement Board and a Permanent Fund advisor, stressed the high caliber of Trustees in a conference call with the study group on June 20. He said that Board decisions in the last ten years have been “stunningly good” and that the Board is one of the best in the nation and would lose more than it would gain with a board with professional qualifications.

Modifying the selection process could help ensure continued appointment of highly qualified individuals. One process that has shown excellent success in Alaska is judicial selection. The Judicial Council screens applicants for a judicial position for the appropriate skills and demeanor (all applicants must meet statutory minimum requirements). This process involves public input, as well as peer review of the applicants. The Judicial Council then forwards the names of the top candidates to the

¹⁷ The Early History of the Alaska Permanent Fund, Trustee Papers, Vol. 5, February 1997.

¹⁸ AS 37.13.050.

¹⁹ AS 37.10.210(b)(2).

Governor for selection. A similar process, namely an independent board, could vet candidates for the Permanent Fund Board's citizen positions. All members of the Board could be expected to meet minimum standards relating to background and appropriate experience.

Role of APFC Trustees

Elmer Rasmuson called upon the Board of Trustees to "take on the conceptual leadership for the financial policies of the State." He cited the economic studies produced by the various Federal Reserve Boards as examples of what the APFC Board could produce for Alaskans. As the needs of the country grew for economic leadership, the Federal Reserve stepped in. The Fund partially fulfills this mission with its excellent intern program, occasional in-depth papers, and economic briefings. It could expand its role by commissioning studies to illuminate the socio-economic impact of the Dividend program, as discussed earlier in this report.

In the same meeting where he affirmed the good stewardship by the current Board of Trustees, Mr. Maynard suggested that the trustees should see what other funds are doing and consult with other fund boards. In addition to the current trustee educational program, increased meetings between the Trustees and fund managers of other endowments, large financial institutions, and university officials would allow the trustees to gain a better understanding of financial stewardship and current trends in the field of institutional investment.

Corporation's Office Locations

Despite the positive performance of the Permanent Fund through its management and board, its office location presents obstacles to continued success. Recruitment is perhaps the largest issue because the APFC's office is located in Juneau. Executive Director Michael Burns said in a talk to the study group on May 2, 2007 that recruiting to fill positions in Juneau is difficult. Juneau is isolated from the major financial markets in the country, and only applicants who choose the "Juneau lifestyle" are attracted to positions with APFC. This difficulty is reflected in the APFC experience of a one-year delay in finding a fixed-income mortgage backed securities expert based in Juneau.

Another issue is ease of travel. For example, an investment professional commented during his discussion with the study group that, due to travel cost and distance, it is more difficult to travel from Juneau to investigate a potential real estate investment. Adding to that, Bob Maynard, CIO of the Idaho Public Employee Retirement System and advisor to the APFC Board, mentioned the fact that travel to financial centers and meeting with other fund managers is much more difficult when travel initiates in Juneau.

Opening a substantial satellite office in Anchorage not only would help in staff recruitment, but it also would be a good way to nurture the nascent investment industry here in Alaska. Anchorage is already home to McKinley Investments, managing \$1.5 billion in Permanent Fund and State Retirement Fund assets, and Alaska Permanent Capital Management, managing \$327 million in Permanent Fund assets. Opening a

major satellite office in Anchorage could provide a synergy for expansion of the Alaska investment management industry.

APFC Employee Compensation

The Permanent Fund is by far the largest state endowment fund in the country, and is larger than the Harvard and Yale University funds. Yale employs a small in-house staff, including its CIO, David F. Swensen, who is paid approximately \$1.5 million per year. Yale had one of the highest levels of return of comparable endowment funds for the ten years ending FY 2006 at 17.2%. The Harvard fund pays at a much higher scale for its managers, as high as \$18 million per year.

In 2004 the APFC commissioned a salary survey of endowment funds across the country that included 24 funds, 23 of which were public. Of this sample, 56% had a compensation package that included some type of incentive pay. In 2007 APFC's Compensation Committee recommended a \$300,000 salary for the executive director, a substantial increase over the pay offered during the last executive director search (which yielded only two finalists). However, the Board of Trustees reduced the salary level recommended by the Compensation Committee to \$260,000. If the Fund management were more removed from State general government operations, the Board of Trustees might be in a better position to evaluate compensation on a job-specific national basis.

The Executive Director of the Permanent Fund and others have stated that hiring in-house investment professionals is difficult due in part to the compensation levels. Attracting investment managers to Juneau is difficult, and the relatively modest pay offered by the APFC intensifies the challenge.

Summary of Observations

Throughout the process of studying the Permanent Fund and writing this report, we are confronted again and again with the high caliber of the Fund's management and stewardship. The performance of the Fund is solid, compared to many endowment and retirement funds, with a 22-year return of 7% despite investment limitations early in its history. Its board of trustees is dedicated to managing the Fund for total return consistent with modern portfolio theory, unhampered by issues such as amounts available for payout. The Fund's Executive Director Michael Burns, staff, and consultants are clearly high quality and effective fund managers.

The time, however, is right for a close analytical look at the Fund's management compared to other funds. On June 30, 1996, the Fund's balance was \$19 billion. Recently the Fund exceeded \$40 billion in market value of assets. Today's balance could be doubled again in ten years. It is much more than a mere possibility that we then will have an \$80 billion Fund and \$4,000 individual dividends. At this level the Fund will be an even more important part of the State's fiscal picture and economy than it is today. Because of this, it is important to look at the existing structure and operation to see how the Fund might be improved—from issues of returns, to board leadership, to income distribution.

The most important observation that we can make is for the Permanent Fund to begin viewing itself more as an endowment fund, rather than a state retirement fund. Endowments are managed differently than retirement funds and have achieved significantly higher returns. They are not faced with the requirement to make set amounts of annual payments, which is true of retirement funds. We feel the objectives of the Permanent Fund are more closely aligned with those University endowments, rather than state pension/retirement funds. In the spirit of open discussion, here is summary of our observations:

Observation #1.

The fund should consider larger investments in alternative assets, using fixed income as the funding source.

Asset allocation is the acknowledged main driver of returns. One of the Fund's outside advisors has urged greater investment in alternative investments. Board response has been to increase investment in modified or quasi-alternative strategies like high yield bonds or so-called enhanced alpha strategies. Fund returns have held up despite the lack of investment in this asset class because of the Fund's larger than normal real estate portfolio and the success of its investments in other asset classes.

Observation #2.

An endowment style payout would provide built-in inflation- proofing.

We hesitate to urge the fund to stay in there and continue to urge passage of a market value based payout system, because it has worked so long and hard unsuccessfully, but it remains a most necessary public policy change for the Fund. Legislative passage by two-thirds vote of the necessary constitutional amendment seems like a difficult threshold to reach but it happened with the New Mexico and Texas endowment funds. Establishment of an endowment style payment through legislation could be an intelligent first step in this process. A 5% market value annual payout could be permitted so long as that amount did not exceed the constitutional limit of a payout restricted to earned income.

Observation #3.

A more rigorous selection process for trustees.

This could include a nomination committee presenting candidates with a financial background to the governor for consideration. Other changes could include better trustee compensation and an annual performance self-analysis.

Observation #4.

The Permanent Fund Trustees could take on a leadership role on issues in their purview in the State.

Part of this leadership should definitely come in the form of commissioning studies of the socio-economic impact of the Dividend.

Observation #5.

A higher level of staff compensation and incentive compensation should be considered as necessary to obtain and retain staff with experience in new investment areas.

As the Fund inevitably enters into partnership with operating companies and expands its ownership of alternative assets, new staff skill sets will become necessary. The 2006 salary survey conducted for the Fund indicated that a majority of the retirement funds included a performance incentive feature. Incentive performance pay increment should again be considered and compensation increased to be more nearly on par with that the major university endowments to which the Fund is most closely comparable.

Observation #6.

The fund should consider opening and staffing a substantial Anchorage office and an office outside.

This would help overcome the difficult Juneau travel situation, allow more frequent contact with financial markets and investments, help grow the Anchorage investment management industry, and ease recruitment problems.

D. Prior Proposals to Use the Fund’s Earnings

Currently, the earnings of the Permanent Fund are primarily used for individual dividends. Additional uses for the earnings of the Permanent Fund have been debated for years. Public opinion surveys over the years show that answers regarding the use of Fund earnings vary depending on the specifics of the proposal. Generic use by government for operations generally receive very low approval. Uses that are more specific, such as for elementary and secondary education, receive higher approval.

The following proposals and approaches to the use of Permanent Fund earnings received significant public attention. Several of these proposals reappear from time to time with renewed public interest, usually when the State experiences a significant drop in revenues. Interestingly, a review of past Commonwealth North reports provides an illustration of the changes over time in perspective concerning the issue of use of the Fund’s earnings.²⁰

State Services

“Principles and Interests” (1997-1998)

The Alaska Humanities Forum held more than 100 town meetings across the state as part of the “Principles and Interests” project. Fifty-six percent of participants supported the use of Permanent Fund earnings to create an endowment for public programs, such as education and the arts, even if it would mean future Dividend checks would not grow as fast.²¹

As described in the *Paradoxes of Public Wealth: A summary report on the Principles and Interests – The Permanent Fund and Alaska’s Future* by the Alaska Humanities Forum, the purpose of the project was three-fold:

- To promote broad and robust dialogue and education on a uniquely Alaskan topic of critical importance to the future of the State;
- To focus on the different principles and competing interests that underlie the continuing controversies surrounding the Permanent Fund; and
- To ensure that the future of Alaska’s largest public asset will be shaped by the informed participation of its major stakeholder, the people of Alaska.

The findings observed as a result of the public process were:

- Alaskans expect the Fund to be permanent, an inheritance to be passed along to future generations.
- Support for the PFD is overwhelmingly strong, but not absolute.
- Distrust of politics and public officials is rampant.

