



## **SJR 6: Amending Constitution to Transition Permanent Fund to an Endowment**

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# SJR 6: Amends Article 9, section 15 of the Alaska Constitution

- SJR 6 amends article 9, section 15 of the Alaska Constitution:
  - Transitions Permanent Fund to an Endowment Structure
  - Goal of Endowment:
    - Invest the assets of the endowment, and spend from the endowment:
      - Sustainable forever
      - Fund the objectives of the endowment today and in the future
  - Elements of an endowment:
    - One account
    - Diversified investments with long-term investment horizon
    - Long-term capital appreciation
    - Distribution rule that balances spending with preserving inflation-adjusted value of the deposited funds
    - Preserves inter-generational equity



# SJR 6: Brief History of Fund Structures – How We Got Here

- Historic Trusts – often had two account structure
  - Principal account and Income account
- Traditional trust spending rule
  - Save the principal; spend the income
  - Income = cash (stock dividends, fixed income coupons, real estate rents)
  - Realized capital gains retained in principal
- Problem with Historic Trust Structure
  - Assets weighted to fixed income to get cash that can be spent
  - Missed opportunity for capital growth
  - Late 1950s academics raised concerns that these portfolios were “inefficient”
  - Solution to inefficient principal and income trust structure: Endowment



## SJR 6: Permanent Fund – Steady but Long Path to Endowment

- 1976-1980: PF created with the traditional principal and income account structure; fixed income investments; capital gains retained in principal
- 1980s: Legislature expands list of permissible investments; realized capital gains flow to income account, with inflation proofing back to principal
- 1980s – 1990s: Legislature continues to expand list of permissible investments
- 2005: Legislature abolishes legal list of investments; replaces with “prudent investor rule”
- 2018: SB 26 distribution rule (5% of lagging 5yr average market value can be spent)
- Each of these was an important step toward a modern endowment that is sustainable forever



# SJR 6: Final Step to Make PF an Endowment

- SJR 6 transitions the PF to a modern endowment by establishing a one-account structure in the Alaska Constitution
- Why is this important?
  - With the current two account structure, there is a risk that the Earnings Reserve Account can be exhausted
    - If exhausted, the legislature may not appropriate from the principal account
    - So, no PFDs and no revenues for government spending
- A one account endowment structure + sustainable distribution rule
  - Permanent Fund is sustainable forever
  - No risk of abrupt inability to provide a distribution



# SJR 6: Considerations for Distribution Rule

- Under SB 26 (2018) the distribution rule for the Permanent Fund is set at 5% of the lagging 5yr average market value
- SJR 6 provides the legislature the power to set and revise the distribution rule
- Distribution rules are intended to limit spending, while allowing the fund to grow to keep up with inflation
- Spend only the real return. Example:
  - Total return: 7%
  - Inflation: 2%
  - Real return: 5%
  - So, limit spending to 5%
- Should compare spending and real return regularly; consider comparisons over moderate to long time horizons



# SJR 6: Considerations for Distribution Rule

- Distribution rules
  - Static. Fixed 5%
  - Dynamic. Floats based on inflation and market returns
  - Hybrid. “No more than” 5% (Public School Trust, HB 213 2018)
  - APFC Trustees discuss in Trustee Papers No. 9 (2020)
- All distribution rules are designed to meet the needs of the present while protecting the needs of the future
  - Guarantee inter-generational equity
- SB 53 implements SJR 6 with a 5% of lagging 5yr average market value distribution rule
  - Projected inflation expected to be 2%
  - Would require projected annual returns to be 7%
  - Should regularly compare experienced real return with spending, make adjustments to distribution rule as necessary to preserve the inflation-adjusted value of the PF



# SJR 6: Allocation of the Distribution

- SJR 6 provides the legislature the power to allocate the PF distribution between PFD and government spending
- SB 53 implements this
  - 50/50 allocation between PFD and government spending
  - Fair compromise for Alaska
- SJR 6 requires a vote of the people for any change to the PFD allocation





# SJR 6: Summary

- Protects Alaska's primary source of state general fund revenue
- Preserves long-term value of the fund by limiting annual draw
- Preserves the critical link between the people and their government by providing every Alaskan a share of the state's natural resource wealth
- Ensures that Alaskans have a voice in future decisions regarding the permanent fund
- Provides the Legislature with the flexibility to adjust the distribution rule to adjust to different market and economic environments

