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Winter 2011

Two Memoirs Tell the History of the Alaska Dividend

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Two Memoirs Tell the History of the Alaska Dividend

Citizen's Income Newsletter, Issue 2, 2011

Rose, Dave and Charles Wohlforth. 2008. *Saving For the Future: My Life and the Alaska Permanent Fund*. Kenmore, WA: Epicenter Press.

Hammond, Jay S. 1994. *Tales of Alaska's Bush Rat Governor*. Kenmore, WA: Epicenter Press.

A Review Essay by
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Alaska's Permanent Fund Dividend is closer to a basic income than almost any other policy in the world today. The lessons of how it was created and how it became so popular and successful are extremely important to the basic income movement. Two autobiographies available now tell different parts of the story of the Alaska Dividend. One is by Jay Hammond, the governor who, more than anyone else, is responsible for creating the fund and dividend. The other is by Dave Rose, the first executive director of the Alaska Permanent Fund Corporation.

Each book tells the story of its author's life. These stories are interesting in their own right, reflecting the experience of many latter-day pioneers who came to Alaska from the lower 48 states before or in the early years of statehood. Hammond moved to Alaska after being a World War II pilot, and he lived the Alaskan experience as a "bush" pilot, a wilderness guide, a homesteader, a legislator, a small-town Borough President, and governor. Followers of current U.S. politics will be interested to know that Sarah Palin took the name of her television show from "Jay Hammond's Alaska," which ran for seven years in the late 1980s and early 1990s.

But followers of the basic income movement will be most interested in the inside accounts of how the Alaska Dividend was created and became the sound and solidly supported program that exists today. Although the Alaska Permanent Fund (APF) is the source of revenue for the Permanent Fund Dividend (PFD), many non-Alaskans are unaware that the two are different programs created at different times by different kinds of legislation.

The events leading up to the creation of the fund began in 1955 when Alaska called a constitutional convention in advance of statehood. The constitution that was finally adopted proclaims that all the natural resources of Alaska belong to the state for the benefit of the people.

One of the most important events toward the development of the fund and dividend happened quietly in an office in Juneau in 1963. At that time, negotiations with the federal government over which lands would be transferred to full state ownership and which would remain federally owned had dragged on for several years. A geologist named Tom Marshall (according to Hammond) and/or the commissioner of natural resources, Phil Holdsworth (according to Rose), persuaded then-governor Bill Egan that there might be oil in far-northern Alaska. Egan then finished the land negotiations with the federal government by agreeing to take a "large, barren and

unpopulated wasteland on Alaska's Arctic Slope, near remote Prudhoe Bay." In 1967, oil was discovered under that barren, unpopulated wasteland.

Jay Hammond was elected governor in 1974, when, he says, "the scent of anticipated oil revenues wafted like musk in the halls of the state legislature." Hammond was possessed with the idea of putting as much of that money as possible into a permanent fund that would pay dividends to Alaskans. The concept had been with him for a long time. Years earlier, as mayor of the small municipality of Bristol Bay Borough he had tried unsuccessfully to create a similar program at the local level using fisheries revenue.

Hammond had many reasons for favoring the fund and dividend. He thought that the temporary windfall should be saved rather than spent as it came in. He was afraid that the government would waste the windfall on poorly designed programs or projects that would benefit only special interests or favored constituents. He wanted to make sure that every Alaskan would benefit from their jointly owned oil resources. And he hoped the dividend would help the poor.

After reading his book and speaking to him at the 2005 USBIG Congress, I still cannot say for sure how this idea came to Hammond and how he came to be so obsessed by it. He appears to have been influenced by the guaranteed income movement of the 1960s, but this does not fully explain where he got the idea for a state-owned fund paying dividends to all citizens.

Although Hammond was not the only person responsible for the creation of the fund and dividend it is clear that it would not have happened without his single-minded pursuit of it for his entire eight years as governor. He made it his top priority. It was the object seemingly of every budget compromise he made from 1974 to 1982. Largely the existence of the Alaska Dividend owes to the right person being in the right office at the right time.

The time was right not only because money was beginning to flow, but also because of public perception. Five years before he took office, in 1969, the state government had received an initial windfall of \$900 million (six times the size of the state budget at that time) from the sale of leases for the right to drill. Some people at the time, including then-governor Keith Miller, argued that the state should invest the money and spend only the interest. But by 1974 all of that money was gone, and there was a widespread (if exaggerated) belief that most of it had been wasted. Thus, there was strong support for saving at least part of the expected oil windfall when Hammond began discussing the ideas of a fund and a dividend with the legislature.

In 1976, after a series of compromises, Alaskans passed an amendment to the state constitution dedicating at least 25 percent of each year's oil royalties to the new APF. It was a fraction of what Hammond wanted. Although he discussed many different figures, he at one time had hopes of dedicating *50 percent* of *all* oil revenue to the fund. Royalties make up only about half of the state's oil revenues. Therefore, the APF is only one-fourth as large as Hammond had wanted.

The biggest missing piece, from Hammond's perspective, was the dividend. There was no mention of it in the amendment, which simply states that at least a minimum amount of certain kinds of mineral revenue would go into a fund of "income producing investments." It did not specify what these investments should be or how the returns would be used. Although these omissions were a disappointment to Hammond, according to Rose, the vagueness of the APF amendment was instrumental to its passage. It drew support from diverse groups that would not all have supported a more clearly defined plan dedicating the returns to a dividend or anything else.

By both Rose and Hammond's account the dividend proposal was not popular with the public or with members of the legislature when Hammond started pushing for it in the late 1970s. The dividend got through thanks both to the strength of the governor's office and to a long series of compromises made by a few dedicated legislators.