²⁰ “Using the Permanent Fund as a Positive Counter-cyclical Force in the Alaskan Economy”; “Permanent Fund Earnings--Phase II: A Cornerstone for Fiscal Certainty” and other reports about the Permanent Fund can be found on the Commonwealth North website www.commonwealthnorth.org.

²¹ Source: The Trustees Papers – Volume 6, “Forum Gives Citizens a Rare Chance for Thoughtful Discussion,” by Mike Doogan, Columnist, Anchorage Daily News.

- Education is on everyone’s mind, but there is no consensus on what should be done about it.
- Willingness to consider a progressive income tax or, less often, a statewide sales tax, came forth at virtually every meeting.
- In the bush and the Anchorage, Fairbanks and Juneau areas, many people believe that the “rainy day” has come. That sentiment was less often shared in the Interior, Mat-Su Valley, Kenai Peninsula, or Southeast regions.

The paradoxes observed as a result of the public process were:

- Alaska is a state that is financially rich, yet overwhelmingly dependent on one, diminishing resource.
- With \$25 billion in the bank, Alaskans see public services in long-term decline and have little confidence that those institutions can be a positive force for a better future.
- Alaskans have the financial means to create an educational system they never dreamed of at statehood, but they are not convinced that more money will bring better educational results.
- The largest contributor to the Fund to date in 1998 was additional legislative deposits, but people distrusted politicians and opposed the idea of political control of the Fund.
- \$25 billion is held in common yet is distributed entirely on an individual basis.

Statewide Advisory Vote (1999)

There have been several proposals for voters to consider. One that the Legislature placed on the ballot in a special election was an advisory vote on a “Balanced Budget Plan.”²² Its legislative statement of intent said it would “preserve the permanent fund dividend, inflation-proof the permanent fund, support public services, and establish a Citizens’ Balanced Budget Task Force”. It then said the plan would further spending reductions, guarantee a dividend, fund essential state services, and have no personal income tax.

The proposal went down to a resounding defeat with 83% of the voters opposing it.

While some pundits suggest the election’s result was a referendum on use of the Permanent Fund’s earnings, others say the structure of the ballot question gave just about everyone a reason to vote “no” and that because of the way the ballot question was structured, there was no clear statement of opinion by voters on any one proposal.

Five years later, a public opinion survey indicated that 60% of the respondents supported the use of a portion of the earnings of the Permanent Fund to support essential services, such as education.²³ This suggests that the 1999 vote may not have been a long-standing referendum on this critical question and that Alaskans can be more receptive to uses of the Permanent Fund earnings for specific purposes.

²²Chapter 1 FSSLA 99.

²³ Source: Alaska Permanent Fund Program Timeline of Public Opinion, 1974 to 2004, presented to Permanent Fund Task Force by Dittman Research & Communications Corporation.

The Conference of Alaskans (2004)

Governor Frank Murkowski convened on February 10th a three-day conference in Fairbanks at the University of Alaska. The Conference was modeled after the 1955-1956 state constitutional convention with its 55 delegates. The Governor chose ten delegates who then selected the other 45. Delegates represented a cross-section of Alaskans— younger and older, business, rural, and urban.

Governor Murkowski asked the delegates to consider and respond to four questions.²⁴ The following are the Governor’s questions and delegates’ responses:

1. Should the use of income from the Permanent Fund be limited by the Constitution to 5% of the Fund’s value, as the Permanent Fund Trustees have proposed?

Yes. We must inflation-proof the Permanent Fund in order to keep it and the Permanent Fund Dividends (PFDs) from evaporating away in the future. The “percent of market value” (POMV), as suggested by the trustees will put inflation-proofing into the Constitution, instead of leaving it to the Legislature’s discretion. POMV is a technical change in determining how much money from the Fund is available, but it has nothing directly to do with the choice of using it for Dividends or spending it on anything else. That’s the next question.

2. Should a portion of the income of the Permanent Fund be used for essential state services, such as education?

Our answer here is “yes, but...” There are two conditions to our endorsement. One, dividends must be paid out first under POMV. Only what’s left over could be used for essential state services. Two, the delegates to the Conference of Alaskans recommend that the governor and legislature take action to balance the State’s revenues and expenditures, including, but not limited to, consideration of a personal income tax, other broad-based taxes and other alternative sources of income.

3. Should the use of the income of the Permanent Fund for dividends and possibly for other purposes be determined annually by the Legislature, as is currently the case? Or, should it be dedicated in the Constitution?

A reasonable percentage of the Permanent Fund money available under POMV should be constitutionally dedicated to PFDs in order to make them “permanent” like the Fund itself. All other uses of the remaining Permanent Fund money should be left for the Legislature to appropriate, since it is impossible for this generation to predict what the needs will be for the next.

4. Should the State maintain a minimum balance in the Constitutional Budget Reserve to stabilize state finances against fluctuations in oil production or prices?

²⁴The questions, the answers of the Conference, and resolutions can be viewed at Juneau Empire website <http://www.alaskalegislature.com/stories/021304/conference.shtml>.

Yes, a prudent amount should be in reserve at all times, for two reasons. We can't afford to send home all the police, firefighters, teachers or other critical personnel because the state treasury is empty due to something unforeseen. It is critical that a prudent amount be retained in a Constitutional Budget Reserve (CBR) to stabilize state finances against fluctuations in oil production or prices. This is necessary to maintain the State's very good credit rating, which will save millions of dollars in the future. Therefore, if oil production is interrupted or prices fall, so that we need to draw the CBR below the prudent balance, the State needs a plan to refill it back to that level as soon as possible.

Based on the recommendations by the Conference of Alaskans, the Governor introduced legislation that proposed POMV and use of earnings for individual dividends, a community dividend, and education. The POMV constitutional amendment²⁵ passed the House but failed to pass on the Senate floor.

Both the Principles and Interests process in 1997-1998 and the Conference of Alaskans in 2004 were high profile events. The Conference of Alaskans received glowing reviews from the Anchorage Daily News. However, each lacked significant "buy-in" or support by the State Legislature and/or Governor. Former legislators made the point to the Study Group that any future effort to engage the public in such discussions must be supported by the governor and legislative leadership in order to have momentum necessary to result in enactment of any recommendations.

Statewide Infrastructure

In 1999 Commonwealth North released a report entitled "Permanent Fund Earnings-Phase II" in which one of the public priorities for use of Permanent Fund earnings was to support statewide capital needs that provide infrastructure to support the economy.

ISER released a preliminary summary of research into the effects of climate change on Alaska's public infrastructure in June 2007²⁶. Larsen and Goldsmith estimated that climate change would contribute \$3.6-\$6.1 billion to the cost of maintaining and replacing infrastructure to 2030. However, the costs of normal wear and tear were estimated to be \$32 billion. To put that in perspective, that is \$1.4 billion annually for the next 23 years in order to maintain and replace infrastructure as necessary.

The American Society of Civil Engineers 2005 Report Card²⁷ details some of the needs in Alaska. According to the report card, 33% of Alaska roads are in poor or mediocre condition, and 80% of Alaska schools have at least one unsatisfactory environmental condition. Alaska has 18 high hazard dams, which is defined as a dam whose failure would cause loss of life and significant property damage. Recently, the condition of the State's bridges has been in public focus.

²⁵ House Joint Resolution 26.

²⁶ "How Much Might Climate Change Add to Future Costs for Public Infrastructure?" UA Research Summary 8

²⁷ <http://www.asce.org/reportcard/2005/page.cfm?id=41>

Community Dividend

In addition to distributing a portion of the Fund's earnings to individuals, some have advocated that local governments also receive "dividends" to spend as they see determine in their community. Local control and decision making allows for dynamic responses to dynamic problems. For understandable reasons, support for a community dividend has been voiced by many local governments, with resolutions of endorsement from the Fairbanks-North Star Borough, the Southwest Alaska Municipal Conference, and the Alaska Municipal League.²⁸ Commonwealth North released a report in 1999 advocating for 20% of the earnings of the Permanent Fund be used for a community dividend. At least one proposal in each of the past six legislative sessions has involved the use of Permanent Fund earnings to fund a community/municipal dividend fund, including HB 1003 submitted by Governor Murkowski.

Educational Funding

There have been several pieces of legislation introduced in the State Legislature that proposed using a portion of the earnings of the Permanent Fund to fund an education endowment. A sample includes:

- In 1993 Senate Joint Resolution (SJR) No. 7 proposed to amend the Constitution to establish an education fund to endow public education to be appropriated only to finance public elementary and secondary education. SJR 7 proposed that 40% of the income of the Permanent Fund be placed each year in the Fund. The legislation never passed out of its first committee of referral.
- In 1997 SJR 1 proposed amending the Constitution to establish a separate account in the Permanent Fund for funding elementary and secondary education only. Initially \$350 million in Permanent Fund income was to be placed in the Fund and that amount would increase based on inflation in future years.
- In 2002 the House approved its version of House Bill 304 which would have created an education fund to be funded by 50% of the earnings of the Permanent Fund that were available for distribution. The education fund could be used to pay for K-12 and the University of Alaska. The legislation passed the House, but failed in the Senate.

Texas is a model of a state which has significantly enhanced education at all levels through state endowments of land and mineral resources. Studies demonstrate that excellent schools and universities are important drivers of economic development, but our University of Alaska enjoys only a modest endowment (\$264 million) compared to Texas (\$32.3 billion total for Texas Public School Fund and Texas University Fund).

²⁸ <http://electra.he.net/~swamc/images/stories/resolut/07-15%20community%20dividend.pdf> and <http://co.fairbanks.ak.us/meetings/Resolutions/2006/2006-16.pdf>.

