

**The Alaska Permanent Fund Dividend:  
A Case Study in Implementation of a  
Basic Income Guarantee**

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## **I. Introduction: Some Background on Alaska**

The Alaska Permanent Fund Dividend program has attracted considerable interest because it is a unique example of a BASIC INCOME GUARANTEE. In this paper, I describe the structure of the dividend program, its economic effects, some of its unintended consequences; and I close with a number of observations about how the dividend might be structured differently. My objective is to give the reader insights into the factors to consider in implementing a BASIC INCOME GUARANTEE in other places.

However, before beginning it is important to present a short description of Alaska because the structure of any BASIC INCOME program and its impacts are contingent upon the particular institutional, economic, political, and social environment in which it is located.

Alaska is the largest of the 50 United States measured by land area—but among the smallest measured by population. Its 700 thousand residents comprise only about two-tenths of one percent of the total U.S. population. As a state within the United States, its border is open to the rest of the nation for the free movement of goods and services, people, capital, and information. Furthermore, it is subject to the laws, regulations, and policies established by the federal government. As I will discuss below, these connections create some challenges for the dividend program because the state cannot totally control its own economic and political environment.

The state economy is driven by natural resource production and federal government spending. Petroleum is the dominant natural resource and accounts for one-third of all jobs, directly and indirectly. Furthermore, most of the growth in the economy since Alaska became a state in 1959 can be attributed to the development of its Arctic oil resources. Because of its small population, Northern location astride the Arctic Circle, and distance from markets, Alaska is sometimes characterized as having a frontier or island economy in the sense that its economic development prospects are limited to exploitation of its natural resources.

Prior to becoming a state in 1959 the federal government exerted considerable control over the economy. The economic history of the territory was one of periodic booms associated with exploitation of a particular natural resource—including furs, gold, copper, timber, and fish—followed by busts when the resource became depleted or market conditions turned against continued production. These economic booms generated

considerable wealth, but most of it went to nonresidents and little was left behind to benefit the permanent residents or to build a stable and permanent economic base. The economic structure could be described as colonialism and the economic development pattern as “rape and pillage.”

Much of the natural wealth of the state is still owned by the federal government and little is in private ownership. But as a condition of statehood, the Alaska state government took title to about 24 percent of the land; and the Native American community, that makes up about 20 percent of the state population, communally holds about 10 percent. State ownership of the land where the oil is produced has meant that a large share of the value added from production, and most importantly a large portion of the economic rent from that production, could be captured by state government through taxes and royalties. This has given rise to the notion espoused by former Governor Wally Hickel, that Alaska is the "Owner State." This is the idea that the residents own the resources and actually have the obligation, spelled out in the state constitution, to develop those resources for the benefit of all Alaskans.

The cumulative value of the 16 billion barrels of oil that have been produced from state land since 1959 has been about \$500 billion, and the state has collected about \$150 billion (2009 \$) of that total. This has allowed the state to eliminate most taxes except those on petroleum, to expand public services, and to create a savings account known as the Alaska Permanent Fund.

Largely because of its dependence on petroleum, the state economy—measured by per-capita income and the unemployment rate—has been strong since the 1970s and has weathered the current recession quite well. However, these statewide average economic indicators mask important regional differences in economic performance. In particular, the remote rural part of the state off the road system, which is home to about half of the Native American population, is burdened with high costs and few employment opportunities in the cash economy. The small villages in that region have low cash incomes and are reliant on government assistance and subsistence harvesting of fish and game for their existence.

The federal government continues to be an important force in the economy, just as it was before statehood. Furthermore, resource production—particularly that of petroleum—is dominated by large, international companies perceived to have little or no interest in the

economic well being of the state and its residents. Both of these contribute to the popularity of the notion that Alaska is in a struggle to take control of its own economic future and that shared ownership of its natural resources is a vehicle to accomplish that goal.

## II. The Alaska Permanent Fund Dividend (PFD) Program

The Alaska Permanent Fund dividend, or PFD as it is commonly called, fits a BASIC INCOME definition quite well.<sup>1</sup> It is essentially universal, individual, non-conditional, uniform, regular, and provided in cash. It falls short in that the size of the annual payment fluctuates from year to year and is small relative to measures of poverty.<sup>2</sup> In this section, I discuss the creation of the PFD and its main features.<sup>3</sup>

The state established the Alaska Permanent Fund in 1976 when oil production began from the Prudhoe Bay field, the largest oil field ever discovered in North America. The primary purpose of the fund was to save a share of the public revenues generated from a non-sustainable resource. Fund deposits come from a twenty-five-percent share of royalties (ownership payments based on the wellhead value of the oil) collected by state government. This deposit represents a saving of only about ten percent of total petroleum revenues because the state also collects significant production, property, and income taxes from the industry. The Fund balance is invested in a portfolio of assets to maximize its long-run rate of return.

These fund deposits are constitutionally prohibited from being spent, but fund earnings are available for appropriation by the state legislature for any purpose, similar to other general revenues. By this mechanism, a share of the non-renewable state revenues from petroleum production is transformed into a sustainable flow of revenues from the investment earnings of the Permanent Fund, and future generations of Alaskans will be able to share in the financial benefits from current petroleum production.

A secondary purpose of the fund was to take some of current revenues "off the table"—removing them from the temptation of the current legislature to overspend and thus to waste public funds while overheating the economy.

The fund grew slowly in its early years because royalty deposits, based on the oil price, were small. Thus annual earnings from the fund were small and attracted little attention.

But with the Iranian Revolution and the increase in the price of oil in 1979, Alaska state oil revenues—including royalties—grew dramatically, and public spending, on both pre-existing

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<sup>1</sup> One definition of Basic Income can be found in Jurgen de Wispelaere and Lindsay Stirton, "The Many Faces of Universal Basic Income," *The Political Quarterly* 75(3) 2004, p. 266-274.

