

The Alaska Permanent Fund Dividend Program

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The purpose of this paper is to provide a short introduction to the Alaska Permanent Fund Dividend Program—a method for returning a portion of the revenues from petroleum development to the citizens of Alaska as a direct cash payment. I will briefly touch on 5 topics—the mechanics of the Dividend, why it was established, its history, its economic, political, and social effects, and the future of the Dividend.

Mechanics of the Dividend

Each year since 1982 in the late fall (just before the Christmas shopping season) every person who has been a resident of Alaska for the previous year and indicates an intention to remain gets a Permanent Fund Dividend (PFD) check from the state. Everyone receives an equal share of the appropriation from the earnings of the Alaska Permanent Fund with parents responsible for the checks of their children.

Last fall the state distributed \$1.172 billion in checks of \$1,963 to 597 thousand Alaskans. This directly accounted for 6.2 percent of the \$18.848 billion of Alaska personal income last year, and 95 percent of the 627 thousand Alaskans shared in the distribution.

The Alaska Permanent Fund Dividend Program

The annual legislative appropriation to fund the Dividend is half of the 5 year trailing average of the nominal Permanent Fund realized earnings. This formula is designed to provide some stability to the annual payout as well as insulate long-term management of the Permanent Fund from the political pressure to maximize the dividend in the short term. Current practice has been to use the Fund earnings not distributed through the Dividend program to protect the Fund from inflation and augment its principal. The legislature however has the authority to use Fund earnings for any public purpose and could, for example, choose not to fund the Dividend and spend the earnings in other ways.

Why Was the Permanent Fund Dividend Program Established

There are many reasons given in support of the PFD, some that were voiced at the time it was first proposed, and some that have only appeared more recently. The following are the ones most often heard.

It is the most equitable way to distribute the benefits from oil development. —Billions have been spent operating state government, building infrastructure, loaning money for housing, education, and business development, and other purposes. The economic benefits of all these programs impact only a portion of the population.

It creates a constituency to protect the Permanent Fund from raids on its principal.

It compensates Alaskans for the high cost of living and the economic hardships residents endured before the discovery of oil.

It produces a larger economic impact, measured by jobs, than any other use of the earnings.

Individuals know better than the government how to use that money.

State ownership of the oil fields means that the people own the resource and the revenues from its sale should be distributed to the owners as a dividend.

The Alaska Permanent Fund Dividend Program

Interestingly, non-Alaskans take an interest in two aspects of the PFD that Alaskans have not paid much attention to. The PFD provides a base income level to each citizen regardless of means, and the PFD contributes to equality in the distribution of income.

Short History of The Permanent Fund Dividend

The original PFD proposal based the size of the dividend on the number of years of residence up to a maximum of 25 “shares”. This feature, designed to reward longevity and instill some stability in a transient population, resulted in the program being declared unconstitutional under the equal protection clause of the Alaska constitution. (Another intriguing alternative proposed at the time but not seriously considered was to have a series of dividends, each funded from a separate oil field, with eligibility based on residence at the time the field was first discovered.) In response to the resulting political firestorm, the program as it is currently structured was passed by the legislature with a special first year Dividend of \$1,000—funded by a special appropriation.

The following year the PFD fell to \$386 based on the formula that has been in use ever since. The PFD has grown in response to growth in the size of the Permanent Fund—due as much to special appropriations to the Fund and a high rate of return on investments as to deposits of royalties on oil production on state lands.

The PFD program was not initially popular among politicians, many of whom thought there were better uses for the money, particularly if invested in infrastructure for economic development. A study of the initial Dividend payout was done to determine the extent to which Alaskans were “wasting” it. There was no evidence of a widespread increase in spending on “wine, women, and song”.

The Alaska Permanent Fund Dividend Program

As the dividend has grown in size and become a regularly anticipated part of the budget of Alaska households, support for it has solidified and many if not most Alaskans now view it as an entitlement rather than an annual appropriation.

Economic, Political, and Social Effects of the Permanent Fund Dividend

The macroeconomic effect of the PFD depends upon a number of factors including—

- Perception that PFD is transitory or permanent income
- Share of Dividends paid to residents
- Average marginal income tax rate
- Average marginal propensity to consume across the entire population
- Parental decisions regarding children's PFDs
- Consumer liquidity constraints

Because the PFD goes in equal amounts to Alaskans rich and poor, most of these factors suggest a large share of the dividend re-circulates in the regional economy and that a significant share goes to fund big-ticket purchases, producing jobs and income in trade and services. Anecdotal evidence supports this notion with auto dealers, furniture and appliance stores, and other durable goods retailers stepping up their advertising and marketing campaigns in the weeks prior to the annual distribution. However, travel agents and financial advisors are also especially busy this time of the year.