Legislative Activity Relating to the Permanent Fund and Its Earnings

Since the Fund's creation in 1976, a total of over 150 pieces of legislation have been introduced relating to the Funds payout mechanism, deposits into the Fund, uses of the Fund, and other subjects directed to the Permanent Fund.²⁹ Here is a summary of these actions:

Topic of Legislation	# Of Bills On Topic
POMV	20
Constitutional Guarantee PFD's	10
Earnings for Gov. Operations	53
Educational Endowment	4
Long Range Fiscal Plan	7
Advisory vote on earnings	14
Special Appropriation or grow the principal	39
PFD's held as annuities or trust	9

²⁹ A complete listing of these bills is available at <http://www.commonwealthnorth.org/fund07/index.html>.

E. Bringing Alaskans Together to Take Responsibility Today for Alaska's Tomorrows

In this report we have addressed a number of points:

- Alaska is facing a potential budget shortfall in the coming years, based on existing budget projections and customarily used revenue sources.
- The earnings of the Permanent Fund have often exceeded other sources of General Fund revenue and this is likely to continue in future years.
- There have been many studies, public forums, and government sponsored commissions looking at the issue of how to best distribute and use the earnings of the Permanent Fund. To date, none of these efforts have led to meaningful changes.
- The Permanent Fund Dividend has become an integral part of Alaska's economy, and its impact on citizens and the economy is significant.

Given this, how do Alaskans position the State to move forward with a positive plan for the economic future of Alaska? How can we build public consensus for change—and what should that change be?

Such decisions reflect a mixture of our values and opinions, technical knowledge and abilities, and political systems. But these views likely will conflict, and as Alaskans have seen over the years, conventional decision-making systems frequently have heightened and accentuated these different perspectives.

Government's traditional approach is to synthesize and bridge gaps among diverse opinions, as well as from incomplete or unknown technical and scientific information. We see this in both legislative and regulatory/permitting systems. Traditionally, the first step is that a legislative committee or agency develops a proposal and then seeks and receives public comments. Staff then sorts through the comments and tries to balance opinions that frequently conflict with one another. Based on the information gathered and the internal governmental assessment process, decisions are made, the public is informed of the decision—and then the problems start. Typically none of the stakeholders affected by a decision are happy with it. They feel that their concerns weren't heard and certainly weren't addressed. These citizens often hear the government decision makers say, "If everyone's angry with us, we must've done our job," which only adds to their anger and frustration. These citizens find themselves asking, "What kind of government do we have where the lowest common denominator decision equals a job well done?" The result is that these citizens' trust and credibility in government dwindles. This decision-making process is commonly known as Decide-Announce-Defend (DAD) and is the norm for a vast majority of public decisions.

But on critical public policy decisions, is this approach sufficient? Are we willing to accept this “least-common denominator” outcome for some of the most important decisions that will ever face our state? The choices Alaska faces are complex—so do we need a different approach than the more traditional D-A-D process? The CWN study group concluded that the stakes are too high to rely on the old approach and we must do things differently.

CWN proposes a collaborative approach, one that ensures those outside the conventional public decision-making process are included. Such a process rests on the premise that citizens prefer to be constructive—which we believe Alaskans do—but too often there is no place in the current decision-making process for their hands-on involvement and little appreciation for their ideas and abilities.

Collaboration and consensus building approaches can augment conventional public decision making by providing a way to handle complex public issues in a systematic, manageable, and less emotional manner. These approaches can provide the ability to be “tough on the problem and easy on the people,” so that even when individuals disagree, they remain focused on the goal—and not on each other. It can provide a place at the table for those affected by a decision and provide ground rules to work constructively together so that even when disagreements occur, productive interactions and outcomes are still possible.

Unlike conventional public participation approaches, collaboration is not just about balancing perspectives. Instead, it can create mutual learning opportunities for those affected by a decision through which agreement can be found and/or new options created that otherwise might not have been thought of or considered.

Collaborative approaches are being used around the country to gain insight about how citizens resolve difficult choices, to create a more informed and engaged public, and to embolden bi-partisan leadership in implementing solutions. With these goals in mind, starting in 2006 the Ford Foundation sponsored a series entitled ChoiceDialogues, about the nation’s fiscal health, the challenge of which is summarized as follows:

“Nearly every credible budget expert—left, right and center—agrees the United States faces some fundamental choices in the coming years, about the future of the country and the role the federal government should play in realizing that future. As our population ages, baby boomers near retirement, and the national debt continues to rise, it is increasingly vital for Americans to have a serious conversation about national priorities, entitlements, what we expect from the Federal government and what we are willing to pay to get it. If we as a nation face up to these challenges now, we can solve them. But the longer we wait, the fewer options we will have, and the greater the risk to our fiscal stability, our way of life and our children’s future.”³⁰

³⁰ “Americans Deliberate Our Nation’s Finances and Future: It’s not about taxes—It’s about trust,” Viewpoint Learning, Inc., Fall 2006, page 3 (www.FacingUp.org).

The national initiative described above, through a public engagement process, brought together four organizations to work on an initiative to engage Americans to enhance their understanding about and build support for choices facing our leaders on national fiscal issues. At the outset project sponsors acknowledged the difficulties of the task:

...engaging the public and building public support for and understanding of difficult choices is a challenge. Conventional wisdom tends to dismiss the public as polarized and apathetic, wanting it all but not willing to pay for it. Leaders are not sure whether or how they can reach the public on these issues, let alone what sorts of solutions the public would find acceptable if they did.

As discussed in this report, there have been a number of efforts and hundreds of bills introduced to address the Permanent Fund and its earnings (see appendix for listing of studies, public efforts, and legislation relating to the Permanent Fund). In spite of all these efforts, they have not resulted in identifying acceptable—and politically doable—solutions. As Commonwealth North explored these issues, what became clear is that no one effort or initiative involved all the parties critical to success—the Administration, the Legislature, and Alaskans. Some efforts were initiated by a Governor who involved the public but not the Legislature; some were sponsored by citizen organizations without the buy-in of the Legislature or Governor; others were sponsored by the Legislature with no support from the Governor.

What we have learned from reviewing—and from some of the Study Group members actually experiencing—the efforts of the past, is that they largely failed because all three “sides”—the Administration, Legislature, and Alaskans—were not part of the process. For meaningful action to result, the Study Group recommends all three must support the process by which consensus is to be built.

With this in mind, any initiative on these major policy decisions has to take a different approach. Accordingly, CWN recommends that a new large-scale collaborative approach be undertaken in which all Alaskans have an opportunity to share their hopes and vision for Alaska’s future—as well as what we as Alaskans and the State can do to achieve these goals.

The following are some of the characteristics for such a collaborative process that is more likely to result in meaningful action on the key policy decisions Alaska faces:

- It’s a deliberative process—Alaskans need to have constructive input on decisions and actions;
- The process frames the issues—it doesn’t control it;
- Alaskans need to be engaged—not “educated”—and be provided opportunities for joint learning;
- Multi-level discussions should be held around the state; the first round would focus Alaskans on their vision for the State’s future and the second would develop recommendations on how to achieve that vision;
- Multiple ideas should be expected; there are no “wrong answers”;
- These ideas/recommendations should serve as “inputs” to elected officials for their decision-making;
- Trust among participants is critical;

- Process needs to be supported by legislators and the governor through their participation and support;
- A broad coalition of organizations is needed to organize, support, and participate. This includes joint and preferably equal funding of the effort by the State, business, and non-profit organizations; and
- The approach needs to be planned by a wide range of interest groups, with support and participation from the governor and legislature.

CWN believes such an approach holds the greatest promise in achieving meaningful action on addressing fiscal stability for Alaska’s public and private sectors. For a collaborative effort to be successful, it must be carefully planned, properly timed, and allow the time necessary for building a public consensus.

We recognize this implementation recommendation, calling for a collaborative process is unusual – especially for Commonwealth North. But the characteristics exist that make collaboration the best hope for success because it is a complex public issue; there are many decision makers; and there are many ideas about what is the “best answer.”

Commonwealth North stands ready to work with other Alaskans and organizations to address what we believe is likely the most critical issue in Alaska’s history—securing the future stability of Alaska’s economy through the wise use of the State’s financial resources.

Glossary of Terms*

Absolute return strategies. An array of investment strategies designed to produce returns uncorrelated with market performance and independent of traditional benchmark indices.

Alternative asset. Typically, investments that are not traditional asset classes found in most investment plans. APFC considers alternative investments to be assets other than common stocks, bonds and real estate.

Asset. Anything owned that has cash value such as stocks, bonds or real estate.

Asset allocation. The distribution of investments among different types of assets.

Bond. A money-raising mechanism in which the bond "issuer" – a corporation, government or government agency – borrows money usually at a preset interest rate for a preset period of time.

Constitutional Budget Reserve Fund (CBRF). Created by voters in 1990, the Constitutional Budget Reserve Fund receives proceeds from settlements of oil, gas, and mining tax and royalty disputes. The legislature may, with a three-quarters majority vote in each chamber, withdraw money from the Fund.

Dedicated funds. Capital set aside for a specific purpose or purposes.

Diversification. "Don't put your eggs in one basket," is the principle of investment diversity. Diversification reduces risk by putting assets in several categories of investments.

Equities. Another name for stocks. Represents a share of ownership in public companies.

Equity real estate. A type of investment in real property in which the investor has an ownership position.

Fixed income. Interest-bearing investments such as government and corporate bonds which mature at specific times, repaying principal plus interest.

General Fund. The State of Alaska's "checking account." The General Fund contains money the state receives and distributes by appropriation.

General Fund Revenue. General Fund Revenue has different meanings in different contexts. In the State's official financial reports, General Fund Revenue is used to designate the sum of General purpose Unrestricted Revenue, General Fund sub-account revenue, program receipts and federal dollars spent through the General Fund. In budget-writing context, General Fund revenue has a definition similar to General Purpose Unrestricted Revenue.