<sup>2</sup> In addition, unlike the Permanent Fund, it is not protected by the state constitution.

<sup>3</sup> Detailed information about the Alaska Permanent Fund can be found on the Corporation website at <http://www.apfc.org/home>.

and new programs, rose commensurately<sup>4</sup>. It was easy for Alaskan citizens to see that the direct beneficiaries of much of this spending were particular interest groups including government workers, the construction industry, and constituents benefiting from low-interest loans like fishermen, senior citizens, and students. The governor at the time, Jay Hammond, was a commercial fisherman who lived in a small village in rural Alaska. He had seen how the benefits from harvesting a publicly owned resource—fish from the sea—were inequitably distributed and went mostly to nonresidents of the state. He proposed an annual cash distribution to all citizens as a means of ensuring that everyone benefited from oil production on state-owned lands.<sup>5</sup>

His original plan, known as "Alaska, Inc.," was to allocate shares to each adult Alaskan—one share for each year of residence up to a total of twenty-five shares. A cash distribution of \$50 per share was then to be made annually to all shareholders who would also be credited with an additional share each year. Thus, those with a longer residency would receive a larger distribution. This reward for length of residence was designed to reduce the annual turnover in the population and to increase its stability.

That plan passed the legislature but died when it was ruled unconstitutional because it did not conform to the equal treatment clause of the U.S. Constitution (because a different number of shares was distributed based on length of residence in the state). In response, the legislature in 1982 quickly passed a plan that paid each Alaska resident regardless of age an equal amount out of the appropriable earnings of the Permanent Fund. The state has paid a dividend each year since then; in the fall of 2010, Alaskans will receive the 29<sup>th</sup> dividend.<sup>6</sup>

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<sup>4</sup> The elimination of the state personal income tax was one of the first laws passed by the legislature after the dramatic increase in petroleum revenues.

<sup>5</sup> For more detail on the creation of the PFD, see Cliff Groh "The Permanent Fund Dividend Story," prepared for Principles and Interest: The Permanent Fund and Alaska's Future, a conference sponsored by the Alaska Humanities Forum, Anchorage, 1997.

<sup>6</sup> It is interesting to note that when the dividend program began, the state already had a cash distribution program for seniors—the Longevity Bonus Program. That program was established in 1972 to provide monthly cash payments of \$100 to each person over 65 who had lived in Alaska at least 25 years and was a resident at the time that Alaska became a state. The purpose of the program was to reward older residents who had helped to establish the state and to help them offset the high cost of living so they could continue to live in Alaska after retirement. After a court challenge, the program was expanded to include all Alaska seniors over 65 and the later the monthly payment was increased to \$250. The program was phased out in the late 1990s. The fact that the PFD was not structured as a monthly stipend like the Longevity Bonus underscores the fact that the dividend was not envisioned to be an income supplement, but rather a wealth distribution.

The size of the PFD is calculated as half of the earnings of the Permanent Fund averaged over the preceding five years divided by the number of eligible residents.<sup>7</sup> An eligible resident is a person of any age who has lived in the state for at least one year who intends to continue to reside in Alaska in the future.<sup>8</sup> About 95 percent of the population receives the dividend each year.

The PFD did not initially have broad support in the legislature. Many lawmakers felt that the money distributed as dividends could be more beneficially spent on public programs and, particularly, on capital projects which would increase the physical infrastructure of roads, harbors, airports, power generation, etc. in the state—investments considered to be a necessary pre-requisite for economic development. There was also fear that much of the PFD would be spent unwisely—on everything from alcohol to trips to Hawaii—and that it would be an inducement for people to drop out of the labor market and become an economic burden. But supporters argued that if the objective was to provide benefits for all Alaskans, there was no better way than to give them cash so they could decide for themselves what to spend it on rather than leaving that decision to the government.

The annual distribution soon became the most popular program of state government. Although the Permanent Fund balance, which ultimately determines the size of the PFD, is constitutionally protected, there is no such guarantee for the annual distribution. The legislature has the authority to change the formula at any time and could, by law, eliminate it entirely. Its only guarantee is its political popularity. No legislator would suggest a change in the formula that would reduce its amount or the share of Permanent Fund earnings allocated to the dividend for fear of losing the next and all subsequent elections.<sup>9</sup>

The dividend also instantaneously created a constituency for the Permanent Fund itself. Without a group defending the fund against attack, it could have easily fallen prey to special interests. Such interests might spend the earnings inappropriately, invest the fund balance in capital projects with no financial return, or eliminate the fund altogether. If that happened,

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<sup>7</sup> The 5-year average serves two purposes: it reduces year-to-year variation in the size of the dividend due to fluctuations in earnings, and it reduces the incentive to manipulate the fund portfolio to report high earnings in the current year rather than to invest to maximize the long-run rate of earnings.

<sup>8</sup> There are some complicating side calculations for determining the size of the dividend when current-year earnings fall below the historical five-year average, making it impossible to fully fund the dividend from current year earnings.

<sup>9</sup> Most recently, the legislature passed a law increasing the number of residents eligible to receive the dividend by a small amount. Although this reduced the size of the dividend, it did not catch the attention of the general public.

there would be no future flow of public revenue to replace that of petroleum when production ended.<sup>10</sup>

Administration of the dividend program has created a small bureaucracy within the state's Alaska Department of Revenue, primarily to interpret the rules for and verify eligibility for the dividend based on a set of residency requirements. Cases such as students who go to school in other states and members of the armed forces who are required to be physically absent from the state for extended periods must be dealt with. This requires that everyone apply for a dividend each year by filling out a form with residency and other information. As one might imagine, these rules can be somewhat arbitrary and quite controversial, and they have increased in complexity over time.