In spite of the size of the PFD program, which is the largest appropriation of state government (exceeding even the school foundation program), there has not been audit to determine how the funds have been used—including what parents are doing with their children's PFDs. Evidence suggests that the PFD has a large macroeconomic effect—much of the economic growth in the last few years can be traced to a doubling of the size of the PFD from \$1,000 to close to \$2,000.

The Alaska Permanent Fund Dividend Program

Effects on labor supply and population through net migration from other states have also not been studied. Conventional wisdom seems to be that labor force participation decisions by Alaska residents would not be influenced by a PFD, but that a large enough PFD would create an incentive for large families to move into the state (and they might not have a strong work ethic). This “population magnet” effect is likely to be investigated in the coming years.

The PFD should reduce the wage differential between Alaska and lower cost regions of the U.S. since employers can offer workers a lower wage without reducing their economic well being. Although wage rates in Alaska have been converging with the rest of the U.S., the importance of the PFD in this trend has not been established.

Another important economic effect of the PFD is the stable flow of cash it provides for rural Alaska where per capita money incomes are among the lowest in the U.S. and non-government sources of income are variable and uncertain. In some Census Areas, the PFD now directly accounts for more than 10 percent of personal income.

The immense popularity of the PFD now means that politicians are virtually falling over one another to demonstrate to the public their efforts to defend the program. Any politician shown to have even suggested anything that might jeopardize the size of the annual distribution had best look for another career. This obsession with the PFD threatens normal discourse over the state budget since every issue is viewed through the lens of what its potential impact will be on the PFD.

Though Alaskans have now enjoyed the PFD for 19 years, no one has formally studied its social impacts. One of its obvious consequences is that an entire generation of Alaskans has grown up in an environment where government distributes checks to citizens instead of citizens sending checks to government since Alaska also has no neither a personal income tax or a broad

The Alaska Permanent Fund Dividend Program

based sales tax. One can speculate on the effect of this on public understanding of fiscal issues and participation in public dialogs on the allocation of public resources. Some feel that the only thing many Alaskans are concerned about is the size of their Dividend and the only interaction they have with government is when they cash their check. The Dividend may also be fostering an environment preoccupied with consumption that may be detrimental to investment and the longer-term needs of the society.

The Future of the Permanent Fund Dividend

The PFD will probably not get bigger in future years because contributions to the Permanent Fund from oil royalties are now increasing the balance more slowly than population is increasing. Furthermore, the years of higher than normal returns on investment are in the past. However it will continue to be important to Alaska and Alaskans.

Alaska has relied almost exclusively on oil revenues to fund state government for a generation, but they have been declining for a decade and budget cuts alone have not been sufficient to offset this revenue loss. Three of the most obvious revenue generating alternatives for the state are use of the unallocated earnings of the Permanent Fund, cutting into the PFD, or re-instituting the personal income tax.

Fear of political retribution has prevented a reasonable discussion of use of the unallocated Fund earnings as opponents can point out that failure to reinvest these earnings will reduce the size of the Dividend in some future year. One recent suggestion to break this stalemate was to terminate the PFD program by paying every resident one last super dividend of \$25,000 in exchange for redirecting future Fund earnings to pay for government programs.

Opponents of using a portion of the PFD to pay some of the costs of government present a number of arguments, often suggesting that an income tax would be preferable. First, paying for government out of the Dividend would result in a bloated public sector since this method would not require government to ask citizens to contribute to government through taxation. Second, the impact of paying for government would fall most heavily on those least able to pay—the poor. Third, the impact would fall almost entirely on Alaskans in contrast to an income tax that would be partially paid by non-resident workers. Fourth, the state personal income tax is deductible from the federal income tax, effectively reducing the cost to Alaskans of funding government by this method compared to a Dividend reduction. Finally, reinstating the income tax would reestablish the link between the public costs of economic development and the revenues to pay for them.

Those who would prefer a reduction of the PFD to a personal income tax point to the disincentive to work created by the tax, the unfairness of putting the burden for paying for government entirely on workers, and the apparent illogic of government collecting an income tax with one hand while simultaneously distributing a Dividend with the other.

As revenues from oil continue to fall, this debate will intensify. In all likelihood eventually some combination of an income tax and a reduced PFD will emerge.

Conclusion

I have avoided until the end mentioning one of the most challenging issues surrounding the PFD. That is the question of who should benefit from the petroleum wealth of the state, and the extent to which the PFD targets those beneficiaries. This involves considerations of

The Alaska Permanent Fund Dividend Program

intergenerational equity and who is a “true Alaskan” to name just a few. I leave that discussion to another paper.