General Purpose Unrestricted Revenue. Revenue not restricted by the constitution, state or federal law, trust or debt restrictions or customary practice. Most legislative and public debate over the budget each year centers on this category of revenue. In deriving this figure from General Purpose Unrestricted Revenues, we have excluded customarily restricted revenues such as shared taxes and marine highway receipts.

Income. The return in money from an investment. Can be derived from interest, dividends, real estate cash flow, capital gains and losses, or appreciation and depreciation of investment market values.

Inflation-proofing. Sufficient monies are appropriated to the Fund's principal from the Fund's earnings to fully offset the effects of inflation on the principal balance.

Lease bonus. A one-time amount paid by a private company competing for the right to lease a section of public land for development.

Net income. The amount of earnings that remain after deducting operating expenses.

POMV. Acronym for "Percent of Market Value," a fund payout method based on an average market value over a specified period of time, and used by most large endowment and trust funds. Trustees advocate using a POMV payout for the Permanent Fund to better protect the Fund and ensure more stable, consistent annual payout amounts.

Permanent Fund GASB (or Market) Income. Under standards adopted by the Governmental Accounting Standards Board, the Permanent Fund's income—and that of any other government fund—is the difference between the purchase price of the investments and their market value at a given point in time, plus any dividends, interest or rent earned on those investments. Under GASB standards, the Permanent Fund does not have to sell the investment to count the gain or loss as it changes value. It is called "marking to market," that is, measuring the value of the Fund's investments by the current market price. This can produce a much different picture than Permanent Fund statutory income, which does not reflect fluctuating investment values until the assets are sold.

Permanent Fund Statutory Income. The annual Permanent Fund Dividend is based on statutory income. This is the sum of realized gains and losses of all Permanent Fund investment transactions during the year, plus interest, dividends and rents earned by the Fund. Though the legislature may appropriate the earnings for any purpose it chooses, the historical practice has been to restrict the use of realized income to dividends and inflation-proofing, and then either leave the excess in the Realized Earnings Account or transfer it to the principal of the Permanent Fund.

Prudent Investor Rule. A standard of judgment and care applied to people who make investments. Under this rule, the investor is to use the same judgment and care that an institutional investor of ordinary prudence, discretion and intelligence would use in managing large investments.

Rate of return. Profit from an investment, expressed as a percentage of the amount invested.

Real rate of return. Total investment rate of return adjusted for the rate of inflation.

Realized earnings. Income from various cash flows, such as stock dividends, bond interest, real estate rental cash flow, or net profit or loss from the sale of an investment.

Renewable resource. A natural resource such as timber or fish that may be replenished or restored while being consumed.

Royalty. Payment to the holder or owner for the right to use property such as a patent, copyrighted material, or natural resources.

Risk. The possibility, which can be measured, of losing value or not gaining value.

Security. Any investment instrument such as a bond, common stock, deed of trust on property, or any evidence of indebtedness or equity.

Statutory net income. The Permanent Fund's net income as defined in law. It includes only realized earnings less various adjustments, not unrealized earnings.

Trustee. A person charged with managing assets in the interest of beneficiaries, such as the residents of Alaska.

Unrealized earnings. Current market value of an asset not yet sold minus its original cost.

**Definitions are from the Alaska Department of Revenue, Revenue Sources Book, Spring 2007, and from Alaska Permanent Fund Corporation, An Alaskan's Guide to the Permanent Fund, 2005.*

Appendix

1. Alaska Statutes: Permanent Fund Earnings

AS 37.13.140. Income.

Net income of the fund includes income of the earnings reserve account established under AS 37.13.145. Net income of the fund shall be computed annually as of the last day of the fiscal year in accordance with generally accepted accounting principles, excluding any unrealized gains or losses. Income available for distribution equals 21 percent of the net income of the fund for the last five fiscal years, including the fiscal year just ended, but may not exceed net income of the fund for the fiscal year just ended plus the balance in the earnings reserve account described in AS 37.13.145.

AS 37.13.145. Disposition of Income.

(a) The earnings reserve account is established as a separate account in the fund. Income from the fund shall be deposited by the corporation into the account as soon as it is received. Money in the account shall be invested in investments authorized under AS 37.13.120.

(b) At the end of each fiscal year, the corporation shall transfer from the earnings reserve account to the dividend fund established under AS 43.23.045, 50 percent of the income available for distribution under AS 37.13.140.

(c) After the transfer under (b) of this section, the corporation shall transfer from the earnings reserve account to the principal of the fund an amount sufficient to offset the effect of inflation on principal of the fund during that fiscal year. The corporation shall calculate the amount to transfer to the principal under this subsection by:

- (1) computing the average of the monthly United States Consumer Price Index for all urban consumers for each of the two previous calendar years;
- (2) computing the percentage change between the first and second calendar year average; and
- (3) applying that rate to the value of the principal of the fund on the last day of the fiscal year just ended.

(d) Notwithstanding (b) of this section, income earned on money awarded in or received as a result of State v. Amerada Hess, et al., 1JU-77-847 Civ. (Superior Court, First Judicial District), including settlement, summary judgment, or adjustment to a royalty-in-kind contract that is tied to the outcome of this case, or interest earned on the money, or on the earnings of the money shall be treated in the same manner as other income of the Alaska permanent fund, except that it is not available for distribution to the dividend fund, and shall be annually deposited into the principal of the Alaska permanent fund.

2. Highlights of Past Efforts Regarding POMV Payout Method for the Permanent Fund

- In 1994 Scott Goldsmith testified at an Alaska State Senate committee hearing on how to maximize returns of the Fund. As a proposed solution, Professor Goldsmith suggested basing the Dividend on the long-term average value of the Fund including unrealized gains and losses.
- In 1995 the Long Range Financial Planning Commission recommended an “endowment model” payout formula. It recommended a 4% payout ceiling in order to grow the Permanent Fund.
- The APFC recommended a POMV Constitutional Amendment in its 2001 Annual Report.
- In July 2003 the Trustees issued a major paper (Paper Number 7, “Making the Case for Complete and Protected Inflation Proofing”). In it, the Corporation recounted advocacy for POMV back to Hugh Malone in 1989 and quoted Arliss Sturgulewski, Jay Hammond, and an editorial from the *Anchorage Daily News* endorsing an endowment payout mechanism.
- An Ivan Moore poll of 500 Alaskans (*Anchorage Daily News*, February 9, 2004) showed a majority favored the concept of a five percent market-value based payout with half to dividends and half to government, but a majority opposed amending the Constitution to achieve this. If the distribution were changed to 80% dividends and 20% to government, then a majority of those surveyed would support such a constitutional amendment.
- In 2004 the House approved Governor Murkowski’s House Joint Resolution 26 that would have placed a Constitutional amendment creating POMV before voters. It passed the House by 27-13, but failed in the Senate by 5-15.
- On April 22, 2005 Mike Burns testified to the House Ways and Means Committee, that the APFC considered the POMV proposal to be entirely separate from any fiscal discussion for Alaska in terms of the use of Permanent Fund earnings.

3. Background Information About Alaska State Revenues and Permanent Fund Earnings

What all Alaskans can agree on is that they want a stable economy. The obvious question is then, how do we bring about stability? To answer that, it's helpful to know a little about the Alaskan economy and state revenue.

Alaska is overwhelmingly dependent on oil for its economic livelihood. The budget of Alaska reflects this dependence. For much of the history of our state, revenue from oil has made up over 80% of the state's sources of money to pay for state services.

- From 1978 to 2006 Oil Revenues averaged 82% of general fund revenues³¹. This number has been as high as 90% in Fiscal Years 1980 and 1981 and as low as 68% in FY 1999.
- When oil began flowing through the pipeline in FY 1978 and again in FY 1979 the share of general fund revenues was 52% and 73%, respectively.

FY 2007 continues the State's dependence on oil revenues to finance state services, with about 87% of general fund revenues coming from oil.

<i>FY 2007 General Fund Revenue (\$ millions)</i>		
Royalty-Net of PF	1583.1	31.0%
Production Tax	2124.6	42.7%
Income Tax	565.0	11.3%
Property Tax	52.0	1.0%
OIL TOTAL	4324.7	86.8%
Non-Oil (including investment)	655.5	13.2%
Total Budget	4980.2	100.0%

Another way to see the impact of the oil industry on Alaska is in terms of jobs. ISER has estimated that one in three jobs in Alaska depend on oil revenues for support, either direct oil and gas industry jobs, state spending, or Alaskans spending their Dividends. With 33% of our jobs dependent on one major industry, the employment in Alaska has the potential to swing rapidly and with little warning. This occurred in the 1980s when Alaska experienced a harsh recession:

- Oil prices, which in the early 1980s were nearly at record highs when adjusting for inflation, came crashing in the latter half of the decade. Facing a huge budget deficit, the State cut over \$1 billion from government expenditures from FY 1985 through FY 1988. The result was devastating to the Alaska economy.

³¹ Revenue Sources Book, Spring 2007

- The Department of Commerce, Community and Economic Development reports that in 1987, Anchorage alone lost 30,000 jobs, almost instantly swinging from the fastest growing to the most rapidly shrinking city in the U.S.
- In all, between 1985 and 1989, Alaska lost 44,000 in population to out migration³² and 22,000 jobs were lost.
- 15 financial institutions failed.

Constitutional Budget Reserve Fund and its Role

When oil prices declined more modestly in the mid-1990s, the impact was partially mitigated by the existence of a special savings account, the Constitutional Budget Reserve. Voters created the reserve fund in 1990 as a fund into which settlements on oil and gas disputed taxes were to be deposited. It has been used by the State to cover revenue shortfalls in the budget. The CBRF has received about \$5.6 billion in deposits, earning about \$1.9 billion in revenues, and been drawn down by \$5.1 billion, for a balance of \$2.5 billion³³. The State has drawn upon the CBRF 12 times since its inception. These withdrawals allowed the State to continue spending money and supporting the economy even though the price of oil was low. However, the State has not been active in repaying the balance of the CBRF for future use. Though it is constitutionally mandated to repay the CBRF, the most recent Legislature passed a budget that deposits only \$50 million into the CBRF, despite record level oil prices.