The dividend amount is calculated and announced after the applications have been processed and the fiscal year has ended (June 30). The Permanent Fund Corporation, the independent state agency that manages the fund assets, transfers the legislatively authorized appropriation into a separate Dividend Account. It is from this account that the Department of Revenue makes the actual distribution beginning in October. Today most dividends are paid electronically at the same time by direct deposit into recipient bank accounts; however, some people continue to receive their dividend in the form of a check delivered through the mail.

The size of the dividend has varied from a low of \$331 in 1984 to a high of \$3,269 in 2008.<sup>11</sup> The 2010 dividend is expected to be about \$1,200. The size of the dividend is driven by the realized earnings of the Permanent Fund which, because it is invested in stocks, real estate, and other assets to maximize the long-term rate of return, can fluctuate dramatically from year to year. Even with the 5 year average formula, the size of the dividend has varied considerably from year to year, particularly in recent times. In 2007 it jumped 49 percent over the preceding year, and in 2009 it fell 37 percent. If there were no significant cyclical fluctuation in annual earnings, the dividend would be about \$1,800

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<sup>10</sup> The early experience of the Alberta Heritage Savings Trust Fund, also established as a savings account for petroleum revenues, demonstrates the effects of an investment policy controlled by special interests. For example see Peter J. Smith, "The Politics of Plenty: Investing Natural Resource Revenues in Alberta and Alaska," *Canadian Public Policy*, 17:2 1991, p. 139-154.

<sup>11</sup> The dividend in 2008 included a special, one-time \$1,200 appropriation from the state general fund to offset the high cost of fuel in Alaska resulting from the high world oil price at the time.



today, based on the \$34 billion balance in the Permanent Fund and an annual return on investment of 8 percent.

The annual fluctuations in the size of the dividend has not been an issue of concern for recipients. It is understood that the dividend will fluctuate with earnings, and people have confidence that the fund itself is well managed.

The dividend today is larger than most people anticipated when the program was first established, and its growth has led to several unsuccessful attempts over the years to "cap" its size at different levels like \$500 or \$1,000.

As a share of total personal income, the dividend remains small. At \$1,305 in 2009, the dividend added 3% to average per capita income of \$42,603.<sup>12</sup> At the same time, it represents a significant aggregate infusion of cash into the economy. The 2009 dividend added about \$900 million in purchasing power to the economy (before taxes), roughly equivalent to the total wages of state government or the retail trade sector. From this perspective it represents a diversification of income sources for the economy similar to adding an entire new industry. This diversification is also a stabilizing force on the economy.

Over the years, policies have been established for numerous complications arising from the dividend distribution. For example, children who are wards of the state are eligible for the dividend. As trustee the state retains those dividends until the child reaches adulthood, at which time he or she receives the accumulated amount. Another example is that certain federal aid programs for low-income families are contingent on monthly income. Those families lose their federal aid in the month that the dividends are distributed and, consequently, the state has instituted a "hold harmless" provision. This is a payment to those families in compensation for their temporary loss of federal assistance.

Today, after 29 years, the dividend has proved to be one of the most enduring institutions of the young state of Alaska. Over time it has evolved in the eyes of the public from a simple and temporary cash distribution in a time of plenty into a personal and permanent entitlement.

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<sup>12</sup> The official estimate of per capita personal income in the U.S. contains a number of non-cash components like the rental value of owner-occupied housing as well as payments that benefit individuals but are made directly to service providers like some medical payments. And although it excludes capital gains, a comparison of the dividend to total personal income underestimates the relative size of the cash infusion directly to households from the dividend.

### III. Possible Economic and Other Effects of the PFD

There are several reasons why there have been very few studies of the effects of the dividend.<sup>13</sup> First, Alaskans tend to view the disposition of dividend income as a private matter that is not the business of government to be investigating. Second, even if it were viewed as a public program rather than a distribution of earnings, there is little tradition in Alaska for funding the studies necessary to evaluate whether a program has been performing as anticipated. Third, because almost everyone in the state receives the dividend, it is difficult to construct statistical analyses that allow researchers to isolate the effects of the dividend from all the other factors simultaneously impacting behavior. And finally, the quality of much of the data that could be used for this type of study is generally not of high enough quality to support rigorous statistical analyses.

As an economist, the question I am asked most often about the dividend is "What do people do with their checks?" A simple answer relies on the economic theory known as the permanent income hypothesis. Assuming that people expect the dividend program to continue indefinitely into the future, they will treat the dividend as a permanent increase in their annual income. They will spread the additional consumption made possible by the dividend income over their entire lifetime, probably on more of the same types of goods and services they would have consumed without the dividend income. Consequently, consumption will not increase at the time when dividends are distributed.<sup>14</sup>

However, the anecdotal evidence, responses of people when directly asked, and a study of the pattern of receipts at retail outlets in communities across the state<sup>15</sup> all suggest that consumer purchases, as distinct from consumption, do tend to concentrate around the

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<sup>13</sup> There have been numerous papers describing aspects of the dividend. These include William Brown and Clive Thomas, "The Alaska Permanent Fund: Good Sense or Political Expediency?" *Challenge* Sept-October 1994, p. 38-44. Scott Goldsmith, "The Alaska Permanent Fund Dividend Program," in *Alberta's Volatile Government Revenues*, ed. L. S. Wilson, Institute for Public Economics, University of Alberta Press, Edmonton, 2002, p. 123-127. Scott Goldsmith, "The Alaska Permanent Fund: An Experiment in Wealth Distribution," in *Promoting Income Security as a Right*, ed. Guy Standing, Anthem Press, London, 2005, p. 553-556. J Patrick O'Brien and Dennis O. Olson, "The Alaska Permanent Fund and the Dividend Distribution Program," *Public Finance Review*, 18, 1990, p. 139-156. Dennis O. Olson and J. Patrick O'Brien, "The Great Alaskan Money Give Away Program," *Economic Inquiry*, 28 1990, p. 604-615.