After a court challenge about how dividends were to be distributed, the final version of the dividend bill was passed and went into affect in 1982. It dedicated roughly half of the APF's returns to the PFD. Unlike the fund itself, the dividend is not protected by a constitutional amendment. It is created by a simple majority vote of the state legislature. It is protected today, mostly, by its enormous popularity. According to Rose, a legislator proposed to do away with the PFD only six months after the first dividends went out. Rose writes, "His proposal had ample support in the Legislature, but when the public heard about it, everyone ran for cover." After one dividend check the PFD has a strong political constituency. After three or four checks, it became politically inviolable.

But the fund was still not fully secure from diversion. The principal only had to be held in "income producing investments." There are many risky, politically motivated projects that can count as income producing investments. Many politicians wanted to use it for subsidized loans or infrastructure projects. Some wanted to restrict the APF to invest only in Alaskan assets. The legislature still has the power to intervene on any of these issues, but for the most part they have not. These issues have been resolved largely by the Alaska Permanent Fund Corporation (APFC), a body that was created in 1980 to manage the fund and dividend.

David Rose became the first executive director of the APFC in 1982. He made it his goal to follow the "prudent investor rule," a legal doctrine in which those who invest on behalf of others must seek the highest returns consistent with the safety of the investment. Investments with almost any other political goal are ruled out by the prudent investor rule, because they tend not to be the safest and most profitable. This rule was nominally established in APF legislation in 1980, but the law has no teeth. It takes discipline of the managers and the oversight of public opinion to keep it in place. The state set up other programs for subsidized loans and development projects. By the time Rose left office in 1992, the prudent investor rule was well established in precedent. The Alaskan public, weary that some bureaucrat might be blowing the source of their future dividends, paid close attention to the fund's performance.

Even Rose felt the temptation to use the fund for political objectives. He tells one story from the late 1980s when the manager of Kuwait's sovereign wealth fund came to him privately and suggested that the Kuwait fund, the APF, and two pension funds from the lower 48 states should pool their assets and buy a controlling interest in British Petroleum (BP). Rose turned it down, of course, but not without some hesitation and daydreaming. It would have been a political move—not the move of a prudent investor.

These two books together lay out the long series of events from 1955 to 1992, leading the place in which the APF is established in the Alaskan state constitution; the PFD is established by law; the prudent investor rule is established by law and precedent; and all are protected by public opinion. At the time of this writing (January 2011), the APF is at more than \$38.4 billion. The most recent PFD (October 2010) was \$1,281 for every man, woman, and child in Alaska.

The dividend is safe for now because it continues to be one of the most popular programs in Alaska, but that might not be true forever. The legislature has recently made several attempts to redirect the principal of the fund toward political

projects, such as infrastructure investments, which show reduced commitment to the prudent investor rule. Alaskans were surprisingly resigned to the \$12 billion the fund lost in the financial crisis of 2008-2009.

Furthermore, Alaska faces difficult budgetary times ahead thanks to decisions made when the oil started flowing. Back when Hammond was trying to create the dividend, he reluctantly and regretfully signed a bill to eliminate the state income tax. Looking at short-term effects only, the elimination of the income tax seemed like a great idea. The state simply didn't need the tax; it was making far more money in oil revenue than it needed to run the state budget. Hammond thought it would be much better to dedicate more oil revenues to the permanent fund and continue to finance most government spending through regular taxes. Eliminating the income tax would benefit Alaskans unevenly and temporarily. Dedicating an equal amount of additional money to the APF (and an accompanying dividend) would benefit all Alaskans permanently. Instead the state decided to live off temporary oil revenue.

Today nearly 85% of the Alaska state budget is funded by oil. When those revenues run out there will be enormous pressure to redirect the PFD and perhaps even APF principal toward supporting the state budget. Furthermore, the state will be in the position of needing to find new tax sources just when the industry that dominates the state economy will be contracting. Perhaps, natural gas will create a new resource boom just as the oil money begins to run out. Perhaps some other part of the Alaskan economy will take over. But it is clear that Alaska is in a more precarious position than it would have been if the state had saved more of its oil revenues.

It's tempting to think what might have been, if Alaska had saved all of its oil revenue in a best-case scenario. Suppose the state had kept the income tax, put all its oil revenues into the APF, and spent only the interest. The APF would now be something in the neighborhood of eight-to-ten times its actual current size of \$38.4 billion. For a best-case scenario, say \$400 billion. Most financial analysts agree that one can withdraw up to 4% or 5% per year from an investment fund and still expect it to grow over time in real terms. Suppose the state was able to withdraw 5% each year, using half of it for dividends and half for the state's operating budget. That would produce a dividend of \$15,000 per person per year and \$10 billion for the state budget. Current total state spending is only \$10.5 billion per year. Thus, the state would only need to raise \$0.5 billion from other sources this year, and it would be able to envision the day when returns to the fund financed the entire state budget.

Enticing, but it is a best-case scenario, relying on the most optimistic assumptions on every issue. It ignores all the financial risks and political, economic, and demographic barriers to maintaining such a system. It also ignores that the state needed to spend some of the oil money as soon as it came in. It was a poor state with weak infrastructure and poor schools; it no longer is—thanks to the oil boom. Although some of the oil money was wasted, some of it was well spent. As Rose argues, "Until basic needs are met, such as education and public safety, the government has no business saving for the future." Alaska had to spend a lot to meet its needs at the time, but it could have saved much more than it has. If Hammond had gotten his way, the fund and dividend would be four times the size they are now.

The APF and PFD give us a model on which we can improve. The memoirs of Hammond and Rose help us understand how we can get it done.

-Karl Widerquist, Doha, Qatar, January 25, 2011