Permanent Fund Earnings

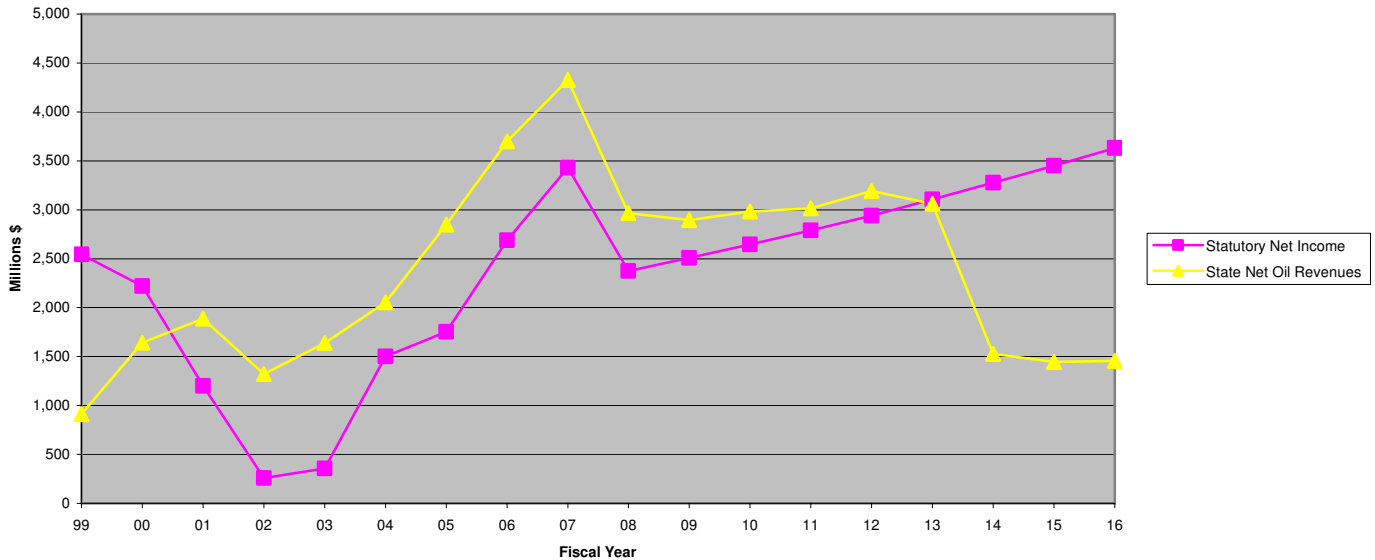
From FY 1996 through FY 2000, the Permanent Fund produced higher earnings than oil. Higher oil prices in the beginning of the new century, combined with the stock market slump reversed that trend. However, that scenario is expected to re-emerge in the next decade, as illustrated in the chart on the next page.

The Permanent Fund's 2007 "Fund Financial History and Projection", available on their website, presents the history of earnings, appropriations, deposits and income. From 1977-2007, the Permanent Fund earned about \$35 billion in statutory net income. From 2008-2018 the Permanent Fund Corporation projects statutory net income to total about \$35 billion. Though this number is a little misleading due to inflation, it is, nonetheless, telling. The size of the Fund is increasing its ability to generate income. Though the Legislature is committed to fully inflation-proofing the Fund, there have been no additional appropriations from the Earnings Reserve Account into principal in recent years.

³² Memorandum from Brad Pierce, Senior Analyst, OMB to Cheryl Frasca, Director, OMB, 1/14/04.

³³ From Spring 2007 Revenue Sources book and Annual Report on the Constitutional Budget Reserve Fund; April 2, 2007.

Net Oil Revenues vs. PF Fund Income



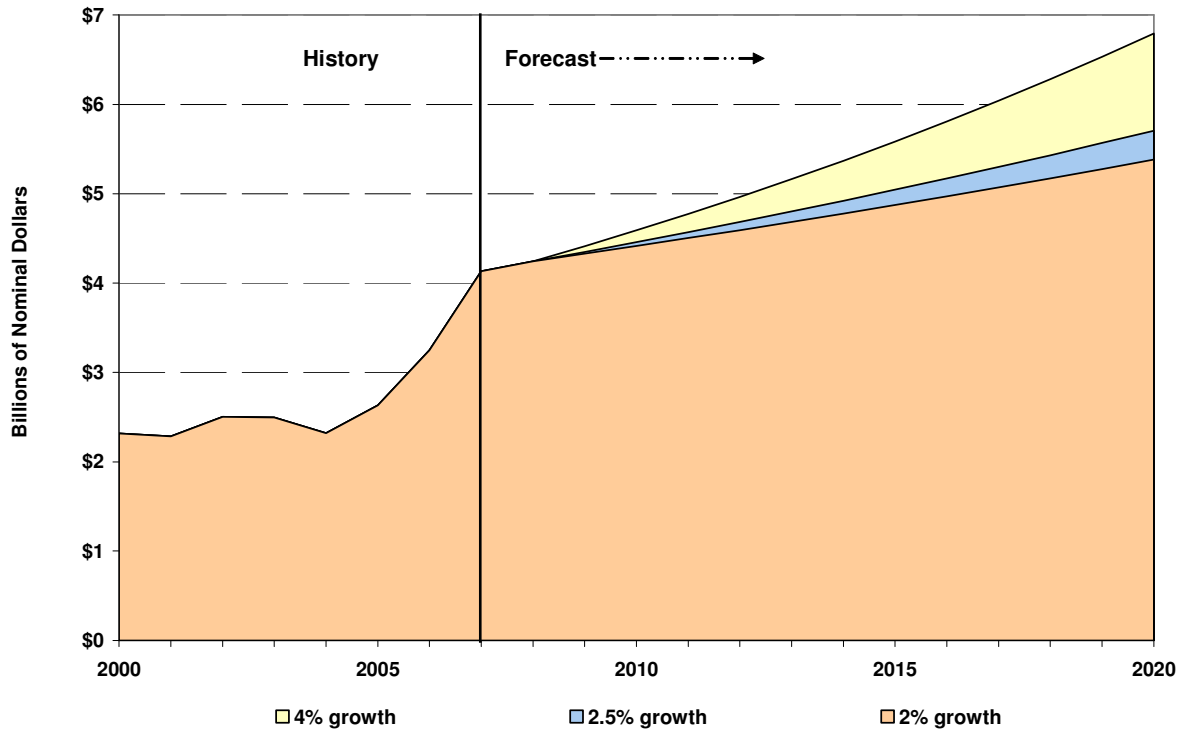
Source: Spring 2007 Revenue Sources Book, Alaska Permanent Fund: Fund Financial History & Projections As of June 30, 2006.

The genius of the Permanent Fund is that it transforms non-renewable royalties into renewable earnings on principal. Constitutionally, 25% of royalty flows into the Permanent Fund, and until 2003, 50% of royalty from newer fields were statutorily routed there. Many—most prominently, Roger Cremo—have suggested that the State could escape the volatility of basing its budget on the fluctuating annual price and volume were 100% of oil revenues dedicated to the Permanent Fund. Cremo suggests this proposal provides stability and fiscal discipline by limiting state expenditure of oil revenues in periods of high oil revenues, and provides for a consistent level of payout of funds from the Permanent Fund. He further says it would resolve questions of intergenerational equity by allowing future generations the same opportunity to make spending decisions as the generation that extracts the non-renewable oil.

4. State General Fund Spending Charts

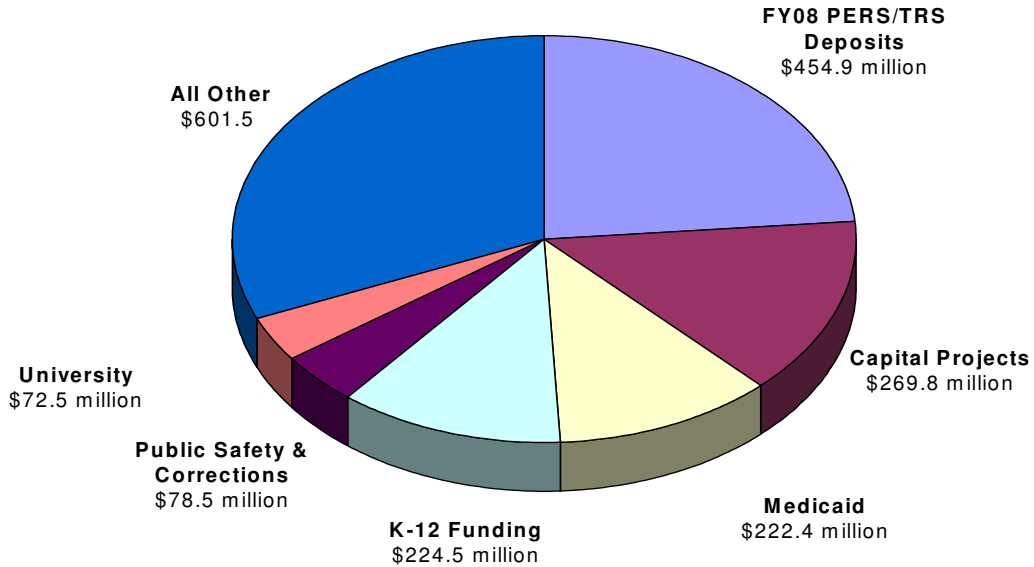
(Presented by Commissioner of Revenue Pat Galvin and Office of Management and Budget Director Karen Rehfeld, on July 25, 2007 at a CWN Forum)

**Historical and Forecasted State Budget Appropriations
FY 2000 to FY 2020**



What's Driving GF Spending Increases?