<sup>14</sup> One study concluded that consumption did not change at the time of the dividend distribution, thus lending support to the permanent income hypothesis. Chang-Tai Hsieh, "Do Consumers React to Anticipated Income Changes? Evidence from the Alaska Permanent Fund," *American Economic Review* 93(1) (March 2003), p. 397-405.

<sup>15</sup> Gunnar Knapp, et al. "The Alaska Permanent Fund Dividend Program: Economic Effects and Public Attitudes," Institute of Social and Economic Research, University of Alaska, 1984.

time that the dividend checks arrive. One reason for this is that a large dividend or the combination of several dividends together provides some recipients with the “liquidity” necessary to buy an expensive consumer durable that provides consumption benefits lasting a long time—appliances, snow machines, etc. The concentration of these consumer-durable purchases however is not inconsistent with the permanent income hypothesis of smoothed consumption.

A second reason for purchases to be concentrated during the dividend distribution season is that businesses compete for a share of the dividend dollars through advertising campaigns, sales, and other types of special offers. Timing the purchase of a new boat motor or a trip to Hawaii with the dividend distribution season can be a smart consumer decision. It also is a happy coincidence for retailers that the distribution comes at the beginning of the Christmas shopping season when people are in a consuming mood.

A popular method for determining what people have done with the dividend checks is to ask them directly when they have them in hand. An informal survey conducted by the Permanent Fund Corporation in 1994 reported that three-quarters of respondents planned to save half or more of their dividend (including reducing their level of debt).<sup>16</sup> Although this is an indication of what people did with their checks when they got them, it does not tell us how their consumption behavior changed over time.

We need to distinguish between what might be termed the proximate vs. the ultimate use of the funds. The easiest way to understand the difference is to consider the person who reports that they used their dividend to buy winter clothes for their children. While it may be true that the dividend check was used in that way, it is unlikely that most parents, had they not received a dividend, would have deprived their children of winter coats in the harsh Alaskan environment.

A study done in 1984 shortly after the first distribution also found that saving out of dividend checks was significant. Net of federal income taxes, about one-third of dividend income went to saving and debt reduction. The majority went to day-to-day expenses, and about 10 to 15 percent went to special large purchases.<sup>17</sup> However, when asked what was

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<sup>16</sup> Gordon Harrison, “The Economics and Politics of the Alaska Permanent Fund Dividend Program,” in *Alaska Public Policy Issues*, ed. Clive Thomas (The Denali Press, 1999) p. 81-91.

<sup>17</sup> Knapp, *op. cit.* After the initial distribution, 1/3 of Alaskans thought it very likely that the program would continue but 1/3 thought it not likely. Consequently, many PFD recipients were probably more likely to save what

the most significant effect of the dividend on their overall consumption behavior, most respondents said it had little or no effect, or that it helped with regular expenses. Roughly 30 percent responded that it was to reduce debt or increase savings.

One reason there may be more savings out of dividend income than other sources is the fact that it comes in a lump sum once a year which might influence some recipients to save it, who would not otherwise do so.<sup>18</sup> However, there is no evidence that the cumulative saving of dividends has resulted in a significant accumulation of wealth or provided a base of assets, or “grubstake” as we say in Alaska, leading to private sector investments generating economic development.

Whatever the pattern of purchases and consumption over time, most of the cash from dividends will ultimately find its way into the Alaska economy to increase employment, population, and income. A rough estimate of the total (direct and indirect) macroeconomic effects of this increase in purchasing power is 10 thousand additional jobs, 15 to 20 thousand additional residents (drawn to the state because of the jobs), and \$1.5 billion in additional personal income.<sup>19</sup>

An important macroeconomic feature of the dividend is the stability it adds to the economy, in spite of its variation in size from year to year. The income flow from the dividend is independent of all the other sources of income coming into the economy, and this additional diversity provides stability when other sources fluctuate.

Two features of the dividend—it is an equal distribution to all residents and it is taxable as personal income by the federal government—contribute to a leveling effect on the distribution of income. The dividend adds a larger percentage to after-tax income at the

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they viewed as a one-time windfall compared to how they have allocated more recent dividend distributions.

<sup>18</sup> Since 1991 applicants have been able to designate a part of their dividend to a University of Alaska Section 529 College Savings Plan established for the benefit of a child. Plan earnings are tax free under current law, and the proceeds can be used to pay qualified expenses at the University of Alaska or any other eligible institution of higher learning. Since its inception there have been about 80 thousand individual deposits into these accounts via PFD applications. The “pick-click-give” program which started in 2009 allows applicants to direct a portion of their dividend to charitable organizations. About 5 thousand people used the program in its first year, and an estimated 10 thousand will use it in 2010.

<sup>19</sup> These rough estimates do not take into account potential general equilibrium effects discussed later in the paper. See Scott Goldsmith and Jeff Wanamaker, “The Economic Impact of the Alaska Permanent Fund Dividend,” Institute of Social and Economic Research, University of Alaska, 1989, and Scott Goldsmith, “A Comparative Analysis of the Economic Effects of Re-imposing Personal Income Taxes, Reducing Permanent Fund Dividends, or Reducing State Spending,” Institute of Social and Economic Research, University of Alaska, 1987.

lower end of the distribution than at the upper end. This has been a factor contributing to the leveling of the income distribution in Alaska since the early 1980s.<sup>20</sup>

The dividend establishes a floor below which the cash income of residents cannot fall, but it is not large enough by itself to provide a BASIC INCOME. For example, the federal poverty guidelines of the U.S. Dept of Health and Human Services defined the poverty level for a two-person household in Alaska in 2009 to be \$18,210.<sup>21</sup> However, there are a number of federal and state “safety net” programs like social security, the earned income tax credit, unemployment insurance, and food stamps that help to lift people above the poverty income level.

