

Opinion

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Protect the fund

Odd way of calculating earnings leaves fund at risk

Alaska's Permanent Fund has bounced back from the stock market slump and now stands at a healthy \$29 billion. It is irrefutable counterevidence to the claim that politicians are always irresponsible spendthrifts. (Though creating the fund required voter approval, two-thirds of legislators first had to vote to put it on the ballot.) The Permanent Fund is the single best thing Alaska has done with its billions in oil money.

Yet for all its success, the Permanent Fund is an oddity among large endowments. By law, money deposited to the fund is treated differently from money earned by the fund.

Deposits may never be spent, but the earnings may. With the fund heavily invested in stocks, whose value swings up and down, the distinction between deposits and earnings gets blurry. When financial markets fall, there may not be enough money on hand to pay those treasured dividends without eating into the constitutionally protected deposits.

Another problem: Deposits stashed in the fund will lose value over time, unless the Legislature each year decides to reinvest a portion of the earnings to offset inflation. To their credit, lawmakers have always fully funded inflation-proofing. However, they do have the power to spend the money elsewhere by simple majority vote. That could be mighty tempting if oil prices crash again and reserves run dry.

All those drawbacks are why the fund's trustees and long-term defenders recommend more conventional management. To preserve and grow the fund's value while providing sustainable income for spending, most endowments use a percent-of-market-value method, or POMV.

With POMV, managers figure the value of all the fund's investments averaged over several years. Then a fixed percentage -- usually about 5 percent -- is made available for spending every year. Over the long run, big funds usually manage to earn 8 percent or more a year with investments. The fund continues to grow, offsetting inflation, while still providing a sustainable supply of money for other uses.

Converting the fund to this conventional endowment model is financially logical but politically difficult. It requires a constitutional amendment, which requires two-thirds approval in the Legislature and ratification by Alaska voters.

In last year's legislative warfare over a fiscal plan, the percent-of-market-value change was one of the casualties. It got killed in the crossfire over how the newly calculated earnings should be spent.

That was unfortunate and unnecessary. No matter how the fund's earnings are spent, they should be calculated in a way that doesn't leave inflation-proofing to the discretion of politicians. Far from being a raid on the fund's principal, as misguided

populist critics assert, the percent-of-market-value approach is a conservative, traditional way to manage an endowment. It is the one long-term financial measure that all sides in Alaska's fiscal wars should be able to support.

BOTTOM LINE: Percent-of-market-value management may seem like a radical change for the Permanent Fund, but it's the financially conservative way to go.