Amount of GF change from FY 04 to FY 08



5. New Mexico and Texas Funds

New Mexico

The New Mexico State Investment Council (SIC) deserves special attention since it is one of the largest state run endowment funds and closest of any U.S. Fund in purpose and function to the Alaska Permanent Fund.

It is run by a nine person board, five of whom are state officials, including the governor and four public members appointed by the governor. The executive head of the agency, the state investment officer, is one of the board members and is appointed by the governor and confirmed by the state senate. The current state investment officer Gary Bland, was previously vice president of trust investments at the Boeing Company. The public members, include the chief financial officer for the University of New Mexico, an equities portfolio manager, a venture capitalist and a real estate entrepreneur.

Until recently the SIC was under a "legal list" of various restrictions regarding alternative investments, which severely limited the alternative asset class types and/or amounts in which we and the state pensions could invest. In 2005, Governor Bill Richardson signed a bill allowing the SIC to govern their investments under the Uniform Prudent Investor Act, and diversify into alternatives including hedge funds, real estate, and private equity among others.

On June 30, 2006, the investment officer managed 35 trust accounts with the assets totaling \$13.6 billion. By March 31, 2007, total assets had grown to \$15.1 billion. The two largest funds managed, the Land Grant Permanent Fund and Severance Tax Permanent Fund, account for all but a small portion of total assets under management. These two funds pay out 5.8 and 4.7 percent respectively, of each fund's five-year rolling average, pursuant to the state constitution. The payout is spent for state purposes, primarily for education. The Land Grant Fund's payout will scale down to 5% over the next decade. The FY 2006 pay out of \$600 million amounted to nearly 15 percent of the State's operating budget.

On March 31, 2007, the SIC held \$1.4 billion in hedge funds. The State Investment Officer's letter states that under newly granted authority the ". . . fund moved forward with a bold but important diversification into the fund of hedge funds field . . . it anticipates return in excess of treasury bills plus 200 basic points with low volatility in mind." (2006 Annual Report).

Also, on March 31, 2007, the SIC held \$780 million in private equity. In 2002 private equity was \$323 million and in 1997 it was approximately \$20 million. One year returns were 24 percent, two years 17.5 percent and three years 14.8 percent. The annual report also states as that of the end of fiscal year 2006 the SIC had outstanding equity commitments of \$1.7 billion with actual invested capital of \$803 million. There is an "invest in New Mexico" component to the private equity allocation and a separate equity

advisory board. Commitments in that program were more than \$200 million as of March 31, 2007.

The annual report states that the "SIC's private equity program has performed extremely well since the first investment was made in November 1988" and that total returns have exceeded those from all other investments" (12). It appears that the combined hedge fund and private equity allocation is in the neighborhood of 14 percent of total assets.

Texas

The Texas Public School Fund is an endowment totaling \$23.9 billion supporting K-12 education. Under a 2003 constitutional amendment, the fund annually distributes 4.5 percent of its trailing 4 years average market value. This may be exceeded up to 6 percent by two-thirds vote of the legislature. The 2006 distribution was \$842 million amounting to 3 to 4 percent of Texas local school district expenditures. The fund also has a very successful local school board guaranty function (\$63.24 billion of school bonds guaranteed).

Fund portfolios are all indexed except for the fixed income portion, which is staff invested. The fund recently determined on a 25 percent allocation to alternative investments but has not as yet started any searches. The fund is now invested 75 percent in fixed income.

Its rates of return:

Year ending June 30, 2006	10.44
3 year	11.72
5 year	7.54

The 15-member State Board of Education oversees the fund through a five-member investment committee who participate in extensive education sessions. Source: telephone interview on May 29, 2007 with Executive Director Holland Timmons and Annual Report 2006.

A smaller sister Texas fund, the \$8.4 billion Texas University Fund, is an endowment fund established to fund Texas higher education. For 2006 it distributed \$400.6 million, which amounted to 4.74 percent of the fund average market value over the 3 years preceding February 2006. Under the state constitution, it cannot distribute more than seven percent of market value.

Its asset allocation policy includes the following:

Venture Capital	4 percent
Private Equity	11 percent
Directional Hedge Funds	10 percent
Absolute Return Hedge Funds	5 percent

The Texas University Fund is managed by a non-profit private investment management company (UTIMCO) with board of regents membership. There has been public controversy over UTIMCO management issues.

6. The Alaska Permanent Fund: A Chronology (Prepared by CWN Study Group Member Arden Page)

Volume V of the “Trustee’s papers”, found on the Alaska Permanent Fund Corporation web site, <http://www.apfc.org/reportspublications/tp5.cfm>, is devoted to “THE EARLY HISTORY OF THE PERMANENT FUND: Perspectives on the Origins of Alaska’s Oil Savings Account histories of the Fund.” Two papers are particularly valuable in outlining the history of the Fund and the debate surrounding its form and uses. One paper, entitled “The Creation of the Alaska Permanent Fund: A Short History,” is found at <http://www.apfc.org/reportspublications/TP5-2.cfm>. A second, entitled “Alaska’s Permanent Fund: Legislative History, Intent and Operations,” is found at <http://www.apfc.org/reportspublications/TP5-4.cfm>.

1968. Alaska population 284,880. Alaska oil production 181,233 bbl/day. State Unrestricted General Fund Appropriations \$113,000,000. Prudhoe Bay discovery well drilled in January by Atlantic Richfield.

1969. Alaska population 294,560. Alaska oil production 203,803 bbl/day. State Unrestricted General Fund Appropriations \$128,000,000. September 10 North Slope lease sale generates \$900 million in high bonus bids.

In an October address to the Alaska State Chamber of Commerce Mr. Robert Kranz of Kidder Peabody & Company advocated for the creation of a capital fund for the future development of Alaska, the principal of which would be kept intact and the income from which would be available to the Legislature.

1970. Alaska population 302,361. Alaska oil production 230,532 bbl/day. State Unrestricted General Fund Appropriations \$172,000,000. Revenue from the 1969 lease sale boosts general fund revenue to \$1,067,264,000.

Gov. Keith Miller introduces legislation to establish a resources permanent fund, which passes the Senate but fails in the House.

1971. Alaska population 319,600. Alaska oil production 217,793 bbl/day. State Unrestricted General Fund Appropriations \$310,000,000.

1972. Alaska population 329,800. Alaska oil production 203,206 bbl/day. State Unrestricted General Fund Appropriations \$310,000,000.

1973. Alaska population 336,400. Alaska oil production 202,606 bbl/day. State Unrestricted General Fund Appropriations \$342,000,000. TAPS authorization legislation passed by Congress.

1974. Alaska population 348,100. Alaska oil production 200,100 bbl/day. State Unrestricted General Fund Appropriations \$370,000,000. TAPS construction begins.

1975. Alaska population 384,100. Alaska oil production 199,302 bbl/day. State Fund Appropriations \$608,506,300.

First permanent fund legislation is passed by the Alaska legislature (CSHB 324 am S). The fund would be created by the dedication of 50% of mineral lease bonuses

realized at competitive lease sales, the fund principal to be used as investment capital by Alaska residents. Income from the fund could be reinvested in the fund, used for administration of the fund or appropriated for State operating or capital expenses. The bill was vetoed by Gov. Jay Hammond, citing potential unconstitutionality as dedicated fund legislation.

1976. Alaska population 409,800. Alaska oil production 185,696 bbl/day. State Fund Appropriations \$726,657,100.

Gov. Hammond proposes a constitutional amendment dedicating 10% of mineral revenues, including mineral taxes, to a permanent fund. The proposed revenue stream was amended by the legislature to be at least 25% of mineral revenues, excluding taxes, and was put to a vote of the people. Article IX, Section 15 of the Constitution of Alaska approved by a vote of 75,588 to 38,518 at the November general election. The section provides: § 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.

Unresolved by the Constitutional amendment were the questions of:

- management structure,
- allowable investments and
- use of earnings.

Public opinion at the inception of the fund favored the use of the fund for economic development by a factor of 4 to 1 (Dittman, 1976), a view strongly shared by the business community which considered the proper use of the fund to be a development bank, utilizing both principal and earnings.

Debate of these issues continued for the following four years, particularly concerning objectives of the fund, categorized as:

- Social (Equalizing income differentials of individuals and regions);
- Economic (Promoting economic diversification and development); and
- Fiscal (A State savings account for governmental expenses).

1977. Alaska population 418,000. Alaska oil production 471,814 bbl/day. State Fund Appropriations \$782,364,500. First barrel of oil transported through TAPS reaches Valdez. First deposit to the Alaska Permanent Fund, \$734,000.

“Economic Considerations in Establishment of Alaska’s Permanent Fund,” by Arlon R. Tussing published by ISER.

1978. Alaska population 411,600. Alaska oil production 846,000 bbl/day. State Fund Appropriations \$928,467,600.

“Permanent Fund and Growth of Alaska Economy: Selected Studies” by Scott Goldsmith, Lee Gorsuch, Lee Huskey, et al. published by ISER.

1979. Alaska population 413,700. Alaska oil production 1,327,000 bbl/day. State Fund Appropriations \$1,206,252,300.

1980. Alaska population 419,800. Alaska oil production 1,531,000 bbl/day. State Fund Appropriations \$1,886,637,000. Alaska’s personal income tax is repealed.

After four years of consultation and debate, the Alaska Legislature answered the questions regarding management, investment and use by:

- Creating the Alaska Permanent Fund Corporation as a public trust, directed by a Board of Trustees charged with following the Prudent Investor Rule in investing in designated types of investments, and,
- Establishing the Permanent Fund Dividend program, the first dividend being \$50 multiplied by the number of an individual’s years of residence since statehood in 1959, subsequently declared unconstitutional by the Supreme Court of the United States. A rationale for a dividend graduated by duration of residence was to limit immigration to the State by persons seeking the dividend.