Consequently as an addition to the “safety net” the dividend has been one factor in the decline in the official poverty rate since Alaska attained statehood, particularly among Native Americans. The Native American poverty rate fell from 25 percent to 19 percent between the census years of 1980 and 1990.<sup>22</sup>

The dividend is particularly important in rural parts of the state where the economy is largely a mixture of government cash-based transfers and subsistence activities and where wage paying employment is scarce. Households are cash poor and the subsistence harvests can fluctuate dramatically from year to year. Under these circumstances the cash provided by the dividend is particularly important not only because of its size but also its predictability.

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<sup>20</sup> Between the early 1980s and the early 2000s, the after-tax income of the richest 20 percent of families increased at a faster rate than the poorest 20 percent in 38 states. In 11 states the growth rates were about the same for the two groups. Alaska was the only state in which the income of the bottom 20 percent grew at a faster rate (25%) than the income of the top 20 percent (10%). In the early 1980s, Alaska had the greatest income equality of any state, measured by the ratio of average income of the top 20 percent of families compared to the lowest 20 percent—6.6. By the early 2000s Alaska had fallen to 43<sup>rd</sup> place at 5.8 while the U.S. average had increased from 5.5 to 7.3. The trend toward greater income equality in Alaska was due both to faster growth in incomes of families at the bottom of the distribution—25% compared to 19% for the total U.S. and to slower growth in incomes of families at the top of the distribution—10% compared to 59% for the total U.S. See Jared Bernstein et al. “Pulling Apart: A State-by-State Analysis of Income Trends,” Center on Budget and Policy Priorities and Economic Policy Institute, Washington D.C., 2006.

<sup>21</sup> These guidelines are used in the determination of eligibility for many, but not all, federal assistance programs. The guidelines are higher for Alaska than other states because of the high cost of living, but they do not reflect differences in the cost of living across regions within the state.

<sup>22</sup> Scott Goldsmith et al. “The Status of Alaska Natives Report”, prepared for the Alaska Federation of Natives, Institute of Social and Economic Research, 2004. The census poverty rate is based on the poverty threshold, a definition that varies with household composition, but does not account for the higher cost of living in Alaska relative to other states. As the relative cost of living has fallen in Alaska since statehood, one would expect the calculated poverty rate to increase if all other variables were held constant. Thus the reported decline in the poverty rate over time is an underestimate of the actual trend in well being of the population.

Economic theory suggests that, other things being equal, an unconditional payment like the dividend would reduce the supply of labor and increase the wage rate. In the 1984 study of the early dividend program, only one percent of survey respondents reported they worked less because of the dividend.<sup>23</sup> This is to be expected since many lower-income Alaskans, those most sensitive to an unconditional increase of income, would prefer more work but are constrained in their opportunity to obtain employment in the cash economy.<sup>24</sup>

There have been no studies that have tried to link the dividend to aspects of economic or social behavior such as health, education status, or general welfare (like the crime rate).<sup>25</sup> This is partly because Alaskans do not think of the dividend as a tool to address these problems and also, as mentioned before, because of the difficulty of identifying the effect of the dividend on these measures independent of all the other programs and influences. For the same reasons, no one has investigated how the dividend might have influenced personal empowerment, feelings of self-worth, sense of community, volunteerism, or other psychological factors.

Of course, it is wrong to conclude that because these potential relationships have not been studied that they do not exist. Furthermore, as we will discuss in the next section, there may also be some effects from unanticipated and unintended consequences of the dividend.

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<sup>23</sup> Knapp et al. *op cit*. A concern motivating this study was that people would become unemployed and create a cost for government.

<sup>24</sup> A complete picture of labor market behavior would require that one also look at whether the PFD accelerates the timing of future retirement.

<sup>25</sup> One exception is a study that found that the death rate increased when the PFD was distributed and subsequently fell below the trend reflecting a phenomenon described as “harvesting.” The study suggested that increased consumption activity led to more strokes and heart attacks among the frail as well as traffic accidents. There was no suggestion the increase was the result of substance abuse. William N. Evans and Timothy J. Moore, “The Short Term Mortality Consequences of Income Receipt,” National Bureau of Economic Research Working Paper 15311, 2009.

#### IV. Unanticipated / Unintended Consequences of the PFD

Policy actions have unintended consequences for a variety of reasons including poor design, forethought, inadequate application, and myopia. Some might be pleasant surprises while others disappoint. In this section we explore some of effects of the dividend that were not expected at the time of its creation. Most have occurred because the dividend has grown much larger than anticipated.

The most important effects result because the dividend is a “population magnet.” It creates an obvious incentive to move into and remain in Alaska. When the dividend program began, it was small and its future was uncertain. The idea that the dividend might encourage people to move into the state only surfaced after it grew in size and became a permanent program. In addition, the program has gained some notoriety in the media in other states, and there are periodic articles describing the “free money” being given away in Alaska.

The magnet effect should be concentrated among lower-income people who are not closely connected to the labor market. The over-65 population is increasing at a rate faster than any other state, and demand for public as well as non-profit programs providing services for lower-income individuals and families has also been growing rapidly. But it is difficult to sort out the causes for these increases among various public programs for seniors and lower-income individuals to be able to attribute any of it to the dividend.<sup>26</sup> No one responding to the 1984 survey indicated that they had moved to Alaska to get the dividend, and almost no one said they had decided not to move out of the state because of the dividend.<sup>27</sup>

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<sup>26</sup> The Case of “Papa Pilgrim” garnered considerable media attention early this decade after it was reported that he had moved to Alaska and settled in a remote location with his wife and 15 children. It seemed clear to most Alaskans that his primary motive was to collect the dividend checks and live off the land and state government services, since the family lived totally cut off in the wilderness.

<sup>27</sup> Knapp et al. *op. cit.* One would expect this response at a time when no one knew whether the program would continue beyond its first year. In addition, in-migrants drawn by the dividend would have had a hard time meeting the 6-month residency requirement. Those who decided not to move because of the dividend could very well only have been temporarily postponing it. Or they may have remained not only in the state but also in the work force. In the case of these individuals, the dividend slowed the rate of population turnover, but did not impact its size.

If the size of the dividend continues to increase and grow relative to personal income, eventually it will become large enough to attract some people to the state. The increase in population will have a number of obvious and not-so-obvious effects. First, the larger population will reduce the size of the dividend. Second, the larger the population the greater the demand for public services. Since the fixed natural resource base is the source for most revenues to pay for these services, the larger population will dilute the ability of the economy to support those public services through taxation.<sup>28</sup> Third, demand for resources in fixed supply, like land and popular fishing streams, will increase in price.

The dividend could also attract people who are in the labor market. Absent the dividend, relative wages in Alaska and elsewhere reflect differences in the cost of living and private and public amenities. In general, a high wage in Alaska compensates workers for the high cost of living and the severe climate. When the dividend is added to Alaskan wages, Alaska becomes relatively more attractive to some workers because they can now get both their wage income and the dividend. This creates an incentive for workers to migrate to Alaska, which increases the labor supply as well as the unemployment rate, which would depress the wage rate. Eventually a new equilibrium would be reached where the Alaskan population and labor supply were larger—and the wage rate was lower—than before the introduction of the dividend.<sup>29</sup>

This can be characterized as the "Hawaii Effect." In that state the warm, sunny beaches create a strong population magnet that operates just like the PFD. Both are freely available to anyone who chooses to become a resident. The relatively low wage rates in Hawaii are probably due at least in part to their form of the population magnet.

If the dividend reduces the Alaska wage rate, then part of the benefit of the dividend goes not to recipients, but rather to those businesses that are able to hire dividend-receiving workers at the lower wage rate. Since workers are unlikely to realize that their wage rate is lower due to the dividend, they would not see this benefit transfer.<sup>30</sup>

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<sup>28</sup> Also because of the remoteness and small size of the Alaska economy, the cost of delivery of those services is higher in Alaska than elsewhere in the US. Thus there is a net loss to the nation as a whole when people move from a low cost region into Alaska where public service delivery is more expensive.

<sup>29</sup> This effect on the labor market has not been studied empirically, and there is no evidence that it has yet happened.

<sup>30</sup> It becomes difficult to trace who ultimately benefits from the increased profits of businesses. Competition may force them to lower prices.



The second way that the dividend could be a “population magnet” is through its effect on the birth rate since it appears to reduce the cost of children. An unpublished study has suggested the birth rate in Alaska has increased 18 percent because of the dividend.<sup>31</sup>

This seems unlikely for a number of reasons. First there is no indication of such a large effect in a simple comparison of the trend in the Alaska birth rate to the rest of nation. Second, studies of direct child subsidies in other countries, designed to stimulate the birth rate, fail to report such dramatic impacts. And third, the effect of the dividend on the birth rate is complicated because, in addition to its price effect, it also has an income effect on the household. Although children are a “normal” consumption good such that demand increases with income, the value of time also increases with income. Since raising children is a time-consuming activity, the cost of children can also increase with income.<sup>32</sup> Consequently, it is possible that the birth rate could fall because of the dividend.

The point of this discussion of the “population magnet” is not to argue that it exists today in Alaska, but rather to illustrate the necessity of considering what economists call “general equilibrium” effects of cash transfers. When a policy like the dividend program is large enough to cause changes in relative prices that influence the allocation of resources and behavior, then looking only at the direct effects will not capture all the important effects and may lead to incorrect conclusions about its benefits.

In addition, in order to measure the effects of the dividend, it is necessary to know how that cash would have been used in the absence of the dividend and what the effects of that alternative use would have been. The true economic effect of the dividend is the DIFFERENCE between how the money has been used and how it would have otherwise been used. The most likely alternative use of the PFD would probably have been to increase capital spending by state government. There has always been a group interested in using the Permanent Fund principal to make loans for physical infrastructure construction, and proposals to spend general fund revenues on capital projects are always greeted more favorably than those that increase the state operating budget.

If the money appropriated for dividends had instead gone to capital projects, economic activity would have been generated, just as has been the case with the dividend; but both

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<sup>31</sup> See Yereth Rosen, “In Alaska, a Push to Curb Perks for Citizens,” *Christian Science Monitor*, May 10 2006.

<sup>32</sup> As family income goes up, the parents might substitute more “quality” for “quantity” in their decision about the number of children to have.

the macro- and microeconomic effects would have been different. Capital spending would have generated less employment and increased income inequality.

One could also envision a case where all Permanent Fund earnings were reinvested, which would have resulted in the Fund today being about twice its \$34 billion balance. The annual earnings from a fund of this size would be sufficient to pay a large share of the cost of government on a sustainable basis. However, it is difficult to imagine that the fiscal discipline necessary to accomplish that savings would be politically feasible.

The dividend may create unintended distortions in the allocation of resources which can undercut other public programs with competing objectives. In Alaska a large share of the Native American population lives in small villages in remote parts of the state, off the road system where employment opportunities in the cash economy are very limited, and where most jobs are funded by the state or federal government providing education, health, and other services to local residents. Although there is considerable migration out of these villages to locations with greater employment opportunities and better social services, most of these villages continue to exist, partly in the hope that economic development will someday bring in jobs. But while waiting for those jobs to materialize, the economic and social conditions in many of these villages are stagnating or deteriorating. Although the dividend provides much needed cash to the residents of these villages, it also enables some to remain who would otherwise move to places where jobs are more readily available and public services less expensive. Although it is difficult to weigh and compare the supportive and enabling effects of the dividend for residents of these communities, both effects need to be recognized.