The legislature makes a \$900 million special appropriation to the Permanent Fund, the amount representing the amount received in bonus bids in the 1969 lease sale, and increased the Permanent Fund’s share of royalties from 25% to 50% for lands leased after 1979.

Commonwealth North study group issues its report in December, “Alaska's Golden Opportunity: Resource Revenues and State Spending, An analysis of the best ways to invest Alaska's resource revenues for the long-term benefit of the state.” Its recommendations:

<http://www.commonwealthnorth.org/studies/recommend3.html>

1. The State needs to draft a 5-6 year Capital Improvement Plan and publish a series of projections illustrating anticipated growth in both state revenues and expenditures.
2. Tax credits should be established for the purpose of encouraging business reinvestment in Alaska.
3. The growth of state and local government operating budgets should be tied to the annual non-government work force.
4. An Alaska Investment Fund should be established to finance large, self-liquidating projects.
5. State loan programs should be strictly limited and contain a provision for independent audit systems.
6. The Permanent Fund should be invested in appreciable assets so that its income will keep pace with inflation.

1981. Alaska population 434,300. Alaska oil production 1,604,000 bbl/day. State Fund Appropriations \$4,259,091,500. The Alaska Legislature makes a second special appropriation to the Permanent Fund, \$1.8 billion.

Having lost on the issue of the use of the Permanent Fund as a development bank, business interests still wished to advance the concept. In June 1981 Commonwealth North issued a study paper, “Investing in Alaska's Future: The Capital Investment Fund.” Its recommendations:

<http://www.commonwealthnorth.org/studies/recommend5.html>

1. Create an "Alaska Capital Investment Fund" whose aim is to channel a portion of current revenues into the financing of Alaska's economic infrastructure.
 2. The Fund will insure that Alaskans have inflation-proof energy and vital transportation links.
 3. The Fund will represent an investment in the future as does the Permanent Fund, but the Capital Investment Fund's dollars will be mandated to be invested in the state.
 4. The "dividends" of the Fund will be new jobs, new services and economic security.
- “Three Basic Policy Questions Concerning the Permanent Fund” by Scott Goldsmith published by ISER.

1982. Alaska population 464,300. Alaska oil production 1,650,000 bbl/day. Oil trades at \$34 per barrel. State Fund Appropriations \$6,056,451,400.

At the request of the Permanent Fund Board of Trustees, the Alaska Legislature passes legislation to inflation-proof the Permanent Fund. The legislature authorizes the Trustees to invest a portion of the fund in U.S common stocks and equity real estate. The first Permanent Fund dividend of \$1,000 is distributed commencing on June 14.

1983. Alaska population 499,100. Alaska oil production 1,700,000 bbl/day. Oil prices drop. State Fund Appropriations \$2,919,162,600.

1984. Alaska population 524,000. Alaska oil production 1,723,000 bbl/day. State Fund Appropriations \$3,257,847,400. Permanent Fund assets reach \$5 billion.

“Future of the Alaska Economy and the Role of the Permanent Fund” by Scott Goldsmith published by ISER.

“Alaska’s Permanent Fund Dividend Program: Economic Effects and Public Attitudes” by Gunnar Knapp, Scott Goldsmith, John Kruse and Greg Erickson published by ISER.

1985. Alaska population 543,900. Alaska oil production 1,750,000 bbl/day. State Fund Appropriations \$3,955,662,000.

Commonwealth North issued a study group report, “Compass North - Five Challenges for Alaska.” Its recommendations:

<http://www.commonwealthnorth.org/studies/recommend10.html>

1. Alaska's ownership revenues should be divided equally between the Permanent Fund and a new capital investment fund.
2. The legislature should enact legislation which establishes long-term goals for the Permanent Fund.
3. Current spending must be reduced to levels that can be sustained in the future.
4. The state government must refrain from using its wealth to usurp local decisions or displace local responsibility.
5. Alaska's statehood lands and resources should be managed as capital assets.
6. The governor should forge the resource development strategy necessary to enact legislative policy.
7. The state should determine its role as an investor in the development of Alaska's resources.

“Spending Strategy for Fiscal Stability: Resetting the Spending Limit and Planning Use of the Permanent Fund” by Scott Goldsmith published by ISER.

1986. Alaska population 550,700. Alaska oil production 1,847,000 bbl/day. ANS crude trades below \$10 per barrel. State Fund Appropriations \$3,094,577,000. Alaska Legislature passes a third special appropriation to the Permanent Fund, \$1.26 billion.

Commonwealth North issues “Alaska's Budget Crisis: Facing the Facts -- Closing the Gap.” As reported on the Commonwealth North web site, “A special task force on the state budget was charged by Commonwealth North directors to review and make recommendations as to how to address the State of Alaska's immediate budget gap and to address issues concerning the general direction and philosophy of state spending.” The body of the report is not available on the web site.

Between 1985 and 1988 the Alaska economy suffered through a severe recession that coincided with the fall in oil prices and a reduction in State spending, particularly capital spending. Among the effects of that recession:

- Statewide, job losses totaled 22,000 (10%).
- Anchorage experienced a population loss of 29,000 residents (9%).
- Statewide, wage income losses totaled \$1.07 billion (13%).
- Anchorage assessed property values declined \$7.2 billion (46%).
- From January 1985 through March 1988, 10,429 residential properties (7%) went into foreclosure.
- Anchorage bankruptcies averaged 93 per month.

1987. Alaska population 541,300. Alaska oil production 1,906,000 bbl/day. State Fund Appropriations \$2,792,190,400.

“Comparative Analysis of the Economic Effects of Reimposing Personal Income Tax, Reducing Permanent Fund Dividends, or Reducing State Spending” by Scott Goldsmith published by ISER.

1988. Alaska population 535,000. Alaska oil production 2,049,000 bbl/day. State Fund Appropriations \$2,658,345,500.

Commonwealth North issues its study group report, “Using the Permanent Fund as a Positive Counter-cyclical Force in the Alaskan Economy.” Its recommendations:

(<http://www.commonwealthnorth.org/studies/recommend11.html>)

1. Permanent Fund earnings should be used as a positive counter-cyclical force in the Alaskan economy.
2. Fund earnings should be appropriated directly to municipalities on a per-capita basis as needed.
3. The Legislature should create an Alaska Development Board which will research and recommend to the Legislature major revenue generating in-state investments to expand and diversify the state's economy.
4. The Legislature should establish an Alaska Development Fund by using a portion of the PF's Earnings Reserve Account.
5. The Permanent Fund Dividend should be capped.
6. Use of the Fund's earnings to "inflation-proof" the Fund should be in proportion to the health of the state's economy.

7. The Fund's earnings should be used for state government operations only in dire emergencies.
8. Strategies for using Fund earnings should be written in statute.

1989. Alaska population 538,900. Alaska oil production 2,005,000 bbl/day. State Fund Appropriations \$2,613,678,700. The Legislature authorizes the Trustees to invest in non-U.S. securities. Permanent Fund assets reach \$10 billion.

“Five Observations on the Permanent Fund” by Scott Goldsmith published by ISER.

“Economic Impacts of Alaska’s Permanent Fund” by Scott Goldsmith published by ISER.

1990. Alaska population 553,171. Alaska oil production 1,879,000 bbl/day. State Fund Appropriations \$2,696,440,200. Constitutional Budget Reserve adopted.

§ 17. Budget Reserve Fund

(a) There is established as a separate fund in the State treasury the budget reserve fund. Except for money deposited into the permanent fund under section 15 of this article, all money received by the State after July 1, 1990, as a result of the termination, through settlement or otherwise, of an administrative proceeding or of litigation in a State or federal court involving mineral lease bonuses, rentals, royalties, royalty sale proceeds, federal mineral revenue sharing payments or bonuses, or involving taxes imposed on mineral income, production, or property, shall be deposited in the budget reserve fund. Money in the budget reserve fund shall be invested so as to yield competitive market rates to the fund. Income of the fund shall be retained in the fund. section 7 of this article does not apply to deposits made to the fund under this subsection. Money may be appropriated from the fund only as authorized under (b) or (c) of this section.

(b) If the amount available for appropriation for a fiscal year is less than the amount appropriated for the previous fiscal year, an appropriation may be made from the budget reserve fund. However, the amount appropriated from the fund under this subsection may not exceed the amount necessary, when added to other funds available for appropriation, to provide for total appropriations equal to the amount of appropriations made in the previous calendar year for the previous fiscal year.

(c) An appropriation from the budget reserve fund may be made for any public purpose upon affirmative vote of three-fourths of the members of each house of the legislature.

(d) If an appropriation is made from the budget reserve fund, until the amount appropriated is repaid, the amount of money in the general fund available for appropriation at the end of each succeeding fiscal year shall be deposited in the budget reserve fund. The legislature shall implement this subsection by law. [Amended 1990]

1991. Alaska population 569,054. Alaska oil production 1,834,000 bbl/day. State Fund Appropriations \$3,147,995,900.

1992. Alaska population 586,722. Alaska oil production 1,825,000.bbl/day. State Fund Appropriations \$3,174,425,400.

“Safe Landing: A Fiscal Strategy for the 1990” by Scott Goldsmith is published by ISER. (<http://www.iser.uaa.alaska.edu/publications/formal/fppapers/fpp7.pdf>)

1993. Alaska population 596,906. Alaska oil production 1,719,000 bbl/day. State Fund Appropriations \$3,049,534,300.

In October, Commonwealth North issues its study group report, “Commonwealth North Budget Conference: Closing the Gap.” Its recommendations:

(<http://www.commonwealthnorth.org/studies/recommend20.html>)

1. All reserves and natural resource revenues should be deposited in the Permanent Fund from which a fixed percentage would be allocated for expenditure each year to maintain a stable and predictable economy (Cremo plan).
2. To reduce spending, two mechanisms are proposed: a forced ratcheting down of spending and the creation of a commission to make budget recommendations.