When the annual dividend payment is distributed, retailers compete to lure recipients to consume as much of their checks as possible. The local media attention concentrated on the story about how people spend their dividends also contributes to a "consumption-frenzy" atmosphere. This competition and the potential misallocation of personal income that results were not anticipated.

At the time of its creation, one of the rationales for the dividend was that it would create a constituency for the Permanent Fund to defend it against attack from special interests wanting to crack it open to spend its assets. Were that to happen, it was argued, Permanent

Fund earnings would not be available to pay for needed public services when oil revenues were gone—the original purpose for which the Permanent Fund was established.

Some would argue that the dividend has become too successful in creating a constituency to protect the Permanent Fund. That constituency has co-opted the Permanent Fund and turned it, de facto, into a fund that exists for the sole purpose of paying the Permanent Fund dividend. It has been converted from a saving account into an income distribution fund. This is evident from the fact that many people mistakenly refer to the Alaska Permanent Fund as the *Alaska Permanent Dividend Fund*.

Following state law, the legislature appropriates roughly half of the Permanent Fund earnings to the dividend each year, leaving the other half available for appropriation for other purposes. By law, the legislature now appropriates a large share of the remainder into the constitutionally protected fund balance in order to "inflation proof" the balance of the fund. "Inflation proofing" is the amount required to maintain the purchasing power of the royalties that have been deposited into the fund,<sup>33</sup> and it incidentally also serves to maintain the purchasing power of the dividend. After payment of the dividend and inflation proofing, there are usually some earnings left which go into an earnings reserve account.

Although this earnings reserve account is available for appropriation for any purpose, its close association with the Permanent Fund and the dividend makes it politically difficult for the legislature to access it for general government purposes—either current spending or saving for future spending.<sup>34</sup> Instead, they have chosen to periodically "sweep" the funds in this sub account into the Permanent Fund itself. When the fund balance increases in this way, earnings will increase, and future dividend payments will be larger.

The problem with identifying the earnings of the Permanent Fund solely with payment of the dividend is that oil production has been declining in Alaska since 1989 and now stands at only one-third of the peak flow. Although high oil prices have temporarily cushioned the state treasury from the fiscal consequences of that decline, it is only a matter of time

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<sup>33</sup> Occasionally, the legislature has made special appropriations into the Permanent Fund that are constitutionally protected, as are the royalties. Thus the constitutionally protected fund balance includes the royalties, the cumulative inflation proofing, and these special appropriations. Each year this entire balance is inflation proofed.

<sup>34</sup> The dividend has clearly instilled fiscal discipline in the budgetary process. Most Alaskans argue that they would

before current oil revenues will be insufficient to pay for public services and a new revenue source will need to be found to replace that of oil.

Unfortunately, the only significant alternative sources of revenue available to the state to fund public programs are use of the earnings of the Permanent Fund or taxes on individuals; neither alone can generate enough revenue to substitute for declining petroleum revenues. The inability to include the earnings of the Permanent Fund—even that portion not currently dedicated to the dividend or inflation proofing—in discussions of state fiscal policy delays resolution of this problem.<sup>35</sup>

After 29 years the dividend has become an integral part of the Alaska experience. Many, if not most, Alaskans view it as an entitlement—a distribution from their share of the natural resource wealth of the state. An entire generation of Alaskans has been raised having received a dividend annually since birth without necessarily understanding the purpose for which it was created.<sup>36</sup> This generation has also never experienced paying for the state services they have received because petroleum revenues have covered all costs. This has fostered a distorted sense that the role of the state is to provide public services at no cost and also to hand out cash to all citizens. Some would compare this generation of Alaskans to trust fund babies. Furthermore, because there are no personal taxes and receipt of the dividend carries no public responsibilities, the two together undermine the sense of community that comes from the need to collectively choose and fund public services. They also foster a disconnection between government and residents, leading to a deterioration of the quality of government.

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prefer a larger dividend to an increase in the state government budget.

<sup>35</sup> A common argument that confounds the impasse is that it does not make sense to distribute a dividend to all residents and at the same time collect an income tax from them.

<sup>36</sup> When asked, many high school students say the purpose of the dividend is to compensate them and their families for the high cost of living in Alaska.

## V. Looking Back and Thinking Ahead

After nearly 30 years, it is useful to reflect on options for how the dividend program for distribution of a share of the rents from oil production could be different. This is not to suggest that changes should be made, but rather simply to recognize that there are different ways that a dividend program providing payments to individuals could be structured as well as different ways that resource revenues could be shared among the population.<sup>37</sup>

One area that has attracted attention is the notion of "framing" which simply means that people make decisions based on how alternatives are presented to them. Historically, the dividend was simply distributed as a check in the mail with no suggestion to recipients about how they might think about using it. (This apparent absence of framing, of course, is actually a form of framing.) In more recent years, the dividend application has included two options that people could choose for allocating a portion of their dividend—a savings account for higher education (University of Alaska College Savings Plan) or a charitable donation (pick-click-give). The availability of both of these options has not been based on any active consideration by the legislature but rather by pressure from the beneficiary organizations. In fact there are many possible suggestions that could be considered. One would be a savings account for minor children that they would gain control of upon reaching 18 years of age. This would be a "grubstake" that could be used for higher education, to purchase a home, to start a business, or for some other purpose.