1994. Alaska population 600,622. Alaska oil production 1,632,000 bbl/day. State Fund Appropriations \$3,595,016,300.

Commonwealth North issues study group report, “Breaking the Fall: Budget Recommendations for Alaska.” Its recommendations:

(<http://www.commonwealthnorth.org/studies/recommend23.html>)

1. Freeze the operating budget and hold future budgets below inflation.
2. Increase taxes including a personal income tax.
3. Create an Alaska Finance Commission to produce a 4-year plan.
4. Encourage increased oil and gas exploration and development.
5. Establish a consolidated account for existing reserves with restrictive access provisions.

1995. Alaska population 601,581. Alaska oil production 1,614,000 bbl/day. State Fund Appropriations \$3,004,489,300.

Legislatively sponsored Long Range Fiscal Planning Commission proposed a cap on dividends and a set of excise taxes. No action was taken on the suggestions.

1996. Alaska population 605,212. Alaska oil production 1,516,000 bbl/day. State Fund Appropriations \$3,139,446,400.

1997. Alaska population 609,655. Alaska oil production 1,440,000 bbl/day. State Fund Appropriations \$3,118,828,500. Permanent Fund assets exceed \$22 billion. Legislature appropriates another \$803 million to the Fund principal.

The Alaska Humanities Forum sponsored a “Principals & Interests” project to consider the Fund. A two-day conference was held on November 21 & 22, 1997, followed by 100 facilitated discussions in 41 communities and schools around the state, concluding with a two hour call-in program in June, 1998. Six options were presented to participants in the meetings: Leave it Alone, Create Separate Funds, Create a Community Dividend, Spend Some of the Income, Invest It in Alaska, and Privatize It.

“Permanent Fund Policy Questions and Informal Review of Proposals for Change” by Scott Goldsmith published by ISER.

1998. Alaska population 617,082. Alaska oil production 1,306,000 bbl/day. State Fund Appropriations \$3,118,590,800. Fund assets exceed \$25 billion.

1999. Alaska population 622,000. Alaska oil production 1,202,000 bbl/day. State Unrestricted General Fund Appropriations \$3,226,645,800. Permanent Fund assets exceed \$26 billion. Legislature authorizes the Trustees to invest up to 5% of fund value in alternative investments.

In April, seven House members propose “The All-Alaskan Plan,” an endowment plan utilizing the Permanent Fund, State enterprises and some tax proceeds to fund State needs. (<http://www.akrepublicans.org/pastlegs/PhillipsG.htm>)

In May 1999, Commonwealth North issued a study group report, “Permanent Fund Earnings--Phase II: A Cornerstone for Fiscal Certainty.” Its recommendations: (<http://www.commonwealthnorth.org/studies/recommend27.html>)

1. Add unrealized gains, realized gains and a portion of the earnings reserve account into the corpus of the PF.
2. Define earnings as 5% of the five-year trailing average of the total value of the PF.
3. Use 40% of earnings to continue the PFD.
4. Use 30% of earnings to support state government.
5. Use 20% for a Community Dividend Plan.
6. Use 10% for statewide capital expenditures.

Alaska Humanities Forum organizes two-day December conference in Girdwood which recommends the formation of Alaska 20/20, a “process” to engage the public in a dialogue “to learn what Alaskan’s value now, and what they want for our State and its people over the next 20 years.”

<http://www.commonwealthnorth.org/studygroup/alaska2020.html>

In a September vote, a proposal to utilize Permanent Fund earnings in excess of those funds needed to pay dividends and to inflation-proof the Fund for the purpose of paying for essential state services was voted down by a margin of 16% for and 84% against.

2000. Alaska population 627,500. Alaska oil production 1,073,000 bbl/day. State Fund Appropriations \$3,063,493,800.

2001. Alaska population 632,249. Alaska oil production 1,020,000 bbl/day. State Fund Appropriations \$3,544,896,600. At the request of the Trustees, legislation is introduced that would propose to the voters a constitutional amendment limiting spending to 5% of market value (POMV).

“The Alaska Permanent Fund Dividend Program” by Scott Goldsmith published by ISER.

“Reflections on the Surplus Economy and the Alaska Permanent Fund” by Scott Goldsmith published by ISER.

2002. Alaska population 640,699. Alaska oil production 1,036,000 bbl/day. State Fund Appropriations \$3,637,625,400.

2003. Alaska population 648,510. Alaska oil production 1,020,000 bbl/day. State Fund Appropriations \$3,512,238,700.

2004. Alaska population 657,755. Alaska oil production 1,004,000 bbl/day. State Fund Appropriations \$3,891,662,200.

The Conference of Alaskans. On February 10-12, 2004, was convened in Fairbanks to consider and respond to four questions raised by Gov. Frank Murkowski. The questions, the answers of the Conference, and related documents can be viewed at: <http://www.alaskalegislature.com/stories/021304/conference.shtml>.

1. Should the use of income from the Permanent Fund be limited by the Constitution to 5% of the Fund's value, as the Permanent Fund Trustees have proposed?

Yes. We must inflation-proof the Permanent Fund in order to keep it and the Permanent Fund Dividends (PFDs) from evaporating away in the future. The "percent of market value" (POMV), as suggested by the trustees will put inflation-proofing into the Constitution, instead of leaving it to the Legislature's discretion. POMV is a technical change in determining how much money from the Fund is available, but it has nothing directly to do with the choice of using it for Dividends or spending it on anything else. That's the next question.

2. Should a portion of the income of the Permanent Fund be used for essential state services, such as education?

Our answer here is "yes, but..." There are two conditions to our endorsement. One, dividends must be paid out first under POMV. Only what's left over could be used for essential state services. Two, the delegates to the Conference of Alaskans recommend that the governor and legislature take action to balance the State's revenues and expenditures, including, but not limited to, consideration of a personal income tax, other broad-based taxes and other alternative sources of income.

3. Should the use of the income of the Permanent Fund for dividends and possibly for other purposes be determined annually by the Legislature, as is currently the case? Or, should it be dedicated in the Constitution?

A reasonable percentage of the Permanent Fund money available under POMV should be constitutionally dedicated to PFDs in order to make them "permanent" like the Fund itself. All other uses of the remaining Permanent Fund money should be left for the Legislature to appropriate, since it is impossible for this generation to predict what the needs will be for the next.

4. Should the State maintain a minimum balance in the Constitutional Budget Reserve to stabilize state finances against fluctuations in oil production or prices?

Yes, a prudent amount should be in reserve at all times, for two reasons. We can't afford to send home all the police, firefighters, teachers or other critical personnel because the state treasury is empty, due to something unforeseen. It is critical that a prudent amount be retained in a Constitutional Budget Reserve (CBR) to stabilize state finances against

fluctuations in oil production or prices. This is necessary to maintain the State's very good credit-rating, which will save millions of dollars in the future. Therefore, if oil production is interrupted or prices fall, so that we need to draw the CBR below the prudent balance, the State needs a plan to refill it back to that level as soon as possible.

2005. Alaska population 663,661. Alaska oil production 936,000 bbl/day. State Fund Appropriations \$4,237,200,000. Legislature changes the guideline for allowable investments from the Prudent Investor Rule with a list of allowable investments to pure Prudent Investor Rule.

2006. Alaska population 669,997. Alaska oil production 863,000 bbl/day. State Fund Appropriations \$5,824,800,000.

2007. Alaska Population 677,362. State Fund Appropriations \$5,188,500,000.

7. Articles and other information available on the Commonwealth North web site
(www.commonwealthnorth.org)

- Fiduciary Obligations (Investor Solutions, Inc.)
- Uniform Prudent Investor Act (National Conference of Commissioners on Uniform State Laws)
- Alaska State Legislature: Bills and Resolutions Regarding the Permanent Fund (Compiled by Chris Kolerok)
- Commissions, Committees, Councils, Task Forces and Other Groups Addressing Alaska's Fiscal Policy (Legislative Research, January 2002)
- Alberta Heritage Fund vs. Alaska Permanent Fund: A Comparative Analysis (Allan A. Warrick and Russell R. Keddie, University of Alberta)

The Study Group expresses its sincere appreciation to the following individuals who shared their expertise and time with us.

<u>Date</u> (All in 2007)	<u>Speakers to Study Group and CWN Membership</u>
May 2	Michael Burns, Executive Director, Alaska Permanent Fund Corp.
May 10	Brian Rogers, Information Insights
May 16	Margaret King, Resource Solutions, University of Alaska, Anchorage
May 23	Dave Dittman, Dittman Research Corporation
May 30	Maria Tsu, Dave Stewart, Rick Schafer, Staff and Consultants, Alaska Permanent Fund Corp.
May 31	Michael O’Leary, Callan Associates and consultant to Alaska Permanent Fund Corp., and Michael Burns, Executive Director, Alaska Permanent Fund Corp.
June 13	Gary Bader, Chief Investment Officer, Alaska Department of Revenue, Treasury Division
June 20	Robert Maynard, CIO Idaho Public Employees Retirement System and advisor to the Permanent Fund (by telephone)
July 11	Michael Williams, Chief Economist, Alaska Department of Revenue
July 18	Scott Goldsmith, Professor of Economics, Institute of Social and Economic Research, University of Alaska, Anchorage
July 25	Nelson Page, Attorney, Burr Pease and Kurtz, on the Alaska Mental Health Trust Fund
July 25	Pat Galvin, Commissioner of Revenue, and Karen Rehfeld, Director Office of Management and Budget

Special thanks to Joe Beedle and Northrim Bank for their hospitality in hosting our early morning study group meetings.

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