Related to this is the issue of how dividends for children should be handled in general. With the exception of wards of the state, whose dividends are held in trust until they turn 18, children's dividends go to the parents who decide what to do with them. In the survey in the 1984 study, about half of the households that included children reported that the decision about how the children's dividends would be spent was shared between the child and the parent. In the other half of households, the parents alone made the decision about how to allocate that money.<sup>38</sup> While parents certainly should be responsible for the well-being of their children, one must wonder if children spending dividend checks is a sensible public policy either in terms of the benefits the children get from those expenditures or from the

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<sup>37</sup> For a more systematic discussion of potential alternative structures for the Permanent Fund, see Scott Goldsmith, "Permanent Fund Policy Questions and An Informal Review of Proposals for Change," prepared for the Principles and Interests: The Permanent Fund and Alaska's Future conference sponsored by the Alaska Humanities Forum, Anchorage, 1997.

<sup>38</sup> Knapp, *op. cit.*

lessons the children learn about responsible financial management from the experience. Although changing the eligibility criteria for the dividend would not be possible, incorporating personal finance curricula in the school at the time of the dividend could be done.

The current distribution schedule is driven by the requirements of calculating Permanent Fund earnings and verifying residency on the applications. The method of electronic deposit or check is designed to be cost effective and as painless as possible for the recipient. Other procedures are possible that would produce different results. One would be to convert to a monthly dividend which would eliminate the "consumption frenzy" but reduce the dividend use for the purchase of consumer durables. Another would be to allow people to leave their dividend in a special account in the Permanent Fund where it could be managed like a mutual fund. Studies of framing decisions about saving options suggests this would increase the rate of savings out dividends.

Receipt of the dividend is not contingent on income or any other economic characteristic; it is only necessary to apply by filling out a two-page form. Likewise, recipients are not required to participate in any public functions like voting, or attending community meetings, or even to be knowledgeable about the source of the funds they are receiving. The application process could be expanded to provide an education function so that people would have a better understanding of why the dividend was established and what it means. It could also be used to informally engage the public to think about important public policy issues.

A significant share of the dividend payment goes to the federal government because the dividend income is subject to the federal income tax. Furthermore, because the Alaska population is still quite transient, a share of the benefit of an individual dividend goes to people who will no longer be residents in a year or two because they will move to another state. One way to keep more of the money in Alaska and more of the benefits for permanent residents, and at the same time increase the incentive for community action, would be to have a "community dividend" that would be distributed to each community based on the number of residents. Residents would be free to spend the community dividend any way they wanted, but they would have to jointly determine how it would be

used. Under such an arrangement it might be more likely that the money would purchase physical facilities that would produce continuing benefits for residents—current and future.

The size of the annual dividend is based on Permanent Fund earnings which fluctuate considerably from year to year.<sup>39</sup> Alternatively, the payout could be managed like an endowment where a fixed percent of the value of fund assets is withdrawn each year for use. This would result in a more stable annual payout from the fund and reduce the annual fluctuations in the size of the dividend.

The funding source for the dividend—Permanent Fund earnings—is not dedicated to the dividend by constitution or statute. In theory, the dividend needs to compete each year against other potential public uses of fund earnings. This brings discipline to the public budgeting process because any spending for a public purpose competes against using the money to expand the size of the dividend. On the other hand, it is often argued that the public budgeting process would be more balanced if there were a special account dedicated only to payment of the annual dividend so that deliberations and decisions regarding the regular operating and capital budgets did not have to take into account their impact on the size of the dividend.

The dividend is ultimately funded by the royalties on oil production, but flows through the Permanent Fund. In this way the beneficiaries are not only those Alaskans who are residents at the time the royalties are being earned, but also later generations of Alaska residents. However, the Permanent Fund makes the connection between petroleum royalties and the dividend less transparent than if it were a direct payment from royalties. A number of different ways of structuring a direct payment out of royalties have been suggested, such as having a separate distribution from the royalties from each producing oil field. Only residents of the state when the field was discovered would be eligible to receive the distribution of royalties from that field. This would eliminate the migration element of the “population magnet”, but be much more costly to administer.

Receipt of the dividend is not contingent on income. For high-income households and individuals, the benefit is modest because it represents a small marginal increase in income, and that increase is taxed by the federal government at the marginal tax rate. In

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<sup>39</sup> The annual earnings of the fund, as it is currently structured, consists of interest and dividends paid and the realized gains from the sale of assets.

this way some of the benefit of the royalty distribution are ultimately passed to others outside the state by the federal government. It can be argued that such a program does not target well the group it is trying to serve. However, in its present form it is relatively easy to administer, and although the federal benefits do not accrue directly to Alaska residents, they should not be ignored.

Finally, although Alaskans would unanimously agree that Alaska has a right to the appropriation of resource rents from petroleum production on state land, there is disagreement about whether ownership of those rents rests with the people communally or individually. If communally, then decisions about how to spend those royalties should be made by the legislature representing the citizens of the state. If individually, then the citizens as individuals should make those decisions. Those who consider the ownership to be communal are more likely to view the dividend as a government program which distributes income, and to view the program as a government redistribution of income. Those who consider the ownership to be individual are more likely to view the dividend as a distribution of their ownership share of the petroleum wealth and to view it as a right independent of government. Thus, it is possible for some Alaskans, as well as many non-Alaskans, to view the program as a form of socialism while at the same time many other Alaskans take an opposite view. For those Alaskans, the government is merely the vehicle for facilitating the annual distribution of ownership shares to the shareholders in the “owner state.” This difference of opinion about whether the dividend is a public program or an entitlement will never be resolved and will be a continuing source of debate and disagreement among Alaskans.



## **VI. Conclusion**

The dividend has been an enduring part of Alaska for generations, and because of its popularity it will continue to influence the state economy, fiscal structure, and society for the foreseeable future. However, it remains a controversial program because it challenges traditional economic and social relationships. If asked, many Alaskans would choose to eliminate the program; but just as many would probably vote to enshrine it in the state constitution.